

BTI 2014 | Panama Country Report

Status Index	1-10	7.07	# 31 of 129	
Political Transformation	1-10	7.35	# 31 of 129	➔
Economic Transformation	1-10	6.79	# 33 of 129	➔
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	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. 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>.

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Key Indicators

Population	M	3.8	HDI	0.780	GDP p.c.	\$	16615.3
Pop. growth ¹	% p.a.	1.6	HDI rank of 187	59	Gini Index		51.9
Life expectancy	years	77.2	UN Education Index	0.741	Poverty ³	%	13.8
Urban population	%	75.8	Gender inequality ²	0.503	Aid per capita	\$	27.9

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Panama's economy continued to boom in 2012. Driven by substantial government expenditures and foreign direct investments on infrastructure projects, the economy is expected to grow at roughly 10%, the fastest in Latin America. The 2013 national budget will be the most expensive in the history of the country at \$16.3 billion. A problem facing the economy, however, is increasing inflation. High oil prices led transportation costs to increase by 13.6%, food and beverage rose 6.1%, and goods and services climbed 7.8%. The then-administrator of the Panama Canal, Alberto Alemán Zubieta, said 2011 was the Panama Canal's best year in history, beating its record for tonnage shipped through the canal and tolls paid. According to a Latin Business Chronicle analysis, Panama is now the region's top recipient of foreign direct investment as a share of GDP.

The firing of Vice President Juan Carlos Varela as foreign minister, on 30 August 2011, marked the end of the coalition that brought President Ricardo Martinelli to power in 2009. Conflict between the president and vice president erupted around the issue of reforming the constitution to allow presidential reelection and to establish a runoff election if no candidate received 50%+1 of the vote. Additionally, President Martinelli successfully managed to enhance and consolidate power by encouraging opposition legislators to switch sides and by merging his own Democratic Change party with one of the political parties of the governing alliance (Unión Patriótica). Martinelli's dismissal of Varela from the post of foreign minister triggered the resignations of other cabinet members in solidarity. Varela declared that, despite being part of the executive (he retains the vice presidency), he will now play the role of "leader of the opposition." The rupture of the alliance has had a dramatic effect on the president's approval ratings. A September 2011 poll by Dichter & Neira showed that Martinelli's popularity plummeted to 46.4%, a 20-point drop from the 66.9% approval he had in August – the biggest fall for a president in 20 years. President Martinelli's approval ratings continued to deteriorate in 2012 as a result of several serious corruption scandals and continued confrontations with indigenous groups, labor unions and the political opposition. Indigenous groups and labor unions engaged in significant protests throughout the year against government policies to further open the economy. In October 2012,

protests became violent as labor unions opposed a plan to sell additional land in the Colón Free Trade Zone. Amateur video showed police quelling the protests using strong measures that led to the death of a 10-year-old child. Earlier in the year, the indigenous Ngäbe-Buglé shut down the Pan-American Highway as part of a week-long protest against government plans to award additional concessions to multinational mining corporations. The rift that led to the breakup of the governing coalition deepened in 2012 as relations between the president and vice president deteriorated. The president filed suit against the vice president, claiming the latter had slandered him by accusing the administration of being corrupt. The allegations stemmed from a bribery scandal linked to an Italian company's attempt to pay substantial kickbacks to Panamanian government officials in exchange for lucrative government contracts. President Martinelli vehemently denied the accusations.

History and Characteristics of Transformation

Panamanian democracy today emerged after a prolonged crisis and confrontation with the United States, and ultimately a military invasion. The invasion, along with the imminent turnover of the Panama Canal and adjacent lands, created the necessary incentives for elites to alter their historical behavior, restructure the institutional framework of the state, and set the foundations for a liberal-democratic regime.

Historically, Panama has been at the “service of the world” since Vasco Núñez de Balboa initiated the conquest of the isthmus in the 16th century. The national motto is *Pro Mundi Beneficio*. Both Panamanian and extraterritorial elites have seen Panama as a function of its strategic geographical location, and thus have sought to deepen its insertion into the international commercial system by enhancing the mechanisms by which the location is exploited. This phenomenon has shaped the nature of the Panamanian political class, its relationship with subordinate groups and extraterritorial powers, and the structures of the Panamanian state. For most of the 20th century, democracy was sacrificed in order to maintain the political stability demanded by world commercial interests.

Between 1903 and 1968, Panama had a political system controlled by an urban commercial elite in alliance with United States military, economic, and political interests. For the United States, this alliance provided the necessary political stability for the smooth operation of the Panama Canal. For Panamanian elites, the alliance secured their right to govern the country through a system of tight social and political networks that excluded popular sectors from political participation and from enjoying the benefits of the transit route.

In 1968, a sector of the Panamanian commercial elite, together with the United States, supported the overthrow by the National Guard of an elected civilian president, ushering in 21 years of military-dominated politics. The military government sought to broaden the ruling alliance by incorporating previously excluded sectors such as labor and small farmers, while continuing to maintain the support of the urban commercial elite. In addition, the military government sought to renegotiate the terms by which the United States controlled the Panama Canal. Those negotiations

culminated in 1977 with the signing of the Torrijos-Carter Treaties, by which the United States agreed to gradually draw down its military presence on the isthmus, culminating in the transfer of the Panama Canal to Panamanian hands on 31 December 1999.

The 1980s were a decade of political turmoil in Panama and of significant changes in U.S.-Panamanian relations. The United States had worked closely with the military government, but saw it, after the de facto takeover by General Noriega, as a threat to its strategic and political interests in Central America. The growing distance between the U.S. and the military precipitated a rupture of the alliance between the commercial elite and the military-led government. The former sought to mobilize opposition to the military by organizing civil society into a National Civic Crusade. The military-led government managed to survive despite the domestic opposition and economic sanctions by two U.S. administrations. When all else had failed, the United States decided to invade on 20 December 1989.

In the decades since the invasion, Panamanians have successfully established the institutional foundations of a liberal democracy. Since 1990, Panama has held four free and competitive elections in which the opposition parties have emerged victorious. Much of the success of the elections is attributed to the institutionalization of an autonomous Electoral Tribunal. Another major accomplishment is the dismantling of the military apparatus and the creation of a new security structure that promotes civilian control. Moreover, there are clear signs that Panamanian elites have learned to behave in a more democratic and conciliatory fashion, thus promoting the necessary agreements to establish democratic rules of the game.

In 2009, Panama held its fourth presidential elections since the U.S. military invasion. The elections held on May 3, 2009, pitted Balbina Herrera, a former Minister of Housing and legislator, against wealthy businessman Ricardo Martinelli. Herrera was the standard-bearer of the governing Revolutionary Democratic Party (PRD), and Martinelli led a coalition of opposition parties headed by the Democratic Change Party. The campaign was mostly devoid of substance and centered on personal attacks between the candidates. Herrera was accused of being a radical leftist who had received support from Hugo Chávez, the controversial president of Venezuela. Martinelli exploited Herrera's strong anti-American statements and past links to General Manuel Noriega's regime. Martinelli's campaign also emphasized the need for change after five years of PRD-led government. For her part, Herrera accused Martinelli of being mentally unstable (rumors have abounded for years that Martinelli is bipolar). She also tried to use Martinelli's wealth and business practices against him. Martinelli turned the charges in his favor by adopting the campaign slogan "the crazies are more" ("los locos somos más"). Herrera countered with the slogan "the poor are more" ("los pobres somos más"). In the end, the desire for change, despite robust economic performance, and Herrera's poor campaign led to a landslide victory for Martinelli, who captured 60% of the vote. His coalition also won a majority of seats in the legislature. Martinelli's victory was considered a setback for the recent leftist trend in Latin America. Importantly, Martinelli's victory may indicate realignment in the political party dynamics because he represented the first presidential winner, since the reestablishment of democracy, not to come from either the Arnulfista (Panameñista) Party or the PRD.

