EXTERNAL DEBT AND DEBT-SERVICE REDUCTION PROGRAM

(PN-0098)

EXECUTIVE SUMMARY

BORROWER AND GUARANTOR:	Republic of Panama
EXECUTING AGENCY:	Ministry of Planning and Economic Policy [Ministerio de Planificación y Política Económica] (MIPPE), with the participation of Banco Nacional de Panamá

AMOUNT AND SOURCE:

Borrower:		US$186 million
Government:	US$108 million	
IBRD;IMF:	US$ 78 million	
IDB:		US$ 30 million
Total:		US$216 million (100%)

FINANCIAL TERMS AND CONDITIONS:

Amortization period:	20 years
Grace period:	5 years
Disbursement period:	9 months
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75%

OBJECTIVES: This operation will advance Panama's economic development by supporting execution of the 1995 financial plan, which is a integral part of the country's economic adjustment program. The objectives of the loan are to: (i) reduce the external debt's burden on the balance of payments; (ii) lower Panama's risk premium on international capital markets; and (iii) fully regularize Panama's relations with its foreign creditors. These three objectives will be accomplished by cofinancing the purchase of collateral instruments under a debt restructuring agreement with the international commercial banks, following a system similar to the Brady Plan launched by the United States.

DESCRIPTION: The proposed program would consist of the purchase of United States Treasury zero coupon bonds that would constitute the collateral under the agreement to restructure the external commercial debt.

ENVIRONMENTAL CLASSIFICATION: The Environment Committee, at its meeting of October 17, 1995, classified this project as a Category II operation.

BENEFITS: This operation will help stimulate new domestic and foreign private investment and build confidence in the Panamanian government's medium-term fiscal pol-

the Panamanian government's medium-term fiscal policy. A successful debt restructuring agreement with international commercial banks will boost the government's economic reform program, and the resulting increase in private investment will have an appreciable impact on economic growth and the creation of job opportunities.

RISKS: Restructuring the external debt and regularizing the significant past due interest would increase external (commercial and multilateral) debt service in nominal terms as of 1996. There is a risk that problems may arise in timely external debt service, but it would be minimized by the stand-by agreement between the IMF and the government, requiring a proper macroeconomic framework and fiscal programming, including scheduling of external public debt service payments.

EXCEPTIONS TO BANK POLICY: The Republic of Panama has requested that the Bank waive the negative pledge clause (Article 8.01, General Conditions of loan contracts) in the amounts required to allow Panama to pledge collateral in order to ensure payment of the principal and interest on the discount bonds, par bonds, and interest-reduction bonds.

SPECIAL FEATURES: It is recommended that the period stipulated in the operational guidelines of the Debt and Debt-Service Reduction Facility (document GN-1686-7 of March 22, 1991) for allocating Bank funds be extended for this operation.

THE BANK'S COUNTRY AND SECTOR STRATEGY: The Bank's strategy in Panama is to: (i) deepen the economic and sector reform program instituted by the government; (ii) improve the efficiency of public spending and support modernization of the State; (iii) make social spending more efficient and better targeted at the poor; (iv) rehabilitate and expand the country's basic infrastructure and revise the regulatory framework for private-sector participation; and (v) identify options for development, management, and private investment in the interoceanic region.

SPECIAL CONTRACTUAL CONDITIONS: In keeping with the operational guidelines of the Debt and Debt-Service Reduction Facility (GN-1686-7, paragraph 5.02), the proposed loan would be disbursed in a single tranche, since the funds will be used to purchase the collateral necessary for a debt-for-bonds swap. The conditions precedent to the single disbursement would be the following:

a. The macroeconomic policy framework must be consistent with the objectives of the debt and debt-service reduction program.

b. The borrower must enter into agreements with the participating commercial banks to exchange, in accordance with the 1995 financial plan, a sum equivalent to at least 95% of the borrower's eligible debt, of which approximately 14% should be swapped for collateralized par bonds, 3% for collateralized discount bonds, and 83% for collateralized interest-reduction bonds, and the borrower must certify that the agreements are demandable.

c. The borrower must enter into an agreement with Banco Nacional de Panamá, appointing the latter as the financial agent for purchase of the collateral.

d. The borrower must take preliminary steps to arrange for the Federal Reserve Bank of New York or another institution acceptable to the Bank to manage the escrow account or accounts for payment of principal and interest on the par bonds and discount bonds, and interest on the interest-reduction bonds. The escrow agent must indicate its acceptance in principle of those duties.

e. The financing from the IMF and IBRD must be formalized and the borrower must have resources to purchase the securities and resources to guarantee payment of the principal and interest on the par bonds and discount bonds, and the interest on the interest-reduction bonds.

The Bank may request prepayment by the borrower of portions of the loan in the event that: (i) loan proceeds are used for purposes other than those allowed; (ii) portions of the collateral are released; or (iii) priority creditor status is lost in favor of the escrow agent. In that event, advance prepayment to the IDB, the World Bank, and the International Monetary Fund will be proportional to each one's contribution.

With the concurrence of the Bank, the loan proceeds may be used to reimburse the borrower for expenses incurred in the purchase of collateral after November 15, 1995, provided the conditions set forth in the loan contract have been fulfilled.

THE BORROWER'S REPORTS TO THE BANK: Under the loan contract, the borrower will agree to submit the reports described in paragraph 4.8.

I. INTRODUCTION

1.1 The Government of Panama initiated contact with a Bank Advisory Committee [Comité Asesor de Bancos] (CAB) to work out the terms for restructuring its commercial bank debt, portions of which have been outstanding since 1987. After several exploratory meetings, on May 5, 1995, the CAB and the government reached an agreement on the heads of terms that would be the basis for restructuring an external commercial debt totaling US$4.008 billion in principal and interest past due.

1.2 The agreement proposed falls within the guidelines of the Brady Plan and, to be successfully implemented, will require the support of multilateral organizations, the International Monetary Fund (IMF) in particular. The organizations would support the agreement in two forms. (i) letters endorsing the cogency and relevance of the Panamanian government's macroeconomic and fiscal program for addressing the economy's structural problems; and (ii) loans to finance the purchase of securities (30-year United States Treasury zero coupon bonds) to collateralize the new bonds that the Panamanian government would issue and that would be exchanged for old debt under terms more advantageous to the country.

1.3 The Panamanian authorities have requested the Bank's support to finance part of the external debt and debt-service reduction under a program that would also include the IMF and the International Bank for Reconstruction and Development (IBRD). The financing from the IDB and other sources (for a total of US$108 million) would be matched by another US$108 million in the country's own resources. Of the grand total, approximately US$86 million would be earmarked for the purchase of the necessary securities, and the remaining US$130 million would be used for partial prepayment of past due interest.

1.4 According to preliminary estimates, the Bank would contribute a US$30-million loan to the program for external debt and debt-service reduction, which is the specific purpose of the operation. In addition, Management has proposed that the Board of Executive Directors authorize disbursements of US$35 million from the second tranche of loans 688/OC-PN and 689/OC-PN, approved in 1992 for the public enterprise reform program (PREP), to enable the government to free up other resources to finance the debt-reduction operation. To make the Bank financing viable, Panama would be granted a waiver of the negative pledge clause, normally included in the General Conditions set forth in all loan contracts entered into by the Bank and its member countries.

1.5 The proposed debt and debt-service reduction operation complements other sector loans included in the Bank lending program for 1995-1997, namely. (i) the infrastructure service reform program

(PN-0097), and (ii) the sector investment program (PN-0056). These two loans call for US$140 million in fast-disbursing IDB funds.

1.6 The proposed operation also complements the World Bank's lending program, which includes the Economic Recovery Program (ERP) approved at the same time as the IDB's public enterprise reform program in 1992, and falls within the framework of the stand-by agreement that the Panamanian authorities and the IMF negotiated in September 1995.

1.7 The combination of sector operations by the Bank, the IBRD, and the IMF, both under way and in the pipeline, justifies the debt and debt-service reduction program proposed in this document.

II. FRAME OF REFERENCE

A. Macroeconomic context

2.1 In the wake of the political crisis of the late 1980s, the Panamanian economy began a period of economic recovery sustained by the construction, financial, commercial, and manufacturing sectors and the Colón Free Zone (CFZ). In 1994, however, gross domestic product (GDP) increased by 4.7%, down from the previous year's showing (5.4%). The 1994 performance was the result of still high aggregate demand despite a slowdown in the growth of consumption.

2.2 In 1995, Panama's economy is growing at an even slower pace. The forecasts for 1995 predict only moderate growth for the country's GDP, at 3%. The causes for the slowdown are the steady decline in aggregate consumption, a drop in banana exports (due to restrictions imposed by the European Union), a downturn in tourism and trade (Colón Free Zone) and, in particular, the closing of the United States military bases in the Panama Canal area.

2.3 The current administration has made serious efforts to achieve a satisfactory fiscal balance. In 1994, the nonfinancial public sector posted a surplus of 0.3% of GDP, while in 1995 a deficit of -0.6% is projected, despite the strong pressure of recurrent expenditures (payroll) and external debt service on the budget. In 1996, the government will seek to streamline public spending, review the financial costs of the social security system, and transfer public investments in infrastructure to the private sector. These measures, accompanied by a stand-by agreement with the IMF, will enhance the capacity of the Panamanian government to regularize its external debt service.

2.4 The fact that Panama is lapsing into the traditional growth rate of around 3% is evidence of structural problems in the Panamanian economy, such as strong effective protectionism, a rigid labor and salary system, and the heavy burden of recurrent expenses (wages) and debt service (25%-35%) in the national budget.

