Panama: Background and U.S. Relations

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Summary

The Central American nation of Panama has had five successive elected civilian governments since its return to democratic rule in 1989, and a sixth is scheduled to assume power on July 1, 2014 with the inauguration of current Vice President Juan Carlos Varela as President. Hailing from the center-right Panameñista Party, Varela won the May 4, 2014 presidential election with 39% of the vote in a three-candidate race. Significantly, Varela defeated the candidate of the ruling Democratic Change party of current President Ricardo Martinelli, who was constitutionally prohibited from running for reelection. Elected in 2009, Martinelli remained generally popular during his presidency despite criticism at various junctures for his combative style of governing. Nevertheless, his popularity ultimately was not enough to convince voters to support his party’s candidate. One controversy that emerged in the campaign was that Martinelli’s wife became his party’s vice presidential candidate. This led to some critics complaining of an attempt by Martinelli to extend his influence in the next government.

Panama’s largely services-based economy has been booming in recent years, spurred on by several large infrastructure projects, including, most significantly, the Panama Canal expansion project that began in 2007 and is expected to be completed in early 2016. A challenge for the Varela government will be how to contend with slower economic growth rates as the Canal expansion project winds down. Another challenge for the government is making more headway in combating poverty and inequality in Panama, which still remain relatively high.

U.S. Relations

The United States has close relations with Panama, stemming in large part from the extensive linkages developed when the Panama Canal was under U.S. control and Panama hosted major U.S. military installations. Relations have been strengthened by a bilateral free trade agreement that entered into force in October 2012. As noted by the State Department, Panama’s central location in the hemisphere, its transportation infrastructure (most notably the Canal), and its financial sector make it an important hub for global trade and a key U.S. strategic partner, but these same characteristics also make Panama vulnerable to drug trafficking, money laundering, and organized criminal activity.

Since Panama is relatively well developed economically compared to its Central American neighbors, the United States provides just small amounts of bilateral assistance to Panama. Nevertheless, the country receives additional assistance through the Central American Regional Security Initiative (Carsi), a U.S. regional security program begun in FY2008 to help Central American states reduce drug trafficking while advancing citizen security. Panama’s anti-drug cooperation with the United States is strong. While the country has made progress in improving its anti-money laundering regime, there are several factors that hinder the country’s efforts to combat such activity.

The Panama Canal expansion project, which will accommodate a new generation of massive container ships, is expected to reduce shipping rates between Asia and the U.S. Gulf and East coasts, resulting in increased Canal transits and trade. A number of U.S. ports have begun readying themselves in order to take advantage of the expansion.

This report provides background on the political and economic situation in Panama and U.S.-Panama relations. An appendix provides links to selected U.S. government reports on Panama.
Panama’s Political and Economic Environment

A Central American nation with a population of about 3.8 million, Panama has made notable political and economic progress since the December 1989 U.S. military intervention that ousted the military regime of General Manuel Antonio Noriega from power. The intervention was the culmination of two and a half years of strong U.S. pressure against the de facto political rule of Noriega, commander of the Panama Defense Forces. Since that time, the country has had five successive elected civilian governments, and a sixth is scheduled to assume power on July 1, 2014 with the inauguration of current Vice President Juan Carlos Varela as President. Current President Ricardo Martinelli, elected in 2009, remained generally popular during his presidency despite criticism at various junctures for his combative style of governing. Panama’s largely services-based economy has been booming in recent years, spurred on by the Panama Canal expansion project that began in 2007 and is expected to be completed in early 2016.

The endurance of elected civilian democracy in Panama for almost 25 years is a significant departure from the country’s previous 21-year history of military rule. This included the populist rule of General Omar Torrijos (1968-1981), who initially governed as a social reformer, and the increasingly repressive rule of General Noriega (1983-1989). In the aftermath of the ouster of the Noriega regime, the duly elected winner of the 1989 presidential election, Guillermo Endara (1989-1994), took office; his coalition government made significant progress in restoring functioning democratic political institutions, although the demilitarization process was difficult at times. The center-left government of President Ernesto Pérez Balladares (1994-1999) of the former pro-Noriega Democratic Revolutionary Party (PRD) implemented an economic reform program that included trade liberalization and privatization of state-owned enterprises. Pérez Balladares sought to amend the Constitution to allow for presidential reelection, but Panamanians rejected the proposal by a large margin in a national referendum. The center-right Arnulfista Party government of President Mireya Moscoso (1999-2004), Panama’s first female President, partially reversed the trade liberalization efforts of her predecessor. The center-left PRD government of President Martín Torrijos (2004-2009), the son of the former military ruler, initiated the Panama Canal expansion project, negotiated a free trade agreement with the United States, and enacted judicial, penal, and anti-corruption reforms.

