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The Proposed U.S.-Panama Free Trade Agreement

Abstract
[Excerpt] On June 28, 2007, after two and a half years of negotiation, the United States and Panama signed a reciprocal free trade agreement (FTA). Negotiations were formally concluded on December 16, 2006, with an understanding that further changes to labor, environment, and intellectual property rights (IPR) chapters would be made pursuant to future detailed congressional input. These changes were agreed to in late June 2007, in time for the FTA to be considered under Trade Promotion Authority (TPA) legislation before it expired on July 1, 2007. TPA allows Congress to consider trade implementing bills under expedited procedures. Panama's legislature approved the FTA 58 to 4 on July 11, 2007. The 110th Congress did not take up the agreement, and so far there is little indication that the 111th Congress is ready to act on the FTA.

The proposed U.S.-Panama FTA is a comprehensive agreement. Some 88% of U.S. commercial and industrial exports would become duty-free upon implementation, with remaining tariffs phased out over a ten-year period. Over 60% of U.S. farms exports to Panama also would achieve immediate duty-free status, with tariffs and tariff rate quotas (TRQs) on select farm products to be phased out by year 17 of the agreement. Panama and the United States signed a separate bilateral agreement on sanitary and phytosanitary (SPS) issues that would recognize U.S. food safety inspection as equivalent to Panamanian standards, which will expedite entry of U.S. meat and poultry exports. The FTA also consummates understandings on telecommunications, services trade, government procurement, investment, and intellectual property rights.

The circumstances framing the proposed U.S.- Panama FTA differ considerably from those of two others that have yet to be considered by Congress. The deep concerns that Congress has expressed over Colombia's violence have not been an issue in the Panama FTA debate, which is framed more by the positive image of a longstanding strategic bilateral relationship based on Panama's canal. Nor does Panama compare well with the continuing debate over the proposed FTA with South Korea, which as a major U.S. trading partner, can affect key industries such as automobile and beef production. To the contrary, Panama trades little with the United States, even by Latin American standards, and so the FTA cannot have a major effect on the U.S. economy.

The final text of the proposed U.S.-Panama FTA incorporates specific amendments on key issues at the behest of congressional leadership. The most significant were adoption of enforceable labor standards, compulsory adherence to select multilateral environmental agreements (MEAs), and an easing of restrictions on developing country access to generic drugs. In these cases, the proposed U.S.-Panama FTA goes beyond provisions in existing bilateral FTAs and multilateral trade rules, including those contemplated in the Doha Round.Two other concerns still linger. The first pertains to a Panamanian labor statute, which some Members of Congress would like to see amended so that the minimum number of workers required to start a union would be reduced from 40 to 20, per ILO guidelines. The second relates to questions raised over Panama's status as a "tax haven" and its refusal to enter into a tax information exchange treaty. Currently, the government of Panama is working closely with the USTR to find a mutually acceptable solution to both these issues. The time frame for completing this process is unclear and may depend in part on whether the Obama Administration and Congress signal that they are prepared to move ahead with implementing legislation. For more on Panama, see CRS Report RL30981, Panama: Political and Economic Conditions and U.S. Relations, by Mark P. Sullivan.

Keywords
Panama, United States, Free Trade Agreement, tariffs, commerce, Congress

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Congressional Research Service

The Proposed U.S.-Panama Free Trade Agreement

J. F. Hornbeck
Specialist in International Trade and Finance

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Prepared for Members and Committees of Congress

Summary

On June 28, 2007, after two and a half years of negotiation, the United States and Panama signed a reciprocal free trade agreement (FTA). Negotiations were formally concluded on December 16, 2006, with an understanding that further changes to labor, environment, and intellectual property rights (IPR) chapters would be made pursuant to future detailed congressional input. These changes were agreed to in late June 2007, in time for the FTA to be considered under Trade Promotion Authority (TPA) legislation before it expired on July 1, 2007. TPA allows Congress to consider trade implementing bills under expedited procedures. Panama's legislature approved the FTA 58 to 4 on July 11, 2007. The 110th Congress did not take up the agreement, and so far there is little indication that the 111th Congress is ready to act on the FTA.

The proposed U.S.-Panama FTA is a comprehensive agreement. Some 88% of U.S. commercial and industrial exports would become duty-free upon implementation, with remaining tariffs phased out over a ten-year period. Over 60% of U.S. farms exports to Panama also would achieve immediate duty-free status, with tariffs and tariff rate quotas (TRQs) on select farm products to be phased out by year 17 of the agreement. Panama and the United States signed a separate bilateral agreement on sanitary and phytosanitary (SPS) issues that would recognize U.S. food safety inspection as equivalent to Panamanian standards, which will expedite entry of U.S. meat and poultry exports. The FTA also consummates understandings on telecommunications, services trade, government procurement, investment, and intellectual property rights.

The circumstances framing the proposed U.S.-Panama FTA differ considerably from those of two others that have yet to be considered by Congress. The deep concerns that Congress has expressed over Colombia's violence have not been an issue in the Panama FTA debate, which is framed more by the positive image of a longstanding strategic bilateral relationship based on Panama's canal. Nor does Panama compare well with the continuing debate over the proposed FTA with South Korea, which as a major U.S. trading partner, can affect key industries such as automobile and beef production. To the contrary, Panama trades little with the United States, even by Latin American standards, and so the FTA cannot have a major effect on the U.S. economy.

The final text of the proposed U.S.-Panama FTA incorporates specific amendments on key issues at the behest of congressional leadership. The most significant were adoption of enforceable labor standards, compulsory adherence to select multilateral environmental agreements (MEAs), and an easing of restrictions on developing country access to generic drugs. In these cases, the proposed U.S.-Panama FTA goes beyond provisions in existing bilateral FTAs and multilateral trade rules, including those contemplated in the Doha Round.Two other concerns still linger. The first pertains to a Panamanian labor statute, which some Members of Congress would like to see amended so that the minimum number of workers required to start a union would be reduced from 40 to 20, per ILO guidelines. The second relates to questions raised over Panama's status as a "tax haven" and its refusal to enter into a tax information exchange treaty. Currently, the government of Panama is working closely with the USTR to find a mutually acceptable solution to both these issues. The time frame for completing this process is unclear and may depend in part on whether the Obama Administration and Congress signal that they are prepared to move ahead with implementing legislation. For more on Panama, see CRS Report RL30981, *Panama: Political and Economic Conditions and U.S. Relations*, by Mark P. Sullivan.

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On June 28, 2007, the United States and Panama signed a free trade agreement (FTA) after two and a half years and ten rounds of negotiations (see **Appendix A** for a chronology of events). Negotiations formally concluded on December 16, 2006, with an understanding that changes to labor, environment, and intellectual property rights (IPR) chapters would be made pursuant to future congressional input. These changes were agreed to in late June 2007. The FTA was signed in time to be considered under Trade Promotion Authority (TPA) legislation, which expired on July 1, 2007. TPA allows Congress to consider certain trade implementing bills under expedited procedures.[1] Panama's legislature ratified the FTA 58 to 4 on July 11, 2007. Neither the 110th nor the 111th Congress to date have taken up implementing legislation.

The FTA incorporates changes based on principles outlined in the "New Trade Policy for America,"[2] a bipartisan policy crafted jointly by leadership in the 110th Congress and the Bush Administration. It requires adoption as fully enforceable commitments, the five basic labor rights defined in the International Labor Organization's (ILO) *Fundamental Principles and Rights at Work and its Follow-up (1998) Declaration*, select multilateral environmental agreements, and new pharmaceutical IPR provisions that may facilitate Panama's access to generic drugs. These changes distinguish the proposed U.S.-Panama agreement from all earlier FTAs that have been implemented, with the exception of the U.S.-Peru agreement, which has similar language.

A congressionally mandated report by the United States International Trade Commission (USITC) concluded that the likely main trade effect of the FTA would be to increase U.S. exports, given that 96% of U.S. imports from Panama already enter duty free. Given the small size of the Panamanian economy, however, the overall effect on the U.S. economy is expected to be very small.[3] In addition, Panama is largely a services-based economy with a relatively small merchandise trade relationship with the United States, even by Latin American standards.

Although many policy issues were addressed in the bipartisan compromise, albeit not to the satisfaction of all Members of Congress, the FTA also faced a sensitive political issue that contributed to delaying congressional action. On September 3, 2007, following an election of his peers, Pedro Miguel González Pinzón assumed the office of President of the National Assembly for a one-year term. Although a deputy in the National Assembly since 1999, he is better known in the United States for his alleged role in the June 10, 1992 murder of a U.S. serviceman in Panama. A Panamanian court acquitted him of the charge in 1995, but the United States does not recognize the verdict and maintains an outstanding warrant for his arrest.[4] His presence in the National Assembly leadership position delayed congressional action on the FTA.[5] Panama, for its part, faced a sensitive situation given it did not wish to appear to be compromising its national sovereignty to accommodate political concerns in the United States. This situation changed on September 1, 2008, when Raúl Rodríguez Araúz was elected to replace González Pinzón, removing one obstacle to congressional consideration of the FTA.

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

[2] Agreed to on May 10, 2007 and available on the website of the Office of the United States Trade Representative (USTR).

[3] USITC. *U.S.-Panama Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects*. September 2007. Publication 3948. pp. 1-1 and 1-5.

[4] U.S. Department of State. Press Statement. *Election of Panamanian National Assembly President Pedro Miguel González-Pinzón*. September 1, 2007.

[5] Inside U.S. Trade. *Committee Chairs Signal FTA Problem Over Panama Assembly Head*. September 21, 2007.

