Order Code RL32540

CRS Report for Congress
Received through the CRS Web

The Proposed U.S.-Panama Free Trade Agreement

Updated November 1, 2005

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The Proposed U.S.-Panama Free Trade Agreement

Summary

On November 16, 2003, President George W. Bush formally notified Congress of his intention to negotiate a bilateral free trade agreement (FTA) with Panama. Negotiations commenced in April 2004 and eight rounds have been held, the latest concluded in February 2005. Since then, talks have stalled, but could resume by year-end 2005. Much of the text has been agreed to, following the framework of earlier FTAs such as the Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR). As with all free trade agreements, the U.S.-Panama FTA cannot enter into force until Congress passes implementing legislation and the President signs it into law.

Panama's economy is based largely on maritime and related services industries that developed around its transisthmian canal, once managed by the United States, but formally returned to Panama in 1999. Canal operations account for 6% of Panama's GDP, with the largest and fastest growing traffic volume generated along the U.S. East Coast-to-Asia trade route (especially U.S.-China). The canal's total economic impact, however, is far greater, supporting income and jobs in various services industries including warehousing, ship registry and repair, salvage operations, insurance, banking, and tourism.

Panama is a small U.S. trading partner, but benefits from significant U.S. investment and unilateral trade preferences offered through the Caribbean Basin Initiative (CBI), which Panama seeks to make permanent in an FTA. The FTA may also be seen as a way to reinforce Panama's varied trade liberalization goals. The services sector is already globally competitive, but the small manufacturing and protected agriculture sectors are far less so. Panama wants an FTA that will meet the needs for openness in services, new export opportunities in manufacturing, and adjustment time for agriculture to develop alternative export crops and minimize rural dislocation. Panama's incentive to negotiate may also be enhanced by the desire to keep pace with other Latin American countries that have, or are negotiating, FTAs with the United States.

For the United States, Panama has long held a strategic military and commercial importance, even as a small trading partner, and an FTA with Panama fits with broader U.S. trade policy. The United States seeks to reduce tariffs and other barriers to U.S. industrial, agricultural, and consumer goods, and to standardize rules for services trade, investment, government procurement, intellectual property rights, and dispute resolution, going beyond WTO standards where possible. Still to be resolved are sensitive agricultural issues, government procurement in the canal area, and market access for U.S. retailers. Textiles and apparel are not an issue given Panama's small production, but U.S. labor groups are challenging Panama's labor conditions, laws, and enforcement efforts. Panama has responded that its labor laws and labor rights record are far superior to those of Central America and comply with internationally recognized standards. This report will be updated periodically.

Related information may be found in CRS Report RL30981, *Panama: Political and Economic Conditions and U.S. Relations*, by Mark P. Sullivan.

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Panama's Canal and Economic Relations with the United States

The United States and Panama have entered into many agreements over the past 150 years, the most prominent ones defining their relative stake in the famous canal that traverses the Central American isthmus, bisecting Panamanian territory. (See **Figure 1**.) The canal has been a critical factor influencing Panamanian domestic and foreign affairs, and like earlier U.S.-Panama agreements, the FTA's significance is tied to a Panamanian economy that has formed largely around the canal.

Early U.S.-Panama Economic Relations

Since first explored by the Spanish at the turn of the sixteenth century, interest in Panama has centered on its unique geographic characteristic: the slender distance separating the Atlantic and Pacific Oceans. Because of the transit possibilities this presented (first for Peruvian gold and other colonial trade), Panama was a natural crossroads for the movement of commerce, a strategic position that grew as the world became ever more traveled and integrated. In fact, Panama's destiny became fused to its geography and, over time, to the vagaries of foreign interests that sought to take advantage of it, particularly the United States.

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[1] For a discussion of the CAFTA-DR and a deeper understanding of the regional economic implications of freer trade, see CRS Report RL31870, *The Dominican Republic-Central America-United States Free Trade Agreement (CAFTA-DR)*, by J. F. Hornbeck and CRS Report RL32322, *Central America and the Dominican Republic in the Context of the Free Trade Agreement (CAFTA-DR) with the United States*, K. Larry Storrs, coordinator.

Figure 1. Map of Panama

Source: Map Resources. Adapted by CRS. (K.Yancey 7/27/04)

Panama was swept to independence from Spain in 1821 as a province of Colombia. By then, the United States and European powers openly coveted the prospect of an inter-oceanic connector. Well before construction of a canal could begin, the United States displaced Britain as the dominant foreign influence, completing a cross-isthmian railroad in 1855. This project was driven by the westward expansion of the United States, which included an anticipated southern water route to the west coast. To secure this transit system, as well as the safety of goods and people using it, the United States resorted to armed intervention in Panama some 14 times in the 19th century. By the time the United States sought permission to construct a canal, a precedent had been set for military defense of U.S. interests in Panama.[2]

The initial U.S. effort to build a canal required a concession from Colombia allowing the United States to complete the bankrupt French project abandoned in 1889. In early 1903, the details were set down in a treaty ratified by the U.S. Senate, but unanimously rejected by the Colombian legislature. The United States responded by reaching out to the growing Panamanian successionist movement. In November 1903, in a quick and bloodless move facilitated by the offshore presence of U.S. warships, Panama declared its independence from Colombia. The United States immediately recognized Panama as an independent state, and in return, Panama signed the Hay-Bunau-Varilla Treaty, ceding to the United States the rights to construct a canal and to control it "in perpetuity."[3]

The opening of the Panama Canal in 1914 led to U.S. dominance in the commercial and, at times, political life of Panama. Although both countries benefitted from its operations, the relationship was far from equal, which along with the perpetual U.S. presence, generated a nagging resentment, periodic protests, and sometimes violence over the tangible loss of national sovereignty. This tension remained a dominant feature of U.S.-Panamanian relations until the canal was ceded back to Panama in 1977 under terms defined in the Panama Canal Treaty signed by Presidents Jimmy Carter and Omar Torrijos. Although tensions flared again in 1989 with the U.S. incursion into Panama to arrest then-chief of state General Manual Noriega on narcotics trafficking charges, the incursion proved to be a catalyst for the return of democracy. Perhaps not coincidently, Panama's decision to promote trade liberalization followed soon thereafter.[4]

The Canal and U.S. Trade Policy

The canal solidified Panama as a maritime economy and its return to Panamanian control raised expectations that Panama would enjoy greater economic benefits from its ownership. The canal operations by themselves account for

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[2] Conniff, Michael L. *Panama and the United States: The Forced Alliance*. Athens: the University of Georgia Press, second edition. 2001. pp. 30-35.

[3] Woodward, Ralph Lee. *Central America: A Nation Divided*. New York: Oxford University Press, third edition. 1999, pp. 187-191 and ibid., pp. 63-70.

