1998 Country Report on Economic Policy and Trade Practices: Panama

PANAMA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Millions of U.S. Dollars unless otherwise indicated)

	1996	**1997**	**1998**	1/
Income, Production and Employment:				
Nominal GDP	8,151	8,700	8,995	
Real GDP (1982 prices)	6,373	6,673	6,880	
Real GDP Growth (pct)	2.8	4.7	3.1	
Real GDP by Sector (1982 prices):				
Agriculture	515	517	435	
Manufacturing	1,169	1,231	1,290	
Services	3,767	3,964	4,185	
Government	921	961	970	
Real Per Capita GDP (US$)	2,383	2,454	2,502	
Labor Force (000s)	1,011	1,044	1,096	
Unemployment Rate (pct)	13.9	13.1	12	
Money and Prices (annual percentage growth):				
Money Supply (M2) Growth (pct) 2/	5.8	0.8	-0.1	
Consumer Price Inflation	1.3	1.2	1.7	
Exchange Rate (Balboa/US$ annual average)	1	1	1	3/
Balance of Payments and Trade:				
Total Exports FOB 4/	566	658	640	
Exports to U.S.	269	293	280	
Total Imports CIF 4/	2,781	2,992	3,150	
Imports from U.S.	1,041	1,103	1,300	
Trade Balance 4/	-2,215	-2,344	-2,510	
Balance with U.S.	-772	-810	1,020	
Colon Free Zone 5/				
Exports	5,492	6,276	6,050	
Imports	4,624	5,390	5,450	
External Public Debt	5,070	5,052	5,246	
Fiscal Deficit(-)/GDP (pct) 6/	-0.4	0.6	-0.7	
Current Account Deficit(-)/GDP (pct)	-0.7	-3.5	N/A	
Debt Service Ratio (pct)	18.2	12.2	13.4	

Gold & Foreign Exchange Reserves 7/	849	1,131	1,312
Aid from U.S.	6.3	9.3	7.1
Aid from All Other Sources	226	N/A	N/A

1/ Figures for 1998 are estimated unless otherwise indicated.
2/ Figure is based on IMF 9/98 International Financial Statistics. M2 = Deposit Money + Quasi Money. Figure for 1998 as of March.
3/ The balboa/dollar exchange rate is fixed at 1:1. The legal tender is the U.S. Dollar, so there is no parallel exchange rate.
4/ Trade statistics do not include the Colon Free Zone.
5/ The Colon Free Zone (CFZ) is the largest free trading area in the hemisphere. Historically, the United States supplies 13 percent of CFZ imports and takes 5 percent of CFZ exports.
6/ Figures indicate deficit of the nonfinancial public sector as percent of GDP.
7/ Figure is based on IMF 9/98 International Financial Statistics. Panama reports no gold holdings. Figure for 1998 as of July.

General Policy Framework

Panama's economy is based on a well developed services sector that accounts for 74 percent of GDP. Services include the Panama Canal, container port activities, flagship registry, banking, insurance, government, and the Colon Free Zone. The industrial sector, which accounts for 19 percent of GDP, is made up of manufacturing, mining, utilities, and construction. Agriculture, forestry and fisheries account for the remaining eight percent of GDP.

During four years in office, the Perez Balladares government has implemented economic policy reforms to liberalize the trade regime, privatize state-owned enterprises, lower tariffs, restructure unfunded pension programs, and attract foreign investment. A Banking Reform Law and a somewhat flawed Foreign Investment Protection Law were enacted in 1998. In November 1997, Panama reduced tariffs beyond the requirements of its June 1997 entry into the World Trade Organization (WTO), resulting in the lowest tariffs in Latin America. Primary objectives of the government continue to be the development of the reverted U.S. military bases and the privatization of public enterprises.

The economy grew 4.7 percent in real terms in 1997, up from 2.8 percent in 1996. The embassy estimates 3 to 4 percent growth in 1998. The more modest growth estimate is based on the harmful effects of a prolonged strike on the important banana industry in March and April and the drought effects of El Nino on agriculture and the electrical sector. In addition, Colon Free Zone trade, after growing at over 10 percent in the first quarter of 1998, has declined in the third quarter due to the downstream effects of the Asian crisis. The principal engine for growth continues to be the maritime sector.

