

# CEPAL

## REVIEW

NUMBER 57  
DECEMBER 1995  
SANTIAGO, CHILE

ANIBAL PINTO  
*Director of the Review*

EUGENIO LAHERA  
*Technical Secretary*



UNITED NATIONS

## CONTENTS

<b>The United Nations and ECLAC at the half-century mark of the Organization</b> <i>Gert Rosenthal</i>	<b>7</b>
<b>The creation of the United Nations and ECLAC</b> <i>Hernán Santa Cruz</i>	<b>17</b>
<b>Human rights and the child</b> <i>Teresa Albáñez</i>	<b>35</b>
<b>Governance, competitiveness and social integration</b> <i>Fernando Calderón G.</i>	<b>45</b>
<b>Port privatization, labour reform and social equity</b> <i>Larry A. Burkhalter</i>	<b>57</b>
<b>New trends in wage policies</b> <i>Andrés Marinakis</i>	<b>75</b>
<b>Central America: macroeconomic performance and social financing</b> <i>Francisco Esquivel</i>	<b>85</b>
<b>Panama and Central American economic integration</b> <i>Luis René Cáceres</i>	<b>95</b>
<b>The dual currency bifurcation of Cuba's economy in the 1990s: causes, consequences and cures</b> <i>Archibald R. M. Ritter</i>	<b>113</b>
<b>Transnationalization and integration of production in Latin America</b> <i>Armando Di Filippo</i>	<b>133</b>
<b>Index of CEPAL Review, Numbers 1 - 57</b>	<b>151</b>
<b>Guidelines for contributors to CEPAL Review</b>	<b>193</b>

# Panama

## *and Central American*

# economic integration

---

**Luis René Cáceres**

*Principal Economist,  
Department of Strategic  
Planning, Inter-American  
Development Bank,  
Washington, D. C.*

This article looks at the benefits that Panama could derive from its possible integration with the countries of the Central American Common Market (CACM). First of all, Panama's production structure is analysed in terms of the phenomenon known as the "Dutch disease": this reveals the de-industrializing effect that the booms in the services sector have had on the economy. An examination is then made of the advantages that Panama could derive from gradual integration with the CACM countries in terms of intra-industry exports, promotion of investments, competition and modernization of production, and it is asserted that these benefits do not exist, on a reciprocal basis, in a scheme based on unilateral trade openness. An examination is also made of the ways in which subregional integration could further a process of modernization of production which could offset the adverse effects of the Dutch disease. Finally, some econometric equations based on a gravity model are presented and a quantitative assessment is made of the appreciable improvement that Panama could secure in its trade balance with the CACM if it became a full member of that integration scheme.

# I

## Introduction

In October 1973, the Central American countries –Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama– signed the Protocol to the General Treaty on Central American Economic Integration, thus updating the integration process to bring it in line with the new lines of national and international economic policy. This Protocol was signed in order to broaden the sectoral and institutional field of action of integration and reflect the political will of the Central American governments to strengthen the integration process. The fact that Panama signed that Protocol could be interpreted as a step towards its adherence to the Central American integration programme. Panama and the Central American Common Market –made up of the other five Central American countries– have been cultivating closer relations for several decades past. Examples of this are Panama's participation in such bodies as the Central American

Institute of Public Administration and the Institute of Nutrition for Central America and Panama; its accession to the Central American Parliament in August 1994; its attendance at Presidential and Ministerial meetings in the subregion since 1990, and the increase in its trade with the CACM countries. All this, however, has not culminated in its definitive incorporation into the Central American integration programme.<sup>1</sup>

In order to see what benefits Panama could obtain from its integration with the CACM, an examination will be made below of some distinctive features of the Panamanian economy and the areas in which integration could have favourable repercussions, and a quantitative assessment is made of the effect that a regime of free trade with the CACM would have on the Panamanian external sector.

