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Panama: 2004 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Panama

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Panama, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 15, 2004, with the officials of Panama on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 8, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of March 23, 2005 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its March 23, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Panama.

The document listed below has been or will be separately released.

Selected Issues Paper and Statistical Appendix

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

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INTERNATIONAL MONETARY FUND

PANAMA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation with Panama

Approved by José Fajgenbaum and G. Russell Kincaid

March 8, 2005

- **Discussions**. A staff team held discussions in Panama City during November 8–23 and December 14–15. The team met with the Minister of Economy and Finance, the General Manager of the National Bank of Panama, other senior officials, and representatives of banks and the business sector.

- **Team**. W. Lewis (Head), M. Dehesa, P. Druck, A. Faria, and E. Verreydt (all WHD) participated in the first mission, which was accompanied by A. Macia (OED). J. Fajgenbaum and W. Lewis participated in the December visit.

- **Previous consultation**. At the conclusion of the 2003 Article IV consultation on March 22, 2004, Directors stressed the need to maintain a sound fiscal policy through compliance with the country's fiscal responsibility law, and to proceed with social security reform. They considered that structural reforms in the fiscal area were needed, including tax policy, tax administration, and the civil service.

- **Effectiveness of past surveillance**. While generally agreeing with the Fund's policy advice during the last Article IV consultation, the previous authorities faced difficulties in pursuing continued fiscal consolidation and structural reform in 2003–04. As a result, the fiscal deficit in 2003 and 2004 exceeded the level required for compliance with the fiscal law. While Directors emphasized the need for fiscal reforms, the pace of reform slowed during the election period. Since then, the new administration has begun to implement a medium-term fiscal adjustment plan, consistent with Fund advice, and is now preparing a reform of the social security agency.

- **Fund relations**. Panama has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions (Appendix I). Panama's outstanding use of Fund credit at end-2004 was 11 percent of quota. Panama participates in the GDDS, and its metadata are posted on the Fund's Data Standards Bulletin Board.

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EXECUTIVE SUMMARY

Background

- **Growth**. An economic recovery has been underway since late 2003, with real GDP growing at 6 percent in 2004, but it is expected to slow down to 3½ percent in 2005. Inflation remains low.
- **Fiscal performance**. The fiscal deficit (excluding the Panama Canal Authority (PCA)) reached 5 percent of GDP in 2004. The administration that assumed office in September 2004 embarked on a medium-term strategy to reduce the deficit.
- **Financial sector**. The banking system experienced a substantial recovery in 2003–04, and the financial system remains essentially sound, with favorable performance indicators and a strong regulatory framework.
- **Medium-term outlook**. The medium-term outlook is encouraging, assuming implementation of the authorities' fiscal program, which should put the public debt ratio on a steadily declining path. A downside risk would emerge if the administration is unable to sustain the fiscal adjustment effort that is now underway.
- **Panama Canal expansion**. An expansion of the Panama Canal at an estimated cost of over 30 percent of GDP could, if approved in a national referendum, have a far-reaching impact on the economy's growth prospects.

Policy discussions

- **Policy objectives**. The government's strategic objectives are to restore fiscal discipline to achieve debt sustainability and provide a basis for sustained growth and jobs creation, poverty reduction, and the development of human capital. The authorities' program gives priority to good governance with transparency and accountability in government.
- **Fiscal program**. A fiscal reform adopted in February 2005 is part of a plan to lower the deficit (excluding the PCA) to about 1 percent of GDP by 2007. It provides for the phased introduction of tax reform, the containment of current expenditure, and a repeal of tax incentives. The budget for 2005 appropriately targets a reduction in the fiscal deficit to 3.6 percent of GDP.
- **Pension reform**. The authorities are preparing a reform of the public pension system, which may entail some combination of changes in the benefit system, eligibility requirements, and financing of the pension system.
- **Medium-term strategy**. The authorities' growth strategy centers on enhancing the competitiveness of the export-oriented service sector, and includes human capital development and adequate infrastructure.
- **Trade policy**. The prospective free trade agreement with the United States signals Panama's commitment to further integration with the regional and global economy.

I. Background and Prospects for 2005

A. Overview

1. **Panama is an open, fully dollarized economy whose mainstay is a large and diversified service sector (Figures 1 and 2)**. The service sector accounts for about three-quarters of total value-added and is growing in importance. Services are diversified, including in particular the operations of the government-owned (since 2000) Panama Canal, the Colon Free Zone, a large banking system integrated with international financial markets, and tourism. The fastest growing services are transport, communications, tourism, and wholesale trade. Two thirds of exports, which amount to 30 percent of GDP, are services.

2. **Over the last decade, Panama experienced moderate growth on average, ranging between 0.6 percent (2001) and 7.3 percent (1998)**. In the last five years, the sources of growth shifted from domestic demand to the external sector with the weakening of investment and imports and continued moderate growth of exports. Unemployment, however, remained above 11.5 percent throughout the period. The fiscal accounts deteriorated on average over the last decade as a result of decreasing revenues and increasing expenditures relative to GDP. Financial deepening during the period was reflected in an increase in the ratio of private credit to GDP of 18 percentage points over the decade to 2004, to 89 percent; the banking system's financial soundness also strengthened during this period.

Overview of Economic Performance 1995–2004

	Annual Averages 1995–99	2000–04	1995–2004
(Contribution to the growth of real GDP, in percent)			
Consumption	4.7	2.3	3.5
Investment	1.8	-0.7	0.5
Domestic demand	6.5	1.5	4.0
Exports	1.3	1.2	1.3
Imports	-3.3	0.4	-1.5
Foreign balance	-2.0	1.6	-0.2
(In percent)			
Real GDP growth	4.5	3.2	3.8
Unemployment rate	13.4	13.3	13.3
(In percent of GDP)			
Fiscal balance 1/	-0.7	-3.2	-1.9
Bank deposits	66.8	80.3	73.5
Bank credit to private sector	80.0	91.4	85.7

Sources: Office of the Comptroller General; and Fund staff estimates.
1/ Nonfinancial public sector, excluding the Panama Canal Authority.

3. **Panama's social indicators compare favorably with the average for Latin America, but rural areas lag behind.** The poverty rate is 37 percent on average (67 percent in rural areas, where 54 percent of the population live in extreme poverty), with a particularly high concentration of poverty among indigenous people (98 percent).[1] Malnutrition among children averages only 6 percent in urban areas, but rises to 15 percent in nonindigenous rural areas and 49 percent in indigenous rural areas. Urban-rural differences in infant mortality rates, access to drinking water, and other social indicators also are large.

B. Political Developments

4. **President Torrijos assumed office in September 2004, following an election that was widely interpreted as giving a mandate for change**. He has a majority in the legislative

[1] Persons with an annual consumption below US$953 in 2003 prices are in poverty; and those with consumption below US$534 are in extreme poverty.

assembly and began a five-year term with an 80 percent approval rating. His stated priorities in the economic field include fiscal discipline, fighting corruption, poverty reduction through job creation, continued trade integration, and a commitment to good governance and transparency in the public sector.

C. Recent Economic Developments

5. **A strong economic recovery has been underway since late 2003.** Real GDP rose 5 percent in the fourth quarter of 2003 and 6½ percent in the first three quarters of 2004, year on year. Despite a growth in jobs, the unemployment rate is likely to have remained above 11 percent of the labor force in 2004, indicating high structural unemployment (see Figure 1). The rebound was led by a boom in construction that has been stimulated by temporary tax incentives[2] and by export-oriented services (in particular the Colon Free Zone and ports). Higher exports of services and merchandise lowered the external current account deficit from 3.4 percent of GDP in 2003 to an estimated 2 percent in 2004, despite a higher oil import bill. Inflation remains low.[3]

Macroeconomic Framework

(In percent of GDP, unless otherwise indicated)

	2002	2003	Est. 2004	Proj. 1/ 2005
Real GDP growth (in percent)	2.2	4.3	6.0	3.5
Inflation (in percent; end of period)	1.8	0.1	2.0	2.0
External current account	-0.5	-3.4	-2.0	-1.5
International reserves (National Bank of Panama)				
In months of imports	3.8	3.2	1.8	1.9
In percent of short-term external debt	406.2	167.5	334.4	97.0
Nonfinancial public sector				
Primary balance 2/	1.0	-0.3	-0.5	1.1
Overall balance 2/	-3.3	-4.7	-5.0	-3.6
Overall balance, including PCA	-2.7	-3.8	-3.3	-2.1
Debt (end of period) 3/	63.7	63.3	68.1	63.7

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

1/ Reflects authorities' fiscal policy.
2/ Excluding the Panama Canal Authority (PCA).
3/ Debt at end-2004 includes a US$600 million bond issue to pre-fund the PSBR for 2005.

6. **The nonfinancial public sector deficit (excluding the Panama Canal Authority) increased slightly in 2004 to an estimated 5 percent of GDP.** Nontax revenue of the central government declined,[4] while public investment fell from the relatively high level of 2003, when the pace of implementation of large projects was stepped up near the end of the previous administration. Although the net revenue effect of a tax reform implemented at the end of 2002 was modestly positive, the buoyancy of the tax system remains weak (Figure 3 and Tables 2–3). A growing surplus of the Panama Canal Authority (PCA) improved the fiscal balance utilized by

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[2] Under the 2002 tax law, construction authorized before end-2003 and completed before end-2004 is exempted from property tax for 20 years. The new government extended this exemption by one year. Subsequently, a shorter tax-exempt period would apply.

[3] CPI inflation in Panama is consistently lower than U.S. inflation.

[4] Dividends fell in 2004, owing to a change in policy regarding their timing. 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 new authorities discontinued this policy in 2004, and the payment of BNP's dividend was shifted to 2005.

the previous administration to measure compliance with the fiscal responsibility law (nonfinancial public sector deficit including the PCA), but the deficit remained well above the limit of 2 percent of GDP, which was established in that law (Section III.A).

7. **Starting in September 2004, the new administration took a number of steps to improve fiscal transparency and contain the deficit**. It introduced revenue and expenditure measures, yielding an estimated 0.2 percentage point of annual GDP, and reviewed aspects of fiscal accounting methods in light of concerns that the reported deficit could be understating the fiscal imbalance.[5] Also, the authorities suspended the fiscal responsibility law (FRL) until end-2005 because they did not regard compliance with the deficit limit of 2 percent of GDP to be feasible.

8. **Domestic financing of the public sector deficit in 2004 led to a decline in net international reserves of US$380 million (Table 4).**[6] Credit to the central government from the state-owned National Bank of Panama (BNP) amounted to about 2.5 percent of GDP 2004, while the social security fund (CSS) withdrew some of its deposits at the BNP, mainly to cover an operating deficit. The resulting contraction of the BNP's foreign assets has reduced its liquidity and weakened the BNP's ability to provide a cushion in the event of a shock to the financial system.

9. **The banking system experienced a sustained recovery in 2003–04, following the turbulence in financial markets in South America during 2002**. Domestic deposits rose by 8 percent in 2004 as the economic expansion gathered strength. Nonresident deposits in the domestic banking system stabilized in 2003 and resumed growth during 2004 (Figure 4). Rapid growth of credit to commerce and mortgages led to an 11 percent increase in domestic credit to the private sector in 2004.

10. **The financial system remains generally sound.** Nonperforming loan ratios have trended downward since end-2002, both for domestic and foreign banks, to 2 percent on average at end-September 2004. At the same time, capital adequacy ratios were 19 percent on average, and liquidity in the private banks remained ample (Table 5). Domestic deposit rates declined, converging to LIBOR (Figure 5). A slower decline in lending rates led to wider interest rate margins, in particular in local banks.

11. **Bond markets have begun to respond favorably to the new administration's emphasis on fiscal discipline and transparency**. Market concern over growing fiscal imbalances in 2004 had been reflected in adverse movements in spread differentials relative to other emerging markets; in recent months, however, there has been some improvement in these differentials (Figure 6). Moody's and Standard & Poor's sovereign ratings for Panama are one and two steps below investment grade, respectively. In mid-February S&P improved Panama's outlook from negative to stable.

[5] The cash-based deficit did not reflect an apparent increase in payables in 2003–04; and certain nontax revenue was over-reported.

[6] Corresponds to net foreign assets of the National Bank of Panama.

12. **Panama's trade policy remained focused on concluding free trade agreements, where some progress was made in 2003–04**. The strategy of attracting foreign investors with a regional focus led to a free trade agreement with Taiwan Province of China in 2003, and negotiations on a free trade agreement with the United States began in April 2004. Within the Central America region, an agreement has been concluded with El Salvador, and negotiations with Costa Rica and Nicaragua are underway.

D. Outlook for 2005

13. **The staff projects a slowdown in real GDP growth from 6 percent in 2004 to 3½ percent in 2005**. Activity in the construction sector is expected to decelerate,[7] but still remain at a high level, induced by the extension of the tax incentives.[8] The contribution to growth from the external sector, while positive, is likely to diminish, as the external environment is expected to be less favorable than in 2004 for merchandise exports, while service exports continue a moderate expansion. The external current account deficit is projected to decrease to 1½ percent of GDP in 2005 (Table 6). Inflation is expected to remain low.

II. Policy Discussions

14. **The authorities seek to promote the country's economic and social development through four strategic, and closely interrelated, objectives**. They regard one of them—fiscal discipline and transparency—to be an essential precondition to sustained progress with the others: poverty reduction, economic growth for the creation of jobs, and the development of human capital. The authorities' program reflects their view that a prosperous economy and cohesive society require sustainable growth, good governance, and policies that extend economic opportunity and social services to impoverished rural areas.

15. **The authorities explained that growth-oriented policies would aim at increased productivity and competitiveness in the export-oriented sectors, drawing upon the potential benefits of Panama's integration with the global and regional economy**. An expansion of the Panama Canal could add to this potential. The authorities recognized that no growth strategy can have a lasting success unless the public finances and public debt are placed on a sustainable path through a reduction of the budget deficit and social security reform. Against this background, the Article IV discussions focused on the economic policies needed to support the objectives of fiscal consolidation and sustainability, growth, and competitiveness.

A. Fiscal Policy

16. **The authorities' fiscal policy objectives are to lower the public debt burden; restore viability to the public pension system; enhance transparency and accountability in the public sector; and, over the medium term, address unmet needs for public investment**. The authorities intend to put the fiscal deficit on a firmly declining path, starting in 2005 with a

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[7] Real value-added in the construction sector has risen by over 55 percent since 2001.

[8] See footnote 1.

1½ percentage-point of GDP reduction in the nonfinancial public sector deficit (excluding the PCA), to 3.6 percent of GDP. The deficit would decrease further, to about 1 percent of GDP by 2007. The staff agreed that these deficit targets were appropriate, in view of the importance for Panama's dollarized economy of fiscal policies that support good public debt dynamics.

17. **To achieve these targets, the authorities have begun to implement an ambitious and comprehensive fiscal strategy, including the following elements:**

- The annual budget underpins most of the planned reduction in the deficit in 2005 (see Table 2). It restricts public investment to the completion of ongoing projects for the most part, and limits low-priority current spending.
- A multi-faceted fiscal reform was adopted in early February 2005, which encompasses a containment of current expenditure, tax reform, the repeal of fiscal incentives for certain sectors,[9] and measures aimed at greater accountability in the public sector (Box 1).
- A proposal for social security reform is being readied for public discussion and presentation to the National Assembly.
- The fiscal responsibility law will be revised in the course of 2005.

Staff agreed that the fiscal targets for 2005 and the medium term, supported by an appropriate sequencing of fiscal reforms, represented a strong adjustment effort that should put the public finances on a path toward sustainability. The measures already adopted should be adequate to achieve, and likely exceed, the fiscal target for 2005, and their phased impact together with plans for social security reform should contribute to further fiscal consolidation in the following years. Once the fiscal impact of these reforms is known, the authorities will be able to assess whether additional measures are needed to meet their medium-term fiscal targets.

18. **Several measures seek to control current expenditure**. Public sector employment is to be reduced to the end-1999 levels by the beginning of 2008, in part through attrition;[10] the growth of primary current expenditure is limited, starting in 2006, to the growth of current revenue in the preceding year; administrative expenses are curtailed; and outlays for professional services are curbed. The rationalization of current expenditure would support deficit reduction and, over the medium term, a shift in the composition of outlays toward roads infrastructure and expanded facilities in the health and education sectors. The staff agreed with the emphasis given to curbs on current expenditure, in particular the phased reduction of public sector employment in response to its excessive growth in recent years.

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[9] In particular, construction, manufacturing, and forestry. Future fiscal incentives are to be explicitly limited in duration.

[10] Taking account of exceptions for health, education, and security services, employment would decline from about 180,000 to a range of 165–170 thousand by end-2007. Government agencies must submit their plans by mid-2005 for achieving the targeted reduction.

19. **The tax reform included in the fiscal package appropriately aims to improve the equity, efficiency, yield, and buoyancy of the tax system**. It will close loopholes in corporate income taxation, introduce an alternative minimum income tax for individuals and corporations, introduce a tax on casino payouts, include representation expenses in taxable income, increase penalties for fraud, and simplify the tax system by eliminating a number of low-yielding taxes. Fiscal incentives were eliminated in some cases where the tax breaks were poorly targeted (e.g., in the industrial sector). Part of the reform will take immediate effect; the full-year revenue effect is estimated at 1 percent of GDP. Staff agreed that the equity considerations leading to the closing of tax loopholes and the removal of ineffective tax incentives could help gain public acceptance of the tax reform.

20. **The authorities are planning to reduce unpaid bills in 2005**. As a first step, payables to suppliers that are more than 90 days old would be eliminated, and then the maximum duration of payables would be lowered to 60 days.[11] Staff agreed that the reduction of arrears was important, and noted that the fiscal reforms could provide room to make even faster progress than currently planned in settling unpaid bills.[12] Also, to improve transparency, an explicit definition of arrears should be adopted, with interest accruing on arrears to suppliers.

21. **The authorities recognize the need for greater fiscal transparency**. Upon assuming office, the administration concluded that a lack of clarity in the fiscal accounts[13] and inadequate reporting on fiscal performance hindered fiscal transparency and accountability. They have requested a fiscal ROSC, which would help identify changes that may be required to bring practices in line with the Code of Good Practices on Fiscal Transparency, especially with regard to open budget processes and availability of information.

22. **The authorities plan to revise the fiscal responsibility law (FRL) in the course of 2005**. In reviewing the FRL, while embarking on medium-term fiscal consolidation, they will consider a combination of numerical and procedural rules, since sole reliance on numerical rules has not worked well. The staff agreed, noting that revised rules should be well-defined, consistent, enforceable, and supported by sound policies; and transparent procedures are needed for monitoring compliance (see Box 2).

23. **The authorities are preparing a reform of the social security sector with a view to restoring its financial viability**. They have taken steps to reduce the high administrative costs and improve the management of the pension reserve fund, and they are aiming for a reform that would address a fundamental imbalance between pension contributions and pension benefits. Without reform, the pension reserve fund may be depleted by 2010–12. The pension reform

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[11] Government payables over 90 days amounted to 1.8 percent of GDP as of late November 2004; the 2005 budget assumes a reduction in payables of about 0.8 percentage point of GDP.

[12] The authorities' budget did not take into account the tax reform that was subsequently presented to the National Assembly (Box 2).

[13] Sizeable government payables are not captured in the cash-based deficit. Also, the new administration believes that revenue was overstated by the inclusion of capital gains from Brady bond buybacks and a part of the BNP's transfers to the government corresponded to future profits.

could entail some combination of changes in the benefit system, eligibility requirements, and financing of the pension system. The details of the reform have not been finalized, but the authorities are focusing their analysis on parametric reforms that might be phased in over time, such as changes in the retirement age and the rate at which benefits accrue. Staff agreed on the need for a comprehensive pension reform, with implementation phased over a number of years, both to eliminate current operating deficits and to align pension fund incomes with future pension obligations. The authorities also are concerned that the finances of the maternal and health care program of social security are no longer financially viable, and they may be evaluating reform alternatives in this area as well.

24. **The authorities have decided to exclude the PCA from the public sector accounts for policy purposes, including for the future revision of fiscal rules**. They noted that the PCA—widely regarded as efficiently run—is an autonomous state enterprise under the Constitution, and its surpluses are unavailable to meet fiscal needs. The authorities and staff agreed to present both the authorities' definition of the fiscal balance (excluding the Canal Authority) and the more comprehensive measure including the PCA as part of the public sector.[14] The authorities stressed that it was important to demonstrate that the PCA is commercially run and to preserve its managerial independence, thus ensuring that it remains fully protected from pressures to engage in quasi-fiscal activities. Staff noted that the treatment of the PCA's operations in the public sector accounts depends in part on whether the Authority is commercially run. The PCA appears not to meet all criteria for being considered commercially run, in most cases because the criteria assume that the private sector holds some equity in the public enterprise, but also because it is exempt from corporate income tax.

