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Rethinking External Financing in Panama: Potential Catalyst for Economic Growth and Poverty Reduction

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Introduction

Throughout the past century, Panama, Latin America, and the world have confronted the forces of globalization and the increasing financial interaction among nations. While some authorities view such interaction as a positive force and one that is necessary to develop underdeveloped countries, the adverse consequences of these relationships deserve consideration. Over the past two decades, Latin America, a region of 150 million people living on an average of less than $2/day, has paid out over $1 trillion in debt service to creditors across the globe. Even with this extraordinary sum of capital flight, the region still owes more than $750 billion. Panama has the highest debt service/GDP ratio among Latin American countries (20 percent), the second highest per capita debt in the region ($2,572), and a comparatively high debt service/export ratio (17 percent). (Potter, p. 6) Further, its external debt/GDP ratio stands at 65 percent. (CIA World Factbook) Looking ahead, critics believe the booming Panamanian real estate market and the recent decision to expand the Panama Canal will raise these numbers to even higher levels.

The magnitude of these figures necessitates a critical study of one of the most significant components of globalization throughout the past century: external financing. During this time, Panama and its Latin American counterparts have increased external financing levels, from commercial and development banks as well as through foreign direct investment from private and public investors. The central debate over escalating external financing is whether this process acts as a catalyst for economic growth and poverty reduction or whether it simply benefits the upper echelons of society.

This article assesses the past and present nature of external financing and its positive and negative effects on Panama, comparing the country's situation to those of Latin American and global counterparts. The article cites examples of current financial initiatives that resemble components of past failed projects which proved disastrous for Panama's people and economy. In addition, it evaluates various current and potential external financing projects, while proposing initiatives to attack the problems of poverty and economic growth. Most importantly, the article advocates a shift away from external financing aimed at export industries and infrastructure benefiting the elite, and towards broader social potential projects, raising human-capital value and reducing poverty throughout the country.

External Debt from Commercial Banks and the World Bank

One of the most highly debated components of external financing is the process and effect of external debt received from commercial and development banks. What are the implications of the Latin American and Panamanian debt figures mentioned above? Is there a distinct causal relationship between debt and important social indicators, such as poverty, the distribution of income, and unemployment? The World Bank estimated the Panamanian poverty rate at 39 percent in 1970 and 37 percent in 1980. (*Panama Poverty Assessment*) Gian Singh Sahota, who has conducted poverty studies throughout Panama over the past 30 years, measured the poverty rate at 39 percent in 1990 (Sahota); and a recent Inter-American Development Bank (IDB) report has Panama's poverty level at 38 percent as of 2004. ("Panama's Country Strategy") Similarly, the Gini coefficient[1] for the income distribution of the country has also stayed relatively static, between .50 and .55 over the past two decades, indicating one of the most unequal distributions of income in the world. (Sahota, p. 82) Further, at the beginning of 1980 Panamanian unemployment was at 12 percent, and has remained between 12 and 14 percent at the turn of the twenty-first century.

In short, 20 years of increasing external debt service coexist alongside unmoving indicators of poverty, distribution of income, and unemployment. Panama and other Latin American countries have paid out more than $1 trillion in debt service over the past 20 years and are en route to pay more in the future; yet, the vital economic indicators have stayed the same. The time has come for a shift in policy to reduce these debt service figures and to improve income and unemployment indicators. First, however, it is necessary to understand how past events have brought Latin American countries to their current situation.

History of the Debt Crisis of the 1980s

One of Latin America's largest involvements with external financing occurred during the 1970s and 1980s, ending with the infamous external "Debt Crisis of the 1980s." There have been many debt crises in Latin America over the past 200 years, such as in the 1820s when loans from English bankers went into default and in the 1930s due to the Depression; but the debt crisis most relevant to this article took place during the 1980s, resulting from the events of the previous decade.

