

# ISSUES IN FINANCING DEVELOPMENT IN CARICOM

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## *ABSTRACT*

*The paper assesses the extent to which the limited availability of funds for the financing of investment, as well as other financing shortcomings, might have contributed to the relatively poor economic performance of several countries in the CARICOM region in recent decades. It is argued that the overall level of domestic savings over the period was relatively high by international standards. In addition, countries in the region were successful in securing foreign financing. Furthermore, the financial sector in the respective countries, although only providing a limited range of savings instruments, appears to have done a reasonable job in mobilizing savings. The problems associated with financing development appear to be centred on shortcomings in the ways in which the available funds were allocated, as well as the costs associated with the acquisition of funds. A series of proposals is outlined, directed at addressing potential inefficiencies in the allocation of funds and at making funds available to investors at more reasonable costs.*

**Keywords:** Savings mobilization: allocation of savings: financing costs:  
JEL. Classification Numbers: E44, G18, O16

## 1.0 Introduction

In this paper an effort is made to ascertain the extent to which financing shortcomings might have had a negative impact on the economic performance of countries in the CARICOM region. A limited availability of financing for investment, which could be due to low levels of domestic savings, as well as limited access to foreign savings, would clearly have had a negative impact on investment levels and economic performance of countries in the region. The supply limitation would also be associated with higher financing costs, exacerbating the difficulties with which potential investors would have to cope. Apart from the overall question of quantity of financing, the efficiency with which the financial sector mobilizes and allocates funds would also affect economic performance. It is also the case that economic performance will be influenced by the share of available funds which are directed towards investment activity as opposed to supplementing consumption. Furthermore, to what extent are the funds directed to the financing of productive investments?

The paper is organized as follows: In the first section, there will be a brief review of the economic performance of countries in the region over the past decade. This will be followed by an evaluation of the significance of the issues of availability and cost of financing for the development prospects for countries in the region. Specifically, what have been the national savings trends, and what success have the countries realized in attracting foreign investment? Furthermore, to what extent might the cost of securing financing be deemed excessive? In the third section, attention is directed to the issue of efficiency in the allocation of available funds. Do shortcomings in the operation of the financial sector result in funds not being directed towards the most productive uses? The paper concludes with a series of proposals for relieving some of the financing constraints to development in the region.

## 2.0 A Review of the Recent Economic Growth Performance of CARICOM Countries

The countries of the Caribbean Community, with the exception of Belize and Trinidad and Tobago, have experienced low rates of economic growth over the past decade. As indicated in Table 1, there has been virtually no real economic growth in Guyana and Jamaica since the late nineties although, in the case of Jamaica, the low reported growth rates have been in part attributed to a failure to incorporate the output of the informal sector. That sector's contribution to GDP is said to have increased dramatically since the beginning of the nineties and by 2000, output from the sector accounted for between 35 and 40 percent of GDP. However, even after making an adjustment for the contribution of the informal sector, GDP growth rates over the period would not have exceeded three percent, still relatively low by international standards (IMF 2006). There has also been limited economic growth in Barbados and the countries of the Eastern Caribbean Currency Union (ECCU) since 2000.

**Table 1**  
**CARICOM Countries: GDP Growth Rates**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
Barbados	3.2	4.6	6.2	0.5	2.3	-2.6	0.5	1.9	4.5
Belize	1.7	3.6	3.7	8.7	12.1	4.9	4.10	9.4	9.7
ECCU <sup>1</sup>	2.7	3.2	4.0	4.1	2.7	-1.3	0.5	3.5	3.9
Guyana	8.0	6.2	-1.7	2.9	-1.4	2.3	1.1	-0.6	1.6
Jamaica	0.2	-1.0	-1.2	1.0	0.7	1.5	1.1	2.3	0.9
Trinidad/ Tobago	2.8	3.0	4.0	5.0	7.3	4.3	6.8	13.2	6.2

<sup>1</sup> ECCU countries include Antigua and Barbuda, Dominica, Grenada, St.Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines.

**Sources:** Central Bank of Barbados, **Annual Statistical Digest**; Central Bank of Belize, **Statistical Digest**; Eastern Caribbean Central Bank, **Statistical Digest**; Bank of Guyana, **Annual Report**; Bank of Jamaica, **Statistical Digest**; Central Bank of Trinidad and Tobago, **Annual Economic Survey**.

