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The U.S.-Panama Free Trade Agreement

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The 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 concluded on December 19, 2006 at the close of the tenth round. As with all free trade agreements, the U.S.-Panama FTA enters into force only after the President signs into law implementing legislation passed by both Houses of Congress.

Panama is a small U.S. trade partner, but benefits from significant U.S. investment and unilateral trade preferences (the Caribbean Basin Initiative and some that require congressional renewal — the Caribbean Basin Trade Partnership Act and the Generalized System of Preferences). These preferences would be replaced and made permanent by the reciprocal FTA. The FTA had to reconcile the requirements of a relatively small developing country with those of a large developed one. For Panama, this meant addressing multiple trade liberalization goals, including expanding its globally competitive services sector, repositioning its much smaller manufacturing sector, and easing slowly into the international market its more protected and less competitive agricultural sector. For the United States, it meant building on a long-standing strategic military and commercial relationship, while accommodating the concerns of sensitive domestic sectors and industries.

The U.S.-Panama FTA is a comprehensive agreement similar to other bilateral FTAs negotiated by the United States. According to the United States Trade Representative (USTR), 88% of U.S. commercial and industrial exports would become duty-free right away, with remaining tariffs phased out over a ten-year period. Approximately half of U.S. farms exports to Panama would achieve duty-free status immediately, with many products restricted by tariff-rate quotas (TRQs) winning additional market access, as would Panamanian sugar exports to the United States. Tariffs and TRQs on other farm products are to be phased out over 9-19 years. Panama and the United States agreed to a separate bilateral agreement on SPS issues, a key to concluding the FTA. Panama would recognize U.S. food safety inspection as equivalent to Panamanian standards, which would expedite entry of U.S. meat and poultry exports. The FTA also consummates understandings on services trade, telecommunications, intellectual property rights, labor, environment, and government procurement, while including support for trade capacity building.

The labor and environmental provisions in the U.S.-Panama FTA are similar to those in other bilateral FTAs. Panama has agreed, however, to keep open the discussion on labor while the USTR seeks bipartisan support for the FTA through additional consultations on labor issues with the 110th Congress. In the past, Panama has alluded to being amenable to stricter labor provisions, including the possibility of accepting enforceable minimal standards. It is possible that this could lead to an amended understanding of the labor commitments as currently conveyed in the FTA. This report will be updated as the congressional debate unfolds.

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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On November 16, 2003, President Bush formally notified Congress of his intention to negotiate a bilateral FTA with Panama. Negotiations commenced in April 2004 and, after an extended hiatus, the tenth and final round concluded on December 19, 2006. The negotiations were delayed by two factors. The first was difficulty in coming to an agreement on sensitive agriculture issues, particularly sanitary and phytosanitary (SPS) measures. The second was the Panamanian government's decision to put off negotiations for much of 2006 while it focused the nation's attention on the Panama Canal expansion referendum. Once the referendum passed, attention again turned to completing the FTA negotiations and common ground was found relatively quickly (details of the FTA are treated in a subsequent section). As with all free trade agreements that address reductions in tariffs and non-tariff barriers, the U.S.-Panama FTA cannot enter into force until Congress approves the agreement, passes implementing legislation, and sends it to the President to sign into law.[1] This report will be updated periodically.

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 details, see CRS Report RL33743, *Trade Promotion Authority (TPA): Issues, Options, and Prospects for Renewal*, by J. F. Hornbeck and William C. Cooper.

Figure 1. Map of Panama

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

Panama was swept to independence from Spain on November 28, 1821, becoming part of a regional group known as Gran Colombia. By this point in time, both the United States and some 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. On November 3, 1903, in a quick and bloodless move facilitated by the offshore presence of U.S. warships, Panama separated from Colombia. The United States recognized Panama immediately 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.[5] Panama held a national referendum on the proposed $5.25 billion expansion on October 22, 2006, which passed by a wide margin.