In the 1970s, spurred by a surplus of $375 billion among OPEC nations, a huge influx of capital entered northern hemisphere banks. In order to pay these funds back with interest, the banks engaged in heavy lending. Due to the large supply of "petro-dollars," loans were initially structured at low variable interest rates. Latin American dictators, such as Panama's General Torrijos, took advantage of these initially low interest loans, expanding public investments during the four years of his administration and tripling Panama's foreign debt. (Rudolf, p. 251) A majority of these investments occurred in the export and international banking sectors.

As "petro-dollars" moved real interest rates towards near-zero rates, the OPEC oil shocks of 1973 caused inflation, setting in

[1]The Gini coefficient is a standard measure of income and wealth inequality. The coefficient is a ratio with values between 0 and 1, where 0 corresponds to perfect income equality (e.g. 10 percent of the population has 10 percent of the income, etc.) and where 1 represents perfect income inequality (e.g. 1 person controls 100 percent of the income).

motion subsequent interest rate increases. These shocks in turn led Americans and other lenders to decrease their demand for imports, causing prices for Panamanian commodities to spiral downwards. Between 1980 and 1982, the prices of coffee and sugar, both vital sources of revenue to fund Panamanian debt service repayment, fell 50 percent and 90 percent respectively on the New York Board of Trade. (New York Board of Trade) As one member of the Economic Commission for Latin America and the Caribbean (ECLAC) wrote, "This evolution of international trade had an extremely harsh effect on Latin America, as it brought about a sharp drop in the international prices of most commodities and Latin America's terms of trade fell steadily and sharply during each of the last three years." (Economic Commission..., p. 1) In addition, the United States attempted to slow inflation by decreasing the money supply, setting off a series of increases in short term interest rates. This move further curtailed international demand for commodities and accordingly hindered the ability of Panama and other Latin American countries to pay back their loans.

To summarize, commercial and development banks issued loans at low interest rates to the governments of Latin American countries. When these loans had to be paid back, the interest rates had risen dramatically while the prices of commodities (the life-blood of Panamanian revenue) dropped, making the loans nonpayable. In addition, there was a significant reversal in capital flow. Many banks went into a "freeze phrase" and abruptly halted loans to Latin America. The loans from the few banks that did continue to loan money to Latin America did not help economic growth within the region because by 1983 most of the new Latin American loans were used to pay interest on old debts. (Potter, p. 21) Even in 1990, the $1 billion sent in aid to Panama went mostly toward paying off international lending institution debt, with the rest going toward paying off the trade deficit. (*Council on Hemispheric News*, p. 3) In addition, two-thirds of all export earnings were used for debt service. (Potter, p. 12) In all, from 1977–1983 Latin American debt rose by 195 percent and interest payments rose by 415 percent, escalating the Latin American debt crisis. Panama's debt increased by a comparable 185 percent during that same time period. (Economic Commission..., p. 10)

By the early 1980s, a merry-go-round of debt rescheduling occurred, calling for coalitions of banks to increase official lending, but also imposing structural conditions. Only those activities that were income-producing could be financed with the new external funds. On Panama's front, Zimbalist and Weeks write that the country negotiated new loans with commercial and development banks mandating the country to reduce public spending on social services and shift that spending towards nontraditional exports in the agricultural sector. (Zimbalist and Weeks, p. 129) Resulting from these conditions, by 1987 thirty percent of World Bank loans went to export production while only 2.8 percent went to health, education and nutrition. (Potter, p. 21)

Effects of the Debt Crisis of the 1980s on Panama

The main effect of the structural conditions was the imposition of an export-led growth model that, according to politicians and the commercial banks that influenced them, would be the fastest way to spark economic growth and repay the banks. Sahota notes that export crops have received priority over subsistence agriculture which cannot earn badly needed foreign exchange. Specifically, emphasis has been placed on exports of bananas, coffee, and sugar, crops that generally use more productive land, leaving less fertile land for subsistence crops. (Sahota, p. 40) Indeed, in a system where a majority of the rural population barely maintains itself at the poverty line, allocating crops away from subsistence farming only worsens the situation. Between 1970 and the time the debt crisis began, the total domestic output of rice, maize, and beans declined by roughly 3 percent, 25 percent, and 35 percent respectively. (Sahota, p. 27) According to Gloria Rudolf, who spent 25 years researching poverty within a small Panamanian rural village called Loma Bonita, these commodities are considered staples in a rural diet. The decrease in the output of agricultural staple crops coupled with a growing population has inevitably contributed to growing starvation communities like Loma Bonita, where community members have faced food shortages more often since the turn of the twentieth century.[2]

