

FREE TRADE AND PANAMANIAN SUPPORT FOR AGRICULTURAL PRODUCERS

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Introduction

The proposed Free Trade agreement between Panama and the United States has been the subject of ongoing negotiations for the past two-and-one-half years. At the time that this article was being written, nine rounds of talks had been held, and a tenth would eventually be necessary to reach a final agreement. While many of the issues have been settled, a few continue to hold up negotiations. Clearly the representatives of both nations wish to secure the most advantageous agreement possible for their respective economies.

In this article I argue that Panama's success hinges on the government's implementation of agricultural support and transition programs for rural producers whose goods are susceptible to competition from imported American products. While other trade-related issues may be important to Panama's economy, it is the agricultural question that is most

likely to cause resistance and domestic problems for the Panamanian government.

Proponents of free trade argue that liberalization results in various benefits for everyone involved, whether consumers or producers, or whether from developing or developed nations. These benefits include a lower cost of living as well as higher national and personal incomes. While some opponents of free trade argue that competition from cheaper imports may result in loss of income and unemployment for certain inefficient domestic producers, supporters maintain that the added available markets for competitive sectors will generate extra revenue that can be used for helping inefficient sectors adapt to competition or transition to a new activity altogether. ("Ten Benefits of the WTO Trading System")

I begin by providing some background information on the trading relationship between Panama and the United States. I then examine two comparable free trade agreements

(FTAs) that the United States has signed in recent history: the North American Free Trade Agreement (NAFTA) and the Central American Free Trade Agreement (CAFTA).¹ After discussing the lessons that can be learned from these past free trade agreements, I attempt to apply these lessons to Panama's FTA with the United States. Finally, based on these applications and my own analysis, I articulate a way for the Panamanian government to ensure that this FTA helps to promote development and stability for the Panamanian people. I also look to see whether Panama is currently taking the appropriate steps to ensure a smooth post-FTA transition process.

U.S.-Panama Trade Relationship

According to the Office of the United States Trade Representative, the United States and Panama have enjoyed "long-standing, strong economic ties." (Office of the United States Trade Representative) The United States is by far Panama's largest trading partner. In 2005 the United States accounted for 43.5 percent of Panamanian exports and 27.2 percent of its imports. (Hornbeck, 2006) This trade relationship has enjoyed substantial growth in recent years. Between 2002 and 2003, U.S. exports to Panama grew by 30 percent. The relationship is also one of broad access, as in 2002 over 90 percent of Panamanian exports to the United States came in duty-free. Clearly, although Panama is one of the United States' smaller trading partners, Panama's relationship with the United States is one of crucial importance.

What then has forced these negotiations to an unusual ten rounds, spanning nearly three years? By all accounts, it seems that agriculture has been the major issue blocking passage of the agreement. In early 2006, Panama's agricultural unions and associations took to the streets of Panama City to protest their government's negotiations with the United States. ("Panama Protests Build over FTA") As I will examine in the next section, agriculture is a vital industry to much of the

¹Although the Dominican Republic was included as part of this FTA, leading to the formal title of DR-CAFTA, for the sake of this article I will be examining solely the Central American participants. DR-CAFTA will thus be referred to as CAFTA.

Panamanian population. Therefore, there is significant concern that if American agricultural goods to which Panamanian producers are particularly vulnerable, such as pork, poultry and rice, were allowed immediate access to Panamanian markets, then the livelihood of these agricultural producers would be threatened. It is not merely Panamanian officials who harbor fears of a massive rural displacement as a result of free market trade with the United States. Many Panamanian farmers who already live in poverty have also expressed concern over the negative effects that an FTA might have on their source of living.

Panamanian Agriculture Issues

Panama's agriculture industry is deceptively important to Panama as a whole. While agriculture only makes up 6 percent of total GDP, it accounts for 17 percent of nationwide employment. This can be explained by the fact that many agricultural producers are among the 40 percent of Panamanians who live in poverty. Agriculture supports 40 percent of Panama's rural population, leading to fears of rural displacement should Panama open its markets to American goods too quickly. For these reasons, Panama has been pushing for a phased reduction of tariffs on American agricultural goods. Panama also wants a transition period to develop other exports which it sees as the most promising sectors for future trade with the United States. Some of these goods include melons, palm oil, and pineapples. (Hornbeck, 2006, p. 13)

Past Free Trade Agreements

NAFTA

In the case of NAFTA, the most useful negotiation issue available is that of the Mexican agricultural industry. In 1995 agriculture made up 5.7 percent of Mexico's economy (Poverty in Mexico — Fact Sheet), and most Mexican farmers lived in poverty, making them similar to Panamanian farmers. Given that nearly twelve years have passed since the implementation of NAFTA, we can analyze the effects of the agreement on the Mexican agricultural community.

