

# Country Development Strategy Statement

**FY 1984**



## PANAMA

January 1982

Agency for International Development  
Washington, D.C. 20523

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USAID/PANAMA

FY 1984 CDSS

February 1982

"History demonstrates that time and again,  
in place after place, economic growth and  
human progress make their greatest strides  
in countries that encourage economic freedom."

President Ronald Reagan  
Cancun, Mexico  
October 22, 1981



EMBASSY OF THE  
UNITED STATES OF AMERICA

Panama, Rep. of Panama  
February 16, 1982

Mr. Otto Reich  
Assistant Administrator (Designate)  
Bureau for Latin America and  
the Caribbean  
Agency for International  
Development  
Washington, D.C. 20523

Dear Otto:

The AID Panama CDSS for the FY 1984-88 period builds upon strategic interests the U.S. and the free world share in Panama - the canal and the \$50 billion international financial center - and supports a process of economic policy reorientation already underway. I wish to give my personal endorsement of this analysis of the Panamanian socio-economic environment and the proposed program which emerges from it.

Panama since 1968 has been a curious amalgam of ideological forces which broke with tradition and initially marched in a leftward direction. During its early phase the Torrijos government supported an organized farm sector and went into direct competition with the private sector in sugar, bananas and rice production. Price controls were imposed and the existing extension and agricultural research systems were dismantled. A heavy ideological tilt in these rural actions was also evident in urban policies like pro-labor legislation, muzzling of the press and exiling of some businessmen. Canal treaty negotiations were given much public exposure and subject to more rhetoric. Openings to the third world, particularly Cuba, were stressed.

Panama is justly proud of its largely successful record of providing health, education, potable water, electricity, and other basic services to forgotten areas throughout the Republic. These stand among Torrijos' greatest achievements. Of course, the cost was enormous. To support its social objectives heavy public investment was begun in order to integrate the hitherto ignored rural populations into the nation-building process. But as the country's debt soared, private investment fell.

In recent years, as a more pragmatic set of policies emerged, monetary and fiscal policies began to receive greater attention. Production, rather than distribution, has begun to be emphasized by the

nation's leaders, and the private sector's role in determining the pace of economic growth has become increasingly recognized. Whereas the creation of the international finance center in the Republic made Panama a locus for international banking, the facts of economic life turned the nation's attention to domestic finance, national economic growth and investment. We see an acceleration of interest in the stimulation of business and investment. For example, the United States and Panamanian Governments are presently well into negotiations on a bilateral investment treaty, and Panama would like to conclude similar negotiations with France, West Germany and the United Kingdom.

This CDSS develops these themes throughout - as has this Embassy during recent years. Panama has increased its courtship of the private sector in public fora where private enterprise is supported to a very heartening extent. As such it is a natural leader within the proposed Caribbean Basin Initiative. Private sector leaders have expressed their pleasure to us over their governments' new direction.

The task facing Panama is to turn words into actions, to mobilize those particular entrepreneurial skills in agriculture, in services, in industry, which are the hallmark of growth in free societies - and to do so in the pre-1984 election climate. AID has stressed agriculture, employment and urban development as its sectors of emphasis for some years - indeed AID already has led and helped shape Panama's response to problems in these sectors. AID's entree and high level of acceptance within the GOP are among our most valuable policy tools in strengthening democratic and stable growth in a nation important in its own right, but also a rare example of growth and equity in a very troubled area. I must underscore the need for us to provide Panama this support at least at the requested levels, and higher should the situation so dictate.

With best regards

Sincerely,



Ambler H. Moss, Jr.  
Ambassador

February 16, 1982

Mr. Otto Reich  
Assistant Administrator (Designate)  
Bureau for Latin America and  
the Caribbean  
Agency for International  
Development  
Washington, D.C. 20523

Dear Otto:

I am pleased to present USAID/Panama's FY 1984 CDSS for your consideration. It represents our best effort to look at Panama's development over the last ten years and to set out a challenging and meaningful course for AID during the FY 84-89 period.

Those separated by long distances from Panama tend to view it, especially in light of the turmoil occurring elsewhere in Central America, as a country which has already solved its basic social and economic requirements. With good reason. While its economy has slowed over the last two years, it is growing. The country has also avoided the social turmoil affecting many of its neighbors. A great deal of that stability has been achieved by an extraordinary government effort over the last ten years to reach out and down to the majority of its people. It is no exaggeration to say that Panama underwent its own social revolution in 1968.

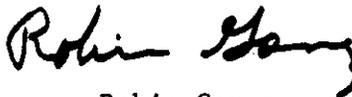
From a closer perspective, however, that stability still remains fragile. Panama has a growing unemployment problem which does not bode well for the future. Despite the great strides made, it still has significant poverty, particularly when contrasted to the minority enjoying the fruits of the sophisticated service sector of Panama's dual economy which caters to the canal, international banking and commerce. It has become clear that this traditional engine of growth will not stimulate the economy sufficiently to absorb the growing number of new entrants into the labor market nor permit the continuance of the social effort made to date. It is clear that a different development strategy will be required in the future.

This concern has given urgency on the part of the government to rethinking the role of the private sector. It realizes that the private sector is critical to its hopes for adequate growth. After some years of hostility the government and the private sector appear to be moving to a more open accommodation. These circumstances make Panama a natural for the private enterprise approach inherent in the Caribbean Basin Initiative. The potential for attracting foreign investment to one of the few stable areas of the Region supported by the opening up of the U.S. market is clear,

although its dimensions still appear murky. We, as well as the Panamanians, are looking forward expectantly to this initiative. It would also stimulate domestic investment as well and provide the stimulus the economy needs to achieve adequate growth rates.

The change and foment underway in Panama provides AID with a unique opportunity and a challenge, assisting at both the policy level and at the institutional development level described herein. To meet that challenge, we will need the resource levels, albeit modest, established in the CDSS. I look forward to reviewing the CDSS with you.

Sincerely,

A handwritten signature in black ink, appearing to read "Robin Gomez". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Robin Gomez  
Director

P A N A M A  
 FY 1984 Country Development Strategy Statement  
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COUNTRY DATA - PANAMA

<u>Area</u>	<u>Population (1980)</u>	<u>Density (1980)</u>
77,082 km <sup>2</sup> (roughly equivalent to South Carolina)	1,830,127 Natural growth rate 2.2% 57% urban 43% rural	24 persons per km <sup>2</sup>

Demographic Indicators (1980)

Crude birth rate (per 1000)	27
Crude death rate (per 1000)	4
Life expectancy	70

Economic Indicators (1980)

(Currency: US Dollar)

GDP (\$ Bil.)	3,391
GDP per capita	1,853
Real An. GDP growth (1974-80)	3.8%
Real An. GDP growth (1980)	4.9%
Real An. GDP growth per capita (1974-80)	1.3%
per capita (1980)	2.6%
An. Inflation rate (1974-80)	10.6%
An. Inflation rate (1980)	13.7%
Balance of Payments, Current Account	-245
Exports	424
Banana (66)	
Petroleum Product (82)	
Sugar (66)	
Shrimp (44)	
Imports	-1,344
Services (net)	688
Transport (481)	
Travel (112)	
Transfers (net)	-13
Private (-54)	
Official (41)	

% of GDP by Sector (1980)

Services <sup>1/</sup>	49.0%
Manufacturing and Const.	18.8%
Agriculture	13.9%
Canal Area (Panamanian wages)	5.0%
Other	13.3%
	100.0%

Labor Force (1979)

Working age (15-65) population	56%
Economically active population Rate	60%
% of employed in agriculture	29%

Social Indicators

Adult Literacy (1980)	85%
% of age group (1974) in	
a. Primary Sch. (5-14)	76%
b. Secondary (15-19)	72%
c. Post secondary (20-24)	17%
% of population with access to safe water (1979)	83%
Daily supply of calories per capita (1977)	2,689
Pop. per physician (1979)	1,178

Government Finances (1980)

Central Government (\$ Mil.)	
Current Revenues	682
Current Expenditures	715
Investment - Cent.Gvt. (\$ Mil.)	107
Public Debt - Total (\$ Mil.)	2,900
External (2,210)	
Internal (690)	
Public Debt, % of GDP	85%
Debt Service - Total (\$ Mil.)	674
Debt Service, % of GDP	20%
Debt Service, % of Exports	159%
Interest on debt, % of GDP	8.5%
Debt service - Cent.Gvt. (\$Mil.)	318
% Cent. Govt. Revenue	47%

<sup>1/</sup> Includes various service-related sectors such as electricity and water.

## PART ONE - DEVELOPMENT OVERVIEW

### 1. Pattern of Development

#### a. Pre 1968

1. Dual Economy: Geography has decisively shaped Panama's economic development. The isthmus of Panama is the narrowest portion of the Western Hemisphere, located far enough north for the convenience of most east-west trade. As long as the world's trade is carried cheapest by sea, Panama will retain this locational advantage. With interoceanic crossing its main attraction, most economic activities developed around the terminal cities of Colon and Panama City rather than in the nation's interior. By 1950 the impact of the Canal was striking: one fifth of the total metropolitan work force was directly employed in the Canal Zone, gross receipts of the Canal Company equaled 37% of Panama's GDP, and 35% of the population (270,000 of 795,000) lived in the Metropolitan Area. Yet there was more to Panama than just the Canal. With a large percentage of the population unaffected by the Canal, Panama in the 1950s could be characterized as a dual economy: a high-income, service-oriented, urban economy adjoining agricultural areas not well-linked to either the Metropolitan Area adjoining the Canal or the banana enclaves near the Costa Rican border. Except for the banana areas, most of the rural population was dedicated to subsistence agriculture. There were few market roads and the low population density and the wide availability of public lands supported development of a semi-nomadic, slash-and-burn farm system and extensive cattle ranching.

2. Rapid Unbalanced Growth: Between 1950 and 1968, Panama's average annual economic growth exceeded 7%. This rapid growth, however, was unbalanced, both spatially and sectorally, and intensified rural-urban disparities. The intensity of the unbalanced growth was reflected in the \$730 versus \$220 difference in per capita disposable income between the cities of Colon and Panama City and the rest of the country in 1968. In addition, one third of all rural residents had per capita incomes below \$100.

Rapidly expanding world trade between 1955 and 1968 produced growth rates in Canal tonnage of 7.4% per year. As a result of the Remon-Eisenhower Treaty of 1955, most Canal Company commercial activities were phased out and were assumed by businesses in Panama City, further boosting growth. During this same period, paving of the Inter-American Highway linked the major population centers and expanded the domestic market. Finally, modest protection--usually by import quotas--encouraged the development of import-substitution industries. The resulting 13-year (1955-68) boom was concentrated in the Metropolitan Area: manufacturing, utilities, and banking all grew at over 10% per annum. By 1968 almost 70% of GDP was generated in Panama and

Colon provinces, which then held half the country's population, a substantial change from 35% in 1950. Sectorally these two provinces accounted for 81% of manufacturing, 94% of construction, 96% of transport, warehousing, and communication, 83% of commerce, and 78% of other services. In agriculture, value added was concentrated in the two western provinces of Bocas del Toro and Chiriqui. In 1968, with just 12% of the population, these two provinces generated almost two thirds of sector value added as a result of heavy banana production. In contrast, the central provinces, which accounted for almost 30% of the population, produced only about one quarter of value added in agriculture. Until the advent of the 1968 revolution, these distortions continued largely unchecked.

3. Low Government Profile, Laissez-faire period: Economic intervention by Panamanian governments during the 1950s and 1960s was slight. Import tariffs were low and import quotas, though heavily protective, did not have a significant effect in the aggregate. Most utilities were privately owned. There was only one state-owned economic enterprise (the Colon Free Zone), two government-owned banks, and a very small government agricultural bank. Infrastructure investment by the government was limited and, except for highways, concentrated in the Metropolitan Area. Nor was there significant spatial or redistributive emphasis in Government policy. The fast-growing Metropolitan Area received most traditional public services. While some 45% of the Central Government budget went to health and education each year, coverage was poor. The lack of sizeable provincial centers and a dispersed rural population (38% in localities of 500 or less) made the provision of services to rural areas more difficult and expensive.

b. Post 1968: Revolutionary Government

1. Strategy: The arrival in 1968 of the Revolutionary Government led by General Omar Torrijos changed the economy and the status of the private sector, which until then had the dominant role in setting economic policy. The laissez-faire period was officially at an end. A period of greater government participation in the economy began with greater emphasis on addressing social inequalities, especially in the rural sector. The new government's goal, therefore, was to continue rapid economic growth, while using the product of that growth to integrate the country socially and economically.

The new government believed that while past growth of the economy and employment generation indeed had been rapid, its unbalanced nature was inequitable. Too many Panamanians lived in rural poverty, unaffected by education and health services--the product of insufficient interest in their welfare by predecessor governments. In addition, the new government (probably quite correctly) believed that

little new marginal export stimulus could be expected from the Canal, that the relatively easy import-substitution phase in industrial growth was ending, and that as a result, with a small domestic market, new sources of export growth were needed.

To attract the required private investment required for export growth, the government supported major public infrastructure investment in power generation, transport and agriculture. In Panama City and Colon, tourism, Free Zone commerce, shipyards, international banking, a container port, transisthmian pipeline, and export manufacturing were to be emphasized based on the government's belief that the nation's comparative advantage lay with international trade and services, which then could be exploited by the Metropolitan Area--if supported by increased public investment--to produce an economic surplus to be invested in the rest of the country, thereby reducing glaring social disparities. The Government expected that the development of rural areas beyond the Canal would slow migration to Panama City, raise incomes of the rural poor, and more closely integrate the economy by decentralizing industry and services. Export diversification was expected from increased agricultural output, especially in meat and vegetables, export of new minerals, and a greater emphasis on the processing of agricultural products in provincial towns. It was expected that the enlarged market would give a natural stimulus not only to industry but to inter-regional integration within Panama. Thus, the Revolutionary Government's program for the 1970s, was threefold: to achieve balanced growth; to greatly expand the public sector while private investment and output were to be encouraged; and to diversify exports away from the Canal area to add greater stability and economic independence to the country.

2. Accomplishments: A 1981 review of the programs begun by the Revolutionary Government in the early 1970s indicates that a significant portion of the ambitious investment plans has been realized. Many infrastructure and urban projects have been completed, or are near completion, viz. a modern international airport, convention center, several first class hotels, and improved port facilities, to mention a few. Enormous investments in hydroelectric power and telecommunications expansion are underway. As a result of new policies, perhaps the Government's most visible success has been the establishment of an international banking center, with some 118 banks holding assets approaching \$50 billion at the end of 1981. Over the decade of the 1970s the government spent approximately \$1.1 billion (in 1960 dollars) on these and other investment programs during the previous 10 years the total public investment reached a mere \$248 million (in 1960 dollars).

Investment in physical infrastructure paralleled heavy investment in social services, designed to improve the physical well-being of the populations

outside the Canal area, especially those in neglected, isolated small communities off the main highways. This program, in which AID has actively participated, is the major success of the present government, and has made major inroads in breaking down previous patterns of rural isolation and backwardness. Access to health service was substantially improved between 1970 and 1979 with 250 new health institutions built; 95 percent of them outside the Canal area. During the same period the share of hospital beds outside the Canal area increased from 35 percent to 40 percent; the proportion of doctors residing outside of the Canal area increased from one quarter to over one third; and births with professional assistance in rural areas increased from 36 percent to 60 percent by 1979.

Rural wells drilled by the Ministry of Health increased from an annual average of 166 (1955 to 1968) to 335 (1970-1980). Between 1970 and 1980, 718 piped water systems were built and 3,351 wells dug, benefitting an additional 258,000 people and raising rural coverage from 43% to 64%. A rural sewerage program was also undertaken during the same period; over 75,000 latrines were built to benefit some 378,000 people and to raise coverage from 68% to 81%. Perhaps the most important indicator of the effectiveness of the Government's rural program was the drop in rural infant mortality from 48.8 to 37.6 per thousand births between 1968 and 1976, and an increase in life expectancy from 66 in 1970 to 70 in 1980 (U.S. is 74). While not totally responsible for the remarkable drop in the population growth rate from 3% in 1970 to 2.2% in 1980 (a figure originally anticipated for 1990), the family planning program has supported an increase in acceptors from 9,800 in 1969 to 119,000 in 1980. In this same period health facilities providing family planning services rose from only 5 to 354.

Finally, educational services expanded: the number of primary and secondary schools increased 45% over the 1969-79 period, students in school increased 74%, with 85% of the new schools, half the increase in students, and three fifths of the new teachers located outside the metropolitan area. Literacy, already high in 1970 at 78%, rose to 85% by 1980.

Maintaining this rapid expansion of education and health change in the rural sector and for the entire economy is expensive, requiring international donor assistance, and about 50% of the Central Government's operating budget, or 10% of GDP. Table 1 summarizes the changes in some of the more important social indicators over the past decade.

3. 1968-1977-- Recession and Structural Problems: Although the economy continued to grow at its accustomed 6-8% annual real rate through the 1968-72 period, and from outward appearances was quite healthy, it was beleaguered by structural

problems that promised to be of long-term impact, and by problems of a more short-term cyclical nature, and by the building reaction among private sector leaders to a series of government policies including the labor code, and price controls; programs, especially expanding state-run enterprises; and the anti-business rhetoric of a number of government spokesmen.

