

ONE

INTRODUCTION TO THE DITCH

FROM A DISTANCE, IN NORTH AMERICA, THE PANAMA CANAL seems like an imperialist anachronism, a historical leftover from a discreditable and nearly forgotten chapter of U.S. history. Up close, however, it is immediately apparent that the Panama Canal is one of the world's great waterways, the highly efficient economic engine for a rather prosperous Latin American country. Both of these interpretations of the Panama Canal are correct. This book was written to reconcile these seemingly conflicting points of view.

There is a stylized narrative many Americans learn about the history of the Panama Canal. In the late nineteenth century, so the story goes, French private interests tried and failed to build a canal across the Isthmus of Panama. Amidst the wreckage of the French effort, President Theodore Roosevelt stepped in, unleashing America's industrial energy on the isthmus, and in the process accidentally inspiring the greatest palindrome in the English language. The Panama Canal became an unparalleled economic and strategic success, cutting the cost of ocean transport and permitting the U.S. Navy to dominate two seas for the price of one. President Jimmy Carter, however, mysteriously decided that the United States could no longer ignore the Panamanians. And so the Americans, controversially, at great risk, and with no gain to themselves, arranged to give one of their greatest engineering triumphs to the Panamanian people, whom they fully expected to squander it.

This standard story of the Panama Canal raises more questions than answers. The Isthmus of Panama might have enjoyed a uniquely privileged geographic location, but Panama remained a

backwater for hundreds of years. The United States and Colombia were unable to negotiate an agreement on the Panama Canal to their mutual benefit, despite the obvious advantages for both nations. The Panama Canal project was a triumph of American engineering skill, but the reports of the time documented extensive delays, cost overruns, and management problems. The independent Republic of Panama remained an underdeveloped country, despite the presence of one of the world's major commercial arteries on its territory. The Carter administration gave into Panamanian requests that American administrations had ignored for decades and agreed to return the canal back to Panama in 1999. Finally, once Panama took back ownership of the canal, the waterway became phenomenally profitable despite the growth of alternative transport routes and fuelled a prolonged economic boom after decades of stagnation and relative decline. What explains these paradoxical outcomes?

Broadly speaking, this book is about the economics of American imperialism. "Imperialism," of course, has almost as many definitions as it has authors who have written about it. The most useful definition of "imperialism," we believe, is the use of state-enforced sanctions (or the threat of sanctions) by one political community to impose policies upon another political community.¹ As with any political institution, imperialism can be formal or informal. "Formal" imperialism follows rules laid down in constitutions or treaties, in which the government of the ruling community either exercises full sovereignty or exercises direct control over specific policy spheres in the subordinate community. "Informal" imperialism follows a less transparent but not necessarily less effective set of sanctions and rewards. (The line between the two is fuzzy; an example would be a treaty giving one country the right to intervene in the internal affairs of another under specific circumstances.) Imperialism can also be direct or indirect. When the government of the ruling political community is able to routinely impose its will upon *individual* members of the subordinate political community—most obviously, but not exclusively, through a formal colonial administration—then imperialism is direct. If the

government of the ruling political community exercises its will through intermediaries, be they traditional tribal rulers or “sovereign” elected governments, then imperialism is indirect.

The literature on the economics of imperialism is long and distinguished. It has two general lacunae, however. The first is a relative lack of detailed case studies informed by quantitative analysis and economic theory. This is not to say that there is not a long and distinguished literature on the history of various imperial ventures. It is simply to say that with a few exceptions (such as Foreman’s work on India), they do not engage in the explicit framing and formal testing of hypotheses. To the extent that they are informed by theory, the theories tend to be vague, ill-defined, and often left implicit. There are, of course, a number of large-N studies of imperialism that do engage in explicit hypothesis testing and are informed by economic theory. The unit of analysis in these studies is colonial governments (as in the cases of Ferguson and Schularick or Mitchener and Weidenmier) or imperial enterprises (as in the cases of Svedberg, Edelstein, and Davis and Huttenback).² These studies have greatly expanded our understanding of European colonialism, but they suffer from the specification problems common to all large-N studies. It is hard to use them to understand exactly how specific institutional arrangements created certain economic effects. Moreover, most of them tend to find (quite convincingly, for the periods that they study) that imperialism produced few benefits (if any) for the metropole but did create a beneficial “empire effect” for the colonies. What we do not know is whether these results are universal, or limited to the periods and empires studied by the authors.

