

Panama

Status Index (Democracy: 7.55 / Market economy: 6.64)		7.10	Management Index		5.65
HDI	0.804		Population	3.1 mn	
GDP per capita (\$, PPP)	6.854		Population growth¹	2.1 %	
Unemployment rate	N/A		Women in Parliament	16.7 %	
UN Education Index	0.88		Poverty²	7.2 %	
			Gini Index	56.4 (2000)	
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003)					

A. Executive summary

In recent years, Panama's transformation has been characterized by political stability on the one hand and strong macroeconomic performance on the other. Although macroeconomic indicators point to economic stability, economic performance was closely tied to global economic trends and thus linked with the cyclical nature of the world economy and world trade. The structure of Panama's economy is unique. Since the Panama Canal was opened in 1914, the Panamanian economy has been characterized by the dichotomy of a large service sector that accounts for 80.8% of the GDP (2003) and small inward-looking agriculture and industrial sectors. The dual structure of the economy translates into the dual structure of society, which consists of two different social spheres. That is, while there is a relatively high standard of living in the urban centers and the Canal Zone, the rural areas are dominated by poverty. In recent years, the country's main problems – such as highly skewed income distribution and the lack of job-creating growth – were not addressed adequately.

Since the overthrow of Noriega in 1989, the political system in Panama has met the minimum criteria of a democracy. In recent years, Panama has remained on a path that is characterized by institutional stability. However, political institutions are still subject to political manipulation and corruption. The main problems include corruption of public functionaries at all levels of government and the low level of professionalism of civil servants. Consequently, Panamanian citizens perceive all branches of government as corrupt. The rise of criminality and the corrupt nature of the judiciary has led to further disillusionment, which could lead to a significant decline of the basis for democracy.

B. History and characteristics of transformation

Since the independence of Panama in 1903, the country's history has been closely tied to the canal. After the opening of the canal in 1914, the service sector grew

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

Democratic transformation thus began in 1990 when Guillermo Endara, winner of the 1989 election, took office. Although this was the starting point of democratic consolidation, Endara did not succeed in strengthening democracy. His administration was mainly characterized by inefficiency. His successor, Pérez Balladarez of the Partido Revolucionario Democrático (PRD), continued implementing free market policy measures and initiated a process of privatization of state companies. Moreover, the military was formally abolished. Although important reforms were pursued, his administration (1994 – 1999) was tarnished by accusations of money laundering, corruption and involvement in drug trade. In 1999, the widow of former president Arnulfo Arias, Mireya Moscoso of the Partido Arnulfista (PA), became president. During her election campaign, she pledged to tackle corruption and to implement an economic policy aimed at reducing poverty, promoting investment, and increasing growth and efficiency.

The Moscoso government failed to implement its campaign promises, however. While economic instability and institutional weakness continued to dominate the country's political and economic development, a series of corruption scandals made the president's popularity decline. After formal control of the canal passed from the United States to Panama in 1999, the country entered a new stage of transformation: for the first time since Panama's independence in 1903, sovereignty extended to the whole of the country. Among international investors, there were many concerns about the future of the canal and the international finance sector. In recent years, however, the canal authorities have shown a clear course in the operation of the canal, and ambitious plans to increase and modernize the canal's capacity are under way.

In 2004, Martín Torrijos, the son of Omar Torrijos, won the presidential elections. As the candidate of social democratic Partido Revolucionario Democrático (PRD), he promised to address the severe structural problems of the country, including rural poverty. Whereas statistical data indicate further macroeconomic success, so far there are no signs of any social improvements.

C. Assessment

1. Democracy

1.1. Stateness

The state's monopoly on the use of force is established nationwide in principle, but does not function completely. Serious spill-over effects from Colombia's civil war can be felt in Panama since the start of the US-led "war on drugs", which has forced Colombian guerrillas to seek refuge in the Darién region. The state's monopoly on the use of force is also undermined by the structural weakness of institutions like the national police and the judiciary. Increasing rates of criminal violence have fostered different forms of self-justice. Indian communities in particular have engaged in violent protests against the state's failure to end incursions by illegal mestizo settlers on their lands.

