

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PANAMA

**PROGRAM FOR MUNICIPAL DEVELOPMENT AND
DECENTRALIZATION SUPPORT**

(PN-0143)

LOAN PROPOSAL

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CONTENTS

EXECUTIVE SUMMARY

I.	FRAME OF REFERENCE.....	1
A.	Institutional and local development policy context.....	1
B.	Diagnosis of municipal management capacity	6
C.	Conceptual overview of the program.....	8
D.	The Bank's and country's strategy	9
E.	The Bank's experience and lessons learned	9
F.	Relationship to other operations and coordination with bilateral agencies and multilateral organizations	10
II.	THE PROGRAM	12
A.	Objectives, program strategy and scope	12
B.	Program description	14
1.	Component 1. Municipal strengthening and development	14
2.	Component 2. Support for local development and decentralization policymaking.....	16
C.	Scale of the program	19
D.	Costs and execution period.....	19
III.	PROGRAM IMPLEMENTATION	21
A.	Borrower and executing agency	21
B.	Program institutional structure	21
C.	Execution of program components	22
D.	Program regulatory instruments	24
E.	Technical cooperation	25
F.	Procurement of works, related goods and services, and consulting services	25
G.	Disbursements and revolving fund.....	25
H.	Program financial and accounting management.....	26
I.	Program monitoring	27
J.	Program evaluation	27
K.	Audits.....	28
L.	Ex post evaluation.....	28
IV.	VIABILITY AND RISKS.....	30
A.	Institutional, financial and economic viability	30
B.	Environmental and social viability.....	31
C.	Social equity and poverty classification.....	31
D.	Benefits	31
E.	Risks	32

ANNEXES

Annex I	Logical framework
Annex II	Procurement plan

BASIC SOCIOECONOMIC DATA

For basic socioeconomic data for Panama, please refer to the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

INFORMATION AVAILABLE IN THE TECHNICAL FILES

Preparation:

Annex 1A	Municipio classification proposal, Altair Asesores, June 2002
Annex 2A	Municipal diagnostic study methodology, Altair Asesores, June 2002
Annex 3A	The fiscal, administrative, financial and institutional situation of municipios in Panama, and a reform proposal, prepared for AMUPA by José Larios of Barents Group, November 1999
Annex 4A	Support for decentralization and municipio development, prepared for the IDB by Héctor Serravalle, June 2001
Annex 5A	Municipal strengthening strategy, Altair Asesores, June 2002
Annex 6A	Review of decentralization regulatory framework and agenda, Javier Aguilar, February 2003

Execution:

Annex 1B	Municipal Action Plan (Arraiján)
Annex 2B	Municipal Action Plan (Barú)
Annex 3B	Municipal Action Plan (Bugaba)
Annex 4B	Municipal Action Plan (Chitré)
Annex 5B	Municipal Action Plan (Colón)
Annex 6B	Municipal Action Plan (David)
Annex 7B	Municipal Action Plan (Olá)
Annex 8B	Municipal Action Plan (Panamá)
Annex 9B	Program Operating Regulations

ABBREVIATIONS

AMUPA	Asociación de Municipios de Panamá [Panamanian Municipios Association]
CCP	Comité Consultivo Programa [Program Consultative Committee]
CONADEL	Coordinadora Nacional para la Descentralización y el Desarrollo Local [National Decentralization and Local Development Coordinator]
DGL	Dirección de Gobiernos Locales [Local Government Office]
DPR	Dirección de Planificación Regional [Regional Planning Office]
FES	Fondo de Emergencia Social [Social Emergency Social Fund]
MEF	Ministerio de Economía y Finanzas [Ministry of Economic Affairs and Finance]
MGJ	Ministerio de Gobierno y Justicia [Ministry of the Interior and Justice]
MIVI	Ministerio de Urbanismo y Vivienda [Ministry of Urban Development and Housing]
PAM	Plan de Acción Municipal [Municipal Action Plan]
PEU	Project executing unit
PNDLD	Política Nacional de Desarrollo Local y Descentralización [National Local Development and Decentralization Policy]
SIAP-PA	Sistema Integrado de Administración Financiera de Panamá [Integrated Financial Management System of Panama]
TA&T	Technical assistance and training
UTM	Unidad Técnica Medioambiental [Environmental Technical Unit]



PANAMA

IDB LOANS

APPROVED AS OF OCTOBER 31, 2003

	US\$Thousand	Percent
TOTAL APPROVED	2,054,573	
DISBURSED	1,629,377	79.30 %
UNDISBURSED BALANCE	425,196	20.69 %
CANCELATIONS	408,470	19.88 %
PRINCIPAL COLLECTED	774,999	37.72 %
APPROVED BY FUND		
ORDINARY CAPITAL	1,728,843	84.14 %
FUND FOR SPECIAL OPERATIONS	280,023	13.62 %
OTHER FUNDS	45,706	2.22 %
OUTSTANDING DEBT BALANCE	854,378	
ORDINARY CAPITAL	785,314	91.91 %
FUND FOR SPECIAL OPERATIONS	69,064	8.08 %
OTHER FUNDS	0	0.00 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	206,410	10.04 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	74,514	3.62 %
ENERGY	392,183	19.08 %
TRANSPORTATION AND COMMUNICATIONS	474,525	23.09 %
EDUCATION	127,423	6.20 %
HEALTH AND SANITATION	132,109	6.43 %
ENVIRONMENT	103,380	5.03 %
URBAN DEVELOPMENT	67,425	3.28 %
SOCIAL INVESTMENT AND MICROENTERPRISE	96,837	4.71 %
REFORM AND PUBLIC SECTOR MODERNIZATION	345,312	16.80 %
EXPORT FINANCING	0	0.00 %
PREINVESTMENT AND OTHER	34,454	1.67 %

* Net of cancellations with monetary adjustments and export financing loan collections.



PANAMA

STATUS OF LOANS IN EXECUTION AS OF OCTOBER 31, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Before 1997	2	53,624	41,013	76.48 %
1997 - 1998	10	403,056	217,502	53.96 %
1999 - 2000	3	67,950	26,640	39.21 %
2001 - 2002	8	145,699	5,834	4.00 %
2003	2	45,500	0	0.00 %
TOTAL	25	\$715,829	\$290,989	40.65 %

* Net of cancellations. Excludes export financing loans.



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Panama

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
PN0159	Improvement Road Integration Corridor PPP	37.0	APPROVED
PN0144	Urban Poverty Colon	8.5	APPROVED
PN0143	Program of Municipal Development and Strengthening	8.0	
Total - A : 3 Projects		53.5	
TOTAL 2003 : 3 Projects		53.5	

2004

Project Number	Project Name	IDB US\$ Millions	Status
PN0139	Priority Activities Hydrographic Basin Panama Canal	5.0	
PN1001	International Trade Capacity Building	5.0	
PN0062	Panama City Sanitation Project	100.0	
* PN0154	Colon International Airport	35.0	
PN0141	Program for a Territorial Economic Development (PROTIERRA)	12.5	
Total - A : 5 Projects		157.5	
PN0157	Justice Program II	20.0	
PN0160	Pension System Reform	100.0	
* PN0155	Bonyic Hydroelectric Project	10.0	
Total - B : 3 Projects		130.0	
TOTAL - 2004 : 8 Projects		287.5	

Total Private Sector 2003 - 2004	45.0
Total Regular Program 2003 - 2004	296.0

* Private Sector Project

PROGRAM FOR MUNICIPAL DEVELOPMENT AND DECENTRALIZATION SUPPORT

(PN-0143)

EXECUTIVE SUMMARY

Borrower:	Republic of Panama	
Executing agency:	Ministry of Economic Affairs and Finance (MEF), with participation from beneficiary municipal governments.	
Amount and source:	IDB (OC):	US\$7,800,000
	Local contribution:	<u>US\$1,950,000</u>
	Total:	US\$9,750,000
Terms and conditions:	<p>The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendation. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1%, of the loan amount¹ (paragraph 2.20).</p>	
	Amortization period:	20 years
	Grace period:	4 years
	Disbursement period:	4 years
	Interest rate:	Adjustable option
	Inspection and supervision:	0%
	Credit fee:	0.25% per annum on undisbursed balances
	Currency:	United States dollars drawn from the Single Currency Facility
Objectives:	<p>The program aims to make municipal governments more responsive to the needs of the local population. Actions will include: (i) modernization of municipal governments to enable them to better fulfill their current responsibilities; and (ii) support for improvements to the institutional and policy framework, to enable municipal governments to gradually become key agents of local development.</p>	

¹ In no case will the inspection and supervision fee exceed, in a given six-month period, the amount that would result from dividing 1% of the loan amount by the number of six-month periods in the original disbursement period.

The program strategy is to make progress simultaneously on municipal capacity strengthening and modernization of the institutional and policy framework, in order to lay the foundations for local development and move the decentralization process forward gradually in a fiscally responsible manner.

The program strategy for municipal government modernization is to establish a system of incentives for better municipal performance, making it possible to gradually reduce municipal governments' financial dependence on central government, and to generate demand conditions for the development of a municipal financing system.

The program strategy for improving the institutional and policy framework for local development and decentralization is to support a gradual process of formulating a national policy that identifies and addresses Panama's mainstay local development issues and extends to the adoption of a local development policy incorporating the necessary legal/institutional reforms. In view of previous experience in Panama, particularly with decentralization bills, an approach has been sought that would make it possible to address key aspects of local development within the current legal framework, or following reforms that can be implemented by the executive branch, thus laying the foundations for any higher-order legal/institutional changes that may subsequently become necessary.

Description:

PROGRAM DESCRIPTION

Component 1. Municipal strengthening and development (US\$8.044 million). This component will finance the formulation, implementation, and monitoring of institutional strengthening plans in participating municipal governments. Activities to be funded include:

- a. **Municipal strengthening subcomponent (US\$2.93 million).** This subcomponent will finance the formulation, implementation, and monitoring of municipal action plans (PAMs) in 15 municipal governments. The plans will be developed on a case-by-case basis, and may include such activities as: (i) financial, tax, and administrative modernization; (ii) strengthening of municipal planning; and (iii) improving service delivery.
- b. **Development of municipal management tools subcomponent (US\$654,000).** This subcomponent will finance the development and implementation of a basic financial management and tax administration system in participating municipios. Activities will include drafting of rules and regulations, design of an implementation strategy based on municipio classifications,

development of information technology applications, and the specifications for the equipment the municipios will need. The system to be developed will be based on the same principles as the Integrated Financial Management System of Panama (SIAF-PA), which the Ministry of Economic Affairs and Finance is promoting for central government agencies.

