

# BTI 2012 | Panama Country Report

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

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

Population	mn.	3.5	HDI	0.768	GDP p.c.	\$	13609
Pop. growth <sup>1</sup>	% p.a.	1.6	HDI rank of 187	58	Gini Index		52.3
Life expectancy	years	76	UN Education Index	0.743	Poverty <sup>3</sup>	%	17.9
Urban population	%	74.8	Gender inequality <sup>2</sup>	0.492	Aid per capita	\$	19.0

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Since 2004, Panama has experienced a period of political stability and strong macroeconomic performance. The country's growth rates in 2007 and 2008 were higher than in any other country in Latin America. The economic and financial crisis of 2008 caused only a temporary slowdown, and Panama was one of the very few countries in the region that did not suffer recession in 2009. In 2010, the economy grew again by over 5%. In particular, the \$5.25 billion investment project to modernize the Panama Canal has served as a stimulus for economic growth. The contract for the largest single project within the expansion plan, the construction of two sets of locks, was awarded in 2010. The economy's strong performance allowed for a well-balanced state budget and a remarkable downsizing of Panama's foreign debt burden. The country's sound macroeconomic policies in recent years were key to attaining investment-grade status in early 2010. Panama's medium-term prospects are very good. According to IMF forecasts, Panama until at least 2015 will grow faster than any other economy in Central America. However, beneath the surface of political stability, political manipulation and deep-rooted corruption still plague state institutions. Because of the authoritarian inclinations of the new head of state, the quality of Panama's democracy has suffered since mid-2009. Deficiencies include an obvious pattern of cronyism, erosion of democratic checks and balances and harassment of the media from President Ricardo Martinelli's administration.

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 service branches stands 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 cohesion and stability. The trend of declining rates of (open) unemployment and poverty, which began in 2004, has continued during the observation period. But economic growth alone cannot cut the roots of poverty and extreme social inequality. Little perceptible progress has occurred in overcoming the structural constraints that traditionally limit management performance and governance capacity (deficient rule of law, poor quality of public schools and so on).

## History and Characteristics of Transformation

Panama was a province 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 exercised a quasi-sovereign control over 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 in the zone. A period of weak civilian rule ended with a military coup in 1968, which brought General Omar Torrijos to power. His most important political achievement was the signing of a new canal treaty, according to which the Canal Zone and the waterway were gradually transferred to Panama. The final handover of the canal was scheduled for 1999. To ease approval of the treaty by the U.S. Congress, Torrijos announced the opening and gradual democratization of the political system. He founded the Democratic Revolutionary Party (PRD) in order to provide the regime with a political platform. After Torrijos's death in 1981, General Manuel Noriega took over the command of the National Guard and soon became the new strongman of the regime. He manipulated the 1984 elections to prevent a victory of the opposition parties. While the army leadership was the real center of power, the PRD-government furnished the authoritarian regime with a democratic facade. 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 intervention ("Operation Just Cause") overthrew the regime later that year. ADOC's Guillermo Endara became president. During his term, Endara made progress in restoring functioning political institutions after 21 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 the May 1999 elections, Arnulfista Party (PA) candidate Mireya Moscoso was victorious. In her second bid for the presidency, 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 31 December 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 slow economic growth. In the 2004 presidential race, Martin 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. The most important challenges facing the Torrijos government were the reform of the deficit-ridden social security system and designing a plan for the modernization of the aged canal. In 2006 a referendum was conducted in which a majority of the population voted for the expansion of the waterway. During the Torrijos term, a spectacular economic upturn, the result of extraordinary favorable conditions in the world market, significantly eased governing. In May 2009 supermarket-tycoon Ricardo Martinelli from the Democratic Change (CD) party was elected president for the 2009-2014 term. With 60% of the vote, he achieved a historical record. This was the first time since the return to democracy that neither of the previous two most important political parties emerged victorious.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 10 (best) to 1 (worst).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

The state's monopoly on the use of force prevails throughout the country and is not disputed by any important political player. However, there are at least two factors that threaten and restrict the authority of the state in some way. First, largely due to its geographic location, Panama is a major transshipment point for Colombian cocaine destined for the U.S. market. Organized crime, which is closely related to the drug trade, represents a growing problem, even if the situation is not as bad as in most Central American countries. Secondly, the civil war in Colombia has produced serious spillover effects in the Darién region. Without an army of its own, Panama is not able to protect its eastern border effectively. Since Colombian forces have successfully blocked domestic Revolutionary Armed Forces of Colombia (FARC) corridors and are pushing the rebels toward the border, these are increasingly penetrating into Panamanian soil in search of alternative safe havens. To address this problem, in September 2010 Panama and Colombia signed an agreement on closer cooperation on security issues. A month later, the Colombian military launched Operación Darién, which began with the bombing of a FARC encampment sited about 700 meters from the border with Colombia which resulted in five deaths.

In principle, all citizens have equal civil 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 citizenship. 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.

Question  
Score

Monopoly on the  
use of force

8

State identity

10

The constitution defines the state and its legal order as secular. Religious dogmas have no perceptible influence in 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 Christians. According to the constitution, the curriculum of public schools must include Catholic religious education though parents have the right to exempt their children from religious instruction.

No interference of religious dogmas  
9

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. Some 31% of the population has no access to improved sanitation facilities. One persistent problem is that a large part of the country’s high-income earners undermines the authority of the state through considerable tax evasion.

