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STUDY BY THE STAFF OF THE U.S.

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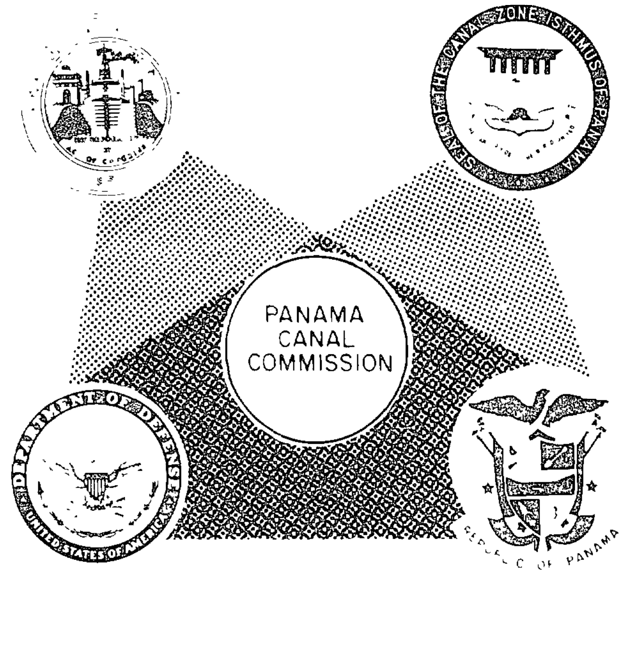
General Accounting Office

Background Information Bearing Upon Panama Canal Treaty Implementing Legislation

The signing of the Panama Canal Treaty by President Carter and General Torrijos on September 7, 1977, culminated 13 years of negotiations involving four administrations of both parties. The new Treaty will provide an entirely new basis for cooperation between the United States and Panama for operation and defense of the Panama Canal and abrogates all prior agreements between the two countries. The Treaty calls for the establishment of the Panama Canal Commission to replace on October 1, 1979, the Canal Zone Government and Panama Canal Company presently responsible for administering Canal operations. The Treaty expires on December 31, 1999, at which time Panama will assume control and responsibility for Canal operations.

In this document, GAO has attempted to summarize information bearing on Congressional consideration of implementing legislation. This study deals with issues addressed by the Comptroller General during testimony before the Senate Committee on Armed Services and House Committee on Merchant Marine and Fisheries concerning the (1) Commission's form of organization, (2) cost of public services and financial viability, (3) orderly transfer of property to and accounts receivable payments from Panama, and (4) other Treaty-related costs.



UNITED STATES GENERAL ACCOUNTING OFFICE

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JUNE 4, 1979

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114839

To the President of the Senate and the
Speaker of the House of Representatives

This staff study discusses the status as of April 30, 1979, of the organizational and financial issues addressed by the Congress and the Comptroller General concerning the Panama Canal Treaty of 1977 and provides an information source and data base.

The United States Government and the Government of Panama signed the Panama Canal Treaty and the Treaty concerning the Permanent Neutrality and Operation of the Canal on September 7, 1977, (Panama Canal Treaty of 1977). Both parties agreed to terminate all prior treaties pertaining to the operation of the Canal and to enter into a new relationship for operating the Canal. The U.S. Senate ratified the ~~Treaty concerning the Permanent Neutrality~~ and Operation ~~of the Canal~~ on March 16, 1978, and the Panama Canal Treaty on April 18, 1978, respectively.

The Panama Canal Treaty of 1977 will become effective no later than October 1, 1979, but it is not known when the treaty-implementing legislation will become effective.

The Panama Canal Enterprise (identifier) comprises the Panama Canal Company (PCC) and the Canal Zone Government (CZG). The CZG, an appropriated-fund agency, operates, administers, and conducts various civil government functions such as education, health, sanitation, fire and police protection, and postal services in the Canal Zone.

The PCC, a corporate agency under the Government Corporation Control Act of 1945, transits ships through the Canal; provides services to shipping interests; maintains and operates the locks; and provides such support services as vessel repairs and operation of the harbor terminals and the railroad and electric power, communication, and water systems. It also provides essential employee welfare services, such as the operation and maintenance of housing, retail stores and service and recreational facilities. In addition, under the terms of an interagency agreement, the PCC administers the legal, personnel, and budget and accounting operations of the CZG. The PCC is a self-sustaining agency.

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The Treaty calls for establishment of the Panama Canal Commission to replace the CZG/PCC organization. It terminates the existence of the CZG, and the health and education functions will be transferred to the Department of Defense, and fragments the PCC by transferring some functions/activities to the Government of Panama and retaining those considered essential to the Canal operation by the Commission.

The Treaty will also have implications for other agencies. For example, the Department of Defense will absorb a large number of personnel from CZG/PCC; transfer properties to the Government of Panama; and incur costs for relocation, military construction, and education and health services. In 1984, the Federal Aviation Administration (FAA) is tentatively scheduled to cease operations in Panama and transfer properties to the Government of Panama. Gorgas Memorial Institute and the Smitnsonian Tropical Research Institute will be affected very little and will not transfer property to the government.

The Commission becomes operational on October 1, 1979. In order for it to become functional, implementing legislation is necessary. As of March 1979, two principal bills had been introduced to make the Commission operational--H.R. 111 by Representative John M. Murphy on January 15, 1979, and H.R. 1716 by the administration on January 31, 1979. A comparison of H.R. 111 and H.R. 1716 shows that they differ in many substantive respects but both provide the legal basis for the Commission to become operational.

The importance of the implementing legislation cannot be overstated. The executive branch has stated that the Treaty will come into effect without the implementing legislation but agrees that it is necessary to carry out the intent of the Treaty.

The objective of this study was to collect available evidence on Treaty issues discussed before congressional committees by the Comptroller General since late 1977 and to focus on how these issues are dealt with in tne two major bills (H.R. 111 and H.R. 1716) 96th Cong considered in the Congress. These issues are:

--The form of U.S. Government organization the proposed Panama Canal Commission should take and who will audit the Commission.

--The orderly transfer of functions, activities, and property.

--Resolution of the Government of Panama's debt for past services.

--Payments to the Government of Panama for public community services in relation to the actual costs incurred and assurance concerning the quality of the services.

--How the annual $10-million contingent payment to the Government of Panama should be treated.

--Payment of interest by the Commission and recovery of U.S. investment.

--Whether the Commission can earn sufficient revenue to cover costs, including who will bear the burden of increased toll rates.

--The magnitude of other Treaty-related costs which might be borne by other U.S. Government agencies.

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We held discussions with representatives of the principal organizations affected by the Treaty--the U.S. Embassy, DLG01723 Canal Zone Government/Panama Canal Company, Department of Defense, Federal Aviation Administration, Smithsonian Tropical Research Institute, and Gorgas Memorial Institute. We reviewed the Panama Canal Treaty of 1977, bills providing for implementing the Treaty, and numerous documents, studies, and reports.

This study also provides comments on significant changes made to H.R. 111 as contained in the Report of the Committee on Merchant Marine and Fisheries dated April 23, 1979, i.e., form of organization, operating expenses, property transfers, implementation costs, etc.

Copies of this study are also being sent to cognizant Committees of Congress; Director, Office of Management and Budget; Secretaries of State, Defense, the Army, the Treasury and Transportation; Commander-in-Chief, U.S. Southern Command; and the President of the Panama Canal Company.

Comptroller General
of the United States

C O N T E N T S

CHAPTER 1

FORM OF U.S. GOVERNMENT ORGANIZATION AND EXTERNAL AUDIT AUTHORITY

The Treaty is silent as to what form of organization the Commission would take--Government corporation or appropriated-fund agency. As of March 1979, two principal bills establishing the form had been introduced in the Congress--the administration's bill H.R. 1716 and H.R. 111. The administration's bill would pattern the Commission after the present Panama Canal Company, making only those changes in organization and functions required by the Treaty. H.R. 111, on the other hand, organizes the Commission as an executive U.S. Government agency--the form of organization which operated the Canal before 1951.

GAO has recommended that the new Commission be operated as a U.S. Government corporation. GAO has testified that, even though the Commission could operate as an executive agency, the administrative burden and loss of management flexibility involved in a change from a Government corporation would not be compensated for by improvement in congressional oversight. Under both bills, the agency is subject to audit by GAO.

A comparison of H.R. 111 and H.R. 1716 showed that they differ in many substantive respects but both provide the legal basis for the Commission to become operational.

Since 1951, PCC has been charged with maintaining and operating the Panama Canal and with conducting business operations. The Canal Zone Government provides civil government services to the Canal Zone and is an appropriated-fund agency. PCC is a U.S. Government corporation which operates under the Government Corporation Control Act; it receives no appropriations, is totally self-sustaining, and is required to pay annual interest to the U.S. Treasury on the U.S. Government's net direct investment in the Canal enterprise as well as to reimburse the Treasury for a portion of the annuity payments to the Government of Panama and for the net cost of CZG operations. PCC is authorized to borrow up to $40 million from the Treasury. Its affairs are managed by a Board of Directors consisting of between 9 and 13 members appointed by the Secretary of the Army, who in turn is designated by the President of the United States.

The CZG, also an independent agency of the United States, is administered by the Governor of the Canal Zone who is designated by the President of the United States and is charged with performing the duties connected with the civil government of the Canal Zone, including its protection, health, and sanitation.

The Secretary of the Army supervises the administration of the CZG and serves as stockholder of PCC. In carrying out those functions, he acts as the direct representative of the President of the United States. The Governor of the Canal Zone serves as President of PCC.

Under the provisions of the Treaty, CZG/PCC will cease to exist. Article III, paragraph 3, of the Treaty provides for establishment of a

> "* * * United States Government agency called the Panama Canal Commission, which shall be constituted by and in conformity with the laws of the United States of America."

The Commission will be supervised by a Board composed of five U.S. citizens and four Panamanian nationals. Through December 31, 1989, the Administrator of the Commission will be a U.S. national and the Deputy Administrator a Panamanian national. These roles will reverse on January 1, 1990, and continue until the termination of the Treaty at noon, Panamanian time, December 31, 1999. Chart 1 shows the CZG/PCC organization and chart 2 the proposed Commission organization.

HISTORICAL BASIS FOR CORPORATE FORM AND PURPOSE OF APPROPRIATED-FUND AGENCY

The Congress, for many years, has incorporated Government agencies which function primarily as commercial or business-type entities. This policy was confirmed by the 1947 Hoover Commission on the Organization of the Executive Branch, which made a Government-wide study and recommended that agencies with "straight-line business activities be incorporated so as to secure greater flexibility in management and simpler accounting, budgeting, and auditing methods."

This position is also in line with a 1950 Bureau of the Budget (now Office of Management and Budget) position that the financial controls generally applicable to Government-type programs, such as civil government, health, and sanitation, were not appropriate for programs which were essentially business operations. The Bureau noted that the operation

