

BTI 2008 | Panama Country Report

Status Index	1-10	7.42	# 24 of 125	
Democracy	1-10	7.80	# 28 of 125	➔
Market Economy	1-10	7.04	# 27 of 125	➔
Management Index	1-10	5.79	# 37 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	3.2	HDI	0.81	GDP p.c.	\$	6,766
Pop. growth ¹	% p.a.	1.8	HDI rank of 177	58	Gini Index		56.1
Life expectancy	years	75	UN Education Index	0.88	Poverty ³	%	18.0
Urban population	%	70.8	Gender equality ²	0.57	Aid per capita	\$	6.1

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

In recent years, Panama's transformation has been characterized by political stability and strong macroeconomic performance. Although macroeconomic indicators point to economic stability, economic performance was closely tied to global economic trends and thus contingent upon the vicissitudes of the world economy and world trade. The structure of Panama's economy is unique. Since the Panama Canal was opened in 1914, the Panamanian economy has been characterized by the dichotomy of a large service sector that accounts for 79.8% of the GDP (2005) and small inward-looking agriculture and industrial sectors. The dual structure of the economy translates into the dual structure of society, which consists of two different social spheres. That is, while there is a relatively high standard of living in the urban centers and the Canal Zone, poverty dominates the rural areas. While the Torrijos government has made steady progress toward sound fiscal policies, rhetorical emphasis on comprehensive poverty reduction, human rights, environmental issues and accountability was not translated into coherent policies. Since the overthrow of Noriega in 1989, the political system in Panama has met the minimum criteria of a democracy. In recent years, Panama has remained on a path characterized by institutional stability. However, political institutions are still subject to political manipulation and corruption. The main problems include corruption of public functionaries at all levels of government and a low level of professionalism among civil servants. Consequently, Panamanian citizens perceive all branches of government as corrupt. The rise of crime and the corrupt nature of the judiciary have led to further disillusionment, which could lead to a significant decline in the popular support for democracy. In general, Panama's economy benefited from its competitive advantages. Notably the construction, communication, transport and tourism sectors have been very dynamic in recent years. In a national referendum in October 2006, the Panamanian electorate approved plans to expand the Panama Canal, the cornerstone of the economy. Whether the project will be managed efficiently and without negative environmental and social impact remains to be seen.

History and Characteristics of Transformation

Since Panama's independence in 1903, the country's history has been closely tied to the canal. After the opening of the canal in 1914, the service sector grew rapidly while the agriculture and industry sectors received little attention. The 1950s and 1960s were characterized by rapid economic growth and weak civilian rule. After General Omar Torrijos took power in 1968, the military leadership aimed at implementing social security principles and increasing equity and growth. Torrijos was a fascinating líder máximo, attracting intellectuals and revolutionaries from many Latin American countries. The most important political step he took was the signing of the Carter-Torrijos Canal Treaty in 1977. Torrijos's successor, Manuel Noriega, oversaw a political regime embroiled in the international drug trade. After Noriega annulled the results of the 1989 election, the U.S. military removed him during an invasion of the country called "Operation Just Cause".

Democratic transformation thus began in 1990 when Guillermo Endara, winner of the 1989 election, took office. Although this was the starting point of democratic consolidation, Endara made no great strides. Inefficiency plagued his administration. His successor, Pérez Balladarez of the Partido Revolucionario Democrático (PRD), continued to implement free market policy measures and initiated a process of privatization of state companies. Moreover, the military was formally abolished. Although the administration (1994 – 1999) pursued substantial reforms, accusations of money laundering, corruption and involvement in drug trade tarnished its reputation. In 1999, the widow of former president Arnulfo Arias, Mireya Moscoso of the Partido Arnulfista (PA), became president. During her election campaign, she pledged to tackle corruption and to implement an economic policy aimed at reducing poverty, promoting investment, and increasing growth and efficiency.

The Moscoso government failed to fulfill its campaign promises, however. While economic instability and institutional weakness continued to dominate the country's political and economic development, a series of corruption scandals chipped away at the president's popularity. After formal control of the canal passed from the United States to Panama in 1999, the country entered a new stage of transformation. For the first time since Panama's independence in 1903, the state's sovereignty extended to the whole of the country. In recent years, the canal authorities have demonstrated clear aptitude in the operation of the canal, and ambitious plans to increase and modernize the canal's capacity are underway. In 2004, Martín Torrijos, the son of Omar Torrijos, won the presidential elections. As the candidate of social democratic Partido Revolucionario Democrático (PRD), he promised to combat corruption and the severe structural problems facing the country, including rural poverty. Torrijos approved the Canal Expansion Project and, following in his father's footsteps, focused on the

country's strategic advantage – its geography. In October 2006, over 78% of the Panamanian electorate approved the plans to amplify the Canal. The Torrijos government announced that the construction of a third channel and new sets of locks would create about 7,000 direct jobs and 35,000 indirect jobs. Opponents to the government assert that the total costs of the canal expansion project are incalculable and that the government has not made any steps toward the eradication of corruption and poverty. Their worries are justified: so far, there are no signs of any comprehensive development and anti-corruption strategy.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force is established nationwide in principle, but does not function completely. Largely due to its geographic location and the banking sector, Panama is a major drug-transit and arms-smuggling country. The civil war in Colombia and the U.S.-led "war on drugs" has caused serious spillover effects, especially in the Darién region. According to the U.S. State Department, efforts to combat insecurity in the Darién region have led to an improved security situation in recent years. The state's monopoly on the use of force is also undermined by the structural weakness of institutions like the national police and the judiciary. Increasing rates of criminal violence have fostered the privatization of security and different forms of self-justice.