In addition, negative ecological effects resulted from an emphasis on export production and slash-and-burn agricultural tactics. In Loma Bonita, the minimum fallow time should be fifteen years. Conservatively, people had left lands rest up to twenty-five years early in the twentieth century; but by 1972 that figure slipped to three years in the economically worst-off families. (Rudolf, p. 99) Also criticizing the emphasis on mass quantity agricultural production of staples, Rudolf noted that in the past, 1,000 coffee trees had yielded 400 lbs. of coffee, whereas during the 1980s the same number of trees yielded only 50 lbs. in a good year and 20 lbs. in a bad year. This decrease in yield resulted from an overuse of the land, which leads to long-term fertility damage to the lands. Combining this situation with an increased demand for export crops only creates long-term ecological effects.

Another negative effect of the imposed structural adjustment conditions was the public sector employment cuts, which along with the agricultural policy led to unemployment problems. The official unemployment rate went from 12 percent in the mid-1980s to 20 percent by 1988. (Zimbalist and Weeks, p. 129) One may wonder how it is possible to link export crop promotion and unemployment effects. As Sahota mentioned in his poverty study, the government implemented investment incentives, subsidizing agricultural capital, such as machines and new farming technologies, for farmers producing crops that the government believed would draw foreign currency into the economy, in order to pay back interest and principal on the financing received throughout the 1970s and 1980s. As to the effects of these capital-providing government programs, Sahota states that "capital is cheapened by concessional credit [government subsidies]….Not only do the *latifundistas* [large landlords] substitute capital for labor, even the *asetiamientos* [small landlords] prefer to rent machinery for cultivation." (Sahota, p. 45) This situation caused a decrease in demand for labor and a widening unemployment gap.

What other effects does unemployment cause? On her last visit to Loma Bonita, Gloria Rudolf heard firsthand from a villager that robbers were outside because "newcomers to Cope or other nearby places can't find work." (Rudolf, p. 202) Also, job loss often contributes to violence and social unrest, a situation not limited to Panama. As reported by a social activist in Haiti, structural adjustment programs that reduce income are responsible for an increase in violence against women due to higher levels of frustration and stress within the family. (McGowan) In Panama, a recent IDB report regarding a project entitled "Institutional Transformation of the Health Sector" stated that violence is currently the largest public health problem and is the second leading cause of death. ("Institutional Transformation…")

As illustrated by the 1980s examples of structurally imposed regulations and negative effects on rural populations, overextending external financing can have drastic macro- and micro-level consequences. These structurally imposed regulations continued throughout the 1990s, leading to the 1995 labor reforms which gave the employers the legal right to reduce working hours and fire workers more easily. The result was an eight percentage point increase in poverty between 1990 and 1995. By 1998, 39 percent of lending, a total of $4 billion, was structurally-conditioned debt. (Rudolf, p. 200)

More importantly, as in the 1970s and 1980s, foreign investors continue to see Panama as a credit-worthy country with a multitude of investment potential, supported by the stability of a dollarized economy. This view has sparked a recent onset of new forms of direct investment that, as shown below, threatens the economic stability of the country, especially Panama's poverty-stricken citizens.

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[2] It should be noted this export-initiative trend began well before the debt crisis, as between 1950 and 1970 the land devoted to basic food crops within the village of Loma Bonita decreased almost 5 percent, while export crop production of bananas and sugar increased by 118 percent and 446 percent respectively. (Rudolf, p. 36) However, because the country was so deeply leveraged on external debt, during the debt crisis this practice was justified and heightened.

