OECD Development Pathways

Multi-dimensional Review of Panama

VOLUME 3. FROM ANALYSIS TO ACTION

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Foreword

Economic growth matters, but it is just one facet of development. Policy makers should focus their attention on ensuring that their country's development path is sustainable and that the lives of their citizens improve. This requires reconciling economic, social and environmental objectives.

OECD Development Pathways is a series that looks at multiple development objectives beyond an exclusive focus on growth. It recognises well-being as part and parcel of development and helps governments identify the main constraints to more equitable and sustainable growth by undertaking a multi-dimensional country review (MDCR). Governments trying to achieve economic, social and environmental objectives need to understand the constraints they face and develop comprehensive and well sequenced strategies for reform that take into account the complementarities and trade-offs across policies. The MDCR methodology is based on quantitative economic analysis, as well as qualitative approaches including foresight and participatory workshops that involve actors from the private and public sectors, civil society, and academia.

The MDCRs are composed of three distinct phases: initial assessment, in-depth analysis and recommendations, and implementation of reforms in the identified key areas. This approach allows for a progressive learning process about the country's specific challenges and opportunities that culminates in a final synthesis report to inform reforms in the country.

The MDCR of Panama – Volume 1, Initial Assessment was launched in October 2017. The second volume, In-depth Analysis and Recommendations, focused on three key constraints for inclusive development in Panama, namely skills and formal jobs, regional development and financing for development. It was launched in July 2018 in Panama. This third volume, From Analysis to Action, is based on the recommendations presented in the second volume, and presents the conditions and actions for making reform happen.

This MDCR is designed to help Panama formulate development strategies, and identify and support the policy reforms needed to achieve further sustainable and inclusive development. This review comes at a time when Panama is achieving a high economic growth but further policy action is needed to expand socio-economic benefits across all economic sectors, regions and households.

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Mario Pezzini, Director of the OECD Development Centre, and Federico Bonaglia, Deputy Director of the OECD Development Centre, guided and oversaw the review. The Multi-dimensional Country Review process is led by Jan Rielaender, Head of the MDCR Unit and Sebastián Nieto Parra, Head of Latin America and the Caribbean Unit, both at the OECD Development Centre.

The review was co-ordinated by Sebastián Nieto Parra, Head of Latin America and the Caribbean Unit at the OECD Development Centre, and drafted by Paula Cerutti, Andrea Colombo, and Nathalia Montoya Gonzalez (OECD Development Centre). Additional inputs were provided by Timothy Balin, Cristina Cabutto and Bruno Pantaleao (OECD Development Centre). The team is grateful for the insightful discussions, data provided and comments made by Juan de Laiglesia, René Orozco, Vicente Ruiz, Juan Vázquez Zamora, and Agustina Vierheller (OECD Development Centre); Monica Bhatia, Bert Brys, Céline Colin and Jeremiah Coder (OECD Centre for Tax Policy); Dorothée Allain-Dupré, Oscar Huerta-Melchor and Varinia Michalun (OECD Centre for Entrepreneurship); Patrick Lenain (OECD Economics Department); Catalina Covacevich (OECD Directorate for Education and Skills); and Paolo Falco (OECD Directorate for Employment, Labour and Social Affairs).

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Ministry of Education, the Ministry of Energy, the Ministry of Health, the Ministry of Labour as well as the National Secretariat of Energy, the Association of Panama's Municipalities (AMUPA-Asociación de Municipios de Panamá), the Deputy Ministry of Indigenous Affairs, the *Comarca* of Kuna Yala, the Secretariat for Decentralisation, the City Hall of Panama City and the Ministry of Government Affairs. Finally, the team is grateful to all the participants of two workshops hosted by the Ministry of the Economy and Finance in Panama in November 2016, October 2017 and July 2018 that brought together stakeholders from a broad set of backgrounds to identify global trends that could affect Panama's future development.

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Acronyms and abbreviations

AIG	Autoridad Nacional para la Innovación Gubernamental
ANATI	Autoridad Nacional de Administración de Tierras
APEDE	Asociación Panameña de Ejecutivos de Empresa
CAPAC	Cámara Panameña de la Construcción
CONADES	Consejo Nacional de Desarrollo Sostenible
CONEP	Consejo Nacional de la Empresa Privada
DGCP	Dirección General de Contrataciones Públicas
DGI	Dirección General de Ingresos
IDAAN	Instituto de Acueductos y Alcantarillados Nacionales
INADEH	Instituto Nacional de Formación Profesional y Capacitación para el Desarrollo Humano
INEC	Instituto Nacional de Estadística y Censo
ITSE	Instituto Técnico Superior Especializado de Panamá
MEDUCA	Ministerio de Educación
MEF	Ministerio de Economía y Finanzas de Panamá
MICI	Ministerio de Comercio e Industrias
MIDA	Ministerio de Desarrollo Agropecuario de Panamá
MIDES	Ministerio de Desarrollo Social
MINSA	Ministerio de Salud de Panamá
MITRADEL	Ministerio de Trabajo y Desarrollo Laboral
MIVIOT	Ministerio de Vivienda y Ordenamiento Territorial Panamá
MOP	Ministerio de Obras Públicas de Panamá
MUPA	Municipio de Panamá
RP	Registro Público de Panamá
SENACYT	Secretaría Nacional de Ciencia y Tecnología e Innovación
SND	Secretaría Nacional de Descentralización
SNM	Servicio Nacional de Migración

Executive summary

This third volume of the Multi-dimensional Country Review (MDCR) of Panama builds on the results of the first two volumes. The first volume identified the main constraints to achieving well-being and sustainable and inclusive development. The second volume provided recommendations in three key areas to address these constraints: skills and jobs, territorial development and financing for development. This third volume proposes a way of prioritising policy interventions and a framework for measuring policy implementation.

Panama has experienced considerable socio-economic progress in recent decades; yet, not all sectors, regions and people benefitted at the same level, resulting in a dual economy. Progress has stemmed mostly from economic growth and improvements in labour productivity in the modern tradeable service sector – mainly financial intermediation and trade, logistics and communications activities. The Canal and the Special Economic Zones (SEZs) have played a considerable role in the country's economic performance. Although the country has a formal sector with high wages in specific activities linked to global trade, export capacity and productivity remain low in the rest of the economy, particularly in the industrial and agriculture sectors, which offer informal jobs to most workers. The result of this dual economy is that income inequality remains high in Panama.

Panama needs to move from a dual economy to one based more on a modern and equitable economy. Modernising its drivers of economic growth, setting public policies designed to improve labour productivity across all sectors and improving its social policies could set in motion this process of transformation.

The path for inclusive and sustainable development puts regional development, skills and formal jobs, and financing for development at the core of Panama's strategy to make a significant positive impact for all their citizens.

Building better skills and creating formal jobs for all Panamanians

The dual economy has translated into a dual employment market, which in turn largely explains income inequality in the country. Informality remains high in Panama and is a challenge for social inclusion and productivity. At the same time, inadequate skills and knowledge are holding back Panama's service sector and a lack of technical and vocational skills is a constraint to modernising agriculture, industrialisation and further expanding the logistics sector. Based on the recommendations presented in Volume 2 of the MDCR, the main policy actions include to:

- Put formalisation as a key item in a national development strategy and a well-co-ordinated approach to increase economic diversification in agro-industry and upgrading existing services.

- Develop better and relevant skills by increasing the access to and quality of secondary and technical education, as well as strengthening active labour market policies such as training programmes with effective participation of the private sector, in particular for young people.
- Increase the incentives to be formally employed and mitigate the pervasive impact of informality by developing an integrated pension system, by providing alternative schemes to incorporate independent workers, domestic workers and temporary agricultural workers in the social security system and also by communicating the benefits of formality and the risks of informality.
- Generate incentives for employers to formalise workers by partially subsidising the social contributions of vulnerable workers, or by establishing a simple scheme to determine minimum wages.
- Enforce labour laws by increasing efforts to supervise informal workers in formal firms.
- Boost the formalisation of small and medium enterprises (SMEs) and independent workers by reducing red tape and administrative costs associated with formal status.

Strengthening regional development policy to boost inclusive growth

Regional disparities across provinces and *comarcas* in terms of productivity, social cohesion and well-being outcomes are persistent in the country. By improving strategic planning and implementation frameworks, well-being can be better promoted at the regional level. To encourage sustainable and inclusive growth, Panama should therefore invest effectively in regions, including the lower-performing ones. Based on the recommendations presented in Volume 2 of the MDCR, the main policy actions include to:

- Strengthen multi-level governance practices to better support regional development by adjusting normative and institutional frameworks for regional development and building sub-national, especially municipal, capacity and resources.
- Support a "new paradigm" approach to regional development. Several actions are required: (i) develop a national regional development policy that clearly articulates national territorial development objectives and priorities; (ii) introduce provincial and *comarca* regional development plans; (iii) create regional development funding mechanisms; (iv) build performance measurement systems; and (v) consider stronger partnerships between the public and private sectors when launching future regional development agencies.
- Enhance horizontal and vertical co-ordination capacity by creating a high-level interministerial body and a dedicated unit for regional development policy. This presupposes the need to build vertical dialogue mechanisms and promote inter-municipal co-operation.

Improving financing for development in Panama

Improving the prospects of tax revenue collection and better private sector involvement, through public-private partnerships, would provide a stable long-term source of income to finance inclusive growth. Revenues can be increased by improving tax collection instead of raising tax rates. Furthermore, Panama provides a wide array of tax benefits that affect the system's efficiency by potentially providing incentives to firms within sectors that would not be profitable in the absence of tax expenditures. At the same time, updating its current legislation on public-private partnerships could finance effectively and efficiently infrastructure projects. Based on the recommendations presented in Volume 2 of the MDCR, the main policy actions include to:

- Enhance the tax system's efficiency by adopting a methodology to measure and report tax expenditures on an annual basis; by ending subsidisation of otherwise unprofitable businesses or firms; and by expanding the tax base by scaling back tax benefits provided to consolidated industries within SEZs.
- Modernise the tax administration by integrating critical processes to improve efficiency and reduce administrative costs, and by continuing the development of electronic invoicing which encourages compliance and fights against fraud and tax evasion.
- Adopt and implement new norms for public-private partnerships with sound regulatory and institutional frameworks. These include the creation of a public-private partnerships unit, transparent and competitive auction processes, effective and efficient participation of citizens in the grant process for environmental and social licences, the execution of land permits, and fiscal accounting for public-private partnerships to avoid using concessions as an option for fiscal space.

Based on the results of previous volumes of the MDCR Panama, this third volume proposes an implementation strategy in the aforementioned three key policy areas. This action plan contains a number of reforms to undertake and actors to involve. These policy actions were discussed with Panamanian authorities, civil society, private sector and academics during several workshops held in Panama City in July 2018. Finally, this report suggests a series of indicators for monitoring the implementation of the reforms proposed.

Chapter 1. From a dual economy towards an inclusive and sustainable high-income country

Panama is embarking on a new reform agenda to transition from a dual economy to sustainable and inclusive high-income country. After almost three decades of strong macroeconomic performance, poverty reduction and advances in some well-being dimensions, prosperity has not translated into social benefits for the whole population. Today Panama is classified as a high-income country but faces the challenges of adopting a new development model to ensure prosperity is to the benefit of all Panamanians. This overview chapter summarises and highlights the main analytical work carried out in Volumes 1 and 2 of the Multi-dimensional Review of Panama to promote further inclusive development.

Panama's successful economic performance in the past decade has contributed to reducing the GDP-per-capita gap with Organisation for Economic Co-operation and Development (OECD) economies and becoming a high-income country. Panama has been one of the fastest-growing economies in the world over the previous decade, at double the regional growth rate. Coupled by a stable macroeconomic framework, this growth has been led by the construction, real estate and commerce (wholesale and retail) sectors and the development of a modern tradeable service sector – financial intermediation and mainly trade, logistics and communications activities surrounding the Canal and the Special Economic Zones (SEZs). Furthermore, thanks to that economic performance, in 2018 Panama has been classified as a high-income country.[1]

Challenges remain to carrying forward the economic performance into better well-being. Panama is a good study case of a country in *development in transition*. While improvements in levels of income per capita have been considerable, they are necessary but not sufficient to close the gaps in various dimensions of well-being (OECD/CAF/ECLAC, 2019). Therefore, the existence of development traps demands innovative policy responses to boosting better lives of all Panamanian citizens. To achieve this, Panama needs to boost labour productivity across sectors and regions, promote formal jobs across all regions, and increase domestic capacities, through further financing for development.

These challenges are strictly interconnected to Panama's dual economy. The dual economy is both a source and a reflection of Panama's inequalities. The scarcity of good employment opportunities has been one of Panama's long-lasting obstacles to making the labour market more inclusive, displaying significant variations across levels of education, income and regions. Panama's successful economic growth model of the past decade has reinforced this duality. The productive tradeable service sector – mainly financial intermediation and trade, logistics and communications activities surrounding the Canal and the Special Economic Zones (SEZs) – that led Panama's strong growth offers formal jobs and high wages for a few skilled workers in Panama City and Colón. In contrast, many working-age Panamanians encounter severe labour-market difficulties. Most of them are self-employed or informally employed in small, low-productive non-tradeable service sector or agriculture firms in the outskirts of Panama City and the provinces.

Indeed, the Canal and, to a lesser extent, the Special Economic Zones have played a considerable role in the economy but both present unexploited opportunities to address the challenges of Panama's dual economy. In particular, export capacity and productivity levels remain low in the industrial and agriculture sectors. Specific policy areas including infrastructure, logistics, innovation, education and skills, and business regulation should contribute to this purpose.

Additionally, current levels of investment in key socio-economic areas for development are low, affecting the policy responses to make growth more inclusive and sustainable. Social expenditure in health, pensions, family support and other social services as a percentage of gross domestic product (GDP) is considerably below Latin America and OECD averages (OECD, 2017a). Similarly, investment in education also lags behind regional and OECD levels. Finally, investment in research and development remains below most Latin American countries and the gap has widened during the past decade. The investment gap with OECD economies is even more striking (OECD, 2017a).

At the same time, poor regional development enhances the burden of the dual economy rather than promoting well-being and economic prosperity. To better meet national objectives of sustained development with greater inclusiveness, a number of territorial challenges should be addressed (OECD, 2017a). These include ensuring more equal access to public services across regions, reducing the level of labour market informality, and strengthening the mechanisms that can finance development. A regional development strategy that is built around the unique and competitive attributes of each region – a "place-based" approach – supported by effective multi-level governance mechanisms could help Panama achieve more inclusive socio-economic outcomes. Taking a regional perspective, including an aim to promote growth in all regions, rather than focusing on high or low performance regions, is likely to yield economies that are less vulnerable to external shocks (OECD, 2012).

This chapter examines the evolution of economic growth in Panama, and the challenges to boosting sustainable and inclusive growth. First, it provides a picture of people's well-being conditions in the country. Second, it portrays the productivity challenges Panama face which are key for sustainable growth. Third, it illustrates how the dual economy has created labour market duality, informality and inequality. Fourth, it explains territorial disparities in this dual context. Finally, it describes the role of Panama's taxation system in efficiency and equity.

