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Panama: Reform takes a Scalpel, not a Hammer

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*Strengthening Africa's
economic performance*



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Dr Greg Mills heads the Johannesburg-based Brenthurst Foundation, established in 2005 by the Oppenheimer family to strengthen African economic performance. He holds degrees from the Universities of Cape Town and Lancaster, and was the National Director of the SA Institute of International Affairs from 1996 to 2005. He has directed numerous reform projects in more than a dozen African governments (including in 2017 for example with the governments of Ghana, Lagos State, the five states of SE Nigeria, Lesotho and Mozambique), sat on the Danish Africa Commission and on the African Development Bank’s high-level panel on fragile states, and has served four deployments to Afghanistan with NATO. A member of the advisory board of the Royal United Services Institute, he is the author, *inter alia*, of the best-selling books *Why Africa Is Poor*, *Africa’s Third Liberation* (with Jeffrey Herbst), and most recently, together with the chairman of the Foundation, President Olusegun Obasanjo, Dr Herbst and Major-General Dickie Davis, *Making Africa Work: A Handbook for Economic Success*. He is currently working on a book-length study entitled *Making Democracy Work* due out at the start of 2019.

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Executive Summary

Panama has transformed to become one of the fastest expanding economies worldwide, growing from a GDP of US\$1 billion to US\$55 billion in 50 years, enjoying an annual average economic growth rate of over 8 per cent since 2003, more than double the regional norm. This is likely to remain high, with high levels of public investment in new infrastructure, notably the US\$8 billion canal expansion project opened in 2016, and backed by large private sector investments, including Cobre Panama, a 350 000-tonne per year, US\$6.3 billion copper project undertaken by the Zambia-based miner First Quantum. While Panama's geography is crucial to its success story, the opportunities from the canal has been built on through the businesses established around its two ports. These have been facilitated by excellent connectivity, simplified bureaucratic procedures, liberal visa requirements, preferential tax rates and, following the departure of Manuel Noriega from the political scene, much better policy choices.

Introduction

Nicolás Ardito Barletta served as president of Panama from 11 October 1984 until 28 September 1985 when he departed over the military's increasingly influential and violent role in the Central American state. Bartella's 'separation' (he says he refused to give the military the satisfaction of his resignation) proved the beginning of the end for Panama's strongman Manuel Noriega.

Panama had been a strategic site for US interests over the canal for the 20th century, as now, the 77km waterway connecting the Atlantic and Pacific Oceans. A first French construction effort went bankrupt in 1889 after spending nearly US\$290 million, and costing the lives of 22 000 of 63 000 workers, mostly from malaria and yellow fever.



Each day up to 60 ships make the voyage, at an average cost each of US\$85 000 and up to US\$490 000, depending on their size.

Restarting in 1904, the US construction finished the job in ten more years, completing the Gaillard Cut, building the 1 000-foot-long locks with their 50-foot thick concrete walls and 88 pairs of 700 ton steel doors, and in the process creating Gatun Lake, then the world's largest man-made reservoir. This stage cost US\$375 million, about US\$9 billion in today's money, and the lives of another 5 600 labourers. Though still shockingly high, the fatality rate was significantly reduced with the discovery of the link between malaria and the mosquito as a result of research led by Drs Carlos Finlay and Walter Reed, and the sanitation and spraying projects that followed.

This commitment necessitated nothing less than regime change, the US blockading Colombian seaborne access to enable the declaration of Panamanian independence from Bogota in November 1903, granting at the same time access rights for the US to build and administer the canal. While the canal became an extraordinary money-spinner for both the US government and, latterly, since the handover of control in 1977, the Panamanians, the presence of the US became a catalyst for local nationalism and the increased status and power of the Panamanian armed forces. Despite this heritage, much like Singapore, it did not allow its past to define its future development.

