Three Reasons Why The Panama Canal Is a Winning Business for Panama and the World (Including the U.S.)

1. The Canal's potential was underutilized prior to Panamanian administration

Since its inauguration in 1914, the Canal was managed more as a support infrastructure than as a profitable business. Its operation primarily was aimed at covering costs and maintaining a steady flow of military and commercial traffic, rather than generate profits.

As Noel Maurer and Carlos Yu highlight in their book *The Big Ditch: How America Took, Built, Ran, and Ultimately Gave Away the Panama Canal*, during the postwar period, **the U.S.-run Panama Canal Company suffered from some of the typical problems of state-owned enterprises lacking market incentives**: prices (toll rates) that did not adequately reflect the commercial value of the route, limited flexibility to adapt to changes in its environment, and a top management team that lacked incentives to prioritize economic efficiency.

Consequently, the Canal failed to generate sufficient profits to allow for significant investments in its modernization. **This situation compromised its competitiveness against alternate routes and limited its capacity to accommodate larger commercial and military vessels, thereby restricting its commercial utility and strategic relevance.** The situation deteriorated during the years leading up to the signing of the Torrijos-Carter Treaties, with profit margins below 5%, reaching negative figures in 1974.

Panama Canal profit margin was declining at the time of negotiating the Torrijos-Carter Treaty.

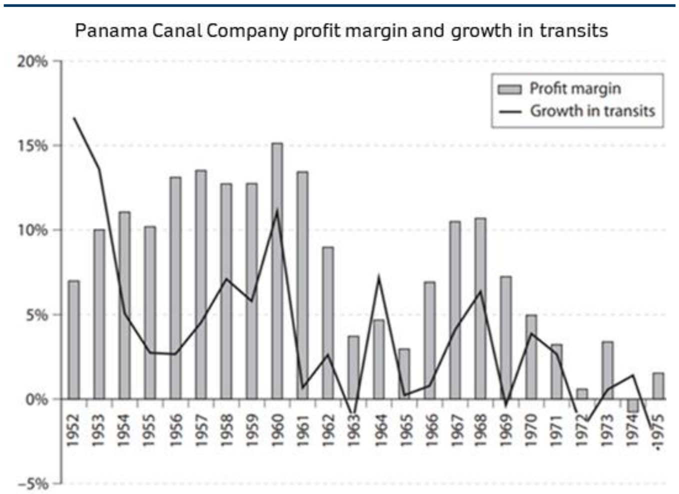


Figure 7.4: Panama Canal Company profit margins and growth in transits, 1952–76. *Source*: Panama Canal Company, *Annual Reports*. *Note*: In 1976, transits fell 11 percent.

Source: Noel Maurer y Carlos Yu (2011). *The Big Ditch: How America Took, Built, Ran, and Ultimately Gave Away the Panama Canal*. Princeton University Press.

The Panama Canal Company's refusal to raise toll rates—at least in real terms—was not the main cause of its financial decline. According to Maurer and Yu's book, **the administration lacked incentives to improve efficiency, limiting itself to maintenance without innovation**. Several attempts to run the Canal commercially failed because no U.S. government was willing to spend political capital to confront opposition from Canal workers. Instead, starting with Lyndon B. Johnson (1963–1969), the U.S. opted to seek a definitive exit rather than reform it.

For Panama, this meant receiving only US$22 million annually (or US$265 million today, adjusted for inflation) in returns over 85 years for the use of a territory equivalent to nearly half the metropolitan area of Panama City. **This figure is one hundred times lower than the US$2.471**

billion the country received in 2024. In that sense, the Panamanian state received just last year 28% more than the total accumulated over those 85 years.

2. The Panamanian administration, focused on maximizing the commercial potential of the route, made the expansion and continuous improvement possible, creating value for its users and driving progress for Panamanians

The Panamanian administration marked a turning point. The Panama Canal Authority (PCA) professionalized the management of the waterway, modernized its infrastructure, and began making long-term investments focused on the route's commercial potential for the first time since the 1920s, as noted by Noel Maurer in an interview with Harvard Business School. All of this happened while competition intensified from other international routes, such as the Suez Canal, as well as from trucks and railroads within the U.S. intermodal system.