In spite of the low GDP growth rates, investment as a share of GDP has been relatively high by international standards. The investment/GDP ratio was highest in Guyana and the ECCU where it averaged between 35 and 40 percent between 1996 and 2004. At the same time, the investment/GDP ratio for the larger CARICOM economies, Barbados, Jamaica and Trinidad and Tobago, as shown in Table 2, ranging between 16 and 28 percent, was close to the 20 to 25 percent range for middle income countries over the same time period (Roache 2006).

**Table 2**  
**Gross Investment as a Percent of GDP**

	Barbados	Belize	ECCU	Guyana	Jamaica	Trinidad & Tobago
1996	15.2	20.3	33.2	43.9	28.9	24.3
1997	18.0	20.1	34.2	44.1	29.0	36.1
1998	18.4	19.0	35.3	41.4	25.7	27.0
1999	19.5	24.5	36.3	38.5	24.3	20.9
2000	18.5	31.7	38.1	38.5	26.6	17.0
2001	15.5	25.2	37.2	38.5	29.0	19.4
2002	16.6	22.6	35.4	38.1	31.6	19.6
2003	16.8	19.0	37.0	35.0	29.7	18.0
2004	19.2	17.7	36.0	32.0		18.0

**Source:** National Authorities

The high rates of investment were a reflection on the success realized by several countries in the region in attracting foreign direct investment. As shown in Table 3, foreign direct investment accounted for a significant share of gross investment in the ECCU countries and Trinidad and Tobago over the past decade. In the case of Barbados and Jamaica this form of investment was of particular significance in the post-1999 period. Trinidad and Tobago was successful in attracting investment into the petroleum sector. Foreign investment inflows in the other countries were primarily directed to the tourism sector. There was also a high level of public investment in Barbados and Belize.

**Table 3**  
**Components of Gross Investment: Percentage Shares**

	1997	1998	1999	2000	2001	2002	2003	2004
<b>Foreign</b>								
<b>Direct</b>								
<b>Investment</b>								
Barbados	7.9	3.8	11.2	36.0	29.6	23.7	35.1	24.2
Belize	6.1	10.2	29.8	8.9	27.7	10.9		62.2
ECCU	31.6	34.5	34.0	30.9	34.9	32.9	45.5	40.3
Jamaica	6.8	14.4	23.0	18.3	22.3	15.2	25.1	
Trinidad & Tobago	47.0	42.6	26.2	45.9	54.8	39.0	30.5	46.9
<b>Public</b>								
<b>Investment</b>								
Barbados	32.2	28.1	27.1	29.4	35.1	43.3	30.0	19.8
Belize	31.0	35.6	43.3	46.9	61.9	58.6	65.0	26.3
ECCU	18.8	20.1	20.0	19.0	21.7	26.4	20.6	17.3
Jamaica	15.4	11.3	10.9	10.3	9.3	6.1	3.9	
Trinidad & Tobago	8.6	6.9	5.3	13.6	8.7	6.3	6.7	12.5

**Source:** Same as for Table 2.

The fact that these rates of investment did not result in higher growth rates is indicative of the low productivity of these investments. This low productivity was attributed, in part, to the nature of the dominant forms of investment activity during this period. A significant share of private investment was in the tourism sector and in countries such as Barbados and Belize, public investment accounted for a very large share of gross investment. The high level of investment in the tourism sector, mostly in the form of resort hotels, was of an enclave sort resulting in few linkages with the domestic economy. As a result, the multipliers of this investment would likely be weak. Furthermore, it was argued that public sector investment is often associated with lower productivity than investment in the private sector. In addition, in a situation where funds

for investment are limited, heavy public investment might crowd out more productive private investment (Roache 2006). Private domestic investment as a share of gross investment declined in all countries, as shown in Table 4, in the post-2000 period. The most significant reductions occurred in Barbados and Belize. In those instances the increased share of public investment might be more a reflection on government addressing infrastructure needs than the crowding out of private investment.

**Table 4**  
**Private Domestic Investment as a Percentage of Gross Investment**

	<b>Average: 1996 -1999</b>	<b>Average: 2000-2004</b>
Barbados	61.2	38.8
Belize	52.0	36.7
ECCU	47.0 <sup>1</sup>	42.1
Jamaica	74.8	72.4 <sup>2</sup>
Trinidad & Tobago	57.1	47.1

<sup>1</sup> 1997 – 1999. <sup>2</sup> 2000 – 2003.

