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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

PROPOSED ECONOMIC RECOVERY LOAN (ERL)

OF US$120 MILLION

TO THE

REPUBLIC OF PANAMA

JANUARY 30, 1992

Public Disclosure Authorized

CURRENCY EQUIVALENT

Currency Unit = Balboa (B/.)
US$1 = B/.1

Note: The issue of Balboas is restricted to coins. The U.S. dollar (US$) is accepted as de facto legal tender.

Fiscal Year

January 1 - December 31

WEIGHTS AND MEASURES

Metric System

GLOSSARY OF ABBREVIATIONS

APN	-	Autoridad Portuaria Nacional (National Port Authority)
BDA	-	Banco de Desarrollo Agrícola (Agricultural Development Bank)
BHN	-	Banco Hipotecario Nacional (National Mortgage Bank)
BLADEX	-	Banco Latinoamericano de Exportaciones (Latin American Export Bank)
BNP	-	Banco Nacional de Panamá (National Bank of Panama)
CA	-	Caja de Ahorros (Savings Bank)
CACM	-	Central American Common Market
CBN	-	Comisión Bancaria Nacional (National Banking Commission)
CCFF	-	Compensatory and Contingency Financing Facility
CEM	-	Country Economic Memorandum
CFZ	-	Colon Free Zone
CIF	-	Cost, Insurance, and Freight
CIT	-	Corporate Income Tax
COBANA	-	Compañía Bananera Nacional (National Banana Company)
COBAPA	-	Corporacíon Bananera del Pacífico (Pacific Banana Corporation)
CSS	-	Caja de Seguro Social (Social Security Agency)
EEC	-	European Economic Community
ERL	-	Economic Recovery Loan
ESW	-	Economic and Sector Work
FMP	-	IMF-Monitored Program
FOB	-	Free-On-Board
ICB	-	International Competitive Bidding
ICOR	-	Incremental Capital-Output Ratio
IDAAN	-	Instituto de Acueductos y Alcantarillados Nacionales (National Water and Sewerage Institute)
IDB	-	Inter-American Development Bank
IFARHU	-	Instituto para el Fomento y Adiestramiento de los Recursos Humanos (Human Resources Development Institute)
IFI	-	International Financial Institution

GLOSSARY OF ABBREVIATIONS (continued)

IMA	-	Instituto de Mercadeo Agropecuario (Agricultural Marketing Institute)
IMF	-	International Monetary Fund
INTEL	-	Instituto Nacional de Telecomunicaciones (National Telecommunications Institute)
IPAT	-	Instituto Panameño de Turismo (Panamanian Tourism Institute)
IRHE	-	Instituto de Recursos Hidroeléctricos y Electrificación (Hydroelectric and Electric Energy Resources Institute)
ISA	-	Instituto de Seguro Agrícola (Agricultural Crop Insurance Institute)
LRMC	-	Long-Run Marginal Cost
MICI	-	Ministerio de Comercio e Industria (Ministry of Commerce and Industry)
MIDA	-	Ministerio de Desarrollo Agropecuario (Ministry of Agriculture and Livestock Development)
MIPPE	-	Ministerio de Planificación y Política Económica (Ministry of Planning and Economic Policy)
MIVI	-	Ministerio de Vivienda (Ministry of Housing)
MOH	-	Ministerio de Salud (Ministry of Health)
OECF	-	Overseas Economic Cooperation Fund of Japan
ORP	-	Oficina de Regulación de Precios (Price Regulation Office)
PIT	-	Personal Income Tax
PSE	-	Public Sector Enterprises
REFPAN	-	Refinería de Panamá, S.A. (Refinery of Panama, Inc.)
SAL	-	Structural Adjustment Loan
SECAL	-	Sectoral Adjustment Loan
SITC	-	Standard International Trade Classification
SOE	-	Statement of Expenditures
UNDP	-	United Nations Development Program
USAID	-	U.S. Agency for International Development
VAT	-	Value-Added Tax

TABLE OF CONTENTS

PANAMA

LOAN AND PROGRAM SUMMARY

Borrower:	Republic of Panama
Amount:	US$120 million equivalent
Terms:	Standard IBRD terms with repayments in 17 years and 5 years of grace.
Executing Agency:	Ministry of Planning and Economic Policy (MIPPE).
Description:	The proposed loan would support the Government's Economic Recovery Program, which is designed to: (i) encourage sustained economic growth by raising public investment, and by increasing private sector efficiency through trade and tax reforms; and (ii) help stabilize public sector finances by reducing the public wage bill and eliminating the social security system's cash deficit in no more than 10 years.
Benefits:	Implementation of the Economic Recovery Program would promote economic growth by ensuring stabilization of public finances, and by increasing the efficiency of the private sector through trade reform and of the public sector through public sector reform. It would also increase employment opportunities in the private sector and help alleviate poverty. In addition, it would facilitate the flow of external financing and foreign investment.
Risks:	The principal risks are weaknesses in institutional capacity to implement the program, and possible opposition by interest groups to trade reform and to retrenchment in public employment.
Disbursements:	The proceeds of the loan would be disbursed in three tranches of US$60 million, US$25 million and US$33.2 million, respectively, as follows: the first tranche upon effectiveness (with retroactive financing of up to US$60.2 million for eligible imports made after September 1, 1990), the second tranche after a satisfactory performance review expected in the third quarter of 1992, and the third tranche after a satisfactory performance review expected in July 1993. In addition, US$1.8 million for technical assistance would be available upon loan effectiveness.
Appraisal Report:	This is a combined staff appraisal and President's Report.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE IBRD
TO THE EXECUTIVE DIRECTORS ON
A PROPOSED ECONOMIC RECOVERY LOAN
TO THE REPUBLIC OF PANAMA

1. I submit the following report and recommendation on a proposed Economic Recovery Loan (ERL) in the amount of US$120 million to the Republic of Panama. The loan would be on standard IBRD terms, with repayment in 17 years, and a 5-year grace period. The loan would support the Government's economic recovery program, which aims to achieve economic stabilization and renewed sustainable economic growth. This would be the first loan to Panama since 1986. The proposed operation would be cofinanced by the Inter-American Development Bank (IDB), and the Japanese Government aid agency (OECF), with US$120 million and US$100 million, respectively.

PART I
THE ECONOMY AND BANK ASSISTANCE STRATEGY

2. The assessment of the Panamanian economy in this report draws on the work of the February 1991 pre-appraisal, the June 1991 appraisal, and the October 1991 and January 1992 post-appraisal missions for the proposed ERL. Annex II presents economic data. This report outlines the Government's economic adjustment program -- a program that should create substantial benefits but that, given Panama's changing domestic political situation, also involves high risks.

A. BACKGROUND

3. After a period of economic and political upheaval, the Government of Panama aims to return the country to a path of sustained economic growth. Traditionally, Panama's location has been important to its economic development. Strategically situated on the narrow isthmus joining North and South America and midway between Europe and Asia, Panama was an important center for Spanish colonial trade for more than two centuries. Construction of the Panama Canal early in this century provided an important source of income, employment, and economic growth until the early 1970s. Capitalizing on their location and international transport facilities, Panamanians built an important export-oriented service sector. The main areas of expansion in the late 1970s and the early 1980s were tourism, international trade, and international banking. During the 1970s, the banking sector grew by 11 percent a year. By 1980, about 130 commercial banks were established in Panama, including subsidiaries of most leading international financial institutions. The activities of the Colon Free Trade Zone -- warehousing, displaying, and transshipping merchandise mainly to markets in Latin America -- also grew significantly in the 1970s and 1980s.

4. Growth of export-oriented services has been facilitated by Panama's unique financial characteristics. Panama has no central bank, the U.S. dollar is de facto legal tender, and there is no restriction on the movement of

capital. Because of the dollar standard, there is no foreign exchange constraint in the conventional sense, so the country's creditworthiness is linked directly to public sector finances.

5. Over the past two decades, Panamanian administrations managed the economy through increasingly interventionist policies. These interventions included heavy protection of industry and agriculture, the introduction of a rigid labor code in 1972, the nationalization of private utility companies, and the creation of many public enterprises. The country cannot devalue its currency, since the U.S. dollar is the de facto legal tender, so the inflexibility of prices for goods and services that was created through state intervention reduced economic efficiency, decreased Panama's international competitiveness, and restrained growth potential, including export growth. The incentive system encourages activities in which Panama does not have a comparative advantage. The result has been production of high-priced goods and services and reduced ability to provide employment to a growing labor force. Moreover, the vested interests that resulted from this web of distortions created a strong lobby against reform.

6. Other factors have reduced growth potential and have increased financial and economic imbalances. First, the tax system discourages private investment, work, and savings, and encourages tax evasion. Second, financial imbalances in the social security system have become more severe over the years and high payroll taxes have discouraged employment. Third, the low level of public investment, especially in infrastructure (such as transport, energy, and social services), has made it difficult to resume sustained economic growth. Fourth, the technical insolvency of most public banks crowds out financing for private investment. Finally, prudential regulations are outdated and banking supervision is weak, which makes it difficult for the National Banking Commission to effectively supervise the financial system.

7. Paradoxically, Panama's monetary regime requires great price and wage flexibility to effect adjustments, but existing rigid price controls, labor laws, and other public sector interventions prevent mobility of resources. In the past, the resulting high unemployment was usually absorbed by the expanding public sector. In the 1970s, for example, the public sector created 70 percent of all new jobs. The high cost of excessive public employment and public sector inefficiency was passed on to the private sector in the form of high user charges and the reduced ability to finance needed infrastructure investments. The costs of industrial inputs increased, reducing the number of jobs available and eroding Panama's international competitiveness.

8. After 1982, the country's debt burden continued to mount as economic growth slowed. Major structural issues remained unaddressed, and public spending and the size of the public sector continued to expand. After the economic recovery of 1984-87, a major confrontation with the United States in 1988-89 sharply reduced revenue from the Canal and from U.S.-owned corporations. As a result, the Government reduced public spending and arrears on the public debt, and Panama experienced a major recession between 1987 and 1989. Unemployment climbed to over 20 percent. Domestic inflation was kept

at historically low levels (in the -0.2 percent to 4.2 percent range during 1982-90), however, because the U.S. dollar continued to be used as de facto legal tender.

B. DEVELOPMENTS IN 1989-91

9. The new government that came to power after the U.S. military action of December 1989 has made efforts to eliminate the corruption prevalent under the prior regime. It established a new police force to restore law and order and has undertaken a major fiscal adjustment. The public sector deficit was reduced from 11.5 percent of the gross domestic product (GDP) in 1989 to 3 percent in 1990 and 2.7 percent in 1991. The Government also focused on resuming payment of the arrears on the public domestic debt. Since April 1990, debts falling due to the international financial institutions (IFIs) have been paid. Arrears to IFIs (i.e., IBRD, IMF, and IDB) are being cleared (see para. 29), and discussions have begun on the rescheduling of debts to bilateral creditors and to money center commercial banks. By the end of December 1991, the Government had made payments totaling US$471 million to the three IFIs, including US$153.5 million to the Bank. Economic assistance from the United States has included US$50 million in emergency assistance to repair damage caused by the military action. After providing emergency assistance, the U.S. Agency for International Development (USAID) approved an aid package of US$420 million. The aid will finance public investment and technical assistance to the Government, supply credit to the private sector, and support the clearance of arrears to the three IFIs.

10. Progress has been slow on preparation and implementation of structural adjustment measures. The Government had to develop a domestic policy agenda while introducing initial measures to stabilize the economy. Priority was given to establishing law and order after the U.S. military action and subsequent incidence of looting, and to building a foundation for the democratic system now in place. Frustrated government efforts to find a national consensus for the reform proposals have prolonged the design and implementation of a stabilization and a structural adjustment program. Panama's President asked the Christian Democratic Party to leave the Government in late March 1991, and the remaining two-party coalition does not have a congressional majority. Nevertheless, the Christian Democrats have been generally supportive of the Government's reform program, including the recent approval by the National Assembly of key pieces of adjustment legislation, such as a tax reform law and a comprehensive social security reform law (see paras. 63 and 95).

C. RECENT MACROECONOMIC PERFORMANCE

11. In 1988 and 1989, real GDP declined by a total of 16.3 percent. Real output fell below the 1980 level, and real per capita output fell below that of 1978. The reduction of output reflected not only the impact of U.S. economic sanctions but also the deep structural distortions and economic disruptions experienced by the previous government. The poor policies of

previous administrations exacerbated the decline. Neglect of maintenance and reduced investment, especially for infrastructure, caused the country's capital stock to deteriorate. However, the economy started to recover in 1990, with a real output growing by 3.4 percent. This trend continued through 1991, with an estimated real GDP growth of 4.5 percent, because of increased use of excess capacity in the economy. Construction, growing at 24 percent after the reactivation of projects halted during the previous two years, provided the main source of stimulus in 1990. Construction continued to grow in 1991. The level of activity was about 30 percent below the 1987 level. In 1990, manufacturing expanded 7.2 percent and commerce by 9.4 percent, mainly through inventory replenishment. Agricultural growth reached 3.3 percent. Banana and sugar production -- the latter reflecting reinstatement of the U.S. quota -- increased by 10.7 percent and 6.1 percent, respectively. In 1990, the activities of the Colon Free Trade Zone grew by 15 percent, as economic conditions in parts of Latin America (the zone's main client) improved. Oil pipeline revenues fell, however, and government services and canal-related activities stagnated.

12. As a result primarily of private investment recovery, total investment jumped from 2.6 percent of GDP in 1989 to 16.3 percent in 1990 (Table 1). The replenishment of inventories contributed partly to this increased investment. Public investment rose from 1.3 percent of GDP in 1990 to 2.4 percent in 1991. However, total investment was lower in 1991 than in 1990, as inventory accumulation slowed down. Public consumption in 1991 remained at about the 1990 level of 21.6 percent of GDP.

Table 1: Selected Macroeconomic Variables, 1986-91

Macro Indicators	1986	1987	1988	1989	1990[1]	1991[2]
Real GDP growth rate (%)	3.4	2.3	-15.6	-0.9	3.4	4.5
Real export growth rate (%)	-4.0	-2.0	-9.2	-0.7	1.9	7.7
Real import growth rate (%)	-11.6	0.0	-34.5	14.7	30.7	7.1
Gross domestic investment/GDP (%)	16.7	17.5	6.9	2.6	16.3	14.2
Public investment	4.1	3.6	2.3	1.8	1.3	2.4
Private investment	12.6	13.9	4.6	0.9	15.0	11.8
Current account balance/GDP (%)	0.8	-0.3	7.1	-1.0	-8.7	-6.9
Domestic inflation (%)	0.4	0.9	0.3	-0.2	1.1	1.5

1. Preliminary.
2. Estimated.

Source: Panamanian Controller's Office, IMF, Bank staff estimates.

13. Investment recovery and increased private capital inflows caused a surge in imports in 1990. Imports of goods and nonfactor services reached an estimated 37.3 percent of GDP in 1990, compared to an annual average of 31.2 percent in 1986-87. Expanded banana and sugar exports did not compensate fully for the surge in imports. The resource balance, which recorded a surplus of 9.5

percent of GDP in 1989, declined to a surplus of 1.2 in 1990. As imports have decreased to more normal levels in 1991, the current account deficit -- excluding official transfers -- has declined. The 1990 deficit in the current account of the balance of payments, which was 8.7 percent of GDP, is projected to drop to 6.9 percent in 1992.

14. In 1990, financing of the current account deficit came from official grants (US$183 million), net direct foreign investment (US$54 million), the release of funds blocked by the United States (US$181 million), and the accumulation of arrears owed to international money center commercial banks and bilateral creditors. In 1991, official grants (US$194 million), net direct foreign investment (US$62 million), and the additional accumulation of arrears to international money center commercial banks and bilateral creditors financed the current account deficit. In 1992, projected debt service payments will equal 26.9 percent of exports of goods and services because of sizeable amortization obligations and the payment of arrears to the three IFIs.

D. GOVERNMENT DEVELOPMENT STRATEGY

15. The present Government has undertaken important stabilization measures. First, fiscal adjustment has reduced the public sector deficit significantly from 11.5 percent of GDP in 1989 to 3 percent in 1990 and 2.7 percent in 1991. The Government has complied with the targets of the September 1990 IMF-monitored program, partly by reducing the public wage bill. Second, the Government has designed a realistic public investment program for 1991-93. Third, it has successfully lifted deposit restrictions on the banking system, thus enhancing confidence in the banking system, increasing the liquidity of banks, and permitting an expansion of credit. Moreover, private investment recovered in 1990 and the economy began to grow. The Government was slow, however, in formulating a comprehensive and consistent structural adjustment program. The Ministry of Planning and Economic Policy (MIPPE) prepared a strategy paper for growth and economic modernization in June 1990, which was widely debated in the country. In September 1990, this strategy paper, together with a matrix summarizing policy intentions, was approved by the Cabinet as the Government's policy program. These documents outlined overall policy intentions, but did not indicate specific actions or timing in most areas.

16. The Bank initiated a close dialogue with the authorities soon after the new Government took office, and in 1991 significant progress was made toward defining a structural adjustment program. This program, described in Part II, is based mostly on Government proposals made during a pre-appraisal mission in February 1991. Further progress was achieved during the visit of high level Government officials to Washington in May 1991. Subsequently, the Cabinet unanimously approved an adjustment program that included trade reform, privatization (for example, of the telephone company), reduced public current expenditures, tax reform, and social security reforms. On the basis of this program, appraisal of the ERL took place in June 1991. The Government published its detailed policy program, with a calendar of actions, in October 1991.

17. Implementation of the economic reform program is expected to change the structure of the Panamanian economy significantly in the 1990s. Trade liberalization and improved productivity should increase the country's international competitiveness. The planned changes should also shift the balance of incentives in favor of exportables and importables over nontradables, and should encourage private sector specialization in accordance with Panama's comparative advantage. Public sector reforms aim at ensuring the stabilization of public sector finances, reduced size of the state, decreased public utility prices, and increased efficiency of the public sector.

E. BANK COUNTRY ASSISTANCE STRATEGY

18. Past operations. Since 1953, Panama has received 32 Bank loans totaling US$505.6 million equivalent, net of cancellations. All loans are fully disbursed. The second tranche of Structural Adjustment Loan II (SAL II) was canceled in December 1987, since the Government did not meet agreed conditionality. No new loans have been approved since 1986. To date, the Government has repaid the Bank US$219.5 million equivalent, and has an outstanding obligation of US$505.6 million as of December 31, 1991.

19. Until the early 1980s, the Bank lent actively in several sectors, including power, urban development, ports and other infrastructure, and, to a lesser extent, agriculture and livestock. As the economic and financial situation deteriorated in the early 1980s, Bank support shifted to helping the Panamanian authorities design and implement programs of structural adjustment to reduce the public sector deficit, address economic distortions, and open up the economy. (Table 2 summarizes Bank lending by sector in 1953-86.)

20. The Bank made two structural adjustment loans (SAL I & II) to Panama. Under the Bank's first structural adjustment loan (SAL I 1983, US$60 million) Panama lifted some export restrictions and price controls, shifted from quotas to import tariffs for a variety of industrial goods, privatized one hotel and a sugar mill, and closed a public development bank, among other things. SAL II (1986, US$100 million) aimed at deepening the reforms started under SAL I. A number of import quotas were removed, the agricultural marketing agency's functions were downscaled, five public sector entities were closed or privatized, the Labor Code was modified, and public employment was reduced. Because of failure to reform the social security system, back-tracking in trade reform, and general deterioration in economic management, the second tranche of SAL II was not released. The design of the ERL benefitted from the analysis of failure of the SAL II operation. Specifically, passage of key pieces of legislation, including social security reform and tax reform, and key actions on trade reform were made Board conditions. When disbursements were suspended (November 1987), Panama's total outstanding debt to the Bank was US$470 million, with arrears equal to about US$217 million. By mid-January 1992, arrears payable to the three IFIs were US$657.8 million (of which US$254.6 million to the IMF, US$225.8 million to the Bank, and US$172.6 million to IDB), including US$57 million owed from the first quarter of 1990. Arrears to IFAD totalled US$4.8 million. Total arrears on debt payments, including those to international money center commercial banks, amounted to about US$3.5 billion at end 1991.

Table 2: Bank Lending by Sector, 1953-86[1/]

Sectors	Amount (US$ million)	Distribution (percent)	Number of projects
Energy	187.2	37	9
Transport	97.8	19	7
Water/urban	50.1	10	3
Agriculture and fishing	35.0	7	8
Credit operations	21.0	4	2
Structural adjustment	114.5	23	3
Total	505.6	100	32

1/ Disbursed amounts.

21. Country assistance strategy. The Bank's strategy for Panama aims to help the country implement policies to open up the economy, reduce the size of the state, and increase efficiency. In this respect, future Bank assistance to Panama depends on successful implementation of the proposed ERL. The instruments of the World Bank assistance strategy for 1992-96 include lending (both policy-based and project assistance) and economic and sector work (ESW). Beyond the proposed ERL, the Bank's lending strategy would help Panama to continue its medium-term reform program by focusing on issues that are not addressed or covered comprehensively by the ERL. Thus, the proposed long-term strategy emphasizes well-focused sector adjustment lending operations to consolidate and deepen reforms that will be started under the proposed ERL together with key investment lending operations. The planned Bank assistance strategy would also focus on helping to address issues in private sector development, in infrastructure, and in the social sectors. The proposed ESW is designed to support this strategy. The proposed ERL would address key economic distortions, and the agreed-upon IMF Standby and Compensatory and Contingency Financing Facility (see para. 134) would help the Government reduce financial imbalances in the public sector.

22. Bank lending program. Within the context of the proposed country assistance strategy described above, proposed Bank lending to Panama in 1992-96 would pursue the following main objectives: (1) addressing the remaining policy distortions in trade, agriculture, and labor markets, thus setting the stage for growth led by the private sector; (2) consolidating public sector reforms; (3) improving the development of human capital; and (4) maintaining and improving physical infrastructure.

23. The Bank's lending program of one to two operations annually for 1992-96 would cover both policy-based loan operations and project assistance. The proposed policy-based operations could include lending for: (1) public sector management, to help modernize the public sector, continue the Government's privatization program that would be initiated under the proposed ERL, and streamline the budget preparation process; (2) the transport sector,

to deregulate trucking, address issues in railways, and continue the privatization of port operations, all of which are being addressed in part under the proposed ERL; (3) further trade reform and the deregulation of labor markets, to help the Government that assumes power in 1994 to reduce the ceiling on import tariff rates to 20 percent and to implement a labor deregulation program along the lines proposed by the World Bank; (4) education, to strengthen the primary and secondary school systems and to address the issues of cost recovery and curriculum modernization; and (5) agriculture, to assist government efforts to stimulate sector productivity and expand exports, and to deepen the reforms that would be initiated under the proposed ERL.

24. Investment project assistance could include a health and nutrition project that would provide a cost-effective safety net for the vulnerable groups in Panama and increase labor productivity. To address the deterioration in infrastructure, Bank lending would focus on the rehabilitation and expansion of priority investments in infrastructure, including power, water and sanitation, and transportation (especially roads).

25. Cofinancing with the IDB and other donors would be sought for some of the proposed operations, especially for policy-based loans. Eventually, as the economy is deregulated and public enterprises are privatized, Bank lending would shift toward supporting private sector activities in close cooperation with the IFC (para. 30).

26. Economic and sector work. The planned ESW for 1992-96 will concentrate on studies supporting planned operations, especially those that are policy-based. A number of economic and sector studies was undertaken as part of the preparation for the proposed ERL. In particular, studies on agriculture, social security finances, tax system, labor deregulation issues, and public sector finances were completed. To support the planned lending program, sector reports on public expenditure and public sector management and the transport sector and a health sector review will be prepared in 1992. A trade/deregulation study and a Country Economic Memorandum (CEM) will be prepared in 1994 to support policy-based lending operations.

27. Bank exposure. The proposed lending program is based on the assumption that the authorities will continue with their reform program. Up to two-thirds of the proposed lending would be policy-based. Implementing the proposed lending program would result in net positive flows from the Bank to Panama. Debt service to the Bank would average about 16 percent of Panama's total external debt obligations, while the stock of debt owed to the Bank as a share of Panama's total external debt would increase from a projected 6 percent in 1992 to 9 percent in 1996. Successful implementation of the agreed macroeconomic and fiscal program under the ERL will be vital for ensuring country creditworthiness and timely debt service payments to the Bank (see also Chapter III).

28. Downside risks. If Panama's political and/or economic situation deteriorates, the Bank would have to limit its lending to a core program, consisting of lending for social sectors and the maintenance of

infrastructure. Economic conditions that would trigger a lower lending program include: (1) abandonment of an IMF program or loss of fiscal stability, crucial for structural adjustment and growth; and (2) inability to reduce public spending and/or abandonment of trade and deregulation reforms. In the event of a complete breakdown of the economic program, political situation, and domestic security, Bank lending would not be possible. The success of the lending program in Panama depends mainly on the Government's ability to implement the agreed policy changes outlined in this report in a timely fashion.

29. Clearance of arrears. A Panama Support Group with a mandate to set up the clearance of arrears was chaired by the United States. Arrears to all IFIs, totaling US$657.8 million, are being cleared (see Annex I for sources and uses of funds for clearance of arrears to the IFIs). Since only US$540 million (or US$410 million, if Panama's own resources in the escrow account are excluded) of the arrears were subject to financing by the Support Group, additional arrears arising from unpaid amounts in the first quarter of 1990 and valuation adjustments to the stock of arrears (US$95 million) are being paid by the Panamanian Government. Additionally, the National Bank of Panama (BNP) is providing two bridges of US$42 million and US$40 million to the Panamanian Treasury for clearance of arrears. Disbursements from IDB and Taiwan are expected to repay Panama's bridge loans. Support Group funds for the clearance of arrears are coming from a variety of sources, including: (1) funds returned to the Government of Panama that had been held in escrow by the United States (US$130 million) and interest earnings on those funds (US$7 million); (2) an allocation from the USAID aid package (US$130 million); (3) a US$40 million loan from Taiwan; (4) a US$3 million grant from the Government of France; (5) two U.S. Treasury bridge loans of US$83 million and US$60 million, to be repaid through expected disbursements from IBRD (US$60 million) and IMF (US$83 million); and (6) expected disbursements from IDB (US$60 million) and OECF (US$50 million).

30. The International Finance Corporation. The IFC has made five investments in Panama. First, it extended an equity investment and a loan to the Corporación de Desarrollo Hotelero, S.A., to build an international hotel in 1971. Second, in December 1978, the IFC lent to and acquired equity in Vidrios Panameños, S.A., a glass container factory. In 1986, the original investment in Vidrios was sold and a standby loan was approved and later canceled. The other investments were commitments made in 1979, 1985, and 1986 to acquire equity in and to lend to the Banco Latinoamericano de Exportaciones (BLADEX), the Latin American Regional Export Credit Bank located in Panama. IFC is presently appraising a small equity investment in a leasing company. IFC plans to assist the Government in its privatization efforts and is considering resuming equity investments and lending operations for efficient private companies in sectors in which Panama has a comparative advantage.

PART II
THE GOVERNMENT'S ECONOMIC RECOVERY PROGRAM, 1991-93

A. Reform of the Public Sector and Privatization Program

31. The immediate priority, to stabilize the economy by raising public savings, requires further efforts to cut current public outlays. User charges and the tax burden remain relatively high -- taxes and social security contributions total over 21 percent of GDP -- and there is an urgent need to expand public investment. In order to expand public savings, the Government aims to reduce public current outlays.

32. The macroeconomic/fiscal program and public employment. The Panamanian public sector creates constant financial disequilibria and operates inefficiently. Its share in the economy tripled in the last three decades to more than 30 percent of GDP. Since the early 1970s, the public sector has been considered the employer of last resort. Employment expanded regardless of need or budgetary constraints. By the end of 1990, about 140,000 people were employed in the public sector -- roughly one-fifth of Panama's total employment. Given Panama's budgetary constraints, the result has been a squeeze on high priority spending (such as supplies, materials, and equipment).

33. The cornerstone of the macroeconomic/fiscal program for 1992-93 is the planned reduction of public current expenditures needed to restore public sector finances to a sustainable position in the medium term. (Table 3 and Annex III, Attachment i, show the financial program planned for the nonfinancial public sector.) The program corresponds with targets for the agreed-upon 1992-93 IMF standby program and the Compensatory and Contingent Financing Facility (see para. 134). The structure of spending should shift significantly in 1991-93, as the public sector wage bill (i.e., excluding National Bank of Panama and the Savings Bank) is planned to be reduced from US$820 million in 1991 to US$765 million in 1993.

34. The planned rise in public sector savings, from negative 1.8 percent of GDP in 1990 to a positive 2.3 percent of GDP in 1993, would permit public investment to increase from 1.3 percent of GDP in 1990 (3.8 percent of public spending) to 4 percent of GDP (about 11.8 percent of planned public spending) by 1993. This increase in public investment is essential for improving seriously deteriorated infrastructure. This shift in current expenditures would be consistent with a shift in the general government's savings from a negative 3 percent of GDP in 1990 to a negative 2.2 percent in 1992, and to a negative 0.5 percent in 1993[1/]. (Annex III, Attachment ii,

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1/ Without severance payments for public employment reduction, the savings for 1991 would equal negative 1.6 percent and would approach zero in 1993.

shows the financial program for the general government[2/] for 1991-93.) Current revenues of the general government are projected to average about 29.2 percent of GDP annually during 1991-93, slightly higher than the level prevailing before the sharp drop of 1988-89.

Table 3: The Macroeconomic/Fiscal Program, 1991-93

(as a percentage of GDP)

	Actual	Program		
	1990	1991	1992	1993
Current revenues	30.7	31.6	32.5	32.2
Current expenditures	32.0	32.1	31.3	30.0
o/w: Wages and salaries	12.1	12.1	11.5	10.4
(w/o the bonus)	(12.0)	(11.9)	(10.8)	(9.7)
Transfers[1/]	8.1	8.5	8.7	8.9
Other agencies, net	-0.5	0.2	0.1	0.1
Current savings	-1.8	-0.3	1.4	2.3
Capital revenues	0.0	0.0	0.0	5.3
Investment expenditures	1.3	2.4	4.0	4.0
Overall balance	-3.0	-2.7	-2.6	3.6
Memorandum items:				
(Millions of US$)				
Public wage bill				
with the bonus[2/]	778.8	820.0	820.0	765.0
without the bonus	-	800.0	765.0	714.0
Central government	412.0	433.0	415.0	398.0
Public enterprises	135.0	134.0	126.0	99.0

1/ Includes severance payments.
2/ Bonus means the thirteenth-month salary for the public workforce (see para. 35).

Source: MIPPE, IMF, and Bank staff estimates.

35. To increase public sector savings, the Government initiated a program to reduce current public outlays. Consolidated current outlays of the nonfinancial public sector were reduced by 2.1 percentage points of GDP in 1990. By March 31, 1991, net employment was reduced by 8,400 positions, salaries for new positions decreased by 10 percent, the public wage bill was cut 7 percent, and the Government maintained its suspension of the thirteenth-month salary bonus for public employees until October 1991. However, in

2/ General government includes the central government, CSS, BDA, BHN, IMA, IFARHU, and the University of Panama.

October 1991, the Supreme Court of Justice ruled the suspension of the thirteenth-month salary bonus unconstitutional. As a result, public wages and salaries increased by US$20 million (one-third of the bonus was paid) in 1991, and will rise US$55 in 1992, and US$51 million in 1993. For 1991, the public wage bill is an estimated US$820 million, including the thirteenth-month salary bonus. Under the proposed ERL, it was agreed that the public wage bill will not exceed US$820 million in 1992 and US$765 million in 1993 (paras. 116(1), 117(1), and 118(1)).

36. Consistent with the targets set by the 1990 IMF-monitored program and the agreed-upon 1992-93 IMF standby program and Compensatory and Contingent Financing Facility (see para. 134), the Government plans to further reduce current public outlays from 32 percent of GDP in 1990 to about 30 percent in 1993. To achieve this target, the public wage bill, including the thirteenth-month salary bonus, will be maintained in 1992 at the estimated 1991 level and will be 6.7 percent lower in nominal terms in 1993 than in 1991-92. To reduce the wage bill, Government introduced several mechanisms in 1991. These include freezing vacancies that existed as of March 31, 1991, initiating voluntary separation packages for public employees with severance payments, not filling all posts that are planned to be vacated during the program period, and privatizing public enterprises.

