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PANAMA

SECOND PHASE OF CANAL TREATY HG PROJECT
INSTITUTIONAL ANALYSIS

Prepared for:

Office of Housing

Agency for International Development

By:

National Savings and Loan League

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NATIONAL SAVINGS AND LOAN LEAGUE

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STATISTICAL TABLES

LIST OF ABBREVIATIONS

GOP	-	Government of Panama
MIPPE	-	Ministry of Planning & Economic Policy
MIVI	-	Ministry of Housing
BHN	-	National Mortgage Bank
BNP	-	National Bank of Panama
CSS	-	Social Security Fund
S&L	-	Savings and Loan
CA	-	Savings Bank
CAPAC	-	Camara Panamena de la Construccion
CD	-	Certificate of Deposit
RPH	-	Regimen de Propiedad Horizontal
INDESA	-	Investigacion y Desarolla, S.A.

PERSONS INTERVIEWED FOR PANAMA RFS

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Statistical information gathered at the Comision Bancaria and Direccion de Estadistica y Censo de la Contraloria General.

SUMMARY

An overview of the housing finance situation in Panama points to one major issue: the low income and low middle income families are not being adequately served by the shelter system. The main difficulty continues to stem from the Ministry of Housing's relationship with the National Mortgage Bank and the role played by the country's five savings and loan associations.

Panama's shelter delivery capacity is far in excess of the actual production in recent years. The Ministry of Housing needs a much larger budget to provide low income housing on a scale that can cope with the demand. The Mortgage Bank is the key institution for producing those funds, but has actually been hampered in its ability to carry out that function by poor cooperation with the Ministry of Housing. The BHN should begin the sale of mortgage backed securities in a secondary market immediately, in order to generate additional resources for low and low middle income housing.

Modernizing the legal base for the savings and loan system can result in a big increase in the contribution of those institutions to housing finance. There is tremendous traditional demand for housing within the low middle income sector. This should be the target group for the savings and loans.

A number of changes in the rent control and home ownership laws have been proposed in Panama with good potential for stimulating increased investment in

housing construction, as well as conversion of existing rental housing to an ownership basis.

I. HOUSING FINANCE POLICY

Article 109 of the Constitution of the Republic of Panama entrusts to the State responsibility for establishing a national housing policy, with the goal of providing shelter as a social right of all citizens, emphasizing the low income sector. In pursuit of this goal, several institutions have important roles in the public sector housing finance framework.

The Ministry of Planning and Economic Policy (MIPPE) prepares the national development plan. In addition, the MIPPE coordinates the regional and sectoral plans, and in the context of its broadest economic and planning goals, advises other governmental institutions on their programs. The MIPPE prepares the public sector budget and oversees its implementation by other governmental agencies.

The National Banking Commission, formerly an agency of the Ministry of Finance and Treasury, became a MIPPE auxiliary as a result of Cabinet Decree No. 238 in 1970. The commission was established to ensure the soundness and efficiency of the banking system, so as to promote conditions conducive to stability and growth in the national economy and to foster conditions favorable to Panama's development as an international financial center. The Banking commission has the power to review and grant applications for banking licenses, and is the key institution in maintaining good cooperation between the private banking sector and the GOP.

In 1973, Law No. 9 of the National Assembly created the Ministry of Housing (MIVI) with responsibilities to establish, coordinate and carry out a national housing and urban development policy, focusing on the lower income groups as called for in Article 109 of the Constitution. The MIVI was given broad powers to direct all public institutions operating in the housing and urban development sphere, as well as orienting policy for private investment in these areas. The MIVI was empowered to determine the policies of state entities providing mortgage loans for housing acquisition.

By Law No. 10, the National Assembly created the National Mortgage Bank (BHN) with the principal purpose of financing MIVI housing programs. The BHN also functions as the regulatory agent of the Panamanian Savings & Loan (S&L) system, consisting of five associations.

An Executive Committee comprised of the Minister of Planning and Economic Policy, the General Manager of the National Bank of Panama (BNP), the Minister of Labor, and its Chairman, the Minister of Housing, controls policy at the BHN. The Minister of Housing is also the Legal Representative of the Mortgage Bank. The BHN's General manager, who is appointed by the President of the Republic, attends Executive Committee meetings in an advisory capacity and serves as Secretary, but is not a poilcy maker. This organizational framework has allowed the MIVI to exercise an excessive degree of control over the BHN.

The conceptual role of the BHN serving as the MIVI's financial arm is acceptable. However, in practice, the BHN has been denied the essential operational autonomy that any financial institution must have to be efficient. Most significantly, the BHN is denied the auditory capacity it needs to verify use of its funds by the MIVI. The result has been perennial operational deficits, and disorder in the BHN's internal acounting. Apparent stifling of BHN initiatives by the MIVI have prevented the Bank from effectively carrying out its responsibilities vis-a-vis the S&L's.

The majority of the MIVI housing projects are financed by the BHN, whose sources of funds include capital injections from the Government of Panama (GOP), loans from AID and other international organizations, loans from commercial banks, low interest loans from the Panamanian Social Security Fund (CSS), cash flows from its existing loan portfolio and various income sources, as well as mortgage backed bond issues for sale to other public sector institutions. The MIVI receives a portion of the Residential Assistance Fund (Fondo de Asistencia Habitacional), stemming mainly from a tax on beer production in Panama, for use in aiding tenants incapable of meeting rental obligations.

The five mutually owned S&Ls' contribute relatively modest resources to housing finance. As regulator of these associations, the BHN's responsibilities include:

- insuring savings accounts up to $10,000;

- insuring mortgage loans up to $16,000;

- supervising operational activities of the institutions;

- financial examinations every two years;

- meeting short terms liquidity needs as well as providing long term resources through its own access to capital markets;

Three of the associations have their main offices in Panama City, one in the city of David, and the other in Chitre. General regulatory constraints, and the BHN's own operational handicaps have been the major obstacles to the S&Ls making a larger contribution to national housing finance.

In the private sector, housing finance takes place within a rather liberal regulatory framework. For a country of its size, Panama boasts of the presence of an exceptionally large commercial banking sector, which with a good number of foreign banks, has made it one of the world's emerging financial centers in recent years. Approximately 127 banks are represented in Panama, with applications for licensing continuing, although at a lesser rate than in the past decade. About 35 percent of these banks are licensed to do international (offshore) business only, with most of the remaining banks having a "general" license allowing for a full scope of operations. A few institutions maintain "representative" offices in Panama. The phenomenal growth of this sector is reflected in the fact that its total foreign deposits by the end of 1982 were in excess of $24.0 billion, as compared with $218 million in 1970.