[4] Conniff, *Panama and the United States*, pp. 134-39 and CRS Report RL30981, *Panama: Political and Economic Conditions and U.S. Relations*, by Mark P. Sullivan.

approximately 6% of Panama's GDP, with the largest and fastest growing traffic volume generated along the U.S. East Coast-to-Asia trade route (especially U.S.-China). About one-third of all cargo passing through the canal has its origin or destination in the United States. The canal's total economic impact, however, is far greater, supporting income and jobs in various services industries including warehousing, ship registry and repair, salvage operations, insurance, banking, and tourism. The two major ports at either end of the canal have been privatized and modernized, a portion of the canal was widened in 2001, but Panama faces a difficult and expensive challenge to enhance the capacity of the entire canal to accommodate much larger post-Panamax ships, increasingly the standard for global shipping in the 21st century.[5]

With transfer of the canal and its operations to Panama, the country also inherited a substantial amount of land and physical assets. The conversion of these assets to private use has been a boon to the Panamanian economy, but has required considerable costs and investment, as well. Privatization efforts eased the transformation of former U.S. government facilities to productive Panamanian use, which has included refurbishing the Panamanian railroad by Kansas City Southern Railways, transforming the former Albrook base into residential housing, and developing a small foreign processing zone in the former Ft. Davis.[6]

The Panama-Pacific Special Economic Area (PPSEA) is perhaps the most ambitious of these projects. This public-private partnership, established in law, aspires to convert the former Howard Air Force Base into a "world class business center," with an emphasis on the export sector. Existing assets include housing and office buildings, a hospital, transportation infrastructure, fiberoptic cable network, an 8,500-foot runway, and four hanger facilities. The government offers businesses various fiscal incentives and a streamlined regulatory process. Firms will be required to commit to state-of-the-art practices that include adopting internationally accepted environmental and labor standards.[7]

With the assistance of the International Finance Corporation (IFC) of the World Bank, Panama is seeking a large global financing package to cover the initial investment needs. The project aims at developing various businesses including computer technology, cell phone manufacturing, international call centers (Dell already operates one on site), aeronautical industry support, and others that require a well-trained work force. The IFC supports this project not only for its prospects as a business venture, but because it is forward looking rather than relying on the "maquiladora" business model common in much of the rest of the region.[8]

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[5] The Economist Intelligence Unit. *Panama: Country Profile 2003.* London, 2003. pp. 16-17 and U.S. Department of Energy. Energy Information Administration. *Panama: Country Analysis Briefs*. October 2003; and [http://www.pancanal.com].

[6] Ibid.

[7] Government of Panama. *Panama-Pacifico Special Economic Area Agency*.

[8] Ibid., and discussion with IFC official.

At the start of the 21st century, the canal and close ties with the United States are still the defining features of Panama's economy, but in the past these hindered Panama's participation in regional integration. Although part of the Central American Integration System, a broadly focused political arrangement, Panama has declined to join the Central American Common Market, relying instead on the canal and the large U.S. economy as its economic anchors. Panama has always had a fully dollarized monetary system and is a beneficiary of U.S. unilateral trade preferences defined in the Caribbean Basin Initiative (CBI).[9] Under these circumstances, there was little external incentive for Panama to become a more open economy. Only since joining the World Trade Organization (WTO) relatively recently in 1997 did Panama begin to reduce tariff rates, an important step in preparing Panama for an FTA with the United States.

Panama's subregional independence and reliance on U.S. economic ties has suited the United States as well, given its continuing interest in the Canal. An FTA with Panama may be seen as one way for the United States to support long-established commercial interests and deepen bilateral relations, particularly if accepted as a mutually negotiated pact with reasonably balanced political and economic outcomes. Although many ships have outgrown the canal, its locale and prospects for enlarging the passageway continue to reinforce Panama's historic, albeit currently diminished, importance for the United States as a strategic trade passage.

A bilateral FTA with Panama is also part of the Bush Administration's "competitive liberalization" trade strategy, in which negotiations are taking place on multilateral, regional, and bilateral levels. This multi-tiered negotiation strategy is predicated on an expectation that gains on one level of negotiation may encourage, if not compel, similar breakthroughs on others. Because of slow progress at the WTO and with the Free Trade Area of the Americas (FTAA), the United States has moved ahead aggressively with bilateral talks, of which the Panama FTA is one. Some, however, have questioned the bilateral approach for the asymmetrical negotiation power the United States wields, the effects it may have on non-participating countries, and the one-sided trading system that is developing around the United States, as opposed to a truly regional or multilateral system.

For Panama, the FTA may be seen as a way to reinforce its varied trade liberalization goals. The services sector is already globally competitive, but the manufacturing sector is small and agricultural remains protected and uncompetitive (see below). For Panama, the chief concern is crafting an FTA that will balance the need to pursue openness for services, export growth and promotion for manufacturing, and adjustment time for agriculture so it can become more competitive, while minimizing social displacement. The incentive to negotiate may also be enhanced by the desire to keep pace with other Latin American countries that have or are negotiating FTAs with the United States.

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[9] Panama's dollarized economy has been a cornerstone of its long-term economic stability. It has safeguarded Panama against exchange rate risk, currency mismatches, and speculative attacks experienced in other developing economies, and eliminated monetizing of deficits, thereby reinforcing fiscal constraint and price stability. See Moreno-Villalaz, Juan Luis. Financial Integration and Dollarization: The Case of Panama. *Cato Journal*, Winter 2005.

Panamanian Trade Relations

Panama is a country of 3.2 million people with a stable, diversified economy that has rebounded briskly from the 2002 global economic downturn. Panama's gross domestic product (GDP) expanded by 4.7% in 2003, 6.0% in 2004, and is expected to grow by 4.0% in 2005 (see **Appendix 1** for selected macroeconomic data). With the exception of Costa Rica, Panama has the highest per capita income in the Central American region, but income distribution is highly skewed, poverty remains a nagging problem, especially in rural areas, and unemployment is high. These disparities could become more contentious issues in Panama as the country debates the costs and benefits of an FTA, particularly given the considerable public disfavor with proposed fiscal and social security reforms. Unlike any other Latin American country, 77% of Panama's GDP is in services, developed around the transportation and commerce generated by canal traffic and the Colón Free Zone (CFZ). Industry is the second most important sector, contributing 17% to GDP followed by agriculture at 6%.[10]

Structure and Direction of Panamanian Trade

Trade is an increasingly important part of this services-based economy. Exports of goods and services compose 29% of GDP and, as seen in **Table 1**, Panama's balance of payments points to a sizeable trade deficit in goods compared to a large services trade surplus. Panama's merchandise trade deficits ranged from $700 million to $1.5 billion from 2001 to 2004. In each year, the merchandise deficit was offset by a services trade surplus of between $900 million to $1.3 billion, unusual for Latin American economies. Panama is placing a strong emphasis on increasing exports as a driver of economic growth, pointing to the Panama Pacific Special Economic Area, Colón Free Zone (see below), and to a lesser extent, the small export processing zones and nontraditional agricultural products as opportunities to execute this vision.