25. **The prospective expansion of the Panama Canal is expected to become a central feature of the government's program**. The expansion project, if approved in a national referendum, could provide a major boost to service exports by the middle of the next decade. The authorities view the separation of the PCA from the fiscal accounts as an essential element of their strategy to promote the markets' perception of the PCA's commercial soundness and secure an investment grade credit rating for the PCA.

26. **Debt management is directed toward balancing cost and risk in determining the mix of external and domestic sources of deficit financing**. Following the retirement of US$400 million in Brady bonds in the first quarter of 2004, only US$370 million remains, for which buybacks are not planned in the near term. The authorities also are restructuring maturities to achieve a smoother path of maturing debt. Staff encouraged the authorities to further develop the domestic public debt market, gradually increasing the share of domestic financing through competitive auctions of government securities. The US$350 million line of credit from the BNP to the government, initially drawn as a short-term liquidity loan in mid-2004, will be repaid over 11 years. The mission recommended a more rapid repayment to allow for a faster replenishment of the BNP's foreign assets.

[14] In any event, the broader measure would be used for national accounts purposes.

B. Financial Sector Policies

27. **The authorities' strategy for maintaining a sound banking system is to emphasize crisis prevention, transparency, and market discipline**. The authorities maintain close supervision of the banking system, with an emphasis on the early detection and prompt correction of bank problems.[15] This prudential approach is of particular importance in view of the authorities' decision not to establish a lender of last resort for the dollarized financial system, or to arrange a contingent line of credit abroad for the BNP, owing to concerns over moral hazard. Also, banks maintain relatively high levels of liquidity. Staff agreed that a strong supervisory framework and ample liquidity cushions have helped limit the vulnerability to deposit runs, but noted that prudential practices cannot fully eliminate the risks of systemic bank problems.[16]

28. **The authorities also have strengthened the coordination with other supervisory authorities in the region in 2003–04 for effective cross-border supervision**. They are participating in a financial sector review in Central America that is being undertaken by MFD, which focuses on regional consolidated supervision and other issues.[17] Also, the authorities have requested that MFD follow up the Module 2 OFC assessment undertaken in 2001; a mission is scheduled for the second quarter of 2005. The Superintendency of Banks is preparing for the adoption of the Basel II principles of bank supervision. Staff agreed with the emphasis that the Superintendency has placed on enhancing regional cooperation, since the expansion of regional banking accentuates the need for effective cross-border supervision.

29. **The authorities are preparing a strategic plan for the National Bank of Panama**. It is expected to entail improvements in governance, adherence to sound commercial banking practices, and a gradual reduction in outstanding credit to government. Also, the BNP's strategy should provide adequate protection from pressures to extend credit to government other than short-term liquidity loans. The authorities also recognize the need to improve governance and promote prudent commercial banking practices in the state-owned Savings Bank. The staff agreed that strategic plans needed to be formulated for both the BNP and the Savings Bank, and suggested that an evaluation of state banks—with a view to future reforms—should extend also to the two development banks, the National Mortgage Bank and the Agricultural Development Bank.

C. Policies for Competitiveness and Growth

30. **Panama's external competitiveness appears to be broadly satisfactory, based on a number of standard indicators**. The real effective exchange rate remained lower in 2004 than

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[15] Onshore and offshore banks are subject to essentially the same prudential requirements.

[16] At end-September 2004, the liquid assets-to-deposits ratio was 27 percent (42 percent, if marketable securities are included).

[17] The regional project also will examine the links between financial and nonfinancial companies within a group, common accounting rules, and the supervision of financial institutions with cross-border operations on a large scale.

in the preceding several years, reflecting the depreciation of the U.S. dollar in 2002–03 (Figure 7); the volume of merchandise exports accelerated in 2002–04, although its growth did not keep pace with that of export markets in 2004 (Figure 2); Panama has expanded its market share for certain service exports in recent years, notably tourism and port services; and the external current account deficit is projected to fall below 2 percent of GDP in 2005.

31. **From a broader perspective, however, Panama's competitiveness falls short of what is needed for the export sector to play the leading role that is envisaged in the government's medium-term growth strategy**. Panama ranked 58th out of 104 countries in the latest World Economic Forum competitiveness report, owing to a perception of weak public institutions, and exports of goods and services have grown only slightly faster than GDP over the five years to 2004 (annual average growth rates of 3½ percent and 3¼ percent, respectively).

32. **Trade policy, which is an integral part of the government's competitiveness strategy, is centered on the prospective free trade agreement with the United States**. The agreement would offer greater permanence than the Caribbean Basin Initiative for merchandise exports, boost market access for the Panamanian export-oriented service sector, encourage foreign investors with a regional focus to establish operations in Panama, and enhance the legal framework that could attract U.S. investors to Panama. Future trade agreements may be sought with other countries, including Singapore and additional Central American countries.

33. **The government's medium-term growth strategy centers on enhancing the competitiveness of the export-oriented service sector, where Panama's comparative advantage is concentrated**. A key objective is to develop Panama further as a regional hub for transportation, trade, banking, and communication services.[18] Elements of this strategy are education reform with emphasis on better meeting the training needs of the workforce; ensuring adequate economic infrastructure; and lowering the cost of doing business by streamlining bureaucratic requirements for businesses. The government is also developing a special economic zone (Howard), with simple administrative procedures and flexible labor rules. The authorities noted that, although there is little support for a general labor reform, greater flexibility in the terms of employment was introduced successfully for this and other special economic zones in mid-2004.[19] The staff recommended that such rules for labor flexibility be generalized to other regions.

34. **The authorities have launched a fight against corruption and are developing institutional reforms that could foster growth**. The authorities aim to improve the rule of law and improve the business climate through their anti-corruption strategy. Emphasizing "zero tolerance" and setting good examples among public sector leaders, the authorities have repealed a decree that impeded implementation of the Law on Transparency; established a national council for transparency and anti-corruption; and undertaken audits of government contractors

[18] The Panamanian multimodal transport system encompasses the Canal, the Caribbean and Pacific ports, airports, and road and rail transport.

[19] They refer to rules for working at night and on weekends, hiring and laying off workers according to demand fluctuations, conflict resolution, and the introduction of productivity clauses.

and public sector institutions. Staff welcomed the emphasis on good governance and noted that efforts to improve efficiency in government (streamlining bureaucratic requirements, establishing more transparent procurement practices, simplifying procedures for exports, etc.) could yield benefits both for the fight against corruption and fiscal adjustment efforts.

D. Medium-Term Outlook and Risks

35. **Staff has prepared an active scenario through 2009 that is broadly based on the authorities' medium-term fiscal policies and objectives**. It assumes full implementation of the February 2005 fiscal reforms, social security reform, and the conclusion of a free trade agreement with the United States. It also assumes the adoption of any additional fiscal measures that may be needed to achieve the authorities' medium-term deficit target of 1 percent of GDP by 2007. Under this scenario, growth in the medium term would benefit from the boost to confidence associated with a markedly improved fiscal position, growth-oriented structural reforms, and enhanced transparency and governance. With the primary balance stabilizing at 3½ percent of GDP, public debt would decline steadily to 53 percent of GDP by 2009, and 38 percent by 2014 (Figure 8 and Appendix V, Tables 1 and 2).

Macroeconomic Framework under Active and Low-Case Scenarios

	Est.	Proj.	Active				Low-Case			
	2004	2005	2006	2007	2008	2009	2006	2007	2008	2009
	(Annual percent change)									
Real GDP	6.0	3.5	4.0	4.0	4.0	4.0	3.0	3.0	2.5	2.5
	(In percent of GDP)									
Nonfinancial public sector										
Primary balance, excl. Canal Authority	-0.5	1.1	2.9	3.4	3.5	3.4	1.2	0.8	0.5	0.2
Central government 1/	2.3	3.8	5.2	5.5	5.6	5.5	4.1	3.8	3.7	3.6
Social security 2/	-2.8	-2.7	-2.4	-2.1	-2.2	-2.0	-2.9	-3.1	-3.2	-3.4
Interest payments	-4.6	-4.8	-4.5	-4.2	-3.9	-3.7	-4.7	-4.9	-5.2	-5.6
Overall balance, excl. Canal Authority	-5.0	-3.6	-1.6	-0.8	-0.5	-0.2	-3.5	-4.1	-4.7	-5.4
Overall balance, incl. Canal Authority	-3.3	-2.1	0.4	1.5	1.7	1.8	-1.4	-1.8	-2.4	-3.2
Public debt (end of period)	68.1	63.7	61.1	58.4	55.6	52.9	63.7	64.9	67.2	70.1
Gross financing needs	11.1	7.0	6.9	4.2	5.9	3.3	8.9	7.6	10.4	8.7

Sources: Office of the Comptroller General; and Fund staff estimates and projections.
1/ Includes other agencies, such as universities and the Inter-Oceanic Regional Authority.
2/ Before transfers from the central government.

36. **A low-case scenario illustrates the possible consequences of a relaxation of policies that would erode the fiscal stance over time**. It is assumed that the fiscal reforms begun during the first several months of the administration are not sustained, with incomplete implementation of the early-2005 fiscal reforms, and no pension reform or other new structural reforms. Public

debt would rise to 70 percent of GDP by 2009, from a projected 64 percent in 2005.[20] With a deteriorating fiscal position, growth would slow down to 2½ percent, owing to an erosion of confidence and a decline in investment activity. Nevertheless, inflation is projected to remain low, given Panama's full dollarization.

37. **An expansion of the Panama Canal is being studied, which could have a far-reaching impact on the economy's growth prospects**. Feasibility studies encompassing assessments of risk may be completed in the first half of 2005 and the project, if approved, might begin in 2007 and be completed around 2014.[21] An assessment of the project's macroeconomic impact, including on the labor market and inflation, will depend on how the magnitude and phasing of the investment, which could total some 30–35 percent of GDP. The authorities' strategy is that the PCA obtain an investment-grade credit rating and secure the needed financing without government guarantees, possibly through a revenue bond. The PCA's potential for self-financing through retained earnings would be boosted by a proposed increase in Canal tolls on container ships, prospectively in three stages starting May 2005 (Box 3). The implications of the canal's expansion for the contingent fiscal liability of the government would need to be assessed in light of the project's financing plans.

38. **The staff's projections are subject to risks**.

- Under either scenario, the volatility and uncertainty regarding oil prices add to the risk that Panama's export markets and world trade could grow more slowly than anticipated, causing exports to fall short of projections. Also, higher than projected oil prices for a sustained period would adversely affect growth through the impact of lower disposable incomes on domestic demand.

- Unexpected instability of the U.S. dollar or abruptly higher global interest rates, through their effect on world trade and output, could put Panama's exports of goods and services on a lower path than assumed in the two scenarios. Such higher international interest rates would be reflected directly in higher domestic interest rates, hence would have a dampening effect on other sectors as well, such as construction.

- The active scenario is subject to downside risks as well as an upside potential. The main downside risk arises if the administration is unable to build consensus for the needed reform of the pension system. On the upside, output growth could move onto an even higher path if a strong fiscal adjustment effort were to give a greater boost to confidence and private sector investment than assumed in the scenario.

- A deteriorating fiscal stance could erode confidence further than envisaged under the passive scenario, with a substantial adverse effect on private investment and economic

[20] The gross financing for 2004 and the end-2004 debt stock reflect a US$600 million bond issue to pre-fund the borrowing requirements for 2005.

[21] Covering engineering, environmental, financial, geological, and hydrological aspects of the canal expansion as well as market research in the shipping sector.

growth that could gain momentum over time. The negative consequences for credit ratings, private investment, and fiscal borrowing costs would tend to be mutually reinforcing; and the prospects for expansion of the Canal could be put at risk, despite the constitutional provision for the Canal Authority's autonomy.

E. Other Issues

39. **The timeliness and coverage of economic statistics is generally adequate for monitoring purposes, but some weaknesses remain**. The authorities have expressed interest in a data module ROSC to help them identify data shortcomings and recommend improvements in macroeconomic statistics, especially with respect to national income accounts, fiscal statistics, and labor market data.

40. As part of their emphasis on transparency, the authorities plan to consent to publication of the staff papers for the 2004 Article IV consultation.

III. Staff Appraisal

41. **Panama's economy has experienced a strong recovery since late 2003**. Growth is likely to slow down in 2005 but still provide for a further decline in unemployment.

42. **The new administration's emphasis on fiscal discipline, transparency, and good governance are commendable, as these are critical for re-establishing the basis for high sustained growth**. In particular, the authorities recognize the central importance of strong fiscal policies in a dollarized economy. The main fiscal policy challenges are to strengthen government finances in 2005 and beyond, reform the public pension system so as to restore its long-term viability, and settle arrears to domestic suppliers. A distinct opportunity to address these challenges is provided by an election outcome that signaled a mandate for change and by a vibrant economy facing a favorable external environment.

43. **The administration's fiscal policies for 2005–07 are comprehensive and should help put the public finances on a sustainable path, based on the authorities' medium-term fiscal targets**. The targeted fiscal deficit of 3.6 percent of GDP for 2005 (excluding the PCA surplus) represents a strong adjustment effort, balancing the need for moving toward fiscal sustainability and avoiding an excessive negative fiscal impulse. The authorities' fiscal targets and policies, which by and large follow through on the staff's and Board's recommendations, have been designed by the authorities to ensure that they reflect the government's objectives, and to provide a solid basis for the government ownership that is needed to ensure successful implementation. The fiscal reform thus includes both tax reform and expenditure measures that reflect equity considerations.

44. **The fiscal reform provides for additional revenues on top of a prudent budget, offering an opportunity to exceed the authorities' goals for 2005, while reducing the large overhang of arrears to domestic suppliers**. In this regard, the authorities appropriately intend to eliminate payables over 90 days when feasible, which will help reinforce the government's fiscal transparency initiatives. In view of uncertainty concerning the impact that the fiscal measures will have in 2006–07, strict implementation and close monitoring of these policies will

be essential to achieve the authorities' objectives and reduce the debt burden towards sustainability.

45. **The emphasis in the authorities' fiscal program on expenditure restraint is appropriate**. It reflects the need to reduce overstaffing and improve the efficiency of other current expenditure, as well as the need to attain greater efficiency of public investment through better project evaluation. The development of a medium-term expenditure framework would be essential to help introduce multi-year planning for infrastructure. These efforts are expected to increase the efficiency of public expenditure and thus allow significant reduction of current expenditure, while also making room for high-priority public investment.

46. **The proposed tax reform is welcome**. The reform focuses on improving the equity of the tax system by establishing an alternative minimum income tax, including representation expenses in taxable income, closing loopholes in corporate income taxation, and curbing poorly targeted fiscal incentives. Some of these measures should improve the buoyancy of the tax system, and the elimination of low-yielding taxes and the stiffer penalties should enhance its efficiency.

47. **The authorities should be commended for recognizing the need for social security reform to restore long-term equilibrium to the public pension system**. The pension system is too generous relative to contribution rates, resulting in a large and growing volume of unfunded pension obligations. While the needed comprehensive reform, with multiple parametric reforms, would likely be implemented over a period of years, improvements in portfolio management and the elimination of overstaffing of the social security system need to be adopted without delay. Furthermore, the need for reform also extends to the health and maternal care program so as to ensure adequate funding and provision of medical services.

48. **The fiscal responsibility law did not function properly, and its suspension provides an opportunity to reformulate fiscal rules for greater effectiveness**. International experience suggests that the revision should place greater emphasis on procedural rules in conjunction with numeric rules. Revised rules need to be well-defined, transparent, enforceable, consistent, and supported by sound policies.

49. **The authorities' decision to assess fiscal transparency practices through a fiscal ROSC is welcome**. The ROSC will highlight areas of current good practice and indicate areas for improvement, including procedures for budget monitoring and reporting. In this context, the presentation of fiscal accounts both excluding and including the accounts of the Panama Canal Authority is appropriate. The authorities would enhance transparency by explaining to the public the government's view on both balances, one for fiscal analysis and one for national accounts purposes. Transparency and governance would be further improved with a clear definition of domestic arrears, and the accrual of interest on arrears to suppliers.

50. **As part of the government's strategy for good governance, there is potential to make use of the PCA as an institutional anchor**. This public enterprise is becoming a model for efforts to build strong institutions, both in government and in other public enterprises. A prospective expansion of the canal, placing the PCA in a position to seek funds in the private capital markets, would give greater clarity about the markets' perception of the PCA's

commercial soundness, hence its ability to maintain managerial independence and resist pressures to engage in quasi-fiscal activities.

51. **The financial system is essentially sound**. The expansion of regional banking heightens the need for effective supervision, which the Superintendency of Banks is further improving through coordinated efforts across countries in the region. Governance needs to be strengthened in the BNP and the Savings Bank, and the business plans for these banks need to be based on sound commercial banking practices and mechanisms to ensure that BNP credit to the government remains short-term in nature.

52. **The authorities have rightly given priority to identifying and implementing policies for fostering greater competitiveness and productivity of the private sector**. Education reform to meet the need for a well-trained workforce should play a significant role. The authorities' strong emphasis on good governance and their policy of "zero tolerance" for corruption could reduce costs and improve competitiveness. Greater labor market flexibility also would be beneficial, but there is little support for a general labor reform. In view of the benefits of flexible employment practices being realized in the special economic zones, the authorities may want to consider extending them selectively to other sectors; doing so in the export-oriented service sector would enhance competitiveness.

53. **The prospective free trade agreement with the United States signals Panama's commitment to further integration with the regional and global economy**. It can help attract foreign investors with a regional strategy who seek Panama's service infrastructure, provide greater assurance of a stable legal framework for foreign investors, and encourage resources to move to the more productive sectors of the Panamanian economy.

54. **There is scope for significant improvement in the quality, timeliness and coverage of economic data**. The authorities' interest in a data ROSC is welcome, as the ROSC provides an appropriate mechanism for assessing the strengths and taking steps to address identified weaknesses in official economic statistics.

55. A further area of collaboration between the staff and the authorities is in the financial sector, for which a follow-up to the OFC Module 2 assessment is planned. The fiscal and data module ROSCs will provide opportunities to identify future technical assistance, and the staff stands ready to assist also in other areas that are supportive of the authorities' economic policy program.

56. It is proposed that the next Article IV consultation with Panama take place on the standard 12-month cycle.

Box 1. The 2005 Fiscal 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 expenditure measures

- Reduction in the replacement rate of vacancies in the civil service, by 30 percent in 2005 and additionally 20 percent in 2006 and 10 percent in 2007. Vacancies for certain categories falling under special regulations (*leyes especiales*) would not be reduced.
- By January 2008, staff in every public institution should not exceed the personnel as of end-December 1999. Exceptions are made for health, education and security services. The number of contractual workers also would be limited.
- Starting January 2006, the percentage increase in current primary expenditure should not exceed the percentage increase in current revenue of the preceding year.
- The use of cell phones, automobiles, and consultants would be controlled. Air travel costs would be contained.

Main tax policy measures 1/

- 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.

1/ Background information on the tax system is given in the selected issues paper "Tax Policy and Performance."

Box 2. Panama: Experience with the Fiscal Responsibility Law 1/

Under the fiscal responsibility law (FRL) of May 2002, public sector net debt was targeted to decline relative to GDP to 50 percent by 2017 (from approximately 58 percent in 2002). A transitory regime set annual limits to the growth of debt, and the fiscal deficit was not to exceed 2 percent of GDP in any given year.

The FRL was ineffective in preventing fiscal slippage and, on taking office in September 2004, the new government decided to review the FRL and suspended it until end-2005.

The disappointing performance of the FRL has shown the need for improvements in several respects:

Definitions. The FRL did not specify whether the 2 percent ceiling applied to the cash deficit or to a deficit defined on an accrual basis. The authorities presented a deficit measure for 2003 that represented a partial adaptation of cash-based data to an accrual basis. Nevertheless the fiscal deficit, including the Panama Canal Authority (PCA), was above the limit, both on a cash basis (3.8 percent of GDP) and, according to available estimates, on an accrual basis (close to 3 percent of GDP).

Coverage. The FRL was not explicit about the coverage of the public sector. The deficit ceiling was interpreted as including PCA's large surpluses, thus lowering the monitored fiscal deficit. The new authorities decided to exclude the PCA from the fiscal accounts for policy monitoring purposes and from future fiscal rules.

Institutional procedures. International experience indicates that simple and transparent numerical rules can be an effective instrument of communication of a government's policy objectives if accompanied by adequate institutional procedures.