Panama at a Glance

| Area: 75,420 sq. km., slightly smaller than South Carolina |
| GDP: $36 billion (2012 estimate). |
| Services, value added (as % of GDP): 78.3 |
| Per Capita Income: $8,510 (2012) |
| Key Trading Partners: United States (24%) China (7.8%) Costa Rica (4.2%) |
| Life Expectancy: 77.4 years (2012 estimate) |
| Literacy: 94.1% (2010 estimate) |
| Legislature: National Assembly, 71 members, unicameral |

Sources: World Bank, Department of State

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Current President Ricardo Martinelli, a businessman and former government minister from the small center-right Democratic Change (CD) party, defeated the PRD candidate by a landslide in the May 2009 presidential election. His electoral alliance, known as the Alliance for Change, also won a majority of seats in the National Assembly. Until September 2011, President Martinelli governed in a coalition with the center-right Panameñista Party (PPA, previously known as the Arnulfista Party), but the coalition fell apart in August 2011 after a rupture in relations between Martinelli and Vice President Juan Carlos Varela of the PPA. Varela was sacked as foreign minister, but continued in his elected position as Vice President, albeit as a strong critic of President Martinelli.

In the last year of his term, President Martinelli remained broadly popular in large part because of the strong performance of the Panamanian economy under his government buoyed by the ongoing Canal expansion and other large infrastructure projects (see “Economic Situation” below). Yet over the course of his tenure, Martinelli’s public approval ratings had dropped several times after strong public opposition and protests over some of his policy proposals related to labor issues, mining, and the sale of land in the Colón Free Zone (the world’s second largest duty free zone after Hong Kong). He was also criticized by civil society groups and political opponents for taking a heavy-handed approach toward governing and for not being more consultative.

May 2014 Elections

In Panama’s May 4, 2014 elections, current Vice President Varela of the center-right PPA won the presidency with 39% of the vote in what was essentially a three-candidate race. President Martinelli was ineligible to run for reelection since, according to Article 178 of Panama’s Constitution, the President may not be reelected until two presidential terms have passed. Under Panama’s electoral system, the President is elected by simple majority, with no provisions for a second round. Varela defeated José Domingo Arias of the ruling center-right CD party of President Martinelli, who received 31%, and Juan Carlos Navarro of the center-left PRD, who received 28%. Arias had led opinion polls during much of the campaign, but the race tightened in the month leading up to the vote.

Initially, the popularity of President Martinelli was a key factor helping Arias in the race. One controversy that emerged, however, was the selection of Martinelli’s wife, Marta Linares, as the CD’s vice presidential candidate. Some critics feared that the first lady’s candidacy could have allowed Martinelli to retain influence in the next government and give rise to a political dynasty. There were also concerns that if Arias had won the presidency, his government could have submitted a constitutional reform to shorten the reelection ban period from 10 years to 5 years, allowing Martinelli to run again in 2019.

President-elect Varela, a long-time businessman who received a degree in industrial engineering from Georgia Tech, has served as leader of the PPA since 2006. As noted above, Varela has served as Vice President since 2009 despite his break in relations with President Martinelli in 2011. He also served as Minister of Foreign Relations from July 2009 until August 2011.

During the 2014 electoral campaign, Varela advocated programs such as emergency price controls for basic products, an electricity project with Colombia, and an integrated public transportation plan for Panama City. Varela also has vowed to combat inequality. As Vice President, Varela
reportedly was instrumental in shaping some of the popular social policies of the Martinelli government, including monthly payments to Panamanian seniors without pensions as well as housing and scholarship programs for the poor.² Anti-corruption was also a major campaign theme for Varela, especially since the Vice President’s break with President Martinelli involved Varela’s allegations of governmental corruption. Since Varela hails from the private sector, where for many years he worked for his family’s rum company, Varela Hermanos, many of the pro-business economic policies of the Martinelli government are likely to remain in place. In terms of foreign policy, Varela has indicated a willingness to resume diplomatic relations with Venezuela, which had been severed in March by Venezuela because of Panama’s efforts to encourage action at the OAS on Venezuela’s recent political unrest.

