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Country Program Evaluation

Panama 1991-2003

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CONTENTS

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ABBREVIATIONS

ACP	Panama Canal Authority
ANAM	Autoridad Nacional del Ambiente [National Environmental Authority]
APN	National Ports Administration
ARI	Autoridad de la Región Interoceánica [Interoceanic Region Authority]
CACM	Central American Common Market
CFZ	Colón Free Zone
COF	Country Office
CS	Country Strategy
CSS	Caja de Seguro Social [Social Security Fund]
CTR	Reimbursable Technical Cooperation
DDSR	Debt and Debt-Service Restructuring
DO	Development Objective
ECLAC	Economic Commission for Latin America and the Caribbean
EFA	External Financial Audit
ERSP	Ente Regulador de Servicios Públicos [Public Utilities Regulatory Agency]
FES	Fondo de Emergencia Social [Emergency Social Fund]
FIS	Fondo de Inversión Social [Social Investment Fund[
HDI	Human Development Index
IBC	International Banking Center
IDAAN	Instituto de Acueductos y Alcantarillados Nacionales [National Water and Sanitation Authority]
IIC	Inter-American Investment Corporation
ILO	International Labour Office
IMF	International Monetary Fund
IP	Implementation Progress
IRHE	Instituto de Recursos Hidráulicos y Electrificación [Water Resources and Electrification Authority]
IVM	Social Security Fund's Disability, Old Age, and Survivor Benefit Program
LAC	Latin America and the Caribbean
LMS	Loan Management System
MEF	Ministry of Economy and Finance
MIF	Multilateral Investment Fund
MOP	Ministry of Public Works
NFPS	Nonfinancial Public Sector
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PAIS	Project Alert Identification System
PBL	Policy-based Loan [Sector Operation]
PCR	Project Completion Report
PPMR	Project Performance Monitoring Report
PPP	Puebla-Panama Plan

PRI	Private Sector Department
SBP	Superintendencia de Bancos de Panamá [Panamanian Banking Superintendency]
SIAFPA	Sistema Integrado de Administración Financiera [Integrated Financial Management System]
TC	Technical Cooperation
TFP	Total Factor Productivity
UNDP	United Nations Development Programme
WTO	World Trade Organization

EXECUTIVE SUMMARY

This report presents the evaluation conducted by the Office of Evaluation and Oversight of the Bank's program with Panama from 1991 to 2003. Its intent is to describe for the Bank's Directors the outcomes of the institution's activity in Panama and extract lessons that can help make future Bank actions more effective.

A. Country and economic context

Panama's economic progress owes much to its privileged geographic location. The three pillars of the nation's modern-era economic development are the Canal, the Colón Free Trade Zone (CFZ), and the International Banking Center (IBC), all of which feature heavy foreign capital participation. Over time the economy took on (and remains today) a dual structure in which a modern, dynamic and competitive services sector that is fully engaged in the international economy, operates alongside a smaller, less advanced and less competitive sector with a focus on agricultural and industrial activities that, essentially, targets the home market.

Helping to drive this duality were some intrinsic or structural features of the economy's leading sectors—limited integration with the rest of the economy, scant job creation (that also tend to demand more skilled labor), pressure on the general wage level and, with the exception of the Canal, generate little fiscal revenue. Over time, distorting policies and inadequate social policy targeting have exacerbated this structural duality.

In the early 1990s Panama was facing some stiff challenges as it attempted to recover from the political, economic, and social consequences of economic sanctions, the military dictatorship of General Manuel Antonio Noriega, the suspension of payments to creditors and, above all, the December 1989 U.S. invasion. Meanwhile it had to ready itself to take over control in a few years' time of its prime economic asset, the Canal, and the Canal Zone territory and infrastructure.

Panama's 5% economic growth average over the span covered in this report places it among the 10 fastest-growing countries of the region during the 1990s. But in recent years the leading economic sectors that were responsible for Panama's external performance—service exports via the Canal and the IBC, and merchandise re-exports via the CFZ—have been slowing and losing competitiveness.

- Despite the orderly, successful transfer of management of Canal operations, revenue increases have come mainly from tariff increases. One reason for the gradual decline in Canal traffic is the emergence of vessels too large to pass through the Canal.
- Some of the reasons for the IBC's shrinking profile as an international banking center are the development of financial markets in other countries in the region, more fluid and direct financial dealings between the United States and major Latin American corporations, mounting pressure from the United States and other developed nations to curb suspected money-laundering operations and, more recently, the adoption of a

modern regulatory framework that tightened bank regulation and supervision rules and standards.

- CFZ business began to decline sharply in the mid-1990s. More important, the CFZ's very existence is dependent on international rules regarding special treatment of free trade zones.

On the fiscal accounts side, rising current expenditures coupled with a declining tax burden have created a worrisome scenario, with the nonfinancial public sector deficit at its center. The following are some salient considerations:

- Panama's external debt has been mounting in recent years, regardless of how it is measured (flows or stocks) or whether it is referenced to GDP, exports, or government revenues. In 2003, debt service payments took up 56% of total central government revenues.
- The actuarial deficit of the Caja de Seguro Social (Social Security Fund) represents a contingent liability for the government which could double Panama's public debt stock in the immediate future unless corrective measures are taken.

In relation to the challenges of reestablishing democracy and institutional reconstruction, the free and fair elections of 1994, 1999, and 2004, as well as the government transitions over those years, and the dissolution of the army, must be noted. Nevertheless, some surveys suggest that support for democracy is still fragile in the country.

The pronounced duality of Panama's economy has left the country with a particular set of features: despite its relatively small population and an economic growth that outperformed the Latin American and Caribbean average during the past 20 years, the country still presents high poverty rates and severe inequality.

Despite Panama's progress toward the Millennium Development Goals, roughly one third of its people still live below the poverty line. Non-extreme poverty afflicts largely urban Panamanian households, a lack of employment being their common thread. Extreme poverty is predominantly a rural problem: 60% of the country's poorest households are in rural areas and indigenous territories.

B. Programming

The central point of the Bank's programming during the period reviewed, was the vision that Panama needed to develop, implement, and deepen reforms to remove price controls and distortions, liberalize markets (notably the labor market and the external sector), and diversify its sources of economic growth (including the sustainable development of the potential of the assets to be reverted to the country). Thus, four overarching programmatic thrusts or objectives stand out: (i) poverty reduction and human development; (ii) support for economic reforms and competitiveness; (iii) sustainable growth; and (iv) strengthening of governance.

Overall, this evaluation found the Bank's program with Panama in 1991-2003 to be consistent and coherent:

- The program is consistent with the Bank's diagnostic that explains Panama's duality fundamentally as the result of a strong State presence in the economy, the adoption of distorting policies, and inadequately targeted social policies.
- The objective of supporting economic reforms was a programming priority throughout the entire period reviewed, and meshed closely with the vision of the Panamanian administrations of the 1991-1999 period. Showing consistency, the Bank upheld its programmatic model and focus during the Moscoso administration despite its more protectionist vision of the economy.
- There was also consistency between programmatic intent and actual program implementation: 69% of approved lending and 44% of projects approved throughout the period pursued the economic reform and competitiveness objective.
- The Bank brought its entire toolkit to bear in its work in Panama. In particular, in keeping with the importance it ascribed to the private sector for Panama's progress, the Bank deployed the financial products available for that sector and crafted a private sector development strategy.

Though the Bank's program and activities in Panama addressed issues that were relevant for the country, programming throughout the period reflects the prevailing 1990s belief that economic reforms and better-targeted social services would be *sufficient* to trigger economic growth with equity, creating income-generating opportunities for the country's poorest. As a result, the Bank underemphasized poverty and equity issues as well as the need for mitigating measures for population groups hardest hit by the adjustment process, and/or transitional measures so that sectors which lost the most from the reforms could ready themselves for a more competitive environment. According to this evaluation's findings, these limitations, in an inequitable environment like Panama's, have reduced the relevance of the Bank's country program.

The Bank's programming during the period reviewed here does not embody lessons learned from outcomes of its work in Panama: none of the four country strategies (CSs) produced over that span assessed or analyzed concrete results achieved by Bank activities in previous programming cycles. This suggests that the Bank has not reflected on the core assumption upon which it structured its activities over the period, and has not explored the possibility that this situation might be better explained by the structural characteristics of the country's economy, inherent in Panama's distinct features and comparative advantages.

C. IDB activity in Panama

Since the Bank resumed lending to Panama in 1992 loans were approved every year, providing US$1.4 billion in current terms for a total of 34 operations. This is roughly 37% of the total number of projects and 46% of all lending approved for Panama since the Bank's inception. These figures are historical highs for number of loans and lending volumes, as well as for average project size. The majority (25) of the projects are investment loans; four are sector operations, four are reimbursable technical cooperation operations, and one is a project approved by the Private Sector Department. The Inter-American Investment Corporation has approved US$30 million in funding for six projects in Panama since 1993. Over that same interval, the Bank also approved US$36.2 million in nonreimbursable resources in the form of 90 technical cooperation operations totaling about US$19 million and 20 Multilateral Investment Fund operations totaling US$17.1 million.

This evaluation found the Bank's Panama program to have good efficiency indicators, albeit at times at the expense of high administrative costs:

- Disbursement patterns and average and median implementation times are better than those observed in relevant comparator groups.
- According to the data available, longer preparation times correlate with better implementation patterns, suggesting that more careful preparation has improved implementation efficiency.
- There was a significant reduction in volatility of Bank disbursements in Panama in the 1990s in both absolute and relative terms (vis-à-vis government revenue performance). Its disbursements behaved countercyclically throughout the entire 1991-2002 span.
- Administrative expenses range from 1% to 27% of total project costs. Administrative costs surpassed 10% in 6 of the 17 projects examined.

OVE also estimated disbursement patterns of investment projects clustered by strategy objective. According to these estimates, average and median disbursements of projects supporting the sustainable growth and human development objectives would be the ones with the worst disbursement patterns: disbursement rates for these latter operations are consistently inferior to the project universe. Projects in support of the governance and economic reform objectives have performed best.

D. Qualitative aspects of the country program

Generally speaking, the diagnostic assessments of the projects reviewed were well developed, the project objectives were clearly spelled out and had a consistent internal logic, in the sense that the project subcomponents and activities duly fit the objectives. However, projects tend to provide limited analysis of the conditions needed to achieve their objectives. Other serious limitations have to do with the presentation of risks and associated mitigating measures. Some implementation problems observed stemmed, according to the Country Office's portfolio review reports, from a lack of timely or inadequate institutional analysis during project preparation.

Another limitation often observed in project design, was the lack of indicators needed to systematically track a project's progress in relation to its the proposed development goals. In most projects, outcome indicators were inadequately defined or absent. One particularly common feature, even in more recent projects, was the lack of baselines for these indicators.

The projects that pursued economic reform and governance objectives come out better than operations in support of the human development and sustainable development objectives as far as diagnostics, definition of objectives, and internal logic are concerned.

These findings are consistent with the discussion above, in which the first type of operations had a better implementation pattern, and could explain, at least in part, those projects' longer preparation times.

E. Outcomes and the Bank's program

This evaluation has found that the good process performance observed have not generated similar results in terms of effectiveness.

The expectation was that liberalization and economic reforms in Panama—a Bank priority both as a goal and on the ground (and a priority for the country up until 1999)—would give the country "*a stronger and more efficient economy with fewer price distortions ... [which ultimately will] boost the competitiveness of Panama's economy and will have the desirable consequences of creating additional jobs and reducing poverty"* (GN-1975-1, p. 15). But overall, to judge from the outcomes, the reforms have not been very effective in achieving those goals:

- The state of the country's public finances is worrisome. The anticipated public sector downsizing has not materialized. Indeed, the ratio of nonfinancial public sector expenditure to GDP and the total civil service roll are larger now than before the reforms, despite the reductions observed in public enterprises.
- The debt and debt service burden on the balance of payments has not been alleviated and there are no signs of improvement in the coming years. Panama's ratios of net present value debt stock to GDP and to government revenues are still acceptable (though approaching the sustainability limit); the debt-to-exports ratio is more comfortable. Debt service vis-à-vis government revenues, for its part, has passed the limit that would ensure its sustainability, and the debt service-exports ratio is nearing the same point.
- The reforms did not enhance Panama's competitiveness nor did they diversify its economic base.
- There has been no improvement in Panama's severe inequality levels. There is evidence to suggest that trade liberalization may even have worsened this situation.
- There was no significant change in the unemployment rate or in job creation. Moreover, considering that 70% of the small number of jobs created in the 1990s were in the modern sectors of the economy and demanded secondary and post-secondary graduates; in terms of employment the economic growth observed in the period reviewed here worked against poor households, particularly because their own labor is their chief productive asset.
- Despite progress made toward the Millennium Development Goals of reducing extreme poverty, Panama's inroads against poverty have fallen far short of expectations: the growth elasticity of poverty in the country was significantly lower than ECLAC estimates for Latin America.

Because of the focus on economic reforms without additional measures to address constraints created by the possible presence of "Dutch disease" and by the intrinsic or structural features of the leading sectors of Panama's economy—limited integration with the rest of the economy, scant job creation (and the fact that most of the new jobs demanded high skilled workers), pressure on the general wage level and, except for the Canal, not much fiscal revenue generation—the reforms did not have the anticipated outcome and, indeed, they appear to have exacerbated the nation's social and economic duality.

The following highlights some of the achievements observed over the course of the period evaluated:

- Improvements ensuing from energy and port sector reforms which, overall, have been beneficial for the country.
- The country's renewed access to international financial markets.
- Strengthening of bank regulation and supervision, which took Panama off the lists of countries classified as tax havens and helped make the sector more crisis resistant.
- Early results from the Bank's science and technology/technological innovation activity suggest this to be a promising area.
- Though the available data reveal no evident improvement in targeting education spending to the poorest children, the (still early) results in the health area point to improvements in primary care coverage for the poor.
- IDB-funded investments in road and highway rehabilitation and improvements have lowered vehicle operating costs.
- Poverty reductions in areas covered by the first Social Investment Program (FIS, PN-0054).
- The Bank-funded Housing Program has given over 25,000 low-income families access to housing, particularly in rural areas.
- Some inroads were made into Panama's severe rural poverty problem through the Darién Sustainable Development Program, which took water to more than 2,600 households via small rural water supply systems and connection of 545 households to the power grid.

F. Recommendations

The data analyzed by the evaluation team suggest that some of the Bank-funded projects have very high administrative costs, thus leaving less resources for project activities. The Bank should analyze the administrative costs of its operations more thoroughly and, with that information, work with the country to find ways of lowering them. Specific recommendations are as follows:

- Evaluate the institution-strengthening components that figure in virtually every project to see how effective they are in improving government management and implementing capacity.
- Review the design of project structuring and provide a detailed rationale for cases that require a more "significant" administrative structure.
- Strengthen mechanisms for ex ante institutional evaluation and monitoring of implementation capacity.
- Introduce mechanisms to evaluate and remunerate executing units' achievement in terms of targets and objectives.

The Bank's experience in Panama shows that good process performance is not a sufficient condition for assuring good outcomes. Panama is a particularly complex case because some sectors of its economy have very clear comparative advantages, successfully exploited for many years, but they: (a) have created a marked economic and social duality owing to structural factors or distorting policies; (b) may have triggered "Dutch disease"; and (c) are losing competitiveness. The evidence thus suggests that the reforms' benefits have not automatically spread to the rest of the economy; moreover, market mechanisms operating in the absence of other signals tend to reproduce the status quo. The lesson that can be drawn from Panama's experience is that different kinds of policies and instruments need to be combined to further the key sectors of the Panamanian economy while also fostering the less dynamic sectors, for the ultimate benefit of the population at large. The main challenge for the Bank is, therefore, to bring its economic and sector analysis work to help Panama develop such policy strategies and, given the structural characteristics of the Panamanian economy, take into careful consideration the implications of the different intervention alternatives.

Accordingly, and specifically as regards the conceptual structuring of the Bank's program, it is recommended that in addition to prioritizing its economic and sectoral analysis work the Bank should:

- Improve the quality of its self-evaluation through deeper critical examination of the outcomes of its activities in Panama and more clearly defined indicators, baselines, and development objectives.
- Consider the issues of poverty and inequality in terms of instruments for reducing the country's duality, not just measures to mitigate its effects. A further recommendation is to analyze complementary mechanisms that can spur development of sectors that are labor-intensive and/or employ less skilled labor, with the aim of expanding opportunities for the poorest of the poor (opportunities) while developing human capital (capabilities).
- Follow more closely the progress of trade liberalization and integration, mindful particularly of the potential impacts of a bilateral agreement with the United States which could substantially increase Panama's home market exposure to global competition and perhaps increase Panama's trade reliance on the U.S. market.
- Thoroughly analyze the possible causal link between Panama's rigid labor market and its job creation and unemployment problems.

Recommendations for future Bank intervention focuses are as follows:

- Examine alternatives for agriculture sector support, particularly credit availability.
- Promote social programs that can help develop capacity among the country's poorest, i.e., that go beyond poverty alleviation and complement opportunity-promoting initiatives.
- Continue treating competitiveness as a priority concern. In particular:
  - The areas of science and technology, technological innovation, and cluster development appear to offer benefits that warrant careful Bank attention. With close monitoring and midterm reviews of active projects in those areas the Bank

can extract important lessons to corroborate these findings and develop these issues more fully.

- Explore how PRI could assist in developing public-private partnerships in Panama. The Bank should use PRI's Action Plan for C and D Countries to maximize returns on those efforts.
- Consider alternative avenues of support for Panama's fast-growing tourism sector.
- Thoroughly analyze the Bank's comparative advantages for supporting Panama in the likely expansion of the Canal.

