



Country Program Evaluation

Panama

2010-2014



Inter-American Development Bank
May 2015

This Country Program Evaluation (CPE) is the third independent evaluation of the country program of the Inter-American Development Bank (the Bank) with Panama. Past evaluations covered the periods 1991-2003 (RE-305), when the country was transitioning to full control of its prime economic asset, the Panama Canal, and the Canal Zone territory and infrastructure, and 2005-2009 (RE-359), a period characterized by extraordinarily good macroeconomic performance and significant fiscal reform. This CPE spans January 2010 to December 2014, years marked by an ambitious public investment program and a strong reduction in unemployment and poverty, although accompanied by income inequality.

According to the Bank's Protocol for Country Program Evaluations (RE-348-3), the main goal of a CPE is *"to provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's overall strategy and program of country assistance."* Like other CPEs, this evaluation seeks to examine the Bank's relationship with the country from an independent perspective, strengthening accountability and facilitating learning to serve as an input to the new Country Strategy under preparation for 2015-2019.

To prepare this document, OVE interviewed the Bank's main counterparts among Panama's authorities, project execution units, civil society and the private sector, multilateral agencies with presence in Panama, and Bank staff in Panama and at Headquarters. OVE also visited Bank-supported projects to assess implementation progress and challenges.

The evaluation portfolio includes all operations approved over the review period, together with those approved previously but implemented during the review period. Chapter 1 examines Panama's economic and social development over 2010-2014 and considers the country's medium-term prospects. Chapter 2 analyzes the strategic and financial relevance of the Bank's program and assesses implementation effectiveness. Chapter 3 discusses the results achieved in the six strategic sectors identified by the 2010-2014 Country Strategy and assesses the use of country systems. Chapter 4 presents concluding remarks and recommendations. The annexes provide details of the portfolio and include figures that support OVE's analysis.

Country Program Evaluation:

Panama 2010-2014

Office of Evaluation and Oversight, OVE



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ABBREVIATIONS AND ACRONYMS

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ABBREVIATIONS

ACP	Panama Canal Authority (Spanish acronym)
CAF	Andean Development Corporation
CAPRA	Probabilistic Risk Assessment Program
CPN	Country Office Panama
CPE	Country Program Evaluation
CPD	Country Programming Document
CGR	Comptroller General
CS	Country Strategy
DPL	Development Policy Loan
GDP	Gross domestic product
HDI	Human Development Index
IDAAN	Instituto de Acueductos y Alcantarillados Nacionales (the water and sanitation company)
IDB	Inter-American Development Bank
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
MEDUCA	Ministry of Education
MEF	Ministry of Economics and Finance
MIF	Multilateral Investment Fund
NSG	Non-sovereign-guaranteed
OPUS	Operations Update System
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PBP	Programmatic policy-based loan
PEG	Plan Estratégico de Gobierno (Strategic Government Plan)
PNGRD	National Plan for the Management of Natural Disaster Risk
PPP	Purchasing power parity
PRODE	Educational Development Project
SD	Structural depth
SFRL	Social and Fiscal Responsibility Law
SG	Sovereign-guaranteed
SIAFPA	Integrated Financial Administration System
SMEs	Small and Medium Enterprises
TFFP	Trade Finance Facilitation Program
TC	Technical cooperation
UNDP	United Nations Development Program

This evaluation was led by Michelle Fryer under the general guidance of Cheryl W. Gray. The team included Cesar Bouillon, Danya Churanek, Jose Fajgenbaum, Alejandro Guerrero, Ana Maria Linares, Jose Claudio Pires, Santiago Ramirez, Patricia Sadeghi, Miguel Soldano, Alejandro Soriano, Alayna Tetreault-Rooney, and Yariela Zeballos. OVE thanks the Panamanian authorities; IDB managers, staff, and country counterparts; and representatives of Panama's private sector and civil society for the generosity of their time during interviews and in data collection. The team would also like to thank colleagues in the Bank for providing valuable inputs during internal and external peer reviews.



Panama has an estimated population of 3.8 million people, of which 65% is urban.

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Executive Summary

CONTEXT

Panama is a small, high-middle-income country with a highly open economy whose strategic location and integration into the global economy have put it on track to become a regional logistics hub. The country has an estimated population of 3.8 million people, of which 65% is urban. It is the fastest growing economy in Latin America and the Caribbean, with an average GDP growth rate of 8.6% between 2008 and 2013, and a GDP per capita of US\$16,658 in 2013. The Panama Canal and a diversified services sector related to trade and finance activities explain the successful performance of the economy. In addition, the country integrated rapidly into the global economy through a number of Free Trade Agreements and the growing activity of the Colon Free Zone.

Panama is characterized by stable macroeconomic conditions anchored by full dollarization, a solid banking system, and the implementation of sound fiscal policies. Public debt declined from 71.2% of GDP in 2001 to about 45.4% in 2008 and to an estimated 41.1% of GDP in 2013. This decline reflected strong growth, tax reforms, and tighter current spending (offset by considerable increases in public investment), as well as larger transfers from the Panama Canal Authority. The strong adjustment effort over the past decade created the fiscal space for the implementation of countercyclical measures to mitigate the impact of the global crisis. Furthermore, Panama formalized its commitment to sound fiscal policies by enacting the Social and Fiscal Responsibility Law (SFRL) in 2008 and creating a Sovereign Wealth Fund in 2012. The SFRL established a limit of 1% of GDP on the overall deficit of the non-financial public sector, combined with a limit of 40% of GDP on public debt. The Sovereign Wealth

Fund was a major step toward sound management of public resources in the future, and toward limiting the “Dutch Disease” effect that could be triggered by spending the expected larger revenue inflow from the expansion of the Canal.

Despite this progress, Panama also has a dual economic structure: the dynamic sectors that drive growth have left the rest of the economy behind. There are significant gaps between the living standards in the Panama City-Colon Corridor and those in the rest of the country, and particularly those of indigenous peoples. Unequal access to economic and social infrastructure within the metropolitan region is also a pressing issue. More generally, while the combination of strong growth and direct government programs has helped reduce poverty, the reduction occurred at a slower pace than expected given the very high growth rates. Inequality persists, with large disparities based on income, wealth, geography, and ethnicity.

While the overall fiscal policy has been strong, weak management capacity in most public sector entities has hindered the efficient use of public resources. This weakness is clearly evidenced in the area of public expenditure planning and execution. Although the SFRL requires the formulation of a medium-term fiscal framework to increase the efficiency and monitoring of public spending, Panama has not developed either an integrated system to design, assess, and monitor public investment projects, or a results-based budgeting framework.

Panama’s financial sector –a pillar of the country’s strength– weathered the global financial crisis well, and its oversight is being strengthened, although further progress is needed. The Superintendence of Banks has adopted risk-based supervision and dynamic (cyclical-based) provisioning. Also, in the absence of a Central Bank, progress is being made toward establishing a lender-of-last-resort facility. However, there are concerns about poor supervision of non-bank financial institutions, particularly cooperatives. Although this evaluation covers the period 2010-2014, it is important to note that in April 2015, Panama approved Law 23 which expands the number of sectors subject to regulation and supervision, and addresses weaknesses in the areas of anti-money-laundering and combatting the financing of terrorism previously identified by the International Monetary Fund.

THE BANK’S COUNTRY PROGRAM FOR 2010-2014

Since 2010, the Bank has concentrated its country program with Panama on deepening economic reforms, strengthening economic and social infrastructure, and addressing service delivery in key sectors, notably in water and sanitation, education, and health. In accordance with its diagnostic assessments, the Bank structured its 2010-2014 Country Strategy (CS) (GN-2596) around three core development challenges: *“(i) strengthening public finances, increasing revenue, and making expenditures more efficient in core sectors under a framework of medium-term fiscal sustainability; (ii) developing basic infrastructure, with a focus on the provinces outside of the Panama*

and Colon Corridor, thus expanding economic and social opportunities to reduce high levels of poverty; and (iii) facilitating access to quality services in education, health, and nutrition, particularly in the indigenous territories and in rural communities.” The CS also committed the Bank to endeavor to strengthen country systems in the areas of financial management, public procurement, and the environment. The Bank’s strategy was generally consistent with Panama’s development challenges and the thrust of the Strategic Government Plan 2010-2014.

This evaluation observed a general lack of coherence between the Bank’s strategic planning and programming exercises and the de facto operational portfolio. This discrepancy reflects an inherent weakness in the Bank’s strategy and programming guidelines, which do not require that the Bank account for the sectors in which it has an active portfolio, despite the size or relevance of that portfolio. The programming of the portfolio was also weakly linked to the CS. Operations were approved in nearly twice the number of sectors as had been included in the strategy, and the share of loans that were eliminated from the work plan on an annual basis was significant.

Between January 1, 2010, and December 31, 2014, the Bank approved approximately US\$2.1 billion in new financial operations—an increase of 60% in volume over the previous CS and substantially higher than the envelope envisioned in the CS. This amount comprised 16 sovereign-guaranteed (SG) loans totaling US\$1,754 million, 15 non-sovereign-guaranteed (NSG) loans for US\$193 million, and 47 technical cooperations and investment grants for an additional US\$56 million. The legacy portfolio included 35 active loans (27 SG and 8 NSG) in 13 sectors, which were approved before the current evaluation period and remained active at the beginning of 2010, with an undisbursed balance of roughly US\$955 million.

The lending portfolio relied heavily on fast-disbursing instruments for budget support. Seventy-two percent (US\$1,250 million) of all SG loan approvals were in the form of fast-disbursing loans: five policy-based programmatic (PBP) loans to strengthen public finances and financial sector supervision, and develop policy frameworks for integrated disaster risk management, and one PBP guarantee to strengthen macro financial and fiscal management. This budget support was instrumental in aiding Panama’s efforts to build a strong macroeconomic policy framework for growth. The Ministry of Economics and Finance counts on the Bank to continue providing policy advice and fast-disbursing resources, which are now an important and reliable source of government funding. Nonetheless, successive changes in focus in the Bank’s programmatic lending prompted the truncation of three of Panama’s four programmatic series. As a consequence, five of 11 planned PBLs of significant structural depth did not materialize, thus diminishing the relevance of the proposed lending series.

Although IDB’s engagement pivoted around budget support, the Bank also provided more limited support to other sectors through investment lending. Panama requested Bank support to strengthen economic and social infrastructure and to address

critical market failures in the social sector. In this context, eight investment loans totaling US\$384 million were approved. These operations offered an opportunity to concentrate financial and technical resources in areas outside of the Panama City–Colon Corridor, including in the indigenous regions, and to ensure that important social programs and processes, which can take time to evolve, were moved forward. In general, the portfolio of investment projects demonstrated the Bank’s capacity to partner with government officials in identifying solutions to some of the country’s most difficult problems.

By sector, public sector financial management (reform and modernization of the state) and financial markets received the highest concentration of loan financing (62%), followed by environment and natural disasters (17%), which was not identified as a priority sector in the CS. The remaining 21% of total Bank financing was divided among the priority sectors that most directly addressed the challenge of a dual economy: infrastructure (water and sanitation, transport, and energy) comprised roughly 10% of total approved loan volume; the social sector (including education and health) 8%; and the private sector 3%.

The Bank was responsive to the Government’s evolving needs in sectors that were not explicitly part of the CS for 2010–2014. In the area of natural disasters and climate change, the Bank approved an emergency facility to address the damages of severe flooding and mudslides (PN-L1071). It also approved a flexible ex ante contingency loan that is immediately accessible for emergency expenditures in cases of catastrophic natural disasters. And although the Bank chose not to single out the financial sector in its CS for the period, there were a significant number of NSG operations in support of individual banks.

IMPLEMENTATION, EFFECTIVENESS, AND SUSTAINABILITY

During the evaluation period the distribution of lending across sectors was highly skewed towards PBLs in areas that were not directly related to addressing the dual nature of Panama’s economy. This bias resulted in a program with a pro poor investment component, but overall not on a scale commensurate with the social and economic disparities of a dual economy. According to the Operations Update System (OPUS), just 7 of the 16 SG loans approved over the review period targeted poverty, social equity, or similar lending priority indicators in GCI-9. In terms of volume, just 16% of the US\$1.754 billion approved for SG lending targeted poverty or social equity.

The Bank’s investment portfolio added value, despite implementation delays. For the most part, investment loans focused largely on social and economic infrastructure in provinces outside the Panama–Colon Corridor. Nonetheless, many of these operations have experienced significant implementation delays, reflecting varying degrees of institutional capacity within executing ministries at the central and regional levels, fiscal constraints stemming from the SFRL, and inefficient country systems.

More specific implementation problems found during the evaluation include lack of ownership by key stakeholders (fiscal PBLs); problems with contractors (transport sector); lack of political will (water and sanitation and competitiveness); procurement issues (energy sector); complexity of design, high personnel turnover, and insufficient funds to move forward (education and health sectors); and excessive requirements for execution of activities (natural disaster emergency response). Low inter-institutional coordination and inefficient country systems affected multiple sectors.

Going forward, the Office of Evaluation and Oversight recommends that the Bank:

1. Work with the client to structure the new CS and background analytic work around key cross-cutting issues such as duality, poverty, productivity, and inequity, rather than by narrow sectors.
2. Given the high levels of inequality in the country and the slow reduction of poverty, seek ways to redouble IDB's efforts to support Government's pro-poor development agenda by focusing budget support more on issues relevant to poverty reduction and by continuing targeting investment lending more toward poor beneficiaries.
3. In the context of the overall strengthening of country systems and project management capacity, continue to support the client with strong institutional components. Support to the client should also include strengthening of municipal and regional development institutions and their capacity to more efficiently and effectively deliver basic services.
4. Strengthen the design, monitoring, and completion of future policy- based programmatic series to avoid interruptions in the Bank's comprehensive support for priority sectors and to ensure the achievement of durable policy reform. When a PBP series is interrupted, it is recommended that the remaining operations be removed from the lending pipeline and a project completion report be prepared for the truncated series.
5. Strengthen risk analysis during project design and periodically reevaluate and reprioritize the lending program based on dialogue between the Bank and the Government of Panama, with a view to lowering the cost of projects prepared but later removed from the pipeline or canceled. Major deviations in the scope or focus of the country program from that envisioned in the CS should be justified and reported to the Board.