Thus, when oil prices tripled in 1974, the economy slid into a recession which lasted until 1977. During this period the economy registered GDP real growth rates of 2.6%, 0.6%, -0.3%, and 4.6%, and saw unemployment jump from 7% in 1974 to 14% for the next two years and finally to 17% in 1977 (the 1974 absolute employment level would not be reattained until 1979). The immediate causes of the recession were price increases of essential imported inputs which squeezed profits in manufacturing and construction, the fall in real domestic purchasing power due to inflation, the weakening world demand for Panamanian goods and services, and the deteriorating investment atmosphere. As domestic demand fell, financially over-extended construction and commerce sectors encountered difficulties. Confidence rapidly eroded. When banks reacted and imposed a virtual moratorium on credits, the construction industry collapsed and the commerce sector was forced to retrench, sending shock waves through the economy.

The traditional economic sector stimulators seemed unable to lift the economy out of the recession: canal tonnage had leveled out with little expectation of significant future growth, and import substitution had become more difficult. This was reflected in the manufacturing sector which slowed from an average annual real growth rate of 11% over 1960-70 to 7.4% over 1970-72 and to only 4.8% in 1973; and in services to the Canal Zone which grew rapidly during the 1960s (at an average annual rate of almost 9%), but stagnated after 1970.

As would be expected, private investment fell during the recessionary period: from the historical high of \$349.6 million (70% of total investment) in 1974 during the construction boom to \$174.6 (34% of total investment) in 1977. Further complicating the investment climate during this period was uncertainty over the Canal Treaty negotiations and prospects for their successful conclusion.

To counteract the decline in private investment, the GOP acted to increase public investment and, except for 1977 when private investment fell by 50%, was more or less able to offset the decline, thus keeping real total annual investment expenditure for the period at about the 1973 level. Unfortunately, the source of most of these investment funds were high cost commercial loans. By 1976 this fiscal policy left the GOP with an almost untenable public debt and little immediate impact on the economy because most projects invested in tended to be capital intensive, to have

large import components, to require long gestation periods, and to have low or negative rates of return. During the 1974-76 period total public debt rose from \$800 million (44% of GDP) to \$1.5 billion (75% of GDP) while the current account of the balance of payments deteriorated grievously, with the public sector deficit reaching, 18.5% of GDP. The onerous debt burden forced the government to reduce its public spending and to begin to take actions to attract the private investment the economy needed for future growth. Unfortunately, these new incentives were not sufficient to stimulate an increase in investment activity by the private sector in 1977. However, a decline in the rate of inflation boosted private consumption in real terms for the first time in three years, and propelled the real growth rate of the economy above zero to 4.5% for the first time in two years and, thus, signaled the beginning of economic recovery.

4. Relationship between Government and Private Sector: The relationship between the Government and the private sector has been evolving from a state of open hostility in the first half of the 1970s to a suspicion-filled process of semi-accommodation in the last few years. Recently, there are signs that the Government is intensifying its dialogue with the private sector and may be ready to translate into concrete actions its previously hortatory statements.

Although external events played an important part in the 1974-77 depression (Panama's worst depression since the late 1940's), to some degree its severity stemmed from Government attitudes and policies towards the private sector. Upon coming to power in 1968, the Revolutionary Government had an overriding concern with the unbalanced nature of the rapid growth of the previous two decades which appeared to bypass the majority of Panamanians. It consequently set out to shift political and economic power from those interest groups which it perceived as having been directing the country's political and economic affairs up to that time. Included in these groups was the "private sector" which it viewed as consisting of a small group of large and medium size merchants, manufacturers, and land owners who had dominated economic policy making until that time. The Government instituted a series of measures to achieve this objective. It entered into a series of production activities that competed directly with established private enterprises, such as cement and sugar. It passed housing legislation establishing rent controls and otherwise favoring the tenant at the expense of the landlord. It passed new labor legislation which not only raised wages but greatly expanded the role of government and unions. The GOP initially decreed that all employers were required to pay an additional month's wage to their workers. A subsequent law increased direct taxation on wages. Then, in February 1972, the Government issued a new labor code, a detailed compendium

patterned after the Mexican labor code, setting regulations for conduct between employers and workers which significantly changed working relationships. Under the new labor code, the Government began implementing those parts that favored the worker. The authority of the Ministry of Labor was greatly increased with the right to fire employers for infractions of the labor code, to regulate strikes, conciliate disputes and appoint arbitrators. The urban workers' tenure, benefits and bargaining power were greatly increased, with the tenure issue probably the most controversial because under the new code it became extremely more difficult and costly to fire an employee. Added to the problems the new legislation would have naturally created was the lack of any consultation with employers and the arbitrary manner in which the GOP began to implement it in favor of the worker instead of impartially. The government also began to actively enforce price controls in Panama for the first time, freezing virtually all prices in December 1972.

With the labor and price policy changes, the rules of the game were altered: for the first time many employers were required to deal with collective bargaining; and the cost of one of the more important factor inputs was suddenly raised by government decree without--thanks to another government decree, price controls--being able to a least partially offset the increased cost by raising prices.

The private sector reacted strongly and traditionally. Agitation began for a change in government. Support was openly available from the private sector to anyone wishing to lead such a change. The Government reacted sharply and precipitously. It rounded-up a dozen opposition political and private sector leaders and shipped them into exile. It stepped up its ideological and anti-private sector rhetoric. With that, all overt opposition collapsed. However, the private sector was traumatized and a devious bitterness was engendered which helped to shape government--private sector relations to this day. In addition, private investment and other activity dropped precipitously. In 1976, the withdrawal of the private sector, the precipitous decline in private investment and the continuing recession began to force the government to reappraise its relations with, and its policies toward, the private sector. It began gradually taking steps to reverse some of its previous policies. The Government initiated a dialogue with private businessmen to assuage their fears. It initiated a series of financial incentives to encourage private investment. These included a system of import quotas and tariff protection, import duty exemptions, tariff holidays, and other tax exemptions aimed at manufacturing and hotel investments. These incentives plus improved infrastructure provisions (e.g., new international airport, convention facilities, utility expansion, etc.), makes up the Government's industrial strategy today. It also, as a first move, temporarily

suspended collective bargaining and other provisions of the 1972 labor code that were causing the greatest amount of resentment.

While private investment did bottom-out and did begin a turn around in 1978, the new incentives did not lead to the expected increase in private manufacturing activities. The private sector could not forget that this was the same Government that seemed intent on redressing the balance of power a little earlier. Several of the top figures involved in the earlier anti-private sector stance continued in the Government in positions which the private sector considered sensitive. In addition, three fundamental policies reflecting that period remained in effect--housing, labor, and price legislation. The private sector, in essence, took a wait and see attitude.

The unfortunate handling of changes in labor legislation over the next several years confirmed the suspicions of many in the private sector. After debate and discussion in the press and behind the scenes, a tripartite group representing government, business, and labor was formed in 1979 to establish a new labor code. The private sector was particularly encouraged by the progress made in the tripartite negotiations and a new code apparently satisfactory to all was hammered out. For unknown reasons the Minister of Labor objected to the revised code and the Government rejected the tripartite revision. This served to confirm the private sector's worst suspicion. It didn't matter that a new Labor Code was subsequently promulgated in 1980 which contained many of the provisions developed by the tripartite group. In many ways the new code is one that both labor and management can live with. Unfortunately, just a few months after passing the new code, which establishes arbitration rules between employer and employee, the Government unilaterally required that salaried employees should receive a specified minimum wage increase irrespective of any collective bargaining agreements in force. The private sector reacted sharply to such government intervention in what they considered hard fought collective bargaining agreements and took it as another sign of the arbitrariness of government action.

Price legislation is still seen to be a problem. The GOP has been caught up in the classic struggle to keep prices of basic necessities low or at least fairly constant and production up. The GOP is keenly aware of the problems that price controls can create and have created in Panama. Yet, it also recognizes that a small economy like Panama tends to have monopolies and oligopolies which need at least to be watched, if not controlled. So, it is doubtful that Panama will ever completely eliminate price controls. In the past two years there has been a tendency to allow prices to change more rapidly, thereby lessening the profit squeeze suffered by many businesses in the past, when many inputs are allowed to rise freely while the final product price is not. A major problem is an administrative, technical one within the

Price Regulation Office itself. The Office simply is not equipped to handle the responsibility delegated to it. As a result there is no set procedure or method for determining whether a price increase should occur or not. The decisions can be quite arbitrary. Fortunately the Government seems to be moving toward some resolution of the problem. Price policy discussions are currently occurring within the GOP. The discussions center on reducing the number of goods controlled and to changing the method of taxing imports. While the final outcome may not be known for some months, there are clear signals coming from several Ministries that the GOP realizes that changes must be made. A positive step in this direction is the recent announcement by the head of the Price Control Office of the GOP's intent to establish a price adjustment board with representatives of business, farmer and consumer groups in this decision-making group.

There are hopeful signs once again of a rapprochement between the private sector and the Government. The Government has taken several recent steps to intensify the dialogue with the private sector. The Vice-President has invited the private sector groups to review the Government's investment plans for 1982-86. The agricultural minister held a day-long conference, attended by the President, to explain to the private sector the 1982 plans of the public sector agencies in agriculture. The Society of Panamanian Industrialists (SIP) held a day-long conference, again attended by the President and his cabinet, to discuss major issues affecting Government-private sector relations. Future progress in the improving climate will depend now on positive actions by the Government and appropriate response by the private sector.

c. Current Economic Situation, 1978-1981

In 1978, private investment increased for the first time since 1973; more than doubling the 1977 level, yet still less than the pre-recession levels. This resurgence in investment produced a 6.5% growth in GDP, and was a response to the increase in private consumption the previous year, to the successful conclusion of the Canal negotiations, and to the lagged response to the policy changes made by the government in 1977.<sup>1/</sup> It was an important year in which the private sector began to show renewed confidence in the economy. Unfortunately, this response was a year late for the GOP planners. When the GOP realized that the private sector had not responded in 1977 to its incentives of 1976, e.g., labor code modifications and a number of investment incentives, and hence was not creating a sufficient number of jobs for the economy, it decided to move ahead with a new, major social program. This was the Plan de Urgencia, begun in 1978 which eventually would employ 17,000-25,000 people at \$100/month through part of 1980. The Plan was designed to maintain social calm in the

face of rising unemployment and the debates over the Canal Treaties. By the end of 1978, it helped raise the total public debt to an unprecedented 96% of GDP (\$2.4 billion) and external public debt to 74% of GDP (\$1.8 billion).

In 1979 the economy grew at to a 7% growth rate as pent-up consumer demand led to a 16% increase in private consumption, and as private investment increased for the second straight year (20%) to partially offset the 33% drop in public investment. The manufacturing and commerce sectors led all sectors with identical 14% rates of growth. These robust growth rates brought these sectors to their pre-recession highs of 1973. Inflation doubled from the previous year to 7.9%. In 1980 the economy's growth slowed to 5%, with inflation reaching 13.7%. Private sector consumption and investment dropped slightly, while public sector investment, reflecting an improved financial position, rose by 31%. Manufacturing slowed to a 4% increase and commerce to 8.5%. The leading sectors were construction and finance at 12.8% and 11.1% respectively. Preliminary data for 1981 indicate that the economy's growth rate has leveled-off at about 4-5%, that manufacturing continued to grow rather slowly, that the economic activity in the Free Zone suffered as a direct result of the worsening economic situation in South America, and that construction slowed somewhat. With the economy providing about 6 to 8 thousand jobs annually and the labor force growing by some 16 thousand a year, the unemployment rate has continued to grow. The Commerce sector has provided the greatest stimulus to job creation.

For 1982, the same 4-5% rate of growth of the past two years is predicted. Important factors will include the negative impact of the new U.S. sugar policy, which may reduce Panama's export earnings by as much as \$15 million, and the encouraging prospects for the Caribbean Basin Initiative's program of trade and investment promotion. The ability of the GOP to stay within the IMF's 5.5% of GDP guideline for public sector deficit may depend on these factors. The major investment at Cerro Colorado appears to have been put aside until after the 1984 elections and thus will not have to be confronted for the moment.

The years 1979 through 1981 were years of financial consolidation: The GOP improved its revenue collections and adopted austerity budgets so that by the beginning of 1982 the public sector deficit had fallen from 15% of GDP in 1978 to 5.5%, and total public debt from 96% of GDP to approximately 85% (or from 74% to 65% for the external debt). With two years of successful financial management completed, the IMF is quite optimistic about the GOP's ability to solve its financial problems, citing as reasons: the tax measures adopted in 1980 which, it is estimated, produced the first substantial savings in the Central Government's current account in several years (\$10 million), and should help bring financial stability in the future; the

commitment to keep the public sector deficit within 5 1/2-6% of GDP; the apparent commitment of the GOP to deal with the inefficient state businesses; the apparent commitment to a more realistic pricing policy, as evidenced by the price changes allowed for some products in 1980 and 1981; and a study to be undertaken with the IDB to examine the country's industrial policy in order to determine the most appropriate plan of action for stimulating industrial development.

d. Impact of Canal Transition on Panamanian Economy

A recent study conducted by the Mission revealed that by 1985, Panama will begin to receive approximately \$118 million in extra annual net revenues from the Canal as a result of the Canal Treaties. The increase in revenues comes from the payments (about \$75 million) directly related to the Canal's operation and the transfer to Panama of various activities: principally the ports, railroad, and retailing activities formerly handled by the Panama Canal Company.

The impact of the transition on Panamanian employment will be minimal, according to the study, since most of the change will reflect merely a change of employer. The steady displacement of U.S. by Panamanian employees called for in the Treaties is offset by the likelihood that a number of Panamanian positions will be lost by the elimination of Canal organization retailing operations. These will be only partially recouped by presumed expansion of retail employment in Panama to accommodate increased U.S. personal spending in Panama. This, of course, does not take into account the potential benefit to Panamanian employment from the development of territory turned over to Panama under the Treaties.

Major financial investment will be needed to maintain existing infrastructure not to mention planned improvement and expansion programs in the Canal Area. For example, emergency repairs to the Balboa and Cristobal ports and related facilities have had to be made, and the railroad requires considerable upgrading. Housing reverting to Panama is a potential revenue producing asset. At this writing, these costs appear to exceed anticipated Canal revenues.

e. Sector Contribution to Growth and Employment

Table 2 presents, in order of magnitude, 1979 and 1980 percentage contribution of economic sectors to gross domestic product and to employment. The first four most important sectors are unchanged, commerce, services, agriculture and manufacturing, with 55.1% of the GDP and employing 80.4%, or 423,700 of the 527,000 workforce. The next three sectors in order of importance, transport, banking and construction contributed 24.6% to GDP and employed 15% of the workforce.

While the contributions of the agricultural and manufacturing sectors to total GDP and to total employment place these two sectors in the top four, when their

contributions to the growth or increase in GDP and in employment are analysed, their importance as leading growth sectors is shown to have diminished substantially since the 1950-60 period and to have reached such a relatively low point that they cannot be expected, at least within the current policy and incentive framework, to provide the growth stimulus they once did. Table 3 reveals the full extent of the changes in leading sectors over the 1950-60 to 1970-79 periods.

Of the total change occurring in GDP over the 1970-79 period, manufacturing accounted for only 7.2% and agriculture for only 6.8% of GDP, a significant drop from the 19.8 and 13.5 percentages of the 1950-60 period. The relatively rapid growth of the transport sector during the 1970-79 period is due principally to the large increase in its storage subsector which reflects the growth in the Free Zone activities. In like manner, the financial sector's rapid rise reflects growth in a particular sub-sector, in this case the banking sector which has received, as we noted earlier, tremendous stimulus by the GOP since the early 1970s. Table 4 also reveals the sectors which created the most employment over the 1970-79 period. Of the 92,726 new employees created during the period, the services sector employed 52% or over 48,000 of them. No other sector employed more than 14% of this increase. Agriculture showed a fall of 3.6% over the period while the Canal area, due to the Treaty signings, fell by 5.3%. In a later section we discuss the implications of the current sector growth patterns for future growth.

#### f. Analytical Description of the Poor

1. Summary: 1980 census data is not yet available; the following analysis uses 1970 data which may distort the numbers and location of the poor. An AID study found 39% (715,000) of Panama's population classified as poor, of whom 21% were "extremely poor." Concentrations were found in the Panama City-Colon Metropolitan Area and in the Central and Western provinces of Veraguas and Chiriqui. As presented in Table 1, however, the situation appears to have improved during the last decade.

Most rural poor live in shelters lacking electricity, potable water and sanitary connections, depending upon wells and latrines for the latter two services. Rural poor tend to live in isolated communities where public services, e.g., health and education, are the most difficult and costly to provide. Hence, malnutrition and its associated consequences tend to be higher in these areas.

The urban poor receive better basic services than their rural brethren, but share the same problem of inadequate housing. In addition, the urban poor live in extremely crowded conditions, in some cases with only communal water sources and unsanitary waste disposal facilities. Many are unskilled, which partly explains why

so many are unemployed or underemployed. In Panama's highly monetized, relatively high-cost economy, the urban poor are particularly subject to the negative aspects of economic fluctuation and inflation. This situation is aggravated by continuing migration to the cities, adding to the rolls of the unemployed and the badly housed. The degree and complexity of their problems grows with their numbers.

## 2. Selected Socio-Economic Indicators

a. Poverty Analysis: Using 1970 income distribution data, two levels of income were calculated for the country, adjusted for location and based on what it would roughly cost a family of five to purchase a basket of minimal goods and services. The first level, descriptive of 39% of the population, is the income barely adequate to provide for a family's basic needs. This income has been calculated in 1980 prices at \$589 per capita annually for Panama City and Colon, \$458 for the other urban centers and \$347 for the rural areas.