Other issues surfaced, however, that have continued to slow action in the 111th Congress. The first is concern over Panama's alleged status as a "tax haven." Many Members of Congress have expressed a refusal to consider the FTA until Panama changes its tax laws to enhance transparency. The second issue concerns Panama's labor code, which some Members of Congress would like to see amended to reflect that the minimum number of workers required to start a union would be reduced from 40 to 20, per ILO guidelines. Currently, the government of Panama is working closely with the USTR to find a mutually acceptable solution. The time frame for resolving the issues is not certain and may depend in part on whether Congress and the Obama Administration signal that they are prepared to move ahead with implementing legislation.

Panama's Canal and Economic Relations with the United States

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

Early U.S.-Panama Economic Relations

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

Panama was swept to independence from Spain on November 28, 1821, becoming part of the Gran Colombia regional group. By this point, both the United States and Britain had openly coveted the prospect of an inter-oceanic connector. Well before construction of a canal could begin, the United States displaced Britain as the dominant foreign influence and completed a cross-isthmian railroad in 1855. This project was driven by the westward expansion of the United States, which included an anticipated southern water route to the west coast. To secure this transit system, as well as the safety of goods and people using it, the United States resorted to armed intervention in Panama some 14 times in the 19th century. By the time the United States sought permission to construct a canal, a precedent had already been set to use military force for defense of U.S. interests in Panama.[6]

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

Figure 1. Map of Panama

Source: Map Resources. Adapted by CRS.

The U.S. effort to build a canal required a concession from Colombia that would allow the United States to complete the bankrupt French project abandoned in 1889. In early 1903, the details were set down in a treaty ratified by the U.S. Senate, but unanimously rejected by the Colombian legislature. The United States responded by reaching out to the growing Panamanian secessionist movement. On November 3, 1903, in a quick and bloodless move encouraged by the offshore presence of U.S. warships, Panama separated from Colombia. The United States immediately recognized Panama as an independent state, and in return, Panama signed the Hay-Buneau-Varilla Treaty, ceding to the United States the rights to construct a canal and control it "in perpetuity."[7]

The Panama Canal opened in 1914, leading to U.S. dominance in the economic and, at times, political life of Panama. Although both countries benefitted from its operations, the relationship was far from equal, which along with the perpetual U.S. presence, generated a nagging resentment, frequent protests, and periodic violence over the tangible loss of national sovereignty. This tension remained a dominant feature of U.S.-Panamanian relations until the canal was ceded back to Panama in 1977 under terms defined in the Panama Canal Treaties signed by Presidents Jimmy Carter and Omar Torrijos. Tensions flared again in 1989 when the U.S. military invaded Panama to arrest then-chief of state General Manual Noriega on narcotics trafficking charges and for threatening U.S. personnel and property. The incursion, nonetheless, proved to be a catalyst for the return of democracy. Perhaps not coincidently, Panama's decision to promote trade liberalization followed soon thereafter.[8]

The Canal and U.S. Trade Policy

The canal solidified Panama as a maritime economy and its return to Panamanian control raised expectations of greater economic benefits from its ownership. The canal operations by themselves account for approximately 6% of Panama's GDP, with the largest and fastest growing traffic volume generated along the U.S. East Coast-to-Asia trade route (especially U.S.-China). About one-third of all cargo passing through the canal has its origin or destination in the United States. The canal's total economic impact, however, is far greater, supporting income and jobs in various services industries including warehousing, ship registry and repair, salvage operations, insurance, banking, and tourism. The two major ports at either end of the canal have been privatized and modernized, a portion of the canal was widened in 2001, but Panama faces a difficult and expensive challenge to enhance the capacity of the entire canal to accommodate much larger post-Panamax ships.[9] Panama held a national referendum on the proposed $5.25 billion expansion on October 22, 2006. It passed by a wide margin and Panama has begun the expansion project.

With transfer of the canal and its operations to Panama, the country also inherited a substantial amount of land and physical assets. The conversion of these assets to private use has been a boon to the Panamanian economy, but not without considerable costs and investment, as well. Privatization efforts eased the transformation of former U.S. government facilities to productive

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

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

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

Panamanian use, which has included refurbishing the Panamanian railroad by Kansas City Southern Railways, transforming the former Albrook base into residential housing, and developing a small foreign processing zone in the former Ft. Davis.[10]

The Panama-Pacific Special Economic Area (PPSEA) is perhaps the most ambitious of these projects. This public-private partnership, established in law, aspires to convert the former Howard Air Force Base into a "world class business center," with an emphasis on the export sector. Existing assets include housing and office buildings, a hospital, transportation infrastructure, fiber optic cable network, an 8,500-foot runway, and four hangar facilities. The government offers businesses various fiscal incentives and a streamlined regulatory process. Firms are required to commit to state-of-the-art practices that include adopting internationally accepted environmental and labor standards.[11]

With the assistance of the International Finance Corporation (IFC) of the World Bank, Panama is relying on a large global financing package to cover the initial investment needs. The project aims at developing various businesses including computer technology, cell phone manufacturing, international call centers (Dell already operates one on site), aeronautical industry support, and others that require a well-trained work force. The IFC supports this project not only for its prospects as a business venture, but because it is forward looking rather than relying on the "maquiladora" business model common in much of the region.[12]

At the start of the 21st century, the canal and close ties with the United States are still defining features of Panama's economy, but in the past these traits have hindered Panama's participation in regional integration. Although part of the Central American Integration System, a broadly focused political arrangement, Panama has declined to join the Central American Common Market, relying instead on the canal and the large U.S. economy as its economic anchors. Panama has had a fully dollarized monetary system since independence and is a beneficiary of U.S. unilateral trade preferences defined in the Caribbean Basin Economic Recovery Act (CBERA), the Caribbean Basin Trade Partnership Act (CBTPA), and the Generalized System of Preferences (GSP).[13] These historical circumstances have given Panama little incentive to become a more open economy. Only since joining the World Trade Organization (WTO) in 1997 did Panama begin to reduce tariff rates, an important step in preparation for an FTA with the United States.

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

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[10] Ibid.

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

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

[13] Panama's dollarized economy has been a cornerstone of its long-term economic stability. It has safeguarded Panama against exchange rate risk, currency mismatches, and speculative attacks experienced in other developing economies, and eliminated the monetizing of deficits, thereby reinforcing fiscal constraint and price stability. See Moreno-Villalaz, Juan Luis. Financial Integration and Dollarization: The Case of Panama. *Cato Journal*, Winter 2005. For more on trade preferences, see CRS Report RL33951, *U.S. Trade Policy and the Caribbean: From Trade Preferences to Free Trade Agreements*, by J. F. Hornbeck.

A bilateral FTA with Panama also supported the Bush Administration's "competitive liberalization" trade strategy, in which negotiations were pursued simultaneously on multilateral, regional, and bilateral levels. This multi-tiered strategy is predicated on an expectation that gains on one level of negotiation may encourage, if not compel, breakthroughs on others. Because of slow progress on the WTO Doha Round and the Free Trade Area of the Americas (FTAA), this strategy played out through aggressive bilateral trade negotiations, of which the proposed Panama FTA is one. Some, however, have questioned the bilateral approach for the asymmetrical negotiation power the United States wields, the negative effects it may have on non-participating countries, and the one-sided trading system that could be developing around a U.S. hub, as opposed to a truly large regional or multilateral system.

For Panama, the proposed FTA reinforces its varied trade liberalization goals and supports continued U.S. foreign direct investment. The services sector is already globally competitive, but the manufacturing sector is small and the agricultural sector remains protected and uncompetitive (see below). For Panama, the chief concern was crafting an FTA that would balance the need to pursue openness for services, export growth and promotion for manufacturing, and adjustment time for agriculture to become more competitive, while minimizing social displacement. The incentive to negotiate was perhaps also enhanced by the desire to keep pace with other Latin American countries that already have or are negotiating FTAs with the United States.

Panamanian Trade Relations

Panama is a country of 3.5 million people with a stable, diversified economy that has experienced strong growth despite the current global economic downturn. Panama's gross domestic product (GDP) expanded by an average of over 9% for the five years ending 2008, and even with the global recession, grew by 2.5% in 2009 (see **Appendix B** for selected macroeconomic data). Panama has the highest per capita income in the Central American region, but income distribution is highly skewed, poverty remains a nagging problem, especially in rural areas, and the unemployment rate has been moderately high. Inflation rose significantly in 2007-2008, but retreated in 2009 with the diminished growth in economic output. Unlike any other Latin American country, 77% of Panama's GDP is in services, developed around the transportation and commerce generated by canal traffic and the Colón Free Zone (CFZ). Industry is the second most important sector, contributing 17% to GDP followed by agriculture, contributing 6% to GDP.[14]

Structure and Direction of Panamanian Trade

Trade is an increasingly important part of this largely services-based economy, but as seen in **Table 1**, Panama has a historically large merchandise trade deficit, exporting relatively little compared to the amount of goods it must import. From 2001 to 2008, Panama's annual merchandise trade deficits ranged from $700 million to $4.7 billion. Panama's declining terms of trade is one factor affecting the trade balance (see **Appendix B**), but the large increases beginning in 2007 reflect two important developments. First, a large rise in oil imports driven by price and quantity, and an increase in construction machinery imports (derricks, dozers, cranes, etc.) related to Panama's strong economic growth and canal expansion. In most years, the merchandise deficit

[14] United Nations. Economic Commission on Latin America and the Caribbean. *Statistical Yearbook for Latin America and the Caribbean 2009*, February 2010.

has been offset by a services trade surplus, which has ranged from $900 million in 2001 to $3.3 billion in 2008. Such a large services component of the balance of payments is unusual for a Latin American country, but reflects the unique aspects of the Panamanian economy. Large trade deficits may be expected to continue as long as energy and food prices remain high and as the canal expansion accelerates.

