

THE PANAMA CANAL: RESOURCE CURSE OR DEMOCRATIC BOON?

By

ADRIAN ZEH

A THESIS PRESENTED TO THE GRADUATE SCHOOL
OF THE UNIVERSITY OF FLORIDA IN PARTIAL FULFILLMENT
OF THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF ARTS

UNIVERSITY OF FLORIDA

2012

© 2012 Adrian Zeh

ACKNOWLEDGMENTS

I thank my parents, my supervising committee, Rachel Mourao, The Panama Canal Museum and all those who made my research possible. I would especially like to thank the ACP, the University of Panama, the Controloria General de la República de Panamá, the Cultural Portobelo, and all the members of Panamanian civil society who aided me in this process for all their time, guidance, and insights.

TABLE OF CONTENTS

	<u>page</u>
ACKNOWLEDGMENTS.....	3
LIST OF TABLES.....	6
LIST OF FIGURES.....	7
ABSTRACT	8
CHAPTER	
1 INTRODUCTION	10
2 LITERATURE REVIEW	16
General Theory.....	17
Commodity Resources.....	18
“New” Resources	21
Renewable Energy	22
Tourism	23
International Banking.....	24
Crude Democracy.....	25
But Why Study Just Panama?	27
3 HISTORICAL BACKGROUND.....	29
The Canal in Law	29
The Hay-Bunau-Varilla Treaty, 1903	29
The Filós-Hines Treaty, 1947	31
The 1964 Protests, 1968 Coup and 1972 Constitution.....	32
The Torrijos-Carter Treaties, 1977-78	34
The Ley Organica, 1997.....	35
The Canal Expansion Project and 2006 Referendum	37
The Concertación Nacional para el Desarrollo, 2007 and the Ley 34, 2009.....	42
Politics	46
Early Political and Economic Groups	48
Military Rule.....	48
1972 Constitution and Reforms.....	51
Presidencies: Guillermo Endara, 1989-1994	51
Ernesto Perez Balladares, 1994-1999.....	53
Mireya Moscoso, 1999-2004	55
Martin Torrijos, 2004-2009	56
Ricardo Martinelli, 2009-Present	57
4 RESULTS	62

Quantitative Analysis	62
Spearman Correlations.....	64
Regression Models.....	65
Regression Results and Interpretation	68
Quantitative Results Versus the Ley de Responsabilidad Social Fiscal, 2008	70
The Canal and Stability	71
Qualitative Analysis: “Deepening” Democracy?.....	73
5 CONCLUSIONS	88
LIST OF REFERENCES	92
BIOGRAPHICAL SKETCH.....	96

LIST OF TABLES

<u>Table</u>		<u>page</u>
4-1	Spearman Correlations – Canal Revenue*Social Budget.....	81
4-2	Social Expenditures Regressed on Canal Revenues, 1980-2010	81
4-3	Social Expenditures Regressed on Canal Revenues, 1980-1989 (Military Government).....	81
4-4	Social Expenditures Regressed on Canal Revenues, 1990-2010 (Democratic Government).....	82
4-5	Social Expenditures Regressed on Canal Revenues, 1980-1992 (PCC Administration).....	82
4-6	Social Expenditures Regressed on Canal Revenues, 1980-1999 (PCC, CCP Administrations).....	82
4-7	Social Expenditures Regressed on Canal Revenues, 2000-2010 (ACP Administration).....	83

LIST OF FIGURES

<u>Figure</u>	<u>page</u>
4-1 Canal Revenues, 1980-2010	79
4-2 Social Expenditures, 1980-2010.....	79
4-3 Canal Revenues, Government Expenditure and GDP.....	80
4-4 The Gini Index, 1980-2010	80
4-5 Political Stability and the Absence of Violence	83
4-6 The State Fragility Index.....	84
4-7 Political and Civil Liberties Index	84
4-8 Press Freedom Index	85
4-9 Corruption Perceptions Index, Score.....	85
4-10 Corruption Perceptions Index, World Rank	86
4-11 Latinobarómetro Public Opinion Surveys	87

Abstract of Thesis Presented to the Graduate School
of the University of Florida in Partial Fulfillment of the
Requirements for the Degree of Masters of Arts

THE PANAMA CANAL: RESOURCE CURSE OR DEMOCRATIC BOON?

By

Adrian Zeh

August 2012

Chair: Phillip Williams
Major: Latin American Studies

The political effects of natural resource wealth have been a source of extensive academic study, with authors coming to widely divergent conclusions on why and how fossil fuels, minerals and other sources of resource rents affect governance. This thesis looks to apply some of these theories to a previously un-scrutinized “resource” – the Panama Canal – and focuses in particular on the Canal’s effect on governmental social spending, regime stability, and democratic quality. This study utilizes a mixed method approach, employing both quantitative data, compiled from official government statistics in Panama, and qualitative data, including historical and legal documents, international databases, and in-depth interviews. Together these sources allow me to argue that while the Panama Canal may have promoted governmental stability under both military and democratic governments, it has not necessarily improved democratic governance in the past twenty years.

In light of recent Panamanian law earmarking significant percentages of Canal revenue for a National Development Plan, as well as an ambitious new Canal Expansion Project currently underway, this study is highly important for Panama itself,

not only in understanding its recent past but also in providing lessons for the future. In a broader context, it highlights the need for future studies on the political effects of a wider variety of sources of government revenue. Finally, it cautions against an over-reliance on solely statistical analyses of the political effects of natural resources, which as this thesis shows, may not tell the entire story.

CHAPTER 1 INTRODUCTION

The Republic of Panama is a small country, encompassing less than 47,000 square miles (roughly the size of South Carolina) and boasting a population of only around 3.5 million (Central, 2012). Serving as the bridge between Central and South America, it owes its independence, as much as anything, to its location in the world. Until 1903, Panama had been a province of Colombia, but a unique set of circumstances would alter the situation. With a silver-tongued French businessman desperate to sell his own bankrupt canal enterprise before his concession ended, Nicaragua discarded as a viable option because of an ill-advised postage stamp featuring an erupting volcano, and Colombia, reeling from a Civil War, refusing to accept the U.S.'s conditions to build the waterway, President Theodore Roosevelt chose Panama as the site for a trans-oceanic canal. With guarantees that the revolutionary elites in the country would support an American canal, the U.S. immediately recognized Panama's status as a sovereign nation after Panama's declaration of independence. A fleet of American warships would serve as the "big stick" ensuring Colombia's non-interference.

Given its colorful history and the incredible engineering feat it entailed, it comes as no surprise that the Panama Canal has been a popular topic of research for historians, sociologists, political scientists and others. Some authors, such as Conniff (1995), have been interested in the social implications of the Canal's construction, particularly in regards to the treatment of West Indian workers brought to Panama to build, operate and maintain the waterway. Other researchers have focused on the Canal's role within the context of the country's military regimes (Gandasegui, 1993; Harding, 2001; Percy,

1998; Ropp, 1982, 1992), economic development (Zimbalist & Weeks, 1991), or with respect to Panama – U.S. relations (LaFeber, 1989; Conniff, 2001). A recent book, *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Canal*, by Maurer and Yu (2011) looks to answer a more pragmatic question, at least for the American taxpayer: was it economically worthwhile for the U.S. to build the Canal?

From my own readings in political science on resource rents (government profits derived from the exploitation of a natural resource, to be discussed later), as well as the work by Maurer and Yu (2011), one question continued to bother me: what about Panama? How has the Panamanian government used Canal money? Following the transfer of the waterway in 2000, but even after the renegotiation of the treaties in 1979, the amount of money transferred to the Panamanian government reached significant proportions, especially given Panama's small size. As it turned out, there was a reason no one (at least to my knowledge) had attempted to find out what Canal revenues were used for: it is impossible, at least directly. The Panamanian government treats the rents as it would any other revenue stream; once the money enters the treasury, it cannot be differentiated from other sources of government income, such as taxes. Clearly, this presented something of a problem.

Though the exact expenses Canal money was used for cannot be tracked, they should presumably be visible in the aggregate. In other words, as Canal revenue rose or fell, one would expect government expenditures to change in those sectors for which the money was used. Readings on resource rents, in particular Thad Dunning's *Crude Democracy*, led me to believe that the revenue may be correlated to social spending, serving as a buffer between the interests of the economic and political elite and those of

the popular classes. In addition, recent Panamanian law (*Ley de Responsabilidad Social Fiscal*, 2008) seems to codify this tie between the resource and social expenditures, earmarking 35% of Canal revenue (for a minimum of \$12.835 billion between 2009-2025) for an ambitious national development plan. With this in mind, this thesis addresses the following questions and tests the related hypotheses:

Question 1: What is the relationship between Canal revenues and social spending rates?

Is there a difference between military and democratic governments?

Is there a difference between the various administrations of the Canal?

Hypothesis 1: Canal revenues have had a positive relationship with spending on government social programs.

Canal revenues have a positive relationship to social spending under both military and democratic governments.

Canal revenues have a positive relationship to social spending under all administrations of the Canal.

Question 2: How does the historical correlation between Canal revenues and social expenditures compare to rates set in recent Panamanian law (*Ley de Responsabilidad Social Fiscal*, 2008) earmarking Canal revenue for development goals?

Hypothesis 2: The historical relationship between Canal revenues and social expenditure will be similar to the rates set in the law.

Question 3: What is the relationship between Canal revenues and stability?

Hypothesis 3: Canal revenues have promoted stability under both authoritarianism and democracy in Panama.

Question 4: In the last two decades, have Canal revenues led to a “deepening” of democracy?

Hypothesis 4: There is no relationship between Canal revenues and public support for Panamanian democracy.

Before delving into the data, the thesis will open with a literature review of publications on resource rents, which have focused primarily on mineral and fossil fuel wealth. In addition, I will present information on how scholars have studied “non-traditional” sources of rents, such as banking, hydroelectric power, and tourism. Chapter 2 will then pass to a close examination of Thad Dunning’s *Crude Democracy*, which is most applicable to the Panamanian case and provides the theoretical underpinning for the thesis. Finally, drawing on Eckstein’s (1992) theory of “crucial case studies,” Chapter 2 will provide the rationale for examining Panama as a case study, rather than doing comparative research.

Chapter 3 will provide a historical background of the Canal, with a focus on the legal documents related to the waterway, and be supplemented by interviews with members of the ACP and PCC. In Chapter 3, I will also discuss the proposed Canal expansion plan, as well as a recent law earmarking Canal revenues for social expenditures. In addition, I will include a brief historical background on the military government and the democratic presidencies. This overview will demonstrate how the Panama Canal has largely enjoyed a high degree of separation from the rest of the political system. Particularly during the democratic period, this partition between the

state and the administration of the waterway has been crucial to the profitability and efficiency of the Canal, though recent events discussed in Chapter 3 suggest that this may no longer be the case. As will be shown, when political considerations affected the operation of the Canal during the 1980s, the long-term viability of the waterway was nearly compromised, which serves as a serious cautionary note for the future. In addition, the historical background provided will serve to illustrate much of the qualitative information presented later in Chapter 3.

With this in mind, the Hypothesis 1 will be addressed quantitatively Chapter 4 of the thesis. This will be done using statistical techniques to test the relationship between changes in government Canal revenues and social expenditure. As a starting point, I use the year 1980, the first full year the Torrijos-Carter treaties came into effect. As mentioned earlier, Canal transfers to the Panamanian government were minimal previous to this point. The study will conclude with the year 2010, as revised figures from the year 2011 are not yet available. To compare military and democratic governments, I will split the sample in two: 1980-1989 (the years of military rule) and 1990-2010 (the years of democratic rule). The comparison of the government use of funds under the three different Canal regimes (1980-1992, 1993-1999, and 2000-2010) will serve to test whether or not the management of the resource affected the government's use of the funds (most scholars contend that resource ownership, whether public or private, does not affect how resource rents are used). The data from statistical analysis will be used to compare how the historical relationship between Canal transfers and governmental social expenditures compares to the rate set in the *Ley de Responsabilidad Social Fiscal* of 2008.

Part two of Chapter 4 will address the the Canal's relationship to governmental stability. Unfortunately, this is difficult to test statistically, as the only regime change came in 1989 and was not caused by internal unrest, but rather a U.S. invasion. In addition, though there were several coup attempts during the first post-military presidency, there have been none since then. To make the case that Canal revenue has indeed helped bolster stability, I will present information from Polity's State Fragility Index (SFI), which scores countries on both legitimacy and effectiveness in four performance dimensions: Security, Political, Economic and Social. Unfortunately, this data is only available starting in 1995. Another measure presented for state stability is the Political Stability and the Absence of Violence index, available from the World Bank's Worldwide Development Indicators, but data for Panama is only available from 1996-2009, with two years missing from the sample. The drawback from using these measurements to report stability is the lack of variation in the sample (in the SFI, for example, Panama's overall fragility score changes only five points over the time period). A preferable way to look at the issue might be through an index of yearly political protests; however, at least to my knowledge, no such database exists for Panama.

Chapter 4 will conclude by addressing Question Four using a variety of international measures on the quality of democracy, including data from the World Bank and Freedom House. In addition, I will present information gathered from interviews with various sources in government and civil society in Panama, as well as from a public opinion survey – Latinobarometro – conducted in Panama. Conclusions of the research will be presented in Chapter 5 of the thesis.

CHAPTER 2 LITERATURE REVIEW

In recent decades, academics began to explore the seemingly paradoxical relationship between natural resources and development. Rather than promote economic growth and improve the welfare of a nation-state's people, an abundance of natural resources seemed to impede development. Initial research on this phenomenon was primarily economic, as, based on observations of the experience of the Netherlands after discovering natural gas deposits during the 1960s, authors elaborated the effects of the "Dutch disease" on a country's economy. According to exponents of this theory, an increase in exports of a natural resource led to an appreciation of local currency, devaluing other export sectors of the economy and leading to an increasing reliance on the natural resource sector, which left the country highly vulnerable to world prices for the good (Ebrahim-Zadeh, 2003).

Subsequent literature expanded this initial work in a number of different directions. Much of this tested the relationship between the presence of natural resources and conflict, with a special focus on Africa, which has seen many countries rent by wars over control of natural resources. A third body of writing began to explore the relationship between high levels of resource wealth and politics using a number of different variables, including regime type, stability, institutional quality, taxation rates, and corruption, among others.

Chapter 2 will not attempt to cover all of these topics. Instead, the literature review will be divided into three sections: (1) General theory regarding resource abundance and political representation; (2) A brief survey of the literature regarding the political effects of commodity resource wealth (of which the primary focus of has been

non-renewable resources such as oil, natural gas, and minerals); and (3) an exploration of the emerging literature on “new,” non-commodity resources, such as renewable energy, tourism, and banking. Chapter 2 will close with a close examination of Thad Dunning’s (2008) *Crude Democracy*, which provides the theoretical basis for this thesis, and a justification of the case-study approach employed in the thesis.

General Theory

In “Revenues, State Formation and the Quality of Governance,” Moore (2004) applies a “fiscal sociology paradigm” to analyze the effect of different types of revenue on governance (297-299). This approach, first developed by Joseph Schumpeter, examines taxation and public finances as drivers of political, economic and social change. Using Western Europe as a model, the author contrasts the rise of the “fiscal state” in the developed world (that is, a state reliant on taxing its citizens for revenue, and thus more highly accountable to them, though this is complicated by the ability of these states to borrow from other sources) with the rentier state, which is funded primarily by “unearned income” and thus not accountable for its citizenry. He also identifies six additional “political pathologies” of these states: a propensity for external intervention to secure a continued supply of the resource, which leads to outside political and military support for non-representative governments; an increase in coups and counter-coups, as different factions vie for control of resources; an absence of incentives for civil society development; vulnerability to insurgents, as state involvement (given the absence of taxation) is low in many areas; a lack of budget transparency; and an ineffective bureaucracy. In addition, the author highlights the importance of the current international economic and political system in shaping state formation in developing countries. The author concludes that taxation could provide a “governance dividend”

that results in more societal influence of government revenue and expenditure and higher voluntary taxation rates (310).

Moore (2004) provides useful insights into state formation and the effects of resource abundance on governance. Of particular interest is his dichotomy between “natural resource rents” and “strategic rents,” which include control over key naval transport facilities, military alliances and subsidies, and rentals of military facilities to foreign powers (306). The author also touches on a subject curiously absent from many studies on the political impacts of resource abundance: the international system. Included in his evaluation is a critique of the IMF and its external imposition of taxation rates, which bypasses the representative system the author sees as crucial to the formation of democratic government. The principal drawback to the article lies in its abstraction, however, for as Moore (2004) himself admits, the analytical tools and data available, as well as the political, social and economic differences between the different countries, offer important challenges for systematic validation of the theory. This is particularly true in the case of “strategic rents,” whose contributions to government coffers tend to be difficult to isolate. However, the basic principles of the theory and approach seems sound though not yet fully elaborated.

Commodity Resources

The literature in comparative politics offers a variety of divergent perspectives on the political effects of dependence on oil, minerals and other commodities and attempts to test theories empirically. Ross (2001) uses data on 113 countries between 1971-1997, showing a strong correlation between oil exports and authoritarianism across the sample, not only in the Middle East. To explain this phenomenon, he theorizes five “democracy-dampening” effects, later expanded by Moore. These are the “taxation

effect:” authoritarian governments replace taxation with oil revenues, and are thus less accountable to their citizens; the “spending effect:” oil wealth leads to greater patronage spending, lessening demands for democratization; the “group formation effect,” wherein the government can use export revenues to prevent independent social groups from forming (i.e. civil society); the “repression effect,” as governments can significantly increase their repressive capabilities; and the “modernization effect,” in which he argues that government spending diminishes the need for specialization, urbanization, higher education, and other drivers for democratization. Drawing on the work of previous authors and his own observations, journalist Thomas Friedman (2006) thus postulates the “First Law of Petropolitics:” “The price of oil and the pace of freedom always move in opposite directions in oil-rich petrolist states” (31).