Varela’s vice presidential running mate, Isabel St. Malo, is a political independent who had worked developing Varela’s campaign platform. She has already been tapped to become Minister of Foreign Affairs in the new government. Some reports describe her as a consensus-builder. She previously served as Panama’s alternative Ambassador to the OAS under the Endara Administration in the aftermath of Panama’s return to democratic rule.

In addition to the presidential race, voters selected members of Panama’s 71-seat unicameral National Assembly and hundreds of local officials—all for five-year terms. While to date not all of the legislative races have been certified, reportedly the CD-led electoral coalition known as Unidos Por Más Cambios (United for More Change) won 33 of the 71 seats; the PRD won 24; President-elect Varela’s PPA-led electoral alliance known as El Pueblo Primero (People First) won 13; and one independent deputy was elected.³ With just 13 legislative seats, Varela faces the challenge of securing legislative support for his agenda. Varela’s coalition and the PRD reportedly have agreed to a pact of governance that will provide the Varela government with a majority in the legislature. Some analysts question whether such a pact will be able to hold together over the long-term given the different political orientations of the PRD and the Panameñista Party and because of the multiple factions within the PRD.

The 2014 elections were considered free and fair by independent observers, including the Organization of American States (OAS) and the Carter Center.⁴ Both organizations lauded Panama’s Electoral Tribunal (TE) for its conduct of the elections, but also raised some concerns about some aspects of the electoral process, including the use of public resources by the candidates of the incumbent party. The OAS, which has observed nine elections in Panama since1972, had raised concerns in March about some attempts to discredit the TE.⁵

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² “Panama Politics: Varela’s Path to the Presidency,” Economist Intelligence Unit (EIU) ViewsWire, June 12, 2014.
Economic Situation

Panama’s services-based economy has been flourishing in recent years, in large part because of the Panama Canal expansion and other large infrastructure projects, such as a metro system for Panama City, a third bridge over the Canal, and expansion of the country’s international airport, regional airports, and several roads and highways. When the Martinelli government took office in 2009, it had to deal with the fallout stemming from the global financial crisis, but the economy weathered the storm and avoided the contraction experienced by many Latin American economies. Before the financial crisis, Panama’s economy had been booming, growing by over 10% in 2007 and 2008. The global financial crisis and U.S. recession slowed Panama’s economic growth to 3.9% in 2009, but this still made Panama’s economy one of the few in the region registering positive economic growth. Since then, the economy has rebounded. Economic growth averaged 9.4% from 2010-2013, and in 2014 the forecast is for 7% growth. The International Monetary Fund issued its latest Article IV consultation staff report on Panama in early June 2014 and concluded that the country’s economic performance remains buoyant, with banks that are well capitalized, profitable, and liquid.

Strong economic growth in recent years has contributed to poverty reduction in Panama. According to the U.N. Economic Commission for Latin America and the Caribbean, the poverty rate declined from 31% in 2005 to 25% in 2011, while indigence or extreme poverty fell from 14.1% in 2005 to 12.4% in 2011. Targeted social programs have also contributed to a reduction in poverty. The Torrijos government initiated a social support program of conditional cash transfers to poor families and the elderly, and the Martinelli government established a program to provide monthly payments (now $120) to seniors over 70 years of age who do not receive a pension, as well as a universal scholarship program that provides monthly grants to students.

Nevertheless, while Panama is classified by the World Bank as having an upper-middle-income economy because of its per capita income ($8,510 in 2012), inequality still remains relatively high, with large disparities between the rich and poor. The World Bank asserts that challenges persist in the provision of public services, particularly for children in indigenous communities who have significantly less access to basic services than children in rural or urban areas. It maintains that accelerating poverty reduction depends on the country developing a more effective social protection system for the poor. Panama has received support from the World Bank for a variety of projects focused on health, social protection, rural development, environment, infrastructure, and efficiency in the public sector.

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7 International Monetary Fund, Panama, 2014 Article IV Consultation – Staff Report; Press Release, and Statement by the Executive Director for Panama, IMF Country Report No. 14/157, June 2014.
Figure 1. Map of Panama

Source: Map Resources. Adapted by CRS.
U.S.-Panama Relations

U.S. relations with Panama date to the country’s independence from Colombia in 1903. While historically there were strains in relations at various times over the operation of the Panama Canal, the Panama Canal treaties negotiated in 1977 reduced tensions in the relationship and set a path for Panama’s assumption of full jurisdiction over the Canal by the end of the century. Relations deteriorated significantly in the 1987-1989 period under the de facto political rule of General Manuel Noriega. Since the December 1989 U.S military intervention, however, and Panama’s return to elected civilian democratic rule, U.S. relations with Panama have been close. Bilateral relations were strengthened with the approval of a bilateral free trade agreement that entered into force in October 2012.