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 are 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 permanent U.S. unilateral trade preferences defined in the Caribbean Basin Initiative (CBI), as well as congressionally renewable trade preferences defined in the Caribbean Basin Trade Partnership Act (CBTPA) and the Generalized System of Preferences (GSP).[9] Under these circumstances, there has been 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 beneficial 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 in negotiations at the WTO Doha Round and 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 a U.S. hub, 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 was crafting an FTA that would balance the need to pursue openness for services, export growth and promotion for manufacturing, and adjustment time for agriculture to become more competitive, while minimizing social displacement. The incentive to negotiate was perhaps also

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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.

enhanced by the desire to keep pace with other Latin American countries that have or are negotiating FTAs with the United States.

Panamanian Trade Relations

Panama is a country of 3.2 million people with a stable, diversified economy that has rebounded briskly from the 2001-2002 global economic downturn. Panama's gross domestic product (GDP) expanded by 4.2% in 2003, 7.6% in 2004, 6.9% in 2005, and 7.1% in 2006 (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, but declining. 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 $1.6 billion from 2001 to 2005. In each year, the merchandise deficit was offset by a services trade surplus of between $900 million to $1.4 billion, unusual for Latin American economies.

Table 1. Panama's Current Account Balance

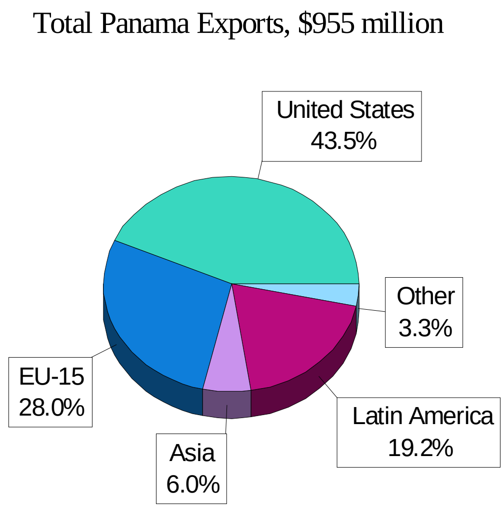
	2001	2002	2003	2004	2005
Balance on Merchandise Trade ($ million)	-696	-1,035	-1,202	-1,588	-1,358
Balance on Services Trade ($ million)	890	968	1,194	1,276	1,433

Data Source: Republic of Panamá, Controller General's Office, [http://www.contraloria.gov.pa].

Overall, the current account deficit widened in 2005 (**Appendix 1**) due in part to the sharp rise in oil prices, which also negatively affected Panama's inflation rate and terms of trade. Panama places 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. As a global trader, it has completed FTAs with El Salvador (2002), Taiwan (2004), and Singapore (2005). In addition to the United States, it is negotiating FTAs with Guatemala, Nicaragua, Costa Rica, and Honduras. Panama 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.

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

Figure 2. Panama Direction of Trade, 2005



Source: CRS from World Trade Atlas.

In 2005, the United States accounted for some 43.5% of Panamanian exports and 27.2% of its imports (see **Figure 2**). The European Union is the second largest export market with a 28.0% share, but accounts for only 7.6% of Panamanian imports. The Latin American countries collectively are Panama's third largest export market with 19.2%, but has the largest import share at 47.0%.

Panama is one of the few Latin American countries with which the United States has a merchandise trade surplus, and although relatively small, it is by far the largest in the region. Panama runs a sizeable trade deficit with Latin America; its 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 6% of Panama's exports, but 11% of its imports, dominated by Japan, South Korea, and more recently, China.

The Colón Free Zone. A distinct feature of Panama's trade regime is the Colón Free Zone (CFZ), which with the exception of Hong Kong, is the largest duty free zone in the world. 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 2005, nearly $5 billion worth of goods passed through the CFZ, with $500 million 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 by, 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 can 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 2005, the United States exported $2,169 million worth of goods and imported $327 million, producing a U.S. trade surplus of $1,842 million, the largest in the Western Hemisphere. Still, Panama ranked as only the 45th largest export market for U.S. goods and 99th for imports. Major U.S. exports, as seen in **Table 2**, include oil and 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

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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 author's 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 author's interviews with representatives from agencies mentioned.

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

accounting for 22% of total imports from Panama.[14] Commodity trade includes precious metal (mostly gold), sugar, and coffee, which together account for 18.5% 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, presented the more difficult negotiation issues.

