

BASIC INFRASTRUCTURE SECTOR REFORM PROGRAM

(PN-0097)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR: Republic of Panama

EXECUTING AGENCY: Ministry of Economic Policy and Planning, through its Public Policy Unit, according to the execution and coordination arrangements with agencies outlined in chapter III.

AMOUNT AND SOURCE:

IDB (quick-disbursing):	US\$120 million (OC)
Technical cooperation:	US\$ 3.34 million (OC)
MIF (grant):	US\$ 1.81 million
Local contribution:	US\$ 1.58 million

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	20 years
Disbursement period:	3 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75%

OBJECTIVES: This operation is intended to support reforms in the telecommunications, electricity, and water and sanitation sectors. Two loans are being proposed: a quick-disbursing loan for US\$120 million, to help cover Panama's external funding requirements; and a technical-cooperation loan for US\$3.34 million, to support implementation of the reform program. A parallel proposal for nonreimbursable technical-cooperation funding in the amount of US\$1.81 million is being submitted to the MIF Donors Committee, to finance the subprogram that will establish the new Public Utilities Regulatory Board.

DESCRIPTION: The program is aimed at setting up a legal, institutional, and regulatory framework that will promote private-sector participation in the expansion and efficient delivery of water supply, sanitation, electricity, and telecommunications services. The policy calls for: (i) reorganizing the market in such a way as to maximize competition, (ii) implementing a stable, transparent legal framework, (iii) adopting institutional frameworks in which the State maintains its sector policy and regulation functions, but transfers to the private sector part or all of the ownership, financing, and direct

service delivery functions; and (iv) the regulatory function is to be entrusted to an independent, autonomous body.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environment Committee, at its meeting of May 21, 1996, classified this as a Category III operation. The environmental summary was to be considered by the Committee at its October 2, 1996, meeting.

BENEFITS:

Participation by the private sector should substantially lower public-sector funding requirements for expanding installed capacity in the sectors involved. The government would then be able to transfer funds thus freed up to the social sectors. External borrowing by the public sector should drop by roughly US\$1 billion between 1997 and 2002. Cost recovery through tariffs should provide the necessary funding for expanding coverage and ensuring that the quality, reliability, efficiency, and sustainability objectives are attained.

RISKS:

The biggest evident risk is whether the legislation to reform the electricity and the water and sanitation sectors will be approved. No real problems are anticipated in this regard, considering the Executive Branch's success in pursuing its legislative agenda, and the internal dialogue and consultations that the government has been engaged in to achieve the necessary consensus for the projects' objectives, scope, and specifics.

A second area of risk is the possible lack of private-sector interest in delivering such services in Panama. In this connection, there are at least two positive factors to bear in mind: the lack of exchange risk involved, and the overwhelming response to the call for bids on cellular telephone services (band A). Initial indications in the area of water and sanitation (a sector with relatively lower returns) are that commercial operation of the systems would be compatible with the strategy of concessioning-out and gradual capitalization of sector utilities.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

The Bank's strategy focuses on lending support to the Government of Panama to lift the structural barriers to economic growth, create more jobs, and improve social conditions in Panama. Its aim is to help attain more equitable growth that is sustainable from an environmental standpoint, with support from a modern State apparatus. The four objectives of the Bank's strategy are: (i) broaden social-policy benefits, especially for vulnerable and under-

privileged groups (growth with equity); (ii) promote sustainable development; (iii) foster sustained economic growth; and (iv) strengthen governance.

The proposed operation is consistent with the Bank's policy and very much in line with the government's program and with the country's efforts to promote greater private-sector participation and to target public-sector spending to the at-risk population.

POVERTY-TARGETING: Bearing in mind that the program's benefits are macroeconomic in nature and will benefit the population at large, the program cannot be classified as specifically targeting low-income groups or as a poverty-reduction or social equity project, as defined in the Eighth Replenishment document.

EXCEPTIONS TO BANK POLICY: It is recommended that the retroactive financing period be extended to cover the 12 months preceding the loan contract signature date (see paragraph 3.23).

It is recommended that the international competitive bidding requirement be waived for imports of petroleum and petroleum products and wholesale electricity (see paragraph 3.22).

It is proposed that authorization be given to hire the United Nations Development Programme directly as the agency to perform administrative support activities for the Policy Unit, such as hiring technical-cooperation services (see paragraph 2.6 of Annex III).

For consulting services, it is proposed that the least-cost selection method be used. Under this method, a minimum acceptable technical level is established for technical bids to qualify. Bids are presented in two separate envelopes. The technical proposals are opened and evaluated first. Bids that do not meet the minimum acceptable technical level are discarded. The price bids are opened only for the technical bids that have qualified. The firm with the lowest price bid is the one selected. When using this method, the term "minimum acceptable" is defined bearing in mind that all bids above the "minimum acceptable technical level" will compete purely on the basis price. The minimum level will be defined explicitly in the respective calls for bids (see paragraph 2.7 of Annex III).

**SPECIAL
CONTRACTUAL
CONDITIONS:**

In addition to the general contractual conditions for this type of loan, the prospective loan contract will contain those outlined in the policy matrix (Annex I).

Simplified international competitive bidding procedures will be used for the procurement of program-eligible goods valued at over US\$5 million (see paragraph 3.19), except for imports of petroleum and petroleum products and wholesale electricity, as indicated above in the paragraph on exceptions to Bank policy.

The prospective loan contract will also include the standard Bank conditions on audits, reports, inspections, evaluation of the loan, bid processes, etc.

I. FRAME OF REFERENCE

A. Background

- 1.1 The Government of Panama is currently implementing a basic infrastructure sector reform program with support from the IDB. Launched in the early 1990s, the program was originally intended to get private enterprise involved in the country's ports and telecommunications sectors and to strengthen and modernize the government agencies responsible for Panama's water and sanitation and electric energy sectors. The Bank's Board of Executive Directors approved loan 688/OC-PN in the amount of US\$80 million and loan 689/OC-PN for US\$40 million in support of this program. The loans were to be released in three tranches. The first tranche, totaling US\$50 million for the two loans, was released in August 1992, and the second (US\$35 million) in November 1995.
- 1.2 The political problems that stood in the way of ports and telecommunications reform under the previous administration have now been resolved. In the electricity and the water and sanitation sectors, however, efforts have fallen short of targets. In any event, it is generally felt that, even if the targets had been fully met, problems would still remain in terms of ability to provide efficient service and to mobilize the necessary funding to ensure acceptable coverage of the public's needs in these areas.
- 1.3 In late 1994, the private sector started taking on an active role in the development of new port facilities. This, coupled with the interest shown in running existing ports, has helped to shape a new market-driven dynamic for the sector. The government recently awarded the ports of Cristóbal and Balboa to a private operator/investor, thus attaining one of the reform program's key objectives in this sector.
- 1.4 In view of the foregoing, the current administration has fully embraced the reform program for telecommunications. In the water and sanitation and electricity sectors, however, it has replaced the programs to strengthen the Water and Sanitation Authority [Instituto de Acueductos y Alcantarillados Nacionales] (IDAAN) and the Water Resources and Electricity Authority [Instituto de Recursos Hidráulicos y Electrificación] (IRHE) with comprehensive sector reform programs. Accordingly, an agreement was reached with the government, and in April 1996 approval was given for the government's request to cancel the balance (US\$35 million) of the two 1992 loans. Approval is now being requested for the present operation, which is more closely geared to reflect the objectives and goals of the current reform program for these sectors.

B. Key issues

- 1.5 The main justification for the proposed program lies in the imbalance between the demand for funds to ensure sustainable development and operations in these sectors and the limited capacity of the sectors' institutional frameworks in terms of the operation, financing, and execution of investment projects.

If Panama is to expand coverage of utilities services and meet the growing demand triggered as it enters the world economy, it will need some US\$270 million over each of the next five years (just over 4.2% of GDP) to finance and develop installed capacity in the telecommunications, water and sanitation, and electricity sectors.

- 1.6 Panama's experience in this area has been limited to the three State-run companies that deliver services directly (INTEL, IRHE, and IDAAN). This means that regulatory powers have been exercised and regulations issued by means of direct government presence in these agencies, or by ensuring public implementation of projects with adherence to rules and procedures in effect in the public sector in the area of hiring, supervision, and funding. As this traditional approach has lost currency, coupled with the need for a complete overhaul of service delivery schemes and more private-sector investment and management, reforms also need to be made in the State regulatory apparatus and in its legal and policy underpinnings.

1. Telecommunications

- 1.7 Telecommunications services in Panama have been in the hands of the Telecommunications Authority [Instituto Nacional de Telecomunicaciones] (INTEL), which was set up in 1973 for the purpose of planning, designing, building, and operating the country's telecommunications systems. As part of the sector reform program, INTEL was converted into a corporation (INTEL S.A.) in early 1995, and the Executive Branch was given authorization to begin a privatization process whereby 49% of the company's share capital would be sold to a strategic investor. With the sole exception of the band A concession for cellular telephone service that was recently awarded to a strategic investor, the company has enjoyed a monopoly in this sector.
- 1.8 The institutional framework in which the company operates does not afford the necessary managerial flexibility, financial and operational autonomy, or incentives for meeting the challenges of economic globalization and keeping pace with advances in the information sector. The problems historically associated with this kind of service structure continue to be present, e.g., limited coverage, low reliability, distorted tariff structure, diversion of

funds to cover other public-sector requirements, and overstaffing in terms of actual service levels.

The plan to expand and modernize local and long-distance telephone service has been priced at around US\$400 million. This presupposes not only timely access to state-of-the-art technology but also the ability to finance and execute a total of at least US\$60 million in capital investments each year, compared with only US\$40 million a year during the period 1990-1995.

2. Water and sanitation

- 1.9 The core agency in this sector is the Water and Sanitation Authority [Instituto de Acueductos y Alcantarillados Nacionales] (IDAAN), which was set up in 1961. IDAAN is in charge of planning, building, and operating water and sewer systems in towns and cities with populations of 1,500 or more.
- 1.10 What this means is that IDAAN provides service coverage directly to just over 80% of the country's population. The agency also performs regulatory functions and oversees sector development policy and planning in the areas of service standards and system expansion. Despite repeated efforts at institutional strengthening, IDAAN still suffers from systemic weaknesses in its administration, finance, and operations departments; it has extremely limited investment program implementation capacity; and it lacks the necessary resources for proper system maintenance and expansion.

To close the gap in drinking water coverage and, especially, in sanitary sewerage services, the country needs to invest somewhere over US\$200 million, in addition to the investments needed for cleaning up the Bay of Panama (roughly US\$50 million per year between 1997 and 2002). Given the sector's current regulatory and institutional frameworks, its investment execution capacity stands at only US\$10 million per year. The funding needs are well beyond the possibilities of current financing mechanisms.

3. Electricity

- 1.11 Panama's electricity sector falls under the aegis of the Water Resources and Electricity Authority [Instituto de Recursos Hidráulicos y Electrificación] (IRHE). IRHE is a vertically and horizontally integrated monopoly that was set up in 1961 to plan, regulate, and provide all services associated with the generation, transmission, distribution, and marketing of electric power.

- 1.12 The sector suffers from problems in service coverage, quality, continuity, and reliability. Energy losses are relatively high, and the thermal generation system is in poor condition owing to insufficient maintenance and repair. The sector lacks the funds and the implementing capacity to make the investments needed in order to meet the projected growth in demand.

The current expansion plan identifies needs on the order of US\$1.2 billion (approximately US\$150 million per year) over the next eight years. This figure is clearly beyond the project financing and execution capacity of the sector's existing institutional framework and operating models.

C. The government's program

- 1.13 The Panamanian government's program for the period 1995-1999 focuses on redefining and resizing the public sector's role in the economy, targeting public spending to the social sectors, and promoting an expanded role for the private sector in productive activities. From a financing standpoint, the fiscal macroeconomic program and the objective of more judicious use of public finances are geared toward replacing traditional external financing options - i.e. government borrowing abroad, income generated by military bases - with export revenue and long-term capital inflows for investment financing.
- 1.14 The program's core policy features are: (i) cut external tariffs and phase out pricing distortions; (ii) introduce clear incentives and a stable legal framework; (iii) curb growth in public spending and target it to the social sectors (a measure that is especially important at the central government level and one that is crucial in light of the strategy itself, since the government will no longer be able to resort to State-run companies to cover its budgetary requirements); (iv) launch rapidly maturing social programs aimed at alleviating the social debt in the very short term; (v) assimilate and develop reverted areas; and (vi) fund this transition through external borrowing, principally from multilateral sources.
- 1.15 With an eye to creating an appropriate enabling environment, the government has undertaken a series of sweeping reforms directly linked to the program's objectives. These include: (i) across-the-board eligibility for production incentives, aimed at eliminating fiscal and financial distortions (Law 28 of June 1995); (ii) reform of the labor code (Law 44 of August 1995), to make the labor market less rigid, reduce the costs associated with labor mobility, and establish an unemployment fund; (iii) the Market Competition Act (Law 29 of February 1996), which contains measures designed to avert monopolistic practices and actions that hamper the efficient operation of goods and services markets; and (iv) presentation of draft legislation to the Assembly on the

protection of intellectual property, in order to provide a legal framework for promoting foreign investment.