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More generally, while the combination of strong growth and direct government programs has helped reduce poverty, inequality persists, with large disparities in terms of income, wealth, geography, and ethnicity.

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1 Context of the Country Program 2010-2014

Panama is a small, high-middle-income country with a highly open economy whose strategic location and integration into the global economy have put it on track to become a regional logistics hub. According to Panama's Census and Statistics Directorate, the country had an estimated population of 3.8 million people in 2010, of which 65% was urban. It is the fastest growing economy in Latin America and the Caribbean (LAC), with an average GDP growth rate of 8.6% between 2008 and 2013 (Annex I.1) and a GDP per capita of US\$16,658¹ (PPP) in 2013.² The Panama Canal and a diversified services sector related to trade and finance activities explain the successful performance of the economy. In addition, the country integrated rapidly into the global economy through a number of Free Trade Agreements and the growing activity of the Colon Free Zone.³

Despite this progress, Panama is also characterized by a dual economic structure: the dynamic sectors that drive growth have left the rest of the economy behind. There are significant gaps between the living standards in the Panama City-Colon Corridor and those in the rest of the country, and particularly those of the indigenous *comarcas*.⁴ Unequal access to economic and social infrastructure within the metropolitan region is also a pressing issue. More generally, while the combination of strong growth and direct government programs has helped reduce poverty, inequality persists, with large disparities in terms of income, wealth, geography, and ethnicity.

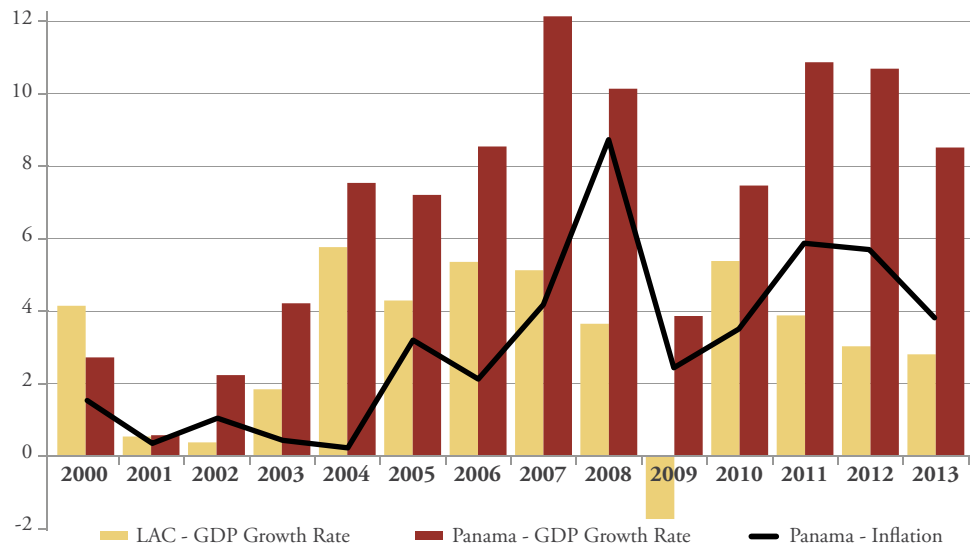
A. ECONOMIC DEVELOPMENT⁵

Panama's economy showed high resilience during the global economic crisis. Real GDP growth, which had been at nearly 8% a year during 2003-2007, slowed to less than 4% in 2009 following the financial crisis (Figure 1.1).⁶ But the economy bounced back

relatively quickly following the implementation of countercyclical fiscal measures and an ambitious public investment program including the Canal expansion, with strong private consumption. Real GDP grew by 7.5% in 2010 and nearly 11% a year in 2011-2012, based on massive infrastructure investment, the housing boom, and expanding activity in transportation, communication, commerce, and tourism. Foreign direct investment, which averaged about 11% of GDP in 2013, played an important role in economic growth, including by covering the growing external current account deficit. Reflecting strong consumption and pressures from imported commodities, inflation has been higher than traditional levels; however, these pressures subsided from 6.3% (2011) to 2.6% (2014), in part through government subsidies and falling commodity prices. Economic growth slowed to 6.2% in 2014⁷ and is expected to remain stable over the medium term with the normalization of global monetary conditions, the expanded Canal, and the new copper mine.

FIGURE 1.1
GDP Growth and Inflation
Rates (in %, 2000-2013)

Sources: World Bank's World Development Indicators and IMF's International Financial Statistics



Macroeconomic stability is anchored by full dollarization, a solid banking system, and the implementation of sound fiscal policies. Public debt declined from 71.2% of GDP in 2001 to about 45.4% in 2008 and to an estimated 41.1% in 2013⁸ (Annex I.3). This decline reflected strong growth, tax reforms implemented since the early 2000s,⁹ and tighter current spending (offset by considerable increases in public investment), as well as larger transfers from the Panama Canal Authority (ACP). This strong adjustment effort also created fiscal space for the implementation of countercyclical measures to mitigate the impact of the global crisis.¹⁰

Although tax reforms have raised government revenue, there are still weaknesses in tax administration, especially with regard to tax compliance and tax avoidance. According to the International Monetary Fund (IMF), while earlier tax reforms did succeed in raising the country's tax-to-GDP ratio, they *"fell short of objectives and Panama still lags its income peer group with respect to tax pressure and effort."*¹¹ Panama scored 48%

in tax effort (the difference between actual tax revenue and estimated tax capacity), compared with a median of 78% for upper-middle-income countries. Such low effectiveness has likely hampered the Government's ability to address the country's social and infrastructure gaps.

To formalize Government's commitment to sound fiscal policies, Panama enacted the Social and Fiscal Responsibility Law (SFRL) and created a Sovereign Wealth Fund (SWF). Among other things, the 2008 SFRL established a limit on the overall deficit of the non-financial public sector of 1% of GDP, and a limit on public debt of 40% of GDP. The need for countercyclical measures, along with higher energy subsidies and extraordinary spending to address the damages of severe rains and mudslides, led to successive modifications of the deficit limit. That performance was generally better than the revised limits attests to cautious fiscal policy, although the modifications may have eroded policy credibility.¹² The creation of the SWF in 2012 was a major step toward sound management of public resources in the future, and to limiting the "Dutch Disease" effect that could be triggered by spending the expected larger revenue inflow from Canal expansion (Box 1.1).¹³ The design of the SWF follows best international practices; its main functions are to accumulate and preserve long-term savings and act as a stabilization fund. Given Panama's strong macroeconomic performance, the country earned its first investment-grade rating in 2010. As of 2014, both Fitch and Standard & Poor's rated Panama BBB.

BOX 1.1 THE PANAMA CANAL

Linking the Atlantic and Pacific oceans, the Canal is a strategic waterway for merchandise shipments across the globe. It is administered by the autonomous *Autoridad del Canal de Panamá*. In recent years, the Canal has contributed 5-6% to GDP and the equivalent of 3% of GDP to government revenue. In 2006, as the Canal reached full capacity, the country decided through a popular referendum to expand the Canal, at a cost of US\$5.3 billion (about 20% of 2007 GDP). The expansion will virtually double the Canal's capacity and allow post-PANAMAX-size ships to use it. Accumulated and ongoing savings of the ACP, amounting to US\$3 billion, and loans from development banks^a totaling US\$2.3 billion finance the project. The expansion should be completed by end-2015.

^a Besides the Inter-American Development Bank, these banks are the European Investment Bank, International Finance Corporation, Japan Bank for International Cooperation, and Andean Development Corporation.

Public expenditure planning and monitoring remains weak. Although the SFRL requires the formulation of a medium-term fiscal framework to increase the efficiency and monitoring of public spending, Panama has not developed an integrated system linking planning and results-based budgeting. Moreover, planning and processes regarding budget and treasury administration are based on outdated legal frameworks. More recently, a number of pilot ministries are implementing a single treasury account.

Panama has established itself as an important regional hub for financial services; while oversight has been strengthened, weaknesses remain in important areas. The strong performance of the economy is sustained by the presence of a stable and well-regulated financial sector. Stress tests conducted by the Financial Sector Assessment Program (IMF-World Bank) indicate that the sector is prepared to withstand a wide range of shocks. To address some risk elements, the Superintendence of Banks has introduced dynamic loan provisioning and risk-based supervision. However, there are concerns about poor supervision of non-bank financial institutions, particularly cooperatives. Given the size of Panama's financial sector and its depth of integration in the global economy, net external liabilities in 2013 were equal to 75.5% of GDP. IMF has recently noted weaknesses in the areas of anti-money-laundering and combatting the financing of terrorism¹⁴ which affect both the financial and non-financial sectors. (Although the review period for this evaluation is 2010-2014, it is important to note that on April 27, 2015, Panama approved Law 23, which expands the number of economic sectors subject to regulation and supervision in accordance with Financial Action Task Force standards.)

Although Panama's competitiveness has strengthened in recent years, there is still room for improvement. Pushed by the US–Panama Free Trade Agreement (FTA),¹⁵ the government has implemented significant measures to reinforce competitiveness, including reducing the time required for administrative procedures; addressing logistics bottlenecks; modernizing customs procedures; expanding ports, roads, and airports; and updating the law on Free Trade Zones. Nonetheless, the country fell eight spots in the World Economic Forum's 2014-15 global competitiveness index due to concerns relating to governance and transparency, including the functioning of institutions (88th), corruption (79th) and crime (95th), trust in politicians (102nd), and judicial independence (116th) (Annex I.4). Despite this setback, Panama is the second most competitive economy in LAC, behind Chile.

Complementarity between public and private investment is a cornerstone of Panama's economic model, but challenges in infrastructure remain. The Canal expansion has fostered the development of private ports, the building of roads has improved connectivity between logistics centers, and the expansion of airports has attracted private investment in tourism. Strong economic performance attracted large private investment projects in the mining sector, particularly the copper mine "Cobre Panama."¹⁶ Public investment is also helping to develop new industries (light manufacturing and warehousing) around the logistics hub. However, severe bottlenecks in the generation and transmission of electricity have resulted in rationing power throughout the country, and deficiencies in the provision of water have led to significant additional costs for the economy (Box 1.2).¹⁷ Furthermore, the cost of transportation inside Panama is among the highest in the region. According to a recent World Bank report, transporting goods in Panama costs twice the Central American average (\$0.33 per ton/km vs. \$0.17)¹⁸.

BOX 1.2. CHALLENGES TO WATER PROVISION

In Panama, challenges to water provision are both technical and managerial. While access to potable water is high in urban centers (92%), rural coverage averages about 73%, and is lower in the indigenous *comarcas*. In December 2010, late 2011, and again in 2012 the larger of two water treatment plants in Panama City stopped working, creating a major disruption throughout the capital. Consequently, water had to be rationed and supplied by trucks. As the technical staff of the plant was unable to fix the problem, the government transferred the responsibility to the ACP, which runs the second plant. The shortfall generated by these deficiencies, combined with unrealistic tariffs and low rates of collection, has resulted in a deficit of about US\$225 million over the past five years.

Finally, Panama is vulnerable to the threats posed by climate change, including the increased probability of being hit by hurricanes because of changes in the patterns of dry and wet seasons. For Panama's economy, it is estimated that an unmitigated high vulnerability scenario could lead to a loss in excess of 14% of GDP by 2100.¹⁹ According to the World Bank's Natural Disaster Hotspot Study,²⁰ Panama ranks 14th among countries most exposed to multiple hazards.

B. UNEQUAL GROWTH, INEQUALITY, AND POVERTY

Panama's economy reflects a dual structure: a dynamic and competitive services sector that is fully engaged in the international economy operates alongside smaller, less advanced and less competitive sectors that mainly target the home market (Annex I.5). According to the growth diagnostic for Panama²¹ developed by the Inter-American Development Bank (IDB, or the Bank), productivity and salaries are high in the modern sectors, including finance and logistics, which demand skilled workers. At the same time, surplus labor is generally employed in the traditional sectors, such as agriculture and small-scale manufacturing, where productivity is particularly low. Raising stock and farming, including higher value-added agricultural exports, and integration into the value chain of the more dynamic sectors of the economy offer opportunities to address the country's economic inequalities and growth.

Duality is also reflected in significant inter- and intraregional gaps in economic and social infrastructure. Economic activity is heavily concentrated around the Canal Zone, where most infrastructure and services are located, where more than half the population lives, and where about 80% of GDP is produced. Transportation infrastructure is generally better in the Panama City–Colon Corridor than in the other provinces. Moreover, the installation of new power generation and transmission capacity has favored this zone. While Panama City has experienced

an amazing real estate boom, overdevelopment, congestion, and rising housing costs have increased disparities in the living standards of different income groups in the metropolitan region.

In terms of income inequality, Panama's GINI coefficient (51.9 in 2012) is among the highest in LAC. The 2014 Human Development Index (HDI)²² ranked Panama 65 of 187 countries, placing it in the high human development category. However, adjusting the HDI for inequality across the population, the country's challenges become evident. The difference between Panama's HDI value (0.765) and the adjusted HDI for inequality (0.596) reflects a large "loss" in potential human development.

Sound economic performance, combined with a strong social safety net and conditional cash transfers, has effectively led to a decline in poverty, but progress could have been stronger. Poverty rates are higher in Panama than in other countries with similar income levels. Between 2006 and 2012, poverty fell from 38.3% to about 25.8%, and extreme poverty fell from 17.6% to 10.4% (Annex I.6). Despite this progress, the gap between urban and rural poverty is larger than the regional average, and growing.²³ Among indigenous peoples, poverty is the highest in the region: four of every five indigenous people live in poverty, three of them in extreme poverty (Annex I.7). If economic growth had had a similar effect on poverty in Panama as in the average LAC country, total poverty would have fallen to 15%, and extreme poverty in urban areas would have been practically eliminated.