- c. **Municipal investment subcomponent (US\$4.46 million).** This subcomponent will finance priority investment projects in areas of municipal jurisdiction. Access to resources will be contingent upon participating municipal governments' gradually fulfilling the institutional modernization targets set in their PAMs. Projects to be financed by this program must be in areas of municipal jurisdiction, including: (i) improving and expanding storm drainage systems; (ii) parks, plazas, and public roads; (iii) erosion and flood protection; (iv) markets; (v) slaughterhouses; (vi) public cemeteries; and (vii) infrastructure for solid waste disposal and treatment. Several different funding alternatives will be studied for sectors in which charges or fees can be collected, so that the projects financed are those of great socioeconomic benefit without other private funding options.

Component 2. Support for local development and decentralization policy-making (US\$735,000). This component will finance consensus building and formulation of the National Local Development and Decentralization Policy (*Política Nacional de Desarrollo Local y Descentralización*, PNDLD), together with improvements to the municipal regime. The following activities will be funded:

- a. **Subcomponent 1. Development of the PNDLD and municipal reforms (US\$285,000).** This subcomponent will support the government in developing the PNDLD and municipal reforms by generating sound and reliable technical information to be used in weighing options and making informed decisions. In particular, funding will be provided for: (i) preparation of the studies and proposals necessary for PNDLD formulation as it relates to developing a municipal financing system, developing a municipal planning system, modernizing modes of municipal service delivery, promoting local governance and citizen participation, and developing municipal training and technical assistance systems; and (ii) development of the PNDLD and proposed legal/institutional reforms within the jurisdiction of the executive branch.

- b. **Subcomponent 2. Support for consensus building and adoption of the PNDLD (US\$450,000).** This subcomponent will support the government in building consensus and the process of adopting the PNDLD, and the municipal reforms necessary for its implementation. Funding will be provided to: (i) strengthen MEF capacity in the area of local development policy; (ii) promote dialogue on local development and decentralization policy options; and (iii) conduct an information and publicity campaign.

**The Bank's
country and
sector strategy:**

The Bank's country strategy with Panama has the following aims: (i) to reduce poverty and enhance equity; (ii) to promote economic reforms to spur competitiveness and growth; (iii) to help consolidate the regulatory, legal, and institutional framework for sustainable growth; and (iv) to contribute to institutional reforms to enhance governance and transparency.

This operation is consistent with the Bank's strategy, since it will finance municipal government modernization, which in turn will contribute to stronger governance and transparency at the local level. The proposed operation is also consistent with the strategy of the Government of Panama, since one of the targets of its social agenda is to move forward on decentralization.

The operation is consistent with the Bank's subnational development strategy, which stresses the importance of supporting central government in providing better technical assistance and training services (TA&T) to municipal governments, establishing municipal financial management systems that affect transparency and local governance; building the institutional capacity of municipal governments; and laying the foundations for steady improvement in municipal finances.

**Coordination
with other
official
development
agencies:**

The activities to be financed by the program will complement and help enhance the effectiveness of such other programs as: (i) the World Bank's second rural poverty, natural resource management, and municipal development program, which includes a strengthening component for rural municipios; (ii) programs for municipal strengthening and proper handling of solid waste financed by the Spanish International Cooperation Agency; (iii) the twenty-first century municipios program financed by the United Nations Development Programme (UNDP); and (iv) programs with municipal strengthening components or activities financed by the United States Agency for International Development (USAID). To facilitate coordination among programs, the Government of Panama has developed a database containing detailed information on the different

municipal projects and their geographic locations, which has been very useful in designing this program. In addition, in the preparation phase, contacts have been maintained with bilateral agencies and multilateral bodies to ensure meaningful coordination (paragraphs 1.29 and 1.30).

Environmental and social review:

The program's intervention strategy is to incorporate the environmental variable into the modernization plans of participating municipal governments, in order to improve their capacity to deliver public environmental services, enforce national environmental regulations, and better manage environmental permits in areas of municipal jurisdiction.

The program also includes resources for investments in municipal environmental services, such as solid waste management and urban greening, which will benefit the local population while also contributing to proper use of the environment.

The program will have a positive social impact by introducing participatory planning methodologies that will make it possible to better align the allocation of municipal investment resources with citizen needs. This will help improve living conditions among the municipio's population by giving them a local government that is focused on providing services and infrastructure that will contribute to local development and help reduce poverty (paragraphs 4.6 and 4.7).

Benefits:

Municipal governments will benefit from the program through access to technical assistance and training (TA&T) for modernization, so as to respond better to citizen needs. On conclusion of the program, the participating municipal governments will be able to assume additional responsibilities, thereby helping to promote local development and decentralization in Panama. In terms of socioeconomic benefits, the program will contribute to greater efficiency in public spending by establishing mechanisms (municipal planning, socioeconomic evaluation methods, and others) that will ensure greater responsiveness to citizen needs and higher-quality local investments. The program will also contribute to better fiscal management by promoting greater mobilization of internally generated municipal funds, resulting in fewer municipios having to rely on subsidies from central government to cover their operating expenses.

Risks:

The main risk to program outcomes is that no political or social consensus may emerge to adopt the PNDLD and the changes to the legal framework needed to start implementing it. To mitigate this risk, the team has structured component 2 so as to give equal importance to the substantive aspects of the PNDLD and municipal reforms as to the design of the implementation strategy. In addition to supporting the

consensus-building process, component 2 promotes strategic partnerships around the main pillars of the PNDLD, so as to create the conditions for its approval and implementation.

There are also execution risks related to institutional shortcomings and the participants' lack of experience with programs such as the one being proposed. Steps have been taken to reduce this risk by funding a range of training and strengthening activities for the MEF and municipios.

The risk to program continuity associated with the elections of May 2004 will be mitigated by conducting information activities with the new national and municipal authorities that will be involved in the program.

**Special
contractual
clauses:**

Conditions precedent to the initial disbursement:

- a. The executing agency has set up the program executing unit (PEU) within the MEF's Regional Planning Office and named the program coordinator and at least one PEU specialist (paragraph 3.2);
- b. Entry into force of program Operating Regulations as agreed between the MEF and the Bank (paragraph 3.18).

The Bank may release up to US\$200,000 for compliance with conditions precedent to the first disbursement, once the Government of Panama has fulfilled the general conditions precedent contained in the loan contract with the Bank.

**Poverty-
targeting and
social sector
classification:**

Social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth General Increase in Resources (document AB-1704). However, it does not qualify as a poverty-targeted investment (PTI) (paragraph 4.8).

**Exceptions to
Bank policy:**

None.

Procurement:

Goods and services procurement will comply with the relevant Bank policies. International competitive bidding will be required for contracts in excess of: US\$1 million for construction works, US\$300,000 for goods and related services, and US\$200,000 for consulting services.

I. FRAME OF REFERENCE

- 1.1 Panama has a land area of 75,517 km² and is divided politically and administratively into 75 municipal districts and 588 *corregimientos*, or resettled indigenous communities. Despite a relatively high per capita GDP of around US\$3,000, over 37% of the Panamanian population live below the poverty line, and half a million (19%) live in extreme poverty.
- 1.2 Panama is a highly centralized country that lacks a policy to organize government local development actions. As a result, the model for allocating responsibilities among the different levels of government does not reflect a clear development strategy, nor does it encourage municipal governments become key agents of local development. Consequently, most investment responsibilities and resources to address the population's needs are concentrated in central government hands and are exercised by line ministries and deconcentrated agencies.
- 1.3 The Government of Panama has decided to address the issue of local development through efforts to promote, firstly, modernization in municipal governments, and, secondly, the adoption and implementation of a National Local Development and Decentralization Policy (*Política Nacional de Desarrollo Local y Descentralización*, PNDLD). This two-pronged approach aims to: (i) generate the institutional and contextual conditions for municipal governments to contribute more effectively to local development; (ii) enable municipal governments to make more efficient use of their resources and leverage more locally generated income to finance investments; (iii) introduce mechanisms to better align spending decisions with local needs; (iv) support greater citizen participation in local development issues; (v) strengthen local governance; and (vi) improve the framework of intergovernmental fiscal relations. Since the work required to make progress on these issues is technically complex and needs to be viewed as a long-term effort, the Government of Panama has requested Bank support in the form of a program for municipal development and decentralization support.

A. Institutional and local development policy context

- 1.4 Municipal governments in Panama have responsibilities in administration, social assistance, justice administration and the management of a number of services. Law 106 of 1973 and Executive Order 25 of 1989 divide municipal government responsibilities into seven categories: (i) delivery of municipal services such as slaughterhouses, markets, street cleaning, solid waste disposal, cemeteries and crematoria; (ii) delivery of administrative services such as issuing vital records certificates, operating permits, certifications and other documents; (iii) first-instance justice administration in family disputes; (iv) municipal development planning, including the management and execution of projects and actions included in such plans; (v) urban development and control, including the construction of parks, walkways and public roads, and the issuance of building permits; (vi) delivery of emergency services in response to natural disasters; and (vii) collection and use of

taxes, fees and charges to finance expenses of municipal administration, services and investments.

- 1.5 Major shortcomings have been identified in three of these areas of responsibility: (i) governance and citizen participation; (ii) the municipal government support and coordination system; and (iii) the municipal financing system.
- 1.6 **Local governance and citizen participation.** There are five key local governance institutions: (i) the mayor, elected by popular vote and responsible for municipal administration; (ii) the treasurer, appointed by the municipal council to head up municipal tax administration and financial management; (iii) the municipal council, consisting of representatives elected from the *corregimientos* and responsible for overseeing municipal government and issuing orders, directives and development policies for the municipio; (iv) community associations (*juntas comunales*) consisting of representatives from the local associations (*juntas locales*), the district *corregidor* and a *corregimiento* representative whose function is to promote community organization and actions to enhance *corregimiento* development; and (v) local associations (*juntas locales*), which are the bodies for citizen participation in issues related to *corregimiento* development.
- 1.7 At first sight, the existence of several local management and decision-making mechanisms suggests a strengthening of democracy and citizen participation. Nonetheless, several situations have developed in practice that require attention:¹ (i) despite being in charge of municipal government administration, and, as such, responsible for the municipal budget, the **mayor** does not have information on revenues and resources available to the treasurer (who answers to the municipal council); consequently, the treasurer sets priorities for, and manages, spending; (ii) the treasurer's tax administration powers are insufficiently regulated, giving rise to broad discretionary powers; (iii) the **municipal council** has a say in decisions that ought to be entirely administrative, such as the appointment of professional staff and budget execution, thereby undermining the mayor's authority and hampering efficient municipal administration; (iv) the **community associations** have no mechanisms for systematically ascertaining citizen needs, so investment priorities do not always respond to the population's needs or fit into a local development strategy; and (v) the requirement for the various central government agencies to coordinate with community associations on any activity calling for community participation weakens efforts to consolidate municipal governments as representing local interests and as interlocutors with the central government.
- 1.8 In addition to these institutions, Panama also has provincial councils consisting of the governor appointed by the executive branch, the provincial representatives of

¹ The analysis that follows is based on studies carried out on a consultant basis by ALTAIR Asesores, Héctor Serravalle, José Larios and Javier Aguilar. These studies are listed in the table of contents for the annexes.

ministries and autonomous and semi-autonomous bodies, representatives of the *corregimientos*, mayors, and district legislators. Some of the main functions of provincial councils are to: (i) prepare plans for public works, capital investments and services in the province; (ii) evaluate the execution of programs and projects financed by central government; (iii) oversee the operation of public utilities; and (iv) oversee the utilization of natural resources. With the current institutional structure, provincial councils should first and foremost be organizations for consultation and coordination of central government activities in the regions. This does not happen, however, owing to the absence of mechanisms and tools for regional planning and the lack of incentives for greater participation by *corregimiento* representatives and mayors.

