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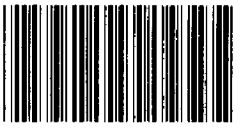
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Statement of

J. Kenneth Fasick

Director, International Division

before the Senate Armed Services Committee Sen 00500

on

Panama Canal Treaty Implementing Legislation

Mr. Chairman and Members of the Committee:

We are pleased to appear before you today to discuss the operational and financial issues involved in the implementation of the Panama Canal Treaty of 1977. In the 22 months since the signing of the Treaty, there has been an extensive analysis and useful debate over these issues. As the Comptroller General said to this Committee on February 1, 1978,

> "We believe that the treaty implementing legislation is the key determinant of the financial viability of the proposed Panama Canal Commission."

With this in mind, we recently issued a staff study which provides an information source and data base on the critical issues. Our study "Background Information Bearing Upon Panama Canal Treaty Implementing Legislation," dated June 4, 1979, has been provided to every member of Congress. Today, we would like to summarize the information in this study. With me is Frank Zappacosta, Assistant Director for our Accounting and Financial Reviews and Henry Avalos, Team Leader.

Testimony

005805

Congressional Oversight and Organization of the Panama Canal Commission

Last Thursday, the House passed H.R. 111 which provides that the new Panama Canal Commission will be an appropriated-fund agency of the U.S. Government. The Administration's proposal S. 1024 would continue the Commission as a corporate entity. We and the Panama Canal Company have testified that the Commission could operate either as an appropriated-fund agency or as a corporate-type organization. There would, however, be an additional administrative burden and loss of management flexibility involved in a change from the Company's present corporate form of organization.

Historically, Congress 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 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 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.

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 Accounting 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 Panama Canal Company, such as appropriation, allotment, and obligation accounts. According to the Company, 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. The supplemental set of books required for appropriated-fund accounting would create an additional administrative burden for the Commission. At this time, there is no estimate of the additional cost of maintaining a supplemental set of books.

For additional points of comparison between government corporations and appropriated-fund agencies, we refer you to an excerpt from our staff study which is attached as Appendix I to this statement.

As a final note, we would like to repeat from the Comptroller General's statement last February before the House Panama Canal Subcommittee that in our opinion

> "the successful operation of the Panama Canal Company since the 1950 legislative changes

has demonstrated the appropriateness of the corporate form of organization."

We wish to emphasize, however, that either form of organization would be workable.

Orderly Transfer of Property and Activities

Last year when Mr. Staats testified before you, he discussed some of the problems to be addressed in the transfer of property and activities to the Republic of Panama. Our principal concern has been that, as required by the Treaty, the transfer be orderly and assure continued efficient operation of the Canal.

DCG 01223 US Embassy

During the past year, the U.S. Government and Government of Panama have established the necessary organizational structures and mechanisms to carry out the transfer and have made considerable progress toward meeting the October 1, 1979, deadline.

Panama Canal Company Panama Canal Organization

The principal organizations responsible for implementation are the Embassy, the Canal Enterprise and Department of Defense agencies, on the U.S. side, and, for Panama, the newly established Panama Canal Authority and the Panama National Guard. DLG 02076

Panama: DLG 02075

Formal planning sessions between the Canal Enterprise 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.

Subcommittees are cochaired by Government of Panama and Canal Enterprise representatives, and, although primarily made up of their officials, each subcommitte 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.

For the military aspects of Treaty implementation, the U.S. Southern Command has established a Joint Working Committee, which is analogous to the Canal Enterprise's Binational Working Group, and 11 subcommittees responsible for 27 Treaty implementation activities or issues.

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

Rather than repeat the details of the property and activity transfers, which are discussed in our staff study, we would like to assure you that we are closely monitoring the situation and in our future audit reports we will report on the property transfers to Panama.

Panama's Debts for Past Services

In previous testimony, we referred to the Government of Panama's debts to the Canal Organization for past services.

As of February 28, 1979, accounts receivable from the Government of Panama totaled about $9.2 million, of which about $8.7 million was delinquent. We testified that these debts should be resolved either through a lump-sum payment or as an offset to treaty-specified payments to Panama.

Earlier this year, the Canal Organization and the U.S. Embassy obtained an oral acknowledgment from the Government of Panama of the total delinquent debt. The U.S. Embassy was working on formalizing payment arrangements through an exchange of notes with Panama. It was expected that the payment of delinquent debts would be made directly over a 3-year period or as an offset to payments to Panama.

As we understand it, H.R. 111, as passed by the House, requires settlement of these debts prior to October 1, 1979. The Administration's bill S. 1024 is silent on repayment of these debts. Expedient resolution of these debts is obviously preferable to extending repayments over 3 years. From an accounting standpoint, repayment before October 1 would also avoid potential conflict on whether revenues from past Panamanian debts would enter into the calculation of the $10 million contingent surplus payment to Panama which is provided for in the treaty.

Payments to Panama for Public Services and Assurance of Quality

The Panama Canal 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, the Canal Organization has developed draft procedures providing a method for verifying the costs and providing guidance to 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 reviewed and modified by Canal Organization 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 services 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 of a jointly determined method of allocating costs that nearly reflects the actual costs 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's correctness is to be certified by an appropriate Panama official and will be used by both parties to evaluate results.

Four joint subcommittees are responsible for the Treaty-specified public services to be provided by the Government of Panama: 1.) garbage, trash collection, and street cleaning; 2.) roads and streets; 3.) police; and 4.) fire protection. The subcommittees, composed of U.S. and Panamanian representatives, are responsible for 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 are submitted to a 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.