Table 1. Panama's Current Account Balance

	2001	2002	2003	2004	2005	2006	2007	2008
Merchandise Trade Balance ($ million)	-696	-1,035	-1,202	-1,537	-1,558	-1,712	-3,382	-4,714
Services Trade Balance ($ million)	890	968	1,240	1,337	1,420	2,211	2,818	3,262

Source: United Nations Economic Commission on Latin America and the Caribbean. *Statistical Yearbook for Latin America and the Caribbean, 2009*, February 2010. pp. 144-145.

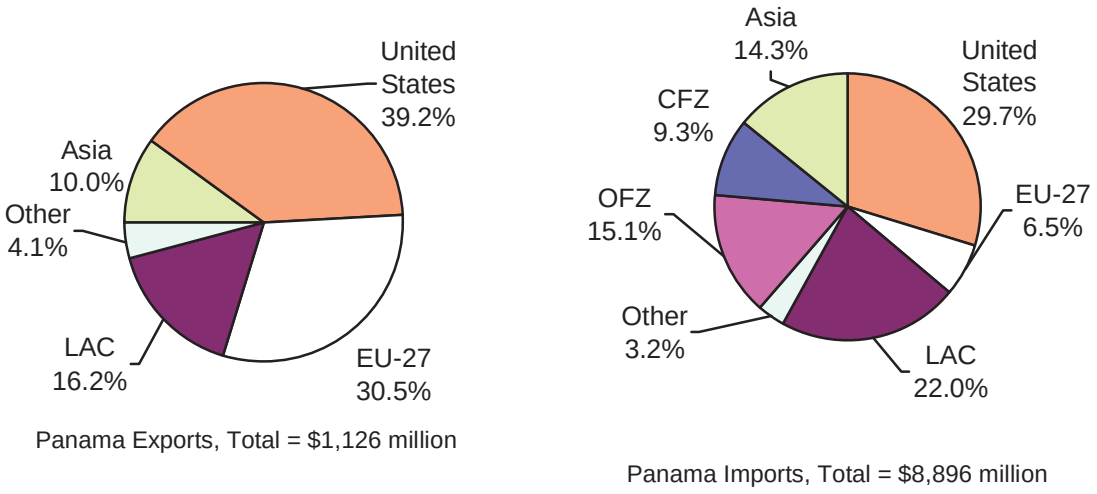
Panama places a strong emphasis on increasing exports as a driver of economic growth, pointing to the Panama Pacific Special Economic Area, Colón Free Zone (see below), and to a lesser extent, the small export processing zones and nontraditional agricultural products as opportunities to execute this vision. Panama is a global trader and since 2002 has ratified FTAs with Singapore, Taiwan, El Salvador, Chile, the Dominican Republic, Costa Rica, Nicaragua, Guatemala, and Honduras. It has finalized an agreement with Canada that awaits formal signing and is negotiating an FTA with the European Free Trade Association (EFTA) countries. Panama, along with the Central American countries, is also negotiating an FTA with the European Union (EU). Panama nonetheless remains closely tied to the United States as its dominant trading partner, which as a single country is a larger trading partner than any of the world's major regions.

Panama levies and average tariff of 7% on U.S. industrial and consumer goods, with some peaking at 81% on some goods. The average tariff on U.S. agricultural goods is 15%, with peaks as high as 260% on some products.[15] In 2008, the United States accounted for some 39.2% of Panamanian exports and 29.7% of its imports (see **Figure 2**). The EU is the second largest export market with a 30.5% export share, but accounts for only 6.5% of Panamanian imports. The Latin American countries collectively are Panama's third largest export market with 16.2%, and have a 22.0% import share. Panamanian trade has two distinct elements of importance on the import side. Over 9% of imports entered Panama through the Colon Free Zone (CFZ), discussed in detail below. In addition, another 15.1% of oil imports entered through the Oil Import Zone (OIZ). Most of these imports originated in the United States, Latin America, and the Caribbean.

Panama is one of the few Latin American countries with which the United States has a merchandise trade surplus, and although relatively small, it is by far the largest in the region. Panama runs a sizeable trade deficit with Latin America; its largest Latin American trade partners are Honduras, Mexico, and Colombia. Panama also imports significant quantities of oil from Trinidad and Tobago. Asia accounts for 10.0% of Panama's exports, but 14.3% of its imports, dominated by China, Japan, and South Korea.

[15] Office of the United States Trade Representative, *2009 National Trade Estimates Report on Foreign Trade Barriers*, Washington, D.C., 2009, p. 385.

Figure 2. Panama Direction of Trade, 2008



Data Source: Global Trade Atlas.

The Colón Free Zone

A distinct feature of Panama's trade regime is the Colón Free Zone (CFZ), which with the exception of Hong Kong, is the largest duty free zone in the world. The vast trade volume that traverses the Panama Canal, multimodal transportation infrastructure, modern financial sector, and Panama's central location in the Americas make Colón a logical, if not ideal, place for a duty free zone. It serves as a "one stop shop" for both Latin American buyers, and sellers from the rest of the world, including Asia and the United States. Sellers operate showrooms targeted at small- and medium-sized buyers, who make wholesale purchases of goods for retail sale in their respective countries. Goods are typically repackaged in smaller lots, priced in the local market currency, and transferred to the purchasing country without incurring income, value added, or transfer taxes. Most CFZ trade is in electronics, clothing, jewelry, and other luxury goods.

Buyers benefit from the ability to purchase in small lots, reduced travel costs, consolidated shipping, improved shipping times, and credit offered by sellers. The sellers benefit from reaching smaller Latin American markets in one location and reduced tax and transaction costs. Panama benefits from the 20,000 direct jobs the CFZ creates and the public revenue they generate. CFZ trade is reported as a separate component of Panama's trade statistics and only those goods entering the Panamanian economy are recorded as imports. In 2008, CFZ trade added a net $807 million to the Panamanian trade balance.[16]

The CFZ is frequently associated with a number of illicit activities including money laundering, illegal transshipment, trademark and other intellectual property violations. In part, this is a

[16] Data from Global Trade Atlas. Discussion based on U.S. Department of Commerce. U.S. Commercial Service. *Doing Business In Panama: 2008 Country Commercial Guide for U.S. Companies*. February 21, 2008 and author's interviews with CFZ representatives, September 21, 2005.

reputation that Panama as a whole has been fighting since the military dictatorship, which was widely known for its flagrant disrespect of the law, if not outright corruption. Panama's proximity to Colombia and headquarters as a transshipment point helped fuel this perception.

The CFZ has attempted to counter this reputation. The zone itself is an enclosed commercial area, encircled by and under the supervision of, customs and other law enforcement agencies of the Republic of Panama. In addition, both the Colón Free Zone User's Association and the CFZ Administration have a strict code of conduct and argue that illicit activity is also policed by individual companies because a bad reputation hurts those dedicated to making the CFZ a world class trading center. Even the accusation of an infraction can lead to a suspension of the license needed to operate in the zone. Cash accounts for only 10% of transactions and there is careful monitoring of all goods that move in and out of the zone through electronic tracking systems.[17]

U.S.-Panama Merchandise Trade

U.S.-Panamanian merchandise trade is small.[18] In 2008, the United States exported $4,913 million worth of goods and imported $377 million, producing a U.S. trade surplus of $4,536 million, the largest in the Western Hemisphere. Still, Panama ranked as only the 40th largest export market for U.S. goods and 97th for imports. Major U.S. exports, as seen in **Table 2**, include oil and mostly capital- and technology-intensive manufactured goods such as aircraft, pharmaceuticals, machinery, medical equipment, and motor vehicles.

Table 2. U.S.-Panama Merchandise Trade, 2008

(top ten U.S. exports and imports by $ value)

U.S. Exports	$ Value million	% of Total	U.S. Imports	$ Value million	% of Total
1. Oil (not crude)	1,820.8	37.0	1. Fish/Seafood:	97.3	25.8
2. Machinery	537.8	11.0	2. Repaired Goods	93.1	24.7
3. Electrical mach.	329.0	6.7	3. Gold	44.2	11.7
4. Vehicles	227.3	4.6	4. Crude Oil	34.9	9.2
5. Repaired Goods	218.3	4.5	5. Sugar	16.2	4.3
6. Aircraft	188.2	3.8	6. Coffee	15.4	4.1
7. Cereals	160.3	3.3	7. Edible Fruit	13.9	3.7
8. Perfume	116.2	2.4	8. Aluminum	5.5	1.5
9. Optical/Med. Equip	108.1	2.2	9. Elec. Mach.	4.6	1.2
10. Plastics	90.5	1.8	10. Copper	4.5	1.2
Other	1,117.7	22.7	Other	329.5	12.6
Total	4,913.3	100.0	Total	377.0	100.0

Source: Global Trade Atlas.

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

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

The United States imports relatively little from Panama, accounting for the growing U.S. merchandise trade surplus. Most imports are primary products; 26% is seafood, mostly fresh fish and shrimp. Repaired goods are number two accounting for 25% of total imports from Panama.[19] Commodity trade includes crude oil, precious metal (mostly gold), fruit, sugar, and coffee, which together account for one-third of total imports. Unlike the Central American countries, where U.S. sensitivities to textile and apparel trade run high, Panama trades little in this sector. Panama's agricultural exports, particularly sugar, presented the more difficult negotiation issue.