Social indexes reflect large disparities in access to basic services, particularly among indigenous peoples. Despite the extraordinary growth of the economy, many remote communities still do not have regular access to electricity, health care, or potable water. Inadequate access to sanitation (62% urban, 9% rural) contributes to a high incidence of diarrhea in children. On average, one in five children suffers from chronic malnutrition; however, the rate among indigenous children is much higher (61% in 2008). The poor quality and limited supply of basic services reflects the weakness of the public sector outside the central provinces.

Panama's education system ranks below what would be expected, given its relatively high GDP per capita. The country is on track to achieve the Millennium Development Goal of universal primary education, and secondary schooling is spreading to rural and indigenous areas. However, the quality of education lags behind the needs of a fast-growing and competitive economy. In a recent evaluation,²⁴ the World Bank noted that Panamanians average 11 years of schooling, but those years are equivalent to only eight when adjusted for test performance.²⁵ The same report links poor education to the relatively high poverty levels that characterize the country, especially rural areas. To support inclusive growth, Panama needs to boost its human capital, including through substantive education reform.

Panama's export-oriented services and financial sectors are quite efficient, but they require more high-skilled labor. The mismatch between the skills demanded and supplied in the labor market is one of the most-cited development challenges in the country. The dynamic sectors of the economy are facing shortages of high-skilled labor, which limit growth potential. To alleviate these shortages, Panama is attracting foreign skilled workers and professionals through new types of visas and residency programs leading to citizenship. These efforts are appropriate to address the immediate needs, but as the economy grows, shortages of human capital will likely reemerge.

Panama has reached its lowest unemployment rate in four decades, yet informality remains an important challenge. Strong economic activity led to a very sharp decline in unemployment rates, from some 9.8% (2005) to around 4.1% (2013).²⁶ A large part of the population works in the public sector or in traditional activities such as agriculture, which are generally uncompetitive and have little capacity to create quality jobs. The rigidity of the labor market has led to high labor costs and the development of a large informal sector (about 40% of the labor force).²⁷ Such a large informal sector, with its limited access to credit for working capital and for the adoption of new technologies, hinders Panama's productivity and growth potential.

Looking ahead, managing the transition from the current rate of economic expansion to a period of lower growth will be key to maintaining the social and economic gains of the past decade and to ensuring that growth is inclusive. GDP growth is expected to remain strong, although it is expected to gradually decline to the 6-7% range over the medium term.²⁸ In addition, limited fiscal space and a poorly skilled labor force may constrain the continuous expansion of the economy, including both the dynamic and traditional sectors. Further attention to these and other development challenges, including significant infrastructure bottlenecks, is essential to address the duality in the country.



The Country Strategy document specified that the Bank would concentrate its operational program in six sectors: public finances, transport, water and sanitation, energy, education, and health.

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2 The Bank's Country Program 2010-2014

A. RELEVANCE OF THE BANK'S STRATEGIC FOCUS AND OPERATIONAL PROGRAMMING

The Bank structured its 2010-2014 Country Strategy (GN-2596) around three core development challenges: (i) strengthening public finances, including increasing revenue and making expenditures more efficient in core sectors under a framework of medium-term fiscal sustainability; (ii) developing basic infrastructure, particularly with a focus on the provinces outside of the Panama and Colon Corridor, thus expanding economic and social opportunities to reduce high levels of poverty; and (iii) facilitating access to quality services in education, health, and nutrition, notably in the indigenous autonomous regions and in rural communities. The Country Strategy (CS) also committed the Bank to endeavor to strengthen country systems in the areas of financial management, government procurement, and environmental management.

The CS document specified that the Bank would concentrate its operational program in six sectors: public finances, transport, water and sanitation, energy, education, and health. According to authorities interviewed, the selection of sectors was demand-driven, informed by sector analytical work (Annex II.1), negotiated with the Government during extensive policy dialogue, and agreed on the basis of the Bank's comparative technical advantage in the country. For each of the six sectors, the strategy defined country-level objectives and outcomes. In practice, the Bank approved loans in 10 sectors—including financial markets, trade, private firms and small and medium enterprise (SME) development, and environment and natural disasters and climate change²⁹—and technical cooperation (TC) resources in an additional three sectors (see Annexes II.2, II.6, and II.11).

The Bank's strategy was generally consistent with Panama's core development challenges and meshed well with the Strategic Government Plan (PEG) 2010-2014 and the Bank's IDB-9 commitments. Approved by Cabinet Council on December 29, 2009, the PEG is the primary instrument for medium-term strategic planning. Mandated by the SFRL, it reflects the goals agreed with civil society during the Dialogue for National Consensus and the electoral commitments of President Martinelli's administration. The PEG is a five-year economic and social strategy aimed at positioning Panama as a world-class financial and logistics hub, while alleviating social exclusion. It envisages the use of tools such as economic policy, public expenditure, and the five-year public investment plan to channel public expenses towards significant sectors, programs, and projects nationwide.³⁰ (Table 2.1 shows the alignment of the Bank's CS framework with associated objectives in the PEG.) The CS also supported the corporate objectives of IDB-9, contributing to the goal of supporting "*small and vulnerable countries*" while providing space to address the target of "*poverty reduction and equity enhancement*" in four of the six priority sectors: water and sanitation, education, health, and transport.

Overall, the Bank's CS was relevant for Panama's needs and helped reconcile the Government's ambitious investment plan with a sustainable fiscal framework. The CS aimed at strengthening public finances by raising revenue levels and modernizing tax administration, while improving the management and efficiency of public expenditure. By achieving these objectives, the Government expected to increase the availability of resources for infrastructure and social investments while staying within the fiscal responsibility law limits, and thereby gain credibility, upgrades in its sovereign credit rating, and better external financing terms.

However, the CS's value as a strategic tool to guide IDB engagement was not always evident. The CS did not document why the Bank prioritized its intervention in the sectors that it did, nor did its diagnostic analyze the opportunity costs of working in other areas of equal or potentially greater relevance to Panama's development needs. Although this level of specificity is not required by current CS guidelines,³¹ it meant that several key sectors in which the Bank had significant expertise or prior engagement were not included in the Bank's agenda, even though they were prioritized by the Government in the PEG. For example, agriculture was not included in the Bank's agenda, although it was identified as one of four "engines of growth" by the PEG; it is also a sector in which the Bank has a long trajectory of collaboration in the region. Likewise, governance and transparency, a cross-cutting theme in the previous CS, was not prioritized, although the Bank's diagnostic identified that strengthening public institutions was essential for growth.

Moreover, the sector approach neither recognized intersectoral synergies nor channeled them toward solving the broad challenges faced by Panama's dual economy. This CPE finds that the Bank's policy dialogue could have been deepened and synergies potentially enhanced by shifting the strategic focus of the CS from individual sectors

to development themes, and by extending the analytical base that was used to inform the Bank's policy dialogue to alternative areas where IDB is substantively engaged or to areas where its diagnostic points to significant returns in development effectiveness.

TABLE 2.1. OBJECTIVES OF PANAMA'S 2010-2014 PEG AND THE IDB'S COUNTRY STRATEGY

<i>Panama PEG: Selected objectives</i>	<i>IDB priority sector</i>	<i>IDB CS objectives</i>
Sustainable public finances: <ul style="list-style-type: none"> • Guarantee a simple and fair distribution of the tax burden, maintain competitiveness • Implement results-based fiscal management • Modernize financial administration 	Public finances	Raise revenue levels and modernize tax administration
		Improve the management and efficiency of public expenditure
Expand coverage and improve the quality and competitiveness of road infrastructure and logistical support	Transport	Improve the quality of road infrastructure and strengthen its maintenance in the country's other provinces
Guarantee access to water and sanitation services in most of the country's urban and rural zones	Water and sanitation	Increase coverage and quality, improve management of water and sanitation services in the country's other provinces
Promote measures to ensure permanent energy supply, both in hydrocarbon management and electric energy generated from various sources	Energy	Reduce electricity costs and improve energy efficiency
Guarantee quality education with equal opportunities for men and women	Education	Improve quality and retention, expand education coverage in indigenous territories
Guarantee access to quality basic health services, prioritize primary care, and expand the hospital network	Health	Reduce health care coverage gaps in indigenous territories and rural communities
<i>Country systems</i>		
Modernize financial administration, strengthen institutional capacity to design and evaluate investments	Financial management, government procurement	Use the Panama Integrated Financial Administration System (SIAFPA)
		Strengthen institutional capacity and government's procurement system
Modernize environmental management	Environmental systems	Consolidate institutional, legal, and regulatory frameworks

Despite the Bank's significant investment of staff time and financial resources in operational programming, these processes did not always produce the desired results.³² The Country Program Document (CPD) defines the Bank's indicative work program for each year. While this approach may have been useful to engage with country authorities, this CPE finds that actual programming was weakly linked to the CS (as evidenced by loans in nearly twice the number of priority sectors), and did not always result in approvals. For example, of the 21 sovereign-guaranteed (SG) loans that were

programmed between 2010 and 2014, 14 were approved over the course of the CS, six were eliminated from the pipeline within a year of their inclusion in the CPD, one was reprogrammed to the next CS as a B operation, and two unplanned loans were added. Reasons for the changes include “government access to other funds,” “loss of priority,” and “slow execution of Phase I loan”. The volatility of programming in Panama can also be measured by the share of SG loans eliminated from the country program on an annual basis. For example, 25% of the 2010 indicative program was dropped from the pipeline, as was 29% of the 2011 program, and 50% of the 2012 and 2013 programs. The two SG operations programmed in 2014 were approved. The cost to prepare the six loans that were dropped was roughly US\$568,000.³³

This evaluation also observed a lack of coherence between the Bank’s strategic planning and programming exercises and the execution of the inherited operational portfolio. This discrepancy reflects an inherent weakness in the CS and programming guidelines, which do not require that the Bank account for the sectors in which it has an active portfolio, despite the size or relevance of that portfolio. This lack of coherence is particularly evident in a country like Panama, where the inherited lending portfolio is larger in number (35 loans) and more disperse (13 sectors) than the approved loan portfolio (28 loans in 10 sectors) (Annex II.3). Similarly, neither the objectives of the CS nor the results framework in the CPD track the performance of the older loans –even those that align with a priority sector. By focusing the CS guidelines and operational programming on new lending and not on how the active portfolio might combine with new lending to produce results, synergies could be overlooked and coordination opportunities lost.

B. FINANCIAL RELEVANCE AND COMPOSITION OF THE OPERATIONAL PORTFOLIO

IDB is the largest multilateral lender to the Government of Panama, followed by the Development Bank of Latin America (CAF) and the World Bank. The 2010-2014 CS estimated the financial envelope for SG loan approvals at US\$990 million, “which together with the existing portfolio, would make it possible to disburse sufficient resources to keep the Bank’s average share of Panama’s external financing at 15%.” Although the country’s debt with the Bank increased by 27% over the evaluation period (from US\$1,281 million in 2010 to US\$1,622 million in 2014),³⁴ IDB’s average share of Panama’s external financing was lower than projected (12.8%) given the country’s growing access to other sources of credit, including international capital markets and commercial banks (Annex II.4). IDB’s share of Panama’s multilateral debt also declined from 72.2% to 55.2% over the period, partly because CAF disbursements increased nearly tenfold.

The current evaluation period opened in 2010 with 35 active loans – 27 SG and 8 non-sovereign-guaranteed (NSG) – and an undisbursed balance of US\$955 million (Annex II.5).³⁵ Over the course of the CS, the Bank approved approximately US\$2.1 billion in new financial operations, an increase of 60% in total approved volume over

the previous CS period (2005-2009). This total comprised 16 SG loans for US\$1,754 million (US\$764 million over the proposed lending envelope), 15 NSG loans totaling US\$193 million,³⁶ and 47 TCs and investment grants for US\$56 million (Annex II.6).³⁷ The active portfolio as of December 2014 is presented in Annex II.7.

Beginning in 2009, the Bank provided budget support when Panama faced a widening fiscal gap, and it has continued to provide budget support in every year since (Figure 2.1 and Annex II.8). Over the review period, US\$1,350 million in budget support had been approved. Of this amount, US\$900 million in PBL resources was disbursed, US\$350 million was cancelled,³⁸ and the balance of US\$100 million remains contingent in an emergency loan. These resources helped to fill important fiscal gaps as the overall fiscal balance deteriorated. The Ministry of Economics and Finance (MEF) counts on the Bank to provide budget support, which is now an important and fluid source of government funding.

