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# **SUMMARY OF FINANCIAL MARKETS IN PANAMA: SECONDARY SOURCE SURVEY**

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## **NOTE**

**This document was prepared by Arthur Young and summarizes existing literature describing the country. Secondary sources were obtained from the International Monetary Fund, the World Bank, the Inter-American Development Bank, the African Development Bank, the Asian Development Bank, the United Nations, and other relevant commercial sources.**

## PANAMA

### SUMMARY OF FINANCIAL MARKETS

#### A. ENVIRONMENT

##### 1. Stable political climate

Prior to 1978, Panama was under military rule. In 1978, the government announced a process of gradual liberalization which resulted in the democratic election in 1984 of Nicoles Ardito Barletta, the military backed candidate.

On September 28, 1985, President Barletta resigned under fierce criticism from both the head of Panama's armed forces, General Antonio Noriega, and all the opposition parties. The new President is Eris Arturo Del Valle, leader of the Republican Party. Del Valle's coalition government faces difficult times. The President must try to implement the austerity plan negotiated with the IMF so as to preserve its Stand-By Agreement and secure future commercial bank credit. However, General Noriega has taken a populist stance against the IMF austerity program. The public has already expressed strong opposition to reducing public spending, liberalizing trade rules and increasing taxes.

##### 2. Unstable economic climate

GOP estimates that the real GDF did not increase in 1985. No growth is expected for 1986 as well. Panama's service oriented economy has been sluggish to recover from the recession of the early 1980s. However, the banking industry is staging a recovery registering an increase in deposits after two years of decreasing funds.

GOP has negotiated a structural adjustment loan with the World Bank in exchange for further austerity measures. The government has agreed to the gradual elimination of price controls for many foodstuffs, reduction of subsidies for rice, privatization of various parastatals, review of government contracts, and revision of legislation providing incentives for local industry.

3. Stable social climate

The majority of Panamanians (72%) are mestizo, individuals of mixed Indian-Spanish heritage. Approximately 10% of the population is white, 6% is Indian and 12% is black. The population is mostly Catholic (>90%). Spanish is the official language and is the mother tongue of 85% of the population.

4. International assistance

- a) Multilateral Donors: IMF  
World Bank  
Inter-American Development Bank
- b) Bilateral Donors: United States  
German Federal Republic  
Venezuela  
Mexico
- IMF Stand-By Agreement: Effective period is 7/15/85 through 3/31/87.

## B. ECONOMY

1. Inflation has not been a problem in Panama. The inflation rate (CPI rate) for 1985 was below 2%. GOP expects inflation to stay under control.

### 2. Balance of payments

Because GOP cannot control the money supply (see Section D), the size of the public sector deficit has been determined by the availability of foreign financing. Panama's access to foreign credit was such that by 1984 the outstanding and disbursed public debt equalled 73.5% of the GDP. Nearly three-quarters of that debt was commercial debt (i.e., bank loans, bonds and supplier credits.)

Interest payments in 1983 equalled:

- 24% of total public sector revenues
- 8% of GDP
- 35% of gross domestic savings.

The current drop in world oil prices will help reduce interest payments and improve Panama's current account balance.

### 3. The public sector role

Panama's major economic sectors are the services sectors, especially financial services. Panama's financial system, which has developed with minimal government interference, is considered a major international center. In contrast, the government has been a central player in the development of industry, agriculture and commerce. The outcome has been less than satisfactory; there has been high inefficiency and low productivity in all these sectors.

Panama's economy has been stagnating since 1982. Real GDP per capita has declined since 1980. The public sector remains under severe financial constraints and cannot be counted on to stimulate the economy. The public sector deficit runs at 5 to 6% of GDP.

GDP: Public Sector vs. Private Sector

	<u>1963</u>	<u>1982</u>
Public	11%	25%
Private	89.9%	75%

(Note: descriptions of non-financial parastatals are included in the Appendix).

4. The private sector

Most economic sub-sectors, such as manufacturing and commerce function as oligopolies for the domestic markets. There is a high degree of ownership concentration (i.e., family groups). The present investment policy (see Section C) supports the oligopoly system.

