January 2006
IMF Country Report No. 06/3

Panama: Selected Issues and Statistical Appendix

This Selected Issues and Statistical Appendix paper for **Panama** was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on **March 8, 2005**. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Panama or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

PANAMA

Selected Issues and Statistical Appendix

Prepared by W. Lewis, M. Dehesa, P. Druck, A. Faria, and E. Verreydt (all WHD)

Approved by the Western Hemisphere Department

March 8, 2005

Contents Page

Figures

Text Tables

Tables

Boxes

Appendix

Statistical Appendix Tables

Panama: Basic Data

I. Social and Demographic Indicators

Area (sq. km)	75,517
Arable land (percent of land area)	7.4
Population (2004 estimates)	
Total (millions)	3.2
Annual rate of growth (percent a year, 2004 est.)	1.8
Density (per sq. km.)	42
GDP per capita (U.S. dollars, 2003)	
Unadjusted	4,127
PPP terms	6,475
Population characteristics (2004 estimates)	
Life expectancy at birth (years)	74.7
Crude birth rate (per thousand)	22.7
Crude death rate (per thousand)	5.1
Infant mortality (per thousand live births)	20.6
Income distribution (2000)	
Percent of income received:	
By highest 20 percent of households	60.3
By lowest 20 percent of households	2.4
Access to safe water (2000)	
Percent of population	
Total	90.0
Urban	99.0
Rural	79.0
Education	
Net enrollment rates	
Primary education (2001)	99.0
Secondary education (2001)	62.4
Tertiary education (1994–97)	27.0
Adult literacy rate (2002)	92.3
Distribution of labor force, in percent (2003)	
Agriculture and mining	21.0
Manufacturing and construction	15.9
Services	63.0
GDP (2004 estimate)	US$13.8 billion

II. Economic Indicators 2000–04

	2000	2001	2002	2003	Est. 2004
	(Percent change)				
National accounts and prices					
GDP at constant 1996 market prices	2.7	0.6	2.2	4.3	6.0
Agriculture and mining	7.6	5.5	4.6	6.5	4.4
Manufacturing and construction	-4.5	-11.4	-3.9	8.0	6.9
Services	5.5	1.7	1.3	3.5	5.9
Consumer price index (end-of-period)	0.7	0.0	1.8	0.1	2.0
Monetary 1/					
Net domestic assets	6.4	7.4	0.4	-2.9	6.1
Credit to the public sector (net)	-0.4	-2.3	0.2	2.7	4.2
Credit to the private sector	6.7	9.9	-8.6	2.2	11.5
Liabilities to the private sector	8.9	9.5	0.9	4.6	8.2
REER, 12-month percent change (depreciation -)	-0.7	-1.4	-0.1	-6.5	-0.7
	(In percent of GDP)				
Investment and saving					
Gross domestic investment	24.6	19.4	18.0	21.5	22.0
Of which: private sector	20.7	15.3	13.7	16.3	17.8
Gross national savings	18.7	17.9	17.5	18.3	20.3
Of which : private saving	14.8	16.2	16.2	17.3	19.4
External current account	-5.9	-1.5	-0.5	-3.2	-1.7
Nonfinancial public sector					
Revenue and grants	24.8	23.8	22.9	22.4	21.3
Expenditure	30.1	26.1	26.2	27.2	26.3
Current	25.5	23.0	22.9	23.0	23.0
Capital	4.6	3.1	3.2	4.1	3.3
Primary balance	-0.4	2.0	1.0	-0.3	-0.5
Overall balance, excluding Canal Authority	-5.2	-2.3	-3.3	-4.7	-5.0
Canal Authority 2/	1.1	0.5	0.5	1.0	1.7
Overall balance, including Canal Authority	-4.1	-1.8	-2.7	-3.7	-3.3
Gross public debt	66.5	71.1	69.8	67.3	71.8
External	48.2	53.0	52.0	50.5	52.6
Domestic	18.3	18.1	17.8	16.7	19.2

Panama: Basic Data

	2000	2001	2002	2003	Est. 2004
			(In millions of balboas)		
Balance of payments					
Trade balance	-1,142.9	-696.2	-1,035.1	-1,092.0	-1,033.3
Exports, f.o.b.	1,047	1,079	970	999	1,126
Imports, f.o.b.	-2,705	-2,304	-2,352	-2,396	-2,650
Colon Free Zone (net)	515	529	346	306	491
Services (net)	854	899	981	1,263	1,421
Income	-577	-602	-250	-820	-884
Of which: NFPS interest	-366	-415	-449	-474	-530
Current account	-689	-174	-61	-408	-237
Capital and financial account balance	203	890	367	163	409
Overall balance	-91	416	62	-149	-375
Stock of net international reserves	707	1,116	1,171	1,013	633
IMF data (as of January 31, 2005)					
Membership status:					Article VIII
Intervention currency and rate					B 1.00 per U.S. dollar
Quota					SDR 206.6 million
Fund holdings of local currency					SDR 218.08 million
(as percent of quota)					105.6 percent
Outstanding purchases and loans					SDR 23.33 million
Extended arrangements					SDR 23.33 million
SDR department					
Net cumulative allocation					SDR 26.32 million
Holdings					0.56 million

Sources: Office of the Comptroller General; World Bank, World Development Indicators 2004; and Fund staff estimates.

1/ In percent of stock of liabilities to the private sector at the beginning of year.
2/ Balance of Canal Authority, after transfers of Canal tolls and distribution of profits to the government.

I. THE FIGHT AGAINST CORRUPTION AS A STRATEGY FOR GROWTH[1]

A. Introduction

1. **The Torrijos administration has given high priority to the fight against corruption.** At the same time, the administration is developing a strategy to enhance growth and competitiveness in the Panamanian economy. This paper argues that fighting against corruption is, indeed, key to raising the country's growth potential.

2. **The organization of the paper is as follows:** Section B describes the nature and extent of corruption in Panama; Section C assesses the impact of corruption on growth; Section D outlines anti-corruption strategies recommended by the World Bank; Section E reviews the administration's initial actions and future plans to combat corruption; and the final section concludes.

B. The Nature and Extent of Corruption in Panama

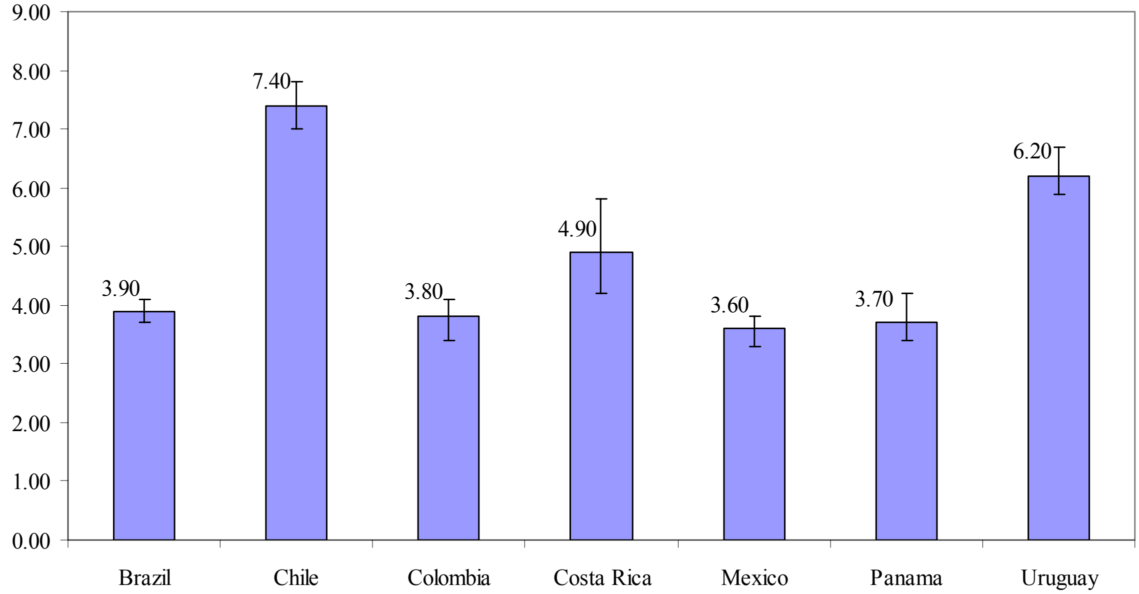
3. **Panama is perceived as being more corrupt than many of the other emerging market countries in Latin America.**[2] Two of the more prominent composite corruption indices, the Corruption Perception Index[3] from Transparency International, and

[1] Prepared by André Faria (WHD).

[2] Excluding oil-rich countries Ecuador and Venezuela.

[3] The Corruption Perception Index uses a homogeneous definition of the extent of corruption: it reflects both the frequency and the total value of bribes paid. This index uses data from up to 18 different surveys from 12 institutions and it varies from zero (high perceived corruption) to 10 (low perceived corruption). For Panama, the Corruption Perception Index uses seven surveys from five different institutions.

Figure 1. Corruption Perception Index, 2004 1/



Source: Transparency International (2004).

1/ Line segment indicates size of standard deviation; see text footnotes 3 and 6.

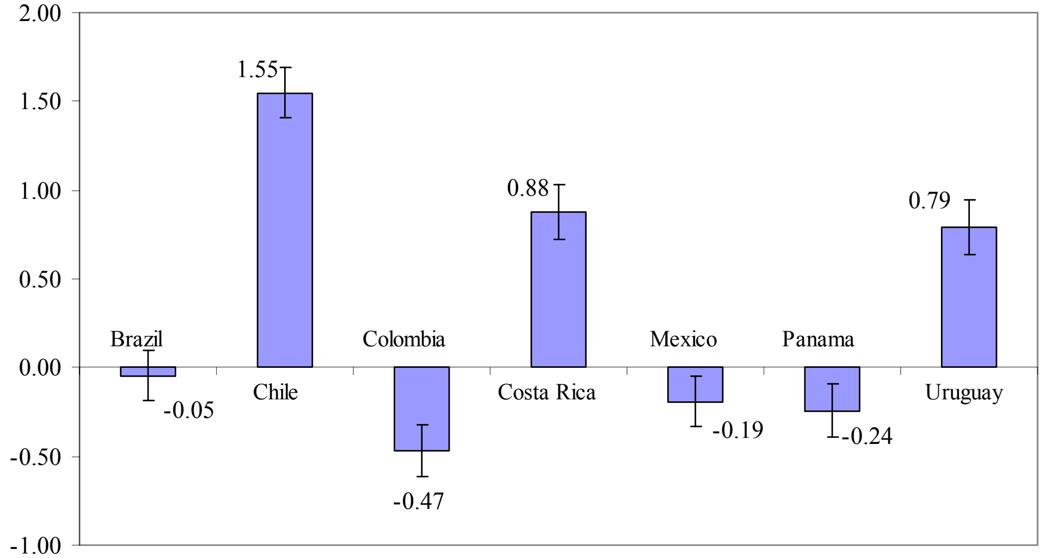
the Control of Corruption Index,[4] created by Kaufmann, Kraay, and Zoido-Lobatón (1999) of the World Bank, agree in their main messages: Chile, Uruguay, and Costa Rica are perceived as the least corrupt of the countries in our sample, whereas Panama, Mexico, and Colombia are perceived as the most corrupt countries of the sample.[5] [6] Although ordering across indices is not robust, the main message is clear: Panama underperforms many of its neighbors regarding perceptions of good governance (Figures 1 and 2).

[4] The Control of Corruption Index measures perceptions of corruption, where corruption is the exercise of public power for private gain. This index uses up to twelve sources and, with 99 percent probability, the sample ranges between -2.5 (high perceived corruption) and 2.5 (low perceived corruption). For Panama, the Corruption Perception Index uses seven surveys from five different institutions.

[5] The sample includes Brazil, Chile, Colombia, Costa Rica, Mexico, Panama, and Uruguay.

[6] Since the indices generate point estimates that are subject to errors, any ranking is imprecise. Point estimate rankings are used for illustrative purposes only, and the standard errors also are presented in the figures.

Figure 2. Control of Corruption Index, 2002 1/



Source: Kaufmann and others (2003).
1/ Line segment indicates size of standard errors; see text footnotes 4 and 6.

4. **Corruption is perceived as a widespread phenomenon that has affected both private and public sectors in Panama at various levels of decision-making**. The World Economic Forum publishes indicators that provide a more disaggregated view of the nature of corruption in Panama.[7] Corruption in the public sector is perceived as ranging from the individual bureaucrat (tax collection, export and import licensing, access to public utilities) to the high-level politician (public contracts, government policymaking), and it may also affect judges (judicial decisions).

[7] Each year, the World Economic Forum conducts an Executive Opinion Survey and combines the answers with some objective data to generate its well-known Global Competitiveness Index. The aim of this index is to evaluate the potential for achieving sustained economic growth.

Table 1. The Nature of Corruption in Panama, 2003

Indicator	Rank 1/	Score	Mean 2/	Relative Performance 3/
Irregular payments in... 4/				
...loan applications	60	4.6 (1.7)	4.9	94
...exports and imports	65	4.0 (1.9)	4.7	85
...public utilities	65	4.5 (1.9)	5.0	90
...tax collection	67	4.2 (1.9)	4.8	88
...public contracts	70	3.2 (1.9)	3.9	82
...judicial decisions	80	3.3 (1.7)	4.5	73
...government policymaking	88	3.0 (1.7)	4.2	71
Diversion of public funds due to corruption 4/	74	2.7 (1.5)	3.7	73
Public trust in financial honesty of politicians 5/	91	1.5 (0.7)	2.7	56
Influence of legal political donations on specific public policy outcomes 4/	96	2.6 (1.2)	3.8	68

Sources: World Economic Forum (2004); and Fund staff calculations.

1/ Ranking of point estimates. Sample includes 102 countries.
2/ Mean of point estimates across 102 countries of the sample.
3/ Ratio of score to mean in percentage points.
4/ 1=common; 7=never occurs. Standard deviation in parentheses.
5/ 1= very low; 7=very high. Standard deviation in parentheses.

5. **The most prevalent type of corruption in Panama appears to be political, as opposed to bureaucratic, corruption.** This "grand" form of corruption, as Kaufmann (2003) classifies it, seems to correspond to what survey respondents perceive to be more serious: people strongly distrust politicians and believe that the diversion of public funds because of corruption is somewhat common. In addition, people believe that powerful interests "capture the state" and condition its actions through political donations, even when the donations are legal (Table 1).

C. Why Does Corruption Matter?

6. **Why should Panama care about corruption?** Apart from moral, ethical, political, and redistributive issues, which are pertinent but are beyond the scope of this paper, Panama should care about corruption for at least two other reasons that bear on economic performance:

- corruption reduces total investment (Knack and Keefer, 1995; Mauro, 1995) and foreign direct investment (FDI) (Smarzynska and Wei, 2000; Wei, 2000); and

- corruption induces the misallocation of resources. On the one hand, in an environment in which rent seeking proves to be lucrative, the most talented individuals may engage in rent-seeking activities in preference to productive activities (Murphy and others, 1991). On the other hand, corruption also affects the composition of government expenditures;

in particular, cross-country studies show that it tends to lower government spending on education as a proportion of GDP (Mauro, 1998).

Corruption hampers growth through both of these channels by reducing the amount of physical and human capital available for economic growth.

7. **Even though Panama currently attracts substantial FDI,[8] corruption may prove an obstacle to a medium-term growth strategy based on foreign investment.** One important component of the medium-term strategy of Panama is the prospect of a free-trade agreement with the United States. The Panamanian authorities believe that such an agreement would make U.S. firms more likely to establish operations in Panama. At the same time, Panama is developing special economic zones with the objective of attracting foreign investors. However, if corruption persists, the gains from this FDI-based strategy may fall short of their potential. For example, Wei (2000, p. 5) estimates that "[an] increase in corruption from the Singapore to the Mexico level [corresponding to Panama's level in statistical terms] has the same negative effect on inward foreign investment as raising the [marginal effective] tax rate [on foreign corporations] by over fifty percentage points."[9] Moreover, UNCTAD (2004) reports that most FDI to Panama has its origin in the United States and, as Wei (2000) showed, American investors are sensitive to corruption in the host country. A reduction in corruption may make Panama an even more attractive place for foreign investors, thus contributing to the success of the authorities' medium-term growth strategy.

D. Anti-Corruption Strategies[10]

8. **This section reviews suggestions and examples of success in the implementation of anti-corruption strategies.** In recent years, there has been a change in the conventional wisdom on strategies to fight corruption. In the mid-1990s, the best means of tackling corruption were believed to be the reform of public sector management and institutional reforms in the judiciary and legal fields. However, recent evidence suggests that these

---

[8] According to UNCTAD (2004), Panama's ability to attract FDI is exactly proportional to its relative size in the world economy (with an inward FDI performance index equal to 1, defined as the ratio of a country's share in global FDI inflows to its share in global GDP).

[9] This also suggests that a substantial decrease in corruption together with a modest increase in corporate tax income may simultaneously increase the inflow of FDI and raise fiscal revenues.

[10] This section relies heavily on the studies by World Bank staff, in particular, Daniel Kaufmann and his co-authors.

reforms, while effective against bureaucratic corruption, are not sufficient to curb political corruption and state capture.[11]

Conventional View on the Fight Against Corruption

9. **Public sector reforms have a key role to play in the fight against bureaucratic corruption.** According to Gray and Kaufmann (1998, p. 9), though much of the success toward controlling corruption is credited to anti-corruption councils, "the broader economic and institutional reforms that have taken place simultaneously" are the true ingredients for success. Botswana and Uganda are examples of success. Botswana reformed its public sector management practices (and, at the same time, created an anti-corruption institution). Uganda adopted a broader set of policies, deregulating the economy, appointing an inspector general to investigate and prosecute corruption cases, launching a campaign against corruption, and implementing a civil service reform.

10. **Institutional anchors may be important catalysts for institutional reforms.** External anchors, in particular, seem to have been especially important for some countries. In the World Economic Outlook of April 2003, IMF staff points to the role of the European Union as an external anchor for the transition economies of Eastern and Central Europe, and the impact of NAFTA on the institutional reforms of Mexico. Berglöf and Roland (1997, p. 3) find that the EU serves, indeed, as "an 'outside anchor' to the reform process in many, if not all, of [the European transition] countries: domestic political battles become subordinated to the overriding goal of membership." The IMF survey also refers to Whalley (1998), who argues that NAFTA served as a commitment device for further economic reforms.[12] These institutional reforms may reduce corruption insofar as they promote deregulation, market and trade liberalization, and a more transparent and efficient public sector, thus reducing rent-seeking opportunities.

New View on the Fight Against Corruption

11. **After several years of implementation of institutional reforms, corruption did not change substantially in many of the countries in question.** Though there are some examples of success, they seem sparse in relation to the institutional reforms that took place. In fact, reviewing trends in corruption as reported by firms in the Global Competitiveness

---

[11] According to Helmann and others (2000, p. 2), "state capture is defined as *shaping the formation of the basic rules of the game* (i.e., laws, regulations, and decrees) through *illicit* and nontransparent private payments to public officials."

[12] The World Bank's *World Development Report 2002* notes that competition is a "transmission mechanism." In Mexico, after NAFTA opened the banking sector to foreign competition, domestic banks pressured the domestic regulators to improve prudential regulations.

Report's yearly survey, one may conclude that there have been no major improvements since 1997 (slight improvements in Eastern Europe and Former Soviet Union) and that Latin America saw a deterioration.[13] One reason may be that countries implemented anti-corruption policies that were not well-targeted to tackle the type of corruption that was most prevalent in these countries.

12. **Political corruption and state capture have not been at the core of traditional anti-corruption strategies.** The conventional fight against corruption focused on strategies better suited to combating bureaucratic corruption. However, evidence suggests that these strategies were not enough to curb political corruption. According to Kaufmann (2003, p. 32) "to attain concrete progress, it may be important to move away from an excessive focus on traditional public sector management and orthodox judicial/legal measures."

13. **Transparency plays a pivotal role in the fight against high-level corruption and state capture.** Transparency "refers to the key characteristics of an effective flow of information [...] to all relevant stakeholders": access, timeliness, comprehensiveness, relevance, quality, and reliability (Kaufmann 2003, p. 20). Transparency is important in the fight against corruption because it facilitates effective external accountability. At the public level, transparency implies, among other things, disclosure of budgetary procedures, budgetary data and other economic statistics, as well as public information about parliamentary votes and the assets and income of public office holders. Developments in information technology have made the dissemination of public information easier than ever: governments may now adopt e-government tools by, for example, disclosing information via internet (e-data) or making procurement web-based (e-procurement).

Common View on the Fight Against Corruption

14. **Political will, civil society involvement, measurement, information gathering, and dissemination are important elements of any anti-corruption strategy, whether it focuses on bureaucratic or political corruption.** Political leadership is needed to launch reforms that address vested interests, whether in the public service or the private sector. Civil society participation raises awareness of corruption and softens resistance to the necessary reforms. Measurement and diagnostic surveys of corruption as well as of the effects of reforms are essential for the design of an effective anti-corruption strategy. Information gathering and rapid dissemination may help to measure objectives, improve services and to reduce bribery, as happened in Bangalore, India, when users of local public services evaluated them with scorecards (Kaufmann, 1998).

---

[13] See Figure 3a in Kaufmann (2003).

E. Torrijos Administration's Anti-Corruption Measures

15. **The Torrijos administration declared "zero-tolerance" of corruption.** Mr. Torrijos ran for election on the promise to curb corruption in Panama. The Panamanian administration has expressed a political will to fight corruption and determination to set a good example from the top. Symbolically, the first measure of the Torrijos presidency was to abolish a controversial decree for applying the Law on Transparency; the decree was perceived by several elements of the society as against the spirit of the law (Box 1). In addition, the administration created the *Consejo Nacional de Transparencia contra la Corrupción* (Anti-Corruption Council).

16. **Political corruption seems to be the most prevalent type of corruption in Panama and, therefore, the primary target of an anti-corruption strategy.** In this light, the administration's focus on transparency seems to reflect the right assessment of the nature of corruption in Panama and of the ways to fight it. To advance the initiative on transparency, the authorities requested a fiscal module of the Report on Standards and Codes (ROSC),[14] looking at open budget processes and availability of information.

17. **However, the administration should not disregard the fight against other forms of corruption.** As the results of the survey suggest, corruption is widespread, and though it is perceived to be more serious among politicians and high-rank public officials, it also may affect the judiciary and the government bureaucracy. The Panamanian authorities could draw on cases of success like those of Botswana, Uganda, and Bangalore, India for the design of institutional reforms. From the surveys, one concludes that judicial reform appears to be critically important. Currently, a strategic plan for the judicial branch supported by the Inter-American Development Bank, USAID, and AECI, Spain's international cooperation agency is underway. Among other objectives, this strategic plan aims to strengthen the financial and budgetary autonomy of the judicial branch and to promote citizen participation, alternative dispute resolution, and communication.

18. **Institutional anchors may also be effective tools in the fight against corruption.** The most obvious of these institutional anchors is the prospective free-trade agreement between Panama and the United States. Such an agreement would signify a commitment device to institutional changes; that is, it would promote an institutional environment favorable to foreign investors, much in the same way as NAFTA worked for Mexico. Less discussed is the possibility of using a well-functioning public institution as an anchor. In the Panamanian case, an obvious candidate would be *Autoridad del Canal de Panamá* (Panama Canal Authority, PCA). For example, in the case of public procurement practices, the PCA

---

[14] A fiscal ROSC assesses whether countries observe the Code of Good Practices on Fiscal Transparency, which was approved by the Executive Board on March 23, 2001.

would be a useful example: it has an e-procurement website with online tenders, a bid calendar, and the names of successful bidders for contracts and those suspended or debarred from receiving contracts.

19. **The appointment of the Anti-Corruption Council makes a political statement, but does not by itself signal a radical change in the fight against corruption.**[15] It is premature to judge the effectiveness of the actions of the Anti-Corruption Council. However, this organ appears to lack the financial, operational, and political independence that would make it an effective institution in the fight against corruption (Box 2). Although it has the support of the President, the Anti-Corruption Council may need a strengthening of technical and human resources to carry out its activities effectively; otherwise, it may be overly dependent upon the goodwill of other public institutions to obtain the required specialized staff to conduct its investigations.

F. Conclusions

20. **Corruption is an impediment to growth.** Corruption deters investment, both foreign and domestic, and misallocates resources, both private and public, contributing to lower the growth rate of an economy. In Panama, corruption is perceived as being high and widespread. A substantial reduction in corruption has the potential to raise Panama's growth rate and would be crucial to the implementation of a growth strategy based on attracting foreign investment.

21. **The Torrijos administration has sent clear signals that it intends to move forward with its anti-corruption agenda.** The emphasis the administration gives to transparency appears appropriate in view of the type of corruption believed to prevail in Panama (political corruption). However, corruption is seen to be widespread in the Panamanian society and not only limited to political circles. Therefore, the administration should consider approaches that have proved successful in tackling other types of corruption (namely, bureaucratic and judicial) elsewhere. Emphasis on transparency is adequate but by itself it is not a panacea against all types of corruption.

22. **Therefore, a more integrated approach to the fight against corruption may be necessary.** The administration and, in particular, the Anti-Corruption Council, could benefit from technical assistance to assess corruption in Panama and to design appropriate strategies to combat it.

---

[15] It is worth noting that one of the first acts of the Moscoso administration also was to create an anti-corruption bureau (*Dirección Nacional contra la Corrupción*), without apparent positive results.

Box 1. Law on Transparency and its Regulatory Decree

On January 22, 2002, the official gazette published Law 6, establishing rules for the improvement of transparency in public management and granting individuals right of access to all information possessed by public institutions (except information classified as confidential or of limited access). Below follows a summary of some of its most important dispositions:

- (Article 2) Everyone has the right to request publicly available information without having to present justification or motivation for doing so.
- (Article 3) Everyone has the right to access personal information in the possession of public institutions and to correct or eliminate any material that is irrelevant, inaccurate, incomplete or outdated.
- (Article 4) Gaining access to information entails no cost except that of the reproduction. Public institutions will provide the technical means for reproduction.
- (Article 8) Public institutions have the obligation to provide information to anyone who requests it, except when information is confidential or of limited access.
- (Article 9) Public institutions must make publicly available (press and internet) information concerning its structure, procedures and the conduct of policies and activities.
- (Article 11) All interested persons have access to all information concerning public servants, officials and public office holders, and their activities (for example, hiring, appointment, travel costs, travel allowances, etc.), independently of the rank of the public servant, official or public office holder.
- (Articles 13 to 16) Chapter IV of the Law makes clear the conditions under which information can be classified as confidential or of limited access.
- (Articles 17 to 19) Chapter V of the Law describes the procedure of *habeas data*, the judicial process by which citizens can enforce their right to have access to publicly available information in the possession of public institutions.

The people and groups who supported this law saw in it the means for increasing transparency and accountability in the public service and, ultimately, an instrument in the fight against corruption.

On May 21, 2002, the official gazette published Executive Decree 124, which regulated Law 6, described above. The most polemic articles of the decree issued by President Mireya Moscoso's Administration were the following:

- (Article 8) For the effects of Article 11 of Law 6 of January 22, 2002, the interested person is the one who has direct relation to the information requested.
- (Article 10) The classification of information as being of limited access is determined by the public official responsible for the public institution or the public servant in whom she delegates this ability.

The people and institutions who opposed the decree saw in these two articles a violation of both the letter and the spirit of the initial law. Article 8 of the decree went forward to define who is an interested person (narrowing the scope of Article 2 of Law 6); Article 10 of the decree attributed a degree of discretion to the public servant not recognized in Law 6 (Articles 13–16). Overall, those opposing the decree saw it as an additional barrier to the free access to information and, therefore, as a setback in the fight against corruption.

On September 2, 2004, President Martín Torrijos voided Decree 124 of 2002.

Box 2. The Anti-Corruption Council

On October 28, 2004, the official gazette published Executive Decree 179, establishing the *Consejo Nacional de Transparencia contra la Corrupción* (Anti-Corruption Council). A summary of the main dispositions of the decree follows.

The Anti-Corruption Council is an advisory council that reports to the President without executive powers. The main objective of the council is to ensure a transparent and efficient public administration. The council consists of:

- the Minister of the Presidency;
- the Solicitor General (*Procurador General de la Nación)*;
- the Administrative Procurator (*Procuradora de la Administración*);
- the Comptroller General;
- the Ombudsperson (*Defensor del Pueblo*);
- and six representatives of different civil society organizations.

The Anti-Corruption Council should meet regularly, and its meetings are to be presided by the Minister of the Presidency and, in his absence, by the Executive Secretary of the Council. The Executive Secretary is nominated by the President. The Executive Secretary reports to the Minister of the Presidency and is responsible for the operational and administrative work of the council.

Among the functions of the Anti-Corruption Council, the following are the most relevant:

- to present legislative and administrative proposals to the President to fight corruption through a transparent public administration;
- to promote educational campaigns against corruption;
- to examine and to provide advice to public and private entities on practices that may contribute for corruption acts and on the means to prevent such acts;
- to receive reports and suggestions from citizens and civil society organizations, and to direct them to the entities involved; and
- to request to all public entities' reports on measures to fight corruption.

The Anti-Corruption Council is also responsible for the approval and dissemination of a Uniform Ethics Code for the Public Sector (already approved and published as Executive Decree 246 on December 15, 2004).

All officials in the Central Government and autonomous or semi-autonomous public institutions are obligate to cooperate with the Anti-Corruption Council whenever this council requires relevant information from them.

The most important functions of Executive Secretary are the following:

- to develop administrative investigations on facts that may constitute acts of corruption;
- to ask other public institutions for specialized staff whenever that is necessary for the success of an investigation; and
- to present formal complains to the responsible authorities whenever a corruption act is found.

The President is committed, through the Ministry of Economy and Finance, to ensuring that the financial resources required for the council's operations are provided in the annual budget of the Republic.

This decree voided Executive Decree 99 of September 13, 1999, which created the *Dirección Nacional contra la Corrupción* (National Bureau against Corruption) in the Ministry of Economy and Finance.

References

Berglöf, Erik, and Gérard Roland, 1997, "EU as an Outside 'Anchor' for Transition Reforms," SITE Working Paper No. 132, published in *A Bigger and Better Europe? — Final Report to the Swedish Government from the Committee on the Economic Effects of EU Enlargement* (Stockholm: Fritzes), pp. 77–94.

Gray, Cheryl W., and Daniel Kaufmann, 1998, "Corruption and Development," *Finance & Development*, Vol. 38 (March), pp. 7–10.

Hellman, Joel S., Geraint Jones, and Daniel Kaufmann, 2000, "Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition," World Bank Policy Research Working Paper No. 2444.

International Monetary Fund, 2003, *World Economic Outlook April 2003: A Survey by the Staff of the International Monetary Fund*, World Economic and Financial Surveys (Washington).

Kaufmann, Daniel, 1997, "Corruption: The Facts," *Foreign Policy*, No. 107 (Summer), pp.114–31.

______,1998, "Challenges in the Next Stage of Anti-Corruption," World Bank. Available via the Internet: http://info.worldbank.org/etools/docs/library/18117/challenges.pdf.

______, 2003, "Rethinking Governance: Empirical Lessons Challenge Orthodoxy," World Bank, Discussion Draft. Available via the Internet: http://www.worldbank.org/wbi/governance/pdf/rethink_gov_stanford.pdf.

______, Aart Kraay, and Pablo Zoido-Lobatón, 1999, "Governance Matters," World Bank Policy Research Working Paper No. 216.