The commercial banks have been large investors in housing. Article No. 33 of the National Banking Law, requires that non-mortgage banking institutions invest not less than 50 percent of any local savings deposits which they receive, in residential mortgage loans, with a term of at least 10 years, or to invest in interest earning mortgages, certificates or bonds issued by the BHN. In financing, the housing of middle and upper-income clients, as well as that of their own employees, the banks have invested sums well in excess of the 50 percent of local savings deposits required.

There are three financial institutions licensed as mortgage banks in Panama. They are full service depository institutions, with the stipulation that they must maintain 75 percent of their loan portfolio in long term mortgages. They are free to make commercial and consumer loans up to 25 percent of their loan portfolio.

Three state-owned institutions, the Savings Bank (CA), the Social Security Fund (CSS), and the National Bank of Panama (BNP) have all been important sources of housing finance in recent years.

The CA is a real success story. Founded in 1934, it is a self-governed autonomous institution, with 23 branches throughout Panama. It has had only four general managers in forty-nine years. The CA has operated aggressively and profitably in solicitation of savings and funding mortgage loans. It is a full service depository institution with the limitation that its lending is confined to interim and long term mortgages. In 1975, the CA began selling mortgage-backed certificates to the public, thus establishing its own secondary mortgage market. By using its own loan portfolio, as a guarantee for those certificates, it was unable to generate new capital resources totalling $10 million since that time.

The CSS has traditionally contributed to housing finance in the form of part of its so called "thirteenth month" contribution to the BHN, and its own direct mortgage lending program as well. The "thirteenth month" contribution is a long term low interest loan that the BHN receives annually from the CSS. Private sector Panamanian employers' payments, as well as irregular GOP payments on behalf of public sector employees make up this fund. The CSS loans have been an important part of the BHN's financing of MIVI projects. A proposal currently under consideration would reallocate the BHN's portion of the "thirteenth month" contribution to a new financial institution called The Workers Bank (Banco de Obreros). This would have serious repercussions on the BHN's ability to fund MIVI projects.

The CSS had been a primary (direct) market lender on terms more advantageous than those offered by the MIVI. In 1982, the CSS stopped funding its own mortgage loans to devote all such resources to a self-conceived development of 12,000 middle-income family housing units. Failure of that project and the related financial loss, has prompted a reevaluation of the CSS's housing finance role by the GOP. No primary market lending has been resumed by the CSS, and its recent participation in the purchase of mortgages from the BHN, along with the CA and BNP, has led to some speculation that this institution's role in future housing finance may be as a secondary market source or purchaser of loans from state institutions.

The BNP performs both public and private banking functions, and also acts as a development bank. While carrying out normal commercial baning activities, it is the depository of a portion of the required reserves for the banking system and the fiduciary agent of the GOP as well. It is the country's largest bank in terms of domestic investment, and the twelfth largest in terms of total assets.

Another source of housing finance is Panama's 81 insurance companies. Mortgage financing is basically a service some of these companies provide for their higher income clients. In 1981, approximately 4.7 percent of insurance company investments was in real estate, not necessarily home mortgage loans.

In sum, the structure for housing finance is conceptually good, and the resources to meet the needs of all of Panama's income sectors are available. But as it presently functions, the housing finance system is not furnishing sufficient resources for low-middle, and low income families.

II. HOUSING PRODUCTION

Table No. 1 shows the overall production of housing in Panama in the public and private sectors from 1977-1981, plus a preliminary estimate for public sector production in 1982. Also shown is the number of units whose construction was financed by the savings and loan associations (the public sector figures include the S&L production). Statistics were not available on the number of units for which the commercial banks, mortgage banks or insurance companies financed construction. Nor were figures available for the number of units built by Housing Cooperatives as financed by the BHN.

With regard to the availability of land and qualified building contractors, there are no constraints in Panama. There is no shortage of either skilled or unskilled labor. The CAPAC (Camara Panamena de la Construccion), an organization representing construction companies, says that the supply of building materials becomes a problem during periods of unanticipated acceleration of activity. CAPAC is critical of the Government of Panama's tariff policy on imported materials in so far as the tariffs constrict the free flow of supplies adding to the problem of shortages. This also, they say, serves to increase inflationary pressures on materials' prices. In many cases, the supply of certain items is completely exhausted, causing corresponding problems of cost overuns, delays and administrative difficulties. CAPAC points out that the highly cyclical nature of the construction industry, combined with the volatility of interest rates in recent years has prompted a predominant attitude of caution among manufacturers of construction materials, especially with respect to expansion of existing capacity in their production plants.

Table No. 1

NUMBER OF HOUSING UNITS BUILT, PRIVATELY AND BY MIVI IN PANAMA

1977 - 1981

YEAR	PRIVATE		MIVI	TOTAL
1977	2,571		5,894	8,465
1978	2,887		3,531	6,418
1979	3,480		1,858	5,338
1980	2,948		1,110	4,058
1981	2,829		1,249	4,078
	14,715	P+M = 28,357	13,642	
1982			3,563 (P)	

*Sources: Direccion de Estadistica y Censo, Contraloria General, y Banco Hipotecario Nacional.

(P) Preliminary figure, subject to change

NUMBER OF UNITS WHOSE CONSTRUCTION WAS FINANCED BY THE SAVINGS & LOAN ASSOCIATIONS*

1978 -- 1982

1978	1979	1980	1981	1982	
185	177	210	182	285	
$ 2.2	$2.3	$2.6	$2.3	$4.2	:Funds disbursed annually in million of Balboas.
$11,890	$12,994	$12,380	$12,637	$14,735	:Average cost per unit

*Source: Banco Hipotecario Nacional

III. ANALYSIS OF THE CURRENT RESOURCES AVAILABLE FOR HOUSING FINANCE AND THE POTENTIAL FOR ADDITIONAL RESOURCES

According to figures released by the Panamanian Office of Statistics and Census, loans for housing, made by both private and public sector financial institutions combined averaged $178.0 million annually for the period 1977-1981. Based on a monthly average for the first nine months of 1982, the final figures for that year will be approximately $182.0 million. Table No. 2 lists these figures by sector, per year.

These figures represent only the formal housing finance taking place. Keeping in mind that according to the September, 1980 study of INDESA, 2/3 of all housing production takes place outside official channels, it is evident that a proportionate amount of financing is taking place on an informal, or non-institutional basis. Personal savings is the likely source of funding for these unofficial units, which often fail to meet minimum construction and health standards.

