



## Transforming Panama Into a World-Class Hub

By Diego Cerdeiro and Fang Yang

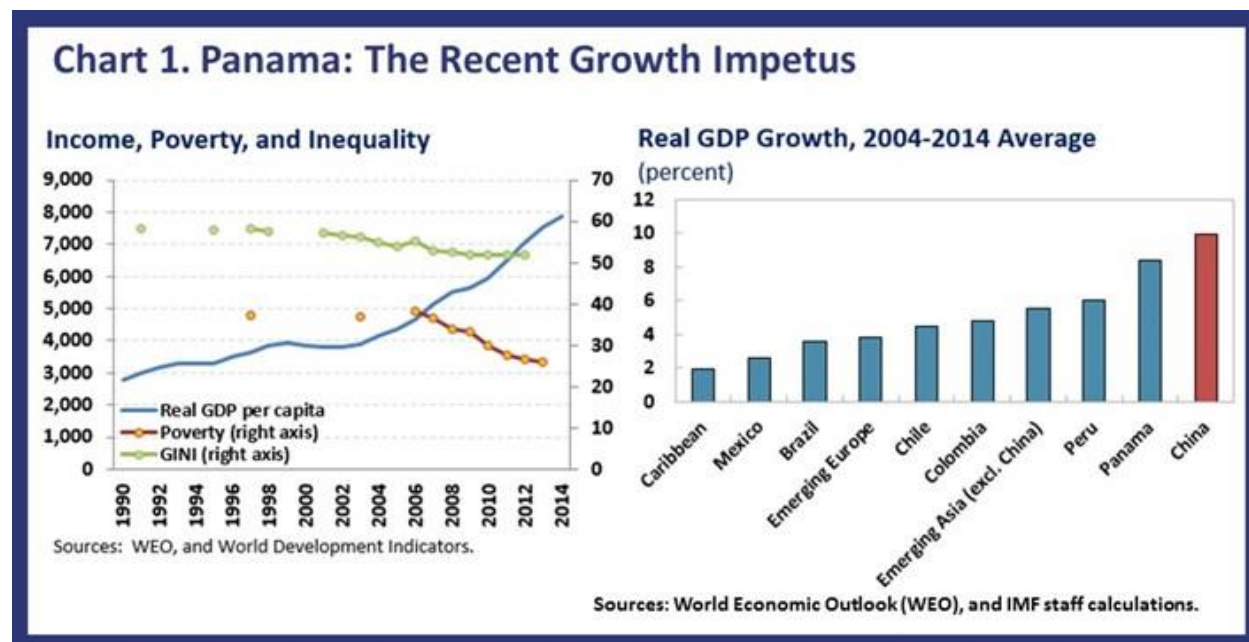
August 19, 2015

Perhaps best known for its canal, Panama has taken advantage of its strategic location to become a multifaceted hub connecting the world. The construction of a third set of locks on the canal—expected to be operational in early 2016—will boost growth and enhance other trade-related activities.