Kaufmann, Daniel, Aart Kraay, and Massimo Mastruzzi, 2003, "Governance Matters III: Governance Indicators for 1996–2002," World Bank Policy Research Working Paper No. 3106. Data on Control of Corruption Index available via the Internet: http://www.worldbank.org/wbi/governance/govdata2002/.

Knack, Stephen, and Philip Keefer, 1995, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures," *Economics and Politics*, Vol. 7, No. 3, pp. 207–27.

Mauro, Paolo, 1995, "Corruption and Growth," *Quarterly Journal of Economics*, Vol. 110, No. 3, pp. 681–712.

______, 1998, "Corruption and the Composition of Government Expenditure," *Journal of Public Economics*, Vol. 69, No. 2, pp. 263–79.

Murphy, Kevin M., Andrei Shleifer, and Robert Vishny, 1991, "The Allocation of Talent: Implications for Growth," *Quarterly Journal of Economics*, Vol. 106, No. 2, pp. 503–30.

Smarzynska, Beata K., and Shang-Jin Wei, 2000, "Corruption and Composition of Foreign Direct Investment: Firm-Level Evidence," NBER Working Paper No. 7969.

Transparency International, 2004, *Global Corruption Report 2004* (Berlin). Data on Corruption Perception Index available via the Internet: http://www.transparency.org/pressreleases_archive/2004/2004.10.20.cpi.en.html.

United Nations Conference on Trade and Development, 2004, *World Investment Report 2004* (Geneva). Data on Inward Foreign Direct Investment Index available via the Internet: http://www.unctad.org/Templates/WebFlyer.asp?intItemID=2471&lang=1.

Whalley, John, 1998, "Why Do Countries Seek Regional Trade Agreements?" in *The Regionalization of the World Economy*, ed. by Jeffrey A. Frankel (Chicago: University of Chicago Press), pp. 63–89.

Wei, Shang-Jin, 2000, "How Taxing is Corruption on International Investors?" *Review of Economics and Statistics*, Vol. 82, No. 1, pp. 1–11.

World Bank, 2002, *World Development Report 2002* (Washington, D.C.).

World Economic Forum, 2004, *Global Competitiveness Report 2003–04* (Davos).

II. Redesigning Panama's Fiscal Responsibility Law[7]

A. Introduction

23. **Panama adopted a fiscal responsibility law (FRL) in 2002, which included limits on fiscal deficits and public debt, whose ultimate goal was to contain public debt over the medium term**. Its impact in 2003 and 2004 was disappointing. Public debt increased as a result of failure to contain fiscal deficits within the legal limit. The government that took office in September 2004 suspended the FRL until end-2005 while embarking on a medium-term fiscal consolidation that would bring the fiscal deficit targets of the FRL within reach. The new authorities found it unfeasible to meet the deficit limit in 2004 both under a comprehensive and a narrower definition of the nonfinancial public sector (NFPS; see below); they viewed a narrower NFPS coverage as appropriate for the purpose of the FRL, but deemed it still not feasible to meet the deficit ceiling under this definition; and there were ambiguities in monitoring compliance.

24. **This paper examines the main features of Panama's FRL and suggests areas for possible design improvements**. The main characteristics of Panama's FRL are described in section B. The fiscal rules embedded in the FRL are compared in Section C to the features of a "model fiscal rule" presented in the literature. This comparison shows that there is room for improvement in several areas, in particular by clarifying definitions and coverage, and establishing institutional procedures to increase transparency and social control. Section D presents some country experience with FRLs, and explores possible avenues for enhancing the chances of future success for Panama's FRLs by drawing on Brazil's and other countries' experiences. Conclusions are presented in section E.

B. Main Features of Panama's FRL

25. **The FRL approved by the National Assembly in May 2002 reflected agreements reached during a process of consultation with employers, unions and civil society in 2002** (the "National Dialogue") on : 1) the use of the assets of the Development Trust Fund (*Fondo Fiduciario,* constituted with the proceeds of privatization); and 2) public debt policy. Chapter 2 of the law (Economic Recovery and Fiscal Responsibility Law, or "Law 20") contained provisions aimed at reducing public debt levels over the medium term, including a limit on the deficit of the NFPS. Under its Article 11, items 1 and 2, public sector net debt was targeted to decline to 50 percent of GDP over 15 years; in addition, the fiscal deficit was capped at 2 percent of nominal GDP in any given year. Until the targeted debt reduction was achieved, a transitory regime of authorized borrowing would apply (item 3). If the annual growth of real GDP was above 1½ percent, gross debt could not grow in absolute amounts by more than the minimum resulting from two alternative formulas: a) applying to the gross debt stock a percentage increase equal to 80 percent of the nominal GDP growth

[7] Prepared by Eric Verreydt (WHD).

rate; or b) calculating an absolute amount equal to 2 percent of GDP (the deficit limit). If the growth rate of real GDP was less than 1½ percent, there was no explicit debt limit, but the overarching 2 percent ceiling on the deficit applied. For purposes of the law, nominal GDP of a given year was supposed to be calculated on the basis of the 12 months ended June of that year. Owing to data limitations, in practice GDP on a calendar year basis was used, which left unresolved the question of how to monitor compliance before year's end.

26. **Using historical GDP growth averages, the FRL rules implied a declining net debt-to-GDP ratio over the medium term**. Net debt targeted by the FRL was defined as gross debt minus the assets of the Trust Fund and Brady bond collateral. At the time Law 20 was passed, net debt amounted to approximately 70 percent of GDP at end-2001; thus, Law 20 targeted a decline in net debt by about 20 percentage points. A large upward revision in the GDP series implemented during 2002 resulted in a marked lowering of debt-to-GDP ratios. Net debt was reestimated at about 58 percent of GDP in 2002 (69 percent for total gross debt minus 11 percent of GDP in assets). As it turned out, the FRL was ineffective in preventing fiscal slippage. The deficit of the NFPS on a cash basis reached 3.8 percent of GDP in 2003 and an estimated 3.3 percent in 2004; net debt increased to 61 percent of GDP at end-2004. The deviation from the annual debt ceiling was particularly large in 2004, owing in part to the prefinancing in November 2004 of the projected deficit for 2005. The prefinancing, though a sensible strategy given market conditions, would have been precluded, had the FRL not been suspended, showing a limitation to the original design of the FRL.

Ceilings under the Fiscal Responsibility Law, 2002–04

	2002	2003	Est. 2004 1/
(In percent of GDP)			
Nonfinancial public sector deficit			
Ceiling	2.0	2.0	2.0
Actual	2.7	3.8	3.3
(In millions of U.S. dollars)			
Increase in total public debt, gross 2/			
Ceiling 3/	260	324	502
Ceiling 4/	245	257	276
Actual	120	140	1,208
Memorandum items:			
(In percent)			
GDP growth			
Real	2.2	4.3	6.0
Nominal	3.9	4.8	7.2
(In percent of GDP)			
Total public debt, gross	69.4	67.3	71.6
Net public debt 5/	58.3	55.6	60.9

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates and projections.

1/ The ceilings for 2004 are notional, since the law was suspended in the last quarter of 2004.
2/ Change in external and domestic debt. The gross debt is not consolidated, as it includes central government debt held by the social security agency.
3/ Constraint 1: If real GDP growth is higher than 1.5 percent, the percentage growth in total public debt should not exceed 80 percent of the growth in nominal GDP.
4/ Constraint 2: If real GDP growth is higher than 1.5 percent, the dollar increase in total public debt should not exceed 2 percent of GDP.
5/ Total public debt (gross) minus Fiduciary Fund assets and collateral for public debt (Brady bonds). Does not take into account government deposits.

C. How Well Does the Design of Panama's FRL Measure up to an "Ideal" Rule ?

27. The characteristics listed below have been identified in the literature as the main features of the design of a model fiscal policy rule.[8]

- **A model fiscal rule should be *well defined* as to the institutional coverage and the indicator to be constrained**. Panama's FRL lacked clarity in these respects. The FRL

[8] See "Fiscal Policy Rules," by George Kopits and Steven Symansky, IMF Occasional Paper No. 162, 1998.

was not explicit about the coverage of the public sector, in particular leaving it open whether the Panama Canal Authority (PCA) should be included or not. Although the PCA is a state-owned enterprise, it is autonomous, and its budget is not part of the public sector budget that is approved by the National Assembly. The deficit ceiling was interpreted under the previous government as including the PCA's large surpluses, which lowered the monitored fiscal deficit.[9] The new authorities were of the opposite view, because by the Constitution the PCA has the right to manage its assets, and does not finance the central government deficit. They decided to exclude the PCA from the fiscal accounts monitored for policy purposes (see the related discussion of adequacy below). There was also a lack of clarity regarding the relevant fiscal indicator. Most fiscal accounts in Panama are on a cash basis, and the FRL did not explicitly specify whether the 2 percent deficit ceiling applied to the balance measured on a cash or accrual basis. A cash-based ceiling would provide an unwelcome incentive to build up arrears. A working group set up at the *Contraloria* to work out the practical details of implementing the FRL ruled in 2003 that an approximation to the accrual deficit was the appropriate benchmark, but this interpretation did not have a clear legal status.

- **The literature stresses the importance of an *effective link* between the fiscal rule and its proximate goal**. The objective of Panama's FRL was to reduce the public debt burden to a sustainable level. This would call in principle for imposing a constraint on the budget balance as a whole for the widest definition of the public sector. While the PCA's surpluses have not financed central government deficits, looking forward, the prospective widening of the Panama Canal (at an estimated cost of 30–35 percent of GDP) would put the PCA in large deficits for a number of years. The substantial borrowing involved would increase fiscal vulnerability, through a possible government guarantee or a reduction in the payment of dividends to the government under a hypothetical worst-case scenario. This raises the issue of the appropriate treatment of the PCA in a revised FRL.[10] The adequacy of the debt ceiling under the suspended FRL is also open to discussion, as the target under the suspended FRL (50 percent) may leave the country too vulnerable to shocks.[11]

- **A fiscal rule should be supported by *transparency* in government operations, including fiscal accounts**. This calls for enhanced clarity in the reporting of Panama's fiscal position and better accounting and statistical standards. Panama's FRL did not spell out the starting year of application, although the authorities noted in their economic report on 2002 (page 21) that the deficit for 2002 was within the limit set under Law 20. In 2003, the first full year of applicability of the FRL, the need for improvement in fiscal transparency was illustrated by the opaque discussion of the fiscal outcome. Data

---

[9] See " *Informe Economico Anual 2002*", Ministry of Economy and Finance, pp. 21–22.

[10] See Chapter IV for a discussion of this issue.

[11] As indicated above, the FRL under Law 20 targeted a debt reduction of about 20 percentage points between 2002 and 2017, which, using the revised GDP series, would implicitly lead to a debt ratio below 40 percent of GDP.

published by the authorities showed a fiscal deficit of 1.9 percent of GDP on an estimated accrual basis, below the legal limit. However, based on revised and more complete data, the deficit appeared later to have been closer to 3 percent of GDP (about 4 percent, excluding the PCA), well above limit. Owing in part to limitations in the coverage of the budget expenditure system (SIAFPA), there was no established methodology to estimate the deficit of the NFPS on an accrual basis; and the claim that the deficit was below limit was based on provisional data.

- **A model fiscal rule should be *enforceable***. The FRL seems not to have been complied with in 2003, but there are no consequences of noncompliance in Panama's FRL, as no sanctions are mentioned, whether financial or judicial, nor any corrective mechanisms triggered.

- **A fiscal rule should be *consistent* internally and with other macroeconomic policies**. In particular, Panama's full dollarization and the absence of a lender of last resort impose a de facto limitation of prudent domestic bank financing of the fiscal deficit to maintain adequate liquidity. The experience in 2004 seems to indicate that, although the deficit ceiling was breached, a loophole allowed the authorities to bypass the legal limit on borrowing. As bond issuance planned under the budget assumed the 2 percent deficit ceiling would be respected, there was an increased use of short-term bank credit lines from the Panama National Bank (BNP) to finance the deficit as it evolved, which led to a sharp decline in BNP's net foreign assets. This credit line was subsequently transformed to a long-term loan, which, by reducing BNP's liquidity and capacity to cushion shocks, was inconsistent with prudent macroprudential management.

- **A fiscal rule should be *simple and easy to understand***, so that it will be accepted by the public and will be effective for communicating the government's fiscal policy intentions. Although the medium-term debt objective may be relatively easy to communicate, the annual debt and deficit limits. with references to the growth of both nominal and real GDP, appear complicated.

- **A fiscal rule should allow for *flexibility* to accommodate exogenous shocks**. Although falling short of introducing a cyclically adjusted balance concept, Panama's FRL sought to address this concern to a modest extent by allowing a relaxation of the debt growth ceiling in periods of slow growth. Alternative ways to allow for flexibility would be to create room for maneuver by targeting a deficit below the legal ceiling when fiscal stimulus is not needed; or allowing by some mechanism a "rainy day reserve" to be built up during an upswing, to be spent to smooth public spending during a slump, subject to well-designed rules governing savings and withdrawals. However, providing for flexibility runs the risk of foregoing simplicity, and applying fiscal rules that are not readily understood and accepted. Moreover, there is also a risk that flexibility could be excessive and undermine the FRL's effectiveness. Since this risk may be higher during the run-up to elections, Panama's FRL would need to contain provisions for the conduct of fiscal policy during the political transition, such as quarterly ceilings.[12]

D. Lessons from Other Emerging Market Countries

28. **Over the last few years, FRLs have been introduced in a number of emerging market economies**, including in Latin America (notably Argentina, Brazil, Ecuador, Peru) and also in Turkey, the European Union, and other countries. The aim was to provide for a comprehensive legal framework and institutional arrangements to improve fiscal policy outcomes. Assessments of experience with FRLs in emerging market economies are generally inconclusive, with Brazil's FRL considered the only clear-cut success story in the Western Hemisphere. The mixed experience appears to indicate that policy rules by themselves do not automatically bring about fiscal sustainability and macroeconomic stability. Political economy considerations are deemed to play a crucial role in the chances of success of FRLs, which need to be understood and supported by the public and policy-makers.

29. **While FRLs have in common that they seek to limit discretion in the conduct of fiscal policy, cross-country comparisons show that there are wide variations in fiscal rules embedded in FRLs**. These variations are welcome to the extent that the design of FRLs is tailored to country-specific characteristics, including the extent of decentralization. FRLs differ in scope, content and operational modalities across countries. They put numerical limits on fiscal deficits, public debt or borrowing, with targets defined mainly for the central government (as in Ecuador) or a larger definition of the public sector (as in Argentina, Brazil and Peru). Some FRLs are enshrined in the Constitution, provide for institutional mechanisms of budget execution and reporting, contain escape clauses for exceptional circumstances, and provide for sanctions for noncompliance. Panama's FRL was a lower-level legislation, relied exclusively on numerical rules, making no procedural provisions, nor providing for escape clauses or sanctions.

30. **Assessments of FRLs conducted at the IMF, and in a recent series of essays that analyze various aspects of the experience with FRLs in emerging markets,[13] contain lessons which could be useful in redesigning Panama's FRL**.

- **Social agreement**. Fiscal rules in emerging market economies need the support of the public to be effective.[14] Brazil's experience illustrates this principle, where the effectiveness of the FRL was enhanced because the fiscal law formalized practices that

[12] Parliamentary and presidential elections are held around mid-year and the incumbent administration assumes office in September, leaving little time to take corrective measures, if needed.

[13] "Rules-Based Fiscal Policy in Emerging Markets: Background, Analysis and Prospects," edited by George Kopits, 2004.

[14] In his opening remarks on a review of the book cited in the preceding footnote, Deputy Managing Director Carstens observed that, "*Fiscal rules can be thought of as a social agreement that fiscal discipline is a critical element of a country's good governance*."

had already been tested and well understood for some time. As noted earlier, Panama's FRL reflected agreements reached during a process of consultation. However, broad social support would require that the definition of the deficit and the coverage of the public sector subject to legal limits, and their rationale should be spelled out in the law in order to avoid ambiguities.

- **Credibility**. Fiscal rules may be strengthened by structural reforms. In Panama's context, this would include fiscal and social security reform to underpin the fiscal targets, and good governance to promote transparency and accountability. Moreover, the experience of other countries seems to show that FRLs should not be introduced during periods when countries have to implement a strong initial fiscal consolidation, when the risk of failure is larger.[15] The Panamanian authorities have decided to take the time to build the political consensus to implement needed structural reforms, in particular the politically sensitive social security reform, before the FRL would be reinstated in modified form by end-2005. The credibility of this strategy would depend on the implementation of a fiscal reform adopted in early 2005 and a reform of social security during 2005.

- **Numerical rules and procedures**. The experience with FRLs seems to indicate that numerical rules work better when supplemented with procedural rules that foster transparency and accountability. Brazil's FRL successfully combined numerical indicators and institutional procedures. It established annual and intra-annual targets for key fiscal variables, with reviews every two months to assess developments. By law, every four months the finance minister must testify before Congress whether the budget is in line with the targets. Moreover, to protect the budget against rent-seeking, a specific law is required for every new tax expenditure, which together with stringent requirements on the publication of fiscal data, contributes to fiscal transparency. A reformed FRL for Panama could consider similar procedural provisions.

- **Pragmatic practices.** Introducing changes to the FRL should be made difficult, to enhance the credibility of the law. In some countries this may call for embedding fiscal rules in the Constitution. However, whatever the legal status of the FRL, pragmatic fiscal practices may be very effective if the spirit of the law is accepted by the public, with buy-in from the policy makers.[16] The principle of simplicity seems to rule out deficit limits based on a cyclically adjusted balance; moreover, economic conditions are often volatile and measurement of potential output may be unreliable. A revised FRL for Panama should seek some simpler mechanism for increasing the primary surplus during an economic upswing, and allowing room for automatic stabilizers in a downturn.

- **Public expenditure management systems**. They should be sufficiently advanced to help implement the rules. It would be important for Panama to improve the coverage of the

---

[15] For example, Argentina adopted a FRL in 1999, when the economy was in recession and fiscal policy had been loosened in the run up to elections.

[16] In Brazil's case, fiscal adjustment efforts were under way when the FRL was adopted in May 2000, and there was a consensus on the need for further fiscal consolidation.

SIAFPA to overcome present fiscal data limitations, allow policymakers to have comprehensive and timely information on fiscal developments, and facilitate a quick response to slippages. Also, there is a need to implement a migration to the 2001 GFS methodology to allow a reliable monitoring of the deficit on an accrual basis.

- **Sanctions.** Institutional sanctions, for example, suspension of eligibility for elected office, rather than judicial penalties are deemed the most effective ways of ensuring accountability, as they appear easier to enforce.[17]

E. Conclusions

31. **The 2002 FRL has been ineffective in preventing fiscal slippage, and thus the new government suspended the law's application until end-2005 and will proceed to revise it**. While this strategy appropriately allows time to implement a strong initial fiscal consolidation, the credibility of a revised FRL will depend on the implementation of fiscal and social security reform starting in 2005. The medium-term fiscal targets to be set by the revised FRL should be ambitious enough to markedly reduce fiscal vulnerability, and they should be explained to the public to gain wide acceptance. The design of the revised FRL should avoid ambiguities and be widely understood. In this regard, country experience with FRLs and a review of the desired features highlight the need to clarify the targeted measure of the deficit and the coverage of the public sector; establish institutional procedures to increase transparency and accountability; and improve the financial information management system with the aim of eventually adopting the 2001 GFS methodology for accrual-based fiscal accounting.

[17] In Latin America, Brazil's and Ecuador's FRLs provide for penal sanctions against public officials, but the lack of automaticity of penal sanctions may undermine their potential effectiveness.

III. Tax Policy and Performance[18]

A. Introduction

32. **Panama's tax-to-GDP ratio declined between the early 1990s and 2003–04, from close to 11 percent to less than 9 percent, reflecting low and declining buoyancy of the tax system.** As a result, central government revenue also weakened relative to GDP, contributing to a deterioration in the fiscal balance since 2001. A tax reform adopted in December 2002 allowed for a combination of tax reductions and increases, whose net revenue yield was insufficient to bring the fiscal deficit onto a declining path. As the need for a fiscal reform aimed at restoring sound public finances became pressing, the authorities adopted a further tax reform in February 2005 as part of a medium-term fiscal reform that also included expenditure measures.

33. **This chapter analyzes the agenda for tax reform based on past performance, seeks to assess the extent to which the 2005 tax reform meets this agenda, and discusses possible needs for further strengthening.** Taxation in Panama is characterized by a low tax-to-GDP ratio—the lowest in Central America—and a lack of buoyancy. A significant part of the revenue needs are met by nontax revenues, which have risen to over 40 percent of central government revenue, mainly as new sources of nontax revenue have emerged[19] (Figure 1). At the same time, there remains scope for an increase in tax effort, which could be used to meet needs for social spending and investment in infrastructure, or to reduce the fiscal deficit. In this chapter, an analysis of the tax structure and tax performance before the 2005 reform will shed light on weaknesses to be addressed. The 2005 tax reform will be assessed in terms of its capacity to raise the level of tax revenue relative to GDP; increase the system's buoyancy and elasticity; strengthen tax collection efficiency; improve the tax structure; and enhance its equity. Areas for a possible further strengthening to achieve fiscal targets will then be discussed.

B. Recent Evolution of the Tax Structure

34. **The 2002 tax reform reduced the share of personal income tax in total tax revenue, while raising the share of sales taxes (Figure 2 and Table 1).** Between 1997–99 and 2000–02, personal income taxes rose by 5 percentage points, to reach 27 percent of total tax revenue, while taxes on businesses declined by 2 points, to 17 percent. Reform plans drawn up in the late 1990s reflected the view that personal income was excessively taxed, in particular low incomes; and that the base of domestic taxes on goods and services was too narrow. A 5-point drop in the share of personal income tax

[18] Prepared by Eric Verreydt (WHD).

[19] In particular, dividends from the Panama Canal Authority and from the government-owned National Bank.

in 2003–04 reflected tax cuts under the 2002 tax reform. The latter provided for increased collections of the ITBMS,[20] whose share rose by 4 points.

35. **The share of sales taxes remains below the Central American average (Figure 3)**. Domestic taxes on goods and services (ITBMS, selective consumption tax, excises) were well below the average of other Central American countries, even after the 2002 reform, reflecting in part the low rate of the ITBMS (5 percent general rate, 15 percent for tobacco). By contrast, Panama is more dependent on import duties than its Central American neighbors, reflecting in part trade liberalization in Central America.

C. Evolution of the Tax Effort

36. **Owing to a lack of tax buoyancy for many years, the tax-to-GDP ratio went down between the early 1990s and 2003–04 (Figure 4 and Table 2).** This decline was temporarily offset by rising nontax revenue in 1999–2000, but with the fiscal deficit deepening since 2001, there was an increased need to enhance the buoyancy of the tax system and sustain revenue growth.

37. **Almost all categories of tax revenues in relation to GDP have declined over time (Table 3).** Until the 2002 reform, the corporate income tax, import duties[21] and domestic taxes on goods and services, including ITBMS, weakened relative to GDP. However, taxes on personal income and on wealth were relatively stable. Owing to efforts to widen the tax base in the framework of the 2002 tax reform, revenue from the ITBMS and the wealth tax strengthened in 2000–04. As a result of the reform there was a marked decline in the ratio of personal income tax to GDP in 2003–04.

38. **Panama is a low-tax country in Central and Latin America (Figure 5 and Table 4).** Panama's tax–to-GDP ratio ranks among the lowest in Latin America. In 2000–03, this ratio was the lowest in the Central American region, well below Honduras's and close to Guatemala's. Panama's decline in the tax-to-GDP ratio since the early 1990s stands in contrast with developments in the rest of Central America, where tax ratios have risen.

---

[20] The ITBMS (*Impuesto a la Transferencia de Bienes Muebles y Prestaciones de Servicios)* is a value-added tax.

[21] A reduction in exemptions contributed to a temporary improvement in collections of import duties in 1998 (see paragraph 9 and Figure 7).

D. Tax Buoyancy Analysis

39. **Tax buoyancy appears to have declined during the period 1994–2004 (Figure 6).**[22] Tax buoyancy has fluctuated with the growth cycle, sometimes with a lag, but over the period as a whole it appears to have trended downward. It peaked above unity in 1995 and 1999, owing mainly to strong collections of direct taxes; and in 2003, reflecting enhanced revenue from ITBMS. Buoyancy reached a trough in 1996 and 2000–01, following marked decelerations in GDP growth. The lack of buoyancy reflected in part the low elasticity of the tax system,[23] owing to loopholes in tax legislation and regulations, special tax regimes,[24] tax evasion, and deficiencies in tax administration, which shielded fast growing sectors from taxes.[25] Moreover, tax policy changes during the 1990s to simplify the tax system may have contributed to the decline in tax buoyancy, including several tax-reducing measures, some of which were taken in the context of the WTO accession. (Box 1).

---

[22] Buoyancy is defined as the ratio of the annual growth rate of tax revenue to the annual growth rate of nominal GDP. A value greater (smaller) than unity implies rising (declining) tax-to-GDP ratio. Disaggregated estimations were carried out of the buoyancy of direct taxes, indirect taxes, the ITBMS, and import duties, based on measures of their respective tax bases. They support the same conclusions as the aggregate analysis.

[23] Tax elasticity measures the buoyancy of the tax system with unchanged tax laws and regulations.

[24] In particular for businesses set up in free trade zones, and income of foreign origin, which are exempt from income tax.

[25] For example, the Colon Free Zone.

Box 1. Tax Policy Changes in the 1990s

The main tax policy changes implemented during the second half of the 1990s included :

- June 1995—Approval of the Tax Incentives Harmonization Law, which phased out or scaled back tax breaks and subsidies; decreased the maximum corporate income tax from 34 percent to 30 percent; increased the income tax for exporters in the Colon Free Zone from 2.5–8.5 percent to 15 percent; generalized a tax credit of up to 25 percent of income tax liabilities for investment in modernization or expansion of production until 2000; extended to the whole manufacturing sector a preferential import tariff of 3 percent on raw materials; and reduced home mortgage subsidies through better targeting to low income beneficiaries.

- January 1996—Phased elimination of the banana export tax by January 1, 1999.

- September 1996—Elimination of the income tax for exporters in the Colon Free Zone.

- July 1997—Reduction in import tariffs for nonagricultural products from 0–90 percent to 0–40 percent in the context of WTO accession. Reduction of import tariffs on certain construction materials and basic foods from a range of 27–40 percent to 10 percent.

- January 1998—Elimination of certain tax deductions for investment in tourism.

- January 1998. Reduction of maximum import tariffs from a range of 40–60 percent to 15 percent, except on rice, lactose, automobiles, and sugar.

40. **Tax exemptions are significant but their cost appears to have been fairly stable in recent years (Figures 7 and 8)**. Exemptions, in particular from custom duties, corporate income tax, real estate tax, and ITBMS have been granted under a variety of incentive schemes and modalities.[26] Their fiscal cost through forgone revenue has been relatively stable in recent years as a percentage of GDP or the specific tax base.[27] An elimination of tax exemptions has the potential to increase tax collections by at least 1 percent of GDP, assuming the elimination of the various incentive schemes.[28] However,

[26] These include incentives to nontraditional exports, small businesses, residential construction, tourism, petroleum products trade, agroindustry, reforestation, foreign direct investment, exports, leasing, Panama’s historic district rehabilitation, public transportation, and several other sectors. Some exemptions are granted in the form of tax certificates, in particular industrial export incentives (Certificados de Abono Tributario, or CATs).

[27] Table 5 gives a breakdown of exemptions from import duties.

[28] CATs are scheduled to expire by end-2005.

notional tax buoyancy, adjusted for tax exemptions and deductions, was less than unity on average in the last decade. This seems to indicate that eliminating tax exemptions may not by itself lead to a permanent increase in tax buoyancy; it may be necessary to widen the tax base to include sectors under special tax regimes.

E. The 2002 Tax Reform

41. **The Interamerican Center of Tax Administration (CIAT) made proposals in 1999 to simplify Panama's tax system.** Simplification of the tax structure was recommended to increase efficiency in tax administration, strengthen tax collections and reduce tax evasion. Regarding direct taxes, a key proposal was to limit tax incentives and other exemptions on corporate income, while decreasing personal income taxation. On indirect taxes, the report recognized that the rate of the ITBM (5 percent) was the lowest VAT-type rate in Latin America. However, since raising the rate was deemed politically difficult, it recommended widening the base to include selected services (Box 2).

Box 2. Recent Changes in Panama's Value-Added Tax

The *Impuesto a la Transferencia de Bienes Corporales, Muebles con Credito Fiscal (ITBM)* was a value-added-type tax levied on imports of goods and domestic sales of goods and a few services. The rate of ITBM was 5 percent, the lowest VAT rate in Latin America. The taxpayer could deduct the ITBM paid on inputs, including investment goods, from the tax liable on sales. Small businesses were exempt from the ITBM, and a large number of goods were exempted, including food, medicines, specified fuels, specified agricultural raw materials, and processed agricultural and fishing products.

Owing to the ITBM's low rate and narrow base, this tax accounted for only 14 percent of tax revenue in 2000–02, of which 8 percentage points was on imports and 6 percentage points was on domestic sales. This represented only 1.3 percent of GDP, well below comparable ratios elsewhere. Moreover, tax evasion was estimated to be high, representing 40 percent of collected ITBMS on domestic sales, or 0.3 percent of GDP, according to the CIAT report.

The 2002 tax reform (Law 61 of December 26, 2002) broadened the ITBM to services (Box 3). The ITBM was accordingly renamed *Impuesto a la Transferencia de Bienes Muebles y Prestaciones de Servicios (ITBMS).* The 2005 tax reform extended the exemptions from ITBMS to fast-food businesses, a social measure targeting low-income households, and otherwise did not modify it.

Following the introduction of the ITBMS, revenue from this tax rose to 18 percent of tax revenue in 2003-04, or 1.6 percent of GDP, with most of the increase related to domestic sales. Further increases in the yield of ITBMS would require narrowing the scope of exemptions, improving tax administration to reduce evasion, and possibly raising the rate.

42. **The 2002 tax reform included some of the measures proposed in the CIAT report, with a positive impact on collections (Box 3 and Table 6).** Tax policy changes

allowed for a combination of tax reductions and increases with a net revenue yield estimated at 0.3 percent of GDP in 2003 and subsequent years. Regarding direct taxes, the annual exemption under the personal income tax was raised, which led to an estimated revenue loss of 0.4 percent of GDP. This was offset by other direct tax measures, which affected mostly businesses, including the introduction of a minimum tax on banks. On indirect taxes, the widening of the ITBM base to include selected services, and taxes on a broader array of luxury goods, increased revenue by 0.3 percent of GDP. There was also some effort to improve tax administration and grant the tax directorate more autonomy. However, little was done to reduce exemptions. Moreover, the Industrial Incentive Act (Law 11/2004) adopted in February 2004 granted new tax incentives to industry while temporary incentives to construction were introduced in 2003, and extended through 2005.

