

BTI 2010 | Panama Country Report

Status Index	1-10	7.49	# 22 of 128	
Democracy	1-10	7.90	# 25 of 128	➔
Market Economy	1-10	7.07	# 27 of 128	➔
Management Index	1-10	5.70	# 40 of 128	

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

This report is part of the Transformation Index (BTI) 2010. 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 128 transformation and developing countries are evaluated.

The BTI is a joint project of the Bertelsmann Stiftung and the Center for Applied Policy Research (C•A•P) at Munich University.

More on the BTI at <http://www.bertelsmann-transformation-index.de/>

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Key Indicators

Population	mn.	3.3	HDI	0.84	GDP p.c.	\$	11391
Pop. growth	% p.a.	1.6	HDI rank of 182	60	Gini Index		54.9
Life expectancy	years	76	UN Education Index	0.89	Poverty ²	%	17.8
Urban population	%	72.4	Gender equality ¹	0.60	Aid per capita	\$	-40.4

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) 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. Economic development was closely connected with global economic trends and thus dependent on the volatility of the world market and international trade flows. Panama's economic structure is unique. Centered upon the Panama Canal as a main crossroads of global trade, an outward-oriented service sector dominates the economy, accounting for more than 80% of the country's GDP. The economic power of the canal exists in sharp contrast to Panama's small inward-looking primary and secondary sectors. The dichotomy of the economy translates into a dual structure of society, which consists of two different social spheres. While people living in urban centers, especially in Panama City, enjoy a relatively high standard of living, persistent and deep poverty defines life in the countryside. To eradicate or at least significantly diminish these blatant inequalities is the most pressing developmental challenge for the country's political leadership. Progressing in this direction seems to be the best tool to strengthen democracy and achieve social stability. In the two years under review, the economy's strong performance led to a certain attenuation of the harsh social discrepancies. It also allowed for a well-balanced state budget and a downsizing of the foreign debt burden. These achievements could easily be reversed if the economy confronts negative trends in accordance with worsening world market conditions. Little perceptible progress occurred in overcoming the structural constraints that traditionally limit management performance and governance capacity (deficient rule of law, poor quality of public schools, etc.). Beneath the surface of political stability, political manipulation and deep-rooted corruption still plague state institutions. In 2007, the government started the implementation phase of the canal expansion project. The optimistic forecasts related to this historical endeavor could rapidly turn into serious risks for the health of the highly vulnerable Panamanian economy if the market conditions of the international sea trade worsen significantly.

History and Characteristics of Transformation

Panama was part of Colombia until 1903, when a U.S.-supported revolt resulted in the proclamation of an independent republic. Since the construction of the Panama Canal, the country's history has been closely tied to this important inter-oceanic waterway. The United States managed the transit service and controlled the Canal Zone, a 10 mile-wide stretch between the two entrances of the canal. Over time, the United States established a dozen military bases. A period of weak civilian rule ended with a military coup in 1968, which brought General Omar Torrijos to power. His main political achievement was the signing of a new canal treaty, under which the waterway was gradually transferred to Panamanian control. The final handover of the canal was set for 1999. To ease approval of the treaty by the U.S. congress, Torrijos promised democratization. After Torrijos's death in 1981, General Manuel Noriega emerged as chief of the armed forces. He rigged the 1984 election to bring the Democratic Revolutionary Party (PRD), then the army's political arm, to power. The Democratic Alliance of Civic Opposition (ADOC) won the 1989 election, but Noriega annulled the vote and held on to power. A U.S. military invasion ("Operation Just Cause") removed him from power late that year. ADOC's Guillermo Endara became president. During his term, Endara made progress in restoring functioning political institutions after twenty-one years of military-controlled government. Under his administration, a new civilian police force replaced Noriega's armed forces. As early as 1994, the PRD staged its political comeback. President Pérez Balladares implemented an economic reform program including the privatization of many state-owned companies. In her second bid for the presidency, Arnulfista Party (PA) candidate Mireya Moscoso was victorious in the May 1999 elections. Moscoso, widow of former president Arnulfo Arias, ran as a populist during the campaign, promising to end government corruption, slow the privatization of state-run enterprises and reduce poverty. On December 31, 1999, Moscoso presided over the defining event in recent Panamanian history, the handover of the Panama Canal. Moscoso's campaign pledges proved difficult to fulfill amid high-profile corruption scandals and poor economic performance. In the 2004 presidential race, Martín Torrijos of the PRD won a decisive victory with 47.5% of the vote, defeating former head of state Endara, who was supported by 30.6% of the voters. In the campaign, Torrijos emphasized anti-corruption measures as well as a national strategy to deal with poverty, unemployment and underdevelopment. The most significant challenges facing the Torrijos government have included dealing with the funding deficits of the country's social security fund, developing plans for the expansion of the aged canal and succeeding to get the citizenry's approval for this ambitious modernization project. During the Torrijos term, a spectacular economic upturn, the result of extraordinarily favorable conditions in the world market, significantly eased governing. The latest general elections took place in May 2009.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force prevails throughout the country and is not disputed by any important political player. Three factors, however, threaten and restrict the authority of the state. First, largely due to its geographic location, Panama is a major trans-shipment point for narcotics destined for the United States and other global markets. Secondly, the civil war in Colombia has produced serious spillover effects, especially in the Darién region. Without an army of its own, Panama is not able to protect its eastern border effectively. Paramilitaries and FARC guerillas frequently cross the border into Darién province, where hundreds of Colombian refugees have settled.

