

Financial Aspects of Growth and Development in the Caribbean

De Lisle Worrell, Anthony Birchwood and
Andrina A. Brackin

Caribbean Centre for Money and Finance

Presented at COTE UWI, Trinidad. 1-2nd October,
2009.

OUTLINE

- Rationale for study
- Review of Literature
- Analysis of Data
- Areas for future research
- Concluding Remarks

Focus of Studies on Finance and Growth in the Caribbean

- Studies have examined the investment growth nexus.
 - Public investment versus private investment.
- Levels of public sector investments in tradeables and non-tradeables.
 - Worrell 1993 found that over 50% in the mid 1970s to 80s were in non tradables.
- The role of banks in economic growth in the Caribbean.
 - Financial sector dominated by commercial banks.
 - Lack of well developed capital markets have limited financing options.

Constraint to Investment

- Low level of domestic savings, limited access to foreign savings and High financing costs Bennett (2006).
- Financing costs: high lending rates, high risk levels, and high taxes. (Roach 2007)
- Public investments tend to be financed by debt and is therefore associated with a fiscal overhang. (Roach 2007)

Comparison of Public and Private Investment

- Government spending tended to lead to improvement in social indicators. Mathias and Birchwood (2004).
- Evidence of the effect of public spending on growth is mixed.
 - Mathias and Birchwood (2004) found its effect was negative. Vittas (2003) found that it had a positive effect.

Role of Banks

- Banks were an “important catalyst in the development of commerce” Birchwood (2003)
 - Lending was skewed in favour Wholesaling and Retailing, and Consumer Sectors.
- Key contributors to GDP were externally financed rather than internally financed. Birchwood (2003)
 - Less than a quarter of loans went to the top three contributors to GDP

Constraint to bank lending

- Bank lending constrained by market imperfections (Birchwood 2003)
 - Asymmetric information
 - Credit culture not geared towards fostering innovation or entrepreneur development.
 - Credit closely tied to economic cycles.
 - Inadequate information infrastructure.

Demand Constraints

(Clarke, Stoddard and Shield (1995))

- Firms tended to be loyal to only a few banks.
- The scale of firms was constrained by market size, followed by cost of financing, and then the availability of finance.
- New firms were constrained by the availability of loanable funds.

Finance Development-Growth nexus

- Should the financial sector be relied on to boost economic growth?
 - Supply leading/demand following.
- Greenidge et al (2007) found a long-run relationship between real gross domestic investment and real gross domestic saving.
- There was no uniformity in the findings of various studies in the region on the direction of causality.
 - Birchwood and Nicholls (1999) found Demand following relationship exists in the long-run and bi directional causality in the short-run.
 - Wood (1993) demand following relationship for Barbados for pre independence period and supply leading in Barbados for the period 1969 to 1990.
 - Bourne (1988) found that financial deepening in Trinidad and Tobago had a positive influence on investment and economic growth.
- Empirically, no causal relationship between savings and investment was found (Birchwood and Nicholls 1999).

Explanation of Variables

- Investment---Gross Fixed Capital Formation was used as a proxy for investment.
- Foreign Savings---Imports less Exports.
- Domestic Savings---Investment less Foreign Savings
- Financial Savings---change in total deposits less change in consumer credit (household loans).
- GDP---Gross Domestic Product at factor cost, current prices
- RGDP---Real Gross Domestic Product at factor cost, constant (1990) prices

Countries used in this study

- Barbados, The Bahamas, Belize, Guyana, Haiti, Jamaica, Trinidad and Tobago, countries in the Eastern Caribbean Currency Union (ECCU).
- Dominican Republic, Iceland, Malta, Mauritius, Netherlands Antilles, Singapore: comparator countries
- United States (US): Benchmark country

Average Use of Foreign Savings (2005-7)

% Range	Country
5-10	Antigua/Barbuda, The Bahamas, Barbados, Belize, Malta, USA, Netherlands
11-20	Jamaica, Kitts/Nevis, St. Lucia, St. Vincent and the Grenadines, Iceland,
21-30	Jamaica, Dominica, St. Kitts and Nevis, St. Lucia, Mauritius,
31-40	Guyana, Anguilla
41-50	Grenada
>50	Montserrat, Dominica Republic.

