Status Index | 1-10 | 7.32 | # 22 of 129
---|---|---|---
Political Transformation | 1-10 | 7.60 | # 25 of 129
Economic Transformation | 1-10 | 7.04 | # 29 of 129
Management Index | 1-10 | 5.91 | # 34 of 129 scale score rank trend

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2016. It covers the period from 1 February 2013 to 31 January 2015. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at [http://www.bti-project.org](http://www.bti-project.org).


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Executive Summary

Transformation in Panama between 2013 and 2015 has tended toward greater political and economic stability, though significant deficiencies remain. The 2014 presidential and parliamentary elections removed the governing party, Cambio Democrático (CD), from power. Though under President Martinelli (2009-2014) the economy performed very well, his increasingly authoritarian style created considerable resentment. While the constitution prohibits an incumbent president from being re-elected, President Martinelli attempted to maintain his control over power by personally selecting his party’s presidential candidate, José Domingo Arias, a relatively unknown politician. José Domingo Arias’s vice presidential candidate was President Martinelli’s wife. By picking his potential successor, President Martinelli hoped to translate his own high popularity ratings into an electoral victory for the CD, but also to extend his grip on power beyond the end of his term. In the months and weeks before the election, José Domingo Arias led the election polls. However, on 4 May 2014, the presidential candidate of the Partido Panamenista (PP), incumbent vice president Juan Carlos Varela, surprised everybody by winning the election with 39.1% of votes. Until then, Juan Carlos Varela had been third in most pre-election polls. José Domingo Arias (CD) won 31.4% of the vote and Juan Carlos Navarro of the Partido Revolucionario Democrático (PRD) won 28.1% of the vote. Following his election victory, President Varela formed a legislative coalition with the PP’s traditional rival, the PRD. The prosecution of corrupt public officials, including President Martinelli, as well as the less confrontational political style under the Varela administration represents a significant change compared to the previous administration.

Panama continues to enjoy comparatively high economic growth rates, despite a recent slowing down. After exceeding 10% in 2011 and 2012, real GDP growth fell to 8.4% in 2013 and to 7% in 2014. Inflation lost momentum in 2014, due partly to a decline in international food prices, but remained relatively high. The rate of inflation in Panama is above the average rate of inflation among its major trading partners, which is evidence of buoyant domestic demand. Strong
economic growth and a degree of fiscal discipline contributed to a decline in the ratio of public debt to GDP. The current account deficit remained high, because of the cost of imports for major physical infrastructure projects. A high level of FDI will compensate for the large external deficit. Furthermore, living conditions among lower socioeconomic groups has improved due to high economic growth, falling unemployment, increasing employment opportunities in the formal sector and the success of conditional cash transfer programs. However, despite the spectacular economic boom of the last decade, a quarter of the population continue to live near or below the poverty line. Indigenous populations account for an increasing share of the poor and extreme poor, while poverty rates among non-indigenous rural populations have decreased due to urban migration. In recent years, social inequality has increased.

The expansion of the Panama Canal was interrupted in early 2014 due to a dispute between the multinational consortium constructing the new lock system and the Panama Canal Authority. The dispute related to costs running over budget. While modernization of the Panama Canal was originally scheduled to be completed by October 2014, delays have pushed the expected completion date to the first quarter of 2016. In contrast, Metro Line One, Panama City’s first subway line, was completed on time. It has been fully operational since mid-2014 and the number of users has exceeded expectations. Additional metro lines are already being planned.

### 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. The creation of the new political entity was closely related to President Theodore Roosevelt’s aspiration to build an inter-oceanic canal on the land bridge between Mexico and Colombia. Since the construction of the Panama Canal, the country’s history has been strongly tied to this 50-mile long masterpiece of engineering. The United States managed the transit service and exercised quasi-sovereign control over the Canal Zone, a 10-mile stretch between the two entrances of the waterway. Over time, the United States established a dozen military bases in the zone. Up to the mid-1930s, Panama was a de facto American protectorate.

Until 1968 an urban economic elite, aligned with the political, economic and military interests of the United States, dominated domestic politics. A period of weak civilian rule ended with a military coup, 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 inter-oceanic passage were gradually transferred to Panama. 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 a plane crash, General Manuel Noriega took over the command of the National Guard and became the new strongman of the regime. His manipulation of the 1984 elections prevented opposition parties from gaining further leverage within the political system. While the army leadership was the real center of power, the PRD government equipped the authoritarian system with a democratic facade. However, the
Democratic Alliance of Civic Opposition (ADOC) won the 1989 election, though Noriega retained power by declaring the vote annulled. A U.S. military intervention overthrew the regime later that year and the ADOC’s Guillermo Endara became president.

During his term, Endara (1990-1994) made progress in reinvigorating Panama’s political institutions after 21 years of military-controlled government. After the abolition of the armed forces, a new civil police organization (Panamanian Public Forces (Fuerza Pública de la República de Panamá)) became the key actor in the national security architecture. As early as 1994, the PRD staged its political comeback with Pérez Balladares winning the 1994 presidential election. Following his election, President Pérez Balladares implemented an economic reform program that included the privatization of many state-owned companies. Mireya Moscoso - the widow of three-time president Arnulfo Arias and the Arnulfista Party candidate – won the 1999 presidential election. On 31 December 1999, President Mireya Moscoso presided over the defining event in recent Panamanian history, the handover of the Panama Canal. However, when she left office, her government was widely perceived as corrupt, incompetent and ineffectual. In the 2004 presidential race, Martín Torrijos - the son of Omar Torrijos and PRD candidate - won a decisive victory with 47.5% of the vote. During his presidency, the most serious challenges his government had to address were the need to reform the deficit-ridden social security system and the modernization of the aging Panama Canal. In 2006 a referendum, a majority of the voters voted for the expansion of the waterway.

During Torrijos’s presidency, Panama experienced a spectacular economic upturn, the result of extraordinarily favorable conditions in the world market, which significantly eased governing. Nevertheless, the high popularity ratings for President Martin Torrijos had little impact on the 2009 presidential election campaign of Balbina Herrera, Torrijos’ housing minister and PRD candidate. Internal divisions within the PRD and a public perception that Herrera was too far to the left allowed Ricardo Martinelli, a wealthy supermarket magnate, to win. Ricardo Martinelli ran as an independent centrist candidate, backed by his small Cambio Democrático (CD) party with support from the Partido Panamenista (PP). He won a landslide victory winning 60% of the vote against Balbina Herrera’s 37.7%. His coalition also won a majority of seats in the National Assembly. However, because the CD won only 14 seats, Martinelli’s ability to govern was dependent on the support of the PP and the 22 seats it won. PP chairman Varela served as vice president and foreign minister in Martinelli’s government. An agreement between the two politicians proposed that in return for the support Martinelli received, Varela would run for president in the 2014 election with the support of the CD.

After repeated criticism, Varela and the PP withdrew their support for Martinelli when he attempted to amend the constitution to allow him to run for re-election in 2014. During Martinelli’s presidency, the Panamanian economy achieved the highest growth rate in the Western Hemisphere. At the same time, due to the autocratic inclinations of the president, the quality of democracy deteriorated considerably. The Martinelli administration proved to be the most corrupt since the re-establishment of the democratic system in the last decade of the 20th century. The incumbent president’s attempt to rule by proxy for another five years failed in the 2014 elections. The surprising winner was Juan Carlos Varela. Prior to the 2014 presidential election, none of the opinion polls had suggested that Varela would win.
The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

Transformation Status

I. Political Transformation

1 | Stateness

The state’s monopoly on the use of force prevails throughout the country and is not challenged by any important political player. Although indigenous groups in the western part of the country have repeatedly resisted government policies and have clashed with the security forces, they do not advocate a separatist or violent agenda. However, state control is weakest in the remote and inhospitable Darién region near the Colombian border. This jungle area is home to the only gap in the famous Panamericana, which stretches from Alaska to Tierra del Fuego. Drug traffickers and the Colombian guerrilla group, the FARC, use the territory quite freely. The trafficking of drugs has been pushed inland, as maritime patrols have been intensified. Meanwhile, the FARC have operated in Darién region for a long time. They use the area to restock supplies, escape the Colombian military and smuggle cocaine. The Panamanian National Border Service (SENAFRONT) launched several operations against the FARC in 2013, weakening the insurgent’s capabilities in Panama to the point where they could not maintain a permanent presence. In more than a dozen clashes between SENAFRONT and armed groups in the last months of 2013, several people were killed or injured. Panama has continued close cooperation with its neighbors, particularly Colombia, to secure its borders. Even though the security situation in the Darién area has improved, as the intensity of the civil war in Colombia has lessened, incursions by the FARC and drug cartels continue to pose a threat to regional security. Approximately 3,000 migrants were stopped by SENAFRONT in 2013, most of them Cubans. In the period under review, the Panamanian government has stepped up the contingent of SENAFRONT officials at the border with Costa Rica after the activities of criminal gangs had significantly increased in this area. In January 2014, Attorney General Ana Belfon drew attention to substantive evidence that criminal cartels were increasingly infiltrating public institutions.
In principle, all citizens have equal civil rights. Furthermore, no major social or political group rejects the legitimacy of the nation-state and constitution. Public opinion polls report that a very high percentage of respondents are proud of their country and citizenship. In contrast to the wording of the constitution, discrimination against black and other ethnic minority groups is widespread, though it is slowly diminishing. Indigenous communities enjoy a degree of autonomy and self-government. They respect the authority of the political system as long as their rights to autonomy are not violated.