2.5 To eliminate these structural obstacles, the administration of President Ernesto Pérez Balladares decided to build upon the economic reform program instituted by the previous administration in 1992. The program for social development with economic efficiency 1/ instituted in October 1994 assigns high priority to spending in the social sectors, opens up telecommunications, electric power, water

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1/ Republic of Panama. *Politicas Públicas para el Desarrollo Integral: Desarrollo Social con Eficiencia Económica* ["Public Policies for Comprehensive Development: Social Development with Economic Efficiency"], September 1994.

supply, and ports to privatization, adopts a policy of free trade, modernization of the economy (Labor Code, tax incentives, regulation of monopolies), and strengthening of the agriculture and tourism sectors. In the medium term, these reforms will create conditions more conducive to sustainable economic growth driven by private investment and increased employment.

2.6 As part of the government program, important legal reforms were approved in 1995. (i) universalization of production incentives to eliminate fiscal and financial disparities in resource allocation; (ii) reform of the Labor Code to allow more flexibility in labor contracts, reduce the costs of labor mobility, and establish an unemployment fund; and (iii) creation of the Development Trust Fund, into which the proceeds of future operations for privatization of public enterprises will be deposited for investment in priority development projects.

2.7 The government has made considerable progress in negotiations to join the World Trade Organization (WTO) and restructure its debt with commercial banks in early 1996. It has also introduced a bill in the Legislative Assembly for protection of intellectual property rights and a bill to combat monopolistic practices, and is actively preparing draft bills for across-the-board reforms and to establish a framework for regulating household utilities.

2.8 As for sector reforms, through 1995 Cabinet Resolution 245, the government approved the policy guidelines for implementing reforms in the delivery of port, drinking water and sanitation, electric power, and telecommunications services. This resolution is fundamental for the country's economic reform program, since it provides these sectors with the tools needed to expand their coverage and improve the efficiency of their services.

2.9 The Panamanian government has indicated its commitment to promoting economic growth through more efficient and productive use of its resources, considerably reducing poverty in the process. This fundamental objective and the reforms through which it can be achieved are set forth in detail in the Policy Letter that supports this loan request (see Annex I).

2.10 Among the most important macroeconomic measures in the short term is restructuring of the external commercial debt, which accounts for approximately 65% of total external public debt. Service of the external debt (both multilateral and commercial), as now scheduled, represents between 25% and 35% of the country's annual budget, which limits the Panamanian economy's chances for growth and places a very severe constraint on the government's short- and medium-term fiscal policy.

2.11 Restructuring the external commercial debt would allow for better macroeconomic and fiscal programming and would open up new opportunities for financing from international commercial banks for future

foreign investments in basic infrastructure and public services slated for privatization.

B. Panama's public debt

2.12 During the 1980s, Panama's external debt grew rapidly because of poor fiscal management of debt service under the military regime. This caused the country to go into arrears in debt service and, finally, into default with foreign creditors, including multilateral banks.

2.13 To remedy the default situation, in 1992 the government mapped out a strategy involving four objectives. (i) normalize relations with multilateral banks and bilateral creditors; (ii) regularize amounts past due and ensure timely payment to suppliers and holders of government bonds and securities; (iii) settle debt between government institutions (ministries and public enterprises); and (iv) restructure the external public debt with international commercial banks.

2.14 In 1992, the government launched the program to make back payments to multilateral banks and bilateral creditors (Paris Club). The Bank supported this process by arranging a global package of US$686 million in new loans and grants. Panama contributed US$306 million of its own resources. This arrangement gave Panama access to new sector and investment loans from the IBRD and the IDB to support the economic reform program and opened up the possibility of initiating a restructuring of the terms of the external commercial bank debt.

2.15 As of December 1994, Panama's total external debt (including external private debt) was estimated at US$6.919 billion, equivalent to 100% of its GDP, making Panama's the fifth largest external debt in Latin America, behind Nicaragua, Guyana, Jamaica, and Honduras. The ratio of external debt service to exports was 3% in 1994, but this figure does not include the considerable past due interest on the external commercial debt.

2.16 The following table shows a breakdown of Panama's external commercial debt as of June 20, 1995 (in millions of US$):

CREDITORS	BALANCE AS OF 6/20/95	PRINCIPAL DEBT OUTSTANDING	(%) DUE	PAST DUE INTEREST	LATE FEES	TOTAL DEBT	(%) TOTAL
Multilateral	691.6	0	0.00%	0	0	691.6	12.18%
Bilateral	526.3	21.1	4.02%	4.3	8.0	538.6	9.49%
Commercial banks	2,076.1	1,859.0	89.55%	1,605.4	0.3	3,681.8	64.86%
Foreign bonds	433.7	2.4	0.54%	0.3	0.4	434.4	7.65%
Miscellaneous suppliers	49.0	1.3	2.65%	0.6	0.1	49.7	0.88%
San José Agreement	158.7	126.5	79.73%	41.5	80.6	280.7	4.95%
Total public debt	3,935.4	2,010.3	51.08%	1,652.1	89.4	5,676.8	100.00%
Central government	3,341.2	1,744.0	52.20%	1,474.0	89.2	4,904.3	86.39%
I. Decentralized	594.2	266.3	44.82%	178.1	0.2	772.5	13.61%

Source. MIPPE, Public Credit Office (see Annex I)

2.17 As of June 1995, external public debt totaled US$5.677 billion. Of this amount, debt with commercial banks stood at US$3.682 billion, of which US$1.605 billion was in past due interest and late fees. According to official government projections, the external commercial debt to be restructured in early 1996 amounts to US$3.936 billion (US$1.968 billion in principal debt outstanding and US$1.968 billion in interest past due).

2.18 As the above figures illustrate, the external commercial debt and its past due interest account for a large share of the total external debt. Since 1992, the arrearage in interest payments on the total debt has been one of the government's financing mechanisms, since past due interest represents such a large proportion of debt service. Once the agreement restructuring the external commercial debt is finalized, Panama will establish escrow accounts to guarantee timely repayment of its external commercial debt.

C. The Bank's strategy

2.19 The Bank's strategy in Panama is to. (i) deepen the economic and sector reform program instituted by the government; (ii) improve the efficiency of public spending and support the modernization of the State; (iii) make social spending more efficient and better targeted at the poor; (iv) rehabilitate and expand the country's basic infrastructure and revise the regulatory framework for private-sector participation; and (v) identify options for development, management, and private investment in the interoceanic region.

2.20 In keeping with this strategy, the Bank's operations program for 1995-1996 will finance projects for external debt reduction, infrastructure service reforms, State modernization (fiscal management, the judiciary, the Legislative Assembly, and foreign relations),

investments in basic infrastructure (drinking water, housing, education, agriculture, electric power expansion), and promotion of private investment (the Panama City-Colón highway).

2.21 The Bank's support for this debt and debt-service reduction operation is warranted given the need to assist the economic reform program and to improve fiscal management by systematically rescheduling external debt service. In the short term (1996-1997), this operation will lessen the fiscal burden that debt service represents (approximately 35% of the central government budget) and, in time, redistribute the impact of the external debt on the balance of payments. These two factors will be crucial to achieving economic growth in the medium term, in a context of fiscal stability.

D. Program of operations with other international organizations

2.22 Both the World Bank and the IMF have been supporting Panama's economic reform efforts since 1992. That year, the World Bank approved the Economic Recovery Loan (ERL) in the amount of US$120 million to revitalize public investment, promote fiscal reform, modernize trade policy, stabilize public finance, and lower the social security system's deficit. In support of the present administration's program, the IBRD extended the deadline for disbursing resources from the ERL to June 1996. Disbursement of a second tranche from the ERL could help the government free up other funds to finance the external commercial debt restructuring agreement. In response to a request from the Panamanian authorities, the World Bank is also preparing an operation specifically designed to assist debt and debt-service reduction (DDSR), for the sum of US$45 million, to be approved in early 1996. Additionally, the World Bank's lending program for 1995-1996 includes three projects. one in education, another in health, and a third for the Social Emergency Fund.

2.23 The IMF, for its part, concluded a stand-by agreement with the Panamanian authorities in September 1995. Spanning a 16-month period that begins in November 1995, the agreement will ensure a proper macroeconomic and fiscal framework and will give Panama access to resources guaranteed by its special drawing rights (SDR), to finance the external commercial debt restructuring agreement. The stand-by agreement will also include resources specifically earmarked for the external commercial debt conversion program.

2.24 The Bank has coordinated implementation of their respective lending programs with the World Bank and the IMF, and has also coordinated preparation of the debt and debt-service reduction program, as a key element in the government's economic reform program, with the Panamanian authorities and the other multilateral organizations.

III. THE SECTOR PROGRAM

A. Program objectives

3.1 The purpose of this operation is to contribute to Panama's economic development by supporting the debt and debt-service reduction program. Its objectives are to. (i) relieve the burden of the external debt on the balance of payments; (ii) lower Panama's risk premium on international capital markets; and (iii) fully normalize Panama's relations with its foreign creditors. These three objectives will be accomplished by cofinancing the purchase of collateral under a debt restructuring agreement with international commercial banks, which will be patterned along lines similar to the Brady Plan established by the United States.

3.2 The proposed operation will induce new infusions of domestic and foreign private investment and will boost confidence in the Panamanian government's medium-term fiscal policy. A successful restructuring agreement with international commercial banks is critical to the government's economic reform program and will have a considerable impact on economic growth and job creation, due to the greater flows of private investment.

B. Program components

1. Debt restructuring agreement

3.3 The restructuring agreement that is expected to be reached by late November 1995, will cover US$3.936 billion, approximately 70% of Panama's external public debt. This figure includes principal debt outstanding, past due interest, and the interest owed on interest in arrears. Briefly stated, the menu of options under the restructuring agreement offers creditors a debt reduction option, a debt-service reduction option, refinancing of past due interest, a mechanism for addressing disparities resulting from the partial payment of debts that Panama made in the past to creditor banks and its resumption of partial cash payments of interest during the period from the time negotiations began (May 1995) to the closing date of the restructuring agreement (March 1996). The financial terms and conditions of the agreement are summarized in Annex II. Using the heads of terms presented by Panama, the following table summarizes the costs, amounts, and discounts expected to be achieved under the agreement.

