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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A

PROPOSED LOAN

IN THE AMOUNT OF US$100 MILLION

TO THE REPUBLIC OF PANAMA

FOR A

SECOND PROGRAMMATIC FISCAL MANAGEMENT AND EFFICIENCY OF EXPENDITURES DEVELOPMENT POLICY LOAN

February 15, 2013

Poverty Reduction and Economic Management
Central America Country Management Unit
Latin America and the Caribbean Region

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PANAMA- GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of February 15, 2013)
Currency unit = Balboas (B/.)
1 B/ = US$1

WEIGHTS AND MEASURES
Metric System

ABBREVIATION AND ACRONYMS

ACP	*Autoridad del Canal de Panamá* (Panama Canal Authority)
CAT-DDO	Catastrophe Deferred Drawdown Option Program
CCT	Conditional Cash Transfer
CND	*Consejo para la Concertación Nacional para el Desarrollo* (National Development Council)
CPS	Country Partnership Strategy
DGCP	*Dirección General de Contrataciones Públicas* (Procurement Agency)
DGI	*Dirección General de Ingresos* (Income General Directory)
DPL	Development Policy Loan
DTCs	Double Taxation Conventions
EOI	Exchange of Information
FY	Fiscal year
GDP	Gross Domestic Product
GTZ	German Organisation for Technical Cooperation
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IFARHU	Instituto para la Formación y Aprovechamiento de Recursos Humanos
IFC	International Finance Corporation
IMF	International Monetary Fund
ITBMS	*Impuesto a las Transferencias de Bienes Corporales Muebles y la Prestación de Servicios* (Tax Revenue Collection from Sales Tax)
ITU	International taxation unit
KYC	Know Your Client
LTU	Large Taxpayer Unit
MEF	*Ministerio de Economía y Finanzas* (Ministry of Economy and Finance)
MIDES	*Ministerio de Desarrollo Social* (Ministry of Social Development)
MIGA	Multilateral Investment Guarantee Agency
MINSA	*Ministerio de Salud* (Ministry of Health)
OECD	Organization for Economic Cooperationa nd Development
PFM	Public financial management
RA	Resident agents
SIAFPA	*Sistema Integrado de Administración Financiera de Panamá* (Integrated Financial Management System)
SFRL	Social and Fiscal Responsibility Law
TAL	Technical Assistance Loan
TIEAs	Tax Information Exchange Agreements

Vice President:	Hasan A. Tuluy
Country Director:	C. Felipe Jaramillo
Sector Director:	Rodrigo A. Chaves
Sector Manager:	Auguste Tano Kouame
Lead Economist/Sector Leader:	Oscar Calvo-Gonzalez
Co-Task Team Leaders:	Friederike Koehler-Geib & Maria Gonzalez de Asis

REPUBLIC OF PANAMA
SECOND PROGRAMMATIC FISCAL MANAGEMENT AND EFFICIENCY OF EXPENDITURES DEVELOPMENT POLICY LOAN

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ACKNOWLEDGEMENTS

This DPL was prepared by an IBRD team led by Friederike Koehler-Geib and Maria Gonzalez de Asis (Task Team Leaders). The team included Adriana Cardozo, Adrienne Hathaway, Agustin Indaco, Aleksandra Iwulska, Andres Mac Gaul, Antonio Blasco, Antonio Velandia-Rubiano, Bertha Mburugu, Christopher Humphrey, Cristian D'Amelj, Daniel Alvarez, Edmundo Murrugarra, Fabianne Mroczka, Karina Ramirez Arras, Kinnon Scott, Luis de la Plaza, Maria Sierra, Meilyn Gem, Nathalie Picarelli, Patricia de la Fuente Hoyes, Rodrigo Silveira Cabral, Rocio Malpica, Silvia Gulino, and Victor Ordoñez. Peer reviewers were Abha Prasad, David Gould, Manuel Salazar, and Raul Junquera. The team gratefully acknowledges the support and guidance provided by C. Felipe Jaramillo, Rodrigo A. Chaves, Auguste Tano Kouame, Arturo Herrera, Ludmilla Butenko, Oscar Calvo-Gonzalez, and Alma Kanani. In addition, the team thanks for helpful comments and support from Alys Willman, Alma Hernandez, Andrea Kucey, Bryan Welsh, Cecile Valadier, Corinne Delechat (IMF), Dianna Pizarro, Ejaz Ghani, Harun Onder, Hippolyte Fofack, Josef Trommer, Julia Dhimitri, Kimberly Vilar, Komal Mohindra, Lauren Benton, Lawrence Bouton, Maryanne Sharp, Michelle McCue, Pedro Olinto, Richard Stern, Sabine Perrissin, Sandra Ospina (IMF), Svetlana Vtyurina (IMF), and Victoria Salinas. Finally, the Bank team would like to express its gratitude for the collaboration of the Government of Panama in the preparation of this Development Policy Loan.

LOAN AND PROGRAM SUMMARY

REPUBLIC OF PANAMA - SECOND PROGRAMMATIC FISCAL MANAGEMENT AND EFFICIENCY OF EXPENDITURES DEVELOPMENT POLICY LOAN

Borrower	Republic of Panama
Implementing Agency	Ministry of Economy and Finance
Financing Data	*IBRD Loan Amount:* US$100 million. *Terms:* Commitment-linked variable spread loan, denominated in US dollar, with level repayments of principal payable in 20 years (including 3 years of grace period). The Borrower wishes to maintain all risk management options embedded in the loan. The front end fee is 0.25 percent of the total loan amount, financed from Borrower's own resources.
Operation Type	Single tranche Development Policy Loan (second in a planned series of three programmatic DPLs) to be disbursed upon loan effectiveness.
Main Policy Areas	The proposed operation supports four areas that are central to the Government's reform program: • Tax Reform • Procurement Reform • Debt Management • Social Protection
Key Outcome Indicators	The following key outcomes are expected to be achieved by the end of the DPL series in 2014: *(i) Tax Reform* • Central government tax revenue as a share of GDP is at least 13 percent in 2014 (baseline: 2009=11 percent). • The ITBMS revenue remains at least 1 percentage point of GDP higher than the baseline (baseline: 2009=2.1 percent; target: 2014=3.3). • The Large Taxpayer Unit covers at least 55 percent of total tax revenue in 2014 (baseline: 2009=0 percent). • Panama has signed 12 tax information exchange agreements and has exchanged information as requested (baseline: 2009=0). *(ii) Modernizing Public Procurement Practices* • Central government agencies and all others subject to Law 22 and its modifications use framework agreements and the number of catalogue items procured under those framework agreements is increased (baseline: 2009=2,452; target 2014=7,300). *(iii) Increasing the Efficiency of Debt Management* • The medium-term debt management strategy is published and revised annually and corresponding debt evaluation reports compare the evolution of risk indicators with the targets in the strategy in 2014 (baseline: 2009=no formal debt management strategy in place). *(iv) Expanding and improving targeting of social transfer programs.* • The proxy means test is in use to select all households that enter in the *Red de Oportunidades* conditional cash transfer (CCT) program (baseline: 2009=0 percent). • Increased ability of *Ministerio de Desarrollo Social* (MIDES) to

	conduct recertification of beneficiaries (evidenced by resolution and recertification strategy of *100 a los 70)* in 2014 (baseline 2009=no tools to conduct recertification). • Percentage of children from the poorest quintile who receive *Beca Universal* increased (baseline: 2009=0; target: 2014=70).
Program Development Objective(s) and Contribution to CPS	The Program Development Objective of the DPL series is to support the Government of Panama in creating fiscal space and strengthening social transfer programs. The operation is envisaged in the Country Partnership Strategy.
Risks and Risk Mitigation	The Program supported by the Fiscal Management and Efficiency of Expenditures DPL series is subject to four main risks: **Economic:** The main economic risks derive from the fiscal stance and the country's vulnerability to external shocks. Some risk of overheating has stemmed from the combination of expansionary fiscal policy, an economy that is growing fast and expansionary US monetary policy to which Panama is tied through its currency peg. Yet this risk is subdued as headline inflation is declining and the global environment is conducive to a smooth transition to trend growth in the medium term. There is some risk that fiscal balances may deteriorate. This would not compromise debt sustainability but would slow the reduction of the public debt-to-GDP ratio and limit room for maneuver should negative shocks hit the economy. The main mitigating factors are: i) flexibility in the timing of capital expenditure; ii) the majority of public infrastructure projects are being executed on time and within budget, and are expected to be completed before the end of the term of the current administration; and iii) the Government has been actively raising revenues. In addition, the country is vulnerable to external shocks. Strong domestic fundamentals, the fact that a large part of current account is financed through relatively stable foreign direct investment inflows, to a limited extent the approval of the *Fondo de Ahorro de Panama* (FAP) sovereign wealth fund, and the country's access to multilateral financing for investment projects mitigate this risk. **Institutional:** The main institutional risks relate to weak participatory processes and the quality of public institutions. The effectiveness of some of the reforms depends on the capacity and ability of the Government to involve relevant stakeholders to create consensus around those reforms (i.e. bearer shares legislation) or social protection (recertification program). The limited use of the *Consejo para la Concertación Nacional el Desarrollo* adds to this risk. Mitigating measures include a close dialogue and consultations with political parties, donor community and stakeholders on the measures supported by the DPL series. A related risk refers to Panama's public sector institutions. Improvements in financial management, and procurement systems would improve the monitoring and evaluation of public investment and spending to better support a more developed economy. To mitigate this risk and improve transparency and efficiency of public spending, the Government is implementing reforms in the areas of fiscal management and procurement, such as strengthening budget execution, accounting and control through an integrated financial management system. These reforms are supported by several donors, including the World Bank, through investment and technical assistance projects.

	Political: With presidential elections coming up in May 2014, the speed of implementation of the Government program supported by this operation may lead to challenges in dealing with sensitive reforms. Some opposition could occur regarding the recertification of eligibility of CCT programs as some current beneficiaries would cease to receive benefits. The Government is mitigating this risk through a consultation process and a communication strategy for current beneficiaries. In response to concerns voiced by some legal firms and other stakeholders regarding tax transparency reforms, the administration has opened a participatory process to reach out to stakeholders and better communicate the benefits of the proposed measures. **Natural Disasters**: Panama is highly vulnerable to multiple natural disasters. According to the World Bank's Natural Disaster Hotspot Study, Panama ranks 14th among countries with the highest economic risk exposure to multiple hazards. The impact of a possible natural disaster during this operation would be mitigated by the CAT-DDO approved in FY12. It would provide immediate liquidity to the Government in order to attend to affected areas and populations. Emergency grants that Panama received from IDB, *Corporación Andina de Fomento*, and the Central American Bank for Economic Integration, show that financing from these institutions is an important mitigation measure for natural disasters. Another mitigation measure is the Country's Disaster Risk Management National Plan 2011-2015, which defines specific actions in improving disaster resilience during the next four years with the support of different stakeholders. Finally, financing through the FAP would be available to mitigate the impact of certain emergencies in the future.
Operation ID	P127332

IBRD PROGRAM DOCUMENT FOR A PROPOSED SECOND PROGRAMMATIC DEVELOPMENT POLICY LOAN TO THE REPUBLIC OF PANAMA

I. INTRODUCTION

1. **This document describes a proposed Development Policy Loan (DPL) in the amount of US$100 million for the Republic of Panama**. The Government has requested this second single-tranche operation in the series of Programmatic Fiscal Management and Efficiency of Expenditures DPLs, designed to help create fiscal space and strengthen social transfer programs. The operation supports four key policy areas: (i) tax reforms to reduce exemptions, widen the tax base and improve tax information sharing; (ii) strengthening procurement practices and transparency; (iii) strengthening debt management; and (iv) expanding and strengthening social transfer programs.

2. **The proposed second of three Programmatic Fiscal Management and Efficiency of Expenditures DPL builds on the progress achieved under the first loan.** The first DPL for US$100 million supported the legislative approval of important reforms in public financial management and social protection with an emphasis on coverage, such as broadening the tax base and increasing number of social protection beneficiaries. This proposed DPL emphasizes the sustained implementation of these reforms and the efficiency of spending and institutions, for example focusing on large taxpayers and improved targeting of social transfer programs. The operational design is summarized in the Policy Matrix (Annex 2).

II. COUNTRY CONTEXT

3. **Panama has made important strides in its economic development in recent years.** Panama's economic growth has been one of the fastest in Latin America over the past decade, a trend that has even accelerated in recent years (Figure 3). The country has done well in integrating into the global economy and has leveraged its geographical position, turning itself into a well-connected logistics hub. Panama has also consolidated its position as the most competitive economy in Central America and second after Chile in Latin America and the Caribbean, according to the 2012-13 Global Competitiveness Report.

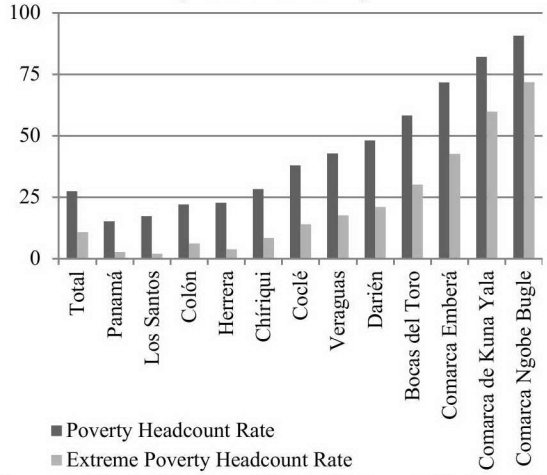
4. **Strong economic growth and public transfers have translated into poverty reduction.** The poverty rate fell from 48.5 percent in 2002 to 27 percent in 2011, while extreme poverty decreased from 21 to 11 percent.[1] Poverty has become more of a rural phenomenon due to the much larger reductions in poverty in urban areas. The highest incidence of poverty is in the three remote and sparsely populated indigenous areas—Ngobe Bugle, Emberá, and Kuna Yala—containing less than 7 percent of the total population but concentrating 16 percent of the poor and 28 percent of the extreme poor (Figure 1).[2] Better targeting of poverty interventions and providing access to services in isolated communities remain challenges of the Government's social programs.

[1] Preliminary Government data for 2012 estimates the poverty rate at 25.8% and extreme poverty at 10.4%.
[2] These numbers are based on the 2010 Household Survey.

5. **Economic growth has been pro-poor and contributed to prosperity being more widely shared.** Income growth of households in the bottom 40 percent of the income distribution reached 7.3 percent between 2002 and 2010, far exceeding the average income growth of 4.3 percent over the same period. Panama is catching up with the most advanced countries in terms of shared prosperity. In fact, a measure of economic growth adjusted for equity has grown faster than the growth of GDP (7.1 percent compared to 5.8 percent annualized growth in 2002-2010). This is because inequality decreased, with the Gini coefficient dropping from 0.57 in 2002 to 0.53 in 2011.

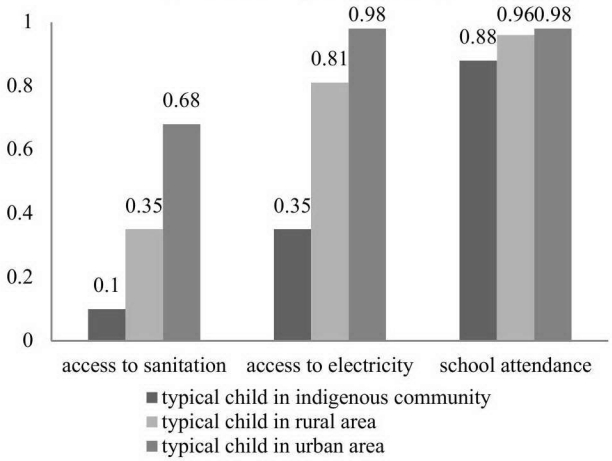
6. **Yet inequality remains in the mid-range for Latin American countries and challenges persist in the public provision of social services.** Panama's Gini coefficient is in the mid-range for Latin American countries (see Annex 9). In addition, ample scope remains for improving the public provision of social services across the country. For example, children in indigenous communities still have significantly less access to basic services than children in rural or urban areas (Figure 2). Addressing these challenges would be critical for Panama to converge towards the most advanced countries in terms of shared prosperity.

Figure 1: Poverty head count,
(Percent, 2011)



Source: World Bank staff calculations, Ministry of Education, Educational Statistics 2010, Household surveys 2002-10.

Figure 2: Children's access to basic services
(Probability of access)[3]



Source: World Bank (2011):"Panama Poverty Assessment".

7. **As part of a strategy to address the country's development challenges, the Government has been improving tax revenue, efficiency of spending and social protection.** At the outset of its term in 2009, the Government presented a five-year strategic plan with the overall objectives of sustainable economic growth and reduction of poverty and inequality. It also presented a strategy to mobilize tax revenue to increase fiscal space for public investment and social protection. The Government is currently implementing two 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 revenue measures have been complemented by financial management and procurement reforms to increase transparency and efficiency of spending. The Government

[3] Based on Human Opportunities Index estimations, the Figure demonstrates what the probability is that a child in different areas will have access to basic services.

has also improved social protection by introducing a non-contributory pension program *100 a los 70* and a universal scholarship program *Beca Universal* and improving the targeting of the conditional cash transfer (CCT) program *Red de Oportunidades*.

RECENT ECONOMIC DEVELOPMENTS IN PANAMA

8. **Panama's strong and relatively stable growth over the past decade has resulted from an open, diversified economy.** Panama's real growth over the past ten years averaged 6.8 percent, double the average for Latin America and the Caribbean. The economy is one of the most open in the region. Growth has mainly stemmed from transport and communications, trade, construction and financial intermediation. The strong growth in these sectors has also translated into increases of 1.3 percentage points of total employment in the transport and communication sector, of 0.6 in construction and of 0.5 in financial intermediation between 2008 and 2012. Over time, growth has transitioned to a more domestic demand-driven model on the back of increased investment growth and related increases in imports (Figure 4). With no independent monetary policy due to dollarization, much of the relative stability can be attributed to prudent fiscal policies that have kept public debt at manageable levels (Figures 5 and 6).

