
I. ECONOMIC ENVIRONMENT

(1) OVERVIEW

1. Panama has enjoyed robust economic growth over the last few years, with GDP expanding at an annual average rate of 4.9 per cent between 2000 and 2006, despite a slowdown at the start of the decade. As a result, per capita GDP increased by 30 per cent in nominal terms between 2000 and 2006, to just over US\$5,200. The main engines of growth since 2002 have been private consumption and investment, with exports also playing a key role since 2004.

2. Much of the recent economic expansion has been the outcome of favourable external conditions and prudent macroeconomic policies. As it uses the dollar as its currency, Panama does not have its own monetary policy instruments, and fiscal policy is the authorities' main macroeconomic tool. Accordingly, the policy to put public finance on to a sound basis is particularly important, especially the reform of the *Caja de Seguros Social* – CSS (Social Security Fund) implemented over the last few years. The total public debt has shrunk in relation to GDP, although its 2006 level of 61.1 per cent remains high. The macroeconomic situation has been boosted by the approval given for the expansion of the Panama Canal, which remains a major catalyst for private investments in the country. Nonetheless, shortcomings in education, relative institutional fragility and domestic regional inequalities continue to pose challenges for the country's development.

3. Panama's balance of payments on current account is traditionally in deficit, and has been financed by surpluses on the capital and financial accounts. International trade in goods and services plays a vital role for the country's economy and was equivalent to 143 per cent of GDP in 2006. Panama has positioned itself as a major supplier of services such as telecommunications; tourism; financial services; port, cargo storage and distribution services; as well as transit through the canal. The latter is fundamentally important for Panama and, in turn, makes the country a crucial link in world trade. Panama's merchandise trade has diversified in recent years, and the share of its main trading partner, the United States, has shrunk from 35.5 per cent in 2000 to 30.8 per cent in 2005. Foreign investment flows into Panama have also grown over the last few years.

(2) MACROECONOMIC TRENDS

(i) Economic structure and trends

4. The Panamanian economy is dominated by service activities, which contribute just over 80 per cent of GDP (Table I.1). Its sector composition has undergone a number of changes since 2000, as the more internationally competitive sectors – transport and communications, financial intermediation and tourism – have outpaced the rest of the economy. Since 2003, the construction sector has benefited from low interest rates, and its expansion has invigorated the economy as a whole.¹ The GDP shares of the agriculture and manufacturing sectors declined in the period 2000–2006, with the manufacturing sector, in particular, affected by a loss of competitiveness in the textile segment and the 2003 closure of the country's single oil refinery.

¹ ECLAC (2006).

Table I.1
Basic economic indicators, 2000-2006

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ^(a) |
|---|-------------|-------------|-------------|-------------|-------------|-------------|---------------------|
| Gross domestic product (GDP) | | | | | | | |
| Real GDP (US\$ million) ^b | 11,371 | 11,436 | 11,691 | 12,183 | 13,099 | 14,005 | 15,142 |
| Nominal GDP (US\$ million) | 11,621 | 11,808 | 12,272 | 12,933 | 14,179 | 15,483 | 17,097 |
| Nominal GDP per capita (US\$) | 3,942 | 3,931 | 4,010 | 4,150 | 4,470 | 4,796 | 5,206 |
| Sector structure of GDP (% of real GDP) | | | | | | | |
| Agriculture and livestock | 5.3 | 5.1 | 4.8 | 4.8 | 4.5 | 4.4 | 4.4 |
| Fisheries | 1.7 | 2.3 | 2.7 | 3.1 | 2.9 | 2.8 | 2.4 |
| Mining and quarrying | 0.7 | 0.7 | 0.8 | 1.0 | 1.0 | 1.0 | 1.0 |
| Manufacturing | 9.6 | 9.0 | 8.5 | 7.9 | 7.5 | 7.3 | 7.0 |
| Primary and industrial sector | 17.4 | 17.1 | 16.8 | 16.8 | 15.9 | 15.4 | 14.7 |
| Electricity, gas and water | 3.3 | 3.1 | 3.3 | 3.2 | 3.1 | 3.1 | 2.9 |
| Construction | 4.7 | 3.7 | 3.3 | 4.2 | 4.5 | 4.3 | 4.6 |
| Commerce | 14.6 | 14.9 | 14.3 | 13.9 | 14.4 | 14.5 | 15.0 |
| Hotels and restaurants | 2.1 | 2.3 | 2.4 | 2.5 | 2.7 | 2.8 | 2.9 |
| Transport, storage and communications | 15.2 | 15.5 | 15.4 | 16.4 | 17.5 | 18.2 | 19.1 |
| Financial intermediation | 9.9 | 9.5 | 8.7 | 7.7 | 6.8 | 7.4 | 7.7 |
| Real estate, rental and business services | 15.6 | 15.7 | 16.0 | 16.1 | 16.1 | 16.1 | 15.7 |
| Public administration and defence | 4.6 | 4.5 | 4.4 | 3.9 | 4.0 | 3.5 | .. |
| Other public and private services | 10.5 | 11.1 | 11.5 | 11.7 | 10.9 | 10.5 | 13.4 ^(c) |
| Services | 80.5 | 80.3 | 79.3 | 79.1 | 80.0 | 80.5 | 81.1 |
| Plus taxes | 5.9 | 6.0 | 6.5 | 6.2 | 6.1 | 6.3 | 6.2 |
| Less financial intermediation services measured indirectly | 3.7 | 3.2 | 2.5 | 2.5 | 2.0 | 2.1 | 2.4 |
| Total GDP | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Employment (% of total working population)^d | | | | | | | |
| Agriculture | .. | .. | .. | .. | 18.1 | 18.1 | 18.4 |
| Fisheries | .. | .. | .. | .. | 1.2 | 1.1 | 1.2 |
| Mining and quarrying | .. | .. | .. | .. | 0.1 | 0.1 | 0.2 |
| Manufacturing | .. | .. | .. | .. | 9.5 | 9.1 | 9.0 |
| Electricity, gas and water | .. | .. | .. | .. | 0.7 | 0.6 | 0.7 |
| Construction | .. | .. | .. | .. | 7.5 | 7.2 | 7.9 |
| Commerce | .. | .. | .. | .. | 17.5 | 18.1 | 18.0 |
| Hotels and restaurants | .. | .. | .. | .. | 5.1 | 5.5 | 5.0 |
| Transport, storage and communications | .. | .. | .. | .. | 7.4 | 7.3 | 7.1 |
| Financial intermediation | .. | .. | .. | .. | 2.1 | 1.9 | 2.0 |
| Real estate, rental and business services | .. | .. | .. | .. | 4.5 | 4.9 | 4.7 |
| Public administration and defence | .. | .. | .. | .. | 6.2 | 5.5 | 5.5 |
| Other public and private services | .. | .. | .. | .. | 20.4 | 20.5 | 20.3 |
| Memorandum item | | | | | | | |
| Population (thousand) ^e | 2,948 | 3,004 | 3,060 | 3,116 | 3,172 | 3,228 | 3,284 |
| Open unemployment rate ^f | 8.8 | 11.2 | 10.9 | 10.9 | 9.2 | 7.6 | 6.5 |
| Average nominal wages (US\$) | 3,753 | 3,728 | 3,769 | 3,905 | 4,052 | .. | .. |