The use of the U.S. Dollar as Panama's currency means fiscal policy is the government's only macroeconomic policy instrument. Therefore, government spending and investment are strictly bound by tax and non-tax revenues (including payments by the Panama Canal Commission) as well as the government's ability to borrow.

2. Exchange Rate Policy

Panama's official currency, the balboa, is pegged to the dollar at a 1:1 ratio. The balboa circulates in coins only. All paper currency in circulation is U.S. currency. The fixed parity means the competitiveness of U.S. products in Panama depends on transportation costs as well as tariff and non-tariff barriers to entry. U.S. exports have no risk of foreign exchange losses on sales in Panama.

3. Structural Policies

The government is committed to trade liberalization and reduction of structural economic distortions. With accession to the WTO and following negotiations with international financial institutions, Panama implemented significant tariff reductions in 1997. Moreover, the government subsequently initiated a program of further reductions, ultimately to achieve an across-the-board 10 percent tariff ceiling. When fully implemented, this would leave Panama with the lowest tariff ceiling in Latin America. Panama is close to completing a Free Trade Agreement with Mexico and continues to negotiate with Chile, though talks have bogged down in the financial services sector.

Panama is pressing forward with major privatizations. The government privatized ports at opposite ends of the Panama Canal in a $22 million per year contract with Hutchison Whampoa, a Hong Kong shipping and port management company. This bid was criticized as less than transparent. The telecommunications company was partially privatized in a $652 million sale to Cable & Wireless (UK). Conversely, this bidding action was praised as open and transparent. A contract to rebuild and operate the historic Panama Canal Railway was signed with Kansas City Southern Industries in January 1998. Three government electrical distribution companies were sold for over $300 million in October 1998, followed by the sale of five power plants in November. In addition, two private toll roads are under construction. Upcoming privatizations include two sugar mills, the international airport, and a convention center.

The restrictive Panamanian Labor Code was revised in 1995, though strong opposition allowed only marginal reform. Unions continue to oppose reform initiatives, on occasion violently. In 1996, a special labor regime for export processing zones was created by executive decree. The constitutionality of the decree was challenged and the question is presently pending before the Supreme Court. Notwithstanding several health and housing programs, the government estimates that over 40 percent of Panamanians live in poverty. Considering the relatively high per capita income level of over $3,300 (current dollars), Panama's historically skewed income distribution does not appear to be abating.

4. Debt Management Policies

In September 1997, Panama issued $700 million in 30 year global bonds, using $600 million to retire Brady bonds and retaining $100 million in cash. This follows the issuance of $500 million in Eurobonds in February 1997. The success of both offerings indicates the positive view of Panama's debt in world markets. The government has reduced its public debt from a level of almost $5.9 billion in 1995 to $5 billion currently. Its program has been stalled by world market conditions.

5. Aid

In FY 1998, aid from the United States included USAID disbursements of $4.6 million. The objectives of the USAID program in Panama are 1) to improve the management and protection of the Panama Canal watershed, and 2) to facilitate the smooth transfer of the Panama Canal and the productive use of the reverted properties in the Canal area. In addition, the United States Department of Justice provided training programs totaling over $500,000 in FY 1998.

Development aid from other sources came primarily from the International Development Bank (IDB) with $90.1 million disbursed in 1996 and a projected $1 billion loan program over the next several years. The International Monetary Fund (IMF) disbursed $78.5 million in 1996 under a standby facility, following disbursements of $13.7 million in 1995. The World Bank disbursed a second tranche of $30 million under an economic recovery loan approved in 1992. The World Bank also disbursed $1.95 million in loans targeted for rural health and education. Germany, Spain and Japan provided a total of approximately $23 million in commodity and technical assistance in 1996. The European Union provided funding to finance a portion of the Panama Canal Universal Congress, to establish the Panama Canal Museum, and to study future canal traffic, all totaling approximately $1.2 million.