Monopoly on the use of force

Thirdly, the country experiences notable deficiencies in law enforcement. Police lack adequate resources to fully and efficiently perform their job, and rising levels of violent crime indicate the state's weakness to guarantee public security. Little concrete evidence, however, suggests that gang "warfare" has escalated as in neighboring countries. Criminal gangs operate in Panama, but they are smaller and less violent than those in other countries of Central America, such as Honduras and El Salvador. A May 2007 report from the U.N. Office of Drugs and Crime ("Crime and Development in Central America: Caught in the Crossfire") stated that, "Panama's murder rates are also relatively low and stable. Of course, the country has not had to deal with the history of civil war afflicting its northern neighbors, but it remains affected by its prominent role in the international drug trade." (p. 57). The document also states, "In Central America, the countries rank as follows, from safest to most dangerous: Costa Rica; Nicaragua or Panama; Guatemala and El Salvador. There is not enough current data on Honduras and Belize to place them, but those that do exist suggest they should be situated near the top." (p. 53). By U.N. standards, Panama ranks among the safest countries in Central America.

In principle, all citizens have the same civic rights and no major social or political group rejects the legitimacy of the nation-state and the constitution. Polls show very high percentages of respondents declaring to be proud of their national citizenship.

State identity

In contrast to the wording of the constitution, however, discrimination against darker-skinned members of society is widespread. Indigenous communities enjoy a degree of autonomy and self-government, but some 90 % of the indigenous population lives in extreme poverty.

The constitution defines the state and its legal order as secular. Religious dogmas have no perceptible influence on politics or law. The constitution guarantees freedom of religion, provided that “Christian morality and public order” are respected. Article 35 recognizes Catholicism as “the religion of the majority” of citizens but does not designate it as the official state religion. Approximately 80% of Panamanians identify themselves as Roman Catholic and 15 to 20 % as evangelical Christian. According to the constitution, Catholicism must be taught in public schools though parents have the right to exempt their children from religious instruction.

No interference of religious dogmas

The structures of public administration extend throughout the territory of the country, but its operation is deficient in some respects. Some institutions function insufficiently, especially in rural areas. The administrative system suffers mainly from corruption, low technical skills of its employees and a lack of economic resources. Most municipalities perform rather badly in respect to providing basic services. Foreign aid programs that aimed to develop the institutional capacity to better respond to the local population’s demands rendered only slow progress. One persistent problem is that some powerful economic groups undermine the authority of the state through considerable tax evasion.

Basic administration

2 | Political Participation

After the overthrow of military strongman Manuel Noriega in December 1989, Panama restored democratic rights and procedures. Since then, universal suffrage and the right to campaign for public office are conducted properly. Panama is a representative democracy and places no constraints on free and competitive elections. Presidential elections held in 1994, 1999 and 2004 resulted in a regular alternation between the two most important political parties.

Free and fair elections

With the abolition of the armed forces, the single most important anti-democratic veto-power disappeared from the political scene. A national police force overseen by civilian authorities replaced the military. Since the early 1990s, elected rulers have, in principle, the effective power to govern. After the takeover of the Canal management and the definitive withdrawal of the United States from the former Canal Zone (i.e. closing of military bases), U.S. influence on Panamanian politics diminished significantly. Business groups (linked to the service sector) and a handful of militant trade unions represent the most influential pressure groups. The lending conditions of the International Monetary Fund somewhat restrict Panama’s room to maneuver in its economic policies.

Effective power to govern

The constitution guarantees unrestricted freedom of association and assembly. In fact, there are limitations on organizing workers. The state restricts trade unions to only one branch office per province and requires a minimum of forty members to set up a branch union, a number excessive by international standards. Strikes can only be declared to demand an improvement in working conditions, in relation to a collective agreement or to protest repeated violations of legal rights. Legally, the state forbids strikes called to protest against certain general policy measures or to demand an increase in the minimum wage. Nonetheless, protests and strikes are called repeatedly to pressure the government to adopt or retract any number of policy initiatives. Public sector workers do not have the right to form unions but are allowed to form associations and engage in collective bargaining, but only if they have a minimum of fifty members. The law governing the autonomous Panama Canal Authority prohibits the right to strike for its employees but does allow unions to organize and bargain collectively. There are also limited workers' rights for employees in export processing zones. After a unionist was shot dead by a policeman during a protest over lax safety legislation in February 2008, some 40,000 members of the construction workers' union took to the streets across the country. Clashes with the police resulted in nearly 500 arrests.

Association /
assembly rights

Freedom of opinion and the press are subject to some intervention that contradicts democratic standards. President Torrijos signed into law new penal code amendments that could limit the watchdog role of the media. One of the new provisions establishes sanctions for anyone who "publishes letters, recordings or documents not intended for publication, without the required permission, even if addressed to them personally." Several cases against journalists under these new laws are pending in the courts, including that of a former reporter with the daily newspaper *El Panamá América*, who was accused of libel by a member of the Supreme Court. The reporter had written about a Supreme Court decision that canceled the judge's \$2 million debt to a government agency. According to the Inter American Press Association, around the middle of 2008, thirty-four journalists faced charges of injuria (insulting or offensive words or actions) and calumnia (false accusations of a crime). Government officials brought most of these cases. Such legal tensions cause many journalists to practice self-censorship.

Freedom of
expression

3 | Rule of Law

As in other Latin American countries, the executive branch's dominance over the other two branches of government threatens Panama's principle of separation of powers. While the deficient functioning of checks and balances between the executive and the legislative was partially neutralized by the lack of a parliamentary majority during the Pérez Balladares and Moscoso administrations (1994-2004), the political constellation changed with the landslide victory of Torrijos' Partido

Separation of
powers

Revolucionario Democrático (PRD) in the 2004 elections. At the end of June 2008, the PRD-dominated congress voted to award President Torrijos “extraordinary powers” for the next two months in order to carry out security reforms by decree. Apart from that, informal clientelist networks and low professional skills in the public administration severely weaken Panama’s system of checks and balances.