I. COUNTRY AND ECONOMIC CONTEXT

A. Introduction and economic overview

1.1 This report presents the evaluation performed by the Office of Evaluation and Oversight (OVE) of the Bank's program with Panama between 1991 and 2003. Its intent is to describe for the Bank's Directors the outcomes of Bank activity in Panama and extract lessons to help make the institution's future actions more effective. This first chapter examines the setting in which the Bank's program was conceived and delivered. Rather than attempting to draw connections between Panama's economic performance and Bank activities it outlines the most prominent features of the Panamanian economy and developments over that time span to provide a frame of reference for the entire report. The figures and tables cited throughout the report are in Annex 1, the boxes in Annex 2.

1.2 Panama is a small country (75,517 square kilometers) with a 2003 population of just over three million, approximately half of whom live in the province of Panama. According to the 2000 census, around 62% of Panamanians are urban dwellers.

1.3 Two core features have driven Panama's history and development, making it unique in Latin America. The first is its geographic location, which since Spanish colonial times has shaped its destiny: situated on the narrowest strip of land between the Atlantic and Pacific, it is a strategic point for merchandise shipments from one hemisphere to the other.

1.4 The second feature is the country's relations with the United States. Panama gained independence thanks to U.S. support; in exchange, the United States secured absolute control of a large tract of the new nation's territory and of its economic mainstay, transportation. The 1903 treaty creating the Canal placed an area of approximately 1,400 square kilometers—the Canal Zone—under U.S. control, and also gave that country control over even inland waterways that feed the Canal. Thus, from 1903 to 1999 when the Canal and Canal area reverted to Panama, part of its land was foreign territory. Furthermore, Article 136 of Panama's first constitution (1904) gave the United States the unilateral right of military intervention in the country.

1.5 Panama's economic progress thus has had a great deal to do with its privileged geographic location. In modern times it has looked to three pillars to advance its economy: the Canal, the Colón Free Trade Zone (CFZ), and the International Banking Center (IBC), in all of which foreign capital figures prominently. As a result, the economy took on (and still has today) a dual structure in which a modern, dynamic, competitive, service-based sector fully engaged in the global economy operates alongside less advanced agricultural and manufacturing sectors that have less outside participation and are not globally competitive, producing thus mostly for the home market. This duality, driven in part by intrinsic or structural features of the leading economic sectors—limited integration with the rest of the economy, scant job creation (and a demand for advanced skills for the small number of jobs that were created), pressure on the general wage level and, except for the Canal, not much revenue for the treasury[1]—has been exacerbated over time by the adoption of distorting policies, such as price controls and tariff protection, and inadequate social policy targeting.

1.6 These features of the three pillars described above—foreign currency generation and weak linkage with the other sectors of the economy—lend credence to the hypothesis that Panama suffers from some measure of "Dutch disease"[2] [3] which tends to reduce the competitiveness particularly of tradable-goods sectors, especially agriculture and industry, that reap no benefit from Panama's singular geographic position. As a result, these labor-intensive segments of the economy typically grow slowly and create few jobs. Compounding the problem is the fact that what little employment is created by the modern sector usually demands advanced skills.[4] [5]

1.7 At the start of the 1990s Panama was contending with some stiff challenges. The country was striving to recover from the political, economic, and social consequences of economic sanctions, the military dictatorship of General Manuel Antonio Noriega, the suspension of payments to creditors and, above all, the December 1989 U.S. invasion (see Box A-1.1). Meanwhile, it had to ready itself to take over, in a few years' time, control of its chief economic asset, the Canal, and of the Canal Zone territory and infrastructure. These elements are the starting point for the discussion in this report.

B. Economic growth

1.8 By virtue of Panama's strong external links plus its unique currency regime, prices have remained stable and service-related industries have grown, particularly international business services.[6] In the period 1991-2003 such service-based activities contributed on average 76% of GDP; the primary sector provided around 9% of output and industry between 8% and 11%.[7] This sharp economic duality has made Panama a singular case: even though it has a relatively small population and its economic growth rates have outpaced the Latin American and Caribbean average for 20 years, its unemployment, poverty, and income inequality rates are high.

1.9 Panama's average growth rate of nearly 5% between 1990 and 2003 places it among the 10 fastest-growing countries in the region in the 1990s.[8] However, the relatively high growth rates of the early 1990s trended down over the course of the period examined here.[9] With a virtually constant population growth rate of about 1.9%, increases in per capita GDP have been a constant except in 1995 and 2001. In 1996 dollars, per capita GDP in 2003 was US$3,906.[10]

1.10 The prime economic growth drivers in the 1990s were investment (some of it public, most of it private) and private consumption (Figures A-1.2 and A-1.3 give a breakdown of economic growth during the 1990s). The rapid expansion in the early years of that decade marked the economy's rebound from the late-1980s crisis: investment, particularly for reconstruction, and normalization of exports explain the strong growth in the first half of the 1990s. The slowdown starting mid-decade suggests that the core pillars of the economy were losing strength, and is attributable mainly to private consumption. Other important elements in the second half of the decade were poor external sector performance and shrinking exports: overall, the external sector's effect on economic growth was either nil (up until 1995) or negative, as CFZ re-export activity slowed and IBC business fell off as those sectors' competitiveness slipped and Panama's economy felt the effects of global crises.[11]

C. The public sector

1.11 Rising current expenditures and a declining tax burden have created a worrisome fiscal scenario.[12] The nonfinancial public sector (NFPS) deficit has worsened: estimates for 2004 are looking at 5% of GDP. To remedy its low tax collection capacity the government has brought in a series of measures such as tax reform (2002), passage of the Fiscal Responsibility Law (2002) which caps medium-term government indebtedness, and a new tax reform proposal by the new administration.[13] [14] The two most pressing financial problems currently facing the government are external debt service payments and the social security system.

1.12 Panama regularized payments on its external debt under the terms of the 1995 restructuring in which the Bank, the World Bank, and the International Monetary Fund (IMF) participated in a tripartite operation. But the debt has swelled in recent years, whether measured as flows or stocks and regardless of which variable is referenced—GDP, exports, or government revenues.[15] Debt service is taking up a huge share of government current revenues: in 2003 in principal payments alone the central government had to spend over 32% of its current revenues to service its total debt, up substantially from the 23% it expended on that item in 1996. For total debt service payments the respective figures those years were 78% and 65%.[16]

1.13 Though the bulk of Panama's external obligations are in the form of bonded debt to private creditors, the last decade has seen an increase in the share of debt owed to multilateral organizations. The Bank is the country's main multilateral creditor, not just because in 2003 Panama's obligations to the Bank constituted around 70% of its multilateral debt but also because that share has been steadily climbing, from 40% in the early 1990s to 60% at the end of that decade and 70.5% in 2003. In that year the IDB was the country's second largest creditor, after bondholders. But given Panama's debt profile, the Bank's exposure in the total public debt stock was less than 15% between 1990 and 2003.

1.14 Another obstacle to balancing the public finances has been the deteriorating financial performance of the Social Security Fund (CSS), which takes in a number of social insurance programs and is one of the chief components of central government finances in Panama, accounting for fully 43.5% of government current expenditure in 2003. The financial situation of the Disability, Old Age and Survivor benefits plan, the most important of the CSS components, has deteriorated in recent years, destabilizing the CSS and public sector finances generally. The CSS has ended the last three years with a cash deficit, which it has funded from pension system reserves. This has widened the actuarial deficit, representing a contingent liability of the government that could double the country's public debt stock in the immediate future unless corrective measures are taken.

D. Drivers of the Panamanian economy

1.15 Thanks mainly to service exports via the Canal and the IBC and merchandise re-exports through the CFZ, Panama's export sector has grown more quickly than most of its Latin American counterparts in recent decades. However, in the last few years these sectors have been slowing and losing competitiveness.

1. The Panama Canal

1.16 In the 1990s Panama was faced with the huge challenge of securing an orderly transition, and one that would benefit the country as the end-1999 date for recovering the Canal Zone approached. Among other things this entailed assuming full responsibility for managing the Canal assets and ensuring its operations, managing its environmental viability, and considering also the costs and benefits of an eventual expansion.

1.17 The transfer of management of Canal operations was gradual, orderly, and successful. Panama has had sole responsibility for operating the Canal since 2000; efficiency levels are higher than before.[17] Though revenues from Canal operations are up—largely because of tariff increases—traffic volume is edging down, owing at least in part to the emergence of a new generation of ships too large to fit through the Canal. This has prompted moves in recent years to start expanding the Canal to be able to accommodate these larger "Post-Panamax" vessels.

1.18 Another focus of attention has been conservation of the area of rivers that feed the Canal, by expanding the acreage of national parks protected from deforestation and environmental degradation. To foster productive, efficient use of the reverted Canal areas the government created the Interoceanic Region Authority (ARI) in 1993. Though some ventures have taken shape, mostly involving international companies that operate logistically in the Canal, the expectations raised in previous years about maximizing use of the reverted areas have yet to materialize.

2. The International Banking Center and the Colón Free Zone

1.19 With its early-1970s creation of the IBC following the liberalization of offshore banking regulations, Panama became one of the world's leading international financial centers. However, the IBC's prominence as an international banking center has been slipping owing to financial market development in other countries in the region, more fluid and direct financial dealings between the United States and major Latin American corporations, mounting pressure from the U.S. and other developed countries to curb certain financial transactions suspected of being money laundering avenues and, more recently, adoption of a modern regulatory framework that tightened bank regulation and supervision rules and standards.[18] [19]

1.20 The Colón Free Zone is another of the niches Panama has been exploiting for decades, thanks to its strategic location. Created in 1948, the CFZ is the second busiest free zone in the world (after Hong Kong) for merchandise traffic. Though it employs barely 1% of the country's workforce its 2003 revenues equaled 7.5% of GDP. The CFZ's two chief business lines have been re-exports of merchandise, mostly of Asian origin, to third countries, especially in Latin America, and distribution of goods and services of large foreign multinationals to different parts of the world.

1.21 CFZ business soared in the first half of the 1990s as Panama emerged from the late-1980s recession. However, activity began to level off in 1995 and declined thereafter, total re-export figures having plunged from over US$10 billion in 1994 to just US$4.5 billion in 2003. One reason for this downturn in the CFZ's activity indicators was its vulnerability to the financial crises that erupted in several Asian countries toward the end of the 1990s and spilled over into Latin America. Even more important, the CFZ's very existence is dependent on international rules governing special treatment for free zones.[20]

E. Governance and transparency

1.22 At the dawn of the 1990s Panama faced the challenge of rebuilding democracy and institutions in a nation that was emerging from the U.S. invasion and the Noriega dictatorship. Among the major milestones in this process were free and fair elections in 1994, 1999, and 2004, government transitions during the period, and disbanding of the army. However, there are data to suggest that support for democracy is still fragile:[21] Panamanians are less likely than their Latin American peers to say that they support a democratic system of government and to consider Congress indispensable and trust that institution. The country also has launched a decentralization process, one highlight of which was the 1999 signature of the "Decentralization and Local Development Pact."[22]

1.23 One of the most serious public administration problems in Panama is the absence of an administrative career service. Some exacerbating factors are the frequent turnover in executives and mid-level managers when the administration changes and appointments are politically based, and the inability to link remuneration to productivity.[23] All of this makes it difficult to strengthen institutions, demand accountability for results, and assure program and project continuity.

1.24 Corruption is a preeminent concern for Panama's public and private sectors alike. Corruption and governance problems drive up transaction costs, reduce efficiency and effectiveness, and leave the government with less money for investment and to deliver essential services. This in turn keeps private investors (local or foreign) away and thereby reduces opportunities for economic growth. Perceptions of banking system corruption are particularly important in the Panamanian context: in the late 1990s and first years of the new millennium Panama was on the OECD list of "uncooperative tax havens" and a 1997-1998 study by the Economist Intelligence Unit ranked Panama's banking sector along with Russia and Syria as having the highest corruption index.[24] To address this situation the government is committed to changes in fiscal and banking system transparency and information-sharing, removing the country from the OECD list.[25] The Financial Action Task Force (FATF) has also removed Panama from the list of countries that are noncooperative in the area of money-laundering control. Another important recent development was the enactment of Law 6 (Transparency Law) on 22 January 2002, which sets out rules on transparency of government operations, including penalties and personal liability of public servants.

F. Human development, poverty, and inequality

1.25 According to projections based on the 2000 census Panama has a population of approximately three million people living in nine provinces and three indigenous territories (*comarcas*). The provinces of Panama, Colón, and Coclé in central Panama are home to just over 63% of the total population. About 10% of the population belong to one of eight different indigenous ethnic groups, most of them living in the province of Bocas del Toro and the three *comarcas* that bear the names of the three main ethnic communities based there.[26]

1.26 Between 1990 and 2000 Panama's population climbed 2% annually—the lowest growth rate in the region but still above the Latin American average. Some 38% of the population live in rural areas, below the regional average. The age structure of the population is quite different from the Central American norm in which young people account for the largest population share: 31% of Panamanians are 14 and under, which is seven percentage points less than the Central American average and slightly below the Latin American and Caribbean average as well.[27]

1.27 Panama's social indicators are good: estimated life expectancy in 2003 was 75 years, longer than the Latin American average of 71 years; the child mortality rate was 20.6 per 1,000 live births, below the 2002 regional average of 28 per 1,000; and 98% of children aged 6 to 11 were enrolled in school in 2002. Panama's

2000 Human Development Index (HDI) of 0.7 places it in the middle of medium-high HDI countries.

1.28 Nevertheless, Panama has one of the highest inequality levels in the region, and hence in the world. The Gini coefficient for per capita household income is over 0.57 not counting the indigenous territories, 0.60 if they are included. This inequality shows up in human development and gender indicators: (a) the HDI ranges from 0.36 ("low HDI" category) in the Ngöbe Buglé indigenous territory to 0.76 in the province of Panama; (b) the HDI standard of living dimension varies from 0.037 ("very low" HDI category) in the Ngöbe Buglé territory to 0.666 in the province of Panama; and (c) the HDI standard of living dimension is lower for women than for men, particularly because women across the country earn less than men. This means that "*despite the growing feminization of the workforce women are not always employed in good labor conditions; they are faced with problems of informality, underemployment and, though they earn the minimum wage, on average they take home less than men*."[28]

1.29 One of the main reasons for Panama's pronounced inequality is the unequal distribution of production assets such as education, land ownership, experience, etc. For instance, the educational attainment of heads of household and their geographic location could explain around 36% of the disparity in mean per capita household income in Panama using the Theil index of income inequality.

1.30 Roughly one in three Panamanians is living in poverty; 60% of poor Panamanian households are in rural areas and indigenous territories. The poverty rate in those parts of the country is twice the national average, and the percentage of households there that earn less than the price of a basic shopping basket is three times the number elsewhere in the country. Though extreme poverty in Panama has a predominantly rural face, urban families are afflicted by non-extreme poverty, their common thread being the lack of employment. In close to 42% of poor urban households the head of household is unemployed or not in the labor force. (For a more detailed discussion of poverty in Panama see Box A-1.2.)

1.31 The Millennium Development Goal for poverty reduction is to halve extreme poverty between 1990 and 2015. Using 1991 estimates, the goal is to lower the extreme poverty rate to around 14%. In the last 13 years this goal has been more than three quarters achieved. Thus, Panama very likely will attain the official target for 2015 just by keeping annual per capita household income growth at 1.1% at least and keeping the income distribution constant.[29]

II. PROGRAMMING

2.1 This chapter presents the findings of the evaluation of the Bank's Panama programming exercises over the period 1991-2003, focusing particularly on the programs' relevance, consistency, and coherence.[30] [31]

2.2 The period reviewed in this evaluation takes in four programming cycles—1991-1993, 1994-1996, 1997-1999, and 2001-2003[32] [33]—and three successive administrations under Guillermo Endara Galimani (1989-1994), Ernesto Pérez Balladares (1994-1999), and Mireya Moscoso (1999-2004).

A. Programming relevance and consistency[34]

1. Diagnostic

2.3 All the programming papers over this period point up the dual nature of Panama's economy, in which a modern, outward-looking services sector operates alongside uncompetitive and heavily protected traditional sectors—manufacturing and agriculture, as well as the country's severe social inequality.

2.4 In its diagnostics the Bank also recognized the growth constraints and loss of competitiveness of service export activities which are Panama's economic mainstay. Though the programming papers note the structural facets of this duality, discussed in the previous chapter of this report (paragraphs 1.5 and 1.6), for the most part the respective diagnostics explain the duality basically as the result of a protectionist economic model pursued during previous decades which had made for *inefficient resource allocation, with an emphasis on capital-intensive activities, that held back growth of agriculture and industry and was unable to absorb high unemployment* (CP-258, p. 5 of the Spanish text).[35] [36]

2.5 All the country strategies (CSs)[37] spotlighted Panama's high poverty rates and pronounced inequality during the period reviewed here, but even though late-1990s figures were still alarming—"*. . . 64.9% of rural dwellers are poor; 38.5% live in dire poverty . . . some 23% of city dwellers are poor*"[38]—the programming papers typically refer to the problem of poverty as though it were concentrated in *pockets*.[39] As the next subsection of this report will discuss, the Bank's limited attention to the factors of the economy which in turn contribute to unemployment, unequal income distribution, and poverty, takes away from the relevance of its activity in Panama.