At the second income level, still based on the 1970 income distribution, descriptive of more than 20% of Panama's population, people live in extreme poverty, or in seriously deteriorating conditions. This extreme poverty line has been calculated at \$308 for the cities of Panama and Colon, \$239 for each other urban areas, and \$182 for the rural areas (see the FY 1981 CDSS for the methodology of this poverty line analysis.)

b. Location of the Poor: The Mission analyzed 1978 data regarding social indicators and access to services at the district level.<sup>2/</sup> The major concentrations of poverty are in Veraguas province and neighboring districts in eastern Chiriqui, Cocolé, Colon, Herrera and Los Santos. The majority of these districts have a number of factors in common, including poor soils, mountainous terrain, highly dispersed population and a lack of access roads. The widespread poverty in these districts is further confirmed by a review of other indicators, such as housing conditions, water, sanitation and access to health services.<sup>3/</sup>

The lack of on-farm employment opportunities forces many rural dwellers to seek off-farm employment in small towns and secondary cities and in the metropolitan corridor, which are unable to absorb these excess rural workers. The situation has been exacerbated by haphazard and uncontrolled development throughout urban areas. Dispersed urban development, which has caused excessive infrastructure costs, places substantial pressures on government institutions to provide and coordinate required educational, health, recreation, and transportation services.

The relative economic well-being of the metropolitan corridor <sup>4/</sup> makes it the preeminent target for employment-seeking rural migrants who historically have congregated at the urban fringe. The largest migrant settlement is San

Miguelito, which has about 160,000 first-generation migrants. The urban poor are not necessarily recent migrants from rural areas. Second and third-generation urban poor live in slums such as Chorrillo and Caledonia in Panama City, which have the same crowded and unsanitary living conditions and excessive rates of unemployment and underemployment as do the more recent migrant settlements.

Of special note in discussing the spatial aspects of poverty is the internal momentum of the urbanization process. Although rural-urban migration will continue to be an important component of urban growth, the natural increase within urban areas will account for almost two-thirds of future urban population growth. This fact presents both opportunities and problems for the GOP. While the provision of services for the poor and the measurement of program impacts will be much easier and more economical, the need for coordination and planning with the private sector and government agencies will place severe demands on the government's ability to avoid many of the foreseeable negative aspects of urban growth.

## 2. Employment

### a. A Growing Problem

Although there is widespread agreement that unemployment in Panama has increased significantly since 1974, debate continues on how high the rate is, with Government estimates among the lowest, e.g., 8.8% in 1979 (Table 6). More common are national estimates in the 15%-20% range, with higher estimates in urban areas near the Canal. In Colon, for example, unemployment may be as high as 25%-35% of the workforce, up from IBRD's 1970 estimate of 17.4%. Worse, unemployment hits the poor the hardest. In 1979-80, an AID survey in four low-income neighborhoods in Panama City and Colon found unemployment rates among low-income families of almost 40%. Unemployment, at 24% for this survey sample as a whole, rose to 39% for individuals from families with per capita incomes of \$500 or less. For women and young people unemployment rates were 45% and 65%. These higher unemployment rates follow the general Metropolitan Area pattern for women and young people. Overall unemployment rates for the lowest income groups in these neighborhoods, however, was triple the most recent Metropolitan Area estimates. A powerful indicator of the urban poor's plight is the recent nutritional finding that the district of San Miguelito, on the outskirts of Panama City, contains more than 50% of the nation's children under six with severe malnourishment problems. While GOP data may overstate the number of people outside of the economically active population (EAP) - and hence neither employed nor unemployed - there is little debate that the problem is serious and growing, demanding joint effort by the Government, domestic and foreign investors and businessmen, if the ranks of unemployed are to be reduced.

And while such policies and programs to reverse growing unemployment are only now beginning to take shape, the workforce is growing, nowhere more so than in the Metropolitan Area surrounding the Canal. As a result of a declining birth rate, from over 3% in the late sixties to an estimated 2.2% in 1980, the labor pool (those 15 and above) and the EAP (a fairly stable percentage of the labor pool, in Panama about 60%) is growing faster than the non-working population (under 15 and over 64). Therefore, whereas the labor pool was 53% of the population in 1970, by 2000 it will be in the 63-67% range. The resulting EAP, consequently, is forecast to double in the 25 year period, from 537,000 in 1975 to 1.1 million requiring employment in 2000. A glance at table 5 will reveal that the Metropolitan Area will soon comprise half the nation's population - with migration forecast to continue. Table 9, which uses the latest (understated) official data, shows 58% of the national EAP to be located in the Metropolitan Area. Casual observation in Colon, where the mix of unemployed poor is most graphic, or in San Miguelito, where the large concentration of poor live within sight of the international banking sector with its shiny new buildings, forces the conclusion that absent increasing opportunities for employment and advancement in society for the masses, the Republic entertains a perilous situation with consequences for instability, a damaged international image and the domestic investment climate.

b. A Closer Look at the Unemployed

With regard to numbers of unemployed, Mission analysis confirms the accuracy of official EAP data for 1967 through 1974 (Table 6). In Table 7, however, we depart from official estimates starting in 1975. Based on a constant 60% EAP rate, considerably higher unemployment rates are revealed. In addition to the EAP adjustments, the Mission has reduced the official 1978 and 1979 employment statistics by 17,000, a conservative estimate of the number of jobs the GOP's Plan de Urgencia created in 1978. Since these jobs were not created by the economy, and since the plan was formally abandoned in March 1980, the official employment figures for those two years appear artificially high.

Making the same adjustments to the Metropolitan Area as were made for the national data, we estimate (Table 8) metropolitan corridor unemployment rates during 1978 and 1979 to have been 20.2% and 17.2% respectively.

estimate of 92,400, nearly double the official figure of 50,700. To check the validity of these figures we used the following procedure: Table 7 indicates that employment did not regain the 1974 level of 487,000 until some time in 1979; hence, one could say that all those people desiring employment, i.e., the increase in EAP (80,000) during the period 1975-79 were unable to find work.<sup>5/</sup> Adding the 34,300 unemployment level of 1974 gives an estimated total unemployment of 114,300 for 1979. Seen in this context, the Mission's estimate of 92,400 appears to be more reasonable than the GOP's official 50,200 figure. Based on this analysis, we conclude that in 1979 there were at least 92,000, and perhaps as many as 100,000 unemployed. One prominent Panamanian economist estimates there were at least 115,000 unemployed in 1981; in a March 1981 report the IMF seemed to give tacit recognition to the GOP's underestimation of unemployment by its use of too low an EAP rate. In any case, the important point is that the debate in Panama no longer revolves around whether unemployment is a serious problem, but around what can be done to begin to reduce it.

With regard to who and where the unemployed are, our analysis, which depends on 1976 data (the last time such detail was made available), reveals:

- 1) For the entire country, of total unemployed, 21.8% were 15-19% years old and 31.5% were 20-24. Therefore, 53.5% of the open unemployed were young (15-24).
- 2) For the entire country, 14.4% of 15-19 and 13.4% of 20-24 were unemployed. These are more than double the 6.7% national rate.
- 3) For the entire country, 21.7% of women 15-19 and 16.6% in age group 20-24 were unemployed. For men the rates were 11.0% and 11.7% respectively.

The situation in Panama City and Colon dominates the picture. According to the latest official (1978) data (Table 9), the metropolitan region's 10% unemployment rate was at least double that of any other region.<sup>6/</sup> Adding the 17,000 Plan de Urgencia employees in the Metropolitan Area to the official 32,780 unemployment figure, the official Metropolitan Area unemployment rate increases to 16%, triple that of any other region. In absolute terms the official figures in Table 9 show the Metropolitan Area to contain 75% of the country's unemployed. Adding the 17,000 Plan de Urgencia employees, the percentage rises to 82%. The difference in unemployment rates and levels is so striking, and the absolute levels in the regions outside the Metropolitan Area so small, one could conclude that unemployment is by-and-large a Metropolitan Area problem. Such a conclusion may not be far from the truth since most of the other regions are agricultural in nature, where underemployment tends to be the norm, and the problem to be confronted, rather than unemployment.

These data imply a direct relationship between unemployment and poverty. With 75%-82% of the nation's unemployed in the metropolitan area, where in 1974

ILO/PREALC estimated underemployment to affect 30%-50% of the EAP, and with unemployment most severe among low income groups, plus recent nutrition data implying widespread incidence of malnutrition in San Miguelito, we find a strong correlation existing between urban unemployment and poverty. Annex A, based upon 1975 data, reveals a different approach to a similar conclusion. Annex B briefly discusses the impact of underemployment, noting its incidence to be greater in rural areas, but serious in urban areas as well.

c. Unemployment in the 1980s and 1990s - Labor Intensity

Three factors presently work to keep unemployment high; the first is the impact in Panama of the 1975-77 recession, caused in part by worldwide dislocation due to sharp increases in OPEC's oil exports, but also by a drop in domestic investment resulting from unfavorable reaction to a series of government policies (e.g., price controls, labor code, exiling of business leaders) and leftist rhetoric. Not until 1979 did the economy reattain 1974 employment levels, while the EAP steadily increased. The second factor is the growth of the labor pool at a rate faster than overall population growth. The third factor, which the Mission's strategy hopes to reverse, is the relative capital-intensity of the economy and the policies which govern it, which translates into fewer jobs per dollar invested.

Examination of the employment data indicates that in the 1960-71 period, the economy (with the exception of two high and low years) was producing between 12,000 and 16,000 jobs each year while the EAP was providing some 10,000 to 16,000 job seekers. With this close similarity in incremental supply and demand for jobs, the country's unemployment rate hovered at the 5-7% level. By 1973-1974, however, the size of the 15-64 age group and, consequently, the number of people seeking work rose to a point where Panama's increasingly capital-intensive economy could not produce enough jobs to keep the unemployment rate in the customary 7% range.

The Mission's June 1981 Employment Strategy analyzes the economy's ability to produce sufficient jobs to keep unemployment at reasonable levels through the year 2000.<sup>7/</sup> In the first part of the analysis we set a 10% unemployment rate as an acceptable intermediate level, and look at the consequences based on the assumptions that the economy will be growing at 7% annually (a level achieved many times up to 1975), that the EAP participation rate is 60% and that the 0.42 employment/output coefficient of the last several years will be maintained.<sup>8/</sup> The analysis concludes that from the early 1970s to the late 1980s, 7% GDP growth would not provide enough jobs to keep unemployment at 10%, much less reduce the unemployment pool that resulted from the mid-1970s recession. Under the assumptions of this model, only in the 1990s does the economy begin to provide more jobs than are sought by the 15-64 age group.

Hence, only in the 1990s will the economy begin to resolve the large unemployment problem inherited in the 1970s, which, as we noted earlier, was estimated to be slightly over 100,000 at the end of 1979. Worse, recent GDP growth rates have not reached 7%.

With the same assumptions and data used in the above analysis, Panamanian economist Guillermo Chapman conducted a series of sensitivity analyses on economic growth and labor-intensive variables to determine their impact. Using alternative assumptions about the GDP growth rate, the employment/output coefficient, and the participation rate of the EAP, he provides 18 alternative unemployment rate figures, ranging from 3.3% to 25.1% in 1985 and from -6.3% to 29.5% in 1990.<sup>9/</sup> The results of the set, based on a 60% EAP participation rate, appear in Table 11. If we assume a 6% GDP growth rate nationwide, an employment/output coefficient of 0.50 (slightly higher than that actually achieved during 1960-74), and a participation rate of 60%, the unemployment rate nationwide would still be 18.6% in 1985 and 19% in 1990. Expressed as numbers unemployed, the rates translate into 138,000 and 153,000 individuals. At an 8% GDP growth rate, however, unemployment would fall to 8.8% by 1990.

The conclusions are starkly obvious: if unemployment is to be held at reasonable levels the economy must average an annual GDP growth rate in excess of 8% at the current employment/output coefficient level; a 6%-8% GDP growth rate will require the nation's economy to become more labor intensive (in order to increase the employment/output coefficient to a level between 0.5 and 0.6); and if either of the two above events do not occur, Panama could suffer unemployment rates ranging from 10%-29.5% over the 20-year period from 1980 to 2000. The analysis highlights the importance of developing effective investment/employment policies and programs as soon as possible.

The need to increase the labor intensiveness of new investment in Panama takes on a sense of urgency when we consider how much new investment would be needed over just the next 10 years to maintain unemployment at 10% if the relationship between investment and job creation in the decade of the 1970s is maintained. Between 1970 and 1979 total investment (private and public) in Panama's economy was approximately \$5.2 billion. With the economy producing 92,727 jobs during this same period, the average cost per job created was \$56,000. From the analysis in our Employment Strategy, we estimate that for the 1980-1989 period it would be necessary to create approximately 234,000 new jobs if we are to keep the unemployment rate at 10%. At \$56,000 per job, the total investment needed during the decade would be \$13 billion or \$1.3 billion per year, almost 50% greater than the present level.

With this evidence, we would be remiss not to help Panamanian public and

private sector authorities to take the necessary actions now, to avoid grave problems in the near future.

### 3. Agriculture

#### a. A Period of Stagnation

During the last decade agriculture has not been a major source of growth and development in Panama. In the 1960-69 period, led by export crops, the sector expanded at a 5% annual rate, however since that time performance has fallen sharply. Production for export, particularly bananas, declined and crop production for domestic consumption did not keep pace with growing local demand. While the sector posted a brief recovery in 1975 because of favorable weather conditions and a return to normal export banana production, performance since then has been lackluster. Recently, one of the major markets for banana exports has softened which augurs for stability at best, and at worst a decline in agricultural exports.

Indicators of the relative level of sector inefficiency include employment in 1979 of 29% of the total labor force, accounting for but 14% of the GDP and an increasingly high annual level of food and fiber imports, which in 1976 cost almost \$70 million in foreign exchange--about 10% of Panama's total import bill--including milk and milk products, vegetables, fruit, oils, pork, and basic grains. While current data are not available, it is suspected that the food import bill has increased in real terms and as a percentage of total imports. Finally, with severe implications for renewed agricultural growth and increased on-farm income, yields of Panama's major basic grains continue among the lowest in Central America. One consequence of the absence of growth and continued low productivity in agriculture is widespread rural poverty and underemployment. Rural to urban migration, in part fueled by the lack of opportunity in agriculture, serves to increase unemployment and underemployment in the metropolitan corridor, a problem dealt with at length in the employment narrative.

A major structural problem facing agriculture is the land tenure situation. The problem is twofold: first, land ownership is skewed; second, land ownership is poorly titled. With regard to ownership, the 1970 census shows that only 200 farm units of approximately 115,000 control one fourth of the land in production. At the other end of this spectrum lie a significant number of units too small for viable production. Of some 83,000 farm units of more than one hectare, for example, 30,000 sold no produce to the market place in 1970. With regard to land titles, some 72% of all farms have no title. This insecurity is a clear disincentive to long-term investment and expansion towards commercial farming.

Nonetheless, despite land maldistribution, a relatively large number of farm

units in the 3-50 hectare range exist which could become viable producing units. (This category constitutes about half of the total number of farms in Panama.) These potential commercial small farms are the focus of our agricultural efforts, and appear to be receiving increasing attention from the GOP. The majority of these producers (some 70%) are located in the Western Pacific Slope Provinces of Chiriquí, Veraguas and Coclé and the Azuero Provinces of Herrera and Los Santos. They generally produce three or four crops including corn, beans, sorghum, rice and bananas using a mix of traditional practices, e.g., hand cultivation, and modern practices including fertilizer and chemical pest controls. Were the policy environment to become more favorable and modern technology, credit and accessible markets to be improved, we believe productivity of these farms would rise, resulting in accelerated agricultural growth and a consequent increase in on-farm income and employment. These assumptions will be examined during the forthcoming agricultural sector review.

b. Agricultural Development Constraints

A mix of program and policy failures have worked to constrain sector growth during the last ten years. While the government has begun major efforts to redress past mistakes, taken in isolation, individual activities have had limited impact because many constraining factors interrelate: a mix of policy and technology improvement, better market access and careful natural resource management together can make a difference.

1. Policy Failures: For the past several years, Panama has administered food prices in order to control inflation and placate urban consumers, particularly concentrated in and around the capital, Panama City. However, farm input prices have not been controlled. The result is a classic squeeze on producers: the price of corn, beans and rice has not risen appreciably since 1979, while the price of fertilizer has about doubled. Farm wages, insecticides and pesticides also have increased proportionally even more. Deterioration of the cost-price ratio of rice and corn is shown in Table 12. As a result, for these and other crops, livestock and dairy, farming profitability and productivity have declined.

In addition to the price situation, Panama's agricultural export policy is in disarray. In the 1960-70 decade, for example, Panama was a major producer of bananas, but tax and other disincentives have contributed to reduced production. Creation of the Association of Banana Exporting Nations under Panama's leadership, an effort to affect the export market, and establishment of a state owned banana production enterprise, directly competing with private enterprise, cannot have helped this situation. In general, social objectives appear to have taken precedence over productivity: agricultural policy urgently needs reconsideration and revision.

Within the Ministry of Agriculture (MIDA) itself there is an over-emphasis on organized farming units (asentamientos), while individual producers are virtually ignored. The extension service was dismantled in the early years of the current government in order to focus more attention on the asentamientos. No extension service exists for over 90% of the farms, and agencies of the Ministry often conflict and duplicate other assistance efforts. MIDA has also lacked solid financial backing by the Central Government. For example, MIDA's operating expenses have been about two percent of the total GOP's operating budget in recent years. Its investment budget (including MIDA agencies), has been between 14-16% of the GOP's investment budget. Worse, MIDA's staff is deficient, suffering from a lack of practical training, experience and orientation. Improvement of MIDA's weak organization and poorly coordinated activities are presently the subject of an IICA management study, but the results have yet to be seen.

