



# Panama: Political and Economic Conditions and U.S. Relations

**Mark P. Sullivan**  
Specialist in Latin American Affairs

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## Summary

With five successive elected civilian governments, the Central American nation of Panama has made notable political and economic progress since the 1989 U.S. military intervention that ousted the regime of General Manuel Noriega from power. Current President Ricardo Martinelli of the center-right Democratic Change (CD) party was elected in May 2009, defeating the ruling center-left Democratic Revolutionary Party (PRD) in a landslide. Martinelli was inaugurated to a five-year term on July 1, 2009. Martinelli's Alliance for Change coalition also captured a majority of seats in Panama's National Assembly that will increase the chances that the President will be able to secure enough votes to enact his legislative agenda.

A significant challenge facing the Martinelli government has been dealing with the economic fallout stemming from the global economic recession, but while the growth of Panama's service-based economy has slowed, it has avoided the economic contraction experienced by many Latin American economies. The Panama Canal expansion project has played a large role in stimulating economic growth. President Martinelli has called for a number of large public infrastructure projects, including a subway for Panama City, and the government has begun to move ahead on some of these projects. In March 2010, President Martinelli secured legislative approval of a tax reform measure that reduces corporate and individual income taxes while raising sales and other taxes that overall is expected to increase government revenue.

The United States has close relations with Panama, stemming in large part from the extensive linkages developed when the canal was under U.S. control and Panama hosted major U.S. military installations. The current relationship is characterized by extensive counternarcotics cooperation, assistance to help Panama assure the security of the Canal, and a proposed bilateral free trade agreement (FTA). U.S. bilateral assistance amounted to a \$3.7 million in FY2008, \$7.6 million in FY2009, and an estimated \$8.7 million in FY2010. The FY2011 request is for \$10.6 million. This funding does not include an estimated \$11 million Panama received in FY2008 and FY2009 under the Mérida Initiative to assist Mexico and Central American countries in their efforts to combat drug trafficking, gangs, and organized crime; beginning in FY2010, Panama will receive assistance under the successor Central America Regional Security Initiative (CARSI) instead of under the Mérida Initiative.

In June 2007, the United States and Panama signed a proposed bilateral FTA, and Panama's National Assembly overwhelmingly approved the agreement in July 2007. While the 111<sup>th</sup> Congress could consider implementing legislation for the FTA, a number of observers believe that it is unlikely that it will be considered this year. Final issues being worked out relate to worker rights and to Panama's bank secrecy laws. H.Res. 987 (Frelinghuysen), introduced in December 2009, would express the sense of the House that the FTA with Panama should be implemented immediately, and H.Res. 1124 (Mack), introduced in February 2010, would call on President Obama to submit the Panama FTA to Congress and work to ensure that it is approved.

For more, see CRS Report RL32540, *The Proposed U.S.-Panama Free Trade Agreement*, CRS Report R40622, *Agriculture in Pending U.S. Free Trade Agreements with Colombia, Panama, and South Korea*, CRS Report R40135, *Mérida Initiative for Mexico and Central America: Funding and Policy Issues*, and CRS Report RL34112, *Gangs in Central America*.

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## **Political and Economic Conditions**

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 civilian governments, with the current government of President Ricardo Martinelli of the center-right Democratic Change (CD) party elected in May 2009 to a five-year term. Inaugurated on July 1, 2009, Martinelli is a businessman and former government minister. His electoral alliance, known as the Alliance for Change, also won a majority of seats in the unicameral National Assembly.

### **From the Endara to the Torrijos Administration**

#### **Endara Government (1989-1994)**

Before the U.S. intervention, Panama had held national elections in May 1989, and in the presence of a large number of international observers, the anti-Noriega coalition, headed by Guillermo Endara, prevailed by a three-to-one margin. The Noriega regime annulled the election, however, and held on to power. By the fall, the military regime was losing political power and relied increasingly on irregular paramilitary units, making the country unsafe for U.S. forces and U.S. citizens. On December 20, 1989, President George H. W. Bush ordered the U.S. military into Panama “to safeguard the lives of Americans, to defend democracy in Panama, to combat drug trafficking, and to protect the integrity of the Panama Canal Treaty.” Noriega was arrested on January 3, 1990, and brought to the United States to stand trial on drug trafficking charges. (Also see “Status of Manuel Noriega” below.)

As a result of the intervention, the opposition coalition headed by Guillermo Endara that had won the May 1989 election was sworn into office. During his term, President Endara made great progress in restoring functioning political institutions after 21 years of military-controlled government, and under his administration, a new civilian Public Force replaced Noriega’s Panama Defense Forces. But Endara had difficulties in meeting high public expectations, and the demilitarization process was difficult, with some police and former military members at times plotting to destabilize, if not overthrow, the government.

#### **Pérez Balladares Government (1994-1999)**

In May 1994, Panamanians went to the polls to vote in presidential and legislative elections that observers called the freest in almost three decades. Ernesto Pérez Balladares, candidate of the former pro-Noriega Democratic Revolutionary Party (PRD), who led a coalition known as “United People,” won with 33% of the vote. Placing a surprisingly strong second, with 29% of the vote, was the Arnulfista Party (PA) candidate, Mireya Moscoso de Gruber, heading a coalition known as the “Democratic Alliance.”

In the electoral race, Pérez Balladares campaigned as a populist and advocated greater social spending and attention to the poor. He stressed the need for addressing unemployment, which he termed Panama’s fundamental problem. Pérez Balladares severely criticized the Endara

government for corruption, and he was able to overcome attempts to portray him as someone closely associated with General Noriega. (Pérez Balladares served as campaign manager during the 1989 elections for candidate Carlos Duque, who the Noriega regime had tried to impose on the electorate through fraud.) Instead, Pérez Balladares focused on the PRD's ties to the populist policies of General Omar Torrijos, whose twelve-year (1969-1981) military rule of Panama ended when he died in a plane crash in 1981.

President Pérez Balladares implemented an economic reform program that included liberalization of the trade regime, privatization of state-owned enterprises, the institution of fiscal reform, and labor code reform. Tariffs were reduced to an average of 8%.

Pérez Balladares also worked closely with the United States as the date of the Panama Canal turnover approached. Under his government, Panama and the United States held talks on the potential continuation of a U.S. military presence in Panama beyond the end of 1999 (the date Panama was to assume responsibility for defending the Canal). Ultimately negotiations ended without such an agreement.

Although Panama's constitution does not allow for presidential reelection, President Pérez Balladares actively sought a second term in 1999. In 1997, the PRD had begun studying the possibility of amending the constitution to allow a second bid for the presidency in the May 1999 elections. Ultimately, a referendum was held on the issue in August 1998 but failed by a large margin.

Late in his administration, Pérez Balladares became embroiled in a scandal involving the illegal sale of visas to Chinese immigrants attempting to enter the United States via Panama. As a result, U.S. officials cancelled the former president's U.S. tourist visa in November 1999.<sup>1</sup>

### **Moscoso Government (1999-2004)**

In her second bid for the presidency, Arnulfista Party (PA) candidate Mireya Moscoso was victorious in the May 1999 elections. Moscoso, who was inaugurated September 1, 1999, for a five-year term, captured almost 45% of the vote and soundly defeated the ruling PRD's candidate Martin Torrijos (son of former populist leader Omar Torrijos), who received almost 38% of the vote. Until March 1999, Torrijos had been leading in opinion polls, but as the election neared, the two candidates were in a dead heat. A third candidate, Alberto Vallarino, heading a coalition known as Opposition Action, received about 17% of the vote.

President Moscoso, a coffee plantation owner and Panama's first female president, ran as a populist during the campaign, promising to end government corruption, slow the privatization of state enterprises, and reduce poverty. She also promised to ensure that politics and corruption did not interfere with the administration of the Canal. The memory of her husband Arnulfo Arias, a nationalist who was elected three times as president, but overthrown each time, was a factor in the campaign, particularly since Arias was last overthrown in 1968 by General Omar Torrijos, the father of the PRD's 1999 and 2004 presidential candidate.

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<sup>1</sup> "Ex-Leader of Panama Linked to Visa Sales," *Washington Post*, November 27, 1999; Pablo Bachelet, "U.S. Uses Visas to Combat Corruption," *Miami Herald*, February 21, 2006.

Although Moscoso took the presidency, the PRD-led New Nation coalition won a majority of 41 seats in the 71-member unicameral Legislative Assembly. Just days before her inauguration, however, Moscoso was able to build a coalition, with the support of the Solidarity Party, the Christian Democratic Party (which later became the Popular Party), and the National Liberal Party, that gave her government a one-seat majority in the Assembly. In August 2000, the Christian Democrats deserted the coalition and formed an alliance with the principal opposition, the PRD. However, corruption scandals in 2002 led to five PRD legislators defecting to support the Moscoso government, once again giving the President majority support in the Legislative Assembly.