Improving well-being conditions as income is increasing

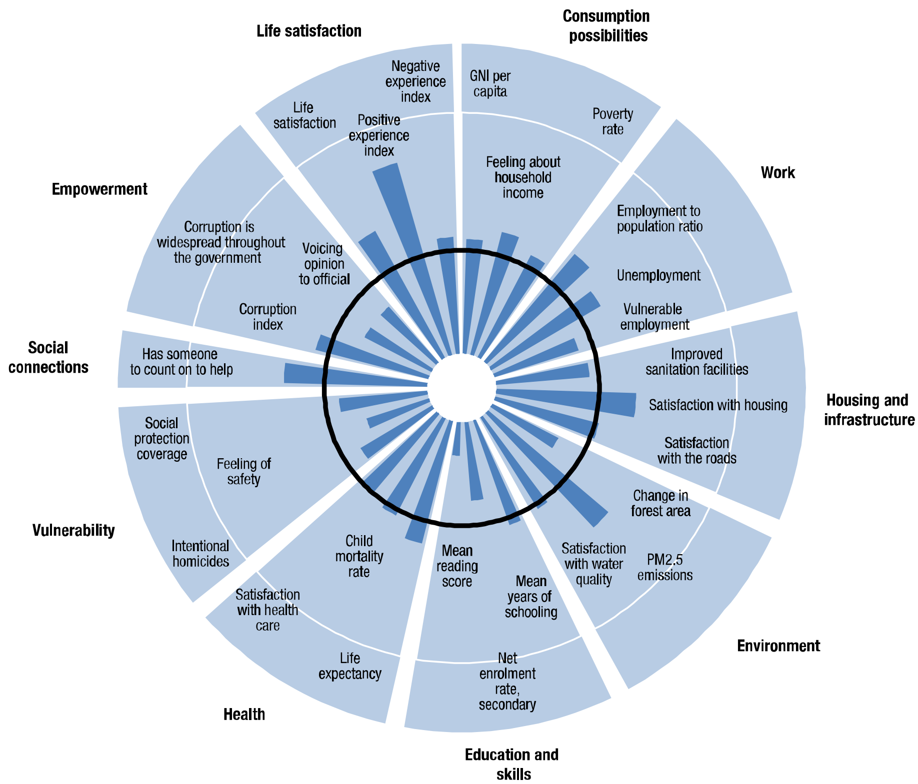
While progress has translated into higher incomes, peoples' quality of life has not necessarily improved in all its dimensions. This thus requires a multi-dimensional approach in Panama to adopt effective policies to address new and persistent structural challenges (OECD/CAF/ECLAC, 2019). Well-being encompasses those aspects of life that people would consider essential to meet one's needs, pursue one's goals and feel satisfied with life.

Panama's well-being performance is mapped across a range of indicators that represent ten dimensions of the OECD's well-being framework. The blue bars represent Panama's actual performance in contrast to its expected performance given its level of GDP per capita represented by the black circle. Results that are outside the circle represent better-than-expected outcomes, while results inside the circle show lower-than-expected outcomes. The longer the bar is, the better Panama's performance in that indicator is in relation to its expected outcome (Figure 1.1).

Although Panama presents areas of strengths, several aspects of well-being are lagging behind. Panama performs reasonably well in the areas of social connections and life evaluations and more generally on material conditions. However, it underperforms in the areas of education and vulnerability.

Despite this complex reality, with areas of strong and poor performance, subjective well-being in Panama is above what could be expected. Life evaluation is measured through distinct channels to disentangle people's daily experiences (feelings and emotions) from overall life satisfaction.

Figure 1.1. Current and expected well-being outcomes for Panama: Worldwide comparison



Note: The bars represent the observed well-being values for Panama and the circle shows the expected values based on Panama's level of GDP per capita obtained from a set of bivariate regressions with GDP as the independent variable and the various well-being outcomes as dependent variables from a cross-country dataset of around 150 countries with a population over a million. All indicators are normalised in terms of standard deviations across the panel. The observed values falling inside the circle indicate the areas where Panama performs poorly in terms of what could be expected from a country with a similar level of GDP per capita. All indicators had been normalised so that the longer the bar, the better the outcome.
Source: Gallup (2017)*, Gallup World Poll,* *http://www.gallup.com/services/170945/world-poll.aspx* (accessed 1 February 2017), Work Bank (2016), *World Development* Indicators (database), Washington DC, *http://data.wroldbank.org* (accessed 1 February 2017), UNESCO Institute of Statistics (UIS), PISA scores (2009), and Transparency International (2016), *Corruption Perception Index* http://www.transparency.org.

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Material conditions are reasonably good in Panama, but inequalities remain high. Given its level of GDP per capita, Panama has good results in the area of consumption possibilities, but nonetheless a large share of the population report difficulties in getting by on their income. Although poverty reduction has been strong and sustainable along the past decade, the gap among the richer and the poorest has been slightly reduced. Moreover, territorial and ethnical inequalities are large.

Despite improvements, some education, skills and health outcomes underperform compared to its level of GDP per capita. In terms of attainment and access to education, Panama performs as expected given its GDP per capita. However, completion rates and quality of its education are major challenges. Finally, Panama performs well in terms of average life expectancy but shows more mitigated results when other aspects of health status are considered.

Panama's results are lowest in terms of vulnerability, which is understood in the OECD well-being framework as the exposure to risks such as food or income insecurity, job loss, illness, or physical violence.

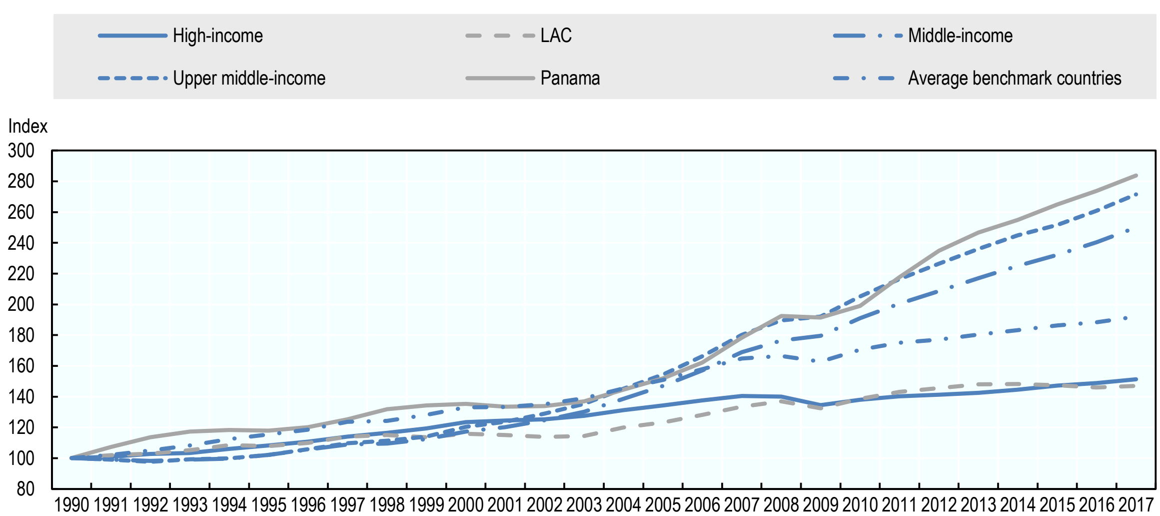
Social connections in Panama are relatively strong. Good proxies of the strength of close personal networks in a country are the share of people feeling that they can count on others in times of need and the amount of time people spend with friends and family.

Enhancing productivity is key to making growth sustainable

GDP per capita growth over the past decade has been associated with consistent macroeconomic performance. Since the beginning of the 21st century, improvements in GDP per capita have been remarkably high compared to Latin America and the Caribbean (LAC) and high-income countries (Figure 1.2). Among Latin American economies, Panama exhibited the highest GDP growth with an average 7.1% over the period 2007-17, above the countries of the Association of Southeast Asian Nations (5.1% on year-to-year average during the same period) and emerging economies (5.3%). In particular, while OECD economies were in recession in the global financial crisis, Panama exhibited resilience; its economy grew by 1.6% in 2009 and more than 5% yearly in the post-crisis period.

Figure 1.2. Panama's macroeconomic performance has been strong

GDP per capita in Panama, 1990-2017 (Constant 2011 international USD, base 100 = 1990)



Note: LAC refers to the average of Latin American and the Caribbean countries. Latin America includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.
Source: World Bank (2019), *World Development Indicators* (database), Washington, DC, http://data.worldbank.org (accessed 1 March 2019).

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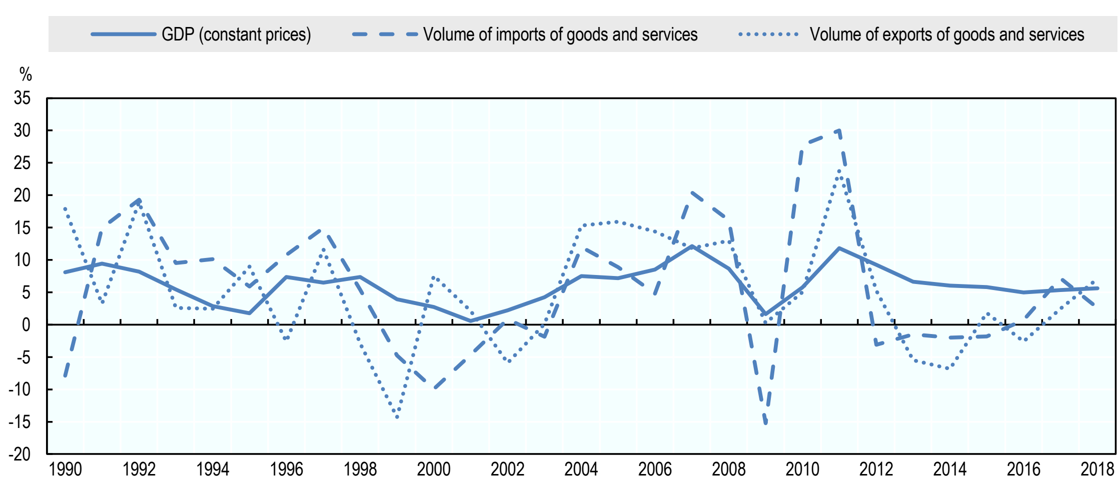
The Panamanian economy depends mainly on five sectors: trade, transport construction, real estate and financial intermediation. Similarly, services and construction, rather than manufacturing and agriculture, drove most of the macroeconomic performance in past years. This highlights the concentration of the Panamanian economy in services.

The importance of the Canal in the economy, estimated between 20% and 40% of total activity, renders Panama highly dependent on world trade, and more precisely on maritime transportation. Low global trade could have a negative impact on Canal activities. Indeed, world trade growth is expected to remain muted in the medium term (OECD/CAF/ECLAC, 2018, 2019). Under such an uncertain and downside global risk scenario in terms of trade and shipping, economic activities linked to the Canal should affect inclusive development in Panama. Especially, since Panama joined the World Trade Organization (WTO) at the end of 1997, linkages between GDP growth and trade have increased (Figure 1.3). Although global trade has revived in the past year, it remains less robust than in decades prior the Financial crisis of 2008. Furthermore, trade and globalisation have been under pressure as there is a growing concern around the world that the benefits from trade and globalisation are not shared by all and that this needs to be fixed (OECD/CAF/ECLAC, 2019; OECD, 2017b).

However, some resilience could reduce the external shock referred above. Indeed, while total cargo has declined, Canal revenues have increased in recent years. Looking forward, the Canal has already started to recover some of its pre-expansion market share and it is therefore expected that the growth in Canal traffic could be somewhat higher than world trade growth. Additionally, the gains from further integration with other countries in the region could be even greater in a scenario of global trade frictions (IDB, 2017). In this context, a more comprehensive integration with other countries in the region, beyond the Central American Common Market (CACM), is welcome.

Figure 1.3. Global trade and GDP in Panama, 1990-2018 (annual growth rates, percentage)



Source: IMF (2018), *World Economic Outlook*, April 2018 edition (database), International Monetary Fund, https://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx (accessed 1 August 2018).

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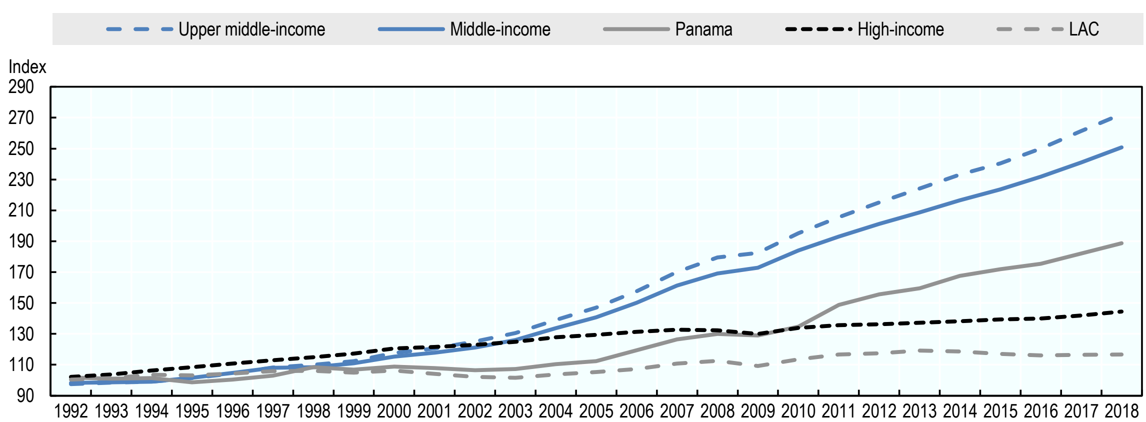
Labour productivity improvements are key to remain a sustainable high-income country

Panama needs to boost its productivity in order to remain a sustainable high-income country. Labour productivity remains low compared to OECD economies, and it is the source of most differences in income per capita from OECD economies. These differences can be broken down into gaps in labour productivity and gaps in labour utilisation, measured as employment as a share of population. Panama, like most emerging economies, features relatively high labour utilisation; the main culprit stifling GDP per capita is labour productivity. Panama's labour productivity shortfall compared to the OECD. Despite recent progress, Panama's labour productivity represents almost half of the average for OECD member countries. Yet, it outperformed labour productivity of LAC countries. The average labour productivity in LAC represents only close to a third of the average labour productivity in the OECD economies.

While its labour productivity remains low in comparison to OECD economies, Panama has made significant gains in the past decade. Labour productivity improved remarkably, tracking the path to other middle-income economies (Figure 1.4).

Figure 1.4. Labour productivity, 1992-2018

Constant USD 2011 PPP, base 100 = 1991



Note: Labour productivity is measured by GDP per person employed.
Source: World Bank (2019), *World Development Indicators* (database), http://data.worldbank.org (accessed 1 March 2019).

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Most of the labour productivity gap is explained by the low performance in human capital and total factor productivity (TFP). Labour productivity in Panama has experienced relatively high rates of growth, on average 4% since 2000 and mainly driven by total physical capital per worker accumulation. On the other hand, human capital and TFP have contributed very little to increases in labour productivity, although their contribution increased compared to the end of the 2000s.

To remain as a sustainable high-income country, Panama will require a set of public policies that should improve labour productivity. While high levels of investments have contributed to closing the gap, Panama should improve several areas that contribute to boosting labour productivity. The experiences of other countries that tackled the middle-income trap show that improvements in the quality of education, governance, the rule of law, the taxation system and the liquidity in the equity market are the main domains that should be prioritised in Panama (Melguizo, Nieto-Parra, Perea and Perez, 2017).

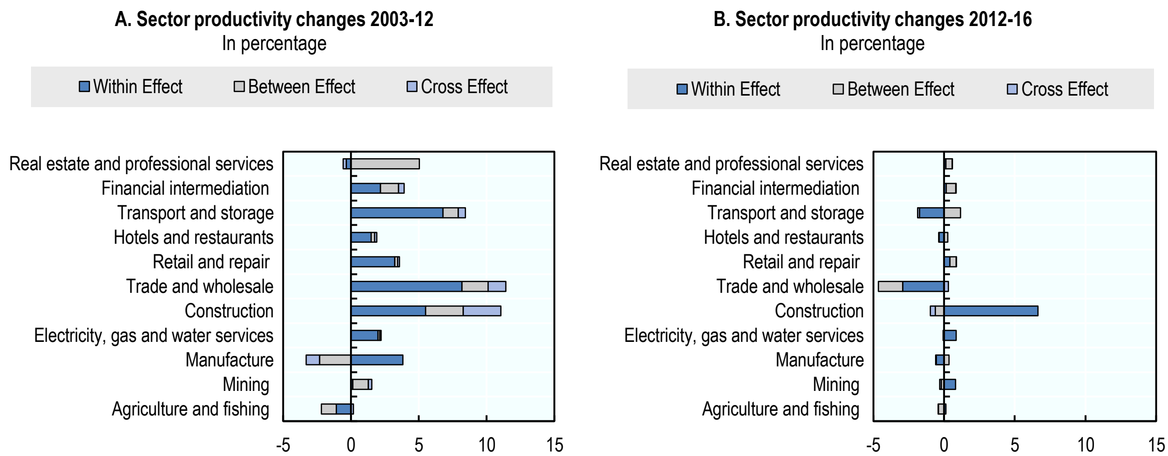
Labour productivity and other dimensions vary across sectors and regions

Labour productivity growth has been particularly high in economic sectors where the concentration of jobs remains relatively high. In absolute numbers, labour productivity was driven mainly by the services sector, most notably within the construction sector, and the manufacture in the period 2003-16 (Figure 1.5).