# II

## The Panamanian economy

The economic structure of Panama reflects the big share accounted for by the services sector in its gross domestic product (approximately 80% in the early 1990s). This trend has been growing more pronounced in recent years, especially in transport, storage and communications, while the shares of agriculture and industry have gone down (table 1 and figure 1).

The share of investment in the GDP has also declined. Public investment has been going down steadily since 1976, and in 1992 it amounted to only a quarter of that year's level. Private investment also shrank between 1974 and 1991, and the recovery

registered in 1992 only managed to bring it back up to a figure below the levels of the early 1970s. The share of private investment in construction, machinery and equipment and transport equipment, as a proportion of GDP, showed a downward trend since the beginning of the 1970s, but recovered somewhat in the 1990s (figures 2, 3 and 4).

It is worth noting that investment in machinery and equipment has been identified as the type of investment that has the biggest impact on economic growth, generates substantial benefits through externalities (De Long and Summers, 1991) and has a

□ The author wishes to express his gratitude for the valuable comments made by Iris Alvarez, Gilberto Chona, Oscar A. Núñez-Sandoval, Javier León, Luis Amado Sánchez and Ernesto Stein, while emphasizing that the views expressed in this article are his own exclusive responsibility.

<sup>1</sup> For an overview of the studies on Panama's relations with the CACM with regard to economic integration, see Thoumi (1994). See also Salazar-Xirinachs (1990); Lachman, Olaso and Vallarino (1991), and Lachman, Chocano, Figge and González (1992).

TABLE I

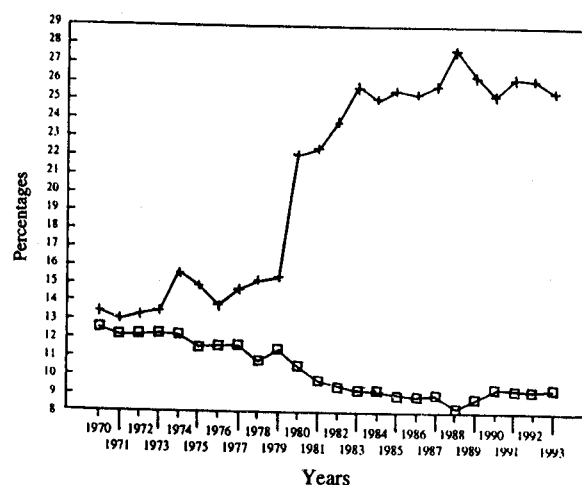
**Panama: Structure of GDP**  
(Percentages)

Sector	1970	1975	1980	1985	1990	1993
Agriculture	9.55	7.80	6.07	6.11	6.90	5.52
Manufacturing	12.53	11.50	10.49	8.96	9.30	9.29
Commerce	15.84	14.34	14.77	12.57	11.69	11.87
Transport, storage and communications	6.02	9.08	22.08	25.62	25.30	25.47
Colón Free Zone	2.15	2.35	4.79	3.20	5.54	8.61
Financial institutions, insurance and business services	12.01	13.99	13.08	14.16	14.22	14.87

Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

FIGURE 1

**Panama: Shares of transport, storage and communications sector and of manufacturing in the GDP**



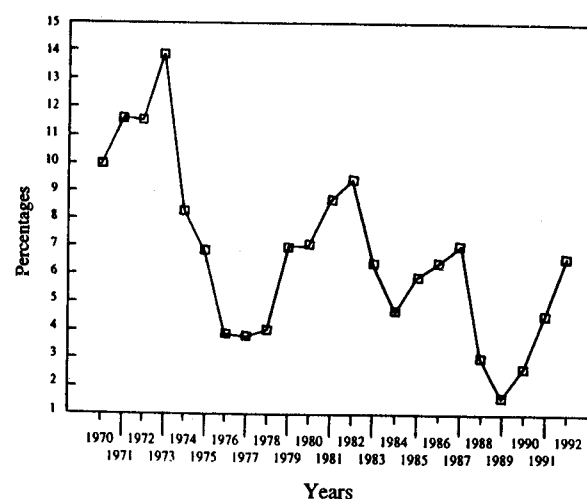
+ Transport, storage and communications  
□ Manufacturing

Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

higher rate of social profitability than its private yield, so that policies which encourage it to rise to levels higher than the corresponding laissez-faire values help to speed up economic growth (De Long and Summers, 1992). Likewise, high prices of investment in machinery and equipment have a negative impact on growth, so that its promotion through tax policy helps to raise the economic growth rate (Jones, 1994). Other authors have found empirical evidence that investment in fixed capital, as well as

FIGURE 2

**Panama: Share of private investment in construction in the GDP**



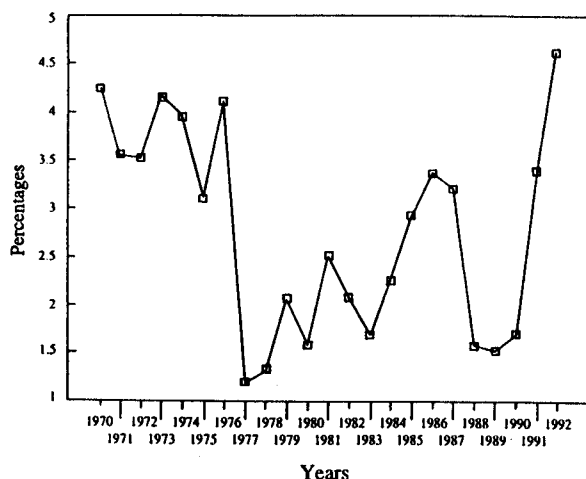
Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

expenditure on research and development, have effects that are just as significant as those of relative prices, or even more so, on the competitiveness of exports (Magnier and Toujas-Bernate, 1994).

The share of exports in GDP showed an upward trend between 1970 and 1980, rising from 38% to 44.03%, but this share fell back to 35% in 1992. The share of imports also grew between 1970 and 1980 (from 41.33% to 47.35%), but it too went down to 36.36% in 1992.

FIGURE 3

**Panama: Share of private investment in machinery and equipment in the GDP**

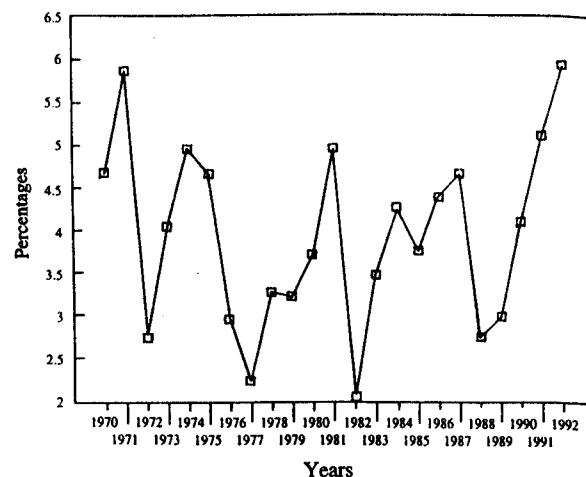


Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

Panama's economic structure may be explained as the result of a process called the "Dutch disease" in the economic literature.<sup>2</sup> This refers to the de-industrializing, and in some cases anti-agriculture, effect that an export boom has on the domestic economy. In the case of Panama, it is necessary to take into account the role played by the Canal Zone and,

FIGURE 4

**Panama: Share of private investment in transport equipment in the GDP**



Source: *Estadística Panameña*, Dirección de Estadística y Censo de la Contraloría General de la República de Panamá (various issues).

more recently, the Colón Free Zone, which have given rise to substantial increases in income. Thus, in 1988-1990 goods accounted for only 22.7% of total exports of goods and services, whereas the transport sector accounted for 34.8%, of which 19.7% came from Canal tolls. The Colón Free Zone, for its part, accounted for 18.1% of total exports.