The Moscoso government partially reversed the trade liberalization process of the Pérez Balladares by raising tariffs on some agricultural products, some of which reached the maximum rate allowed under Panama's World Trade Organization obligations.<sup>2</sup>

As noted above, Moscoso was elected as a populist, with pledges to end government corruption and reduce poverty, but her campaign pledges proved difficult to fulfill amid high-profile corruption scandals and poor economic performance. As a result, the President's popularity declined significantly from a 70% approval rating when she first took office in 1999 to only 15% in 2004.<sup>3</sup>

### **Torrijos Government (2004-2009)**

In the May 2004 presidential race, Martín Torrijos of the PRD won a decisive victory with 47.5% of the vote, defeating former President Guillermo Endara, who received 30.6% of the vote, and former Foreign Minister José Miguel Alemán, who received 16.4% of the vote. Torrijos' electoral alliance also won a majority of seats in the unicameral National Assembly (formerly known as the Legislative Assembly), 43 out of 78 seats, which should provide him with enough legislative support to enact his agenda. Elected at 40 years of age, Torrijos – the son of former populist leader General Omar Torrijos (1968-1981) – spent many years in the United States and studied political science and economics at Texas A&M University. He served four years under the Pérez Balladares government as deputy minister of interior and justice, and as noted above, became the PRD's presidential candidate in the 1999 elections.

Leading up to the election, Torrijos had been topping public opinion polls, with 42%-49% support. In the campaign, he emphasized anti-corruption measures as well as a national strategy to deal with poverty, unemployment, and underdevelopment. He was popular among younger voters and had a base of support in rural areas. Torrijos maintained that his first priority would be job creation.<sup>4</sup> He called for the widening of the Canal, a project that would cost several billion dollars, and would seek a referendum on the issue. During the campaign, all three major candidates supported negotiation of a free trade agreement with the United States, maintaining that it would be advantageous for Panama. Endara and Alemán appeared to emphasize the protection of some sensitive Panamanian sectors such as agriculture, while Torrijos stressed that such an agreement would make Panama's economy more competitive and productive.<sup>5</sup>

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<sup>2</sup> United States Trade Representative, *2006 National Trade Estimate Report on Foreign Trade Barriers*, p. 501.

<sup>3</sup> "Toss Up Between Torrijos and Endara," *Caribbean and Central America Report*, February 17, 2004.

<sup>4</sup> Frances Robles, "Ex-leader's Son Wins Presidency in Panama," *Miami Herald*, May 3, 2004.

<sup>5</sup> "Panama: Presidential Candidates Remark on FTA with US," *La Prensa* (Panama), January 24, 2004, translated by (continued...)

During his five years in office, President Torrijos faced such major challenges as dealing with the deficits of the country's social security fund (Caja de Seguro Social, CSS); developing plans for the expansion of the Panama Canal; combating unemployment, poverty, and increasing crime; and contending with the effects of the global financial crisis and U.S. recession on the Panamanian economy.

After protests and a protracted strike by construction workers, doctors, and teachers in June 2005, the Torrijos government was forced to modify its plans for reforming the social security fund. After a national dialogue on the issue, Panama's National Assembly approved a watered-down version of the original plan in December 2005. The enacted reform did not raise the retirement age but will gradually increase required monthly payments into the system and introduces a dual pension system that combines aspects of privatization with the current system.<sup>6</sup> In mid-December 2007, an almost six-week strike by doctors in the public healthcare system was resolved, with the government offering a 26.7% increase in salaries equivalent and a commitment not to privatize the system.<sup>7</sup>

In April 2006, the government unveiled its ambitious plans to build a third set of locks that would double the Canal's capacity, and allow larger post-Panamax ships to transit the Canal. Panama's Cabinet approved the expansion plan in June, and the National Assembly approved it in July 2006. A referendum on the expansion project took place on October 22, 2006, with 78% supporting the project. The referendum was viewed as a victory for the Torrijos government, which advanced the project as integral to Panama's future economic development and one that helped restore the President's popularity.<sup>8</sup>

The Torrijos government's agenda also included judicial, penal and anti-corruption reforms, as well as an economic development strategy to target poverty and unemployment. The government implemented a new penal code in May 2008 that took a tougher stance on crime by increasing sentences on serious crimes and other measures. In early July 2008, Panama's National Assembly gave President Torrijos powers to carry out security sector reforms over the next two months. In August 2008, President Torrijos enacted five decree laws reorganizing Panama's law enforcement and security services, including the establishment of a National Border Service and a National Intelligence and Security Service (SENIS). Some critics fear that the actions will lead to Panama's re-militarization, while Torrijos maintains that the new agencies are needed to combat growing drug crimes.<sup>9</sup> In mid-December 2008, the Torrijos government approved additional changes to the penal code that increased penalties for the illegal possession of firearms and introduced sentences for attacking a police official.<sup>10</sup>

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(...continued)

Foreign Broadcast Information Service.

<sup>6</sup> Marion Barbel, "Panamanian Congress Approves Modified Social Security Reform," *World Markets Research*, December 22, 2005.

<sup>7</sup> "Panama: Country Report," *Economist Intelligence Unit*, January 2008, p. 2.

<sup>8</sup> Richard Lapper, "Good Luck, Good Timing," *Financial Times*, July 24, 2007.

<sup>9</sup> "Panama: Torrijos to Undertake Security Reform by Decree," *Latin American Weekly Report*, July 3, 2008; "Torrijos Forges Ahead with Security Decrees," *Latin American Regional Report, Caribbean and Central America*, September 2008.

<sup>10</sup> "Panama: Torrijos Pushes Through Changes to Penal Code," *Latin American Weekly Report*, December 18, 2008.

In order to deal with the effects of the global financial crisis, President Torrijos announced the establishment of a \$1.1 billion fund in January 2009 to allow for eased credit access and loans to financial institutions in Panama. The fund—financed with support from the Inter-American Development Bank, the Andean Development Corporation, and the National Bank of Panama—was established in order to counter the tightening of credit because of the global financial crisis.<sup>11</sup>

## **Martinelli Government (2009-2014)**

### **May 2009 Elections**

Because Panama's Constitution does not allow for immediate re-election, Torrijos was ineligible to run in the May 3, 2009, presidential election, which supermarket mogul and former government minister Ricardo Martinelli of the small center-right Democratic Change (CD) party won in a landslide. Despite strong economic growth and reductions in poverty, support for the Torrijos government in its last year in office eroded because of concerns about rising crime, the effects of the global financial crisis, and problems in improving infrastructure and public services. This contributed to the PRD's poor showing in the 2009 presidential and legislative elections.

While initially in 2008 it appeared that the candidate of the ruling PRD, former housing minister Balbina Herrera, was favored to win, opinion surveys late in the year reflected a significant shift in favor of Ricardo Martinelli. Polls in January 2009 showed Martinelli with 43% support compared to 25% for Herrera and almost 15% for Juan Carlos Varela of the center-right Panameñista Party (PP).<sup>12</sup> In late January 2009, Martinelli and Varela struck a deal to run together in a four-party coalition dubbed the Alliance for Change, with Martinelli leading the ticket and Varela as his running mate. The new alliance further widened Martinelli's lead in opinion polls. Ultimately, Martinelli captured 60% of the vote compared to almost 38% of the vote for Herrera.<sup>13</sup>

Martinelli's Alliance for Change also won a majority of seats in the unicameral National Assembly that will increase the chances that the President will be able to secure enough votes to enact his legislative agenda. The Alliance for Change parties captured 42 out of 71 seats in the legislature, with Martinelli's CD winning 15 and the center-right Panameñista Party (PAN) winning 21 seats. The opposition PRD, however, still remains the largest single party in the legislature, with 26 seats although internal divisions could weaken its power.<sup>14</sup> The Alliance for Change coalition faces some internal divisions that could jeopardize its cohesion, especially if President Martinelli's popularity begins to falter.

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<sup>11</sup> Marion Barbel, "President Unveils U.S. \$1.1 billion Anti-Crisis Fund in Panama," *Global Insight*, January 23, 2009.

<sup>12</sup> "Panama: Martinelli's Presidential Prospects Strengthen," *Latin American Weekly Report*, January 15, 2009.

"Panama Mogul Extends Lead in Election Race – Poll," *Reuters*, January 11, 2009.

<sup>13</sup> Tribunal Electoral de Panama, "Elecciones Generales del 3 de mayo de 2009."