According to the State Department, the country’s central location in the hemisphere, the Panama Canal, its transportation infrastructure, and its financial sector make it an important hub for global trade and a key U.S. strategic partner, but these same characteristics make Panama vulnerable to drug trafficking, money laundering, and organized criminal activity.10 Upon Juan Carlos Varela’s election in May 2014, Secretary of State John Kerry commented that “our longstanding cooperation and commitment to Panama and the Panamanian people will endure with the next Administration.”11

In terms of foreign policy, Panama has been a strong U.S. ally in the region. While many other Latin American countries had a timid response to the Venezuelan government’s suppression of protests beginning in February 2014, Panama spoke out and called for a special meeting of the OAS and even made a Venezuelan opposition legislator a temporary member of its OAS delegation.12 In July 2013, Panama detained a North Korean freighter, which had made stops in Cuba, as it prepared to enter the Panama Canal due to suspicion that the ship was carrying illicit narcotics; instead, the ship was found to be carrying military weapons. The U.N. Security Council’s Panel of Experts for North Korea visited Panama and concluded in a report issued by the Security Council in March 2014 that the military shipment destined for North Korea constituted a violation of U.N. sanctions violation. During a trip to Panama in November 2013, Vice President Biden lauded Panama for stepping up and taking on that international responsibility and contribution to global security.13

Looking ahead, Panama is scheduled to host the next Seventh Summit of the Americas in 2015. At issue is a possible invitation to Cuba to participate in the summit; Panama’s Minister of Foreign Affairs reportedly has suggested extending an invitation to Cuba.14 Several Latin American nations have vowed not to attend the summit unless Cuba is allowed to participate. The United States and Canada opposed Cuba’s attendance at the 2012 summit because it was not a democracy, and ultimately Cuba was not invited.

14 “Debate Over Cuba Over Participation in Next Year’s Summit of the Americas,” Deutsche Presse-Agentur, June 5, 2014.
U.S. Foreign Aid and Other Support

A number of U.S. agencies provide support to Panama. The State Department, the Drug Enforcement Administration, the U.S. Coast Guard, the Department of Homeland Security, and the Department of Defense are all involved in providing counternarcotics support. The U.S. Southern Command (Southcom) provides support to Panama through military exercises providing humanitarian and medical assistance, and at times provides emergency assistance in the case of natural disasters such as floods or droughts. Southcom has sponsored annual multinational training exercises since 2003 focused on the defense of the Panama Canal. Panama also participates in the Container Security Initiative (CSI) operated by the U.S. Customs and Border Protection of the Department of Homeland Security, and the Megaports Initiative run by the National Nuclear Security Administration of the Department of Energy. Panama hosts the Smithsonian Tropical Research Institute dedicated to studying biological diversity. The Peace Corps has about 190 volunteers in the country working on a range of development projects.

Because of Panama’s relatively high per capita income level and progress in economic development, the United States has not provided large amounts of foreign aid to the country in recent years. At this juncture, the United States provides just small amounts of bilateral assistance to Panama, but Panama has also received U.S. assistance through the Central American Regional Security Initiative (CARSi), a U.S. regional security program begun in FY2008 to help Central American states reduce drug trafficking while advancing citizen security.

U.S. bilateral assistance to Panama amounted to $3.4 million in FY2013 and an estimated $3 million in FY2014. The Administration’s FY2015 request for bilateral assistance is for $4 million, including:

- $1.8 million in Foreign Military Financing (FMF) to help support Panama’s capacity to protect its borders and maritime territory from transnational threats such as drug trafficking;
- $720,000 for International Military Education and Training (IMET) to support training for Panamanian defense personnel at U.S. military institutions in the United States;
- and $1.5 million in Nonproliferation, Antiterrorism, Demining and Related Programs (NADR) assistance to support a Department of Justice program to strengthen Panama’s ability to detect, investigate, and prosecute money laundering and terrorist financing cases, and to help Panama refine its strategic trade management system.