Table 1. Panama's Current Account Balance

	2001	2002	2003	2004
Balance on Merchandise Trade ($ million)	-696	-1035	-1113	-1585
Balance on Services Trade ($ million)	890	968	1254	1295

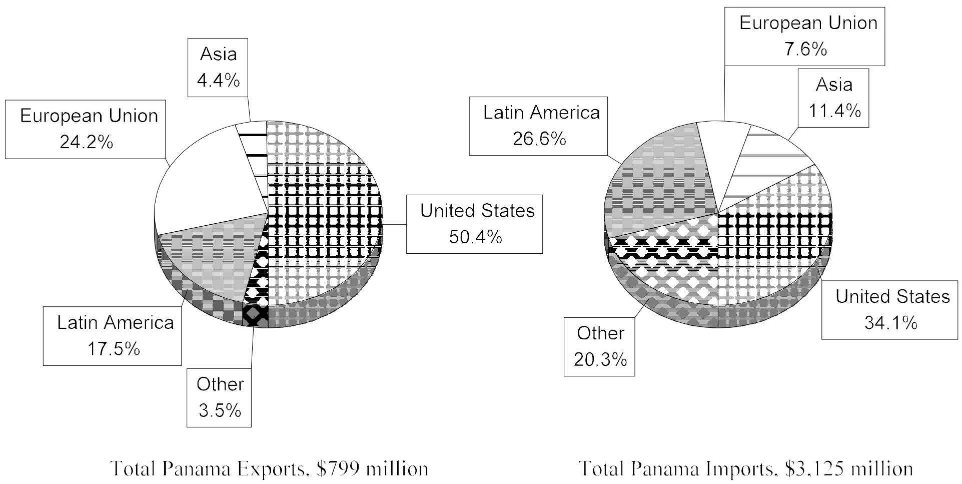
Data Source: Republic of Panamá, Controller General's Office, 2005.

Panama is a global trader. In addition to the United States, it is negotiating FTAs with Singapore and the five Central American countries. It has completed FTAs with El Salvador (2002) and Taiwan (2004). It nonetheless remains closely tied to the United States as its dominant trading partner, which as a single country is a far larger trading partner than the world's major regions combined. The United States accounts for some 50% of Panamanian exports and 34% of its imports (see **Figure 2**). The European Union is the second largest export market with a 24% share, but accounts for only 8% of Panamanian imports. The Latin American

[10] Republic of Panamá. Controller General's Office. 2005.

countries collectively are Panama's third largest export market with 18%, but has the second largest import share at 27%.

Figure 2. Panama Direction of Trade, 2003



Source: CRS from República de Panama, Ministerio de Comercio e Industrias, June 2005.

Panama is one of the few Latin American countries with which the United States has a merchandise trade surplus, and it is by far the largest in the region. Panama also runs a sizeable trade deficit with Latin America. Panama's largest Latin American trade partners are Mexico, Costa Rica, and Brazil. Panama also imports significant quantities of oil from Peru, Venezuela, and Ecuador. Asia accounts for only 3% of Panama's exports, but 11% of its imports, dominated by Japan, South Korea, and more recently the fast growth in Chinese imports.

The Colón Free Zone. A distinct feature of Panama's trade regime is the Colón Free Zone (CFZ), which is the largest duty free zone in the world except for Hong Kong. The vast trade volume that traverses the Panama Canal, multimodal transportation infrastructure, modern financial sector, and Panama's central location in the Americas make Colón a logical place from which to operate a duty free zone. It serves as a "one stop shop" for both Latin American buyers, and sellers from the rest of the world, including Asia and the United States. Sellers operate showrooms targeted at small- and medium-sized buyers, who make wholesale purchases of goods for retail sale in their respective countries. Goods are typically repackaged in smaller lots, priced in the local market currency, and transferred to the purchasing country without incurring income, value added, or transfer taxes. Most CFZ trade is in electronics, clothing, and other consumer goods.

Buyers benefit from the ability to purchase small lots, reduced travel to distant foreign countries, economies of scale that arise from consolidating lots for shipping, minimal transaction costs, vastly improved shipping times, and credit offered by sellers. The sellers benefit from reaching smaller Latin American markets in one location and reduced tax and transaction costs. Panama benefits from the 20,000 direct jobs the CFZ generates, including the public revenue they generate. CFZ trade is reported as a separate component of Panama's trade statistics and only those goods entering the Panamanian economy are recorded as imports. In 2004, nearly $5 billion worth of goods passed through the CFZ, but only $600 million was added to the Panamanian trade balance.[11]

The CFZ is frequently associated with a number of illicit activities including money laundering, illegal transshipment, trademark and other intellectual property violations. In part, this is a reputation that Panama as a whole has been fighting since the military dictatorship, which was widely known for its flagrant disrespect of the law, if not outright corruption. Panama's proximity to Colombia and headquarters as a transshipment point helped fuel this perception. The CFZ has done much to counter this reputation. The zone itself is an enclosed commercial area, encircled and under the supervision of customs and other law enforcement agencies of the Republic of Panama. In addition, both the Colón Free Zone User's Association and the CFZ Administration have a strict code of conduct and argue that illegal activity is also policed by individual companies because a bad reputation hurts those dedicated to making the CFZ a world class trading center. Even the accusation of an infraction will lead to a suspension of licence needed to operate in the zone. Cash accounts for only 10% of transactions and there is careful monitoring of all goods that move in and out of the zone through electronic tracking systems.[12]

U.S.-Panama Merchandise Trade

U.S.-Panamanian merchandise trade is small. In 2004, the United States exported $1,835 million worth of goods and imported $316 million, producing a U.S. trade surplus of $1,519 million, the largest in the Western Hemisphere. Still, Panama ranked as only the 48nd largest export market for U.S. goods and 99th for imports. Other major U.S. exports, as seen in **Table 2**, are mostly capital- and technology-intensive manufactured goods such as aircraft, pharmaceuticals, machinery, medical equipment, and motor vehicles.[13]

The United States imports relatively little from Panama, accounting for the growing U.S. merchandise trade surplus. Most imports are primary products; fully one-third is seafood, mostly fresh fish and shrimp. Repaired goods are number two accounting for 20% of total imports from Panama.[14] The United States has run a merchandise trade surplus with Panama for many years, reflecting large growth in

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[11] U.S. Department of Commerce. U.S. Commercial Services. *Doing Business In Panama: A Country Commercial Guide for U.S. Companies 2005.* April 7, 2005. p. 3 and interviews with CFZ representatives, September 21, 2005.

[12] Colón Free Zone User's Association. *Rules of Conduct for the Members of the Colón Free Zone Users' Association*, 1995; and interviews with representatives from agencies mentioned.

[13] Services trade data are not available for smaller U.S. trading partners, including Panama.

[14] Technically classified as "products of the United States when returned after having been exported, without having been advanced in value or improved in condition by any process."

exports relative to Panamanian imports. An interesting current trend is the 139% increase in U.S. crude oil imports in 2004. Precious metal (mostly gold), sugar, and coffee together account for 12.5% of total imports. Unlike the Central American countries, where U.S. sensitivities to textile and apparel trade run high, Panama trades little in this sector. Panama's agricultural exports, particularly sugar, present the more difficult negotiation issues.

Table 2. U.S.-Panama Merchandise Trade, 2004
(top ten U.S. exports and imports by $ value)

U.S. Exports	$ Value million	% of Total	U.S. Imports	$ Value million	% of Total
1. Oil	402.8	22.1%	1. Fish/Seafood:	97.0	30.8%
2. Aircraft	198.8	10.8%	2. Repaired Goods	63.5	20.1%
3. Machinery:	180.6	9.8%	3. Crude Oil	34.0	10.8%
- Office mach.	(38.6)				
- Computers	(38.1)				
4. Electrical mach.	151.0	8.2%	4. Gold	19.5	6.2%
5. Pharmaceuticals	120.9	6.6%	5. Coffee	10.5	3.3%
6. Optical/Medical Equipment	65.8	3.6%	6. Sugar (cane)	9.3	3.0%
7. Vehicles	58.3	3.2%	7. Prepared Shrimp	8.9	2.8%
8. Cereals	51.8	2.8%	8. Edible Fruit	8.1	2.6%
9. Paper	51.3	2.8%	9. Aluminum	6.0	1.9%
10. Perfume	48.1	2.6%	10. Glass	5.5	1.7%
Other	506.7	27.5%	Other	53.6	16.8%
Total	1,835.3	100.0%	Total	315.9	100.0%

Data Source: U.S. Department of Commerce.