The Current State of External Financing and Foreign Direct Investment

Panamanians need to be concerned with the location of new foreign direct investment (FDI), in particular FDI associated with the real estate boom and expansion of the Panama Canal, and how current tax structures treat these investments. Most of all, Panamanians should be concerned with how the FDI and its effects are distributed among the population and who benefits.

According to studies done by Dirk Willem te Velde of the Overseas Development Institute, 96 percent of FDI received from the United States goes towards Panama's financial and services sectors. (Willem te Velde, p. 56) As mentioned by many speakers at Panama's City of Knowledge, 70 percent of Panama's GDP comes from these sectors. Yet, according to Domingo Latorraca of PriceWaterhouse-Coopers, those FDI-rich sectors employ only 15 to 20 percent of the population, a segment consisting of mostly skilled labor. (Latorraca) Accordingly, while current increases in FDI may be seen as conducive to GDP growth in Panama and other Latin American countries, increases in FDI may not necessarily lead to improving income equality across the country. The reason is that the sectoral location of the FDI fails to benefit 80 to 85 percent of the labor force, most of which is unskilled. Willem te Velde has also shown that throughout the 1990s there was no significant reduction in wage inequality stemming from increases in FDI in Panama, Argentina, Brazil, and Honduras. Furthermore, in some countries such as Bolivia, half of the increases in wage inequality seen throughout the 1990s can be attributed to increases in FDI. (Willem te Velde, p. 22)

In addition to FDI's inability to reduce wage and income inequality in the labor market, FDI has also failed to trickle down to the rest of the population because of current tax structures. As Latorraca also mentioned, Panama has a territorial tax system, whereby taxes are applied only on revenue earned in the country. If a U.S. company located in Panama sells its products abroad, that revenue is tax-free, an attractive way to entice companies to locate, manufacture, and hire workers in Panama. However, if a given company sells its product in the United States, Panamanian society receives no benefits in the form of tax revenue for public projects that could build up the surrounding communities. In past years, Panama attempted to tax companies, such as in 1974 when it (along with Honduras and Costa Rica) placed a $1/box tax on all banana exports. Transnational corporations such as United Brands responded by cutting back on exports. In addition, United Brands gave a $1.25 million bribe to General Oswaldo Lopez of Honduras to lower the tax from $1/box to $.25/box, an illustration of the corruption associated with the elite and powerful transnational companies. (Elson, p. 303)

A new type of FDI is associated with the real estate and construction boom, whose characteristics mirror those of the 1970s. U.S. and European investors, as well as Panamanian elites, are investing heavily into building and developing commercial and residential properties throughout Panama City. A prime example is the $220 million Trump Ocean Club International Hotel and Tower project, a joint venture between American real estate tycoon Donald Trump and the K-Group. In addition, the Spanish Grupo Mall is building the $600 million Los Faros de Panama, which will become one of the world's largest residential towers. In addition to the territoriality tax system, Panama has sectoral tax incentives that apply to investments in the construction of hotels, whereby the investor is exempt from import duties and value-added tax on equipment and materials used in the construction process. The investor is also exempt from real estate taxes on these structures and can employ accelerated depreciation accounting practices, thereby masking positive net income during the first few years of the project's life. ("Tax Incentives…," p. 165) Accordingly, the $220 million dollar foreign investment of Trump in his hotel and resort may not necessarily generate spillover benefits to the surrounding community and Panamanian society as a whole.

The need for external financing will further escalate due to the overwhelming vote in October 2006 in favor of the canal expansion project. According to Arnold Carlo of the finance department of the ACP, the organization that administers the operations of the canal, the expansion of the canal has a projected cost of around $5.25 billion.[3] Mr. Carlo has suggested that at least $2.27 billion dollars of financing would need to come from external sources — close to 20 percent of the country's GDP — at a time when the country has already accumulated a 65 percent external debt/GDP ratio. (Carlo)

Shifting External Finance towards Human Capital Improvement

Instead of focusing on external financing projects that are directed towards the canal and real estate, Panama should consider directing financing towards socially beneficial projects, such as those that benefit education, job training, and health services. One way for Panama to measure whether an externally financed project provides direct social benefits is by assessing whether the direct goal of a given project aims to raise personal income.