- 1.9 **Municipal government support system.** With the current institutional structure, responsibility for municipal government support is divided between the Ministry of the Interior and Justice (*Ministerio de Gobierno y Justicia*, MGJ) and the Ministry of Economic Affairs and Finance (*Ministerio de Economía y Finanzas*, MEF). Technical assistance and training (TA&T) provided by the MGJ through its Local Government Office (*Dirección de Gobiernos Locales*, MGJ/DGL) is characterized by: (i) a focus on justice administration and the workings of the various local government institutions (especially the *corregimientos*, community associations and local associations); (ii) unsystematic implementation in the absence of work plans to organize activities and set measurable and verifiable targets; and (iii) failure to promote the development of a TA&T market, since services are provided directly or with what little support can be obtained from other public bodies. Furthermore, on issues in which the Local Government Office has managed to develop a degree of institutional capacity (essentially justice administration and legal counsel), this tends to be more the result of efforts by a handful of staff members than an institutional strategy.
- 1.10 The Ministry of Economic Affairs and Finance (MEF) is another major player within the municipal-government support and coordination system. According to its legal mandate, the MEF is responsible for setting up and operating structures for public investments, budget, finance, the national treasury, cadastre, public credit and modernization of the State, to support formulation and adoption of economic, financial and social policies. In fulfilling this mandate, the MEF designs and executes policy guidelines and sets specific tasks for the government in such areas as finance, cash management and modernization of the State. Acting through its Regional Planning Office (*Dirección de Planificación Regional*, DPR), the MEF interacts with other regional, provincial, municipal and local institutions, and provides leadership in establishing uniform criteria, methods and standards in the areas under its authority for the different levels of government. In addition to this, the MEF—acting through the DPR—is responsible for promoting local/regional

development, for which purpose it designs and executes projects with municipal governments,² incorporating financial and institutional strengthening activities.

- 1.11 Other government agencies that provide TA&T to municipios include the Ministry of Agricultural Development, the National Environment Authority and the Office of the General Government Prosecutor. Activities carried out by these agencies are confined to their respective areas of jurisdiction and are poorly coordinated.
- 1.12 **Condition of the municipal financing system.** The following figures reflect the scant economic importance and financial shortfalls of municipal governments: (i) just 2.75% of total public spending is by municipios, compared to an average of 6% in other Central American countries; (ii) municipal investments average US\$0.5 per capita per year; and (iii) two out of every three municipios receive subsidies to cover their operating expenses.
- 1.13 Municipal revenues come from the following sources: (i) tax collection (65% of the total); (ii) non-tax revenues including charges, duties, transfers, rental and sales, and miscellaneous income (31%); and (iii) capital revenue (4%). The main structural weaknesses affecting revenues are as follows:
 - a. **Municipal taxes:** (i) these are heavily concentrated in sources that have the potential to distort resource allocation, such as taxes on economic activity; (ii) land tax is a central government responsibility, when in most cases it could be administered efficiently at the municipal level; (iii) very weak development of local taxation administration systems and regulations; and (iv) insufficient human resources trained in municipal tax policy and administration .
 - b. **Administrative and municipal service charges:** (i) costs and benefits are only loosely correlated as a general rule, creating problems for service sustainability; (ii) charges are out of date; (iii) there are no rules on service quality and coverage; and (iv) shortcomings in administration generate technical and business inefficiencies.
 - c. **Transfers:** Panama still lacks a transfer system that would provide an incentive for better institutional performance or raise and channel municipal investment. The meager transfers made to municipios are used to cover the current deficit in two out of every three municipalities in Panama. Some US\$2.5 million in transfers for current expenditures are distributed on the basis of historical

² The main local/regional development projects executed by the MEF include the Darién and Bocas del Toro sustainable development programs and the Colón urban poverty reduction program. MEF is also participating in the design of the World Bank's second rural poverty, natural resource management, and municipal development program, which contains a municipal development component targeting a sample of rural municipalities.

municipal budget data, and there is no strategy for reducing this item of expenditure.³

- 1.14 The municipal government expenditure structure allocates 70% of the total for current expenditure (including wages, nonpayroll services, materials and supplies), 2% for capital expenditure, and 5% for allowances and subsidies. The remaining 23% is absorbed by transfers to *corregidores*. The inefficiency of local tax administrations, combined with inflexible expenditure, makes it hard to generate current saving and thus impairs the municipio's capacity to undertake investments. In a budget of nearly US\$70 million (in 2002) combining a sample of municipios, total municipal investments were less than US\$1.5 million per year (2%). These data highlight the minor role played by municipal governments in local development and the delivery of services to citizens.
- 1.15 Panama also lacks policies that contribute to financial strengthening among municipal governments, or promote their greater autonomy. In particular, Panama would benefit from: (i) a strategy to reduce the financial reliance of many municipios on current transfers from central government; (ii) basic rules and systems for municipal financial management and tax administration that would enable it to improve expenditure management and increase public revenues; (iii) a long-term strategy to develop new sources of municipal financing; and (iv) a policy under which the funds the country spends on training and technical assistance (usually as components of sector programs) are linked to measurable and verifiable results in terms of greater financial sustainability.
- 1.16 **Proposals for modernization of the institutional and legal framework.** In view of the problems mentioned above, municipal governments and a number of political and civil-society organizations have been carrying out actions to promote greater decentralization towards the municipios. In 1998, the National Decentralization and Local Development Coordinator (CONADEL)⁴ persuaded the three leading presidential candidates to sign a "Decentralization Pact." This established a commitment to promote decentralization by setting up a Presidential Commission for Decentralization of the State⁵ and creating a Decentralization and Municipal Affairs Committee in the Legislative Assembly, as well as to by fostering greater

³ The budget of the Republic of Panama contains a Community Civil Works Program, which steers some US\$15,000 per year to each of the approximately 600 *corregimiento* representatives. Although channeled through the municipal budget, these resources not classified as transfers to municipal governments.

⁴ This body is comprised of municipal governments through the Association of Municipios of Panama (AMUPA); the Kuna General Congress; the Civil Society Assembly; NGOs (the Panamanian Center for Social Studies and Action (CEASPA), and the Panamanian Institute of Municipal Studies (IPADEM)); and MGJ/DGL. It has also received support from UNICEF; the United Nations Population Fund (UNFPA); UNDP; and, subsequently, the MEF and IDB.

⁵ The commitment to decentralization is also expressed in target 4 of the current government's social agenda.

citizen participation in local planning processes; development of municipal management capacity; inclusion of the environmental considerations in managing local development; and respect for the traditional government structures of indigenous peoples.

- 1.17 Nearly five years after the decentralization pact was signed, the situation is as follows: (i) a preliminary draft of a bill to amend the rules and regulations applicable to municipios has been introduced by one of the opposition parties in three consecutive legislative sessions (2000-2002), but it has never proceeded further than the initial debate; (ii) work to review amendments to the rules governing municipios initiated by the Presidential Commission was never completed, and the Commission was disbanded without achieving any tangible results; and (iii) efforts by the Panamanian Municipios Association (AMUPA) to reach consensus on a proposed Decentralization Framework Law were unsuccessful.
- 1.18 The most hotly disputed issues in the various proposals for municipal reform are: (i) the powers and duties delegated to the provincial governor and provincial council in the areas of local/regional development planning and public investment; (ii) the transfer or nontransfer of property tax to the municipios; (iii) greater or lesser regulation of the makeup of community associations and their functions; (iv) the amount, funding sources, conditionality and distribution arrangements of a new intergovernmental transfers system; and (v) the imbalance between resource decentralization and expenditure responsibilities. It is also worth noting that none of the reform proposals for the legal framework was based on a diagnostic study of the current situation faced by municipal governments, or on technical studies to underpin the reform proposals, or on public policy proposals in relation to local development.

B. Diagnosis of municipal management capacity

- 1.19 The diagnostic study of municipal management capacity was carried out with support from technical-cooperation operation ATN/SI-7509-PN on decentralization and municipal development, drawing on experience gained in the Panama City comprehensive municipal development program (ATN/JSF-6925-PN). For the diagnosis, municipios were classified on the basis of three parameters: (i) population; (ii) receipt of operating subsidies; and (iii) whether or not the municipal governments had institutional planning and coordination mechanisms⁶ (see Table I-1). Based on this classification, a sample of municipal governments

⁶ In the classification, this administrative structure criterion is measured as complete or partial.

was selected, consisting of Panamá, Arraiján, David, Barú, Colón, Bugaba, Chitré, Olá, Changuinola and Chepigana.⁷

Table I-1
Municipio Classifications

Metropolitan			Panamá
Urban		Complete administrative structure	David, Arraiján
		Partial administrative structure	Colón
Semiurban	Not subsidized	Complete administrative structure	
		Partial administrative structure	Barú, Bugaba, Changuinola, Chitré
	Subsidized	Complete administrative structure	
		Partial administrative structure	
Rural	Subsidized	Complete administrative structure	
		Partial administrative structure	Chepigana, Olá

- 1.20 For each of the municipal governments in the sample, a diagnostic study was prepared, together with a Municipal Action Plan (PAM) for institutional modernization, which was validated with authorities and technical staff from each municipio. The studies identified the following municipal management areas as having the most substantial shortcomings: (i) financial, tax and human resource management; (ii) management of local services; and (iii) local development planning and environmental management. In addition to these management problems, there is also considerable unsatisfied investment demand in areas of municipal responsibility.
- 1.21 **Financial, taxation and human resource management.** Nearly all municipios in the sample suffer from severe financial management and tax administration problems. Few municipios in Panamá have reliable standards and systems for accounting, budget, cash management and cadastre⁸ that would enable them to make transparent and efficient use of public resources. The main shortcomings in financial management and tax administration are: (i) a low level of computerization making it impossible to streamline processes and to reduce errors and discretionary action; (ii) lack of taxpayer services to make it easier to pay taxes and charges; (iii) inefficiency in all phases and stages of financial management and tax

⁷ Strengthening activities in the last two municipios mentioned will be financed with funds from the Bocas del Toro Sustainable Development Program, following the methodology established in the present program.