- Foreign savings as a percentage of GDP in most Caribbean countries was higher than Malta, USA and the Netherlands.
- Montserrat and Guyana had relatively large increases in their investment ratios between 1980 and 2007.

Domestic Savings Trends

% range	Country
<0	Anguilla, Grenada, Montserrat, Dominican Republic, Iceland, Mauritius.
0-10	Guyana, Jamaica, Dominica, St. Lucia.
11-20	Barbados, Belize, St. Vincent, Malta, USA
> 20	The Bahamas, St. Kitts/Nevis, Trinidad and Tobago, Singapore, The Netherlands

- Domestic Savings ratios of Caribbean countries tended to be lower than USA and Malta.
- Domestic savings ratio tended to be lower than foreign savings ratio in Guyana, Jamaica, Anguilla, Dominica, Grenada, Montserrat, St. Lucia, St. Vincent, **Mauritius.**

Investment Trends in the Caribbean

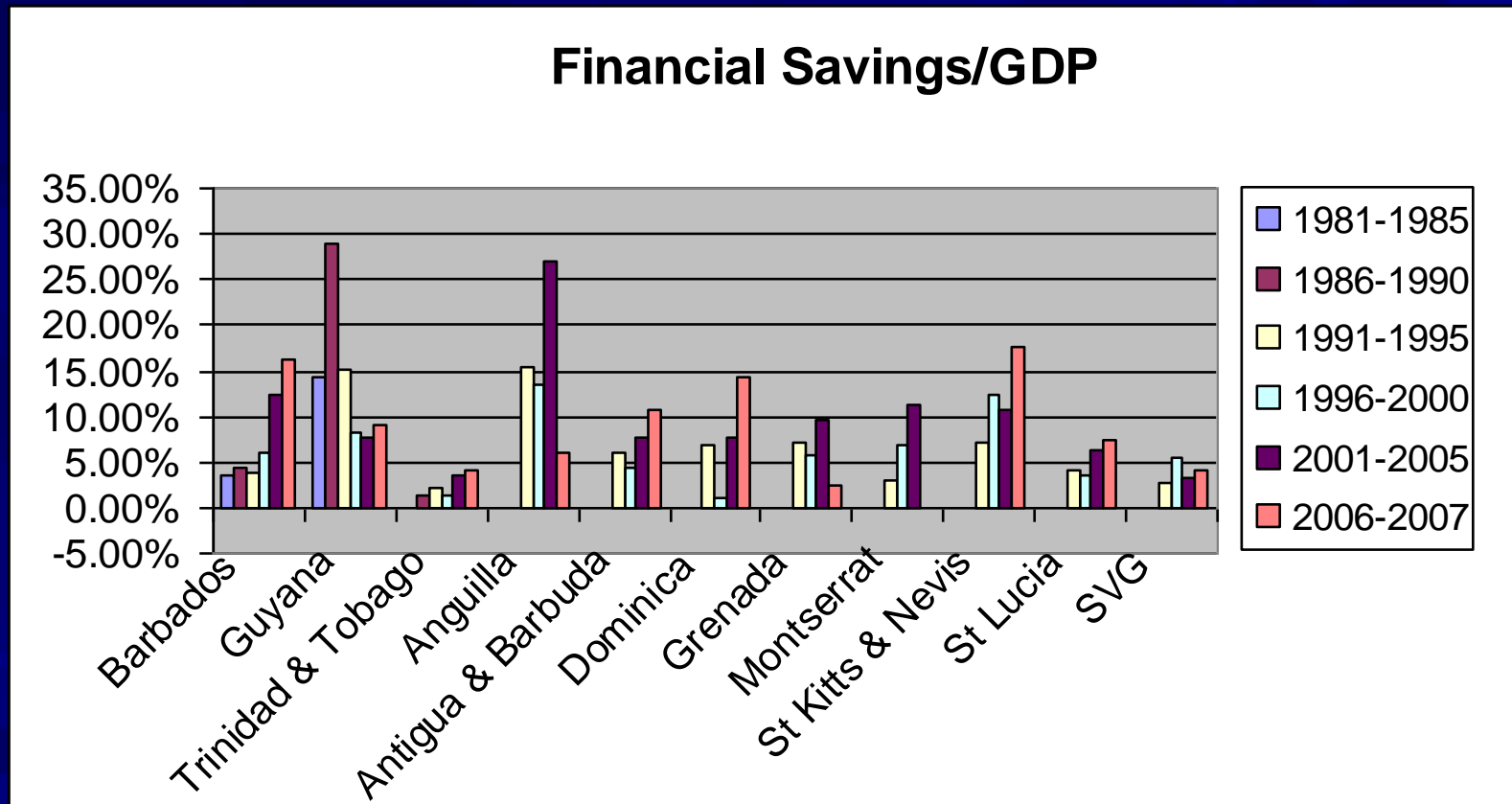
- Investment ratios of Caribbean economies tend to be in the range of 20% to approximately 35%.
- Most of the Caribbean Territories relied heavily on the use of foreign savings to finance investment.
- Investment ratios tended to be higher than the USA, Singapore, Mauritius and the Netherland Antilles.