Fiscal data. It will be important to improve the financial information management system (SIAFPA) and adopt the 2001 GFS methodology for accrual-based fiscal accounting.

1/ More details are given in the *Selected Issues* paper.

Box 3. 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).

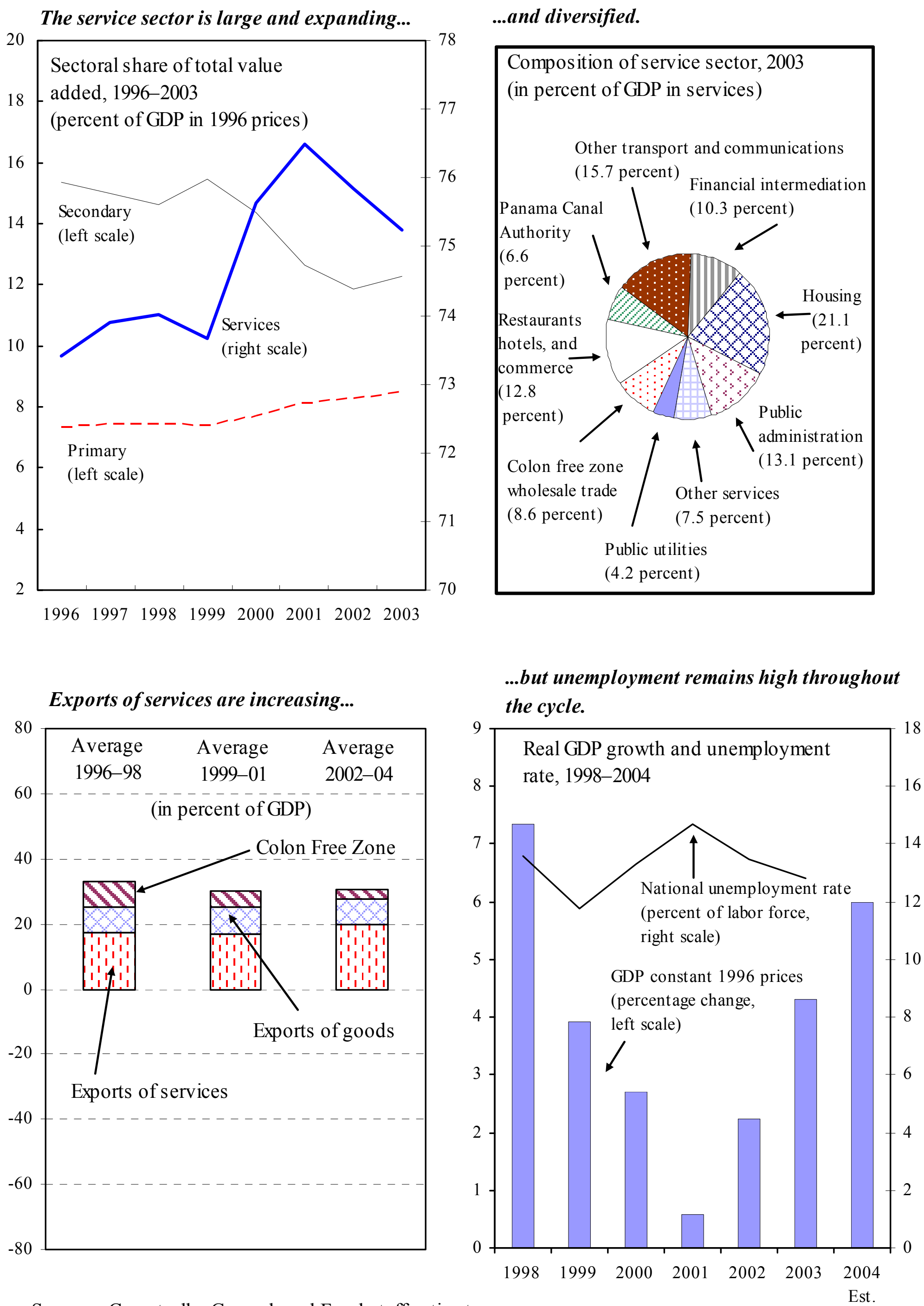
7/ Liabilities in percent of total assets.

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.

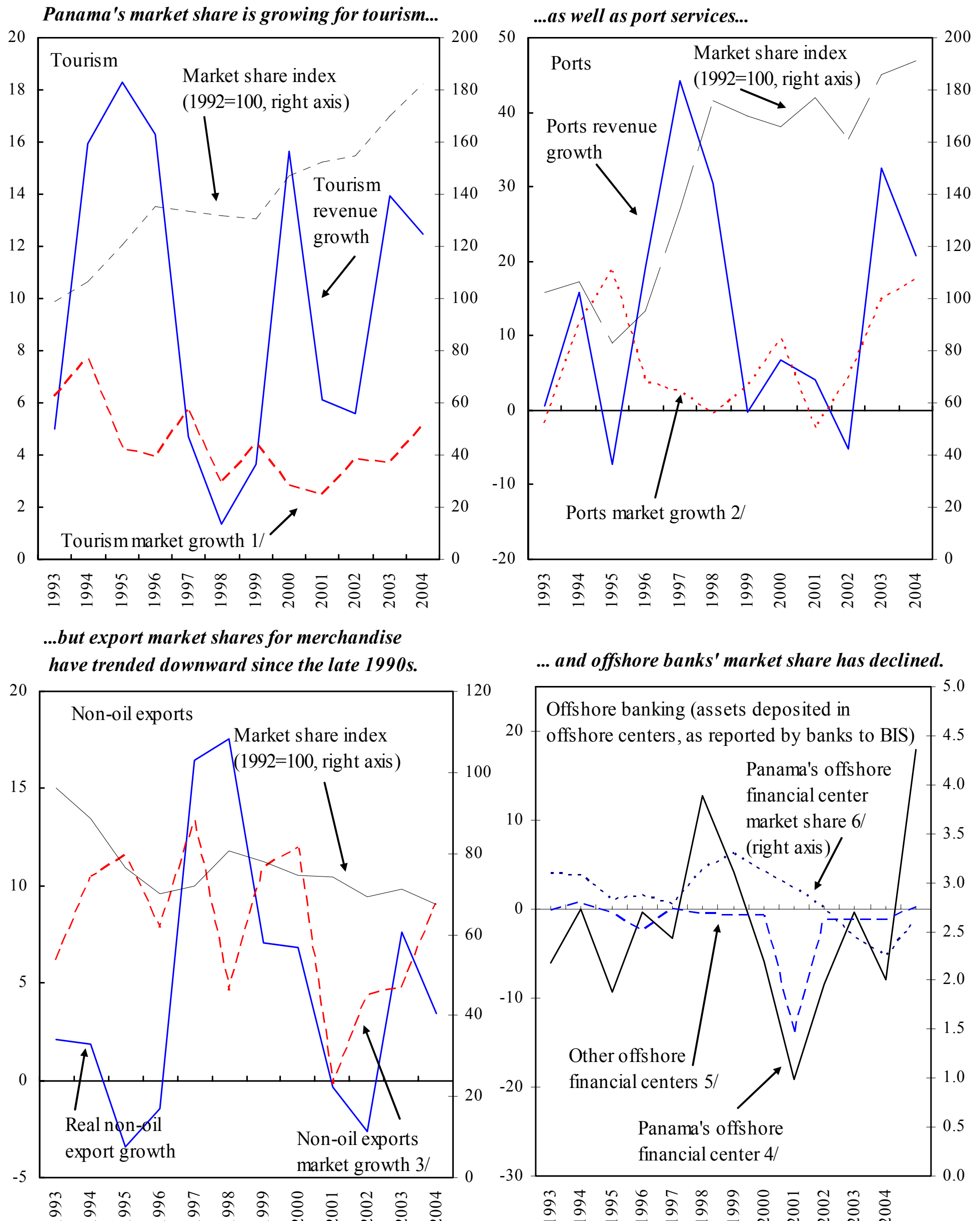
Figure 1. Panama: Structural Characteristics of the Economy



Sources: Comptroller General; and Fund staff estimates.

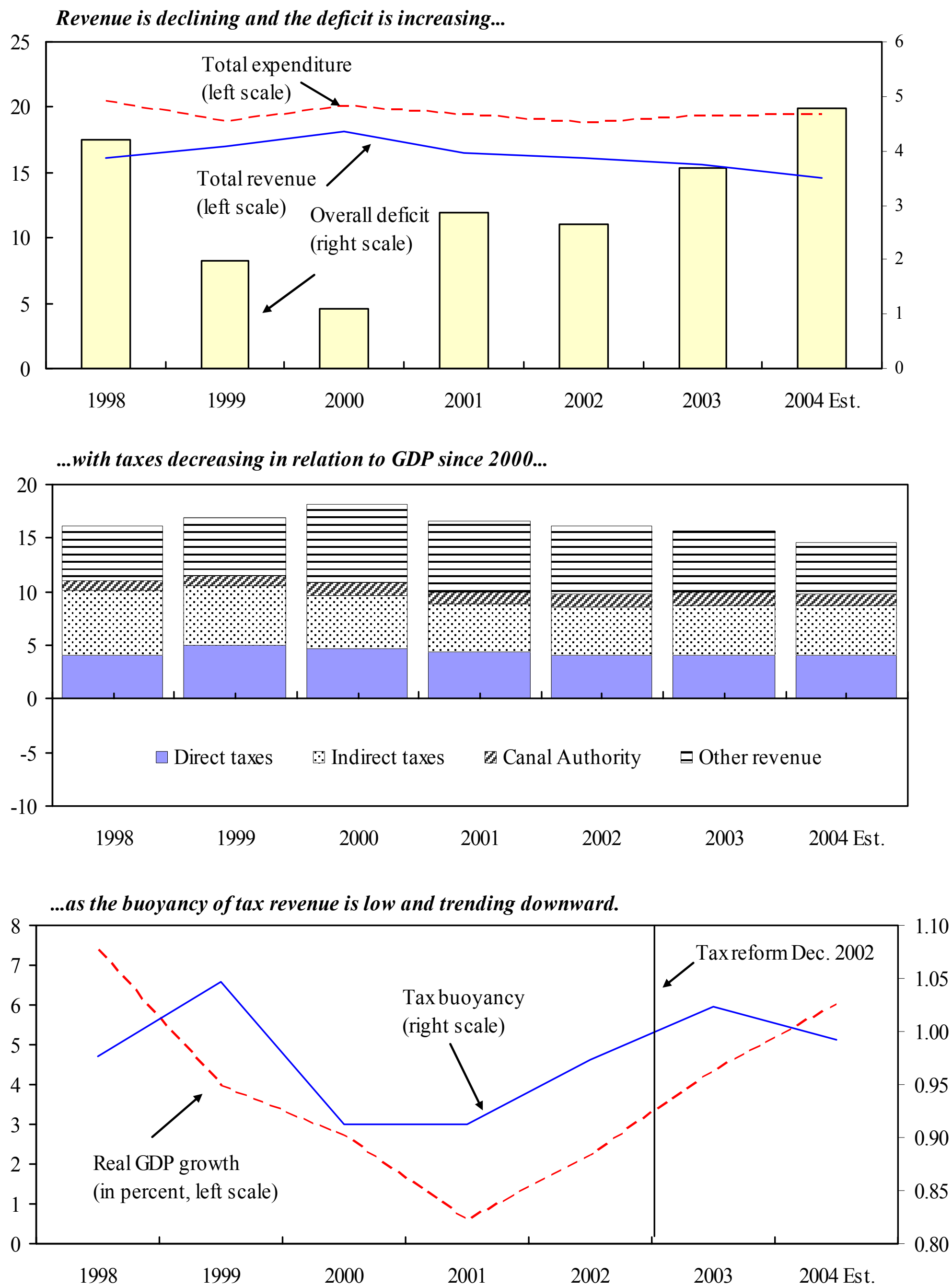
Figure 2. Panama: Export Performance, 1993–2004

The performance of service exports continues at a solid pace



Sources: BIS; Panamanian authorities; and Fund staff estimates and projections.
1/ Based on foreign exchange earnings in 27 Latin American countries.
2/ Ports market growth is based on the WEO index of world trade.
3/ Based on WEO data for Panama’s main trading partners.
4/ Growth of total assets.
5/ The other four of the five largest offshore financial centers: Hong Kong SAR, Cayman Islands, The Bahamas, and Singapore.
6/ Panama's share of the assets of the five largest offshore financial centers.

Figure 3. Panama: Central Government Fiscal Indicators, 1998–2004
(In percent of GDP, unless otherwise indicated)

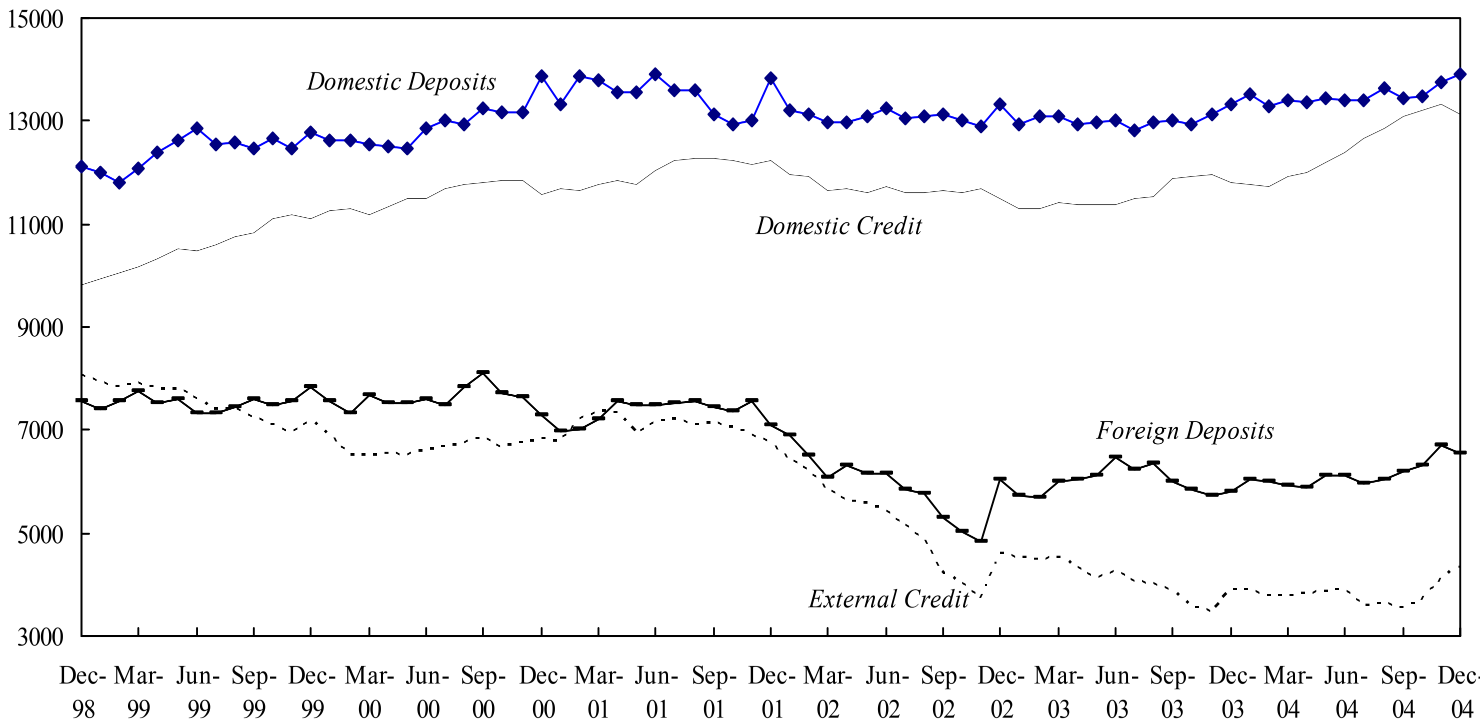


Sources: Comptroller General; and Fund staff estimates and projections.

Figure 4. Panama: Credit and Deposits in the Panamanian Banking System

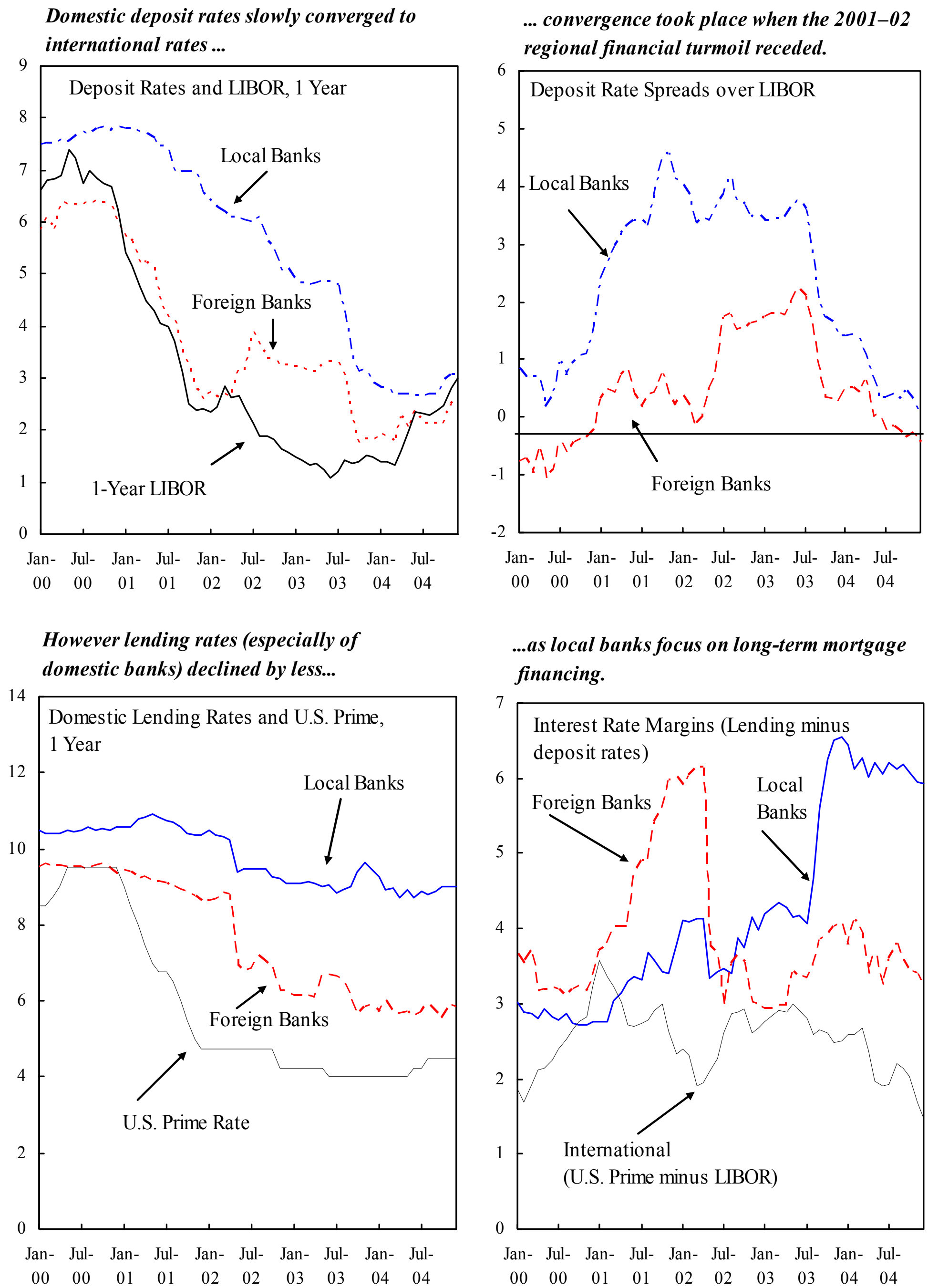
(In millions of U.S. dollars)

Domestic deposits and credit grew in 2004, while foreign operations stabilized at a low level after the regional shock of 2001–02.



Source: Superintendency of Banks.