Basic administration  
7

## 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. Ricardo Martinelli’s success in the 2009 presidential race interrupted this pattern. Because of his great wealth, Martinelli could spend much more money for election propaganda than his political opponents. During the 2009 election campaign some decisions of the electoral management body (Tribunal Electoral) were influenced by the incumbent government.

Free and fair elections  
9

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 military bases), U.S. influence on Panamanian politics diminished significantly. Business groups (linked to the service sector) and a handful of militant labor unions represent the most influential pressure groups. In the past, the lending conditions of the IMF restricted Panama’s room to maneuver in

Effective power to govern  
9

its economic policies. Due to the strong growth of the economy and increasing government revenues, the influence of the IMF declined in the period under review.

The constitution guarantees unrestricted freedom of association and assembly, yet in fact there are limitations on organizing workers. The state restricts labor unions to only one branch office per province and previously required a minimum of 40 members to set up a branch union, until the outgoing Torrijos government lowered the requirement to 20. 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 frequently to pressure the government to adopt or retract a number of policy initiatives. Public sector employees do not enjoy the right to form unions but are allowed to set up associations and engage in collective bargaining, but only if they have a minimum of 50 members. The law governing the autonomous Panama Canal Authority prohibits the right to strike for its workforce but does allow unions to organize and bargain collectively. There are also restrictions on worker's rights in export processing zones. In July 2010, the parliament approved Law 30 which reformed labor regulations to the detriment of employees. The most controversial changes introduced by the new law included: amendments to labor regulations which establish that the payment of union dues is no longer mandatory; that contracts of striking workers can be suspended; and that a company can hire replacement workers during strikes. This obvious attempt to weaken union power provoked demonstrations from trade unions and civil society groups. Two banana workers were killed and more than 100 people were injured following clashes with the police during protests in the Bocas del Toro region. Under international pressure from organizations such as the High Commissioner of the United Nations for Human Rights, the government held talks with the unions. In October 2010, President Martinelli agreed to repeal the controversial Law 30. Already in May 2010, a group of intellectuals, lawyers, business leaders and human rights lobbyists issued a statement declaring themselves to be in a "state of alert" in response to "signs of authoritarianism" on Martinelli's part. The statement was prompted by acts of intimidation against leading activists who had been vocal in challenging various government measures.

Association /  
assembly rights  
8

Freedom of opinion and the press are guaranteed by the constitution but in reality subject to some intervention that contradicts democratic standards. President Martinelli's predecessor Torrijos signed into law penal code amendments that could limit the watchdog role of the media. Under the new government, the pressure on the media has increased. International media organizations have lambasted the Martinelli administration for its encroachment on independent media. Reporters without Borders dropped Panama 30 spots in the latest Press Freedom Index (2010), noticing that the country "has taken an opposite direction, in an atmosphere

Freedom of  
expression  
7

growing increasingly tense between the media and the authorities.” The Interamerican Press Association says in its most recent report (2010) on Panama that “over the past six months, freedom of the press has been threatened by actions by institutions belonging to the government...as well as from the Judicial Branch and the Prosecutor’s Office.”

### 3 | Rule of Law

As in other Latin American countries, the executive branch’s dominance over the other two branches of government threatens the constitutionally enshrined principle of separation of powers. While the deficient functioning of checks and balances between the executive and the legislative (National Assembly, or Asamblea Nacional) was partially neutralized by the lack of a stable parliamentary majority during the Pérez Balladares and Moscoso administrations (1994–2004), the political constellation changed with the clear victory of Torrijos’ Democratic Revolutionary Party (PRD) in the 2004 elections and the overwhelming triumph of Martinelli’s party alliance five years later. Under Martinelli, the parliament serves frequently as a mere rubber stamp for the president’s legislative projects. Law 30 was not only controversial for its content but also because of the dubious way it was passed through the National Assembly. The law was approved (in June 2010) during an extraordinary weekend session without any serious debate while the rest of the country was distracted by the World Cup. In accordance with the degradation of the legislative body, the judiciary is often instrumentalized for political purposes by the executive. In January 2010, the Supreme Court, at the Martinelli administration’s request, suspended the attorney general under questionable charges of “abuse of power.” The move was aimed to purge the government of its last PRD official. Martinelli created a new, and legally not existing, post called the “supplemental” attorney general, in order to fill the position with a loyal follower.

Separation of  
powers

7

The judiciary is institutionally differentiated, but its decisions and doctrine are frequently subordinated to political considerations 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 20 months and 31 different procedures to enforce a commercial contract. There are different degrees of justice available to Panamanians, depending on their political and social standing. In making appointments to top positions in the judicial branch, professional criteria are not decisive. Upon taking office, President Martinelli pledged that two upcoming appointees to the Supreme Court would be selected through an open nomination process. When he found the recommended candidates objectionable, he ignored

Independent  
judiciary

5



them and appointed two close associates. The hierarchical method of appointments makes the judicial system particularly prone to clientelism and corruption.

Corrupt officeholders are not prosecuted adequately under the law but frequently attract adverse publicity. The Consejo Nacional de Transparencia contra la Corrupción, created by the Torrijos government, is incapable to fulfill its assigned task satisfactorily. The secretary at the top of this administrative unit is a political position appointed by the president. Whoever sits in this office is therefore more concerned about investigating acts of corruption committed by members of the previous than of the current administration. Hence the “anti-corruption czar” becomes more a shield or filter to protect the incumbent government than an effective weapon against any current or ongoing corruption within the actual administration. The daily newspaper, Panamá América, published a report covering the period from July to October 2009, in which the Anti-Corruption Secretariat received a total of 142 citizen complaints on alleged acts of corruption, and of those 125 were neglected. Of the 17 that were processed, only one was presented before the relevant authorities. After 18 months of criticism over the way he managed the position from civil society groups “Anti-Corruption Czar” Fernando Nunez, a close relative of President Martinelli, resigned in January 2011.

