

TABLE 3A
PANAMA - SOCIAL INDICATORS DATA SHEET

	PANAMA			REFERENCE GROUPS (WEIGHTED AVERAGES - MOST RECENT ESTIMATE)	
	1960 /a	1970 /b	MOST RECENT /c ESTIMATE /b	WORLD TOTAL LATIN AMERICA & CARIBBEAN	WORLD TOTAL 1970/c
EDUCATION					
ADJUSTED ENROLLMENT RATIOS					
PRIMARY: TOTAL	96.0	103.0	113.0	104.3	102.4
MALE	98.0	108.0	118.0	106.6	107.1
FEMALE	94.0	103.0	113.0	103.3	99.0
SECONDARY: TOTAL	29.0	39.0	46.0	41.3	40.2
MALE	28.0	38.0	42.0	40.4	46.4
FEMALE	31.0	41.0	70.0	41.8	34.0
VOCATIONAL ENROL. (% OF SECONDARY)	27.3	32.3	30.6	33.7	31.8
POPUL-TEACHER RATIO					
PRIMARY	28.3	27.1	28.3	29.9	22.8
SECONDARY	22.9	20.7	23.4	18.7	22.2
ADULT LITERACY RATE (PERCENT)	73.0	78.3	..	79.1	73.9
CONSUMPTION					
PASSENGER CARS PER THOUSAND POPULATION	16.1	31.1	40.4/c	42.8	31.0
RADIO RECEIVERS PER THOUSAND POPULATION	148.9	137.3	158.9	370.3	137.2
TV RECEIVERS PER THOUSAND POPULATION	10.0	97.0	122.8	107.7	123.7
NEWSPAPER ("DAILY CENTRAL INTEREST") CIRCULATION PER THOUSAND POPULATION	36.9	68.8	82.3	63.7	112.3
CINEMA ANNUAL ATTENDANCE PER CAPITA	..	4.7	..	2.7	4.0
LABOR FORCE					
TOTAL LABOR FORCE (THOUSANDS)	358.7	500.8	582.3	..	..
FEMALE (PERCENT)	21.1	23.9	23.4	24.4	26.6
AGRICULTURE (PERCENT)	20.9	31.6	27.3	31.3	28.7
INDUSTRY (PERCENT)	13.7	18.0	18.1	22.9	23.9
PARTICIPATION RATE (PERCENT)					
TOTAL	32.8	34.2	31.7	33.6	44.5
MALE	30.6	49.6	44.3	30.4	36.3
FEMALE	14.2	18.1	18.4	36.8	32.8
ECONOMIC DEPENDENCY RATIO	1.3	1.4	1.4	1.3	0.9
INCOME DISTRIBUTION					
PERCENT OF PRIVATE INCOME RECEIVED BY					
HIGHEST 5 PERCENT OF HOUSEHOLDS	..	22.1	..	..	..
HIGHEST 10 PERCENT OF HOUSEHOLDS	..	61.8	..	..	..
LOWEST 10 PERCENT OF HOUSEHOLDS	..	2.0	..	..	..
LOWEST 40 PERCENT OF HOUSEHOLDS	..	7.2	..	..	..
POVERTY TARGET GROUPS					
ESTIMATED ABSOLUTE POVERTY INCOME LEVEL (US\$ PER CAPITA)					
URBAN	..	..	349.0	..	..
RURAL	..	..	183.0	154.1	..
ESTIMATED RELATIVE POVERTY INCOME LEVEL (US\$ PER CAPITA)					
URBAN	..	..	442.0	318.0	..
RURAL	..	..	287.0	371.1	108.6
ESTIMATED POPULATION BELOW ABSOLUTE POVERTY INCOME LEVEL (PERCENT)					
URBAN	..	..	21.0	..	..
RURAL	..	..	30.0	..	..

.. Not available
.. Not applicable.

NOTES

/a The group averages for each indicator are population-weighted arithmetic means. Coverage of countries among the indicators depends on availability of data and is not uniform.

/b Unless otherwise noted, data for 1960 refer to any year between 1959 and 1961; for 1970, between 1969 and 1971; and for most recent indicators, between 1978 and 1980.

/c 1973; /d 1974; /e 1977; /f 1983.

TABLE 2A
PANAMA - SOCIAL INDICATORS DATA SHEET

AREA (THOUSAND SQ. KM.)	PANAMA			REFERENCE GROUPS - WEIGHTED AVERAGES	
	MOST RECENT			- MOST RECENT ESTIMATED -	
	1960	1970	ESTIMATE	LATIN AMERICA & CARIBBEAN	EUROPE
TOTAL	17.3				
AGRICULTURAL	17.3				
GDP PER CAPITA (1955)	240.0	730.0	1700.0	1902.0	2073.9
ENERGY CONSUMPTION PER CAPITA (1000 KILOGRAMS OF OIL EQUIVALENT)	414.8	536.4	695.0	1059.9	2107.6
POPULATION AND VITAL STATISTICS					
POPULATION, MID-YEAR (THOUSANDS)	1095.0	1444.0	1835.0		
URBAN POPULATION (PERCENT OF TOTAL)	61.3	77.7	84.3	65.7	67.9
POPULATION PROJECTIONS					
POPULATION IN YEAR 1980 (MILLIONS)			2.8		
STATIONARY POPULATION (MILLIONS)			6.3		
YEAR STATIONARY POPULATION IS REACHED			2070		
POPULATION DENSITY					
PER SQ. KM.	14.2	19.0	23.3	25.2	65.3
PER SQ. KM. AGRICULTURAL LAND	74.3	87.0	103.8	92.3	125.4
POPULATION AGE STRUCTURE (PERCENT)					
0-14 YRS.	44.0	43.4	40.1	29.7	21.1
15-64 YRS.	31.8	32.9	33.8	36.1	61.2
65 YRS. AND ABOVE	4.2	3.7	4.1	4.2	7.7
POPULATION GROWTH RATE (PERCENT)					
TOTAL	2.8	2.9	2.3	2.4	1.6
URBAN	4.3	4.4	3.8	3.8	3.5
CRUDE BIRTH RATE (PER THOUSAND)					
CRUDE DEATH RATE (PER THOUSAND)	40.7	36.8	30.3	31.4	23.8
CRUDE INFANT MORTALITY RATE	10.2	7.8	5.7	8.4	9.2
FAMILY PLANNING	2.8	2.3	1.9	2.1	1.8
ACCEPTORS, ANNUAL (THOUSANDS)	..	..	15.0/6	..	..
SEXES (PERCENT OF MARIED WOMEN)	..	..	47.6/6	..	..
FOOD AND NUTRITION					
INDEX OF FOOD PRODUCTION					
PER CAPITA (1959-71=100)	58.0	94.0	102.0	110.0	118.0
PER CAPITA SUPPLY OF					
CALORIES (PERCENT OF REQUIREMENTS)	108.8	105.8	104.2/6	108.4	125.1
PROTEINS (GRAMS PER DAY)	50.3	50.8	63.2/6	64.0	92.7
OF WHICH ANIMAL AND PULSE	27.3	30.0	33.4/6	34.0	35.9
CHILD (AGE 1-4) MORTALITY RATE	5.5	2.8	0.3	5.4	9.2
HEALTH					
INFANT MORTALITY RATE (PER 1000)	63.2	64.1	70.4	64.2	67.8
INFANT MORTALITY RATE (PER 1000)	67.6	48.9	31.7	64.2	65.1
ACCESS TO SAFE WATER (PERCENT OF POPULATION)					
TOTAL	48.2	59.0	79.3/6	65.6	..
URBAN	89.3	100.0	93.5/6	78.9	..
RURAL	9.6	41.0	63.0/6	43.9	..
ACCESS TO SEWAGE DISPOSAL (PERCENT OF POPULATION)					
TOTAL	..	78.0	89.5/6	59.3	..
URBAN	..	87.0	97.0/6	75.3	..
RURAL	..	49.0	73.0/6	30.0	..
POPULATION PER PHYSICIAN					
POPULATION PER NURSING PERSON	2732.7	1584.4	1223.3/6	1817.3	1105.4
POPULATION PER HOSPITAL BED	3440.0/6	1444.0	1411.5/6	1043.3	834.4
TOTAL	257.6	326.9	220.9/6	472.4	228.8
URBAN	..	286.3	185.3/6	579.8	192.0
RURAL	..	1382.3	1123.5/6	1903.4	..
DISMISSES PER HOSPITAL BED	..	24.0	21.0	27.3	20.0
HOUSING					
AVERAGE SIZE OF HOUSEHOLD					
TOTAL	4.7	4.9	..	..	..
URBAN	4.4	..	..	..	..
RURAL	4.3	..	..	..	..
AVERAGE NUMBER OF PERSONS PER ROOM					
TOTAL	2.4	2.2	..	..	..
URBAN	2.2	1.8	..	..	..
RURAL	2.6	2.3	..	..	..
ACCESS TO ELECTRICITY (PERCENT OF POPULATION)					
TOTAL	44.0	52.0	..	..	..
URBAN	82.7	90.0	..	..	..
RURAL	21.3	14.3	..	..	..