Under CARSi, approximately $51.2 million was designated for Panama from FY2008 through FY2012, a little over 10% of the almost $500 million appropriated for CARSi for those years. The assistance funds programs for crime prevention efforts, justice sector reform, counternarcotics interdiction, and law enforcement professionalization and support. Those funding figures are derived from a Government Accountability Office report on CARSi issued in September 2013.  

FY2015 CARSI request, are not available since the State Department does not release funding information by country. Overall funding for CARSI, however, amounted to $145.6 million in FY2013 and an estimated $161.5 million in FY2014, while the Administration’s FY2015 request is for $130 million. Panama will receive a portion of this assistance. (Also see discussion on “Drug Trafficking and Money Laundering” below.)

Drug Trafficking and Money Laundering

Securing Panama’s cooperation to combat drug trafficking and money laundering has been an important concern to U.S. policy makers for many years. Because of its geographic location, large maritime industry, and containerized seaports, Panama remains a major transit country for illicit drugs from South America. According to the State Department’s March 2014 International Narcotics Control Strategy Report (INCSR), transnational drug trafficking organizations, including Mexican and Colombian groups, use Panama’s remote Darién province (bordering Colombia, see Figure 1) and the country’s coastline and littoral zones to move illicit drugs. Drug traffickers also exploit the country’s well-developed transportation infrastructure, including four major container seaports, the Pan-American Highway and the fourth busiest airport in Latin America. Panama’s large financial sector and the Colon Free Zone (CFZ), also make the country vulnerable to money laundering, which is attributed largely to drug trafficking proceeds. According to the INCSR, lax enforcement of existing controls in the CFZ and other free trade zones leaves Panama susceptible to other illicit financial activities by various criminal groups.

Panama seized 41 metric tons of cocaine in 2013, a significant increase compared to 34 tons seized in 2012. This increase reversed a three-year downward trend for Panama’s rate of interdiction. According to the State Department, this can be credited to Panama’s enhanced operational readiness of its maritime interdiction vessels and continued forward deployment of U.S. air and maritime surveillance and interdiction assets.

With regard to bilateral cooperation, in a November 2013 trip to Panama, Vice President Joe Biden lauded Panama for its efforts to stop illegal drug trafficking and characterized U.S.-Panamanian law enforcement cooperation as excellent. The State Department also asserted in the INCSR that the United States enjoys a strong partnership with all Panamanian security services.

U.S. assistance, provided largely through CARSI noted above, has included support for citizen security, law enforcement, and rule-of-law programs with the goal of expanding Panama’s capabilities to interdict, investigate, and prosecute illegal drug trafficking and other transnational crimes. Under CARSI, the United States has also provided training and equipment to the Panamanian National Police (PNP) for anti-gang enforcement and community policing.

U.S. support for Panama’s interdiction efforts includes assistance to modernize and maintain vessels and facilities of the Air Naval Service (SENAFRONT), the National Border Service (SENAFRONT), and the PNP. Technical training has been provided to improve the


17 The CFZ is the world’s second largest free trade zone after Hong Kong.

18 The White House, Office of the Vice President, “Remarks to the Press by Vice President Joe Biden and President Ricardo Martinelli of Panama,” November 19, 2013.
Panama: Background and U.S. Relations

professionalism and effectiveness of Panama’s security services in such areas as small boat operations, small unit tactics, maritime interdiction, equipment, and logistics support. As a result of support from the United States and Colombia, SENAFRONT has been able to provide training to regional partners such as Belize, Costa Rica, and Honduras.

For a number of years, the leftist Revolutionary Armed Forces of Colombia (FARC), a U.S.-designated foreign terrorist organization, had a small presence in the Darién region, which they used as a safe haven. In 2013, however, Panama’s SENAFRONT undertook several operations against the FARC that degraded their capabilities and Panama reports that the guerrilla group no longer has a permanent presence in the country. Nevertheless, the FARC reportedly continues to use Panamanian territory for the transit of illegal drugs.

The State Department lists Panama as a “major money laundering country,” and in the 2014 INCSR maintained that numerous factors hinder the country’s efforts to combat such activity, including the existence of bearer share corporations (see discussion below), a lack of cooperation among Panamanian government agencies, inconsistent enforcement of laws and regulations, and a weak judicial system susceptible to corruption and favoritism.

Taking a longer view, Panama has made significant progress in strengthening its anti-money laundering regime since the year 2000, when it was cited as a ‘non-cooperative country’ in combating money laundering according to the Financial Action Task Force (FATF), a multilateral anti-money laundering body. The Panamanian government subsequently took comprehensive action by enacting laws and issuing decrees to improve its operations against money laundering that led the FATF to remove Panama from its non-cooperative country list in June 2001.