Prosecution of  
office abuse  
5

Civil rights are guaranteed by the constitution, but are partially or temporarily violated. Regulations and institutions to prosecute, punish and redress violations of civil rights are in place, but often prove to be ineffective. There is an obvious tendency of the Martinelli government to intimidate people who exercise their civil rights actively. After demonstrations against tax and education reforms in March 2010 the government-controlled National Assembly passed a new law which states that “whoever, abusing the right to meetings or demonstrations, by use of violence, impedes or obstructs the free transit of vehicles on the public ways of the country and causes damage to public or private property shall be punished by six months to two years in prison.” About the same time when the controversial Law 30 was adopted, the government announced a change to the police code whereby police officers who commit crimes while on duty may not be jailed pending trial or face internal discipline proceedings (i.e., suspension) until they have been convicted. The new regulation was even criticized by the Martinelli-friendly business sector. For the first time since the days of Noriega, security forces used bird shot munitions against protesters during the demonstrations in June 2010. The clash left 52 people wounded by bird shot to the eyes. A cable released by online whistleblowing site Wikileaks and signed by then U.S. Ambassador to Panama Barbara Stephenson describes Martinelli’s “autocratic tendencies,” such as asking the U.S. government for help to wiretap political opponents.

Civil rights  
7

#### 4 | Stability of Democratic Institutions

Panama's democratic institutions perform their functions more or less effectively and are free from extensive, counterproductive frictions. The good economic situation of recent years has helped to prevent frequent personnel changes in important government posts. Due to the overwhelming majority of the governing parties in parliament, the legislature often appears as an extension of the executive branch. In general, low levels of professionalism, waste of resources (money) and widespread corruption continue to plague the public administration.

Performance of democratic institutions

8

In principle, all relevant political and social actors accept democratic institutions as legitimate. Some civil society groups, especially indigenous and peasant organizations, do not have much confidence in public institutions. The public image of the legislature is particularly bad. Of concern is the disregard of the independence of the judiciary and the legislative by the current administration.

Commitment to democratic institutions

9

#### 5 | Political and Social Integration

During the first two decades after the restoration of democracy, two groups have dominated the Panamanian party system. Guillermo Endara (1989-1994) headed a coalition government led by the conservative Arnulfista Party (Partido Arnulfista, PA). Furnished with a fresh social democratic profile, the Democratic Revolutionary Party (PRD) won the 1994 presidential elections and thus returned to political center stage just five years after the overthrow 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 a permanent change. A party that does not obtain at least 4% of the vote in two consecutive elections is deleted from the electoral register. After 1990, 32 new political parties emerged, only to disappear again a few years later because of a lack of success at the ballot box. Since the mid-1990s, there has been a clear trend toward a decrease in the number of political parties. While in 1994, 15 parties applied for seats in parliament, only eight parties took part in the elections in 2009. Ideological polarization and policy divergence among parties are low. Programmatic objectives do not mean much in political reality, and party cohesion and loyalty are weak. In general, the party system is focused around just a few personalities. Though the rate of party registration is rather high (the sum of all registered party members is about half the country's adult population) this does not

Party system

7

correspond to actual support for political parties because it is based more on clientelism.

To achieve his political ambitions, the current president in 1998 founded his own party (Democratic Change, Cambio Democrático (CD)). Through an alliance with the Panamenista Party (Partido Panamenista, the former PA) and two small parties the government enjoys a comfortable majority. The PRD's poor performance in the presidential contest was replicated in the legislative vote. Its representation dropped from 46 seats to 26 in the new 71-seat congress. Not even all registered party members voted for the PRD.

The most influential interest groups are those from the business sector (especially service branches) and a handful of labor unions. Although the interests of organized labor are largely consistent with the programmatic profile of the PRD, the relationship between the party and the trade unions was rarely free of tensions. The weakening of the PRD in recent elections may change the political landscape: The Frenadeso (Frente Nacional por la Defensa de los Derechos Económicos y Sociales) movement which was formed in 2005 to protest for social security reforms has considered the possibility of competing in the 2014 elections. One of the main changes in the tableau of political actors is the rapidly increasing importance of civil society groups in spite of the adversary endeavors of the current administration. The Martinelli government cares little for democratic standards when it comes to weaken trade unions and civil society groups politically. The social interests of vulnerable groups, such as peasants, workers of the informal sector and ethnic minorities are poorly represented in the political system.

Interest groups  
7

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 increased by six points to 64% in the first year of the Martinelli presidency. In 2010, the approval rate fell to 61%. According to the results of a national survey that was conducted in October 2010, a large majority, some 68% of respondents, were satisfied with the work of the president. However, declining levels of support for the incumbent democratic government are not synonymous with a rising popularity of autocratic political alternatives. According to Latinobarómetro (2010), 70% of Panamanians under no circumstances are willing to accept an autocratic system; a rather hypothetical issue, given the non-existence of a military institution.