**Source:** Same as Table 3.

In an empirical study by Khan and Kumar (1997) based on a sample of 95 developing countries in Asia, Africa, Latin America and the Middle East and covering a period from 1970 – 1990, they found that there was little difference in the contribution of public and private investment to growth in the African countries. On the other hand, there were significant differences in the Asian and Latin American countries where private investment had a much higher impact on economic growth. They were able to attribute the differences to the generally higher levels of income in the Asian and Latin American countries. Given that Caribbean countries, with the exception of Guyana are, by UN standards, middle income countries, public investment is then likely to have a relatively small impact on economic growth.

### **3.0 The Availability and Cost of Financing for Development**

The matters of availability and cost are usually central to any discussion on the role of financing in development. These factors will, in part, be determined by the ability on the part of countries to mobilize increasing amounts of savings from domestic as well as foreign sources. This will be required to support the increase in investment necessary to raise levels of income. In addition, the efficiency of the financial sector in performing its function as an intermediary between savers and investors will play a critical role in determining the contribution of any given level of savings to economic growth. In this section we will begin with an evaluation of the domestic savings effort in countries in the region.

An increase in the level of domestic savings in countries in the region should have a positive impact on economic growth. The level of gross national savings for the respective countries in the region from 1996 to 2004 is set out in Table 5. It can be seen that in the case of Barbados and Belize, there was a sharp decline in national savings levels in the post-2000 period resulting in lower absolute amounts saved during that period. On the other hand, there were large increases in national savings in Trinidad and Tobago, as well as in Jamaica over the entire period. In the case of Trinidad and Tobago, the level of national savings in 2004 was 80 percent higher than in 2000. In the case of the ECCU countries, there was a significant increase in national savings levels between 1996 and 2000. However, there was a significant drop in the level of savings in the subsequent three years and in 2004 the level was at that attained in 2000. National savings levels remained virtually unchanged in Guyana over the entire period.

**Table 5**  
**CARICOM Countries: Gross Savings**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>Barbados<sup>1</sup></b>									
National <sup>a</sup>	763	699	829	679	603	651	529	575	372
Foreign <sup>b</sup>	-155	93	44	286	344	143	291	329	708
%GDP	15.2	18.0	18.4	19.5	18.5	15.5	16.6	16.8	19.2
<b>Belize<sup>1</sup></b>									
National <sup>a</sup>	153	146	130	130	232	117	86	72	14
Foreign <sup>b</sup>	109	118	133	230	296	316	359	334	397
%GDP	20.3	20.1	19.0	24.5	31.7	24.9	24.0	20.7	19.8
<b>ECCU<sup>1</sup></b>									
National <sup>a</sup>	1171	1158	1497	1473	1658	1480	1215	1334	1684
Foreign <sup>b</sup>	885	1078	988	1218	1243	1390	1580	1744	1529
%GDP	33.2	34.2	35.3	36.3	38.1	37.2	35.4	37.0	36.0
<b>Guyana<sup>2</sup></b>									
National <sup>a</sup>	36	32	30	34	30	27	32	35	36
Foreign <sup>b</sup>	8	15	15	13	20	24	21	16	14
%GDP	44.4	44.0	41.7	38.0	38.5	38.2	38.3	35.4	32.0
<b>Jamaica<sup>2</sup></b>									
National <sup>a</sup>	58	55	57	62	72	70	72	93	129
Foreign <sup>b</sup>	13	21	16	12	18	38	58	48	31
%GDP	29.3	28.8	25.8	24.5	26.5	28.9	31.7	29.8	29.6
<b>Trinidad &amp; Tobago<sup>1</sup></b>									
National <sup>a</sup>	8804	9597	6693	9222	12161	13460	11300	18076	22287
Foreign <sup>b</sup>	-409	3618	4053	-192	-3416	-2764	-475	-6168	-9336
%GDP	24.3	36.1	27.0	20.9	17.0	19.4	19.2	17.7	16.8

<sup>a</sup> Gross National Savings = GDP - (Household consumption + Government consumption) + net factor payments + net transfers.

<sup>b</sup> Foreign savings = Gross investment – Gross National Savings

<sup>1</sup> Millions of dollars in national currency.