### III

#### The export boom and the Panamanian economy

In order to illustrate the process of de-industrialization which has taken place in Panama, a model is presented here which divides the economy into three sectors: the booming sector (A), which may be equated with the activities in the Canal Zone or the Colón Free Zone; the lagging industrial or agricultural sector (R), and the non-tradeable goods or services sector (N). In each of these, production is determined by the capital, natural resources and labour factors. The last-

named factor is movable, seeking to match the wages paid in the three sectors in question.

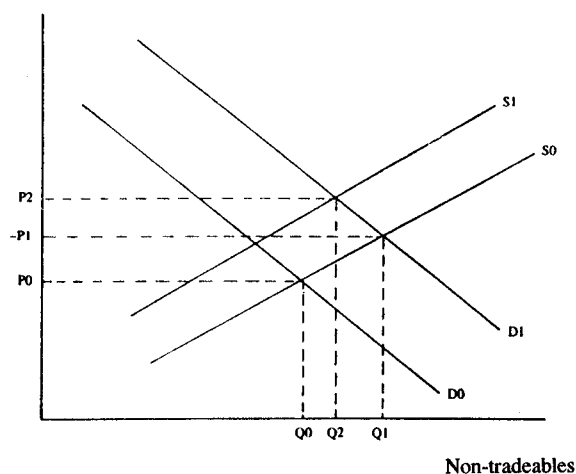
Let us suppose that the boom in sector A raises the incomes of those representing the factors used in it, and this in turn has two other effects: the expenditure effect and the resource transfer effect (Corden, 1984). On the side of the expenditure effect, as a result of the boom in sector A demand is stimulated in the services sector, N, so that prices rise, the production of non-tradeable goods is encouraged, and labour is attracted from sectors A and R, thus reducing the production of sector R. This can be seen from figure 5, where the vertical axis shows the relative

<sup>2</sup> See Gregory, 1976; Corden and Neary, 1982; Corden, 1984; Enders and Herbeg, 1983. For a summary of the experience of several developing countries, see Cuddington, 1989.

FIGURE 5

**Panama: Graphic representation of the effects of the "Dutch Disease"**

Prices of non-tradeables  
in relation to  
tradeables



Source: Prepared by the author.

price of a non-tradeable compared with a tradeable, while the horizontal axis shows the output of services. The supply curve is derived from the transformation function between  $N$  and the two tradeable goods sectors. The demand curve shows the demand for services at their different prices. The income effect displaces the demand curve from  $D_0$  to  $D_1$ , which increases the consumption of services from  $Q_0$  to  $Q_1$  and the price of services from  $P_0$  to  $P_1$ . The rise in the price of services attracts labour from the lagging sector and reduces the production of sector  $R$ .

The resource transfer effect is due to the increased demand for labour in  $A$ , which causes labour to move to it from  $R$  and  $N$ . The outflow of labour from sector  $R$  causes a further reduction in the output of that sector, which is termed "direct de-industrialization". In turn, the movement of labour from the services sector to  $A$  generates an excessive demand for services, which is represented in figure 5 by the movement of the supply curve from  $S_0$  to  $S_1$ . This increase in demand gives rise to a fresh increase in the price of services from  $P_1$  to  $P_2$ , and this in turn causes an additional outflow of labour from the lagging sector to the services sector, thus accentuating the contraction of the former. The combination of the expenditure effect with the effect of the transfer of labour from  $R$  to  $N$  causes what is called "indirect

de-industrialization", which is added to the direct de-industrialization caused by the movement of labour from the lagging to the booming sector.

At the same time, the profitability of sectors  $A$  and  $N$  increases because of the rise in production, while it goes down in the case of sector  $R$ . The lower profitability of the lagging sector discourages investment in it, which is attracted instead to sector  $N$ .

In the model, it is considered that both agricultural and industrial production go down even in conditions of unemployment, if it is assumed that the movement of labour primarily affects skilled workers. If it is assumed that the booming sector does not attract labour from the other sectors, then the resource transfer effect would not occur. The expenditure effect *would* occur, however, as a result of the increase in the prices of  $N$ , thus causing revaluation of the real exchange rate and a consequent reduction of  $R$ . In this case, the expenditure effect could also take place through increased public sector consumption due to possibly greater fiscal revenue thanks to the boom in  $A$ .