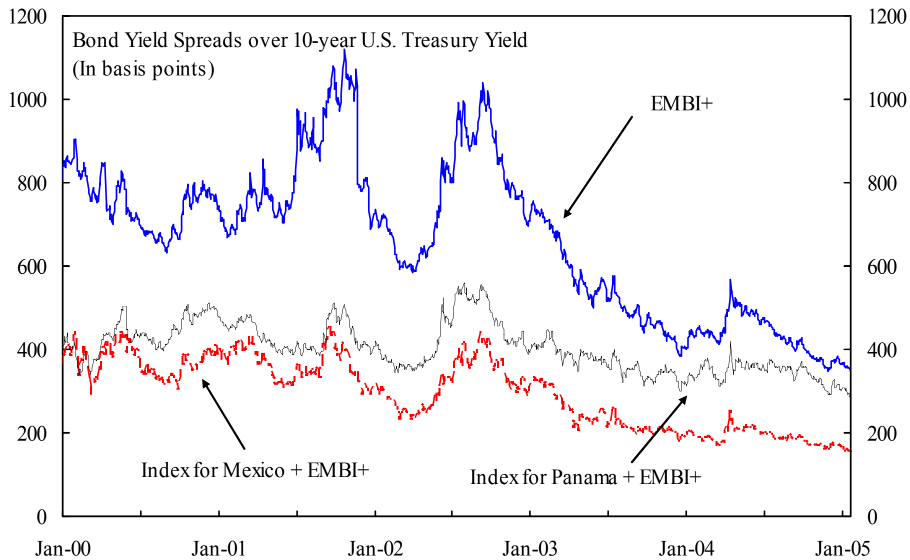
Figure 5. Panama: Interest Rates and Spreads, 2000−04
(In percent)



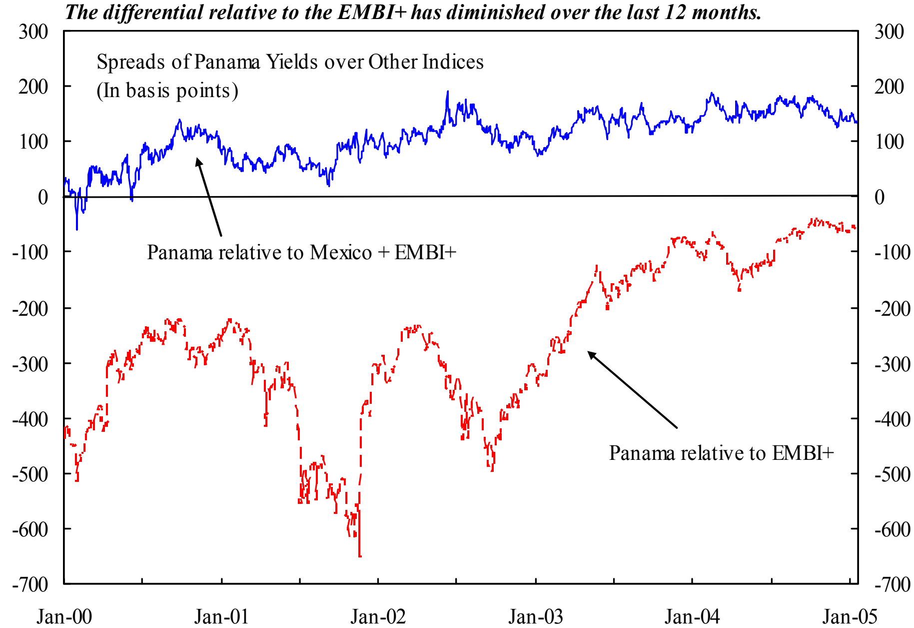
Sources: Superintendency of Banks; and Bloomberg.

Figure 6. Panama: Regional Sovereign Bond Spreads, 2000–04

Although Panama's sovereign spreads are consistently lower than the average for emerging markets (EMBI+), its weak fiscal position keeps the spread relatively high.



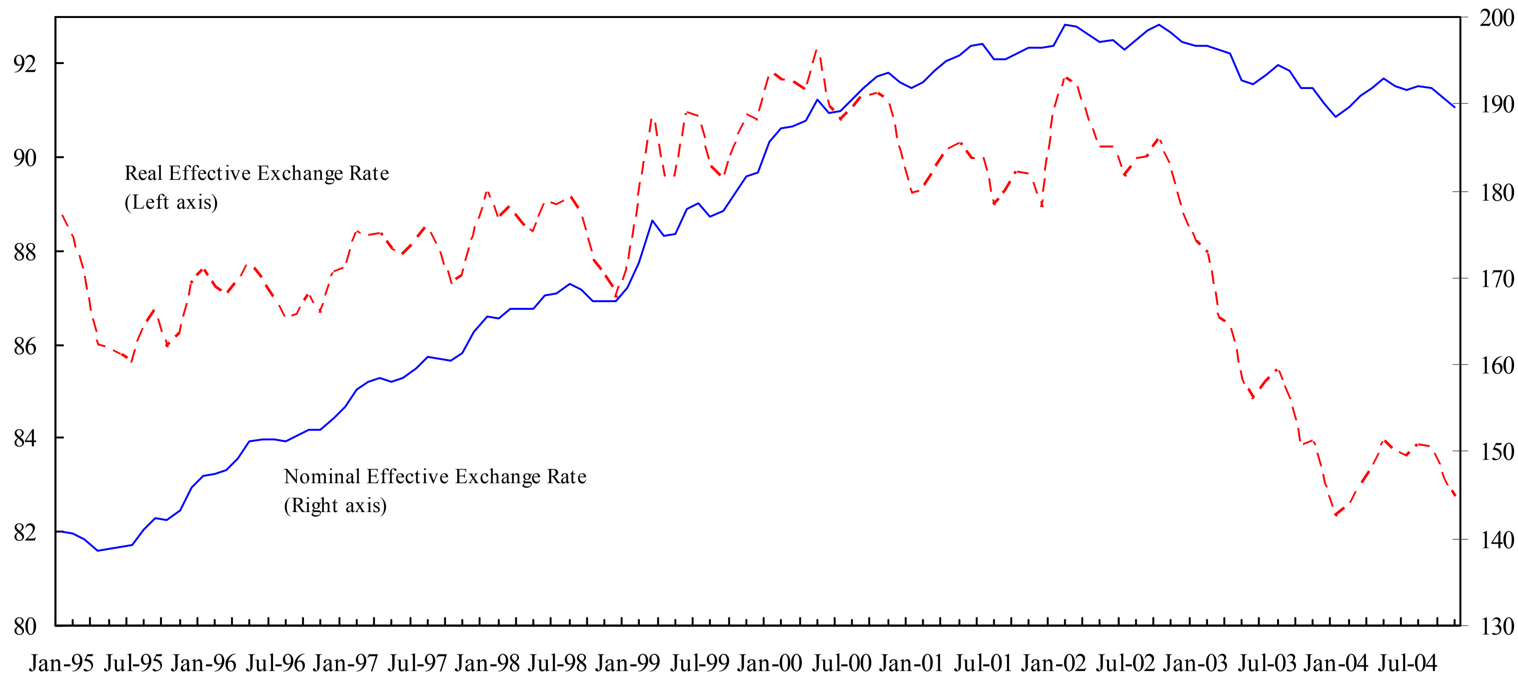
The differential relative to the EMBI+ has diminished over the last 12 months.



Source: Datastream.

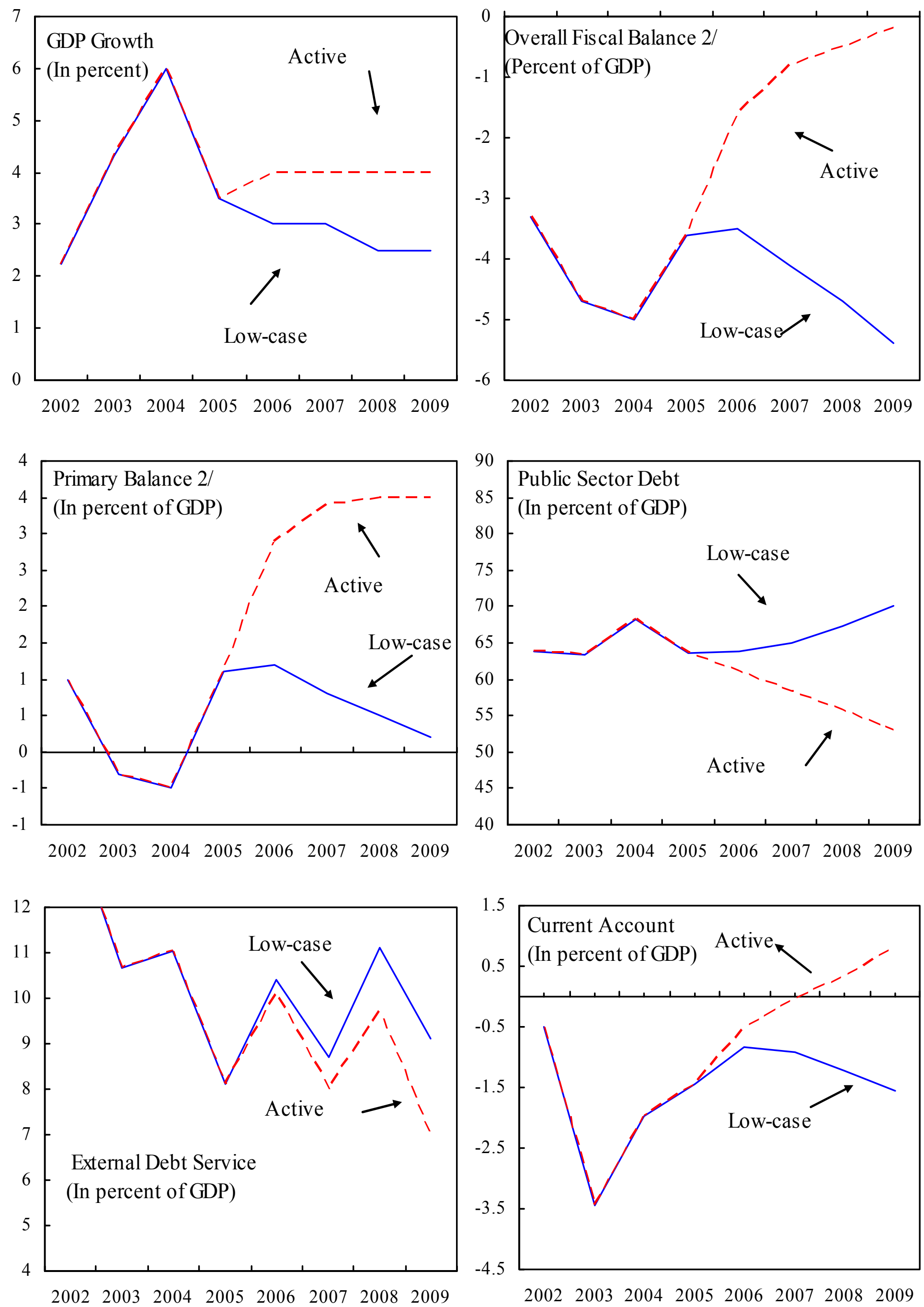
Figure 7. Panama: Real and Nominal Effective Exchange Rates, 1995–2004
(1990=100)

The real effective exchange rate has trended downward since early 2002, owing to the depreciation of the U.S. dollar.



Source: Information Notice System.

Figure 8. Panama: Alternative Medium-Term Scenarios 2002–09 1/



Source: Fund staff projections.

1/ The low-case scenario assumes a lower growth and a higher fiscal deficit than the active; the active scenario assumes a lower deficit path, as indicated in the top two panels.

2/ Excluding the Panama Canal Authority.

Table 1. Panama: Selected Economic Indicators

	2001	2002	2003	Est. 2004	Proj. 2005
(Annual percent change, unless otherwise indicated)					
Production and prices					
Nominal GDP	1.6	3.9	4.8	7.2	5.4
Real GDP (1996 prices)	0.6	2.2	4.3	6.0	3.5
GDP deflator	1.0	1.7	0.5	1.2	1.8
Consumer price index (end of year)	0.0	1.8	0.1	2.0	2.0
Domestic demand (at constant prices)					
Public consumption	6.7	0.4	4.6	-0.4	3.2
Private consumption	2.7	6.1	1.1	4.9	4.0
Public investment	4.6	9.5	23.9	-14.2	-9.2
Private investment	-31.5	0.8	9.1	13.0	-2.3
External trade					
Merchandise exports	3.0	-10.1	1.8	12.8	5.2
Merchandise imports	-14.8	2.1	4.7	10.6	5.8
Net oil imports (in millions of U.S. dollars)	417	374	231	393	447
(In percent of GDP)					
National accounts					
Gross domestic investment	19.4	18.0	21.5	22.0	20.6
Public sector	4.1	4.3	5.2	4.1	3.7
Private sector	15.3	13.7	16.3	17.8	16.9
Gross national saving	17.9	17.5	18.0	20.0	19.1
Public sector	1.7	1.3	1.0	0.9	2.0
Private sector	16.2	16.2	17.0	19.1	17.2
External current account	-1.5	-0.5	-3.4	-2.0	-1.5
Nonfinancial public sector					
Revenue and grants	23.8	22.9	22.4	21.3	22.5
Expenditure	26.1	26.2	27.2	26.3	26.2
Current	23.0	22.9	23.0	23.0	22.9
Capital	3.1	3.2	4.1	3.3	3.3
Balance, excluding Canal Authority	-2.3	-3.3	-4.7	-5.0	-3.6
Canal Authority 1/	0.5	0.5	1.0	1.7	1.5
Balance, including Canal Authority	-1.8	-2.7	-3.8	-3.3	-2.1
Nonfinancial public sector debt	64.7	63.7	63.3	68.1	63.7
External debt	53.0	51.7	50.5	52.6	49.5
Domestic debt	11.7	12.1	12.9	15.5	14.1
Memorandum item:					
GDP at current prices (in millions of balboas)	11,808	12,272	12,862	13,793	14,531

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

1/ Balance of Canal Authority, after transfers of Canal tolls and distribution of profits to the government.

Table 2. Panama: Summary Operations of the Nonfinancial Public Sector 1/

(In percent of GDP)

	2000	2001	2002	2003	Est. 2004	2005 Budget	2005 Proj. 2/
Revenue and grants	**24.8**	**23.8**	**22.9**	**22.4**	**21.3**	**21.6**	**22.5**
Current revenue	24.2	23.3	22.7	22.0	21.2	21.3	22.5
Tax revenue	9.6	8.8	8.6	8.8	8.7	8.3	9.0
Nontax revenue of central government 3/	7.6	6.8	6.9	6.1	5.3	5.9	5.9
Of which: Panama Canal fees and dividen	1.7	1.7	2.2	2.2	2.3	2.6	2.6
Social security agency	6.4	6.2	5.9	5.6	5.7	5.5	6.0
Public enterprise operating balance	0.7	0.8	0.8	0.7	0.7	0.8	0.7
Other 4/	0.0	0.7	0.4	0.8	0.9	0.8	0.9
Capital revenue	0.5	0.5	0.2	0.4	0.1	0.1	0.1
Grants	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Expenditure	**25.4**	**26.1**	**26.2**	**27.2**	**26.3**	**25.4**	**26.2**
Current primary expenditure	18.1	18.7	18.7	18.6	18.4	17.7	18.2
Central government	9.0	9.1	8.9	8.9	8.9	8.4	8.5
Rest of the general government	9.1	9.5	9.8	9.7	9.6	9.3	9.7
Social security agency	7.8	8.3	8.6	8.6	8.5	8.2	8.7
Decentralized agencies	1.3	1.2	1.2	1.1	1.1	1.1	1.0
Interest	4.3	4.4	4.2	4.4	4.6	4.5	4.8
Capital	3.1	3.1	3.2	4.1	3.3	3.1	3.3
Overall balance, excluding PCA	**-0.6**	**-2.3**	**-3.3**	**-4.7**	**-5.0**	**-3.8**	**-3.6**
Panama Canal Authority balance	**1.1**	**0.5**	**0.5**	**1.0**	**1.7**	**1.7**	**1.5**
Operating surplus	2.0	1.4	1.6	2.0	2.7	2.6	2.4
Capital expenditure	0.8	0.9	1.1	1.0	0.9	0.9	0.9
Overall balance, including PCA	**0.5**	**-1.8**	**-2.7**	**-3.8**	**-3.3**	**-2.2**	**-2.1**
Financing (net)	**-0.5**	**1.8**	**2.7**	**3.8**	**3.3**	**2.2**	**2.1**
Net financing, excluding PCA	**0.6**	**2.3**	**3.3**	**4.7**	**5.0**	**3.8**	**3.6**
External	0.9	3.3	3.4	2.4	1.1	3.8	3.7
Net disbursements	1.0	6.2	1.8	1.2	5.5	-0.4	-0.4
Deposits (increase -) and other	-0.1	-2.9	1.6	1.2	-4.3	4.1	4.1
Domestic	-0.3	-1.0	-0.1	2.4	3.9	0.1	-0.1
Trust Fund 5/	-0.2	1.0	0.0	0.0	0.3	0.5	0.5
Others	-0.1	-2.0	-0.1	2.3	3.6	-0.5	-0.6
Privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Panama Canal Authority 6/	**-1.1**	**-0.5**	**-0.5**	**-1.0**	**-1.7**	**-1.7**	**-1.5**
Memorandum items:							
Savings (incl. PCA)	3.9	1.7	1.3	1.0	0.9	1.8	2.0
Primary balance (incl. PCA)	4.8	2.5	1.5	0.6	1.3	2.4	2.6
Primary balance (excl. PCA)	3.6	2.0	1.0	-0.3	-0.5	0.7	1.1
Fiscal deficit (millions of balboas)	60	-217	-337	-484	-459	-314	-311
Change in payables (increase -)	...	...	...	-0.4	0.2	0.8	1.0
Public debt	59.8	64.7	63.7	63.3	68.1	63.9	63.7
GDP (millions of balboas)	11,621	11,808	12,272	12,862	13,793	14,520	14,531

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

1/ Official presentation excludes the operations of the Panama Canal Authority (PCA) which reverted to Panama on Decen
2/ Reflects authorities' deficit target and an initial impact of tax reform used to fund additional settlement of payables.
3/ Excludes US$116 million advance interest from the Development Trust Fund in 2001.
4/ Includes the balances of the nonconsolidated public sector and revenue of the decentralized agencies.
5/ Includes US$5 million in 2003 and US$65 million in 2004 to finance infrastructure projects.
6/ Change in financial assets of the PCA not included in public sector deposits.

Table 3. Panama: Summary Operations of the Central Government

(In percent of GDP)

	2000	2001	2002	2003	Est. 2004	2005 Budget	2005 Proj. 1/
Revenue and grants	**18.2**	**16.5**	**16.1**	**15.7**	**14.6**	**14.9**	**15.4**
Current revenue	18.1	16.3	16.1	15.4	14.5	14.6	15.4
Taxes	9.6	8.8	8.6	8.8	8.7	8.3	9.0
Direct taxes	4.7	4.4	4.1	4.0	4.0	3.8	4.0
Indirect taxes	4.9	4.4	4.4	4.7	4.7	4.5	5.1
Nontax revenue	8.5	7.5	7.5	6.6	5.8	6.3	6.3
Dividends	1.9	1.8	2.0	2.0	1.2	1.6	1.6
Panama Canal Authority 2/	1.2	1.2	1.2	1.1	1.0	1.2	1.2
Other	5.4	4.4	4.3	3.5	3.6	3.5	3.5
Capital revenue	0.0	0.3	0.0	0.3	0.1	0.1	0.1
Grants	0.0	0.0	0.0	0.0	0.0	0.1	0.0
Total expenditure	**20.0**	**19.4**	**18.8**	**19.3**	**19.4**	**18.7**	**18.9**
Current	16.9	16.7	16.1	16.2	16.2	15.8	16.0
Wages and salaries	5.5	5.7	5.7	5.7	5.5	5.4	5.4
Goods and services	1.9	2.0	1.6	1.8	1.8	1.8	1.9
Pensions and transfers	5.3	4.8	4.6	4.4	4.4	4.1	4.0
Interest	4.2	4.2	4.1	4.3	4.6	4.5	4.7
Domestic	1.0	0.8	0.5	0.7	0.7	0.7	0.7
External	3.1	3.4	3.6	3.7	3.9	3.8	4.0
Capital and on lending	2.4	2.7	2.7	3.2	3.2	2.8	2.9
Savings 3/	**1.3**	**-0.5**	**0.0**	**-0.8**	**-1.7**	**-1.1**	**-0.6**
Overall balance	**-1.1**	**-2.9**	**-2.7**	**-3.7**	**-4.8**	**-3.8**	**-3.5**
Financing (net)	**1.1**	**2.9**	**2.7**	**3.7**	**4.8**	**3.8**	**3.5**
External	1.0	3.3	3.3	2.3	1.1	3.8	3.7
Domestic	0.1	-0.4	-0.6	1.4	3.6	-0.1	-0.2
Of which: Trust fund 4/	0.0	1.0	0.0	0.0	0.3	0.5	0.5
Memorandum items:							
Primary balance	3.1	1.4	1.5	0.7	-0.2	0.7	1.2
Change in payables (increase -)	...	...	...	-0.4	0.2	0.8	1.0
GDP (in millions of balboas)	11,621	11,808	12,272	12,862	13,793	14,520	14,531

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

1/ Reflects authorities' deficit target and an initial impact of tax reform used to fund additional settlement of paya

2/ Canal tolls and fees.