In his study of poverty in Panama, Sahota described individual income as a function of personal characteristics, such as human capital (education, training, health), inherited wealth, and the labor market. To reduce poverty, human capital must be increased via improvements in health and education. A decline in sickness increases the number of days worked not only by the individual but also by other family members who are no longer burdened with caretaking. (Sahota, p. 98) As Sahota has also noted, "The expenditure on health, literacy, and similar social services thus is an investment in the poor that probably has a very high payoff in terms of GDP….From Panama's experience it appears that social services that reach the poor are indeed growth-promoting as well as income-redistributing and poverty-reducing." (Sahota, p. 100) Much of the external financing that Panama has received from the Inter-American Development Bank (IDB) has focused on these types of social services with positive results. Accordingly, in the next section the discussion turns towards examples of external financing projects that can result in growth promotion and poverty reduction. These examples suggest potential projects for Panama as well as provide evidence from other countries where their implementation has had notable success.

External Debt Projects from the Inter-American Development Bank

The Inter-American Development Bank and its representatives are aware of the Panamanian problems already discussed in this article: staggering debt issues, a social framework characterized by poverty and inequality, and a robust service industry whose benefits do not necessarily trickle down to rural and poverty-stricken inhabitants. In response to such problems, the IDB has drawn up and implemented socially productive financing initiatives for Panama. In particular, the IDB has four lending programs to reduce poverty and spark economic growth within the country.

The first program, approved in November 1999 with implementation beginning at the start of the millennium, is the Poverty Reduction and Community Development program. The IDB has issued a loan to Panama to fund this program under standard financial terms with an amortization period of 30 years at variable interest rates, and a 4.5 year grace period, in order to give the country ample time to successfully implement the program and pay back the loan. The program emphasizes local investment and basic social infrastructure developments to increase the value of human capital. The program intends to create a collaborative program between the Emergency Social Fund (ESF), a government funded financial instrument created in 1990 to satisfy the needs of poverty-stricken communities, and local community organizations, local non-governmental organizations (NGOs) and other governmental institutions in Panama. The program consists of a local investment component of $47 million in which a select group of the poorest regions in Panama have an opportunity to give input on projects they believe will best fit their specific local needs. Such projects

[3] More liberal estimates based on a higher level of unexpected delays and extra costs bring this figure close to $15 billion, as mentioned by Tom Drohan, a Panamanian engineer affiliated with the canal in past years. (Drohan)

include providing basic highway infrastructure in rural areas to more efficiently transport their income-producing goods.

Community-driven social projects that serve specific localities have been implemented successfully in some African communities. One such program is "Africare," a coalition that works with local leaders and invites all villagers to work together to better their communities and assist with income- and sustenance-producing activities. Stephen Smith, author of *Ending Global Poverty*, witnessed these programs first-hand. One villager in a rural region of Uganda, assisted by Africare and taken to Northern Uganda to get a sense of potential projects, observed people fishing on a lake. The villager came back and began to fish farm, creating a tilapia pond and providing himself with a sustainable food source. (Smith, pp. 149–51) Smith reports that Africare acts as part of the group, providing technical assistance when needed but allowing the villagers to make independent decisions.

The second IDB program, established in September 2002, is the Institutional Transformation of the Health Sector program, also known as Project PAISS (Programa de Atencion Integral Servicios de Savalanche). The program is aimed towards developing a broad package of health services which will directly affect 450,000 of Panama's poorest people. There has always been an unequal distribution of healthcare resources throughout the country; and as of 2004, 65 percent of Panama's health expenditures have been allocated to hospitals and 28 percent have been allocated to primary care, in an environment where the poorest quintile uses primary care and the richest quintile uses public hospitals. ("Institutional Transformation of the Health Sector") The IDB project expects to spend $23.3 million on the delivery of services to the poorest jurisdictions and to those with the least access to healthcare. Services include prenatal checkups, pap smears, labor and delivery assistance, HIV education, and nutritional pills.

