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IMF Concludes Article IV Consultation with Panama

The IMF Executive Board on December 10, 1997 concluded the 1997 Article IV consultation[1] with Panama and approved the authorities' request for financial support under the Extended Fund Facility (see Press Release No. 97/56).

Background

During the first half of the 1990s, the Panamanian economy recovered from the adverse impact of the political crisis of the late 1980s. The present Administration, which assumed office in September 1994, embarked on a medium-term economic strategy based on market principles and an efficient public sector. The authorities' efforts were supported by the international community, including policy loans from the World Bank, the IDB, and a 16-month stand-by arrangement from the IMF that expired in March 1997.

The Administration carried out major structural reforms in the areas of privatization, deregulation, and trade, while maintaining a small overall surplus in the public sector operations. In the three-year period ended September 1997, the authorities sold 49 per-cent of government shares in the telecommunication company and transferred 2 percent of the shares to employees, leased two major seaports and an oil storage complex, established a new export processing zone, promoted private investment in the reverting areas, and supported the private sector in developing large-scale road and seaport projects. Trade protection was substantially lowered through tariff reductions and elimination of nontariff barriers. Concrete actions were taken to promote competition within the economy, to improve the regulation of public utilities, to help increase labor

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

mobility through revisions to the labor code, and to convert the supplementary civil service pension fund into a voluntary and self-financed plan.

Real GDP growth, which had slowed to 1.8 percent in 1995 after the strong recovery of the early 1990s, increased to 2.5 percent in 1996 and 3.6 percent (annual rate) in the first quarter of 1997. In this period, inflation remained low mainly because of the discipline associated with Panama's monetary and exchange rate arrangements. The public finances were strengthened through expenditure control and a debt restructuring package with commercial banks in 1996, as the overall balance of the public sector shifted to a small surplus in 1994–96. While the external current account deficit widened in 1995 to 3.4 percent of GDP because of the adverse impact of the Mexican crisis on exports it narrowed to 1.6 percent of GDP in 1996, reflecting a recovery in exports and lower interest payments despite a pick-up in foreign investment-related imports.

The authorities' economic program for the next three years seeks to deepen structural reforms in the context of a continued pursuit of prudent fiscal policies, with the objective of promoting sustainable growth of output and employment and reducing poverty. More specifically, the program aims at raising the rate of growth of real GDP to 5 percent by the year 2000, while maintaining inflation at about 1½ percent. Reflecting the initial cost of certain structural measures, e.g., privatization and pension reform, the public sector operations will shift to small overall deficits in 1997–99 before returning to a growing surplus position beginning in the year 2000. The temporary deficits are projected to be more than covered by external project and policy loans, which would facilitate a reduction in domestic indebtedness. Divestment proceeds would continue to be used to build up net foreign assets of the government's Trust Fund for Development. Initially, domestic investment (largely on infrastructure, mining, and tourism) would rise faster than national saving. The external current account deficit would widen temporarily, and would be virtually covered by net capital inflows.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They noted that under the recent Stand-By Arrangement, economic conditions, particularly the economy's growth performance, had improved following the implementation of structural reforms in the areas of privatization, deregulation and trade, and fiscal policies that maintained equilibrium in the public sector operations. However, impediments to economic efficiency and private sector investment remained, and the structure of public finances remained weak. Directors, therefore, endorsed the authorities' intention to consolidate the recent economic gains and to further increase economic growth through the implementation of the proposed medium-term program of substantial additional structural reforms in the context of fiscal consolidation, supported by an extended arrangement from the IMF.

Directors stressed that achievement of the program's fiscal targets was crucial for ensuring medium-term fiscal viability. To that end, they urged prompt efforts to eliminate tax loopholes, improve tax administration, and implement the planned comprehensive tax reform in the second half of 1999. In addition, the authorities should continue to exercise expenditure restraint. In particular, the growth of the government wage bill should be controlled to strengthen public finances and to provide appropriate signals for private sector wage settlements.

Directors observed that the program's strategy of reducing the role of the public sector in commercial activities was sound, as it would help increase efficiency and create room for private sector investment. In this context, Directors noted that implementation of the authorities' ambitious privatization plan would be a key element, and stressed the importance of transparency in the privatization process. They praised the authorities for the recent privatization of the telecommunications company, and urged them to continue to pursue their plans for privatization and integration of the areas of the Panama Canal Zone that were reverting to Panamanian sovereignty so as to attract domestic and foreign private investments.