Table 2. U.S.-Panama Merchandise Trade, 2005
(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	559.7	25.8%	1. Fish/Seafood:	104.5	32.0%
2. Machinery	238.5	11.0%	2. Repaired Goods	71.3	21.8%
- Office mach.	(35.3)				
- Computers	(49.7)				
3. Electrical mach.	171.4	7.9%	3. Sugar (cane)	29.2	8.9%
4. Pharmaceuticals	164.8	7.5%	4. Gold	19.3	5.9%
5. Aircraft	140.7	6.5%	5. Coffee	11.6	3.6%
6. Vehicles	78.1	3.6%	6. Edible Fruit	9.3	2.8%
7. Optical/Medical Equipment	75.9	3.5%	7. Prepared Shrimp	8.1	2.5%
8. Cereals	67.0	3.1%	8. Aluminum	7.9	2.4%
9. Paper	53.9	2.5%	9. Glass	6.5	2.0%
10. Perfume	48.1	2.5%	10. Wood	5.8	1.8%
Other	570.7	26.1%	Other	53.5	16.3%
Total	2,168.8	100.0%	Total	327.0	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. The amount of U.S. investment in

[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."

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

Panama well exceeds that in the five Central American countries combined, although it is a small fraction of U.S. investment in Mexico. Plans to widen and improve the canal will likely provide an 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	2005
Panama	5,141	5,842	5,409	5,631	5,162
Mexico	52,544	56,303	59,851	63,502	71,423
Central America	2,994	3,199	2,333	2,857	3,230

Data Source: U.S. Department of Commerce. Bureau of Economic Analysis. International Economic Accounts. BEA website. Data are stock of foreign direct investment (FDI) presented on a historical-cost basis.

Summary of Trade Negotiations and the U.S.-Panama FTA

Panama approached the United States for a stand-alone FTA, preferring to avoid a direct link to the U.S.-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR).[16] 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.[17] Another unique feature of this FTA is the treatment of business issues within the Panama Canal itself. As an autonomous legal entity under the Panamanian Constitution, it raised issues in government procurement, labor, investment, and other areas. The United States is the only country with which Panama has been willing to negotiate canal issues in an FTA.

It took ten rounds to complete the agreement, the last concluding on December 19, 2006. The U.S.-Panama FTA follows closely the text framework of the CAFTA-DR and other earlier FTAs. Exceptions include market access schedules, provisions unique to businesses operating in the Panama Canal Area, and other areas where Panama differs from the Central American countries. A significant aspect of the FTA is the commitment Panama made to continue discussing labor provisions to accommodate concerns that some Members of the 110th U.S. Congress may raise.

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[16] 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.

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

Below is a more detailed discussion of the major negotiation areas and a description of the issues that have been of particular interest to the U.S. Congress in previous agreements. Importantly, the agreement cannot take effect until it is approved by the U.S. Congress and implementing legislation is signed into law by the President. This section will be updated to reflect details of the text and other factors as they emerge.

Market Access[18]

Most U.S. imports from Panama, including most manufactured goods, enter duty free under the normal trade schedule or the unilateral trade preference programs (CBI, CBTPA, or GSP). 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.

The market access working group negotiated the tariff structures and rules of origin that would govern the movement of commercial, industrial, and agricultural goods. Specific tariff schedules were negotiated on a product-by-product basis defining the "staging categories" that prescribe the time that each country would be given to reduce product-specific tariff levels to zero. Tariffs on 88% of industrial and commercial goods would go to zero immediately, with the remaining tariffs phased out over a ten-year period (agriculture market access is discussed below).

Rules of origin define which goods would be eligible for duty-free treatment based on the country of origin of their content. Rules of origin are intended to prevent transshipment of goods made from materials originating in countries outside the agreement. They are particularly pertinent to apparel and textile trade. Apparel products made in Panama would be given duty-free treatment if they are made from U.S. or Panamanian fabric and yarns (the yarn forward rule). A special textile safeguard would provide for temporary protection if U.S. apparel producers demonstrate that they have been harmed by increased Panamanian imports.

