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SOME PROBLEMS OF INDUSTRIALISATION IN PANAMA

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I

1. Even a cursory acquaintance with Panama's recent history will reveal the predominant role which her canal has played in shaping her economic destiny. For although legally a special treaty gives the United States authorities control over the ten mile wide strip through which the canal runs ("the Canal Zone"), the geographical and economic ties between this interoceanic water-way and the Republic of Panama have always transcended all legal and international considerations. Small in terms both of territory (29,000 sq. miles) and population (about 310,000 in 1914 when the canal was completed and only 1.3 million now) and endowed with no outstanding natural resources, Panama understandably looked on the canal as a major source of employment and trade. From the outset, therefore, the canal overshadowed everything else in the young Republic and as Panamanian society evolved it became basically and permanently divided into two groups: a static and self-contained rural community, and an urban community dependent in different ways on the canal and the activities which it engendered.

2. This seems to have worked out fairly satisfactorily in the inter-war years; but World War II and its aftermath have disclosed the weaknesses inherent in such a situation. For at one point during the war the canal had reportedly accounted for 30-35 per cent of the national income and employed not less than 40,000 people. The repercussions on the level of income, savings and consumption were true to scale. By reference to the figures for 1939, public income had by 1946 increased almost 2.5 times and demand deposits multiplied eightfold, and total imports scored a record increase of 175 per cent.

3. With the return of peace and the consequent reduction of United States military expenditure the situation was drastically altered and the country was confronted with sizeable unemployment. From a war-time peak of 40,000 persons employed in the Canal Zone, the figure dropped to 18,000 in 1950; and the usual repercussions followed: between 1945 and 1951 the index number of services to the zone fell from 277.5 to 94.6; sale of

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goods to the zone dropped from 97.6 to 40.1 million balboas; and the country's import capacity declined from 131.7 to a mere 70 million balboas. However, the existence of surplus liquidity in the economy together with substantial pent-up demand, so characteristic of post-war years, temporarily obviated large-scale unemployment; but a central government mounting deficit was to precipitate the crisis. Not only was surplus liquidity wiped out; but since Panama's domestic currency and its international reserves were one and the same thing and the latter were used up in financing the country's imports, an acute shortage of money supply developed culminating eventually in a balance of payments deficit of some 75 million balboas (1946-50). By the end of 1950 the number of the unemployed had reached nearly 13,400 in Panama district and more than 4,500 in Colon district. These figures reportedly represented some 17 and 19 per cent of the economically active population in the two districts respectively.

4. Before long, however, various circumstances combined to put the economy on the way to recovery. These need not detain us at this point. What is essential to emphasise here is the structural adjustments that the economy was able to make thereby off-setting, to a certain extent, the loss of revenue which resulted from the curtailment of activities in the Canal Zone. In part these adjustments were made possible by developments which occurred during the war years.

5. War-time shortage spurred local enterprise into the quest for and use of a variety of industrial and agricultural opportunities that were never considered feasible before. Apart from an improvement of the country's road and communications network, this endeavour took the form of substantial increases in agricultural and industrial output. Between 1941 and 1946 the sown area for the three major crops (i.e. rice, maize and beans) was increased by more than 50 per cent; cattle and pig slaughtering by 70 and 19 per cent respectively; output of sugar rose by 82 per cent and condensed milk by 80 per cent; and the consumption of gas and electricity increased by 73 and 62 per cent respectively.

6. These developments during the war years paved the way for the structural changes which took place in the economy after the war. Encoraged by

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Panama's comparatively advantageous price structure after the war, imports substitution proceeded especially rapidly between 1950 and 1955 and continued at a slower pace thereafter. Thus, eleven categories of imports of consumer goods including food stuffs, drinks, textiles, leather goods, and paper products, which accounted for some 45.2 per cent of total imports in 1950, dropped to about 35 per cent in 1955 and again to 32 per cent in 1963. Similarly, the export sector showed encouraging dynamism. The trend was reflected both in the range and quantity of exports of goods. To the traditional list of exports were now added cattle, meat, wood, paper products, and refined oil and oil derivatives, so that from 22.1 million balboas in 1950, exports rose to 54.7 million balboas in 1963 (at constant prices of 1960) - an increase of some 150 per cent.

7. It is a significant fact that this dynamism has not been confined to the foreign trade sector. Indeed, the encouraging trade picture presented here reflects a general record of growth which caused gross domestic product (GDP) to shoot up from 276.7 million balboas in 1950 to 533.1 million balboas in 1963 (in constant prices of 1960). In terms of sustained annual growth this represented an average of 4.2 per cent for the period 1950-60; 7.5 per cent during the five years 1960-1964 and 8.1 per cent in 1964-65.

8. It is noteworthy that among the six major sectors (i.e. agriculture, manufacturing industry, retail and wholesale trade, housing and miscellaneous services including those performed for the Canal Zone) which between them had accounted for some 87 per cent of GDP in 1950, manufacturing industry took the lead: from a total of 23.5 million balboas (or 8.4 per cent of GDP) in 1950 its contribution rose to 91.5 million balboas (or 16.4 per cent of GDP) in 1964. Distributive trade came a moderate second from 34.9 million balboas (or 12.6 per cent of GDP) in 1950, its share rose to 82.6 million balboas (or 14.5 per cent of GDP) in 1964. The contribution made by all the other major sectors to the GDP had, however, declined proportionately by 1964. This is particularly true of agriculture which, while it had contributed to the country's trade balance, was nevertheless disappointing. This is illustrated by the decline of the agricultural share in the GDP from 26.9 per cent in 1950 to just over 20 per cent in 1964. The explanation lies, of course, in the disparate character of Panamanian

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agriculture; the most progressive part of this, which consists of foreign-owned and operated plantations, remains small, while the bulk of the product is still produced under very primitive conditions by a peasant population who account for 55 per cent of the country's total population. On the other hand, the minor sectors of the economy (i.e. building and construction, transport, utilities, banks and finance and public administration) which between them contributed slightly more than 13 per cent in 1950, have continued their growth at an annual rate of 7.8 per cent, so that by 1964 they were able to account for 19 per cent of the GDP.