3/ Revenues and grants less current expenditure.

4/ Includes US$5 million in 2003 and US$65 million in 2004 to finance infrastructure projects.

Table 4. Panama: Monetary Accounts

	2000	2001	2002	2003	Prel. 2004	Proj. 2005
(In millions of balboas at end of period)						
Net foreign assets	**1,506**	**1,693**	**1,744**	**2,488**	**2,706**	**2,869**
Short-term foreign assets, net	1,557	1,745	1,783	2,524	2,757	2,920
National Bank of Panama	707	1,116	1,171	1,013	633	683
Rest of banking system	850	629	612	1,511	2,124	2,238
Long-term foreign liabilities	51	58	39	36	51	51
National Bank of Panama	46	52	36	34	29	29
Rest of banking system	5	6	3	2	22	22
Net domestic assets	**7,446**	**8,112**	**8,152**	**7,862**	**8,498**	**9,122**
Public sector (net credit)	-1,216	-1,422	-1,399	-1,134	-701	-803
Central government (net credit)	315	158	128	381	650	537
Rest of the public sector (net credit)	-1,531	-1,580	-1,526	-1,515	-1,351	-1,340
Private sector credit	10,851	11,735	10,891	11,105	12,296	13,284
Private capital and surplus	-2,555	-2,631	-2,425	-2,745	-3,330	-3,508
Other assets (net)	365	430	1,084	636	233	149
Liabilities to private sector	**8,952**	**9,805**	**9,896**	**10,350**	**11,204**	**11,991**
Total deposits	8,952	9,805	9,875	10,305	11,121	11,904
Demand deposits	1,166	1,296	1,342	1,458	1,618	1,735
Time deposits	6,145	6,572	6,271	6,400	6,874	7,729
Savings deposits	1,641	1,938	2,262	2,447	2,630	2,441
Bonds	0	0	20	45	82	87
(12-month change in relation to liabilities to the private sector at the beginning of the period)						
Net foreign assets	2.6	2.1	0.5	7.5	2.1	1.5
Net domestic assets	6.4	7.4	0.4	-2.9	6.1	5.6
Public sector credit (net)	-0.4	-2.3	0.2	2.7	4.2	-0.9
Private sector credit	6.7	9.9	-8.6	2.2	11.5	8.8
Private capital and surplus	3.6	0.9	-2.1	3.2	5.7	1.6
Other assets (net)	3.7	0.7	6.7	-4.5	-3.9	-0.8
Liabilities to the private sector	8.9	9.5	0.9	4.6	8.2	7.0
(12-month percent change)						
Memorandum items:						
M2 1/	8.9	9.5	0.9	4.6	8.2	7.0
Private sector credit	5.4	8.1	-7.2	2.0	10.7	8.0
Share of demand deposits in total deposits (in percent)	13.0	13.2	13.6	14.1	14.5	14.6
(In percent of GDP)						
Total deposits	77.0	83.0	80.5	80.1	80.6	81.9
Credit to private sector	93.4	99.4	88.7	86.3	89.1	91.4

Sources: Superintendency of Banks; National Bank of Panama; Savings Bank; and Fund staff estimates and projections.

1/ M2 comprises bank deposits; estimates of U.S. currency in circulation are not available.

Table 5. Panama: Commercial Bank Performance Indicators, 2000–04 1/

(In percent at end-period, unless otherwise noted)

				2003				2004		
	2000	2001	2002	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.
Asset quality										
Nonperforming loans as percent of total loans										
Banking system	1.4	2.8	3.4	3.3	3.2	2.9	2.7	2.8	2.1	2.0
Domestic banks	1.4	3.0	4.6	4.2	4.1	3.6	3.3	3.3	2.6	2.6
Foreign banks	1.2	2.7	2.6	2.5	2.4	2.4	2.3	2.5	1.7	1.6
Ratio of provisions to nonperforming loans										
Banking system	133.8	87.9	136.8	145.4	128.1	125.9	135.6	126.1	160.3	151.2
Domestic banks	158.2	85.5	54.5	60.1	58.6	69.6	72.0	73.3	93.5	96.5
Foreign banks	163.7	89.9	281.1	286.3	253.9	215.6	240.1	212.5	277.4	254.7
Profitability										
Pretax return on average assets										
Banking system	1.3	1.0	0.5	1.6	2.3	2.2	2.1	2.5	2.2	2.3
Domestic banks	1.6	1.3	2.0	1.9	2.0	1.9	1.9	2.3	1.9	1.9
Foreign banks	0.8	0.7	-1.5	1.3	2.8	2.6	3.2	2.7	2.7	2.9
Liquidity										
Ratios to total deposits										
Liquid assets										
Banking system	35.5	31.4	29.4	29.1	31.1	27.3	28.6	28.0	26.7	26.5
Domestic banks	38.8	34.0	29.0	27.7	28.2	24.4	25.3	23.3	21.6	19.2
Foreign banks	31.9	28.3	29.9	31.1	34.9	31.2	33.2	34.6	33.1	35.7
Liquid assets plus marketable securities										
Banking system	43.3	40.2	40.3	43.7	44.1	39.8	42.6	41.5	40.0	42.2
Domestic banks	52.6	43.1	41.9	45.8	44.1	39.5	44.1	41.5	38.4	35.3
Foreign banks	40.1	36.7	38.1	42.3	43.8	40.2	42.7	43.5	42.1	43.1
Capital adequacy ratios										
Ratio of capital to risk-weighted assets										
Domestic banks	13.5	13.6	14.5	14.8	17.1	17.6	17.5	17.8	19.8	19.6
Foreign banks 2/	17.2	17.9	22.5	22.5	22.2	20.6	18.7	19	18.9	17.5
Ownership										
Foreign banks' share of banking system assets (in percent)	50.1	50.1	43.8	43.3	43.5	42.5	41.5	41.1	42.5	42.8

Sources: Superintendency of Banks; and Fund staff estimates.

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

2/ Calculated only for subsidiaries of foreign banks (excludes branches).

Table 6. Panama: Balance of Payments

	2000	2001	2002	2003	Est. 2004	Proj. 2005
	(In millions of U.S. dollars)					
Current account	**-689**	**-174**	**-61**	**-442**	**-273**	**-211**
Trade balance excluding Colon Free Zone	**-1,658**	**-1,225**	**-1,382**	**-1,476**	**-1,611**	**-1,711**
Exports, f.o.b.	1,047	1,079	970	987	1,113	1,171
Imports, f.o.b.	-2,705	-2,304	-2,352	-2,463	-2,724	-2,883
Net exports from Colon Free Zone	**515**	**529**	**346**	**359**	**552**	**575**
Re-exports, f.o.b.	4,791	4,914	4,345	4,057	4,941	5,149
Imports, f.o.b.	-4,276	-4,384	-3,998	-3,698	-4,389	-4,574
Services, net	**854**	**899**	**981**	**1,254**	**1,411**	**1,574**
Travel, net	269	310	334	377	428	473
Transportation, net	545	537	592	799	883	995
Other services	39	52	54	79	100	106
Income, net	**-577**	**-602**	**-250**	**-820**	**-884**	**-922**
Private sector	-330	-289	78	-438	-400	-427
Public sector	-247	-313	-328	-382	-484	-494
Of which: NFPS interest	-366	-415	-449	-474	-530	-577
Current transfers, net	**177**	**226**	**244**	**241**	**259**	**273**
Capital and financial account	**203**	**890**	**367**	**163**	**409**	**271**
Capital account (public sector grants)	**2**	**2**	**0**	**0**	**0**	**0**
Financial account	**201**	**889**	**367**	**163**	**409**	**271**
Public sector	103	325	350	290	218	609
Nonfinancial public sector	117	339	322	288	216	607
National Bank of Panama	-6	-7	-8	-8	-8	-8
Other net flows	-8	-7	36	10	10	10
Private sector	98	563	17	-127	191	-338
Direct investment	700	405	99	792	739	706
Financial sector						
Portfolio investment	-93	-745	-52	-60	-641	-211
Other (flows of loans less deposits)	-240	1,013	-17	-737	46	68
Other, including Canal Authority	-269	-110	-13	-121	47	-902
Errors and omissions	**395**	**-301**	**-243**	**130**	**546**	**0**
Overall balance	**-91**	**416**	**62**	**-149**	**682**	**60**
Financing	**91**	**-416**	**-62**	**149**	**375**	**-60**
Net foreign assets of the National Bank of Panama	117	-409	-54	158	380	-50
Net use of Fund credit	-52	-34	-8	-9	-5	-10
Exceptional financing	26	27	0	0	0	0
	(In percent of GDP)					
Memorandum items:						
Merchandise exports	9.0	9.1	7.9	7.7	8.1	8.1
Merchandise imports	-23.3	-19.5	-19.2	-19.2	-19.8	-19.8
Net exports from Colon Free Zone	4.4	4.5	2.8	2.8	4.0	4.0
Current account	-5.9	-1.5	-0.5	-3.4	-2.0	-1.5
Direct foreign investment	6.0	3.4	0.8	6.2	5.4	4.9

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

Table 7. Panama: Gross External Debt Flows of the Nonfinancial Public Sector

(In millions of U.S. dollars)

	2000	2001	2002	2003	Est. 2004
Total disbursements	**485**	**1,219**	**1,076**	**421**	**1,361**
Multilaterals	84	94	115	128	132
IBRD	22	26	30	16	17
IDB	53	59	71	99	51
IMF	0	0	0	0	0
Others	9	10	14	13	64
Bilateral and guaranteed suppliers	22	21	26	11	12
Commercial banks	28	6	6	6	44
Global bonds	350	1,098	930	275	1,173
Total debt service	**758**	**950**	**1,395**	**762**	**1,135**
Multilaterals	176	160	138	176	239
IBRD	45	46	46	50	60
IDB	69	72	74	103	149
IMF	58	37	9	11	12
Others	4	5	9	12	18
Bilateral and guaranteed suppliers	87	84	44	40	37
Commercial banks	33	7	10	8	13
Brady bonds	196	222	521	168	450
Global bonds	266	477	681	370	396
Amortization	**391**	**536**	**946**	**288**	**605**
Multilaterals	106	89	76	115	148
IBRD	24	26	28	35	38
IDB	28	28	34	61	87
IMF	52	34	8	10	9
Others	2	2	7	10	13
Bilateral and guaranteed suppliers	67	67	33	29	27
Commercial banks	32	6	9	8	8
Brady bonds	120	148	453	135	422
Global bonds	66	225	374	0	0
Interest	**366**	**415**	**449**	**474**	**530**
Multilaterals	69	71	62	60	91
IBRD	20	20	18	15	21
IDB	41	44	40	42	62
IMF	6	4	1	1	3
Others	2	3	2	2	5
Bilateral and guaranteed suppliers	19	17	12	11	11
Commercial banks	1	1	0	0	5
Brady bonds	76	74	68	33	28
Global bonds	200	252	307	370	396
Memorandum items:					
Debt service as percent of exports of goods and services	21.3	26.3	38.8	19.5	25.4
Debt service as percent of GDP	6.5	8.0	11.4	5.9	8.2
Exports of goods and services	3,557	3,613	3,594	3,903	4,473
GDP	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 and projections.

Table 8. Panama: Debt of the Nonfinancial Public Sector

	2000	2001	2002	2003	Est. 2004	Proj.1/ 2005
	(In millions of U.S. dollars)					
External debt	**5,604**	**6,263**	**6,349**	**6,503**	**7,259**	**7,196**
Multilaterals	1,113	1,099	1,175	1,228	1,212	1,151
IBRD	284	283	287	270	248	221
IDB	711	727	795	866	830	813
IMF	90	54	50	45	35	25
Others	28	35	43	47	99	92
Bilateral and guaranteed suppliers	380	330	331	313	298	274
Commercial banks	13	13	9	7	43	78
Brady bonds	1,648	1,496	954	800	378	365
Global bonds	2,450	3,325	3,880	4,155	5,328	5,328
Domestic debt 2/	**1,340**	**1,376**	**1,474**	**1,642**	**2,140**	**2,051**
Private creditors	620	748	870	1,136	1,280	1,287
Public financial institutions	719	628	605	506	860	764
Total	**6,944**	**7,639**	**7,823**	**8,145**	**9,399**	**9,247**
	(In percent of GDP)					
Total	**59.8**	**64.7**	**63.7**	**63.3**	**68.1**	**63.7**
External	48.2	53.0	51.7	50.6	52.6	49.5
Domestic	11.5	11.7	12.1	12.8	15.5	14.2
Memorandum items:						
Official definitions for Law 20 3/						
Total public debt (gross) 4/	7,732	8,401	8,521	8,661	9,869	9,675
In percent of GDP	66.5	71.1	69.4	67.3	71.6	66.6
Net total public debt 5/	6,376	7,000	7,154	7,146	8,397	8,280
In percent of GDP	54.9	59.3	58.3	55.6	60.9	57.0
GDP (millions of U.S. dollars)	11,621	11,808	12,272	12,862	13,793	14,531

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

1/ Projection for 2005 reflects authorities' deficit target and an initial impact of tax reform.
2/ Excluding government debt held by the social security agency.
3/ Definitions used for the debt limits stipulated in the Law 20 (Fiscal Responsibility Law).
4/ External and domestic debt, including government debt held by the social security agency. If real GDP growth is higher than 1.5 percent, the growth in total public debt should not exceed 80 percent of the growth in nominal GDP.
5/ Total public debt (gross) minus Fiduciary Fund assets and collateral for public debt (Brady bonds).

Table 9. Panama: Indicators of the External Position and Financial Vulnerability

(In percent of GDP, unless otherwise indicated)

	2000	2001	2002	2003	Est. 2004
Financial indicators					
Broad money (12-month percent change)	8.9	9.5	0.9	4.6	8.2
Private sector credit (12-month percent change)	5.4	8.1	-7.2	2.0	10.7
Deposit rate (6-month; in percent) 1/	6.5	5.5	3.8	3.6	2.2
External indicators					
Merchandise exports (12-month percent change)	22.8	3.0	-10.1	1.8	12.8
Merchandise imports (12-month percent change)	-2.4	-14.8	2.1	4.7	10.6
Current account balance	-5.9	-1.5	-0.5	-3.4	-2.0
Capital and financial account balance	1.7	7.5	3.0	1.3	3.0
Of which: direct investment	6.0	3.4	0.8	6.2	5.4
Public sector external debt	48.2	53.0	52.0	50.5	47.3
In percent of exports of goods and services 2/	157.6	173.4	177.5	166.3	145.8
External interest payments (in percent of exports of goods and services) 2/	10.3	11.5	12.5	12.2	11.9
External amortization payments (in percent of exports of goods and services) 2/	11.0	14.8	26.3	7.4	13.5
Exchange rate (balboas per U.S. dollar)	1.0	1.0	1.0	1.0	1.0
REER, percent change (depreciation -) 3/	-0.7	-1.3	-0.2	-6.5	-0.4
Net international reserves at end of period					
In millions of U.S. dollars 4/	707	1,116	1,171	1,013	633
In percent of broad money	7.9	11.4	11.9	9.8	5.7
In percent of short-term external debt	132.0	118.0	406.6	167.5	334.4
Memorandum items:					
Nominal GDP (millions of balboas)	11,621	11,808	12,272	12,862	13,793
Exports of goods and services (millions of U.S. dollars) 2/	3,557	3,613	3,594	3,903	4,473

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

1/ Period average for the banking system. In 2005 data refer to the period January-September
2/ Includes net exports of the Colon Free Zone.
3/ Figure for 2004 is the percentage change during the first 11 months of 2004.
4/ Corresponds to net foreign assets of the National Bank of Panama (a publicly owned commercial bank).

Table 10. Panama: Social Indicators

	Panama	Central America Average	Central America Range	Latin America and the Caribbean Average
Rank in 2004 UNDP Human Development Index (out of 177 countries)	61	94	45–121	...
GDP per capita PPP, U.S. dollars (2002)	6,170	4,842	2,470–8,840	7,223
Life expectancy at birth (years) (2002)	74.6	71.2	65.7–78	70.5
Under-5 mortality (per 1,000 live births) (2002)	23	33	9–49	34
People not expected to survive to age 40 (in percent of population) (2000–05)	6.8	9.8	3.7–14.1	9.7
Undernourished people (as percent of total population, avg. 1992–2001)	26	20	6–25	11
Population without access to an improved water source (2000)	10	14	5–23	22
Per capita health expenditure, U.S. dollars (2001)	458	318	153–562	...
Physicians per 100,000 people (2003)	121	111	62–160	...
Adult illiteracy (2002)	7.2	18	4.2–30.1	11.4
Primary school net enrollment (2001–02) (percent of relevant age of the population)	98	89	82–99	93
Secondary school net enrollment (2001–02) (percent of relevant age of the population)	62	45	28–62	65
Income share of: 1/				
The top 20 percent of the population	60.3	58.6	51.5–64.1	...
The lowest 20 percent of the population	2.4	3.1	2.4–4.2	...
Gini index 1/	56.4	52.4	46.5–56.4	...
Poverty 2/				
Percent of population below official poverty line 3/	37.6	51	19–67.4	50.7
Percent of population below official extreme poverty line 4/	16.8	...	...	...
Corruption perceptions index (2003) 5/	3.4	3.1	2.3–4.3	3.4

Sources: MEF, 2003 Living Standards Measurement Survey; World Bank, World Development Indicators 2002; UNDP, Human Development Report 2004; and Transparency International (www.transparency.org).

1/ Data for Panama refer to 2000.
2/ Not comparable across countries, owing to methodological issues. For Guatemala, Honduras, and Nicaragua, the information refers to the Poverty Reduction Strategy Paper.
3/ In Panama a person below poverty has an annual consumption below US$953.00 in 2003 prices. Data for Panama refer to the 2003 Living Standards Measurement Survey.
4/ In Panama a person below extreme poverty has an annual consumption below US$534.00 in 2003 prices. Data for Panama refer to the 2003 Living Standards Measurement Survey.
5/ The CPI score relates to perceptions of the degree of corruption as seen by business people, academics and risk analysts, and ranges between 10 (highly clean) and zero (highly corrupt).

Table 11. Panama: Millennium Development Goals

(In percent, unless otherwise noted)

	1990 Benchmark	2015 Goal	Latest Available Information		Status
			Estimate	Year	
Poverty					
Halve extreme poverty 1/	31.4	15.7	23.9	2000	On track
Halve malnutrition 2/	...	3.4	6.8	1997	...
Education					
Achieve full enrollment in primary education to 100 percent	91.0	100.0	99.0	2001	On track
Gender equality					
Raise girls/boys ratio in primary and secondary education	96.0	100.0	100.6	2001	Achieved
Children mortality					
Reduce child mortality under 5 years of age by two-thirds	34.0	22.7	23.0	2002	On track
Maternal health					
Reduce maternal mortality rate (for each 1,000 live births) by three-fourths	0.5	0.1	0.6	2000	Off track
Raise the contraceptive prevalence rate (percent of women ages 15–49)	...	...	58.2	1984	...
Environment					
Halve the proportion of individuals without access to improved water source	21.3	10.7	11.8	2000	On track
Halt forest degradation (percent of total land)	45.6	45.6	38.6	2000	Off track
Global partnership for development 3/					
Develop and implement strategies for youth employment unemployment rate in percent of total labor force ages (15/24)	21.6	...	23.5	2000	Off track
Make available the benefits of new information technologies access to personal computers (per 1,000 people)	...	...	38.3	2002	...

Sources: World Bank, World Development Indicators 2002; UNDP, Human Development Report 2004; and Fund staff estimates.

1/ Percentage of population with income less than US$1.00 per day. This definition of extreme poverty differs from the official definition used by the Panamanian authorities in the survey Encuesta de Niveles de Vida 2003.

2/ Percentage of children under 5 years old.

3/ The objective has various qualitative targets.