<sup>2</sup> Billions of dollars in national currency

**Source:** Estimated from regional central bank publications

The decline in gross national savings after 2000 in Barbados, Belize and the countries of the ECCU was offset by significant inflows of foreign savings. Guyana and Jamaica were also recipients of large inflows

of foreign savings. As indicated in Table 5, the annual inflow of foreign savings to Belize from 1999 to 2004 was greater than gross national savings. Over the same period inflows of foreign savings to the countries of the ECCU were a major contributor to gross savings, especially in the post-2000 period. In the case of Trinidad and Tobago, the buoyancy of the international petroleum market resulted in the country realizing large surpluses on the current account of the balance of payments. Low levels of savings, per se, do not appear to have been a significant constraint on development.

The extent to which the savings/GDP ratio might be indicative of the ease with which investors may have access to finance will depend on how the financial sector functions in its role as an intermediary between savers and investors. This will be determined by the extent to which institutions in the sector are able to attract funds from savers by satisfying their needs with respect to earnings, risk avoidance and liquidity. At the same time, the cost at which the sector is able to make funds available will have a bearing on the accessibility to financing. The financial sector in virtually all CARICOM countries features a small number of institutions offering a limited range of instruments to savers, with commercial banks being the dominant institutions.

One criterion which might be applied to assess the effectiveness of the sector in mobilizing savings would be to compare the growth in savings within deposit-taking institutions to that of overall growth in GDP, at current market prices. Table 6 provides information on the annual growth rate of deposits within financial institutions in the various CARICOM countries between 1996 and 2004 along with the GDP growth rate for the comparable period. In the case of Belize, the countries of the ECCU and Guyana the information is based on the activities of commercial banks only. Specific attention was directed towards deposits made by individuals and private incorporated and unincorporated non-financial business enterprises. In spite of the limitations in the sector outlined above, the sector in most countries in the region seems to have been effective in attracting savings from these sources.

**Table 6**  
**Financial Institutions Deposits: Individuals and**  
**Non-Financial Business Firms**

	1996 millions of national currency	2004 millions of national currency	G.R . Deposits 1996 – 2004 %	G.R. GDP 1996- 2004 %
Barbados	2,355.7	4,590.7	8.7	4.4
Belize	513.9	962.7	8.2	6.1
ECCU	3,650.1	7,876.4	10.1	4.7
Guyana	46,674.4	92,872.7	9.0	5.9
Jamaica	101,624.9	244,115.4	11.6	10.5
Trinidad& Tobago	13,532.6	27,473.0	9.3	10.4

**Source:** Estimated from regional central bank publications.

The annual rate of growth of deposits was significantly higher than that of nominal GDP in Barbados, the countries of the ECCU and Guyana. In the case of Trinidad and Tobago and Jamaica, the deposit growth rate was close to that of GDP.

The willingness on the part of savers to accumulate deposits would be influenced by such factors as the rate of return offered by the deposit-taking institutions, and the range of available alternative savings instruments. Institutions in the ECCU, as shown in Table 6, accumulated deposits at more than twice the annual rate of growth of GDP, the highest among institutions in that region for the period. This could be a reflection on the fact that the average annual real interest rate on deposits was by far the highest among all of the countries in the region. In addition, residents of that part of the region had the fewest alternative savings options. At the same time, the success realized by deposit taking institutions in other countries in the region in accumulating deposits occurred in spite of the fact that nominal and for the most part, real rates of return, as shown in Table 7, were very low. This could be seen as being reflective of the dominant position of these institutions and the persistence of traditional savings behaviour, in which the rate of return is not the predominant consideration, reinforced by the limited range of savings options.

**Table 7**  
**Commercial Banks: Average Annual Deposit Rates 1996 – 2004 (%)**

Barbados		Belize		ECCU		Guyana		Jamaica		Trinidad & Tobago	
Nom	Real	Nom.	Real	Nom.	Real	Nom.	Real	Nom.	Real	Nom.	Real
3.9	1.8	5.5	3.8	9.2	7.2	7.5	2.2	13.1	2.3	4.9	0.8

<sup>1</sup> Average: 1997 - 2004

Source: Estimated from regional central bank publications

The information on aggregate savings rates and the ability of the financial sector to mobilize funds suggests that overall supply limitations might not have been the major constraint on investment activity. Among the additional factors worthy of consideration are the competition for funds between the public and private sectors, and the costs of securing financing. Competition from the public sector could restrict access of the private sector to financing as well as raise the cost of acquiring financing. The impact of public sector financing requirements on the availability of funds for the private sector appears to have been of importance in Guyana and Jamaica between 1996 and 2004. In both countries, commercial bank loans to the public sector and investment in government securities absorbed a major portion of deposit holdings. In the case of Jamaica, the share of funds allocated to the public sector almost doubled over the period, amounting to 56 percent of deposits. In Guyana, about 40 percent of deposits were directed to public sector loans and investments. In other countries in the region, with the possible exception of Barbados, the share of deposits allocated to public sector loans and investments, as shown in Table 8, was quite small. The Barbadian share was 33 percent in 2004, but this represented a significant decline when compared with the share in 1996. The potential crowding out effect, not surprisingly, appears to be of relevance in the two countries with the highest levels of government debt.