Herb (2005) runs similar econometric models, albeit using different data and variables, including a larger number of countries, but over a shorter time period. In contrast to Ross (2001), he finds no negative correlation between rentier states and democracy. He concludes that the most important variables regarding worldwide variation in democracy are the region a country is in, income, and the percentage of the population that is Muslim, arguing that though rentierism may have negative effects for democracy, other factors are at work that may be more important.

The use of varying data and approaches makes comparison of these pieces exceedingly difficult, if not impossible. Many of the statistics used serve as proxy measures for what the authors want to measure, and to their credit, usually include caveats mentioning this fact; the models presented are extreme simplifications of reality. How to measure democratic quality continues to be an issue of contention today, not to

mention when evaluating regimes 40 years in the past. In addition, as Herb (2005) mentions, the extensive variability between any two countries in the sample, not to mention hundreds, makes broad conclusions somewhat dubious.

In response to this confusion, authors such as Robinson, Torvik and Verdier (2006), turned these arguments on their head, arguing that what explains the poor performance of many resource-rich, poor countries was not the presence of the resource itself, but the political institutions that are present in those countries. The actors studied in this case are neither states nor classes, but individual politicians, and the authors contend that resource booms lead to rational political incentives to engage in inefficient clientilistic redistribution, primarily through an increase in the size of the public sector. The authors thus construct theoretical models of incumbent behavior in terms of resource extraction and redistribution and also extend the model to dictatorships. Differing development outcomes are explained by the institutional quality present in the country, which inhibits (or allows) varying extents of political attempts at redistribution to stay in power. Evidence for their assertions is provided by several case studies distinguishing those with “bad” institutions (e.g. Ecuador, Venezuela, Nigeria) from those with “good” institutions (Chile, Malaysia, Thailand).

In looking at political actors and their motivations for engaging in clientelistic practices, the authors provide a fresh insight into the political economy of the “resource curse” and go beyond the simplicity of previous models. Of course, the work by no means escapes many of the problems mentioned before, in terms of the validity of statistics and variables used, and supplies evidence for only 15 case studies. It is also unclear what happens in their model in the case of constitutional term limits – that is,

when the incumbent is barred from seeking power – and also raises even more questions: what, for example, explains the divergence in the quality of institutions present? In addition, it leaves no room for differences in political behavior rising from the ideology of actors – politicians and voters – nor the regional and international context.

As these articles show, the literature on commodity resources is extremely diverse, but as of yet inconclusive and incomplete. A great deal of the problem is in the variables and statistics available for empirical tests of theoretical assumptions, an issue that is not likely to be solved anytime in the near future. Given the vast differences in the results of these scholars, it is likely that the effects of resource wealth on political systems are highly complex and variable, necessitating a more in-depth view of individual case-studies before broad assumptions can be made. The lack of discussion of the international context in the literature is somewhat puzzling, given that such states are dependent on the globalized international market for the wealth they derive from their resources, as well as the role much of the developed world – particularly the United States – has played in supporting autocratic rentier states.

“New” Resources

Contrary to the mineral and fuel-based resource-abundant economies, the study of the political effects of revenue generated from non-traditional sources of rents is in a much more infant stage, and to my knowledge, little, if anything exists in the way of a comprehensive theory regarding this area of study. As Moore (2004) indicates in his brief discussion of “strategic rents,” this is partly due to the difficulties in quantifying the economic revenues generated by such activities, but also because of the varied nature of these rents, the complexities of the issues involved and the difficulty of establishing correlation between a “resource” and state formation or political behavior. Though a

relationship between “political pathologies” and foreign aid loans, for example, might be proved, it is not clear that the foreign aid is the cause (305-306). As such, the following review is by no means comprehensive, and simply looks at how various non-traditional sources of state income have been evaluated in the literature.

Renewable Energy

The Itaipú and Yacretá treaties between Paraguay, Brazil and Argentina, and subsequent completion of the dams in the 1980s spurred a flurry of scholarly interest in the project, particularly in the fields of international law and international politics. Eliseo da Rosa’s (1983) article explores the economic and political determinants of the treaties in a historical context, and aptly identifies issues that would subsequently become a major issue for future Paraguayan politicians – namely renegotiating the compensation for the electricity sold to Brazil and Argentina. Though the article would likely benefit from a systematic theoretical underpinning to its analysis, it does provide compelling explanations for Paraguayan-Brazilian-Argentine cooperation in the project, especially with regard to the hegemonic role of Brazil in pushing forward negotiations, as well as the inability of Paraguay to balance Brazil through alliance with an economically and militarily weak Argentina. This issue was of particular interest in the similarities it showed with U.S.-Panamanian negotiations over the terms of the Canal Treaties, for in both cases the countries involved were highly unequal in terms of power. Unfortunately, few articles seem to have explored the topic recently, outside of journalistic accounts of Paraguay’s recent attempts to gain more economic benefit from the project and publications issued by the bi-national public corporations in charge of the dams.

Tourism

Tourism has received much more attention than the previous topic mentioned, but analysis seems to have been restricted to economic, development, and policy analysis. Though the articles examined here do not evaluate the political effects of tourism, they do reveal interesting potential for analysis. Gooroochurn and Sinclair's (2004) article, for example, evaluates how tourism taxes can serve as an important source of government revenues (supplying half of government revenue in the Bahamas, for example), and could provide an important vehicle for improvements in social welfare. They include a detailed list of existing policy measures designed to capture revenue from foreign visitors, as well as analysis of the economic and equity distortions caused by tourism taxation relative to taxing other sectors, concluding that the former are more effective in both areas. The Capó, Riera Font, and Rosselló Nadal (2007) piece covers ground highly familiar to students of the economic effects of resource wealth, exploring the application of the "Dutch disease" to tourism with a case study of the Spanish Balearic and Canary islands, finding both areas to have become increasingly specialized in the tourist trade, and leaving the economy highly vulnerable to potential changes in the number of visitors to the islands.

Similar to rents gained from more traditional resources, certain tourist taxation policies do seem to provide windfall gains to governments, given that they do not directly affect taxpayers, and thus could potentially have similar political effects (not to mention offering an attractive destination of study for researchers). Given that scholars are already beginning to tread down some of the paths explored by researchers of commodity resource rents, it is not out of the question that this may become an area of future research.

International Banking

Far and away the most explored of these “new” resources is international banking, for a number of reasons. Research on the domestic political ramifications of this industry has been outweighed by concerns on the development prospects and record of Offshore Financial Centers (OFCs). In addition, a great deal of research has focused on the challenges OFCs present to the international system, in terms of the potential for corruption and money laundering, but also for their role in undermining one of the traditional prerogatives of the nation-state: the right to tax its citizens. As Wescheler (2001) indicates, experts estimate that the United States alone may be losing up to \$70 billion annually through offshore tax evasion by individuals. In his article, the author examines the emergence of international regimes designed to police these developments, with a particular focus on the United State’s role in promoting this agenda, as well as OFC attempts to move the debate to a more favorable global arena, such as the UN General Council. OFCs present interesting challenges to generally-held international theories about power relationships between sovereign nations, as well as to the effect of globalization on the relationship between developing and developed states.

Abbott’s (2000) and Hampton’s (1996) articles instead take a case-study approach, focusing on the economic impact and political implications of OFCs on Labuan (Malaysia) and Jersey (UK), respectively. Both of these cases confirm Abbott’s (2000) differentiation of OFCs – which have low taxation rates, but include government oversight and regulation – from tax havens, which have little of either. The two case studies provide insight into the preferences of large nation-states in tacitly approving the creation of OFCs (Labuan is a Malaysian island, and Jersey, though largely

autonomous, is technically a dependency of the UK) and provide a generally rosy picture of the prospects for development through international banking, with little concern for corruption, criminal abuse and the domestic political effects of the industry. However, in small, independent countries without ties to a major sovereign power, these issues certainly could be of much greater concern. Future academic studies certainly will have to address this issue and create a theoretical framework for study, though the limited transparency of the data in these locations, along with the potential for personal danger, will present serious obstacles to those interested.

Crude Democracy

In terms of the relationship between resources and governance, Dunning's (2008) work seems to present the most theoretically plausible argument for the Panamanian case. His model is class-based, categorizing the rich and poor as unitary actors. Regime type is either democratic or authoritarian; and government policy involves setting tax rates and distributing rents (profits beyond that of "normal" returns to capital). The economy is also divided into two sectors: the state-controlled resource sector (rents are gained either through taxation of this sector or through direct control), and the non-resource, or "private" sector. Under democracy, elites can either support a coup – or not – once the tax rate and rent distribution has been set; under authoritarianism, the poor will either revolt – or not – following the implementation of the authoritarian government's policy set. An important additional variable is introduced here: the costs of the coup or revolution, which will have an effect both now and in the future.

In this model, the principal conflict caused by democratic government is not increased political representation, but the threat of the redistribution of wealth. Under a democracy, resource rents can play a major role in consolidation, for the availability of

resource revenue to the government mitigates the need for redistributive policies (simplified to taxation in his model). There is, however, also an opportunity cost to elites for being out of power, as they do not control the allocation of resources. These factors are also relevant under authoritarianism, for though the elite want to continue controlling the distribution of rents, the lessened threat of redistribution makes transitioning to democracy less costly. As Dunning (2008, 55) writes, “resource rents can underwrite democratic stability (or lessen the cost of democratic transition) by reducing polarization over economic policy and particularly over redistributive tax policy.” A key independent variable in his model is thus the amount of inequality in the private sector: with a higher level of inequality, elites will be concerned more about redistribution, increasing the importance of this variable; in countries where the non-resource sector is relatively equal, conflict will arise primarily over the control of resource rent distribution.

Another key variable lies in the distinction between resource-rich (RR) and resource-dependent (RD) states; in RR countries, though a large percentage of government revenue may be derived from a resource, it does not represent a large portion of overall GDP, while in RD countries, the resource is both the basis for government revenue and the overall economy. According to his model, RR countries are more likely to be democratic than RD countries, as the larger size of the “private” sector will make the level of inequality in this sector more important (Dunning, 2008).

The use of “coup” or “revolution” as a dependent variable is not particularly useful in the case of Panama over the period 1980-2010. Similarly, a dichotomous definition of democracy would not be an effective manner to test the political effects of Canal rents in recent history, as only one externally-induced regime change occurred. However, the

underlying theoretical propositions of Dunning's (2008) work do seem applicable. His conclusions are the following: resources are more likely to have a "democratic" effect when they a) represent a significant portion of government revenue, but a small portion of the overall economy; and b) the private sector is highly unequal. Per Dunning's theory, one would expect countries that fit such criteria to have a) relatively high level of social spending, primarily financed by rents captured from the resource, and b) a relatively low level of elite taxation. This would result in a higher level of democratic stability, decreasing the likelihood of authoritarian regression. In Chapter 4, I show strong evidence supporting these hypotheses in Panama. Though his models primarily test democracy as a dichotomous variable, Dunning (2008) warns that the quality of the democracy that arises in such cases may be far from desirable – hence his title, *Crude Democracy*. Chapter 5 of the thesis will present some of these concerns.

But Why Study Just Panama?

Given that many of the previous works mentioned utilize a comparative methodology to study of resources and their political effects, the decision to focus on a particular case study may seem somewhat puzzling. A justification for such an approach can be found in Eckstein's (1992) *Regarding Politics: Essays on Political Theory, Stability and Change*. In the book, the author elaborates on the advantages of the "crucial case study," defined as a case that "must closely fit a theory if one is to have confidence in the theory's validity, or conversely, must not fit equally well any rule contrary to that proposed" (Eckstein, 1992, 157). "Crucial cases," according to the author, may actually be the best approach in certain contexts, particularly in the study of macro-politics. Comparative study in such situations has some practical disadvantages – time, effort and money being the most obvious – and though preferable to case

studies in terms of range, tends to be more superficial. As Eckstein (1992) writes, “Inquiry into macropolitical units involves problems of scale and of sound comparison that point strongly toward crucial case study as the preferable method” (160). When attempting to evaluate the political effects of potential “strategic rents,” which are not only widely varied, but also may be difficult to quantify in terms of their contribution to government, this seems to be particularly true. An examination of the “most-likely” case thus seems to be a better approach. In Chapter 3 and Chapter 4, I will argue that Panama may represent just such a case, as the Canal provides the government with a quantifiable and important source of revenue. In addition, other factors, such as the ratio of Canal transfers to the overall economy and the level of inequality present in the country, suggest that the waterway is an especially good fit to test Dunning’s (2008) theory of the potential “democratic effects” of resource rents.

In sum, academics have examined the political effects of resource rents in a number of ways and come to vastly different conclusions. Research on strategic rents is in a much more incipient stage, and has not focused on how these sources of revenue may influence the political system. As mentioned in the previous section, the most appropriate way to examine this issue may be through the selection of a crucial case study: Panama. With this in mind, the thesis will now pass to a closer examination of the legal and political history of the Canal and Panama.

CHAPTER 3 HISTORICAL BACKGROUND

The Canal in Law

The Hay-Bunau-Varilla Treaty, 1903

As alluded to in the introduction, the first treaty governing the Canal's construction and operation was the Hay-Bunau-Varilla treaty of 1903. Previous to the signing of the treaty, Panama was a province of Colombia, isolated from the rest of the country by the Andes and dense Darién rainforest. Even today, no road exists connecting Eastern Panama to Colombia; at the beginning of the 20th century, it took longer for a rider on horseback to reach Panama City from Bogotá than a steamship from the eastern seaboard of the United States (Percy, 1998). Given this isolation, separatist sentiment arose in Panama from a combination of anti-Colombian feeling, the memory of Panama as an important commercial center, and sheer opportunism, as Colombia was severely weakened by the civil war. Without an army to back secession, however, Panamanian rebels turned to the United States. They found an "ally" in the figure of Philippe Bunau-Varilla, a French businessman with a major stake in the failed French canal project. Bunau-Varilla had his own motivations for the U.S. to build a Canal through Panama, as his company's concession to construct a canal was soon ending, and he hoped to be able to recoup at least a portion of his investment. An arrangement between the two was soon made: Bunau-Varilla would act as Panama's representative in discussions over the terms of a Canal treaty, though Panamanians would later argue that he was not given the authority to actually approve anything. In retrospect, the decision was not in the best interests of the revolutionaries, for not only did Bunau-Varilla negotiate a treaty extremely unfavorable to Panama, but signed it (Conniff, 2001).

The treaty granted the United States the ownership of the Panama railroad and installations the French had already put in place, and allowed for the U.S. construction of a Canal bisecting the country, beginning at Panama City on the Pacific and ending at Colón on the Atlantic (though the two cities would remain part of Panama). Several provisions in the text of the treaty were particularly troubling to Panamanians. After defining the geographic area to become the 10-mile “Canal Zone,” Article III grants the U.S. “all the rights, power and authority within the zone...which the United States would possess and exercise if it were the sovereign of the territory...to the entire exclusion of the exercise by the Republic of Panama of any such sovereign rights, power or authority” in perpetuity. Article VII expands U.S. authority even further, declaring that the “right and authority are granted to the United States for the maintenance of public order in the cities of Panama and Colon and the territories and harbors adjacent thereto in case the Republic of Panama should not be, in the judgment of the United States, able to maintain such order”.

Economic remuneration for the Canal concession would also prove unfavorable to Panama. Article XIV specifies an annuity of \$250,000 to Panama, to go along with a one-time payment of \$10 million (Yale, 2008).

Essentially, Panama thus not only gave up its sovereign power in the territory of the Zone itself, but also allowed the U.S. to intervene in any part of Panama for reasons of ‘public order.’ The vagueness of the language left the provision open to interpretation, and over the next twenty years, would be used along with the ‘Roosevelt Corollary,’ - which asserted the right of the U.S. to intervene to ‘stabilize’ Central American and Caribbean nations – to justify a number of U.S. military interventions in Panamanian

politics (Harding, 2001). The provision would stand until 1939, when the Hull-Alfaro treaty abrogated the article as part of the Good Neighbor Policy, and also slightly adjusted the annuity upwards for inflation (to \$400,000 per year) (Maurer, 2011). The location of the Canal, placed as it was next to the country's two major cities, was a constant reminder of the U.S. presence, and Panamanians found it difficult to even travel from one side of the country to the other. Needless to say, these issues would become a major cause of anti-American sentiment over the coming years.

The Filós-Hines Treaty, 1947

During the Second World War, the U.S. and Panama signed an agreement to allow for the construction and use of 134 military bases outside of the Canal Zone. Fearing that Axis attacks against the Canal would compromise the ability of U.S. warships to quickly cross between the oceans, the U.S. negotiated a five-year lease with the government of Panama to ensure the waterway's safety. By 1947, this term had expired, and the majority of the Panamanian public, including much of the legislature, was heavily against continuing the American presence. Despite these objections, Panama's foreign minister and the U.S. ambassador would sign a treaty extending the term of the lease for the bases already built, as well as allow for the construction of additional military installations.

In the words of scholar Thomas Percy (1998), what followed was "largest, most diverse, united, and focused political crusade in contemporary Panamanian history" (110). In light of extreme police repression of protestors, what began as a student movement became broad nationalistic opposition to the government and U.S. presence. As a result of the movement, legislators in the National Assembly failed to ratify the

treaty two weeks after it was signed, and within a month, the U.S. army had withdrawn from the bases (Gandasegui, 1993).

Though ultimately a failure and not directly related to the Canal, the treaty was significant in two ways to later laws regarding the waterway. On the one hand, it brought into the open widespread public sentiment, which had had little voice in the oligarchic democracies of early Panamanian history. In 1964, the 1947 protests would serve as a major inspiration for even more extreme riots that would cause a complete governmental collapse and eventually lead to the Torrijos-Carter treaties. In addition, the Filós-Hines treaty completely discredited the representative façade of Panamanian Democracy, and, ironically, made the National Police (later the army) the most powerful political actor in the country. Though the military would rule behind the scenes and later “democratically” during the 1950s (Police Commander Remón won the presidency in 1952), by 1968 the group was powerful and legitimate enough to take over direct control of the country (Ropp, 1998).