STRUCTURE OF THE AGREEMENT AND ESTIMATED IMPACT ON THE DEBT
(IN MILLIONS OF US$)

1. Estimated pre-agreement debt (as of 3/31/96, the expected closing date)			3,936
Eligible principal			1,968
Exchanged for par bonds		276	
Exchanged for discount bonds		59	
Discount (45%)	26		
Exchanged for interest-reduction bonds (IRB)		1,633	
Eligible interest			1,968
Exchanged for past due interest bonds (PDI bonds)		1,350	
Eliminated through cash payments		130	
Single interest payment at closing	100		
Monthly interest payments	30		
Amount eliminated by recalculating interest		488	
2. Estimated post-agreement debt (as of 3/31/96, the expected closing date)			3,292
Discount bonds			33
Par bonds			276
Exchanged for interest-reduction bonds (IRB bonds)			1,633
Past due interest bonds (PDI bonds)			1,350
3. Reduction in the face value of the debt (3=1-2)			644
Through discount bond swaps			26
Through cash payments			130
Through recalculation of interest			488
4. Debt reduction equivalent by other means			416
Savings due to lower interest rates (par bonds, discount bonds, and IRB bonds)			502
Collateral prepayment equivalent (par, discount, and IRB bonds)			86
5. Debt reduction equivalent (5=3+4)			1,146

3.4 Under the agreement's heads of terms, holders of eligible principal (US$1.968 billion) may opt to swap all their debts for discount bonds, par bonds, or interest-reduction bonds at below-market rates, but will be under no obligation to choose any one type of bond or any specific combination of the three instruments.

3.5 The characteristics of the three main instruments are described below:

a. The discount bond option involves exchanging the debt with holders at a 45% discount on its face value for another instrument issued by Panama that would mature in 30 years and earn interest at the rate of LIBOR plus 13/16%.

b. The par bond option involves exchanging debt with the holders for a new bond for the original amount, with a 30-year maturity and an interest rate that would initially be below market but would balloon from some 3.25% in year one to 5.5% from year 11 to maturity at year 30.

c. <u>The interest reduction bond (IRB bond) option</u> involves exchanging debt with the holders against a new bond for the same amount, maturing in 18 years with a 5-year grace period, and which would be amortized semiannually from year 6 to maturity at year 18. These bonds will accrue interest at the rate of 3.5% in year one; 3.75% in year two; 4% in year three; 4.25% in year four; 4.5% in year five; 4.75% in year six; 5% in year seven; and LIBOR plus 13/16% in years eight to 18. Interest payments will be guaranteed through a revolving fund covering six months of payments in advance. No collateral guarantees on the principal will be offered.

3.6 The principal of the discount and par bonds would be collateralized with 30-year United States Treasury zero coupon bonds held in an escrow account handled by an agent acceptable to all parties. Both options require Panama to set up a revolving guarantee fund equal to two semiannual interest payments. Both types of bonds would be amortized in a bullet payment at maturity in year 30.

3.7 The heads of terms for the principal included two other options. debt conversion bonds (DC bonds) and new money bonds. Both would have been tied. specifically, electing to swap 100% of the eligible principal for DC bonds would have required purchasing 10% of the value of those bonds in new money bonds (see Annex II). However, none of the creditor banks selected either DC bonds or new money bonds.

3.8 The eligible interest (US$1.968 billion) would be exchanged for past due interest bonds (PDI bonds), which would mature in 20 years, with a 10-year grace period, and pay semiannually at the rate of LIBOR plus 13/16%. Using a gradual amortization system, PDI bonds would be amortized in 21 semiannual payments starting in year 11 (see Annex II).

3.9 In 1995, Panama would make supplementary payments of past due interest at a rate of US$2 million per month, payable every six months, for a total of US$30 million in 1995 and 1996 plus a final payment of US$100 million by the closing date of the agreement. Recalculation of interest at the new rates proposed in the new instruments would reduce the interest that Panama owes on its commercial debt by approximately US$488 million.

3.10 On November 17, 1995, the creditor banks selected the following percentage breakdown of options. 13.66% in par bonds, 3.64% in discount bonds, and 82.7% in interest reduction bonds. This breakdown was used as the basis to compute the costs and debt reduction achieved under the debt restructuring agreement described above. According to the current timetable, new contracts will be drawn up between November 1995 and February 1996, and the bond swap (closing) will occur in March or April 1996.

2. Financing needs

3.11 The Government of Panama plans to finance the purchase of collateral using coordinated loans from the multilateral organizations and the Japanese government and contributing the balance in its own funds from its current budget, previously earmarked for this purpose. The following table illustrates the needs and sources anticipated to cover the purchase of collateral.

Needs and Sources of Financing
as of 11/17/95
(in millions of US$)

1. Financing needed for the operation		216
Cash payments		130
Monthly payments of past due interest 1/	30	
Lump-sum payment of past due interest at closing	100	
Collateral investments		86
Principal collateral		49
Par bonds	44	
Discount bonds	5	
Interest collateral		37
Par bonds	6	
Discount bonds	2	
Interest reduction bonds (IRB)	29	
2. Sources of financing (100%)		216
Multilateral organizations		108
International Monetary Fund (22%)	48	
World Bank (14%)	30	
IDB (14%)	30	
Government of Panama (50%)		108

1/ The partial cash interest payments of US$30 million in 1995 and 1996 will be covered with Panama's own funds.

3.12 The final amount of resources needed to purchase the collateral and replenish reserves used for advance interest payments will depend on the interest rates in effect at the time the instruments are exchanged (closing) and on when the bonds that will serve as collateral are actually purchased. Based on the information currently available, the total financing required will be an estimated US$216 million, including the cash interest payments made as of closing. Anything over that amount will be supplied by Panama.

3. Available financing

3.13 This operation would be financed in accordance with the operational guidelines of the Debt and Debt-Service Reduction Facility (GN-1686-7). The available financing will be determined on the basis of the limits the facility sets.

3.14 According to the review conducted by the project team, the financing requested is within the amounts allowed under the Debt and Debt-Service Reduction Facility for commercial debt.

3.15 The Panamanian government also hopes to receive financing from the IMF, from disbursement of the first two tranches of the stand-by agreement and an increase in the special drawing rights (SDR) quota for a total of approximately US$48 million. The World Bank, for its part, would provide US$30 million for a specific debt and debt-service reduction (DDSR) operation. In addition, the second tranche of the Economic Recovery Loan (ERL) for US$20 million, cofinanced by another US$25 million from the Government of Japan, will enable the Panamanian government to free up other matching resources to finance the prepayment of interest required for the closing of the debt restructuring agreement.

4. <u>Analysis of the proposed restructuring</u>

3.16 As noted above, the proposed restructuring agreement covers 70% of total external public debt and all eligible commercial debt. The agreement is therefore expected to contribute significantly toward reducing Panama's debt service up to the year 2001. Implementation of the agreement will accomplish the following:

a. Reduce the nominal amount of the external commercial debt by US$644 million, through an initial payment of interest arrears (US$130 million), the exchange of 3.64% of the principal debt at a discount of 45% (US$26 million) and lower interest through recalculation of the interest at rates lower than those originally set out in the respective loan contracts (US$488 million).

b. Reduce interest payments to commercial banks by approximately US$45 million annually from 1996 to 2001, as a result of the smaller debt stock and lower interest rates applied to discount bonds, par bonds, and IRB bonds.

c. Effectively prepay the bullet amortization and the interest due on the discount bonds, par bonds, and IRB bonds in the year 2025 or an earlier year (IRB bonds) by placing the collateral beyond Panama's control, in an amount equivalent to the specific collateral investments (US$86 million).

d. Achieve a debt reduction equivalent of approximately US$1.146 billion when all the previous items are combined, representing approximately 29% of the eligible external commercial debt if the agreement were not closed in March 1996.

e. Achieve the debt reduction (approximately US$1.146 billion) at an estimated cost of US$216 million (the financing the operation will require), equivalent to 19% of the debt reduction achieved, indicating that the loan proceeds would be used

efficiently when compared with a buyback equivalent price of 24.5 cents on the United States dollar on the secondary market for Panamanian debt. This point is discussed in greater detail in chapter III, section 5.

f. Regularize arrears through an exchange of US$1.35 billion in past due interest against 20-year bonds (PDI bonds).

g. End amortization payments to commercial banks except for those payable on the past due interest bonds (PDI bonds), the semiannual payments on IRB bonds, and the bullet payment in 2025 (discount and par bonds), leading to a reduction of approximately US$45 million annually in scheduled amortization payments by the end of the five-year period from 1996 to 2001 (at present value, a savings of US$184 million).

h. Reduce interest rate risk by swapping 14% of the principal debt for par bonds bearing a fixed interest rate.

i. Require commitment by Panama of funds that might have otherwise been used for alternative purposes, i.e., set-asides for the equivalent of approximately US$108 million from loans from multilateral organizations and another US$108 million in reserves.

j. Increase indebtedness with official creditors in relative and absolute terms by reducing commercial debt and funding collateral purchases and prepayment of interest through additional borrowing of US$108 million (the debt with official creditors as a percentage of total external public debt would increase from approximately 21% prior to the debt restructuring agreement to 23% after closing).

k. Reduce flexibility in case of future debt service difficulties as bank loans potentially subject to rescheduling or new money calls are exchanged for bonds.

