AN OVERVIEW OF THE REPUBLIC OF PANAMA'S WORLD TRADE ORGANIZATION COMMITMENTS

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I. Introduction

The Republic of Panama's business climate is improving considerably after several years of stagnant growth resulting from the departure of the U.S. military establishment and the Asian and South American economic crises. The Panamanian economy rebounded in 2003 to expand by 4.1% (GDP) and continues to maintain the highest per capita GDP in the region at US$3,906.00.[1] The Panama Canal accounts for approximately 7% of Panama's GDP, with traffic volume growing significantly along the U.S. East Coast-to-Asia trade route (U.S.-China).[2] The calendar year 2004 expiration of the World Trade Organization (WTO) Agreement on Textiles and Clothing will further increase port traffic as China increases its share of the global textile market. In order to accommodate the expanding volume of trade and larger modern container vessels, the Panama Canal is expected to undergo major renovations and additions within the next ten years.

Panama's greatest economic distinction is the dominant role of services in its overall economy. Services account for 77% of Panama's GDP, primarily consisting of transportation, maritime, tourism, insurance, and banking services associated with the Panama Canal and the Colon Free Zone (CFZ), the second largest free trade zone in the world.[3] Panama's large and growing services sector also includes telecommunications, energy, construction and engineering services. Major areas of projected growth include tourism (hotel and restaurant), maritime, construction and telecommunications services.

While traditional agricultural goods play a small overall role in Panama's economy (roughly 7% of GDP), domestic demand for non-traditional agricultural imports such as snacks, processed fruits, and alcoholic beverages is expected to grow in the coming years. Panama's high per capita income continues to favor high value-added consumer goods and services.

In order to take advantage of Panama's growing and distinctive services-based economy, U.S. investors and exporters need a basic understanding of Panama's international trade commitments and obligations. Under the terms of its Protocol of Accession to the WTO, Panama is obligated to provide non-discriminatory market access to other WTO Members. In some areas Panama is not obligated to provide open market access and is allowed to retain certain barriers to trade and investment. U.S. businesses must have a grasp of the parameters of Panama's WTO membership in order to negotiate and obtain favorable investment and trade terms.

II. World Trade Organization & Free Trade Agreements

The WTO is an international organization established in 1995 to

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[1] United Nations Commission on Latin America and the Caribbean, *Preliminary Overview of the Economies of Latin America and the Caribbean*, 2003, at pp.140-158.

[2] Congressional Research Service, CRS Report for Congress, RL32540, *The Proposed U.S.-Panama Free Trade Agreement*, at CRS 3-4, August 23, 2004. *See also* Robert Wright, U.S. east coast gears up for a big increase in cargo capacity, *Financial Times*, December 15, 2004.

[3] Note 1, *supra* at pp.143-44.

govern and regulate international trade.[4] The WTO currently consists of 148 Members with the primary goal of facilitating world trade by minimizing tariff and non-tariff barriers. The heart of the WTO is the substantive agreements negotiated and signed by the bulk of the world's trading nations.[5] Each of these agreements delineates within their substantive areas the parameters of non-discriminatory market access required of WTO Members. In general terms, WTO non-discriminatory practices require Members to exercise "national treatment" (treat imports no less favorably than you would treat domestic like products) and "most favored nation treatment" (treat imports no less favorably than you would treat imports from other WTO Members) with respect to imports.

The Republic of Panama acceded to the WTO on September 6, 1997.[6] Panama is considered a developing country and therefore is entitled to certain "special and differential" treatment within the WTO.[7] The United States designated Panama a beneficiary developing country for purposes of the Generalized System of Preferences (GSP) and the Caribbean Basin Economic Recovery Act (Caribbean Basin Initiative or CBI), both of which grant Panama preferential access to the United States market.[8]

In addition to its WTO membership, Panama is a party to several bilateral Free Trade Agreements (FTAs) that further liberalize its market access commitments and obligations beyond the parameters of the WTO.[9] Panama currently has FTAs with El Salvador and Taiwan and preferential trade agreements (more limited in scope than FTAs) with Costa Rica, Honduras, Guatemala, Nicaragua, Dominican Republic, Mexico, and Colombia.

Panama and the United States are in the late stages of negotiating their own bilateral FTA. The proposed U.S./Panama FTA will not only secure permanent preferential market access for Panama, but will achieve significant reciprocal market access for the United States. Tariffs on many industrial and agricultural goods would immediately be reduced to zero. Tariffs and tariff rate quotas on sensitive products such as sugar, rice, dairy, pork, and beef would phase out over a number of years.