5. Service sector contribution to GDP (1983)

	<u>%</u>
GDP	100.0
Transport, storage & communications	16.0
Financial Services	9.9
Commerce	12.2
Panama Canal	9.1
Other Services	23.8

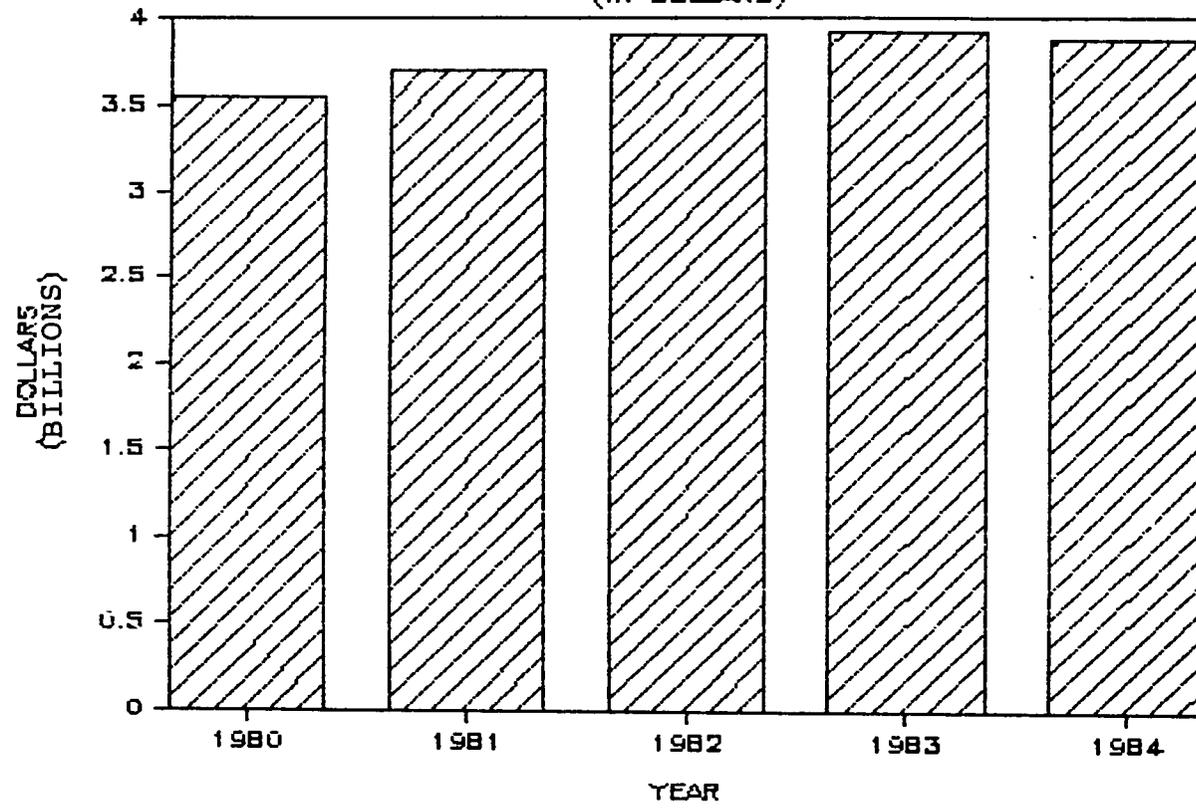
6. Labor Force Analysis

Population growth rate	
Literacy rate	84%
Unemployment Rate	9.5% (1984)
Employment Distribution	<u>%</u>
Public sector	24.3
Canal area	2.8
Private companies	38.5
Cooperatives and self-employed	34.4