The PCA designed a toll policy aimed at capturing the value of the route, which has been crucial in making the expansion project possible. The new locks, designed and financed under the Panamanian administration and inaugurated in 2016, tripled the Canal's capacity, allowing the transit of vessels of up to 15,000 TEU, compared to the 4,900 TEU limit of the original 1914 locks.

"As the idea of transferring the Panama Canal back to Panama gained currency, many Americans grew increasingly worried that the Panamanians would be unable to manage the canal. In retrospect, these worries seem doubly ironic. Not only did the post-1999 Panamanian management of the canal turn out to be first-rate, but there is significant evidence that the United States managed the canal particularly poorly during the postwar period."

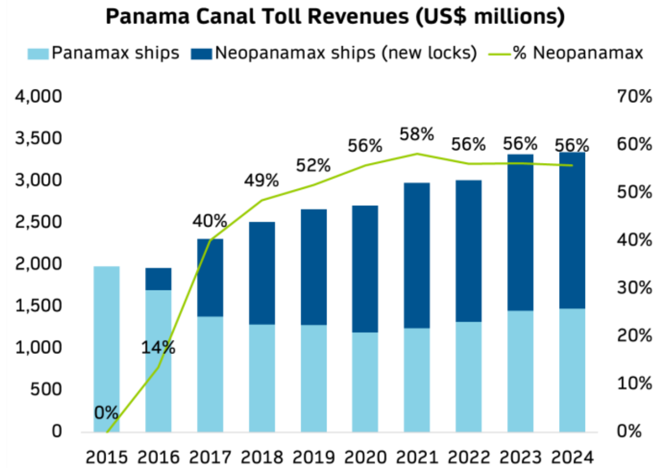
Noel Maurer y Carlos Yu (2011). *The Big Ditch: How America Took, Built, Ran, and Ultimately Gave Away the Panama Canal.* Princeton University Press.

The expanded Canal has boosted global trade and lowered costs for exporters and importers by enabling greater economies of scale through the transit of larger vessels. This has translated into savings of between 33% and 76% in vessel operating costs, depending on the route and ship size, as well as a 12% to 34% increase in port traffic in Latin American countries. Additionally, traffic to the U.S. East Coast has increased without significantly affecting West Coast traffic, contrary to initial concerns. Overall, these changes have generated greater benefits for exporters and consumers connected by the interoceanic route, especially in the U.S., which accounts for 46% of the origin and 29% of the destination of goods (in long tons) transiting the Canal.

Today, more than half of the cargo tonnage passing through the Canal does so via the locks built by the Panamanian administration with European contractors. In fact, 56% of toll revenues are generated by the Third Set of Locks—a milestone that would not have been possible without the specialized training of the PCA's 8,500 Panamanian workers, including pilots—responsible for navigating vessels throughout the transit—, traffic controllers, technicians, and administrative and managerial staff.

In a demonstration of prudent financial stewardship, the debt accrued for the construction of the Third Set of Locks has been expeditiously paid out. The outstanding debt with regional, European, and Japanese development banks, which provided the expansion's financing, were reduced from US$2.3 billion in 2014, upon receipt of full funding, to US$384 million in 2024. Simultaneously, PCA's debt-to-assets ratio decreased from 27.9% to 8.3%. Conversely, whereas the Panama Canal achieved a substantial reduction in its debt, the Central Government tripled its debt burden over the same decade

More than half of the Canal's toll revenue comes from the new locks, built under the Panamanian administration.



Source: indesa with data from PCA and INEC.