.. Not available.

a GDP data for 2006 are estimates.

b Real GDP at 1996 consumer prices.

c Equivalent to aggregate data for public administration and other public and private services.

d Data obtained from household surveys conducted in August each year.

e Population estimated from the 2000 census.

f Unemployed labour force actually seeking employment, as a percentage of the economically active population. The calculation methodology was changed as of 2001.

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

5. The Panamanian economy entered a downswing phase in 1999 as a result of factors such as the closure of American military bases, rising international interest rates and a slowdown in lending for domestic consumption. In 2001, the adverse international economic climate also affected the country's exports, which stagnated along with the economy in general during that year (Table I.2). In response to this slowdown, in 2000-2003 the Government implemented a countercyclical fiscal policy to expand investment and public expenditure (see below).

6. The economy began to recover as from late 2002, driven mainly by growth in private-sector domestic demand; and the revival of domestic credit (in response to lower interest rates) in particular boosted the expansion of private consumption. There was also a major increase in public investment in infrastructure projects, accompanied by private investment in capital goods (housing and shopping centres). Net exports of goods and services became the main engine of economic growth, expanding at an average annual rate of 15 per cent in 2004-2006.² The economy as a whole grew by 8.1 per cent in 2006.

Table I.2
GDP growth, measured by expenditure, 2000-2005

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|------------------------------------|-------|-------|------|-------|------|-------|
| Real annual growth rate (%) | | | | | | |
| GDP | 2.7 | 0.6 | 2.2 | 4.2 | 7.5 | 6.9 |
| Total consumption | 0.2 | 3.9 | 7.3 | 7.3 | 3.9 | 7.2 |
| Private consumption | -0.1 | 3.1 | 6.9 | 8.7 | 4.3 | 7.6 |
| Public consumption | 1.8 | 8.1 | 9.1 | 0.4 | 1.9 | 4.8 |
| Gross capital formation | -9.3 | -24.2 | -5.4 | 19.0 | 9.9 | 2.9 |
| Gross fixed capital formation | -7.3 | -25.7 | -5.6 | 23.3 | 9.4 | 6.4 |
| Variation in stocks | -20.8 | -13.2 | -4.1 | -7.0 | 13.8 | -25.2 |
| Exports of goods and services | 18.5 | 0.3 | -2.5 | -10.1 | 18.6 | 11.6 |
| Imports of goods and services | 10.3 | -4.3 | 0.7 | -3.5 | 14.4 | 10.8 |
| Real GDP, composition (%) | | | | | | |
| Total consumption | 73.8 | 76.3 | 80.0 | 82.4 | 79.7 | 79.9 |
| Private consumption | 61.9 | 63.5 | 66.4 | 69.3 | 67.2 | 67.7 |
| Public consumption | 11.9 | 12.8 | 13.6 | 13.1 | 12.4 | 12.2 |
| Gross capital formation | 23.8 | 18.0 | 16.6 | 19.0 | 19.4 | 18.6 |
| Gross fixed capital formation | 20.9 | 15.5 | 14.3 | 16.9 | 17.2 | 17.1 |
| Change in stocks | 2.9 | 2.5 | 2.3 | 2.1 | 2.2 | 1.5 |
| Exports of goods and services | 75.5 | 75.4 | 71.9 | 62.0 | 68.4 | 71.4 |
| Imports of goods and services | 73.1 | 69.6 | 68.5 | 63.4 | 67.5 | 69.9 |

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

7. Agriculture, commerce and personal services are the three leading job creators in Panama, each of them accounting for roughly 20 per cent of the total working population. The manufacturing sector finds it hard to create new jobs (Table I.1). As a result of the economic slowdown in the late 1990s, open unemployment started to rise and reached a rate of 11.2 per cent in 2001 (Table I.1). Since then, however, as the economy has returned to a growth path, employment has revived, particularly in the province of Panama, and the open unemployment rate had dropped back to 6.5 per cent by 2006.