The 1964 Protests, 1968 Coup and 1972 Constitution

With the Cuban Revolution of 1959 galvanizing students, labor groups, and the poor in Panama, the ruling elite could no longer ignore the anti-US, nationalist sentiment present in the country. Throughout the latter half of the 1950s and 1960s, they would begin to push the United States for the renegotiation of the Canal treaty. Riots in 1959 had led to an opening of skilled jobs to Panamanians in the Canal Zone, but the population was no longer satisfied with piecemeal reforms (Harding, 2001).

In 1964, open confrontation broke out between Panamanian students and US marines over the symbolic flying of the Panamanian flag in the Canal Zone. This would lead to three days of riots, with US businesses and government buildings being looted

and burned. During this period, the National Guard would actually remain in the barracks. These events would have their desired effect, convincing the US to finally come to the negotiating table on the Canal, though even discussing the treaty would meet serious opposition in the US Congress. At the same time, however, police inaction during the riots would convince the US of the military's role as a "trustworthy" force, and \$3 million would be directed to the institution by 1969 (Harding, 2001). A year earlier, the army would depose Arnulfo Arias before taking office and suspend many civil liberties, leading to over two decades of military rule.

Under U.S. and international pressure, the military agreed to a gradual reopening of the political process and ratified a new Constitution in 1972, still the foundation of the government today (with various amendments). Certain aspects of the text are decidedly undemocratic: Article 277 recognizes General Omar Torrijos as the "Líder Máximo de la Revolución," entitling him to name the heads of most government bodies, including Ministers of State, the Electoral Tribunal, and Supreme Court judges (Asamblea, 1972). Most important in terms of issues regarding the Canal, however, was Article 310, which declared that any international treaty or agreement regarding the Canal, the Canal Zone, the construction of a sea level Canal, or a third set of locks would require ratification in a public referendum (Asamblea, 1972). This had important repercussions in the future, as both the 1977 Torrijos-Carter treaties and 2006 Canal Expansion Project required public approval. Despite its undemocratic origins, the 1972 Constitution thus clearly recognizes the Canal as part of Panamanian patrimony, and gives the people the right to have a say in how it is administered and used.

The Torrijos-Carter Treaties, 1977-78

Despite his being an autocratic ruler, many Panamanians will always regard General Omar Torrijos as a national hero, for he did what no previous government had been able to do: return the canal to Panama. Partly due to the stability of his position, and in part because of the United States' commitment to human rights and greater equity under the Carter administration, Torrijos was able to negotiate a gradual transition to a fully Panamanian waterway. Parties in both countries opposed the agreement for differing reasons, and Torrijos himself was not fully happy with its provisions, but the document was finally ratified by the U.S. Senate in 1978, and went into effect in the final quarter of 1979 (Ropp, 1982).

The treaties actually consist of two documents: *The Treaty Concerning the Permanent Neutrality and Operation of the Panama Canal*, which establishes the Canal as a politically neutral waterway, and *The Panama Canal Treaty*, which dictates the terms of the transfer of the Canal and Canal Zone to Panama (Conniff, 2001). The first part of the treaty is relatively straightforward, declaring the neutrality of the Canal in both times of war and peace, as long as vessels pay standard rates and commit no acts of hostility while transiting the waterway. In addition, it declares that no country but Panama will have military bases in the country following the conclusion of *The Panama Canal Treaty*, an issue of primary importance to most Panamanians (Full text included in LaFeber, 1989). Torrijos and critics of the treaty in Panama did dislike the lack of an expiration date for this section of the treaties, worried that the text could be used to justify a future U.S. intervention in the country (LaFeber, 1989).

The Panama Canal Treaty, on the other hand, touches on many issues controversial in both the United States and Panama. Though a far cry from what the

Panamanian government wanted, the new treaty increased the fixed annuity to \$10 million, with up to an additional \$10 million for operating expenses, and paid \$0.30 per net ton of shipping transiting the Canal. The operation and maintenance of the Canal was given to the PCC (Panama Canal Commission), headed by an American but involving Panamanians in the decision processes. In 1992, these positions would be inverted, with a Panamanian becoming the top administrator of the waterway. Most importantly, the treaty called for a gradual return of the Canal Zone to Panama, a gradual “Panamazation” of the work force, and total handover of Canal operations in the year 2000 (LaFeber, 1989).

In Panama, the (lack of) speed of the handover was a major point of contention, as were the terms of compensation for the Canal’s use. In the United States, the bill spurred the longest debates in Senate history, largely over Panama’s ability to operate and defend the waterway and over the necessity of giving up something that “belonged” to the United States. In the end, however, both Panama and the U.S. ratified the treaties, with the Panamanian legislature and national referendum approving the text in 1977 and the U.S. Senate ratifying the treaties a year later (Zimbalist, 1991).

The Ley Organica, 1997

After 20 years that included a new military dictator (Manuel Noriega), a U.S. invasion and a return to Democracy, Panama finally prepared to take over full operations of the Canal. The first step in the process came three years before the transfer, with the passing of the Ley Orgánica, or Organic Law, creating the Autoridad del Canal de Panamá (ACP). The document is an extensive one, including a number of labor and environmental protections, as well as the body’s responsibilities regarding the

Canal watershed, proper sanitation and the water supply for Panama City. In the interests of brevity, Chapter 3 will highlight only those sections relevant to the study.

One of the first articles establishes the Canal as a national good belonging to the people of the country: “El canal constituye un patrimonio inalienable de la nación panameña, por lo cual no puede ser vendido, ni cedido, ni hipotecado ni, de ningún otro modo, gravado o enajenado” (Asamblea, 1997). The national ownership of the waterway implied in the 1972 Constitution is thus written into law in the more modern document. Articles 4-11 dictate the function of the body – to maximize profit from the waterway – and its autonomy from the central government, as the ACP alone is responsible all financial, operational and administrative duties surrounding the Canal. The law defines an elaborate administrative structure, headed by a body of 11 directors appointed by the president and legislature, and also provides for the creation of an advisory group of domestic or foreign experts (in practice, members of the international shipping industry, port representatives, etc.) (Asamblea, 1997).

An interview with a prominent member of the International Shipping division of the ACP characterized the 1990s as a period of “revolution” in management, equating that period of time in the PCC to being in a university. According to the interview, the PCC knew little about its clients and the international shipping trade up until that time. With the creation of the ACP, this changed, as the administration now has a department for each sector of the shipping industry responsible for contacting customers and studying the shipping market for that product. Toll rates on different types of transports vary according to the product and the market for that product, taking into consideration

alternative transport routes (such as the Suez Canal, or transport by train across the United States) (Personal Communication, July 4, 2011).

The second and third sections of the document cover the financial aspects of Canal administration, including payments to the National Treasury. Article 39 establishes a fee to be paid per ton of shipping transiting the Canal, to be set by the ACP but greater than the sum received in 1999. In addition, Article 41 states that once covered the cost of operation, investment, modernization and expansion of the Canal, as well as any necessary reserves established by law, all profits derived by the ACP are to be transferred to the national treasury. To ensure the truth and objectivity of the organization's accounting practices, both an internal and external audit are called for in Article 40.

As time would show, the law has been largely successful in creating a modern, efficient administration for the Canal and in isolating the ACP from political interests or corruption. The organization has increased the profitability of the waterway to an enormous extent: in ten years of operation, it has provided more money for the Central Government than in all of the Canal's previous history. Though legally mandated floors set minimum transfers to the Panamanian government (first using 1999 as a baseline year, then 2005), my contact in the Shipping Department indicated that the ACP has an unofficial practice of increasing the amount each year (Personal interview, June 14, 2010).

The Canal Expansion Project and 2006 Referendum

The rationale for building a third set of locks has been in existence for a long time. The American administration made initial excavations for an expansion of the waterway as early as the 1930s, though the project was later scrapped with the onset of the

Second World War. The 1972 Constitution explicitly mentions the third set of locks project, and a tripartite commission of the United States, Panama and Japan during the 1980s concluded that the plan was the best way for the waterway to maintain its relevance in international shipping (ACP, 2006a). In earlier years, the primary motivation behind increasing Canal capacity was in order for the waterway to accommodate larger warships; today, the project looks primarily to accommodate “post-Panamax” container ships. At the time of the publication of the expansion proposal (2005), these vessels had become by far the fastest-growing and most important sector of Canal traffic, accounting for over 40% of the transits through the waterway. However, 27% of the container fleet was too large to transit the waterway, with that number expected to increase to 37% by 2011 (ACP, 2006b).

The expansion plan consists of three basic components: (1) The construction of a third set of locks; (2) The digging of access channels to the new lock systems; and (3) The widening and deepening of current channels, including the raising of the level of Gatún Lake, both through excavation and increasing the height of the Madden Dam. The project is expected to cost \$5.25 billion, with about half being used for the construction of the new lock doors. The ACP subcontracted the project out via a system of blind bids, with the organization accepting the least expensive offers. The project is accompanied by environmental and social impact studies, which include for the relocation of animals and squatters in affected areas (Autoridad, 2006a). Per an interview with Luis Ferreira, a senior engineer and spokesman with over three decades experience working for the ACP and PCC, the number of individuals illegally residing on the land is estimated to number less than a dozen (Personal Interview, June 14, 2011).

According to Ferreira and published progress reports, the project is currently ahead of schedule, and is to be completed in 2014.

As per the Constitution of 1972, a national referendum was required to approve the plan. Proponents of the expansion view the results as confirmation of public support for the project, as over 75% of voters approved the proposal (Resultados, 2006). Interviews with Juan Jované and Marcos Gandasegui, academics in Economics and Sociology at the University of Panama, raised some concerns over the referendum process, as the opposition to the proposal could not compete with the resources of the government in presenting the plan (Personal Communication, June 28, 2011; Personal Communication June 17, 2011). In addition, informal conversations with several Panamanians led me to believe that many citizens feel that they do not have the right to weigh in on issues regarding the Canal or the ACP. Without making too broad a generalization, people I spoke to gave me the impression that they feel that the ACP is “above” or “better,” than the rest of the country, part of Panama but not. Low voter participation in the referendum (only 43% of the eligible populace voted) seems to back up this theory (Georgetown, 2006).

The construction plan has come under criticism from various sectors. Felipe Len Rios, a former head engineer for the PCC, raised several points regarding the safety of the new lock systems and their cost. In the current system, locomotives on either side of the lock compartments are responsible for stabilizing transiting ships. This method has its own drawbacks in terms of fuel efficiency and the stress the trains place on the concrete islands they run on, which often fissure and initially had to be reinforced by work crews pouring concrete into the cracks. Len Rios was responsible in the 1980s for

designing ready-made concrete panels, complete with a section of railroad track, as well as a system of controlled explosives to remove compromised sections of the islands. The ready-made panels could then be set into place by crane, greatly speeding up the repair process.

In a personal interview, Len Rios criticized several points of the new lock systems. Water is to fill the new chambers from the sides, rather than from the bottom as in the current system, which he alleges may cause instability in the large ships transiting the locks. This could potentially lead to costly damage to the boats, which the ACP would be responsible for paying. In addition, the chambers will use tugboats rather than locomotives to stabilize the ships in the lock chambers, reducing their carrying capacity. To solve these issues, Len Rios designed a system of electromagnets, to be placed at the bottom of each lock, which he presented to the ACP. Though it is unclear whether an electromagnetic system would work in practice (the ACP rejected the plan due to uncertainty over the effect a large magnetic field would have on the hulls of the boats), the issue of instability and the decreased capacity due to the use of tugboats are legitimate concerns not addressed in the Plan Maestro.

Perhaps most troubling, however, is the issue of water. The reservoirs used by the Canal also serve as the principal supply of water for Panama City, so conservation is a major issue. The proposed lock systems are accompanied by recycling basins, unlike the previous ones, which simply flush the liquid back into the Canal and eventually out to sea. Despite being much larger, the new locks will use the same amount of water; even so, their construction means that the Canal will use twice as much fresh water as it does currently (Autoridad, 2006b). Given a growing metropolitan population (between

2010-2015, urban areas are expected to grow by 2.3% annually, while rural areas are projected to contract by 1.2%) and the uncertainties of climate change, this could prove a major problem (U.N.S.D.). The Canal's greater capacity will mean little if there is not enough water for the larger ships to transit.

One of the most common critiques of the expansion plan is its cost. The project is to be half funded through ACP reserves, with the other half coming from loans taken out by ACP, not the national government. Eric Jackson, editor of the Panama News, questioned the right of the ACP to have those reserves, for they predated public approval of the Canal expansion project (Personal Communication, June 25). As mentioned earlier in the discussion of the Ley Orgánica, the law does give the ACP the right to accumulate reserves as it sees fit; at the same time, the Constitution stipulates that the Panamanian people would have a say in any discussion about creating a third set of locks. While the fact that the ACP had created a savings fund for the expansion program says much about the organization's foresight and planning, it does call into question the body's respect for the general public's say in Canal matters.

Questions about the accuracy of cost projections have been raised, as some experts argue that the final cost of the expansion will be much higher than \$5.25 billion. An article in The Council for Hemispheric Affairs (COHA) also raises questions of corruption in the bidding and construction process. The group that won the contract to build the new set of locks made an offer of over a billion dollars less than any other company, suspicious in itself. When compounded with the fact that the consortium includes a Panamanian construction company that is led by the cousin of the head ACP administrator, foul play seems even more likely. Wikileaks documents show concern

even in the Panamanian government itself over the ability of the company to build the locks. As cited in COHA,

Vice President Varela told Congressional Delegation member U.S. Representative Pedro Pierluisi of Puerto Rico that the consortium was “very weak” and that he had “real doubts” about its ability to perform according to specifications. Separately, Varela said to the Deputy Chief of Mission, “You don’t mess around with something as important as the Canal. When one of the bidders makes a bid that is a billion dollars below the next competitor, then something is seriously wrong. Of course I hope for the best, but I’m afraid that Alberto [Canal administrator Alberto Alemán] has made a big mistake.” According to the same cable, President Martinelli expressed similar doubts in a conversation with U.S. Ambassador to Panama Barbara J. Stephenson on the margins of a GOP presentation to a congressional delegation on January 4, 2010. When the Ambassador asked how he thought the canal expansion project was going, Martinelli grimaced and indicated that he was a bit worried. He said that he feared that Canal Administrator Alemán might have favored the consortium that included CUSA, which is run by his cousin Rogelio Alemán (COHA, 2011).

If true, these allegations are a problem indeed, for as the Vice President is quoted as saying, one doesn’t “mess around” with something as long-term as the Canal expansion. These issues could have grave repercussions on the Panamanian government and society as a whole, as the government receives a significant portion of its income from Canal revenue, and as will be seen in the following section, has pledged to follow a national development plan partly funded by this money.

The Concertación Nacional para el Desarrollo, 2007 and the Ley 34, 2009

Partly as a response to some of these issues, the Panamanian government requested that the United Nations help organize a national conference representative of all Panamanians to discuss and plan long-term development goals. The meetings consisted of representatives from most groups of Panamanian civil society and government, including individuals from each region, indigenous groups, human rights advocates, environmentalists, businesses, lawyers, judges and many others.

Representatives were divided into one of seven broad topics: Equity and Well-being; Economic Growth and Competitiveness; Education; Institutional Modernization; Ethics, Justice and Citizen Security; Health; and issues regarding Rural and Indigenous Provinces.

The result of the conference is the *Acuerdos de la Concertación Nacional para el Desarrollo*, a nearly 200 page document spelling out the country's plan for development in the next 20 years. As can be imagined, the accords spell out a vast number of goals, both specific and more general. The educational plan, for example, calls for achieving full and obligatory school enrollment for those under 14 by 2025, with a focus on marginal urban, rural and indigenous areas. Achieving greater transparency is a consistent institutional objective, while the goal to turn Panama into a financial and maritime hub pervades the economic agreements. The document also creates an official government body, the *Consejo de la Concertación Nacional para el Desarrollo*, whose responsibility it is to track progress on the development plan and publish periodic reports, to be made publicly accessible. In practice, however, I was unable to locate any publications since a *Memoria de la Concertación* in 2008.

In terms of the relationship of the national development project to the Canal, the *Acuerdos* are important in that they call for 35% of the transfers from the waterway to be used in achieving the national development plan. In the period up until 2009-2014 (pre-expansion) these funds are to be no less than \$350 million per year; in the ten years following, \$500 million. Between 2015-2025, the total contribution of the Canal to projects related to the *Acuerdos* is fixed at a minimum of \$10.735 billion, meaning that

in practice, at least according to the financial plan, yearly payments must be significantly more than the half billion mentioned (Consejo, 2007).

In 2009, the National Assembly passed the *Ley 34*, or *Ley de Responsabilidad Social Fiscal*. Article 24 of the document approves into law the provisions regarding the Canal described in the *Acuerdos*. For the period up to 2014, the law also makes available \$185 million from the Fiduciary Fund for Development (created from the sale of various public corporations in the 1990s) and up to \$815 million from the sale of government fixed assets. In the following ten years, however, the only specifically earmarked funds are those stemming from the Canal (Asamblea, 2008).

Though the democratic nature of the *Concertación* and the inclusion of civil society in creating a national development plan are laudable in themselves, there are some serious flaws in the accords regarding the contribution of funds from the Canal to the project. To begin with, the size of the document and the number of goals it contains mean that in practice, Canal funds could be used to justify just about any government expense. Under the agreement, buying new computers for government offices would be just as valid as funding increased school supplies or maternal health programs.

Perhaps most troubling, however, are the problems of accountability and transparency. Despite being promised to achieve certain goals, Canal revenue is not differentiated in the government's official statistics. Confounding the issue is the fact that the ACP operates on the American fiscal calendar (with the fiscal year ending in the fall), while the government operates using a January-December calendar year. The reported Canal income is thus different depending on the source. Even taking the government figures as accurate, once the transfers enter the budget they mix with all

other government revenues, so there is no way to truly know where the funds are actually used.