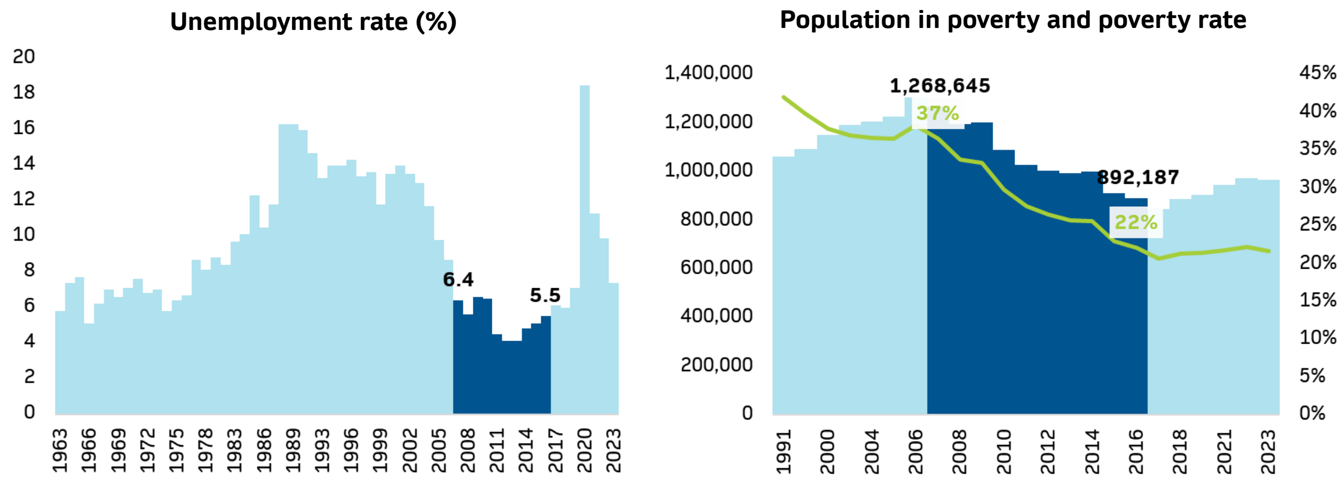
The transfer of the Canal to Panamanian hands and its subsequent expansion were key factors in one of the country's most prosperous economic and social decades. The mere announcement of the expansion, formalized through the 2006 referendum, spurred private investment equivalent to 1.8 times the total project investment (US$9.9 billion versus US$5.5 billion) and, on average, 33% more than the expected private investment trend had the expansion not taken place, according to an IDB study.

This momentum also translated into better living conditions for Panamanians. Between 2007 and 2016, during the construction of the Third Set of Locks, Panama experienced its longest period of prosperity in history with unemployment rates below 7%. Likewise, during the same period, poverty declined from 36.5% to 22.1%, and the housing deficit dropped from 50.6% to 28.9%—marking the largest decade-long reductions in the country's recent history.

Beyond its impact on well-being, **the Canal has upheld its commitment to the country, even in its most challenging moments**. In 2024, the Canal faced one of its worst operational crises, and despite capacity constraints caused by low rainfall—resulting in a 20.2% drop in transits that year, the largest decline in PCA history—it managed to maintain transfers to the Government at levels comparable to previous years: $2.471 billion. Few shareholders can claim that their assets have delivered such stellar performance.

To ensure long-term sustainability, **the PCA, through its management model, possesses the resources to finance the construction of supplementary reservoirs. This endeavor will secure a reliable water supply for both navigational and potable purposes**. Through this strategic measure, the Canal will be capable of mitigating the consequences of future operational demands precipitated by droughts, thereby further accentuating its role as a pivotal catalyst for the country's advancement.

During the construction of the New Set of Locks, the unemployment rate hit historic lows, while the poverty rate and the number of people in poverty saw the fastest recorded decline.



Source: indesa with data from INEC and MEF.