In the canal museum in the *Casco Viejo* ('Old Quarter') of Panama City is a fading photograph of Generals Omar Torrijos and Noriega. Torrijos, the leader of the military who took power in 1968, but never officially became the president of Panama, and who held titles such as 'Maximum Leader of the Panamanian Revolution' and 'Supreme Chief of Government', died in a plane crash in 1981. He had led a reformist *El Gobierno Revolucionario* ('The Revolutionary Government')



'Maximum Leader of the Panamanian Revolution' meets 'Old Pineapple Face'

which included improvements in health-care coverage and education. Military power peaked during the regime of Colonel Noriega who seized control over the *Guardia Nacional* in 1983. Once Washington's man, 'Old Pineapple Face' had installed himself as *de facto* ruler in 1989 while running a parallel drug economy. His overturning of the electoral process, anti-Americanism and links with Colombian drug cartels prompted a US military intervention on 20 December 1989. Noriega's asylum in the Holy See embassy was ended ten days after the US bombarded the building with heavy metal rock music – invasion by Van Halen. The *generalissimo* was later convicted and sentenced to 40 years imprisonment in the US on drug trafficking charges, dying in 2017, having been repatriated to Panama to spend his last days in a small white prison alongside the canal.

As the politics settled, Panama transformed to become one of the fastest expanding economies worldwide, growing from a GDP of US\$1 billion to US\$55 billion in 50 years. From 2003 growth has averaged over 8 per cent, more than double the regional norm.¹ Growth is expected to remain high with large-scale public investment after the construction of a second Metro line and new airport terminal along with the increased traffic from the US\$8 billion canal expansion project, opened in 2016. This is backed up by increasing private sector investments, including in logistics, tourism, financial services and mining. The latter centres on Cobre Panama, a 350 000-tonne per year, US\$6.3 billion copper project near the Caribbean coast, the largest currently underway worldwide. When it comes on stream in early 2019 it will add US\$2 billion to Panama's export revenues.

Incentivising competitiveness

Unlike other developing countries where the presence of natural resources has routinely distorted governance and disincentivised the elite from attempting to improve competitiveness and diversify, the Panamanians have used the revenue from the canal to build business at either end. Each day up to 60 ships make the voyage, at an average cost

each of US\$85 000 and up to US\$490 000, depending on their size. The canal expansion allows vessels to pass with a beam of 180 foot, equivalent to 13 500 containers. The charge per vessel through the new locks is some US\$1.5 million.

While geography helps, it is no guarantee of success. Planning, policy and making the right choices matter more.

Panama could have been nearby Nicaragua, where long-term schemes to cut a canal linking the two oceans have never born fruit. The difference between success and failure is now that between a US\$13 700 per capita economy in Panama and that of Nicaragua's US\$2 150. It's not just about infrastructure. And it's about what is done with it at either end.

This is not the only sensible long-term investment Panama has made.

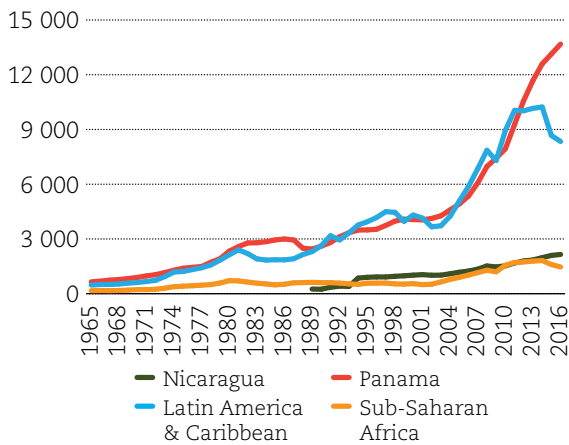
While others talk about special economic zones (SEZs), Panama has created six. American troops were based in Panama across 14 bases until 31 December 1999. While their presence was an affront to some Panamanians, most realised the financial benefit these 'hidden tourists' brought. Rather than lament this financial loss, working together the government and private sector set about converting these areas into productive centres and economic communities. The former US Air Force base at Howard is now *Panama Pacifico*, a SEZ just a 15 minute drive across the Bridge of the Americas. This SEZ hosts 248 companies, two-thirds of which are in manufacturing. Most are foreign, including big names such as 3M, BASF, Caterpillar and Dell. *Panama Pacifico* aims to attract businesses which will ultimately employ 40 000 with residential space for 60 000. Its motivation was to 'find ways', says Frank Terracina, the director of marketing, 'of adding value to the goods passing through the canal'.

Past the Pacific end of the Panama Canal Railway's sidings where 40-foot containers are loaded onto 50-wagon double-decker trains, is the City of Knowledge on the site of the old Clayton US Army base, where now 5 000 people work. The brainchild of two visionary businessmen, Gabriel Lewis and Fernando Eleta, the City was created as an innovation centre. If the land was the endowment for the Foundation behind

the City, the rentals from the 200 buildings on the 120 hectare site provide the cash flow. The types of businesses, international and non-governmental organisations, and research institutions are carefully selected on account of their technology and knowledge component.