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 disputed by any important political player. While indigenous groups in the western part of the country have mobilized for greater control of their resources, and in opposition to certain decisions of the government, and have clashed with government security forces, they neither seek complete separation from the nation, nor have they taken arms against the authority of the nation-state.

The state's full control of the Darién jungle has been challenged by narcotraffickers and the Revolutionary Armed Forces of Colombia (Fuerzas Armadas Revolucionarias de Colombia, or FARC) guerrilla forces. The government of Panama has intensified its efforts to confront the presence of the insurgents and has cooperated closely with Colombia to secure its borders. At the same time, the weakening of the FARC movement resulted in a decline in guerilla activity in the Darién jungle. In this way, the slowdown of the civil war in Colombia has helped to improve security in the Darién territory of Panama, thus consolidating the state's monopoly on the use of force.

The vast majority of Panamanians accept the dominant concept of the nation-state. Indigenous communities enjoy a degree of autonomy on local matters through the system of "comarcas," or semi-autonomous regions. Indigenous communities, however, participate actively within the political system and accept the fundamental constitutional structures of the nation-state. Indigenous groups respect the authority of the nation-state, as long as their autonomy and rights 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. The constitution stipulates that Catholicism be taught in

Question
Score

Monopoly on the
use of force

9

State identity

10

No interference of
religious dogmas

9

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 their operation is deficient in many respects. Some institutions function ineffectively, especially in rural areas and in indigenous communities. Corruption is a major problem affecting many levels of public administration, particularly the judicial and municipal systems. Municipal governments are weak and inefficient in their service delivery, particularly in rural areas far from the main cities. Lack of funding and politicization hinder the ability of local governments to meet public demands. Some 30% of the population have no access to improved sanitation facilities, and most schools in rural areas have very poor facilities. According to local press reports, more than half of the 3,260 public schools are in urgent need of maintenance operations.

Basic
administration
7

2 | Political Participation

Panama is a representative democracy and places no constraints on free and competitive elections. Presidential elections held in 1994, 1999, 2004 and 2009 resulted in regular alternation between government and opposition parties.

Free and fair
elections
8

Even though the three-member Electoral Tribunal (Tribunal Electoral, TE) in the past did not constitute a truly independent political entity, pressure on the institution has grown under the Martinelli government. In September 2012, an electoral reform package (law 54) was approved by the Martinelli-friendly legislative majority. The reform eliminated the party-list proportional representation system for the Congress (in the legislature, 26 members are elected by plurality vote in single-member constituencies, and 45 members are elected through a party-list system). Another innovation stipulates a two-stage system for presidential elections, which requires a run-off if no candidate wins an outright majority. The reforms are obviously aimed at improving the chances of the president's party in the next elections. The Electoral Tribunal urged Martinelli to veto the reform on the grounds that some sections were unconstitutional or "unsuitable." Among other things, the three magistrates criticized a provision to limit the TE's capacity to act when confronted with requests for the suspension of electoral propaganda (the unregulated use of money in campaigns is a major problem, and one that will surely get worse in the 2014 elections). The Chamber of Commerce, the Civic Forum pro Electoral Reform, the Ecumenical Committee of Panama and the opposition parties, among other organizations, expressed similar concerns about the electoral reform, but the president ignored these voices along with the request of the TE.

By and large, democratically elected political representatives have the effective power to govern. Since the abolition of the armed forces, the danger of a uniformed veto power has vanished. Business groups and individual businessmen (mainly from

Effective power to
govern
9

the service sector), particularly those that are allied with the current administration, exercise considerable influence on public policy. The lack of clear campaign finance laws means that powerful and wealthy interests have significant influence over politicians they help finance. A handful of militant labor unions represent the most influential pressure groups from below. On the one hand, by means of weakening the political opposition (in the legislature), the government was able to increase its political leeway; on the other hand, public protests several times prompted the executive to cancel existing commitments or laws. The policy spectrum in Panama is narrowly construed as primarily favoring upper-class-oriented solutions to collective problems and promoting a neoliberal economic model.

The constitution guarantees unrestricted freedom of association and assembly, yet in fact there are limitations on organizing workers. The state restricts labor unions to only one branch office per province and requires a minimum of 20 members to set up a branch union. Strikes can only be declared to demand an improvement in working conditions, to enforce a collective agreement or to protest repeated violations of legal rights. The state forbids strikes called to protest general policy measures or to demand an increase in the minimum wage. Nonetheless, protests and strikes are conducted frequently to force the government to adopt or retract certain policy initiatives. Public sector employees do not enjoy the right to form unions. They are allowed to set up associations and engage in collective bargaining, but only if they have a minimum of 50 members. The law governing the autonomous Panama Canal Authority denies the right of its workforce to strike, but does allow unions to organize and bargain collectively.

The free trade agreement (FTA) with the United States includes some clauses that made an adaptation of the Panamanian labor code necessary. Legislation approved by Panama's National Assembly in March 2011 abolished restrictions on collective bargaining in export processing zones and also eliminated the prohibition against the right to strike in companies less than two years old.

Protests have often been met with excessive police force, resulting in some injuries and deaths among the demonstrators. Particularly violent were clashes in 2012 between indigenous communities and security forces in the wake of the government's attempt to open more lands to transnational mining companies. In October 2012, protests became violent as labor unions and other civil society groups opposed a plan to sell state-owned land in the area of the Colón Free Trade Zone.

The Constitution guarantees freedom of expression. However, the law permits journalists to be prosecuted for "offenses" related to the leaking of government information. Laws punishing "disrespect" toward public officials are still enforced. During 2011 and 2012, the Martinelli administration routinely threatened and pursued lawsuits against journalists it considered critical of the government's policies and performance. Particularly, the Panamanian daily La Prensa has a long history of

Association /
assembly rights

8

Freedom of
expression

7

reporting on corruption and has clashed more than once with the president. In August 2012, scores of workers from one of Panama's largest construction companies blockaded the newspaper. The workers used 30 trucks to surround the offices of La Prensa, which has published investigative articles about the company, reporting that it had received millions of dollars in favorable government contracts. The editor of the newspaper called the blockade, which lasted several hours, part of a rising number of actions aimed at intimidating the news media in Panama. The press regularly exercises self-censorship because of government intimidation.

