

Trade Policy Review Body

TRADE POLICY REVIEW

Report by the Secretariat

PANAMA

This report, prepared for the first Trade Policy Review of Panama, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from Panama on its trade policies and practices.

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SUMMARY OBSERVATIONS

1. Trade in goods and services plays a vital role in Panama's economy, representing 143 per cent of GDP (including re-exports). In consonance with this, Panama maintains an essentially liberal trade and investment regime, with applied MFN tariffs averaging 8.5 per cent and very few non-tariff trade barriers in place. Its service-oriented economy acts as an international hub for activities such as maritime transport, distribution services, and banking. In contrast, the production of a number of agricultural and manufactured goods receives assistance through border protection and fiscal incentives, some contingent upon exportation.

2. Simplifying the trade regime, particularly the tariff structure, and rationalizing other assistance programmes would enhance transparency, reduce transaction costs, help consolidate the fiscal position, and create a more uniform incentive structure. Building on Panama's comparative advantage as a supplier of international services, notably transportation through the Canal, these and other reforms would help sustain the robust economic growth achieved in recent years.

(1) ECONOMIC ENVIRONMENT

3. Panama's GDP grew at an annual average rate of around 4.9 per cent during 2000-06, and is expected to rise around 8 per cent in 2007. Growth has been particularly strong since 2004, resulting largely from an increase in investment and service exports. GDP per capita was just over US\$5,200 in 2006. Services constitute by far the most important sector of the Panamanian economy, accounting for some 80 per cent of GDP and 70 per cent of employment.

4. Panama's fiscal position has improved as a result of fiscal reforms and increased Canal revenue, but it requires further consolidation, especially in view of the heavy financial commitments that the expansion of the Canal would bring about. The public debt

to GDP ratio has declined but remains relatively high (61 per cent). Panama has had no monetary policy instruments available since it adopted the US dollar as its legal tender in 1904. Inflation has been historically low although some upward pressure has been observed of late.

5. The current account of the balance of payments has been traditionally in deficit but this shortfall has decreased since 2004, to some 2.2 per cent of GDP in 2006. Trade in goods and in services account for, respectively, 110 per cent and 33 per cent of GDP. The current account deficit largely reflects a shortfall in the trade in goods balance. On the other hand, the services balance is in surplus and has been expanding, mostly as a result of higher Canal revenues.

6. Panama's main trading partner is the United States, which accounts for almost one third of Panamanian merchandise trade (excluding re-export operations, which represent approximately 70 per cent of Panama's total merchandise trade). Panama's main merchandise exports are food products, while just over two thirds of imports are manufactured goods. Main service exports are transport services (including Canal operations), tourism, and financial services. Panama is a net recipient of foreign direct investment, which represented an average of around 7 per cent of the GDP over 2000-2006.

7. The Panama Canal plays a vital role in the economy. Its expansion, expected to commence in 2007 and be concluded by 2014, is likely to sustain economic growth in the short to medium term. The estimated cost of the project is some US\$5.2 billion, or some 30 per cent of Panama's GDP.

(2) TRADE AND INVESTMENT POLICY FRAMEWORK

8. Panama acceded to the WTO in 1997. It is a party to the Information Technology Agreement, but not to any other WTO plurilateral agreements. Panama has made numerous notifications to the WTO although

some are still pending. It has been involved in the dispute settlement mechanism in three cases as a complainant and in one, involving consultations only, as a respondent.

9. Panama has participated actively in the Doha Development Agenda (DDA), presenting proposals individually and together with other Members. It advocates offering greater flexibilities to non-original developing Members. It considers trade liberalization an important policy tool to achieve development, but favours a flexible approach to liberalization. Panama would have much to gain from a successful conclusion of the DDA in view of the diversified nature of its trade and its deep integration in the global economy.

10. Panama grants at least MFN treatment to all its trading partners. As at mid 2007, Panama had three free-trade agreements (FTAs) in force, with Chinese Taipei, El Salvador, and Singapore. It participates in more limited preferential agreements with six other partners. Panama has also finalized the negotiation of new FTAs with Chile, Honduras, and the United States, and is negotiating FTAs with Costa Rica, Guatemala, and Nicaragua. The entry into force of the agreement with the United States is likely to have a particularly important institutional and economic impact on Panama.

