

USAID/Panama

Annual Report

FY 2004

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Related document information can be obtained from:
USAID Development Experience Clearinghouse
8403 Colesville Road, Suite 210
Silver Spring, MD 20910
Telephone: (301) 562-0641
Fax: (301) 588-7787
Email: docorder@dec.cdie.org
Internet: <http://www.dec.org>

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Panama

Performance:

Background: Panama returned to a democratic government in the early nineties, but the vestiges of two decades of military dictatorship still remain. The lack of sustained economic structural adjustments and judicial reforms impeded policy consistency. More than ten years into this process, the structure of Panama's economy and pattern of growth continue to limit potential growth. A dual economy persists. Typically, internationally-oriented economic enclaves, such as the Canal, the international banking sector and the Colon Free Zone pay higher wages in contrast to the domestically-oriented sectors. High productivity is standard in the former while low productivity and labor surplus are characteristic in the latter. The incidence of poverty is high in the backward rural sector of the economy where 50% of the country's population lives. For example, policies in Panama that increase the cost of labor and lower the cost of capital also contribute to segmentation in the factors of production market.

Commensurate political will has not always supported needed economic and judicial reforms. This generalized attitude on the part of the Government of Panama (GOP), regardless of the political party in power, stands in the way of building a prosperous Panama. Weak judicial systems undermine economic growth and development. Panama, like many developing countries, lacks the domestic resources it needs to meet required investment levels for sustainable economic growth; however, transaction costs associated with corruption discourage needed investment. Direct foreign investment has been steadily declining since 1998 as a percentage of Gross Domestic Product (GDP). It dropped from 13.1% of GDP in 1998 to 4.5% of GDP in 2002.

The GOP's commitment to protecting the environment has improved, but must be reinforced. Raising the level of commitment to the environment will promote further sustainable development and future economic growth. Improvements in the capacity of key institutions responsible for the Panama Canal Watershed (PCW) are making watershed management activities more viable. Institutional arrangements are also in place that will facilitate implementation of sustainable management activities in the PCW at the community level within selected pilot sub-watersheds. Obtaining policy reforms, meaningful community participation, watershed management demonstration projects, and application of conservation technologies and regulations are important next steps to protect and conserve the Canal watershed.

The macroeconomic outlook in Panama is not encouraging. The annual real GDP growth rate declined from 1998 to 2001, when it reached only 0.3%. In 2002, the rate of growth increased, but only to 0.8%. The growth rate projected for 2003 is 1.5%, well below the 4.4% experienced in 1998. In the absence of economic structural adjustments, these variations in the growth rate are cyclical in nature rather than sustainable. Panama continues to experience double digit unemployment rates, registering 13.7% unemployment in 2002. The rate of unemployment in the urban areas was 16% in 2002. Women represent 34.5% of the labor force and have an 18% unemployment rate. The unemployment rate for men is 11.5%. The inflation rate was on average 0.6% between 2000 and 2002. During the first three quarters of 2003, the consumer price index increased 1%. The non-financial public sector had an overall deficit in 2002, totaling \$244 million or -1.9% of GDP. The GOP projections for 2003 place the overall deficit around -2% of GDP. There is no political will to implement necessary measures to resolve the Social Security actuarial crisis. Even though the actuarial deficit continues to increase, the problem is passed from one GOP administration to the next. By June 2003, it reached \$2,657 million. This imbalance represents a serious threat to Panama's public finance situation. The external public debt/GDP ratio rose from 57.3 in 1998 to 62.5 in 2002. That same year, the GOP's external debt service totaled \$1,289 million.

Trade policy in Panama is not conducive to economic growth. Barriers to trade, especially nontariff

barriers, continue to restrict imports. The prospect of launching bilateral negotiations on a Free Trade Agreement (FTA) with the United States in 2004 is an opportunity to address outstanding reforms that Panama has yet to adopt and implement. The underpinnings to a successful FTA imply that Panama must make significant policy changes. Hence, the agreement will promote not only trade, but also respect for internationally recognized worker rights, greater respect for rule of law, sustainable development, and accountability by governing institutions. Especially important are the strong anti-corruption and transparency requirements in the FTA that will require Panama to fight system-wide corruption in the country.

U.S. Interests and Goals: The United States Government (USG) has economic and strategic interest in the efficient functioning of the Panama Canal, a vital waterway for U.S. and world commerce, as well as for the expedient transit of U.S. military vessels. The United States and Panama also maintain strong economic and commercial ties. In 2002, U.S. exports to Panama represented \$1.4 billion of the \$1.7 billion in bilateral trade between the two countries. Approximately half of Panama's total imports are from the United States. U.S. direct foreign investment in Panama totals around \$25 billion.