² Net exports exclude inputs, re-exports, bank profits on offshore and other operations. This methodology differs from that used in the balance of payments and in Table I.2.

8. The level of underemployment remains relatively high, however, affecting an estimated 21 per cent of the employed population. Informality is also one of the characteristics of the labour market:³ household surveys conducted in 2006 show that about half of the non-agricultural working population is employed on an informal basis, mostly in the commerce sector.

9. Per capita GDP grew at an average real rate of 3.0 per cent in 2000-2006, to reach a nominal level of US\$5,206 in 2006. Nonetheless, about 37.2 per cent of the population was still living in poverty in 2003 (the last year for which data are available).⁴ Moreover, major regional inequalities persist, as shown by the figures for per capita GDP in 2004 (the latest available per province), which ranged from US\$7,000 in the provinces of Panama and Colon to just US\$2,000 in the rest of the country.⁵ The standard of living index for 2000 (the latest available) also reveals major differences: 9.1 points in the provinces of Panama and Colon and 22.9 points in the rest of the country.⁶

10. A World Bank study shows that Panamanian education levels are among the best in Central America, although problems of inequality persist in terms of access and quality.⁷

11. A report by the International Monetary Fund (IMF) has also identified a problem of corruption, which is perceived as a widespread phenomenon affecting the public and private sectors alike.⁸ Nonetheless, the same report acknowledges the high priority given by the Panamanian Government to combating this scourge. Measures adopted include the passing of Law No. 6 of 22 January 2002, issuing regulations for transparency in public governance; the creation in 2004 of the National Council for Transparency against Corruption (CNTC); and ratification in 2005 of the United Nations Convention against Corruption. The main objectives of the CNTC include helping the Government to operate in a framework of legality and integrity, and to ensure transparent and efficient public governance that contributes to sustainable development.

(ii) Fiscal policy

12. The Ministry of the Economy and Finance (MEF) is in charge of formulating and executing fiscal policy.⁹ The Fiscal Responsibility Law (LRF) of 2002 establishes that in no circumstances may the fiscal deficit of the non-financial public sector (NFPS) surpass 2 per cent of GDP.¹⁰ It also establishes the following targets for public borrowing: total net public debt at 50 per cent of GDP, and net external debt at 35 per cent of GDP.¹¹ Nonetheless, the legal limits were breached in 2003, 2004 and 2005. According to the IMF, the 2002 LRF lacks institutional sanctions or automatic correction mechanisms to ensure its enforcement; it is too rigid to accommodate recessionary periods; and it fails to specify whether or not the Panama Canal Authority (ACP) is considered part of the NFPS.¹² In early 2007, the Government was holding internal discussions on a new draft fiscal responsibility law.

³ Statistics and Census Department of the Comptroller General of the Republic.

⁴ Ministry of the Economy and Finance.

⁵ Data calculated by the WTO Secretariat on the basis of information obtained from the Office of the Comptroller General of the Republic.

⁶ Data on the standard of living index can be consulted in UNDP (2002), p. 110; a high index means a lack of basic services and income.

⁷ World Bank (2005).

⁸ IMF (2005).

⁹ Law No. 97 of 21 December 1998.

¹⁰ Law No. 20 of 7 May 2002.

¹¹ As is the case with net external public debt, net total public debt reduces the balance of State monies that form part of the Trust Fund for Development.

¹² IMF (2005)

13. The deterioration of the NFPS financial accounts in 2000-2004 partly reflected the policy of increasing public expenditure to counteract the recession, which generated an increase in current expenditure and interest payments (mainly external) in subsequent fiscal years. Secondly, the weak reaction of tax revenue to changes in GDP, as a result of evasion and tax breaks, meant that revenue growth lagged behind the overall growth rate in the economy.¹³

14. Since 2005, the deficit trend in public finances has been reversed, mainly through current saving, to which the following factors contributed: reform of the pension system in 2005, which produced a reduction in the deficit of the *Caja de Seguros Social* (CSS) in 2005-2006; growth in transfers from the canal; the tax reforms in 2002 and 2005 which abolished a number of tax breaks and expanded the tax base in several cases; and the robust growth of the economy in 2004-2006. Preliminary data suggest a fiscal surplus of 0.5 per cent of GDP for 2006 (Table I.3).