Approval of  
democracy  
8

There is a substantial number of autonomous, self-organized groups, associations and organizations, mostly religious groups or parents' organizations, but also neighborhood associations. Civil society organizations have played a more important role in recent years but their role in society as a "participative" civil society (i.e., taking part in demonstrations) is still minor compared to countries such as Argentina or Bolivia. Patterns of cooperation and mutual support between

Social capital  
7

citizens are (traditionally) more important in indigenous communities. With regard to social capital, the Latin American Public Opinion Project (LAPOP) Americas Barometer shows a more or less solid level of social capital with almost 60% of interviewees confirming that they trust their fellow citizens. This is confirmed by data from the Latinobarómetro survey (2010) which indicates a medium level of interpersonal trust in society, the Panamanian result being slightly above the Latin American average. The notwithstanding considerable lack of trust in other people, however, correlates with lack of public security and high crime rates. After having increased by 50% in 2009, in 2010 the murder rate went down for the first time in many years. According to the director of the national police, there was a 35% reduction in crime in 2010.

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Poverty and social exclusion are quantitatively and qualitatively significant and to a large extent structurally ingrained. At first glance, this assessment seems incompatible with the country's relatively high Human Development Index coefficient. In UNDP's 2010 Report, Panama occupies rank 54, with only three Latin American countries ranked higher. However, Panama's high per-capita income goes hand in hand with one of the most heterogeneous and deeply divided socioeconomic entities in the world. The country has a distinct 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 many parts of the republic. Panama exhibits one of the most unequal income distributions in Latin America. The Gini coefficient value was 0.523 in 2009. While the poorest quintile of the population has a mere 4.5% share of the national income, the richest 20% account for 53%. The share of the top decile in total income is 36.8%. The United Nations Economic Commission for Latin America (CEPAL) data rate the percentage of people living below the poverty rate at 26.4% (2009). That is about 10 points less than in 2002. The difference is the result of the economic boom of the last years which has led to a significant expansion of formal and informal employment and increased income. There is a clear divide between urban and rural living standards. Four out of five people living in extreme poverty are inhabitants of rural regions. The great majority of the extremely poor are members of the indigenous minorities. With regard to the gender inequality index, Panama is ranked 27 places lower than the general HDI. Following the recent election, the

Question  
Score

Socioeconomic  
barriers

5

representation of women in parliament has been reduced by more than half (six out of 71 seats).

Economic indicators		2007	2008	2009	2010
GDP	\$ mn.	19794.0	23184.0	24711.0	<b>26688.8</b>
GDP growth	%	12.1	10.7	2.4	<b>4.8</b>
Inflation (CPI)	%	4.2	8.8	2.4	<b>3.5</b>
Unemployment	%	6.8	5.9	-	-
Foreign direct investment	% of GDP	9.0	9.5	7.2	<b>8.9</b>
Export growth	%	22.0	10.3	-0.9	<b>6.2</b>
Import growth	%	18.1	10.3	-5.6	<b>21.2</b>
Current account balance	\$ mn.	-1407.0	-2722.1	-43.5	<b>-2953.2</b>
Public debt	% of GDP	48.5	41.5	40.4	<b>40.9</b>
External debt	\$ mn.	9328.2	9572.8	11267.0	<b>11412.1</b>
Total debt service	\$ mn.	844.9	1605.6	905.8	<b>1077.4</b>
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	11.3	10.3	10.5	<b>5.8</b>
Public expnd. on edu.	% of GDP	-	3.8	-	-
Public expnd. on health	% of GDP	6.7	7.2	8.3	-
R&D expenditure	% of GDP	0.20	0.21	-	-
Military expenditure	% of GDP	0.0	0.0	0.0	-

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

## 7 | Organization of the Market and Competition

Although market competition has a strong institutional framework, many functional deficits remain. Panama's profile in the 2011 Doing Business survey is a mixed one. Starting a business requires seven (2009: six) different procedures and lasts nine days (2009: 13), while the time required to go through insolvency takes on

Market-based  
competition

7

average more than two years. It is quite easy to get credit, but it takes a long time and a lot of money to enforce business contracts. The cost to enforce a contract is the highest in Latin America. With respect to the aggregate ranking, Panama ranks 72 out of 183 countries. Four Latin American countries are ranked better. While the conditions for investors in most countries of the region have improved more or less over the past five years, Panama's aggregate ranking changed only minimally. The informal sector encompasses more than 40% of the national workforce. The structure of the formal economy is characterized by the dichotomy between a large and very capital-intensive service sector that accounts for 80% of 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. Because of the unusual structure of the economy, even very strong growth means only a slight reduction of the informal sector. In his inauguration speech, President Martinelli promised to do everything within his power to advance the ideals of a free economy. He pledged to make Panama "the best place in Latin America to do business," declaring he was going to take "our private sector experience and put the government to work as you have never seen before."

The 1996 law establishing the Commission on Free Competition and Consumer Affairs was amended in 2007 for the purpose of overseeing free competition and consumer protection to prevent monopolistic practices in the economy. One result was to end the monopoly on the marketing of bananas, held by U.S. company Chiquita. 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.

Since the early 1990s, Panama's trade policy pursued the objective of an increasingly open economy. In 1995, the country subscribed to the General Agreement on Tariffs and Trade (GATT) so it could join the WTO. 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%). Any company may import raw materials or semi-processed goods into Panama duty-free for export production, except for sensitive agricultural products, such as rice, pork, poultry and corn. The 2011 Doing Business Report for Latin America ranks Panama first 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. The free trade agreement with the United States has been ratified by Panama but awaits approval by the U.S. Congress. A group of U.S. senators wants to see Panama loosen its banking secrecy laws in

Anti-monopoly  
policy  
7

Liberalization of  
foreign trade  
10

return for the agreement. Recent changes in Panamanian law will provide greater access for U.S. law enforcement agencies to bank records, thus meeting one of the demands of the U.S. Congress for ratification of the agreement. The Central American region and the European Union have concluded, in May 2010, the negotiations of an Association Agreement that includes a free trade agreement.