37. By implementing these measures, the Government expects to reduce public employment by about 19,000 (or about 14 percent) by the end of the reform program to be supported under the proposed ERL. To compensate partially for the cost of the thirteenth-month salary, the public employment reduction program may need to be accelerated and extended to 1994. (Annex III, Attachment iii, shows the expected public employment reduction.) The projected cuts in public employment will reduce the public wage bill to targeted levels. Annex III, Attachment iv, shows quarterly targets that will be used to monitor and confirm compliance with the program before each tranche release. The Government will prepare quarterly reports on its achievements of targets and send them to the Bank on a regular basis no later than three months after the end of each quarter.

38. The program for restructuring the public sector aims to ensure lasting job cuts. The Bank agreed with the Government on a financial program for the public sector, with targets for increasing general government savings and for reducing the public wage bill (para. 116(1)). In order to judge compliance with the public finance targets for general government savings and public wage bill (conditions of second and third tranche release), the Bank will review developments in the six months preceding each review (paras. 117(1) and 118(1)). Meeting program targets, and thus achieving savings targets for the general government in nominal terms, will be conditions for tranche releases (paras. 117(1) and 118(1)). The Bank will monitor and confirm compliance with the targets for general government savings and public wage bill cuts before each tranche release.

39. Public sector enterprises (PSEs). Public sector enterprises operate inefficiently and have high levels of employment, salaries, benefits, and receivables. Salaries in public sector enterprises are on average 50

percent higher than salaries in the private sector. Moreover, the Government constrains efficient PSE operations by exercising excessive control, through a parallel administration in key ministries and cumbersome procedures for budgeting, execution, control, and procurement of goods and services. Traditionally, the excessive costs of PSE services and products have been passed along to consumers in the form of high user charges, undermining the economy's international competitiveness.

40. The inefficiency of the public enterprises responsible for important infrastructure services -- especially power, water, telephone, and port services -- remains a particular concern. PSEs accounted for about less than one quarter of total public current spending during 1989-90. They, however, produced operational surpluses, equalling an annual average 3.6 percent of GDP during the same period. Previous administrations treated these enterprises as "cash cows." They confiscated PSE financial surpluses arbitrarily, preventing PSEs from making vital investments. In 1989. public enterprises transferred US$139 million to the central government. Reducing current expenditures, improving the collection of accounts receivable, and eliminating subsidies should enable public enterprises to catch up with needed investments. These actions should also permit PSEs to continue transferring to the central government a return on the government's equity and reduce prices to consumers.

41. Because Panama cannot use monetary and exchange rate policies, decreased production costs, which are passed on to consumers in reduced user charges, imply a real devaluation and thus increased international competitiveness. Within the macroeconomic/fiscal program, increasing efficiency and lowering prices are feasible objectives based on cost reductions. The Panamanian Government prepared action plans for IRHE (Hydroelectric and Energy Resources Institute) and IDAAN (National Water and Sewerage Institute) to increase productivity and reduce employment, accounts receivable, and non-technical losses. Management practices would be improved by strengthening managerial responsibilities and accountability. These plans also aim to privatize new capacity of IRHE and IDAAN, maintenance and security services for IRHE, and meter reading and billing systems for IDAAN. Agreement was reached with the Government on the content and timing of action plans (para. 116(3)). Successful progress in implementing action plans for IRHE and IDAAN and complying with the financial and operational efficiency targets in the aforementioned action plans, are conditions of second and third tranche release (paras. 117(4) and 118(3)).

42. The content of the draft law on PSEs' procurement and budgetary practices will be reviewed and discussed with the Government before second tranche release and the Government plans to submit a proposal law to Congress in March 1992. Passage of an enabling law, satisfactory to the Bank, will be a condition for second tranche release, and implementation of the program will be a condition for third tranche release (paras. 117(3) and 118(3)).

43. As part of the program, the consolidated noninterest current outlays of the nine public enterprises (IRHE, IDAAN, INTEL, APN, Cemento

Bayano, Victoria Sugar Mills, Zona Libre, IPAT, and Cítricos de Chiriquí) should not exceed US$308 million in 1992 and US$234 million in 1993;[3/] these will be the conditions for second and third tranche release (paras. 117(4) and 118(3)). Annex III, Attachment v, summarizes the Government's financial program for the public enterprises. Implementation of programs to privatize IRHE and IDAAN's nonbasic services are conditions for second and third tranche release (paras. 117(4) and 118(3)).

44. The Bank agreed with the Government on the principles for pricing public utilities and services (para. 116(3) and Annex III, Attachment vi). Undertaking a study on pricing for telecommunications and ports and on updating the long-run marginal cost study for electricity and agreement on an action plan to move electricity prices toward long-run marginal costs are conditions for second tranche release (para. 117(4)). IDB will fund the studies for the pricing of electricity, water, telephone, and port services. Implementing action plans for pricing of water, ports and telecommunications services and introduction of steps toward more efficient pricing and a rational tariff structure for electricity, based on the results of the electricity pricing study, will be conditions for third tranche release (para. 118(3)). If the electricity pricing study shows that revenue collection has been strengthened, nontechnical losses have been reduced, and costs have been cut, then prices could be determined based on long-run marginal costs. Price reductions, therefore, should not be a deterrent to investments in the power sector under the agreed-upon public investment program (paras. 53-56). The Government also agreed that IRHE's cash flow should cover financing costs.

45. IRHE (Instituto de Recursos Hidroeléctricos y Electrificación, Hydroelectric and Electric Energy Resources Institute). Despite high electricity tariffs, IRHE faces extremely difficult financial problems, because of bad management practices and high operating costs. The high operating costs resulted from overemployment, poor commercial practices, and the corrupt practices of the previous government, among other things. The average 1990 tariff equaled 11.7 US cents/kWh, 40 percent higher than the long-run marginal cost. Moreover, IRHE's tariff structure is not based on economic criteria and it subsidizes different consumer groups. The electric power generation system has deteriorated over the past 5 years due to a lack of spare parts and because scheduled maintenance was postponed. As a result, one-third of thermal capacity is out of service, and the other units operate on average at 32 percent of capacity. Maintenance of the transmission and distribution systems has also been neglected and needed investments have been deferred. Electricity losses now amount to 26 percent of net generation, resulting in an annual revenue loss of US$34 million. To address these problems, the Government prepared an action plan to strengthen the company's finances and to improve its managerial practices. Successful progress in implementing the agreed-upon action plan, including the compliance with

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3/ The Government plans to privatize Cemento Bayano, Victoria Sugar Mills, and Citricos de Chiriqui as part of its privatization program.

financial and operational efficiency targets, will be a condition for second and third tranche release (paras. 117(4) and 118(3)). In order to comply with the financial and operational efficiency targets, the main features of the action plan include:

(1) implementing measures to make labor more productive and to reduce operating costs;

(2) strengthening the company's finances by reducing current expenditures, and improving revenue collection;

(3) taking steps to establish a regulatory framework for the electricity sector, before second tranche release, that will help ensure future private investments in the sector;

(4) strengthening management practices; and

(5) increasing IRHE's control over its operating budget, after introducing improved management practices.

46. IDAAN (Instituto de Acueductos y Alcantarillados Nacionales, National Water and Sewerage Institute). IDAAN's problems include: inadequate investments, overemployment, high operating costs, poor management practices, and inadequate revenue collections. About half of the water produced is unaccounted for or "lost", mostly from unmetered consumption. Only 20 percent of IDAAN's residential customers are metered and public enterprises generally do not pay for water services. IDAAN has 11 staff members for each 1,000 water connections, while comparable water utilities in Latin America operate with 6 to 7 staff for each 1,000 water connections. To finance operations and investments, IDAAN began to accumulate arrears on its obligations. Accounts payable amounted to US$58 million at the end of 1989. To address these problems, the Government has prepared an action plan to improve the company's financial and management practices (para. 116(3)). Progress in successfully implementing the agreed-upon action plan, including compliance with the financial and operational efficiency targets, will be a condition for second and third tranche release (paras. 117(4) - 118(3)). Planned actions to comply with the financial and operational efficiency targets include installing meters to decrease water theft, improving revenue collection, decreasing current outlays (partly by cutting employment), and giving the company both administrative and financial autonomy by introducing managerial improvements.

47. APN (Autoridad Portuaria Nacional, National Port Authority). Panama has failed to economically exploit its geographically advantageous ports. Poor management, overemployment, high operating costs that result in high user charges, and inadequate maintenance have contributed to this failure. APN services are perceived to be expensive, unreliable, and inefficient. Freight rates to and from Panama are consistently higher than those to and from major U.S. ports (and 30 percent higher than those of Jamaica, a competing regional port), reflecting the higher cost of port operations. Rates for container traffic in some APN ports are among the highest in Latin America. As a result, some large container companies have

moved their hub operations away from Panama to geographically less advantageous locations in the Caribbean.

48. To promote trade and create employment opportunities, the Government prepared a program to restructure the country's main ports. It is also taking steps to improve efficiency and to reduce high costs in Cristobal and Balboa. To achieve these objectives, the Government is finalizing an action plan to transfer port operations, equipment, and services to the private sector by means of concessions and leases awarded through a transparent and competitive process. Bidding for the concessions and licenses is expected to begin before June 1992. In addition, a promoter and developer for the new port in Telefers Islands will be selected by mid-1992. The first concession for a waterfront site will be provided by mid-1992. Similarly, the Government has prepared plans for attracting private investment to other Central Corridor ports, such as those in Bahía Las Minas and Coco Solo. The Bank agreed with the Government on an action plan to grant concessions to the private sector for the ports of Balboa and Cristobal and the Cabinet approved the APN's privatization plan (para. 116(4)). Satisfactory progress in implementing the agreed-upon action plan is a condition for second and third tranche release (paras. 117(5) - 118(4)).

49. INTEL (Instituto Nacional de Telecomunicaciones, National Telecommunications Institute). INTEL acts as both the operator and regulator of telephone services. To maintain its monopoly position and to discourage future competition, INTEL prohibits other companies from providing even the complementary services that it does not offer (such as cellular telephones). INTEL contributed nearly US$55 million of its 1990 sales revenue of US$165 million to the central government, making it by far the most financially profitable of the public enterprises. These large transfer payments were achieved at a high cost to consumers, especially those who call overseas. Excessive rates for international and long distance telephone services subsidize the flat rate local service. In 1990, international service revenues came to US$80 million, or about 50 percent of sales. INTEL's ratio of 18 employees for each 1,000 lines reflects labor inefficiency. An efficient company has 10 employees or fewer per 1,000 lines, and the ratio in the United States is 4 employees per 1,000 lines. A flat salary structure discourages the hiring of skilled technical staff, so faults per line and fault repair time are twice as high as in efficient companies -- with an average line installation period of 75 days. Although 47 percent of the lines are digital, INTEL has done little to promote such technologies as touchtone telephones. And INTEL does not provide card-operated public telephone or credit cards because of government restrictions. The Government reform program includes an action plan to privatize INTEL, restructure the telecommunications sector, and introduce competition in the telecommunications sector.

50. INTEL's privatization program will require creating a regulatory agency with the power to regulate tariffs, address public complaints, regulate the interconnection of operators, and grant licenses for operating services. The Bank agreed with the Government on INTEL's privatization program. The

Cabinet approved INTEL's privatization plan, and in late 1991 the Government established a technical unit at MIPPE to privatize INTEL (para. 116(4)). Congressional approval of a law, satisfactory to the Bank, that would restructure the telecommunications sector, create a regulatory authority for telecommunications, and privatize INTEL, is a condition for second tranche release (para. 117(5)). The establishment of a regulatory framework and of an adequately staffed regulatory agency, along with satisfactory steps toward the international selection of a prospective buyer for INTEL, are conditions for third tranche release (para. 118(4)).

51. Agreement was reached with the Government and IDB that the Bank will closely supervise implementation of the program to privatize INTEL and the provision of technical assistance for this purpose. The Bank agreed with the Government on a tripartite arrangement between the Bank, IDB, and the Government on coordinating the technical assistance to privatize INTEL (see para. 124).

52. Privatization. Privatization is a strategic component of the Government's economic recovery program. The Government has prepared a privatization program to promote economic growth and to reduce the size of the public sector. The Government submitted a draft framework privatization law to the Panamanian Congress and the first congressional debate took place in December 1991. The Government expects that the Congress will discuss and approve the framework law in March 1992. The draft law was designed to provide a framework that will enable the Executive Branch to privatize public companies and other assets quickly and in a transparent manner. Passage of a satisfactory framework privatization law after April 30, 1992, will be an event of default (see para. 115). It was agreed at negotiations that the Bank will have a right to prior review of all norms to be issued to ensure that procedures for privatization are timely, efficient, and transparent. Issuance of satisfactory norms is a condition of second tranche release (para. 117(5)). Annex III, Attachment vii, lists the public companies that the Government plans to privatize. The program also aims to transfer to the private sector some nonbasic services and to privately fund expansion of IRHE and IDAAN (paras. 41 and 43). The Government brought Air Panamá and Cítricos de Chiriquí to the point of sale in late 1991. The Government also plans to sell Cemento Bayano, COBANA, COBAPA, Victoria Sugar Mills, and ISA. Bringing the rest of the public companies listed in Annex III, Attachment vii, to the point where tender documents for bidding have been issued to private investors, or offers have been solicited, is a condition for second tranche release (para. 117(5)). Finalizing sales transactions for at least three of the public companies listed in Group A will be a condition for third tranche release (para. 118(4)).

B. PUBLIC INVESTMENT PROGRAM

53. To address fiscal problems, earlier governments in Panama cut capital spending sharply. As a result, public investment, which reached an annual average of about 5 percent of GDP during 1984-87, declined to 1.8

percent of GDP in 1989. In 1987-89, even minimum maintenance was not carried out. In spite of a slight increase in maintenance expenditures in 1991, the need to rehabilitate highways, most schools, urban infrastructure, health care posts, Tocumen airport, and IRHE installations remains urgent.

54. The public investment program contemplates raising public investment from about 1.3 percent of GDP in 1990 and 2.4 percent in 1991 to 4.0 percent annually both in 1992 and in 1993. About a third of the program will address the expansion and maintenance needs of the power sector, and a sixth will provide for transport sector rehabilitation. The program consists of well-designed, high-priority projects. In 1992-93, financing for the public investment program will come from increased public savings, the public sector's accumulated cash surplus at the National Bank of Panama (BNP), and expected disbursements from the multilateral financial institutions.

55. Considering the amount of financing that will likely be available and the implementation capacity of the public sector, the Government has prepared a realistic public investment program that focuses on maintenance and rehabilitation. No less than three-fifths of the total investment program will be allocated to power, transport, education, and health during the program period. Agreement has been reached with the Government on the size (as a share of GDP) and sectoral composition of the public investment program (see Annex III, Attachment viii; para. 116(2)); satisfactory compliance is a condition for second and third tranche release (paras. 117(2) - 118(2)). Before each tranche release, the Bank will review budget projections and progress in executing the agreed-upon public investment program.

56. The investment program for 1991-93 includes the following urgently needed minimum investments:

(1) in the IRHE, maintaining transmission and distribution lines;

(2) in the IDAAN, acquiring pumping equipment for several towns and for the drinking water plant in Chilibre, and acquiring and installing metering devices;

(3) in the health sector, repairing health posts and hospitals and acquiring high priority surgical, laboratory, and dental equipment;

(4) in the Education Ministry, repairing school buildings and school furniture; and

(5) in the Ministry of Public Works, repairing key highways.

C. TAX REFORM

57. Tax reform is an important element of Panama's economic reform. The tax system discourages investment and the use of labor and encourages tax evasion. Generous tax exemptions and exclusions reduce revenues and place an

inequitable tax burden on some socioeconomic groups. The system is also complicated and difficult to administer.

58. The tax system's ability to generate adequate revenue is eroded by such factors as a narrow tax base and a poor system of incentives and exemptions. The low elasticity of the tax system means that tax revenues respond very little to changes in GDP. The Government's reform program aims to minimize disincentives to work, invest, and save and to ensure the revenue-neutrality of the reform program.

59. The corporate income tax (CIT). Under the previous tax regime, the CIT rate structure for companies located outside of the Colon Free Trade Zone ranged from 20 to 50 percent. The progressive rate structure encouraged companies to break up into smaller parts in order to avoid paying high marginal tax rates. By restricting their operations for tax purposes, companies misallocate resources. Some taxpayers report their personal income under the lower CIT rate rather than under the higher personal income tax (PIT) rate, leading to loss of revenues. The existence of several tax rates and brackets increases administrative costs and needlessly complicates procedures for an already overburdened tax administration.

60. The personal income tax (PIT). Prior to the reform of the tax system in 1991, high marginal personal income tax rates discouraged employment, investment, and savings and encouraged tax avoidance and evasion. Marginal rates ranged from 2.5 percent to 56 percent in 20 different income tax brackets, creating a false sense of vertical equity. Also, the level of personal exemptions was not adjusted for inflation for many years, leading to inequity for the poorest groups in Panama.

61. The value-added tax (VAT). This consumption tax, which excludes services, has a narrow base that causes resource misallocation, reduces fiscal revenues and is inequitable. The VAT rate of 5 percent is lower than rates in other Latin American countries -- for example, 10 percent in Bolivia, Colombia, and Costa Rica; 15 percent in Mexico; and 18 percent in Chile. In 1990, VAT collection on domestic transactions accounted for 5 percent of tax revenue and only 0.6 percent of GDP. Panama's comparative advantage lies in the service sector, so the VAT should be extended to services once the country's economic distortions have been addressed and high user charges to the service sector have been reduced. In the short-term, the Government increased the VAT on alcoholic beverages and cigarettes, and raised other charges and fees to ensure the revenue-neutrality of the tax reform mentioned in para. 63.

62. Tax incentives. Panama has a vast array of tax incentives designed to promote mining, tourism, construction, investment, industrial production, nontraditional exports, regional economic development, the production of agricultural commodities, and employment in the Colon Free Trade Zone. These incentives sprang up in an ad hoc fashion over the years, violating all sound fiscal criteria. They are costly (in revenue foregone), complex, inefficient (in resource allocation), and inequitable, but no estimates of their fiscal costs exist, either in terms of general or

individual incentives. The Government plans to reduce tax incentives during the program period supported by the proposed ERL.

63. Congress approved a tax reform law, satisfactory to the Bank, in December 1991 (para. 116(8)). This law reduces high marginal tax rates for corporate and personal income taxes, simplifies the tax system, and reduces the burden on poor groups. (Annex V, Matrix of Policy Action, page 5, shows the tax reform program.) The tax reform law: (1) will reduce CIT by 1994 to two rates: 34 percent for companies whose annual earnings exceed US$0.5 million and 30 percent for companies whose annual earnings are less than US$0.5 million; (2) will reduce the marginal tax rate for the PIT, and will narrow the spread of brackets from 2.5 to 56 percent to 4 to 30 percent in 1992; (3) reduces the number of taxable income brackets from 20 to 11; (4) increases the value-added tax rate on beverages and cigarettes from 5 percent to 10 percent and increases some charges and fees to make the tax reform revenue-neutral; and (5) is more equitable to lower income earners (for example, it raises exempt income to US$350 a month, personal exemption from US$600 to US$800 a year, dependent allowance from US$150 to US$250 a year, and the threshold for income taxation from US$1,000 to US$3,000 a year). Satisfactory implementation of a program to reduce corporate and personal income tax rates and to decrease the number of personal income tax brackets are conditions for second and third tranche release (paras. 117(6) - 118(5)). The Government will introduce the interim corporate income tax rate in 1992 (maximum rate 45 percent, minimum 27 percent as a condition for a second tranche release (para. 117(6)). It will also introduce the interim targets for 1993 (maximum rate 42 percent, minimum 30 percent), as a condition for third tranche release (para. 118(5); see Table 4 below). The pace of reducing the high marginal tax rate is too slow in order to avoid fiscal losses in the first years of the tax reform, although the supply response would be faster if the program were implemented in a shorter time.

Table 4: Reform of Corporate Tax

Tax rates (in percentages)	Year			
	1991	1992	1993	1994
Maximum rate	50	45	42	34
Minimum rate	20	27	30	30

D. TRADE REFORM

64. Trade protection. Panama's nominal tariff protection is the highest and most widely dispersed in Central America. Before the introduction of the first phase of the trade reform in August 1991, the average production-weighted nominal protection equalled 51 percent for the whole economy, 57 percent for agriculture, and 50 percent for manufacturing. Dispersion in

nominal protection was greater than 100 percent of the average in all cases. Given exemptions for goods not produced domestically -- most of them industrial inputs and capital goods used by protected industries and agro-industries -- effective protection is much higher than nominal protection. High protection has led to high-priced goods and has discouraged the growth of efficient export oriented firms. Hence, it has resulted in high unemployment. High nominal protection also encourages smuggling. The Government has recently decided to participate as an observer of the Central American regional group. The five Central American Common Market (CACM) countries have recently agreed to reduce the import tariff ceiling to 20 percent by 1993. Therefore, the speed of tariff reform in Panama must accelerate if Panama is to conform with the CACM countries and increase the efficiency of its domestic economy.

65. Current policies on trade and economic incentives -- in place for two decades -- have directed agriculture and manufacturing production toward import-substitution. In Panama's small domestic market, protection has discriminated against the service sector, in which Panama enjoys a comparative advantage. Moreover, exports represent only a 2-percent share of manufacturing production, despite a battery of export incentives. Agricultural exports, primarily traditional crops, have also been stagnant. Because of high protection levels, the contribution of the industrial and agricultural sectors to long-term growth has declined drastically.

66. Because of slow growth in traditional financial services and stagnation in canal-related activities, Panama must rely on the growth of its most efficient tradable sectors, especially the service sector. Reducing protection in industry and agriculture will help reduce costs and increase economic efficiency. Excessive protection in import-substitution activities should be phased out, and trade incentives for exports and imports should be equalized. These changes should promote export-oriented development, generating renewed and sustainable growth and employment.

67. Trade liberalization. The Government's trade liberalization program aims to reduce the level and dispersion of effective and nominal protection in 1991-93, by:

(1) reducing the ceiling on import tariffs for industrial products to 60 percent and for agro-industrial products to 90 percent on August 1, 1991 (para. 116(5)), and to 40 percent for industrial products and 50 percent for agro-industrial products before third tranche release (para. 118(6));

(2) eliminating all specific import tariff rates before the end of the program period, supported by the proposed ERL, before third tranche release (paras. 117(7) - 118(6)), (during the program period of the proposed ERL, no new specific import tariff rates will be introduced, except for on a limited number of agricultural products, and those will also be eliminated before third tranche release (para. 118(6));

(3) eliminating quantitative import restrictions (QRs) for agricultural products and replacing them with tariff protection, then, reducing these import tariff rates according to the program presented in the Matrix of Policy Action (Annex V, page 7, and Annex III, Attachment ix, before each tranche release (paras. 116(5), 117(7), and 118(6));

(4) increasing import tariffs to 5 percent for goods classified under the Centro de Compras (i.e., tourist goods) on January 1, 1992, and maintaining a 3-percent import tariff for industrial inputs covered under Law 3 (paras. 116(5), 117(7), and 118(6));

(5) unifying import tariff rates on inputs and final products in agriculture (paras. 116(5) and 117(7)); and

(6) eliminating all export restrictions (para. 116(5)).

68. The fiscal impact of the planned trade reform is expected to be revenue-neutral. The decline in revenues from reduced import tariffs is expected to be offset by: (1) increased revenue from higher import tariffs for goods classified under the Centro de Compras; and (2) the replacement of quantitative import restrictions with import tariffs.

69. Agricultural trade liberalization program. The previous administrations' agricultural trade policies emphasized "food self-sufficiency," inward looking development, state intervention in price formation, and income transfers to producers through high prices and subsidies. These policies did not yield the intended results; the sector has grown slowly and food prices remain high. This has led to demands for compensatory wage increases and has reduced Panama's international competitiveness.

70. The incentive system emphasizes self-sufficiency in rice, corn, beans, and sorghum, and promotes the production of sugarcane, potatoes, onions, chicken, eggs, and milk. High and nontransparent protection of domestic agricultural production imposes high costs on the consumer and high allocative costs in agricultural exports foregone (Annex III, Attachment ix, pages 2 and 3 describe import tariff rates, quantitative import restrictions (QRs) and price controls on key agricultural commodities). Import quotas for agricultural goods prompt the use of quantitative restrictions for the downstream users of agricultural inputs, leading to an array of wholesale and retail price controls. Basic grains and their first transformations are subject to import quotas, so wholesale and retail prices of basic goods manufactured from them are then subject to domestic price controls. Dairy products, as well as crude and refined vegetable oils, are subject to a similar scheme of protection and controls.

71. Panama's agricultural protection covers a small number of basic grains and vegetables (accounting for about half of domestic agricultural production) and meat products (representing about three-fifths of livestock). Quotas and specific import tariff rates -- with steep ad-valorem equivalents

(about 700 percent on tomatoes, for example) -- usually amount to de facto import prohibition. Panama has 65 tariff positions for agriculture under import quotas and import permits, which accounts for about half of domestic agricultural production.

72. The Panamanian Government plans to open the agricultural sector gradually to international competition. As a small country, Panama cannot alter world agricultural prices. However, exposing agriculture to international markets should allow consumers to benefit from low-priced imported food products. Producers would then have an incentive to redirect domestic production toward activities that are more profitable in world markets. Thus, both consumers and producers would gain.

73. The agricultural trade liberalization program will address trade distortions and regulations. The Government announced its agricultural liberalization program and initiated its implementation by eliminating export restrictions and import and price controls. The Government also reduced the import tariff rate to 30 percent for beef in late 1991 and eliminated domestic price controls, quantitative import restrictions, and accompanying import tariff reductions to 50 percent on vegetables (except for beans, potatoes, onions, and tomatoes; para. 116(5)). Continuing to reduce import tariff rates for agricultural products and eliminating QRs and price controls will be conditions for second and third tranche releases (paras. 117(7) and 118(6)). The Government will shift to a variable import tariff rate system for corn, rice, and sorghum, with a maximum applicable rate, as a condition for second tranche release. Implementing the agreed-upon reform program for agriculture should shift resource allocation in favor of the country's comparative advantages. The production of beef, some tropical fruits, and vegetables and imports of basic grains are expected to expand, while consumer prices should decline (except for beef meat, which would be exported). Since the production of export crops is labor-intensive and food crop prices will probably decline, agricultural liberalization should improve the real incomes of the poorest groups in Panama.

E. DOMESTIC DEREGULATION

74. Domestic deregulation should help to increase total factor productivity and accelerate the supply response to trade reform. To make trade reform more effective, the Government intends to introduce domestic deregulation measures to increase labor mobility and flexibility, to reverse the anti-labor bias of the tax regime, to free controlled domestic prices, and to improve the efficiency and pricing of public services. The Government plans to make the prices of petroleum derivatives internationally competitive during the program period. The Government realizes that introducing trade reform without domestic deregulation would not sufficiently improve resource allocation in the economy.

75. Price controls. Price controls on various products are maintained with the stated objective of protecting both consumers and producers. Most of the price controls are for agricultural products. The Price Control

Commission, Oficina de Regulación de Precios, and the producers and importers negotiate to set prices. Controlled prices are revised at the request of producers and importers. This cost-plus price-setting mechanism allows highly inflated domestic prices because price-controlled products are shielded from import competition through quotas and import permits. The Government has begun a program to progressively remove many price controls. Since December 1990, the Government has lifted controls on many products, including vegetables and other food items and some household goods, but controls remain on many agricultural and pharmaceutical products. Price controls on industrial and agricultural products will be phased out during the program period (paras. 116(5), 117(7), and 118(6)). The planned conversion of the price-setting institution into a consumer protection agency, Oficina de Protección al Consumidor, which will address consumer complaints and disseminate information about prices and product quality, and amending Decree 60, March 1969, accordingly, is a condition for third tranche release (para. 118(6)). Eliminating price controls on industrial products covered under Law 3 is a condition for second tranche release (para. 117(7)).

76. Labor markets. Overregulation of hiring and firing practices in Panama's labor market seriously impairs job creation and mobility. Among other things, government regulations: (1) require firms to obtain government approval to reduce employment; (2) prohibit worker reallocation within the same firm; and (3) mandate high nonwage costs as a share of basic wage costs, including a long service bonus (1.92 percent), a thirteenth-month salary bonus (9.09 percent), and a one-month vacation (11 percent). Also, Panama has three taxes on labor: a social security tax (18 percent, of which 10.75 percent is paid by the firm), insurance against professional risk (2.3 percent), and education insurance (1.5 percent). Moreover, the legal requirement to close firms during a strike threatens the financial viability of many private enterprises.

77. High overtime charges increase the cost of labor by 45 percent over base pay. The minimum wage has raised and compressed the wage structure and seems to inhibit the creation of jobs for unskilled labor. In the past, the Government decreed general wage increases, unrelated to increases in productivity. The so-called "lost wages" rule requires firms to pay dismissed workers who appeal their dismissal the salaries they would have earned during the appeal process had they remained with the firm -- whether they have found new employment or not. Employee dismissal is also costly because of legal procedural delays that cause uncertainty about the total cost of reducing labor. These dismissal procedures have contributed to dampening demand for labor and depressing domestic and foreign investment in Panama.

78. Employment trends reflect this restrictive regulatory framework. The unemployment rate more than doubled, from 8.8 percent in 1979 to 20 percent in 1990, partly because of the crisis of 1987-88, dropping to 16 percent in late 1991. (Some evidence suggests that informal employment, mainly self-employment and employment in small firms and agriculture, has grown faster than registered employment.) The economy's capacity to create jobs has significantly declined in the past two decades and the public sector

has absorbed much of the new employment in the last decade. Increases in labor costs and government intervention in the labor market have reduced the private sector's demand for labor. Also, increases in wage costs have not matched labor productivity growth, so Panama's international competitiveness has declined. Planned trade reform and deregulation should improve domestic productivity, but increases in wage costs should be contained so that Panama does not become even less competitive in international markets.

79. Indeed, containing wage increases is crucial to improving Panama's economy. While abrogating the labor code would be too radical an approach to attract popular support in Panama at this time, inaction in labor reform would prevent a meaningful resource allocation in response to trade and other deregulation reforms. The domestic deregulation program proposes to introduce labor reform a step at a time. Given Panama's legal requirements, maintaining minimum wages at current levels, while highly desirable, is not a formal condition of tranche release. However, since Panama cannot effect nominal devaluation, the Bank will closely monitor wage developments as a major determinant of competitiveness as part of the overall supportive macroeconomic framework (para. 115).

80. Para. 21 of the Letter of Development Policy (Annex IV) refers to the principles and objectives to be considered in determining any adjustment of the minimum wages during the program period supported by the proposed ERL. During negotiations, the Bank delegation recommended that any adjustment to the minimum wages should reflect past cost-of-living increases, productivity growth since the last adjustment in 1982, and international competitiveness as measured by competitive labor costs.

81. The Government has already introduced measures to reduce labor costs and make labor markets more flexible. Government actions introduced since October 1990 include the following:

(1) allowing the Government to designate a third party to arbitrate on work-related issues to expedite the resolution of labor conflicts and prevent labor conflicts;

(2) allowing automatic extension of collective bargaining agreements for 1991-92;

(3) extending the period of collective bargaining to 3 years for newly established firms; and

(4) establishing a tripartite committee (representing the Government, labor, and management) to review labor regulations that affect how labor markets operate.

82. As part of its overall reform program, the Government is committed to reducing labor costs and increasing the flexibility of the labor market. Before Board Presentation of the proposed ERL, the Government announced its labor deregulation program (para. 116(6)), which aims, among other things, to:

(1) reduce the cost of dismissing employees for economic reasons;

(2) allow firms facing difficult economic and financial problems to use a workable mechanism for modifying labor constraints;

(3) allow operation of private employment agencies; and

(4) shorten the time permitted for the Ministry of Labor to process labor regulations.