Monopoly on the use of force

All citizens have the same civil rights. Since 1996, the Panamanian government approved three indigenous semi-autonomous territories: the Madungandi comarca (1996), the Ngobe-Bugle comarca (1997) and the Kuna Wargandi comarca (2001). Although the comarca status grants indigenous governance structures and collective control of 20% of the national territory, the comarca population is subject to national laws. However, the system of land tenure remains weak and violent conflicts between comarcas and non-indigenous colonists still occur.

State identity

The state is largely defined as secular. Even though the Constitution (§35) recognizes the right to practice all forms of worship, it prescribes that the Roman Catholic faith is the country's predominant religion and moral standard. Almost 80% of Panamanians are Roman Catholic. The twentieth century, however, has witnessed a rapid growth of protestant churches such as Pentecostal dominations. Moreover, there is a long-standing protestant tradition within the Antillean community and a large Jewish community in Panama City. Nevertheless, Catholicism continues to be the main institution of moral reference in Panamanian society.

No interference of religious dogmas

The state infrastructure extends beyond maintaining law and order, but administrative structures do not reach all segments of society. Some institutions function insufficiently, especially in rural parts of the country. The administrative system suffers mainly from corruption, arbitrary use of power and lack of economic resources and technology.

Basic
administration

2 | Political Participation

After the overthrow of Noriega, universal suffrage and the right to campaign for office were restored in Panama. Panama is a representative democracy and there are no restraints on free and fair elections.

Free and fair
elections

After Noriega was forcibly removed from office in 1989, the civilian government regained the power to govern. It sought to solidify its position by abolishing the military and reorganizing the security forces. The Panamanian military was dissolved after the U.S. invasion in 1989 and was replaced by a national police service overseen by civilian authorities. The national police have no veto powers. While civilian supremacy over the military is consolidated, a limited number of business groups (linked to the service sector) still exercise pressure on government decisions.

Effective power
to govern

The constitution guarantees unrestricted freedom of association and assembly. In Panama, Indian organizations and labor unions are important civil society forces that associate and assemble freely. It is important to note, however, that workers in the export processing zones (zonas francas) and the employees of the Panama Canal Authority have limited workers' rights. However, the government's response to demonstrations against social security reforms did not involve excessive violence. During the protests of May and June 2005, there was one case of police abuse reported.

Association /
assembly rights

The Moscoso government had always been criticized for not repealing the tough media laws permitting lawsuits against journalists for defamation (desacato). Although the Torrijos government repealed the restrictive Article 33.1 of Panama's 1972 constitution in May 2005, there is still concern about pending libel cases and the legal situation. In June 2006, a presidential commission unveiled its plans to reform the penal code, still including several articles permitting prison sentences for defamation (§212, 213, 214). However, as of now, the penal code still includes defamation laws and some lawsuits against journalists are still pending. Press freedom remains restricted.

Freedom of
expression

3 | Rule of Law

Separation of powers is not restricted formally, but in practice, a number of factors pose severe limitations: the traditional dominance of the executive branch of government, corruption and the structural weakness of the judiciary. Although the function of checks and balances between the executive and the legislative was often guaranteed by the government's lack of an absolute majority in parliament, the political process is still dominated by corruption and the influence of informal, clientelistic networks. Furthermore, the system of checks and balances is severely weakened by the low degree of professionalism in public administration.

Separation of powers

The judiciary is institutionally differentiated, but its decisions and doctrine are often politically manipulated. Moreover, the judicial system is ineffective and subject to endemic corruption, which is the greatest obstacle to democratization. The political leadership has yet to address the persistent major problems adequately, such as the continued presence of corrupt judges at all levels of the justice system and the low level of professionalism among public servants. One of the most striking deficiencies is the difficulty poor citizens have in using the judicial system. The Indian population in particular lacks the economic and educational resources necessary to protect their rights in what are usually long and costly lawsuits.

Independent judiciary

Although the public views corruption as one of the most urgent problems facing the country, little has been done to address this problem in recent years. Corrupt officeholders are still not prosecuted adequately under the law. The Torrijos administration, which had promised to fight corruption, was itself widely perceived as corrupt. In October 2006, the newspaper *El Siglo* revealed that Torrijos engaged in nepotism, appointing several family members as ambassadors or consuls. A report submitted by the National Transparency Council against Corruption (Consejo Nacional de Transparencia contra la Corrupción) indicated that only five out of 20 state institutions analysed complied with principles of good governance: the General Income Administration, the National Securities Commission, the National Secretary of Science, Technology and Innovation, the Canal Authority and the Electoral Tribunal. Torrijos, who had promised "more work and zero corruption" during his electoral campaign, has made some steps to address the legal environment of corruption. For instance, the government approved a public procurement law introducing electronic government procurement.