9. Besides the success achieved by manufacturing industry, there are two other encouraging trends which should be noted: first, there is the continued decline in the importance of the Canal Zone as a component of the gross domestic product. Indeed, the one-time preponderant role of the Canal Zone has so diminished that its net contribution in goods, services and annuity accounted for no more than 12 per cent of the gross national product (GNP) in 1959. Since then, however, it has risen again but never to anything like its war-time dimensions. As matters stand, the canal's annual contribution has averaged during 1960-64 some 14 - 15.5 per cent of the GNP. Secondly, gross domestic formation and national savings have registered appreciable growth records. Gross investment in the private sector rose from 47.6 million balboas in 1959 to 86.9 million in 1965, and the corresponding figures for the public sector were 16.6 and 22.0 million balboas respectively. Within both sectors gross capital formation represented some 18 of the GDP in 1965. Similarly, national savings more than doubled in the period 1959-65 rising from 42.8 to 94.6 million balboas.

10. Several factors have combined to stimulate and foster growth. Besides such obvious ones as the country's geographical location and its agricultural resources and skilled labour, there has been a definite government policy consciously designed to encourage and reinforce the process of growth. This policy is embodied in a wide range of measures introduced or accepted by successive political groups who have acceded to power in the past two decades. These included the retention of the special ties with the U.S. dollar; the free movement of funds into and out of the country; a liberal trade policy tempered by a measure of protective tariff for the benefit of infant industries; a realistic programme of top-priority public works projects; a

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preferential tax policy especially intended to attract the foreign investor; and, above all, an indomitable faith in, and respect for, the principles of private ownership and enterprise.

11. The significance of these successes should not, however, be exagerated. They were accompanied by sizeable unemployment (especially in the urban centres) which account for 11 per cent of the country's labour force and by chronic weakness in the balance of payments: available figures of the last six years show that trade deficit has nearly doubled, rising from 55 million balboas in 1959 to 96 million in 1965. Moreover, despite the declining importance of the canal as an economic factor and the modest start that has been made to broaden and diversify the country's economic base, the record of the past two decades or so unmistakeably shows that national solvency still remains largely a function of extraneous forces over which Panama has very little control. For the ever-widening gap has been met by foreign exchange receipts from four main sources: (i) the sale of goods and services to the canal (which though relatively declining has contributed a yearly average of some 92 million balboas between 1962 and 1964); (ii) continual external borrowing (which by the end of 1964 exceeded 112 million dollars and is still rising); (iii) an inflow of private capital, estimated at some 20 million dollars a year; and (iv) a deterioration in the foreign assets of the banking system.

12. The weakness inherent in this situation is all too obvious; dependence on external finance has become a way of life in Panama, but the availability of outside funds to finance current consumption cannot be expected to continue indefinitely even at their present rate, much less at a rate commensurate with continual growth and rising living standards.

13. If this evaluation of Panama's performance sounds somewhat harsh, it is nevertheless suggested by a closer look at the record. Take, for instance, the phenomenal population growth which the country has lately been experiencing at the rate of 3.2 per cent a year. This has not only increased the supply of labour and, therefore, unemployment (which official statistics show as having increased from 8.8 per cent in 1950 to 11.2 in 1960 of the so-called "economically active" population). It has also raised the ratio of child population to adults, and consequently, the rate of dependency.

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Reliable estimates put this latter rate in the order of 9 - 10 dependents per person within the working age group. Seen in this light unemployment is evidently a greater problem than official statistics imply and is causing greater hardship to a much larger and ever-increasing section of the population, not to mention the underemployed and the seasonally employed and their dependents. That this state of affairs should exist in a phase of prosperity is a curious paradox. It can only mean that this prosperity is either over-rated or is confined to certain groups. Possibly both explanations are partly true.

14. Or, consider the case of the balance of payments. Here the most encouraging item has been the receipts from exports of goods. They have gone up from 36 million dollars in 1959 to 67 million in 1964. Against this, however, must be placed a corresponding increase in imports so that the ratio between the two items has remained unaltered. Even then, this relative success in maintaining the same proportion between imports and exports was possible only because of the exports of refined oil products and other minor items.

Otherwise, Panama's staple exports have been gradually loosing ground, so much so that by 1964 they represented no more than 30 per cent of the value of total imports (excluding imports of crude oil).

15. Put in quantitative terms, unlike imports, staple exports have lagged considerably behind the GNP: while the GNP has increased at the rate of 7.2 per cent in the past five years and imports at the rate of 11.8 per cent in the same period, staple exports have increased only at the modest rate of 5.8 per cent. Nor should this disappointing performance be surprising, so long as the country continues to rely on a few major but capricious agricultural commodities for her staple exports.

16. Nor does the data on capital formation give much ground for optimism. According to official statistics, gross domestic capital formation in the most prosperous period that Panama has experienced, that is the years 1959-65, has risen from 55 million balboas (or 16 per the GDP) to 109 million (or 18 per cent of the GDP). This means an annual average of some

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88 million balboas or about 17 per cent of the domestic product. Against this favourable record, however, it should be remembered that in the same period Panama's deficit on current account has averaged some 16.5 million dollars a year, that capital transfers, both private and public, have averaged about 26.5 million dollars a year, and that changes in net foreign assets of the banks have added an average of some 3.8 million dollars a year. In other words, not less than one equivalent of 45 per cent of annual average domestic investment has come from abroad. Further, while investment in the public sector has more than doubled between 1960 and 1964 and has been devoted to projects of top priority (e.g. transport, electricity, water supply, low-cost housing, health and education), private investment, which accounted for nearly two-thirds of the total, has lagged considerably behind. It rose from 58.6 million balboas in 1956 to 76.8 million in 1964 (in 1960 prices). Worse still, a substantial part of this was concentrated in residential development which, ironically enough, was given an added stimulus by means of a five-year tax exemption. Thus, while in aggregate figures gross domestic capital formation may present a fairly encouraging picture, the fact is that almost half of it has come from abroad and a substantial part of the other half was in the form of investments in real estate.