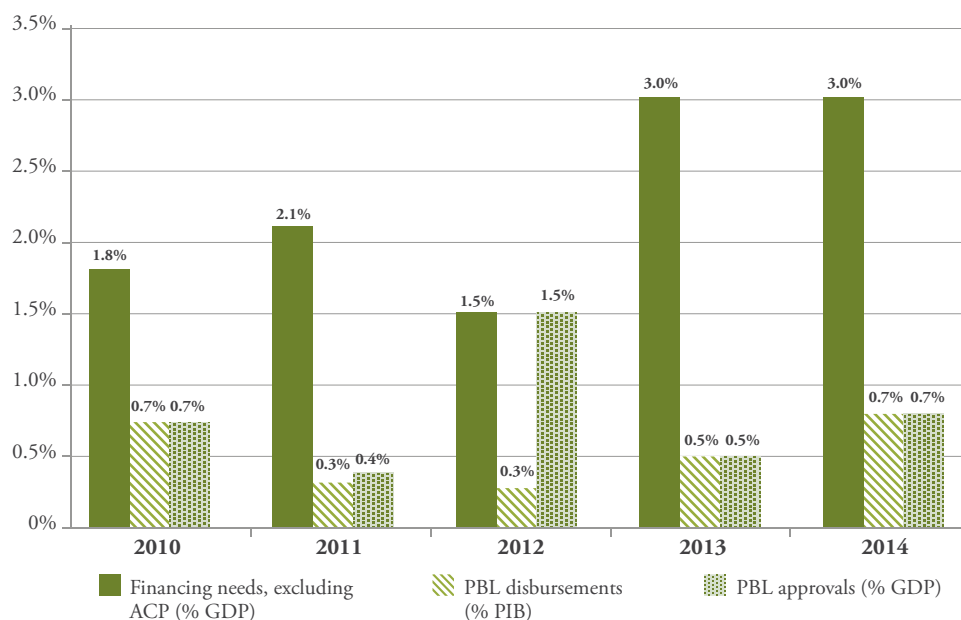
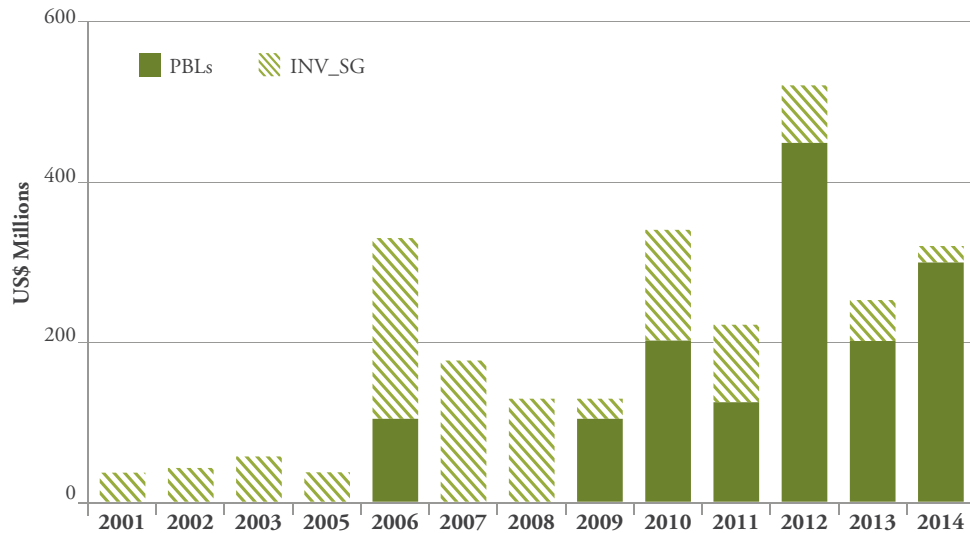


FIGURE 2.1
IDB Budget Support
2010 -2015

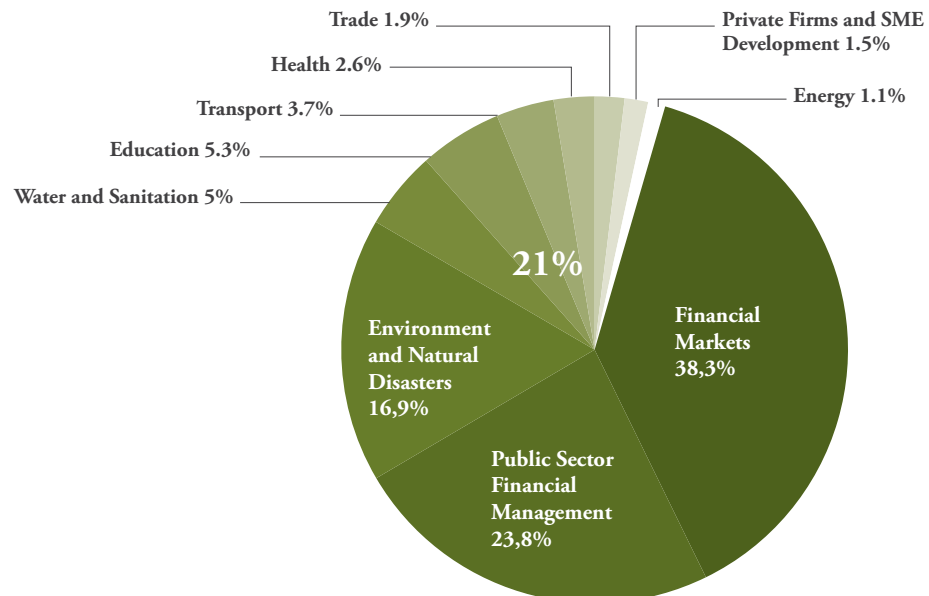
The composition of SG lending from 2010 to the present has favored fast-disbursing operations over investment loans, which tend to be much smaller in size and take longer to prepare and execute (Figure 2.2). Panama's strong appetite for budget support was aimed at facilitating further public investment in large infrastructure projects within and around the highly developed Panama City-Colon Corridor. That portfolio focus has meant limiting the Bank's financial resources available to address issues relating to poverty and equity, thereby reducing the potential relevance of the Bank's program to narrowing the economic and social gap between the c and the rest of the country. According to the Operations Update System (OPUS), just 7 of the 16 SG loans approved over the review period targeted poverty, social equity, or similar lending priority indicators in GCI-9. In terms of volume, just 16% of the US\$1.754 billion approved for SG lending targeted poverty or social equity (Annex II.9).

FIGURE 2.2
Investment Loans vs
PBLs



The distribution of loan resources across sectors was highly skewed and not on a scale commensurate with the social and economic disparities of a dual economy. By sector, public sector financial management (reform and modernization of the state) and financial markets received the highest concentration of total loan financing (62%), followed by environment and natural disasters (17%), which was not identified as a priority in the CS (Figure 2.3). The remaining 21% of Bank financing was divided among the five priority sectors that most directly addressed the challenge of a dual economy: infrastructure (water and sanitation, transport, and energy) comprised roughly 10% of total approved loan volume; the social sectors (education and health) received around 8% of loan financing; and the private sector 3%.

FIGURE 2.3
Distribution of IDB
lending by sector
2010-2014



The proportion of lending that flows to Panama in the form of budget support is about twice the average of the Central American region, and double that of all other C countries in the Bank (Figure 2.4). In the evaluation period, 72% (US\$1,250 million) of all SG loan approvals accounted for the six PBP that were part of four programmatic series: Strengthen Fiscal Policy and Tax Equity (US\$200 million); Reduction of Vulnerability to Natural Disasters and Climate Change (US\$200 million); Strengthen Macro Financial and Fiscal Supervision (US\$550 million); and Fiscal Stability and Transparency Improvement (US\$300 million). In addition, the Bank approved one contingent loan for natural disaster emergencies (PN-X1007, US\$100 million).

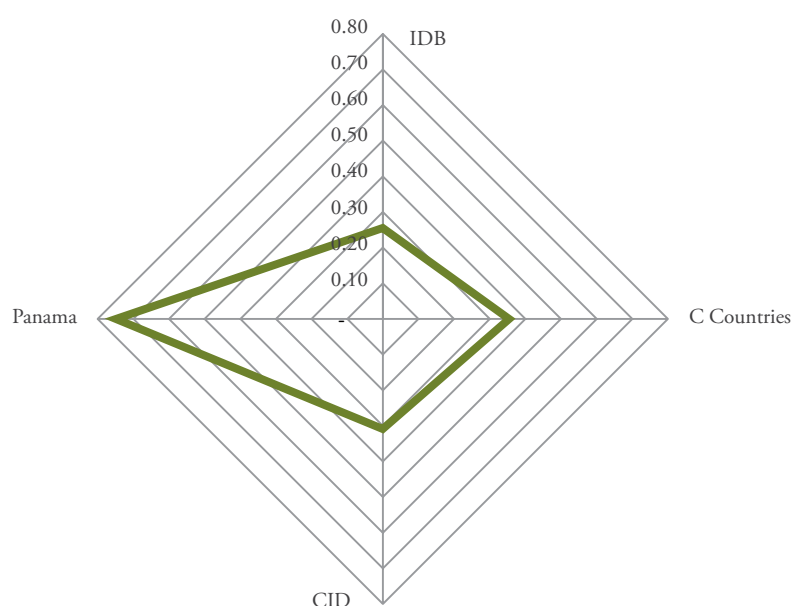
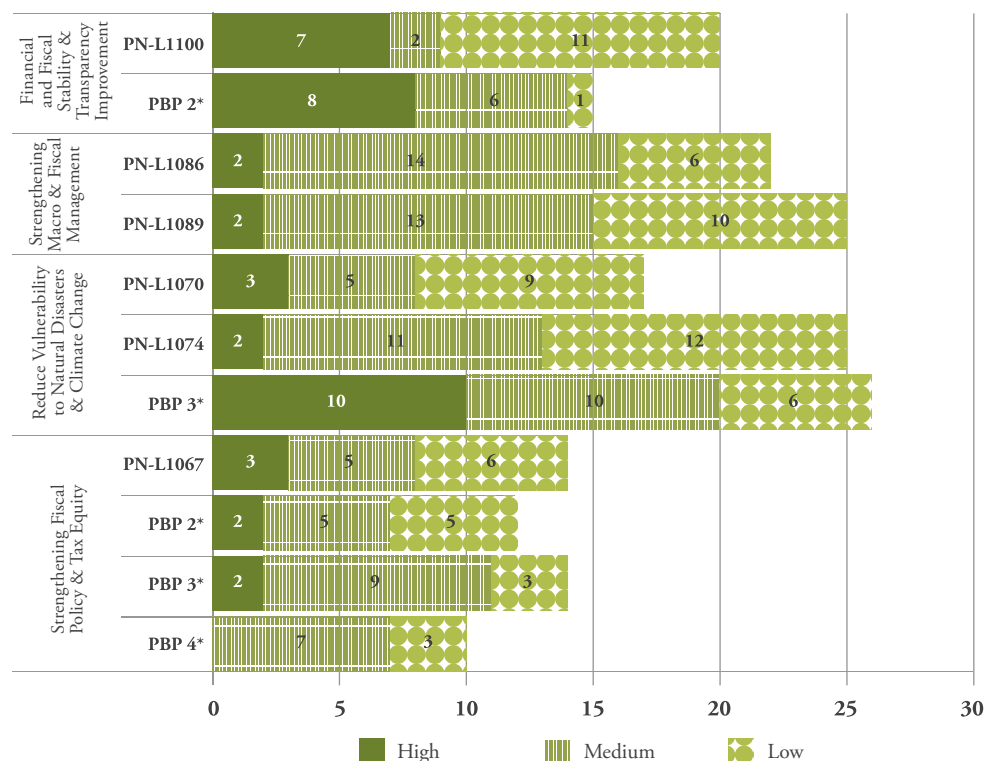


FIGURE 2.4
Budget Support as
a Share of SG Loans
2010-2014

The programmatic series were generally broad in scope and relatively balanced in terms of the structural depth (SD)³⁹ of the supported reforms (Annex II.10). The Office of Evaluation and Oversight (OVE) applied a specific methodology developed by the IMF's Independent Evaluation Office to (i) capture the degree of structural change that any of the 200 policy conditions in the four PBP series could be expected to bring about if implemented; and (ii) identify the policy areas in which the rated conditions were concentrated (Figure 2.5). In terms of scope, each programmatic series included a substantial number of policy measures –50 on average– as triggers for disbursement. Overall, 21% of the proposed policy conditions had a sufficiently high SD to generate sustainable changes in the institutional environment, 43% of the measures had medium SD, and the remaining 36% of the conditions were low in SD. Most conditions with high SD were associated with financial sector regulation and oversight and natural disaster management. They included, for instance, the entry into force of a regulation on financial conglomerates, financial risk, liquidity risk, and derivative instruments, and the approval of the National Disaster Risk Management Policy.

FIGURE 2.5
SD of Proposed
Policy Measures in
PBBs (by series and
by tranche)

Note: *Truncated PBL



However, despite the programmatic approach, five of the planned 11 PBP tranches did not materialize, thus diminishing the relevance of the proposed reforms. PBP series are designed as a coherent sequence of loan operations—usually two to four with a mid-term horizon—whose full results can only be achieved by completing the entire series of reforms. The truncation of three of Panama’s four programmatic series midway through resulted in a shift in the policy focus of the Bank’s PBL support every 12 to 18 months—from public finances (2010), to natural disaster risk management (2011), to fiscal risk management (2012), and then to financial sector oversight in the last two years. The truncations may have also weakened progress towards the achievement of durable policy reforms, particularly given the number of high-SD commitments that were affected.

The truncation of three of the four PBP series resulted in an overall loss of about one third of high-SD commitments. The cost of not completing a PBP series is defined as the share of conditions that were not implemented. Figure 2.6 shows the SD of policy commitments across programmatic PBP series that did not materialize because the series was truncated. The shifts in policy support particularly affected the Program to Reduce Vulnerability to Natural Disasters and Climate Change, as the truncated PBL contained 67% of all high-SD commitments in the sector reform package⁴⁰ (Figure 2.5). Similarly, the fact that three of the four planned fiscal PBLs from the Program to Strengthen Fiscal Policy and Tax Equity did not materialize affected the overall depth and relevance of the reform effort, particularly in budgeting and public expenditure management, although some conditions were then included in a subsequent World Bank policy loan (Chapter 3 and Annex II.11).