Box 3. The 2002 Tax Reform

The main components of the December 2002 tax law were:

- The annual exemption under the personal income tax was raised from US$3,900 to US$10,400.
- Banks' income, previously largely exempt, became subject to a minimum tax.
- The annual business registration fee (*Tasa Unica*) was raised from $150 to $250.
- The business license fee was raised from 1 percent to 2 percent of capital.
- Some fiscal incentives, authorizing deductions to corporate income tax, were to be phased out over five years.
- The corporate income tax rate was scheduled to be lowered from 30 percent to 29 percent in 2005, and 28 percent starting in 2007.
- The ITBM (renamed ITBMS) base was widened to include services, albeit with many exceptions (health, education, transportation, electric power, fixed telephone, press, mail, insurance, and various other services). Small businesses are exempted (annual sales less than $36,000).
- The 5-percent consumption tax levied on a selective basis was extended to include luxury goods.
- Tax exemptions for the housing sector were modified for better targeting to low-income housing.
- A law to reform the revenue directorate to give it more operational autonomy was approved in 2002, supported by regional technical assistance to improve tax administration.

43. **The 2002 reform appears to have done little to increase the elasticity of tax revenue**. After adjusting tax revenue for the effects of the 2002 tax policy change, tax

elasticity in 2003-04, at 0.85, was below unity, notwithstanding the strong economic recovery. This indicates that the existing tax system was structurally not able to ensure tax collections in proportion to the growth of the economy.

A. The 2005 Tax Reform[29]

44. In February 2005, the National Assembly approved a reform plan to address the tax system's weaknesses (Box 4). Tax policy changes were a major component of the medium-term fiscal adjustment program, which also included cuts in current expenditure. Increasing the yield and buoyancy of the tax system through equity-enhancing tax policies was a major objective of reform. Moreover, the reform sought to raise the tax system's elasticity to sustain permanent revenue performance; and improve its efficiency. To reduce tax evasion, all businesses beyond a certain size were included in the tax net, through an alternative minimum income tax, starting in 2006, amounting to 1.4 percent of sales. Taxable income of wage-earners was broadened to include representation expenses, and a minimum income tax of 10 percent was imposed on nonwage earners above a certain threshold. Moreover, to involve Colon Free Zone businesses in the fiscal effort, the cost of public services provided to businesses in the Zone was raised and indexed to the level of activity in the Zone. The ITBMS was maintained at 5 percent with some exceptions, including an exemption for fast-food businesses that was granted for social reasons. Some tax incentives were repealed or gradually phased out, the expiration of CATs by end-2005 was confirmed, and the Industrial Incentive Act (which had not yet taken effect) was abrogated. Sanctions for noncompliance with the tax law were increased. Low-yielding taxes were eliminated.

[29] A summary of the tax system prior to the adoption of the 2005 reform is presented in the 2003 Selected Issues and Statistical Appendix (March 4, 2004).

Box 4. The 2005 Tax Reform

The fiscal reform package adopted in early February 2005 aims at reaching a sustainable fiscal position through a reduction in the fiscal deficit, to 1 percent of GDP in 2007 or an adjustment of about 4 percentage points of GDP in three years. This adjustment would be achieved through cuts in current outlays, especially the wage bill, while raising spending efficiency, and through increased revenues from tax policy changes that target improved buoyancy and enhanced equity.

Main Tax Policy Measures

- The corporate income tax rate is maintained at 30 percent in 2005 (against a scheduled lowering to 29 percent under the 2002 tax law).
- The maximum income tax rate for individuals is reduced from 30 percent to 27 percent.
- Effective 2006, introduction of a minimum tax on income, amounting to 6 percent of gross income for individuals earning at least $60,000 annually. Individuals earning solely wages are exempt from this tax.
- Effective 2006, limits on deductions for businesses result in a minimum income tax of 1.4 percent of sales. Loss-making businesses can appeal to the Tax Directorate for exemption from these limits on deductions.
- Sales of services to businesses in the Colon Free Zone are liable to income tax.
- Increase in the annual business registration fee (*Tasa Unica*) from US$250 to US$300.
- Amounts in excess of $300 won in casinos are subject to a Selective Consumption Tax of 5 percent.
- Inclusion of representation expenses in taxable income.
- Narrowing of the definition of tax exempt income of foreign origin.
- Reduced property transfer tax schedule combined with an incentive to update assessed values.
- Exemption of VAT (ITBMS) for fast-food businesses; increase in ITBMS rate on tobacco to 15 percent.

Other Measures

- Increase in fees paid by businesses in the Colon Free Zone, by an additional US$30 million in 2005.
- Cancellation of the 2004 Industrial Development and Incentive Act (*Ley 11 de 2004*).
- Elimination of reforestation tax incentives starting in 2005.
- Tax incentives to nontraditional exports (CATs) would be eliminated by end-2005.
- Continued tax incentives for home improvement.
- Heavier sanctions for noncompliance with tax laws.
- Businesses will have to adopt international accounting and auditing standards.

45. **The 2005 tax reform is an important step toward a more buoyant, elastic, and equitable system.** Tax policy changes incorporated in the 2005 fiscal reform are projected to yield about 1–1.2 percent of GDP in extra revenue; projected expenditure savings are in the range of 0.8-1.0 percent of GDP. There would be some limited increase in tax collection during 2005, mainly as taxes on representation expenses would start to be withheld, and fees for services to corporations in the Colon Free Zone would be raised. The majority of extra revenue would come on stream during 2006, with the introduction of the minimum tax, in particular on businesses (projected at 0.8 percent of GDP), and the reduction in tax exemptions. In addition to raising the tax-to-GDP ratio, the broadening of the tax base resulting from these measures would increase the elasticity

of the tax system while enhancing its equity, as some categories of income and sectors previously outside the tax net or exempted would be liable to taxation. Also, the elimination of low-yielding taxes would increase the system's efficiency.

G. The Remaining Agenda

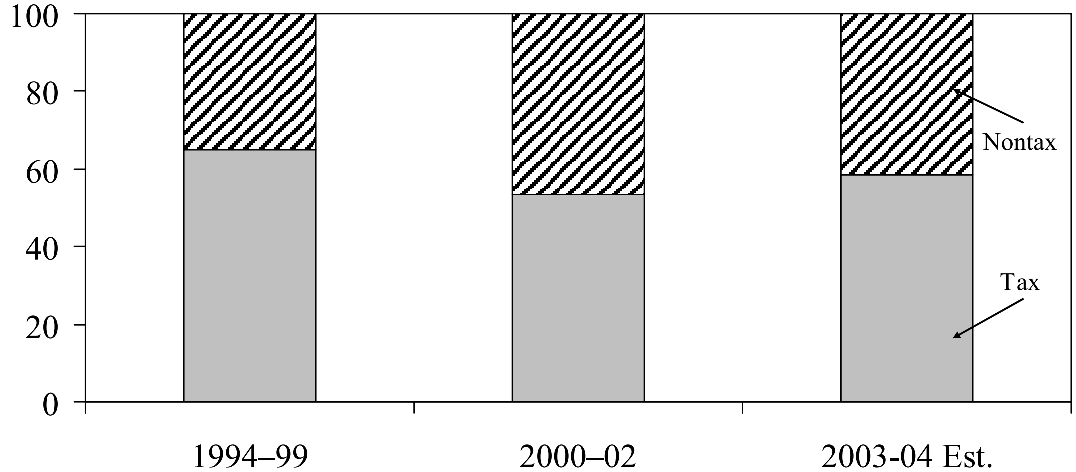
46. **The need for additional tax policy measures to achieve the government's medium-term fiscal targets could be assessed after experience has been gained in implementing the 2005 reform.** Looking forward, the contribution of tax reform to fiscal adjustment may need to be strengthened through additional action in several areas.

- **Tax pressure.** Taking into account the increased revenue from the 2005 tax reform, the tax-to-GDP ratio, at a projected 9½ percent of GDP by 2006, would still be below the levels achieved in the 1990s and low compared with neighboring countries.
- **Tax structure.** The prospective free trade agreement with the United States would result in a significant loss of import duties, likely to be incurred early on in the liberalization process.[30] This would -call for compensatory tax policy measures beyond the 2005 tax reform, possibly in the area of indirect taxation since the share of domestic taxes on goods and services is markedly lower than in Central America.
- **Tax administration.** Assessments of governance indicate that there is scope to reduce tax evasion and improve tax administration.[31] The 2005 tax reform raised sanctions to taxpayers for noncompliance, a step in the right direction, which should be supplemented by a strengthening of the institutional capacity of the tax directorate, including through stepped-up training of staff and possibly the hiring of additional tax officers.

[30] See Chapter VI.

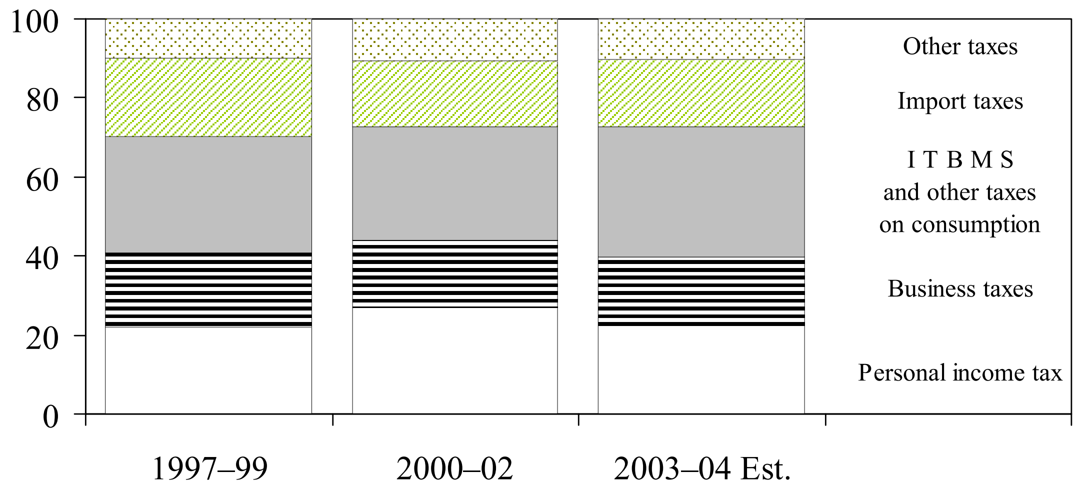
[31] See Chapter I.

Figure 1. Composition of Current Revenue, 1994–2004
(In percent of total revenue)



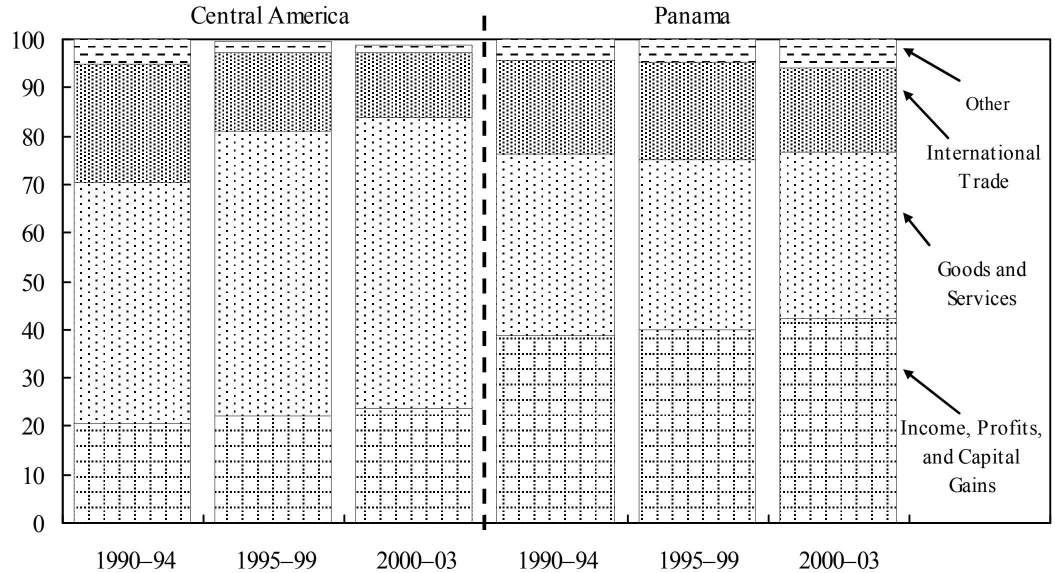
Sources: Ministry of Economy and Finance; and Fund staff estimates.

Figure 2. Composition of Tax Revenue, 1997–2004
(In percent of total tax revenue)



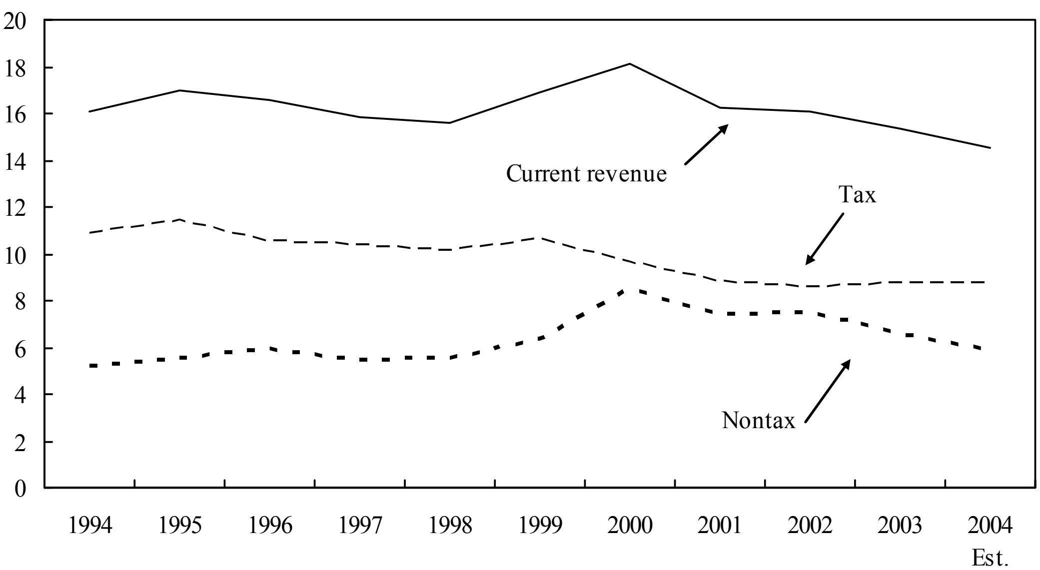
Sources: Ministry of Economy and Finance; and Fund staff estimates.

Figure 3. Tax Structure in Central America
(In percent of tax revenues)



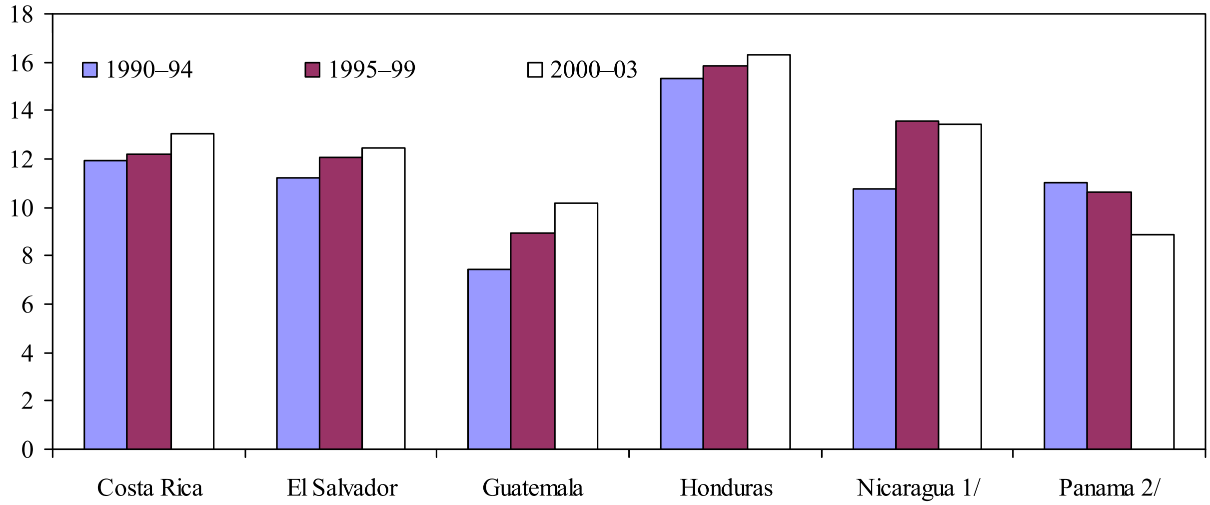
Sources: IMF, Government Finance Statistics 2004; and IMF, International Finance Statistics.

Figure 4. Tax and Nontax Revenue, 1994–2004
(In percent of GDP)



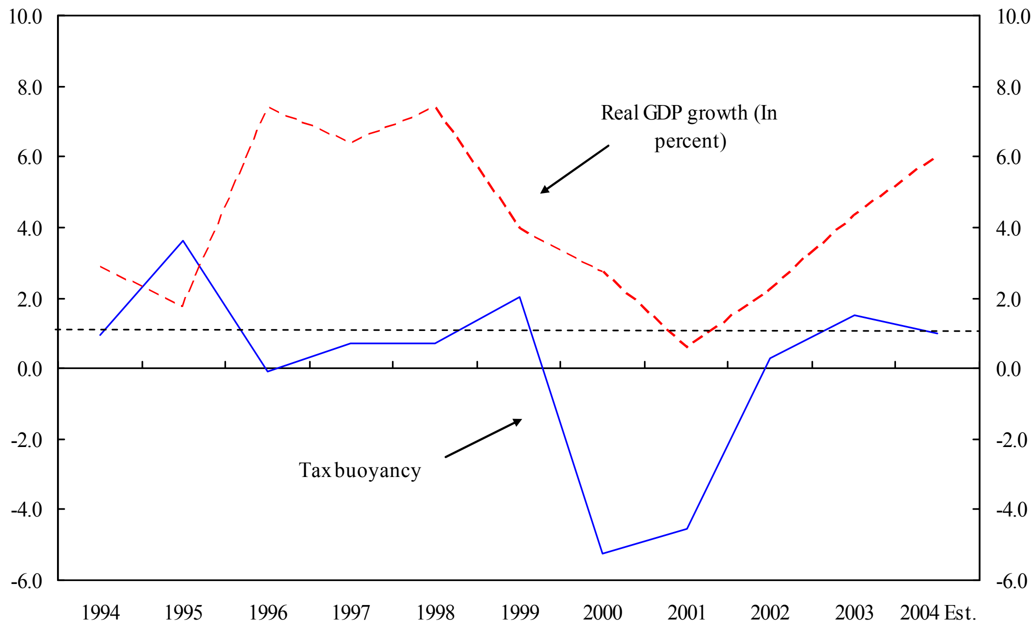
Sources: Ministry of Economy and Finance; and Fund staff estimates.

Figure 5. Central American Countries: Tax Revenue, 1990–2003
(In percent of GDP)



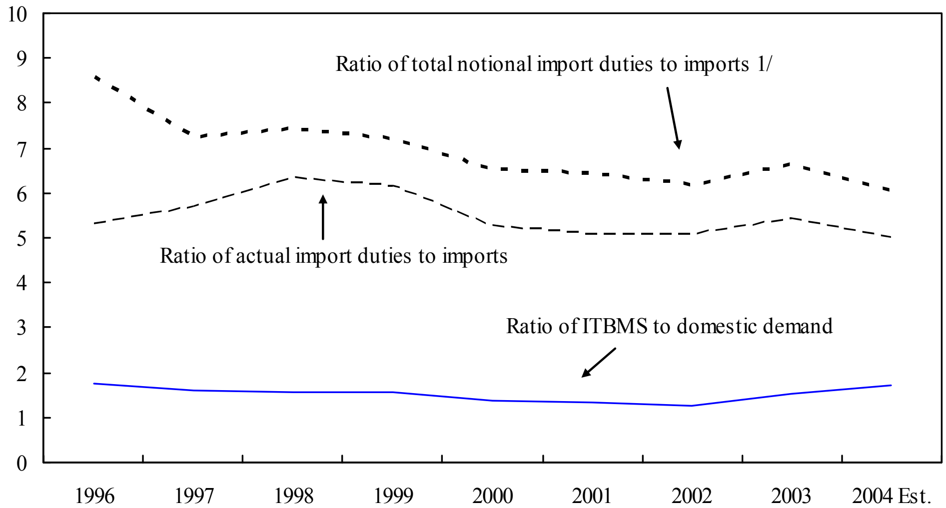
Sources: Authorities documents; and Fund staff calculations.
1/ Last column refers to 2000–02.
2/ First column refers to 1992–94.

Figure 6. Panama: Tax Revenue Buoyancy, 1994–2004



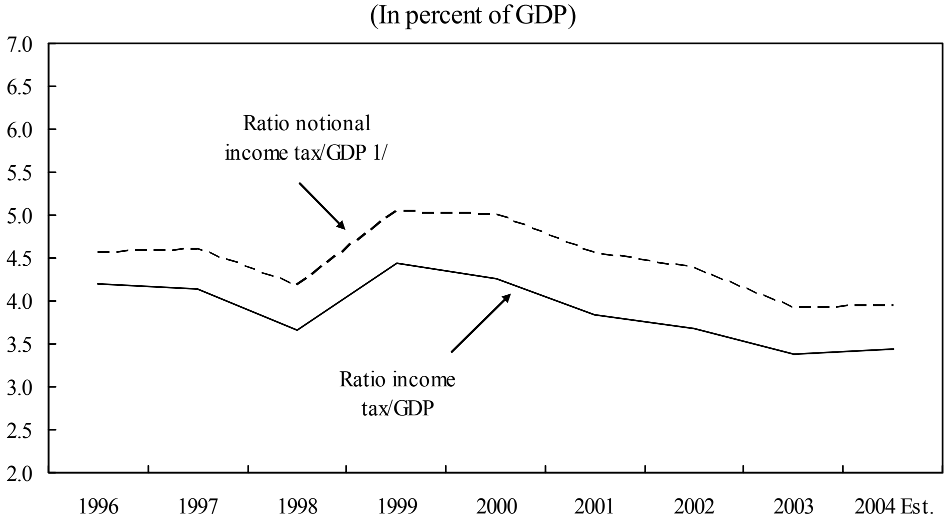
Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

Figure 7. ITBMS and Import Duties, 1996–2004
(In percent of their tax base)



Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.
1/ Notional import duties are defined as the sum of import duties actually collected and the cost of exemptions under Laws 2/86 and 3/86.

Figure 8. Income Tax, 1996–2004
(In percent of GDP)



Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.
1/ Notional income tax is defined as the sum of income tax actually collected and the cost of exemptions under Law 28/95 and 20/99, and CATs.

Table 1. Panama: Tax Revenue, 1997–2003

(In millions of balboas)

	1997	1998	1999	2000	2001	2002	2003
Tax revenue	**1,109.3**	**1,129.1**	**1,243.6**	**1,156.5**	**1,067.5**	**1,088.3**	**1,163.1**
Direct taxes	536.0	479.9	600.4	583.4	546.9	545.3	555.0
Income tax	457.0	399.5	508.4	494.2	454.1	451.7	435.2
Individuals	19.4	18.7	21.7	20.3	28.2	22.6	24.1
Corporations	181.8	115.0	186.8	155.2	124.3	113.8	130.0
Wages	167.7	179.5	200.5	220.1	209.5	232.2	184.7
Dividends	8.1	12.6	17.0	17.9	15.2	12.9	15.3
Supplementary tax	7.9	9.4	13.3	13.3	11.5	11.2	14.4
Panama Canal Authority (wages)	49.1	50.3	54.5	54.7	54.0	48.7	53.3
Colon Free Zone	14.1	3.7	5.0	3.4	3.6	2.6	3.0
Property sales tax	9.0	10.3	9.7	9.3	7.9	7.7	10.3
Wealth tax	53.3	51.7	59.6	52.7	60.9	56.1	84.0
Real estate tax	30.9	35.2	41.5	33.9	42.0	39.6	52.3
Business licences	16.2	16.6	18.1	18.8	18.9	16.4	31.8
Ships	6.2	0.0	0.0	0.0	0.0	0.0	0.0
Inheritance and donations	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education insurance	25.7	28.6	32.4	36.4	31.8	37.6	35.8
Indirect taxes	573.3	649.2	643.1	573.2	520.6	543.0	608.1
ITBMS	163.7	188.8	186.9	165.2	152.8	156.0	193.3
Imports	100.6	118.3	112.5	96.2	86.1	90.3	98.2
Domestic sales	63.1	70.4	74.4	69.0	66.7	65.7	95.1
Import duties	211.0	243.9	238.4	200.3	170.5	181.0	197.8
Export duties	6.2	2.9	0.6	0.2	0.0	0.0	0.0
Selective consumption taxes	150.2	169.9	173.8	159.8	157.0	165.7	174.0
Insurance fees	14.5	14.8	16.6	16.6	16.7	16.6	17.8
Fuel	93.9	115.2	122.0	108.8	106.9	115.6	116.7
Beer	17.0	19.1	18.4	18.2	17.0	17.5	19.3
Liquor	13.4	13.4	14.5	13.8	14.0	13.6	13.8
Sparkling drinks	1.8	2.4	2.2	2.3	2.4	2.4	2.6
Tobacco	9.5	4.9	0.0	0.0	0.0	0.0	0.0
Wine	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Perfumes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Jewelry, weapons	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Cable TV, microwaves, mobile phones	0.0	0.0	0.0	0.0	0.0	0.0	3.5
Casinos	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Legal commercial acts	2.2	2.2	2.4	2.8	2.6	2.6	0.6
Other legal accounts	37.3	38.5	38.5	42.3	35.2	34.8	33.7
Other taxes	2.8	3.0	2.6	2.6	2.4	2.9	8.7

Source : Tax Directorate, Ministry of Finance and Economy.

Table 1. Panama: Tax Revenue, 1997–2003

(In percent of total tax revenue)

	1997	1998	1999	2000	2001	2002	2003
Tax revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Direct taxes	48.3	42.5	48.3	50.4	51.2	50.1	47.7
Income tax	41.2	35.4	40.9	42.7	42.5	41.5	37.4
Individuals	1.7	1.7	1.7	1.8	2.6	2.1	2.1
Corporations	16.4	10.2	15.0	13.4	11.6	10.5	11.2
Wages	15.1	15.9	16.1	19.0	19.6	21.3	15.9
Dividends	0.7	1.1	1.4	1.5	1.4	1.2	1.3
Supplementary tax	0.7	0.8	1.1	1.1	1.1	1.0	1.2
Panama Canal Authority (wages)	4.4	4.5	4.4	4.7	5.1	4.5	4.6
Colon free zone	1.3	0.3	0.4	0.3	0.3	0.2	0.3
Property sales tax	0.8	0.9	0.8	0.8	0.7	0.7	0.9
Wealth tax	4.8	4.6	4.8	4.6	5.7	5.2	7.2
Real estate tax	2.8	3.1	3.3	2.9	3.9	3.6	4.5
Business licences	1.5	1.5	1.5	1.6	1.8	1.5	2.7
Ships	0.6	0.0	0.0	0.0	0.0	0.0	0.0
Inheritance and donations	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education insurance	2.3	2.5	2.6	3.1	3.0	3.5	3.1
Indirect taxes	51.7	57.5	51.7	49.6	48.8	49.9	52.3
ITBMS	14.8	16.7	15.0	14.3	14.3	14.3	16.6
Imports	9.1	10.5	9.0	8.3	8.1	8.3	8.4
Domestic sales	5.7	6.2	6.0	6.0	6.2	6.0	8.2
Import duties	19.0	21.6	19.2	17.3	16.0	16.6	17.0
Export duties	0.6	0.3	0.0	0.0	0.0	0.0	0.0
Selective consumption taxes	13.5	15.0	14.0	13.8	14.7	15.2	15.0
Insurance fees	1.3	1.3	1.3	1.4	1.6	1.5	1.5
Fuel	8.5	10.2	9.8	9.4	10.0	10.6	10.0
Beer	1.5	1.7	1.5	1.6	1.6	1.6	1.7
Liquor	1.2	1.2	1.2	1.2	1.3	1.2	1.2
Sparkling drinks	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Tobacco	0.9	0.4	0.0	0.0	0.0	0.0	0.0
Wine	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Perfumes	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Jewelry, weapons	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cable TV, microwaves, mobile phones	0.0	0.0	0.0	0.0	0.0	0.0	0.3
Casinos	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Legal commercial acts	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Other legal acts	3.4	3.4	3.1	3.7	3.3	3.2	2.9
Other taxes	0.3	0.3	0.2	0.2	0.2	0.3	0.8

Source: Tax Directorate, Ministry of Finance and Economy.

Table 2. Panama: Central Government Revenue, 1992–2004

(In percent of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Est. 2004
Revenue and grants	**17.4**	**17.0**	**16.1**	**17.1**	**16.6**	**16.6**	**16.2**	**17.0**	**18.2**	**16.5**	**16.1**	**15.7**	**14.6**
Current revenue	**17.4**	**17.0**	**16.1**	**17.0**	**16.6**	**15.8**	**15.6**	**16.9**	**18.1**	**16.3**	**16.1**	**15.4**	**14.5**
Tax revenue	**11.4**	**10.9**	**10.8**	**11.4**	**10.6**	**10.3**	**10.1**	**10.6**	**9.6**	**8.8**	**8.6**	**8.8**	**8.7**
Direct taxes	5.0	4.7	4.7	5.2	4.7	4.6	4.1	5.0	4.7	4.4	4.1	4.0	4.0
Income tax	4.5	4.2	4.2	4.7	4.2	4.1	3.7	4.4	4.3	3.8	3.7	3.4	3.4
Tax on wealth	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.7	0.6
Indirect taxes	6.4	6.1	6.2	6.3	5.9	5.7	6.0	5.6	4.9	4.4	4.4	4.7	4.7
Trade taxes	2.2	2.0	2.1	2.2	2.0	2.2	2.3	2.1	1.7	1.5	1.5	1.6	1.5
ITBMS	1.6	1.7	1.7	1.7	1.8	1.6	1.7	1.6	1.4	1.3	1.3	1.5	1.7
Other taxes on domestic transactions	2.5	2.5	2.4	2.4	2.1	1.9	2.0	1.9	1.8	1.7	1.7	1.7	1.5
Nontax revenue	**6.0**	**6.2**	**5.2**	**5.6**	**6.0**	**5.5**	**5.5**	**6.3**	**8.5**	**7.5**	**7.5**	**6.6**	**5.8**
Dividends 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.3	1.6	1.9	1.8	2.0	2.0	1.2
Panama Canal fees	1.0	1.0	1.0	1.1	1.0	0.9	0.9	0.9	1.2	1.2	1.2	1.1	1.0
Other nontax revenue	5.0	5.2	4.3	4.5	5.0	4.6	4.4	3.8	5.4	4.4	4.3	3.5	3.6
Capital revenue	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.3**	**0.0**	**0.3**	**0.1**
Grants	**0.0**	**0.0**	**0.0**	**0.1**	**0.0**	**0.7**	**0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum item:													
GDP (millions of balboas)	7,273	7,942	8,469	8,658	9,322	10,084	10,933	11,456	11,621	11,808	12,272	12,862	13,793

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

1/ Including the Panama Canal Authority, starting in 1999.