17. This brief survey enables us to summarize some essential features of the Panamanian economy. On more than one occasion the economy has shown that it possessed fairly adequate resources and the dynamism to make the necessary structural adjustments when challenged by circumstances. But the economic performance in the face of changing circumstances, though satisfactory on the whole, has not been a story of unmitigated success. National solvency was maintained despite the post-war decline in the economic role of the canal; satisfactory progress was also made by native industry in producing essential consumer goods for the home market; exports of goods were expanded and diversified but only maintained their relative position against continually rising imports. Among the circumstances which have made this success possible are a favourable geographical location, the possession of a fairly adequately trained labour force, the availability

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of some unexploited natural resources and the application of a government policy which can best be described as a mixture of protectionism and laissez-faire. However, the main weakness which offsets this record is that self-sufficiency still remains more distant than ever before. Despite the decline in the relative importance of the canal, the economy is hopelessly dependent on external economic forces over which is has little or no control.

II

18. So much then for past developments and the forces that determined their course. Now, at a stage of her struggle for economic survival when her needs for outside resources are perhaps greatest, Panama has come to learn that the canal cannot be relied upon for much longer as a source of revenue, even to see her through this transitional phase. While she was laying plans to place her economy on its feet, she suddenly discovered that she had been out-stripped by events. Costly to run and maintain and quite unsuited for the passage of the new ocean-going giant tankers, the canal may have to be replaced by a sea-level substitute. Naturally enough those concerned with current financial pressures are dismayed by the discovery. For the sudden loss of 18 per cent of GDP in the face of mounting unemployment and ever increasing reliance on foreign funds is a grave matter indeed. Yet one wonders if the consternation and panic atmosphere are really justified, and if this new development is not a blessing in disguise. After all Panama has long reckoned on the possibility that the canal would eventually cease to be an important factor in her economy, so that the urgency of the present debate arises more from the timing of the proposal than from its novelty. All the same, Panamanians are faced with two pressing and immediate problems: (i) the immediate dislocation which the projected abandonment of the canal would entail, and (ii) the extent to which this scheme can be turned to account in the process of planning for economic independence.

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19. Several studies are being prepared to assess the short and long-term effects of the proposed canal; on different sectors of the economy; the present one is an attempt to asses its impact upon the industrial sector.

20. Essentially there are three main lines of investigation which need to be pursued. The first concerns the supply of, and demand for, labour directly required for work on the new canal at various stages of its construction. Specifically, what should be investigated here is the types of skill and number of skilled workers needed for various phases of the project, and whether or not (and if not, then how) they can be made available locally.

21. The second relates to the demand for goods and services during the various phases of construction and the employment opportunities this demand will generate. This means that an attempt should be made to project the demand for construction materials, and their availability locally; for foods and other consumer goods and their availability locally too; for dwelling houses...etc.; and for miscellaneous other services, e.g. transport and communications and professional services. Both these approaches bear upon the immediate and medium-term repercussions of the project.

22. The third inquiry should be concerned with the situation after the canal is completed. Surplus labour released as a result of the closure of the present canal as well as that released after the completion of the new one, will coincide to aggravate the unemployment situation. It is no consolation that the full impact may be spread out over a period of time as the redundant labour is gradually released. So long as aggregate demand will continue to fall, widespread unemployment will ultimately result, unless of course, new forces are gradually brought into play to absorb the unemployed.

23. The approach to these problems will need to be more than merely quantitative. The Government will be called on to introduce a wide range of regulatory and corrective measures and much of this will entail administrative reorganisation. It will, therefore, be necessary to give careful consideration to the aspects of public policy involved if the government is to anticipate events rather than have decisions forced upon it by circumstances.

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24. However, an analysis along the lines suggested would be both impracticable and premature at this stage. It would require the labour of more than one person over a period of time much longer than that allowed the present writer; an attempt to trace the ramifications of such a wide range of functionally related variables and to assess their repercussions should form the major part of a long-term government plan. So far, however, planning has been concerned with short- or medium-term targets and has not touched on or even recognised the problems posed by the canal. What is required is the formulation of a long-range plan (which will be subject to periodic evaluation and revision) including the proposed canal as an integral and major part of it. Whether the cost of construction and actual execution of the project would be the responsibility,wholly or partially of another party has no bearing on the point under discussion. What the planners will need to ascertain is all such engineering and technical data as will have direct bearing on the long-term comprehensive model which it will be their task to construct. In particular their data must include the physical location of the canal; the technique of construction (i.e. whether conventional or nuclear engineering methods will be used); the duration of the construction process and how it is proposed to phase it; the labour and building material requirements within each phase as well as estimates of expenditure on both items within Panama. It will be some time, no doubt, before this type of information can be ascertained; but this need not cause discouragement; a great many preparatory measures can and should be undertaken by the government before the stage is reached when this information becomes available and useable.

25. These preparatory measures are in fact a prerequisite to the success of the long-range planning. For this reason and while the various technical and political aspects of the canal project are being debated, the planners

should suspend their attempt to construct a quantitative model which can only be highly conjectural at this stage in favour of a thorough review of the framework of government economic policy to see how compatible this is with the country's broad development objectives and to suggest the structural and legislative alterations that will make future plans more realistic and their objective more attainable.

26. What we shall endeavour to sketch out in the following part of this study, then, is a broad guide to policy. We shall indicate the structural adjustments which will be needed to stimulate and complement full and efficient use of productive factors and to facilitate the flow of production. Our discussion will, of necessity, be confined to manufacturing industry, although obviously this by itself can hardly provide the answer to Panama's quest for economic independence. However, agriculture and services will be dealt with by other members of the team and as such lie outside the scope of this discussion.

III

27. It needs little perception and only a slight acquaintance with recent events and the international financial scene to see that one of the main obstacles that will face the planners of Panama's industrialisation will arise from shortage of capital. This may sound surprising at present since the country has somehow always managed to finance her capital and current requirements. However, rising trends of interest rates in recent years have presented difficulties not only to developing countries but even in some of the most reputable and attractive international capital markets. With an ever-growing and intensified quest for development and industrialisation throughout the world, it is a safe assumption that the trend will continue and be re-inforced in the years to come. This is just about the period when Panama's development plans will be in full swing and her capital requirements will have approached their maximum.