The divergence in labour productivity grew more accentuated in the last decade, mainly owing to the slow reallocation of labour among sectors. The changes in productivity can be broken down into a “within-sector” effect (driven by technical change and capital accumulation), a “between-sector” effect (driven by reallocation of labour resources between sectors) and a “cross-sector” effect (driven by the interaction between productivity changes and employment shares). In the period 2012-16, on average, both the effect of reallocation of labour and the cross-sector effect accounted only for 3% of the change, while the within-sector effect explained the remaining 97% of the labour productivity growth (Figure 1.5). The within-sector effect, pushed by capital accumulation per worker, occurred primarily in the construction sector and to a lesser extent in the service sector, where retail and wholesale, and transport and communications led the advance. Despite progress in productivity, the slow effect of labour reallocation is worrying since it reinforces the productivity and income gap between fast-growing and slow-growing sectors.

Segmented labour productivity across economic sectors translates to high disparities at the regional level. Panama exhibits high heterogeneity across provinces in terms of GDP per capita, labour productivity and several social dimensions. Although there are no reliable data covering all sub-national authorities (i.e. some key productive and social variables are not available in data on the comarcas), estimations show that Colón and Panama exhibit a high level of labour productivity compared to other provinces. Colón is an important contributor to the economy in terms of logistics and services including the Colón Free Trade Zone (Zona Libre de Colón) as well as tourism and port activities. Modern services such as in logistics and a variety of commercial and trade services have potential for diversification in Colón. Such development could advance existing manufacturing sectors close to Colón, such as the plastics, foodstuffs and paper industries (Hausmann, Morales and Santos, 2016). Panama province exhibits a diversity of economic sectors, including financial services, construction, real estate and activities around public administration. The rest of provinces present low levels of labour productivity and structural challenges. In particular, provinces such as Los Santos and Darién have the least complex and connected industrial structure in Panama. The most promising sectors still have a long way to go in terms of capabilities. The government is developing policies in the poorest provinces to tackle these inefficiencies. But the urgency to improve key areas, such as education and health, demonstrates the state’s relatively low capacity to achieve effective policies in these provinces.

Figure 1.5. Productivity increases are led by within-sector growth with a few exceptions



Notes: The total change in productivity can be broken down into a within-industry effect, measuring the average yearly growth of output per employed person driven by technical change and capital accumulation; a between-industry effect measuring compositional shifts in sectoral shares of employment and relative price changes driven by reallocation of labour resources between sectors; and a cross effect measuring the productivity gains which are driven by increases in the employment/market shares of firms whose productivity is increasing quickly, driven by the interaction between productivity changes and employment shares. In particular, the cross-sector effect represents the joint effect of changes in employment shares and sectoral productivity. This term is positive if, on the average, labour goes to sectors whose productivity is growing.

Source: OECD calculations based on data provided by INEC.

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The most productive sectors create little employment

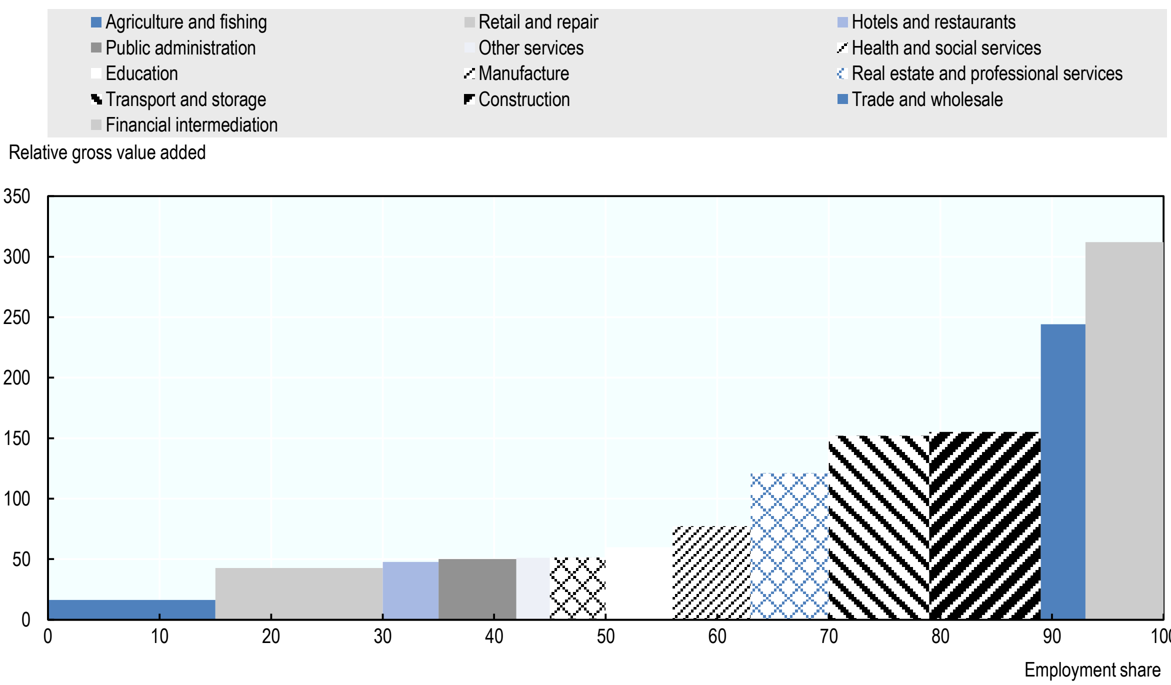
Panama's employment it is still concentrated in low-productivity and informal sectors. Although the construction boom created new formal jobs, two out of three workers in Panama are employed in a sector with below average labour productivity such as agriculture and fishing, retail and repair, and low productive segments of hotels and restaurants, a fact that might be at the core of the large income inequality in Panama. Moreover, half of the Panamanian construction workers are still employed informally. This demonstrates both the inverse relationship between productivity and informality and that Panama's current economic model is not currently conducive to increased formal job creation.

Relative productivity across sectors shows some particularities of the Panamanian economy: a highly productive modern tradeable service sector, a fast-growing construction sector and a low-productivity non-tradeable service sector. The labour productivity of Panama's financial sector and logistic sector activities – trade, repackaging services, and transportation, storage and communications – are between 2.5 and 3 times the total labour productivity (Figure 1.6). These are the internationally competitive activities that have driven Panama's economic growth in the last two decades. Additionally, the construction and real-estate sectors have made significant gains in productivity, driven by expansion of the Canal and the renovation of Tocumen airport, office buildings, warehouses, telecom infrastructure, shopping malls and other infrastructure demanded by the modern service sector. At the same time, the non-tradeable service sector – mainly retail and repair, hotels and restaurants, education, health and social services – halves the total labour productivity of Panama but employs half of the working population. The analysis on the basis of sector-level data is limited by the level of detail available in labour statistics. For example, Figure 1.6 aggregates all trade and wholesale activities, while there are large productivity gaps between Panama Canal-related activities, the SEZs, and other types of wholesale. Likewise it considers the agricultural, livestock, hunting, forestry and fishing sectors as a whole as well as aggregate all restaurants and hotels whose productivity levels are very heterogeneous across the country under the same category.

Figure 1.6. Productivity and the distribution of labour in Panama, 2016

Relative value-added as a percentage of workers and employment by economic sectors

(y-axis: 100 = total labour productivity and x-axis: % of employment)



Note: Labour productivity is measured as the annual value added (the value of output less the value of intermediate consumption) per employee.
Source: OECD calculations based on data provided by INEC.

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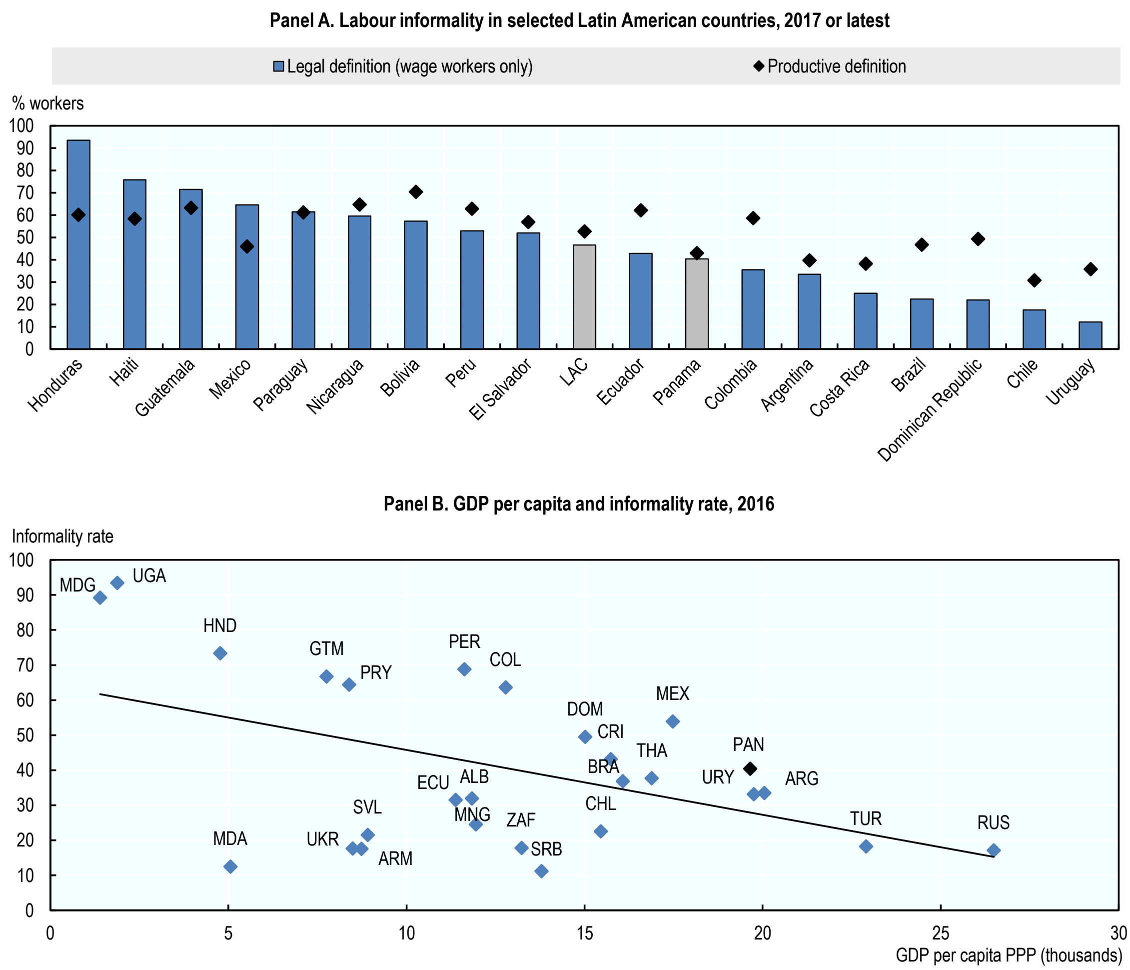
High labour market duality, informality and inequality

The high incidence of informality is one of the most salient features of Panama’s labour market. Informality is a key obstacle to making Panama more inclusive and labour productive. The informal sector in Panama is smaller than in most Latin America countries, but large by Organisation for Economic Co-operation and Development (OECD) standards. Despite recent progress, labour informality remains higher than other countries with similar levels of GDP per capita such as Argentina, Turkey and Uruguay. In fact, in 2016, labour informality still affected around four out of ten non-agricultural workers and almost half of all Panamanian workers, especially affecting those in the lowest quintiles of the income distribution and thus contributing to inequality (Figure 1.7). Informal workers are salaried and self-employed workers who are not affiliated to social security systems (do not pay pension contributions) and therefore will not have the right to a pension when retired.

Figure 1.7. Informality rates in Panama and selected Latin American countries (LAC)



Notes: Legal definition of informality used: workers are considered informal if they do not have the right to a pension when retired; for cross-country comparability rates are calculated for wage and salary workers only. Productive definition of informality: workers are considered informal if they are salaried workers in a small firm, non-professional self-employed, or zero-income workers. For Panel A, LAC average of 17 countries: Argentina, Bolivia, Brazil, Chile, Costa Rica, Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay. Data for Argentina are only representative of urban areas and wage workers.

Source: OECD calculations based on data provided by INEC (National Institute of Statistics and Census of Panama), OECD and World Bank tabulations of SEDLAC (CEDLAS and World Bank, 2018), ILO, ILOSTAT (2017) and IMF (2017), *World Economic Outlook* (database), https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx.

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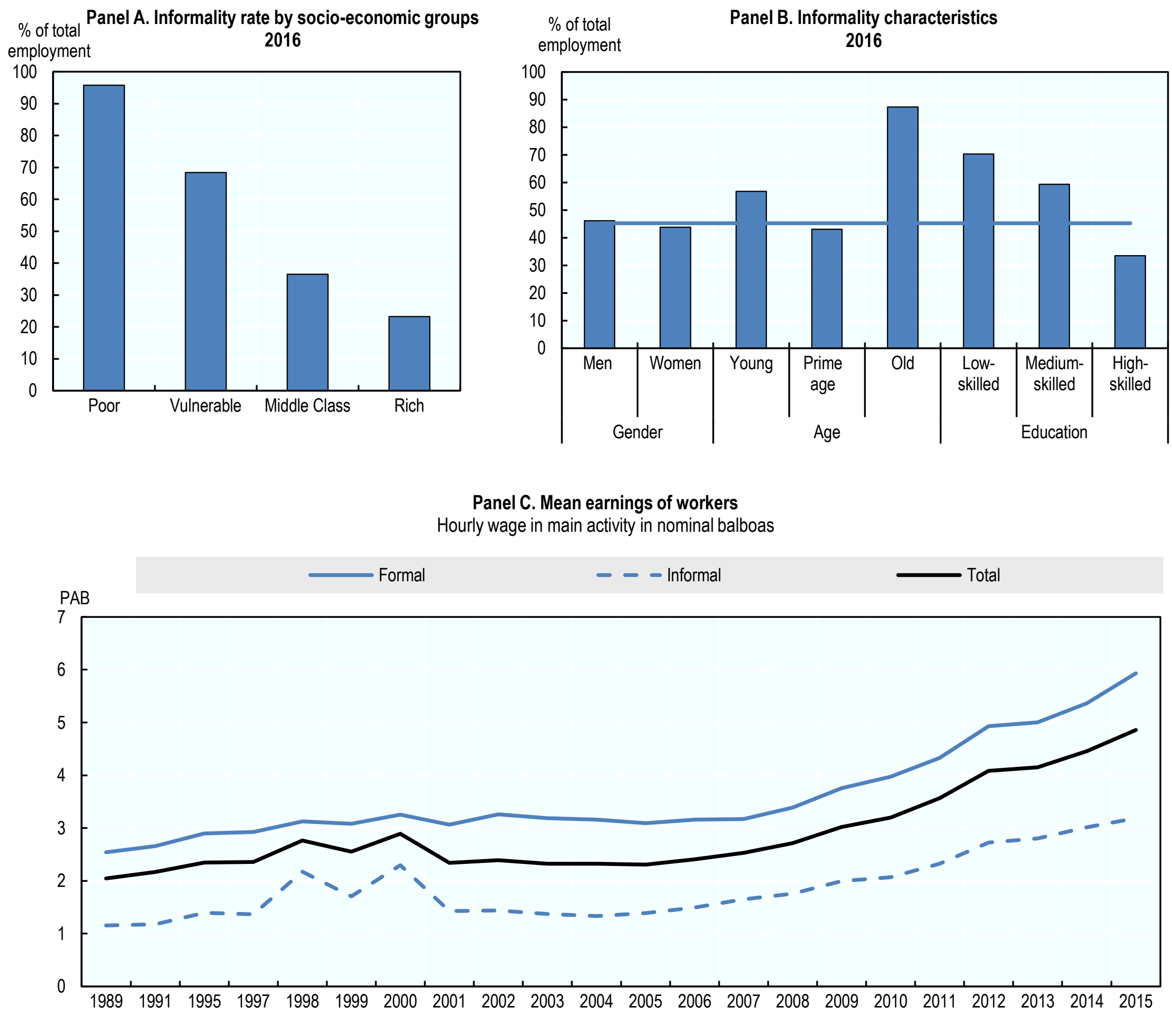
The incidence of informality is much higher for workers from poor and vulnerable households, youth, and the less educated, perpetuating the vicious cycle of the social vulnerability trap (OECD/CAF/ECLAC, 2019; Figure 1.8).