Figure 3: Real GDP

(GDP index; 2002=100)

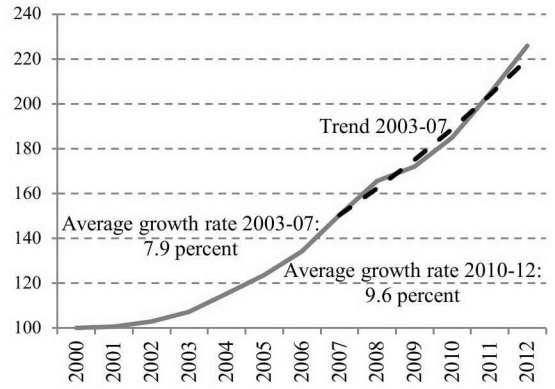


Figure 4: Real growth—decomposition of aggregate demand components
(Percentage points contribution (lhs); percentage change y-o-y (rhs))

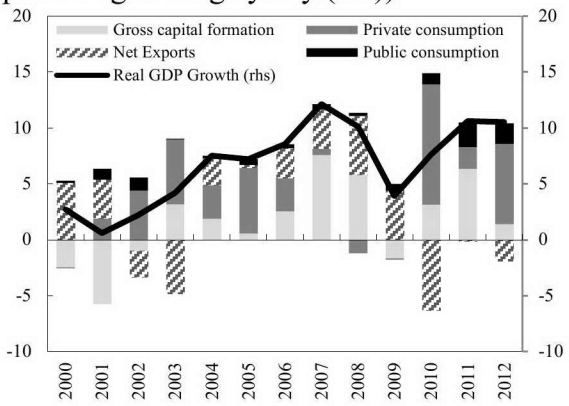


Figure 5: Overall fiscal balance
(percent of GDP)*

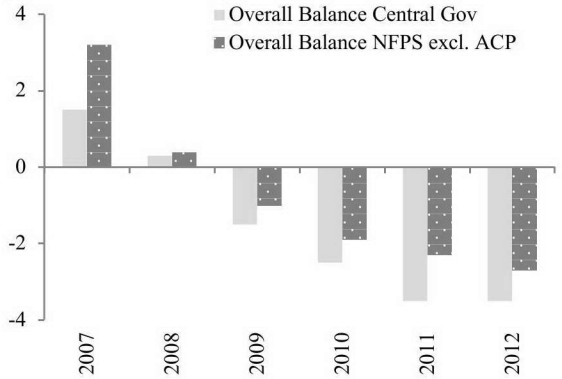
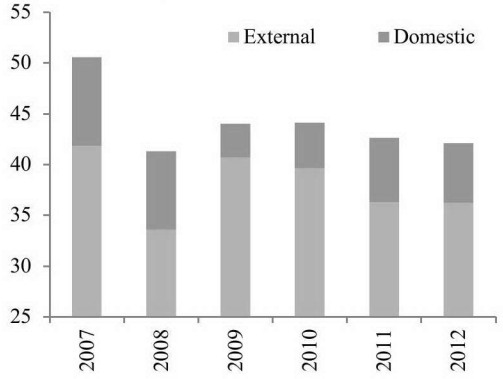


Figure 6: Total public debt
(percent of GDP)



Source: World Bank staff calculations, MEF, Comptroller General, and IMF.
Note: * NFPS excl ACP = Non Financial Public Sector excluding Panama Canal Authority.

Table 1: Panama—Key economic indicators 2008-2015
(percent of GDP, unless otherwise stated)

					Estimated	Projected		
	2008	2009	2010	2011	2012	2013	2014	2015
			(annual percentage change)					
Real GDP	10.1	3.9	7.6	10.6	10.5	8.5	7.0	6.6
CPI Inflation (eop)	6.8	1.9	4.9	6.3	5.0	4.9	4.5	3.8
			(in percent of GDP)					
Savings and investment								
Gross national savings	16.7	24.9	15.5	16.4	17.5	19.2	18.6	16.6
Gross fixed investment	27.6	25.6	26.4	29.0	30.0	31.0	29.7	26.5
Fiscal accounts								
Central government								
Total revenues (including grants)	19.8	18.5	18.6	18.7	19.7	19.7	19.2	19.2
Current revenue	18.4	18.1	18.4	18.6	19.0	19.2	19.0	19.1
Tax revenues	10.6	10.9	11.6	12.1	12.6	13.0	13.0	13.1
Nontax revenues	7.8	7.2	7.0	6.5	6.4	6.2	6.0	5.9
o/w Panama Canal fees and dividends	3.0	3.2	3.1	2.9	2.9	3.0	3.5	3.5
Capital revenue	1.1	0.3	0.1	0.2	0.6	0.5	0.2	0.1
Total expenditure	19.4	19.9	21.1	22.2	23.2	22.8	21.4	21.3
Capital expenditure	5.6	6.2	7.4	8.4	9.1	9.5	8.1	8.0
Primary Balance	3.4	1.4	0.1	-1.2	-1.4	-1.3	0.5	0.4
Overall Balance	0.3	-1.5	-2.5	-3.5	-3.5	-3.1	-2.2	-2.1
Nonfinancial Public sector								
Overall Balance (excluding ACP)	0.4	-1.0	-1.9	-2.3	-2.5	-2.8	-2.7	-2.1
Overall Balance (including ACP)	2.5	-0.4	-3.4	-5.5	-4.3	-3.7	-2.9	-1.8
External sector								
Current Account Balance	-10.9	-0.7	-10.8	-12.8	-12.5	-11.8	-11.1	-9.9
Trade Balance (of goods)	-19.9	-9.0	-17.1	-19.6	-18.6	-17.9	-16.9	-16.2
Net exports from Colón Free Zone	0.0	8.1	1.8	1.8	1.7	1.7	1.6	2.2
Services Balance	13.6	13.8	12.9	12.2	11.1	10.6	10.2	11.0
Net factor income	-6.9	-6.0	-7.0	-5.9	-5.3	-4.9	-4.8	-5.1
Net current transfers	2.3	0.5	0.5	0.4	0.3	0.4	0.4	0.4
Foreign direct investment	9.3	5.2	8.8	9.1	9.2	9.3	9.0	9.0
Total Public Debt[1]	41.3	44.0	44.1	42.6	42.1	41.0	39.9	39.1
GDP (in millions of current US$)	23,002	24,163	26,590	31,084	35,902	40,713	45,394	50,115

Source: Comptroller General, IMF and World Bank staff calculations.
1/ Gross debt of the non-financial public sector and including the debt of the ACP and excluding FAP.
Note: ACP = Panama Canal Authority.

9. **After a temporary deceleration in 2009, economic growth has exceeded the pre-crisis pace, mainly driven by massive infrastructure investment and private consumption.** The 7 percentage point fall in GDP growth in 2009 mainly resulted from the effects of the global slowdown through declines in credit growth, reduced transshipment and trade financing and a halt in new real estate construction. Yet, the economy continued growing at 3.9 percent in that year and has picked up based on the public investment program, the Canal expansion and private consumption. Economic growth in 2011 and 2012 reached 10.6 percent and an expected 10.5 percent, respectively, based on massive investment in infrastructure, reinforced by housing construction, retail and wholesale trade, transportation and communication, as well as tourism. Growth of domestic credit, export and foreign direct

investment also provided important growth impulses. The Government's five-year US$15 billion investment program has primarily accounted for the increase of public capital expenditures from 5.6 percent of GDP in 2008 to an expected 9.1 percent in 2012 and the US$5.3 billion expansion of the Panama Canal has also driven up investment rates. At the same time, the external current account deficit widened sharply to 12.8 and 12.5 percent of GDP respectively in 2011 and 2012, up from 0.7 in 2009.

10. **Fiscal deficits have expanded to accommodate the Government's crisis response as well as investment and social protection projects.** In 2009, authorities raised the fiscal deficit ceiling mandated under the Social and Fiscal Responsibility Law (SFRL) to allow an expansionary fiscal stance in 2009. Social assistance expenditures increased by 6.6 percent in 2009 and stimulus measures included subsidies on basic goods, a new labor program (*Mi Primer Empleo*) to help the youth find jobs and an increase in the minimum wage. Since then, the Government with the support of Congress has raised the deficit ceiling of the nonfinancial public sector (excluding ACP) twice to allow deficits to reach 2.9 percent of GDP in 2012. Central government capital expenditure has increased from 5.6 percent of GDP in 2008 to an expected 9.1 percent in 2012, accounting for most of higher public spending. Major public investment projects under the Government's five-year plan include the construction of a first metro line in Panama City (US$1.9 billion), a major improvement of the national road network (US$677 million) and an expansion of airport infrastructure (US$227 million). So far, these projects have been advancing within the budget and planned timeframe and are expected to be finalized before the end of the term of the current administration in May 2014.

Table 2: Central government revenues (in percent of GDP)

					Proj.
	2008	2009	2010	2011	2012
Revenues and grants	**19.8**	**18.5**	**18.6**	**18.7**	**19.7**
Current revenue	**18.4**	**18.1**	**18.4**	**18.6**	**19.0**
Taxes	10.6	10.9	11.6	12.1	12.6
Direct taxes	5.5	5.9	5.9	5.9	5.9
Income tax	4.9	5.2	5.0	4.9	4.8
Of which : Capital gains	0.0	0.0	0.0	0.0	0.0
Tax on wealth	0.5	0.6	0.6	0.7	0.7
Indirect taxes	5.1	5.0	5.7	6.2	6.7
Import tax	1.8	1.6	1.5	1.7	1.8
ITBMS	2.1	2.1	2.7	3.2	3.2
Petroleum products	0.4	0.5	0.4	0.4	0.4
Other tax on domestic transactions	0.7	0.7	0.9	0.9	1.1
Nontax revenue	**7.8**	**7.2**	**6.8**	**6.5**	**6.4**
Dividends	2.9	2.7	2.7	2.6	2.6
Of which : Panama Canal Authority	1.5	1.8	1.8	1.6	1.6
Panama Canal Authority: fees per ton 1/	1.5	1.4	1.3	1.3	1.3
Transfers from decentralized agencies	1.8	1.6	1.6	1.6	1.4
Other	1.5	1.4	1.2	1.0	0.9
Capital revenue	**1.1**	**0.3**	**0.2**	**0.1**	**0.6**
Grants	**0.4**	**0.1**	**0.1**	**0.1**	**0.1**

Source: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.
1/ Includes public service fees.
2/ Revenues and grants less current expenditure.

11. **Panama's debt-to-GDP ratio has been declining along with the risk exposure of the debt portfolio.** Rapid growth and contained fiscal deficits are reflected in debt declining from 53 percent of GDP in 2007 to 42.1 percent in 2012. In addition, the quality of the debt portfolio has steadily improved as the authorities have extended the maturities of new issues and smoothed the portfolio redemption profile. The value of Treasury notes issues in the domestic market during 2011 reached US$538 million, which corresponds to 30 percent of financing needs. These policies have significantly reduced exposure to refinancing and interest rate risk. This overall improvement has been recognized by all credit rating agencies, which awarded Panama investment grade in the spring of 2010 and have further improved the rating since. With the last upgrade by Moody's in October 2012, Panama's sovereign rating is on par with Brazil, Mexico, and Peru. The debt management reforms supported by this operation will further contribute to these improvements.

12. **The Government has also addressed the low tax-to-GDP ratio through tax reforms that are achieving expected results.** The Government has been implementing tax policy and administration reforms that were approved in September 2009 and March 2010. Implementation of the reforms was expected to raise an additional 1.7 percent of GDP in revenues consisting of a 0.9 percentage point increase through the changes in the personal and corporate income tax, a negative impact of 0.6 percentage points through the lowering of the tax rates and the increase of income thresholds, and a further increase of 1.4 percentage points due to other reforms, including 0.5 percentage points related to tax administration reforms (see Annex 4). While the first DPL in the series supported tax policy measures under the 2010 tax reform, the current DPL operation supports their implementation and other tax administration efforts. To date, results have been considerable: overall tax revenue as percent of GDP has increased by 1.5 percentage points relative to 2008 and reached 12.1 percent in 2011 and an expected 12.6 percent in 2012 (see Table 2). In 2008, the economy grew at a comparable rate to 2011 and 2012, suggesting that the higher tax-to-GDP ratio results from the reforms rather than an increase in economic activity.

13. **However, the tax-to-GDP ratio is still low by international standards, and reforms supported by this DPL are relevant to further increase spending efficiency.** Panama's tax revenues undershoot the Central American average of 13.3 and are significantly lower than the 19.2 percent average for Latin America[4]. While dividends and fees from the Panama Canal and other non-tax revenues add around another 7 percentage points of GDP to total public revenues, they remain low by international standards. A higher tax-to-GDP ratio would help alleviate the Government's resource constraint, reflected by below-average social spending. Panama spent 9.4 percent of GDP on social expenditure compared to a 13 percent average for Latin America and the Caribbean[5]. The scarcity of resources highlights the relevance of reforms in the areas of procurement, debt management, and social protection to increase efficiency of spending.

MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. **The Panamanian economy is likely to continue growing at a strong pace.** Infrastructure investment and private consumption will continue driving growth in 2013 and

[4] OECD (2011).
[5] Economic Commission for Latin America and the Caribbean (2011).

2014. The Government's investment program is expected to extend into 2014 when major infrastructure projects would be finalized within budget and the planned time horizon. The Panama Canal expansion is also expected to sustain strong growth in 2013 and 2014. The project is progressing within budget and the expanded canal is expected to start operation in April 2015. After the finalization of the canal expansion, large private investment projects such as a US$ 6.5 billion investment in copper mining due to start in 2013 and new public investment such as a second line of the Panama City metro would further sustain growth. In addition, increased activity around the Canal would kick in and drive growth. Current growth rates are likely to be sustained and lead to a smooth transition towards trend growth in the medium term. Yet, sustaining high growth in the long run will require investment in education and innovation for growth to rely more on increases in total factor productivity and less on capital accumulation.

15. **Inflation and current account deficits are expected to remain at manageable levels in the short term and decrease in the medium term.** CPI inflation is expected to moderate to 5-6 percent in 2013. It had reached 6.3 percent in 2011 based on an increase in the minimum wage, record levels of investment and higher commodity prices (food and oil) (Figure 4). The decline is expected to stem from stabilized international commodity prices; however, domestic demand pressures are likely to keep rates above historical rates. In the medium term, inflation is expected to gradually drop to around 4 percent. A potential spike in oil prices and a continued rise in food prices are upside risks to the inflation outlook. The current account deficit has risen largely on account of the import content of the Government investment program and the canal expansion, and is expected to decrease slowly with the investment rates in the medium term (Table 1). While the large deficit exposes the economy to deteriorations in external demand and changes in the risk aversion of foreign investors, strong domestic fundamentals mitigate the impact of such shocks. The economy's demonstrated resilience during the 2009 crisis and subsequent reforms to improve the financial safety net and financial sector supervision further mitigate external vulnerability.

16. **Although the fiscal deficit has been increasing, projections suggest a declining debt-to-GDP ratio on account of strong economic growth.** Panama's fiscal deficit is projected to reach 2.5 percent of GDP in 2012 and to be below 2 percent in 2016 (non-financial public sector excluding the canal authority). With the finalization of the current public investment projects and the completion of the Canal expansion, fiscal accounts are expected to improve primarily through higher revenues from the expanded Canal.

17. **Under conservative assumptions, Panama's public debt is expected to remain sustainable.** A 2013 debt sustainability analysis by the International Monetary Fund (IMF) shows that a combination of a gradual rise in revenue and a containment of current expenditure would allow the authorities to expand public investment while keeping public debt sustainable in coming years. Under a number of alternative scenarios, debt sustainability shows the greatest sensitivity to shocks to the country's growth rates. However, under reasonable assumptions, these shocks are not expected to undermine debt sustainability in the medium term. While a further deterioration of fiscal accounts would decrease the room for maneuver in case of an external shock, it would not endanger debt sustainability. With capital expenditure explaining the bulk of deficit expansion, the Government has some room to cut spending if necessary. In addition, the Government has engaged in reforms to increase revenue, including tax policy and administration reforms and the approval of the *Fondo de Ahorro de Panama* (FAP) in 2012. This sovereign wealth fund will save transfers from the

Panama Canal Authority to the Treasury in excess of 3.5 percent of GDP starting in 2015. Yet, as pointed out by several analysis (IMF and Moody's) the net savings (savings less incremental debt incurred during the year) in the FAP will likely be low if the Government were to register the maximum permissible deficits under the SFRL. Regarding mitigation measures, the Ministry of Finance (MEF) is also preparing a medium-term debt management strategy, supported by this DPL series. As a result, the quality of the debt portfolio is likely to further improve.

18. **Panama's macroeconomic framework is deemed adequate for development policy lending.** Fiscal policy remains prudent and consistent with medium-term sustainability. This is even more important given the specific set-up of the economy without independent monetary policy and the large degree of openness.

III. THE GOVERNMENT'S PROGRAM AND PARTICIPATORY PROCESSES

GOVERNMENT PROGRAM

19. **In December 2009, the Government presented a five-year Strategic Plan with the overall objectives of sustainable economic growth and reduced poverty and inequality.** The plan is built around strategies for economic growth and social development accompanied by a detailed five-year investment plan and fiscal projections. This combination facilitates the implementation of the plan within the country's resource envelope. To ensure fiscal sustainability, the Government has complemented the plan with a set of reforms to increase tax revenue and the efficiency of public spending.

20. **The strategy emphasizes logistics, tourism, agriculture and financial services as drivers of future economic growth.** Panama is considered to have a competitive advantage in these sectors, and their expansion through additional public investment worth US$5.8 billion promises clear economic and social return. The sectors were also selected as a means to promote opportunities in less developed parts of the country, to reduce inequalities and to generate self-reinforcing clusters of growth.