3 | Rule of Law

The constitution establishes nominal separation of powers. However, the executive branch traditionally holds significant authority vis-à-vis the legislature and the judiciary. During the period under review, President Martinelli undertook several activities to undermine the system of democratic checks and balances and thereby maximize his political power. With the help of government resources, the president managed to induce opposition lawmakers to abandon their party and join ranks with his own party Cambio Democrático (CD). Opposition legislators were courted by promising them public spending in their districts, committee assignments and future jobs in the government if they changed sides. By the end of 2012, nine of the 26 PRD deputies elected to Congress in 2009 had switched to the CD. Once the Unión Patriótica (UP; with four mandates), which was part of Martinelli's successful Alianza por el Cambio (Alliance for Change), had merged with the CD in July 2011, the number of Martinelli's supporters in the legislature reached a threshold that allowed him to break up the coalition with the Partido Panameñista (PP). The PP won 22 seats in 2009, while the CD was represented by only 14 deputies. Martinelli made Juan Carlos Varela, the PP's leader, his running mate, who served as foreign minister in the new government. In exchange for the PP's support, Martinelli agreed to let Varela run on the alliance's ticket for president in 2014. In August 2011, Martinelli announced that the CD would field its own presidential candidate and sacked Varela from his post as foreign minister, justifying his decision on the grounds that Varela was devoting too much time to his electoral ambitions and neglecting his duties as member of the government. (While Varela retained his position as vice president, his dismissal triggered the resignation of other PP cabinet members in solidarity.) At the end of 2012, no fewer than 13 of the original 22 PP deputies had converted to the camp of the CD. At the same time, the CD's parliamentary group numbered 38 members. The CD's Alianza ally, the Nationalist Republican Liberal Movement (Movimiento Liberal Republicano Nacionalista, MOLIRENA), whose decision to merge with the CD was rejected by Panama's electoral authorities for procedural reasons in mid-2011), began in 2009 with two deputies and by now had grown to six.

Separation of
powers

6

With its comfortable pro-Martinelli majority, Congress has become a subsidiary of the executive.

The strengthening of Martinelli's political stance was not only the result of the changing balance of power in Congress but also due to the rapidly growing influence of the government over the judiciary. In January 2012, two new justices were sworn onto the nine-member Supreme Court (CSJ) for a 10-year term. At that time, four of the nine CSJ justices were Martinelli appointees, after two others were selected in 2010 in a hotly contested process. Just as in the first case, in January 2012 proceedings violated the legal regulations for the appointment of new CSJ judges. In April 2011, one of the Supreme Court justices chosen by Martinelli resigned after accusations emerged that he had conspired to unseat former Attorney General Ana Matilda Gómez, who had been appointed by Martinelli's predecessor. The outgoing justice was replaced with an acting deputy minister even though a constitutional provision prohibits someone from being a justice if they have held a position of authority in the executive branch of the current administration. In late 2012, the president moved the incumbent attorney general, a close ally, to the Supreme Court, again stoking concerns about the independence of powers in the country.

The judiciary is institutionally differentiated. In Panama, judges are appointed by their immediate superior in the judicial hierarchy. Superiors are not obligated to choose the most qualified candidates. The judicial system's capacity to resolve contractual and property disputes is weak and plagued by corruption, as illustrated by the most recent World Economic Forum's Global Competitiveness Report, which rates Panama's judicial independence as ranking 132nd out of 144 countries. There is a tremendous lack of confidence in the judicial system as an objective, independent arbiter in legal and commercial disputes, especially when the case involves powerful local firms and personalities.

The relative autonomy of the Supreme Court was further reduced under the Martinelli government. The president's appointment scheme for high posts in the judiciary was strongly influenced by political motives. One of two Supreme Court judges Martinelli appointed in 2010 stepped down in March 2011 after he was accused of being behind a plot to oust former Attorney General Ana Matilde Gómez, who was aligned with the opposition PRD. Gómez's replacement, Giuseppe Bonissi, a Martinelli ally, was forced to resign in December 2010 amid concerns raised by the U.S. Drug Enforcement Administration regarding possible links to drug traffickers.

Reviving legislation originally approved under the Pérez Balladares government (1994-1999), Martinelli intended to expand the CSJ from nine to twelve judges and establish a fifth chamber (court of constitutional guarantees) within the Supreme Court. Critics maintained that this would give the president even more influence over the court by awarding him the authority to appoint three new justices. In June 2012,

Independent
judiciary
5

overheated congressional sessions and strong public protests led the president to withdraw his proposal for the fifth chamber.

In September 2011, Panama started a four-year conversion to the accusatory system, which is expected to simplify and expedite criminal judicial cases.

Concern about corruption in the government apparatus remains high in Panama. Despite President Martinelli's electoral pledge to tackle corruption, his government has made no progress at all in this area since taking office in July 2009. The World Economic Forum's Global Competitiveness Report indicates that corruption is viewed by business executives as the most problematic factor in doing business in the country. U.S. companies have alleged that Panamanian government officials may ask outright for payments to guarantee an award, or, more indirectly, may insist that they closely cooperate with a favored local firm. The head of state at times has defended cabinet members accused of corruption, while in other cases he has taken action to dismiss government officials or, in one case, let a minister resign on his own. Jimmy Papadimitriou, the minister of the presidency and one of Martinelli's closest allies, stepped down over a land-titling scandal. The case had no legal consequences at all. Even the president himself several times was confronted with allegations of corruption (bribery); however, no hard evidence was presented to prove the accusations.

Prosecution of
office abuse
4

Generally, corrupt public officials are rarely brought to justice. While many are accused publicly, and some resign as a result of media attention, few are ever effectively prosecuted, let alone sent to jail. Corruption seems to be one of the most important driving forces behind the widespread disregard of the rule of law.

Civil rights are guaranteed by the constitution, but are partially or temporarily violated. Regulations and institutions to prosecute, punish and redress violations of civil rights are in place, but often prove to be ineffective. There is an obvious tendency of the Martinelli government to intimidate people who actively exercise their civil rights. Legal provisions allow the government to use preemptive injunctions and other means to restrict the free exercise of civil liberties. The Martinelli administration routinely deploys police force to stop protests by labor, indigenous and student groups. Such force often involves rubber bullets and tear gas. Dozens of injuries and several deaths have been attributed to such tactics in the last two years. The Martinelli government has been more willing than its predecessors to use excessive police force to handle antigovernment protests. In February 2012, two protesters were killed during several days of clashes between police and indigenous demonstrators in Chiriquí Province, and, in late October 2012, three persons were killed in clashes with police forces in the city of Colón during protests over a government plan to sell state-owned territory in the Colón Free Trade Zone.

Civil rights
7

Discrimination against citizens with darker skin prohibits these individuals from fully exercising their civil rights, which are enshrined in the constitution.

The right to life and security is affected by the high crime rate. After the annual homicide rate increased significantly in 2008 and 2009, the number of murders fell to 759 in 2010 and to 704 in 2011, partly due to an expansion of the national police force.

4 | Stability of Democratic Institutions

Traditionally, Panama's democratic institutions performed their functions more or less effectively and were free from extensive, counterproductive frictions. After the 2009 elections, the functioning and interplay of democratic institutions were severely affected by President Martinelli's frequent machinations aimed at expanding his own political power and his influence on the political system. Because close Martinelli cronies have too often been named to posts that ought to be manned by politically independent professionals, the performance of state institutions has worsened. In general, low levels of professionalism, waste of tax money and widespread corruption continue to plague the public administration.

Performance of democratic institutions

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Survey evidence suggests that democracy is accepted as the best form of government by vast majorities of Panamanian citizens. In principle, all relevant political and social actors accept democracy as the "only game in town." However, the increasing concentration of political power in the hands of the president, plus the alarming increase of influence by certain economic actors tied to the president, have the potential for undermining democratic governance. Indeed, the government has been the only important political actor that systematically undermined the democratic pillars of the nation-state.