Figure 1.8. Informality enhances inequality



Notes: PAB = Panamanian Balboa. Panels A and B: Legal definition of informality: workers are considered informal if they do not have the right to a pension when retired; for cross-country comparability rates are calculated for wage and salary workers only. Panel C: Productive definition of informality: workers are considered informal if they are salaried workers in a small firm, non-professional self-employed, or zero-income workers. A firm is considered small if it employs fewer than five workers. The three skills level groups are formed according to years of formal education: low=0 to 8 years, medium=9 to 13 years, and high=more than 13 years.
Source: INEC (2017), World Bank and CEDLAS (2018), SEDLAC (Socio-economic Database for Latin America and the Caribbean), http://www.cedlas.econo.unlp.edu.ar/wp/en/estadisticas/sedlac/.

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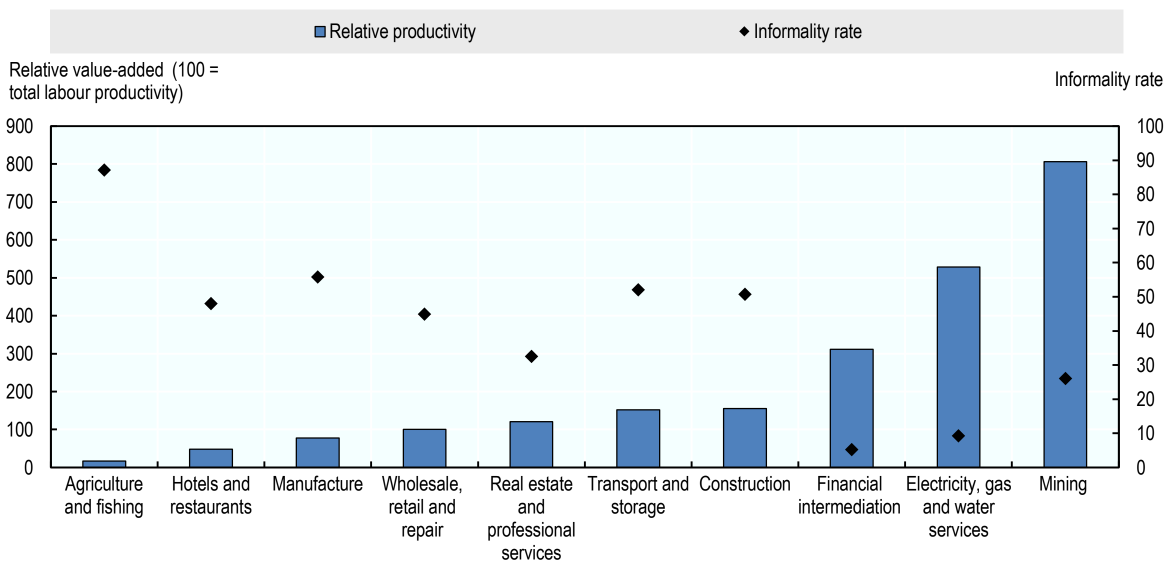
While the benefits of economic growth can trickle down to the informal, without formal employment-oriented policies, growth by itself cannot be relied upon to translate spontaneously into productive jobs and better working conditions. The pattern and sources of growth are equally important in reducing labour informality in the long run.

Informality is closely linked to productivity. The most direct connection between productivity and labour informality is that low-productive workers do not produce enough value-added to cover the costs of being hired formally. Their production remains profitable only under informal working conditions. Evidence confirms this strong correlation between low productivity and high informality, with higher levels of informality concentrated in developing countries (La Porta and Shleifer, 2014). Panama is no exception; the least productive sectors such as agriculture and fishing, wholesale retail and repair, hotels and restaurants, and manufacturing are highly informal, and employ two-thirds of all informal workers (Figure 1.9).

Figure 1.9. Relative productivity and labour informality in Panama, 2016



Note: Legal definition of informality: workers are considered informal if they do not have the right to a pension when retired. Labour productivity is measured as the annual value added (the value of output less the value of intermediate consumption) per employee.
Source: OECD calculations based on data provided by INEC.

StatLink http://dx.doi.org/10.1787/888933946229

The dual economy is cause and consequence of poor regional development

Regional development is a lever to help Panama continue on its growth trajectory and achieve more inclusive socio-economic outcomes. Regional disparities across provinces and *comarcas* in terms of productivity, social cohesion and well-being outcomes are persistent. Regional development, being a policy area that accounts for multiple sectors, can provide the basis for improving strategic planning and implementation frameworks in order to promote well-being and economic prosperity in Panama. The state should therefore strategically invest in regions, including the lower-performing ones, to encourage sustainable growth in Panama.

There is a large gap between provinces and *comarcas* in terms of well-being outcomes. Residents of *comarcas* are much more likely to live in poverty and report lower levels of satisfaction about their living conditions. They are also at greater risk of having an informal job, or not having access to drinkable water in their dwelling. The lowest level of electricity coverage in Panama is among the indigenous population. However, low outcomes in material and living conditions are also evident in the provinces as well, generally those that are rural, and regardless of whether they have a high percentage of indigenous residents (OECD, 2017a).

Projections indicate that the greatest population growth is expected in some of the least advantaged territories, where quality of life and well-being outcomes are already low, particularly in the *comarcas,* Bocas del Toro, and Los Santos. In addition, Panama City is also expected to grow significantly and the challenge will be to ensure adequate infrastructure, housing, amenities, and public service delivery capacity to keep up with growing demand, while also maintaining or improving quality of life.

Although Panama has a decentralisation law since 2015, there is no overarching strategy to guide regional development in the long term, nor a road map in the medium term. The implementation of regional development initiatives is spread across line ministries, with each territory introducing and executing its sectoral objectives and plans. At the national level, regional development is consequently fragmented and sector-driven, with limited effectiveness and a lack of concrete results. At the sub-national level, newly introduced District Strategic Plans (*Planes Estratégicos Distritales*) combine development and land-use planning, and are designed with the Strategic Government Plan 2015-2019 (*Plan Estratégico de Gobierno*) and the National Strategic Plan 2030 (*Plan Estratégico Nacional con Visión de Estado: Panamá 2030*) in mind.

Institutional responsibility for regional development is fragmented

Responsibility for regional development is fragmented across sectors in Panama. The Ministry of Economy and Finance (*Ministerio de Economía y Finanzas* – MEF), and specifically its Direction for Public Policy, and the Department for Regional Planning within the Direction for Investment Programming, play important roles. Line ministries with a territorial logic, such as the ministries of Agriculture, Education, Employment and Labour Force Development, Health, Housing and Land Use, Social Development, and the Vice-ministry for Indigenous Affairs, as well as relevant agencies, are also involved, realising their objectives through a variety of plans and programmes. In addition, the Ministry of Government and its Department for Planning and International Co-operation also have a hand in the cross-sector co-ordination of subnational initiatives that support productive development. Finally, the Secretariat for Decentralisation will likely play an increasingly visible role with respect to local development and development planning.

This current institutional framework influencing regional development underscores two issues. First, responsibility for regional development is highly fragmented, within institutions as well as among actors across sectors. Second, there is no government body exclusively dedicated to regional development in terms of its design, implementation, co-ordination, monitoring and evaluation.

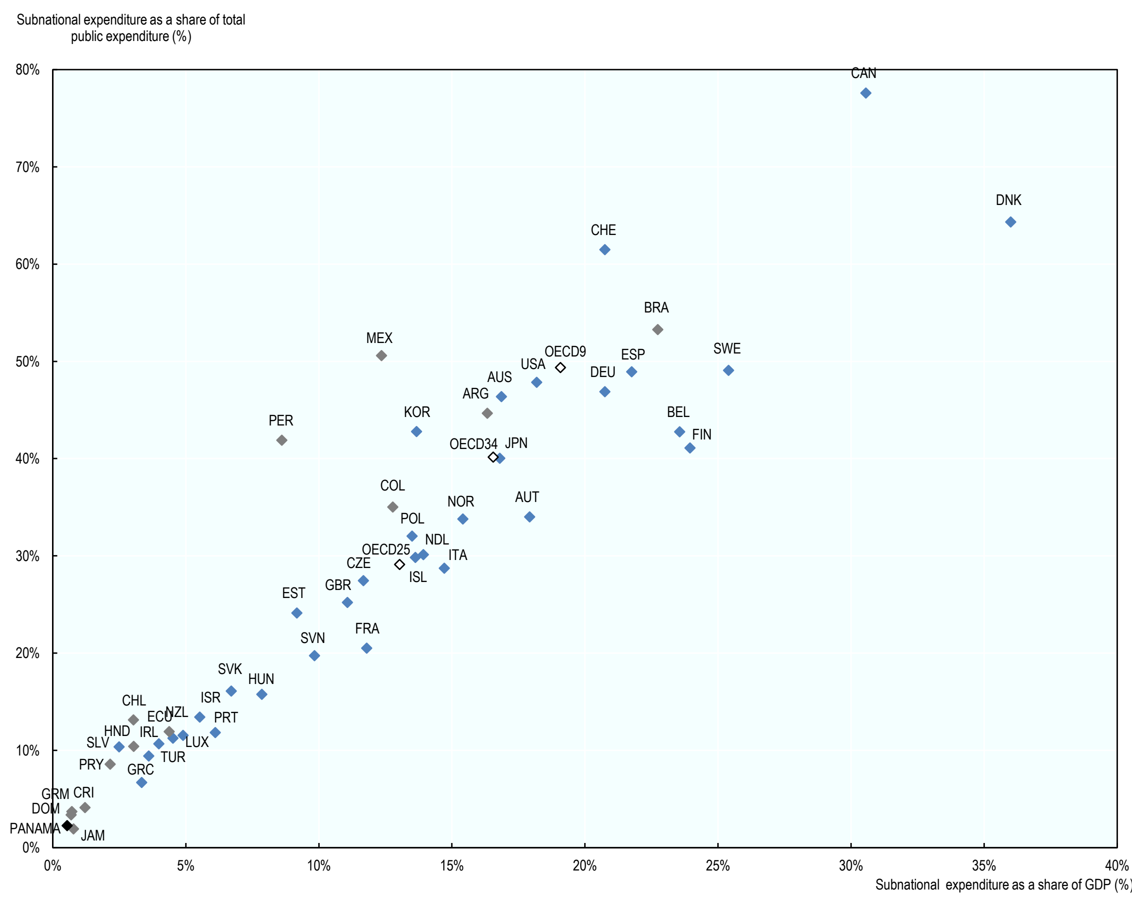
Centre-of-Government (CoG) bodies are often responsible for ensuring co-ordination across government, for instance in the area of regional development. Cross-government co-ordination committees, in turn, can delegate the oversight of the policy's implementation to a specific ministry, which can be vital to success. In Panama, however, the level of influence that the CoG has over line ministries to encourage co-ordination is relatively low. Also, there appears to be limited to no responsibility on the part of the CoG to organise cross-government policy co-ordination committees (OECD, 2016c).

Generating regional level growth depends on greater subnational capacity

Panama's subnational governments face a number of constraints. In particular, they are challenged by limited financial, administrative, and management capacity. This limits the scope of policy actions promoting regional development, as well as the implementation of place-based plans and programmes. The law on decentralisation could help address these issues; however, it is in its early stages, making it difficult to assess its real or potential impact.

As currently structured, Panama's financing and investment frameworks do not easily support a "place-based", regionally-driven approach to development. This is true at the provincial and municipal levels, where governments play a limited role in public expenditures, supposing a high degree of centralisation (Figure 1.10).

Figure 1.10. Subnational government expenditure is low in Panama (2016 or the latest)



Notes: Data for Panama are for 2016. Subnational government calculations for Panama reflect expenditure by municipalities and Juntas Comunales, because provincial expenditure is counted as part of central government expenditure. Panama is highlighted in, Latin American countries in grey, OECD countries in blue.
Source: OECD calculations from Contraloría General de la República – Dirección General de Fiscalización, Municipalidades de la República y Ministerio de Economía y Finanzas Dirección de Presupuesto de la Nación (DIPRENA) (2018); OECD (2017c), *Making Decentralisation Work in Chile: Towards Stronger Municipalities*, OECD Multi-level Governance Studies, http://dx.doi.org/10.1787/9789264279049-en.

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Local authorities are autonomous entities able to generate own source revenue. Thus, they are expected to cover their operating and administrative costs, as well as deliver services and invest in development. However, this does not appear to be the case for most municipalities. It is currently estimated that close to 80% of Panama's municipalities are receiving state subventions for operation and administrative costs.

Municipal administrative and management capacity is also challenged by human resource limitations. This is evidenced by the number of inhabitants per municipal staff, which shows – in the case of financial capacity – significant disparities. Across Panama there are 420 people per civil servant on average, however, regional ratios range from 73:1 in Taboga to 1 370:1 in La Pintada (OECD, 2017a).

Sufficient financial capacity is needed to guarantee the high skills of public servants. The law on decentralisation stipulates that all municipalities must employ a municipal engineer, a legal advisor, an administrator, a planner, a person responsible for citizen services, and a person responsible for municipal services. However, it may not be enough if the quantity and variety of responsibilities increase with the progression of the decentralisation process. Thus, sufficient financial capacity remains a challenge to ensure that remuneration levels are appropriate to recruit subnational public servants with the right skills and experience.

The role of public finances in a context of development in transition

Financing for development is a key step in Panama to move forward in the context of development in transition. Similar to other Latin American economies, to finance new opportunities for development, Panama needs to increase domestic capacities thanks to further fiscal revenues and more effective public spending (OECD/CAF/ECLAC, 2019). Increasing its income levels requires that other socio-economic indicators improve. Ensuring the availability of sufficient financial flows to drive Panama's continued national development and to foster social inclusion is critical to sustain the country's recent high-income status.

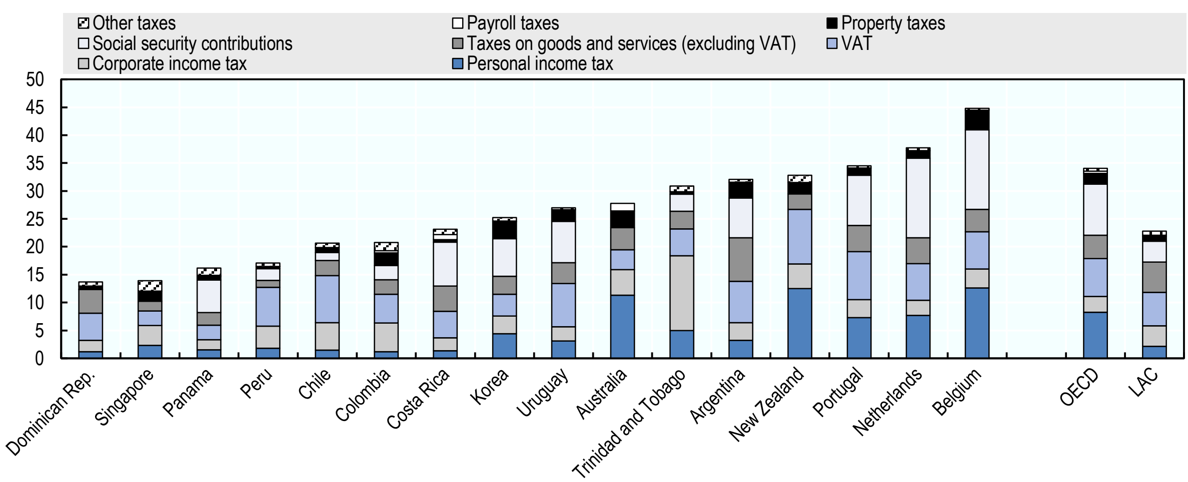
A priority is to improve the quality and coverage of key public services, especially those that affect individuals of low socio-economic background, such as education and skills (OECD, 2017a). Furthermore, financing investments that promote regional development and reduce disparities across provinces and *comarcas* is also critical for long-term sustainable growth. Current levels of investment in key socio-economic areas and in research and development are well below those of other Latin America and the Caribbean countries and OECD economies (OECD, 2017a; OECD, 2018).