5. Financial efficiency of the agreement

3.17 As mentioned in subparagraph 3.17 e. above, the cost of the restructuring agreement compared with the size of the commercial debt to be restructured represents 19% of the debt reduction achieved. This means that the cost of each United States dollar of debt reduction was 19 cents. By comparison, the theoretical price called buyback equivalent price (BEP) of Panamanian debt on the secondary market as of the date on which the menu of options was agreed upon in principle (May 4, 1995) was 24.5 cents. This comparison price was reckoned by applying a discount factor of 0.5 to the secondary market price (49 cents), given the fact that the proportion of principal compared with interest past due eligible for the debt restructuring agreement was an estimated 50%. By comparing the figures of 19 cents and 24.5 cents, it can be

concluded that if even it had actually been possible to purchase Panama's external debt on the secondary markets on the above-mentioned date, this option would have been more costly than through the commercial debt restructuring agreement. In short, the cost of the agreement compared with the external debt reduction obtained is efficient from a financial viewpoint.

3.18 A more rigorous evaluation method proposed by the World Bank requires a comparison of the flows of new debt service associated with the rescheduling agreement, expressed in present value 2/, to effectively incorporate the opportunity cost of the funds applied toward the debt restructuring agreement and properly measure the reduction in payments of principal and interest achieved through the agreement.

3.19 Relative efficiency in the use of the loan proceeds can thus be determined by using the debt reduction equivalent (DRE) method, which compares the present value of the debt reduction obtained under the agreement with the total value of the eligible pre-agreement commercial debt. The DRE is expressed as a percentage, which can be compared with the DRE obtained by other countries under Brady Plan agreements, to evaluate the comparative efficiency of the restructuring agreement proposed for Panama.

3.20 The figures for the DRE appear in Annex IV. In present value, Panama would achieve a reduction of $1.146 billion, which represents a DRE of 29.1%. This figure is below the weighted average debt reduction obtained by the 13 countries (38.9%) that have restructured their commercial debt under the Brady Plan before Panama.

3.21 A comparison of the debt reduction obtained by other countries under the Brady Plan shows that the merits of Panama's debt restructuring agreement should be evaluated in light of the external debt reduction achieved and its impact on the fiscal accounts of the government, full access to the international financial markets, and reduction of the country risk premium that will help attract fresh private investment.

3.22 The qualitative evaluation conducted by the project team shows that the impact of the debt restructuring agreement on the fiscal accounts will be slight, whereas access to the capital market and a better country risk rating for Panama will be achieved in the short term. Therefore, the restructuring agreement is considered efficient according to the operational guidelines of the Debt and Debt-Service Reduction Facility.

2/ The debt reduction equivalent method is amply discussed by the World Bank in: SecM92-296. *Analytic Aspects of Debt and Debt Service Reduction Operations*, World Bank, March 9, 1992.

3.23 The evaluations of external commercial restructuring agreements conducted by the World Bank in 1992 and 1995 underscore the fact that the financial efficiency of commercial debt reduction is enhanced by implementation of a sound economic adjustment program. This will be the case for Panama, since, as mentioned earlier, the restructuring agreement is coupled with a program of macroeconomic and fiscal reforms and reforms in priority infrastructure sectors.

6. Financial sustainability

3.24 In 1995 and up to the closing date of the agreement, Panama will make approximately US$130 million in monthly interest payments (US$30 million) and cash payments to retire past due interest (US$100 million). The government will finance a portion of these disbursements with its own resources, through the Development Trust Fund. International organizations may finance part of these prepayments of interest.

3.25 The specific collateral investments (approximately US$86 million), as noted earlier, would by financed by multilateral organizations.

3.26 Service of the restructured debt with commercial banks would total US$88.4 million in 1996 and from US$190 million to US$220 million annually from 1997 through 1999; US$280 million to US$320 million from 2000 through 2002; and would peak at US$420 million before gradually declining to US$390 million from 2003 through 2005 (see Annex IV). As of the year 2000, debt service payments would increase considerably, since by then the grace period for the PDI bonds would have expired and Panama would have to begin paying interest on those bonds at the rate of LIBOR plus 13/16% beginning in the year 2003.

3.27 World Bank projections show that while total debt service as a percentage of exports of goods and services would increase considerably in the years ahead, thereafter it would gradually decline, rising from 7.3% in 1995 to 19.9% in 1996 and then dipping to 13.1% in 1999. The estimated average for the period 2000-2005 is 10%. At the same time, total external debt as a percentage of GDP would drop from 98.9% in 1995 to 93.6% in 1996, 91% in 1997, 85.9% in 1999, and an average of approximately 74% during the period 2001-2005. The projections will vary to the extent that debt service of a high proportion of IRB bonds grows proportionately higher than GDP. However, the slight fiscal impact of the agreement reached by Panama is expected to be reflected in a higher GDP growth rate than that initially projected by the World Bank. The two trends together should improve Panama's external debt indicators in the medium term.

3.28 Provided the government's program of economic and sector reforms continues, the aforementioned debt service payments are compatible with the medium-term fiscal and balance-of-payments projections prepared by the IMF for purposes of the stand-by agreement.

IV. PROGRAM FINANCING AND EXECUTION

A. Program financing

4.1 Given the financing that the program will require, it is proposed that the fast-disbursing loan under this operation total up to US$30 million from the Bank's ordinary capital. Given the amount of fast-disbursing loans to be granted during the period from 1995 to 1997 and the availability of resources under the Eighth Replenishment, the financing for this operation would fall under that replenishment.

4.2 In keeping with the requirements for Bank funding for debt and debt-service reduction operations set forth in document GN-1686-7, the loan proceeds would be used to purchase the collateral required to guarantee payment of principal and interest on the par bonds, the discount bonds, interest-reduction bonds (IRB), and past due interest bonds (PDI), which would be negotiated at the closing of the external commercial debt restructuring agreement.

B. Program execution

1. Borrower and executing agency

4.3 The borrower in this operation will be the Republic of Panama while the executing agency will be the Ministry of Planning and Economic Policy [Ministerio de Planificación y Política Económica] (MIPPE), which will be responsible for maintaining the loan accounts, preparing and presenting withdrawal requests, and keeping all program records.

2. Disbursements

4.4 Since the IDB financing would be used to purchase the collateral necessary for the bond swaps mentioned in 4.2, it would have to be disbursed in a single tranche. The IDB's operational guidelines authorize disbursement in a single tranche when conditions so dictate.

4.5 Plans call for the bonds to be swapped and the agreement signed during the first quarter of 1996. The proceeds of the IDB loan would be disbursed simultaneously with the loans from the World Bank and the International Monetary Fund, once the borrower has confirmed the availability of sufficient resources to institute the 1995 financial plan of the agreement and the following agreements have been signed. (i) debt-for-bond swap agreements with the participating banks; and (ii) the respective agreement with the Federal Reserve Bank of New York or another institution acceptable to the Bank to administer the escrow accounts for the principal and interest. As a condition precedent to disbursement, the prevailing

macroeconomic framework must be consistent with the objectives of the debt and debt-service reduction program.

3. Procurement, recognition of previous expenditures, and prepayment

4.6 Given the nature of the operation, no restrictions on procurement procedures will apply to use of the loan proceeds. Under the operational guidelines of the Debt and Debt-Service Reduction Facility (GN-1686-7), previous expenditures may be acknowledged if the government purchases collateral prior to the closing date of the agreement. However, the borrower must prepay portions of the loan if. (i) loan proceeds are used for purposes other than those allowed; or (ii) portions of the collateral are released. In either event, prepayment will be made to the IDB, the World Bank, and the International Monetary Fund in proportions equal to their respective contributions.

4. Inspection, supervision, and auditing

4.7 The executing agency will be responsible for keeping separate records of the transactions regarding use of disbursements that will allow for prompt preparation of the program's balance sheets and reports. The inspection and supervision fee will be 1% of the Bank loan (US$300,000). The Bank's technical units and its Country Office (COF/CPN) will supervise the program.

5. Reports

4.8 The borrower, through the executing agency, will submit the following reports to the Bank:

a. during the disbursement period, at the request of the Bank, reports on execution of the project, the macroeconomic program, and the financial plan, in addition to which the borrower will meet with the Bank to exchange views in this respect and will submit reports on trends in the performance indicators agreed upon with the Bank by September 30 each year for the first four years of the life of the contract;

b. with each disbursement request, a report containing data that will allow the Bank to ascertain whether the payments either made or to be made and for which the request is being filed are eligible for funding with loan proceeds, on which the Bank may request any additional information reasonably required to so ascertain;

c. within 15 days of receipt of every monthly report filed by the escrow agent, a copy of said report; and

d. within 90 days after disbursement of the entire loan, a balance sheet audited by a firm of public accountants acceptable to the Bank, itemizing the use of the resources and the debt-for-bonds swap.

6. Ex post evaluation

4.9 The Panamanian authorities do not consider an explicit ex post evaluation of the program to be necessary.

C. Environmental impact

4.10 None of the activities planned under this program will have any appreciable environmental impact. The Bank's Environment Committee, at its meeting of October 17, 1995, classified this project as a Category II operation.

V. WAIVER OF THE NEGATIVE PLEDGE CLAUSE

5.1 This chapter examines the Panamanian government's request that the Bank grant a limited waiver of the negative pledge clause in the Bank's loan and guarantee agreements with Panama. Panama needs the waiver in order to implement the debt and debt-service reduction program and adopt the 1995 financial plan with its creditor commercial banks. It is important to note that all the loan contracts entered into by the Bank and the Republic of Panama contain a negative pledge clause (Article 8.01 of the General Conditions).