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. Few restrictions limit opening banks, and the government exercises little control over the allocation of credit. Foreign and domestic banks are treated equally. Currently, 93 banks operate in Panama City's Centro Bancario (representative offices included), of which 70% are branches of foreign banks. The sector employs 20,000 people and accounts for around 10% of the country's GDP. Panama is currently on the OECD's "grey list" of jurisdictions that have committed to the internationally agreed tax standard (to prevent tax havens and money laundering) but not yet substantially implemented it. To be removed from the "grey list," Panama has to sign 12 bilateral tax information exchange agreements. The agreement signed in November 2010 with the United States was the tenth of this kind.

Banking system

8

## 8 | Currency and Price Stability

Panama does not have any monetary policy instruments at its disposal since the country adopted the U.S. dollar as its official currency. The lack of monetary policy authority leaves the government with fiscal policy as the only tool to control inflation. Like in neighboring countries, inflation rose sharply during the recent economic boom, reaching almost 9% in 2008, after averaging only 1.5% in the two decades before. In 2009, the inflation rate rose to 2.4%.

Anti-inflation /  
forex policy

9

Fiscal improvements have helped reduce Panama's public debt (domestic and external) from 70% of GDP to around 42% in 2009 and 2010. Approximately three-quarters of the \$11 billion public debt stock is owed to private creditors (the majority comprising bonds). After running a deficit of 4.6% of GDP in 2004, Panama ran surpluses between 2006 and 2008. In 2009, when growth slowed, the country fell into the red for 1% of GDP. In recognition of Panama's solid fiscal dynamics, major rating agencies have recently upgraded the country's rating to investment grade. One month after Fitch, in May 2010 Standard & Poor's raised Panama's credit to investment grade (BBB-minus). Improved creditworthiness is reducing financing costs and facilitating access to international capital markets.

Macrostability

8

## 9 | Private Property

Property rights and the regulation of property acquisition are well-defined in principle but inadequately implemented. According to the 2011 Doing Business Report, with respect to property rights Panama ranked 113 out of 183 economies. In average eight different procedures and a time of 32 days are required to register property. The cost of registration amounts to 5.4% of the property value. The U.S. government has received numerous property dispute complaints from U.S. investors. Many of these complaints appear to stem from the general lack of titled land in Panama, along with inadequate government administration of the property system and a weak judiciary. Panama enacted Law 80 of 2009, which attempts to address the lack of titled land in certain parts of the country. However, it does not cure deficiencies in government administration or the judicial system. The government is making efforts to strengthen the enforcement of intellectual property rights (IPR). Since 1997, two district courts and one superior tribunal have been exclusively adjudicating antitrust, patent, trademark and copyright cases. The Panamanian government reports that in 2009, there were 185 convictions for IPR-related violations, and it seized over \$17 million of illicit goods.

Property rights  
7

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 2007, the state carried out 20 privatization projects, mostly during the 1990s. The most important state-owned enterprises are the Autoridad del Canal de Panama (ACP), the Colón Free Zone, the National Welfare Lottery, the National Bank of Panama and the Tocumen International Airport. Moreover, the 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 telecommunications company. The government limits some foreign ownership, for example in non-franchise retail and media, where ownership must be Panamanian, and in some 55 professions, such as medicine, law and custom brokering. Although elected on a free market platform, President Martinelli's position on privatization is far from clear. On the one hand, his administration plans to privatize Correos y Telégrafos de Panama, the postal service, on the other hand it purchased two toll roadways (corredores Norte y Sur), which were previously operated by a private firm.

Private enterprise  
8

## 10 | Welfare Regime

According to the United Nations Economic Commission for Latin America (CEPAL) statistics, 26.4% of the population lives in poverty and 11.1% in extreme poverty (2009). Welfare institutions exist but do not cover all risks for all segments of the population. The most important institution is the Caja de Seguro Social

Social safety nets  
6



(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. The Torrijos government's intention to fundamentally reform the seriously underfunded institution was only partially successful. In 2008, there were 939,971 persons registered as contribution payers. At the same time the number of insured persons amounted to 2,651,510. Currently the government pays a subsidy to the CSS of \$100 million annually to offset the deficit. After protest and demonstrations by retirees, the government approved an increase of pensions by \$30 to \$50 in the end of 2010. The additional expenditures raise the deficit of the Programa de Invalidez, Vejez y Muerte, which was \$64 million in 2009. Since early 2010, persons over 70 years old who are not entitled to a regular pension receive a monthly payment of \$100 from the state. President Martinelli thereby fulfilled a pledge of his election campaign.

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, roughly 90% of the 300,000 people belonging to the seven different indigenous groups live in extreme poverty. Poverty and extreme poverty are concentrated in rural regions. A strong correlation exists between poverty and child malnutrition. Approximately 12% of all children under 5 suffer from some form of malnutrition. Nearly 20% of the rural population does not have access to an improved water source. Disparities in education are key causes of poverty, malnutrition and social 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. Violence against women, and especially domestic violence, remains a serious problem. The Torrijos government created the Red de Oportunidades program, which provides cash grants to poor families for keeping their children in school and for meeting mother and infant health controls, child growth monitoring and vaccination schedules. In 2010, around 76,000 households profited from the program. The proportion of children that completed elementary school rose by 10.4%, thanks to the program. In indigenous areas the program increased enrollment only in elementary schools by roughly 9%. Consequently, child labor in children ages 12 to 15 declined in rural and indigenous areas.