A. THE PUBLIC SECTOR

The greatest obstacle to the MIVI's successful construction and delivery of low income housing in greater quantities has been insufficient financial resources. Funds generated by the BHN for the MIVI projects have fluctuated

Table No. 2

LOANS FUNDED BY BANKING ENTITIES IN PANAMA FOR HOUSING, 1977 - 1981, AND JANUARY THROUGH SEPTEMBER, 1982

	1977	1978	1979	1980	1981	1982 (P) (Jan. - Sept.)
PUBLIC SECTOR	33,465,000	34,710,000	49,147,000	84,407,000	73,243,000	35,594,000
PRIVATE SECTOR	131,642,000	90,421,000	109,488,000	148,781,000	138,908,000	100,811,000
TOTAL	165,107,000	125,131,000	158,635,000	233,188,000	212,151,000	136,405,000

(P) Preliminary Figures.

greatly from year to year (See Table No. 3). The only consistent source of funds for the BHN has been the thirteenth month contribution of the CSS. This has been in the form of ten year loans at 3 percent interest, with an average contribution of $10 million annually since 1972. Loans from AID and the Inter-American Development Bank (BID) at favorable interest rates and terms of 24 to 40 years have been an important, but irregular BHN funding source. In recent years, the BHN has also engaged in borrowing from commercial banks, but on much shorter terms, and at rate levels averaging 1.75 percent over the LIBOR. Funding the MIVI projects which today result in 12 percent interest rate mortgages on individual units, with such loans from the commercial banks is not a financially viable alternative for the BHN. The short term principal amortization of such loans poses serious cash flow problems as is. The possibility that the LIBOR index could return to the levels experienced in the last several years makes the risk of this kind of borrowing prohibitive.

Table No. 3

NUMBER OF HOUSING UNITS BUILT, PRIVATELY AND BY MIVI IN PANAMA

1977 - 1981

YEAR	PRIVATE	MIVI	TOTAL
1977	2,571	5,894	8,465
1978	2,887	3,531	6,418
1979	3,480	1,858	5,338
1980	2,948	1,110	4,058
1981	2,829	1,249	4,078
1982		3,563 (P)	

(P) Preliminary figure, subject to change

With the BHN loan portfolio functioning at a net loss of revenues, the only remaining funding source for the institution is the GOP. These chronic operational deficits have necessitated large GOP contributions just to keep the BHN solvent. In 1979, the BHN received from the GOP $17.0 million, as compensation for 1978-1979 losses. The 1980 and 1981 subsidies were $4.9 million and $4.1 million, respectively. The anticipated subsidy (since they are actually received in arrears and not budgeted for in advance) is $4.6 million for 1982. Given its own current severe budget constraints, with no short term prospects for improvement, the ability of the GOP to continue these subsidies is in doubt. This fact, even more than in the past, points to the need for establishing a secondary mortgage market in order to generate the additional resources for the BHN's use. If in fact the CSS terminates "thirteenth month" contributions to the BHN, the need for a secondary market could be critical, if even the present level of public housing projects is to be maintained.

In recognition of this problem, an agreement was reached in October 1982, by the terms of which the BNP, the CA and the CSS committed to the direct purchase of mortgage loans or bonds secured by the BHN loan portfolio, in amounts totalling at least $16.0 million over a three-year period. Additional future purchases were planned for in the agreement, but actual amounts would depend on the budgetary capacity of the individual institution. This agreement represents an effective means of directing resources of the state entities concerned for the use of the BHN. It appears especially appropriate for the CSS to continue using funds that it previously budgeted for its own loan program, in the purchase of mortgage securities from the BHN.

While it is not known what effect the recent failure of the CSS's own project initiative will have on its financial condition, it is known that the CSS was able to contribute an average of $3.25 million annually from 1977-1980, via its direct lending program at 9 percent over 25 years, to participants in the national insurance system. The October 1982 agreement calls for a $6 million CSS purchase of BHN securities in 1983, and an amount to be determined at a later date with respect to a 1984 purchase. Whether a powerful financial institution such as the CSS will accept what amounts to a behind the scenes role is another question. But hopefully, in this manner, it will maintain at least its earlier investment level.

B. THE PRIVATE SECTOR

1. Commercial Banks

The key to private sector involvement in middle and low income housing lies in the medium of a secondary mortgage market. The commercial banks are encountering no difficulty complying with Article 33 of Cabinet Decree No. 238. An adjustment of the provisions of that Article could result in a requirement of direct investment in BHN securities. But such forced investment would possibly prove counter productive in terms of long range efforts to raise capital in the private markets. On a voluntary basis, only the viability and competitiveness of such an investment will make it attractive to an institution considering the various alternatives in the market. In 1980 and 1981, the commercial banks invested $136 million and 139.2 million respectively, which was far in excess of the Article 33 requirement.

2. Insurance Companies

Insurance companies have no legal obligation to invest in mortgages. They do invest in bonds, government and otherwise, stocks, and maintain cash accounts in banks. Some of them make real estate related investments, including home loans to their clients, generally in the upper income sector. In 1981, combined investment budgets of the 81 insurance companies doing business in Panama totalled $114 million. Of that, $5.4 million went into real estate investments. Because there is no official stock or commodities market in Panama, investment alternatives are limited. Presently, bond prices are quite low, (6-7 percent) and the insurance companies are maintaining high liquidity levels. They currently represent a strong potential market for mortgage securities.

3. Mortgage Securities

Overall, conversations with private sector institutions confirmed that mortgage securities would be an attractive investment. To compete well with existing investment alternatives, a mortgage-backed certificate would have to offer the following:

1. Security: In the form of guaranty from the institution issuing the certificate, or, as would be possible in the case of the BHN, a GOP guarantee; the mortgages themselves in the BHN portfilio serve as further guarantee;

2. Tax Free Yield: The interest rate or effective yield of the instrument must be attractive as compared to alternative investments; it must be tax free;

3. Institutional Confidence: Potential investors must perceive the institution issuing the certificates as being an efficient one, and capable of servicing the portfolio well;

4. Liquidity: While the mortgage instrument may have a term of five, ten or more years, investors must be assured of the liquidity of their investment, out of concern for their own operational and liquidity needs.

The last two points deserve some elaboration.

The BHN does not enjoy the kind of reputation in the Panamanian financial community that one would like to see in an institution issuing mortgage certificates. Convincing private sector institutions to invest in BHN paper may require more promotion than an add in the newspaper or a door-to-door sales pitch. Given a competitive tax-free yield and government guarantee, the initial success of the issuance of BHN mortgage certificates could be assured if the GOP intervened in the process to the extent of personally contacting potential investors to enlist their support. The GOP has done so in the past, when in the mid-1970s, a number of the foreign banking entities in Panama participated in a

$30.0 million low income housing program, largely because of direct government overtures. The current chief executive of Panama has a strong banking background. He is aware of the study and preparation of a secondary mortgage market that has taken place in this country and so, is uniquely qualified to make such an appeal to the financial community. In addition to being conceptually sound, it could be argued that such an investment is a strong economic stimulant in terms of jobs produced in the construction industry, and for the good of inadequately housed Panamanians as well.