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[4] Prior to 1994, global trade was regulated through a loose series of agreements known collectively as the General Agreement on Tariffs and Trade (GATT), which are now incorporated into the WTO.

[5] WTO trade agreements exist in the following substantive areas, *inter alia*: Agriculture, Services, Textiles and Clothing, Rules of Origin, Subsidies and Countervailing Measures, Safeguards, Intellectual Property Rights, and Government Procurement.

[6] Accession of the Republic of Panama, WT/ACC/PAN/21.

[7] Exactly what constitutes "special and differential treatment" is unclear and subject to ongoing negotiations by WTO Members in the Doha Round of trade negotiations. *See* Doha Work Programme, WT/L/529.

[8] In many instances, Panama's goods are entitled to tariff free treatment upon entry to the United States. Imports receiving duty free treatment include fish, seafood, precious metals, coffee, and electrical machinery. *See* 19 U.S.C. 2461, *et seq.*, as amended (GSP) & 19 U.S.C. 2702, *et seq.*, as amended (CBI).

[9] Pursuant to the terms of the WTO, FTAs are only permissible if they liberalize market access beyond WTO commitments in "substantially all" areas of trade. *See* General Agreement on Tariffs and Trade, Art. XXIV. This requirement is subject to varying interpretations and has not been definitively ruled upon by the WTO dispute settlement body or the General Council.

Trade in services under the FTA would extend beyond Panama's WTO commitments in many important sectors, including telecommunications, maritime, financial services, insurance, banking, and other categories of professional services. U.S. lawyers will be allowed to practice in Panama with respect to issues involving U.S. or international law. Other professional service providers will be allowed to participate in the Panamanian market through temporary licensing.

Perhaps most importantly, the proposed U.S./Panama FTA would include a government procurement agreement. As discussed in section III (D), *infra*, government procurement with respect to the Panama Canal Authority, a semi-autonomous and independent entity under Panamanian law, could be profitable for U.S. businesses if and when the Panama Canal undergoes renovations.

There is a strong possibility that the U.S./Panama FTA will be concluded during the next round of negotiations scheduled to begin in Washington, DC on January 10, 2005. Please note that conclusion of the agreement under Trade Promotion Authority (TPA or Fast Track) does not necessarily mean that the agreement will become law in the U.S. As the ongoing acrimonious debate over the Central American Free Trade Agreement (CAFTA) illustrates, free trade agreements concluded under TPA must be approved by Congress and thus are ultimately subject to the political process.

III. Panama's Substantive WTO Commitments

(A) General Agreement on Trade in Services (GATS)

Many consider the GATS to be the greatest triumph of the Uruguay Round of negotiations leading to the creation of the WTO. As subsequent rounds of WTO and FTA negotiations have minimized and eliminated tariffs and quotas on many goods, traditional goods-based economies are evolving towards services-based economies. Technological advances allowing service providers to access and serve clients across the globe have drastically altered the services marketplace. Services and service providers now account for roughly 80% of U.S. employment and 64% of U.S. GDP.[10] According to a University of Michigan study, a one-third decrease in global barriers to trade in services would increase annual U.S. income by $150 billion.[11] The importance of trade in services to the U.S. cannot be understated and Panama represents an important emerging market for U.S. services providers.

Services represent by far the largest portion of Panama's economy, accounting for over three-quarters of yearly GDP. Panama's major services centers include the Panama Canal, CFZ, Export Processing Zones (EPZs), and Petroleum Processing Zones (PPZs). As noted in the Introduction, Panama's major services sectors include transportation, maritime, tourism, insurance, energy, banking, construction, engineering, and professional services.

Like all WTO Members, Panama's WTO services commitments are

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[10] USTR Press Release, U.S. Services Offers in WTO Trade Talks, March 31, 2003.
[11] *Id.*

contained in its Schedule of Specific Commitments on Services.[12] Unlike trade in goods, which is governed by scheduled tariffs and quotas, there are no border tariffs on services. Trade in services is governed by sector and mode of supply commitments. WTO Members voluntarily commit to open their domestic markets to foreign service providers (i.e., market access and national treatment obligations) in certain scheduled sectors and modes of supply.[13] WTO Members are allowed to maintain discriminatory market access exceptions but they must be specified in the Members' schedule.[14]

Because trade in services does not involve border tariffs, foreign businesses are more likely to experience discriminatory domestic regulations and other non-tariff barriers limiting their ability to successfully operate in the foreign market. Accordingly, service providers must fully understand the nature and extent of service commitments prior to engaging in negotiations and investment in a foreign market.