It should be noted that expectations that the economic boom would continue could give rise to a tendency to spend beyond the means of the economy. This would not only accentuate the contraction of the industrial and agricultural sectors but could also create a chronic situation of low rates of saving, current account deficits, and external indebtedness.

Although the "Dutch Disease" model does not analyse the repercussions on the demand for and supply of credit, the increased demand for the goods of sector  $N$  could raise the demand for credit to finance that sector's production. Thus, the financing that might have gone to sector  $R$  would be displaced to sector  $N$ , and this would further accentuate the former's contraction. In Panama, credit to the agricultural and industrial sectors represents 4% of the total (Loehr, 1991).

Furthermore, in view of the tendency towards contraction the lagging sector might demand protection, to which end a number of measures to inhibit competition might be applied. Thus, in Panama there has been a rigid system of quotas, customs tariffs and support prices. This has been a factor in creating a situation in which the prices of some agricultural products are as much as three times higher than the Central American average (Loehr, 1991). Tariff protection for the manufacturing industry, weighted by production, has averaged 66.8%, but the effective level of protection has been much higher, since industrial

inputs have been exempt from customs duties. The fact is that Panama has higher and more dispersed customs tariffs than the CACM countries (Loehr, 1991), and according to Thouni (1994) it has been one of the most protectionist countries in the whole continent.

This high level of protection could explain the concentrated structure of manufacturing, but on the other hand this structure could itself be responsible for the high protection, since it has been observed in various countries that the greater the concentration of industry, the more intensive are the campaigns for higher protection (Connolly and de Melo, 1994).

It should be noted, however, that Panama's export boom is not necessarily a negative factor. On the contrary, its good effects are reflected in the high per capita income levels, the level of social development, and the rates of growth attained. At the same time, however, in view of the progress being made all over the world in economic liberalization, the fact of remaining aloof from an important source of benefits deriving from industrial production could represent a high opportunity cost for the country. It should be noted that manufacturing has been recognized as a source of technological change which benefits the economy as a whole, specifically through reductions in costs, improvements in quality, and the acquisition of new skills. The expansion of the services sector, on the other hand, has been criticised because it does not make possible the cultural, technical and intellectual development that only a sound and vigorous manufacturing sector, and the urban development associated with it, can bring (Kaldor, 1981). It has also been noted that an economy accustomed to receiving

a steady inflow of rents runs the risk of being incapable of generating its own income when the source of those rents disappears (Ellman, 1981).

Furthermore, recent studies have shown that the expansion of the services sector does not generate economic growth (Dutt and Lee, 1993). In particular, Harry Johnson (1976) has expressed his pessimism about the effects of the financial sector on the Panamanian economy. This is why it is important to strengthen the country's productive sector and at the same time correct the constraints imposed by the Dutch Disease.

In other words, it would be desirable to put the Panamanian economy on a new track, both in order to help surmount the protectionism and stagnation of its productive sector and in order to take advantage of the benefits of competition and productivity. Panama should not remain aloof from the integration movements which have grown up in the subregion. These movements, based on open regionalism, seek to promote efficiency through subregional competition and coordination and are effective means of securing better linkages with the international economy (ECLAC, 1994; Fuentes, 1994).

For these reasons, if the country is to take full advantage of its geographical location it must take a number of measures to endow its production apparatus with competitiveness and innovative capacity. This modernization of the national economy would not only lead to a faster increase in productivity but also to the consolidation and expansion of Panama's role as an international centre. In the following paragraphs we will see whether integration with the CACM can be an effective means of furthering the modernization of the Panamanian economy.

## IV

预览已结束，完整报告链接和二维码如下：

[https://www.yunbaogao.cn/report/index/report?reportId=5\\_3513](https://www.yunbaogao.cn/report/index/report?reportId=5_3513)