Furthermore, the BHN could take a major step in enhancing its own reputation by issuing small denomination mortgage certificates for sale to individual investors, much in the way that the CA has done. A small denomination issue would serve to generate more capital by tapping the small saver sector of the market. Successfully carried out, the issuance of certificates at this level would demonstrate the BHN's capacity as an institution. Greater confidence in the BHN will enhance demand for the certificates. If you have the first three characteristics in a mortgage instrument, security, tax-free yield, and confidence in the agent, then liquidity should follow as a result of demand.

In other words, investor demand for the instrument will provide the liquidity needed to buy out any certificate holder who wishes to reconvert or sell prior to maturity. In a practical sense, the BHN will have to establish a sinking fund to help assure liquidity of the investment, and support its own buy-back guaranty. The certificate should also be transferrable and free from capital gain tax.

4. BHN Funding Sources

The INDESA study estimates that the BHN will need to generate at least $34.0 million annually to meet the low income family housing demand in Panama during this decade. The same study concludes that the sale of mortgage-backed certificates by the BHN could generate $238.5 million in this decade, or, $23.85 million a year. To meet the minimal $34.0 million level, BHN would need roughly an additional $10.0 million annually. Possibly, up to $3.25 million a year could come from the CSS through the sale of loans or securities. Continuation of the "thirteenth month" contributions of $10.0 million or more annually would give the BHN total resources in excess of the $34.0 million goal. In addition, it is anticipated that operational losses will have stopped at the BHN sometime in the mid 1980s, at which time that institution's own net positive cash flows would produced resources for reinvestment. When added to this, the AID funds which should average $10 million annually for the next five years, plus other loans, the BHN may obtain from international organizations, it appears quite feasible to exceed the $34 million level. The MIVI also has direct sources of funds including GOP contributions and the Residential Assistance Fund generated mostly from a tax on beer production. According to a MIVI employee, as of 1980 the Ministry was receiving nearly $1 million annually from that fund.

5. The Savings and Loan Associations

The Panamanian Savings and Loan (S&L) system was founded in 1963. Today, it consists of five associations with total assets of $56.3 million, with $37.8

million in savings accounts. These figures imply a very slow growth rate, given twenty years of operation and a financial environment in which other institutions have grown at a phenomenal rate. The simple explanation is that the Panamanian S&Ls suffer from an acute regulatory disadvantage. Because of interest rate restrictions on their ability to make loans, as well as general operational constraints, these institutions are not able to compete with the commercial and mortgage banks.

Like the mortgage banks, the S&Ls can pay 1 percent higher on savings accounts (5-1/2 vs. 4-1/2 percent) than can the commercial banks. In the early and mid 1970s, in an environment of low interest rates and low inflation, this difference was important and the S&Ls enjoyed strong deposit growth in these accounts. The basic difficulty lies in the fact that the S&Ls have a 9 percent limit on the rate they can charge on mortgages. As interest rates rose, growth in savings deposits slowed significantly. The investment alternatives the S&L's offer are able to include certificates of deposit in amounts of $14,000 or more. There is no rate limitation on such accounts and for much of the period of 1978 through 1982, the cost of obtaining such funds was close to, or greater than, the 9 percent mortgage yield they could obtain making loans. Obviously, the S&Ls could only assure themselves of losing money by trying to attract such high cost funds, with the ability to invest at only 9 percent. The S&Ls have an advantage relative to other financial institutions as the only entities able to offer certificates of deposits in amounts less than $14,000. Rates offered on these accounts range in between the 5 1/2 percent savings account rate, and the prevailing market rate for the $14,000 C.D.'s depending on the size of the certificate. It does not appear that they have exploited that advantage up to the present.

The S&Ls are subject to a maximum loan limit of $30,000 which effectively confines their lending activity to middle and lower income levels of the market. With as great a level of demand as exists at these levels, it seems appropriate to have a housing finance specialist prepared to serve this market. But because they are unable to attract the resources, this role is not being carried out by the S&Ls. In 1981 and 1982, the S&Ls made 73 and 74 mortgage loans respectively, with total principal advanced of $991,947 in 1981 and $1,153,311 in 1982. The average loan amount for both years combined was $14,593.

The rate limit on loans should be removed. The BHN should incorporate the issuance of mortgage-backed certificates based on the S&L's portfolios into its secondary marketing program. Since the BHN would be selling its own certificates through the S&Ls, this must be coordinated to prevent BHN certificates from competing with S&L certificates. The interest rate scale according to the denomination of certificates should be the same.

The S&Ls should be allowed to make small consumer loans as an additional service to their customers.

All five of the associations are mutually owned. Conversion to stock ownership should be considered as another means of raising capital.

Proper implementation of some of these changes would require some technical assistance, but they are really quite fundamental and would go a long way towards enabling the S&Ls to generate more resources. A direct comparison of the operation of these institutions with S&Ls in the United States points to a number of other changes, in the form of increased lending powers, that would make these institutions even more competitive in the financial market place, especially since they would constitute initiatives in Panama. However, additional changes can and probably should wait until the aforementioned are adopted.

Implementation of these few regulatory changes would allow the S&Ls to compete for resources and increase their lending activity significantly. If the CSS does in fact permanently withdraw from the market place as a primary lender, the S&L's would be the appropriate institution to fill that void.

6. Other Housing Finance Institutions

Important contributions in housing fiannce are also being made by Panama's three mortgage banks (Primer banco de Ahorros, Banco General and Banco Panameno de la Vivienda) as well as the state owned Savings Bank (CA). At the end of 1982, the three mortgage banking institutions had assets in excess of $220 million, and the CA more than $200 million in assets. All appear to be enjoying consistently strong growth rates.

In 1980 and 1981, the mortgage banks funded $97.2 and $72.8 million respectively in housing loans. The CA's mortgage funding level has been running at about $30 million annually for the last several years. Since 1970, the CA has succeeded in attracting approximately $10 million through the sale of mortgage backed securities; $500,000 through small denomination certificates ($100-$10,000), and $9.5 million large denominations.

With 600,000 savers in a country of less than 2 million people, the CA is highly regarded among Panamanian savers. More aggressive management of the S&Ls is likely to result in stronger competition with the CA. The presence of two S&Ls in secondary cities and the corresponding name identification could give them a competitive advantage outside the Panama City metropolitan area.

IV. BHN: FAILURE TO DEVELOP A SECONDARY MORTGAGE MARKET

Accelerating the generation of financial resources by means of a secondary mortgage market, has been contemplated in Panama for a number of years. Since 1977, four studies have thoroughly evaluated the need, the feasibility, and the mechanics of establishing such a market. There has been little doubt of the need for a market, general agreement that it can be accomplished, and substantial concurrence in the studies as to how it should be implemented.