Table 3. Panama: Tax Revenue

(In percent of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Est. 2004
Tax revenue	**11.4**	**10.9**	**10.8**	**11.4**	**10.6**	**10.3**	**10.1**	**10.6**	**9.6**	**8.8**	**8.6**	**8.8**	**8.7**
Direct taxes	**5.0**	**4.7**	**4.7**	**5.2**	**4.7**	**4.6**	**4.1**	**5.0**	**4.7**	**4.4**	**4.1**	**4.0**	**4.0**
Income tax	4.5	4.2	4.2	4.7	4.2	4.1	3.7	4.4	4.3	3.8	3.7	3.4	3.4
Personal income	2.3	2.1	2.2	2.5	2.5	2.3	2.3	2.4	2.5	2.5	2.5	2.0	1.8
of which: Panama Canal	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4
Business	2.2	2.1	2.0	2.2	1.7	1.8	1.4	2.0	1.7	1.4	1.2	1.3	1.6
Wealth	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.7	0.6
Indirect taxes	**6.4**	**6.1**	**6.2**	**6.3**	**5.9**	**5.7**	**6.0**	**5.6**	**4.9**	**4.4**	**4.4**	**4.7**	**4.7**
Taxes on foreign trade	2.2	2.0	2.1	2.2	2.0	2.2	2.3	2.1	1.7	1.5	1.5	1.6	1.5
Imports	2.1	1.8	1.9	2.1	1.9	1.8	2.3	2.1	1.7	1.5	1.5	1.6	1.5
Exports	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on domestic transport.	4.2	4.2	4.1	4.1	3.9	3.6	3.7	3.5	3.2	3.0	2.9	3.2	3.1
ITBMS	1.6	1.7	1.7	1.7	1.8	1.6	1.7	1.6	1.4	1.3	1.3	1.5	1.7
Petroleum products	1.2	1.2	1.1	1.1	1.0	1.0	1.1	1.1	0.9	0.9	0.9	0.9	0.7
Tobacco and beverages	0.5	0.5	0.5	0.5	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other	0.9	0.8	0.8	0.8	0.7	0.7	0.6	0.5	0.6	0.5	0.5	0.5	0.4

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

Table 4. Panama: Tax Effort in a Regional Context, 1998–2003 1/
(Tax revenue in percent of GDP)

	1998	1999	2000	2001	2002	2003
Western Hemisphere Countries:						
Argentina 2/	21.1	21.2	21.6	21.0	20.0	23.3
Barbados	...	30.5	30.2	31.2	31.3	30.9
Bolivia 2/	19.7	18.6	18.7	18.1	18.0	18.3
Brazil 2/	29.8	32.2	33.0	33.9	35.8	36.1
Chile	16.3	15.6	16.4	17.2	17.6	...
Colombia	10.5	10.0	11.2	13.2	13.4	14.1
Costa Rica 2/	...	11.9	12.4	13.3	13.2	13.1
Dominican Republic	15.0	14.7	14.8	15.8	16.0	...
Ecuador	8.5	8.8	10.9	11.0	11.1	...
El Salvador	...	10.2	10.2	10.5	11.1	11.6
Guatemala	8.7	9.3	9.4	9.7	10.6	10.3
Haiti	8.3	8.8	8.1	7.3	8.0	...
Honduras	17.0	17.7	16.6	16.2	15.9	...
Jamaica	23.0	24.5	25.7	26.6	24.4	26.0
Nicaragua	14.9	14.7	13.8	13.0	13.6	15.1
Panama	**10.1**	**10.6**	**9.6**	**8.8**	**8.6**	**8.8**
Paraguay	...	11.1	11.1	11.3	9.1	9.8
Peru	13.8	12.3	12.0	12.9	11.9	13.0
Suriname	23.8	19.8	23.1	33.5	24.5	27.8
Trinidad & Tobago	13.5	12.9	14.5	13.7	15.7	...
Uruguay	18.3	18.1	17.9	18.6	18.9	...
Venezuela	12.7	12.1	12.5	11.0	...	...
Unweighted average	15.8	15.7	16.1	16.7	16.6	...

Source: IMF staff reports.
1/ Central government unless otherwise noted.
2/ General government (central and local governments).

Table 5. Panama: Cost of Import Duty Exemptions, 2000–03
(In millions of U.S.dollars)

	2000	2001	2002	2003
Total	**75.16**	**91.45**	**75.02**	**70.50**
A. Exemptions from import duties 1/	**49.27**	**47.40**	**40.07**	**44.39**
Industry	27.33	22.23	15.22	...
Public sector	5.91	6.73	5.46	...
Embassies	0.54	0.47	0.69	...
International organizations	0.31	0.95	0.40	...
Corporations	14.52	16.53	17.79	...
Public transportation	0.66	0.49	0.50	...
B. Tax payment certificates 2/	**24.61**	**41.43**	**33.40**	**23.93**
C. Tax annulment certificates 3/	**0.65**	**0.96**	**0.98**	**0.47**
D. Special tax annulment certificates 3/	**0.01**	**1.23**	**0.19**	**1.28**
E. Import duty refunds 4/	**0.62**	**0.43**	**0.40**	**0.43**

Source: Ministry of Economy and Finance.

1/ Excluding ITBMS (a value-added tax) and other duties.
2/ Incentives for nontraditional exports (Certificados de Abonos Tributarios, or CATs).
3/ Tax credits, accumulated ITBMS.
4/ Article 9, Law 3 of March 20, 1986 (Incentives to industrial export enterprises).

Table 6. Panama: Impact of the 2002 Tax Reform, 2003–05 1/
(In millions of balboas)

	Actual 2003 2/	Estimated 2004	Projection 2005
Total	35.0	37.4	39.7
Income taxes	-38.1	-49.3	-50.2
Of which : on wages	-39.9	-54.5	-55.8
ITBMS (Value-added tax)	28.2	42.5	44.6
Selective consumption tax	7.4	9.9	10.4
Business registration fee (*Tasa Unica*)	18.4	15.1	15.2
Bank licenses	7.2	7.2	7.5
Commercial and industrial business licenses	14.3	13.9	14.1
Other	-2.3	-1.9	-1.8
Memorandum item:			
Total, in percent of GDP	0.3	0.3	0.3

Source: Ministry of Economy and Finance.

1/ Law 61 of December 2002.
2/ Some articles of the law went into effect in April 2003.

IV. The Panama Canal Authority: Fiscal Accounting and Policy Issues[32]

A. Introduction

47. **Panama's new administration in September 2004 decided to exclude the balance of the Panama Canal Authority (PCA) from the measure of the fiscal deficit utilized for policy purposes and future fiscal rules.** The PCA, a public entity whose autonomy is guaranteed by the Constitution, has full control over the administration of its assets and does not engage in quasi-fiscal activities. While its retained profits have grown markedly in recent years, looking forward, it may need to borrow substantial amounts over the medium term to finance an ambitious program to widen the waterway. The authorities' goal is to secure an investment grade credit rating for the PCA, and they view the separation of the PCA from fiscal accounts as key to convincing financial markets of PCA's commercial soundness and ability to maintain managerial and financial autonomy.

48. **This chapter will discuss the PCA's treatment in the fiscal accounts, and its implication for the appropriate measure of the fiscal deficit and the optimal coverage of a revised FRL**. The Fund's Executive Board recently recognized that excluding the operations of commercially run public enterprises allows an alternative measure of the fiscal stance. However, the PCA appears not to meet the Fund's minimum criteria for being considered commercially run; on this basis, it would not qualify for exclusion from fiscal accounts and public debt. It nevertheless appears to be a profitable, efficient, and well-managed undertaking. If the canal expansion project proceeds, future assessments of public debt sustainability will partly depend upon the extent of explicit or implicit government guarantees for the financing of the project.[33] There is no firm evidence at this stage to judge whether markets would be willing to finance the PCA without an explicit government guarantee. Given the canal's macroeconomic importance, an implicit government guarantee, to be assessed in light of the financing plan for expansion of the canal, may not be ruled out in a hypothetical worst-case scenario, such as a natural catastrophe.

B. Finances of the Canal Authority

49. **The PCA was established by the Constitution and its structure set by law 19 of June 1997 in preparation for the transfer of the canal from the United States**. On December 31, 1999, the PCA assumed full responsibility for the administration and operations of the waterway. The Constitution and Law 19/1997 provided for the PCA's financial autonomy and the right to administer its assets (Box 1). It was set up to be run efficiently with sound business practices. While the canal under U.S. administration sought

---

[32] Prepared by Eric Verreydt.

[33] Article 309 of Panama's Constitution and Article 3 of PCA's Organic Law state that the canal belongs to the Panamanian nation, and prohibit the sale, mortgaging, or any transaction that would reduce sovereignty over the canal.

to recover costs, the PCA has generated profits and increased the canal's contribution to Panama's economy.

50. **The PCA's gross operating surplus, before transfers to the central government, has grown steadily in recent years**. Operating expenses were kept under control throughout 2000–04, through significant increases in efficiency. Over the period 2000-03, PCA employment declined (by 3 percent between 2001 and 2003), operating expenses increased by about 3 percent in real terms, while traffic (measured in net tonnage) rose by over 5 percent. Operating income rose markedly, starting in 2002, as a result of a toll increase, higher fees for transit services, and rising transit tonnage (Appendix and Table 1). The operating surplus, before transfers of fees and dividends to the central government, increased from 3.3 percent of GDP in 2000 to 4.8 percent in 2004.

51. **Transfers to the central government have risen as dividend payments have become substantial**. In addition to income tax withheld on employees' wages, transfers from the PCA recorded in central government revenue include: a fee for power, water, and other utilities provided by the rest of the public sector (about 0.2 percent of GDP); a fee based on transit tonnage (about 1.1 percent of GDP); and dividends. Dividends have grown markedly, from 0.3 percent of GDP in 2000–01 to over 1 percent of GDP in 2004.

52. **In anticipation of future investments, the PCA's retained profits were increased to well over 1 percent of GDP in 2003-04.** The PCA's financial assets (about US$800 million at end-2004) are not available to finance central government deficits; the bulk of these assets are invested abroad. However, consistent with the treatment of other public enterprises in the fiscal accounts, the policy until late 2004 was to include this growing flow of profits in the accounts of the nonfinancial public sector (NFPS), on a nonconsolidated basis, as a revenue and a financing item. This substantially reduced the overall fiscal deficit reported in recent years.

53. **A recent decision to exclude the PCA from the fiscal balance has raised a fiscal accounting issue with policy implications.** The government that came to office in September 2004 decided to exclude the PCA from the fiscal balance monitored for policy purposes and future fiscal rules, as it felt that its inclusion was giving an inappropriate measure of the deficit, inconsistent with the Fiscal Responsibility Law.[34] The broader measure of the fiscal balance, which includes the PCA, continues to be used for national accounts purposes and for comprehensive public sector statistics.

54. **The PCA's strong financial performance warrants a discussion whether it can be considered commercially run, and whether excluding it from fiscal accounts is a sensible option**. A prospective widening and modernization of the canal at a cost of possibly 30-35 percent of GDP would likely be financed in part through borrowing by the PCA (see Appendix). The PCA's prospective large borrowing over a number of years will need to be considered in future assessments of public debt sustainability. At present, there are no clear indications about the market's rating of PCA's commercial soundness and credit risk that

[34] The PCA's surplus created an inconsistency between the deficit and the gross debt targets. See Chapter II.

would provide a basis for assessing whether PCA's future borrowing would impact on public debt sustainability through an explicit guarantee.

C. Assessing the PCA's Commercial Orientation

55. **The Fund recently advanced the view that a country's fiscal stance could be measured for policy purposes by excluding the operations of commercially run public enterprises**.[35] Preliminary criteria have been developed to assess the commercial orientation of public enterprises, to be reviewed by the Executive Board after experience has been gained. These criteria rely on readily available data, and need to be monitored to ensure continuing compliance, as even commercially run enterprises can borrow and invest in ways that could pose macroeconomic risks. At any rate, accounts of all public enterprises—commercial or not—should be reported to the public and covered in fiscal accounts under the Fund's surveillance activities and for statistical purposes.

56. **A public entity that relies substantially on government financial support, or on extensive government guarantees, would not be considered a commercial enterprise**. The authorities' goal is to secure an investment grade credit rating for the PCA by convincing markets that it is a commercially sound undertaking with no need for a government guarantee. Under the Fund's criteria, to be considered commercially run, an enterprise's profitability and creditworthiness should be comparable to the industry-wide average. Its personnel policy should be independent of civil service laws and free of government intervention. It should be subject to the same regulations and taxes as private firms in the same industry, and there should be no special transfers to or from the government. The firm should be audited externally and publish comprehensive annual reports, and minority shareholders' rights should be protected.

57. **The PCA appears not to meet the minimum criteria for being considered commercially run, in part because it is fully state-owned (Box 2)**. Some criteria on governance do not apply, as there are no minority shareholders and no listing on the stock exchange. The PCA's profitability and creditworthiness indicators cannot be compared to industry-wide indicators in the country; and a comparison with other major canals (in particular the Suez Canal) is difficult as operating conditions and constraints are different. One criterion that is not met concerns tax exemptions. The PCA is not subject to the same tax regime as private firms, as it is exempt from corporate income tax (though it transfers fees to the central government).[36] Its annual budget has to be approved by the Cabinet, which conceivably could give rise to a conflict of interest in the determination of dividends.

---

[35] See Public Information Notice 04/45 for a summary of the views of the Executive Board, at an informal seminar on April 2, 2004, based on the reports "Public Investment and Fiscal Policy" and "Public-Private Partnerships."

[36] The ratio of dividends to pre-tax income (47 percent on average; see table) was above the corporate income tax rate (30 percent).

58. **The PCA's business operations are considered to be financially sound and profitable.** In economic terms, the PCA is a monopoly supplying a transportation service. It is facing competition, as the elasticity of demand for its service is affected by the cost of alternative routes. Its pricing policy (see Appendix) appears to be geared toward increasing profits, as evidenced by the marked rise in profits before dividend payments (see table). Its debt is presently very low. The PCA has an independent personnel policy, based on a merit system. It is financially autonomous and prepares an annual budget. Following cabinet approval (see above), the National Assembly must approve or reject its budget without modifications by a majority of votes.

59. **The conduct of canal operations, PCA's primary mission, is widely regarded as safe and efficient.** Given the waterway's pivotal role for global trade and shipping, ensuring safety and efficiency of transit, is PCA's key responsibility. The PCA has developed a set of performance indicators to assess progress in these and other areas. Safety, as measured by the rate of accidents, has improved in recent years, to reach historical records.[37] Transit efficiency has increased, with crossing time reduced to 26.7 hours in FY 2004 from about 33 hours in 1999. These improvements reflected ongoing substantial investment in maintenance and equipment (about US$180 million annually), the widening of the narrowest part of the waterway (completed in 2001), workforce training, and the adoption of modern management techniques.

60. **Transparent procedures and reporting are indicative of good governance.** The PCA is audited externally and publishes a comprehensive annual report. Its procurement system is transparent, with tenders online; names of successful bidders and those suspended or debarred from receiving contracts are available on the web as well.

D. Concluding Remarks

61. **While the accounting treatment is an important issue, ensuring debt sustainability is paramount.** Whether the PCA's debt would be included in public or private debt, Panama needs to ensure that the returns on canal expansion allow servicing of PCA's debt. This requires that the project be economically sound; that its implementation be well managed; and that PCA's financial autonomy be maintained. The careful preparation of the canal's master plan, the PCA's record of efficient management, and the government's commitment to the PCA's autonomy seem to augur well in these respects.

62. **The PCA's indebtedness, even if sustainable, would increase Panama's vulnerability.** While the canal expansion may be greatly beneficial to Panama, it involves various types of financial and other risks, as would be true for any large investment project. The market would have to price these risks into the debt. Nevertheless, given the canal's strategic importance for Panama's economy and international trade, one cannot discard the possibility that, in a hypothetical worst-case scenario, an implicit government guarantee

[37] There were 10 accidents out of 14,035 transits in FY 2004 (ending September 30, 2004), the lowest rate in the canal's history.

would be called. This possibility creates a source of potential vulnerability, independent of the public ownership of the canal.

63. **The appropriate way to measure the impact of prospective PCA borrowing on public debt sustainability is an open issue, assuming an implicit guarantee**. By established international standards, an *explicit* government guarantee to PCA's debt would result in its inclusion in public debt statistics. Performing a debt sustainability exercise on government and government-guaranteed debt is useful. The likelihood that an *implicit* guarantee would be called depends in part on factors outside Panama's control, such as a natural disaster or major bottlenecks in U.S. ports, which for some are difficult to predict and susceptible to change over time. An informed discussion of the appropriate weight to be attached to an implicit guarantee could only take place after the details of the prospective financing of the canal expansion would be known.

64. **Achieving and maintaining fiscal discipline is often the appropriate response to increased vulnerability.** Implementation of the authorities' reform plans to achieve sound public finances would help guarantee that the PCA would not be pressured to engage into quasi-fiscal activities. Maintaining ongoing fiscal discipline would reduce the risk of a possible conflict of interest at the Cabinet level; and with healthy public finances, government support under a hypothetical worst-case scenario would be less susceptible to be destabilizing.

65. **Measuring the fiscal deficit, both including the PCA and excluding it, would enhance fiscal transparency.** The case for excluding the PCA from the measure of the fiscal deficit utilized for policy purposes would be strengthened if the canal expansion project could be financed without an explicit government guarantee. But even so it would be useful to publish both measures of the deficit, as well as other fiscal measures related to the public sector's net worth, consistent with the GFS recommendation to present various fiscal concepts, geared toward different analytical purposes. The narrower measure would facilitate a monitoring of the implementation of the February 2005 fiscal reform. The broader measure would be relevant for national accounts compilation and statistical reporting of public sector accounts.

66. **Fiscal discipline may be strengthened by excluding the PCA from a revised FRL.** The canal expansion program is a well-defined project. After its scope and financing plan would be approved by referendum, it would be binding on future governments. In this context, excluding PCA's operations from the FRL's umbrella might give a clear signal that the central government's efforts at observing statutory deficit and debt ceilings would not be allowed to interfere with the canal project's implementation.

Box 1. Key Financial Provisions of the Constitution and the Organic Law of the Panama Canal Authority (PCA)

Provision	Legal provision	
	Constitution	**Law 19/1997**
Tax and regulatory exemptions		
• The PCA budget is not part of the government budget, and is not subject to the provisions of the budget law of the government.		Article 36
• The PCA will pay the government fees to be charged on ships transiting through the canal (fee per ton).	Article 315	Article 39
• The PCA will transfer annually to the central government the excess of income over operating costs, investment outlays, provisions for investment (left to PCA's discretion) and depreciation, and other legal provisions.		Article 41
• The PCA is exempt from taxes and duties, except contributions to social security and fees as defined in Article 39 of law 19/1997.	Article 310	Article 43
Other financial provisions		
• The use of PCA's revenues or assets as a guarantee to government borrowing is prohibited.		Article 45
• Canal tolls will be set to recover operating costs and investment needs.		Article 75
• The PCA's employment regime is based on employees' performance, separate from the general labor code.	Article 316	Article 81
Corporate governance		
• The 11 members of the executive board will be appointed for nine years; 10 are appointed by the President (nine subject to parliamentary approval and one with the rank of minister), and one by the National Assembly.	Article 312	Article 13
• The PCA is headed by a managing director and a deputy managing director, appointed for seven years.		
• A financial report will be issued annually.		Article 21
• The PCA will be audited externally.		Article 40

Box 2. Commercial Orientation of the Panama Canal Authority 1/

	Status	Consistent With Criterion?
Managerial Independence		
1. Pricing policy		
Prices reflect costs 2/	yes	yes
Subsidized prices	no	yes
2. Employment policy		
Personnel policy independent of civil service rules 3/	yes	yes
Civil servants in management positions	no	yes
Relations with Government 4/		
3. Subsidies and loan guarantees	no	yes
4. Tax and regulatory exemptions 5/	yes	no
Financial Conditions		
5. Profitability 6/	10.8	yes 9/
6. Creditworthiness		
Debt level 7/	6.3	yes 9/
Debt cost 8/	0	yes 9/
Governance Structure		
7. Stock listing	no	no
8. Outside audits and annual reports	yes	yes
9. Protects shareholders rights	... 10/	no

Sources: Legislative Assembly, Organic Law of the Panama Canal Authority; and Panama Canal Authority.

1/ For a public enterprise to be considered commercially run, criteria 1–4 would have to be met, plus at least one of the criteria related to financial conditions and at least one related to the governance structure.

2/ A new tolls pricing structure was approved in August 2002, and a two-phase toll increase was implemented, by an average of 8 percent in October 2002 and an additional 4.5 percent in July 2003. Operating results of the ACP during FY 2003 showed an increase in net income and profitability as a result of the toll and transit tonnage increase.
The toll pricing structure applicable to container ships will be reformed effective May 1, 2005, with a three-stage toll increase, by 35 percent in May 2005, and an additional 17 percent and 10 percent in January 2006 and January 2007, respectively.

3/ The employment regime is based on a merit system; the provisions of the Labor Code do not apply.

4/ In addition to the listed criteria, the Canal Authority's budget has to be submitted to Parliament, which must approve or reject it without modifications.

5/ The Canal Authority is exempt from corporate income tax. However, it transfers tolls and fees to the government (1.1 percent of GDP in 2003), and distributes part of its net profit to the government as a dividend (0.8 percent of GDP in 2003).

6/ Net profits as a percentage of net worth during fiscal year 2003 (ended September 30, 2003).

7/ Liabilities in percent of total assets.

8/ Debt comprises payables that do not bear interest.

9/ The high profitability and low debt cannot be compared to industry-wide average in the country.

10/ There are no minority shareholders.

Table 1. Panama: Operations of Panama Canal Authority (accrual basis)

	2000	2001	2002	2003	Prel. 2004
(In millions of balboas)					
Operating surplus	**380.0**	**349.0**	**434.0**	**533.0**	**660.0**
Operating revenue	785.0	775.0	830.0	953.0	1086
Operating expenses	405.0	426.0	396.0	420.0	426
Less: transfers to central government	**203.1**	**203.5**	**271.0**	**278.5**	**311.9**
Fees based on net tonnage 1/	142.4	141.1	152.1	144.6	142.6
Service fee	30.0	26.6	30.2	28.6	28.6
Dividends	30.8	35.8	88.8	105.3	140.7
Remaining operating surplus	**176.9**	**145.5**	**163.0**	**254.5**	**348.1**
Fixed investment	97.0	112.0	131.0	129.0	121.0
Retained profits	**79.9**	**33.5**	**32.0**	**125.5**	**227.1**
(In percent of GDP)					
Operating surplus	**3.3**	**3.0**	**3.5**	**4.1**	**4.8**
Operating revenue	6.8	6.6	6.8	7.4	7.9
Operating expenses	3.5	3.6	3.2	3.3	3.1
Less: transfers to Central Government	**1.7**	**1.7**	**2.2**	**2.2**	**2.3**
Fees based on net tonnage 1/	1.2	1.2	1.2	1.1	1.0
Service fee	0.3	0.2	0.2	0.2	0.2
Dividends	0.3	0.3	0.7	0.8	1.0
Remaining operating surplus	**1.5**	**1.2**	**1.3**	**2.0**	**2.5**
Fixed investment	0.8	0.9	1.1	1.0	0.9
Retained profits	**0.7**	**0.3**	**0.3**	**1.0**	**1.6**
Memorandum items:					
Overall balance, before dividend payments (percent of GDP)	1.0	0.6	1.0	1.8	2.7
Ratio of dividends to pre-tax income (percent) 2/	27.8	51.6	73.5	45.6	38.3
GDP, millions of balboas	11,620	11,808	12,272	12,862	13,793

Sources: Panama Canal Authority; and Fund staff estimates and projections.

1/ Article 39 of the Organic Law establishes that Panama Canal Authority (PCA) shall pay annually to the Panamanian Treasury a fee per net ton, or its equivalent, collected from vessels paying tolls for the use of the Canal. This fee is set by the PCA.

2/ Pre-tax income is the overall balance, equal to retained profits plus dividends.

The Panama Canal: Main Features and Prospects

Highlights of the Panama Canal

67. **Hailed as an engineering and human achievement, the Panama Canal has been a major artery of international trade since its opening in 1914**. It is estimated that about 5 percent of world trade transits through the canal. Petroleum products, grains, and containerized cargo represent more than half of the total transit tonnage, with the latter cargo the fastest growing segment. The main shipping route through the waterway connects the east coast of the Unites States with Asia. This route accounts for more than 40 percent of the transit cargo and is expanding rapidly.

68. **The canal operates essentially as its designers envisioned a century ago**. About 50 miles long, the canal has three sets of locks that elevate ships to a large central artificial lake fed by a river and then lower them to sea level. The waterway is dependent on a regular flow of fresh water, thus on the maintenance of the ecological health of its basin, but throughout its history even extreme droughts have not markedly reduced transit capacity. Transit currently takes on average 8 to 10 hours (about 23 to 27 hours in total, including the approach and queuing).

69. **Ownership of the Canal Zone and management of the waterway were transferred from the United States in a process that culminated in December 1999**. Following a 1977 treaty (known as the "Torrijos-Carter Treaty") providing for the gradual transfer of the Canal Zone to Panama during the following two decades, between 1979 and 1999 the canal was operated with growing participation of Panamanians in its administration. The land and facilities of the zone, renamed the "reverted areas," were gradually handed over to Panama during the 1990s. An autonomous government entity, the Panama Canal Authority (PCA), was established by the Constitution to manage the waterway, and organized by law 19 of June 1997 (*Ley Organica de la Autoridad del Canal de Panama)*. On December 31, 1999, the PCA assumed full responsibility for the administration and operations of the canal.

70. **The canal is a natural resource that plays a key role in the development of Panama's service-based economy.** The value-added produced directly by the canal is significant.[38] In addition, the large traffic passing through the waterway (about 14,000 ships annually) has created opportunities in ship handling and maritime insurance and financing. Port activity has been stimulated by the economic activity in the Colon Free Zone and the canal traffic. Two large port complexes, which are specialized in containerized cargo

---

[38] 4.9 percent of GDP in 2003, composed to a large extent of wages paid to about 9,000 permanent workers (about 5 percent of employment in the public sector), and profits.

transshipment, have been expanding recently on land in the "reverted areas" at both entrances to the canal.[39] Reflecting these and other projects, including a new railway transoceanic connection, the transportation sector accounted for about 17 percent of GDP in 2003.

71. **Canal tolls were restructured and toll rates were raised in 2002–03 without noticeable impact on the number of transits.** A reform of the canal tolls structure was approved in August 2002, which replaced the uniform toll structure in force since the start of the canal operations, with differentiated rates according to tonnage.[40] Toll rates were increased in two stages, by 8 percent in October 2002 and an additional 4.5 percent in July 2003.[41] Moreover, fees for ancillary services (such as the use of locomotives and tug boats) were raised. Spurred in part by the recovery in the world economy, the transit of large vessels increased in 2003, and income and operating results of the PCA rose as a result of the toll and transit tonnage increase. Further transit growth led to a 10 percent increase in tonnage during 2004.

The Challenge Ahead

72. **Traffic growth and trends in the shipping industry pose a challenge to future operations.** Owing to continuous modernization and improvements,[42] the canal has been able to accommodate recent traffic growth satisfactorily. However, it is gradually getting closer to maximum capacity, which may be reached within the next several years unless major investment is carried out.[43] Moreover, with the trend toward building larger cargo ships, the

[39] In addition to the waterway, facilities in the reverted areas included former military bases, two airports, schools, hospitals, residential areas, industrial areas, storage facilities, and recreational facilities.

[40] Tonnage as defined under the Panama Canal Universal Measurement System (PC/UMS), equivalent to 100 cubic feet of capacity. The rate is lower for an empty ship, however.

[41] According to the PCA's estimates, the cost of transiting through the canal amounts to about 10 percent of the total shipping cost of users.

[42] Widening of the narrowest part of the canal (the "Gaillard Cut"), deepening of parts of the navigational channel to increase water resources, more powerful tugboats and towing locomotives, locks machinery, traffic control system, traffic maximization techniques.

[43] In 2004, the canal handled on average about 38 to 40 ships daily. According to the PCA, this was about 90 percent of the waterway's maximum daily capacity under optimal circumstances and assuming the completion of ongoing investment projects.

proportion of "Post-Panamax" vessels in the world shipping fleet is projected to increase substantially in the next decade, which may divert traffic to other shipping routes.[44]

73. **The PCA is finalizing a long-term master plan for canal modernization.** The plan aims at meeting future transit demand, allowing the largest cargo ships (up to 160 feet wide) to use the canal, while enhancing water conservation. Numerous studies were commissioned, including industry studies; environmental, financial, and economic impact assessments; and engineering feasibility studies. Options for modernizing the waterway would include increasing the capacity of ports; and building an additional set of locks. Execution is projected to take 10 to 15 years, at an estimated cost of possibly 30 to 35 percent of GDP.

74. **The master plan would be submitted to a national referendum.** The master plan is projected to be submitted to the PCA's board in the first half of 2005. Following its approval, it would be sent to the cabinet and in the final stage to the National Assembly. The National Assembly would then call a referendum on the canal expansion plan, possibly in late 2005. The population would be asked to accept or reject the plan. Opinion polls conducted in early 2005 indicated a high rate of approval.

75. **Increases in toll fees in 2005–07 would contribute to financing expansion plans.** A new toll pricing structure applicable to container ships was approved in February 2005 after consultations with users. The PC/UMS-based toll will be replaced by a unit fee per container above deck and raised in three stages, to reach US$54 by January 1, 2007, from the equivalent of US$31 at end-2004. The toll reform will be effective May 1, 2005 and lead to a toll increase on container traffic, by 35 percent in May 2005, and an additional 17 percent and 10 percent in January 2006 and January 2007, respectively.

[44] Ships built with the maximum allowable width to pass through the current locks of the canal (106 feet wide) are referred to as "Panamax," and vessels too wide to pass are "Post-Panamax." There were about 5,300 transits of Panamax vessels in FY 2004 (38 percent of the total).

V. PUBLIC BANKS IN PANAMA [45]

A. Introduction

76. **The aim of this paper is to assess the financial structure and performance of four public sector banks in Panama and draw some policy recommendations**. As in many developing countries, public banks in Panama were created to support economic development in general and to accomplish specific aims such as financing low income housing and catering to the financing needs of low-income agricultural producers. However, Panama also developed an efficient and densely populated private banking sector. The banking sector benefited from free entry and competition with foreign banks, leaving little room for public banks to collect savings and direct them toward "strategic long term projects."

77. **The paper concludes that the public banks' mission needs re-assessment in view of the well-developed private banking sector in Panama, problems of corporate governance in public banks, and weaknesses in their balance sheets**. Public commercial banks need to define a business strategy and at least in one case consider privatization. Public development banks may be substituted with more efficient instruments for achieving the banks' original social objectives. Public banks should fully comply with the regulatory framework of the Superintendency of Banks (SB).

78. **The paper is organized as follows**. Section B provides an overview of the government ownership of banks. The financial structure and performance of commercial banks is evaluated in section C and that of the development banks in section D. Section E presents the conclusions.

B. Overview of the Public Banks

79. **Through the mid-1990s government ownership of banks was pervasive worldwide.** Even after a wave of privatization, as of 1995 government ownership of banks was quite common; in a typical country 38.5 percent of the equity of the largest banks was state-owned, excluding former socialist countries (La Porta 2000). State banks were especially significant in countries with low levels of per capita income, underdeveloped financial systems, interventionist governments and poor protection of property rights. Government ownership of banks is associated with slower subsequent financial development (Levine 2001).

80. **Panama has a well developed financial system dominated by private banks**. Well capitalized, profitable, liquid, and with a low nonperforming loan (NPL) ratio, the onshore

---

[45] Prepared by Mario Dehesa (WHD).

banking system, including 23 foreign banks, had assets over 200 percent of GDP in 2004 while public banks had assets amounting to 38 percent of GDP. Domestic credit to the private sector reached close to 85 percent of GDP, a fourth of which originated in public banks.