28. The point can hardly be over-emphasised. To appreciate the magnitude of the problem involved let us (admittedly at the risk of great over-simplification) give it a quantitative expression. For the moment, let us disregard the canal and assume that we are only concerned with maintaining the growth rate which has averaged during the five-year period 1960-64 some 7.5 a year. This is, in fact, not quite as ambitious as it may sound: after allowing for a population growth of some 3.2 a year it comes to about 4.3 which would double per capita income once every 17 years. Now, let us take as our point of departure the GNP for 1964 which stood at 590 million balboas (at current prices). At a compound growth rate of 7.5 this should by the end of 1974, reach 1,306.8 million balboas, an increase of 716.8 million balboas over the base year, or a mean annual increase of 71.6 million balboas. If we assume a capital co-efficient of 3 (hardly unrealistic in view of the long gestation period which generally precedes the take-off stage and a large investment in social overhead that would pay dividend only in the long run) average annual investment will have to be in the order of 214.8 million balboas in order to attain

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the desired target rate. This means an investment ratio of about 0.22 which obviously could hardly be met out of domestic savings alone even if the country were to curb its consumption very drastically which on present showing seems unlikely.

29. Worse still; capital scarcity in Panama will be aggravated by two factors; a conspicuous disparity in income and wealth distribution and peculiar rigidity in the internal interest rate structure. Both factors are already adversely affecting the process of capital accumulation and will continue to do so in the future unless urgent and serious efforts are made to remedy the situation.

30. With regard to the concentration of income and wealth in the hands of the few, it is unnecessary to dwell here on the social and political instability it is breeding. These are obvious enough. The point here is that his concentration of economic power is operating in practice to the detriment of industrial growth. This is because investment decision within the private sector is at present concentrated in the hands of traders and landlords whose traditional interest lies outside, or even runs counter to, manufacturing industry. These groups have always favoured transactions with quick turn-over and high return. This is why the greater part of capital accumulation in Panama has taken the form of investment in luxury residential buildings, speculative land-ownership and the building up of inventories and expansion of import trade. The pattern is all too familiar and has received adequate treatment in various reports which are already available to the government, such as Professor Taylor's excellent Fiscal Survey.

31. However, even if corrective measures were immediately introduced to mitigate this inequality they could hardly be expected to produce the desired effect in the near future. Redistributional fiscal measures are essentially long-term instruments; so that along with them some positive legislative action will be necessary if investors are to be induced to take the risk inherent in new industrial undertakings. We shall have occasion to review some of these measures in another part of this paper.

32. The problem of interest rate is equally involved. It is part of the thornier question of Panama's monetary system which raises a host of political issues that are best avoided because, if for no other reason, they fall outside the present terms of reference.

33. At the time of writing and for some time past official policy has fixed interest rate at a maximum of 7 per cent. As we said before, this made the Panamanian market attractive while interest rates were low abroad. When these started to rise the picture was complicated. Short term financing was hardly affected, presumably because of the adequacy of the resources of the commercial banking system. In long- and medium-term finance, however, new trends began to show. Competent entrepreneurship was able to attract capital in three main fields; luxury buildings, speculative land purchases and consumer credit. Over the past two decades these proved the most rewarding fields of investment and have consequently succeeded in absorbing the lion's share of foreign and domestic capital. It is highly doubtful whether the raising of interest rate by one or two points will alter the situation and divert capital to manufacturing industry. In fact, it is quite likely that this measure may produce the opposite effect, so that the three established markets will remain unaffected, or may even benefit by the rise, while the cost of borrowing to industry will be increased.

34. In the present writer's opinion, therefore, the question of interest rate should be tackled on a different level altogether. It should be settled once and for all by reorganizing the banking system along the lines suggested by the proposal gently put by the International Monetary Fund consultation team of 1964. The Bank can then exercise its influence not only through its re-discount policy which can be manipulated to meet the requirements of the market; with adequate discretionary powers its range of rediscount operations may be extended to include industrial papers. This device will have to be employed deftly and carefully, but that is a question of management and is no different from other central banking techniques. It need not confuse the question of principle.

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35. Besides a redistributive fiscal policy and a flexible interest rate managed by the Central Bank, there are several tax measures which the government may wish to consider with a view to encouraging investment in manufacturing industry. In the first place, the government may feel inclined to review and repeal the preferential tax treatment at present allowed to investors in real estate. To an outside observer it is odd that in the present circumstances of keen competition for capital among the various sectors, real estate transactions should enjoy advantages denied to other sectors. At present, income from real estate developments is allowed tax free for the first five years as against the ineffective and dubious exemption from import duties on capital equipment and raw materials and on income from exports which industrial enterprises theoretically enjoy. As we shall see presently, with the singular exception of the oil refinery, industry rarely avails itself of either. Unless there are some compelling reasons to maintain this arrangement it would seem more logical, therefore, to reverse the situation so that more effective and generous tax benefits be granted to manufacturing enterprise and that real estate investment be denied any such benefits if a better allocation of capital resources is to be achieved between these two sectors.

36. It is also necessary to put a limit to speculative land purchases (e.g. through the application of some form of capital gains tax) and to ration funds now channelled to consumer credit organisations. The present free-for-all competition for capital funds cannot continue unchecked if industry is to have its fair share of the limited capital in the country.

37. Another piece of legislation which calls for urgent review and revision is the Development of Production Act (No. 25 of 1957). The act is defective in three respects: its cumbersome and time-consuming procedure, its crude and nebulous criteria of evaluation, and its scanty but grossly over-rated benefits. Evaluation of projects for which tax exemption or protection is claimed is undertaken by the Ministry of Agriculture, Commerce and Industry, and by the National Economic Council and is finally approved by no less a body than the Cabinet. Applications are examined as they arise by these bodies of whom, however, none possesses a full-time

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and adequately trained staff to undertake this task. Consequently, the process may, according to report, take any time from three to fifteen months. Moreover, considering that the mass of information required by the Act and the conditions with which a grant of exemption is hedged, it is hardly surprising that there have been so many complaints that the legislation will not work. For even if objectively enforced (and there is no reason to believe that it is not) the process of evaluation is inevitably crude with an element of arbitrariness about it and leaves no room for the application of such refined evaluation techniques as the accounting prices procedure.