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,” but does not designate it as the official state religion. There are no official statistics on religious affiliation, but various sources estimate that 75% to 85% of the population is Roman Catholic and 15% to 20% belong to other Christian affiliations. The constitution stipulates that Catholicism is taught in public schools. However, parents have the right to exempt their children from religious instruction.

The structures of the public administration extend throughout the country, but are unevenly distributed and their operation is deficient in many respects. Some institutions function ineffectively, especially in rural areas and indigenous communities. Corruption is a major problem affecting many levels of public administration. Because of low level of technical proficiency among employees and lack of financial resources, most municipalities perform rather badly in providing basic services. More than a quarter of the population has no access to adequate sanitation facilities, while 6% have no access to an adequate drinking water source. A large portion of schools in rural areas are in poor condition, even if the situation has improved somewhat in recent years. One in five school age children did not attend any school in 2013.

2 | Political Participation

Since the restoration of democracy and universal suffrage, national and local democratic elections have been conducted regularly. The constitution requires that the president, vice-president, national legislators and local representatives are elected by a popular and direct vote every five years. Since the 1994 presidential election, no party of the incumbent president has succeeded in extending its mandate. Although no legislation protecting democratic principles was violated, the last two presidential elections were not entirely fair. In the 2009 presidential election, the eventual winner Ricardo Martinelli spent much more money on his election campaign than his political opponents. The outcome of the 2014 parliamentary election similarly indicates that those candidates with greater campaign funds have a large advantage.
Hence, electoral fairness is compromised by the inadequate regulation of campaign financing. This criticism has been highlighted by independent observers of the Organization of American States and the Carter Center. A few months later after the May 2014 election, the Tribunal Electoral admitted challenges to 11 legislative results. Ten of these challenges were made against Martinelli’s Cambio Democrático (CD) party. These challenges included allegations that public funds had been misused for campaign purposes. As a result of the investigations into the 11 challenges, the Tribunal Electoral ordered fresh legislative elections in six districts. These elections were held on 21 December 2014. The CD lost five of the 30 seats it had previously won, while President Varela’s Partido Panamenista increased its share of seats from 13 to 17 and the Partido Revolucionario Democrático won one more seat.

By and large, democratically elected political representatives have the effective power to govern. With the abolition of the armed forces, the single most powerful veto player has vanished. Business groups and individuals (mainly in the service sector) exercise considerable political influence, even though no government is likely to act against the interests of the business community due to the structural characteristics of the economy. The lack of clear legislation regulating campaign financing means that wealthy interests have significant political influence. A handful of militant labor unions and indigenous collectives represent the most influential grassroots pressure groups. On several occasions during the period under review, public protests prompted the Martinelli administration to abandon or modify policies. In general, the policy spectrum is narrowly construed. It primarily favors policies that benefit higher socioeconomic groups and promote a neoliberal agenda. Due to the simple majoritarian system and the absence of a hegemonic political party, the ability to govern depends on the formation and stability of parliamentary coalitions. In general, presidents have been able to use state resources to build coalitions in the legislature in order to get their programs approved.

The constitution guarantees freedom of association and assembly. During the period under review, the government generally respected these rights. Nevertheless, police frequently used force to disperse demonstrators, especially when highways or streets were blocked. The use of force against demonstrators blocking transit routes is further supported by legislation, which states that anyone who uses violence to block public roads or causes property damage should be sentenced to six to 24 months in prison. Freedom of association is limited by restrictions on the unionization of workers. To form a private sector union, a minimum of 40 members is required. Legislation permits only one trade union per business establishment. Strikes must be supported by a majority of union members and can only demand an improvement in working conditions, in relation to a collective agreement or to protest repeated violations of legal rights. Strikes called to protest against particular general policy measures or to demand minimum wage increases are forbidden. Public sector employees do not enjoy the right to form unions, but are allowed to set up associations and engage in
collective bargaining. However, public sector worker associations require a minimum of 50 members. There may not be more than one association in a public sector institution and only one chapter per province is permitted. By law, the National Federation of Public Servants (FENASEP), an umbrella federation of 21 public sector worker associations, is not authorized to call strikes or negotiate collective bargaining agreements. This right rests with the individual associations under FENASEP alone.

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. In addition, the right to strike does not apply in sectors deemed vital to public welfare and security, including the police and health service. The government lacks sufficient resources to enforce laws prohibiting employer interference in unions and protecting workers from employer reprisals. In the period under review, union leaders continued to express concerns about government actions, such as delays in union registration and the auditing of union budgets. Union leaders accused the Martínez administration of harassing unions, including false accusations of corruption against labor leaders, setting up roadblocks to prevent workers from gathering and criminalizing social protest. However, in 2013 and 2014, violent clashes between protesters and security forces comparable to those registered in the two previous years, did not occur.

The constitution guarantees freedom of speech and of the press, but these rights (with the exception of internet access) were not really respected in practice. The law allows for the prosecution of journalists for vaguely defined offenses related to the exposure of private information. There are also serious penalties for leaking confidential or defamatory government information. Although libel is a criminal offense, no person has been jailed for it since 2008. However, the Martínez administration repeatedly exerted pressure on critical journalists and newspapers. It was to be expected that the executive branch would continue this undemocratic practice through the last 18 months of his presidency. In May 2013, President Martínez criticized a local reporter and businessman linked to the daily newspaper, La Prensa, after it published stories accusing him of improper ties with several hydroelectric dam contracts. In June 2013, prosecutors issued orders compelling journalists from two different newspapers to reveal their sources, after the newspapers had published articles raising concern about government corruption. There were other cases in which the executive branch violated the press’ right to freedom. In June 2013, both the United Nations and Inter-American Commission on Human Rights special rapporteurs for freedom of expression criticized Martínez’s government for illegally conducting surveillance of journalists and detaining reporters. Because of repeated threats by government officials against journalists, Panama ranked 111 out of 179 countries in Reports Without Borders’ 2013 Freedom of Expression Index, a dramatic decline from 2009 when Panama ranked 55 out of 179 countries. Since the beginning of Varela’s presidency, the working conditions of journalists has apparently improved.
3 | Rule of Law

The constitution establishes nominal separation of powers. However, traditionally the executive branch holds significant authority vis-a-vis the legislature and the judiciary. Things turned worse under the political leadership of Ricardo Martinelli who, from the day he took office, set off to run Panama more like a business. President Martinelli has distinguished himself as a politician who despised the checks and balances of democratic governance, and had no qualms with using authoritarian means to enforce his political interests and objectives. Indeed, he has copied some of the strong-arm tactics of contemporary populist, left-wing presidents of other Latin America countries to control government and secure power for himself. Starting with only 14 seats in the National Assembly, he managed to make his party, Cambio Demócratico (CD), the dominant force within the four-party coalition government. By inciting deputies from other parties to defect in return for committee assignments, jobs in the public administration and other benefits, the CD parliamentary group swelled to 36 delegates. Thanks to his control of the legislative branch, President Martinelli was able to dominate Panama’s political agenda.