Though that would be fine in a vacuum, if a government is truly serious about earmarking certain funds to be used in specific programs or objectives, it should be able to show where that money has been used. In interviews with government representatives, including the Executive Secretary of the *Consejo de la Concertación Nacional para el Desarrollo*, Jaime Jacome, officials expressed frustration over this fact and were unable to say exactly what programs the Canal helped fund (Personal Interview, June 28, 2011). In discussions with statisticians employed at the *Controloría General de la República*, the pressing need for yearly internal audits of the government's finances was continually expressed (Personal Interviews, June 29, 2011).

A need for extensive accounting reform, as banal as it seems, is thus one of the most necessary steps for the state to take. The lack of such a system leads, on one hand, to a great deal of potential for corruption. The millions alleged to have been stolen from PRODEC (Programa de Desarrollo Comunitario), a government initiative aimed to foster development projects in rural and marginalized areas, provide a perfect example. In a 2010 article by *La Prensa*, the Secretary of the Counsel for Transparency alleged that “many businesses that carried out different social projects charged (for their services) even before finishing the contracted works,” and is reported as having filed an official denunciation against the Public Ministry for the misuse of \$380 million (Pinilla, 2010).

On the other hand, the lack of accountability also hampers the ability of honest individuals to properly fulfill their positions. By all indications, the individuals I spoke with

at the *Controloría* took a great deal of pride in their work and repeatedly expressed their frustration over the lack of proper accounting methods (Personal Interviews, June 29). Taking their case as an example, it is clear how widespread institutional problems not only allow for bad behavior, but also hamper the efforts of those who mean well.

In sum, legal documents demonstrate that the Canal has been a focal point for conflict throughout its history. During the 20th century, the battle was primarily a disagreement between states, though as early as 1972, the Canal was already being acknowledged as part of Panamanian patrimony, belonging to all Panamanians. Following the waterway's transfer to Panama, the primary disagreements are over the use of these funds themselves. As the *Concertación Nacional para el Desarrollo* and the *Ley 34* show, some progress on making the distribution of Canal funds more equitable has been made, but much remains to be done.

With this legal background on the Canal, its administration, and its relationship to government and Panamanian society as a whole, the thesis now moves to a brief examination of the country's political system and its leaders. As the following section will show, the period 1980-1989 is characterized by two distinct military governments. In the following 20 years, democratic rule is the norm, with four successful transitions in power. Despite differences in party and rhetoric, however, these presidencies will be shown to have been largely similar in terms of actual policy.

Politics

In the early morning hours of December 20, 1989, over 27,000 U.S. soldiers invaded strategic positions in Panama to remove the military dictator, Manuel Antonio Noriega, from power. U.S. President George H.W. Bush would justify Operation Just Cause, as it would come to be known, as necessary to "restore democracy, safeguard

American lives, and protect U.S. rights under the Panama Canal Treaty” (quoted in Harding, 2011, p. 176). Within two weeks, Noriega would turn himself over to U.S. forces, and, for Panamanians, over 20 years of military rule would come to an end.

Despite U.S. success in achieving its immediate objective, the resulting economic and political picture did not look favorable for the incoming Panamanian government. Not only had the economy been poorly managed under the military regime, but U.S. sanctions from 1987-1989 had crippled the country economically. Up to several thousand Panamanians died during the invasion, and more than 25,000 people were left homeless. All in all, the sanctions and the invasion were estimated to have cost Panama anywhere from 3-10 billion dollars (Zimbalist & Weeks, 1991).

Given Panama’s recent history, most outside observers expected the fragile democratic government to quickly collapse, as had been the case so many times before. Though the military had been dismantled following the invasion, former military officers held important positions in the police force, and several failed coup attempts during Panama’s first post-invasion presidency did little to inspire confidence in the fledgling regime. Contrary to these expectations, however, what would come next would be over two decades of uninterrupted democratic rule, including four peaceful transfers of power (Ropp, 2011a, p. 333).

In the following sections, Chapter 3 will examine Panamanian leaders since 1980, including the economic interests of the groups they represent and the economic and social policies instituted during their terms. To understand some of the constraints and challenges these governments faced, however, a brief background of Panama’s political and economic history is necessary.

Early Political and Economic Groups

Contrary to most Latin American nations, Panama did not have a significant landed oligarchy, as the strategic location of the country lent itself to commerce rather than intensive agriculture. The early period of the 20th century was dominated by this largely white, urban commercial class, which preferred pro-business, laissez-faire economic policies and small government, as well as close ties to the U.S. Unfavorable economic conditions during the 1920s and 1930s, however, would provide serious challenges for this group. Complicating the issue was the pervasive presence of the U.S. and the Canal enclave – in essence, a U.S. colony dividing Panama in two – which also employed primarily West Indian labor. Arnulfo Arias would capitalize on the nationalistic and xenophobic sentiment present at the time, uniting disenfranchised Panamanian mestizos and blacks, who resented the close U.S. ties of the commercial elite and English-speaking blacks. Arias's party looked to open up opportunities to mestizo professionals and Panamanian laborers to the higher-paying jobs associated with the Canal and sought to distance Panama from automatic alignment with the U.S. (Ropp, 2011b). Though elected to the presidency multiple times, Arias would never complete a full term, as his antagonistic stance towards the United States and later the Panamanian military would lead to coups removing him from office. The latter would gradually emerge as the dominant political actor beginning in the 1950s with José Antonio Remón and culminating in the military's takeover in 1968 (Ropp, 1982).

Military Rule

Most analysts divide military rule into two distinct periods: the years of Torrijos's rule, 1968-1981, and Noriega's rise to power following the former dictator's death in 1981. Torrijos was one of several officers who led the coup against Arias in 1968; by

1972, the new Panamanian Constitution would declare Torrijos the “maximum leader of the Panamanian Revolution” (Ropp 2011a, 331). In contrast to previous political leaders, Torrijos came from the interior of the country, considered himself a “man of the people,” and attempted to govern through an inclusive authoritarian regime along the lines of Mexico’s PRI. Particularly during the early 1970s, he took a progressive stance, greatly increasing government spending on infrastructure projects and social programs, and reforming labor laws to benefit the working class (Collazos, 1991). Torrijos would nearly double the number of government employees during the 1970s, increasing the public workforce from 55,578 in 1970 to 109,397 by 1979 (Mayorga, 2000). In the latter half of the decade, however, the burgeoning fiscal deficit would temper Torrijos’s ambitious agenda, culminating in an austerity agreement signed with the IMF in 1979, and resulting in a less antagonistic stance towards business (Zimbalist & Weeks, 1991). Torrijos’s most famous accomplishment, however, would come with the renegotiation of the terms of the Canal treaties with the United States in 1977. The new Torrijos-Carter treaties improved Panama’s economic remuneration for use of the Canal and called for the gradual return of the Canal and military bases to Panama, with full Panamanian control beginning in 2000. As a condition for the treaties, Carter stipulated the need for a democratic opening, which led Torrijos to plan a gradual withdrawal of the National Guard from politics and to create the PRD, or Partido Revolucionario Democrático. As mentioned before, this was an effort to institutionalize military rule along the lines of Mexico’s PRI and marked the beginning of a series of puppet presidencies under both Torrijos and later Noriega (Harding, 2001).

In 1981, Torrijos's death in a plane crash threw a wrench in the plans for this "guided transition," and ushered in the second phase of military rule. Noriega, head of military intelligence under Torrijos, would eventually emerge in 1983 as the head of the military dictatorship. Unlike his predecessor, he seemed to have little in the way of a national development plan, rolling back many of the progressive reforms Torrijos implemented and relying on government repression, including the murder of opposition members, to control the population. Instead, Noriega's primary concern was increasing his personal power and wealth. As described by Ambler Moss, the former U.S. ambassador to Panama, Noriega "was a person without any particular ideology. Although he did not have Torrijos's messianic sense of destiny in the world, he was driven by simple principles: power and money" (quoted in Harding, 2001, 156). In addition to being a covert CIA agent since the 1960s, Noriega received U.S. payments to aid the Contras in their struggle against the Sandinistas in Nicaragua. Concurrently, he turned the military's involvement in the drug and money-laundering business into a massive vehicle for personal profit: according to the Congressional testimony of one apprehended cartel member, he was paying Noriega \$10 million monthly for his services in money-laundering (Zimbalist & Weeks, 1991). By 1987, the U.S. had decided it could no longer tolerate the status quo, and imposed harsh economic sanctions on Panama in the hope that Noriega would be overthrown. Faced with economic crisis and public protests, Noriega employed increasingly draconian methods to remain in power, but by 1989, would be driven from office by the U.S. invasion (Harding, 2001).

1972 Constitution and Reforms

One final consideration before beginning an examination of Panamanian presidencies since 1989 is the 1972 Constitution implemented by Torrijos, which was reinstated following the U.S. military intervention. Drawing on the Iberian tradition, the document outlined three branches of civilian political institutions – Executive, Legislative and Judiciary – with a clear bias toward the presidency. Even today, the Legislature has little say in establishing law or policy or in approving the budget, and the Supreme Court rarely acts as more than a rubber stamp for the president (Harding, 2011). Only one round of elections is provided for, meaning that candidates can (and often do) win the presidency with a minority of the overall vote (Moral, 1992). Presidents serve five-year terms, and cannot be reelected until ten years after their term ends. The use of this document, written by Torrijos himself, creates serious structural problems, particularly in terms of the balance between the three branches of government. In addition, it undermines the legitimacy of democratic governments, as they justify their power through a decidedly non-democratic document. One significant amendment to the Constitution post-invasion was the abolishment of a standing military, though provisions were included to provide for the creation of a special police force in the case of external aggression (Harding, 2001).

Presidencies: Guillermo Endara, 1989-1994

On the evening of December 19, 1989, Guillermo Endara, the winner of the 1989 elections annulled by Noriega, was invited to dinner at a U.S. military base. Hours before the invasion, he was informed of the U.S.'s plans, and that evening, along with his two vice presidents, was sworn into office by U.S. Army officers. Given this inglorious beginning, it is of no surprise that Endara had little legitimacy in the eyes of

the public, who saw him as a puppet of the U.S (Harding, 2001). The candidate of the Panameñista party (the modern descendant of Arias's party) until his removal by a rival party member, Endara nevertheless won the presidency, with an estimated 62.5% of the vote, at the head of a minority-four party coalition (Garibaldi, 2009). He took office promising to aid economic recovery, bring the military under civilian control, and strengthen democratic institutions in the country. With the removal of Noriega, however, the coalition of opposition parties found that they had little in common other than opposition to the dictatorship, and alliances soon splintered. Inheriting a crippled economy and reliant on the removal of U.S. sanctions and the injection of U.S. financial aid, Endara had little room to maneuver when it came to domestic policy (Harding, 2001).

Endara's first move came against the PDF (Panamanian Defense Forces), which were reorganized into the PF (Public Forces), restructured into four independent units and placed under civilian command, in an attempt to break the military's political power and ensure police loyalty to the democratic government. However, without the ability to replace most of the members of the armed forces, most of these changes (at least initially) were in name only. What followed were a series of attempted coups – put down by the U.S. (further delegitimizing Endara) – that culminated in the eventual removal of all PDF members from the PF. Though this would help remove the threat to the national government, the new forces lacked extensive training and experience, and were viewed by the public as corrupt and inefficient. Ironically, Endara would also later use the PF extensively to control public protests. In addition, the president would appoint several former business partners as Ministers, leading to allegations of corruption and

nepotism. By 1992, Endara was so illegitimate in the eyes of the public that his call for a Constitutional referendum, however justifiable, was roundly defeated (Harding, 2001).

In retrospect, it is clear that Endara was put in an impossible political position, given the economic situation, his dependency on the U.S., the lack of public support for his administration, and the continued threat presented by the military. His success in depoliticizing the military cannot be undervalued, but on the other hand, he became increasingly authoritarian himself, and was unable to resist the temptations of personal power, corruption and cronyism. Given his record, it is of little surprise that voters would turn in a different direction in the following elections.

Ernesto Perez Balladares, 1994-1999

The 1994 elections were a turning point in the history of the country, as for the first time since 1968, Panama held free and fair elections. In a wide-open race featuring seven candidates, Ernesto Perez Balladares won the presidency with 33% of the vote as the PRD representative, governing at the head of a three party coalition. In order to distance the party from the Noriega regime, Balladares emphasized the party's Torrijista roots, relying on a populist, multi-class coalition of urban and rural workers, youth, professionals, and businessmen, among others. His campaign promises included fortifying democracy; investing in infrastructure, agriculture and social policies; privatizing inefficient government companies; and renegotiating the external debt (Garibaldo, 2009). Other promises included an overhaul of the National Police, still viewed as inefficient and corrupt.

As his first move, Balladares looked to strengthen his mandate and reduce inter-party conflict by appointing opposition members to four of the twelve cabinet ministries, in addition to the post of Attorney General. As time progressed, Balladares abandoned

his social agenda to focus primarily on the issue of foreign debt, which in 1994 was the second highest per capita in Central America (only slightly behind Nicaragua), by selling off public enterprises and reducing government spending. Like his predecessor, the president also resorted to authoritarian tactics to put down dissent, letting loose the PF on both student and union demonstrators. Coupled with his close ties to Washington (Balladares even allowed some 10,000 Cuban refugees to be housed in the Canal Zone at the U.S.'s request), his proposal to grant amnesty to members of Noriega's military regime, and his use of gag laws to censor the press, his popularity began to precipitously decline. Furthering the trend toward authoritarianism and corruption, Balladares employed temporary powers to circumvent Congressional approval for ratification of Panama's admission to the WTO, increased the salaries of high officials significantly, ordered back payments to some of the most repressive members of the PDF, and called a referendum to reform the Constitution in order to allow for reelection. Again, the public overwhelmingly rejected the call for a referendum, with 64% voting against a reformulation of the country's most essential political document. Balladares also was favorable towards negotiating a continued U.S. military presence in Panama post-2000, which, needless to say, generated less than glowing reviews from the public. With U.S. funds, he also cooperated in the creation of a specialized police force designed to combat drug trafficking, leading to renewed fears as to the role of the police in Panama (Harding, 2001).

Inheriting a much more stable political and economic situation, enjoying much higher levels of public legitimacy, and lacking a clear threat to the regime, Balladares clearly had a wider range of policy options than his predecessor. Initially, he seemed set

to deliver on his campaign promises, but like his predecessor, chose a more strictly neoliberal path. In addition, he succumbed to the temptations of corruption, and increasingly relied on authoritarian tactics in order to control dissent. Unfortunately, this would continue to prove the rule rather than the exception for Panamanian presidents.

Mireya Moscoso, 1999-2004

With Perez Balladares unable to run, Mireya Moscoso, widow of the late Arnulfo Arias, won the presidency in 1999. Running on the Arnulfista ticket (as the Panameñista party came to be known), she defeated the PRD candidate, Omar Torrijos's son Martin, by a margin of 44.9% to 37.6%. Becoming Panama's first female president, she ran on a campaign of ensuring the Canal's independence from political manipulation, increasing investment in social programs including health, unemployment and education, reforming the judicial system, and halting the privatization of state enterprises (Garibaldo, 2009). Moscoso capitalized on the widespread public dissatisfaction with the Balladares regime by promising to roll back some of his neoliberal reforms and address the needs of Panama's poor, and by embracing a populist platform typically associated with the PRD.

In practice, however, change proved quite difficult. From the beginning, the outgoing PRD administration made the transition of power difficult for Moscoso, resulting in a great deal of political bickering between the two parties. Shortly before leaving office, Balladares also managed to push through legislation to pack the Supreme Court with his supporters and limit the President's authority over certain discretionary funds, weakening Moscoso's position before she began her tenure. Furthermore, once in power, the PRD majority in Congress proved uncooperative in working with her, and the economic climate and constraints imposed by the IMF offered

her little leeway to increase government spending (Harding, 2001). In 2000, she was able to fund less than 88% of her social budget, and for 2001, that number was estimated to have been even lower. In 2002, a corruption scandal in the PRD allowed her to regain a slim congressional majority and pass long-delayed legislation, including an IMF-backed tax reform and a bill allowing the sale of reverted properties to be used to pay for public works projects. Particularly damning to her image, however, were a number of corruption scandals plaguing her party and her modification of certain government accounting techniques, as well as electoral rules that allowed parties to choose their own methods of selecting candidates. This final move allowed her to position her former Finance Minister as her preferred Arnulfista candidate in the next elections, though he would be unsuccessful (Economist, 2004).

Moscoso's most significant achievement was to oversee the transfer of the Canal into Panamanian hands and the consolidation of the ACP (Autoridad del Canal de Panama) as an apolitical and semi-autonomous entity (Economist, 2004). Though not completely of her own doing, Moscoso's inability to fully deliver on her campaign promises undermined the President's popularity. Once again, this would lead to a rotation of the party in power, with the PRD retaking the presidency in the 2004 elections.

Martin Torrijos, 2004-2009

Running in his second consecutive election, Torrijos was able to take advantage of deep divisions with the opposition and widespread disenchantment with Moscoso and the Arnulfista party. With over 47% of the vote, he defeated his closest rival, former President Endara, by almost 17%. Torrijos's electoral platform included improving security and combating rising crime; expanding social spending, including in education,

rural areas, and health; restructuring the inefficient social security program; a focus on infrastructure development and community and grass-roots programs; and the continued reforms of the political and justice system (Garibaldo, 2009).

Buoyed by a dynamic economy – with GDP growth estimated at over 11% in 2007 – Torrijos enjoyed high levels of public approval during the beginning of his term. This aided his goals of reforming the social security program, which had been steadily losing money, and establishing fiscal discipline, which had grown lax during the Moscoso presidency (Economist, 2008). In addition to general increases in social spending, he invested in new programs aiming to combat extreme poverty in rural areas, including the Red de Oportunidades Conditional Cash Transfer program. Torrijos will best be remembered, however, for pushing through the 2006 national referendum for the Canal Expansion Project (Ropp, 2011a).

Near the end of his term in office, however, Torrijos's popularity began to decline, as the price of basic necessities rose significantly, drug-related crime continued to rise, and allegations of corruption tarnished his party. Party infighting did little to help the PRD's chance at reelection, nor did the eventual selection of Balbina Herrera, a former Housing Minister with ties to the Noriega government, as the candidate. As in previous experiences, the incumbent party once again lost power, though this time, its replacement would be something of a surprise.