Prosecution of office abuse

While civil rights are protected by the law, the enforcement of these laws is restricted by the structural weakness of the judiciary. After the overthrow of Noriega in 1989, human rights violations have no longer been committed

Civil rights

systematically, but some instances of abuse continue at the hands of the security forces. In principle, human rights violations under previous authoritarian regimes can be prosecuted in court. In 2002, a truth commission set up by President Moscoso presented its findings. The commission documented 70 cases of extrajudicial executions and 40 cases of disappearances that occurred during the decades of military rule. Torrijos promised to prosecute past human rights violations, most of them committed during the years of his father's rule. Although Torrijos created a special prosecutor's office, scepticism remains as to whether it will fulfill its function. In January 2007, Noriega's attorney publicly announced that the former dictator may be released in September 2007. Noriega, who received a 30-year sentence for drug trafficking and money-laundering, is being held in a prison in Miami. The announcement revived the debate over prosecution of past human rights violations. Actually, as the political history of Panama is closely linked to the presence of U.S. troops in the country throughout the 20th century, the history of political repression and human rights violations is partly perceived as an external problem.

4 | Stability of Democratic Institutions

The ensemble of democratic institutions is characterized by stability and continuity. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. This applies especially to formal proceedings, which have a strong legalistic character. However, corruption continues to plague the judiciary and administrative systems.

Performance of democratic institutions

Despite some severe problems, all relevant political and social players accept democratic institutions as legitimate. One persistent problem however is that some powerful economic groups do not fully submit to the state's monopoly on taxation and the use of force. The weakness of the judiciary has led to a strong tradition of self-justice. Many civil society actors, especially indígena and campesino organizations, do not have great confidence in political institutions. Nevertheless, they regard state institutions as legitimate and responsible for the enforcement of established law.

Commitment to democratic institutions

5 | Political and Social Integration

Following "Operation Just Cause" and the reestablishment of democracy in 1989, the party system remained somewhat contradictory. Since then, the political process was dominated by competition between the conservative Partido Arnulfista (PA) and the social democratic Partido Revolucionario Democrático (PRD). The Endara government (1990 – 1994) was followed by the

Party system

administration of Ernesto Pérez Balladares (1994 – 1999) of the PRD. In 1999, Mireya Moscoso (PA), the widow of former President Arnulfo Arias, took office. Her rival, Martín Torrijos (PRD), the son of authoritarian ruler Omar Torrijos (1968 – 1981), won the 2004 elections. On the other hand, Panama has a multi-party system, with seven parties currently holding seats in parliament. The Laakso/Taagepera Index scores 4.4, indicating a moderate level of fragmentation. Ideological polarization and policy divergence among Panamanian parties is low. Some parties represent the interests of clientelistic networks. In general, the party system is focused around just a few personalities. One example of this is the PRD, founded in 1979. The PRD was always focused around personalities and showed little interest in formulating coherent programmatic objectives. After Noriega was overthrown in 1989, the party remained ideologically unstable: under Pérez Balladares (1994 – 1999), the PRD supported orthodox market reforms and privatization politics. In contrast, Martín Torrijos promised to concentrate on reversing the devastating social effects of privatization policies and orthodox market reforms. Voter volatility is moderate, with a certain degree of loyalty to political parties.

In general, the connections between political parties and civil society are stable, but closely tied to local structures of power and clientelistic networks. Powerful economic interest groups linked to the service sector dominate the network of interest groups. In other words, prevailing economic interests, including external ones, dominate civil society. The social interests of vulnerable groups such as campesinos and Indians are poorly represented in the political system. A more dynamic and pluralistic civil society is beginning to emerge, but it is highly dependent on the financial and political support of foreign donors. Recent years have seen a significant increase in the number of environmental and indigenous organizations. Although the authoritarian regimes of Torrijos and Noriega have set the tone for Panama's political history in the 20th century, there has always been a tradition of civil society opposing the presence of U.S. troops. Furthermore, the women's movement of the 1930s, which included lobbying for women's political rights, also contributed to foundations of a vibrant civil society, which was very active during the 1970s in the Panamanian countryside.

In 2006, 55% of Latinobarómetro's Panamanian interviewees supported the statement, "Democracy is preferable to any other form of government". Compared to 1996, when 75% of the interviewees agreed with this statement, agreement on democratic norms and procedures seems to have declined. It is important to note, however, that there are no political movements calling democracy into question. Moreover, according to the 2006 survey of Latinobarómetro, 57% of the population approves of the Torrijos government. Approval of democracy in Panama, as elsewhere in the region, is linked to economic and social performance. According to the latest survey of

Interest groups

Consent to
democratic
norms

Latinobarómetro, 17% of the interviewees feel that Panamanian politicians are governing with the well-being of the people as a primary goal. Sixty-one percent of the interviewees perceive democracy as a central necessity for achieving development. It is important to recognize, however, that Panama's citizens have not perceived the state as sovereign throughout the 20th century. Public perceptions have changed since democracy was restored and the Panama Canal was handed over from the United States to Panama. Political protests do not tend to question the country's constitutional framework.