President Martinelli also packed the Supreme Court with loyal followers, frequently disregarding the legal regulations for the appointment of judges. Since January 2013, five of the nine judges were appointed by President Martinelli. The influence of the executive over the Supreme Court became clear in October 2013 after the Supreme Court overturned a ruling by the Electoral Tribunal. The Electoral Tribunal had initially prohibited an advertising campaign against the PRD’s 2014 presidential candidate, Juan Carlos Navarro, ruling that it violated his dignity. However, the Supreme Court later overruled the decision, saying that the Electoral Tribunal’s decision had violated free speech. The Supreme Court’s judgment triggered complaints that it had acted outside of its jurisdiction, as the Electoral Tribunal is supposed to have final say over electoral matters. President Martinelli’s plan to amend the constitution to allow the immediate re-election of the incumbent president, led in 2011 to the withdrawal of the Partido Panamenista from the governing coalition. Having failed to change the constitution, President Martinelli attempted to install himself as a power behind the throne by selecting his successor. José Domingo Arias, President Martinelli’s selected successor, was widely seen as a proxy candidate for the outgoing president, especially as President Martinelli’s wife was selected to be the vice presidential candidate. However, this approach also failed, as José Domingo Arias failed to win the election. There have no reported gross violations of the separation of powers under the new government of President Juan Carlos Varela.
Undoubtedly, the judicial branch is the weakest and least functional element of the democratic system. The law provides for an independent judiciary, but in reality, the judicial system is inefficient, and susceptible to corruption and outside influence. Although the lack of an independent judiciary is not a new phenomenon, the manipulation of the judiciary by the government increased significantly under President Martinelli. This was particularly evident in the selection of new judges for the Supreme Court and the inaction of public prosecutors to properly investigate the frequent allegations of corruption made against government officials, including the president himself. The Supreme Court failed to respond when opposition supporters petitioned it to reject the vice presidential candidacy of President Martinelli’s wife on grounds that her candidacy was unconstitutional. While the World Economic Forum acknowledged that Panama had made major economic advances in recent years, its 2014-15 Global Competitiveness Report ranked Panama 116 out of 144 countries for judicial independence. The fact that contract enforcement takes an average 686 days, costs 38% of the value of the claim and requires 32 procedures is evidence of the inefficiency of the judicial system. The main issue facing the justice system is a serious backlog of cases, owing in part to the shortcomings of the inquisitorial system and corruption. It is not uncommon for people summoned to court to have to pay a bribe. A 2011 reform of the justice system intended to change Panama’s inquisitorial system into an accusatorial system. In 2011, the new system was expected to be implemented nationwide within four years. However, in 2013 the legislative voted to delay full implementation of the reform for a further two years.

The law provides criminal penalties for official corruption, but these laws have not been effectively enforced. Corruption is widespread and almost an integral part of the political system. Despite President Martinelli’s electoral pledge to tackle corruption, his government made no progress during his tenure. On the contrary, there is evidence that cases of corruption cases within the upper government increased under his presidency. There were also several allegations of corruption made against the president himself, including an allegation that he, his son, and other government officials demanded bribes from Italian businessmen in exchange for public works contracts. For example, Italian authorities confirmed an allegation that bribes were paid to secure contracts relating to the capital city’s Metro system. The selection of trusted allies to occupy top positions in the Supreme Court and the Prosecutor General’s office explains at least partially the reluctance of these organizations to investigate such allegations. Despite this tendency, some public officials were held accountable for corrupt practices. In August 2013, following pressure from civil society, the National Assembly dismissed the incumbent Ombudsman based on charges made by the Public Ministry that public funds had been mismanaged. President Martinelli’s successor in office, Juan Carlos Varela, who campaigned on a promise to clean up Panamanian politics, has already moved from words to deeds. In November 2014, the National Assembly decided to suspend Supreme Court magistrate Alejandro Moncada, an ally of former President Martinelli, so that he
could be investigated for alleged corruption. Shortly thereafter, prosecutors indicted him, seizing millions of dollars from his bank accounts. In January 2015, the Supreme Court voted in favor of investigating President Martinelli over corruption allegations. The court will appoint a special prosecutor to investigate claims that the former president inflated multi-million dollar contracts during his mandate.

Civil rights are guaranteed by the constitution, but are often violated. Regulations and institutions to prosecute, punish and redress violations of civil rights are in place, but are largely ineffective. There was an obvious tendency of the Martinelli administration to intimidate people who were willing to exercise their civil rights. The principle of equality before the law has limited practical significance for members of lower socioeconomic classes. Although the constitution prohibits torture and other degrading treatment, the Ombudsman’s office reported that prison officials tortured and degraded inmates. Prison conditions are generally harsh and in some cases life threatening. Overcrowding, gang rivalries, a shortage of prison guards and inadequate provision of health services are the main causes for the poor conditions within prisons. Under the inquisitorial regime, pretrial detention in many cases exceeds the minimum sentence for the alleged crime.

Despite legal protections, discrimination against people with darker skin remains widespread within society, as demonstrated by the staggering under-representation of Afro-Panamanians within positions of political and economic power. Legally, indigenous persons have the same political and civil rights as other citizens with special protections for ethnic identity and native languages. Furthermore, indigenous communities have a legal right to participate in policy decisions that affect their lands, cultures, traditions and the exploitation of natural resources. There are legally designated territories governed by traditional community leaders for five of the country’s seven indigenous groups (comarcas). During 2013, indigenous groups came into conflict with the government on several occasions over government decisions that affected indigenous land. In July 2013, the U.N. special rapporteur on the rights of indigenous peoples urged the Martinelli administration to respect international standards, and cooperate with indigenous authorities to protect their lands and natural resources.

In general, the right to life and security is affected by the high crime rate. Overall, there were 654 murders in 2012, a decrease from 759 murders in both 2011 and 2010. For 2012, the murder rate was 17.2 murders per 100,000 people. However, the murder rate in Panama City was three times higher at 53.1 per 100,000 people.
4 | Stability of Democratic Institutions

Traditionally, Panama’s democratic institutions performed their functions more or less effectively and were free from extensive, counterproductive frictions. During the presidency of Ricardo Martinelli (2009-2014), democratic institutions were severely affected by the president’s multiple attempts to expand executive prerogatives. He showed little tolerance for political opposition or separation of powers. Because cronies close to President Martinelli often held senior positions, which should have been politically independent, the performance of state institutions worsened. There are clear indications that, under the new government of President Varela, democratic values are more respected and that the country is rapidly returning to the political normality of the pre-Martinelli years.

In principle, all relevant political and social actors accept democracy as the “only game in town.” Moreover, responses to public opinion surveys suggest that democracy is widely accepted as the best form of government. During the presidency of Martinelli, the government was the only important actor that systematically damaged the democratic pillars of the nation-state. Meanwhile, the frequent criticism from opposition parties and civil society of the authoritarian conduct of President Martinelli is evidence of a broad commitment to democratic attitudes and beliefs. At the same time, among the political elite and a segment of the population there is a more pragmatic (i.e., opportunistic) attitude toward democratic values. The picture is ambivalent. On the one hand, despite undemocratic tendencies, President Martinelli almost until the end of his term retained exceptionally high popularity ratings. However, the majority of the electorate demonstrated an unwillingness to support his attempt to hold on to power through his personal selection of his party’s presidential candidate.

5 | Political and Social Integration

Since the fall of the military regime and until recently, Panama has had a two-party system, split between the Revolutionary Democratic Party (PRD) and the Panamenista Party (PP). The PRD was founded in 1979 by General Omar Torrijos in order to provide the military regime with a political platform. The PP emerged in the mid-1940s from a political movement created by Arnulfo Arias, the other great caudillo of 20th-century Panamanian politics. While voter volatility is moderate, there are enough swing voters to ensure a regular turnover of power between parties. The supermarket tycoon Ricardo Martinelli won the 2009 presidential election leading a coalition of the PP and his own Cambio Democrático (CD) party, which in the 2004 elections had won only 5% of the votes. The PRD and the PP have some loose grassroots party organizations, which they rely on to mobilize support. However, the CD lacks any significant grassroots affiliations and is primarily a vehicle for the political ambitions of Ricardo Martinelli. Beyond these three parties,
most other parties are very weak and only attract attention around election campaigns. Most parties, including the PRD and PP, lack a clear ideology. Their programs are rather pragmatic and their organizational structures are dominated by a few prominent personalities. The low degree of polarization in the party system was confirmed by the very thin ideological and programmatic differences between the top three candidates in the 2014 elections. There is a relatively high level of party affiliation in Panama with registered party members accounting for more than half of the total electorate. This is due largely to the clientelistic style of political parties. It is common for the membership of the party considered most likely to win an upcoming election to increase. After quadrupling its membership in the three years following the 2009 elections, the CD lost nearly 20% of its enrolled members between April 2014 and January 2015. At the same time, membership of the PP increased by almost 10%. Due to its personalistic nature, it is unlikely that the CD will establish itself as a political party as strong as the PP and PRD.

The most influential interest groups are those from the business sector (especially the service sector) and a handful of labor unions. One of the main changes in national politics has been the increasing importance of civil society groups, despite unamenable disposition of the Martinelli administration. Indeed, as a result of the former president’s deliberate weakening of the parliament and judiciary, the necessity for civil society groups to act as a counterbalance to government has grown. President Martinelli’s autocratic style became so explicit that opposition emerged within the business community. Several times, the president revised decisions in response to public criticism. Nonetheless, civil society remains generally weak. In the last years, indigenous groups have exercised increasing power to mobilize to defend their rights to autonomy. In general, the social interests of the poorest and most vulnerable groups, such as small-scale farmers, workers in the informal sector and ethnic minorities, are poorly represented in the political system.