⁸ Panamá is making major strides in improving its real estate registry and cadastre systems. But this progress contrasts with scant development of fiscal cadastres at municipal level, given that property tax is a central government competency. Nonetheless, even within this framework, strengthening of the fiscal cadastre of municipal taxpayers is a very important part of the process of modernizing the municipal tax system.

administration;⁹ (iv) acute lack of skilled human resources at municipios; and (v) weak linkages between makeshift municipal systems and those developed at national level. In addition, municipal governments are not structured to provide services to the citizenry; they lack a suitable management structure, do not always possess professional and technical resources with the right skills set for municipal work, and lack an adequate system of technical assistance and training to respond to their different needs.

- 1.22 **Management of municipal services.** The administration of municipal services (solid waste, markets, cemeteries, greenspace and parks, etc.) is generally done directly. The most common management problems include: (i) low service coverage and poor quality; (ii) lack of resources for new investments; (iii) absence of cost accounting systems; (iv) rate structures that do not allow for costs to be recouped or service coverage to be expanded; and (v) lack of rules regulating the correct functioning of services. In addition to these problems, several municipal governments have taken steps to involve the private sector in service provision, but with unsatisfactory results owing to inexperience with tendering processes.
- 1.23 **Municipal development planning.** Municipal development planning functions (which would normally include physical, participatory and strategic planning, together with investment management) are poorly developed because municipalities make few investments and a major share of urban planning functions are in the hands of the Ministry of Urban Development and Housing (MIVI). Nonetheless, within municipal competencies, there are major shortcomings in municipios' capacity to: (i) enforce the construction standards issued by MIVI; (ii) prepare and implement development plans and projects; (iii) build citizen participation into community and *corregimiento* development planning; (iv) manage the project cycle and programming of municipal investments; and (v) promote better environmental management through education campaigns.¹⁰ Recent efforts to include citizen participation in the local investment planning process, promoted by the Social Emergency Fund (FES), have been positive at the community association level, but have not yet had an impact on strengthening the municipal planning system.

C. Conceptual overview of the program

- 1.24 Municipal development problems in Panama are too complex to be resolved without simultaneous intervention locally and in the public policy domain. If municipal government strengthening takes place without an enabling environment, there is a risk of results achieved in the short run proving unsustainable. On the other hand, if the public policy framework is modernized without municipal

⁹ For example, the total revenue actually collected from the tax on economic activity is just 50% of the expected amount.

¹⁰ The National Environment Authority has plans to establish environmental technical units (UTMs) in each municipio, although their specific functions have yet to be determined.

government strengthening, there is a risk of designing public policy instruments that are unsuited to the country's needs, and of expanding the competencies of municipal governments, which, in some cases, are unable even to discharge their current responsibilities. Accordingly, the program envisages parallel actions at the local and central government levels, in order to create the conditions for municipal governments to become key agents of local development, in a gradual and fiscally responsible fashion.

- 1.25 Valuable input on project design and preparation was provided by municipal governments, the Panamanian Municipios Association, and representatives from several central government bodies (especially the Ministry of Economic Affairs and Finance, and the Ministry of the Interior and Justice). Three stakeholder events have been held: (i) a consultancy study startup workshop; (ii) a workshop to present the findings of preparatory studies; and (iii) a workshop on the logical framework. In addition, the program Operating Regulations have been reviewed with a group of municipal and central government representatives. All the above is intended to ensure that the program responds as closely as possible to the identified needs and perspectives of the different stakeholders.

D. The Bank's and country's strategy

- 1.26 The priorities of the Bank's country strategy with Panama (Country Paper GN-2136-1) are: (i) poverty reduction and greater equity; (ii) economic reforms to spur competitiveness and growth; (iii) consolidation of the legal and institutional framework for sustainable growth; and (iv) institutional reforms to strengthen governance and improve transparency. This operation is consistent with the Bank's strategy, since it will provide funding for municipal government modernization and the creation of conditions favoring local development. This, in turn, will contribute to improved governance and transparency among municipal governments. In addition, the proposed operation is consistent with the strategy of the Government of Panama, given that the fourth goal set in its social agenda is to make progress on decentralization.
- 1.27 The operation is consistent with the subnational development strategy, since actions will be carried out in all the Bank's priority project areas, namely: (i) intergovernmental relations; (ii) subnational financing; (iii) local governance; and (iv) strengthening of subnational governments. The recommendations for establishing an incentives system to improve municipal government performance have been incorporated into both PNDLD design and municipal development activities.

E. The Bank's experience and lessons learned

- 1.28 The Bank has broad experience in municipal strengthening and decentralization programs, as described in the Sector Evaluation Report on Decentralization

(document RE-323/98). This report identifies the following lessons learned: (i) assignment of responsibilities to municipal governments needs to be matched by an adequate funding system; (ii) decentralization requires tighter definition of the jurisdictions of intermediate levels of government; (iii) care is needed to prevent intergovernmental transfers from discouraging municipalities from harnessing own resources; (iv) steps should be taken to ensure that TA&T activities are demand-driven and flexible enough to respond to the diversity of municipal governments; (v) citizen participation should be encouraged in all decision-making processes; (vi) the poorer municipal governments should be given support in investment planning; and (vii) incentives should be put in place to improve municipal governments' financial and institutional performance. The Bank's most recent operational experiences (e.g. state and municipal strengthening programs in Mexico (ME-0208 and ME-0231), the program for municipal strengthening and development in Nicaragua (NI-0156), and the local development program in El Salvador (ES-0120)), show that municipal development and decentralization need to be pursued simultaneously, that improving municipal government financial and institutional capacities is more effective when undertaken as part of a system of incentives, and that support for decentralization should take a medium- to long-term outlook. These lessons have been taken into account in the preparation of this program.

F. Relationship to other operations and coordination with bilateral agencies and multilateral organizations

- 1.29 In Panama there has been a tendency to distribute the benefits of municipal strengthening projects on geographic criteria in keeping with the priorities of international cooperation agencies or multilateral organizations. This program sees potential benefits in seeking the common ground among the various projects and supporting the coordinating role played by municipal authorities. The proposed operation will therefore complement other programs and projects financed by the Bank. Specifically, it will: (i) help to ensure that cadastral information generated in the framework of the national land administration program (PN-0148 [1427/OC-PN]) is useful for municipal government planning functions; (ii) help to consolidate participatory planning methodologies promoted by the poverty alleviation and community development program (PN-0111 [1226/OC-PN]) by relating them to municipal planning processes; (iii) help to ensure that efforts to improve financial management and tax administration at the national level also extend to municipal governments; and (iv) create conditions to ensure that investments in urban poverty projects (Colón urban poverty program) (PN-0144 [1476/OC-PN]) do not occur in isolation, but rather are complemented by a comprehensive municipal development program.
- 1.30 Program activities will complement and help enhance the effectiveness of such other programs as: (i) programs for municipal strengthening and solid waste management financed by the Spanish International Cooperation Agency; (ii) the

twenty-first century municipios program financed by United Nations Development Programme (UNDP); (iii) programs with municipal strengthening components or activities financed by the United States Agency for International Development (USAID); and (iv) the World Bank's second rural poverty, natural resource management, and municipal development program, which is in preparation and includes a strengthening component for a sample of rural municipios. The MEF, acting through the DPR, is responsible for executing both the municipal component of the World Bank's second rural poverty program and the program proposed here, so conditions exist for close coordination and complementarity between the two operations.

II. THE PROGRAM

A. Objectives, program strategy and scope

- 2.1 **Objective.** The program aims to make municipal governments more responsive to the needs of the local population. Actions will include: (i) modernization of municipal governments to enable them to better fulfill their current responsibilities; and (ii) support for improvements to the institutional and policy framework, to enable municipal governments to gradually become key agents of local development.
- 2.2 **Program strategy.** The program strategy is to make progress simultaneously on municipal capacity strengthening and modernization of the institutional and policy framework, in order to lay the foundations for local development and move the decentralization process forward gradually in a fiscally responsible manner.
- 2.3 The program strategy for municipal government modernization is to promote the adoption of good municipal management practices, such as performance measurement and the implementation of comprehensive institutional modernization plans. In addition, a series of targets has been established for each type of municipio, which will enable them to gradually reduce their financial dependency on central government transfers and generate demand conditions suitable for the development of a municipal financing system in the medium and long term. This set of targets for each type of municipio has been designated as a phased approach. More specifically, the municipal government modernization strategy consists of the following:
 - a. **Differentiation and integral nature of municipal strengthening packages.** In recognition of the heterogeneity among municipal governments, it has been decided to classify them by type (see paragraph 1.19) and, based on a sample, design a strengthening package best suited to their requirements. The package of strengthening activities defined for each type of municipio is set out in municipal action plans (PAMs) containing performance indicators in the three program areas of (i) finance and administration; (ii) service management; and (iii) municipal development planning.
 - b. **Measurement of financial and institutional performance.** Municipios will receive technical assistance to achieve the targets for better financial and institutional performance contained in each PAM. In addition, municipios' access to investment resources has been made contingent on their meeting those targets. This arrangement strengthens the incentives for municipios to modernize.

- 2.4 The program strategy for local development and decentralization policy is to support the central government in a gradual process of formulating a national policy that identifies and addresses Panama's mainstay local development issues and extends to the adoption of a local development policy incorporating the necessary legal/institutional reforms. In view of previous experience in Panama, particularly with decentralization bills, an approach has been sought that would make it possible to address key aspects of local development within the current legal framework, or following reforms that can be implemented by the executive branch, thus laying the foundations for any higher-order legal/institutional changes that may subsequently become necessary. More specifically, the program strategy at this level is to:
- a. **Identify the pillars of local development.** Five pillars or priority areas for promoting local development in Panama have been identified: (i) design of a municipal financing system conducive to the creation of supply and demand conditions that give municipal governments access to different financing options, depending on their means; (ii) modernization of the local and regional planning system; (iii) modernization of modes of municipal service delivery; (iv) local government strengthening and the creation of effective mechanisms for citizen participation; and (v) establishment of mechanisms to foster the formation of skilled human resources to work in the municipalities.
 - b. **Apply basic principles.** The basic principles guiding the design of a local development and decentralization policy should include the following: (i) subsidiarity, whereby competencies are exercised at the most local level feasible; (ii) allocative efficiency, creating conditions for closer correspondence between investment needs and decisions; (iii) gradualness, whereby the transfer of competencies to local levels should be gradual, differentiated by type of municipal government, and fiscally responsible; (iv) incrementalism, building on the basis of what already exists; (v) technical efficiency, producing more with the same quantity of inputs; and (vi) sustainability, whereby institutional progress in local development should be lasting.
 - c. **Achieve policy consensus.** The adoption and implementation of a new national policy for local development and decentralization will depend largely on its being underpinned by a process of consensus-building that takes account of interests likely to be affected by the introduction of reforms, and on the establishment of a sequence of activities that enables the government to make sure progress at each stage.
- 2.5 **Scope of the program.** Actions aimed at municipal strengthening and establishment of a national policy for local development and decentralization will be carried out simultaneously. The scope of strengthening and municipal development activities will be confined to a group of 15 municipal governments, in order to gain experience to design and implement a local development and decentralization policy based on the genuine potential and ability of municipal

governments to assume greater responsibilities. As regards local development and decentralization policy, the program will concentrate on issues relating to design, instituting an implementation strategy, support for the consensus-building and approval process, and development of municipal management tools. The program will also include adoption of reforms to the legal/institutional framework that can be carried out by government agencies, and promote higher-order changes to the municipal legal/institutional system calling for legislative approval.