D. Macroeconomic setting

- 1.16 The sector reform objectives are feasible within the current macroeconomic setting. The government's 1995-1999 economic program in fact attaches special importance to redefining the public sector's role. One of the main objectives of the reform - relieving the public sector of its role as direct deliverer of services - is especially consistent with, and indeed reinforced by, the actions to balance public finances and strengthen the finances of the central government.
- 1.17 In support of the Panamanian government's program, the World Bank extended to March 1997 the deadline for disbursements under the Economic Recovery Program, originally slated to expire in March 1995. As well, the Executive Board of the International Monetary Fund has approved a 15-month stand-by arrangement (as from December 1995), which places emphasis on strengthening the central government's finances. One of the quantitative targets set is the balancing of nonfinancial public sector accounts; and the bulk of the adjustment will be in the area of central-government finances. The program also includes targets for Banco Nacional de Panamá's domestic assets and sets ceilings for short- and medium-term external borrowing.

E. Proposed operation

- 1.18 The proposed operation consists of a quick-disbursing loan to the Republic of Panama in the amount of US\$120 million, to be released in four tranches as follows: US\$45 million in the first quarter of 1997; and the other three (for US\$25 million each) to be released independently as program objectives are fulfilled for each of the sectors as set forth in the policy matrix (Annex I). The loan would have a disbursement period of 36 months. The tranche amounts and structure coincide with Panama's balance-of-payment requirements and the reform program timetable.
- 1.19 The operation includes as well a proposed technical-cooperation loan for US\$3.34 million and nonreimbursable technical-cooperation funding in the amount of US\$1.81 million from the Multilateral Investment Fund (Facility I) for the purpose of: (i) restructuring the electric power and the water and sanitation utilities; (ii) drawing up the technical, financial, and economic specifications for the concessions; (iii) lending support for the bid process and for bringing private enterprise into these two sectors; and (iv) organizing the Public Utilities Regulatory Board and setting it in motion.

F. Rationale for the sector loan

- 1.20 The proposed financing of US\$120 million is consistent with Panama's balance-of-payment requirements for the 1997-1999 period. The central government's budget projections envisage external financing of approximately US\$915 million, of which US\$540 million would be for projects and roughly US\$350 million for budgetary support.
- 1.21 External borrowing and fiscal support requirements have a strong cyclical component, with the bulk expected to occur in 1997. The total amount indicated takes into account the increase in current interest payments resulting from the normalization of relations with commercial banks, the funds required to close out the Supplementary Pension Fund, and the phasing out of transfers from INTEL to provide budgetary support for the central government. Together, these items will generate some US\$261 million in supplemental financing requirements for the government between 1997 and 1999.
- 1.22 With regard to the content of the reform programs that are to receive support from the Bank, the operation is fully consistent with the rationale for sector loans. Specifically, the support to be provided is of a strictly temporary nature, and actions will focus on solving structural problems that have been affecting public-sector finances and balance-of-payment performance.
- 1.23 The government is seeking Bank support to remedy this imbalance by means of two quick-disbursing operations. The first is the present loan for basic infrastructure reform, and the second is an operation to support reform of the financial sector and the social security system (PN-0056), which is currently being studied by Management.

G. Program results and development impact

- 1.24 This program is expected to mobilize private-sector resources for the purpose of financing the expansion of the sectors involved and reducing their fiscal burden, while increasing service coverage, enhancing service quality, and ensuring sustainable development in these sectors.
- 1.25 The program should produce at least the following results within a period of 24 to 36 months: (i) the Public Utilities Regulatory Board will be up and running; (ii) a 49% interest in INTEL S.A. will have been sold off to private investors who will be in charge of operating the country's local and long-distance (domestic and international) telephone services, and cellular telephone service will be in operation; (iii) private operators will be responsible for the direct delivery of and investments in water and sanitation services in metropolitan Panama City, and work will be under way to award concessions in the rest of the country; (iv) IRHE will have

been converted into at least two hydroelectric generation companies, one thermoelectric generation company, one transmission company, and at least one distribution company; and (v) the stock of at least one generation company and two distribution companies will have been sold.

- 1.26 As a result, within a period of three to five years, there should be a noticeable change in service quality and coverage and in the operating and financing arrangements of these infrastructure sectors (see Annex V).

H. Lessons learned

1. Lessons from the public enterprise reform program

- 1.27 The public enterprise reform program has had a positive impact on the telecommunications and port sectors. At the same time, evidence from the institutional, financial, and operational strengthening of IRHE and IDAAN shows that the program's ultimate objectives in the electricity and the water and sanitation sectors could not be attained under the institutional structure, market organization, and regulatory framework in place for these sectors. The sector studies performed have ascribed such problems as inefficiency, endemic lack of funds, and coverage shortfalls to the low level of autonomy given to these companies, imprecisely defined institutions, the structure of the markets, political interference, and the lack of a proper incentive structure for the various agents that are active in the sector. As a result, the public enterprise reform program did not have the full impact that was anticipated in terms of sector efficiency and sustainability. 1/
- 1.28 One important lesson to be learned from the program has to do with the conceptual framework. It raises legitimate doubts as to the logic of supporting reform programs in Panama that limit themselves to institutional, operational, or financial strengthening of State-run companies as the end goal for the sector, and justifies the need to support comprehensive sector reform programs.
- 1.29 A second lesson learned was in the area of program design, specifically, monitoring arrangements and the degree of detail in the conditions set for an operation. The experience gained suggests that supervision and monitoring activities need to focus on a minimum number of development impact indicators, and that the program's design should be flexible enough to allow the most appropriate mechanisms to be selected to this end.
- 1.30 Lastly, from the standpoint of program implementation, experience has shown that it is crucial for the government to entrust this

1/ See the report on fulfillment of the conditions for release of the second tranche of loans 688/OC-PN and 689/OC-PN (October 1995).

stage to an agency or office with high-level political authority that has a specific interest in seeing the reform objectives attained. In addition to overseeing the program, such an office will ensure that the necessary consensus is obtained for carrying the reforms through. The lack of this type of backing was especially apparent in the difficulties encountered by the telecommunications sector reforms. Draft legislation of high technical caliber had been drafted, but since there was no support at the political level, it was ultimately discarded without even being considered by the Legislative Assembly.

2. Incorporation of the lessons learned

- 1.31 The clearest lesson learned is embodied in the objectives and scope of this new operation. With the restated objectives and level of detail of the reforms, the institutional strengthening programs have been replaced by sector reforms, and the emphasis is now on modernizing institutional structures, reorganizing markets, and revamping regulatory frameworks.
- 1.32 With regard to the need for programs to have the necessary political support, the Executive Branch - acting directly from the Office of the President - has assumed a leadership role for the economic program generally. Acting through the line ministries, it has also taken an active role in both the overall design and the specifics of the sector reforms. As a result, discussion and approaches to solutions have been sought from the very beginning in such strategic issues as the scope of market reorganization, the private sector's role, bidding on contracts, employee entitlements, etc. In the case of telecommunications reform, the detailed discussion of the program and the draft legislation also included active participation by the INTEL employees union.
- 1.33 For the electricity and the water and sanitation sectors, the draft reform legislation has been entrusted to broad-based working groups, with support from the Bank and guidance and advice from outside consultants who have taken part in similar programs elsewhere in the region.

II. THE SECTOR REFORM PROGRAM

A. Objectives of the reform program

- 2.1 With an eye to enhancing efficiency, broadening coverage, improving quality, and ensuring sustainable sector growth, looking to private-sector funding for infrastructure, the government's policy seeks to provide a legal framework for institutional reform and a regulatory framework for service delivery. The institutional-reform actions will include separating actual service delivery from sectoral policy-setting and regulatory functions. Competitive market arrangements will also be implemented, along with regulatory instruments designed to promote private-sector participation in service delivery.
- 2.2 The reform is mandated by Cabinet Resolution 245 of August 16, 1995, which approved the policy guidelines governing reform in these sectors. The resolution sets forth policy guidelines for the institutional structure of the sectors and defines roles and areas of authority for setting sector policy, for technical and economic regulation, and for delivering services, making provision for semipublic or private service suppliers.
- 2.3 Under these guidelines, the State retains full responsibility for defining and coordinating sector policies. Provision is also made for an independent, autonomous regulatory agency for the country's public utilities. This agency - the Public Utilities Regulatory Board [Ente Regulador de los Servicios Públicos] (ERSP) - has been assigned responsibility for enforcing the law and regulations thereunder, with its core mandate being to protect consumers, promote conditions conducive to competition in service delivery, and prevent any abuses of monopolistic positions that could jeopardize efficient service delivery.

B. Telecommunications

1. Program features

- 2.4 Reform of the telecommunications sector was mandated under Law 5 of February 1995, which provides for the restructuring of INTEL; Law 31 of February 1996, which sets forth sector regulations; and Law 26 of January 1996, which created the Public Utilities Regulatory Board (ERSP). Subsequent to this legislation, INTEL was converted into a corporation, authorization was given for private enterprises to deliver services in this sector, 49% of INTEL S.A.'s stock was cleared for sale, the market was restructured, and a regulatory framework was set up for the telecommunications sector in Panama. INTEL S.A. holds a concession for one of the cellular telephone bands, as well as a temporary exclusive concession for all local and long-distance telephone services. The sector will be

regulated by the ERSP, while actual service delivery will fall to semipublic or private carriers.

- 2.5 Under the reform program, telecommunications services will be awarded through concessions that are granted on competitive bases, except when technical or economic reasons limit the number of potential service providers, or when temporary exclusive concessions are awarded to a limited number of carriers. The program also establishes that services are to be provided even-handedly and that rates are to reflect the economic cost of providing the service. The legislation further states that concessions in market segments in which there will be no competition are to be awarded through competitive bidding, with the process and eligibility requirements being outlined in the legislation.

2. Rationale for the proposal

- 2.6 By opening markets up to competition and charging rates that reflect the actual cost of providing services, the idea is to promote efficient allocation of resources in the sector. The plan is that a strategic investor/operator be assigned primary responsibility for the local and long-distance telephone concession. The temporary exclusive arrangement, to be determined during negotiation of the agreement for the concession granted to INTEL S.A. for basic and long-distance telephone services, is aimed at attracting investors and allowing the new carrier time to reconfigure the rate schedule. Long-distance services are the company's sole source of profits and constitute the government's incentive for attracting funds in order to expand the local telephone network. Since there will be no "competition in the market" for providing basic services during the exclusivity period, the State will receive a portion of the monopoly rent by means of "competition for the market" among interested carriers, based on international competitive bidding to select the strategic provider. At the end of the exclusivity period, these services will be opened to competition.
- 2.7 Tariffs for these services will be regulated by means of a price cap system. The regulatory principles and formulas are set forth in the legislation. The rate levels and structure for the exclusivity period will be agreed upon when the concession is put out to bid, based on the investment plans and the efficiency costs of providing the service in such a way as to reach the stated service and incremental coverage targets. Accordingly, the program does not call for any adjustment of rates prior to the award of the concession.
- 2.8 The preceding information will be included in concession agreements with prospective carriers. In keeping with established practice, the agreements will also include mutually agreed upon arrangements covering nominal adjustments and a schedule for periodic reviews.

The aim of such reviews would be to reflect changes in delivery targets, efficiency parameters, and plans for expanding installed capacity.

- 2.9 The government has been moving ahead with its privatization program in this sector. The first of the two cellular telephone bands was awarded in early February 1996 to an internationally renowned foreign company. A contract has also been signed with Banco de Inversión, a proposed concession agreement has been drafted, and work has begun on prequalifying strategic investors interested in bidding on the 49% interest in INTEL S.A.