<sup>14</sup> Asamblea Nacional de Panama, listing of deputies, available at: <http://www.asamblea.gob.pa/diputados/index.html>



## Challenges for the Martinelli Government

At this juncture, while President Martinelli's popularity has declined somewhat since the end of 2009, he still retains high approval ratings of around 75%.<sup>15</sup> Nevertheless, Martinelli faces a number of significant challenges, including economic recovery and increasing crime.

One of the most significant economic challenges facing the Martinelli government has been dealing with the fallout stemming from the global financial crisis, but the economy has weathered the storm and avoided the contraction experienced by many Latin American economies. Panama's service-based economy had been booming in recent years, largely because of the Panama Canal expansion project, but the global financial crisis and the related decline in U.S. import demand stemming from the U.S. recession slowed Panama's economic growth. The economy grew 12.1% in 2007 and 10.7% in 2008. Initially, some economists were predicting that the economy would contract in 2009, but the economy ended up growing an estimated 2.4%.<sup>16</sup> While this is a significant decline in economic growth from the previous two years, it also makes Panama's economy one of the few economies in the region registering positive economic growth in 2009. Moreover, forecasts for 2010 are for a growth rate over 4%.<sup>17</sup>

Although Panama is categorized by the World Bank as having an upper-middle-income economy because of its relatively high per capita income level of \$6,180 (2008), one of the country's major challenges is highly-skewed income distribution with large disparities between the rich and poor.<sup>18</sup> In order to tackle poverty, the previous Torrijos government initiated a social support program of conditional cash transfers to poor families (Red de Oportunidades) and in mid-2008, the government extended the program to include the elderly living in extreme poverty. Poverty rates have been reduced from almost 37% in 2002 to almost 28% in 2008, but the slowdown in economic growth because of the global economic crisis and U.S. recession threaten to erode progress that has been made in recent years. Extreme poverty or indigence in Panama was estimated to have increased from 12% of the population in 2007 to 13.5% in 2008.<sup>19</sup> Since taking office, President Martinelli has fulfilled his campaign pledge to provide \$100 a month to poor seniors.

During the presidential campaign, Martinelli pledged to simplify the tax system by the introduction of a flat tax for individuals (with an exemption for the first \$10,000 of income) and for corporations in order to discourage tax evasion. Instead, however, the government enacted a tax measure in March 2010 that will reduce the corporate tax rate from 30% to 25%, lower taxes for those in the lowest brackets, and gradually reduce individual taxes overall from 27% to 15%. The loss of revenue will be offset by raising the sales tax from 5% to 7% (not including food) and raising other taxes on banks, casinos, airlines, and the free-trade zone, with a projected net increase in revenue. The government maintains that additional revenue from the reform will be used to augment social expenditures (such as scholarships and cash transfers to the elderly), but critics of the measure maintain that the poor will be hit by an increase in the cost of living. The tax measure prompted protests against the government in March, with violent clashes between

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<sup>15</sup> "Country Report: Panama," *Economist Intelligence Unit*, April 2010, p. 3.

<sup>16</sup> "Country Report: Panama," *EIU*, April 2010.

<sup>17</sup> *Ibid.*

<sup>18</sup> World Bank, *World Development Report 2010*.

<sup>19</sup> U.N. Economic Commission for Latin America and the Caribbean, *Social Panorama of Latin America 2009*.

police and demonstrators and some 200 people were detained.<sup>20</sup> The tax measure, however, also led to an upgrading of Panama's investment-grade credit rating that should improve the country's financing costs and its attractiveness for foreign investment.<sup>21</sup>

During the campaign, Martinelli also called for a number of large public infrastructure projects, including a subway system for Panama City, a light rail system on the outskirts of Panama City, regional airports and roads, and a third bridge over the Canal. The government has already begun to move ahead on some projects. It has set up a body to oversee a \$1 billion plan to construct a subway system in Panama City, and maintains that it should not have trouble funding the transportation project.<sup>22</sup> In November 2009, the government signed an agreement with the Andean Development Corporation that will allow it to finance over \$1 billion in infrastructure projects.

With regard to Panama's rising crime rates, during the electoral campaign Martinelli proposed a safe streets program that included increasing the number of police and raising police pay.<sup>23</sup> Pay increases for the national police have already been approved, but Panama's crime situation grew worse in 2009, with homicides up 23% in 2009 compared to 2008. Panama had 806 murders in 2009, about 24 per 100,000, with drug trafficking the driving force behind the increase.<sup>24</sup> In February 2010, President Martinelli announced an expansion of the national police force with an additional 4,000 officers that would raise the total force to over 15,000.<sup>25</sup>

The Martinelli government has initiated a number of anti-corruption investigations against officials from the PRD who served in government, including former President Ernest Pérez Balladares (1994-1999). The PRD maintains that Martinelli is using an anti-corruption crusade to prosecute its political opposition. In late January 2010, Panama's Supreme Court voted to suspend Attorney General Ana Matilde Gomez on allegations of abuse of authority. Gomez had been appointed by the Torrijos government in 2005 to a 10-year post, but the Martinelli government had criticized her for failing to act in cases involving former high-ranking PRD government officials. The government has also initiated a criminal case against former President Ernesto Pérez Balladares for libel, although critics of the government maintain that the investigation is aimed at weakening the opposition PRD.

Some observers have criticized President Martinelli for undermining the independence of the judiciary because of his nomination of two political allies to the Supreme Court in December 2009. The National Assembly quickly approved the nominations, and the two justices took office in January 2010. A complaint on this and the broader issue of problems with Panama's judicial

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<sup>20</sup> Inti Landauro, "Panama Approves Tax Bill to Boost Revenue, Cut Deficit," *Dow Jones Newswires*, March 16, 2010; Sean Mattson, "Panama: President Ricardo Martinelli Moves His Agenda Forward," *Noticen: Central American & Caribbean Affairs*, March 18, 2010; "Panama Unions Show New Signs of Life," *Latin American Regional Report: Caribbean & Central America*, April 2010.

<sup>21</sup> "Panama: Credit Update," *EIU – Business Latin America*, March 29, 2010.

<sup>22</sup> "Martinelli Assumes Office," *Latin America Weekly Report*, July 2, 2009; "Funding Approved To Keep Panama President's Campaign Promises," *BBC Monitoring Americas*, July 8, 2009; and "Adopta Martinelli Primeras Medidas Ante Débiles Señales de Oposición," *Agencia Mexicana de Noticias*, July 10, 2009.

<sup>23</sup> "Country Report: Panama," *EIU* May 2009; and "Panama: Martinelli Faces Economic Challenges," *Oxford Analytica*, May 5, 2009.

<sup>24</sup> "Panama: Drug-Fueled Violence on the Increase," *Noticen, Central American & Caribbean Affairs*, January 28, 2010.

<sup>25</sup> "Panama Politics: President's Popularity Slips," *EIU ViewsWire*, March 23, 2010.

system was heard by the Inter-American Commission on Human Rights in March 2010. (See “Human Rights Issues” below.)

Another domestic political challenge in 2009 was dealing with the political fallout related to the government’s move to establish 11 air and naval bases in the country to combat drug trafficking. In September 2009, comments by Minister of Government and Justice José Raúl Mulino regarding an “international agreement” to combat drug trafficking led to widespread concerns that the United States was going to establish anti-drug bases in the country.<sup>26</sup> Subsequent Panamanian statements clarified that the bases would be Panamanian, and U.S. State Department officials asserted that United States had no agreement nor any plans to establish bases in Panama.<sup>27</sup> Nevertheless, the suspicion of U.S. involvement in the bases prompted protests by university students in November 2009.<sup>28</sup> (Also see “Cooperation against Drug Trafficking and Money Laundering” below.)

## **Human Rights Issues**

The Panamanian government generally respects human rights, but, as noted by the State Department in its 2009 human rights report (issued in March 2010), human rights problems continue in a number of areas. Prison conditions overall remain harsh, with reported abuse by prison guards, and prolonged pretrial detentions remains a problem. According to the report, the judiciary is marred by corruption and ineffectiveness, and is subject to political manipulation. Other serious problems include discrimination and violence against women, trafficking in persons, discrimination against indigenous communities, and child labor.

**Administration of Justice.** As noted above, there has been some criticism in Panama regarding the administration of justice and the independence of the judicial branch. Some observers have criticized President Martinelli for undermining the independence of the judiciary because of his nomination of two political allies to the Supreme Court in December 2009. A complaint on the issue regarding the justice system was heard by the Inter-American Commission on Human Rights on March 23, 2010, with representatives of the Citizens Alliance for Justice (Alianza Ciudadana Pro Justicia). The alliance represents 20 Panamanian civil society organizations dedicated to implementing judicial reform and improving the administration of justice.<sup>29</sup>

**Freedom of the Press.** In past years, Panama had been criticized by the State Department and international human rights groups for vestiges of “gag laws” used by the government to silence those criticizing policies or officials, but the legislature repealed these laws in May 2005. Nevertheless, as noted in the State Department’s human rights report, the legislature approved penal code amendments in May 2007 that allows for the prosecution of journalists who violate the privacy of public officials or who publish classified information. The new penal code went

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<sup>26</sup> “New Anti-drugs Bases in Panama Spark Suspicions,” *Latin American Regional Report, Caribbean & Central America*, December 2009.