21. **The strategy for social development is built around the formation of human capital and greater social inclusion.** This strategy aims to reduce the stark inequality of opportunities and alleviate the bottleneck of a qualified labor force for a fast-growing economy. In addition, the social strategy aims to strengthen social protection programs for vulnerable groups such as poor, indigenous and children. This strategy includes an additional US$3.8 billion in infrastructure for the construction of hospitals, social housing, water and sewage as well as funds to increase coverage of CCT programs.

22. **The Government complemented its plan with measures to increase fiscal space and improve the transparency and efficiency of institutions.** In addition to the previously-mentioned tax policy and administration reforms, the Government has also launched several measures to improve spending efficiency in the areas of public procurement, debt management and targeting of transfer programs.

PARTICIPATORY PROCESS

23. **Panama has a formal consultative body approved by law.** The national consultation process started in 2006, resulting in the creation of the National Development Council (*Consejo para la Concertación Nacional para el Desarrollo*—CND) (Law 20, 2008) with representatives of civil society, political parties, labor organizations and the private sector. Its primary objective has been to discuss how to best use the additional revenues expected to be generated by the expansion of the Panama Canal after its completion in 2015. In 2008, the CND dialogue included six focal areas: (i) poverty reduction and equality; (ii) economic growth and competitiveness; (iii) education; (iv) institutional strengthening; (v) health; and (vi) justice and personal security. Following a resolution approved in 2010, the role of the CND today is to monitor progress on the agreements in these six focal areas.

24. **While the current administration has used the CND selectively, it relied on other mechanisms to reach agreement on reforms supported by this DPL.** On tax transparency, the current administration has held consultations with the private sector (*Consejo Nacional de la Empresa Privada*, Chamber of Commerce, *Asociación Panameña de Ejecutivos de Empresa*) and civil society on the Global Forum recommendations. In the area of procurement, a participatory committee including civil society and public and private sector representatives is discussing options to replace existing regulations and better accommodate public investment projects.

25. **In the area of social protection, the Government has developed an Indigenous Peoples Plan and a communication strategy to generate social consensus.** The plan and strategy were outcomes of a broad consultation process in 2009. They are still under implementation in 2013 and can help generate consensus around the reforms supported by this DPL. As a consequence of the formulation of the Indigenous Peoples Plan, the operational manual for the *Red de Oportunidades* was modified to distinguish households living in the same dwelling as separate, eligible households, reflecting indigenous practices. Similarly, payment mechanisms have been adapted to ensure the inclusion of illiterate household heads and are scheduled to take into account indigenous and rural seasonal patterns. Still, in some cases, the administration's desire for speedy implementation of its program has presented a challenge when legislation was approved with insufficient prior consultations with civil society (e.g., sale of state-owned land in the Colon Free Zone). The lack of consultations led to protests and was followed by the National Assembly voting to rescind the law.

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

LINK TO CPS

26. **The proposed DPL is envisaged in the Country Partnership Strategy (CPS) (Report No. 54265-PA), discussed by the Executive Directors on September 21, 2010.** A new CPS is currently under preparation to be presented to the Board in March 2013. The original CPS objectives remain valid to support improvement of Panama's productive capacity, enhance public sector efficiency, increase coverage of basic public services in remote areas and promote inclusive growth. The DPL will influence CPS outcomes in all three pillars: (i) tax administration measures contribute to fiscal sustainability, which is a precondition for *economic growth that supports competitive advantages*; (ii) the expansion of the *Beca Universal* program under the social protection component feeds into the CPS

objective of *greater opportunities for all*; and (iii) measures to enhance tax information sharing, improve procurement, strengthen debt management and improve the targeting of social programs all contribute to the CPS objective of *enhanced public sector transparency, effectiveness and efficiency*.

27. **The CPS aligns with Government objectives and aims to provide Panama with flexible, demand-driven and focused support to achieve its development goals.** Shared objectives between the Government and the World Bank include fostering economic growth to generate greater opportunity for all with the help of more transparent, effective and efficient institutions.

COLLABORATION WITH THE IMF AND OTHER DONORS

28. **The Bank collaborates closely with the IMF.** The IMF and the World Bank have maintained a close dialogue on Panama, particularly in the area of monitoring the macroeconomic situation and discussing the Government's program.

29. **The proposed operation was also prepared in coordination with other donors such as the Inter-American Development Bank (IDB).** The Bank and the IDB undertook joint analytical work that underpinned the proposed operation (a recently completed public expenditure and financial accountability assessment). For the *Red de Oportunidades,* both institutions provide parallel financing using harmonized fiduciary, procurement, and monitoring and evaluation systems. In terms of lending and technical assistance operations, the Bank and the IDB are supporting several complementary areas of the Government's development strategy including several activities in the areas of planning, budgeting and evaluation.

RELATIONSHIP TO OTHER BANK OPERATIONS

30. **The tax transparency component of this DPL has strong complementarities with advisory services provided by IFC**. Jointly with the Bank, IFC has provided technical assistance to Panama to improve the transparency of the country's tax system and enhance its ability to exchange tax information, by implementing international best practices on transparency and exchange of information for tax purposes recommended by the OECD Global Forum.

31. **The procurement reforms supported by this loan are linked the Enhanced Public Sector Efficiency Technical Assistance Loan (P121492) and convening services supporting the improvement of financial management and procurement.** These projects support the implementation of better management and more transparent procurement practices, which would contribute to enhanced efficiency and effectiveness of public spending.

32. **The debt management component is related to two advisory services provided by the World Bank Treasury and a MIGA guarantee.** The advisory services cover public debt management and asset management. MIGA has issued a US$320 million guarantee to support the construction financing of the Panama City metro, its first coverage of a sovereign financial obligation in Latin America.

33. **The fourth pillar of this DPL series reinforces investment lending operations in the social protection and health sectors.** The Social Protection project (P098328), focuses on improving the management and delivery of the flagship *Red de Oportunidades* CCT. The project has four objectives: (i) improve the management of the CCT program to enhance its effectiveness in reaching the poorest and indigenous groups; (ii) provide beneficiaries with an incentive framework to increase demand for education and maternal and infant health services; (iii) strengthen the supply of nutrition and child growth promotion interventions in the indigenous areas of the *comarcas*; and (iv) enhance capacity to develop coherent and efficient social sector policies and interventions on the basis of evidence. The Health Equity and Performance Improvement project (P106445) focuses on: (i) increasing access of targeted underserved rural communities to basic health services to improve mother and child health; and (ii) supporting the development of strategic planning regulatory and monitoring mechanisms to improve health system performance. Reforms implemented under Component 4 of this DPL will have a positive impact on both operations.

LESSONS LEARNED

34. **The design of the proposed operations takes into account lessons learned from previous DPL operations in Panama and the Bank's experience with other middle-income countries.** Main lessons include the following:

- **Ownership of reform, as illustrated by previous operations in Panama that exclusively supported Government-led initiatives.** The legal and regulatory framework underpinning reform was initiated and developed by the administration, with technical input from the Bank. The Government made substantial progress in areas that were not monitored by the Bank. DPL objectives were strategically aligned with the Government strategy (procurement reform is a good example). In public financial management components, the core DPL objectives were linked to the Government's reform and strategy. Two critical entities, the MEF and Comptroller General's Office, shared the objective of strengthening fiscal transparency and coordinated efforts to achieve it.

- **Strong analytical underpinnings and links to complementary Bank investment lending social protection.** Key economic and sector work, including the Public Expenditure Review helped inform the reform efforts of Government and supported a fruitful policy dialogue. In particular in the area of social protection, complementarities of the loan program with other Bank projects have helped progress.

ANALYTICAL UNDERPINNINGS

35. **The design of the proposed operation draws on a wealth of analytical work conducted by the World Bank, the Government and others, notably on tax issues, procurement and debt management**. The design of tax policy and administration reforms in Panama was informed by Le, Moreno-Dodson and Rojchaichaninthorn (2008), who suggest that both are necessary in countries like Panama to increase tax revenue collection. Furthermore, several studies, including the Panama Centro Regional de Asistencia Técnica para Centro América (CAPTAC) report (2010) and the GTZ report (2010), point to the importance of introducing a large tax payer unit and improving tax audit capacity, measures

that the DPL series is supporting as prior actions in DPL II and indicative triggers in DPL III. Further detail is provided in Annex 4.

36. **The inclusion of social protection and the design of those measures have also been guided by a large body of literature.** The forthcoming Panama poverty assessment shows the relevance and pro-poorness of investment in expanding transfer programs as supported by the proposed operation. In line with Marques (2009), the reform program supported by this operation focuses on improving targeting of social protection programs. A further argument for the focus on education and social protection derives from their role in employment creation, as shown by a 2012 World Bank study on employment in Panama. Finally, Arraiz and Rozo (2011) and Waters (2009) show the positive impact of the *Red de Oportunidades* network on school enrollment and a reduction in child labor in rural and indigenous communities. In line with the findings of these studies, the expansion of the *Beca Universal* program to lower grades supported by the proposed loan is increasing the pro-poorness and progressivity of the program. Further detail is provided in Annex 4.

V. THE PROPOSED SECOND PROGRAMMATIC FISCAL MANAGEMENT AND EFFICIENCY OF EXPENDITURES DEVELOPMENT POLICY LOAN

OPERATION DESCRIPTION

37. **The Program Development Objective of the DPL series is to support the Government in creating fiscal space and strengthening social transfer programs.** Specifically, the operation supports four key policy areas: (i) tax reforms to reduce exemptions, widen the tax base, and improve tax information sharing; (ii) strengthening procurement practices and transparency; (iii) improving debt management; and (iv) expanding and strengthening social transfer programs. This section describes Government actions supported by this DPL in each of these areas, as summarized in Annex 4 and Annex 7.

POLICY AREAS

Component 1: Tax reform

38. **This Component supports the Government's tax policy and administration reforms and its improvements in international tax information sharing.** Together, these reforms are expected to mobilize tax revenue and facilitate the international exchange of tax information.

Objective 1: Mobilize tax revenue through tax policy and administration reforms

Prior actions for DPL II: The Government, through the MEF, has created the Large Taxpayer Unit (LTU) within the DGI and has made it operational through:[6] 1) the identification of 72 Large Taxpayers; 2) the selection and training of ten (10) tax auditors to carry out audits of large taxpayers; 3) the preparation by DGI of an action plan to be implemented by the LTU in

[6] There are varying definitions of large taxpayers in different countries. Criteria to define the size of the tax payers range from total of past tax payments on selected taxes (e.g. India) to the value of assets or number of partners in a partnership (e.g. US). In Panama, large tax payers are defined based on a usual set of economic variables.

2013 to increase tax collection from Large Taxpayers; and 4) the implementation of an audit system that tracks validation of Large Taxpayers' compliance against their declared tax liabilities; as evidenced by (i) Ministerial Resolution No. 065 issued by the MEF on December 12, 2012 and published in the Borrower's Official Gazette on January 4, 2013 and (ii) the DGI's Note No. 201-01-8462 dated December 11, 2012 to the Bank.

39. **The main reasons for the low tax revenue collection have been a narrow tax base, significant tax exemptions and inefficiencies in tax administration.** For example, tax revenue collection from the sales tax (ITBMS) was very low due to a low general tax rate (5 percent) and limited tax base because of various exemptions. Another set of tax exemptions was linked to free trade zones, where for example, real estate transactions were exempted from taxation. Tax administration was improved over the past decade through the implementation of an e-tax system, including e-returns and e-payments. However, relative to international best practices, tax administration in Panama lagged behind, as manifested in the lack of a tax tribunal, the lack of focus on large taxpayers, and the lack of legislation on transfer pricing.

40. **To address this weakness, the Government started comprehensive tax policy and administration reforms in 2009 to enhance revenue mobilization.** The first tax reform (Law 49 of 2009) made the Colon Free Zone, casinos, maritime transportation, and oil trade subject to a more comprehensive corporate and dividend taxation treatment, while taxing profits from some foreign operations. It also increased license fees, introduced taxes on real estate transaction—including capital gains on the sale of property—and brought bank commissions under ITBMS coverage. The second reform (Law 8 of 2010, supported by the first DPL in the series) lowered personal and corporate income tax rates, eliminated most personal expenditure deductions, modified the method for corporate expenditure calculations (notably for the financial sector) and raised the ITBMS rate from 5 percent to 7 percent. The 2010 tax reform also streamlined tax administration by creating an Administrative Tax Tribunal and an International Taxation Unit. The former fosters transparency and accountability within DGI, while the latter administers the international taxation legal framework.

41. **More recent advances in tax administration include the establishment of the LTU, which has been made operational. This has been selected as a prior action for DPL II.** The LTU is expected to provide tax compliance control and monitoring of large corporate taxpayers. As a follow-up action from the first DPL, DGI has established the criteria for identifying the universe of large taxpayers under the LTU's oversight. In addition, an action plan has been developed and a timeline established for the full operation of the LTU by 2013, including tax audits. The LTU has been initially endowed with a workforce of ten trained auditors, which has been instrumental to achieve critical short-term outputs such as: (i) selection of the 72 largest taxpayers to be monitored by the LTU, representing 28 percent of the total tax collection; (ii) validation of total tax information related to those taxpayers; (iii) implementation of an audit system that tracks actual payments against declared liabilities; and (iv) formulation of detailed audit programs by economic sector. The administrative resolution needed to formally establish the LTU within organizational structure of DGI was signed on December 12, 2012.

42. **Following through with its action plan, the LTU is strengthening the monitoring of tax compliance.** LTU auditors are being trained in advanced audit techniques for at least two additional economic sectors other than construction, in which they already received training. Audits are to be conducted in those new sectors in 2013. This action is an indicative trigger for DPL III.

43. **In the same vein, the DGI is further strengthening monitoring of tax compliance through timely online access to payment information.** In particular, DGI envisions expanding its network of connected banks to seven in 2013, allowing a real time monitoring of tax payments. As part of DGI's larger efforts to increase tax compliance, this has been selected as an indicative trigger for DPL III.

44. **Moreover, the Government has been addressing potential tax base erosion risks through an update of transfer pricing legislation.** As an open economy, Panama is subject to increasing flows of cross border trade with other countries and thereby other tax jurisdictions. This confronts the tax administration with the challenge of protecting the domestic tax base from possible manipulations among related parties that operate in different countries to avoid overall tax burden. In this context, the introduction of transfer pricing rules as part of Law 33 of 2010 is relevant following international best practices under the arm's length principle.[7] Moreover, Law 52 of 2012 further extended the scope of the transfer pricing regime to include business transactions between a resident taxpayer with related parties hosted in other tax jurisdictions, regardless of the existence double taxation conventions (DTCs) or tax information exchange agreements (TIEA) with Panama. According to Law 52, since January 2012 it has been mandatory for taxpayers to present an annual report of transfer pricing.

45. **Following the approval of Law 52, the International Taxation Unit (ITU) has built capacity and defined a process to start carrying out transfer pricing audits.** The ITU is adding staff to respond to the increased audit mandate. Since its inception, the ITU has taken measures to build tax administration expertise based on OECD and international best practices and provided training in different areas (economics, commercial, banking and financial system, market analysis) to their staff. To date, the ITU has received 67 transfer pricing information filings from taxpayers carrying out business transactions with related parties hosted in foreign tax jurisdictions. Based on risk management criteria, nine requirements to fulfill transfer pricing studies have been requested by the ITU under the presumption of possible violations to the arm's length principle embraced by legislation. The ITU is planning to finish the audits of these nine studies by June 2013, and five audit processes have already started in 2012. While Law 52 is being contested before Panama's Supreme Court, it remains effective, and the Government is strongly committed to the reform progress in this area.

46. **The selected prior action strongly supports the medium-term key outcome indicators for the tax component, which are well on track for completion.** The indicators are that (i) tax collection of the central government is at least 13 percent of GDP by end 2014;

[7] The arm's length principle is part of international best practices formulated by the OECD and states that commercial and financial transactions between related companies should be valued as if they had been carried out between unrelated parties, each acting in his own best interest (OECD, 2006, Annual Report on the OECD Guidelines for Multinational Enterprises: Conducting Business in Weak Governance Zones, OECD, Paris.)

(ii) ITBMS revenue is increased by at least 1 percentage point of GDP; and (ii) the LTU covers at least 55 percent of total tax revenue. The tax-to-GDP ratio is not an optimal indicator of the Government's tax effort for two reasons. First, the supported reforms show impact with a lag, given that the LTU is starting its operations in 2013. Second, many factors influence the tax-to-GDP ratio that do not exclusively measure the results of the supported reforms. A better indicator would be an estimate of the tax gap. However, such measure is unrealistic in the context of Panama's capacity constraints. Hence, the tax-to-GDP ratio is the best available measure to keep track of tax effort and is complemented with two additional indicators that are closely related to the program. A practical measure of the effort that the tax administration is exercising to mobilize tax revenue is the coverage of the LTU.

Objective 2: Improve tax information sharing

Prior actions for DPL II: The Government, through DGI's *Subdirección de Intercambio de Información Tributaria* has effectively exchanged tax information with foreign tax jurisdictions by responding to twenty one (21) exchanges of information (EOI) requests, in accordance with Law 2 of February 1, 2011 and its corresponding tax information sharing obligations, as evidenced by DGI's Note No. 201-01-8458 dated December 13, 2012.

47. **Significant reform advances on domestic legislation in line with international taxation standards have been helping the Government protect domestic tax bases and comply with international tax transparency standards.** The Global Forum's peer review report from September 2010 highlighted a number of shortcomings that need to be addressed to move on to the second phase of the review process.[8] Identified challenges at that point included: (i) uncertainties regarding the authorities' powers to obtain information for exchange purposes; (ii) reluctance to enter into TIEAs rather than DTCs as a way to exchange information; (iii) availability of ownership information, particularly in relation to joint stock corporations; (iv) sanctions for failure to keep or produce information for exchange purposes; and (v) access to accounting information on entities that do not receive Panamanian source income. Moreover, the lack of specificity on the role of pre-existing secrecy legislation and the remaining anonymity of holders of companies' bearer shares were also flagged. By participating in the Global Forum peer review process on tax transparency, the Government has been moving towards improving its international standing.