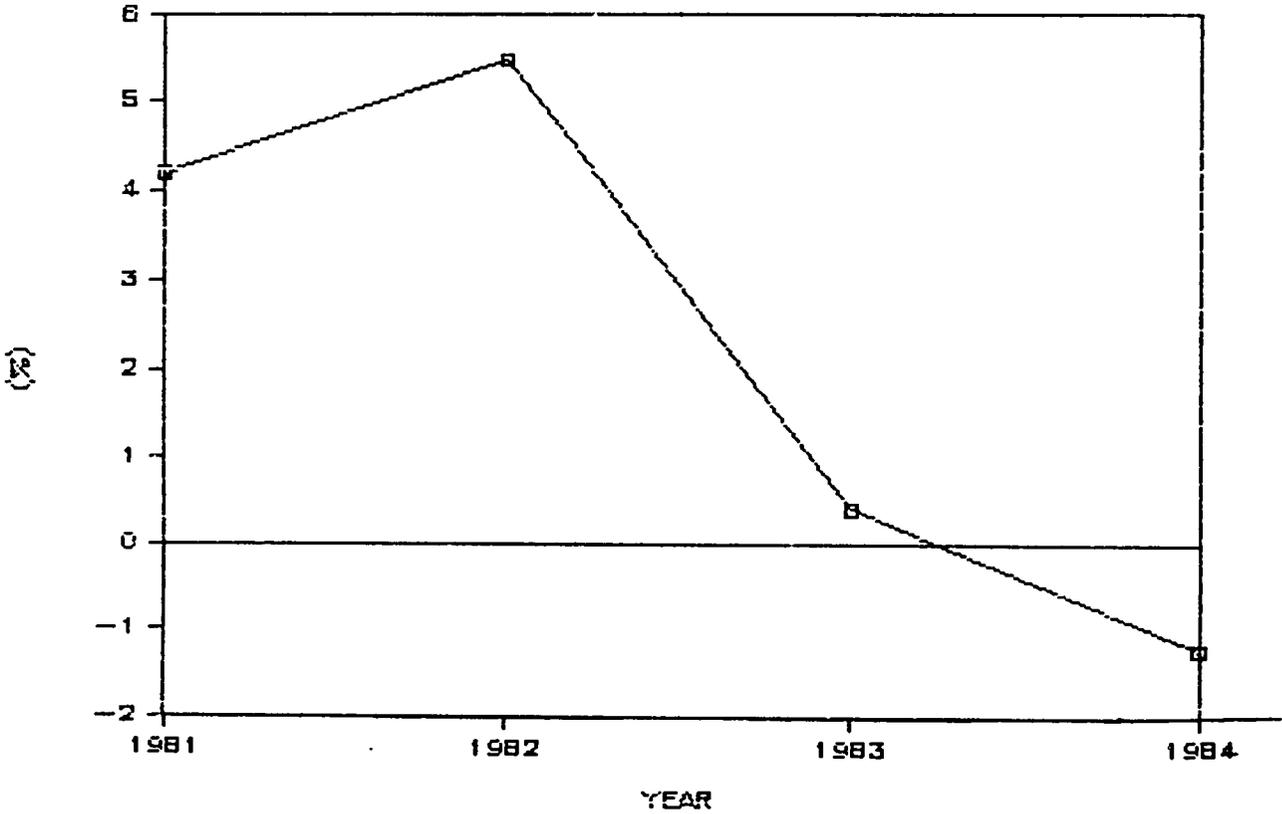
Financial Services and Real Estate employed 24.4% of the labor force.

# GROSS DOMESTIC PRODUCT

(IN DOLLARS)