3. The successful redevelopment of the reverted areas has established Panama as a prime destination for foreign investment, notably from the U.S

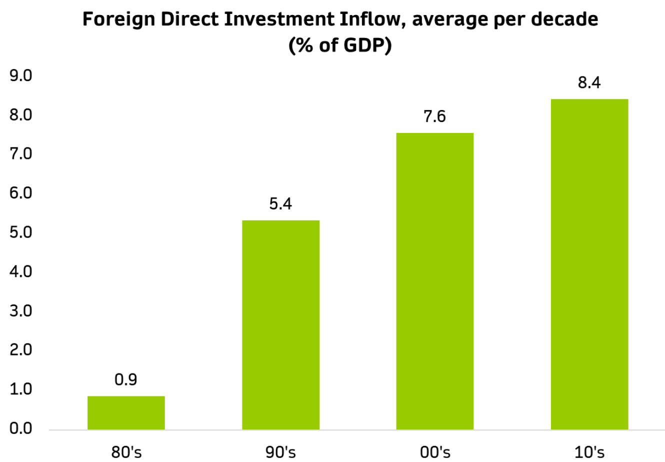
Panamanians not only made the Canal more competitive but also capitalized on the economic potential of the areas previously occupied by Americans. **The reversion of these military and residential facilities became one of the greatest economic opportunities in Panama's history, as they were transformed into free trade zones, leading ports in the region, business centers, and spaces dedicated to education, innovation, technology, and tourism.**

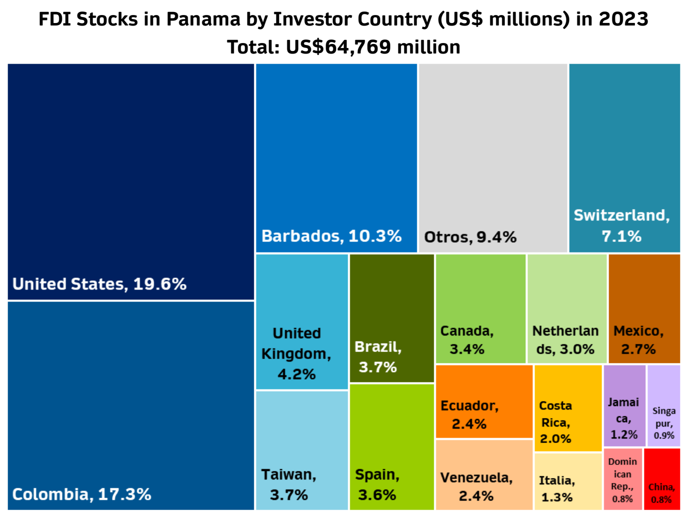
The Panama Pacifico Special Economic Area, a logistics, industrial, and business hub, and the City of Knowledge, a cluster for innovation and knowledge, have become regional leaders in attracting multinational companies, research centers, and international organizations.

These areas have been crucial in driving foreign investment, positioning Panama as a strategic development center in the region. In this regard, Foreign Direct Investment (FDI) has progressively increased, from 0.9% of GDP in the 1980s to 8.4% of GDP in the second decade of the millennium, following the transfer of the Canal and during its expansion.

U.S. companies have been the primary investors in the country, representing 20% of the foreign investment stock in 2023, which encompasses all investments made by foreign companies up to that point. Notable examples are Procter & Gamble, Caterpillar, and AES, among the pioneering firms to establish Multinational Company Headquarters (SEM) in 2008, a legal framework designed to promote these operations.

Foreign investment in the country has multiplied following the transfer of the Canal and its expansion, with the majority coming from U.S. companies.





Source: Indesa with data from the World Bank and INEC.

The Canal's administration faces environmental challenges that require priority attention to maintain its competitiveness, such as climate change and water management. Furthermore, in recent years, Panama has lost ground in attracting foreign investment compared to countries like Costa Rica and the Dominican Republic, making it necessary to explore new formulas to add value to the interoceanic route.

In the face of future challenges, over its 25 years of management, the Panamanian administration of the Canal has demonstrated its ability to create value for its users and contribute to the country's economic progress. At the same time, it has strengthened its financial robustness, which has allowed it to fulfill its commitments, even during periods of extreme drought, and be prepared to make the necessary investments to ensure its competitiveness.