U.S. Foreign Direct Investment

Panama has no formal restrictions on capital flows, does not discriminate between foreign and domestic investment, and maintains bilateral investment treaties with the United States and many European countries. Critics have pointed out, however, that the legal environment can be cumbersome and that Panama's relatively high labor costs (for the hemisphere) and inflexible labor laws can be a frustration if not an impediment to U.S. foreign direct investment (FDI).[20] Still, U.S. companies are well represented in Panama, including the largest container port facility in the region, multiple financial institutions, transportation firms, and manufacturing facilities from various sectors. Like other countries pursuing an FTA with the United States, Panama seeks closer ties for the continued FDI that may be generated from having a permanent rules-based trade relationship with a large trading partner.

Table 3. U.S. Foreign Direct Investment in Panama, Mexico, and Central America

($ millions)

	2001	2002	2003	2004	2005	2006	2007	2008
Panama	5,141	5,842	5,409	4,919	4,826	4,636	6,509	7,243
Mexico	52,544	56,303	59,851	63,384	73,687	82,965	91,259	95,618
Central America	2,994	3,199	2,333	4,884	3,902	3,595	5,315	7,515

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

U.S. FDI represents over a third of total FDI in Panama. **Table 3** compares U.S. FDI in Panama to other regional destinations. The dollar value of U.S. investment in Panama is often nearly equal to or higher than that in the five Central American countries combined, and amounts to some 28% of Panama's GDP, compared to only 6% for Central America. Plans to widen and improve the canal will likely provide an opportunity for some $5 billion of investment in the canal itself, and perhaps related large amounts of FDI for other sectors of the economy with a significant U.S. presence.

[19] Technically classified in the Harmonized Tariff System (HTS) as "products of the United States when returned after having been exported, without having been advanced in value or improved in condition by any process."

[20] U.S. Department of Commerce, *Doing Business In Panama: 2008 Country Commercial Guide for U.S. Companies.*

Summary of Trade Negotiations and the Proposed U.S.-Panama FTA[21]

Panama approached the United States for a stand-alone FTA, preferring to avoid a direct link to the U.S.-Dominican Republic-Central America Free Trade Agreement (CAFTA-DR). Panama wanted to maximize an FTA's potential to win U.S. congressional approval by emphasizing the historical and strategic nature of the U.S.-Panamanian relationship, while separating the negotiations from the divisive CAFTA-DR accord. Panama's service economy, small textile and apparel industry, and limited integration with the Central American economies also bolstered the case for separate negotiations.[22] Another unique feature of the FTA negotiations was the treatment of business issues with respect to the Panama Canal Area. Its status as an autonomous legal entity under the Panamanian Constitution required separate negotiations for government procurement, labor, investment, and other areas. The United States is the only country with which Panama has been willing to negotiate issues related to the canal area in an FTA.

The proposed agreement was completed in ten rounds of negotiation, concluding on December 16, 2006 and in general follows the text framework of earlier FTAs. It was signed on June 28, 2007 following some significant last minute changes to the labor, environment, intellectual property rights, and government procurement chapters to accommodate new commitments agreed to by the USTR and bipartisan congressional leadership. Market access schedules, drawn from previous FTA templates, reflect both U.S. and Panamanian interests, as do other market access provisions.

Congress requires that the United States International Trade Commission (USITC) make an economic assessment of the potential impact of an FTA on the U.S. economy. The analysis usually is done with both a general equilibrium model to estimate economy-wide changes and a partial equilibrium model to estimate sector or industry-level changes. In Panama's case, there was insufficient data to make a meaningful estimate from a general equilibrium model, and so detailed estimates of how the FTA might affect U.S. economic growth, employment, trade, and income were not offered. In general, however, through other quantitative and qualitative indicators, the USITC concluded that because Panama's economy is very small relative to that of the United States, the likely overall effect on the U.S. economy will be similarly very small.[23]

At the sector level, the USITC finds that the "main effect" of the FTA would likely be to increase U.S. exports, while causing little growth in U.S. imports from Panama. In general, the estimates are in line with general expectations based on: (1) the small amount of goods imported from Panama; (2) the small production capacity of Panama; and, (3) the fact that most imports from Panama (96% by value) already enter the United States duty free through either normal trade relations (NTR) or preferences provided by the Caribbean Basin Initiative (CBI) programs or the Generalized System of Preferences (GSP).[24]

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[21] This summary reflects information in the final text of the proposed FTA, released on July 2, 2007.

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

[23] USITC, *U.S.-Panama Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects,* pp. 1-1 and 1-5.

[24] Ibid., pp. 1-5, 2-1, and 2-7.

Specific estimates suggest that when fully implemented, the largest growth potentially will accrue to U.S. exports of rice (145%), pork (96%), beef (94%), and passenger vehicles (43%). Again, these would amount to a very small dollar value increase given that, with the exception of rice, the U.S. exports of these goods to Panama represent less than two-tenths of one percent (0.2%) of U.S. exports to the world and even a smaller portion of U.S. production. With respect to the services provisions in the FTA, they exceed WTO commitments, but the gains for U.S. providers are also expected to be small, with the potential for further gains once the Panama Canal expansion project is fully underway.[25]

Below is a more detailed discussion of the major negotiation areas and a description of the issues that have been of particular interest to Panama and the United States, including the U.S. Congress. Where relevant, changes made pursuant to the May 10, 2007 bipartisan "New Trade Policy for America" are discussed.

Market Access

Market access (chapter 3 of the FTA) covers provisions that govern barriers to trade such as tariffs, quotas, safeguards, other nontariff barriers, and rules of origin (chapter 4). The proposed U.S.-Panama FTA would replace unilateral trade preferences provided to Panama under the Caribbean Basin Economic Recovery Act (CBERA), the Caribbean Basin Trade Partnership Act (CBTPA), and the Generalized System of Preferences (GSP), under which most imports from Panama enter the United States duty free along with those entering under the normal trade relations schedule. Panamanian agricultural products face some of the highest barriers, particularly sugar, which is subject to a tariff rate quota (TRQ). U.S. exports face tariffs, with most falling in the range of 3-10%, plus the additional 5% transfer tax, which applies to domestic goods as well.

Market access provides for national treatment for traded goods of both parties, with a detailed schedule defining the progressive elimination of customs duties for manufactured and agricultural goods. There are nine staging categories that classify each country's goods based on the time to tariff elimination, with the most sensitive products given lengthier phase out of tariffs. The USTR reports that tariffs on 88% of industrial and commercial goods would go to zero immediately, with the remaining tariffs phased out over a ten-year period. Similarly, over half of U.S. farm exports would receive immediate duty free treatment.[26] Tariffs on some agricultural goods would remain in place longer, with some taking up to 17 years to be completely eliminated. Safeguards have been retained for many products only for the period of duty phase out, but antidumping and countervailing duties were not addressed, leaving these trade remedy laws fully operational, as required under TPA.

Rules of origin define which goods would be eligible for duty-free treatment based on the country of origin of their content. Rules of origin are intended to prevent transshipment of goods made from materials originating in countries outside the agreement. They are particularly pertinent to apparel and textile trade, of which there is very little exported from Panama

[25] Ibid., pp. 2-1 and 2-7.

[26] Office of the United States Trade Representative. *Free Trade with Panama: Summary of the Agreement*. January 2007.

Agricultural Trade

U.S. domestic agricultural support programs are not addressed in the proposed FTA, which focused on reducing tariffs, adjusting quota levels, and defining more clearly sanitary and phytosanitary (SPS) rules and enforcement measures. Market access was particularly difficult for four highly protected products: pork; poultry; rice; and sugar. The United States was basically "offensive" on pork, poultry, and rice, expecting to open Panama's markets further. It was "defensive" on sugar, attempting to limit increases in the sugar quota that might disrupt operations of the U.S. sugar program as defined in legislation. Panama's position was the reverse, pressing to minimize increases in U.S. exports of pork, poultry, and rice, and to increase its sugar export quota.

The U.S. sugar program reflects a historical commitment to protect the income of sugar beet, sugar cane, and sugar processing firms with below-prime-rate loans, limitations on sales in the domestic market, and tariff rate quotas (TRQs). TRQs restrict imports with prohibitively high tariffs on imports above a defined quota amount, as permitted under WTO rules. In fiscal year 2008, the above-quota tariff rate on sugar was estimated to be 86%.[27] For comparative purposes, on average, Panama harvests only a quarter of the sugar produced by each of the five Central American countries, but it still plays a disproportionally important role in the Panamanian agricultural sector. Sugar constitutes: 1) a third of Panama's total agricultural exports, compared to less than 10% for the Central American countries, and; 2) 41% of agricultural exports to the United States. The U.S. market consumes 76% of Panamanian sugar exports, compared to less than 10% of sugar exports from Central America.

Given the dependence of Panamanian sugar producers on the U.S. market, in part driven by the industry's relatively high wage rates that make it cost prohibitive to produce for the world market, the Panamanians argued that even a relatively small quantitative increase in their portion of the U.S. sugar quota would have a large benefit for their industry. The U.S. sugar industry, however, continued to resist the inclusion of sugar in bilateral FTAs, arguing that the WTO is the forum for addressing domestic support programs and TRQs in the agricultural sector.

For Panama, pork, rice, and poultry were the most sensitive products. These are also protected by TRQs, with in-quota tariffs of 15% and out-of-quota tariffs rising to 74%, 103%, and 273%, respectively. Pork and poultry have a special issue related to the consumption of white versus dark meat. The United States consumes considerably more white meat than dark, leaving a disproportional amount of dark cuts for export, which face the highest tariffs. In Panama, as with much of the world, dark meat is preferred. The concern revolved around U.S. producers' willingness to sell dark meat cuts at a low price in foreign markets, putting downward pressure on prices and hurting domestic producers in those countries. The Panamanians argued that because of the relatively high profit margins on white meat in the United States, on a cost allocation basis, U.S. producers can actually afford to sell the dark meat at below cost. The cost accounting can be debated, but concerns over the price effect in the Panamanian market remained unchanged.