All citizens have the same civil rights. Indian communities in the Comarca Kuna Yala have the constitutional right to a large degree of self-governance.

The state is largely defined as secular. Nevertheless, Catholicism continues to be the main institution of moral reference in Panama's society.

The state infrastructure extends beyond maintaining law and order, but administrative structures do not reach all segments of society. Some institutions function insufficiently, especially in rural parts of the country.

1.2. Political participation

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

After Noriega was forcibly removed from office in 1989, the civilian government regained the power to govern. It sought to solidify its position by abolishing the military and reorganizing the security forces. The Panamanian military was dissolved after the U.S. invasion in 1989 and was replaced by a national police service overseen by civilian authorities. The national police have no veto powers. While civilian supremacy over the military is consolidated, a limited number of business groups (linked to the service sector) still exercise pressure on government decisions. The constitution guarantees unrestricted freedom of association and of assembly. In Panama, Indian organizations and labor unions are important civil society organizations that associate and assemble freely. Nevertheless, the government response to demonstrations against social security

reforms tends to involve violence. Under President Moscoso (1999 – 2004), the media were still limited by tough media laws permitting lawsuits against journalists for defamation (*desacato*). After the outgoing Legislative Assembly passed a constitutional reform law in 2004, the repeal of Article 33.1 of Panama's 1972 constitution was approved by the newly elected legislators and published in *Gaceta oficial* N° 25.176 in November 2004.

1.3. Rule of law

Separation of powers is not restricted formally, and in practice, it is severely limited by the traditional dominance of the executive branch of government, by corruption, and by the structural weakness of the judiciary. Although the function of checks and balances between the executive and the legislative was often guaranteed by the government's lack of an absolute majority in parliament, the political process is still dominated by corruption and the influence of informal, clientele-istic networks. Furthermore, the system of checks and balances is severely weakened by the low degree of professionalism in public administration. The judiciary is institutionally differentiated, but its decisions and doctrine are often politically manipulated. Moreover, the judicial system is ineffective and subject to endemic corruption, which is the greatest obstacle to democratization. Major problems such as the continued presence of corrupt judges at all levels of the justice system and the low level of professionalism among public servants have still not been addressed adequately. One of the most striking deficiencies is the difficulty poor citizens have in making use of the judicial system. The Indian population in particular lacks the economic and educational resources necessary to protect their rights in what are usually long and costly lawsuits.

Although the public views corruption as one of the most urgent problems facing the country, little has been done to address this problem in recent years. Corrupt officeholders are still not prosecuted adequately under the law. The Moscoso administration, which had promised to fight corruption, was itself widely perceived as corrupt. Panama is ranked 62nd in Transparency International's Corruption Perception Index of 145 countries. The first months of the Torrijos administration have seen some moves to address corruption. Cristóbal Arboleda was appointed anti-corruption attorney and Mireya Moscoso is on trial for corruption.

While civil rights are protected by law, the enforcement of these laws is restricted by the structural weakness of the judiciary. Following the overthrow of Noriega in 1989, human rights violations are no longer committed systematically, but there do continue to be some instances of abuse at the hands of the security forces.

In 2001, Moscoso created a truth commission to investigate cases of disappearances that occurred during the decades of military rule. While the creation of the truth commission should be evaluated as part of Moscoso's

election campaign, the creation of this institution and official acknowledgment of 132 disappearance cases did help to overcome the legacy of past human rights violations. In principle, human rights violations under previous authoritarian regimes can be prosecuted in court. As the political history of Panama is closely tied to the presence of U.S. troops in the country throughout the 20th century, the history of political repression and human rights violations is partly perceived as an external problem.

1.4. Stability of democratic institutions

The ensemble of democratic institutions is characterized by stability and continuity. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. This applies especially to formal proceedings, which have a strong legalistic character. However, corruption continues to plague the judiciary and administrative systems. Despite some severe problems, all relevant political and social players accept democratic institutions as legitimate. One persistent problem, however, is that some powerful economic groups do not fully submit to the state's monopoly on taxation and the use of force. The weakness of the judiciary has led to a strong tradition of self-justice. Many civil society actors, especially indígena and campesino organizations, do not have great confidence in political institutions. Nevertheless, they regard state institutions as legitimate and as responsible for the enforcement of established law.