Similarly, relatively little of the literature on economic imperialism deals with the difference between formal and informal empire in a modern context. (Mitchener and Weidenmier and Alfaro, Maurer, and Ahmed’s work on the effects of U.S. policy in the circum-Caribbean are partial exceptions.) In 1961, David Landes concluded on remarkably little evidence, “Informal imperialism paid—in spite of occasional crashes and repudiations, if only because the use of power in such situations was minimal and the

outlay of funds was based on essentially rational grounds. Formal imperialism, on the other hand, rarely paid.”³ Both types of imperialism considered by Landes, however, took place in an almost unrecognizable historical and institutional context. The subordinate political societies were often not organized as states. When they were organized into states, those states generally lacked Westphalian legal sovereignty, let alone significant access to modern military technology. Nor were these societies generally motivated by nationalism in the Western sense. Moreover, the dominant European colonizers were rarely characterized by democratic governments that periodically needed to win elections based on universal male suffrage, let alone universal suffrage. The question of the economic impact of old-style European imperialism is an important one for understanding how the world of the early twenty-first century emerged, but it offers only limited lessons for today.

America’s imperial venture in Panama took place in a context that seems remarkably familiar to a reader from a century later, unlike the superficially similar (but actually quite different) Suez Canal project in Egypt. Despite the undemocratic nature of the regimes in the southern states, the general disenfranchisement of women, and the indirect election of the U.S. Senate, American politics circa 1903 were populist and democratic in a way instantaneously recognizable to a modern observer. The states of Latin America, like states today, enjoyed full Westphalian sovereignty (in theory), and despite their internal weaknesses they possessed modern national identities that governments could and did mobilize for their own purposes. The United States may have declared itself “practically sovereign upon this continent,” as Secretary of State Richard Olney maintained in 1895, but it also faced foreign powers lurking in the wings who could potentially do it grievous damage, economically if not militarily. In short, President Theodore Roosevelt faced a context both domestic and external that more resembled that faced by the current leaders of powerful countries—be it Barack Obama, Lula da Silva, Vladimir Putin, or whomever it is that runs the European Union—than it resembled that faced by his European contemporaries.

The specific question that this book seeks to shed light on, then, is whether a relatively modern democratic nation, operating inside the strictures of Westphalian sovereignty, was able to leverage its ability to impose military and economic sanctions into sustainable economic gains. Conversely, why did that selfsame nation decide to withdraw from its imperial commitment a few decades later? Was it because of changing ideologies at home and changing power balances abroad, or was it because the economic value of its imperial venture had declined?

To answer these questions about America's imperial endeavor in Panama, we employed a form of the "analytic narrative" method pioneered by Bates, Greif, Levi, Rosenthal, and Weingast.⁴ There is a vast and almost bewildering amount of economic, institutional, and historical data available about the Panama Canal. The analytic narrative allowed us to place these rich sources of information within a theoretical context to move forward from specific to more general conclusions, reasoning from the "thick" to the "thin," as the method's authors described it. In doing so, we borrowed the rational choice assumption that political actors seek to maximize their benefits in their interactions with others. This clarified several confusing points in the political history of the Panama Canal, such as the deliberate policy of the Colombian government to hamstring its own diplomats during its negotiations with the United States over the canal. As later events proved, this was a mistaken strategy for Colombia regarding the Panama Canal, but it was not an irrational one.