Over the past quarter of a century, consent for democracy has been moderate to high. However, recent survey data indicates that there has been a decline in support for democracy among citizens. According to data from Latinobarómetro, the proportion of the population that considers democracy the best possible form of government decreased from 60% in 2011 to 49% in 2013. The share of those who classified democratic and authoritarian forms of government as equivalent increased over the same period from 11% to 26%. This is evidence of a growing dissatisfaction with the democratic system. Furthermore, 38% of survey respondents agreed with the statement that democracy is possible even without political parties, while a similar proportion of respondents agreed that democracy could exist without a parliament. These results indicate low public trust in political institutions. In 2013 data published by Latinobarómetro, 43% of respondents were satisfied with the performance of the Martinelli administration. In a similar survey, the Panama based market research agency, Dichter & Neira detected significantly higher approval ratings. According to this source, the government left office with an approval rate of 65%.
Compared with other countries in Latin America, social capital is relatively underdeveloped in Panama. While interpersonal trust might be relatively robust (69% of respondents stated that they trust others, Americas Barometer 2012 survey), participation in community groups is relatively low. Patterns of cooperation and mutual support between citizens are traditionally more widespread among indigenous groups. In recent years, the state has launched several initiatives to promote and support citizens in overcoming pressing social problems. For example, the Redes Territoriales program focused on 116 municipalities with high poverty rates in 2014. Through cooperation between central government, civil society and private enterprises social challenges can be tackled effectively. The Varela administration adopted a similar approach with its Mi Escuela Primero program, which aims to renovate school facilities with the assistance of parents and pupils.

II. Economic Transformation

The World Bank categorizes Panama as an upper middle-income country. GDP per capita (PPP) stood at $16,379 in 2013. 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 (HDI) coefficient (0.765). In the UNDP’s 2014 Human Development Report, Panama ranked 65 out of 187 countries, with only four Latin American countries ranked higher. The 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 spectacular economic boom of recent years coincided with an increase in income inequality. Panama’s 2012 Gini coefficient value of 0.519 underestimates the real level of economic inequality within Panama, since the coefficient excludes capital assets. The inequality adjusted HDI score in 2013 was 0.596. With regard to the UNDP’s Gender Inequality Index, Panama ranked 107 out of 149 countries with a score of 0.506, 42 places lower than in the overall HDI. According to the U.N. Economic Commission for Latin America and the Caribbean (ECLAC), the proportion of the population living in conditions of poverty fell from 37% in 2002 to 26% in 2009 and to 23% in 2013. Meanwhile, the proportion of the population living in conditions of extreme poverty fell from 18.6% in 2002 to 12.2% in 2013. However, over 50% of rural populations live in conditions of poverty, while over 90% of indigenous peoples live in conditions of poverty,
indicating an extreme level of exclusion. In the Ngöbe-Buglé comarca there are only two physicians for a population of 157,000, while in the Kuna Yala comarca there are no doctors for a population of 33,100. Because families that belong to lower socioeconomic classes have more children on average, poverty is more widespread among minors. In 2012, 43.7% of children under the age of 10 were living in conditions of poverty, with 25.6% of under 10 year olds living in conditions of extreme poverty. Most poor people work in the informal sector, where more than 40% of the overall workforce is employed.

<table>
<thead>
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<th>Economic indicators</th>
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<th>2013</th>
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<tr>
<td><strong>Unemployment</strong></td>
<td>%</td>
<td>9.8</td>
<td>6.5</td>
<td>4.1</td>
</tr>
<tr>
<td><strong>Foreign direct investment</strong></td>
<td>% of GDP</td>
<td>7.1</td>
<td>8.8</td>
<td>11.8</td>
</tr>
<tr>
<td><strong>Export growth</strong></td>
<td>%</td>
<td>11.3</td>
<td>5.0</td>
<td>-</td>
</tr>
<tr>
<td><strong>Import growth</strong></td>
<td>%</td>
<td>11.2</td>
<td>26.0</td>
<td>-</td>
</tr>
<tr>
<td><strong>Current account balance</strong></td>
<td>$ M</td>
<td>-1021.8</td>
<td>-3076.3</td>
<td>-4919.5</td>
</tr>
<tr>
<td><strong>Public debt</strong></td>
<td>% of GDP</td>
<td>66.2</td>
<td>44.1</td>
<td>41.7</td>
</tr>
<tr>
<td><strong>External debt</strong></td>
<td>$ M</td>
<td>8108.5</td>
<td>11381.6</td>
<td>16471.0</td>
</tr>
<tr>
<td><strong>Total debt service</strong></td>
<td>$ M</td>
<td>1759.7</td>
<td>1046.4</td>
<td>1667.0</td>
</tr>
<tr>
<td><strong>Cash surplus or deficit</strong></td>
<td>% of GDP</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Tax revenue</strong></td>
<td>% of GDP</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Government consumption</strong></td>
<td>% of GDP</td>
<td>13.2</td>
<td>12.3</td>
<td>-</td>
</tr>
<tr>
<td><strong>Public expnd. on education</strong></td>
<td>% of GDP</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Public expnd. on health</strong></td>
<td>% of GDP</td>
<td>5.2</td>
<td>5.7</td>
<td>4.9</td>
</tr>
<tr>
<td><strong>R&amp;D expenditure</strong></td>
<td>% of GDP</td>
<td>0.25</td>
<td>0.20</td>
<td>-</td>
</tr>
<tr>
<td><strong>Military expenditure</strong></td>
<td>% of GDP</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

Sources (as of October 2015): The World Bank, World Development Indicators 2015 | International Monetary Fund (IMF), World Economic Outlook, October 2015 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2015.
Panama scored 64.1 and ranked 68 out of 178 countries in the Heritage Foundation’s 2015 Index of Economic Freedom. In the South and Central America region, Panama ranked 14 out of 29 countries. According to the World Bank’s 2015 Doing Business Survey, starting a business in Panama requires five procedures, takes on average six days and costs 6.4% of income per capita, which indicates that it is easier to start a business in 2015 than it was in 2012. However, the President of the National Council of Private Enterprise claimed in January 2015 that it requires more time to complete the procedures for starting a business than reported in the Doing Business 2015 report. In the 2015 report, Panama ranked 38 out of 189 economies for ease of starting a business, which was a decline from 2012 when it ranked 29. For ease of getting credit, Panama ranked 17 out of the 189 economies. Dealing with construction permits requires 15 procedures (a decrease from 17 in 2012) and takes on average 101 days (a decrease from 113 in 2012). Enforcing a contract requires 32 procedures, takes on average 686 days and costs 38% of the value of the claim. Panama ranked 84 for enforcing a contract, an increase from 119 in 2012. However, this was mainly due to the deterioration among other countries.

Because of its open economy, Panama has few barriers to market access. There are no formal restrictions on capital flows or discrimination between foreign and domestic investment, and in principle there is no discrimination between enterprises. After being ranked 40 in the World Economic Forum’s Global Competitiveness Report 2012 – 2013, Panama consolidated its position the following year, before dropping eight places to 48 for the 2014 - 2015 report. The World Economic Forum attributed the drop to a deterioration in the perceived functioning of institutions, most notably in terms of an inability to fight corruption and improve government efficiency. The informal sector is still considerable, employing 40% of the total workforce. In addition, as prices for basic foodstuffs increased considerably, President Varela introduced temporary price controls on 22 basic goods after his election.

Nonetheless, Panama continues to rank second to Chile among Latin American countries and is once again the most competitive economy in Central America. In a recent World Bank study comparing the competitiveness of the largest cities in Central America, Panama City ranked top of the list.
The introduction of competition policy in Panama was part of a process of economic modernization and structural change in the country initiated in 1994 after the election of President Ernesto Pérez Ballares. His administration began transforming Panama’s corporate state structure from one that was subject to many controls into one that was private sector-led and responsive to market incentives. The explicit aim of the economic liberalization was to increase overall efficiency in the economy and improve the allocation of resources. Privatization of state enterprises and of government assets together with market liberalization, spearheaded the country’s economic transformation. The government privatized and liberalized large parts of the economy to make it more efficient and competitive. It also created regulatory institutions to assist in the implementation of market reforms. To ease general competition, the government eliminated the agency that managed price controls and passed Law 29 in 1996, which created a combined competition and consumer protection agency. Ten years later this body was transformed into the current Autoridad de la Protección del Consumidor y Defensa de la Competencia (ACODECO). According to an OECD/IDB report published in 2012, ACODECO despite scarce financial funding has managed to perform well. In the Global Competitiveness Report 2014-2015, Panama ranked 51 out of 144 countries and 5 among Latin American countries for the effectiveness of anti-monopoly policy.