Table I.3
Financial accounts of the non-financial public sector (NFPS), fiscal years 2000-2006
(Percentage of current GDP)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ^a |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------------|
| I. Total revenues | 26.0 | 25.5 | 24.3 | 22.3 | 21.1 | 22.4 | 25.1 |
| Current revenues | 24.3 | 23.4 | 22.0 | 21.0 | 20.1 | 20.5 | 23.7 |
| Central Government | 17.2 | 16.5 | 15.4 | 14.8 | 13.9 | 14.7 | 17.9 |
| Tax revenues | 9.6 | 9.0 | 8.9 | 9.0 | 8.8 | 8.9 | 10.6 |
| Income tax (ACP) ^b | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 |
| Import duty ^c | 2.6 | 2.2 | 2.2 | 2.3 | 2.3 | 2.3 | 2.5 |
| Other taxes | 6.5 | 6.3 | 6.3 | 6.3 | 6.1 | 6.2 | 7.8 |
| Non-tax revenues | 5.5 | 5.5 | 6.1 | 5.6 | 4.8 | 5.6 | 7.3 |
| Canal toll duties | 1.4 | 1.2 | 1.2 | 1.1 | 1.0 | 1.2 | 1.6 |
| Public services in the Canal area | 0.1 | 0.2 | 0.3 | 0.2 | 0.2 | 0.1 | .. |
| Dividends transferred from the ACP | 0.3 | 0.3 | 0.7 | 0.9 | 1.3 | 1.3 | 2.0 |
| Other non-tax revenues | 3.7 | 3.8 | 3.9 | 3.4 | 2.3 | 3.0 | 3.7 |
| Other current incomes | 2.1 | 2.0 | 0.4 | 0.2 | 0.3 | 0.2 | 0.1 |
| Social Security Fund (CSS) | 6.4 | 6.2 | 5.9 | 5.6 | 5.6 | 5.3 | 5.2 |
| Consolidated agencies ^d | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.5 | 0.6 |
| Financial balance of public enterprises ^e | 0.7 | 0.8 | 0.8 | 0.7 | 0.6 | 1.0 | 0.9 |
| Financial balance of non-consolidated agencies ^f | 0.5 | 0.6 | 0.6 | 0.2 | 0.2 | 0.6 | 0.2 |
| Capital revenue | 0.5 | 0.7 | 0.9 | 0.4 | 0.2 | 0.3 | 0.2 |
| II. Total expenditure | 25.5 | 26.2 | 26.2 | 27.1 | 26.0 | 25.6 | 24.6 |
| Current expenditure | 18.1 | 18.6 | 18.7 | 18.6 | 18.3 | 17.4 | 17.1 |
| Central government | 9.0 | 9.1 | 8.9 | 8.9 | 9.1 | 8.7 | 8.8 |
| Social Security Fund | 7.8 | 8.3 | 8.6 | 8.5 | 8.1 | 7.7 | 7.3 |
| Consolidated agencies ^d | 1.3 | 1.2 | 1.2 | 1.2 | 1.1 | 1.0 | 0.9 |
| Total interest | 4.3 | 4.3 | 4.1 | 4.4 | 4.2 | 5.2 | 4.4 |
| External interest | 3.2 | 3.5 | 3.6 | 3.7 | 3.5 | 4.4 | 3.3 |
| Domestic interest | 1.1 | 0.8 | 0.5 | 0.7 | 0.7 | 0.8 | 1.1 |
| Capital expenditure | 3.1 | 3.3 | 3.3 | 4.1 | 3.5 | 3.0 | 3.1 |
| Current saving | 6.2 | 4.8 | 3.3 | 2.4 | 1.8 | 3.1 | 6.6 |
| Primary balance^g | 4.8 | 3.6 | 2.0 | -0.4 | -0.7 | 2.0 | 4.9 |
| Surplus or deficit | 0.5 | -0.7 | -2.0 | -4.8 | -4.9 | -3.2 | 0.5 |
| Memorandum item | | | | | | | |
| Current GDP (US\$ million) | 11,620.5 | 11,870.5 | 12,272.4 | 12,933.2 | 14,179.3 | 15,483.3 | 17,097.1 |
| Total public debt (US\$ millions) | 7,732.1 | 8,400.8 | 8,521.2 | 8,661.6 | 9,976.8 | 10,231.3 | 10,453.0 |
| Total public debt/GDP | 66.5 | 71.2 | 69.4 | 67.0 | 70.4 | 66.1 | 61.1 |

Table I.3 (cont'd)

¹³ IMF (2005).

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ^a |
|--|------|------|------|------|------|------|-------------------|
| Consolidated domestic public debt/GDP ^b | 11.5 | 11.7 | 12.1 | 12.7 | 15.1 | 13.2 | 12.2 |
| External public debt/total exports | 59.6 | 66.8 | 74.7 | 85.9 | 81.5 | 73.5 | .. |

.. Not available.

a Preliminary data.

b Panama Canal Authority.

c Cumulative ITBMS tariff duties, levied on imports of goods and services.

d Consolidated agencies: BDA, IMA, BHN, University of Panama and IFARHU.

e Public enterprises: ETESA, IPAT, AITSA, AMP, AAC, IDAAN and ZLC.

f Remainder of NFPS decentralized agencies; includes the balance of the ACP as reported in the 2000-2002 accounts.

g Total revenue less current and capital expenditure (excluding interest payments).

h Pursuant to IMF recommendation, the consolidated domestic public debt is measured as domestic debt minus the debt of the CSS.

Source: Prepared by the WTO Secretariat on the basis of data from the Office of the Comptroller General and MEF.