Agricultural Trade. Two major issues that delayed conclusion of the FTA negotiations were agricultural market access and sanitary and phytosanitary standards (SPS). Market access was particularly difficult for four highly protected products: pork; poultry; rice; and sugar. The United States was basically "offensive" on pork, poultry, and rice, expecting to open further Panama's markets as soon as possible. It was "defensive" on sugar, attempting to limit increases 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 was the reverse, pressing to minimize increases in U.S. exports of pork, poultry, and rice, and to increase its U.S. sugar export 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-

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[18] The text of the FTA is being finalized and has not been released at this point. Unless otherwise noted, details are drawn from: United States Trade Representative. *Free Trade with Panama: Brief Summary of the Agreement*. December 19, 2006.

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: 1) a third of Panama's total agricultural exports, compared to less than 10% for the Central American countries, and; 2) 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 argued 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, continued 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.

In Panama, pork, rice, and poultry were the most sensitive products. These are also protected by TRQs, with in-quota tariffs of 15% and out-of-quota 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 willingness to sell dark meat cuts at a low price in foreign markets, putting downward pressure on prices and hurting domestic producers in those countries. The Panamanians argued 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 remained unchanged. Panama's rice industry, which supplies over 90% of the domestic demand, was also convinced that opening their market to U.S. subsidized rice would decimate their industry, which, because of its protection, sells rice considerably above the world price.

Panamanian agriculture represents only 6% of GDP, but 17% of employment. These numbers point to both an inherent inefficiency, due in part to protection, but also the strong role agriculture plays in supporting rural employment and social stability. In fact, agriculture's 17% of national employment actually supports 40% of the country's 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 argued 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

[19] The economic effect is to raise the price of sugar in the United States above the world price, increasing income to sugar-producing industries, but raising costs to sugar-using firms and consumers. CRS Report RL33541, *Sugar Policy Issues*, by Remy Jurenas.

rural-urban migration. For these reasons, Panama wanted 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.

The compromise struck in the FTA would provide duty-free treatment for over half of U.S. farm exports to Panama including high quality beef, poultry products, soybeans, most fresh fruits, and a number of processed goods. Remaining tariffs would be phased out between 9-19 years after the FTA takes effect. Rice tariffs, one of Panama's most sensitive products, would remain in effect for the full 19 years. Pork, chicken leg quarters, diary products, corn, rice, among others, will receive expanded quotas under the Panamanian tariff rate quota system, with chicken legs given 17 years to phase out the TRQ. The United States agreed to give Panama an additional 7,000 metric tons of sugar imports in the first year under a three-tiered TRQ system, which will grow by 1% per year, capped eventually for some types of sugar. Reportedly, the American Sugar Alliance has agreed not to come out against the agreement.[20]

Sanitary and Phytosanitary Standards (SPS). SPS was one of the most difficult issues to resolve. Although understood as necessary to ensure the safety of agricultural imports, SPS standards can be a burden, and are often denounced as a veiled form of protectionism. Panama's SPS standards, on the whole, are thought to be very high and meet WTO standards. The USTR, however, has long raised concerns over procedural transparency with respect to phytosanitary permits and also Panama's requirement that imports of poultry, beef, and pork, its most protected products, come from processing plants that have been individually inspected by Panamanian officials. The United States contends that this process has often been cumbersome, drawn out, and ultimately very costly to U.S. producers.[21]

The United States sought to have Panama recognize the USDA certification process as equivalent to Panamanian standards for the purpose of securing unimpeded entry into Panama of U.S. meat exports. This issue became highly controversial during the ninth round of negotiations, when U.S. negotiators proposed this agreement be put into a formal side letter. Panama responded by noting that the SPS chapter had already been closed, that its meat inspection standards are among the highest in the world, and that a last minute effort to change SPS provisions raised sovereignty issues in Panama by potentially requiring Panama to lower its standards in some cases.[22]

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[20] Inside U.S. Trade. *Panama FTA Offers Limited Sugar Access; Labor Changes Possible*. December 22, 2006.

[21] United States Trade Representative. *2006 National Trade Estimate Report on Foreign Trade Barriers.* Washington, D.C. March 2006. p. 502.

[22] Berrocal R. Rafael E. Panamá Reconcoce Sistema Sanitario de Estados Unidos. Presna.com. February 22, 2006 and *Inside U.S. Trade.* Dispute Over Agriculture Inspections Holding up U.S.-Panama FTA Talks. January 23, 2006. Also see USTR Press Release, February 13, 2006.