1.5. Political and social integration

There is a stable, moderate and socially rooted party system. Following the reestablishment of democracy in 1989, the party system was dominated by competition between the conservative Partido Arnulfista (PA) and the social democratic Partido Revolucionario Democrático (PRD). The Endara government (1990 – 1994) was followed by the administration of Ernesto Pérez Balladares (1994 – 1999), of the PRD. In 1999, Mireya Moscoso (PA), the widow of former President Arnulfo Arias, took office. Her rival, Martín Torrijos (PRD), the son of authoritarian ruler Omar Torrijos (1968 – 1981), won the 2004 elections.

The party system is characterized by moderate fragmentation, low polarization and low voter volatility. The PA and PRD are deeply rooted in society. The party system is focused on just a few personalities, however. One example of this is the PRD, founded in 1979. The PRD was always focused on personalities and showed little interest in formulating coherent programmatic objectives. After Noriega was overthrown in 1989, the party remained ideologically unstable: under Pérez Balladares (1994 – 1999), the PRD supported orthodox market reforms and privatization politics. In contrast, Martín Torrijos promised to concentrate on

reversing the devastating social effects of privatization policies and orthodox market reforms.

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

According to Latinobarómetro, support for democracy is high (81% in 2004). Political protests do not tend to question the country's constitutional framework. Because of the presence of U.S. troops throughout the 20th century, Panama has never been perceived as a sovereign state by citizens. Approval of democracy is linked to the country's economic performance and per-capita growth. Especially in the rural areas, society always had to organize itself. In general, there is a robust, but heterogeneous web of autonomous, self-organized groups, associations and organizations. According to Latinobarómetro, the level of interpersonal trust in Panama is above the Latin American average. However, rising fear of crime leads to a tendency toward spatial segregation and social disintegration.

2. Market economy

2.1. Level of socioeconomic development

Social exclusion is quantitatively and qualitatively rather marked and structurally ingrained. Panama's socioeconomic situation reflects the dual structure of the economy and its social consequences. Whereas the socioeconomic situation in Panama City and the Canal Zone is characterized by a relatively high standard of living, the situation in rural areas is worse. According to the United Nations Development Program, 48% of the Panamanian population lives in poverty. Statistics indicate that 15.3% of the population in urban areas and 65% of the population in rural areas lives below the poverty line, with women and the indigenous population particularly disadvantaged. Social exclusion and

marginalization is evident and closely tied to structural developments. The Moscoso government (1999–2004) failed to reduce social disparities and imbalances between the Canal Zone and rural areas.

2.2. Organization of the market and competition

The structure of Panama's economy is characterized by the dichotomy of a large service sector that accounts for 80.8% of the GDP (2003) and small inward-looking agriculture and industrial sectors. The service sector is based on the operation of the Panama Canal, the Colón Free Trade Zone, the open registry for container ships, and the International Financial Center. Since the early 1970s, Panama's secrecy laws attracted financial offshore activities. In the 1980s, 125 banks operated in the country. That number declined in the 1990s due to international competition from other offshore markets and increasing international concerns about money laundering.

Market competition has a strong institutional framework. However, economic activities are dominated by small national and international business groups. The informal sector is large and substantial in rural areas. Although the foundations of a competitive market economy are strong, the relevant political institutions are characterized by corruption and deficiencies in the rule of law. After formal control of the canal was returned to Panama in December 1999, the government pursued an active policy of privatization that was not based on anti-monopoly principles. The operation of port facilities (Balboa, Cristóbal, Manzanillo, Colón) – one of the most dynamic sectors of the Panamanian economy – is controlled by international companies. The fixed-line and mobile phone services have been privatized, as has the electricity sector.

Foreign trade is mostly liberalized, and there is no fundamental state intervention in free trade. Most protective tariffs were removed in the 1980s as a precondition for structural adjustment loans. Successive Panamanian governments have pursued an active policy of liberalization of foreign trade, negotiating or signing free trade agreements with Asian countries (Taiwan and Singapore) and other western hemisphere countries (El Salvador, United States and Mexico).

