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Panama's President Martin Torrijos has introduced profound fiscal reforms aimed at boosting tax collection and reducing poverty, and he has called a special legislative session to deal with them. The measures, say economists, change the economic model of the country, and they have sparked fierce opposition across a broad swath of the nation's sectors.

As Minister of Economy and Finance Ricaurte Vazquez explained the motives of the changes, "In the Panamanian model, there is no correspondence between economic growth and the distribution of income, which generated unjustified inequalities, given the high level of national wealth." The reforms seek a 7% reduction in poverty over a four-year period. Vasquez called it "inconceivable" that a country of 3 million people, with a GDP of more than US$14 billion, could have 40% of its population living in poverty.

The bill the government has sent the congress was therefore titled the Ley de Equidad Fiscal (fair taxation law). It will undergo a difficult debate in the treasury committee of the legislature and is slated to emerge from committee in early February. Long overdue, but no one felt obligated Although Panama has not changed its tax policy in more than a decade, the reforms are finding little support among the general population. Despite the lofty goals of the new law, few, according to a recent poll, find themselves in sympathy with the objectives.

The Pulso de la Nacion inquiry conducted by the newspaper La Prensa found, "The Panamanian does not feel obligated to contribute with taxes to the development of society and institutions. Not even the proposal of fiscal reforms that offers "fairness" can motivate them." Pollsters deduced this from poll results showing that 61% of respondents pay taxes only because they have no legal alternatives. Slightly more than that number distrust government, agreeing that the government uses taxes inefficiently or very inefficiently. Among the very poorest who pay taxes, the number of those feeling that way rises to almost 69%.

Individual taxpayers also resent businesses, specifically those in the Zona Libre de Colon, that go tax-free (see NotiCen, 1996-08-29). Nearly 87% of respondents think those enterprises ought to ante up. Originally, so did the government.

An early version of the Ley de Equidad Fiscal called for a 2% tax on sales in the free-trade zone, but that proposal never made it through deliberations of the Cabinet on Jan. 19, because of pressure from the powerful entrepreneurs of the zone. Zona Libre businesses did about US$10.29 billion in tax-free trade in 2004, a rise of 18.9% over 2003.

New revenues needed, really

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Nevertheless, the government projects an increase in revenues of some US$300 million, which will allow it to reduce its deficit from 5% to 1% of GDP. The package includes a new minimum alternative tax (impuesto sobre la renta minimo alternativa, IRMA) for businesses and individuals of 1.4%. From that feature alone, just from corporations, the expected increase in collections is US$130 million. The plan envisions raising the percentage of total taxable income on which the tax is applied and is therefore the most controversial element in the package.

Both businesses and professionals complain that the new calculation will eat into income, affecting the profitability of businesses and the net income of individuals who earn more than US$60,000 a year. IRMA would not apply to small businesses with gross receipts below US$150,000. Most irksome for the business classes is the fact that under the new calculus, entertainment expenses would no longer be deductible.

The Asociacion Panamena de Ejecutivos de Empresa (APEDE) complains that these expenses are as much as 25% of the income of the professional classes who, they say, pay more than half the income tax in the country.

Donations at risk

Nonprofit organizations are also opposed to provisions of the reforms. The new regime would put a cap on the deductibility of donations. Article 15 of the bill limits business donations to 1% of taxable income. The nonprofits want written into the bill provisions that would differentiate those foundations specifically formed for the purpose of tax avoidance from those that actually provide community functions.

Marta de Vallarino of Fundacancer said her organization would not only see a decline in donations, "but it would affect people sick with cancer who depend on this type of support to continue their care." Vice Minister of Finances Rolando Mirones denied that the new rules would curtail donations. He said the administration has studied the effect of the regulation and determined that even the largest donors contribute less than the 1%. But that defense fell flat.

Another representative of the nonprofit sector, Rosina de Sucre of Fundamujer, pointed out that, "with the assignment of the 1.4% [IRMA] on gross income in place of the income tax, donations [of more than 1%] will doubly cut into the real profits of the donor." Popular rejection of the reforms was not lost on opposition politicians. In the Asamblea Nacional, representatives of the Partido Panamenista, the Movimiento Liberal Republicano Nacionalista (MOLIRENA), and the Partido Solidaridad all voiced doubt and rejection.

Panamenista Marco Ameglio said the reforms do not promote fairness "because they are directed at an economically active sector, which invests." In general, the opposing arguments broke down to three:

the government would do better to collect from evaders rather than raise taxes on those who pay;

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the cap on donations penalizes organizations that depend on them and their clientele;

entertainment-expense exemptions should be available for all but public officials. In the face of widespread opposition, the Torrijos government is adamant.

Against warnings that the reforms will hurt the economy, Torrijos has said that these tax increases, along with spending cuts, will save the country from bankruptcy. Without the projected US$350 million annual boost to the treasury, it will be impossible to pay the state's obligations, which include social security, which is in danger of collapse, a situation that has been worsening for years. The previous administration of Mireya Moscoso (1999-2004) wanted to privatize it. Such a move would likely be explosive.

On the fairness issue, the president contends that the poor pay a 400% higher percentage of income in taxes than do those in the highest brackets. He has promised not to impose taxes for the great majority of workers who earn less than US$800 a month. This amount is higher than the US$500 tax floor that some analysts expected. The reform package is not a stand-alone fix. The government will also cut the number of state workers, reduce perks, and even restrict the use of cell phones among state officials. The cuts will shrink the state apparatus by 14%. Markets support reforms

Nor is the plan universally abhorred. When the details of the reforms were announced, sovereign bond prices soared on international markets. A report by Credit Suisse First Boston predicted, "Given Torrijos' solid majority and his still-high approval rating, we expect the government to pass the fiscal package with few, if any, revisions." His ratings are more than "still high;" at 80%, they are the highest of any president in the hemisphere, according to the Mitofsky surveying firm in Mexico. If Credit Suisse is right, a tax system that analysts have called "notoriously skewed in favor of the rich" will be leveled.

In the end, as a Panama News editorial pointed out, "The nation does not raise enough money to do the things that the government needs to do, and, despite any attempt to point to a part of a tax reform package and extrapolate it as an overall tax cut, any "tax reform" that will be accepted by international financial institutions as such means a net tax increase when all of its elements are considered."

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