BHN personnel have participated in training seminars in secondary mortgage market operations. Visits to other Latin American countries were made to study existing secondary market activities. AID consultants provided direct assistance to the BHN to the extent that in 1979, prospective investors in mortgage certificates to be issued by the BHN were contacted. The evaluations done by Marlo Schram in 1979 and by INDESA in 1980, judged the BHN to be sufficiently prepared to embark on the marketing of mortgage-backed certificates. Nevertheless, the marketing attempt has yet to be made. While the BHN has been idle in this respect, since 1975 the CA has issued certificates in much the same manner as has been recommended for the BHN, and has succeeded in attracting $10 million in investment. The CA has not aggressively pursued the program, thus, the $10 million figure is less significant than the fact that the sale of mortgage certificates has been accomplished.

Conversations with the BHN personnel as well as other members of the Panamanian financial community have provided several explanations for the failure to initiate the market.

A. UNFAVORABLE MARKET CONDITIONS

The most serious obstacles to the successful issuance of mortgage backed securities by the BHN in the past several years, has been the high level and volatility of interest rates. As of December 31, 1982 the BHN had an average yield of 9.48 percent on an income producing mortgage portfolio of $132 million. The BHN estimates that it has about $10-12 million of 12 percent mortgages, which the MIVI did not begin originating until 1982. The remainder of the portfolio is at rates of 9 percent or less. Likewise, the S&L's portfolios have few loans over 9 percent.

The interest rate paid on a mortgage certificate must be somewhat less than the rate on the mortgage or group of mortgages backing the certificate. The interest rate spread gives the institution issuing the certificates the margin it needs to cover operational expenses and make some measure of profit. Likely competition for certificates issued by the BHN would be GOP bonds and certificates of deposit (C.Ds). Both GOP bonds and C.D.'s are tax-free.

From 1979 through much of 1982, the market rates on bonds and C.D.s were running at levels close to, or in excess of, the best rates in the BHN loan portfolio. Thus, during that period of time, the cost of obtaining funds via the secondary market would exceed, or at best be, marginally less than the yield the BHN had on its loans, or at which it could reinvest to support the debt service on the security issued.

The present interest rate ceiling of 12 percent, and rate limits that have existed in the past on MIVI loan originations are important in enabling low income families to qualify for financing. At the same time, it is a restricting factor on the BHN's ability to pay market rates on the securities it wishes to sell. The 9 percent limit on S&L loans is even that much more restrictive of the prospect for issuing securities based on their portfolios.

With bond and C.D. rates having averaged well over the double digit level from 1979 through 1982, this explanation is largely acceptable. Presently though, GOP bond rates are approximately 6-7 percent, and C.D. rates are 8-8.5 percent. The future cash flow from the 12 percent loans in the BHN portfolio, plus the prospect of reinvestment in MIVI project loans at 12 percent, would allow for a comfortable margin of net positive cash flow on the marketing of securities at today's rates.

The Schram, Brady and INDESA studies have thoroughly analyzed the mechanics of making such a market work. The general conclusion is that it is both legally and practically feasible. There was no major point of disagreement in those studies, except on the subject of how and where to market the certificates.

The small denomination certificate should be marketed through the offices of the S&Ls. This has its advantages since the established presence of their offices provide good exposure to the public, and facilitate BHN's ability to oversee the program by means of its existing relationship with these institutions. BHN could use its own personnel to carry out the sales, or train S&L employees to do so. Large denomination certificates would be sold directly by BHN personnel assigned to that task from their main office. The program could include the sale of certificates backed by the S&L's portfolios as well.

The BHN says it has been handicapped in its ability to put the secondary market in place by a lack of "control over the loan portfolio." The complaint is that the MIVI, as servicing agent of the monthly payments, does not provide specific data on the make up of the loan portfolio. When monthly remittance of principal and interest takes place, it should be accompanied by a report showing the borrowers name and/or loan number, the amount of principal and the amount of interest being remitted, the interest rate on the loan, and the outstanding loan balance. If payment was not made, it should be so indicated. If the payment received is for a month other than the current one, than the month to which it is applicable should be indicated. The BHN needs this kind of fundamental information for proper internal operations, as well as to prepare and maintain secondary marketing activities.

According to BHN personnel, the MIVI is capable of conveying this kind of data on a regular basis. MIVI apparently has this information in its computer system. The fact that MIVI does not pass it on to BHN, despite repeated requests to do so, is a reflection of some continuing difficulties in their relationship. The Minister of Housing, as Chairman of the Executive Committee of the BHN, retains administrative powers that, because they are not delegated, handicap the efficiency of that institution, and in this case, specifically obstruct execution of a secondary mortgage market plan.

The Minister of Housing retains the right to review any documents related to secondary market transactions. Anytime the BHN would want to market additional securities, it must be approved by the Executive Committee. These are managerial functions. They should be delegated to the BHN management.

In discussing the prospects for establishing a secondary mortgage market with potential investors such as the commercial banks and insurance companies, the fact that Panama has no formal stock or commodity investment market was pointed out. Apparently, the idea of creating such a market has been considered now for some time too. The implication seemed to be that the secondary mortgage market had not come to be because it had not caught the attention of the proper authorities who might give it further momentum. If launched within the context of a broader investment market, including stock and other negotiable instruments, it was suggested that the secondary mortgage market might catch on. If in fact the successful launching of a secondary market needs a push, the needed impetus could come as a result of a direct appeal to the GOP President for his support. The BHN's general manager is said to be good friends with the President who has a background in mortgage banking, and specific knowledge of this subject. Resorting to political channels to solve this difficulty may be the best approach since the failure to start a secondary mortgage market after all this time is at least in part due to the political overtones affecting the overall BHN-MIVI relationship. (Seefollowing section on BHN relationship to MIVI).

With regard to the subject of creating a general investment market, it should be pointed out that the sale of negotiable savings certificates is being considered as a means of stimulting the development of an investment market in Panama. A representative of a U.S. bank doing business in Panama stated that they were actively trying to sell a portion of their own mortgage portfolio. Along those lines, the Panamanian National Banking Commission is considering measures designed to increase local trading among private banks, and in so doing, augment the utility of the banking sector.

The interest rate climate is conducive to the issuance of a mortgage backed security by the BHN at this time. With a little better cooperation from the Ministry of Housing, it can be successfully accomplished.

V. OVERALL IMPROVEMENTS IN THE BHN's OPERATING EFFECTIVENESS

The BHN's state of fiscal health can be described as improving, and progress in operational effectiveness in the past few years has been made. The Mortgage Bank has sufficiently competent employees to run the institution well. Effective dominance of the BHN by the MIVI and the lack of cooperation between the two, has frustrated the bank's employees.