81. **In Panama, the public banking sector comprises two commercial and two development banks**. The two commercial banks are the National Bank of Panama (BNP) and the Savings Bank (CA). The BNP is one of the largest commercial banks and has the largest network of branches. It has a loan per employee ratio that is less than two thirds of the banking system average, symptomatic of overstaffing. The CA is a mid-size player with an extensive branch network, similar to the largest private banks. It has a loan per employee ratio which is about one-third of the banking system average, also suggesting overstaffing. The two public development banks, National Mortgage Bank (BHN) and the Agricultural Development Bank (BDA), are nondeposit taking institutions attached to the Ministry of Housing and the Ministry of Agricultural Development, respectively, and whose official mission is to provide financing to the low-income population. Both public development banks seem to have redundant staff.

Panama: Public Banks Indicators

	2003				
	BNP	CA	BHN	BDA	Banking System
Assets/GDP, in percent	25.5	7.8	3.0	1.9	204
Branches	54	40	13	34	329
Employees	2,267	1,440	450	620	12,033
Unweighted Capital/Assets, in percent	15.3	13.1	74.4	59.4	12.8
Profit/Average assets, in percent	2.6	1.1	…	…	2.1

Sources: National Bank of Panama (BNP); Savings Bank (CA); National Mortgage Bank (BHN); Agricultural Development Bank (BDA).

C. Public Commercial Banks

BNP Balance Sheet

82. **Most of the BNP's funding comes from public sector entities that by law are required to deposit their funds at the BNP.** Over half of the BNP's deposits comes from the public sector, with the lion's share related to the Social Security Agency (CSS) (Table 1). A large share of public sector deposits are placed as sight deposits for extended periods of time without earning interest. As a result, the effective rate of interest paid by the BNP on its

total deposits has been about 200–250 basis points lower than the effective interest paid by the banking sector, or about one-third lower. This source of subsidy to BNP activities increased the bank's profits by an estimated one-third in 2003.

83. **The low interest paid by the BNP on its public sector deposits has been a major source of disagreement with the CSS**. In September 2004, the CSS had deposits at BNP of about 38 percent of the actuarial reserves of the public pension fund. However, the low deposit interest rate paid to the CSS is partially explained because the CSS funds were deposited at very short maturities, including overnight deposits. The term structure of CSS deposits is out of line with the long-term nature of the CSS's liabilities, comprising pension payments.

84. **The BNP and CSS reached an agreement in November 2004 to reschedule CSS deposits at BNP**. Under the agreement, the CSS distributed US$404 million of its deposits (out of US$680 million in September 2004) with terms ranging from 6 months to 10 years, at market-related interest rates ranging from 1.8 percent up to 7.25 percent. The CSS kept $240 million at the overnight interest rate. Nevertheless, the deterioration of CSS finances due to growing pension payments, combined with the low interest rates paid to its deposits, has motivated a massive deposit withdrawal over the past four years. CSS deposits at the BNP decreased by the equivalent of 10 percent of BNP total assets over the period 2001–04.

85. **The BNP reduced its holdings of international reserves to finance the deposit withdrawal and a rapid expansion of credit to the central government**. The BNP's international reserves decreased from 34 percent of total assets in 2002 to 19 percent in 2004, while the share of loans to the central government increased to 34 percent of total assets. The BNP credit to the central government is at an interest rate somewhat below market interest rates. For example, while a 10-year global bond placed in November 2004 carried a coupon of 7.25 percent, the BNP refinanced in December 2004 an 11-year loan to the central government at an interest rate of 6.5 percent. The main source of repayment are the dividends that BNP transfers to the central government, which in turn uses the dividends to pay back BNP.

86. **BNP credit to the private sector is almost twice private sector deposits (Table 1)**. BNP's effective interest rate on assets has been 60 basis points below the banking system average during the last three years, supported by the low interest rates paid on public sector deposits.

87. **Public and private commercial banks compete to lend to the same sectors, especially for mortgages, commerce, and personal consumption**. Within the mortgage sector, public commercial banks specialize in low- and medium-income housing, while private banks focus on the higher-income segment of the market. Public banks give priority to mortgage lending to address the constitutional mandate to implement a housing policy focusing on low-income housing. However, the mortgage portfolio of the banking system is well developed and equivalent to 25 percent of GDP in 2004, of which 3.5 percent of GDP is managed by the BNP and 2.5 of GDP is administered by the CA.

Panama: Credit Distribution by Sector in 2004
(In percent)

	Public commercial banks	Private banks
Public sector	29.9	0
Mortgages	29.2	25.6
Commerce	15.4	28.9
Personal consumption	12.7	23.5
Agriculture and industry	7.7	8.5
Others	5.1	13.4
Memorandum item:		
Total credit (in millions of U.S.dollars)	2,819	10,325

Source: Superintendency of Banks.

88. **The BNP financial soundness indicators are generally solid, but not as strong as the private banks prudential indicators (Table 2)**. The BNP is a well capitalized, profitable bank. However, its profitability arises in part from not paying market interest rates to public entities, as mentioned before, and from low provisions to cover nonperforming loans. The share of nonperforming loans to the private sector decreased over the period 2000–04, but are still higher than the banking system average. With the loss of international reserves, the ratio of liquid assets plus marketable securities to deposits diminished to 36 percent in September 2004, below the banking system average of 42 percent.

Corporate Governance

89. **The 1998 Banking Law is not fully applicable to public banks**. BNP is supervised by an external auditor dependent of the Comptroller General of the Republic and by the SB in transactions involving private sector operations, according to Article 150 of the Banking Law. The corporate governance guidelines set up by the SB, which do not apply to the BNP, require transparent mechanisms to avoid conflicts of interest with related parties, including relations with an economic group. At end-2004, BNP direct loans to public sector entities were over one and a half times its net worth, beyond the SB limit of bank loans to a related economic group set at 50 percent of the net worth of a bank. In addition, the BNP law does not require the bank to set up a Risk Assessment Unit as is required by the SB for private banks.

90. **Potential conflicts of interest are not addressed in the BNP's organic law.** The BNP law does not provide clear guidelines to deal with potential conflicts of interest between the government as shareholder of the BNP and the government as customer of the BNP.

91. **The BNP's payments of dividends to the government as sole shareholder do not follow a transparent rule**. During the 1990s, the BNP's dividends were used to repay BNP loans to the central government made in the late 1980s. The government agreed to accelerate the old loans repayment through a decree. However, during 2000–03, the BNP paid dividends to the Treasury that exceeded realized profits by a total of 0.5 percent of annual GDP. The administration that took office in September 2004 discontinued this policy, and the next payment of BNP's dividends was shifted to 2005.

BNP's Medium-Term Challenges

92. **The BNP faces a challenging outlook**. The BNP should define a business strategy, rebuild international reserves, and cope with a potentially large deposit withdrawal from the CSS. Without a pension reform, CSS funds would be depleted within 5-7 years and the BNP could lose close to 30 percent of its deposits. In a well developed but overpopulated banking system, the BNP has to find a market niche that could prioritize low-income housing (see below) and the needs of small producers. Best practices suggest that lending to the government should decrease with the development of the domestic securities market. Public entities' deposits should be remunerated at market interest rates for its deposits, without unduly high bank fees, to give them an incentive to distribute their deposits at the BNP between sight and term deposits according to efficient cash management criteria. To sustain BNP profitability while paying market interest rates to its depositors, the BNP will have to reduce overstaffing.

Caja de Ahorros

93. **In contrast to the BNP, the CA's deposits come mainly from the private sector (Table 3).** The effective rate of interest paid by the CA on its total deposits has been about 200 basis points over of the effective interest rate paid by the banking sector in the last three years due to the higher interest paid to CSS to attract her deposits, and despite having the largest number of saving accounts, which typically pay low deposit rates.

94. **Loans to the private sector increased substantially in 2004**. In a departure from prudent credit policies, loans to the private sector increased by an estimated 43 percent in 2004, compared with an 11 percent growth for the banking system, with most of the increase taking place in the first three quarters, i.e., the final nine months of the Moscoso administration. The CA's effective lending rate has been 150–200 basis points above the banking system average since 2002, reflecting higher risk in its credit portfolio, but not fully in line with its mandate to focus on low-income housing. In fact, since 2002 the CA diversified its loan portfolio away from mortgages. However, the sectors receiving more credit show an increasing trend in overdue payments. In 2004, overdue payments as percent of the sector loans reached 23.5 percent in the expanding sectors compared to the reduction to 21 percent in the ratio of overdue payments to loans in the mortgage sector. The CA loan diversification away from mortgages is not consistent with its original mission.

95. **The CA's financial soundness indicators are weaker than the average for the banking system.** The share of nonperforming loans has been about 12 percentage points above the industry average over the last four years (Table 2), and provisions for bad loans also were substantially below the banking sector average. In 2002–03, the CA had a ratio of administrative costs-to-loans of 5.8 percent, compared with 4.2 percent on average in the banking system. With the low loan quality and high operational costs, the CA's return on assets has been below the industry average since 2000.

Corporate Governance

96. **The CA's governance and credit policies have serious weaknesses**. Audits by the SB in the second half of 2004 suggest shortcomings in governance. According to press reports, a trust department attached to the Board of Directors was able to effectively grant credits without following the bank's own credit policies, and without the control of a Risk Assessment Unit as required by SB regulations.[46] Loans made under the trust umbrella amounted to about $200 million, equivalent to about 17 percent of total assets at end-2004.

Medium-term Strategy

97. **The CA could be privatized**. The creation of the CA in 1934 was justified on the grounds that a then emergent private banking industry could not satisfy the financing needs of the housing sector. CA activities now overlap with those of well developed private banks and the BNP. To avoid duplicating public sector efforts to address the need for housing finances, the CA could be privatized, leaving to the BNP the task of supplementing private sector efforts to address the housing needs of the population.

D. Public Development Banks

Banco de Desarrollo Agropecuario

98. **BDA is not a deposit taking institution**. BDA is funded mainly through a 1 percent tax on new credits granted by the banking sector (FECI),[47] equivalent to about 0.15 percent of GDP in 2004, and with transfers from the central government to address contingencies faced by rural producers (Table 4).

99. **Asset quality is poor.** Accounting deficiencies make it difficult to have a full assessment of the balance sheet. However, available data show high nonperforming loans, equivalent to 32 percent of total loans, and a low provision coverage equivalent to only

---

[46] See Panama's national newspapers, "Panama América," December 16, 2004, and "La Prensa," December 15, 2004.

[47] In the fiscal reform initiative adopted by the National Assembly in February 2005, FECI is scheduled to end in 2008.

25 percent of the nonperforming loans (Table 5). Most of the loans granted to address contingencies faced by producers end up being rescheduled and guaranteed by future crops. Furthermore, deducting loans that have been in arrears for more than one year reduces assets by about $90 million or 55 percent of BDA net worth at end-2004.

BDA Reform Strategy

100. **An initial step to reform the BDA** was the external audit of the BDA included as a structural performance criterion in the 2000 Stand-by Arrangement. Although the external audit was achieved with a delay, no substantial reforms followed.

101. **The BDA's objectives can be achieved through alternative mechanisms.** Panama has a well developed banking system that can accommodate the financial needs of profitable agricultural firms. According to market participants, under current practices, a significant amount of BDA resources is not directed to low-income producers but to well established agricultural enterprises that benefit from low cost loans. Social needs of rural small producers can be addressed at a lower cost through alternative mechanisms, including insurance schemes for agricultural activities. Financing social objectives, e.g., providing interest rate subsidies or loan repayment subsidies may be transparently provided by the government through budgetary resources and channeled through the private banking system.

Banco Hipotecario Nacional

102. **Legislation to close the BHN to the National Assembly was a structural performance criterion in the 2000 Stand-by Arrangemen**t. The proposal aimed for approval for the sale of the bank's performing assets, the release of its employees and its liquidation. However, the performance criteria was not achieved.

103. **The BHN continues to have management problems.** The bank has been used for political purposes and lacks basic tools to conduct sound banking practices. It does not report audited financial statements, nor does it follow generally accepted accounting rules in financial institutions, or have an adequate corporate governance framework. In addition, it has a poor information technology infrastructure, and it lacks a complete record of its own assets and the status of past loans.

BHN Balance Sheet

104. **The BHN is not a deposit taking institution.** The BHN is funded through the budget and through the Ministry of Housing with resources amounting to a cumulative 0.4 percent of 2004 GDP since 1998. The Ministry of Housing provides in-kind resources in the form of land and buildings (Table 6). The buildings are then managed by the BHN, which leases or mortgages them. The CSS also funded the BHN in the past but the BHN is in arrears to service those funds. The dominant group of assets is the mortgage portfolio, which represents 39 percent of total assets.

105. **Asset quality is also poor.** Nonperforming loans reached approximately 44 percent of the loan portfolio at end-2004 (Table 7); loan-loss provisions covered 16 percent of the nonperforming loans. The high nonperforming loan ratio may reflect both the risk levels of the bank's loans and difficulties in managing the portfolio efficiently. In particular, many debtors do not have a stable employment; loan repossession is minimal; and interest on past due loans continues to accrue more than one year after payments become overdue. The BHN does not have a concept of unrecoverable loans. There is no loan classification by credit risk.

106. **In addition a "no payment" culture has developed among the BHN debtors.** The BHN failed to collect payments on time and had long delays in title processing and regularization. A large but unspecified share of the tenants in the apartments leased by BHN are not current in their rent. However, the BHN has to pay the maintenance cost of those apartments.

107. **The BHN's current priority is to implement a financial, administrative, and operating re-structuring**. BHN should adopt accounting rules applicable to financial institutions, update the asset register, focus on asset recovery, and upgrade its information technology systems.

E. Conclusions

108. **Public commercial banks do not address any obvious market failure in Panama's relatively well developed banking system**. Public commercial banks need to implement sound banking practices, improve efficiency, enhance governance, and define a business strategy to find their niche in an over-banked financial system. Corporate governance needs to be modernized, including the appointment of Board of Directors members whose term should not coincide with the government cycle. Intra-public sector transactions should be conducted on an arms length basis using market prices to avoid the misallocation of resources.

109. **The CA's privatization could save public resources** related to the duplication of efforts between the CA and the BNP in financing low-income housing. The CA's loan diversification away from mortgages is not consistent with its original mission and its financial soundness indicators are relatively poor. While the BNP's financial soundness indicators are somewhat better than those of the CA, they remain below the average for the banking system.

110. **The BDA and BHN perform essentially quasi-fiscal functions and should be closed**. Both institutions have a large portfolio of nonperforming loans, have governance problems, and are inefficiently run. There is also concern about how well their subsidies are targeted. Since development banks do not have deposits, the main closure costs are related to severance payments that can be partially financed with the sale of the bank's performing loans and fixed assets.

111. Alternative ways to target assistance to rural producers and low-income housing can be designed. The social functions these banks perform should be carried out directly by the government, and reflected in explicit budgetary subsidies with loan administration being turned over to commercial banks.

Box 1. Public Commercial Banks

The mission of the National Bank of Panama (BNP) is to support the development of the Panamanian economy. It combines commercial banking activities with extensive banking services to the government, acting as fiscal agent and managing the clearinghouse. Public enterprises and municipalities must deposit their resources at BNP. The government guarantees all BNP liabilities.

The BNP does not have a modern corporate governance framework. The BNP operates under the terms of its 1975 Organic Law, which predates the Superintendency of Banks (SB) and its regulatory framework; and the BNP lacks operational independence from the government. The upper BNP management is appointed by the President and its term coincides with that of the administration. The BNP is managed by a five-member Board of Directors and a General Manager.

The BNP's profitability on average assets has been above the industry average during 2000–03, in part because it does not pay deposit interest rates to public entities and has a low provision in relation to its nonperforming loans.

The Savings Bank (CA) mission is to promote savings and provide financing to address the shortage of low-income housing problem. It has the largest number of small savings accounts. The CA offers deposit insurance that doubles the minimum guideline set for the private banking sector in the banking law.

The CA Board of Directors is appointed by the President, subject to approval by the Assembly. Its five year term overlaps with the administration cycle.

The CA's profitability has been below the industry average since 2000.

Box 2. Public Development Banks

Public development banks follow the accounting rules applicable to government entities and not the accounting rules set by the SB for financial institutions. Income is registered on an accrual basis and the banks lack a loan classification framework.

The BDA's objectives are to lend to small and medium-size producers specialized in traditional crops (rice, beans, corn), to support new agricultural activities with higher value added aimed to increase nontraditional exports, to finance their equipment acquisition and to provide resources to agricultural producers in trouble due to weather or other type of contingencies.

BDA management rules are inconsistent with sound banking practices. BDA corporate governance entails conflicts of interest. The Executive Committee is chaired by the Minister of Agricultural Development and includes the Minister of Commerce and Industry and representatives from organized independent producers.

BDA follows the accounting rules applicable to government entities and not the accounting rules set by the SB applicable to financial institutions. Income is registered on an accrual basis and the bank lacks a loan classification framework. BDA does not pay taxes.

The BDA is a loss making institution. Although accounting deficiencies make it difficult to have a full assessment of the BDA financial statements available data reports losses on a cash basis of about $1.7 and $1.4 million in 2003 and 2004 respectively.

The BHN mission is to finance low-income housing as the Constitution states that housing is a social right of the population. BHN activities include providing the land to build either to future dwellers or to developers. BHN also manages apartment buildings constructed by the Ministry of Housing.

The government appoints the Board of Directors. The Board of Directors is chaired by the Ministry of Housing and other four members appointed by the President, including representatives from the construction industry and savings and loans associations with potential conflicts of interest. BHN is tax exempt.

The BHN has had losses on a cash basis since 2000.

References

Andrews, Michael A., 2005, "State-Owned Banks, Stability, Privatization, and Growth: Practical policy decisions in a World Without Empirical Proof." IMF Working Paper 05/10 (Washington, D.C: International Monetary Fund).

Banco de Desarrollo Agropecuario, 2004 " Estado de Operaciones," several issues, Panamá City, Panamá.

Banco Hipotecario Nacional , 2004 "Memoria 2003," Panamá City, Panamá.

Banco Nacional de Panamá, 2004" Ley Número 20 de 1975 por la cual se reorganiza el Banco Nacional de Panamá" May, Panamá City, Panamá

La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer, 2000 "Government Ownership of Banks" Harvard Institute for Economic Research, Discussion Paper Number 1890, Harvard University, Cambridge MA.

Levine, Ross (1999), "Law, Finance, and Economic Growth," Journal of Financial Intermediation vol. 8 No. 1-2, January-April, U.S.A.

Morales, A. and Alfred Schipke, 2005, "Regional Integration and Financial Systems Issues," mimeo, Western Hemisphere Department, International Monetary Fund, Washington D.C.

Stiglitz, J.E., 1993, "The role of the state in financial markets. Proceedings of the world Bank Annual Conference on Economics Development, Washington D.C. World Bank.

Sapienza, Paola, 2004, "The effects of government ownership on bank lending" Journal of Financial Economics number 72 p. 357-384, Amsterdam.

Table 1 . Panama: Accounts of the National Bank of Panama

(In millions of balboas at end period)

	2000	2001	2002	2003	2004
Net foreign assets	**661**	**1,064**	**1,135**	**979**	**604**
Net international reserves	707	1,116	1,171	1,013	633
Long-term foreign liabilities	**46**	**52**	**36**	**34**	**29**
Net domestic reserves	**611**	**331**	**-9**	**-173**	**-210**
Net domestic assets	**-839**	**-830**	**-436**	**-96**	**317**
Public sector (net)	-1,149	-1,369	-1,172	-962	-488
Central government (net)	178	-50	83	247	501
Credit	717	666	714	658	981
Deposits	-540	-716	-631	-411	-480
Rest of public sector (net)	-1,327	-1,319	-1,255	-1,209	-988
Of which: Social Security	-1,078	-1,112	-1,064	-985	-692
Private sector	748	976	1,119	1,228	1,305
Official capital and surplus	-500	-500	-500	-500	-500
Unclassified assets (net)	63	63	117	137	0
Liabilities to domestic private sector	**433**	**566**	**690**	**710**	**711**
Demand deposits	59	85	87	84	94
Time deposits	164	245	303	334	317
Savings deposits	203	229	291	285	296
Memorandum item					
Credit to the private sector, 12-month growth rate	28.1	30.5	14.6	9.8	6.2
Liabilities to domestic private sector, 12-month growth rate	9.1	30.7	22.0	2.8	0.2
Social Security deposits/ Total liabilities, in percent	32.4	31.2	30.3	28.8	21.6
NIR/short term external debt, in percent	132.0	118.0	406.6	167.5	256.2

Sources: National Bank of Panama; and Superintendency of Banks.

Table 2. Panama: Commercial Bank Performance Indicators, 2000–04 1/
(In percent at end-period, unless otherwise noted)

	2000	2001	2002	2003	2004 Mar.	2004 Jun.	2004 Sep.
Asset quality							
Nonperforming loans as percent of total loans							
National Bank of Panama 2/	5.3	7.3	5.5	3.4	4.3	4.2	3.8
Savings Bank	14.4	13.7	20.6	14.8	12.8	8.1	8.8
Banking system	1.4	2.8	3.4	2.7	2.8	2.1	2.0
Ratio of provisions to nonperforming loans							
National Bank of Panama 2/	46.3	45.5	58.1	71.2	66.8	60.9	70.3
Savings Bank	40.1	36.1	22.8	37.0	37.6	61.1	54.8
Banking system	133.8	87.9	136.8	135.6	126.1	160.3	151.2
Profitability							
Pretax return on average assets							
National Bank of Panama	3.4	2.2	2.9	2.6	2.7	2.2	2.1
Savings Bank	0.9	0.9	0.9	1.1	1.8	0.7	1.0
Banking system	1.3	1.0	0.5	2.1	2.5	2.2	2.3
Liquidity							
Ratios to total deposits							
Liquid assets							
National Bank of Panama	61.3	59.1	51.1	42.2	39.4	33.4	22.0
Savings Bank	48.0	35.5	28.9	21.9	21.6	22.4	24.0
Banking system	35.5	31.4	29.4	28.6	28.0	26.7	26.5
Liquid assets plus marketable securities							
National Bank of Panama	68.2	71.3	63.3	53.7	51.8	47.2	36.2
Savings Bank	62.9	55.9	50.4	43.8	43.9	42.9	46.9
Banking system	43.3	40.2	40.3	42.6	41.5	40.0	42.2
Capital adequacy ratios							
Ratio of capital to unweighted assets							
National Bank of Panama	14.9	13.9	14.0	15.3	15.3	15.7	16.4
Savings Bank	12.8	12.3	12.6	13.12	13.15	11.4	12.1
Banking system	10.2	10.2	11.3	12.83	13.2	13.1	13.4

Sources: Superintendency of Banks; and Fund staff estimates.

1/ Data refer to the domestic banking system, comprising general license banks.

2/ In relation to private sector loan portfolio.

Table 3 . Panama: Accounts of the Savings Bank
(In millions of balboas at end of period)

	2000	2001	2002	2003	Est. 2004
Net foreign assets	**5**	**10**	**7**	**2**	**-12**
Net domestic reserves	**200**	**-1**	**176**	**150**	**137**
Domestic currency	0	0	0	2	0
Deposits in local banks (net)	196	-3	174	144	135
Demand deposits	6	5	5	6	6
Time deposits	205	18	169	139	129
Deposits of banks	-14	-26	0	0	0
Net domestic assets	**170**	**396**	**319**	**385**	**434**
Public sector (net)	-203	-260	-151	-165	-211
Central government	1	2	120	141	152
Loans and advances	1	2	120	141	152
Deposits	0	0	0	0	0
Rest of public sector	-204	-261	-271	-307	-363
Of which : Social Security	-191	-249	-259	-302	-358
Debentures	-126	-118	-128	-96	-168
Deposits	-78	-143	-143	-210	-195
Private sector	465	517	533	551	747
Loans and discounts	433	500	519	539	738
Investment	33	17	14	13	8
Unclassified assets (net)	11	249	55	132	27
Official capital and surplus	103	110	118	133	129
Liabilities to domestic private sector	**376**	**404**	**502**	**537**	**560**
Demand deposits	12	17	22	19	25
Time and savings deposits	364	387	478	501	525
Time deposits	142	153	171	159	146
Savings deposits	221	234	286	297	297
Memorandum items:					
Credit to the private sector, 12-month growth rate	9.6	11.1	3.2	3.4	35.4
Liabilities to domestic private sector, 12-month growth rate	-3.5	7.5	24.2	6.9	4.2
Liquid assets/private deposits, in percent	54.7	2.0	36.5	28.3	22.5
Social Security deposits/Total liabilities, in percent	30.1	34.6	31.1	34.1	35.9

Sources: The Savings Bank; and Superintendency of Banks.

Table 4. Panama: Agricultural Development Bank Balance Sheet
(In millions of U.S. dollars)

	2000	2001	2002	2003	2004
Assets	**192**	**207**	**231**	**245**	**261**
Current assets	55	47	54	45	59
Interest receivable	28	31	33	38	50
Loans	107	131	147	124	123
Agricultural loans	108	120	129	104	102
Provisions agriculture	-4	-6	-7	-8	-8
Fixed assets, net	12	12	12	12	11
Other assets	17	17	18	63	68
Liabilities	**110**	**99**	**94**	**88**	**84**
Short-term liabilities	36	35	35	34	33
Long-term liabilities	74	64	59	55	51
Foreign loans	29	24	21	18	15
Other liabilities	1	0	0	0	
Official capital	**81**	**109**	**137**	**156**	**177**
Contributions to programs	63	79	85	88	90
Contributions to capital	69	82	105	122	142

Source: The Agricultural Development Bank.

Table 5. Panama: Agricultural Development Bank—Portfolio in Arrears

	2000	2001	2002	2003	2004
Total portfolio	**90.9**	**100.5**	**100.8**	**103.6**	**102.2**
Loans overdue	**23.6**	**28.4**	**25.9**	**30.9**	**32.9**
Loans overdue as a share of total portfolio	**26.0**	**28.3**	**25.7**	**29.8**	**32.2**
Loans with payments overdue	**23.6**	**28.4**	**25.9**	**30.9**	**32.9**
Overdue 30–90 days	2.9	3.1	3.5	3.9	3.7
More than 90 days overdue	20.8	25.4	22.4	27.0	29.2
Percent of total with payments overdue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Overdue 30–90 days	12.2	10.8	13.5	12.6	11.2
More than 90 days overdue	87.8	89.2	86.5	87.4	88.8

Sources: The Agricultural Development Bank.

Table 6 . Panama: National Mortgage Bank Balance Sheet

(In millions of U.S. dollars)

	2000	2001	2002	2003	2004
Assets	**369**	**365**	**368**	**385**	**389**
Current assets	48	59	94	109	124
Interest receivable	55	72	76	88	98
Leasing receivable	6	8	9	11	13
Liquid resserves	11	9	3	3	3
Loans	183	165	152	146	137
Provisions	1	-7	-24	-24	-24
Investments	24	30	19	19	19
Fixed assets	103	102	100	107	107
Land	75	75	74	83	84
Buidlings	42	42	42	42	41
Liabilities	**105**	**99**	**96**	**102**	**108**
Short-term liabilities	29	29	26	42	40
Long-term liabilities	71	64	62	50	54
Other liabilities	6	6	8	11	14
Official capital	**264**	**267**	**272**	**283**	**281**

Source: The National Mortgage Bank.

Table 7. Panama: National Mortgage Bank—Portfolio in Arrears 1/

	2000	2001	2002	2003	2004
Total portfolio	193.4	184.7	182.4	176.9	166.3
Total arrears	44.1	54.1	59.3	64.9	73.7
Share of arrears in total portfolio	22.8	29.3	32.5	36.7	44.3

Sources: The National Mortgage Bank.

1/ This portfolio includes bad loans related to projects financed through the Ministry of Housing aid at alleviating the problem of housing for lower income families.

VI. Fiscal Cost of a Free Trade Agreement with the United States[48]

A. Introduction

112. **Free trade agreements are part of Panama's strategy to boost its export-oriented sector**. Trade agreements may provide Panama with numerous benefits: they may encourage foreign investors with a regional focus to establish their operations in Panama, enhance the legal framework to attract U.S. investors, and expand access to the U.S. market. Free trade agreements with El Salvador and with Taiwan Province of China were concluded in 2003, and the authorities have held several rounds of negotiations since April 2004 on a free trade agreement with the United States, Panama's most important trading partner. Implementation of such an agreement could have a significant adverse effect on import tax revenues, however.

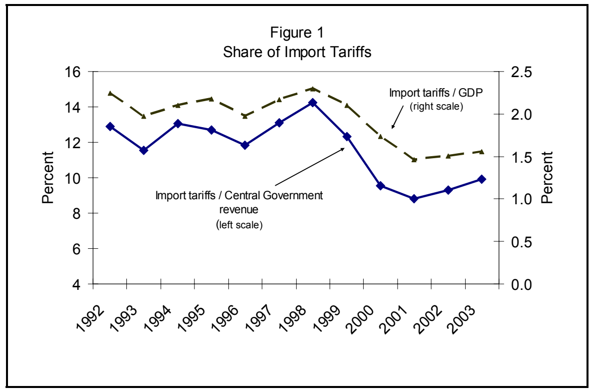
113. **This chapter presents estimates of the fiscal cost of a prospective free trade agreement between Panama and the United States.** The direct effect of removing tariffs on imports from the United States is estimated to be on the order of ½ percent of GDP, phased over several years. On the basis of an assumed timetable for tariff reductions, more than half of the impact would arise during the first five years after the agreement takes effect. If, as a result of the removal of tariffs, imports from third countries are displaced by imports from the United States, the total loss of tax revenue might range as high as 1 percent of GDP. However, these estimates do not incorporate the potential dynamic effects of higher growth that might, over time, result from the FTA. In view of the authorities' fiscal policy objectives, which include revenue mobilization, the implementation of a trade agreement with the United States would likely give rise to a need for compensating fiscal revenue measures. The range of estimates of foreign tax revenue presented here suggest the potential size of the revenue gap that may be created by the FTA.

114. **The chapter is organized as follows**: Section B presents background information; Section C discusses methodology and data; Section D presents estimates of the revenue loss; and Section E concludes.

---

[48] Prepared by Pablo Druck (WHD).

B. Tariff Revenue in Panama



115. **Although tariffs have declined since the beginning of the 1990s, they continue to account for a significant portion of total revenue**. Over the last decade, customs duties accounted for 11 percent of government revenue on average. Even though tariff revenues have been an important source of revenue, their share of total tax revenue has declined since 1998. In the period 1992–99, customs duties accounted for 13 percent of total revenues, or about 2.1 percent of GDP, while during the period 2000–03, these ratios declined to 17.5 percent and 1.6 percent of GDP, respectively.

116. **Tax revenue from trade with the United States is an important source of Panama's fiscal revenue.** The United States is Panama's main supplier of imports with 35 percent of the total, followed by the Colon Free Zone (a tax-free distribution center located in Panama) with 19 percent. Also, trade with the United States accounts for 39 percent of total import tariffs, or 7 percent of total tax revenues. Hence, removing tariffs has the potential to significantly reduce tax collections.