Chart I

CZG/PCC ORGANIZATION STRUCTURE

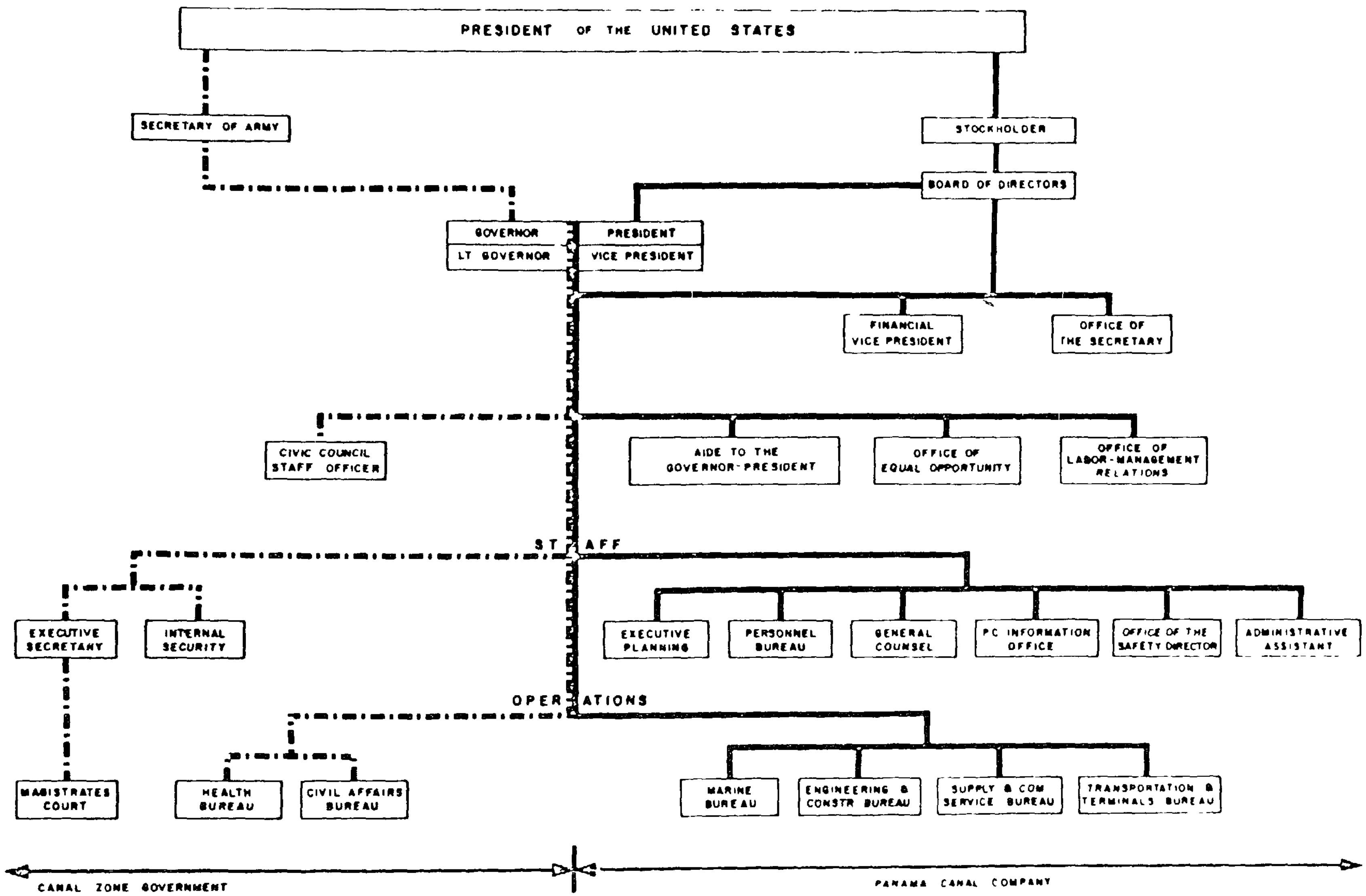
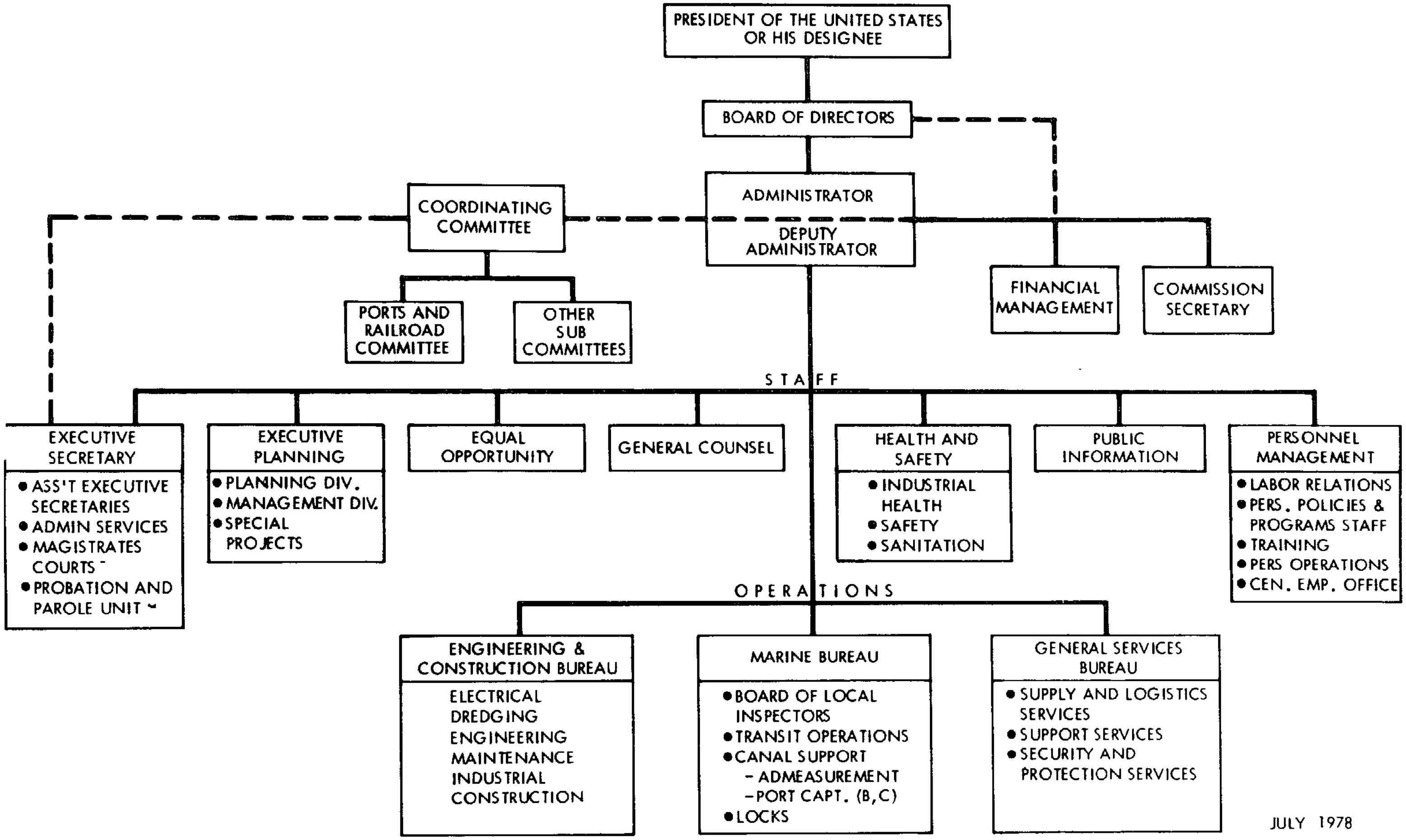


Chart 2

COMMISSION ORGANIZATION STRUCTURE



a/ The Board of Directors will comprise 5 U.S. citizens and 4 Panamanians.

b/ The Coordinating Committee will serve as the liaison between the Commission and the Government of Panama.

of the Canal was a business which produced revenue, was expected to be self-sustaining, and required considerable operating flexibility. It concluded that the business-type budgeting, accounting, and auditing provisions of the Government Corporation Control Act were more appropriate for operating the Canal than were the provisions of the Budget and Accounting Act of 1921 under which the Canal organization was then operating. We concurred in this conclusion, because we had found that the accounting system at that time was inadequate for determining and presenting revenues, costs and expenses and net profits or losses.

The Government Corporation Control Act brings Government corporations and their transactions and operations under annual scrutiny by the Congress and provides current financial control over them. Incorporation of the Commission would, therefore, be consistent with past congressional policy.

The intent of an appropriated-fund agency is to provide tax-supported Government services; its primary financial responsibility is to control the disbursement of U.S. Treasury funds within the statutory limitations established by the Congress. In that sense, agency activities financed by annual appropriations are subject to greater control. The agency's financial statements are not intended to show whether it is being operated at a profit or loss, only the financial measurement of its activities.

COMPARISON OF CORPORATE VS. APPROPRIATED-FUND AGENCY

A major contrast between the administration's bill and H.R. 111 concerns the form of organization which would be established for the Commission. (App. I compares these forms.) Several major areas of difference between the two forms are discussed below.

Organizational and accounting structure

As previously stated, the administration's bill continues for the Commission the corporate form of the PCC, whereas H.R. 111 proposes that the Commission be established as an appropriated-fund agency. The Secretary of the Army has recommended to the Senate Foreign Relations Committee and the Subcommittee on the Panama Canal, House Committee on

Merchant Marine and Fisheries, that the future Canal organization continue to be operated under the Government Corporation Control Act. Arthur Andersen & Company, financial consultants to PCC, also concluded that a Government corporation would be the best form of organization. GAO has testified in agreement with these positions, noting that it would preserve the businesslike accounting and budgeting principles which have successfully served the PCC for over 25 years.

The distinguishing budgeting, accounting, and auditing features of a Government corporation are

--business-type budgets and maintenance of accounting records in accordance with commercial corporate accounting principles and standards and

--audit by the General Accounting Office, with a mandatory report to the Congress.

As an appropriated-fund agency as required by H.R. 111, the Commission would be required not only to maintain the business-type accounting system required of Government corporations, but also to adhere to the policies and procedures for Government accounting prescribed in the Acccounting and Auditing Act of 1950. Under this change, the Commission would have to develop an accounting system which would conform with the principles, standards, and related requirements prescribed by the Comptroller General for executive agencies. This system would include a series of accounts not now maintained by PCC, such as appropriation, allotment, and obligation accounts. According to the PCC, the result would be the necessity to maintain two sets of books--one for appropriated-fund accounting and a second for accrual-type profit and loss accounting.

PCC has testified that profit and loss accounting would be indispensable to the Commission's operations. It would provide Commission management with timely and accurate financial information so that costs could be kept in line with revenues, assure the Government of Panama that the determination that revenues had or had not exceeded expenditures had been made consistently and accurately, and provide the Congress with a true measure of the Canal enterprise's economic condition. In PCC's view, nothing more than a profit and loss accounting system need be established. The supplemental set of books required for appropriated-fund accounting would create an additional administrative burden for the Commission.

Financial discipline

As a corporation, the Commission would continue the existing requirement for the Canal to be self-sustaining; that is, it would have to live within its resources. Although there are provisions in the administration's bill for the Commission to seek appropriations to cover losses and meet capital requirements, such appropriations would be forthcoming only upon the approval of the Congress as exceptions to normal procedures. On the other hand, as an appropriated-fund agency--as provided for in H.R. 111--the Commission would have access to appropriations. According to the PCC, the Commission might become increasingly dependent upon taxpayer subsidy if this latter concept were adopted. In PCC's view, this potential loss of self-discipline provides the strongest argument for supporting the administration's bill rather than H.R. 111.

According to PCC, there is no better justification for continuation of the Government corporation form for the Commission than the record of achievements amassed by PCC since it began in 1951 to the present. During this period PCC has been completely self-sufficient financially. Although it is authorized to seek appropriations to cover both losses and capital needs and to borrow up to $40 million, it has never done so despite a 4-year period of operating losses. Also, during its 28 years of existence, PCC has paid back to the U.S. Treasury $40 million in dividends as a return on the Government's investment and more than $300 million in interest on the U.S. investment in the Canal. Moreover, it has invested more than $300 million of internally generated funds in capital replacements and improvements to CZG/PCC facilities.

PCC officials have stated that there are not many Government agencies with similar records. The use of the corporate form to carry out the legal requirement that PCC live within its resources contributes to that success. These officials feel that the corporate form of organization would provide the best assurance to the U.S. taxpayer that the Canal would continue to be self-sufficient.

Emergency fund

H.R. 111 also establishes, through appropriation, an emergency fund of $40 million which the Commission could draw against to defray emergency expenses and to insure continuous operations of the Canal if funds appropriated for operations and maintenance were insufficient for their purpose. By continuing the corporate form, however, the Commission would retain the PCC's present flexibility to meet unexpected needs from its own resources and would, in addition, continue the $40 million borrowing authority.

According to PCC officials, a key difference between the two forms of organization is that there is a strong relation between the Canal's costs and its revenues. The Commission must be able to adjust its costs and rates to respond to changing traffic. The PCC cited the following example: the normal lagtime between submission of an appropriated-fund budget and the beginning of the fiscal year in which the appropriation is received and spent is more than a year. The corporate-type budget submitted by the PCC for fiscal year 1978 projected $304.1 million in operating costs to handle 141.6 million net tons of Canal traffic and all supporting activities. Instead, 157.3 million net tons passed through the Canal, costing $314.3 million, which was more than covered by the increase in revenues generated by the additional workload. Had PCC been operating under the appropriated-fund concept, it would have had to request a supplemental appropriation for the additional manpower and other costs associated with this unexpected traffic upturn. In order not to delay traffic or cut needed maintenance programs, PCC would have been forced to substantially reduce non-transit-related areas until that appropriation had been granted.

Despite the PCC wish to continue the corporate form, PCC officials stated that the Commission could operate as an appropriated-fund agency but questioned the need for the additional workload.

EXTERNAL AUDIT AUTHORITY

Both the administration's bill and H.R. 111 provide that GAO shall audit the Commission. The administration's bill allows for audits under the Government Corporation Control Act. H.R. 111 requires a two-pronged audit; section 236(a) requires a GAO audit pursuant to the Accounting and Auditing Act of 1950, while section 236(b) requires that the report be in the form of an audit report for a Government corporation. In fact, section 236(b) is virtually identical to section 106 of the Government Corporation Control Act, which specifies what should be included in audit reports for Government corporations. In essence, sections 236(a) and 236(b) of H. R. 111 require GAO to audit the Commission in accordance with standards established for Government agencies and corporations. From an audit and reporting standpoint, we believe that this requirement would increase the complexity and degree of GAO's involvement.

We have testified to several other differences between our current audits of the Panama Canal Company and the provisions of H.R. 111. First, the PCC is now required to reimburse GAO for its financial audits; H.R. 111 does not provide for reimbursement. Second, H.R. 111 requires an annual audit with a report to the Congress no later than 6 months after the end of the fiscal year. Under a 1975 amendment to the Government Corporation Control Act, GAO is required to audit each corporation at least once every 3 years. At present, we are conducting the majority of the required examinations biennially, which has proved satisfactory. Our last audit of the PCC covered fiscal year 1977, the transition quarter, and fiscal year 1976. Because of the financial significance of the Treaty, we are following up this audit with an audit of fiscal years 1978 and 1979. After the first few years under the new organization, however, biennial audits may again be satisfactory.

On April 23, 1979, the House Committee on Merchant Marine and Fisheries approved and reported out H.R. 111 which provided for the Commission to be an appropriated-fund agency. The House Rules Committee adopted a resolution that H.R. 111 will be considered by the full House.

CHAPTER 2

ORDERLY TRANSFER OF FUNCTIONS, ACTIVITIES, AND PROPERTY TO THE GOVERNMENT OF PANAMA

The U.S. Government and Government of Panama have established organizational structures and mechanisms to carry out the Treaty's provisions on the transfer of functions and property. As of March 1979, the various committees and subcommittees were in the early planning phases for the transfer beginning October 1, 1979. Problems have begun to surface as a result of differing positions of the two governments on certain issues, and the outcome of these issues remains uncertain.

ORGANIZATION AND MECHANISM

According to the Treaty Documents, representatives of the two governments are responsible for preparing the preliminary work to implement the Treaty. The principal organizations responsible for implementation are the U.S. Embassy, the CZG/PCC, Department of Defense agencies, and the Panama Canal Authority and Panama National Guard. The organizational structure, coordinating mechanism, responsibilities of the organizations, and the status of these activities as of March 1, 1979, are discussed below.