2.6 Another issue emphasized in programming exercises is the economic impact of the reversion of the Canal and surrounding areas. The Bank recognizes the appropriate use of those assets as one of the prime challenges for the country during the period examined here.

2. Objectives, activities, and anticipated outcomes

2.7 In keeping with its diagnostic assessments the Bank structured its programming around the vision that Panama needed to develop, implement, and deepen reforms to remove price controls and distortions, liberalize markets (particularly the labor market and external sector), and diversify its economic growth drivers (including sustainable use and development of the potential of the assets slated to revert to the country). Recognizing that Panama was emerging from severe political and economic turmoil, the first CS defines the Bank's country strategy for that period as one of "reactivation."[40] Thus, the CS concentrated virtually all the programmed resources in projects to support economic reform and strengthen economic and social infrastructure. The strategy also marked a unique effort to organize the Bank's program by short-, medium-, and long-term objectives, which was a valuable and noteworthy approximation to a clear elucidation of priorities. In the following three CS papers the emphasis gradually shifted to the need for interventions in other areas: social, environmental protection, and governance. Thus, four overarching programmatic thrusts or objectives stand out in the period 1991-2003: (i) poverty reduction and human development; (ii) support for economic reforms and competitiveness; (iii) sustainable growth; and (iv) strengthening governance (see Table A-2.1).[41] [42] But support for economic reforms was the priority programming intent throughout the entire period analyzed (see Figures A-2.1 and A-2.2 and A-2.3 to A-2.10).[43] [44]

2.8 This stress on economic reform is particularly in evidence during the first three programming cycles (1991 through 1999): approximately 48% of projects and 73% of lending approval figures up until 1999 pursued that objective (see Figures A-2.11 and A-2.12).[45] [46] [47] This matched the thrust of the administrations in office over that span (Endara and Pérez Balladares), whose economic agendas called for economic reforms to develop the private sector and instill market rules of competition in the economy as a whole.[48] [49] In this respect, then, the Bank's and Panamanian administrations' visions meshed closely from 1991 to 1999.[50]

2.9 The situation changed when the administration of president Mireya Moscoso took office in May 1999. That administration had a more protectionist vision of the economy; the Bank—consistent with its stated approach in previous programming cycles—continued to uphold an economic liberalization model. This made it difficult to arrive at a consensus on a common programming approach, as evidenced in the 2001 CS in which the IDB made clear its divergence with some government measures and reiterated the need to stay the course of economic reforms and liberalization: "*In October 1999 the new administration raised import tariffs on selected agricultural commodities to the WTO ceiling (up to 130% in the case of rice). Though the aim . . . was to protect the wages of poor rural families, the regulations worsened the lot of the urban poor and pushed up the price of the basic food basket. . . . the tariff increases mark a deviation in the trade-liberalization trend, reduce incentives for productivity and competitiveness, and run* *counter to the objectives of building on Panama's comparative advantages as an investment destination for trade and goods and services exports."*[51] These differences considerably held up the CS's preparation.[52]

2.10 In those circumstances, and though the latest CS continued to underscore the need to continue with economic reforms and liberalization and keep promoting such reforms as a strategy objective, the Bank was obliged to limit its support in that sphere to projects that were no longer informed by those principles, concentrating instead on specific pro-competitiveness activities (e.g. science and technology) and on developing operations more in line with the government's vision and strategy with its emphasis on social issues and poverty reduction.[53] The paper's cautious tone suggests that no firm agreement was reached as to the country strategy the Bank would be pursuing.[54] Thus, in the last programming cycle one observes a clear shift in the "de facto" program's priorities: a rise in the share of funding allotted to human development and poverty reduction and a drop in the share devoted to the economic reform objective. However, there was no provision in the programming intent for any significant increase in social-sector lending, suggesting that the change observed was largely directed by the Panamanian government (see Figures A-2.1 and A-2.2, and A-2.9 and A-2.10).

2.11 The Bank's programming in 1991-2003 reflects the prevailing 1990s view that opening up markets and protected sectors, incentives to private participation, trimming the role of the State, and sharper targeting of social services would be enough to create economic growth with equity along with income opportunities for Panama's poorest: *"The major cause of the high level of poverty is, as was already mentioned, inequality of income distribution, which is a product of inadequate economic and social policies implemented over an extended period.*"[55]

2.12 In practice, strict adherence to that action model has meant limited Bank attention to issues of poverty and equity, thereby reducing the relevance of its program in Panama, especially because "*[the economic reforms have not] raised the standard of living of Panamanians in rural parts of the country or evened out the income distribution*."[56] It is especially noteworthy that in 2001, after 10 years' work in the country, the Bank is still asking itself "*which challenges are holding up* ***equity*** *improvements, so these challenges can be put into a short- and medium-term perspective."*[57] Moreover, the 1993 CS had already underscored the need for a more detailed poverty diagnostic for Panama,[58] and suggested an arrangement with the World Bank in which the IDB would take the lead in undertaking a poverty diagnostic.[59] However, the poverty diagnostics and maps were piloted by the World Bank and by the United Nations Development Programme (UNDP) and, according to Economy Ministry authorities, the IDB has not worked with the country on poverty and equity studies or analyses.

2.13 Firmly convinced as the Bank and the Endara and Pérez Balladares administrations were of the effectiveness of the propounded economic model there was in general no emphasis on the need for mitigating measures for segments of the population hardest hit by the adjustment process or transitional measures for sectors that stood to lose the most from the reforms, so they could ready themselves for a more competitive marketplace. Concerns of this type are more in evidence in the latest two programming cycles. The most recent CS, for instance, addresses the possibility of the government implementing direct subsidies to families, consumers, and rural workers: "*[it is] important that Panama stay the course of the reforms while seeking formulas (direct subsidies or others) to ease the reforms' impact on the poor*."[60]

2.14 The view that inadequate policies are at the root of Panama's economic problems, coupled with a minimization of the importance of structural factors in the country's duality, leads to circular reasoning in the programming. On the one hand the Bank refers to the "*exhaustion of both the service sectors and the protected sectors*;"[61] on the other it affirms that "*the reversion of [these] areas to Panamanian ownership provides an opportunity to strengthen the open economic model by maximizing the comparative advantages Panama enjoys with respect to maritime services and multimodal transport by virtue of its unique geographical location, its monetary regime, and the existence of the canal, the CFZ and the CBI, in tandem with new economic uses for the reverted areas.*"[62] In other words, the programming paper affirms that the model has lost currency but proposes basically more of the same.

2.15 One final consideration is that the possible presence of "Dutch disease" would make the nondynamic sectors of the economy less competitive, operating against the economic diversification objective. This would mean that opening up the economy would not be enough, in and of itself, to ensure a more diverse economic base. Achieving that goal would require additional measures, incentives, and policies—for example, credit access for the sectors to be promoted The Bank does not go into this issue in its analysis.[63] [64]

2.16 The elements discussed in the preceding paragraphs 2.12 to 2.15 have reduced the effectiveness of the Bank's activity in Panama (see the last two chapters of this report).

2.17 As for spelling out expected outcomes of Bank activity in the country, only the most recent CS ties in the programming cycle objectives, strategy focuses, active projects, lending program, and activities of the government and other donors to outcome expectations.[65] In most cases, however, the indicators reference outputs rather than outcomes, no baselines are provided, and some of the proposed indicators have no relation to the proposed Bank activities.[66] Furthermore, the new projects listed in the summary strategy matrix are presented as a "*prospective project pipeline*" and listed as a pipeline in Annex I to the CS.[67] Consequently, the matrix does not define priority instruments via which the CS proposes to achieve its objectives.

3. Self-evaluation

2.18 A review of the programming papers indicates that none of the CSs provides an assessment or analysis of concrete outcomes achieved by Bank activities in previous programming cycles. For the most part the papers confine themselves to a review of the Bank's portfolio implementation. The papers covering 1994-1996 and 2001-2003 also describe the aims of the immediately preceding strategies.

2.19 One way to try to get around this limitation is to use approvals of operations proposed in the CSs as a proxy for achievement of the Bank's country programming intent (see also Tables A-2.3 to A-2.9).[68] Overall, the ability to anticipate projects that would ultimately be approved has been limited (approximately 39% in terms of number of operations and 52% in terms of amounts).[69] Something else that stands out is the recurrence and repetition of projects in successive Bank programming cycles over the course of the period examined here. The different programming instruments anticipate more than once, and for different cycles, several of the projects envisaged for Panama (Table A-2.9).[70] Box A-2.1 presents a brief analysis in this regard for each of the programming cycles.

4. Assumptions and risks

2.20 The successive country papers have spotlighted risks associated with fissures in government coalitions, the time it was taking for democracy to solidify, and the process of bolstering and continuing with the economic reforms. Another frequently cited risk element is the Panamanian government's institutional and/or political capacity to implement the programmed strategies.

2.21 These documents usually do not clearly distinguish between risk and uncertainty.[71] For example, one item labeled a risk is "*uncertainty as to the government's resolve to entrench and continue with some major structural reforms.*"[72] Being an intrinsic element of the concept of risk, uncertainty is a necessary, but not sufficient, condition of risk. Elsewhere, the consequence of an event (e.g. slow implementation of reforms, projects, or studies) is cited as a risk and not the causal factors or assumptions. Also treated as risks are elements defined by the Bank as "knowns," such as the government's limited institutional and/or fiscal capacity.[73]

2.22 Despite a succession of economic reforms, Panama still features the same duality as at the start of the 1990s (see discussions in chapters I and V). However, the Bank's programming papers do not reflect the core assumption around which it structured all its activity throughout the period examined here: that this duality is the result of a strong State presence in the economy, the adoption of distorting policies—such as price controls, labor legislation, and tariff protection—and inadequate social policy targeting. Nor do the papers explore the possibility that this situation might be attributable more to structural causes inherent in Panama's unique features and comparative advantages—a scenario that would call for a set of actions different from the ones hitherto pursued.

B. Programming coherence

2.23 The question in looking at coherence of Bank programming is whether the program made use of the Bank's entire toolkit and whether it coordinated its activities with those of other agents. Overall, the program has sought to bring the full menu of Bank products to bear: it has worked with investment projects and sector loans and has made use of, and coordinated with, technical cooperation operations (TCs) and Multilateral Investment Fund (MIF) grants. A case in point is the public enterprise reform plan, which started out with sector projects, received TC support, and was executed by way of investment projects. In the health sphere, TCs financed a number of health sector studies. Generally speaking the CSs attempt to show the interface between the TCs, economic and sector studies, and projects being proposed for the country.

2.24 As noted earlier, the programming emphasizes the importance of unlocking the potential of the assets (Canal and Interoceanic Region) that were to revert to Panama at the end of the 1990s. In support of that objective the Bank approved a reimbursable TC (PN-0066 for US$7.6 million) to produce studies on possibilities for utilizing Interoceanic Region resources, and two projects with the MIF (totaling just over US$1.6 million). But the findings of these studies were not incorporated into the programming papers.

2.25 In keeping with the importance the Bank ascribes to the private sector and market mechanisms for Panama's development, it has deployed the financial products it has available for that sector. The Bank also crafted a strategy to support private sector development, mapping out an ambitious IDB group action plan for the country that included institutional support for public utility privatizations and concessions, support for regulation and strengthening of the anti-trust system, capital market development, support for development of microenterprise and small and medium-sized businesses, human resources development, and fostering of private investment. Though this strategy called for substantial involvement of the Private Sector Department (PRI) and the Inter-American Investment Corporation (IIC), the MIF was the instrument most used to further Panama's private sector. Despite the PRI's efforts, it has developed only one operation; the IIC approved four loans after the strategy was prepared in 1997, two of them in areas marked out therein—one to finance small and mid-sized enterprises, the other for the electricity sector.

2.26 Another facet of programming coherency is the tie-in between the Bank's operations program and those of leading multilateral and bilateral donors. In large measure the first CS inscribes the Bank's activities within the frame of the envisaged economic sector operation with the World Bank. The second CS describes other agencies' aid activities but the reader cannot ascertain whether or not there was a clearly articulated division of work in advance. Not until the third programming cycle (1997-1999) does the programming paper present a clear strategy consolidated with other lending agencies' work. The CS for 2001-2003 does not discuss other donors' activities in the body of the document, listing them only in the Bank's summary strategy matrix in Annex II.

III. THE BANK'S ACTIVITY IN PANAMA

3.1 This chapter assesses how closely the Bank's activity in Panama matched its stated programming objectives and how efficiently the Bank prepared and delivered the products agreed upon with the country.[74]

3.2 Between 1961 and 2003 the Bank approved 93 projects for Panama, for a total of about US$3.6 billion in constant 2003 terms[75] (see Figure A-3.1). This was approximately 3.7% of total project approvals for the borrowing member countries overall during that period, and 1.9% of approved lending.[76]

3.3 The Bank is a relatively small player in Panama: disbursements from its projects have averaged just under 3% of government expenditure (not counting interest), or about 2.6% of government revenues.

A. Profile of Bank activity from 1991 to 2003

3.4 After the Bank resumed lending to Panama in 1992[77] it approved one or more loans every year, for a total of 34 operations totaling US$1.4 billion in current terms (US$1.7 billion in constant 2003 values).[78] This is roughly 37% of total projects and 46% of total lending approved for Panama since the Bank's inception. These figures are historical highs in terms of number of loans and amounts approved, and also for average project size. The majority (25) of the projects were investment loans; four were sector operations, four were reimbursable technical-cooperation operations, and one was a Private Sector Department (PRI) project.[79] The Inter-American Investment Corporation (IIC) has approved a total of US$30 million for Panama since 1993, for six projects. Table A-3.1 provides basic information on Panama project approvals between 1991 and 2003.[80]

3.5 Over this same span the Bank approved US$36.2 million in nonreimbursable funding under 90 TCs totaling about US$19 million and 20 MIF operations for US$17.1 million.

3.6 Owing to a combination of a more favorable economic climate and closer affinity as to objectives, the Bank's activity was significantly higher during the Endara and Pérez Balladares administrations—particularly the latter, when about 60% of lending by volume and 50% of projects were approved—than during the Moscoso administration, in terms of total and annual approval volumes as well as average project size (see Figure A-3.2 and Table A-3.2). Because of the time it takes to prepare and approve projects and the governments' interest in seeing the operations they are promoting approved before their term in office is up, there is an observed tendency for approvals to be bunched toward the end of each administration. Thus, approximately 60% of the Bank's funding by volume during the Endara administration and 60% of the projects were approved in 1993, and 6 of the 17 project approvals and 40% of lending approved during the Pérez Balladares administration came in 1998.

3.7 As discussed above, the objective of supporting economic reforms was the prime focus of the Bank's activity in Panama. Its support was structured around the four sector projects approved between 1992 and 1997, most notably the Public Enterprise Reform Program approved in 1992[81] and the Basic Infrastructure Sector Reform Program approved in 1996.[82] A number of investment projects were directly or indirectly related to those operations' core objectives: total or partial privatization of various public utilities (telecommunications, ports, electricity, and water and sanitation), and the creation of legal, institutional, and regulatory frameworks to encourage private sector participation in those sectors (see Box A-3.1).[83]

3.8 Complementing those reforms were others launched in the latter half of the 1990s focusing on State modernization, institution-strengthening, and management capacity improvements. These, too, came in for Bank financial support, this time by way of investment loans that addressed various areas in the three branches of government.[84] In that respect one can say that the Bank's activities adhered closely to the programming emphasis discussed in the previous chapter and corroborate the findings presented there regarding the high level of consistency and coherence in Bank programming.

3.9 It is important to remember that at the start of the period examined here the Bank had a significant number (17) of operations in its Panama portfolio that had been halted owing to the country's suspension of payments to multilateral organizations starting in the late 1980s. Nine of those projects, totaling about US$79 million, were reactivated between 1992 and 1995. With the new projects that had been prepared and approved in the years following the normalization of payments the Bank's Panama portfolio soared, between 1992 and 1999, from 5 to 25 projects and from US$66 million to US$412 million (Figure A-3.3).[85] [86]

3.10 A look at the makeup and performance of the new projects in the portfolio—i.e., not counting reactivated operations—shows a steady increase over the course of the evaluation period in the number of projects in support of the economic reform and competitiveness objective. These account for roughly half the operations in the portfolio (Figures A-3.4 and A-3.5). Significantly, the share of human development and poverty reduction projects has been slipping since 1997, suggesting that the intent to emphasize that objective has not been reflected in any increase in their portfolio share. Furthermore, throughout the entire period there were only three projects each for the sustainable growth and governance objectives. Taken together, these two areas account for barely 30% of the number of portfolio projects.[87]

B. Implementation and project preparation times

3.11 By and large, efficiency indicators for investment projects approved for Panama are good: (a) disbursement patterns are relatively satisfactory; in general it takes about five years to complete a project in Panama (average and median annual disbursement rates for all investment projects during the review period are an estimated 22.1% and 20.1%, respectively); (b) average and median implementation times—from eligibility to final disbursement—for closed investment projects are slightly shorter than for relevant comparator groups (Figure A-3.8);[88] and (c) between 1998 and 2003, the years for which information is available, disbursement efficiency improved in Panama and worsened for the Bank as a whole. By the end of the period, then, the two performance figures were similar (Figures A-3.9 to A-3.12).[89]

3.12 OVE also estimated the disbursement pattern for investment projects clustered by strategy objective (see Figure A-3.13 and Table A-3.3).[90] Its findings suggest that projects supporting the sustainable growth and human development objectives are the ones with the worst disbursement patterns, their average and median disbursement rates consistently underperforming the project universe. Projects in support of the governance and economic reform objectives perform the best. The evaluation team observed an inverse relation between preparation and implementation times. Projects pursuing objectives that typically take longer to define and, hence, to approve—namely, economic reform and governance projects—are the ones that ultimately present the best implementation patterns. The opposite occurs with the other two objectives—human development and sustainable growth (Figure A-3.14). The data at hand suggest that longer preparation times have yielded gains in implementation efficiency.