Indicator	Amount (million US\$ at current prices) 1975	Annual Growth Rates (%) /a										
		Actual									Projected	
		1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
NATIONAL ACCOUNTS /c												
Gross Domestic Product /a	1,840.8	1.7	1.7	1.1	9.8	4.3	5.3	3.8	4.0	0.0	1.5	2.0
Agriculture	205.6	7.2	5.4	5.0	7.7	-4.5	-1.9	2.9	4.4	-4.0	1.5	2.5
Industry	612.1	3.1	2.7	8.3	12.4	7.3	10.0	3.7	9.9	-1.3	2.3	4.2
Services	1,203.1	0.3	0.3	3.4	9.4	5.3	5.0	4.0	4.0	1.0	1.2	1.1
Consumption	1,407.4	0.2	0.9	6.3	9.7	5.5	4.9	2.2	7.3	-2.4	0.0	1.5
Gross Investment	567.4	-3.5	-0.9	-10.5	29.5	7.8	17.9	4.4	11.7	0.7	1.3	3.1
Exports of GNP	865.4	1.7	-2.5	10.6	7.0	-1.3	34.3	-0.5	-5.0	2.0	4.0	3.0
Imports of GNP	999.4	-4.7	-5.2	3.9	14.9	2.7	18.7	-3.5	-3.5	-2.4	1.0	3.0
Gross National Savings	406.6	11.3	-8.0	-27.0	27.1	-15.5	37.0	-10.0	25.4	16.4	6.4	3.9
PRICES												
GDP Inflation		9.4	4.5	4.6	7.9	9.3	10.1	6.0	5.5	5.0	6.0	6.0
Exchange Rate		1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Share of GDP at Market Prices (%) (at current prices) /b												
		1960	1970	1975	1980	1985	Average Annual Increase (%) (at constant 1960 prices)					
		1960-70	1970-75	1975-80	1980-85		1960-70	1970-75	1975-80	1980-85		
Gross Domestic Product		100.0	100.0	100.0	100.0	100.0	8.0	4.7	3.9	2.2		
Agriculture		23.3	14.6	11.2	10.0	9.6	5.3	1.2	2.3	1.5		
Industry		18.6	21.4	23.5	21.4	23.0	9.1	5.4	4.9	3.7		
Services		58.1	64.0	65.3	68.6	67.4	8.5	5.2	6.9	2.3		
Consumption		88.9	75.5	76.5	75.0	68.8	7.0	4.6	5.4	0.8		
Gross Investment		16.3	27.8	30.8	28.5	31.3	13.6	6.0	1.8	4.1		
Exports of GNP		30.6	30.0	47.0	44.3	41.1	9.8	3.6	8.7	0.7		
Imports of GNP		35.9	41.4	54.3	48.7	41.3	10.3	4.6	4.2	1.1		
Gross National Savings		9.1	22.1	22.1	36.6	25.2	15.4	5.2	4.1	8.0		
As % of GDP												
		1960	1970	1975	1980	1985	1960-70	1970-75	1975-80	1980-85		
PUBLIC FINANCE (Public Sector)												
Current Revenue		16.1	21.1	29.0	30.2	30.5	--					
Current Expenditures		14.9	18.9	26.0	26.7	28.8	--					
Current Surplus (+) or Deficit (-)		1.2	2.2	3.0	3.5	1.7	2.7					
Capital Expenditures		5.7	6.4	13.2	8.9	12.2	8.7					
Foreign Financing		1.9	3.7	9.8	6.7	10.3	6.0					
OTHER INDICATORS												
		1960-70	1970-75	1975-80	1980-85							
GDP Growth Rate (%)		8.0	5.1	5.3	2.1							
GDP per Capita Growth Rate (%)		5.0	2.5	2.7	0.0							
Energy Consumption Growth Rate (%) /a		--	--	--	1.9							
Iron		2.4	5.4	6.4	5.4							
Marginal Savings Rate		0.23	0.43	-0.15	0.38							
Import Elasticity		1.29	0.43	1.04	0.28 /d							

/a At market prices/components are expressed at market prices, not as factor cost.

/b Projected years at constant prices (1980-1990).

/c Growth rates are for GDP in 1960 prices.

/d 0.7 for 1981-1985; the lower 1981-1985 rate stems from fall in imports expected after 1980 after heavy build up of stocks in 1979 and 1980.

/e All imports growth rate.

/f Preliminary

/g Projected

Indicators	Amount (million US\$ at current prices) 1975	Annual Growth Rates (%) (at constant 1977 prices)										
		Actual							.. Projected			
		1975	1976	1977	1978	1979	1980/6	1981/6	1982/6	1983	1984	1985
EXTERNAL TRADE												
Merchandise Exports	286.5	2.2	-16.3	6.0	7.0	2.2	16.3	-9.2	0.2	2.0	4.0	3.0
Primary	112.1	2.1	-4.3	-2.1	3.2	3.5	22.3	-4.0	0.1	1.0	1.0	1.0
Manufactures and other	174.9	2.3	-26.0	14.4	0.8	7.4	11.4	-12.8	0.3	3.0	5.0	4.0
Merchandise Imports	815.6	11.6	-11.1	-4.7	23.1	4.6	16.0	1.3	-0.4	-2.4	1.0	3.0
Petroleum	374.5	20.6	-24.7	6.7	-7.4	58.5	16.5	6.7	-5.2	-2.5	0.0	2.0
Machinery and Equipment	156.6	15.2	6.9	11.1	32.9	-6.4	15.3	14.2	0.0	3.0	1.0	4.0
Manufactures	176.9	-11.7	8.7	-3.2	38.2	-4.6	18.0	-5.7	0.5	-1.5	1.5	2.0
Others	87.9	21.5	-35.0	3.7	19.2	2.8	14.7	-5.0	1.1	2.0	1.0	2.0

PRICES

Export Price Index	101.3	100.6	100.0	100.1	115.7	118.6	118.6	121.5	130.7	137.3	144.1
Import Price Index	98.5	96.1	100.0	96.4	116.6	121.6	131.5	138.1	165.0	152.3	159.9
Terms of Trade Index	100.0	98.5	100.0	105.8	97.2	97.3	90.2	90.2	90.1	90.2	90.1

	Composition of Merchandise Trade (%) (at current prices)					Average Annual Increase (%) (at constant 1977 prices)			
	1960	1970	1975	1980	1985	1960-70	1970-75	1975-80	1980-85
Exports	100.0	100.0	100.0	100.0	100.0	n.a.	n.a.	2.5	0.1
Primary	73.9	74.2	44.6	47.5	45.0			1.3	0.1
Others	26.1	6.0	55.4	52.5	55.0			2.8	0.1
Imports	100.0	100.0	100.0	100.0	100.0	n.a.	n.a.	7.5	0.5
Petroleum	9.9	19.0	13.9	17.2	15.0			12.1	0.1
Machinery and Equipment	22.1	22.5	29.0	26.3	30.0			9.8	3.1
Others	53.3	45.0	57.1	58.3	55.0			5.9	-0.4

	Share of Trade with Industrial Countries (%)				Share of Trade with Developing Countries (%)				Share of Trade with Capital Surplus Oil Exporters (%)			
	1960	1970	1975	1980	1960	1970	1975	1980	1960	1970	1975	1980

DIRECTION OF TRADE

Exports	99.0	69.6	74.8	79.0	1.0	10.4	24.6	20.0	0.0	0.0	0.6	1.0
Primary	n.a.	n.a.	96.7	n.a.	n.a.	n.a.	2.3	n.a.	n.a.	n.a.	1.0	n.a.
Manufactures	n.a.	n.a.	0.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Imports	74.9	61.3	41.4	63.7	74.7	20.7	18.9	6.5	0.4	18.0	33.7	29.8

/a 1961 World Bank Atlas

/b Estimated

May, 1983.

PANAMA - BALANCE OF PAYMENTS, EXTERNAL CAPITAL AND DEBT
(Millions 1985 at current prices)

	1975	1976	Actual 1977	1978	1979	1980	Actual 1981	Preliminary 1982	Projected		
									1983	1984	1985
BALANCE OF PAYMENTS											
Exports of goods and services (NP)	851.5	827.7	908.7	946.7	1,140.7	1,614.8	1,608.0	1,620.0	1,985.9	2,209.3	2,461.1
Of which: Merchandise f.o.b.	(330.8)	(270.6)	(235.5)	(235.4)	(314.1)	(373.4)	(339.3)	(365.0)	(432.0)	(408.2)	(545.9)
Imports of goods and services (NP)	922.1	976.8	927.8	1,076.8	1,380.0	1,702.9	1,785.0	1,872.6	2,165.9	2,374.3	2,600.0
Of which: Merchandise f.o.b.	(621.9)	(704.1)	(704.1)	(862.0)	(1,095.6)	(1,344.6)	(1,375.0)	(1,459.3)	(1,667.2)	(1,827.6)	(2,001.5)
Net Transfers	-5.0	-3.9	-2.1	-1.3	17.2	-12.6	-26.1	30.1	3.7	4.7	5.7
Investment Income (Net)	-20.8	-33.8	-61.4	-85.0	-70.6	-143.9	-180.0	-216.2	-187.1	-208.6	-232.5
Current Account Balance	-166.4	-206.8	-152.8	-216.4	-300.7	-244.6	-383.1	-453.8	-363.4	-364.3	-365.7
Official Capital Net	79.2	290.2	256.3	511.9/a	191.6	230.9	80.5	215.4	242.0	269.2	298.8
Amortization	27.5	41.9	86.9	440.5	109.6	201.2	300.5	267.2	339.4	332.1	331.8
Disbursement	106.7	332.1	173.2	954.4	381.2	434.1	381.0	482.6	621.4	601.3	630.6
Private Capital (Net) /b	61.4	-141.1	-167.2	-383.8	49.9	13.0	-65.2	153.2	121.4	99.7	66.9
Monetary Capital Net	175.7	30.7	4.9	-167.5	-2.9	-24.8	76.8				
Unidentified private inflow, errors & omissions	-149.9	27.0	58.8	251.8	62.1	25.5	160.6	-	-	-	-
EXTERNAL CAPITAL AND DEBT											
Gross Disbursement	249.0	375.1	341.2	986.4/a	381.2	434.1	381.0				
Official Grants	8.6	13.7	7.7	4.7	19.3	1.0	7.0				
Concessional Loans	25.6	24.9	24.2	19.2	28.9	12.6	n.a.				
Non-Concessional Loans											
Official Export Credits	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.				
IMB	25.8	24.1	14.1	11.8	17.0	20.4	31.0				
Other Multilateral	12.4	14.7	16.0	32.1	29.9	47.6	n.a.				
Private	172.2	290.6	279.6	901.5	206.1	352.5	n.a.				
Public External Debt /c											
Debt Outstanding and Disbursed	564.8	774.2	1,104.6	1,356.2	1,909.8	2,089.7	2,276.3				
Official	194.7	262.6	337.0	390.3	461.4	493.9	555.4				
Private	370.1	511.6	767.6	965.9	1,444.4	1,595.8	1,720.9				
Undisbursed Debt	192.9	353.3	340.6	495.1	513.9	476.2	450.4				
Debt											
Total Service Payments	72.4	105.0	165.7	571.0	401.0	500.5	580.8				
Interest	41.2	60.4	78.4	129.5	211.0	303.0	280.3				
Payments as % Exports	7.3	12.7	18.2	60.4	35.2	44.7	36.1				
Average Interest Rate on New Loans (%)	-	-	-	-	-	-	-				
Official	5.6	6.6	8.0	5.7	6.2	9.3	n.a.				
Private	9.2	8.7	8.4	9.4	11.2	11.0	n.a.				
Average Maturity of New Loans (years)											
Official	21.5	18.5	18.5	17.8	19.1	17.0	17.0				
Private	7.8	6.5	7.0	10.3	12.1	8.0	8.0				

/a Panama undertook large refinancing of the debt in 1978.