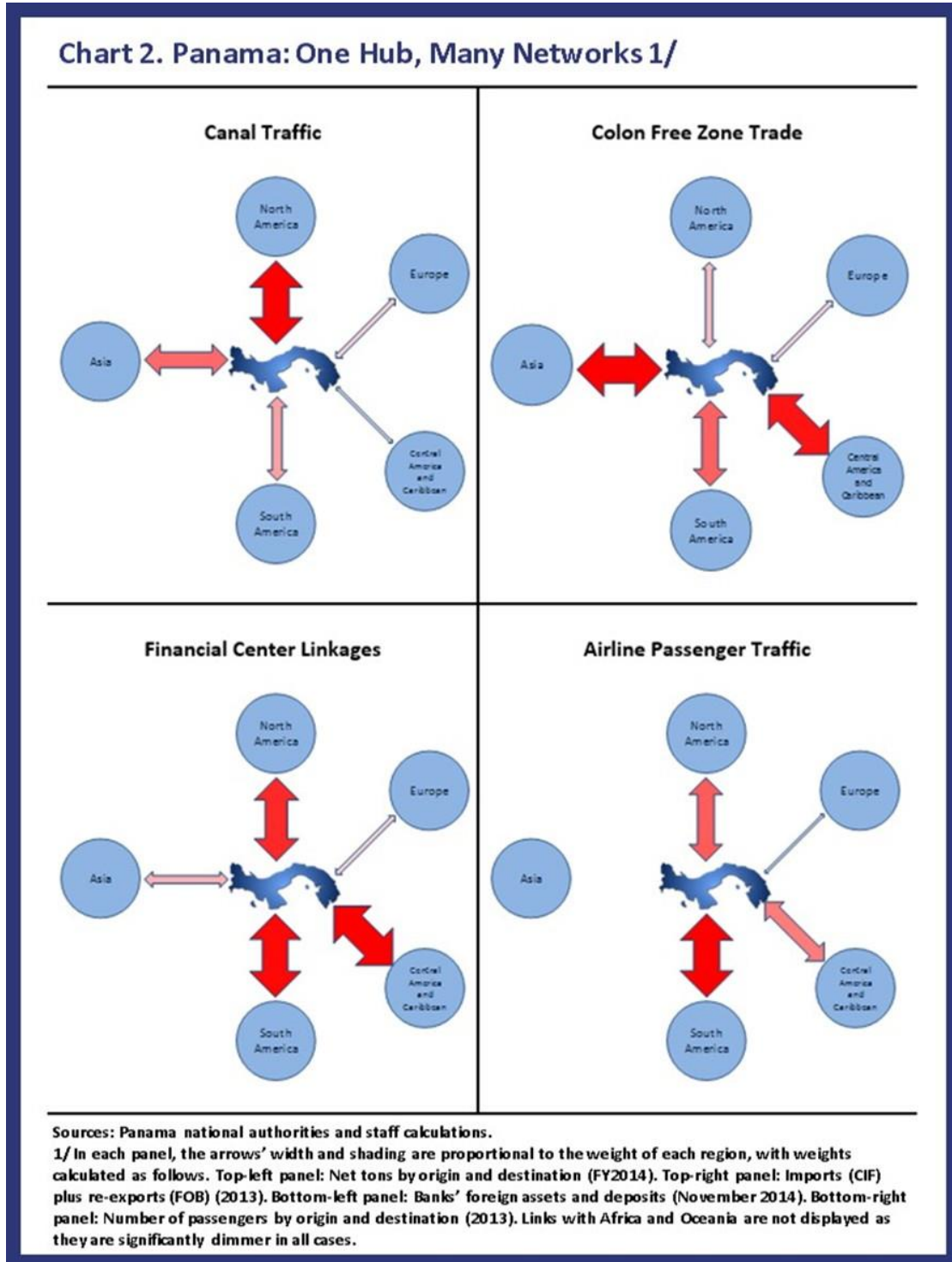
In this blog, we look at Panama’s central role in mobilizing goods, people, and capital across the world and especially within Latin America, and discuss what more can policymakers do to keep the economy growing once the expanded canal opens.

### One hub for many networks

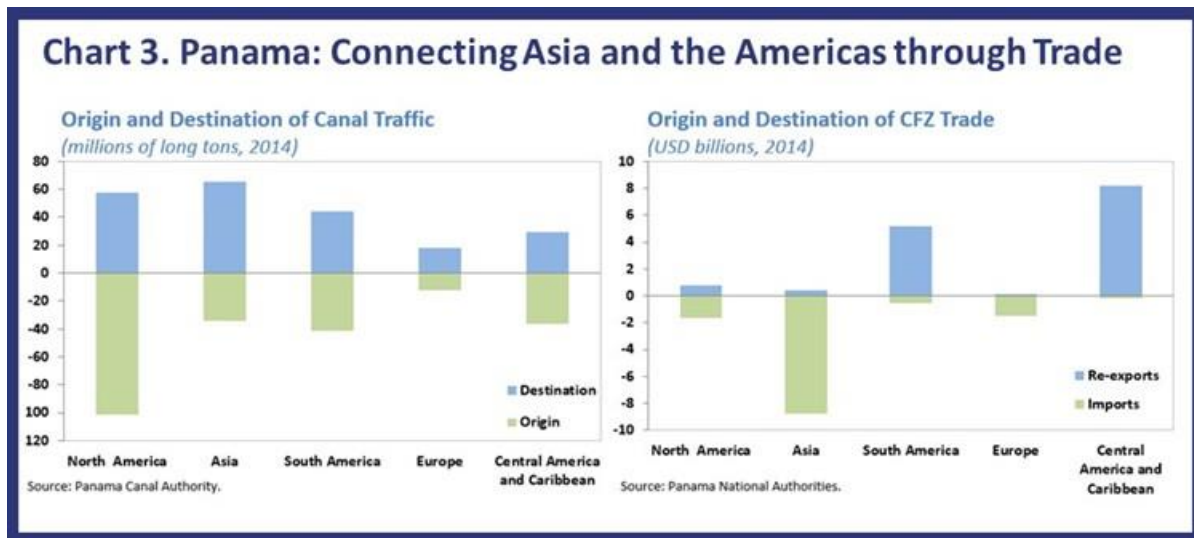
Before the turn of the century, Panama’s economy was stagnant and more than one-third of the population lived in poverty (see Figure 1). After substantial structural reforms and the transfer of the canal at the end of 1999 to the Panamanians, the country became one of the most dynamic economies in the world, with the highest growth rates in Latin America and declining poverty and inequality.