5.2 From the Bank's standpoint, the fact that Panama is pledging collateral to secure payment of the par and discount bonds and the interest thereon means that it would be creating encumbrances on its assets of the kind provided for in Article 8.01 of the General Conditions ("Negative Pledge Clause") for the loan contracts that the Bank enters into with governments of member countries or government agencies, including Panama. Article 8.01 stipulates that if such an encumbrance is created, the Bank must also benefit from it; in other words, an encumbrance in the Bank's favor must be created. The relevant part of Article 8.01 reads as follows:

> "If the Borrower should agree to create any specific encumbrance on all or part of its assets or revenues to secure an external debt, it shall at the same time create an encumbrance guaranteeing to the Bank, equally and proportionally, the fulfillment of the pecuniary obligations arising from the Contract.... In the event that the Borrower is a member country, the term assets or revenues shall mean all types of 'assets or revenues' which belong to the Borrower or any of its dependent agencies which are not autonomous entities with their own separate capital." 3/

5.3 The program described in this document involves the creation of an encumbrance of this kind. For the 1995 financial plan to be carried out, the Bank, like all Panama's other creditors that are similarly protected, should grant Panama's request for a waiver of the negative pledge clauses that are part of its loan and guarantee contracts.

5.4 Panama has asked the Bank to grant the waiver in the amount required for it to be able to pledge guarantees of payment of the discount and par bonds and interest thereon. The formal request from Panama was presented in a letter dated November 16, 1995, from Mr. Guillermo Chapman, Jr., Minister of Planning and Economic Policy (see Annex VI). The letter reaffirmed Panama's obligation to continue to repay the Bank's loans in full, thereby indicating

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3/ A similar clause appears in the Bank's guarantee contracts.

that said loans will not be subject to any rescheduling. A similar request will be presented to the World Bank and the International Monetary Fund.

5.5 The Republic of Panama calculated that US$200 million would be needed for purchase of the collateral and has requested a waiver for that amount. Consequently, for Panama to issue the secured par bonds, discount bonds, IRB bonds, and PDI bonds, the Bank should allow encumbrances to be created on an amount not to exceed the equivalent of US$200 million, the estimated maximum cost of the collateral that Panama would purchase to guarantee payment of the principal of the PAR bonds, discount bonds, IRB bonds, and PDI bonds and the interest thereon, based on the 1995 financial plan.

5.6 In the past, the Bank has granted waivers of the negative pledge clause in cases involving restructuring of a borrowing country's external debt. The most recent were granted to Ecuador in 1994; Brazil in 1994 (document FN-489); the Dominican Republic in 1994 (document FN-486); Bolivia in 1994 (document FN-479); Argentina in 1992 (document FN-474); Uruguay in 1991 (document FN-445); Venezuela in the last quarter of 1990 (document FN-429); and Mexico in 1990 (document FN-426) and in 1988 (document GN-1616).

5.7 Based on the foregoing, it is proposed that Panama's request be granted in the amount required for it to be able to create the encumbrances necessary to guarantee payment of the principal and interest on the discount bonds, the par bonds, the IRB bonds, and the PDI bonds. The waiver granted by the Bank would be limited to the operations described in this document and would take effect only if the other creditors of whom a similar request has been made also grant waivers. The waiver would cover current loans drawn on not only the Bank's ordinary capital and Fund for Special Operations, but also Bank-administered funds.

VI. FEASIBILITY AND RISKS

A. Feasibility

6.1 External debt-reduction agreements such as the one for which support is being proposed in this document tend to create expectations of a higher price on the secondary market for the restructured debt. In practice, this represents a financial gain for the holders of Panama's external debt and an added financial cost to the country. An agreement such as the one proposed in the 1995 financial plan not only makes creditors' debts less risky from the financial standpoint, but also enables them to realize a tangible financial profit on the uncollateralized portion of the external commercial debt. This "expropriation technology" 4/ thus becomes a factor ensuring the feasibility of the agreement for the restructuring of Panama's external commercial debt.

6.2 To evaluate the restructuring agreement, it is even more important to determine whether, through the collateralized instruments, it will lower the financial cost to the country. As noted in chapter III, the restructuring agreement will mean substantial financial savings for Panama. In an alternative scenario of directly buying back the commercial debt on the open market, many holders would invariably take advantage of the higher price on the secondary market at little or no cost (the free-rider problem). The resulting BEP would not be to Panama's advantage. The structure of the restructuring agreement that this operation would support is feasible because it will minimize the financial cost to the country and eliminate the possibility of financial speculation (in other words, it excludes any "free riders").

6.3 The restructuring agreement will make external commercial debt service less flexible, but under a coherent, IMF-supported macroeconomic program, which will reduce the likelihood of problems with timely payment of external debt service. This is partially because the restructuring agreement reduces the long-term external debt obligations and is coupled with a structural economic reform program.

6.4 Then, too, the external commercial debt reduction under the restructuring agreement will be feasible from the fiscal standpoint because in recent years the Panamanian government has improved its budgetary planning and established clear rules for fiscal discipline in the coming years.

4/ For a systematic discussion of this topic, see: Bulow, Jeremy et al, *Estimating the Efficiency Gains of Debt Restructuring*, World Bank Research Working Paper 1317, July 1994.

B. Risks

6.5 The restructuring agreement that Panama proposed to the CAB will imply an appreciable increase in the amount earmarked each year for external debt service, which means that Panama will have to make an additional effort for financial planning. The main risk in this operation is that outside factors such as international prices for Panamanian exports, any delays in disbursements of loans from multilateral organizations, or smaller flows of private capital could mean that the fiscal resources and/or international reserves are not available in time to honor the commitments resulting from the agreement.

6.6 To minimize this risk, the government has pledged to make adequate provision for the resources to cover payments on its external debt in the corresponding annual financing plans and the national budget. This commitment is backed up by a consistent program for macroeconomic and sector reforms supported by the IMF, the World Bank, and the IDB. The government also reached agreement with the IMF on a stand-by program that would last 16 months, starting in November 1995. Under that program, the government will establish clear fiscal goals that are consistent with adequate and timely service of the external debt.

6.7 The restructuring of external commercial debt under the debt agreement will require substantially higher debt service payments, especially after the year 2001. Given recent experience, there is a risk that Panama may not be able to make the restructured external debt payments or may accrue substantial arrears due to the burden of recurrent expenditures. This risk will be mitigated through fiscal planning and the government's intention to transfer investment in infrastructure from the public sector to the private sector. Fiscal planning is included in the current stand-by agreement and possible future agreements with the IMF. Privatization of infrastructure investment and streamlining of public spending fall within the framework of the sector loans for Panama from the IBRD and the IDB. The government has given strong assurances that it will maintain an expeditious, consistent program for macroeconomic and sector reforms.

VII. RECOMMENDATIONS

7.1 The conclusion drawn from the information reported in the preceding sections is that Panama qualifies to receive financing under the Debt and Debt-Service Reduction Facility for commercial bank debt (document GN-1686-7). First, the country has an adequate medium-term macroeconomic and sector reform program. Second, debt reduction is essential to achieving its medium-term economic objectives. Third, the resources that the IDB would provide are an essential component of the debt program. Fourth, the external financing plan is viable and will contribute significantly towards achieving the country's economic benefits. Moreover, the additional resources that the debt and debt-service reduction are expected to generate will enhance Panama's growth and development prospects.

7.2 Based on the description presented in this document, the proposed operation is considered to be consistent with the Bank's country strategy and with its Charter. Since the financing of the operation would be under the Eighth Replenishment, it is recommended that the proposed resolution, which is attached as an appendix to this document, be approved by the Board of Executive Directors.

7.3 This operation conforms to the operational guidelines of the Debt and Debt-Service Reduction Facility (document GN-1686-7), which the Board of Executive Directors approved on March 13, 1991. Even though the guidelines stipulate that the facility resources would be available during the three-year period from January 1, 1991 to December 31, 1993, it is important to note that. (i) this time frame was established to coincide with the period originally stipulated for sector lending under the Seventh Replenishment, during which negotiation of the debt reduction programs of the countries of the region was expected to be completed; (ii) a small group of countries (Panama among them) are not expected to complete the debt restructuring process until after the period stipulated in the operational guidelines; and (iii) through Resolution AG-10/90, the Board of Governors authorized the Bank to provide financing for debt and debt-service reduction operations in its borrowing countries as an integral part of its sector lending program, and the Report on the Eighth General Increase in the Resources of the Bank states that "policy lending during the Eighth Replenishment will continue to support economic adjustment programs for those countries still in need of such financing..." (document AB-1704, paragraph 2.52).

7.4 Based on the foregoing, it is recommended that the period for the allocation of Debt and Debt-Service Reduction Facility resources as established in the operational guidelines (paragraph 2.03 of document GN-1686-7) be extended for this operation.

7.5 Based on the options selected by the creditor banks, which will result in a significant increase in debt service beginning in the year 2001, and at the request of the Strategic Planning and Operational Policies Department (DPP), the project team recommends that the Bank support future initiatives that would help implement alternative strategies for external debt management and reduction in Panama. These could include (but would not be limited to) horizontal technical cooperation (CT-INTRA) to explore debt-for-nature swaps and debt-for-development swaps (social investment, alleviation of extreme poverty, etc.), channeling resources from bilateral grants and technical cooperation for institutional strengthening in external debt management.

7.6 It is also recommended that the Board of Executive Directors authorize Panama to create the encumbrances required for the guarantees on the discount bonds, par bonds, IRB bonds, and PDI bonds and the interest thereon, in an amount not to exceed US$200 million. Such authorization will only take effect once Panama has received authorization from the other creditors to which it has applied for similar waivers.

República de Panamá
Ministerio de Planificación y Política Económica
Despacho del Ministro
Apartado 2694, Panamá 3

11 de octubre de 1995
DM No. 164-95

Señor
Enrique V. Iglesias
Presidente
Banco Interamericano de Desarrollo
Washington D. C.