Table. Country Origin of Imports and Import Tariff Revenue 1/

Origin of Imports	Share of Total Imports	Share of Total Import Tariff Revenues	Ratio of Import Tariffs to Total Tax Revenue
		(in percent)	
United States	35.4	39.2	7.4
Colon Free Zone	18.8	14.9	2.8
Japan	9.4	11.2	2.1
Mexico	4.3	4.7	5.6
Other countries	32.2	30.0	0.0

Source: Ministry of Economy and Finance, and Fund staff estimates.
1/ Estimates based on data for 2003.

C. Methodology and Data

117. **A free trade agreement with the United States could affect tax revenue in several ways**. The direct effect, which arises at unchanged import volumes and (pre-tariff) prices, consists of the loss of tariffs on imports from the United States, plus a small additional impact on VAT revenue (ITBMS in Panama), which is levied on the tariff-inclusive price of imports. Indirect effects result from changes in import volumes, prices, and country of origin; they could include some or all of the following:

- An increase in import demand may result from the tariff cuts (trade creation), with a positive effect on import taxes. However, if the authorities respond to the initial loss of tariff revenues with compensating increases in other indirect taxes, the extent of trade creation would likely be diminished.

- Over the medium term, the FTA is expected to raise economic growth, particularly in the production of merchandise and service exports. While this effect may be important, estimation of the magnitude and timing of the impact on tax revenues lies beyond the scope of this paper.

- Trade diversion, in which duty-free imports from the United States displace dutiable imports from third countries, may occur to the extent that there is substitutability between goods. In an extreme case of nearly perfect substitution, the U.S. share of Panama's imports would rise sharply.[49] The likely extent of trade diversion cannot be estimated ex ante; to illustrate the potential impact of this indirect effect, alternative assumptions will be made.

- Third-country exporters may seek to maintain their market share by cutting their pre-tariff price enough to prevent trade diversion. This effect, which assumes a high degree of substitution but imperfect competition, would result in a smaller tax revenue loss than would occur with trade diversion.

118. **The estimation of the direct fiscal cost assumes the full elimination of tariffs from imports coming from the United States, with no change in import volumes or the sourcing of imports**. The fiscal cost is the result of adding all collected tariffs from imports arriving from the United States. The resulting estimation of revenue loss will be understated by as much as 5 percent, because it does not include the impact that tariff reductions have on the VAT base, hence on VAT revenue.[50]

119. **Since the FTA negotiations with the United States have not been concluded, some assumptions need to be made concerning the schedule of tariff reductions**. As a benchmark, this chapter draws upon the results of the free trade agreement signed between the United States and Central American countries (CAFTA). The CAFTA contains a common schedule for specified groups of goods that applies to imports from the United States by all Central American countries, and a set of country-specific schedules for other goods. Specifically, it is assumed that the timetable for tariff elimination in Panama parallels the negotiated common schedule in CAFTA, reflecting the view that there are important

[49] Imports that enter duty-free from all countries (38 percent of the total) would be unaffected by trade diversion.

[50] The VAT rate is 5 percent, but some goods are exempt.

similarities between the structure of CAFTA and the Panama-U.S. FTA currently being negotiated.

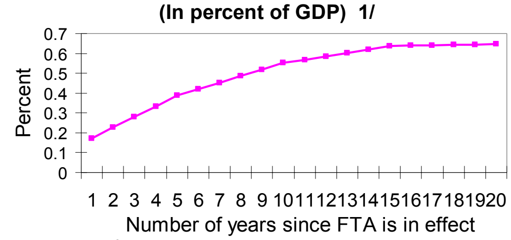
120. **Under the assumed schedule for removing tariffs on imports from the United States, the longer phase-out periods are associated with the highest import tariff rates (Table 1)**. In many cases, negotiators may seek to delay the elimination of tariffs on those goods considered sensitive for the country, and these sensitive goods may be protected with higher than average tariffs. Hence, it is expected that tariffs would be removed more slowly for goods with higher pre-agreement tariffs.

121. **Data were provided by the Contraloria General and the Ministry of Economy and Finance**. The Contraloria General provided information for each (8-digit) tariff line on the origin of imports, value of imports, collected taxes, taxable status (exemption, tax free under special trade treaty, and taxable). Additionally, the Ministry of Economy and Finance provided information on tariff rates by tariff line.

D. Estimate of Revenue Loss

122. **The direct fiscal cost of the free trade agreement between Panama and the United States is estimated at 0.6 percent of GDP, or around US$83 million, in 2003 prices**. This fiscal cost is estimated assuming that all tariffs on imports from the United States are removed, and import volumes remain unchanged. However, this revenue loss would be spread out over time, depending on the timetable for removing tariffs.

Figure 2
Tax Revenue Loss
(In percent of GDP) 1/



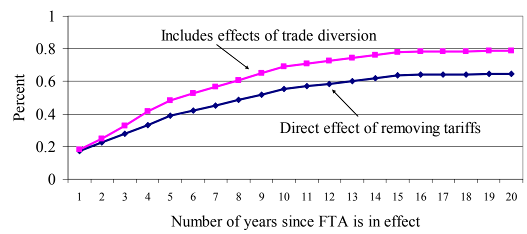
1/ In prices of 2003.

123. **Under the assumed schedule for tariff removal, the direct fiscal impact of the FTA would be a revenue loss of 0.2 percent of GDP, or US$22 million in 2003 prices, during the first year after the agreement enters into effect (Figure 1)**. About half of the revenue loss would be realized by the fourth year, and most of the full effect (more than 85 percent) would be realized by the tenth year of the FTA. Nevertheless, this pattern could be affected significantly to the extent that additional revenue losses are caused by trade diversion.

Next, two simulations of trade diversion are presented to illustrate its potential consequence for fiscal revenue. The simulations assume trade diversion of 15 percent and 50 percent of import goods, respectively, corresponding to the percentage of imports from non-U.S. suppliers that are replaced by U.S. imports.[51] While the probable extent of trade diversion is not known, it may be observed that the U.S. share of Mexico's imports after one decade of NAFTA has actually decreased.[52] This is only suggestive of there not being a large degree of trade diversion. For example, Fukao, Okubo and Stern (2003)[53] found evidence of trade diversion for U.S. imports of textiles, apparel, and some footwear products at a 4-digit level of the harmonized system. Since the extent of trade diversion following a FTA with the United States would differ from one country case to another, the simulations presented below are best viewed as highlighting the sensitivity of the results to the assumed degree of trade diversion. Since the extent of trade diversion following a FTA with the United States would differ from one country case to another, the simulations presented below are best viewed as highlighting the sensitivity of the results to the assumed degree of trade diversion.

124. **Trade diversion of 15 percent of imports would lower tax revenue by an additional 0.1 percent of GDP**. Figure 3 shows both the benchmark case and the cost of incorporating trade diversion of 15 percent of imports. This scenario assumes trade diversion of 3 percent of imports in the first year of the agreement, and continues increasing in the following year until a plateau of 15 percent of imports is reached in the fourth year.

Figure 3
Tax Revenue Loss with Trade Diversion of 15 Percent of Imports
(In percent of GDP)



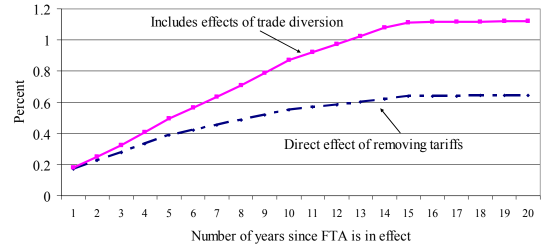
[51] These percentages are applied to each of the 8-digit tariff lines for which there were imports from both the United States and third countries in 2003.

[52] From 1994 to 2003, the U.S. share of Mexico's imports decreased from 72 percent to 62 percent (source: IMF, Direction of Trade Statistics).

[53] Fukao K., T. Okubo, and R. Stern, 2003, "An Econometric Analysis of Trade Diversion under NAFTA", North American Journal of Economics and Finance, vol. 14, pp. 3-24.

125. **On the other hand, the fiscal cost of the FTA, assuming a trade diversion of 50 percent, could reach just over 1 percent of GDP**. This exercise assumes a phased switching of imports until trade diversion reaches 50 percent in the 15th year. Figures 3 and 4 suggest that estimates of foregone tax revenue strongly depend on the degree of import substitution from non-U.S. suppliers to U.S. suppliers. Also, if trade diversion were as high as assumed in the high-case simulation, the estimated revenue loss would be nearly twice as large as the direct effect alone.

Figure 4
Tax Revenue Loss with trade diversion of 50 Percent of Imports
(In percent of GDP)



E. Conclusion

126. **The free trade agreement between Panama and the United States could reduce Panama's tax revenues by more than ½ percent of GDP, and could exceed 1 percent of GDP under a strong assumption about the degree of trade diversion (50 percent)**. The lower bound of the revenue loss reflects the static effect of assuming unchanged volumes and prices of imports, both from the United States and from third countries. Estimates of the direct and indirect effects are sensitive to the assumptions made concerning the extent and timing of trade diversion. Nevertheless, the fiscal cost would depend on the speed of removing tariffs. The estimation mentioned above considers the full effect of removing tariffs, but it is expected that the elimination of tariffs would be gradual to allow the economy a smooth transition to the free trade agreement.

Table 1. Assumed Timetable for Tariff Removal

	Number of Years After Free Trade Agreement Takes Effect																			
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Initial tariff rate (in percent)	(Percentage reduction of initial tariff rate)																			
Less than 10	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
10–14.9	20	40	60	80	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
15–19.9	10	20	30	40	50	60	70	80	90	100	100	100	100	100	100	100	100	100	100	100
10–59.9	7	13	20	27	33	40	47	53	60	67	73	80	87	93	100	100	100	100	100	100
20–99.9	0	0	0	0	0	0	8	17	25	33	46	60	73	87	100	100	100	100	100	100
Over 100	0	0	0	0	0	0	0	0	0	0	10	20	30	40	50	60	70	80	90	100

Source: Fund staff estimates.

Table 2. Distribution of Customs Duties by Tariff Rate, all Countries 1/

Statutory Tariff Rate (in percent)	As percentage of total Imports	As percentage of total Tax Revenue	Effective Tariff 2/ (in percent)	Tax Revenue (US$ million)
0	38.0	0.0	0.0	0.0
0.6	1.5	0.1	0.6	0.3
1	1.8	0.3	1.2	0.7
2	0.4	0.1	1.9	0.2
2.5	0.0	0.0	2.5	0.0
3	6.0	2.7	3.0	5.6
4	0.0	0.0	3.7	0.0
5	14.4	10.6	4.9	22.5
5.1	0.1	0.0	4.9	0.1
6	0.6	0.6	5.7	1.2
7	0.4	0.5	8.8	1.2
7.5	0.0	0.0	7.6	0.0
8	0.7	0.9	8.5	2.0
9	0.0	0.0	9.1	0.0
10	14.2	21.0	9.1	44.4
12	0.0	0.0	5.8	0.0
12.5	0.0	0.0	12.5	0.0
15	16.8	37.1	13.1	78.6
18	2.1	5.5	17.8	11.6
20	1.1	3.1	19.3	6.6
25	0.0	0.1	18.0	0.2
30	0.3	1.2	15.4	2.5
50	0.0	0.2	13.4	0.4
54	0.0	0.0	18.8	0.1
58	1.2	11.7	64.0	24.7
63	0.1	0.8	23.6	1.6
65	0.2	1.5	65.0	3.1
66	0.0	0.0	19.6	0.1
73	0.0	0.4	65.3	0.8
74	0.0	0.2	34.6	0.5
76	0.0	0.1	28.7	0.2
81	0.0	0.1	80.9	0.3
83	0.0	0.2	19.2	0.4
103	0.1	1.0	110.0	2.0
147	0.0	0.0	149.1	0.0
159	0.0	0.1	66.6	0.2
273	0.0	0.0	281.5	0.0
Total	100.0	100.0		212.0

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

1/ Information refers to imports and import duties in 2003.

2/ The effective tariff is the ratio of tariff revenues (shown in the final column) to imports in 2003 at each tariff rate.

Table 3. Distribution of Customs Duties by Tariff Rate
Based on Imports from the United States 1/

Statutory Tariff Rate (in percent)	As percentage of total		Effective Tariff (in percent)	Tax Revenue (US$ million)
	Imports	Tax Revenue		
0	32.8	0.0	0.0	0.0
0.6	0.2	0.0	0.4	0.0
1	0.4	0.1	1.7	0.1
2	0.4	0.1	2.0	0.1
2.5	0.0	0.0	2.5	0.0
3	9.2	3.5	3.0	2.9
5	20.2	13.0	5.0	10.8
5.1	0.0	0.0	5.1	0.0
6	0.8	0.6	6.2	0.5
7	0.4	0.4	9.4	0.4
8	0.4	0.4	8.9	0.4
9	0.0	0.0	9.3	0.0
10	13.9	16.7	9.3	13.9
12.5	0.0	0.0	12.4	0.0
15	14.8	25.1	13.1	20.8
18	0.9	2.0	17.7	1.6
20	0.9	2.3	19.1	1.9
25	0.1	0.3	17.7	0.2
30	0.6	1.9	26.6	1.6
50	0.0	0.2	50.0	0.2
54	0.0	0.0	45.1	0.0
58	3.6	29.7	64.0	24.7
63	0.0	0.2	37.1	0.1
73	0.0	0.3	74.0	0.3
74	0.1	0.3	26.2	0.3
76	0.0	0.1	22.4	0.1
81	0.0	0.0	80.4	0.0
83	0.2	0.2	10.0	0.2
103	0.2	2.4	110.0	2.0
147	0.0	0.0	149.1	0.0
159	0.0	0.0	161.1	0.0
273	0.0	0.0	281.5	0.0
Total	100.0	100.0		83.1

Sources: Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

1/ Information refers to imports and import duties in 2003.

Table 1. Panama: National Accounts by Productive Activity

	1999	2000	2001	2002	2003
(In millions of balboas at 1996 prices)					
Gross domestic product at market prices	**11,070**	**11,371**	**11,436**	**11,691**	**12,196**
Primary activity	815	877	925	967	1,030
Agriculture	727	798	849	877	918
Mining	88	79	76	90	112
Secondary activity	1,710	1,632	1,446	1,389	1,500
Manufacturing	1,180	1,095	1,026	999	983
Construction	530	537	420	390	517
Services	8,154	8,601	8,748	8,866	9,177
Public utilities	343	375	357	382	388
Commerce, restaurants, and hotels	1,823	1,893	1,963	1,946	1,964
Colon Free Zone wholesale	694	805	894	817	792
Restaurants and hotels	236	235	259	277	308
Other	893	854	810	851	864
Transport and communications	1,532	1,724	1,768	1,803	2,048
Panama Canal Authority	521	533	549	554	604
Other transport and comm.	1,011	1,191	1,219	1,249	1,444
Financial intermediation	1,024	1,123	1,090	1,012	950
Housing	1,715	1,777	1,794	1,868	1,936
Public administration	1,048	1,067	1,129	1,171	1,201
Other services	670	643	648	685	691
Plus: import taxes	264	221	209	212	212
Plus: other taxes minus subsidies	502	457	477	546	584
Less: imputed banking services	374	416	369	288	307
(Percent change)					
Gross domestic product at 1996 market prices	**3.9**	**2.7**	**0.6**	**2.2**	**4.3**
Primary activity	3.1	7.6	5.5	4.6	6.5
Agriculture	1.0	9.8	6.5	3.3	4.6
Mining	23.9	-10.6	-4.1	18.7	25.2
Secondary activity	9.8	-4.5	-11.4	-3.9	8.0
Manufacturing	1.1	-7.2	-6.3	-2.6	-1.6
Construction	36.0	1.3	-21.8	-7.1	32.5
Services	3.4	5.5	1.7	1.3	3.5
Public utilities	12.0	9.3	-4.7	6.9	1.7
Commerce, restaurants, and hotels	-3.9	3.8	3.7	-0.9	0.9
Colon Free Zone wholesale	-13.6	16.0	11.1	-8.6	-3.1
Restaurants and hotels	10.7	-0.8	10.5	7.0	10.9
Other	1.3	-4.4	-5.2	5.1	1.6
Transport and communications	6.7	12.5	2.5	2.0	13.6
Panama Canal Authority	1.4	2.3	3.1	0.9	9.0
Other transport and communications	9.6	17.8	2.3	2.5	15.6
Financial intermediation	5.3	9.7	-2.9	-7.2	-6.2

Table 1. Panama: National Accounts by Productive Activity

	1999	2000	2001	2002	2003
(In millions of balboas at 1996 prices)					
Housing	6.1	3.6	1.0	4.1	3.7
Public administration	0.8	1.8	5.8	3.8	2.6
Other services	8.6	-4.0	0.7	5.8	0.9
Plus: import taxes	-3.0	-16.2	-5.4	1.2	0.2
Plus: other taxes minus subsidies	8.8	-8.9	4.3	14.5	6.9
Less: imputed banking services	19.5	11.4	-11.4	-21.9	6.5
(Percent distribution)					
Gross domestic product at 1996 market prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Primary activity	7.4	7.7	8.1	8.3	8.4
Agriculture	6.6	7.0	7.4	7.5	7.5
Mining	0.8	0.7	0.7	0.8	0.9
Secondary activity	15.4	14.4	12.6	11.9	12.3
Manufacturing	10.7	9.6	9.0	8.5	8.1
Construction	4.8	4.7	3.7	3.3	4.2
Services	73.7	75.6	76.5	75.8	75.2
Public utilities	3.1	3.3	3.1	3.3	3.2
Commerce, restaurants, and hotels	16.5	16.6	17.2	16.6	16.1
Colon Free Zone wholesale	6.3	7.1	7.8	7.0	6.5
Restaurants and hotels	2.1	2.1	2.3	2.4	2.5
Other	8.1	7.5	7.1	7.3	7.1
Transport and communications	13.8	15.2	15.5	15.4	16.8
Panama Canal Authority	4.7	4.7	4.8	4.7	4.9
Other transport and communications	9.1	10.5	10.7	10.7	11.8
Financial intermediation	9.3	9.9	9.5	8.7	7.8
Housing	15.5	15.6	15.7	16.0	15.9
Public administration	9.5	9.4	9.9	10.0	9.9
Other services	6.0	5.7	5.7	5.9	5.7
Plus: import taxes	2.4	1.9	1.8	1.8	1.7
Plus: other taxes minus subsidies	4.5	4.0	4.2	4.7	4.8
Less: imputed banking services	3.4	3.7	3.2	2.5	2.5

Sources: Office of the Comptroller General; and Fund staff estimates.

Table 2. Panama: National Accounts by Expenditure

	1999	2000	2001	2002	2003
(In millions of balboas at current prices)					
Consumption	8,937	9,046	9,316	10,119	9,930
Public consumption	1,274	1,264	1,353	1,372	1,455
Private consumption	7,663	7,782	7,963	8,747	8,475
Gross domestic investment	3,158	2,863	2,289	2,212	2,762
Public	509	456	479	530	663
Private 1/	2,649	2,407	1,810	1,682	2,099
Total domestic demand	12,095	11,910	11,605	12,330	12,692
Exports of goods and services	3,279	3,557	3,613	3,569	3,861
Imports of goods and services	3,918	3,846	3,410	3,627	3,690
Foreign balance	-639	-289	203	-58	171
Gross domestic product at current prices	**11,456**	**11,621**	**11,808**	**12,272**	**12,862**
(In percent of GDP)					
Consumption	78.0	77.8	78.9	82.4	77.2
Public consumption	11.1	10.9	11.5	11.2	11.3
Private consumption	66.9	67.0	67.4	71.3	65.9
Gross domestic investment	27.6	24.6	19.4	18.0	21.5
Public	4.4	3.9	4.1	4.3	5.2
Private 1/	23.1	20.7	15.3	13.7	16.3
Total domestic demand	105.6	102.5	98.3	100.5	98.7
Exports of goods and services	28.6	30.6	30.6	29.1	30.0
Imports of goods and services	34.2	33.1	28.9	29.6	28.7
Foreign balance	-5.6	-2.5	1.7	-0.5	1.3
Gross domestic product at current market prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Sources: Office of the Comptroller General; and Fund staff estimates.

1/ Includes changes in inventories.

Table 3. Panama: Saving and Investment

	1999	2000	2001	2002	2003
	(In millions of balboas)				
Gross domestic investment	**3,158**	**2,863**	**2,289**	**2,212**	**2,762**
Fixed capital formation	2,756	2,541	1,992	1,936	2,505
Public sector	509	456	479	530	663
Private sector	2,247	2,084	1,513	1,406	1,842
Change in inventories	402	323	297	276	257
Gross national saving	**1,999**	**2,174**	**2,115**	**2,151**	**2,354**
Public saving	298	454	202	164	131
Private saving	1,701	1,721	1,914	1,986	2,224
Foreign saving	**1,159**	**689**	**174**	**61**	**408**
	(In percent of GDP)				
Gross domestic investment	**27.6**	**24.6**	**19.4**	**18.0**	**21.5**
Fixed capital formation	24.1	21.9	16.9	15.8	19.5
Public sector	4.4	3.9	4.1	4.3	5.2
Private sector	19.6	17.9	12.8	11.5	14.3
Change in inventories	3.5	2.8	2.5	2.2	2.0
Gross national saving	**17.4**	**18.7**	**17.9**	**17.5**	**18.3**
Public saving	2.6	3.9	1.7	1.3	1.0
Private saving	14.9	14.8	16.2	16.2	17.3
Foreign saving	**10.1**	**5.9**	**1.5**	**0.5**	**3.2**

Sources: Office of the Comptroller General; and Fund staff estimates.

Table 4. Panama: Electricity Generation and Consumption

(In thousands of gigawatt hours) 1/

	2000	2001	2002	2003	2004 2/
Net generation	**4.67**	**4.86**	**5.00**	**5.28**	**5.47**
Hydro	3.40	2.55	3.28	2.89	3.90
Thermal	1.27	2.31	1.72	2.39	1.58
Total consumption	**3.85**	**4.04**	**4.04**	**4.24**	**4.49**
Residential	1.12	1.26	1.26	1.34	1.44
Commercial	1.57	1.73	1.73	1.95	2.06
Industrial	0.50	0.37	0.37	0.25	0.24
Government	0.59	0.66	0.66	0.69	0.74
Other	0.07	0.02	0.02	0.01	0.01

Sources: ETESA (Empresa de Transmisión Eléctrica, SA), Elektra, Nordeste, and Unión Fenosa.

1/ A gigawatt hour is equal to one billion watts being generated or consumed for one hc
2/ Preliminary.

Table 5. Panama: Private Sector Construction Permits

(In thousands of U.S. dollars)

	Total	Panamá	San Miguelito	Colón	Others
1999	461,544	302,258	82,447	28,561	48,278
2000	509,251	363,666	72,278	29,004	44,303
2001	397,385	293,154	44,184	23,780	36,267
2002	372,123	233,789	63,661	35,293	39,380
2003	883,420	707,561	68,637	46,076	61,146
2004 1/	463,024	355,685	43,252	16,752	12,771

Source: Office of the Comptroller General.

1/ Preliminary data.

Table 6. Panama: Premium and Regular Gasoline Sales in Stations

(In thousands of barrels)

Month	2000	2001	2002	2003	2004
January	271	264	271	258	270
February	257	240	248	250	245
March	279	271	285	255	295
April	257	263	261	267	281
May	266	250	274	267	251
June	266	259	251	254	260
July	253	260	272	271	273
August	269	271	270	269	271
September	0	237	262	261	265
October	265	252	277	287	258
November	250	271	253	262	...
December	279	291	289	294	...
Total	**2,912**	**3,129**	**3,212**	**3,196**	**2,668**

Sources: Ministry of Commerce and Industry; and Fund staff estimates.

Table 7. Panama: Diesel Sales in Stations

(In thousands of barrels)

Month	2000	2001	2002	2003	2004
January	214	210	211	216	239
February	208	195	204	218	220
March	234	236	239	221	266
April	216	219	224	231	264
May	227	218	237	235	221
June	213	214	206	224	231
July	218	203	226	233	246
August	225	223	224	228	235
September	0	199	214	220	239
October	214	209	224	247	228
November	209	217	214	226	...
December	208	214	228	237	...
Total	**2,386**	**2,555**	**2,651**	**2,736**	**2,390**

Sources: Ministry of Commerce and Industry; and Fund staff estimates.

Table 8. Panama: Monthly Index of Economic Activity

(Base Year 1997=100)

	Original	Trend	Percent Change Original	Percent Change Trend
		(Period average)		
2000	112.8	112.9	2.4	2.6
2001	109.5	109.3	-2.9	-3.2
2002	109.8	109.5	0.3	0.2
2003	114.5	113.7	4.2	3.8
2004	121.1	121.0	5.8	6.4
		(End of period)		
2000	108.6	111.3	-3.6	0.1
2001	105.8	109.0	-2.6	-2.0
2002	108.9	109.3	2.9	0.2
2003	118.5	117.3	8.9	7.3
2004	129.9	124.8	9.6	6.5

Sources: Office of the Comptroller General (Contraloria); and Fund staff estimates.

Table 9. Panama: Canal Statistics

Fiscal year Ended Sep. 30	Total Traffic				Traffic Assessed Toll on Net Tonnage Basis 1/		
	Number of Transits (In thousands)	Tolls (In millions of balboas)	Cargo Tonnage (In millions of long tons)	Average Toll (balboas per long ton)	Number of Transits (In thousands)	Net Tonnage 2/ (In millions of p.c. net tons)	Average Tonnage per Transit (In thousands of p.c. net tons)
Total traffic							
1999	14.3	568.9	196.0	2.9	14.1	227.6	16.2
2000	13.7	574.2	193.7	3.0	13.5	229.9	17.1
2001	13.5	579.5	193.2	3.0	13.3	231.2	17.4
2002	13.2	588.8	187.8	3.1	13.1	234.9	17.9
2003	13.1	665.9	188.3	3.5	13.0	242.5	18.7
2004	14.0	757.7	…	…	13.9	266.7	19.2
Of which Commercial ocean traffic 3/							
1999	13.1	568.1	196.0	2.9	13.0	227.4	17.5
2000	12.3	573.0	193.7	3.0	13.7	229.5	16.8
2001	12.2	578.4	193.1	3.0	12.1	230.7	19.1
2002	11.9	587.6	187.8	3.1	11.8	234.5	19.9
2003	11.7	664.6	188.3	3.5	11.6	242.0	20.9
2004	12.5	756.2	...	...	12.4	266.1	21.5

Sources: Panama Canal Authority; and Fund staff estimates.

1/ Traffic tolls not assessed on net tonnage basis are assessed on displacement-tonnage basis.
2/ One Panama Canal (p.c) net ton equals 100 cubic feet space. Noncommercial ocean traffic is mainly U.S. government traffic.
3/ Ocean traffic includes ships of 300 p.c. net tons and over.

Table 10. Panama: Labor Force Statistics

	1999	2000	2001	2002	2003 1/
	(In thousands of persons)				
Total population	2,811.9	2,948.0	3,004.0	3,058.0	3,113.0
Working age population	1,779.1	1,814.8	1,907.2	1,949.7	1,984.8
Total labor force 2/	1,089.4	1,086.6	1,154.0	1,285.0	1,315.3
Employment by activity	961.4	942.0	984.2	1,111.7	1,146.6
Agriculture and mining	168.4	163.0	210.0	236.3	240.6
Manufacturing	94.0	85.3	86.0	100.2	103.6
Public utilities	7.0	6.9	9.3	8.6	9.3
Construction	73.0	69.2	63.9	71.9	79.7
Commerce	182.7	181.0	170.8	195.6	199.8
Banking	23.9	27.3	20.6	22.5	21.3
Transportation and communication	73.0	71.7	73.2	81.9	86.0
Other services	339.4	337.6	323.9	394.6	406.3
Unemployment	128.0	144.6	169.7	173.3	168.8
Unemployment rate	11.8	13.3	14.7	13.5	12.8
Memorandum items:					
Employment by sector	961.4	942.0	984.2	1,111.7	1,146.6
Public sector	156.1	171.6	177.7	181.0	182.0
Private business	424.1	401.6	421.3	443.3	443.3
Self-employed	296.1	291.3	296.0	333.2	333.2
Other	85.0	77.5	89.2	154.2	188.1
	(Annual percent change)				
Total population	1.7	4.8	1.9	1.8	1.8
Working age population	2.1	2.0	5.1	2.2	1.8
Total labor force	0.5	-0.3	6.2	11.4	2.4
Employed	2.7	-2.0	4.5	12.9	3.1
Unemployed	-13.0	12.9	17.4	2.1	-2.6
Labor force participation rate 3/	61.2	59.9	60.5	65.9	66.3
Employment rate 4/	54.0	51.9	51.6	57.0	57.8
Unemployment rate	11.8	13.3	14.7	13.5	12.8
Of *which* :					
Metropolitan areas 5/	13.8	15.2	17.0	16.1	16.1

Sources: Ministry of Labor; and Office of the Comptroller General.

1/ As of August 2003 household survey.
2/ Excludes indigenous population, canal area, and collective housing, but includes employees in the formal and informal sectors, employers, and the self employed.
3/ Total labor force as a percentage of the working-age population.
4/ Employed labor force as a percentage of the working-age population.
5/ Includes the cities of Panama and Colon.

Table 11. Panama: Wholesale Price Index
(12-month percentage change)

	Total	Imports	Industrial	Agricultural
	(In percent)			
Weights	100.0	43.7	45.1	11.2
	(Period average)			
1999	2.7	6.0	-0.3	0.8
2000	8.7	13.1	6.2	0.6
2001	-3.2	-5.1	-1.9	0.5
2002	-3.0	-4.5	-1.8	-0.8
2003	1.7	1.6	2.9	-2.8
2004 1/	4.5	5.3	4.1	2.6
	(End of period)			
1999				
March	-2.1	-2.6	-2.3	0.7
June	0.4	4.1	-3.4	0.8
September	5.6	10.5	1.9	0.9
December	6.8	12.2	2.9	0.9
2000				
March	10.9	17.0	7.7	-0.6
June	10.3	13.8	8.5	1.5
September	6.9	10.9	3.8	1.3
December	7.2	10.9	4.7	0.3
2001				
March	1.7	2.8	0.4	1.1
June	-1.3	-2.5	-0.4	0.9
September	-3.5	-6.1	-1.3	0.4
December	-9.4	-13.9	-6.3	-0.3
2002				
March	-7.8	-11.3	-6.1	2.4
June	-3.3	-3.9	-3.4	-0.3
September	-2.7	-4.0	-1.3	-3.0
December	2.2	1.7	3.8	-2.2
2003				
March	4.8	5.7	6.2	-5.0
June	-0.9	-2.6	2.2	-5.3
September	1.9	1.6	3.0	-1.2
December	1.0	1.9	0.3	0.4
2004				
March	2.1	3.0	1.1	2.6
June	7.0	8.3	6.3	3.7
September	5.0	5.6	4.7	3.2

Source: Office of the Comptroller General; and Fund staff estimates.
1/ Year through September.