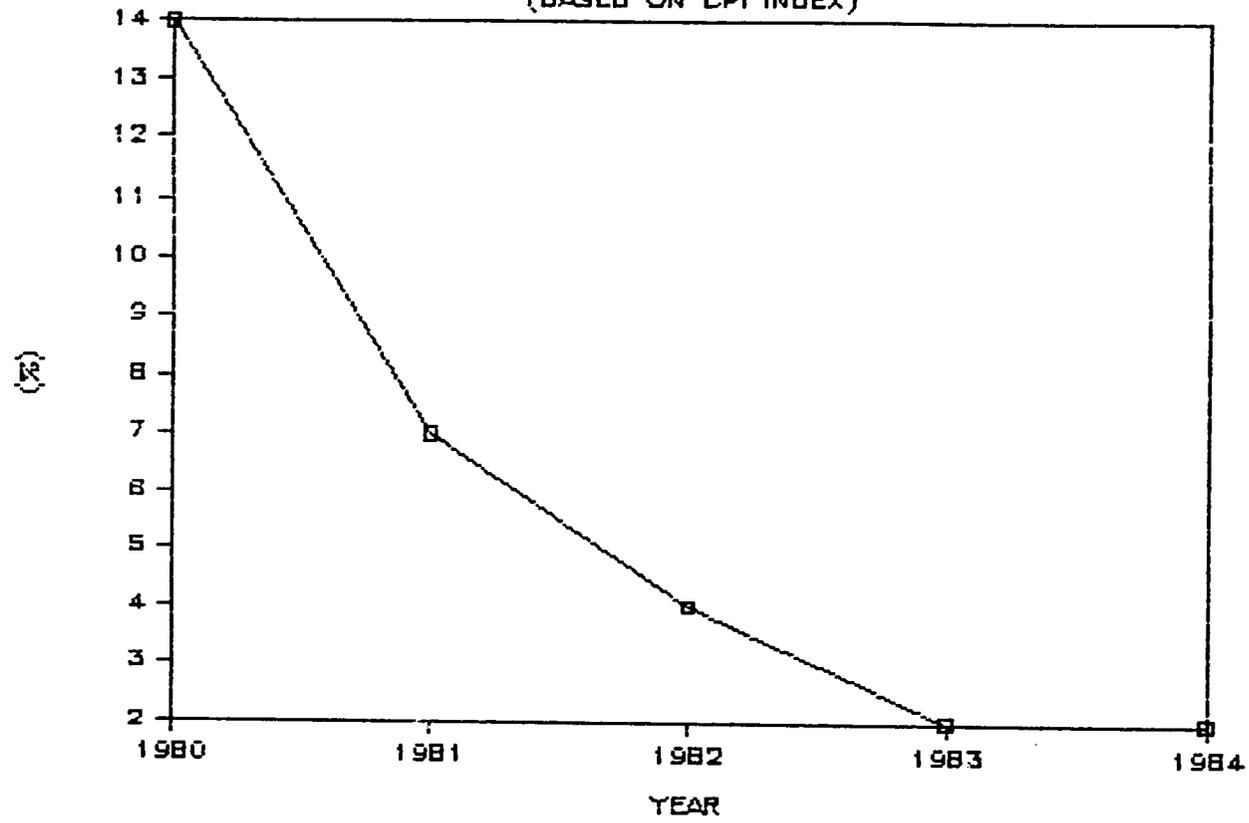


# GROWTH RATE OF GROSS DOMESTIC PRODUCT



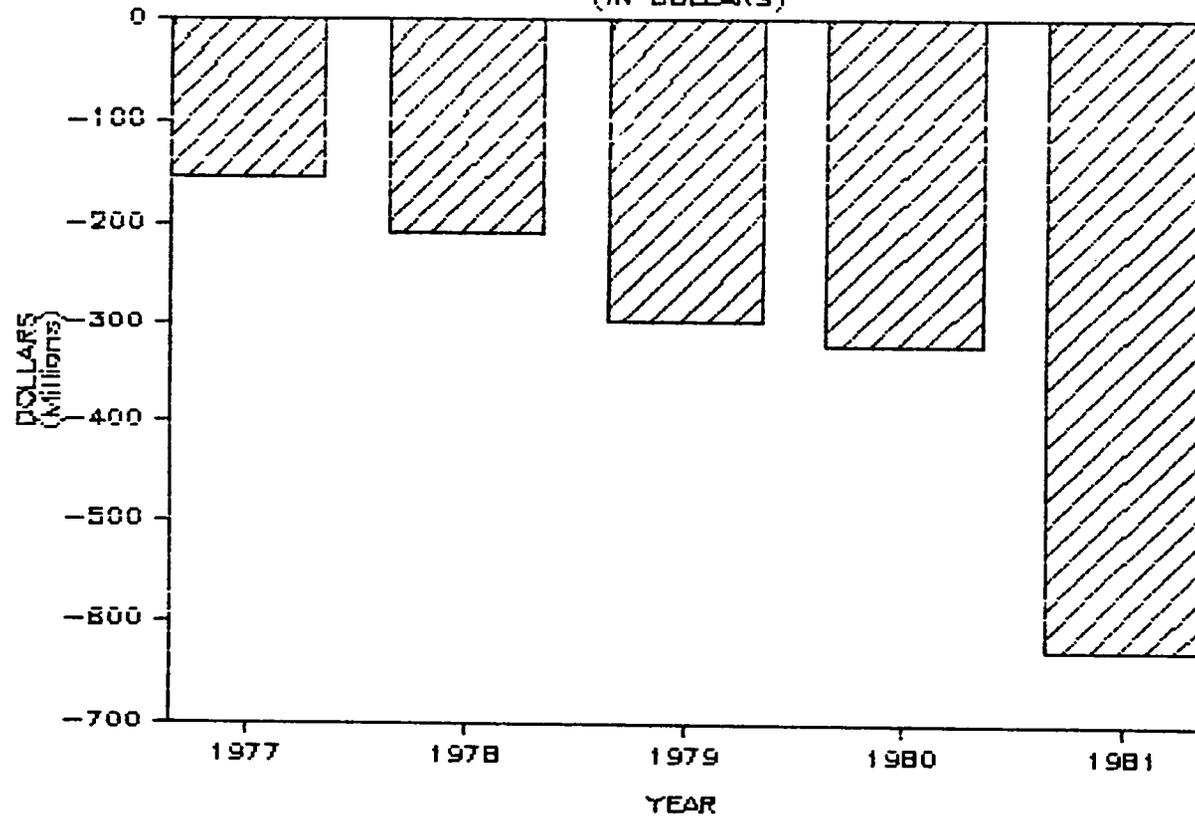
# PANAMA'S INFLATION RATE

(BASED ON CPI INDEX)



# CURRENT ACCOUNT BALANCE

(IN DOLLARS)



## C. GOVERNMENT ATTITUDES

1. GOP is sensitive to the needs of the country in terms of maintaining its reliable business image in the international markets. Therefore, the government has been very cooperative with the country's lenders in arranging suitable terms of repayment and discussing ways for Panama to improve its economic position.