C. Water and sanitation

1. Program features

- 2.10 As a first step in the process, a seminar was organized in Panama for government and sector authorities, labor representatives, and foreign experts. The seminar provided input for drafting terms of reference and hiring an international consulting firm to perform a sector study. With the national team, and with support from the Bank, that firm drew up a sector plan containing a detailed proposal for sector reform. The proposed guidelines were included in Cabinet Resolution 245 of August 16, 1995 (see paragraph 2.3) and served as a basis for draft legislation to reform the sector's legal and regulatory framework.
- 2.11 The reform is based on the new legal framework that will be adopted subsequent to approval of the legislation setting forth the regulatory and institutional framework for water supply and sanitary sewerage services (currently being discussed within the Executive Branch) and the Public Utilities Regulatory Board Act (passed by the legislature in January 1996).
- 2.12 The draft legislation assigns the policy-setting function to a new high-level unit, possibly at the level of a General Directorate, specifically empowered for such purpose and located within the Health Ministry. The unit's functions will include: (i) proposing sector development objectives, (ii) formulating and coordinating financing policy, (iii) assessing funding requirements, and (iv) formulating the sector's subsidies policy. The Health Ministry will also be responsible for ensuring the quality of public drinking water and adherence to quality standards governing sewage released into receiving bodies. Responsibility for regulating the sector will lie with the ERSP (created in January 1996), while actual service delivery may be entrusted to public, semipublic, or private companies.
- 2.13 The draft legislation allows for different modes of private-sector participation, e.g., service contracts, management contracts, lease contracts, and long-term concessions. Private firms will be able to enter this market by means of competitive bidding ("competition

for the market"); the procedures for this process are likewise set out in the legislation.

- 2.14 The government's working group evaluated 13 options for reorganizing the delivery of sector services at the national level: seven covered the metropolitan Panama City area (east and west sectors) and six covered other urban areas and the provinces (Chiriquí and the central provinces). The options were analyzed on the basis of four main criteria: (i) ability to mobilize private-sector funds in order to step up investments in the sector, (ii) lag time for the increase in service delivery efficiency to be felt, (iii) incentive structure needed in order to attract qualified operators, and (iv) impact on tariffs.
- 2.15 For the Panama City area, the government has decided, in principle, to set up a semipublic company by corporatizing IDAAN; for the other urban areas and the provinces, services will be concessioned out. Implementation of the two plans should take from 12 to 18 months as of the approval of the legislation establishing the regulatory framework for the sector.

2. Rationale for the proposal

- 2.16 Separating and decentralizing IDAAN's operations would produce a series of benefits that tie in directly with the objectives proposed for the sector. For instance, without losing economies of scale, it would make it easier to set quality and coverage standards consistent with the public's willingness to pay; and it would simplify and firm up the relationship between service coverage, quality, and rates.
- 2.17 IDAAN's current rate revenues barely cover the cost of service operation, maintenance, and depreciation, let alone any investments. Under the new legislation, water and sewer rates are to reflect the level and structure of the efficiency cost for delivering the services, thus ensuring that funds will be available to cover all service operation, maintenance, and expansion costs.
- 2.18 The contracts that are to be let will include efficient business parameters designed to ensure attainment of service quality and expansion targets, the necessary associated investments, and the resulting rates for operators. Review of water and sewerage tariffs will be part of the process and should be performed after costs have been segregated within the company for each proposed service region, prior to the definition and agreement with new operators on quality and coverage expansion targets.
- 2.19 Concessions will be awarded through competitive bidding, a procedure that will allow the country to obtain the benefits of competition for the market among prospective operators.

D. Electric power

1. Program features

- 2.20 The reform program for this sector will be implemented through the new legal framework proposed in the draft legislation to establish the regulatory and institutional framework for the electricity sector (currently under discussion in the Executive Branch) and the recently passed Public Utilities Regulatory Board Act.
- 2.21 The key elements of the proposed reform are: (i) segregate the policy functions for which the State is responsible, (ii) promote competition in power generation and sales to large-scale consumers, (iii) seek private equity participation in all sector activities - except transmission - by means of concessions, licenses, or equity purchases in existing companies, (iv) separate generation, transmission, and distribution activities, (v) create various commercial firms to replace IRHE, and (vi) create a transmission company to be responsible for overall operation of the inter-connected grid and development and operation of the national transmission grid, with a five-year transition period during which it will plan the expansion of the generation and transmission system, in its role as principal block-energy purchaser from generators. After this transition phase, electricity purchasing will be agreed on within a framework of unfettered competition, and system planning will be strictly indicative.
- 2.22 Under the proposed institutional reform for the sector, responsibilities would be assigned as follows: (i) policy-setting will fall to the Executive Branch, through the Energy Policy Commission; (ii) regulation and inspection will be the responsibility of the recently created ERSP; and (iii) actual service delivery will be performed by public, semipublic, or private companies, subject to regulation.
- 2.23 Panama's wholesale energy market has the following structure: (i) the transmission company, in its role as principal purchaser during the transition phase, carries out the expansion plan by purchasing electricity from independent generating firms, following procedures that promote unrestricted competition; (ii) during the transition phase, large-scale consumers and distribution companies have the option of freely negotiating up to 15% of their supply with independent generators (although the ERSP may raise this percentage); (iii) generators, distributors, and large-scale users have free access to the transmission and distribution grid, for which they pay charges that are subject to regulation; (iv) small-scale power generation and cogeneration projects are carried out that are not part of the expansion plan; (v) integrated operation, based on economic dispatch, by the National Dispatch Center, which is part of the transmission company; (vi) block rates may be set freely for sales to the principal purchaser or large-scale users; (vii) end-user rates are regulated; and (viii) at the end of the

five-year transition period, electricity would be purchased through a private process which would be regulated by the ERSP.

- 2.24 The new legislation states that all end-user rates will be regulated, except for large consumers (over 500 kW). The guiding principle for setting rates at all levels is economic efficiency (within a framework of financial equilibrium). At the distribution level, this function would be exercised periodically through Regulatory Board determinations on the added value of distribution.
- 2.25 At the transmission level, regulated prices are calculated under assumptions of economic efficiency in the implementation of the transmission company's expansion plan approved by the Regulatory Board. The requirement of observing economic efficiency in such cases leads to costs based on marginal or incremental principles, with adjustments that seek second-best solutions in order to make for financial equilibrium.
- 2.26 At the generation level, prices are set by means of *competition for the market*, through competitive bids carried out by the transmission company, which has the role of principal purchaser in the regulated market during the first five years that the law is in force. The bid processes are based on supply requirements identified under the optimal expansion plan. Bids from generators must include power and energy prices. The legislation states that energy prices are to reflect the real variable costs of operation in order to allow economic dispatching. Accordingly, the power prices that result from the competitive bids will reflect the least expansion cost.
- 2.27 The current tariff structure comprises 21 rate classes. These categories are not based on methods that seek economic efficiency, but rather reflect a financial accounting approach that was instituted in 1977 with only six rate classes and has grown through successive reviews to the 21 currently in place today. While the rates do meet the objective of producing adequate financial returns for IRHE, they do not send clear signals to encourage consumers to use energy efficiently. The system displays other outdated, inappropriate features as well, such as its declining block structure.
- 2.28 The current tariffs result in a mean-price structure that is, in general terms, similar to rates based on marginal costs. In both cases, the commercial rate is higher than the residential rate, the residential rate is higher than the industrial rate, and the industrial rate is higher than the public-sector rate. The Regulatory Board may study the possibility of simplifying the current system and replacing it with a system similar to the one described, which clearly promotes economic efficiency and is in line with the objectives of the new electricity legislation. Furthermore, since the 1994 study showed that the prevailing rates were, on average, 11% higher than the marginal-cost rates, it is

not essential that they be adjusted in order to achieve balance in the IRHE budget.

- 2.29 The proposed reform and transition to the new system would be carried out in two stages: (i) IRHE would be restructured by separating it into two hydroelectric generation companies, one thermal generation company, one transmission company, and at least two distribution companies, over a maximum period of 20 months; and (ii) at least 51% of the company's stock would be sold to the private sector and up to 10% to employees, beginning in the fourth month after the IRHE restructuring.

2. Rationale for the proposal

- 2.30 Since Panama's power grid is so small, one might ask whether it is worth overhauling the entire structure or whether ownership should simply be transferred in order to achieve the objectives of the reform. The government-appointed working group studying the matter reached the conclusion that regulation of a private monopoly would not be workable in a country that lacked a tradition of regulation and antitrust institutions. These risks are the rationale for opening all segments in this sector to as much competition as possible, maintaining central planning and the principal purchaser only to the extent justified by economies of scale.
- 2.31 The structure proposed for the transition phase would make it possible to establish a more competitive wholesale market in that distributors (on a limited basis initially) and large-scale consumers would be authorized to purchase electricity directly from local generators or elsewhere in Central America. After the transition phase, competition in the energy purchase market would be rounded out by distributors who could purchase electric energy.
- 2.32 To ensure that there is competition in distribution activities — even if only on a yardstick basis for quality and prices — and so that work can begin on creating a wholesale market at the national and Central American level, there need to be at least two distributors in the country. In this regard, examples can be cited of profitable distribution companies in markets less than half the size of the Panamanian market, e.g., in Santa Cruz and Cochabamba in Bolivia, Maracaibo and Barquisimeto in Venezuela, Tuluá in Colombia, and several companies in Chile. In any event, the possible losses in efficiency related to economies of scale and scope should be compared with the risk of ending up with a poorly regulated monopoly.

E. The Public Utilities Regulatory Board

1. Program features

- 2.33 Under the new configuration, the concept of service delivery includes creating markets either under competitive business

conditions (e.g., in the telecommunications and electricity sectors) or under concessions or management contracts aimed at tapping private initiative (e.g., in the water supply sector). Against this backdrop, the planned legal, regulatory, and institutional reforms will provide a guarantee for the operation of new markets, they will promote competitive conditions wherever possible, they will deregulate and dismantle institutional barriers to private investment, and they will protect consumer interests by regulating services having the features of a natural monopoly, as is the case with water supply and electricity distribution and transmission.

- 2.34 The legislation assigns the following main responsibilities to the Regulatory Board: (i) grant and revoke concessions, licenses, and authorization to deliver public utility services that are under its authority; (ii) verify compliance with technical, commercial, legal, and environmental requirements and standards; (iii) verify compliance with facility quality, expansion, and maintenance targets as set by sector legislation and regulations, or by individual concessions, licenses, or authorizations; (iv) define efficiency criteria for sector operations and develop tariff models; (v) supervise and verify compliance with rate schedules and amounts; (vi) issue regulations on user rights and responsibilities; (vii) impose penalties; (viii) organize public hearings as mandated by sector legislation or whenever the Regulatory Board deems fit; (ix) establish accounting standards; and (x) in general, perform all such acts as may be necessary to promote competition and efficiency in the country's public utilities. It also stipulates that the Regulatory Board is to report each year to the President and to the legislature on the status of public services; any action taken by the Board is to be publicized through the means specified in the enabling legislation; and, with special reference to the water and sanitation sector, the Board is to report regularly to the Health Ministry on the quality of service delivery.

2. Rationale for the proposal

- 2.35 The purpose of the proposed regulatory reform is to establish the basic rules and standards that will govern the new utility delivery system, seeking to create a stable, predictable environment for private investors that is built on clear regulations and contractual relationships that stipulate the rights and responsibilities of the parties and, at the same time, protect consumer interests by making sure that these contracts and regulations are observed. To this end, the government has set up the Public Utilities Regulatory Board to act as a specialized agency in this area for regulating, inspecting, and verifying operations, while ensuring the existence of competitive conditions and preventing abuses by companies with market power.

- 2.36 To keep regulatory risk at a minimum for the private sector, efforts are being made to ensure a stable, predictable environment for the formulation of regulations and surveillance of contracts. For this purpose, the independence and autonomy of the Regulatory Board is essential in order to avoid conflicts of interest between short-term political priorities and the need to guarantee a stable regulatory setting for private business. With this in mind, the legislation establishes that the terms of office of the Board's commissioners will be staggered, and they may only be removed from office for cause, as specified in the legislation. Also, the Regulatory Board has full legal status and its own assets, which it is authorized to administer, and separate, independent funds. A regulatory assessment will be levied to finance the cost of the Board's operations.

F. Technical cooperation to support the program

- 2.37 To support implementation of the basic infrastructure sector reform program, technical cooperation will be provided under three subprograms: (i) creation and startup of the Public Utilities Regulatory Board (ERSP), (ii) reform of the electricity sector, and (iii) reform of the water and sanitation sector.
- 2.38 The ERSP subprogram has the following components: (i) organization and outfitting of the Board; (ii) drafting of general regulations applicable to all sectors; (iii) drafting of sector-specific regulations for the telecommunications, electricity, and water and sanitation sectors; and (iv) supply of some equipment for the Board.
- 2.39 The electricity sector subprogram has the following components: (i) formulation of the strategy and action plan for restructuring IRHE; (ii) development of arrangements for purchasing electricity and integrated operations, including the drafting of electricity sales contracts and regulation of operations of the load dispatch center; (iii) drafting of charters and by-laws for the new companies; (iv) investment advice, including technical, financial, labor, and environmental impact evaluation for the sale of stock; and (v) legal counsel for the sale of stock.
- 2.40 The water and sanitation sector subprogram includes the following components: (i) incorporation of the private sector in the delivery of public water supply and sewerage services throughout the country, including environmental impact assessments to deal with environmental problems; (ii) strengthening of the policy unit at the Health Ministry; and (iii) solid waste collection and treatment program.