3.13 One important consideration in operations with Panama is that the Office of the Comptroller General's authorization is required for approval of contracts, agreements, and payments exceeding US$10,000. This has a direct impact on the pace of project implementation. An interesting case in this regard is the good experience and best practices observed in PN-0022 (Road Rehabilitation and Administration, approved in 1993) in which the government instituted, in 1995, an ad hoc budget execution mechanism whereby the Comptroller's Office facilitated the ex ante review process, which expedited project contracting and payments.

3.14 Another notable feature of the Panama portfolio was the sizable percentage of funds canceled in three of the four sector projects:[91] 28% in the Public Enterprise Reform Program (PN-0018), 20% in the Basic Infrastructure Sector Reform Program

(PN-0097), and 46% in the Financial Sector Program (PN-0056). The latter operation is noteworthy also because six years after approval it is only 50% disbursed, after the canceled funds are subtracted. These numbers suggest a lack of political capacity or will to implement part of the agreed reforms and an inability to deliver all these projects' objectives (see also chapter V).

3.15 Administrative costs are another facet of implementation efficiency in Bank projects. If these costs are too high there is less funding available for the project activities per se. On average, administrative costs of investment projects in Panama take up close to 7% of a project's resources,[92] but this average masks a huge variation: the administrative cost share actually ranges from 1% to 27%. In 6 of the 17 projects examined the administrative costs topped 10%; in one of them (PN-0144) such costs represented over 15% of the total project cost and in another (PN-0134) over 27%. The percentage is high in this latter project owing to coordination costs in each component of a relatively small project (US$3.3 million). Though the evaluation team found a negative correlation between project size and percentage share of administrative costs (suggesting the existence of fixed costs and economies of scale), none of the projects except PN-0134 with administrative costs topping 10% are small operations: four are for over US$15 million and PN-0144 is for US$8.5 million. Administrative costs for projects supporting the economic reform and competitiveness objective typically were lower than the general average and than operations pursuing the human development and sustainable growth objectives.[93]

3.16 Over the course of the 1990s the volatility of Bank disbursements in Panama, both in absolute terms and relative to government revenue performance, diminished significantly (Table A-3.4).[94] Thus, late-1990s volatility data for Panama were below the average observed in comparator groups. The high relative volatility observed in the early part of the decade could be explained at least in part by the economic instability of a country that was coming out of a suspension of payments to multilateral organizations and the worst economic crisis in its history. Likewise noteworthy is the countercyclical performance of Bank disbursements throughout the 1991-2002 period (see also Figures A-3.15 to A-3.17).

IV. QUALITATIVE ASPECTS OF THE COUNTRY PROGRAM

4.1 This chapter discusses some qualitative elements of the Bank's program with Panama. Information provided here complements the analysis presented in the two preceding chapters.

4.2 OVE reviewed investment projects approved during the period covered by the evaluation, looking at different facets of the operations' design and execution.[95] The next section of this chapter is a general discussion of the analysis findings. The following section looks at results of the use of the Bank's monitoring and evaluation tools.

A. Project design

4.3 Generally speaking, the projects analyzed have well-developed diagnostic assessments, clearly spell out their objectives, and have a consistent internal logic, i.e., their subcomponents and activities fit their objectives.[96] Typically, however, the projects present a limited analysis of the conditions needed to achieve those objectives.[97] The evaluation team observed serious limitations regarding the presentation of risks and mitigating measures.[98] Also noted were implementation problems which the Country Office portfolio review reports ascribe to the lack of adequate and/or timely institutional analysis at the project preparation stage.

4.4 Another frequently observed limitation in project design is the inadequate definition of development target indicators and benchmarks with which to systematically monitor a project's progress, to eventually be able to evaluate whether it is firmly on track toward the proposed targets. In most cases outcome indicators are inadequately defined, if they are provided at all. One very common finding was a lack of baselines for such indicators, even in the more recent projects. A noteworthy exception is the PPP Integration Corridor Improvement Program (PN-0159, 1468/OC-PN, approved in 2003), which sets out precise outcome indicators and targets. The origin of many of the targets (from projections run) is explained in the body of the document.

4.5 Though over 80% of the approved projects did include in their design the construction of monitoring and evaluation systems, many of them do not specify the mechanisms via which the systems are to be implemented. Nor do projects specify, in general, the data sources for monitoring and supervision indicators or the information gathering methodology. One exception are the transportation projects, which have designed good, clear output and outcome monitoring tools.[99]

4.6 The evaluation team also observed that projects supporting the economic reform and governance objectives come out better than operations that support the human development and sustainable development objectives in terms of diagnostic analysis, definition of objectives, and internal logic structuring.[100] These findings are consistent with the discussion in the previous chapter regarding superior implementation patterns in the first type of operations, and could explain at least in part why those projects take longer to prepare (see paragraph 3.12).

4.7 Twenty-four projects in the portfolio were examined more closely to look at their evaluability ex ante (i.e., at the design level) and during implementation.[101] OVE's findings were similar to what it has observed in other countries. The overall ex ante evaluability index for Panama is 45%, which drops to 38% when only information on development (outcome) indicators is considered. The data likewise suggest that no major changes occur in the course of a project's implementation as far as output evaluability is concerned. Data in the Bank's monitoring and evaluation systems suggest that outcome evaluability does improve during implementation (the index climbs considerably, from 38% to 49%). This would indicate a growing concern over time to try to ascertain the impact of Bank operations in Panama.[102] A final item of note is that when the evaluation team differentiated projects by their development objectives it observed no major differences in project evaluability.

B. Implementation, monitoring, and supervision

4.8 This section presents OVE's findings from its compilation of the use and results of the Bank's monitoring and supervision tools. Table A-4.1 summarizes compliance with various of the Bank's supervision policy requirements, most of which the Region satisfied.

4.9 Thirty-two of the 34 projects approved during the period examined here were active in or after 1998, the year in which the Bank instituted its Project Alert Identification System (PAIS). The system classified 12 of the 32 projects (37.5%) as on "alert" status; 8 of these (75%) kept that rating for two years or longer (Table A-4.2). The most common reasons for the "alert" rating were slow annual disbursement,[103] unsatisfactory implementation progress according to the respective Project Performance Monitoring Reports (PPMRs), lengthy extensions,[104] and slow initial disbursement.[105] Half the projects supporting the human development objective have been on "alert" status. Though the number of "alert" projects in 1999-2002 ranged from three to six, in terms of funding amounts, the percentage share of the portfolio on "alert" status more than doubled over that period (from 17% to 35%), then fell back to 25% in 2003.

4.10 Four operations were classified as "problem projects" during this period, i.e., projects that were unlikely to achieve the development objectives for which they had been approved (Table A-4.3). Several cases stand out: (a) the Housing Program operation was on "alert" status in 1999, classed as a problem project in 2000 and 2001, and put back on alert status the following two years;[106] (b) the project to support IDAAN's restructuring was directly classified as a problem project in 1999 and kept that rating for three years, until 2001, then was moved to alert status in 2002 and 2003;[107] and (c) the Financial Sector Program was classed as a problem project in 1999 and changed to alert status from 2000 to 2002.[108] In light of these data the potential anticipated outcomes of those projects may well have been definitively compromised (see also the next chapter). Fortunately the operations classed as problem projects have represented a small (less than 10%) and diminishing share of the portfolio.

4.11 Technical and financial inspection visits are a core element of the supervision function of the Country Offices (COF). Between 1998 and 2003, taking approval date as a reference point, the Panama Country Office performed approximately

66% of the required minimum number of technical visits and 42% of financial visits.[109] [110] However, the fact that the COF made more than one technical and/or financial visit annually to problem projects and those on "alert" status indicates that it has used technical and financial inspection visits to monitor these particular projects more closely.

4.12 External financial audits (EFAs) are another important Bank supervision tool. In the case of Panama, 100% of the required EFAs were conducted.[111] In 27% of the cases the auditors presented a qualified opinion; these represented approximately 32% of funding approved for projects in the portfolio between 1998 and 2003, or 41% of resources already disbursed on those loans (see Table A-4.4). Some noteworthy items in this regard are the sharp decline in these percentages between 1998 and 2002, and the presence of projects PN-0082 (Housing Program) and PN-0032 (Agricultural Modernization Program) every year and of PN-0069 (Education Program) in five of the six years. The data available show problems in monitoring of projects that had received a qualified opinion in 1998 and 1999: in 1998, six of the nine projects which received that form of opinion did not undergo the required annual financial inspection; the same occurred in 1999 in four of the six projects that earned a qualified opinion. However, more financial inspection visits were conducted of projects that had received frequent qualified EFAs.

V. DEVELOPMENT OUTCOMES AND THE BANK'S PROGRAM

5.1 This chapter describes the main development outcomes observed in Panama in spheres relating to the program the Bank funded and delivered in the country from 1991 to 2003. In a nutshell, the question the chapter seeks to answer is this: what were the development outcomes in areas supported by the Bank's country program over the past decade? Accordingly, the chapter does not offer a project-by-project analysis of Bank approvals during that period or present or discuss outputs generated by Bank activities in Panama.

5.2 It is useful to clarify one important aspect for the following discussion of outcomes: since the successive CSs' inadequate definition of development objectives and the absence of baselines, indicators and/or targets relating to expected project outcomes make it difficult to identify the marginal contribution of operations approved by the Bank, the intent here is not to draw any direct causal link between Bank operations and the development outcomes obtained, but rather to analyze how the Bank's program interacted with events in the country between 1991 and 2003 and, from that, extract lessons that could help improve Bank-country interaction.

5.3 The following sections discuss the outcomes observed in respect of each of the four objectives that link the programming cycles in the period evaluated here: economic reform and competitiveness, governance, sustainable growth, and human development.

A. Economic reform and competitiveness

5.4 As was noted earlier, the aim of the reforms implemented in Panama was to create a more open, competitive economy and a smaller, financially solid State, the ultimate goal being macroeconomic stability and sustainable growth, building an enabling environment for private sector investment and employment.[112] The objective of fostering economic reforms and competitiveness was the prime focus of the Bank's program throughout the period.[113] The Bank acted on two main fronts. First, it delivered support for the reform process, in concert with other multilateral lending institutions, largely in the form of sector loans. Its three specific focuses were: (i) creation of sound regulatory frameworks and privatization of public enterprises (approximately US$253 million in approvals between 1992 and 1996); (ii) normalization of Panama's relations with external creditors to whom payments had been suspended (US$30 million approved in 1995); and (iii) financial and State reform (US$130 million approved in 1997).[114]

5.5 Second, the Bank assisted Panama in its efforts to improve competitiveness and spur private-investment-driven economic growth, also by way of investment loans for transportation, energy, science and technology, and tourism projects, among others, with a total of US$579 million in approvals between 1993 and 2003.

1. Public enterprise reform[115]

5.6 Panama has privatized more sectors that were previously part of the State apparatus than any other Central American country. Today, ten years into the reforms, the nation's telecommunications utilities and ports have been privatized with Bank support, as have virtually all electric utilities.[116] Panama has yet to privatize its water and sanitation sector despite the intentions of the government at the time (and the Bank) to see those utilities transferred to private hands.

5.7 The evaluation team looked at the impact of this ambitious move to overhaul public enterprises, in which the Bank was actively engaged, from two standpoints: at the sector level—illustrated with a description of two emblematic cases, the energy sector, where the reform policy was successful, and the water and sanitation sector where privatization plans did not materialize[117]—and at the macroeconomic level, i.e., the overall impact of the reform package.

5.8 In the energy sector the Bank has acted directly, not just through its sector loans but also with an investment loan (for a project still in progress at this writing) and a private sector loan.[118] [119] Overall, the electric sector reform, which succeeded in creating eight enterprises operating under private commercial law and privatizing seven of them (four generating utilities, three distribution and marketing utilities),[120] appears to have benefited the country in various respects and significantly improved the state of its power sector relative to its neighbors: there was a sizable increase in electricity supply as well as a considerable increase in the sector's reserve margin and a positive impact on tariff reduction. These gains notwithstanding, some other aspects need to be mentioned: (a) the pace of coverage expansion has been similar to the pre-privatization period; (b) rural coverage figures are still lower than desirable; (c) generating losses have yet to come down to acceptable levels, even though this concern was one of the factors driving the privatization process; and (d) thermal power generation is up considerably, heightening dependence on (imported) oil-based fuels and creating more polluting emissions. (For a more detailed discussion of energy sector reform outcomes see Box A-5.2.)

5.9 The Bank's interventions in the water and sanitation sector did not achieve their objective. Conditionalities attached at the outset for the two sector loans the Bank approved for public enterprise reform (PN-0018 and PN-0097) were intended, inter alia, to privatize that sector.[121] [122] In 1997 the Bank also approved a US$45 million investment loan for IDAAN's restructuring (PN-0030, 1029/OC-PN) to assist with actions and studies for the sector's reorganization and the private investments envisaged in the sector programs. However, confirming the political platform of its election campaign, the Moscoso administration decided not to privatize the sector. The result in both cases was a failure to fulfill the Bank's requirements followed by cancellation of disbursements for that sector in the case of the sector loans, and restructuring and cancellation of about 75% of the original IDAAN project funding after that operation was "stopped" for two and a half years, with the ensuing costs to the country. Thus, no outcome in terms of coverage expansion or service improvements can be attributed to the Bank.

5.10 As for the privatization exercise's macroeconomic impact, the evaluation team's observations were as follows (see Table 5.1):[123] [124] (a) the anticipated public sector downsizing did not happen. On the contrary, the ratio of nonfinancial public sector spending to GDP is higher now than before the reforms, as is the total civil service roll;[125] and (b) the reforms did not have the anticipated impact on economic growth, employment, or private investment, nor did they translate into competitiveness improvements for Panama (on this last issue see the subsection on competitiveness below).[126] [127]

2. External debt restructuring

5.11 During the period of economic reforms discussed in this section the Bank approved a sector loan in 1995 to finance a program to reduce Panama's external debt stock and debt service (the Debt and Debt-Service Restructuring Program, or DDSR).[128] This loan was part of a tripartite IDB-IMF-World Bank operation to cofinance the purchase of collateral instruments as part of the agreement on renegotiation of Panama's sovereign debt to international commercial banks. The operation had three core objectives: fully normalize Panama's relations with its external creditors, alleviate the burden of the external debt on the balance of payments, and lower Panama's risk premium in the international capital markets.[129]

5.12 The DDSR reinstated Panama's access to the international markets, whereupon its exchange and interest rate risks dropped. In the medium term, however, the DDSR ended up being an expensive option for the country, in addition to making future debt management less flexible.[130] In that sense, the hoped-for alleviation of the debt and debt service burden on the balance of payments did not materialize, and the situation shows no signs of improving in the coming years (see Table A-5.2).[131] [132] Panama's sovereign and private debt rating improved in 1996-1997. According to Moody's the country's rating remained unchanged from 1997 to 2003; Standard & Poors downgraded it between 1997 and 2001 (from BB+ to BB), and held it at that level until 2003, but with a downward trend.

5.13 Since Panama has been, and still is, an economy with heavy external debt, particularly compared to the Latin American average, OVE ran a country debt sustainability analysis (see Box A-5.3).[133] Its general finding is that the ratios of net present value debt stock to GDP and to government revenues are still acceptable, albeit approaching the sustainability limit; the debt stock-to-exports ratio is more comfortable. But debt service relative to government revenues has gone beyond sustainability limits; relative to exports it is nearing that point.

3. Financial reform

5.14 Another objective pursued by the Bank in the sector loans it approved for Panama was financial reform on two fronts: public sector and banking sector, through adoption of a new bank regulation and supervision framework.[134]

5.15 Privatizing public enterprises, reducing the external debt burden, and overhauling social security and government banks all had a common purpose: strengthen the public finances. But current outcomes are far from what the Bank and the country hoped when this package of operations was approved: primary saving of the nonfinancial public sector fell from 4.3% of GDP to 2.6% between 1993-1995 and 2001-2003 and the state of the Social Security Fund's Disability, Old Age and Survivor benefit program (IVM) has worsened in recent years, destabilizing the Fund (unless the current IVM parameters change, the system's finances will ultimately collapse) and the public finances generally (see Table A-5.2 and Box A-5.4).[135]

5.16 The financial system managed to adapt satisfactorily to the new tighter bank regulation and supervision environment, through bank consolidations and consequent improvements in capital strength and liquidity ratios of financial institutions that adjusted to the new ground rules. The result was a shrinkage in total asset volumes and a diminished international profile for Panamanian banks.

4. Competitiveness

5.17 The aim of the IDB-backed economic reforms was to make Panama's economy more competitive and diversify its export base by opening up the economy and liberalizing trade. Exposing protected sectors to international competition was expected to lower absolute prices and adjust relative prices (see also Box A-5.5).