Estimado Señor Iglesias:

El propósito de la presente carta es describir los objetivos y las acciones de política, tanto económica como social, más importantes contenidos en el programa de gobierno de la República de Panamá, así como los resultados de las negociaciones para reestructurar el capital y los intereses que se adeudan a los bancos comerciales y diversas entidades financieras, en base a lo cual la República de Panamá solicita apoyo a la institución a su digno cargo, para el Programa de Reducción de la Deuda.

Marco Macroeconomico

Los objetivos del Programa del Gobierno son los de promover el crecimiento económico por medio del logro de una mayor eficiencia y productividad en el uso de los recursos con que cuenta el país, y de esta manera lograr una reducción importante de la pobreza.

Se reconoce que la falta de crecimiento de la economía y la pérdida de competitividad de la misma, obedecen al uso ineficiente de los recursos, altos costos de los servicios básicos, el proteccionismo, distorsiones microeconómicas y a una infraestructura deficiente.

Para llevar adelante el programa de reformas económicas es un requisito indispensable que las finanzas públicas se desarrollen dentro de un ambiente de estabilidad fiscal. En este contexto, la pronta solución del problema de la deuda comercial es una pieza clave.

El Programa de Reformas.

Este Programa apunta hacia la solución de los problemas de falta de eficiencia, competitividad y altos costos en la economía, por medio de acciones en los campos de empresas públicas, política laboral, comercio internacional y la eliminación de distorsiones Microeconómicas que promuevan una verdadera economía de mercado en nuestro país.

Con el componente de reformas sectoriales y de empresas públicas se tiene por objetivo reducir los costos a la empresa privada al hacer uso de los servicios básicos y otra infraestructura económica. Los altos precios de estos servicios, son una de las causas de la perdida de competitividad de nuestra economía, al encarecer los costos de producción directos y los relacionados con el comercio internacional. Para el logro de las metas en este componente se ha utilizado el esquema de eliminación de monopolios estatales en la provisión de algunos servicios públicos y además se impulsa la participación del sector privado en tales actividades a través de privatizaciones y de concesiones.

En febrero del presente año se modificaron las Leyes Orgánicas del Instituto de Recursos Hidráulicos y Electrificación (IRHE) y del Instituto Nacional de Telecomunicaciones (INTEL).

En la primera empresa, las modificaciones permiten la generación, distribución y venta de electricidad, asociada a la nueva capacidad de generación, por parte de operadores privados. En el caso del INTEL, se permite la venta del 49% de sus acciones al sector privado. La empresa calificada que adquiera tales acciones tendrá un contrato de administración por 20 años para el manejo de la misma. Adicionalmente en el sector telefónico, se licitará a final de año una de las bandas de telefonía celular.

La estrategia seguida en los puertos ha sido la de otorgar concesiones tanto en los principales puertos terminales del Canal, como para la construcción de nuevas facilidades portuarias al sector privado. En la actualidad se encuentra bajo estudio el esquema a seguir en el caso de la empresa potabilizadora de agua.

En materia de infraestructura vial, se ha otorgado la concesión a la empresa privada para que construya y opere la Autopista de Panamá-Colón y el Corredor Norte y se encuentra en proceso de licitación el Corredor Sur.

Los recursos provenientes de las privatizaciones ingresarán a un fondo de inversión, creado por el gobierno para financiar obras de infraestructura y de desarrollo humano

Con las reformas contempladas y en proceso, en el sector de empresas públicas, se logrará por medio de la atracción de capitales privados, la incorporación de nuevas tecnologías que incrementen la eficiencia y reduzcan los costos a los usuarios.

En materia laboral, recientemente se realizaron modificaciones al Código de Trabajo, con lo cual se logrará una mayor flexibilidad en las relaciones laborales. Las mismas promueven una mayor productividad en el uso de la mano de obra, lo cual se traducirá en un menor costo de la misma.

Actualmente se realizan negociaciones para lograr la adhesión de Panamá a la Organización Mundial de Comercio, en el marco de las mismas, uno de los primeros beneficios será el ordenamiento y modernización de toda nuestra legislación en materia comercial y sanitaria relacionada. Además, se producirá una reducción en los niveles arancelarios y la eliminación del sistema de cuotas de importación. En adición a lo anterior, el gobierno estudia la posibilidad de nueva reducción de aranceles en productos agropecuarios.

Con el objetivo de eliminar distorsiones y lograr una mejor asignación de los recursos, al igualar el tratamiento de incentivos a los diversos sectores, la Asamblea Legislativa aprobó la Ley de Universalización de Incentivos a la Producción. En la misma, se reduce el impuesto sobre la renta a las personas jurídicas y se readecúa el tratamiento a las empresas en la Zona Libre de Colón. En el sector industrial, los incentivos existentes se hacen extensivos a todos los agentes económicos. En otros sectores se reducen paulatinamente, o se redireccionan para lograr un mayor impacto en el campo social.

Próximamente el Gobierno presentará ante la Asamblea Legislativa la Ley de Defensa de la Competencia. La misma, promueve los mecanismos de mercado al legislar en materia de prácticas anticompetitivas (monopolios) y concentraciones económicas. Además, se dictan medidas en materia de protección al consumidor. Este Proyecto de Ley, también incluye medidas sobre las prácticas de comercio desleal, elemento importante en comercio internacional. Con la aprobación de esta Ley por parte de la Asamblea Legislativa, la

reforma comercial en progreso y la finalización del uso de controles de precios, se sentarán las bases para la operación de una verdadera economía de mercado en Panamá.

En el campo de las finanzas públicas un objetivo de corto plazo, es el logro de un incremento en el ahorro, con la finalidad de financiar las crecientes necesidades en materia social de la población. En materia de gastos, el objetivo es contener el crecimiento del renglón salarios, por medio de un congelamiento en el nivel de empleo y salarios, con excepción de los sectores amparados por leyes especiales y reduciendo el empleo a través del no reemplazo en puestos que queden vacantes a partir de enero de 1996.

Con una visión de mediano plazo, la Asamblea Legislativa aprobó en 1994 la Ley de Carrera Administrativa para los servidores públicos, y actualmente se encuentra en estudio una Ley General de Sueldos, con lo cual el Estado contará con mejores elementos para manejar el costo de la planilla estatal.

En relación a la Caja del Seguro Social, se han iniciado medidas administrativas para incrementar sus ingresos y lograr un uso más eficiente de los recursos con que cuenta. Simultáneamente, el Gobierno junto con la Caja, estudian diversas alternativas para definir la futura estrategia financiera de la misma.

Es necesario señalar que el programa de reformas económicas ejecutadas por el gobierno de la República de Panamá ha contado con el apoyo de sendos préstamos del Banco Interamericano de Desarrollo (Préstamo para la Reforma de Empresas Públicas) y del Banco Mundial (Préstamo para la Recuperación Económica). Actualmente se encuentra en fase final de negociación un Acuerdo Stand-By con el Fondo Monetario Internacional.

Acuerdo de Renegociación de la Deuda.

El 5 de mayo de 1995, Panamá concluyó negociaciones con el Comité Asesor para reestructurar el capital y los intereses que se adeudan a los bancos comerciales y diversas entidades financieras. Como parte de este proceso, a principio de octubre se distribuyó a la Comunidad Financiera Internacional la descripción detallada de los términos y condiciones del Plan de Financiamiento de 1995.

El Plan de Financiamiento prevé canjear el capital de la deuda comercial a mediano y largo plazo, que suma aproximadamente US$2,010 millones, por los siguientes bonos:

Bonos de Descuento, Bonos de Interés Reducido, Bonos a la Par, y Bonos de Nuevo Dinero/Conversión. Todos los bonos ofrecidos por Panamá serán registrados y emitidos en dólares. Los Bonos de Descuento y a la Par tendrán garantía sobre su capital y sobre 12 meses de interés. Los Bonos de Interés Reducido sólo tendrán 6 meses de garantía sobre intereses.

Los Bonos de Descuento, pagaderos en 30 años, tendrán el 55% del valor de la deuda canjeada y devengarán un interés de LIBOR más 13/16% por año. Los Bonos a la Par, también pagaderos en 30 años, ofrecerán un interés de 3% en el año 1; 3.25% en el año 2; 3.5% en el año 3; 3.75% en el año 4; 4.25% en los años 4 y 5; 4.75% en los años 6 y 7; 5.25% en los años 9 y 10 y 5.5% en los años 11 al 30.

Los Bonos de Interés Reducidos ofrecerán un interés de 3.5% en el año 1; 3.75% en el año 2; de 4.00% en el año 3; de 4.25% en año 4; de 4.50% en año 5; de 4.75% en el año 6; de 5.00% en el año 7 y de LIBOR más 13/16% anual para los años subsiguientes. Los Bonos de Interés Reducido se amortizarán en 27 pagos iguales y semi-anuales comenzando 5 años después del cierre.

Los acreedores que seleccionen los Bonos de Conversión/Nuevo Dinero deben prestarle a Panamá nuevos fondos equivalentes al 10% de la deuda canjeada por Bonos de conversión. Los Bonos de Conversión se amortizarán en 22 pagos iguales y semi-anuales comenzando 9.5 años después del cierre. Estos bonos ofrecerán un interés de 4.50% en el año 1; de 4.75% en los años 2, 3 y 4; de 5.75% en los años 5, 6 y 7; y una tasa de LIBOR más 13/16% para los últimos 12 años. Los Bonos de Nuevo Dinero tendrán un plazo de 15 años y serán amortizados en 16 pagos iguales y semi-anuales después del año 7.5. El interés de estos Bonos será de LIBOR más 13/16% por año.