The Panamanian capital market is characterized by two distinguishing features. First, the economy is fully "dollarized". Panama has no central bank and no national monetary policy. A second distinctive feature is the large international banking sector, which amounts to 10% of total GDP. Due to liberal supervisory and secrecy regulations, the international banking sector grew considerably between the 1970s and 1980s. Growing competition from other financial offshore markets (e.g. Cayman Islands) and increasing international concerns regarding the illegal activities of the Noriega regime (1983 – 1989) led to the liquidation of several important banks, however. New supervisory legislation laid the

foundations for an improved banking sector, but serious concerns regarding illegal banking activities in Panama have again been raised in the wake of the 2001 terrorist attacks in the United States. The internationally oriented financial sector does not offer adequate services for the rural areas in Panama. Micro-finance, especially for small and medium sized entrepreneurs or for the small-scale rural economy, is not sufficiently provided.

2.3. Currency and price stability

Controlling inflation is not an issue for the fully dollarized Panamanian economy. The inflation rate is thus low and reflects the inflation rate in the United States. Macroeconomic stability is consistently determined by fiscal policy and the balance of payments. In the 1980s, public sector deficits were drastically reduced and subsequent governments have managed to keep the budget deficit under control. Recently, the public sector deficit has increased from 2% of the GDP in 2002 to 3.4% in 2003. On the other hand, newly elected President Martín Torrijos has signaled his intention to preserve macroeconomic stability and budgetary discipline. Outward net resource transfers rose from \$4 million in 2000 to \$1.297 billion in 2004. Torrijos has stabilized public external debt, but external debt still hovers at a high level. At \$6.639 billion in 2004, this figure is relatively high compared to other Central American countries.

2.4. Private property

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

The legal framework for a functional private sector exists in Panama. Private companies represent the backbone of the economy, but there are still state companies and strong market concentrations such as oligopolies. In some cases, concentration of market power is encouraged by the state. Because of the privatization of state assets and holdings, strong market concentrations have been fostered in recent years, in particular in the operation of port facilities.

2.5. Welfare regime

Social networks are well developed in part, but do not cover all risks for all segments of the population. Panama has a rudimentary version of a welfare state covering some social risks, but it varies according to territory, social strata and sector. While the standard of living in urban areas and the Canal Zone is relatively high, social indicators in rural areas are much worse. Estimates indicate that 42% of the population lives in poverty and 23% in extreme poverty. Fifteen percent of the urban population and 65% of the rural population live below the poverty line, with women and the indigenous population particularly disadvantaged. While public expenditure on health, education and social security is high, the population in rural areas has only limited access to social services. Thus, state measures for providing social safety are ineffectively focused. The state is not only unable to combat poverty systematically, but it also seems unwilling to do so.

There are a number of institutions that work to correct gross social differences. Although expenditure for health care is high (17% of the national budget), health care is only accessible to a segment of the population. All those who are formally employed are affiliated with the Panamanian Institute for Social Security (Caja del seguro social, CSS), which does not cover workers active in the informal sector or campesinos engaged in subsistence-based agriculture. In general, the efficiency of the health sector is severely affected by the lack of coordination between the CSS, the health ministry and the private health sector. The inefficient health system offers scant coverage and recent programs have fallen far short of expectations.

The educational system reflects the dual structure of Panama's society and economy. Good job opportunities are tied to English language skills, which are seldom taught in rural areas. Social data indicate that women are disadvantaged in general, but women from higher social strata have significantly greater access to higher education, public office, etc. There are no official mechanisms to promote women's access to higher education or public office. Although it is true that a woman was president from 1999 to 2004, it is important to note that Mireya Moscoso is the widow of former President Arnulfo Arias.