2. Technology: Per hectare yields of major crops and agricultural enterprises in Panama are among the lowest in Central America. With the exception of rice, trends are discouraging; yields of most crops either have been virtually stable or have declined over the last decade. The problem is a virtually total absence of new technology for farmers to increase productivity, nor is there a viable extension service to private farmers to disseminate results. Extension was formally eliminated by the Ministry of Agriculture in 1973; research was also cut back to favor the asentamientos. What to plant, where, how much fertilizer to apply, which chemical works best, not to mention a host of market price issues, etc., confront farmers daily without answer. Alternatives do exist for the larger producers, some of whom travel to the United States each year to acquire the latest information on varieties, cultured practices and harvesting. Most rice producers however, cannot afford this luxury--nor can producers of other food and fiber products.

This sorry situation is slowly changing. In 1975 a new research service (IDIAP) was established and received an AID loan (525-T-050) in early 1979. The basic purposes of this \$7 million program is to help build IDIAP's basic physical facilities and to initiate on-farm research programs for key crops and enterprises in eight pilot priority areas of the country. Highly useful research is underway with preliminary results already available. Long-term technical assistance from a U.S. university is about to begin. However, the present areas of IDIAP's concentration are but a fraction of Panama's farming area; an expanded research program for other areas of the country, including additional agricultural commodities, is called for and planned during the CDSS period.

Plans to develop agro-industrial research for food production and

processing need strengthening. The example of one major transnational firm working with industrial tomatoes in the central provinces is exemplary. In just a little over a decade, this company built a major processing and canning business employing thousands of farmers and laborers in tomato production and in two major canning plants. The Government is anxious to replicate this experience in the private sector with other commodities; however the effort is constrained by a lack of basic research information on post-harvest technology, storing, processing, and canning.

Finally, to support IDIAP's research efforts, and to strengthen the new extension service to be supported by AID in FY 1983, an upgrading of middle-level agricultural training is needed. Only one institution in Panama, the Instituto Nacional de Agricultura (INA), now trains students at the technical level, but since the early 1970s its facilities as well as its teaching program have badly deteriorated. INA now trains only 25-30 students annually; a recent review of INA's operations noted many serious deficiencies. Not only must the number of new technical level graduates be increased, but the quality of their education must be improved if Panama's agricultural sector is to become revitalized.

3. Markets and Market Access: As noted, many of Panama's small producers make no sales to local markets; this relationship is reciprocal, these farmers do not buy significant quantities of goods and services from local markets. Basically, these farmers are subsistence producers or producers tangentially linked to local markets, incentives and a cash economy. One reason for this situation is that the markets themselves either do not exist, do not function adequately, or are inaccessible. There are neither adequate outlets for farmers to sell their products nor are there adequate facilities in the countryside where agricultural inputs and supplies can easily be procured. Farmers have virtually no source of information about prices of agricultural commodities, locally or in major population centers. While credit has been a problem for the small individual producer, the asentamientos (4% of total farms) have been relatively well financed. A new \$30 million IDB loan in 1982 and AID's FY 1982 Cooperative loan should assist the small producers to obtain better access to farm credit.

In addition to the problems of farm markets at the local level, major urban center facilities have also deteriorated to the point that they neither can adequately serve producers or consumers. Panama City's urban market is located in a congested downtown area with few storage and refrigeration facilities, using virtually no system of grades and standards for consumer protection. Sanitation is inadequate. Access for farmers is virtually impossible; for experienced truckers and middlemen it is difficult. In other cities a similar situation applies. As production in the

countryside increases, there is a need to relocate, expand and upgrade selected urban market facilities. Refrigeration and cold storage must be installed and grades and standards established. Direct access to market facilities should be made available to farmers interested in selling their products directly to the consumer.

4. Natural Resources: Panama's land resources suitable for agriculture and intensive cattle raising are relatively limited. Most of the terrain is undulating to mountainous with poor soils; overall less than one fourth of the country's land mass (about 1.5 million hectares) can be farmed in row crops. On soil already in cultivation or in pastures serious erosion and top soil loss is widespread resulting from poor land management, overgrazing and deforestation of areas including hillsides and gullies. One estimate is that over 500,000 hectares of land extending West from Panama City to Tolé are irreversibly eroded.

Slash-and-burn practices are still common, particularly in the agricultural frontier regions of the Atlantic Slope and the Darien. There nomadic-type subsistence operators clear and burn a given parcel, utilize it intensively for corn, beans and rice until soil productivity declines and then they "sell" it to cattlemen for intensive grazing who use it until it is depleted. Erosion is serious in prime producing areas where commercial small farmers operate. A recent estimate for the small commercial farm vegetable producing area of Chiriqui, sees top soil losses as high as 100 tons per hectare annually. Almost total deforestation, even on steep slopes, is another reason for heavy run-off and top-soil loss. Appropriate conservation methods, e.g., drainage/terracing is almost totally lacking. Adequate land management, including crop and pasture rotation, is not practiced. Given the serious shortage of good crop land in Panama, there is an urgent need to address this situation.

5. Private Sector Services: The institutional mechanisms serving private sector agriculture from farm to policy levels have failed in several respects, especially since the early 1970's. Following the revolution of 1968 major emphasis was placed on the establishment of state agri-business enterprises and state farms or asentamientos. In 1974, there were almost 6,000 families in 147 asentamientos and 1,360 families in 34 juntas agrarias (community farm units). Chiriqui and Panama provinces had the largest number of asentamientos and juntas agrarias units. Rice, by far the major crop, was produced under relatively capital intensive conditions, with machinery and equipment supplied by MIDA. Over \$61 million has been lent to these units between 1973 and 1980 by the Banco de Desarrollo Agropecuario (BDA), a sizeable portion of which is in arrears. IICA estimates a relatively small portion of the asentamientos turn a profit. In spite of an estimated 90% of MIDA's budget devoted to

them since the early 1970s, GOP officials are aware of the continuing precarious situation of the asentamientos, arguing, however, that their social benefits more than offset their high economic costs. While difficult to quantify, and with strong ideological support among certain elements in Panama, relative peace and tranquility have prevailed in Panama's countryside in recent years in the midst of political turmoil in the rest of rural Central America. Progress and change is occurring for private farmers as well, however. We perceive a definite trend towards greater concern by GOP authorities with food and fiber production and towards the individual producer. The banking community, trade and professional groups are involved in a new dialogue with the Government on policy and priorities. In January 1980 and again in February 1982, major seminars representing all major interests of the agricultural sector were held with the attendance of the President and his entire cabinet where public sector policy developments and plans were debated. Recently, some of the state-owned enterprises have been subject to hard economic feasibility analysis by outside consultants; the banana enterprise has been closed, the government-run sugar enterprise may be restructured. Finally, the private sector has recently invited outside consultants to assist the GOP in agricultural policy and program formulation, a process which AID is supporting.

#### 4. Urban Development

Urbanization trends indicate that a rapid rural to urban transition is underway in Panama (Table 5). By the year 1970 the country was half urban, with 44% of the population living in the Metropolitan Area (Panama, Colon and suburbs). By 1980 totals were 57% and 49% respectively, an over 10% increase in the Metropolitan Area. By the year 2000 the Metropolitan population is projected to exceed 60%.

The problems associated with this rapid growth are diverse; one, a key element of this strategy, is the need for new employment opportunities for the burgeoning population. Another problem is the need to improve rural productivity in an environment where a smaller population will have to produce the basic products needed by growing urban populations - also a key element of our strategy. There exist, however, a different series of problems other than employment generation and agriculture that need to be identified, which justifies ongoing and planned efforts in the urban sector. These are associated with the provision of shelter, services and facilities for urban dwellers, including the need to strengthen and expand the policy, financial and managerial capacity and ability of private and public institutions responsible for urban development. How rapid urbanization is managed by Panama will determine whether resources now and in the future are efficiently managed; if they are not Panama will develop the chaotic urban sprawl, so costly in terms of services and

job access, which already affects most of the large Latin American cities.

a. Estimating Shelter Needs

An initial definition of what should be provided to satisfy family shelter needs determines the degree of investment necessary to meet target group requirements. The IBRD - Churchill report on low-income family basic needs defines and ranks in order of importance the following basket of goods and services in the shelter area: (1) security of land tenure; (2) a minimum service package for the site, i.e., site preparation, adequate vehicular and pedestrian access, water supply and waste disposal systems; (3) a basic unit of minimum size; (4) service connections to the site; (5) bedrooms of minimum size.

For the period 1981-2000 Panama's shelter requirements for below median income families, based on those criteria, plus the investment needed to meet these needs, appear on Table 13. Total investment required for all income levels for this period is \$1,792 million. However, to serve families below the median income in accordance with their paying capacity (which implies a reduced level of goods and services) about 42% of the total investment projected (\$752 million) is needed. In absolute numbers annual investment to serve these families for this 20 year period will be approximately \$39 million. During the period 1977 to 1980 the investment was approximately \$16 million per year.

b. Urban Planning

Master plans exist for Panama City and major secondary cities. These plans, however, have little authority behind them and are largely ignored. Zoning regulations, for example, are set by the Ministry of Housing and the Municipalities. Serious conflicts constantly arise between the two which result in costly delays for investors interested in a particular area. A unique Metropolitan Area problem now being confronted by the GOP relates to the manner in which the lands reverting to Panama under the 1977 Canal Treaties are to be used. This is an area of high political sensitivity, which the GOP has yet to confront.

An agile urban planning system needs sound legislation supporting expeditious land recording, encouraging the production of certain desirable kinds of investments, e.g., rental housing, medium-rise apartment buildings, etc. More important, Panama badly needs planned reception areas to accommodate ongoing urban migration. The lack of such planning has resulted in large, disorganized squatter communities in and around Panama City and Colon. Institutionalization of a dynamic process in which shelter, services and facilities are planned, financed and built in an integrated fashion is needed. This process would help balance popular demand for more, better and affordable housing with rational planning of available physical and financial resources.

c. Public and Private Institutions

Panama has a multifaceted shelter delivery system. These include institutions dealing with new housing for the poor, i.e., the National Mortgage Bank (BHN) and the Housing Ministry (MIVI), and other providing infrastructure services, e.g., water, sewerage, and electricity (IDAAN, IRHE). The private sector is involved in housing through mortgage banks and the Savings and Loan system. The Social Security system also finances housing.

The problems with this institutional framework run from the need for a stronger financial base for the public sector (BHN-MIVI), through better programming, planning, design, and management, to the lack of incentives to the private sector to become involved in the financing of housing for families below the median income. The lack of a rational financial policy in the sector produces such distortions as the Social Security system financing housing for middle income families at rates below those offered by BHN-MIVI for low income groups. Finally there is a lack of a system to address the needs of families close to the median. Neither the public nor the private sector is working at this level, which results in families at just above the median, competing for units developed by the GOP for lower income groups.

5. Host Country Commitment.

a. Commitment

Discussions with key government officials and a review of key financial data indicate that after two years of diligent work, the GOP has finally put into place an effective public sector financial management program which should begin to alleviate the pressures created by the large public sector deficits and the consequent large external debts of the late 1970s. The reduction of the public sector deficit to 5 1/2% of GDP and of the external public debt to 70% of GDP is ample evidence of the GOP's intention to follow the IMF's conservative financial plan, and of the commitment to realize a sustained economic growth, spurred by the private sector, which will reduce the high unemployment rates to tolerable levels.

As part of this new commitment to financial responsibility, the government hired a consortium of respected international banking and investment firms to examine the status of many of its inefficient, subsidized state enterprises which not only have created political problems with the private sector but have put severe strain on the government budget. The experts will recommend either sale, closure, or a management improvement program for each. So far, the resort island of Contadora has been put up for sale, consideration is being given to selling the sugar lands of the La Victoria sugar enterprise, and to dissolving the troubled state-owned banana corporation, COBAPA, which recently lost its principal market, Yugoslavia.

The GOP's recent publicly stated policy decision to follow the IMF recommendation to hold public sector deficits to 5 1/2-6% of GDP for the next several years is a full and unmistakable signal that the government indeed will no longer operate as a leading economic agent, but rather will play a role complementary to private activity, supporting it with appropriate tax, price, and incomes policies designed to sustain the economic recovery. The GOP appears to recognize the critical role the private sector must play to achieve sustained economic growth, and to solve the unemployment problem while maintaining the social benefits gained over the past 13 years.

This shift of emphasis to the private sector, while dictated principally by financial realities, also reflects the realization that significant accomplishments in the provision of social services and infrastructure investment have been made, and that for social benefits to be maintained, the country must invest in projects which will spur economic growth--projects that are best handled by the private sector.

In recognition that accelerated growth will require additional private investment, and that, the international banking sector's presence alone will not attract the investment funds the economy will need, the GOP will establish, in early 1982, an autonomous agency, the National Investment Council, composed of three successful, respected businessmen from the private sector, three government Ministers and a managing director responsible for four directorates. The salary levels are highly competitive. As presently comprised, the Council will be the sole agency responsible for the promotion of investment in Panama, and will have employment generation as a principal objective. As currently envisioned the new agency will include within its functions job creation targets for new investment; market research to identify profitable investment opportunities; project promotion with offices in Panama, New York, Frankfurt, and Tokyo; project development and assistance in legal matters and manpower training; and financial aid and real estate services to assist investors in arranging financing and industrial site location. In other words, the council will serve a one-stop shop function for would-be investors. It will cut through red tape, ensuring that needed services such as telephones are made available quickly. The proposed yearly operating budget is \$3.8 million.

In addition to investment promotion in the past year the GOP has taken numerous actions to reshape policies, and rethink positions in order that the private investors and entrepreneurs might have an increased incentive to invest in the industrial and agricultural sectors. Some of the more notable actions have been:

- Agricultural Policy development: Several initiatives are being undertaken or being designed. Principle among them is the upgrading of MIDA's planning division, capability to analyse the impact of pricing and other policies.

- Issuance of MIDA's Basic Lines of Action, in which concern for the entire food system and the institutions that service it is manifested. This is an important change from past programs which tended to focus on food production problems in isolation.
- Issuance of a Draft Agricultural Incentive Law which recognizes the need to make the sector responsive to market forces and private investment.
- Creation of industrial development extension services: both the BNP and APEDE have initiated technical extension services for small-medium businesses to strengthen their technical, financial and sales management procedures.
- Employment and Industrial Policy Review and development: through a BID financed industrial sector study, industrial policies will be examined to assess changes needed to attract more investment. Price and interest rate policy analyses will be key elements of the study; through the Policy Analysis and Research Systems (PARS) unit, an employment study will be mounted to define the extent and depth of the problem so that adequate programs can be developed to eliminate them.

While it is unlikely that the GOP will ever consider totally eliminating price controls and interest rate subsidies, there is a strong commitment to improve these policies. The GOP is keenly aware of the problems that price controls can create and have created in Panama. Yet, it also recognizes that a small economy like Panama tends to contain monopolies and oligopolies which need at least to be watched, if not controlled. Several plans for establishing a new pricing policy are circulating within the GOP. One has been presented publicly. Whatever final form the policy takes, it undoubtedly will result in a large reduction in the number of items being controlled, with the price control office shifting its focus to those areas or sectors where monopolies or oligopolies exist. Where competition is considered adequate, the market will be allowed to set the price. Rather than having controlled prices, a system of supervised prices may arise. In this latter case the Price Regulation Board will have the option to challenge the increases ex post.

The market rate(s) of interest, as established by a Banking Commission composed of GOP and private bankers, is the rate which prevails for most of the loan transactions in Panama. The notable subsidy exceptions are in agriculture, the small business sector, and housing for median and below median income families.

In an attempt to channel more private banking monies toward the agricultural sector, the GOP initiated a sectoral redistributive subsidy system for agricultural loans in 1980 by adding a 0.5% charge to certain non-agricultural loan categories. Private banks collect the 0.5% add-on charge and pass it on to the Banking Commission. Then the private banks that make subsidized agricultural loans (about

4-5% below the market rate) are reimbursed from the 0.5% fund to cover the interest payments theoretically lost by not placing the loan monies in non-agricultural sectors which pay the market rate of interest.

In 1980, the Government through the subsidized interest rates of BDA, supplied \$39 million or only 27% of all agricultural credit. The small business loan programs available from several GOP programs currently charge 8 1/2-12% at varying terms. Through its EPG project, the Mission has been able to obtain some increases in these rates, and expects to see further increases in the future. These GOP programs represent only 1% of all loans made by the private banking community for similar purposes. Their distortionary affect, thus, would appear minimal. Some housing programs, for social welfare reasons, subsidize interest rates charged to borrowers. The issue of target group benefits vs. public sector costs of a subsidized interest program is complex. It will be examined by the PARS, the IDB Industrial study and the forthcoming AID agriculture sector review.

b. Plans and Development Budget

Not in recent memory has a Panamanian Government taken such an active role in presenting and explaining the new 1982 budget, and future investment and development plans to the nation. Newspapers have carried a series of articles explaining the plans, costs and benefits. Underscoring the importance the government places in gaining acceptance and cooperation from the many elements of society, high government officials, with the Vice-President taking the lead, have taken the message directly to leading financial, industrial, business, and labor groups, many of whom have been openly skeptical of government intentions in the past.