The USAID Program in Panama contributes directly to the achievement of U.S. foreign policy objectives in homeland security, regional stability, democracy and economic prosperity and security. It also contributes indirectly to the disruption of criminal organizations. Working in selected Panama Canal sub-watersheds, USAID supports sustainable watershed management at the community level and in critical national parks, ensuring the operation of the Canal for the passage of military vessels and hemispheric commerce. The justice reform follow-on activities and new democracy and governance program will also address corruption and support transparency and accountability activities while sustaining the pace of improvements in the justice system, civil society policy dialogue and advocacy. In the Darien Province bordering Colombia, the USAID program contributes to the Mission Performance Plan (MPP) goal that Panama remains a stable and secure regional partner by creating a buffer against spillover of the Colombian conflict. The importance of Darien to the USG centers on stemming the flow of trafficking in illegal drugs, humans, arms and violence as well as controlling the spread of human and agricultural diseases across the Colombian border.

Donor Relations: Working in close coordination with other key donors, USAID seeks to ensure complementarities and avoid duplication of efforts whether working in the sustainable management of the Panama Canal Watershed, judicial reform, or community development in Darien. The exchange of information and sharing lessons learned with the IDB, UNDP, FAO, JICA and GTZ on activities in the PCW is an on-going standard practice. The Mission also emphasizes donor coordination and communication with the IDB regarding the justice sector as the IDB is the largest donor in the sector. Equally important is coordination with the IDB, FAO and UNDP regarding on-going activities in Darien.

Challenges: During the reporting period, Panama achieved momentum towards fairer and faster justice. Political will played an important role in this achievement. USAID will determine if the AOJ bridge activities and a subsequent Democracy and Governance program will have similar support from the Supreme Court of Justice (CSJ) under the tenure of a newly elected Chief Magistrate who will assume office in January 2004. Without the commensurate commitment and political will, USAID will collaborate more heavily with civil society on anti-corruption efforts and local communities on administration of justice to sustain the pace of improvements gained. Similarly, the design of the new Democracy and Governance program will emphasize catalyzing justice reforms and fighting corruption. Programmatic challenges were met in the PCW Strategic Objective (SO). The SO Results Framework was modified to provide a more focused approach, moving away from institutional strengthening to a more practical emphasis on policy reform and active local community participation. USAID consolidated Intermediate Results (IRs), reducing the number of IRs from four to two, incorporating both the NGO and local government activities into the new IRs--Integrated Watershed Management Demonstrated in Selected Sub-Watersheds and Environmental Management of Protected Areas Upgraded. The purposes of this integration is to focus and concentrate activities for greater impact, generate synergies, and develop watershed and protected areas management models that are more easily replicated within the PCW and at the national level. This reorientation will increase the efficiency and usefulness of USAID assistance to the GOP. Two key partners--the Panama Canal Authority (ACP) and the National Environmental

Authority (ANAM)--met challenges presented during this reporting period. The ACP is increasingly more open to a participatory approach to watershed management with other GOP agencies, private sector, NGOs and communities. ANAM is undergoing behavioral change as demonstrated in its willingness to form alliances with NGOs and the private sector. The direction of the USAID Program in Darien encompasses activities in selected communities based on assessed needs, vulnerability, and potential for community development. Active participation of the communities is a priority to achieve sustainability and replication through self-help and leveraging additional funds. The Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (ACDI/VOCA) consortium is stressing strengthening local communities through development strategies that emphasize community participation in the design and implementation of local small-scale projects. The consortium accelerates identification and approval of proposed activities, thereby improving financial performance and delivery of results under the Cooperative Agreement.

Key Achievements: During FY 2003, the USAID/Program met its overall objective in the Administration of Justice Program by establishing momentum toward a fairer and faster justice system. It reached important milestones towards the achievement of the overall PCW Strategic Objective. GOP institutions within the Inter-Institutional Commission for the Canal Watershed (CICH) working in the PCW were strengthened and alliances developed. Additional funds were leveraged through public-private partnerships. A new management model for protected areas and a sustainable source of funding to implement the Chagres Conservation Area Plan resulted from the alliance formed under the Tropical Forest Conservation Act (TFCA) \$10 million debt-for-nature swap.