<sup>27</sup> “Panamanian Minister Says Foreign Anti-Drugs Aid ‘Nothing Substantial,’” *BBC Monitoring Americas*, September 30, 2009.

<sup>28</sup> “Protests in Panama over New ‘U.S.’ Naval Bases,” *Latin American Weekly Report*, November 12, 2009.

<sup>29</sup> See the website of the Citizens Alliance for Justice at: <http://www.alianzaprojusticia.org.pa/> ; The Washington, D.C.-based Due Process of Law Foundation has also done work on the issue of Panama’s judicial system. For more information, see: [http://www.dplf.org/index.php?c\\_ID=395&catID=1](http://www.dplf.org/index.php?c_ID=395&catID=1)

into effect in May 2008. Nongovernmental organizations assert that the new code threatens freedom of speech and press.

As noted in the State Department human rights report, there have been some official attempts to impede freedom of speech and the press. International press rights groups such as the Committee to Protect Journalists and Reporters Without Borders have expressed concern about several cases. In September 2008, a judge ordered the seizure of a local newspaper, *El Periódico*, because it published the tax returns of a prominent businessman. The paper subsequently went out of business, but the case remains under appeal. In February 2009, a Panamanian court sentenced Jean Marcel Chéry, the director of the daily *El Siglo*, to two years in prison for trespassing in connection with reporting on alleged corruption involving a Supreme Court Justice. Chéry has appealed the decision. In September 2009, a Panamanian court convicted a journalist from *La Prensa* of libel against a former vice president.

**Past Human Rights Abuses Under Military Rule.** In an attempt to redress human rights abuses that occurred under military rule (1968-1989) and to prevent their recurrence, the Moscoso government established a Truth Commission in 2001 that documented 70 cases of murder and 40 disappearances, but progress has been slow in investigation and prosecution of these cases. In 2008, Panama's attorney general announced that investigations had either been opened or reopened in 47 of these cases because of new evidence. According to the State Department's 2009 human rights report, more than half of these cases have been temporarily dismissed or closed, but 19 are at various stages of the trial process.

In 2008, the Panamanian government opened an investigation into the alleged killings of more than 20 persons who reportedly were thrown from helicopters in the Darién region in 1982-1983. In November 2009, Panama's attorney general asked a court to call to trial former Minister of Government and Justice Daniel Delgado for a killing in 1970 when he was a member of Panama's National Guard.

In July 2006, just as a human rights trial was approaching an end, a former military officer implicated in the 1970 killing of activist Heliodoro Portugal died from an apparent heart attack. In September 2008, the Inter-American Commission on Human Rights ordered the Panamanian government to pay restitution to the family of Portugal.

**Displaced Persons.** In recent years, violence from the civil conflict in neighboring Colombia has resulted in hundreds of displaced persons seeking refuge in the neighboring Darién province of Panama. Many of the Colombians have lived in Panama for years, have given birth to children in Panama, and do not want to return to Colombia because of family and cultural ties to local Panamanian communities. While many of the displaced are Afro-Colombians, there have also been indigenous people from Colombia who have fled to Panama because of the violence.

The State Department's 2009 human rights report notes that there are around 1,000 officially recognized refugees in Panama, but also reports that the Office of the U.N. High Commission for Refugees (UNHCR) classifies some 15,000 people in the country as "persons of concern" in need of international protection. UNHCR has a permanent office in Panama and was generally allowed access to provide services to refugees, internally displaced persons, and persons under temporary humanitarian protection.

In April 2008, UNHCR lauded Panama for the approval of a new law that allows long-standing refugees (those residing 10 years or more) the opportunity to apply for permanent residency.

According to UNHCR, the new law will largely affect refugees from Nicaragua and El Salvador who arrived in Panama during the Central American conflicts of the 1980s, and will not affect the more recent refugees from Colombia.<sup>30</sup> According to the State Department's 2009 human rights report, 41 cases have been approved under the law and another 140 cases are pending.

**Worker Rights.** With regard to worker rights in Panama, the State Department's 2009 human rights report notes that while Panamanian law recognizes the right of private-sector workers to form and join unions of their choice, the law requires a minimum of 40 persons to form a union, and only one trade union is allowed per business. The International Labor Organization Committee of Experts criticizes both provisions as violations of workers' rights to organize, according to the State Department human rights report. Public servants may not form unions, but they may form associations, which can bargain collectively, and there is a limited right to strike with the exception of those areas vital for public welfare and security. The National Federation of Public Servants (FENASEP), an umbrella organization of 21 public-sector worker associations, is not permitted to call strikes, and the ILO has expressed concerns about this. The State Department report also noted that child labor was a problem, with violations occurring most frequently in rural areas at harvest time and in the informal sector.

**Human Trafficking.** According to the State Department's 2009 Trafficking in Persons (TIP) report, Panama is a source, transit, and destination country for women and children trafficked for commercial sexual exploitation. The principal traffickers in Panama were owners of houses of prostitution; prostitution is legal and regulated in Panama, but the majority of prostitutes are not registered with the government. Most victims trafficked into Panama come from Colombia, the Dominican Republic, and Central America. Some Panamanian women are trafficked out of the country to Jamaica, Europe, and Israel.

In 2008, Panama had been on the State Department's Tier 2 Watch List for failing to show evidence of increasing efforts to combat human trafficking and for failing to provide adequate victim assistance. In June 2009, however, Panama was placed on the Tier 2 List because of the government's anti-trafficking efforts. Since the 2008 TIP report, the government had increased prevention efforts, enacted a legislative reform package to strengthen its anti-trafficking laws, and eliminated a special visa category that had been used to facilitate the trafficking of Colombian women into the sex trade. Nevertheless, the 2009 TIP report recommended that Panama intensify law enforcement efforts to investigate and prosecute trafficking offenses and convict and sentence trafficking offenders; dedicate more resources for victim services; develop a formal system for identifying trafficking victims among vulnerable populations; and amend anti-trafficking laws to prohibit forced labor, including involuntary domestic servitude.

## **U.S. Relations**

### **Background on the 1989 U.S. Military Intervention**

The December 20, 1989, U.S. military intervention in Panama, known as Operation Just Cause, was the culmination of almost two and a half years of strong U.S. pressure, including economic sanctions, against the de facto political rule of General Noriega, Panama's military commander.

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<sup>30</sup> "UNHCR Welcomes New Panama Law," *UNHCR Briefing Notes*, April 1, 2008.

Political unrest had erupted in mid-1987 when a high-ranking Panamanian military official alleged that Noriega was involved in murder, electoral fraud, and corruption, which prompted the formation of an opposition coalition that challenged his rule. The regime nullified the results of May 1989 national elections, which international observers maintain were won by the opposition by a 3-1 margin. It also harassed U.S. citizens in Panama, including the killing of a U.S. Marine lieutenant. President George H. W. Bush ultimately ordered U.S. forces into combat to safeguard the lives of Americans in Panama, to defend democracy, to combat drug trafficking, and to protect the operation of the Panama Canal.

In early January 1990, with the restoration of democracy and Noriega's arrest to face trial in the United States on drug charges, President Bush announced that the objectives of the U.S. intervention had been achieved. In terms of casualties, 23 U.S. soldiers and three U.S. civilians were killed, while on the Panamanian side, some 200 civilians and 300 Panamanian military were killed. While Congress was not in session during the intervention, in general, Members were strongly supportive of the action. In February 1990, the House overwhelmingly approved a resolution, H.Con.Res. 262, stating the President acted appropriately to intervene in Panama after substantial efforts to resolve the crisis by political, economic, and diplomatic means.

### **Status of Manuel Noriega**

In the aftermath of the 1989 U.S. military intervention, General Manuel Noriega was arrested in January 1990 and brought to the United States to stand trial on drug charges. After a seven-month trial, Noriega was convicted on 8 out of 10 drug trafficking charges in U.S. federal court in Miami in 1992, and sentenced to 40 years in prison. That sentence was subsequently reduced to 30 years, and then to 20 years. With time off for "good behavior," Noriega was scheduled to be released from jail on September 9, 2007, but remained in U.S. custody pending appeals of his extradition to France. Noriega's defense filed a final appeal with the Supreme Court in July 2009 on the grounds that Noriega was granted "prisoner of war" status under the Geneva Convention in a 1992 U.S. court ruling and therefore was entitled to return to Panama. Noriega lost that appeal, and was extradited to France on April 26, 2010. In France, Noriega faces a 10-year prison sentence for his conviction in absentia in 1999 on money laundering charges, but is eligible for a new trial.