In the past several years, the BHN has undergone managerial restructuring and created an office of financial control.

No clear benefit appears to have been derived from the managerial shifts since the practical result was simply the reassignment of personnel. At the same time, the BHN has suffered from a high level of turnover which may have negatively affected the desired result of the managerial changes. The turnover problem is due at least in part to a wage scale that is uncompetitive with that of private sector institutions who have lured away some of the more qualified employees.

The BHN has over 150 employees. For an institution with assets at 12-31-82 of $297 million, that does not have to service its own mortgage portfolio, to have half that number of employees would imply operational inefficiency.

The financial control initiative does not appear to have improved BHN control of funds disbursed to the MIVI. In fact, this continues to be a point over which the bank's employees voice their strongest concern. A "Disbursement Agreement" between the two institutions has been agreed to, and should be implemented soon. It is expected to give the BHN improved auditory controls over funds disbursed to the MIVI for construction projects, including accounting procedures prior to conversion of the interim loan to long term mortgages.

VI. BHN/MIVI RELATIONSHIP: BHN's ABILITY TO CONTROL ITS OWN DESTINY AND MANAGE THE HG FUNDING FOR GOP

What can only be seen as a fundamental flaw in the BHN's legal basis has led to its domination by the Ministry of Housing to an extent that has proved counter-productive for both institutions.

The legally stated priority for the BHN is to provide financing for national housing programs, whose execution is the MIVI's legal task. With the goal of expanding its housing programs, it would appear to be in the MIVI's interest not only to have allowed, but to have fostered the development of a secondary mortgage market. The housing law gives the MIVI responsibility for attracting private sector investment for use in these programs. However, a lack of cooperation between the MIVI and the BHN has hindered efforts to establish such a market.

The S&L system has long shown potential to be an important source of housing finance for the lower middle class. The need to change some of the regulations stifling these institutions are clearly recognized by the BHN. Independently, the Mortgage Bank has lacked the means to accomplish these legal changes, and the MIVI has not assisted the BHN in this area. The MIVI may regard the S&Ls as a threat to their relative monopoly of BHN resources.

A more independent BHN will not only better assist the S&Ls, but the MIVI as well. Successful creation of a secondary mortgage market will generate additional resources for MIVI projects. An efficiently functioning, financially solvent BHN will no longer require GOP capital injections; capital that might otherwise be budgeted for public housing projects.

Chairmanship of the Executive Committee should be rotated annually, with each Committee member serving in that capacity by turn. In addition, a new committee member should be added to allow for a representative of the S&L associations. The BHN's general manager should be made its legal representative, as is the case at the CA.

VII. AN ASSESSMENT OF THE BHN's ROLE IN SUPERVISING, MONITORING AND ORIENTING THE S&Ls

As the supervisory agency for Panama's five savings and loan associations (S&Ls), the BHN has the following responsibilities:

- insuring savings accounts up to $10,000;

- providing mortgage loan guarantees up to $16,000;

- supervising and regulating operational activities and providing managerial assistance;

- making financial examinations every two years;

- meeting short term liquidity needs of the S&Ls as well as serving as a source of long term lending through its own access to the capital markets.

The $10,000 limit on account insurance has its origins in the 1963 Law No. 50 creating the S&L system and the IFHA (Institute for the Development of Insured Mortgages). The amount should be increased to at least $25,000, as it fails to cover many of the larger savers in today's market. This would also be a means of increasing premium income to the BHN which receives a 1/2 of one percent fee on all insured accounts.

The S&Ls are now authorized to lend up to $30,000. The loan guaranty should also be increased to cover this amount. This too would increase fee income for the BHN which receives a 1/4 of one percent fee on all insured mortgages.

The BHN receives monthly reports from the S&Ls including fairly complete data on their activities. The BHN evaluates this information and takes action if and when necessary. For example, a financial crisis at one of the associations has resulted in an operational take over by the BHN, hopefully as an interim action until the condition of the S&L improves. However, as regulator of the S&Ls, the BHN should be offering technical and managerial assistance. While part of the problem stems from the lack of staff or budget allocated to this function, the real difficulty lies in the BHN's failure to accomplish the needed legal changes for the system.

Broader powers needed by the S&Ls to permit them to compete in lending and attracting savings, can only come from legal changes which must be initiated by the BHN. Here again, the BHN/MIVI relationship seems to be the problem. The BHN must go to the Minister of Housing, its legal representative, with its proposals for legal change, with which they have had little success to date. Under the circumstances, the BHN is not inclined to fulfill its regulatory role too actively, as it would only serve to highlight the need for changes which the BHN thus for has been unable to effect.

Because of the BHN's shortcomings in this area, it has been suggested that another institution take over this role. If the BHN fails to get the kind of independence it needs to help the S&Ls' in the next two years, then this would be a good idea. But right now, to strip the BHN of this responsibility at a time when it is trying hard to solve its problems and beginning to show progress would be a serious blow to its moral.

In order to give the S&Ls greater consideration in BHN policy making, the composition of the Executive Committee should be expanded to include one representative selected by the associations. The position could be rotated, with each S&L providing its own nominee for one year terms each.

The BHN has not come close to meeting the needs of the S&Ls in the provision of short or long term funds. The domination of use of BHN resources by the MIVI being the reason. As of 12-31-82, the BHN had only 7 percent of its assets invested in the S&Ls, and 84 percent in MIVI programs. Implementation of a secondary mortgage market should make use of the S&L's portfolios as well in order to generate resources for their own use. But unless the 9 percent loan rate restriction is lifted, the S&Ls will almost certainly have no prospect of profitable reinvestment of any capital raised through the sale of mortgage backed certificates.

The BHN must be given the ability to effect needed changes on behalf of the S&Ls. If there is no real prospect of this, then a new regulator with such abilities should be selected. Without the needed legal changes, the S&Ls will remain relatively inactive.

VIII. LEGISLATIVE CONSTRAINTS TO INCREASED PRIVATE SECTOR INVOLVEMENT IN HOUSING PRODUCTION

In Panama's private sector, excepting the affects of the rent control system, the underutilized capacity in housing production can be attributed more to market factors, than any legislative constraints.

High interest rates have discouraged developers and builders in the past few years, especially in the middle and low middle income market. Aside from the price of construction funds, some contractors have experienced difficulty in obtaining short term project financing for reasons that may be in part legislative. One construction firm, which builds generally for the middle income market, has been purchasing commitments for long term financing from one of the mortgage banks. That same bank, however, has been unwilling to do construction lending. A representative of another mortgage bank confirmed that since by law, not more than 25 percent of their lending can be short term (less than 5 years), they preferred to make a greater number of small loans, rather than just a few big project loans, thus spreading risk more widely.