Equal opportunity  
6

## 11 | Economic Performance

Since 2005, Panama is one of the fastest growing economies in Latin America. The country's GDP increased from \$14.2 billion in 2004 to \$27.2 billion in 2010. The global financial crisis in 2008 and 2009 induced only a short and moderate economic downturn. Panama was one of the few countries of the region that avoided a recession during this time. After expanding a modest 2.4% in 2009, the country's GDP grew around 5% in the following year. Inflation has remained low (2009: 2.4%; 2010: 3.2%) after reaching more than 8% in 2008. At the same time, employment expanded significantly, leading to a decline in (open) unemployment to an unprecedented low level (6.5%) With the award of the contract to construct two completely new chains of locks, the labor-intensive phase of the canal expansion project has begun (2010). The new sets of locks will double capacity and allow larger vessels to use the waterway. The construction of the new locks will create 7,000 new jobs. Additionally, the construction of the first line of the Panama City metro, President Martinelli's flagship project, will have a positive impact on the labor market. In November 2010, the IMF issued a report which forecasts that Panama's GDP growth rate would be the fastest in Central America from 2010 until at least 2015. The weakest part of the economy is the agricultural sector. In recent years, the country's arable acreage has fallen.

Output strength  
9

## 12 | Sustainability

Environmental considerations are taken into account, but are often subordinated to growth requirements when it comes to large investment projects. Air and water pollution, soil erosion and deforestation are the primary environmental problems in Panama. In recent years, the environmental debate has concentrated on the impact of the ambitious canal modernization plan. The initial plan included the construction of several dams and storage lakes and was met with vocal protest from rural communities. The actual plan envisages the building of retention basins next to the new locks 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, or warmer weather, years. In addition to the water for the locks, Gatún Lake provides drinking water for most of Panama's urban population. There is evidence that the ecological situation in the water catchment area of the lake has improved in recent years. Panama's national environmental authority, Autoridad Nacional del Ambiente (ANAM), is responsible for formulating the country's environmental policies and monitoring compliance with ecological standards. It also manages the national system of protected areas (18.5% of the national territory) and has oversight over water and forest resources. The

Environmental  
policy  
6

current government has tried to weaken environmental regulations for investment projects (by one of the amendments of the failed Law 30) in order to support the expansion of the metallic mining sector (copper and gold). A change of the 1963 mining law which repeals the ban on foreign government investment provoked protests from civil society groups and the indigenous sector (many concessions lie within its territory i.e., the semi-autonomous comarcas).

Panama's educational system reflects the dual structure of the country's economy and society. According to World Bank data, government spending for education is moderate at 3.8% of GDP (2008). Social expenditure in 2010 accounted for 44% of government spending, of which over 28% went into education. Educational spending is clearly biased toward 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 three years less than urban pupils. Deficiencies in teachers' capabilities translate into disappointing achievements of schoolchildren. At the primary level, more than 10% of the children stop attending classes before completing the 5th grade. In respect to school attendance and mean years of schooling of children from poor families, the cash transfer program Red de Oportunidades has brought some progress. World Bank figures put the country's overall adult literacy rate at 93.5% (2008). The miniscule expenditure on R&D (0.21% of GDP in 2008) reflects both the small size of the economy and the extraordinary weight of the service sector.

Education policy /  
R&D  
5

## Transformation Management

### I. Level of Difficulty

The structural constraints on governance remain largely latent, given at least moderate growth and inflation 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 macrostability and cohesion 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. But strong economic performance cannot translate into broadly shared prosperity, as Panama has the second-worst income distribution in Latin America. Structural constraints on governance include inefficient state institutions and agencies, a lack of political accountability, the high level of corruption and extreme social disparities.

Structural  
constraints  
5

The country has only weak to moderate traditions of civil society. Surveys indicate that Panamanians' participation in civil society organizations was among the lowest in Latin America until recently. In the last few years a clear trend toward both increasing and strengthening civil society groups and organizations can be observed. For a long time especially environmental groups played the leading role in the formation of civil society. Anti-corruption and pro-judicial reform NGOs, such as Alianza Ciudadana Pro Justicia, play an increasingly important political role but depend heavily on international donors or local business sponsorship. The significant weakening of the Democratic Revolutionary Party (PRD) in the 2009 elections and the subsequent internal crisis within the former ruling party has opened new political spaces for civil society groups and organizations, a chance they have used effectively.

Civil society  
traditions  
5

As social indicators demonstrate unequivocally, deep social inequalities divide Panamanian society. Although there are ethnic tensions and conflicts, they regularly remain on the edge of political events. Since the return to democracy, violent confrontations related to social or political differences are rare and mainly linked to disputes over land in rural areas. Violence also occurs occasionally during urban

Conflict intensity  
3

strikes. Under the right-wing Martinelli government social conflicts have become more violent, and human rights violations have increased. The political elite is not fragmented or polarized along ethnic, religious or social boundaries. Despite the increasing infiltration of Panamanian territory by rebels and paramilitaries, the negative repercussions of the Colombian civil war are limited to the remote Darién province. Of particular concern for the population in general and especially the residents of cities is the high rate of violent crime.