83. In addition to the program mentioned above, it is vital that the next stage of reform be deepened to deregulate labor markets and make them more flexible and to reduce labor costs so that resource allocation can improve in response to structural reform. Based on the recommendations of a study carried out for the appraisal of the proposed ERL, the next stage of labor deregulation should include: (1) eliminating required government approval for reducing the labor force; (2) permitting firms to shift workers within the same firm without government approval; (3) limiting payment for overtime; (4) limiting compensation for "lost wages"; (5) restricting compensation for dismissals without a legal justification; and (6) allowing firms to operate during a strike.

84. Petroleum prices. Oil prices above international levels inhibit Panama's international competitiveness. The Ministry of Commerce and Industry (MICI) determines petroleum prices, subsidies, and margins for all products except bunker and jet fuels. It also calculates the insurance and freight cost (CIF) of fuels imported by Refinería de Panamá, S.A. (REFPAN). Domestic petroleum prices that are higher than international and Central American levels are the result of: (1) high refining costs, (2) price and import controls, (3) high sales taxes and bunker fees, (4) heavy import protection at the refinery, and (5) a shrinking fuel market in Panama and the canal area because domestic prices are higher than those from other sources. (Annex III, Attachment vi, pages 5 and 6 discuss issues related to pricing of petroleum products).

85. REFPAN, established in 1956, has a monopoly on the domestic supply of petroleum in Panama. It operates at low capacity (about 20 percent in 1988-90), is not economically viable, and imposes a major cost to the economy. Profits from direct imports are used to offset refinery losses, thus enabling REFPAN to realize the 10 percent minimum rate of return on assets guaranteed by the Government. If Panama had imported oil, instead of refining and buying products from REFPAN, it could have saved an estimated US$25 million in 1989, with fiscal gains of about US$12 million. Net of tax and import duty, the gains from importing petroleum would have averaged more than 30 US cents a gallon on jet fuel and 20 US cents a gallon on gasoline in 1989. The Government plans to liberalize petroleum prices and imports as part of its reform program. It will either renegotiate the contract at better terms to cut petroleum prices or it will not renew REFPAN's contract when it expires at

the end of 1992. These actions, although fully supported by the proposed ERL, are not conditions of the ERL.

F. REFORM OF THE SOCIAL SECURITY SYSTEM

86. The underfunded social security system (CSS) continues to weaken the economy, diverting public resources from higher priority activities. In 1990, more than three-fourths of the public deficit was attributable to the operations of CSS. Its operating deficit in 1988 was US$67 million, rising to US$99 million in 1989, US$107 million in 1990, and an estimated US$187 million in 1991 (see Annex III, Attachment ii, page 4). The projected deficit for 1992, without the introduction of a reform program, was US$200 million. However, the introduction of a social security reform law in December 1991 is expected to reduce the estimated deficit to about US$150 million in 1992.

87. CSS provides pensions for insured retirees, for disabled persons, and for close surviving relatives upon the death of an insured participant. Comprehensive medical care, including hospitalization and drugs, is provided not only to workers and their families but also to the uninsured through Ministry of Health facilities. In 1990, out of a total labor force of about 700,000, some 379,000 workers were covered by the system. Including covered dependents, CSS provides benefits for about 1.3 million people, more than half the population of Panama.

88. The social security tax -- a compulsory contribution of 18 percent of wages (7.25 percent paid by employees and 10.75 percent by employers) -- plays a key role in driving up labor costs, discouraging employment growth, and reducing Panama's international competitiveness. Despite high contribution rates, the system faces major financial difficulties. Revenues from contributions and the return-on-investment reserves declined substantially in the three years between 1988 and 1990. Contributions fell from US$339 million in 1987 to US$285 million in 1990 and US$280 million in 1991, and the number of insured contributors declined in 1988 and in 1989. At the same time, CSS's outlays rose steadily.

89. CSS's return on investment reserves is low. Accrued earnings of US$87 million on its reserves in 1990 represent a return of 7.3 percent. Two-thirds of CSS's reserves are invested in government promissory notes that pay interest in other government securities. Thus, cash earnings of US$26 million provided an annual return of only 2.2 percent on the total portfolio. Nonperforming assets constitute one-fifth of CSS's total assets. In the past, part of the investment reserves were used to finance questionable housing investments. Moreover, CSS has used its reserves in recent years to finance a growing operating deficit. The absence of clear investment and financial policy partly reflects CSS s lack of administrative autonomy.

90. The high operating cost of Panama's social security system stems from many factors. Most importantly, the low retirement age (55 for women, 60 for men) fails to reflect how substantially life expectancy has improved since the retirement age was established almost 50 years ago. Moreover, a 1975 law

on early retirement based on outdated actuarial projections allows women to retire at age 50 and men at age 55. In 1988-89, one out of three workers eligible for retirement chose to retire early. About 6,000 people have applied recently for early retirement. The high level of pension benefits -- starting at 60 percent of the salary earned during the best 3 years of the past 15 years -- also drives up the system's cost and losses. Not only does the benefit formula use an unusually high initial percentage (60 percent), but the benefit may rise to 100 percent of the monthly base salary. Given the weak finances of the social security system, the practice of revaluing pensions to reflect cost-of-living also increases substantially the system's losses.

91. The system is further burdened by laws that give certain public employees (such as policemen, firemen, and teachers) generous retirement privileges, such as the right to retire at 100 percent of their highest income after 25 years of service. The government complementary pension scheme was established to finance these additional costs. An extra payroll tax of 2 percent on eligible public sector employees and a 0.3 percent contribution from the central government contribute to the scheme. These contributions fell short of actuarial obligations under the law, however, and the scheme's deficit in recent years has not been fully funded by central government transfers. The scheme's shortfall for 1990 amounted to US$18 million. The total deficit through 1990 that the central government owes the CSS is about US$120 million.

92. CSS's administrative expenses are higher than for similar social security schemes in Latin America. Salaries, the costliest component, accounted for an estimated US$115 million, or 21.2 percent of total expenditures, for 1991. Efforts to cut personnel have been initiated by the current management, but legal constraints impede staff reduction in CCS's medical branch.

93. CSS's financial problems stem partly from an integration of the pension fund and the domestic health-care system that does not reflect proper cost allocation. This integration has allowed CSS to accommodate the health service needs of its fast-growing constituency by using the Ministry of Health's underused health-care facilities instead of building its own parallel and overlapping health-care infrastructure. But under this system, CSS must provide staff and medicine for use in government hospitals that provide services to Panamanians who do not contribute to the social security system. The net cost to CSS of providing these services averages about US$30 million a year. Because there is no clear framework for determining appropriate contribution levels, procedures, and operating methods for the Ministry of Health and CSS, CSS's operating costs have risen since the integrated health-care system was introduced in 1973. To resolve cost allocation problems, the Government plans to define and implement a plan in order to rationalize the cost allocation system during the program period, supported by the proposed ERL. Agreement has been reached with the Government on the terms of reference for a study for developing an action plan (para. 116(9)). Agreement on an action plan and initiation of implementation of the action plan are conditions

of second tranche release (para. 117(8)). Completing implementation of the action plan is a condition of third tranche release (para. 118(7)).

94. Reform of the social security system, vital for economic recovery, aims to ensure the financial solvency of the social security system without increasing the already high social security tax rate. Expected increase in employment and the resulting rise in contributions and the introduction of the reform law in 1991 will reduce the deficit in the next several years. Coupled with cost reduction efforts and improved management practices, the cash deficit of the social security system will likely be eliminated in ten years.

95. In May 1991, the Government identified three objectives for social security reform: (1) eliminating the cash deficit of the social security system in no more than 10 years without increasing the social security tax rate for employers; (2) eliminating the cash deficit of the government complementary pension scheme in 1993; and (3) giving administrative autonomy to CSS. The Congress approved a law, whose salient features are outlined in Annex V, pages 9-10, in December 1991, and the Bank agreed on the terms of reference both for eliminating the cash deficit of the government complementary pension scheme and for developing an action plan to rationalize the integrated health-care system and avoid having CSS and the Ministry of Health subsidize each other (para. 116(9)). Agreement between the Bank and the Government on an action plan to eliminate the cash deficit of the government complementary scheme is a condition for second tranche release (para. 117 (8)). Starting implementation of the action plan to eliminate the cash deficit of the government complementary scheme in 1993 and completing implementation of an action plan to rationalize integrated health-care services are conditions for third tranche release (para. 118 (7)). To achieve these objectives, the law provides for the following:

(1) no increase in contribution rates for employers;

(2) eliminate the early retirement provisions on January 1, 1993;

(3) increase the retirement age for men from 60 to 62 and for women from 55 to 57 on January 1, 1995;

(4) allocate one-third of the thirteenth month salary bonus for both public and private sector employees to CSS;

(5) reduce the benefit formula from 60 percent of the base salary plus 1.25 percent after 10 years and 1.5 percent after 20 years to 60 percent plus 1.25 percent after 15 years of service;

(6) allow eligibility for disability pensions for up to retirement age to reduce pension cost;

(7) base the salary used to calculate the pension on the highest 7 years of working life prior to retirement instead of the present

best 3 years of the past 15 years, as was the case prior to the enactment of the law;

(8) continue with the practice of not revaluing pensions for domestic inflation, except for minimum pensions (i.e., US$145 a month) which will be adjusted every three years provided CSS's finances permit;

(9) shift 0.5 percent of workers' contributions from the medical scheme to the pension scheme. (The Government plans to rationalize the use of resources for health-care services and to eliminate the cash deficit of the medical component through cost containment measures before the end of 1994, in part through the implementation of an action plan which will be supported by USAID.);

(10) manage investment funds profitably and, to increase yield, invest reserves in high-grade securities at a prudent level of risk;

(11) give administrative autonomy to CSS;

(12) introduce a program to reduce CSS's operating costs; and

(13) introduce a satisfactory cost allocation system between the Ministry of Health (MOH) and CSS to avoid cross-subsidization between the two entities.

96. The Bank agreed with the Government that a study of the government complementary pension scheme should be started immediately after Board presentation and finalized in no more than 4 months so that options arrived at in the study could be evaluated before second tranche release (para. 116(9)). Agreement between the Bank and the Government on an action plan to eliminate the cash deficit of the government complementary pension scheme will be a condition for second tranche release (para. 117(8)). Implementation of the plan will be a condition for third tranche release (para. 118(7)). It was agreed that in order to be satisfactory: (1) actions included in the plan should be self-sustaining and should permanently increase revenue or reduce expenditure (or both); (2) implementation of the plan should produce cash savings of US$21-25 million a year; and (3) implementation of the action plan should eliminate the cash operating deficit in 1993 and should prevent the reemergence of cash operating deficits in the following 10 years.

G. REFORM OF THE FINANCIAL SECTOR

97. Because of economic and political upheavals in the 1980s, financial sector activities contracted sharply. Assets of the banking system (mostly the offshore banking system) fell 70 percent between 1982 and 1990. Domestic bank deposits began to recover after the new government took office, rising by US$3.5 billion in 1990. Restrictions placed on withdrawals during

the crisis of 1989 were gradually removed by July 1990. There are now no controls on loan interest rates, and restrictions on deposit interest rates do not significantly affect the economy. Directed credit programs of private commercial banks also remain negligible. Major issues in the financial sector include the technical insolvency and inefficiency of most public banks and the weakness of the regulatory and supervisory framework.

98. The public banking system comprises four institutions: a large commercial bank that acts as a public sector depository and fiscal agent (National Bank of Panama, BNP), the Savings Bank (Caja de Ahorro, CA), the National Mortgage Bank (Banco Hipotecario Nacional, BHN), and an Agricultural Credit Bank (Banco de Desarrollo Agrícola, BDA). Public banks have been used in the past to direct lending to agriculture, construction, and low-income housing. BHN insures deposits at the five privately-owned savings and loan associations (S&Ls), three of which are reported to be technically insolvent. Although the BNP's portfolio of private sector loans represents only 16 percent of its lending, it had to create reserves for potential losses for close to half of its private sector portfolio. Moreover, the BNP has not received interest on outstanding loans and overdrafts of the central government during the crisis years 1989-90. The sizeable nonperforming portfolios of the other three public banks have resulted primarily from poor lending decisions. The public banks also suffer from excessive staff costs and inadequate management and administration. The Government is finalizing an action plan to address problems in the public banks. Annex II, Attachment x, outlines restructuring needs of public banks and terms of reference for carrying out a study to develop an action plan for restructuring BDA. USAID will finance the aforementioned study. The proposed ERL will support the Government's program through technical assistance during the program period (para. 125), but actions under this program are not conditions of the ERL.

99. Regulation and supervision of the banking system are also inadequate. The outdated Banking Law of Panama should be modified to ensure the solvency of commercial banks and to bring public banks under the supervision of the National Banking Commission. Prudential regulations have to be modified. Required capitalization ratios are too low and provisioning requirements for classified assets and for asset classification techniques are inadequate. Annex II, Attachment xi, describes the proposed study on prudential regulations and outlines the technical assistance under the ERL (para. 125) to help the Government strengthen bank supervision during the program period.

100. Mismanagement and poor lending decisions have left public banks technically insolvent. The Government plans to provide US$50 million in 1992 to capitalize the Savings Bank, pending completion of a sound restructuring plan that will include the possible sale of the Savings Bank's stock to the public through Panama's newly created capital market. With this exception, it is not advisable to recapitalize these institutions before carefully considering all available options. The Government plans to draft comprehensive restructuring plans based on information obtained from audits. The audits have already been completed or are being finalized. The

restructuring plans will include timing for recapitalization (only for the Savings Bank), privatization, abrogation of BHN's deposit insurance responsibility, and restoration of sound and safe procedures in the private savings and loan associations. Actions under the Government's financial sector reform program, which are not conditions of the proposed ERL, include:

(1) closing and liquidating three privately owned S&Ls and transferring their assets to the Savings Bank (CA);

(2) restructuring the National Mortgage Bank (BHN);

(3) restructuring the Agricultural Development Bank (BDA);

(4) placing public bank lending operations on an equal footing with private banks;

(5) defining the future role of commercial activities at the BNP and CA;

(6) strengthening prudential regulations and bank supervision; and

(7) resuming payment of interest by BNP on its overdrafts to the Government in 1992.

H. SOCIAL SECTOR REFORM

101. The 1987-89 economic crisis increased poverty in Panama. Unemployment reached about 16 percent (after climbing to 20 percent in 1990), and many of the people in the informal sector (small traders and market vendors, for example) remain underemployed. About three-fourths of the unemployed live in urban areas, principally in Panama City and Colon. In the past three years, real incomes have dropped sharply for about a quarter of the population, the number estimated in 1991 to be extremely poor. The average monthly income in 1991 is insufficient to purchase the minimum food basket, which costs about US$185 a month.

102. Although social indicators have improved in the past 20 years (see Annex VI), in the 1980s this positive trend ceased. But geographical disparities are significant. Infant mortality, for example, was an estimated 24 per 1,000 infants nationally in 1987, but exceeded 35 per 1,000 in some of the poorest areas, which represent 13 percent of the population. Health statistics are even worse in areas with a heavily concentrated Indian population, such as Darien, Bocas del Toro, and Comarca de San Blas. In 1988, an estimated one-quarter of Panama's population suffered from malnutrition, while this figure was 40 to 70 percent of the people in Darien, Bocas del Toro, and Comarca de San Blas.

103. Health coverage has expanded in the last decade, but about a third of the population still lacks access to health-care services. Health-care services remain extremely inefficient. Agency responsibilities are not clearly defined, so the system lacks clear lines of authority and uses

existing capacity inadequately. Health and education facilities have significantly deteriorated, especially in the past couple of years, as budgetary constraints have severely limited repairs and maintenance.

104. Authorities have taken several measures to address the most urgent short-term social issues. In 1990, as part of a USAID assistance package, the Government established an emergency needs program to provide food, shelter, and replacement housing for the displaced, as well as emergency employment and technical assistance for several key ministries.

105. Other social sector measures are planned to alleviate the social costs of adjustment for Panama's poorest groups. First, health and education's share of spending in the 1992 budget will be maintained at the 1990 level. Second, the Government intends to reallocate more resources toward primary health and education spending within the social sectors budget. Third, a plan of action for nutrition will be implemented in the poorest regions of Panama, incorporating programs for: (1) lactating mothers and children up to the age of 5, and (2) school-age children (including school benefits and lunches). The nutrition program at the national level is estimated to cost about US$7.5 million annually. UNDP will help the Government to implement the program, and the Bank will also support the Government through the technical assistance under the proposed ERL (para. 123). Annex III, Attachment xii, shows options that the Government is pursuing. MIPPE will be the executing agency for the nutrition program (para. 116(7)). Agreeing on a pilot program is a condition for second tranche release (para. 117(9)). Evaluating the results of the pilot program and agreeing on a national program is a condition for third tranche release (para. 118(8)).

PART III
MEDIUM-TERM PROSPECTS, EXTERNAL FINANCING NEEDS, AND CREDITWORTHINESS

106. The economic growth that has resumed since 1990 has been based mostly on unused existing capacity. Sustaining economic growth will increasingly require investment in new capacity. The base case projections presented below assume that beyond implementing the reform program supported by the proposed ERL, the authorities will continue to deepen reform efforts in the projection period. Implementation of the Government's reform program is expected to significantly change the structure of the Panamanian economy in the 1990s. Trade liberalization and deregulation of the labor market will bring about effective real devaluation, making Panama more competitive internationally. They will also change the balance of incentives, favoring exportables and importables over nontradables and encouraging private sector specialization suitable for the country's comparative advantages. Part of this transformation will be the elimination of incentives for capital-intensive production processes, the result of decades of import-substitution strategies.

107. Assuming successful implementation of the reform program and continued structural adjustment, the country's GDP is expected to grow an average 5.1 percent a year between 1992 and 1995, and about 5.8 percent a year in the second half of the 1990s (Table 5). The projected growth rates are considered to be attainable. The domestic economy is service-oriented, so the investment requirements for expansion are relatively modest and vast untapped opportunities exist for growth, such as putting reverted areas from the Canal Zone into use. The projected growth rates are comparable to those recorded in the early 1970s, when GDP grew by about 6.5 percent a year.

108. During the projection period, 1992-1999, the main sources of growth will come from domestic private services and from sectors oriented toward external trade, including bananas, shrimps, and nontraditional manufacturing activities, especially maquila. The activities of the Colon Free Trade Zone have also started to register significant growth. During the projection period, the service sector will continue to be the heart of the economy, contributing to 79 percent of projected GDP after 1995. Growth in the increasingly efficient and dynamic industrial and agricultural subsectors is expected to offset a projected decline in inefficient industries and agriculture, raising industry's share of GDP to about 12 percent while agriculture's share remains at 9 percent after 1995. Shares in the service sector are expected to change, with the share for public sector activities, the Canal, and the pipeline declining, as the share for financial services, insurance, tourism, and transportation (ports) increases.

109. Gross domestic investment is expected to increase in the first half of the decade, mostly because of an improved investment climate and the recovery of public investment -- to pre-crisis (before 1988)--levels of about 17.5 percent of GDP. After peaking in 1994 at 18.2 percent of GDP, gross domestic investment as a share of GDP should decline somewhat, to 17.5 percent by 1999, because of improved capital efficiency. (In this period, the incremental capital-output ratio is expected to decline from a projected 3.3 in 1994 to around 3.0 by 1999.)

Table 5: Selected Macroeconomic Variables for Selected Years

(projected - in percentages)

	1992	1993	1994	1995	1996-1999 3/
Real GDP growth (%)	5.0	5.0	5.0	5.5	5.8
Private per capita consumption 1/	93.5	98.0	102.0	105.5	117.0
Domestic savings/GDP (%)	18.3	19.3	20.5	20.7	21.7
Gross domestic investment/GDP(%)	16.2	17.1	18.2	18.0	17.7
ICOR	2.8	3.2	3.3	3.2	3.0
Real export growth (%)	3.4	6.0	6.6	7.0	7.7
Resource balance/GDP (%)	2.1	2.2	2.3	2.7	3.9
Current account balance/GDP (%) 2/	-6.8	-6.8	-4.2	-4.0	-1.8

1/. Index, with 1987 as the base year.
2/. Excluding official transfers.
3/. Annual average growth rates.

Source: Bank staff estimates.

110. Trade reform will reduce the anti-export bias of the economy, inducing a shift of resources from formerly protected industries to exportable activities and efficient import-substitution. In response to trade reform and deregulation, the share of exports of goods and nonfactor services are projected to grow from 38.5 percent of GDP in 1990 to 42.9 percent in 1995 and 47.9 percent in 1999. The structure of exports should change, with nontraditional exports increasing as a share of the total from 47.9 percent in 1990 to 55.1 percent in 1995 and 55.8 percent by 1999. Conversely, traditional exports, such as sugar, should decline in importance. As the economy opens up, imports are projected to increase from 37.3 percent of GDP in 1990 to about 40.2 percent in 1995 and 43.3 percent in 1999. More importantly, the composition of imports would change. Imports of consumer and intermediate goods would increase, as the share of imported capital goods declines in response to the growth in labor-intensive production. The resource balance is expected to improve steadily during the period, from a projected 2.2 percent of GDP in 1991 to 2.7 percent in 1995 and 4.6 percent in 1999. The current account deficit is expected to decline from a projected 6.8 percent of GDP in 1992 to 4 percent in 1995 and 2.3 percent in 1999.

111. Given Panama's open capital account, projections for the capital account of the balance of payments are not relevant for analyzing the country's creditworthiness. Rather, creditworthiness is related to public sector finances, which are described as part of the Government's agreed macroeconomic/fiscal program (see paras. 33-38). Projections assume that multilateral financial institutions will provide relatively strong financial support during this period. The multilateral lending programs, together with an expected increase in net direct foreign investment, should compensate for an expected decline in official grants in the remainder of the 1990s. (Annex III, Attachment xiii, shows projected gross capital inflows.) Panama should be able to rely less on foreign sources of financing as private savings grow. Under the base case scenario the Bank and IDB would provide, in about equal amounts, significant financial assistance to Panama in the projection period. The share of domestic investment financed by national savings should expand as national savings increase from an estimated 11.1 percent of GDP in 1991 to 16.1 percent by 1999. Also the IFIs are expected to provide net positive flows to Panama during 1992-1996.

112. Under the base case scenario presented here, indicators of Panama's creditworthiness will improve substantially, with total external debt declining from 102.9 percent of projected GDP in 1992 to 96.1 percent in 1995 and 70.3 percent by 1999. Total debt service payments, as a share of exports of goods and services, will decline from 26.9 percent in 1992 to 16.7 percent in 1995 and 9.3 percent in 1999. Interest payments as a share of current revenues are projected to decline from 26.4 percent in 1990 to an estimated 23 percent in 1993. Panama is accumulating large cash balances because it does not service its debt to money center commercial banks at present. The authorities have begun discussing the issue of overdue payment obligations with the international commercial banks to seek a lasting solution of the arrears problem. Whether the medium-term prospects presented in this report are attained depends very much on Panama's effective implemention of the

reform program to be supported by the proposed ERL and on maintaining political stability.

Low-case scenario

113. Under the low-case scenario, whose main assumptions are described in para. 28, GDP growth would be much lower, averaging at best 2 percent a year during the projection period. Inability to carry through public employment reduction would result in continued depressed levels in public investment, leading to a further deterioration in the capital stock of the country. This would be exacerbated by a sharp decline in official capital flows. If trade/deregulation/and tax reforms are not fully implemented, private investment would be much lower and possibly less efficient with a higher incremental capital/output ratio than under the base-case scenario, since it would be geared to the small domestic market in which further efficient import-substitution opportunities are limited. Exports, especially manufactured and other nontraditional exports, would grow very slowly compared to the base case. Furthermore, growth of traditional exports (bananas, sugar) would likely be lower given the inadequate incentive framework. In view of the uncertainty about economic policies, net direct foreign investment and private transfers would be considerably lower compared to the base case. These lower inflows would also result in a corresponding cut in imports. Reduced capital inflows would shrink import capacity further. Reductions in imports, in turn, would have an adverse effect on investment, productivity, and growth. The Government might be forced to apply import controls, thereby introducing further distortions into the economy. In the absence of further deregulation of labor markets, the cost of labor would likely increase and the unemployment situation could become untenable. With slow growth in GDP and in exports, the share of external debt in GDP and in government revenues, and the debt service ratio would likely climb to critically high levels. Under these circumstances, it is highly unlikely that the country would be able to service its external debt, and Panama's creditworthiness could be undermined.

PART IV
THE PROPOSED LOAN

A. Background

114. After the U.S. military action in 1989, a Bank reconnaissance mission visited Panama in January 1990, followed by economic missions in May, August, and October of 1990 and a pre-appraisal mission for the proposed ERL in February 1991. Panama's economic team, headed by Vice-President Ford, visited the Bank in early May, and the ERL was appraised in June 1991. The Bank appraisal team worked closely with the IDB on the public enterprise reform program. A representative from Japan's aid agency, OECF, also participated in the Bank's appraisal mission. Negotiations began in September 1991 in Washington, D.C., and were concluded on January 22, 1992. This

section describes the policy actions to be supported under the ERL and the proposed timing for the loan.

B. Conditions for Tranche Releases

115. Most of the proposed ERL of US$120 million will be disbursed in three tranches (para. 122) and will support the Government's reform program, outlined in the Government's Letter of Development Policy (Annex IV) and the Matrix of Policy Action (Annex V). A US$1.8 million portion of the loan will be made available at effectiveness for short-term technical assistance (paras. 123-126). Actions taken before Board presentation and proposed actions to be met before second and third tranche release are summarized below. If a satisfactory framework privatization law is not passed by April 30, 1992, the Bank will have the right to suspend disbursements under the loan. All tranche releases will be contingent upon: (1) Panama's maintaining a supportive enabling macroeconomic policy framework consistent with the program outlined in the Letter of Development Policy; (2) satisfactory performance in implementation of the program outlined in the aforementioned Letter and the Matrix of Policy Action; and (3) the Government's progress in carrying out the specific actions required under the program. Among other things, the Bank will review any adjustment to the minimum wages and any policy measures, that may negatively affect the implementation of the program, taken by the Government before each tranche release.

116. The following summarizes agreements reached at negotiations and the Government's actions taken so far. All actions taken prior to Board presentation are shown in the respective column of Annex V.

(1) Agreement on savings targets for the general government and targets for reducing the public wage bill (paras. 33-38 and Annex III, Attachments i, ii, iii, and iv).

(2) Agreement on the size and composition of the public investment program for 1991-93 (paras. 54-56 and Annex III, Attachment viii).

(3) Agreement that a draft enabling legislation will be presented to Congress in March 1992 to improve procurement and budgetary practices for public enterprises; on principles for pricing public utilities and services; on action plans for IRHE and IDAAN; on a program to improve the finances of PSEs, including targets for the consolidated non-interest current outlays for the nine PSEs listed in para. 43; on a program to privatize maintenance and security services for IRHE and meter reading and bill collection for IDAAN; and on expansion program for IRHE and IDAAN (paras. 41-46).

(4) Agreement on the privatization program; the Government established a technical privatization unit at MIPPE and brought Air Panama and Cítricos de Chiriquí to a position where tender documents for the bidding were issued to private investors; Cabinet approved a

privatization plan for INTEL and APN; and the Government established a technical unit to privatize INTEL (paras. 48, 50-52).

(5) Agreement on the trade reform program with a calendar of actions that includes: (i) implementation of the first steps of the trade reform program (reduced import tariff ceilings to 60 percent for industrial products and 90 percent for agro-industrial products on August 1, 1991); (ii) agreeing to reduce import tariff rates to 40 percent for industrial products and 50 percent for agro-industrial products before third tranche release; (iii) eliminating specific import tariff rates on 261 products, which cover about 90 percent of domestic production before second tranche release, and eliminating the remaining specific import tariff rates before third tranche release; (iv) raising the import tariff rate on goods classified under the Centro de Compras (i.e., tourist goods) to 5 percent on January 1, 1992 (action already taken), and agreeing to maintain import tariff rates for industrial inputs, covered under Law 3, at 3 percent; (v) unifying import tariff rates on agricultural products used both as inputs and for final consumption before second tranche release; (vi) taking action to eliminate domestic price controls, quantitative import restrictions, and accompanying import tariff reductions on vegetables (except beans, potatoes, and onions for which QRs and price controls will be eliminated before second tranche release and for tomatoes before third tranche release); and (vii) taking action to eliminate export restrictions and QRs on domestic price controls on beef (and reducing the import tariff rate on beef to 30 percent) before Board presentation, on chicken and pork before second tranche release, and on agricultural products, except sorghum and rice for which quantitative restrictions and price controls will be eliminated before second and third tranche release, respectively (paras. 67, 73, 75).

(6) Agreement on a program to liberalize labor markets and to reduce labor costs along the lines of the Government's program as outlined in para. 82.

(7) Agreement that MIPPE will be the agency to execute the nutrition program (para. 105).

(8) Passage of a satisfactory tax legislation through Congress in late December 1991 (para. 63).

(9) Passage of a satisfactory social security legislation through Congress in early December 1991, agreement on terms of references for preparing action plans to eliminate the projected cash deficit of the government complementary pension scheme in 1993, for developing an adequate cost allocation system between the Ministry of Health and CSS, and to reduce costs of the health-care component of the social security system (para. 93-96).

117. Second tranche release will be conditional on adherence to the implementation of the agreed-upon macroeconomic/fiscal program (paras. 33-38), and the following actions:

(1) Achievement of the agreed-upon savings targets for the general government and implementation of the program to reduce the public wage bill (paras. 33-38).

(2) Satisfactory implementation of the agreed-upon public investment program (paras. 54-56).

(3) Congressional approval of a law, satisfactory to the Bank, establishing improved procurement and budgetary practices of public sector enterprises (paras. 41-42).

(4) Implementation of a program to improve the finances of PSEs, including not exceeding the targets for the consolidated non-interest current outlays for the PSEs mentioned in para. 43; progress in successfully implementing action plans, including compliance with the financial and operational efficiency targets for IRHE and IDAAN; updating the long-run marginal cost study for electricity; agreement on an action plan to move electricity prices to long-run marginal costs; and undertaking a study on pricing for telecommunications and ports (paras. 41-46).

(5) Congressional approval of a law, satisfactory to the Bank, to restructure and regulate the telecommunications sector and to privatize INTEL; to issue satisfactory norms to ensure that mechanisms and procedures for privatization are timely, efficient, and transparent; to bring all public companies listed in Annex III, Attachment vii (Group A) to the point where tender documents for bidding have been issued by private investors or offers have been solicited; and to grant concessions for the ports of Balboa and Cristóbal to the private sector (paras. 48, 50-52).

(6) Implementation of a program to adjust corporate income tax rates and decrease the number of personal income tax brackets according to the approved law (para. 63).

(7) Elimination of price controls on industrial products covered under Law 3 and continued phasing out of QRs and import permits, domestic price controls, and related import tariff rate reductions on corn, sorghum, potatoes, onions, beans, chicken, and pork; elimination of specific import tariff rates on 261 products, which cover about 90 percent of production; unifying import tariff rates on agricultural products used both as inputs and for final consumption, and maintenance of a 3 percent minimum import tariff rate on industrial inputs covered under Law 3 (paras. 63, 67, 73, 75).

(8) Agreement on an action plan to eliminate the cash deficit of the government complementary pension scheme in 1993; agreement on an action plan and initiation of its implementation to rationalize the cost allocation system between the Ministry of Health and CSS; and agreement on an action plan to reduce costs of the health-care component of CSS (para. 93-96).

(9) Agreement on the objectives, actions, targets, and timetables for the pilot phase of the nutrition program (para. 105).

118. The third tranche release would be conditional on adherence to the implementation of the agreed-upon macroeconomic/fiscal program (paras. 33-38) and on the Government's:

(1) Achieving agreed-upon savings targets for the general government and completing the program to reduce the public wage bill (paras. 33-38).

(2) Satisfactorily implementing the agreed-upon public investment program (paras. 54-56).