15. The tax reforms of 2002 and 2005 increased the relative importance of a number of taxes in total central government revenue. The transfers made by the ACP (22 per cent), and the collection of tariff duties and ITBMS¹⁴ on imports (14 per cent) continued to account for significant proportions of the total central government income in 2006.

16. It should also be noted that according to an IMF study, the FTA between Panama and the United States (see chapter II(4)(ii)) has the potential to reduce the revenue collected on imports (excluding the effects of potential trade deviation) by one fifth, which would be equivalent to a 0.6 per cent reduction in GDP per year.¹⁵

17. Total public debt grew considerably between 2000 and 2004, reflecting the public sector's additional funding needs and the rise in international interest rates. Nonetheless, total public debt decreased from 66.5 of GDP per cent in 2000 to 61.1 per cent of GDP in 2006, partly because of an improvement in the external debt profile obtained through the refinancing operation put into effect in late 2005. External debt accounted for 75 per cent of total public debt in December 2006. Panama has a Stabilization Fund consisting of the proceeds of privatizations, which is worth approximately 7 per cent of GDP and is largely invested in Panamanian public debt bonds. In addition, thanks to export growth, the ratio of external public debt to exports declined substantially in 2003-2006 (Table I.3).

(iii) Monetary policy

18. Panama has no monetary policy instruments. It has no central bank or other institution that performs the functions of currency issuance, credit regulation, administration of bank reserves, or lender of last resort.¹⁶ The banking system is supervised by the Banking Supervisory Authority (see chapter IV(5)(iii)).

19. The United States dollar was adopted as currency of legal tender in Panama, on an equal footing with the national currency, by the Monetary Convention of 1904.¹⁷ The nominal exchange rate is still 1:1 between the United States dollar and the national currency (balboa), which is hardly used at all as current money. The money supply and local interest rates are determined by the bank market, in response to supply and demand and international interest rates. There are no legal reserve

¹⁴ ITBMS: Goods and Services Transfer Tax (a value added tax).

¹⁵ IMF (2005).

¹⁶ The State-owned *Banco Nacional de Panamá*, serves as the depository of the Government's financial resources.

¹⁷ Ministry of the Economy and Finance (2000).

ratios on deposits or any restrictions on fund movements to or from the banking system. Nor, in practice, does there appear to be any restriction on the establishment of foreign banks in Panama (see chapter IV(5)(iii)).

20. Deposit interest rates are similar to those prevailing on the international market, particularly the LIBOR in US dollars. Until late 2004, the spread between local and international interest rates was explained by country risk, which pushed Panamanian rates higher (Table I.4). Nonetheless, since mid-2004, when international rates reversed their downward trend and began to rise, local rates have stayed below the LIBOR, which is indicative of an excess supply of funds on the local market.

Table I.4
Main monetary indicators, 2000-2006
(Percentages)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 ^(a) | 2006 ^a |
|---|------|------|------|------|------|---------------------|-------------------|
| Monetary aggregates | | | | | | | |
| Total deposits (% of GDP) | 77.0 | 83.0 | 80.5 | 79.7 | 78.4 | 77.6 | .. |
| Total deposits (12-month rate of variation) | 8.9 | 9.5 | 0.9 | 4.6 | 8.6 | 7.2 | .. |
| Credit to the private sector (% of GDP) | 93.4 | 99.4 | 88.7 | 85.9 | 86.3 | 90.6 | .. |
| Nominal interest rates | | | | | | | |
| Interest rate on deposits (Panamanian banks) ^b | 7.1 | 6.8 | 5.0 | 4.0 | 2.2 | 2.7 | 4.5 |
| Interest rate on deposits (foreign banks) ^b | 5.8 | 4.2 | 2.6 | 2.3 | 1.9 | 2.7 | 4.3 |
| Interest rate on loans (Panamanian banks) ^c | 10.3 | 10.6 | 9.2 | 8.9 | 8.2 | 8.3 | 8.1 |
| Interest rate on loans (foreign banks) ^c | 9.5 | 9.5 | 7.4 | 6.1 | 6.1 | 6.6 | 7.5 |
| Inflation | | | | | | | |
| Consumer price index (CPI-end period) ^d | 0.7 | 0.3 | 1.9 | 1.5 | 2.0 | 3.5 | 2.3 |
| Wholesale price index (end period) | 8.8 | -3.2 | -3.0 | 1.6 | 4.4 | 5.7 | 6.1 |
| Exchange rate | | | | | | | |
| Nominal exchange rate | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |

.. Not available.

a Preliminary figures.

b Six-month deposits.

c One-year loans for commercial activities.

d As from 2004, the figures belong to a new series based on October 2002.

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

21. In early 2000, foreign banks established in Panama were offering interest rates on deposits and loans that were lower than those offered by Panamanian banks, as a result of the foreign banks' greater efficiency and better access to international markets.¹⁸ This differential narrowed in 2000-2006, as the absolute level of interest rates also fell. On the other hand, the bank spread¹⁹ has increased during this period, although the figures reported in Panama reflect the average of interest rates charged on current loans and not the rates on new loans (see chapter IV(5)(iii)).

22. In 2005, given the rising international oil price and problems with the supply of food products, inflation reached a 15-year peak, with a CPI of 3.5 per cent (Table I.4). Thereafter it dropped to 2.3 per cent in 2006, among other reasons because of the regularization of food supply following the opening of new tariff quotas (see chapter IV(2)).²⁰ Nonetheless, the CPI rose again in the first four months of 2007.