2.6. Economic performance

Panama's economic performance over recent years has been moderate, with average annual growth of 0.8% in 2002 and 3.9% in 2003. World Bank estimates indicate an average annual growth of 2.9% from 2003 – 2007. However, growth of per capita GDP is lower at -0.7% in 2002 and 2.4% in 2003. Growth of per capita GDP is not expected to be higher than 1.1% for the period 2003 – 2007. According to ECLAC data, annual growth has been even stronger in recent years, with annual growth of 0.7% in 2001, 2.1% in 2002, 4.7% in 2003, and an

estimated 6.0% in 2004. Economic performance in recent years was closely tied to global economic developments.

Panama has an official unemployment rate of 14%, but this understates the true unemployment rate. In general, the socioeconomic structure is dominated by the service sector (80.8% of the GDP in 2003). Positive macroeconomic data such as growth of the GDP often reflect the performance of the service sector, with an average annual growth of 4.1% from 1993 to 2003. The structural problem of Panama's economy is that this growth does not generate more jobs in the formal economy. On the other hand, there is a corresponding expansion of informal employment, but this undermines such strategic aims as improving tax revenues.

Growth of per capita GDP is associated with other moderately positive macroeconomic data. Economic performance is further characterized by price stability, although budget finances continue to be of concern. While the target of balancing the budget was met in 2002, with an overall budget deficit of 1.9% of the GDP, that figure rose from 3.0% in 2003 to 3.4% in 2004.

Panama's economy is consistently characterized by a large merchandise trade deficit, with imports amounting to \$3.383 billion and exports amounting to \$1.269 billion in 2003. This merchandise trade deficit is partially compensated for by the service sector, which includes the Colón Free Trade Zone, the banking sector and the Panama Canal. As economic stability was never determined by monetary policy, economic performance is consistently characterized by high debt.

2.7. Sustainability

Air and water pollution, soil erosion and deforestation are the primary environmental problems in Panama. Ecological concerns tend to be subordinated to economic growth efforts. Because the Panamanian economy relies on world commerce and revenues from the Panama Canal, recent plans for the development of the Canal Zone do not include environmental protection. Plans for the construction of additional locks and storage lakes imply devastating ecological effects. In 2003, the Panama Canal Authority announced that it would invest \$200 million on improving the canal's capacity, which will involve dredging the Gatún Lake. In this context, ecological considerations receive only scant attention and are not adequately reflected in the ambitious project to broaden the canal to allow ships to pass through in both directions simultaneously. On the other hand, the growing importance of tourism might lead to growing awareness of environmental matters.

The system of education reflects the dual structure of Panama's economy and society. Although overall expenditure on education is high, institutions for education remain inconsistent overall. In general, human capital is negatively

affected by substantial inequalities in the quality of education. Compared to other Central American countries, investment in education, training, research and development is high. Nevertheless, state and private institutions for advanced education are focused on the needs of the large service sector. Modern training facilities are thus limited to major cities and the Canal Zone.

3. Management

3.1. Level of difficulty

The structural constraints on governance are high. Panama relies on the large, internationally oriented service sector. Consequently, the country is highly vulnerable to external economic forces and relies on the cyclical nature of global economy and international trade. The segmented Panamanian economy is further characterized by poor social conditions in the rural areas of the country. This includes extreme poverty, severe infrastructural deficiencies and highly skewed income distribution. Structural constraints on governance include inefficient state institutions, a lack of accountability and the dominance of short-term political gains.

On the other hand, there is a broad basic consensus about democracy and core democratic principles and rules. In Panama, 72% of citizens think that it is important to vote – the highest percentage in Latin America. Social trust is likewise high: 20% of citizens think that they can trust the majority of people. There are moderate traditions of civil society. In general, public life was influenced by the presence of the U.S. military in the country throughout the 20th century. Public engagement was primarily linked with party politics, especially for the PRD and PA. Numerous non-governmental organizations (NGOs) have also been active in recent years, with indigenous, women's and ecological organizations being the most dynamic civil society groups. The majority of NGOs and other mobilized groups suffer from scarce organizational resources.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	4
System of government:	<i>Presidential</i>	Electoral system disproportionality:	22.61
		Latest parliamentary election:	02.05.2004
		Effective number of parties:	2.7
1. Head of State:	<i>Mireya Moscoso</i>	Cabinet duration:	09/99-09/04
Head of Government:	<i>Mireya Moscoso</i>	Parties in government:	1
Type of government:	<i>unified government</i>		
2. Head of State:	<i>Martín Torrijos Espino</i>	Cabinet duration:	09/04-present
Head of Government:	<i>Martín Torrijos Espino</i>	Parties in government:	1
Type of government:	<i>unified government</i>		
		Number of ministries:	12
		Number of ministers:	12
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>			