B. Program description

- 2.6 To achieve its objectives, the program has been designed in two components: (i) municipal strengthening and development; and (ii) support for local development and decentralization policy-making.

1. Component 1. Municipal strengthening and development (US\$8.044 million)

- 2.7 This component will finance the formulation, implementation and monitoring of municipal action plans (PAMs) in the participating municipal governments. PAMs will be formulated on a case-by-case basis, and may include activities for financial and administrative modernization, strengthening of municipal planning functions, and improvements to service administration. Access to the program's investment resources will require proof of progress made in the strengthening activities agreed in each PAM.
- 2.8 **Subcomponent 1. Municipal strengthening (US\$2.93 million).** Using the funding allocated to this subcomponent: (i) PAMs will be designed and executed in the municipios of Panamá, Arraiján, David, Colón, Bugaba, Barú, Chitré and Olá; and (ii) PAMs will be designed and executed in another seven municipal governments, to be selected by the executing agency using criteria established in the program's Operating Regulations. Activities eligible for funding include the following:
- 2.9 **Modernization of administration and finance.** This includes training, technical assistance and equipment to: (i) prepare and execute a financial improvement plan; (ii) re-engineer administrative and decision-making processes; (iii) implement a basic municipal financial management and tax administration system (compatible with SIAF-PA); (iv) expand and improve the taxpayer database by upgrading the municipal property registry; (v) establish rules and procedures on procurement of goods and services; (vi) improve human resource management; and (vii) design and implement a municipal training plan.
- 2.10 **Better management of municipal services.** Technical assistance and training (TA&T) activities will be financed to: (i) prepare and execute modernization plans in at least one municipal service; (ii) achieve greater private-sector participation in the delivery of municipal services; (iii) improve the services' technical and business

- efficiency indicators; (iv) establish independent accounting and management systems for paid municipal services; (v) review and improve the rate structure within the current legal framework; (vi) improve and regulate the quality and operation of municipal services; (vii) support the creation of leagues of municipios and other institutional arrangements aimed at making service delivery more efficient; and (viii) design and implement environmental education campaigns to elicit behavior among the population that helps to ensure services (particularly solid waste management) are provided in accordance with national environmental protection laws.
- 2.11 **Municipal development planning.** This includes funding to: (i) establish mechanisms for promoting broad and inclusive citizen participation in the municipal planning process; (ii) prepare and implement a Municipal Development Plan (PDM); (iii) establish a municipal program of priority investments, developed on a participatory basis; (iv) conduct preinvestment studies for the municipal projects to be financed by the program that meet the eligibility criteria of the Operating Regulations; (v) create and build capacity at the municipal planning office in such areas as land use, cadastres, environmental management and natural disaster prevention and response; and (vi) develop a capability to prepare and evaluate projects from the technical, financial, economic and environmental standpoints. Local and community organizations also could be strengthened, enabling them to participate actively in municipal planning processes.
- 2.12 **Subcomponent 2. Development or adaptation of municipal management tools (US\$654,000).** This subcomponent will finance the development of a basic financial management and tax administration system in participating municipios under the PAMs. Activities will include drafting of rules and regulations, design of an implementation strategy based on municipio classifications, development (or adaptation) of information technology applications, and the specifications for the equipment the municipios will need. The system to be developed will be based on the same principles as the Integrated Financial Management System of Panama (SIAF-PA), which the Ministry of Economic Affairs and Finance (MEF) is promoting for central government agencies. The system will also be designed for better information linkage, compatibility and flow with other systems developed by the central government, such as the cadastre system.
- 2.13 **Subcomponent 3. Municipal investments (US\$4.46 million).** Priority investment projects may be financed in areas of municipal jurisdiction. Access to investment funding will require the municipal government to execute a PAM; this will enable it to improve its financial and institutional performance, according to its municipio category. A framework agreement will specify the maximum amount of investment funding that can be allocated to each municipio and the conditions on its use. Access to the funds will involve three stages: (i) 30% of the maximum amount will be allocated once the municipal council adopts the PAM and undertakes to made the contribution applicable to its category; (ii) in the second stage, 40% of the

maximum amount will be allocated once the first financial and institutional targets have been achieved, as agreed in the respective PAM, and 50% of resources and work from the first stage are shown to have been committed and executed; and (iii) the final 30% will be allocated once the second group of targets been achieved, as agreed in the respective PAM; execution of projects financed with resources from the first stage has been completed; and 50% of resources and works financed with funds from the second stage are shown to have been committed and executed. As a general condition for access to investment funding, the beneficiary municipal government must provide evidence of having taken action to come up with its contribution. Local contributions may be made in cash or in the form of land plots suitable for investments, provided these have been appraised by the MEF's Property Registry Office (*Dirección de Catastro y Bienes Patrimoniales*) and the Engineering Office (*Dirección de Ingeniería*) of the Office of the Comptroller General (*Contraloría General de la República*), as required by law. The maximum amount of the contribution in kind will be as established in the Operating Regulations (100% for rural municipios, 75% for semiurban municipios, and 50% for urban ones).

- 2.14 Projects to be financed by this program must be in areas of municipal jurisdiction, including: (i) improving and expanding storm drainage systems; (ii) parks, plazas and public roads; (iii) erosion and flood protection; (iv) markets; (v) slaughterhouses; (vi) public cemeteries; and (vii) infrastructure for solid waste disposal and treatment. Several different funding alternatives will be studied for sectors in which charges or fees can be collected, so that the projects financed are those of great socioeconomic benefit without other private funding options. When investments are made in paid services, the municipal government will ensure that action is taken to: (i) recoup operating and maintenance costs; (ii) place responsibility for cost recovery with the body or entity responsible for service delivery, setting it up as a separate cost center; and (iii) use revenues to expand service coverage and improve quality. Such investments can only be made if the respective PAM includes activities to modernize service management.

2. Component 2. Support for local development and decentralization policymaking (US\$735,000)

- 2.15 This component aims to support the Government of Panama in the formulation, adoption and implementation of a National Local Development and Decentralization Policy (*Política Nacional de Desarrollo Local y Descentralización*, PNDLD). This will include regulations and other ancillary rules affecting the municipal legal/institutional framework that can be enacted by the executive branch. The component is divided into two subcomponents for execution and monitoring purposes: (i) development of the PNDLD and changes to the rules and regulations governing municipios; and (ii) support for consensus building and adoption of the PNDLD.

2.16 **Subcomponent 1. Development of the PNDLD and municipal reforms (US\$285,000).** Under this subcomponent, the program will finance: (i) technical studies to be used in weighing options and making informed decisions on the PNDLD; (ii) the drafting of the PNDLD and necessary implementing regulations and other ancillary rules affecting the municipal legal/institutional framework that can be enacted by the executive branch; and (iii) studies to include the special issue of indigenous reserves and their handling in the PNDLD framework. The baseline studies to be financed will cover the following specific areas (see paragraph 2.4a):

- a. ***A municipal finance system***, to study and make policy recommendations in such areas as municipal taxation, intergovernmental transfers and their uses, municipal borrowing. On the issue of municipal taxation, the potential for expanding the municipal tax base will be studied, along with mechanisms to improve municipal tax administration. Along with other aspects of transfers, options will be explored for establishing a revenue-sharing system that involves incentives for better budget resource management and review of the municipios' spending responsibilities, so that they put the transfers to good use. Lastly, in regard to municipal financing, an analysis will be made of proposals to regulate and promote fiscally responsible municipal borrowing.
- b. ***A municipal planning system***, to make policy recommendations on improving the municipal planning system and developing basic municipal planning standards that will help enhance the quality of municipal spending and the tools citizens and communities have for articulating their needs to municipal governments; set standards for investment master plans in basic municipal infrastructure; and establish tools for coordination among local and regional development agencies.
- c. ***Municipal and other services***, to study and make policy recommendations on new ways of improving municipal service delivery with a view to promoting scale economies, actions to make municipal services sustainable, expansion of modes of service delivery, and establishment of technical standards. In addition, ways will be sought to build municipal government capacity to contribute to the delivery of other services that currently are not within their direct jurisdiction. Temporary and low-cost service delivery mechanisms may be introduced, in order to ensure access for low-income populations.
- d. ***Strengthening of governance and citizen participation mechanisms***, including reengineering of decision-making processes within municipal governments, design of incentive mechanisms for intergovernmental cooperation (leagues of municipalities, delegation agreements, etc.), and promote citizen participation in decision-making and oversight of municipal government spending.
- e. ***Support systems to generate skilled human resources for the municipal level***, including studies and proposals to establish an accreditation system for

municipal technical staff and design of a national TA&T program, making it possible to organize supply to respond appropriately to municipal government demand.

2.17 **Subcomponent 2. Support for PNDLD consensus-building (US\$450,000).** This subcomponent will finance actions to build consensus and foster dialogue leading to adoption and institution of the PNDLD and reforms to the municipal legal/institutional framework that do not require legislative approval. The following activities in particular will be funded:

- a. ***Strengthening policy development capacity.*** The program will finance technical assistance to support and strengthen local development and decentralization policy design and monitoring capacity at the central government agencies involved, mainly the MEF and MGJ. It also will help facilitate their interagency coordination activities, communication strategy, political/institutional road map¹¹ to be followed, and monitoring of municipal finances using a database to be generated in the PNDLD studies.
- b. ***Policy dialogue.*** A systematic dialogue process will enable relevant institutions to make policy decisions on issues identified as crucial for local development and decentralization in Panama. The dialogue will be based on the findings of technical studies to be carried out on each topic. Participants will include relevant stakeholders in decision-making processes, and, depending on the issue being addressed, different social actors will be invited, such as indigenous organizations and settlement authorities. The dialogue will enable participating institutions to compare and discuss the advantages and disadvantages of the different alternatives, using basic local-development principles to reach firm decisions that will constitute inputs for the PNDLD.
- c. ***A program to disseminate relevant information on local development.*** This will include: (i) support for the establishment of a permanent forum for the study of decentralization and local development; (ii) a program of seminars and workshops to discuss studies and ensure participation by stakeholders in the design of the PNDLD; (iii) publication and dissemination of studies and research; and (iv) design and implementation of an Internet portal aimed at strengthening municipal governments and promoting local development. In addition, dialogue with the new authorities to be elected in 2004 will help secure program continuity.

2.18 The expected outputs are as follows:

¹¹ The stakeholder map will make it possible to analyze the following: (i) the key stakeholders in the country's local development; (ii) leadership capacities and constituent strength of bodies responsible for promoting the PNDLD; (iii) the key stakeholders' main areas of interest and their attitude towards a PNDLD proposal; (iv) resources, and ability to attract them; and (v) the strategic role they could play.