[27] CRS derived this effective ad valorem equivalent by applying the current U.S. over-quota tariff of 33.87 cents per kilogram for "raw cane sugar" against the FY2008 import unit value for such imports entering under HTS 17011110. The economic effect is to raise the price of sugar in the United States above the world price, increasing income to sugar-producing industries, but raising costs to sugar-using firms and consumers. See: CRS Report R40995, *Sugar Policy Issues*, by Remy Jurenas. p. 7.

Panama's rice industry, which supplies over 90% of the domestic demand, also argued that opening the market to U.S. subsidized rice would decimate their industry, which, because of its protection, sells rice considerably above the world price. In fact, the USITC report estimates that when fully implemented, the FTA will have the greatest impact on U.S. rice exports. Although the rice provisions will not be fully implemented until year 20 of the agreement, for milled rice, the TRQ for the first year will be 20 times the current level of U.S. exports to Panama, which may be expected to affect rice growers shortly after implementation, perhaps causing them to shift production to other crops, or leave farming for alternative employment.[28]

Panamanian agriculture represents only 6% of GDP, but 17% of employment. These numbers point to both an inherent inefficiency, due in part to protection, but also the strong role agriculture plays in supporting rural employment and social stability. Agriculture's 17% of national employment actually supports 40% of the country's population living in rural areas, most of whom exist at or below the poverty line. Given the potential to dislocate much of the poor in the country, the Panamanians argued that opening the agricultural sector too quickly to the large production capacity of the United States would have been highly detrimental to the social structure of the rural economy, leading to increased unemployment, poverty, and rural-urban migration. For these reasons, Panama wanted a slow transition to open markets in the agriculture sector, as well as an increase in the sugar quota to boost employment. This would also buy time for Panama to develop its non-traditional export crops, such as melons, palm oil, and pineapples, which some view as the future of this sector.

The compromise struck in the proposed FTA would provide duty-free treatment for over half of U.S. farm exports to Panama including high quality beef, poultry products, soybeans, most fresh fruits, and a number of processed goods. Remaining tariffs would be phased out between years 7 and 17 of the FTA. Rice tariffs, which protect one of Panama's most sensitive products, would remain in place until year 20 of the FTA. U.S. exports of rice and other products would receive expanded quotas under the Panamanian tariff rate quota system. The United States agreed to give Panama an additional 7,000 metric tons of sugar imports in the first year under a three-tiered TRQ system, which would grow by 1% per year, capped eventually for some types of sugar.[29]

Other protective measures for agriculture were negotiated. Whereas export subsidies, voluntary restrain agreements (VREs), and import licensing are generally prohibited, TRQs, safeguards, and a sugar compensation mechanism would be allowed. The sugar mechanism gives the United States the option to compensate Panamanian sugar producers in lieu of giving Panamanian their exports duty-free treatment. This option might be employed if the U.S. sugar program were threatened with disruption.

Sanitary and Phytosanitary Standards (SPS)

SPS was one of the most difficult issues to resolve. Although understood as necessary to ensure the safety of agricultural imports, SPS standards can be a burden, and are often denounced as a veiled form of protectionism. Panama's SPS standards, on the whole, are considered to be very high and meet or exceed WTO standards. The USTR, however, has long raised concerns over procedural transparency with respect to phytosanitary permits and also Panama's requirement that

[28] USITC, *U.S.-Panama Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects*, pp. 2-7, 2-10, and 2-18 through 2-19.

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

imports of poultry, beef, and pork, its most protected products, come from processing plants that have been individually inspected by Panamanian officials. The United States contends that this process has often been cumbersome, drawn out, and ultimately very costly to U.S. producers.[30]

The United States wanted Panama to recognize the USDA certification process as equivalent to Panamanian standards for the purpose of securing unimpeded entry of U.S. meat exports. This issue became highly controversial during the ninth round of negotiations, when U.S. negotiators proposed this agreement be put into a formal side letter. Panama responded by noting that the SPS chapter had already been closed, that its meat inspection standards are among the highest in the world, and that a last minute effort to change SPS provisions raised sovereignty issues in Panama by potentially requiring Panama to lower its standards in some cases.[31]

As part of the resolution, Panamanian officials visited the United States to review the food safety inspection system for meat and poultry and found that accepting the U.S. system would pose no sanitary threat to Panama. This understanding was formalized in a separate bilateral agreement between the two countries, along with a streamlined import documentation system. Signed and entered into force on December 20, 2006, the agreement states that for meat, poultry, dairy, and other processed products, Panama agrees to accept U.S. sanitary, phytosanitary, and regulatory systems as equivalent to those of Panama and will no longer require individual plant inspections. Panama has since amended its laws accordingly.[32]

Textiles and Apparel

In general, textiles and apparel make for difficult market access negotiations, but Panama produces very little of these goods. The proposed FTA would provide immediate duty-free access for all textile and apparel goods, subject to rules of origin. The permanence of the provisions and more accommodating measures provide a benefit to the small Panamanian industry. Safeguard measures would allow duties to increase on imports in which a sudden increase in volume either threatens or actually harms U.S. producers. The text also provides for short supply lists of fabrics, yarns, and fibers that otherwise would face duties. The market access provisions were not the major apparel issue. Because Panama is a huge transshipment point for international trade and has its own duty free zone, the main concern was to assure U.S. apparel producers that there would be effective customs cooperation to deter illegal transshipment of goods that do not meet rules of origin. There is an extensive provision on consultation, monitoring, and onsite visit procedures in support of adhering to the rules of origin.[33]

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[30] United States Trade Representative. *2007 National Trade Estimate Report on Foreign Trade Barriers*. Washington, D.C. March 2007. p. 452.

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

[32] *United States-Panama Agreement Regarding Certain Sanitary and Phytosanitary Measures and Technical Standards Affecting Trade in Agricultural Products*. December 20, 2006.

[33] Inside U.S. Trade. *U.S. Panama FTA Includes Restrictive Textile Rules of Origi*n. January 5, 2007 and USTR, *Free Trade with Panama*, p. 2.

Government Procurement

Transparency in the bidding process for government contracts was listed as one of the most important issues by the U.S. Chamber of Commerce in Panama.[34] Some of the concerns expressed were addressed in the 2006 amendments to the procurement law, which codified advancements such as allowing use of internet procurement. These changes modernized and made more transparent procurement regulations, government purchasing information, and transactions. A separate administrative court for public contracting disputes was also created. These changes enhanced Panamanian laws that already require transparency in the bidding process. Panama has not acceded to the WTO Government Procurement Agreement, which the United States has encouraged.[35]

The government procurement chapter differs from earlier FTAs by stating that a firm's adherence to "acceptable" environmental and labor standards may be included as a standard in the bidding and procurement process. The technical specifications article states that it is not intended to preclude a procuring entity from using technical specifications to promote conservation of natural resources, or to require a supplier to comply with generally applicable laws regarding fundamental principles and rights to work; and acceptable conditions of work with respect to minimum wages, hours of work and occupation safety and health in the territory in which the good is produced or the service is performed.

Government procurement takes on a greater importance when considered in light of the proposed expansion of the Panama canal and related prospects for large long-term investments. The Panama Canal Authority (PCA) operates independently of the national government and Panama required separate negotiation apart from the regular government procurement chapter. Panama negotiated to maintain the canal authority dispute settlement system within the proposed FTA, as well as to keep small business set aside provisions for Panamanian firms. In addition, for 12 years after the agreement takes effect, Panama may set aside contracts let by the PCA to Panamanian firms subject to clear notice of intent to do so and limitations on the size of contracts. The text otherwise addresses U.S. concerns over nondiscriminatory, fair, and open government procurement procedures for all national government authorities. Like the PCA, subnational governments (e.g. states and municipalities) are not required to uphold the government procurement provisions, but those willing to do so appear in an appendix of the proposed FTA.

Investment

Panama has a well-developed financial services industry to support the flow of capital and is an important regional financial center. U.S. firms invest heavily in Panama relative to other Latin American countries and a permanent rules-based trade agreement may be seen as enhancing this relationship. Panama signed a bilateral investment treaty with the United States in 1991, the first in the region, which includes investor-state provisions and further guarantees of the free flow of transfers under a 1998 law. Although the Panamanian government has been responsive to U.S. foreign investment interests, concerns have arisen in particular cases involving investment in highly regulated industries. Resolution of these concerns facilitated the FTA negotiations and the

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

[35] USTR, *2009 Foreign Trade Barriers*, p. 386.

potential exists for further significant foreign investment in Panama, including the canal expansion and reverted areas of the former canal zone.[36]

The FTA text provides for clear and enforceable rules for foreign investments, which is largely accomplished by "standard" language (identical to the CAFTA-DR) requiring national and most-favored-nation (nondiscriminatory) treatment. It further clarifies rules on expropriation and compensation, investor-state dispute settlement, and the expeditious free flow of payments and transfers related to investments, with certain exceptions in cases subject to legal proceedings (e.g., bankruptcy, insolvency, criminal activity). Transparent and impartial dispute settlement procedures provide recourse to investors.

Two investment issues stand out. First is the investor-state provision, which was controversial during the CAFTA-DR debate, but is commonly used in U.S. bilateral investment treaties (BITs) and in earlier FTAs. It allows investors alleging a breach in investment obligations to seek binding arbitration against the state through the dispute settlement mechanism defined in the Investment Chapter. U.S. investors have long supported the inclusion of investor-state rules to ensure that they have recourse in countries that may lack the institutional capacity to adequately protect the rights of foreign investors. Since bilateral investment treaties are usually made with developing countries that have little foreign investment in the United States, it was not anticipated that these provisions would be applied in the United States. Circumstances changed under NAFTA, when investor-state provisions gave rise to numerous "indirect expropriation" claims against subnational (state) governments in the United States, Mexico, and Canada over environmental and other regulations.[37]

Although none of the claims filed against the United States has prevailed, Congress instructed in Trade Promotion Authority (TPA) legislation that future trade agreements ensure "that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors." In response, Annex 10-B of the proposed U.S.-Panama FTA states that "except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations." This provision, along with one that allows for early elimination of "frivolous" suits, is intended to address congressional concerns.