48. **The Government has taken important steps to adapt the regulatory framework and DGI's operational capabilities to the recommendations.** These reforms have been helping Panama to increase transparency and are stepping stones for a positive outcome of the Global Forum's Phase 1 peer review. Reform actions taken by the Government include the following Global Forum Recommendations: (i) the approval of Law 33-2010 amending the fiscal code to incorporate key international taxation legislation; (ii) the empowerment of DGI to request and obtain taxpayer information; (iii) the negotiation of 18 double taxation

[8] In September 2009, the OECD Global Forum launched a formal process of peer review to monitor and review progress made towards full and effective exchange of information. The Peer Review Process consists of two phases: Phase 1 (review of legal and regulatory frameworks of each country) and Phase 2 (assessment of the practical implementation of the "internationally agreed standard" on tax transparency). A country that signs agreements with 12 countries (OECD or other countries) is considered to have "substantially implemented" the standard.

avoidance agreements, the signing of 15 DTCs with peer tax jurisdictions (plus three pending) and the negotiation of nine TIEAs with different countries, of which eight have been already signed including the one with the USA; (iv) the approval of Law 2-2011 applying Know Your Client (KYC) rules to allow disclosure of corporate ownership (Box 1); and (v) the operation of international tax units within DGI.

49. **The Government's has taken further important reform steps to implement and apply the KYC legislation.** This legislation sets forth the obligation to resident agents (RAs) to obtain the necessary information to identify the final beneficiary owner of at least 25 percent of the capital of their client corporation, including beneficial owners of bearer shares and third parties representing others. Furthermore, this legislation allows DGI and judicial entities to access such information for EOI as well as to prevent money laundering, financing of terrorism and tax evasion. Since the approval of the Law in 2011, Panama received 25 request of EOI from treaty partner tax jurisdictions in compliance with the provisions of the treaties and protocols; 21 have already been executed in an average of 60 days and the rest are in process. This is recognized as a prior action for DPL II.

Box 1. Know Your Client (KYC) Legislation in Panama

One of the recommendations of the Global Forum for Panama is to apply KYC rules to its legislation. KYC rules are the controls and supervision processes that a legal entity must maintain in order to know the economic activities and income sources of current and former clients.

Panama had incorporated KYC rules as part of its legislation since 1994. The legislation required RAs of corporations, trusts and private interest foundations to maintain enough information to be able to identify their client. This legislation, however, did not specify what information was required, nor did it define the term "client," and this is one of the reasons why Panama was not able to successfully pass the First Phase Review of the Global Forum.

Law 2 of February 2011 was enacted to enhance the obligation for RAs in applying KYC rules in Panama and comply with the First Phase Review. Law 2 states that all lawyers and law firms licensed to practice in Panama and acting as RAs are required to know their clients and keep enough information to identify the clients, even if shares representing the share capital of the corporation are issued in bearer form. The RA must keep client information for five years and when necessary, must supply it to the requesting entity within 30 working days. The information shall be requested by means of notice not through search and seizure, and RAs have a five-year window to comply with the information required of former clients. The sanctions applied to RAs for not complying with the law are a warning, fines or a temporary suspension of the right to provide services.

50. **In addition, the Government is working on reforms related to transparency on stockholders, accounting information, and bearer shares.** In anticipation of the Global Forum's follow-on review expected by mid-2013, the Government is consulting with stakeholders from the private sector and the National Assembly in order to further adjust the domestic legal framework to fulfill different objectives, including: (i) allowing full information on the identity of owners and other stakeholders of stock corporations (*sociedad*

anónima) and private interest foundations[9]; (ii) allowing availability of accounting information to be kept for a time span of five years for resident corporations operating outside Panama; and (iii) reforming of bearer shares to identify ownership, which has been identified as an indicative trigger for DPL III. To enable a more informed policy debate previous to the discussion by the National Assembly, the Government is organizing a series of international workshops and seminars to disseminate worldwide best practices and experiences related to the implementation of similar legislations.

51. **The selected prior actions and indicative triggers for DPL II and III are important contributions to the medium-term objective of improved tax information sharing.** Implementing KYC rules including the exchange of information with other tax jurisdictions is an important step in this direction. Further steps are needed and the Government's commitment to this process suggests the feasibility of reaching this outcome. The actions taken thus far would protect domestic tax bases from inbound and outbound international transactions and comply with transparency international standards.

Component 2: Modernizing Public Procurement Practices

Prior actions for DPL II: The Government, through its *Dirección General de Contrataciones Públicas*, within the e-procurement platform *PanamaCompra,* has introduced new mandatory Framework Agreements for all Public Entities since April 2011; and published all Framework Agreements signed in years 2011 and 2012.[10]

52. **The Government faced the challenge of high transaction costs and an elevated administrative effort in buying goods and contracting services.** Procurement reforms are expected to significantly increase accountability and transparency and reduce transaction costs, since 37 percent of non-financial sector public spending is done through procurement.

53. **The Government has continued to strengthen the public procurement system since its initial reform in the mid-2000s.** The Government has made significant achievements in efficiency and transparency through the introduction of a modern e-procurement platform. Since 2001, the Bank has supported the new e-procurement platform (*PanamaCompra*) of the Procurement Agency (*Dirección General de Contrataciones Públicas*—DGCP) through a technical assistance loan and additional financing (P055844 and P105526).

54. **The Government increased its efficiency through the introduction of framework agreements for common use goods and services.** This measure was supported through DPL I. As reported by DGCP, by the end of 2012, the number of goods commonly purchased by Government agencies covered by framework agreements has more than doubled (from a baseline of 2,452 catalogue items in 2009 to 5,629 items in 2012), almost reaching the end-program target of the DPL series (6,000 items for 2013).

[9] Currently, Law 2-2011 sets a disclosure limitation of 25 percent ownership.

[10] "Framework Agreement" ("*Convenio Marco*") means a contract to be entered into between a public entity and one or more potential suppliers of goods and providers of services for the procurement of goods and services of common use (*uso comun*) under the e-procurement platform *PanamaCompra*.

55. **The Government has taken further important steps to improve the efficiency and transparency of its national procurement system.** Currently central government agencies are using framework agreements, thereby complying with Law 22 of 2006 and with the prior action of DPL II. The use of framework agreements by central agencies is helping the Government to address the current administration's public procurement plan as well as savings in time, price and transaction costs. The Government is using long-term agreements with suppliers, contractors and providers of non-consulting services that sets out terms and conditions under which specific procurements can be made framework agreements.

56. **The new e-procurement platform, *PanamaCompra,* is being improved through its integration with other systems.** *PanamaCompra* is already integrated with DGI databases and is in the process of integration with the databases of the Ministry of Industry and Commerce. Moreover, the functionality required to further integrate it with the Integrated Financial Management System (*Sistema Integrado de Administración Financiera de Panamá*—SIAFPA) has been already built and the two systems will be integrated once the new SIAFPA is in place. The implementation of SIAFPA will be supported by the Enhanced Public Sector Efficiency Technical Assistance Loan - TAL(P121492), scheduled to close on September 30, 2016.[11]

57. **The Government is still facing some challenges regarding its procurement regulations.** One of the challenges is that the legal framework was not designed to accommodate the current administration's public investment plan, which involves complex infrastructure projects. In an attempt to address these issues amongst others, the Government has already passed ten amendments to the procurement law, while new amendments are being prepared. This resulted in an unbalanced legal framework with outdated regulations. Another challenge is that despite the overall transparent operation of the procurement system, subjective award criteria are still used. While 83 percent of the awarded amounts result from open competition, only 36 percent result from purely economic considerations while the remaining procurement includes non-economic evaluation criteria (quality, experience, etc.) in addition to price. Eighteen percent of the total is procured with a two-envelope method.

58. **The Government has made progress in addressing the shortcomings of the legal framework and ensuring transparency, competition, efficiency and value for money.** Specifically (i) standard bidding documents and contracts will be used by all central government agencies; (ii) a regulatory decree will be drafted by a participatory committee made up of civil society, public and private sector representatives to replace the existing outdated regulations and better accommodate public investment projects; (iii) guidance notes on evaluation criteria other than price will be prepared; and (iv) all Government agencies will use *PanamaCompra* to publish and receive bidding offers. The Government will thus be able to better exploit economies of scale and reduce transaction costs and time for the purchase of common use goods. These actions have been selected as likely triggers for DPL III.

59. **In the medium term, the measures taken under the DPL series will help ensure that all central government procurement activities will be undertaken through**

[11] In the area of procurement, the technical assistance loan supports the Government to increase the ratings of the OECD benchmark methodology to assess national procurement systems and improve private sector perception of transparency and efficiency in Panama's public procurement system. At the same time, it is helping develop specialized training to increase the level of procurement professionalism in the public sector.

PanamaCompra. New framework agreements and standard contracts are expected to be used by all Government agencies. Additionally, the number of catalogue items procured under framework agreements will increase from 2,452 in 2009 to 7,300 in 2014. This way the majority of common use goods and services will be covered by framework agreements. Government expects that at least half of the public officials involved in procurement activities will be certified and accredited through the project.

Component 3: Increasing the Efficiency of Debt Management

Prior actions for DPL II: The Borrower, through the MEF has approved the organizational structure of the *Dirección de Crédito Público,* including the functions and responsibilities for each of its internal units, as evidenced by Ministerial Resolution No 003 issued by the MEF on January 16, 2013.

60. **A major challenge for debt management in Panama is the lack of a medium-term debt management strategy.** In particular, while overall guidelines such as the development of the domestic debt market and the smoothing of the debt profile exist, there is no formal debt management strategy in place. Such a strategy would establish target ranges for selected indicators of financial risk after assessing the cost-risk tradeoffs of different alternatives. This strategy would be the main guideline for public debt management and would summarize the Government's intentions regarding the debt portfolio. The annual borrowing plan would then be annually derived from this broader strategy.

61. **A sound organizational structure is also a prerequisite for efficient debt management.** A sound structure assigns operational responsibility for public debt management to separated front, middle and back offices, with clear and distinct functions and accountability. Typically, the front office is in charge of executing debt management operations, which include contractual borrowing, domestic auctions, and international issuances of bonds. The middle office is in charge of risk management and the design of the medium-term debt management strategy. The back office is in charge of debt registering, making debt payments and constructing debt statistics.

62. **The Government has recently formalized an organizational structure of *Crédito Público* in line with international best practices, selected as prior action for this operation.** Since 2010, funding, risk analysis and strategy design functions were created and assigned to different units in *Crédito Público*. In practice, this means that front, middle and back offices were established, aligning *Crédito Público* to best practices. However, another fundamental step, the institutionalization and legal formalization of this new structure, was achieved in January 2013, through a ministerial resolution. The institutionalization of the organizational structure defines not only the institutional set-up of *Crédito Público*, but also the functions and responsibilities of each unit inside it, guaranteeing institutional stability over time and improving accountability of debt management.

63. **In parallel, the Government has taken several important measures to develop the domestic debt market.** The issuance of Treasury Notes—begun in 2010 with the support of DPL I—reached US$538 million in 2011, or 30 percent of Government financing needs and significantly above the target of 10 percent established in DPL I. Moreover, the authorities launched a primary dealers program in June 2011, which is an important step to contribute to

a liquid market, ensure reliable pricing and reduce the cost of funding as the secondary market grows. Regular meetings with the primary dealers have allowed *Crédito Público* to fine tune the frequency and volumes of the auctions and to promote the increase in transactions on the secondary market. Finally, *Crédito Público* launched an Annual Borrowing Plan, which improves transparency for the society and especially for investors. By reducing uncertainties, a borrowing plan has positive effects on demand and liquidity, and consequently on Government borrowing costs.

64. **Although authorities have pursued a deepening of the domestic debt market, a concrete development plan based on cost-risk analysis underlying a debt management strategy is pending.** Domestic debt market development supports the implementations of the public debt management strategy and reduces risk for Government funding by broadening the investor base and reducing demand volatility. An important component of the medium term debt management strategy is thus the development of the domestic debt market. Although the Government has pursued domestic debt market development as part of a broader strategy to turn Panama into an international financial hub, it does not have a formal plan connected to a medium term debt management strategy. Furthermore, the spread currently paid by the Government in the domestic market vis-à-vis its international issuances show that there is still room to further deepen the local debt market. To fill these gaps, *Crédito Público* will, by June 2013, prepare and start implementing a plan to further develop the domestic market with measures to improve liquidity, price discovery, and broaden the investor base. Examples of measures that other countries have taken in this context are ex-post publishing of trades (prices), incentives to trading in electronic platforms, liability management operations, regular meetings with market players and measures to attract foreign investors to the local markets. Part of the formulation of the plan for domestic market development will consist of the definition of those exact measures. This action has been selected as an indicative trigger for DPL III.

65. **The Government is addressing high turn-over of technical staff in *Crédito Público*, which has slowed down the formulation of a medium term debt management strategy.** *Crédito Público* has lost key technical personnel, which has forced management to revise work plans and focus on rebuilding the institutional capacity required to meet debt management objectives. A first step in this direction has been hiring a core group of technical officials with the basic skills to work in each unit of *Crédito Público*. The unit is designing an action plan to mitigate the turnover of technical staff in the funding and risk analysis units by June 2013.

66. **The expected result of this programmatic operation is the development of institutional capacity to formulate and execute a medium term debt management strategy that includes a plan to develop the domestic market.** The main expected outcome is the publication, by end of 2013, of the first medium term debt management strategy of Panama. This outcome will result from the analytical work assessing the risk return characteristics of different possible debt portfolios taking into account different scenarios on the development of the economy and financial markets. This will require training the middle office on the methodology, process for data aggregation and use of a model to compare alternative borrowing strategies in terms of cost and risk, and would be complemented with a reasonable understanding of the investor base and the potential demand for securities. Most of the debt management technical assistance of the Bank in this operation will be dedicated to this capacity building. This strategy would be revised annually and annual debt reports would

be published showing the evolution of risk indicators in comparison with the targets set in the strategy.

Component 4: Expanding and improving targeting of social transfer programs

Prior actions for DPL II:

- The Government, through the Ministry of Social Development (MIDES), has adopted the new criteria to evaluate the eligibility of elderly citizens for the *100 a los 70* cash transfer program, as evidenced by Ministerial Resolution No. 225, 2012 issued by MIDES on October 4, 2012 *and* published in the Government's Official Gazette on December 13, 2012.

- The Government, through the *Instituto para la Formación y Aprovechamiento de Recursos Humanos* (IFARHU), has expanded the *Beca Universal* scholarship program to include grades 1 to 6 of all the Borrower's public schools.

67. **High poverty rates and inequality in the public provision of social services remain serious challenges in Panama.** Poverty rates are particular high in rural areas and even more so in the *comarcas*, where a large part of Panama's indigenous population lives. In the three *comarcas* poverty rates are close to or even exceed 90 percent. In addition, the Human Development Index is low in those areas, underscoring shortfalls in public health and education service provision (see Figures 1 and 2). It is as low as 0.45 in the *comarca* Ngobe Bugle, compared to 0.77 in the province of Panama. Some 40 percent of pregnant indigenous women do not have any prenatal health checks while it is almost universal for the rest of the population, and drop-out rates from the premedia and media cycles in *comarcas* Kuna Yala, Ngobe Bugle or Darien are around 20 percent, compared to 2.3 in the province Los Santos (World Bank 2012).

68. **In response, the Government expanded social protection programs with a focus on the poorest families, the elderly and school-age children.** As part of the five-year strategic plan in 2009, the Government developed a social strategy to strengthen social protection with the aim of reducing poverty and income inequality. In particular, the Government improved the targeting of the already-existing CCT program, *Red de Oportunidades,* which had been introduced in 2006 and introduced a non-contributory old age pension, *100 a los 70,* in 2009 and a cash transfer to children for school grade achievements, *Beca Universal*, in 2010. These programs have enriched the social protection toolkit and resulted in an increased coverage of the Panamanian population.

69. **The *Red de Oportunidades* program channels resources to the poorest mothers conditional on their children attending school and receiving basic health and nutrition services, mainly benefiting indigenous populations in rural areas.** The program is also linked to supply-side interventions to ensure provision of health and nutrition services in rural and indigenous areas, in coordination with the Ministry of Health (MINSA). The targeting accuracy of the Program has been positively reviewed[12] and confirms the ability of the program to channel resources to the poor in remote geographic areas. About 46.3 percent of beneficiary households are indigenous, reaching more than 90 percent in areas with high

[12] IPEA, 2008

indigenous population (provinces of Bocas del Toro and Darién, and in the Kuna Yala, Emberá y Ngobe Buglé *comarcas*).

70. **An important reform for the program was the reduction of exclusion errors, which was supported under DPL I**. In 2010, the program put in place a management information system that identified and excluded non-eligible households that had moved to other regions, showed duplicate records or were no longer eligible due to their employment status (e.g. having a formal job). This inclusion of all incoming beneficiaries and some existing ones in the management information system will gradually allow verification of beneficiary eligibility conditions, thereby freeing up funds to enroll new eligible households—as per the proxy means test used for targeting—that could not be covered before. This is an important step towards reducing targeting errors and ensuring an appropriate expansion of a very progressive scheme. In 2012, the program received the Americas Award from CIFAL and United Nations Institute for Training and Research for its efforts in eradicating extreme poverty and hunger, especially in remote rural and indigenous areas.

71. **In 2009, the Government introduced a program of non-contributory pensions for those aged 70 or older in an effort to address poverty among the elderly.** The program, called *100 a los 70*, provides a US$100 per month to all eligible persons in this age group. The program was conceptualized with two criteria for eligibility: be at least 70 years of age and receive no other pension income. Following the introduction, more than 1,100 elderly *Red de Oportunidades* beneficiaries were transferred to the new program.

72. **The program initially did not verify socioeconomic conditions due to the lack of assessment instruments.** As a consequence, initial coverage included more than 100,000 elderly, where exclusions were based only on social security information. In 2010, the Government addressed this excess coverage by approving Law 86 to include an additional eligibility condition, namely social risk, vulnerability or poverty. This measure was supported by DPL I. Enhancing targeting in *100 a los 70* is critical for reducing inclusion errors. With those savings, the program could improve entrance into the program of eligible elderly currently queuing for an assessment by limited social workers. Implementing this additional eligibility condition hinges on technical capacity to carry out a socioeconomic assessment of the elderly, which is currently jeopardized by limited budgetary resources.