To ensure financing for development in Panama, citizens' willingness to pay taxes – known as "tax morale" – is fundamental. Trust in institutions and satisfaction with public services go hand in hand and are a key element in the "fiscal pact", understood as the agreement that citizens pay taxes to the state in exchange for certain public services and goods. It is one of the main components of the social contract. Although Panama remains slightly better than the region's average in terms of citizens' satisfaction with public services, it has shown a slight deterioration between 2010 and 2015 (OECD/CAF/ECLAC, 2018). Reinforcing credibility of public policies and trust in institutions is fundamental since, similar to Latin American economies, only half of the population declares tax evasion as never justifiable. This erodes the capacity of states to raise revenues that are critical to finance good quality public goods and services, which are key to improve citizen satisfaction and respond to the greater aspirations of a larger middle class (OECD/CAF/ECLAC, 2018; OECD 2017a).

Taxes and social security contributions remain low compared to Latin American economies and OECD countries. Tax revenues in Panama have remained low compared with OECD and LAC averages. In 2016, Panama's tax revenues amounted to 16.6% of GDP, compared with 22.7% in LAC and 34.0% in OECD economies (Figure 1.11). Furthermore, tax revenue collection has remained stationary during the last 27 years, averaging 16% of GDP. Between 1990 and 2016, tax levels increased by 0.7 percentage points of GDP, an annual average growth of 0.03 percentage points, one of the lowest in LAC. In comparison, the LAC economies raised their tax collection by an average of 0.26 percentage points of GDP each year, a total increase of 6.8 percentage points of GDP (OECD/ECLAC/CIAT/IDB, 2018). During the same period, Panamanian GDP per capita at constant prices increased by a factor of 1.8, highlighting that Panama's high levels of growth have not translated into higher tax revenues, a key challenge in the context of development in transition and as a high-income country (OECD/CAF/ECLAC, 2019).

Figure 1.11. Panama's tax revenue structure compared with benchmark countries

Percentage of GDP, 2016



Notes: As in OECD/ECLAC/CIAT/IDB (2018), taxes refer to compulsory unrequited payments to the general government. Taxes are unrequited in the sense that benefits provided by governments to taxpayers are not normally in proportion to taxes paid by them. Compulsory social security contributions paid to the general government are treated here as tax revenues. Revenues from the Canal are not included.
Source: Based on OECD/ECLAC/CIAT/IDB (2018), *Revenue Statistics in Latin America and the Caribbean 2018* and OECD (2018), *Revenue Statistics 2018,* https://doi.org/10.1787/rev_stats-2018-en.

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Non-tax revenues from public enterprises complement the intake from tax revenues, but they tend to be more pro-cyclical and volatile than tax revenues. Non-tax revenues, including fees and dividends from the Canal, rose an average of 4% of GDP during the last five years. Countries with high levels of income from non-renewable natural resources tend to exhibit a lower tax effort (IDB, 2013). Although Panama's fees and dividends from the Canal are not a traditional non-renewable natural resource, they provide the government with a significant stream of non-tax revenue amounting to 11%

of total fiscal revenues (fiscal revenue is the sum of total tax revenue and the dividends and fees of public non-financial enterprises).

Social security contributions (SSCs) represent 37% of total tax revenues (OECD/ECLAC/CIAT/IDB, 2018). Taxes on goods and services accounted for 30% of Panama's total tax revenues, similar to the OECD share (32%) but significantly lower than the LAC average (51% of total tax revenues). At the same time, revenues from personal income tax (PIT) and corporate income tax (CIT) amount to 22% of total tax revenues, below the LAC average of 24% and far below the 33% average for OECD economies. Finally, property taxes accounted for 4% of total tax revenues, 2 percentage points higher than in LAC countries and 2 percentage points below the OECD average.

Revenues from the VAT are one of the lowest in the LAC region. Panama raises 2.6% of GDP through VAT receipts. Amid LAC countries, only the Bahamas raises less (2.5% of GDP), while the averages for LAC and OECD economies are 6.3 and 6.7% of GDP, respectively.

Panama collects 62% of the VAT's potential revenue and therefore loses 38% of its potential revenue. Potential VAT revenue is estimated by levying the generalised VAT tax rate on final consumption. Although VAT's losses cannot be decomposed due to lack of information, these losses should be explained by several aspects including VAT tax expenditures, evasion, fraud and other factors that diminish the tax administration's capacity to raise revenue.[2] Estimates of the VAT revenue ratio (VRR), a measure of the amount of VAT actually collected (net of refunds) relative to the potential VAT collection show that Panama could increase tax collection by 1.6% of GDP if zero rated items, exemptions that diminish VAT collection, evasion, fraud and other forms of elusion were completely abolished.

Measuring tax expenditures is critical to fine-tuning the tax system's efficiency

Broadening tax bases is critical to raising additional direct revenues and maintaining current tax rates. Panama's tax bases are narrowed due to numerous tax exemptions provided to firms, individuals and special sectors through special economic zones (SEZs) to promote investment. A crucial issue lies in the quantification of the fiscal costs triggered by these benefits. According to available estimates provided by the MEF, in 2015 tax expenditures amounted to 0.8% of GDP. This does not seem high relative to the LAC average (4.6% in 2012) (Pecho, 2014); however, this figure contrasts with other estimates of tax expenditures presented for Panama, in which tax relief channelled through consumption taxes in the country amounted to 2.3% of GDP in 2012, behind only Nicaragua, Costa Rica, the Dominican Republic and Uruguay (Pelaez Longinotti, 2017; OECD, 2017e).[3] This reflects the difficulty of international comparability since differences in tax expenditure benchmarks will lead to certain tax provisions being considered as tax expenditures in one country and not in another.

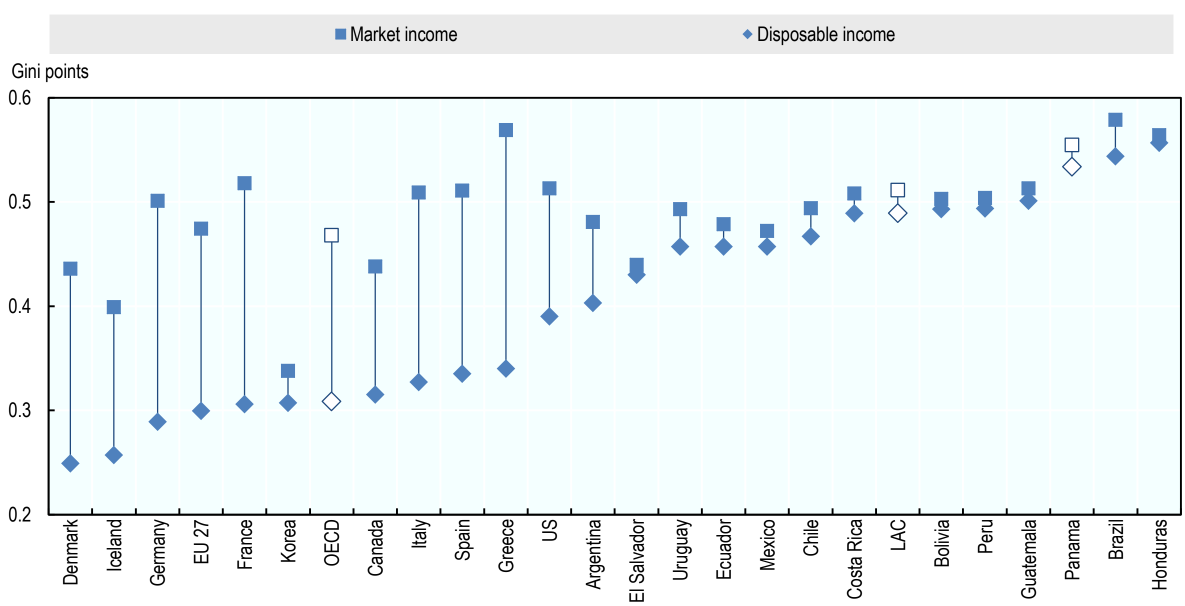
Tax expenditures are directed towards a myriad of economic goals, but it is necessary to measure their efficiency. They are aimed at social and environmental policy goals that include creating more and better jobs, boosting innovation, improving education and reducing inequality. These tax benefits are enacted and pursued through the fiscal code. Yet, it is necessary to quantify these tax expenditures to appraise their effectiveness and efficiency in achieving their intended goals (Redonda, 2016). This is particularly important since tax expenditures are automatically enforced year after year, circumventing controls and creating opportunities for tax avoidance. Therefore, improving the comprehensiveness of tax expenditure data will provide a more accurate depiction of foregone revenues in Panama.

Panama's tax system is progressive but not redistributive enough

The tax system does not reduce inequalities enough compared with OECD countries. Similar to Latin American economies, the tax system's redistributive power is low; it reduces the market income Gini coefficient by 0.021 Gini points (vs. 0.022 points in Latin America), while in OECD economies it decreases by 0.16 points (Figure 1.12). This does not mean that the system is not progressive, as the greater percentage change in after-tax income is in the more affluent individuals. Indeed, individuals in the poorest decile contribute 5.5% as a share of their market income in direct and indirect taxes and SSCs. The fifth decile pays 8.4% and the richest decile pays 11.6% as a share of market gross income (Cerutti and Martinez-Aguilar, forthcoming). However, average tax rates are relatively similar among individuals across the income distribution, highlighting the available space to improve the redistributive power of the tax system.

The tax system's low redistributive power stems from low effective average tax rates which translate into few revenues to affect the disposable income distribution. Low average tax rates indicate that the income distribution is heavily skewed towards the wealthiest individuals. Tax measures that lead to a narrower distribution of disposable income include a progressive PIT design, broadening the taxable base by eliminating or reducing regressive tax expenditures and by taxing all forms of income, and reducing tax avoidance and evasion opportunities available to the wealthy through aggressive tax planning (Brys et al., 2016).

Figure 1.12. Impact of taxes and transfers on income distribution in Panama, Latin America, the European Union and selected OECD economies, 2016 or latest



Source: OECD and the Commitment to Equity (CEQ) Institute at Tulane University, based on national household survey (INEC, 2016); OECD/CAF/ECLAC (2018) *Latin American Economic Outlook 2018: Rethinking Institutions for Development*, http://dx.doi.org/10.1787/leo-2018-en.

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Conclusions

Macroeconomic performance and stability registered in the past decade have contributed to socio-economic improvements in the country. Thanks to Special Economic Zones and Canal related activities as well as to some non-tradable sectors, including construction, GDP growth and GDP per capita growth have been considerably high compared to other Latin American economies. Therefore, Panama is closing the income gap with OECD countries. In 2018, Panama was classified as a high-income country. Furthermore, improvements in income have been translated into social benefits, such as poverty reduction.

Panama is currently in a phase to make the benefits achieved in the past decade more inclusive and sustainable. Moving from a dual economy towards a sustainable and inclusive high-income country supposes innovative policies to tap recurrent and new challenges. This makes Panama a good example of a country in *development in transition* (OECD/CAF/ECLAC, 2019). While few sectors and regions have performed considerably well, composed of high-skills workers with high wages, the rest of the country has been characterised to have informal workers, with low-skills and low levels of education and productivity.

Similar to other countries in the region, to make growth more inclusive and sustainable in a context of high-income country, Panama should adopt a series of policies to confront several traps, including social, institutional and productivity traps (OECD/CAF/ECLAC, 2019). To address these traps, key dimensions should be prioritised: better jobs and skills, spatial inclusion thanks to a territorial development strategy and financing for development. Regarding the latter, a stronger fiscal framework is needed and requires to improve the level and structure of the taxation system for development.

Notes

[1] See https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups for the World Bank's classification according to the level of income.

[2] Other factors that affect the VRR estimates are measurement errors of the GDP and final household consumption (Keen, 2013; Diaz de Sarralde, 2017).

[3] It should be noted that caution is warranted as countries employ different methods to estimate their tax expenditures and comparisons might be misleading.

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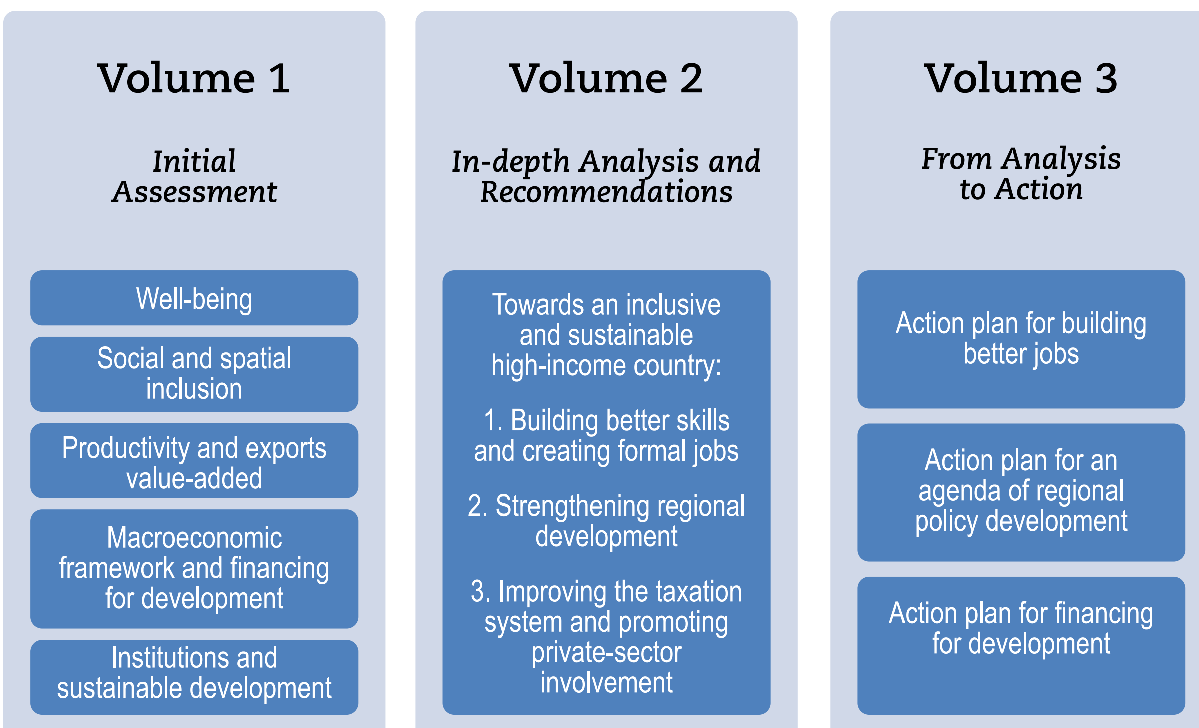
Chapter 2. Policy recommendations: Action plan and implementation strategies

This chapter presents the action plan towards three major goals in Panama: building better skills and creating formal jobs; strengthening regional development to boost inclusive growth; and improving the taxation system and promoting private-sector involvement to support financing for development. The action plan contains a number of reforms to undertake that were discussed with Panamanian authorities, civil society, private sector and academics during several workshops held in Panama City in July 2018. It also includes the expected results of such reforms, detailed actions for implementation, and their degree of priority.