The program has shown positive preliminary results. For example, Jorge Tristan, the head of Project PAISS, has targeted two of the population groups with a combined total of 15,300 people. Each of these population groups is served by one doctor, a nurse, and a health education advisor. Tristan is in charge of a variety of services, such as the Program of Complimentary Feeding for children who are affected by moderate and severe undernourishment. Tristan reports that he has enabled a number of traditional midwives to assist with childbirth. (Tristan) The program brings healthcare to poverty-stricken workers, potentially leading to increases in their human capital and income.

Similar primary care health projects aimed at the poor that have long term objectives of raising the stock of human capital have been implemented successfully in such countries as Kenya. There millions of children live in communities where hookworm and roundworm parasites are nearly universal. This problem also exists in Latin American countries such as Panama where tropical conditions along with inadequate sanitation provide a breeding ground for these types of parasites. As Stephen Smith reports, in the Kenyan district of Busia 92 percent of schoolchildren were infected with at least one parasite. After the International Christian Support Fund began to implement de-worming programs to poverty-stricken children, absenteeism from school decreased by 25 percent. Wiafred Mujema, a teacher at Nangina Primary School in Busia village, reported that "'pupils who had been miserable now became active and lifeful.... When they were still infected, they acted dull. Then, after deworming, they had their hands up and were active in class." (Smith, p. 59) By strengthening primary care, which receives less than 1/3 of public health expenditures in Panama, the country can improve the human-capital potential of its poverty-stricken students by giving them the opportunity to enjoy a more productive and fulfilling primary education.

The third program financed by the IDB, approved in May 2002, is the $10.5 million Training and Employment Systems Development (TESD) program. This program aims to build a training and placement system to improve the employment prospects and competitiveness of Panamanian workers, especially youths and other at-risk groups. Like the Transformation of the Health Sector program, the TESD seeks to raise the value of

Panamanian human capital by creating a more skilled labor force.

In Chile similar technical education programs aimed at lower income families have had positive results. One such program, established in 1992 with support from the IDB, is called "Chile Joven." Providing marketable skills to young people with low levels of income and education, the program takes its participants through 200 hours of hard technical skills as well as 50 hours of soft skills, such as communication and negotiation practices. According to "Poverty, Growth, and Skills Development: A Focus on Latin America," a study published by the Working Group for International Cooperation in Skills Development, the program reached its target market and resulted in the majority of the trainees entering the labor market or going on to further education. In addition, 90 percent of the enterprises which hired these laborers were satisfied with the training given by the program. ("Poverty, Growth, and Skills Development…," p. 16) For Panama, where the unemployment rate is near 30 percent for the 15 to 24-year-old category, this program has enormous potential.

The fourth external debt project that the IDB has set up for Panama, created in November 2003, is called the Rural Microcredit Expansion in the Central Provinces program. This program aims to boost the incomes and improve the living conditions of poor, rural inhabitants in Panama's central province by providing greater access to microfinance services and products. Currently, small and micro businesses have a difficult time obtaining funding from the government. Where available, private lending usually comes at usurious interest rates. Under the IDB program, 8,000 low-income rural inhabitants will have the opportunity to gain access to affordable credit to create their own businesses.[4] Further, microfinance allows small farmers to gain access to credit to employ innovative agricultural techniques to restore ecologically unstable land. As Rudolf wrote in her study of Loma Bonita, "Community members suffered a lack of capital, credit, education…that set great constraints on what they could do or reap." (Rudolf, p. 214) The microfinance program, along with the training and development program, could help break down those constraints, enhancing rural productivity and potential.