Panama’s economy has focused on free trade. In the World Bank’s 2015 Doing Business Survey, the country occupies the 9th place in the ranking of 189 economies on the ease of trading across borders. Exporting a standard container of goods requires three documents, an average of ten days and costs $665. Importing a container of goods requires three procedures, an average of nine days and costs $1,030. The country has signed more than a dozen of bilateral free trade agreements with a number of Latin American countries, among others. Five years after the original negotiations a free trade agreement with the United States (TPA) entered into force in October 2012. Since then, over 87% of U.S. exports of consumer and industrial products, and over 50% of agricultural products to Panama have been duty-free. The TPA requires Panama to the removal of its remaining tariffs over the next decade, with the exception of tariffs on U.S. farm products that should be phased out within 15 years. The treaty also provides easier access for U.S. companies to Panama’s large service sector markets. In the year after the TPA became effective, bilateral trade grew by approximately 20%. President Martinelli was eager to join the Pacific Alliance trade bloc, which requires free trade agreements among all bloc members. Panama already had treaties with Peru and Chile, while in June 2013, a deal was agreed with Colombia. In May 2013, trade negotiations began between Panama and Mexico, and were concluded by the end of November 2014. However, in January 2015, Panama suspended the implementation of its free trade agreement with Colombia, after Bogotá imposed a special tax on textiles and footwear coming from the Colón Free Zone. Panama is member of WTO since 1997.
Panama City is home to the second largest international banking center in the world next to Switzerland. The most important competitive advantage for Panama’s banking sector is the country’s dollarized economy. As of November 2014, the banking sector comprised 91 banks. Of these 91 banks, 50 were full-service general-license banks, open to the general public, while a further 27 were international-license banks, authorized to receive deposits only from non-Panamanians. The remaining 14 financial institutions are categorized as banks with a license for representation (licencia de representación). Offshore banking in Panama is tax-free and provides complete privacy. The International Banking Center (IBC) ended November 2014 with total assets of $108.2 billion, an 11.7% increase over November 2013. The ICB has more than 18,000 employees, a payroll sum that exceeds $200 million a year and investment expenditures in fixed assets (e.g. buildings and equipment) totaling almost $500 million.

Because Panama uses the U.S. dollar as legal tender, Panama has no central bank. The National Bank of Panama fulfills certain functions of a central bank, such as serving as a clearinghouse of the banking sector. According to World Bank data, the ratio of nonperforming loans to total gross loans held by banks was about 1% between 2012 and 2013. An independent Banking Superintendence oversees the financial sector, but is only partially able to comply with international standards. The large financial sector attracts both foreign capital investors and money laundering. Although Panama has made progress in improving financial transparency in recent years and was removed from the OECD’s “grey list” (i.e. a list of tax havens), serious problems and risks still persist. According to a statement by an IMF evaluation team in February 2014, Panama remains highly vulnerable to the laundering of money from drug trafficking and financial fraud. The IMF criticized the limited implementation of Financial Action Task Force (FATF) recommendations designed to combat money laundering. The Colombian government added Panama to its list of tax havens in October 2014, after Panama refused to share information about Colombian assets being held in its banking center. According to Fitch Ratings, the recent revision of Panama’s bank capital rules implies an important step toward Basel III standards, yet would fall short of full adoption.

8 | Currency and Price Stability

The official currency is the balboa, which has been pegged to the United States dollar since independence was secured in 1903. Balboas are available only in coin form up to a maximum value of one balboa. Panama does not, however, print its own paper currency and instead uses the U.S. dollar as legal tender. Thus, the government has no control over foreign exchange, while fiscal policy is the government’s only mechanism of regulating inflation. Historically, inflation rates have been relatively low. However, high international commodity prices and domestic economic growth as well as increases in Value Added Tax, the minimum wage, foreign direct
investment and the public budget deficit have pushed inflation above historical averages in recent years. Annual inflation was 2.6% for 2014, a decrease from 3.9% in 2013 and 5.7% in 2012. However, the prices of basic foodstuffs rose considerably above average. This issue became a major concern for voters in the 2014 elections and contributed to the popularity of presidential candidate Varela, who pledged to regulate prices for basic food staples. President Varela’s first act after taking office was to introduce price controls on 22 basic goods in order to reduce inflation.

Although the public budget deficit is capped at 2% of GDP, in recent years the executive has used various clauses to justify running a higher public deficit. These justifications include carrying any “unused” spending over from the previous year’s budget. In 2013, the fiscal deficit was equivalent to 3% of GDP due to higher public investment. Previously the parliament had revised the ceiling, allowed under the Social and Fiscal Responsibility Law, to allow for emergency expenditure, such as the costs related to flooding in 2012. As long as financing conditions remain favorable and GDP growth continues to be strong, there should be little difficulty managing the relatively high fiscal deficit. In addition, considerable public investment is a key driver of high and stable economic growth. While public debt is on the rise in absolute terms, due to the buoyancy of the economy, the ratio of public debt to GDP is declining. The ratio fell from 66% in 2005 to approximately 42% in 2013. The ratio of public external debt to GDP decreased from 39.1% in 2010 to 28.7% in 2013. A series of fiscal reform packages designed to simplify tax collection, increase revenues and attract foreign investment has helped drive government debt down. Current public debt levels are sustainable and fairly resilient to external shocks. Given the sound economic environment, public debt is projected to decrease to about 32% of GDP in the medium term.

The current account deficit increased to 11.9% in 2013, reflecting a slowdown in (service) export earnings and an increase in import costs driven by the technology needs of several large infrastructure programs. As in recent years, high FDI inflows are the main source for the compensation of the large external deficit. In April 2013, all three rating agencies confirmed their BBB rating for Panama, one notch above investment grade and comparable to Brazil, Mexico and Peru. In view of the increasing fee revenues after the completion of the Canal expansion works, the Martinelli administration created the Panama Savings Fund (Fondo de Ahorro de Panama, FAP). The government envisages that annual payments made by the Panama Canal Authority (ACP) in excess of 3.5% of GDP are to be channeled to the FAP. The core purpose of the FAP is to use this income to carry out countercyclical fiscal policy to compensate for economic downturns as well as respond to natural disasters and pay off public debt. Because of the foreseeable delays to the completion of the new Panama Canal facilities, the FAP will not be fully operational until 2016. Therefore, at the end of October 2014, the National Assembly adopted legislation allowing the executive to increase the budget deficit ceiling for 2015, if the ACP is unable to make financial transfers equivalent to 3.5% of GDP.
9 | Private Property

Private property rights are generally protected by law, but the application of legal norms is inefficient and often subject to corruption. Globally, Panama ranked 61 out of 189 countries in the World Bank’s Doing Business survey concerning registering property. Completing property registration requires seven procedures, an average of 22.5 days and costs 2.4% of the property value. The Heritage Foundation and Wall Street Journal’s 2015 Index of Economic Freedom ranked Panama similar to Paraguay and Honduras, and substantially worse than Colombia, Brazil and Mexico for property rights. This low rating is further supported by the large number of reports the U.S. embassy in Panama has received concerning property-related fraud or corruption by U.S. investors as well as complaints from U.S. businesses concerning inconsistent handling of their concessions. These issues are due to an inefficient and corrupt judicial system, and a lack of political will for change.

The legal framework for a functional private sector exists. Private enterprises represent the backbone of the economy, but a few state-owned companies remain. The Panama Canal Authority (ACP) is the largest state-owned company. Since taking over the responsibility for the canal, the ACP has continuously been improving its services. In the private sector, representatives of private enterprises regularly complain about the time-consuming bureaucratic procedures that undermine their economic activities. Taking advantage of Panama’s geographic location, multinational companies have established distribution bases in Panama to access Central American, South American and the Caribbean markets.

10 | Welfare Regime

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 geographical region, social stratum and economic sector. The CSS mainly benefits employees in the formal sectors of the economy and covers only a part of the rural population. Those who are self-employed can make voluntary contributions to qualify for CSS benefits. Since 2010, the number of people enrolled in the CSS increased by approximately 170,000. At the end of 2013, there were 1.19 million people registered as contribution payers, while a total of 1.42 million people are entitled to use CSS services. The number of pensioners rose from 182,000 in 2009 to 235,000 in late 2013. Currently, the monthly pension minimum is $175 and the maximum is $1,500. From 2010 to 2013, the number of CSS employees grew by 12% to 15,927, among the new entrants, there were 659 physicians and 660 nurses.
Fulfilling an electoral pledge, the Martinelli administration implemented a program of cash transfers for elderly people who do not qualify for a pension within the CSS scheme. The program known as “100 at 70” provided $100 per month for people over the age of 70. President Varela expanded the program by lowering the eligibility age to 65 and raising the monthly amount to $120. Since 2006, the Red de Oportunidades conditional cash transfer program provides grants to poor families for ensuring their children attend school, and to ensure mother and infant health controls, child growth monitoring and vaccination schedules. In 2014, almost 73,000 households took part in the program, with a total of 362,800 beneficiaries. In contrast, public expenditure on universal, non-targeted subsidies has been high and ineffective, including price reductions for piped water and electricity.