73. **The Government has been gradually enhancing the design and implementation of these programs in order to develop a more articulated social protection system.** The Technical Secretariat of the Social Cabinet (*Secretaria Técnica del Gabinete Social*) of the MIDES provides the space for social policy coordination across different agencies and is gradually developing analytical capacity and creating space for thematic policy dialogue. MIDES has been exploiting synergies in the design of targeting instruments and in critical operational activities, such as payment processes. These synergies represent efficiency gains in social policy design and implementation that need to be expanded. During 2013, the Secretariat will finalize the implementation of a unique registry for the three CCT programs (*Red de Oportunidades*, *100 a los 70*, and the *Beca Universal* program), which is an indicative trigger for DPL III.

74. **The Government has adapted legal backing to a social vulnerability survey and developed the criteria to evaluate the eligibility of elderly for *100 a los 70*, which is**

included as a prior action in this DPL. Since passing Law 86 in 2010, the program prepared a social vulnerability survey, designed a socioeconomic evaluation proxy means test and piloted the survey to assess the effectiveness in distinguishing poor from non-poor elderly. The Government also prepared and approved legal instruments to ensure that the survey and socioeconomic evaluation have adequate legal grounds for determining eligibility (Ministerial Resolution 225, October 4, 2012). In 2012, MIDES received technical assistance from the World Bank to assess compliance to new eligibility rules, including a geographically targeted approach to recertify beneficiaries. MIDES has already piloted the survey and criteria with more than 150 beneficiaries. Based on this pilot, MIDES is developing a strategy for recertification including an operational action plan including among others a plan of resource allocation, a time-line, and a plan of the logistics for the actual recertification.

75. **This prior action feeds directly into the intended medium term outcome indicator of increased ability of MIDES to conduct recertification of beneficiaries.** The formalization of the social vulnerability survey and the development of criteria to evaluate program eligibility is a critical precondition for recertification. The recertification strategy maximizes the number of beneficiaries identified as not eligible by prioritizing *corregimientos* where inclusion errors might be higher. Recertification would provide financial space for incorporating eligible elderly. In addition, the Government has drafted legislation establishing the Directorate for *100 a los 70*, providing it with regular staff and an adequate operational budget. This executive decree is awaiting approval by the Presidency.

76. **In October 2010, the Government introduced the *Beca Universal*, a cash transfer for children based on passing grades**. The enactment of Law 40 of 2010 establishing *Beca Universal* was supported by DPL I. The program transfers US$20 per month per child, conditioned on academic performance (getting a passing grade of 3). Payments are made directly to children by the IFARHU, and the Comptroller General certifies that children comply with the academic conditions and identification records. The program's primary objective is to help families afford schooling costs and help reduce drop-out and repetition rates in public schools.

77. **The *Red de Oportunidades* and *Beca Universal* thereby provide complementary assistance**. While the former provides incentives to increase enrolment with a household-level transfer, the latter creates incentives to improve academic performance with individual-level transfers. In 2010, the *Beca Universal* program covered 7th to 12th-grade eligible students in all public schools in the country. In the province of Bocas del Toro and in the indigenous *comarca* Ngobe Bugle, all grades were covered from the beginning because *comarcas* face the highest drop-out rates in premedia and in Ngobe Bugle repetition rates in primary school are three times the national average.

78. **The *Beca Universal* program has reached full coverage from grades 1 to 12 in public schools in 2012; this is a prior action for DPL II.** The third phase of the roll out of the *Beca Universal* program has been under implementation in 2012, reaching all eligible students in grades 1 to 12 in public schools. By August 2012, students in grades 1-3 were added to the program, reaching a total of 403,336 students in public schools with passing grades (out of a total of 507,000 students in public system). The Government has also adopted technical and legal actions preparing the implementation of the expansion plan for school year 2013 that include students in grades 1st to 12th in private schools of low socioeconomic

background. To ensure this condition, the Government has made schools that charge less than US$1,000 per year in tuition and fees eligible.

79. **The roll out of the *Beca Universal* to younger pupils will increase the program's potential impact on poverty reduction and progressivity.** Due simply to the fact that poorer households have more children and that the probability of attendance in primary school is higher than secondary school among the poor, the number of beneficiaries of the program among the poor increased as the program expanded to the lower grades. Therefore, the roll out of the program to grade levels 1 to 6 is likely to help reach the medium term outcome indicator of reaching a high share of children from the poorest quintile of the population, although there are no accurate monitoring instruments to properly estimate this indicator. Ongoing support would ensure that Comptroller General incorporate these issues in the planned 2013 household survey to serve as the basis for a rigorous evaluation. This is considered as an indicative trigger for DPL III.

80. **The Government has been gradually addressing issues of complementarity in the design and implementation of these programs, moving toward a more comprehensive social protection system.** The Technical Secretariat of the Social Cabinet is responsible for aligning the different CCT programs. In addition, the Government is in the process of implementing a single registry for the three CCT programs to improve targeting, which is an indicative trigger for DPL III.

OPERATION DESIGN

81. **This operation is the second in a programmatic series of three DPLs designed to support the Government's fiscal management and efficiency of spending program**. While the first DPL emphasized legislative changes, the subsequent DPLs focus more on the sustained implementation of the reforms. Given the medium term nature of the reform efforts, Bank engagement naturally lends itself to a programmatic approach. The operational design is summarized in the Policy Matrix (Annex 5).

82. **Initially, the DPL series was designed to consist of four operations and has been shortened to three.** This adjustment results from the time that has elapsed between the preparation of DPL I and the Government request for DPL II, as well as presidential elections coming up in May 2014. Some prior actions and the results framework have been adjusted to reflect reform progress and implementation in different areas.

83. **DPL II prior actions differ in some aspects from the set of indicative triggers identified in DPL I, reflecting the varying speed of reform implementation.** Out of a set of seven indicative triggers, five were converted to prior actions including slight changes in the formulations, while one of the remaining two was substituted with an alternative prior action. Out of the five triggers that remained generally the same, one was updated to reflect faster than expected reform progress (summarized in Table 3). The quality of the program supported in DPL II is comparable to what was originally proposed in DPL I. Moreover, the Government remains committed in all the areas, as evidenced by policy continuity. However, the speed of reform implementation varies as the Government may face competing political priorities or implementation capacity constraints.

84. **The analysis of tax expenditures and subsequent inclusion into the budget is taking longer than expected and is, therefore, not included as a prior action**. This prior action was planned as part of the policy objective to mobilize tax revenue through policy and administration reforms. While progress has been registered, the analysis itself is still under preparation and does not lend itself for inclusion. The Government is committed to following through on this measure and is working on the analysis of tax expenditures for later inclusion into the budget with support from IDB. In addition, advances in the area of tax administration including the creation of the LTU are substantive.

85. **Similarly, the ambitious measure of recertifying beneficiaries of the *100 a los 70* according to the revised targeting criteria will be substituted.** This prior action was part of the objective to expand and strengthen social transfer programs. It has become clear that the instruments to carry out the recertification were not in place, including the legal backing for an evaluation that potentially results in the exclusion of ineligible beneficiaries. The revised prior action and new indicative trigger for DPL III reflects this reality by recognizing the necessary steps towards the recertification. The operation will instead support the Government putting in place the necessary instruments to be able to reach the medium term outcome indicator. The approval of the vulnerability survey and the criteria for the assessment of eligibility through a resolution have been selected as prior actions for this operation.

RESULTS FRAMEWORK

86. **The Government is performing well against the targets identified in the first DPL operation, in particular, in the areas of tax reform, procurement and debt management.** On the tax reform component, the tax-to-GDP ratio has increased significantly to 12.6 percent. With 83 cases resolved, the administrative tax tribunal has resolved far more cases in 2011 than targeted in that year (36). Also Panama has shared tax information with three as opposed to the required two countries in 2011 to meet the target. Regarding procurement, the number of catalogue items covered by framework agreements—5,629—has by far exceeded the target of 4,756 for 2011. On debt management, Panama has issued 30 percent of its debt in the local debt market, far surpassing the target of 10 percent.

87. **In the social protection area, the program is on track to reach the medium term outcome indicators.** The number of beneficiary households of the *Red de Oportunidades* has actually been slightly reduced in 2011 relative to 2010. As of end 2011, 73,535 households were benefitting from the program, below the DPL I target of 75,260. However, according to MIDES, coverage missed the target by just 230 households in late 2010; since then, the reach of the program has been expanded to nearly all potential beneficiaries and the reduction in the number of participating households reflects improved targeting and monitoring of compliance with co-responsibilities. Coverage of the *Beca Universal* program exceeds the target, with all public school students in grades 4-12 eligible to receive the *Beca Universal* scholarship, surpassing the DPL I target of covering all public school students in grades 7-12. A target that the Government has missed is the payment of the transfers in the *100 a los 70* program due to lack of compliance with the health co-responsibility of the beneficiaries. MIDES is aware of the challenge but limited budgetary resources have slowed down progress towards a monitoring system.

88. **The targets for key outcome indicators of the overall program have been updated to reflect changes in the program (prior actions and indicative triggers) as well as varying reform speed.** This is summarized in Annex 8.

VI. OPERATION IMPLEMENTATION

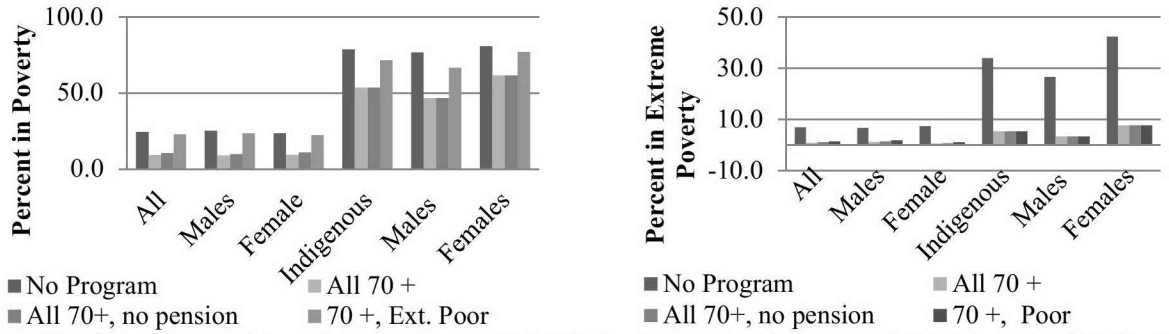
POVERTY AND SOCIAL IMPACTS

89. **The Government actions supported in this DPL are expected to have a positive poverty and social impact.** There are reasons to expect a positive or neutral impact of each of the supported reforms, as explained below. In addition, recent qualitative and quantitative analyses, for example Arraiz and Rozo (2011) and Waters (2009), also found a positive impact. Annex 6 provides a summary of those studies.

90. **The tax reform is expected to have an indirect positive effect on Panamanians at the low end of the income distribution.** Increased tax compliance for large corporations will generate fiscal space for increased social spending. Given the commitment of the current administration to its social development strategy, it can be expected that part of additional tax revenue will be used for this agenda. There is a slight possibility of a negative impact, if corporations pass on the higher tax burden to their customers and if Panamanians with low incomes buy goods of those corporations. The impact is likely to be negligible.

Figure 10: Potential impact of the 100 a los 70 program on poverty by population group

(a) Overall Poverty (b) Extreme Poverty



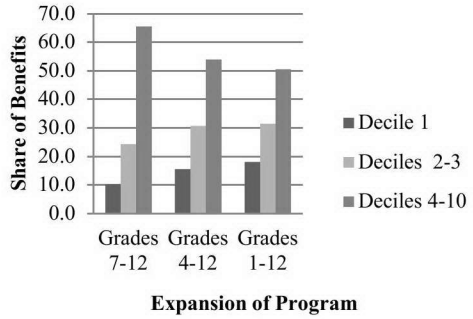
Note: The first column shows the actual poverty levels in the country by group (national, male female, and indigenous, male and female). Column two shows the poverty rate if all persons 70 and older receive the benefit, column three is all persons 70 and older with no other pension who receive the benefit and the last column shows the poverty rates if all persons 70 and older in extreme poverty receive the benefit. *Source:* Authors' calculations based on *Encuesta de Hogares* 2009.

91. **The tax information sharing and the procurement component are not expected to directly impact poverty or the distribution of incomes.** However, indirect effects could occur, for example, based on an overall increased transparency which could generate an improved business environment and hence, more employment. Also, more efficient spending may free up resources for social development spending.

92. **Measures related to social protection programs are expected to generate significant, positive impacts for indigenous, rural and extremely poor Panamanians.** The development of tools to implement the recertification of the *100 a los 70* program is important in order for the program to have a positive distributional impact. A universal, untargeted

program would be regressive, since poorer people tend to have lower life expectancies: people over 70 make up 3.5 percent of the lowest decile, but 8.7 percent of the top decile. Focusing the program according to economic need greatly improves its progressive nature. The untargeted program has a small impact on national poverty rates but halves the poverty rate among those 70 and older and almost eradicates extreme poverty. Given the very high poverty rates among the indigenous, extreme poverty remains a concern, especially among women as they are poorer than men. Targeting extreme poverty erases much of the effect on overall poverty changes but has the same effect of almost eliminating extreme poverty at less than a third of the cost.

Figure 11: **Share of benefits of *beca universal* by income decile**



Source: *Encuesta de Hogares 2009*
Note: The first decile corresponds roughly to the extreme poor and the second and third deciles to the moderate poor.

Figure 12: Potential poverty impact of *beca universal*

	Overall Poverty	
	National	Indigenous
Before *Beca Universal*	32.0	85.3
With *Beca Universal* Grades 1-12	30.6	83.3
	Extreme Poverty	
	National	Indigenous
Before *Beca Universal*	11.0	47.8
With *Beca Universal* Grades 1-12	9.4	41.5

Source: Encuesta de Hogares 2009

93. **The expansion of *Beca Universal* will also improve progressivity.** Given that poorer households have more children and the probability of attendance in primary school is higher than secondary school among the poor, the number of program beneficiaries among the poor increased as the program expanded to the lower grades (Figures 11 and 12). In addition to increasing attendance, the program has also had a small effect on lowering poverty levels, particularly among the extreme poor in the *comarcas*. The positive impact of the program appears particularly relevant in light of Panama's persistent difficulty in the public provision of social services.

ENVIRONMENTAL ASPECTS

94. **The measures supported under the proposed DPL are not likely to have significant effects on the environment, forests or other natural resources**. Policy actions in the areas of tax administration, tax information sharing, public procurement, debt management and social policy are not likely to have either positive or negative environmental impacts.

IMPLEMENTATION, MONITORING AND EVALUATION

95. **The MEF is responsible for the implementation of the DPL operation as well as for coordinating the actions among the concerned agencies**, including the MIDES and the MINSA. Together with MEF and the National Institute of Statistics, these institutions collect

the necessary data for the identified monitoring indicators. The MEF and the Bank have agreed to monitor the progress in the program supported by the programmatic series.

FIDUCIARY ASPECTS

96. **Panama's public financial management (PFM) and public procurement systems are adequate for this operation.** A public expenditure and financial accountability assessment is currently being completed by the World Bank in coordination with the IDB. The overall findings indicate that even though the general PFM environment is adequate, several areas would benefit from further improvement, such as budget preparation, budget execution, key financial management functions related to accounting, recording and reporting expenditures, and monitoring and evaluation of public programs. In addition, the budget is published promptly after its approval in the official gazette (the 2012 budget approved on October 11, 2011 was published on the same day) and can also be downloaded from the Ministry of Finance's webpage.[13] Data on budget execution is also publicly available and can be consulted online.[14]

97. **The Government is moving ahead to further strengthen its PFM environment.** In line with its Strategic Plan for 2010-2014, the Government is implementing a set of key reforms to strengthen and modernize planning and budgeting, strengthen the financial management system and the financial control framework, and continue strengthening procurement systems. The Bank has been supporting the Government in the improvement of PFM through the previous DPL operation (P123255), as well as the Enhanced Public Sector Efficiency Technical Assistance Loan (P121492). These operations, in particular the latter, support the implementation of better management practices in the use of public resources around the budget cycle, which would contribute to enhanced efficiency and effectiveness of public programs, as well as transparency and accountability in the use of public resources. IDB has also been supporting the Government in the implementation of complementary activities in the areas of planning, budgeting and evaluation.

DISBURSEMENT AND AUDITING

98. **The proposed loan will follow the Bank's disbursement procedures for development policy loans.** Once the loan is approved by the Board and becomes effective, the Bank would make the single loan disbursement to the MEF's Treasury Single Account. Since this account centralizes Government revenue for financing Government spending, upon its deposit, the DPL disbursement will become available to finance budgeted expenditures. The account is denominated in US dollars, which has legal tender in the country, and is held at the National Bank of Panama, the financial agent of the Government. During the review of external audit reports and the experience with special designated accounts for investment lending, nothing came to the attention of the Bank that would indicate that the banking control environment into which the loan proceeds will flow is other than adequate. The Loan Agreement will include a clause for the provision upon the Bank's request of a written confirmation of the described transaction that the amount of the loan has been credited to an account that is available to finance budgeted expenditures. If the proceeds of the loan are used for ineligible purposes as defined in the Loan Agreement, IBRD will require the Borrower to,

[13] http://sipresweb.mef.gob.pa/diprena_web/PDF_OUTPUT/2012/ley2012.pdf
[14] http://www.mef.gob.pa/Portal/Transparencia-Ejecucion-Presupuestaria.html

promptly upon notice from IBRD, refund an amount equal to the amount of said payment to IBRD. Amounts refunded to the Bank upon such request shall be cancelled. The administration of this loan will be the responsibility of the MEF.