Ricardo Martinelli, 2009-Present

Unlike his political predecessors, Ricardo Martinelli represented a break from the traditional PRD and Panameñista leadership. After making millions of dollars as a supermarket magnate, Martinelli held various high posts in the previous two governments. As the candidate for Cambio Democrático (CD), a party he created in

1996, Martinelli formed an alliance with the Panameñistas and won the 2009 election in a landslide. With a booming economy, drastic increases in government Canal revenues, and the CD and its allies taking a legislative majority in Congress, Martinelli was in a particularly strong position to pursue his economic and political goals. Though the Panameñistas would later abandon the coalition, mass defections to the CD would once again result in a legislative majority for the President. As can be imagined given his background, his agenda included a strong pro-business orientation, including an effort to transform Panama into a regional transport and communications hub, and a strong stance against rising crime (Economist, 2011). October 12, 2011 saw the U.S. ratification of a Free Trade Agreement (FTA) with Panama, which is expected to benefit the economy as a whole, though certain sectors, in particular domestic agriculture and industry, may be adversely affected (Sullivan & Rivas, 2009). The president also finalized what experts called a highly overdue tax reform targeting the regressive Panamanian tax system (Gambotti, 2010; Parillo, 2010). Thus, Martinelli has tempered his policy with an expansion of many of the social policies instituted under Torrijos (Economist, 2011). In addition, Martinelli has created several highly publicized social programs of his own, including 100 hasta los 70, a program transferring 100 dollars a month to senior citizens lacking pension plans.

Despite high levels of public approval, however, both academics and media sources have noted several troubling tendencies of Martinelli's administration. In 2010, Martinelli used the National Police to break up union strikers, resulting in the deaths of two protesters, and he has persistently attacked media freedom in the country (Burnette & Salzburger, 2010). A more recent article brings to light corruption allegations

surrounding the president himself, as well as several other dubious transactions involving Martinelli's close associates. Even more troubling are seeming improprieties associated with the Canal Expansion project, especially given the billions of dollars Panama has invested in the undertaking, not to mention the millions other countries are spending to modernize ports in anticipation of the project's completion (COHA, 2011). In addition, analysts predict that he may attempt to extend the term limits imposed by the Constitution, though polls seem to indicate that voters would reject such a proposal in the case of a national referendum (Economist, 2011).

In sum, Panama's political history shows little in the way of a clear divide in terms of ideology. The military, though undemocratic, was fairly progressive during its early years and increased the level of social expenditure dramatically. After Torrijos's death, this stance was largely abandoned, and government became increasingly authoritarian. Since the U.S. invasion, political leaders have all belonged to a small clique, aside from the current President, and do not show a great degree of variation in terms of their rhetoric or policy. All presidents have largely pursued a neoliberal path in terms of the economy, while increasing social expenditures to aid those left behind. *Personalismo*, rather than any deep divides in ideology, thus seems to be the norm in Panama.

In contrast to this deeply flawed political system, at least for most of the recent past, has been the administration of the Canal. During the 1980s, when the corruption and inefficiency of the Noriega government began to hinder the maintenance of the Canal, the long-term viability of the waterway was seriously threatened. During the 1990s, however, the Canal was able to get 'back on track,' and fresh off the experience of nearly losing their national resource, Panamanian politicians intelligently created

safeguards to insulate the ACP from the rest of the government. Recent events, however – particularly the allegations of corruption regarding the Canal expansion project – suggest that this may not be the case in the future, which could potentially profitability in the future.

Having concluded the literature review and legal and historical background, the thesis will now move present the statistical information used to test the hypotheses presented in the introduction. To reiterate, these questions and hypotheses are:

Question 1: What is the relationship between Canal revenues and social spending rates?

- a) Is there a difference between military and democratic governments?
- b) Is there a difference between the various administrations of the Canal?

Hypothesis 1: Canal revenues have had a positive relationship with spending on government social programs.

- a) Canal revenues have a positive relationship to social spending under both military and democratic governments.
- b) Canal revenues have a positive relationship to social spending under all administrations of the Canal.

Question 2: How does the historical correlation between Canal revenues and social expenditures compare to rates set in recent Panamanian law (*Ley de Responsabilidad Social Fiscal*, 2008) earmarking Canal revenue for development goals?

Hypothesis 2: The historical correlation between Canal revenues and social expenditure will be similar to the rates set in the law.

Question 3: What is the relationship between Canal revenues and stability?

Hypothesis 3: Canal revenues have promoted stability under both authoritarianism and democracy in Panama.

CHAPTER 4 RESULTS

Quantitative Analysis

With these hypotheses in mind, the thesis now passes to a statistical examination of the relationship between Canal revenues and the social expenditures of the Central Government. In Figure 4-1, I present information on the amount of Canal transfers in the years 1980-2010. In order to account for inflation, monetary values are calculated in constant 1980 dollars.¹ Over the first twenty years of the period, Canal revenue essentially remains static, increasing from \$74.385 million in 1980 to just \$74.9 million in 1999. The exceptions to the trend are the years 1988 and 1989, when transfers dwindled to \$16.4 million and \$2.3 million, respectively, as the United States suspended payments to the Noriega government. Since 2000, however, the rate of increase in the profitability of the waterway has been astounding. Over the ten year period, the ACP has more than quadrupled the amount of yearly transfers to the Panamanian government, from \$74.9 million in 1999 to \$328.4 million in 2010. The data seems to largely confirm the ACP's informal practice of increasing transfers to the government from year to year, even when accounting for inflation, with the only anomaly being the years 2007 to 2008, when revenue declined some \$30 million dollars.

Government social expenditures (reported in constant 1980 dollars) are calculated as a composite of funds spent on education, health, employment and social security, housing, and communal services. Over the period 1980-2010, the social budget shows a trend similar to the Canal transfers, though the truly explosive growth occurs somewhat later, in 2006. Between 1980 and 1989, the yearly government social

¹ Calculated using the Purchasing Power Calculator: <http://www.measuringworth.com/uscompare/>

expenditure actually declines slightly, from \$289 million to \$261 million. Between 1990 and 1999, the figures increase gradually, from \$265 to \$494 million. Over the next five years, the social budget largely stagnates, decreasing to \$491 million in 2005, before increasing dramatically over the period 2006-2010, reaching \$1.141 billion (Figure 4-2). Over the first 25 years examined, the yearly social expenditure increases by 170%; in the most recent five years reported, this figure is an astounding 230%.

In the following two figures, the thesis looks to establish the appropriateness of Panama as a case study for Dunning's (2008) theory. As mentioned in Chapter 2, the author's models predict that resource rents will be most likely to be used to fund social expenditures in countries with a high degree of inequality and a resource sector that represents a small figure of overall GDP. Figure 4-4 presents data on Canal transfers as a percentage of Central Government expenditures and GDP. Up until the year 2000, the Canal funded between 5-10% of the government's budget, with the exception being the previously-mentioned suspension of payments in 1988 and 1989. Since 2000, however, the Canal has generally represented between 10-20% of government revenue, peaking at a high of 28% in 2007. The rate of canal rents to GDP, however, is much lower, never exceeding more than 5% of the overall economy over the period.

Figure 4-3 presents the Gini Index – a widely-used measure of inequality in the distribution of family income – for the country over the period 1980-2000. The index uses a scale of 0-100, with zero representing perfect income inequality and 100 perfect inequality.² As Figure 4-3 shows, there has not been a great deal of variation in the

² Because the Gini index is calculated intermittently, several years are missing in the sample. The data presented in the year 1980 is from 1979, as the Gini Index for Panama was not calculated between 1980-1988.

index over the period. During the 1980s, income distribution became more unequal and remained essentially the same over the 1990s, before returning close to 1980 levels (48.74) in 2010 (51.92). To put these figures in perspective, Panama's 2010 Gini score, its most egalitarian since 1980, ranks the country as the 18th most unequal in the world (CIA, 2012). As these figures show, Panama thus presents an exceptional case study for Dunning's (2008) theory of the potential "democratic effects" of resource rents.

Spearman Correlations

Having established the appropriateness of the country to the model, two sets of statistical tests are run to address Question 1 and Question 2 of the thesis. Table 4-1 presents the degree of correlation between Canal transfers and Central Government social expenditures. Because the data does not have a Gaussian, or normal, distribution, Spearman correlations, designed for non-parametric statistics, are the most appropriate measure. Essentially, this statistical test measures to what extent one variable (in this case, social expenditure) increases as another (Canal revenue) increases.

The data is first presented for all years included in the sample, which display a nearly one-to-one (0.813) relationship between the variables at a strong statistical significance ($SS < 0.01$). The data is then split into the different forms of government and Canal administration. Possibly due to the small sizes of the samples, the periods of military government (1980-1989), the PCC (Panama Canal Commission, 1990-1992), and the CCP ((Comisión del Canal de Panamá, 1993-1999) fail to reach significance.

The democratic period (1990-2010) shows the highest degree of correlation, with coefficient of 0.848 ($SS < 0.01$), followed by the ACP (Autoridad del Canal de Panamá)

administration (2000-2010) with a correlation coefficient of 0.718 ($SS < 0.05$), and both the PCC and CCP administrations (1980-1999), with a coefficient of 0.484 ($SS < 0.05$).

In sum, what these statistics show is that over the whole period, changes in Canal transfers have been highly correlated to changes in social expenditure. Because of the small sample sizes, it is unfortunately not possible to compare the different forms of government, but there is some evidence that the form of Canal administration may have had an impact on how the funds were used. However, as the previous sections have mentioned, Canal revenues were a less significant percentage of government expenditures during the 1980-2000 period. In addition, many other variables – mismanagement of the waterway under Noriega, the U.S. invasion, and the effect of the national debt and foreign aid likely outweighed the effect of Canal transfers to the government coffers.

Unfortunately, Spearman Correlations do not measure directionality – in other words, they do not measure the effect of changes in one variable (Canal revenue) on another (social expenditure). Just as important, however, they do not control for the possibility that another variable may be influencing the nature of the relationship between the two, as mentioned in the previous paragraph. In order to account for these issues, multiple linear regression analysis was conducted.

Regression Models

In order to verify the effect of Canal transfers on social expenditures, I ran two OLS regression models including one dependent variable, social expenditures (in constant 1980 dollars), and a number of independent variables, including Canal revenues (also in constant 1980 dollars). Model 1 controls for three additional independent variables: inflation (measured as the annual percentage increase in

consumer prices), unemployment (measured as a percentage of the total labor force), and the Gini index³. Inflation, unemployment and inequality are generally considered drivers for social expenditures, though for different reasons. On the one hand, inflation is expected to have a negative relationship with government social expenditures, as governments are forced to curb spending in an attempt to get prices under control. On the other hand, inflation also usually affects the poorest members of society most acutely, as they may no longer be able to afford even basic needs such as food, water or housing, and thus could lead to an increase in the social budget. Unemployment is expected to have a positive relationship with social spending, with government expected to increase spending to meet the needs of those out of work. The Gini index is also expected to have a positive relationship to social expenditure: when inequality is high, some form of income redistribution usually occurs.

Ideally, these regression models would also account for two additional variables: GDP growth and growth in the government budget. Unfortunately, these variables could not be included in the regression model due to multicollinearity, or a high degree of correlation between the independent variables themselves. This issue causes major problems in regression, for though the results remain valid, the individual contribution of each variable cannot be distinguished from those independent variables with which it is highly associated. Canal transfers had an extremely high degree of correlation (with a Spearman correlation coefficient of over 0.9) with both GDP and Central Government Expenditures; as this thesis looks to isolate the effect of Canal revenues on social expenditure, those variables thus had to be omitted from the models. The strength of

³ Unemployment data from 1981 and 1982 was not available, so I used data from 1983 for those years; in years the Gini score was missing, I used data from the previous available year.

the association is somewhat surprising, but may be explained partially by the backward and forward linkages the Canal has with the economy at large. There are a large number of businesses and services associated with the Canal, including port facilities, container storage areas, locomotive freight services, and tourism. An increase in Canal traffic would clearly result in increased business for ports; vice-versa, an increase in port capacity, or efficiency, and thus more port transits would also result in an increase in Canal activity and thus Canal revenue.

Model 2 includes two additional independent variables: Official Development Assistance (ODA) (measured per capita) and Debt Service (measured as a percentage of Gross National Income). These variables are included to try to account for some of the specificities of the Panamanian case, as the country receives a large amount of foreign aid relative to its size (ODA includes both bilateral loans from developed countries and aid received from multilateral groups and NGOs). The debt service measure is included to account for some of the previously-mentioned difficulties faced by the governments following the U.S. invasion, as the military government incurred a large amount of debt during its tenure and halted payments in the period just previous to Noriega's removal from office. Conceptually, ODA is expected to have a positive correlation to social spending, as money oriented toward development projects often falls into categories associated with social spending. ODA is also expected to weaken the relationship between Canal transfers and the social budget, as the presence of another revenue stream directly tied to social programs could weaken the incentive for governments to use Canal revenues for those ends. Debt service, on the other hand, is expected to have a negative relationship with social expenditures: the more money a

government has to spend paying off loans, the less it likely has available for “non-essential” services such as literacy or vaccination programs.

Regression Results and Interpretation

With an explanation of these models in mind, the results displayed in Tables 4-1 through 4-6 can now be examined, with a primary focus on the relationship between the Canal and the social budget. Table 4-2 includes the most data points, covering the period 1980-2010, and shows the most robust results. In Model 1, the Canal is shown to have a strong positive relationship with social expenditures, with a coefficient of 1.943 and high statistical significance ($SS < 0.001$). When accounting for ODA and debt service in Model 2, the relationship remains statistically significant at the same level, and the regression coefficient declines only slightly, to 1.81. Interestingly, ODA is also shown to have a positive relationship with social expenditures at weak significance (ODA with a coefficient of 2.01 and a $SS < 0.1$).

Table 4-3 and Table 4-4 separate the period into military and democratic governments. During the military period (Table 4-2), only inflation is shown to have a negative effect on social spending in Model 1, with a coefficient of -3.092 at an $SS < 0.05$. In Model 2, however, inflation no longer remains significant. During the democratic period (Table 4-3), Canal revenues, along with the other variables, fail to achieve significance in either model.

These results suggest that separating the time period into the different governmental regimes may be inappropriate, and provide evidence for Part A of Hypothesis 1: the type of government does not matter. Table 4-1 shows that Canal revenues have a strong positive relationship with social expenditures over the whole period at an extremely high significance. When separated into military and democratic

governments, this relationship disappears. As more years or additional variables become available, this may change, but with the data available, nothing seems to suggest a difference between the type of government ruling the country.

Given that the type of regime in power does not appear to have an influence on how Canal transfers are used, the second set of regression models looks to test Part B of Hypothesis 1: Canal revenues will have a positive relationship with social spending under all administrations of the waterway. Table 4-4 thus examines the period of PCC administration (1980-1992), the years of PCC and CCP administration (1980-1999), and the ACP administration (2000-2010) of the Canal⁴.

In Table 4-5, Canal revenues reach a high level of significance in Model 1, with a $SS < 0.01$, and with a positive coefficient of 1.222. When accounting for the additional independent variables included in Model 2, the relationship is no longer significant. The models become slightly more robust when the years of CCP administration are included into the sample (Table 4-6), with the regression coefficient reaching 2.074 in Model 1 ($SS < 0.05$) and 2.579 in Model 2 ($SS < 0.1$). Paradoxically, debt service shows an inverse relationship to social spending to what was predicted, with an extremely high positive correlation coefficient of 6.593 ($SS > 0.05$).

Table 4-7 examines the period following the transfer of the Canal to Panama. Possibly because of the small numbers of years in the sample, Canal revenues fail to reach statistical significance. ODA and debt service display the expected relationship

⁴ Because of the limited number of years in the CCP sample (1993-1999), I was unable to run regression analysis on solely this period. Instead, I chose to run a separate model condensing both the PCC and CCP samples (1980-1999), as the most significant changes in the Canal's administration did not come until the transfer of the Canal to Panama in 2000.

with the social budget in Model 2, with ODA having a positive coefficient of 6.033 and debt service having a negative coefficient of -14.545 (both at an $SS < 0.1$).

To sum up the results of the regression analyses, strong evidence is provided for Hypothesis 1. Table 4-1 suggests a very strong relationship between Canal revenues and social spending over the entire time period at a high level of statistical significance. Separating the sample into the different governmental regimes does not provide strong evidence that there is much variation between how military and democratic governments have used funds derived from the waterway. Viewing the different administrations independently also seems to suggest that management does not matter, at least in terms of affecting the relationship between Canal transfers and the Central Government's social budget.

Quantitative Results Versus the Ley de Responsabilidad Social Fiscal, 2008

Hypothesis 2 postulates that the historical relationship between Canal revenues and social expenditure will be similar to rates set in the *Ley de Responsabilidad Social Fiscal* of 2008. Comparing the statistical results to the “earmarking” measures stipulated in the law is not possible directly. For one, the measures – correlation and regression coefficients versus a percentage – are different. A larger obstacle, however, lies in the afore-mentioned fact that the law does not specify to what degree different development goals should be funded by the Canal. The *Ley de Responsabilidad Social Fiscal* (2008) does include objectives that would be considered social spending, but also covers issues that deal more with modernization of the state and economy, as well as environmental protection.

That being said, the historical correlations and regression results do suggest that the earmarking measures may be quite low. The Spearman correlations showed that

Canal transfers and Central Government social expenditures have increased at nearly a one-to-one ratio between 1980-2010; regression results suggest that the Canal transfers over the whole period have an important and positive relationship with social spending. In comparison, applying 35% of Canal funds to development goals, many of which do not even fall into the realm of social expenditures, seems like a relatively minor contribution. Though Hypothesis 2 can thus not be rejected outright, evidence does suggest that there may be significant differences between the role the Canal has played in funding social expenditures and the payments stipulated by law.