A number of institutions and political programs work to compensate for gross inequalities, though their efforts remain insufficient. Equality of opportunity is enshrined in law, but implementation is undermined by corruption, limited resources and a lack of political will. Discrimination is outlawed, but Afro-Panamanians and those of indigenous origin suffer from labor exclusion. Women increasingly make up a higher proportion of the labor force, but are more susceptible to discrimination than men. While social data indicate that women are disadvantaged in general, women from the upper social strata have significantly easier access to higher education, better jobs and public office. As a rule, women are underrepresented in political office. Only 13 of the 71 members of the current National Assembly are female. Policy issues concerning the most disadvantaged and vulnerable groups in society are usually only addressed during election campaigns. The increase in employment among lower socioeconomic classes was primarily driven by improvements in the macroeconomic environment.

11 | Economic Performance

The country’s unique economic structure is dominated by a conglomerate of outward-oriented service branches, accounting for about 80% of GDP. The primary service branches include the Panama Canal, Colón Free Zone (the second largest free trade zone worldwide), container ports, registration of merchant ships, as well as banking and insurance sectors. Panama has been the fastest growing economy in Latin America for the last few years. The average economic growth rate between 2010 and 2013 was close to 9%, although it decreased from 8.4% in 2013 to 6.7% in 2014. Over the last eight years, GDP more than doubled in nominal terms. The drivers of this dynamic economic growth have been a series of projects aimed at modernizing Panama’s physical infrastructure, including the expansion of the Panama Canal, Panama City’s international airport and the national highway network as well as the construction of a metro system in Panama City and a third bridge over the Panama Canal. Another important driver of economic growth was the unprecedented boom in
real estate in the heart of Panama City. The unemployment rate declined to 4%, an all-time low. The inflation rate decreased from 5.7% in 2012 to about 4% in 2013. Since 2010, there has been little substantial decrease in the public budget deficit, though there has been a modest decrease from 4.4% of GDP in 2013 to 4.1% of GDP in 2014. The current account deficit amounted to $4.9 billion in 2013, an increase from $3.5 billion in 2012. At the end of November 2014, public debt was over $18 billion, an increase of $2.4 billion over the year. Net inflows of foreign investment were equivalent to 11.8% of GDP in 2013, compared to 13.2% in 2011 and 8.7% in 2012. The World Bank forecasts economic growth to be 6.1% in 2015 and 5.2% in 2016.

12 | Sustainability

Panama is rich in biodiversity with the greatest diversity of wildlife in Central America. At the beginning of the 21st century, primary forests covered around 40% of national territory, a decrease from 70% half a century earlier. Besides deforestation, major environmental issues include water pollution (e.g. high levels of toxic chemicals in Panama Bay), collapse of fisheries, threats to wildlife habitats, land degradation, soil erosion and the destruction of wetlands (e.g. over the last few decades more than half of Panama’s mangrove forests have been lost). Rural poverty continues to undermine Panama’s reserves of natural resources. There are 76 different protected areas (e.g. national parks and wildlife reserves), which cover approximately 25% of national territory.

The government agency primarily responsible for environmental protection is the Autoridad Nacional del Ambiente (ANAM). There are a handful of independent civic and non-governmental organizations, which act as environmental watchdogs. Panama is the only country in Central America that requires an environmental assessment to be undertaken before a large-scale physical infrastructure project can begin. According to the President of the National Council of Private Enterprise, a procedure with ANAM may take up to one year to complete. The largest project for which ANAM has conducted an environmental assessment, during the review period, is the construction of a mega port close to the Caribbean entrance of the Panama Canal. The port is designed to accommodate post- and super post-Panamax ships and is expected to cost $8 billion. As in most countries, ecological risks are not internalized within economic development strategies. In other words, money takes precedence over conservation with relevant civil society groups too weak to influence the process.
Despite some progress in recent years, Panama’s education system continues to be plagued by significant inequalities in coverage and quality with substantial differences between urban and rural areas. In 2012, about 70% of primary schools were “multigrado” facilities (i.e., taught several grade levels simultaneously). Between 2010 and 2014, the Martinelli administration invested around $240 million in repairing, restoring and building hundreds of schools. Panama ranked 93 out of 144 countries in the Global Competitiveness Report 2014-2015 for quality of primary education. In 2013, one in five children did not attend any school. According to 2012 data, 13,000 children left school prematurely, while over 5,000 teachers had not received proper training. The Martinelli administration significantly increased teachers’ salaries, as a means of attracting better qualified individuals.

Children from higher socioeconomic backgrounds usually attend private schools. There are 42 private primary schools in Panama City with annual fees between $650 and $3,650, while private colleges in the capital have annual fees between $800 and $5,000. The University of Panama is the largest university in the country. The higher education system also includes, in addition to a number of private institutions, the Technological University of Panama. However, the quality of education provided by the University of Panama is undermined by politicization, bureaucratic inefficiencies and inadequate financial resources. The national literacy rate is 94%, but varies significantly between urban and rural areas. Literacy rates among indigenous communities are especially low. A historical obstacle to innovation in the education system has been teachers’ unions. The poor quality of public schools positively correlates with the lack of skilled workers. The shortage of skilled labor is exacerbated by legislation mandating that 90% of employees must be Panamanians. The vast majority of Panama’s management positions are held by non-Panamanians or national citizens who studied abroad. The country’s R&D spending is below 0.3% of GDP. However, given the specific structure of the national economy, this is not a substantial handicap.
Transformation Management

I. Level of Difficulty

Panama’s structural constraints stem from the very nature of the country’s economic and social systems. Because both economic development and tax revenues depend heavily on the Panama Canal, and the performance of the outward-oriented service branches, the country is highly vulnerable to external economic influences. Significant economic growth in the last ten years has helped to ameliorate underlying structural constraints. This economic growth has been driven by the expansion of the Panama Canal and other major physical infrastructure projects, rising foreign direct investment, and higher government expenditures. Despite declining poverty rates, Panama remains a country with deep economic and social inequalities. The metropolitan area of Panama City has experienced unprecedented levels of growth and economic activity in recent years, while rural and indigenous communities continue to struggle from a lack of basic service provision and limited economic opportunities. Violent crime, perpetrated largely by street gangs, is a serious threat to public security in Panama City and other cities. Transnational crime networks, particular drug traffickers, have infiltrated social and economic structures, while money laundering is a persistent problem. Widespread corruption, inefficient institutions and a judicial system that lacks independence and professionalism are major structural constraints. While some sectors of the economy can claim First World status, many other sectors, especially the judiciary, display typical Third World features. There is broad consensus over core democratic principles, although the strength of this consensus is strongly influenced by economic trends. With the end of President Martinelli’s term, the democratic prospects for the country have improved.

Historically, civil society mobilization has been moderate in Panama. Survey evidence suggests that participation in civic organizations is relatively low compared with other countries in Latin America. Business groups exert much more influence over political processes than civil society actors. However, during particular junctures Panamanians have mobilized to a considerable extent to articulate certain political concerns or goals. For example, mass demonstrations during the late 1980s sought to topple the Noriega regime. In the 1990s, labor and student groups joined forces to oppose neoliberal economic reforms including privatization programs.
Under President Martinelli, indigenous groups successfully protested against mining concessions that applied to their autonomous territories. Labor unions mobilized several times to protect their organizational rights and the economic interests of their members. Given the de facto neutralization of the separation of powers by President Martinelli, civil society groups proved to be too weak to act as an effective opposition to government. After a number of major corruption cases became public, with allegations made against prominent officials within the Martinelli administration, several large-scale, nationwide marches were organized in November 2014 against the idea of “Corruption with Impunity.”

As social indicators demonstrate unequivocally, deep social inequalities divide Panamanian society. A quarter of the population still live in conditions of poverty. The economic boom of the last decade has contributed to a reduction in the number of people living in conditions of poverty, but there has also been a further widening of the gap between upper and lower socioeconomic classes. Although there are ethnic tensions and conflicts, they regularly remain on the edge of political events. Political violence is almost non-existent and most conflicts are settled through negotiations. Generally, governments have demonstrated a willingness to retract or revise policies against which strong public protests form. On several occasions, the Martinelli administration deployed security forces to control public protests. In a few cases, clashes between the security forces and protesters led to fatalities. Violence is strongly correlated with crime. According to official sources, in early 2013 there were 355 youth gangs in the country with a total of 7,500 members. The Varela administration has launched “Barrios seguros con más oportunidades y mano firme,” which aims to reintegrate gang members back into society. However, there are severe punishments for gang members who refuse to participate in the program. By the end of 2014, 2,000 gang members had joined the program.
II. Management Performance

14 | Steering Capability

In the context of an unstable and crisis-prone economy, governments have traditionally given priority to short-term political goals, thereby neglecting strategic objectives. In the last ten years, the economy has performed well and been stable, driven mainly by favorable external conditions. Since 2007, the modernization of the Panama Canal as well as other large physical infrastructure projects have stimulated domestic demand, consolidating the economy. This stable macroeconomic growth has enabled government to shift its focus toward key strategic economic objectives, which will form a long-term basis for social and political stability.