Commitment to democratic institutions

8

5 | Political and Social Integration

Traditionally, there have only been two strong political parties in Panama. The Revolutionary Democratic Party (PRD) and the Panameñista Party (PP). The former was founded by General Omar Torrijos during the military regime that governed the country from 1968 to 1989. The latter derives from the political movement created by Arnulfo Arias, the other great caudillo of 20th-century Panamanian politics. In 2009, Ricardo Martinelli gained the presidency leading a coalition of the PP and his own Democratic Change Party, which in the 2004 elections had won only 5% of the votes. The PRD and the PP have some loose social affiliations on which they rely to mobilize support. The Democratic Change Party is devoid of any significant social roots, and is primarily a political vehicle for the political ambitions of Ricardo Martinelli. Most other parties are very weak and exist essentially around election

Party system

7

periods. Most parties, including the PRD and PP, lack clear ideological roots. Their programs are rather pragmatic, and their organizational structures are dominated by a few prominent leaders.

The relative high level of party affiliations (the sum of all registered party members is about half the country's adult population) refers mainly to the clientelistic core of political parties. As a rule, governing parties and parties likely to win in the next elections report growing memberships, while affiliation figures go down in opposition parties. Between its 2009 loss and November 2012, the PRD saw its membership decline from 641,651 to 522,134. During the same period, Cambio Democrático nearly quadrupled its membership (126,806 vs. 475,917 affiliations). As reelection is prohibited by the constitution, the fate of the CD will depend primarily on continued strong economic growth, and on whom the CD nominates for president in 2014.

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 the arena of political actors is the increasing importance of civil society groups in spite of the adverse environment created by the current administration. Indeed, as a result of Martinelli's deliberate weakening of the legislative and judicial branches, the relative importance of interest and civil society groups as a corrective for government policy has grown. Nevertheless, civil society is generally weak in Panama. In the last two years, indigenous groups have exercised increasing power to mobilize, particularly the Ngöbe-Buglé located in northwestern Panama. In general, the social interests of vulnerable groups, such as small farmers, workers of the informal sector and ethnic minorities, are poorly represented in the political system.

Interest groups
7

Over the past two decades, consent for democracy has been moderate to high. Recent survey data have shown substantial support for democracy among Panamanian citizens. The AmericasBarometer survey indicates that over 74% of Panamanians believe that, despite problems, democracy is the best form of government. However, there has been a recent significant decline in the levels of confidence in state institutions, particularly the judiciary and the presidency. Additionally, satisfaction with how democracy works remains rather weak with only 56% of respondents in the 2012 AmericasBarometer survey indicating approval of the incumbent government's performance. In the aftermath of the abrupt break with the PP, Martinelli's approval tumbled by more than 20 percentage points, from 67% in August 2011 to 46% in early September. The popularity of the president hit an all-time low in February 2012 after the announcement of a government plan to liberalize the mining sector. According to a survey published in May 2012 in the daily La Prensa, 55.5% of respondents rated Martinelli's performance as "bad" or "very bad" – the first time that a majority disapproved of his leadership since he took office in July 2009. However, declining levels of support for the incumbent government are not correlated

Approval of
democracy
7

with a rising popularity of autocratic political alternatives. This has been repeatedly confirmed by the results of the Latinobarómetro surveys.

Compared with other countries in Latin America, social capital is relatively low in Panama. While interpersonal trust might be relatively robust (69% trust others: Americas Barometer 2012 survey), and there are autonomous social groups, participation in community groups is relatively low. Additionally, compared with business groups, community and social organizations exercise little power to influence public policy. Patterns of cooperation and mutual support between citizens are (traditionally) more important in indigenous communities.

Social capital

7

II. Economic Transformation

6 | Level of Socioeconomic Development

Question

Score

Panama is categorized by the World Bank as having an upper-middle-income economy.

Socioeconomic
barriers

5

Poverty and social exclusion are quantitatively and qualitatively significant and to a large extent structurally ingrained. At first glance, this assessment seems incompatible with the country's relatively high Human Development Index coefficient. In the UNDP's 2011 Human Development Report, Panama occupies rank 58, with only five Latin American countries ranked higher and only shortly behind Mexico, Saudi Arabia and Bulgaria. However, Panama's high per-capita income goes hand in hand with one of the most heterogeneous and deeply divided socioeconomic entities in the world. The country has a distinct dual economic structure, in which relative wealth and prosperity in Panama City, where over 45% of the population lives, masks deep pockets of poverty and inequality in many parts of the republic. Panama exhibits one of the most unequal income distributions in Latin America. The Gini coefficient value was 0.519 in 2010.

According to the U.N. Economic Commission for Latin America and the Caribbean (ECLAC), Panama's poverty rate was almost 37% in 2002, but declined to about 26% in 2009 and 25.3% in 2011. Extreme poverty or indigence in Panama also fell from 18.6% in 2002 to 12.4% in 2011. However, in rural areas, poverty reaches over 60% and in the indigenous areas even 90%, indicating a thorough degree of exclusion. With regard to the gender inequality index, Panama is ranked 37 places lower than the general HDI.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	24162.9	26589.6	31315.8	36252.5
GDP growth	%	3.9	7.6	10.6	10.8
Inflation (CPI)	%	2.4	3.5	5.9	5.7
Unemployment	%	6.6	6.5	4.5	-
Foreign direct investment	% of GDP	4.5	8.3	10.3	9.3
Export growth	%	-5.6	7.6	-	-
Import growth	%	-12.2	19.2	-	-
Current account balance	\$ M	-177.8	-2764.6	-3825.6	-3267.0
Public debt	% of GDP	43.5	39.6	39.8	38.8
External debt	\$ M	11243.6	11382.0	12583.4	-
Total debt service	\$ M	874.7	1046.6	930.1	-
Cash surplus or deficit	% of GDP	-	-	-	-
Tax revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	10.7	11.2	-	-
Public expnd. on edu.	% of GDP	-	-	4.1	-
Public expnd. on health	% of GDP	6.1	6.1	5.5	-
R&D expenditure	% of GDP	0.21	0.19	-	-
Military expenditure	% of GDP	0.0	0.0	0.0	0.0

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

7 | Organization of the Market and Competition

Panama's economic freedom score is 65.2 in the Heritage Foundation 2012 Index of Economic Freedom, making its economy the 55th freest in the 2012 Index. The score is 0.3 points better than last year due to improvements in freedom from corruption, monetary freedom, and fiscal freedom. Panama is ranked 11th out of 29 countries in the South and Central America/Caribbean region, and its overall score is above the world and regional averages. Panama's overall economic freedom continues to be restrained by institutional shortcomings that undermine prospects for long-term economic expansion. Anticorruption laws seem to have had little impact, and the judicial system remains vulnerable to political interference. According to data

Market-based
competition

7

collected by the World Bank, starting a business in Panama requires six procedures, takes on average eight days, costs 9.9% of income per capita. Panama stands at 29 in the ranking of 183 economies on the ease of starting a business. Dealing with construction permits there requires 17 procedures, takes on average 113 days and costs 95.5% of income per capita. Enforcing a contract requires 31 procedures, takes on average 686 days and costs 50.0% of the value of the claim. Panama stands at 119 in the ranking of 183 economies on the ease of enforcing contracts. According to the Doing Business Report 2012, Panama reduced the time required to register a new company by extending the operating hours of the public registry. Because of its open economy, Panama has few market-access problems. There are no restrictions on the outflow of capital or outward direct investment. In the Global Competitiveness Report 2012 – 2013, Panama attains 40th place worldwide (nine ranks up since last year); concerning only the level of competition it ranked 31st. In Latin America, only Chile has a better overall ranking (33rd).