Within the narrative, we relied on quantitative techniques, many first developed by Robert Fogel. We especially borrowed from his social savings methodology in order to determine the economic value of the Panama Canal and examine the various policy options surrounding the canal at particular historical junctures. Fogel's simple yet powerful method of analysis compared the cost savings of a historical enterprise—in his case, U.S. railroads—to those of the next-best option that would exist in that enterprise's absence—in his example, a counterfactual network of canals and highways.⁵ Fogel defined the difference between the two as the "social

savings,” e.g., the additional amount of economic activity created by the venture.

As an object of economic inquiry, the Panama Canal is obviously well suited for Fogellian methods. In addition, the Panama Canal has a wealth of “roads not taken” in its history, which allow us to evaluate the relative value (to the United States, the titular government of the isthmus, and others) of a variety of political options involving the canal. Finally, because of Panama’s unique geographic location, we could compare the economic and historical effects of the modern Panama Canal to that of other isthmian transportation enterprises in earlier and later eras.

Panama enjoyed a privileged geographic location, but the basic question in its history has always been: who gets the economic rents generated from that geography? Would it be the people who occupied the land, the people who financed the infrastructure, or the people who used that infrastructure to move goods and people? The answer has historically been determined by three related factors: the value of the infrastructure to consumers (itself a function of the availability of good transport substitutes); the ability of those consumers to mobilize their government to defend their interests at a reasonable cost; and the symbolic power of ownership over infrastructure.

The Panama Canal was not the first transportation technology across the isthmus to reshape the world’s economic geography. It was in fact the third. In the early Spanish colonial era, a trans-Panamanian road built by tens of thousands of slaves from Nicaragua allowed the Spanish to transport high-value silver from Peru to the Atlantic. Colonial Panama boomed—and native Panama dwindled—until competition from overland routes via Buenos Aires undercut the Panama route in the seventeenth century. A few centuries later, the process repeated itself. Just as the Spanish conquest of Peru unleashed a mass of precious metals heading east and a wave of prospectors heading west, so did the American conquest of California and subsequent gold rush. The Panama Railroad proved very profitable for its New York investors, until competition from the 1869 opening of the Transcontinental Rail-

road undercut it. Once the United States emerged as a transcontinental power, its geography and industrial economy ensured that its residents stood to benefit more from cheaper passage across the Isthmus of Panama than those of any other country. In that sense, it was inevitable that the United States would become involved in the politics of Panama. The question was what form such involvement would take.

The form of involvement taken by the United States in Panama proved to be a rather odd sort of imperialism. Washington employed a mix of strategies to take, build, and run the Panama Canal. In 1903, President Theodore Roosevelt used the threat of force against the Colombian government to permit local secessionists to peel the Panamanian isthmus away from Colombia. He then used the threat of force against the newly created Republic of Panama to take direct and *formal* control over the Canal Zone. Finally, he imposed indirect but formal rule over Panama (via Article 136 of the Panamanian constitution). Why did Roosevelt's administration choose the mix that it did?

The reasons were economic. The U.S. government under Roosevelt developed a set of political strategies that enabled it to expropriate most of the rents generated by Panama's geography through its imperial control of the Panama Canal. The Canal Zone drew a bright line around the canal, from which it was relatively easy to exclude Panamanian (and other potential foreign) competition from the provision of services or other ancillary operations. Article 136 provided a ready-made justification for intervention that could be wielded against domestic and foreign opponents. In addition, as part of the Panamanian constitution, it provided the occasional presence of American troops on Panamanian streets with an additional dollop of legitimacy—a vital thing in any foreign occupation. Limiting American involvement in Panama to excluding the Panamanians from the Zone and the occasional intervention freed the U.S. government from potential opposition at home.