/b Estimates as the difference between the resource gap and net official capital.

/c DOD at beginning of the year.

Country Programs I
Latin America and the Caribbean
Regional Office

THE STATUS OF BANK GROUP OPERATIONS IN PANAMA

STATEMENT OF LOANS (as of March 31, 1983)

	Year	Borrower	Purpose	US\$ Million (less cancellations)	
				Amount	Undisbursed
	(1953-80)	Fully disbursed		159.0	-
PAN	1977	BNP	Livestock Credit	8.0	3.0
PAN	1977	IRHE	Power	73.3	37.8
PAN	1978	Republic of Panama	Highway Maintenance	12.0	0.7
PAN	1978	COFINA	Industrial Credit	15.0	1.6
PAN	1979	BNP	Tropical Tree Crop Dev.	19.0	13.0
PAN	1980	IRHE	Power	23.0	4.7
PAN	1980	Republic of Panama	Urban	35.0	32.8
PAN	1981	Republic of Panama	Energy Planning and Petroleum	6.5	6.2
PAN	1981	COFINA	Industrial Credit II	20.0	17.2
PAN	1981	Republic of Panama	Road Rehabilitation	19.0	18.8
PAN	1982	APN	Second Port	24.4	24.0
PAN	1983	IDAAN	Water Supply II	21.6	21.6
Total (less cancellations)				435.8	
of which has been repaid				58.5	
Total now outstanding				377.3	
Amount sold				9.2	
of which has been repaid				9.2	0.0
Total now held by Bank				377.3	
Total undisbursed					181.4

Includes a supplementary loan of US\$31.3.

A Sixth Power Loan was also approved on June 3, 1982, but not yet signed. Amount US\$32.1 million

STATEMENT OF IFC INVESTMENT (as of March 31, 1983)

	Amount in US\$ Million		
	Loan	Equity	Total
71 Corporacion de Desarrollo Hotelero	1.2	0.3	1.5
78 Vidrios Panamencos, S.A.	2.4	1.4	3.8
80 Banco Latinoamericano de Exportaciones, S.A.	-	2.5	2.5
	<u>3.6</u>	<u>4.2</u>	<u>7.8</u>
Total gross commitments			
less cancellations, terminations, repaymen, and sales	<u>0.6</u>	<u>0.3</u>	<u>0.9</u>
Total commitments now held by IFC	<u>3.0</u>	<u>3.9</u>	<u>6.9</u>
Total undisbursed	<u>-</u>	<u>0.1</u>	<u>0.1</u>

C. STATUS OF PROJECTS IN EXECUTION (as of March 31, 1983) 1/

Loan 1397: Second Livestock Development Project: US\$5 Million Loan of
April 26, 1977; Date of Effectiveness: February 1, 1978;
Closing Date: August 28, 1984.

After a slow start, progress is picking up. Changes in the milk legislation required in connection with the project involve a modification in the method of determining milk grade and thus the price paid to producers: the grade of milk is now determined by the standard of on-farm processing facilities. The modified legislation requires that producers be paid according to the quality of milk produced. The legislation was approved in 1977 but is not being implemented. Government has indicated that implementation will commence once the Ministry of Health is equipped with control equipment. In 1981, the Bank agreed to modify the livestock breeding farm component which was to be carried out in an autonomous state farm that has become part of a military base; it is now being carried out in five different research extension farms of the Ministry of Agriculture. The Loan is fully committed and is expected to be fully disbursed by mid-1984.

Loan 1470: Fourth Power (Fortuna Hydroelectric) Project: US\$73.3 Million
Loan of July 1, 1977; Date of Effectiveness: February 8, 1978;
Closing Date: April 30, 1985.

All major contracts have been awarded. The underground civil works have suffered delays in the excavation work largely resulting from unforeseen geological problems in the tunnels and underground cavern. The project is now expected to be completed in October 1984 with a delay of some 16 months. Management and supervision of the project have improved considerably. Construction of the dam has been completed and procurement of equipment and transmission are proceeding satisfactorily. There is a substantial increase in the project cost because of the change in the powerhouse design, and the longer construction period. The cost overrun is approximately US\$162 million, or 73 percent of the original cost estimates, excluding interest during construction and preparatory work for a second stage project. A supplementary loan of US\$31.3 million was approved on March 29, to help in financing the increase in cost. The IDB is also providing a supplementary loan and co-financing from other sources is being arranged for the balance. The project remains economically justified in spite of the substantial cost increase.

1/ These notes are designed to inform the Executive Directors regarding the progress of projects in execution, and in particular to report any problems which are being encountered and the action being taken to remedy them. They do not purport to present a balanced evaluation of strengths and weaknesses in project execution.

Loan 1565: Highway Maintenance Project: US\$12 Million Loan of June 30, 1978; Date of Effectiveness: October 2, 1978; Closing date: December 31, 1983.

The project started about one year behind schedule due to delays in fielding a team of consultants to provide technical and management assistance to MOP. A group of six experts is presently completing the final phases of these services while additional assistance in equipment and workshop management, as well as training is being financed under Loan 2020-PAN. The project is progressing steadily. Following testing in two pilot provinces, nationwide implementation of standard maintenance procedures and a new maintenance management system started in 1981, but was stalled for almost one year due to lack of priority accorded to systematic management by the previous MOP management. The project is substantially completed.

Loan 1641 Development Banking Project: US\$15 Million Loan of January 23, 1979; Date of Effectiveness: September 25, 1979; Closing Date: June 30, 1983.

The loan only became effective on September 25, 1979 because of delays in obtaining Government guarantees covering COFINA's exposure in several enterprises in excess of the limits stipulated in COFINA's Policy Statement. The problem was resolved. The Loan is fully committed and final disbursements are being made. Restructuring and reorganization of COFINA is being considered.

Loan 1672: Tropical Tree Crop Development Project: US\$19 Million Loan of April 25, 1979; Date of Effectiveness: July 25, 1979; Closing Date: June 30, 1985.

The coffee and cocoa components are proceeding satisfactorily. The banana component has suffered delays because of a change in management in one of the key implementing organizations, the Banana Corporation of the Pacific (COBAPA) and two consecutive bad harvests in 1979 and 1980 which led to a deterioration of its finances and technical capability. The Ministry of Agriculture has been trying to resolve the problems, and cancellation of this component is being considered. Undisbursed funds for this component would be reallocated to the Coffee and Cocoa component for which consultants are being contracted. The oil palm component is also facing some problems, but with the appointment of a new project director and the assistance of consultants, it is expected that there will be an improvement in project execution generally. The Bank is monitoring the situation.

Loan 1778: Fifth Power Project: US\$23 Million Loan of January 30, 1983;
Date of Effectiveness: April 22, 1980; Closing Date
December 31, 1983.

Under the direction of a new project manager, project execution is progressing satisfactorily. The delays experienced at the beginning have been compensated and completion is expected in March 1984, only 3 months behind schedule. A cost overrun of about 30 percent over appraisal estimate is being financed from ITRHE's own resources.

Loan 1878 Colon Urban Development Project: US\$35 Million Loan of
August 7, 1980; Date of Effectiveness: August 14, 1980;
Closing Date: June 30, 1984.

Execution of the housing component was delayed by changes in type and location of some of the housing units proposed by the Government. Implementation, according to the modified proposal, which has been approved by the Bank, is proceeding well but behind schedule. The port expansion and the technical assistance components are also making satisfactory progress, and the development of the commercial area in the Free Zone continues to progress. Phase I of the road component has been completed and Phase II is substantially completed and scheduled to be opened to traffic shortly. Structural works for phase III have been started. Other minor components are proceeding satisfactorily after initial delays. However, the employment generation component (the industrial estate) may fall short of appraisal expectations due to reduced demand and delays in implementation, which may require substantial modifications in the component. Efforts are being made to resolve existing problems and developments are being closely monitored.

Loan 1954: Energy Planning and Petroleum Exploration Promotion Project:
US\$6.5 Million Loan of April 23, 1981; Date of Effectiveness:
July 21, 1981; Closing Date: December 31, 1984.

All main studies provided under the Energy Planning and Auditing components have been or are being completed, including substantial training of CONADE staff. A National Energy Strategy Paper by CONADE will be available for Bank review shortly. However, appointment of the petroleum and coal exploration consultants has been delayed. The Government is reassessing investment priorities and has put a hold on contracting of consulting services for all exploration activities under the project. Implementation of all project exploration components is about 20 months behind schedule. Discussions are underway with the Government to clarify future implementation of these components and the future status of CONADE.

Loan 1955: Second Development Banking Project; USS20 Million Loan of
April 22, 1981; Date of Effectiveness: July 21, 1981;
Closing Date: June 30, 1985.

Forty percent of the loan is committed. However, progress of this project is less than satisfactory: loan collections are low and arrears are rather high and a substantial portion of COFINA's portfolio may not be recovered. During the first half of 1982, COFINA had three different general managers and almost all management positions were changed recently in an attempt to improve COFINA's public image. Complete restructuring and reorganization of COFINA is being considered.

Loan 2020: Road Rehabilitation Project; USS19 Million Loan of July 24, 1981;
Date of Effectiveness: October 13, 1981; Closing Date:
December 31, 1985.

Due to initial delays resulting from two changes of the Ministry of Public Works' management, the project is about a year behind scheduled. Under the present MOP management implementation is improving. Detailed engineering for the first year's roadworks is complete. Rehabilitation of three road sections has been contracted and a fourth contract awarded, with bid invitations for five more contracts expected during the next two months. Bids are also being invited for an agreed list of quarry equipment and orders have been placed for spare parts needed to overhaul several crushing plants. Engaging a consulting firm to provide technical assistance for management of equipment and workshops is being seriously delayed due to administrative obstacles. However, other consultants are presently assisting MOP in starting a training program. The Bank is monitoring the situation.

Loan 21S2: Second Port Project; US\$24.4 Million Loan of September 15, 1982;
Date of Effectiveness: December 15, 1982; Closing Date:
December 31, 1986.

Consultant and staff appointments have been completed and procurement action is underway. The tariff study has been completed and a new tariff structure became effective on April 1, 1983.