III. PROGRAM FINANCING AND EXECUTION

A. The borrower and the executing agency

- 3.1 The borrower will be the Republic of Panama, and the executing agency will be the Ministry of Economic Policy and Planning, through its Public Policy Unit.
- 3.2 The UTPP will be responsible for general coordination of this program, including the technical-cooperation loan and the non-reimbursable technical-cooperation funding from the MIF. The UTPP will work in cooperation with the institutions responsible for the public utilities (INTEL, IDAAN, and IRHE) and with the Regulatory Board (ERSP).
- 3.3 The UTPP will have the following responsibilities: (i) coordinate program execution; (ii) coordinate dialogue on program-related matters of sector policy with local agencies and the Bank; (iii) monitor program execution, including fulfillment of conditions for loan disbursements and MIF grant disbursements; (iv) support the ERSP in carrying out subprogram I of the technical-cooperation operation to organize the ERSP and put it in motion; (v) coordinate and prepare the respective documentation to be submitted to the Bank with disbursement requests; and (vi) prepare and present reports and documents associated with the contractual conditions agreed upon with the Bank.

B. Financing of the operation

- 3.4 The proposed operation consists of a quick-disbursing loan to the Republic of Panama in the amount of US\$120 million, to be released in four tranches: the first one for US\$45 million, and the remaining three for US\$25 million each, to be disbursed independently as the objectives identified in the policy matrix are met (Annex I). The loan would have a disbursement period of 36 months.
- 3.5 The disbursement period and the proposed structure are consistent with the program's objectives and with the scope and complexity of the actions involved in its execution.
- 3.6 The operation also includes a proposal for a technical-cooperation loan in the amount of US\$3.34 million and nonreimbursable technical-cooperation funding of US\$1.81 million from the Multilateral Investment Fund. Further details are presented in Annexes III and IV.

C. Status of fulfillment of conditions precedent to first-tranche release

- 3.7 The government has submitted draft legislation establishing regulatory frameworks for the electricity and the water and sanitation sectors to the legislature, and expects it will be passed before the end of March 1997. As part of the INTEL privatization process, the government has also prepared draft legislation on telecommunications regulation.

D. Environmental considerations in each sector

1. The program's policy elements

- 3.8 The reform program includes policy elements that are directly linked to environmental considerations, specifically: (i) tariffs are to reflect the economic cost of service delivery, including all costs related to resource conservation and environmental sustainability; (ii) the mobilization of private-sector funding should provide the resources needed for operating and expanding services - this is an especially important consideration in the water and sanitation sector, which suffers from an *endemic shortage of resources that has resulted in low levels of coverage, notably for sanitary sewerage and sewage treatment*; and (iii) the ERSP's authority to check all matters relating to compliance with environmental standards, and to impose penalties as necessary.

2. Sectoral legal framework

- 3.9 The draft legislation for the electricity sector reform includes: (i) a section devoted especially to *environmental conservation*; (ii) a section on renewable and nonconventional energy sources; and (iii) a section on energy conservation.
- 3.10 The draft legislation to implement the regulatory and institutional framework for the water and sanitation sector establishes that the concept of "drinking water production" includes the tapping both surface and ground water sources; and that "sanitary sewerage" refers to the collection, treatment, and disposal of sewage. The cost-recovery pricing principles adopted include environmental considerations and provide, accordingly, the necessary elements for meeting the objectives of water conservation and environmental sustainability.

3. Private-sector involvement

- 3.11 In addition to the institutional and regulatory considerations referred to above, the success of private-sector participation in these sectors will hinge on *environmental considerations being properly defined and incorporated into any contracts signed with private-sector investors and operators*. The contracts are to contain the necessary specifics on assigning responsibilities,

resources, and instruments available to deal with the environmental features of the projects.

- 3.12 In order to provide assurances and support for the government when compiling this information and designing contracts, the program will include the *preparation of environmental status reports on each of the activities that is to be contracted out to the private sector*. The audits will help to identify and define the objectives and targets which are to be part of the private operators' contractual responsibilities, and ascertain the impact on expansion and investment plans and tariff levels and structure.
- 3.13 Accordingly, the program calls for the preparation of environmental assessments, inclusion of environmental considerations in the legal framework and regulations for the electricity and the water and sanitation sectors, and environmental profiles, including the handling of environmental risks and degradation associated with the concessions.
- 3.14 Given its nature, objectives, and content, the program is expected to have an indirect, positive impact on the environment, thanks to the explicit inclusion of environmental standards in the regulatory frameworks of the various sectors and contracts with the private sector, the recognition of environmental costs as an integral part of service delivery, and cost recovery through the charging of rates.

4. Environmental classification and recommendations

- 3.15 The Environment Committee classified this as a Category III operation and recommended that, prior to any privatizations, the regulatory frameworks for the water and sanitation and the electricity sectors be adjusted to include environmental standards, and that institutional authority be assigned for implementing and enforcing these standards. It also recommended that responsibility and authority for solving environmental problems be assigned appropriately during the negotiation of the concession contracts.

E. Development impact indicators

- 3.16 Given the program's nature and objective of assigning the private sector a role in service delivery, the program does not yet have a defined set of development indicators. Some indicators have been proposed for the telecommunications sector, but since they will be subject to negotiation during the bid processes, they are still confidential. In the electricity and the water and sanitation sectors, indicators cannot be prepared until costs and finances have been segregated within IRHE and IDAAN, and the details have been decided on for the new companies or concessions that will be contracted out to the private sector (see Annex V).

F. Procurement

1. Import procedures

- 3.17 Loan proceeds may be used to reimburse the total foreign-exchange cost of eligible imports, i.e., those that are not on the negative list. In keeping with the Bank's established policy on sector lending, eligible costs incurred during the six months preceding the loan signature date will be recognized for retroactive financing. It is recommended that this period be extended to 12 months, since gross external funding requirements in 1996 have proved to be higher than normal owing to efforts and actions undertaken to clear arrears with commercial banks and to pay for oil imports from Venezuela and Mexico.
- 3.18 Public-sector procurement is governed by the Fiscal Code and the bylaws of each public-sector company. Normally, private-sector importers of capital goods make their procurement decisions on the basis of more than one proposal, while consumption goods are usually procured through direct negotiation under long-term agreements with individual manufacturers, a procedure that is generally acceptable.
- 3.19 Based on this analysis, and bearing in mind that: (i) Panama's private sector accounts for most of the country's import volume; (ii) individual import amounts are relatively small, and (iii) the country has limited experience with procurement funding under World Bank and IDB structural adjustment operations, it is recommended that a threshold of US\$5 million be set for international competitive bidding.
- 3.20 Accordingly, procurement under this operation would be carried out as follows: (i) contracts to purchase goods or products for the private or public sector in the amount of US\$5 million equivalent or higher would be awarded through simplified international competitive bidding procedures that are acceptable to the Bank; (ii) public-sector contracts for less than US\$5 million will be awarded to the lowest bidder, following procedures acceptable to the Bank; and (iii) private-sector contracts for less than US\$5 million may follow established commercial practices, provided they are awarded after the evaluation and comparison of quotes from eligible suppliers from at least two IDB member countries.
- 3.21 In addition, it is recommended that private-sector imports be backed by customs documents in view of the nature of Panama's monetary system, which lacks a central bank, uses the U.S. dollar as legal tender, and, accordingly, in the traditional sense of the term, has no foreign exchange. At the same time, every effort should be made to ascertain payments and effective payment dates. For this purpose, it is recommended that the effective procurement date be the date on which receipt is acknowledged by the

appropriate authority, as shown by the customs documentation. Public-sector imports should also be backed by customs documents.

2. Exceptions to the international competitive bidding requirement for procurement

- 3.22 It is recommended that the international competitive bidding requirement for the import of petroleum and petroleum products and wholesale electricity be waived, since such purchases are transacted in accordance with standard commercial practices for these operations. The amount for these items is not expected to exceed 50% of each disbursement under the proposed sector loan.

G. Audit and control

- 3.23 Loan proceeds will be disbursed against expense statements submitted by the Government of Panama. These statements are to give details on transactions executed during the period and evidence that eligibility requirements were met. They are also to include information on the type of import, country of origin, dates, and amounts.
- 3.24 The program's executing unit (UTPP) is responsible for keeping the accounting records and preparing and submitting disbursement requests. The financial statements are to be audited by an independent auditing firm acceptable to the Bank, and are to be presented within the 90 days following the last disbursement under each tranche. The audited statements are to show, in accordance with procedures acceptable to the Bank, that the goods covered in the disbursement request during the respective tranche are eligible for reimbursement against the loan proceeds.
- 3.25 The Bank reserves the right to perform ex post inspections of the documentation and stages of all program-related procurements.

H. Inspection and supervision

- 3.26 The Bank will establish such inspection procedures as it feels are necessary to ensure proper program execution, and the executing agency is to cooperate fully to that end.

I. Program monitoring

- 3.27 To provide technical support and assess the program's progress, technical responsibility for the operation will remain with the project team, which will make periodic visits to Panama in coordination with the Country Office.
- 3.28 In addition to the evaluation missions that will be conducted in association with loan disbursement requests, the Bank will send missions relating to the preparation of development impact indicators for the water and sanitation and the electricity sectors

(see paragraph 3.16 and Annex V). Given the nature of this program, there is no need for an ex post evaluation. Instead, the targets set in the concession agreements will be monitored by the ERSP, observing terms similar to the development indicators presented herein.

J. Tariff clauses in current Bank loans to IRHE and IDAAN

- 3.29 According to 1995 data, IRHE and IDAAN have not complied with the rate clauses that had been agreed upon with the Bank. Specifically, IRHE (loans 7-A/IC-PN, 399/OC-PN, and 649/SF-PN) obtained a rate of return of 7% on its fixed assets, which was below the rate of 8.75% stipulated in the contract. In IDAAN's case (loans 90/IC-PN and 673/SF-PN), the contracts excluded investment funding and only referred to the rate needed to cover operating, maintenance, and depreciation costs; the actual rate was marginally below the contractual level. Receivables, however, were equivalent to 32% of invoicing, well above the 15% level agreed on with the Bank. The reforms proposed here are intended to address specifically these problems, as well as the systemic problems discussed in chapter I. The regulatory framework and tariff guidelines embodied in the new legislation for these sectors, coupled with the powers that have been granted to the ERSP, will force those companies that remain under government control as well as those that are transferred to the private sector to comply with cost recovery policies that are based on the economic cost of service delivery.

IV. BENEFITS, VIABILITY, AND RISKS

A. Benefits

- 4.1 The program will generate benefits in terms of investment, growth, and coverage in the sectors involved, better allocated of freed-up public resources, and greater economic efficiency (in both production and resource allocation).

1. Investment, growth, and coverage

- 4.2 As mentioned earlier, the current institutional structure of the public sector does not have the capacity to finance all the major investments required over the coming years. By opening up to private enterprise, new local and international sources of private-sector financing can be tapped. Experience elsewhere (e.g., Chile, Argentina, Peru, and Bolivia) has shown this to be the case in the telecommunications and electricity sectors, where reform programs have led to greater participation by the local and international private sector. The management of utility companies and investments in them by suitable private operators (foreign or local) also will promote the transfer of technology and know-how to the reconfigured sectors.
- 4.3 Service delivery based on commercial terms, such as rate-based cost recovery, should help provide the funds needed to expand coverage and attain the objectives set in the areas of service quality, reliability, efficiency, and sustainability.
- 4.4 The reforms are also expected to have a favorable impact on consumers, in the form of broader coverage and better quality services. This is particularly important for low-income groups, since they normally are the ones lacking acceptable electrical, water, and sewer services; indeed, water supply and sewage treatment services are virtually nonexistent for this group.
- 4.5 Restructuring of the telecommunications sector (including the privatization of INTEL) will bring major benefits to the Panamanian economy; in the near term, the services sector in particular is expected to benefit, specifically the country's financial services.

2. Better public resource allocation

- 4.6 Successful program implementation should mean that private-sector participation will considerably reduce the flow of government funds to finance investment programs in these sectors, so that the government can transfer the resources thus freed up to the social sectors. An expected US\$1 billion will be freed up over the 1997-2002 period, and this will have a significant impact on the

balance of payments in the medium and long term as a result of lower debt service and external borrowing.