Panama has also made progress in improving financial transparency. In November 2010, the government signed a Tax Information Exchange Agreement (TIEA) with the United States as part of its negotiations for implementing a free trade agreement. By early July 2011, Panama had signed enough tax agreements with other countries that the Organization for Economic Co-Operation and Development (OECD) remove it from the so-called “gray list” of countries judged to lack an internationally agreed tax standard. (Jurisdictions with at least 12 signed agreements for exchanging tax information are considered by the OECD to have substantially implemented the tax standard, and are removed from the list). Although Panama was removed from the OECD’s “gray list,” its legal and regulatory system for the exchange of information for tax purposes are still subject to peer reviews.

Another issue, noted above, that arose during talks for implementing a bilateral free trade agreement was U.S. concern regarding the use of bearer shares in Panama because of their frequent use for laundering money connected to drug trafficking. In February 2011, former President Martinelli signed into law “know your client” legislation meant to immobilize (but not eliminate) bearer shares, although the law only goes into effect in 2018. The State Department’s Country Reports on Terrorism 2013 maintains that continued existence of bearer share corporations in Panama remains a prime vulnerability of its regulatory framework.

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19 This was noted in the State Department’s 2014 INCSR as well as in its Country Reports on Terrorism 2013, issued in April 2014.

20 A bearer share is a stock certificate which is the property of whoever holds physical possession of it.
On a positive note, in October 2013, Panama and the United States signed an asset-forfeiture sharing agreement that provides some $36 million from a past money laundering investigation involving the U.S. Drug Enforcement Administration and Panamanian authorities. The funds are to be used to support jointly-agreed upon projects that support anti-money laundering efforts in Panama.21

**Commercial Relations: Trade and Investment**22

Panama is largely a services-based economy, and has historically run a merchandise trade deficit with the United States. In 2013 the United States ran a $10.1 billion trade surplus with Panama, exporting about $10.6 billion in goods and importing $449 million (see Table 1). Panama’s major exports to the United States include repaired goods, seafood, gold, electrical machinery, and sugar. Major imports from the United States include oil, machinery, electrical machinery, iron and steel products, aircraft, and agricultural products.23 The stock of U.S. foreign direct investment (FDI) in Panama was estimated at $5.1 billion in 2012 (based on a historical-cost basis), led by the nonbank holding and manufacturing sectors, and accounted for about 44% of all U.S. FDI in Central America.24

**Table 1. U.S.-Panama Trade, 2003-2013**
(U.S. $ millions)

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<thead>
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<th>Year</th>
<th>U.S. Exports</th>
<th>U.S. Imports</th>
<th>Trade Balance</th>
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<td>1,848</td>
<td>301</td>
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<tr>
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<tr>
<td>2013</td>
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<td>449</td>
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</tbody>
</table>

**Source:** U.S. Department of Commerce data, as presented by Global Trade Atlas.

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23 U.S. Department of Commerce statistics, as presented by Global Trade Atlas.

As noted above, Panama and the United States originally negotiated a free trade agreement (FTA) in 2007. While Panama’s National Assembly approved the agreement that year, the United States did not approve and enact implementing legislation until October 2011 (P.L. 112-43). Following approval of the FTA, both countries conducted a thorough review of their respective laws and regulations related to the agreement’s implementation. In late September 2012, Panama’s National Assembly approved a final package of laws needed for FTA implementation, including regulations on the country’s copyright and intellectual property rights regime. President Martinelli signed these measures into law in October 2012, along with an executive decree tied to Panama’s administration of tariff-rate quotas. This cleared the way for the exchange of letters and for the FTA to enter into force on October 31, 2012.25

Panama sought the FTA to make its trade rules with the United States permanent, and as a means of increasing foreign investment in the country. The United States stressed that an FTA with Panama would not only enhance U.S. access to Panama’s growing market, but also provide access to the country’s large services market. According to U.S. officials, Panama’s strategic location as a major shipping route (with some 10% of U.S. international trade passing through the Canal) enhanced the significance of a free trade agreement for the United States.26

The FTA includes disciplines related to customs administration and trade facilitation, technical barriers to trade, government procurement, investment, telecommunications, electronic commerce, intellectual property rights and labor and environmental protection. Since the FTA entered into force in October 2012, over 87% of U.S. exports for consumer and industrial goods to Panama have been duty-free, as well as over 50% of U.S. agricultural goods. Panama will gradually phase out remaining tariffs over the next decade, although tariffs on most U.S. farm products will be phased out within 15 years. The agreement also provides improved access for U.S. companies to Panama’s $22 billion services market, which includes financial, telecommunications, computer, express delivery, energy, environmental, and energy services.