### 2. Private sector participation

- a) The National Banking Commission (see Section E). Of the seven members, four are from the private sector (three bankers and one from industry).
- b) The National Securities Commission (see Section E). There are five members in the securities commission of which three are from the private sector. There is one representative from banking, one from heavy industry and one from commerce.

### 3. Investment code

The investment code favors heavy industry. Incentives include:

- import tax and import duties exemptions;
- tax credit certificates;
- automatic renewal of government contracts;
- protection against foreign goods through import, quotas and tax breaks; and
- accelerated depreciation allowances.

Recent policy changes (developed with the IMF) will be instituted in the near future. These changes include:

- Phasing out of quantitative restrictions (import quotas) and introducing a tariff system;
- Gradually reducing the level of effective protection; and
- Creating incentives giving exporting the edge over import substitution.

#### 4. Preferential treatment for parastatals

    GOP supports many of the parastatals financially (see Appendix). The National Bank of Panama supplies funds obtained from:

- Multilateral and bilateral grants and loans, and
- The IMF funds.

#### 5. Privatization

    GOP has agreed to disinvest some of the parastatals. As of October, 1985, it had not yet started the process. The Appendix describes various parapublics which could be sold to the private sector.

#### 6. Land reform

    During 1968-1973 over 16% of Panama's land was redistributed among the poorer farmers. Approximately 200 agrarian reform settlements (asentamientos) were formed. These settlements have received extensive government assistance.

## D. REGULATORY CLIMATE

### 1. Foreign exchange policy

GOP issues only coins; the Panamanian Balboa equals one US\$. Panama uses American paper money. Therefore, Panama has no foreign-exchange reserves and no short-term foreign exchange constraints.

### 2. Price controls

Producer official prices are set by the Ministry of Agricultural Development (MIDA), the Agricultural Marketing Institute and the Price Regulation Office (ORP). The prices are negotiated annually with producers and are based on production controls. ORP also regulates prices for processed commodities. Price controls for non-food items are set at the retail level.

GOP is planning to reduce price control considerably. There is a well-developed contraband market in Panama.

### 3. Restrictive labor laws

The organized labor movement is very strong in Panama. It has already pressured President Del Valle not to change the present labor code in the near future.

#### Summary of the labor Code

- Minimum compensation for dismissal is 30 days pay.
- After two years of service, an employee cannot be dismissed without a trial.
- Bankruptcy does not excuse a firm from regular or severance pay obligations.
- Employees are guaranteed a base salary overtime pay, one month of vacation and an annual thirteenth month bonus.

### 4. New Businesses and Branches

Starting a new company or expanding in Panama is very easy. The major requirement is registration at the Mercantile Registry.

### 5. Foreign investment

- a) The National Investment Council was created to assist foreign investors by streamlining the bureaucratic process of investment.

b) Foreign investment restriction

Foreigners may not:

- engage in retail trade
- engage in certain professional activities
- invest in radio stations
- own a majority in any utility company

In addition, 90% of the workforce in a company must be Panamanian. Lastly, all foreign nationals are required to obtain work permits.

6. Business Regulation

The Panamanian Ministry of Commerce and Industry is the government's regulatory body.

## E. FINANCIAL SYSTEM

### 1. Banking System

- a) Banco Nacional de Panama  
Panama has no Central Bank. Instead, Banco Nacional de Panama acts as a parastatal bank, serving as the depository of public funds and of banks' required reserves. The Bank also functions as a regular commercial bank.
- b) The National Banking Commission  
The Banking Commission is the regulatory body for the banking industry. It is responsible for:
  - issuing and revoking banking licenses;
  - setting the levels of reserves required of banks;
  - enforcing bank laws (i.e., punitive powers); and
  - supervising bank activities.
- c) Banking parapublics
  - The Agricultural Development Bank (BDA)  
BDA assists mainly small and medium farmers and organized farmer groups (cooperatives and asentamientos). Approximately a quarter of the Bank's portfolio consists of loans which are in default or have been rolled over to avoid default.
  - The National Mortgage Bank (BHN)  
BHN has not been very successful in developing housing because of serious operational and financial problems. It is heavily subsidized by the government and multilateral donors. The Bank is a supplier of loans to the Savings and Loan Associations.
  - The National Savings Bank  
The Savings Bank is restricted to receiving savings deposits and making loans secured by first mortgages or other suitable forms of collateral.
  - The National Finance Corporation (COFINA)  
COFINA, created to supply long-term loans to industry, is illiquid. In 1983, it ceased its lending operations to reorganize. GOP assumed responsibility for COFINA's debt.