Murdoch and Armendáriz de Aghion's *Economics of Microfinance* illustrates the impacts of microfinance on rural inhabitants. One of their anecdotal examples consists of a woman with a family of seven who lives in a poor area of Mexico. With $150 from ADMIC, a local micro-lender, the woman bought sewing supplies and grew a business where she could sell approximately one hundred baskets, dolls and mirrors. By the tenth loan, she had enough capital to install a toilet in her home. (Murdoch and Armendáriz de Aghion, p. 199) Another illustration deals with members of the Grameen Bank, one of Bangladesh's oldest microfinance banks, whose membership has grown to over 2.4 million people since 1976. The average borrower from the bank experiences a 126 percent increase in self-employment profits. (Murdoch and Armendáriz de Aghion, p. 202) The demonstrated growth of microfinance institutions across the world should give Panama assurance that the practice will be beneficial in raising its citizens out of poverty by replacing indirect large-scale debt with smaller scale affordable debt.

Recommendations

Like its Latin American counterparts, Panama has over-leveraged itself with large-scale debt financing, thereby promoting unsustainable development and forcing the country to act in the best interest of its commercial bank creditors. These actions have benefited a narrow elite class within and outside Panama, all to the detriment of internal economic growth among the broader general population.

The costs of growth-promoting initiatives are relatively low in contrast to the gross amount of debt service currently paid out on an annual basis. In its *Panama Poverty Assessment* of 2000, the World Bank stated that the cost of eliminating extreme poverty in Panama would not be high, with an estimated

[4]The program is consistent with Sahota's recommendation of creating capabilities among the poor through a micro approach rather than simply creating jobs through a macro approach. (Sahota, p. 194)

cost of five percent of GDP ($750 million) to bring all poor Panamanians to the poverty line. (*Panama Poverty Assessment*) And yet, according to Potter and other researchers, Panama currently pays twenty percent of its GDP, or $3 billion per year, in the form of debt service on loans from commercial banks unwilling to favorably restructure the terms of the loans. Restructuring loans in terms favorable to Panama could free up resources to eliminate poverty, creating healthier and more stable financial partnerships with the commercial banks. As illustrated by the four IDB programs, long-term external financing by developmental banks geared towards socially productive projects has the potential to produce poverty-reducing results, leading to the end goal of sustainable development.

Panama needs to critically assess and change the external financing it receives to obtain affordable and economically and socially productive financing from both commercial and developmental banks as well as from foreign direct investment from individuals and institutions. In addition, Panama needs to actively anticipate global market trends related to interest rates and commodity prices to avoid another crisis similar to that of the 1980s.

With regard to global financial interaction, Panama needs to implement financial controls to prevent devastating amounts of capital flight from leaving the country, as happened during the Noriega invasion in 1988, when an estimated $7 billion left in capital flight to the Cayman Islands and the Bahamas. (Zimbalist and Weeks, p. 148) If Panama wants to hedge against the negative effects of these actions, it might emulate the model of Chile, which requires foreign investors to keep a portion of capital that is brought into the country in interest-free accounts with the country's central bank. (Potter, p. 63)

Panama also needs to restructure its current debt, much of which was contracted during the 1980s, by creating agreements with creditors to reduce service payments and deploy the savings towards developmental infrastructure as has been done in Uganda. Uganda, ranked as one of the poorest countries in the world in 1999, persuaded its creditors to reduce debt service from $150 million to $120 million, and invested the savings towards health and education programs. Accordingly, its Universal Primary Education initiative increased primary education participation from 2.6 million to 5.9 million children. These education initiatives aim to create a class of productive and skilled people, leading to a long-term increase in economic growth. (Hanlon)

Panama must also take action to regulate and balance its external financing, investment, and loans not only to raise GDP, but to fund projects to reduce poverty and promote broader development. External financing that narrowly aims to build up GDP quickly without building a sound infrastructure, such as the export-initiatives of the 1980s and 1990s, has not solved the problems of unemployment, violence, and poverty, all of which have remained relatively constant over the past quarter century. Panama needs to aggressively ensure that new financing related to real estate and the canal is controlled and paired with long-term economic development projects.

By structuring and utilizing external financing with the aim of long-term economic growth that benefits all of its inhabitants, Panama can stabilize its economy, reduce unemployment, and more evenly distribute income throughout the country.

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