¹⁸ Moreno-Villalaz (1999) and Goldfajn F. (2001).

¹⁹ Difference between the interest rate paid on deposits and that charged on loans.

²⁰ Ministry of the Economy and Finance (2006).

23. Three factors explain the low inflation traditionally recorded in Panama: (i) the money supply equilibrium resulting from the dollarization regime²¹; (ii) the stability of real wages associated with the substantial labour surplus that exists because of the high level of unemployment (21 per cent) and a low activity rate among the population (63 per cent in 2006)²²; (iii) the relative stability of international prices, which is mostly passed through to Panamanian prices thanks to the major role of imports in domestic supply.

24. The consumer price index in Panama has been below the equivalent index for the United States (CPI) throughout the 2000-2006 period, except in 2005, which would suggest a slight but continuous devaluation of the real exchange rate (US\$/B).

(iv) Balance of payments

25. Panama usually records a current account deficit on the balance of payments, and the gap widens in years of rapid economic growth, when goods imports tend to grow faster than exports, pushing the deficit higher. During strong growth years, this effect is intensified by an increase in profit remittances from foreign trade enterprises operating in the Colon Free Zone (ZLC). In 2004, the current account deficit amounted to 7.5 per cent of GDP, but it fell back to 2.2 per cent in 2006 (Table I.5).

26. During the period 2000-2006, the current account deficit has largely been financed by foreign direct investment flows. Moreover current account imbalances are "automatically" adjusted by financial flows, given certain characteristics of the Panamanian economy such as dollarization, the absence of controls on capital movements, and financial integration.²³

27. The merchandise trade balance has also traditionally been in deficit, partly because of the small scale of Panamanian industry and its heavy reliance on imported inputs. Other factors that stimulated the growth of merchandise imports were the rise in international oil prices and the expansion of shopping centres in Panama City, which boosted consumer goods imports. The ZLC made positive contributions to the merchandise trade balance in 2000-2006. In contrast, the balance of trade in services is traditionally in surplus, largely as a result of the services provided by the canal and tourism (see below).

Table I.5
Balance of payments, 2000-2006.
(US\$ million).

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ^a |
|---------------------------|---------------|---------------|--------------|---------------|-----------------|---------------|-------------------|
| I. Current account | -672.5 | -170.3 | -95.5 | -570.3 | -1,061.5 | -781.6 | -378.2 |
| A. Trade balance | -289.3 | 193.7 | -67.0 | -4.6 | -259.9 | 99.3 | 408.8 |
| Exports | 7,832.9 | 7,985.2 | 7,592.6 | 7,581.5 | 8,816.9 | 10,735.6 | 12,412.7 |
| Goods (f.o.b.) | 5,838.5 | 5,992.4 | 5,314.7 | 5,071.9 | 6,078.3 | 7,591.2 | 8,508.8 |
| Colon Free Zone | 4,791.1 | 4,913.6 | 4,344.6 | 4,080.4 | 4,997.3 | 5,904.8 | .. |
| Other sectors | 1,047.4 | 1,078.8 | 970.1 | 991.5 | 1,081.0 | 1,686.4 | .. |
| Services | 1,994.4 | 1,992.8 | 2,277.9 | 2,509.6 | 2,738.6 | 3,144.4 | 3,903.9 |
| Imports | 8,122.2 | 7,791.5 | 7,659.6 | 7,586.1 | 9,076.8 | 10,636.3 | 12,003.9 |
| Goods (f.o.b.) | 6,981.4 | 6,688.6 | 6,349.8 | 6,274.2 | 7,616.6 | 8,907.2 | 10,309.9 |

Table I.5 (cont'd)

²¹ Chapman, G. (1999).

²² The activity rate is defined as the economically active population as a percentage of the total population of working age (15 or older). Consulted at <http://www.contraloria.gob.pa/dec/>.

²³ Moreno-Villalaz (1999) and Chapman, G. (1999).