The Canal and Stability

As mentioned in the introduction, an ideal way to measure governmental stability, at least for the purposes of this thesis, would consist of a political protest index measuring the number of demonstrations or strikes for the years examined. Such data would allow for the construction of a regression model testing the effects of social spending on unrest, as there would likely be extensive variation from year to year. Unfortunately, at least to my knowledge, no such data is available for Panama.

In the absence of a political protest index, international measures for state stability are available, including the World Bank's Political Stability and the Absence of Violence index, as well as Polity's State Fragility index. The drawback to these measures is that they do not lend themselves well to regression, as there tends to be little change in the figures, even over a long period of time.

The Political Stability and the Absence of Violence index uses a five-point scale that combines various measures of political stability drawn from surveys of firms and individuals, along with the assessments of commercial risk-rating agencies,

nongovernmental organizations and think tanks, and multilateral aid agencies⁵. As Figure 4-5 shows, Panama has been at, or slightly more stable than, the world average between 1996 and 2009. As mentioned previously, data is missing from two of the years in the sample, 1997 and 2001.

The State Fragility Index (SFI) covers a slightly longer time period (1995-2010) and has data for all years in the sample. The index combines data from various academic and international sources to measure political stability on a scale of 0-25, from least to most fragile. States are evaluated on both their effectiveness and legitimacy in each of four categories: Security, Politics, Economics, and Social Policy. As Figure 4-6 shows, Panama has shown a gradual improvement in both its overall score and its effectiveness between 1995 and 2010, moving from an SFI of 10 in 1995 to 4 in 2010. In terms of legitimacy, Panama's score has ranged between 5 and 3 over the period, and has remained unchanged at 4 since 2002. Panama's SFI score of 4 in 2010 classifies the country as being in the lowest rung of "low risk" countries; in the interest of comparison, the United States scores only one point lower in the same year (Marshall, 2011).

Though the two measures do have some variation – the SFI seems to portray a gradual progression to increasing state stability in Panama, while the World Bank measure indicates that stability has largely stagnated at just above the world average – both portray Panama as a relatively stable country since the mid-1990s, with no major shocks to the system over the period. Studies such as Dunning's (2008) and the SFI

⁵ The World Bank scale runs from -2.5 to 2.5, with 0 representing the world average. In the interest of consistency with other measures presented in the thesis, I converted this to a scale of 0 to 5, with 2.5 representing the world mean.

matrix itself suggest that social spending helps stabilize governments; given the regressions previously presented, it seems that Canal transfers have had a strong positive correlation with the social budget. Thus, though Hypothesis 3 cannot be verified empirically, circumstantial evidence does suggest that the Canal has helped to mitigate conflict in Panama, at least during the democratic period.

With Questions 1-3 of the thesis addressed, the next section Chapter 4 will look to examine qualitative issues about the nature of democracy in Panama. In particular, the thesis aims to show that though the Canal may have played a role in stabilizing democratic governments in the country, the nature of the those governments may be far from ideal.

Qualitative Analysis: “Deepening” Democracy?

Though the primary goal of this thesis has been to establish the relationship between the Canal, Central Government social expenditures, and stability, Chapter 4 concludes by presenting some qualitative concerns about the nature of the democracy that has emerged in Panama. Various international measures for assessing democratic performance are available, both through expert assessment and public opinion surveys. Without attempting to provide a comprehensive view of the matter, the thesis looks to establish that despite the relationship between Canal revenues and social expenditure suggested in the previous sections, democratic governance in Panama has not necessarily met expectations.

Figure 5-1 presents data drawn from Freedom House’s Political and Civil Liberties index, which utilizes a seven-point scale (from more to less free) based on yearly expert assessments. Political rights are defined as “rights that enable people to participate freely in the political process,” while civil liberties are “conceived of as freedoms to

develop views, organizations and personal autonomy apart from the state” (DataGov, 2012). Not surprisingly, Panama does poorly over the military period, with political and civil liberty scores actually worsening between 1980 and 1989. Over the 1990s, these numbers gradually improve until 2000, when Panama achieves the highest degree of political liberty and stagnates at 2 in its civil liberties score.

An interview with Juan Jované, an Economics professor at the University of Panama, disputed the extent of political liberty in the country characterized by Freedom House. In particular, he condemned electoral laws that made difficult for independent candidates to run for the presidency. In order to highlight these flaws, he ran an unsuccessful campaign for the presidency in 2009 (Personal communication, June 28, 2011). As the Burnette and Salzburger (2010) article shows, recent governments have also targeted the civil rights of unions and indigenous groups, with national police killing two protestors and wounding hundreds of others. Eric Jackson, the editor of the *Panama News*, highlighted a recent tragedy that, to him, symbolized the government’s opinion of its citizens. Apparently, some months before my arrival in Panama, a juvenile detention center had caught fire. As the media transmitted live coverage, members of the national police watched and even insulted those inside the building as they burned alive, locked in their cells (Personal Communication, June 25, 2011). Even an Economist (2011) country report, typically favorable toward the current business-oriented administration, notes a troubling trend of President Martinelli only responding to opposition and critiques when it comes through overwhelming public pressure, rather than democratic institutions.

The lack of improvement in the country's civil liberties score since 2000 may also be partially explained by the indicator presented in Figure 5-2. Freedom House's Press Freedom index is also based on expert analysis, and gives a composite score based on a consideration of the legal, political and economic environment surrounding the media in states surveyed. Countries are measured on a scale of 1-100, with scores of 0-30 classified as "free," 31-60 as "partly-free," and 61-100 as "not free."

The state of the media in Panama over the available time period has actually worsened, moving from a score of 27, or "free," in 1993 to a score of 44, or "partly free," in 2010. Particularly over the last decade, Panamanian governments have targeted whistleblowers in the media through the use of intimidation and libel laws. The Burnette and Salzburger (2010) article cites several cases in which journalists have been unfairly jailed, and concludes that despite recent progress partially decriminalizing defamation, "the regulations are still being used as a mechanism to silence journalists and intimidate those who are merely exercising the rights afforded them under the constitution."

One of the greatest obstacles to good governance in Panama today is corruption. As mentioned in Chapter 3, sources interviewed within government itself bemoaned the opacity of Panama's government, and highlighted the necessity of creating a system of internal audits of the government's budget. Miguel Antonio Bernal, one of the country's most famous dissidents during the military period and a former mayoral candidate in Panama City, criticized the patronage system present in Panama, particularly during electoral cycles. He alleged that presidential candidates often used government funds to pay citizens, especially in rural areas, for their votes (Personal Communication, July 7, 2011). In the *COHA* (2011) article, authors also shed light on the current president's

practice of distributing governmental land to political allies and friends. Marcos Gandasegui, a Sociology professor at the University of Panama, questioned the reliability of government data itself, contrasting the high level of educational expenditure recorded in official government documents with actual conditions in schools, which often operate without the most basic of materials (Personal Communication, June 17, 2011). As mentioned in Chapter 3, corruption may have even spread to the Canal Expansion Project, which could affect the profitability of the waterway in the future.

Quantifying corruption is obviously a difficult thing to do, given its very nature. Figure 5-3 and Figure 5-4 present data from Transparency International's Corruption Perceptions Index, which uses expert assessments to grade countries on a ten-point scale of most to least corrupt. Figure 5-3 presents Panama's score on the measure, which improves slightly between 2003 and 2010 (3.46 to 3.69). For comparison, data on Latin America and the Caribbean as a whole is included, and shows that despite Panama being one of the wealthiest countries in the region, it has been roughly at or below the regional average over the period. Figure 5-4 presents this data in terms of Panama's world ranking. Panama's ranking slightly improved between 2003 and 2010, from 66th to 73rd most corrupt out of 174 countries, and again, performs slightly worse than the regional average.

The final form of democratic assessment presented comes through public opinion surveys. Surveys do have their drawbacks and weaknesses, but viewed in conjunction with expert opinions, offer some interesting insights. Two such sources are available for Panama: the Latin American Public Opinion Project (LAPOP) and Latinobarómetro. Though LAPOP data does offer some interesting advantages in terms of the questions

surveyed, this thesis will present Latinobarómetro information, as the former survey has only been conducted biyearly since 2006, while the latter began in 1995 and is collected each year.

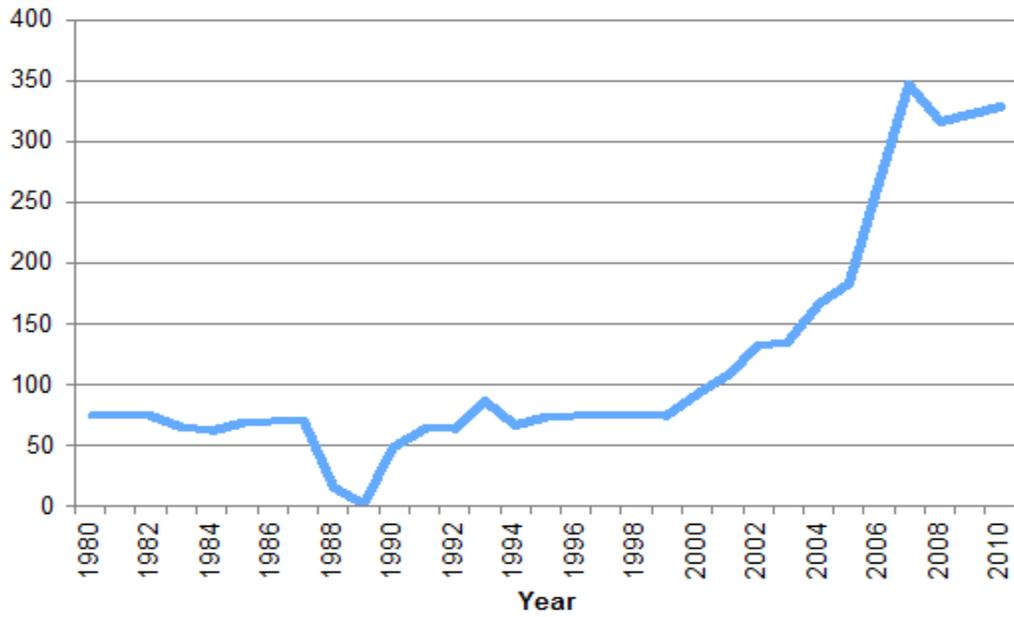
In choosing which survey questions to present, I was limited by two factors. First and foremost, not all of the questions were asked over the entire period, so I selected only those that gave at least several years of data (with one exception, to be discussed later). Secondly, I limited myself to questions that related principally to a citizen's perception of governance or institutions, rather than individual leaders. Unfortunately, Latinobarómetro only included questions about the presidency in the mid-2000s; in addition, the question asks about the performance of the President himself, not a respondent's opinion of the office.

Figure 5-5 presents percentages for the following topics: (1) Satisfaction (very or somewhat satisfied) with Democracy as a form of government; (2) Satisfaction with Democracy as it works in Panama; (3) Confidence (A lot or some) in Congress; (4) Confidence in the Judiciary; (5) Confidence in Political Parties; and (6) Percentage of respondents who would support a military government if things became more difficult. This last measure only has two data points (2005-2009), but the change is so significant that I decided to include it.

Support for Democracy as a form of government is consistently the highest measure, with nearly 75% support in 1996 and 64% support in 2009. The year 2001 does show a sharp decline to 34.3% in 2001, which is mirrored by a similar fall in most of the other topics surveyed. Satisfaction with Panamanian democracy is significantly lower, ranging between 20-40% between 1996-2008, until increasing dramatically to

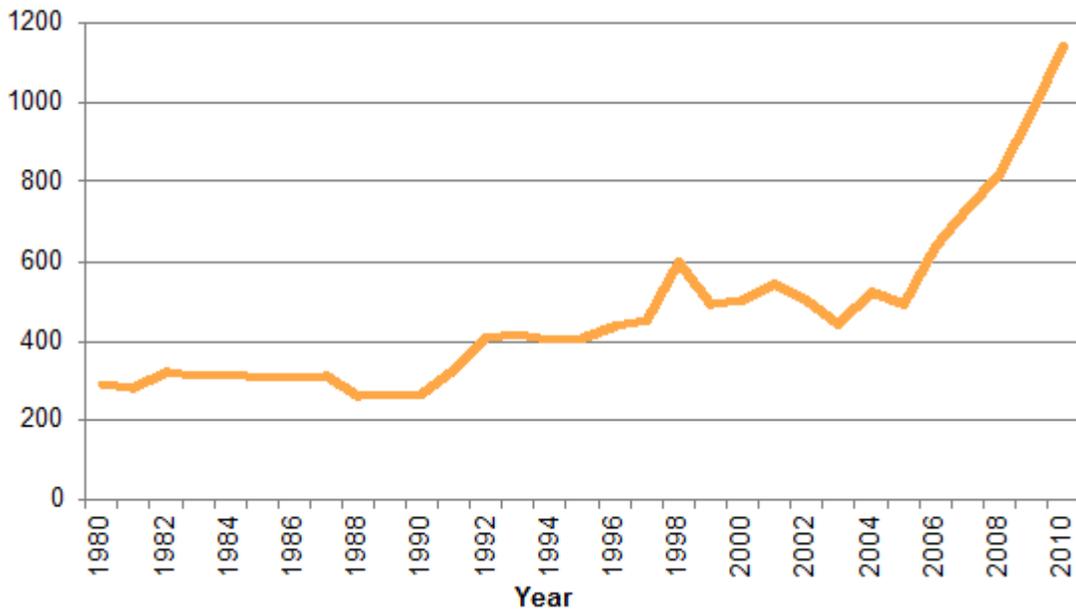
61% in 2009. Confidence in the Judiciary, Congress, and Political Parties are consistently the lowest measures, peaking in 2004. The last measure included – the percentage surveyed who say they would support a Military Government given worsening conditions – changes dramatically between 2005 and 2009. In 2005, only 18% of those interviewed responded positively to the question, while in 2009, over 70% indicated that they would welcome the return of the military to power in the face of strife.

Taken as a whole, these responses give a complicated and sometimes contradictory picture. On the one hand, support for the current form of regime, excepting an anomaly in 2001, seems quite strong, and support for Democracy as it works in practice seems to be improving. On the other hand, confidence in some of the most important institutions of the government is extremely low, and the number of respondents saying they would welcome a military coup in the face of deteriorating conditions has skyrocketed. This would seem to suggest that public support for democratic government is highly contingent on other factors, likely issues such as the economy, insecurity, and the personal charisma of the president in power. In any case, the results clearly do not suggest a highly consolidated and healthy democracy



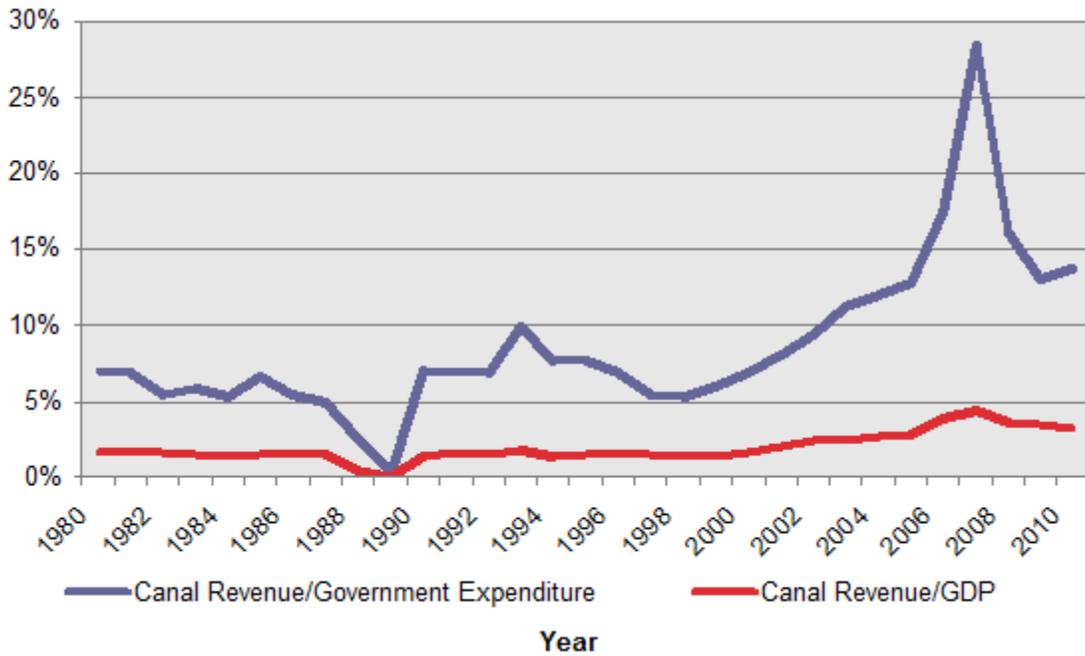
Source: Hacienda Pública 1980-2010, Contraloría General de la República de Panamá

Figure 4-1. Canal Revenues (Millions of US\$), 1980-2010



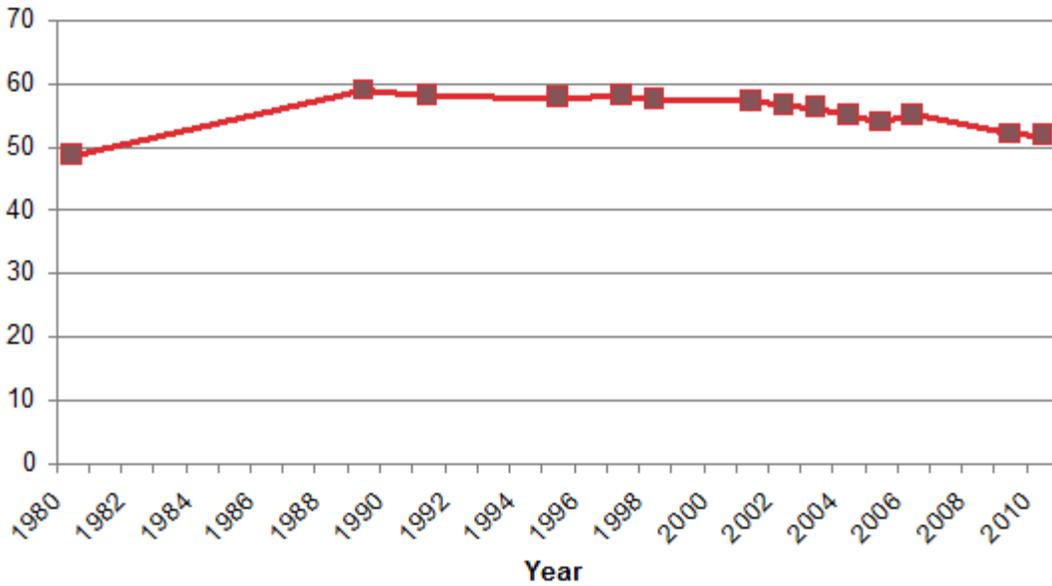
Source: Hacienda Pública 1980-2010, Contraloría General de la República de Panamá