Panama is generally regarded as having an "open" services sector, with limited domestic regulations forming barriers to entry. However, a review of Panama's WTO services schedule illustrates that it is closed in many competitive areas where foreign competitors might flourish.

One of the areas consistently mentioned as ripe for growth in Panama is construction and related engineering services. A review of Panama's WTO services schedule shows that Panama has assumed no market access and national treatment obligations regarding the cross-border supply of general construction work for buildings (i.e., supply of construction services for buildings by a foreign service provider). This sub-sector is listed as "unbound" in Panama's schedule, which means that Panama is free to impose limitations on both market access and national treatment. In other words, Panama assumed no obligation to provide foreign construction providers equal and fair access to its market and can favor local service providers without running afoul of the WTO. This information is obviously crucial to foreign investors seeking to provide construction services for buildings in Panama.

Another area of perceived growth in Panama is tourism and related services. A review of Panama's WTO schedule in this area shows some liberalization, albeit in a small sub-sector. Panama allows free and open market access with no national treatment limitations for tour operator services designed to promote, organize, operate and sell tour packages to Panama individuals or groups. While this sub-sector represents a small niche

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12 WT/ACC/PAN/19/Add.2.

13 The GATS consists of 12 main services sectors, each of which are sub-divided into various sub-sectors. Examples of primary sectors include business services, communication services, construction and engineering services, environmental services, financial services, and tourism services. *See* MTN.GNS/W/120. Member commitments in each service sector are further delineated by one of four potential modes of supply of the service: (1) cross-border; (2) consumption abroad; (3) commercial presence; and (4) presence of natural persons. Members are free to limit or grant access by sector and mode of supply as they see fit.

14 These exemptions allow Members to provide preferential market access to certain countries that are identified in a List of Article II Most Favored Nation Exemptions.

service, it could prove important to U.S. businesses and localities seeking to establish an in-country presence to promote tourism. On the other hand, Panama assumes no obligations whatsoever with respect to convention services, a more lucrative area in which many U.S. cities and states have significant expertise.

WTO services commitments are complicated and can often lead to confusion and misinterpretation.[15] Accordingly, it is extremely important to consult someone with knowledge of Panama's WTO commitments prior to considering investment opportunities in your area of business expertise. Potential services providers should also remember that the ongoing U.S./Panama FTA negotiations will likely result in a substantial liberalization of Panama's services commitments, particularly in areas such as telecommunications, port and maritime, and professional services.

(B) General Agreement on Tariffs and Trade (GATT)

In contrast to services, Panama's economy does not support a large market for trade in goods. GATT governs market access issues related to trade in goods, including application of tariffs and non-tariff barriers (NTBs). GATT requires Members to provide non-discriminatory national and most favored nation treatment[16] to goods imported from other Members.

1. *Tariffs*

Prior to its 1997 accession to the WTO, Panama maintained average ceiling duty rates of approximately 60% on industrial products, 90% on agro-industrial products, and over 90% on certain sensitive products such as lentils, rice, pork, and beef. Following its WTO accession, Panama significantly lowered tariffs in all major areas to an overall average of 12%, among the lowest average tariffs in Latin America.[17] These "applied" tariff rates do not represent Panama's negotiated "bound" rates under the WTO agreement.[18] Under WTO rules, Panama is free to increase its "applied" tariff rates up to its "bound" tariff rates at will. In 1999 Panama increased agricultural tariffs on many sensitive goods up to the bound rates in order to appease local industry.

2. *Non-Tariff Barriers (NTBs)*

In addition to tariffs, Panama also maintains NTBs for certain agricultural products, including pork, beef, poultry, and rice. The primary NTBs are

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[15] In fact, a WTO dispute settlement panel recently ruled in the *U.S.-Internet Gambling* case that the U.S. committed itself to non-discriminatory market access to foreign gambling service providers despite the fact that the U.S. services schedule contains no explicit commitment in this sub-sector. The U.S. is appealing the decision on the grounds that the panel misinterpreted its services schedule. *See United States-Measures Affecting the Cross-border Supply of Gambling and Betting Services*, WT/DS285/R.

[16] *See* parenthetical explanation of national and most favored nation treatment, *supra* at Section II.

[17] Office of the United States Trade Representative (USTR), *2004 Panama National Trade Estimate*, at 367.