6. Significant Barriers to U.S. Exports

The Perez Balladares government has followed through on its commitment to liberalize Panama's trade. With its accession to the WTO and its initiative to further lower tariffs, Panama has transformed a tariff regime that just a few years ago was one of the highest in the region. However, some non-tariff barriers have continued to plague U.S. exporters, especially in the agricultural sector.

The Panamanian judicial system also presents potential obstacles to investors. There is a backlog previously estimated at 100,000 criminal and civil cases, increasing at approximately 20,000 per year. Many investors have expressed concerns over the potential for corruption in the judicial process.

The combination of relatively high costs for both utilities and labor makes unit production costs higher than average for the region. Also, investors complain of burdensome and excessive product registration requirements. The government is trying, however, through a "one-stop shopping" concept, to make its regulations more investor-friendly for those producing for export. As a WTO member, Panama's customs valuation system conforms to international standards. The processing of customs documents for imports is generally fast, efficient, and reliable. However, some importers have complained of product misclassification and, in isolated cases, demands for excessive duties. In addition, importers of agricultural goods have faced sudden and arbitrary changes in procedures and practices.

In financial services, restrictions on foreign ownership is minimal except for finance companies. U.S. banks, insurance companies and brokerages are welcome and in some cases are leaders in the local market.

7. Export Subsidies Policies

The Universalization Law, enacted in June 1995, allows any company to import raw materials or semi-processed goods at a duty of three percent for domestic consumption or production, or duty free for export production. In addition, companies not receiving benefits under the "Special Incentives Law" of 1986 will be allowed a tax deduction of up to 10 percent on their profits from export operations through 2002.

The Tax Credit Certificate (CAT) program, which subsidizes production of non-traditional exports, is being phased out. Through the year 2000, the program allows exporters to receive CATs worth 15 percent of value added. After 2000, the program is slated to be eliminated.

8. Protection of U.S. Intellectual Property

Panama belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is a signatory to the Paris Convention, Berne Convention, Rome Convention, Phonograms Convention, Universal Copyright Convention, and the Satellites Convention. In 1998, the U.S. Trade Representative maintained Panama on the "Special 301" Other Observations list.

Panama's intellectual property legislation, including Law 15 of 1994 (Copyrights) and Law 35 of 1996 (Industrial Property), is generally consistent with the standards specified in the WTO TRIPs Agreement. The laws explicitly protect foreign works. Although enforcement has improved in recent years, piracy and counterfeiting remain problems, particularly in the Colon Free Zone (CFZ).

Patents: The Industrial Property Law establishes a standard of 20 years of protection for all patent holders and protects processes. Although the law imposes a working requirement on patent holders, the patent holder can satisfy the requirement by importing the product. Under the law, the government can issue compulsory licenses only after notice to, and a hearing for, the patent holder. In addition, a patent holder can still preserve his rights by beginning manufacture or importation within one year of the initial notification of the compulsory licensing proceeding. The recipient of a compulsory license must have the capacity to manufacture the product in Panama.

Trademarks: The Industrial Property Law also provides for protection of trademarks and trade secrets. It simplifies trademark registration and gives protection for 10 years, renewable for an unlimited number of additional 10-year periods. While the law provides adequate protection, enforcement is another matter. Counterfeit merchandise, particularly apparel and footwear, watches, perfume, and sunglasses, are available in Panamanian stores. Trademark-infringing merchandise is also transshipped through the CFZ for distribution in Latin American markets. In implementing the Industrial Property Law, the CFZ administration created an Intellectual

Property Department in March 1998. The new IP Department and the CFZ Customs Office have conducted more than 15 raids and seizures in 1998.

Copyrights: Video and sound recording piracy have long been a serious problem in Panama. However, since late 1996, aggressive action by the 10th Circuit Prosecutor's Office (Fiscalia) of Panama City has reduced the incidence of video piracy. The Fiscalia has broken up several large-scale illicit video reproduction operations and has brought charges against two notorious video pirates. The Recording Industry Association of America (RIAA) has stated that pirates reproduce and distribute pirated sound recording cassettes and compact discs from the CFZ throughout Latin America. In September 1998, the Fiscalia raided warehouses at Tocumen International Airport and seized approximately 5 million East Asia-produced pirated compact discs, along with CD-ROM computer games and counterfeit microchips.