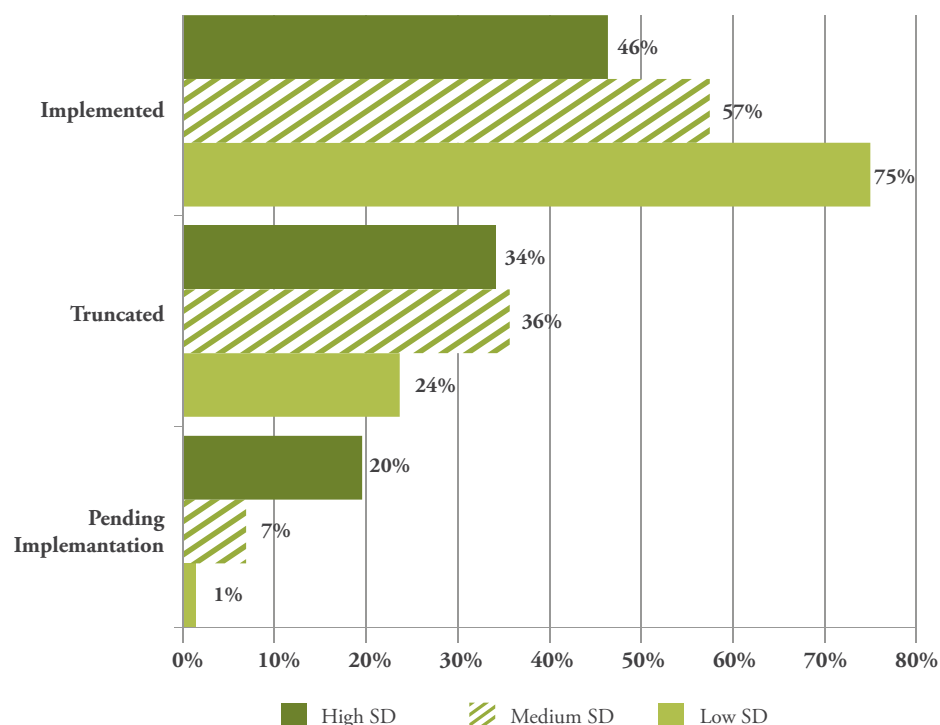


FIGURE 2.6
The Cost of Not
Completing a
PBP Series

The shift in PBP focus also signaled a broadening of Bank priorities. To mitigate the fiscal risks associated with external shocks, the PBP series that was approved in 2012 had two objectives: (i) improve the Government's management of public assets and liabilities; and (ii) enhance the Government's capacity to oversee and regulate the financial sector. While the first objective fit squarely within the purview of the CS, the second did not. The cost of adding the new series was the truncation of the three subsequent operations under the PBP series for Consolidation of Fiscal Policy and Tax Equity, which was fully aligned with the Bank's strategic priorities. This gives rise to two issues. First, important reforms envisaged in the CS were not supported (e.g., results-based budgeting, strengthening investment formulation, monitoring and evaluation); although the World Bank incorporated some of the measures into its Development Policy Loans (DPLs), about half were lost. Second, the reason given for the truncation of those operations was that they "lost priority," without any further explanation to the Bank's Board of Directors, hampering the Board's oversight capacity. OVE considers that a change of this nature should be justified and documented as part of the annual programming exercise if the CS and CPD are to remain relevant.⁴¹

The PBP guarantee that was approved in 2012 supported a number of significant macroeconomic and financial sector reforms, while enabling the Government to refinance liabilities (related to a turnkey project) with commercial banks. The reforms included the establishment of Panama's Sovereign Wealth Fund, the development of the domestic market for government securities, the creation of the Financial Coordination Council, steps toward banks' adopting dynamic provisioning, and the strengthening of

risk-based supervision. The PBP guarantee enabled Panama to extend the maturity of payments coming due.⁴² Moreover, by enabling the Government to defer its loan obligations, this instrument also helped Panama comply with the fiscal constraints set by the SFRP, as the public accounts are recorded on a cash basis. The guarantee was cancelled at the end of 2014.

Although IDB's engagement pivoted around budget support, the Bank also provided more limited support to other sectors through investment lending. Panama requested Bank support to strengthen economic and social infrastructure and to address critical market failures in the social sector. In this context, eight investment loans totaling US\$384 million were approved. These operations targeted five of the six priority sectors identified by the CS: water and sanitation, education, health, rural electrification, and transport. They also offered an opportunity to concentrate financial and technical resources in areas outside of the Panama City–Colon Corridor, including in the *comarcas*, and to ensure that important programs and processes of a social character, which can take time to evolve, were moved forward. In general, the portfolio of investment projects demonstrated the Bank's capacity to partner with government officials in identifying solutions to some of the country's most difficult problems.

The Bank was responsive to the Government's evolving needs in sectors that were not explicitly part of the CS for 2010–2014. In the area of natural disasters and climate change, the Bank approved an emergency facility to address the damages of severe flooding and mudslides (PN-L1071). It also approved a flexible *ex ante* contingency loan that is immediately accessible for emergency expenditures in cases of catastrophic natural disasters.

The NSG portfolio that was approved diverged from the sectors in the CS, but this is in line with the flexibility allowed in the NSG lending policy.⁴³ The only sector in which the CS anticipated NSG lending was energy; however, no IDB operations were approved.⁴⁴ Two loans related to hotel development and tourism were inserted in the 2011 and 2012 CPDs, but neither materialized. Although the Bank chose not to include the financial sector in its strategy, there were a significant number of loans in support of individual banks. Of the 15 NSG operations approved since 2010 (US\$192.7 million), 11 were through the Trade Finance Facilitation Program (TFFP).⁴⁵ These loans aimed to promote economic growth through the expansion of trade financing to local banks. IDB also funded traditional intermediation lines to four banks to help them grow their SME, green lending, and mortgage portfolios.⁴⁶

In addition to its loan portfolio and knowledge products, the country program made good use of grant resources, including C&D Action Funds. In approaching cross-sectoral challenges, the Bank combined previous analytical work and TC resources with investment loans and PBP lending: 42 non-reimbursable TC grants (US\$15.9 million)

and five investment grants (US\$40.4 million) account for about 3% of the operational portfolio (Annex II.12). For the most part, these resources were used to generate sector diagnostics to inform the design of loans, achieve previously established conditions, or overcome execution bottlenecks. Importantly, they were also used to maintain active policy dialogue in sectors that were not prioritized by the CS, such as social protection. In terms of sectors, most TC resources were directed toward priority social investments, including in water and sanitation, and to the environment and natural disaster sector. About half of these operations were associated with the approved loan portfolio and the other half with the execution of the inherited loan portfolio. In terms of scope, a large investment grant (PN-X1011, US\$29.9 million) for the Expansion of Comprehensive Security in Panama complemented the Comprehensive Security Program loan already in execution. The US\$7.5 million Rural and Indigenous Water and Sanitation Program (PN-G1003) was financed by the Spanish Fund for Water and Sanitation to reduce the coverage gap in underserved and unserved communities. This operation also complemented loans in execution: IDAAN Water and Sanitation Investment Program (PN-L1042) and CONADES Water and Sanitation Investment Program for the Provinces (PN-L1019).

C. INSTITUTIONAL RELEVANCE AND DONOR COORDINATION

Of the 13 main development institutions present in Panama, the IDB, CAF, and World Bank are the primary multilateral lenders. Panama also receives support from bilateral agencies, including the Spanish International Development Cooperation Agency and the United States Agency for International Development. Given the breadth (24 sectors) and size of Panama's public investment program, the Government encourages cofinancing. In water, for example, the World Bank is working in Colon, CAF in Panama City, and the Bank in the other provinces. In public finances, IDB and the World Bank coordinate efforts to improve public financial management and tax collection through PBPs. Particularly important was the role World Bank played in taking over a share of the policy actions originally included in the cancelled series of fiscal PBLs, thus compensating for the Bank's shift in program priorities. While there has been some overlap and sector overcrowding over time, there have generally been strong synergies among the different development actors.

The Bank has leveraged its reputation as a solid financial institution and strong collaborator to bring additional partners into the fold. Borrower representatives interviewed for this evaluation identified the Bank's capacity to ensure the technical quality of project design and execution and to build coalitions of support for critical initiatives, including the financing of the Canal expansion, as "value added." The "seal of approval" implied by the Bank's social, environmental, and fiduciary safeguards has reportedly enhanced project acceptance across institutional and party lines, thereby increasing the likelihood that long-term programs will survive different political administrations—that is, making them more sustainable.

D. PORTFOLIO MANAGEMENT

Between 2009 and 2014, there was a large reduction in program delivery costs compared to the prior CS 2003-2008— from US\$12,700 per US\$1 million approved to US\$8,600 per million approved.⁴⁷ While this trend is indicative of a portfolio that favors fast-disbursing loans, it also reflects actions taken to eliminate lingering operations.

Beginning in 2009, the Bank's Country Office in Panama (CPN) initiated a major restructuring of its operational program to enhance relevance and improve performance. Early and direct dialogue with the new administration made it possible to harmonize the Bank's portfolio with the PEG by simplifying the execution of various projects and consolidating like interventions. The effort to streamline the portfolio also led to a reduction in the number of executing agencies and in transaction costs. Between 2010 and 2014, US\$446 million in SG loans was cancelled (Annex II.13). Significant cancellations occurred in 2010 and 2011 when three older loans were brought to a close and a large share of the sustainable development portfolio was cancelled following a political decision to suspend the decentralization process. In 2013 the PBP guarantee was reduced by US\$85 million, and the remaining balance was cancelled the following year.

Efficiency indicators related to the preparation of investment loans have improved, yet the achievement of first disbursement still lags behind. The preparation of investment loans during the current strategy period averaged 12 months⁴⁸ to approval—less than half the average time required to achieve this milestone during the prior strategy period (24 months). This improvement is in part related to the streamlining of loan processing under the new lending framework, and to the strengthening of country office staff and functions under the realignment. However, once approved, an additional 17 months was required, on average, to achieve first disbursement—a decline in efficiency from the 11 month average during the 2005-2009 strategy period. The lack of improvement in this indicator is partly associated with constraints in the allocation of financial resources by MEF, due to the narrowing of fiscal space under the SFRL.

The investment portfolio has experienced implementation delays, reflecting varying degrees of institutional capacity and resources in key executing entities. Although the average age of the Panama's investment portfolio was 4.6 years in 2014, compared to 4 years for CID countries (Annex II.14), the share of loans with extensions declined from 54% in 2006 to 19% in 2010, and further still to 13% in 2014 (Annex II.15). This improvement was the result of ongoing COF actions to address protracted execution. Many investment projects and TCs stalled because of rotating project leadership, weak ownership, execution capacity, and changing overall priorities—most of which are cross-cutting issues in Panama. Particularly lengthy procurement processes, due to the required *ex ante* review by the Comptroller General (CGR)

of most procured goods and services, also contributed to the slow implementation of investment loans, as did the MEF's slow allocation of adequate budgetary resources, due to limited fiscal space. Annex II.16 illustrates key findings on project implementation that have affected the Program to Strengthen Fiscal Management (PN-L1066).

An increase in disbursements from PBLs has produced a significant increase in the flow of Bank resources to Panama. In 2005, the Bank's balances with the country were negative, and over the course of the 2005-2009 CS, net cash flows averaged just US\$12.4 million per year (Annex II.17). Since 2010, average net flows to Panama have increased to about US\$197 million per year, and disbursements have averaged US\$381 million per year. (The increasing participation of PBLs in annual disbursements over the past decade can be seen in Annex II.18.) This improvement is in part due to the flexibility of the programming exercise, which enables the Bank to engage annually with authorities in identifying interventions and instruments.



3

Panama Canal Expansion Project

The transport sector in Panama has great potential to drive economic growth and contribute to Panama's competitiveness as a major logistics hub, a strategic goal of the PEG.

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3 Program Effectiveness⁴⁹

This chapter examines the effectiveness of the Bank's country program in terms of implementation progress, the fulfilment of strategic objectives, and the sustainability of results. Not all projects are reviewed, as many of the investment loans designed and approved under the current CS have low disbursement rates and few if any documented outcomes and a number of inherited operations that were executed largely during the prior CS period were reviewed in the corresponding 2005-2009 CPE. Therefore, this results analysis focuses primarily on the four programmatic loan series that were approved and executed under the current strategy and that make up 72% of total SG lending in the period. It also includes loans and related grants approved during the current and prior strategies that were sufficiently advanced to produce results and which disbursed at least 30% of their original proceeds between 2010 and 2014.

As noted above, the 2010-2014 CS structured the Bank's program with Panama around six priority sectors, one cross-cutting theme, and 10 strategic objectives. The Results Framework included 27 outcomes and 42 indicators to measure the performance of the country program. Except for two indicators, the associated baseline and indicative targets are complete. (See Annex III.1 for the Results Framework, including data gathered by OVE on implementation progress.)

A. RESULTS BY PRIORITY SECTOR AND STRATEGIC OBJECTIVE ESTRATÉGICO

1. Sustainable public finances

- a) Raise revenue levels and modernize tax administration**
- b) Improve the management and efficiency of public expenditure**

Initially, the portfolio reflected the objectives of the CS in the sector (Annex III.2). The inherited PRODEV TC (PN-T1024, Support to Results-Based Management, US\$1.5 million) envisaged an integrated planning system within the MEF, facilitating results-based expenditure management through a monitoring and evaluation system, and creating incentives for public sector performance. While the TC failed to deliver this ambitious agenda, it opened the discussion on results-based budgeting and management within the MEF. In December 2010, the Bank approved the first (PN-L1067, Program to Strengthen Fiscal Policy, US\$200 million) of a programmatic series of four PBLs, which aimed at deepening tax policy and public expenditure reforms. Because it was the first PBL in the series, most of the policy triggers referred to reforms that had largely been implemented by the project approval date. The following year, the Bank approved an investment loan (PN-L1066, Program to Strengthen Fiscal Management, US\$50 million) to complement the policy reforms by strengthening capacity and upgrading systems and processes within the MEF (involving tax administration, the budget office, the investment planning office, treasury, and the financial administration systems).⁵⁰

The Bank adapted well to Panama's evolving priorities when in 2012 it shifted the focus of its cooperation from traditional revenue generation and expenditure management to macro-financial management and financial sector oversight. While the shift in focus was well aligned with the recommendations of international financial institutions, including the IMF, it represented an important departure from supporting the policy priorities stated in the CS. The subsequent truncation of three of the four planned PBLs in the first programmatic series resulted in a loss of key reforms with high SD from the sector policy framework, as well as a loss of synergies with the complementary investment loan to implement the reforms.