**Table 8**  
**Government Loans and Securities as a Percentage of**  
**Commercial Bank Deposits**

	1996	2004
Barbados	45.1	33.3
Belize	8.3	9.8
ECCU	5.3	10.2
Guyana	37.8	42.4
Jamaica	29.1	56.4
Trinidad & Tobago	21.5	19.0

**Source:** Estimated from regional central bank publications

Let us now turn to an assessment of the matter of the cost associated with the financing of investment. In a recent paper (Roache 2006) it was pointed out that this could involve examining the costs associated with financing with loans or by means of equity. Given the relatively undeveloped state of equity markets in the region, the scope for raising funds in that manner is limited. As a result, attention will be directed to interest rates on loans charged by commercial banks.

The lending rates charged by commercial banks in the region over the past decade are set out in Table 9. It can be seen that, with the exception of Jamaica, there was limited year to year variation in nominal rates over the period. The Jamaican situation reflects the strategy followed by the Bank of Jamaica to stabilize the exchange rate. The highest rates were charged by the banks in Jamaica, where in the pre-2000 period, nominal lending rates were in the 26 to 40 percent range. High nominal lending rates were associated with high real rates. It was only in Jamaica that there was evidence of a decline in real rates since 2000. In the other countries, the maintenance of high rates in that period, with a trend towards declining interest rates internationally, led to a widening of the gap between lending rates in the region and other major financial centres. This suggests that a lowering of rates would not automatically result in a weakening of the balance of payments position of the respective countries.

The question arises as to what accounted for these high lending rates over the period. In Jamaica's case, government borrowing at high rates of interest clearly had an impact on the rate of interest charged to private borrowers. An argument could be made that the high interest premiums paid by the Jamaican government seemed excessive in relation to that of other countries in the region. In the case of all the countries, it was argued in an earlier study (Bennett 2004) that the high cost of borrowing could not be attributed purely to conditions in financial markets in the region. All of the commercial banks in the region maintained holdings of liquid assets well in excess of legal requirements. The high cost of debt financing, given the limited alternatives, would clearly place domestic producers at a disadvantage. An empirical investigation of factors which affect the cost of private domestic investment has shown that for the average

Caribbean country, lower interest rates are likely to have a more powerful effect on the cost of capital than lower corporate taxes (Roache 2006). The high cost of borrowing does not seem to be linked primarily to a scarcity of funds or to the demands of government, even in the more heavily indebted countries.

#### **4.0 The Allocation of Finance**

It was argued in the previous section that in most of the CARICOM countries it was the issue of the high cost of financing rather than that of an overall shortage of funds which might have had a greater impact on economic performance. The high cost of funds could have given rise to a situation in which financing was diverted from potentially more productive activities towards those which were less productive, but where cost would not be a deterrent. High borrowing costs would not act as a deterrent to those borrowers who could easily pass on the additional costs. This would be the case, for example, where the borrower was exposed to limited competition, such as in some services and the distributive trades. In addition, there are those situations, such as in the case of personal loans, where the financing requirements can be