Panama—Fund Relations
(As of January 31, 2005)

I. Membership Status: Joined March 14, 1946; Article VIII.

A. Financial Relations

II. General Resources Account:

	SDR Million	Percent of Quota
Quota	206.60	100.00
Fund holdings of currency	218.08	105.56
Reserve position in the Fund	11.86	5.74

III. SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	26.32	100.0
Holdings	0.56	2.11

IV. Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
Extended Arrangement	23.33	11.29

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	06/30/00	03/29/02	64.00	0.00
EFF	12/10/97	06/20/00	120.00	40.00
Stand-By	11/29/95	03/31/97	84.30	84.30

VI. Projected Obligations to the Fund: (SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	**2006**	**2007**	**2008**	**2009**
Principal	6.67	6.67	6.67	3.33	
Charges/interest	1.30	1.10	0.88	0.68	0.59
Total	**7.96**	**7.76**	**7.55**	**4.01**	**0.59**

VII. Safeguards Assessment

Under the Fund’s safeguards assessment policy, National Bank of Panama (NBP) was subject to the transitional procedures with respect to the Stand-By Arrangement, which was approved on June 30, 2000 and expired on March 29, 2002. The transitional procedures required a review of the NBP’s external audit mechanism only. The assessment was completed on July 12, 2001 and concluded that NBP’s external audit mechanism was at the time adequate.

B. Nonfinancial Relations

VIII. Exchange Rate Arrangement:

Panama uses the U.S. dollar as the primary means of payment in the local economy. Its national currency (balboa) is issued in the form of coins only and serves as a unit of account. The exchange rate of the balboa is fixed at B 1 per U.S. dollar. Panama has accepted the obligations of Article VIII, Sections 2(a), 3, and 4, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. Last Article IV Consultation:

The 2003 Article IV consultation was concluded on March 22, 2004. Panama is on the standard 12-month consultation cycle.

X. Technical Assistance:

a. MFD: In May 2001, a mission visited Panama to review compliance with the Basel Core Principles under Module 2 of the Fund’s offshore Financial Sector Initiative.

b. STA: In April 2001, a STA expert visited Panama to provide assistance on a number of issues relating to the compilation of the national accounts, including the implementation of the 1993 SNA. In September 2002 a mission visited Panama to support the authorities’ participation in the Coordinated Portfolio Investment Survey (CPIS).

c. STA: In February 2004, a GFS expert on behalf of STA provided assistance to improve fiscal data quality and prepare the implementation of the 2001 Government Finance Statistics Manual (GFSM2001).

XI. Resident Representative:

None.

Panama—Relations with the Inter-American Development Bank

The IDB program objectives are to promote environmentally sustainable growth and reduce poverty and inequality. IDB projects aim to improve efficiency in social expenditure, invest in human capital and improve access to basic services in priority areas. Given the link between growth and poverty reduction, the IDB program supports reforms devoted to increasing competitiveness and job creation while promoting governance and accountability. The loan portfolio focuses on competitiveness and growth (39 percent of the portfolio) as well as social sector development (38.9 percent of the portfolio). In addition, the IDB supports the modernization of the state and capacity building for negotiations and regional integration.

The 2005 program includes three project loans amounting to US$70 million. Their objectives are:

- Cleaning up Panama City and the surrounding bay. This has three stages to sequentially modernize the system to collect and channel sewage and build a plant for water treatment.
- Capacity building to negotiate and implement free trade agreements.
- Support of hydrological works in the Panama Canal.

Panama: Financial Relations with the Inter-American Development Bank

(in millions of U.S. dollars as of December 31, 2004)

IDB Lending Operations	Disbursed	Undisbursed
Ongoing Operations		
Agriculture	2.6	24.4
Education	19.8	38.3
Energy-Electricity	58.1	43.9
Environment	38.9	62.5
Health	9.0	26.0
Reform and modernization of the State	56.7	50.1
Science and Technology	17.4	7.1
Social development	20.5	22.7
Tourism	1.4	1.1
Transportation	68.6	53.4
Urban Development	12.6	10.0
Water supply and sewerage	7.5	3.1
Total	313.2	342.7
IDB loans approved since 1960		
Total operations	2,103.3	
Cancellations	433.0	
Principal payments	897.9	
Debt outstanding	853.1	
New commitments CY 2004	-	
Disbursements CY 2004	37.0	

Recent activities:

During CY2004 US$23.8 million was cancelled from three loans in execution.
In CY2004, the Bank no new loans were approved.
Anticipated approvals for CY2005 are US$70 million and expected disbursements for CY2005 are US$90 million.

Source: The Inter-American Development Bank

Panama—Relations with the World Bank

The last Country Assistance Strategy for Panama covered FY1999–2001. This CAS was discussed by the Board in October 1998, and was based largely on the findings of an extensive Poverty Assessment. The CAS lending program reflected strong performance under the previous CAS and endorsed a lending level of US$314 million. The Moscoso administration revised priorities and relied on other financing sources, leaving a good portion of the CAS unimplemented.

The **current portfolio** consists of four IBRD projects under implementation totaling US$98 million, of which about US$65 million are undisbursed. The bulk of resources available (94 percent) support two investment operations—a Land Administration Project and a Basic Education Project. The remaining operations finance two projects in the areas of health and public policy reforms. Portfolio performance deteriorated under the Moscoso Government due to political interference and growing counterpart fund shortages. The new government is seeking to realign project priorities to its development agenda and fiscal constraints.

In terms of ***future program*****,** the Bank is currently contemplating, in consultation with the new Government, an Interim Strategy Note (ISN) to include a small, well-targeted program of Bank activities through FY06 that could include a Public Expenditure Review and a Poverty Assessment. Based on the Government's interests, these activities would aim to renew the Bank's knowledge of and dialogue with Panama. Although future lending is not settled, given the renewed governmental interest the Bank is tentatively willing to finalize preparation of two operations requested by the previous Government. These two new operations are a Second Rural Poverty and Natural Resources Project (US $38 million) and a Canal Watershed Management Project (US $11 million). However, it was agreed that any future Bank lending to Panama should be demand-driven.

Financial Relations of the World Bank Group with Panama
(In millions of U.S. dollars)

IBRD Lending Operations As of February 28, 2005	Disbursed	Undisbursed
Total operations by sector	**919.2**	**64.5**
Electric power and other energy	186.6	0
Agriculture	24.2	0
Transportation	163.4	0
Social sector	21.1	0
Urban development and housing	28.6	0
Water supply & sanitation	23	0
Environment	31.3	37.2
Health, population, and nutrition	29.4	0.4
Finance	21.0	0
Education	46.5	23.4
Multisector	344.1	3.5
Total operations since 1953		
Disbursements	919.2	
Repaid 1/	665	
Debt outstanding 2/	245.2	
Gross disbursements by calendar year:		
2001	26.1	
2002	29.9	
2003	16.1	
2004	11.8	

Source*:* The World Bank.
1/ Including amounts sold to third parties (US$9.2 million).
2/ Including valuation changes (US$0.4 million).

PANAMA—STATISTICAL ISSUES

Economic statistics are generally adequate for monitoring purposes, but there is a need for more timely reporting. There is a need to improve coordination between the Comptroller General's Office, which is responsible for official economic statistics, and other government entities, including the Ministry of Economy and Finance. Panama has participated in the Fund's General Data Dissemination System (GDDS) since December 2000 and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB).

1. Real sector

The authorities completed a revision of the national accounts in 2004, based on the *1993 SNA,* with a change in the base year from 1982 to 1996. The revised data are available for the period 1996−2003. In the second half of 2004 the authorities introduced a new CPI, based on weights of the 1997/98 household survey. This index has national coverage whereas the previous one was limited to Panama City. The authorities also introduced two additional regional indices, one for Panama and San Miguelito and the other for the remaining urban areas. Time lags for the release of consumer price data are long; the latest CPI data are for June 2004.

Technical assistance: The United Nations Economic Commission for Latin America and the Caribbean is supporting the development of a supply-use table.

2. Government finances

a. **Current status**: Data on central government finances, public enterprises, and agencies are compiled only on a cash basis. Monthly and quarterly data for the operations of the budgetary central government are currently available through September 2004.

b. **Pending issues**: Monitoring of public sector financial developments would be facilitated if data were provided on an accrual basis and were more timely, if the consistency of information on intrapublic sector transfers were improved, and if the coverage of the investment program were made complete. The authorities decided in September 2004 to exclude the operational balance of the Panama Canal Authority (PCA) from the definition of the nonfinancial public sector used for fiscal policy purposes but agreed to also present a more comprehensive measure including the PCA as part of the public sector. However, for its inclusion in the comprehensive fiscal accounts, there is a need to ensure a consistent and timely flow of PCA statistics on a calendar year basis. In addition to broadening the integrated financial administration system's (SIAFPA) scope of coverage, there is a need to address the issue of unrecorded expenditures, which have resulted in persistent and significant discrepancies in the measurement of fiscal performance from above and below the line. In this regard, the authorities have received technical assistance from STA directed toward the adoption of the *Government Finance Statistics Manual 2001 (GFSM 2001).*

c. **Technical assistance**: A STA mission in February 2004 undertook a comprehensive review of the coverage and methodology currently in use in the fiscal accounts. The mission made several recommendations, and prepared a tentative timetable for a migration to the *GFSM 2001*.

3. **Monetary accounts**

Provision of monthly data by the monetary authorities has been regular and reasonably current. Monthly data on the operations of the private commercial and savings banks are prepared by the Superintendency of Banks and reported to STA with a lag of one to two months. The state-owned development banks, the Agricultural Development Bank, and the Mortgage Bank are not regulated by the Superintendency of Banks and no data on these banks are reported to the Fund. There is a lack of consistent data prepared on the financial positions of the National Mortgage Bank and the Agricultural Development Bank.

4. **Balance of payments**

Despite substantial progress in compilation procedures, data are subject to sizeable revisions each quarter. Revised estimates of merchandise imports, transportation services and foreign direct investment data often result in substantial revisions of the current and financial accounts of the balance of payments. These revisions may reflect improvements in coverage, but they also suggest that there is room for improvement in quality control procedures. There is a need to improve the quality of the Colon Free Zone statistics. The authorities are currently working on a full reconciliation between data of the banking sector and balance of payments capital flows consistent with the compilation method introduced by the Superintendency of Banks in 2002. Data are not yet available on nonfinancial private sector debt or on transactions involving financial derivatives. International Investment Position data for 1995−2003 have been compiled. The most recent data on balance of payments statistics pertain to September 2004.

PANAMA: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(AS OF FEBRUARY 16, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	Fixed	NA	NA	NA	NA
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	12/2004	01/2005	M	M	A
Reserve/Base Money	NA	NA	NA	NA	NA
Broad Money	12/2004	02/2005	M	M	M
Central Bank Balance Sheet	12/2004	01/2005	M	M	A
Consolidated Balance Sheet of the Banking System	12/2004	2/05/2005	M	M	M
Interest Rates[2]	12/2004	02/2005	M	M	M
Consumer Price Index	6/2004	8/2004	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	NA	NA	NA	NA	NA
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	9/2004	11/2004	Q	Q	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/2004	01/2005	M	M	M
External Current Account Balance	9/2004	01/2005	Q	Q	Q
Exports and Imports of Goods and Services	9/2004	01/2005	M	M	M
GDP/GNP	2003	4/2004	A	A	A
Gross External Debt	12/2004	01/2005	M	M	M

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

PANAMA—DEBT SUSTAINABILITY ANALYSIS

Under an active scenario broadly consistent with the authorities' medium-term fiscal targets, the debt-to-GDP ratio would be on a firmly declining path. Under this scenario, implementation of the February 2005 fiscal reform, followed by a reform of social security and other supportive fiscal measures that may be needed in the outer years to achieve the authorities' fiscal targets, would result in a primary surplus of about 3½ percent of GDP by 2008–09. Structural reforms would enhance investor confidence and help boost real GDP growth to 4 percent a year, and public debt would decline to 53 percent of GDP by 2009 (Table 4). If the scenario were extended to a longer period, with the primary surplus maintained at 3½ percent of GDP, the debt ratio would decline to 38 percent by 2014.

Under a low-case scenario that assumes fiscal slippage from the authorities' fiscal program, public sector debt would be on an unsustainable path, rising steadily relative to GDP starting in 2007. The staff's "low-case" scenario assumes no pension reform nor the implementation of the government's competitiveness strategy, and it assumes that an easing of the fiscal stance offsets the positive fiscal impact of the authorities' fiscal measures in 2006–08. The primary surplus, projected at about 1.2 percent of GDP in 2006 (excluding the Panama Canal Authority), would start declining in 2007. The debt-to-GDP ratio would increase to 70 percent by 2009, from 64 percent in 2005, entailing large gross financing needs, growing interest payments, and a sustained rise in public debt relative to fiscal revenue.

Potential temporary shocks under the active scenario would be manageable, delaying by two or three years the downturn in the debt ratio (Tables 4 and 6). The most important vulnerability, however, arises from the possibility of sustained fiscal slippage, as presented in the low-case scenario; adding growth or interest rate shocks to this scenario would accelerate the rise in public debt ratios (Tables 5 and 7).

In a fully dollarized economy, the sustainability of debt is a fiscal issue and not a potential balance of payments problem. However, external debt would be vulnerable to a simultaneous shock from several key parameters, the more so in the low-case scenario in which the authorities only partially implement their fiscal program (Tables 6 and 7).

Table 1. Panama: Medium-Term Macroeconomic Framework—Active Scenario

	2003	Est. 2004	Projections 2005	2006	2007	2008	2009
	(Percent change)						
Economic growth and prices							
Real GDP at market prices	4.3	6.0	3.5	4.0	4.0	4.0	4.0
Real domestic demand	3.5	4.4	2.5	2.6	3.3	3.7	3.7
GDP deflator	0.5	1.2	1.8	2.4	1.9	1.7	1.7
CPI (period average)	1.0	0.5	2.4	1.8	1.5	1.5	1.5
CPI (end of period)	0.1	2.0	2.0	1.5	1.5	1.5	1.5
	(In percent of GDP)						
Savings and investment							
National savings	18.0	20.0	19.1	21.1	22.5	23.7	24.8
Public sector	1.0	0.9	2.0	4.4	5.5	5.8	6.0
Private sector	17.0	19.1	17.2	16.7	17.0	18.0	18.8
Gross domestic investment	21.5	22.0	20.6	21.7	22.5	23.4	24.0
Public sector	5.2	4.1	3.7	4.0	4.1	4.1	4.2
Private sector	16.3	17.8	16.9	17.6	18.4	19.3	19.8
External savings	-3.4	-2.0	-1.5	-0.5	0.0	0.3	0.8
Nonfinancial public sector							
Revenue	22.4	21.3	22.5	23.8	24.6	24.7	24.7
Expenditure	27.2	26.3	26.2	25.5	25.4	25.2	24.9
Primary balance	-0.3	-0.5	1.1	2.9	3.4	3.5	3.4
Overall balance, excluding Canal Authority	-4.7	-5.0	-3.6	-1.6	-0.8	-0.5	-0.2
Canal Authority 1/	1.0	1.7	1.5	2.0	2.2	2.2	2.1
Balance, including Canal Authority	-3.8	-3.3	-2.1	0.4	1.5	1.7	1.8
Net external financing, excluding Canal Authority	2.4	1.1	3.7	1.3	0.7	0.5	-0.6
Net domestic financing, excluding Canal Authority	2.4	3.9	-0.1	0.4	0.0	0.0	0.8
Canal Authority	-1.0	-1.7	-1.5	-2.0	-2.2	-2.2	-2.1
Total public debt	63.3	68.1	63.7	61.1	58.4	55.6	52.9
Total interest payments (as percent of debt)	6.9	6.7	7.5	7.3	7.2	7.0	6.9
External							
Exports, f.o.b. 2/	7.7	8.1	8.1	8.1	8.3	8.6	8.9
Imports, f.o.b. 2/	-19.2	-19.8	-19.8	-19.5	-19.3	-19.2	-19.3
Net exports of Colon Free Zone	2.8	4.0	4.0	3.9	4.0	4.0	4.1
Current account balance	-3.4	-2.0	-1.5	-0.5	0.0	0.3	0.8
External debt	50.5	52.6	49.5	47.8	45.8	43.7	40.8
Memorandum items:							
Nominal GDP (millions of U.S. dollars)	12,862	13,793	14,531	15,469	16,400	17,354	18,347
Gross financing requirements							
Total	1,211	1,304	799	750	320	648	221
External	492	570	586	632	-36	554	-313

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

1/ Balance of Canal Authority, after transfers of Canal tolls and distribution of profits to the government.

2/ Excluding Colon Free Zone.

Table 2. Panama: Medium-Term Macroeconomic Framework—Low-Case Scenario

		Est.	Projections				
	2003	2004	2005	2006	2007	2008	2009
	(Percent change)						
Economic growth and prices							
Real GDP at market prices	4.3	6.0	3.5	3.0	3.0	2.5	2.5
Real domestic demand	3.5	4.4	2.5	1.9	2.5	2.4	2.4
GDP deflator	0.5	1.2	1.8	2.1	1.7	1.3	1.3
CPI (period average)	1.0	0.5	2.4	1.8	1.5	1.5	1.5
CPI (end of period)	0.1	2.0	2.0	1.5	1.5	1.5	1.5
	(In percent of GDP)						
Savings and investment							
National savings	18.0	20.0	19.1	19.6	19.5	18.6	17.6
Public sector	1.0	0.9	2.0	2.4	2.1	1.5	0.8
Private sector	17.0	19.1	17.2	17.2	17.4	17.1	16.9
Gross domestic investment	21.5	22.0	20.6	20.5	20.4	19.8	19.2
Public sector	5.2	4.1	3.7	3.9	4.0	4.0	4.0
Private sector	16.3	17.8	16.9	16.5	16.4	15.8	15.2
External savings	-3.4	-2.0	-1.5	-0.8	-0.9	-1.2	-1.6
Nonfinancial public sector							
Revenue and grants	22.4	21.3	22.5	22.6	22.5	22.4	22.3
Expenditure	27.2	26.3	26.2	26.2	26.6	27.1	27.7
Primary balance	-0.3	-0.5	1.1	1.2	0.8	0.5	0.2
Overall balance, excluding Canal Authority	-4.7	-5.0	-3.6	-3.5	-4.1	-4.7	-5.4
Canal Authority 1/	1.0	1.7	1.5	2.1	2.3	2.3	2.2
Balance, including Canal Authority	-3.8	-3.3	-2.1	-1.4	-1.8	-2.4	-3.2
Net external financing, excluding Canal Authority	2.4	1.1	3.7	3.2	4.1	4.7	5.4
Net domestic financing, excluding Canal Authority	2.4	3.9	-0.1	0.3	0.0	0.0	0.0
Canal Authority	-1.0	-1.7	-1.5	-2.1	-2.3	-2.3	-2.2
Total public debt	63.3	68.1	63.7	63.7	64.9	67.2	70.1
Total interest payments (as percent of debt)	6.9	6.7	7.5	7.4	7.5	7.7	7.9
External							
Exports, f.o.b. 2/	7.7	8.1	8.1	8.1	8.2	8.3	8.4
Imports, f.o.b. 2/	-19.2	-19.8	-19.8	-19.5	-19.3	-19.4	-19.5
Net exports of Colon Free Zone	2.8	4.0	4.0	3.9	3.8	3.8	3.8
Current account balance	-3.4	-2.0	-1.5	-0.8	-0.9	-1.2	-1.6
External debt	50.5	52.6	49.5	50.3	52.1	54.8	58.2
Memorandum items:							
Nominal GDP (millions of U.S. dollars)	12,862	13,793	14,531	15,279	16,004	16,623	17,264
Gross financing requirements							
Total	1,211	1,304	799	1,038	854	1,351	1,110
External	492	570	586	922	494	1,254	727

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

1/ Balance of Canal Authority, after transfers of Canal tolls and distribution of profits to the government.

2/ Excluding Colon Free Zone.