U.S. Foreign Direct Investment

Panama has no formal restrictions on capital flows, does not discriminate between foreign and domestic investment, and maintains bilateral investment treaties with the United States and many European countries. Critics have pointed out, however, that the legal environment can be cumbersome and that Panama's relatively high labor costs (for the hemisphere) and inflexible labor laws can be a frustration if not an impediment to U.S. foreign direct investment (FDI).[15] Still, U.S. companies are well represented in Panama, including the largest container port facility in the region, multiple financial institutions, transportation firms, and manufacturing facilities from various sectors. Like other countries pursuing an FTA with the United States, Panama seeks closer ties for the continued FDI that may be generated from having a permanent rules-based trade relationship with a large trading partner.

U.S. FDI represents over a third of total FDI in Panama. **Table 3** compares U.S. FDI in Panama to other regional destinations. U.S. investment is similar to that in the five Central American countries combined, although a small fraction of U.S. investment in Mexico. Plans to widen and improve the canal will likely provide an

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[15] U.S. Department of Commerce, *Doing Business in Panama*, pp. 3-4.

opportunity for some $5 billion of investment in the canal itself, and perhaps related large amounts of FDI for other sectors of the economy with a significant U.S. presence.

Table 3. U.S. Investment in Panama, Mexico, and Central America
($ millions)

Sector	2001	2002	2003	2004
Panama	5,141	5,844	6,497	5,868
Mexico	52,544	55,724	61,526	66,554
Central America	5,093	5,255	5,585	4,448

Data Source: U.S. Department of Commerce. Bureau of Economic Analysis. *Survey of Current Business*. September 2004. p. 136 and BEA website. Data are stock of foreign direct investment (FDI) presented on a historical-cost basis.

Status of Trade Negotiations and Trade Policy Issues

Panama approached the United States for a stand-alone FTA, preferring to avoid a direct link to the CAFTA-DR. Panama wanted to maximize the FTA's potential to win U.S. congressional approval by emphasizing the historical and strategic nature of the U.S.-Panamanian relationship, while separating the negotiations from the divisive CAFTA-DR accord. Panama's service economy, small textile and apparel industry, and limited integration with the Central American economies also bolstered the case for separate negotiations.[16] Another unique feature of this FTA is the Panama Canal itself, which as an autonomous legal entity under the Panamanian Constitution, raises issues in government procurement, labor, investment, and other areas in the proposed FTA. In no other country than the United States is Panama willing to include canal issues in trade negotiations.

Eight rounds have taken place, the last concluding in February 2005. Since then, negotiations have been delayed for various reasons. In September 2004, Panama elected a new president, which included a major change of senior representatives in all ministries. In the spring of 2005, Congressman Rob Portman replaced Robert Zoellick as USTR, just as the CAFTA-DR implementing legislation became the overriding trade focus for Congress. Perhaps most importantly, a small number of highly sensitive issues remained unresolved that required the full attention of negotiators. These included government procurement related to the Panama Canal Area, constitutional restrictions to foreign ownership of retail establishments in Panama, and agricultural market access. Opinions diverge with respect to how easy it may be to close these last items.

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[16] Inside U.S. Trade. *Panama FTA Unlikely To Be Docked Into CAFTA as Talks Set to Begin*. April 23, 2004.

The U.S.-Panama FTA will likely follow closely the text framework of the CAFTA-DR. Exceptions will include details of market access rules, provisions governing treatment of business in the Panama Canal Area, and other areas where Panama may differ from the Central American countries. Below are the major negotiation areas and a description of the issues that have been of particular interest to Congress in previous agreements. This section will be modified to reflect details of the text and other factors as they emerge.

Market Access

The market access working group negotiates the tariff structures and rules of origin that would govern the movement of commercial, industrial, and agricultural goods. Specific tariff schedules are being negotiated on a product-by-product basis defining the "staging categories" that prescribe the time that each country will be given to reduce tariff levels to zero. Tariffs on many industrial and commercial goods are expected to go to zero immediately, although none will likely be extended beyond ten years. Tariff phase-outs on sensitive products would typically be extended beyond ten years to accommodate either politically powerful industry groups, or sectors deemed in need of more time to adjust to freer trade. Despite political pressure exerted in both countries, the goal is to avoid excluding any good from the negotiations.

Rules of origin define which goods would be eligible for preferential treatment based on their content, with the intent of preventing transshipment of goods made from materials originating in countries outside the agreement. They are particularly pertinent to textile trade, but given Panama's small textile production, this is unlikely to be the volatile issue it was for the CAFTA-DR.

Panama acceded to the WTO in 1997, and part of its accession agreement included unilateral reduction of tariff levels. Panama's average tariff has fallen to 8%, but tariffs on agricultural products are higher, with some reaching the maximum permitted under Panama's commitments under the WTO. The WTO further encouraged Panama to amend its export subsidies (tax credits), but it has delayed a commitment to do so until December 2005. In February 2004, a replacement subsidy was signed into law that is expected to be acceptable to the WTO. Panama uses tax exemptions to attract foreign investment in certain export-oriented industries, such as shrimp farming and tourism, and in "export processing zones," where imports of manufacturing inputs are duty free as long as they are transformed for re-export.[17]

Sanitary and phytosanitary (SPS) standards and certification measures are other important issues for the United States. Although understood as necessary to ensure the safety of agricultural imports, SPS standards can be cumbersome, and are often denounced as a veiled form of protectionism. Panama's SPS standards, on the whole, meet WTO standards. Panama, however, requires that U.S. imports of poultry, beef, and pork, its most protected industries, come from processing plants that have been individually inspected by Panamanian officials. The inspection

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[17] Office of the United States Trade Representative. *2005 National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C. March 31, 2005. pp. 471-476.

process has been drawn out at times and the United States seeks to have Panama recognize the U.S. meat inspection process as part of the FTA negotiations.[18]

Most U.S. imports from Panama, including all manufactured goods, enter duty free under the normal trade schedule or the CBI, as amended (see **Appendix 3** for selected tariff rates). Petroleum and agricultural products face some tariffs, particularly sugar, which is subject to a tariff rate quota. U.S. exports face tariffs, with most falling in the range of 3-10%, plus the additional 5% transfer tax, which applies to domestic goods as well.

Agricultural Trade. The major issue delaying closing of the FTA negotiations is finding the proper balance for the treatment of agricultural market access, particularly for four highly protected products: pork, poultry, rice, and sugar. The United States is basically "offensive" on pork, poultry, and rice, expecting to open further Panama's markets as soon as possible. It is "defensive" on sugar, attempting to limit any increase in the sugar quota that might disrupt operations of the sugar program as defined in the Farm Security and Rural Investment Act of 2002 (the Farm Bill). Panama's position is the opposite, pressing to delay increases in U.S. exports of pork, poultry, and rice, and to increase its U.S. sugar quota.