The introduction of competition policy in Panama was part of a process of economic modernization and structural change in the country initiated in 1994 with the election of President Ernesto Pérez Balladares. 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. Panama also created regulatory institutions to assist in the implementation of market reforms. To promote general competition, the government eliminated the agency that managed price controls and passed Law 29 on 1 February 1996. The law created a combined competition and consumer protection agency called the "Comisión de Libre Competencia y Asuntos del Consumidor" (Commission of Free Competition and Consumers Affairs, or CLICAC), headed by three commissioners. This agency served as the predecessor to the current "Autoridad del Protección del Consumidor y Defensa de la Competencia" (Authority for the Protection of the Consumer and Defense of Competition, ACODECO, or the Agency), created in 2006 by a modification to Law 29/1996.

In general, ACODECO has managed to perform well, given scarce resources and limited government support.

Panama's economy has long focused on free trade. Since the early 1990s, Panama's trade policy pursued the objective of an increasingly open economy. In 1995, the country subscribed to the General Agreement on Tariffs and Trade (GATT) so it could join the WTO.

Anti-monopoly
policy
7

Liberalization of
foreign trade
10

Globally, Panama stands at 11 in the ranking of 183 economies on the ease of trading across borders. Nowhere in Latin America is the average tariff rate lower than in Panama. The country has more than a dozen bilateral free trade agreements with neighbors in Latin America and other countries, and, in October 2012, a free trade agreement with the United States was finally ratified by the U.S. Senate. The United States is Panama's most important trading partner, covering more than 30% of the import market. When the FTA entered into force, over 86% of U.S. exports of consumer and industrial goods became duty-free, as well as about 50% of agricultural exports to Panama.

Panama City is home to the second largest international banking center in the world next to Switzerland. As of November 2012, the center was composed of 93 banks, of which 48 were full-service general-license banks, open to the general public, and 29 international-license banks, which can receive deposits only from non-Panamanians. At the end of September 2012, assets totaled nearly \$87 billion. The financial sector represents a full 8% of the GDP, and employs about 20,000 people. Because the U.S. dollar is the country's currency, Panama has no central bank. The National Bank of Panama has certain functions of a central bank, such as serving as a clearinghouse of the banking sector. According to World Bank data, bank nonperforming loans to total gross loans were at about 1% from 2010 to 2012.

An independent Banking Superintendency oversees the financial sector. Few restrictions limit opening banks, and the government exercises little control over the allocation of credit. The IMF recommends that Panama upgrade its financial sector supervision and infrastructure. According to the 2012 "FSI Survey on Basel II, 2.5 and III Implementation" by the Bank for International Settlement, Panama has emphasized regulatory aspects of corporate governance and the overall framework of risk management before moving to Basel II. In 2008, Panama amended the banking law that allows the regulator to apply capital requirements for market and operational risk; to date, for credit risk, Panama is applying Basel I. Studies probably will begin to move towards Basel II starting in 2013.

The signing of a Tax Information Exchange Agreement with the United States was a precondition for the U.S. Congress' approval of the bilateral FTA. This took place in November 2010. After signing a 12th agreement of this kind (with France, in 2011), Panama was removed from the OECD's "grey list" (of countries that have not committed to internationally agreed upon tax standards and that serve as tax havens).

8 | Currency and Price Stability

The dollar is legal tender in Panama, thus the country has no control over foreign exchange policy. The government can only use fiscal policy to regulate inflation. Historically, Panama has had relatively low inflation rates. However, high

Banking system

8

Anti-inflation /
forex policy

8

international commodity prices and increases of both the Value Added Tax and the minimum wage in combination with the overall economic boom (driven strongly by the Canal expansion project) and growing influx of foreign direct investment as well as an increasing public budget deficit have pushed inflation above historical averages. The inflation rate was recorded at 5.9% in 2011, and rose slightly during the following year.

After having reached 2.1% of GDP in 2012, the non-financial public-sector (NFPS) deficit will grow further in 2013. According to official figures, the projected deficit will amount to 2.8%. Although fiscal responsibility legislation set the deficit target at 2% of GDP, the authorities have used various clauses to justify a larger deficit, including the ability to carry over any “unused” deficit from the previous year (the 2011 deficit of 2.3% of GDP, below the 3% deficit target set for the year). The Martinelli administration has never complied with the original deficit limits, raising concerns about its commitment to fiscal prudence. However, as long as financing conditions stay favorable and nominal GDP growth remains strong, there should be little difficulty in financing the fiscal deficit. In addition, strong capital spending is likely to boost long-term growth. Panama’s sovereign bond rating was upgraded to investment-grade status in 2010. The investment-grade rating lowers the cost of borrowing abroad for the government and functions as a strong market signal that the country is a creditworthy debtor, despite carrying a relatively high and increasing foreign debt (\$11.4 billion in 2010; \$13.1 billion at the end of 2012) as well as facing a growing budget deficit. Panama is one of only six Latin American states to achieve this distinction. Nevertheless, in November 2012, the IMF recommended efforts to reduce the budget deficit in order to contain inflation and repay public debt faster.

Macrostability
8

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 stands at 120 in the ranking of 183 economies on the ease of registering property. U.S. government authorities have received many property dispute complaints from U.S. investors and individual property holders. The complaints relate to broken contracts, demands of extra payments, fraud perpetrated by organized-crime groups and corruption. A large part of these complaints can be attributed to the general lack of titled land in Panama, along with an inefficient judiciary and inadequate government administration of the property system.

Property rights
7

The legal framework for a functional private sector exists. Private enterprises represent the backbone of the economy, but a few state companies remain. While the electric sector is controlled by the private sector, the transmission company is fully owned and operated by the government. The main privatizations took place in the 1990, but there has not been a privatization in several years. There were rumors about

Private enterprise
8

privatizations of the water authority or some functions of the public health system, but up to now the Martinelli government did not proceed with these or any other privatizations. According to The Washington Times, in 2012 the government repealed a measure to sell state-owned land in a duty-free zone along the Panama Canal after a week of sometimes violent protests.

According to the 2012 Doing Business Report, it takes an average of seven days to carry out the six bureaucratic procedures required to register and start a new business. Hardly consistent with the pro-business orientation of the Martinelli administration, the government, in 2010, created the National Road Company to revive failed highway concessions. In 2011, the executive sent a new Public-Private Partnership law to Congress, but it was withdrawn because of opposition from public sector employees who saw greater private sector participation as a threat to their job security.

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 Seguro 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. In the period under review, the number of insured persons increased by approximately 150,000. At the end of 2012, there were 1.26 million persons registered as contribution payers. A total of 2.8 million insured persons and pensioners are entitled to benefits of the CSS. The government pays an annual subsidy of \$100 million to the institution to offset the deficit.

Fulfilling an electoral pledge, the Martinelli administration implemented a program of cash transfers for elderly who did not qualify for social security. The program known as “100 at 70” provides \$100 per month to elderly who are 70 years or older. The government has also implemented a program of delivering basic school supplies to needy families as long as the children remain in school. While overall poverty levels have decreased in the past five years, poverty in rural and indigenous areas remain significantly higher than in the cities. For example, 90% of indigenous communities live in poverty.

A number of institutions work to compensate for gross social inequalities, though their efforts remain insufficient. Equality of opportunity is enshrined in law, but implementation of policy varies and often is subject to corruption and lack of capacity. Discrimination is outlawed, but Afro-Panamanians and those of indigenous origin persistently suffer from labor exclusion. Women increasingly make up a

Social safety nets
6

Equal opportunity
6

greater proportion of the labor force, but are more susceptible to discrimination than men. Social data indicate that women are disadvantaged in general, but women from higher social strata have significantly easier access to higher education, better jobs and public office.