Panama has no formal restrictions on capital flows or discrimination between foreign and domestic investment. According to the Department of State, however, several factors add risk and complication to doing business in the country; these include poor rule of law, lack of judicial independence, a shortage of skilled workers, high levels of corruption, and poorly staffed government institutions. The U.S. Embassy also has received numerous reports of fraud and corruption in connection with titles to property purchased by U.S. investors as well as complaints from U.S. companies about inconsistent treatment of their concessions.27 Nevertheless, U.S. companies are well represented in Panama’s various sectors, including its largest container port facility, multiple financial institutions, transportation firms, and manufacturing facilities.

25 Before the current FTA had entered into force in October 2012, Panama had benefited from almost 28 years of preferential U.S. import programs for Caribbean Basin nations.

26 Office of the United States Trade Representative, Statement by Ambassador Miriam Sapiro, Deputy United States Trade Representative, Statement before the House Committee on Ways and Means, Subcommittee on Trade, March 30, 2011.

Panama: Background and U.S. Relations

Panama Canal Operations

Historical Background

After Panama’s independence from Colombia in 1903, it concluded a treaty with the United States ceding rights to build, administer, and defend a canal cutting across the country and linking the Pacific and Atlantic oceans. The Hay-Bunau-Varilla Treaty established the so-called Canal Zone (about 10 miles wide and 50 miles long) to be managed by the United States “as if it were sovereign” and “in perpetuity.” Subsequent construction of the Canal was completed in 1914. However, this treaty soon became a source of conflict between the U.S. and Panamanian governments. In the 1960s, growing Panamanian resentment over the extent of U.S. rights in the country led to riots that spurred negotiations for a new treaty arrangement for the operation of the Canal. Draft treaties were completed in 1967, but rejected in 1970 by Panama.

New negotiations, however, ultimately led to agreement on two Panama Canal Treaties that were signed in September 1977 by U.S. President Jimmy Carter and Panama’s head of government, General Omar Torrijos. Under the first treaty, known as the Treaty on the Permanent Neutrality and Operation of the Panama Canal, or simply the Neutrality Treaty, the two countries agreed to maintain a regime of neutrality for keeping the Canal open to ships of all nations. The Neutrality Treaty has no termination date, and under the first condition to the treaty (known as the DeConcini condition), if the Canal is closed or its operations are interfered with, both countries independently have the right to take steps as each deems necessary, including the use of military force, to reopen the Canal or restore its operations. The second treaty, known simply as the Panama Canal Treaty, gave primary responsibility for operating and defending the Canal to the United States until December 31, 1999. The U.S. Senate gave its advice and consent to the Neutrality Treaty in March 1978, and to the Panama Canal Treaty in April 1978; Panama and the United States exchanged instruments of ratification for the two treaties in June 1978, and the two treaties entered into force on October 1, 1979.

After the treaties were signed, U.S. officials consistently affirmed over the years their commitment for ensuring a smooth transition of the Canal to Panamanian control. At the end of 1999, when the Panama Canal Treaty terminated, the U.S. agency operating the Canal, the Panama Canal Commission (PCC), was succeeded by its Panamanian government counterpart, the Panama Canal Authority (ACP).

Canal Expansion Project

Since the ACP has run the Canal beginning in 2000, it has been lauded for increasing Canal safety and efficiency. In September 2012, Jorge Quijano was appointed by the ACP’s Board of Directors to become the new Canal administrator for a seven-year term, succeeding Alberto Alemán Zubieta who had served as administrator since 1996. Quijano, an engineer, has worked at the Canal since 1975, and led the Canal expansion project beginning in 2006.

In April 2006, the ACP presented to then-President Martin Torrijos its recommendation to build a third channel and new set of locks (one on the Atlantic and one on the Pacific) that would double the capacity of the Canal and allow it to accommodate giant container cargo ships known as post-Panamax ships. The estimated cost of the seven-year project was $5.25 billion, to be self-financed by the ACP through graduated toll increases and external bridge financing. According to the ACP, the overall objectives of the expansion project are to (1) achieve long-term sustainability and
growth for the Canal’s financial contributions to the Panamanian national treasury; (2) maintain the Canal’s competitiveness; (3) increase the Canal’s capacity to capture the growing world tonnage demand; and (4) make the Canal more productive, safe, and efficient.\textsuperscript{28} The Canal expansion project was approved by a national referendum in October 2006 with 78% support, and officially launched in September 2007.