Loan 2222: Second Water Supply and Sewerage Project: US\$21.6 Million Loan of
February 17, 1983; Date of Effectiveness: April 7, 1983;
Closing Date: December 31, 1988.

Procurement has started and progress is satisfactory.

Loan : Sixth Power Project; USS32.1 Million Loan of _____, 1983
Date of Effectiveness: _____ Closing Date: June 30, 1987

The loan is not yet signed.

PANAMA

STRUCTURAL ADJUSTMENT LOAN

SUPPLEMENTARY PROJECT DATA SHEET

I. Timetable of Key Events

(a) Project Preparation - Preappraisal

- | | | |
|-----|---|-----------------|
| (1) | Project prepared by: | Government/IBRD |
| (2) | Initial request for Bank financing: | December 1982 |
| (3) | First Bank mission to consider project: | March 1983 |

(b) Appraisal Mission Departure: June 1983

(c) Negotiations Completed: October 1983

(d) Loan Effectiveness Planned: November 1983

II. Special Bank Implementation Actions

None contemplated.

III. Special Conditions

Assurances were obtained that:

- (a) The Government would submit to the Bank quarterly reports on the progress of its structural adjustment program and of the technical assistance studies (para. 122); and
- (b) The second tranche of US\$20 million equivalent would be made available upon satisfactory review of the progress of the technical assistance studies and of the draft Bills of the Agricultural and Industrial Incentives Laws (para. 122).

ANNEX IV

Government's Letter of Economic Policy being revised
for Green Cover.

Structural Adjustment Program

Sector and Policy Issue	Action Already Taken	Steps to Be Taken
AGRICULTURE AND RURAL DEVELOPMENT		
<u>Pricing, Regulation and Marketing</u>		
(a) Export restrictions	-Beef export restrictions lifted, March 1983.	-Restrictions on exports of coffee, to be lifted by mid September 1983 and target date on fishmeal and cacao set by end May, 1984.
(b) Pricing	-Producer support price of rice reduced -Potato prices freed. -Milk classified according to grades and appropriate prices set.	-Substantial reductions in support prices for rice, corn and sorghum to be announced by March 1983. -Prices of tomatoes, onion and other horticultural products to be freed, by October 1984. -Grading system for meat established, and freeing of domestic prices of extensive cuts of meat by mid September 1983. -Announcement of price for grade "B" milk by December 31, 1983.
(c) Market intervention and regulation.		-Bank financed pricing study to be completed by second half of 1984 to indicate progress of reductions in state intervention in agriculture and reform of institutions in keeping with new development strategy.
<u>Land Ownership and Titles</u>	-14 reformed settlement converted into cooperatives in 1982.	The Government's policy is to continue with the extension of formal land titles. A program will be evolved for the reformed settlements giving them the option to convert to cooperatives or individual titles.
<u>Institutional Reforms</u>	-Felipillo sugar mill closed, March 1983. -Activities at other state sugar mills reduced, March 1983. -State banana corporation closed, 1982. -Subsidies to state development corporations eliminated in 1983 budget. -Production and distribution of maize initiated. -All new Agricultural Development Bank credits covered by crop insurance.	-Further institutional reforms to await results of Bank financed sector study to be completed by mid-1984. Policy aims to be addressed include: creation of an effective agricultural policy coordination capability; adequate management information for better institutional control; reduction of the State's role in directly productive activities; further strengthening of Agricultural Development Bank; reduction of state intervention in marketing and elimination of some state marketing monopolies; securing wholesale and retail price controls; and strengthening capability of research institutes. -Draft legislation for new Agricultural Incentives Law ready for Bank comment end-May 1984.
URBAN INDUSTRIAL AND TRADE POLICIES		
<u>Articulation and Implementation of an Appropriated Industrial Development Strategy</u>	-Under the coordination of the Ministry of Planning and Economic Policy, a new industrial policy was established in late 1982 incorporating a strategy based on the expansion of export-oriented, labor-intensive activities.	

Sector and Policy Issue	Structural Adjustment Program	Steps to Be Taken
Action Already Taken		
1. <u>Export Promotion</u>	<ul style="list-style-type: none"> -National Investment Council established in October 1982 to promote foreign investment and provide investors with one-stop agency in dealing with local bureaucracy. -Export incentives provided in the form of redeemable tax certificates (CAT). -Flexible interpretations of Labor Code in the case of specific, export-oriented industries, late 1982 early 1983. 	<ul style="list-style-type: none"> -Simplification of CATS and their link to factory employment by May 1984.
1. <u>Protective Structure</u>	<ul style="list-style-type: none"> -Cabinet Decree establishing policy objective of elimination of quantitative restrictions signed by the President in 1982. -38 quotas removed by end-June 1983. -Maximum term of new and renewed individual contracts between the Government and private firms reduced from 10 to 5 years, March 1983. -Public announcement in March 1983 that new industries will not be offered any form of quota protection. -Maximum tariff protection for new industries initially 125 percent of local value added reduced after one year to 100 percent, March 1983. 	<ul style="list-style-type: none"> -Approximately 150 quotas to be removed by mid-September 1983. -Timetable for removal of remaining quotas to be agreed by end May 1984. -Industrial and commercial policy studies, financed by IDB, AID and World Bank financed technical assistance on effective protection to be completed by end May, 1984. These will assist Government in determining initial level of tariff protection with which to replace quotas when reasonable estimates are unavailable. -Draft legislation for new industrial incentives law ready for Bank comment end-May, 1984. -Maximum and minimum tariffs to be defined, and timetable for reaching law, uniform tariff ready by end-May 1984.
<u>Price controls</u>	<ul style="list-style-type: none"> -Maximum tariff protection for existing industries set at 100 percent except in prior consultation with Bank. 	<ul style="list-style-type: none"> -Government will dismantle price controls on industrial products following removal of quotas.
1. <u>Labor Legislation</u>		<ul style="list-style-type: none"> -Study financed by AID to be completed by mid-1984 to be followed further by modifications in the Labor Code after elections.
<u>PUBLIC SECTOR EFFICIENCY</u> <u>Financial Stabilization</u>	<ul style="list-style-type: none"> -Establishment of minimum tariff and increase crude petroleum import taxes. -Substantial reductions in capital and current public sector expenditures in CY 1983. -Strict cash limits on all expenditures established and monitored by Economic Cabinet. -Directorate of Public Credit established in Ministry of Planning to coordinate commercial borrowing by all public sector agencies. 	<ul style="list-style-type: none"> -With the assistance of an IMF financed expert major reforms are to be made in the Customs Administration including eventual application of Brussels tariff nomenclature. Reforms to be completed by end 1984.

Sector and Policy Issue	Structural Adjustment Program	
	Action Already Taken	Steps to be Taken
1. <u>Public Investment Program</u>	<ul style="list-style-type: none"> -Detailed investment budget for 1983 includes major reductions and deferral of nonpriority projects. -Draft program for 1984 and prepared by mid-May 1983. 1983/84 program coherent and in accordance with structural adjustment priorities. 	<ul style="list-style-type: none"> -Tentative 1985 program to be ready for review by Bank end-July, 1983. -Detailed investment budget for 1984 and draft 1985 program to be ready for review by Bank in December 1983.
3. <u>Reform and Restructuring of Public Entities.</u>	<ul style="list-style-type: none"> -Major financial review of all public sector entities completed April 1983. -Sale of a major loss-making hotel in January 1983. -Firm timetable set for ending cross-subsidization of private cement-making company. -Some agricultural entities closed; see item 1.3 above. 	<ul style="list-style-type: none"> -Disposal of La Contadora Panama. -Disposal of national airline. -Reduction in domestic cement price, March 1984.
4. <u>Public Sector Housing</u>	<ul style="list-style-type: none"> -Rent controls freed on all new housing projects carrying a monthly unit rent of \$250 or more, March 1983. -Rationalization of National Mortgage Bank including increased interest rates for mortgages and no further independent access to commercial bank credit, late 1982. -Social Security Agency formally undertook in late 1982 not to engage in further direct mortgage financing. -From January 1983 Social Security funds used as secondary mortgage financing at attractive rates of interest. 	
5. <u>Financial Institutions</u>	<ul style="list-style-type: none"> -Reform and restructuring of development finance corporation COFINA initiated. Instructions issued to dissolve or auction off those parts of the portfolio which have become a fiscal burden. New management has been appointed and process of privatization initiated. 	<ul style="list-style-type: none"> -Audit of current portfolio completed by June 15, 1983. -Commitments from the private sector for purchase of shares in restructuring COFINA to be received by end March 1984. -Number of COFINA staff to be reduced from 108 to 50 by March 31, 1984.
6. <u>Canal Zone Lands and Assets</u>	<ul style="list-style-type: none"> -Legislation to facilitate leasing or selling of land and infrastructure in the old Canal Zone presented to Congress, in March 1983. 	<ul style="list-style-type: none"> -Study of trans-Isthmian transport corridor completed by May 1984.
7. <u>Health and Social Security</u>	<ul style="list-style-type: none"> -Financial reform of housing department of Social Security Agency completed December 1982. 	<ul style="list-style-type: none"> -Study of Integrated System of Health Care to be initiated by end 1983 and completed by mid 1984. -Financial, managerial and actuarial studies of Social Security Agency to be initiated by December 1983. -Study of state system of unemployment insurance financed by AID to be completed by mid 1984.