Developers and lenders involved in housing in the United States, generally find that the optimal method of project financing involves only one institution doing both the interim and long term lending. This approach is usually more efficient for both borrower and lender.

It is more profitable for the lender to do both phases, rather than just one, and less costly for the borrower to negotiate and pay fees to one institution, rather than two. In Panama, the loan portfolio restrictions of the mortgage banks effectlively discourage construction lending on projects. While the commercial banks do not have this restriction, they for the most part, are not interested in expanding their long term lending beyond the level necessary to meet the needs of their upper income clients and their own employees. The CA appears to be the only institution doing the financing for both aspects of housing projects. The S&Ls will be more able to function in this manner if and when they are freed from the interest rate restrictions that prevent them from competing with other institutions in the depository market. (The S&Ls do operate within the private sector and do suffer from legislative constraints; see the Financial Resources and the BHN/S&L sections for a discussion of this problem). In the meantime, the mortgage banks are serving a portion of the demand for permanent financing well. It is not advisable that the percentages regulating their loan portfolio investment be adjusted.

IX. RENTAL HOUSING

Law No. 93 of October 4, 1973 froze all residential property rents up to $250/month and all commercial property rents up to $500/month. While the law has permitted increases above those levels in certain cases, for the most part it has proven overly restrictive, and greatly discouraged investment in rental housing.

With such strict laws in effect, potential housing investors are discouraged by the prospect of an investment which, even if initially profitable, will continue to decline in real return due to inflation.

The investors have had no incentive to improve or even maintain the property and the law requiring them to do so is not respected.

The law No. 93 allows landlords to petition the MIVI for an increase in the rent level which could go above the legal limit, if the owner could demonstrate that his annual return on the housing investment (this apparently means the initial cost) is less than 15 percent. In theory, the prospect of a 15 percent return on investment would attract tremendous investment in rental housing. In practice, the petition process has proven very tedious. Investors have turned to alternative investments, or when they have invested in housing, simply ignored the rent control laws. A representative of the MIVI's rental housing administration estimated that 35-45 percent of existing leases, and the corresponding rental deposits, have not been registered with the Ministry. Such a figure prompts serious doubt of the MIVI's ability to administer and enforce the rental laws.

A. PROPOSALS FOR CHANGE

A number of significant changes in the rent control laws have been proposed and could go a long way toward remedying the situation. The first part of the proposal was actually made law by Executive Decree No.5 on February 25, 1983. It exempts any buildings constructed for rental purposes after that date from the application of the law No. 93 and its modifications, with the exception of some of the fundamental and less restrictive articles of that law. In effect, any building constructed after that date can be rented at any price agreed to by landlord and tenant. It is doubtful that this liberalization of the law will result in an immediate rush to construct rental housing. It may take some time before the level of private sector confidence in the government's long term policies will be sufficient to result in a high level of rental housing investment.

Other proposals under consideration which could result in important changes in the rental laws include:

1. exemption from taxes, of all interest income received by any institution or individual, on loans resulting in the construction of rental housing which in the judgement of the MIVI, is of social interest;

2. exemption from taxes of the interest income on any loans resulting in rental properties priced at less than \$250/month residential, or, \$500/month commercial;

3. exemption from the 2 percent real estate proprety transfer tax of any building incorporated into the Regimen de Propiedad Horizontal (system for management of apartment buildings - or divided and leased portions of residences - RPH), when the subject proprety is converted from rental status to condominium or individual ownership, and sold to the existing tenant;

4. With respect to No. 3, the MIVI will be responsible for determining the remaining useful life and approving the sales prices of any properties converted for individual ownership under the RPH auspices; the goal here is to broaden ownership possibilities for the low income and lower middle income families. If approved, this proposal could accomplish that objective. The MIVI anticipates that many landlords would pursue this option as a unique opportunity to sell their property and circumvent the old rental laws;

5. The assumption by the BHN of the duties of administering the governments' real estate property assets and real estate mortgages; while the MIVI would continue to service the mortgage payments on the public housing projects, the BHN would be responsible for any real estate owned by the government, or other collateral received as partial or full payment of mortgage obligations;

6. Exemption from real estate proprety taxes for up to twenty years of any construction resulting in the lease of residential property for \$250/month or

less, or up to $500/month for commercial property; a MIVI representative expressed doubt that this particular proposal would motivate any rental construction since building costs are too high to make a profitable return feasible, and income tax exemptions alone will not stimulate investment if there is no prospect of real return.

Included in the new rent law proposals was a discussion of motives for change. The discussion observed that under the existing law there has been insufficient incentive to build housing of social interest. It stated that a reanalysis of the laws was needed with special consideration to be given to landlord-tenant relationships as a whole, and to modifying them in an integral manner. The goal is to stimulate the sale of existing housing as well as the consruction of new housing.

X. INTEREST RATES, POLICIES AND MARKET EFFECTS

A. PRIVATE SECTOR

Financial institutions in the private sector are not restricted in the interest rates that they can charge. Housing finance rates, both short and long term, are determined by the general market factors relating to the supply and demand for funds.

Construction loans in Panama during the past several years have been priced at rates varying from 1 to 2 percent over the LIBOR (London Inter-Bank Offered Rate), plus loan fees of 1-1/2 - 2 percent. Long term mortgage loan rates have fluctuated from 10 - 18 percent in the last four years. Currently in the Panama financial market place, mortgage rates vary from 11 to 14 percent. Loan fees are about 3 percent of the loan amount.

Thus, in the private sector, interest rate policy is quite liberal and the open market concept regulates the price and availability of funds.

1. Savings and Loans

While the S&Ls are really operating in the private sector, they are regulated by the BHN and dependent on this public sector institution for their own interest rate policies. The maximum that these institutions can charge on mortgage loans is 9 percent. Since the cost of attracting term deposit funds has generally been close to or even greater than this level in recent years, the S&Ls are unable to attract deposits. They must depend on whatever savings account deposits trickle in to fund these 9 percent loans. As a result, the S&Ls have grown much more slowly than other financial institutions in Panama, and their contribution to housing finance is insignificant.

2. Public Sector

Low income housing projects are carried out by the MIVI, resulting in individual mortgages at 12 percent. Mortgage loans on projects completed prior to 1982 were funded at rates of 9 percent or less. Many of these projects have been funded by the BHN which eventually holds the mortgages. In its efforts to sell mortgage certificates in a secondary market, the rates that BHN could afford to pay to investors relate directly to the yields it enjoys on mortgages in its portfolio. In this respect, rate limits on MIVI loans influence the BHN's ability to attract further resources. At the same time, it is important that the MIVI provide financing at a rate which will not cause low income families greater difficulty in qualifying for home loans. Hopefully, the 12 percent mortgage rate, relative to the investment market, will be sufficient to give the BHN the margin it needs in selling certificates.