38. There are other extraordinary and anomalous features in the Act. Thus, in considering an application for tax exemption, the Law places on the applicant the onus of proving, among other things, (i) the "adequacy of the machinery, instruments and tools for the manufacture of the product and its productive capacity to the current and future internal demand", (ii) "the importance of the research apparatus which the proposed enterprise may establish", (iii) and its beneficial "contribution to the national income and distribution of same among the factors of production..."

39. Then, if and when exemption is finally granted in principle, the entrepreneur is required to apply for exemption from duty every time a new consignment of imported goods arrives in the country. The detailed Report of Continental-Allied Co. Inc. lists no less than ten distinct administrative steps, involving at least six separate departments and entailing considerable loss of time that a privileged applicant must undertake before he obtains exemption on a new consignment of imported goods.

40. But perhaps one of the most curious features of the Law under review is the provisions under paragraph (b) of Article 6 and paragraph (f) of Article 7. The first of these prohibits the use of imported raw materials by enterprises granted tax exemption except when these materials are locally unobtainable in sufficient quantity; and in any case no importation can be authorised without prior consultation with the domestic producers of these materials. The second requires enterprises to buy domestic raw materials

/"at a price

"at a price not less than the minimum fixed by the official agencies and in quantities which will not exceed the requirements of the enterprise as determined by the Ministry". This is not the kind of control of industry that is desirable in a country professing adherance to the principles of free enterprise and one that is short of capital, entrepreneurial talent and possesses no great unusual natural resources of her own. Indeed, the cost in terms of lost time, inconvenience and expense sustained by enterprises is such that many industrialists are said to decline the advantages of exemption from duty in order to retain their freedom of action. Clearly the weakness in the Act lies in its attempt to reconcile two basically conflicting interests: those of raw material producers and those of the industrialists when, in practice, it has proved beneficial to neither. It has hardly benefitted the former as industrialists have been able to by-pass its provisions whenever necessary by paying the duty and importing the materials they preferred; and while it pretended to help industrialists through exemptions from duty, it has imposed on them such limitations (through the use of specially priced home products) as to have outweighed the benefits of exemption. As a result, the only effect this law seems to have is to penalise the domestic consumer and render Panamanian manufactures less competitive abroad. The Act needs to be completely revised without delay. A considerable fund of experience in this field now exists in many of the smaller developing countries and Panama would be well-advised to acquaint herself (through the appropriate channels of the UN Secretariat) with some of the most recent legislation on this problem. In these countries special attention has been given to three vital points: (1) the competitiveness of their home industrial products abroad, (2) the protection of such infant industries as may be thought to be potentially capable of making good, and (3) the protection of the domestic market against monopolistic practices.

41. However, even a careful revision or repeal of this law would not in itself suffice to attract foreign enterprise and capital to Panama. More positive concessions will be needed. Exemption from income tax (both individual and corporate) for a limited period of time, the granting of

/free land

free land sites, the reduction in the rates charged for public utilities (especially gas, electricity and water), the granting of warehousing and storage facilities are just a few of the many inducements that have been employed by various African and Asian states in the endeavour to attract capital and enterprise to their countries. It is difficult to see how Panama can compete successfully in this field without adopting the same devices. A comparison with recent legislation in some of these countries will reveal that Panama's attitude towards capital and enterprise has been too conservative. This may well account for the lack of interest especially among European manufacturers and entrepreneurs in exploring the country's potential despite its unique location. For what these men look for in their quest for new opportunities is some distinct advantages that will make it worth their while to set up new industrial bases overseas in the face of obvious risks arising from limited local markets, low personal income and laborious administrative practices. Clearly, in the eyes of many manufacturing enterprises Panama's tax concessions are not attractive enough to outweigh these risks.

42. These fiscal measures by themselves, no matter how liberally framed, will not be enough to alter the present pattern of industrial growth. They may well supplement, but can never supplant, equally essential measures in related fields.

43. One such obvious measure is that of improving the mechanism of Panama's industrial finance. There already exists in Panama an industrial bank to meet long- and medium-term credit requirements of industry. It was organised, with government encouragement, by some of the banks now operating in the country together with eminent businessmen and industrialists. It was granted a U.S. loan of 4 million dollars for a period of twenty years at 2.5 per cent interest. The loan was intended to tide the bank over its initial stage in the hope that as this went on, it would build up its own resources until it could eventually stand on its own feet. What actually happened, however, was that the inflexibility of interest rate (to which reference will be made later in this paper)

limited its ability to attract deposits. So for the time being at any rate the bank's capital and the U.S. Government loan remain its main sources of funds. Understandably the scope of the bank's operations was greatly restricted. Oddly enough, any hope that this problem might have been overcome by a judicious and selective equity participation or through the exercise of stock options in projects it might help to finance, has been ruled out by an extraordinary provision in the bank's charter which prohibited this otherwise common practice. Thus, despite an able management and numerous opportunities in the country where it could have made valuable contributions, the bank is being frustrated by a combination of rules that are not conducive to the purpose to which it was intended to serve.

44. It is recommended that these restrictions on the bank's operations be removed and that its charter be thoroughly revised. The bank's range of industrial finance should be widened to include not only equity participation, the acquisition of stock through the exercise of options, mortgages and guaranties ..... etc., but also in view of the absence in the country of a proper capital market, the bank should be allowed to undertake such operations as underwriting, private and public bond floating, and hire-purchase finance.

45. Another measure which recommends itself as an essential and integral part of a public policy favourable to industrial growth and one closely related to the proposed reform of the industrial bank is direct public participation in the financing of some basic industrial enterprises. The recommendation is not as incompatible with the principles of private enterprise as it may sound. The practice is widely accepted in many states where private enterprise is held as a tenet of their political philosophy. It is also one of the practices often advocated by the World Bank and its subsidiary, the I.F.C., as well as the U.S. Government bilateral financial agencies. Its purpose is to provide the leadership and initiative needed for the establishment of new industries and to minimize the financial risks involved. It will be found far more effective than what has so far been attempted in persuading private investors to risk their capital in government fostered projects. For so far (apart

/from investment

from investment in infrastructure) the only direct contribution the public sector has made in this respect has consisted of setting up a semi-public agency, (INPADE), whose work has consisted of providing advisory services and feasibility and work studies for private industry.