July 14, 1983

PANAMA: PUBLIC INVESTMENT PROGRAM 1983 - 1985
(Millions of US\$)

	1983			1984			1985		
	Local	Foreign	Total	Local	Foreign	Total	Local	Foreign	Total
AGRICULTURE									
Agriculture and Rural Development	36.6	32.3	68.9	42.9	34.1	77.0	30.8	25.2	56.0
Forestry and Industry	7.1	20.6	27.7	7.8	12.4	20.2	12.6	5.9	18.5
Total	<u>43.7</u>	<u>52.9</u>	<u>96.6</u>	<u>50.7</u>	<u>46.5</u>	<u>97.2</u>	<u>43.4</u>	<u>31.1</u>	<u>74.5</u>
TRANSPORT AND COMMUNICATIONS									
Transport	19.2	59.1	78.3	21.7	68.1	89.8	22.4	69.6	92.0
Communications	38.1	17.2	55.3	45.8	20.7	66.5	55.6	25.1	80.7
Total	<u>11.5</u>	<u>0.6</u>	<u>12.1</u>	<u>8.8</u>	<u>2.1</u>	<u>10.9</u>	<u>17.6</u>	<u>2.4</u>	<u>20.0</u>
INDUSTRIAL SECTOR									
Manufacturing	15.3	3.0	18.3	14.3	0.5	14.8	18.2	2.0	20.2
Construction	28.0	4.3	32.3	23.3	6.2	29.5	33.1	6.9	40.0
Other	54.9	10.1	65.0	47.5	11.2	58.7	33.1	6.9	40.0
Total	<u>98.2</u>	<u>17.4</u>	<u>115.6</u>	<u>85.1</u>	<u>17.9</u>	<u>103.0</u>	<u>84.4</u>	<u>15.8</u>	<u>100.2</u>
Other									
Intersectoral and Community Projects	0.7	0.5	1.2	0.5	-	0.5	1.4	0.6	2.0
Total	<u>23.2</u>	<u>7.2</u>	<u>30.4</u>	<u>14.6</u>	<u>6.2</u>	<u>20.8</u>	<u>6.1</u>	<u>16.8</u>	<u>22.9</u>
Total	<u>23.9</u>	<u>7.7</u>	<u>31.6</u>	<u>15.1</u>	<u>6.2</u>	<u>21.3</u>	<u>7.5</u>	<u>17.4</u>	<u>24.9</u>
GRAND TOTAL	<u>234.6</u>	<u>154.9</u>	<u>389.5</u>	<u>227.2</u>	<u>161.5</u>	<u>388.7</u>	<u>230.9</u>	<u>161.4</u>	<u>392.3</u>

REPORT AND RECOMMENDATION
OF THE
PRESIDENT OF THE
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
TO THE
EXECUTIVE DIRECTORS
ON A
PROPOSED LOAN
IN AN AMOUNT EQUIVALENT TO US\$5.0 MILLION
TO
THE REPUBLIC OF PANAMA
FOR A
TECHNICAL ASSISTANCE PROJECT

August 29, 1983

CURRENCY EQUIVALENTS

Currency Unit = Balboa (B/.)
US\$1 = B/.1

Note: The issue of Balboas is restricted to coins. The US Dollar (US\$) is accepted as currency.

Fiscal Year

January 1 - December 31

WEIGHTS AND MEASURES

Metric System

GLOSSARY OF ABBREVIATIONS

BDA	-	Banco de Desarrollo Agropecuario (Agricultural Development Bank)
BHN	-	Banco Hipotecario Nacional (National Mortgage Bank)
CFF	-	Compensatory Finance Facility
COFINA	-	Corporacion Financiera Nacional (National Finance Corporation)
COBAPA	-	Banana Corporation
CSS	-	Caja de Seguro Social (Social Security Agency)
EEC	-	Empresa Estatal de Cemento (Bayano) (Cement State Corporation)
ENS	-	Empresa Nacional de Semillas (National Seed Company)
ENM	-	Empresa Nacional de Maquinaria (National Machinery Company)
IDB	-	Interamerican Development Bank
IMA	-	Instituto de Mercadeo Agropecuario (Institute of Agricultural Marketing)
ISA	-	Instituto de Seguro Agropecuario (Institute for Agricultural and Livestock Insurance)
MICI	-	Ministerio de Comercio e Industrias (Ministry of Commerce and Industry)
MIDA	-	Ministerio de Desarrollo Agropecuario (Ministry of Agriculture and Livestock Development)
MIPPE	-	Ministerio de Planificacion y Politica Economica (Ministry of Planning and Economic Policy)
OPE	-	Office of Projects Execution
PAHO	-	Pan American Health Organization
SAL	-	Structural Adjustment Loan
TAL	-	Technical Assistance Loan
UNDP	-	United Nations Development Programme
USAID	-	U.S. Agency for International Development

PANAMA

TECHNICAL ASSISTANCE PROJECT

LOAN AND PROJECT SUMMARY

Borrower: Republic of Panama

Amount: US\$5.0 million equivalent (including capitalized front-end fee)

Terms: 15 years, including 3 years of grace, at the standard variable interest rate.

Project

Description:

The proposed project would support the Structural Adjustment Loan to Panama, which is being submitted simultaneously. It aims at assisting the Government in implementing its structural adjustment program by providing studies, expert advice and implementation assistance in key areas of the economy. Specifically, the proposed project would finance about 400 man-months of consultant services to study:

- (a) trade and pricing policies in the agricultural sector and strengthening of its institutions;
- (b) effective protection in the industrial sector;
- (c) financial, actuarial, administrative and managerial issues in the Social Security Agency;
- (d) the Health System;
- (e) transport infrastructure in the Panama City-Colon corridor, and;
- (f) other currently unidentified studies needed to carry out the structural adjustment program.

Risk:

The complexity of the project requires efficient coordination both at the technical and administrative levels. Assisted by a panel of local and foreign economists, the Director of Economic and Social Planning in the Ministry of Planning and Economic Policy would be in charge of technical coordination (Project Coordinator). A full-time Project Manager would be in charge of administrative and logistical coordination, including the appointment of counterpart staff in the technical agencies to work with the consultants. Arrangements are also being finalized with UNDP OPE to act as procurement agent for the Government. Another risk would be that the agreed recommendations of the studies would not be implemented. Such a risk is minimal since a consensus exists in Government and in major opposition parties on the need for new direction of the economy which is supported by these studies, and the Government is committed to implementation of such recommendations. In order to ensure continuity and commitment, staff of individual agencies would be fully involved in the consultants work. Progress of the studies would be closely monitored.

Estimated Cost:

	<u>Local</u>	<u>Foreign</u>	<u>Total</u> ^{1/}
	- - - - - US\$ Thousand - - - - -		
Agricultural trade and pricing policies study	19	65	84
Agricultural institutions			
Phase 1	173	583	756
Phase 2	250	842	1,092
Effective protection in the industrial sector	35	97	132
Audit of Social Security Agency (CSS)	60	390	450
Financial, Administrative and Managerial studies and training to SSA	220	788	1,008
Health system study	77	259	336
Trans-isthmian transport study	26	86	112
Training study tours	85	113	198
Interview travel for experts	-	25	25
Project Management	120	-	120
Equipment	50	120	170
Further technical assistance related to structural adjustment program	196	682	878
Contingencies (10% of total)	<u>89</u>	<u>450</u>	<u>539</u>
Total Project Costs	1,400	4,500	5,900

Financing Plan

Bank	0.5	4.5	5.0
Government	<u>0.9</u>	<u>-</u>	<u>0.9</u>
Total	<u>1.4</u>	<u>4.5</u>	<u>5.9</u>

Estimated Disbursements (US\$ Million)

Bank Fiscal Year	<u>1984</u>	<u>1985</u>	<u>1986</u>
Annual	2.1	1.7	1.2
Cumulative	2.1	3.8	5.0

Rate of Return: n.a.

Staff Appraisal Report: None

^{1/} Cost estimates, particularly of Government input, are being revised. Front end fee will most likely be included in loan amount.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE IBRD
TO THE EXECUTIVE DIRECTORS ON
A PROPOSED LOAN IN AN AMOUNT EQUIVALENT TO US\$5.0 MILLION
TO THE REPUBLIC OF PANAMA
FOR A TECHNICAL ASSISTANCE PROJECT

1. I submit the following report and recommendation on a proposed loan to the Republic of Panama for the equivalent of US\$5.0 million, including the capitalized front-end fee, to help finance a Technical Assistance project. The loan would have a term of 15 years, including 3 years of grace, with interest at the standard variable rate.

PART I. THE ECONOMY ^{1/}

2. An Economic Memorandum entitled "Panama: Special Economic Report on Metropolitan Unemployment" (3833-PAN) was distributed to the Executive Directors on June 7, 1982. Since then, there has been a sustained dialogue between the Government and the Bank leading to the development of a policy framework to confront the challenges of a more difficult international economic environment. The Government first formally requested a SAL in December 1982; after a series of identification missions, an appraisal mission for the proposed loan visited Panama in June 1983. Country data are given in Annex I.

A. Main Features of the Panamanian Economy ✓

3. Panama's geographic location has traditionally determined its economic development. Situated strategically on a narrow isthmus, joining North and South America, midway between Europe and Asia, Panama functioned as an important center for Spanish colonial trade for nearly four centuries. Following independence from Spain, this entrepot role was enhanced by two major investments in the transport infrastructure. The first was the building of the trans-isthmian railway in the 1850's. The second, of much greater significance, was the construction of the Canal in the early years of this century. The Canal, and the employment and income it generated, brought relative affluence and economic growth until the early 1970's.

4. Panama has capitalized on its geographic location and international transport facilities to build an important export-oriented service sector. The main areas of recent expansion have been in banking, tourism and international commerce. During the 1970's, the banking sector grew by 11 percent per year in response to legislative incentives. By 1982, there were about 120 banks physically established in Panama, among them subsidiaries of leading money center institutions; they employ over 7,000 people. Tourism has grown by 10.6 percent per year since 1970. The activities of the Colon Free Zone--warehousing, display and transshipment of merchandise mainly towards the markets of Latin America--expanded by an annual 14 percent. By 1982, these and other services accounted for 70 percent of total value added.

1/ Parts I to III are the same as those appearing in the President's Report for the Panama Structural Adjustment Loan, dated August 26, 1983.

5. The growth of export-oriented services has been facilitated not only by Panama's geographic location and transport infrastructure, but also by its financial characteristics which are unique to the Region. There is no Central Bank, the U.S. dollar circulates inside the country and there is no restriction on the movement of capital. Because of this dollar standard, there is no foreign exchange constraint in the conventional sense, and the country's credit-worthiness is directly linked to Government finances. It is easily monitored through such indicators as the size of the public deficit in relation to GDP and the Government's ability to meet all debt obligations as they come due. Moreover, the extent to which relative and absolute factor and product prices can be manipulated by Government intervention is limited.

6. The historical importance of the Canal has concentrated economic activity in the two terminal cities, Panama City and Colon. Today, the metropolitan area formed by these two cities and the corridor between them, adjacent to the Canal, contains more than half the nation's population and produces over 70 percent of total value added. Panama's essentially urban nature contributes to its relatively high standard of living with the Region. Per capita income in 1981 was approximately US\$1,900 compared with an average of US\$930 for Central America and US\$1,700 for Latin America and the Caribbean as a whole.