RISKS AND RISK MITIGATION

99. **The program supported by the Fiscal Management and Efficiency of Expenditures DPL series is subject to four main risks.**

100. **Economic: The main risk derives from the fiscal stance, which is mitigated through Government policies.** Some risk of overheating has stemmed from the combination of expansionary fiscal policy, an economy that is growing fast and expansionary US monetary policy to which Panama is tied through its currency peg. Yet this risk is subdued as headline inflation is declining and the global environment is conducive to a smooth transition to trend growth in the medium term. The Government has twice increased the deficit limit mandated under the SFRL in 2010 and 2011, to accommodate fiscal deficits of up to 3 percent of GDP. Higher deficits would not compromise debt sustainability but diminish the prospect of continued reduction of the public debt to GDP ratio and limit room for maneuver should negative shocks hit the economy. Three main factors mitigate this risk. First, the deficit increase is fully accounted for by the expansion of capital expenditure, which is easier to cut than current expenditure should this become necessary. Second, public infrastructure projects, such as the metro line and the expansion of the road network, are being executed on time and within budget. They are to be completed before the end of the term of the current administration in May 2014. Third, the Government has engaged in activities to raise revenues, including the tax policy and administration reforms supported by this operation and to a limited extent the approval of the FAP. As pointed out by several analysis (IMF and Moody's) the net savings (savings less incremental debt incurred during the year) in the FAP will likely be low if the Government were to register the maximum permissible deficits under the SFRL.

101. **A second economic risk stems from the country's vulnerability to external shocks.** The country's high degree of economic and financial openness as well as its heavy reliance on foreign financing render Panama vulnerable to external shocks. Strong domestic fundamentals, the fact that a large part of current account is financed through relatively stable foreign direct investment inflows, the approval of the FAP, and the country's good access to multilateral financing for investment projects mitigate this risk.

102. **Institutional: The main institutional risks relate to weak participatory processes and the quality of public institutions.** The effectiveness of some of the reforms depends on the capacity and ability of the Government to involve relevant stakeholders to create consensus around those reforms (i.e. bearer shares legislation) or social protection (recertification program). The limited use of the *Consejo para la Concertación Nacional el Desarrollo* adds to this risk. Mitigating measures include a close dialogue and consultations with political parties, donor community and stakeholders on the measures supported by the DPL series.

103. **A related risk refers to Panama's public sector institutions.** Improvements in financial management, and procurement systems would improve the monitoring and evaluation of public investment and spending to better support a more developed economy.

To mitigate this risk and improve transparency and efficiency of public spending, the Government is implementing reforms in the areas of fiscal management and procurement, such as strengthening budget execution, accounting and control through an integrated financial management system. These reforms are supported by several donors, including the World Bank, through investment and technical assistance projects.

104. **Political: With presidential elections coming up in May 2014, the speed of implementation of the Government program supported by this operation may lead to challenges in dealing with sensitive reforms.** Some opposition could occur regarding the recertification of eligibility of CCT programs as some current beneficiaries would cease to receive benefits. The Government is mitigating this risk through a consultation process and a communication strategy for current beneficiaries. In response to concerns voiced by some legal firms and other stakeholders regarding tax transparency reforms, the administration has opened a participatory process to reach out to stakeholders and better communicate the benefits of the proposed measures.

105. **Natural Disasters**: **Panama is highly vulnerable to multiple natural disasters.** According to the World Bank's Natural Disaster Hotspot Study, Panama ranks 14th among countries with the highest economic risk exposure to multiple hazards. The impact of a possible natural disaster during this operation would be mitigated by the CAT-DDO approved in FY12. It would provide immediate liquidity to the Government in order to respond to affected areas and populations. Emergency grants that Panama received from IDB, *Corporación Andina de Fomento*, and the Central American Bank for Economic Integration show that financing from these institutions is an important mitigation measure for natural disasters. Another mitigation measure is the Country's Disaster Risk Management National Plan 2011-2015, which defines specific actions in improving disaster resilience during the next four years with the support of different stakeholders. Finally, financing through the FAP would be available to mitigate the impact of certain emergencies in the future.

ANNEX 1: LETTER OF DEVELOPMENT POLICY

República de Panamá
Ministerio de Economía y Finanzas
Despacho del Ministro

December 26, 2012
DdCP/UCSP/1105

Mister
Jim Yong Kim
World Bank
Washington D.C.

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

Dear Mr. Kim:

The Government of Panama is committed to the strategic objectives established three years ago to address key development challenges to expand economic opportunities and reduce poverty.

In the past three years, the Government has reached 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 prudent 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 targeti of a non-contributory pension program ("100 a los 70"), introducing and expanding a universal scholarship program ("Beca Universal") to grades from 1 to 12, and improving the target of conditional cash transfer (CCT) programs, including "Red de Oportunidades".

I. The Strategic Government Plan

The Strategic Government Plan is composed by 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 was the first time that one administration, at the beginning of its mandate, has presented a set of documents that have constituted

guidelines 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 reduction in the level of income inequality, poverty and unemployment. Maintaining macro-fiscal stability is one of the 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 healthy and 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 7.6 percent in 2010, 10.6 percent in 2011 and a growth rate above 10 percent for first three quarters of 2012. Consumer price index averaged at 3.5 percent in 2010 and 5.9 in 2011.

The Government's fiscal strategy consists of maintaining prudent debt levels by complying with the Social Fiscal Responsibility Law. The tax reforms led to higher tax revenues, amounting to 12.1 percent in 2011 and are projected to have grown to 13.4 percent in 2012. Public debt stood at 40.9 percent of GDP in 2011 and is estimated to decline to 39.6 percent of GDP in 2012.

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

- **Improve tax revenue collection through the expansion of the tax base, the reduction of tax expenditures, and the improvement of tax administration**

The Government has established the Large Taxpayer Unit (LTU) by a ministerial resolution, which has been made operational through the selection and training of 10 auditors and selection of 72 large tax payers representing 28 percent of total tax

revenue. In addition, the LTU has formulated an action plan for the full implementation of the LTU. The Government has also implemented an automated system that detects noncompliance resulting in 0% of tax delinquency.

In the following years the Government will be working towards strengthening the monitoring of tax compliance. In the context of the LTU, auditors are being trained in advanced audit techniques for at least two additional economic sectors and are expected to carry out audits in those sectors, in 2013. At the same time, the DGI is further strengthening monitoring of tax compliance through timely online access to payment information. In particular, the DGI is connected to a minimum of seven banks, allowing the DGI a real time monitoring of tax payments.

- **Improve tax information sharing**

The Government has made substantial progress towards greater tax information sharing. The Government has been requesting information from resident agents to identify their clients based on the "Know Your Client" legislation, as part of the implementation of Law 2 of 2011. In addition, the Government has implemented a monitoring system for the compliance of Law 2 of 2011, including sanctions such as the suspension of the right to provide services for non-compliant resident agents.

The Government expects to approve legislation that allows the immobilization of bearer shares to identify ownership of shares to comply with the Global Forum's standards of transparency and exchange of tax information Phase 1 of its peer review process and move to Phase 2 in 2014.

- **Further development of public procurement practices**

The Government is committed to improve the delivery of goods and services to citizens and to this end it has continued to work towards increasing its efficiency and transparency. To achieve this goal the Government has developed and has made mandatory for all Central Government agencies, a new module of framework agreements within the procurement platform.

Furthermore the Government aims to implement the following changes: (i) all central government agencies are using standard bidding documents and contracts; (ii) approve a regulatory decree to replace obsolete procurement regulations and better accommodate public investment projects drafted by a Participatory Committee formed by civil society, public and private sector; (iii) formulate and publish Guidance Notes with evaluation criteria in addition to the price for selecting and contracting.

- **Strengthen debt management and develop domestic debt market**

The Government of Panama is preparing a medium-term debt management strategy aimed at managing financial debt portfolio in a cost effective manner. Since 2010, authorities have maintained an organizational structure of public debt management in line with the international best practices. Front, middle and back offices exist already, with the desired separation between the emission, risk management/strategy and registration/debt payments. The Government will finalize the formalization and

institutionalization of the new organizational structure, with definitions of the functions of each unit, in form of a ministerial resolution by the end of 2012.

The Government is taking measures to increase liquidity, introduce mechanisms of transparency and price discovery, and broaden the investor base with the formulation and implementation of a plan for domestic market development.

- **Expanding and strengthening social transfer programs**

The Government has formalized a social vulnerability survey and the criteria to evaluate the eligibility of elderly for the 100 a los 70 programs, through the Ministerial Resolution 255, signed on December 12, 2012. In this order, the Ministry of Social Development (MIDES) adopted a data collection instrument of the beneficiary (Social Vulnerability Survey) that collects essential information for the evaluation of socioeconomic status of the elderly. The Government has also rolled out the Beca Universal program from 1st to 12th grade for public schools in the entire country, covering a total of 481,788 students.

The Government will approve in the near future a recertification strategy through a resolution by the executive director of the program as well as develop and implement a single registry for the 3 CCT programs to avoid overlap.

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,

Frank De Lima
Minister

FDEL/DAE/AVdeO/VMRC

ANNEX 2: PROGRAMMATIC FISCAL MANAGEMENT AND EFFICIENCY OF EXPENDITURES DEVELOPMENT POLICY LOAN SERIES--POLICY MATRIX

Objective	Key Issues	Prior Actions Supported by First Programmatic Loan	Second DPL (Prior Actions)	Indicative Triggers for Third Programmatic Loan	Indicative Medium-Term Outcome Indicators
		I. Tax Reform			
1. Improve tax revenue collection by expanding the tax base, reducing tax expenditures, and improving tax administration.	The current tax system has a number of important loopholes that reduce the Government's ability to mobilize revenues. The tax administration has weaknesses in collection, enforcement and taxpayer services.	The Government has widened its tax base and reduced tax exemptions by enacting Law 8 of 2010, which: (i) increases the ITBMS rate from 5 to 7 percent; (ii) eliminates ITBMS exemptions for air passenger transport, residential phone calls and lubricants; (iii) taxes real estate transactions in the Colon Free Zone and other existing free zones (including in free zones created in the future); (iv) expands the taxation of dividends, including for companies located in the Colon Free Zone and other existing free zones (including in free zones created in the future by the Government); (v) eliminates certain personal deductions; and (vi) modifies the calculation of expenditure deductions, to take into account the proportion of taxable income versus total income (including tax exempt income and income from foreign sources) The Government has implemented the following measures to improve the performance of its tax administration: (i) the establishment of an Administrative Tax Tribunal, as evidenced by Law 8 of 2010 which creates the Tribunal and the appointment of the Magistrates for the Tribunal; and (ii) the creation of a unit of tax information sharing and a unit of international taxation within the DGI.	The Government, through the MEF, has created the LTU within the DGI and has made it operational through: 1) the identification of 72 Large Taxpayers; 2) the selection and training of ten (10) tax auditors to carry out audits of large taxpayers; 3) the preparation by DGI of an action plan to be implemented by the LTU in 2013 to increase tax collection from Large Taxpayers; and 4) the implementation of an audit system that tracks validation of Large Taxpayers' compliance against their declared tax liabilities; as evidenced by (i) Ministerial Resolution No. 065 issued by the MEF on December 12, 2012 and published in the Government's Official Gazette on January 4, 2013 and (ii) the DGI's Note No. 201-01-8462 dated December 11, 2012 to the Bank. *Responsible Agency: DGI.*	The LTU has carried out audits in at least two new economic sectors based on training in advanced audit techniques for LTU auditors. The DGI has strengthened the monitoring of tax compliance by connecting a minimum of 7 Banks online with the DGI. *Responsible Agency: DGI.*	Central Government tax revenue as a share of GDP is at least 13 percent in 2014 (baseline: 2009=11 percent). ITBMS revenue increased by at least 1 percentage point of GDP (baseline: 2009=2.1 percent; target 2014=3.3). The LTU covers at least 55 percent of total tax revenue in 2014 (baseline: 2009=0 percent).

Objective	Key Issues	Prior Actions Supported by First Programmatic Loan	Second DPL (Prior Actions)	Indicative Triggers for Third Programmatic Loan	Indicative Medium-Term Outcome Indicators
2.Improve tax information sharing by changing and implementing the legal framework	Panama is included in the Global Forum's list of countries that do not meet the standard on transparency for sharing and exchanging information for tax purposes	The Government has taken steps to implement some of the Global Forum's Peer Review-Phase 1, as evidenced by: (i) signing double taxation conventions with 10 countries; (ii) signing of the Agreement for Tax Cooperation and Exchange of Information Related to Taxes with the United States; (iii) enactment of Law 33 of 2010, which empowers the DGI to obtain information for the purposes of complying with any international agreement that provides for the exchange of information in tax matters, regardless of the relevance of the information for domestic tax purposes; and (iv) enactment of Law 2 of 2011.	The Government, through DGI's *Subdirección de Intercambio de Información Tributaria* has effectively exchanged tax information with foreign tax jurisdictions by responding to twenty one (21) exchanges of information (EOI) requests, in accordance with Law 2 of February 1, 2011 and its corresponding tax information sharing obligations, as evidenced by DGI's Note No. 201-01-8458 dated December 13, 2012. *Responsible Agency: DGI.*	The Government has approved legislation to allow the immobilization of bearer shares to identify ownership of shares. *Responsible Agency: DGI.*	Panama has signed 12 tax information exchange agreements and has exchanged information as requested (baseline: 2009=no TIEAs in place).
II. Modernizing Public Procurement Practices					
3. Modernize public procurement practices	The Government needs to increase transparency, efficiency and compliance with principles, policies and procedures in the procurement system.	The Government has taken steps to improve the efficiency and transparency of its national procurement system, as evidenced by the implementation of a new e-procurement platform, *PanamaCompra* (version 2.0) including the core system for publication and receipt of bidding offers, which is currently being used by the central government.	The Government, through its *Dirección General de Contrataciones Públicas*, within the e-procurement platform *PanamaCompra,* has introduced new mandatory Framework Agreements for all Public Entities since April 2011; and published all Framework Agreements signed in years 2011 and 2012. *Responsible Agency: DGCP.*	All central government agencies are using standard bidding documents and contracts. The Government approves a regulatory decree to replace obsolete procurement regulations and better accommodate public investment projects drafted by a participatory committee formed by civil society, public and private sector The Government has formulated and published guidance notes with evaluation criteria in addition to the price for selecting and contracting. *Responsible Agency: DGCP.*	Central government agencies and all others subject to Law 22 and its modifications use framework agreements and the number of catalogue items procured under those framework agreements is increased (baseline: 2009=2,452; target 2014: 7,300).
III. Increasing the Efficiency of Debt Management					
4. Increase the efficiency of debt	*Crédito Público* needs to enhance the	The Government has started to design a medium-term debt management strategy	The Government, through the MEF has approved the	The Government has taken measures to increase liquidity,	The medium-term debt management strategy is

Objective	Key Issues	Prior Actions Supported by First Programmatic Loan	Second DPL (Prior Actions)	Indicative Triggers for Third Programmatic Loan	Indicative Medium-Term Outcome Indicators
management	cost-risk analysis function and the Middle Office's capacity to design a medium term debt management strategy Recently constituted Front Office lacks analytical capacity and procedures to execute liability management operations in a safe and efficient manner. The Government lacks a plan to promote the development of the domestic market for Government securities.	which includes the development of its domestic public debt market, as evidenced by: (a) Cabinet Decree No.4 of January 26, 2010, which authorizes the issuance up to US$600 million in Treasury Notes; and (b) the issuance of Treasury Notes with an aggregate value of more than US$500 million during 2010.	organizational structure of the *Crédito Público,* including the functions and responsibilities for each of its internal units, as evidenced by Ministerial Resolution No 003 issued by the MEF on January 16, 2013. *Responsible Agency: Crédito Público.*	introduces mechanisms of transparency and price discovery, and broadens the investor base with the formulation and implementation of a plan for domestic market development. *Responsible Agency: Crédito Público.*	published and revised annually and corresponding debt evaluation reports compare the evolution of risk indicators with the targets in the strategy in 2014 (baseline: 2009=no formal debt management strategy in place).
IV. Expanding and Improving Targeting of Social Transfer Programs					
5.Expand and improve targeting of social transfer programs	The *Red de Oportunidades CCT* program is an effective program that could benefit from better beneficiary outreach and transitioning into full-fledged conditional cash transfer program. The administration has launched two additional transfer programs: (i) a non-contributory pension program, *100 a los 70*; and (ii) a	The Government has taken the following measures to increase the outreach of its key social protection programs: - Improved the targeting of beneficiaries under its *Red de Oportunidades* CCT by: (a) eliminating ineligible households enrolled in the program; and (b) enrolling 3,000 new households, eligible as per the proxy-means test. - Improved the operating rules and enhanced the proper targeting of poor and vulnerable beneficiaries under its 100 a los 70 cash transfer program, through the enactment of Law 86 of 2010. - Established the *Beca Universal* scholarship program through the enactment	The Government, through MIDES, has adopted the new criteria to evaluate the eligibility of elderly citizens for the *100 a los 70* cash transfer program, as evidenced by Ministerial Resolution No. 225, 2012 issued by MIDES on October 4, 2012 *and* published in the Borrower's Official Gazette on December 13, 2012. The Government, through IFARHU, has expanded the	MIDES has approved a recertification strategy for *100 a los 70*. The Government has developed and implemented a single registry for the *Red de Oportunidades, 100 a los 70, y Becca Universal* CCT programs to improve targeting. The Government has improved monitoring of the *Beca*	The proxy means test is in use to select all households that enter in the *Red de Oportunidades* CCT program (baseline: 2009=0 percent). Increased ability of MIDES to conduct recertification of beneficiaries (evidenced by resolution and recertification strategy of *100 a los 70)* in 2014 (baseline 2009= no tools to conduct recertification). Percentage of children from the poorest quintile who

Objective	Key Issues	Prior Actions Supported by First Programmatic Loan	Second DPL (Prior Actions)	Indicative Triggers for Third Programmatic Loan	Indicative Medium-Term Outcome Indicators
	universal scholarship program *Beca Universal.* Critical support is needed to: (i) undertake adequate parametric changes in each transfer program; and (ii) rationalize and strengthen the social protection system as a whole. The World Bank will be supported both areas through a specific investment operation.	of Law 40 of 2010, and started implementing said scholarship program in public secondary schools during 2010.	*Beca Universal* scholarship program to include grades 1 to 6 of all the Borrower's public schools. *Responsible Agency: MIDES and IFAHRU.*	*Universal* program by including related questions into the 2013 household survey. *Responsible Agencies: MIDES and IFAHRU*	receive *Beca Universal* (baseline: 2009=0; target 2014=70 percent)

ANNEX 3: FUND RELATIONS NOTE

PANAMA—ASSESSMENT LETTER FOR THE WORLD BANK

December 18, 2012

This letter updates the assessment contained in the 2011 Article IV Consultation staff report dated January 25, 2012. The 2012 Article IV Consultation mission took place on November 6–16, 2012.