While the project originally was expected to be completed by October 2014, delays have pushed the completion date to the first quarter of 2016.\textsuperscript{29} In February 2014, the multinational consortium constructing the third set of locks known as Grupo Unidos Por el Canal (United Group for the Canal or GUPC), led by a Spanish construction company, halted its work due to disagreement with the ACP over who would pay some $1.6 billion in cost overruns. ACP officials complained that the consortium underestimated its costs when it bid $3.12 billion to build the new set of locks, well below bids from competing companies. By March 2014, however, the ACP and the GUPC settled the dispute. Another delay involved a two-week strike by construction workers that ended in early May 2014 after a wage-increase agreement was reached.\textsuperscript{30} According to the ACP, the expansion project was 76% complete at the end of May 2014.\textsuperscript{31}

The Canal expansion is expected to reduce shipping rates between Asia and the U.S. Gulf and East coasts, resulting in significant savings and increased trade using that route; it is also expected to increase Latin American trade with Asia as well as intra-Latin American trade. ACP Administrator Jorge Quijano maintains that when the expansion project is complete, it will be able to accommodate 98% of all containerships. Quijano and energy analysts expect an increase in the export of liquefied natural gas from the United States to Asian markets, particularly in light of the rapid increase in natural gas production from shale in the United States.\textsuperscript{32} As a result of the reduced transportation cost, U.S. grain producers are expected to gain from increased exports as they become more competitive with other world producers. A number of U.S. ports have begun readying themselves in order to take advantage of the trade expansion.

While the largest trade route using the Canal is East Coast/United States to Asia, which accounted for almost 37% of all Canal traffic in FY2013, the second largest trade route is East Coast/United States to West Coast/South America, which accounted for about 13% of all traffic.\textsuperscript{33} Several countries in this region – Chile, Colombia, and Peru – already have free trade agreements with the

\textsuperscript{28} Autoridad del Canal de Panama (ACP), “Proposal for the Expansion of the Panama Canal, Third Set of Locks Project,” April 24, 2006.


\textsuperscript{31} For further updates on progress of the Canal expansion project see the ACP’s website, available at http://micanaldepanama.com/expansion/.


United States, and lower transportation costs resulting from the Canal expansion could further boost their trade linkages with the United States.

**Outlook**

Panama’s political and economic outlook appears promising. The country is now approaching 25 years of elected civilian democratic rule, and its services-based economy remains strong. The Panama Canal expansion project, other infrastructure projects, and the country’s large financial sector position Panama to continue to play a significant role in international and regional trade. The government’s challenges include efforts to combat poverty and inequality and to continue to make headway in combating threats from drug trafficking, money laundering, and organized crime. U.S. relations with Panama under the incoming government of Juan Carlos Varela are expected to continue to be strong, with extensive cooperation on drug trafficking and other security issues and robust trade and investment linkages. Panama is scheduled to host the Seventh Summit of the Americas in 2015. Several Latin American nations have vowed not to attend unless Cuba is invited to participate.
Appendix. Selected Executive Branch Reports

**Bilateral Relations Fact Sheets, Panama**, State Department

*Date*: October 15, 2013  

**Congressional Budget Justification for Foreign Operations FY2015, Annex 3: Regional Perspectives (pp. 693-695)**, State Department

*Date*: April 18, 2014  

**Country Reports on Human Rights Practices 2013, Panama**, State Department

*Date*: February 27, 2014  

**Country Reports on Terrorism 2013 (Western Hemisphere Overview)**, State Department

*Date*: April 2014  

**International Religious Freedom Report 2012, Panama**, State Department

*Date*: May 20, 2013  


*Date*: March 2014  


*Date*: March 2014  

**Investment Climate Statement, 2014, Panama**, State Department

*Date*: June 26, 2014  

**National Trade Estimate Report on Foreign Trade Barriers, 2014, Panama**, Office of the United States Trade Representative

*Date*: March 31, 2014  
Trafficking in Persons Report 2014 (Panama, pp. 292-295), State Department

Date: June 20, 2014

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