XI. OTHER CONSTRAINTS ON HOUSING FINANCE

In the housing sector, no major constraints are posed by such factors as land availability, building contractors, or the supply of materials. Financial institutions regard the mortgage instrument and the concurrent lien on a residence as an excellent means of securing a loan. Homeownership is socially important in Panama and mortgage borrowers on the whole are very responsible in servicing their debt. The system of foreclosure in Panama is sufficiently expeditious, so as not to be a constraint on mortgage lending.

As a means of providing further protection to the lenders, the existing system of mortgage insurance, as established under the auspices of the IFHA in 1963, could be greatly expanded. Through the BHN, this mortgage insurance program is available to any state institution offering mortgage credit as well as any private financial institution which applies for such coverage, up to $16,000. The premium presently charged for this coverage is 1/4 of one percent, which is passed on to the borrower. In the past, the BHN has failed to maintain a separate fund for potential claims. As a result, not many institutions have taken advantage of the availability of this coverage. Those who have such insurance, lack confidence in the BHN's ability and willingness to pay quickly in the event of a claim.

The $16,000 limit should be removed. The BHN should be made to account for the premium income proprely and maintain a separate account for the insurance program. A representative of a mortgage insurance company in the United States could assist the BHN in the expansion of this program. Varying degrees of coverage could be set up with a corresponding scale of premiums, allowing financial institutions to select the level of mortgage insurance that they deem necessary, according to the risk involved.

Evidence of demand for mortgage insurance among Panamanian financial institutions can be found in the fact that one prominent insurance company has been facilitating their own clients efforts to obtain mortgage financing, by offering mortgage insurance to the lenders. They expressed strong interest in expanding their own mortgage insurance program and have consulted with a U.S. firm in this area.

Several financial institutions have suffered periodic net savings outflows causing concern in the banking sector. From a depository standpoint, expansion of the existing program of depository insurance would be reassuring to savers, and lend greater stability to the Panamanian banking community. At present, the BHN insures deposits at the five S&Ls up to $10,000, for which it receives a 1/2 of one percent fee from the depository institution. The $10,000 figure has its origins in the 1963 law creating the IFHA.

Coverage should be increased to at least $25,000 to offer security to larger savers. The program should be made available to all Panamanian depository institutions, via the BHN. Along with the mortgage insurance premiums, this could become a significant source of income for the BHN.

Here again, a separate account must be maintained by the BHN as a reserve for potential claims. Taking advantage of its contract with the FHLB, AID could request that an employee of the FSLIC (Federal Savings and Loan Insurance Corporation) provide the BHN with the technical assistance necessary to accomplish this.

XII. MACRO-ECONOMIC SECTION

The pattern of Panama's economic development has long been tied to its strategic location and the presence of the Canal. In the last twenty years, rapid growth has resulted from development of modern commercial and transportation facilities, and the emergence of this country as an international finance center. The other side to Panama's economy includes some commercial fishing and agricultural production. Tropical forests resources and copper deposits hold potential for exploitation, but this may not be financially feasible for a number of years.

After three years of relatively high growth, economic activity slowed in 1981, and in 1982 a modest 1 percent increase in real terms was registered. The worldwide recession has been severely felt in neighboring Latin American countries, decreasing demand for Panamanian export items. The construction boom that the country experienced since 1978 finally slowed as the market for luxury apartment housing and commercial office space became virtually saturated. With export earnings holding little prospect for improvement, the outlook is for zero or little growth in GDP. Estimates of 1982 inflation vary from 4 to 5 percent. High unemployment (national estimates are between 13 and 17 percent), and low agricultural productivity continue to be a serious problem. Expansion in the banking sector continues both in terms of the number of licensed institutions and assets, but here too, the pace may decline based on worldwide and regional economic activity.

Panama's monetary sector is unique in that the U.S. dollar serves as currency. Thus, the Government of Panama (GOP) has no control over money supply, and, in fact, no central bank exists in this country largely for that reason. This also results in a lack of control over inflation and unemployment, since a central bank's traditional role in expanding or tightening credit is not a factor here. For Panama then, fiscal policy and balance of payments take on greater significance.

The growth of the banking sector has largely facilitated a rapid growth in domestic credit, from about 40 percent of Gross Domestic Product (GDP) in 1970 to about 80 percent now. The growth of credit has allowed a shift from subsistence agriculture and small scale manufacturing to modern types of agriculture and manufacturing requiring greater capital.

Government expenditures have risen sharply. Public sector debt as of December 31, 1982 was 93 percent of the GDP and external debt was 70 percent of GDP. Reduced trade and tax revenues resulting from the economic slowdown resulted in a GOP budget deficit equal to 8 percent of GDP, which was 2 percent higher than the figure agreed to in the stand by agreement with the IMF for 1982. Particularly vexing for the GOP have been declined revenues in the state controlled sugar export sector, greater than anticipated subsidies of rice exports and the electric company, and losses from the failure of the National Social Security Fund's housing project initiative.

The Balance of Payments current account figure has fallen from a 1980 $5.0 million surplus to a $627,000 deficit as of 1981, with 1982 figures expected to show further decline. Exports of shrimp, clothing, meat and leather products increased in 1982, but were more than offset by declines in export of sugar, bananas, coffee and fishmeal. Lack of diversity in export products is a major problem. In addition, while a number of Panama's regional trading partners have implemented currency devaluations in part to support their own exports, Panama's dollar priced goods have become relatively more expensive.

In 1982, the Canal had its second highest year in revenues due to heavy shipment of Alaskan oil and transportation of grain to India and China. The completion of a new oil pipeline will cut Canal volume, but GOP revenue should not suffer since income from the pipeline itself will offset by shipping losses.

Renewed growth for Panama still depends on exploitation of the comparative advantage of logistics, the Canal itself, and the service and financial industries. Development of the agricultural sector is hampered by inefficient farm technologies, poor marketing systems and low quality soils. Growth in manufacturing will be slow because of the difficulties in the export markets, and lack of a domestic one. Worldwide demand for export crops, bananas, sugar and coffee, is expected to be sluggish, throughout this decade.

Short term growth prospects for Panama's economy depend on the duration of the worldwide recession, and more directly, on U.S. economic recovery. Canal traffic and re-export from the Colon Free-zone will show little increase in 1983. The GOP will have to implement major cuts in public sector expenditures. Concern over international debt to several Latin American countries will result in slow growth of credit available to Panama.

The longer term outlook depends on the timing and extent of recovery from the current recession. Proper handling of its fiscal and debt service problems by the GOP will be key factors in determining the level of investment confidence of foreign banks relative to Panama, and the continued expansion of credit this country will need to finance further development.