The judiciary is institutionally differentiated, but its decisions and doctrine are frequently subordinated to political authorities or severely restricted by corruption or functional deficits, such as inhomogeneous territorial penetration and lack of resources. Undoubtedly, the judicial branch is the weakest and least functional element of the democratic system. The institutional framework lacks efficiency. It takes an average of twenty months to solve a simple commercial dispute in court. Mainly the rich can afford to go to court, whereas most of the poor do not have the economic and educational resources necessary to protect their rights in what are usually long and costly lawsuits. At the same time, in many cases the politicized trait of the judiciary gives the rich and powerful impunity even for criminal activities.

Independent
judiciary

Corrupt officeholders are not prosecuted adequately under the law but frequently attract adverse publicity. The government of Martín Torrijos, whose election campaign included the slogan “zero corruption,” was plagued by a series of corruption scandals. In June 2007, the former head of the Servicio Marítimo Nacional (Coast Guard) was arrested because he and another eight agency officials were involved in drug trafficking and money laundering. The chief of state himself was accused of being part of at least two dubious private business transactions. On the other hand, Torrijos created the Consejo Nacional de Transparencia contra la Corrupción to monitor the performance of state institutions. Its most recent report (December 2008) indicated that nine out of the thirty-three public institutions it analyzed complied with principles of good governance. The Panama Canal Authority scored the highest ranking.

Prosecution of
office abuse

While the constitution guarantees civil rights, both the inefficiency of the judiciary and the rising delinquency rate restrict the enforcement of these laws. After the end of the Noriega regime, members of the security forces have ceased in their systematic violations of human rights. Since then, acts of abuse at the hands of police officials occur only occasionally. The 2008 criminal code reform emphasized longer sentences for various crimes, leading to concerns about the potential repercussions for the penal system and human rights. The State Department’s 2007 human rights report found that pretrial detention sometimes exceeds the maximum sentence for the alleged crime, and that not less than 60 % of inmates are awaiting trial. The penal system is distinguished by violent disturbances in decrepit, overcrowded facilities. Since the 1990s, indigenous groups have protested the encroachment of illegal settlers on their lands and government delays in formally demarcating them. Legislation proposed in 2006 to recognize indigenous territorial

Civil rights

rights has been postponed indefinitely. The leaders of indigenous groups frequently complain about human rights violations. In the La Amistad Biosphere Reserve, where the government is constructing four hydroelectric power plants, indigenous people suffer from discrimination, abuse and displacement.

4 | Stability of Democratic Institutions

Panama's democratic institutions perform their function more or less effectively and are free from extensive, counterproductive frictions. Nevertheless, low levels of professionalism, waste of resources (money) and widespread corruption continue to plague public administration.

Performance of democratic institutions

Despite some severe problems, all relevant political and social actors accept democratic institutions as legitimate. Some documented incidents of "self-justice" have occurred, which indicate a certain weakness of the judicial branch, but they are of minor importance, particularly when compared to other Central American nations, such as Guatemala. Some civil society groups, especially indigenous and peasant organizations, do not have much confidence in public institutions. Some opportunism with respect to democratic values exists among the membership of the governing party (PRD), which was part of the power structure during the Noriega years. This, however, does not mean that essential democratic beliefs are more deeply rooted in other political parties. The PRD demonstrated a clear adherence to the democratic rules of the game when it relinquished power after losing the 1999 elections.

Commitment to democratic institutions

5 | Political and Social Integration

Since the restoration of democracy, two organizations have dominated the Panamanian party system. Guillermo Endara (1989-2004) headed a coalition government led by the conservative Partido Arnulfista (PA). Furnished with a fresh social democratic profile, the PRD won the 1994 presidential elections and thus returned to the political center stage just five years after the end of the authoritarian Noriega regime. The presidential term of Ernesto Pérez Balladares was followed by another PA administration under the leadership of Mireya Moscoso, the widow of former President Arnulfo Arias. Defeated by Moscoso, PRD candidate Martín Torrijos got a second chance and triumphed in the 2004 presidential elections. For the first time since the ouster of Noriega, a president's party won a legislative majority (41 of 78 seats). Apart from the two major political parties, Panama's multiparty system has undergone permanent change. Since the mid-1990s, there has been a clear trend towards a decrease in the number of political parties. While in 1994 fifteen parties applied for seats in parliament, only seven parties took part in the elections ten years later. Ideological polarization and policy divergence among parties are low. Programmatic objectives do not mean much in the political reality.

Party system

Party cohesion and loyalty are weak. In 2007, three opposition congressmen changed sides and entered into the group of the governing PRD. Some parties represent the interests of clientelistic networks. In general, the party system is focused around just a few personalities. The fact that Martín Torrijos is descendant of a famous father (authoritarian ruler Omar Torrijos, 1968-1981), for example, helped earn him the candidacy in 1999 and 2004. Survey results indicate that the regular alternation between PA (renamed in Partido Panameñista) and PRD will come to an end in the 2009 elections. According to Latinobarómetro data series, less than a third of the population approves of the performance of the country's political parties. This is difficult to reconcile with the fact that the quantity of all registered party members amounts to roughly half of the country's adult population.

In general, the connections between political parties and civil society are stable but weak and closely tied to local power structures and clientelistic networks. As such, the relationship is strongly biased to the upper and middle echelons of society. Powerful economic circles linked to the international service sector dominate the array of pressure groups. The economic boom helped to increase the bargaining power of some trade unions during the review period. The social interests of vulnerable groups, such as peasants and members of ethnic minorities, are poorly represented in the political system. Recent years saw an increase in the number of environmental organizations, often assisted by international NGOs.