In the United States, the sugar program reflects a historical commitment to protect the income of sugar beet, sugar cane, and sugar processing firms with below-prime-rate loans, limitations on sales in the domestic market, and tariff rate quotas (TRQs). TRQs restrict imports with prohibitively high tariffs on imports above a defined quota amount, as defined in WTO rules agreed to by the United States. In 2003, the above-quota tariff on sugar was 78%.[19] On average, Panama harvests only a quarter of the sugar produced by each of the five Central American countries, but it still plays a disproportionally important role in the agricultural sector. Sugar constitutes a third of Panama's total agricultural exports, compared to less than 10% for the Central American countries, and 41% of agricultural exports to the United States. The U.S. market consumes 76% of Panamanian sugar exports, compared to less than 10% of sugar exports from Central America.

Given the dependence of sugar producers on the U.S. market, in part driven by the relatively high wage rates that make it cost prohibitive to produce for the world market, the Panamanians argue that even a relatively small quantitative increase in their portion of the U.S. sugar quota would have a large benefit for their industry. The U.S. sugar industry, however, continues to resist the inclusion of sugar in bilateral FTAs, arguing that the WTO is the forum for addressing domestic support programs and TRQs in the agricultural sector. The U.S. sugar industry fought the CAFTA-DR to the end and has made clear its intention to do the same for other bilateral FTAs.

In Panama, pork, rice, and poultry are the most sensitive and protected products. These are also protected by TRQs, with in-quota tariffs of 15% and out-of-quota

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[18] Ibid., p. 472.

[19] The economic effect is to raise the price of sugar in the United States above the world price, increasing income to sugar related industries, but reducing it to sugar-using firms and consumers. CRS Issue Brief IB95117, *Sugar Policy Issues*, by Remy Jurenas.

tariffs rising to 74%, 103%, and 273%, respectively. Pork and poultry have a special issue related to the consumption of white versus dark meat. The United States consumes considerably more white meat than dark, leaving a disproportional amount of dark cuts for export, which face the highest tariffs. In Panama, as with much of the world, dark meat is preferred. The concern revolves around U.S. producers willing to sell dark meat cuts at a low price in foreign markets, putting downward pressure on prices and hurting domestic producers in these countries. The Panamanians argue that because of the relatively high profit margins on white meat in the United States, on a cost allocation basis, U.S. producers can actually afford to sell the dark meat at below cost. The cost accounting can be debated, but concerns over the price effect in the Panamanian market remain unchanged. Panama's rice industry, which supplies over 90% of the domestic demand, is also convinced that opening their market to U.S. subsidized rice will decimate their industry, which, because of its protection, sells rice considerably above the world price.

Panamanian agriculture represents only 7% of GDP, is inefficient in part because of protection, but is nonetheless considered critical for other reasons. The Panamanian perspective points up the strong role agriculture plays in supporting rural social stability. While only a small fraction of output, agriculture accounts for 17% of employment, which supports 40% of the national population living in rural areas, most of whom exist at or below the poverty line. Given the potential to dislocate much of the poor in the country, the Panamanians argue that opening the agricultural sector too quickly to the large production capacity of the United States would be highly detrimental to the social structure of the rural economy, leading to increased unemployment, poverty, and rural-urban migration. For these reasons, Panama wants a slow transition to open markets in the agriculture sector, as well as an increase in the sugar quota to boost employment. This would also buy time for Panama to develop its non-traditional export crops, such as melons, palm oil, and pineapples, which some view as the future of this sector.

Services

Services trade is negotiated separately, including financial services, shipping, telecommunications, and e-commerce. Panama is largely a service-based economy, is competitive in many services industries, and known for its "open regulatory environment for services." Panama does require local licensing for many professionals to practice in the country, which the United States wants to change. Panama was the first country in Latin America to pass e-commerce legislation. It recognizes the legal standing of electronic transactions and provides for the creation of an oversight agency, but the regulatory framework has yet to be developed.[20] The United States is pressing for even greater transparency in regulatory procedures and U.S. business groups have identified services as a critical negotiating area given U.S. competitive advantages and the large services sector in Panama.

Insurance and other financial services are of particular interest to the United States and the financial services industry is open to foreign banking and investment. The United States has succeeded in winning greater access for U.S. firms to enter the

[20] USTR, *2005 Foreign Trade Barriers*, pp. 475-76.

brokerage business, including majority ownership. Panama wants greater transparency in the state financial services regulatory system to help ease the possible opening of Panamanian banks in selected U.S. states. The United States government, however, argues that it is unable to make commitments related to state financial services regulatory matters.

Maritime Issues. Cabotage is the transport of cargo or passengers in coastal waters, or between two points within a country, and is defined in U.S. law in the Jones Act and 1886 Passenger Vessel Services Act (PVSA). Under the PVSA, passenger vessels calling on more than one consecutive U.S. port must be U.S. flagged, crewed, and built. Foreign flag ships may call at a second U.S. port only after touching a designated "distant foreign port." Most Caribbean ports, including those in Panama, are designated "nearby foreign ports" and so do not qualify. Panama is a major flag of convenience and wanted to have its status changed in the FTA to be designated a "distant foreign port," in expectation that it would increase cruise ship traffic linked to the U.S. market.[21]

In the United States, changes to the PVSA could benefit cruise ship companies (many foreign owned and Panamanian flagged), U.S. ports, and some port-city businesses that might gain from increased tourist trade, in the same way that Panama might, if it were designated a "distant foreign port." Opponents to such changes include U.S. shipbuilding interests and organized labor, which have argued that they would "lose the only advantage they enjoy over foreign flag ships" and that U.S. jobs would be lost. Some Members of Congress conveyed this concern to the USTR and added that passenger shipbuilding is a vital strategic interest for the United States for the movement of troops and supplies.[22]

The Panamanians requested that a maritime chapter be included in the FTA that would allow Panama to be designated a "distant foreign port." This was rejected by the United States. In the past, the American-flag maritime industry has successfully lobbied against including maritime issues in free trade agreements, and prevailed again in the U.S.-Panama FTA.

Government Procurement and Intellectual Property Rights

These two areas are of particular interest to the United States and a bilateral FTA is seen as an opportunity to remedy deficiencies in rules that limit the opportunities of U.S. companies, and to set the pace for standardized practice in the region. In the area of government procurement, Panamanian laws require transparency in the bidding process, a practice generally followed, but concerns have

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[21] This change would allow foreign flag cruise ships to leave one U.S. port, pass through Panama, where they could add or disembark passengers, and return to another U.S. port, altering Caribbean and U.S. bi-coastal non-U.S.-flag cruise line traffic. Inside U.S. Trade. *Administration Is Warned Over Maritime Services in Panama FTA*. July 16, 2004.