However, many projects are financed through deficit spending, funded by foreign loans, which could undermine future economic stability. Furthermore, the approach of presidents to appoint officials based on political loyalty rather than technical skills has long been a constraint of strategic planning. Strategic planning has also been hindered by the process of replacing an entire administration’s bureaucratic staff between changes of government. This discontinuity has been exacerbated by the fact that no ruling party has ever won two consecutive presidential elections, since the return to democracy in 1990. Unlike most of his predecessors, President Varela has staffed many ministerial posts with people who already occupied senior positions in previous governments. At the beginning of 2015, the Ministry of Economy and Finance announced the Government Strategic Plan 2015-2019, which proposes investing around $19.5 billion into social development. This includes education, basic sanitation, drinking water, housing, transportation, health, agriculture, energy and security.

Strong economic growth has significantly increased government revenue. The Martínez administration was able to implement the majority of its policy proposals, particularly regarding large physical infrastructure projects. However, the expense of these projects has led to relatively high budget deficits, which have increased public debt. In addition, the expansion of the Panama Canal has cost substantially more than was originally calculated. In January 2014, the international consortium, Grupo Unido por el Canal (GUPC), suspended work for several weeks in order to force the government to cover unanticipated costs of $1.6 billion. After the Spanish government became involved in mediating the dispute, the consortium resumed work. In December 2014, an independent arbitration panel accused the state-owned Panama Canal Authority (ACP) of unfairly violating the terms of its contract with the GUPC. According to the ruling, the ACP was liable for the unanticipated costs.
because it had failed to detect the existence of geological fault lines that ran underneath the canal. The project had initially been expected to be completed by October 2014, but will not be finished now until early 2016. President Martinelli was able to realize most of his political goals with little resistance because he succeeded in restricting the power of parliament. His administration has not fulfilled its promise to fight corruption. On the contrary, the Martinelli administration proved to be much more corrupt than any government since 1989.

The last few governments exhibited a capacity for changing course when confronted by strong public protests. This reflects the culture of transaction that is fundamental to Panama’s political landscape. President Martinelli’s autocratic approach toward governing several times provoked substantial opposition, thus causing the executive to repeal laws or to make political concessions. Overall, the spectrum of policy options is rather limited. Panamanian elites are culturally, socially, economically and politically rooted in a neoliberal mentality, which emphasizes limited state intervention and private enterprise. The neglect of primary education has been shaped largely by the preferences of higher socioeconomic groups, with most wealthy parents sending their children to private schools. Other public services, such as waste collection and public security, are similarly neglected, as the highest income quintile purchase services privately. Panama has a large private security sector. There are more than twice as many private security guards (978 per 100,000 people) as there are police officers (423 per 100,000 people). The lack of long-term policy efficiency and the dearth of technocratic skills among bureaucrats also hinder policy learning. In summary, it can be emphasized that learning processes occur, but rarely lead to innovative approaches with respect to designing and implementing policies. The performance of the Varela administration is likely to be affected by its ability to learn from the high level of corruption under the previous Martinelli administration, the ongoing prosecutions of public officials and President Martinelli’s repeated violation of democratic principles.

15 | Resource Efficiency

Traditionally, human capital has been inefficiently utilized, because senior public appointments have prioritized political loyalty over technical skills. Thus, limited professionalism, a lack of technical skills and widespread corruption are major obstacles to efficient government operation. The public budget available to governments today is higher than ever, because of buoyant economic growth and rising tax revenues. Yet, there is no evidence that the Martinelli administration made any significant efforts to improve human capital formation or move towards a more meritocratic bureaucratic system. Under President Martinelli, the state bureaucracy continued to be characterized by corruption, inefficiency and a vulnerability to political manipulation. President Martinelli awarded numerous government contracts
without due process, which inflated public expenditure. After several government contracts were awarded contentiously, the Panamanian Association of Business Executives (APEDE) stated in August 2013 that public procurement processes should be conducted with greater transparency, integrity and respect for the law. In April 2013, a new independent tax administration unit - the Autoridad Nacional de Ingresos Públicos (ANIP) - was created. The ANIP replaced the Dirección General de Ingresos and is placed under the responsibility of the Ministry of Economy and Finance (MEF). Since its creation, the ANIP has improved tax collection and reduced tax evasion. Yet, tax receipts before and after the creation of the ANIP never met expectations. This has forced the government more than once to ask for the suspension of deficit spending limits. The current account deficit amounted to approximately $5 billion in 2013. At the end of 2014, public debt was over $18 billion. The sanction system (for non-compliance) works poorly. According to a statement of the Minister of Finance, arrears of taxpayers amounted to $1.2 billion in October 2014. Another weakness is the lack of clear standards in the budget formulation and execution process, which results in large discrepancies between budget plan originally approved by the legislative branch and the executed budget.

The country has a highly centralized, hierarchical and bureaucratic coordination system. This was further exacerbated by President Martinelli’s personalistic and erratic style of governing. Recent macroeconomic growth and stability have enabled governments to manage conflicts with little impact on its capability to govern or the performance of the economy. The ability of the private sector to take advantage of economic opportunities, despite a dysfunctional political environment, has allowed the economy to thrive. On the whole, political goals are rarely incompatible. This is largely due to the specific structure of the national economy.

Some domestic anti-corruption mechanisms exist, including asset forfeiture, whistleblower and witness protection. However, these regulations are seldom applied. The judicial system has a poor record of prosecuting individuals accused of corruption, particularly in high profile cases. The lack of legislation regulating party funding and campaign financing means that the political system is highly opaque, which increases the susceptibility of the system to manipulation. Instead of fulfilling his campaign pledge to root out corruption in the public sector, the administration of President Martinelli proved to be highly dishonest and corrupt. During his term, public procurement processes became increasingly less transparent. There is a lack of strong systemic checks and balances to promote and enforce government accountability. For example, financial reports submitted to the legislative branch are not subject to external auditing and often omit important expenditures, assets, and account balances. Although tackling institutional corruption is a common election pledge, President Varela seems eager to transform his words into action. By the end of 2014, several close allies of the former president had been removed from their positions and indicted, including the Comptroller General Gioconda Torres. Prior to taking up
this position, Gioconda Torres had worked as an auditor for Martinelli’s company for 15 years. In January 2015, the Supreme Court unanimously voted to open an investigation into allegations of corruption against President Martinelli. However, the same day as this vote, the former president left the country, to attend a regular session of the Central American Parliament in Guatemala, of which he is a sitting member with immunity. President Martinelli has since refused to return. It is still too early to be able to determine whether Panama has reached a turning point in its fight against corruption.

16 | Consensus-Building

In principle, all major Panamanian political actors and leaders agree that democracy is the best form of government. There is also a strong belief in the concept of a market economy. In the context of Panama, these two aspects are virtually inseparable, even though the official commitment to and practice of democratic values do not always correspond. With the end of Martinelli’s presidency, the recent autocratic tendencies appear to have waned.

There is no significant dissent concerning the concept of a market economy. Historically, Panama’s elites have come from the merchant sector and relied heavily on the service branches, whose relative weight in the national economy has grown considerably in recent decades. Near universal acceptance of the strategic importance of the Panama Canal and the country’s role as a major trading hub means that economic policies are rarely disputed among elites. This pattern has been further reinforced by the extraordinary economic boom of the last ten years. However, conflicts have emerged between elites and the wider public regarding certain economic and social policies. The public nonetheless continues to accept the strategic importance of the Panama Canal and demonstrates support for democratic principles. The public accepts the modus operandi of the unusually structured economy, but are increasingly demanding a more equitable distribution of the returns to economic growth. The 2014 election campaign demonstrated the limited ideological and programmatic differences between the three main candidates. For example, all three candidates pledged to maintain President Martinelli’s popular social programs, public works projects and the neoliberal economic framework. However, a prolonged economic recession would threaten the current sociopolitical consensus.

Panama is free of any politically relevant, anti-democratic forces. Even the fiercest opponents of neoliberal economic policies support democratic principles. Groups with militant tendencies, such as labor unions, student organizations and indigenous communities, may criticize the manner in which democracy is being implemented, but do not advocate an alternative to the democratic system. The abolition of the armed forces in 1994 eliminated the most powerful potential threat to democratic governance in Panama. Although the new security apparatus seems to be firmly under
public control, some tendencies towards the remilitarization of, for example, the SENAFRONT border police can be observed. These tendencies are beginning to conflict with the constitution, though the security forces currently do not represent a serious threat to the democratic system. The Martinelli administration demonstrated unequivocally that parts of the elite under certain circumstances have a rather instrumental attitude to democratic forms of government.