Just as Panama has certain agricultural products that are sensitive to trade, Mexico faced similar problems with maize, dry beans, grain, and malt barley. It was known that Mexican production of these foods was inefficient; and if Mexican producers were subjected to American competition, the Mexican industries would likely suffer. (Yunez-Naude) As a compromise, NAFTA became the first free-trade agreement to use tariff-rate quotas (TRQ). A tariff-rate quota is a two-tier tariff system that allows for lower tariffs until a certain level of imports is reached, at which level the tariff significantly increases, making it very difficult for any imports beyond the TRQ level to achieve market access. Under the agreement, no tariffs were levied on imports that were within yearly quotas. With the TRQ system, tariffs for over-quota imports in sensitive areas were to be slowly phased out over a certain period of time. For maize and dry beans, a phase-out period of fifteen years was established; for grain and malt barley, nine years. (Yunez-Naude)

Observers predicted certain effects at the time of NAFTA's implementation. First, an overall increase in both agricultural imports and exports was expected. As market access expanded, it made sense that the flow of trade would do likewise. Many also anticipated that the product mix would change, reflecting the comparative advantage of certain crops and the comparative disadvantage of others. There was also fear that some rural displacement could result from the entrance of certain American goods into the Mexican market, potentially forcing the least efficient of Mexican farmers to give up production.

As expected, prices of products for which Mexican producers were less competitive did drop overall. Real domestic prices within Mexico for such agricultural goods dropped by an average of 25 percent from 1993–2000. However, after seven years of NAFTA, statistics showed that only for soybeans and wheat did domestic production drop and imports rise. For barley, beans, and maize, imports did in fact increase, but there was no accompanying drop in domestic production. Analysis has shown that yields per hectare (Ha) of these various grains under irrigated conditions did in fact increase in efficiency, going from an average of

3.61 metric tons per Ha during 1983–1990, to 4.6 metric tons per Ha during the post-NAFTA period. (Yunez-Naude, p. 19) Because one can generally assume that irrigated conditions indicate commercial production, these statistics have led some Mexican experts to the conclusion that “trade liberalization of importables have promoted a more efficient land use by commercial farmers.” (Yunez-Naude, p. 20)

It is important to note that no accompanying increase in efficiency appeared in rain-fed (non-irrigated) lands that produced Mexican importable goods. This would create an expectation that those producers operating rain-fed lands would be forced to shut down, unable to compete with commercially produced and imported competition. This in turn would create rural dislocation. However, this dislocation did not occur.

A possible explanation for the survival of rain-fed farms is that these producers are mainly small farmers producing food for their own families' consumption. Were this the case, even with an influx of cheaper imports it is unlikely that a farmer would change his entire crop. This possibility is particularly convincing given the Mexican Agricultural Census of 1990, in which more than 55 percent of agricultural units under 5 Ha of arable land produced food for self-consumption. (“Mexican Agricultural Census 1991...”) This would explain the lack of rural displacement and have significant implications for Panama's case. If a substantial portion of Panama's rural poor produce vulnerable agricultural products for their own consumption, then the fear of detrimental effects resulting from American penetration of Panama's markets would be largely reduced.

Similarly, a 2003 World Bank report concludes that “NAFTA has not had a devastating effect on Mexico's agriculture. In fact, both domestic production and trade in agricultural goods rose during the NAFTA years.” (Lederman, Maloney and Serven) The study offers three possible arguments for why the predicted negative effects did not occur. First, it points out that aggregate demand for agricultural products grew in Mexico and the United States in the late 1990s. In addition, the study mentions the increase in productivity in Mexican irrigated land, and it suggests that the Mexican

government made more efficient use of its agricultural subsidies and income supports. Furthermore, an analysis carried out by the U.S. International Trade Commission concluded that “many of the concerns expressed prior to NAFTA about agricultural unemployment and environmental degradation never materialized.” (“The Impact of Trade Agreements...”)