As social indicators demonstrate, Panamanian society is deeply divided by social classes. Although ethnic conflicts exist, they do not dominate politics. Violent incidents are mainly linked with land conflicts in rural areas. The political elite are not polarized along ethnic, religious or social differences. Political actors restrict their activities to creating conditions conducive to investment. Accordingly, political confrontations are discursive in nature and tied to conservative or social democratic political agendas.

3.2. Steering capability

The political leadership claims to pursue long-term aims, but these are regularly replaced by short-term interests of political bargaining and office seeking. In general, the administration has demonstrated very little reliability in achieving or even pursuing its goals. President Mireya Moscoso (1999 – 2004) did not implement her political program, which placed emphasis on improving social conditions and on combating poverty. Instead, corruption was pervasive and the president was later accused of having acted in her own interests. Martín Torrijos, elected in 2004, has claimed that he will pursue long-term aims and place emphasis on fostering constitutional democracy and socially responsible market economy. His strategic priorities include poverty reduction and sustainable human development. In general, the government is committed to democracy and market

economy, but has demonstrated only limited success in implementing its announced reforms.

The political leadership responds to mistakes and failed policies with changes, but policy frequently remains stuck in the same routines. Learning processes occur, but rarely affect the knowledge base or cognitive framework upon which policies are based. One manifestation of this is the persistence of low professionalism in the government and the administration as a whole. Although recent years have seen moves by the political leadership to open a more constructive dialogue on reform policies, these efforts did not represent a general change in policy. The persistent “top down” routines of policy formulation and policy implementation demonstrate the limits of complex learning and policy innovation.

3.3. Resource efficiency

The government uses only some of the available resources efficiently. Corruption and waste of financial, human and organizational state resources continue to plague Panama. Although there is a strong legalistic tradition, the number of corruption and bribery scandals is an indicator of the level of inefficiency. While the national budget is openly discussed in congress, implementation of the budget is severely affected by corruption. A quantitative indicator is the high number of corruption proceedings initiated after Torrijos took office in 2004. The tradition of appointing personal friends or contacts to public office likewise damages government efficiency. Mireya Moscoso had been criticized for her failure to overcome this clientele-istic practice. Partly due to frequent personnel changes, public administration does not operate as efficiently as it should.

Although economic policy has not consistently shown a clear course in recent years, overall policy is coherent. Nevertheless, trade-offs with policy goals are not well-balanced, and intra-governmental frictions, redundancies and lacunae negatively affect policy coordination. Conflicting goals such as creating new jobs and maintaining macroeconomic stability were not coordinated into a coherent and credible policy. While Mireya Moscoso pledged to combat poverty during her campaign, the government did not carry out the programs it had announced. Instead, it focused more on attracting foreign investment. In general, policy measures have been characterized by a lack of careful preparation and hasty implementation.

Although it had been a key election campaign promise, the campaign against corruption made no progress during the Moscoso presidency. According to Transparency International’s Corruption Perception Index, Panama ranks 62nd of 145 countries. The government has undertaken only some efforts to improve integrity, such regulating party financing and conducting parliamentary reviews of state spending practices. Corruption in Panama remains endemic, however, and is

pervasive among different levels of government and administration. Although some codes of transparency and legal conduct exist, corruption is still a fundamental characteristic of the administrative and state culture.

3.4. Consensus-building

All major political actors agree that a market economy and democracy are strategic, long-term aims. One manifestation of this was the political discussion on adopting new supervisory regulations. An important feature of Panama's economy is its international banking sector, which attracts international financial capital because of its secrecy rules and supervisory practices. When the Panamanian government implemented new and internationally compliant supervisory legislation, no fundamental conflicts over the goal of a free market-based economy arose.