1. **Panama's economy continues to expand at a fast pace**. Real GDP growth reached 10.6 percent in 2011 and could exceed 9.5 percent in 2012 driven by the Canal expansion, other large public investment projects and strong private demand. Headline and core inflation declined markedly in the third quarter of 2012, owing to lower world commodity and domestic services price pressures, with inflation in 2012 projected at 5 percent (year-on-year). The external current account deficit improved in the first half of 2012 owing to strong exports and a deceleration in capital goods imports. Buoyant FDI inflows are projected to continue to finance most of the current account deficits. Following the upgrade by Moody's in October, Panama's sovereign rating is now on par with Brazil, Mexico and Peru. The political climate has been difficult ahead of the 2014 presidential elections, and recent reform initiatives had to be withdrawn due to strong popular opposition.

2. **Panama's baseline outlook is positive, with broadly balanced risks**. Implementation of large public infrastructure projects and strong domestic demand are expected to continue to support growth and domestic demand, while keeping inflation above that of trading partners in the near term. Overheating pressures are expected to continue to moderate as public investment unwinds. At the same time, the global economy remains weak, and downside risks have intensified. Panama's trade and financial openness increases the country's vulnerability to external shocks, though strong domestic fundamentals would mitigate their impact.

3. **A tighter fiscal stance than the one currently envisaged by the authorities is needed in order to avoid overheating risks and preserve fiscal space**. Near-term budget deficit ceilings have been revised upwards in the context of the approval of the Sovereign Wealth Fund law. In 2012, the fiscal stimulus could amount to up to 0.8 percent of GDP, while the economy is already growing above capacity. Higher deficits would not compromise debt sustainability, but imply reduced room for maneuver should negative shocks hit the economy.

4. **There are no signs of stress in the financial sector, though continued easy credit conditions could create vulnerabilities**. The 2011 FSAP confirmed that the system is well-prepared to absorb even large external shocks. Nonetheless, strong credit growth, particularly in commercial real estate, tourism, and the Colón Free Zone should be closely monitored, together with rising household and corporate leverage. The authorities are strengthening the financial safety net and financial sector supervision, in line with FSAP recommendations.

5. **Medium-term economic prospects are bolstered by the ongoing Canal expansion and public investment.** The creation of a Sovereign Wealth Fund to save additional revenue from the expanded Canal should further strengthen the economy's resilience to external shocks. However, managing the transition to a slower growth rate once the Canal expansion and the public investment projects end will require reforms aimed at boosting labor productivity and improving living standards.

Table 1. Panama: Selected Economic and Social Indicators

Population (millions, 2010 census)	3.4	Poverty line (percent, 2008)	32.4
Population growth rate (percent a year)	1.6	Adult literacy rate (percent)	94.5
Life expectancy at birth (years)	75.4	GDP per capita (USD, 2011)	8,991
Total unemployment	4.5	IMF Quota (SDR, million)	206.6

	2008	2009	2010	2011	Proj. 2012	Proj. 2013
			(Percent change)			
Production and prices						
Real GDP (1996 prices)	10.1	3.9	7.6	10.6	9.5	8.0
Consumer price index (average)	8.8	2.4	3.5	5.9	5.7	5.2
Consumer price index (end-of-year)	6.8	1.9	4.9	6.3	5.0	4.8
Domestic demand (at constant prices)						
Public consumption	2.6	4.1	12.2	21.1	15.5	8.7
Private consumption	-2.1	-2.8	24.4	2.8	-14.2	31.8
Public investment 1/	58.3	17.2	35.6	23.3	11.2	3.3
Private investment	14.2	-13.4	-2.9	25.7	8.2	5.0
Financial sector						
Private sector credit	14.6	1.3	13.6	16.8	16.0	14.1
Broad money	18.5	9.4	11.6	8.1	11.7	6.8
Average deposit rate (1-year)	3.5	3.1	3.5	2.7	...	...
Average lending rate (1-year)	8.5	7.5	7.5	6.9	...	...
External trade						
Merchandise exports	75.5	-37.1	12.7	29.0	16.6	8.0
Merchandise imports	33.7	-16.1	19.1	26.2	13.3	4.6
			(In percent of GDP)			
Saving-investment balance						
Gross domestic investment	27.6	25.6	26.0	29.0	29.0	28.0
Public sector	8.2	9.4	12.0	14.0	12.9	13.9
Private sector	19.4	16.2	14.0	15.0	16.1	14.1
Gross national saving	16.7	24.9	15.2	16.2	17.9	17.8
Public sector	6.4	6.0	7.8	8.8	8.0	9.2
Private sector	10.3	18.9	7.4	7.4	9.9	8.6
Public finances						
Revenue and grants	34.9	33.5	33.1	32.9	32.1	32.1
Expenditure	32.4	33.9	36.4	38.4	37.3	37.0
Current, including interest	24.1	24.5	24.5	24.4	24.4	23.2
Capital	8.2	9.4	12.0	14.0	12.9	13.9
Overall balance	2.5	-0.5	-3.4	-5.5	-5.2	-4.9
Overall balance, excluding ACP	0.4	-1.0	-1.9	-2.3	-2.9	-2.8
External sector						
Current account	-10.9	-0.7	-10.8	-12.8	-11.1	-10.2
Net exports from Colon Free Zone	0.0	8.0	1.8	1.0	1.8	1.0
Net oil imports	-1.0	0.1	0.3	0.9	1.3	1.5
Foreign direct investment	9.3	5.2	8.8	9.1	9.2	9.3
Total public debt						
Total debt 1/	45.4	45.4	44.9	44.9	42.2	40.3
External 1/	36.9	42.0	40.4	38.6	34.0	33.7
Domestic	8.5	3.4	4.5	6.2	8.3	6.6
Memorandum items:						
GDP (in millions of US$)	23001.6	24162.9	26589.6	30569.0	35149.5	38371.2

Sources: Comptroller General, Superintendency of Banks and IMF staff estimates.
1/ Includes Panama Canal Authority (ACP).

ANNEX 4: ANALYTICAL UNDERPINNINGS

Links between the DPL and Prior Analytical Work

Report	Findings and Recommendations
I. TAX REFORM	
Informe de la visita realizada entre el 17 al 21 de Mayo 2010 (CAPTAC- RD/DGI Panama)	In order to improve tax administration performance: (i) restructure the organization of the tax administration unit (DGI); (ii) divide the taxpayers in different groups creating a large taxpayer unit; and (iii) improve the e-tax system.
Public Expenditure Review (WB 2006)	To ensure that the fiscal gains from the 2005 fiscal reform are sustained, the authorities are advised to strengthening the Government's tax audit capacity and avoid the re-emergence of new tax incentive regimes.
Tax Administration in OECD and Selected Non-OECD Countries (OECD 2008, Comparative Information Series)	This information series provides internationally comparative data on aspects of tax systems and their administration in OECD and selected non-OECD countries. Key findings of the research: a) The majority of the revenue bodies are set up as unified semi-autonomous bodies responsible for both direct and indirect taxes administration; b) There is an emerging trend for revenue bodies to create specialist/dedicated operational units (i.e. large taxpayer offices, national call centers, and data processing centers; c) Around three quarters of revenue bodies reported that they required to meet one or more Government imposed targets over and above budgeted revenue goals; d) Over half of revenue bodies reported major changes in course in their recruitment, staff development, performance management, and reward systems and policies; e) pre-filling of tax returns has evolved to become a significant element of some revenue bodies e-services strategy; and f) With minor exception, all revenue bodies operate with a formal set of taxpayers' rights set out in law or other statutes, or in administrative documents.
Tax gap and equity in Latin America and the Caribbean – Fiscal Studies no 16 (GTZ 2010)	The report concludes that despite the relatively small share of income tax revenue in overall revenue, high income tax evasion would compromise any redistributive effect such taxes may have, and ultimately would end up increasing income inequality in the region, casting doubt on the very function and purpose of taxes as a tool of economic policy. The design of the tax system itself can also encourage evasion and avoidance, by creating opportunities for arbitrage and tax planning practices that reduce tax obligations. This is largely attributable to the complexity of the region's tax systems, as well as the existence of significant tax deductions, such as the exemptions granted for certain types of income. The average gap between potential and effective tax burden hides significant differences between countries. E.g. Panama could increase its burden by 6 to 8 points of GDP as it generates significant revenues from other sources (the Panama Canal, for example), which partially offset their low tax burden

Expanding Taxable Capacity and Reaching Revenue Potential : cross-country analysis (Le, Moreno-Dodson and Rojchaichaninthorn WB 2008)	Panama is classified by low tax effort and low tax collection (tax effort is defined as an index of the ratio between the share of the actual tax collection in gross domestic product and the predicted taxable capacity.) Authors indicate that in such countries an improvement in tax collection would require that these low and lower-middle-income countries undertake comprehensive reforms of both tax policy and tax administration. Revenue enhancement should be one of the key objectives for the reforms as long as it is compatible with efficiency and equity criteria. In tax policy, they particularly need to broaden the base, rationalize the rate structure and incentive schemes, and remove tax-induced economic distortions with focus on enhancing revenue productivity of major taxes, particularly the broad-based consumption value added tax.
Revenue mobilization in Developing Countries (IMF 2011)	The need for additional revenue is substantial in many developing countries. The centrality of taxation in the exercise of state power means that more efficient, fairer, and less corrupt tax systems can spearhead improvement in wider governance relations. There are several measures to raise additional revenue: (i) building administrations that effectively limit incentives and opportunities for rent seeking and inappropriate behavior (tailoring intervention and services to the distinct challenges posed by different groups, starting with a large taxpayer office); (ii) adopting and making readily available clear laws and regulations embodying strong taxpayer protection; (iii) implementing a broad-based value added tax with a fairly high threshold; and (iv) establishing a broad-based corporate income tax, at rates competitive by international standards; etc.
Public Expenditure Review (WB 2006)	The tax system contains many incentive regimes that result in a considerable revenue loss, the elimination of which could remove important economic distortions and help improve progressiveness. Panama receives very little revenue from its value-added tax (ITBMS), which is characterized by a very low general rate (5 percent) and limited tax base. The tax's high productivity suggests that there is significant room for improving revenues from this source. Selective consumption taxes on beverages and tobacco products are significantly lower in Panama than in neighbor countries, providing scope for raising revenues through higher rates. Replacing the selective consumption tax on fuels by a value added tax would allow Panamanian exporters to recover the taxes paid on inputs.
Panama: Consideraciones metodológicas y estimación de los gastos tributarios y del coeficiente de cumplimento del ITBMS (Sabaini 2009)	ITBMS legislation includes a considerable number of exemptions and exceptions and does not cover food and medicines, restricting the tax collection capacity and generating negative effects when the production costs are based on exempted goods and services.
Peer Review Report – Phase 1 Legal and Regulatory Framework (OECD 2010)	Panama has committed to the OECD's international standards of transparency and effective exchange of information since 2002. Panama is actively seeking to negotiate DTCs with other jurisdictions. It is essential that additional steps are now taken to ensure that relevant information is available, that the appropriate authorities have access to it and that Panama can engage in effective exchange of information for tax purpose.

II. MODERNIZING PUBLIC PROCUREMENT PRACTICES	
Panama: Enhanced Public Sector Efficiency Technical Assistance Project, Report No. 59159-PA	The report identifies the challenge of an inefficient procurement management and room to modernize the system and generate savings in the budget implementation. Recommendations include: 1) supporting the institutional strengthening of DGCP, building the capacity of public procurement officials; 2) supporting the ongoing legal and regulatory reforms to pursue the modernization of the Borrower's public procurement system and processes; 3) supporting the ongoing development of the e-procurement platform *PanamaCompra version2*; and 4) developing a research center in the Procurement Administrative Tribunal.
III. INCREASING THE EFFICIENCY OF DEBT MANAGEMENT	
Public Debt Management and Market Development Needs Assessment (WB 2007)	Increasing the share of domestic debt is not feasible without a well-designed plan to develop the domestic market and reducing higher costs of borrowing. A comprehensive debt management strategy should be formulated based on detailed cost/risk analysis taking into account market development considerations. This should include strengthening the middle office to produce risk reports on a regular basis.
Public Debt Markets in Central America, Panama, and the Dominican Republic (IMF 2007)	The absence of a deep **local market** exacerbates financial shocks in the event of a large-scale sell-off by external investors. A clear commitment to develop the domestic market would be desirable, the domestic market would be reintroduced. Initiatives to facilitate the development of the secondary market require a wider range of public debt instruments to establish a liquid yield curve. The absence of a deep **local market** exacerbates financial shocks in the event of a large-scale sell-off by external investors. A clear commitment to develop the domestic market would be desirable, the domestic market would be reintroduced. Initiatives to facilitate the development of the secondary market require a wider range of public debt instruments to establish a liquid yield curve. market require a wider range of public debt instruments to establish a liquid yield curve.
Non Lending Technical Assistance on Debt Management (WB NLTA 2010)	The Non Lending Technical Assistance program will include assistance in (i) strengthening the functionality of the middle office, and (ii) developing and implementing a plan to promote domestic debt market development.
IV. EXPANDING AND IMPROVING TARGETING OF SOCIAL TRANSFER PROGRAMS	
Review of Social Assistance Programs and Recommendations for Priorities and the Way Forward (Marques, 2009) *Social Protection Responses to the triple wave of crises in Central America and Panama (Marques, 2010)* *Panama Poverty Assessment (World Bank, forthcoming)* *Mejores Empleos en Panama: El Rol del Capital Humano (World Bank, 2012)*	Two reports highlight the relative burden of untargeted subsidies but confirm the need to expand well-targeted transfer programs linked to human capital outcomes and suggest critical steps for a more efficient and effective social protection system, including interactions with labor markets. Expanding the base of well-targeted productive income transfers is a top priority Emerging findings from the World Bank poverty assessment confirm the pro-poorness of investment in expanding the base for transfer programs and enhancing their targeting. This study sheds light on the needs for education, employment training, and social protection systems as key factors for employment creation.

Red de oportunidades: Conditional cash transfer evidence from Panama (Arraiz, S. Rozo 2011)	The paper estimates the impact of the conditional cash transfer program, Red de oportunidades, on school enrollment and child labor in Panama. The results show that the program increased school enrollment in rural and indigenous areas and was able to reduce child labor only in rural areas. A further analysis by education level (elementary, middle, and high school) shows that, in rural areas, the effect of the program is limited to middle school enrollment. Results found that the program reduces child labor through a decline in work in children ages 12 to 15 in rural areas (which corresponds to the ages of children attending middle school). In indigenous areas the program increases enrollment only in elementary school by approximately 9.3%.

ANNEX 5: ESTIMATED FISCAL IMPACT OF TAX REFORM

September 2009 and March 2010 tax reforms	Est. permanent increase in tax collections (% of GDP)
Income tax reform	**0.3**
Corporate and dividend taxation	0.3
PIT rate reduction to 15-25 percent	-0.4
Higher exempted income threshold	-0.1
Elimination/minimization of personal income deductions	0.3
CIT reduction to 25 percent	-0.1
New method to calculcate expense deductions	0.3
Property tax reform	**0.2**
Increased license fees	**0.2**
Consumption tax reform	**0.7**
ITBMS tax to bank commissions	0.0
ITBMS rate increase from 5 to 7 percent	0.5
ITBMS coverage net expansion	0.2
Other reforms	**0.3**
TOTAL	**1.7**

Source: MEF estimates.

ANNEX 6: POVERTY AND SOCIAL IMPACT OF SOCIAL PROTECTION PROGRAMS

Recent qualitative (Waters, 2009) and quantitative (Arráiz and Rozo, 2011) studies examine the impact of the Panama's *Red de Oportunidades* program on indigenous communities. Introduced by the Government in the mid-2000s, the *Red de Oportunidades* program has four parts: (1) conditional cash transfers to beneficiaries, contingent on their use of preventative health care and education services; (2) the supply of the health and education services required by beneficiaries; (3) the provision of assistance to help families access such services; and (4) infrastructure improvement. (MIDES in Waters, 2009). The Ministry of Social Development (MIDES) manages the program, with cooperation from ministries including health and education. (Arráiz and Rozo, 2011)

Using information collected through focus groups and individual interviews in the *comarcas* (autonomous indigenous regions) of Kuna, Ngobe-Buglé and Emberá-Wounaán in March and April 2009, Waters (2009) explores community beneficiaries' perceptions of the program. Through the responses of 140 focus group participants and 9 individual interviews, the author documents support for the conditional cash transfer program and some of the challenges currently faced in its implementation.

Overall, Waters' analysis finds there to be a positive general perception of the program, with respondents noting its importance both in the form of helping families in poverty as well as increasing their ability to access local services. Respondents noted using transferred funds for a variety of purposes, including funding health and education related expenses, transportation, and household investments, as well as saving for future emergencies. Additional benefits noted included a greater sense of social inclusion and female empowerment. Respondents expressed the need for the program to continue, not only due to its direct economic impact, but also to its ability to improve access to healthcare and nutrition services. Challenges to accessing the program included physical difficulties in reaching places where services and transfers are provided, inadequate service staffing, and feelings of discrimination, among others. The study recommends expanding the program to cover districts that have not been covered by the program yet (in particular indigenous population) as well as improved monitoring and evaluation of the program. Improved targeting of the program, supported by this DPL, could lead to greater efficiency in reaching families in need.