5.18 However, post-reform external trade data do not point to any pattern of competitiveness improvements:[136] (a) Panama's exports are increasingly dependent on U.S. demand, suggesting a limited capacity to diversify consumer markets; (b) the country's export trade is still heavily concentrated in a handful of traditional commodities; the relative share of nontraditional and higher value added products has fallen sharply, which would indicate a limited capacity to diversify the menu of exportables; (c) Panama has succeeded in establishing more sophisticated trading relations (i.e., with product differentiation and industrial complementarity) only with the Central American Common Market countries, whose economies tend to be less developed; and (d) the structure of Panama's trade with its principal commercial markets—the United States and the European Union—is still North-South, with little industrial complementarity.[137]

5.19 There has been no significant diversification of Panama's export sector: merchandise exports increased only 20% in 1991-2003 while services exports rose 110%.[138] But even in the service industries the trend is somewhat at odds with the diversification goal: the increase in service exports via the CFZ, the Canal, and the banking industry was approximately 20% higher than for other service sector exports. These results would not be entirely surprising if one posits the presence of some degree of "Dutch disease" and given the absence of a nontraditional-export development policy.

5.20 The Bank has assisted Panama in its efforts to become more competitive by delivering support for such specific areas as energy, transportation, science and technology, and tourism. In the transportation sector,[139] according to the available evidence, road rehabilitation and improvement outcomes have reduced vehicle operating costs,[140] though the objective of routine road system maintenance was not fully achieved.[141] The fact that project PN-0117 included the same objectives of strengthening Public Works Ministry capacity and extending coverage of routine road maintenance points up these limitations.

5.21 In the agriculture sector, the last decade saw a decline in physical productivity for Panama's leading agricultural commodities. An important recent development as far as expanding production is concerned is the emergence of two new crops—cantaloupe and watermelon—that have been gaining prominence on the country's nontraditional agricultural export menu since the mid-1990s. The Bank supported moves to improve agriculture sector competitiveness through its Agricultural Modernization Program,[142] but none of the quantitative targets in that project's main component were attained[143] nor were those referring to private agents' delivery of technology transfer services.

5.22 In the last five years the Bank approved three projects (all of them still in progress) to enhance Panama's competitiveness by developing in-country science and technology and technological innovation capacity.[144] Project PN-0134 which provides support for the "City of Knowledge" established 89 companies, institutions, and programs in the City of Knowledge between 1999 and 2004. These services have created over 1,300 jobs and generated some US$46 million in investment in the country. The outcomes of these ventures will need to be evaluated in the coming years.

5.23 Panama's tourism industry has experienced strong growth in recent years: according to annual counts, international tourist arrivals have increased approximately 60% in this decade. The Bank approved only one technical-cooperation loan directly pertaining to this area, to help the Panamanian Tourist Board (IPAT) develop tourism in the country.[145]

B. Governance

5.24 Midway through the 1990s Panama launched a series of reforms complementing the ones discussed in the previous section, focusing on State modernization, institution-strengthening, and management capacity improvements. These efforts were particularly important given the need to rebuild institutions in a country emerging from a dictatorship and which had suffered the consequences of a foreign invasion. The Bank's support for creation of a Treasury Department and Public Debt Directorate was important at that juncture.

5.25 The Program to Strengthen Economic and Fiscal Management[146] sought also to improve tax revenue collection, a critical issue in heavily indebted Panama which has one of Latin America's lowest tax burdens.[147] Nevertheless, tax revenue intake as a percentage of GDP dropped between 1993-1995 and 2001-2003 (Table A-5.3).[148]

5.26 This project also helped create the Integrated Financial Management System (SIAFPA). Despite some gains, the proposed objective of bolstering central government management capacity was not achieved.[149] [150] That outcome was corroborated by a recently-commissioned Bank study which found that the SIAFPA is still above all a record of budget execution, hence, it is not yet ready for use as a management tool.[151] Box A-5.6 presents a brief discussion on the judicial branch.

C. Sustainable growth

5.27 Except for PN-0066 (778/OC-PN, reimbursable TC, Studies of the Interoceanic Region, approved in 1993 for US$8.4 million), all the projects that supported the environmental protection and sustainable growth objective were approved in 1999 and thereafter and thus are still in progress. Consequently, it is too early to attempt an impact assessment. However, a few items warrant special mention.[152]

5.28 The Bank-backed creation of an autonomous government agency in charge of Panama's environmental sector (the National Environmental Authority, ANAM) prepared the way for charting of a national environmental strategy and a new institutional base for the sector.[153] Since ANAM's inception there has been an increase in acreage of protected areas or national parks as a percentage of Panamanian territory. However, this agency's financial sustainability is an issue since project PN-1022 is funding a sizable share of its budget.

5.29 The IDB's main rural environmental venture in Panama during the period reviewed here was the Darién Sustainable Development Program (PN-0116) approved in late 1998.[154] As one inroad into rural poverty this operation brought water to more than 2,600 families via small rural water supply systems as well as electricity to 545 project area households.

D. Human development and poverty reduction

5.30 For the Bank and two successive Panamanian administrations in the 1990s the country's high poverty rate and severe inequality were attributable to inadequate social policy targeting, inefficient operation of State enterprises and, above all, the protectionist economic policies hitherto in place.[155] However, the information available suggests that, after a decade of reforms, *the effects of structural adjustment that could be attributed largely to trade liberalization worsened inequality*.[156]

5.31 Job creation was an intrinsic piece—along with better targeted social sector investments—of poverty and inequality reduction policies in Panama.[157] Regrettably, the economy's rapid growth particularly in the early 1990s had a modest impact, at best, on unemployment and job creation (Figure A-5.2). There was scant improvement in unemployment rates even in years of robust growth and little or negative flow toward the workforce.[158] Furthermore, considering that 70% of the small number of jobs that were created in the 1990s called for secondary and post-secondary school graduates in the more modern sectors of the economy, from an employment standpoint the economic growth observed over that period worked against poor households, especially because their chief productive asset is their own labor.[159] But this pattern has been shifting since 2000: economic growth has cooled but there is relatively stronger growth in employment of the less skilled labor pool (see Figure A-5.3).[160]

5.32 The changes in income distribution over this interval, though marginal, back up these observations: between 1991 and 2000 per capita household income inequality in Panama, measured by the Gini coefficient, trended slightly upward, returning in the first years of the new millennium to levels close to the initial ones (Figure A-5.4).[161]

5.33 As for the poverty effect of growth, the economic expansion over the period brought the total poverty rate down from 47% in 1991 to 34% in 2003. There were improvements as well in the percentage of households with per capita income lower than the price of the basic food basket (i.e. extremely poor households), which fell from 28% to 17% over that span. At first glance this suggests a substantial decline in the poverty rate, but if one considers the robust growth figures over that interval, the reduction is far behind expectations: growth-poverty elasticity in Panama between 1991 and 2003 is under 0.26 both for total poverty and extreme poverty—significantly below ECLAC's estimate of 1.6 for Latin America.[162] [163]

5.34 According to a breakdown of the change in poverty by growth effect and inequality effect (Figures A-5.5 and A-5.6) the small decline in poverty in the 1990s can be attributed essentially to economic growth, notably the strong recovery in the first half of that decade, whereas the reduction since 2000 can be ascribed to a modest improvement in income distribution (see also Box A-5.7 for a discussion of poverty and the rural sector).[164]

5.35 Heavy social spending in the 1990s was poorly targeted and inefficient in the sense that virtually all the outlays were for current expenditures and failed to reach the country's poorest.[165] The Bank structured its social-sector investment projects around that diagnostic.[166] There were two broad opposing trends in aggregate social spending as a percentage of GDP throughout the 1990s: an uptrend from 1991 to 1995 followed by a downtrend between 1996 and 1999 (Figure A-5.8).[167] Nevertheless, social spending in real terms rose significantly.[168] As for the redistributional function of social spending, highly regressive social security spending and its weight in total social expenditure means that the latter presents a regressive trend that disappears when social security spending is factored out (see Figures A-5.9 to A-5.11).[169] In the health and education subsectors public spending presents a redistributional trend toward low middle income groups (less pronounced in education, Figure A-5.12).[170]

5.36 In the 1990s spending on secondary and higher education in Panama increased relatively more than primary education expenditure.[171] [172] Furthermore, the 43% of the Panamanian student population who are poor come in for just 28% of total education spending.[173] This would indicate that the goal of sharpening education spending targeting has not been achieved. The Bank-funded education project seeks to assist the government in education sector reform with the aim of improving operating efficiency and enhancing access to education.[174] According to the data available, a higher percentage of poor students than their non-poor peers have no textbooks, repetition rates are higher for poor children and youth, and children and young people who are poor have lower educational achievement and literacy performance.[175] However, the June 2004 PPMR for that project suggests that many of its proposed targets were attained and, where final results are still to come, the gains that have been posted are on the right track. Box A-5.8 compares the findings of the 2001 midterm review, which pointed up some structural problems in this project, and the June 2004 PPMR.

5.37 The Bank's health sector operations have made a considerable contribution. Two projects totaling US$77 million (PN-0029 and PN-0076) were approved during the period examined here.[176] Removing the CSS from project PN-0029 severely constrained achievement of the objective at the outset of the sector reform since CSS spending accounts for around 60% of overall public health spending and, because the CSS and the Ministry of Health are not well integrated, there are overlaps and inadequate use of services, creating inefficiencies.[177] Though PN-0076 is only 25% disbursed, according to the Country Office's August 2003 portfolio review report the project *has already achieved 75% of one of the key targets in the sector's institutional reform: extension of primary health care coverage to 310,000 people (of the 450,000 planned by the end of year 3) who did not have access to the system and are living below the poverty line* (p. 18 of the Spanish text). But this assertion contradicts the preliminary midterm review report, which finds *no evidence of development of a unifying focus to enable attainment of all the outcomes of the three components and which would help with the institutional reform that is this program's ultimate goal. At this writing there is no decentralization plan envisaged as the linchpin for all the activities intended to revamp the sector's institutions* (p. 24 of the Spanish report).

5.38 The Bank also approved two social investment projects during the period: PN-0054 and PN-0111, for a total of approximately US$79 million, US$14.5 million of which was later canceled.[178] According to the PCR for PN-0054 (p. XX of the Spanish text): *the conclusion is that according to this new poverty characterization methodology barely 55% of the funded projects benefited the country's poorest.* Regarding the heavy weight of the road component, the report goes on to say that *the project built some roads whose users are not necessarily project area residents*.[179] These problems notwithstanding, in its recently completed ex post evaluation of PN-0054 OVE notes a 3% to 5% reduction in total poverty rates in the project areas relative to non-project areas with similar characteristics.[180] However, targeting may continue to be a problem in PN-0111.[181] According to a sample of resource execution for projects between 2001 and 2003 and per-district allocations in 2004, there is no clear positive correlation between district poverty levels and funds that the Social Investment Fund expended for works projects (Figure A-5.14).

5.39 The midterm review report on the Housing Program (PN-0082) indicates that the project has benefited more than 25,000 low-income families, thereby strongly impacting housing conditions of the most disadvantaged population groups, particularly rural dwellers.

VI. FINDINGS AND RECOMMENDATIONS

A. Findings

6.1 Overall, this evaluation found adequate levels of consistency, coherence, and efficiency in the Bank's program and activity in Panama during the 1991-2003 period. However, the findings also indicate that good process performance has not yield similar levels of effectiveness and relevance.

6.2 Specific findings with regard to consistency and coherence were as follows:

(i) The Bank's Panama country program—structured around a model that sought to develop, implement, and deepen reforms to liberalize markets and remove distortions, and diversify sources of economic growth—comes directly out of the diagnostic that attributes Panama's duality primarily to a strong State presence in the economy, adoption of distorting policies such as price controls, labor legislation, and tariff protection, and inadequately targeted social policies.

(ii) The objective of supporting economic reforms was a priority programming intent throughout the entire period reviewed, and meshed closely with the vision of the Panamanian administrations of the 1991-1999 period. Consistently, the Bank upheld its programmatic approach and model during the Moscoso administration despite its more protectionist vision of the economy.

(iii) There was also consistency between the programmatic intent and the program on the ground: 69% of approved lending and 44% of projects approved during the period evaluated here supported the economic reform objective and competitiveness objective.

(iv) The Bank used its entire toolkit to in its work in Panama. In particular, in keeping with the importance it ascribed to the private sector for Panama's advancement, the Bank attempted to use the financial products it had available for that sector and crafted a private sector development strategy.

(v) The programming consistency and coherence is clearly evident in the economic reform objective of the first half of the 1990s, which was furthered by four sector loans and various investment projects directly or indirectly related to those operations' objectives. The Bank's financial support for reforms launched in the latter half of that decade, complementing the preceding reforms, took the form of investment loans only.[182]

6.3 This evaluation found the Bank's program with Panama to have good efficiency indicators, albeit at times at the expense of very high administrative costs:

(i) Disbursement patterns and average and median implementation times are better than those observed in relevant comparator groups.

(ii) According to the data at hand, longer preparation times correlate with better implementation patterns, suggesting in turn that more careful preparation has yield gains in implementation efficiency.[183]

(iii) There was a significant reduction in volatility of Bank disbursements in Panama in the 1990s in both absolute terms and relative to government revenue performance. The Bank's disbursements behaved countercyclically throughout the entire 1991-2002 span.

(iv) Administrative expenses of investment projects in Panama account, on average, for close to 7% of a project's cost. However, this average masks a huge variation: the administrative cost share actually ranges from 1% to 27% of total project cost. Administrative costs surpassed 10% in 6 of the 17 projects examined.

6.4 The expectation was that liberalization and economic reforms in Panama—a Bank priority both as a goal and on the ground (and a priority for the country up until 1999)—would give the country "*a stronger and more efficient economy with fewer price distortions ... [which ultimately will] boost the competitiveness of Panama's economy and will have the desirable consequences of creating additional jobs and reducing poverty"*.[184] But overall, to judge from the outcomes, the reforms have not been very effective in achieving those goals:

(i) The state of the country's public finances is worrisome. The anticipated public sector downsizing has not materialized. Indeed, the ratio of nonfinancial public sector expenditure to GDP and the total civil service roll are larger now than before the reforms, despite the reductions observed in public enterprises.[185]

(ii) The debt and debt service burden on the balance of payments has not been alleviated and there are no signs of improvement in the coming years. Panama's ratios of net present value debt stock to GDP and to government revenues are still acceptable (though approaching the sustainability limit); the debt-to-exports ratio is more comfortable. Debt service vis-à-vis government revenues, for its part, has passed the limit that would ensure its sustainability, and the debt service-exports ratio is nearing the same point.

(iii) The reforms did not enhance Panama's competitiveness nor did they diversify its economic base.

(iv) There has been no improvement in Panama's severe inequality levels. There is evidence to suggest that trade liberalization may even have worsened this situation.[186]

(v) There was no significant change in the unemployment rate or in job creation. Moreover, considering that 70% of the small number of jobs created in the 1990s were in the modern sectors of the economy and demanded secondary and post-secondary graduates; in terms of employment the economic growth observed in the period reviewed here worked against poor households, particularly because their own labor is their chief productive asset.

(vi) Despite progress made toward the Millennium Development Goals of reducing extreme poverty, the inroads made against poverty have fallen far short of expectations: the growth elasticity of poverty in Panama was significantly lower than ECLAC estimates for Latin America.

6.5 The following are some highlights of positive outcomes over the course of the period examined in this report:

(i) Gains from energy and port sector reforms which, overall, have been beneficial for the country.

(ii) The reinstatement of Panama's access to international financial markets, secured by way of the debt restructuring program financed by the Bank, the World Bank, and the IMF.

(iii) Strengthening of bank regulation and supervision, which took Panama off the lists of countries classified as tax havens and helped make the sector crisis resistant.

(iv) Though these are early results, the Bank's action in the science and technology/technological innovation sphere shows this to be a promising area.

(v) Though the data available would appear to indicate no improvement in targeting education spending to the poorest children, the (still early) results in the health sphere point to improvements in primary care coverage for Panamanians living below the poverty line.

(vi) IDB-funded investments in road and highway rehabilitation and improvements have lowered vehicle operating costs.

(vii) Reductions in poverty in areas covered by the Social Investment Fund program (PN-0054).

(viii) The Bank-funded Housing Program has given over 25,000 low-income families (particularly in rural areas) access to housing.

(ix) Some inroads were made into Panama's severe rural poverty problem by the Darién Sustainable Development Program, which brought water to more than 2,600 families via small rural water supply systems and connected 545 households to the electric grid.

6.6 Though the Bank's program and activities in Panama addressed issues that were relevant for the country, programming throughout the period reflects the prevailing 1990s belief that economic reforms and better-targeted social services would be *sufficient* to trigger economic growth with equity, creating income-generating opportunities for the country's poorest. As a result, the Bank underemphasized poverty and equity issues as well as the need for mitigating measures for population groups hardest hit by the adjustment process, and/or transitional measures so that sectors which lost the most from the reforms could ready themselves for a more competitive environment. According to this evaluation's findings, these limitations, in an inequitable environment like Panama's, have reduced the relevance of the Bank's country program.

6.7 The concentration on economic reforms without additional measures to address constraints created by the possible presence of "Dutch disease" and by the intrinsic or structural features of the leading sectors of Panama's economy—limited integration with the rest of the economy, scant job creation (and the fact that most of the new jobs demanded high skilled workers), pressure on the general wage level and, except for the Canal, not much fiscal revenue generation—the reforms did not have the anticipated outcome and, indeed, they appear to have exacerbated the nation's social and economic duality.

B. Recommendations

6.8 The data analyzed by this suggest that some of the Bank-funded projects may have very high administrative costs, thus leaving less resources for project activities. The Bank should analyze the administrative costs of its operations more thoroughly and, with that information, work with the country to find ways of lowering them.[187] Specific recommendations are as follows:

(i) Evaluate the institution-strengthening components that figure in virtually every project to see how effective they are in improving government management and implementing capacity.

