Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 04-Feb-2019| Report No: PIDC25949

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Panama	P168338	Fourth Programmatic Shared Prosperity Development Policy Financing (P168338)	P166159
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
LATIN AMERICA AND CARIBBEAN	Apr 30, 2019	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Ministry of Finance and Economy	Ministry of Finance and Economics		

Proposed Development Objective(s)

The objectives of the DPF series are to:

- Strengthen the frameworks for international tax transparency, financial integrity, and fiscal management
- Strengthen institutional arrangements to support social assistance and education
- Enhance the regulatory and sustainability framework in the energy and water sectors

Financing (in US$, Millions)

SUMMARY

Total Financing	100.00

DETAILS

Total World Bank Group Financing	100.00
World Bank Lending	100.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Panama is a small, open, high-income economy in Central America with some of the highest rates of economic growth in the world, which have been accompanied by a significant poverty reduction. With a population of around 4 million, economic growth averaged around 6.5 percent between 2010 and 2018. In the same period, the poverty rate declined from 22 to projected 13.4 percent.[1] Panama's per capita income of $13,100 (Atlas method) in 2018-19 meant it was classified by the World Bank as a High-Income Country for the first time during 2018. Adjusting for prices results in a GDP per capita of around $20,000. The economy's capacity to translate growth into jobs helped to drive poverty rates down. The labor force in Panama increased by nearly 90 percent between 2000 (when it was 1.1 million) and 2018 (nearly 1.9 million), more than double the employment growth in LAC (34 percent). Panama's exceptional growth performance over the past decade stems from significant growth in investment, but also from an open, competitive, and diversified economy.

Panama's macroeconomic policy framework is sustainable and adequate for the proposed operation. Panama is a fully dollarized economy without a Central Bank.[2] The main macroeconomic tools available to the government is thus fiscal policy. The annual budget is set by the Ministry of Economy and Finance (MEF) and approved by the National Assembly. It is regulated by the Social and Fiscal Responsibility Law, which establishes limits to net public debt and fiscal deficits as a share of GDP, and also limits some types of public expenditure increases. Growth is projected to rebound to its potential of around 5 percent annually over the medium-term, with low inflation, and the fiscal and external balances are expected to remain sustainable. These outcomes are underpinned by prudent macroeconomic management and the implementation of structural reforms, some of which are supported by the DPF series. Nonetheless, the outlook is vulnerable to some downside risks. Being a small, open and well-integrated economy, Panama is vulnerable to external shocks. Uncertain global market conditions could limit Panama's service exports, FDI inflows and fiscal receipts. As a dollarized economy, Panama's exports would become less competitive as interest rate policy is normalized in the US and the US Dollar appreciates. In addition, Panama could also be impacted by changes in global and regional trade and immigration policies. Further discussion of risks and mitigation measures is contained in the risk section of this document.

[1] Using a poverty line of US$5.50 per day.

[2] Reserve requirements are established by the banking regulator, the *Superintendencia de Bancos*, and cannot exceed 35 percent of gross deposits (limit established by the 2008 banking law).

Relationship to CPF

The proposed DPF is fully consistent with the Country Partnership Framework for 2015-2021. The proposed DPF plays an instrumental role in influencing outcomes in the three pillars of the Country Partnership Framework: (i) supporting continued high growth; (ii) ensuring inclusion and opportunities for marginalized and Indigenous groups; and (iii) bolstering resilience and sustainability. Building on the progress made by the previous DPF in enhancing social inclusion and fiscal management, the current DPF aims to consolidate reforms particularly in the areas of fiscal management, social protection and environmental sustainability. The WB's active portfolio comprises operations in the areas of social protection, water and sanitation, disaster risk management, public financial management and support for Indigenous Peoples. The objectives of relevant operations are linked to the objectives of the proposed DPF-4. In addition, the prior actions complement ongoing activities supported by the IFC in the energy and education sectors. The IFC has joined forces with the WB to support energy efficient facilities, with a focus on financing renewable energy generation plants.

The proposed DPF is also fully consistent with the WB's Group strategy aimed at eradicating extreme poverty and promoting shared prosperity. The PDOs are directly linked with specific priorities of the Government's reform program, and in addition, as noted in Section V, the DPF program is likely to have positive effects for poverty reduction and shared prosperity. The program aims to improve social assistance, education, as well as regulatory and sustainability framework in the water and energy sectors, including by helping to contribute toward Panama's COP-21 commitments. At the same time, the program aims to safeguard macroeconomic stability and resilience, which are key preconditions for sustained poverty reduction.