También, se anticipa la reestructuración de todos los intereses atrasados. Los Bonos de Interés Atrasado no tienen garantía y son por un plazo de 20 años. Estos bonos se amortizarán en 21 pagos variables comenzando en el décimo aniversario del cierre. Estos devengarán interés a la tasa LIBOR más 13/16% por año.

Finalmente, una proporción importante de los fondos necesarios para cerrar la adquisición de las garantías y el pago al cierre se obtendrá de entidades multilaterales. Se anticipa que el remanente provendrá de recursos propios de Panamá. El costo de las garantías y de intereses para el cierre no excederán de US$325 millones.

Con la seguridad de contar con el decidido respaldo de vuestra institución, hacemos propicia la oportunidad para reiterarle los sentimientos de nuestra mayor estima y consideración.

Atentamente,

Guillermo O. Chapman Jr.
Ministro de Planificación y
Política Económica

FINANCIAL TERMS AND CONDITIONS OF THE AGREEMENT

	Amount US$ millions	Discount and/or reduction	Interest rate	Time (years)	Grace period (years)	Amortization	Principal collateral	Interest collateral	Observations
I. OPTIONS FOR THE PRINCIPAL									
nds ed)	271 (Exchanged for US$603 million in eligible debt)	45%	Six-month LIBOR + 13/16%	30	0	A bullet payment 30 years from the closing date.	100% (US$47.6 million)	12 months renewable (US$17.4 million)	The principal will be collateral year United States Treasury ze bonds (reference rates for the principal, US$0.1414 per US$ interest, 5.25%)
5%	704	-	Year 1: 3.00% Year 2: 3.25% Year 3: 3.50% Year 4: 3.75% Years 5-6: 4.25% Years 7-8: 4.75% Years 9-10: 5.25% Years 11-30: 5.50%	30	0	A bullet payment 30 years from the closing date.	100% (US$101 million)	12 months renewable (US$16.2 million)	The principal will be collateral year United States Treasury ze bonds. (Reference rates for th principal, US$0.1414 per US$ interest, 2.30%)
nds	704	-	Year 1: 3.50% Year 2: 3.75% Six-month LIBOR + 13/16%	18	5	27 semiannual payments beginning five years from the closing date	None	6 months renewable (12.5 million)	Reference rates for interest co 1.78%
ion	0	-	Year 1: 4.50% Years 2-4: 4.75% Years 5-7: 5.75% Years 8-20: Six-month LIBOR + 13/16%	20	9 1/2	22 semiannual payments, ensuring full amortization in year 20.	None	None	The principal payments will be second half of the ninth year, t guaranteeing full amortization They involve buying an additio NM bonds.
/ n	0 (additional 10% of the purchase of DC bonds)	-	Six-month LIBOR + 13/16%	15	7 1/2	16 semiannual payments, thereby ensuring full amortization in year 15.	None	None	The principal payments will be second half of the seventh year guaranteeing full amortization The amount should be 10% of bonds.

	Amount US$ millions	Discount and/or reduction	Interest rate	Time (years)	Grace period (years)	Amortization	Principal collateral	Interest collateral	Observations
II. TREATMENT OF INTEREST									
est	124			1		June '95 = US$12 million June-Sept.'95 = US$6 million Oct./Dec. '95 = US$6 million At closing date = US$100 million			Panama pledged to make mont payments of US$2 million unti date.
est	1,350		Six-month LIBOR + 13/16%. During the first six years the difference between this rate and a rate of 4% per annum can be capitalized.	20	10	21 semiannual graduated payments: 1-8: 2.00% of the principal 9-11: 3.00% of the principal 12-21: 7.50% of the principal	None	None	The principal payments will be tenth year from the closing dat difference between the LIBOR 13/16% and the 4% interest ra 1 to 6 could be capitalized, at t discretion.
tion	523	100%							Preliminary estimate of the red resulting from recalculating int LIBOR + 13/16% instead of t the loan contracts.

MINISTRY OF PLANNING AND ECONOMIC POLICY
PUBLIC CREDIT OFFICE

ITEMIZATION OF BALANCE AND ARREARS OF THE EXTERNAL PUBLIC DEBT

AS OF JUNE 30, 1995
(in United States dollars)

CREDITORS	BALANCE AS OF 6/30/95	PRINCIPAL DEBT	(%) OUTSTANDING	PAST DUE INTEREST	PAST DUE FEE	TOTAL DEBT	% TOTAL
MULTILATERAL	**691,570,459**	**0**	**0.00%**	**0**	**0**	**691,570,459**	**12.18%**
IMF	129,536,822	0	0.00%	0	0	129,536,822	2.28%
Central government	129,536,822	0	0.00%	0	0	129,536,822	2.28%
WORLD BANK	155,950,620	0	0.00%	0	0	155,950,620	2.75%
Central government	127,361,163	0	0.00%	0	0	127,361,163	2.24%
Decentralized agencies	28,589,457	0	0.00%	0	0	28,589,457	0.50%
IDB	397,205,595	0	0.00%	0	0	397,205,595	7.00%
Central government	210,745,464	0	0.00%	0	0	210,745,464	3.71%
Decentralized agencies	186,460,130	0	0.00%	0	0	186,460,130	3.28%
IFAD	8,877,423	0	0.00%	0	0	8,877,423	0.16%
Central government	8,877,423	0	0.00%	0	0	8,877,423	0.16%
OFFICIAL BILATERAL	**526,328,110**	**21,139,368**	**4.02%**	**4,279,090**	**8,001,644**	**538,608,844**	**9.49%**
USAID	117,488,428	0	0.00%	0	0	117,488,428	2.07%
Central government	104,392,227	0	0.00%	0	0	104,392,228	1.84%
Decentralized agencies	13,096,200	0	0.00%	0	0	13,096,200	0.23%
USAID-GUARANTEED	61,534,611	0	0.00%	0	0	61,534,611	1.08%
Central government	53,928,755	0	0.00%	0	0	53,928,755	0.95%
Decentralized agencies	7,605,856	0	0.00%	0	0	7,605,856	0.13%
OFFICIAL SUPPLIERS	46,372,778	0	0.00%	0	0	46,372,778	0.82%
Central government	48,807,352	0	0.00%	0	0	18,807,352	0.33%
Decentralized agencies	27,565,425	0	0.00%	0	0	27,565,425	0.49%
SUPPORT GROUP	96,446,281	0	0.00%	0	0	96,446,281	1.70%
Central government	96,446,281	0	0.00%	0	0	96,446,281	1.70%
PARIS CLUB II	183,146,743	0	0.00%	0	0	183,146,743	3.23%
Central government	183,146,743	0	0.00%	0	0	183,146,743	3.23%
FINEXPO	147,349	147,349	100.00%	5,561	126,319	279,230	0.00%
Central government	147,349	147,349	100.00%	5,561	126,319	279,230	0.00%
FIVEN (PROJECTS)	1,191,921	992,019	83.23%	446,584	712,746	2,351,251	0.04%
Central government	888,096	780,506	87.89%	288,206	537,325	1,713,627	0.03%
Decentralized agencies	303,825	211,513	69.62%	158,378	175,421	637,624	0.01%
LIBYAN ARAB FOREIGN BANK	20,000,000	20,000,000	100.00%	3,826,944	7,162,579	30,989,523	0.55%
Central government	20,000,000	20,000,000	100.00%	3,826,944	7,162,579	30,989,523	0

COMMERCIAL BANKS	2,076,067,180	1,859,036,313	89.55%	1,605,350,025	329,678	3,681,746,883	64.86%
-Central government	1,785,199,568	1,584,895,971	88.78%	1,416,415,140	329,678	3,201,944,386	56.40%
-COAGRO/BDA. (GC)	8,064,423	8,064,423	0.00%	10,967,681	0	19,032,104	0.34%
-Decentralized institutions	238,899,559	222,172,289	93.00%	155,807,524	0	394,707,083	6.95%
-Lines of credit (ID)	43,903,630	43,903,630	100.00%	22,159,681	0	66,063,311	1.16%
FOREIGN BONDS	433,732,375	2,359,223	0.54%	318,879	370,563	434,421,817	7.65%
Restructured	428,795,152	0	0.00%	0	0	428,795,152	7.55%
Not restructured	2,359,858	2,359,858	100.00%	318,879	369,011	3,047,748	0.05%
Guaranteed (Annual Canal Fees)	2,577,365	(635)	-0.02%		1,552	2,578,917	0.05%
MISCELLANEOUS SUPPLIERS	49,044,474	1,300,000	2.65%	598,000	84,500	49,726,974	0.88%
Central government	1,300,000	1,300,000	100.00%	598,000	84,500	1,982,500	0.03%
Decentralized agencies	47,744,474	0	0.00%	0	0	47,744,474	0.84%
SAN JOSE AGREEMENT	158,653,320	126,493,156	79.73%	41,537,920	80,549,215	280,740,456	4.95%
TOTAL PUBLIC DEBT	3,935,395,919	2,010,328,060	51.08%	1,652,083,914	89,335,600	5,676,815,433	100.00%
CENTRAL GOVERNMENT	3,341,227,362	1,744,040,628	52.20%	1,473,958,331	89,160,179	4,904,345,873	86.39%
DECENTRALIZED AGENCIES	594,168,556	266,287,432	44.82%	178,125,583	175,421	772,469,560	13.61%