Interest groups

Consent to democracy is moderate to high and seems to vary according to the ups and downs of the economic cycle. Latinobarómetro data show that approval of democracy declined from 62% in 2007 to 56% one year later. However, data from the Americas Barometer 2008 survey shows over 70% support for the idea that despite problems democracy is the best system of government. No evidence suggests that substantial numbers of Panamanians support authoritarianism. According to Latinobarómetro, only 41% of the citizens interviewed in 2008 expressed satisfaction with the performance of the Torrijos administration, down from 57% in 2006. Diminishing approval of the incumbent government is no evidence that substantial numbers of Panamanians support authoritarianism. Although unusual price increases led to more political protests in 2008, this tide of events did not call the constitutional framework into question.

Consent to democratic norms

Civil society organizations are growing in importance in the country. Their most prominent fields of action are in ecological and social matters. The civil society movement has gained steam with the formation of a broad alliance against the government's project to modernize the Panama Canal waterway by constructing a new set of locks. With regard to the development of social capital, the Latinobarómetro survey indicates a low level of interpersonal trust in society, even if the Panamanian result is above the Latin American average. Lack of trust in other people correlates with worsening public security and rising crime rates. In January 2009, the attorney general reported a 50% increase in armed robberies in the last year. Homicides numbered 346 in 2008, up from 246 in 2006.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

Poverty and social exclusion are quantitatively and qualitatively significant and in large measure structurally ingrained. At first glance, this assessment seems incompatible with Panama's relative high Human Development Index coefficient. Panama occupies HDI rank 62 (2007-2008), with only six Latin American countries ranked better. However, Panama's high per capita income level is accompanied by one of the most inequitable income distributions in the world. Panama has a dual economic structure in which relative wealth and prosperity in Panama City – where over 45% of the population lives – masks deep pockets of poverty and inequality in the rest of the country. Panama has among the worst distribution of income in Latin America and the world. The Gini coefficient value is 0.56. While the poorest quintile of the population has a mere 3.2% share of the national income, the richest 20% account for 60%. CEPAL data rate the percentage of people living below the poverty line at 28.6% (2007). In rural areas, the percentage is above 60%. In Indian communities it reaches over 90%. The high standard of living in Panama City and the Canal Zone contrasts with the modest living conditions in rural areas. According to 2008 Latinobarómetro data, more than half of the interviewees did not perceive any positive change in social inequality since the restoration of democracy. This impression is not supported by statistics. CEPAL data claim that the poverty rate went down eight percentage points between 2001 (36.7%) and 2007. The economic boom led to a moderate increase in formal employment during the two years under review. At the same time, strong economic growth in combination with rising import prices has pushed up inflation, which was running at an annual rate of 9.5% for the 12 months to October 2008. In August 2008, some 20,000 Panamanians marched in the capital in protest. Demonstrations also took place in other key cities to demand an end to increasing living costs and inflation.

Socioeconomic
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	14179.3	15464.7	17137	19485.4
Growth of GDP	%	7.5	7.2	8.5	11.5
Inflation (CPI)	%	0.2	3.2	2.1	4.2
Unemployment	%	12.4	10.3	9.1	6.8
Foreign direct investment	% of GDP	7.2	5.9	14.6	9.8
Export growth	%	18.5	11.3	11.1	15.0
Import growth	%	14.4	11.2	7.4	19.3
Current account balance	\$ mn.	-1003.2	-1021.8	-526.8	-1422.4
Public debt	\$ mn.	7215.0	7492.0	7774.2	8266.6
External debt	\$ mn.	9378.5	9742.9	9989.1	9862.2
Total debt service	% of GNI	10.6	14.5	21.8	4.7
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	13.6	13.2	12.3	11.5
Public expnd. on edu.	% of GDP	3.8	-	-	-
Public expnd. on health	% of GDP	4.5	5.0	5.0	-
R&D expenditure	% of GDP	0.2	0.2	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

7 | Organization of the Market and Competition

Although market competition has a strong institutional framework, many functional deficits remain. Panama's profile in the 2009 Doing Business survey is a very mixed one. Starting a business requires seven different procedures and takes thirteen days (rank 32 out of 181 countries), but the time required to close a business is on average more than two years (rank 72). It is quite easy to get credit (rank 28), but it takes a long time and a lot of money to enforce business contracts (rank 116). The informal sector encompasses 44% of the work force. The structure

Market-based
competition

of the formal economy is characterized by the dichotomy between a large service sector that accounts for 80% of the GDP and small inward-looking agriculture and industrial sectors. Services include operating the Panama Canal, banking, the Colón Free Zone, insurance, container ports, ship registry (flag of convenience) and tourism. Panama was one of the world's fastest growing economies in 2007 with real growth rising to 11.2%, following an average growth rate of nearly 8% between 2004 and 2006.

The 1996 law establishing the Commission on Free Competition and Consumer Affairs was recently (2006) amended for the purpose of overseeing free competition and consumer protection. The 1990s saw the implementation of a program to privatize state-owned enterprises, which brought to an end a series of market distortions and opened the telecommunications sector, railways and the country's main ports to private investors. The privatization of state assets and holdings, however, has led to strong market concentrations in recent years, particularly in the operation of port facilities at both ends of the Panama Canal.