According to the World Bank, Panama has actually underperformed in alleviating poverty compared to the rest of Latin America, despite formidable growth rates. To address these challenges, Panama has introduced various programs to reduce poverty and increase access to services, such as the Red de Oportunidades conditional cash transfer program, which provides cash grants to poor families for keeping their children in school and for meeting mother and infant health controls, child growth monitoring and vaccination schedules.

11 | Economic Performance

According to ECLAC, the Panamanian economy grew by 10.6% in 2011. Growth was driven mainly by public and private investment in projects such as the expansion of the Panama Canal and the building of the metro system in Panama City. During the past 10 years, Panama's economy grew an average of 7.3% per year. The unemployment rate declined sharply in 2011 to 4.5%. However, the inflation rate rose to 6.3%. The current-account deficit grew to 12.7% of GDP, compared with 10.8% in 2010. Foreign direct investment inflows increased to 9.1% of GDP, compared with 8.8% in 2010. Following a modest deceleration in the fourth quarter, the economy is expected to exhibit real GDP growth of 10.1%, marking the second consecutive year of double-digit expansion. For the years 2013 and 2014, GDP growth will remain driven by Canal expansion and other large-scale investment projects. After slowing to 7.7% in 2013, growth is expected to quicken to 8.1% in 2014 as public spending and investment accelerate in the run-up to the presidential and legislative elections scheduled for May of that year.

Output strength
8

12 | Sustainability

Regulation and protection of the environment in Panama come under the jurisdiction of the Instituto de Recursos Naturales Renovables (INRENARE, Institute for Renewable Natural Resources), the Ministry of Agricultural Development, and the Ministry of Health. There are a handful of independent civic and non-governmental organizations – some more radical than others – which play a role as watchdogs. The major non-governmental environmental organizations are: Asociación Nacional para la Conservación de la Naturaleza (National Association for Nature Conservation), Asociación Centro de Estudios y Acción Social Panameño (Panamanian Center for Research and Social Action), Fundación para el Desarrollo de los Jóvenes (Foundation for the Development of Youth) and Fundación Dobbo-Yala.

Environmental
policy
5

Key current environmental issues in Panama include water pollution from agricultural runoff, threats to fishery resources, endangerment of wildlife habitats, deforestation, land degradation, wetland destruction, and soil erosion.

There is a need for increased public awareness of, and sensitivity to, the protection of land, biodiversity and natural resources. The development of a national policy in this regard is also imminent. The government historically has given greater priority to private sector economic interests than to environmental protection. Agencies charged with protecting the environment are underfunded and understaffed and they lack regulatory authority. However, recent mobilization of civil society groups has raised awareness of environmental concerns and some development projects have been delayed or derailed.

In 2011, popular pressure forced President Martinelli to repeal a reform of the mining law, which would have opened the sector up to foreign government investment. His decision to revisit the issue and sending a corresponding bill to Congress, less than a year later, once again brought indigenous and environmental groups onto the streets. Indigenous concerns are based on the fact that Cerro Colorado, believed to hold the biggest copper reserves in the country, is located in the Ngäbe-Buglé Comarca, which spans some 8% of the national territory. In March 2012, President Martinelli bowed to popular pressure and agreed to repeal the changes to the mining law.

Panama's educational system is still plagued by significant inequalities between urban and rural areas in both coverage and quality of education. On average, rural children attend school three years less than urban pupils. At the primary level, more than 10% of the children leave school before completing 5th grade. There is a shortage of secondary schools, and teaching is of poor quality in those that exist. The education system is ranked 62nd out of 65 countries screened by the OECD. Panama's R&D spending is 0.21% of GDP. Expenditure on education is less than 4% of GDP. The University of Panama is the largest university in the country. The higher-education system also includes the Technological University of Panama, plus a number of private institutions. The University of Panama is affected by politicization and bureaucratic inefficiencies, plus lack of funding.

Education policy /
R&D
5

Literacy rates are high at 93%, but the rates vary significantly between urban and rural areas. Additionally, schooling might provide adequate basic education but it fails to provide the best pedagogical practices. Teacher training is deficient, and innovation is hampered by opposition by teachers unions. The bad quality of public schools correlates positively with the lack of skilled workers in various sectors of the economy. The shortage of skilled labor is exacerbated by a Panamanian law that mandates 90% of an employer's staff must be national citizens. A recent study found that 80% of Panama's management positions are held by non-Panamanians or Panamanians who studied abroad.

Transformation Management

I. Level of Difficulty

Panama's structural constraints stem from the very nature of the country's economic and social systems. Because of the strong fiscal dependency on the Panama Canal and the outward-oriented service branches, the country is highly vulnerable to external economic influences. While significant economic growth in the last decade, driven by foreign direct investment, government spending and the expansion of the Panama Canal, helped to ameliorate underlying constraints, Panama remains a country with a dual economy. The metropolitan area of Panama City has seen significant levels of growth and economic activity, while rural and indigenous communities still struggle with a lack of basic services or economic opportunity. Security is a major concern as the country's inability to fully protect its borders makes it vulnerable to transnational criminal networks, particularly drug and arms traffickers, as well as money launderers. Corruption, inefficient institutions and dysfunctional checks and balances represent major structural constraints. Another structural problem lies in a judicial system that lacks independence, is slow and inefficient, and exhibits significant levels of corruption. On the other hand, there is a broad basic consensus about democracy and core democratic principles. Evidence from the Americas Barometer 2012 survey indicates that Panamanians believe strongly that democracy is the best system of government and overwhelmingly reject authoritarian measures. However, in practice, the current government and especially the president himself show little respect for democratic principles.

Structural
constraints
5

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. Civic organizations' influence on public policy is modest, with the exception of business groups. However, during particular junctures Panamanians have mobilized significantly to promote key political and social goals (for example, in the mobilizations aimed at toppling the Noriega regime in the late 1980s). Again, in the 1990s, labor and student groups joined forces to oppose privatization efforts and neoliberal economic reforms. Lately, indigenous groups have mobilized significant protests against efforts by the Martinelli administration to expand multinational corporations' participation in mining. Labor unions mobilized successfully against proposed legislation that would further weaken

Civil society
traditions
5

their organizational abilities. After the Martinelli government's successful machinations to neutralize the independence and scope of action of both the legislative and judicial branch, there are only civil society groups left to exercise checks and balances.

As social indicators demonstrate unequivocally, deep social inequalities divide Panamanian society. Although there are ethnic tensions and conflicts, they regularly remain on the edge of political events. Panama is a transactional society. Its elites were predominantly merchants; doing business is deeply engrained in their soul. Deal-making, transacting for the purpose of advancing an agenda or one's economic or political interest, is a vital component of Panamanian culture. There is little tradition of political violence, and most conflicts are settled through negotiations. The modus operandi of governments is to push for a particularly onerous law, which is then opposed, often with significant mobilizations by labor unions, students and indigenous communities, followed by negotiations which typically lead to a reversal or modification of the original proposal. There are few cleavages that lead to violence. The Martinelli administration has resorted to the use of security forces on several occasions to deal with social protests. In a few instances, these clashes have resulted in injuries and a few deaths. However, despite an appearance of violence, conflicts have never degenerated to the point that widespread violence would engulf the nation. Violence manifests itself mainly in crime.