[22] Inside U.S. Trade. *Administration Warned Over Maritime Services in Panama FTA* and Letters to USTR Robert Zoellick from Representatives Duncan Hunter and Ike Skelton, and Senators Trent Lott and John Breaux. July 16, 2004. [http://www.insidetrade.com] and Letter from the Transportation Institute to USTR Robert Zoellick, June 10, 2004.

been raised by U.S. firms not only with respect to the bidding on contracts, but also the appeals process as well. Panama has not acceded to the WTO Government Procurement Agreement, which the United States would like to encourage in the FTA.[23] Transparency in the bidding process for government contracts was listed as one of the most important issues by the U.S. Chamber of Commerce in Panama.[24]

Government procurement is an important negotiation area for the United States given the prospects for large long-term investments to expand the canal and related facilities. The Panama Canal Authority operates independently of the national government and negotiators have yet to finalize separate government procurement and investment rules for the canal area. The Panamanians argue that the procurement system in the Canal Authority is the most modern in the country with an effective dispute settlement system, both of which grew out of treaty commitments to keep the canal functioning without interruption. Panama negotiated to maintain the canal authority dispute settlement system within the FTA. Panama is also negotiating to keep small business set aside provisions for Panamanian firms with respect to canal maintenance and operations.

Intellectual property rights (IPR) are a U.S. priority. The objective is to have Panama's standards approximate more closely those of the United States. The USTR reports that Panama's IPR laws and institutional support have improved through courts dedicated specifically to IPR cases. Panama updated its patent law in 1996 and has a law governing trademark protection. Panama signed on to the World Intellectual Property Organization (WIPO) Copyright Treaty and Performances and Phonographs Treaty. The 1994 copyright law improved protection and increased the options to prosecute violators. The United States is negotiating for Panama to sign additional IPR treaties. Piracy is carefully monitored, but remains a challenge because Panama is such a high-volume transshipment point.[25]

Investment

Panama has actively encouraged foreign direct investment, has a well-developed financial services industry to support the flow of capital, and is a regional financial center in its own right. U.S. firms are heavily invested in Panama relative to other Latin American countries. Panama signed a bilateral investment treaty with the United States in 1991, the first in the region, which includes investor-state provisions and further guarantees of the free flow of transfers under a 1998 law. Although the Panamanian government has been responsive to U.S. foreign investment interests, concerns have arisen in particular cases involving investment in highly regulated industries. Resolution of these concerns facilitated proceeding with the FTA.[26]

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[23] USTR, *2005 Foreign Trade Barriers,* pp. 472-473.

[24] Panamcham. *Issues of Importance in the U.S.-Panama FTA Negotiations,* March 12, 2004. [http://www.panamcham.com/business_center/FTA.asp].

[25] USTR, *2005 Foreign Trade Barriers,* pp. 474.

[26] Ibid., p. 475.

There is potential for further significant foreign investment in Panama, including the reverted areas of the former canal zone and the Panama canal expansion project needed to accommodate the post-Panamax ships. This, in turn, could spur investment in related services industries. How government procurement and investment rules, yet to be completed, are treated in the FTA negotiations will affect the U.S. competitive position in Panama's investment future.

Labor and Environment

Labor and environment are issues are contentious in trade agreements, and there is considerable disagreement in Congress and elsewhere over how aggressive language in trade agreements should be in accommodating these concerns. From an economic perspective, labor and environment advocates in the United States argue that developing countries may have an "unfair" competitive advantage because their lower standards are a basis for their lower costs, which in turn are reflected in lower prices for goods that compete with those produced in developed countries.[27] It follows from this argument that the difference in costs is an inducement to move U.S. investment and jobs abroad.

On the other hand, studies suggest that these cost differentials are usually not high enough to determine business location alone, and that productivity is the more important factor.[28] Further, many economists view trade liberalization as part of the overall development process that, in and off itself, can promote improved social and economic conditions.[29] Developing countries are concerned with the loss of sovereignty should specific standards be defined in trade agreements, as well as, with the possibility that such provisions can be misused as a disguised form of protectionism.

Labor Issues. The labor chapter is reportedly identical to that of the CAFTA-DR. At issue for the U.S. Congress is disagreement over language covering inclusion of International Labor Organization (ILO) fundamental labor rights and the extent to which the dispute settlement provisions are effective in ensuring that countries are

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[27] The difference is that in most developing countries, the social costs associated with environmental degradation, pollution, and poor working conditions may not be captured in the market price of goods (so-called *external* costs). Through legal and regulatory measures, developed countries require that businesses correct for many of these social costs, thereby *internalizing* them to the business, where they are then reflected in the final (relatively higher) price of the good in the market place.

[28] See CRS Report 98-742, *Trade with Developing Countries: Effects on U.S. Workers*, by J.F. Hornbeck. September 2, 1998. Productivity and wage levels are highly correlated, suggesting that lower productivity jobs gravitate toward countries with a relative abundance of low-skilled (and hence low-wage) workers. Rodrik, Dani. *Sense and Nonsense in the Globalization Debate*. Foreign Policy. Summer 1997. pp. 30-33.

[29] Some broader evidence suggests that FTAs have not "forced a race to the bottom of regulatory standards," but rather to the contrary, that policy convergence is affected more by countries agreeing to "norms of governance" via cooperation through international agreements. See Drezner, Daniel W. Globalization and Policy Convergence. *International Studies Review*. Vol. 3, Issue 1, Spring 2001. pp. 75 and 78.

held to these standards.[30] The debate also centers on how well bilateral trade agreements are perceived to meet these congressionally defined trade negotiating objectives outlined in Trade Promotion Authority (TPA) legislation. Those who support tougher standards argue that the CAFTA-DR provisions are a step backward from those allowing for the suspension of trade benefits found in the U.S. unilateral trade arrangements like the Generalized System of Preferences (GSP) and CBI, which currently apply to much of the U.S. trade with Latin America. Opponents note that suspension of trade benefits has not been done often and that these provisions may be less effective and less desirable in a bilateral trade agreement where all parties, including the United States, may be subject to such treatment.

Specifically, there are three provisions in the CAFTA-DR given different weight: 1) the effective enforcement of domestic labor laws; 2) the reaffirmation of commitments to ILO basic principles; and 3) "non-derogation" from domestic standards (not weakening or reducing protections to encourage trade and investment). In the CAFTA-DR, failure to enforce domestic labor laws can be formally challenged under the agreement's dispute resolution chapter. In the case of the other two provisions, which are supported in principle, such recourse is not available and labor advocates argue that unless all three are fully enforceable, an FTA does not provide a meaningful trade discipline.[31]

In addition, for labor and environmental issues, the dispute resolution process in other FTAs has operated differently than for commercial issues. In the CAFTA-DR, for example, if a commercial dispute remains unsettled, the country faces the possibility of suspension of benefits under the FTA "of equivalent effect" (Article 20.16), resulting in the raising of tariffs or payment of a monetary assessment (fine) equal to 50% of what a dispute panel determines is "of equivalent effect." This article does not apply to the disputable labor (or environmental) provision. The difference is that the option for failing to resolve a labor dispute is a fine that would be capped at $15 million per year, per violation, with recourse to an equivalent dollar value of suspended benefits (higher tariffs) if the fine is not paid. The fine would also be paid by the government into a government fund and expended for "appropriate labor initiatives." Critics charge that by capping the assessment at $15 million and having it paid into a fund in the offending country, the labor provisions are rendered ineffective. The USTR argues that for small countries, such a fine levied annually for each violation would be significant relative to the dollar value of the trade benefits it would receive.[32]

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[30] The 1998 *Declaration on Fundamental Principles and Rights at Work* identifies four fundamental principles and rights: freedom of association and the right to bargain collectively; abolition of forced labor; equal opportunity and treatment in employment; and elimination of child labor. ILO. *Promoting Better Working Conditions: A Guide to the International Labor Standards System.* Washington, D.C. 2003. pp. 33-34.