(ii) Review the design of project structuring and provide a detailed rationale for cases that require a more "significant" administrative structure.

(iii) Strengthen mechanisms for ex ante institutional evaluation and monitoring of implementation capacity.

(iv) Introduce mechanisms to evaluate and remunerate executing units' achievement in terms of targets and objectives.

6.9 The Bank's experience in Panama shows that good process performance is not a sufficient condition for assuring good outcomes. Panama is a particularly complex case because some sectors of its economy have very clear comparative advantages, successfully exploited for many years, but they: (a) have created a marked economic and social duality owing to structural factors or distorting policies; (b) may have triggered "Dutch disease"; and (c) are losing competitiveness. The evidence thus suggests that the reforms' benefits have not automatically spread to the rest of the economy; moreover, market mechanisms operating in the absence of other signals tend to reproduce the status quo. The lesson that can be drawn from Panama's experience is that different kinds of policies and instruments need to be combined to further the key sectors of the Panamanian economy while also fostering the less dynamic sectors, for the ultimate benefit of the population at large. The main challenge for the Bank is, therefore, to bring its economic and sector analysis work to help Panama develop such policy strategies and, given the structural characteristics of the Panamanian economy, take into careful consideration the implications of the different intervention alternatives.

6.10 Accordingly, and specifically as regards the conceptual structuring of the Bank's program, it is recommended that in addition to prioritizing its economic and sectoral analysis work the Bank should:

(i) Improve the quality of its self-evaluation through deeper critical examination of the outcomes of its activities in Panama and more clearly defined indicators, baselines, and development objectives.

(ii) Consider the issues of poverty and inequality in terms of instruments for reducing the country's duality, not just measures to mitigate its effects. A further recommendation is to analyze complementary mechanisms that can spur development of sectors that are labor-intensive and/or employ less skilled labor, with the aim of expanding opportunities for the poorest of the poor (opportunities) while developing human capital (capabilities).

(iii) Follow more closely the progress of trade liberalization and integration, mindful particularly of the potential impacts of a bilateral agreement with the United States which could substantially increase Panama's home market exposure to global competition and perhaps increase Panama's trade reliance on the U.S. market.

(iv) Thoroughly analyze the possible causal link between Panama's rigid labor market and its job creation and unemployment problems.

6.11 Recommendations for future intervention focuses of the Bank are as follows:

(i) Examine alternatives for agriculture sector support, particularly credit availability.

(ii) Promote social programs that can help develop capacity among the country's poorest, i.e., that go beyond poverty alleviation and complement opportunity-generating initiatives.

(iii) Continue treating competitiveness as a priority concern. Specifically:

a. The areas of science and technology, technological innovation, and cluster development appear to offer benefits that warrant careful Bank attention. With close monitoring and midterm reviews of active projects in those areas the Bank can extract important lessons to corroborate these findings and develop these issues more fully.

b. Explore how PRI could assist in developing public-private partnerships in Panama. The Bank should use PRI's Action Plan for C and D Countries to maximize returns on those efforts.

c. Consider alternative avenues of support for Panama's fast-growing tourism sector.

d. Thoroughly analyze the Bank's comparative advantages for supporting Panama in the likely expansion of the Canal.

Recommendations and Lessons Learned from Bank Activities and the CPE: RE2 Thoughts

Notes

[1] "*Many distortions and problems of the Panamanian economy under Torrijos (and after) could be traced to its international service platform nature. The Canal distorted Panama's wage structure and created a disadvantage for labor-intensive export promotion. In fact, most of Panama's international services were more capital intensive, paid higher salaries, and generated less employment per unit of output than the remaining sectors of the economy.*" A. Zimbalist and J. Weeks (1991), *Panama at the Crossroads. Economic Development and Political Change in the Twentieth Century,* p. 44.

[2] The term "Dutch disease" is so named because of the negative effects on the Dutch manufacturing industry of the discovery of natural gas deposits in the North Sea, fundamentally triggered by the appreciation of the real exchange rate. This phenomenon affects various countries, especially ones with abundant natural reserves or in which one sector (geared to the external market) is significantly more dynamic than the others. According to the classic model, the economy in such scenarios can be divided into three sectors: booming, lagging, and "nontradable" (nonexport). Dutch disease can create two main effects: a spending effect that ends up in an appreciation of the real exchange rate, and a resource movement effect whereby the booming sector attracts labor away from other sectors. See, for example, W. M. Corden and J. P. Neary (1982), "Booming Sector and De-Industrialization in a Small Open Economy," *Economic Journal*, 92: 825-48, and W. M. Corden (1984), "Booming Sector and Dutch Disease Economics: Survey and Consolidation," *Oxford Economic Papers*, 36: 359-80. In the specific case of Panama, profits and high wages generated in the leading sectors of the economy put upward pressure on prices. Since prices in the nontradable sector tend to rise more quickly than traded-goods prices (since those typically mirror world prices), the real exchange rate appreciates.

[3] Figure A-1.1 shows the uptrend in the nontradable/tradable price ratio observed throughout the period 1993-2002.

[4] This non-absorption of labor would characterize the booming sector of the Panamanian economy as an enclave.

[5] Nevertheless, one feature that distinguishes the structure of the Panamanian economy from others feeling the effect of Dutch disease is that Panama does not have a single key activity as is the case in the oil economies, but rather three service-based activities, with relatively low volatility dependent on the pace of the global economy.

[6] The U.S. dollar is used as local currency, denominated as the balboa. Hence, the nation earns no seigniorage from currency issuance. Though this gives Panama price stability it also means that the fiscal deficit is financed with debt (domestic or external borrowings).

[7] According to the Manufacturing Output Index industry did not improve between 1999 and 2002.

[8] The GDP calculation basis changed in 1996, so caution is needed in making intertemporal comparisons. Based on the Ministry of Economy and Finance's 2002 Economic Statistics report, the base change variation in nominal terms is US$1,002.9 million, equivalent to a 12.3% increase over the value of the previous series with base year 1982.

[9] Economic growth rates averaged 6.8% between 1990 and 1994, 4.5% in 1995-1999, and 2.4% between 2000 and 2003.

[10] According to ECLAC's 2002 Statistical Yearbook of Latin America and the Caribbean and World Bank data (World Development Indicators), Panama's per capita GDP in current U.S. dollars that year measured by purchasing power parity (PPP) was US$6,170, similar to the Dominican Republic with US$6,640 and Belize with US$6,080, but trailing Costa Rica (US$8,840) and Mexico (US$8,970). Figures for the other Central American countries are lower than Panama's.

11 The falloff in CFZ business in the 1990s has affected Panama's merchandise balance, which has been structurally negative because the economy is so service-driven. The situation worsened toward the end of the decade as it became clear that the traditionally surplus-generating Canal and IBC activities were no longer enough to finance the increasingly negative merchandise trade balance. The result was a widening of the balance of payments current account deficit. If this problem was remedied in part from 2001 onward, it was largely because the slowing economy and changes in Panama's tariff policy depressed imports.

12 Panama's tax system kept the tax burden above 11% of GDP until 1997, after which it began to edge down, now standing at 9% of GDP.

13 Tax revenues were up 6% in 2003, the first full fiscal year following the 2002 tax reform. Though it is too early to draw conclusions, one could posit that the reform's impact has been less than impressive. Corroborating that conclusion is the Torrijos administration's move to put together a new tax reform proposal. One item of note is that the 2002 reform has impacted mostly indirect taxes, especially the value added tax (ITBM).

14 The ceilings prescribed by the Fiscal Responsibility Act have been suspended until late 2006.

15 The country's high debt stock to GDP ratio came down from 74% in 1996 to 66% in 2001. The trend appears to have reversed in 2002 and 2003, as the ratio climbed anew to 70% and 68%, respectively.

16 Panama's domestic debt stock has accounted for roughly 20% of its total debt—that percentage having held relatively constant throughout the period reviewed here. But on the debt service side, the domestic debt share has increased, suggesting that the total cost of domestic debt service may be greater than the cost of servicing international loans.

17 The Panama Canal Authority, which is in charge of operating, administering, conserving and maintaining, and improving and modernizing the Canal, operates as an independent government agency with financial autonomy and its own capital.

18 This last factor also has been cited as a reason for higher IBC earnings in 2003, suggesting that the absence of regulation might have slowed, not invigorated, Panama's banking system. In any event, there is broad consensus that given current domestic and global market conditions the IBC will be hard pressed to regain its early-1980s prominence in the country's economy.

19 In the wake of the late-1980s recession and financial and banking sector crisis 23 banks pulled out of the country, whereupon the system lost two thirds of its assets. Though the sector rallied in the 1990s it never regained early-1980s activity levels.

20 In World Trade Organization discussions the developing nations are seeking an extension, beyond 2010, for the functioning of free zones that benefit those countries.

21 Data published in the statistical appendix to the 2004 UNDP report *Democracy in Latin America,* based on Latinobarómetro polls (2002).

22 As of the end of 2003, approval of the draft bill for the Local Decentralization Law had not been secured.

23 See, for example, Marianela Armijo, "Investigación Diagnóstica de la Administración Pública Panameña y Lineamientos de Acción." Procuraduría de la Administración, January 2004.

24 Data presented by Daniel Kaufmann, "Governance and Controlling Corruption is Central for Socio-Economic Development and Growth: New Reports and Evidence," presentation to the International Center for Policy Studies, Kiev, November 2000.

25 Letter dated 15 April 2002 from Norberto Delgado D., Minister of Economy and Finance, to Donald Johnston, Secretary General of the Organization for Economic Cooperation and Development.

[26] The Ngoble ethnic community is the most numerous, accounting for 59% of the indigenous population, spread over the Ngoble territory and the provinces of Bocas del Toro and Chiriquí. Members of the Kuna Yala ethnic group, making up 22% of the indigenous population, live in the territory that bears their name and in the province of Panama. The Emberá community makes up just under 8% of the total and is evenly distributed across its territory and the provinces of Panama and Darién. The other of the five ethnic groups—11% of the indigenous population—live in different parts of the indigenous territories and the provinces of Bocas del Toro, Panama, Chiriquí, Darién, and Veraguas.

[27] Panama is in the early stages of transition in age structure of the population. Its youngest (under 24) population segment is increasing barely 1% a year while the 35-and-older group is growing 3.5% (three and a half times faster). Though the 65-and-older share of the Panamanian population is similar to the Costa Rican figure—well below the LAC average—at current rates of increase that percentage could double in less than 50 years.

[28] UNDP (2002). *National Human Development Report,* p. 79.

[29] An extreme poverty rate of over 10% is still high if one compares Panama's per capita GDP with other countries in the region. Hence, in a second exercise run, the 2003 extreme poverty rate was halved for 2015. In that scenario the required annual growth rate jumped to more than 4% with no change in income distribution—25% above the historical average. This is where Panama's severe income inequality begins to constrain improvements in household welfare, since a 10% reduction in inequality would be more than sufficient to achieve the target. "*To the extent that growth is sustainable in the long-run whereas there is a natural limit to redistribution, it may reasonably be argued that an effective long-run policy of poverty reduction should rely primarily on sustained growth. According to the basic identity analyzed in this paper, however, income redistribution plays essentially two roles in poverty reduction. A permanent redistribution of income reduces poverty instantaneously through what was identified as the 'distribution effect.' But, in addition, it also contributes to a permanent increase in the elasticity of poverty reduction with respect to growth and therefore to an acceleration of poverty reduction for a given rate of economic growth.*" (François Bourguignon, *The Growth Elasticity of Poverty Reduction: Explaining Heterogeneity across Countries and Time Periods*, World Bank Working Paper No. 28104, 2003)

[30] The following questions were posed to gauge relevance, consistency, and coherence: Did the program address Panama's most serious development challenges? Are there any contradictions between the various programming cycles over time? Did the program make full use of all the Bank's instruments and coordinate its activities with those of other agents?

[31] The specific aims of country programs are set out in country strategy (CS) papers, which are the broad frames of reference for the Bank's programming with a country. Worked out by consensus between the Bank and the country authorities as to strategy aims and the lending program, they define the Bank's programming cycles for its work with member countries. Note that CSs form part of a larger programming exercise that includes other tools such as programming memoranda and programming missions and their respective reports, as well as economic and sector studies (see OP-201), which build a dynamic dimension into the process and seek to reaffirm the priorities mapped out in the CSs.

[32] Five country strategy papers were produced for Panama over the period examined in this evaluation: CP-258 setting out the Bank's strategy for 1991-1993, CP-573 for 1994-1996, CP-1136 for 1996-1998, GN-1975-1 for 1997-1999, and GN-2163-1 covering 2001-2003. As the foregoing list shows, two of the CSs overlap: CP-1136 of 19 September 1996 presents the Bank's strategy for 1996-1998 and GN-1975-1 of 28 January 1998 outlines the strategy for 1997-1999. However, the two CSs have identical programmatic objectives and a very similar operational thrust and content. Since the preceding country strategy covered the 1994-1996 programming cycle and CP-1136 was approved late in the year, the evaluation team treated that programming cycle as having started in 1997 and ended in 1999.

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33 Note also that none of the CSs explicitly deals with the year 2000, owing to difficulties the Bank encountered in working out a strategy with the Moscoso administration.

34 To answer questions regarding the program's relevance and consistency OVE examined the following programming elements: diagnostic, objectives, proposed actions, and anticipated outcomes; self-evaluation of the program; and country program assumptions and risks identified in the strategy papers. These were the key questions to assess these programming elements: Were the country's main problems or needs clearly identified? Did the programs present an analysis of these problems' causes and determinants? Do the objectives and actions proposed in the programming clearly address the country's problems and needs, and are they consonant with the government's strategy? Does the programming clearly define the outcomes sought in achieving its objectives? Do the programming papers assess outcomes achieved by the previous programming and analyze to what extent its objectives were attained? Were the conditions needed to attain the programming objectives identified and explicated? Were the risks for the Bank's program identified and explicated?

35 The World Bank shared the same diagnostic assessment: "*Structurally-induced duality, while important, should not be overstated[,] . . . duality problems should be redressed through broad reform that introduces a much more active role for private market forces and eliminates policy-induced market segmentation.*" World Bank (1995), *Panama: A Dual Economy in Transition*, p. ii.

36 The programming diagnostic assessment does not examine the consequences of economic liberalization in a scenario of consistent real exchange rate appreciations induced by the key sectors' earnings.

37 This evaluation uses the current terminology "country strategy," which takes in also the documents formerly called "programming paper" or "country paper."

38 GN-2136-1, p. 7.

39 For example, "*In light of the existence of pockets of poverty*" (GN-1975-1, p. 38); *"[would enable Panama] to reduce pockets of poverty"* (GN-2136-1, Executive Summary, p. 1). However, the second CS in the period reviewed, CP-573, refers to a problem of structural poverty.

40 CP-258, p. 25 of the Spanish text.

41 Table A-2 presents the four CSs' programmatic objectives and operational thrusts.

42 To compare the various programming cycles the evaluation team spliced the programmatic objectives of the first three cycles with the ones set out in the most recent CS (see Table A-2.2). Tables A-2.5 to A-2.8 show projects and lending programmed and approved in the four cycles and compare them to the cycle objectives and the spliced objectives. In most cases the evaluation team was able to establish with relative confidence a correspondence between the projects and the spliced objectives.

43 49% of programmed funding and 39% of programmed projects between 1991 and 2003, and 69% of approved funding and 44% of approved projects, support the economic reform objective. If sector loans are excluded, economic reform-related approvals still account for more than half of total funding and approximately 37% of number of projects. The downtrend between the first and third programming cycles depicted in Figures A-2.1 and A-2.2 was inevitable: it is difficult to imagine that the Bank's program could focus almost exclusively on a single objective as the first CS did.

44 Figures A-2.1 and A-2.2 show how each of the spliced programming objectives has evolved over the course of the four cycles in terms of share of programmed and approved funding. Figures A-2.3 to A-2.10 show programmed and approval figures by CS.

45 This finding holds even if the sector operations are factored out: 43% of programmed lending and 61% of lending approvals by volume supported the economic reform objective.

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46 The third programming cycle (1997-1999) warrants a special note. Its programmatic intent combined economic reforms (called 'sustained growth' in the programming paper) with a heavy emphasis on the environment, human capital, and governance. Approvals supporting the sustained-growth objective accounted for approximately 65% of lending by volume and 42% by number of loans (respectively 57% and 36% if finance sector operation PN-0056, approved during that cycle, is excluded). As the Bank put it, "*the bulk of the Bank's loans [in the period 1997-1999] went to support sustained growth, specifically by way of public enterprise reform (with an aggressive privatization program) and financial-sector reforms*." GN-2136-1, p.18.

47 This prioritization is even more pronounced in the actual program for this period: between 65% and 85% of total country program lending approvals between 1991 and 1999 were for the economic reform objective.

48 For these administrations, the State's role was to foster development of the market through enabling legal and regulatory frameworks and improved public sector efficiency.

49 The fact that this also was the area in which approvals most exceeded the programmed figures both for lending and number of projects (see Figures A-2.11 and A-2.12) confirms the government's economic reform priorities for the period.

50 In a bid to rebuild Panama's credibility in the international community and normalize relations with international financial organizations the Endara administration negotiated the government's economic program with the multilateral agencies.

51 GN-2136-1 pp. 4-5, paragraphs 2.12 and 2.13.

52 The CS paper (GN-2136-1) was approved in April 2001, leaving the year 2000 out of the programming cycles.

53 The CS even brings up the idea of a review of the portfolio: *"the government and the Bank could consider reviewing the loan portfolio and priorities for future programs with a view to reducing poverty and enhancing equity."* GN-2136-1, p. 23.