The attraction to business and others to attempt to enter both *Pacifico* and the City of Knowledge lies in a combination of excellent connectivity, simplified bureaucratic procedures, liberal visa laws, and no taxes. Hence the City of Knowledge has 15 times as many applicants than spaces. It's about putting in place the conditions to attract the right skills and businesses. Although Panama's minimum wage varies around US\$600, the average pay in these facilities is more than US\$1 500.

Who is getting richer?



A University of Chicago-trained economist, and former World Bank vice-president, Barletta went on after his short-lived presidency to serve as head of the canal authority.

'Panama', he says, 'is a tiny market of just four million people, a corner of Mexico City, Buenos Aires or São Paulo. But what a corner we have! As a small economy,' he notes, 'we have to be an exporting economy, with which to generate income to import everything we cannot grow or manufacture.'

Four connectivities

The economy is based, in his view, on four 'connectivities': maritime (through the canal), air (through the Panamanian-based airline Copa which flies to 74 destinations, with 13 million transit passengers annually through Tocumen airport), telecomms, and financial (with 90 banks in Panama with assets of over US\$120 billion). While services make up 83 per cent of GDP and 90 per cent of exports, this is spread across these and other sectors, including tourism. The number of international visitors has increased consistently, from 520 000 in 2011 to over two million in 2016. Annual receipts in this sector have increased tenfold to over US\$5 billion this century.



'Plan B' of elite Venezuelans, cheaper and easier than Miami, but stable

'The advantage of a concentration of services,' Barletta says, 'is that the revenues are more stable in volume and pricing than natural resources.' This is assisted, too, by dollarisation, where interest rates remain low, 'discouraging big speculative inflows'. Or as Ivan Zarak, deputy minister of finance in President Juan Carlos Varela's administration between 2015 and 2018, puts it neatly: 'We are slowly diversifying into commodities'.

Panama has benefitted from being an island of stability for various regional failings. 'It's well known as the "Plan B" of elite Venezuelans, cheaper and easier than Miami, but stable,' smiles Zarak.

Many emigres invest in real estate, another reason why Panama consumes around double the amount of cement per capita per annum than the regional average.

Panama has also been highly pragmatic in dealing with investors.

First Quantum, with operations in seven countries, has until now generated most of its revenue from its two African projects; Zambia and Mauritania. Its Cobre Panama project has been facilitated through a special 20-year, renewable 'Law 9', including a competitive tax regime. This is the type of stability required for an investment involving a 25km slurry pipe to the coast, and building a port and two 150MW power stations along with the extensive mining and processing operation. Interestingly First Quantum's similar proposals to build bespoke power facilities to supply its mines and develop the national grid in Zambia have been met with bureaucratic obstacles, where narrow interests have so far trumped national considerations.

It's not always been smooth sailing. In 2016 the Panama Papers revealed the isthmus as a popular tax haven. While poverty has fallen by more than half to under 20 per cent since 2008, it remains high in the rural areas and especially among the indigenous *comarcas*. There are, too, widespread concerns about rising inequality.

And getting the politics right requires ongoing work.

'The dynamism was there during the Torrijos period in the 1970s' says Barletta, who served the military strongman as Minister of Finance for seven years in a strangely military-led civilian regime. 'Noriega was a blockage to this process' says the former President, 79 in 2018.

After the US military intervention, the results of the May 1989 election results which had been overturned by Noriega, were reinstated. They are now held regularly and cleanly, one element of political stability. Panama scores highly on Freedom House's rankings, with an aggregate score of 83/100 (where 0 = Least Free and 100 = Most Free).

In 2004 the presidential race was won by Martin Torrijos, son of the late leader, on his second attempt. Torrijos, 55, sees democracy

'as essential' to the country's success. 'Although my dad came to power through a military coup,' he explains, 'the old system clearly was not working. He implemented a new constitution, and a new approach to education and housing among other social programmes, while also uniting the country around its sovereignty over the canal.' During his own presidency, given that he won at his second attempt, 'We were able to plan ahead, and prepare for fiscal and social security reform, and to tackle the canal expansion project.' But it was not easy going. 'What we found was not what we expected. We had no statistics to measure things, which made both finding the right tools difficult as well working out where to apply them,' especially in tackling 'the social agenda'.