United States Mission

The Ambassador has designated Treaty implementation as the absolute priority of the U.S. Mission during 1979 and 1980. The Embassy is charged with insuring that the Treaty and related arrangements are carried out smoothly, effectively, and punctually. It is responsible for coordinating the activities of the U.S. organizations directly involved in the transfer of functions and property, providing authoritative Treaty interpretations, and negotiating bilateral agreements directly with the Government of Panama for specific U.S. agencies. A Treaty Implementation Consular and three assistants have been assigned to the Embassy by the Department of State to assist the U.S. organizations (principally CZG/PCC and the Defense agencies) in implementing the Treaty.

The Embassy has identified issues which must be resolved by October 1, 1979. These issues have been assigned to the Embassy, Agency for International Development, and International Communication Agency officials, who are charged with monitoring the tasks and keeping the Treaty Implementation Consular informed of any significant developments within their responsibilities.

The Embassy is also responsible for providing guidance to insure that the CZG/PCC's joint subcommittees and the U.S. Southern Command's joint working subcommittees are conducting implementation activities in accordance with the Treaty. Also, as issues develop and discussions proceed, the Embassy and/or the U.S. Government will develop new policies or adjust old ones to meet new circumstances.

The Embassy's third principal function is to negotiate, with assistance from U.S. agencies, bilateral agreements between the Department of State and the Government of Panama. Bilateral agreements are being negotiated for use of postal services and commissary and post exchange facilities by Commission employees; nature protection and wildlife preservation; economic and military cooperation; FAA air traffic control services; the Gorgas Memorial Institute; Smithsonian Tropical Research Institute; Barro Colorado Island; Foreign Broadcast Information Service; the Corozal Cemetery; and prisoner exchange. As of January 1979, agreements had been reached on the continued use of Corozal Cemetery, prisoner exchange, and FAA air traffic control services.

Canal Zone Government/Panama Canal Company

Formal planning sessions between CZG/PCC and the Government of Panama began in early 1978, and, to accomplish Treaty implementation, they have formed 23 joint subcommittees and an ad hoc financial group, all subordinate to a Binational Working Group. These subcommittees are shown in appendix II.

Subcommittees are cochaired by Government of Panama and CZG/PCC representatives, and, although primarily made up of their officials, each subcommittee has an observer from the U.S. Mission and U.S. Southern Command. These joint subcommittees are responsible for preparing initial collaboration between the two countries before entry into force of the Treaty, including developing objectives and work programs and identifying alternative implementation actions.

According to the CZG/PCC, the subcommittees' initial goals were to familiarize the members with the provisions of the Treaty and related documents and to formulate specific objectives to accomplish Treaty requirements. Individual subcommittee objectives were approved by the Binational Working Group during meetings in September and October of 1978.

The CZG/PCC officials stated that during the early weeks of subcommittee work, Government of Panama officials, Panamanian subcommittee members, and their supporting advisors were given orientation briefings and field inspections to acquaint them with CZG/PCC facilities and areas in the Canal Zone. Detailed lists of equipment and personnel presently employed in certain Canal operations have also been provided to Panamanian subcommittee members for use in determining internal resource requirements.

As of March 1979, the joint subcommittees were completing their first planning phase, which includes finalizing a schedule for accomplishing actions necessary for Treaty implementation. Upon completion of staff review of the planning documents by CZG/PCC, the U.S. Southern Command, and the Embassy, the plans will be submitted to the Binational Working Group for final approval.

The Group is cochaired by a representative of the CZG/PCC and the Government of Panama. It will develop the detailed implementation planning on those matters requiring direct coordination between CZG/PCC and the Government of Panama. Specifically this Group will review the periodic reports, schedules, and plans developed by the joint subcommittees and will be responsible for disposition of all problems not resolved by these subcommittees. It will also forward final plans and schedules for formal approval to the coordinators, who will be appointed by the U.S. Government and the Government of Panama to the Coordinating Committee, upon entry into force of the Treaty.

Article II, paragraphs 1 through 5, Agreement on Implementation of Article III of the Treaty, state that the Commission's Coordinating Committee shall:

1. Be composed of one U.S. representative and one Panamanian representative of equal authority within the Committee, each of whom may have one or more deputies on a parity basis.

2. Perform the functions specifically indicated by the provisions of this Agreement and others entrusted to it by both governments concerning implementation of this Agreement. (A review of this Agreement reveals that the Coordinating Committee will perform a function in the majority of the Articles of this Agreement.)

3. Establish its rules of procedure within the spirit of this Agreement and may designate such subcommittees as it may deem necessary for the fulfillment of its functions.

4. Be organized so that it may meet promptly and at any time upon request of the U.S. or Panamanian representative. The Coordinating Committee shall send periodic reports on its activities to both governments.

5. Refer any matters which it has not been able to resolve to the two governments for their consideration through appropriate channels.

Thus the Coordinating Committee will be the liaison between the Commission and the Government of Panama for matters that need resolution.

According to CZG/PCC officials, probably the most urgent and complicated planning involves the railroad and Ports of Balboa and Cristobal, which are scheduled for transfer to the Government of Panama upon entry into force of the Treaty. While the government has stated repeatedly that it will assume operational responsibility for the ports and railroad on October 1, it has also indicated that, to do so, it will be necessary for PCC to assign certain employees on a temporary basis to perform certain support functions on a cost-reimbursable basis.

CZG/PCC officials said it appears that PCC will be able to assist the Government of Panama with those operations that are turned over pursuant to the Treaty. The PCC's fiscal year 1980 budget is based on the assumption that, effective October 1, 1979, the Government of Panama will perform all functions transferred to it by the Treaty; however, provisions in the Treaty would permit the Commission either to assign its employees to help perform those activities or to continue to perform them itself until the Government of Panama can take them over. On the basis of these provisions, the government stated that it will require assistance; consequently, the PCC 1980 budget will have to be revised accordingly. CZG/PCC has informed the government that any additional requirements must be made known to them very soon if the Commission is to have the resources to provide such support on October 1, 1979, and that these additional requirements will be on a cost-reimbursable basis.

U.S. Southern Command

To conduct Treaty implementation, the U.S. Southern Command has established the Joint Working Committee, which is analogous to CZG/PCC's Binational Working Group, and 11 subcommittees responsible for 27 Treaty implementation activities or issues. (See app. III.)

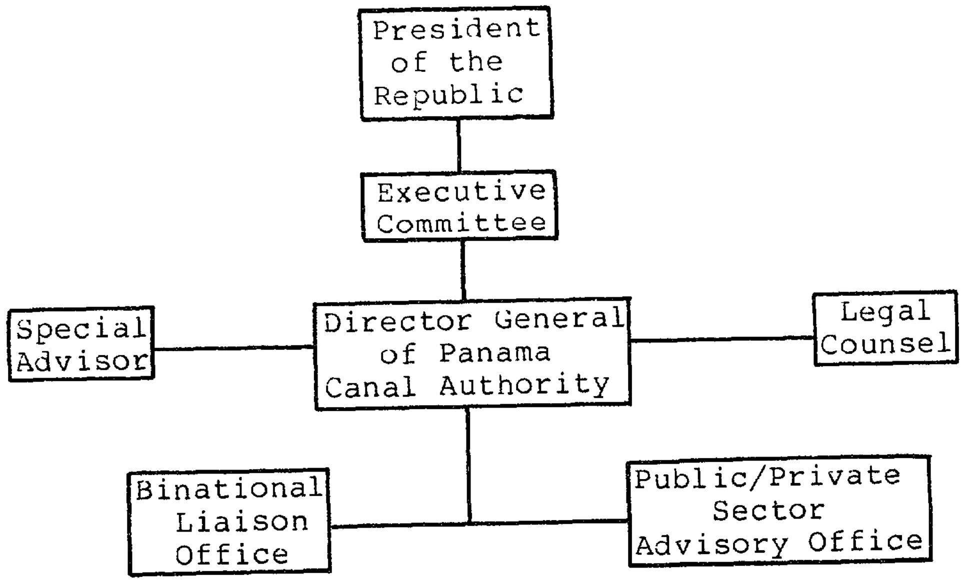
These subcommittees are cochaired by a representative of the Government of Panama and the U.S. Southern Command, and no Mission or CZG/PCC officials are formally involved. However, Command officials stated that the Mission and/or CZG/PCC are informed about subcommittee meetings, and sometimes their representatives are requested to attend.

The subcommittees will be responsible for preparing the initial collaboration between the two countries before October 1, 1979, by developing work programs and schedules. The initial plans and schedules defining objectives and milestones have been completed, and proposed solutions are being developed.

The Joint Working Committee, also cochaired by a representative of the Government of Panama and the U.S. Southern Command, reviews the periodic reports, programs, and schedules of the joint working subcommittees and is responsible for disposition of all problems not resolved by them. This Committee also will forward final plans and schedules to representatives to be appointed by the governments of both countries to the Joint Committee upon entry into force of the Treaty. These representatives will study and approve the proposed agreements reached on specific issues on October 1, 1979.

Government of Panama

The following chart depicts the primary Government of Panama components involved in Treaty Implementation.



The Executive Committee approves the Panama Canal Authority's policies, general plans, and projects; it also submits proposals to the executive branch after consultation with the Director General of the Panama Canal Authority.

The Panama Canal Authority is the primary organization for carrying out Treaty implementation. It exercises all functions and responsibilities designated by Panamanian law, Canal Authority regulations, and regulations authorized by the Executive Committee.

The Special Advisor deals with the political impacts of Treaty Implementation. The Legal Counsel interprets the Treaty and drafts legislation and Panama Canal Authority regulations for Treaty Implementation. The Public and Private Sector Advisory Office coordinates advisory services provided by government agencies; the 600 advisors representing civic, labor, professional, and religious organizations; and other advisory sources as requested. The Binational Liaison Office coordinates planning between the Panama Canal Authority and U.S. Government counterpart officials through the representatives on CZG/PCC and U.S. Southern Command subcommittees. Finally, the Panama National Guard is in charge of negotiations with the U.S. Southern Command regarding joint use of forces and joint defense plans for the Panama Canal.

COORDINATION OF TREATY IMPLEMENTATION

Since the Binational Working Group and the Joint Working Committee are pursuing many identical issues and activities simultaneously, coordination is essential to assure that agreements reached with the Government of Panama are compatible and to prevent problems which could result from inconsistent or contradictory agreements. This coordination is being provided by the Treaty Implementation Consular and his staff through U.S. Mission officials who participate in the many joint working subcommittee meetings, and through review of the reports provided by these subcommittees.

Overall coordination and resolutions of problems that develop within the subcommittees that cannot be worked out by the Binational Working group and/or the Joint Working Committee are resolved by a Treaty Implementation Subcommittee and Panama Review Committee. The Treaty Implementation subcommittee includes the Embassy's Treaty Implementation Consular, the U.S. Southern Command Chief of Staff, and the CZG Executive Secretary. The subcommittee performs tasks and identifies issues for the Panama Review Committee, which is responsible for overall coordination and problem resolution. The Panama Review Committee consists of the Ambassador, the Commander in Chief of the Southern Command, and the Governor, who represents the CZG/PCC.

The CZG/PCC and the Southern Command are coordinating their Treaty implementation planning activities with Panama by having Government of Panama officials cochair both the Binational Working Group and the Joint Working Committee and each of their respective subcommittees. Additionally, both governments have established a Combined Board, composed of senior military representatives, to facilitate the participation and cooperation of the armed forces of both governments. The Combined Board is developing joint defense plans for the Panamá Canal. Also the governments have conducted joint military exercises and will conduct other operations involving Canal protection and defense.

The planning efforts required of the government organizations implementing the Treaty are complex. A significant amount of joint planning is underway, but many issues remain to be resolved and additional planning must be accomplished before entry into force of the Treaty on October 1, 1979, to insure a smooth and orderly transfer of property and functions to the Government of Panama.

FUNCTIONS AND ACTIVITIES TO BE TRANSFERRED

The Commission shall not perform government or commercial operations as stipulated in paragraph 4(a) and 4(b) of the Annex to the Treaty, provided, however, that this shall not be deemed to limit in any way the right of the Commission to perform those functions that may be necessary for efficient management, operation, and maintenance of the Canal.

The Annex to the Treaty sets forth the procedures for transferring the functions/activities performed before entry into force of the Treaty by CZG or PCC which are not to be carried out by the Commission. The following functions will be transferred to the Government of Panama on October 1, 1979.

1. Postal services.

2. Customs and immigration.

3. Partial fire protection (two community stations).

4. Commercial operations or any other commercial activity of a similar nature not related to management, operation, or maintenance of the Canal.

5. Port operations.

6. Panama Railroad.

7. Commercial vessel repair.

Also, paragraph 4(b) of the Annex states that within 30 calendar months from October 1, 1979, the jurisdiction function (police, courts, and prison system) will be transferred; i.e., on March 1, 1982. The U.S. Government will provide postal services for 5 years and participate in police protection for 30 months. Upon termination of this Treaty on December 31, 1999, the Government of Panama shall assume total responsibility for managing, operating, and maintaining the Panama Canal, which shall be turned over in operating condition and free of liens and debts, except as the two parties may otherwise agree.

REAL PROPERTY TRANSFERS AND VALUES

The present Canal Zone is about 10 miles wide and 51 miles from deep water to deep water, for a total of 647 square miles. As a result of the changes in functional authority and responsibilities, there will also be major changes in the areas and facilities made available to the Commission. The U.S. operating and housing areas for U.S. employees will represent only 42 percent (271.7 square miles) of the present areas of operation for the Canal enterprise.

CZG/PCC

The total net book value for the CZG/PCC as of January 31, 1979, was $573 million for property, plant, and equipment. The net book value of properties to be transferred by the Treaty is listed below.