Conflict intensity
3

II. Management Performance

14 | Steering Capability

Traditionally, Panamanian governments have placed a premium on short-term political goals rather than strategic objectives, especially in the face of strong public protests against certain policies. Macroeconomic growth has enabled recent governments to better develop and promote strategic objectives, such as the expansion of the Panama Canal and other major infrastructure projects. However, many projects are financed through (foreign) debt which could undermine future economic stability. Technocratic capacity within the Panamanian government is weak since presidents prefer political loyalty over technical skills as the key criterion for appointments. Long-term strategic planning is also hindered by the wholesale displacement of bureaucrats from one administration to the other. This is made worse by the fact that each political transition since 1989 has been from governing to opposition parties. While good for democracy, these transitions have not helped to consolidate strategic goals.

Question
Score

Prioritization
6

Economic growth has significantly increased the revenues available for the implementation of government policies. The Martinelli administration has been able to implement most of the policies it has formulated, particularly regarding infrastructure spending. Some political objectives, such as reforming the constitution and changing the electoral laws, have been hampered by political opponents of the president. After the 2011 break-up of the governing coalition, the ability of the president to get his political agenda through has been reduced only for a short time. Through control of government resources, the president has been able to co-opt enough legislators to build a new majority in the unicameral National Assembly. This level of authority has meant the president can obtain almost anything he wants from the National Assembly.

Implementation
7

The government has not fulfilled its promise to fight corruption. Having fought the 2009 election on an anticorruption platform, Martinelli in his tenure was already confronted with several cases of corruption in his own government.

The government exhibits a capacity for changing course when confronted with popular mobilizations. This reflects the culture of transaction that is fundamental to Panama's political system. Martinelli's heavy-handed approach toward governing several times provoked opposition and public protests, thus causing the executive to repeal laws or to make policy adjustments.

Policy learning
6

However, the spectrum of policy options is rather limited. Panamanian elites are culturally, socially, economically and politically grounded in a neoliberal ideological point of view which emphasizes a reduced state sector and private solutions to collective problems. The defunding of public education continues because of the dominant role of private K-12 schools. Other public services, such as garbage collection and security, are deficient in part because those who pay the most taxes are generally able to pay for those services from private companies. The lack of long-term policy efficiency and the dearth of technocratic ability among bureaucrats also hinders policy learning. Additionally, the overwhelming use of political rationality to formulate and implement policy makes it very difficult to shift whenever policy failures occur.

In summary, it can be emphasized that learning processes occur, but rarely lead to innovative approaches with respect to designing and implementing policies.

15 | Resource Efficiency

Political loyalty continues to be the primary criterion for appointment of government bureaucrats. Corruption and lack of technical capacity are major hindrances to efficient government operation. Macroeconomic stability and growth in revenues have allowed the Martinelli administration to make use of resources not available to

Efficient use of
assets
4

prior governments. This has meant greater spending on social programs and infrastructure development. However, there is no evidence that the government has made significant efforts to improve human capacity nor to move toward a greater reliance on merit and technical capabilities as key criteria for filling bureaucratic positions. Martinelli executed massive job cuts in the overstuffed state apparatus. While some efforts have been made to speed the processing of some bureaucratic procedures, such as the Public Registry, these efforts are few and far between and have not changed demonstrably the basic characteristics of the Panamanian bureaucracy: corrupt, inefficient and politically motivated. More than once, President Martinelli seemed to prefer no-bid contracts for the many public works that he is launching, thus heightening suspicions about the misuse of public funds. The Panama Canal Authority (ACP) appears as an island of professionalism and efficiency in an ocean of suboptimal administrative performance. It has managed to significantly improve the transit service since the handover of the waterway. However, in connection with the award of contracts for the modernization of the waterway, the ACP in 2011 was confronted for the first time with serious allegations of corruption.

Panama has a highly centralized, hierarchical and bureaucratic coordination system. During the Martinelli administration, the president's personalist and sometimes erratic style of governing has further undermined policy coordination. The administration addresses conflicts on an ad hoc basis without a long-term strategic goal of mediating and resolving political or social conflicts. Policy development and implementation are marred by corruption and shifting of blame. Again, macroeconomic stability has enabled the government to manage the fallout of conflict with minimal detriment to its ability to govern and minimal damage to the country's economy. This, however, has more to do with the nature of Panama's economic system rather than any meaningful strategic policy coordination system.

Policy
coordination
6

Domestic anticorruption mechanisms exist, such as asset forfeiture, whistle-blower and witness protection, and conflict-of-interest rules. However, the general perception is that anticorruption laws are not applied rigorously. Panama's government lacks strong systemic checks and balances that incentivize accountability. The Martinelli administration has been accused of participating in major corruption cases. One allegation stems from a bribery scandal linked to an Italian company's attempt to pay substantial kickbacks to Panamanian government officials in exchange for lucrative government contracts. In addition, Panama has also long been notorious as a transshipment point for drugs and a haven for money launderers. Combating corruption, in Martinelli's view, means primarily the investigation of corruption charges against high-ranking members of former PRD governments. Mainly in pursuit of political objectives, he encouraged prosecutors to investigate PRD ex-ministers and party officials, leading to a series of criminal charges against them.

Anti-corruption
policy
3

Worth mentioning in this context is a law amending the code of criminal procedure, which set a two-month deadline for the Supreme Court to resolve all criminal charges against national deputies or, failing that, to dismiss the cases. Ratified in August 2012, the bill was criticized by the media as a means of granting legislators immunity, given the unlikelihood of cases being resolved within the stipulated timeframe. Independently of this, Martinelli's deliberate weakening of the system of checks and balances has undermined the mutual control of judicial and legislative powers. Panamanian law provides that only the Congress may initiate corruption investigations against Supreme Court judges and that only the Supreme Court may launch investigations against members of Congress, thereby encouraging, in effect, a kind of "non-aggression pact" between these branches of government.

16 | Consensus-Building

In principle, all major Panamanian political actors and leaders agree that democracy is the best form of government; they also believe in the singular performance capabilities of the market economy. Historically, elites have derived from the merchant sector and have relied heavily on the service economy. Near universal acceptance of the country's role as a major transit point for commerce and of the centrality of the Panama Canal minimizes disputes around economic policies within the upper classes. However, conflicts have emerged between elites and popular sectors regarding the economic mode of production. Popular sectors nonetheless embrace the centrality of the Panama Canal in the country's development scheme and support democracy as the best form of government. The important players in Panama tend to be from the business sector; the president is a prime example. Political parties are rather weak but some leaders represent cross-cutting cleavages, particularly within the business community, and thus exercise leadership as businessmen and politicians.

Under the democratic shell of the country's political system, there have always been authoritarian tendencies and enclaves, although the Martinelli government set a new record in this regard.

There are few to no antidemocratic actors within the Panamanian political system. Even the most vociferous opponents of neoliberal economic policies are basically supportive of democracy. These groups, such as labor unions, student organizations and indigenous communities, may oppose the manner in which democracy is being implemented in Panama, but do not question that democracy is the best form of government. The abolition of the armed forces in 1994 eliminated the one institution that historically had posed a threat to democratic governance in Panama. The new security apparatus is firmly in civilian hands. There is no chance of a military coup. Panama's transactional culture makes the rise of anti-system armed groups highly

Consensus on goals
8

Anti-democratic
actors
9

unlikely. The greatest threat to democratic values and practices is currently emanating from the government itself.