(3) Implementing a program to improve the finances of PSEs, including not exceeding the targets for the consolidated non-interest current outlays for the PSEs mentioned in para. 43; achieving progress in successfully implementing action plans, including compliance with the financial and operational efficiency targets for IRHE and IDAAN, implementing the privatization program for IRHE and IDAAN, and implementing an action plan for pricing for electricity, water, telecommunications, and ports; and ensuring implementation of satisfactory legislation to improve procurement and budgetary practices of public sector enterprises (paras. 41-46).

(4) Establishing an adequately staffed regulatory agency for telecommunications and issuing tender documents for international bidding by private investors for a controlling ownership interest in INTEL; completing implementation of the privatization program for IRHE and IDAAN; privatizing at least three public companies listed in Annex III, Attachment vii (Group A); and continuing to implement the program to grant concessions on ports of Balboa and Cristóbal to the private sector (paras. 48, 50-52).

(5) Implementing a program to adjust corporate income tax rates and decreasing the number of personal income tax rate brackets according to the approved law (para. 63).

(6) Completing the agreed-upon trade reform program by eliminating all remaining specific import tariff rates; establishing an import tariff rate ceiling of 40 percent for industrial products and 50 percent for agro-industrial products; maintaining a 3 percent

minimum import tariff rate on industrial inputs, covered under Law 3; converting the price-setting institution, Oficina de Regulación de Precios, into a consumer protection agency, Oficina de Protección al Consumidor (para. 75), and amending Decree 60, March 1969, accordingly; eliminating QRs and domestic price controls on rice and tomatoes, and introducing agreed tariff rate reductions (paras. 63, 67, 73, 75).

(7) Starting implementation of the program to eliminate the projected cash deficit of the government complementary pension scheme, and completing implementation of the action plan to introduce a satisfactory cost allocation system between the Ministry of Health and CSS, and finalizing the implementation of a program to reduce costs of health-care component of CSS (paras. 93-96).

(8) Evaluating the results of the pilot program for nutrition and agreeing on a plan to implement the nutrition program nationally (para. 105).

C. Procurement, Auditing, Retroactive Financing, and Special Account

119. Loan proceeds would be used to finance the CIF cost of general imports and relevant foreign services, excluding goods financed by other multilateral and bilateral agencies, luxury goods, military equipment, and other goods specifically prohibited in a negative list defined under the Standard International Trade Classification (SITC), and including services for technical assistance under the proposed ERL. Retroactive financing of up to US$60.2 million of the loan amount is recommended for eligible imports which took place since September 1, 1990. Although this would exceed the standard 20 percent guideline for retroactive financing under adjustment operations, exemption from this rule is justified, as it will enable clearance of arrears to the Bank and other IFIs to take place. Audits by the independent external auditors acceptable to the Bank will be completed 90 days after each tranche withdrawal, or for corresponding fiscal years when withdrawals are made for technical assistance. The technical assistance component (paras. 123-126) of US$1.8 million would finance the cost of consultants to help the Government implement the agreed-upon reform program.

120. A recent Country Procurement Review (CPR) by the Bank concluded that private sector importers' procurement procedures are generally acceptable. Public sector procurement is governed by the Fiscal Code and specific by-laws of public sector enterprises. Procedures are based on competition with only minor exceptions for direct contracting, which are compatible with Bank guidelines. Private sector importers of capital goods and commodities normally base their purchase decisions on more than one quotation. Importers of consumer goods, however, tend to purchase by direct negotiation based on long-term agreements with individual manufacturers. On the basis of this review, the following procurement procedures will apply:

(1) Imports by public and private importers valued at US$3 million or more would be procured under simplified ICB procedures in accordance with Bank procurement guidelines, except for future petroleum imports for which modified ICB procedures, satisfactory to the Bank, may be used. Such procedures were agreed upon with the Government during negotiations. For petroleum imports, under existing contracts, relevant expenditures qualify for reimbursement under the loan in an amount not to exceed per unit the reference average FOB price (high and low) published in Platt's Oilgram for the U.S. Gulf Coast or the Caribbean, as applicable, on the date of loading. This price will be adjusted for type and quality of crude or product, plus ocean freight rates (that would apply to the largest tankers that can be handled at the receiving terminal), insurance, allowance for ocean losses, and inspection costs. No finance charge on such contracts would be eligible for reimbursement under the loan. (The first tranche disbursement of the proposed ERL will be made against oil imports). A similar criterion would apply to commodities under existing contracts for which the reference unit price would be the average price posted by a recognized commodity exchange.

(2) Imports by public sector importers, valued below US$3 million, would be procured in accordance with the procedures of the importing agencies. Import contracts by private importers would be awarded in accordance with established commercial practices of the private sector, requiring price quotations from at least two eligible suppliers, except where direct contracting may be appropriate under para. 3.5 of the Operations Directive guidelines.

121. MIPPE would administer the loan. The Controller-General's Office (Contraloría) would collect and review relevant procurement documentation regarding public sector imports and payments to ensure that only imports that meet the eligibility criteria and satisfy agreed-upon procurement procedures are included in withdrawal applications; MIPPE would be responsible for the same regarding the private sector and for submitting all withdrawal applications. To assist in this work, MIPPE would retain an experienced procurement consultant. Disbursements against contracts valued under US$1 million would be made on the basis of statements of expenditure (SOE), except for disbursements for technical assistance for which the limit would be US$100,000. The relevant procurement documentation would be retained by Contraloría for review by the Bank and independent auditors.

D. Tranching, Disbursement, and Closing Date

122. The loan proceeds would be disbursed over an 18-month period in tranches of US$60 million (first tranche); US$25 million (second tranche); and US$33.2 million (third tranche). The first tranche would be available for disbursement upon loan effectiveness. It is expected that a further 8 months,

and subsequently 10 months, respectively, would be required to meet the conditions for second and third tranche release. US$100,000 would be made available upon loan effectiveness through a Special Account at BNP for technical assistance. Cofinancing from the IDB of US$120 million is expected in the form of parallel financing of a sectoral adjustment loan to support the Government's public enterprises reform program, also supported under the proposed ERL. OECF is expected to cofinance the Bank operation with a US$100 million concessional loan with the same timing under the proposed Bank tranche disbursements. Bank's tranche disbursements will also be timed with IDB's expected tranche disbursements under its proposed Public Enterprise Reform loan. The closing date for the proposed loan is December 31, 1993.

E. Technical Assistance

123. Given the complexity of Panama's economic adjustment effort, the Government has requested technical assistance of US$1.8 million under the proposed ERL. Annex III, Attachment xiv, describes the agreed-upon technical assistance program under the proposed ERL. The bulk of this assistance is designed to help strengthen the Government, and in particular MIPPE, so it can carry out the agreed-upon structural adjustment program. Approximately US$1.6 million of the assistance would finance the services of external experts in macroeconomic/fiscal policies, public employment reduction program, agriculture, customs, social security, nutrition program, procurement, and privatization. US$200,000 will be provided to enable the Government to create public awareness of the need for introducing reforms. Consultants would be hired in accordance with Bank procedures and would work with the various technical units recently established at MIPPE.

124. Technical assistance, to be financed by an IDB concessional loan, will also be provided to the Government to establish an adequate regulatory framework for telecommunications as part of the program to privatize INTEL. The Bank will monitor the provision of technical assistance to privatize INTEL through a tripartite arrangement among the Bank, IDB, and the Government. The technical assistance for INTEL will focus on building expertise in: (1) regulatory policy; (2) price, cost, and financial analysis; (3) service, investment planning, and technical standards; and (4) administrative, legal, and information systems. The planned technical assistance for INTEL is described in Annex III, Attachment xv.

125. Assistance would also be provided to strengthen bank supervision and to complete a review and revision, as needed, of the regulatory framework for financial institutions. A technical assistance component of US$120,000 would be used to finance the services of external experts who would: (1) provide operational training to the banking supervision staff of Panama's National Banking Commission; and (2) support efforts to update the country's banking regulatory framework. USAID will fund studies to develop action plans to restructure public sector banks (para. 98).

126. The Bank's technical assistance would complement other donor actions (Annex III, Attachments xvi and xvii include terms of references for a

study of options to reduce health-care costs of CSS and a study of the government complementary pension scheme, respectively). UNDP will fund a study to strengthen the Ministries of Industry and Commerce and of Agriculture to enable them to implement reform programs supported by the proposed ERL. IDB would provide assistance on public sector management and public enterprises. USAID, the UNDP, and the IDB would jointly fund a study to evaluate viable options for financing expansion and maintenance for the Canal, as well as its possible privatization. USAID will also fund some studies and preparation of action plans which are being supported under the proposed ERL. Given the enormous investment and maintenance needs required before Panama's assumption of operational control of the Canal in 1999, the study is very timely (para. 127).

F. The Study of Viable Options for the Canal

127. The Panama Canal, a major asset of the country, exploits Panama's unique geographic location. The canal accounts for about 8-10 percent of GDP and is the second largest source of employment in the country. Although it is presently operated by the United States Government, through a binational commission under a Panamanian administrator, the canal will revert to Panama in the year 2000. Changes in the structure of world trade and other factors have reduced demand for the canal services. Canal traffic has decreased 2.8 percent a year since 1982. Economic assets (railroads, ports, housing, and other buildings), already reverted to Panama under the terms of the 1977 Carter-Torrijos treaty, were not adequately maintained by previous administrations. The Government understands the need to maintain the quality of canal services. An explicit commitment to maintenance of the canal is all the more important, considering that shippers will be deciding in the next few years whether to build vessels that are too large for the Panama Canal. Relying only on toll-generated funds would not permit rapid construction, and alternative sources of financing may not be forthcoming, until there is a clearer definition of how Panama will manage the canal after the year 2000.

128. The President of the Republic established an interagency Cabinet-level Consultative Council in early 1991 to oversee preparations for reverting the canal to Panama. Preparation of a master plan for the canal area will be a key step. The USAID, the UNDP, and the IDB will jointly fund a study to evaluate viable options -- including privatization -- for financing expansion and maintenance of the canal. The study would also review such issues as land use and development priorities, environmental protection, and the use of reverted assets.

G. Program Benefits and Risks

129. The benefits of the proposed ERL operation include the establishment of a sound basis for sustained economic recovery, which should reduce unemployment, and the initiation of trade reform and domestic deregulation, which should promote export growth and efficient import substitution. The operation would also reduce state control and improve

efficiency in the public sector. Higher savings and increased foreign and domestic investment would accelerate economic growth. Deregulation and public sector reform would expand economic efficiency. Changes in tax legislation would stimulate private investment. Social security reform would strengthen public finances by eliminating CSS's cash deficit. The proposed ERL would also help to move the economy from being heavily protected and inward-looking toward a more outward-looking orientation. In addition, the proposed loan would facilitate Panama's movement out of nonaccrual status and reestablishment of its creditworthiness. Once arrears to the three IFIs are cleared, Panama would be able to conclude debt settlements with the Paris Club and to initiate negotiations with the international money center commercial banks. Thus, a major benefit from this operation will be the regularization of Panama's relationship with international financial institutions (IFIs).

130. Timely implementation of the reform program, supported by the proposed ERL, is expected to lead to a major turnaround for the Panamanian economy within the next few years. First, public employment reduction and social security reform would put public sector finances on a sound financial footing and permit recovery of badly needed public investment in key areas, such as in infrastructure, while strengthened management practices for public enterprises would improve the quality of public services and establish the principle of financial accountability in the public sector. Second, reforms in trade, deregulation, tax, and social security would provide incentives for private sector-led growth in areas of Panama's comparative advantages. These reforms, coupled with the reforms in public sector enterprises, would lower the cost of living through reducing costs and prices. Reforms in trade, deregulation, and in ports would help the economy to integrate better with the rest of the world and open opportunities for sustained growth. Third, privatization of companies and services would shrink the size of the public sector in the economy, expand efficiency, and improve services. Fourth, deregulation and labor reforms would encourage flexibility in resource allocation and would reduce unemployment. Fifth, privatization of public banks, rationalizing the operations of banks that will remain in the public sector, improved prudential regulations, and strengthened bank supervision would ensure that one of the major assets of the country, the financial sector, would remain solvent and continue to provide stimulus for growth to the rest of the economy. Lastly, social sector reforms would start a vital process of providing nutritional assistance to the poorest groups in Panama.

131. Effect on Poverty. Over time the planned reform program should have a positive impact on the poorest groups in Panama through the recovery of sustained economic growth. As employment and incomes grow, the number of poor should decline. Economic recovery will result principally from: (1) trade reform, which will stimulate economic growth by increasing efficiency and specialization in areas that reflect Panama's comparative advantages; (2) agricultural trade liberalization, which will reduce food costs and thus boost real incomes for the poorest groups; (3) deregulation of the labor market, which should reduce unemployment; (4) tax reform, which should stimulate private investment, avoid the increase in the anti-labor bias of the incentives system, and exempt the poorest groups from income taxation; and (5) reform of the social security system, which should prevent the financial

collapse of the social safety net for a large part of the Panamanian population. Firms and labor markets will probably adjust gradually, and unemployment could increase during the transition period. The groups most vulnerable include children under the age of 5 and pregnant and lactating women, whose malnutrition and mortality rates could increase during the transition period. The proposed conditionality under the ERL supports a nutrition program for these vulrerable groups (para. 105, and Annex III, Attachment xii).

132. Risks. The proposed operation also faces important risks. The principal risk is the weakness in the institutional capacity to implement the program. However, technical assistance under the ERL, as well as assistance from IDB, USAID, and UNDP, are all designed to help the Government to implement the reform program. Moreover, opposition from interest groups that would be negatively affected by the reform program -- including labor unions and the owners of protected industries -- may put pressure on the Government to dilute the reform program, or even to reverse parts of it. The fluidity of the current political situation may have a negative effect on successful and timely program implementation. The proposed tranching conditions, which would be matched by IDB and OECF, would give the Government incentive for full and timely implementation, and contain the risk of failure. In addition, at the Government's request, most of the program has been discussed with and is supported in principle by the Christian Democratic Party, which has the largest number of seats in the National Congress. In fact, the passage of the laws on social security reform and tax reform through Congress has been made possible by the strong support of the Christian Democratic Party. The Government has started formal discussions with the Christian Democratic Party to solicit their continued support for program implementation. The newly established Technical Policy Unit at MIPPE should facilitate implementation of the planned economic recovery program. The fact that the program requires sacrifices from both the public and the private sector should facilitate the Government's ability to gain political backing for the program's implementation.

H. Relations with External Creditors

133. External Debt. By the end of 1991, Panama's outstanding stock of external debt, including interest arrears, stood at about US$5.4 billion -- 111 percent of GDP. Without payment arrears, debt to commercial creditors accounted for close to three-fifths of total external stock of debt, multilateral debt accounted for about one-fourth, and bilateral debt about 14 percent. The rest of the external debt stock included bonds and debt to suppliers. Panama was over US$3.5 billion in arrears. Arrears on principal and interest totaled US$2.2 billion and US$1.3 billion, respectively.

134. IMF program. On September 12, 1990, the IMF Executive Board approved an 18-month Fund-monitored program (FMP), in the framework of the intensified collaborative approach to resolving the problem of Panama's overdue debt obligations to the IFIs. The program included quarterly fiscal targets, quarterly limits on the BNP's credit to the public sector and on

BNP's net domestic assets, and limits on public foreign borrowing and on the domestic arrears of the central government. Performance under this program has been broadly satisfactory. In November 1991, the IMF concluded negotiations on a 22-month upper credit tranche standby and a Compensatory and Contingency Financing Facility (CCFF), pending the clearance of arrears to the IFIs. The program will continue the fiscal adjustment started in 1991, aimed at consolidating public sector finances, strengthening public financial institutions, and normalizing relations with all domestic and external creditors, but also supports structural reforms under the proposed ERL, specifically those in trade, privatization, taxation, social security, and public enterprises.

135. The Paris Club. An agreement with the Paris Club for rescheduling the official debt service payments in arrears, including those falling due through March 1992, was reached in November 1990. Paris Club creditors agreed to reschedule bilateral credits of US$180 million. These comprise 100 percent of past due principal, interest, and late interest through the end of October 1990 (US$132 million) and 100 percent of principal and interest falling due in the period November 1990 through March 1992 (US$48 million). Repayments will be in ten equal, semi-annual installments beginning in January 1997. Under the terms of the agreement, Panama was required to have an IMF program in place by the end of June 1991. Since the IMF standby was not concluded by that date, the Paris Club provided a final waiver, extending the deadline to January 31, 1992. Since Bank and IMF documents are being circulated to their respective Boards, and Panama intends to pay US$42 million to the Paris Club creditors along with repayment of arrears to IFIs during early Februray 1992, the Paris Club rescheduling agreement is expected to stay in full force.

136. Commercial creditors. The Government started a formal dialogue with its international money center commercial bank creditors in late 1991. It is the declared intention of the Government to start making payments to domestic commercial banks starting in late 1993. By the end of 1991, arrears to money center commercial banks reached about US$2.3 billion. Bank projections assume that an increasing share of the interest obligations coming due will be paid to international money center commercial banks during the projection period. The settlement of arrears to commercial creditors will likely involve debt reduction operations. No part of the proceeds of the proposed ERL will be made available for this purpose.

PART V
IBRD/IMF/IDB COLLABORATION

137. The Bank has worked closely with the IMF and the IDB in preparing and appraising the ERL. The proposed ERL is closely associated with both the proposed IMF and the IDB operations. The planned macroeconomic/fiscal program -- especially the component that would reduce the public wage bill by cutting the number of public jobs -- is an integral part of the proposed operations of both the Bank and the IMF. Both the Bank and the IDB support public enterprise reform and privatization, including that of INTEL. Bank staff accompanied IMF missions in July and in December 1990, and IMF staff joined

the Bank's pre-appraisal mission in February 1991. The IDB fielded a mission for public enterprise reform at the time of the Bank's pre-appraisal mission in February 1991. During that mission, the Bank provided support to IDB regarding public utility pricing, petroleum deregulation, and INTEL's privatization program. A Bank consultant participated in the IMF's standby negotiation mission in June, which preceded the Bank's appraisal mission. The Bank's appraisal mission was fielded in July 1991, to coincide with the IDB's pre-appraisal mission. The Bank's appraisal mission provided technical support to IDB for financial projections for IRHE and to INTEL's privatization program, including a program of technical assistance to privatize INTEL. The Bank's appraisal mission also provided technical support to the IMF for the macroeconomic/fiscal program and the employment reduction program, as well as the structural reforms that IMF is supporting under its agreed standby program and the Compensatory and Contingency Financing Facility.

PART VI
RECOMMENDATION

138. I am satisfied that the proposed loan would comply with IBRD's Articles of Agreement and recommend that the Executive Directors approve the proposed loan.

Lewis T. Preston
President

Attachments

Washington, D.C.
January 30, 1992

PANAMA

Clearance of Arrears

PANAMA'S ARREARS TO IFIs 1/

IMF	US$254.6 million
World Bank	US$225.8 million
IDB	US$172.6 million
IFAD	US$ 4.8 million
TOTAL	US$657.8 million

CLEARANCE OF ARREARS

Date:	Day 1			Day 30	Day 60 plus		
Purpose:	Clear Arrears to IMF	Clear Arrears to WB	Clear Part of Arrears to IDB	Clear US Bridges	Balance of Arrears to IDB	Clear Arrears to IFAD	Clear Panama Bridge
Financing:	254.6	225.8	127.4	143.2	45.2	4.8	82.0
1. Panama	134.7	2.3					
2. US grant		72.2	57.8				
3. US bridges	83.0	60.0					
4. IMF				83.0			
5. World Bank				60.0			
6. Japan cofinancing							
7. IDB cofinancing					45.2	4.8	60.0
8. Taiwan							40.0
9. France grant		3.0					
10. Panama bridge		40.0	42.0				
11. Addit. Panamanian contribution	36.9	48.3	27.6				

Memorandum Items (in millions of US$)

Total stock of arrears to the IFIs	657.8
End-1989 arrears at end-1989 exchange rates	545.0
Total upfront Panamanian contribution 2/	331.8
Total net contribution from Panama	231.8

1/ Total stock of arrears varies based on currency fluctuations.
2/ Including disbursements from Taiwan (US$40 million) and IDB first tranche (US$60 million).

- For simplicity, this table divides grants, bridges, and other contributions toward repayment among various IFIs. In fact, funds will be put into one account and disbursed according to the following list of priorities: (1) IMF and World Bank; (2) IDB; and (3) IFAD.
- US bridges total US$143.0 million, close to the commitment of US$150 million.
- Bridge loan repayments will also include interest for the term of bridge financing, at the current three-month Treasury bill rate.

Annex II

Attachment 1

PANAMA: Key Economic Indicators.

	Actual						Estimated		Projected					
	1980	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1999
Real Growth Rates:														
Gross Domestic Product (GDP) /a.	15.1	(0.4)	4.7	3.4	2.3	(15.6)	(0.9)	3.4	4.5	5.0	5.0	5.0	5.5	6.0
Gross Domestic Income (GDI)	0.0	3.1	4.7	4.5	(0.2)	(17.9)	(1.2)	3.3	4.6	5.0	4.9	4.9	5.4	5.9
Real per Capita Growth Rates:														
Gross Domestic Product (GDP) /a.	10.9	(2.6)	2.6	1.3	0.2	(17.7)	(3.0)	1.4	2.6	3.1	3.1	3.1	3.6	4.2
Total Consumption	(2.8)	6.9	(0.4)	(2.7)	(0.4)	(20.6)	7.6	(5.5)	4.8	1.1	1.7	1.3	3.1	3.4
Private consumption	(6.4)	9.4	(0.3)	(5.4)	(1.5)	(20.6)	17.8	(7.3)	5.6	2.2	4.8	4.0	3.5	4.0
Debt Indicators: /b.														
Total DOD (Million US$) /c.	2,974	4,369	4,759	4,933	5,640	4,686	5,037	5,360	5,413	5,336	6,098	6,194	6,256	6,507
Total DOD/Exports G&S (%) /c.	70.3	85.5	87.5	108.9	133.3	203.2	219.2	221.6	207.6	194.9	205.8	190.7	176.2	124.6
Total DOD/Current GDP (%) /c.	83.6	93.7	97.1	95.9	106.2	103.0	110.7	112.8	107.4	99.4	106.6	100.2	93.3	69.5
Debt service MLT (Million US$)	466	537	410	471	382	31	8	106	173	528	481	509	482	433
Debt service MLT/Exports G&S (%)	11.0	10.5	7.5	10.4	9.2	1.3	0.3	4.4	6.6	19.3	16.2	15.7	13.6	8.3
Debt service MLT/Current GDP (%)	13.1	11.8	8.4	9.2	7.2	0.7	0.2	2.2	3.4	9.8	8.4	8.2	7.2	4.6
Interest MLT (Million US$)	252	304	303	322	225	10	2	59	71	122	206	300	305	332
Interest MLT/Current GDP (%)	7.1	6.7	6.2	6.3	4.2	0.2	0.0	1.2	1.4	2.3	3.6	4.8	4.5	3.5
Interest MLT/Exports G&S (%)	6.0	6.0	5.6	7.1	5.4	0.4	0.1	2.4	2.7	4.4	6.9	9.2	8.6	6.4
National Accounts (share of current GDP):														
Total Investment	27.7	16.7	15.4	16.7	17.5	6.9	2.6	16.3	14.2	16.2	17.1	18.2	18.0	17.5
Public fixed	7.4	6.9	4.8	4.1	3.6	2.3	1.8	1.3	2.4	4.0	4.0	5.0	4.5	3.8
Private fixed /d.	20.3	9.8	10.5	12.6	13.9	4.6	0.9	15.0	11.8	12.2	13.1	13.2	13.5	13.7
National Savings	18.3	13.7	12.5	17.5	17.2	12.4	2.3	8.3	8.0	10.2	11.1	14.9	14.9	16.1
Public /e.	3.7	2.5	3.2	3.5	3.0	(9.2)	(10.3)	(1.8)	(0.3)	1.4	2.3	4.8	5.2	6.8
Private	14.6	11.2	9.3	14.0	14.2	21.6	12.6	10.1	8.3	8.8	8.8	10.1	9.7	9.3
Foreign Savings	9.4	3.0	2.9	(0.8)	0.3	(5.5)	0.3	8.0	6.2	6.0	6.0	3.3	3.1	1.4
ICOR	0.2	1.0	2.3	3.1	5.2	(1.2)	(7.7)	0.8	3.5	2.8	3.2	3.3	3.2	2.9
Non Financial Public Sector (as % of current GDP):														
Total Current Receipts /e.	28.7	31.7	31.2	30.6	32.1	23.2	23.8	30.2	31.8	32.7	32.3	31.0	30.9	30.5
Total Current Expenditures	25.0	29.2	28.0	27.1	29.1	32.6	34.1	32.0	32.1	31.3	30.0	26.2	25.7	23.7
Public Savings	3.7	2.5	3.2	3.5	3.0	(9.4)	(10.3)	(1.8)	(0.3)	1.4	2.3	4.8	5.2	6.8
Capital Revenue	0	0	0	0	0	0.0	0.0	0.1	0.0	0.0	5.3	1.0	0.5	0.5
Capital Expenditures & Net Lending	8.8	8.0	4.9	4.8	4.0	1.3	1.2	1.3	2.4	4.0	4.0	5.0	4.5	3.8
Overall Balance	(5.2)	(5.5)	(1.7)	(1.3)	(1.0)	(10.7)	(11.5)	(2.9)	(2.7)	(2.6)	3.6	0.8	1.2	3.5
Balance of Payments:														
Exports GNFS (real growth rate)	38.2	(6.4)	9.0	(4.0)	(2.0)	(9.2)	(0.7)	1.9	7.7	3.4	6.0	6.6	7.0	7.8
Exports GNFS/Current GDP	46.2	38.2	39.7	36.9	35.3	38.0	37.5	38.5	39.8	39.6	40.9	41.9	42.9	47.9
Imports GNFS (real growth rate)	17.4	(4.7)	3.6	(11.6)	0.0	(34.5)	14.7	30.7	7.1	4.3	5.4	5.9	5.6	6.1
Imports GNFS/Current GDP	47.7	37.2	36.8	31.6	30.8	24.1	27.9	37.3	37.6	37.6	38.8	39.6	40.2	43.3
Import Elasticity	3.0	34.2	2.3	(10.8)	0.0	9.6	(19.1)	10.5	1.7	0.8	1.2	1.3	1.1	1.1
Resource Balance/Current GDP	(1.5)	1.0	2.9	5.4	4.5	13.9	9.5	1.2	2.2	2.1	2.2	2.3	2.7	4.6
Current Account Balance/Current GDP /f.	(9.0)	(3.0)	(2.5)	0.8	(0.3)	7.1	(1.0)	(8.7)	(6.9)	(6.8)	(6.8)	(4.2)	(4.0)	(2.3)
Terms of Trade Index (1980=100)	100.0	95.9	93.8	84.2	106.3	108.3	103.9	99.9	102.0	101.8	100.8	100.2	99.7	100.0
Prices and Exchange Rate :														
Consumer Price Index (annual <>) /g	14.5	1.0	0.4	0.4	0.9	0.3	-0.2	1.1	1.5	1.5	1.5	2.9	2.8	2.8
Nominal Exchange Rate (C/US$)	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
GDP (million B$):	3,559	4,566	4,902	5,145	5,310	4,551	4,549	4,750	5,039	5,370	5,723	6,183	6,706	9,366

Notes:

/a. All GDP figures for 1980 include the incorporation of the Canal activities to the Panamanian Economy. Real GDP growth excluding these activities was 6.0% in 1980.

/b. Historical data through 1987 is from World Debt Tables 1990-91 (cash basis). From 1988 to 1993, debt data is based on IMF historical and projected debt. From 1994 to the year 2000, debt data is based on DRS estimated pipeline.

/c. Includes accumulation of arrears. 1988-1992 Stocks include currency adjustments.

/d. Includes change in stocks.

/e. Includes all other agencies.

/f. Excludes Official Capital Grants. This accounts for the discrepancy with foreign savings.

/g. 1991-93 figures are IMF projections. In the 1994-99 period. CPI is projected to change in line with international inflation (G-5 MUV).

Annex II
Attachment 1a
(Page 1 of 2)

PANAMA - NATIONAL ACCOUNTS

1989 Per Capita GNP in US$: 1780.0
Mid-1989 Population (mils.) 2.37

A. National Accounts (As % of current GDP)	Actual a/ 1980	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
Gross Domestic Product m.p.	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	9.0	9.5	10.5	11.0	11.0	10.8	10.6	10.4	10.0	9.0
Industry	17.3	13.2	9.6	9.6	10.2	10.4	10.5	10.7	11.1	12.0
(of which Manufacturing)	10.0	8.3	..	..	..	..	..	..	..	..
Services	73.7	77.3	79.9	79.4	78.8	78.8	78.9	78.8	78.8	79.0
Resource Balance	-1.5	4.5	13.9	9.5	1.2	2.2	2.1	2.2	2.7	4.6
Exports of GNFS	46.2	35.3	38.0	37.5	38.5	39.8	39.6	40.9	42.9	47.9
Imports of GNFS	47.7	30.8	24.1	27.9	37.3	37.6	37.6	38.8	40.2	43.3
Total Expenditures	101.5	93.5	86.1	90.5	98.8	97.8	97.9	97.8	97.3	95.4
Total Consumption	73.8	78.0	79.2	87.8	82.6	83.6	81.7	80.7	79.3	77.9
Private Consumption	54.7	54.9	54.6	66.1	61.0	62.2	61.5	62.5	63.2	63.2
General Government	19.1	23.1	24.6	21.7	21.6	21.4	20.3	18.2	16.1	14.7
Gross Domestic Investment	27.7	17.5	6.9	2.6	16.3	14.2	16.2	17.1	18.0	17.5
Fixed Investment	24.3	17.6	9.0	7.2	11.5	14.2	16.2	17.1	18.0	17.5
Changes in Stocks	3.4	-0.2	-2.1	-4.6	4.7	0.0	0.0	0.0	0.0	0.0
Gross Domestic Saving	26.2	22.0	20.8	12.2	17.4	16.4	18.3	19.3	20.7	22.1
Net Factor Income	-4.5	-6.0	-8.4	-9.8	-9.1	-8.4	-8.1	-8.2	-5.9	-6.0
Net Current Transfers	0.4	1.2	1.6	1.5	3.1	3.1	5.5	1.1	0.9	0.0
Gross National Saving	22.1	17.2	14.0	3.9	11.4	11.1	15.7	12.2	15.7	16.1

B. National Accounts Growth (Constant Prices)	Actual a/ 1980	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
Gross Domestic Product m.p.	6.0	2.3	-15.6	-0.9	3.4	4.5	5.0	5.0	5.5	6.0
Agriculture	-1.9	-4.0	-5.0	3.1	3.3	3.0	3.0	3.2	3.2	3.0
Industry	11.3	1.5	-35.0	-1.4	9.8	6.1	6.8	7.0	7.5	8.0
(of which Manufacturing)	5.9	3.7	..	..	..	..	..	..	..	..
Services	4.7	2.0	-12.4	-2.0	2.6	4.5	5.0	5.0	5.5	6.1
Exports of GNFS	39.5	-1.9	-2.8	-0.7	1.9	7.7	3.4	6.0	7.0	7.8
Imports of GNFS	16.6	-4.4	-34.1	16.9	28.3	7.1	4.3	5.4	5.6	6.1
Total Expenditures	-1.5	1.8	-27.0	4.0	11.9	4.2	5.3	4.8	4.9	5.2
Total Consumption	-2.6	1.7	-18.5	9.7	-3.5	6.7	3.0	3.6	5.1	5.2
Private Consumption	-4.9	0.6	-18.5	19.9	-5.4	7.5	4.1	6.7	5.4	5.8
General Government	5.1	5.0	-18.8	-12.7	2.2	4.5	-0.3	-5.8	3.6	2.8
Gross Domestic Investment	2.4	2.4	-63.6	-62.4	526.6	-8.9	19.8	10.8	4.3	5.4
Fixed Investment	3.1	0.2	-54.5	-19.6	60.0	28.5	19.8	10.8	4.3	5.4
Capacity to Import	..	-9.2	-6.8	-1.4	1.6	8.0	3.4	5.8	6.8	7.6
Gross Domestic Income	..	-0.2	-17.9	-1.2	3.3	4.6	5.0	4.9	5.4	5.9
Gross National Income	..	0.1	-20.9	-2.9	4.5	5.5	5.5	5.1	5.3	5.9
Gross National Product/a	-1.9	2.7	-18.2	-2.6	4.7	5.3	5.5	5.1	5.3	6.0
Gross Domestic Saving	45.7	28.4	-15.4	-41.4	52.5	-5.6	15.4	11.3	7.2	8.8
Net Current Transfers	..	-13.2	25.1	-2.1	101.8	4.1	83.9	-79.0	-15.0	-100.0
Gross National Saving	..	48.5	-29.7	-72.3	226.2	-4.4	45.1	-15.5	5.5	9.4

/a. 1980 figures exclude incorporation of Canal Zone.