46. Although in theory, privately supported, in fact INPADE has existed only on the financial contribution of the government and the technical support it has been receiving from the U.S. aid programme. The fact that, in spite of several years of experiment with various ideas, this agency has not yet been able to get any of its sponsored projects accepted by private industry calls for a critical evaluation of the basic concepts on which it was founded. Most of those involved in this experiment agree that it has failed because the risk which these projects involved would have fallen solely on the private investors. Understandably, the private investor was not impressed by industrial schemes advocated by a group of officials who took no share of the risk or financial responsibility.

47. It is perhaps worth emphasising that the idea of public sharing in the risk capital of some basic industries does not imply government ownership of industrial enterprises. Rather the contrary. What is proposed here is that public funds be used as a device to convince the private investor (and especially foreign concerns) of the soundness of the new project. Once the initial stage of raising the necessary capital and selecting the right management is over and the new enterprise has demonstrated its ability to stand on its feet, the government may well choose to turn over its equity or loan interest to the private sector and thus use its limited resources as a lever for the creation of several basic industries. Experience in other countries shows that this method can be an effective instrument in gaining the confidence not only of domestic investors but of foreign enterprises as well.

48. To put this recommendation into effect the following measures or re-organisation would be necessary:

(1) INPADE should be integrated in the Development Bank as its Planning and Research Unit.

(2) Further, it should be reorganised and more adequately staffed so as to make it capable of carrying out basic research and feasibility studies for government sponsored projects.

(3) The Bank should be subsidised by the government (and possibly by the Chamber of Industry and Commerce or some such body) as well as by the U.S. Technical Aid Programme for at least part of the annual cost of staff and research work.

(4) The Bank's research programme should be drawn up as a result of a coordinated effort between (a) The Planning Commission, (b) the private sector (e.g. the Chamber of Industry and Commerce), and (c) the U.S. United Nations aid authorities, and approved by the Board of Management of the Bank.

(5) The Planning Commission should include in the capital budget adequate sums to ensure government equity and/or loan participation in certain industries which will have been covered by INPADE's research programme, proved feasible and approved both by the Bank and the Planning Commission. Government participation should not fall below, say, 10 per cent and not exceed 49 per cent of the equity needed and if desired, should not be held permanently by the Treasury. The inclusion in the capital budget of sums earmarked for industry is an essential step without which the rest of the measures recommended here will lose much of their force.

(6) It is essential that coordination be maintained between the Planning Commission, representatives of the private sector, representatives of the aid donating agencies, and the Bank's Planning and Research Unit. A committee consisting or representatives of each with the President of the Bank as Chairman should meet at least three or four times a year. Its main tasks should be: (a) to select a programme of project investigation and assign priority to projects within the programme; (b) to suggest an order of magnitude of government commitments which will serve as a basis for inclusion in the capital budget; (c) to follow up the progress of the investigation schedule and revise it when necessary; and (d) to act as an advisory body both to the Planning Commission and the Ministry of Commerce, Industry and Agriculture on industrial policy and all matters related to industrial development.

/IV

IV

49. Our discussion of the broad policy necessary to stimulate industrial capital accumulation will not be complete without a brief allusion to one important question invariably present throughout the current debate on the canal. This concerns the capital equipment now available in the Canal Zone which may well be turned over to the Panamanian authorities as part of the settlement between Panama and United States. The list of capital equipment now available is fairly extensive. It includes an up-to-date computer unit; an electricity generating plant; central air conditioning plant; refrigerated trucks, and a refrigeration plant of the Atlantic coast; a one-thousand ton dry dock with complete facilities as well as two smaller dry docks; a complete iron foundry; a fully equipped maintenance workshop capable of servicing a wide range of industries; a machine tool shop, a printing press; an oil tank farm and pipe line. The transfer of these assets to the Panamanian authorities should provide an excellent starting point for an industrialisation programme. The fact that all this diversified equipment happens to be conveniently located in one place is an unsurpassed opportunity for setting up a substantial industrial estate, the like of which cannot be found anywhere in Central America.

50. Following the transfer of the assets to the Panamanian government the estate can be established (preferably within the zone, but outside it if necessary) through the setting up of a corporation whose assets will consist principally of the equipment in question. Its stock may be sold to the general public, the banks and the Industrial (Development) Bank. The government may retain a share in the equity -say about 20-25 per cent. The inclusion of the Bank among the principal shareholders is strongly recommended. It will make for closer coordination between it and the industrialists whose plants and workshops will form part of the complex and thus ensure the prompt and smooth provision of financial and technical aid.

51. The corporation should aim at the gradual disposal or sub-contracting of its equipment to the private sector retaining to itself only that part which will be needed for the communal services within the estate, namely

/power generation

power generation, and communication transport, storage, air-conditioning, water distillation... etc. After the estate has been surveyed, a proper plan should be prepared so that land either within the present "zone" or adjacent to it may be improved, landscaped and divided into lots which should be offered (for outright sale or lease) either as improved sites or general-purpose workshops. Certain parts of the estate may also be reserved for custom-built factories.

52. Certain qualifing conditions may be laid down for the admission of enterprises to the estate. Priority should be given to applicants whose manufacturing activity can benefit by its location within the estate. Apart from those already established in the "zone" (e.g. the dry docks, machine tools) metal conversion industries should have prior claim on sites in the estate.

53. With regard to the dry docks, a survey should be carried out to determine the following facts:

(a) The availability of similar facilities in the region and the repair work that will be potentially available to Panama.

(b) The utility of equipment, its condition and cost of repair, replacement and expansion if necessary.

(c) The location of the main dock and whether or not the smaller ones should be incorporated in it.

(d) The feasibility of building small craft, barges etc. and their market potentials.