The results of the government's campaign are quite encouraging. The presentations appear to have satisfied many of the government's earlier critics. Indeed, the presentations have been remarkably frank and open. There is open recognition by the GOP that there have to be changes in numerous policies. There is a sense that the significant social achievements of the GOP may now be complemented by programs whose objective is increased economic growth and productivity.

In describing its plans and programs for the future the GOP highlights the following: (1) the need to create 250,000 jobs during the decade (presumably to keep unemployment at about 8%). The GOP estimates that the economy will grow at about 5.5% for the decade and that the growth rate is sufficient to generate the 250,000 jobs discussed earlier. (2) the need to raise productivity of labor in order to overcome the relatively high wage structure in Panama vis a vis the rest of the LDC's; (3) in agriculture, the need to provide more credit to small and medium farmers, to improve technology transfer, to improve marketing, and to change policies, all for the purpose

of increasing production; (4) in commerce and industry, the need to provide, through MICI, BNP, and COFINA, \$300 million of credit over the decade to meet demand not being met by private banking sector; (5) the plan to convert the successful asentamientos into cooperatives, with the unprofitable ones either disbanded or recognized as a social welfare problem and treated accordingly; (6) the need to maintain some form of price control to offset various monopolistic elements and to protect the poorer segments of the economy; (7) and the plan to reduce protectionism by revising the system of import controls.

The emphasis on increased investment, job creation, and increased agricultural production for the next decade is reflected in the investment budget of \$617 million for 1982 (a 20% increase over 1981), which increases investment expenditure in the commerce and industries sector by 52.6%, in the agricultural sector by 38.8%, in the housing sector by 38.7%, and in the transport sector by 24.5%. Education's budget rose by 18.4%, while the remaining five sectors experienced declines. The relative positions, however, changed only slightly, with housing switching with the electricity sector to rise from 2nd to number one, and agriculture switching with transport to rise from fourth to third place. The five leading sectors, Agriculture, Commerce and Industries, Electricity, Transport, and Housing account for 82.6% of the investment budget, with Commerce and Industries at the low end at 13.8% and Housing at the high end at 18.8%.

c. Other Donors

As of June 30, 1981 the IDB and IBRD pipeline was about \$370 million, or 69% of a portfolio of \$529 million. The IBRD has focused on highway, power and energy planning loans. It has contributed \$35 million to the five-year \$120 million Colon redevelopment program, \$70 million of which is to be provided by a consortium of Japanese banks. Objectives of this program include increasing permanent employment in the depressed Colon area through expansion of the Colon Free Zone and creation of an industrial park, as well as construction of some 3700 low-income housing units. The IBRD has placed relatively little emphasis on policy development, however.

The IDB has also focused on highways and power generation plus industrial and agricultural credit. IDB's future program closely parallels AID's agricultural focus. IDB has recently approved a rural small irrigation program (\$8.7 million) and the bank's fifth agricultural credit loan (\$29.5 million). A comprehensive agriculture study nears completion and a \$50 million program is in early planning stages. IDB has reached conclusions similar to our own, that with carefully planned assistance, agricultural stagnation may be remedied.

We have begun to give especially close attention to coordinating our plans

and sharing our strategic objectives with the IDB. The initial response is encouraging; IDB's program, focused on capital assistance to strengthen agricultural production, marketing and processing, pure seed production and perhaps forestry, technology transfer and institutional strengthening, may become a more focused approach including for the first time by the IDB, support for more fundamental GOP policy and program reorientation. AID will report further in this regard. We anticipate particularly close support.

The UN system in 1980 provided about \$4.6 million in technical assistance, and \$1.5 million from the UNDP with \$1.9 million in energy studies financed by the World Bank through the UN and \$1.1 million from the UNFPA. UNDP assistance had been provided to help draft the 1981-85 Five Year Plan, work on which remains incomplete. During 1982 UNDP plans a \$2.8 million program in Panama. Of special interest are plans to resume assistance in preparing parts of a five year investment budget, conducting a poverty study update and an income distribution study using data now becoming available from the 1980 census.

Bilateral programs of the DAC countries consist primarily of procurement credits, training assistance and scholarships.

d. Human Rights/Political Environment

Panama has had a good record of human rights progress in recent years. After a decade-long "moratorium" on organized political activity instituted to give the "revolution" an opportunity to consolidate its reforms, as well as to maintain internal cohesion during the protracted Canal Treaties negotiation process, the political system in Panama has undergone significant liberalization.

Panama is governed under a Constitution promulgated in 1972. Under a transitory provision of the Constitution, General Omar Torrijos held broad powers as "maximum leader of the Panamanian revolution" for a six-years period. With the expiration of those powers in 1978 until his death, Torrijos retained only his position as Commander-in-Chief; nevertheless, he exerted great influence in Panamanian governmental affairs, e.g., his designees were elected President and Vice President by the National Assembly in 1978.

Under the Constitution, 505 community representatives are elected by secret, popular vote for six-year terms and constitute the National Assembly. Because representatives are elected from municipal subdivisions (corregimientos), and not on the basis of population, the less populous rural districts are dominant in the Assembly. This system has resulted in greater participation in public life of the less advantaged segments of the population giving the poor, women and indigenous minorities greater voice in the affairs of state.

Under 1978 constitutional reforms, legislative power, except for the power of the purse, was shifted from the Executive Branch to a National Legislative Council composed of 37 National Assembly members (similarly reflecting rural districts) and 19 representatives popularly elected in September 1980. The President and Vice President are to be chosen in direct popular elections beginning in 1984. In the meantime, real power continues to be centered around the National Guard and the civilian Executive Branch.

Respect for civil and political liberties has increased over the last few years as a result of a series of political reforms, giving legal status to several political parties, some of which have been sharply critical of the government. Reports of degrading treatment and arbitrary arrest do occur, but such cases are not common, and the police work of the Guardia Nacional has not been associated with major corruption. The inviolability of the home is respected. In ordinary criminal cases, Panamanians have the benefit of a fair and public trial. In politically sensitive cases, however, the judiciary appears to have been susceptible to the influence of the Executive Branch. With a few exceptions, labor unions are free to organize and operate, and the government increasingly solicits their views and those of a broad range of private sector groups and associations during the formulation of policy initiatives.

There is considerable freedom of the press in Panama. Two opposition dailies, opposition radio stations, and other newspapers, television and radio stations are permitted to run stories critical of government policies and programs with little harassment or censorship. Foreign publications circulate freely. The Government, however, in early 1980 cancelled the professional licenses of four journalists whom it accused of irresponsible reporting. Radical supporters of the GOP were implicated in a recent incident against the opposition daily La Prensa, although the GOP itself, through the President, the chief of the National Guard and other high officials, as well as the pro-GOP press, denounced this attack.

#### 6. Prospects For, And Constraints To, Future Growth

By accepting the challenge to maintain the public sector deficit within 5 1/2%-6% of GDP, the GOP is asserting that it can attract sufficient private investment to attain its economic and employment, growth objectives. The National Investment Council is key to that effort. The GOP estimate that the economy will have to create 250,000 new jobs during the decade of the 1980s (presumably keeping unemployment at 8%) is comparable to our earlier 224,000 estimate if unemployment is to be kept at 10%. The 250,000 figure implicitly recognizes that there are some 100,000 people currently unemployed.

The infusion of needed capital on a \$3.5 billion economy, coupled with our earlier analysis in the employment section about minimum growth rates needed to keep unemployment at reasonable levels, lead us to conclude that growth rates not only will have to be in the 6%-8% range for the GOP to realize its objective of creating 250,000 new jobs over the next decade, but will be at that level if the additional investment occurs. The 5.5% GDP growth figure and a much lower new investment figure would be adequate if and only if new investments were much more labor intensive than historically has been the case.

The policies and legislation promulgated during the 1970s have had the effect of favoring investment in time deposits, in services, in finances, in re-exportation through the Free Zone, and in speculation in real estate. Conversely during the same period, profitability in agriculture, livestock, industry and agroindustry fell. For example at the end of the 1960s profitability for these sectors was slightly greater than 20%, with inflation rates about 5%. By the end of the 1970s, however, profitability was less than 10% and inflation was on the order of 14%, producing a negative real profit.

As we noted in Table 3, the financial and free zone sectors were the leading growth sectors during the 1970s. The rapid growth of these two sectors led to large real increases in the salaries of the best paid labor group in the economy, representing a mere 3-4% of total employment. The rapid growth of these sectors has spawned the growth of high-class commercial establishments, of high real estates values, and of specialized professional services,--the creation of practically a separate wealthy economy within the overall Panamanian economy. Furthermore, increases in these two sectors induce little demand in the manufacturing and agriculture and livestock sectors.

Estimates of future GDP growth rates lie in the 4-5% range. While there may be some opportunities for import substitution, the key element to more rapid growth and higher employment, in an economy as small as Panama's, is the development of a strong export program covering as wide a range of products as possible, with concentration on the three neglected sectors agriculture, livestock, and manufacturing industry (including agroindustry), which provided the 7-8% annual growth rates during the 1950s and 1960s needed to keep unemployment at reasonable levels.

The success of the more balanced growth hinges on three key factors: (1) the successful change in policies which have been hampering the several sectors discussed above; (2) the ability of the National Investment Council to attract new investment; and (3) the ability of the agricultural authorities to raise sector profitability. The pivotal element is policy change. Until the private sector receives this positive

policy signals, the other two factors will have little if any chance of success.

To the extent the country can obtain some modicum of policy change, can promote private investment, can raise agricultural productivity and production, and export some portion of this increased industrial and agricultural production, the country will have a chance to obtain the rates of growth necessary to raise employment to satisfactory levels.

## PART TWO - STRATEGY

### Introduction

Panama stands at a crossroads of much of the world's commerce and finance. The interoceanic Canal is a major commercial crossroad. The adjacent Colon Free Zone handles some \$4 billion worth of merchandise in transit to markets within the hemisphere. Panama's 118 bank international finance center manages over \$50 billion in assets invested throughout the world. Reflecting close ties, Panama ranks third in U.S. investment in Latin America (after Mexico and Brazil).

Panama lies at the southern end of the troubled Central American isthmus. The U.S. places great importance on its military presence in Panama, the U.S. Southern Command, to protect both the Canal and our strategic interests throughout this region. Its activities include the administration of U.S. military assistance, disaster relief and search and rescue operations throughout Latin America. The U.S. Army School of the Americas and the Inter-American Air Forces Academy military schools are principal training sites for Latin American military forces.

Panama is also a prominent member of the non-aligned movement encompassing much of the Third World. It presently holds an elected seat on the Security Council and is active in such other international bodies as the Group of 77 and the Latin American Economic System (SELA). How the U.S. manages its relations with a smaller, less powerful country to which it is tied by an accident of geography influences how the U.S. is perceived throughout Latin America and the rest of the Third World.

For these reasons, the United States and, indeed, the free world, have major strategic and political interests in Panama. The United States supports Panama's continuing efforts to achieve an adequate rate of economic growth and the development of an equitable economic and social environment which will permit continued momentum towards increased democratic participation in the political process, avoidance of the economic and social turmoil sweeping the region, and the successful operation of the Canal.

The next few years are a crucial transition period for Panama. The 1977 Canal Treaties increased Panama's role in the operation and maintenance of the Canal and, by the year 2000, Panama will assume full control over Canal operations. During this

transition period, implementation of these treaties will likely continue as a source of friction between the U.S. and Panama as both countries attempt to interpret their provisions across cultural barriers and differing perceptions of national interests. Extraordinary effort will be needed on both sides to not permit this friction to affect the transition process or to spill over onto other aspects of our bilateral relations. As the transition proceeds, Panama also faces a difficult political transition from a military to a democratically elected, representative government in 1984. The balance which the late General Omar Torrijos provided between conflicting ideologic and economic groups is under strain. A more sympathetic attitude toward business and investment is evident. The left is concerned with the perceived danger that the revolution of the last 13 years might be swept aside; the right sees a chance to regain power lost. Panama now must balance these conflicting forces without either a solid democratic tradition or a political "strongman" to check the emergence of anti-democratic forces of the right or the left.

In addition to the strategic considerations outlined above there are solid development considerations for a modest US assistance program focused on selected problem areas, whose resolution is central to Panama's achieving self-sustained and balanced economic growth with equity. Panama is unequivocally committed to improving the quality of life of the majority of its people. It has been engaged over the last 10 years in a major development effort - perhaps the most successful in Latin America - to expand basic social services to its rural and urban poor. The World Bank, in reviewing the effort of the last several years, reported that "...the greatest success (of this Government) has been in the provision of basic services to its rural citizens at the same time it expanded coverage and improved the quality of services in urban areas".

Although these social achievements are solid, they nonetheless obscure a significant failure - an inability to maintain adequate across-the-board economic growth on a sustained basis. Despite a positive real growth rate, unemployment is unacceptably high and is growing. Literate young people without jobs represent a political time bomb to the country's stability--and to U.S. interests.

The recession of the mid 1970s exacerbated the Government's tendency to finance most of its social programs with foreign loans which by the late 1970s were at increasingly high interest rates. With total public debt for several years running at 90% of GDP, the Government was forced to adopt austerity budgets. The result has been reduction in new social programs over the last several years. At the same time, policies and legislation such as the new labor code and price control system, promulgated by the Government and designed to protect low income families,

unintentionally encouraged investment in time deposits, services, finance, re-exportation through the Free Zone, and in speculative real estate. These same policies tended to reduce profitability in the traditional productive sectors, i.e., agriculture, livestock, industry and agroindustry. The present-day consequence of this unbalanced growth pattern has been rates of economic growth insufficient to meet growing employment demand.

Thus, if Panama is to maintain the extraordinary social gains it has achieved over the last 10 years, it must find ways to restore growth to the agriculture, livestock, and manufacturing sectors. During the 1950s and 1960s these sectors provided the 7-8% annual growth rates which were sufficient to meet increasing job requirements. The greatest challenge is getting agriculture moving. It has been an essentially stagnant area for the last decade with some of the lowest yields in Central America, an organized farming system (asentamientos) still deficit ridden, requiring heavy state subsidy and consuming the bulk of the Agriculture Ministry's budget, although representative of about 4% of the farming population. Other problems which beset Panamanian agriculture, e.g., antiquated technology, unrealistic and restrictive price policies, insufficient marketing facilities and non-existent agro-industrial infrastructure, are familiar to knowledgeable observers of the Panamanian economy because they have persisted unchanged for so long.

Over the CDSS period Panama faces a newly emerging problem - growing unemployment. During the late 60s and early 70s Panama's economy scored impressive economic growth with attendant increases in jobs. Yet even then, observers in and out of the government saw growing poor populations in Colon, San Miguelito and Panama City, fed by migration from rural areas, and signaling structural problems not easily resolved. And when economic growth slowed, as it did later in the 1970s, the problem became acute and began to be more widely acknowledged. The Government at one stage even attempted to address the problem through public works programs and hired between 17,000 and 25,000 unemployed under its Emergency Plan (Plan de Urgencia) (1978-1980). This high cost-low productivity approach now is recognized as having been largely a failure because it was economically unsustainable. Further complicating the picture is the increasing capital intensity of the economy and the government's penchant to focus on large scale capital projects without considering their employment consequences, resulting in increased cost to the economy of each new job created.

Panama appears to be at a turning point in the development strategy which it has been pursuing since 1968. The new leadership which then came to power was committed to introducing major political, social and economic changes aimed at improving the standard of living and shifting the power structure to benefit the heretofore

neglected rural areas and urban poor. The Government consequently took a significantly more active role in the economy in areas up to then exclusively the purview of the private sector. Public utilities were nationalized and investments were made in industries which had formerly been exclusively the domain of private investors, e.g., sugar, bananas, cement. In agriculture reliance was placed on the asentamientos and state enterprises, thereby ignoring the majority of Panama's private farmers. This was combined with a high degree of ideologic rhetoric. The result was a precipitous drop in private investment and stagnant agriculture and domestic manufacturing.

In recent years a growing recognition and conscious acceptance of the role of the private sector has begun. There now seems to be a developing consensus among important groups, i.e., some elements in the Government, farmers, the banking sector, the national university and the major private sector associations, that a change is needed. An effort has begun by the GOP to rethink previous policy, to mend relations with the private sector and to restimulate private investment. This has been a slow, suspicion-filled process requiring changes in established policies and mechanisms supported by groups with vested interest in the status quo. The government is divided. While some see the need to work with the private sector if minimal efficiency is to be achieved and the unemployment problem is to be solved, others see attempts to work with the private sector as compromising the social gains made to date. The private sector, in a similar fashion, cannot forget that it was attacked not too long ago by a government that now seeks its cooperation. Our strategy is designed to help support and encourage this change in the Government's development strategy while simultaneously encouraging and supporting positive private sector response to that change.

This policy change has important regional implications. One of the aspects of the region-wide turmoil bordering Panama involves a struggle over the proper role of the private and public sectors and the relative merits of a free market economy. The private sector is under attack throughout the region, linked by its detractors to economic and political systems that operated at the expense of the many for the benefit of the few. Despite its revolutionary background, Panama has the strongest private sector with some of the most progressive members in Central America; it thrives on a market economy. It is important to demonstrate to Central America, particularly at this time, that a market economy can meet the aspirations of all members of society, not just a few. In addition, the private sector in Panama provides a moderating influence on those private sectors under siege throughout the region.