Table 12. Panama: Consumer Price Index 1/

(Index 1987=100, unless otherwise noted)

	Total	Food	Clothing	Housing 2/	Transport	Other
			(Period average)			
2000	114.0	113.6	108.9	117.4	110.1	115.2
2001	114.3	112.8	113.5	119.8	106.6	116.8
2002	115.5	112.1	113.1	121.3	113.7	117.0
2003	117.1	113.5	114.5	124.3	114.5	118.4
2003 3/	100.5	99.7	102.0	101.7	99.8	100.3
2004 (January - June) 3/	100.5	100.1	99.7	101.3	101.0	100.3
			(Monthly index)			
2000 - December	114.1	113.4	109.8	119.6	107.0	115.7
2001 - December	114.1	112.8	113.6	120.2	103.8	117.3
2002						
March	115.3	112.0	113.1	120.9	112.5	117.4
June	115.2	111.1	113.3	121.3	113.6	117.3
September	115.7	112.7	112.9	121.2	114.7	116.5
December	116.1	112.3	114.0	122.2	115.5	117.2
December 3/	100.0	100.0	100.4	99.9	100.1	99.8
2003						
March	117.1	112.3	114.9	129.0	116.1	122.6
June	116.9	113.3	114.8	130.6	116.3	122.8
September	117.3	114.0	114.6	129.8	116.8	122.5
December	118.1	115.0	113.0	131.4	116.5	122.6
2003 3/						
March	100.7	99.2	103.0	102.2	101.1	100.3
June	100.5	99.7	101.7	102.3	99.1	100.4
September	100.4	100.0	101.2	101.1	100.3	100.1
December	100.1	100.0	100.2	100.8	99.8	99.8
2004 3/						
March	100.3	99.7	99.7	101.3	100.6	100.4
June	100.9	100.6	99.3	101.6	102.4	100.5
			(Annual percent change)			
2001	0.3	-0.6	4.2	2.0	-3.2	1.4
2002	1.0	-0.7	-0.4	1.3	6.7	0.1
2003	1.4	1.3	1.2	2.4	0.6	1.2
2004 (January - June) 3/	0.0	0.4	-2.2	-0.5	1.2	0.0
			(12-month percent change)			
2001 - December	0.0	-0.5	3.5	0.5	-3.0	1.4
2002 - December	1.8	-0.4	0.4	1.6	11.3	-0.1
2003						
March	1.6	0.3	1.6	6.7	3.2	4.4
June	1.5	2.0	1.3	7.7	2.4	4.7
September	1.4	1.2	1.5	7.1	1.8	5.2
December	1.7	2.4	-0.9	7.6	0.9	4.7
December 3/	0.1	0.0	-0.2	0.8	-0.3	0.0
2004 3/						
March	-0.4	0.5	-3.2	-0.9	-0.5	0.1
June	0.4	0.9	-2.4	-0.6	3.3	0.2
Memorandum items:						
Weights CPI 1987=100	100.0	34.9	5.1	21.0	15.1	23.9
Weights CPI October 2002=100	100.0	32.3	9.7	20.2	13.0	24.8

Source: Office of the Comptroller General.

1/ The new CPI with October 2002 as reference period is a national index, whereas the 1987-base CPI refers only to Panama City. The new CPI was released in October 2004 and its weights are based on the 1997/98 household survey.

2/ Includes rent, furniture, maintenance work, and utilities (water, electricity, and domestic gas).

3/ Based on revised CPI (October 2002=100).

Table 13. Panama: Operations of the Nonfinancial Public Sector

	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of balboas)					
Revenue and grants	**3,110.7**	**2,980.2**	**3,006.0**	**3,140.4**	**2,072.8**	**2,291.1**
General government current revenue	2,821.3	2,654.8	2,714.4	2,720.7	1,815.1	1,895.7
Central government	1,999.2	1,836.8	1,901.1	1,917.4	1,237.4	1,255.5
Social security agency	741.9	733.9	724.5	725.0	518.7	580.7
Decentralized agencies	80.2	84.0	88.9	78.4	59.0	59.5
Public enterprise operating balance (deficit -)	307.4	269.4	300.1	346.5	211.2	364.3
Overall balance of nonconsolidated public sector (deficit -)	-68.7	-2.4	-30.6	21.6	21.2	21.9
Educational insurance balance (deficit -)	-16.2	-2.4	-5.9	2.7	14.4	3.8
Capital revenue	63.1	60.3	28.0	48.8	10.9	5.4
Grants	3.8	0.6	0.0	0.0	0.0	0.0
Expenditure	**3,050.3**	**3,197.5**	**3,343.3**	**3,624.0**	**2,715.9**	**2,827.6**
General government current expenditure	2,593.9	2,718.4	2,813.7	2,961.0	2,297.9	2,365.0
Central government	1,541.1	1,594.5	1,610.3	1,709.8	1,372.7	1,403.7
Social security agency	905.5	982.5	1,055.2	1,104.9	816.6	854.2
Decentralized agencies	147.4	141.4	148.2	146.2	108.5	107.1
Capital	456.4	479.1	529.6	663.0	418.0	462.7
Fixed investment	528.1	528.1	528.1	528.1	528.1	528.1
Transfers to private sector	55.2	55.2	55.2	55.2	55.2	55.2
Saving 1/	**449.9**	**201.0**	**164.3**	**130.6**	**-236.0**	**-79.3**
Overall balance (deficit -)	**60.4**	**-217.2**	**-337.3**	**-483.6**	**-643.1**	**-536.5**
Financing	**-60.4**	**217.2**	**337.3**	**483.6**	**643.1**	**536.5**
External	109.9	365.7	328.5	287.4	292.6	145.3
Disbursements	510.1	1,245.8	1,079.5	421.0	386.2	662.9
Repayments	391.3	535.7	946.2	287.9	278.0	536.4
Change in deposits abroad	8.9	344.4	-195.2	-154.3	-184.4	-18.8
Domestic (net)	-171.4	-148.9	8.9	196.3	350.6	391.2
Trust Fund for Development	-28.8	115.6	0.0	5.0	0.0	39.2
Panama Canal Authority	-130.9	-57.5	-66.0	-126.9	-145.7	-210.0
Other	-11.7	-207.0	74.9	318.2	496.3	562.0
Of which: banking system	-35.1	113.4	213.1	225.0	368.0	351.3
Privatization	1.1	0.4	0.0	0.0	0.0	0.0

Table 13. Panama: Operations of the Nonfinancial Public Sector

	2000	2001	2002	2003	January–September 2003	January–September 2004
	(Percent change)					
Revenue	**11.1**	**-4.1**	**0.9**	**3.8**	**7.3**	**10.5**
Expenditure	**3.7**	**4.8**	**4.6**	**8.4**	**9.4**	**4.1**
Current	6.7	4.8	3.5	5.2	7.6	2.9
Capital	-10.3	5.0	10.6	25.2	20.7	10.7
	(In percent of GDP)					
Revenue and grants	**26.8**	**25.2**	**24.5**	**24.4**	**21.5**	**22.1**
Expenditure	**26.2**	**27.1**	**27.2**	**28.2**	**28.2**	**27.3**
Current	22.3	23.0	22.9	23.0	23.8	22.9
Capital	3.9	4.1	4.3	5.2	4.3	4.5
Saving 1/	**3.9**	**1.7**	**1.3**	**1.0**	**-2.4**	**-0.8**
Overall balance (deficit-)	**0.5**	**-1.8**	**-2.7**	**-3.8**	**-6.7**	**-5.2**
Financing	**-0.5**	**1.8**	**2.7**	**3.8**	**6.7**	**5.2**
External	0.9	3.1	2.7	2.2	3.0	1.4
Domestic	-1.5	-1.3	0.1	1.5	3.6	3.8
Trust Fund for Development	-0.2	1.0	0.0	0.0	0.0	0.4
Panama Canal Authority	-1.1	-0.5	-0.5	-1.0	-1.5	-2.0
Other	-0.1	-1.8	0.6	2.5	5.1	5.4
Of which : banking system	-0.3	1.0	1.7	1.8	3.8	3.4
	(In millions of balboas)					
Memorandum items:						
External interest obligations	366.3	414.4	448.5	471.59	413.3	424.1
GDP (market prices)	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

1/ Current revenue less current expenditure.

Table 14. Panama: Central Government Operations

	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of balboas)					
Revenue and grants	**2,113.5**	**1,951.7**	**1,978.5**	**2,014.1**	**1,279.7**	**1,298.2**
Current revenue	2,108.5	1,919.2	1,977.0	1,978.2	1,281.7	1,298.2
Tax revenue	1,120.1	1,038.5	1,050.7	1,127.3	816.1	862.7
Income tax	494.2	453.8	451.7	435.2	319.9	333.1
Wealth tax	52.7	60.9	56.1	84.0	59.4	61.5
Taxes on foreign trade	201.9	172.4	184.2	200.1	137.5	148.7
Taxes on domestic transactions	371.3	351.4	358.7	407.9	299.2	319.4
Nontax revenue	988.4	880.7	926.3	850.9	465.6	435.6
Panama Canal	142.4	141.1	152.1	144.6	109.3	104.9
Transfers from the rest of public sector	340.5	251.9	211.7	206.6	145.2	140.6
Other	505.6	487.7	562.5	499.6	211.2	189.6
Capital revenue	1.2	32.0	1.5	35.9	-2.0	0.0
Grants	3.8	0.6	0.0	0.0	0.0	0.0
Expenditure	**2,242.1**	**2,291.5**	**2,305.0**	**2,487.4**	**2,004.9**	**2,030.9**
Current	1,964.9	1,974.0	1,972.6	2,081.0	1,686.2	1,685.5
Wages and salaries	641.7	673.6	695.5	728.3	534.0	561.4
Goods and services	178.3	172.3	146.9	179.2	140.9	134.9
Pensions and transfers	615.6	562.4	567.8	560.2	479.4	445.7
Of which:						
Social security agency	346.4	297.7	280.4	281.8	245.7	211.7
Decentralized agencies	85.0	92.9	91.8	92.7	71.7	74.5
Public enterprises	2.0	3.0	2.1	1.6	1.4	0.0
Interest	484.6	500.1	508.1	559.4	490.0	501.0
Domestic	121.5	93.7	66.2	89.8	78.2	78.2
External	363.1	406.4	441.9	469.6	411.7	422.8
Other current expenditure	44.7	65.5	54.3	53.9	41.9	42.4
Capital	277.2	317.5	332.3	406.4	318.7	345.4
Fixed capital formation	223.4	242.4	283.9	332.3	259.5	265.6
Transfers of capital	53.8	75.1	48.5	74.1	59.1	79.7
To public enterprises	5.1	17.9	10.3	5.8	2.0	48.4
Saving 1/	**147.4**	**-54.3**	**4.4**	**-102.8**	**-404.5**	**-387.3**
Overall balance (deficit-)	**-128.6**	**-339.8**	**-326.5**	**-473.3**	**-725.2**	**-732.6**
	(In millions of balboas)					
Financing	**128.6**	**339.8**	**326.5**	**473.3**	**725.2**	**732.6**
External	119.9	365.5	311.6	433.7	433.5	681.7
Disbursements	484.5	1218.8	1059.8	420.6	366.9	661.5
Repayments	381.3	535.7	946.9	144.7	118.2	0.0
Debt rescheduling	25.6	26.8	3.5	3.5	0.4	1.4
Arrears	0.0	0.0	0.0	0.0	0.0	0.0
Change in deposits abroad	8.9	344.4	-195.2	-154.3	-184.4	-18.8
Domestic (net)	7.6	-26.1	14.9	39.6	291.7	50.9
Trust Fund for Development	0.0	115.6	0.0	0.0	20.9	39.2
Others	7.6	-141.7	14.9	39.6	270.8	11.7
Of which : banking system	-142.5	-165.4	149.7	223.3	428.5	393.6
Privatization	1.1	0.4	0.0	0.0	0.0	0.0

Table 14. Panama: Central Government Operations

	2000	2001	2002	2003	January–September 2003	January–September 2004
	(Percent change)					
Current revenue	**8.9**	**-9.0**	**3.0**	**0.1**	**7.0**	**1.3**
Tax revenue	-7.5	-7.3	1.2	7.3	6.3	5.7
Nontax revenue	36.2	-10.9	5.2	-8.1	8.3	-6.5
Total expenditure	**3.2**	**2.2**	**0.6**	**7.9**	**9.0**	**1.3**
Current	10.0	0.5	-0.1	5.5	8.6	0.0
Capital	-28.2	14.6	4.7	22.3	11.5	8.4
	(In percent of GDP)					
Current revenue	**18.1**	**16.3**	**16.1**	**15.4**	**13.3**	**12.5**
Tax revenue	9.6	8.8	8.6	8.8	8.5	8.3
Nontax revenue	8.5	7.5	7.5	6.6	4.8	4.2
Total expenditure	**19.3**	**19.4**	**18.8**	**19.3**	**20.8**	**19.6**
Current	16.9	16.7	16.1	16.2	17.5	16.3
Capital	2.4	2.7	2.7	3.2	3.3	3.3
Saving 1/	**1.3**	**-0.5**	**0.0**	**-0.8**	**-4.2**	**-3.7**
Overall balance (deficit -)	**-1.1**	**-2.9**	**-2.7**	**-3.7**	**-7.5**	**-7.1**
Financing (net)	**1.1**	**2.9**	**2.7**	**3.7**	**7.5**	**7.1**
External	1.0	3.1	2.5	3.4	4.5	6.6
Domestic	0.1	-0.2	0.1	0.3	3.0	0.5
Trust Fund for Development	0.0	1.0	0.0	0.0	0.2	0.4
Other	0.1	-1.2	0.1	0.3	2.8	0.1
Of which: banking system	-1.2	-1.4	1.2	1.7	4.4	3.8
Privatization	0.0	0.0	0.0	0.0	0.0	0.0
	(In millions of balboas)					
Memorandum item:						
GDP (market prices)	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; Ministry of Economy and Finance; and Fund staff estimates.

1/ Current revenue less current expenditure.

Table 15. Panama: Central Government Revenue

	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of balboas)					
Total revenue and grants	**2,113.5**	**1,951.7**	**1,978.5**	**2,014.1**	**1,279.7**	**1,298.2**
Tax revenue	**1,120.1**	**1,038.5**	**1,050.7**	**1,127.3**	**816.1**	**862.7**
Direct taxes	547.0	514.7	507.7	519.2	379.3	394.6
Income tax	494.2	453.8	451.7	435.2	319.9	333.1
Wealth tax	52.7	60.9	56.1	84.0	59.4	61.5
Taxes on foreign trade	201.9	172.4	184.2	200.1	137.5	148.7
Export taxes	0.2	0.0	0.0	0.0	0.0	0.0
Import taxes	201.7	172.4	184.2	200.1	137.5	148.7
Taxes on domestic transactions	371.3	351.4	358.7	407.9	299.2	319.4
Tobacco and beverages	32.5	33.4	31.1	37.1	26.7	32.5
Value added tax	165.6	154.1	155.0	193.3	135.2	165.3
Petroleum products	108.8	106.9	115.6	116.7	89.4	76.7
Other	64.4	57.1	57.0	60.8	47.9	44.9
Nontax revenue	**988.4**	**880.7**	**926.3**	**850.9**	**465.6**	**435.6**
Panama Canal	142.4	141.1	152.1	144.6	109.3	104.9
Other services	176.2	161.8	192.4	163.1	111.3	105.4
Transfers from rest of public sector	340.5	251.9	211.7	206.6	145.2	140.6
Of which:						
Consolidated public sector	109.3	82.3	76.0	60.8	42.0	42.7
Nonconsolidated public sector	231.2	169.5	135.7	145.8	103.2	97.9
Interest earnings and dividends	329.4	325.9	370.1	336.5	99.9	84.2
Capital revenue	**1.2**	**32.0**	**1.5**	**35.9**	**-2.0**	**0.0**
Grants	**3.8**	**0.6**	**0.0**	**0.0**	**0.0**	**0.0**
	(In percent of GDP)					
Total revenue and grants	**18.2**	**16.5**	**16.1**	**15.7**	**13.3**	**12.5**
Tax revenue	**9.6**	**8.8**	**8.6**	**8.8**	**8.5**	**8.3**
Direct taxes	4.7	4.4	4.1	4.0	3.9	3.8
Income tax	4.3	3.8	3.7	3.4	3.3	3.2
Wealth tax	0.5	0.5	0.5	0.7	0.6	0.6
Taxes on foreign trade	1.7	1.5	1.5	1.6	1.4	1.4
Import taxes	1.7	1.5	1.5	1.6	1.4	1.4
Taxes on domestic transactions	3.2	3.0	2.9	3.2	3.1	3.1
Tobacco and beverages	0.3	0.3	0.3	0.3	0.3	0.3
Value added tax	1.4	1.3	1.3	1.5	1.4	1.6
Petroleum products	0.9	0.9	0.9	0.9	0.9	0.7
Other	0.6	0.5	0.5	0.5	0.5	0.4
Nontax revenue	**8.5**	**7.5**	**7.5**	**6.6**	**4.8**	**4.2**
Panama Canal	1.2	1.2	1.2	1.1	1.1	1.0
Services	1.5	1.4	1.6	1.3	1.2	1.0
Transfers from rest of public sector	2.9	2.1	1.7	1.6	1.5	1.4
Of which:						
Consolidated public sector	0.9	0.7	0.6	0.5	0.4	0.4
Nonconsolidated public sector	2.0	1.4	1.1	1.1	1.1	0.9
Interest earnings and dividends	2.8	2.8	3.0	2.6	1.0	0.8
Capital revenue	**0.0**	**0.3**	**0.0**	**0.3**	**0.0**	**0.0**
Grants	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum item:						
GDP (market prices)	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

Table 16. Panama: Central Government Expenditure

					Jan.–Sept.	
	2000	2001	2002	2003	2003	2004
Total expenditure	**2,242.1**	**2,291.5**	**2,305.0**	**2,487.4**	**2,004.9**	**2,030.9**
Current expenditure	**1,964.9**	**1,974.0**	**1,972.6**	**2,081.0**	**1,686.2**	**1,685.5**
Wages and salaries	641.7	673.6	695.5	728.3	534.0	561.4
Goods and services	178.3	172.3	146.9	179.2	140.9	134.9
Interest	484.6	500.1	508.1	559.4	490.0	501.0
Pensions and transfers	615.6	562.4	567.8	560.2	479.4	445.7
Other	44.7	65.5	54.3	53.9	41.9	42.4
Capital expenditure	**277.2**	**317.5**	**332.3**	**406.4**	**318.7**	**345.4**
Investment	223.4	242.4	283.9	332.3	259.5	265.6
Transfers	53.8	75.1	48.5	74.1	59.1	79.7
Memorandum item:						
Noninterest expenditure	1,480.3	1,473.8	1,464.5	1,521.6	1,196.3	1184.5
		(In percent of GDP)				
Total expenditure	**19.3**	**19.4**	**18.8**	**19.3**	**20.8**	**19.6**
Current expenditure	**16.9**	**16.7**	**16.1**	**16.2**	**17.5**	**16.3**
Wages and salaries	5.5	5.7	5.7	5.7	5.5	5.4
Goods and services	1.5	1.5	1.2	1.4	1.5	1.3
Interest	4.2	4.2	4.1	4.3	5.1	4.8
Pensions and transfers	5.3	4.8	4.6	4.4	5.0	4.3
Other	0.4	0.6	0.4	0.4	0.4	0.4
Capital expenditure	**2.4**	**2.7**	**2.7**	**3.2**	**3.3**	**3.3**
Investment	1.9	2.1	2.3	2.6	2.7	2.6
Transfers	0.5	0.6	0.4	0.6	0.6	0.8
Memorandum item:						
Noninterest expenditure	12.7	12.5	11.9	11.8	12.4	11.4
		(Annual percent change)				
Total expenditure	**3.2**	**2.2**	**0.6**	**7.9**	**9.0**	**1.3**
Current expenditure	**10.0**	**0.5**	**-0.1**	**5.5**	**8.6**	**0.0**
Wages and salaries	-6.3	5.0	3.3	4.7	4.1	5.1
Goods and services	9.2	-3.4	-14.7	22.0	22.1	-4.3
Interest	19.3	3.2	1.6	10.1	12.9	2.3
Pensions and transfers	26.9	-8.6	1.0	-1.3	5.6	-7.0
Other	-5.9	46.7	-17.1	-0.9	13.5	1.2
Capital expenditure	**-28.2**	**14.6**	**4.7**	**22.3**	**11.5**	**8.4**
Investment	-36.3	8.5	17.1	17.1	3.9	2.4
Transfers	50.9	39.6	-35.5	52.9	64.5	34.8
Memorandum items:						
Noninterest expenditure	7.2	-0.4	-0.6	3.9	6.9	-1.0
Nominal GDP	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

Table 17. Panama: Operations of the Social Security Agency

	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of balboas)					
Current revenue	**741.9**	**733.9**	**724.5**	**725.0**	**518.7**	**580.7**
Contributions	592.4	584.6	580.1	601.6	436.3	482.6
Professional risk premium	46.5	44.1	43.4	43.4	29.0	34.0
Administered funds	7.5	6.8	0.0	0.0	0.0	2.7
Income from investment	68.0	72.2	44.2	33.3	24.5	35.0
Other	27.5	26.4	56.8	46.7	28.8	26.3
Current expenditure	**905.9**	**982.8**	**1,055.3**	**1,104.0**	**815.9**	**853.4**
Wages	180.3	204.2	226.1	249.5	182.6	193.8
Goods and services	120.6	134.0	143.7	135.7	97.2	100.5
Transfers	604.5	644.3	685.3	718.7	536.0	559.1
Domestic interest	0.4	0.3	0.2	0.1	0.1	0.0
Operating balance (deficit -)	**-164.0**	**-248.9**	**-330.9**	**-379.0**	**-297.2**	**-272.7**
Current transfers (net)	**345.8**	**296.9**	**279.3**	**280.8**	**244.8**	**210.9**
Transfers from central government	346.4	297.7	280.4	281.8	245.7	211.7
Transfers to central government	0.5	0.8	1.1	1.0	0.8	0.8
Capital revenue	**15.1**	**15.3**	**0.5**	**1.7**	**4.9**	**-0.1**
Saving 1/	197.5	64.1	-50.0	-95.5	-46.5	-61.1
Capital expenditure	**22.1**	**20.9**	**19.0**	**14.6**	**11.0**	**9.1**
Fixed investment	22.1	20.9	19.0	14.6	11.0	9.1
Overall balance (deficit -)	**174.9**	**42.4**	**-70.0**	**-111.1**	**-58.4**	**-71.0**
	(In percent of GDP)					
Current revenue	**6.4**	**6.2**	**5.9**	**5.6**	**5.4**	**5.6**
Of which:						
Contributions	5.1	5.0	4.7	4.7	4.5	4.7
Total expenditure	**8.0**	**8.5**	**8.8**	**8.7**	**8.6**	**8.3**
Of which:						
Current	7.8	8.3	8.6	8.6	8.5	8.2
Operating balance (deficit -)	**-1.4**	**-2.1**	**-2.7**	**-2.9**	**-3.1**	**-2.6**
Current transfers (net)	**3.0**	**2.5**	**2.3**	**2.2**	**2.5**	**2.0**
Overall balance (deficit -)	**1.5**	**0.4**	**-0.6**	**-0.9**	**-0.6**	**-0.7**

Sources: Social Security Agency; and Ministry of Economy and Finance.

1/ Including capital revenue.

Table 18. Panama: Operations of the Decentralized Agencies 1/

					Jan.–Sept.	
	2000	2001	2002	2003	2003	2004
	(In millions of balboas)					
Operating revenue	**80.2**	**84.0**	**88.9**	**78.4**	**59.0**	**59.5**
Operating expenditure	**153.3**	**147.2**	**153.3**	**149.1**	**112.1**	**110.2**
Interest	6.0	5.8	5.1	2.9	3.6	3.1
Other	147.4	141.4	148.2	146.2	108.5	107.1
Operating balance (deficit -)	**-73.1**	**-63.2**	**-64.4**	**-70.7**	**-53.1**	**-50.7**
Current transfers (net)	**57.9**	**70.4**	**91.8**	**90.3**	**70.0**	**73.2**
Transfers from central government	85.0	92.9	91.8	92.7	71.7	74.5
Transfers to central government	27.1	22.4	0.0	2.4	1.7	1.3
Capital transfers from central government	4.2	16.1	6.3	9.8	0.6	0.4
Capital revenue	17.2	13.0	13.0	11.2	5.5	5.5
Saving 2/	**-2.2**	**4.2**	**34.1**	**21.0**	**21.8**	**27.6**
Capital expenditure (fixed investment)	**30.5**	**25.0**	**20.5**	**9.4**	**6.9**	**4.1**
Overall balance (deficit -)	-24.3	11.3	26.2	31.2	16.1	24.3
	(In percent of GDP)					
Operating revenue	0.7	0.7	0.7	0.6	0.6	0.6
Operating expenditure	1.3	1.2	1.2	1.2	1.2	1.1
Operating balance (deficit -)	-0.6	-0.5	-0.5	-0.5	-0.6	-0.5
Current transfers (net)	0.5	0.6	0.7	0.7	0.7	0.7
Overall balance (deficit -)	**-0.2**	**0.1**	**0.2**	**0.2**	**0.2**	**0.2**
Memorandum item:						
GDP (market prices)	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

1/ Includes the operations of the University of Panama, Human Development Institute (IFARHU), Agricultural Development Bank (BDA), Agricultural Marketing Institute (IMA), and National Mortgage Bank (BHN).

2/ Including capital revenue.

Table 19. Panama: Operations of the Public Enterprises 1/

	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of balboas)					
Current revenue	**238.9**	**243.6**	**244.0**	**223.4**	**164.7**	**164.0**
Operating expenditure	**159.4**	**143.7**	**140.9**	**132.8**	**99.2**	**96.7**
Wages and salaries	46.1	43.8	48.1	45.3	33.7	35.1
Goods and services	58.7	61.5	55.9	43.9	35.7	34.7
Transfers	27.6	20.0	26.6	26.7	15.7	19.4
Other 2/	22.7	12.5	9.4	13.0	12.7	6.0
Interest 3/	4.3	5.9	0.9	3.9	1.4	1.5
Operating balance (deficit -)	**79.5**	**99.9**	**103.1**	**90.6**	**65.5**	**67.3**
Current transfers net of taxes	**-80.6**	**-57.9**	**-74.7**	**-86.0**	**-46.6**	**-88.6**
Transfers from central government	2.0	3.0	2.1	1.6	1.4	0.0
Transfers to central government	-81.7	-59.1	-74.9	-57.4	-41.8	-40.6
Capital revenue	1.8	0.1	0.0	0.0	0	0.0
Capital transfers from central government	0.9	1.8	1.9	30.2	6.2	48.0
Saving 4/	**0.7**	**42.0**	**28.5**	**4.6**	**18.9**	**-21.3**
Capital expenditure	**34.7**	**21.5**	**37.1**	**107.5**	**83.5**	**65.5**
Overall balance (deficit -)	-32.2	20.6	-8.6	-102.9	-64.6	-86.8
	(In percent of GDP)					
Current revenue	2.1	2.1	2.0	1.7	1.7	1.6
Operating expenditure	1.4	1.2	1.1	1.0	1.0	0.9
Operating balance (deficit -)	0.7	0.8	0.8	0.7	0.7	0.7
Current transfers (net)	-0.7	-0.5	-0.6	-0.7	-0.5	-0.9
Capital expenditure	0.3	0.2	0.3	0.8	0.9	0.6
Overall balance (deficit -)	**-0.3**	**0.2**	**-0.1**	**-0.8**	**-0.7**	**-0.8**
Memorandum item:						
GDP (market prices)	11,621	11,808	12,272	12,862	9,647	10,345

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

1/ Includes the operations of the Hydraulic Resources and Electricity Institute (IHRE), Colon Free Zone (operating agency), Civil Aviation Authority, National Water and Sewerage Institute (IDAAN), La Victoria Sugar Corporation, Tourism Institute.

2/ Unclassified expenditure that was authorized during a previous budget year.

3/ Domestic interest.

4/ Including capital revenue.

Table 20. Panama: Domestic Debt of the Nonfinancial Public Sector
(In millions of balboas; end of period)

	2000	2001	2002	2003	2004
Private sector creditors	**620.1**	**747.6**	**869.6**	**1,136.0**	**1,301.4**
Short-term treasury notes	114.0	250.0	243.4	218.0	236.6
Medium-term treasury notes	0.0	0.0	159.5	500.0	708.2
Domestic bonds	102.0	92.8	81.4	60.8	31.4
Recognition bonds	363.9	363.9	363.9	345.1	307.4
Private financing	15.3	10.8	6.3	5.8	14.0
Other lending	24.9	30.1	15.1	6.4	3.9
Public financial institutions	**683.9**	**602.6**	**579.2**	**505.6**	**833.7**
Total domestic debt (gross)	**1,304.0**	**1,350.2**	**1,448.8**	**1,641.6**	**2,135.0**

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

Table 21. Panama: Accounts of the Banking System 1/

(In millions of balboas, end of period)

	2000	2001	2002	2003	2004
I. National Bank of Panama					
Net foreign assets	**661**	**1,064**	**1,135**	**979**	**604**
Net foreign reserves	707	1,116	1,171	1,013	633
Assets	756	1,156	1,215	1,044	667
Reserve position with IMF	15	17	16	18	18
SDR holdings	0	0	0	0	0
Foreign currencies	70	84	82	73	59
Bonds	0	0	0	0	0
Deposits abroad	670	1,056	1,117	953	590
Short term liabilities	43	26	37	23	23
Deposits from nonresidents	6	14	7	7	11
Long-term foreign liabilities	46	52	36	34	29
Net domestic reserves	**611**	**331**	**-9**	**-173**	**-210**
Domestic currency	4	4	3	2	4
Interbank deposits (net)	553	266	-50	-222	-262
Checks in clearing	54	61	38	47	49
Net domestic assets	**-839**	**-830**	**-436**	**-96**	**317**
Public sector (net)	-1,149	-1,369	-1,172	-962	-488
Central government (net)	178	-50	83	247	501
Rest of public sector (net)	-1,327	-1,319	-1,255	-1,209	-988
Of which: Social Security	-1,078	-1,112	-1,064	-985	-692
Private sector	748	976	1,119	1,228	1,305
Official capital and surplus	-500	-500	-500	-500	-500
Unclassified assets (net)	63	63	117	137	0
Liabilities to domestic private sector	**433**	**566**	**690**	**710**	**711**
Demand deposits	59	85	87	84	94
Time deposits	164	245	303	334	317
Savings deposits	203	229	291	285	296
Cashier's checks in circulation	6	6	9	6	4
II. Private Banks					
Net foreign reserves	**840**	**619**	**602**	**1,507**	**2,114**
Assets	4,144	4,084	3,159	3,603	4,443
Foreign currencies	139	304	255	231	247
Deposits abroad	3,533	3,314	3,073	3,292	4,181
Other unclassified	471	466	234	291	118
Liabilities	**360**	**445**	**196**	**209**	**209**
Overseas operations (net)	-2,943	-3,020	-2,361	-1,887	-2,120
Credit to nonresidents	8,475	8,619	6,576	6,176	7,365
Operating profit or loss (-)	7,230	7,113	5,985	5,720	6,467
Foreign banks	4,987	5,094	3,889	3,208	3,953
Private nonresidents	2,243	2,019	2,096	2,512	2,514
Other foreign liabilities	4,188	4,526	2,952	2,343	3,018

Table 21. Panama: Accounts of the Banking System 1/

(In millions of balboas, end of period)

	2000	2001	2002	2003	2004
	II. Private Banks				
Net domestic reserves	**-663**	**-485**	**-380**	**-206**	**-193**
Domestic currency	12	0	0	0	0
Interbank deposits (net)	-675	-485	-380	-206	-193
Net domestic assets	**10,528**	**11,339**	**10,918**	**10,570**	**11,356**
Net credit to public sector	137	207	-75	-7	-3
Private sector credit	11,117	11,766	11,174	11,003	11,587
Unclassified assets (net)	-726	-634	158	-99	30
Liabilities to the private sector	**10,704**	**11,473**	**11,140**	**11,871**	**13,277**
Monetary liabilities	8,150	8,842	8,715	9,126	9,947
Demand deposits	1,095	1,193	1,233	1,354	1,499
Time and savings deposits	7,055	7,649	7,482	7,772	8,448
Time deposits	5,839	6,173	5,797	5,907	6,410
Savings deposits	1,216	1,476	1,685	1,865	2,038
Private capital and surplus	2,555	2,631	2,425	2,745	3,330
	III. Savings Bank				
Foreign assets (net)	**5**	**10**	**7**	**2**	**-12**
Net domestic reserves	**200**	**-1**	**176**	**150**	**137**
Domestic currency	0	0	0	2	0
Deposits in local banks (net)	196	-3	174	144	135
Demand deposits	6	5	5	6	6
Time deposits	205	18	169	139	129
Deposits of banks	-14	-26	0	0	0
Checks in clearing	4	1	2	3	2
Net domestic assets	**170**	**396**	**319**	**385**	**434**
Public sector (net)	-203	-260	-151	-165	-211
Central government	1	2	120	141	152
Loans and advances	1	2	120	141	152
Rest of public sector	-204	-261	-271	-307	-363
Loans and advances	-126	-118	-128	-96	-168
Deposits	-78	-143	-143	-210	-195
Private sector	465	517	533	551	747
Loans and discounts	433	500	519	539	738
Investment	33	17	14	13	8
Unclassified assets (net)	11	249	55	132	27
Official capital and surplus	103	110	118	133	129
Liabilities to private sector	**376**	**404**	**502**	**537**	**560**
Demand deposits	12	17	22	19	25
Time and savings deposits	364	387	478	501	525
Time deposits	142	153	171	159	146
Savings deposits	221	234	286	297	297

Table 21. Panama: Accounts of the Banking System 1/

(In millions of balboas, end of period)

	2000	2001	2002	2003	2004
IV. Consolidated Banking System					
Net foreign assets	**1,506**	**1,693**	**1,744**	**2,488**	**2,706**
Assets	4,909	5,250	4,384	4,651	5,120
Liabilities	455	523	272	268	283
Overseas operations (net)	-2,949	-3,034	-2,368	-1,894	-2,131
Credit to nonresidents	8,475	8,619	6,576	6,176	7,365
Deposits from nonresidents	7,236	7,127	5,992	5,727	6,478
Other foreign liabilities	4,188	4,526	2,952	2,343	3,018
Net domestic assets	**10,000**	**10,743**	**10,577**	**10,607**	**11,828**
Public sector (net)	-1,216	-1,422	-1,399	-1,134	-701
Credit	767	801	751	759	1,021
Deposits	-1,983	-2,223	-2,149	-1,894	-1,722
Private sector credit	12,330	13,259	12,826	12,783	13,638
Official capital and surplus	-603	-610	-618	-633	-629
Unclassified assets (net)	-652	-322	-9	-157	-201
Other assets (net)	945	1,162	1,247	1,182	1,075
Other items (net)	-1,597	-1,485	-1,256	-1,339	-1,277
Net domestic reserves	**141**	**-162**	**-224**	**-252**	**-279**
Domestic currency	16	13	3	4	4
Net interbank deposits	74	-222	-259	-300	-330
Checks in clearing	58	62	40	50	51
Cashier's checks in circulation	-6	-6	-9	-6	-4
Liabilities to private sector	**11,507**	**12,436**	**12,321**	**13,095**	**14,534**
Monetary liabilities	8,952	9,805	9,875	10,305	11,121
Demand deposits	1,166	1,296	1,342	1,458	1,618
Time and savings deposits	7,786	8,510	8,533	8,847	9,504
Time deposits	6,145	6,572	6,271	6,400	6,874
Savings deposits	1,641	1,938	2,262	2,447	2,630
Private capital and surplus	2,555	2,631	2,425	2,745	3,330

Sources: National Bank of Panama; Superintendency of Banks; and the Savings Bank.