3. Greater economic efficiency

- 4.7 In terms of productive efficiency, benefits will accrue as a result of better and more expeditious utility operations and maintenance under the private sector. This in turn is an outgrowth of its objective of maximizing net benefits (and, accordingly, minimizing costs) in a competitive setting or under a regulated framework with a price cap system. Panama's thermal power situation, for instance, has traditionally been well below international standards. This should change with the reform, and will produce both capital and cost savings. Improvements would also be seen in the water sector, with a drop in unaccounted-for water levels.
- 4.8 Benefits in the area of efficient resource allocation would stem from the new price structure implemented under the new institutional frameworks. Prices - both those that are regulated under monopolies (natural or other) and those that are determined by free market competition - will mirror the economic cost of providing the service. The net result will be better allocation of resources, and higher consumption levels in cases where current prices are above efficiency prices and lower consumption when the opposite is the case. In either case, the efficiency loss triangle will be tightened and quality of life will improve.
- 4.9 Although a boon for the economy as a whole, the new proposed telephone tariffs could well have mixed results in different income groups and branches of economic activity. Tariff adjustments will seek to reduce rates overall, but will entail reductions in long-distance rates and increases in local service rates. Investments in rural telephone service and expansion of cellular telephone service are especially important in the country's rural areas.
- 4.10 Furthermore, the drop in commercial (i.e., nontechnical) losses that will result from private-sector participation will help to enhance efficiency by making consumers that defrauded the system by using a service without paying pay the real price for the service they had hitherto obtained illegally.

4. Program costs

- 4.11 The program's biggest cost will be in terms of its impact on workers in the affected sectors, which is expected to be felt mostly in the short term and mostly in the electricity and water sectors. But overall, this toll has to be looked at alongside the cost to the economy of gaps and interruptions in these services, and the benefits generated by more efficient production and allocation, and by the rechanneling of public spending, which will result from the reforms.

B. Viability and risks

- 4.12 Given the program's size and complexity, coupled with the uneven distribution of benefits and costs over time and across population groups, the program faces a series of risks. An attempt has been made to offset these risks in the program's design, sizing, and financing. The biggest risks have to do with the political setting, the legislative process, the international economic climate, the perceived country risk abroad, and Panama's lack of experience in the area of utilities regulation.
- 4.13 The legislature might not approve, or might significantly modify, the draft legislation for the regulatory frameworks for the water and sanitation and the electricity sectors. On the program side, efforts were made to minimize this risk through the process used to formulate the reform program, specifically through internal discussions of the draft legislation awaiting approval. For its part, the Bank has sought to reduce the risk by separating the conditions for presentation to the Board from the conditions for approval of release of the first tranche of the financing.
- 4.14 There is also the risk that the internal dialogue process will result in legal, institutional, and regulatory frameworks that do not ultimately provide the necessary legal certainty, or they could be inconsistent with the objectives of the government's program. This risk was addressed directly when formulating the sector reform programs and subsequently in the internal discussions and dialogue during the preparation of the draft legislation.
- 4.15 Yet another risk is that the private sector might not be interested in privatization projects in Panama. In addition to the reasons discussed above, investment possibilities elsewhere may be more appealing. However, despite its relatively small size, Panama's economy has some very attractive features: the lack of exchange risk, which normally ranks at the top of the private sector's list of concerns when investing abroad. Equally important in this regard are the general thrust and the specific measures taken under the government's economic reform program, e.g., economic openness, normalization of relations with commercial banks, reform of the labor code, and unification of tax incentives. In the water and sanitation sector, a further damper on investor interest may be the low rate of return for the private sector. This risk was addressed directly during the design of the privatization strategy, and the program proposes participation formats that include capitalization arrangements and concession contracts as alternatives to asset sales as a means for including the private sector in this sector.
- 4.16 Lastly, there is also some risk associated with Panama's lack of experience with autonomous, independent regulatory agencies, with regard both to the public sector's sphere of influence and the possibility of regulatory capture of the ERSP by service providers. In this connection, the Public Utilities Regulatory Board Act

contains the necessary elements (such as financial and budgetary autonomy and procedures for appointing and removing commissioners from office) to establish and protect the ERSP's independence. Attention was given to controlling this risk when designing the technical cooperation for the ERSP strengthening and organization subprogram. To the extent possible, the design took account of experience in other countries and is reflected in the components and activities that are being funded out of the technical-cooperation operations.

POLICY MATRIX FOR REFORM OF THE TELECOMMUNICATIONS, WATER AND SANITATION, AND ELECTRICITY SECTORS

Sector	Prior to presentation to the Board	For release of first tranche	For release of the remaining tranche
Macroeconomic environment	Maintain a macroeconomic environment consistent with the objectives of the reform program and the operation.		
Telecommunications	<p>The legislation restructuring INTEL and legislation regulating Panama's telecommunications sector is to have entered into force.</p> <p>Band A for cellular telephone service is to be in operation.</p>	Enabling regulations are to have been issued for the telecommunications regulatory legislation.	A 49% interest in INTEL S.A., and a concession agreement for domestic and international long-distance telephone service and for band B of cellular telephone service are to have been awarded to a strategic investor.
Water and sanitation	Legislation establishing the regulatory and institutional framework for water supply and sanitary sewerage services is to have been submitted to the legislature.	<p>The legislation establishing the regulatory and institutional framework for water supply and sanitary sewerage services is to have entered into force.</p> <p>Work is to have begun on corporatizing the firm for metropolitan Panama City, and on the concessions for Chiriquí and the central provinces.</p>	Delivery of water and sanitation services in metropolitan Panama City is to have been awarded to a private operator, and operators are to have been invited to participate in the concession process for Chiriquí and the central provinces.
Electricity	Legislation establishing the regulatory and institutional framework for the electricity sector is to have been submitted to the legislature.	<p>The legislation establishing the regulatory and institutional framework for the electricity sector and the legislation creating the Energy Policy Commission is to have entered into force.</p> <p>Work is to have begun on converting and separating IRHE into at least two electric generation companies, one transmission company, and at least two distribution companies.</p>	At least one generation company and distribution companies are to have been awarded to private operators and transferred to private operators for delivery and expansion of services.

Sector	Prior to presentation to the Board	For release of first tranche	For release of the remaining t
Board	<p>The legislation creating the Public Utilities Regulatory Board (Law 26 of January 1996) is to have entered into force.</p> <p>The Regulatory Board's commissioners are to have been appointed by the Executive Branch and to have assumed office; the budget is to have been approved; and work is to have started to implement the action plan setting the Board in motion.</p>		

October 30, 1996

Mr. Enrique V. Iglesias
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Iglesias:

I. MACROECONOMIC SETTING

1. Since the 1950s, and notably since the first oil shock, a series of developments on the political, economic, and social fronts in Panama have left their mark on the country's human development indicators and on economic performance generally.

2. In the political arena, the early 1990s saw the dawn of a new era of representative democracy that has been gradually putting down roots. The year 1994 ushered in a new government, following an electoral process whose transparency was recognized both nationally and abroad. As of this writing, the transition to full democracy is solidly under way, as the country's legislature and judicial branch and civil society organizations are strengthened.

3. On the economic side, Panama has historically based its development on hubs or enclaves that have sought to draw on the country's comparative advantages from its location on a narrow isthmus between the Atlantic and Pacific Oceans, at the heart of the Americas. But this development pattern conceals a sharp dichotomy between a relatively modern and open service sector – that accounts for over 70 percent of the country's GDP – and two overprotected, uncompetitive sectors that supply the domestic market (agriculture and industry), each of which brings in some 10 percent of GDP.

4. The presence and operation of a maritime transshipment facility the size of the Panama Canal, U.S. military bases, the Colón duty-free zone, the international banking facilities, and business associated with the setup of local and foreign corporations – these being the primary engines of the service sector – have exacerbated a series of distortions in the progress of economic and social indicators. Despite their previous buoyancy in both relative and absolute terms, these indicators offer little room for future improvement unless economic and social development strategies, structures, and policies are completely overhauled. The above-mentioned hubs alone are not enough to ensure sustained development, nor do they produce enough tax revenue to sustain public investment.

5. On the social front, Panama has a high "human development index" according to the United Nations scale, which ranks our country 43rd in the world, but its income distribution is one of the most uneven in all Latin America. While the economically active population employed at the above-mentioned service hubs have excellent access to high-quality social services in the areas of health and education, 44% of families continue to live below the poverty line, particularly rural dwellers, indigenous groups, and the growing urban informal sector.

6. This situation is compounded by the special challenge facing Panama with the imminent transfer of the canal and the reversion of extensive assets and property in the Canal Zone. Although this transition promises to trigger growth and real opportunities for development in the medium and long terms, in the short term it could reduce job numbers and cause the economy to contract, in part owing to the withdrawal of U.S. military bases, unless compensatory action is taken.

7. In the above-described circumstances, the Government of Panama recognizes that the import-substitution economic development model that was the engine of growth in the domestic market is no longer viable. The Government also is fully aware that the once dynamic, modern service sector which drove the Panamanian economy is in need of adjustments and updating if it is to thrive in today's globalized and competitive world. Sluggish economic growth and an increasingly limited capacity to absorb labor underlie the main problem facing Panamanian society today: unemployment. The country thus needs new, dynamic export services, and more efficient services targeted to the home market, which can compete effectively and offer export potential.

8. Since it assumed office, the present administration has been streamlining and modernizing its institutional economic structures, through a number of public policy measures designed to improve the quality of life of all Panamanians as quickly as possible.

9. This political and social decision entails a commitment to a citizenry that is waiting for concrete action to be able to realize its aspirations, alongside efforts to strengthen democracy and the legislative and judicial branch and civil society organizations.

10. Despite some resistance to change on the part of a number of sectors affected by the modernization policies that many other countries have adopted, the national government took the initiative and presented to the public a Public Policy Program for Comprehensive Development, which offers a set of proposals to reconfigure the country's economic and social sectors. Among the proposed initiatives are some that would revamp fiscal and trade policy, streamline government and public agencies, rewrite sector policies, develop reverted areas, ensure the orderly transfer of the Panama Canal, deal with the external debt, and reform basic infrastructure sectors. The labor laws were also amended to ease hitherto rigid restrictions that had stood in the way of job creation.

11. On the fiscal policy front, Panama has pursued, and still has in place, a fiscal program that has succeeded in streamlining public expenditure, and for one thing has curbed growth in spending on personal services. On the revenue side, the tax administration is being further strengthened. As a result, the government has been able to step up capital spending on social and productive development infrastructure projects and still post an acceptable current account balance; indeed, 1996 forecasts are for a surplus of some 0.5% of GDP. Furthermore, the country recently concluded an arrangement to normalize relations with its commercial bank creditors.

12. In terms of trade policy, the objective is for Panama to be a member of a trade bloc; negotiations are currently under way to establish bilateral free-trade agreements with other countries. One prerequisite has now been satisfied, as Panama has taken its place as a full member in the World Trade Organization. As part of this process, and in concert with the legislature, parts of nation's foreign trade laws are to be rewritten. The national government also intends to deepen tariff reforms and lift nontariff barriers that are impeding imports of goods, in order to foster competition in the production sectors.

13. With respect to programs aimed at enhancing competition in the market, a body of laws has been enacted to modify systems of special incentives for the productive sectors, penalize anticompetitive behavior, and promote competition in sectors as yet not included in the free market.

14. To continue to streamline the public sector, private enterprise is being encouraged to participate in activities that were hitherto the exclusive domain of the State, specifically, ports, telecommunications, electricity, and water and sanitation. This shift is necessary to be able to tap private capital for investment in these sectors, state-of-the-art technology, and the private sector's management capacity in these areas. The new approach is expected to enhance efficiency and slowly push down the price of these utility services in the short and medium term. This action will be accompanied by major changes in the State's traditional modus operandi in the social areas, such as the housing sector, where the line ministry will target its work even more closely to the most disadvantaged groups, setting policy and creating transparent incentives to encourage direct private investment in this sector.

II. THE SECTOR REFORM PROGRAM

15. The broad reform measures listed in the section describing the macroeconomic setting earlier at the start of this letter are expected to foster economic growth and social development in our country. In the near term, however, many of the structural adjustment measures and reforms will have an impact on public finances, and specifically on the nonfinancial public sector borrowing requirement, most notably at the central government level. This is one key element in the rationale for

the amount of the quick-disbursing operation being proposed as part of the basic infrastructure sector reform program.

16. National government policy on public utilities reform is embodied in Cabinet Resolution 245 of August 16, 1995, which sets out the policy guidelines adopted for reform of the telecommunications, electricity, and water and sanitation sectors. Those guidelines have served as the cornerstone for the institutional reconfiguration of these sectors, and for segregating service delivery functions from policy-setting and the regulatory function, with the adoption of competitive market structures and regulatory instruments to encourage private business to operate utility services.

17. The Public Utilities Regulatory Board (ERSP) was established by Law 26 of January 1996, with a mandate to ensure adequate service coverage, protect consumers, create an enabling environment for private-sector operation of utilities, and prevent abuse of monopolistic positions that compromise the efficient delivery of public utility services.