2. Political Background

7. A major watershed in Panama's modern history occurred in October 1968, when the National Guard overthrew the Government of President Arnulfo Arias and soon thereafter established a new administration under the de facto control of General Omar Torrijos. The Torrijos Government had three major goals: to increase national economic sovereignty, particularly over the Panama Canal; expand the Panamanian political and social process to the rural poor and urban workers; and deepen the country's development process, stimulating growth through increased and diversified exports and investment in human resources. The high point of the regime was reached in 1979 with the signing of a Canal Treaty with the United States. Following this, the Government reduced the military control of the country and began a gradual restoration of democratic institutions. In the economic field, more emphasis was placed on the role of the private sector which partially restored confidence following a period of uncertainty associated with the Canal Treaty negotiations. 1/27

8. After the accidental death of General Torrijos in July 1981, Panamanian politics went through a turbulent year, as political leaders began to jockey for power. The prior fiscal austerity was relaxed and several public sector agencies exceeded their budgets by wide margins. There was considerable uncertainty as to the direction of policy, particularly in the economic field. In April 1982, General Torrijos' successor as head of the National Guard was replaced by General Ruben Dario Parades; President Aristides Rojo resigned in August and was replaced by Vice-President Ricardo de la Espriella. A new Constitution, laying the foundations for presidential and congressional elections was approved by popular referendum in May, 1983. Also, political parties have been legalized and campaigning for the presidential elections, scheduled for mid-1984, is to begin in September.

9. Despite this uncertain political atmosphere, the Government has shown its determination to confront a deteriorating economic situation and carry through a number of necessary measures. Not only have strong budgeting control and discipline been restored, but the Government has also embarked on a program of fundamental structural reforms which, although politically unpopular in the short-term, are vital for medium-term economic recovery.

10. The results of the forthcoming elections will likely not threaten the ongoing process of structural adjustment: there is widespread consensus concerning the economic outlook and the measures necessary to confront its challenges. Moreover, the principal opposition parties represent factions which also favor policies encouraging private initiative.

C. Past Economic Trends and Recent Changes

11. The 1960's saw rapid economic expansion in Panama, with GDP growth averaging 8 percent per year (or 5 percent per capita). Much of the impetus came from buoyant-Canal related activities, and the effects of the Remon-Eisenhower treaties which transferred some economic activities from the Canal Zone to Panama. Real agricultural output increased by nearly 5.3 percent per year, based largely on expansion of grass-fed beef production and on increased output of bananas following important disease eradication measures. These were major factors contributing to a substantial growth of exports. Industrial growth was also strong, with a 10.9 percent annual average increase in real value added, though most of this was directed towards the domestic market. Almost as impressive was the growth of the construction and services sectors at over 8 percent per year. It was during this period that the petroleum refinery near Colon began operations, selling its output in the form of bunker to ships traversing the Canal as well as refined products for home consumption and for export to third countries. Other important service activities included the rapid expansion of the Colon Free Zone, which had been established in the early 1950's. The principal source of investment finance and entrepreneurial talent for this growth was from the private sector. Private domestic savings averaged about 15 percent of GDP, while private investment increased at a real 12.5 percent between 1960 and 1970, rising from 11.9 percent to 18.0 percent of GDP. Total employment grew at 3.5 percent per year, well in excess of the 2.5 percent annual increase in population. Nearly all the expansion in employment opportunities was provided by the private sector, and occurred in the urban areas; in the agricultural sector, employment expanded at only 0.7 percent per year.

12. The benefits of this rapid development were, however, concentrated in relatively few hands. Real wages were held down; the nominal minimum salary remained constant between 1960 and 1968. Acute poverty persisted, mostly in the countryside. Moreover, the social and economic infrastructure, particularly in rural areas, were inadequate to ensure continued economic and social improvement outside of the metropolitan corridor.

13. Accordingly, the development strategy initiated by the Torrijos Government in 1968 aimed at major social reforms while attempting to sustain growth through increasing and diversifying exports. Greater national integration was achieved by increasing and improving the communications and linkages among the regions of the country; social improvements were made by supporting human resources development, agrarian reform and the provision of basic needs, and by strengthening the country's institutional framework. The strategy was executed through expanded and improved social services (particularly in health and education), through the development of infrastructure by constituting public utilities (electricity, telephones, water) into single state entities, and by an ambitious public investment program. Private investment was encouraged, especially in the construction and service sectors linked to the international transportation systems. Panama's status as an entrepot center was enhanced by legislation of 1970 which led to the establishment of a major international banking sector. It was given further impetus by public sector investments in the international airport, tourism infrastructure, rapid expansion of the international free zone, an international re-insurance center, the growth of commerce, and other export services. The system of hydro-electric generation, roads, educational, water and health facilities which was built up throughout the country provided services to wide sections of the population which had not previously enjoyed them.

14. Initially, this strategy was successful in combining growth with social reform; between 1968 and 1973 real GDP rose by 7.3 percent per year. However, from 1973 to 1977, the economy was adversely affected by both external and domestic developments. The increase in world oil prices and inflation brought about international economic uncertainty, while Canal activities slowed after the end of the Vietnam war in 1973. Domestic uncertainty stemmed mainly from the intensive Canal Treaty negotiations. Per capita income stagnated and private investment fell in absolute terms by over 50 percent between 1973 and 1977 (or from 20.4 percent of GDP to 6.8 percent). Private sector confidence was also undermined by some actions which adversely affected the entrepreneurial environment. Among these were a highly restrictive Labor Code, price controls, housing rental regulations and exaggerated concentration of subsidized credit and technical assistance on the state supervised agricultural cooperatives. These regulations were not only inimical to the growth of agricultural and industrial output; they were also costly in fiscal terms. The increased state subsidies and high support prices were absorbing nearly 15 percent of Central Government revenues. → Public sector employment grew at an annual 12.2 percent and accounted for over 80 percent of the new jobs created. In the 10 years ending in 1977, real public consumption grew by 7.5 percent per year compared to 4.7 percent for GDP.

15. The Government compensated for the retrenchment in private sector activity through further investments in large infrastructure projects (a fishing port, Convention Center, hydroelectric power, extended telecommunications systems and an improved national road network), and by the creation or acquisition of a number of directly productive enterprises. These included four sugar mills, two banana corporations, a cement plant, a citrus plantation and several agro-industries and agricultural/regional

development corporations. Public investment increased from an average of \$79.1 million per year between 1968 and 1973 to \$271.6 million per year between 1974 and 1977, or from 7.0 percent to 13.7 percent of GDP. During the latter period, it accounted for half of total investment compared with only a quarter during 1968-73.

16. Without additional revenue measures, the cost of this expansion was quickly reflected in a sharp increase of the public sector deficit: from an average of 5.6 percent of GDP in the five years ending in 1974, to an average of 15.6 percent in 1976-78. Owing to the absence of a Panamanian central bank and an independent currency, the deficit had to be financed through dollar-denominated debt, whether locally or internationally issued. Thus, public sector medium-term debt increased from \$195 million (18.6 percent of GDP) in 1970 to \$1,940 million (nearly 80 percent of GDP) in 1978.

17. After 1978, the public sector entered into a period of retrenchment as several large capital projects were completed, no further state enterprises were created, and the Government began a sustained effort to reduce the public deficit through increased taxes and tighter controls on expenditures. The deficit was reduced from 15.4 percent of GDP in 1978 to 11.8 percent in 1979, and to 5.2 percent in 1980. This improvement was maintained in 1981, so that the country fully complied with the targets established under IMF Standby Arrangements.

18. This improvement in public finances was accompanied by some restoration of private sector confidence. This was enhanced by the ratification of the Torrijos-Carter Canal Treaties in 1979, and by the introduction of new export, investment and employment incentives. These covered not only direct financial assistance to exporters (through redeemable tax certificates called CATS based on a percentage of value added), but also tax exemptions and a more flexible interpretation of Labor Legislation for certain specified categories of export-oriented industries. However, private investment did not recover to the levels of the 1960's and early 1970's. Between 1978 and 1982 it was still less in real terms, and as a percentage of GDP, than between 1968 and 1973. Furthermore, although the service and construction sectors once again flourished, agriculture and industry continued to be adversely affected by the policy and institutional environment. Real per capita agricultural output was less in 1982 than in 1977, while industrial value added declined from 11.5 percent of GDP to 9.8 percent.

19. ✓ In 1982, Panama began to feel the impact of the world recession in general, and of the deepening economic and financial crisis in Latin America in particular. Growth in the financial sector was less than half that of recent years, while value added in tourism and in the Colon Free Zone declined sharply. Private investment fell in real terms following the completion of the trans-isthmian oil pipeline project in 1981. Partly to compensate for this, and partly because of increased political pressures (para.8), controls on public expenditure were loosened. Several entities exceeded their capital budgets by wide margins, particularly the public electricity company, IRHE, and the Social Security Agency. Meanwhile, public revenues were adversely affected by the economic slowdown, and by mid-1982 it

had become clear that Panama's fiscal targets would be grossly exceeded. The consolidated public sector deficit for the year as a whole was 11 percent of GDP, almost double the amount stipulated in the Government's Standby Arrangement with the IMF. Public investment was over 12 percent of GDP as against a target of 10 percent. Net foreign borrowing by the public sector amounted to over \$500 million, and the outstanding public medium-term debt reached \$3.1 billion at the end of 1982, equivalent to 73 percent of GDP. Interest on the debt absorbed over 30 percent of total Government revenues ^{2/}.

20. The recession deepened in late 1982, and in 1983 real GDP is expected to stagnate. The necessary fiscal adjustment (paras. 25-27) is inevitably having a contractionary effect on economic activity--especially the construction sector--while access to foreign bank credit is now severely limited. Through 1984, there will likely be little if any growth in the traditionally buoyant sectors of the economy. The banking sector has reached an advanced stage of maturity, while the Colon Free Zone and tourism are dependent upon financial and economic recovery in the rest of Latin America. This is unlikely to materialize before 1985. Reduced Government spending will, in the absence of compensating investment by the private sector, lead to further deterioration in the employment situation; unemployment is already estimated at about 20 percent of the available labor force in the urban metropolitan area.