- The Social Security Institute (SSC)  
SSC's aggregate value equalled 7.1% of GDP for 1983. It supplies funds to BHN and for hospital construction. It is also the major holder of government bonds.
- d) Regional banks  
The Latin American Export Bank (Bladex) is situated in Panama but serves as a regional export bank. The bank promotes non-traditional exports by providing short- and medium-term loans.
- e) Commercial banks  
Panama's commercial banking system is highly sophisticated and dominates Panama's financial activities. There are 129 commercial banks, many of which are off-shore banking units. Panama is an ideal location for off-shore banking because of:
- the highly developed telecommunications network;
  - the available transportation;
  - the favorable tax system; and
  - the lack of government regulation.

The banking activities of Panama are comparable to those found in industrialized nations. The interest rates are based on the LIBOR rate. The banks do offer some long-term loans (15 years), mostly for mortgages.

The three types of banking licenses granted by the license commissions are:

- general license;
- foreign license; and
- representative license.

## 2. Securities market

- a) The National Securities Commission is the regulatory body for the securities market. Its responsibilities are:
- to verify the published information of traded companies and mutual fund companies;
  - to authorize or prohibit the sale of securities;
  - to approve mutual fund licenses and issues; and
  - to enforce the laws affecting securities sales.

All new securities issues must be registered with the securities commission.

b) Underwriters and Brokers  
Underwriters and brokers must pass an exam prior to obtaining their licenses.

c) Primary Market  
In 1984, eighty-one companies were registered with the Securities Commission. The total value of authorized public placement was nearly US\$ 3 billion. The breakdown of securities offered and sold by economic sector for 06/30/83-06/30/84 was:

° Total Shares Offered - \$21,268,609;

° Total Shares Sold - \$2,919,320.

	<u>% of Total Shares Offered</u>	<u>% of Total Shares Sold</u>
Real estate	9.3	1.5
Holding companies (mutual funds?)	30.2	-
Finance companies	37.6	93.7
Industrial companies	20.0	3.5
Public services	2.9	1.3
	<u>100%</u>	<u>100%</u>

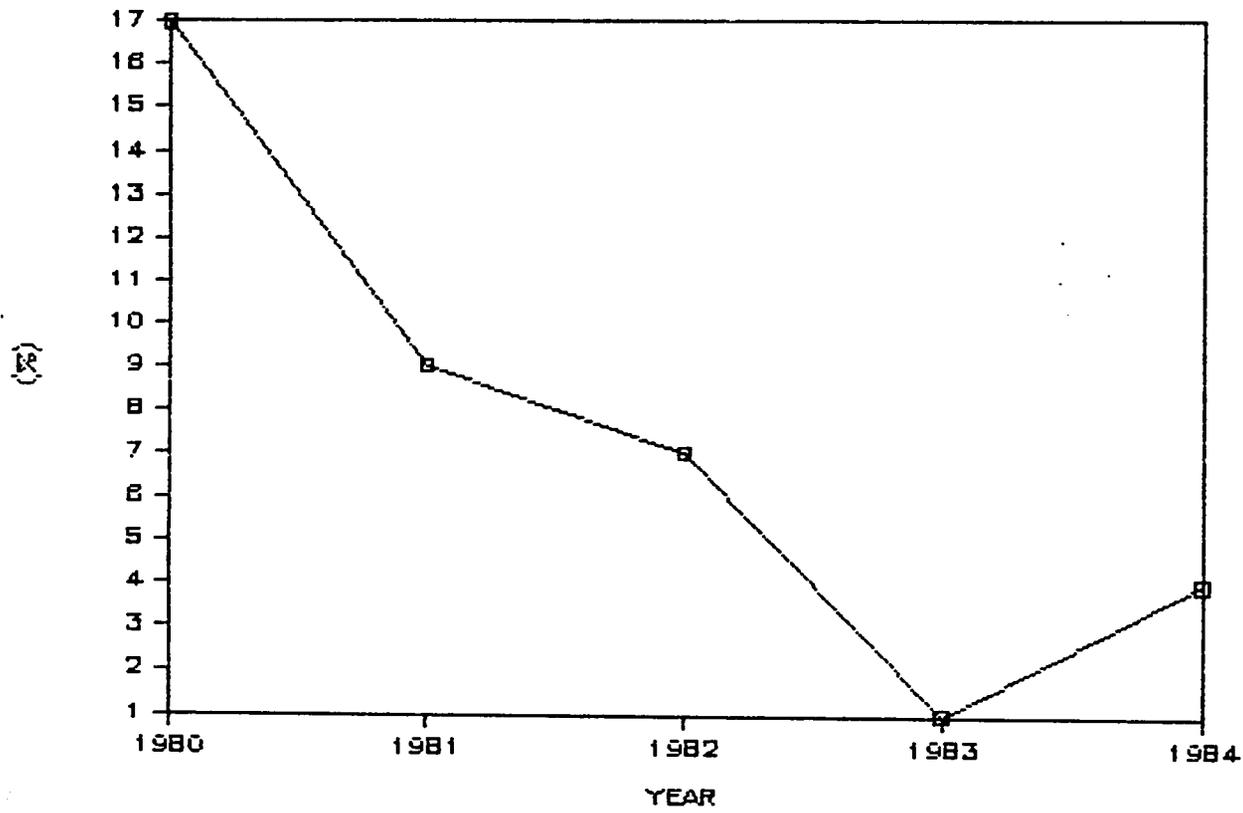
The types of securities being offered include:

- ° common stocks
- ° preferred stocks
- ° tax credit certificates
- ° bonds
- ° commercial paper
- ° mutual fund options
- ° subordinate debentures

d) Secondary Market  
Panama has no stock exchange so data on secondary market activity are not available. GOP is studying the possibility of setting up an exchange to complement Panama's banking system.

e) No information was found on insurance companies, on the number of mutual funds, on S & L associations or leasing companies.

# PERCENT CHANGE IN MONEY SUPPLY



F. TAX SYSTEM

1. Corporate income tax rate
  - a) The maximum tax rate is 50% for income from domestic sources over US\$500,000.
  - b) The maximum tax rate on export income for companies in the Colon Free Trade Zone is 8.5% for income over \$100,000.
  - c) The maximum dividend tax is 10% levied on 40% of the after-tax profit if no dividends are distributed. Branches of foreign companies are subject to this imputed dividend tax on 100% of their after-tax income.
  - d) All non-Panamian sources of income is excluded from taxable income.
2. Personal income tax
  - a) The highest tax bracket is 56%.
  - b) Capital gains tax is based on a variable rate determined by the size of gain and the number of years of ownership.
  - c) Dividends tax is 10% if profit distribution exceeded those already taxed under the corporate dividend tax.
  - d) The inheritance and gift tax rate varies from 4-33.75% depending on the value of the item.
3. Value Added Tax (VAT)

VAT is 5% of the sales price.
4. Business Franchise tax is 1% of a company's capital up to a maximum of US\$20,000.
5. Bank licenses
  - General banking license: US\$25,000
  - International banking license: US\$15,000
6. Finance company license

The license costs 2.5% of paid-in capital up to a maximum of US\$12,500.
7. Other taxes
  - Business license
  - Property tax
  - Stamp tax
  - Export tax
  - Import tax

## G. ACCOUNTING

Since most Panamian companies are closely held, public disclosures of earnings are rare. Audit reports are required for banks, insurance companies and the few corporations with publicly traded shares.

### 1. Professional Organizations

- The Institute of Authorized Public Accountants of Panama
- The Association of Women Accountants of Panama
- The Association of Accountants and Authorized Public Accountants of Panama.

Members from each of these organizations serve on the Financial Accounting Standard Committee (CNCF). The Panamian Standards are supplemented by the U.S. Financial Accounting Standards in areas where CNCF has made no ruling.

### 2. Accounting Ethics Code

The Code, established in 1984, is comparable to that of the U.S. profession.

**APPENDIX**

- A. Decentralized government agencies and parastatals (Non-financial)
1. Ministry of Planning and Economic Policy (MIPPE)  
MIPPE administers the public investment program. Public investment has concentrated on energy, transport and telecommunications infrastructure, and agriculture.
  2. The University of Panama  
University revenues cover 10% of its current expenditures. The balance is paid by the government.
  3. The Human Resource Development Institute (IFARHV)  
The institute supplies loans and scholarships to Panamanian students. It is in deep financial trouble because of rare loan repayment.
  4. Agricultural Marketing Institute (IMA)  
IMA is obliged to buy surpluses of selected crops to maintain the official price. The institute also runs a modern slaughter house, a chicken processing plant and the national marketing of hides and skins. It is the sole importer of various foodstuffs (maize, beans, etc.). IMA is facing serious financial difficulties.
  5. Bayano Development Corporation (BDC)  
The corporation was created to protect the watershed of the Bayano hydroelectric reservoir and to administer a capital-intensive state farm. BDC has never been self-sufficient.
  6. The Chirique Citrus Company  
The company has generated a small profit for the last two years. GOP plans to convert it into a mixed-capital enterprise.
  7. La Victoria Sugar Corporation  
The corporation is comprised of sugar cane farms and sugar mills, and is the major sugar producer in the country. The corporation has experienced heavy losses since its production costs are well above the world market price of 14 cents per pound.
  8. The Machinery Pool (ENDEMA)  
The company provides farm machinery rental and repair services.
  9. The Crop Insurance Agency (ISA)
  10. Agricultural Research Institute (IDIAP)
  11. The National Seed Corporation (ENASEM)  
The goal of ENASEM is to market 56% of Panama's certified seed requirements by 1989.