In general, societal interest are represented in the political system. The network of civil society, which had played an active role in the transition to democracy, is committed to dialogue. In Panama, there are some powerful trade unions in all sectors of economy. Even though divisions and internal conflicts plague the trade union movement, unions still manage to be the backbone of social dialogue processes. The robust but heterogeneous web of autonomous, self-organized groups, associations and organizations includes community groups and environmental organizations campaigning against the anticipated consequences of the canal amplification project. The umbrella organization "National Front for the Defense of Economic and Social Rights" (FRENDESOS) played an important role in the campaign against the expansion project. Given Panama's long history of money laundering, drug trafficking and other transnational organized crime, the network of interest groups has a "dark side." In July 2006, the director of the counter-narcotics unit of the police, Franklin Brewster, died in suspicious circumstances (an alleged poisoning). According to the latest U.S. International Narcotics Control Strategy Report, the use of bribery and coercion in the drug trade severely affects the political system. According to Latinobarómetro, the level of interpersonal trust is above the Latin American average. Thirteen percent of the interviewees affirmed that they would "trust in the majority of the people." Such lack of trust in unknown people correlates with rising crime rates and spatial segregation. In January 2007, the police reported a 15% increase in homicides over the last five years.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Social exclusion is quantitatively and qualitatively rather marked and structurally ingrained. Panama's socioeconomic situation reflects the dual structure of the

Socioeconomic
barriers

economy and its social consequences. The high standard of living in Panama City and the Canal Zone contrasts with the sparse existence in rural areas. According to the latest ECLAC Statistical Yearbook for Latin America and the Caribbean, 17.4 % of the population has incomes amounting to less than the cost of a basic food basket (2002). Just under one-third (31.5%) of the rural population lives in poverty, as compared to 8.9% in urban areas. The data indicate that women and the indigenous population are particularly disadvantaged. Social exclusion and marginalization is evident and closely tied to structural developments. Even though Torrijos claims compliance with the U.N. Millennium Objectives, to date there are few signs of comprehensive poverty reduction strategies.

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	12,272	12,933	14,204	15,467
Growth of GDP	%	2.2	4.2	7.6	6.4
Inflation (CPI)	%	1	0.1	0.4	3.3
Unemployment	%	14.1	13.6	12.3	-
Foreign direct investment	% of GDP	0.8	6.3	7.1	6.6
Export growth	%	-2.5	-10.1	11.1	13.8
Import growth	%	0.7	-3.5	14.5	14.2
Current account balance	\$ mn.	-95.5	-579.5	-1061.5	-781.6
Public debt	\$ mn.	6,405.6	6,490.0	7,233.8	7,513.9
External debt	\$ mn.	8,295.1	8,697.0	9,397.3	9,764.7
External debt service	% of GNI	13.9	7.8	10.6	14.5
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	14.8	14.0	13.6	11.5
Public expnd. on edu.	% of GDP	4.4	4.4	3.8	-
Public expnd. on health	% of GDP	5.5	5.1	5.2	-
R&D expenditure	% of GDP	0.4	0.3	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

Market competition has a strong institutional framework. However, small national and international business groups dominate economic activities. The informal sector is large and substantial in rural areas. Employment in the informal sector is estimated to account for 65% to 70% of the working population. Although the foundations of a competitive market economy are strong, the relevant political institutions are characterized by corruption and deficiencies in the rule of law. The structure of Panama's economy is characterized by the dichotomy of a large service sector that accounts for 74.8% of the GDP (2005) and small inward-looking agriculture and industrial sectors. The service sector is based on the operation of the Panama Canal, the Colón Free Trade Zone, the open registry for container ships, and the International Financial Center. Since the early 1970s, Panama's secrecy laws attracted financial offshore activities. In the 1980s, 125 banks operated in the country. That number declined in the 1990s due to international competition from other offshore markets and increasing international concerns about money laundering.

Market-based
competition

Since 1996, a legal framework has established the rules on the protection of competition. There is a Free Competition and Consumer Affairs Commission, attached to the Ministry of Trade and Industries, which reviews monopolist practices. Private companies represent the backbone of the economy, but there are still state companies and strong market concentrations such as oligopolies. In some cases, the state encourages concentration of market power. The privatization of state assets and holdings has fostered strong market concentrations in recent years, in particular in the operation of port facilities.

Anti-monopoly
policy

Foreign trade is mostly liberalized, and there is no fundamental state intervention in free trade. Most protective tariffs were removed in the 1980s as a precondition for structural adjustment loans. Successive Panamanian governments have pursued an active policy of liberalization of foreign trade, negotiating or signing free trade agreements with Asian and western hemisphere countries. The Torrijos government basically continues the free trade policies of its predecessor. Recently, in June 2006, Panama signed a free trade agreement with Chile and ratified a free trade agreement with Singapore. Free trade negotiations with the United States are expected to restart in early 2007. Furthermore, the government announced or started free trade negotiations with Guatemala, Honduras, Nicaragua, Costa Rica and the European Union.

Liberalization of
foreign trade

The Panamanian capital market is characterized by two distinguishing features. First, the economy is fully dollarized. Panama has no central bank and no national monetary policy. A second distinctive feature is the large international banking

Banking system

sector, which amounts to 10% of total GDP. Due to liberal supervisory and secrecy regulations, the international banking sector grew considerably between the 1970s and 1980s. However, growing competition from other financial offshore markets (e.g., Cayman Islands) and increasing international concerns regarding the illegal activities of the Noriega regime (1983 – 1989) led to the liquidation of several important banks. New supervisory legislation laid the foundations for an improved banking sector, but serious concerns regarding illegal banking activities in Panama have again been raised in the wake of the 2001 terrorist attacks in the United States. The internationally oriented financial sector does not offer adequate services for the rural areas in Panama. Micro-finance, especially for small- and medium-sized entrepreneurs or for the small-scale rural economy, is not sufficiently provided.