- a. **For component 1.** A strengthening model will have been established for each category of municipio, and institutional foundations will have been laid for municipal governments to become key agents of local development. Specifically, by program end the beneficiary municipal governments will be expected to have: (i) improved their financial performance and increased their capacity to generate own revenues and make investments; (ii) adopted a basic municipal financial management system; (iii) set up a municipal planning unit with a budget allocation and current operating manuals; and (iv) prepared a three-year municipal development plan using participatory methods, which has been approved by the municipal council.
- b. **For component 2.** Adoption, through dialogue, of the PNDLD and the changes to the legal/institutional framework needed to begin its implementation. The PNDLD will contain, as a minimum, proposals for: (i) modernization of the municipal tax system; (ii) establishment of an intergovernmental transfer system; (iii) establishment of a basic municipal planning system; (iv) modernization of municipal service delivery; (v) strengthening of local governance and citizen participation; and (vi) adoption of a municipal TA&T system that can marshal supply to meet municipal needs.

C. Scale of the program

- 2.19 The total estimated cost of the program is US\$9.75 million for the four years of execution. These figures include administration, supervision, contingencies and financial expenses. The cost of activities in component 1 has been calculated bearing in mind the average cost of the PAMs, based on consultancy studies conducted by a sample of 10 municipalities. Additional investment resources have been added for priority projects to help strengthen capacity in investment management and other areas at the municipios. Scaling of the activities in component 2 has been based on an analysis of consulting costs needed to support the development of local development policies.

D. Costs and execution period

- 2.20 The estimated cost of the program is US\$9.75 million. Bank would fund 80% of the total program cost through an Ordinary Capital loan of US\$7.8 million in United States dollars under the single currency facility. The local contribution of US\$1.95 million equivalent (20% of the total program cost) would come from central and municipal governments; the foregoing statement in no way limiting the Republic of Panama's liability to contribute all the additional resources for the program to be fully executed. The proposed financial terms and conditions for the loan are: (i) 20-year amortization period; (ii) 4-year disbursement period; (iii) 4-year grace period; (iv) adjustable option interest rate; (v) credit fee of 0.25% per annum on undisbursed balances; and (vi) inspection and supervision fee of 0%. The interest rate, credit fee, and inspection and supervision fee specified in this

document are based on document FN-568-3-Rev, and may be modified by the Board of Executive Directors taking into account the available background information, as well as the respective Finance Department recommendation. In no event will the credit fee exceed 0.75%, or the inspection and supervision fee 1%, of the loan amount.

2.21 Costs break down as follows:

Table II-1
Investment Categories
(in thousands of U.S. dollars)

	IDB	Local	Total	%
I. Direct costs	6,961	1,818	8,779	90.0%
1. Municipal strengthening and development	6,396	1,648	8,044	82.5%
1.1 Municipal strengthening	2,340	590	2,930	
1.2 Development of municipal management tools	496	158	654	
1.3 Municipal investments	3,560	900	4,460	
2. Support for local development and decentralization policy-making	565	170	735	7.5%
2.1 Preparation of PNDLD	240	45	285	
2.2 Support for PNDLD consensus-building	325	125	450	
II. Management and supervision	739	110	849	8.7%
1. Program executing unit	555	100	655	
2. Audits	140		140	
3. Midterm review and final evaluation	44	10	54	
Contingencies	100		100	1.0%
Financial expenses	0	22	22	0.2%
1. Inspection and supervision (0%)	0	-	80	
2. Credit fee (0.25%)	-	22	22	
Program total	7,800	1,950	9,750	100%
Percentage	80%	20%	100%	

2.22 The figure for financial expenses does not include interest charges, because the Government of Panama has decided to finance these from other budgetary sources.

III. PROGRAM IMPLEMENTATION

A. Borrower and executing agency

- 3.1 The borrower in this program will be the Republic of Panama, with the Ministry of Economic Affairs and Finance (MEF) as executing agency, acting through the Regional Planning Office (DPR/MEF) with participation from the beneficiary municipal governments. The MEF will work in conjunction with the Ministry of the Interior and Justice (MGJ) and municipal governments, as described below.

B. Program institutional structure

- 3.2 **Regional Planning Office.** The executing agency will have a program executing unit (PEU) at its Regional Planning Office. Among other responsibilities, the program executing unit will: (i) plan all program activities, establish progress indicators and work execution timetables, and keep these constantly up to date; (ii) serve as liaison between the two program components, to ensure that they effectively complement one another; (iii) procure the goods and services needed for program activities, except for the municipal investment projects of the beneficiary municipal governments; (iv) review technical analysis of investment projects and progress in their execution, according to the technical criteria established in the Operating Regulations; (v) supervise each program activity as it unfolds, to ensure timely detection of any delays or deviations from the work execution timetable, taking corrective action as necessary; (vi) maintain the program's financial and accounting system as specified in paragraph 3.26; and (vii) disseminate information for municipal development at the national level.
- 3.3 The program executing unit will have, as a minimum, a coordinator, a financial specialist, a procurement specialist, a municipal development specialist, and a specialist in local development and decentralization policy, who will all be paid out of program funds. The borrower will provide the support staff needed to run the program executing unit. **As a condition precedent to the first disbursement of loan proceeds, the executing agency must have set up the program executing unit (PEU) and named the program coordinator and at least one PEU specialist.**
- 3.4 **Program Consultative Committee.** A high-level Program Consultative Committee (CCP) will be established. Serving on the CCP will be the Minister of Economic Affairs and Finance or his delegate, the Minister of the Interior and Justice or his delegate, the directors of DPR/MEF and DGL/MGJ, a representative from the municipal governments participating in the program, and a national association of Panamanian municipios represented by a municipal government that has not participated in the program. The CCP will serve as a mechanism for consultations among participating entities to ensure compliance with program

guidelines. Among its functions, the CCP will: (i) make recommendations for preparation of the work plan and annual budget; (ii) make observations and recommendations on program execution; (iii) support the coordination of efforts by State institutions and other financial organizations and donors; (iv) channel the political participation of national authorities, governors, mayors and *corregidores*; and (v) review and express an opinion on program progress reports and financial statements.

C. Execution of program components

- 3.5 **Component 1. Municipal strengthening and development.** The preparation, approval and execution of PAMs and investments will be based on the following cycle: (i) the program executing unit will use the criteria given in the Operating Regulations to draw up the list of municipios that will be invited to participate in the program, as described in the following paragraph; (ii) an invitation will be issued to municipios included on the list to take part in a startup workshop will be held to present the objectives and methodologies of the program, an estimate of the amount of resources that could be allocated to each municipio, rules governing activities eligible for financing, and procedures for formalizing participation in the program; (iii) following the workshop, the municipios will express their interest in a letter, approved by their municipal council, applying for the program and stating their commitment to abide by the rules of the program and contribute counterpart resources for the execution of their investment plan; (iv) a framework agreement will be entered into by the MEF and the beneficiary municipal government; (v) PAMs will be prepared/updated; (vi) the agreement will be updated to introduce the specific performance indicators for each municipal government; (vii) PAM execution will begin, including resources for technical assistance activities and for investments, according to the access conditions described in paragraph 2.13; and (viii) PAMs and investments will be monitored and supervised, with assistance from consulting firms and/or individual consultants hired using program funds.
- 3.6 A total of 15 municipios will participate in the program, distributed as follows: 1 metropolitan, 4 urban, 5 semiurban and 5 rural. The list of municipios to be invited to participate includes the 8 municipal governments in the sample, plus another 7 that will be invited for a total of 15. Within each category, invitations will be sent out in descending order of per capita income as recorded in the municipio according to official data. If any municipio is not interested in participating in the program, its invitation will be passed to the next municipio on the list.
- 3.7 It is envisaged that the PAMs will be implemented as soon as they have been approved by the municipal council and put into operation, subject to nonobjection by the MEF and the Bank. Implementation will be supported by a consulting firm for each municipio or, where possible, for groups of municipios that are geographically close to one another. This means of execution allows for greater integration and organization in the execution of activities; favors technology

transfer both to municipal technical staff and to local subcontracted consultants; and reduces transaction costs and times by minimizing the number of contracts.

- 3.8 ***Municipal investments.*** The framework agreement will specify the maximum amount of funding available to the municipal government, both for technical assistance and for investments. Allocation of investment resources will be contingent upon progressively meeting the financial/institutional strengthening targets set in the PAMs, and upon progress in the execution of investments. The agreement will also state the counterpart resources to be contributed by the municipal government, structured as follows: (i) 5% for rural municipios; (ii) 20% for semiurban municipios; and (iii) 25% for urban ones. As a general condition for access to investment funding, the beneficiary municipal government must provide evidence of having taken action to come up with its contribution. Local contributions may be in cash or in kind, such as land plots suitable for investments, provided these have been commercially appraised by the MEF's Property Registry Office (*Dirección de Catastro y Bienes Patrimoniales*) and the Engineering Office (*Dirección de Ingeniería*) of the Office of the Comptroller General (*Contraloría General de la República*), as required by law. The maximum amount of the contribution in kind will be as stated in the Operating Regulations.
- 3.9 Amounts earmarked for investment by a beneficiary municipal government will cease to be available in the following cases: (i) the beneficiary municipal government fails to satisfy conditions for access to first-stage resources within one calendar year after the date of signing the framework agreement; and (ii) the beneficiary municipal government fails to satisfy conditions for access to 40% or 30% of resources corresponding to the second and third stages, respectively, within two years after the date of signing the framework agreement.
- 3.10 Whereas all municipal governments will have access to resources for strengthening activities, investment funding will be distributed according to a formula that allocates more resources to municipios with lower per capita incomes, as established in the Operating Regulations. The municipio of Panamá will be ineligible, because its financial means give it access to credit on the local financial market. A resource distribution breakdown is contained in the Operating Regulations.
- 3.11 Access to investment resources will require proof of compliance with the relevant indicators; evidence that the necessary local counterpart contribution has been deposited in the proper municipal government account for the project or by making suitable land available; and a commitment by the municipality to charge rates or fees to ensure the sustainability of the services, where applicable. Only investment projects that have undergone technical, economic, financial and environmental feasibility studies can be financed under the program.

- 3.12 All costs recovered must be allocated to the institution or entity responsible for delivering the services, which must be set up as a separate cost center. Maintenance of public-use civil works not subject to direct charges (e.g. drains, greenspace, urban roads, etc.) will be the responsibility of the respective municipio, and so stipulated in the framework agreement.
- 3.13 **Component 2. Support for development policy-making.** The Regional Planning Office will execute this component through the program executing unit.
- 3.14 Execution of the component will begin with the hiring of consultants for the technical studies. As each study reaches its final stage, the program executing unit will organize workshops and other activities to generate systematic dialogue on policy options, in order to arrive at firm definitions on each topic. Once the studies are complete and policy decisions have been reached on each of the core local development issues, the program management firm will arrange with the program executing unit for consulting services to draft the PNDLD and the political feasibility study for adoption and implementation. Based on this plan, the sequence and phasing of the other activities will be organized, including dissemination and information activities.