**Table 9**  
**Commercial Bank Lending Rates<sup>1</sup> (%)**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>Barbados</b>									
Nominal	11.9	11.7	11.7	11.6	12.1	11.5	10.7	10.2	9.9
Real	9.3	3.7	13.2	9.9	9.5	8.5	10.5	8.5	8.4
<b>Belize</b>									
Nominal	16.3	16.3	16.5	16.3	16.0	15.4	14.8	14.3	13.9
Real	9.2	15.1	17.6	17.7	15.3	15.0	12.3	11.4	10.5
<b>ECCU<sup>2</sup></b>									
Nominal	12.0	12.5	12.5	12.5	12.25	12.25	12.25	12.0	12.0
Real		10.1	9.9	9.8	9.4	10.4	11.8	10.6	10.0
<b>Guyana<sup>2</sup></b>									
Nominal	17.2	16.9	16.6	17.3	17.2	16.8	16.3	14.9	14.5
Real	9.4	12.8	11.5	9.1	10.1	13.8	10.4	8.4	9.7
<b>Jamaica</b>									
Nominal	39.5	33.4	32.5	26.6	20.7	18.2	16.0	15.0	14.4
Real	10.4	21.6	22.0	19.4	11.6	10.5	8.3	4.3	0.7
<b>Trinidad &amp; Tobago</b>									
Nominal	14.2	13.9	15.2	15.9	15.3	14.5	12.8	11.2	9.5
Real	8.4	10.3	9.1	12.1	11.3	8.5	8.3	7.1	5.6

<sup>1</sup> Weighted average lending rates.

<sup>2</sup> Prime lending rate.

**Source:** Regional central bank publications.

structured to alleviate the burden of meeting payments. Furthermore, in those countries where there is a high level of government borrowing on the domestic market, the ready availability of a large quantity of high yielding secure instruments would tend to encourage institutions to concentrate on lending to well-established firms

Table 10 provides information on the allocation of loans to the private sector by commercial banks in the region. It can be seen that in all the countries, with the exception of Belize where it was second to the distributive trades in 2004, the greatest share of private sector loans was in the form of personal loans. In Barbados, Jamaica, Belize and the countries of the ECCU, personal loans accounted for 40 to 55 percent of loans extended to the private sector. In addition to personal loans, lending was concentrated in the distributive trades, tourism and construction. On the other hand, the share of loans directed to agriculture and manufacturing was small and declined between 1996 and 2004. The degree of concentration in lending is underscored by the fact that in all countries two or three sectors accounted for more than 60 percent of loans flowing to the private sector.

**Table 10**  
**Allocation of Commercial Bank Loans to the Private Sector**  
**as a Percent of Total Commercial Bank Loans**

	Barbados		Belize		ECCU		Jamaica		Trinidad & Tobago	
	1996	2004	1996	2004	1996	2004	1996	2004	1996	2004
Agriculture	2.7	1.1	12.8	8.9	3.5	4.6	5.0	1.5	3.6	0.6
Manufacturing	8.6	3.3	8.1	1.3	4.9	2.8	16.2	4.5	17.1	11.0
Distribution	16.6	10.9	21.7	16.6	16.0	11.2	9.0	8.1	12.3	7.6
Tourism	11.0	12.2	4.0	7.5	10.7	8.9	10.4	19.0		
Construction	5.3	9.0	22.1	23.7	6.1	6.5	11.0	7.1	3.0	8.0
Personal	34.6	49.5	18.9	21.2	47.7	54.7	25.1	40.3	34.2	39.5

Source: Calculated from central bank publications

There would seem to be a need for a redirection of funds flowing to such traditional areas as the distributive trades and personal loans to non-traditional activities in manufacturing, agriculture and services, which

would have a greater positive impact on economic performance. In addition, addressing the issue of cost must be a part of any strategy geared to achieving a greater diversity in the allocation of finance.

## **5.0 Proposals for Relieving Financing Constraints**

In the previous sections it was argued that the quantity of available finance did not appear to be the major constraint on investment activity in the region. It was suggested that shortcomings in the institutional structure of the financial sector resulted in high borrowing costs which in turn had a negative impact on the allocation of funds. Furthermore, in the case of Guyana and Jamaica, the two most heavily indebted countries, the financing requirements of the public sector affected both the cost and availability of funds for the private sector.

There is a general consensus that there is a need for reforms in the institutional, legal and operational features of the financial sector to achieve a more reasonable interest rate structure in countries in the region (CARICOM Secretariat et al. 2003). Among the specific reforms called for was a reduction in liquid asset requirements imposed on commercial banks which require them to adopt a lending rate structure geared to offset the costs incurred in satisfying these requirements. It was also recommended that the tax systems might be amended to incorporate an interest rate reduction incentive. In addition, it was suggested that more emphasis should be placed on the development of alternative sources of capital, specifically equity markets, to reduce demand pressure on credit markets, leading to an easing of interest rates.