H.R. 111 provides that all payments to Panama, except the $10 million contingent surplus payment, will be made monthly from appropriations for such purposes. There is no provision in the Administration's bill for the frequency of payments. With respect to payments for public services, H.R. 111 requires that GAO annually audit these payments. The legislation incorporates, as we suggested in previous testimony, Understanding 1 to the Treaty. This Understanding provides a mechanism for establishing the quality of public services to be provided by Panama and a procedure for relating payments to actual costs.

Financial Viability of the Commission

Considerable time and effort have gone into projecting the financial viability of the Panama Canal Commission. In our staff study, we discuss the Panama Canal Company's toll study which was completed in March of this year. This study estimated that a toll rate increase of 21.8 percent, effective October 1, 1979, would be required to cover projected toll revenue deficiencies in fiscal years 1980, 1981, and 1982. The study assumed that interest payments on the U.S. investment would continue to be required and, therefore, included these payments in the toll base. Liability for early retirement costs was not included in the calculations but the Panama Canal Company roughly estimated a toll rate increase of

35 percent would be required if these costs and interest were both included. As passed by the House, H.R. 111 would make the Panama Canal Commission liable for the unfunded costs of early retirements. There is no comparable provision in the Administration's bill.

Frankly, until final enactment of the treaty-implementing legislation, the total costs that the Commission will have to recover are not known. Therefore, the extent of which toll rates will have to be increased cannot be accurately projected.

As an illustration of the importance of the implementing legislation, H.R. 111 provides authority for a toll surcharge on transiting cargo originating or destined for countries other than the United States or Panama. The purpose of the surcharge would be to recover costs for interest, depreciation, and capital for plant replacement, expansion and improvements. According to its sponsor, Congressman Treen, this provision would authorize the Commission to separate operational and capital costs in the rate structure and establish two sets of toll rates based on the origin or destination of cargo passing through the Canal. Congressman Treen estimated that the fiscal year 1980 operational cost per ton of cargo would be $1.34 and the capital cost would be 32 cents per ton. Cargo originating in or destined for the United States or Panama could be exempted from the capital surcharge and be charged the $1.34 per ton rate. "Foreign" cargo would be charged an estimated toll rate of $1.81 to cover the entire capital costs.

We have not analyzed the implications of the capital surcharge provision, but it is apparent that such a provision could have a significant effect on future toll rates.

Other Treaty-Related Costs

Treaty-related costs, other than those specified payments to Panama, have received a significant amount of attention. Appendix II to this statement lists the costs which are discussed in greater detail in our staff study. These costs could vary over time because some are one-time costs, others are expected to occur over the life of the Treaty.

The net amount of these other treaty-related costs is estimated at $1,009.7 million. $344.7 million of these costs would be recovered through tolls and about $663.7 million would require appropriations.

We should add the caveat to this list of costs that the costs are estimates subject to continual refinement.

Mr. Chairman, this concludes our statement. We will be pleased to answer any questions you or members of the Committee may have.

APPROPRIATED AGENCY		CORPORATION
Strict congressional control with budetary 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.

APPROPRIATED AGENCY		CORPORATION
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	Corporation 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.

SCHEDULE OF OTHER TREATY-RELATED COSTS (note a)

		(millions)	Appropriations	Tolls
I	DOD IMPLEMENTATION			
	--FY 1979-84	$ 277.0	277.0	-0-
	--FY 1985 - 1st Quarter, FY 2000	480.0	480.0	-0-
		$ 757.0	757.0	-0-
II	DOD AND FCC PERSONNEL ACTIONS			
	--FCC Early Optional Retirement	[b]265.0	-0-	265.0
	--FCC Potential Liability for Interest on Retirement Benefits Transferred	2.0	-0-	2.0
	--DOD Non-Appropriated Fund Employees Retirement	2.0	2.0	-0-
	--FCC Leave and Repatriation	10.0	-0-	10.0
	--FCC Severance Pay	4.6	-0-	4.6
	--FCC General and Administrative Expenses	1.8	-0-	1.8
	--FCC Cost of Living Allowance (1985-1989)	61.3	-0-	61.3
		$ 346.7	2.0	344.7
III	OTHER ACTIONS			
	--FCC Residual Retail Inventory	1.3	-0-[d]	-0-
	--Embassy Consular Services	3.7	3.7	-0-
	--DOS Joint Committee Expenses	3.8	3.8	-0-
	--FCC Relocation of Cemetary Remains	1.7	1.7	-0-
	--DOD Relocation of Cemetary Remains	1.5	1.5	-0-
	--DOD Foreign Military Sales Reserve	5.0	5.0	-0-
		$ 17.0	15.7	-0-
	Gross Amount of Other Treaty-Related Costs (FY 1979-99)	$1,120.7	774.7	344.7
IV	LESS			
	--Annuity Payments to COP	(36.0)		
	--FAA Operations and Facilities	(75.0)		
		$ 111.0	111.0	-0-
	Net Amount of Other Treaty-Related Costs (FY 1979-99)	$1,009.7	663.7[c]	344.7

[a]These costs could vary 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]These costs have been accrued through tolls. However, the Congress may wish to legislate the action needed to prevent this from becoming a taxpayer's liability.

[d]FCC Residual Retail Inventory will be a loss to the FCC and should not affect appropriations or tolls. Thus the totals for the categories do not add up.

Source: Departments of State and Defense; Office of Personnel Management; and CZC/FCC.