Historically, conflict has not played a substantial role in the political culture of Panama. Excluding the final phase of the Noriega regime, serious human rights violations were rare even under military rule. Democratic governments generally negotiate with opposition groups in order to prevent an escalation of disagreements. However, negotiations concerning controversial legislation only occur after opposition groups are able to mobilize public support. The Martinelli administration had been more willing than its predecessors to push controversial legislation precipitating large-scale mobilizations of labor and indigenous groups. Strong economic growth has increased state resources, which have been used to neutralize opposition. Pronounced socioeconomic cleavages exist, but are mitigated by economic growth. Thus, the risk that cleavages rooted in Panama’s highly unequal social structure will transform into political conflict increases inevitably should economic and social conditions deteriorate considerably. There is no evidence whatsoever that President Varela will adopt a similar confrontational political approach as his predecessor.

Generally, civil society’s role in politics is weak. Therefore, there is little incentive for the political leadership to seek the participation of civil society actors in agenda setting, policy formulation, decision-making and performance monitoring. The Martinelli administration in particular did not involve civil society in policy formulation and regularly ignored recommendations or criticism from civil society groups. On the other hand, President Martinelli’s undemocratic violations of the separation of powers inadvertently created a space for civil society groups to function as a political corrective to government. Civil society was been particularly vocal against President Martinelli’s violations of the independence of the Supreme Court. One particularly prominent group was the Alianza Ciudadana Pro Justicia, a conglomerate of civic groups focused on anti-corruption and the judicial system. The November 2014 protest marches, against allegations of corruption in the public sector during the Martinelli administration, highlighted a growing sensitivity toward abuses of political power.
Panama’s major issues of reconciliation and justice relate to the victims of the military-led regime (1968-1989), particularly in its last phase dominated by General Noriega, and to the U.S. invasion of December 1989. Efforts by the Moscoso (1999-2004) and Torrijos (2004-2009) administrations settled most of the cases related to these incidents. While there might be isolated attempts to seek resolution of cases from the invasion or the military regime, the topic has almost disappeared from the political debate. Nothing significant has happened in the last few years and there is little chance that these issues will attract any attention in the foreseeable future. Indeed, reconciliation is virtually a non-issue in present-day Panama.

(The BTI-Board decided not to rate Panama on this item due to its low systemic profile compared to many other countries where past injustices are profound. This however does not imply that individual complaints about past injustices – for example, concerning victims of the U.S. invasion of 1989 - would be unjustified.)

17 | International Cooperation

Panama’s overarching development goal is to further strengthen its role as a global crossroads of highly competitive service branches built around the world’s second most important man-made waterway, which is expected to provide economic and political stability. The planning and implementation of large-scale physical infrastructure projects, such as the expansion of the Panama Canal, depend heavily on technical expertise from abroad. Furthermore, many large-scale physical infrastructure projects, such as the construction of new ports, also require foreign investment. Foreign capital plays an important role in the booming real estate sector.

Overall, the executive makes efficient use of external assistance to achieve its key development objectives. However, this does not necessarily imply a willingness to learn from foreign expertise in order to build domestic capabilities. In practice, technical expertise is purchased from abroad rather than domestically nurtured.

Generally, Panama’s government is perceived by the international community as a credible partner, particularly regarding economic policies. The massive influx of FDI in recent years indicates the favorable perception of Panama’s outward-oriented economy by foreign actors. The awarding of investment grade status by the three leading rating agencies in 2010, which has subsequently been reaffirmed, contributed significantly to the improved international perception the Panama’s economy. However, these favorable perceptions are undermined by frequent complaints from foreign companies about the cumbersome bureaucracy, inefficiency of the judicial system and widespread corruption within public administration. The U.S. government expressed concerns regarding drug trafficking within Panama and the evidence of money laundering in various sectors of the economy. Particularly, the Colón Free Zone seems to be vulnerable to illicit financial activities, because of the
lack of customs, trade and financial oversight. Colombia criticizes Panama for a lack of cooperation in tackling tax evasion. In addition, international NGOs complained that the Martinelli administration disregarded civil rights and restricted press freedom.

In June 2013, Panama joined the Central American Integration System as a full member. In recent years, Panama has been a net exporter of goods to Central America, but a large proportion of exports were re-exports from the Colón Free Zone. The free trade treaty with the United States has increased bilateral trade. The new agreement with Mexico will further strengthen Panama’s role in regional cooperation. Due to the unusual structure of its economy and its chronic trade deficit, Panama is primarily a sales market. On the day of his inauguration, President Varela restored ties with Venezuela, which had been severed by Venezuela’s President Maduro in March 2014 in protest to Panama’s intervention in internal Venezuelan politics. Due to security concerns along their border, Panama and Costa Rica are intensifying bilateral cooperation. In November 2014, the two heads of state agreed to share intelligence information to combat contraband, drug trafficking, human trafficking and other organized crime activities that affect both countries. In contrast, relations with Colombia have deteriorated since October 2014 when the Colombian government accused Panama of facilitating tax evasion. Resolving these differences is essential to the realization of a bilateral free trade agreement.
Strategic Outlook

As expected, the new government of President Varela has maintained the business-oriented economic strategy of President Martinelli. Given Panama’s specific economic structure, no major political party has presented an alternative economic strategy. Given the lack of an alternative, the Varela administration will continue to promote the economy’s competitive advantage as a hub for international trade and services. However, this strategy increases the economy’s vulnerability to external economic and financial shocks. Tightening fiscal policy would help to reduce inflationary pressures and this exposure to external shocks.

Panama’s competitive advantage as a hub for international trade will be strengthened by the expansion of the Panama Canal, now expected to be completed by the first quarter of 2016. Further delays in reopening the Panama Canal would have an adverse impact on medium-term revenue. A modernized Panama Canal will increase trade between Asia, the Gulf, the East Coast of the United States and Latin America as well as intra-Latin American trade. According to the Panama Canal Authority, the new system of locks, which are part of the modernization of the Panama Canal, will be able to accommodate 98% of all container ships. However, competition for this intercontinental trade is already increasing and is likely to reduce income generated from fees, which will reduce government revenue. For example, Nicaragua is planning a similar inter-oceanic canal financed by Chinese investors, while Honduras and Guatemala are planning a rail network linking Pacific and Atlantic ports. If these projects are realized, the competition between Central American economies for trade will be ruinous competition.

Panama has several large-scale physical infrastructure projects currently under development, which will presumably contribute significantly to maintaining the economy’s high economic growth rate and ensure the inflow of foreign capital. These projects include a modernized national highway network, a second metro line for Panama City, a fourth bridge over the Panama Canal, a new container terminal in Colón Province, a Panamax and post-Panamax shipyard in Puerto Armuelles and a port in the Corozal region. However, several physical infrastructure projects have already been delayed or are significantly over cost.

Panama has a lot of economic potential in, for example, tourism, energy, mining and in the former Canal Zone reclaimed land. Furthermore, one of the world’s largest undeveloped copper deposits is near Cerro Colorado in the east of Panama. However, as the deposits are located in an indigenous comarca, the exploitation of this mineral wealth is unlikely in the foreseeable future.

Continued structural reforms are crucial to maintain international competitiveness, reduce poverty, address income inequality, enhance human capital and increase productivity. In particular, the public school system must be improved. Current calculations anticipate that that there will be demand for an additional 100,000 skilled workers in the near future. If the current deficiencies in the education system persist then the domestic workforce will fail to meet this increased demand,
which will undermine future economic growth. In addition, policies to professionalize the judicial system and tackle organized crime activities, such as money laundering, must be developed.

President Varela’s program of social policies is ambitious. Yet, even if he was only able to implement part of this program, the country would benefit. Recent economic and social developments in Panama have demonstrated that poverty will not be eradicated solely by economic growth. Instead, economic growth should be complemented by an expansion of those conditional cash transfer programs that have already been successfully trialed. However, the current slowdown in economic growth and increasing the costs of servicing public debt will be a formidable challenge to reducing economic inequality and poverty. Furthermore, it is unclear whether reforms to fight corruption will succeed. In particular, a reduction in poverty is essential for social cohesion, especially in building links with indigenous groups.

President Varela’s ability to govern depends on the stability of power in the National Assembly. However, it is unlikely that the present governing coalition between former rival political parties, the PP and PRD, will hold together until the end of the legislative term. It is likely that the PRD will leave the coalition before the next election campaign period to distance itself from the PP. Nevertheless, the performance of President Varela will most likely be perceived as far more democratic than his authoritarian-minded predecessor. However, the increased exposure of the economy to external shocks and fragility of the governing coalition are substantial risks.