V

54. So much for capital. Let us now turn to another productive factor, labour. Two main characteristics are generally held to distinguish Panamanian labour; its high rate of growth and its reportedly high technical standards as compared with other Central American states. Yet doubt has been expressed on both points. With regard to the growth rate U. N. estimates indicate that the so-called "economically active" population which stood at about 346 000 in 1964 will have increased to nearly

644 000 by 1980. On the other hand a survey carried out a few years ago by an expert from the World Bank asserted that "in the long run, if development proceeds as it should, Panama faces a scarcity of labour especially in agriculture". The latter statement sound incredible, for normal experience suggests that as agricultural productivity improves, under-employment, a prevalent feature at present, will increase and labour suspluses will eventually spill over into the urban markets. However, the problem cannot be dismissed so lightly on general theoretical grounds. It must be assumed that the expert in question has some grounds for making the statement. A careful examination of this point is therefore necessary to ascertain its validity. The agricultural expert and the human resources specialist in the United Nations' team should be aware of the IBRD's warning and should be asked to give an opinion on it. As far as government action is concerned there is little that can be recommended at this point. Any detailed planning of the number of jobs that will have to be created will, of necessity, have to await the factual data and technical information that have been alluded to above.

55. Opinion is equally divided about the quality of Panamanian labour. While Messrs Tanenbaum and Associates, who have undertaken a detailed comparative study of labour productivity in Panama and neighbouring countries, are quite optimistic about the present state of affairs, the IBRD survey quoted above gives a different impression: "There is a general shortage of skilled mechanics and operators. Generally speaking, Panamanians are reluctant to become mechanics and prefer office jobs. Some industries have found it necessary to hire persons of other nationalities for jobs requiring a high degree of mechanical skill".

56. But even if the favourable assessment of Messrs Tanenbaum and Associates were to prove correct, the present situation leaves much to be desired. For what should be borne in mind is that so far the country has discovered no outstanding mineral or other natural resources. Her labour force will, therefore, continue to be her most valuable asset. Further, as a small country whith no exceptional resources, Panama will have to depend on a diversified list of exports destined for marketing not only in the region but all over the world. To achieve this, Panamanian

/exports will

exports will have to have one or two obvious attractions: they will have to be either competitive in price, or of an exceptionally high quality. Most feasibility studies carried out under INPADE's auspices seem to indicate than Panamanian products cannot successfully compete with mass-produced commodities abroad and that this has been a reason for disappointment and frustration. If Panama's resources, as they are at present known, do not enable her to offer her manufactures on favourable terms in competition with large-scale producers, then she will have to change her industrial orientation and concentrate on quality products intended for customers within high income brackets in richer markets. Switzerland's experience may be cited here as a classic example of what may be accomplished with meagre natural resources but a highly trained and well disciplined labour force. A considerable amount of Swiss products consists of consumer goods (e.g. lace, embroidery and textiles, leather goods, confectionary and dairy products, drinks and cigarettes, pharmaceuticals, paper and paper products). Between them these constitute well over half the country's total exports of which nearly 75 per cent goes to markets within Western Europe (EFTA and EEC countries) and the United States. Indeed, technical qualifications have in themselves become in Switzerland a source of considerable foreign exchange earnings. For besides the obvious services such as insurance and banking, some Swiss enterprises have found it more practicable to earn their profits by passing their technical skill to foreign subsidiaries rather than by the expert of manufactures, their role being continued to the training of labour and management and the carrying out of basic research. It has been reported that in Nestle's industrial complex no more than 3 per cent of the labour force is Swiss, the rest is foreign whose training was carried out by the parent company in accordance with the provision of licensing agreements with foreign enterprises abroad.

57. To say this, however, is not to imply that the proposed change of orientation is easy or can be accomplished in a relatively short time. No struggle for survival is easy. But it is essential at the outset to recognize the need for a new orientation and to know its cost in terms

/of time

of time and effort. Once the objective and its cost are recognised, its adoption becomes possible and the task of putting it into effect a practical proposition.

58. Should the foregoing be accepted as a part of the broad strategy for development, then the endeavour to raise the standards of technical training should receive the same high priority in government planning as that of the encouragement of foreign capital. The two must go hand in hand. Action in this field does not have to await any elaborate technical data or detailed quantitative information. It falls within the broad policy framework whose adoption and implementation should proceed as rapidly as possible in order to pave the way for the quantitative planning that will follow in the next stage.

59. In the attempt to raise standards of technical training there should be no room for compromise. The government should aim at nothing but the highest, not by national but by international standards, bearing in mind that Panamanian exports will be competing with a vast variety of similar products in some of the more sophisticated world markets.

60. Luckily considerable opportunities exist in bilateral and international programmes for assistance with technical training. Special emphasis should be placed on vocational training and on advanced training and research. Of special significance to the country are such fields as engineering (including metal conversion industries), the food industries, arts, crafts and design, leather goods, ceramics and pottery. It may be found practicable to interest universities and institutions of advanced technology in Europe or the United States in establishing field stations in Panama where the cost and benefits of training and research may be shared by Panama, the institution in question and the donating agency. The Science and Engineering Faculties of the University may be used as a nucleus for the programme.

61. Along with this programme for training skilled workers and technicians, there should be introduced a parallel programme of management training. Highly skilled labour requires highly trained and efficient management to provide it with leadership and enterprise; the one is inseparable from

/the other.

the other. Arrangements for a joint management programme may also be explored with any one of several institutions abroad. The United States is ahead of many countries in this field and Business Administration Schools like those in Harvard, New York and other centres have a great deal to offer in this field.

62. Panama may also wish to consider making the proposed training establishments serve as regional centres for the Central American Repubics. In taking a step of this kind, Panama will assert her regional identity, underline her interest in common regional problems and make a contribution beneficial alike to her neighbours and her own economy and prestige. Needless to say, the success of the experiment will depend on the quality and contents of the programmes. Here again there should be no room for half measures. Instruction and training should be of the highest standard possible.

VI

63. The foregoing part of this paper has broadly dealt with two major factors of production. The third, the country's natural resources, is at present being extensively investigated by another United Nations team. At the time when the present writer visited Panama the team was in the field, but shortage of time and the dispersal of the team in various parts of the country has unfortunately prevented any useful discussion of the team's findings. At this point, therefore, the economist has nothing to offer; but as soon as these findings are available an economic assessment should be attempted. Together with the technical data referred to early in this paper, this assessment should provide adequate information with which to assess Panama's ability to cope with the demands generated by the construction of the new canal, and to suggest the bases for quantitative targets.