As stated earlier, Panama's political culture is one of transaction rather than confrontation. The government generally negotiates with opposition forces in order to prevent escalation of conflicts to an unmanageable level. However, negotiations only take place once opposition forces have mobilized. There are few mechanisms for preventive conflict resolution. The Martinelli administration has been more willing than its predecessors to push controversial legislation precipitating large-scale mobilization of indigenous and labor groups; as such it has been less willing and able to prevent cleavage-based conflicts from escalating. Nonetheless, in all cases the government ultimately has been willing to negotiate to quell opposition. Economic growth has allowed the current administration to use resources in order to placate opposition groups. Thus, the risk that cleavages rooted in Panama's highly unequal social structure will transform into political conflict increases inevitably with deteriorating economic and social conditions.

Cleavage /
conflict
management

7

Generally, civil society's participation in policymaking is weak. The Martinelli administration in particular has not involved civil society consistently in policy formulation, and regularly ignores recommendations by civil society groups on policy or on government appointments. Civil society has been particularly vocal against the president's judicial appointments. One group that has engaged in significant opposition is the Alianza Ciudadana Pro Justicia, a conglomerate of civic groups focused on anticorruption and the judicial system. Opposition from Alianza and others stopped the administration's plan to add a fifth chamber to the Supreme Court, thus denying the president the ability to pack the court.

Civil society
participation

4

Martinelli's undemocratic maneuvers to reduce the independence of the Supreme Court and the Congress inadvertently created political space for civil society groups, thereby enhancing their ability to function as a political corrective to government policy.

Panama's major issues of reconciliation and justice relate to the victims of the military-led regime (1968 – 1989) and to the U.S. invasion of December 1989. Efforts by the Moscoso (1999 – 2004) and Torrijos (2004 – 2009) administrations settled most of the issues related to these two events. While there are some groups that continue to seek resolution of cases from the invasion and the military regime, little significant social or political attention is paid to these matters. Nothing significant has happened since 2011 and there is little chance that these issues will receive any attention in the foreseeable future. General Manuel Noriega was extradited to Panama from a French jail in December 2011. While the extradition received worldwide media attention, it has had little impact on Panama's political system; nor has it made

Reconciliation

5

a major impact on opening any of the historical claims from the military or U.S. invasion periods.

Martinelli's frequent attempts to blame the PRD for its authoritarian past (during the Noriega years) are hardly to reconcile with the fact that the president named several high representatives of the Noriega era to important posts in his government, the police force and the Supreme Court.

17 | International Cooperation

International trade and cooperation are major components of Panama's economic success. The Panama Canal is an international waterway that relies on global users for its success. The Martinelli administration cultivates good economic and political relations with international partners, particularly the United States and European Union. U.S. assistance mainly consists of (little) foreign aid, port security efforts and cooperation to combat drug trafficking and money laundering. The government has also made efforts at further integrating Panama into the regional economy by focusing on participation in the Central American Integration System and seeking observer status within the Andean Pact. The ratification of the free trade agreement with the United States will further advance cooperation between the two countries. Problems of corruption and administrative inefficiencies, however, hinder the ability of the government to take full advantage of the international connections.

Effective use of support

7

The Panamanian government is seen as a credible partner by the international community, particularly when it comes to economic development policies. The growth in foreign direct investment is an indication that Panama's economy is seen as stable and a good investment possibility. Attaining and securing investment grade status in 2010 has been helpful in strengthening the prestige of the Panamanian economy in the international community. The inability to deal with corruption, and the perception that in fact corruption has grown under the current government, is a major hindrance to full respectability within the international community. Recent concerns over debt financing of infrastructure development projects have tarnished the image of the Martinelli administration as a good steward of the economy. In comparison to the authoritarian tendencies of the left-leaning governments in Latin America, Martinelli's undemocratic machinations go rather unnoticed outside of Panama.

Credibility

8

The Martinelli administration has made efforts to integrate Panama more fully into the Central American Integration System. The government has also made efforts to cooperate more closely with the Andean countries. The recently ratified free trade agreement with the United States will further integrate Panama into the U.S. market. Panama is expected to join the Central American Common Market in 2012. This fulfills the requirement requested by the European Union for Panama to be part of

Regional cooperation

9

the Association Agreement signed by the EU with the current members of the SIECA: Costa Rica, El Salvador, Honduras, Guatemala, and Nicaragua. Panama has great commercial importance for its neighbors. It is the main buyer of Costa Rican products in Central America. Panama is a member of the Organization of American States and was a founding member of the Rio Group. Although it was suspended from the Latin American Economic System – known informally both as the Group of Eight and the Rio Group – in 1988 due to its internal political development under Noriega, Panama was readmitted in September 1994 as an acknowledgment of its newly acquired democratic credentials. During the 2009 electoral campaign, Martinelli pledged to remove Panama from the Central American Parliament (Parlacen), but a January 2012 ruling by the Supreme Court found the country's exit from the Parlacen unconstitutional. Therefore, for the time being, Panama remains a member of this regional legislature.

Strategic Outlook

Following a modest deceleration in the fourth quarter, 2012 saw real GDP growth of 10.1%, marking a second consecutive year of double-digit expansion. In 2013 and 2014, GDP growth will remain driven by Canal expansion and other large-scale investment projects. Growth should continue in 2014 as public spending and investment accelerate in the run-up to the presidential and legislative elections scheduled for May of that year. The government's ambitious spending plans will underpin public consumption (particularly in 2013 – 2014), while the ongoing Canal expansion and construction of a metro system in the capital will drive fixed investment in those years.

The next presidential and legislative elections are scheduled for May 2014. Consecutive reelection is constitutionally barred. Electoral dynamics – including the eventual number of presidential candidates and the way in which alliances are forged between now and the election – will determine the outcome. The chances of victory for the governing party will hinge in large part on whether Martinelli manages to revive his administration's approval ratings during his remaining time in office and also on whether the party chooses a candidate with widespread popular appeal to contest the election.

Policy priorities will remain focused on a series of large capital investment projects, including the expansion of the Panama Canal and the construction of a metro rail system in Panama City. These infrastructure upgrades form part of wider plans to develop Panama into a regional logistical hub and to expand its capacity for reassembly operations. In the medium term, the main challenge is to ensure a smooth transition to sustainable growth once the major public investment projects are completed.

The huge gap between living standards of residents of the capital and those in the rest of the country will remain significant and could widen even further as the focus on infrastructure spending comes at the expense of investment in agriculture (the main employer outside the capital). Panama's business environment will continue to be hampered by corruption and administrative inefficiency, a complex and burdensome tax regime, and poor contract enforcement.

Despite corruption scandals and widespread demonstrations, governability is likely to remain secure until the 2014 general elections. This will, to some extent, be supported by a strong legislative position resulting from the active recruitment by the ruling Democratic Change Party of defectors from the opposition Revolutionary Democratic Party (PRD), which has suffered from infighting since its election defeat in 2009. The ruling party has also recruited some deputies from the opposition Partido Panameñista (PP), which, until September 2011, was part of the governing coalition. This strategy gave the CD a solid 40-seat majority in the 71-seat unicameral legislature, which it is likely to hold until the 2014 elections.

Social unrest will remain, for now, a feature of the political scene. Indigenous communities such as the Ngäbe-Buglé will continue to oppose mining and hydroelectric projects on their land, as the government continues to seek to develop Panama's mineral reserves. With the majority of Panamanians sympathizing with indigenous communities' resistance to mining and hydroelectric projects, further unrest could inflict more damage on the president's approval ratings, which have also been affected by a perception that he governs and responds to protests in a heavy-handed manner.