Panama has the potential for being one of the most successful programs under the

Caribbean Basin Initiative (CBI). The essence of the initiative is to bring together trade, investment and foreign assistance in a manner which will permit private initiative in each country to flourish. The Country Team already has begun a series of related efforts to help improve the investment climate in Panama and channel increasing private foreign investment into Panama: a bilateral investment treaty is under negotiation; opportunities offered by IDCA-TDP, OPIC and EX-IM are being explored and the American Chamber of Commerce (now two years old) is being encouraged. Considerable effort is being made to facilitate Panamanian exports to the US, particularly in relation to GSP. AID's role in this effort is to help build the institutions and mechanisms that will help Panama take advantage of the CBI. The GOP is working toward the establishment of a one-stop investment promotion agency to promote foreign investment in Panama. We will seek means to strengthen this new investment promotion agency. In addition, we are encouraging a regional investment conference and ways private sector groups can support investment promotion activities and will be prepared to work with private sector organizations to enhance their contribution to national development goals.

This CDSS proposes a third thrust, urban development, because of the impact of the rural/urban transformation underway, the volatility of this migration adjacent to the Canal, and the importance of housing ownership to building a private sector. The consequences of Panama's rapid transformation from a rural to an urban society - from 42% urban in 1950 to over 57% in 1980 and projected to rise to over 71% by the year 2000 - has had a direct and visible impact on the Canal area. Although extensive public investment has maintained water, sewerage, education, health and other public services at adequate levels, urban development has not kept pace with demand. Panama, especially the Canal corridor, faces a unique set of problems - the boundaries of the former Canal Zone imposed a sprawling, crazy-quilt growth pattern on Panama City and made physical expansion of Colon virtually impossible. The legal disappearance of the Zone now permits development of both cities into hitherto unavailable area. The Canal Treaties will also eventually turn over some 2,500 former Canal Company housing units to Panamanian jurisdiction. Overshadowing these spatial and managerial challenges is the requirement for some 149,000 new and upgraded shelter "solutions" for below median income families in the Canal corridor and in secondary cities by the year 2000.

Therefore, AID will support a balanced program of policy formulation and institution building supporting expansion of the productive sector, which during the period of this CDSS will have a direct and evaluable impact in the areas of agriculture, employment generation and urban development, with particular attention to the private sector's role and targeted at vulnerable and key population groups. The

strategy will attempt to help direct increased private sector resources into the economy and will be closely coordinated with the IBRD and IDB, the former which is supporting major job-creation and infrastructure expansion under the Colon Development Plan, and the latter which has under initial design at this writing a \$50-\$80 million agricultural sector development program.

1. Employment.

The goal of the AID employment program in Panama is to assist both the Government and the private sector to develop and implement a continuous program marshalling public and private resources to increase employment opportunities. While such a program implies accelerated growth rates spurred by higher investment levels, it also implies a change in the historical pattern of growth and investment. Following historical patterns, recent high rates of growth and investment appear neither sustainable nor sufficient to absorb the growing labor force absent policy and structural changes in the economy, in investment patterns and in the relationship between the public and private sectors. For example, a recent study indicates that assuming historical investment patterns, annual growth rates of 8-10% and annual investment of \$1.3 billion (almost double current levels) would be required to keep national unemployment at 10%. Investment of this magnitude would imply an increase in government investment and role in the economy with a concomitant reduction in support of social services as the Government, unable to increase its foreign debt, switched from operational expenditures supporting social programs to investment.

The measures required to change the historical pattern of investment and growth to a more labor-intensive pattern need further definition and study. As discussed previously, the private sector will have a central role in revitalizing the economy and creating jobs. There are a series of measures which that sector views as constraints to expansion of their activities. In addition to the necessary policy (and political) framework, there are an absence of effective institutions and programs which promote and finance investment. Finally, there is a lack of manpower planning and manpower development programs.

The objectives of the Mission program to accomplish the employment goal are to:

- (a) strengthen the government's ability to analyze employment problems and devise policies and programs that will increase investment which maximizes employment;
- (b) establish and strengthen those institutions and programs which promote labor intensive activities consistent with acceptable levels of efficiency; and
- (c) rationalize the labor market by strengthening government capacity for manpower planning, development and providing employment services.

In order to achieve the above, the Mission program contains five elements: Policy

Formulation, Small Business Development, Labor-intensive Industries Promotion, Manpower Planning and Development, and Private Sector Strengthening. Together, they form our approach to promoting greater resource mobilization and efficiency of resource use by both Panama's public and private sectors.

a. Policy Formulation

The Mission is promoting a continuing process of analysis, design and evaluation of public sector programs, legislation and investments aimed at increasing employment. There is a need to introduce explicitly employment considerations at all levels throughout the public sector from the design of national growth strategies and the required macro-policies, to sector policies, to project considerations. For example, a fundamental policy decision appears to have been made - that greater reliance is to be placed on the private productive sector rather than on the public productive sector as heretofore. This requires a review of government price control programs and labor legislation, both of which discourage labor-intensive investment in favor of capital-intensive. There is also a tendency within the GOP to favor major capital-intensive projects, e.g., coal slurry pipelines, open-pit copper mines, container rail line, without an adequate weight being given to the employment implications.

The Policy Analysis and Research System (PARS), developed under the FY 1981 Employment Planning and Generation project (525-0221), is the major initiative in this area. It is designed to provide a locus for government employment policy development, and includes private sector participation to evidence a commitment to recognize each sector's role and requirements in the process which translates policies to actions and ideas into investment. An FY 1985 loan is contemplated to further strengthen PARS, including training to develop a "critical mass" of professionals skilled and sensitive to various aspects of job creation. At the same time we will reinforce the effort through PARS by supporting national employment seminars and research on employment questions at the national university as well as efforts by private sector organizations to investigate and publicize employment related issues.

b. Small Business Development

Research has confirmed the theoretical premise that small business is more labor-intensive, and generates employment at a lower cost than larger enterprises. In Panama small business creates jobs at 1/8 the national average cost, which is to say eight jobs may be created by small business at the same cost as one in the more capital intensive medium-large sector. In helping to increase employment the Mission is helping to build and strengthen a system of credit and technical assistance mechanisms to support the expansion of the small business subsector in Panama. The

Ministry of Commerce's small industry fund, financed under the URBE Loan (525-T-047), is aimed at micro-entrepreneurs. The FY 1981-82 \$5 million loan through the National Bank (BNP) under the Employment Planning and Generation project is aimed at small and medium entrepreneurs in the less than 50 employee range. The IIPUP-C program (912-0071) is an experimental credit mechanism established along the lines of a community development authority in San Miguelito, the largest concentration of the poor in the Panama City area. Depending upon the experience of these programs, an FY 1985-86 \$8 million loan is planned to broaden the coverage of these programs. In addition, consideration will be given to expanding activities into the artisan and handicrafts area subject to further analysis by the Mission.

Technical assistance has a number of critical functions in small business development, including project development and business management (fiscal, personnel, inventory, production engineering, marketing, etc.). Services in these areas, provided from within the business community itself, is being supported under the ongoing Entrepreneurial Development OPG (525-0225) with the Panamanian Association of Business Executives (APEDE) and is scheduled for expansion beyond the Panama City-Colon area in FY 1983. A small business technical assistance mechanism is in the process of being established in conjunction to the National Bank's loan fund under the Employment Planning and Generation project. In addition, the possibility of establishing a small business industrial extension service in conjunction with the Ministry of Commerce's Small Industry Fund will be explored. Alternate approaches are under consideration with two small business associations employing a PVO such as Technoserve, Inc. At this stage we forecast several OPGs, small grants, seminars or workshops throughout the CDSS period to develop a series of institutional systems to deliver relevant support through the private sector to small entrepreneurs.

Throughout the period consideration will be given to developing a credit guarantee program suitable to Panama's credit needs and acceptable to Panama's uniquely open, market oriented credit system, which includes some 118 resident international banks. Experience with AID's PCGP will be included in this review.

#### c. Labor-intensive Industry Promotion

In comparison with some Caribbean, Central and South American nations, as well as such Asian nations as Singapore, Malaysia and Taiwan, Panama's labor-intensive industry (e.g., assembly and packaging industries) appear to be relatively under-exploited, even considering the significant and successful bonded warehouse operations of the Colon Free Zone. We shall assist appropriate authorities in the public and private sectors to more aggressively pursue such possibilities. The Government is seriously considering establishing this year a one-stop investment

agency which will promote foreign investment in Panama, assist foreign investments in-country, and itself finance investments. This provides a unique opportunity in support of the CBI. We will consider a \$10 million loan program, divided between FYs 1986 and 87, to help develop "Maquila" light assembly including textiles, transistor circuit assembly and packaging. Panama's well-educated workforce and superior transportation facilities lend easy access to a larger market than many competitors. This, plus the stable environment with strong U.S. presence, may offset Panama's non-membership in the CACM and somewhat higher labor costs. Such assistance may include an industrial park. The former Canal Company industrial facilities at Mt. Hope, warehouse and former hangars at Albrook AFB, plus large open tracts throughout the former Canal Zone all having unparallel access to transportation infrastructure and the urban labor supply, are among the options for industrial park development in the Canal corridor. Such parks offer lower start-up costs for light industry. Although the issue of future exploitation of former Canal Zone facilities is sensitive, our initial soundings are encouraging. The linkage between Panamanian production potential and foreign and domestic markets needs strengthening. An export promotion loan for labor-intensive industry, aimed at the US market under the CBI, is planned for FY 1988. Agribusiness will receive a boost from programs in the cooperative sector.

d. Manpower Planning and Development

Although Panama enjoys a relatively well educated workforce, and the public and private sectors provide worker training opportunities in a wide variety of areas of specialization, our examination with government and private sector representatives reveals significant deficiencies in the interdependent relationship between worker training and skills required by Panamanian business.

AID is already helping Panama's Labor Ministry develop better information on unemployment - its cyclical pattern, and geographic, economic and demographic dimensions under the Employment Planning and Generation project. An ongoing OPG, Employment Training For Women (525-0229), will train some 600 low-income women in marketable skills. An initial project is being designed at this writing, to be financed in FYs 1983 and 84, to support the coordinated expansion of worker-training programs, skills analyses activities, counseling and job-placement services. Private sector involvement, through on-the-job training programs, as well as through participation in skills requirement surveys, is also included. A second loan in FY 1987 would further strengthen job training facilities to include new areas of the Republic or new economic sectors. By concentrating on the relatively unskilled, generally the poorest and youngest of the unemployed, these activities provide

openings for the presently unemployed to otherwise inaccessible economic opportunities.

e. Private Sector Strengthening

The Mission's strategy addressing the unemployment problems is aimed at strengthening the private sector. This will be accomplished by: (i) encouraging the Government to change its historical attitude toward the private sector and improve the investment climate of Panama; (ii) encouraging the private sector to examine and redefine its role in society and become engaged in activities addressing the development problems of the country; and (iii) strengthening private sector organizations and encouraging them to work together.

Panama's private sector is the strongest on the isthmus; due to the long history of contact with international commerce and finance it has an unusually large number of leaders who are fully aware of their importance to economic growth and the consequent need for greater cooperation between the public and private sectors. There has been a history of antagonism between the Government and the private sector dating back to 1968 when the current Government came to power. It equated the private sector with a small self-interested oligarchy and set out to break the economic and political power of the "private sector." It now appears that the Government has reached a turning point and realizes it must rely on the private sector.

The Policy Analysis and Research System (PARS) will deepen and encourage this change. It will examine constraints to private investment and other factors affecting the investment climate and make policy recommendations. In addition, we will look for opportunities to encourage consultation between the Government and the private sector in policy matters affecting the private sector. The Mission is promoting active rethinking by leading private sector figures of the private sector's role in society and how it could respond positively to the Government's apparent opening to it on principal development problems. We are considering sponsoring several weekend seminars along the lines of the Action Caribbean program, or utilizing the recent INCAE private sector study as a basis. This will be followed by a series of activities by various private sector groups which demonstrate the private sector's concern and active participation in the development of the country. The Entrepreneurial Development project's success and APEDE's interest in future expansion is representative of widespread private sector interest in taking a leadership role in national development. In FY 1984 we plan a \$4 million loan and \$500,000 grant to the Union of Panamanian Industrialists (SIP) to develop a Productivity Center to act as transfer agent for new technologic applications for small business. This activity allows the private sector itself to develop, access, and transfer small business improvements to make them more competitive and to help them increase employment. To

strengthen and help unify the private sector's national representation, Chamber of Commerce "twinning" is being considered; and a more active participation by the nation's private bankers in innovative small business financial and technical services will be encouraged. We foresee several small grants, to strengthen the quality of the private sector's approach to development issues (a "think tank" to improve the quality of the private sector's dialogue with the Government and the promotion of a private sector-government consultative mechanism are being pursued).

Finally, we will look for one or two activities that will unite the private sector by working together on a major project (e.g., FY 1986 a \$3.5 million Training for Development Scholarship Program II loan).

## 2. Agriculture.

The goal of our agricultural program is to assist the Government to increase food production and employment opportunities in the agricultural sector while conserving the natural resource base. The decline in productivity and the need to import basic staples are indicative of the agriculture sector's malaise as is the steady emigration from farm to urban areas. A combination of inappropriate government policies, low levels of technology, inadequate marketing structure and lack of land title are at the core of Panama's agricultural stagnation problem, which also has contributed to serious undernutrition among a third of Panama's youth under six.

In order to help Panama reach the above goal, the Mission will focus on (i) strengthening the capacity of the GOP to analyze and formulate policies that promote greater productivity and job creation; (ii) improving the Government's capacity to develop new production and processing technologies and disseminate them widely to both public and private sector users; (iii) strengthening public and private agricultural marketing, processing and transportation services; and (iv) strengthening both the Government and private sector's capacity to protect and conserve the national resource base of the country.

Mission activities will concentrate on institutions, systems, and programs in each area, leaving significant resource transfer activities such as credit, land tenancy, and infrastructure to other donors. The target of this approach are small and medium-size farmers with commercial potential holding from 3 to 50 hectares - about 50% of farms in the Republic. The major part of these small and medium farms are located in the western slope (Chiriquí, Veraguas and Coclé) and the Azuero Peninsula, where the bulk of AID attention in improving social services has been placed in recent years.

The AID agriculture program strategy over the next five years has five thrusts: Policy Formulation, Technology Improvement, Market Systems Development, Natural

Resource Management, and Private Sector Strengthening.

a. Policy Formulation

There is a growing realization that government policies in effect over the last decade have not yielded results. These range from a fundamental lack of appreciation of the role of agriculture in a country which considers itself an international center of commerce and finance, to overdependence on state farms and state enterprises for developing agriculture, to lack of marketing and land use policies. Recently released data indicating more widespread undernutrition than had been expected, also is cause for concern. Some officials in the Ministry of Agriculture and throughout the government, as well as key figures in the private sector, have realized the need for change. They are actively encouraging public debate, seeking solutions and trying to initiate policy changes.

AID will assist in developing the capacity of the Ministry of Agriculture to analyze major problems and devise policies and programs that lead to increased productivity and job creation. As a first step we are beginning to work with the Ministry of Agriculture's Planning Office to carry out a diagnosis of the sector, identifying a nucleus of a future planning staff and identifying policy issues deserving further analysis. We plan to continue this process with major planning grants in FY 1983, 1984, 1985 and 1986 to provide technical assistance, training and limited equipment support to build the Ministry's planning capability and institutionalize a process of dynamic policy analysis and formulation. A complementary study by IICA will provide the Ministry with a major agricultural sector institutional organization plan, offering the potential for improved outreach of services to small and medium producers. The Mission will also support private sector groups in investigating and publicizing studies on the major agricultural issues of the day. We have supported efforts by the Panamanian Agricultural Society to hold national seminars and to bring down experts to review and hold discussions on the major problems in the sector and to further support ongoing policy debate.

b. Technology Improvement

Production costs are relatively high in Panama due to inefficient use of land, labor, and inputs; in large part this results from low technology levels presently in use. While the creation of the Panamanian Agricultural Research Institute (IDIAP) in the late 1970s and AID's 1979 \$6 million loan (525-T-050) are steps in the right direction, much more needs to be done to forge the system from technology producer through technology consumer. With this in mind, a Technology Transfer loan is programmed for FY 1983 and FY 1984 to provide extension services to private independent producers. A second loan is planned to IDIAP in FY 1986 and 1987

by which time IDIAP should have sufficient trained personnel, research systems in place and management know-how to expand its concern from the present eight priority areas to a nation-wide system of agricultural research.

To improve the level of technology and to accelerate production of qualified middle-level agricultural technicians, AID will assist in by developing a local capacity to train new technicians and provide continuing in-service training for them. The Mission's FY 1985 proposed loan and accompanying grant would assure creation of a technical and economically efficient system for developing qualified middle-level agricultural technicians, not only for employment in research and extension, but in the private sector as well. At the same time we see a need to link IDIAP, the new extension system and MIDA's middle-level education facility (INA, the National Agricultural Institute) into one technology system and, perhaps, into one organization. For all intents and purposes, INA's current state denies any effective source of middle-level agricultural technicians to Panama. The FY 1983 Training for Development Scholarship program will support advanced training in areas including agricultural sciences.