The rents were enjoyed by a broad base of the imperial power's society—that is, the average American consumer. The cost of defending America's new Panamanian possession was small

compared to these benefits. Unlike other empires of the era, the United States in Panama extracted significant value for its citizens. The flip side of this successful American venture into imperialism, of course, was a thorough lack of economic benefit for Panama, which captured essentially none of the rents from the Panama Canal. Neither did the American involvement in Panama lead to stronger political institutions, greater investment, nor lower borrowing costs for the Panamanian government. Rather, the major—but far from inconsiderable!—benefit from the American presence in Panama was an accidental spillover: the improvement in disease mortality rates caused by the public health programs the United States implemented during construction.

Why then did the United States choose to abandon its formal control over the Panama Canal in 1977—only to invade and overthrow the country's government in 1989? The answer to the first part of that question is simple: the strategic and economic value of U.S. ownership of the Panama Canal declined after World War II. The strategic benefits proved chimerical. The economic benefits fell as domestic cargoes made up less and less of the traffic through the canal, lured away by falling railroad and trucking costs. In addition, the industrialization of the West Coast meant that it consumed more and more of its own primary product production, leaving less to be shipped east via Panama. Moreover, falling transport costs meant that American agricultural exporters to Asia—who became the largest users of the canal by the 1970s—grew almost indifferent between shipping their grain south to the Gulf Coast and moving it west to Seattle. These changes in the users of the Panama Canal meant that Washington had less and less reason to fear that a Panamanian-owned canal would jack up transit rates at the expense of American consumers and producers. Rather, by the 1970s the primary burden of higher rates would fall on Asian exporters of inexpensive manufactured goods.

As the American interest in the Panama Canal declined, however, Panamanian political voice regarding the canal expanded. While American policy largely denied Panama economic benefits from the canal, increasing Panamanian national sentiment

required the United States to channel compensating aid flows to Panama. At the same time, the long-term American workforce on the Panama Canal had captured the institutional administration of the canal, making it more inefficient and less profitable as a business enterprise. These two factors made the transfer of the Panama Canal from the United States to Panama mutually beneficial by the 1960s. The Panama Canal in Panamanian hands became more valuable to the United States than the Panama Canal in American hands. American nationalism, however, postponed the signing of any agreement to 1977.

Nevertheless, Washington's imperial role in Panama did not come to an end with the signing of the Carter-Torrijos treaties. Following the death of President Omar Torrijos in a mysterious plane crash, General Manuel Noriega rose to power. Noriega proved very useful to an American administration deeply concerned about Communist penetration of Central America. Noriega also proved to be spectacularly corrupt and even more spectacularly brutal. The result was an escalating conflict with Washington. The United States, however, did not contemplate a military invasion of Panama until Noriega made it clear he would interfere with the operation of the Panama Canal.

Noriega's 1989 overthrow by American troops ironically cleared the way for the end of America's imperial relationship with Panama. The two dictatorships of Omar Torrijos and Manuel Noriega had produced the side benefit of greatly weakening Panama's traditional patronage-based politics. (In Torrijos's case, the weakening of the old oligarchy was part of a deliberate reform strategy; in Noriega's it was merely a side effect of his attacks on anyone who threatened his political control or narcotics profits.) In the aftermath of the invasion, with the old parties needing to compete for votes on a far more open political market, Panamanian democracy began to thrive. After decades of dictatorship and despite the long-term effects of the American patron-client relationship, Panamanian voters were finally able to choose and dismiss candidates in favor of their own political and economic interests without fear of losing the benefits that came from membership in

a particular political machine. Tampering with the Panama Canal for political gain (or even seeming to tamper with the Panama Canal for political gain) rapidly became the quickest way to lose support among the electorate. As a result, competitive politics led to a new Panama Canal Administration that ran the canal much more efficiently and commercially than the United States ever did. Consequently, the Panama Canal became an engine of growth for Panama for the first time in its history, and the presence of the United States receded into that of a distant neighbor, rather than one next door, or sometimes on the lawn. The 1999 handover of the Panama Canal to Panama marked the beginning of a new phase in the U.S. Panamanian relationship, one of mutual benefit through voluntary association—or, given the power difference between the two nations, a phase perhaps more accurately described as an “empire by invitation.”