[31] Lee, Thea M. Assistant Director for International Economics, AFL-CIO. *Comments on the Proposed U.S.-Central American Free Trade Agreement,* before the USTR Trade Policy Committee, November 19, 2002.

[32] Ibid and USTR, *CAFTA's Labor Provisions: World Class, Best Ever*. [http://www.ustr.gov].

In recently passed bilateral FTAs, Congress has agreed to adopt the implementing legislation largely because a majority of Members have been reconciled to the labor issues by assurances that the labor laws of the countries in question cover basic ILO commitments and are being reasonably enforced. Additional measures to monitor progress or assist these countries in enforcing labor rights also helped win approval. The exception so far has been CAFTA-DR, which passed by only a single vote and drew the ire of many Members of Congress over the perceived inadequacy of language covering labor laws and their enforcement.

Panama has higher wage rates, stronger labor laws, and fewer impediments to union formation compared to the region. In fact, the business community, including U.S. firms operating in Panama, argue that the labor laws are too generous with respect to firing or downsizing the labor force, which can actually encourage unintended responses by business, such as extended use of temporary workers. In 1970, Panama created the Tripartite Council on Union Freedom and Participation in Economic and Social Development with representatives from the government, labor, and business. Its primary function is to oversee that worker rights are being observed in Panama.

The U.S. Department of State has pointed out problems, however, such as the widespread use of temporary workers in general and child labor in rural areas. Also, in the Canal Area workers are prohibited from striking.[33] The Colón Free Zone and the small export processing zones, however, are all subject to national labor laws. Although the Canal Zone has separate statues governing labor, they tend to be more generous with respect to workers rights and compensation, and jobs in the Canal Zone are highly coveted. Workers may organize and exercise their rights to collective bargaining, but the prohibition on striking goes to Panama's commitments under the Panama Canal Treaties, which stipulate that the canal must be operated without interruption.[34]

It is unclear how Congress will receive the Panama FTA with respect to labor rights. Many Members may still disagree with the formulation of the chapter, even though it can be argued that it follows the TPA guidelines. The comfort level with Panama's labor code and efforts to enforce it may be another determining factor in the overall congressional approval of this FTA.

Environmental Issues. For environment advocates, major goals in FTAs include protecting and assuring strong enforcement of existing domestic environmental standards, ensuring that multilateral environmental agreements are not undermined by trade rules, promoting strong environmental initiatives to evaluate and raise performance, developing a systematic program of capacity-building

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[33] U.S. Department of State. *Panama: Country Report on Human Rights Practices - 2004.* Washington, D.C. February 28, 2005, the Economist Intelligence Unit. *Country Report - Panama*. London, June 2004. p. 14, and American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). *Panama: Labor Rights and Child Labor Reports*. Washington, D.C. August 9, 2004. p. 3.

[34] Panama Legislative Assembly. *Law No. 19* — "*Whereby the Panama Canal Authority is Organized.*" Chapter V — Personnel Administration and Labor Relations. June 11, 1997.

assistance, and assuring that environmental provisions in FTAs are subject to the same dispute resolution and enforcement mechanisms as are other aspects of the agreements.[35]

Environmental provisions in the U.S.-Panama FTA are likely to be similar to those in the CAFTA-DR. These emphasize: 1) encouraging high levels of environmental protection; 2) not failing "to enforce environmental laws," and 3) recognizing that it is inappropriate to weaken or reduce protections as an encouragement for trade and investment. The CAFTA-DR also provides for formal cooperation among governments on environmental issues and a dispute resolution mechanism.[36]

Advocates raise the issue of the environmental effects of trade, particularly in developing countries that may have weak laws and lax enforcement mechanisms. Some of these same advocates, however, have agreed that thus far trade agreements have not led to catastrophic pollution nor encouraged a "regulatory race to the bottom." There has also been a certain acknowledged degree of success in having environmental issues addressed in the body of FTAs, in side agreements on environmental cooperation, and through technical assistance programs, the latter of which developing countries can use to respond to specific problems. Advocates still note that much can be improved, such as tightening enforcement language and ensuring that the United States allocates financial resources to back up promises of technical assistance.[37]

As required under TPA, the USTR conducted an environmental review of the potential environmental effects possibly attributable to the FTA. It noted that Panama "faces a number of challenges in protecting its environment as it supports its economic and population growth." Deforestation, land degradation, loss of wildlife, threats to water quality and wetlands, among other problems are serious issues for Panama. The Panama Canal also places severe water use requirements on the country. Panama has responded through the public policy process, establishing environmental standards in law and entering into international and U.S. bilateral environmental cooperation agreements.[38] These issues were already factors in Panama's development process prior to the negotiation of the FTA. Thus, the environmental review maintains that the marginal effects of the FTA on environmental standards would be small, whether in terms of projected impacts on the United States or on Panama.

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[35] See [http://www.sierraclub.org/trade/fasttrack/letter.asp], *Principles for Environmentally Responsible Trade.* Another important issue for the United States is ensuring that its higher environmental standards defined in law and regulation not be compromised by challenges of protectionism. See CRS Report RS20904, *International Investor Protection: "Indirect Expropriation" Claims Under NAFTA Chapter 11*, by Robert Meltz.

[36] The Dominican Republic-Central America-United States-Free Trade Agreement. Chapter 17. Environment.

[37] See Audley, John. *Environment and Trade: The Linchpin to Successful CAFTA Negotiations?* Carnegie Endowment for International Peace. Washington, D.C. July 2003.

[38] Office of the United States Trade Representative. *Interim Environmental Review: U.S.-Panama Free Trade Agreement.* June 2004. pp. 7-9.

The environmental review further notes that Panama's service-oriented economy and the small trade volume with the United States are unlikely to be greatly affected by the proposed FTA and so will change marginal production and trade little. The FTA, however, may have both positive and negative effects. The negative effects of pollution, environmental degradation, and endangering wildlife would come mostly from increased agricultural trade and production, which might be addressed with increased environmental oversight and policies. The positive effect of the FTA could include improvements in environmental standards that may be encouraged by the provisions of the agreement and the consultative and cooperation agreements attached to the FTA.[39] Panama's environmental regulatory agency (Autoridad Nacional de Ambiente — ANAM) points out that Panama is increasingly using environmental impact studies, but realizes it has enforcement capacity issues that may require time to remedy, which could be accommodated in the FTA.

Trade Capacity Building

The FTA would likely include a Committee on Trade Capacity Building (TCB), designed to assist Panama with the transition to freer trade with the United States. In general, the committee's mission includes providing technical assistance and financing to accelerate the transition period in hopes of increasing the gains of trade while minimizing the adjustment costs. The TCB Committee would help coordinate technical assistance provided by U.S., regional, and multilateral agencies in helping Panama meet its obligations under the FTA.