1/ Excludes operations of international banks which are licensed to perform only offshore operations, but includes the offshore operations of banks licensed to perform both domestic and offshore operations.

Table 22. Panama: Banking System Credit to the Private Sector

	2000	2001	2002	2003	2004
(In millions of balboas; end of period)					
Total	**10,801**	**11,218**	**10,892**	**11,266**	**12,299**
Commerce	3,815	3,475	3,112	3,156	3,421
Housing	2,756	2,798	3,019	3,247	3,463
Other construction	256	403	372	456	607
Industry	509	708	639	593	630
Personal consumption	2,307	2,391	2,483	2,559	2,789
Financial and insurance enterprises	808	1,018	877	833	887
Agriculture	148	145	136	153	195
Livestock	156	189	188	217	256
Fishing	34	28	25	21	17
Other	12	63	41	31	35
(12-month percentage change)					
Total	**5.5**	**3.9**	**-2.9**	**3.4**	**9.2**
Commerce	1.8	-8.9	-10.4	1.4	8.4
Housing	13.3	1.5	7.9	7.6	6.6
Other construction	12.8	57.4	-7.7	22.6	33.2
Industry	8.3	39.1	-9.7	-7.2	6.2
Personal consumption	9.9	3.6	3.8	3.1	9.0
Financial and insurance enterprises	-14.9	26.0	-13.9	-5.0	6.5
Agriculture	24.4	-2.0	-6.2	12.5	27.2
Livestock	1.3	21.2	-0.5	15.4	18.0
Fishing	0.0	-17.6	-10.7	-16.0	-18.8
(In percent of total credit)					
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Commerce	35.3	31.0	28.6	28.0	27.8
Housing	25.5	24.9	27.7	28.8	28.2
Other construction	2.4	3.6	3.4	4.0	4.9
Industry	4.7	6.3	5.9	5.3	5.1
Operating expenditure	21.4	21.3	22.8	22.7	22.7
Financial and insurance enterprises	7.5	9.1	8.1	7.4	7.2
Agriculture	1.4	1.3	1.2	1.4	1.6
Livestock	1.4	1.7	1.7	1.9	2.1
Fishing	0.3	0.2	0.2	0.2	0.1

Source: Superintendency of Banks.

Table 23. Panama: Foreign Operations of Private Banks 1/

(In billions of U.S. dollars, end of period)

	2000	2001	2002	2003	2004
Foreign assets	**19.8**	**19.7**	**16.0**	**15.8**	**17.4**
Foreign reserves	7.3	6.6	5.5	6.1	6.0
General license banks	4.1	4.1	3.2	3.6	4.4
Offshore banks 2/	3.2	2.5	2.4	2.5	1.6
Credit to nonresidents	12.5	13.1	10.5	9.7	11.3
General license banks	8.5	8.6	6.6	6.2	7.4
Offshore banks	4.0	4.5	4.0	3.6	3.9
Foreign liabilities	**18.5**	**18.7**	**14.9**	**13.6**	**14.5**
Short-term liabilities	0.4	0.4	0.5	0.3	0.3
General license banks	0.4	0.4	0.2	0.2	0.2
Offshore banks	0.0	0.0	0.3	0.1	0.1
Deposits from nonresidents	13.0	12.8	10.7	10.2	10.5
General license banks	7.2	7.1	6.0	5.7	6.5
Banks	5.0	5.1	3.9	3.2	4.0
Nonbanks	2.2	2.0	2.1	2.5	2.5
Offshore banks	5.8	5.7	4.7	4.5	4.1
Other liabilities	5.1	5.5	3.8	3.1	3.7
General license banks	4.2	4.5	3.0	2.3	3.0
Offshore banks	0.9	0.9	0.8	0.8	0.7
Capital and reserves	**0.4**	**0.4**	**0.5**	**0.6**	**0.7**

Source: Superintendency of Banks.

1/ Includes offshore operations of international license banks.

2/ Refers to international license banks.

Table 24. Panama: Interest Rate Structure

(In percent)

	2000	2001	2002	2003	2004
Lending rates (less than one year)					
Commercial	10.0	10.0	8.4	7.5	7.2
Industrial	9.1	9.7	8.8	8.7	8.5
Personal	13.2	12.4	12.2	12.2	12.2
Domestic deposit rate (six-month)	6.5	5.5	3.8	3.3	2.1
U.S. prime rate (six-month)	9.2	6.8	4.7	4.1	4.4
LIBOR (six-month)	6.6	3.1	1.9	1.3	1.8
Difference between the deposit rate and LIBOR (percentage points)	-0.2	2.4	1.9	2.0	0.3

Source: Superintendency of Banks.

Table 25. Panama: Public Sector Banks—Operating Revenue and Expenditure

(In millions of balboas)

	2000	2001	2002	2003	2004
I. National Bank of Panama					
Operating profit or loss (-)	**117.2**	**76.2**	**104.2**	**91.2**	**11.2**
Operating revenue	**161.5**	**139.5**	**130.9**	**146.3**	**142.6**
Net interest	**143.6**	**120.2**	**101.6**	**118.4**	**124.3**
Interest receipts (cash)	251.7	212.2	147.1	147.9	154.9
Interest payments accrued	-108.1	-92.0	-45.5	-29.5	-30.6
Noninterest income	**17.9**	**19.3**	**29.3**	**27.9**	**18.3**
Operating expenditure	**44.3**	**63.3**	**26.7**	**55.1**	**131.4**
Wages and salaries	22.8	23.1	22.9	23.3	24.2
Goods and services	14.4	14.9	16.0	17.9	19.2
Other	7.1	25.3	-12.2	13.9	88.0
II. Savings Bank					
Operating profit or loss (-)	**10.4**	**13.2**	**20.6**	**25.4**	**27.4**
Operating revenue	**31.8**	**36.2**	**45.5**	**52.9**	**59.5**
Net interest	**23.4**	**26.0**	**32.6**	**37.0**	**37.5**
Interest receipts (cash)	60.5	68.1	72.1	74.1	77.7
Loans	40.5	46.1	52.0	56.0	62.0
Fixed deposits	15.2	13.3	8.7	5.4	3.5
Investments	4.8	8.7	11.4	12.7	12.2
Interest payments accrued (-)	-37.0	-42.1	-39.4	-37.1	-40.3
Noninterest income	**8.3**	**10.2**	**12.8**	**15.9**	**22.1**
Operating expenditure	**21.4**	**23.0**	**24.9**	**27.5**	**32.1**
Expenditure	**25.2**	**28.9**	**37.7**	**40.0**	**64.1**
Wages and salaries	13.4	14.7	15.8	17.6	20.6
Other operating expenses	8.0	8.3	9.1	9.9	11.5
Depreciation	2.1	2.9	3.2	3.4	3.6
Provisions for bad loans	1.6	2.9	9.6	9.1	28.4

Table 25. Panama: Public Sector Banks—Operating Revenue and Expenditure

(In millions of balboas)

	2000	2001	2002	2003	2004
		III. National Mortgage Bank			
Operating profit or loss (-)	**-0.3**	**-0.5**	**0.0**	**-1.5**	**0.0**
Operating revenue	**7.1**	**6.5**	**5.6**	**5.9**	**5.6**
Net interest	**3.3**	**2.8**	**2.8**	**2.4**	**2.8**
Interest receipts (cash)	9.1	8.0	5.6	6.4	5.6
Loans	8.4	7.5	5.4	6.2	5.4
Fixed deposits	0.7	0.4	0.1	0.1	0.1
Investments	0.0	0.1	0.1	0.1	0.1
Interest payments cash	5.8	5.2	2.8	4.0	2.8
Noninterest income	**3.8**	**3.7**	**2.8**	**3.5**	**2.8**
Operating expenditure (cash)	**7.4**	**7.0**	**5.6**	**7.4**	**5.6**
Wages and salaries	4.2	4.1	4.0	4.4	4.0
Goods and services	3.2	2.9	1.6	3.0	1.6
		IV. Agricultural Development Bank			
Operating profit or loss (-)	**-4.7**	**-3.1**	**-1.8**	**-1.7**	**-1.4**
Operating revenue	**4.3**	**5.9**	**6.9**	**7.4**	**7.6**
Net interest	**3.5**	**5.1**	**6.3**	**6.9**	**7.2**
Interest receipts (cash)—loans	5.8	7.3	7.9	8.3	8.4
Interest payments accrued	2.3	2.2	1.6	1.4	1.2
Noninterest income	**0.8**	**0.8**	**0.6**	**0.5**	**0.4**
Operating expenditure (cash)	**9.0**	**9.0**	**8.7**	**9.1**	**9.0**
Wages and salaries	4.5	4.6	4.7	4.9	5.0
Goods and services	4.5	4.4	4.0	4.2	4.0

Sources: National Bank of Panama; Savings Bank; National Mortgage Bank; and Agricultural Development Bank.

Table 26. Panama: Public Sector Banks—Portfolio in Arrears

(In millions of balboas)

	2000	2001	2002	2003	2004
I. National Bank of Panama					
Total private sector portfolio	**689.3**	**817.5**	**968.5**	**1155.1**	**1226.9**
Commerce	68.4	90.1	116.9	178.5	177.6
Agriculture and forestry	119.9	132.8	141.7	166.9	177.7
Personal loans	450.7	506.8	588.3	672.1	719.3
Others	50.3	87.9	121.6	137.6	152.3
Total arrears	**80.3**	**111.0**	**89.8**	**75.7**	**98.2**
Commerce	16.7	17.1	12.7	13.5	27.9
Agriculture and forestry	15.5	20.6	17.8	9.4	11.6
Personal loans	41.5	61.1	46.3	44.8	49.2
Others	6.6	12.2	13.0	8.0	9.5
Share of arrears in total portfolio	**11.6**	**13.6**	**9.3**	**6.6**	**8.0**
Commerce	24.4	19.0	10.9	7.6	15.7
Agriculture and forestry	12.9	15.5	12.6	5.6	6.5
Personal loans	9.2	12.1	7.9	6.7	6.8
Others	13.1	13.9	10.7	5.8	6.2
Loans with payments overdue	**80.3**	**111.0**	**89.8**	**75.7**	**98.2**
Between 30 and 90 days	43.7	51.7	37.0	36.6	38.4
Over 90 days	36.6	59.3	52.8	39.1	59.8
Percent of total with payments overdue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Between 30 and 90 days	54.4	46.6	41.2	48.3	39.1
Over 90 days	45.6	53.4	58.8	51.7	60.9
II. Savings Bank					
Total portfolio	**432.6**	**500.2**	**521.2**	**547.7**	**738.2**
Mortages	301.3	321.9	334.6	338.7	350.7
Personal loans	94.8	81.5	70.3	84.1	76.9
Operating expenditure	36.5	96.7	116.4	124.9	310.7
Loans overdue	**62.2**	**68.4**	**125.1**	**114.3**	**154.5**
Mortages	..	..	100.5	92.1	73.0
Personal loans	..	..	11.3	4.0	8.5
Other		..	13.3	18.2	72.9
Share of arrears in total portfolio	**14.4**	**13.7**	**24.0**	**20.9**	**20.9**
Share of arrears in their individual portfolios	..				
Mortages		..	30.0	27.2	20.8
Personal loans	..	..	16.1	4.7	11.1
Other	..	..	11.5	14.6	23.5

Table 26. Panama: Public Sector Banks—Portfolio in Arrears

(In millions of balboas)

	2000	2001	2002	2003	2004
	III. National Housing Bank 2/				
Total portfolio	**193.4**	**184.7**	**182.4**	**176.9**	**166.3**
Total arrears	**44.1**	**54.1**	**59.3**	**64.9**	**73.7**
Share of arrears in total portfolio	**22.8**	**29.3**	**32.5**	**36.7**	**44.3**
	IV. Agricultural Development Bank 3/				
Total portfolio	**90.9**	**100.5**	**100.8**	**103.6**	**102.2**
Loans overdue	**23.6**	**28.4**	**25.9**	**30.9**	**32.9**
Loans overdue as a share of total portfolio	**26.0**	**28.3**	**25.7**	**29.8**	**32.2**
Loans with payments overdue	**23.6**	**28.4**	**25.9**	**30.9**	**32.9**
Overdue 30–90 days	2.9	3.1	3.5	3.9	3.7
More than 90 days overdue	20.8	25.4	22.4	27.0	29.2
Percent of total with payments overdue	**100.0**	**100.0**	**100.0**	**100.0**	**42.8**
Overdue 30–90 days	12.2	10.8	13.5	12.6	4.8
More than 90 days overdue	87.8	89.2	86.5	87.4	38.0

Sources: National Bank of Panama; Savings Bank; National Mortgage Bank; and Agricultural Development Bank.

1/ In 2001 the Superintendency of Banks introduced a new methodology to determine arrears on commercial bank loans. In previous years only the outstanding installments were recorded as arrears on loans on which scheduled payments had not been made for between 30 and 90 days. For loans more than 90 days overdue, some banks continued to define as arrears only the outstanding installments, while others included the entire balance outstanding. By end-2001 all banks were required to register the entire outstanding balance of a loan as in arrears, once payment was more than 30 days overdue. This led to a significant increase in arrears in the accounts of the Banco National de Panama. End-2000 data have been adjusted to reflect the new standard. In addition, the BNP has also increased its provisioning substantially.

2/ This portfolio includes bad loans related to projects financed through the Ministry of Housing for lower income families.

3/ Excludes portfolio in arrears for more than one year.

Table 27. Panama: Summary of Balance of Payments

	1999	2000	2001	2002	2003	Jan.–Sept. 2003	Jan.–Sept. 2004
	(In millions of U.S. dollars)						
Current account	**-1,159**	**-689**	**-174**	**-61**	**-442**	**-580**	**-735**
Trade balance excluding Colon Free Zone	**-1,918**	**-1,658**	**-1,225**	**-1,382**	**-1,476**	**-1,088**	**-1,205**
Exports, f.o.b.	853	1,047	1,079	970	987	720	792
Imports, f.o.b. (-)	-2,772	-2,705	-2,304	-2,352	-2,463	-1,808	-1,997
Net exports from Colon Free Zone	578	515	529	346	359	100	92
Re-exports, f.o.b.	4,435	4,791	4,914	4,345	4,057	2,865	3,419
Imports, f.o.b. (-)	-3,857	-4,276	-4,384	-3,998	-3,698	-2,764	-3,328
Services, net	**701**	**854**	**899**	**981**	**1,254**	**929**	**935**
Travel, net	206	269	310	334	377	267	290
Travel credits	396	458	486	513	585	420	466
Travel debits	-190	-188	-176	-179	-208	-153	-176
Transportation, net	416	545	537	592	799	583	606
Colon Free Zone	-242	-269	-290	-275	-255	-188	-230
Panama Canal Authority	698	748	709	778	890	650	750
Other	-40	66	118	89	164	121	86
Other services	79	39	52	54	79	78	39
Income, net	**-691**	**-577**	**-602**	**-250**	**-820**	**-695**	**-740**
Private sector	-456	-330	-289	78	-438	-346	-380
Public sector	-236	-247	-313	-328	-382	-349	-360
Of which:							
NFPS interest	-327	-366	-415	-449	-474	-412	-422
Current transfers, net	**171**	**177**	**226**	**244**	**241**	**174**	**183**
Capital and financial account	**1,364**	**203**	**890**	**367**	**163**	**319**	**193**
Capital account (public sector grants)	**3**	**2**	**2**	**0**	**0**	**0**	**9**
Financial account	**1,361**	**201**	**889**	**367**	**163**	**319**	**184**
Public sector	-64	103	325	350	290	142	124
Nonfinancial public sector	-63	117	339	322	288	131	123
Disbursements	630	485	1,219	1,076	421	386	663
Amortization	-414	-392	-536	-946	-288	-255	-541
Other	-280	24	-345	192	155	0	0
National Bank of Panama (BNP)	-6	-6	-7	-8	-8	0	0
Other portfolio flows (net)	5	-8	-7	36	10	10	1
Private sector, medium and long-term	409	931	-270	129	430	288	-91
Direct investment	864	700	405	99	792	612	425
Portfolio investment	-546	-96	-743	-49	-59	87	-410
Loans	91	327	69	79	-302	-410	-106
Short-term flows	1,016	-832	833	-112	-557	-111	151
Errors and omissions	**-296**	**395**	**-301**	**-243**	**130**	**189**	**12**
Overall balance	**-91**	**-91**	**416**	**62**	**-149**	**-71**	**-530**
Financing	**91**	**91**	**-416**	**-62**	**149**	**71**	**530**
Net foreign assets of the BNP	82	117	-409	-54	158	76	534
Net use of Fund credit	-23	-52	-34	-8	-9	-5	-5
Exceptional financing	32	26	27	0	0	0	0
	(In percent of GDP)						
Memorandum items:							
Merchandise exports	7.4	9.0	9.1	7.9	7.7	...	...
Merchandise imports	-24.2	-23.3	-19.5	-19.2	-19.2	...	...
Net exports from Colon Free Zone	5.0	4.4	4.5	2.8	2.8	...	...
Current account	-10.1	-5.9	-1.5	-0.5	-3.4	...	...
Direct foreign investment	7.5	6.0	3.4	0.8	6.2	...	...

Sources: Office of the Comptroller General; and Fund staff estimates.

Table 28. Panama: Direction of Trade 1/

(In percent)

	2000	2001	2002	2003	Jan.–Sept. 2/ 2003	Jan.–Sept. 2/ 2004
Exports, f.o.b.	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Western hemisphere	**70.3**	**74.4**	**73.1**	**70.8**	**70.2**	**66.5**
United States	43.3	48.1	45.8	49.9	49.5	47.2
Central America and the Caribbean	20.8	19.9	22.0	16.9	16.4	15.3
South America	2.7	4.0	2.6	2.0	2.2	2.3
Other	3.5	2.4	2.7	2.0	2.1	1.7
Europe	**22.9**	**20.2**	**22.2**	**24.8**	**24.6**	**27.0**
Belgium and Luxembourg	5.2	4.5	4.4	3.6	3.5	3.8
Germany	1.7	3.2	0.9	0.5	0.5	0.6
Italy	3.3	2.7	1.0	1.2	1.3	1.4
Sweden	8.5	3.7	6.1	6.2	5.9	6.8
Other	4.2	6.1	9.8	13.3	13.4	14.4
Other countries	**6.8**	**5.4**	**4.7**	**4.4**	**5.2**	**6.5**
Of which:						
Exports through the Colon Free Zone	1.3	1.1	1.3	1.2	1.0	0.9
Imports, c.i.f. 3/	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Western hemisphere	**65.6**	**66.4**	**65.7**	**69.9**	**65.1**	**64.4**
United States	32.7	32.6	33.4	34.4	34.7	29.1
Mexico	3.9	4.0	3.7	3.8	3.8	4.2
Central America and the Caribbean	9.0	8.5	12.3	19.9	14.4	17.9
Costa Rica	3.5	3.6	4.2	4.8	4.8	5.0
Trinidad and Tobago	0.1	0.1	1.3	0.6	0.6	0.6
Other	5.4	4.8	6.8	14.5	9.0	12.3
South America	20.0	21.3	16.3	11.8	12.2	13.2
Venezuela	6.6	5.2	4.2	2.7	2.9	3.3
Ecuador	7.2	7.9	3.3	0.2	0.2	0.2
Brazil	1.1	1.1	1.6	3.0	3.1	3.4
Other	5.1	7.1	7.2	5.9	6.0	6.3
Europe	**9.2**	**8.6**	**7.7**	**7.9**	**8.2**	**7.6**
Germany	1.6	1.7	1.5	1.6	1.6	1.3
France	0.5	1.5	0.6	0.6	0.6	0.6
Spain	1.8	1.7	1.4	1.6	1.6	1.3
Italy	0.7	0.6	0.6	0.7	0.7	0.6
Netherlands	0.6	0.6	0.6	0.5	0.5	0.5
United Kingdom	0.9	0.7	0.6	0.8	0.9	0.4
Other	3.1	1.8	2.4	2.1	2.3	2.9
Other countries	**25.2**	**25.0**	**26.6**	**22.2**	**26.7**	**28.0**
Of which:						
Imports from the Colon Free Zone	12.0	12.0	13.0	12.5	11.9	11.7

Sources: Office of the Comptroller General; and Fund staff estimates.

1/ Based on customs data.
2/ Preliminary information
3/ Excludes sales of bunker oil.

Table 29. Panama: Operations of the Colon Free Zone
(In millions of balboas)

	2000	2001	2002	2003	Jan.– Mar. 1/ 2003	Jan.– Mar. 1/ 2004
Imports 2/	**4,630.2**	**4,759.5**	**4,358.3**	**4,146.6**	**883.6**	**1,051.1**
Textiles and clothing	1,188.2	1,310.0	1,142.3	1,055.8	226.8	280.7
Beverages and tobacco	102.3	116.5	144.4	132.5	24.4	41.8
Chemical products	642.6	717.2	672.5	719.7	159.3	169.3
Instruments	272.6	248.4	236.0	194.9	38.1	52.9
Machinery and transport goods	1,271.3	1,266.4	1,137.1	1,112.6	240.4	277.7
Other	1,153.2	1,101.0	1,026.0	931.1	194.6	228.7
Exports, f.o.b. 2/	**5,318.7**	**5,410.1**	**4,837.1**	**4,566.9**	**954.8**	**1,139.3**
Textiles and clothing	1,312.9	1,400.6	1,224.3	1,048.8	214.2	247.4
Beverages and tobacco	108.2	133.7	146.4	143.1	25.3	35.8
Chemical products	959.5	990.3	921.0	986.6	220.5	247.9
Instruments	278.2	261.4	231.5	208.0	44.7	52.2
Machinery and transport goods	1,438.2	1,408.3	1,243.3	1,211.4	252.2	303.6
Other	1,221.7	1,215.8	1,070.6	969.0	197.9	252.4
Memorandum item:						
Number of Panamanians employed in Colon Free Zone 3/	14,575	15,300	15,152	13,349	...	...

Sources: Office of the Comptroller General; Administration of the Colon Free Zone; and Fund staff estimates.

1/ Preliminary information.
2/ Excludes balance of payments adjustments.
3/ Average for the year.

Table 30. Panama: Composition of Merchandise Exports

(In millions of balboas, unless otherwise specified)

	2000	2001	2002	2003	Prel. 2004
Merchandise exports, f.o.b. 1/	**1,047.4**	**1078.8**	**970.1**	**987.4**	**1,113.4**
Petroleum exports	**158.0**	**134.3**	**102.0**	**...**	**...**
Nonpetroleum exports, f.o.b 2/.	**779.1**	**809.0**	**759.6**	**805.0**	**890.3**
Bananas					
Value	159.8	122.1	113.2	112.8	108.2
Volume (millions of boxes)	29.2	23.6	23.0	22.5	21.9
Unit value per box	5.5	5.2	4.9	5.0	4.9
Sugar					
Value	19.9	13.9	15.1	12.7	10.4
Volume (thousands of metric tons)	69.0	41.1	37.9	35.2	27.5
Unit value per pound	0.1	0.2	0.2	0.2	0.2
Shrimp					
Value	59.4	70.3	58.1	56.5	53.8
Volume (thousands of metric tons)	5.9	6.7	5.7	7.2	7.2
Unit value per pound	4.6	4.8	4.6	3.6	3.4
Coffee					
Value	16.0	11.1	9.3	12.2	10.9
Volume (thousands of metric tons)	7.4	7.0	5.4	7.0	5.1
Unit value per pound	1.0	0.7	0.8	0.8	1.0
Fishmeal					
Value	8.2	7.6	4.2	10.9	6.2
Volume (thousands of metric tons)	29.1	23.6	10.8	28.0	14.4
Unit value per pound	0.1	0.2	0.2	0.2	0.2
Other seafood					
Value	81.4	96.0	101.8	132.0	160.8
Volume (thousands of metric tons)	28.8	32.5	33.0	39.4	46.7
Unit value per pound	1.3	1.3	1.4	1.5	1.6
Clothing					
Value	18.0	15.3	12.8	11.0	8.8
Volume (metric tons)	0.6	0.5	0.5	0.6	0.5
Unit value per pound	13.6	14.0	11.6	8.3	8.0
Other exports					
Value	416.4	472.7	445.1	456.9	531.2
Re-exports	**28.8**	**45.4**	**40.7**	**33.8**	**29.4**
Adjustment 3/	**81.5**	**90.1**	**67.8**	**...**	**...**

Sources: Office of the Comptroller General; and Fund staff estimates.

1/ Including re-exports and adjustment (coverage and valuation). Petroleum export data for 2003 are not available.

2/ Excluding re-exports and adjustment (coverage and valuation).

3/ For reconciliation between total merchandise exports, and the breakdown that come from a different database.

Table 31. Panama: Travel Receipts and Expenditure, and Number of Visitors

	2000	2001	2002	2003	Jan.–Sep. 2003	Jan.–Sep. 2004
	(In millions of balboas)					
Net travel receipts	**269.4**	**303.6**	**334.2**	**376.9**	**267.1**	**290.0**
Travel receipts	457.8	477.1	513.0	584.6	420.5	466.4
Tourists	193.0	201.3	215.7	248.1	179.6	199.1
Business, official, and education related travel	98.1	103.3	104.1	115.1	87.0	92.9
Travelers in transit and others	166.7	172.5	193.2	221.4	153.9	174.4
Expenditure of Panamanians traveling abroad (-)	-188.4	-173.5	-178.8	-207.7	-153.4	-176.4
	(In thousands)					
Visitors 1/	**472.4**	**485.2**	**502.3**	**542.3**	**398.7**	**424.7**
Tourists	318.8	324.1	342.7	368.5	267	288.6
Business, official, and education related travel	153.6	161.1	159.6	173.8	131.7	136.1
Travelers in transit 2/	**685.2**	**715.9**	**818.8**	**887.8**	**611.6**	**719.9**

Sources: Office of the Comptroller General; and Fund staff estimates.

1/ Entries into Panama excluding residents, immigrants, and persons in transit or whose destination is the Canal area.

2/ Nonresidents who spent less than 48 hours in Panama.

Table 32. Panama: External Public Debt Indicators

(In percent)

	2000	2001	2002	2003	2004
Debt-service ratios 1/					
In percent of central government receipts 2/	35.9	48.7	70.5	37.8	56.4
Principal due	18.5	27.4	47.8	14.3	30.0
Interest due	17.3	21.2	22.7	23.6	26.3
In percent of GDP	6.5	8.0	11.4	5.9	8.2
Principal due	3.4	4.5	7.7	2.2	4.4
Interest due	3.2	3.5	3.7	3.7	3.8
In percent of exports of goods and nonfactor services	21.3	26.3	38.8	19.5	25.4
Principal due	11.0	14.8	26.3	7.4	13.5
Interest due	10.3	11.5	12.5	12.2	11.9
External debt in terms of GDP 3/	**48.2**	**53.0**	**51.7**	**50.6**	**52.6**
Multilateral and bilateral 4/	12.8	12.1	12.3	12.0	10.9
Of which					
IMF	0.8	0.5	0.4	0.3	0.3
Other 5/	35.4	40.9	39.5	38.6	41.7
Effective external interest rate on total debt 6/	6.5	6.6	7.1	7.3	7.3

Sources: Office of the Comptroller General; and Ministry of Economy and Finance.

1/ Debt-service ratios exclude payments due on short-term debt, but include payments due to the IMF.
2/ Central government receipts include transfers from the rest of the public sector and exclude grants.
3/ Includes interest arrears.
4/ Includes insured suppliers' credits.
5/ Includes nonguaranteed suppliers' credits.
6/ Interest rate on outstanding debt at the end of the period.