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

Cleavages can be seen in the dual structure of Panama's economy and society. These cleavages are not reflected in the party system, however, as it is consistently linked with the economic elite. The political leadership is able to prevent cleavage-based conflicts. On the other hand, restricted sovereignty, the political isolation of rural areas and the importance of the canal made it easy for the political leadership to prevent structural conflicts from escalating. There continues to be a broad consensus on basic democratic principles.

In recent years, the political leadership did nothing to promote social capital and was indifferent with respect to the role of civic engagement and solidarity. Civic engagement and solidarity have been encouraged by non-state actors. Social capital is developed primarily by the Catholic Church and by other civil society organizations. Newly elected president Martín Torrijos has announced his intention to promote social capital.

The political leadership frequently ignores civil society actors and formulates its policies autonomously. The government has shown little interest in organizing an adequate process of policy formulation. On the other hand, the weak organizational power of civil society groups has facilitated ignorance. Furthermore, the media are subject to political pressure and punitive action based on certain laws that include prison terms for media offences. In contrast to most civil society organizations, economic interest groups are able to make their voices

heard. The political leadership takes into account and accommodates the interests of economic associations.

The political leadership recognizes the need to deal with historical acts of injustice. In 2001, President Mireya Moscoso established a truth commission to investigate the fates of the disappeared. However, this effort to address the conflict-laden past must be evaluated within the context of her electoral campaign. Although the truth commission contributed to the achievement of moral justice, the memories of historical injustice were partly used as a weapon against Moscoso's political opponent, Martín Torrijos, the son of former dictator Omar Torrijos.

3.5. International cooperation

The Moscoso government worked closely with international donors and used international support to improve its policies. Recent months have seen further steps toward the improvement of Panama's battered image as a reliable partner.

Overall, the political leadership works well with bilateral or multilateral international donors. The government makes use of international assistance, but this does not facilitate significant policy learning and improvement. In the 1980s, Panama had been forced to implement reform programs and to reform the public sector, mainly under the auspices of the International Monetary Fund and the World Bank. Many substantial reforms like removing trade barriers and passing supervisory legislation for the banking sector were implemented as a precondition for loans. In general, the government tries to act as a credible and reliable partner, but major international actors still express doubts regarding about the country's reliability. In October 2004, former Minister Fernando Gracia was accused of having embezzled \$45 million. Panama is still not considered a stable partner by many foreign investors and governments. On the other hand, the Panamanian government is considered more reliable than some other Central American governments.

In general, Panama maintains positive relations with its neighboring countries. Although Panama supports regional organizations such as the regional parliament PARLACEN, the political leadership does not actively promote further regional integration. Panama is part of the Plan Puebla Panma (PPP), signed in 2001. Panama did not join other Central American governments negotiating a U.S.-Central American free trade agreement (CAFTA). Referring to the peculiarities of the Panamanian economy, Mireya Moscoso instead began negotiating a bilateral free trade agreement.

The government tried to further build cooperative international relationships and is in the process of negotiating agreements with Mexico, Colombia and several

Asian governments. Since Panama has demonstrated compliance with internationally accepted standards of secrecy and supervision, it has been removed from the OECD's blacklist of non-cooperating countries. Although the government is committed to the fight against drugs, Panama remains a main transit route for drugs. Local institutions in particular are affected by the corrupting and violent influence of drug trafficking.

4. Trend of development

4.1. Democratic development

In general, the political system in Panama meets the minimum requirements of a democracy. In the last years, stateness, political participation and the rule of law have remained at their former levels of quality. The level of consolidation of democracy has not changed significantly. Panama remains on a path that is characterized by institutional stability. On the other hand, political institutions are still subject to political manipulation and corruption. Thus, the population perceives all branches of government as corrupt. The rise of criminality and the corrupt nature of the judiciary lead to further disillusionment. In other Latin American countries, the explosive mixture of growing violence, impunity and corruption has caused a deterioration of political integration.