Anti-monopoly
policy

Beginning in the 1990s, Panama's trade policy pursued the objective of an increasingly open economy. The average tariff dropped from 15.9% in 1996 to 8.6% in 2006. Currently, tariffs for agricultural products are on average more than twice as high (15.3%) as for industrial items (7.2%). The 2009 Doing Business survey ranks Panama eighth in "trading across borders." The country does not belong to any economic bloc, but has signed a series of free trade agreements with Latin American and Asian countries. Panama signed a free trade treaty with the United States in June 2007, which was thereafter ratified by the parliament. Chances for approval by the U.S. Congress, on the other hand, are rather shaky. The United States is Panama's most important trading partner. U.S. exports to Panama in 2007 were \$3.7 billion and U.S. imports from Panama totaled \$ 366 million.

Liberalization of
foreign trade

Panama's financial sector is relatively well developed and stable. The country is a regional financial hub and home to many international companies and financial institutions. Because the U.S. dollar is legal tender, Panama has no central bank. An independent Banking Superintendency oversees the financial sector. Since 1998, regulations have largely been brought into compliance with international standards, thus removing Panama from the OECD's tax haven and money laundering blacklist. Few restrictions limit opening banks, and the government exercises little control over the allocation of credit. Foreign and domestic banks are treated equally, and one-third of the banking sector consists of foreign institutions. Currently, seventy-seven banks operate in Panama and employ 17,000 people. The sector accounts for around 10% of the country's GDP.

Banking system

8 | Currency and Price Stability

Panama has had no monetary policy instruments available since it adopted the U.S. dollar as its legal tender in 1904. Like in neighboring countries, inflation has sharply accelerated recently, reaching almost 10% in 2008 (2007: 4.2%), after averaging about 1.5% during the last twenty years. Although the surge in inflation is mainly due to higher global food and fuel prices and distortions in the agricultural sector, core inflation (excluding food and fuel) is rising as well. This reflects Panama's buoyant economic growth and the emergence of some capacity constraints.

Anti-inflation /
forex policy

Panama's fiscal position has improved as a result of fiscal reforms and increased canal revenue, but it requires further consolidation, especially in view of the heavy financial commitments that the expansion of the canal will require. The public debt to GDP ratio has declined but remains relatively high (51%). Public finances have strengthened remarkably. The overall balance of the non-financial public sector, excluding the Panama Canal Authority, turned from a deficit of about 5% of GDP in 2004 into a surplus of 3.5% in 2007. As in the past, fiscal policy is not immune to populist intentions. The political opposition and certain civil society actors have criticized the bill for the 2009 budget, which represents a 17% increase on the 2008 budget, for being inappropriate given the current financial climate. They characterize it as a crude attempt at gaining support in an electoral year.

Macrostability

9 | Private Property

Property rights and the regulation of property acquisition are well-defined in principle but inadequately implemented. While government policies support property rights within the outward-oriented service sector, the secondary sector and the agricultural export branches, the situation in poor, especially rural, areas is quite different. State institutions do not adequately address violations of property rights caused by the rise in crime, spillover effects from the civil war in Colombia and the several land conflicts. Moreover, in some comarcas (semi-autonomous indígena districts), mestizo settlers tend to occupy land. In some cases, government policies fail to protect well-defined land titles. The enforcement of copyrights and trademarks, though still inadequate, is improving.

Property rights

The legal framework for a functional private sector exists. Private enterprises represent the backbone of the economy, but a few state companies remain. From the start of the privatization process until the beginning of 2007, the state carried out twenty privatization projects, mostly during the 1990s. The most important state-owned enterprises are the Colón Free Zone, the National Welfare Lottery, the National Bank of Panama and the Tocumen International Airport. Moreover, the

Private enterprise

state held between 49% and 51% of the shares of six electric power companies and owned 49% of the shares of the Panamanian branch of the British Cable & Wireless telecommunication company. Foreign investment receives equal treatment in most sectors. The government limits some foreign ownership, for example in non-franchise retail and media, where ownership must be Panamanian, and in some fifty-five professions, such as medicine, law and custom brokering.

10 | Welfare Regime

According to CEPAL statistics, 28.6% of the population lives in poverty and 11.7% in extreme poverty. Welfare institutions exist but do not cover all risks for all segments of the population. The most important institution is the Caja de Seguridad Social (CSS), a public corporation administered by the state and charged with managing various social services and entitlement programs such as health care, medical insurance and pensions. The scope and effectiveness of the social security system varies according to territory, social stratum and economic sector. The CSS mainly benefits workers in the formal sector of the economy and covers only a part of the rural population. Nearly a third of the 3.3 million Panamanians are not included in the CSS scheme. The Torrijos government carried out a major reform of the CSS to overcome the serious under-funding of the institution. In December 2005, the legislature approved a new law that gradually increases the monthly contribution rate (applied on salary) by employees and employers from a combined 18% to 21.5% by 2013. Torrijos had originally wanted to raise the age of retirement and augment monthly payments further, but after violent protests he compromised and submitted the new reform. Currently, the system covers about 170,000 retirees, 72% of whom receive monthly pensions below \$500.

Social safety nets

A number of institutions work to compensate for gross social inequalities, though their efforts remain insufficient. Blacks and most notably members of the indigenous communities have limited access to (higher) education, better paid jobs and public office. According to national surveys, nearly 90% of the 300,000 people belonging to the seven different indigenous groups live in extreme poverty. Poverty and extreme poverty are concentrated in the countryside. A strong correlation exists between poverty and child malnutrition in Panama. Approximately 12% of all children under five suffer from some form of malnutrition. 10% of the population does not use an improved water source. Disparities in education are key causes of poverty, malnutrition and inequality. Close to 80% of the poor work in the informal sector. Social data indicate that women are disadvantaged in general, but women from higher social strata have significantly easier access to higher education, better jobs and public office. With its Red de Oportunidades (Network of Opportunities) program, the Torrijos government established a conditioned cash transfer to some 75,000 of the country's poorest households. This initiative provides cash grants to

Equal opportunity

poor families for keeping their children in school and for meeting mother and infant health controls, child growth monitoring and vaccination schedules, among other requirements.