While the envisaged reforms were only partially aligned with the CS, they appropriately strengthened the sustainability of public finances, a key broad objective of the Bank's strategy. Under the new policy focus, building fiscal buffers against macroeconomic instability and addressing weakness in regulatory oversight became critical priorities for the Government. Three macro-financial PBLs (Strengthening Macro Financial and Fiscal Management, PN-L1086 and PN-L1089; and Financial and Fiscal Stability and Transparency Improvement I, PN-L1100) amounting to US\$765 million were approved. These three operations absorbed most of the country envelope for FY12, FY13, and FY14. The approved policy actions were aligned with IMF recommendations

under Article IV consultations and, given Panama's external vulnerability and its large and internationalized financial sector, gained political momentum in the wake of the financial and fiscal crisis in the Eurozone.

In terms of effectiveness, the objective of supporting sustainable fiscal policies in Panama was largely achieved; however, the results of the Bank's intervention were uneven, with more progress in revenue generation strengthening, fiscal risk management, and financial sector oversight than in public financial management.

- *Macro-financial reform and fiscal stability.* The effectiveness of this program, aimed at mitigating fiscal risks and reforming financial oversight, was strong; important reforms were passed and linked to the triggers in the three macro-financial PBLs (PN-L1086, PN-L1087, and PN-L1100). As a result, the Government has established the Sovereign Wealth Fund, which should help accumulate savings from the increased revenue arising from the expanded Canal and provide resources to maintain macroeconomic stability in economic downturns. The development of the public debt division of the MEF (and of the domestic market for government securities) helped the Government improve its management of its liabilities and gain credibility with capital markets. The financial sector's regulatory and supervision framework has been strengthened, and additional measures have been put in place to prevent money laundering, financial terrorism, and the financing of weapons of mass destruction. The Government has also made progress toward establishing a liquidity fund to act as a lender of last resort for the banking sector. Some advances in the area of regulation and supervision of the insurance sector have been achieved, but no progress has been made toward strengthening the supervisory framework for cooperatives, and there are delays in implementing the single treasury account.
- *Tax and public financial management.* The attempts to introduce better investment planning, results-based budgeting, and other expenditure management tools did not achieve significant results, because of severe implementation problems and lack of ownership by key stakeholders. To date, 10 institutions (8.3%) are using SIAFPA-Web, far from the 80% target in the CS; and although progress has been made in introducing the regulatory framework for the single treasury account, only 23 central government entities are currently using it (19.1% versus a target of 90%). The substantial progress made in tax administration stands out as the exception –the revenue collection targets for two major types of taxes were achieved and are sustainable. However, these outcomes cannot be attributed solely to the Bank's contribution, as revenue collection levels are also largely driven by strong economic growth. In the context of this progress, there was important (lasting) improvement in transparency and international coordination of taxation, enabling the OECD to remove Panama from its gray list –a key objective of the CS.



The installation of photovoltaic systems in Guna Yala has allowed its residents to extend their activities beyond sunset.

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The sustainability of results attained in the sector is not assured in areas where achievements are partial and the capacity in some executing agencies fragile, but is highly likely in areas where the authorities' commitment and social consensus are strong. For example, progress in modernizing the semi-autonomous tax administration has been significant but incomplete: building internal capacity, upgrading processes, and turning toward performance management remain pending tasks. Moreover, the removal of the authority's managerial and budgetary autonomy by a July 2014 resolution of the Constitutional Court could affect policy continuity and ownership of the reforms. By contrast, the reforms in the financial sector are firmly anchored in a broad domestic consensus and international requirements, and they are likely to continue. The same applies to the Sovereign Wealth Fund, which has strong political support. However, one of the ultimate goals in the CS –reducing the public debt as a proportion of GDP to ensure medium-term fiscal sustainability– was not achieved if the indebtedness linked to turnkey infrastructure projects is included in Panama's public accounts. As these debts mature in the coming years, the new government will need to constrain its expenditure or raise revenue to remain within the limits of the fiscal responsibility law.

2. Transport

a) Improve the quality of road infrastructure and strengthen its maintenance in other provinces

The transport sector in Panama has great potential to drive economic growth and contribute to Panama's competitiveness as a major logistics hub, a strategic goal of the PEG. Accordingly, IDB's country program focused on the sustainable improvement of overland freight and passenger transportation in priority corridors of the country, and on the inherited loan to expand the Panama Canal (Box 3.1).

BOX 3.1. THE PANAMA CANAL PROJECT (PN-L1032, US\$400 MILLION)

According to the Administrator of the Canal, the effectiveness of Bank support in this project centers on the Bank's ability to convene a consortium of multilateral support for the ACP. Although the Bank did not participate in the bidding design, it provided financial additionality through funding and by mobilizing resources (B lenders). The Bank properly led and coordinated the network of multilateral development banks, which required that idiosyncrasies and institutional norms be reconciled under a "single contract" approach. The Bank also provided environmental assistance to the project through a series of TCs. Although the Bank's loan is fully disbursed, it will not be possible to measure impacts until after the expansion is completed in December 2015.

Overall, the results in roads were mixed. The loan approved in 2010 (PN-L1047, Multiphase PPP Road Infrastructure for Competitiveness, US\$70 million) was the second phase of a loan already in execution (PN-L1070, US\$70 million). Both loans have experienced significant delays. Phase I was approved in 2006 and did not complete its disbursements until May 2014; and Phase II, which was approved in 2010, has only disbursed 22%. Some of the delays were due to problems with contractors; for example, one construction company that had been awarded three contracts abandoned them. On the other hand, the Ministry of Public Works did not have the capacity to properly execute the program. Despite these delays, Phase I surpassed its targets in terms of km of roads rehabilitated, reaching 493 km (vs. 290 km planned); however the maintenance fund is still not operational, putting at risk not only the sustainability of the Bank's projects, but all investment in the sector.

Another high priority for Panama was the construction of Metro Line 1, which opened in April 2014. Although the Bank did not participate in the works project, which involved CAF and European Investment Bank, it did finance a US\$1 million TC (PN-T1075) for pre-investment studies. A second TC (PN-T1117, US\$1.5 million) for Metro Line 2 has been approved, but has not yet begun to disburse. Although the use of Infra-Fund resources enabled the Bank to engage in the sector, it did not result in investment lending, given the relatively small size of the Bank's lending envelope in Panama after accommodating the Government's requests for budget support.

3. Water and sanitation

a) Increase coverage and quality, and improve the management, of water and sanitation services in the country's other provinces

Progress in managing the sector has been achieved, in part, through the programmatic approach that the Bank has taken. Bank interventions in water and sanitation are based on strong analytical work that began in 2008 and resulted in the preparation of a strategic plan for the sector in 2009. During the preparation of the CS, this body of work also informed the policy dialogue through which the Bank and Panama's authorities reached agreement on the objectives for the sector. A result of the process was a series of Bank-funded projects that

includes the combining and reformulation of four sustainable development loans (US\$119 million) in January 2010 into two operations in water and sanitation (PN-L1012, PN-L1005), the approval of a US\$94 million multiphase operation (PN-L1042, 2010; and PN-L1093, 2013) to improve water and sanitation coverage and strengthen IDAAN (the water and sanitation company); US\$30 million in supplementary financing (PN-L1053, 2009) for an older loan designed to improve sewage collection and treatment in Panama City; and a US\$7.5 million investment grant (PN-G1003, 2013) to increase the coverage of drinking water in select indigenous communities. These projects were complemented by six TCs valued at US\$2.85 million to strengthen IDAAN and CONADE's capacities to prioritize investments and manage change, to prepare an inventory of projects, and become more energy-efficient. By the end of 2014, water and sanitation was the largest of all active SG portfolios in infrastructure.

The Bank's intervention in the sector focused on increasing the coverage and reliability of water and sanitation services throughout the country. Except for the supplementary loan (which has not yet disbursed), the emphasis has been on medium and small urban cities and rural areas in provinces outside the capital, and on the institutional strengthening of IDAAN. To help IDAAN upgrade its managerial structure, the Bank used change management techniques that are frequently used in the private sector. With expert advice from the Bank, the Government appointed a high-level committee to reform IDAAN. The Minister for Canal Affairs, one of the most important cabinet members of the government, leads the committee. The committee has been instrumental in preparing new water laws for consideration by the National Assembly and in developing a business plan for the sector. The business plan includes a road map to restructure and modernize IDAAN, a financial model to inform the reform process, and an internal and external communication plan to inform employees and stakeholders about the importance of the reform. To date, the new institutional framework for IDAAN has not been approved, and several key staff exited the program following the change of administration; consequently, the achievement of the institutional targets and long-term sustainability of the institutional strengthening investments remain to be achieved. While it is likely that IDAAN will achieve or surpass several of its physical targets, including those for increased water supply (currently 93%, target 85%) and increased coverage of sanitation services (currently 57%, with a target of 63%), the quality of treated water remains precariously low—with just 18% of all samples meeting established standards in 2013. Losses due to non-revenue water dropped from 50% in 2013 to 48% in 2014 following the installation of meters and technology to detect and repair losses, financed with loan support.

4. Energy

a) Reduce electricity costs and improve energy efficiency

Panama is going through an energy crisis that has led to rationing electrical power. While there have been changes in the regulatory framework and policies, and significant investment in infrastructure, the sector not has been able to meet the

growing demand. There are bottlenecks both in the generation and transmission of electricity and in institutional capacity. Although the Bank approved only one loan in the energy sector during 2010-2014, a portfolio of around US\$80 million was in execution. The Bank's intervention was concentrated in the areas of institutional capacity, distribution, transmission, and generation.

Despite significant investment in transmission and distribution, the Bank has seen limited results. In 2008 the Bank approved the Investment and Corporate Transformation of ETESA Program – Phase I (PN-L1030, US\$12.5 million). This operation finished its disbursements in December 2013 after a six-month extension in the execution period and a US\$1.2 million cancellation. The delays were largely related to procurement and institutional capacity, especially in the management of corporate governance practices. The project still has not produced the expected results. The extension works of substations Santa Rita and Panama II had advanced only 65% by the end of the project, and the Chagres-Panama II and Santa Rita-Cáceres transmission lines only 47%. In distribution, the Bank approved the Rural Electrification Program (PN0150, US\$30 million) in 2006 to increase the coverage of the electrical distribution system, including photovoltaic systems. Delays at the beginning of execution, caused by lack of technical and administrative capacity for implementation, resulted in a two-year extension in the execution term. The main problems were related to procurement, specifically long delays in the bidding of isolated systems. Although the project did not disburse 100% of the approved amount, cancelling around US\$9 million, a second phase was approved in April 2014, for US\$22.25 million (PN-L1095).

Despite the cancellation of funds, the Rural Electrification Program reached most of its physical targets, but their sustainability is unclear. The program achieved 100% of its target to connect new users with national distribution systems, and 82% of its target to connect houses in isolated areas with photovoltaic systems. Of the 52 schools that were to be provided photovoltaic systems, 41 received them; and of the 11 health centers scheduled to receive the systems, 10 did. Notwithstanding this progress, during site visits to several remote indigenous communities that were previously off the grid in the Guna Yala Region, OVE noted that local committees organized to maintain the equipment were not working properly in most of the communities visited. The useful life of the batteries is between 5 and 10 years, and while the batteries were initially provided through the project at no fee, replacement batteries could cost up to US\$300 per family, making it almost impossible for impoverished communities to continue service. These communities also lag behind in the management of solid waste, which for the most part ends up in the sea, affecting the ecosystem. In reefs that surround the islands, it is common to see all kinds of waste, including compact fluorescent lamps used in photovoltaic systems, which are known for their high mercury content. Since there is no mechanism in place to dispose of the batteries and supplies used by these systems, there is a high risk of destroying vital coastal zones.

5. Education

a) Improve quality and retention, and expand the coverage, of education in indigenous territories

The Bank has been active in basic education in Panama through the Educational Development Project (PRODE) (PN0069, US\$58.1 million), which was approved in 1997, reformulated in 2006, and completed in December 2011. In addition, two new loans were approved over the period, of which one, Educational Facilities and Learning Quality (PN-L1064, US\$30 million) is at an advanced stage of execution. These operations collectively provided for improved conditions and quality of learning among 50,000 of the poorest and most vulnerable children in approximately 250 rural and indigenous communities. Specific actions targeted expanding the supply of education at the preschool and basic education levels through the repair and construction of 95 educational centers; enhancing learning quality through the provision of educational materials, instructional guides, and teacher training; and helping the Ministry of Education (MEDUCA) to reform basic and secondary education.

PRODE's implementation was continuously troubled by the complexity of its design, the low level of installed technical capacity in MEDUCA, frequent rotations of staff in the executing unit, and cost overruns, which frustrated many of the efforts to improve execution and limited the expected results. Lessons learned from PRODE's execution informed the design of PN-L1064, which identified well-defined targets and invests in actions that are expected to have the greatest impact on the identified problems. Consequently, PN-L1064 has disbursed 79% of its resources since approval in late 2010 and is on track to close in 2016.

According to the final external evaluation of PRODE,⁵¹ the project eventually met or surpassed all of its physical targets for new school construction and refurbishment. Preschool coverage was extended by an additional 8,286 places (6,000 planned) in 224 centers, and basic education coverage increased by a reported 27,840 places (7,200 planned) in 244 new and refurbished schools. Given the increase in demand, nearly 70% more teachers were trained and placed than originally planned. Although the measurement of learning outcomes was not envisioned in the project's design, a quasi-experimental evaluation is currently underway. To date, three data collections have been completed and the final analysis is in progress. While PN-L1064 is on target to achieve its outputs by the close of 2015, insufficient funds for continued execution has been identified as a possible risk moving forward, given limitations on public debt.