As part of the resolution, Panamanian officials visited the United States to review the food safety inspection system for meat and poultry and found that accepting the U.S. system poses no sanitary threats to Panama. This understanding was formalized in a separate bilateral agreement between the two countries, along with a streamlined import documentation system. Signed on December 22, 2006, the agreement states that for meat, poultry, dairy, and other processed products, Panama agrees to accept U.S. sanitary, phytosanitary, and regulatory systems as equivalent to those of Panama and will no longer require individual plant inspections. Panama further agreed to amend its laws accordingly by February 28, 2007.[23]

Services

Services trade were negotiated in a separate chapter and include financial services, shipping, telecommunications, professional services, 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 wanted 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.[24] The United States pressed for even greater transparency in regulatory procedures and U.S. business groups identified services as a critical negotiating area given U.S. competitive advantages and the large services sector in Panama.

Equal ability to compete in retail trade, express delivery, and financial services, including insurance and portfolio management, was negotiated in the FTA, an issue of primary importance to the United States. In reducing restrictions in these areas, U.S. firms would be better able to compete in the largest sector of the Panamanian economy, the one most likely to grow with canal expansion and increased merchandise trade through the canal. Panama wanted greater transparency in the U.S. state-level financial services regulatory system to help ease the possible opening of Panamanian banks in select U.S. states. The United States government argued, however, that it was unable to make commitments on state-level financial services regulatory matters.

Government Procurement and Intellectual Property Rights

These two areas are of particular importance to the United States. With respect to government procurement, Panamanian laws require transparency in the bidding process, a practice generally followed, but concerns have been raised by U.S. firms not only with regard to contract bidding, but the appeals process as well. Panama has not acceded to the WTO Government Procurement Agreement, which the United

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[23] *United States-Panama Agreement Regarding Certain Sanitary and Phytosanitary Measures and Technical Standards Affecting Trade in Agricultural Products*. December 22, 2006.

[24] USTR, *2006 Foreign Trade Barriers*, p. 506.

States would like to encourage in the FTA.[25] 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.[26]

Government procurement takes on a greater importance when considered in light of the proposed expansion of the Panama canal and related prospects for large long-term investments. The Panama Canal Authority operates independently of the national government and required separate negotiation apart from the regular government procurement chapter. Panama negotiated to maintain the canal authority dispute settlement system within the FTA, as well as to keep small business set aside provisions for Panamanian firms with respect to canal maintenance and operations. The FTA reportedly addresses U.S. concerns over fair and open government procurement procedures for all government entities, including the Panama Canal Authority.

Intellectual property rights (IPR) were a major U.S. priority. The objective was to have Panama's standards approximate more closely those of the United States, which was apparently negotiated in the new FTA. 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 continues to encourage Panama to accede to additional IPR treaties and remain vigilant against an admittedly challenging piracy problem.[27]

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.[28]

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

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[25] Ibid., p. 503.

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

[27] USTR, *2006 Foreign Trade Barriers*, p. 505.

[28] Ibid., p. 475.

investment in related services industries. The FTA would protect all forms of investment, giving U.S. investors equal rights to Panamanians, in most cases.

Labor and Environment

Labor and environment provisions are often highly contentious issues 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. An important aspect of the U.S.-Panama FTA is the agreement to continue discussions on labor provisions in light of concerns that many Members of the U.S. Congress have expressed over weak provisions in early U.S. bilateral FTAs. This understanding may prove to be another important milestone in the evolution of the treatment of labor standards in FTAs.

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.[29] 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.[30] 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.[31] 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

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[29] 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.

[30] 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.

[31] 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.

of International Labor Organization (ILO) fundamental labor rights and the extent to which the dispute settlement provisions are effective in ensuring that countries are held to these standards.[32] 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 standard is a step backward from those allowing for the suspension of trade benefits found in the U.S. unilateral trade arrangements like the 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 the same treatment.

Specifically, there are three provisions that are 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). 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.[33]

In addition, for labor and environmental issues, the dispute resolution process in other FTAs has operated differently than for commercial issues. 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 an annual fine that would be capped at $15 million 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.[34]

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[32] 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.

[33] 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.

[34] Ibid and USTR, *CAFTA's Labor Provisions: World Class, Best Ever*.
(continued...)