This third report synthesises the analyses of the first two reports and enriches the recommendations through the "government learning" approach. This is a useful technique for discussing public policy findings or recommendations in settings facing a complex political economy. The purpose of this dialogue is to transfer the knowledge contained in the reports to local specialists and decision makers, as a first step before implementation.

Three workshops were held in Panama City from 3-5 July 2018. Public administration, private sector, civil society, academics, technical and financial partners and other international organisations took an active role in this joint effort. The workshop on skills and jobs brought together 22 institutions and 42 participants; the workshop on regional development brought together 11 institutions and 23 participants; and the workshop on taxation brought together 12 institutions and 16 participants (see Acknowledgments section). During the workshops, the participants endorsed, rejected or reformulated the policy recommendations proposed by the OECD in Volume 2. Subsequently, a discussion was held on the potential modalities and relevant actors for implementation and their priority level. This exercise ensures that the OECD recommendations are relevant to the local context and endorsed by the Panamanian government. Figure 2.1 summarises the process of the Multi-Dimensional Country Review (MDCR) of Panama.

Figure 2.1. The multi-dimensional review process of Panama



Source: Own elaboration.

This chapter presents the results of this work, in the form of an action plan, which can potentially contribute to the discussions in the implementation of the strategic plan with a 2030 horizon and the design of the next Strategic Government Plan. For each constraint, the chapter summarises the analysis conducted by the OECD (see Volume 2 for details, OECD, 2018), the main lines of reform, and an action plan for implementing such reforms.

Building better skills and creating formal jobs for all Panamanians

The scarcity of good quality employment opportunities, poor employability of a large share of the population and informality are persistent issues in Panama. The dual economy has resulted in a dual employment market, which in turn largely explains income inequality in the country. On one hand, Panama has a strong and productive modern tradeable service sector, which has steered the country's recent economic growth. This sector is mainly composed of skill-intensive activities that create relatively little employment. On the other hand, the less-productive service sector, agriculture and in some measure the manufacturing sector, in which own-account workers and micro-productive units have proliferated, offers subsistence and informal jobs to most workers.

The spike in non-residential construction that promoted employment for low-skilled workers has started to slow down. The demand for infrastructure from the transport and financial sectors has offered a large share of low-skilled workers from the agriculture sector formal and more productive jobs, reducing informality, raising salaries and ultimately reducing poverty and inequality.

At the same time, labour informality remains high. Although between 2003 and 2011 high economic growth contributed to reducing the informality rate, since 2012, as the modern tradeable service sector slowed down, informality increased and two out of three new jobs created were informal jobs. Informality poses a triple interrelated threat representing large losses for workers, for firms and the wider economy. Latin American experiences prove that public polices can help reduce informality and create better jobs for their workers (Table 2.1)

Table 2.1. Policies to reduce informality in Latin America

Country	Period	Evolution	Average annual GDP growth	Public policies
Argentina	2004 II – 2015 II	↓ 14.5[1]	4.1%	Monotributo regime (tax register and social security coverage)
				National plan for the regularisation of work (supervision). Creation of the National Registry of Agricultural Workers and Employers (RENATEA).
				Law on the promotion of registered employment and prevention of labour fraud
Brazil	2002 – 2014	↓11.9[2]	3.4%	SIMPLES and SUPER SIMPLES (monotributo)
				Labour inspection (plan to combat informality PLANCITE)
				Support for MSEs (SEBRAE)
Colombia	2009 IV – 2015 IV	↓4.9[3]	4.1%	National system of MIPYMEs
				Labour formalisation agreements
				Formalisation law and "Colombia is formalised" programme
Ecuador	2009 – 2012	↓ 10.8[4]	4.4%	Extension of social security coverage
				Strengthening of labour inspectorates
				Homologation of working conditions of domestic work (greater penalties)
Mexico	2009 IV – 2014 IV	↓ 2.1	2.0%	Business development (government purchases) and national productivity programme
				"Grow Together" programme (simplified taxation + access to social security + housing access)
				Presidential formalisation programme

Paraguay	2001 – 2011	↓ 5.8	3.5%	Extension of social security coverage to excluded groups
				New management model in the IPS
Peru	2005 – 2014	↓ 8.9	6.1%	Inspection: Plan Reto and Electronic Form
				Mype Law (reduction of labour costs)
				NRUS
Uruguay	2004 – 2012	↓ 15.1[5]	5.5%	Specific policies: domestic work, rural work
				Tax reform (simplification, monotributo) and extension of social security (health for family members, includes private)

Note: 1 Non-registered salaried employment; 2 Employment without portfolio, unpaid and own account; 3 Urban informal employment; 4 Informal non-agricultural employment; 5 Informal employment or without social security registry.
Source: Díaz et al. (2018), "Pathways to Formalization: Going Beyond the Formality Dichotomy -- The Case of Peru", *Policy Research Working Paper* No. 8551.

To promote more formal jobs and mitigate the negative effects of informality, public policy should identify and combine: 1) a short-term agenda to deal with proximate causes of informality, including poor enforcement, and encourage formalisation of firms and workers, 2) a long-term agenda to address structural causes of informality such as insufficient productive development, slow labour productivity growth in sectors that create large employment and poor skills and 3) an effort to address and mitigate the consequences of informality across a number of areas, especially in social protection coverage (OECD, 2018).

Five main policy areas or axes are recommended to promote formal, better quality jobs and formal economic activities in Panama.

An action plan for building better skills and creating formal jobs presents options for implementation

The recommendations and sub-recommendations presented in Table 2.2 were previously formulated in Volume 2 of the Multi-Dimensional Review of Panama (OECD, 2018), based on an in-depth analysis of the country's key conjunctures. Participants of the workshop *"La mejora de las competencias y la creación de empleos formales para todos los panameños"*, held in Panama City on 5 July 2018, discussed these recommendations with the aim of endorsing, rejecting or reformulating them. Participants also contributed new ideas for policy recommendations based on the workshop discussions and their extensive experience on key sectors. Changes to original recommendations are marked with asterisks. The proposals for action, actors involved and the order of priority (1 designating the highest priority and 3 the lowest priority) come entirely from the participants of the workshop.

Table 2.2. Action plan for building better skills and creating formal jobs

Axis 1: Create better conditions for productive development

This axis was not discussed during the workshop.

Axis 2: Boost the formalisation of Micro, Small and Medium Enterprises (MSMEs) and independent workers

Policy recommendation	Proposed actions for implementation	Key actors	Priority
Consider a simplified tax system for independent workers and micro-productive units	● Channel policy efforts through AMPYME ● Consider a staggered tax, including social security, rent and ITBMS (*Tax on the Transfer of Material Goods and Services*)	AMPYME, MEF, DGI, MICI and RP	1-2
Adapt CSS (*Caja de Seguro Social*) contributions for independent workers (frequency and payment method) and enforce the mandatory contribution of independents to the CSS	● Reform the current legal and regulatory framework of CSS ● Create less complex processes to register and contribute to the system ● Support with financial education for all professionals	CSS, DGI, National government, labour unions and civil society	1-3
Disseminate and extend the use of incorporation and tax regimes for MSMEs	● Strengthen the tax culture and morale ● Launch a large-scale dissemination campaign ● Provide training sessions to foster the use of information and communications technology (ICT) ● Reassess the current regulations and create a specialised inter-institutional commission	AMPYME, MICI, MEF, MEDUCA and municipalities	2
Reduce red tape and administrative/recurrent costs associated with formal status, especially at the municipal level, and the compliance costs of formally operating	● Unify the sequence of administrative procedures ● Systematise and guarantee effective institutional communication	MICI, MITRADEL, MEF, CSS and municipalities	1
Facilitate the use of the existing one-stop shops for business creation and licensing procedures	● AMPYME may take the leadership for: ○ Establish the sequence of procedures to create an enterprise ○ Create a One-Stop Shop ● Introduce the necessary controls	MITRADEL, MEF, MICI and RP	1
Establish clearer and simple schemes to determine minimum wages as well as future indexations which include objective productivity criteria	● Reassess current regulations ● Create salary scales for all sectors ● Establish a method based on productivity level	MITRADEL, MEF, CAPAC, labour unions and National Assembly	1-2
Introduce progressivity into social security contributions and lower social security contributions temporarily for new low-income workers	● Provide information and training campaigns about the importance of saving for retirement and other benefits of social protection, such as health and disability insurance ● Consider a reform of Law 51 of the CSS *Note:* Social security payments to the CSS cannot be skipped unless an exception is generated to the workers' contribution for retirement. This case could only apply to foreigners, but not to nationals. Social security payments by employers on healthcare to employees cannot be skipped.	MITRADEL and CSS	2-3

Axis 3: Adjust the pension system to increase the incentives of being formal

Policy recommendation	Proposed actions for implementation	Key actors	Priority
Strengthen current social programmes and their beneficiary set *	● Increase efforts to improve the efficiency of programmes' targeting for later moving towards a wider coverage (universal coverage)	INADEH, MITRADEL and MEDUCA	3
Integrate the *120 a los 65* non-contributory pension and the contributory system (Pillar I of the CSS) into a unique pension system	● Improve targeting mechanisms	CSS, INADEH, MITRADEL and MEDUCA	3
Guarantee that the pensions of all the workers who contributed to the CSS are larger than the non-contributory pension of workers who never contributed	● Improve targeting and planning mechanisms	MIDES, CSS and MEF	2
Provide alternative schemes to incorporate independent workers, domestic workers and temporary agricultural workers into the social security system, which should be compulsory but accompanied by 1) possibilities for gradual incorporation to the system, 2) allowances for specific contribution patterns (e.g. less regular contributions), and 3) unification of charges and services provided across all similar types of activities	● Implement new mechanisms and tools to enforce the existing laws	MITRADEL, MEF and CSS	1
Provide financial education and foster the creation of savings and insurance instruments for vulnerable groups (e.g. insurance against occupational hazards, crop insurance, etc.)	● Provide training sessions ● Provide financial education and guidance in the national education policy	CSS, MEF, MINSA, MEDUCA and MITRADEL	1
Communicate the benefits of formality and the risks of informality, especially in terms of old-age poverty (including in secondary school)	● Provide training sessions ● Design a medium-term dissemination campaign	CSS, INADEH, MITRADEL and MEDUCA	1

Axis 4: Invest in better and relevant skills for the labour force to accompany the productive development of Panama

Policy recommendation	Proposed actions for implementation	Key actors	Priority
Increase coverage of secondary education (including adult education) and strengthen the mechanisms to support students at risk of dropping out *	● Improve the current planning, diagnostic, execution and evaluation mechanisms ● Provide adequate financial and human resources to cover the currents needs ● Ensure permanence, continuity and completion of school (secondary education)	MEDUCA, MEF, National Assembly and the educative community (teachers and parents)	1
Enhance the quality of technical secondary education and incorporate current and future needs of the productive sectors into the curricula	● Undertake a diagnostic analysis of the current needs ● Homogenise quality by strengthening teaching infrastructure and curriculums ● Strengthen relations with the private sector and provide information about the benefits of offering internships and apprenticeships	MEDUCA, MEF, INADEH and private sector (CONEP, APEDE, etc.)	1-2
Increase the involvement of employers in the design of education curricula, technical programmes and workplace education	● Provide more information and foster a greater engagement with the private sector ● Create strategic alliances with the private sector ● Create sectoral work committees including the private sector ● Strengthen research, development and evaluation activities	MEDUCA, MITRADEL, INADEH and private sector (CONEP, APEDE, etc.)	2

Increase educational offerings and quality in technical careers (including non-university degrees and alternative training diplomas), especially in the provinces	● Improve the current offer of existing educational institutions by offering both technical and university careers ● Perform a diagnostic analysis on the needs in the area ● Mobilise funding resources ● Launch more effective information campaigns targeting citizens	MEDUCA, MEF, MIDES, INADEH, ITSE and SENACYT	2-3
Provide reliable and free information about employment options, wage levels in different industries, and labour market status by degree and university	● Create links with key entities to gather relevant information ● Create an updated database containing information on both public and private sector ● Strengthen the labour market intelligence and research unit and ensure a more strategic role	MITRADEL, MEF, MEDUCA, INEC, INADEH, academia and private sector	2-3
Generate links between academic and technical education by implementing a national qualifications framework to align technical and vocational education with general education and allow students to easily transit across academic and technical schools as well as INADEH, ITSE and all tertiary institutions	● Provide more effective information to high school graduates about the current higher education offer ● Create alternative options, such as validation of exams, in order to minimise school lags and desertion	INADEH, ITSE and academia	1-3
Include business training earlier in the educational curriculum (accounting, finance, management and supervisory, etc.)	● Introduce modifications to the curriculum of secondary education ● Provide training session and classes on finance, savings, self-funding mechanisms in school curriculums	MEDUCA and INADEH	1-2
Reinforce active labour market policies by strengthening employment services and youth training programmes to prevent young people from entering into informal jobs	● Strengthen relations with the private sector ● Provide more effective information to the private sector about the benefits of offering these programmes ● Create incentives for companies to participate	MITRADEL, MEF, National Assembly and private sector	1-2
Establish a policy of lifelong learning that includes regular on-the-job training	● Mobilise the financial resources needed ● Undertake permanent diagnostic analyses ● Encourage companies to invest in their human capital by promoting training for their employees ● Improve monitoring mechanisms	MEDUCA, INADEH, private sector and academia (including business training centres)	1
Create an specialised school to provide teacher's education **		MEDUCA, MEF and National Assembly	1

Axis 5: Supervise and enforce labour laws

Policy recommendation	Proposed actions for implementation	Key actors	Priority
Improve the links between different institutions guaranteeing labour rights (MITRADEL, CSS) and those responsible for business formalisation (MICI, AMPYME). Other institutions such as SNM, MEF (DGI) and MUPA also have a key role *	● Strengthen work committees formalised by law decrees to guarantee rights and those responsible for formalisation	MEF (DGI), MICI, MITRADEL, INEC, SNM and MUPA	1
Increase efforts to supervise firms by endowing the MITRADEL with more and better-qualified inspection personnel, and improving its co-ordination with the CSS. Other institutions such as SNM, MEF (DGI) and MUPA also have a key role *	● Increase in human resources trained for supervision ● Foster participation through the work of committees mentioned above	MICI, MEF, MITRADEL, CSS, INADEH, MUPA and SNM	2

Increase fines and make the sanctioning power of the MITRADEL more effective *	● Create an executing court to guarantee the payment of fines (MITRADEL) ● Strengthen current mechanisms to enforce compliance of fines ● Strengthen the coercive power of entities such as MICI and MUPA ● MEF may consider introducing new taxes	MITRADEL, MICI, MUPA and MEF (DGI)	3
Make the processes of conciliation and sanctions more efficient for instance by reducing the number of procedures	● Diversify the type of penalties, considering not only pecuniary penalties	MICI, MUPA and MEF (DGI)	2
Increase the capacity of the labour inspectorate to address issues of safety at work for informal workers and firms through the provision of information and counselling about labour rights to workers	● Increase engagement of the community to participate ● Launch information campaigns ● Provide training to general public and staff ● Contribute to decentralisation by involving local authorities	INADEH, governorates, MITRADEL, CSS and migration authorities	1
Reform the current legislation regarding labour and corporate responsibility **	● Review legislation, create working committees and draft law proposals	MICI, CSS and MITRADEL	3
Create inter-institutional links among key actors, such as MICI, MITRADEL and CSS, to exchange relevant information in order to reach a higher coercive power. This may mitigate labour and business informality ** *Note:* MITRADEL has no executing judge, thus it is not able to enforce compliance of fines. MITRADEL should be able to inform CSS about companies that are not complying the mandatory worker/employer payments. In this way, CSS can start the corresponding investigations and actions (Migration, Municipality, MEF (DGI))	● Strengthen this action with State projects ● Simplify procedures for enterprises' creation, as well as inspection procedures of local authorities and institutions	MICI, MITRADEL and CSS	

Note: Based on the workshop "*La mejora de las competencias y la creación de empleos formales para todos los panameños*", held in Panama City on 5 July 2018. * Participants in the workshop reformulated the recommendation. ** Participants in the workshop introduced this recommendation.
Source: Own elaboration.