Second, Annex 10-F of the proposed FTA seeks to reserve certain rights with respect to disputes filed under Section - B of the investment chapter that may affect the Panama Canal Authority (PCA). First, it clarifies that Panama has sole authority over the canal and its operations, and should a claim be made against the PCA, the dispute tribunal "may not order attachment or enjoin the application of a measure that has been adopted or maintained by the Panama Canal Authority in pursuance of ..." its responsibility for the canal. Second, a claim arising from acts of the PCA that alleges a breach of the investment agreement must first be made to the PCA, where it will have three months to respond before the claim may be made to the dispute settlement panel under the proposed FTA.

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[36] Ibid., p. 475.

[37] Indirect expropriation refers to regulatory and other actions that can adversely affect a business or property owner in a way that is "tantamount to expropriation." This issue and many cases are discussed in CRS Report RL31638, *Foreign Investor Protection Under NAFTA Chapter 11*, by Robert Meltz.

Services

Services trade was negotiated in multiple chapters and includes financial services, shipping, telecommunications, professional services, and e-commerce. Panama is a service-based economy, has many competitive services industries, and is known for its "open regulatory environment for services." In general, the FTA provides for market access commitments in services that exceeds the WTO General Agreement on Trade in Services (GATS). With the possible exception of future canal expansion projects, the USITC estimates that the new commitments, although important changes, will have only a small economic impact on U.S. provides.[38]

Panama does require local licensing for many professionals to practice in the country, which the United States wanted to change, but was only partially successful in some cases (e.g., lawyers). Panama was the first country in Latin America to pass e-commerce legislation. It recognizes the legal standing of electronic transactions and provides for the creation of an oversight agency. The United States pressed for even greater transparency in regulatory procedures and U.S. business groups identified services as a critical negotiating area given U.S. competitive advantages and the large services sector in Panama.[39]

Equal ability to compete in retail trade, express delivery, and financial services, including insurance and portfolio management, was achieved in the proposed FTA, an issue of primary importance to the United States. In particular, restrictions on investment in retail trade and access to contracts let by the Panama Canal Authority were either eliminated or reduced. Greater access to other professional services and transparency in licensing and other accreditation were clarified. To the extent that restrictions in these areas are reduced, U.S. firms are better able to compete in the largest sector of the Panamanian economy, the one most likely to grow with canal expansion and increased merchandise trade through the canal. Panama wanted greater transparency in the U.S. state-level financial services regulatory system to help ease the possible opening of Panamanian banks in select U.S. states. The United States government argued, however, that it was unable to make commitments on state-level financial services regulatory matters.

Intellectual Property Rights

Strengthening intellectual property rights (IPR) was a major U.S. priority, in particular by harmonizing standards at U.S. levels, and by securing Panama's commitment to join an array of international agreements related to IPR protection. The most contentious IPR issues revolved around patent and data exclusivity issues related to pharmaceutical products.

The USTR reports that Panama's IPR laws and institutional support have improved with the creation of courts dedicated specifically to IPR cases. Panama updated its patent law in 1996 and has a law governing trademark protection. Panama signed on to the World Intellectual Property Organization (WIPO) Copyright Treaty and Performances and Phonographs Treaty. The 1994 copyright law improved protection and increased the options to prosecute violators. The United States continues to encourage Panama to accede to additional IPR treaties, as now required in the

[38] USITC, *U.S.-Panama Trade Promotion Agreement: Potential Economy-wide and Selected Sectoral Effects*, p. 3-1.

[39] USTR, *2007 Foreign Trade Barriers*, pp. 455-456.

proposed FTA, and to remain vigilant in its antipiracy commitment, a primary concern given the large amount of goods that are shipped through the Canal Free Zone.[40]

IPR provisions in the proposed FTA exceed those in the WTO. They provide that all businesses receive equal treatment and that Panama ratify or accede to various international IP agreements. Trademark registration is better enforced through a transparent online process and special system to resolve disputes over internet domain issues, among other requirements. Copyright provisions clarify use of digital materials (exceeding TRIPS standards) including rights over temporary copies of works on computers (music, videos, software, text), sole author rights for making their work available online, extended terms of protection for copyrighted materials, strong anti-circumvention provisions to prohibit tampering with technologies, the requirement that governments use only legitimate computer software, the prohibition of unauthorized receipt or distribution of encrypted satellite signals, and rules for liability of internet service providers for copyright infringement. Patents and trade secrets rules conform more closely with U.S. norms. End-user piracy is criminalized and all parties are required to authorize the seizure, forfeiture, and destruction of counterfeit and pirated goods. The text also mandates statutory damages for abuse of copyrighted material.[41]

Pharmaceutical Issues

The proposed U.S.-Panama FTA adopts new IPR pharmaceutical standards that reflect a bipartisan understanding as developed by congressional leadership and the USTR in the May 10, 2007 "New Trade Policy for America." They affect three important issues. The first and perhaps most complicated issue is *data exclusivity*. To bring a patented drug to market, a drug company must demonstrate through clinical trials that the drug is both safe and effective, a time-consuming and costly process. Under U.S. law, the data used to establish these claims are protected for a period of five years from the time the patented drug is approved for use in a country's market, the so-called data exclusivity term. Under this protection, regulatory agencies cannot use these data or rely on references to such data in the certification of a generic version of the medicine or drug until the data exclusivity period ends. This issue was raised by Members of Congress during the CAFTA-DR debate, but was only partially addressed in a side agreement ("understanding") assuring that relevant WTO rules would be in force. Critics, however, wanted the side agreement to include an explicit exception to the data protection requirement for cases where compulsory licensing under the WTO rules might be invoked, and to include the language in the body of the FTA.[42]

Congressional input led to significant changes to the Panama text. The IPR chapter provides that if a company files to bring to market a new drug in a foreign country (e.g., Panama), and the foreign regulatory agency relies on marketing approval of the initial filing in the home country (e.g., the United States) for approval in Panama, and the Panamanian regulatory agency approves the drug within six months of that filing, the data exclusivity term begins at the time the drug was approved in the United States, not Panama. This provision is intended to speed the entry of

[40] USTR, *2009 Foreign Trade Barriers*, p. 388.

[41] U.S.-Panama FTA, Chapter 15.

[42] U.S. Congress. House of Representatives. Committee on Ways and Means. *Dominican Republic-Central America-United States Free Trade Agreement Implementation Act*. H.Rept. 109-182. pp. 50-51. The side agreement is available at http://www.ustr.gov and for a summary of the debate, see Brevetti, Rosella. CAFTA Opponents Blast U.S. Stance on Guatemalan Data Protection Law. *International Trade Reporter*. BNA, Inc. March 10, 2005.

generic drugs into Panama's market by encouraging both drug companies and foreign governments to engage in the approval process as efficiently as possible. Because the six-month rule effectively reduces the data exclusivity term in Panama, drug companies are encouraged to file as soon as feasible to maximize the time their data may be protected in Panama after receiving market approval. Because countries must approve within the sixth-month rule to benefit from it, they are encouraged to put in place an efficient drug certification process.[43]

In addition, there is language in the IPR chapter stating that in cases such as epidemics, extreme urgency or national emergency, and other cases of public non-commercial use, a waiver from the data exclusivity laws would be allowed. The WTO public health provisions allow for compulsory licensing, circumventing patents in public health emergencies or other circumstances of public use deemed necessary. In the case of the U.S.-Panama FTA, which requires a period of data exclusivity not mandated by the WTO, the waiver is extended to the data exclusivity term as well.

A second issue is *patent term restoration*, which allows for the retroactive application of patents in cases where the approval process for a patent extends beyond some legal- or regulatory-determined standard period of time. Although there are provisions that require term restoration for patents in general, in the case of pharmaceutical products, term extension is only optional.

The third issue is *patent linkage*. This term refers to linking the sanitary registration process (done, for example, by the Food and Drug Administration in the United States) with the patent registration process. U.S. firms effectively wanted mandatory linkage that would automatically check for patent infringement when an application for bringing a drug to market is made in a foreign country sanitary registration office. The Panama agreement was amended to make patent linkage voluntary, and allows for administrative or judicial remedies to expedite patent challenges.

Public health advocates have long pushed for re-balancing international rules in ways that would facilitate the introduction of lower cost generic equivalents into developing countries. The revised IPR chapter in the Panama FTA supports congressional interest in pursuing this goal, although not to the full satisfaction of some public health advocates. Pharmaceutical companies, by contrast, lobbied against these changes, arguing that they bear their full cost through cumbersome administration and lost revenue by the earlier introduction of generic competition. They further argued that they count on this revenue to offset the high costs of research and development that allows new drugs to be properly tested and approved in the first place.

Labor and Environment

Labor and environment provisions have been highly contentious issues in trade agreements, with considerable disagreement in Congress and elsewhere over how aggressive language in trade agreements should be in accommodating these concerns. An important aspect of the proposed U.S.-Panama FTA is that it adopts new standards for both the labor and environment chapters that reflect a bipartisan understanding as developed by congressional leadership and the USTR in the "New Trade Policy for America." Despite the bipartisan nature of the agreement, many Members

[43] There are further complicated implications. This process is useful for countries with weak drug certification mechanisms, but for those that have developed such capability, it may encourage hasty responses or circumventing the process all together to qualify for the six-month time constraint.

continue to express reservations about the effectiveness of labor provisions, as well as the overall benefits of bilateral FTAs.