Figure 4-2. Social Expenditures, 1980-2010



Source: Hacienda Pública 1980-2010, Contraloría General de la República de Panamá

Figure 4-3. Canal Revenues, Government Expenditure and GDP



Source: Panama, World Development Indicators 1980-2010, World Bank

Figure 4-4. The Gini Index, 1980-2010

Table 4-1. Spearman Correlations – Canal Revenue*Social Budget

Description	Time Period	Correlation Coefficients
All Years	1980-2010	0.813**
Military Government	1980-1989	0.248
Democratic Government	1990-2010	0.848**
PCC - US head	1980-1992	0.242
CCP - Panama head	1993-1999	0.36
PCC and CCP	1980-1999	0.484*
ACP	2000-2010	0.718*

Source: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá

**Significant at .01 level or less

*Significant at .05 level or less

Table 4-2. Social Expenditures Regressed on Canal Revenues, 1980-2010

Independent variables	Model 1	Model 2
Constant	-123.599	-715.234
Canal Revenues	1.943***	1.810***
Inflation	-7.614	-8.193
Unemployment	-3.46	-14.359
GINI	7.681	11.433
ODA/Capita	-	2.010*
Debt/GNI	-	-7.005
R Square	0.822	0.855

Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá
Panama, World Development Indicators 1980-2010, World Bank

***Significant at .001 level or less

*Significant at .1 level or less

Table 4-3. Social Expenditures Regressed on Canal Revenues, 1980-1989 (Military Government)

Independent variables	Model 1	Model 2
Constant	292.695	258.453
Canal Revenues	0.581	0.408
Inflation	-3.092**	-3.038
Unemployment	-3.081	-1.054
GINI	0.309	0.265
ODA/Capita	-	0.444
Debt/GNI	-	1.545
R Square	0.811	0.833

Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá
Panama, World Development Indicators 1980-2010, World Bank

**Significant at .05 level or less

*Significant at .1 level or less

Table 4-4. Social Expenditures Regressed on Canal Revenues, 1990-2010 (Democratic Government)

Independent variables	Model 1	Model 2
Constant	3298.176*	2498.543
Canal Revenues	0.239	0.342
Inflation	-2.036	-14.06
Unemployment	-25.803	-41.432
GINI	-43.769	-25.627
ODA/Capita	-	1.906
Debt/GNI	-	-6.905
R Square	0.809	0.848

Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá Panama, World Development Indicators 1980-2010, World Bank

*Significant at .1 level or less

Table 4-5. Social Expenditures Regressed on Canal Revenues, 1980-1992 (PCC Administration)

Independent variables	Model 1	Model 2
Constant	85.149	184.672
Canal Revenues	1.222***	-0.043
Inflation	-2.825	-4.058
Unemployment	-0.464	8.922
GINI	3.138	-1.406
ODA/Capita	-	0.05
Debt/GNI	-	10.38
R Square	0.44	0.741

Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá Panama, World Development Indicators 1980-2010, World Bank

***Significant at .01 level or less

Table 4-6. Social Expenditures Regressed on Canal Revenues, 1980-1999 (PCC, CCP Administrations)

Independent variables	Model 1	Model 2
Constant	-288.823	-313.864
Canal Revenues	2.074*	2.579**
Inflation	-6.797	-5.801
Unemployment	-5.993	10.212
GINI	11.22	7.516
ODA/Capita	-	-3.217
Debt/GNI	-	6.593**
R Square	0.594	0.748

Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá Panama, World Development Indicators 1980-2010, World Bank

**Significant at .05 level or less

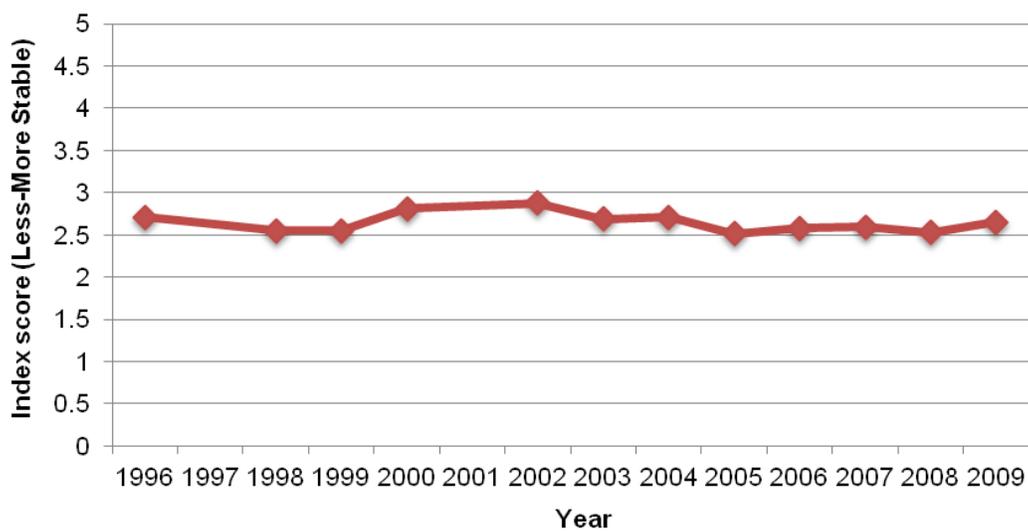
*Significant at .1 level or less

Table 4-7. Social Expenditures Regressed on Canal Revenues, 2000-2010 (ACP Administration)

Independent variables	Model 1	Model 2
Constant	3673.615	-782.016
Canal Revenues	4.761	3.076
Inflation	64.073	2.897
Unemployment	167.811	39.224
GINI	-106.695	8.56
ODA/Capita	-	6.033*
Debt/GNI	-	-14.545*
R Square	0.809	0.948

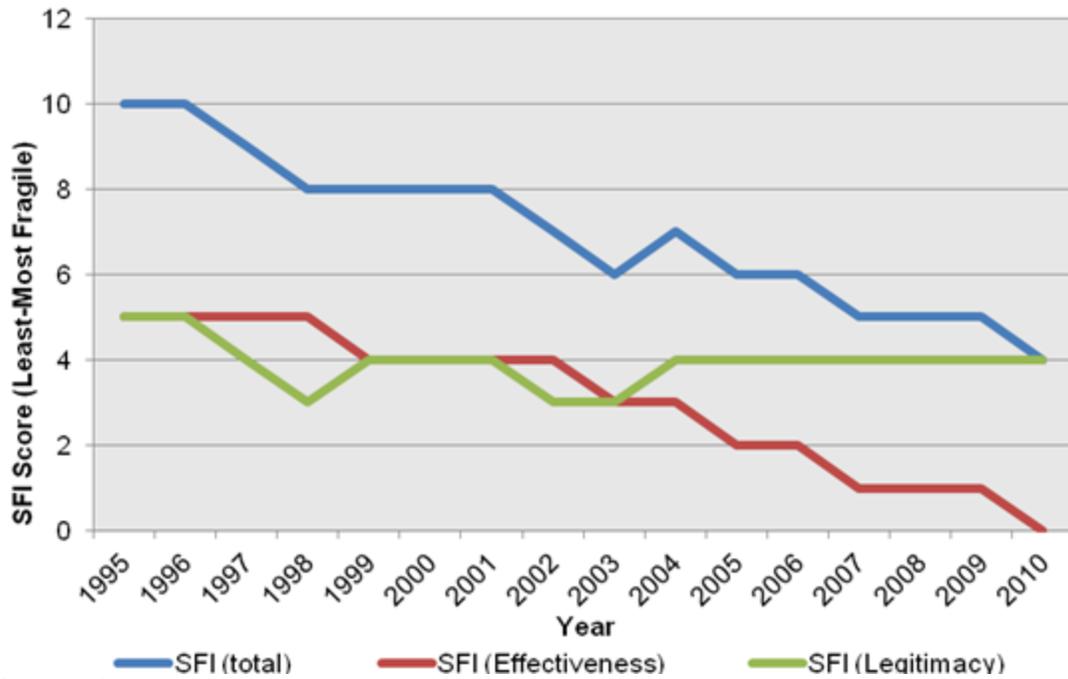
Sources: Hacienda Pública 1980-2010, Contraloría General de la República, Republica de Panamá Panama, World Development Indicators 1980-2010, World Bank

*Significant at .1 level or less



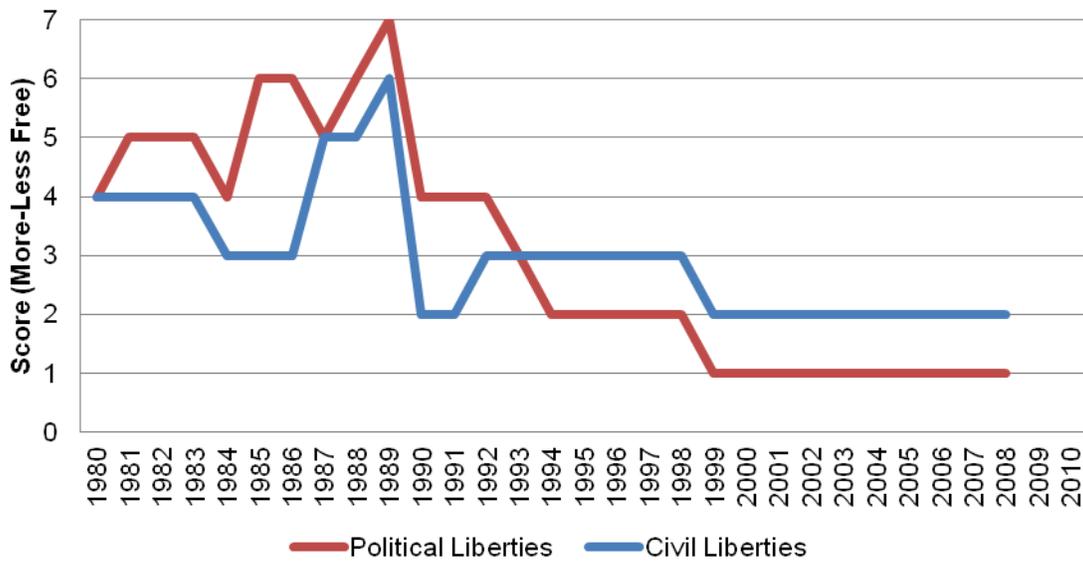
Source: World Bank Worldwide Governance Indicators DataGov database, IADB: <http://www.iadb.org/datagob/index.html>

Figure 4-5. Political Stability and the Absence of Violence



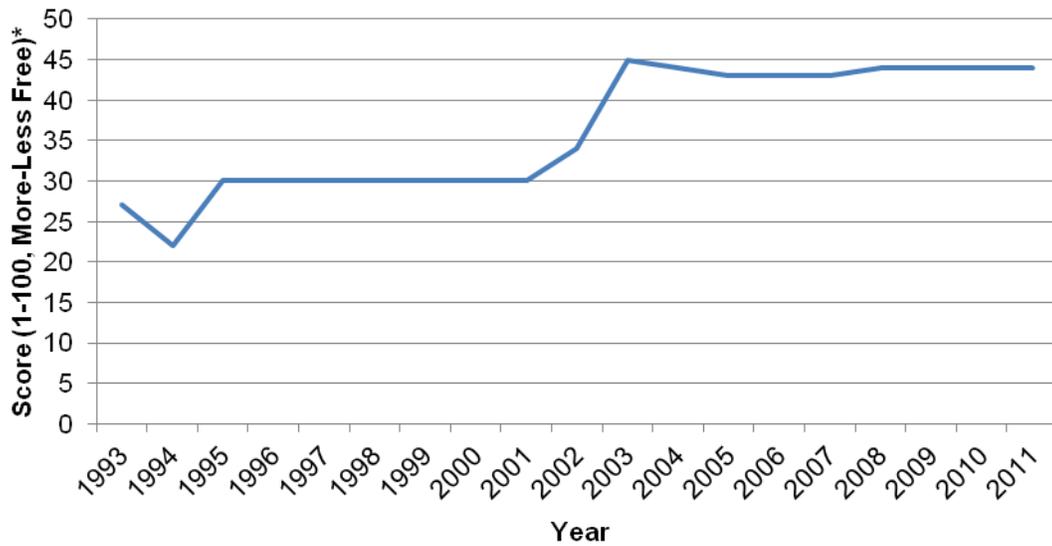
Source: State Fragility Index, Polity IV Project: <http://www.systemicpeace.org/polity/polity4.htm>

Figure 4-6. The State Fragility Index



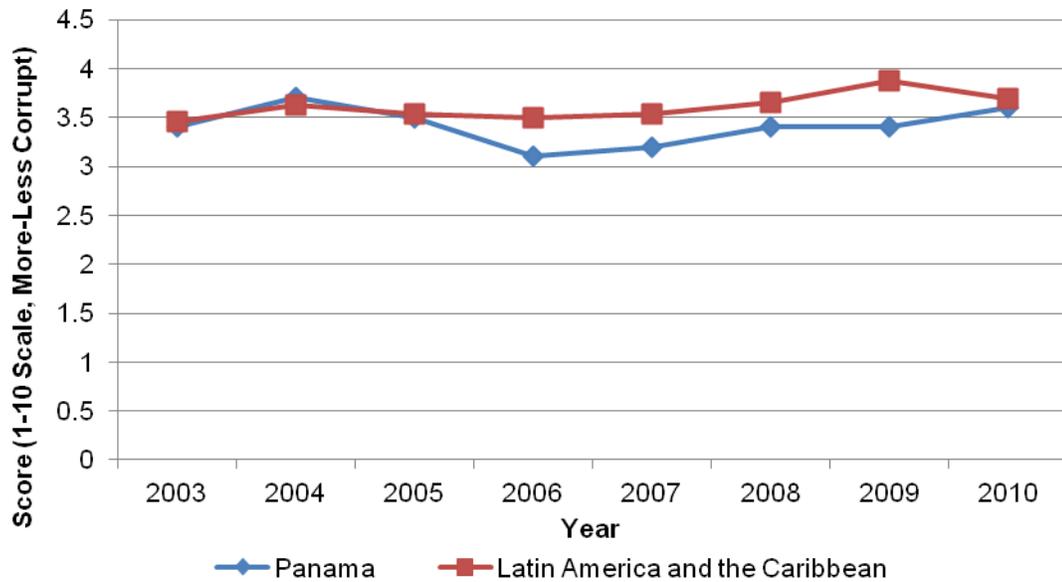
Source: Freedom House International, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>

Figure 4-7. Political and Civil Liberties Index



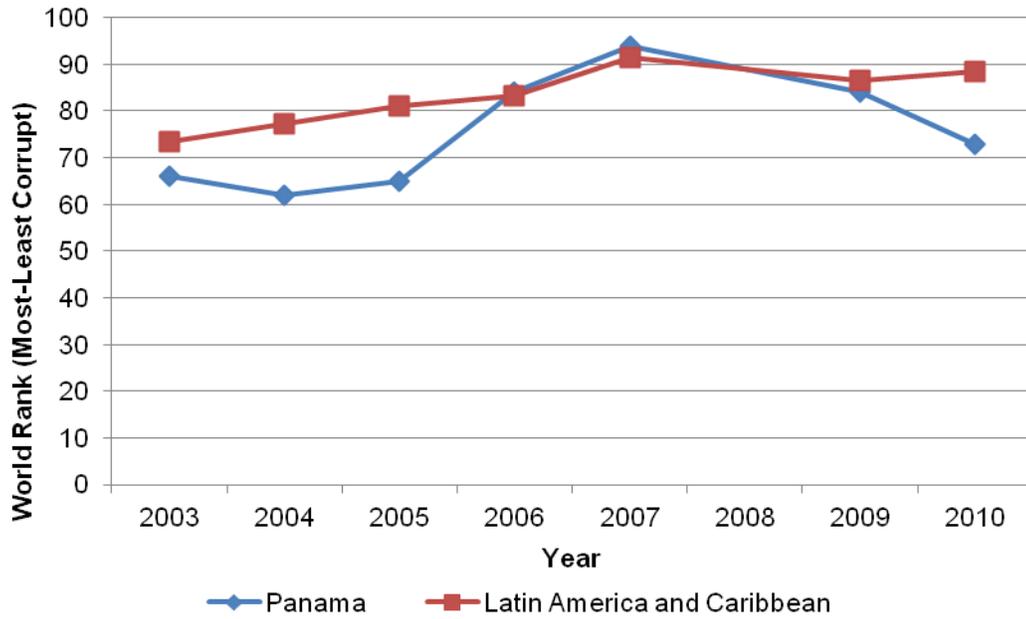
Source: Freedom House International, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>
 *Categorized as “Free” (0-30), “Partly Free” (31-60), “Not Free” (61-100)