11 | Economic Performance

During the period under review, macroeconomic indicators show that the Panamanian economy performed extraordinarily well. The 2007 growth rate of 11.2% was the country's most elevated in fifteen years and the highest in the hemisphere, topping solid levels of 8.1% in 2006 and 6.9% in 2005. The large service sector, including the canal, ports and the Colón Free Zone, strongly benefited from the expansion of regional and international trade. Construction soared. The well-developed financial center quickly responded to new opportunities and has attracted significant new investment. At the same time, employment expanded significantly, leading to a decline in (open) unemployment to an unprecedented low level (7%). Growth in 2008-2009 is projected to slow somewhat, to about 8%, with the canal expansion and related investment activities partially offsetting the effects of the slowdown in the United States and the world economy. The country's GDP increased from \$14.2 billion in 2004 to \$19.7 billion in 2007. The most flourishing segment of the economy is the construction sector, which rose 29% year-on-year in the third quarter of 2008. Building projects include the expansion of the inter-oceanic waterway, the extension of port facilities and the construction of skyscrapers, especially in Panama City. Suspicion is growing that drug dealers from Colombia and elsewhere are using Panama's real estate sector to launder money.

Output strength

12 | Sustainability

Environmentally compatible growth is taken into account at the institutional level in important aspects of economic life but tends to be subordinated to growth exigencies. Air and water pollution, soil erosion and deforestation are the primary environmental problems in Panama. Currently, the environmental debate concentrates on the environmental impact of the government's ambitious canal expansion plan. In September 2007, President Torrijos gave the official start for the \$5.3 billion project. Work should be finished by 2014, when the waterway completes its centenary. The initial plan included the construction of several dams and storage lakes and was met with harsh protest from rural communities. The current plan includes the building of retention basins next to the new locks in order to reduce water consumption. While the Panama Canal Authority states that the project is environmentally viable, prominent scientists claim that the canal-feeding Gatún Lake faces a high risk of salinization and that water shortages will increase during El Niño incidences. Gatún Lake provides the drinking water for most of

Environmental policy

Panama's urban population. In 2007, with the assistance of the Inter-American Development Bank (IDB), the government started a project to modernize and strengthen Panama's national environmental agency (ANAM). ANAM is responsible for formulating the country's environmental policies and monitoring compliance with environmental standards. It also manages the national system of protected areas and has oversight over water and forest resources.

Panama's educational system reflects the dual structure of the country's economy and society. According to the 2007-2008 Human Development Report, government spending for education is moderate at 3.8% of GDP (2002-05; 18.6% of government expenditures in 2005). Educational spending is clearly biased towards institutions beyond the primary and secondary levels. The low quality of public schools is a significant obstacle to the broadening of opportunities for personal and social progress, especially in rural areas. On average, rural children attend school for four years less than urban pupils. Deficiencies in teachers' capabilities translate into disappointing achievements of schoolchildren. At the primary level, 12% of the children stop attending classes before completing the 5th grade. According to the World Bank, the country's overall adult literacy rate is 91.9% (2005), which seems far too optimistic in view of the country's pronounced social inequalities. Panama's miniscule expenditure on R&D (0.34% of GDP in 2005) reflects both the small size of the economy and the extraordinary weight of the service sector.

Education policy /
R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance will probably not manifest themselves, given at least moderate economic growth rates. Because of the strong fiscal dependency on the Panama Canal and the outward-oriented service branches, the country is highly vulnerable to external economic influences. The national economy's extraordinary openness and level of global integration makes the radius of operation and performance of the incumbent government, the internal economic development in general, and the macro-stability of the social fabric contingent upon the cycles in world markets and international trade. Economic booms have a cushioning effect on the structurally ingrained harsh social inequalities. Decreasing approval of democratic rule occurs side by side with worsening living conditions for a large part of the population. Structural constraints on governance include inefficient state institutions and agencies, a lack of accountability, and a high level of corruption.

Structural
constraints

Panama has only weak to moderate traditions of civil society. Surveys indicate that Panamanians' participation in civil society organizations is among the lowest in Latin America. In recent years, an obvious tendency exists toward both increasing and strengthening civil society groups and organizations. In Panama, environmental conservation organizations play the most prominent role in the development of civil society. Business groups and some trade unions also promote civic activism. Anti-corruption NGOs, such as Alianza Ciudadana Pro Justicia and the local chapter of Transparency International, are among the most active civil society actors, but they depend heavily on international donors or local business sponsorship. Political parties rarely promote active civil society engagement.

Civil society
traditions

As social indicators demonstrate, deep social inequality divides Panamanian society. Although ethnic conflicts exist, they do not dominate the course of politics. Violent incidents are rare and mainly linked to disputes over land in rural areas. Violence also occurs occasionally during urban strikes. The political elite is not fragmented or polarized along ethnic, religious or social lines. Political actors focus their efforts on creating conditions conducive to economic growth and progress. So far, the negative repercussions of the Colombian civil war are limited to the adjacent parts of Darién province. Particularly worrisome for the population in general and especially the city dwellers is the steadily rising violent crime rate.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership claims to pursue strategic aims in order to foster economic development and political stability, but these commitments are frequently flawed by political bargaining and office seeking. In general, the incumbent government has demonstrated little reliability in achieving or even pursuing its officially declared goals, at times because of a lack of financial resources. Policies geared towards improving the living standards of the poor often rely on symbolic effects without tackling the structural roots of the problem. Because of the solid state of the economy, the Torrijos government had more favorable conditions than its predecessors to deliver on its reform promises.