	(millions)
Transfers at Treaty entry into force	a/ $ 96.0
Transfers during first 5 years of Treaty	4.0
Capital improvements during life of Treaty to be transferred at Treaty termination	381.0
Assets retained by U.S. Government to be transferred at Treaty termination	147.0
	$628.0
Less transfer to Department of Defense	-34.0
Total net book value of CZG/PCC properties transferred to Panama by Treaty	$594.0

Other U.S. agencies

Defense will also be transferring certain facilities and property to Panama. About $27.5 million will be transferred upon entry into force of the Treaty, $33.5 million more during the life of the Treaty, and about $292 million more at Treaty

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a/See app. IV for property breakdown.

termination. Unlike CZG/PCC property, costs of military real property are not depreciated, and no estimate of net book value comparable to CZG/PCC figures is available. The above figures do not include funds needed for relocation expenses resulting from the Treaty or improvements to the real property during the life of the Treaty.

The Federal Avaiation Administration has spent and continues to spend funds on FAA-owned facilities and equipment located in the Canal Zone. From 1961 to 1964, FAA established and equipped a traffic control center to service aircraft using the Tocumen Airport of Panama. Since that time these facilities have been improved and maintained and facilities and equipment inplace have been capitalized at $4.7 million. FAA has equipment and materials on order for a total obligation of about $545,000.

On January 8, 1979, the two countries signed an agreement whereby FAA will continue to provide air traffic control and will train Panamanians until the Government of Panama can assume full responsibility for air traffic control and can maintain and operate the FAA equipment. The tentative time for FAA to withdraw from the Canal Zone is 5 years, or about January 1984.

FAA plans to decommission, dismantle, and return to the United States a long-range radar system valued at about $1.6 million. The remainder of the facilities and equipment, valued at about $3.1 million, will be transferred to the Government of Panama.

The Treaty's impact on U.S. agencies, like the Gorgas Memorial Institute and the Smithsonian Tropical Research Institute, will not be substantial; these organizations will not be transferring property.

TRANSFER OF REMOVABLE PROPERTY

To facilitate the transfer of functions, activities, and property, CZG/PCC has established a policy for retaining and transferring removable property to other U.S. agencies and the Government of Panama and is making a physical inventory of plant assets of the affected areas.

CZG/PCC policy

A policy was developed due to management's questions concerning the authority and obligation the Commission will have under the Treaty regarding disposition of certain equipment and other removable property currently owned by CZG/PCC. CZG/PCC requested and received input from the Department of

State and GAO in developing the policy. The policy was formally approved by the Executive Committee of PCC's Board of Directors on September 27, 1978 1/. (See app. VIII.)

The policy has three general principles, which will be applied to all transfer of equipment, supplies, materials, and other removable property to the Government of Panama. They state that removable property transfers are to be made without charge (1) when specifically required by the Treaty, (2) when such property is required for the normal and efficient operation of a function or an activity transferred and a substantial and demonstrable U.S. benefit is expected to result, or (3) when such property is located in areas transferred and is not required by the Commission or other U.S. agencies and the cost of its removal is expected to exceed its recovery value.

To implement these principles, CZG/PCC has identified removable property to be transferred with or without charges for (1) ports and railroads, (2) property supporting public service functions transferred and property for which the Commission will pay the Government of Panama for their continuation, and (3) property located in areas and other functions transferred. The following schedule indicates the original costs and net book value of property to be transferred.

	Values at January 31, 1979	
	Original Cost	Net Book Value
	(millions)	
Ports and railroads	$12.430	$5.312
Property supporting public services functions transferred	.550	.290
Property located in areas and other functions transferred	1.135	.478
Total	$14.115	$6.080

1/As of April 9, 1979, CZG/PCC changed its policy concerning the definition of "fair value."

The property's total net book value is $6.080 million, of which $.6 million will be offered to the Government of Panama at "fair value" and the balance without charge.

CZG/PCC has defined fair value as the estimated reasonable price in dollars which that property would bring if offered for sale in the open market with a reasonable time allowed to find a buyer who knew the original cost, age, present condition, and purposes for which the property was best adapted and was capable of being used, assuming neither the buyer nor the seller was under compulsion. If this determination is not feasible, fair value could be construed as net book value; i.e., original cost less accumulated depreciation at time of transfer. (See footnote 1, p. 20, and app. VIII.)

Equipment, supplies, materials, and other removable property for which the Commission or other U.S. agencies have a need will be removed. Property will be left inplace or sold to the Government of Panama within 90 days following the effective date of the transfer if not needed by the Commission or a U.S. agency. Otherwise, paragraph 7(b) of Article III of the Agreement on Implementation of Article III of the Panama Canal Treaty will apply.

> "(b) All equipment, installations, materials, supplies or removable property left by the United States in an area made available under this agreement beyond 90 days from the date the use of such area by the United States ceases shall, unless agreed otherwise by the two Parties, become the property of the Republic of Panama."

Department of Defense policy

Defense agencies have established a policy that defines real and installed personal property which is nonremovable.

As of March 1979, a U.S. Southern Command official stated that the policy was being reviewed and updated so that no misunderstandings prevent the orderly transfer of property to the Government of Panama.

The U.S. Navy has completed a physical inventory of the removable property of the Naval Industrial Reserve Shipyard that it owns as of March 30, 1979. The list of property will be submitted to higher headquarters to determine disposition; i.e., give or sell it to the Government of Panama or return it to the United States.

CZG/PCC physical inventory of plant assets

CZG/PCC is making a physical inventory of major and minor plant assets and furniture to be transferred. Major plant assets are nonfurniture capital assets costing $1,000 or more, whereas minor plant assets, which cost less than $1,000, are normally expensed at the time of purchase. Furniture includes office equipment and furniture regardless of cost. The inventory is being made to accurately document the carryover of assets to the Commission as well as the transfer of assets to both Defense and Panama. The last complete physical inventory and valuation of the CZG/PCC plant and equipment were taken in 1950-56 to establish the present organization.

An inventory is being made for all functions or activities which will, in whole or in part, be assumed by the Government of Panama upon entry into force of the Treaty. The inventory includes all items within a function or activity which might be retained by the Commission or transferred to Defense or Panama. The final determination of which items are to be retained or transferred will be made after the inventory.

The present inventory will run from December 2, 1978, through June 15, 1979, and 14 different activities are being inventoried. As of April 1, 1979, 11 of the activities had been completed. During August and September 1979, a followup physical inventory will be made on just those plant assets which are to be transferred to Panama.

IMPLEMENTING LEGISLATION

The administration bill does not address real or removable property. The administration's position is that this can be accomplished under the Foreign Excess Property Act. On the other hand, H.R. 111 conveys authority to the Secretary of State to transfer only those properties required when the Treaty Documents enter into force; all subsequent transfers of public property must be pursuant to laws enacted by the Congress.

CHAPTER 3

GOVERNMENT OF PANAMA'S DEBTS FOR PAST SERVICES

CURRENT STATUS

As of February 28, 1979, accounts receivable from the Government of Panama totaled about $9.2 million, as shown below. About $8.7 million of this amount was delinquent, having not been paid for 90 days for water processing and 30 days for all the other categories after billing and some of it has been outstanding since 1959.

Category	Total	Current debt	Past due debt
Water processing	$2,908,927.90	$519,765.26	$2,389,162.64
Garbage disposal	387,553.00	2,250.00	385,303.00
Palo Seco Hospital	5,509,335.15	38,622.07	5,470,713.08
Other	437,963.50	7,510.28	430,453.22
	$9,243,779.55	$568,147.61	$8,675,631.94

Although over $209,000 for general expense charges was included in accounts receivable that were in dispute, CZG/PCC and the U.S. Embassy have obtained an oral acknowledgement from the Government of Panama of the total delinquent debt. The U.S. Embassy is obtaining a mutual understanding with the government on the delinquent debt and then exchanging notes.

CZG/PCC arrangements for payments of accounts receivable for water processing are as follows: IDAAN (Water Authority) has started paying its delinquent debt of $744,156.85 for November 1975 through September 1976 on a monthly basis of $20,671 for 36 months beginning January 1979. In February 1979, CZG/PCC received a check for $41,342.00 from IDAAN to cover the payments for the first 2 months of 1979. Thus IDAAN's delinquent debt as of March 1, 1979, was $702,814.55. The Government of Panama will assume IDAAN's debt of $1,686,347.79 for the 1959-60 period on a quarterly basis over a 3-year period. Panama is expected to agree to pay the balance of the delinquent debts, which amounts to $7,921,702.24 (including IDAAN's debt for 1959-60) on a quarterly basis over a 3-year period.

The U.S. Treasury asked the U.S. Embassy to attempt to get payments of past debts in a one-year period. Embassy officials stated that they would pursue this request with Panama but were doubtful about the outcome. On February 22, 1979, a CZG/PCC official stated that the U.S. Treasury had dropped the issue of payments within a year and that the CZG/PCC Board of Directors and the U.S. Government were then in agreement with the 3-year pay periods of delinquent debts.

The U.S. Government is seeking the right to offset any nonpayment of delinquent debts for such services against Treaty-specified payments to Panama; H.R. 111 states that payment for providing such services as water and electric power may be affected by direct payment to the Commission or by offset against amounts due to Panama by the United States. The administration's bill is silent on the right to offset.

Background on the debt and service categories is presented below.

BACKGROUND

At various times, the Government of Panama has failed to pay its bills due the Panama Canal entity; however, until 1959 the bills were eventually paid and CZG/PCC continued to provide services under multiple agreements. This matter was the subject of a GAO report in 1964 wherein we reported on the delinquent accounts receivable, then totaling $2.5 million, and recommended to the President that he take the necessary action to collect the accounts.

During Treaty ratification deliberations, the delinquent accounts receivable were described as being "disputed" by Panama and the consensus was that the dispute would be settled by arbitration or diplomacy before CZG/PCC could expect payment or could properly offset the delinquent accounts against amounts earned by Panama under Treaty provisions.

Water processing

The entire accounts receivable for water processing covering the periods 1959-60 and 1975-76 were delinquent.

1959-60

Between 1956-61 there was no formal agreement between the United States and Panama covering the amounts Panama would agree to pay for water processed by CZG/PCC and delivered for distribution in the cities of Panama and Colon. During this period, until 1959, the Government of Panama paid 8.7 cents per 100 cubic feet of water for Panama City, 8.9 cents for suburban Panama City, and 8.3 cents for Colon. However, in January 1959, it ceased paying its water bills although it continued to receive water. During the ensuing 23 months, a debt was accumulated totaling $1.7 million for water, which remains unpaid.

The substance of the dispute was the price of water during the 1959-60 period, even though the water had been paid for on the basis of a cost-reimbursement principle since the Government of Panama had taken over water distribution in 1946. Effective in April 1960, the President of the United States approved an arbitrary reduction in the rate to 7.5 cents per 100 cubic feet of water in the interest of improving relations with Panama. This was well below the actual cost of processing the water and, therefore, effectively eliminated general expense. Panama claimed in 1959 that it should pay no more than 7 cents per 100 cubic feet of water, and the Minister of Foreign Relations, in a June 1960 letter to the U.S. Ambassador expressed his country's objection to the rate charged, as follows.

> "My Government finds it necessary to maintain its position that in view of existing conventions between our two countries, the price of drinking water the Canal Zone furnishes Panama and Colon should not exceed the net cost of processing this water and the new rate (7.5 cents per 100 cubic feet) indicated by President Eisenhower still exceeds by one-half a cent per unit of 100 cubic feet what Panama Government experts consider as the net cost* * *."

The water controversy temporarily ended in January 1961 when Panama resumed paying its water bills, but it never paid for water received from February 1959 through December 1960, about $1.7 million.

<u>1975-76</u>

Panama paid its water bills through October 1975, when CZG/PCC announced that beginning November 1, 1975, the rate for water would be 12 cents per 100 cubic feet. While the rate increase was 50 percent, it was considerably lower than rates charged to others and did not provide for recovering the indirect costs. Panama continued paying its water bills at the 8 cents a hundred rate, saying that the matter should be taken up with the Foreign Ministry.

According to PCC, the Company also established a surcharge on water consumption in excess of maximum daily allowance. On September 13, 1976, after various negotiations, the Foreign Ministry accepted the 12 cents per 100 cubic feet rate; subsequently, Panama also agreed to pay $85,268 in delinquent charges when CZG/PCC agreed to write off $306,899. These amounts are attributable to the surcharge on water consumption.

Garbage disposal in Colon

As of February 28, 1979, CZG/PCC records showed delinquent accounts receivable of $385,303 for disposal of garbage from Colon. There is no record that the Government of Panama disputes the propriety of the charges, but there was disagreement on the arrangement from the beginning. On July 1, 1953, the government began collecting refuse in Colon, a service previously rendered by PCC, but Panama has continued to use PCC's garbage dump area. Letters were exchanged delineating each side's understanding of its responsibilities, but there was also considerable disagreement over the amount which Panama was charged for garbage collection equipment purchased from PCC.

There is little information in the records concerning the government's specific defense, if any, for making only nominal payments for Colon garbage disposal since 1959. However, considering the initial disagreements which were never resolved, the amounts owed could realistically be characterized as being in dispute.

Palo Seco Hospital

For the years 1908-48, the Government of Panama reimbursed the United States 75 cents per patient-day for Palo Seco patients who were the responsibility of the government. In 1948, Panama's Comptroller General agreed to the principle of reimbursing the United States for out-of-pocket costs for providing health services to Panamanian citizens not considered to be the responsibility of the Canal Zone. The first revised daily charge was $1.32, even though costs had risen to above $2 a day.