Annex II
Attachment 1a
(Page 2 of 2)

PANAMA - NATIONAL ACCOUNTS (continued)

C. Price Indices (1980=100):	Actual 1980	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
Consumer Prices (IFS 64)	100.0	118.3	118.7	119.7	120.9	122.7	124.6	126.4	130.0	133.6
Implicit GDP Deflator	100.0	122.7	124.5	125.6	126.8	128.7	130.6	132.6	136.3	140.1
Implicit Expenditures Deflator	100.0	121.2	127.6	125.8	128.3	129.2	130.9	133.0	141.1	159.4

D. Other Indicators:	75-80	80-90	90-95	95-99
Growth Rates (% p.a.):				
Population (IFS 99z)	2.3	2.2	1.9	1.8
Labor Force	1.1	4.7	..	..
Gross Nat'l. Income p.c.	1.0	-2.6	3.4	1.6
Private Consumption p.c.	2.3	-0.6	4.0	3.6
Import Elasticity:				
Imports (G+NFS) / GDP(mp)	1.9	-0.5	1.1	1.0
Marginal Savings Rates:				
GRS wrt. GNY	..	..	0.34	0.49
GDS wrt. GDY	..	..	0.36	0.45
ICOR (lagged):	11.1	0.5	2.8	3.1

Share of Total Labor Force in:	1975	1980	1988
Agriculture	32.5	26.4	30.4
Industry	10.8	15.1	12.9
Services	56.7	58.5	56.7
Total	100.0	100.0	100.0

E. National Accounts (1980 mln. Balboas)	Actual 1980	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
Gross Domestic Product m.p.	3559	4328	3655	3623	3746	3915	4110	4316	4781	5979
Agriculture	320	436	414	368	380	392	403	416	443	500
Industry	621	580	377	322	353	375	400	428	493	664
(of which Manufacturing)	356	387	300	..	..	..	..	..	..	..
Services	2617	3312	2864	2933	3013	3148	3307	3471	3845	4815
Resource Balance	-118	399	785	351	86	101	92	106	157	372
Exports of GNFS	1567	1669	1622	1380	1406	1514	1566	1659	1893	2542
Imports of GNFS	1685	1270	837	1028	1320	1413	1474	1553	1736	2171
Total Expenditures	3676	3929	2870	3272	3660	3814	4018	4210	4624	5607
Total Consumption	2690	3196	2603	3177	3066	3273	3370	3492	3787	4589
Private Consumption	2010	2373	1935	2392	2264	2435	2534	2704	3019	3721
General Government	680	822	668	785	802	838	836	787	768	868
Gross Domestic Investment	987	734	267	95	594	541	648	719	838	1019
Fixed Investment	867	742	338	263	421	541	648	719	838	1019
Changes in Stocks	120	-9	-71	-168	173	0	0	0	0	0
Capacity to Import	1567	1284	1197	1181	1199	1295	1340	1417	1514	1629
Terms of Trade Adjustment	0	-385	-425	-199	-207	-218	-226	-242	-379	-913
Gross Domestic Income	3559	3943	3230	3424	3539	3696	3884	4074	4402	5066
Gross National Income	3398	3682	2904	3063	3207	3377	3566	3745	4146	4748
Gross National Product	3398	4067	3329	3262	3414	3595	3792	3987	4525	5662
Gross Domestic Saving	869	1133	1052	446	680	642	741	824	994	1390
Net Factor Income	-161	-261	-326	-361	-332	-319	-318	-329	-256	-317
Gross National Saving	721	920	787	141	461	441	640	541	777	1073

obs: Preliminary and projected data are based on RMSM estimates.

PANAMA - EXTERNAL TRADE

Annex II
Attachment 1b

A. Volume, Value and Prices	Actual 1980	1987	1988	1989	Pre. 1990	Projected 1991	1992	1993	1995	1999
Merchandise Exports										
	Volume Index 1980=100									
Coffee	100.0	245.2	293.5	195.1	302.5	332.3	341.2	353.1	369.0	391.2
Bananas	100.0	134.4	133.0	134.7	148.3	143.9	148.2	157.8	169.7	183.3
Sugar	100.0	40.3	22.6	27.2	57.4	45.3	33.2	34.5	35.9	37.3
Shrimp	100.0	111.3	98.4	122.6	96.3	96.3	99.1	103.6	109.8	118.6
Other	100.0	103.4	101.2	102.4	104.4	123.4	124.8	132.9	142.9	154.3
Total Merch. Exports	100.0	118.2	101.7	104.9	109.2	117.3	118.5	125.3	134.4	144.9
	Value-Current Prices (Million $)									
Coffee	10.2	18.0	20.6	10.8	13.8	14.7	16.2	18.4	25.2	44.4
Bananas	61.6	85.7	85.3	82.5	89.4	88.8	93.4	100.6	118.8	172.6
Sugar	65.8	17.0	6.2	10.2	36.8	26.7	21.0	22.3	25.3	38.6
Shrimp	43.7	65.5	51.9	62.8	44.4	49.1	52.0	56.8	69.7	110.8
Other	90.3	145.8	156.8	157.4	169.6	204.5	212.7	235.3	293.3	463.4
Total Merch. Exports FOB	271.6	332.0	320.8	323.7	354.0	383.8	395.3	433.4	532.3	829.7
Merchandise Imports										
	Volume Index 1980=100									
Food	100.0	121.7	81.9	102.8	118.4	114.2	119.9	125.6	133.2	142.0
Other Consumer Goods	100.0	119.2	119.2	153.9	202.8	207.9	264.0	276.5	293.3	310.9
Petroleum and Derivatives	100.0	55.6	55.6	58.7	60.6	70.5	75.8	80.3	86.9	94.7
Intermediate	100.0	143.0	168.8	203.9	369.6	395.7	221.8	233.5	248.9	268.3
Capital Goods	100.0	91.9	91.9	84.9	122.0	155.4	186.2	204.3	213.2	224.7
Total Merch. Imports	100.0	102.7	61.7	72.3	98.1	105.8	110.3	116.8	123.9	132.0
	Value-Current Prices (Million $)									
Food	123.0	151.8	119.4	142.9	155.2	145.2	157.4	174.0	218.7	349.4
Other Consumer Goods	353.0	503.1	325.7	417.4	581.0	607.6	793.2	863.3	1036.8	1505.2
Petroleum & Derivatives	424.4	196.3	145.0	183.4	246.4	240.6	251.3	283.4	365.7	711.6
Intermediate	139.4	197.0	155.5	186.6	357.3	390.2	224.8	245.9	298.3	454.7
Capital Goods	258.7	257.5	149.6	137.1	208.1	270.5	333.1	379.8	477.7	674.2
Total Merch. Imports CIF	1298.5	1305.7	895.2	1067.3	1548.0	1654.1	1759.9	1946.4	2397.1	3695.1
Terms of Trade Indices										
	Price Indices 1980=100									
Merchandise Exports	100.0	104.0	115.1	112.5	118.4	119.6	121.9	126.4	146.4	216.7
Merchandise Imports	100.0	97.9	106.2	108.3	118.5	117.3	119.8	125.4	146.9	216.7
Merchandise Terms of Trade	100.0	106.3	108.3	103.9	99.9	102.0	101.8	100.8	99.7	100.0

	B. As % of Total (current prices) Actual 1980	Est. 1990	Projected 1995	1999	C. Growth Rates (%)(constant prices) Actual 80-89	Est.1/ 1990	Projected 90-95	95-99
Merchandise Exports								
Coffee	3.8	3.9	4.7	5.3	7.7	55.0	4.9	5.5
Bananas	22.7	25.3	22.3	20.8	3.4	10.1	4.2	8.0
Sugar	24.2	10.4	4.8	4.7	-13.5	111.0	-8.2	4.0
Shrimp	16.1	12.5	13.1	13.4	2.3	-21.4	3.8	7.7
Other	33.2	47.9	55.1	55.8	0.3	2.0	8.0	8.0
Total Merch. Exports FOB	100.0	100.0	100.0	100.0	0.5	4.2	5.6	7.7
Merchandise Imports								
Food	9.5	10.0	9.1	9.5	0.3	15.2	3.4	6.3
Other Consumer Goods	27.2	37.5	43.3	40.7	4.9	31.7	8.7	5.7
Petroleum and Derivatives	32.7	15.9	15.3	19.3	-5.8	3.3	8.8	8.6
Intermediate	10.7	23.1	12.4	12.3	8.2	81.2	-6.6	7.0
Capital Goods	19.9	13.4	19.9	18.2	-1.8	43.6	14.3	5.0
Total Merch. Imports CIF	100.0	100.0	100.0	100.0	-3.5	35.7	6.1	6.2

1/. Sugar export growth in 1990 reflects the reinstatement of the U.S. quota.

PANAMA - BALANCE OF PAYMENTS

(US$ Millions)

Annex II

Attachment 1c

BALANCE OF PAYMENTS	Actual 1986	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
A. Exports of Goods & NFS	1,645	1,876	1,729	1,705	1,829	2,004	2,128	2,341	2,878	4,484
1. Merchandise (FOB)	272	332	321	324	354	384	395	433	532	830
2. Non-Factor Services	1,373	1,544	1,408	1,381	1,475	1,620	1,733	1,908	2,346	3,654
B. Imports of Goods & NFS	1,698	1,636	1,096	1,271	1,774	1,892	2,017	2,218	2,696	4,054
1. Merchandise (FOB)	1,159	1,176	814	970	1,407	1,504	1,600	1,769	2,179	3,359
2. Non-Factor Services	538	460	282	301	366	389	417	448	517	695
C. Resource Balance	(53)	239	634	434	55	112	111	123	182	430
D. Net Factor Income	(283)	(320)	(383)	(446)	(434)	(425)	(436)	(468)	(393)	(565)
1. Factor Receipts	2,588	1,351	577	593	590	603	610	621	672	741
2. Factor Payments	(2,871)	(1,671)	(960)	(1,039)	(1,024)	(1,028)	(1,046)	(1,089)	(1,065)	(1,306)
a.Total Interest Paid	(248)	(300)	(11)	(2)	(82)	(101)	(135)	(216)	(326)	(336)
b. Interest Arrears	0	0	(356)	(405)	(347)	(318)	(289)	(242)	(0)	(0)
c. Other Factor Payments 1./	(2,623)	(1,371)	(594)	(632)	(594)	(609)	(622)	(631)	(739)	(970)
E. Net Current Transfers 2./	(32)	(49)	(40)	(36)	(35)	(36)	(42)	(45)	(60)	(80)
F. Current Account Balance										
1. Before Official Grants	(388)	(130)	211	(48)	(414)	(349)	(366)	(390)	(271)	(216)
2. Official Grants	67	114	112	105	183	194	340	110	120	80
3. After Official Grants	(322)	(16)	323	58	(230)	(156)	(27)	(280)	(151)	(136)
G. M&L Term Capital Inflow	361	(264)	346	429	210	246	65	332	226	323
1. Net Direct Investment	(47)	51	(47)	27	54	62	70	80	125	200
2. Net M&L Term Loans	408	(488)	(1,030)	(533)	(405)	(288)	(269)	10	101	123
a. Disbursements	408	104	57	3	5	0	328	285	279	224
b. Repayments	0	(592)	(1,087)	(535)	(410)	(288)	(597)	(275)	(178)	(101)
3. Other M&L Term Inflows 3./	0	173	1,422	935	560	473	264	242	0	0
H. Total Other Items (net)	327	(305)	(669)	(486)	352	32	145	0	0	0
1. Net Short Term Capital	45	1	0	0	0	0	0	0	0	0
2. Capital Flows N.E.I. 4./	0	143	(165)	(135)	331	32	145	0	0	0
3. Errors and Omissions	282	(449)	(504)	(351)	22	0	0	0	0	0
	0	0	(0)	0	(0)	0	0	(0)	(0)	(0)
I. Change in Net Reserves	(366)	585	1	(1)	(332)	(122)	(184)	(52)	(75)	(188)
[() indicates increase]										
1. Net Credit from the IMF	(18)	(58)	0	(1)	(70)	(55)	(70)	43	(40)	(50)
Shares of GDP (current US$):										
1. Resource Balance	-1.5	4.5	13.9	9.5	1.2	2.2	2.1	2.2	2.7	4.6
2. MLT Interest Payments	-7.0	-5.7	-0.2	-0.0	-1.7	-2.0	-2.5	-3.8	-4.9	-3.6
3. Current Account Balance	-9.0	-0.3	7.1	1.3	-4.8	-3.1	-0.5	-4.9	-2.3	-1.4
4. LT Capital Inflow (line G)	10.1	-5.0	7.6	9.4	4.4	4.9	1.2	5.8	3.4	3.5
5. Net Credit from the IMF	-0.5	-1.1	0.0	-0.0	-1.5	-1.1	-1.3	0.8	-0.6	-0.5
Foreign Exchange Reserves:										
1. Int'l. Reserves (IFS 11d)	117	78	72	119	..	..	..	..	..	..
2. Gold (nat. val., IFS 1and)	4	..	..	..	..	..	..	..	..	..
3. Reserves Level (net of assets)	455	391	(379)	(379)	(118)	(50)	64	159	263	641
4. Net Res. in Months Imports	..	..	(4.1)	(3.6)	(0.8)	(0.3)	0.4	0.9	1.2	1.9
Exchange Rates (B/US$):										
1. Nom. Off. X-Rate (IFS ae)										
2. Real Eff. X-Rate Base 1980	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
3. X-Rate for GDP Conversion	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Memorandum Item:										
GDP (US$ Million)	3,559	3,310	4,551	4,549	4,750	5,039	5,370	5,723	6,706	9,366
GDP curr. mill. Balboas	3,559	3,310	4,551	4,549	4,750	5,039	5,370	5,723	6,706	9,366

1./ Includes Dividend Repatriation. 2./ Includes only Private Capital Grants.
3./ Includes Debt service Arrears.
4./ Includes Escrow Funds and Refinancing of Arrears.

Annex II
Attachment 1d
(Page 1 of 2)

PANAMA - EXTERNAL CAPITAL AND DEBT

(US$ Millions)

		Actual 1/			Est.	Projected				
A. Disbursements:	1986	1987	1988	1989	1990	1991	1992	1993	1995	1999
1. Public & P.Guar. LT	405	142	57	3	5	0	328	285	279	224
Official Creditors	95	32	43	1	0	0	328	282	266	204
Multilateral	68	41	0	0	0	0	213	257	241	174
of which IBRD	20	16	0	0	0	0	90	114	90	67
of which IDA	0	0	0	0	0	0	0	0	0	0
Bilateral	27	11	43	1	0	0	115	25	25	30
Private Creditors	310	90	15	2	5	0	0	3	13	20
Suppliers	13	8	15	2	5	0	0	3	13	20
Financial Markets a/	297	82	0	0	0	0	0	0	0	0
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	0
3. Total LT Disbursements	405	142	57	3	5	0	328	285	279	224
4. IMF Purchases	0	14	0	0	0	0	126	53	50	0
5. Short-Term Capital	0	160	0	0	0	0	0	0	0	0
6. Unidentified Sources	0	0	0	0	(0)	0	(0)	0	0	0
7. Total (all sources)	405	316	57	3	5	0	454	338	329	224
B. Repayments:										
1. Public & P.Guar. LT	204	158	21	6	47	102	406	275	178	101
Official Creditors	18	107	2	2	44	96	400	113	86	86
Multilateral	9	61	1	0	42	95	354	91	76	54
of which IBRD	6	35	1	0	40	56	173	48	37	32
of which IDA	0	0	0	0	0	0	0	0	0	0
Bilateral	9	46	0	1	1	0	45	22	10	31
Private Creditors	186	51	19	4	4	6	6	162	92	15
Suppliers	23	9	1	2	2	6	6	24	3	10
Financial Markets a/	163	42	18	1	2	0	0	138	89	5
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	0
3. Unidentified Sources	0	0	0	0	0	0	0	0	0	0
4. Total LT Repayments	204	158	21	6	47	102	406	275	178	101
5. IMF Repurchases	17	73	0	1	70	55	196	10	90	50
6. Amortization Arrears	..	..	1,066	530	234	166	186	0	0	0
C. Interest:										
1. Public & P.Guar. LT	151	227	10	2	59	71	122	206	305	332
Official Creditors	35	84	3	0	56	68	87	105	119	161
Multilateral	20	67	2	0	55	67	54	62	97	135
of which IBRD	12	34	1	0	33	35	23	24	38	47
of which IDA	0	0	0	0	0	0	0	0	0	0
Bilateral	15	17	1	0	1	2	32	43	21	26
Private Creditors	116	143	8	2	3	3	35	101	186	171
Suppliers	11	7	1	1	2	3	5	5	3	7
Financial Markets 2./	105	136	7	1	0	0	30	96	183	164
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	0
3. Total LT Interest	151	227	10	2	59	71	122	206	305	332
4. IMF Service Charges	3	25	0	0	23	30	13	10	21	4
5. Interest Paid on ST Debt	2	9	0	0	0	0	0	0	0	0
6. Unidentified Sources	0	0	0	0	0	0	(0)	(0)	0	0
7. Total (all sources)	156	261	11	2	82	101	135	216	326	336
8. Interest Arrears	..	16	356	405	326	306	286	242	0	0
Memo: Tot. Arrears (Amort.+Int.):	..	..	1,422	935	560	473	472	242	0	0

1./ Historical data through 1987 is from World Debt Tables 1990-91. From 1988 to 1993, data is based on IMF historical and estimated debt. From 1994 to 2000, debt data is based on DRS estimated pipeline (cash basis).
a./ Includes bonds. Under repayments also includes ST.

Annex II
Attachment 1d
(Page 2 of 2)

PANAMA - EXTERNAL CAPITAL AND DEBT
(US$ Millions)

	Actual 1./				Est.	Projected				
D. External Debt (DOD) b/	1980	1987	1988	1989	1990	1991	1992	1993	1995	1999
1. Public & P.Guar. LT	2,271	4,054	3,978	3,928	4,041	3,882	3,804	4,101	4,249	4,691
Official Creditors	605	1,637	1,622	1,623	1,690	1,537	1,465	1,921	2,251	2,823
Multilateral	327	1,081	1,029	1,024	1,020	938	797	1,225	1,525	2,071
of which IBRD	133	523	478	465	462	403	319	507	602	764
of which IDA	0	0	0	0	0	0	0	0	0	0
Bilateral	278	556	593	599	670	599	668	696	726	752
Private Creditors	1,666	2,417	2,356	2,305	2,352	2,345	2,339	2,180	1,998	1,867
Suppliers	126	69	195	195	213	213	207	186	200	255
Financial Markets a/	1,540	2,348	2,161	2,110	2,138	2,132	2,132	1,994	1,798	1,612
2. Private Non-Guar. LT	0	0	0	0	0	0	0	0	0	0
3. Total Long-Term DOD	2,271	4,054	3,978	3,928	4,191	4,063	3,994	4,291	4,439	4,767
4. IMF Credit	23	346	330	320	272	212	141	365	374	184
5. Short-Term Debt	680	1,240	378	789	1,047	1,320	1,390	1,632	1,632	1,632
6. Unidentified Sources	0	0	0	0	0	0	(0)	(0)	0	0
7. Total (all sources) (exc. ref.)	2,974	5,640	4,686	5,037	5,360	5,413	5,336	6,098	6,256	6,507
8. Accumulated Arrears	680	1,240	1,752	2,703	3,093	3,547	3,352	3,594	3,594	3,594
A. Amortization Arrears	..	16	1,374	1,914	2,046	2,227	1,962	1,962	1,962	1,962
B. Interest Arrears	..	..	378	789	1,047	1,320	1,390	1,632	1,632	1,632
o/w Refinancing Arrears	..	..	0	0	150	182	190	190	190	76
Share of Public LT DOD:										
1. On Concessional Terms	18.9%	9.7%	9.7%	10.0%	9.9%	..	..	..	..	..
2. With Variable Int. Rates	81.1%	57.9%	57.8%	58.6%	58.2%	..	..	..	..	..
E. Bank and IDA Ratios										
1.IBRD to total LT DOD (line 3)	5.9%	12.9%	12.0%	11.8%	11.0%	9.9%	8.0%	11.8%	13.6%	16.0%
2.IDA to total LT DOD (line 3)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
4.IBRD to total LT DS (line 3)	5.1%	17.9%	6.5%	2.6%	69.3%	53.0%	37.2%	15.0%	15.5%	18.2%
5.IDA to total LT DS (line 3)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
F. DOD-to-Exports G&S										
1. Long-Term Debt	53.6%	125.6%	172.5%	170.9%	173.3%	155.8%	145.8%	144.8%	125.0%	91.2%
2. IMF Credit	0.5%	10.7%	14.3%	13.9%	11.2%	8.1%	5.2%	12.3%	10.5%	3.5%
3. Short-Term Debt	16.1%	38.4%	16.4%	34.3%	43.3%	50.6%	50.8%	55.1%	46.0%	31.2%
4. LT+IMF+ST DOD	70.3%	174.8%	203.2%	219.2%	227.8%	214.6%	201.8%	212.2%	181.6%	126.0%
G. DOD-to-current GDP										
1. Long-Term Debt/GDP	63.8%	76.3%	87.4%	86.4%	88.2%	80.6%	74.4%	75.0%	66.2%	50.9%
2. IMF Credit/GDP	0.6%	6.5%	7.2%	7.0%	5.7%	4.2%	2.6%	6.4%	5.6%	2.0%
3. Short-Term Debt/GDP	19.1%	23.4%	8.3%	17.3%	22.0%	26.2%	25.9%	28.5%	24.3%	17.4%
4. LT+IMF+ST DOD/GDP	83.6%	106.2%	103.0%	110.7%	116.0%	111.0%	102.9%	109.9%	96.1%	70.3%
H. Debt Service/Exports G&S										
1. Public & Guaranteed LT	8.4%	11.9%	1.3%	0.3%	4.4%	6.6%	19.3%	16.2%	13.6%	8.3%
2. Private Non-Guaranteed LT	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
3. Total LT Debt Service	8.4%	11.9%	1.3%	0.3%	4.4%	6.6%	19.3%	16.2%	13.6%	8.3%
4. IMF Repurchases+Serv.Chgs..	0.3%	3.0%	0.0%	0.0%	3.9%	3.2%	7.7%	0.7%	3.1%	1.0%
5. Interest Only on ST Debt	0.0%	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
6. Total (LT+IMF+ST Int.)	8.9%	15.2%	1.3%	0.4%	8.3%	9.9%	26.9%	16.9%	16.7%	9.3%
I. Interest Burden Ratios										
1. Total Interest/current GDP	4.4%	4.9%	0.2%	0.0%	1.7%	2.0%	2.5%	3.8%	4.9%	3.6%
2. Total Interest/Exports G&S	3.7%	8.1%	0.5%	0.1%	3.4%	3.9%	4.9%	7.3%	9.2%	6.4%

1./ Historical data through 1987 is from World Debt Tables 1990-91. From 1988 to 1993, data is based on IMF historical and estimated debt. From 1994 to 2000, debt data is based on DRS estimated pipeline (cash basis).

a./ Includes bonds. Under repayments also includes ST.

b./ 1988-1992 Stocks include currency adjustments. Stocks include amortization arrears. ST stock includes interest arrears.

Annex II
Attachment 1e

PANAMA - PUBLIC FINANCE, MONEY AND CREDIT

I. Consolidated NF Public Sector (In Millions of B.)	Actual 1980	1987	1988	1989	Est. 1990	Projected 1991	1992	1993	1995	1999
A. Total Current Receipts	1,008	1,705	1,073	1,083	1,435	1,600	1,752	1,850	2,072	2,851
1. Tax Revenue 1/	918	1,118	835	812	996	1,070	1,169	1,263	1,455	2,033
2. Non-Tax Current Receipts 2/	47	437	134	132	251	326	327	381	483	678
3. Op. Surplus of Pub. Ent.	44	150	104	139	188	205	257	206	134	140
B. Total Current Expenditures	891	1,545	1,491	1,551	1,519	1,617	1,679	1,717	1,726	2,215
C. Current Budget Balance 3/	117	160	(418)	(468)	(84)	(16)	73	133	347	636
D. Capital Exp. & Net Lending	314	211	59	55	60	120	213	229	302	356
E. Capital Revenue	13	(0)	0	0	4	2	3	303	34	5
F. Overall Balance Financed by:	(184)	(51)	(477)	(523)	(140)	(134)	(137)	207	79	285
1. Official Capital Grants	2	0	0	0	0	0	0	0	0	0
2. External Borrowing (net)	226	36	403	418	140	134	137	(207)	(79)	(285)
3. Domestic Financing	(44)	15	83	105	0	0	0	0	0	0
As percent of Current GDP:										
A. Total Current Receipts	28.3	32.1	23.6	23.8	30.2	31.8	32.7	32.3	30.9	30.4
1. Tax Revenue 1/	25.8	21.0	18.3	17.9	21.0	21.2	21.8	22.1	21.7	21.7
2. Non-Tax Current Receipts 2/	1.3	8.2	2.9	2.9	5.3	6.5	6.1	6.7	7.2	7.2
3. Op. Surplus of Pub. Ent.	1.2	2.8	2.3	3.0	4.0	4.1	4.8	3.6	2.0	1.5
B. Total Current Expenditures	25.0	29.1	32.8	34.1	32.0	32.1	31.3	30.0	25.7	23.7
C. Current Budget Balance 3/	3.3	3.0	-9.2	-10.3	-1.8	-0.3	1.4	2.3	5.2	6.8
D. Capital Exp. & Net Lending	8.8	4.0	1.3	1.2	1.3	2.4	4.0	4.0	4.5	3.8
E. Capital Revenue	0.4	-0.0	0.0	0.0	0.1	0.0	0.0	5.3	0.5	0.1
F. Overall Balance Financed by:	-5.2	-1.0	-10.5	-11.5	-2.9	-2.7	-2.6	3.6	1.2	3.0
1. Official Capital Grants	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. External Borrowing (net)	6.3	0.7	8.9	9.2	2.9	2.7	2.5	-3.6	-1.2	-3.0
3. Domestic Financing	-1.2	0.3	1.8	2.3	0.0	0.0	0.0	0.0	0.0	0.0
G. GDP (mill. Balboas)	3,559	5,310	4,551	4,549	4,750	5,039	5,370	5,723	6,706	9,366

1/ Central Government tax revenues and contributions to CSS.
2/ Includes non-tax revenue of Central Government and Other Agencies' Revenues.
3/ Excludes Grants-in-aid.

PANAMA - PUBLIC FINANCE, MONEY AND CREDIT (cont.)

Annex II
Attachment 1e

II. Money and Credit	Actual 1980	1984	1985	1986	1987	1988	1989	1990	Growth (%) 1980-89	1990
A.In millions of balboas:										
Money Supply (34)	335	381	410	450	442	304	307	433	-1.0	41.0
Money + Quasi-Money (34+35)	1,316	1,863	1,953	2,360	2,278	1,649	1,600	2,184	2.2	36.5
Total Net Domestic Credit	2,313	3,328	3,422	3,658	3,711	3,114	3,091	2,692	3.3	-12.9
To Government (net) (32an)	242	792	822	774	674	642	624	209	11.1	-66.5
To Official Entities (32b)	..	..	..	..	..	..	..	..		
To Private Sector (32d)	2,071	2,537	2,600	2,884	3,037	2,472	2,468	2,483	2.0	0.6
Net Foreign Assets (31n)	(605)	(512)	(353)	(211)	(600)	(904)	(784)	56	2.9	107.2
All Other Items (net) (37r)	425	1,047	1,209	1,285	920	665	617	672	4.2	9.0
B.Offsets to expansion of M2M (in %):										
Net Foreign Assets	146.8	(76.6)	176.7	34.9	472.6	48.4	(248.9)	143.9	..	..
Credit to Government	15.1	179.9	34.0	(11.9)	121.3	5.1	37.3	(70.9)	..	..
Credit to Official Entities	..	..	..	..	..	..	..	..	..	..
Credit to Private Sector	(32.4)	20.2	70.1	69.8	(186.4)	89.7	9.5	2.6	..	..
Net Other Assets & Liabilities	(29.4)	(23.5)	(180.8)	7.2	(307.5)	(43.3)	302.1	24.5	..	..
2	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	..	..

PANAMA: Financial Program for the Non-Financial Public Sector, 1990-93

(Millions of US$)

	1990	1991	1992	1993
CURRENT REVENUES	1457	1592	1746	1842
Central Government	855	979	1016	1137
CSS	363	355	420	442
Public Agencies	50	53	53	57
Oper. Surplus of PSEs	189	205	257	206
CURRENT EXPENDITURES 1/	1519	1617	1679	1717
Total Wages and Salaries	574	612	619	593
Wages and Salaries	568	599	580	556
Bonus 2/	6	13	39	37
Goods and Services	167	189	191	186
Transfers	384	428	469	507
Interest	384	383	397	431
Other	10	5	3	0
OTHER AGENCIES, NET	-22	9	6	8
PUBLIC SAVINGS	-84	-16	73	133
CAPITAL REVENUES	4	2	3	303 3/
CAPITAL EXPENDITURES	60	120	213	229
OVERALL BALANCE	-140	-134	-138	207

1/ Includes severance payments of US$16.4 million in 1992 and US$36 million in 1993.
2/ Thirteenth month salary.
3/ In 1993 it includes proceeds from privatization of INTEL and other PEs.

Source: MIPPE, IMF, Bank Staff Estimates.

PANAMA: Financial Program for the Non-Financial Public Sector, 1990-93

(Percentage of GDP)

	1990	1991	1992	1993
CURRENT REVENUES	30.7	31.6	32.5	32.2
Central Government	18.0	19.4	18.9	19.9
CSS	7.6	7.1	7.8	7.7
Public Agencies	1.1	1.0	1.0	1.0
Oper. Surplus of PSEs	4.0	4.1	4.8	3.6
CURRENT EXPENDITURES	32.0	32.1	31.3	30.0
Total Wages and Salaries	12.1	12.1	11.5	10.4
Wages and Salaries	12.0	11.9	10.8	9.8
Bonus 1/	0.1	0.3	0.7	0.6
Goods and Services	3.5	3.8	3.6	3.2
Transfers 2/	8.1	8.5	8.7	8.9
Interest	8.1	7.6	7.4	7.5
Other	0.2	0.1	0.1	0.0
OTHER AGENCIES, NET	-0.5	0.2	0.1	0.1
PUBLIC SAVINGS	-1.8	-0.3	1.4	2.3
	====	====	====	====
CAPITAL REVENUES 3/	0.0	0.0	0.0	5.3
CAPITAL EXPENDITURES	1.3	2.4	4.0	4.0
OVERALL BALANCE	-3.0	-2.7	-2.6	3.6
	====	====	====	====

1/ Thirteenth month salary.
2/ Includes severance payments.
3/ In 1993, it includes proceeds from privatization of INTEL and other PEs.

Source: MIPPE, IMF, Bank Staff Estimates.