54 In the presentation of the Bank's strategy objectives, for example: *"The Bank is <u>tentatively</u> <u>proposing</u> four development objectives to <u>pursue</u> in its common strategy with the government."* GN-2136-1, p. 16; emphasis added.

55 GN-1975-1, p. 8.

56 GN-2136-1, p. 2.

57 GN-2136-1, p. 6, emphasis in the original.

58 CP-573, pp. 6 and 19.

59 CP-573, Note 22.

60 GN-2136-1, p. 6.

61 GN-1975-1, paragraph 1.1. The rationale continues in the following paragraph: *". . sluggish growth is continuing owing to the performance of the three main service-oriented export activities (Panama Canal, the CBI, and the CFZ), which have experienced declining international competitiveness and have failed to establish effective linkages with the rest of the economy."*

62 *"Under this alternative model, it is hoped that the private sector's use of the reverted facilities will enhance the comparative advantage of Panama's export services and will enable industry and agriculture to contribute more to increased production and employment, in a more liberalized trading environment and with limited government intervention. This new model should result in the more efficient allocation of economic incentives in the market, a greater role for the private sector, and increased and more sustained economic growth."* GN-1975-1, p. 2.

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63 The agriculture sector is a case in point. Its share of total credit allocations had historically been lower than its contribution to GDP formation, and the percentage declined sharply after 1995, suggesting that the authorities abandoned agricultural credit as an active policy instrument for this sector. In the last 20 years credit received by the agriculture sector accounted for less than 2.5% of overall credit allocation in the country. Between 1994 and 1999 the percentage share dropped by about half (from around 1.9% to 1%).

64 Some authors acknowledge the need for subsidies to sectors harmed by Dutch disease if that phenomenon would slow the "learning by doing" process that could heighten the country's comparative advantage. See, for example, S. van Wijnbergen (1984), "The 'Dutch Disease': A Disease After All?", *Economic Journal*, 94: 41-55.

65 These relations are shown in the summary Bank strategy matrix in Annex II to the CS but, as will be noted further on, there is no discussion in the paper of other donors' activities. Though the concern with defining development outcomes is recent in the Bank, some late-1990s strategies (e.g. the 1998 Paraguay CS) did attempt to relate objectives and outcomes sought.

66 For instance, two nutrition indicators are presented even though the program envisages no project to reduce malnutrition.

67 The pipeline projects tend to be low priority and/or undefined operations.

68 Tables A-2.3 and A-2.4 summarize information about anticipated and approved projects and lending for the four programming cycles, respectively. Tables A-2.5, A-2.6, A-2.7, and A-2.8 list projects identified and/or approved in each cycle. Table A-2.9 presents consolidated information on the lending programs for the complete 1991-2003 period.

69 Interestingly, programming performance (anticipated projects ultimately consummated) was worst during the Pérez Balladares administration, particularly the first two years (1994-1996), even though the Bank's affinity with that administration in terms of economic policy was the closest. Perhaps this performance bespeaks overoptimism on the Bank's and country's part about what they could deliver together.

70 The Panama City Sanitation Project (PN-0062), for instance, was programmed or added to pipelines more than 10 times between 1992 and 2003.

71 Uncertainty understood as a lack of certain, clear knowledge of something.

72 GN-2136-1, p. 29.

73 There are repeated references in the Bank's documents to problems of lack of funding for the local counterpart. However, the programming targets appear to ignore that large funding lines would require significant improvements in the country's fiscal situation, that being still a stiff challenge for Panama, as the Bank itself has acknowledged.

74 To gauge program efficiency the evaluation team looked at the time it took to prepare and implement loans that the Bank approved for Panama.

75 US$2.145 billion in current terms.

76 Not included in these figures (lending and number of loans) are Project Preparation and Execution Facility (PPEF) operations, Project Preparation Facility (PPF) operations, and Small Projects. Dollar amounts were corrected by the U.S. Bureau of the Census estimated Consumer Price Index.

77 As noted earlier, in 1987, after the U.S. imposed economic sanctions on Panama, the country suspended payments to multilateral institutions. It normalized financial relations with these agencies in 1992.

78 Original approval amounts.

79 A private sector operation approved in 1997, the Toll Highway Project (PN-0105), was canceled. According to PRI, a significant improvement in international financial market conditions would have enabled the sponsor to finance the project more efficiently via a bond offering.

80 As of December 2004 no operation had been approved for Panama that year.

81 PN-0018, 688/OC-PN, 689/OC-PN.

82 PN-0097, 969/OC-PN, 970/OC-PN.

83 For a discussion of outcomes see chapter V.

84 TC loan Legislative Branch (PN-0078, 923/OC-PN, 923A/OC-PN, approved in 1996), Strengthening and Modernization of Economic and Fiscal Management (PN-0089, 1004/OC-PN, approved in 1997), Program to Improve the Administration of Justice (PN-0086, 1099/OC-PN, approved in 1998), and Fiscal Management II (PN-0147, 1430/OC-PN, US$10 million, approved in 2002).

85 "Portfolio" projects are active operations plus operations eligible for disbursement that year. Active projects were defined as those that had been declared eligible and were not yet fully disbursed.

86 Two items of note: In funding terms the portfolio peaked in 2000 at approximately US$427 million. It increased rapidly in the first years following the country's normalization of payments, especially until 1994, when the number of loans more than doubled (from 5 to 12) and the portfolio reached US$317 million.

87 Conversely, in terms of amounts, as time went on the economic reform and competitiveness objective's portfolio share declined sharply. The share of resources supporting the human development and sustainable growth objectives increased, the former accounting for the highest share of portfolio funds in 2003 (Figures A-3.6 and A-3.7). However, data on amounts need to be approached with caution because they tend to be affected by disbursement rates: a given area's relative share may increase because disbursement patterns in that area are less efficient than in the others (see discussion in section III.B).

88 Comparing with the Bank as a whole, other Group C countries, the other countries of the Central American isthmus, and other Central American countries. "Central America" encompasses the countries on the isthmus plus the Dominican Republic. Other than for the Bank in the aggregate, Panama is not included in the comparator groups.

89 Disbursement efficiency can be measured as the ratio of percentage of funds disbursed for a project to the elapsed portion of the originally programmed implementation period. Disbursements follow an S-shaped curve, some 45% to 50% being disbursed as of the originally scheduled project completion date.

90 Disbursement rates were calculated as the ratio of funds disbursed in a year to funds available in the portfolio the previous year.

91 None of the funding for the Debt Reduction Sector Loan (PN-0098) was canceled.

92 Data based on project budget information. The projects selected are operations approved between 1991 and 2003 (excluding sector operations and reimbursable TCs) in which the evaluation team was able to identify cost categories existing in the Bank's database relating to administration, supervision, and coordination. Hence, only these categories are counted in the findings; there may be other administrative expenses not factored into the analysis.

93 These findings need to be treated with caution because there were few projects per objective in the sample analyzed, particularly for the sustainable growth objective (three). Five projects supported the human development objective and seven supported economic reform.

94 Absolute volatility of disbursements is computed as the ratio between the standard deviation and disbursement average measured as a percentage of GDP throughout the period. Relative volatility is the ratio of absolute disbursement volatility to absolute volatility of public expenditure.

95 Focuses of the evaluation were diagnostics, definition of objectives, internal logic, assumptions and risks, output and outcome indicators, baselines for outcome indicators, and output and outcome monitoring and evaluation.

96 The Health Sector Reform Program (PN-0076, 1350/OC-PN), for example, clearly relates the problems identified, the proposed strategy, and the project components, in the context of a longer-range vision of a multiphase operation.

97 In the IDAAN Restructuring Project (PN-0030), for instance, there is no mention of the possibility that the government might backtrack on the reforms (privatization), even though there was known to be popular and political opposition to the sector's privatization. The project follows the blueprint set out in the Basic Infrastructure Sector Reform Program (PN-0097) assuming the process to be irreversible. The problems encountered in implementing this project show that the assumptions and risks were not duly analyzed and/or addressed in the project design to be able to contemplate different scenarios.

98 Risks are usually discussed in very general terms, without solid substantiation for prospective mitigating measures and/or with no provision for actions to counter risks if they materialized.

99 Specifics of the Bank's monitoring and supervision systems are discussed in the next section.

100 Nevertheless, when it came to how assumptions and risks had been defined the evaluation team found no major differences between projects supporting the governance objective and those intended to further human development. We could advance several hypotheses to help explain the projects' good disbursement pattern despite that major constraint: (a) problems perhaps were not picked up by the Bank's monitoring tools; (b) the problems may have been "minor" and/or easy to fix; and (c) it may be a matter of luck that unidentified risks did not materialize as the projects were implemented.

101 The purpose of this analysis is to ascertain whether the projects do, or do not, present indicators, baselines, and interim and final targets to reference in an eventual evaluation and, if so, how much information the progress reports and project completion reports provide to be able to gauge a project's progress toward the proposed objectives.

102 Thanks to Country Office and Region efforts to retrofit PPMRs the 2003 portfolio review report marks an improvement in quality.

103 ROS Indicator "4": "Less than 10% of opening balance disbursed over the past 12 months for projects that have reached first eligibility for 3 or more months. Opening balance refers to the available balance 12 months prior."

104 ROS Indicator "7": "Extensions for final disbursement date greater than 24 months."

105 ROS Indicator "2": "Period from date of legal effectiveness equal to or greater than 5 years with 25% to 75% disbursed."

106 The Housing Program (PN-0082; 949/OC-PN) with its US$26.4 million in funding was approved in September 1996 and declared eligible for disbursement in June 1997. It was classed as a problem project in 2002 and received an "unsatisfactory" implementation rating almost consistently for three years, from June 1999 to June 2002, the likelihood of its achieving its development objectives not having been questioned. According to the most recent available PPMR (June 2004) this project is on "alert" status because of extensions for its implementation. It was restructured (without altering its development objectives) and almost half the original loan amount (US$12.2 million) was canceled in late 2002.

107 PN-0030, 1029/OC-PN.

108 PN-0056, 1073/OC-PN and 1074/OC-PN.

109 Though frequency requirements for these visits depend on project-specific circumstances, COF work plans should include at least one visit annually to the executing unit and one visit to the project site.

110 When the reference point is eligibility date these percentages edge up to 68% and 48% for technical and financial visits, respectively.

111 Two waivers were approved: one in 2001 for PN-0097 (969/OC-PN and 970/OC-PN, Basic Infrastructure Sector Reform), the other in 2003 for PN-0149 (1439/OC-PN, Multiphase Program, Darién Sustainable Development).

112 In the early 1990s Panama's economy was characterized by a sharply dual structure in which a modern, predominantly service-oriented and outward-looking sector operated alongside two heavily protected traditional sectors—manufacturing and agriculture—that were not globally competitive. The nation's public sector was in crisis: high cost, poor quality, and inadequate coverage of essential services and infrastructure; too many employees protected by rigid, inadequate labor legislation; a complex, inefficient tax system that created severe distortions; an expenditure structure heavily concentrated on the wage bill, and a suspension of payments to international commercial banks.

113 Approximately 50% of programmed lending and 69% of approved lending between 1991 and 2003 supported that objective.

114 All the figures here are for approvals and therefore do not reflect cancellations, which in the case of the sector loans were sizable (see chapter III).

115 The specific aim of the Public Enterprise Reform Program (PN-0018, 1688/OC-PN, 1689/OC-PN) approved in 1992 for US$120 million, the reimbursable TC supporting that sector loan (PN-0035, 690/OC-PN, US$9.4 million approved), and the Basic Infrastructure Reform Program (PN-0097, 969/OC-PN, 970/OC-PN) approved in 1996 for US$123.3 million, was to support public enterprise reform in Panama. The following were some of the stated benefits sought by PN-0018: (i) favorable fiscal impact; (ii) more private investment opportunities (largely associated with service expansion and efficiency gains); and (iii) improved resource allocation, promoting economic growth and efficiency. Among the anticipated benefits cited in the PN-0097 loan document (PR-2158, pp. 24 and 25) were: (i) considerably reduce the flow of government funds needed to finance installed capacity expansion in these sectors so that the government can transfer the resources thus freed up to the social sectors; (ii) lower the external debt; (iii) rate-based cost recovery to help provide the funds needed to expand coverage and attain the objectives set in the areas of service quality, reliability, efficiency, and sustainability; and (iv) greater economic efficiency (in both production and resource allocation) and benefits in terms of investment, growth, and coverage in the sectors involved.

116 Panama was the first country in the isthmus to launch and consummate a telecommunications sector reform. There also has been a marked improvement in quantity, quality, and range of services delivered by this sector since the start of the reform, which coincides with unprecedented growth of the telecom industry worldwide. But unlike other countries in the region, the Panamanian government gave the privatized carrier an exclusive for telecommunications service in the country until 2003, which may have reduced economic efficiency and subdued the sector's growth prospects. Since January 2003 when the exclusivity clause expired, new entrants can provide voice, local telephony, and long-distance circuits and operate public telephones. Since active competition for basic services is only now beginning to develop it is too early to assess what this may mean for the country, particularly in terms of rates. The Bank also lent support to the Panamanian government's port privatization initiative but as of the mid-1990s, following execution of the Bank's ports sector loan, only limited progress had been made toward the objective of revamping the National Ports Administration (APN), and efforts to attract private investors had failed. Not until 1996 was Panama able to concession out its main ports, after the impact generated by the success of a new private port on the Atlantic side. Thanks to better tariffs and more efficient operation that port quickly diverted traffic from the port of Colón,

creating huge losses for the APN and port workers. It soon became evident that the port system would have to be concessioned out, and in the end the port workers backed that move. Since then cargo and container traffic has surged (increases of 125% and close to 200%, respectively). Over the course of the 1990s Panama also overhauled other transportation subsectors like railways and road maintenance.

117 For the telecommunications and transportation experiences see Box A-5.1.

118 PN-0061, 1113/OC-PN, Electric Expansion Program (US$72 million) approved in 1998 and still under way; and PN-0136, 1244A/OC-PN, 1244B/OC-PN, La Chorrera Power Project (US$20.3 million) approved in 2000. Since the first transmission lines financed by PN-0061 were placed in service only recently (June 2004) no data have been generated yet so no evaluation could be done of the pertinent indicators (undelivered energy due to transmission outages, transmission losses, forced outage rate). The latest two PPMRs have already moved the development-objective targets for 2005. There is no calculation of estimated economic rate of return in PN-0136.

119 In the early 1990s Panama's energy sector was contending with the following problems: (i) poor state of its undermaintained thermal generating plants, which was jeopardizing the energy supply to the system and heightening the risk of power outages during dry years; (ii) difficulties in developing new generating ventures because of less than transparent tendering processes; (iii) low productivity because of IRHE's large staff and sizable energy losses; (iv) too much State control over IRHE's administration; (v) installed capacity barely sufficient to supply peak demand; and (vi) high electricity rates (Miguel Mann, "El sector eléctrico en la República de Panamá," 2003). To address these issues the energy sector reform sought to attract private investors, foster competition and market mechanisms for resource allocation in the sector (to improve service quality and lower electricity prices in all consumer segments), and spur growth of the sector, increasing energy supply, demand, and coverage while reducing government involvement in the subsector. One of the top problems the reforms proposed to remedy was high electricity losses (over 20%): costs associated with these losses were one of the factors that most hurt the State utilities' finances.

120 Only the transmission utility remained in State hands. According to ECLAC, Panama is the "*best example of an orderly transition*" (ECLAC, Evaluation of Ten Years of Electric Industry Reform in the Central American Isthmus, December 2003).

121 In 1992, concurrently with the first sector loan, the Bank approved technical cooperation (ATN/SF-4036-PN) for Panama to finance studies to determine what needed to be done to improve IDAAN's performance and facilitate its transfer to private hands.

122 Law 26 enacted early in 1996 created a Public Utilities Regulatory Agency (ERSP). Law 2 the following year established the legal framework for the water and sanitation sector's operation and development, segregating its regulatory, service delivery, and policy functions and thereby opening the door to private sector participation. Though the ERSP has been the regulatory agency for barely seven years ECLAC rates it among the region's regulators with an intermediate level of autonomy. Occasionally when ERSP has decided a rate increase was needed it has run into opposition from the executive and legislative branches, which at times have intervened to keep rates where they were; this would suggest that the regulator might not be entirely independent. But in other instances increases have gone through and the government has had to find another way to subsidize these services in order to counteract the rate increases; this has strengthened the regulator's independence.

123 The table presents the gist of the discussion of public enterprise reform, listing Bank operations in this sphere along with some financial and/or physical indicators that depict the pre-reform picture (1993 through 1995) and the situation a few years after the reforms (2001 through 2003). Indicators in the table were selected by reference to the benefits the Bank expected to see after Panama's public enterprise reform was consummated, as conveyed in the country strategies at the time or in the individual loan documents. Supplementing this information are other data such as related operations (if any) of other lending agencies, specific observations about data, sources consulted, etc.

124 The analysis that follows is strictly factual, and does not purport to sort out the multiple reasons why the public enterprise reform program's impact may have been better or worse than what the Bank had expected at the time, this being an issue that falls outside the scope of this evaluation.

125 The ratio of nonfinancial public sector spending to GDP climbed from 24.8% on average in 1993-1995 to 30.4% in 2001-2003, these figures being significantly above the Latin American average. The total civil service roll increased 3.4% between 1993-1995 and 2001-2003. As a percentage of population the public service roll edged down from 5.6% of the total to 5.2%. 1982 was the base year used in comparative data for GDP.