Prioritization

Although the administration approved anti-corruption measures, corruption remains pervasive. Even the president himself was accused of having engaged in nepotism and shady business transactions. The clientelist logic of Panamanian politics remained untouched. On the other hand, Torrijos has made fiscal responsibility a cornerstone of his administration. By reducing costs and gaining from growing revenues (due to tax reform and rising Canal earnings) the public sector deficit, accounting for 5% of the GDP in 2004, has declined quickly and turned into a surplus of 3.5% in 2007. The debt burden measured as a proportion of GDP has declined from 70% in 2004 to 51% in 2007. Cleaning up public finances was key to Torrijos ambitious plan to expand the country's inter-oceanic canal, whose locks are too small for the new generation of large vessels. In spite of the sound state of public finances, Torrijos proved unable or unwilling to keep his promise to thin out the public bureaucracy. On the contrary, the number of public servants grew by more than 10% (to 185,500 employees) within five years. Furthermore, he did not take the opportunity to implement courageous measures to reduce poverty. In light of the economic boom, even the IMF stressed the importance of providing "some additional room to expand programs to support the poor."

Implementation

The political leadership responds to mistakes and failed policies with changes, but its policy frequently remains stuck in the same routines. Learning processes occur but rarely lead to innovative approaches in respect to designing and implementing policies. As long as politicians are able to satisfy their ambitions by traditional political means and strategies and the majority of the population plays by the rules of the game, strong incentives to change the peculiar functional logics of Panamanian politics will not emerge.

Policy learning

15 | Resource Efficiency

The government uses only a part of its available economic and human resources efficiently. Still, a remarkable improvement in efficiency has occurred in comparison to the preceding Moscoso administration. Though less evidence suggests corruption and administrative inefficiency, both problems continue to plague the political system and hamper public services. Implementation of government programs is severely affected by corruption, waste of money and delays. The practice of appointing personal friends or party cronies to public office also damages government efficiency. Public administration does not operate as effective as it should, partly due to frequent personnel changes in key positions. The Panama Canal Authority (ACP), on the other hand, is outstanding with respect to professionalism and efficiency. It has managed to significantly improve the transit service since the handover of the waterway.

Efficient use of assets

The Torrijos government tries to coordinate conflicting objectives and interests but has obtained only partial success. Trade-offs between policy goals and essential state responsibilities are not well balanced, and intra-governmental frictions thwart policy coordination. The government failed to coordinate conflicting goals, such as improving environmental conditions and maintaining macroeconomic stability, into coherent and credible policies. In addition, the resistance and public actions of pressure groups in many cases hampered the implementation and effective coordination of economic and social policy programs. This is particularly true with regard to reforms in the public transportation and education systems, and concerning the implementation of environmentally sound sustainable development strategies.

Policy coordination

The government's progress in combating corruption is more symbolic than real. Torrijos created the Consejo Nacional de Transparencia contra la Corrupción to monitor and evaluate the performance of government institutions. The PRD-dominated parliament approved a new public contract law that will make all information on public bids available online in an effort to boost transparency. Only a couple of months later, a construction company owned by the family of the current ACP administrator Alemán Zubieta won the first public tender related to the canal expansion project, an incidence that raised doubts over the transparency of the tendering process carried out by the ACP. Apart from that, corruption and nepotism remain endemic among all levels of public administration.

Anti-corruption policy

16 | Consensus-Building

In principle, all major political actors agree that a further strengthening of the market economy and consolidation of the democratic system are Panama's strategic, long-term aims, although ideas about the best way to achieve these goals

Consensus on goals

vary significantly. While representatives of trade unions and many civil society organizations demand social reform to improve the living conditions of the lower strata, business groups advocate for little state intervention in economic matters. Frequently, disagreement about important policy measures between the main political parties is induced for tactical reasons. While the backing of the authoritarian Noriega regime (1983-89) by the PRD and other political and societal groups cast doubt on the democratic credentials of some political players, no evidence suggests that leading players within the PRD are less than supportive of democracy. Though the party originated with the military dictatorship, the PRD has shown a commitment to the democratic rules of the game both in terms of internal party democracy – the PRD was the first political party to institute primaries for the selection of candidate – and in its behavior while in government. The party has demonstrated, however, a somewhat opportunistic stance with respect to democratic values.

The army (National Guard) established an authoritarian regime in 1968 and acted as the main anti-democratic political player until the end of the Noriega regime. The armed forces were dismantled after the U.S. invasion (Dec. 1989) and formally abolished in 1994. Today, no anti-democratic veto actor has any importance in Panamanian politics. In Torrijos' 2008 reorganization of the security apparatus (creating a national border service and an aero-naval service), opposition parties claimed to see an attempt to resurrect the country's authoritarian past. Although a partial militarization of the police forces can be observed, the proclaimed danger is nonexistent. The reforms, while controversial among certain sectors of the population, did not alter the basic non-military structure of Panama's national security apparatus. There is no threat of a return to a military-led regime.

Anti-democratic
veto actors

The political leadership is able to prevent cleavage-based conflicts. Cleavages become manifest in the dual structure of the country's economy and society and the pronounced social inequalities. Because of the close relationship between the leaders of the main political parties and the economic elite, these cleavages are only partially reflected in the party system, even if basic social cleavages play important roles during election campaigns. The risk that cleavages will transform into political conflict increases with deteriorating economic and social conditions. Thus, the extraordinarily high dependency of the Panamanian economy on external factors constitutes a latent danger to the cohesion of the social fabric. However, the weakness of trade unions vis-à-vis business groups and the relative weakness of associations representing the poor minimize the risk of structural conflict. Indian communities have mobilized in defense of their rights, but the government has provided for the creation of semi-autonomous regions for indigenous groups, thus minimizing the risk of conflict. No significant groups advocate secession from the national territory.