Noriega wanted to return to Panama in order to appeal his convictions in absentia, including for two murders: the brutal killing of vocal critic Hugo Spadafora in 1985; and the killing of Major Moisés Giroldi, the leader of a failed 1989 coup attempt. Panamanian courts sentenced Noriega to at least 60 years in prison, but the law only allows him to serve a maximum sentence of 20 years, and according to some reports, 18 years of Noriega's imprisonment in the United States could be subtracted from his sentence in Panama.<sup>31</sup> Nevertheless, there are additional outstanding cases against Noriega, including alleged responsibility for the deaths of several members of the Panamanian Defense Forces involved in the failed 1989 coup.<sup>32</sup>

Noriega's attorneys argued that since Noriega had been recognized as a prisoner of war in the U.S. courts, the United States should have repatriated him to his native Panama, insisting that this

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<sup>31</sup> Kathia Martinez, "A Homecoming for Noriega after Miami Release? Many Hope Not," *Associated Press Newswires*, August 12, 2007.

<sup>32</sup> "Torrijos on Edge over Noriega Release," *Latin American Regional Report, Caribbean and Central America*, August 2007.

complies with the Geneva Conventions. U.S. officials argued that France's extradition should be honored because Panama by law does not extradite its nationals.<sup>33</sup> Panama had filed an extradition request for Noriega in 1991.

While Panamanian officials called for Noriega's extradition to Panama, they did not oppose the possibility of Noriega being extradited to France and stated that the government would respect the decision of the U.S. courts on this matter. Some observers maintained that Panamanian officials were reluctant to have Noriega return because of changes to Panama's penal code that could allow Noriega to serve little, if any, of his sentence.<sup>34</sup> In response to Noriega's extradition to France, Panama's Foreign Minister Juan Carlos Varela maintained that the Panamanian government respected the United States' sovereign decision, but that it would pursue legal and diplomatic means to return Noriega to Panama to serve sentences handed down by Panamanian courts.<sup>35</sup>

## **Overview of Current U.S.-Panamanian Relations**

Since the 1989 U.S. military intervention, the United States has had close relations with Panama, stemming in large part from the extensive history of linkages developed when the Panama Canal was under U.S. control and Panama hosted major U.S. military installations. Today, about 25,000 U.S. citizens reside in Panama, many retirees of the former Panama Canal Commission, and there are growing numbers of other American retirees in the western part of the country.<sup>36</sup>

The current U.S. relationship with Panama is characterized by extensive cooperation on counternarcotics efforts, U.S. assistance to help Panama assure the security of the Canal, and a proposed bilateral free trade agreement (FTA) that was signed in 2007. Panama is seeking the FTA as a means of increasing U.S. investment in the country, while the United States has stressed that an FTA with Panama, in addition to enhancing trade, would further U.S. efforts to strengthen support for democracy and the rule of law.

The United States turned over control of the Canal to Panama at the end of 1999, according to the terms of the 1977 Panama Canal Treaty, at which point Panama assumed responsibility for operating and defending the Canal. All U.S. troops were withdrawn from Panama at that time and all U.S. military installations reverted to Panamanian control. However, under the terms of the Treaty on the Permanent Neutrality and Operation of the Panama Canal, or simply the Neutrality Treaty, the United States retains the right to use military force if necessary to reopen the Canal or restore its operations.

## **U.S. Foreign Aid and Other Support**

Because of its relatively high per capita income level, the United States has not provided large amounts of foreign aid to Panama in recent years. Nevertheless, aid has included development assistance to improve business competitiveness and trade-led economic growth; child, survival,

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<sup>33</sup> Carmen Gentile, "Noriega Court Bid Called a Charade; Aims to Avoid Extradition," *Washington Times*, August 14, 2007.

<sup>34</sup> Marc Lacey, "An Ambivalent Panama Weighs Noriega's Debt and Threat," *New York Times*, July 29, 2007.

<sup>35</sup> "Panama's Noriega Extradited to France," *LatinNews Daily*, April 27, 2010.

<sup>36</sup> U.S. Department of State, Background Note: Panama, December 2009.

and health assistance to help in the fight against HIV/AIDS; and security assistance to improve Panama's counterterrorism capabilities, security programs, and maritime interdiction. In recent years, U.S. bilateral assistance (not including Peace Corps assistance) amounted to \$3.7 million in FY2008, \$7.6 million in FY2009, and an estimated \$8.7 million in FY2010. For FY2011, the Obama Administration is requesting \$10.6 million in assistance for Panama, including \$7.5 million in Development Assistance and \$2.1 million in Foreign Military Financing.

These figures do not reflect additional assistance that Panama has been receiving since FY2008 under the Mérida Initiative, a program providing assistance to Mexico and Central American countries in their efforts to combat drug trafficking, gangs, and organized crime. In March 2009, Panama and the United States signed a letter of agreement for \$2 million in funding under the initiative; overall, Panama will receive an estimated \$11 million in Mérida Initiative assistance for FY2008/2009. For FY2010, instead of funding under the Mérida Initiative, Panama will receive a portion of the \$83 million in assistance under the Central America Regional Security Initiative (CARSI), a successor to the Mérida Initiative for Central America. For FY2011, the Obama Administration has requested \$100 million in assistance for CARSI. The lack of details for actual and proposed country funding for Panama under the Mérida Initiative and CARSI makes it difficult to provide an overall picture of U.S. assistance going to Panama.

A number of U.S. agencies provide support to Panama. The U.S. Agency for International Development has a mission in Panama administering U.S. foreign aid programs, and the Peace Corps has over 180 volunteers in the country working on a range of development projects. The State Department, the Drug Enforcement Administration, the U.S. Coast Guard, and the Department of Homeland Security are involved in providing counternarcotics support to Panama. The Department of Health and Human Services provided support in 2007 to launch a Regional Training Center for health-care workers in Panama City that trains students from throughout Central America. The U.S. Southern Command (Southcom) also 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 also has sponsored annual multinational training exercises since 2003 focused on the defense of the Panama Canal. Panama also hosts the Smithsonian Tropical Research Institute dedicated to studying biological diversity.

### **Port Security and Other Counterterrorism Efforts**

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. Three Panamanian ports—Balboa, Colón, and Manzanillo—participate in the CSI, which uses a security regime to ensure that containers that pose a potential risk for terrorism are identified and inspected at foreign ports before they are placed on vessels destined for the United States. The Megaports Initiative, which involves deploying radiation detection equipment in order to detect nuclear or radioactive materials, became operational at the ports of Balboa and Manzanillo in December 2008.<sup>37</sup>

The State Department's Country Reports on Terrorism, 2008, issued in April 2009, maintained that Panama has taken serious terrorism prevention and preparedness efforts. It pointed to the

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<sup>37</sup> "Panama Begins Radiation Detection Efforts at Two Ports" *State News Service*, December 12, 2008.



government's reforms of its security forces in the summer of 2008, which the Panamanian government asserted would help protect the Panama Canal from potential terrorist attacks. The reforms created a National Border Service that will allow a police force to be deployed permanently at the Colombian border to protect against drug traffickers as well as members of the Revolutionary Armed Forces of Colombia (FARC). There have been some incursions of the FARC into Panama's Darién province, with reports of FARC members entering villages to steal supplies. In late January 2010, three FARC members were killed and two were captured in a clash with Panamanian forces in the Darién.

## **Drug Trafficking and Money Laundering**

An important concern for U.S. policymakers over the years has been securing Panamanian cooperation to combat drug-trafficking and money-laundering. Panama is a major transit country for illicit drugs from South America to the U.S. market because of its geographic location and its large maritime industry and containerized seaports. Moreover, the country's service-based economy, with a large banking sector and trading center (Colón Free Zone, CFZ), makes Panama vulnerable to money laundering. The State Department's March 2010 *International Narcotics Control Strategy Report* (INCSR) maintains that there was increased narcotics trafficking by Colombian, Mexican, and other drug trafficking organizations through Panama. According to the report, the increased trafficking and the presence of Colombian illegally armed groups in the Darién region contributed to rising crime, violence, and gang presence throughout the country. The country's murder rate increased from 11.1 per 100,000 to 23.2 in 2009 according to the INCSR.<sup>38</sup> The report also maintains that the majority of money laundering in the country relates to proceeds from drug trafficking (especially the sale in the United States and Europe of cocaine produced in Colombia) or from the transshipment of smuggled, pirated, and counterfeit goods through the CFZ.