III. ENVIRONMENTAL ELEMENTS OF THE PROGRAM

18. The reform program contains policy elements specifically to address environmental concerns. The most important have to do with recovering costs, including those connected with environmental conservation and development and building environmental standards into the new legal and regulatory framework for public utility operation, in order to conserve resources. We will also be preparing environmental diagnosis studies and impact assessments to ensure that contracts with the private sector contain better mechanisms and incentive structures to undo past environmental damage and avert future harm. The Regulatory Board is now authorized by law to perform inspections and to levy penalties when environmental standards are not observed.

19. With these objectives in mind, environmental consultants will be hired to draft, in accordance with preestablished terms of reference, background documentation and recommendations to help with (1) enabling regulations for sector legislation, and (2) contracts for private-sector participation in the delivery of public utilities.

IV. THE PUBLIC UTILITIES REGULATORY BOARD

20. The Public Utilities Regulatory Board [Ente Regulador de los Servicios Públicos] (ERSP) was set up under Law 26 of January 1996, passed by the Legislative Assembly, which charges this body with the oversight of public utility services. The agency is headed by an executive board of three commissioners, appointed by the Executive Branch and ratified by the Assembly, for five-year terms.

21. Law 26 of 1996 marks a new approach in Panama's agency legislation. For one thing, an appointed commissioner can be removed only in circumstances specifically set out in the Act, after due legal process in the Supreme Court, which has the authority to order such removal. This provision affords absolute stability to Executive Branch appointments in this instance, and ensures that the Board will operate independently and autonomously, and that its acts will be legally binding.

22. The ERSP has full legal status and its own capital, which it is authorized to administer, with segregated and independent funds. To finance ERSP operations, the law authorized the levying of a regulatory assessment which will provide the agency with the revenue it needs to run efficiently.

23. The ERSP has the following basic powers: grant and revoke concessions and licenses to deliver public services that are under its authority; verify adherence to technical, commercial, legal, and environmental rules and standards; verify compliance with facility quality, expansion, and maintenance standards prescribed by sector legislation and regulations or for individual concessions and licenses; define operating efficiency criteria; approve and oversee utility tariff regimes; oversee and verify the application of rate schedules and charges; issue regulations on user rights and responsibilities; levy penalties; organize public hearings as mandated by sector legislation or whenever the ERSP sees fit; and establish accounting standards for utility companies.

24. Law 26 of 1996, bills drafted for the water and sanitation and energy sectors, and the Telecommunications Act all contain express provisions to ensure transparency and disclosure of ERSP actions, and authorize the agency to oversee environmental matters in the sectors it will be regulating.

25. The ERSP Act and the new legal frameworks that will be governing public utilities clearly identify the ERSP as the agency authorized to approve and oversee the tariff regime, pursuing criteria of financial adequacy, economic efficiency, equity, simplicity, and transparency. These laws make clear that the same principles are to be observed by public, private, and semipublic operators of public utilities regulated by the ERSP.

V. TELECOMMUNICATIONS

26. Reform of the telecommunications industry was mandated under Law 5 of February 1995, which provides for the restructuring of INTEL; Law 31 of February 1996, which contains sector regulations; and Law 26 of January 1996, which created the Public Utilities Regulatory Board (ERSP). Pursuant to this legislation, INTEL was converted into a corporation, private carriers were authorized to provide telecommunications services, 49% of INTEL S.A.'s stock was cleared for sale, the market was restructured, and a regulatory framework was set in place for the

country's telecommunications sector. INTEL S.A. holds a concession for one of the cellular telephone bands, as well as a temporary exclusive concession for all local and long-distance telephone services. The sector will be regulated by the ERSP; telecommunication services will be provided by semipublic or private carriers.

27. Under the reform program, telecommunications services will be awarded through concessions for which carriers will compete, except when for technical or economic reasons there are a limited number of potential carriers with market power, or when temporary exclusives are awarded to a limited number of concessionaires. Services are to be provided under equal conditions, and rates are to reflect the economic cost of providing the service. The legislation states that concessions in market segments in which there will be no competition are to be awarded through competitive bidding.

VI. WATER AND SANITATION

28. Reforms in the water and sewerage sector will be underpinned by the new legal framework to be instituted upon the enactment of the law governing water and sanitation services, and the already approved Public Utilities Regulatory Board Act.

29. A bill that would assign the policy-setting and policy-coordination function to the Executive Branch, by way of the Health Ministry, is now before the legislature. These functions will include proposing sector development objectives, formulating and coordinating financing policy, developing criteria and assessing funding requirements, and devising criteria for the sector's subsidy policy. The Health Ministry will also be responsible for monitoring the quality of public drinking water and enforcing standards for sewage released into receiving bodies.

30. To equip the Ministry of Health to perform the aforesaid functions, the national government intends to analyze that agency's current structure and determine what areas need to be strengthened, to then take steps to enable it to operate properly, in coordination with State agencies discharging related functions in the areas of environmental protection, natural resources, and funding for the sector.

31. Responsibility for regulating the sector will lie with the ERSP, while actual service delivery may be entrusted to public, semipublic, or private companies.

32. The draft water and sewerage legislation envisages different forms of private-sector participation, among them service contracts, management contracts, lease arrangements, and long-term concessions. Private operators will be sought through competitive bidding for concessions and privatization ("competition for the market").

33. The national government has examined possible avenues of private-sector provision of water and sanitary sewerage services, so that systems could reach more of the population and with an eye to improving quality and expanding water supply and sewer networks in the future. After looking at many options, it was decided that to ensure competition and efficient service delivery in this sector, the country would need to be divided into at least three independent service areas. In selecting the best alternatives for private-sector involvement, we have given preference to those that provide for a structure of incentives to boost efficiency, expand coverage, and minimize the impact of tariffs on final users.

VII. ELECTRICITY

34. The Government is moving forward in its work to develop a reform program for the electric power industry. Underlying the reforms will be the new legal framework proposed in the electricity sector bill recently introduced in the legislature.

35. The following are the reforms proposed in the electricity sector bill: introduce limited competition in power generation and distribution operations; divide the sector into separate segments for generation, transmission, and distribution; set up various companies to replace IRHE; broaden private-sector participation by selling stock in public, semi-public, or private companies that hold concessions or licenses to operate in specific segments of the sector.

36. The law would also set up the Energy Policy Commission, made up of the Ministers for Economic Policy and Planning, Trade and Industry, Finance, and Treasury. The commission will be responsible for making general policy recommendations and mapping out development strategies for the energy sector, including the electricity subsector.

37. Development of Panama's power sector in the years ahead will be based on a new operating arrangement for the electricity market, in which market agents will compete as the best way of making the sector run efficiently and securing funding for future outlays for system expansion. The plan is to split the State electric power company vertically and horizontally, and bring private enterprise into the power industry by selling shares in the companies created out of this transformation. With these reforms, the electricity sector will be able to draw on managerial capacity from the private sector, to operate more efficiently and be assured of funding for future expansions.

VIII. FINAL CONSIDERATIONS

38. Our policy for the start of the next century rests on a recognition of the undeniable link between economic growth and social development. At the root of the severe poverty afflicting so many Panamanians is an

economy that is unable to generate new jobs and ensure a sustained pace of economic growth.

39. Stated another way, the central premise of the new program is that the most effective way of addressing social problems is to have a robust economy capable of participating fully in the global marketplace.

40. To achieve this, the factors of production need to be made more mobile, so that Panama's goods and services sectors can develop with the twin parameters of efficiency and competitiveness.

41. The ultimate aim of this new approach is a model based on unfettered private enterprise and ownership. Accordingly, the hallmark of the new system would be supply and demand as an effective engine of economic and social advancement.

42. In keeping with the foregoing, the reform program calls for a shift in the State's role, to make it an active co-contributor to the social development process. This will require greater attention in social spending to the core principles of effectiveness and efficiency, since spending on health and education – though levels have remained relatively high – still falls far short of what would be needed to significantly improve the quality of life of the country's poor.

43. Overall, substantial progress has been achieved under the program, in close pursuit of the objectives mapped out in September 1994, with a new body of laws and regulations that afford a coherent framework for seeking social development with economic efficiency. This is the clearest possible manifestation of the national government's political will to see the proposed objectives realized.

PLAN OF OPERATIONS

**TECHNICAL-COOPERATION LOAN AND
NONREIMBURSABLE TECHNICAL-COOPERATION FUNDING
IN SUPPORT OF THE**

BASIC INFRASTRUCTURE SECTOR REFORM PROGRAM

(PN-0097)

EXECUTIVE SUMMARY

**BORROWER AND
GUARANTOR:** Republic of Panama

EXECUTING AGENCY: Ministry of Economic Policy and Planning, through the
Public Policy Unit

AMOUNT AND SOURCE:

IDB:	US\$3.34 million (OC)
MIF:	US\$1.81 million
Local counterpart funding:	US\$1.58 million
Total:	US\$6.73 million

TERMS:

Execution period:	42 months
Disbursement period:	48 months

RESPONSIBILITY: Division FI2 of Regional Operations Department 2 and
the IDB Country Office in Panama

OBJECTIVES: The purpose of this operation is to provide financing
for the basic infrastructure sector reform program.
The proceeds of the Bank's technical-cooperation loan
will be used to finance activities related to sector
reforms in the electricity and the water and
sanitation sectors. Development of regulatory
frameworks for these sectors will be financed through
a grant (TC-96-083-26-PN) from the Multilateral
Investment Fund (MIF), which is financing similar
projects elsewhere in the region.

DESCRIPTION: This operation is divided into three subprograms:
(i) organization and outfitting of the Public
Utilities Regulatory Board; (ii) electricity sector
reform; and (iii) water and sanitation sector reform.
The first subprogram will set up and equip the
Regulatory Board to enable it to exercise its
regulatory functions in the telecommunications,
electricity, and water and sanitation sectors. With

support under the other two subprograms, service delivery will be restructured, separated, divested, and/or concessioned out to private-sector operators and investors.

BENEFICIARIES: The direct beneficiaries of the technical cooperation and the MIF grant will be the Public Utilities Regulatory Board (ERSP), the Water Resources and Electricity Authority (IRHE), the Water and Sanitation Authority (IDAAN), and the Health Ministry. Given the complexity of the reform package, the government will be able to hire, with the proceeds of this financing, specialized consultancies to perform financial, legal, technical, environmental, and economic analyses and evaluations of the program's components.

RISKS: The biggest risk stems from the program's size and complexity. This risk is addressed by having the Public Policy Unit act as the coordinating and main executing agency under the program. A second area of risk is associated with the highly specialized profile of several of the main consulting services that are to be engaged. To counter this risk, the operation's disbursement conditions will be built around the Bank's general procurement procedures, and the Bank will participate in the identification and selection of consultants, and in the preparation of the terms of reference and review of consultants' work. A last area of risk has to do with the administration of resources, specifically the procedures and time frames for hiring consultants. To address this risk, the operation proposes hiring the United Nations Development Programme.

EXCEPTIONS TO BANK POLICY: It is proposed that authorization be given to hire the United Nations Development Programme directly as the agency to perform administrative support activities for the Policy Unit, such as hiring technical-cooperation services (see paragraph 2.6).

For consulting services, it is proposed that the least-cost selection method be used. Under this method, a minimum acceptable technical level is established for technical bids to qualify. Bids are presented in two separate envelopes. The technical proposals are opened and evaluated first. Bids that do not meet the minimum acceptable technical standard are discarded. The price bids are opened only for the technical bids that have qualified. The firm with the lowest price bid is the one selected. When

using this method, the term "minimum acceptable" is defined bearing in mind that all bids above the "minimum acceptable technical level" will compete purely on the basis of price. The minimum level will be defined explicitly in the respective calls for bids (see paragraph 2.7).

**CONDITIONS
PRECEDENT:**

Release of loan disbursements will be subject to the following conditions: (i) the government is to have signed an agreement with UNDP to provide administrative support (see paragraphs 2.5 and 2.6); and (ii) the Public Policy Unit is to have submitted the action plan for carrying out the program, as outlined in paragraph 4.3.

The funds for the electricity sector reform subprogram will be eligible for release once the legislation establishing the regulatory and institutional framework for the sector has entered into force.

The funds for the water and sanitation subprogram will be eligible for release once the legislation establishing the regulatory and institutional framework for the sector has entered into force. The components on strengthening of the Sector Policy Unit and solid waste management are not included here.

**OTHER
CONDITIONS:**

The technical-cooperation and grant agreements will include standard Bank and MIF conditions on audits, reports, inspections, evaluations of the technical cooperation, and the hiring of consultants.