President Martin Torrijos and the author, March 2018

'I think my father would, on the one hand, be very proud of our achievements. On the other, he would be looking at the underprivileged, and asking why we are not more successful in translating social progress to others and to other cities.'

As with his father's agenda, Torrijos believes that a similar type of reform is needed today. 'It's hard not to succeed in Panama, given our geographic location. But even as we are growing the economy fast, so too is unemployment increasing, as our GDP growth is mainly in capital intensive sectors. Our next step has to be about how to build a better workforce and democratise, not only government, but economic opportunities within the country.'

Torrijos was succeeded in 2009 as president by Ricardo Martinelli who promised to promote free trade, establish a metro, reform health care, and

complete the canal expansion project started by his predecessor. He did all this, but in the process was accused of using public money for illegal surveillance, and of financial crimes, taking bribes and giving illegal pardons. He was extradited from a prison in Atlanta to Panama earlier this month.

With presidents only elected for a single five-year term, there is 'little continuity between individuals in government,' admits Barletta, 'but there is a great deal of consensus around policy. This is particularly true of government's relationship with business.'

This is a strength, but only if it is accompanied by appropriate institutions and regulation. Arturo Hoyos served as Chief Justice for an unprecedented six years until 2000. 'We have enjoyed the longest period of economic growth in our history. At the beginning of this period we had the good fortune of a president who was both a lawyer and interested in the rule of law. We continue,' he notes, 'to be a dynamic democracy, but the rule of law has weakened. The main problem,' he says, 'with the current political order stem from the disproportionate influence of money in the public and political spheres, coupled with the general unprofessionalism of the civil service and weakness of "control" institutions, including the judiciary, comptroller-general and attorney-general, contrasting with hyper-executive powers.' The existence of a 'commercial republic' in this environment has created, he observes, a 'clientalistic political culture', around the unions, especially the teachers' unions which are an obstacle to innovation, and the 200 000-strong public service more generally.

The role of democracy

Barletta agrees. 'Democracy is very important,' he observes. 'Corruption ruins an efficient government, making democracy and the rule of law that goes with it, more important.'

Part of the problem, notes Hoyos, is a 'culture of money' in political funding with the expectation of payback. '[Francis] Fukuyama and [Samuel] Huntington teach us,' says this erudite man, 'that

when the elite captures institutions, you have political decay.' As a result elections are not fought around ideological differences, but rather such elite interests and personalities.²

Fukuyama insists that democratic institutions are only ever one component of political stability. Two other building blocks are required: a strong state and the rule of law. Fukuyama argues that it matters to get the sequence right. Without a strong state first, he believes that democracy will only amplify weakness since it is subjected to many competing and conflicting demands, eating away at its capacity to deliver and exert authority.

Yet, the paradox in this view is that without democracy, there would not have been a strong state in Panama, or at least a state moving in the direction of a majority. Hoyos' comments also illustrate one of the tensions within a democracy. People who rule themselves have far greater opportunities to complain about governments they don't like.³

No incumbent party has won re-election in Panama since the American invasion in 1989.

Martinelli was succeeded by Juan Carlos Varela of the opposition People First Alliance. Varela's administration, which took office in July 2014, has focused on what had become a fairly standard Panamanian policy template: improving infrastructure, quality of life, productivity, human capital and the environment. 'We compare ourselves to Singapore, with whom there is 12 hours difference,' says Ivan Zarak, 'in thinking what comes next in our economic story. We are a point of commerce, of exchange between the Americas, and between East and West.'

'We know that we have to improve education to reduce inequality,' he states, 'but as a 25-year long project that is difficult for a five-year president to focus on.' Regardless, 'openness' he says, 'is our greatest strength, which should allow us to take more time, do things better, more transparently. This will allow a continuous evolution from where we are, and not a destructive revolution.'

'After all,' Zarak thinks, and adds, 'progress requires a scalpel, not a hammer.'

Endnotes

1. <http://www.worldbank.org/en/country/panama/overview>
2. This section is based on two research trips to Panama, in 2015 and 2018. Hoyos, Torijjos and Zarak were interviewed in 2018; Barletta on both occasions.
3. See Francis Fukuyama, *Political Order and Political Decay: From the Industrial Revolution to the Globalisation of Democracy*. London: Profile, 2014. See its review, too, at <https://www.ft.com/content/67b8f490-4269-11e4-9818-00144feabdc0>.