64. On the subject of these country's natural resources, a word may be in order in connexion with the work that has been done in the past few years on the feasibility of certain manufacturing industries.

/65. It has

65. It has been pointed out above that a major weakness of this work has been its academic character in the sense that the work was carried out without any attention to the availability of the capital that will be needed for implementation. However, even on a technical basis the work seems far from satisfactory. The decision to allocate funds and carry out a feasibility study seems to be made at random. So far as the present writer is aware, three reports have been submitted listing a number of industries thought to be feasible by the authors. The earliest of these is the IBRD study to which reference was made earlier; the second is that carried out by Messrs George Fry and Associates under the auspicies of the U.S. I.C.A.; and the third is that by Dr. Jack U. Mowll. Because of the lack of any definitive information concerning the mineral and other natural resources of the country, the recommendations in these studies were inevitably broad and general. Thus the first two simply listed a number of manufacturing possibilities largely on the basis of the import substitution principle. Moreover, in all three studies there was either implied or explicit emphasis on two assumptions: (a) Panama's geographical location was an important factor in reducing production cost, and (b) tariff protection was an indispensable part of government industrial policy.

66. Both assumptions are reasonable enough. What is objectionable is that so much emphasis has been placed on them that they now form an unquestioned part of the country's industrial policy. The present writer is very sceptical about this approach. Tariff protection should be used with extreme caution and only as a temporary measure during the initial stage of certain industries. As for the location, it is obviously a valuable asset; but not such as would reduce costs in the industries suggested to the extent of making Panamanian products competitive in world markets. Panama's location may reduce costs but it will not make her manufactured goods so cheap that other countries will be induced to buy from her what they can just as well manufacture at home.

67. So long as these assumptions persist, it is likely that Panama's industrial potential will be limited. As was said earlier, a change of

/orientation is

orientation is imperative. The main emphasis for the future should be placed on raising the quality of Panama's products.

68. The present writer wishes to associate himself with that part of Dr. Mowll's report which recommends that surveys of various natural resources should be conducted to list those building materials required by the construction of the new canal which may be manufactured locally.

69. Of the industries proposed in previous studies, clearly the building materials industry offers the best opportunities. Provided that the surveys disclose an adequate supply of raw materials, the administration might be well advised to consider such industries as structural clay including pottery and ceramics and related products, oil prints; flat and laminated glass; concrete brick and block and other concrete products such as central mixed, shrink mixed and/or transit mixed concrete; asbestos cement products including siding, shingles, flat corrugated sheet, pressure pipe, conduits, ducts... etc. paving mixtures and blocks; asphalt felts and coatings; clay and non-clay refractories; nail and wire products; woodworking ... etc.

70. The size of the internal market will, no doubt, be an important factor in determining the feasibility of any of these industries since they will be primarily meant for domestic consumption. Hence, the urgent need for the date repeatedly referred to this paper. As soon as this becomes known, detailed feasibility studies should be undertaken preferably in conjunction with a group of manufacturers of these materials abroad.

71. The chemical industry is another field which holds promise for Panama. Some branches of this industry can, in fact, be investigated at once since the country's agricultural and industrial developments will require these products regardless of the canal. Within this group one may include mixed fertilizers, materials such as sulphuric, phosphoric or nitric acids, superphosphate, ammonia and ammonia compounds... etc. Similarly, essential oils, animal glue, albumin, acetic acid and acetone, citric acid... etc., have already been recommended in previous reports and should be investigated as early as possible. It is essential that investment in these industries be carried out at a minimal scale at first,

/leaving future

leaving future expansion to be decided by later developments. Here again, foreign participation would prove most useful, especially if the foreign partner happens to be a large and well-known concern with established markets overseas. The government and the Industrial Bank will have to take an active interest in these projects and it would be advisable to have the entire complex undertaken and managed by one large concern.

72. A wide range of consumer goods both in the field of foods and household goods has been recommended in previous reports; and some of these recommendations have already been implemented while others have not presumably proved sufficiently attractive to encourage investors to consider them seriously. It is suggested that existing feasibility studies be reviewed by the Industrial Bank's new Research and Policy United (see paragraph above) with a view to shifting the emphasis from producing cheap and competitive products to producing quality goods largely intended for the more sophisticated markets of Western Europe and the United States. Better quality foodstuffs, craft goods, knitware, decorative furniture, etc., would obviously fall into this category. Besides quality, special attention will have to be devoted to marketing endeavour. This is particularly important since Panamanian goods will be unknown to consumers and will need time to create an image, and an expensive distribution network will have to be created to bring them within the reach of consumers. Here again these industries will benefit much from integration; this will make the sales effort easier and distribution cost manageable. Or perhaps one national marketing agency may be created to assume the task of being Panama's super-salesman.

73. As far as the home market is concerned, household goods including fabricated metals (e.g. garden, camp and dual purpose sleep and office furniture, agricultural implements as well as a wide variety of related items), appliances, electric bulbs, transistor radios, clothing, leather goods have all been attempted by other countries with varying degrees of success. Between them the IBRD report and that submitted by Messrs. George Fry and Associates lists some 30 items which fall within this category of small industries. A short list may be selected and closely

examined by the Research and Policy Unit of the Industrial Bank. Here again, association with overseas manufacturers should be considered wherever possible. Apart from the obvious technical advantages such an association would bring along with it, this arrangement is likely to reduce a considerable part of overhead cost such as the expenditure on design, research, marketing and management. Preference should be given to industries which will depend on domestic raw materials and which will be sustained by a sufficiently broad home market.

74. In conclusion, it must be emphasised that economic development is a long and complex process. Industrialisation is only one of its components; so it will be wrong to equate the two, let alone to identify the process of development with the creation of a few basic industries or the provision of aid or encouragement to investment in the industrial sector. Government action should extend just as widely over the fields of agriculture, which will always constitute the back-bone of the economy, and services, where there remains substantial potential for expansion. No measures to encourage one sector alone, much less certain parts of one sector, can possibly provide the answer to Panama's present dilemma. Industrialisation should always be regarded as an integral part of an extensive plan of action which will pay dividends only when all its components have received the attention, determination and perseverance they deserve.