## II. Management Performance

### 14 | Steering Capability

The possibility to take on a longer-term political perspective has improved thanks to the stable macroeconomic situation. However, because of the extreme vulnerability of the economy through external factors the context for political action may deteriorate rapidly in the short term. As an immediate re-election of the president is not authorized by the constitution, his actions are determined less by tactical political calculations than in other Latin American countries. However, the head of state in everything he does or does not has to take into account the chances of his party in the next elections. Strategic political objectives are usually expressed in very general terms (promotion of economic growth, increasing exports, attracting foreign investment, reducing the foreign debt) and are always present in the rhetoric of everyday politics. In case of conflict, all democratically elected Panamanian governments have sacrificed strategic objectives for short-term political goals.

Due to the favorable economic situation, the conditions for the government to implement its own political plans and priorities have improved significantly. Many promises that President Ricardo Martinelli made during the election campaign have been realized in the first 19 months of his administration. In contrast, the government has failed as it has tried to limit labor rights and environmental standards for investment projects. Having fought the 2009 election on an anti-corruption platform, Martinelli in his tenure was already confronted with several cases of corruption in his own government. In spite of having blamed the previous governments for their networks of patronage and clientelism, Martinelli behaves much the same. For example, an accountant from Martinelli's supermarket business has been appointed as general comptroller, public procurement processes have been ignored, and government contracts have been arbitrarily granted to relatives and political associates. In sum, though Martinelli has been able to implement many of

Question  
Score

Prioritization  
6

Implementation  
7

his policies, they are not always compatible with the BTI's normative framework of transformation toward democracy and a market economy.

The political leadership responds to mistakes and failed policies with changes, but its policy frequently remains stuck in the same routines. While in the ruling parties there was a total lack of resistance against the bill, it was the public protest of labor unions and civil society groups that led to the cancellation of the controversial Law 30. 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 logic of Panamanian politics will not emerge.

Policy learning  
6

## 15 | Resource Efficiency

The government uses only a part of its available financial and human resources efficiently. Hardly less than in the past, corruption and administrative inefficiency plague the political system and hamper public services. Implementation of government programs is often severely affected by corruption, poor fiscal decisions and delays. The practice of appointing personal friends and party cronies to public office also undermines government efficiency. Public administration does not operate as effective as it should. The Panama Canal Authority (ACP) appears as an island of professionalism and efficiency in an ocean of sub-optimal administrative performance. It has managed to significantly improve the transit service since the handover of the waterway. On the one hand, increasing government revenue and a balanced state budget facilitate the art of governing, but on the other hand they work as a disincentive for reforms to raise the efficiency of the public administration.

Efficient use of  
assets  
4

In the first 19 months of its mandate, the Martinelli government has not demonstrated that it is really interested in a well-balanced trade-off between conflicting objectives of different sectoral policies. Rather, it tends to neglect the implementation of less important political programs or to replace them with acts of symbolic politics. Despite the business-friendly profile of the government, it keeps the course set by the previous administration with regard to a poverty reduction policy.

Policy  
coordination  
6

During the election campaign, Martinelli blamed the traditional ruling parties for pervasive and systemic corruption. So far, however, is not discernible whether corruption could be really reduced. The new government has already had to deal with corruption cases. The secretary of the national anti-corruption agency resigned because of harsh public criticism on its conduct of office. The Consejo Nacional de Transparencia contra la Corrupción, created by the Torrijos government, has not

Anti-corruption  
policy  
4

been able to fulfill its assigned tasks satisfactorily. Even the renowned Panama Canal Authority (ACP) was suspected that in awarding the contract for the construction of new locks, nepotism was at play. The consortium that won the bidding included a Panamanian company, whose chairman is a cousin of the Panama Canal administrator.

## 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 vary significantly. Representatives of labor unions and many civil society organizations demand social reform to improve the living conditions of the lower strata and judicial reform to guarantee equal rights for all. Business groups advocate for little state intervention in economic matters and moderate tax rates. Frequently, disagreement about important policy measures between the main political parties is induced for tactical reasons. The Martinelli government has shown that it puts little emphasis on democratic values and procedures when it comes to strengthening or securing its power position.

Consensus on goals  
9

After the dismantling of the armed forces in the wake of the U.S. military invasion, the main anti-democratic actor disappeared from the national political landscape. Today there is no anti-democratic political actor of any importance. Only vanishing small minorities are followers of extreme ideological ideas on the margins of both sides of the political spectrum. President Martinelli has challenged the political framework in place since the early 1990s by strengthening security institutions, a policy timidly pursued by the Torrijos administration (and then strongly criticized by the opposition Popular Party), but now in full force. He has allowed the construction of forward operation bases off of Panama's coastline against drug trafficking in the country and created a new ministry to coordinate their activities.

Anti-democratic  
actors  
9

In comparison with the previous government, the Martinelli administration is less willing and able to prevent cleavage-based conflicts from escalating. Cleavages become manifest in the dual structure of the country's economy and society and its pronounced social inequalities. Because of the close relationship between the leadership 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 prominent roles during election campaigns. The risk that cleavages will transform into political conflict increases with deteriorating economic and social conditions. Thus, the extraordinary high dependency of the economy on external factors constitutes a latent danger to the cohesion of the country's social fabric. Street protests and strikes regularly used to attempt to sway political decisions and demonstrate public dissatisfaction do not pose a threat to the country's overall

Cleavage /  
conflict  
management  
8

security or political stability. Indigenous communities have mobilized in defense of their rights, but by providing for the creation of semi-autonomous districts for indigenous groups the state has reduced the risk of conflict. The authoritarian inclinations of the current head of state and in particular the controversial Law 30 have repeatedly contributed to an aggravation of social tensions and political problems. On the other hand, various measures such as the significant increase of the minimum wage, the raise of pensions or the new financial assistance to needy persons over 70 have helped to mitigate social disparities.