1. **Sustainable Management of the Panama Canal Watershed and Buffer Areas:** Under this SO, USAID supports sustainable protection and management of the Panama Canal Watershed (PCW) to protect the fresh water necessary for Canal operations, which underlines U.S. Government's economic and strategic interests in the efficient functioning of this vital waterway. An effectively functioning Canal ensures rapid transit of cargo, cruise ships and U.S. military vessels between oceans. The Panama Canal Watershed (PCW) also provides the water resources for industrial and human consumption in Panama City and Colon and the production of hydro-electricity. In 2003, USAID, in close partnership with the Panama Canal Authority (ACP) and the CICH, set the stage for development of activities in selected pilot sub-watersheds and national parks. The purpose of these pilots is to demonstrate elements of successful watershed management at the community and park level. USAID committed \$2.5 million to a seed capital fund that will be matched dollar for dollar by the ACP for a total of \$5.0 million. A debt swap under the Tropical Forest Conservation Act will provide seed capital to fund pilot and future activities required for sustainable management of the Chagres National Park. USAID is also participating in the development of an eco-tourism pilot in Soberania Park and a small town sanitation pilot in an urbanized part of the trans-isthmian corridor. Participation by the private sector is encouraged through the Global Development Alliance.

2. **Improved Governance and Judicial Reform -** Significant milestones towards consolidating momentum for fairer and faster justice have led to important improvements in the criminal and commercial justice systems of Panama listed below in the corresponding Special Objective narrative. The Supreme Court of Justice (CSJ) made progress in judicial reforms and civil society played a more proactive role in promoting and achieving sustained reform at the grassroots level. The stage for fundamental changes in the Panamanian justice system is set. USAID achieved these results with \$3.0 million in technical assistance and training provided over a three-year period under the Administration of Justice SpO. A one-year bridge program in administration of justice activities will serve as a transition into a broader Democracy and Governance (DG) program in FY 2004. The new DG program will build on the current justice reform momentum and will migrate into the Central America and Mexico (CAM) Regional Strategy, focusing on sustainable rule of law and transparency issues to mitigate corruption.

3. **Community Development Assistance in Panama's Darien Province -** USAID initiated in FY 2003 a three-year \$6 million program under the Andean Regional Initiative to establish a buffer against spillover of the Colombian conflict and to support stability in Panama's Darien province. USAID is providing small grants, technical assistance, and training directly to communities for self-help development programs to strengthen community-based organizations and NGOs in Darien, and improve the financial and social

well-being of the population in selected communities.

Gender: The Mission encourages gender participation in its activities in watershed management, justice reform, advocacy, and community strengthening. In addition, USAID plans on increasing women's roles across the board, including the policy level, based on the results of a gender analysis that will be prepared in FY 2004 in connection with Panama's Country Plan under Central America and Mexico (CAM) Regional Strategy.

Trade Capacity Building: The recent announcement that the USG intends to initiate bilateral negotiations for a Free Trade Agreement (FTA) with the Republic of Panama will raise interest in trade capacity building (TCB). The U.S. Trade Representative expects to launch negotiations during the second quarter of CY 2004. As a result, USAID anticipates discussing technical assistance needs with the Government of Panama (GOP), in coordination with other USG entities such as the State Department, the U.S. Trade Representative, and Department of Commerce.

Country Close and Graduation:

N/A

Results Framework

525-004 Panama Sustainably Manages the Canal Watershed and Buffer Areas

SO Level Indicator(s):

ACP Contribution to GOP Budget
Water Quality Index

IR-4.1 Integrated Watershed Management Demonstrated in Selected Sub-Watersheds

IR-4.2 Environmental Management of Protected Areas Upgraded

525-005 Momentum Towards Fairer and Faster Justice System Established

SO Level Indicator(s):

Level of Completion of Alternative Dispute Resolution Pilot Projects
Total Score of Pre-Trial Pilot Projects Implemented

IR-5.1 Access to Justice in Targeted Areas Increased

IR-5.2 Proactive Role of Civil Society in Justice Sector Reform Improved

525-006 Selected Darien Communities Strengthened

SO Level Indicator(s):

Number of Beneficiaries in the Target Region Who Benefit from Access to Social and Productive Infrastructure

Number of Jointly Developed Proposals Approved

Percent of Community Members Who Express Satisfaction with Community Capacity to Respond to Local Problems

IR-6.1 Social Infrastructure in Selected Communities Improved

IR-6.2 Organizational Capacity of Local Governments and Community-based Organizations Strengthened

IR-6.3 Productive Infrastructure in Selected Communities Improved

525-021 Ruling Justly: More Responsive, Transparent Governance

SO Level Indicator(s):

N/A

N/A N/A

525-022 Economic Freedom: Open, Diversified, Expanding Economies

SO Level Indicator(s):

N/A

N/A N/A

525-023 Investing in People: Healthier, Better-Educated People

SO Level Indicator(s):

N/A

N/A N/A