From 1950 to 1959, Panama paid its bills for Palo Seco reasonably on time, but it stopped paying in 1959 without notice or any reason. Current billings only were paid for a time in 1961, and no payments on this account have been received since.

While the record is not entirely clear as to the agreements between the Canal Company and Panama for Palo Seco charges, past events clearly indicate that Panama accepted the cost-reimbursement principle, and PCC has billed it on a basis of recovering direct costs only; that is, no indirect costs or overhead have been charged, such as the cost of Health Bureau management.

Other delinquent accounts

At February 28, 1979, accounts receivable for items other than water processing, Palo Seco Hospital, and garbage disposal totaled $437,963.50, of which $430,453.22 was considered delinquent. These charges had also been accumulating since 1959, with the greatest amounts in 1959, 1960, and 1970. The charges were for such items as (1) providing launch services, (2) providing electricity, (3) materials and supplies, (4) mail service aboard the PCC-owned ship, and (5) medical services for tuberculosis patients and Panamanian National Guard members. Panama has not disputed these delinquent accounts receivable.

CHAPTER 4

PAYMENTS TO PANAMA FOR PUBLIC SERVICES AND ASSURANCE OF QUALITY

CZG/PCC is developing procedures for verifying the actual osts incurred by Panama in providing certain Treaty-specified ublic services in the Canal operating and housing areas. As f March 1979, these procedures were being reviewed and modi- ied by CZG/PCC officials. In addition, the various joint ubcommittees have developed or are developing the final plans utlining specific objectives to be accomplished before the reaty becomes effective in order to assure the quality of hese services after they are assumed by Panama. At the time f our study, no cost estimates were available for providing he Treaty's specified public services.

Paragraph 5 of Article III of the Treaty provides that he Commission will pay Panama $10 million a year in reim- ursement for costs incurred in providing police and fire rotection; maintenance, lighting and cleaning of streets; raffic management; and garbage collection. H. R. 111 re- uires GAO to audit annually the costs involved in furnish- ng these services and any overpayment shall be refunded by anama or offset against amounts payable under this para- raph. 1/ The two bills provide that this payment be treated s an operating cost of the Commission.

A brief review of the rationale for this Treaty- pecified payment is necessary. According to a 1978 Senate oreign Relations Committee report on the Panama Canal Treat- es, the arrangement for cost sharing in paragraph 5 Article II of the Treaty stems from the transferring to the Govern- ent of Panama the responsibility for providing government ervices in portions of Panamanian territory that remain edicated to the operation of the Canal with no new tax base o support these services. We understand that the Commission ill be immune from the government's taxing authority. Cur- ently, the costs of maintaining CZG, in excess of the revenues t generates, are borne by PCC from Canal revenues. When the reaty goes into effect, Panama will be responsible for most f the necessary governmental services in the former Canal one, including those within the areas made available for anal operation and for housing U.S. employees.

/See reference to Understanding 1 on p. 29.

CHAPTER 4

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Paragraph 5 of Article III of the Treaty provides that the Commission will pay Panama $10 million a year in reimbursement for costs incurred in providing police and fire protection; maintenance, lighting and cleaning of streets; traffic management; and garbage collection. H. R. 111 requires GAO to audit annually the costs involved in furnishing these services and any overpayment shall be refunded by Panama or offset against amounts payable under this paragraph. 1/ The two bills provide that this payment be treated as an operating cost of the Commission.

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1/See reference to Understanding 1 on p. 29.

The U.S. and Panamanian negotiators considered it appropriate for the Commission to continue to pay for police and fire protection; maintenance, lighting, and cleaning of streets; traffic management; and garbage collection by means of a yearly payment in lieu of taxes to the Government of Panama. In light of the difficulty of assessing costs accurately, the parties agreed that the Commission initially would pay $10 million a year for these services, with the understanding that this sum would be reexamined on the basis of actual costs incurred to determine whether the annual amounts should be adjusted after the first 3-year period. H.R. 111 provides that the $10 million shall be paid on a monthly basis for services rendered by Panama. PCC has estimated that it would cost Panama about $4.4 million a year to provide the Treaty-specified public services. If the Commission continued to provide these services, its estimated costs would be $10 million. The difference is attributed to a lower cost of police services, if provided by Panama.

Understanding number 1 adopted by the U.S. Senate while considering the Treaty for ratification states in part:

> "* * *If payments made under paragraph 5 of Article III for the preceeding three-year period, including the initial three-year period, exceed or are less than the actual costs to the Republic of Panama for supplying, during such period, the specific levels and quality of services agreed upon, then the Panama Canal Commission shall deduct from or add to the payment required to be made to the Republic of Panama for each of the following three years one-third of such excess or deficit, as the case may be. There shall be an independent and binding audit, conducted by an auditor mutually selected by both Parties, of any costs of services disputed by the two Parties pursuant to the reexamination of such costs provided for in this understanding."

In congressional testimony, we have recommended that procedures be developed to verify the costs of public services to be provided by Panama and that standards be developed concerning the quality of these services after they are assumed by Panama.

PAYMENTS FOR PUBLIC SERVICES IN RELATION TO ACTUAL COSTS INCURRED

The Commission is required to reimburse the Government of Panama for costs incurred in providing certain Treaty-specified public services. To relate the payments to the actual costs incurred, CZG/PCC has developed draft procedures providing a method for verifying the costs and providing guidance to the joint subcommittees for (1) developing working agreements governing the provision of the specified services and (2) assuring that the working agreements and the cost-reporting system are compatible. The procedures are being reviewed and modified by CZG/PCC officials. These procedures recommend that two general principles be followed in verifying the costs of the public services to be provided, regardless of the particular cost element in question.

1. The actual costs incurred in providing the service should be recorded in the accounts and reported to the Commission as the cost of service.

2. When the assignment of actual cost is not possible or practical, there should be agreement in advance on a jointly determined method of allocating costs that most nearly reflects the actual cost of providing the service.

The rationale for these principles is that it is in the best interest of both the Commission and Panama that every effort be made to plan work situations and agreements so as to permit actual costing of the service. In any event, the methods to be used in verifying allowable costs to the Commission should be mutually agreed upon in advance by both parties and contained in plans in sufficient detail to assure that the handling of all facets of costs to be incurred are fully understood and acceptable.

The draft procedures also recommend that Panama prepare a monthly report detailing the costs incurred during that month in providing the specified public services to the Commission. The report, whose correctness is to be certified by an appropriate Panama official, will be used by both parties to evaluate results.

ASSURANCE OF QUALITY

Four joint subcommittees are responsible for the Treaty-specified public services to be provided by the Government of

Panama: the subcommittees on garbage, trash collection, and street cleaning; roads and streets; police; and fire protection. The subcommittees, composed of U.S. and Panamanian representatives, are responsible for preparing the initial collaboration between the two countries before the entry into force of the Treaty by developing plans governing the quality of services to be provided, standards of work performance, and verification of services received. The subcommittees also coordinate actions to be taken by both countries in preparation for implementation of the Treaty until its entry into force. The plans serve as the working agreement between the Commission and Panama. They are submitted to the Binational Working Group as recommendations, and, upon its approval, the final plans and schedules are forwarded for formal approval to the Coordinating Committee. The Committee becomes operational upon entry into force of the Treaty.

Garbage, trash collection
and street cleaning

This subcommittee coordinates plans for transfer of responsibility for garbage and trash collection and street cleaning in the Canal operating and housing areas. It also coordinates all matters related to the continuity of these services and establishment of operation standards and levels and frequency of service.

As of March 1979, the joint subcommittee had developed a draft plan outlining specific objectives to be accomplished in order to assure the quality of these services after they are assumed by Panama. The objectives basically call for:

--Programing the transfer of these services in all areas and towns which are no longer part of the Commission areas and in Canal operating areas and housing areas.

--Determining the type of equipment and the method by which Panama will collect garbage and trash in the Canal operating and housing areas.

--Establishing the necessary liaison to insure continuity of service when the responsibility for garbage and trash collection is transferred.

--Preparing standards of operation required by the Commission for collection of garbage and trash.

--Determining whether the refuse collected from the areas turned over to Panama will be disposed of at Commission refuse disposal sites.

The subcommittee chairman expected to have the plan in final form by March 1979. It then has to be submitted to the Binational Working Group for approval and issuance of a policy on providing the service. The chairman does not anticipate any problems with approval by the Group or in accomplishing the planned objectives before the Treaty goes into effect.

Roads and streets

This subcommittee is responsible for coordinating plans to maintain roads and streets within Canal operating and housing areas. It also coordinates plans for the transfer of roads and streets and the Bridge of the Americas and the turnover of maintenance responsibility for those facilities as may be pertinent. Further, it makes recommendations on standards for levels of road and street maintenance and coordinates plans for the turnover of street-lighting systems.

This subcommittee has developed the final plan outlining the objectives to be accomplished in order to assure the quality of roads and streets maintenance after this service is assumed by Panama. The plan calls for identifying and transferring the roads, streets, bridges, and drainage responsibilities and establishing standards for maintaining roads, streets, parking lots, sidewalks and driveways, and road and street drainage for which reimbursement is to be made.

The subcommittee has taken an inventory of the roads and streets to be maintained and surveyed their physical condition. In addition, PCC has established procedures for evaluating the physical condition of these roads and streets and the preventive maintenance required. The evaluation system consists of codification and inspection of each section of the Canal's roadway system; recording of field inspections; and evaluation of each section, with a summary of the results.

The PCC has evaluated the present condition of a portion of the roads and streets in the Canal housing and industrial areas and intends to evaluate them again immediately before the Treaty goes into force. Technical and administrative representatives from the Ministry of Public Works are working with PCC to learn the techniques used in keeping the roads and streets in good condition.

To verify the work done, the subcommittee is developing a system whereby (1) a log is maintained detailing such items as the estimated cost of a particular maintenance job and personnel and equipment assigned to it and (2) inspections are made during and after the planned work.

Fire protection

This subcommittee develops and coordinates planning for the transfer of Balboa and Coco Solito Fire Stations. It also develops and coordinates planning for functional cooperation for fire protection in the area of the Canal to establish the primary areas of responsibility, overlapping areas of responsibility, and central dispatching.

The subcommittee has developed a draft plan outlining the objectives to be accomplished in order to assure the quality of fire protection services after they are assumed by Panama. The objectives are to

--efficiently transfer Balboa and Coco Solito Fire Stations;

--plan for mutual aid and coordinated fire service;

--plan for joint training programs; and

--coordinate emergency medical service.

These objectives are to be accomplished before the Treaty goes into force. Panama representatives have given the subcommittee a proposed budget for 1979 outlining the cost of operating the Balboa and Coco Solito Fire Stations, a list of requirements for enrolling in the Panama Fire Corps and working in the Canal Zone, and curriculum of training for members of the Fire Corps. The subcommittee chairman told us that the enrollment requirements and the training curriculum had been adopted by the subcommittee as the minimum standards necessary to assure quality fire protection service. He does not anticipate any problems in obtaining Binational Working Group approval of these standards.

Police

This subcommittee is responsible for coordinating plans for providing police protection in the Canal operating and housing areas and the Ports of Balboa and Cristobal during the 30-month transition period. The subcommittee

--reviews concepts of joint patrol operations;

--coordinates planning for the police presence of the Guardia Nacional (National Guard) in Canal areas during the transition period;

--initiates discussions concerning planning for the Canal Zone Penitentiary as specified in the Treaty;

--coordinates plans for transferring the responsibility for traffic management; and

--coordinates the study of procedures for licensing of operators, registration and inspection of motor vehicles, and bearing of private firearms.

This subcommittee has developed a draft plan outlining the objectives to be accomplished before the Treaty becomes effective in order to assure the quality of police services after they are assumed by Panama. These objectives are to

--develop joint patrol administration, a joint training program, procedures for joint patrol operation, and to provide for arrestee exchanges;

--develop liaison services;

--develop traffic services covering agreements for traffic signal transfer, vehicle registration and inspections, license plate and driver's license issuance, and traffic management;

--develop firearms control procedures;

--provide for a joint communications agreement; and

--develop a plan for the phaseout of Gamboa Penitentiary.

The subcommittee chairman stated that the plan called for phasing the National Guard into the Canal Police Department on an incremental basis beginning when the Treaty goes into force--100 National guardsmen will be phased in every 10 months through the end of the Treaty transitional period. The goal is to place 300 National guardsmen in the Canal Police department over 30 months. The chairman told us that the subcommittee is finalizing the plan for submission to the Binational Working Group.

CHAPTER 5

FINANCIAL VIABILITY OF THE COMMISSION

This chapter deals with the ability of the Commission to be operationally self-sustaining if the United States continues to receive interest payments and also attempts to recover its investment. It also discusses the treatment of the contingency payment and the impact of these costs on U.S. taxpayers.

According to the Panama Canal Company's latest toll study: 1/

--The Commission, with an initial toll rate increase, can generate sufficient revenue to cover its increased operating costs, including interest payments and Treaty-specified payments to Panama, with no impact on Canal traffic, i.e., only a 3.1 percent diversion in 1982.

--The impact of likely toll increases on U.S. taxpayers will be minimal.

In March 1979, PCC completed a study evaluating the adequacy of toll rates to cover the costs of Canal operation over a 3-year period starting with fiscal year 1980. The study included a detailed projection of the level of cost differences between the years, a projection of toll revenues anticipated for the period based on existing toll rates, and an appraisal of the effect of a toll rate increase on the level of traffic and toll revenues. The study also considered the extent to which increases in toll rates will affect the quality of the human environment.