6. Health

a) Reduce health care coverage gaps in indigenous territories and rural communities

Panama's historical data show a link between inequities in socioeconomic status and access to primary health care services. At the end of 2011, the Bank approved the Health Equity Improvement and Services Strengthening Program (PN-L1068, US\$50 million) and



the 2015 Mesoamerica Health Initiative grant (PN-G1001, US\$2 million) with the objectives of closing the gap in health equity for those in the lowest income quintile, by increasing access to and use of quality primary health care services in indigenous *comarcas* and adjacent rural areas. Expected outcomes include a reduction in maternal mortality, child mortality, and chronic malnutrition of children under five years of age. Both operations became eligible for disbursement in 2012. The loan is currently 46% disbursed and the grant 54% disbursed. According to the PMR, execution has been problematic because of “*limited fiscal space*” which resulted in inadequate counterpart funding and a delay of 447 days between loan approval and disbursement eligibility. Consequently, 2013 is considered the first year of implementation for PN-L1068, hence it has not progressed sufficiently to report on outcomes. By contrast, Mesoamerica 2015 made significant progress towards the achievement of 8 of 10 results indicators in its first 24 months of operation, including access to family planning methods, pre- and post-natal care for mothers and infants, and child health monitoring. The operation also informed the inclusion of zinc in the national norm for the treatment of diarrhea.

At the end of 2011, the Bank approved the Health Equity Improvement and Services Strengthening Program and the 2015 Mesoamerica Health Initiative grant with the objectives of closing the gap in health equity for those in the lowest income quintile, by increasing access to and use of quality primary health care services in indigenous *comarcas* and adjacent rural areas.

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7. Country systems

- a) Use the Panama Integrated Financial Administration System
- b) Strengthen institutional capacity and the functions of the country's government procurement system
- c) Consolidate the institutional, legal, and regulatory framework for environmental management

The Bank is making only partial use of country systems in Panama. The CPN fiduciary team has worked and continues to work closely with government counterparts to achieve targets agreed in the CS; however, the use of national budget, accounting, treasury, and reporting

subsystems is low, and the public financial management modules are still not fully integrated.⁵² For example, the public investment system is only partly developed; and the integrated financial administration system (SIAFPA) uses an outdated technological platform that in 2013 was deemed unreliable for the financial management of projects without the addition of a projects module. As a result, just two-thirds of active loans use the budget subsystem, 15% use the treasury subsystem, and fewer than 10% use the accounting subsystem (Annex III.3). In the area of procurement, nearly all Bank projects use the Traditional Shopping and Framework Agreements subsystems of Panama Compras. Given the lengthy *ex ante* controls exercised by the CGR, government institutions' internal audit and control capacity is generally inefficient. As a result, most Bank-financed projects use trust companies or cooperation agencies, for which CGR *ex ante* controls are not required. In addition, the Bank requires that external auditors review all projects. Finally, the Bank did not address country systems dealing with environmental issues with as much attention as disaster risk management.

B. RESULTS IN OTHER SECTORS

1. Disaster risk management and climate change

Even though disaster risk management and climate change were not explicitly part of the CS for 2010-2014,⁵³ the Bank's program during the evaluation period included several operations in this area: a programmatic series of three PBLs to reduce vulnerability to natural disasters and climate change, of which only two were approved (PN-L1070 and PN-L1074); an emergency operation to respond to the 2010 flooding (PN-L1071); and a contingent loan for natural disaster emergencies (PN-X1007). TC resources were used for the preparation and implementation of the PBL series (PN-T1089) and for emergency response to the floods in two districts of Panama City in 2012 (PN-T1109). A total of four loans amounting to US\$320 million were approved, accompanied by two TCs totaling US\$850,000.

The strategic objectives of the PBP series were relevant as they sought to address priority problems of the country's disaster risk management and climate change sectors through (i) governance and financial management to improve and consolidate institutional capacity for comprehensive natural disaster risk management, and (ii) development of instruments and capacities for disaster risk management and climate change adaptation at the sector and subnational levels. In the context of financial management of disaster risk, the PBLs contributed to strengthening the institutional framework of the MEF particularly by expanding financial coverage of emergency assistance through contingent instruments, including the approval of a parallel US\$100 million (PN-X1007, 2012) contingent loan for emergency assistance.

Although implementation of the first two PBLs presented no major problems, the PBP series was not completed and important policy commitments were not implemented as a result. The first two PBLs contributed to progress in three areas:

(i) governance, including consolidation of Panama's legal and institutional framework for disaster risk management;⁵⁴ (ii) risk identification, an improved institutional framework for the exchange of information through inter-institutional agreements, and incorporation of the Probabilistic Risk Assessment Program tool into land management; and (iii) risk reduction, by incorporating the analysis of disaster risk into the public investment and land management planning processes. However, progress was interrupted by the non-completion of the third operation of the PBP series (PN-L1088). This third operation included more than 26 policy commitments of which at least 10 were considered of high SD for the sector, including the establishment of a permanent budget account for the efficient implementation of the National Plan for Management of Natural Disaster Risk (PNGRD). Three policy conditions were later incorporated in the subsequent PBP series on fiscal stability (PN-L1100), but only one of those was deemed to have high SD. Most of the remaining policy commitments have not been implemented to date.⁵⁵

Through the Emergency Program for the Immediate Response to Floods in Panama (PN-L1071), the Bank provided US\$20 million to support the Government's efforts to reinstate basic services for the population affected in 2010. The program included interventions in road infrastructure, potable water and sanitation, other infrastructure, health, and equipment for schools. The expected outcomes were the reinstated provision of basic services and infrastructure for the population affected by the floods and landslides in the provinces of Darién and Colón and the Panama East region. The program achieved most of its expected outcomes even though some of the planned activities were reduced in scope⁵⁶ or simply cancelled. However, in the context of a disaster emergency this loan faced difficulties in implementation. The Emergency Facility imposed excessive requirements and rigid deadlines for the execution of activities, which delayed the disbursement of funds beyond the immediate need.

2. The financial sector

The financial sector was not identified as a priority in the CS document, but the Bank ended up approving a significant number of operations. During the evaluation period, the IDB approved 11 lines with exposure under the TFFP facility, with a combined approved amount of approximately US\$50 million.⁵⁷ Apart from the TFFP, five additional loans for roughly US\$143 million were granted to Financial Intermediaries with the objective of growing their SME, green lending, or mortgage portfolios. OVE found that IDB added technical expertise, and a valued "seal of approval" that attracted other financiers. IDB played a countercyclical role as other sources became scarcer during the crisis. However, system liquidity in Panama is among the highest in LAC, so IDB's added value was predicated on other aspects.

OVE attempted to obtain evidence of IDB's potential additionality in other aspects, such as extending the banks' financing sources and tenors, increasing access to finance to more SMEs, and promoting innovation. OVE found that via TFFP operations IDB provided regional LAC banks with access to a large network of global financial intermediaries. This

gave smaller banks the opportunity to build long-term relationships for future businesses. By contrast, other operations aimed at extending the tenor of the bank's funding, yet OVE found that the small relative size of IDB's operations vis-à-vis funding pools did little to extend total tenors. Lastly, in an operation designed to increase access to finance for low- and middle-income housing, OVE found little evidence of further value added by IDB's involvement during this strategy period, almost 15 years after the borrower had started its innovative low/middle income mortgage approach. In fact, before IDB's 2011 operation, the borrower had already transformed itself into a regulated deposit-taking institution capable of supporting its regional subsidiaries.

3. Competitiveness

From 2010 to 2014, the Bank's involvement with the competitiveness agenda was primarily related to the implementation of loans and grants approved in the previous strategy. The loans consisted of two operations on trade, one on private sector development, and one on technological innovation. None of them met the original expectation to be disbursed within four years, nor did their objectives match the CS objectives for 2010-2014.

The disbursement of the two operations aimed at the trade sector was slow. The International Trade Capacity Building (PN-L1001, US\$4.7 million) and Competitiveness and Trade (PN-L1014, currently US\$33.3 million) loans were approved respectively in 2005 and 2007. One component of PN-L1014 was partially cancelled (about US\$15 million), and the loan was completed in June 2014. Regarding private sector development, the Investment Climate and Trade loan (PN-L1009, US\$4.8 million) was approved in 2006 and executed by the MEF. This project also suffered delays, attributed to coordination problems among the various government institutions with technical responsibility for program activities; its macroeconomic and fiscal components were reformulated in 2010, and it was completed in 2013. In the technological innovation area, the Bank implemented the Technological Transformation Program (PN-0158, US\$19.7 million), a 4-year program approved in 2008 that is not yet completed. Two problems hampered project implementation: the project was approved under the previous government, and changes in administration priorities led to the renegotiation of components, delaying the project's start. Also, lack of coordination between MEDUCA and the National Secretariat for Science, Technology, and Innovation imposed additional transaction costs. As of December 2014, the project had disbursed 81% of its approved amount.

There is no evidence that the Bank's operations were effective in boosting Panama's competitiveness. All outcome indicators of the completed projects raise attribution problems, since it is not possible to link the project's completion with the achievement of the expected impacts: enhanced GDP growth, exports, trade account and foreign direct investment, improved global competitiveness indexes, and increased private investment, technology absorption, and free competition in local markets.⁵⁸

Nevertheless, these projects delivered their main products. In the completed International Trade Capacity Building project, the Bank financed several activities aimed at strengthening the technical capacity of the Vice-Minister of Trade to negotiate and implement trade agreements, promote exports, attract investment, and build the Export Promotion Agency. In turn, the Competitiveness and Trade project supported the creation of the Guarantor Fund to Finance SMEs and funded the development of the E-government export platform, the Intellectual Property National System, and the implementation of the Master Plan of SME Authority. Lastly, the Investment Climate and Trade project delivered its reformulated outputs regarding the macro and fiscal area –such as the MEF’s multiannual financial program– but fell short in supporting the update of the legal framework for private sector participation in ports and airports and the development of an innovation strategy. It is still too soon to assess the effectiveness of the Technological Transformation Program.

4. Sustainable development, decentralization, and municipal management

The effectiveness of the inherited investment in Municipal Development and Decentralization Support Program (PN0143, U\$7.8 million) was very limited, because of a long, difficult implementation and the Government’s decision to suspend the decentralization process (Annex III.4). Likewise, at the request of the incoming administration, the inherited sustainable development portfolio,⁵⁹ which also had significant uncommitted balances related to strengthening local governance, was reformulated in January 2010 to focus exclusively on water and sanitation in provinces outside of Panama.

5. Social protection

The Social Protection Program, Phase I (PN-L1007, US\$20.17 million) was approved in 2007 and achieved 100% disbursement over the period. The program was accompanied by a set of TC operations intended to strengthen Panama’s social safety net through the design of related operations and reforms. One TC, PN-T1094 (Strengthening of the Social Protection Network in Panama), supported the design of a social protection and early childhood loan (PN-L1075), which was not approved because of lack of fiscal space. The Government’s Social Protection Note emphasized that the Red de Oportunidades displayed adequate coverage with potential to expand to additional extremely poor households; however, the program also presents leakage problems. The program’s target population is the extremely poor. Leakage was about 57.8% (33.5% of recipient households are moderately poor and 24.3% are not poor), and just 45% of all beneficiaries verified compliance. The sustainability of the program has diminished since its completion because of the lack of fiscal space to continue financing expenditures.



The distribution of loan resources across sectors was highly skewed and not on a scale commensurate with the social and economic disparities of a dual economy.

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4 Conclusions and Recommendations

The Bank is the largest multilateral lender to the Government of Panama. Over time, it has adapted to the Government's increased demand for fast-disbursing loans when the country faced a widening fiscal financing gap. This budget support, which was equivalent to 72% of all SG lending, aided Panama's efforts to build a strong macroeconomic policy framework for growth. The MEF counts on the Bank to continue to provide policy advice and fast-disbursing resources, which are now an important and reliable source of Government funding and a fluid component of IDB lending.

Despite a significant investment of staff time and financial resources, this evaluation observed a lack of coherence between the CS, the country program, and the de facto operational portfolio. This discrepancy reflects an inherent weakness in the Country Strategy and programming guidelines, which do not require that the Bank account for the sectors in which it has an active portfolio, despite the size or relevance of that portfolio. Likewise, actual programming was weakly linked to the CS. Operations were approved in nearly twice the number of sectors as prioritized in the CS, and the share of loans that were eliminated from the work plan on an annual basis was significant.

The Bank's programmatic lending has experienced successive changes in focus, which prompted the cancellation of a number of programmatic PBLs that supported reforms of high structural depth—cancellations that may have weakened progress towards the achievement of the agreed policy reforms. These changes were not justified in the CPDs, nor was the Board informed through an updated CS. Moving forward, the Bank will need to take additional measures to ensure the development effectiveness of its budget support.

The distribution of loan resources across sectors was highly skewed and not on a scale commensurate with the social and economic disparities of a dual economy. Panama's strong appetite for budget support was aimed at facilitating further public investment in large infrastructure projects within and around the highly developed Panama City-Colon Corridor. That portfolio focus has meant limiting the financial resources available to support pro-poor programming. Just 18% of Bank financing was allocated to the priority sectors that most directly addressed the challenges of a social character: infrastructure (water and sanitation, transport, and energy) comprised roughly 10% of total approved loan volume and the social sector (education and health) 8%.

Despite significant implementation delays, the Bank's investment portfolio contributed value. For the most part, investment loans offered an opportunity to concentrate financial and technical resources in areas outside of the Panama City-Colon Corridor, including in the *comarcas*, and to ensure that important programs and processes of a social character, which take time to evolve, were moved forward. While the operations were generally well-targeted and relevant for development challenges, many have experienced significant implementation delays, reflecting varying degrees of institutional capacity within executing ministries at the central and regional levels, fiscal constraints stemming from the SFRL, and inefficient country systems.

The mobilization of savings in Panama is considerably higher than in other countries in LAC. In turn, this makes financing to bankable clients and projects readily available and competitively priced. As a consequence, the IDB Group, which initially expected to mobilize a considerable amount of NSG resources in Panama, ended up playing a significant role only in connection with lines to financial intermediaries. In this niche, IDB brought a product with relatively low bureaucratic costs that was competitively priced vis-à-vis other funding sources. Although this did not preclude IDB from engaging in other areas, NSG funding was not used in areas such as infrastructure that require up-front tailoring and may involve challenges in complying with the Bank's environmental and social standards. The perception of market participants is that the IDB Group could play a significant role in not-yet-bankable projects that require a significant pre-investment and/or extensive public and private sector coordination.