Analytical and advisory activities complement the DPF program. The 2015 Systematic Country Diagnostic identified challenges and priority areas to advance social inclusion, service delivery, and fiscal sustainability. A 2015 assessment of social spending for Central American countries, including Panama, analyzes the fiscal sustainability and effectiveness of social programs, providing recommendations for the short- and medium-term. The proposed DPF-4 builds on the findings in these studies and seeks to strengthen policy coordination to ensure the greatest possible impact of public expenditures in terms of poverty reduction and shared prosperity. Ongoing technical assistance on social protection supports the strengthening of the institutional functions for enhanced coverage of social programs. The Bank works closely with other donors, in an ongoing engagement to assist the Government to improve the transparency of the country's tax system, enhance the capacity of the tax administration to use the data received by exchange of information with other countries to tackle tax evasion, and promote the exchange of tax information to meet the standards of the Global Forum.

C. Proposed Development Objective(s)

Objectives

The objectives of the DPF series are to:

- Strengthen the frameworks for international tax transparency, financial integrity, and fiscal management
- Strengthen institutional arrangements to support social assistance and education
- Enhance the regulatory and sustainability framework in the energy and water sectors

Key Results

AML/CFT: The supported measures are expected to result in Panama starting to exchange financial information for tax purposes on automatic basis in line with the country's international commitments. These exchanges will allow Panama to enhance its role in the international efforts to tackle tax evasion.

Fiscal Management: The creation of an independent Fiscal Council will strengthen oversight and accountability of fiscal performance and policy. The new Fiscal Council will be led by three independent professionals with relevant experiences, who will hold their posts for seven years. It will analyze fiscal policies and plans and evaluate them based on the overall objectives of government and discuss its analysis in regularly published report.
CCT: These actions are expected to improve the targeting and coverage of CCT programs in Panama within the shrinking fiscal envelope. Regular updates to the registry of beneficiaries, and improvements in the targeting formulas are expected to increase the number of extreme poor and vulnerable people benefitting from social assistance by reducing inclusion errors, and improving the coverage and targeting of social assistance schemes.
Education: The actions supported by the operation are aimed at supporting medium- and long-term improvements in Panama's education and training system, facilitate the school-labor market transitions for youth while supporting firm productivity (by reducing mismatches).
Energy efficiency: The regulations supported by DPF-4 seek to promote energy efficiency and more responsible use of energy by consumers to prevent pollution and excessive greenhouse gas emissions.
Water management: The measures supported by the DPF program will strengthen the regulatory and sustainability framework in the water and sanitation sector and improve service delivery.

D. Concept Description

The proposed DPF is the final operation in the programmatic series of four loans, aimed at supporting the Government of Panama's efforts to: (i) strengthen the frameworks for international tax transparency, financial integrity, and fiscal management; (ii) strengthen institutional arrangements to support social assistance and education; and (iii) enhance the regulatory and sustainability framework in the energy sector. These three pillars complement and reinforce each other. First, a stronger framework for international tax transparency and financial integrity will improve investor confidence and support economic growth, while the strengthening of fiscal management will help ensure fiscal sustainability. Second, improved transparency and better targeting of social protection systems will help direct resources to those that need them the most, while improved quality of education will contribute to advancing opportunities, particularly for vulnerable youth, and supporting the competitiveness agenda to boost long-term productivity growth. Finally, an enhanced regulatory and sustainability framework for energy will help increase the fiscal space needed to safeguard social assistance and education programs and heling to meet global commitments on climate change.

The policies supported in the DPF series have positive global externalities beyond Panama, help to address institutional capacity challenges within Panama and are fully aligned with the Government's program. Pillar 1 supports, among other reforms, progress in aligning Panama with global standards in the area of Anti-Money Laundering (AML) to contribute to the international community's fight against abuses of the global financial system and help combat terrorism and other illicit activities. It also supports the advancement of international tax transparency, including in the area of automatic exchange of financial information for tax purposes between Panama and the rest of the world; thereby supporting international coordination and collective action to fight tax evasion and erosion of the tax base across countries. Pillar 3 supports initial energy efficiency measures under Panama's action plan to meet its global commitments on climate change (under the Paris COP-21). Pillar 2 is focused on the domestic poverty alleviation and shared prosperity agenda.