[18] These tariffs also do not account for other non-discriminatory internal charges and taxes. For example, most imports into Panama are subject to a 5% transfer tax levied on the CIF value. (exemptions exist for pharmaceuticals, foods, and school supplies).

phytosanitary import permits, which many exporters categorize as unfair and lacking transparency. Panama's alleged justification for the phytosanitary NTBs are health and safety concerns. NTBs in this area are governed by the WTO Agreement on Sanitary and Phytosanitary Measures ("SPS"), which allows SPS measures "necessary to protect human, animal or plant life or health, subject to the requirement that these measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Members . . . or a disguised restriction on trade."[19]

SPS measures effectively blocking imports are an increasingly common phenomenon, particularly in light of increased outbreaks of food-borne illness such as mad cow disease. As a result, SPS measures have increasingly been subject to WTO dispute settlement procedures, with importers alleging that the adopted measures are discriminatory and serve no reasonable health safety purpose. To date, none of the Panamanian SPS measures have been challenged in the WTO dispute settlement system, likely because of the small size of the Panamanian market.

(C) Agreement on Textiles and Clothing

Trade in textiles is governed by the WTO Agreement on Textiles and Clothing. As noted in the introduction, this agreement is set to expire at the end of 2004, with potentially massive negative consequences for textile producing nations in the Americas. Trade in textiles does not form a large part of the Panamanian economy so it will not be negatively affected. On the contrary, many predict that Panama will benefit from the expiration of the agreement through increased Panama Canal traffic created by growing textiles trade between China and the Americas. Both China and the U.S. have initiated internal mechanisms designed to prevent a massive disruptive shift in the textiles market as a result of the agreement's expiration, and the topic is currently being negotiated by textiles-dependent developing countries in the ongoing WTO Doha Round of negotiations.

(D) Agreement on Government Procurement

The WTO Agreement on Government Procurement is a non-mandatory "plurilateral" agreement governing procurement of government contracts. Panama is only an observer to the agreement, which means that it assumed no commitments to non-discriminatory access to government contracts. Panamanian domestic law generally requires transparency in the bidding process. Article 29 of the Panamanian Fiscal Code requires public tenders for state purchases above B$150,000.00. Invitations to bid, as well as the specifications of the concession, must be publicly announced. Despite the domestic law, many U.S. firms have raised concerns regarding transparency and fairness in both the bidding and appeal processes. Potential long-term government projects involving the Panama Canal and related facilities are could be extremely valuable and the U.S. is negotiating a government procurement agreement in the U.S./Panama FTA. Any government procurement agreement

[19] *See generally* WTO Agreement on the Application of Sanitary and Phytosanitary Measures

in the FTA would provide the U.S. preferential access to government contracts vis-à-vis other WTO Members because Panama is not a member of the WTO Agreement on Government Procurement.

(E) Trade Related Investment Measures (TRIMS)

The TRIMS agreement is generally regarded as one of the weakest of the WTO agreements. The agreement's lack of ambition is likely a result of the numerous Bilateral Investment Treaties (BITs) already existing between WTO Members. The U.S. and Panama entered into a BIT on October 27, 1982. The BIT guarantees national and most favored nation treatment for foreign investments and imposes investor/state dispute settlement with international arbitrators.[20]

In addition to the non-discriminatory guarantees of the U.S./Panama BIT, Panama maintains a significant array of incentives for foreign investors. Panama grants tax exemptions for foreign investment in export-oriented industries, including shrimp farming and tourism. Panama's EPZs provide duty free treatment to imports of manufacturing inputs as long as they are subsequently transformed and re-exported.[21] Panama's foreign investment incentives are attractive options for assembly and distribution centers, particularly for products that receive zero or preferential tariff treatment in destination countries.

IV. Conclusion

Panama's economy is slowly emerging from the recent slump endured by most countries in the region. Importantly, Panama's economic recovery differs from other nations in the region in that it is not driven by China's voracious appetite for natural resources. Panama's distinctive services-based economy continues to favor imports and is rebounding under its own terms and at its own pace. Diversification is already underway and the necessary overhaul of the Panama Canal and related facilities should further expand the economy in the coming years.

U.S. businesses and investors face a unique opportunity to catch Panama on the upswing. Knowledge of Panama's WTO commitments and the preferential market access currently being negotiated in the U.S./Panama FTA are crucial to successfully entering Panama.

If you have any questions regarding this publication, Panama's WTO/FTA commitments, or any other international trade issues, please feel free to contact the author.

[20] Significantly, the U.S./Panama BIT was amended in 2000 to reflect Panama's entrance into the International Center for the Settlement of Investment Disputes (ICSID).
[21] Law 25 of 1996.