21. In the face of these difficulties, the Government has formulated a new medium-term development strategy. This strategy, which has already been translated into a number of important actions, involves remedying existing policy inconsistencies, encouraging private investment, promoting and diversifying exports and improving public sector efficiency. (political)

D. The Government's Development Strategy

22. The principal objectives of the Government's development strategy are the creation of new employment opportunities and the reorientation of the economy towards a new growth path. Given the small size of the domestic market and the limited prospects for the service and public sectors, these opportunities must be sought in Panama's external markets for goods and services through the accelerated production of goods for export. Such a strategy would be fully consistent with Panama's comparative advantages and its unique economic characteristics (paras 3-6). These assets could be a springboard for access to foreign markets provided industrial and agricultural goods are produced at competitive cost.

23. Given the country's relatively high wage structure, efficiency in agricultural and industry must be increased to improve competitiveness and reduce upward pressures on wage rates. In many countries increased wage competitiveness can be achieved through an adjustment in the exchange rate. Panama's monetary structure rules this out, and it is therefore necessary to

^{2/} Defined as the current revenues of Central Government and autonomous agencies plus the current surplus of the public sector enterprises.

Panama's monetary structure rules this out, and it is therefore necessary to address the causes of inefficiency both directly and individually in each sector of the economy. Since the financially weakened public sector can no longer expand in relative terms, the private sector is to be the main source of investment finance and entrepreneurial talent. Public sector intervention is to be restricted to the provision of the necessary social and economic infrastructure, much of which is already in place. In order to release resources for growth-oriented activities, public sector expenditures are being rationalized. This involves reductions in subsidies and the sale, close-down or restructuring of loss-making public enterprises. State intervention in product and factor markets is to diminish. Price controls are to be greatly reduced and the question of the Labor Code addressed in order to bolster private sector confidence. Industrial incentives are to be directed more towards exports and less towards import substitution. Consequently, the scope and depth of effective protection is to be substantially reduced. Similarly, the bias inherent in the current incentive structure in favor of capital-intensive production techniques is to be reversed. So as to increase efficiency and productivity in the agricultural sector, policies are to be re-oriented towards higher production at competitive prices and less towards the redistribution of income.

24. This process of structural adjustment will take some years to complete. Moreover, it can only be fully successful if the economies of the OECD and Latin America recover in the mid-1980's together with world trade and services. If this occurs, the Government visualizes Panama as having a more open, export-oriented economy in which the efficiency of the productive sectors would be on a par with that already achieved by Panama's international services. A more fully employed urban workforce would be dedicated to a broader variety of industrial and service tasks undertaken at competitive world costs. Clearly the policy is not without risk, but Panama's private sector responded well to market signals in the 1960's. Furthermore, the strategy is based on the Government's recognition that re-orientation towards the export of goods provides the best, if not the only, alternative to continued economic stagnation and increasing unemployment.

E. Short Term Stabilization Measures

25. To provide the necessary context of financial stability for its new development strategy, the Government is now carrying out a major fiscal adjustment to reduce the public sector deficit to no more than \$270 million in 1983, or about 6 percent of GDP. Additional revenue is being raised through an increase in the minimum tariff and crude petroleum import taxes. Substantial cutbacks are planned in current and capital expenditures (paras 34-41). Except for school teachers and low-paid workers, who were given public assurances of wage increases in mid-1982, no increase in wages is allowed in the 1983 Budget. External commercial borrowing by state entities is now coordinated by the Ministry of Planning which has created the new post of Director of Public Credit for this purpose.

26. These measures led to successfully concluded negotiations with the IMF for a two year Standby Arrangement of SDR 150 million (about \$173 million) of which one third will be available in CY1983 and the rest in CY1984. The IMF Board approved the Standby in late June, 1983. In addition, Panama will receive some \$60 million in 1983 from the Compensatory Financing Facility. The main conditions attached to the Standby, which will be monitored every three months, are a public sector deficit of no more than 5 percent of GDP in 1983 and 5.5 percent in 1984, and no net increase in commercial foreign borrowing in 1983 or 1984 by the public sector. The current account saving and gross borrowing requirement implied by the program agreed with the Fund are shown in Table 1.

Table 1: SUMMARY PUBLIC FINANCES
(US\$ Million)

	1979	1980	1981	1982	1983 (Proj.)	
	Actual			(Prel.) (\$ million)		% of GDP
Public Sector Savings	-42.4	126.7	172.8	60.6	120	2.7
Capital Expenditure	303.6	299.8	390.1	524.6	390	8.7
Overall Deficit	346.0	173.1	217.3	464.0	270	6.0
Amortization	191.3	213.8	215.2	388.2	280	6.2
Gross Borrowing Requirement	537.3	396.3	460.8	852.2	550	12.2

27. While this program will reduce the deficit in the short term, it is important to point out that Panama already has a relatively highly taxed economy: the tax burden is about 20 percent of GNP. Consequently, the structural requirement for a lower public sector deficit must primarily be met through a rationalization of expenditures rather than further taxes. Thus, as part of its medium term structural adjustment program, the Government is to reduce the scope of the public sector and make the remainder more efficient.

PART II - THE STRUCTURAL ADJUSTMENT PROGRAM

A. Introduction

28. The policy measures designed to give practical shape to the Government's medium term development strategy may be divided into three main areas: first, to reduce the scope and improve the efficiency of the public sector; second to reorient the incentive structure in the urban, industrial sector; and, third, to increase productivity and output in the agricultural sector. Changes in the latter two areas are designed to permit and encourage accelerated agricultural and manufactured exports. In the services and energy sectors, there is little need for structural reforms. The former already benefits from a favorable legislative regime and substantial private sector participation. In the energy sector, as indicated in a recent Bank sector review, pricing policy is generally adequate (regular grade gasoline retails at US\$2.10 per gallon) while recent measures have been taken to enable the private petroleum company to operate at lower unit cost. IRHE, the public power company, is well run and makes the legal 8.75 percent return on its assets. Moreover, the Bank has had a direct and beneficial influence on the energy/power sector through project lending and related institution building.

29. The Government has already taken a considerable number of important actions in each of the three areas emphasized in its program. The following sections review the progress achieved and describe further actions which the proposed loan supports.

B. Public Sector Efficiency

Overview

30. The financial constraints that the public sector is likely to face in the years immediately ahead make it of vital importance that policies be aimed at fostering greater efficiency in the allocation of resources. Accordingly, the Government's structural adjustment program is concentrating reforms in those areas of public sector activity which are significant and continuous sources of fiscal drain; which result in the misallocation of resources through, for example, inappropriate pricing policies; and which suffer from inadequate institutional or budgetary control. The overall aims of the reforms would be to significantly increase public sector savings both absolutely and in relation to GDP in order to release resources for the private sector; to reduce the scope of the public sector's investment activities to the provision of the necessary infrastructure for private sector activities; and to improve the maturity structure, and hence reduce the servicing burden, of the public external debt.

31. ✓ The major components of the Government's action program for improved public sector efficiency include: (i) a major review of public sector enterprises; (ii) the preparation of a coherent investment program for the period 1983-1985 consistent with the priorities of the new development strategy; (iii) reform of public sector housing policy; (iv) reform of the public health and social security systems; (v) more effective management of state-owned assets especially those located in the old Canal Zone, recently reverted to Panama; (vi) reform of the Customs Administration; and (vii) improved public sector debt management.

Public Sector Enterprises

32. In February, 1983, the Government concluded a comprehensive financial review of all State enterprises and decentralized agencies, concentrating on those that have been dependent on large government subsidies. As a result, a number of these entities have been liquidated and the operations of others, which still have the potential of becoming economically viable, have been rationalized. Some of these operate in the agricultural sector and are discussed in paragraphs 80-82 below. Actions taken or planned for other entities will together result in immediate savings equivalent to about 12 percent of the 1983 public sector deficit and eventually lower public sector product prices. The principal reforms are the following:

- In January, 1983, a major, money-losing hotel was sold to a group of Japanese interests. The Government, which had guaranteed the loan to the hotel, had inherited it when the hotel encountered financial difficulties. The sale price was \$34 million; since its cost to the Government had been \$54 million, it was publicly forced to accept a major loss. ^{\$20MM+} Plans are well advanced for the sale of another money-losing hotel (La Contadora Panama) for which specific offers are currently being considered. *Hotel Marriott*

- On March 14, 1983, the Government announced a timetable for ending the contractual arrangement by which the state-owned cement company, Cemento Bayano, cross-subsidizes the only private cement company operating in Panama by charging a higher final price for cement. This will permit, by May, 1984, a 35 percent drop in the domestic cement price. The Government is studying further means of improving the efficiency of Cemento Bayano, including switching from fuel oil to use of coal. *Gov 13A*

- The Government is now undertaking a major restructuring of its development finance corporation, COFINA. A recent analysis of its portfolio revealed losses of some US\$37 million in nonrecoverable loans and interest. A new manager, appointed in August, 1982, has commenced the difficult task of recovering as much as possible from the portfolio and restructuring the Corporation's ownership with a view to only a minority of the shares being held by the Government. In April, 1983, COFINA engaged a well-known international auditing company to carry out a full financial audit and an evaluation of the portfolio as of June 30, 1983. Targets have also been set for substantial staff reductions and other measures designed to permit a more efficient operation. *Gov Panama*

- The Government is actively considering a number of options for divesting itself of all or part of the national airline, Air Panama. After making heavy losses for a number of years, the airline's debts were taken over by the Central Government from COFINA in June, 1981. The accumulated deficit of Air Panama on December 31, 1981 (the latest date for which comprehensive data are available) was US\$30.9 million compared to total assets of US\$17.4 million) while the loss for the calendar year 1981 was US\$3.1 million. The authorities are considering selling part of the enterprise to another international airline (with the Government having assumed the net liabilities); or disposal of the physical assets together with sale or leasing of the routes and landing rights to other international carriers.

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33. While the majority of other non-agricultural entities do not require current subsidies, the Government recognizes the scope for increasing their efficiency and hence their cost to the consumer. Accordingly a number of studies are to be commissioned to determine how costs can be reduced in the context of each agency's individual circumstances. Some of these are already supported by Bank project loans (e.g., technical assistance to the Port Authority, institution building in the power and water utilities) while others will likely be financed by other multilateral or bilateral agencies. This work is expected to be completed by late 1984, so that recommendations may be implemented by the newly elected Government.