This success was largely associated with the country being able to tap into the various international commercial, financial, and production networks (see Figure 2). These networks—originally centered on the canal, which handles 5 percent of world trade—have strong synergies with each other.



**Goods.** Facilitating trade between the Pacific and the Atlantic, the canal is the backbone of the logistics sector. It opened in 1914 and by 2014 it generated revenues of about \$2.4 billion (6 percent of GDP). The construction of a third set of locks—expected to be completed in 2016—will double the tonnage capacity of the canal. Panama’s Colon Free Trade Zone facilitates many trade routes, mainly from Asia to Latin America (see Figure 3). Established in 1948, it is now the second largest free trade zone in the world after Hong Kong, with re-exports of about \$11.5 billion in 2014, and a contribution to GDP of about 8 percent.

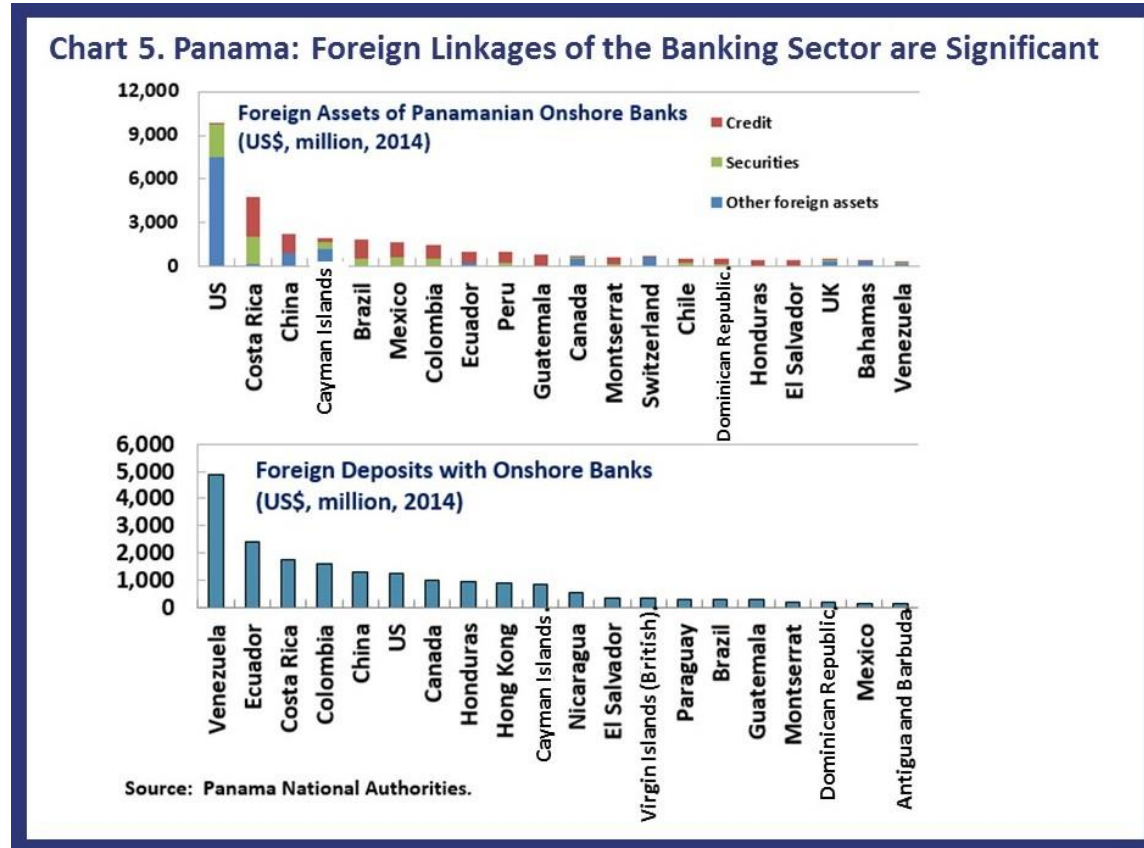


**People.** The number of passengers using Tocumen International Airport nearly quadrupled over the past decade, reaching almost 8 million in 2013, about twice the size of Panama’s population (see Figure 4). The 50 airlines that operate at the airport support the fast-growing tourism industry, facilitate the settlement of multinational companies, and contribute to Panama’s role as a logistics and business hub. After nearly 70 years of using Tocumen Airport as its main hub, Panama’s main national airline (Copa Airlines) now serves 72 destinations in 30 different countries, and is estimated to account for around 4 percent of GDP.