CANAL REVENUE AND TRAFFIC OUTLOOK

Revenue

Since 1967, toll revenues have risen from about $82 million to $196 million in fiscal year 1978. According to PCC's toll study, toll revenue from North Slope oil traffic for

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1/This toll study does not contain the additional liabilities specified in H.R. 111 and the House Committee on Post Office and Civil Service Report; i.e., early retirement program and social security fund. (See ch. 6.)

fiscal year 1978 was about $20 million, or 10 percent of the total. Projected toll revenues as of March 1979 are shown in detail below.

Fiscal Year	Total toll revenue	North Slope	Percent of total
	($ millions)		
1979	$224.6	$26.5	11.8
1980	227.6	22.4	9.8
1981	236.8	22.4	9.5
1982	244.2	22.4	9.2

The Canal also derives revenues from support facilities and services. In accordance with the provisions of the Treaty Documents, the Commission will have no authority to perform many of the commercial services presently provided by PCC. These services include operation of the ports of Balboa and Cristobal; stevedoring and bunkering; operation of commercial launch services, the railroad, and retail facilities; commercial vessel repair; and operation of restaurants, theaters, and bowling alleys. Accordingly, the revenues projected in PCC's toll study pertain only to those functions--navigation service and control, supporting services, and other--that will continue to be performed by the Commission. These revenues are estimated at $72 million, $78 million, and $85 million for fiscal years 1980, 1981, and 1982, respectively, and will be treated as offsets to operating expenses.

Traffic

The PCC toll study shows that total Panama Canal traffic is expected to increase from 157.7-million Panama Canal net tons in fiscal year 1978 to 180.9 in 1979, 183.1 in 1980, 190.4 in 1981, and 196.3 in 1982. The study projects traffic from North Slope oil for the selected period at 22.8 million tons in 1979 and 19.3 million tons each in 1980, 1981, and 1982.

INCREASED FINANCIAL REQUIREMENTS

The U.S. Government currently pays the Government of Panama an annuity of about $2.3 million a year; PCC's portion is about $519,000 and the balance is paid by the U.S. Government. A significant impact of the Treaty on future Canal financial operations will be that several annual payments will be funded out of revenues as operating expenditures of the new Commission.

Article XIII, paragraphs 4(a) and 4(b) require that an annual amount based on a payment of 30 cents per Panama Canal ton and a fixed annuity of $10 million be paid by the Commission from Canal operating revenues each year to Panama. Another $10 million is to be paid each year from the operating revenues of the Canal, to the extent that such revenues exceed expenditures. Article III requires that the Commission pay from toll revenues an additional $10 million for police and fire protection; street maintenance, lighting, and cleaning; and traffic management and garbage collection services which Panama will provide and which are now provided by CZG.

As of March 1979, PCC's toll study estimates that payments under the terms of Article XIII could range from $55 million to $69 million, excluding the payment under 4(c). If Article III payments are included, total Treaty payments range from $65 million to $79 million over the 3-year period compared to the $2.3 million Panama currently receives. As a result, PCC will increase tolls for the Commission to cover these costs.

According to the administration bill and H.R. 111, the Commission is expected to set tolls to cover as nearly as practicable all costs of maintaining and operating the Canal and its facilities, including Treaty-specified payments to the Government of Panama pursuant to paragraph 5 of Article III and paragraphs 4(a) and 4(b) of Article XIII. Concerning depreciation of Canal property, both the administration bill and H.R. 111 provide for depreciation of the assets to be included in the toll base. However, the administration bill transfers PCC assets directly to the Commission and H.R. 111 provides for all assets to revert to the United States.

Although, H. R. 111 and the administration bill have several cost elements in common for inclusion in the toll base, H.R. 111 now provides for the inclusion of interest, and the House Committee on Post Office and Civil Service report on H.R. 1716 provides for costs of the early retirement program and social security funds. H.R. 111 states that interest shall be computed on the investment of the United States in the Panama Canal as shown in the accounts of the Panama Canal Company at the close of business on the day preceding the effective date of this Act and adjusted as follows:

1. Shall be increased by-

    a. the amount of subsequent appropriation to the Panama Canal Commission, and

b. the value of property transferred to the Commission by other U.S. Government agencies as determined by the Director of the Office of Management and Budget.

2. Shall be decreased by-

a. the amount of the funds covered into the Treasury pursuant to section 232 of this Act. [Commission Funds]

b. the net book value of property subsequently transferred to Panama pursuant to this or any other Act, and

c. the net book value of property transferred by the Commission to any other U.S. agency.

Also, interest on the investment shall be computed at a rate determined by the Secretary of the Treasury, taking into consideration the average market yield, during the month preceding the beginning of each fiscal year, on outstanding marketable obligations of the United States of comparable maturities.

The administration bill does not include these costs, but does include elements which take into account the matching of costs and revenues over a given period of time and the desirability of maintaining toll rate stability as long as possible. Specifically the administration bill provides for including in the toll base any unrecovered past costs and establishing reserves for the purpose of matching revenues with expenses. H.R. 111 also includes recovery of past costs from the effective date of the Act.

Both bills, however, effectively exclude the contingent payment from the toll base. This position has been accepted by the Government of Panama and, according to Embassy officials, there is a mutual understanding that surplus will be determined by the Commission's Board of Directors after completion of the annual audit and after determination that a surplus exists for such payments. The United States and Panama have exchanged notes, and the Goverment of Panama accepts the position that the United States need not set toll rates for the Canal at levels designed to produce revenues to cover the congingent annuity payment under Article XIII 4(c) of the Treaty.

According to PCC, the viability of the Canal depends upon the ability and the willingness of world shipping to pay the cost of its operation and care must be exercised not to over-price the value of the services.

TOLL OUTLOOK

PCC has made an estimate of the toll increase that will be required effective October 1, 1979, to recover the increased costs of operating the Canal for the following 3 years. According to PCC, because of North Slope oil movements through the Canal and a healthy growth in other segments of traffic, the Canal is experiencing a much higher level of traffic and tolls than previously forecast. Except for some possible reduction in North Slope oil movements, PCC expects this high level to continue at least through 1982.

As shown below, PCC projects toll revenue deficiencies in fiscal years 1980, 1981, and 1982 of about $51.2 million, $51.6 million, and $51.9 million, respectively.

	Fiscal year		
	1980	1981 (thousands)	1982
Total operating expenses	$350,850	$366,310	$380,689
Total revenues other than tolls	- 72,027	-77,918	-84,553
Net operating expenses to be recovered from tolls	278,823	288,392	296,136
Toll revenues at existing rates	227,600	236,800	244,200
Toll revenue deficiency	$ 51,223	$ 51,592	$ 51,936

The PCC tolls study estimates that a toll rate increase of 21.8 percent will be required to recover the full amount of these deficiences over a 3-year period, effective October 1, 1979.

The study assumes that interest payments will be included in the toll base. PCC has roughly estimated that a toll rate increase of 35 percent would be required if interest and early retirement costs were included in the toll base as proposed by H.R. 111. Further, PCC estimates that if the Company were to lose North Slope oil during the initial Treaty period, the above rate increases would be even higher.

We have previously testified that whether the United States should continue to receive interest payments and also attempt to recover its investment are policy questions which should be decided by implementing legislation. These decisions will have significant financial implications for the new Commission, future toll rates, and U.S. consumers and taxpayers.

Interest on U.S. investment

From inception, interest has been charged on the U.S. investment in the Canal enterprise. When the present organization was established in July 1951, interest charges were continued for PCC but not for the investment in CZG. As of September 30, 1978, the U.S. investment in the equity of the Panama Canal enterprise was about $589.8 million, only $318.9 million of it considered to be interest-bearing. The remainder, which has been legislatively determined to be non-interest-bearing, consists of reinvested earnings ($187.3 million), investment in CZG ($65.4 million), and the Thatcher Ferry Bridge ($18.1 million).

The applicable rate of interest is determined by the Secretary of the Treasury. Under present practice, it is the computed average coupon rate on outstanding bonds as of July 31 of each year. For fiscal year 1978, the rate was 6.071 percent and interest payments were $19.3 million. Since interest payments are an operating cost for PCC, toll rates have been set to recover this cost.

Under Senate Reservation 6 to the Treaty, the Commission would continue to pay interest, at a rate determined by the Secretary of the Treasury, unless new legislation provided otherwise. By eliminating the requirement to pay interest, the administration bill reduces the Commission's operating costs and relieves some of the pressure to increase toll rates; but it also reduces Treasury receipts and, thereby, increases the burden on U.S. taxpayers. H.R. 111, on the other hand, retains interest payments to the Treasury. 1/ Higher toll rates, however, affect U.S. citizens as producers and consumers by adding to the cost of goods shipped through the Canal.

1/See pp. 37 and 38.

Recovery of U.S. investment

PCC currently repays invested capital only through dividends declared by the Board of Directors; it has repaid $40 million in dividends since its incorporation. The capital invested in CZG, however, is being systematically repaid. CZG operating costs and capital programs are initially financed by appropriations, and CZG charges users for services and pays the revenues into the Treasury. The difference between these revenues and expenses, including depreciation, which is the net cost of CZG, is then paid into the Treasury by the Company. Therefore, the entire costs of CZG, including the capital investment, are being recovered.

The administration bill and H.R. 111 both preclude the recovery of the U.S. investment in the Canal except through dividends. Under the Treaty, however, dividends could be paid only after the $10 million contingent surplus payment to Panama. However, H.R. 111 requires that implementation costs be paid before the contingent payments to Panama are made. It is our understanding that the administration has raised a question that this may be in violation of Article XIII 4(c) of the Treaty.

Toll sensitivity

The PCC's latest toll study indicates that toll rates could be raised high enough to cover interest payments on the U.S. investment up to 1982. PCC's recently completed study on the sensitivity of traffic to toll increases showed that an increase up to 25 percent would not have a significant adverse impact on traffic. An increase of this magnitude could result in a maximum diversion of about 0.9 percent of traffic in 1982, and the impact of a 40-percent increase could divert 3.1 percent of traffic in the same year. The study defines sensitivity as the extent that an increase in toll rates appreciably reduces commodity volumes shipped through the Canal. The study does not include the cost of retirement.

A 1978 study by International Research Associates on toll sensitivity found that toll rate increases of certain levels would sufficiently increase total revenue to cover Commission costs despite some dropoff in traffic; an increase of 15 percent would increase revenue 13 percent and reduce traffic 2.4 percent; a 50-percent increase would increase revenue 33 percent and reduce traffic 12 percent; and a 75-percent increase would raise revenues 58 percent in the first year, dropping to a maximum attainable stable increase of 40 percent after 7 years, which would decrease traffic

20.6 percent. The study projects that the maximum revenue would probably result from a toll increase of between 75 to 100 percent.

Forecasts of Canal traffic and revenues are necessarily uncertain, especially beyond 10 years. PCC has expressed concern about the long-range ability to raise toll rates to cover projected costs. This concern was based on anticipated cost inflation and the foreseeable drop in North Slope oil traffic because of alternative pipeline development. On the other hand, the Canal has historically generated adequate revenues to pay interest on the U.S. investment. Existing legislation requires PCC to make annual interest payments to the Treasury to the extent earned. If not earned in any given year, interest payments shall be made from subsequent earnings unless the Congress otherwise directs. H.R. 111 continues the interest liability to the Commission.

We have testified that, on the basis of the current value of the interest-bearing investment and the applicable rate of interest for fiscal year 1978, interest payments over the life of the Treaty could amount to about $396 million. This is only a rough projection; the actual annual amounts and cumulative total will depend on the value of the interest-bearing investment after property transfers to other U.S. agencies and the Government of Panama and on the applicable rates of interest determined each year by Treasury.

IMPACT OF TOLL INCREASES ON U.S. TAXPAYER

The Treaty's toll provisions should have no major impact on the U.S. taxpayer. Toll increases would, of course, lead to increased costs for all shippers using the Canal, including U.S. shippers, but this cost is not expected to be large.

According to testimony by the president of International Research Associates, the users of the Canal would, collectively, pay from $40 million to $75 million a year more in tolls if rates were increased from 25 to 46 percent. U.S. businesses and consumers are the ultimate payers of about one third of all tolls paid at the Canal, which amount to about $13 million to $25 million a year. This amount is considered negligible when compared with the total U.S. import bill. In addition, the 1978 Senate Foreign Relations Committee Report on the Panama Canal Treaties concluded that, overall, the annual U.S. costs likely as a result of the new Treaty would be minimal relative to the U.S. economy.

On the other hand, GAO has testified that if Canal transits fell short of current estimates and toll revenues were insufficient to cover the costs of the Commission, including the scheduled payments to the Government of Panama, the United States would likely be required to provide financial assistance either through congressional appropriations or allowing the Commission to borrow from the Treasury. PCC has recommended to the Congress that the Commission be authorized to borrow up to $40 million from the U.S. Treasury and to seek appropriations to cover funding requirements beyond those that can be met from its operating revenues.

PCC presently has the authority to borrow up to $40 million from the Treasury for any purpose. The administration bill continues this authority. H.R. 111, however, replaces this authority with a $40 million Emergency Fund on which the Commission can draw to defray emergency expenses and to insure continuous, efficient, and safe operation of the Canal; if funds appropriated for the maintenance and operation of the Canal prove to be insufficient for that purpose, withdrawals cannot be made for the purpose of making payments to the Government of Panama under Article XIII of the Treaty.

CHAPTER 6

OTHER TREATY-RELATED COSTS

Costs associated with the Treaty have been the subject of considerable discussion. This chapter highlights some of the costs, (excluding Treaty-specified payments and property transfers--see chs. 3 and 5) which will be borne by CZG/PCC or its successor, the Commission, and other U.S. agencies or the U.S. Treasury.

We could not accurately identify all costs and establish the grand total because some are one-time costs and others are expected to occur over the life of the Treaty. A summary of information available shows that these costs could total about $1,009.7 million over the life of the Treaty. These costs will be financed by tolls and appropriations. (See app. V.)