A 2004 report from the Carnegie Endowment for International Peace points out that the net effect of NAFTA has, in many senses, been neutral. (Polaski) The agricultural sector did suffer losses, as total Mexican agricultural employment went from just over 8 million in 1993 to fewer than 7 million in 2002.² However, total net job growth in export manufacturing jobs over the same period of time equaled approximately 1 million jobs, largely offsetting the job losses in agriculture. As the report states, “The substitution of manufacturing jobs for agricultural jobs is generally positive for development, representing a move up the production ladder.” (Polaski)

The Peso Crisis of 1994–1995 created a complicated situation for economists, who have had difficulty untangling the effects of the crisis when attempting to accurately gauge the effects of NAFTA on Mexico’s economy as a whole. Nonetheless, the evidence suggests that there have been both positive and negative effects on Mexico. While the agricultural industry did experience negative growth, it seems that the growth in Mexico’s more competitive sectors, such as manufacturing, has offset the losses experienced by farming. Additionally, it is possible that the Mexican government failed to provide adequate unemployment insurance and transition assistance to its agricultural producers, thus making the task of adjustment to newly liberalized markets much more difficult for the average farmer. (Polaski, p. 12)

CAFTA

The Central American Free Trade Agreement (CAFTA) was signed into law by President Bush on August 2, 2005. Over the

course of nine rounds of negotiation between the United States and its Central American counterparts, many of the same issues arose that we now face in U.S.-Panama negotiations. The Central American participants in CAFTA are Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. A primary concern among all Central American actors was the predicted effect that the removal of quotas on American imports of agricultural staple products would have on the rural poor populations of these countries. Fearing that the influx of cheaper American goods would drive the prices of such products down, there was a prediction that the rural producers of noncompetitive goods would be unable to sufficiently protect their livelihoods. This led many to forecast possible rural displacement and migration. The Central American nations were, nevertheless, able to reach a compromise with the United States, establishing similar agricultural TRQ rates to those that were agreed upon between Mexico and the U.S. under NAFTA.

Currently there are very few studies assessing the impact of the agreement on the Central American countries as a whole, let alone on their rural poor populations. However, it is possible to take advantage of the scholarly analysis and literature that exists concerning Central American agricultural policy in the context of free trade agreements.³ Such literature does not exist with specific reference to Panama, but by using CAFTA information it is possible to become familiar with the dilemmas that the Panamanian government faces and to suggest some strategies that should lead to agricultural development. When discussing “Central American nations,” it is important to remember that Panama is included in this category.

It is clear that the Central American nations have a comparative advantage in terms of labor when compared to the United States. (Hornbeck, 2005) Therefore, one would expect that trade liberalization will result in increased production of labor-intensive agricultural

²Note that these figures reflect only official statistics; notably, a significant number of Mexican farmers in rural areas of the country are not included in government reports.

³The most important works include Winters, McCulloch, and McKay, as well as “DR-CAFTA: Challenges and Opportunities for Central America,” in addition to Todd, Winters, and Arias.

products. In order for this advantage to be fully realized, Panama (and other Central American nations) must work towards several conditions.

First, according to a 2006 World Bank report entitled “DR-CAFTA: Challenges and Opportunities for Central America,” public infrastructure needs to be improved in order for Central American rural farmers to take advantage of international market access. According to the Inter-American Development Bank, many poor rural areas in Central America lack the transportation and communication infrastructure to participate in international trade. (Todd, Winters and Arias, p. 29) This means that even if poor farmers with competitive goods were granted increased access to international markets, many of them would either not be aware of this newfound possibility or would be unable to efficiently ship their goods to a city where they could take advantage of international trade. If infrastructure can be improved, then those farmers who produce exportable products can make use of free markets, thereby increasing trade and profits.

Secondly, the World Bank recommends that Central American governments need to invest in transition assistance aimed at poor rural producers of goods whose prices will decrease as a result of foreign competition. This transition assistance should be aimed at providing income support and technical assistance so that farmers will be able to change what they produce to adapt to new market conditions. (“DR-CAFTA: Challenges...”) In the years following the implementation of NAFTA, despite Mexican income assistance to noncompetitive farmers, many smaller producers were unable to transition themselves to produce goods that were more competitive, due to a lack of capital and technical ability.