11. Panama maintains an open investment regime although the State still has a significant presence in activities such as transportation, electricity, and telecommunications. Foreign participation is formally restricted in retail trade, broadcasting, and air transport. Panama has bilateral investment treaties with 16 countries.

(3) MARKET ACCESS FOR GOODS

12. Panama has taken measures to simplify and modernize customs procedures, as well as to improve customs control. The tariff is Panama's main trade instrument. All tariffs are *ad valorem*. The average applied MFN tariff is 8.5 per cent; the average tariff of 14.2 per cent for agricultural products

(WTO definition) is considerably higher than for other products (5.6 per cent). The tariff structure is complex, with 37 tiers (including duty free). Panama has bound all tariff lines, thus providing greater predictability to its trade regime; however, this is reduced somewhat by the gap of some 15 percentage points between average applied and bound tariffs. There are at least three tariff lines for which the applied tariff is higher than the bound rate.

13. Panama grants preferential access to imports originating from nine trading partners, provided they comply with the appropriate rules of origin.

14. In addition to tariffs, imports are subject to a customs service fee levied at a specific rate. Domestic and imported goods and services are subject to a valued-added tax (ITBMS) and a selective consumption tax (ISC). Imports receive national treatment in the application of domestic taxes except in the case of certain national liquors, which are taxed at a lower ISC rate than imported products.

15. Panama has made limited use of contingency measures. It has carried out one anti-dumping investigation, but this did not result in the imposition of duties. In addition, it notified one safeguard investigation, which resulted in the imposition of a provisional measure in the form of a tariff surcharge on certain plastic products; as at May 2007, a final decision on the application of a safeguard measure had not yet been made.

16. Panama has notified 49 measures under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures, of which slightly more than half concern live animals, meat or sub-products. Panama has also notified 34 technical regulations, the majority related to food products.

(4) EXPORT MEASURES

17. Panama prohibits the exportation but not the domestic consumption of unprocessed

logs of certain tree species from natural forests. It imposes a 1 per cent export tax on certain processed wood products. The exportation of certain marine products and of non-ferrous scrap requires a permit.

18. Panama has notified the WTO that it grants export subsidies through three programmes: Export Processing Zones (ZPE), the Tax Credit Certificate (CAT), and the Official National Industry Registry (ROIN). The ZPE regime grants tax exemptions to companies that fulfil a minimum local-value-added requirement; no date has been set for its elimination. The CAT offers tax credits to exporting companies that produce non-traditional products; although the CAT has been formally abolished, benefits will continue to be paid until 2010. The ROIN exempts companies that export all their production from import duties, income tax, and other domestic taxes; the ROIN was to be phased out in late 2005 but its termination was postponed following the SCM Committee's decision to extend the deadline for the elimination of subsidies notified under Article 27.4 of the SCM Agreement.

19. The Colon Free Zone (ZLC) grants similar benefits to those provided under the ZPE regime. Although the ZLC aims to encourage both commercial and industrial activities, in practice only service and re-export operations take place in it. The ZLC functions as a global logistical and distribution centre, and accounts for just over three quarters of Panama's total merchandise exports.

(5) OTHER MEASURES AFFECTING TRADE

20. Panama maintains numerous incentive schemes, in addition to export subsidies, that target micro and small businesses, research and development projects, as well as specific sectors such as agriculture, forestry, mining, and tourism. By and large, such schemes seek to assist the production of goods by granting tariff or other tax concessions. There are no estimates of the net benefits to the economy of

these incentives. A reassessment of the nature and number of such schemes with a view to their possible rationalization could contribute to greater transparency and efficiency in their use; it might also permit the redeployment of fiscal resources towards areas such as education and infrastructure.