D. Program regulatory instruments

- 3.15 The program will be governed by the loan contract entered into between the Republic of Panama and the Bank, and by the corresponding Operating Regulations. The relationship between participating municipal governments and the MEF will be established through framework agreements, which will be a prerequisite for participation in the program. These will stipulate the parties' obligations for the preparation, financing and execution of PAMs and projects, and establish monitoring targets. The program's Operating Regulations were agreed with the Panamanian authorities during the preparation stage.
- 3.16 The framework agreements between the executing agency and municipal governments will impose at least the following obligations on municipal governments: (i) to adopt the PAMs; (ii) to attain the targets established therein; (iii) to present evidence of the local counterpart contribution for the investments; (iv) to open separate accounts to manage investment funding; and (v) to implement a single accounting system approved for the program, making it possible to maintain detailed information on activities financed with program funds.
- 3.17 Each framework agreement will establish the level of funding allocated to the respective municipality, both for strengthening activities and for investment projects. Any amendment to the agreement will require the Bank's nonobjection.
- 3.18 Implementation of activities by the MEF and participating municipalities will be governed by the program's Operating Regulations, which will contain:

(i) requirements for municipality participation in the program; (ii) criteria for distribution of funds; (iii) activities eligible for funding; (iv) the approval and execution cycle for PAMs and investments; (v) a model of the framework agreement to be entered into by the MEF and participating municipalities; (vi) criteria and stages for access to investment resources, including the maximum counterpart contribution in kind; and (vii) program performance indicators. Once approved by the Bank, amendments to these Operating Regulations can only be made on the basis of a justified written request from the MEF, and with the Bank's nonobjection. **Entry into force of the Operating Regulations, prepared in accordance with terms agreed by the Bank, will be a condition precedent to the first disbursement.**

E. Technical cooperation

- 3.19 A technical cooperation operation has been designed in parallel with this program, in order to support preparatory activities. It will be financed with resources from the CABILICA Fund (TC-0306015) and address the following three broad issues: creation of institutional conditions conducive to implementation of the PNDLD; development of a system to evaluate program impact; and preparation of PAMs. Planned technical cooperation activities include: (i) preparation of the work plan for program execution; (ii) a program startup workshop; (iii) a local development and decentralization update workshop; (iv) generation of information to evaluate program effectiveness, including the establishment of a baseline for the current condition of municipal governments and development of a system to evaluate program impacts; (v) preparation of final designs of the PAMs for the eight municipalities whose preliminary proposals were prepared during program design. The technical cooperation operation has received preliminary approval and is expected to have been formally approved and be in execution when the Bank approves the program. The technical cooperation operation will last for 18 months.

F. Procurement of works, related goods and services, and consulting services

- 3.20 Procurement of goods and services will be carried out in accordance with Bank policies. International competitive bidding will be required on contracts for over US\$1 million in the case of construction work, US\$300,000 for goods and related services, and US\$200,000 for consulting services.
- 3.21 The program executing unit will procure the goods and services needed for execution of the PAMs and component 2, while municipal governments will be responsible for procurement and contracting to execute their investment projects. In each case, Bank rules will be followed and competitive processes held.

G. Disbursements and revolving fund

- 3.22 It is proposed to establish a revolving fund equivalent to 5% of the loan amount.

- 3.23 Municipal governments will be responsible for executing the investment works approved in their respective PAMs, for which they will receive program resources from the MEF in a proportion that maintains the disbursement rate at 80/20%. Each municipal government will open a bank account in the name of the IDB-Municipality project; this will have two separate subaccounts: one for transfer of the investment resources, and the other for the local counterpart resources. In each case, transfer of program resources will be contingent upon the municipal government having deposited in the respective account its local counterpart contribution. When the local counterpart contribution is provided in kind, evidence of unrestricted title to the land in question and its appraised value will be required.
- 3.24 Eligible expenses under an investment project executed by the municipal government include works, consulting services, and goods needed for project execution. Payments for investments will be made on the basis of an advance not exceeding 30% of the work and, subsequently, against expenses incurred as the works proceed. The documentation to be presented to the program executing unit for it to make the transfers will include contracts for works, services or goods, together with partial progress invoices duly certified by the works supervisor.
- 3.25 The disbursement timetable will be as follows:

Table III-1
Disbursement Timetable
(in thousands of U.S. dollars)

Source	Year 1	Year 2	Year 3	Year 4	Total
IDB	1,560	2,340	2,340	1,560	7,800
Local	390	585	585	390	1,950
Percentage	20%	30%	30%	20%	100%

H. Program financial and accounting management

- 3.26 The MEF will maintain the program's financial accounting and internal control systems, performing the following functions: (i) design of the accounting system to include the chart of accounts, operational accounting manuals, reporting guidelines, design of financial statements and identification of the accounting software to be used; (ii) maintenance of the program's financial and accounting records, itemized by investment category and subcategory for each of the program's beneficiary municipios; (iii) maintenance of an organized filing system containing original supporting documentation for program-eligible expenses; (iv) submission of disbursement requests and vouchers for eligible expenses to the Bank; (v) preparation of semiannual reports on the revolving fund, and their presentation to the Bank within 60 days following the end of each semester; and (vi) preparation and submission of audited financial statements on an annual basis, as required by the Bank, together with any other financial reports the Bank may request. The

financial accounting system will ensure the maintenance of: (i) separate bank accounts for IDB and local counterpart disbursements; (ii) separate accounting records for the use of program funds; (iii) detailed information for the preparation of consolidated financial statements; (iv) original supporting documentation in accessible program files; and (v) proper records of disbursement requests.

- 3.27 The Bank's Country Office in Panama will perform technical and financial inspections before replenishing the revolving fund; this will include an examination of supporting documentation, including files and receipts, to determine whether the expenses incurred are eligible. The inspection will also verify that the PEU maintains disbursement request documents showing that the funds were used in accordance with the terms of the loan contract.

I. Program monitoring

- 3.28 Program execution will be monitored and evaluated on the basis of information supplied by the project monitoring system used by the program executing unit. The IDB project team will meet with the PEU team every six months to review the program and evaluate: (i) the process of promotion and incorporation of participating municipalities; (ii) the extent to which the performance indicators agreed in the PAMs have been achieved and their impact on improving municipal management and the efficiency and coverage of services/infrastructure; (iii) progress in the physical and financial execution of municipal investment projects; (iv) implementation of the recommendations of studies carried out in component 2; and (v) problems encountered and solutions adopted. These meetings will take place within 30 days after submission of the progress report by the MEF.
- 3.29 The borrower, acting through the MEF, will submit semiannual progress reports on program execution to the Bank. These will indicate the program's financial condition, actions and activities carried out, outcomes achieved and targets attained; together with the chief constraints that have been encountered and proposed ways of overcoming them. The format of the report will be agreed previously with the Country Office.

J. Program evaluation

- 3.30 The program will undergo a midterm review and final evaluation. Evaluation factors will include: (i) the attainment of program indicators; (ii) achievement of program objectives; and (iii) achievement of targets agreed in PAMs, as established in the framework agreements. Any recommendations made in the midterm review will be used to take corrective action to improve program execution, where necessary. An independent consulting firm acceptable to the Bank will carry out the evaluations. The midterm review will be conducted once 50% of the loan proceeds have been disbursed, and the final evaluation 60 days after the end of program execution.

- 3.31 With support from a parallel technical cooperation operation, a baseline of the main institutional financial performance indicators will be established for a municipio sample that includes the 15 municipal governments that will participate in the program. This baseline will allow two types of impact evaluation: (i) a comparative analysis of ex ante and ex post conditions in municipal governments that have executed a PAM; and (ii) an ex post comparative analysis of the performance of municipal governments participating in the program, in relation to those that did not participate. The first analysis will determine whether the performance indicators of participating municipalities have improved; the second analysis will discriminate between improvements attributable to the program and those caused by other intervening variables.
- 3.32 The main issues in the program evaluation process include: (i) whether municipal governments have improved their financial performance and are now in a better position to generate their own resources; (ii) whether municipal governments have increased their rate of investment financed with own resources; (iii) whether the municipal investment program addresses the main local needs; (iv) whether municipal governments are better placed to manage the project cycle; (v) whether municipal governments that were receiving operating subsidies at the start of the program are now covering at least their current expenditure on a sustainable basis; (vi) whether the proposed local development and decentralization policy is supported by the various stakeholders; and (vii) whether the new local development and decentralization policy reflects the heterogeneity of municipal governments in Panama. The program evaluation will also look at whether participating municipalities have made investments aimed at reducing poverty and creating the physical capital conditions needed to promote local development.

K. Audits

- 3.33 The annual external audit of the program will be conducted in accordance with Bank policy (documents AF-100 and AF-300) and include the program, the PEU, and the municipal investment projects. It will also include a semiannual report, and an annual report to be delivered within 120 days after the close of the fiscal year, duly audited by a private firm of auditors acceptable to the Bank, and in accordance with terms of reference approved by it (document AF-400). The cost of the program's external audit will be charged against the loan proceeds. The audit firm will be selected and hired using the Bank-approved procedures (document AF-200).

L. Ex post evaluation

- 3.34 Because one-half of the beneficiary municipios will complete their municipal action plans during the first three years of the program, a final evaluation can be conducted at the end of the execution period, to address the issues raised in paragraph 3.32. Although the Government of Panama has said it will conduct no ex post evaluation of the program, a midterm review and final evaluation would

allow comparison between the baseline and outcomes achieved under the program, yielding valuable lessons learned for the design of similar operations.

IV. VIABILITY AND RISKS

A. Institutional, financial and economic viability

- 4.1 **Institutional and financial viability.** The functions of the Ministry of Economic Affairs and Finance include promoting modernization of the state, and ensuring this is consistent with sound macroeconomic and financial management. The MEF, and in particular its Regional Planning Office, have several delegated areas of authority that are relevant to the program, such as: (i) formulation of regional and local development strategies and plans; (ii) preparation (in conjunction with central government agencies at the provincial, municipal and local levels) of standard criteria, norms and methodologies for the preparation, execution and evaluation of regional and local development plans, programs and projects; and (iii) interagency coordination to promote adoption, at the subnational level, of instruments, rules and methodologies relating to cadastre, institutional planning and development, and municipal financial management and tax administration.¹² The Regional Planning Office has previous experience in preparing, executing and supervising projects financed by multilateral organizations, such as the Darién and Bocas del Toro sustainable development programs.
- 4.2 The strategy to ensure the program's institutional viability is based on building institutional capacity at the MEF with the support of a Regional Planning Office strengthened in the areas of municipal development and the design of local development and decentralization policy proposals.
- 4.3 The MGJ will participate, through the Program Consultative Committee, in the process of dialogue that the MEF will organize for the development and implementation of the PNDLD. A representative of the national association of Panamanian municipios will also serve on the Program Consultative Committee; such involvement in the design phase of this program has been highly constructive in facilitating direct work with municipios.
- 4.4 Analysis of the institutional and financial viability of component 1 showed that, with the support envisaged in the PAMs, all municipal governments would be able to: (i) execute the program's modernization activities; (ii) make the local contributions required; and (iii) cover the operating and maintenance costs expected to be generated by the program. In addition, an analysis was made of the program execution cycle vis-à-vis the electoral cycle (May 2004), and it was decided to allocate funds for the purpose of informing and building awareness of the program's objectives and scope among the new municipal authorities.

