



PANAMA

SELECTED ISSUES

March 2023

This paper on Panama was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on February 8, 2023

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Price: \$18.00 per printed copy

**International Monetary Fund
Washington, D.C.**



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February 8, 2023

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CONTENTS

Acronyms	3
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TOWARD A MODERN TAX SYSTEM 4

A. Introduction	4
B. Growth and Tax Revenues	4
C. Consumption Taxes	8
D. Taxation of Labor Income	13
E. Business Taxation	15
F. Concluding Remarks and Policy Implications	19

FIGURES

1. Growth and Revenue Performance	5
2. International Tax Comparison	7
3. ITBMS C-Efficiency	9
4. Excise Revenue and Comparison	12
5. Taxation of Labor and Informality	14

TABLES

1. Panama, Latin and Central America, and OECD: Revenues in 2019	6
2. Latin and Central American Countries: VAT Indicators	8
3. Who Benefits From VAT Reduced Rates and Exemptions?	9
4. Benefits From ITBMS on Selected Goods	10
5. Taxes on Business—Revenue and Tax Expenditures	17

References	22
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PANAMA'S GROWTH STORY	23
A. Introduction and Background	23
B. Regional Perspective and Cross-Country Context	27
C. Growth Decomposition	28
D. Drivers of Growth Over Time	34
E. Conclusion	38
BOX	
1. Neoclassical Growth Accounting	33
References	39
MEASURING RESERVES AND ASSESSING RESERVES ADEQUACY	40
A. Introduction	40
B. Experiences from Other Countries	43
C. A Stylized Central Bank Balance Sheet	45
D. Liquidity in Panama's Banking Sector	48
E. Measuring Panama's International Reserves Adequacy	49
F. Indicator for Government Liquidity	50
G. Conclusion and Policy Implications	53
FIGURE	
1. Statutory Liquidity Reserves	49
TABLES	
1. A Central Bank's Balance Sheet	46
2. Banking Sector's Balance Sheet	47
3. Central Government Deposits in Months of Government Expenditures	51
4. Selected Fiscal Reserves Indicators	51
BOX	
1. How Does the ARA EM Metric Work?	42
ANNEXES	
I. Main Characteristics of the Countries with Foreign Legal Tender	54
II. Relationship Between International Reserves, Central Government Deposits and Banks' Liquidity Reserves	55
References	56

Acronyms

B2C	Business to Consumer
BEPS	Base Erosion and Profit Shifting
CAIR	Alternative Calculation of Income tax (Cálculo alternativo del impuesto sobre la renta)
CFC	Control Foreign Company
CIT	Corporate Income Tax
DGI	Revenue Directorate General
EMMA	Multinational Enterprises Providing Services Incentive Related to Manufacturing (Empresas Multinacionales para la prestación de servicios relacionados con la manufactura)
ESL	Education Security Levy
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GloBE	Global Anti-Base Erosion
IBFD	International Bureau of Fiscal Documentation
IIR	Income Inclusion Rule
ITBMS	Tax on Transfer of Tangible, Mobile Goods and Service Rendering
LAC	Latin and Central American countries
LVIGs	Low Value Imported Goods
MNCs	Multinational Companies
OECD	Organization for Economic Cooperation and Development
PIT	Personal Income Tax
QDMTT	Qualified Domestic Minimum Tax
SEM	Multinational Regional Headquarters Incentive
SSC	Social security contribution(s)
STTR	Subject to Tax Rule
VAT	Value-Added Tax
WEO	World Economic Outlook
WoRLD	IMF Internal World Revenue Longitudinal Database

TOWARD A MODERN TAX SYSTEM

A. Introduction

1. **Panama's tax collection has been historically low, reflecting the authorities' overarching strategy to promote an investment-friendly environment with low taxation.** The level of revenue is a result of relatively low tax rates, as well as ample use of base-eroding policy measures, such as tax incentives and exemptions across all taxes, that also affect fairness and efficiency. Although low taxation could help the country achieve the policy objective of attracting investments, it leads to chronic fiscal deficits (Figure 1.1) and limits fiscal space for social inclusion policies. Even if national preferences and public choice in Panama are in favor of a small government and public sector, there is ample space to modernize the Panamanian tax regime by increasing its progressivity and transparency, reducing distortions, and aligning it with international best practices through revenue neutral reforms. This paper presents the main features and weaknesses of the current Panamanian tax system and provides an international comparison of its performance.
2. **This paper is structured as follows.** Section II describes the performance of the Panamanian tax system in international comparison. Sections III to V analyze the different taxes in Panama and Section VI summarizes and concludes.

B. Growth and Tax Revenues

3. **Panama's macroeconomic performance has been notably robust** (Figure 1.2). A significant increase in investment led to a rapid accumulation of capital that boosted economic growth to impressive and comparatively high levels. Over the last three decades real Gross Domestic Product (GDP) multiplied fivefold (Figure 1.3). Foreign and domestic investments have been supported by several factors: Panama's geographic location, trade openness, world-class ports, airport, and logistics operations, financial system depth, and the doubling of the Canal's capacity to accommodate much wider ships.¹ The country's policy to attract investment was also reflected in historically low tax collections.
4. **Government revenues have fallen during the period following the Global Financial Crisis (GFC), reflecting cyclical and structural forces (Figure 1.5).** Tax and non-tax receipts contribute equally to Panama's central government revenues, both accounting for about 10 percent of GDP. Non-tax collections include social security contributions (SSC) (about 6.0 percent of GDP) and contributions from the Panama Canal Authority (about 3.5 percent of GDP). These receipts fell steadily until 2016 despite the expansion of the canal, due to the slowdown in global trade (Figure 1.4); and revenue from most taxes also declined (Figure 1.6). After the GFC, tax buoyancy—a measure of responsiveness of revenue mobilization to economic activity—has on average remained below unity, as tax collection has failed to keep-up with growth (Figure 1.7)²

¹ <https://www.imf.org/en/News/Articles/2021/11/17/na111821-panamas-story-of-convergence>.

² The only exception was 2012 due to a tax reform that, among other measures, increased the rate of some excises and the ITBMS (the Panamanian VAT) rate by 2 percentage points.