Drug traffickers use fishing vessels, cargo ships, small aircraft, and go-fast boats to move illicit drugs—primarily cocaine—through Panama. Some of the drugs are transferred to trucks for northbound travel or are placed in sea-freight containers for transport on cargo vessels. Traffickers also utilize hundreds of abandoned or unmonitored airstrips as well as couriers who transit Panama by commercial air flights. There also has been increasing domestic drug abuse, particularly among youth.

According to the 2010 INCSR, the Martinelli government “continued Panama's history of strong cooperation with the U.S. on counternarcotics operations.” In 2009, according to the report, the government seized 54 metric tons of cocaine and over \$11 million in cash linked to drug trafficking.

U.S. support has included programs to improve Panama's ability to intercept, investigate, and prosecute illegal drug trafficking; strengthen Panama's judicial system; improve Panama's border security; and promote stricter enforcement of existing laws. The United States also has provided resources to modernize and maintain vessels and bases of the National Aero-Naval Service (SENAN), the National Border Service (SENAFRONT), and the National Police (PNP); assisted with training and maintenance for aircraft involved in interdiction efforts; provided training and

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<sup>38</sup> In addition, see: United Nations Development Programme, *Human Development Report for Central America, 2009-2010, Opening Spaces to Citizen Security and Human Development*, p. 12; and Louisa Reynolds, “Panama: Drug-Fueled Violence on the Increase,” *Noticen: Central American & Caribbean Affairs*, January 28, 2010.

support for a multi-agency drug interdiction team at Tocumen Airport; trained a quick response motorcycle team; and continued support for a PNP law enforcement modernization program to develop police leadership and implement community-based policing procedures.

Looking ahead, the 2010 INCSR encourages Panama to devote more resources to the modernization of its security services and to continue with reform efforts that improve public sector accountability and transparency.

Panama has made significant progress in strengthening its anti-money-laundering regime since June 2000, when it was cited as a non-cooperative country in the fight against money laundering by the Financial Action Task Force (FATF), a multilateral anti-money-laundering body. Subsequently, the government undertook a comprehensive effort to improve its anti-money-laundering regime by enacting two laws and issuing two decrees in 2000. As a result of these efforts, the FATF removed Panama from its non-cooperative country list in June 2001.

Nevertheless, the 2010 INCSR maintains that while Panama has a comprehensive legal framework against money laundering and financial crimes, it lacks the investigative and judicial infrastructure to prosecute cases. According to the report, Panama has not prosecuted a money laundering case in recent years. The report maintained that Panama should increase its efforts to detect, prevent, and combat money laundering and terrorist financing and pointed to the need for better training and pay for law enforcement personnel and customs officials. As in the past, the report expressed concern about the issuance of bearer shares, and maintained that the government should take steps to eliminate or immobilize these financial instruments. It also called on the government to devote more resources in order to combat bulk cash smuggling and trade-based money laundering in the CFZ.

Panama has received small amounts of regular U.S. bilateral counternarcotics assistance in recent years. For example, Panama received almost \$1 million in International Narcotics Control and Law Enforcement (INCLE) assistance in FY2008 and \$2.2 million in FY2009. In addition, however, as noted above, Panama is receiving a portion of assistance under the Mérida Initiative. For FY2008/FY2009 assistance, Panama received an estimated \$11 million in assistance under the initiative. Beginning in FY2010, instead of under the Mérida Initiative, Panama is receiving funding under the successor Central America Regional Security Initiative (CARSI). Congress appropriated \$83 million for CARSI in the Consolidated Appropriations Act, 2010 (P.L. 111-117), and the Obama Administration has requested \$100 million in CARSI funding for FY2011. Panama will receive a portion of this assistance.

As noted above, the Martinelli government has moved to establish 11 air and naval anti-drug bases in the country, six on the Pacific side of the country and five on the Caribbean side. The first air-naval base was established in late November 2009 on Chapera Island off Panama's Pacific coast, and several more have been opened so far in 2010, including one in the Darién region. U.S. officials maintain that the United States has no plans to establish U.S. bases in Panama, while Panamanian officials maintain that U.S. support for Panama's effort will consist of providing some training and equipment.<sup>39</sup>

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<sup>39</sup> "Panamanian Minister Says Foreign Anti-Drugs Aid 'Nothing Substantial,'" *BBC Monitoring Americas*, September 30, 2009; and "Panama's Naval Air Stations Not Covert U.S. Military Bases – Minister," *BBC Monitoring Americas*, December 6, 2009.

## Tax Haven Status<sup>40</sup>

While there is no single accepted definition for a tax haven, the Organization for Economic Co-Operation and Development (OECD) has stated four criteria can be used to identify tax haven jurisdictions.<sup>41</sup> The criteria are no or nominal taxes and three criteria related to transparency and the exchange of information.

Whereas the OECD recognized that the determination of appropriate tax policy is a national concern, the organization has stated that the areas of transparency and information exchange require a multilateral solution. Following this belief, the OECD has an ongoing project, the Global Forum on Taxation, working to increase transparency and information exchange. In April 2002, Panama committed itself to meet the OECD principles on transparency and information exchange, thus averting a designation as a non-cooperative tax haven.

In spite of this commitment, in 2008 the OECD identified Panama as one of 11 countries that do not currently have tax information exchange agreements in force.<sup>42</sup> Further, Panama is one of three countries that does not allow tax information exchanges for either civil or criminal matters. Panama does have a Mutual Legal Assistance Treaty (MLAT) with the United States, which covers the exchange of tax information if the income is effectively tied to an illegal activity, such as unreported income from drug trafficking.

Notwithstanding this apparent lack of transparency, it is not clear the extent to which Panama is used as a corporate tax haven. According to the most recent IRS data, 159 U.S. corporations have subsidiaries in Panama. This accounts for less than 2% of all U.S. corporations. Focusing on larger corporations, 18 of the 100 largest publicly traded companies and 14 of the 100 largest federal contractors had subsidiaries in Panama.<sup>43</sup> The revenue cost of these subsidiaries to the United States is unknown.

Panama's corporate tax is more similar to the United States' than other possible tax havens. The Panamanian corporate tax rate of 30% is at nearly the level of the top U.S. corporate tax rate of 35%. In comparison, other commonly cited tax havens, such as the Cayman Islands, do not levy a tax on corporate income. As a result, the corporate tax rate is unlikely the motivating factor for the location of U.S. subsidiaries in Panama.

Non-tax factors could provide motivation for U.S. corporations to have subsidiaries in Panama. In the case of Panama, it, along with Liberia, is commonly used as a flag of convenience. Traditional reasons for choosing a flag of convenience include protection from income taxes, wage scales, and regulations. A specific example of the type of advantage flying a flag of convenience offers is bypassing the 50% duty the United States government charges on repairs performed on

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<sup>40</sup> Prepared by Donald J. Marples, Specialist in Public Finance, ext. 7-3739

<sup>41</sup> A full discussion of the criteria can be viewed at [http://www.oecd.org/document/23/0,3343,en\\_2649\\_33745\\_30575447\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/23/0,3343,en_2649_33745_30575447_1_1_1_1,00.html) and a broader discussion of tax havens can be found in CRS Report R40623, *Tax Havens: International Tax Avoidance and Evasion*, by Jane G. Gravelle.

<sup>42</sup> OECD, *Tax Co-Operation: Towards a Level Playing Field*, 2008, p6. In addition, other widely cited tax haven definitions include Panama.

<sup>43</sup> U.S. Government Accountability Office, *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Haven or Financial Privacy Jurisdictions*, GAO-09-157, December 18, 2008.

American-flagged ships in foreign ports. Other non-tax factors could also motivate U.S. corporations to have subsidiaries in Panama.

Panama's lack of tax transparency and information exchange agreements could make it a destination for tax evasion. In testimony before the Senate Committee on Finance, several speakers commented that a lack of transparency and strong bank secrecy laws are commonly found in tax evasion destinations.<sup>44</sup> Additionally, other commentators have specifically identified Panama as being an ideal location for tax evasion activities.<sup>45</sup>

## **U.S. Trade Relations and a Potential Free Trade Agreement**

Panama has largely a service-based economy, which historically has run a merchandise trade deficit with the United States. In 2009, the United States had a \$4.1 billion trade surplus with Panama, exporting almost \$4.4 billion in goods and importing \$304 million. Panama was the 40<sup>th</sup>-largest U.S. export market in 2009.<sup>46</sup> Panama's major exports to the United States include fish and seafood, gold, sugar, and fresh fruits. Major imports include oil, machinery and other capital goods, consumer goods, and foodstuffs. About 38% of Panama's exports were destined for the United States in 2008, while about 30% of its imports were from the United States. The stock of U.S. foreign investment in Panama was estimated at \$7.2 billion in 2008, largely concentrated in the financial and wholesale sectors. This almost equaled the combined U.S. foreign investment in the five other Central American nations.<sup>47</sup>

With the exception of two years (1988-1989), when the United States was applying economic sanctions on Panama under General Noriega's rule, Panama has been a beneficiary of the U.S. preferential import program known as the Caribbean Basin Initiative (CBI), begun in 1984. The program was amended several times and made permanent in 1990. CBI benefits were expanded in 2000 with the enactment of the Caribbean Basin Trade Partnership Act (CBTPA) (Title II, P.L. 106-200), which provided NAFTA-equivalent trade benefits, including tariff preferences for textile and apparel goods, to certain CBI countries, including Panama. The program currently continues in effect until September 30, 2010, or the date on which a free trade agreement enters into force between the United States and a CBTPA beneficiary country.