In FY 1988, depending upon the success of the planned ROCAP - INCAP - ICAITI - CITA Regional Food Technology program, establishment of a national food technology institute and laboratory having close operational, technical and perhaps, financial, linkages to private agribusiness will be considered. This program would consolidate and upgrade disparate public and private research and development efforts in food processing, preparation and marketing, in order to introduce more nutritious, affordable products into the marketplace.

c. Marketing Systems Development

A sizable proportion of Panamanian small farmers do not sell food and fiber products to the marketplace. While data on their purchases is not available, we suspect they also buy little from the marketplace and are essentially subsistence farmers. While we shall refine this conclusion in future studies and review of census data, most analysts agree that one contributing factor to this lack of participation in the marketplace is inadequate market access in which to sell products and buy fuel, fertilizers and seed. A considerable program to strengthen market access and facilities is underway and will continue. Completion of the \$6.9 million loan (525-T-042) to Panama's Marketing Institute (IMA) will leave terminal grain silos in three major production areas and provide technical assistance in marketing and management. The ongoing FY 1978 Rural Growth and Service Center URBE loan (525-T-047) is supporting development of agri-business operations, transport terminals and other facilities in eight secondary towns to strengthen their role as linkage between farmers

and major markets. The ongoing FY 1978 Rural Access Roads project will leave a network of all weather farm to market roads and an institutional capacity within the Ministry of Public Works to relate road building programs to marketing requirements. In FY 1982 a second Rural Cooperative loan will support production and marketing by the private rural cooperatives and their membership, including improved packaging, transport and where possible, processing of farm production.

A final portion of our program of strengthening marketing systems will support construction of major wholesale and retail market centers. Presently scheduled for FY 1988, this loan will help modernize the highly unorganized, unsanitary and inefficient retail and wholesale marketing systems in Panama's major population centers. Institution of a national market information system, to better connect producers of all sizes with the marketplace, is also scheduled for FY 1988. A possible alternate project during the CDSS period may be a second rural road loan to help communities break out of their isolated state with access to the marketplace and to receive agricultural and other services from GOP programs. A significant portion of this loan will involve institutionalizing a program of rural road maintenance.

d. Natural Resources Management

Panama has taken the leadership in Central America in protecting its natural resources, including management, conservation and control. The GOP appreciates that for the Canal to continue to function, its watershed must be carefully managed and conserved. Under an FY 1979 loan (525-T-049), AID is assisting Panama's Renewable Natural Resources Institute (RENARE) to protect three major watersheds, including that of the Canal, and to strengthen RENARE's technical and managerial capacities. A second loan is planned for FY 1984 to expand RENARE's watershed protection activities to the rest of the country including the Darien, which is visibly suffering from overzealous colonization. Based on the recent AID-financed national environmental profile, which identified soil erosion and deforestation as major resource management dilemmas, an FY 1987 loan in reforestation and soil erosion control is contemplated focusing attention in farm production areas of the Western Slope and the Azuero peninsula. By that time, work under earlier institution strengthening programs with RENARE should be completed and sufficient tree seedling nurseries been developed so that this program could be rapidly implemented, with cooperating inputs from IDIAP and MIDA.

e. Private Sector Strengthening

The principal target group of the Mission's effort in agriculture is the private sector. An important objective of the policy formulation activity is to get the Government to examine the experience of state-directed agriculture and to define a

role for the private sector. An important objective of the technology activity is to provide new technology to small and medium size independent producers. In marketing we have supported a loan fund for small agro-industry loan and will support services and facilities for small and medium producers. In addition we will support several activities through private sector institutions. The Rural Cooperative loan in FY 1983 will further strengthen the independent private agricultural cooperative federation, member cooperatives and member private farmers. Further support to organizations of private farmers - by geographic region, crop or type - is also under review. Support for a national conservation society, modeled on ASCONA in Costa Rica, will be studied. We have supported the Panamanian Agricultural Society in its seminars on agricultural policy and in improving its understanding of sector problems, and are in contact with associations of milk, cattle and rice producers as well as groups in initial phases of establishing a private sector agricultural bank.

### 3. Urban Development.

The Mission's urban development strategy will concentrate resources on the production of shelter solutions, including new and upgraded units, based upon sound urban planning, and support participation of private sector institutions to broaden their involvement in below median income housing in the Panama Canal corridor and in secondary cities.

#### a. Shelter Production

HIG financing has long supported institutional strengthening along with financing of construction. For the CDSS period, a portion of the three planned \$15 million guaranties will continue to strengthen the BHN-MIVI financial and management capacity to deal with low-income housing, the key element of the present HIG Panama program being implemented as part of the 1977 Panama Canal Treaties.<sup>10/</sup> These resources will support use by BHN/MIVI of existing non-profit developers such as housing cooperatives and credit unions as promoters (packagers) of low-income housing, serving as vehicles for BHN-MIVI to expand the number of families they serve. Grant-financed technical assistance will be used to strengthen the capacity of these non-profit developers to act in conjunction with BHN and with other shelter finance institutions.

#### b. Urban Planning

Our approach is to encourage rational approaches in selection of areas for new shelter programs, so projects will match present or planned municipal growth. We have begun this process with the implementation of projects in the Treaty package where close coordination is required among MIVI, IDAAN and the Ministry of Planning.

For the CDSS period our program will furnish technical assistance: to help

evaluate the manner in which public sector urban planning responsibilities are carried out and coordinated; to develop an inter-institutional approach to urban planning; and to strengthen local government (municipality) capabilities to implement and enforce zoning and related land use regulations. A key area of assistance will help the GOP examine alternate ways land and existing residential areas in the former Canal Zone which are reverting to Panama might be used as new reception areas to alleviate the pressure on such districts as San Miguelito.

Key institutions such as IDAAN, which provides water and sewerage services, will be assisted to strengthen their efforts in providing improved services in crowded low-income areas. This activity will build on the experience gained with the successfully completed integrated program for San Miguelito funded with HG resources. In brief, the Mission will implement a program which will be focused on practical, substantive issues with short term applications.

c. Private Sector

Shelters to be built with HIG resources planned for the CDSS period shall involve the private sector in direct construction of units and infrastructure. Our program in this area is to encourage the private sector to become primary lenders for below median income family shelters. Non-profit institutions such as housing cooperatives and credit unions will be helped with HIG financing and technical assistance to participate in shelter programs. The major objective is to have mortgage banks and savings and loan institutions to direct resources to low income housing. To reach this objective a portion of the three CDSS-period HIGs will be directly channeled to the private sector.

Finally, a process has begun to review national housing finance policy to see what legal and financial constraints prevent greater concentration by the private sector on housing for lower middle income families, i.e., those at or close to the median. The target, through technical assistance provided during the CDSS period, is to help develop and strengthen a financial system in which mortgage discount and mortgage insurance can help increase the mobility of mortgage paper generated in the Panamanian market. The potential for changing the role of the Social Security fund in a new, targeted housing program will also be addressed.

4. Other Activities.

a. Health and Education

Over the next year the Mission will phase out of its very successful involvement in these two sectors.

b. Population

AID has been providing the GOP with direct assistance for population programs since FY 1968. USAID strategy is to terminate the bilateral program in 1984 based

upon a careful review of the degree to which it has been accepted and supported by the GOP and by the private sector family planning association - APLAFA.

Prior to the present Population II Grant (525-0204), our efforts had been directed at institutionalizing family planning through the maternal child health services of the Ministry of Health (MOH) and APLAFA. By 1979, family planning became secure within the GOP's nationwide health system. As a result of this official acceptance of family planning, the present five-year bilateral \$3.25 million grant, which will terminate in September 1984, focuses on providing family planning information (through sex education) to the younger, adolescent groups and on motivating and providing services to the rural population that is not using contraceptive methods but is at risk of unwanted pregnancy. In order to reach these target groups, the implementing agencies under Population II include not only the MOH and APLAFA, but also the Ministry of Education, the National Directorate for the Child and Family (DINNFA) and the Panamanian Institute for Special Education (IPHE).

The previous CDSS projected AID bilateral population assistance to Panama to phase-over to intermediary support in late 1984. We have already initiated some activities along these lines. The Pathfinder Fund, which receives AID central funding, is now assisting the Confederation of Panamanian Workers (CTRP) in providing information/education and in distribution of condoms through member unions. The Futures Group (also AID centrally-funded) is being encouraged to assist APLAFA in establishing a commercial retail sales project. Nevertheless, recent indications as to future level of project support to Panama from the major population organizations such as UNFPA and IPPF have not been encouraging. UNFPA has greatly reduced financial support in Panama, with no new projects contemplated for the next few years. Like AID, it no longer considers Panama a priority country in the area of family planning. IPPF has reduced its support to APLAFA. The IBRD and IDB have not considered population programs within their Panama portfolio. We are providing program assistance to APLAFA's adolescent sex education activities, and will continue to encourage APLAFA to strengthen its own fund raising capabilities. Until these capabilities are established, however, APLAFA will continue to require external assistance. In line with our strategy, we are presently encouraging Pathfinder Fund, FPIA, AVS-International Project and other AID centrally-funded groups to assist APLAFA's adolescent fertility and family planning activities.

Under our population strategy, therefore, we presently consider central AID support for the purchase of family planning commodities (contraceptives and minor sterilization equipment) to be necessary on a continuing basis. The degree to which we would continue support to the sex education and adolescent fertility programs which

not only benefit Panama, but may serve as models for other developing countries in the region, will depend upon their evaluated success here, and the importance to the region of the model programs.

c. Energy

The pilot Alternative Energy grant (525-0207) will be completed in FY 1983. In the absence of sufficient program resources, the Mission's effort in this sector will phase out. The possibility of future assistance within a regional mode, however, will be considered.

d. Nutrition

During the CDSS period AID plans to continue the Title II program for approximately 115,000 recipients. By the end of FY 1984 the phase out of the school feeding program will be completed, with the Ministry of Education assuming full budget and program responsibility. Simultaneously, the remainder of the program (except for 1600 recipients of a CRS orphanage and old-age feeding program) will be targeted upon preschool children under six through the Ministry of Health's Maternal-Child Health (MCH) programs.

The incidence of undernutrition in preschool children, as measured by growth monitoring, has changed little since 1967 in spite of significant public investment in social infrastructure and services. A 1980 survey reveals severe undernutrition (more than 2 SD) measured by weight for age, to affect at least 13.4% of children under six with fully one-third of this age group evidencing some growth retardation. Rural urban differences are significant, with 18.6% of this age group in rural areas affected and 8.9% in urban areas. Significant geographic variation also exists with as high as 50% incidence in the districts of San Francisco de Veraguas (near Santiago) and 22.9% in nearby Soná, where the Integrated Rural Development program (525-T-046) will concentrate major development resources. Family food consumption data support the national nutrition survey and indicate that about a third of Panamanian families do not meet even 80% of their calorie requirements - which over time is likely to have a detrimental affect on family health.

Nutrition is already a component of the planned agricultural diagnostic. The AID/W funded "Consumption Affects of Agricultural Policies" activity, now beginning in Panama with the Ministries of Health and Agriculture, will supplement the agricultural sector investigation. Planned agricultural activities in this CDSS also have direct implications for improved nutritional well-being, especially those within the Policy Formulation, Technology Improvement (including food technology) and Marketing Systems Development categories. In the employment sector, future targeting of activities at vulnerable groups and use of food resources to support employment generating

activities such as is planned under the recently begun Employment Training for Women OPG (525-0229) will be considered.

In this manner, Mission strategy will help Panama improve the nutritional well-being of Panamanian youth through a targeted PL 480 Title II MCH program and will assure that nutrition concerns are given continuous review as agriculture and employment activities are developed and implemented. This approach integrates nutrition concerns within overall agricultural and employment generation activities. Further program strategy and target group details will be provided in the FY 1984 ABS narrative, to be based upon the results of the recently completed AID/W Title II evaluation of the Panama program.

### PART THREE - ASSISTANCE PLANNING LEVEL

#### 1. Proposed Assistance Planning Level

Levels for the AID program are inadequate to the demands - and opportunities - the proposed strategy offers. In FY 1981 obligations were only \$8.6 million, including two loans split between FYs 1981 and 1982. In FY 1982 the current program level is \$9.2 million, an increase from the FY 1982 \$6.9 million level in the current CP. This CDSS proposes annual program levels of between \$19 and \$20 million, up from the designated AAPL of \$12 to \$15 million between FY 1984 to FY 1987. We believe a program of the proposed size, combined with Country Team support, will permit us to influence the direction of future public and private sector agricultural, employment, and urban investments.

Achievement of our program objectives will depend upon:

- a continuation of political stability, a condition which already makes Panama unique on the isthmus, and which is fundamental to investor confidence and economic growth;
- a committed GOP leadership, receptive to maintaining a policy dialogue with the private sector, who are innovative and forward-looking;
- our ability to respond to and stimulate the developing policy dialogue between the Government and the private sector;
- improved absorptive capacity by the government, (our Development Administration project addresses some of these constraints); and
- careful program coordination among the donor agencies.

We believe our objectives and strategy are already understood and largely shared and shall work towards better coordination of timing of project design and institutional development approaches. In this regard, while at this time we do not foresee the requirement for formal coordination, we will seek AID/W support for greater support in coordination and in policy development.

The proposed program, at a level approximating \$20 million, follows:

		<u>PROPOSED ASSISTANCE PLANNING LEVELS</u>					
		FY	<u>84</u>	<u>85</u>	<u>86</u>	<u>87</u>	<u>88</u>
<u>Employment Generation</u>							
A.	Policy Formulation	(G)	.4	.4	.2	.2	.2
		(L)	-	3.0	-	-	-
B.	Small Business Development						
	--Employment Generation	(L)	-	6.0	2.0	-	-
	--OPGs		.5	.3	1.0	.5	1.0
C.	Labor Intensive Industry Promotion						
	--Maquilla Promotion	(L)	-	-	6.0	4.0	-
	--Export Development	(G)	-	-	-	.3	.2
		(L)	-	-	-	-	4.0
D.	Manpower Planning and Development						
	--Skills Training and Placement	(L)	5.0	-	-	6.0	-
E.	Private Sector Strengthening						
	--Productivity Improvement	(G)	.5	-	-	-	-
		(L)	4.0	-	-	-	-
	--Scholarship Program II	(L)	-	-	3.5	-	-
	--OPGs		-	.2	.5	.3	.3
<u>Agriculture</u>							
A.	Policy Formulation	(G)	1.0	.5	.5	.2	.2
B.	Technology Improvement						
	--Tech. Transfer	(L)	2.5	-	-	-	-
	--Research	(L)	-	-	4.0	3.0	-
	--Tech. Education	(G)	-	1.0	-	-	-
		(L)	-	7.0	-	-	-
	--Food Technology	(G)	-	-	-	-	.5
		(L)	-	-	-	-	4.0
C.	Marketing Systems						
	--Marketing Information	(G)	-	-	-	.3	.3
		(L)	-	-	-	-	3.0
	--Urban Markets	(L)	-	-	-	-	5.0
D.	Natural Resources Management						
	--Watershed Management II	(L)	5.0	-	-	-	-
	--Reforestation	(L)	-	-	-	5.0	-
E.	Private Sector Strengthening	(G)	.3	.3	.5	.5	.5
<u>Urban Development</u>							
A.	Housing Guaranties		15.0	-	15.0	-	15.0
B.	Urban Planning	(G)	-	.3	.5	.5	.5
<u>Other <sup>1/</sup></u>							
		(G)	.5	.1	.1	.1	.1
Totals: DG			3.2	3.1	3.3	2.9	3.8
DL			16.5	16.0	15.5	18.0	16.0
(Total DA)			(19.7)	(19.1)	(18.8)	(20.9)	(19.8)
PL 480 Title II			3.2	4.0	4.4	4.4	4.5
HG			15.0	-	15.0	-	15.0

<sup>1/</sup> Includes population, SDA.

## 2. Staffing Implications

USDH levels are being reduced from 20 to 17 during the present fiscal year. Thereafter, in order to develop new programs in Agriculture and Private Enterprise, as well as to implement active projects and to strengthen the Mission's policy analysis capabilities, a 17 USDH level will be necessary. While holding at this level during the CDSS period, we plan to alter the composition of present staff, for example moving towards more employment related fields such as private enterprise and labor economics.

### USDH STAFFING LEVELS 1/

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Direction and Program/Economics <u>2/</u>	4	4	4	4	4
Development Resources	3	3	3	3	3
Agriculture and Rural Development	3	3	3	3	3
Multisector (Private Enterprise)	3	3	3	3	3
Program Support <u>3/</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>4</u>
	17	17	17	17	17

1/ Excludes Regional Housing Office (3 USDH).

2/ Offices of the Director, and Development Planning.

3/ Executive and Controller offices, Regional Contract Officer.

## FOOTNOTES

- 1/ All percentage increases or growth figures are real changes, e.g., 6.5% growth in GDP implies a 6.5% real growth in GDP.
- 2/ The country is divided into nine provinces and 65 districts. In addition, there is one special district set aside for the Cuna Indian tribe.
- 3/ The Mission's current Rural Growth and Service Centers project (525-185) has activities in some of these districts, and the reprogrammed IRD project (525-186) is located in one of them (Soná). During the CDSS period, we will support agricultural productivity efforts in these same regions.
- 4/ Although median monthly family income in Panama City and Colon in 1976 was \$457 and \$434, respectively, well over 60% of the families in the poor barrios earn less than \$200 monthly, i.e., \$480 per capita annually.
- 5/ Calculated by subtracting the number of people in the 15-and-above population group in 1974 (869,500) from those in 1979 (1,002,900), and multiplying the difference (133,400) by the labor-participation rate (.6).
- 6/ We use the official regional data without any adjustments except for the 17,000 because, while the application of the 0.6 EAP would raise the absolute level of unemployment in all regions, the relative values would not change, and because our argument can be made without resorting to the other adjustment.
- 7/ Employment Strategy, USAID Panama, June 1981. Copies available in LAC/DR bulk files.
- 8/ The relationship between the rate of growth in employment and the rate of growth in output (GDP). The lower the ratio, the more capital intensive the economy tends to be. Negative values reflect fall in employment; OIT/PRELAC, Situación y Perspectivas del Empleo en Panamá, for 1960 and 1970, and INDESA, Factores que Afectan la Demanda por Mano de Obra en Panamá, December 1979, pp.59-65.
- 9/ The negative figure indicates that labor demand would exceed labor supply. Only six cases are shown in Table 11.
- 10/ A note from Secretary of State Vance to the Panamanian Ambassador on September 7, 1977 stated that the United States was prepared to develop an economic program including up to \$75 million in guaranties to support an approved FY 1979-1984 shelter program.