Table 3. Panama: Medium-Term Balance of Payments—Active Scenario, 2003–09

	2003	Est. 2004	Projections 2005	2006	2007	2008	2009
	(In millions of U.S. dollars)						
Current account	**-442**	**-273**	**-211**	**-82**	**-6**	**59**	**149**
Trade balance excluding Colon Free Zone	**-1,476**	**-1,611**	**-1,711**	**-1,752**	**-1,788**	**-1,850**	**-1,906**
Exports, f.o.b.	987	1,113	1,171	1,259	1,369	1,488	1,628
Imports, f.o.b.	-2,463	-2,724	-2,883	-3,012	-3,158	-3,338	-3,534
Net exports from Colon Free Zone	**359**	**552**	**575**	**611**	**652**	**699**	**747**
Re-exports, f.o.b.	4,057	4,941	5,149	5,468	5,842	6,258	6,692
Imports, f.o.b.	-3,698	-4,389	-4,574	-4,857	-5,189	-5,559	-5,945
Services, net	**1,254**	**1,411**	**1,574**	**1,766**	**1,902**	**1,998**	**2,100**
Travel, net	377	428	473	527	585	646	712
Transportation, net	799	883	995	1,126	1,197	1,224	1,252
Other services	79	100	106	113	120	128	135
Income, net	**-820**	**-884**	**-922**	**-997**	**-1,080**	**-1,113**	**-1,136**
Private sector	-438	-400	-427	-448	-477	-507	-528
Public sector	-382	-484	-494	-548	-603	-606	-608
Of which : NFPS interest	-474	-530	-577	-604	-608	-612	-614
Current transfers, net	**241**	**259**	**273**	**290**	**308**	**326**	**344**
Capital and financial account	**163**	**409**	**371**	**242**	**165**	**146**	**51**
Financial account	**163**	**409**	**371**	**242**	**165**	**146**	**51**
Public sector	290	218	609	262	122	83	-102
Nonfinancial public sector	288	216	607	260	121	80	-105
National Bank of Panama	-8	-8	-8	-9	-9	-7	-7
Other net flows	10	10	10	10	10	10	10
Private sector, medium and long-term	430	708	684	741	784	819	867
Direct investment	792	739	706	752	798	844	893
Portfolio investment	-59	-640	-210	-233	-236	-264	-275
Loans	-302	608	188	222	223	239	249
Short-term flows	-557	-516	-922	-760	-741	-757	-714
Errors and omissions	**130**	**546**	**0**	**0**	**0**	**0**	**0**
Overall balance	**-149**	**682**	**160**	**160**	**160**	**205**	**200**
Financing	**149**	**375**	**-160**	**-160**	**-160**	**-205**	**-200**
Net foreign assets of the National Bank of Canada	158	380	-150	-150	-150	-200	-200
Net use of Fund credit	-9	-5	-10	-10	-10	-5	0
	(In percent of GDP)						
Memorandum items:							
Merchandise exports	7.7	8.1	8.1	8.1	8.3	8.6	8.9
Merchandise imports	-19.2	-19.8	-19.8	-19.5	-19.3	-19.2	-19.3
Net exports from Colon Free Zone	2.8	4.0	4.0	3.9	4.0	4.0	4.1
Current account	-3.4	-2.0	-1.5	-0.5	0.0	0.3	0.8
Direct foreign investment	6.2	5.4	4.9	4.9	4.9	4.9	4.9

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

Table 4 . Panama: Public Sector Debt Sustainability Framework Based on Active Scenario, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Est.	Projections					
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
									I. Projections based on active scenario					Debt-stabilizing Primary Balance 8/
Public sector debt 1/	61.5	59.8	64.7	63.7	63.3			**68.1**	**63.7**	**61.1**	**58.4**	**55.6**	**52.9**	**0.6**
Of which: foreign debt	48.6	48.2	53.0	51.7	50.6			52.6	49.5	47.8	45.8	43.7	40.8	
Change in public sector debt	2.3	-1.7	4.9	-0.9	-0.4			4.8	-4.5	-2.6	-2.7	-2.7	-2.8	
Identified debt-creating flows (4+7+12)	-3.6	-0.3	1.4	1.1	1.5			0.8	0.2	-2.2	-2.7	-2.7	-2.8	
Primary balance (deficit= +)	-2.4	-3.6	-2.0	-1.0	0.3			0.5	-1.1	-2.9	-3.4	-3.5	-3.4	
Revenue and grants	24.5	24.8	23.8	22.9	22.4			21.3	22.5	23.8	24.6	24.7	24.7	
Primary (noninterest) expenditure	22.0	21.2	21.8	21.9	22.8			21.7	21.4	21.0	21.2	21.2	21.2	
Automatic debt dynamics 2/	0.9	3.4	3.4	2.1	1.2			0.3	1.3	0.6	0.7	0.7	0.7	
Contribution from interest rate/growth differential 3/	0.9	3.4	3.4	2.1	1.2			0.3	1.3	0.6	0.7	0.7	0.7	
Of which: contribution from real interest rate	3.2	5.0	3.7	3.5	3.7			3.9	3.6	3.0	3.0	2.9	2.8	
Of which: contribution from real GDP growth	-2.2	-1.7	-0.3	-1.4	-2.6			-3.5	-2.3	-2.4	-2.3	-2.2	-2.1	
Other identified debt-creating flows	-2.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-2.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 4/	5.9	-1.5	3.6	-2.1	-1.9			4.0	-4.7	-0.3	0.0	0.0	0.0	
Public sector debt-to-revenue ratio 1/	251.4	240.9	271.8	278.5	282.4			320.2	282.3	256.2	236.9	225.2	214.3	
Gross financing need 5/	7.3	6.2	8.6	12.3	10.4			11.1	7.0	6.9	4.2	5.9	3.3	
in billions of U.S. dollars	841.9	722.8	1009.6	1514.6	1336.4			1,533.6	1,016.1	1,066.5	688.2	1,023.6	604.6	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	4.0	2.7	0.6	2.2	4.3	3.5	2.3	6.0	3.5	4.0	4.0	4.0	4.0	4.3
Average nominal interest rate on public debt (in percent) 6/	6.4	7.0	7.4	6.8	7.2	6.0	1.7	7.8	7.4	7.5	7.3	7.1	7.0	7.3
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.6	8.3	6.4	5.6	6.2	5.2	2.5	6.6	5.6	5.1	5.3	5.4	5.3	5.6
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	0.8	-1.3	1.0	1.2	1.0	0.8	1.2	1.2	1.8	2.4	1.9	1.7	1.7	1.8
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.1	-1.4	3.5	3.5	7.7	3.1	9.6	1.2	2.0	1.8	5.1	4.2	4.0	3.1
Primary deficit	-2.4	-3.6	-2.0	-1.0	0.3	-2.1	1.5	0.5	-1.1	-2.9	-3.4	-3.5	-3.4	-2.3
									II. Stress Tests for Public Debt Ratio					Debt-stabilizing Primary Balance 8/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 7/								**68.1**	**62.4**	**60.9**	**59.7**	**58.5**	**57.3**	**0.9**
A2. No policy change (constant primary balance) in 2005-09								**68.1**	**65.2**	**66.0**	**67.2**	**68.5**	**69.8**	**0.8**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**68.1**	**66.6**	**67.3**	**64.6**	**62.0**	**59.3**	**0.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**68.1**	**67.7**	**70.8**	**70.4**	**70.0**	**69.5**	**0.8**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**68.1**	**65.7**	**66.8**	**64.2**	**61.5**	**58.8**	**0.7**
B4. Combination of B1-B3 using one standard deviation shocks								**68.1**	**67.0**	**70.3**	**67.7**	**65.0**	**62.4**	**0.7**
B5. 10 percent of GDP increase in other debt-creating flows in 2005								**68.1**	**73.7**	**71.2**	**68.6**	**66.0**	**63.3**	**0.8**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as $-g$.

4/ For projections, this line includes exchange rate changes.

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 5. Panama: Public Sector Debt Sustainability Framework Based on Low-Case Scenario, 1999-2009
(In percent of GDP, unless otherwise indicated)

	Actual							Est.	Projections					
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
									I. Projections based on low-case scenario					**Debt-stabilizing Primary Balance 8/**
Public sector debt 1/	61.5	59.8	64.7	63.7	63.3			**68.1**	**63.7**	**63.7**	**64.9**	**67.2**	**70.1**	**3.2**
Of which: foreign debt	48.6	48.2	53.0	51.7	50.6			52.6	49.5	50.3	52.1	54.8	58.2	
Change in public sector debt	2.3	-1.7	4.9	-0.9	-0.4			4.8	-4.5	0.1	1.2	2.3	2.9	
Identified debt-creating flows (4+7+12)	-3.6	-0.3	1.4	1.1	1.5			0.8	0.2	0.4	1.3	2.3	2.9	
Primary balance (deficit= +)	-2.4	-3.6	-2.0	-1.0	0.3			0.5	-1.1	-1.2	-0.8	-0.5	-0.2	
Revenue and grants	24.5	24.8	23.8	22.9	22.4			21.3	22.5	22.6	22.5	22.4	22.3	
Primary (noninterest) expenditure	22.0	21.2	21.8	21.9	22.8			21.7	21.4	21.5	21.7	21.9	22.1	
Automatic debt dynamics 2/	0.9	3.4	3.4	2.1	1.2			0.3	1.3	1.5	2.0	2.7	3.1	
Contribution from interest rate/growth differential 3/	0.9	3.4	3.4	2.1	1.2			0.3	1.3	1.5	2.0	2.7	3.1	
Of which: contribution from real interest rate	3.2	5.0	3.7	3.5	3.7			3.9	3.6	3.4	3.9	4.3	4.7	
Of which: contribution from real GDP growth	-2.2	-1.7	-0.3	-1.4	-2.6			-3.5	-2.3	-1.8	-1.8	-1.6	-1.6	
Other identified debt-creating flows	-2.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	-2.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 4/	5.9	-1.5	3.6	-2.1	-1.9			4.0	-4.7	-0.3	-0.1	0.0	0.0	
Public sector debt-to-revenue ratio 1/	251.4	240.9	271.8	278.5	282.4			320.2	282.3	281.4	288.6	300.1	314.5	
Gross financing need 5/	7.3	6.2	8.6	12.3	10.4			11.1	7.0	8.9	7.6	10.4	8.7	
in billions of U.S. dollars	841.9	722.8	1009.6	1514.6	1336.4			1,533.6	1,016.1	1,354.1	1,221.4	1,726.6	1,493.6	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	4.0	2.7	0.6	2.2	4.3	3.5	2.3	6.0	3.5	3.0	3.0	2.5	2.5	3.4
Average nominal interest rate on public debt (in percent) 6/	6.4	7.0	7.4	6.8	7.2	6.0	1.7	7.8	7.4	7.8	8.0	8.3	8.6	8.0
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	5.6	8.3	6.4	5.6	6.2	5.2	2.5	6.6	5.6	5.6	6.4	6.9	7.3	6.4
Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	0.8	-1.3	1.0	1.2	1.0	0.8	1.2	1.2	1.8	2.1	1.6	1.4	1.3	1.6
Growth of real primary spending (deflated by GDP deflator, in percent)	-1.1	-1.4	3.5	3.5	7.7	3.1	9.6	1.2	2.0	3.2	4.4	3.4	3.4	2.9
Primary deficit	-2.4	-3.6	-2.0	-1.0	0.3	-2.1	1.5	0.5	-1.1	-1.2	-0.8	-0.5	-0.2	-0.5
									II. Stress Tests for Public Debt Ratio					**Debt-stabilizing Primary Balance 8/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 7/								**68.1**	**62.4**	**60.9**	**59.7**	**58.5**	**57.3**	**0.9**
A2. No policy change (constant primary balance) in 2005-09								**68.1**	**65.2**	**67.0**	**69.5**	**72.9**	**76.7**	**3.5**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**68.1**	**66.6**	**69.7**	**71.1**	**73.6**	**76.8**	**3.5**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**68.1**	**67.7**	**72.7**	**76.2**	**81.0**	**86.5**	**4.0**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**68.1**	**65.7**	**67.8**	**69.2**	**71.7**	**74.8**	**3.4**
B4. Combination of B1-B3 using one standard deviation shocks								**68.1**	**67.0**	**70.3**	**71.8**	**74.3**	**77.6**	**3.5**
B5. 10 percent of GDP increase in other debt-creating flows in 2005								**68.1**	**73.7**	**74.0**	**75.5**	**78.3**	**81.7**	**3.7**

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ For projections, this line includes exchange rate changes.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 6. Panama: External Debt Sustainability Framework Based on Active Scenario, 1999–2009
(In percent of GDP, unless otherwise indicated)

	Actual							Est.	Projections					
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
									I. Projections based on active scenario					**Debt-stabilizing Non-interest Current Account 5/**
1 **External debt**	48.6	48.2	53.0	51.7	50.6			**52.6**	**49.5**	**47.8**	**45.8**	**43.7**	**40.8**	**-2.5**
2 Change in external debt	-0.3	-0.4	4.8	-1.3	-1.2			2.1	-3.1	-1.7	-2.0	-2.1	-2.9	
3 Identified external debt-creating flows (4+8+9)	5.1	0.1	3.6	-1.9	-4.6			-2.2	-4.6	-5.8	-6.1	-6.2	-6.6	
4 Current account deficit, excluding interest payments	7.3	2.8	-2.0	-3.2	-0.3			-1.9	-2.5	-3.4	-3.7	-3.9	-4.2	
5 Deficit in balance of goods and services	5.6	2.5	-1.7	0.5	-1.1			-2.5	-3.0	-4.0	-4.7	-4.9	-5.1	
6 Exports	28.6	30.6	30.6	29.3	30.3			32.4	33.0	33.6	34.1	34.2	34.5	
7 Imports	34.2	33.1	28.9	29.8	29.3			29.9	30.0	29.6	29.4	29.4	29.4	
8 Net nondebt creating capital inflows (negative)	-2.8	-5.2	2.9	-0.4	-5.7			-0.7	-3.4	-3.4	-3.4	-3.3	-3.4	
9 Automatic debt dynamics 1/	0.6	2.5	2.7	1.6	1.3			0.4	1.3	0.9	1.0	1.0	1.0	
10 Contribution from nominal interest rate	2.9	3.2	3.5	3.7	3.7			3.8	4.0	3.9	3.7	3.5	3.3	
11 Contribution from real GDP growth	-1.8	-1.3	-0.3	-1.1	-2.1			-2.8	-1.7	-1.9	-1.8	-1.7	-1.7	
12 Contribution from price and exchange rate changes 2/	-0.4	0.6	-0.5	-0.9	-0.2			-0.6	-0.9	-1.1	-0.9	-0.8	-0.7	
13 Residual, incl. change in gross foreign assets (2-3)	-5.4	-0.4	1.2	0.6	3.5			4.2	1.5	4.1	4.1	4.1	3.6	
External debt-to-exports ratio (in percent)	169.8	157.6	173.4	176.6	166.6			162.3	150.2	142.1	134.5	127.8	118.2	
Gross external financing need (in millions of U.S. dollars) 3/	1572.8	1080.5	709.3	1007.2	729.5			878.2	400.3	785.6	216.2	790.3	26.4	
In percent of GDP	13.7	9.3	6.0	8.2	5.7			6.4	2.8	5.1	1.3	4.6	0.1	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.9	2.7	0.6	2.2	4.3	3.5	2.1	6.0	3.5	4.0	4.0	4.0	4.0	4.3
GDP deflator in US dollars (change in percent)	0.8	-1.3	1.0	1.7	0.5	1.0	1.3	1.2	1.8	2.4	1.9	1.7	1.7	1.8
Nominal external interest rate (in percent)	6.1	6.6	7.4	7.2	7.5	5.8	1.8	8.2	7.9	8.4	8.2	8.1	8.1	8.2
Growth of exports (U.S. dollar terms, in percent)	0.5	8.5	1.6	-0.5	8.6	4.1	6.6	14.6	7.1	8.6	7.3	6.4	6.6	8.4
Growth of imports (U.S. dollar terms, in percent)	0.0	-1.8	-11.3	7.4	2.8	3.7	7.0	9.4	5.6	5.1	5.2	5.8	5.8	6.2
Current account balance, excluding interest payments	-7.3	-2.8	2.0	3.2	0.3	-1.3	3.8	1.9	2.5	3.4	3.7	3.9	4.2	3.2
Net nondebt creating capital inflows	2.8	5.2	-2.9	0.4	5.7	4.9	5.0	0.7	3.4	3.4	3.4	3.3	3.4	2.9
									II. Stress Tests for External Debt Ratio					**Debt-stabilizing Non-interest Current Account 5/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 4/								**52.6**	**51.2**	**52.5**	**53.8**	**55.3**	**56.2**	**-4.2**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**52.6**	**50.2**	**49.0**	**47.0**	**45.0**	**42.1**	**-2.4**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**51.7**	**52.5**	**50.7**	**48.9**	**46.1**	**-2.6**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**51.3**	**51.7**	**49.8**	**47.9**	**45.1**	**-2.6**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**60.9**	**71.6**	**70.1**	**68.6**	**66.2**	**-1.9**
B5. Combination of B1-B4 using one standard deviation shocks								**52.6**	**59.1**	**68.7**	**66.9**	**65.0**	**62.2**	**-2.3**

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 0) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 7. Panama: External Debt Sustainability Framework Based on Low-Case Scenario, 1999–2009

(In percent of GDP, unless otherwise indicated)

	Actual							Est.	Projections					
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
								I. Projections based on low-case scenario						**Debt-stabilizing Non-interest Current Account 5/**
1 **External debt**	48.6	48.2	53.0	51.7	50.6			**52.6**	**49.5**	**50.3**	**52.1**	**54.8**	**58.2**	**-2.2**
2 Change in external debt	-0.3	-0.4	4.8	-1.3	-1.2			2.1	-3.1	0.8	1.8	2.8	3.4	
3 Identified external debt-creating flows (4+8+9)	5.1	0.1	3.6	-1.9	-4.6			-2.2	-4.6	-4.9	-4.4	-3.6	-3.1	
4 Current account deficit, excluding interest payments	7.3	2.8	-2.0	-3.2	-0.3			-1.9	-2.4	-2.6	-2.1	-1.5	-0.9	
5 Deficit in balance of goods and services	5.6	2.5	-1.7	0.5	-1.1			-2.5	-3.0	-3.9	-4.4	-4.5	-4.5	
6 Exports	28.6	30.6	30.6	29.3	30.3			32.4	33.0	33.6	33.9	34.0	34.2	
7 Imports	34.2	33.1	28.9	29.8	29.3			29.9	30.0	29.6	29.5	29.5	29.6	
8 Net nondebt creating capital inflows (negative)	-2.8	-5.2	2.9	-0.4	-5.7			-0.7	-3.4	-3.3	-3.0	-2.8	-2.6	
9 Automatic debt dynamics 1/	0.6	2.5	2.7	1.6	1.3			0.4	1.1	1.0	0.8	0.8	0.4	
10 Contribution from nominal interest rate	2.9	3.2	3.5	3.7	3.7			3.8	3.8	3.4	3.1	2.7	2.4	
11 Contribution from real GDP growth	-1.8	-1.3	-0.3	-1.1	-2.1			-2.8	-1.7	-1.4	-1.4	-1.3	-1.3	
12 Contribution from price and exchange rate changes 2/	-0.4	0.6	-0.5	-0.9	-0.2			-0.6	-0.9	-1.0	-0.8	-0.7	-0.7	
13 Residual, incl. change in gross foreign assets (2-3)	-5.4	-0.4	1.2	0.6	3.5			4.2	1.5	5.6	6.2	6.3	6.5	
External debt-to-exports ratio (in percent)	169.8	157.6	173.4	176.6	166.6			162.3	150.2	149.8	153.7	161.3	170.4	
Gross external financing need (in millions of U.S. dollars) 3/	1572.8	1080.5	709.3	1007.2	729.6			878.2	400.3	831.8	358.5	1054.1	444.5	
In percent of GDP	13.7	9.3	6.0	8.2	5.7			6.4	2.8	5.4	2.2	6.3	2.6	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.9	2.7	0.6	2.2	4.3	3.5	2.1	6.0	3.5	3.0	3.0	2.5	2.5	3.4
GDP deflator in US dollars (change in percent)	0.8	-1.3	1.0	1.7	0.5	1.0	1.3	1.2	1.8	2.1	1.7	1.3	1.3	1.6
Nominal external interest rate (in percent)	6.1	6.6	7.4	7.2	7.5	5.8	1.8	8.2	7.6	7.3	6.4	5.4	4.6	6.6
Growth of exports (U.S. dollar terms, in percent)	0.5	8.5	1.6	-0.5	8.6	4.1	6.6	14.6	7.1	7.0	5.7	4.2	4.4	7.2
Growth of imports (U.S. dollar terms, in percent)	0.0	-1.8	-11.3	7.4	2.8	3.7	7.0	9.4	5.6	4.0	4.1	4.1	4.2	5.2
Current account balance, excluding interest payments	-7.3	-2.8	2.0	3.2	0.3	-1.3	3.8	1.9	2.4	2.6	2.1	1.5	0.9	1.9
Net nondebt creating capital inflows	2.8	5.2	-2.9	0.4	5.7	4.9	5.0	0.7	3.4	3.3	3.0	2.8	2.6	2.7
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing Non-interest Current Account 5/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 4/								**52.6**	**51.2**	**54.0**	**57.3**	**60.8**	**64.5**	**-4.1**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**52.6**	**50.4**	**52.1**	**54.0**	**56.7**	**60.1**	**-2.2**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**51.7**	**54.6**	**56.7**	**59.8**	**63.6**	**-2.4**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**51.3**	**54.1**	**56.2**	**59.3**	**63.0**	**-2.4**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**52.6**	**60.7**	**73.1**	**75.3**	**78.4**	**81.9**	**-2.0**
B5. Combination of B1-B4 using one standard deviation shocks								**52.6**	**59.1**	**70.5**	**72.6**	**75.9**	**79.6**	**-2.3**

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 0) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Statement by the IMF Staff Representative
March 23, 2005

This statement contains information that has become available since the staff report was issued on March 9, 2005. The information does not change the thrust of the staff appraisal.