The Comptroller General has testified before congressional committees at various times regarding some of these other Treaty-related costs, highlighting that these costs will be borne by the U.S. Government unless otherwise legislated. He has also stated that the implementing legislation is the key element in addressing this issue.

CZG/PCC

This U.S. agency has identified seven other Treaty-related cost categories for which preliminary calculated costs are over $340 million. 1/ GAO has stated that the Congress may wish to consider whether to nullify certain costs or to specifically state in the implementing legislation how some costs should be treated. These are discussed below.

Early optional retirement

We could not obtain from CZG/PCC the cost of the early optional retirement contained in the administration bill and H.R. 111. However, the Office of Personnel Management estimate as of May 2, 1979, reduces the added retirement outlay from $29.4 million to $21.8 million--dynamic costs amortized over 20 years 2/--resulting in a total increased liability of $265 million.

1/Includes cost of living allowances of $61.3 million over a 5-year period.

2/The difference between $265 million and $436 million (21.8 million X 20 years)--$171 million--represents interest.

The magnitude of these costs has caused considerable public concern, especially about who would pay for the program --the U.S. Government or the users of the Canal. H.R. 111 and the House Committee on Post Office and Civil Service Report of April 11, 1979, make the Commission liable for the early optional retirement program. They also state that the Commission shall pay the unfunded liability of the Civil Service Retirement and Disability Fund. The Committee recommends also that the Commission pay the amounts from tolls or from any otner funds under its control, provided they are not derived from the Treasury. Moreover, it recommends that the Commission pay from tolls or any other non-Treasury fund the unfunded liability caused by the transfer and payment of funds to the Social Security System of Panama for employees separated from CZG/PCC or the Commission as a result of the implementation of the Treaty.

Leave and repatriation

By October 1, 1979, CZG/PCC leave and repatriation liability will total about $10 million for the 2,571 leave-accruing employees transferring to DOD; The CZG/PCC's stated position is that neither PCC nor the Commission can properly make payments for these employees.

Such leave and repatriation costs have already been accrued as a cost to Canal users. If the CZG/PCC is allowed to retain the $10 million, DOD will have to seek appropriations, as needed, up to this amount. The Comptroller General testified in February 1979 that the implementing legislation should specifically require the Commission to transfer the necessary funds either to DOD or to the U.S. Treasury.

Severance pay

CZG/PCC will incur a liability of $4.6 million by terminating 2,044 employees. About 1,580 of these will be reemployed by Panama almost immediately to perform their same duties. The liability for these employees is about $3.5 million. About 464 employees will not be reemployed by any government agency. The liability for these employees is about $1.1 million.

The question has been raised whether the $3.5-million payment to the employees being transferred to Panama was in accord with existing laws and regulations. CZG/PCC's position is that the Company must give severance pay to these employees. We reviewed the applicable statutes and regulations to determine whether employees of PCC who continue to work at the same jobs are entitled to severance pay when the functions they are performing are transferred to Panama and concluded that they were legally entitled to severance pay. To preclude payment of severance pay to such employees, the applicable regulations or statutes will have to be amended.

Our opinion is based on the Civil Service Regulation which suggests that the policy is to exclude from entitlement to severance pay those employees who upon transfer will receive no less favorable pay, life insurance, and retirement benefits. The Treaty, implementing agreements, and proposed implementing legislation all indicate an intention to insure that transferred employees receive no less favorable terms and conditions of employment; i.e., Article VIII of Agreement on Implementation of Article III of the Panama Canal Treaty.

However, Panama's duty under the Treaty is to insure such comparability "to the maximum extent feasible." (Article X, paragraph 7.) This mitigates to some extent what would otherwise be a duty of Panama to insure no less favorable terms and conditions of employment for transferred employees. However, in our view, the mitigating phrase does not necessarily mean that employment benefits would not be insured to the extent needed to justify a policy determination that at least some transferred employees should be precluded from receipt of severance pay.

In sum, under current statutes and regulations, transferred employees would be entitled to severance pay.

Residual retail inventories losses

On October 1, 1979, CZG/PCC, which operates retail activities, may incur an estimated loss of about $1.25 million--$.75 million in inventories (at cost basis) and about $.5 million for closeout tasks.

When the Treaty enters into force, the Commission may not perform any commercial activities, such as retail outlets managed now by CZG/PCC. Therefore, CZG/PCC plans to continue all retail outlets on a full-service concept, providing all essential goods and services to minimize inconveniences to its customers and employees until the Treaty becomes effective.

CZG/PCC officials stated that, since its employees had a commitment from CZG/PCC to be employed until October 1, 1979, the CZG/PCC had to maintain sufficient inventories to generate revenues to meet payroll and other costs. Also, post exchange and commissary privileges will not be granted to non-U.S.

citizen employees. U.S. citizen employees expect to be granted post exchange privileges on October 1, 1979, and commissary privileges from one to two weeks before the Treaty goes into effect.

On the basis of CZG/PCC commitments to its employees, residual retail inventories losses are unavoidable. CZG/PCC officials, however, are making a conscious effort to minimize the losses by negotiating with the Army and Air Force Exchange Service and Troop Support Agency to absorb some of its potential losses from retail outlets.

Cemetery

The U.S. Government will incur about $1.7 million in costs for disinterment, transportation, and reinterment of the remains of U.S. citizens and members of their immediate families buried in Canal Zone cemeteries in accordance with Reservation (3) (b) to the Panama Canal Treaty of 1977. These costs are currently proposed to be funded by CZG through a supplemental budget request.

The CZG/PCC record shows that the reinterment should not be a liability of PCC, since the Treaty Reservation specifies that the plans for reinterment are "to be carried out at the expense of the United States Government."

An estimated 1,300 graves at Mount Hope Cemetery on the Atlantic side of the Canal Zone, must be removed before October 1, 1979; it is assumed that 975 will be moved to Corozal Cemetery and 325 will be transported to and reinterred in the United States. Corozal Cemetery contains 3,395 graves, of which only an estimated 65 will be moved to the United States. Thus a total of 1,365 graves movements are estimated for fiscal year 1979.

PCC general and administrative expenses

PCC will incur an increase of about $1.8 million in this cost category for fiscal year 1979 to meet abnormal repatriation costs related to the Treaty ($1,672,000) and additional recruitment costs as a result of greater than anticipated turnover among pilots and other skilled employees required in continuing operations ($165,000). These additional costs apply to the entire PCC and not just to general and administrative expense activities, since all Company recruitment and repatriation estimates are under the limitation.

Cost of living allowance 1/

Pursuant to Article XIII, Paragraph 3, of the Implementing Agreement of Article III of the Treaty, the Commission's U.S. employees are authorized to use military postal services, commissaries, and military exchanges for 5 years after entry into force of the Treaty, or up to October 1, 1984.

H. R. 111 and H.R. 1716 require that U.S. citizen employees of the Commission be paid an allowance to offset the cost of living increases resulting from losing the military postal services and commissary and exchange privileges in 1984.

A CZG/PCC official testified before members of the Post Office and Civil Service Committee at the Canal Zone on February 16, 1979, that the preliminary cost of living allowance would be about $61.3 million for the first 5-year period, using a 15-percent cost of living allowance factor and assuming a U.S. work force of about 2,088.

Potential liability for interest on retirement benefits transferred

Article VIII (3) (c) of the Agreement on Implementation of Article III of the Treaty provides for the transfer of funds to the Social Security System of Panama equal to the amount of employee/employer contributions to the Civil Service Retirement Fund of the United States held for certain CZG/PCC employees who become employed by the Government of Panama as a result of the Treaty. This transfer is at the option of the employee. The Department of State said that it is difficult to estimate the cost of this provision until the number of employees opting for the Panama system is known. It has been the experience of the Office of Personnel Management that employees separated by a reduction in force who lack enough service for early retirement generally request refunds of their contributions to the Civil Service Retirement Fund.

The Office of Personnel Management has estimated that, if 300 employees elected to transfer their contributions, the cost of these transfers to the Social Security System of Panama, including U.S. matching funds, would not be more than $1 million to $2 million.

1/The House Committee on Post Office and Civil Service did not report out section 324 of H.R. 1716, which would have provided a cost of living allowance.

This is not a net incremental cost to the Treasury, since the transfer would be financed from contributions already made to the Civil Service Retirement Fund. Should interest on the employer/employee contributions be paid, the cost to the Treasury would be from $1 million to $2 million. Thus, a potential liability of up to $2 million could occur.

DEPARTMENT OF DEFENSE

The principal U.S. expenses in carrying out the Canal Treaty will be borne by DOD, which by October 1, 1979, must relocate certain military facilities and take over the operation of schools, hospitals, and certain community services from the CZG. As of March 1979, DOD estimated its Treaty implementation costs at $277 million for fiscal years 1979 through 1984, as shown below.

	Fiscal year (note a)						
	1979	1980	1981	1982	1983	1984	Total
			(millions)				
Base operations	$3.8	$16.5	$16.6	$16.6	$16.6	$16.6	$86.7
Commissary operations	.4	3.4	1.1	1.1	.7	.7	7.4
Port operations	.1	.9	.9	.9	.9	.9	4.6
Communications	1.6	.8	.5	.5	.5	.5	4.4
Disposal of remains	.1	.2	.2	.1	.1	.1	.8
Criminal investigation	.1	.1	.1	.1	.1	.1	.6
Medical operations	.6	14.6	16.3	16.7	3.5	3.8	55.5
Postal operations	.5	1.5	1.4	1.3	1.3	1.3	7.3
School system	-	6.0	6.0	6.0	6.0	6.0	30.0
Military pay	-	3.5	3.5	3.5	3.5	3.5	17.5
Military construction	40.6	6.0	13.6	12.2	.5	-	72.9
Equipment procurement	-	10.0	6.6	2.4	2.8	.8	22.6
Less Hospital operations (note b)	-	-7.5	-7.5	-6.7	-5.8	-5.8	-33.3
Total	47.8	56.0	59.3	54.7	30.7	28.5	277.0

a/Fiscal years 1980-84 shown in 1980 values

b/Represents revenue generated as a result of medical care provided to persons who, although authorized to receive it, are required to pay for it in accordance with established rates. These amounts exclude that portion of the revenues returned to the O&M, Army Appropriation, and include only those amounts returned to the Military Personnel, Army Appropriation, and to Miscellaneous Receipts, Treasury account.

Non-appropriated-fund employees retirement

Annex C of the Agreement on Implementation of Article IV of the Treaty provides that non-U.S. citizens who are not presently covered by U.S. Civil Service Retirement, or employees paid by U.S. nonappropriated-fund instrumentalities, shall be covered by Panamanian Social Security, with contributions paid by the insured and the employer according to the rates established by the Social Security laws of Panama. The DOD budget will include a one-time request for about $2 million to cover unfunded retroactive retirement annuities for non-appropriated-fund employees.

Foreign military sales reserve

The Department of State estimates that the Economic and Military Cooperative Program with the Government of Panama will total $345 million. This program consists entirely of loans, guarantees, and credits. It includes issuance of repayment guarantees under the Foreign Military Sales Program not to exceed $50 million over a 10-year period. Appropriations would be required only to cover the 10 percent of the annual program in the form of deposits in a special reserve account. The maximum amount required for this purpose will be $5 million.

Cemetery

In accordance with the Senate Reservation to the Treaty, DOD estimates that about $1.5 million may be required to cover the cost of transporting the remains of U.S. citizens from Corozal Cemetery to the United States.

Additional Treaty costs

DOD projects additional Treaty costs at $480 million for the balance of the Treaty period (fiscal year 1985 through 2000). This is based on estimated operating expenses of $30 million a year for 16 years commencing in fiscal year 1985 for replacement of capital items and urgent military construction. However, DOD points out that this projection is on a straight-line basis; i.e., on the basis of zero change from the fiscal year 1984 level. Further, DOD stated that its actual Treaty-related costs over this period will most certainly be significantly less that those based on this assumption.

DEPARTMENT OF STATE

The Department of State estimates additional Embassy costs of $3.7 million over the life of the Treaty, because the Embassy will assume certain consular services previously handled by CZG, mainly passports, citizenship, and welfare and protection services.

Also, State estimated that about $3.8 million will be needed to meet expenses for participation of the Consultative Committee and the Joint Commission on the Environment for the life of the Treaty. These expenses will be included in State's budget.

FEDERAL AVIATION ADMINISTRATION

The FAA will close out its operations in Panama in 1984 in accordance with a separate Agreement signed in Janaury 1979 between the United States and Panama. We could not obtain the estimated costs for the closeout from the local FAA officials. However, other Treaty-related costs will be involved, at least for transport of a radar system to be returned to the United States.

OTHER

Other costs identified for which estimates were not available are:

--Battle Monuments Commission costs for maintaining the cemetery for U.S. citizen remains.

--DOD costs for maintaining the cemetery for non-U.S. citizen remains during Treaty transition period.

COMPARISON OF CORPORATE FORM versus APPROPRIATED-FUND AGENCY

APPROPRIATED AGENCY		CORPORATION
Strict congressional control with budgetary limitation.	LEGAL FORM	Legal and financial autonomy and operating flexibility through fund reallocation.
Treasury funding without reference to income from operations.	FINANCING	Sustained by its own operating revenue
Reflects agency's expenditures within budgetary limitations.	ACCOUNTING	Uses standard means to reflect profit and loss.
Requires congressional approval to meet emergency reallocation of funds	FLEXIBILITY	Resources may be reallocated at management discretion to meet unexpected demands.
With expenses budgeted annually agency has no incentive to reduce expenses as revenue declines.	PRUDENCE	Management must live within its income.
As demand for services increases funds are not available to expand the scope of the operation.	EXPANSION	As demand increases added revenue is available to provide additional services.
Congress may be politically motivated to provide services not economically justified by operating revenues.	BALANCE	Only financially justified services will be provided
Capital improvements made from appropriated funds only.	DEPRECIATION	Depreciation included in toll base provides funds for capital improvements from revenue.
A federal agency may be sued.	LITIGATION	A corporation may sue or be sued.
Government accounting methods when applied to a business operation may be subject to differing interpretations.	STANDARDIZATION	Corporate accounting procedures use standard, generally accepted methods.
While the agency's budget may be balanced, profit or loss must be shown in another set of books.	ACCOUNTABILITY	Management must demonstrate its good stewardship in standard business terms.