I. PROGRAM DESCRIPTION

- 1.1 To support implementation of the basic infrastructure sector reform program, the technical cooperation has been organized into three subprograms: (i) organization and outfitting of the Public Utilities Regulatory Board, (ii) reform of the electricity sector, and (iii) reform of the water and sanitation sector.

A. Subprogram I: Public Utilities Regulatory Board

- 1.2 The government has set up the Public Utilities Regulatory Board [Ente Regulador de los Servicios Públicos] (ERSP) and charged it with regulating, setting guidelines for, inspecting, verifying, and preserving competitive conditions and preventing abuses by companies with market power. The purpose of the regulatory reform is to establish the basic rules and standards that will govern the new service system and protect national interests, seeking to create a stable, transparent environment for private investors that is built on precise regulations and contractual relationships that stipulate the rights and responsibilities of the parties and, at the same time, protect consumer interests by making sure these contracts and regulations are observed.

- 1.3 The subprogram has the following components: (i) organization and outfitting of the Board; (ii) drafting of general regulations applicable to all sectors; (iii) drafting of sector-specific regulations for the telecommunications, electricity, and water and sanitation sectors; and (iv) supply of some equipment for the Board.

B. Subprogram II: Electricity sector reform

- 1.4 The reform will be implemented through the new legal framework proposed in the draft legislation to establish the regulatory and institutional framework for the electricity sector and the recently passed Public Utilities Regulatory Board Act. The proposed reform includes a transition period for the shift over to the new system and calls for: (i) IRHE to be separated into two hydroelectric generation companies, one thermal generation company, one transmission company, and at least two distribution companies; and (ii) the corporatization of these companies, and the sale of at least 51% of the stock to private operators and 10% to employees.
- 1.5 The electricity sector subprogram has the following components: (i) studies for the IRHE restructuring; (ii) study on electricity purchases and integrated operations, including the preparation of electricity sales contracts and regulation of operations of the load dispatch center; (iii) drafting of charters and bylaws for the

new companies; (iv) hiring of investment advisors to advise on selling stock, including the preparation of technical, financial, labor, and environmental impact evaluations; and (v) legal counsel for the sale of stock.

C. Subprogram II: Water and sanitation sector reform

- 1.6 The reform is based on the new legal framework that will be adopted subsequent to approval of the legislation setting forth the regulatory and institutional framework for water supply and sanitary sewerage services, and on the Public Utilities Regulatory Board Act, passed by the legislature in January 1996.
- 1.7 The draft legislation assigns the policy-setting and coordination function to a new high-level unit, specifically empowered for such purpose and located within the Health Ministry. The legislation allows for different modes of private-sector participation, e.g., service contracts, management contracts, lease contracts, and long-term concessions.
- 1.8 The water and sanitation sector subprogram includes the following components: (i) incorporation of the private sector in the delivery of public water supply and sewerage services throughout the country, including assessments of environmental impact and proposed solutions for dealing with environmental problems; (ii) strengthening of the policy unit at the Health Ministry; and (iii) formulation of a solid waste collection and treatment program.

II. ORGANIZATION AND EXECUTION

- 2.1 The borrower will be the Republic of Panama, and the executing unit will be the Ministry of Economic Policy and Planning through its Public Policy Unit, which was set up to support implementation of loans 688/OC-PN, 689/OC-PN, and 690/OC-PN (currently under way). The Public Utilities Regulatory Board was established pursuant to Law 26 (published in the Official Gazette on January 30, 1996) for the purpose of regulating the delivery of telecommunications, electricity, water supply, and sanitary sewerage services.
- 2.2 In carrying out and administering the program, the executing unit will coordinate its work with the Water Resources and Electricity Authority [Instituto de Recursos Hidráulicos y Electrificación] (IRHE), the Water and Sanitation Authority [Instituto de Acueductos y Alcantarillados Nacionales] (IDAAN), and the Health Ministry, and with the ERSP for all matters related to that board. These agencies will be the direct beneficiaries of this operation, which

will be implemented and administered using the same format as for loan 690/OC-PN (see description below).

A. Functions of the executing unit

- 2.3 The Public Policy Unit (UTPP) of the Ministry of Economic Policy and Planning will be the executing unit and will be responsible to the Bank for the progress of the program and the technical-cooperation operation. It will also serve as liaison between the Bank and the other participating agencies. The unit's functions will include: (i) administering funds and providing the Bank with the necessary documents; (ii) coordinating with the beneficiary institutions to identify, rank, select, and prepare background information for consulting service contracts; (iii) presenting reports, and monitoring and evaluating the program and the technical-cooperation operation; (iv) coordinating and supervising the work of the other participating agencies; (v) supervising the participation of UNDP; (vi) coordinating technical work with the Bank; (vii) ensuring that the activities supported by the technical cooperation are consistent with the reform program's policy elements; (viii) coordinating the work of the participating agencies to ensure compliance with the contractual conditions of the technical-assistance program and with the standard contractual conditions of the Bank, preparing all the necessary documents; (ix) presenting disbursement requests; (x) presenting duly audited financial statements to the Bank each year; and (xi) supervising performance of the consulting services.
- 2.4 The beneficiary agencies of this technical cooperation are to: (i) cooperate with the UTPP in preparing the necessary documentation for procuring required services and working with UNDP; (ii) coordinate work and act as technical and administrative counterpart for consultants; (iii) follow up and prepare monitoring and evaluation reports on work in progress for presentation to the UTPP; and (iv) ensure the quality of the products delivered by the firms engaged.
- 2.5 The ERSP will have exclusive decision-making power with regard to execution of subprogram I (creation and startup of the ERSP), for which purpose it will be authorized to: (i) establish and define definitive terms of reference for consulting services, (ii) oversee the prequalification and final selection of consultants, and (iii) review and approve consultant reports and authorize the respective payments. For purposes of this subprogram, the UTPP will limit itself exclusively to providing such complementary administrative and technical support as the ERSP feels is necessary for execution of the subprogram. The ERSP will have full decision-making power with regard to execution of subprogram I (creation and startup of the ERSP) and, accordingly, the UTPP will limit itself to providing such complementary administrative and technical

support as the ERSP feels is necessary for execution of that subprogram.

B. Execution arrangements

- 2.6 The government has asked for authorization to continue working with UNDP, which has been providing administrative support for loan 690/OC-PN. This would make it possible to build on the successful experience gained in other projects financed with loans from the Bank and other multilateral agencies. It is recommended that UNDP be allowed to act as administrator for the procurement of goods and services, since it meets the institutional advantage criteria outlined in the Procurement Manual (GS-603) for the purposes expressed above.
- 2.7 The recommendation of using the least-cost method for selecting consultants and consulting firms is warranted, given the nature of the work to be carried out under the program. For the most part, this work is complex and is governed by a well established body of standards and professional best practices. Experience has often shown that once technical proposals are ranked, there is a clearly defined group of proposals that are technically similar and that are all suitable for attaining the stated objectives. The proposed methodology places the burden on the consultants to formulate solid technical proposals and forces them to devise economical and competitive arrangements.
- 2.8 General administration of the procurement of services to be financed under this technical cooperation will be entrusted to UNDP, in keeping with the execution arrangements in place between the Government of Panama and UNDP. Under these arrangements, UNDP will work with the UTPP to prepare a project document defining the activities to be carried out and the products to be delivered by UNDP. Once cleared by the Bank, this would be the basis for the assistance to be provided by UNDP.
- 2.9 For purposes of implementing the technical cooperation, the Ministry of Economic Policy and Planning will ask the Bank to deposit the loan proceeds with UNDP. The UTPP will keep accounting records in accordance with generally accepted accounting standards and all applicable legislation. It will also keep budget records by spending category and will be subject to an audit by an independent public accounting firm.
- 2.10 Basic and technical responsibility for the operation will lie with the project team for program PN-0097. The operation will be administered through the Bank's Country Office in Panama, with support from the Finance and Basic Infrastructure Division (RE2/FI2) and the project team.

III. PROGRAM COSTS AND FINANCING

- 3.1 After including the funds remaining from technical-cooperation loan 690/OC-PN, the program has a cost of US\$9.63 million. The total cost of this operation is US\$6.73 million. The Bank would contribute the equivalent of US\$3.34 million, and the government would contribute US\$1.58 million equivalent; the MIF would contribute US\$1.81 million (see Table 1). The US\$2.9 million remaining from operation 690/OC-PN would be used to finance specific activities as a complement to this operation (see Appendix Table 2).

Table 1 Technical Cooperation (in thousands of US\$)				
Subprograms/Categories	Financing			
	IDB	MIF	Local	Total
1. Regulatory Board	300	1,810	80	2,190
2. Electricity sector	840			840
3. Water and sanitation sector	1,510			1,510
4. Contingencies	507			507
5. Executing unit (UTPP)			1,500	1,500
6. UNDP fees	150			150
7. Inspection and supervision	33			33
Grand total	3,340	1,810	1,580	6,730
Percentage	50%	27%	23%	100%

- 3.2 Since this technical cooperation will be carried out in conjunction with program PN-0097, the execution period has been estimated at 42 months, and the disbursement period at 48 months, as of the date on which the technical-cooperation agreement enters into force. These periods include the necessary time frames for complying with conditions precedent, calls for bids, hirings, and execution and settlement of contracts.
- 3.3 Funds from the Bank and the MIF will be used to hire individual consultants and consulting firms to perform specified program activities, in keeping with the general rules of the two organizations on the use of funds. The government's contribution will be used to finance administration and supervision costs, and to cover the procurement of furnishings and equipment for the UTPP

- and the Regulatory Board, as well as the fees and expenses of local consultants involved in program execution.
- 3.4 The Bank's contribution will be drawn on the ordinary capital. Under the current regulations, the terms and conditions for the operation will be as follows: (i) amortization period: 20 years; (ii) interest rate: variable, pursuant to the Bank's policy on interest rates; (iii) disbursement period: 48 months; (iv) credit fee: 0.75% on undisbursed amounts; and (v) inspection and supervision fee: 1% of the loan amount.
- 3.5 The MIF funds will be disbursed on a grant basis.

IV. MONITORING AND REPORTS

A. Project monitoring

- 4.1 The project team will remain active throughout the program execution period and, in coordination with the Country Office, will hold technical and operational responsibility for the operation's execution. Reports will be produced by the executing agency (Ministry of Economic Policy and Planning) and presented to the Bank according to the work plan that is agreed upon.

B. Reports

- 4.2 The Ministry of Economic Policy and Planning, by way of the UTPP, is to produce and present the following reports, with copies to the Ministry and the Bank.

1. Initial report (work plan)

- 4.3 The executing agency is to present the work plan as a condition precedent to the first disbursement. The work plan, which is to be based on the matrix agreed upon with the Bank, is to contain a timetable for execution of the program's components and activities and a description of all activities, including means of verification for each.

2. Progress reports and review meetings

- 4.4 Throughout the execution period, beginning on the date on which the work plan is presented, a short semiannual report is to be presented within the 30 days following the end of each six-month period on the progress made and problems encountered. The identified problems will be the subject of discussions, as necessary, with the project team and will serve as input for preparing the work plan and operating schedule for the following six-month period. The progress reports are to include, as an

annex, updated lists of activities and of consultants hired during the period.

- 4.5 As part of the program monitoring activity, two meetings will be held each year with the project team on the dates indicated for evaluation and monitoring of the reform program. These meetings will provide a forum for a joint review of the progress reports and the program's advances, with an eye to making any adjustments that may be necessary and to assessing the results of each stage.

3. Final report

- 4.6 Based on the progress reports presented to the Bank, a final report is to be submitted during the two months following completion of the technical-cooperation components. The final report is to provide a summary of the activities carried out and results obtained, comparing them with the objectives initially proposed for the operation.

Table 2
Itemized Budget for Technical Cooperation
(in thousands of US\$)

	Balance from loan 690/OC-PN	Financing for the operation			
		Gov't.	MIF	IDB	Total
1. Support for Regulatory Board	1,440	80	1,810	300	2,190
1.1 Organization, equipping, and general regulations	720			300	300
1.2 Telecommunications regulations	720				
1.3 Electricity sector regulations (Annex IV)			1,100		1,100
1.4 Water and sanitation sector regulations (Annex IV)			710		710
1.5 Staffing, furnishings, and equipment		80			80
2. Electricity sector reform	590			840	840
2.1 Restructuring of IRHE	330				
2.2 Electricity purchase contracts. Regulations for load dispatch center operation	200				
2.3 Charters and bylaws of new companies	60				
2.4 Investment advice, including technical, financial, labor, and environmental evaluation				520	520
2.5 Legal advice for stock sale process				320	320
3. Water and sanitation sector reform	480			1,510	1,510
3.1 Inclusion of private sector in public drinking water and sewerage services in metropolitan areas, including environmental impact studies	360			480	480
3.2 Inclusion of private sector in public drinking water and sewerage services in rural areas, including environmental impact studies	120			620	620
3.3 Strengthening of Health Ministry (sector policy area)				210	210
3.4 Formulation of solid waste collection and treatment program				200	200
Subtotal (1 + 2 + 3)	2,510	80	1,810	2,650	4,540
4. Contingencies	390			507	507
5. Executing unit (UTPP)		1,500			1,500
6. UNDP fees				150	150
7. Inspection and supervision				33	33
Grand total	2,900	1,580	1,810	3,340	6,730
Percentage share in financing		23%	27%	50%	100%

BASIC INFRASTRUCTURE SECTOR REFORM PROGRAM
MULTILATERAL INVESTMENT FUND
DEVELOPMENT OF REGULATORY FRAMEWORKS FOR THE ELECTRICITY
AND THE WATER AND SANITATION SECTORS
(TC-96-08-32-6)

I. COUNTRY ELIGIBILITY

- 1.1 The Donors Committee declared Panama eligible for all modalities of financing under the Multilateral Investment Fund on February 9, 1995.

