



# **HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT**

## **PANAMA**

### **Fiscal Transparency Evaluation**

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### High-Level Summary Technical Assistance Report Fiscal Affairs Department

#### Fiscal Transparency Evaluation

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**The *Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.**

**ABSTRACT:** An IMF team found that Panama has a cash-based system of budgeting and accounting that generates good information on many aspects of public finances. There are, however, many weaknesses in the system which diverge from the sound practices included in the Fund's Fiscal Transparency Code. Panama's ratings are lower than those of regional comparators, especially in the area of fiscal risks. The team developed high-priority recommendations to improve Panama's fiscal transparency principles.

JEL Classification [H00, H1, H5, H6, H7] (consult <https://www.aeaweb.org/econlit/jelCodes.php>)

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## Background

In response to a request from the Ministry of Economy and Finance of Panama (MEF), the IMF's Fiscal Affairs Department (FAD) conducted a Fiscal Transparency Evaluation (FTE) mission covering three pillars of the IMF's Fiscal Transparency Code (FTC) during the period May 3-16, 2023.

## Summary of Findings

Panama has a traditional cash-based system of budgeting and accounting that generates good information on many aspects of public finances. The budget is passed well before the year begins, and it presents the revenue and spending of not only the central government but also most financial and nonfinancial public corporations. The Comptroller-General's annual report shows how actual spending and revenue compare with budgeted amounts, and quarterly reports summarize in-year fiscal developments.

Several modern practices have been grafted on to this traditional system that further improve transparency. For example, the Social-Fiscal Responsibility Law (SFRL), approved in 2018 and one of the first in the region, sets out fiscal targets against which fiscal policy can be judged, and the government consults the public on budgeting, publishes a concise citizens' budget, and makes detailed financial information available on its transparency pages. Other helpful developments have been underway under the current government, including the preparation of an organic budget law and performance budgeting.

There are, however, many weaknesses in the system which diverge from the sound practices included in the Fund's Fiscal Transparency Code. Panama's ratings are lower than those of regional comparators, especially in the area of fiscal risks.

The SFRL does not guide fiscal policy in the way that was intended. The deficit targets have been modified frequently since the law was introduced, and they have been met in ways that do not always fundamentally improve public finances. Reported debt excludes arrears, SDRs, and debts of turnkey contracts. Fiscal reports exclude the spending, revenue, assets, and liabilities of 14 or more *fideicomisos* (trust funds). Partly because of these issues, actual debt has been increasing more quickly than can be explained by reported deficits.

In addition, while fiscal reports cover central government, they do not consolidate the general government or the entire public sector. Final annual financial statements are produced by the National Accounting Directorate of MEF, but they are for internal use only. The Comptroller-General does not audit and issue an opinion on the annual financial statements.

The estimates presented in this Fiscal Transparency Evaluation provide a broader picture of public finances that suggests, among other things, that in 2021:

- The net worth of the entire public sector amounted to 68 percent of GDP, higher than most economies worldwide.
- The debt of the central government was about 71.7 percent of GDP, compared to the reported 60.1 percent of GDP; the difference being mostly explained by accounts payable and SDR.
- The central government had assets amounting to 116 percent of GDP, including copper reserves worth about 11 percent of GDP, and its net worth was about 44 percent of GDP. This amount excludes, however, the present value of the future deficits of the now-closed defined-benefit pension scheme, which is about 120 percent of GDP.
- The expenditure of the nonfinancial public sector was around 27.2 percent of GDP compared to the reported 23.7 percent of GDP.

Also, the government does not publish a document that explains its fiscal strategy or exposure to fiscal risks. The budget law shows only detailed appropriations without narrative. Some of the main

assumptions underlying budget-year forecasts are for internal use only, and no medium-term fiscal forecasts have been published since 2019. Nor does the government discuss fiscal risks. Budget planning is weak, and the initial budget is not a fully credible representation of the government's policy intentions. Changes to appropriations are made as often as every week, starting soon after the year begins. There is no supplementary budget. In addition, capital and operating expenditures are not properly distinguished, and there is no significant reserve for contingencies.

Finally, there are no long-term fiscal projections of the deficit and debt of the kind that would put the financial problems of the defined-benefit pension scheme in context and indicate the extent to which its deficits can be met from the government's existing sources of revenue.

These problems limit citizens' understanding of public finances, and in many cases the government's as well. They undermine the government's efforts to direct public resources to the best uses, and they limit its ability to identify and respond to developing fiscal problems. They may prove particularly serious if Panama confronts a future economic crisis with its now increased level of public debt and higher global interest rates.

The pandemic interrupted improvements in fiscal transparency and explains some of the current shortcomings. Now that it has receded, the government can resume its work on these issues in a way that reflects both recent developments in transparency practices around the world and Panama's individual circumstances, such as the constitutional independence of the Panama Canal Authority and the absence of a central bank that can use monetary policy to stabilize the economy. The recommendations set out below offer suggestions for doing so.

## Summary of Recommendations

Looking ahead, to align Panama's practices with sound fiscal transparency principles, the mission team has identified the following high-priority recommendations:

- Improve fiscal reporting:
  - o Start publishing existing internal and discontinued fiscal reports widening their scope to include *fideicomisos*
  - o Provide an accurate view of Panama's financial position by enriching the content of the fiscal reports through completion of data gaps on assets, liabilities and fiscal flows
  - o Conduct external financial audits on Central Government Consolidated Statements and publish the statements and audit findings
  - o Publish fiscal statistics consistent with GFSM 2014
- Strengthen macro-fiscal forecasting and budgeting:
  - o Publish a yearly fiscal strategy report with forecasts, narrative and analytical discussion on government's key medium-term priorities
  - o Enact the General Budget Administration Law to legislate the requirement for a medium-term budget framework.
  - o Prepare a supplementary budget informed by a mid-year budget review and refrain from weekly line-item reallocations
  - o Improve the execution of capital projects by strengthening the link between planning and budgeting
- Establish fiscal risk management practices
  - o Include a chapter on fiscal risks (a statement of fiscal risks) in each fiscal strategy report that discusses i) macroeconomic fiscal risks, and ii) specific fiscal risks
  - o Extend medium-term fiscal projections out to 20 years, given simple assumptions about government policy, demographics, economic growth, and other variables.