8 | Currency and Price Stability

Controlling inflation is not an issue for the Panamanian economy, which has been fully dollarized since 1904. Panama thus has no central bank. The inflation rate is low and reflects the inflation rate in the United States. According to the International Monetary Fund, the consumer price index is expected to remain low in 2006 (1.9%). Macroeconomic stability is consistently determined by fiscal policy and the balance of payments. Even though GDP growth reached 4.5% in 2003 and 7.7% in 2004, public finances deteriorated. According to the World Bank, the public sector deficit (without the operating surplus of the Panama Canal Authority) has increased from 2.3% of GDP in 2001 to 4.9% in 2004. Since then, the Torrijos government has made significant fiscal consolidation efforts. In 2005, the public sector deficit reached 3.2% of GDP.

Anti-inflation /
forex policy

In Panama, debt service and social security transfers absorb the largest part of public spending. The government's fiscal plan, presented with the annual budget in November 2006, forecasts a public spending increase of 9.4% in 2007. Forty-seven percent of public expenditures are expected to be devoted to the social sector, with high spending on poverty reduction and the education system. Other fiscal policy measures include supervision of the banking system, with the Superintendency of Banks directing its efforts to the reinforcement of the regulatory framework. The political leadership made further efforts to strengthen a fiscal responsibility law, implementing monitoring systems for the non-financial public sector. To increase the amount of public revenues from tax sources, the Torrijos government approved a tax reform in February 2005. To date, Panama's tax-to-GDP ratio is among the lowest in Latin America.

Macrostability

9 | Private Property

Property rights and the regulation of property acquisition are well defined in principle, but inadequately implemented. While the large, internationally oriented service sector, the industrial sector and the small agricultural export sector are supported by government policies that ensure well-defined property rights, the situation in poor, especially rural, areas, is very different. The rise in crime, spillover effects from the conflict in Colombia and several land conflicts lead to violations of property rights that state institutions do not adequately address. Moreover, in some indigenous areas, mestizo settlers tend to occupy lands. In some cases, well-defined land titles are not protected adequately by government policies.

Property rights

The legal framework for a functional private sector exists in Panama. Private companies represent the backbone of the economy, but there are still state companies and strong market concentrations such as oligopolies. Because of the privatization of state assets and holdings, strong market concentrations have been fostered in recent years, in particular in the operation of port facilities. After formal control of the canal was returned to Panama in December 1999, the government pursued an active policy of privatization that was not based on anti-monopoly principles. The operation of port facilities (Balboa, Cristóbal, Manzanillo, Colón) – one of the most dynamic sectors of the Panamanian economy – is controlled by international companies. The fixed-line and mobile phone services have been privatized, as has the electricity sector.

Private enterprise

10 | Welfare Regime

Social networks are well developed in part, but do not cover all risks for all segments of the population. Panama has a rudimentary version of a welfare state covering some social risks, but it varies according to territory, social strata and sector. The relatively high standard of living in urban areas and the Canal Zone bears little resemblance to conditions in the rural areas. Estimates indicate that 34% of the population lives in poverty and 17.4% in extreme poverty; 25.3% of the urban population and 48.5% of the rural population live below the poverty line, with women and the indigenous population particularly disadvantaged. While public expenditure on health, education and social security is high, the population in rural areas has only limited access to social services. Thus state measures for providing social safety are ineffectively focused. Even though Panama devotes a high share of public spending to the social sector, governmental poverty reduction programs do not attack the root causes of the problem. In 2006, 23,870 families received a bi-monthly payment of \$35. The government announced that 30,000 more families will have access to this

Social safety nets

program in 2007. Opponents criticized that the state is unable to combat poverty systematically. At the time of this writing, it remains unclear whether the government will implement a comprehensive poverty reduction strategy.

There are a number of institutions that work to correct major social differences. Although public expenditure for health care is high (5% of GDP), health care is only accessible to a segment of the population. All those who are formally employed are affiliated with the Panamanian Institute for Social Security (Caja del seguro social, CSS), which does not cover workers active in the informal sector or campesinos engaged in subsistence-based agriculture. The CSS is comprised of four major components: pensions, health and maternity care, professional risks and administration. In recent years, the CSS has faced a severe financial crisis, being rooted in structural causes such as the aging of society. In 2005, the government was forced to modify its plans for reforming the social security system after protests by teachers, health personnel and construction workers. A second proposal was approved by parliament in December 2005. Both increasing revenues and a burden-sharing system will be embedded in the reform project. In general, the lack of coordination between the CSS, the health ministry and the private health sector severely damages the efficiency of the social sector. The inefficient health system offers scant coverage, and recent programs have fallen far short of expectations. After weeks of health scandal, Torrijos announced a public health reform in November 2006. To date, at least 90 people are known to have been poisoned by medicines produced in the laboratory of the CSS and 45 of them have died. Individuals have near equal access to public services such as higher education, assistance mechanisms and public office. The educational system reflects the dual structure of Panama's society and economy. Good job opportunities are tied to English language skills, which are seldom taught in rural areas. Social data indicate that women are disadvantaged in general, but women from higher social strata have significantly greater access to higher education, public office, etc. There are no official mechanisms to promote women's access to higher education or public office. Although it is true that a woman was president from 1999 to 2004, it is important to note that Mireya Moscoso is the widow of former President Arnulfo Arias.