Panama and the United States began negotiations for a free trade agreement in April 2004. There had been expectations that the negotiations would be completed in early 2005, but continued contention over several issues and a lengthy hiatus prolonged the negotiations until December 2006. Issues included market access for agricultural products, considered sensitive by Panama; procurement provisions for the Panama Canal Authority regarding expansion activities; and sanitary control systems governing the entry of U.S. products and animals to enter the Panamanian market. Negotiations were suspended for some time in 2006 until after Panama held its Canal expansion referendum in October, but a 10<sup>th</sup> round led to the conclusion of negotiations on December 19, 2006.

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<sup>44</sup> U.S. Congress, Senate Committee on Finance, *Offshore Tax Evasion: Stashing Cash Overseas*, 110th Cong., 1st sess., May 3, 2007.

<sup>45</sup> Martin A. Sullivan, "Ah, Panama," *Tax Notes*, June 25, 2007, p. 1246.

<sup>46</sup> Department of Commerce statistics, as presented by World Trade Atlas.

<sup>47</sup> U.S. Department of Commerce, Bureau of Economic Analysis, "Survey of Current Business," September 2009, p. 225.

Under the proposed agreement, over 88% of U.S. exports of consumer and industrial goods would become duty-free immediately, while remaining tariffs would be phased out over 10 years. Over 50% of U.S. agricultural exports to Panama would become duty-free immediately, while tariffs on most remaining farm products would be phased out within 15 years. In December 2006, Panama and the United States also signed a bilateral agreement on sanitary and phytosanitary measures in which Panama will recognize the equivalence of the U.S. food safety inspection to those of Panama and will no longer require individual plant inspections. Under the FTA, U.S. companies would be guaranteed a fair and transparent process to sell goods and services to Panamanian government entities, including the Panama Canal Authority.<sup>48</sup>

When the negotiations were concluded, then-U.S. Trade Representative Susan Schwab stated that the agreement would be subject to additional discussions on labor, and that the Administration would work with both sides of the aisle in Congress to ensure strong bipartisan support before submitting it to Congress.<sup>49</sup> On May 10, 2007, congressional leaders and the Bush Administration announced a bipartisan trade deal whereby pending free trade agreements would include enforceable key labor and environmental standards. This included an obligation to adopt and maintain in practice five basic internationally recognized labor principles: freedom of association; recognition of the right to collective bargaining; elimination of forced or compulsory labor; abolition of child labor; and elimination of discrimination in respect of employment and occupation.

The United States and Panama ultimately signed the proposed FTA on June 28, 2007, with the enforceable labor and environmental standards outlined in the bipartisan trade deal. Panama's National Assembly ratified the agreement on July 11, 2007, by a vote of 58 to 3, with one abstention.

The U.S. Congress had been likely to consider implementing legislation for the agreement in the fall of 2007, but the September 1, 2007, election of Pedro Miguel González of the ruling PRD to head Panama's legislature for one year delayed consideration of the FTA. González is wanted in the United States for his alleged role in the murder of U.S. Army Sergeant Zak Hernández and the attempted murder of U.S. Army Sergeant Ronald Marshall in June 1992. The State Department issued a statement expressing deep disappointment about the election of González because of his October 1992 indictment in the United States for the murder of Sergeant Hernández. Although González was acquitted in Panama in 1997 for the Hernández murder, observers maintain that the trial was marred by jury rigging and witness intimidation. González denies his involvement, and his lawyer asserts that ballistic tests in the murder were inconclusive. While polls in Panama in 2007 showed that Panamanians believed that González should have stepped down, the case also energized the populist anti-American wing of the ruling PRD.<sup>50</sup> González did not seek a second term as president of the National Assembly when his term expired on September 1, 2008, and another PRD official, Raúl Rodríguez, was elected Assembly president. This essentially removed the issue as an impediment to U.S. congressional consideration of the FTA.

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<sup>48</sup> Office of the United States Trade Representative, "Free Trade with Panama, Brief Summary of the Agreement," December 19, 2006.

<sup>49</sup> Rosella Brevetti, "Panama, United States Conclude Negotiations on Free Trade Pact," but Labor Issues Remain," *International Trade Daily*, December 20, 2006.

<sup>50</sup> Marc Lacey, "Fugitive from U.S. Justice Leads Panama's Assembly," *New York Times*, November 28, 2007.

The Obama Administration is trying to work out some final issues with Panama related to worker rights and to Panama's bank secrecy laws that have allowed the country to serve as a tax shelter.<sup>51</sup> Some Members of Congress have raised concerns about these issues. Concerns on worker rights center on certain provisions of Panama's labor laws that restrict unions and that have been criticized by the International Labor Organization. (Also see discussion of worker rights in the "Human Rights Issues" section above.)

With regard to Panama's bank secrecy laws, some Members want to delay consideration of the Panama FTA until the United States and Panama sign a tax information exchange agreement (TIEA). The Organization for Economic Cooperation and Development (OECD) includes Panama on its list of jurisdictions that have committed to an internationally agreed tax standard to help prevent tax evasion, but that have not yet substantially implemented the standard.<sup>52</sup> In November 2009, the Martinelli government signed an agreement with Mexico to eliminate double taxation and facilitate the exchange of tax information, and talks reportedly are underway with Italy and will soon begin with the Netherlands. Panama reportedly is committed to concluding 12 such agreements that would lead to its removal from the OECD list. The U.S. Treasury Department maintains that Panama should sign a more stringent TIEA with the United States that spells out in greater detail the procedures for exchanging tax information.<sup>53</sup>

Legislation introduced in the 111<sup>th</sup> Congress (H.R. 1265/S. 506) would take measures to restrict the use of offshore tax havens in order to avoid U.S. federal taxation. (Also see "Tax Haven Status" section above and also see CRS Report R40114, *The OECD Initiative on Tax Havens*, by James K. Jackson.)

With regard to the FTA with Panama, H.Res. 987 (Frelinghuysen), introduced in December 2009, would express the sense of the House that the FTA with Panama should be implemented immediately, and H.Res. 1124 (Mack), introduced in February 2010, would call on President Obama to submit the Panama FTA to Congress and work to ensure that it is approved.

For more details on the bilateral FTA, see CRS Report RL32540, *The Proposed U.S.-Panama Free Trade Agreement*, by J. F. Hornbeck.

## **Operation and Security of the Panama Canal**

### **Historical Background and the Panama Canal Treaties**

When Panama proclaimed its independence from Colombia in 1903, it concluded a treaty with the United States for U.S. rights to build, administer, and defend a canal cutting across the country and linking the Pacific and Atlantic oceans. (See **Figure 1**, *Map of Panama*, at the end of this report.) The treaty gave the United States rights in the so-called Canal Zone (about 10 miles wide and 50 miles long) "as if it were sovereign" and "in perpetuity." Construction of the Canal was completed in 1914. In the 1960s, growing resentment in Panama over the extent of U.S.

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<sup>51</sup> "U.S. Presses on Panama, Colombia Deals," *Reuters News*, May 5, 2009.

<sup>52</sup> Organization for Economic Co-operation and Development, "A Progress Report on the Jurisdictions Surveyed by the OECD Global Forum in Implementing the Internationally Agreed Tax Standard," January 20, 2010.

<sup>53</sup> "Panama Pushes Treasury to Accept Double Tax Agreement," *Inside U.S. Trade*, October 23, 2009.

rights in the country led to pressure to negotiate a new treaty arrangement for the operation of the Canal. Draft treaties were completed in 1967 but ultimately rejected by Panama in 1970.

New negotiations ultimately led to the September 1977 signing of the two Panama Canal Treaties by President Jimmy Carter and Panamanian head of government General Omar Torrijos. Under the Panama Canal Treaty, the United States was given primary responsibility for operating and defending the Canal until December 31, 1999. (Subsequent U.S. implementing legislation established the Panama Canal Commission to operate the Canal until the end of 1999.) Under 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, whereby the Canal would be open to ships of all nations. The U.S. Senate gave its advice and consent to the Neutrality Treaty on March 16, 1978, and to the Panama Canal Treaty on April 18, 1978, both by a vote of 68-32, with various amendments, conditions, understandings, and reservations. Panama and the United States exchanged instruments of ratification for the two treaties on June 16, 1978, and the two treaties entered into force on October 1, 1979.