The Martinelli government tends to neglect civil society participation and to ignore civil society actors. Undoubtedly, in recent years the importance of civil society groups in Panamanian politics has increased markedly. In part, this was provoked by unpopular or “non-democratic” decisions of the government. At the same time the significant weakening of the Democratic Revolutionary Party (PRD) created political space for other social actors. Civil society groups played a key role in the resignation of the secretary of the national anti-corruption agency and the dismissal of Martinelli’s “supplemental” attorney general (November 2010). By mid-2010 the president proposed to hold so-called popular consultations about important national issues. His public security minister defended the idea on the grounds that the consultations would “sidestep the supposed interlocutors of civil society” by reaching out directly to “the people.”

Civil society  
participation  
4

In the Panamanian case the issue of reconciliation refers to both the human rights violations of the military-led regimes and the victims of the U.S. invasion in December 1989. The last proceedings related to this matter ended during the Torrijos years. In sum, there has been a systematic failure in dealing with victims of the military dictatorship and the U.S. invasion, partly because the problem is seen as historical and not relevant to today’s political debate, and partly because no agreement has been reached on the equivalency between the dictatorship’s victims and those from the U.S. invasion.

Reconciliation  
6

A French court has found Panama’s former military ruler Manuel Noriega guilty of laundering money through property purchases and sentenced him to seven years imprisonment. Having already served 20 years in a U.S. prison, including almost three years pending extradition, the former CIA collaborator was finally sent to France in April 2010 to face new charges. Panama has delivered a formal request for the extradition of the former dictator to stand trial in his own country.

## 17 | International Cooperation

The Martinelli government closely cooperates with international partners and donors and tries to use international assistance to foster economic development and achieve its political goals. However, there are still some deficiencies in devising a

Effective use of  
support  
8



consistent long-term strategy to integrate international support effectively. The World Bank, IMF, Interamerican Development Bank (IDB), the United States (USAID) and the European Union rank among the country's most important multilateral and bilateral lenders and donors. Most of the work to modernize the Panama Canal is carried out by foreign companies and consortia. With regard to the presence of foreign know-how in the economically predominant service sector, Panama is the most globalized country in the Western hemisphere.

In general, the government acts as a credible and reliable partner in its relations with the international community. Although deficiencies in core functions of the state apparatus continue to complicate business transactions, Panama is very attractive to investors given its fully dollarized economy with no exchange risk, an absence of barriers to repatriation of funds, low inflation and its stable and sophisticated banking sector. However, a "wikileaks" cable concerning autocratic tendencies of the Martinelli administration, signed by then U.S. Ambassador to Panama Barbara Stephenson, shows evidence of high level questioning of the reliability of the current administration.

Credibility

8

Because of its unique economic structure and a disadvantageous cost of labor, Panama was not willing to join the Central American Economic Community (Sistema de Integración Económica Centroamericana, SIECA) or participate in CAFTA's (U.S.-Central American Free Trade Agreement) cooperation scheme. However, Panama has been member of the political integration scheme of Central America (SICA) and is a member of the Central American Parliament (PARLACEN). In order to be integrated into the EU-Central America Association Agreement, signed in May 2010, Panama formally joined SIECA in July 2010.

Regional cooperation

8

Signed in June 2007, the free trade agreement with the United States still awaits approval by the U.S. Congress. The United States has increasingly leaned on this issue to exercise leverage over Panama. In general, the Panamanian state complies with the rules set by regional and international organizations. However, there are still deficiencies in the implementation of OECD regulations to combat money laundering and tax evasion. President Martinelli has intensified his country's bilateral relations with conservative governments in the region, while the relationship with Latin America's left-wing populists is rather formal.

## Strategic Outlook

In macroeconomic terms, the recent boom period of the international economy made Panama a winner of globalization. Since 2004, the small economy benefited from favorable external conditions and growing domestic consumption. The economic and financial crisis of 2008 caused only a short-term slowdown of the economic cycle. In 2010 the economy grew again by 5% and the inflation rate moved back to a moderate level after having reached an all-time high in 2007–2008, though it remains a major concern and is one of the cautionary notes on Panama's macroeconomic outlook. 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 substantially, thus leading to an attenuation of social disparities. High economic growth, however, does not affect the deep-rooted causes of extreme social inequalities. Since the handover of the inter-oceanic waterway, the Panama Canal constitutes the main stimulus of the economy and has become the single most important source of state revenue. In order to accommodate the aged waterway to the rapidly changing conditions in sea trade, the government launched the largest infrastructure program ever seen in Latin American history. The expansion project, due to be completed in 2014, is being funded by the canal's cash flow and \$2.3 billion in loans from multilaterals.

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. After the completion of the new Panama Canal, transit fees and, consequently, government revenue will increase considerably. At the same time, an economic downturn is very probable and the pressure on the labor market will grow. Steps to enhance productivity in the agricultural sector, including improved access to financing, insurance and technical assistance, will help to 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 at gradually overcoming the country's fundamental social dichotomy. Improving the quality of public schools, especially in rural areas, is essential for widening the range of choices for the poor. Finally, in order to strengthen the basis of the democratic system, efforts against corruption and crime should be intensified. The political elite could set an example by making election campaign financing more transparent. Combating corruption is not merely a technical issue but is closely tied to transforming political culture.