There has been little formal economic history written specifically about the Panama Canal. In writing this book, we found the topic nearly untouched, like the proverbial \$50 bill left on the sidewalk. Even the basic question of the economic impact of the Panama Canal on the world economy produced wildly divergent opinions. Lebergott in 1980 believed the Panama Canal generated little to no benefits for the economic interests of the United States.⁶ On the other hand, in 2004 Hutchinson and Ungo estimated that the Panama Canal paid for itself in a single year soon after its opening.⁷ Unsurprisingly, this book argues that the economic benefits of the Panama Canal lie between these two poles.

The Panama Canal is richly documented in primary source material. The annual reports first issued by the Isthmian Canal Commission, later the governor of the Panama Canal, the Panama Canal Company, and finally the Panama Canal Commission are invaluable both as sources of economic data and as political documents for understanding the complex relationship of the Canal Zone administration with Washington. The creators of the Panama Canal were not shy about their accomplishments, and left considerable writing in their memoirs and correspondence about their intent. The U.S. Senate testimony in the debate regarding the con-

struction of an isthmian canal is eye-opening, as are the Colombian diplomatic documents collected in the *Libro azul* concerning the canal and the rebellion in Panama.⁸ The *Foreign Relations of the United States* provides a somewhat sanitized version of U.S. attempts to placate or ignore Panama in the decades before the handover of the canal. Finally, the U.S. National Archives have an immense amount of material pertaining to the Panama Canal, of which we have only used crumbs from a very rich plate.

We are not ashamed to admit that we have relied on Walter LaFeber's *The Panama Canal* and John Major's *Prize Possession: The United States and the Panama Canal, 1903–1979*, while writing this book to better understand the specific historic, diplomatic, and institutional situation of the Panama Canal. So too we have relied upon many authors about Panama itself, not least among them Conniff, Pearcy, Pippin, Zimbalist, and Weeks. Many of our findings have seemed almost serendipitous: in particular, Bonham Richardson's work on Barbadian history and Samuel Eliot Morison's maritime and naval histories led us down paths of research we would not have previously considered. Finally, we must mention two works that appeared during the writing of this book, Adam Clymer's *Drawing the Line at the Big Ditch: The Panama Canal Treaties and the Rise of the Right*, on the interplay between the domestic American politics of the 1970s and the handover of the canal to Panama; and Julie Greene's *The Canal Builders: Making America's Empire at the Panama Canal*, on the complicated and disturbing history of the foreign workers who built the Panama Canal for the United States.⁹ Both Clymer and Greene made points that we wanted to make, but earlier and more thoroughly.

To recap, this book advances two arguments. One is a substantive argument about the nature of economic imperialism. We argue that the United States developed strategies that enabled it to leverage its military dominance into a far better economic outcome than it otherwise could have achieved. We also argue that the United States returned the Panama Canal to Panama when the economic benefits from *ownership* of the canal (if not necessarily the benefits of the canal's existence) sufficiently declined.

Moreover, America's indirect imperialism produced little in the way of institutional or economic development for Panama, which continued to be an authoritarian underdeveloped nation until the 1990s. The United States was instrumental in removing the blight of Manuel Noriega, but the robust democracy that emerged thereafter was *hecho en Panamá*, and had little to do with the previous decades of U.S. intervention.

The other argument we make in this book is a methodological statement about history and the social sciences. The social sciences are fundamentally about the study of social processes—the ways that human beings interact and the institutions that structure those interactions over time. Thus, social scientists do not really have a choice regarding the use of history—their interest in change over time gives them little choice but to make historical arguments. The real choice for economists and political scientists is whether the historical arguments they make are supported by systematically gathered and carefully analyzed evidence, or whether they are supported by “stylized facts.” We strongly support the former, and hope that this book provides at least a modest example.