1. Real GDP grew 6.2 percent in 2004, according to preliminary data, slightly above the staff estimate presented in the staff report (6 percent).

2. Consumer price inflation during 2004 was 1.5 percent, compared with the staff estimate of 2 percent.

3. The unemployment rate for 2004 (based on household survey data for August) was 11.8 percent, down from 13.5 percent in 2002.

4. The deficit of the nonfinancial public sector in 2004 was in line with the staff report estimate (5 percent of GDP, excluding the Panama Canal Authority). Expenditure on a cash basis was about 0.4 percentage point of GDP higher than estimated, reflecting substantial progress in reducing the outstanding stock of payables near the end of 2004. Revenue exceeded the staff's estimate also by 0.4 percentage point of GDP, owing to increased transfers from the Canal Authority to the central government of canal fees and dividends. The nonfinancial public sector deficit, including the Canal Authority, was 4 percent of GDP.

5. Staff is reviewing the coherence of preliminary data on the 2004 balance of payments, which suggests that the current account may have substantially exceeded the level estimated in the staff report. In particular, according to the preliminary data, the Colon Free Zone, which provides transshipment services, registered a large drop in net exports in 2004, despite a rapid growth of income.

INTERNATIONAL MONETARY FUND
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EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes Article IV Consultation with Panama

On March 23, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Panama.[1]

Background

For the second consecutive year, real GDP growth was strong. In 2004, real GDP grew about 6 percent led by a boom in construction (stimulated by temporary tax incentives) and by export-oriented services (in particular the Colon Free Zone and ports). Unemployment declined modestly in 2004, despite high real GDP growth. Though 2004 was a year of high oil prices, inflation remains low as has been traditional in Panama.

The nonfinancial public sector deficit (excluding the Panama Canal Authority) increased slightly, to 5 percent of GDP in 2004 from 4.7 percent in 2003. The new administration took revenue and expenditure measures starting in September 2004 to contain the deficit. Aspects of fiscal accounting methods were also reviewed to improve fiscal transparency.

The banking system experienced a second year of recovery, after the financial markets turmoil in financial markets in South America during 2002. Domestic deposits rose by 9 percent and nonresident deposits remained stable in 2004. Domestic credit to the private sector grew

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

9 percent in 2004 because of rapid growth of credit in commerce and mortgages fuelled by the economic expansion.

The financial system remains sound. Nonperforming loans ratios averaged 2 percent and capital adequacy ratios were 19 percent at end-September 2004. Liquidity remains ample despite pressures on the liquidity of the National Bank of Panama resulting from increased credit to the government and a reduction in deposits from the social security fund.

Panama remains focused on concluding free trade agreements. After reaching agreements with Taiwan and El Salvador, Panama is now pursuing negotiations with the United States, Costa Rica, and Nicaragua. Negotiations with the United States are at an advanced stage.

In 2005, GDP growth is likely to slow down. Construction sector activity will decelerate, though the level of activity will remain high because tax incentives were extended until end-2005. The ontribution to growth from the external sector, though positive, is likely to be smaller than in 2004 as a result of a less favorable, though still positive, external environment. The administration is committed to reducing the nonfinancial public sector deficit in 2005. Inflation is expected to remain low.

Executive Board Assessment

Executive Directors welcomed Panama's strong economic growth performance, which has helped lower unemployment in a setting of continued low inflation. Noting the progress made in reducing extreme poverty, Directors encouraged the authorities to continue with the development of a well-targeted program for rural poverty reduction and the achievement of the Millennium Development Goals. Directors commended the authorities' emphasis on fiscal discipline and transparency in their economic program, and concurred that fiscal deficit reduction and the related improvement in public debt dynamics are key for sustaining economic growth and lowering poverty. They noted that, in moving forward, the main challenges are to strengthen government finances and to restore the long-term viability of the public pension system, while fostering medium-term growth prospects by enhancing the competitiveness of the private sector.

Directors commended the authorities' commitment to strengthening the fiscal position, as reflected in the budget for 2005 and in the recently adopted fiscal reform. They supported envisaged reductions in current expenditure and the recently adopted reforms to the tax system, which could underpin a stronger-than-targeted fiscal performance in 2005. In this regard, Directors encouraged the authorities to make use of stronger-than-budgeted revenues to further reduce unpaid bills to domestic suppliers.

Directors welcomed the emphasis of the fiscal reform on equity considerations, and the focus of the tax reform on increasing the buoyancy of tax collections and enhancing its efficiency. They concurred that the focus of the authorities' fiscal program on expenditure restraint appropriately targets overstaffing and improved efficiency in other spending areas, including public investment.

Directors commended the authorities' efforts to launch an information campaign on the reform of social security. They noted that, given the fundamental imbalance between pension contributions and benefits, substantial efforts will be necessary to restore long-term equilibrium to the public pension system. Directors agreed with the importance of the authorities' actions to improve portfolio management and eliminate inefficiencies of the social security system.

Directors, observing that the fiscal responsibility law had not functioned well, recommended that revisions incorporate procedural as well as numeric rules, and emphasized that the revised rules be well-defined, transparent, and supported by sound policies. In this context, Directors agreed that the presentation of fiscal accounts both excluding and including the accounts of the Panama Canal Authority is appropriate, and they welcomed the authorities' decision to assess fiscal transparency practices through a fiscal ROSC.

Directors commended the soundness of Panama's financial system. They observed that the expansion of regional banking heightens the need for effective supervision, and supported the efforts of the Superintendency of Banks to enhance coordination across countries in the region. Directors encouraged the authorities to strengthen governance in the National Bank of Panama and the Savings Bank. The business plans for these banks should be based on sound commercial banking practices and include mechanisms to ensure that the National Bank's credit to the government remains short-term in nature.

Directors noted the importance of strengthening the competitiveness of the export-oriented service sector for Panama's medium-term outlook. They welcomed Panama's commitment to further integration with the regional and global economy and observed that the prospective free trade agreement with the United States could help attract foreign direct investment by providing greater assurance of a stable legal framework, and stimulate resources to move to the more productive sectors of the Panamanian economy. Directors supported the authorities' strategy for fostering greater competitiveness and productivity by strengthening the business climate, streamlining business procedures, and enhancing the quality of human capital through sustained investment in education. They encouraged the authorities to enhance labor market flexibility by extending flexible employment practices from the special economic zones to other sectors.

Directors welcomed the authorities' emphasis on good governance and supported their efforts to fight corruption. They encouraged the authorities to adopt an integrated approach to addressing governance problems, including in the civil service and in government procurement. Directors noted that the Panama Canal Authority could potentially provide an anchor for institution building, and noted that a prospective expansion of the canal, if approved in a referendum and well-managed, could yield important benefits for the Panamanian economy. In view of the project's prospectively large financing costs, Directors supported the authorities' aim of minimizing fiscal risks, in particular by ensuring that the Canal Authority is run on a commercial basis.

Directors encouraged the authorities to improve the quality, timeliness and coverage of economic data. They welcomed the authorities' interest in a data ROSC, which would assess strengths and identify weaknesses in economic statistics, and supported the authorities' intention to request a follow-up to the Offshore Financial Center assessment.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Panama: Selected Economic Indicators

	2001	2002	2003	Est. 2004	Proj. 1/ 2005
(Annual percentage change, unless otherwise indicated)					
Real economy					
Nominal GDP	1.6	3.9	4.8	7.4	5.4
Real GDP (1996 prices)	0.6	2.2	4.3	6.2	3.5
Consumer price index 2/	0.0	1.8	0.1	1.5	2.0
Unemployment	14.0	13.5	13.1	11.8	...
Money and credit					
Broad money 3/	9.5	0.9	4.6	8.2	7.0
Credit to private sector	8.1	-7.2	2.0	10.7	8.0
Deposit rate (6-month)	5.5	3.8	3.6	2.2	...
(In percent of GDP, unless otherwise indicated)					
Savings and investment					
Gross domestic investment	19.4	18.0	21.5	22.0	20.6
National savings	17.9	17.5	18.0	20.0	19.1
External savings	1.5	0.5	3.4	2.0	1.5
External sector					
Current account	-1.5	-0.5	-3.4	-2.0	-1.5
Capital and financial account	7.5	3.0	1.3	3.0	1.9
Real effective exchange rate (depreciation –) 4/	-1.4	-0.1	-6.5	-0.7	...
External public debt	53.0	51.7	50.5	52.6	49.5
Nonfinancial public sector					
Revenue and grants	23.8	22.9	22.4	21.3	22.5
Expenditure	26.1	26.2	27.2	26.3	26.2
Balance, excluding Canal Authority	-2.3	-3.3	-4.7	-5.0	-3.6
Canal Authority 5/	0.5	0.5	1.0	1.7	1.5
Balance, including Canal Authority	-1.8	-2.7	-3.8	-3.3	-2.1

Sources: Panamanian authorities; and IMF Staff estimates and projections.

1/ Fund staff projections.
2/ End of period.
3/ Corresponds to cash in circulation plus total private sector deposits in the banking system.
4/ For the year 2004, information is available up to October.
5/ Balance of Canal Authority, after transfers of Canal tolls and distribution of profits to the government.

Statement by Murilo Portugal, Executive Director for Panama and Alfredo N. Maciá, Advisor to Executive Director March 23, 2005

1. Our Panamanian authorities are grateful to the staff for the open policy dialogue with the Fund and for the support to their efforts to maintain macroeconomic stability by strengthening fiscal prudence, moving forward with crucial reforms, and enhancing the investment environment.

2. Economic growth rebounded at over 6 percent of GDP in the first quarter of 2004, a trend that has been largely maintained throughout the year, with real GDP growth reaching 6.2 percent by end-year, compared to 4.1 percent in 2003. This robust economic performance has been broad based resulting from strong construction activity, agricultural exports, tourism and entertainment, the Panama Canal operations, and the Free Zone. Inflation remained subdued despite pressures of higher transport and oil costs, with end-of-year inflation projected at 1.5 percent compared to 1.7 percent at end-2003. According to the 2004 Household Survey, the unemployment rate decreased to 11.8 percent at end-2004, compared to 13.1 percent at end-2003. Prospects for 2005 are favorable, with GDP growth expected to remain well above the last decade's average.

3. Panama's external competitiveness is favorable. The real effective exchange rate has declined with the depreciation of the US dollar; the country has increased its export volumes and expanded its market share in a number of services. While the external current account deficit at end-2004 reached 8 percent of GDP compared to a 4 percent deficit at end-2003, it was almost totally covered by foreign direct investments that reached 7.3 percent of GDP. Exports grew at a faster rate than imports, and the revenues of the Panama Canal Authority (ACP) increased 15.8 percent in FY2004, breaking the one billion dollar level.

Fiscal Policy

4. As it took office on September 1, 2004, the new administration encountered a deteriorated fiscal stance, with the non-financial public sector deficit reaching 5.0 percent of GDP at end-2004. The authorities adopted immediate action to start reversing the fiscal situation, including the non-renewal of personnel contracts, and an immediate expenditure restraint of US$225.8 million. They also developed a plan to gradually reduce unpaid arrears with suppliers.

5. The 2005 budget envisages a fiscal deficit of 3.8 percent of GDP, with stiff controls on current public expenditures. The authorities expressed their commitment to protect outlays for key social sectors and to improve the targeting of subsidies for electricity, water, cooking gas, and preferential interest rates for low-income housing. On investments, the authorities will provide for the continuation of priority infrastructure projects related to water distribution, electricity, and irrigation. The authorities are also going to propose new norms to be included into the Fiscal Responsibility Law to enhance fiscal transparency, provide for clear enforcement of fiscal policy, and promote healthier public finances. The staff

considered the authorities' fiscal policies and targets appropriate and in line with the Fund's recommendations.

6. The public debt level increased to US$9.98 billion at end-December 2004. The authorities have already started to take structural measures to tackle the deteriorated fiscal stance and growing public debt. As mentioned below, a fiscal reform yielding a 1 percent of GDP has been approved, and a social security reform package is under discussion, in addition to the tighter government expenditure controls that have been put in place.

Financial Sector

7. Panama's banking system has remained strong with assets at US$33.2 billion, a 4.5 percent increase compared to 2003, ample liquidity, and high capital levels. The liquid assets to deposit ratio was 42 percent last September. The capital adequacy ratio stood at 18.6 percent, compared to a regulatory required CAR of 8 percent. The return on capital for the banking system was 16.2 percent and the return on assets, at 2.3 percent, was slightly higher than in 2003. Non-performing loans declined to 1.8 percent from 2.7 percent in 2003. Domestic credit has grown steadily, with both foreign private banks and public banks accounting for most of the growth.

8. The SoB has enhanced its consolidated and cross-border supervision of the banking system and is taking steps to move forward on the main issues regarding the Basel II risk requirements so that they are in place by 2008. Banking system surveys are now in progress to evaluate future capital requirements, risk supervision, and the legal framework for adopting the Basel II rules. An MFD mission is to travel to Panama shortly to complete a Model 2 OFC review. The mission will look into the AML/FT, the insurance sector legislation, and the domestic stock market framework vis-à-vis international standards.

Structural Reforms

9. The Torrijos administration announced on January 12, 2005 an overall fiscal reform package. By February 2, the legislature approved Law no. 6 (explained in Box 1), an equitable fiscal law that calls for fiscal discipline by the government and increased revenues to be paid by the private sector. Public payroll is to be scaled down by early 2008 to a range of about 165-170 thousand from the existing over 180 thousand taking into account exceptions in health, education and security services. The fiscal law also imposes ceilings on current expenditures, professional service contracts and, amongst other measures, reduces by 60 percent the number of vacancies within the next three years. The new law increases operating fees, eliminates the industrial incentive law of 2004, and the exports incentives certificates (CAT's), which will expire at end-2005. It also limits tax breaks on donations, while taxing a share of Panamanians' foreign income. It widens the income tax base including in it representation expenses, and envisages an anticipated withholding tax of 10 percent. Implementation of the representation expenses measure took place last February; the Free Zone new operating fees will take effect in June of 2005; and other tax measures in January 2006. The revenues to GDP ratio are expected to increase to 15.4 percent from the

present 14.6 percent level. Strong fiscal discipline and the prospect of a social security (SS) reform may bring the investment grade up on Panama's sovereign rating.

10. Consultations aimed at a social security reform started in mid-2001 under the UNDP sponsorship and were previously discussed during the 2003 Article IV consultation. Our authorities are cognizant of the urgency to push forward an overall reform despite the political cost. The reforms may entail changes in contributions, retirement age, services coverage, and in the replacement payments, amongst other issues, in order to ensure the long-term fiscal sustainability of the system. In mid-February, an information campaign about the precarious fiscal situation of the SS system was launched to increase awareness of the population. The reform package, which retains full ownership by the authorities, will reach the legislature as soon as the consultation process is concluded with the civil society and stakeholders.

11. Other important structural reforms aimed at improving Panama's competitive strategy, which already are in their initial stages, include judicial reform, deregulation, governmental restructuring, attracting foreign investments, and promoting exports.

12. Free trade agreements are at the top of the 2005 agenda. Panama is presently negotiating trade agreements with Costa Rica, Mexico, Nicaragua, Singapore, and the United States. In addition, Panama wants access to other markets and has interest in joining the G-3 Group integrated by Mexico, Venezuela, and Colombia. Furthermore, the country has joined Ecuador, Honduras, Guatemala, Costa Rica, Colombia, and Nicaragua on efforts to curb the EU proposed "tariff only" for banana imports to be in effect in January 2006. EU has proposed a US$300 dollar tariff per ton --from the present US$75 per ton-- when the 2.6 million-ton quota system expires. Panama exports 80 percent of its production to the EU and has to compete with the duty-free banana from the Africa, Caribbean, and Pacific group (ACP).

13. The negotiation of a free trade agreement with the United States (US), which started in April 2004 and has gone through eight rounds of talks, will broaden the attraction of US investments into Panama and strengthen the country's growth potential in the medium term. The areas remaining for a ninth and conclusive round of negotiations are agricultural products, access to the Panama Canal procurements, and textiles among others, while most non-agricultural issues have now been settled.

Investment Activity

14. The reverted areas of the Panama Canal keep on attracting large foreign and local investments. The second bridge over the Panama Canal accounting for a US$200 million public investment effort is now in the final conclusion of its access routes. In addition, ACP implemented an investment and maintenance program of nearly US$170 million in 2004. Private investments surged at over US$300 million primarily in the maritime sector, tourism, commercial services and infrastructure. On port facilities, the Panama Ports Company (PPC-Hutchison Wampoa) concluded in 2004 a port expansion at a cost of over US$200 million

that will allow it to service Panamax ships. In addition, the Evergreen and Manzanillo International Terminal (MIT) has upgraded its ports facilities.

15. Other investments outside the Panama Canal reverted areas include a new shopping mall and hotel in Panama City costing US$100 million that are now in service, and the expansion of Tocumen international airport, which began at end-2004. The hydroelectric plant Bayano increased its capacity by 20 percent after a US$40 million investment. In addition, La Fortuna hydroelectric is starting a US$ $225 million expansion program to increase its capacity to 150 megawatts. At end-2004, total electricity production stood at slightly over 5,000 megawatts, with 58 percent produced by hydroelectric plants.

16. In addition to these investments, several mega investment projects are also being considered, which will substantially increase the growth potential of the economy. The most important of these projects is the construction of new sets of locks in the Panama Canal, an approximate investment of over US$4.5 billion. In 2004, the Canal serviced 14,035 ship-crossings, a 6.7 percent increase compared to 2003, with a large portion accounted for by super ships, including Panamax ships. At the present rate of growth in cargo and ship-crossings, the capacity of the canal may be reached by 2012. A referendum is expected to take place late this year to authorize the expansion of the canal, which has an estimated construction time of eight years. Today, the main users of the canal are the U.S., China, Japan, Taiwan, and Chile. The expansion of the Canal will broaden Panama's participation in the regional and global trade through the use of its waterway.

17. In November 2004, President Torrijos signed with President Uribe a Memorandum of Understanding to pursue the construction of a gas pipeline and build an electricity inter-connection between Panama and Colombia. Venezuela is also pursuing an agreement with Panama to interconnect a gas pipeline to the Colombia-Panama project given market demands from China and the U.S. West Coast. The gas pipeline project has an estimated cost of US$200 million and could be in operation in 24 months. The Colombian electricity 300 megawatts interconnection has two alternate routes of 571 km and 514 km costing US$169 million and US$139 million respectively.

18. Venezuela is also considering transporting oil in the trans-Panama oil pipeline (Petroterminales) built in 1982 to transport Alaskan oil, which now operates below its pumping capacity of 860,000 bbl per day. Both countries initiated talks on the gas and oil pipelines in early January 2005.

19. A third mega project under consideration is the construction of a port in the Pacific coast with an investment of US$600 million. Evergreen, Port of Singapore Authority (PSA), China Ocean Shipping Co. (COSCO), Maersk Sealand, and P& O are five of the maritime enterprises interested in the concession.

20. PPC-Hutchinson Wampoa and MIT port operator will invest US$500 million in 2005 for expanding their port facilities in the Atlantic side of the Canal. MIT has already invested US$300 million in its port facilities and PPC-Hutchinson Wampoa has a total investment to date of US$340 million in the Balboa Port located in the Pacific side of the Canal.

Conclusion

21. The challenges of the new administration center around needed reforms to enhance the country's economic growth potential, improve government finances, and strengthen transparency and accountability. There is a strong commitment by the authorities for the zero-tolerance policy on the fight against corruption. An Anti-Corruption Council was established, and audits of specific government institutions are underway to investigate corruption allegations. These are clear steps taken by the Torrijos administration to support its anti-corruption policy. In addition, the new administration has sent the UN Convention Against Corruption to the Legislature for approval. Our authorities are aware of the need to further enhance the private sector environment and pursue policies to strengthen foreign investments. The President has announced the reactivation of the "Compete Panama" program, in partnership with the IDB, to reduce the red tape to the establishment of new businesses, thereby enhancing business creation, investments, and employment generation. Our authorities would like to state their strong determination to improving social conditions for the poor and the most vulnerable groups, supported by the strong political mandate of the May 2004 elections.