¹² These areas of program interest are the responsibility of the following MEF divisions: the General Cadastre Office, the General Revenue Office, and the Institutional Planning and Development Office.

- 4.5 **Technical and economic viability.** One of the program's objectives is to improve investment planning and efficiency at the municipal level. To achieve this, a requirement has been established (see the Operating Regulations) for all investment projects to undergo technical and economic feasibility studies, to ensure that the solution adopted is the most appropriate and that the socioeconomic benefits are positive. Selection criteria require projects to be least-cost technical solutions and generate an EIRR of over 12%. Specialized consulting firms will conduct preinvestment studies to identify and evaluate projects from the technical and economic standpoint, in order to ensure their viability and transfer know-how to the municipal governments. Projects will be executed by subcontracted firms.

B. Environmental and social viability

- 4.6 The program's intervention strategy is to incorporate the environmental variable into the modernization plans of participating municipal governments in a way that enhances their capacity to deliver public environmental services, enforces national environmental standards and improves the administration of environmental permits within the areas of municipal jurisdiction. The program also includes resources for investments in municipal environmental services, such as solid waste management and greenspace, which will benefit the local population while also contributing to good use of the environment.
- 4.7 The program will also have a positive social impact by introducing participatory municipal planning methodologies that will lead to municipal development plans in which investments are more closely aligned with the local population's needs. This will help raise living standards for municipal inhabitants generally, particularly among the population with greatest investment needs.

C. Social equity and poverty classification

- 4.8 This operation classifies as a social equity enhancing project, as described in the indicative targets mandated in the report on the Eighth General Increase in Resources (document AB-1704). It does not qualify as a poverty targeted investment (PTI).

D. Benefits

- 4.9 Municipal governments will benefit from the program by gaining access to technical assistance and training for modernization, along with investment resources enabling them to respond better to the needs articulated by citizens. By the end of the program, participating municipal governments will be better placed to fulfill their current responsibilities, and thus able to assume more important functions in terms of poverty reduction and promotion of local development. In terms of socioeconomic benefits, the program will help to make public spending more efficient by establishing mechanisms (participatory planning) to ensure closer

coordination between citizens' needs and local investments. The program will also make it possible to increase the municipios' own revenues, which will lead to larger investments more directly responsive to the needs of the local population, once the participatory planning system is adopted.

- 4.10 The program will also have positive fiscal impacts benefiting the country as a whole. Municipally generated revenues (taxes, charges and contributions) are expected to improve, reducing the reliance of certain municipalities on transfers from central government to cover their operating expenses.
- 4.11 On the expenditure side, the introduction of new financial management systems will improve budgetary and accounting processes, thereby taking a major step towards reducing corruption and promoting transparency. This will benefit the local population by building trust in local authorities and by channeling additional resources into local development.

E. Risks

- 4.12 The main risk to program outcomes is a possible failure to achieve political and social consensus for adoption of the PNDLD and the changes to the legal framework needed to implement it. In order to mitigate this risk, the project team has structured component 2 in a way that gives equal weight to the substantive design of the PNDLD and the rules and regulations governing municipios, as to the design of an implementation strategy. In addition, support for the consensus-building process contained in this component is designed to foster agreement and strategic partnerships around the main pillars of the PNDLD and conditions for its execution.
- 4.13 There are also execution risks stemming from insufficient institutional capacity in the participating entities. The program aims to reduce this risk through technical assistance and training, and setting up the program executing unit with specialized technical staff at the MEF's Regional Planning Office.
- 4.14 The continuity of program execution faces a risk stemming from the national and municipal elections to be held in May 2004. This will be mitigated through: (i) information and awareness-raising activities with the new authorities on the importance and benefits of the program; and (ii) ongoing participation by the Panamanian Municipios Association in the different activities of program design and execution.

Panama
Program for Municipal Development and Decentralization Support (PN-0143)
Logical Framework

Narrative Summary	Performance Indicators	Means of Verification	Assumptions
Goal To help improve the capacity of municipal governments to satisfy their citizens' needs.	Larger and more effective municipal investments. Greater harnessing of own resources.	Evaluations of progress in local development.	Political and economic stability is maintained.
Purpose To expand the capacity of participating municipal governments, to enable them to better fulfill their current responsibilities; and to improve the institutional and policy framework, to enable municipalities to become key agents of local development.	At least 10 municipios have successfully executed their modernization plans (PAMs). At least 10 municipal governments have increased municipally generated revenues by 5% per year (in real terms) without increasing the percentage of their budget allocated to operating expenses. The country has a consensus-based local development policy in place.	Report on the evaluation of program outcomes.	Political support for the program exists among authorities at all levels of government.
Component 1: Municipal Strengthening and Development			
Participating municipal governments have increased their institutional and financial capacity to fulfill their current responsibilities and are in a position to promote local development. Specifically, municipal governments have managed to:			

Narrative Summary	Performance Indicators	Means of Verification	Assumptions
1.1 Improve their financial position.	<p>1.1a At least 10 municipal governments have updated their taxpayer registry, revised their tax structure, and improved collection of own revenues.</p> <p>1.1b At least 10 municipal governments have not increased the percentage of their budget allocated to operating expenses.</p>	1.1 Data from the PAMs monitoring system and financial statements of municipal governments.	<i>For the whole component:</i> framework agreements are signed between the MEF and participating municipal governments.
1.2 Improve their internal organization and functioning.	1.2 At least 10 municipal governments have reengineered 10 key administrative processes and use a new financial management and tax administration system developed under the program.	1.2 Consultancy report on reengineering of processes and adoption of the financial management and tax administration system.	Authorities in participating municipal governments display the political will needed to implement the activities agreed in the PAMs.
1.3 Implement municipal planning processes.	<p>1.3a At least 10 municipal governments have development plans approved and in use in local investment programming.</p> <p>1.3b At least 10 municipal governments have a planning unit in place with a budget allocation and operating manuals.</p> <p>1.3c At least 30 municipal staff (2 per municipio) have received training in project cycle management.</p>	<p>1.3a Municipal council resolution approving the development plan.</p> <p>1.3b Municipal budget and operating manuals of the municipal planning unit, approved at the relevant levels.</p> <p>1.3c Consultant report on PAM implementation.</p>	The new national and municipal authorities elected in May 2004 continue to support the program and efforts to improve municipal capacities.
1.4 Enhance the efficiency of municipal services.	<p>1.4a At least 10 municipal governments have a service with an independent management and accounting system, and have obtained improvements in charging the respective rates.</p> <p>1.4b At least 10 municipal governments have an environmental education campaign.</p>	<p>1.4a Data from the PAM monitoring system.</p> <p>1.4b Idem.</p>	The local population supports improvements in services and is willing to pay for them.
1.5 Carry out investments identified in the framework of municipal planning activities.	1.5 Participating municipios have executed at least 45 priority municipal investment projects.	1.5 Information from the PAM monitoring system.	Municipal investments reflect the needs of the local population.

Narrative Summary	Performance Indicators	Means of Verification	Assumptions
Component 2: Support for Local Development Policy-making			
The government has a national local development and decentralization policy agreed and implemented by the proper decision-making authorities, and has begun modernization of the legal framework governing municipios. Specifically, the government has:			<p>The process of consultation and building consensus around the PNDLD and municipal reforms is successful.</p> <p>Activities to ensure program continuity following the national elections are carried out successfully.</p>
1.1 Studies and policy proposals in the main components of the PNDLD (municipal finance, municipal planning system, municipal services, strengthening of governance and citizen participation mechanisms, and the system to support the generation of skilled human resources).	<p>1.1a Program Advisory Committee up and running.</p> <p>1.1b PNDLD and municipal reform documents approved by the proper executive branch authorities.</p>	<p>1.1a Report on the evaluation of program outcomes.</p> <p>1.1b PNDLD and municipal reform documents approved by the proper executive branch authorities.</p>	The PNDLD has broad political support and becomes national policy.
1.2 Mechanisms for consultation and consensus on the PNDLD.	1.2 PNDLD consensus building and consultation program carried out successfully.	1.2 Program evaluation reports.	There is consensus that decentralization is a gradual process and that municipalities need to be strengthened while policies are being designed.

Activities	Resources
Activities of Component 1: Municipal Strengthening and Development	
Activities to modernize: (i) finance and administration; (ii) municipal services; and (iii) municipal planning, defined on a case-by-case basis in the PAMs. Development of municipal management tools. Execution of priority municipal investments.	The whole component has an allocation of US\$8.044 million.
Activities of Component 2: Support for Local Development and Decentralization Policy-making	
Activities in support of the PNDLD including: (i) preparation of the PNDLD and municipal reforms; and (ii) support for the process of building consensus on the PNDLD.	The whole component has an allocation of US\$735,000.

PROGRAM FOR MUNICIPAL DEVELOPMENT AND DECENTRALIZATION SUPPORT PROCUREMENT OF GOODS AND SERVICES <i>(in thousands of U.S. dollars)</i>						
Categories	Total amounts	Type of contracting*	Amounts year 1	Amounts year 2	Amounts year 3	Amounts year 4
1. CONSULTANCIES AND SERVICES						
Program executing unit	655	ICB	131	196.5	196.5	131
Technical assistance: PNDLD	735	LCB	147	220	221	147
Development of financial management and tax administration systems	639	ICB	129	190	191	129
Audit	140	LCB	35	35	35	35
Midterm and final evaluation	54	LCB		27		27
Municipal strengthening (15 municipios in groups of 5)	2,795	ICB	559	838.5	838.5	559
Subtotal	5,018		1,001	1,507	1,482	1,028
2. EQUIPMENT						
Equipment (for the MEF's Regional Planning Office and municipal governments)	150	LCB	30	45	45	30
Subtotal	150		30	45	45	30
3. WORKS						
Investments in basic services and municipal infrastructure (approx. 80 projects of at least US\$50,000)	4,460	LCB	892	1,338	1,338	892
Subtotal	4,460		892	1,338	1,338	892
Totals	9,628		1,923	2,890	2,865	1,950
* The procurement of goods and related services, and construction work and consulting services will be conducted in compliance with the Bank's procurement policy. International competitive bidding (ICB) will be required for procurement of goods and related services in amounts above US\$300,000, and for construction work valued at over US\$1 million. International competitive bidding will be used for consulting contracts in amounts greater than US\$200,000.						