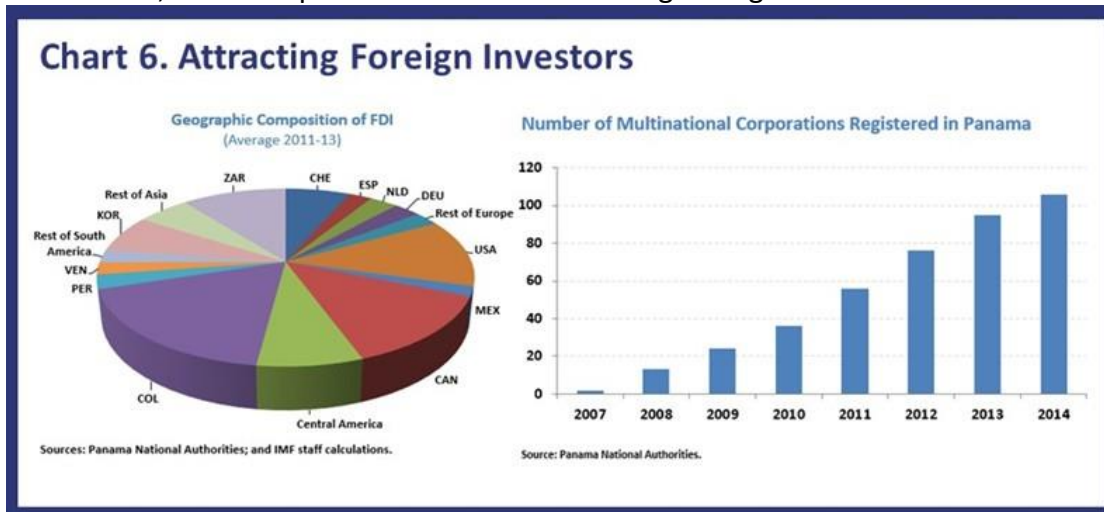
**Capital.** Panama is an important regional financial center for Latin America and the Caribbean (see Figure 5). Its regional role started in 1970 with the creation of an international banking center. The financial sector now accounts for roughly 7 percent of GDP, with more than 70 banks present in Panama and gross financial positions at around 235 percent of GDP. Part of its success depends on the important trade and transport linkages, but other factors play a role, such as dollarization and



stable macroeconomic conditions, free flow of capital, the country’s geographic location, a liberal business environment, and double taxation treaties (the elimination of double taxation of income or gains imposed by two or more jurisdictions).



Over the past years, Panama’s role as a logistics and financial hub has also attracted a well-diversified inflow of foreign direct investment (see Figure 6) in logistics, tourism, mining, financial services, and—coupled with tax incentives—a growing number of multinationals.



## A services hub makes the economy more resilient

Panama's service-oriented economy makes it more resilient to commodity price fluctuations than other countries in Latin America. This implies a smaller need for relative-price adjustments, and hence a better ability to reap the benefits of dollarization. In terms of stability, by reducing the price uncertainty associated with international transactions (compared to an independent currency), dollarization, in turn, reinforces Panama's competitive advantage as a services hub.

## Going forward

Consolidating Panama as a world-class hub for logistics, finance, business, and tourism will require steady improvements in productivity, human capital, and institutions. A decomposition of growth into the contributions of capital, labor, and productivity suggests that the recent

growth spur was mainly driven by investment (capital accumulation) and improvements in productivity (see Table 1).

As public investment is expected to slow its pace from the high levels of recent years, growth will depend more on raising productivity. It is crucial to intensify efforts in areas that still need progress, for

example, by improving the quality of public education and health, addressing skill mismatches, promoting greater female labor force participation (for instance, by increasing the flexibility of working arrangements), and strengthening institutions. Doing so will significantly enhance human capital, reduce skills shortages and youth unemployment, improve the business environment, as well as raise living standards. A broader discussion of the IMF's policy recommendations can be found in our recent [report on Panama's economy](#).

Sources of Growth in Panama				
Panama: Real Growth and Input Contributions (%)				
	1980-2014	1980-1990	1991-2003	2004-2014
<b>GDP</b>	<b>5.0</b>	<b>2.3</b>	<b>4.5</b>	<b>8.4</b>
<b>Capital</b>	<b>2.7</b>	<b>0.7</b>	<b>3.3</b>	<b>4.0</b>
<b>Public</b>	<b>0.8</b>	<b>0.2</b>	<b>0.5</b>	<b>1.6</b>
<b>Private</b>	<b>1.8</b>	<b>0.2</b>	<b>2.7</b>	<b>2.5</b>
<b>Labor</b>	<b>2.5</b>	<b>2.6</b>	<b>2.8</b>	<b>2.2</b>
<b>TFP</b>	<b>-0.2</b>	<b>-1.1</b>	<b>-1.6</b>	<b>2.3</b>
<i>Memorandum item</i>				
<b>Investment/GDP</b>	<b>19.3</b>	<b>11.2</b>	<b>21.9</b>	<b>25.0</b>
TFP stands for Total Factor Productivity.				
Source: Staff estimates.				

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