Additionally, the fact that so many Central American agricultural producers operate on a small scale (Todd, Winters and Arias, p. 45) has implications for a transition to the international market. There is a considerable difference between selling products to a local market and being involved in exports to the United States. For example, Central American governments will need to provide additional assistance to their agricultural producers to enable them to meet American sanitary and inspection standards. It

is likely that very few of these standards apply to local transactions in rural areas.

The literature has provided a clear idea of how to achieve agricultural success in free trade. Improvement of infrastructure, transition assistance, and general government support all play a substantial role for CAFTA participants; but more importantly they are crucial to Panama’s experience. I will now examine how the Panamanian government has approached agricultural support programs.

Panamanian Government Assistance Programs

According to the Panamanian Ministry of Finance and Economics, the Panamanian government has been increasing its agricultural spending from 2005–2007. Panama committed slightly less than \$83 million to agricultural investment in 2006, an increase of nearly \$15 million from 2005. (“Documento Descriptivo del Presupuesto...”) Panama’s 2006 agricultural spending totals 8.2 percent of the federal budget, a significant portion for an industry whose revenue equals only 6 percent of GDP. Panama’s agricultural funds include money from the Panamanian Bank of Agricultural Development, the Panamanian Ministry of Agricultural Development, the Panamanian Institute of Agricultural Security, and external sources such as the Inter-American Development Bank and the United States. This funding is for projects designed to improve infrastructure, technology, competitiveness, and productivity.

A brief look at some of the projects that the Panamanian government has funded and carried out will provide a better idea as to whether Panama can handle the stresses that often accompany an FTA. The parts of the country most in need of attention and assistance, i.e., the regions with the highest poverty rates, are not coincidentally also the most rural regions in Panama. These include the regions of San Blas, Darien, Bocas del Toro, Cocolé, and Chiriquí. (Panama Poverty Assessment...) These are the regions that contain many of the farmers and agricultural workers that have been discussed throughout this article.

There is a government project run by the Panamanian Ministry for Agricultural

Development entitled “Commercialization of Agricultural Products in Boquete,” the function of which is to help farmers in Chiriqui become more competitive. (“Comercializacion de Productos Agricolas en Boquete”) This project will include the construction of an inspection center designed to streamline the crop inspection and sanitation process, a requirement that precedes the export of any Panamanian agricultural goods. The Panamanian government will also establish an office in Panama City devoted solely to the development and competitiveness of Chiriqui agricultural exports. This office will reportedly oversee the construction of proper infrastructure (roads, bridges, etc.) that will allow the workers of Chiriqui to be better connected both to Panama City and to the international market. The entire cost of the project will be \$1.3 million.

A similar project was administered in 2005 and 2006 which was dedicated to the repair of dilapidated roadways connecting extremely underdeveloped rural areas to Panama’s urban areas. At a cost of \$5.5 million, the Panamanian government repaired approximately 550 km (341 miles) of rural roadways, including 75 km each in the regions of Coclé and Chiriqui. In addition to these two regions, roads were repaired in Bocas del Toro, Colón, Darién, Herrera, Los Santos, Panama Este, Panama Oeste, and Veraguas. Most of these regions rank among Panama’s poorest, and the attention to roads is badly needed. As previously mentioned, proper infrastructure will allow Panamanian farmers to better take advantage of their newly expanded market in the United States.

Yet another project is focused on the improvement of the onion industry in the Coclé region. In April, May, and June of 2005, poor weather caused the yearly production of onion crops, one of the most important products for farmers in Coclé, to drop by 50 percent. (“Planta Procesadora...”) This project therefore allows for the construction of a plant which will serve as a place where farmers can dry, cure, and then store their onions, thereby reducing their weather-related losses. Factory personnel will be trained in the technology necessary to maximize crop productivity, a luxury that very few of the native farmers in the Coclé region have. This will allow the farmers of Coclé to better

compete with imported onions, some of which will soon be American.

As was previously noted, in the case of NAFTA there was a significant difference in the impact of the FTA between those Mexican agricultural producers that used irrigation systems and those that did not. It seemed that on the whole, those farmers who used irrigation were more efficient and therefore more competitive in a free-market environment. With this in mind, it is significant that the Panamanian government undertook a project in 2006 designed to provide irrigation water management systems to the poorest farmers in the regions of Chiriqui, Bocas del Toro, Colón, and Veraguas. These particular areas suffer not only from extreme poverty, but also from irregular patterns of rainfall, making it difficult for farmers to establish a consistent pattern of productivity. Irrigation will make it possible for the farmers to have access to water even in times of low rainfall.