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

The DPF-4 supports actions that are expected to have largely neutral or positive effects on poverty reduction and income distribution in the short-term, and overall positive effects over the medium- and long-term. The poverty and distribution effects are expected to differ across actions. The **institutional strengthening of social transfers and the rollout of the youth active labor market program** are expected to have immediate positive implications for household income, especially among the poor. The **reforms related to international tax transparency, financial integrity, and financial information management systems** will affect administrative processes that will not expectedly bring immediate effects on poverty and inequality. Finally, actions on **sustainable construction and energy efficiency** do not directly benefit the poor in the short-run. Economy-wide benefits from less emissions and more energy efficiency will compensate some of the negative distributional effects of these actions.

In November 2016, the Single Registry of Beneficiaries and the Single Payment Platform for all CCT programs were created under Law 54. The Registry facilitates the monitoring of potential overlaps across programs and the cross-checking with other administrative databases, improving efficiency and auditing of payments. It also increases social assistance transparency and equity by improving program targeting, minimizing inclusion and exclusion errors, eliminating program duplications, allowing the application of eligibility criteria and recertification for new and existing beneficiaries. The recertification process and the new PMT are resulting in substantive changes in the eligibility of beneficiaries, which analyses suggest are positive at large. These changes will substantively expand the coverage of extreme poor beneficiaries under *Red de Oportunidades* and the poor elderly under *120 at 65*. However, non-negligible increases in the leakage of such programs to non-poor beneficiaries are also expected if no further improvements take place. To the extent that such targeting shortfalls are redressed, a more transparent, efficient, and agile social assistance system will render immediate positive effects on poverty and inequality reduction. After all, without social assistance programs poverty in Panama would rise by an estimated 50 percent (or 5 percentage points).

The reforms related to international tax transparency, financial integrity, and financial information management systems will affect administrative processes, improving compliance with international standards, auditing, information security, supervision and independence. These actions are not expected to have direct benefits accruing to the poor. However, failure to implement these reforms might affect the confidence in the state and in its efficiency, negatively impacting economic growth, fiscal sustainability, job creation and, ultimately, poverty reduction in the medium- and long-run.

The adoption of the Simplified Sustainable Construction Guidelines is not expected to have major impact on poverty although it might have limited negative effects on distribution. Social housing, the government program to provide low-income housing, is excluded from the new construction guidelines. Had otherwise been included, the increased construction costs for social housing—and the likely reduction in social housing delivered—might have well exceeded the cost savings on energy that would have accrued to the poor from the new construction techniques. This leaves the poverty effects neutral and the income distribution effects negative-to-neutral in the short run. In the longer-run, the poor, along with the rest of the population, will benefit from the lower emissions of greenhouse gases that result from the application of the guidelines.

Environmental Impacts

The measures supported under the proposed DPF are not expected to have significant effects on the environment, forests or other natural resources. Pillars 1 and 2 of this DPF are primarily institutional in nature and thus, unlikely to have significant effects on the environment.

- Prior Actions 1 and 2 are aimed at improving the international tax transparency framework in Panama in order to bring them closer in line with international standards and best practices, with no expected impact on the environment, forests or other natural resources.
- Prior Actions 3 to 6 focus on the strengthening of the AML/CFT framework and adoption of new supervision procedures to facilitate implementation of the amended anti-money laundering legislation. They are not expected to have significant impacts on the environment, forests or other natural resources.
- Prior Actions 7 and 8 focus on strengthening fiscal management and accountability and increase the ability of Panama to increase savings through the Panama Savings Fund. They are not expected to have significant impacts on the environment, forests or other natural resources.

Strengthening institutional arrangements to support inclusion in social assistance and education can have indirect, positive environmental effects (Prior Actions 9-11). The supported CCT programs require beneficiaries to regularly visit primary health care providers, who might identify and help prevent diseases caused by environmental conditions, including respiratory diseases caused by household air pollution or diarrheal diseases stemming from inadequate water supply, sanitation and hygiene. The Government may use the data gathered at health centers to inform assess existing policies and design further interventions to improve environmental health conditions. Similarly, strengthening educational programs will increase vulnerable populations' knowledge and intangible capital, both of which can have positive, indirect effects on Panama's environment, forests, and other natural resources.

Promoting increased energy efficiency through standards for residential and commercial construction is expected to have positive environmental effects (Prior Action 12). These reforms will increase energy efficiency in new constructions. This is expected to result in lower emissions of local and global air pollutants, particularly because thermal energy is the source of 40 percent of Panama's electricity. These measures can therefore contribute to reduce local air pollution, as well as to achieve the goals of Panama's nationally determined contribution (NDC).

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APPROVAL

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