Panama prioritized TCB needs in its national trade capacity building strategy. The overriding goal is to formulate a strategy that would allow Panama to assume all the commitments under the FTA, in the context of meeting the country's development needs. The National TCB Strategy places strong emphasis on sectoral adjustment strategies, recognizing that some industries are already competitive by international standards (e.g. financial services), whereas others will need considerable assistance when faced with increased competition from the United States (e.g. agriculture). Emphasis is also placed on supporting existing and potentially new micro, small, and medium-sized businesses, which may need the most assistance and constitute a significant portion of the Panamanian economy, as well as government capacity to administer trade-related activities.[40]

The major goals identified include inter-sectoral coordination, increasing exports to the United States, enhancing the investment climate, better integrating education and innovation into the business community, and improving government trade facilitation (processing imports and exports.) The strategy identifies 18 action plans covering major trade and trade-related issues, ranging from market access and rules of origin, to labor, environment, transparency, and trade agreement administration. In each case, the status of Panama's commitments under the proposed FTA is identified along with action items that may need to be pursued to

[39] Ibid., pp. 15-20.

[40] Government of Panama. Ministry of Trade and Industry. *Panama's National Strategy for Trade Capacity Building (TCB) in Light of the Free Trade Agreement with the United States*. Panama, March 4, 2005. pp. 20-23.

improve capacity in the respective area. Successfully implementing the strategy, however, will require resources and coordinated assistance among international and U.S. agencies.

Outlook

Panama, because of its unique economic structure, presents an unusually clear example of the difficult choices countries face in pursuing free trade agreements. Its highly dominant services sector, poised to take advantage of increasing trade liberalization, may be juxtaposed against its much smaller and far less efficient manufacturing and agricultural sectors, which will struggle under freer trade. Panama has weighed the substantial overall benefits of trade opening, with the economic and social transition costs that the agriculture sector, in particular, would bear. This inherent conflict is one reason the negotiations were interrupted in 2005. Panama wants to achieve what it considers a "balanced" agreement that will meet its long-term development goals for the entire economy. This has proven to be at odds with U.S. priorities, particularly accelerating agricultural market access.

Panama has held firm on the agriculture negotiations because the political and social stakes are high, as expressed in two very different Panamanian visions of the country's economic future. One sees protected Panamanian crops overwhelmed by large U.S. producers, leading to either a "slow or quick death," depending on the speed of market access. Such a scenario doubts the likelihood of a successful adjustment for products like rice, anticipating increased rural unemployment, poverty, and rural-urban migration pressures.

An alternative vision expresses the possibility for a "balanced" FTA easing Panama further into the globalized economy. With sufficient time and resources, the agriculture sector would be able to apply more modern production technologies, continue to develop alternative export crops, and minimize displacement in the rural sector. The result could be a revitalized and growing agricultural sector, with increased employment and income that would contribute to long-term development, rather than relying on traditional farming techniques and work patterns that may be reinforcing entrenched rural poverty. This scenario relies on negotiating a lengthy transition period with effective trade capacity building assistance in recognition of the important role that the small agriculture sector plays in maintaining rural stability.

In fact, the economic tradeoffs implied in these contrasting visions are well understood. It is the nature of freer trade to challenge inefficient sectors to either change or be replaced, at least in part, if long-term development is to occur. Lower cost agricultural imports would surely be a net gain for the poor, particularly in urban areas where there is no related adjustment costs. Minimizing the displacement that can occur in rural areas, however, is a critical issue for Panama. It may be more difficult to win popular support for an FTA that appears to threaten the livelihoods of rural workers. It is still unclear what balance will be struck, but the details of the final agreement will be important, not only for getting it passed by the respective legislatures, but in setting the tone for the two countries' overall relationship in the 21st century.

Appendix 1. Chronology of U.S.-Panama FTA Negotiations

Date	Milestone
November 18, 2003	The USTR notifies Congress of President George W. Bush's intent to enter into negotiations on a free trade agreement (FTA) with the Republic of Panama.
April 26-29, 2004	First round of negotiations occurs in Panama City.
June 11-15, 2004	Second round of negotiations takes place in Los Angeles.
July 12-16, 2004	Third round of negotiations held in Panama City.
August 9-12, 2004	Fourth round of negotiations held in Tampa.
October 18-22, 2004	Fifth round of negotiations takes place in Panama City.
December 6-10, 2004	Sixth round of negotiations held in Washington, D.C.
January 10-15, 2005	Seventh round of negotiations held in Washington, D.C.
Jan. 31-Feb. 6, 2005	Eighth round of negotiations occurs in Washington, D.C.

Appendix 2. Panama: Selected Economic Indicators

	2000	2001	2002	2003	2004
GDP Growth (%)	2.7	0.7	2.1	4.7	6.2
Per Capita GDP Growth (%)	1.8	-1.1	0.2	2.8	4.1
Urban Unemployment Rate (%)	15.2	17.0	16.5	15.6	——
Inflation (%)	0.7	0.0	1.9	1.5	2.5
Current Account Balance (% GDP)	-5.9	-1.5	-0.8	-3.2	-0.3
Terms of Trade (Indices, 1997=100)	96.5	99.1	98.1	93.8	92.0
Foreign Direct Investment ($ mil)*	700	405	78	792	467

Source: United Nations Economic Commission on Latin America and the Caribbean. *Preliminary Overview of the Economies of Latin American and the Caribbean, 2004.* December 2004. pp. 148-63.
*Net investment = direct foreign investment in Panama minus Panamanian direct investment abroad.

Appendix 3. U.S.-Panama Tariff Rates for Selected Products

(% of total dollar value)

Major U.S. Exports[a]	% of Total	Tariff Rate	Major U.S. Imports[a]	% of Total	NTR Tariff Rate[b]	Free under CBI[c]
Oil (2710)	22.1	5%[d]	Fish/Seafood (0302)	30.8	Free	
Aircraft (8802)	10.8	10%	Repaired Goods (9801)	20.1	Free	
Machinery - ADP (8473) - computers (8471) - gas turbines	9.8 (2.0) (1.8) (0.5)	 3% 5% 3%	Precious Metals (7112) - gold/scrap	6.2	Free	
Electrical Machinery (8517)	8.2	5%	Oil (2710) - gasoline - crude	10.8	 .525/bbl .105/bbl	
Pharmaceuticals (3004)	6.6	Free	Sugar (1701) - under quota - over quota (avg. 2003)	3.0	 0 78%	
Optical/Medical Instruments - cameras (9006) - parts (9009) - medical (9018)	3.6 (0.8) (0.7) (0.5)	10% 5% 15% 10%	Coffee	3.3	Free	
Cereals - corn (1005) - under quota - over quota - mesline (1001) - rice (1006) - under quota - over quota	2.8 (1.8) (1.0) (0.2)	 3% 58% Free 15% 103%	Fruit - bananas - papaya - watermelon	2.6		Free under CBI and GSP
Other	34.2		Other	22.8		
Total	100%		Total	100%		

Data Source: U.S. Department of Commerce.

Note: all Panamanian imports are subject to a 5% transfer tax, which is also collected on domestic products. This tax is considered similar to a nondiscriminatory sales or value added tax (VAT.

a. By HTS number = Harmonized Tariff Schedule of the United States.

b. NTR is the general or normal tariff rates (also known as most favored nation rates) applied to products not given preferential tariff treatment.

c. CBI = Caribbean Basin Initiative, which provides unilateral preferential tariff treatment to selected Caribbean and Central American country products as amended most recently in the Caribbean Basin Trade Partnership Act (CBTPA). P.L. 106-200.

d. Tariffs on oil vary depending on end use. Discussions with U.S. Department of Commerce officials suggest most U.S. oil exports to Panama (for automotive use) face a 5% tariff. Some oil for maritime use has tariffs as high as 30%.