Arráiz and Rozo (2011)'s quantitative approach also finds evidence of the positive impact of the *Red de Oportunidades* program on outcomes in rural and indigenous areas of Panama. The authors used data from the 2008 Living Standards Measurement Survey (in which program beneficiaries can be identified) to estimate the impact of the conditional cash transfers program on school enrollment, child labor, use of preventative child and women's health services, and pregnancy via propensity score matching.

In rural areas, the authors found that participation in the program increases middle school enrollment by 10.2 percentage points and decreased child labor among children aged 12 to 15 by a similar magnitude (10.1 percentage points). In indigenous areas, program participation was found to increase elementary school enrollment by 7.9 percentage points and to reduce child labor among 12 to 15 year olds by 15.8 percentage points. While the authors did not find any evidence of an impact on use of preventative health care services for children (visits or polio, influenza, hepatitis B, "rotavirus" and DPT vaccinations) (which they explain by the universality of such coverage in these areas), they found female participants over 15 in both rural and indigenous areas to be more likely to have had a Papanicolau test (11.7 and 14.7 percentage points, respectively). (The conditional cash transfers program is also found to have positively impacted pregnancies in rural areas, perhaps as a result of the (mistaken) belief that women needed to be pregnant to receive the transfer).

ANNEX 7: DPL II--COMPARISON OF INDICATIVE TRIGGERS AND PRIOR ACTIONS

Medium-Term Objectives	Policy Actions	
	Second DPL (Indicative Triggers as envisaged at the time of the first operation)	Second DPL (Prior Actions)
1. Mobilize tax revenue through tax policy and administration reforms	The Tax Administration Unit has advanced in the implementation of the modernization plan; in particular, the LTU has been established and is operational. An analysis of tax expenditures has been incorporated in the national budget.	The Government, through the MEF, has created the LTU within the DGI and has made it operational through: 1) the identification of 72 Large Taxpayers; 2) the selection and training of ten tax auditors to carry out audits of large taxpayers; 3) the preparation by DGI of an action plan to be implemented by the LTU in 2013 to increase tax collection from Large Taxpayers; and 4) the implementation of an audit system that tracks validation of Large Taxpayers' compliance against their declared tax liabilities; as evidenced by (i) Ministerial Resolution No. 065 issued by the MEF on December 12, 2012 and published in the Government's Official Gazette on January 4, 2013 and (ii) the DGI's Note No. 201-01-8462 dated December 11, 2012 to the Bank.
2. Improve tax information sharing by changing and implementing the legal framework	Panama has implemented the measures introduced by Law 2 of 2011, which requires resident agents to apply measures to "Know Your Client" including, inter alia, in the case of legal entities, obtain the identity of shareholders at least 25 percent of a legal entity.	The Government, through DGI's *Subdirección de Intercambio de Información Tributaria* has effectively exchanged tax information with foreign tax jurisdictions by responding to twenty one (21) EOI requests, in accordance with Law 2 of February 1, 2011 and its corresponding tax information sharing obligations, as evidenced by DGI's Note No. 201-01-8458 dated December 13, 2012.
3. Modernize public procurement practices	A new platform module for framework agreements is implemented and used by all central government agencies.	The Government, through its *DGCP*, within the e-procurement platform *PanamaCompra,* has introduced new mandatory Framework Agreements for all Public Entities since April 2011; and published all Framework Agreements signed in years 2011 and 2012.
4. Increase the efficiency of debt management	Approval of the organizational structure and responsibilities of Public Credit by a resolution of the Ministry of Finance.	The Government, through the MEF has approved the organizational structure of the *Crédito Público,* including the functions and responsibilities for each of its internal units, as evidenced by Ministerial Resolution No 003 issued by the MEF on January 16, 2013.
5. Expanding and improving targeting of social	The Government has recertified beneficiaries of the *100 a los 70* program according to the	The Government, through MIDES, has adopted the new criteria to evaluate the eligibility of elderly citizens for the *100 a*

transfer programs	revised targeting criteria. The Government has rolled out the *Beca Universal* program from 4th to 12th grade for public schools in the entire country	*los 70* cash transfer program, as evidenced by Ministerial Resolution No. 225, 2012 issued by MIDES on October 4, 2012 *and* published in the Borrower's Official Gazette on December 13, 2012. The Government, through IFARHU, has expanded the *Beca Universal* scholarship program to include grades 1 to 6 of all the Borrower's public schools.

ANNEX 8: RESULTS FRAMEWORK

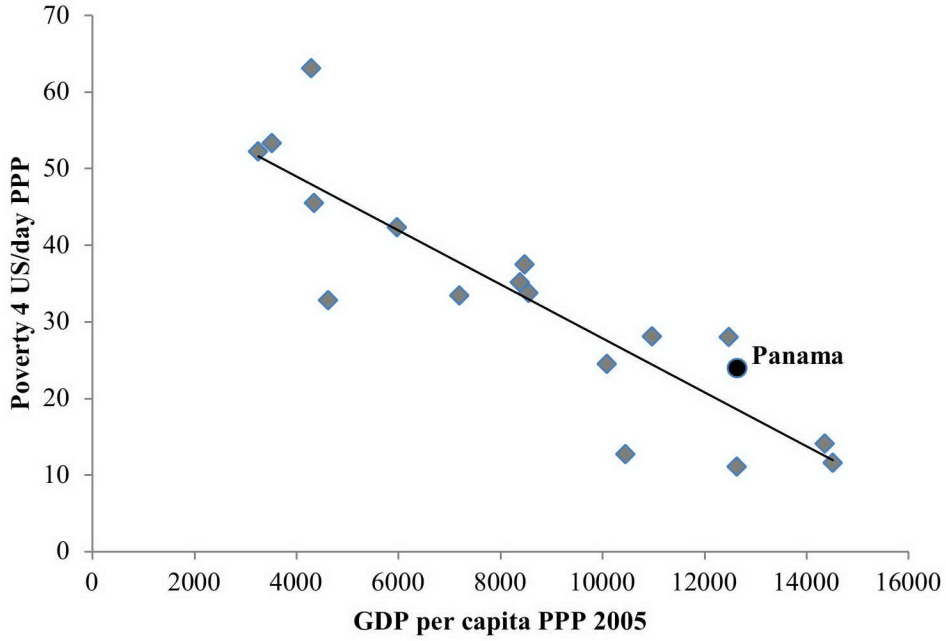
Medium-Term Objectives	Intermediate Outcome Indicator as envisaged at the time of the first DPL (March 2012)	Indicative Medium Outcome Indicator envisaged at the time of the first DPL (March 2012)	Revised Indicative Medium Outcome Indicator (February 2013)
1. Mobilize tax revenue through tax policy and administration reforms	Central Government tax revenue as share of GDP increases to 12.8 percent in 2011(baseline: 2009=11.0 percent). Number of cases resolved by the Administrative Tax Tribunal (baseline: 2009=0; target: 2011=36)	Central Government tax revenue as a share of GDP increases to 13.1 percent in 2013 (baseline: 2009=11.0 percent).	Central Government tax revenue as a share of GDP is at least 13 percent in 2014 (baseline: 2009=11 percent). ITBMS revenue increased by at least 1 percentage point of GDP (baseline: 2009=2.1 percent; target 2014=3.3). The LTU covers at least 55 percent of total tax revenue in 2014 (baseline: 2009=0 percent).
2. Improve tax information sharing by changing and implementing the legal framework	Tax information shared with two countries (baseline: 2009=0; target: 2011=2)	Panama meets the Global Forum's standards of transparency and exchange of tax information and complies with both phases of its Peer process.	Panama has signed 12 tax information exchange agreements and has exchanged information as requested (baseline: 2009=no TIEAs in place).
3. Consolidate and further develop of public procurement practices	The number of items (of goods commonly purchased by Government agencies) covered by framework agreements has increased by at least 90 percent (baseline: 2009=2,452; target: 2011=4,756)	More efficient and transparent public procurement system. Increase in the number of framework agreements in place as well as number of items available (baseline: 2009= 2,452 items; target: 2013=6,000). All central government transactional procurement activities undertaken through the Government's e-procurement platform	Central government agencies and all others subject to Law 22 and its modifications use framework agreements and the number of catalogue items procured under those framework agreements is increased (baseline: 2009=2,452; target 2014: 7,300).

		PanamaCompra (baseline: 2009=0 percent; target: 2013=100 percent). Reduction in time and transaction costs for the purchase of common used goods through the use of framework agreement (baseline 2009=3-5 days; target 2013= 2-4 days).	
4. Increase the efficiency of debt management	Bonds placed in the domestic market increase as a share of financing needs (baseline: 2009=0 percent; target 2011=at least 10 percent)	Maintain a continuous presence in the primary market through the supply of Treasury Notes at levels consistent with creating and maintaining benchmark securities.	The medium-term debt management strategy is published and revised annually and corresponding debt evaluation reports compare the evolution of risk indicators with the targets in the strategy in 2014 (baseline: 2009=no formal debt management strategy in place).
5. Expand and improve targeting of social transfer programs	The number of households covered by the *Red de Oportunidades* CCT program increased by 5 percent (baseline: 2010=72,000 households; target: 2010= 75,260 households). Percentage of beneficiaries of 100 a los 70 for whom compliance with health co-responsibility determines payment (baseline: 2010=0; target: 2011=10)	The *Red de Oportunidades CCT* program covers all eligible household (as per the proxy-means test) (baseline 2010= 72,000 households; target 2013= 80,000 households). Percentage of beneficiaries recertified in 100 a los 70 (i.e. eligible according to the revised targeting criteria (baseline 2010=0; target 2013=100). Percentage of beneficiaries of 100 a los 70 for whom compliance with health co-	The proxy means test is in use to select all households that enter in the *Red de Oportunidades* CCT program (baseline: 2009=0 percent). Increased ability of MIDES to conduct recertification of beneficiaries (evidenced by resolution and recertification strategy of *100 a los 70)* in 2014 (baseline 2009= no tools to conduct recertification).

		responsibility determines payment (baseline: 2010=0; target: 2013=80).	
	The *Beca Universal* scholarship program covers all eligible children in grades 7-12 in public schools (baseline: 2010=291,000 children; target: 2011=466,000 children)	Percentage of children from the poorest quintile who receive *Beca Universal* (baseline: 0; target 2013= 80 percent)	Percentage of children from the poorest quintile who receive *Beca Universal* (baseline: 2009=0; target 2014=70 percent)

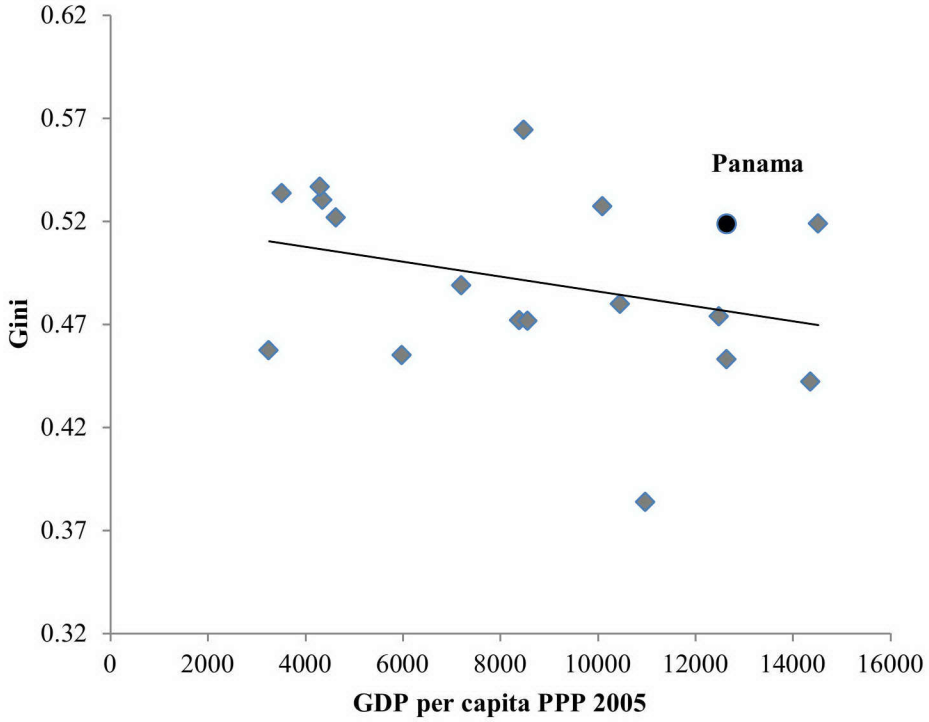
ANNEX 9: COMPARISON WITH LAC COUNTRIES

International comparison, Per capita GDP versus Poverty



Source: World Bank, World Development Indicator, SEDLAC (CEDLAS and the World Bank).
Note: The moderate poverty line used is equivalent to $ 4/day in 2005 PPP.

International comparison, Per capita GDP versus Gini



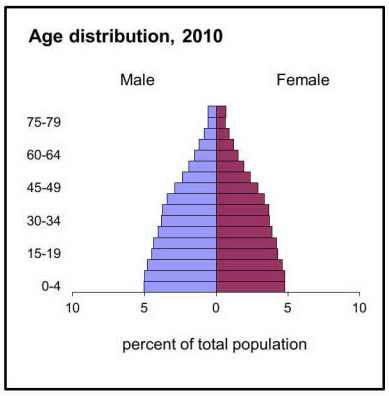
Source: World Bank, World Development Indicator, SEDLAC (CEDLAS and the World Bank).
Note: Observations with zero income were not considered.

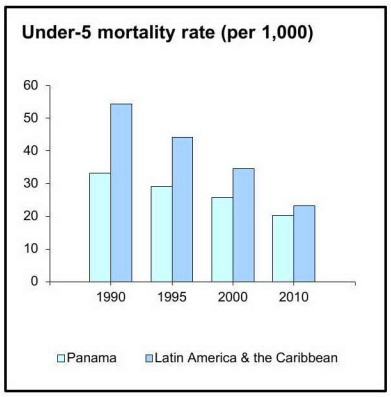
ANNEX 10: COUNTRY AT A GLANCE (INCLUDES COUNTRY MAP)

Panama at a glance

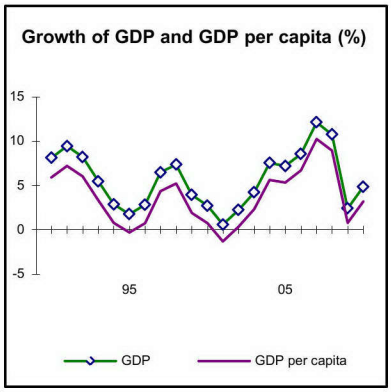
4/5/12

Key Development Indicators (2010)	Panama	Latin America & Carib.	Upper middle income
Population, mid-year (millions)	3.5	583	2,452
Surface area (thousand sq. km)	75	20,394	59,328
Population growth (%)	1.6	1.1	0.7
Urban population (% of total population)	75	79	57
GNI (Atlas method, US$ billions)	24.5	4,505	14,429
GNI per capita (Atlas method, US$)	6,970	7,733	5,884
GNI per capita (PPP, international $)	12,770	10,926	9,970
GDP growth (%)	4.8	6.2	7.8
GDP per capita growth (%)	3.2	5.0	7.1
(most recent estimate, 2004–2010)			
Poverty headcount ratio at $1.25 a day (PPP, %)	7	6	..
Poverty headcount ratio at $2.00 a day (PPP, %)	14	12	..
Life expectancy at birth (years)	76	74	73
Infant mortality (per 1,000 live births)	17	18	17
Child malnutrition (% of children under 5)	..	3	3
Adult literacy, male (% of ages 15 and older)	94	92	96
Adult literacy, female (% of ages 15 and older)	93	90	91
Gross primary enrollment, male (% of age group)	109	119	111
Gross primary enrollment, female (% of age group)	106	115	111
Access to an improved water source (% of population)	93	94	93
Access to improved sanitation facilities (% of population)	68	79	73





Net Aid Flows	1980	1990	2000	2010
(US$ millions)				
Net ODA and official aid	45	99	15	129
Top 3 donors (in 2010):				
Japan	2	2	3	102
United States	15	97	-9	12
Spain	0	6	13	6
Aid (% of GNI)	1.3	2.0	0.1	0.5
Aid per capita (US$)	23	41	5	37



Long-Term Economic Trends

Consumer prices (annual % change)	13.8	-5.1	1.5	6.7			
GDP implicit deflator (annual % change)	33.7	0.6	-1.2	3.0			
Exchange rate (annual average, local per US$)	1.0	1.0	1.0	1.0			
Terms of trade index (2000 = 100)	84	88	100	86			
					1980–90	**1990–2000**	**2000–10**
					(average annual growth %)		
Population, mid-year (millions)	2.0	2.4	3.0	3.5	2.1	2.0	1.7
GDP (US$ millions)	3,810	5,313	11,621	26,689	0.5	4.7	6.8
			(% of GDP)				
Agriculture	8.9	9.8	7.2	5.3	2.5	3.1	2.9
Industry	19.5	15.1	19.1	16.8	-1.3	6.0	6.0
Manufacturing	11.0	9.7	10.1	6.1	0.4	2.7	1.7
Services	71.5	75.1	73.6	77.9	0.7	4.5	7.3
Household final consumption expenditure	44.9	56.9	59.9	71.4	3.8	6.4	5.7
General gov't final consumption expenditure	17.6	18.1	13.2	5.8	1.2	1.7	3.6
Gross capital formation	28.1	16.8	24.1	26.7	-9.2	10.4	10.6
Exports of goods and services	98.2	86.8	72.6	65.2	0.4	-0.4	7.8
Imports of goods and services	88.8	78.6	69.8	69.2	1.0	1.2	7.4
Gross savings	..	24.2	23.1	17.1			

Note: Figures in italics are for years other than those specified.
.. indicates data are not available.

Development Economics, Development Data Group (DECDG).

PANAMA

SELECTED CITIES AND TOWNS
PROVINCE CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PROVINCE BOUNDARIES
INTERNATIONAL BOUNDARIES

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