Managing the transition from rapid economic expansion to a period of lower growth over the medium term will be key to maintaining the social and economic gains of the past decade. Panama has a textbook dual economy, so making growth more inclusive is essential to improving equity. Looking forward, the key challenge is to identify interventions that could promote inclusive growth in the non-Canal economy. This challenge was also identified in the previous CPE. Understanding what constrains the more traditional, labor-intensive sectors of the economy and supporting policy recommendations to accelerate their growth can have a potentially sizable payoff.

Going forward, OVE recommends that the Bank:

1. Work with the client to structure the new CS and background analytic work around key cross-cutting issues such as duality, poverty, productivity, and inequity, rather than by narrow sectors.
2. Given the high levels of inequality in the country and the slow reduction of poverty, seek ways to redouble IDB's efforts to support Government's pro-poor development agenda by focusing budget support more on issues relevant to poverty reduction and by continuing targeting investment lending more toward poor beneficiaries.
3. In the context of the overall strengthening of country systems and project management capacity, continue to support the client with strong institutional components. Support to the client should also include strengthening of municipal and regional development institutions and their capacity to more efficiently and effectively deliver basic services.
4. Strengthen the design, monitoring, and completion of future policy-based programmatic series to avoid interruptions in the Bank's comprehensive support for priority sectors and to ensure the achievement of a durable policy reform. When a PBP series is interrupted, it is recommended that the remaining operations be removed from the lending pipeline and a project completion report be prepared for the truncated series.
5. Strengthen risk analysis during project design and periodically reevaluate and reprioritize the lending program based on dialogue between the Bank and the Government of Panama, with a view to lowering the cost of projects prepared but later removed from the pipeline or canceled. Major deviations in the scope or focus of the country program from that envisioned in the CS should be justified and reported to the Board.

- ¹ Panama's economy is fully dollarized, having adopted the US dollar as legal tender in 1904.
- ² In 2013, Panama's GDP per capita (PPP) was the highest in Central America, followed by Costa Rica (US\$12,942), Belize (US\$8,176), El Salvador (US\$7,515), Guatemala (US\$5,282), Honduras (US\$4,839), and Nicaragua (US\$4,554). Source: IMF (2014), *Regional Economic Outlook: Western Hemisphere*. Washington, DC.
- ³ The Colon Free Zone is the second largest free trade zone in the world after Hong Kong.
- ⁴ Panama is divided into 10 provinces and three *comarcas*—administrative regions with a substantial indigenous population. According to the 2010 census, just over 12% of the population is indigenous.
- ⁵ See Annex I.2 for the complete Macroeconomic Overview.
- ⁶ Panama's national accounts are currently being rebased from 1996 to 2007. The revision includes enhancements to the computation methodology in key sectors (including trade, transportation, and financial). The upward revision of nominal GDP is between 5% and 8%, depending on the year. The revised statistics had not been released as of this report.
- ⁷ IMF (2015). *Concluding Statement of the 2015 Article IV Mission*. Washington, DC.
- ⁸ In addition to this debt, contingent liabilities resulting from turnkey projects (a practice followed by the previous government) amounted to nearly 10% of GDP. These liabilities, which are to be paid between 2014 and 2019, are not counted as debt until the project is completed and taken over by the Government.
- ⁹ Reforms were implemented in 2002, 2005, 2009, and 2010.
- ¹⁰ IMF's debt sustainability analysis concluded that Panama's public debt is sustainable over the medium term, even in the presence of significant shocks. See Annex II, 2014 Article IV consultation.
- ¹¹ IMF (2013). *Panama: Selected Issues*. IMF Publications Services. Washington, DC.
- ¹² The limit on the overall deficit of the non-financial public sector was modified to 2.5% of GDP in 2009 and 2% in 2010. Nevertheless, as Annex I.1 shows, the actual fiscal deficits were 1% and 1.8% of GDP, respectively. The limit was further modified in 2011-2012 to 3% of GDP to finance extraordinary spending to address the damages of severe rains and higher energy subsidies; again, the actual deficits were lower. The 2014 fiscal deficit reached 4.1% of 2007-base GDP.
- ¹³ This should also apply to the bulk of extra revenue that could be collected from Cobre Panama (see ¶1.10).
- ¹⁴ IMF (2014). *Panama: Staff Report for the 2014 Article IV Consultation*. Washington, DC.
- ¹⁵ The US-Panama FTA entered into force on October 31, 2012, following a long negotiation process that began in April 2004.
- ¹⁶ Cobre Panama is expected to produce 320,000 tons a year, adding (at current prices) some US\$2 billion to annual exports.
- ¹⁷ APEDE CADE (2014). *Democracia y Desarrollo: Retos para un futuro sostenible*.
- ¹⁸ World Bank Group (2013). Osborne, T; Pachon, M.C; Araya, G.E. *What drives the high price of road freight transport in Central America?*
- ¹⁹ ECLAC (2010). *The Economics of Climate Change: Summary 2010*.
- ²⁰ Dilley, M. Chen, R.S., Deichman, U., Lerner-Lam, A.L., and Arnold, M. (2005). *Natural Disaster Hotspots: A Global Risk Analysis*. Disaster Risk Management Series, No. 5.
- ²¹ IDB (2007). Cárdenas M., Salazar N. *Panamá's Growth Diagnostic*.
- ²² United Nations Development Programme (2014). Human Development Report. New York.
- ²³ In 2006, the incidence of poverty and extreme poverty in rural Panama was 2.7 and 6.8 times higher in rural areas than in urban areas; however, by 2012, the gap widened to 4 and 8.4 times higher, respectively.
- ²⁴ Banco Mundial (2012). *Mejores Empleos en Panamá: El rol del capital humano*. Departamento de Desarrollo Humano, Región de América Latina y el Caribe.

- ²⁵ The 2009 Program for International Student Assessment (PISA) ranked Panama among the bottom 3 of 65 participating economies in reading, science, and math proficiency for students aged 15 years. PISA also measures competencies, such as problem solving, that students have acquired. International evidence shows that students who do not attain PISA baseline proficiency lack the skills needed to participate effectively and productively in society and contribute to inclusive growth. Panama opted out of PISA 2012.
- ²⁶ Census and Statistics Directorate of Panama.
- ²⁷ The International Labor Organization Statistical Update on Employment in the Informal Sector of June 2012 shows in Table 1 that Panama's informal employment in the nonagricultural sector was 43.8%.
- ²⁸ IMF, 2015 Article IV Consultation, March 2015.
- ²⁹ Although not a priority sector, climate change was identified as an area of dialogue in footnote number 12 of the CS document.
- ³⁰ Panama's Strategic Government Plan 2010-2014 aims to sustain annual economic growth of 6-9%, and to reduce poverty and income inequality through human capital formation and social inclusion. Value-added logistics services, tourism, agriculture, and financial services were identified as the four engines of growth in which Panama has or could develop a sustainable competitive advantage, and where government actions could be used more efficiently to realize the potential of these sectors. The PEG envisaged a 104% increase (US\$13.6 billion) in the public investment program for 2010-2014 (excluding the Canal expansion), compared to the US\$6.7 billion in investments executed in 2005-2009. Of this amount, about 70% addressed long-term investments in economic infrastructure (i.e., expanding irrigation systems, tourism, airports and roads) and social infrastructure (including the construction of schools, hospitals, housing, the urban metro, sewage, drainage, and new penitentiary centers).
- ³¹ See Country Strategy Guidelines: GN-2468-6 (2009).
- ³² See Mid-Term Evaluation of IDB-9 Commitments: Country Programming Background Paper, OVE 2013, for a detailed analysis of challenges in operational programming across Bank countries.
- ³³ This cost represents the administrative budget expenditures assigned to these projects in the Lawson system.
- ³⁴ MEF, Dirección de Crédito Público, Movimientos del Periodo por Acreedor. October 14, 2014.
- ³⁵ The inherited loan portfolio included operations in reform and modernization of the state, the environment and disaster prevention, water and sanitation, education, transport, energy, social protection, private firms and SME development, agriculture, housing, urban development, financial markets, technology, and trade.
- ³⁶ This number includes non-committed amounts under TFFP lines.
- ³⁷ Source: Loan Management System of the IDB.
- ³⁸ The undisbursed balance includes the US\$350 million PBP guarantee (subsequently cancelled in 2014), and a US\$100 million contingent facility for natural disasters.
- ³⁹ *Structural depth* is defined as the extent and durability of structural change that a policy condition could in itself bring about if implemented. Ratings are defined as: (i) *low SD*: commitments that would not by themselves bring about any meaningful changes, although they could perhaps serve as stepping-stones for more significant reform in the future; (ii) *medium SD*: commitments that can be expected to have immediate and significant, though not long-lasting, effects; and (iii) *high SD*: commitments that by themselves would bring about long-lasting changes in the institutional environment. Programmatic loans are expected to contain a mix of SD conditionality that leads to securing durable reform.

- ⁴⁰ Three of the 26 policy conditions of the last operation in the climate change PBP series were later included in the fiscal PBP series (PN-L1100); only one of the three condition was considered of high SD. There were nine additional high SD conditions in the last operation, of which the government implemented at least two on its own (see Chapter III, Disaster Risk Management and Climate Change section).
- ⁴¹ While CPD 2012 states that “the country strategy is currently being updated to include new sectors of priority to the Government of Panama: (i) climate change and natural disasters; (ii) social protection; and (iii) technological innovation” it does not reference the shift in PBL sector financing. As of the close of 2014, the CS had not been updated.
- ⁴² It should be noted that the PBP guarantee was not part of the Bank’s approved lending instruments at the time that PN-L1086 was approved. Nonetheless, the guarantee facilitated a delay in recording the debt and expenditures associated with the completion of large-scale turnkey projects. By law, these liabilities are not recorded until the projects are completed and taken over by the Government. In 2014, the incoming administration of President Varela faced approximately US\$3.6 billion in liabilities and deferred payments related to large-scale public investment projects contracted by the previous administration. These liabilities, which will fall due over 2015-2019, will effectively narrow the new Government’s spending room, consistent with the deficit limit set by the SFRL.
- ⁴³ NSG Lending Policy, GN2400-17, Par. 1.10: “NSG operations would continue to be country-focused and consistent with the country programming process. While individual country strategies shall be given priority in the origination of IDB NSG operations, such strategies should be applied with flexibility in order to allow the financing of those operations that are important to a country and are of high development impact, and for which the IDB brings additionality, but may not correspond to a specific priority in its country strategy.”
- ⁴⁴ Although outside the scope of the CPE, IIC approved a US\$10.5 million loan to Hidroeléctrica San Lorenzo.
- ⁴⁵ Data regarding TFFPs may differ from other reports because they are mostly administered outside current bank wide systems (OPUS, LMS); and the data in the official Bank’s repository (EDW) is incomplete.
- ⁴⁶ Structured and Corporate Finance activities were complemented by the approval of seven MIF operations. Although the evaluation of MIF is outside the purview of this CPE, it is worth noting that the sole project approved by the Bank in the agriculture sector was a MIF grant to develop sustainable economic alternatives and conservation strategies.
- ⁴⁷ This cost is calculated using administrative expenditures specifically assigned to Panama’s total portfolio and total approvals for every given year. Source: Lawson.
- ⁴⁸ This indicator is calculated from the first month that a total of 40 hours were reported to a specific project in the T&L system, to ensure consistency when comparing loans approved before and after the “new project cycle”.
- ⁴⁹ For the purpose of this evaluation, the operational portfolio comprises all SG and NSG loan and TC grant operations (excluding IIC and MIF) that were either active or approved between January 1, 2010, and December 31, 2014.
- ⁵⁰ IDB has been a continued close partner of the Government in the sector, particularly in the area of fiscal management. As OVE noted (IDB 2009. Evaluation of the Role of the IDB in the Fiscal Sector. Washington, DC), between 1990 and 2004 the Bank approved 12 projects with components aimed at strengthening this sector in Panama: Three focused on strengthening customs, three targeted tax administration, three supported the integrated financial management system, two dealt with the national investments system, and one aimed at implementing the decentralization law. Thus, the Bank addressed the entire set of institutions involved in the different stages of revenue generation and expenditure management in this continuous effort, developing good diagnostics of their level of progress and institutional capacity.
- ⁵¹ Instituto IDEA International (2012).

- ⁵² By comparison, a recent sector and thematic OVE evaluation documented that virtually all high- and middle-income countries use national budget and treasury subsystems for Bank projects. Source: IDB (2013). *How is the IDB Serving Higher-Middle-Income Countries? Borrowers' Perspective*. Washington, DC.
- ⁵³ As stated earlier, although not a priority sector, climate change was identified as an area of dialogue in footnote number 12 of the CS document
- ⁵⁴ Approval of the PNGRD.
- ⁵⁵ The government implemented at least a couple of policy conditions on its own, such as the creation of the Panamanian Spatial Data Infrastructure for using, exchanging, and accessing geospatial information, and the approval of the National Plan for Integrated Management of Water Resources.
- ⁵⁶ Because of cost overruns, only 11 of 41 potable water systems were rehabilitated.
- ⁵⁷ Un préstamo por US\$10,5 millones para la Hidroeléctrica San Lorenzo.
- ⁵⁷ Data regarding TFFPs may differ from other reports because they are mostly administered outside current bank wide systems (OPUS, LMS); and the data in the official Bank's repository (EDW) is incomplete.
- ⁵⁸ It is worth noting that a short-term impact evaluation of SENACYT's support found that it has been an effective tool for promoting innovation efforts. On average, firms that received support from SENACYT invested three times more than firms that did not receive support. See Crespi, G., G. Solis and E. Tacsir. *Evaluación del Impacto de Corto Plazo de SENACYT en la Innovación de las Empresas Panameñas*, Notas Técnicas IDB-TN-263, April 2011.
- ⁵⁹ The sustainable development portfolio was made up of four inherited loans: PN-0062, PN-L1053, PN-L1042, and PN-L1093.