Strengthening regional development policy to boost inclusive growth

Panama is growing rapidly, and with this comes increasing pressure on governments of all levels to ensure continued growth while promoting greater inclusiveness and well-being. Adjustments to multi-level governance practices and a coherent approach to regional development will be key for achieving this goal. Indeed, an explicit regional development policy – one that supports a strategic vision on how Panama would like its territory to look for the next generation – would be a positive step forward.

Strengthening the normative and institutional frameworks supporting regional development should be further considered. Currently, there is no overarching strategy to guide regional development in the long term, nor is there an explicit regional development policy to serve as a road map in the medium term. The implementation of regional development initiatives is spread across line ministries, each introducing and executing its sector objectives and plans. This renders policy delivery a fragmented and sector-driven exercise, with limited visibility as to overall effectiveness and concrete results.

A "new paradigm" that relies on regional development policy could complement existing strategies in order to make them more effective. Under this paradigm, policy actions are place-based and success rests on the coherence and co-ordination among different levels of government. Moreover, success further relies on subnational decision-making ability and resource capacity. Subnational governments play a very limited role in Panama's economic and social growth. The revised Law on Decentralisation could have a positive impact, but additional clarity is needed regarding how responsibilities will be transferred to municipal authorities, whilst ensuring them greater capacity – financial and human resources – in a sustainable manner.

Better data and evidence on territorial development process, as well as more robust monitoring and evaluation mechanisms, will be critical to ensure that Panama effectively addresses its development challenges.

Enhancing institutional co-ordination is fundamental to support regional development. While there are strong horizontal co-ordination practices at the national level, these are less evident with respect to vertical co-ordination between levels of government. This is particularly important given what is perceived as a gap between "macro" level national priorities, such as ensuring greater inclusiveness, and "micro" level local priorities, such as education, healthcare, and transport/connectivity. While these are not mutually exclusive, work needs to be done to bridge the gap and help subnational authorities to translate national priorities into initiatives that meet local needs. This, ultimately, is one of the fundamental roles of regional development policy at the national and subnational levels.

An action plan for strengthening regional development policy presents options for implementation

The recommendations and sub-recommendations presented in Table 2.3 were previously formulated in Volume 2 of the Multi-Dimensional Review of Panama (OECD, 2018), based on an in-depth analysis of the country's key conjunctures. Participants of the workshop *"El refuerzo de la política de desarrollo regional para estimular el crecimiento inclusivo en Panamá"*, held in Panama City on 3 July 2018, discussed these recommendations with the aim of endorsing, rejecting or reformulating them. Participants also contributed new ideas for policy recommendations based on the workshop discussions and their extensive experience on key sectors. Changes to original recommendations are marked with asterisks. The proposals for action, actors involved and the order of priority (1 designating the highest priority and 3 the lowest priority) come entirely from the participants of the workshop.

Table 2.3. Action plan for strengthening regional development policy

Axis 1: Strengthen multi-level governance practices to better support regional development

Policy recommendation	Proposed actions for implementation	Key actors	Priority
1.1. Consider supporting and adjusting normative and institutional frameworks for regional development, including:			
Taking a more strategic, long-term approach to regional development, inspiration could be drawn from practices in Finland and Slovenia (legal frameworks), the United Kingdom (white papers), Sweden (state strategies), France (state-region planning contracts) or New Zealand (regional growth programmes)	● Assess the available planning instruments for implementation, e.g. "regional planning" ● Define a strategic planning policy, whilst establishing a strategic plan and steps for implementation, monitoring and evaluation ● Create a governing body for regional planning and co-ordination of actors, public and private, at the national, and sub-national level	MEF, AMUPA, National Assembly, regional governments, private sector and civil society	1-2
Building evidence based to manage territorial growth and development, particularly in light of expected population growth and the pressures placed on services, infrastructure, jobs, and administration	● Identify and delegate a responsible administrative unit to compile information from different institutions ● Conduct socio-economic-environmental studies to understand regional differences and local challenges ● Develop statistical systems and databases at the subnational level as well as relevant indicators	MEF, AMUPA, SND, regional governments, and civil society	1
Reinforce the Law on Decentralisation by ensuring: ● Clarity in competence attribution among levels of government, and transparency in the transfer of responsibilities. ● Carefully monitoring and evaluating its contribution to municipal financial and administrative capacity and its impact on local administrative and fiscal prioritisation and decision-making autonomy	● Provide more precise information about the Law of Decentralisation and Dissemination ● Define the internal structures and create manuals of procedures ● Create a dialogue committee to analyse possible changes to the law	MEF, SND, MINGOB, National Assembly, General Comptroller, municipalities and regional governments	1-3
1.2. Build subnational capacity and resources, especially at the municipal level, by:			
Enhancing subnational fiscal autonomy in decision making and budget management	● Identifying potential strategies towards sustainable self-financing ● Developing a legal instrument that allows territories to benefit from resources produced within its area ● Strengthening the competence of MEF for training and delegate fiscal management in municipalities	MEF, National Assembly, DGCP, regional governments, municipalities, Comptroller General and civil society	2
Considering a new municipal classification system based on functional areas rather than population and density. The lack of basic services or resources across territories should also be considered for classification purposes*	● Implementing the use of such classification in all actions developed by the National Government ● Modifying the decentralisation law	SND, INEC, MEF, ANATI, MIVIOT, MIDES, Comptroller General and regional guilds	3

Ensuring training for local public servants, including in skills in planning, budgeting, municipal management, and administrative service delivery	● Prepare a training manual for municipalities and Central Government entities ● Approve the municipal administrative career ● Foster an inter-institutional academic co-operation (SENACYT, INADEH, etc.)	SND, MEF, INADEH, SENACYT, academia, municipal authorities and labour unions	1

Axis 2: Support a "new paradigm" approach to regional development

Policy recommendation	Proposed actions for implementation	Main actors involved	Priority
Develop a national regional development policy that clearly articulates national territorial development objectives and priorities. Countries such as Colombia, France, Ireland, Mexico and Sweden have taken diverse approaches to formalising their regional development strategies. Consider including a specific development framework for the *comarcas* within the policy's framework, and possibly reintroducing a multi-stakeholder, cross-sectoral body dedicated to promoting *comarca* development. Canada has adopted a similar mechanism	● Build on inter-institutional and inter-sectoral co-ordination and communication. Create spaces for such purposes ● Progress towards better integration and compatibility ● Progress towards greater inclusion of territorial agencies ● Improve the engagement of civil society in participatory planning processes ● Provide training of local government officials ● Concede greater decision power to subnational governments for actions and investments in their territory ● Align regional plans to national and international (ODS) agendas in the long term	Central and regional governments, academia and private sector	1
Introduce provincial and *comarca* regional development plans, elaborated by the corresponding subnational authorities, in order to better address subnational priorities and harness the unique opportunities corresponding to each area	● Strengthen the role of subnational actors ● Provide accompaniment to subnational actors ● Strengthen subnational government structures to develop a provincial vision that includes local governments	Provincial technical committees, local authorities and organisations and community leaders	1
Introduce regional development funding mechanisms that include a degree of predictability for the intermediate level. This can be through either a dedicated budget line or a special development fund. Uruguay may provide a useful example	● Provide adequate training to public entities ● Provide unified manuals of procedures to central government and General Comptroller ● Progress towards legal framework modernisation, including new financing instruments and greater budgetary independence ● Contracts or agreements between the central government and sub-national authorities to co-ordinate their investment agendas and focus on specific projects ● Public-private partnerships	DPP (MEF), National Assembly, Social Cabinet	1-2
Consider stronger partnership between the public and private sector when launching future regional development agencies. Poland's approach to regional development agencies may be of value	● Define the guidelines for a more inclusive public-private partnership policy in Panama ● Identify public-private co-execution spaces ● Strengthen centres of regional competitiveness ● Strengthen law on public-private partnerships (MEF, DPP) (currently being developed)	SND, MEF, MINGOB, General Comptroller, private sector and civil society	2
Build performance measurement systems to better understand policy and programme effectiveness and build evidence based at the national and subnational levels (seen in Canada, Chile, Scotland and the United States, for example), including:			
1. Output and outcome indicator sets, and programme reviews to measure the effectiveness and impact of a national regional development policy, and	● Create information systems for tracking and monitoring policies and programmes ● Define budget according to outputs ● Provide training on evaluation measures and	INEC, DPP (MEF) and Presidency	2

subnational development plans	mechanisms ● Establish a set of indicators to measure results		
2. Communicate objectives and intended targets to citizens, updating results on a predictable basis (e.g. biannually), in an easy and accessible format to understand advances, challenges and actors involved in these targets	● Create mechanisms for citizen participation, such as social audits, accountability, etc. ● Ensure availability of information ● Design a baseline	MEF, CONADES, Presidency and institutional and social local actors	1-2

Axis 3: Enhance horizontal and vertical co-ordination capacity

Policy recommendation	Proposed actions for implementation	Key actors	Priority
Create a high-level inter-ministerial body for guiding regional development policy, its priorities and performance, in an integrated, cross-sectoral manner	● Create a Technical Secretariat attached to the Ministry of the Presidency ● Define by decree a political and technical representation	***Political:*** MIVI, MEF, AN (commissions), Presidency and MiAMBIENTE ***Technical:*** MOP, IDAAN, INEC and CONADES	1
Form a dedicated unit for regional development policy to act as a steward, guiding and co-ordinating the policy design and implementation process on a day-to-day basis	● Create a unit within the MEF that is officially recognised and supported by law	MEF, CONADES, AMUPA and sectoral representatives	2
Build vertical dialogue mechanisms at the political and potentially civil servant level to better understand priorities, capacities and the synergies that can arise from sectoral programming. Ensure that they meet regularly, have a clear agenda, and can point to results. Sweden's Forum for Sustainable Regional Growth and Attractiveness offers a successful example	● Promote a commonwealth of municipalities, in order to have a mechanism of co-ordination between the central government and the commonwealth of local governments	MEF, INEC, municipalities of the Commonwealth, central and regional governments	3
Promote inter-municipal co-operation as a horizontal co-ordination mechanism to overcome capacity challenges in service delivery and local administration. Countries as diverse as Chile, Greece, Iceland, the Netherlands, New Zealand and Ukraine have mechanisms to support such co-operation			

Note: Based on the workshop "*El refuerzo de la política de desarrollo regional para estimular el crecimiento inclusivo en Panamá*", held in Panama City on 3 July 2018. * Participants in the workshop reformulated the recommendation. ** Participants in the workshop introduced this recommendation.
Source: Own elaboration.

Improving the taxation system and promoting private-sector involvement to finance development

Improving Panama's tax collection should provide further financial resources for development, which are crucial to respond to socio-economic challenges and to sustain recent macroeconomic performance. Panama's economy has performed relatively well compared with other Latin American economies. Sustaining this position demands continued growth through efforts to fund public investments in physical and digital infrastructure and social expenditure in human capital development at both national and regional levels. In turn, ensuring higher fiscal revenues is critical to maintain macroeconomic stability, ensure compliance with the Fiscal Responsibility Law and fund the necessary investments to achieve development goals. In recent years, repeated primary deficits have begun to put pressure on public debt and risk constraining capital expenditures to prevent the debt from rising.

Panama's total tax revenues have remained stable during the past two decades. Total taxes and social security contributions in Panama (at 16.6% of GDP) remain well below those in OECD economies (34.0% of GDP) and in LAC countries (22.7% of GDP). However, revenues from the Canal and other public enterprises – on average 3.2% of GDP in the past decade – have in part compensated for low fiscal revenue intake.

Improved tax revenue collection, by broadening the tax base and strengthening the tax administration, could provide a stable, long-term source of income to finance inclusive growth through sustained investments without harming Panama's international competitiveness or hampering growth. Revenues can potentially be increased by improving tax collection. For instance, the VAT forgoes approximately 2% of GDP due to currently excluded items, fraud and evasion (Jorrat, 2014). Furthermore, Panama provides a wide array of tax benefits: some of these affect the system's efficiency by potentially providing incentives to firms within sectors that do not require these benefits. Rationalising these incentives and eliminating distortions to the allocation of investments can enhance both revenue and efficiency. Moreover, exemptions, deductions and other special treatments affect both the vertical and horizontal equity of the tax system, thus requiring further in-depth analysis. All of these exemptions diminish average tax rates, which in turn decreases the system's redistributive power. Environmental taxes are also an untapped source of potential revenue that could provide additional revenue while improving environmental outcomes. Finally, curbing evasion and fraud through the use of technology and institutional strengthening can also provide additional revenues.

Private-sector involvement, through public-private partnerships, should help increase resources for development. However, Panama needs to adopt and implement a public-private partnerships framework to deliver effective and efficient infrastructures.

An action plan for financing for development presents options for implementation

The recommendations and sub-recommendations presented in Table 2.4 were previously formulated in Volume 2 of the Multi-Dimensional Review of Panama (OECD, 2018), based on an in-depth analysis of the country's key conjunctures. Participants of the workshop *"La mejora del sistema tributario y el fomento de la participación del sector privado para apoyar la financiación para el desarrollo en Panamá"*, held in Panama City on 4 July 2018, discussed these recommendations with the aim of endorsing, rejecting or reformulating them. Participants also contributed new ideas for policy recommendations based on the workshop discussions and their extensive experience on key sectors. Changes to original recommendations are marked with asterisks. The proposals for action, actors involved and the order of priority (1 designating the highest priority and 3 the lowest priority) come entirely from the participants of the workshop.

Table 2.4. Action plan for financing for development

Axis 1: Ensure macroeconomic stability and bolster international creditworthiness

This axis was not discussed during the workshop.

Axis 2: Improve the efficiency, equity and revenue-raising capacity of the tax system

Policy recommendation	Proposed actions for implementation	Main actors involved	Priority
2.1 Enhance the tax system's efficiency			
Adopt a methodology to measure and report tax expenditures on an annual basis	● Engage civil society and create working committees ● Hire a consulting firm to assess the effectiveness of existing methodologies ● Create a database (baseline) and identify milestones	DGI, DPP (MEF), INEC, custom houses, municipalities and civil society	1
Review tax expenditures and incentives periodically to ensure they are achieving their intended goals and reaching their intended targets	● Systematise available information and data ● Improve co-ordination and communication among relevant entities ● Perform a diagnostic analysis	DGI, DPP, MEF, business conglomerates and academia	1
Revise benefits provided to economic sectors, as the tax system might be subsidising otherwise unprofitable businesses or firms within these sectors	● Perform a diagnostic analysis ● Target subsidies to the poorest and most vulnerable population ● Create alternatives and capacities to increase productivity in order to gradually eliminate benefits (while avoiding social risks)	DGI, DPP (MEF), MIDA, MINSA, MEDUCA, MIDES, guilds and private sector	1-2
Review the tax base and consider to scale back tax benefits provided to well-established and consolidated industries within Special Economic Zones	● Perform a cost-benefit analysis ● Undertake a review of the current laws ● Perform a comparative analysis to balance tax burdens across contributors. The most productive Special Economic Zones should contribute more and those with lower productivity should contribute less ● Evaluate and reassess free-trade agreements	*Zona Libre de Colón*, Panamá Pacífico, *Ciudad del Saber*, DGI, MEF, MICI and Cabinets	2-3
Abolish the annual operation licence tax and the complementary tax to improve the system's neutrality and simplicity	● Reappraise current exemptions and subsidies ● Identify other potential sources of substitute income	DGI, MICI and AMPYME	2-3
Adopt strong mechanisms to prevent firms abusing granted tax benefits and shifting profits	● Identify and assess the biggest sources of tax evasion ● Analyse potential strategies to mitigate evasion ● Foster a greater use of information technology, such as data mining ● Train personnel in the use of new technology ● Implement legal frameworks that allow companies the use of tax planning mechanisms	DGI, MEF, MICI, AIG and SENACYT	1-2