Directors noted the authorities' efforts to promote competition and raise efficiency through further trade reforms, and welcomed the authorities' intention to maintain the momentum of their trade reform efforts. In this connection, they commended the recently announced lowering of the maximum tariffs to 15 percent and reduction in tariff dispersion that would become effective on January 1, 1998. Directors also welcomed the authorities' preparedness to prevent deviations from the program's medium-term fiscal path by taking fiscal actions to offset any loss of revenue that may result from the tariff reform measures.

A modern banking law, with strengthened banking supervision, was considered essential by Directors to promote efficient financial intermediation and preserve Panama's international competitiveness in the area of financial services. They urged the authorities to implement as planned the strengthening of the banking law and to allow trading in new financial instruments, and to modernize the financial sector in line with international standards. Also, they welcomed the proposed restructuring of public financial institutions which would help increase efficiency and mobilize savings.

Directors stressed the importance of reforming the social security system in order to ensure its long-run financial viability, and they urged the authorities to complete the reform of civil service pensions. While noting that stable financial conditions were crucial for a lasting reduction in unemployment and poverty, Directors welcomed the strengthening of the social safety net for the most vulnerable groups in society.

Press Information Notices (PINs) are a new series of IMF press notices (see Press Release 97/21). PINs are issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Panama: Key Economic Indicators, 1992-2002

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	In annual percent changes										
Real GDP	**8.2**	**5.5**	**2.9**	**1.8**	**2.5**	**3.7**	**4.3**	**4.5**	**4.8**	**5.3**	**5.5**
Consumer price index (end of year)	**1.6**	**1.0**	**1.3**	**0.8**	**2.3**	**1.4**	**1.7**	**1.6**	**1.6**	**1.5**	**1.5**
Banking system liabilities to the private sector	**23.7**	**15.3**	**17.9**	**8.2**	**8.1**	**10.2**	**10.1**	**10.8**	**10.8**	**11.1**	**11.1**
	In percent of GDP, unless otherwise indicated										
Gross domestic	**19.7**	**24.1**	**24.5**	**26.2**	**23.6**	**25.1**	**26.2**	**27.3**	**28.7**	**29.0**	**29.6**
Public	3.1	4.0	3.4	3.4	3.8	4.1	3.4	2.8	4.0	4.0	4.1
Private	16.5	20.1	21.1	22.8	19.8	21.0	22.8	24.5	24.7	25.0	25.5
Gross national saving	**15.4**	**22.0**	**24.1**	**22.8**	**22.0**	**22.2**	**22.7**	**23.6**	**26.3**	**27.4**	**28.3**
Public	4.7	2.6	3.8	3.5	4.2	2.8	2.6	2.2	4.6	4.9	5.2
Private	10.8	19.4	20.4	19.3	17.8	19.4	20.1	21.4	21.7	22.5	23.1
Public sector borrowing requirement (net)	**-1.6**	**1.4**	**-0.3**	**-0.2**	**-0.4**	**0.7**	**0.7**	**0.5**	**-0.6**	**-0.9**	**-1.0**
External borrowing (net)	0.2	2.2	1.5	2.6	-1.8	2.8	1.8	0.9	0.0	-0.6	0.0
Domestic borrowing (net)	-1.8	-0.8	-1.8	-2.8	1.4	-2.1	-0.9	-0.4	-0.6	-0.3	-1.0
External current account	**-4.3**	**-2.2**	**-0.4**	**-3.4**	**-1.6**	**-2.9**	**-3.5**	**-3.6**	**-2.4**	**-1.6**	**-1.4**
External public debt	**78.0**	**74.9**	**71.2**	**75.2**	**61.8**	**59.4**	**57.8**	**55.3**	**51.8**	**47.8**	**44.5**
External public debt service/exports of goods and nonfactor services	**26.3**	**21.0**	**20.3**	**21.9**	**15.4**	**46.2**	**15.5**	**15.5**	**15.3**	**14.9**	**23.6**
Memorandum item: Nominal GDP	6,641	7,253	7,734	7,906	8,244	8,668	9,172	9,740	10,377	11,095	11,885

Sources: Office of the Comptroller General; and Ministry of Planning and Economic Policy.