PANAMA: Financial Program for the General Government, 1991-93

(Millions of US$)

	Historical	Program		
	1990	1991	1992	1993
GENERAL GOVERNMENT REVENUES	1375.8	1454.0	1560.8	1685.6
CENTRAL GOVT. CURRENT REVENUES	963.0	1046.2	1087.8	1187.1
Taxes	633.3	714.4	748.4	830.5
Non-tax Revenue	329.7	331.8	339.4	356.6
SOCIAL SECURITY	362.5	355.4	420.1	441.9
CONSOLIDATED PUBLIC AGENCIES	50.3	52.4	52.9	56.6
CURRENT EXPENDITURES	1519.0	1616.6	1678.5	1716.9
Total Wages	574.4	611.9	618.5	593.0
Wages	568.7	599.0	580.0	556.0
Bonus	5.7	12.9	38.5	37.0
Goods and Services	166.5	188.9	190.6	184.6
Transfers 1./	384.0	428.0	469.3	507.4
Interest	384.3	383.3	397.1	431.9
Other	9.8	4.5	3.0	0.0
CURRENT EXPEND., excl. interest	1134.7	1233.3	1281.4	1285.0
GENERAL GOVERNMENT SAVINGS	-143.2	-162.6	-117.7	-31.3
CAPITAL REVENUES	0.2	1.8	2.6	302.6
CAPITAL EXPENDITURES	33.4	71.1	94.0	110.1
OVERALL BALANCE	-176.4	-231.9	-209.1	161.2

1./ Includes severance payments.

Source: MIPPE, IMF, Bank Staff Estimates.

PANAMA: Financial Program for the General Government, 1991-93

(Percentage of GDP)

	Historical	Program		
	1990	1991	1992	1993
GENERAL GOVERNMENT REVENUES	29.0	28.9	29.1	29.5
CENTRAL GOVT. CURRENT REVENUES	20.3	20.8	20.3	20.7
Taxes	13.4	14.2	13.9	14.5
Non-tax Revenue	6.9	6.6	6.4	6.2
SOCIAL SECURITY	7.6	7.1	7.8	7.8
CONSOLIDATED PUBLIC AGENCIES	1.1	1.0	1.0	1.0
CURRENT EXPENDITURES	32.0	32.1	31.3	30.0
Total Wages	12.1	12.1	11.5	10.4
Wages	12.0	11.9	10.8	9.8
Bonus	0.1	0.2	0.7	0.6
Goods and Services	3.5	3.7	3.5	3.2
Transfers	8.1	8.5	8.7	8.9
Interest	8.1	7.6	7.5	7.5
Other	0.2	0.1	0.1	0.0
CURRENT EXPEND., excl. interest	23.9	24.5	23.8	22.5
GENERAL GOVERNMENT SAVINGS	-3.0	-3.2	-2.2	-0.5
CAPITAL REVENUES	0.0	0.0	0.0	5.3
CAPITAL EXPENDITURES	0.7	1.4	1.9	1.9
OVERALL BALANCE	-3.7	-4.6	-3.9	2.9

Source: MIPPE, IMF, Bank Staff Estimates.

CENTRAL GOVERNMENT FINANCES[1/], 1990-93

	Historical 1990	Estimated 1991	Projected 1992	Projected 1993
Total Revenues	963.0	1047.4	1089.8	1189.1
Current revenues	958.1	1030.2	1081.8	1177.1
Tax revenue	633.3	714.4	748.4	830.5
Income taxes	238.8	294.8	278.3	330.1
PIT	129.3	133.0	131.2	141.7
CIT	109.5	161.8	147.1	188.4
Panama Canal	10.2	29.8	28.5	30.2
PTP	18.4	25.5	21.3	21.1
Other	80.9	106.5	97.3	137.1
Property	40.1	35.5	37.1	39.7
Taxes on international trade	137.5	134.0	147.0	157.4
Imports	124.9	121.0	134.0	143.4
Exports	12.6	13.0	13.0	14.0
Taxes on domestic transactions	216.9	250.1	284.0	303.3
Value added tax	80.3	86.0	94.0	100.6
Petroleum	71.2	94.5	98.4	103.3
Tabacco and beverages	33.1	30.8	35.2	37.0
Others	32.3	38.8	56.4	62.5
Non-tax revenues	324.8	315.8	333.4	346.6
Panama Canal	68.4	73.0	75.0	79.6
Oil pipeline	10.4	9.7	8.9	8.8
Other services	97.0	118.3	128.0	155.7
Transfer from rest of the public sector	149.0	114.8	121.5	102.5
Capital Revenues	0.0	1.2	2.0	2.0
Grants	4.9	16.0	6.0	10.0
Current Expenditures	1187.6	1227.2	1275.5	1299.3
Wages and salaries	411.9	433.0	415.0	398.0
Goods and servies	111.2	105.0	105.0	100.0
Pensions and transfers	285.0	305.7	321.0	318.6
Interest	370.6	371.5	385.8	418.6
Other	8.9	12.0	48.7	64.7
Current Savings	-224.6	-179.8	-177.7	-110.2
Capital Expenditures	55.7	98.4	111.0	128.0
Overall Balance	-280.3	-278.2	-288 .7	-238.2

1/ Revenues are on a cash basis and expenditures are on a commitment basis.

FINANCES OF THE SOCIAL SECURITY AGENCY, 1990 - 93

	Historical	Preliminary	Projected	
	1990	1991	1992	1993
CURRENT REVENUES	362.6	355.4	420.1	442.0
Quota Payments	285.2	280.0	297.0	297.0
Professional Risk	22.8	22.2	23.8	25.5
Bonus	0.0	0.0	45.0	48.2
Complementary Scheme	16.7	13.4	14.3	30.3
Investment Income	26.0	24.8	25.0	26.0
Others	11.9	15.0	15.0	15.0
CURRENT EXPENDITURES	469.3	542.8	573.5	591.9
Wages and Salaries	107.7	115.0	115.0	114.0
Goods and Services	50.1	72.9	74.6	73.0
Transfers	311.5	352.0	377.1	398.0
Others	0.0	2.9	6.8	6.9
OPERATIONAL BALANCE	-106.7	-187.4	-153.4	-149.9

Source: MIPPE.

Public Sector Employment Reduction Program[1]

Programs	Number of Employees	
1. Retirement Program[2]		
a) During 1991 (April-December)	100	
b) January-June 1992	500	
c) July-December 1992	600	
d) January-March 1993	350	
Sub-total		1550
General Government	1370	
Public Enterprises	180	
2. Voluntary Retirement Program[2]		
a) During 1991 (April-December)	1000	
b) January-June 1992	3500	
c) July-December 1992	4000	
d) January-March 1993	2500	
Sub-total		11000
General Government	11000	
Public Enterprises	-	
3. Privatization Program		
a) During 1991 (April-December)	-	
b) January-June 1992	1450	
c) July-December 1992	2700	
d) January-March 1993	1600	
Sub-total		5750
General Government	-	
Public Enterprises	5750	
4. Not Filling Expected Vacancies[3]		
a) During 1991 (April-December)	50	
b) January-June 1992	250	
c) July-December 1992	250	
d) January-March 1993	150	
Sub-total		700
General Government	450	
Public Enterprises	250	
Total		19000
General Government	12820	
Public Enterprises	6180	

1. The base figure of public sector employment is 125,000 as of March 31, 1991.

2. It is assumed that there will be no replacement of these retirees (i.e. no filling of vacancies resulting from the retirement programs).

3. Vacancies created by factors other than the retirement programs mentioned in items 1 and 2, so as to avoid double counting of reductions.

PANAMA: PUBLIC SECTOR EMPLOYMENT REDUCTION PROGRAM TARGETS 1/ AND RESULTING SAVINGS: BY QUARTERS, 1991-1992

Public Sector Components	Employment Reduction (Number of Employees)							Savings, Annual Rates (Millions of US$) 2/						
	1991	1992				1993	91-93	1991	1992				1993	91-93
	Apr-Dec	IQ	IIQ	IIIQ	IVQ	IQ	Total	Apr-Dec	IQ	IIQ	IIIQ	IVQ	IQ	Total
PUBLIC SECTOR	1150	2725	2975	3550	4000	4600	19000	6.3	16.5	18.4	22.6	25.3	29.1	118.2
1- General Government 3/	1120	2050	2050	2175	2520	2905	12820	6.1	11.2	11.2	11.9	13.8	15.9	70.1
ow/ Central Gov.	875	1605	1605	1700	1970	2270	10025	4.8	8.8	8.8	9.3	10.8	12.4	54.9
CSS	160	290	290	310	360	410	1820	0.9	1.6	1.6	1.7	2.0	2.2	10.0
Consol. Agencies	85	155	155	165	190	225	975	0.4	0.8	0.8	0.9	1.0	1.3	5.2
2- Public Enterprises	30	675	925	1375	1480	1695	6180	0.2	5.3	7.2	10.7	11.5	13.2	48.1

1/ The table is based on public wages and salaries, excluding the effect of the thirteenth-month salary.

2/ Savings are calculated at US$455 per month (or US$1365 per quarter or US$5460 per year) per employee for general government and at US$650 per month (or US$1950 per quarter or US$7800 per year) per employee for public enterprises. It must be recognized that the savings resulting from employment reductions for any quarter would be realized with a lag of subsequent quarters.

3/ The breakdown of general government employees is calculated as: Central Government, 78.2%; CSS, 14.2%; and Consolidated Agencies, 7.6% -- percentages existing as of 3/31/91.

Source: Bank Staff Estimates.

Attachment IV

PANAMA: PUBLIC SECTOR WAGE BILL TARGETS: BY QUARTERS, 1991-93

(Millions of US$)

	1991	1992					1993
		IQ	IIQ	IIIQ	IVQ	Total	Total
PUBLIC SECTOR	820	212	212	202	194	820	765
1. General Government	599	149	149	144	138	580	556
o/w Central Gov.	433	107	107	103	98	415	398
2. Public Enterprises	134	34	34	31	27	126	99

Source: Bank Staff Estimates.

Annex III

Attachment v

PANAMA: Financial Program for Public Enterprises, 1990-93 1/

(Millions of US$)

	Historical	Program		
	1990	1991	1992	1993
CURRENT REVENUES	558	597	634	508 2/
CURRENT EXPENDITURES	370	392	376	302 3/
Total Wages & Salaries	135	134	126	99
Wages & Salaries	134	129	115	90
Bonus	1	5	11	9
Goods and Services	96	138	148	113
Transfers	27	29	29	22
Interest	98	80	68	68
Other	14	11	5	0
CURRENT SAVINGS	188	205	258	206
Net Transfers	-81	-41	-46	-19
CAPITAL REVENUES	4	0	0	0
CAPITAL EXPENDITURES	27	49	119	119
OVERALL BALANCE	84	115	93	68
Memorandum Item:				
Consolidated Non-Interest Current Expenditures	272	312	308	234

1/ Includes the following public enterprises and companies: IRHE, IDAAN, APN, INTEL, Cemento Bayano, Victoria Sugar Mills, Zona Libre, IPAT, and Citricos de Chiriqui.

2/ Excludes income from Victoria Sugar Mills of US$22.1 million, US$12.0 million from Cemento Bayano, US$99.8 million from INTEL, and US$36.6 million from APN, due to their transfer to the private sector.

3/ Excludes expenditures of Victoria Sugar Mills of US$15.1 million, US$9.4 mi'lion of Cemento Bayano, and US$28 million of INTEL, due to their transfer to the private sector.

Source: MIPPE, IMF, IDB, Bank Staff Estimates.

PRINCIPLES OF PUBLIC UTILITY PRICING

1. This section describes the understandings reached with the Government on the principles to be applied in public utility pricing. The studies for public utility pricing will be financed by IDB. The basic principles of public utility pricing include allocative efficiency (a countrywide objective) and sound finances (a utility objective).

2. The Government of Panama plans to introduce action plans to improve finances and operating efficiency of public utilities. The Government plans to rely on sound economic principles to guide the production and consumption of the services of these utilities. In particular, increasing use will be made of marginal cost pricing policies. Price is the most effective instrument for demand management, and pricing policy is more effective when coordinated properly with other demand management tools. Long-run marginal cost (LRMC)-based tariffs also promote better use of existing facilities and more efficient expansion of supply.

Tariff Requirements

3 Tariffs should reflect the actual costs of supply and should encourage energy saving. Tariffs based on historical accounting costs and financial rate of return criteria will be replaced by more efficient tariffs that give users the right signals on supply costs and pass efficiency gains on to users.

4. The modern approach to pricing public services recognizes the existence of several objectives or criteria, not all of them mutually consistent. First, economic resources must be allocated efficiently; prices must signal the actual costs of supplying services. Second, certain principles of equity must be satisfied, including: (1) the fair allocation of costs among consumers according to the burdens they impose on the system; (2) the avoidance of sudden large fluctuations in price; and (3) the provision of a minimum level of service to users who may not be able to afford the full cost. Third, prices should raise enough revenues to meet the utility's financial requirements and attract private investors. Fourth, the tariff structure must be simple to facilitate metering and billing, and so it can easily be understood by users.

5. Since those criteria are often in conflict with one another, it is necessary to accept certain trade-offs. The LRMC approach to tariff design has both the analytical rigor and flexibility needed to provide a tariff structure responsive to these basic objectives.

LRMC-based Tariffs

6. A tariff schedule based on LRMC is consistent with efficient allocation of resources. Investment requirements and operating costs tend to increase as existing consumers increase their demand and as new consumers are connected to the system. Therefore, prices should act as a signal to consumers on the cost of providing services. These costs should reflect the value to the country of the present and future resources needed to meet the increase in present and projected demand. The accounting approach that uses historical asset values implies that future economic resources will be as cheap or as expensive as they were in the past. This usually leads to overinvestment and waste, or underinvestment and the additional costs of unnecessary scarcity (rationing and outage costs).

7. To promote better utilization of capacity, the LRMC approach permits the structuring of prices so that they vary according to the marginal costs of serving demands by: (1) different consumer categories; (2) peak (capacity) or off-peak demand (energy); (3) different seasons; (4) level of consumption; and (5) different regions.

8. The economic resource costs of future consumption are allocated as far as possible among the customers according to the incremental costs they impose on the supply system. In the traditional approach, fairness was often defined narrowly and led to the arbitrary allocation of accounting costs to various consumers, thus violating the economic efficiency criteria. Because the LRMC method deals with future costs over a long period -- usually at least 5 to 10 years -- constant prices based on LRMC tend to be stable over time. This smoothing out of costs over a long period is especially important, given the lumpiness of investments in infrastructure.

9. Demand-side improvements occur through changes in tariff levels, by sending consumers the right signals to adjust consumption patterns. The consumer has to be able to understand tariff structure, and should be given the option of reducing his consumption. The tariff must inform the user as clearly as possible that electricity consumed during peak demand on the system is more expensive. Tariffs should induce conservation and thus contribute to savings on capacity and production requirements.

10. The LRMC method uses economic opportunity costs (or shadow prices -- especially for capital, labor, and materials) instead of purely financial costs, and considers externalities wherever possible, thus further strengthening the link with efficient resource allocation. Externalities are especially important for sewerage services.

Practical Tariff Setting

11. The first stage of the LRMC approach is to calculate pure or strict LRMC that reflect economic criteria. If prices were set strictly equal to LRMC, consumers could indicate their willingness to pay for more consumption, thus signaling the justification of further investment to expand capacity.

12. In the second stage of tariff setting, the LRMC estimates are adjusted to meet other objectives, among which the financial requirement is important. If prices are set equal to strict marginal costs, the power company is likely to face increased financial losses and long-term financial surpluses because marginal costs tend to be higher than average costs when supply costs are increasing. Thus, the tariff structure is set according to marginal costs and the tariff rate level according to the utility's projected cash flow. Performance indicators should be enforced by the regulatory agencies to reduce inefficiencies in the utilities.

13. Electricity tariffs should be structured to reflect supply costs by voltage levels. Tariffs should give users the chance to structure consumption more economically and thus pay a lower tariff. Tariffs need to send the right cost signals to consumers to choose the right type and amount of fuel to consume and the right time to consume it. They also need to pass on to consumers changes in the opportunity costs of supply made possible by efficiency gains.

14. Rate levels should reflect supply- and demand-side improvements undertaken to make utilities more efficient. Supply-side measures should increase efficiency and reduce costs. Labor costs and losses should be reduced by increasing operation efficiency through better operation and maintenance (O&M) policies and plant rehabilitation programs.

15. The tariff level should allow the utility to cover financial costs and investment requirements, while taking into account the above-noted efficiency targets. The success of the efficiency measures should be reflected in the tariff level.

16. Another reason for deviating from strict LRMC arises because of "second-best" considerations. When prices elsewhere in the economy do not reflect marginal costs, departures from strict marginal cost pricing are justified. The computation of strict LRMC is based on the utility's least-cost expansion program, so LRMC may also need to be modified by short-term considerations if previously unforeseen events make the long-run system plan suboptimal in the short-run. For example, a sudden reduction in demand growth and an excess in installed capacity may justify somewhat reduced charges, or a rapid unforeseen increase in supply costs because of a rise in the international price of petroleum might warrant a short-term tariff increase.

17. The LRMC approach permits a high degree of tariff structuring, but data constraints and the objective of simplifying metering and billing procedures

usually means that there should be a practical limit to differentiation of tariffs by: (1) major customer categories (such as residential, industrial, commercial, special loads, and rural); (2) consumption levels (bulk and retail); (3) peak capacity or off-peak demand; (4) time of use (summer, winter, wet or dry season); and (5) geographic region.

PETROLEUM PRICING

Bunker Fuels

1. The volume of fuel oil and diesel sold to ships crossing the Panama Canal fell from about 30 million barrels in 1970 to about 5.2 million in 1989. Currently about 15 percent of the vessels crossing the Canal refuel in the area.

2. The main reason for the decline is the high final bunker price of fuel. The purchase price to vessels in the canal area averages about US$2.70 a barrel higher than in the US West coast or the Gulf of Mexico. High fees and charges account for part of this large differential: bunkering fees total US$1.77 a barrel, and pumping fees rose from US$0.35 to US$1.25 a barrel during the last decade. To promote the growth of the shipping industry in Panama, bunker fuels should be competitive with those of nearby points of supply in the US West coast, the Caribbean, and the Gulf of Mexico .

Jet Fuel

3. Jet fuel sales in Panama declined by 50 percent in the 1980s. Air traffic also declined because of political problems during 1989-90, reduced tourism activities, and the high cost of jet fuel in Panama. The delivered price of jet fuel to airlines in Panama is currently about US$1.25 a gallon; the comparable price in the United States is only about US$0.85. As a result, airline companies avoid fueling in Panama.

4. The Texaco Company has an exclusive license to import jet fuel in Panama. It imported jet fuel at an average CIF price of US$0.63 a gallon during 1989 and sold it at the refinery price of US$0.95 per gallon, realizing a profit of US$0.32 a gallon. The profit margin partially compensates for refinery losses and subsidizes losses on imports of liquefied petroleum gas (LPG).

5. The decline in airline traffic due to high jet fuel prices caused tourism, cargo and revenue to drop as well. Liberalizing imports of jet fuels for marketing companies would stimulate competition and drive down prices. This would make the maximum domestic charges (fees, margins, and transport costs) on jet fuel become competitive with prices in alternative supply locations.

Other Petroleum Products

6. Domestic prices of diesel and gasoline in Panama are high and above international prices -- two times more for diesel and three times more for gasoline. Taxes constitute about 45 percent of the final price of gasoline and 20 percent of diesel.

7. Four different sales taxes are levied on petroleum products. Two taxes are included in the ex-refinery tax and collected by REFPAN: a uniform stabilization tax of US$0.0842 a gallon and an economic reactivation tax (ranging from

US$0.0525 on kerosene to US$0.3158 cents a gallon on premium gasoline). The other two taxes are collected by the marketing companies: a US$0.10 consumption tax on gasoline and an import duty equivalent tax, ranging from US$0.02 a gallon on diesel to US$0.405 on premium gasoline.

8. Import duties on fuels for the domestic market are set at levels to protect REFPAN from international competition. The duties range from US$0.4 a gallon on fuel oil to US$0.7 on premium gasoline. However, little of the revenue from these duties goes to the Ministry of Finance because REFPAN, the sole importer, is exempt from paying import duties. REFPAN collects a surcharge on gasoline, kerosene, and diesel to compensate it for losses incurred in selling LPG and fuel oil to IRHE and diesel fuel to the fishing fleet at subsidized prices. The surcharge is set at a level needed to compensate for the revenue loss.

9. The Government recognizes that all end-user prices for the same fuel (diesel for fishermen, fuel oil for power generation, LPG for households, etc.) need to be equalized. Inefficiency can be reduced by phasing out the subsidies granted through lower taxes and prices to specific users. Although not a condition of tranche release under the proposed ERL, the Bank will review developments in petroleum pricing during the program period.

Annex III

Attachment vii

PANAMA
GOVERNMENT'S
PRIVATIZATION PROGRAM

List of companies

A. Complete transactions on the sale or liquidation of at least three of the following public companies during the program period:

1. Air Panama.

2. Cítricos de Chiriquí.

3. Cemento Bayano.

4. Victoria Sugar Mills.

5. Others:

ISA.
COBANA.
COBAPA.

(or others for a total of no less than US$10 million annual sales value).

B. INTEL

- Privatize with a controlling ownership by the private sector.

C. Grant concessions to the private sector.

- APN.

D. Privatize future expansion, non-basic services, some activities, and operations.

1. IRHE.
2. IDAAN.

PANAMA: Public Investment Program, 1991-93

SECTORS	1991	1992	1993	1991	1992	1993
	(Millions of US$)			(As % of total)		
Agriculture	6.8	14.4	15.7	5.7	6.8	6.8
Commerce & Industry	1.2	5.3	0.2	1.0	2.5	0.1
Education	5.8	15.8	20.5	4.8	7.4	8.9
Energy	18.9	41.5	76.8	15.8	19.5	33.4
Health	10.7	33.9	31.0	8.9	15.9	13.5
Telecommunications	19.9	17.3	0.0	16.6	8.1	0.0
Transport	27.9	35.8	39.3	23.3	16.8	17.1
Tourism	0.2	2.6	0.2	0.2	1.2	0.1
Housing	5.7	20.2	14.2	4.7	9.5	6.2
Others	22.8	26.2	32.2	19.0	12.3	14.0
TOTAL	120.0	213.0	230.0	100.0	100.0	100.0
Percentage of GDP	2.4	4.0	4.0			

FINANCING (Millions of US$)				Composition (As a % of total)		
TOTAL	120.0	213.0	230.0	100	100	100
Central Government	16.0	39.4	57.8	13	19	25
Use of Entity Surpluses	33.5	74.0	82.5	28	35	36
External Financing	13.6	54.4	89.7	11	26	39
USAID Grants	56.8	45.2	0.0	47	21	0

AGRICULTURAL TARIFF REDUCTION PROGRAM

(Percentages)

AGRICULTURAL	TARIFF RATES		
	Before Board	Second Tranche	Third Tranche
Vegetables	50	40	30
Sorghum		50 1/	
Beans		60	40
Onions		45	30
Potatoes		80	60
Tomatoes			50
Corn		70	50 1/
Rice			60 1/
Beef meat	30		20
Chicken meat		60	50
Pork meat		60	50

1/ A system of variable import tariff rates for these products will be agreed as part of the condition of second tranche release, including the maximum applicable rate under the system.

TRADE REGIME FOR THE MAIN AGRICULTURAL AND LIVESTOCK PRODUCTS IN PANAMA

A. CROPS	Specific Tariff Rates	Ad-Valorem Equivalent Tariff Rates	QRs	Price Detemination		
				Consumer Level	Wholesale Level	Producer Level
1. RICE	.3086KB+7.5%	97%	QR	Fixed	Fixed	"Agreed"
2. CORN	.09927KB+7.5%	109%	QR	Free	Free	"Agreed"
3. SORGHUM	.0926KB+7.5%	82%	QR	Free	Free	"Agreed"
4. BEANS	0.15KB+7.5% or 27.5%, whichever is higher	27.5%	QR	Free	Free	Free
5. POTATOES	.50KB+7.5%	225%	QR	Free	Free	Free
6. ONIONS	0.11KB+7.5%	41%	QR	Fixed	Fixed	Free

B. LIVESTOCK PRODUCTS	Specific Tariff Rates	Ad-Valorem Equivalent Tariff Rates	QRs	Price Detemination: Consumer Level	Wholesale Level	Producer Level
1. BEEF MEAT[1/]	2.50KB+2.5% OR 40%, whichever is higher	N/A	De Facto quota to export and a permit to import	Fixed	Fixed	Free
2. PORK MEAT	2.50KB 2.5%	343%	Permit to import	Fixed for popular cuts	Free	"Agreed"
3. CHICKEN MEAT	0.50KB+7.5%	50%	Permit to import	Fixed	-	Fixed
4. DRIED POWDER MILK 26%	1.25KB+7.5%	64%	Quota to import	Fixed	Fixed	Fixed
5. BUTTER	1.75KB+7.5% OR 80%, whichever is higher	80%	Quota to	Fixed	Free	Fixed
6. CHEESE	0.50KB+3.5% OR 50%	20%	Quota to import	Free	Free	Fixed

Source: IMA, MIPPE, Bank staff estimates.

1/ Before the introduction of reforms in 1991.

KEY ACTIONS PLANNED TO RESTRUCTURE PUBLIC SECTOR BANKS

National Mortgage Bank (BHN)

- Cease further real estate development.
- Improve credit criteria for loans for sales of housing units.
- Transfer assets and liabilities of three failed S&Ls to BHN.
- Sell or transfer viable assets (of failed S&Ls and of BHN), and some existing debt of BHN, to the Savings Bank (CA) and to private commercial banks.
- Liquidate real assets (foreclosed real estate) of S&Ls.
- Assess potential to liquidate or privatize real assets of BHN (low-income housing projects) and develop a strategy to rehabilitate these assets.
- Establish a process for collecting nonviable financial assets of S&Ls and BHN (mortgage loans).
- Close BHN.

Agricultural Development Bank (BDA)

- Sell viable assets and branches to private sector banks or commercial firms.
- Establish a process for collecting nonviable financial assets.
- Liquidate repossessed assets.

Savings Bank (CA)

- Take action to permit competition on an equal footing with private banks.
- Complete the recapitalization (contribution of land by the Government) of the Bank.

Create Level Playing Field for Public and Private Banks

- Eliminate direct and indirect subsidies to public banks.

- Permit public and private banks to participate in programs to support low-income housing or small-scale producers.

- Implement appropriate institutional changes regarding the composition of the boards of public sector banks and their relationship to management.

Privatization

- Partially privatize BHN assets.

- Do not privatize BDA at this time. Eventually, the Government could sell its existing shares or new shares to private firms or individuals.

- Privatize CA after 1992.

Terms of Reference for the Agricultural Development Bank (BDA)

1. BDA currently provides financing for small and medium-size agricultural producers. The Government has used this bank to channel financial (and technical) support to such producers. The Bank holds a sizeable volume of unrecoverable loans and has relied historically on central government budget allocations to remain solvent. Future budget allocations will be severely limited so the Government must introduce actions to deliver more efficient support to these producers.

2. Therefore, the goals of the study regarding BDA are to:

- Develop concrete options for both: (1) the restructuring and privatization of BDA, and (2) its closure, with the sale or transfer of its assets and liabilities to other entities.

- Develop recommendations for future policies on small and medium-size agricultural producers.

3. The options and recommendations prepared under the proposed study should have as their objectives:

- Promoting private sector development, and

- Assuring the continued availability of financial resources to small and medium- size producers.

4. The Government's involvement has tended to stifle the development of efficient private producers and commercial firms in the past. The two principal forms of government disincentives that have suppressed the private sector in rural markets are:

- Market-distorting policies and programs.

- The competition in many such markets of up to three public sector banks (BDA, BNP and CA), each of which operates with several competitive advantages over private sector banks.

5. The following assumptions can be made about future policies and programs:

- The system of price controls, quotas, tariffs, and permits will be abolished and replaced by import tariffs through the program supported under the proposed ERL.

- Interest rate controls and subsidy programs will be phased out.

6. The study will assess how the operation of other public sector banks affects the private sector's ability to penetrate this market, and should recommend new policy for those state-owned banks. The study will also identify and propose methods to rationalize any other policies that affect this market.

7. The second objective (assuring the availability of financial resources) involves basically two issues:

- The level and type of government support needed to ensure that the legitimate credit needs of viable small and medium-size producers are met, and

- The means by which this support is to be delivered.

8. Several private sources of credit exist for small and medium-size producers, including suppliers of inputs, processors, wholesalers, retailers, and producer cooperatives. To some extent, private banks provide credit indirectly to small- and medium-sized producers.

9. In evaluating options for restructuring BDA, the proposed study should:

- Determine the value of BDA assets under alternative strategies for collecting those assets.

- Assess management, policies, and operations and determine actions to assure financial solvency of the entity.

- Determine prospects for diversifying the asset base if BDA were to be privatized.

- Determine changes needed in risk taking and risk pricing to ensure profitability when government subsidies end.

FINANCIAL SECTOR ISSUES

A. Proposed Study on Prudential Regulations

1. The existing Banking Law is inadequate and needs to be updated to take account of developments in banking over the past 20 years. Above all, prudential regulations should be modified to ensure the solvency of the financial system in Panama. Bank supervision also needs to be strengthened, and the authority and resources of the National Banking Commission (CBN) need to be expanded to deal with bank insolvency. The Government has agreed to review prudential regulations and design an action plan for their improvement.

2. This study, financed partly by the ERL --in the amount of US$0.12 million --would contain the following main topics:

(1) The present fragmentation of regulatory authorities for the financial sector;

(2) The degree of autonomy of the National Banking Commission (CBN);

(3) The need for strengthening CBN's enforcement powers;

(4) Procedures for intervening problem banks;

(5) Handling ailing banks;

(6) Establishing adequate liquidity ratios;

(7) Ensuring adequate capital ratios for financial institutions;

(8) Loan-loss provisioning and write-offs;

(9) Classification of assets;

(10) Reducing risk in lending (reducing the amount of concentrated and connected lending); and

(11) Improving CBN's relations with internal and external auditors.

3. Several suggestions about prudential regulations will be thoroughly analyzed by the proposed study, including the following:

(1) Revise upward the minimum capital requirement for banks of US$1 million and the minimum capital-plus-reservesrequirement of 4 percent of earnings --a very low ratio by international

standards. Consider replacing the simple 4-percent ratio with a system of ratios relating different risk categories of bank assets to their equity capital (Art. 30 of the Banking Law, BL, and Acuerdo 1-83).

(2) Consider introducing a lending limit for each borrower and group of borrowers, expressed as a percentage (20 to 25 percent) of a bank's equity --in addition to or in place of the existing lending limit of 5 percent of bank deposits, capital, and reserves (Art. 53 BL).

(3) Clearly define loans to related parties (Art. 55 BL).

(4) Remove unnecessary or overlapping regulations on bank reserves.

(5) Increase the penalty for noncompliance with legal reserve requirements (Art. 40 BL). The minimum liquid-assets requirement (Art 45 BL), if it remains, should be set at a level equivalent to a positive real interest rate.

(6) Introduce an automatic penalty for noncompliance with the minimum capital requirements (Art. 30 BL) in the form of a 100-percent reserve/liquidity requirement on all additional deposits received after the date of non-compliance.

(7) Consider deleting or replacing the regulations on "contingent credit" with another instrument (Art. 34-35 BL).

(8) Strengthen BL Art. 65, which is unclear about the banking supervisor's right to inspect credit files and evaluate asset quality. Empower CBN to examine the credit files of all banks and financial intermediaries.

(9) Introduce a regulation that defines what ratio of capital deficiency represents insolvency and allows CBN to intervene in such cases (Art. 83 BL).

(10) As needed, introduce regulations that allow and promote the use of new financial instruments, including NOW accounts, cash management accounts, certificates of deposit, bankers' acceptances, and private sector bonds.

(11) End the asymmetrical tax treatment of bank deposits, the income from which is tax exempt, and capital market instruments (bonds, shares) income from which (interest, dividends) is subject to a withholding tax of 5 to 10 percent.

Because the Government intends to promote the development of capital markets, these instruments should be taxed similarly.

B. Proposed Technical Assistance to Strengthen Banking Supervision

4. The ERL aims to help the Government of Panama to strengthen the CBN's supervisory capabilities to ensure financial center's solvency. The proposed technical assistance would aim to strengthen bank supervision, providing training on the following:

(1) On-site examinations.

(2) Off-site examinations.

(3) Early warning systems.

(4) Information systems.

(5) The analysis of asset quality, profitability, capital adequacy, liquidity, and the management of financial institutions (CAMEL rating system).