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 ^a |
|--|---------------|----------------|---------------|---------------|-----------------|-----------------|-------------------|
| Colon Free Zone | 4,194.4 | 4,296.4 | 3,928.7 | 3,757.4 | 4,889.8 | 5,315.2 | .. |
| Other sectors | 2,787.0 | 2,392.2 | 2,422.0 | 2,516.8 | 2,726.8 | 3,592.0 | .. |
| Services | 1,140.8 | 1,102.9 | 1,309.8 | 1,311.9 | 1,460.2 | 1,729.1 | 1,694.0 |
| Balance of merchandise trade | -1,142.9 | -696.2 | -1,035.1 | -1,202.3 | -1,538.3 | -1,316.0 | -1,801.1 |
| Balance of trade in services | 853.6 | 889.9 | 968.1 | 1,197.7 | 1,278.4 | 1,415.3 | 2,209.9 |
| B. Net income | -560.2 | -590.1 | -272.3 | -821.3 | -1,021.2 | -1,124.3 | -1,044.9 |
| Colon Free Zone | -151.6 | -175.4 | -110.3 | -128.8 | -203.9 | -375.8 | .. |
| External debt service | -370.1 | -425.4 | -437.1 | -468.2 | -490.7 | -566.8 | .. |
| Other | -91.8 | -1.6 | 275.1 | -144.9 | -326.6 | -181.7 | .. |
| C. Unilateral transfers | 177.0 | 226.1 | 243.8 | 246.4 | 219.6 | 243.4 | 257.9 |
| II. Capital and financial account | -9.7 | 1,280.4 | 194.3 | -13.5 | 391.2 | 1,804.3 | 718.6 |
| A. Capital account | 1.7 | 1.6 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| B. Financial account | -11.4 | 1,278.8 | 194.3 | -13.5 | 391.2 | 1,804.3 | 718.6 |
| Direct investment | 603.4 | 404.6 | 98.6 | 770.8 | 1,003.9 | 1,027.0 | 2,560.0 |
| Portfolio investment | -187.0 | -20.6 | 90.3 | 109.0 | 167.2 | -706.5 | -441.4 |
| Other investments | -427.8 | 894.8 | 5.4 | -893.3 | -779.9 | 1,483.8 | 668.9 |
| III. Errors and omissions | 397.5 | -462.9 | 47.2 | 249.1 | 274.9 | -347.9 | -79.3 |
| IV. Financing | -327.7 | 644.0 | 146.0 | -267.1 | -395.4 | 674.8 | 261.1 |
| Variation in international reserves | -109.2 | 633.3 | 137.9 | -266.6 | -396.3 | 521.3 | 166.1 |
| Other financing | -218.5 | 10.7 | 8.1 | -0.5 | 0.9 | 153.5 | 9.5 |
| Memorandum item | | | | | | | |
| Current account/GDP (%) | -5.8 | -1.4 | -0.8 | -4.4 | -7.5 | -5.1 | -2.2 |

.. Not available.

a Preliminary figures.

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

28. The net income account was in deficit in 2000-2006. Remittances of profits and dividends abroad (mainly by firms based in the ZLC) have increased. Interest payments on the external debt have continued to be the main cause of the deficit on this account (50 per cent of the total in 2005). Unilateral transfers were always positive during the period.

29. Except for 2000 and 2003, the capital and financial accounts were in surplus every year between 2000 and 2006. In the case of Panama, variations in international reserves represent changes in the external asset position of *Banco Nacional de Panamá*.

(3) TRADE AND INVESTMENT FLOWS

(i) Trend of merchandise trade

30. The composition and direction of Panama's merchandise trade are shown in Tables AI.1 to AI.4, although the figures exclude the vast majority of ZLC operations, which account for roughly three quarters of the value of Panama's total goods trade (imports and exports). The tables and analysis presented in this section therefore do not include imports from other countries to the ZLC, or exports or re-exports from the ZLC to other countries. Nonetheless, Table AI.3 includes sales (exports) made from Panamanian customs territory to the ZLC and other Panamanian duty free zones, while Table AI.4 shows purchases (imports) made from that territory to all Panamanian duty free zones.

31. The value of merchandise imports grew at an annual average rate of 4.2 per cent between 2000 and 2005, while exports growth averaged 4.5 per cent per year, both series fluctuating slightly during the 2001-2002 biennium. In 2005, imports and exports amounted to US\$4.155 billion and US\$964 million, respectively.

(a) Composition of merchandise trade

32. Panama mainly exports food products, such as various fruits (mainly fresh melon, watermelon and papaya); fresh, frozen, dried or filleted fish; bananas; and frozen crustaceans. In 2000-2005, the share of the various fruits grew more than sevenfold, the share of different types of fish doubled, while that of bananas fell by half (Table AI.1). Fuel exports virtually disappeared following the closure of the country's single oil refinery in late 2002. The share of manufactured goods in total exports, on the other hand, has fallen considerably: after reaching a peak of nearly 18 per cent in 2001, they slumped to 9.1 per cent of total exports in 2005. The drop affected exports of chemicals and semi-manufactured products, such as leather goods and wood pulp articles, in particular.

33. With regard to Panama's imports, the share of manufactures remained stable at around 68 per cent during 2000-2005 (Table AI.2). The main categories of imported manufactures are chemical products (medicines), telecommunications equipment and motor vehicles. The share of agricultural imports remained broadly stable in 2000-2005, representing 13 per cent of imports in 2005. Fuel accounted for 17.9 per cent of total imports in 2005.

(b) Direction of merchandise trade

34. Although its share of Panama's imports has declined significantly, especially since 2003, the United States remains the leading source of the country's imports, accounting for 27.5 per cent of the total (Table AI.3). The next most important import sources are the Netherlands Antilles, the European Union and Costa Rica.²⁴ China and Brazil have also seen their shares increase considerably since 2001.

35. The United States is also the main destination for Panamanian exports, absorbing 45 per cent of the total in 2005 (Table A.I.4). The European Union's share has grown significantly since 2001, rising to 28.2 per cent in 2005. In contrast, exports to Latin American countries have declined, particularly since 2003, but continue to represent a significant 19.3 per cent of the total. It should be noted that re-exports from the ZLC are mostly sent to Latin American countries.²⁵

(ii) Trade in services

36. Panama's trade in services is traditionally in surplus. Service exports represent roughly 29 per cent of Panamanian GDP and 81 per cent of net exports of goods and services (Table I.6). In 2006, transport and storage services (including those provided by the ACP and by firms from the ZLC) accounted for just over half of all service exports. Exports of tourism services (24.6 per cent), financial services (6.8 per cent), and other business services (6.7 per cent) were also important.