II. FRAME OF REFERENCE

- 2.1 This financing is part of a basic infrastructure sector reform program (PN-0097) that also includes telecommunications. The MIF funding will serve as a complement to a quick-disbursing sector loan that is intended to help cover Panama's external financing requirements during the program execution period, and a technical-cooperation loan to finance the rest of the consulting services included in the reform program.

III. THE PROJECT

A. Objective

- 3.1 The purpose of this financing is to attract technical and operational capacity and venture capital from the private sector for the purpose of delivering service and expanding coverage in the electricity and the water and sanitation sectors.

B. Description of activities

- 3.2 The government has set up a Public Utilities Regulatory Board [Ente Regulador de los Servicios Públicos] (ERSP) and charged it with regulating, setting guidelines for, inspecting, verifying, and preserving competitive conditions and preventing abuses by companies with market power. The purpose of the regulatory reform is to create a stable, transparent environment for private investors that is built on precise regulations and on contractual

relationships that protect national interests and stipulate the rights and responsibilities of the parties and, at the same time, safeguard consumer interests.

- 3.3 The MIF funds will be used to develop and establish regulatory frameworks for the electricity and the water and sanitation sectors.
- 3.4 In order to prepare these frameworks, technical assistance will be needed from experts in the field of sector regulation. Work will be referenced to the Public Utilities Regulatory Board Act (passed by the legislature in January 1996), the draft legislation to establish a regulatory and institutional framework for the electricity sector, and the draft legislation to establish a regulatory and institutional framework for the water and sanitation sector.
- 3.5 Consulting services will be hired to draft the following:
(i) enabling regulations for each sector's framework law;
(ii) tariff estimates and procedures for setting and revising rates for services that are subject to rate regulation; (iii) regulations for technical standards; (iv) regulations for the wholesale electricity market; and (v) model concession contracts for water supply and sanitary sewerage services.
- 3.6 These activities are a vital counterpart to the effort to segregate IRHE vertically and horizontally, and are a prerequisite to including the private sector in generation and distribution activities in this sector. They also represent a necessary prelude to a private-sector role in delivery of drinking water and sanitary sewerage services in metropolitan Panama City, in Chiriquí, and in the central provinces.

IV. COST AND FINANCING

- 4.1 The MIF will furnish a total of US\$1,810,000 on a nonreimbursable basis. The IDB will provide US\$3,340,000 equivalent (technical-cooperation loan) and the government will provide US\$1,580,000 equivalent (see Table 1).

Table 1				
Technical Cooperation (in thousands of US\$)				
Subprograms/Categories	Financing			
	IDB	MIF	Local	Total
1. Regulatory Board	300	1,810	80	2,190
2. Electricity sector	840			840
3. Water and sanitation sector	1,510			1,510
4. Contingencies	507			507
5. Executing unit (UTPP)			1,500	1,500
6. UNDP fees	150			150
7. Inspection and supervision	33			33
Grand total	3,340	1,810	1,580	6,730
Percentage	50%	27%	23%	100%

- 4.2 Given the complex nature of the consulting services required, consulting firms will be hired to help coordinate the execution of project activities. Accordingly, the respective budget figures include professional fees, transportation costs, and general costs.

V. EXECUTION AND DISBURSEMENTS

- 5.1 The project will be implemented and administered following the same execution arrangement as for IDB loan 690/OC-PN. Consulting services will be engaged pursuant to applicable IDB and MIF procedures.
- 5.2 Disbursements will be made in accordance with IDB procedures. Full implementation of all the components under this subprogram is expected to take 18 months. A disbursement period of 24 months is proposed for the MIF resources.
- 5.3 In duly justified cases, consideration will be given to reallocating funds within the subprogram covered by the MIF grant, provided the proposed changes are consistent with the program's objectives. Any such reallocation will be subject to approval by the IDB, in consultation with the Office of the MIF.

VI. COMPLIANCE WITH ELIGIBILITY CRITERIA

- 6.1 This technical cooperation has been designed for the purpose of supporting modernization and a broader role for private enterprise in the infrastructure sector. It is fully consistent with the MIF's general objective, which is to strengthen and expand private investment as a basis for promoting economic growth and social development.
- 6.2 The proposal also meets the funding criteria of the Technical Cooperation Facility, Article 3, Sections 2(c) and 2(d), of the Agreement Establishing the MIF, which authorizes the granting of funds to governments for the purpose of financing consulting services that are needed in order to establish or strengthen regulatory agencies. The proposal is also consistent with the recent recommendations of the MIF Task Force to the effect that support be given for the development of legal, regulatory, contractual, and supervisory frameworks to give priority to promoting private investment in the infrastructure and public utilities sector.

VII. COMPATIBILITY WITH THE BANK'S COUNTRY PROGRAM

- 7.1 This financing is a complement to, and is justified by, the support that the Bank is lending to the Government of Panama for the reform of the country's basic infrastructure sectors. The operation is an integral part of this effort, and is crucial to promoting the participation of private enterprise in these sectors.

Logical Framework
Basic Infrastructure Sector Reform Program

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
<p>Overall objective</p> <p>More efficient and better quality and lower costs in the sectors. More private-sector participation in infrastructure financing, and reduction of the burden of the sectors. Higher capacity for investment projects.</p>	<p>Indicators (see Appendix 1)</p>	<p>ERSP figures, audited balance sheets of the companies. National budget.</p>	
<p>Specific objective 1</p> <p>Private operators in delivering basic services.</p>	<p>Contracts awarded, and shares transferred.</p>	<p>Copies of contracts, official notifications.</p>	<p>The private sector is efficient and capable of participating and mobilizing funds on its own. The proposed regulatory framework will promote private-operator efficiency.</p>
<p>Specific objective 2</p> <p>Completion and outfitting of the ERSP. Development of regulatory frameworks.</p>	<p>ERSP and policy bodies separate from service delivery companies. Enabling regulations issued for sector legislation. Contracts with private sector (sale of shares, concessions, management, etc.)</p>	<p>Official Gazette. Copy of model contracts.</p>	<p>The private sector is interested in participating. The regulatory framework is adopted and the ERSP will provide assurances and will encourage private participation. Transparent bid process to serve both national interests and the interests of interested investors.</p>
<p>Means and activities</p> <p>Technical assistance, and enabling regulations and legislation. Restructuring of IRHE. Privatization, and environmental management. Preparation of IRHE and IDAAN. Preparation of contracts for private-sector participation in the electricity and the water sectors.</p>	<p>Execution of the budget contained in the plan of operations for the technical cooperation (see Annexes III and IV).</p>		<p>Restructuring of IRHE and IDAAN is politically viable. The legislature will adopt legal frameworks that are essential for the ones being proposed. The external arrangements and budgets for the technical cooperation are adequate. The companies selected will perform their work.</p>

Development Indicators
A-V.1 Telecommunications Sector

INDICATOR	DEFINITION	CURRENT LEVEL
Private financing (%)	(Private financing/total financing) x 100	0
Annual investment rate (US\$ per year)	Actual annual investments (average)	US\$40 million
Tariffs (ratio)	Rates/efficiency rates	
a. Local		2.5
b. International long distance		0.4
Coverage (%)	Telephone lines per 1,000 persons	9.3
	Public telephones per 1,000 persons	<3
	Public telephones in communities of less than 300 inhabitants	<1
Pending requests for telephone service (%)	(Pending requests/telephone lines in service) x 100	16
Local calls successfully put through by exchanges (%)	(Successful calls per month/ attempted calls per month) x 100	60
Incoming international calls successfully completed automatically (%)	(Calls answered per month/ attempted calls per month) x 100	60
Outgoing international calls successfully completed automatically (%)	(Successful calls per month/ attempted calls per month) x 100	60
Productivity per employee	No. of employees per 1,000 lines	16

A-V.2 Water and Sanitation Sector

INDICATOR	DEFINITION	CURRENT LEVEL
Private financing (%)	Private financing/total financing	0
Annual investment rate (US\$ per year)	Actual annual investments (average)	US\$10 million
Tariffs (ratio)	Rates/efficiency rates	n.a.
Water losses(%)	$[1 - (\text{water invoiced}/\text{water produced})] \times 100$	49
Coverage		
Drinking water (%)	$(\text{Population with household connection}/\text{total population}) \times 100$	
a. Panama City		75
b. Provinces		70
Sanitary sewerage (%)	$(\text{Population with household connection}/\text{total population}) \times 100$	
a. Panama City		46
b. Provinces		40
Treated sewage (%)	$(\text{Sewage treated}/\text{sewage produced}) \times 100$	0
Efficiency	Employees per 1,000 connections	9
Collection (%)	Invoices collected in 45 days	12

A-V.3 Electricity Sector

INDICATOR	DEFINITION	CURRENT LEVEL
Private financing (%)	$(\text{Private financing}/\text{total financing}) \times 100$	0
Annual investment rate (US\$ per year)	Actual annual investments (average)	US\$80 million
Tariffs (ratio)	Rates/efficiency rates a. Residential b. Commercial c. Industrial	1.29 1.03 1.03
Coverage (%)	$(\text{Population with household connection}/\text{total population}) \times 100$	65
Thermal-generation availability (%)	$(\text{Hours that equipment is available}/24) \times 100$	29.3
Water-generation availability (%)	$(\text{Hours that equipment is available}/24) \times 100$	91
Total electricity losses (%)	$(1 - \text{electricity billed}/\text{electricity generated}) \times 100$	20.7
Electricity sold, per employee	MWh/employee	622
Collection period	Average number of days between billing and receipt of payment	176

PROPOSED RESOLUTION

PANAMA. LOAN ____/OC-PN TO THE REPUBLICA DE PANAMA
(Sectorial Program to Reform Basic Infrastructure Sectors)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Panamá, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Sectorial Program to Reform Basic Infrastructure Sectors. Such financing will be for the amount of up to US\$120,000,000, which are part of the resources of the Single Currency Facility of the Ordinary Capital of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.

PROPOSED RESOLUTION

PANAMA. NONREIMBURSABLE TECHNICAL COOPERATION FOR A PROGRAM TO SUPPORT THE DEVELOPMENT OF A REGULATORY FRAMEWORK FOR THE SECTORS OF ELECTRICITY, POTABLE WATER AND SANITARY DRAINAGE. (TECHNICAL COOPERATION TO SUPPORT THE SECTORIAL PROGRAM TO REFORM BASIC INFRASTRUCTURE SECTORS)

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the República de Panamá and to take such additional measures as may be pertinent for the execution of the plan of operations with respect to a Technical Cooperation for a Program to Support the Development of a Regulatory Framework for the Sectors of Electricity, Potable Water and Sanitary Drainage, which is part of the Technical Cooperation to Support the Sectorial Program to Reform Basic Infrastructure Sectors, referred to in Document PR-

2. That up to the amount of US\$1,810,000, or its equivalent in other convertible currencies, is authorized for the purpose of this resolution, chargeable to the resources of the Technical Cooperation Facility of the Multilateral Investment Fund.

3. That the above-mentioned sum is to be provided on a nonreimbursable basis.

PROPOSED RESOLUTION

PANAMA. TECHNICAL COOPERATION LOAN TO SUPPORT THE
SECTORIAL PROGRAM TO REFORM BASIC INFRASTRUCTURE
SECTORS

The Board of Executive Directors

RESOLVES:

1. That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such agreements as may be necessary with the República de Panamá and to adopt such measures as may be pertinent for the execution of the plan of operations with respect to a Technical Cooperation Loan to Support the Sectorial Program to Reform Basic Infrastructure Sectors, referred to in Document PR-_____.

2. That up to the sum of US\$3,340,000, is authorized for the purposes of this resolution, chargeable to the resources of the Single Currency Facility of the Ordinary Capital of the Bank.

3. That the above-mentioned sum is to be provided on a reimbursable basis.