The political leadership has made no progress in its capacity for social integration. Programs to achieve sustainable human development were not been implemented during the Moscoso presidency. Although the landscape of civil society groups and organizations shows positive development, this has not translated into any fundamental changes in the process of policy formulation.

4.2. Market economy development

In recent years, Panama has not made much progress in the direction toward a socially responsible market economy. Panama's development status has not changed in the past five years. Measured by changes in the Human Development Index (HDI), Panama's level of development has improved only slightly in recent years, by only 0.003 points from 2001 to 2004. Nevertheless, Panama's HDI does not represent the country's level of development because it primarily reflects the high standard of living in the urban areas and the Canal Zone. In the past five years, the government has been unable to reach its main development goals. While the government highlighted poverty reduction as the main social policy priority, the social situation of many Panamanians, especially in the Darién region, has worsened in recent years.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in % ^a	2.7	0.6	2.2	4.3	6.2
Export growth in % ^a	10.0	2.7	-11.9	-5.0	14.2
Import growth in % ^a	5.1	-4.4	-3.2	-3.0	21.2
Inflation in % (CPI) ^a	0.7	0.0	1.9	1.5	1.5
Investment in % of GDP ^a	21.2	15.7	14.5	17.1	18.3
Tax Revenue in % of GDP ^b	n.a.	n.a.	n.a.	8.8	8.8
(Urban) Unemployment in % ^a	15.2	17.0	16.5	15.9	14.0
Budget deficit in % of GDP ^a	-1.1	-1.7	-1,9	-3,8	-5.6
Current account balance in bn \$ ^a	-0.71	-0,17	-0,10	-0,44	-1.10

Sources: (a) CEPAL: [Estudio Económico de América Latina y el Caribe, 2004-2005](#); (b) Ministerio de Economía y Finanzas: Estadísticas 2004 Panamá

Although significant deficiencies in the organization of the market and competition remain, the institutional framework has improved. After control of the Panama Canal was handed over to Panama on December 31, 1999, there has been uncertainty regarding privatization policy and the future of the canal. In recent years, significant foreign and national investment has been made, revenues from the canal have increased, and plans to increase the canal's capacity have proceeded. Moreover, the new supervisory legislation for the banking sector has improved the framework for market-based action.

Overall, economic development has improved quantitatively, with growth of 2.2% in 2002 and 4.7% in 2003. Growth in 2004 is expected to be 6.0%. However, the strong economic performance was closely tied to global economic trends. There were no changes in the status of sustainability. Shortcomings persist in the welfare regime and in the high level of unemployment and poverty.

D. Strategic perspective

The structure of Panama's economy is unique. Semi-legal activities such as banks facilitating money laundering and the open registry for container ships constitute the backbone of the Panamanian economy. These sectors are linked with both the formal and criminal economies.

Although estimates indicate an average annual growth of 2.9% from 2003 – 2007, poverty is still worsening and income distribution remains highly skewed. In this context, a consistent program of reforms over several years would be necessary. During his campaign, Martín Torrijos presented a comprehensive political plan. He called for the implementation of an economic policy based on market forces

with social solidarity principles. He highlighted poverty reduction and sustainable development as the main development goals. He announced his intention to eliminate any remaining market distortions and to promote competitiveness and investment. Moreover, he highlighted an economic policy based on the country's comparative advantage – its geography. One manifestation of this is the title of one of the electoral program's 25 chapters: *La ruta hacia el Primer Mundo: Ciencia y Tecnología*. Built on a strong consensus among political elites, Torrijos will focus on the progressive and modern service sector. Panama appears to be continuing on a path that reflects the dual structure of the country's economy and society. While efforts to modernize the service sector are consistently made, some social programs and policies are still not sustainable.

Seen from a long-term perspective, a transformation strategy should focus on two key elements: Rule of law: In order to avoid a further decline of the basis for democratization, efforts against crime and corruption should be increased. This is not a merely technical issue, but closely tied to a change in political culture. Social policy: Poverty reduction and sustainable human development should be the main long-term development goals. Social and economic policies should aim to overcome the fundamental social dichotomy. In this context, a key problem to be solved is the problem of increasing job-generating growth.