Some treaty critics have argued that Panama did not accept the amendments, conditions, reservations, and understandings of the U.S. Senate, including the DeConcini condition to the Neutrality Treaty. That condition states: “if the Canal is closed, or its operations are interfered with, the United States of America and the Republic of Panama shall each independently have the right to take such steps as each deems necessary, in accordance with its constitutional processes, including the use of military force in the Republic of Panama, to reopen the Canal or restore the operations of the Canal, as the case may be.” However, others argued that Panama, in fact, had accepted all U.S. Senate amendments. The State Department asserted that Panama expressly accepted all amendments, conditions, and understandings to the two treaties, including the DeConcini condition. The United States and Panama signed the instruments of ratification for both treaties, which incorporated all the Senate provisions. The two countries cooperated throughout the years on matters related to the canal and established five binational bodies to handle these issues. Two of the bodies were set up to address defense affairs and conducted at least 16 joint military exercises between 1979 and 1985 involving Panamanian and U.S. forces.

## **Canal Transition and Current Status**

Over the years, U.S. officials consistently affirmed a commitment to follow through with the Panama Canal Treaty and turn the Canal over to Panama at the end of 1999. That transition occurred smoothly on December 31, 1999. The Panama Canal Treaty terminated on that date, and the Panama Canal Commission (PCC), the U.S. agency operating the Canal, was succeeded by the Panama Canal Authority (ACP), a Panamanian government agency established in 1997.

Under the terms of the Neutrality Treaty, which has no termination date, Panama has had responsibility for operating and defending the Canal since the end of 1999. As noted above, both Panama and the United States, however, in exercising their responsibilities to maintain the regime of neutrality (keeping the Canal secure and open to all nations on equal terms) independently have the right to use military force to reopen the Canal or restore its operations. This is delineated in the first condition of the Neutrality Treaty.

The secure operation of the Panama Canal remains a U.S. interest since about 13%-14% of U.S. ocean-borne cargo transits through the Canal. The United States provides assistance to Panama to improve its ability to provide security for the Canal and to enhance port and maritime security. U.S. officials have consistently expressed satisfaction that Panama is running the Canal

efficiently, and since 2003, the U.S. military has conducted exercises with Panama and other countries to protect the Canal in case of attack.

Headed by Alberto Alemán Zubieta, the Panama Canal Authority has run the Canal for more than 10 years and has been lauded for increasing Canal safety and efficiency. In January 2006, the Martín Torrijos government established a social investment fund backed by Panama Canal revenues that invests in schools, hospitals, bridges, roads, and other social projects. The initiative, according to the government, was designed to show Panamanians that the Canal is contributing to economic development and improving the quality of life for Panamanians.<sup>54</sup>

## **Canal Expansion Project**

In April 2006, the Panama Canal Authority presented to President 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 project would also widen and deepen existing channels and elevate Gatun Lake's maximum operating level. The estimated cost of the seven-year project is \$5.25 billion, to be self-financed by the ACP through graduated toll increases and external bridge financing of about \$2.3 billion that would be paid off in about 10 years. 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.<sup>55</sup>

President Torrijos and his Cabinet approved the expansion project in June 2006, and the Legislative Assembly overwhelmingly approved it in July 2006, with 72 out of 78 deputies voting for the project. Pursuant to Panama's Constitution (Article 319), the project had to be submitted to a national referendum. The Torrijos government chose to hold the referendum on October 22, 2006, close to the anniversary of October 23, 1977, the date when Panamanians approved the two Panama Canal treaties in a national plebiscite by a two-to-one margin. The expansion project was approved by 78% of the vote.

There had been some vocal opposition to the Canal expansion project. The organization known as the Peasant Coordinator Against the Dams (CCCE, *Coordinadora Campesina Contra los Embalses*), consisting of agricultural, civil, and environmental organizations, asserted that the expansion project would lead to flooding and would drive people from their homes. An umbrella protest group known as the National Front for the Defense of Economic and Social Rights (*Frenadeso*), which was formed in 2005 during protests against social security reforms, called for a "no" vote.<sup>56</sup> Former Presidents Jorge Illueca and Guillermo Endara, as well as former Panama Canal administrator Fernando Manfredo, also opposed the expansion project, maintaining that the price was too high and too much of a gamble. Critics feared that the total price tag could rise

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<sup>54</sup> Rainbow Nelson, "Canal Cash to Pay for Social Development," *Lloyd's List*, January 18, 2006.

<sup>55</sup> Autoridad del Canal de Panama (ACP), "Proposal for the Expansion of the Panama Canal, Third Set of Locks Project," April 24, 2006.

<sup>56</sup> "Torrijos Appeals for Approval of Canal Expansion," *Latimews Daily*, September 1, 2006.



considerably and expressed concern that toll increases could make alternative routes more economically attractive.<sup>57</sup>

The ACP is moving ahead with the Canal expansion project. The Panamanian government officially launched the project on September 3, 2007, with a ceremony led by former President Jimmy Carter, whose Administration negotiated the Panama Canal Treaties. The project is expected to be completed by 2014. In March 2009, three multinational consortiums placed bids for the multi-billion contract to build the new set of locks.<sup>58</sup> The ACP announced in July 2009 that the consortium *Unidos por el Canal* (United for the Canal) led by Spanish construction company Sacyr Vallehermoso was the winner of the contract after posting a bid of \$3.12 billion. The consortium also includes Italian, Belgian, and Panamanian companies, as well as two U.S. companies—Montgomery Watson Harza and Tetra Tech—involved as design subcontractors.<sup>59</sup>

In January 2010, the ACP awarded the fourth and final dry excavation contract to a consortium made up of Spanish, Mexican, and Costa Rican companies. The excavation work will create an access channel linking the new Pacific locks with the Gaillard Cut, which is the narrowest stretch of the Canal.

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<sup>57</sup> “Panama: Torrijos Reveals Plans to Expand Canal,” *Latinnews Daily*, April 25, 2006; Chris Kraul and Ronald D. White, “Panama is Preparing to Beef up the Canal,” *Los Angeles Times*, April 24, 2006; John Lyons, “Panama Takes Step Toward Expanding the Canal,” *Wall Street Journal*, April 24, 2006.

<sup>58</sup> “Panama: Groups Bid on Canal Expansion,” *Economist Intelligence Unit, Business Latin America*, March 9, 2009.

<sup>59</sup> “Unidos por El Canal Virtual winner of ACP contract,” *Business News Americas*, July 8, 2009; and “Panama Canal Announces ‘Best Value’ Proposal for New Set of Locks Expansion Contract,” *States News Service*, July 9, 2009.

**Figure 1. Map of Panama**



**Source:** Map Resources. Adapted by CRS.

## **Appendix A. Links to U.S. Government Reports**

### **Background Note, Panama**

*Date:* December 2009

*Full Text:* <http://www.state.gov/r/pa/ei/bgn/2030.htm>

### **Congressional Budget Justification for Foreign Operations FY2011, Annex: Regional Perspectives (p. 745-749 of pdf)**

*Date:* March 2010

*Full Text:* <http://www.state.gov/documents/organization/137937.pdf>

### **Country Reports on Human Rights Practices 2009, Panama**

*Date:* March 11, 2010

*Full Text:* <http://www.state.gov/g/drl/rls/hrrpt/2009/wha/136121.htm>

### **Country Reports on Terrorism 2008 (Western Hemisphere Overview)**

*Date:* April 30, 2009

*Full Text:* <http://www.state.gov/s/ct/rls/crt/2008/122435.htm>

### **International Religious Freedom Report 2009, Panama**

*Date:* October 26, 2009

*Full Text:* <http://www.state.gov/g/drl/rls/irf/2009/127399.htm>

### **International Narcotics Control Strategy Report 2010, Vol. I (Panama , pp. 506-509 of pdf)**

*Date:* March 2010

*Full Text:* <http://www.state.gov/documents/organization/138548.pdf>

### **International Narcotics Control Strategy Report 2010, Vol. II (Panama, pp. 184-187 of pdf)**

*Date:* March 2010

*Full Text:* <http://www.state.gov/documents/organization/138451.pdf>

### **Trafficking in Persons Report 2009 (Panama, pp. 53-54 of pdf link)**

*Date:* June 16, 2009

*Full Text:* <http://www.state.gov/documents/organization/123363.pdf>

## **Author Contact Information**

Mark P. Sullivan  
Specialist in Latin American Affairs  
msullivan@crs.loc.gov, 7-7689

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