Equal opportunity

11 | Economic Performance

Panama's economic performance over recent years has been positive, with annual growth of 7.6% in 2004 and 6.4% in 2005 (World Bank). According to ECLAC data, annual growth has been 7.5% in 2004, 6.9% in 2005, and an estimated 7.5% in 2006. Per capita GNI was \$4,310 in 2004 and \$4,630 in 2005. Economic performance in recent years was closely tied to global economic developments, domestic demand and, especially, to the booming construction sector, with an

Output strength

estimated growth of 15.7% in 2006. Currently, high-rise buildings such as the “Ice tower” (expected to be the highest building in Latin America) and “Los Faros de Panamá” are under construction. In general, the Panama Canal and the debate on the ambitious amplification project have been major engines of growth. In recent years, the country has attracted foreign investment, contributing, for instance, to the dynamic telecommunications sector, maritime services and tourism. Panama has an official unemployment rate of 9.6% (2005), but this understates the true unemployment rate. In general, the socioeconomic structure is dominated by the service sector (74.8% of the GDP in 2005). Positive macroeconomic data such as growth of the GDP often reflect the performance of the service sector, with an annual growth of 7.1% in 2005 and 5.5% in 2006. The structural problem of Panama’s economy is that this growth does not generate enough jobs in the formal economy. On the other hand, there is a corresponding expansion of informal employment, but this undermines such strategic aims as improving tax revenues. Growth of per capita GDP is associated with other moderately positive macroeconomic data. Economic performance is characterized by price stability, although budget finances continue to be of concern. While the target of balancing the budget was met in 2002 with an overall budget deficit of 1.9% of the GDP, that figure rose from 3.0% in 2003 to 3.6% in 2005. The debt-to-GDP ratio, reaching 63% of GDP, remains high. It is important to note, however, that the Torrijos government is committed to improving the public debt profile. In recent years, Panama witnessed a marked increase in the total volume of both exports and imports. According to the latest ECLAC Preliminary Overview of the Economies of Latin America and the Caribbean, exports amounted to \$8,817 million in 2004, \$10,736 million in 2005, and \$12,351 million in 2006. Imports valued at \$9,077 million in 2004, \$10,636 million in 2005, and \$12,143 million in 2006. Panama’s economy, which has always been characterized by a large merchandise trade deficit and a large services trade surplus, has registered a positive merchandise trade balance in recent years. The current account deficit however amounted to \$-1,061 million in 2004, \$-782 million in 2005 and \$-716 million in 2006. The balance of payments reached \$-395 million in 2004, \$-675 million in 2005 and \$-100 million in 2006.

12 | Sustainability

Air and water pollution, soil erosion and deforestation are the primary environmental problems in Panama. Ecological concerns tend to be subordinated to economic growth efforts. The NGO World Monuments Fund placed the entire Panama Canal area on its Watch List of endangered sites. WMF underlined the fact that large-scale infrastructure projects, housing developments and the privatization of real estate are posing serious threats to the area. The plans to construct a third set of locks generated considerable debate about the

Environmental
policy

environmental implications of Canal amplification. In the beginning, environmental considerations received only scant attention and were not adequately reflected in the ambitious project to broaden the canal. Because the parliament had approved a law enlarging the watershed by 213,112 hectares in 1999, the government's plan to broaden the canal met with harsh protest from communities that would be dredged. Although a final decision is still pending, recent statements include the option of building retention basins next to the new locks. While the Panama Canal Authority states that the project is ecologically viable, prominent scientists claim that there would be high levels of salinization of waters of Gatun Lake and that environmental studies are not adequately reflected in recent plans. Many question the government's ability to estimate the number of jobs being created and the probable costs. Moreover, opponents claim that it is unrealistic to attempt to predict future water shortages, transit revenues and usage of sea routes. Another project that deserves further attention is the Plan Puebla-Panamá. Although few concrete facts have been revealed until now, public statements stimulate the debate over what the future in the Darién region might look like. In July 2006, as part of its strategy of regional integration, Colombia has joined with Mexico, Costa Rica, Guatemala, El Salvador, Honduras, Panama and Belize in this regional project. The Plan Puebla-Panamá includes infrastructure projects that aim at connecting and improving streets, electricity grids, telecommunication lines and custom procedures. The construction of a highway connecting Panama to Colombia is also envisaged in the project. Opponent groups however state that the plan is rife with environmental and social risks.

The system of education reflects the dual structure of Panama's economy and society. According to the latest Human Development Report, investment in education is moderate, at 3.9% (2002 – 2004). According to the annual budget for 2007 presented by the government in November 2006, the Ministry of Education will benefit from an \$88.9 million budget increase. Although overall expenditure on education is not low, institutions for education remain inconsistent. In general, these substantial inequalities in the quality of education have damaged Panama's human capital. Compared to other Central American countries, investment in education, training, research and development is high. Nevertheless, state and private institutions for advanced education are focused on the needs of the large service sector. Modern training facilities are thus limited to major cities and the Canal Zone.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance are moderate. Panama relies on both the Panama Canal and the large, internationally oriented service sector. Consequently, the country is highly vulnerable to external economic forces and its successes and failures are contingent upon the cycling of global economy and international trade. The segmented Panamanian economy also reflects the poor social conditions in the rural areas of the country. This includes extreme poverty, severe infrastructural deficiencies and highly skewed income distribution. Structural constraints on governance include inefficient state institutions, a lack of accountability and a high level of corruption. On the other hand, there is a broad basic consensus about democracy and core democratic principles and rules. In Panama, pro-democratic values are widespread. In general, Panamanians support democracy, though few think that state institutions work well. According to the latest Latinobarómetro survey, 77% of citizens voted in the 2004 presidential elections.