Interest Rate Policies

5. The current interest rate structure also needs to be reviewed. The proposed study will cover the following:

(1) Allowing payment of interest on domestic demand deposits (Art. 48 BL).

(2) Permitting BNP to pay a market-determined interest rate on the financial institutions' reserves held in the form of sight deposits and treasury bills (Acuerdo No. 3-96 CBN and Art. 37 BL).

(3) Considering the possibility of removing interest rate ceilings for savings deposits, which discriminate in favor of mortgage banks (Art. 48 BL).

(4) Phasing out preferential interest rates for credit to agriculture and housing (Acuerdo 12-84) and any other such interest rate subsidies.

PANAMA

NUTRITION ASSISTANCE PROGRAM

Need for a Nutrition Assistance Program

1. Although nutrition has improved in Panama over the last 20 years, malnutrition is worse than in countries with a smaller GDP per capita. There are some indications that it may even have worsened in the last several years. In 1988, half of the households in Panama were below the poverty level (i.e., did not have enough income to meet their basic needs). Critical poverty (income insufficient to buy the basic food basket) affected about one-third of households. Most poor families experience diet deficiencies both of quantity and quality, with particular deficits in calories, proteins, vitamin A, calcium, iron, riboflavin, and folic acid.

2. Other indications of the severity of malnutrition are Panama's infant and child mortality rates. The country average was 24.3 deaths per thousand births in 1987, but several regions (such as Darien, San Blas, and Bocas del Toro) had levels as high as 40-50 per thousand. And it appears there may be a recent trend toward higher infant mortality rates that have not yet been registered in official statistics. Census figures on height from the Ministry of Health (MOH) show that in 1988 about one-fifth of school-age children suffered from moderate malnutrition and 6 percent from severe malnutrition.

3. The current nutrition assistance program in Panama have a limited reach. The MOH has a nutrition assistance program that provides breakfasts or school lunches to primary school children. The program is well targeted to 10 districts with the highest incidence of malnutrition and there are plans to expand it to 30 districts. The protein and calories represent about one-sixth of total requirements for a 7-year old child. In 1990, the MOH had a budget of US$600,000 which would have allowed its programs to reach only 12,000 children or less than 5 percent of children enrolled in primary schools. In fact, because of administrative limitations, only US$300,000 was spent. In addition to the MOH program, the food-for-work program of the World Food Program has distributed US$5000,000 of food to 2,300 Indian families, less than 3 percent of the families living in critical poverty.

The Proposed Nutrition Assistance Program

4. To address the malnutrition problem, the Government intends to implement a pilot nutrition assistance program that would give special protection to mothers and children under 5 who face malnutrition. The program would operate in the regions with the most malnutrition (such as Bocas del Toro, Darien, Comarcas de San Blas) and possibly in some areas of Panama City and Colon. The program would be funded from the Government's budget and from

expected donations. It would be implemented through the primary health care network, would benefit an estimated 6,000 to 10,000 mothers and children in the pilot phase, and would cost about US$600,000.

5. Based on experiences in other countries, the Bank recommended to the Government to use a food coupon system. Under such a system, pregnant and lactating women who attend health care centers for periodic check-ups, well-baby checks, growth monitoring, vaccination, and such, would receive food coupons every month, one for each mother and one for each child. Based on a food basket recommended to beneficiaries, the coupon would provide a supplement in calories and proteins to mothers and children participating in the program. The size of the coupon payments would be based on the results of an analysis of: (1) the income of targets groups, (2) the share of income spent on food, (3) the type of severity of malnutrition (to determine that a coupon of US$x per month should be suffficient to supplement y percent of the food basket), (4) the minimum transfer needed to have a significant impact on the family, and (5) the minimum income transfer needed to make a coupon attractive to beneficiaries, taking into consideration travel costs and expected waiting time. One of the main objectives of a pilot program would be to test whether a coupon would be acceptable to beneficiaries and determine whether any modifications are needed. The coupon would not only transfer income but would also indirectly improve health and nutrition by increasing the health-care services mothers and children receive at health-care centers. The beneficiaries would use the coupon to buy food at a local store participating in the program and the local store would redeem the coupon against cash at a commercial bank, funded by BNP.

6. The pilot food coupon program would be evaluated after 6 months before it is expanded to a national level. Depending on the availability of food and the monthly amount distributed per beneficiary, experience in other countries suggests that a well-targeted program may reach from about 100,000 to 150,000 beneficiaries and cost from US$5.0 million to 7.5 million a year plus administrative costs (estimated at about a sixth of the total cost).

7. Another less desirable yet feasible alternative would be to distribute food to the beneficiaries. The usual argument in favor of this mechanism is that it ensures that beneficiaries actually receive food whereas the coupon could be traded for nonfood products. Food distribution programs usually have several disadvantages, however, including the following: (1) beneficiaries are not properly targeted for lack of information; (2) food aid program are not well-coordinated, partly because different donors have different motives, so there is usually duplication and waste, (3) most of the food tends to be distributed to people near ports and the capital, and the needy people in remote areas do not receive enough food for lack of transport, warehouse facilities, and personnel because of complicated bureaucratic procedures; (4) the types of food distributed are not always acceptable to beneficiaries; and (5) supplies vary depending on the availability of surpluses (such as skimmed milk from the EEC).

8. A food coupon system (a coupon used to buy food in private stores) is more efficient because: (1) it is simpler, (2) it relies on the private sector for distribution, and (3) it is self-targeting (most high-income women go to private clinics, not to government health-care centers).

Rationale for the pilot program

9. A pilot program is considered essential for the success of a nutrition assistance program because it allows a program to be adopted to a country's particular conditions. The Bank has had experience with similar programs in Jamaica and Honduras, for example, but conditions in Panama -- such as coverage of the MOH, the geographic distribution of the population, and topography -- are different. Because of the small scale of the pilot program, lessons can be learned quickly, the system can be modified easily and if errors are made their economic and political cost would be small.

PANAMA: Projected Financing Requirements

(Selected years)

(US$ Millions)

	1992	1993	1994	1995	1997	1998	1999
GROSS FINANCING REQUIREMENTS	(1,273)	(770)	(536)	(574)	(499)	(493)	(504)
Current Account Balance	(366)	(390)	(257)	(271)	(232)	(229)	(216)
Amortization Payments 1/	(793)	(285)	(210)	(267)	(208)	(174)	(151)
o/w : IBRD	(173)	(48)	(49)	(37)	(33)	(33)	(32)
IDB	(177)	(41)	(37)	(37)	(35)	(25)	(20)
IMF purchases	(196)	(10)	(1)	(90)	(25)	(75)	(50)
Banking system net foreign assets	(113)	(95)	(68)	(36)	(59)	(90)	(138)
SOURCES	1,273	770	536	574	499	493	504
A. Official Grants	340	110	120	120	80	80	80
B. Net Direct Foreign Investment	70	80	110	125	180	190	200
C. MLT Gross Disbursements	454	338	306	329	239	223	224
o/w : IBRD	90	114	92	90	62	58	67
IDB	120	143	131	152	128	115	107
IMF repurchases	126	53	50	50	0	0	0
D. Net Other Flows 2/	409	242	0	0	(0)	0	0

1/ Includes rescheduling.
2/ Includes escrow funds, debt service arrears and net short term capital flows.

Source: Bank staff estimates.

TECHNICAL ASSISTANCE PROGRAM

AREAS	COST
A. Institutional Assistance to be Financed by the Bank	
I. Technical Unit at MIPPE	
a) Assistance to monitor the implementation of the Economic Recovery Program and promote public awareness of the program	
b) Agriculture	
c) Nutrition program	
d) Customs administration assistance	
e) Procurement	US$ 1,300,000
II. Privatization Technical Unit at MIPPE	
a) Legal issues	
b) Financial issues	
c) Regulatory issues	US$ 350,000
III. Financial Sector	
a) Prudential regulations	
b) Banking supervision	US$ 120,000
IV. Social Security	
a) Update of financial and actuarial projections of social security system	US$ 30,000
TOTAL	US$ 1,800,000

B. Institutional Assistance to be Undertaken by DEVTEC (a private consulting company, financed by USAID)

a) Public sector banks (BHN, BDA)
b) Health-care cost reduction program for CSS
c) Government Complementary Pension Scheme action plan
d) Management of external debt

TECHNICAL ASSISTANCE FOR REGULATION OF THE TELECOMMUNICATIONS SECTOR

1. The Government of Panama has adopted a new telecommunications reform strategy that centers on privatizing INTEL through international competitive bidding and reorganization of the sector. The objectives of reform are to increase competition in the telecommunications sector, to create a regulatory entity (RE) for the telecommunications sector, and to transform INTEL into an operating company of mixed ownership. The Government will sell 55 percent of the shares to a private operator and will introduce competition as appropriate.

2. The Government has proposed creating a new, independent regulatory entity for telecommunications because it believes that a suitable regulatory regime is needed to support reform of the telecommunications sector. A new and greatly improved government regulatory capability will be needed especially to enforce provisions of the INTEL sale concerning tariffs, services, and competition in the sector.

Four Parallel Consultancies

3. Four separate consultancies (each with its own contract) will cooperate closely in preparing a sector plan for and implementing the reform and restructuring telecommunications in Panama. The first consultancy will advise the Panamanian Government on restructuring the sector. The second will provide legal advisory services as the sector plan is created and implemented and during preparation and the sale of INTEL. The third will provide investment advisory services to assist in the marketing and sale of INTEL. The fourth will provide technical assistance to the Government of Panama to help establish, train, and operate the regulatory entity for the telecommunications sector.

Consultancy to Help Restructure the Telecommunications Sector

4. This consultancy will advise the Panamanian authorities on preparation of the telecommunications sector restructuring plan, on the sector's best structure, on specific proposed government actions, and on appropriate terms for the sale of INTEL. It will recommend policy and organizational principles needed to establish a new telecommunications RE within the Panamanian Government. It will also prepare the work plan to train personnel for and to implement the RE.

Legal Advisory Services

5. This consultancy will provide legal and policy advice to MIPPE and other relevant Government authorities during development of the telecommunications sector reform plan, in the drafting of the national telecommunications law, and preparation of the terms for selling INTEL.

6. The legal advisory services will provide legal and policy advice as well as other professional services to MIPPE in support of creating and presenting the telecommunications sector reform plan; in surveying relevant Panamanian law affected by telecommunications sector reform; in drafting proposed changes to Panamanian law; and in recommending procedures to use in implementing the sector plan and selling INTEL. The firm will also serve MIPPE as an outside general counsel for telecommunications reform and the sale of INTEL.

7. Legal services related to the sale of INTEL will include:

1) advising on the required legal framework for the transaction and drafting of all documents required for the sale;

2) providing legal advice on all areas of Panamanian and international law that could affect INTEL's sale;

3) assessing the legal implications of the sale;

4) advising on and implementing changes in INTEL's capital structure and articles of incorporation;

5) reviewing and revising the documents that are made available to potential purchasers;

6) negotiating legal documents and regulations with potential purchasers;

7) assessing the antitrust implications of the sale;

8) coordinating efforts with lawyers responsible for the legal work on labor and pension aspects of the transaction; and

9) advising on the tax and legal aspects of proposed participation by INTEL's employees.

Investment Advisory Services

8. An international investment advisory company, to be selected, will help present INTEL to qualified buyers and place stock offerings as much as necessary. The IDB will fund and the UNDP will administer the operating expenses of the investment advisor. The investment advisory group will probably also receive a "success fee" from the Government when the sale closes. This fee will probably be a percentage of the final sales price negotiated through competitive bidding.

9. The services of the investment banker will include the following:

1) providing independent advice to the Government on the terms and conditions of sale proposed by the Government;

2) preparing the sales memorandum for presentation to potential bidders;

3) preparing and assisting potential buyers through the "due diligence" process;

4) organizing, as much as necessary, an inventory of the firm's assets and liabilities;

5) marketing the company to prospective buyers;

6) preparing presentations on the sale process and status and on the advantages of the proposed sale of INTEL and making these presentations to the Congress, political parties, Government staff, and the general public;

7) prequalifying the offerers;

8) coordinating and managing the international competitive bidding;

9) evaluating offers from bidders and helping the Government negotiate the contract of sale with the successful bidder; and

10) assisting in the closing of the transaction.

IMPLEMENTING THE REGULATORY ENTITY

10. Technical assistance will help the RE undertake regulatory activities by providing experts and consultants, assistance for experienced personnel, on-the-job and off-site training, and computers The institutional

assistance will focus on building up expertise in (1) regulatory policy, (2) pricing, cost, and financial analysis, (3) monitoring the quality of service, the investment program, and technical standards, and (4) administrative, legal and information systems. Tentative estimates of the minimum requirements of RE professional staff, and of the requirements and costs of experts and training for the initial 3 years of development of these areas, are summarized below.

Regulatory Policy

11. RE must build a capability to develop and implement regulatory policies with respect to:

1) the licensing of telecommunications networks facilities;

2) the licensing of resellers and other competitive service providers;

3) the provision of leased lines;

4) anticompetitive or unduly discriminatory behavior by facilities-based service providers;

5) network interconnection and revenue settlement arrangements; and

6) other regulatory issues.

Pricing, Cost, and Financial Analysis

12. RE must build up a capability to:

1) monitor, analyze, and approve or reject tariff proposals;

2) review financial projections of service providers and develop an RE financial model of the operating company to forecast rates of return and other financial indicators; and

3) review methodologies and estimate costs of providing telecommunications services.

Monitoring Quality of Service, the Investment Program, and Technical Standards

13. RE must develop a capability for:

1) establishing performance indicators and systems to monitor results;

2) assessing the operating company investment program, depreciation, and procurement policies; and

3) establishing, monitoring, and enforcing technical standards for networks (including national fundamental technical plans) and terminal equipment.

Administrative, Legal and Information Systems

14. The RE must develop a capability to:

1) operate modern administrative systems for externally-oriented needs (such as the processing of license applications and the management of regulatory proceedings) and internal requirements (such as managing personnel, finances, and supplies);

2) provide in-house legal advice and undertake legal actions in support of its operations; and

3) establish and maintain information systems to support the RE's operations.

STUDY OF THE OPTIONS TO REDUCE HEALTH-CARE COSTS OF CSS

1. The health-care branch of the social security system in Panama has produced operational deficits in the past. These deficits resulted from the operation of the integrated health-care program. Further, the medical care branch of the CSS confronts high actuarial costs caused by high overhead costs due to an excessive number of doctors, yielding a low ratio of services per medical hour, excessive costs of drugs and other medical components, and the practice of entering into service agreements with private medical entities without a proper cost control and evaluation of the cost and quality of services performed.

2. Furthermore, the enactment of the legal amendments to the social security scheme would cost the medical branch about US$10 million annually, due to the reduction of its share of contribution from 9 percent to 8.5 percent of salaries under the recently approved law.

3. The actuarial analysis will aim to:

(i) quantify future costs and, hence, project the actuarial and operational deficit of the scheme;

(ii) determine the unit cost of the scheme and its service components, such as hospitalization, drugs, ambulatory care, surgery and auxiliary services of diagnostic treatment; and

(iii) develop an action plan to ensure the financial solvency of the scheme, including cost-containment measures and budget limits for each medical component. Specifically, the medical cost of the CSS should not exceed its proposed statutory allocation of 8.5 percent of salaries, so as to avoid transfer of funds from the pension reserves to cover any deficits of the medical component.

STUDY OF THE GOVERNMENT COMPLEMENTARY PENSION SCHEME

Coverage and Legal Provisions

1. The complementary and special pension schemes for public employees and decentralized agencies cover about 130,000 persons, 42 percent of the total insured population of the social security system.

2. The "Special Schemes" allow for a generous retirement pension after 20 to 30 years of service, and provide coverage to about two-fifths of the total employees in the public sector. These schemes cover teachers, the police and armed forces, nurses, and employees in the following areas: mail and telecommunications, the judiciary, the University of Panama, and the National Bank of Panama.

Funding Basis

3. The government complementary pension scheme started operations without a proper actuarial analysis to ensure its financial solvency. Further, the legal provision requiring the payment of an initial "capital" to cover past service liabilities was never implemented by the participating institution or required by the CSS. Rather, a 2-percent contribution rate by employees and 0.3 percent by the employer was arbitrarily set in 1975. By 1991, the expenditures of the government complementary pension scheme exceeded the contributions and have continued to increase since then.

Objectives of the Actuarial Valuation

4. The objective of the actuarial analysis of the government complementary pension scheme is to develop options to eliminate the cash deficit in 1993 and avoid the emergence of operational cash deficits in the next 10 years. Specifically the study will aim to:

(1) collect and analyze data to carry out the actuarial review;
(2) prepare actuarial projections; and
(3) determine options to permanently eliminate the operational cash deficit by reducing expenditures, increasing revenues, or both.

Annex III

Attachment xviii

PANAMA - Statement of IBRD Loans

(In US$ Millions)

Number	Loan	Approved	Approval Cancelled	Year
0086-0	Agricultural Machinery	1.20	0.54	1953
0087-0	Grain Storage	0.29		1953
0123-0	Highway Rehabilitation	5.90		1955
0264-0	Second Road	7.20		1956
0322-0	Central Provinces Electrific.	4.00		1962
0661-0	Second Power	42.00		1970
0783-0	Tocumen International Airport	20.00		1971
0784-0	Fisheries	3.40	0.03	1971
0901-0	Livestock Development	4.70		1973
0948-0	Third Power	30.00		1973
1114-0	Fishing Port	24.00		1975
1280-0	Water Supply & Sewarage	12.00		1976
1397-0	Second Livestock	8.00	0.49	1977
1398-0	Second Fisheries	7.50	2.63	1977
1470-0	Fourth Power	42.00		1977
1470-1	Fourth Power I	31.30	0.34	1983
1565-0	Highway Maintenance	12.00		1978
1641-0	Development Banking	15.00	0.83	1978
1672-0	Tropical Tree Crop Development	19.00	8.09	1979
1778-0	Fifth Power	23.00		1979
1878-0	Colon Urban Development	35.00	7.98	1980
1954-0	Energy Planning and Petroleum	6.50	5.91	1981
1955-0	Second Development Banking	20.00	13.15	1981
2020-0	Road Rehabilitation	19.00	4.29	1981
2182-0	Second Port	24.40	10.43	1982
2222-0	2nd Water Supply & Sewarage	21.60	10.57	1982
2313-0	Sixth Power	32.10	18.75	1983
2356-0	Third Livestock	9.00	6.23	1983
2357-0	Structural Adjustment Loan	60.20		1983
2358-0	Technical Assistance	5.00	0.50	1983
2506-0	Seventh Power	51.00	49.72	1985
2768-0	2nd Structural Adjustment Loan	100.00	50.17	1986
	TOTAL COUNTRY	696.29	190.65	

STATEMENT OF IFC INVESTMENTS

October 30, 1991
(Millions US$)

Fiscal Year Approved	Obligor	Type of Business	IFC GROSS LOAN	IFC GROSS EQUITY	IFC GROSS TOTAL	Held by IFC
1971	Corp. de Hotelero	Tourism	1.17	0.30	1.47	7.50
1978	Vidrios Panamenos[1/]	Glass Factory	2.40	1.40	3.80	
1979/85, 1986/88	Bco. Latino Americano de Exportaciones, S.A	Money & Capital Markets	47.33	2.50	49.83	7.50
	Total Commitments		50.90	4.20	55.10	
	Less Cancellations, terminations, repayments and sales		45.90	1.70	47.60	
	Total Commitments presently held		5.00	2.50	7.50	7.50

[1/] sold in July 1991.

República de Panamá

Ministerio de Planificación y Política Económica

September 20, 1991

Mr. Lewis Preston
President
The World Bank
Washington, D.C. 20433

Dear Mr. Preston:

1. When the democratically elected Government of Panama assumed power in December 1989, it faced the enormous task of simultaneously reestablishing democratic institutions and respect for the rule of law, resuscitating an economy which had suffered a 20 percent drop in production over two years, and restructuring the economy to correct extreme distortions inherited from the past. We have achieved considerable progress in all three interrelated areas. Now Panama is a well-functioning democracy. Growth has resumed and domestic and foreign business confidence is growing. These positive developments have restored Panama's position within the international community. We have complied with the Fund-Monitored Program since September 1990. The public sector deficit was reduced from 11.5 percent of the GDP in 1989 to 2.9 percent in 1990. We have initiated the implementation of a sound public investment program addressing critical infrastructure needs. We lifted the deposit restrictions which had been introduced to avoid deposit withdrawals following the closure of banks in 1988. Deposits in the banking system have increased by US$3.5 billion in 1990. Strengthened public confidence contributed to real GDP growth of 3.4 percent in 1990. The GDP is estimated to increase by 4.5 percent in 1991.

2. The Government recognizes, however, that in addition to stabilizing our economy, fundamental reforms are required to promote efficiency and international competitiveness. Thus, our Government intends to pursue policies of economic liberalization. This process will be neither fast nor easy. However, to establish the basis for long-term sustainable growth, employment creation and social progress, we must pursue comprehensive policies to increase productivity in the private sector, reduce costs, limit state control, strengthen public finances, and increase incentives to work, save, and invest.

3. We started restoring Panama's relations with the international financial community. Since April 1990, we have made all payments on maturing debts owed to the IFIs and have made preliminary contacts with the money center commercial banks and bilateral creditors on the rescheduling of debt obligations. In November 1990, an agreement was reached with the Paris Club for the rescheduling of official debt service payments in arrears, including those falling due through March 1992, and we have proceeded to reach agreement with bilateral creditors on the rescheduling of debt obligations.

4. The actions taken to stabilize the economy after a period of extreme economic and social turmoil need to be strengthened by a more comprehensive restructuring of the economy. In September 1990, we made public an economic strategy paper in order to stimulate national debate. In early May 1991, the Cabinet unanimously approved a comprehensive economic recovery program, which includes: trade reform, reduction in the size of the state through privatization, decrease in public current outlays, improved public sector efficiency, tax reform, social security reform, and the preparation and implementation of a sound public investment program.

5. The implementation of the economic reform program is expected to create significant changes in the structure of the Panamanian economy in the 1990s. Trade liberalization and increased domestic productivity would enhance international competitiveness. These changes would also shift the balance of incentives in favor of exportables, encouraging private sector specialization in line with Panama's comparative advantages. The elimination of incentives to capital-intensive productive processes, which have resulted from decades of import-substitution strategies, will become part of our economic transformation. We expect that exports of goods and services will grow from 39.7 percent of the projected GDP in 1992 to around 44 percent by 1999 in response to implementation of our reform program.

6. With the planned reforms, the country's GDP is expected to grow at an average rate of 5.4 percent a year between 1992 and 1995, and at about 6.8 percent in the latter part of the decade. Given that our domestic economy is service-oriented, and investment requirements for expansion are relatively modest, the projected growth rates are attainable. The main sources of growth would be in those sectors oriented toward external trade, including bananas, shrimp, and non-traditional products in manufacturing, especially maquila activities. The Colon Free Trade Zone has already registered significant growth recently, and the activities of financial services, insurance, tourism, and transportation should become dynamic sectors.

7. The principal components of our economic recovery program and the steps for its execution are summarized below.

I. Public Sector Reforms

8. Our Government is determined to further reduce the public sector deficit. Since user charges and taxes are relatively high, and given that there is an urgent need to increase public investment, our reform program will reduce significantly public current outlays. We believe that the establishment of a sound macro/fiscal position is a prerequisite for the introduction of structural adjustment measures to regain sustained growth.

9. Public Employment and Public Sector Finances. The Government intends to shift the emphasis from current to investment expenditures. Current expenditures of the General Government is projected to decline from 31.9 percent of GDP in 1991 to 30 percent in 1992. To achieve this goal, the public sector wage bill will decline in 1992 by about 3 percent in nominal terms and by a further 6 percent in 1993. A public employment reduction program will be implemented. This program is based on the implementation of the following mechanisms: offers of voluntary separation packages, which are in part to be financed externally by bilateral donors and multilateral institutions, the non-replacement of a large share of retiring employees, normal retirement as well as privatization. We estimate that the implementation of the above-mentioned mechanism will result in a net public employment reduction of about 19,000 positions during the program period, of which the implementation of the voluntary separation program is expected to account for a reduction of approximately 11,000 positions. A new Personnel Office will be created shortly to review all applications from ministries and public institutions and make recommendations on whether to fill vacancies created by resignations or retirements; in case of new hirings, the salaries normally would be 10 percent below those of previously employed personnel. As a result, General Government savings will shift form a negative 3.1 percent of the GDP in 1991 to a negative 1.9 percent in 1992 and to 0.4 percent in 1993.

10. Public Sector Enterprises. Our Government will implement a program to reform public enterprises, especially in the power, water, and port services. The reforms will support efforts to reduce costs, improve quality, and increase the coverage and reliability of public services. The reform program will promote private sector participation, improve operating and administrative efficiency, reduce non-technical losses, and, hence, strengthen the financial position of these enterprises. Cost cutting and enhanced collection will enable public enterprises to catch up with delayed investments and to continue transferring financial resources to the Central Government as a return on equity. As a result of the expected strengthening in finances of these enterprises, price reductions to consumers should be possible over time. We also plan to reform the procurement and budgetary practices for the public enterprises. A draft enabling law will be sent to Congress shortly.

11. IRHE and IDAAN. In order to make IRHE and IDAAN more efficient, we will introduce the following measures:

- implement programs to improve labor productivity and to reduce costs.

- introduce steps to recover and strengthen the financial situation of enterprises including reducing current outlays, enhancing revenue collection and improving metering, billing and collection.

- establish a regulatory framework for the electric sector, enabling the privatization of future investments.

- introduce managerial improvements to achieve administrative and financial autonomy.

II. Privatization Program

12. Our Government has prepared a privatization program to increase the efficiency of the economy and reduce the size of the public sector. In addition, the program aims to transfer some non-basic services and future expansion programs of IRHE and IDAAN to the private sector. We will submit to Congress draft legislation on a regulatory framework for privatization. We have also established a Privatization Committee at MIPPE to facilitate the privatization program. Presently, we are making efforts to privatize Air Panama and Cítricos de Chiriquí. We also plan to sell Cemento Bayano, COBANA, ISA, and Victoria Sugar Mills. By the end of the reform program, we hope to have either sold to the private sector or liquidated at least three public companies.

13. INTEL. The Government will implement an action plan to restructure the telecommunications sector, introduce competition, and privatize INTEL. A regulatory commission will be created to foster competition in the telecommunications sector, grant licenses for the operation of services, regulate tariffs, attend to public complaints, and regulate operations. Congressional approval will be sought for a new law that will restructure the telecommunications sector and enable INTEL's privatization.

14. APN. To promote trade and create employment opportunities, we have prepared a program to restructure our main ports. We are taking steps to improve efficiency in Cristobal and Balboa. To this end, we have already started implementing a program to transfer port operations, equipment, and services to the private sector by means of concessions and leases which are awarded through a transparent and competitive process. Before the end of June 1992, the bidding for concessions and licenses is expected to be underway. We will have also selected a promoter/developer for our new port in Telfers Island. We expect the first concession for a water front site by early 1993. Similarly, we have prepared plans for attracting private investment to other Central Corridor ports, such as in Bahía Las Minas and Coco Solo.

III. Public Investment

15. The planned public investment program contemplates that public investment will rise from about 1.3 percent of GDP in 1990 to an estimated 2.7 percent in 1991, 4 percent in 1992 and in 1993. The program features

power and transport investments and includes well-designed, high priority projects. In 1991, two-fifths of the program will be funded by USAID grants. During 1992-93, however, funding for the program will come from increased public savings and the expected high level of disbursements from the international financial institutions (IFIs).

IV. Tax Reform

16. We have submitted a draft law to Congress to rationalize and simplify our tax system in order to promote efficiency and equity and to reduce disincentives to working, investing, and saving. We aim at reducing the corporate income tax rate to a unified 30 percent by the end of 1994. We will reduce the marginal personal income tax rate to 30 percent by the end of 1992. In addition, the number of personal income tax brackets will be cut from 20 to at most 11. To provide equity, the draft law proposes to increase the level of income which will be exempted from taxation. To ensure the revenue-neutrality of the tax reform, the draft law contains a new tax on luxury services at 10 percent, and an increase in the minimum import tariff to 5 percent for tourist goods (Centro de Compras), maintain the existing 3 percent for industrial inputs under Law 3, and a reduction in exemptions on imports.

V. Trade and Domestic Deregulation

17. Trade. We will reduce protection to import-substitution activities. This change should encourage export-oriented growth by exploiting our comparative advantages. The trade reform program aims at reducing the level and dispersion in effective and nominal protection, and includes:

- reducing the import tariff rate ceiling to 60 percent for industry and to 50 percent for agro-industry on January 1993.
- eliminating all specific import tariff rates.
- phasing out price controls and quantitative import restrictions for agricultural products and replacing them with tariff protection; said tariff rates will be reduced subsequently in line with our trade liberalization program.
- eliminating all export restrictions.

18. In support of our trade liberalization program, we have already taken the first steps by reducing import tariff rate ceilings to 60 percent for industry and to 90 percent for agro-industry on August 1, 1991. We also plan to eliminate all specific import tariff rates. We will start the elimination of specific import tariff rates before June 1992, with 261 products, which represent about 90 percent of domestic industrial

production. Before March of 1993, we will have eliminated all specific import tariff rates. In addition, the agricultural imports, regardless of their use as either inputs or final products, will be taxed at the same tariff rate.

19. Price Deregulation. According to the agricultural trade liberalization program which aims at encouraging domestic deregulation, price controls on industrial products and protected agricultural products will be phased out during the program period. Since December 1990, our Government has eliminated price controls on a number of products, including vegetables, other food products, and various household goods. We intend to eliminate all remaining price controls by January 1993. Also, the Oficina de Regulación de Precios, which sets prices, will be converted into the Oficina de Protección al Consumidor to address consumer complaints and disseminate information about prices and product quality.

20. Domestic Deregulation. To increase the effectiveness of our planned trade policy reform, complementary domestic deregulation will be introduced to encourage labor mobility and flexibility, free controlled domestic prices, improve the efficiency of public services, and move toward efficiency pricing for public services.

21. Labor Markets. In line with constitutional and legal requirements, minimum wages are reviewed every two years. Adjustment to the minimum wages during the program period will be consistent with the need to encourage employment growth and with the spirit of the Economic Recovery Program. We will also introduce a program to make labor markets more flexible and reduce non-wage labor cost for the subsequent phase of our reform program along the lines of the Government's Directrices.

VI. Social Security Program

22. We have prepared draft legislation to reform the Social Security System. Social security taxes in Panama, with a compulsory contribution of 18 percent of wages, play a key role in driving up the labor costs and reducing the international competitiveness of our economy. In addition, employers must pay an average of 1.7 percent of the wage bill for workers' compensation, plus the costs of employment injuries. Despite high contribution rates, however, the system faces major financial difficulties. During the last three years, revenue declined while expenditure rose. Presently, the system has been incurring large actuarial and operational losses, with an operating deficit of US$106 million in 1990.

23. Thus, social security reform is vital and urgent. We aim to ensure financial solvency of the system. Our Government will take measures to eliminate the cash deficit of the social security system within 10 years without increasing the already high social security tax

rate. We will also prepare a reform program to eliminate the current cash deficit of the Government Complementary Scheme by mid-1992 and start implementation before end 1992. Our Government will also grant administrative autonomy to CSS. Legal changes will help to achieve these objectives. The changes would include the following: phasing out the present practice of early retirement, modifying the benefit formula, introducing a program to reduce CSS's operational expenditures, shifting 0.5 percent of contribution from the medical scheme to the pension scheme, rationalizing the integration of health-care services to ensure that both CSS and the Ministry of Health pay respective costs through a well-defined cost allocation system, managing the investment reserves profitably through investing reserves in high grade securities to increase yield on investment reserves consistent with prudent levels of risk.

VII. Financial Sector Reform

24. Our Government intends to rationalize the operation of public banks. The Banco Hipotecario Nacional (BHN) will stop lending, while it transfers assets to the Caja de Ahorros (CA), except for lending of funds transferred from the Ministry of Housing (MIVI). We also plan to rationalize agricultural sector lending, to avoid duplications, and to restructure BDA. We will also seek to capitalize the CA.