The debate over labor and environmental standards reflects differences in both economic and political perspectives. From an economic perspective, it has been argued that developing country firms may have an "unfair" competitive advantage because their lower standards are a basis for their lower costs, which in turn are reflected in lower prices for goods that compete with those produced in developed countries.[44] It follows from this argument that the difference in costs may be an inducement to move U.S. investment and jobs abroad. In addition, critics have also argued that trade agreements should not support a status quo in production standards that leads to unacceptable working conditions and severe environmental degradation.

On the other hand, some studies have suggested that cost differentials are usually not high enough to determine business location alone, and that productivity is the more important factor.[45] Further, many economists view trade liberalization as part of the overall development process that, in and off itself, can promote improved social and economic conditions over the long run.[46] Developing countries are concerned with the loss of sovereignty should specific standards be defined in trade agreements, as well as with the possibility that such provisions can be misused as a disguised form of protectionism.

Labor Issues

Preliminary drafts of the U.S.-Panama FTA adopted the CAFTA-DR labor chapter language verbatim. Many Members of Congress and others objected to four key aspects of this language. First, it emphasized that a country must effectively "enforce its own labor laws," rather than define specific labor standards to be codified and enforced. Second, this was the only provision in the labor chapter subject to the FTA's labor dispute resolution process (other commitments were unenforceable). Third, labor (and environment) provisions had their own dispute settlement mechanism separate from the process used for commercial and other disputes. Critics argued that the labor dispute mechanism was inferior for many reasons. Fourth, language that required Parties to the agreement only to "strive to ensure" that they do not waive or derogate from their labor law commitments was considered both inadequate and unenforceable.[47]

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

[45] See Perkins, Dwight H., Steven Radelet, and David L. Lindauer. *Economics of Development, Sixth Edition.* New York: W. W. Norton Company. 2006. pp. 745-746. Productivity and wage levels are highly correlated, suggesting that lower productivity jobs gravitate toward countries with a relative abundance of low-skilled (and hence low-wage) workers. See also Rodrik, Dani. *Sense and Nonsense in the Globalization Debate*. Foreign Policy. Summer 1997. pp. 30-33.

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

[47] As defined by the United Nations International Labor Organization (ILO) in the *Fundamental Principles and Rights at Work and its Follow-up (1998) Declaration.*

In short, there existed a basic criticism that the labor provisions in the bilateral FTAs did not reflect the intent of Congress in defining labor negotiating objectives in Trade Promotion Authority (TPA) legislation, were a step backward in U.S. policy on this issue that conditions trade benefits on meeting basic ILO labor commitments as defined in the Caribbean Basin Initiative (CBI) and the Generalized System of Preferences (GSP), and were effectively meaningless without a credible enforcement mechanism.[48]

Although supporters of the CAFTA-DR model prevailed in earlier agreements, a new bipartisan consensus emerged with the 110th Congressional leadership that led to a significantly changed model for bilateral FTA labor chapters. The principles of this change, as defined in the May 10, 2007 "New Trade Policy for America," were incorporated into the labor chapters for proposed U.S. bilateral FTAs with Panama, Peru, and Colombia. The major changes from the CAFTA-DR model state that each country:

- shall adopt and maintain in its statutes, regulations and practices as rights, the five core ILO labor principles: freedom of association; the effective recognition of the right to collective bargaining; the elimination of all forms of compulsory or forced labor; the effective abolition of child labor and, for purposes of this Agreement, a prohibition on the worst forms of child labor; and, the elimination of discrimination in respect of employment and occupation;
- shall not waive or otherwise derogate from, or offer to do so, in a manner affecting trade or investment between the countries in implementing the above commitment;
- shall not fail to effectively enforce its labor laws in accordance with the above commitment and that each party retains the right to the reasonable exercise of discretion in using resources to achieve this goal, provided the exercise of such discretion is not inconsistent with the obligations of the chapter, and;
- will be required to use the dispute settlement process defined for the entire agreement (rather than a separate process for labor disputes as defined in the CAFTA-DR).

The change in language is intended to make commitments to ILO basic principles binding and enforceable to the same extent as all other commitments in the proposed FTA, including having recourse to trade sanctions. The rest of the labor chapter conforms largely to commitments in previous bilateral FTAs. These include procedural guarantees of transparency and fairness in the use of tribunals to enforce a Party's labor laws and institutional arrangements that include creation of a joint Labor Affairs Council to oversee implementation and review of commitments made in the Labor Chapter. A new Labor Cooperation and Capacity Building Mechanism is also to be established.

[48] U.S.-Panama Free Trade Agreement. *Report of the Labor Advisory Committee for Trade Negotiations and Trade Policy (LAC).* April 25, 2007. pp. 3-7, and U.S. Congress. House of Representatives. Committee on Ways and Means. *Dominican Republic-Central America-United States Free Trade Agreement Implementation Act.* H.Rept. 109-182. pp. 47-50.

Panama's Labor Conditions

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

The U.S. Department of State has pointed out that Panama's labor laws guarantee all the ILO basic principles. All private-sector and most public-sector employees have the right to organize, bargain collectively, and strike (limited for the public sector). In general, major violations of labor laws have not been found. Nonetheless, the ILO has raised concerns about a number of ongoing practices. These include the widespread use of temporary workers to circumvent the labor code, the minimum requirement of 40 workers to form a union, and the use of child labor, particularly in agricultural areas during harvest times and for domestic employment. Lax enforcement of health and safety standards was also cited as a continuing problem.[49] These issues were cited by some Members of Congress as needing to be addressed before the FTA could be considered.[50]

The Colón Free Zone and the small export processing zones are all subject to national labor laws. The Panama Canal Area presents a unique issue. Although the Canal Zone has separate statutes governing labor, they tend to be more generous with respect to workers' rights and compensation. For this and other reasons, jobs in the Canal Zone are highly coveted. Workers may organize and exercise their rights to collective bargaining, but they are prohibited from striking because of commitments under the Panama Canal Treaties, which stipulate that the canal must be operated without interruption.[51]

Environmental Issues

Environmental specialists have stressed the need to achieve multiple goals in U.S. reciprocal FTAs. These include protecting and assuring strong enforcement of existing domestic environmental standards, ensuring that multilateral environmental agreements are not undermined by trade rules, promoting strong environmental initiatives to evaluate and raise performance, developing a systematic program of capacity-building assistance, and assuring that environmental provisions in FTAs are subject to the same dispute resolution and enforcement mechanisms as are other aspects of the agreements.[52]

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[49] U.S. Department of State. Bureau of Democracy, Human Rights, and Labor. *2008 Human Rights Report: Panama.* Washington, D.C. February 25, 2009 and American Federation of Labor and Congress of Industrial Organizations (AFL-CIO). *Panama: Labor Rights and Child Labor Reports*. Washington, D.C. August 9, 2004. p. 3.

[50] David J Lynch, "U.S.-Panama Trade Deal May Test Obama Goals: Congress Wants to See Bank, Tax Reforms There First," *USA Today*, July 31, 2009, p. B1.

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

[52] See http://www.sierraclub.org/trade/fasttrack/letter.asp, *Principles for Environmentally Responsible Trade.* Another important issue for the United States is ensuring that its higher environmental standards defined in law and regulation not be compromised by challenges of protectionism. See CRS Report RL31638, *Foreign Investor Protection Under* (continued...)

At issue is identifying and attempting to ameliorate the environmental effects of trade, particularly in developing countries that may have weak laws and lax enforcement mechanisms. Even among environmental experts, opinions vary. Some have suggested that thus far trade agreements have not led to catastrophic pollution nor encouraged a "regulatory race to the bottom." There has also been a certain acknowledged degree of success in having environmental issues addressed in the body of FTAs, in side agreements on environmental cooperation, and through technical assistance programs, which developing countries can use to respond to specific problems. Advocates and many Members of Congress still note that much can be improved, such as clarifying obligations, tightening enforcement language, and ensuring that the United States allocates financial resources to back up promises of technical assistance.[53]

As with the proposed FTA labor chapter, revisions made pursuant to ideas outlined in the "New Trade Policy for America," reflect a bipartisan sense of that although the text recognizes sovereign rights and responsibilities with respect to the management of natural resources, that trade and environmental policies should be mutually supportive and dedicated to the objective of sustainable development. The new language, therefore, strengthens the commitments to environmental obligations and their enforcement, requiring that each country:

- adopt, maintain, and implement laws, regulations, and other measures to fulfill their obligations under selected multilateral environmental agreements (MEAs) listed in Annex 18.2;
- shall not fail to effectively enforce environmental laws and regulations, including those adopted as signatories to the MEAs;
- shall not waive or otherwise derogate from, or offer thereto, from such laws (replacing the "strive to ensure" language with "shall not");
- adopt a commitment to policies that will promote conservation and sustainable use of biological diversity;
- subject disputes to the FTA's overall dispute settlement mechanism rather that a mechanism developed solely to deal with labor and environmental disagreements that was used in previous FTAs, and;
- meet obligations for formal cooperation among governments on environmental issues and use of the consultation and dispute resolution mechanism in a way that is transparent and involves public input.[54]

As required under TPA, the USTR conducted an environmental review of the potential environmental effects possibly attributable to the proposed FTA. It noted that Panama "faces a number of challenges in protecting its environment as it supports its economic and population growth." Deforestation, land degradation, loss of wildlife, and threats to water quality and wetlands, among other problems are serious issues for Panama. The Panama Canal also places severe water use requirements on the country. Panama has responded through the public policy process, establishing environmental standards in law and entering into international and U.S.