12. The Hydroelectric Resource Institute (IRHE)  
IRHE is the sole provider of electricity for the country except for the Panama Canal region and a few isolated areas. The institute accounts for one third of the state enterprises net savings. However, the cost of electricity to industry is among the highest for the Central American region.
13. The National Telecommunications Institute (INTEL)  
INTEL controls the country's telephone and telecommunications network. INTEL's operating surplus is second only to IRHE. It has, therefore, been able to finance capital expenditure while contributing to the overall fiscal balance.
14. The Bayano Cement Company (Cemento bayano)  
Cemento Bayano is one of two companies producing cement. The two companies produce twice the amount demanded by the construction industry. The market share of Cemento Bayano is 48%.
15. The National Water and Sewage Institute (IDAAN)  
IDAAN has managed to improve its financial performance and has had a steadily increasing operating surplus.
16. The Colon Free Trade Zone  
The trade zone is the second largest free trade zone in the world. Its main attractions for business are:
  - free convertibility to U.S. dollars;
  - the absence of any controls on remittance of dividends, royalties and interest payments; and
  - readily available financial services.

The zone is facing strong competition from other free zones, such as Miami. In addition, its dependency on the depressed Latin American market has hampered its growth.

17. The National Port Authority  
The Port Authority administers 14 ports and the Panama Canal. Although it still is a revenue generator it has problems. First, the ports are not equipped to handle the increasing container traffic. Second, the cost plus tariff policy of the Port Authority has made Panama's ports less price-competitive in comparison to Puerto Rico's and Jamaica's. Lastly, the increasing tendency to use larger ships has reduced traffic through the Canal. More shippers are using the U.S. land bridge between the US West Coast and Miami or routing their vessels around Cape Horn.

B. Partial Listing of Commercial Banks

Banco Aleman - Panameno

Banco Andino

Banco Comercial de Panama

Bancomer

Banco Continental de Panama

Bancode Colombia

Banco de Iberoamerica

Banco del Comercio

Banco de Credito de Peru

Banco de Credito de Peru Internacional

Banco del Pacifico

Banco de Santander y Panama

Bnco de Ultramar

Banco Exterior

Banco General

Banco Industrial Colombiano de Panama

Banco Rio de la Plata

Banco Santander

Banco Sudameris Internacional

Banco Suramericano de Desarrollo

Bank of America

Bank of Commerce & Finance

Bank of Tokyo

Banque Anual

Caja de Ahorros Financiera Bamerical

Citibank

Chase Manhattan

First Chicago

First Interamericas Bank

Interamerican Bank Corp.

Primer Banco de Ahorros

Tower International

C. THE EIGHT LEADING GENERAL LICENSE BANKS:  
LOCAL LOANS AND DEPOSITS, 1979-82  
(US\$ Millions)

	1979	1980	1981	1982
<u>Deposits</u>				
Bank of America	152.1	124.2	121.4	123.1
Citibank	93.6	118.2	142.8	172.5
Banco Nacional de Panama	414.5	518.5	686.6	608.9
Banco de Colombia	108.1	134.1	157.6	175.8
Chase Manhattan	189.6	218.9	284.9	289.3
Banco Fiduciario	78.3	86.2	92.1	89.3
Banco Santander	a/	101.8	115.9	118.4
Caja de Ahorros	199.2	143.1	159.1	190.9
Total	<u>1,235.4</u>	<u>1,445.0</u>	<u>1,760.4</u>	<u>1,768.2</u>
Percentage of Total Local Deposits	68.5	60.1	55.0	50.1
<u>Loans b/</u>				
Bank of America	167.0	215.5	247.7	259.1
Citibank	187.1	213.0	243.1	236.4
Banco Nacional de Panama	379.7	408.0	648.2	741.8
Banco de Colombia	84.0	93.5	101.2	113.3
Chase Manhattan	286.8	343.7	350.2	349.8
Banco Fiduciario	105.8	102.3	107.3	122.9
Banco Santander	a/	120.1	122.7	99.5
Caja de Ahorros	122.3	137.9	149.2	158.2
Total	<u>1,332.7</u>	<u>1,634.0</u>	<u>1,969.6</u>	<u>2,081.0</u>
Percentage of Total Local Loans	62.5	64.6	62.6	62.1

a/ Not registered

b/ Gross