

## ANALYSIS OF ECONOMIC POTENTIAL OF PANAMA: MAXIMIZING SPILLOVERS OF THE PANAMA CANAL

Panama has been one of the fastest growing economies in the world over the previous decade. In that short but vibrant time span, the country managed to double its income per capita. Growth has been spearheaded by the development of a modern service sector on the activities surrounding the Canal, and non-residential construction. Large public infrastructure projects and the private provision for infrastructure demanded by the service sector, have fueled growth and expanded job opportunities for non-skilled workers.



Two warning signals hover over Panama's stellar performance. The construction sector has been growing at a rate equivalent to doubling its stock of structures every four years. The demand for non-residential construction cannot grow indefinitely at a higher rate than the rest of the economy. Once the stock of infrastructure required by the service sector is set and large infrastructure projects are completed, the rate of growth will recede and other sectors shall take the leading role. The deceleration of construction, characterized by a lower demand of non-skilled labor, will feed into the second warning signal: Income inequality.

In spite of the minor improvements registered over the accelerated-growth spell, Panama remains amongst the world's top five most unequal countries. Both warning signals point to the need to further diversify the Panamanian economy and promoting economic activity in the provinces so as to deconcentrate growth and make it more inclusive.

In collaboration with the Inter-American Development Bank (IADB), we've launched a research initiative aimed at exploring export diversification opportunities, identifying

goods and services that are likely to develop at the national and sub-national levels. We have also studied the underlying conditions and made an effort to pinpoint potential binding constraints that Panama can run into in the process of shifting gears.

The Growth Lab deployed a team of scholars and research fellows over eight months, interviewed business leaders, government authorities, indigenous communities that have migrated and established in the outskirts of the capital, and is applying its research toolkits and trademark methodologies to analyze Panama's economic, entrepreneurial, and social landscape from different angles:

**Panama Complexity Profile:** This report identifies productive capabilities already in place in Panama, as signaled by the variety and ubiquity of products and services that are already able to manufacture and provide competitively. Once there, we move on to identifying opportunities for productive diversification based on technological proximity. As a result, we provide a roadmap for potential diversification opportunities both at the national and sub-national levels.

We deployed our **Growth Diagnostic methodology** in order to identify potential binding constraints to that process. Our findings indicate that skilled labor, necessary to gradually diversify into more complex and higher value-added activities, is relatively scarce. This scarcity manifests into large wage-premiums to foreigners across all occupations, which are particularly large within more complex industries. Major investments in education have improved indicators of schooling quantitatively, but quality remains a major concern.

**Special Economic Zones (SEZ) Report:** SEZ have played an important role in Panama's successful growth story over the previous decade. We analyzed the performance of the three largest SEZ in Panama (Colon Free Zone, Panama-Pacific and City of Knowledge) from a static and a dynamic standpoint. Our results suggest that SEZ have been successful as measured by static indicators, such as foreign investment, job creation and productivity. We also find that SEZ have boosted inflows of high-skill immigrants, who are most likely generating positive knowledge spillovers on Panamanians productivity and wages. However, significant legal instruments and institutional arrangements are preventing Panama from taking full advantage of the skill variety hosted at the SEZ. Complex immigration processes inhibiting foreigners from transitioning out of the SEZ, a long list of restricted professions and even citizenships considered as a national security concern, are hindering the flow of knowledge, keeping the benefits coming from more complex multinational companies locked inside the gates of SEZ.

**Policy Recommendations Report:** This report aims to summarize the main findings of the project as gathered by the three baseline documents, and frame them within a coherent set of policy recommendations that can help Panama to maintain their growth momentum in time and make it more inclusive. Three elements stand out as cornerstones of our proposal: (i) attracting and retaining qualified human capital; (ii) maximizing the diffusion of knowhow and knowledge spillovers, and (iii) leveraging on public-private dialog to tackle coordination problems that are hindering economic activity outside the Panama-Colón axis.