In addition to these individual projects, Panama recently released its federal budget for 2007. It is highly encouraging to see that spending on agricultural development has vastly increased. While total Panamanian agricultural development spending in 2006 was just under \$83 million, this year’s funding from the Bank of Agricultural Development and the Ministry of Agricultural Development totals \$137 million. In fact, 2007 spending by the Bank of Agricultural Development alone will equal \$73 million, an increase of \$30 million from the year before. Clearly the Panamanian government recognizes that agricultural competitiveness is crucial if Panama is to solve the problem of extreme rural poverty, particularly in the face of increasingly open markets.

The Panamanian Ministry of Agricultural Development currently has 44 projects pending for 2007, the vast majority of which are dedicated to the improvement of infrastructure and competitiveness. These include the construction of a new sanitary inspection site in Coclé, funding for crop disease prevention in Colón, and nationwide assistance for the development of crops that are competitive for exportation. (“Sistema Nacional de Inversiones Publicas”) These programs all target the appropriate areas in order for Panama to successfully deal with market liberalization.

The impact of all these projects and dollar figures is of course contingent on the efficiency and effectiveness of the Panamanian government. Whether or not the government is up to the task remains to be seen, but it can at least be said that it has taken well-targeted steps to address the problem by providing substantial funds and directing the projects toward the most obvious problems.

The Inter-American Development Bank (IDB) is also playing a major role in assisting Panama with its transition to a more liberal economy. The IDB recently committed to a project for Panama geared towards the improvement of trade competitiveness. This will provide \$100 million from the IDB, a sum that should be enough to make a strong impact, given that Panama's agricultural labor force is only around 278,000. The IDB's Panamanian country strategy describes several explicit steps through which the IDB plans to attack rural poverty in Panama. These steps include an expansion of electrical power service in rural areas, the improvement of nation-wide road infrastructure, an increase in telecommunications coverage throughout the countryside, and an improvement in drinking water and sanitation services for the poorest areas of the country. ("Inter-American Development Bank: Country Strategy with Panama")

In addition, the United States Agency for International Aid (USAID) has committed another \$32.2 million to assist Panama with economic liberalization and trade transition for the years 2004–2008. Much of this aid is intended for the purpose of assisting vulnerable Panamanian agricultural producers in their transition to more competitive sectors after the Free Trade Agreement with Panama and the United States has been signed. ("Regional Strategy for Central America and Mexico") Although the USAID Panamanian country strategy is rather vague on a number of issues, it does provide some specifics. For example, USAID plans to implement a program that increases awareness among Panamanians of how exactly an FTA would affect the Panamanian people. To measure success in this area, USAID will measure Panamanian understanding of the U.S.-Panama FTA through a

succession of public surveys. An improved understanding of the FTA's impacts will lead to a quicker transition by the Panamanian people to newly advantageous sectors.

It is important to consider that the phase-out of TRQs for the most sensitive agricultural goods will most likely take place over 15 to 20 years. It is generally accepted that the structure of the TRQs will be similar to those agreed upon for CAFTA, as will many other sections of the agreement, including environmental and labor rights. (Hornbeck, 2006, p. 16) This will provide ample time for Panama's producers of sensitive goods to either make an effective transition to producing more competitive products or to improve their productivity within their existing industry. This is especially true given the amount of assistance that is being provided both by the Panamanian government and external sources such as the IDB.

Conclusion

It is clear that the Panamanian government has taken into consideration the importance and value of proper support and assistance for its rural agricultural producers. Success will be partly measured by the stated goals of the Panamanian government. If the government is seeking simply to avoid rural displacement, then simple income assistance will probably be enough to make sure such displacement does not happen. If the goal of the government is to significantly increase the average income of rural agricultural producers and to help pull them out of poverty, then more significant investments will be required in areas such as technological assistance and infrastructure. Either way, there does not seem to be a justification for the fear of mass unemployment and rural displacement as a result of the Panama/United States Free Trade Agreement. Panama's government must do a better job of communicating with its citizens concerning government-run programs that will provide infrastructure and technical assistance to poor farmers. If rural producers can be convinced that their livelihoods will not be in jeopardy, then Panama should be able to come to an agreement with the United States and enjoy successful economic liberalization.

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