21. The administrative cost to establish new enterprises in Panama has been traditionally low. Panama has also set up a relatively well developed competition policy framework although the level of competition in some activities seems limited, including in certain agricultural markets protected by high tariffs. It does not apply price controls on goods. Panama has notified the WTO that it does not maintain state-trading enterprises. In the 1990s, Panama carried out an ambitious privatization programme; in recent years, privatization has slowed considerably along with the reduction of state participation in production activities.

22. Panama is not a member of the WTO Government Procurement Agreement but it is an observer and is negotiating accession. New government procurement regulations were introduced in 2006 which, among other things, guarantee national treatment to foreign bidders. Procurement for the Canal is under a separate regime.

23. As part of its accession process to the WTO, Panama modified its legislation to protect intellectual property rights, seeking to bring it into line with the TRIPS Agreement. However, no specific regulations have been adopted yet on layout designs for integrated circuits.

(6) SECTORAL POLICIES

24. The sectoral structure of the Panamanian economy shows a clear dichotomy between the highly competitive services sector and the relatively low productivity in agriculture and manufacturing. As a result, international services such as the Canal, the ZLC, international banks, maritime transport, and tourism are strong competitors

in world markets and play a crucial role in the economy. In contrast, the production of goods has often depended on trade protection measures and incentive schemes.

25. The agriculture, forestry and fishing sector contributes just under 7 per cent of Panama's GDP, but it is responsible for 20 per cent of total employment and generates approximately 43 per cent of merchandise exports (excluding re-exports). Certain agricultural products, such as sugar, as well as milk and beef and their products receive particularly high tariff protection. Panama administers tariff quotas for all the products in its list of tariff quota commitments; fill rates have been close to 100 per cent for most products. Panama has notified the WTO of the granting of domestic support and export subsidies to agricultural products. Official credit is provided to agriculture and agroindustry.

26. The manufacturing sector is small and concentrated in few activities, mainly related to the processing of agricultural products. Panama liberalized and partially privatized the electricity sector in 1998-99 but the State continues to hold a de facto monopoly in transmission and owns substantial assets in generation and distribution.

27. Panama's GATS commitments are substantial, although they fall short of the degree of access afforded in practice to foreign service suppliers. Panama undertook specific commitments in 11 of the 12 GATS sectors, with respect to both market access and national treatment. Panama submitted in April 2003 an initial offer in the context of the DDA but as at mid 2007 had yet to present a revised offer. Expanding the level of commitments would add predictability to Panama's investment regime.

28. The telecommunications sector was privatized in 1997 and opened up to competition in 2003. Regulatory changes to foster competition have continued, although access to and use of the incumbent's fixed local network remain somewhat problematic.

There are no restrictions to foreign private investment but Panama undertook specific GATS commitment only for value-added services and did not accept the Reference Paper on Telecommunications.

29. Panama has a large financial sector, including 37 international banks providing services exclusively to foreign-based customers. There are no restrictions to foreign participation in banking but, in the insurance sector, risks that occur in Panama may only be insured by companies established in Panama. Panama undertook GATS commitments in most of the categories specified in the services sector classification, reflecting its fairly liberal regulatory framework in financial services.

30. In domestic air transport services, foreigners may not legally own more than 40 per cent of a firm's shares. However, there are no restrictions to foreign participation in international routes. As the law requires, airports providing public services are owned and managed by the State.

31. There are no nationality restrictions for the provision of domestic maritime transport services. The main ports, owned by the State, are operated by private companies. Panama has the largest ship registry in the world due, *inter alia*, to its advantageous tax conditions and liberal registration regime.

32. The administration of the Canal reverted to Panama in 1999, and the Canal has become a main pillar of Panama's economy. The expansion of the Canal, expected to be financed by toll revenues, should consolidate Panama's position as a global entrepot and a key link in international trade. However, careful project management will be required to prevent cost overruns or constructions delays, which would impose a heavy burden on Panama's economy.

33. Foreign professionals have limited access to the Panamanian market, the provision of most regulated professional services is restricted to Panamanians citizens. Panama's universities have signed mutual recognition

agreements with universities in ten countries. Panama undertook limited specific commitments in professional services under the GATS.