²⁴ Since 2004, Panama has imported a large proportion of its consumption of fuels and other petroleum products from the Netherlands Antilles.

²⁵ See: <http://www.zonalibredecolon.com.pa/main.htm>.

Table I.6
Trade in services, 2000-2006
(US\$ million)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 ^a | 2006 ^a |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------|----------------------|
| Balance of trade in services | 853.6 | 889.9 | 968.1 | 1,197.7 | 1,278.4 | 1,415.3 | 2,209.9 |
| Services imports | -1,140.8 | -1,102.9 | -1,309.8 | -1,311.9 | -1,460.2 | -1,729.1 | -1,694.0 |
| Services exports | 1,994.4 | 1,992.8 | 2,277.9 | 2,509.6 | 2,738.6 | 3,144.4 | 3,903.9 |
| Panama Canal Authority | 756.7 | 739.1 | 806.1 | 930.9 | 1,054.9 | 1,234.1 | .. |
| Colon Free Zone | 55.0 | 44.9 | 71.0 | 47.1 | 61.6 | 79.2 | .. |
| Other transport services and storage | 340.9 | 347.3 | 332.4 | 375.6 | 402.1 | 462.3 | 2,210.7 ^b |
| Tourism services | 457.8 | 477.1 | 513.0 | 584.6 | 651.0 | 779.8 | 960.0 |
| Financial services | 140.5 | 126.6 | 271.0 | 292.8 | 240.0 | 197.4 | 267.4 |
| Insurance services | 38.8 | 31.4 | 26.6 | 27.6 | 32.6 | 34.0 | 34.7 |
| Communications and construction services | 33.7 | 43.9 | 37.3 | 46.6 | 53.6 | 65.5 | 104.5 |
| Information technology services | 0.0 | 0.0 | 0.0 | 0.0 | 14.4 | 17.9 | 21.1 |
| Other business services | 138.0 | 148.0 | 183.9 | 167.8 | 193.0 | 236.0 | 262.6 |
| Government services | 33.0 | 34.5 | 36.6 | 36.6 | 35.4 | 38.2 | 42.9 |

.. Not available.

a Preliminary figures.

b Includes services provided by the ACP and by firms from the ZLC.

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

(iii) Foreign investment

37. The net flow of foreign direct investment (FDI) quadrupled between 2000 and 2006, reaching a level of US\$2.56 billion in 2006.

38. FDI flows in Panama grew significantly in the late 1990s with the privatization of firms in the electric power and telecommunications sectors. Then, between 2000 and 2002, they faltered sharply as a result of weak economic growth and low levels of profitability in the banking sector. Since then, net FDI flows have again expanded rapidly (Table I.7).

Table I.7
Flows of foreign direct investment by sector, 2000-2006
(US\$ million)

| | 2000 | 2001 | 2002 | 2003 | 2004 ^a | 2005 ^a | 2006 ^a |
|--|--------------|--------------|-------------|--------------|-------------------|-------------------|-------------------|
| Banking sector | 154.5 | -81.7 | -187.3 | 350.6 | 405.7 | 280.3 | 1,636.1 |
| Firms in the Colon Free Zone | -38.5 | 26.6 | 7.2 | 78.7 | 190.8 | 440.9 | 383.9 |
| Transport, storage and communications sector (excluding ZLC) | 173.4 | 68.8 | 43.3 | 114.7 | 271.3 | .. | .. |
| Wholesale and retail trade | 95.4 | 78.2 | 152.5 | 56.6 | 78.0 | .. | .. |
| Other sectors | 239.1 | 375.2 | 82.9 | 216.9 | 58.1 | 305.8 | 540.0 |
| Total | 623.9 | 467.1 | 98.6 | 817.5 | 1,003.9 | 1,027.0 | 2,560.0 |

a Preliminary figures.

Source: Statistics and Census Department, Office of the Comptroller General of the Republic.

39. The relative shares of FDI received by the different sectors began to change in 2003 as the new economic growth cycle took hold. In recent years, FDI has been undertaken particularly by ZLC user enterprises, by other enterprises in the transport and storage sector and by call centre service providers. Increasing amounts of FDI have flowed into the banking sector in response to the granting of new licences and the acquisition of national banks by foreign groups (e.g. the purchase of Banistmo by HSBC for US\$770 million in 2006). It is also worth mentioning the significant foreign share in new real estate projects since 2005.

(4) PROSPECTS

40. The 2006 Annual Economic Report published by the MEF projected real GDP growth of 8.0 per cent per year in 2007-2009, based mainly on mega-scale construction projects, in particular a third set of locks in the Canal (see chapter IV(5)(v)). The current account deficit is also projected to widen substantially, reflecting the imported inputs needed for those constructions. The same report anticipates a favourable international climate for Panamanian exports and traffic through the Canal, as well as stabilization of the oil price, which would allow domestic expenditure to grow without generating inflationary pressures. In a document entitled *Visión Estratégica para el Desarrollo Económico y de Empleo hacia el 2009*, published in 2005, the Government proposes a central government fiscal surplus of 1 per cent of GDP and stabilization of the total public debt/GDP ratio at 60 per cent, as targets for 2009.²⁶

²⁶ See: <http://www.mef.gob.pa/>.