(...continued)

NAFTA Chapter 11, by Robert Meltz.

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

[54] U.S.-Panama FTA, Chapter 17, The Environment.

bilateral environmental cooperation agreements.[55] These issues were already factors in Panama's development process prior to the negotiation of the proposed FTA. Thus, the environmental review maintains that the marginal effects of the proposed FTA on environmental standards would be small, whether in terms of projected impacts on the United States or on Panama.

The environmental review further notes that Panama's service-oriented economy and the small trade volume with the United States are unlikely to be greatly affected by the proposed FTA and so will change production and trade little. Still, the FTA may have both positive and negative effects. The negative effects of pollution, environmental degradation, and endangering wildlife would come mostly from increased agricultural trade and production, which might be addressed with increased environmental oversight and policies. The positive effect of the FTA could include improvements in environmental standards that may be encouraged by the provisions of the agreement and the consultative and cooperation agreements attached to the proposed FTA.[56] Panama's environmental regulatory agency points out that Panama is increasingly using environmental impact studies, but realizes it has enforcement capacity issues that may require time to remedy, which could be accommodated in the FTA.

Trade Capacity Building

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

Panama prioritized TCB needs in its national trade capacity building strategy. The overriding goal is to formulate a strategy that would allow Panama to assume all the commitments under the proposed FTA, in the context of also meeting the country's development needs. The National TCB Strategy places strong emphasis on sectoral adjustment strategies, recognizing that some industries are already competitive by international standards (e.g., financial services), whereas others will need considerable assistance when faced with increased competition from the United States (e.g., agriculture). Emphasis is also placed on supporting existing and potentially new micro, small, and medium-sized businesses, which may need the most assistance and constitute a significant portion of the Panamanian economy, as well as government capacity to administer trade-related activities.[57]

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

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

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

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

FTA is identified along with action items that may need to be pursued to improve capacity in the respective area.

Successful implementation of the strategy, however, requires financial and technical resources coordinated among international and U.S. aid agencies. Already in place is a U.S. Agency for International Development (USAID) project to support Panama's transition to more open trade. It has two major initiatives: supporting implementation of the proposed FTA and assisting Panama with sectoral adjustment to the increased competitiveness arising from international trade. In the first case, the USAID project has helped prepare and disseminate a product that explains the benefits of the proposed FTA and how Panama might better access the U.S. market with its specific products.

The second initiative focuses on helping three major sectors of the economy, each with a differing level of product complexity, to increase their exposure and market share in the United States. Specifically, agro-industry, information and communications technology, and artisan products were identified as sectors with potential to benefit from the proposed FTA. Sector strategies range from targeted product design, to "hands on" assistance in participating in trade fairs, and building contacts and linkages with venture capitalists and other key business facilitation professionals.[58]

Outlook

On June 28, 2007, representatives of Panama and the United States signed a reciprocal bilateral free trade agreement, establishing a commitment, subject to congressional approval, to more liberalized rules on trade and investment between the two countries. Panama's National Assembly ratified the FTA by a vote of 58 to 4 on July 11, 2007. The United States has yet to take up the FTA. Trade policy and agreements affect more than commercial ties between countries. For Latin America, and in particular for countries in the Caribbean Basin region, U.S. trade arrangements historically have been an important part of U.S. foreign economic policy. The proposed U.S.-Panama FTA is no exception and presents the U.S. Congress with a complex and multifarious policy challenge.

The significance of the proposed U.S.-Panama FTA has not been lost on Congress, as exemplified by a vigorous ongoing debate. Votes on FTAs, as on many trade policy matters, present difficult choices because they have become increasingly complex and can pit interest groups within a state or district against one another. This challenge is made even more difficult at a time when doubts over "globalization" and the lingering effects of the financial crisis have created widespread anxiety. To the extent that a bilateral FTA may be viewed as compromising or directly hurting certain industries, firms, or jobs, the arguments favoring specific economic interests face off against those emphasizing broader foreign and economic policy goals.

Often, the significance of such a trade off depends on the specifics of a particular trade agreement. The circumstances framing the Panama FTA differ considerably from those of two other FTAs that have yet to be considered by Congress. For example, the deep concerns that Congress has expressed over Colombia's violence have not been an issue in the Panama FTA debate, which is framed more by the positive image of a longstanding strategic bilateral relationship based on Panama's canal. Nor does Panama compare well with the continuing debate

[58] Miller, Eric. *USAID/Panama-Supported TCB Programs*. Summary chapter. Nathan and Associates. May 9, 2007.

over the proposed FTA with South Korea, which as a major U.S. trading partner, can affect key industries such as automobile and beef production. To the contrary, Panama trades little with the United States, even by Latin American standards, and so the FTA cannot have a major economic effect on the U.S. economy.

Congress is still debating the important FTA issues of labor rights and the environment. In the case of Panama, the final text of the proposed FTA incorporates specific amendments on these topics at the behest of congressional leadership. The most significant were adoption of enforceable labor standards, compulsory adherence to select multilateral environmental agreements (MEAs), and an easing of restrictions on developing country access to generic drugs. In these cases, the proposed U.S.-Panama FTA goes beyond provisions in existing multilateral trade rules and even those contemplated in the Doha Round. Members of Congress perhaps now face an even more difficult choice, in part depending on how important they view these changes.

Two other concerns still linger in the congressional debate over whether to introduce an implementing bill for the proposed U.S.-Panama FTA. The first issue concerns certain Panamanian labor statutes, particularly the law requiring a minimum of 40 workers to start a union, which was criticized by the ILO.[59] The second issue relates to questions raised over Panama's banking and Colon Free Zone financial operations, which some suggest may present transparency issues with respect to tax laws.[60] The GAO listed Panama as one of 50 countries described as having "tax havens" or "financial privacy jurisdictions" according to a number of international organizations.[61] In addition, Panama has declined to enter into any tax information exchange treaties.

Some Members of Congress want to see Panama address both these issues, in legislation where appropriate, before considering the FTA. Currently, the government of Panama is working closely with the USTR to find a mutually acceptable solution. The time frame for completing this process is unclear and may depend in part on whether Congress and the Obama Administration signal that they are prepared to move ahead with implementing legislation.

[59] U.S. Department of State. Bureau of Democracy, Human Rights, and Labor. *2008 Human Rights Report: Panama*. Washington, D.C. February 25, 2009.

[60] Inside U.S. Trade. *Administration Signals Panama Issues Not Major FTA Obstacles*. March 13, 2009 and Schatz, Joseph J. Pending Panama Trade Agreement No Sure Thing as Opponents Mobilize. *CQ Today*. March 11, 2009. p. 6.

[61] United States Government Accountability Office (GAO). *International Taxation: Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*. GAO-09-157. December 2008.

Appendix A. Chronology of U.S.-Panama FTA

Date	Milestone
November 18, 2003	The USTR notifies Congress of President George W. Bush's intent to enter into negotiations on a free trade agreement (FTA) with the Republic of Panama.
April 26-29, 2004	First round of negotiations occurs in Panama City.
June 11-15, 2004	Second round of negotiations takes place in Los Angeles.
July 12-16, 2004	Third round of negotiations held in Panama City.
August 9-12, 2004	Fourth round of negotiations held in Tampa.
October 18-22, 2004	Fifth round of negotiations takes place in Panama City.
December 6-10, 2004	Sixth round of negotiations held in Washington, DC.
January 10-15, 2005	Seventh round of negotiations held in Washington, DC.
Jan. 31-Feb. 6, 2005	Eighth round of negotiations occurs in Washington, DC.
Jan. 17-20, 2006	Ninth round of negotiations held in Washington, DC.
Dec. 16, 2006	Tenth and final round of negotiations concludes in Washington, D.C. Chapters on labor and environment left open.
March 27, 2007	Bipartisan "New Trade Policy for America" released.
March 30, 2007	President Bush formally notifies Congress of his intention to sign the proposed U.S.-Panama FTA.
April 27, 2007	USTR transmits to the White House and Congress 27 trade advisory reports on the U.S.-Panama FTA.
May 10, 2007	Congressional leadership and Bush Administration agree to change labor, environment, and intellectual property rights chapters in this and other FTAs based on principles outlined in the bipartisan "New Trade Policy for America."
June 28, 2007	The United States and Panama sign a free trade agreement at the Organization of American States in Washington, D.C.
July 2, 2007	USTR releases final text of proposed U.S.-Panama FTA.
July 11, 2007	Panama's National Assembly approves U.S.-Panama FTA 58-4.

Appendix B. Panama: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP Growth (%)	2.7	0.6	2.2	4.2	7.5	7.2	8.5	11.5	9.2
Per Capita GDP Growth (%)	0.8	-1.3	0.4	2.3	5.6	5.4	6.7	9.7	7.4
Unemployment Rate (urban %)	13.5	14.0	13.5	13.1	11.8	9.8	8.7	6.4	5.6
Inflation – CPI (%)	0.7	0.0	1.9	1.5	1.5	3.4	2.2	6.4	6.8
Current Acct. Bal. (% GDP)	-5.8	-1.4	-0.8	-4.5	-7.1	-4.9	-3.1	-7.3	-12.1
Terms of Trade (2000=100)	100.0	102.7	101.6	97.2	95.3	93.5	90.8	90.0	85.9
Foreign Direct Invest. ($ mil)[a]	624	467	99	818	1,019	918	2,498	1,907	2,402

Source: United Nations Economic Commission on Latin America and the Caribbean. *Estudio económico de América Latina y el Caribe, 2008-2009*. July 2009.

a. FDI = net investment or direct foreign investment in Panama minus Panamanian direct investment abroad.

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