25. To promote the healthy growth of the banking system, our Government will enhance the capabilities of Comisión Bancaria Nacional (CBN) within the existing legal framework. Our Government aims at enabling CBN to improve supervision of the banking system based on increased financial and human resources.

VIII. Poverty Alleviation

26. Our Government has started to improve the social indicators that worsened during the 1987-89 economic crisis. As part of our program, we intend to maintain the share of expenditure on health and education in the 1991-92 budgets at the 1990 level. This will ensure that the delivery of social services will be maintained during the program period. Also, we plan to reallocate more resources toward primary health and education. With UNDP assistance, we plan to implement a nutrition program that will incorporate food delivery for lactating mothers and young children in the poorest areas of our country.

Guillermo Ford
Second Vice-President
of the Republic and Minister
of Planning

Mario Galindo
Minister of
Finance and Treasury

República de Panamá

Ministerio de Planificación y Política Económica
Despacho del Ministro

November 8, 1991

Mr. Lewis Preston
President
The World Bank
Washington, D.C. 20433

Dear Mr. Preston:

This is in connection with our Letter of Development Policy dated September 20, 1991 where we summarized Panama's Economic Recovery Program and the steps we plan to introduce for its successful implementation. As you may know, there has been a recent decision of Panama's Supreme Court that has the effect of reinstating the thirteenth month salary for all public sector employees. This will have an impact on public sector finances, and particularly the public sector wage bill.

Consequently, after discussions with your staff, we have jointly determined that the references in paragraph 9 of the aforesaid letter to declines in levels of the aforesaid public wage bill for years 1992 and 1993 should be modified. As a result, third sentence of paragraph 9 of the aforesaid Letter should be changed as follows: "...The public sector wage bill will not exceed in 1992 in nominal terms the estimated level for 1991, i.e., US$820 million (all wage bill targets include the thirteenth month salary and automatic wage increases), and it will decline in 1993 to US$765 million."

In view of the changes in the public wage bill target, second sentence of paragraph 9 of the said Letter should be changed as follows: "Current expenditures of the General Government are projected to decline from 32 percent of GDP in 1991 to 30.7 percent in 1992 and to 29 percent in 1993."

Furthermore, it was also agreed that the percentage rate of General Government savings in the last sentence of said paragraph 9 should be changed to -3.2, -1.6 and +0.5 for 1991, 1992 and 1993, respectively, and that the percentage rate set forth for public sector investment in the third line of paragraph 15 of the said letter for 1991 should be changed to 2.4.

Sincerely yours,

Mr. Guillermo Ford
Vice-President of the Republic
and Minister of Planning

Mr. Mario Galindo
Minister of the Treasury
and Finance

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

A. PUBLIC SECTOR FINANCES

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Reduce imbalances in public sector finances and ensure stable macroeconomic balances.			
a. Increase general government savings (see Annex III, Attachment ii).	-The Cabinet prepared and announced a satisfactory program to increase general government savings, and announced the savings targets.	-Continue to implement the agreed-upon program.	-Complete the implementation of the agreed-upon program.
b. Introduce a program to decrease general government non-interest current outlays.	-The Cabinet approved and announced a satisfactory program to decrease noninterest current outlays for the general government and improve operational productivity, and agreed on the targets.	-Continue to implement the agreed-upon program.	-Complete the implementation of the agreed-upon program.
b.1 Reduce public wage bill (see Annex III, Attachments iii and iv).	-The Cabinet approved and announced a satisfactory program to reduce public wage bill through the implementation of various mechanisms mentioned in the Letter of Development Policy, and started implementation of the program.	-Continue to implement the agreed-upon program.	-Complete the implementation of the agreed-upon program.
2. Increase public investment to adequate levels.			
a. Prepare and implement a Public Investment Program for 1991-93 (see Annex III, Attachment viii).	-The Cabinet approved and announced a 3 year public investment program, satisfactory in size and composition, and started implementation of the program.	-Continue to implement the agreed-upon program.	-Complete the implementation of the agreed-upon program.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

B. PUBLIC ENTERPRISE REFORMS

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Improve procurement procedures for public sector enterprises (PSEs).	-The Cabinet agreed to present draft enabling legislation, satisfactory to the Bank, to Congress during March 1992.	-Congressional approval of enabling legislation, satisfactory to both the Bank and the Executive Branch in Panama.	-Ensure implementation.
2. Reduce costs and increase efficiency.			
Introduce a program to improve finances of public enterprises by reducing the wage bill, improving the collection of accounts receivable, and decreasing nontechnical losses, and increase operational productivity (See Annex III, Attachment v).	-The Cabinet announced targets for the consolidated non-interest current outlays for the 9 public enterprises.[1/]	-Not exceed the targets.	-Not exceed the targets.
	-The Cabinet announced action plans for IRHE and IDAAN.	-Comply with the financial and operational efficiency targets of the agreed-upon action plans.	-Comply with the financial and operational efficiency targets of the agreed-upon action plans.
3. Privatization			
a. Privatize maintenance and security services for IRHE, and meter reading and billing services for IRHE and IDAAN.	-The Cabinet approved and announced privatization plans for IRHE and IDAAN.	-Implement the plans.	-Complete the implementation of the plans.
b. Future expansion program for IRHE and IDAAN.			
4. Reduce distortions and rationalize the structure of utility pricing.			
a. Restructure utility pricing.	-The Cabinet approved the principles for determining public utility pricing.	-Update the long-run marginal cost study for electricity pricing and agree on an action plan to move toward efficiency pricing for electricity and rationalization of the tariff structure.	-Implement the action plan.
		-Start and finalize a study on pricing for telecommunications and ports, and agree on an action plan.	-Implement the action plan.

1/ IRHE, IDAAN, APN, INTEL, Victoria Sugar Mills, Cemento Bayano, Zona Libre, IPAT and Cítricos de Chiriquí.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

C. PRIVATIZATION PROGRAM

POLICY OBJECTIVES	BEFORE BOARD	BY APRIL 30, 1992	SECOND TRANCHE	THIRD TRANCHE
1. Increase the efficiency of the economy and reduce the size of the public sector.	-The Cabinet approved a privatization program, and established institutional framework and a technical privatization unit at MIPPE to carry out the privatization program.			
		-Congress to approve a framework privatization law to enable the Executive Branch to divest efficiently of public companies, public assets, activities and services.[2]	-Issue norms to ensure timely, efficient, and transparent mechanisms for privatization.	
	-The Cabinet brought Air Panama and Cítricos de Chiriquí to a position where tender documents for bidding were issued by private investors (See Annex III, Attachment vii, Group A).		-Bring the rest of the public companies (See Annex III, Attachment VII, Group A) to a position where tender documents for bidding have been issued by private investors or offers solicited.	-At least 3 publ'c companies listed in Annex III, Attachment VII, Group A have been sold to the private sector, [or that their liquidation has been determined appropriate by the relevant authorities, including the Judiciary, if applicable.]
	-The Cabinet approved and announced a privatization plan for APN, to enable establishment of a regulatory framework for port operations and grant concessions to the private sector on the ports of Balboa and Cristobal.		-Implement the agreed-upon privatization plan.	-Verify compliance.

[2] Not approving a satisfactory law will trigger an event of default.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

C.I. Privatization of INTEL

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
Restructure the telecommunications sector and privatize INTEL to increase the sector's efficiency; foster competition and technological advances in the sector; and reduce high charges for overseas calls.	-The Cabinet approved and announced a privatization program, and appointed a technical privatization unit at MIPPE.	-Congressional approval of a law, satisfactory to the Bank and the Executive Branch in Panama, to restructure the telecommunications sector, to establish a regulatory authority for the telecommunications sector, and to privatize INTEL.	-Establish the regulatory agency, with adequate staffing, for telecommunications. -Initiate the international selection of a prospective buyer to operate INTEL.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

D. TAX REFORM

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Reduce disincentives to work, invest, and save; simplify and rationalize the tax system; and improve its elasticity and equity. Ensure revenue-neutrality of the tax reform program.	1. Congress approved a tax reform law in December 1991 that contains the following measures:		
	a. Corporate income tax Reduce the highest marginal tax rate (i.e., 50%) in stages and apply 34% for companies whose annual earnings exceed US$0.5 million and 30% for companies whose yearly earnings are less than US$0.5 million by no later than January 1, 1994.	-Implement the program pursuant to the new law to reduce tax rates; with the minimum rate being raised from 20% to 27.5%, and the maximum rate being reduced from 50% to 45%.	-Continue to implement the program, with the minimum rate being increased to 30%, and the maximum rate being reduced to 42%.
	b. Personal income tax rates Reduce the tax rate spread from 2.5% - 56% to 4% - 30% by 1992.	-Implement the program.	-Verify compliance.
	c. Tax brackets Reduce the number of tax brackets from 20 to 11.	-Continue to implement a program to reduce tax brackets.	-Finalize the program to reduce the number of tax brackets.
	d. Package of measures to ensure revenue-neutrality of the tax reform Increase the value added tax on alcoholic beverages and cigarettes from 5% to 10%, and increase a number of agreed-upon charges, and fees to ensure revenue-neutrality of the tax reform package.	-Verify compliance to ensure revenue-neutrality.	-Verify compliance.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

E. TRADE REFORM

E.I. Industry/Agro-Industry

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Eliminate specific import tariff rates and convert all rates to ad-valorem rate.	-Import tariff rates were reduced to 60% for industrial products and to 90% for agro-industrial products.	-Eliminate specific import tariff rates on 261 products, which cover about 90% of domestic production.	-Eliminate all remaining specific import tariff rates.
2. Reduce high nominal tariff rates.	-The Cabinet approved and announced a tariff reduction program to reduce impor" tariff rates to 40% for industrial products and 50% for agro-industrial products before third tranche.		-Reduce impor: tariff rates to 40% for industrial products and 50% for agro-industrial products.
3. Reduce high effective protection and eliminate import tariff exemptions.	-The Cabinet increased the minimum import tariff rate to 5% for all goods classified under the Centro de Compras (i.e. tourist goods) on January 1, 1992; maintained the minimum import tariff rate at 3% for industrial inputs covered under Law 3.	-Verify compliance. -Unify import tariff rates for agricultural products used both as inputs and final consumption.	-Verify compliance.
4. Decontrol prices.		-Eliminate price controls on industrial products covered under Law 3.	-Restrict the scope and powers of the Price Regulations Office to an informational function, and amend Decree 60, March 1969, accordingly.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

E.II. Agricultural Trade Liberalization Program[3/]

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
5. Introduce a trade liberalization program for agriculture to increase the efficiency of the economy by reducing import tariff rates and eliminating quantitative restrictions (QRs) on imports and domestic price controls.			
A. Main crops (rice, corn, sorghum, beans, potatoes, onions, tomatoes and other vegetables).	-Eliminated QR and domestic price controls on vegetables, except for potatoes, beans, onions, and tomatoes.	-Eliminate QR and domestic price controls on corn, sorghum, beans, potatoes, and onions.	-Eliminate quantitative import restrictions and domestic price controls on rice and tomatoes.
B. Export products (including bananas and coffee).	-Eliminated all export restrictions.	-Maintain elimination. **	-Maintain elimination. **
C. Main Livestock products (beef, chicken, and pork).	-Eliminated QR and domestic price controls on beef.	-Eliminate QR and domestic price controls on chicken and pork.	

[3/] In all cases, required tariff rate reductions are presented in Annex III, Attachment ix, page 1.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

F. DEREGULATION OF LABOR MARKETS

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Reduce labor costs, including the cost of dismissals and increase labor mobility.	1. The government introduced the following measures: (a) allowing the government to designate a third party to arbitrate on work-related issues to expedite the resolution of labor conflicts and prevent labor conflicts; (b) allowing automatic extension of collective bargaining agreements for 1991-92; (c) extending the period of collective bargaining to 3 years for newly established firms; and (d) establishing a tripartite committee (representing the Government, labor, and management) to review labor regulations that affect how labor markets operate. 2. The Cabinet approved a program to liberalize labor markets and reduce labor costs. The program, among others, will include the following: (a) reducing the cost of dismissing for economic reasons; (b) allowing firms facing difficult economic and financial problems to use workable mechanisms for modifying labor constraints; (c) allowing the operation of private sector employment agencies; and (d) shortening the time permitted for the Ministry of Labor needs to process labor regulations.		

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

G. SOCIAL SECURITY REFORMS

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Eliminate the cash deficit of the social security system in no more than 10 years without raising contribution rates for employers.	-Congress approved a social security reform law in December 1991, to eliminate the cash deficit of the social security system in no more than 10 years. Key measures included in the law are: a) No increase in contribution rates for employers. b) Eliminate the early retirement provisions on January 1, 1993. c) Increase the retirement age for men from 60 to 62, and for women from 55 to 57 on January 1, 1995. d) Allocate one-third of the thirteenth-month salary bonus for both public and private sector employees to CSS. e) Reduce the benefit formula base from 60% of the base salary plus 1.25% after 10 years and 1.5% after 20 years to 60% plus 1.25% after 15 years. f) Allow eligibility for pensions for up to retirement age to reduce pension cost. g) Set pensionable salary for the pension calculation on the highest best (in nominal terms) 7 years of working life instead of the present best 3 years of the past 15 years. h) Maintain the current practice of not revaluing pensions, except for minimum pensions (i.e. US$145 a month) which will be adjusted every three years provided CCS's finances permit. i) Shift 0.5% of contribution from the medical scheme to the pension scheme and improve administration to eliminate deficit of the health-care component before the end of 1994.	-Verify compliance.	-Verify compliance.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

G. SOCIAL SECURITY REFORMS (cont.)

POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
	j) Define an appropriate investment policy and, as part of this, invest reserves in high-grade securities to increase yield consistent with prudent levels of risk.		
2. Eliminate the cash deficit of the government complementary pension scheme in 1993.	-Agreed on terms of reference for a study to develop an action plan to generate annual savings of US$21-25 million by increasing revenues and/or reducing expenditures to eliminate the cash deficit of the government complementary pension scheme.	-Finalize preparation of, and agree on the action plan, to eliminate the projected cash deficit of the government complementary pension scheme in 1993 and avoid the emergence of cash deficits in the next 10 years.	-Start implementing the agreed-upon action plan.
3. Provide administative autonomy to CSS.	-The above-mentioned law gives administrative autonomy to CSS as part of the social security reform program.		
4. Rationalize the use of resources in the provision of health-care services and eliminate the cash deficit of the medical care through cost containment.	-The Cabinet agreed on the terms of references for developing action plans to introduce a cost allocation scheme between the Ministry of Health and CSS, and an action plan to reduce costs of the health-care component of the CSS.	-Agree on action plans and initiate implementation of plans.	-Complete implementation of the action plans.

PANAMA'S ECONOMIC RECOVERY LOAN

POLICY MATRIX

H. SOCIAL SECTOR COMPONENT

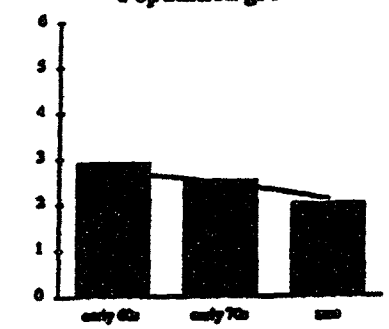
POLICY OBJECTIVES	BEFORE BOARD	SECOND TRANCHE	THIRD TRANCHE
1. Address the nutritional needs of lactating mothers, children up to the age of 5, and school-age children in the poorest regions.	-The Cabinet decided that MIPPE will be the executing agency to carry out the nutrition program.	-Agree on the objectives, actions, targets, and timetables for the pilot phase of the nutrition program.	-Evaluate the results of the pilot program and agree on a national program.

Panama

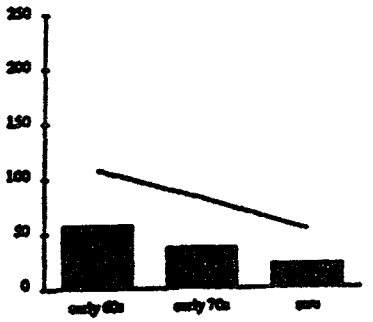
SOCIAL INDICATORS

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mrc)	Same region / income group: Latin America, Caribbean	Same region / income group: Lower-middle-income	Next higher income group
HUMAN RESOURCES							
Size, growth, structure of population							
Total population (mrc = 1989)	thousands	1,326	1,748	2,370	422,417	666,815	422,994
14 and under	% of pop.	44.1	43.1	35.4	36.5	37.9	33.6
15-64		51.8	53.0	59.9	58.9	57.6	60.8
Age dependency ratio	unit	0.93	0.89	0.67	0.70	0.73	0.64
Percentage in urban areas	% of pop.	44.4	49.1	54.3	73.6	59.2	68.2
Females per 100 males	number						
Urban		..	107	105	104	..	..
Rural		..	89	88	..	..	..
Population growth rate	annual %	2.9	2.5	2.0	2.0	2.1	1.8
Urban		4.4	3.1	2.9	2.9	3.0	2.9
Urban/rural growth differential	difference	2.6	1.2	1.9	3.0	1.9	3.1
Projected population: 2000	thousands	..	..	2,826	514,043	831,021	510,348
Stationary population		..	..	4,632	..	..	..
Determinants of population growth							
Fertility							
Crude birth rate	per thou. pop.	39.9	32.9	25.3	27.9	30.0	25.5
Total fertility rate	births per woman	5.74	4.41	2.98	3.45	3.87	3.27
Contraceptive prevalence	% of women 15-49	..	44.0	58.0	..	..	..
Child (0-4) / women (15-49) ratios							
Urban	per 100 women	..	55	41	..	..	..
Rural		..	96	66	..	..	..
Mortality							
Crude death rate	per thou. pop.	8.9	6.5	5.0	7.1	8.1	8.0
Infant mortality rate	per thou. live births	56.4	36.4	21.8	51.7	52.7	45.2
Under 5 mortality rate		..	..	24.1	61.6	81.5	54.4
Life expectancy at birth: overall	years	63.4	68.1	72.4	67.0	65.2	67.4
female		64.5	69.7	74.5	70.0	67.6	69.9
Labor force (15-64)							
Total labor force	thousands	441	580	850	148,480	243,588	159,186
Agriculture	% of labor force	46.2	36.6	..	..	..	..
Industry		15.8	17.8	..	..	..	..
Female		23.1	25.8	27.1	26.6	30.2	30.7
Females per 100 males:							
Urban	number	..	110	108	106	..	..
Rural			83	84	88	..	..
Participation rate: overall	% of labor force	33.5	33.2	35.8	35.1	38.8	38.7
female		15.7	17.4	19.8	18.5	22.6	23.5
Educational attainment of labor force							
School years completed: overall	years	..	..	..	..	..	..
male		..	..	..	..	..	..
NATURAL RESOURCES							
Area	thou. sq. km	77	77	77	20,308	21,088	16,264
Density	pop. per sq. km	17	23	30	20	30	25
Agricultural land	% of land area	21.5	22.7	24.6	36.5	36.9	31.9
Agricultural density	pop. per sq. km	80	100	120	55	82	79
Forests and woodland	thou. sq. km	46	43	40	9,703	6,084	6,887
Deforestation rate (net)	annual %	-0.6	-0.7	-0.7	-0.5	-0.7	-0.4
Access to safe water	% of pop.	..	77.0	82.0	73.2	63.5	79.7
Urban		..	100.0	100.0	83.6	77.2	90.4
Rural		..	54.0	63.0	52.6	46.8	63.2

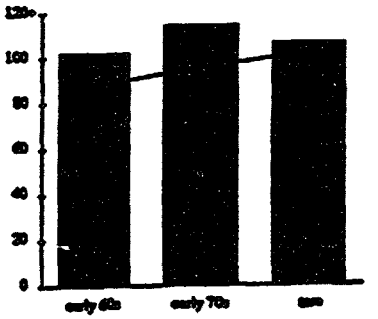
Population growth



Infant mortality



Primary school enrollment



Panama

SOCIAL INDICATORS

	Unit of measure	25-30 years ago	15-20 years ago	Most recent estimate (mrv)	Same region / income group: Latin America, Caribbean	Same region / income group: Lower-middle-income	Next higher income group
INCOME AND POVERTY							
Income							
GNP per capita (mrv = 1989)	US$	490	1,030	1,760	1,950	1,320	3,810
Total household income							
Share to top 10% of households	% of income	..	..	..	..	..	..
Share to top 20% of households	"	..	..	..	..	..	..
Share to bottom 40% of households	"	..	..	..	..	..	..
Share to bottom 20% of households	"	..	..	..	..	..	..
Poverty							
Absolute poverty income: urban	US$ per person	..	..	..	..	..	..
rural	"	..	..	..	..	..	..
Pop. in absolute poverty: urban	% of pop.	..	..	..	..	..	..
rural	"	..	..	..	..	..	..
Prevalence of malnutrition (under 5)	% of age group	..	..	..	..	..	..
EXPENDITURE							
Food	% of GDP	..	..	..	..	..	..
Staples	"	..	..	..	..	..	..
Meat, fish, milk, cheese, eggs	"	..	..	..	..	..	..
Cereal imports	thou. metric tonnes	39	70	116	17,357	40,386	36,788
Food aid in cereals	"	..	2	0	..	7,767	..
Food production per capita	1979-81=100	90.4	98.5	87.8	103.8	99.9	102.9
Share of agriculture in GDP	% of GDP	17.8	11.2	10.2	10.1	15.2	13.1
Daily calorie supply	calories per person	2,254	2,307	2,468	2,728	2,741	2,980
Daily protein supply	grams per person	57	62	62	69	71	77
Housing	% of GDP	..	..	..	..	..	..
Average household size	persons per household	..	5	..	..	..	..
Urban	"	..	5	..	..	..	..
Fixed investment: housing	% of GDP	..	3.8	3.7	..	..	..
Fuel and power	% of GDP	..	..	..	..	..	..
Energy consumption per capita	kg of oil equivalent	3,064.9	3,722.6	1,626.3	967.1	843.7	1,537.7
Households with electricity							
Urban	% of households	..	..	..	..	..	..
Rural	"	..	..	..	..	..	..
Transport and communication	% of GDP	..	..	..	..	..	..
Population per passenger car	persons	44	26	18	17	30	15
Fixed investment: transport equipment	% of GDP	..	3.4	2.4	..	..	..
Total road length	km	..	..	8,665	..	..	..
Population per telephone	persons	..	12	9	12	17	8
INVESTMENT IN HUMAN CAPITAL							
Medical care	% of GDP	..	..	..	..	..	..
Population per: physician	persons	2,128	1,700	1,000	938	1,551	1,020
nurse	"	..	1,563	390	879	..	601
hospital bed	"	..	300	300	..	..	..
Access to health care	% of pop.	..	..	..	..	..	..
Immunized (under 12 months): measles	% of age group	..	..	78.0	52.7	62.9	..
DPT	"	..	..	73.0	62.4	63.2	..
Oral Rehydration Therapy use (under 5)	% of cases	..	..	34.0	33.6	27.5	..
Education	% of GDP	..	..	..	..	..	..
Gross enrollment ratios							
Primary: total	% of school-age group	102.0	114.0	106.0	106.8	102.0	102.6
female	"	99.0	111.0	104.0	105.4	101.1	99.7
Secondary: total	"	34.0	55.0	59.0	47.9	51.1	55.9
female	"	36.0	57.0	63.0	51.3	52.4	56.5
Tertiary: science/engineering	% of tertiary students	24.5	18.7	24.5	..	..	..
Pupil-teacher ratio: primary	pupils per teacher	30	27	22	24	26	23
secondary	"	19	26	19	..	17	..
Pupils reaching grade 4	% of cohort	..	84.9	89.5	69.3	..	75.4
Repeater rate: primary	% of total enrollment	17.9	12.6	11.3	19.6	8.6	19.5
Illiteracy rate: overall	% of pop. (age 15+)	..	..	11.8	16.7	25.4	22.3
female	% of females (age 15+)	..	..	12.4	19.0	31.6	25.8
Newspaper circulation	per thou. pop.	76.2	74.9	58.1	81.7	78.9	83.0

Source: World Bank International Economics Department, September 1990.

PANAMA

ECONOMIC RECOVERY LOAN

Supplementary Loan Data Sheet

Section I: Timetable of Key Events

(a)	Time taken by the country to prepare the loan	:	7 months
(b)	Appraisal mission	:	June 1991
(c)	Completion of negotiations	:	January 1992
(d)	Planned date of effectiveness	:	February 1992

Section II: Special Bank Implementation Actions

Event of default. Passage of a satisfactory privatization framework law by April 30, 1992

Section III: Board Presentation Conditions

(1) Agreement on savings targets for the general government and targets for reducing the public wage bill (paras. 33-38 and Annex III, Attachments i, ii, iii, and iv).

(2) Agreement on the size and composition of the public investment program for 1991-93 (paras. 54-56 and Annex III, Attachment viii).

(3) Agreement that a draft enabling legislation will be presented to Congress in March 1992 to improve procurement and budgetary practices for public enterprises; on principles for pricing public utilities and services; on action plans for IRHE and IDAAN; on a program to improve the finances of PSEs, including targets for the consolidated non-interest current outlays for the nine PSEs listed in para. 43; on a program to privatize maintenance and security services for IRHE and meter reading and bill collection for IDAAN; and on expansion program for IRHE and IDAAN (paras. 41-46).

(4) Agreement on the privatization program; the Government established a technical privatization unit at MIPPE and brought Air Panama and Cítricos de Chiriquí to a position where tender documents for the bidding were issued to private investors; Cabinet approved a privatization plan for INTEL and APN; and the Government established a technical unit to privatize INTEL (paras. 48, 50-52).

(5) Agreement on the trade reform program with a calendar of actions that includes: (i) implementation of the first steps of the trade

reform program (reduced import tariff ceilings to 60 percent for industrial products and 90 percent for agro-industrial products on August 1, 1991); (ii) agreeing to reduce import tariff rates to 40 percent for industrial products and 50 percent for agro-industrial products before third tranche release; (iii) eliminating specific import tariff rates on 261 products, which cover about 90 percent of domestic production before second tranche release, and eliminating the remaining specific import tariff rates before third tranche release; (iv) raising the import tariff rate on goods classified under the Centro de Compras (i.e., tourist goods) to 5 percent on January 1, 1992 (action already taken), and agreeing to maintain import tariff rates for industrial inputs, covered under Law 3, at 3 percent; (v) unifying import tariff rates on agricultural products used both as inputs and for final consumption before second tranche release; (vi) taking action to eliminate domestic price controls, quantitative import restrictions, and accompanying import tariff reductions on vegetables (except beans, potatoes, and onions for which QRs and price controls will be eliminated before second tranche release and for tomatoes before third tranche release); and (vii) taking action to eliminate export restrictions and QRs on domestic price controls on beef (and reducing the import tariff rate on beef to 30 percent) before Board presentation, on chicken and pork before second tranche release, and on agricultural products, except sorghum and rice for which quantitative restrictions and price controls will be eliminated before second and third tranche release, respectively (paras. 67, 73, 75).

(6) Agreement on a program to liberalize labor markets and to reduce labor costs along the lines of the Government's program as outlined in para. 82.

(7) Agreement that MIPPE will be the agency to execute the nutrition program (para. 105).

(8) Passage of a satisfactory tax legislation through Congress in late December 1991 (para. 63).

(9) Passage of a satisfactory social security legislation through Congress in early December 1991, agreement on terms of references for preparing action plans to eliminate the projected cash deficit of the government complementary pension scheme in 1993, for developing an adequate cost allocation system between the Ministry of Health and CSS, and to reduce costs of the health-care component of the social security system (para. 93-96).

C. Loan Effectiveness Conditions

None

D. The Following are Conditions for Second Tranche Release

(1) Achievement of the agreed-upon savings targets for the general government and implementation of the program to reduce the public wage bill (paras. 33-38).

(2) Satisfactory implementation of the agreed-upon public investment program (paras. 54-56).

(3) Congressional approval of a law, satisfactory to the Bank, establishing improved procurement and budgetary practices of public sector enterprises (paras. 41-42).

(4) Implementation of a program to improve the finances of PSEs, including not exceeding the targets for the consolidated non-interest current outlays for the PSEs mentioned in para. 43; progress in successfully implementing action plans, including compliance with the financial and operational efficiency targets for IRHE and IDAAN; updating the long-run marginal cost study for electricity; agreement on an action plan to move electricity prices to long-run marginal costs; and undertaking a study on pricing for telecommunications and ports (paras. 41-46).

(5) Congressional approval of a law, satisfactory to the Bank, to restructure and regulate the telecommunications sector and to privatize INTEL; to issue satisfactory norms to ensure that mechanisms and procedures for privatization are timely, efficient, and transparent; to bring all public companies listed in Annex III, Attachment vii (Group A) to the point where tender documents for bidding have been issued by private investors or offers have been solicited; and to grant concessions for the ports of Balboa and Cristóbal to the private sector (paras. 48, 50-52).

(6) Implementation of a program to adjust corporate income tax rates and decrease the number of personal income tax brackets according to the approved law (para. 63).

(7) Elimination of price controls on industrial products covered under Law 3 and continued phasing out of QRs and import permits, domestic price controls, and related import tariff rate reductions on corn, sorghum, potatoes, onions, beans, chicken, and pork; elimination of specific import tariff rates on 261 products, which cover about 90 percent of production; unifying import tariff rates on agricultural

products used both as inputs and for final consumption, and maintenance of a 3 percent minimum import tariff rate on industrial inputs covered under Law 3 (paras. 63, 67, 73, 75).

(8) Agreement on an action plan to eliminate the cash deficit of the government complementary pension scheme in 1993; agreement on an action plan and initiation of its implementation to rationalize the cost allocation system between the Ministry of Health and CSS; and agreement on an action plan to reduce costs of the health-care component of CSS (para. 93-96).

(9) Agreement on the objectives, actions, targets, and timetables for the pilot phase of the nutrition program (para. 105).

E. The Following are Conditions for Third Tranche Release

(1) Achieving agreed-upon savings targets for the general government and completing the program to reduce the public wage bill (paras. 33-38).

(2) Satisfactorily implementing the agreed-upon public investment program (paras. 54-56).

(3) Implementing a program to improve the finances of PSEs, including not exceeding the targets for the consolidated non-interest current outlays for the PSEs mentioned in para. 43; achieving progress in successfully implementing action plans, including compliance with the financial and operational efficiency targets for IRHE and IDAAN, implementing the privatization program for IRHE and IDAAN, and implementing an action plan for pricing for electricity, water, telecommunications, and ports; and ensuring implementation of satisfactory legislation to improve procurement and budgetary practices of public sector enterprises (paras. 41-46).

(4) Establishing an adequately staffed regulatory agency for telecommunications and issuing tender documents for international bidding by private investors for a controlling ownership interest in INTEL; completing implementation of the privatization program for IRHE and IDAAN; privatizing at least three public companies listed in Annex III, Attachment vii (Group A); and continuing to implement the program to grant concessions on ports of Balboa and Cristóbal to the private sector (paras. 48, 50-52).

(5) Implementing a program to adjust corporate income tax rates and decreasing the number of personal income tax rate brackets according to the approved law (para. 63).

(6) Completing the agreed-upon trade reform program by eliminating all remaining specific import tariff rates; establishing an import tariff rate ceiling of 40 percent for industrial products and 50 percent for agro-industrial products; maintaining a 3 percent minimum import tariff rate on industrial inputs, covered under Law 3; converting the price-setting institution, Oficina de Regulación de Precios, into a consumer protection agency, Oficina de Protección al Consumidor (para. 75), and amending Decree 60, March 1969, accordingly; eliminating QRs and domestic price controls on rice and tomatoes, and introducing agreed tariff rate reductions (paras. 63, 67, 73, 75).

(7) Starting implementation of the program to eliminate the projected cash deficit of the government complementary pension scheme, and completing implementation of the action plan to introduce a satisfactory cost allocation system between the Ministry of Health and CSS, and finalizing the implementation of a program to reduce costs of health-care component of CSS (paras. 93-96).

(8) Evaluating the results of the pilot program for nutrition and agreeing on a plan to implement the nutrition program nationally (para. 105).