These are all worthwhile initiatives. However, some of the special features of the sector could allow the monetary authorities in the region to adopt a more direct approach to interest rate management (Bennett 2005). Commercial banks are the dominant institutions in all of the countries. However, there are no more than seven commercial banks in any of the larger countries in the region. In addition, a significant share of the commercial bank business is controlled by two leading banks, with the exception of Guyana. The highest degree of concentration, as shown in

Table 11, was in Jamaica where the two leading banks accounted for almost 80 percent of the deposits and loans of the banking system at the end of 2004. The small number of institutions provides an appropriate setting for the conduct of monetary management in which the central bank and commercial banks could function as partners in the management of interest rate policy.

**Table 11**  
**Structure of the Commercial Banking System, 2004**

	Barbados	Belize	Guyana	Jamaica	Trinidad & Tobago
Number of Banks	6	5	7	6	6
Share of Loans <sup>1</sup> (%)	57	63	32	77	59
Share of Deposits <sup>1</sup> (%)	57	63	32	80	53

<sup>1</sup>: **Barbados:** Barbados National Bank, First Caribbean International Bank; **Belize:** Belize Bank, Scotia Bank; **Guyana:** Bank of Trade and Industry, Demerara Bank; **Jamaica:** National Commercial Bank, Scotia Bank; **Trinidad and Tobago:** Republic Bank, Scotia Bank.

**Sources:** Data for the respective banks derived from annual reports, data for the sector from central bank sources.

Let us now turn to the matter of the relatively small share of available funds channelled into productive private investment. It is our contention that this issue is linked as much to demand as to supply considerations. Applications for loans are frequently rejected because of the inability of borrowers to satisfy the collateral requirements of lending institutions. Apart from the issue of collateral, another important factor could be the limited pool of propositions worthy of financial support. This might be deemed to reflect limitations in the pool of entrepreneurial talent in the region. The reason why this might be the case has been attributed to such factors as historical inequities in our societies, reflected in unequal access to such things as education and health, as well as discrimination based on colour and class.

It is argued here that the institutions in the financial sector will have to adopt a more proactive role to realize the objective of a greater share of available funds being directed to productive private investment. This implies that institutions in the region would have to go beyond performing their traditional intermediary role in assessing requests for financial support. They would have to become more actively involved in the identification and development of viable projects and provide the necessary financial support. In other words, the financial sector must not only be working to effectively mobilize savings, but must also be engaged in finding new ventures for the allocation of funds.

This proposed change in function carries important implications for the human resource needs of institutions in the sector. In addition to such traditional areas as accounting and finance, they would need to either develop internally, or have ready access to, expertise in interpreting trends in technological developments which might point to productive opportunities in new as well as traditional products and services. In addition, there would be a need to be current on global marketing trends. This would mean that private financial institutions in the region will have to be encouraged to do something which they have in the main traditionally ignored, but which has been accepted as being essential in other jurisdictions, namely, the establishment of research departments. Such departments play an essential role in providing management with an independent assessment of the implications of domestic and external economic, technical and political developments on an ongoing basis.

There is a role for government in facilitating this transformation of the sector through the provision of fiscal incentives. Tax incentives, for example, could be used to encourage the establishment of research centres in the sector, since such centres could be seen as initially entailing a cost with no obvious short-term return. To the extent that the costs associated with this activity could be written off in whole or in part, this could reduce resistance to the undertaking of such expenditure.

Apart from the provision of tax incentives, changes in the regulatory environment could encourage the type of innovative activity proposed for the sector. Such changes, for example, could make it

possible for institutions to engage in areas of activity from which they have been traditionally barred.

In summary, it is our view that in trying to identify what are some of the important issues in financing development in CARICOM, attention should not be directed primarily to the matter of adequacy of supply. The relatively poor economic performance of countries in the region is, in part, related to the fact that most of the investment projects for which support is sought are not of the sort which make a significant contribution to income and employment. This is reflective of a relative scarcity of entrepreneurial talent. Consequently, institutions in the financial sector may have to adopt a more proactive approach in order to ensure that the full potential of this scarce talent is realized. They have a role to play in helping to identify and encourage innovative activity. An area in which this new approach could be critical is in that of small non-traditional business activity. More emphasis should be placed on ways of developing community-based micro finance schemes.

The high cost of borrowing imposes a significant constraint on economic growth. At the same time the small size of the financial sector provides an opportunity for an innovative approach to monetary management involving direct interaction between the monetary authorities and the commercial banks. This should make it easier to identify what are the critical issues to be resolved in bringing into effect an interest rate structure which would not place domestic producers at a competitive disadvantage.

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