Structural
constraints

According to Latinobarómetro, in Panama only 13% of the interviewees affirmed that they “can trust most people,” indicating a low level of social trust. There are moderate traditions of civil society. In general, public life has been influenced by the presence of the U.S. military in the country throughout the 20th century. Public engagement was primarily linked with party politics, especially the PRD and PA. Numerous NGOs have also been active in recent years, with indigenous, women’s and ecological organizations being the most dynamic civil society groups. The majority of NGOs and other mobilized groups suffer from scarce organizational resources. Despite these attempts however rates of political activity are relatively low: only 7% of the population have ever participated in any legal demonstration.

Civil society
traditions

As social indicators demonstrate, deep social inequality divides Panamanian society. Although ethnic conflicts exist, they do not dominate politics. Violent incidents are mainly linked to land conflicts in rural areas. The political elite are not polarized along ethnic, religious or social differences. Political actors focus their efforts on creating conditions conducive to investment. Accordingly, political confrontations are discursive in nature and tied to conservative or social democratic political agendas.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership claims to pursue long-term aims, but these tend to be replaced by short-term interests of political bargaining and office-seeking. In general, the administration has demonstrated little reliability in achieving or even pursuing its goals. To date, part of the strategic priorities identified by Torrijos during his electoral campaign have not been addressed. His political program placed emphasis both on a national strategy to improve social conditions and on anti-corruption, both of which have yet to appear in any feasible initiative.

Prioritization

Although the administration approved anti-corruption measures, corruption remains pervasive and the president was later accused of having engaged in nepotism. On the other hand, the Torrijos government addressed the funding deficit of the country's social security fund, the tax system and, finally, the limits of the Panama Canal's capacity. The country's political leadership acknowledges the necessity of amplification with the construction of a third set of locks. While the political elites are committed to this long-term economic objective, they are unwilling to pursue long-term political goals corresponding to the principles of good governance. These principles tend to be replaced by short-term economic interests and the goal of political bargaining.

Implementation

The political leadership responds to mistakes and failed policies with changes, but policy rarely makes a break from the routine. The party system, for instance, appeared to be in crisis after presidential and legislative elections in 2004. While Endara formed a new party, the Moral Vanguard of the Fatherland, the Arnulfista Party broke with the widow of its founder, Mireya Moscoso, and renamed itself the "Panamanian Party." This kind of political culture does not help to raise political parties' approval rating or credibility. According to the latest Latinobarómetro survey, 25% of the population approve of the work of political parties. In general, learning processes occur, but rarely affect the knowledge base or cognitive framework upon which policies are based. One manifestation of this is the persistence of low professionalism in the government and the administration as a whole. Although recent years have seen moves by the political leadership to open a more constructive dialogue on reform policies, these efforts did not precipitate a general change in policy. The persistent "top-down" routines of policy formulation and policy implementation assure that complex learning and policy innovation will remain limited.

Policy learning

15 | Resource Efficiency

The government uses only some of the available resources efficiently. Corruption and waste of the state's financial, human and organizational resources continue to plague Panama. Although there is a strong legalistic tradition, the number of corruption and bribery scandals is an indicator of the level of inefficiency. While the national budget is openly discussed in congress, implementation of the budget is severely affected by corruption. The tradition of appointing personal friends or contacts to public office likewise damages government efficiency. Torrijos has been criticized for his failure to overcome this clientelistic practice. Partly due to frequent personnel changes, public administration does not operate as efficiently as it should. On the other hand, the government is using some of the available resources under criteria of professional rationality. Since 31 December 1999 when the Panama Canal was handed over to Panamanian control, the canal's efficiency has improved. The Panama Canal Authority proved its ability to manage efficiently.

Efficient use of assets

Although poverty reduction policy has not shown a clear course in recent years, overall policy is coherent. Nevertheless, trade-offs with policy goals are not well-balanced, and intra-governmental frictions, redundancies and lacunae thwart policy coordination. Conflicting goals such as improving environmental conditions and maintaining macroeconomic stability were not coordinated into coherent and credible policies. The most important mechanism of public policy coordination however is the personal intervention of the president. In February 2007, President Torrijos called for a political dialogue on national development policy. He invited the leaders of political parties on both sides of the political spectrum to meet in the presidential palace. In general, many policy measures remain characterized by a lack of careful preparation and hasty implementation.

Policy coordination

Despite having been a key election campaign promise, the campaign against corruption has made little progress. The government has undertaken some efforts to improve integrity, such as approving a Transparency Law and establishing two special prosecutor's offices to investigate corruption scandals. However, these institutions lack both financial and human resources. Moreover, no progress has been made in the investigation and prosecution of recent and past high-profile corruption scandals. In sum, corruption remains endemic and is pervasive among different levels of government and administration. Although some codes of transparency and legal conduct exist, corruption is still a fundamental characteristic of administrative and state culture.