Figure 4-8. Press Freedom Index



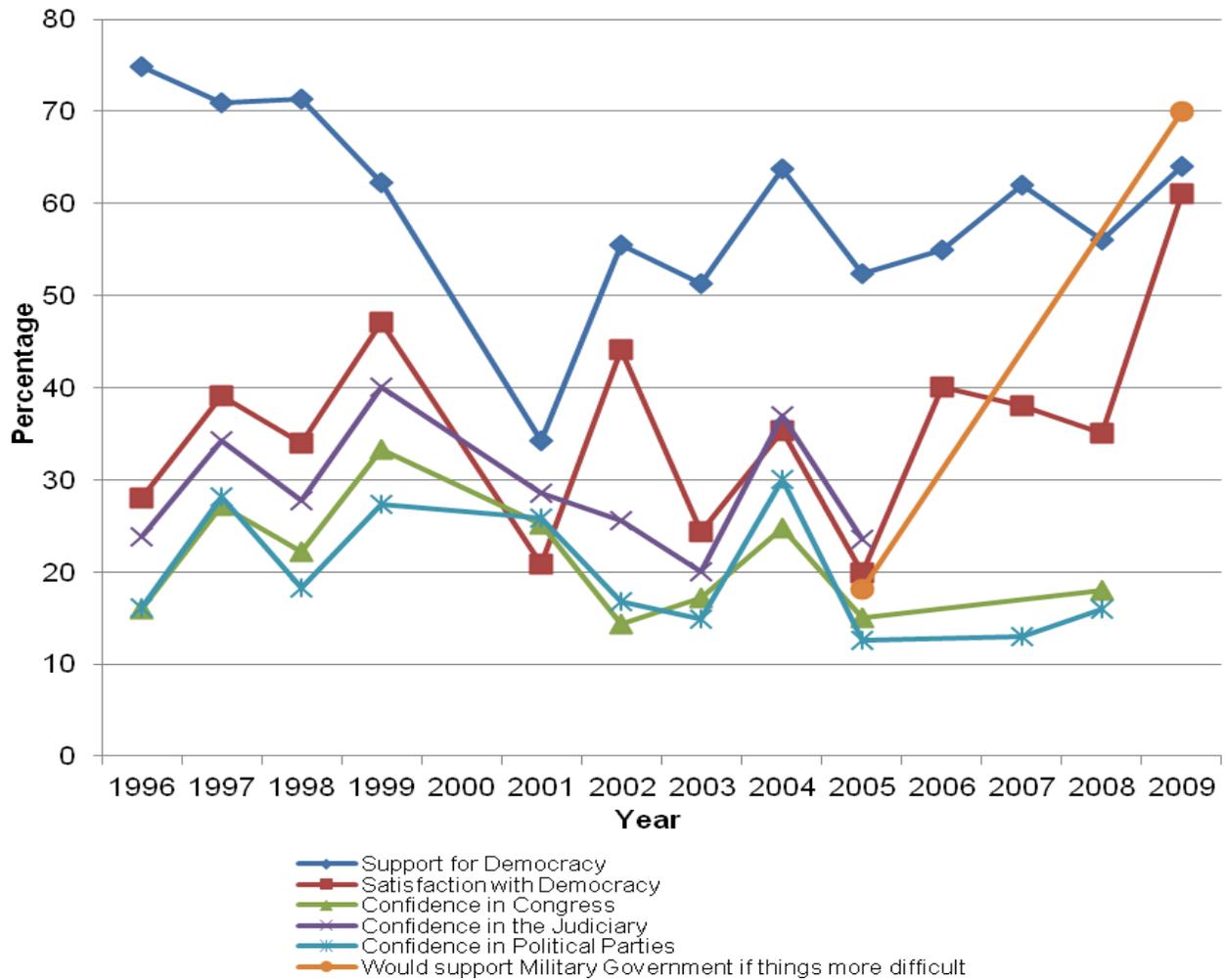
Source: Transparency International, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>

Figure 4-9. Corruption Perceptions Index, Score



Source: Transparency International, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>
 Source: Latinobarómetro, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>

Figure 4-10. Corruption Perceptions Index, World Rank



Source: Latinobarómetro, DataGov database, IADB: <http://www.iadb.org/datagob/index.html>

Figure 4-11. Latinobarómetro Public Opinion Surveys

CHAPTER 5 CONCLUSIONS

In conclusion, this thesis has used an “exceptional case-study” approach, as theorized by Eckstein (1992), to examine the relationship between a “strategic rent,” the Panama Canal, and government. The study shows that strategic rents may indeed share many of the traits hypothesized for traditionally studied forms of resources, such as petroleum, natural gas, and certain types of minerals. These include some of the “political pathologies” elucidated by Moore (2004). Historically, Panama has clearly shown a propensity for external intervention to ensure the Canal’s security and operation, and the U.S. clearly provided military and political support for several non-representative Panamanian governments. In addition, Panama has a relatively weak civil society, and clearly has major problems of budget transparency and an ineffective bureaucracy.

In particular, the thesis looks to test Thad Dunning’s (2008) idea of the possible “democratic effects” of rents, while hypothesizing that the same incentives to use Canal transfers for social spending would also be present under authoritarian governments, as argued by Ross (2001). Statistical methods including Spearman correlations and OLS regression models provide strong evidence that the Canal has indeed had a positive relationship with the social budget over the period studied, regardless of the form of government. In addition, the models and correlations suggest that this relationship is not affected by the different administrations of the Canal, as theorized by Dunning (2008) and other political scientists studying the political effects of natural resources. Recent international indicators measuring the stability of government in Panama show the country to be relatively stable during the democratic period; as social expenditures have

been shown to help stabilize governments in other studies, it is likely that the Canal has thus played a role in ensuring the maintenance of the democratic regime.

That being said, stability does not necessarily equate to quality. Various international indicators show some serious problems with democracy in Panama, including freedom of the press, widespread public support for a return to authoritarianism given worsening conditions, and most of all, corruption. This data is supported by several international media sources, as well as qualitative interviews with key informants in Panama. Articles in COHA highlighting potential corruption in the expansion project and interviews with various members of Panamanian civil society suggest that the weak institutional quality described by Robinson, Torvik, and Verdier (2006) may help to explain Panama's relatively poor performance in these areas. The mixed-method approach employed by the thesis illustrates the complexities of each individual case, and highlights the fact that the statistical data alone does not necessarily tell the whole story. While comparative studies including a large number of countries may be useful in providing wide generalizations, this study suggests that the political effects of resource rents may be more complex.

In sum, the Canal does seem to have played a role in funding social expenditure and thus mitigating conflict in Panama. On the one hand, laws such as the recent Ley de Responsabilidad Social Fiscal (2008) are a step forward, at least in reaffirming the idea of the Canal as a potential transformative force benefitting all Panamanians. This is especially important given that in the future, the waterway may become an even more important source of revenue for the government. On the other hand, if progress in improving the quality of governance in Panama is not made, this great potential could

as easily benefit only the few. Only time will tell whether the Canal is used to catalyze a true social transformation, or serves simply as another source of pocket insulation. Improving the country's democratic performance will necessitate not only reform of Panama's institutions, but also a renewed commitment to the separation of the ACP from the rest of the political system.

In terms of the wider implications of this thesis, the Panamanian case illustrates the potential for misuse of "windfall" funds that circumvent public accountability. What differentiates these forms of government income from other more traditional sources is the lack of any form of tax, whether explicit or implicit, on the consumer at a national level. As other authors have elucidated, this can lead to the inverse of the cry made famous by the Boston Tea Party: "No representation without taxation."

The political effects of windfall revenues garnered from fossil fuels and certain types of minerals have been a rich source of study for academics, but other sources of rents have been much less scrutinized. Potential examples include some of the new resources mentioned in the literature review – hydroelectric power, tourism, and banking – but could also conceivably include transportation facilities, oil and gas pipelines, and previously un-prized minerals now used in the high technology sector. Conceptually, the thesis could also have implications for government income derived from the taxation of foreign companies or individuals operating within a country's national borders, particularly with regards to corporations producing products designed solely for export. Just as the Panama Canal is held accountable by the shipping industry – transit costs cannot be too high, or ships would simply use another route – corporations do hold national governments accountable, in terms of the tax rates set on

these businesses, by pressuring their own national governments to act, funding members of the opposition, or threatening to take their operations elsewhere. However, as with the Canal revenue, the income the government receives from these taxes does not come from voters, decreasing the pressure for the government to use these funds wisely. This may also be true for countries with large foreign populations without voting rights, be they working immigrants or retirees living abroad, or any number of other sources of government revenue. Clearly, there is thus a great deal of research remaining to be done.

Finally, the thesis shows that obtaining reliable data on resource rents is not at all straightforward. Regardless of the form of government, many of the countries included in large comparative studies have deeply flawed political institutions, and the yearly statistics compiled by these governments may not be necessarily accurate. In addition, as the Panamanian case shows, the relationship between natural resources or other windfall gains and political systems is multi-layered and complex. Statements such as Friedman's (2006) "Law of Petropolitics," or the "price of oil and the pace of freedom always move in opposite directions in oil-rich petrolist states," thus clearly oversimplify reality (31). In future studies, academics will need to address these issues, or at the very least recognize the limitations they impose. A mixed methods approach, such as the one utilized in this thesis, may be the best way to address these problems.

LIST OF REFERENCES

- Autoridad del Canal de Panamá. (2010). *Annual Report*. Panama City: Budget and Financial Analysis Division, Department of Finance, Autoridad del Canal de Panamá. Accessed September 5, 2010, from <http://www.pancanal.com/eng/general/reporte-anual/index.html>
- Autoridad del Canal de Panamá. (2006a). *Plan Maestro 2005-2025*. Retrieved from <http://www.pancanal.com/esp/plan/temas/plan-maestro/>
- Autoridad del Canal de Panamá. (2006b). *Proyecto del Tercer Juego de Esclusas*. Retrieved from <http://www.pancanal.com/esp/plan/index.html>
- Asamblea Legislativa, República de Panamá. (1904). *Constitución de la República de Panamá*. Panama City, Panama. Retrieved from <http://www.asamblea.gob.pa/main/LegispanMenu/Legispan.aspx>
- Asamblea Legislativa, República de Panamá. (1972). *Constitución Política de la República de Panamá*. Panama City, Panama: Gaceta Oficial 17210. Retrieved from <http://www.asamblea.gob.pa/main/LegispanMenu/Legispan.aspx>
- Asamblea Legislativa, República de Panamá. (1997). *Ley. 19: Por la que se Organiza la Autoridad del Canal de Panamá*. Panama City, Panama. Retrieved from <http://www.asamblea.gob.pa/main/LegispanMenu/Legispan.aspx>
- Asamblea Legislativa, República de Panamá. (2008). *Ley 34: De Responsabilidad Social Fiscal*. Panama City, Panama: Gaceta Oficial 11115. Retrieved from <http://www.asamblea.gob.pa/main/LegispanMenu/Legispan.aspx>
- Burnette, R. & Salzburger, S. (2010). Martinelli's "Chorizo Law" Gets Sliced, but Concerns Remain Over his Past and Future Machinations." *Council on Hemispheric Affairs*. Retrieved from: <http://www.coha.org/martinelli%E2%80%99s-chorizo-law-gets-sliced-but-concerns-remain-over-his-past-and-potential-future-machinations/>
- Central Intelligence Agency. (2012). Panama. *CIA World Factbook*. Retrieved January 29, 2012 from <https://www.cia.gov/library/publications/the-worldfactbook/geos/pm.html>
- Consejo de la Concertación Nacional para el Desarrollo, Gobierno de Panamá. (2007). *Acuerdos de la Concertación Nacional para el Desarrollo*. Panama City, Panamá. Retrieved from <http://www.concertacion.org.pa/Publicaciones-numero-43.html>

- COHA. (2011). "Titling Scams and Suspicious Canal Bids: Panamanian Corruption Spreads to Land Holdings and Prominent Politicians." Retrieved from <http://www.coha.org/titling-scams-and-suspicious-canal-bids-panamanian-corruption-spreads-to-land-holdings-and-prominent-politicians/>
- Collazos, S.P. (1991). *Labor and Politics in Panama: The Torrijos Years*. San Francisco: Westview Press.
- Conniff, M.L. (1995). Afro-West Indians on the Central American Isthmus: The Case of Panama. In Davis, D.J.(Ed). *Slavery and beyond: the African impact on Latin America and the Caribbean* (pp. 147-173). Lanham, MD: SR Books.
- Conniff, M. L. (2001). *Panama and the United States: The Forced Alliance*. Athens, GA: University of Georgia Press.
- Dunning, T. (2008). *Crude Democracy: Natural Resource Wealth and Political Regimes*. New York: Cambridge University Press.
- Ebrahim-Zadeh, C. (2003), Back to Basics - Dutch Disease: Too much wealth managed unwisely. *Finance & Development*, 40 (1).
- Eckstein, Harry. (1992). *Regarding Politics: Essays on Political Theory, Stability, and Change*. Berkeley, CA: University of California Press.
- Economist Intelligence Unit. (2004). *Panama Country Profile - Main report: August 1st 2004*. Retrieved from www.eiu.com
- Economist Intelligence Unit. (2008). *Panama Country Profile - Main report: December 10th 2008*. Retrieved from www.eiu.com
- Economist Intelligence Unit. (2011). *Panama Country Report - Main report: October 14th 2011*. Retrieved from www.eiu.com
- Eliseo da Rosa, J. (1983). Economics, politics, and hydroelectric power: The Paraná River Basin. *Latin American Research Review* 18(3), 77-107.
- Friedman, T. L. (2006). The First Law of Petropolitics. *Foreign Policy*, 154, 28-36.
- Gandasegui, M.A. (1993). The Military Regimes of Panama. *Journal of Interamerican Studies and World Affairs* 35(3), 1-17.
- Gambotti, M. A. D. (2010, March 31). Government announces last phase of three-part tax reform. *Tax Notes International* 116(58), 116.

- Garibaldo, B.R. (2009). *Las elecciones en Panamá: Descripción política y periodística de los procesos electorales, 1984-2004*. Panamá: Cultural Portobelo, 2009.
- Georgetown University: Center for Latin American Studies (2006) Resultados del referendo 2006. *Political Database of the Americas*. Retrieved from <http://pdba.georgetown.edu/Elecdata/Panama/ref06.html>
- Harding, R. C. (2001). *Military foundations of Panamanian politics*. New Brunswick, N.J.: Transaction Publishers.
- Inter-American Development Bank. (2012). *DataGov: Governance Indicators Database*. Retrieved from <http://www.iadb.org/datagob/index.html>
- LaFeber, W. (1989). *The Panama Canal: The crisis in historical perspective*. New York: Oxford University Press.
- Maurer, N. & Yu, C. (2011). *The Big Ditch: How America Took, Built, Ran and Ultimately Gave Away the Canal*. Princeton: Princeton University Press.
- Marshall, M.G. & Cole, B.R. (2011). *State Fragility Index and Matrix 2010: The Center for Systemic Peace*. Retrieved from <http://www.systemicpeace.org/SFImatrix2010c.pdf>
- Mayorga, E.A. (2000). *Estado, clases sociales y proyecto nacional en Panamá: procesos y tendencias ante el siglo XXI*. IDEN: Panama City, Panama.
- Moore, M. (2004). Revenues, state formation, and the quality of governance in developing countries. *International Political Science Review* 25(3), 297-319.
- Moral, O.D. (1992). *Diagnostico Crítico de la Democracia en Panamá: Hacia una Asamblea Nacional Constituyente*. Panama City, Panama: Pro Ley.
- Parillo, K. A. (2010, October 25). IMF welcomes Panama's substantive tax reforms. *Tax Notes International* 211(60), 239.
- Pearcy, T. L. (1998). *We answer only to God: Politics and the military in Panama, 1903-1947*. Albuquerque: University of New Mexico Press.
- Pérez, O. J. (2011). *Political Culture in Panama: Democracy after Invasion*. New York: Palgrave-Macmillan.
- Pinilla, José Gonzales. (2010, August 25). Cuestionan manejos del Prodec. *La Prensa*. Retrieved from <http://especial.prensa.com/caso-prodec/cuestionan-manejos-del-prodec/>

- Robinson, J. A., Torvik R., & Verdier, T. (2006). Political foundations of the resource curse. *Journal of Development Economics* 79(2), 447-468.
- Ropp, S.C. (1982). *Panamanian politics: From guarded nation to national guard. Politics in Latin America*. New York: Praeger.
- Ropp, S.C. (1992). Explaining the Long-Term Maintenance of a Military Regime: Panama before the U.S. invasion. *World Politics* 44(2), 210-234.
- Ropp, S. C. (2007). Panama: New Politics for a New Millennium? In H.J. Wiarda & H.F. Kline (Eds.), *Latin American Politics and Development* (550-564). Cambridge, MA: Westview.
- Ropp, S.C. (2011a). Panama and the Canal. In Black, J.K. (Ed.), *Latin America: Its Problems and its Promise* (324-338). Boulder, CO: Westview Press.
- Ross, M.L. (2001). Does oil hinder democracy? *World Politics* 53(3), 325-361.
- Ross, M.L. (2004). Does taxation lead to representation? *British Journal of Political Science* 34(2)- 229-249.
- Scholz, W., Cichon M., & Hagemeyer, K. (2000). *Quantitative Methods in Social Protection Series: Social Budgeting*. London: International Labour Office.
- United Nations Statistics Division. (2012). *Country Profile: Panama. World Statistics Pocketbook*. Retrieved from <http://data.un.org/CountryProfile.aspx?crName=Panama>
- Yale Law School. (2008). Convention for the construction of a Ship Canal (Hay-Bunau Varilla Treaty), November 18, 1903. *The Avalon Project: Documents in Law, History and Diplomacy*. Retrieved from http://avalon.law.yale.edu/20th_century/pan001.asp
- Zimbalist, A. S., & Weeks, J. (1991). *Panama at the crossroads: Economic development and political change in the twentieth century*. Berkeley: University of California Press.

BIOGRAPHICAL SKETCH

After completing his undergraduate degree at the University of Nevada, Reno, in international relations, Spanish, and French, with a minor in economics, Adrian spent two years in Huelma, Spain, teaching English to high school students. Upon his return to the United States, Adrian began his Masters program in Latin American studies, with a concentration in political science, at the University of Florida. Adrian chose to do his research in Panama, where he lived for nearly seven years as a child, on the political effects of the Panama Canal as a source of funding for the Panamanian government.