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 two votes 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 concerns, 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.[35] 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.[36]

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. However, the agreed commitment to continue the labor discussion with congressional concerns in mind may prove to be an important element in diminishing resistence to 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

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[34] (...continued)
[http://www.ustr.gov].

[35] U.S. Department of State. *Panama: Country Report on Human Rights Practices - 2005*. Washington, D.C. March 8, 2006, 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.

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

undermined by trade rules, promoting strong environmental initiatives to evaluate and raise performance, developing a systematic program of capacity-building 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.[37]

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.[38]

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.[39] 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.

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 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

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[37] 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 RL31638, *International Investor Protection: "Indirect Expropriation" Claims Under NAFTA Chapter 11*, by Robert Meltz.

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

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

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.[40] 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.

Environmental provisions in the U.S.-Panama FTA reportedly are essentially the same standard found in other U.S. bilateral FTAs and attempt to address the major concerns outlined above. Specifically, with respect to the two governments the FTA would: 1) encourage high levels of environmental protection; 2) require that governments not fail "to enforce their environmental laws," and 3) recognize that it is inappropriate to weaken or reduce protections as an encouragement for trade and investment. There is also a requirement for formal cooperation among governments on environmental issues and use of a dispute resolution mechanism that is transparent and involves public input.[41]

Trade Capacity Building

The FTA would create 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.[42]

The major goals identified include inter-sectoral coordination, increasing exports to the United States, enhancing the investment climate, better integrating

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

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

[42] 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.

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 FTA is identified along with action items that may need to be pursued to 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, presented 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 increased trade liberalization, may be juxtaposed against its much smaller and less efficient manufacturing and agricultural sectors, which will struggle more in adjusting to freer trade. Panama has weighed the substantial overall benefits of further trade opening with its largest trade partner against the economic and social transition costs that the agriculture sector, in particular, would bear. Panama's goals in the agriculture sector were at odds with U.S. interest in opening it further to U.S. exports. The FTA presents a compromise, allowing for considerable adjustment time for Panama's most vulnerable crops, but eventually leading to full free trade between the two countries.

For the United States, concluding a comprehensive agreement compatible with earlier FTAs was critical, not only for achieving an acceptable bilateral arrangement, but to retain a consistent approach, if not another building block, toward the overall U.S. vision of regional integration embodied in the Free Trade Area of the Americas (FTAA). The U.S.-Panama FTA is a compromise of U.S. interests as well, but achieves major U.S. goals. Completion of the side agreement on SPS measures was key to meeting U.S. negotiating concerns, as was Panama's promise to keep the discussion on labor provisions open, a new development in U.S. bilateral trade negotiations. Also, in as much as many key industries, such as sugar and textiles, appear to have accepted the FTA, at least preliminarily, many issues that generate much of the traditional opposition to FTAs may have already been addressed. Still, the U.S. Congress is not always unified on many other trade issues and will likely engage in lively debate over the U.S.-Panama implementing legislation, as it has with previous FTAs.

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, DC.
January 10-15, 2005	Seventh round of negotiations held in Washington, DC.
Jan. 31-Feb. 6, 2005	Eighth round of negotiations occurs in Washington, DC.
Jan. 17-20, 2006	Ninth round of negotiations held in Washington, DC.
Dec. 15-19, 2006	Tenth and final round of negotiations held in Washington, DC. Agreement is concluded; allows for continued discussion on labor issues.

Appendix 2. Panama: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005
GDP Growth (%)	2.7	0.6	2.2	4.2	7.6	6.9
Per Capita GDP Growth (%)	0.8	-1.3	0.4	2.3	5.7	4.2
Urban Unemployment Rate (%)	15.2	17.0	16.5	15.7	14.1	12.0
Inflation (%)	0.7	0.0	1.9	1.5	1.5	4.0
Current Account Balance (% GDP)	-5.9	-1.5	-0.8	-3.4	-8.4	-9.8
Terms of Trade (Indices, 2000=100)	100.0	102.7	101.6	97.2	95.3	93.5
Foreign Direct Investment ($ mil)*	700	405	99	792	1,012	750

Source: United Nations Economic Commission on Latin America and the Caribbean. *Preliminary Overview of the Economies of Latin American and the Caribbean, 2006.* December 2006.
*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%.