## ANNEX A

### Geographic Distribution of the Poor

Using 1975 data, Broehl developed an urban/rural family poverty distribution for Panama which indicates that 60% of all poor families (defined as living below a specified subsistence level) are found in the rural areas.<sup>1/</sup> As Table 10 indicates, of the remaining 40% which are urban, 31% live in the metropolitan area while the remaining 9% are scattered among the smaller urban areas. Even though there were more poor families in the rural areas than in the urban, the 20% difference is small, and given the potentially greater volatility of the urban groups, the number of families in the 40% urban figure is more than large enough to require careful consideration.

And, with the recession of the 1974-78 period and the slow upturn since, and the greater need to rely on the market place for goods than in the rural sector where at least a meager existence can be eked out, it is likely that more of the marginal urban people have slipped into the poor classification than has occurred in the rural areas.

With increasing urbanization the difference in geographic spread should diminish. For example, if we make the reasonable assumption that the same current relationship between urban poverty (40%) and urbanization (57%) will exist in the year 2,000 we would conclude that as the country becomes more urban (71%), the percent of poor families living below the poverty line, as established by Broehl, will rise to nearly 50% in the urban areas. In other words, as Panama becomes more urbanized, the urban and rural areas will tend to contain about the same number of poor families. And, of more importance, they are and will be, to an even greater extent, more concentrated in the Metropolitan Area than in the rural.

<sup>1/</sup> Broehl, Allan. Workforce Development Project: Panama 525-0214. Report prepared for USAID/Panama, 13 November-1 December 1978.

## ANNEX B

### Underemployment

Exacerbating the effects of high unemployment is a high rate of underemployment in both the urban and rural sectors. As Table 9 implies, underemployment, and not unemployment, is a major concern in rural areas.

Underemployment may be defined in a number of ways, including (1) differences between actual days worked and an appropriate "full-employment" norm, and as (2) a measure based on the number of persons in the EAP whose incomes are insufficient to meet minimum basic-needs standards for themselves and their families. The latter mixes employment and income factors and as a result can be criticized for not being a precise definition of unemployment. Notwithstanding the shortcoming, however, it is an important definition because it recognizes that many persons who are fully employed in a labor-time sense have incomes below poverty lines determined by minimum basic-needs standards. This is true in both rural and urban areas, and is especially true at this time in the rural areas where, as we have noted 60% of poor families are located.

The GOP estimates that 14-19% of the work force was underemployed in 1975 and that this is a critical problem in the agricultural sector. A 1974 study by ILO/PREALC estimated that 30-50% of the economically active population was underemployed., with the greater incidence occurring in the rural areas.

Although its character is decidedly different than rural agriculturally related underemployment, urban underemployment is a serious problem too. Utilizing the findings of the low-income study in Panama City and Colon, some employment characteristics of these low income urban families can be determined. Of most importance is the large number of income earners in wage and salary employment. One of the key findings of the Broehl 1978 study, and one which has strong implications for employment strategies of AID and the GOP directed toward low-income individuals

living in urban areas, is that the majority of those interviewed (70%) fall under the category of the "modern" or "wage and salary sector." This finding is further substantiated by Broehl in his work on employment profile of low-income workers in the Metropolitan Areas of Panama using 1975 data. Over 50% of those workers identified as low-income were wage and salary workers. The income levels are significantly lower for those working in small firms (with five or less employees) and for the self-employed. As expected, the highest employment concentration of low-income urban workers is in the commerce and service sectors. While a great deal more information is required to better understand the employment problems of urban low-income families, it is significant that they represent such a large proportion of the total number of poor families and that most of them depend on organized wage and salary employment.

TABLE 1  
SOCIO ECONOMIC INDICATORS 1/

<u>Sector</u>	<u>1970</u>	<u>1980</u>
Access to Safe Water <u>2/</u>		
URBAN	100.0%	100.0%
RURAL	43.0%	64.0%
Access to Sanitary Facilities		
URBAN	87.0%	81.0%
RURAL	68.0%	81.0%
Infant Deaths <u>3/</u>		
URBAN	41.0	37.0
RURAL	48.8	37.6
Physicians/1,000 Population	6.3	9.0
Subcenters and Health Posts <u>4/</u>	109.0	210.0
Health Centers <u>4/</u>	53.0	139.0
Live birth delivery assistance <u>5/</u>		
URBAN	97.3%	98.9%
RURAL	36.4%	60.4%
Natural Population Growth Rate (does not include migration)	3.0%	2.2%
Life expectancy at birth	66.0	70.0
Family Planning Acceptors	9,800	119,000
General Fertility Rate (live births/1,000 women 15-49 yrs. of age)	135.0	99.0
Health facilities providing family planning services	5.0	354.0
Literacy Rate	78.0%	85.0%

1/ Some data are from years slightly prior to 1970 or to 1980.

2/ Within 200 meters: includes piped water, hand pumps, and well water.

3/ In 1st year of life/1,000 live births.

4/ 95% of new ones are outside of metropolitan area.

5/ By phisician, nurse or other authorized personnel (not mid-wife).

TABLE 2

Sector Contribution to GDP and Employment, by Order of Magnitude 1/

<u>Sector</u>	<u>% of 1980 GDP</u>	<u>Sector</u>	<u>% of 1979 Employment 2/</u>
1. Commerce	14.0	1. Agriculture	29.4
2. Services	13.7	2. Services	27.4
3. Agriculture	13.7	3. Commerce	13.5
4. Manufacturing	13.7	4. Manufacturing	10.1
5. Transport	11.6	5. Construction	5.9
6. Finance	7.8	6. Transport	5.4
7. Construction	5.2	7. Banking	3.7
Total	79.7		95.4

1/ There are 12 economic sectors reported for GDP and 10 for employment by the GOP's Dirección de Estadística y Censo. In Tables 2 and 3 we have chosen the seven which have played the prominent role in the country's development over the last thirty years. For the first four sectors, the lists in the two tables represent each sector's actual position within the entire sector list. The two exceptions to this occur in lower ranked sectors. Thus, to develop a clear, concise presentation, we have omitted the GDP sector, Housing Property, first because it does not generate employment, and second because its omission does not affect the veracity of the argument. This latter rationale also applies to the omission of the sectors Electricity (7.8%) and Public Administration (3.2%) for the 1970-79 period in Table 3.

2/ Latest available data. Relative positions would not have changed substantially over one year.

Table 3

Leading Sector Contribution to GDP Growth, by order of Magnitude 1/

<u>Sector</u>	<u>% of GDP Growth 1950-60</u>	<u>Sector</u>	<u>% of GDP Growth 1970-79</u>
1. Manufacturing	19.8	1. Transport	20.7
2. Services	15.5	2. Finance	14.2
3. Commerce	14.7	3. Services	14.2
4. Agriculture	13.5	4. Commerce	12.4
5. Construction	7.9	5. Manufacturing	7.2
6. Transport	5.9	6. Agriculture	6.8
7. Finance	3.7	7. Construction	2.4
Total	81.0	Total	77.9

1/ See footnote Table 2.

Table 4  
SECTOR CONTRIBUTION TO EMPLOYMENT GROWTH DURING 1970-1979 PERIOD 1/

Sector	% of Employment Growth 1970-1979
1. Services	52.0
2. Transport	13.2
3. Manufacturing	11.7
4. Finance	11.3
5. Commerce	10.1
6. Construction	7.8
7. Electricity	2.8
8. Mining	0.2
9. Agriculture	-3.6
10. Canal Area	-5.3
Total	<u>100.0</u>

Table 5  
Population Trends 1/

Year	Total Population	Metropolitan Population	Other Urban Pop.	Total Urban Pop.	Total Rural Pop.	Urb. as % of total Pop.	Metropolitan as % of Total Pop.
1950	805,285	284,000	51,300	335,300	469,985	42%	35%
1960	1,075,541	411,300	77,000	488,300	587,241	45%	38%
1970	1,428,082	623,000	116,000	739,000	689,082	52%	44%
1980	1,830,175	889,000	157,000	1,046,000	784,175	57%	49%
1990	2,320,022	1,254,022	221,464	1,475,486	844,536	64%	54%
2000	2,940,977	1,768,922	312,389	2,081,321	859,656	71%	60%

1/ Calculations are based on official government statistics from the Census and Statistics Division of the Controller General and work done by Fox, Robert W., and Jerrold W. Hugguet, Population and Urban Trends in Central America and Panama, Inter-American Development Bank, Washington, D. C. 1977.

TABLE 6

Labor Force Data 1960-1979 (Reported) <sup>1/</sup>  
(thousands of persons)

Year	Population 15 years Old +	Economically Active	Labor Force Participation Rate (%)	Employ- ment	Unemploy- ment	Unem- ployment Rate (%)
1960	571.0	330.0	57.8	300.0	30.0	9.1
1961	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1962	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1963	620.0	360.0	58.1	339.0	21.0	5.8
1964	636.0	365.0	57.5	338.0	27.0	7.4
1965	659.0	379.0	57.5	350.0	29.0	7.7
1966	680.0	391.0	57.5	371.0	20.0	5.1
1967	697.0	409.0	58.7	384.0	25.0	6.1
1968	713.0	435.0	61.0	404.0	31.0	7.1
1969	737.0	450.0	61.1	420.0	30.0	6.7
1970	762.7	466.2	61.3	432.9	33.3	7.1
1971	786.8	471.3	60.7	435.6	35.7	7.6
1972	811.7	482.2	60.2	449.4	32.8	6.8
1973	835.8	499.0	59.7	464.1	34.9	7.0
1974	869.5	517.4	59.5	487.4	30.0	5.8
1975	896.1	492.8	55.0	461.2	31.6	6.4
1976	917.9	505.3	55.0	471.6	33.7	6.7
1977 (R)	950.1	515.2	54.2	470.4	44.8	8.7
1978 (R)	973.7	543.0	55.8	499.2	43.8	8.1
1979 (P)	1,002.9	577.8	57.6	527.0	50.7	8.8

Source: Dirección de Estadística y Censo, Contraloría General de la República; Panama en Cifras, Años 1974 a 1978, y Años 1975 a 1979 and unpublished GOP documents.

<sup>1/</sup>Data for 1960 are from the national census conducted in that year. For the remaining years the data are based on annual labor force surveys beginning in 1963.

n.a. Not available.

(R) Revised by GOP.

(P) Preliminary.

TABLE 7

Labor Force Data, 1970-1979 (Mission Estimates)<sup>a</sup>  
(thousands of persons)

Year	Population 15 Years Old +	Economically Active Population <sup>b</sup>	Labor Force Participation Rate (%) <sup>b</sup>	Employ- ment <sup>a</sup>	Unemploy- ment <sup>b</sup>	Unemployment Rate (%) <sup>b</sup>
1970	762.7	457.6	60	434.3	23.3	5.0
1971	786.8	472.0	60	441.3	30.7	7.0
1972	811.7	487.0	60	455.4	42.4	6.0
1973	835.8	501.5	60	464.1	37.4	7.0
1974	869.5	521.7	60	487.4	34.3	7.0
1975	896.1	537.7	60	461.2	76.5	14.0
1976	917.9	550.7	60	471.6	79.1	14.0
1977	950.5	570.3	60	470.5 <sup>b</sup>	99.8	17.0
1978	973.7	584.2	60	482.3 <sup>b</sup>	101.9	17.0
1979	1,002.9	601.7	60	509.3 <sup>b</sup>	92.4	15.4

<sup>a</sup> Source: Panama en Cifras, Años 1975-79. Dirección de Estadística y Censo, Contraloría General de la República.

<sup>b</sup> A constant 60% labor force participation rate has been used to smooth-out the unexplained and erratic participation rate used in official statistics. In addition the official 1978 and 1979 employment figures have been reduced by the 17,000 workers placed on the public dole under the Plan de Urgencia.

**TABLE 8**  
**LABOR FORCE TRENDS FOR THE METROPOLITAN REGION**  
**1974-1979**

	1974	1975	1976	1977	1978	1978 (Adjusted)	1979	1979 (Adjusted)
Population 15 years and over	455,800	478,630	501,060	534,260	552,000	552,000	574,317	574,317
Economically Active Pop.	280,300	284,100	279,760	289,680	314,020	331,200	342,522	344,590
Participation Rate	61.5%	59.4%	55.8%	54.2%	56.9%	60.0%	59.6%	60.0%
Non-economically Active Pop.	175,500	194,530	221,300	244,580	237,980	220,800	231,795	229,727
Percentage of Pop.	38.5%	40.6%	44.2%	45.8%	43.1%	40.0%	40.4%	40.0%
Employed	260,400	259,030	254,920	256,000	281,240	264,240	301,835	284,835
Unemployed	19,900	25,070	24,840	33,680	32,780	66,960	40,687	59,755
Unemployment Rate	7.1%	8.8%	8.9%	11.6%	10.4%	20.2%	11.9%	17.3%

Source: 1974-1979, Controller General, Bureau of Statistics and Census.  
1978-1979 Adjusted - Mission estimates, based on 0.60 EAP rate and reduction of  
official GOP employment figure by 17,000 for 1978 and 1979 to account for those  
being employed under the Plan de Urgencia.

Table 9  
Unemployment by Geographic Location, 1978

	Total Population 15 Years Old and Above	Economically Active Population	Employed	Unemployed	Unemployment Rate (%)
Metropolitan region	552,000	314,020	281,240	32,780	10.4
Eastern region	27,200	15,350	14,860	490	3.2
Central region	242,490	131,390	124,730	6,660	5.1
Western region	152,020	82,280	78,410	3,870	4.7
Total:	<u>973,730</u>	<u>543,040</u>	<u>499,240</u>	<u>43,800</u>	<u>8.1</u>

Source: "Dirección de Estadística y Censo, Contraloría General de la República"  
(preliminary data).

Table 10  
 URBAN/RURAL DISTRIBUTION OF POVERTY  
 1975

<u>Geographic Location</u>	<u>Poverty Line <sup>1/</sup> (Dollars)</u>	<u>Number of Poor Families</u>	<u>Percent of Families in Geographic Location</u>	<u>Percent of Poor Families</u>
Urban Panama/Colon	175	40,068	29.8	31.3
Other urban areas	125	10,240	32.5	8.8
Rural areas	75	77,616	54.6	60.7
TOTAL	-	127,924	41.5	100.0

Brohel, Allan. Workforce Development Project: Panama 525-0214. Report  
 USAID/Panama, 13 November - 1 December 1978.

<sup>1/</sup> Monthly family income.

TABLE 11

IMPACT OF ECONOMIC GROWTH AND  
ECONOMIC STRUCTURE ON UNEMPLOYMENT

1979-1990

	GDP GROWTH RATE	EMPLOYMENT/ OUTPUT <sup>1/</sup> COEFFICIENT	ANNUAL JOBS CREATED 1979-1985	UNEMPLOYMENT RATE <sup>2/</sup> 1985	ANNUAL JOBS CREATED 1979-1990	UNEMPLOYMENT RATE 1990
1	4%	0.40	8.3	25.1%	8.7	29.5%
2	4%	0.60	12.8	21.5%	13.6	23.1%
3	6%	0.50	16.3	18.6%	17.6	18.0%
4	6%	0.60	19.8	15.8%	21.8	12.6%
5	8%	0.50	22.3	13.8%	24.7	8.8%
6	8%	0.60	27.3	9.7%	30.9	0.8%

<sup>1/</sup> The coefficient is rate of growth of employment over rate of growth of GDP.

<sup>2/</sup> An EAP of 0.6 is assumed.

Source: Factores Que Afectan La Demanda Por Mano de Obra en Panama by Guillermo O. Chapman, Jr., prepared for the Ministry of Planning and USAID/Panama, Panama City, December 1979. In all of the cases above, a 60% labor participation rate is assumed.

Table 12

Cost/Price Relationships of Rice and Corn Production, 1977-1980

Cost/Price Ratios

Year	Rice	Corn
	(\$/qq fert. : \$/qq rice)	(\$/qq fert. : \$/qq corn)
1977	1.12	1.38
1978	1.19	1.40
1979	1.40	1.60
1980	1.46	1.80

Source: IMA and COAGRO.

Table 13

Projected Shelter Needs  
(For families below the median income)

	<u>Totals</u>	<u>Rural Areas</u>	<u>Secondary Cities</u>	<u>Metropolitan Area</u>
New Shelter	91,000	13,500	23,500	55,000
Upgrading	<u>145,500</u>	<u>75,500</u>	<u>25,000</u>	<u>45,000</u>
Totals	<u>236,500</u>	<u>88,000</u>	<u>48,500</u>	<u>100,000</u>

Investment Needed Period 1981-2000  
(To serve needs of families below the median income)

(U.S. \$ Millions)

	<u>Totals</u>	<u>Rural Areas</u>	<u>Secondary Cities</u>	<u>Metropolitan Area</u>
New Shelter	503.6	12.2	87.8	403.6
Upgrading	<u>248.2</u>	<u>34.5</u>	<u>47.0</u>	<u>166.7</u>
Totals	<u>751.8</u>	<u>46.7</u>	<u>134.8</u>	<u>570.3</u>