Public Investment

34. The preparation of the public investment program in Panama is the responsibility of the Direction of Economic and Social Planning in the Ministry of Planning and Economic Policy (MIPPE). This Ministry, and not that of Finance, also produces and monitors the current budget. The investment budgets are prepared with a high standard of professional competence, and the institutional framework for the formulation of a coherent investment program is therefore in place. Estimates of financial requirements are prepared on a project by project basis by each Ministry or agency, but the overall responsibility for matching them with available financial resources belongs to MIPPE. General development policy objectives are detailed on a sector by sector basis, and the total investment requirement for each sector determined accordingly. Considerable importance is now attached to the calculation of economic rates of return, and the staff of MIPPE who prepare the budget are well versed in the techniques of project appraisal. Controls have been tightened, and rare departures from the MIPPE budget must be approved by the Finance Commission, a body which includes the entire Economic Cabinet, and is chaired by the Vice President of the Republic. These controls are applied not only to individual Ministries but also to each autonomous entity, while all public borrowing (short, medium and long term) is now monitored by, and subject to the approval of, the new Director of Public Credit, also in MIPPE (para 57).

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35. These procedures represent a considerable improvement upon past practices. Previously, although the Government's development program was theoretically sound, control of investment expenditures was often poor in practice. A number of projects, particularly in the agricultural, transport, tourism and housing sectors, were initiated without clear economic justification. Others went ahead without being included in the budget. These latter were frequently financed from the current savings of the entity concerned or by its independently borrowing commercial funds.

36. Within the context of preparation of the proposed SAL, the Government has focussed on further improving the quality of the 1983-85 investment program. The 1983 budget involves a reduction of 26 percent from 1982 and 29 percent from the amount originally requested by the different Ministries and agencies. Investment ^{3/} is budgetted at US\$389.5 million compared with US\$516.9 million in 1982. These cuts have necessitated a careful reconsideration of priorities and the program has been formulated in strict accordance with economic criteria and the demands of the new development strategy. The Government's freedom of action in making cuts was severely limited by the substantial cost overruns of the vital La Fortuna project. This now accounts for over one fifth of total budgetted capital expenditures in 1983. Almost all other outlays of the public electricity company have been deferred. Most of the projects left out have less pressing priority, while nearly all those that remain are economically sound. Profitable state entities, such as the telephone company and the Airport Authority are to be restricted to investments financed from their own resources. Because of its critical financial situation, the State Finance Corporation, COFINA, is being restructured and is permitted no new net lending. The inefficient state sugar corporation is also being reformed; its highest cost mill was recently closed (para 81), and the other three are being rationalized, so that no new gross investment is proposed. Most transport investments are for necessary maintenance and rehabilitation, since a developed infrastructure is largely in place. Despite diplomatic and contractual difficulties, the Government cancelled a low priority but expensive (approximately US\$200 million) Canal bridge project sponsored by a neighboring country. A US\$30 million road project with a low economic rate of return has also been dropped. Nearly all the projects remaining in the budget, which are not to be financed from internally generated resources, are supported by bilateral and multilateral aid agencies. Loans from concessionary sources are expected to finance almost half of total net outlays in 1983 and 1984.

37. After the severe curtailment of 1983, capital expenditures are projected to fall slightly in nominal terms in 1984, to US\$388.7 million thereby implying a sharper reduction in real terms, and as a percentage of GDP (from 8.7 percent in 1983 to 7.9 percent in 1984). In 1985, a small nominal increase is foreseen to US\$392.3 million, though this will again likely signify a real reduction. According to economic projections prepared by Bank staff (paras 95-105), this implies that public investment will have fallen to 7.2 percent of GDP in 1985. This is consistent with the Government's medium term target of substantially reducing the share of public sector investment in the GDP from the average of 13 percent prevailing

^{3/} This refers to net investment by the nonfinancial public sector and does not include credits from financial ~~entities~~ financed out of loan proceeds.

between 1976 and 1982 to about 7 percent by the mid 1980's. It is expected that the institutional procedures established in 1983 to increase control over the execution of the budget and approval of new projects will be retained and strengthened.

38. The sectoral priorities of the 1983-85 program are reasonable and in accordance with the structural adjustment strategy (Annex VI, page 2). Investment in the directly productive sectors would represent about 25 percent of total public investment over the period, and about 75 percent of this would be in agriculture. Emphasis in this sector would, as in the past be on direct credit to farmers, irrigation projects and shrimp farming. Resources are also set aside for projects to stimulate production of raw materials for local agroindustries.

39. In energy, which accounts for about one fifth of total expenditures, the Fortuna project dominates, absorbing practically all resources in 1983 and about 40 percent thereafter. This project will enable virtually all demand to be met from hydroelectricity from 1985 onwards, leading to anticipated savings of US\$65 million per year. In 1984 and 1985, there will be important projects for improving transmission and distribution systems for which Bank support is being requested. After revising demand forecasts, IRHE has postponed initiation of the next major hydroelectric project (Changuinola) until the end of the decade.

40. Infrastructure investment other than energy amounts to about 21 percent of the total. As already indicated, most transport expenditures are for rehabilitation and maintenance, the exception being the continuation of Bank-supported port improvements and a low cost improvement to the urban transport infrastructure in Panama City and other centers.

41. Social sector investment would represent about 27 percent of expenditures in the 1983-85 period. Outlays are being significantly reduced from the high levels recorded up to the end of 1982. Over half the contemplated investment is in public housing and community projects where the emphasis is on providing adequate shelter for poor urban communities. Severely deteriorated slum areas of Panama City and Colon are to be provided with low cost apartment buildings. The Colon Urban Development Project (Loan No. 1878) of August 7, 1980, supports part of this program. In the health sector, the program emphasizes rehabilitation and remodeling of existing hospitals and health centers as well as Bank-supported improvements in water supply and sewerage facilities. The education sector has been sharply cut back in the light of an already well-developed infrastructure, and again the program concentrates on the upgrading and rehabilitation of existing facilities.

Public Sector Housing Policy

42. As part of its structural adjustment program, the Government has recently taken a number of important measures designed to strengthen institutions and financial control in the public housing sector. Prior to

these reforms, the sector's financial situation was becoming increasingly precarious.

43. Since its creation in 1973, the Ministry of Housing (MIVI) has rapidly increased its housing construction from a level of 1,200 units to over 6,000 per year in the early 1980's. The purchase of these low income houses is normally financed by loans from the National Mortgage Bank (BHN), which was established as a subordinate agency of MIVI to undertake the financial management of the Ministry's activities and also promote the expansion of private housing finance. This expansion was to be achieved by strengthening the savings and loan system and, eventually, by creating a secondary mortgage market.

44. Up to the end of 1982, little progress had been made in achieving these objectives. In a number of cases, MIVI housing projects were initiated without proper control or disbursement procedures, and in the absence of any guarantees that the necessary finance would be forthcoming. This frequently led the BHN to obtain external commercial credits to supplement its finances; the terms and conditions attached to these loans were inconsistent with the nature of the bank's portfolio and its activities. Moreover, interest rates on BHN loans were fixed arbitrarily on a case-by-case basis by MIVI. In some cases, rates were granted which were insufficient to cover costs and ensure recuperation of the loan.

45. The situation became further complicated in 1981 and 1982 by the intervention of the Social Security Agency (CSS) in direct mortgage financing at heavily subsidized rates of interest. This impeded efforts by the BHN to establish a more realistic interest rate structure. In addition, the CSS program grew beyond the Agency's management capacity (over US\$100 million were spent in 1981 and 1982) with consequent control failures and substantial losses. As of mid-1983 the total losses had still not been finally determined, but are estimated to have exceeded US\$40 million.

46. To ameliorate this situation, the Government has carried out a number of important reforms. The CSS has formally undertaken not to engage in further direct mortgage financing. This would be a condition of the proposed SAL (Section of the draft Loan Agreement). Instead, the Agency will invest in BHN bonds. A procedure has been established by which MIVI only receives money from the BHN for projects backed by proper studies, which meet the correct social criteria; also disbursements will only be made against vouchers of work performed. Projects cannot commence until MIVI has received formal assurance from the BHN that there are funds available to finance them. The BHN will no longer be permitted independent and uncontrolled access to commercial bank credit, while its direct Central Government subsidy is to be gradually eliminated. Consequently, it is to rely much more on loan recoveries, bond placements with the CSS and loans on favorable terms and conditions from concessionary agencies. The BHN has also revised its interest rate policy. All future loans will carry a standard rate of interest, initially of 10 percent annually for low income housing, which will be sufficient to cover the cost of finance to the bank, plus its

operating expenses. The Government has announced its intention to gradually adjust the rate towards full compatibility with market conditions.

Social Security and Health

47. The Social Security Agency (CSS) is financially the most important public sector institution outside the Central Government. In 1982, the CSS had a total cash income of nearly USS.320 million (7.6 percent of GDP), generated cash savings of USS.52 million (1.2 percent of GDP), and was responsible for nearly one fifth of the total public sector capital expenditure. Despite its apparently healthy current financial situation, there is growing recognition that the CSS will face serious financial problems in the medium term unless remedial action is taken. These problems, should they arise, will be extremely difficult to solve in Panama where the authorities have no recourse to Central Bank finance to cover shortfalls. A financial crisis in the social security system would, therefore, have potentially grave political as well as economic consequences.

48. After the change of Government in August 1982, a new management team was appointed to the CSS. This team has reversed the short term difficulties associated with the Agency's intervention in direct housing finance and is now concerned with the more fundamental problems. These include an inappropriate management and decision making structure, lack of adequate statistical and internal financial information, the absence of an accurate, up-to-date actuarial evaluation and an inappropriate investment policy. The CSS's coverage is continuously being extended in all three of its principal areas of activity, which are health and maternity; old age, disability and death; and professional risks. Not only this, but benefits are sometimes increased without always considering the consequences for the CSS's long term financial viability.

49. Another area of concern which is intimately linked to the financial well-being of the CSS is that of the Integrated System of Health Care. This is meant to cater for low income patients located in areas outside the main Metropolitan Zone of Colon-Panama City. In theory, it is operated jointly with the Ministry of Health, but since the Ministry's budget is insufficient, it is the CSS which in practice finances the System. The quality of service is generally poor and there is a considerable amount of wastage.

50. In order to tackle these sensitive and complex problems, the authorities have requested technical assistance to help establish an effective and financially sound health and social security system. This assistance would take the form both of studies and of experts to implement new methods and train CSS staff in their use. It is anticipated that the policy recommendations from this assistance, for which Bank support has been requested, will be ready for the Government's consideration before the end of 1984.