Panama, August 14, 1995
Exchange rate as of June 29, 1995

valent in debt and debt-service reduction operations

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Changes in Face Value					Adjustments			Debt Reduction		
Face Value of Eligible Debt	Face Value of Debt Reduction	New Money	Net Face Value of Debt Reduction	Face Value of New Debt	Present Value of Interest Reduction	Equivalent Prepayments of Collateral	Net Adjustments	Debt Reduction Equivalent	Additional Multilateral Debt	Total Debt Reduction Equivalent
(1)	(2)	(3)	(4)=(2)-(3)	(5)=(1)-(4)	(6)	(7)	(8)=(6)+(7)	(9)=(4)+(8)	(10)	(11)=(9)-(10)
47,170	7,190	1,091	6,099	41,071	7,090	7,122	14,212	20,311	3,128	17,183
6,600	2,600	850	1,750	4,850	1,107	464	1,571	3,321	402	2,919
1,608	1,020	0	1,020	588	122	38	160	1,180	183	997
19,011	1,954	1,212	742	18,269	2,494	1,736	4,230	4,972	637	4,335
1,610	628	89	539	1,071	158	111	269	808	33	775
5,339	3,310	0	3,310	2,029	612	357	969	4,279	0	4,279
29,335	3,415	0	3,415	25,920	4,797	3,059	7,856	11,271	1,752	9,519
895	147	0	147	748	112	118	230	377	0	377
57,600	4,718	353	4,365	53,235	3,204	3,800	7,004	11,369	0	11,369
8,174	3,130	0	3,130	5,044	302	394	696	3,826	232	3,594
1,186	712	0	712	474	0	56	56	768	0	768
14,333	6,490	138	6,352	7,981	1,425	624	2,049	8,401	390	8,011
7,429	1,839	0	1,839	5,590	1,031	591	1,622	3,461	498	2,963
4,008	918	0	918	3,090	432	195	627	1,545	159	1,386
204,298	38,071	3,733	34,338	169,960	22,886	18,665	41,551	75,889	7,414	68,475

onal multilateral debt (10).

ge based on percentage structure of column (1).

view of the IBRD Program to Support Debt and Debt Service Reduction (Document SecM95-385), April 21, 1995. Its calculations.

TOTAL EXTERNAL PUBLIC DEBT AND COMMERCIAL DEBT. COMPARATIVE PROJECTION
CONTRACTUAL vs. RESTRUCTURED DEBT SERVICE
(in millions of US$)

	1996	1997	1998	1999	2000	2001	2002	2003	2004
t Service - Contractual ut 1995 Financing Plan)	756.5	762.3	704.5	713.7	747.6	810.4	754.2	633.4	590.4
zation st	328.3 428.2	309.5 452.8	223.6 480.8	236.5 477.2	272.1 475.4	339.8 470.6	309.1 445.1	205.9 427.5	181.2 409.2
t Service - Restructured 1995 Financing Plan)	563.8	615.4	629.7	663.1	741.0	854.5	758.0	736.9	654.3
zation st	230.8 325.1	238.7 368.3	223.6 397.3	242.8 420.3	315.5 425.5	419.8 434.7	389.1 368.9	285.9 451.0	254.9 399.4
l Bank Debt Service ut 1995 Financing Plan)	369.6	338.2	278.9	268.5	268.5	268.5	268.5	268.5	268.5
zation st	97.5 272.1	70.8 267.4	0 278.9	0 268.5	0 268.5	0 268.5	0 268.5	0 268.5	0 268.5
l Bank Debt Service 1995 Financing Plan)	88.4	191.3	204.2	217.9	288.1	364.7	324.4	424.1	384.5
zation st	0.0 176.8	0.0 191.3	0.0 204.2	6.3 211.6	69.5 218.6	132.1 232.6	132.1 192.3	132.1 292.0	125.8 258.7

Republic of Panama
Ministry of Planning and Economic Policy

Panama City, November 16, 1995
DS/DE/N-43/95

Mr. Enrique Iglesias
President
Inter-American Development Bank

Dear Mr. Iglesias:

On May 5, 1995, the Republic of Panama (hereinafter "Panama") and the Bank Advisory Committee reached agreement on the terms of reference for restructuring the medium- and long-term commercial bank debt under the 1995 Financial Plan (hereinafter the "Financial Plan").

To formalize the agreement, Panama made available to the international financial community the terms under which the Financial Plan would be implemented (see attached copy of the terms and conditions). The plan is a key element in the fiscal and economic reforms that President Ernesto Pérez Balladares has implemented to stimulate private investment and make the national economy more efficient. With these objectives in mind, the administration of President Pérez Balladares has launched programs to: (1) modernize government and public finance, (2) allow the private sector to invest in certain public service industries, (3) control and reduce the fiscal deficit, and (4) institute structural reforms in Panama's labor, trade, and productive sectors. The government has also pledged to alleviate poverty, help generate new jobs, support social services, assist those affected by the economic transition, and preserve the environment. The government knows that the external debt has to be reduced through the Financial Plan in order to sustain economic growth and clear away a major obstacle to Panama's medium-term macroeconomic stability.

Specifically, under the Financial Plan, the principal outstanding on the medium- and long-term commercial debt, which totals some US$2.01 billion, will be swapped for the following bonds: discount bonds, par bonds, interest-reduction bonds, and debt conversion/new money bonds. All the bonds issued by Panama will be registered and issued in dollars. The principal and 12 months of interest on the discount and par bonds will be collateralized, while only 6 months of interest will be collateralized in the case of the interest-reduction bonds.

The 30-year discount bonds will be 55% of the value of the debt for which they are swapped and will pay interest at the rate of LIBOR plus 13/16% per annum. The par bonds, also 30-year bonds, will pay interest of the rate of 3% in year 1; 3.25% in year 2; 3.5% in year 3; 3.75% in year 4; 4.25% in years 4 and 5; 4.75% in years 6 and 7; 5.25% in years 9; and 10 and 5.5% in years 11 through 30.

The interest-reduction bonds will pay interest at the rate of 3.5% in year 1; 3.75% in year 2; 4% in year 3; 4.25% in year 4; 4.50% in year 5; 4.75% in year 6; 5% in year 7; and LIBOR plus 13/16% per annum thereafter. The interest-reduction bonds will be amortized in 27 equal, semiannual payments beginning 5 years from closing.

Creditors opting for the debt-conversion/new money bonds will lend Panama new funds equivalent to 10% of the debt swapped for debt-conversion bonds. Debt-conversion bonds will be amortized in 22 equal, semiannual payments starting 9.5 years after closing. They will pay interest at the rate of 4.50% in year 1; 4.75% in years 2, 3, and 4; 5.75% in years 5, 6, and 7; and LIBOR plus 13/16% in the last 12 years. The new money bonds mature in 15 years and will be amortized in 16 equal, semiannual payments after year 7.5. The interest on these bonds will be LIBOR plus 13/16% per annum.

Under the plan, all past due interest will be restructured. The past due interest bonds will not be collateralized and are 20-year bonds that will be amortized in 21 variable payments, starting the tenth year from closing. They will pay interest at the rate of LIBOR plus 13/16% per annum.

One of the preconditions for exchanging eligible debt for the instruments described in the preceding paragraphs is that Panama collateralize the principal and interest of the par and discount bonds and the interest on the interest-reduction bonds. A considerable share of the funds needed to purchase the collateral and for the payment at the exchange's closing date will come from Panama's own funds. The cost of the collateral and interest to be paid at closing will not exceed an estimated US$200 million.

By November 14, 96% of Panama's creditors had reported their reaction to the Financial Plan, indicating their willingness to exchange their debt for one or more of the bonds mentioned above.

Approximately 4% of the debt will be exchanged for discount bonds, 14% for par bonds, and 82% for interest-reduction bonds. Before closing, all creditors participating in the Financial Plan will consent to the waivers required to close the transaction, including the waivers needed to pledge the required collateral.

In order for Panama to be able to guarantee the par bonds, discount bonds, and interest-reduction bonds called for under the Financial Plan, it is asking all its creditors whose contracts prohibit the creation of

encumbrances on Panama's assets or revenues to secure its external debt, to waive all such limitations to the extent necessary to collateralize the bonds in question. Panama hereby requests that the Inter-American Development Bank ("IDB") waive the negative pledge clauses contained in agreements with the IDB that stipulate that Panama may not dispose of or create encumbrances on assets to the benefit of third parties (Article 8.01 of the General Conditions). The waiver is requested for the sole purpose of allowing Panama to pledge the collateral needed to guarantee payment of the principal and interest of the par and discount bonds and the interest on the interest-reduction bonds to be issued under the 1995 Financial Plan. Panama has also asked the World Bank and the International Monetary Fund to waive their negative pledge clauses. This waiver will not in any way alter Panama's obligation to pay, by the agreed upon dates, all amounts owed by Panama, its agencies, and other government institutions, either as collateral or under loan contracts, and does not imply any restructuring of those obligations.

Panama therefore respectfully requests a waiver of the negative pledge clause stipulated in Article 8.01 of the General Conditions set forth in loan contracts with the IDB. It also reaffirms all commitments undertaken vis-a-vis the IDB. The waiver would only be for guarantees under the Financial Plan and, with this one exception, would not curtail any right that the IDB has under that clause. We understand that any waiver that the Bank should grant in this regard would only take effect once Panama has been granted similar waivers by the other creditors from which it has made such requests. In view of the foregoing, we hope that the Bank will look favorably upon our request.

We would like to take this opportunity to send you our warm regards.

Very truly yours,

Guillermo D. Chapman Jr.
Minister

Appendix I
PN029P
PN-0098
Orig:Spanish

PROPOSED RESOLUTION

PANAMA. LOAN No. /OC-PN TO THE REPUBLICA DE PANAMA
(Program of External Debt and Debt Service Reduction)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República de Panamá, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a program of external debt and debt service reduction. Such financing will be for an amount of up to US$30,000,000, or its equivalent in other currencies, except that of Panamá, which are part of the Ordinary Capital resources of the Bank, and will be subject to the "Terms and Financial Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.