The Business Software Alliance (BSA) has an active public awareness program in Panama, and periodically obtains warrants to search businesses for appropriate use of software licenses. Several criminal and civil cases have been brought for illegal software use; most have been settled out of court. While most pirated products are imported, local software companies have also been victimized by illicit copying and use of their products.

According to estimates by the International Intellectual Property Alliance (IIPA), U.S. copyright-based industries' losses in Panama due to piracy were $24.4 million in 1997. Losses due to trademark infringement are believed to be large, especially considering the CFZ transshipment problem, but are not easily quantifiable.

USAID, through the Panamanian private sector, is assisting the government in bringing the public administration of IPR together under one autonomous institution. Draft legislation is expected to be presented to the Assembly by early 1999.

9. Worker Rights

a. The Right of Association: Private sector workers have the right to form and join unions of their choice, subject to registration by the government. Neither the government nor the political parties control or financially support unions. There are 257 active unions, grouped under 6 confederations and 48 federations, representing approximately 10 percent of the employed labor force. Civil service workers are permitted to form public employee associations and federations, though not unions. Union organizations at every level may and do affiliate with international bodies.

b. The Right to Organize and Bargain Collectively*:* The Labor Code provides most workers with the right to organize and bargain collectively. The law protects union workers from anti-union discrimination and requires employers to reinstate workers fired for union activities. The Labor Code also establishes a conciliation board in the Ministry of Labor to resolve complaints and it provides a procedure for arbitration. The Civil Service Law allows most public employees to organize and bargain collectively and grants them a limited right to strike.

c. Prohibition of Forced or Compulsory Labor: The Labor Code prohibits forced or compulsory labor, and neither practice has been reported.

d. Minimum Age for Employment of Children*:* The Labor Code prohibits the employment of children under 14 years of age as well as those under 15 if the child has not completed primary school. Children under age 16 cannot work overtime; those under 18 cannot work at night. Children between the ages of 12 and 15 may perform light farm work that does not interfere with their education. The Ministry of Labor enforces these provisions in response to complaints and may order the termination of unauthorized employment. However, it has not enforced child labor provisions in rural areas due to insufficient staff.

e. Acceptable Conditions at Work: The Labor Code establishes a standard work week of 48 hours and provides for at least one 24-hour rest period weekly. It also establishes minimum wage rates, though in the relatively high cost urban areas, the minimum wage is not sufficient to support a worker and family above the poverty level. The Ministry of Labor does not adequately enforce the minimum wage law due to insufficient personnel and financial resources. The government sets and enforces occupational health and safety standards. It conducts periodic inspections of particularly hazardous employment sites as well as doing so in response to complaints. Workers may remove themselves from situations that present an immediate health or safety hazard without jeopardizing their employment. Health and safety standards generally emphasize safety rather than long-term health hazards. Complaints of health and safety problems continue in the construction, banana, cement, and milling industries.

f. Rights in Sectors with U.S. Investment: Worker rights in sectors with U.S. investment generally mirror those in other sectors. As mentioned above, the banana industry, which has significant U.S. investment, continues to produce complaints of health hazards largely due to workers' exposure to pesticides. The Panama Canal operates under separate labor regulations. As part of the Canal transition process, Panamanian mediators are being trained, with USAID financing, in alternate dispute resolution to resolve labor conflicts within the Panama Canal Authority post-1999.

Extent of U.S. Investment in Selected Industries
U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

Category	**Amount**
Petroleum	724
Total Manufacturing	102
Food & Kindred Products	30
Chemicals & Allied Products	(1)
Primary & Fabricated Metals	(1)
Industrial Machinery and Equipment	0
Electric & Electronic Equipment	0
Transportation Equipment	0
Other Manufacturing	40
Wholesale Trade	509
Banking	89
Finance/Insurance/Real Estate	19,585
Services	33

Other Industries	-83
TOTAL ALL INDUSTRIES	**20,958**

(1) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.