126 Real GDP growth rates in the three-year period 1993-1995 were higher, on average, than in 2001-2003 (this indicator clearly is a very generic measure of the public enterprise reforms' impact, and its performance can be affected by domestic and external shocks; nevertheless the 2001 CS used GDP growth as an outcome indicator). There has been virtually no change since the 1990s in the percentage of job-seekers in Panama who do not find employment. Though gross fixed capital formation in the private sector increased between 1995 and 2001-2003, total investment (i.e., gross private investment plus inventory changes and public sector investment) declined over that interval.

127 The anticipated improvements in coverage, quality, reliability, and delivery efficiency of the privatized services should have translated, as the Bank put it, into more efficient allocation of economic resources and lower production costs. One way of verifying such improvement is by reference to its eventual impact on the economy's external competitiveness.

128 PN-0098, 908/OC-PN, US$30 million approved; 99% of the loan proceeds was disbursed in a single tranche.

129 Document PR-2094, November 1995, page 8.

130 The DDSR entailed a swap of existing debt for fixed-rate bonds and consolidation of a pool of currencies to the U.S. dollar. Though this reduced Panama's exposure to future adverse changes in these variables, the downside was not being able to take advantage of favorable changes in the variables. The commercial debt-bond swap left the government with less room for maneuver if it ran into debt service difficulties: in contrast to the pre-swap external commercial debt, there was no restructuring option for the post-DDSR bonded debt. According to World Bank estimates, when the DDSR became effective the share of relatively inflexible public debt (bonded debt) soared from 22% to 90% (World Bank, Report No. P-6810-PAN, March 1996). In these circumstances the prime objective of Panama's Public Debt Directorate with the commercial bank debt restructuring was to take advantage of the favorable environment to buy back a good part of the DDSR instruments and thereby reduce the debt service burden. The authorities adopted this bond swap approach on several occasions, driving down the DDSR bond share of the external debt stock from 73% in February 1997 to just over 30% in March 2000 and just 6% in March 2004.

131 This operation's impact on public sector finances and the economy in general was estimated by tracking the performance of some indicators suggested by OVE, focusing on the performance of variables mentioned in the loan document (PR-2094). Surprisingly, that document presents no standard indicator for tracking the debt following the agreement. The figures in the table (where data were available) correspond to the 1996-1998 average (when the DDSR was launched) and the 2001-2003 average (post-DDSR) for a series of key indicators.

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[132] According to Ministry of Economy and Finance data, Panama's external debt swelled between the two periods examined here, regardless of how it is measured (flows or stocks) and of which reference variable is used. There were increases in the ratios of debt stock to GDP (from 59% to 64.7%), to exports (from 81.4% to 116.8%), and to NFPS fiscal revenue (from 206.8% to 213%). Interest payments on the debt as a percentage of exports and of government revenues climbed as well, from 3.7% to 7.9% and from 9.4% to 14.4%, respectively (nominal GDP figures for recent years were adjusted for the effect of the base year change to 1996). The increase would have been even larger had Panama not been able to swap the DDSR bonds before maturity.

[133] This analysis is based on an approach that takes account of the quality of institutions and policies to determine the sustainable level of a country's debt.

[134] On the public sector side, the three sector loans discussed earlier plus the Finance Sector operation (PN-0056, 1073/OC-PN, 1074/OC-PN, US$130 million), were closely associated—by way of their government banking and social security reform components—with the objective of balancing the public sector finances.

[135] Between 1993 and 1995 Panama failed to pay a large portion of the interest on its external debt, so the NFPS primary balance is a more accurate indicator for the two-period comparison. The results also show the NFPS moving from a surplus of 2.9% of GDP on average in 1993-1995 to a deficit averaging 1.8% of GDP in 2001-2003. This is consistent with the outcomes discussed earlier, which show that despite the privatizations the public sector was not downsized and the DDSR did not effectively reduce the external debt service burden. Furthermore, the Finance Sector Program's government banking and social security reform subprograms had to be canceled because agreed conditions had not been performed. These cancellations five years after the operation was approved were over 46% of the original approval amounts and required a restructuring of the program, which is still under way.

[136] Data in the discussion on foreign trade draw heavily on the INT/ITD working paper "Sectoral Note on Trade and Integration," April 2004.

[137] Also noteworthy is the *low intra-industry trade coefficient with the Andean Community which, considering the geographic proximity and similar level of development, suggests a failure to take advantage of industrial complementarity opportunities and identify differentiated products in strategic market segments*. INT/ITD "Sectoral Note on Trade and Integration," p. 12 of the Spanish text.

[138] While the decline in CFZ exports may be the main reason for the muted performance of merchandise exports, the other sectors' export sales declined throughout the period as well (Figure A-5.1).

[139] The Bank approved three transportation-related loans during the period: PN-0022 (769/OC-PN, Road Rehabilitation and Administration Program, approved in 1993, US$179.9 million—fully disbursed), PN-0117 (1116/OC-PN, Rehabilitation of Local Roads and Bridges, approved in 1998, US$156 million—US$71 million canceled, still in progress), and PN-0159 (1468/OC-PN, Improvement of the PPP Integration Corridor, approved in 2003, US$37 million).

[140] Reductions in transportation costs documented one year after completion of the project PN-0022 works were thanks to periodic maintenance work (4%), rehabilitation of secondary roads (36%), and rehabilitation and widening of the Pan American Highway (20%). (Ministry of Public Works estimates using the HDM model)

[141] The PCR for PN-0022 says that the Ministry of Public Works was given neither sufficient budget funding nor the right kind of institutional mechanisms for the planned restructuring's implementation.

[142] PN-0032, 924/OC-PN, approved in 1996 for US$33.6 million—US$3.5 million canceled, the balance disbursed in full.

[143] Increase in output of 10 high-weighted exportables and 16 of medium weight; 12% increase in yield/hectare of priority commodities, and improvements in productivity indexes of competitive products.

[144] The projects are: PN-0109 (1108/OC-PN, Support for Competitiveness of the Producing Sectors, approved in 1998, US$14.2 million); PN-0134 (1273/OC-PN, Support for Implementation of the Science and Technology Center, approved in 2000, US$3.3 million); and PN-0145 (1410/OC-PN, Program to Strengthen Competitiveness, approved in 2002, US$7 million). Though the latter is not strictly speaking a science and technology project, it does promote the development of competitiveness clusters.

[145] PN-0120, 1132/OC-PN, approved in 1998, US$2.5 million (still in progress).

[146] PN-0089, 1004/OC-PN, approved in 1997, US$11.2 million, disbursed in full. This program's stated objective is to advance the process of operational integration of macro-fiscal programming, budgeting and budget execution, and public sector financial management. The objective was to be pursued through three subprograms: (i) strengthening of economic analysis; (ii) modernization of tax administration; and (iii) strengthening of financial management.

[147] Panama's tax revenue-to-GDP ratio is known to be one of Latin America's lowest, comparable only to such other extreme cases as Haiti, Guatemala, and Paraguay. Add to this the fact that the country is heavily indebted, that a sizable portion of its public enterprises have been privatized, and that it does not have the tool of currency issue to help defray the costs of running the government, and it becomes very clear how vital it is for Panama to boost its tax revenue intake.

[148] 12.1% of GDP, on average, for 1993-1995; 10.9% for 2001-2003.

[149] Fundamentally because of the lack of integration of the various subsystems, which would have made for coordinated, effective economic data gathering and use.

[150] Consequently, in 2002 the Bank approved a second economic and fiscal management modernization operation, with one component specifically designed for SIAFPA integration and consolidation (PN-0147, 1430/OC-PN, US$10 million, currently in progress).

[151] ATN/FG 8326-RG. Evaluation of Financial Management Improvement Programs. Panama, Modernization of Economic and Fiscal Management II, loan 1430/OC-PN. Program component: Financial Management Strengthening. Quasar Consultores, Madrid, June 2004.

[152] The objective of PN-0066 was to help the Panamanian government plan the use of the reverted areas and assets. Other than the indication that the commissioned studies were produced there is no information on their impact or on if, how, and how thoroughly their recommendations have been implemented. According to the most recent PPMR for this project (June 1999), *the study regarding the structuring and institutional development of the ARI was completed. Studies for the Master Plan and Regional Plan also were finished (March 1997) and passed into law by the legislature. The Metropolitan Plan study was completed, after starting far later than the other studies.*

[153] Now that ANAM has been integrated with the national agency in charge of forest and water resources management, work is needed to mesh the traditional natural resources management culture with the environmental vision.

[154] 1160/OC-PN, approved funding of US$70.4 million.

[155] As a corollary to this diagnostic it is asserted that economic reform and liberalization would give Panama "*a stronger and more efficient economy with fewer price distortions ... [which ultimately will] boost the competitiveness of Panama's economy and will have the desirable consequences of creating additional jobs and reducing poverty.*" GN-1975-1, p. 15.

[156] Niek de Jong and Rob Vos, "Reformas económicas y la distribución del ingreso en Panamá," in Enrique Ganuza, Ricardo Paes de Barros, Lance Taylor, and Rob Vos (eds.), *Liberalización, desigualdad y pobreza: América Latina y el Caribe en los 90.* EUDEBA, UNDP, ECLAC, Buenos Aires, 2001.

[157] "*To redress Panamanian structural poverty impeding equitable and sustained growth, the Bank would invest in social sector and employment generation activities targeted at improving the welfare and income levels of the poor.*" CP-573, p. 17.

[158] From 1993 onward, i.e., a few years after Panama began rallying from the late-1980s economic crisis, the unemployment rate held relatively stable for the rest of the period at about 14%. Applying the specification proposed by Okun's Law to the last 20 years of the Panamanian economy the unemployment rate would drop one fifth (0.2) of a percentage point for each one percent of annual overall GDP growth in excess of 3.9%. In other words, Panama's total GDP would have to climb nearly 9% in a year to push the jobless rate down a single percentage point. These figures are significantly behind estimates for the United States where 2%-3% growth would lower unemployment by one percentage point. See for example Arthur Okun, *The Political Economy of Prosperity*, The Brookings Institution, Washington, D.C., 1970.

[159] Meanwhile, sectors such as agriculture, in which over 80% of the labor force has a primary school education or less, lost significant growth ground between 1990 and 2000. Moreover, the youth unemployment rate (age 15-24) continued to worsen over that interval, being two to two and a half times the overall average.

[160] The main reason for this change was the pickup in agriculture and fishing—the second fastest-growing sector during that period, after transportation—which accounted for 35% of all employment creation, particularly very low skilled jobs.

[161] Echoing Gini coefficient calculations, the change in the Theil index was marginal over this period.

[162] ECLAC estimate from a sample of 18 Latin American and Caribbean countries. Using a different methodology, François Bourguignon (*The Growth Elasticity of Poverty Reduction: Explaining Heterogeneity across Countries and Time Periods*, World Bank Working Paper No. 28104, 2003), computes this value at slightly above unity for the case of extreme poverty. The paper begins: "*Part of the ongoing debate on poverty reduction strategies bears on the issue of the actual contribution of economic growth to poverty reduction. There is no doubt that faster economic growth is associated with faster poverty reduction. But what is the corresponding elasticity? If it is reasonably high, then poverty reduction strategies almost exclusively relying on economic growth are probably justified. If it is low, however, ambitious poverty reduction strategies might have to combine both economic growth and some kind of redistribution*."

[163] Had the growth elasticity of poverty been unity in Panama in the 1990s the total poverty rate would have fallen from 47% to 15% rather than 34%, i.e., the poverty rate would now be less than a third of the early-1990s figure.

[164] Extreme poverty is considerably more sensitive than total poverty to changes in inequality: given Panama's severe income inequality, marginal changes in income distribution can mute economic growth's potential positive impact on the poorest.

[165] Hence, *more efficient and better targeted social spending was needed as well as profound changes in the resource allocation system and social policy institutions*, CP-1136, Executive Summary.

[166] Between 1993 and 2003 the Bank approved seven projects in support of the human development objective, with a total of about US$276 million in funding, and a National Land Administration Program (PN-0148, 1427/OC-PN approved in 2002, US$27 million). Only two of those projects (PN-0029, 803/OC-PN, Health Program, approved in 1993, US$42 million, and PN-0054, 854/OC-PN, 855/OC-PN, Social Investment Program, approved in 1994, US$30 million) are finished. The other operations are PN-0082, 949/OC-PN, Housing Program, approved in 1996 for US$26.4 million, US$12.2 million of which was canceled; PN-0111, 1226/OC-PN, Poverty Alleviation and Community Development Program, approved in 1999 for US$48.9 million, US$14.1 million canceled; PN-0069, 1013/OC-PN, Education Program, approved in 1997 for US$58.1 million; PN-0076, 1350/OC-PN, Institutional Reform of the Health Sector, approved in 2001 with US$35 million; and PN-0144,

1476/OC-PN, Urban Revitalization and Poverty Reduction in Colón, approved in 2003 for US$8.5 million. After the economic reform and competitiveness objective this has been the programming objective for which the Bank has approved the most funding.

167 Because of the change in GDP calculation base as of 1996 the data are not strictly comparable between the two periods.

168 Actual expenditure rose approximately 78% between 1991 and 1999. After accounting for 98% of overall social spending in 1990, current expenditures came down in the following two years and held at between 90% and 92% of total social spending for the rest of the decade.

169 The incidence of social spending was calculated using data from the 1997 National Living Standards Survey. Aggregate social expenditure estimates take in health, education, social security, and feeding programs for children under five.

170 No data were available on how public health spending was apportioned among the different care levels or on its incidence on different income segments.

171 One item of note: In real terms, total government education spending in 1999 was 82% higher than in 1991, the increase for primary education is 52%.

172 Regarding public spending on the different levels of education there is a clear redistributional pattern in primary education spending, a pro middle class bias in secondary spending, and higher education expenditure is regressive (Figure A-5.13).

173 Data from the 2000 Living Standards Survey, cited in the 2002 National Human Development Report.

174 The development objectives set out in the loan proposal are to "*improve the external efficiency or relevance, the internal efficiency, and accessibility of education from pre-school to grade 12.*" The specific objectives were to review the primary education program, improve student retention rates, ensure textbook availability, center on nutrition and vision problems, and institute a program to assess performance and knowledge acquisition and evaluate schools.

175 UNDP, 2002 National Human Development Report.

176 Unfortunately, not only are the indicators proposed in PN-0029 output rather than outcome indicators, but in most instances they are difficult to measure as well. Furthermore, various of the evaluation steps called for in the loan document either were not done or were ultimately of limited usefulness: *the absence of a baseline was a real constraint for the midterm evaluation … the absence of a logical framework also will make it difficult to perform an impact evaluation in future* (PCR, p. 17 of the Spanish text).

177 The PCR itself says: .. *subsequently limited the achievement of important goals such as regional integration of health services*.

178 Virtually every country in the region has some form of Social Investment Fund, and there is a body of knowledge built up from different experiences across the region. Generally, as the 2002 report *Social Funds: Assessing Effectiveness* produced by the World Bank's Operations Evaluation Department notes, FIS-type programs "*have been highly effective in delivering small-scale infrastructure, but much less so in achieving consistently positive and significant improvements in outcomes and welfare improvements.*"

179 The findings of the late-1996 evaluation report on the first FIS program, based on a sample of completed projects and projects approved but not implemented, were as follows: (i) though the infrastructure works were judged to be technically sound and for the most part responded to the communities' main priorities, the budgeted costs were overestimated; (ii) the communities were not systematically involved in all phases of the project cycle; (iii) the beneficiaries of the road projects, which took up close to 40% of funding (this not having been the initial plan) were not clearly spelled out; (iv) there was a high project loss potential because of the lack of maintenance, especially in road

projects; (v) because road projects are so complex there was a tendency to change a single project into several (road, bridge etc.) to stay below the per-project cost ceiling; and (vi) at the outset, municipalities were identified based on the 1990 Census poverty classification, but living conditions of the prospective benefiting communities were not verified during promotion or inspection visits.

180 Interestingly, these findings are obtained using a more rigorous (clusters) methodology that takes into account criteria for participating in the FIS. Other methodologies indicate an increase in poverty in FIS areas compared to areas not served by the program.

181 For FIS II there is a 2003 concurrent evaluation report halfway through the project, but it is based on a sample of 35 projects and describes only the experience with the projects as far as community participation and quality of construction materials are concerned. It also reports the communities' quality ratings and provides a general description of the projects' benefits.

182 These latter "second generation" reforms focused on State modernization, institution-strengthening, and management capacity improvements.

183 The assumption obviously being that preparation time is a fair proxy for preparation quality.

184 GN-1975-1, p. 15.

185 There was no reduction in the central government roll at any time in the 1995-2003 span.

186 Niek de Jong and Rob Vos, "Reformas económicas y la distribución del ingreso en Panamá," in Enrique Ganuza, Ricardo Paes de Barros, Lance Taylor, and Rob Vos (eds.), *Liberalización, desigualdad y pobreza: América Latina y el Caribe en los 90*. EUDEBA, UNDP, ECLAC, Buenos Aires, 2001.

187 Minimizing the tradeoff between quicker implementation times and lower administrative costs is no easy task. External executing units that seek to bypass bureaucracy and/or the country's weak institutional capacity in order to improve project implementation are one common example of the strategy used by the Bank in its projects that has administrative cost implications. However, the very high administrative costs observed in some cases reviewed in this evaluation, their variability, and the example of the best practices developed for project PN-0022's implementation are strong considerations in support of this recommendation.