APPENDIX I

 APPENDIX II

PANAMA CANAL COMPANY/CANAL ZONE GOVERNMENT

SUBCOMMITTEES OF THE BINATIONAL WORKING GROUP

1. LANDS AND WATERS
   - A. Surveys
   - B. Land Use Licensing
   - C. Public Facilities
   - D. Historical Monuments
2. PORTS AND RAILROAD
   - A. Ports
   - B. Railroad
3. HOUSING
4. COMMERCIAL SERVICES
5. BUSINESS ACTIVITIES
6. NONPROFIT ORGANIZATIONS
7. HEALTH AND SANITATION
8. SOCIAL SECURITY
9. UTILITIES
   - A. Power
   - B. Communications
   - C. Water
   - D. Sewers
10. GARBAGE, TRASH COLLECTION AND STREET CLEANING
11. SCHOOLS
12. POSTAL SERVICES
13. FISCAL MATTERS
    - A. Importation
    - B. Taxation
14. ROADS AND STREETS
15. FIRE PROTECTION
16. EMPLOYEE DOCUMENTATION
17. LICENSING AND REGULATION
18. JURIDICAL
19. CLAIMS
20. PERSONNEL
21. POLICE
22. ENVIRONMENTAL
23. LIAISON

 APPENDIX III

U.S. SOUTHERN COMMAND SUBCOMMITTEES OF THE JOINT WORKING COMMITTEE

1. LANDS AND WATERS
   - A. Surveys
   - B. Land Use Licensing
   - C. Military Community Support Facilities
   - D. Environmental
   - E. Housing
   - F. Historical Monuments
2. PORTS AND RAILROAD
3. BUSINESS ACTIVITIES AND NONPROFIT ORGANIZATIONS
4. COMMUNITY SERVICES
   - A. Health and Sanitation
   - B. Schools
   - C. Postal Services
5. PUBLIC SERVICES
   - A. Power
   - B. Water
   - C. Sewers
   - D. Garbage, Trash Collection, and Street Cleaning
   - E. Roads and Streets
   - F. Fire Protection
   - G. Vector Control
6. TELECOMMUNICATIONS
7. CUSTOM MATTERS
8. LEGAL
9. PERSONNEL ADMINISTRATION
   - A. Civilian Employment
   - B. Employee Documentation
   - C. Social Security
10. LAW ENFORCEMENT
    - A. Licensing and Registration
    - B. Police
11. PROCUREMENT AND CONTRACTING

NET BOOK VALUE OF PROPERTY TRANSFERS TO PANAMA

ON OCTOBER 1, 1979

(In thousands of dollars)

CHANNELS, HARBORS: Land improvements, streets and facilities.	$13,743
THATCHER FERRY BRIDGE: Bridge structure, access roads and equipment.	13,212
MARINE BUNKERING: Balboa/Mt. Hope tank farms, petroleum products tanks, pipelines and pumping facilities, access roads and oil handling equipment.	4,038
HARBOR TERMINALS: Docks, piers, sheds, yards, fencing, light & power systems, a/c system, sewer system, tractors conveyors, forklifts gangways, trailers, fueling systems, etc.	6,101
EMPLOYEE HOUSING A,B,C,D,E, & F: All housing, except minor transfers to Other Government Agencies.	34,530
MARKETING OPERATIONS: Gasoline retail facilities at Balboa, Margarita Coco Solo, Paraiso, retail facilities at Rainbow City, Paraiso and Gamboa.	3,185
RAILROAD DIVISION: Main line & Spur track, signals, gate crossings, stations, platforms, frt. houses, rolling stock and equipment.	2,154
OTHER: Dry docks, Port Captain, Balboa, Vessel repair, MTD buildings/facilities No. District, communication system, misc. company bldgs., etc.	2,615
Sub-Total Panama Canal Co.	$79,578
CANAL ZONE GOVERNMENT:	
DIVISION OF SCHOOLS: swimming pools and equipment, Gatun Gynasium, etc.	$ 701
ROADS, STREETS AND SIDEWALKS: In areas transferred.	6,374
SEWER SYSTEM: In areas transferred.	2,089

APPENDIX IV

PERMANENT TOWNSITES: Site leveling, fills, retaining walls, drainage, ditches, etc.	$ 2,562
STREET LIGHTING SYSTEM: Cable conduit, control equipment, transformers, etc.	886
MISC. GOVT. BUILDINGS: Ancon Court House, Civil Affairs Bldg., Shaler Bus Terminal, Magistrates Court, Latin American School Bldgs., etc.	2,595
OTHER: Balboa/Coco Solito Fire Stations and two fire trucks, Balboa/Gamboa Post Office Bldgs, Fire Hydrants, Experimental Gardens (Summit), Tennis Courts, Playgrounds, Monuments, Palo Seco Hospital Complex, Siren systems, etc.	972
Sub-Total Canal Zone Government	$16,179
GRAND TOTAL	$95,757

Source: Panama Canal Company

SCHEDULE OF OTHER TREATY-RELATED COSTS (note a)

		(millions)
I	DOD IMPLEMENTATION	
	--FY 1979-84	$ 277.0
	--FY 1985 - 1st Quarter, FY 2000	480.0
		$ 757.0
II	DOD AND PCC PERSONNEL ACTIONS	
	--PCC Early Optional Retirement	[b] 265.0
	--PCC Potential Liability for Interest on Retirement Benefits Transferred	2.0
	--DOD Non-Appropriated Fund Employees Retirement	2.0
	--PCC Leave and Repatriation	10.0
	--PCC Severance Pay	4.6
	--PCC General and Administrative Expenses	[c] 1.8
	--PCC Cost of Living Allowance (1985-1989)	61.3
		$ 346.7
III	OTHER ACTIONS	
	--PCC Residual Retail Inventory	1.3
	--Embassy Consular Services	3.7
	--DOS Joint Committee Expenses	3.8
	--PCC Relocation of Cemetary Remains	1.7
	--DOD Relocation of Cemetary Remains	1.5
	--DOD Foreign Military Sales Reserve	5.0
		$ 17.0
	Gross Amount of Other Treaty-Related Costs (FY 1979-99)	$1,120.7
IV	LESS	
	--Annuity Payments to GOP	(36.0)
	--FAA Operations and Facilities	(75.0)
		$ 111.0
	Net Amount of Other Treaty-Related Costs (FY 1979-99)	$1,009.7

[a] These costs could vary over time because some are one-time costs and others are expected to occur over the life of the Treaty.

[b] Estimate costed over period of 20 years.

[c] Eliminated by House Committee on Post Office and Civil Service.

Source: Departments of State and Defense; Office of Personnel Management; and CZG/PCC.

APPENDIX VI

MILCON CONSTRUCTION SUMMARY FOR T-DAY RELOCATIONS

Phase I Minimum Essential Construction Including Temporary Relocations.

		(millions)
	HQ 193d Inf Bde relocation to Albrook and Clayton	$ 3.0
	210th Avn Bn relocation to Howard, Kobbe and Albrook	3.4
	470th MI Gp to Corozal (incl costs to move F&A to Bldg 519)	2.6
	Post Offices at Albrook and Davis	.8
	Miscellaneous (PDO; guard booths; fencing; trash equipment maint)	1.1
	Total Phase I	$10.9

Phase II Balance of Construction Necessary to Execute T-day Relocations.

Army:	HQ 193d Inf Bde relocation to Clayton	$12.6
	210th Avn Bn to Howard and Kobbe	9.4
	470th MI Gp to Corozal (incl costs to move F&A to Bldg 519)	2.7
	TTC (road, tower, fencing, lighting - Cerro Pelado)	.8
	Army Total	$25.5
Air Force:		
	Security fencing (Howard & Albrook)	$ 2.7
	Guard towers & kennels	.1
	Miscellaneous	.7
	Air Force Total	$ 3.5
Navy:	Harbor Craft facility	$ .3
	Security fencing & miscellaneous	.4
	Navy Total	$ .7
	Total Phase II	$29.7
	Grand Total Phase I & II	$40.6

As of 29 January 1979

MILCON CONSTRUCTION SUMMARY FOR POST T-DAY REQUIREMENTS

			(millions)
Army	FY 80	Relocation of Medical Warehouses to Corozal	$ .6
	FY 81	Renovation of Gorgas Hospital	3.4
		Ft Davis Health/Dental Clinic	5.3
		Ft Clayton Dental Clinic	1.1
		Construct AAFES Warehouse	3.6
	FY 82	Relocate activities from Gulick to Davis	7.5
		Construct Gymnasiums at Clayton and Davis	4.8
	FY 83	Construct 2 Ballfields, Clayton and Davis	.5
		Army Total	$26.8
Air Force	FY 80	Construction of Enlisted Recreation Center and expansion of Existing Gymnasium at Howard	1.7
		Relocation of Transmitter Site at Curundu to Howard area	1.0
		Air Force Total	$ 2.7
Defense Mapping Agency	FY 80	Relocation of IAGS from PAD to Corozal	.7
		Renovation of FAcilities at Clayton	1.8
		DMA Total	$ 2.5
		DOD Total	$32.0

As of January 29, 1979

Source: U.S. Southern Command

PCC/CZG POLICY ON FAIR VALUE OF REMOVABLE PROPERTY TO BE OFFERED TO PANAMA

SUBJECT. Policy on establishment of fair value of removable property to be offered to the Government of Panama under the treaty

REFERENCES.

A. Supply and Community Service Director requests development of simple technique for determining fair value of items to be offered for purchase to the Government of Panama. (1/8/79)
B. Draft proposal on simple valuation method presented to Supply and Community Service by Financial Vice President. (2/22/79)
C. Concurrence with draft proposal by Supply and Community Service Director. (2/23/79)

BACKGROUND. In addition to assets required to be transferred to the GOP under the treaty, there are other items of removable property which will be offered for purchase by Panama at fair value. These include items used in support of public service functions and property located in certain areas or functions that will be transferred to Panama.

Normal procedure for establishing fair value of plant items to be excessed is found in Section 89.6 of the CZAR and involves individual inspection and evaluation of each item. The large number of items that require valuation makes impractical the application of the normal procedure; a simplified method of establishing fair value has been developed in its place.

DISCUSSION. For removable plant assets, minor items and furniture pool items, the net book value consitutes a fair value except for those items which are carried at or near zero net book value. In a random sample of fully depreciated removable property items still carried on the books of the Company/Government, it was determined that the extended life of these items exceeded 30% of the established service life. In practice, this additional life over and above the original service life is a result of the Company's preventative maintenance program. The concept of extending the useful life of assets whose service life has already been completed is set forth in Engineering Valuation and Depreciation (Marston, Winfrey and Hempstead; McGraw Hill; New York.)

For furniture and fixture items, small tools, and the like, Company policy is to capitalize the initial complement of items purchased, stop depreciation at 40% of costs, and charge future purchases of replacement items to operating expense. Since, in theory, the continuous replacement of items maintains the value of the full complement at 60% of the original costs, it appears reasonable to establish the fair value of such items at 60% of the initial purchase price.

For Storehouse inventory stock items, the fair value is established as the inventory cost plus freight.

ACTION RECOMMENDED. Approval of attached draft memorandum to Bureau Directors setting forth policy and responsibilities.

APPROVED/~~DISAPPROVED~~

W. D. Bjorseth

W. D. Bjorseth
Financial Vice President
FV- (52-3194)

MAR 1 1979

President

Date: 9 april 1979

COORDINATION.

Supply and Community Services	Concur	3/13	Nonconcur	
Executive Planning Staff	Concur	3/16	Nonconcur	
General Counsel	Concur	3/28	Nonconcur	
Executive Secretary	Concur	3/29	Nonconcur	

DISPOSITION AFTER ACTION. Return to Financial Vice President to arrange for duplication and distribution.

APPENDIX VIII

OPTIONAL FORM NO 10
5010-101

UNITED STATES GOVERNMENT

Memorandum

TO : Bureau Directors and Heads of Independent Units DATE:

In reply refer to:
FV-

FROM : Financial Vice President

SUBJECT: Policy on establishment of fair value of removable property offered to the Government of Panama under the treaty

Purpose. This memorandum describes the policy governing the establishment of fair value of removable property items offered for purchase by the Government of Panama under the treaty. For these items, this policy supersedes the provisions of CZAR-89.6 relating to the establishment of fair value.

Policy.

a. For removable plant assets, minor items and furniture pool items, the fair value shall be the net book value or 30% of original cost, whichever is greater. When the original cost is unknown, a fair value will be established by the Valuation Engineer, Plant Accounting Branch and the Excess Disposal Manager, Division of Storehouses.

b. For furniture and fixture items, small tools and like items generally costing less than $100, a standard fair value price list will be developed by the Valuation Engineer and the Excess Disposal Manager, using the following criteria: where the cost to purchase the item can be determined through catalogs or price quotation information, the standard fair value of the item will be established at 60% of the purchase cost. Where the cost to purchase the item cannot be determined, a fair value will be estimated by the Valuation Engineer and the Excess Disposal Manager.

c. For Storehouse inventory stock items, the fair value will be the inventory cost plus freight. The inventory cost is the standard cost of the item.

W. D. Bjorseth

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