Anti-corruption policy

16 | Consensus-Building

All major political actors agree that a market economy and democracy are strategic, long-term aims. There is a basic consensus on the long-term economic goal to participate in the opportunities of the globalized economy. One manifestation of this was the broad support for the ambitious Canal amplification project. Reforms on the tax system, on the other hand, are part of Panama's agreement with the International Monetary Fund. The economic elite blocked the attempt to increase tax revenues and to close loopholes. The conflicts over legal procedures reducing tax evasion and enforcing the rule of (fiscal) law demonstrate that the economic elite supports the goal of a free market-based economy, but still resists taxation. In sum, there is little consensus on public finances and redistributive measures.

Consensus on goals

The veto power of anti-democratic actors has been eliminated. Since 1989, Panama de facto no longer has a military force, which had been the most important veto actor throughout Panamanian history. In recent years, a trend toward greater concentration of land ownership has characterized the situation in rural areas. Needless to say, large landowners do not oppose economic policies that benefit them.

Anti-democratic veto actors

Cleavages can be seen in the dual structure of Panama's economy and society. These cleavages are not reflected in the party system however, as the latter is consistently linked only with the economic elite. The political leadership is able to prevent cleavage-based conflicts, although it has been historically aided by restricted sovereignty, the political isolation of rural areas and the importance of the canal. There continues to be a broad consensus on basic democratic principles.

Cleavage / conflict management

The political leadership frequently ignores civil society actors and formulates its policies autonomously. The government has shown little interest in organizing an adequate process of policy formulation. In general, the political process is characterized by disruptive forms of civil society involvement. In 2005 for instance, the Torrijos government was forced to modify its proposals for social security reform after protracted strike action. In other key areas of public policy however, the weak organizational power of civil society groups has bred ignorance. Furthermore, the media are subject to political pressure and punitive action based on certain laws that include prison terms for media offences. In contrast to most civil society organizations, economic interest groups are able to make their voices heard. The political leadership takes into account and accommodates the interests of economic associations.

Civil society participation

The Torrijos government committed itself rhetorically to addressing historical acts of injustice as well as to advance prosecution. Torrijos created a special

Reconciliation

prosecutor's office to investigate 70 cases of extra-judicial executions and 40 cases of disappearances documented by the truth commission. However, there are no reports on new developments regarding these cases, most of them committed during the years of Omar Torrijos' rule. The Panamanian economic elite and political leadership are not committed to initiating a process of dealing with the past. Instead, silencing is the dominant response in public and in private.

17 | International Cooperation

The Torrijos government works closely with international donors and uses international support to improve its policies. Recent years have seen further steps toward the improvement of Panama's battered image as a reliable partner. International donors are involved in virtually all major recent reform efforts. It remains unclear however whether the political leadership would resume strong ownership for the reform process.

Effective use of support

Overall, the political leadership works well with bilateral or multilateral international donors. The government makes use of international assistance, but this does not facilitate significant policy learning and improvement. In the 1980s, Panama had been forced to implement reform programs and to reform the public sector, mainly under the auspices of the International Monetary Fund and the World Bank. Many substantial reforms like removing trade barriers and passing supervisory legislation for the banking sector were implemented as a precondition for loans. International donors recognized that the Torrijos government has made significant progress, notably in restoring sound fiscal policies. Nevertheless, some doubts regarding the political leadership's reliability remain.

Credibility

Facing the challenge of globalization, the willingness to build and expand as many cooperative international relationships as possible is mainly a market strategy. Although the government promotes international integration, efforts to intensify cooperation remain janus-faced. For instance, Panama supports regional organizations such as the regional parliament PARLACEN. On the other hand, it did not join other Central American governments negotiating a U.S.-Central American free trade agreement (CAFTA). While Panama is committed to both internationally accepted standards of bank supervision and the fight against drugs, there are still concerns regarding the influence of organized transnational crime. Since Colombia became a member in the controversial Plan Puebla Panama in 2006, infrastructure projects to overcome the Darién gap – the natural barrier between Panamá and South America – seem more probable than ever. After weeks of intense debate, Panama won a non-permanent seat on the U.N. Security Council in November 2006.

Regional cooperation

Strategic Outlook

The structure of Panama's economy is unique. Semi-legal activities such as banks facilitating money laundering and an open registry for container ships constitute the backbone of the Panamanian economy. These sectors are linked with both the formal and criminal economies. Panama's economy is projected to show a growth of 6.5% in 2007. In recent years, the economy benefited from favorable external conditions and growing domestic demand. Panama witnessed a boom in private investment and a constant growth of the construction sector as well as trade-related services. However, the Panama Canal is still the main stimulus of the economy. Although key economic sectors have performed well in recent years, poverty continues to worsen and income distribution remains highly skewed. During his electoral campaign, Torrijos emphasized the expansion of the trans-oceanic Panama Canal as well as anti-corruption measures and a comprehensive poverty reduction strategy. Built on a strong consensus among political elites, President Torrijos focused on the implementation of relatively sound fiscal policies and on capitalizing on Panama's competitive advantage – the country's geographical location. Panama appears to be continuing on a path that reflects the dual structure of the country's economy and society. Despite consistent efforts to modernize the service sector, some social programs and policies are still not sustainable.

A long-term transformation strategy should focus on two key elements:

Rule of law: In order to keep the basis for democratization from eroding further, efforts against crime and corruption should be increased. This is not merely a technical issue, but is closely tied to transforming the political culture.

Social policy: Poverty reduction and sustainable human development should be the main long-term development goals. Social and economic policies should aim to overcome the fundamental social dichotomy. In this context, a key focus area should be increasing job-generating growth.