Cleavage /
conflict
management

Because civil society actors lack political clout, the government can frequently afford to ignore these groups and formulate its policies autonomously. Rallying around issues of nationwide importance, such as reforming the social security fund and the canal expansion project, civil society organizations managed to form broad alliances that succeeded in getting some concessions. In 2008 the Panamanian Center for Research and Social Action (CEASPA), acting as some kind of coordinating bureau in the civil society sphere, initiated the drafting of a law of public participation to be submitted for agreement and approval in the current or next legislative period. It intends to make consultations with civil society groups in certain matters an obligation for the state. Turning the draft into law alone, however, will not break with decades of clientelist culture.

Civil society participation

The issue of reconciliation refers to both the human rights violations of the military-led regimes and the alleged victims of the U.S. invasion in December 1989. In December 2000, President Mireya Moscoso set up a truth commission to investigate the assassinations and disappearances committed under the Omar Torrijos and Manuel Noriega regimes between 1968 and 1989. The major part of the commission's work was to locate clandestine graves, determine the identity of the victims and fix the circumstances of their deaths. After several setbacks caused by a lack of funds and opposition from the PRD, the commission delivered its final report in May 2002, documenting 110 of the 148 cases examined. During the presidential term of Martín Torrijos, the search for the truth about the dead continued at a slow pace, but as – in the words of the president – “a scientific inquiry rather than as a political smear.” At the same time, Torrijos appointed many incriminated persons of the authoritarian past to key positions in the public administration. Because of the relative small number of confirmed victims, the issue has rarely risen beyond the level of a small minority of political activists. The issue was not debated in the 2004 elections or in the 2009 campaign.

Reconciliation

17 | International Cooperation

The Torrijos government cooperates closely with international partners and donors and tries to use international assistance to foster economic development and achieve its political goals, but it has had problems devising a consistent long-term strategy for integrating international assistance. The World Bank, IMF, Inter-American Development Bank (IDB), the United States (USAID) and the European Union rank among the country's most important multilateral and bilateral lenders and donors.

Effective use of support

In general, the government acts as a credible and reliable partner in its relations with the international community. The recent economic boom has improved the attractiveness of the country, although functional deficiencies in the state continue to complicate business transactions.

Credibility

Because of its unique economic structure and a disadvantageous cost of labor, Panama was unable to join the Central American Economic Community (SICA) or participate in CAFTA (U.S.-Central American Free Trade Agreement). In its international trade strategy, the country concentrates on bilateral agreements. Signed in June 2007, the free trade agreement with the United States, as the most important of such treaties, awaits approval by the U.S. Congress. After the inauguration of President Martín Torrijos, Panama reestablished diplomatic relations with Cuba, broken by the Castro regime some weeks before when President Moscoso pardoned four imprisoned Cuban American citizens convicted of plotting to assassinate the Cuban leader. During the period under review, Panama held the two-year rotating Latin America seat on the U.N. Security Council.

Regional
cooperation

Strategic Outlook

In macroeconomic terms, the recent boom cycle of the international economy made Panama a winner of globalization. Since 2004, the small economy benefited from favorable external conditions and growing domestic demand. Panama witnessed a surge in private investment and a strong growth of the construction sector as well as an expanding demand for its trade-related maritime services. As a consequence of the soaring economy, unemployment and the poverty rate declined, though without the state addressing the structural roots of Panama's abysmal social inequalities. A combination of rising state revenues and moderate austerity measures resulted in healthy state finances and an alleviation of the external debt burden. Beginning in 2006, the economic boom was accompanied by a steep rise in the inflation rate unusual in Panamanian terms. Since the handover of the inter-oceanic waterway, the Panama Canal constitutes the main stimulus of the economy. In order to accommodate the capacity of the aged waterway to the rapidly changing conditions in sea trade, the government launched the largest infrastructure program ever seen in Latin American history. According to the government's plan, the project will be financed through a combination of the state's own resources (mainly originating from recently elevated transit tolls) and international borrowing. Aside from environmental concerns, the current downturn of the world economy poses some risks for the implementation of the ambitious expansion plan. Sharply declining freight charges, which result in decreasing profits of shipping companies, create growing economic disadvantages for the expensive Panama route. In January 2009, Maersk Line, the world's leading shipping company, decided to no longer use the Panama Canal for some of its ships but to travel via Cape Horn. Cutting tolls as a possible means to uphold (or reestablish) the competitiveness of the waterway would probably endanger the financing scheme of the expansion project.

Panama's long-term transformation strategy should focus on three key elements. First, with regard to economic policy, Panama should strengthen its inward-oriented economic sectors in order to reduce its high dependency on global economic conditions and, thus, the extreme vulnerability of the national economy. Steps to enhance productivity in the agricultural sector, including improved access to financing, insurance and technical assistance, will help increase agricultural production and promote food security. Secondly, poverty reduction and sustainable human development should be central long-term development goals. Social and economic policies should aim to gradually overcome the country's fundamental social dichotomy. Improving the quality of public schools, especially in rural areas, is essential to widen the range of choices for the poor. Finally, in order to strengthen the basis of the democratic system, efforts against crime and corruption should be increased. Combating corruption is not merely a technical issue but is closely tied to transforming the political culture.