Adopt environmental taxes and implement new incentives that align private and social costs with the environment *	● Strengthen the institutional framework to protect the environment ● Learn from other countries' experiences ● Follow international standards, such as Paris Climate Change Agreement ● Perform studies of environmental risks and environmental externalities ● Request reports and environmental impact studies ● Create fiscal incentives that are beneficial for the environment	MEF, DGI, ATP, SENACYT, MiAMBIENTE private sector, *Comarcas* and municipalities	1
2.2 Increase the redistributive power of the tax system			
Revise the base of ITBMS (Panama Sales Tax) to include currently exempted services while maintaining current exclusion of basic food staples and goods and compensating poorer households through direct transfers *	● Perform an diagnostic analysis	DGI, public sector, private guilds and civil society	3
Turn PIT allowances into tax credits as the value of allowances increases with marginal tax rates while the value tax credits is equal for all taxpayers. Make the tax credits refundable	● Perform a cost-benefit analysis to define the net value-added of that measure ● Implement a more progressive and equitable tax system	MEF, DGI, CONADES , national and regional governments	NA

Axis 3: Modernise the tax administration

Policy recommendation	Proposed actions for implementation	Main actors involved	Priority
Integrate critical processes (registration of taxpayers, access and management of information, current tax accounts, billing systems, taxpayer service, risk management, auditing, invoicing management, tax collection, and compliance) of the tax administration to improve efficiency and reduce administrative costs	● Perform a diagnostic or debugging of information systems ● Implement risk planning analysis by critical processes ● Provide qualified personnel to carry out the integration	MEF, DGI and AIG	1
Raise the likelihood of auditing to increase voluntary tax compliance	● Encourage compliance and voluntary payment through a prompt payment discount ● Provide manuals with standardised processes ● Provide qualified personnel to undertake auditing, transfer pricing, outlining international agreements and exchanging information ● Determine a model that allows to identify strategically and through indicators the audits to be carried out	DGI and MEF	2
Employ big-data analytics to identify evasion and fine tune risk-management models	● Develop a technological platform to analyse big data ● Integrate institutions that can provide relevant information ● Implement a system that allows the validation of information ● Adjust risk management models ● Provide qualified personnel to handle big data	DGI and INEC	2

Continue the development of electronic invoicing to fight fraud and evasion, and to encourage compliance	● Evaluate and monitor the results of the pilot plan ● Incorporate companies (voluntarily) ● Provide incentives for companies to incorporate, such as trainings, credits, etc.	MEF, DGI and AIG	3

Axis 4: Adopt and implement sound regulatory and institutional frameworks for public-private partnerships

Policy recommendation	Proposed actions for implementation	Main actors involved	Priority
Create a public-private partnerships unit to improve the quality of institutional design, the design of public-private partnerships contracts, and the management of hold-up and expropriation risks	● Create and strengthen capacities through seminars, workshops, etc. ● Strengthen institutional framework and links with international development agencies (human resources, platforms, etc.) ● Prepare a list of potential projects ● Create a fund for technical contracting	MEF, DGCP, APEDE, CAPAC, IDB and OECD	1
Adopt regulatory procedures, such as value-for-money or cost-benefit analyses, transparency and competition in the auction process and public-private partnership fiscal accounting	● Specific measures to be included in the public-private partnership law	MEF, APEDE, private sector and academia	3
Implement the effective and efficient participation of citizens in the grant process for environmental and social licences	● Conduct pre-feasibility studies ● Create links among subnational governments with a national development strategy ● Strengthen the decentralisation law, particularly on these financing mechanisms, and develop alliances with regional competitiveness centres	MEF, SNC, national and regional governments and centres of competitiveness	3
Achieve a communication strategy with citizens, highlighting the benefits of having sound regulatory and institutional frameworks for public-private partnerships in Panama	● Launch information campaigns about financing strategies for development ● Elaborate a communication strategy for the National Assembly ● Perform an analysis of good regional practices, in order to learn from other experiences and speed up implementation in Panama	MEF, MIVIOT, CONEP, MOP, MINSA, DGCP, National Assembly and academia	2

Note: Based on the workshop "*La mejora del sistema tributario y el fomento de la participación del sector privado para apoyar la financiación para el desarrollo en Panamá*", held in Panama City on 4 July 2018.
* Participants in the workshop reformulated the recommendation.
Source: Own elaboration.

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Chapter 3. The dashboard of monitoring indicators for proposed reforms

This chapter proposes a series of indicators for monitoring the implementation of the reforms proposed in the areas of skills and labour standards, regional development, and financing development. After presenting the methodology behind the scorecard, the chapter presents the objectives for each indicator that Panama should aim to achieve by 2025 and 2030.

Panama can achieve its targets of inclusive and sustainable development by monitoring the implementation of public policies through an informed range of indicators. Panama pegged the success of its development agenda to the achievement of the Sustainable Development Goals (SDG) by 2030. The government measures the achievement of these goals through a set of 51 indicators, as reported by the *Plan Estratégico Nacional con Visión de Estado* (PEN). The *Mecanismo de Coordinación y Sistema de Monitoreo y Evaluación* (M&E) *de la Agenda Social* tracks the contribution of public policies to the progress towards the SDGs by monitoring these indicators and publishing annual reports.

This chapter aims to provide the M&E with a tool that should enhance the capacity of the government to monitor the indicators of development of interest. These indicators are closely related to the expected results of the reforms proposed by the OECD in the previous chapters, and are validated by the government of Panama. The set of indicators proposed provides an overview of progress towards the goals of improving skills and labour standards, achieving balanced regional development, and financing development through taxation and involvement of the private sector.

By setting targets and clearly tracking their progress, the scorecard contributes to the transparency of the government's action. The extent to which citizens and stakeholders can monitor the evolution of the development agenda is essential for a balanced social contract. More accountability improves public administration's capacity and encourages the engagement of citizens. For this to happen, the scorecard must rely on recent, high-quality and sufficiently disaggregated data.

The scorecard proposes indicators for achieving the Sustainable Development Goals by 2030

For the three action plans identified in the previous chapter and MDCR phases (skills and formal jobs, regional development, and financing for development), the scorecard presents a number of primary and secondary indicators. Primary indicators measure the overall progress towards the 2030 goals, and an aggregate result of the proposed reforms. Secondary indicators monitor accurately the expected results for each proposed reform.

For all these indicators, the scorecard presents the following values:

- The level reached by Panama at the launch of the PEN (2016, or latest available year).
- The level attained in the two years before the launch of the PEN and in 2017, when available.
- The objectives to be attained according to the PEN (2030) if no further reforms are implemented, as well as the intermediate objectives (in 2025).

The scorecard combines data from international sources with local data and surveys. Estimations of the targets are based on data released by: the *World Development Indicators* by the World Bank; the International Labour Organization; the institute of statistics of the United Nations Educational, Scientific and Cultural Organisation (UNESCO); the *Enterprise Survey* by the World Bank; the World Justice Project; and the World Value Survey. Statistical collaboration with the institutions of Panama (in particular, the *Instituto Nacional de Estadística y Censo* [INEC], the M&E, and several ministries involved) is essential to complete the scorecard with the most recent and complete data and information.

Targets to be achieved in 2030 are calculated according to two main methodologies:

1. The first methodology allows the comparison of Panama's performance with countries with a similar income per capita. According to the latest classification by the World Bank, Panama belongs to the group of 81 high-income countries in the world.

   Although not all high-income countries are necessarily a model of development for Panama, they are likely to share similar socio-economic characteristics. If the sample of high-income countries is not large enough to ensure enough statistical power of the analysis, upper middle-income countries are considered.

2. When international data are not available, the scorecard has to be completed with national data. In this case, targets reflect those reported in the PEN (when available).

The first methodology is based on a three-step procedure:

1. First, the 2030 target for gross domestic product (GDP) per capita in Panama is computed.[1] The figure is based on the 2017 level of GDP per capita (USD 22 267) and on the objective of constant annual GDP growth rate (5%), as specified in the PEN. Under this scenario, Panama is expected to attain a per capita GDP of USD 39 988 by 2030.

2. Each indicator is regressed on the GDP per capita of each country in the sample. High-income (or upper middle-income countries) with an outlying GDP per capita are excluded from the analysis.[2] Calculations are based on the value of the indicator in 2017, or latest available year.

   Technically, in each regression equation, the dependent variable is the indicator of interest for country *i* in 2017 (or latest available year); the independent variable is the GDP per capita of country *i* in 2017 (or latest available year) (Equation 1).

$$indicator_{i,2017} = \alpha + \beta * GDP\ per\ capita_{i,2017} \qquad (1)$$

3. For each indicator and the respective estimated coefficients, the 2030 targets for Panama are derived. In particular, the estimated intercept (that captures the mean characteristics of the relevant benchmarking group of countries) is added to the product of the estimated coefficient of GDP per capita – as computed in step 2 – and of the long-term target for GDP per capita – as computed in step 1 (Equation 2).

$$indicator_{Panama,2030} = \hat{\alpha} + \hat{\beta} * \ 39\,988$$

The intermediate objectives (2025) are calculated by linearly interpolating the last available figure for Panama and the target of 2030 (independently on the method of calculation used). Linear interpolation is a method of estimating the value of an indicator between two points in time. For instance, based on the value of a certain indicator in 2017 and its target in 2030, the intermediate target in 2025 is derived according to the following equation:

$$\frac{indicator_{2025} - indicator_{2017}}{2025 - 2017} = \frac{indicator_{2030} - indicator_{2017}}{2030 - 2017}$$

The interpretation of the targets presented in the scorecard requires caution. For instance, sampling errors specific to each of the sources may have bias in the estimations. Moreover, the way in which Equations 1 and 2 are modelled, the relationship between the indicators and the GDP per capita may fail to capture non-linearity and therefore introduce other specification errors. Finally, the estimations do not take into account potential future shocks and global trends that may accelerate or slow down the evolution of certain indicators, further biasing the above estimations. Yet, the scorecard delineates a trend that Panama should follow in order to achieve long-term sustainable and inclusive growth. For this reason, the target values should be interpreted while taking into account the past values, rather than focusing on year-to-year changes.

Panama has developed a quality and independent statistics system, yet progress could be made in collecting better data on the productive structure of the country and sub-national level data. The *Instituto Nacional de Estadística y Censo* (INEC) of Panama is committed to the quality of statistical outputs and processes, in particular to timeliness and punctuality, accuracy coherence and comparability – although some discrepancies can be found between data published by INEC and by specific government ministries and agencies. Given Panama's current challenges, it is key to improve their productive structure statistics to better understand the needs of each sector. For example, efforts could be made to develop more in-depth enterprise surveys on manufacturing and services sectors. Likewise, to advance Panama's territorial development plan, richer regional and local household surveys and administrative data are needed.

Efforts could also be made to ensure user-friendly data access and dissemination. This is a key aspect so that statistics are presented in a clear and understandable form, released in a suitable and convenient manner, including in machine-readable form ("open data"), can be found easily, and are available and accessible on an impartial basis with supporting metadata and guidance. This also entails a commitment to respond to major misinterpretations of data by users.

Table 3.1. General indicators of economic performance and statistical capacity

	2013	2014	2015	2016	2017	2025	2030	Method	Source
GDP per capita (constant LCU)	8 531	8 813	9 151	9 453	9 803	14 604	17 604	1	WDI
GDP per capita PPP (constant 2011 international $)	19 378	20 018	20 787	21 473	22 267	33 172	39 988	1	WDI
Overall level of statistical capacity (scale 0 - 100)	75.6	82.2	78.9	73.3	68.9	72.4	74.7	1 **	WDI

Note: **: estimation of the target is based on information from high-income and upper middle-income countries.

Table 3.2. Increasing regional domestic capacities

			Primary indicators						
	2013	2014	2015	2016	2017	2025	2030	Method	Source
Subnational public expenditure (% GDP)				0.5		9.7	14.8	1	OECD Revenue Statistics
			Secondary indicators						
	2013	2014	2015	2016	2017	2025	2030	Method	Source
Subnational public expenditure (% total public expenditure)				2.2		22.3	33.4	1	OECD Revenue Statistics

Table 3.3. Improving skills and labour standards

Primary indicators	2013	2014	2015	2016	2017	2025	2030	Method	Source
Literacy rate adult total (% of people ages 15 and above)	91.9	92.1	92.6	92.9		95.0	96.3	1	UNESCO/UIS
Mean years of schooling (ISCED 1 or higher) population 25+ years both sexes	10.4	10.5				11.4	11.8	1	UNESCO/UIS
Lower secondary completion rate total (% of relevant age group)	74.2* (72.3)	- (70.1)	- (91.3)			90.0	96.1	1	UNESCO/UIS; Local data
Government expenditure per student primary (% of GDP per capita)	6.3* (8.6)	- (10.1)	- (10.5)			16.2	19.7	1	WDI; Local data
Government expenditure per student secondary (% of GDP per capita)	9.3* (14.6)	- (16.8)	- (17.4)			19.1	22.6	1	WDI; Local data
Share of youth not in education, employment or training total (% of youth population)		32.6		26.3		17.0	11.8	1	UNESCO/UIS
Informal employment (% of total non-agricultural employment)	38.6	39.1	39.9	40.2	40.8	38.3	36.9*	1	ILO; Local data

Note: Value in parenthesis come from local data and complement internationally comparable data. *: due to data unavailability value refers to a year older than 2013.

Secondary indicators	2013	2014	2015	2016	2017	2025	2030	Method	Source
Primary completion rate total (% of relevant age group)	99.5	96.7				98.4	99.2	1	UNESCO/UIS
Proportion of students at the end of primary education achieving at least a minimum proficiency level in mathematics, both sexes (%)	73.7					90.8	98.0	1 **	UNESCO/UIS
Proportion of students at the end of primary education achieving at least a minimum proficiency level in reading, both sexes (%)	76.9					93.4	100	1 **	UNESCO/UIS
Proportion of 15-24 year-olds enrolled in vocational secondary education, both sexes (%)	7.5 *					9.5	10.3	2	UNESCO/UIS
Vulnerable employment total (% of total employment) (modelled ILO estimate)	29.9	29.9	32.4	32.3	32.1	19.0	10.9	1	ILO

Note: *: due to data unavailability value refers to a year older than 2013. **: estimation of the target is based on information from high-income and upper middle-income countries.

Table 3.4. Financing development through taxation and involvement of the private sector

Primary indicators	2013	2014	2015	2016	2017	2025	2030	Method	Source
Revenue from environmental taxes (% GDP)		0.6				1.7	2.1	1	OECD Revenue Statistics
Tax revenue (% GDP)	17.4	16.1	16.2			28.3	34.0	1	OECD Revenue Statistics

Secondary indicators	2013	2014	2015	2016	2017	2025	2030	Method	Source
Informal payments to public officials (% of firms)						17.7	13.4	1	World Bank Enterprise Survey
Time to prepare and pay taxes (hours)	417.0	417.0	417.0	417.0	417.0	250.6	146.6	1	World Bank Enterprise Survey
Number of visits or required meetings with tax officials (average for affected firms)						1.6	1.4	1	World Bank Enterprise Survey
Tax payments (number)	52.0	52.0	52.0	52.0	52.0	28.6	14.0	1	World Bank Enterprise Survey
Total tax rate (% of commercial profits)	37.0	37.2	37.2	37.2	37.2	37.6	36.3	1**	World Bank Enterprise Survey
Gini coefficient on income distribution after taxes and transfers				0.5		0.4	0.3	1	CEQ, Tulane University
Percent of firms identifying tax administration as a major constraint						1.1	0.0	1	World Bank Enterprise Survey
% of people that consider the administrative proceedings to be conducted without unreasonable delay		37.8	45.2	50.7	56.5	62.4	66.0	1	World Justice Project
% of people that considers the government open		52.4	55.3	57.6	59.3	66.5	71.0	1	World Justice Project
% of interviewees that do not justify tax cheating							94.3	1	World Value Survey

Note: **: estimation of the target is based on information from high-income and upper middle-income countries.

Notes

[1] We consider GDP per capita in power purchasing parity and 2011 international USD.

[2] Outliers are defined as those high-income (or upper high-income) countries with a GDP per capita that is at least 1.5 higher – or lower – than the inter-quantile range of the GDP per capita distribution – that is, the difference between the 75th and 25th percentiles.

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