Percentage of Incremental investment capital ratio

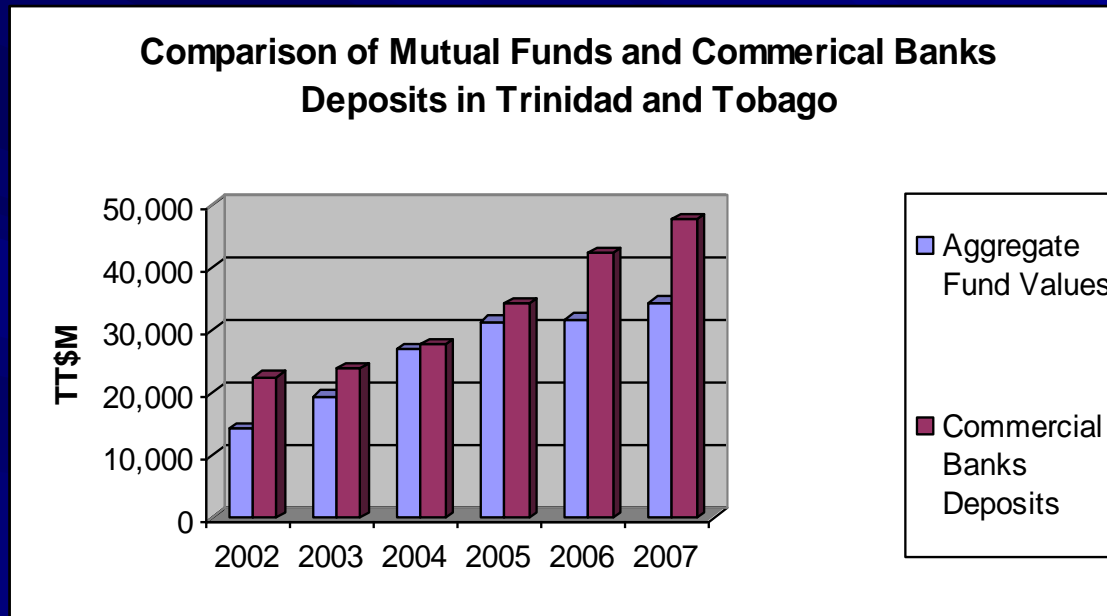
<10	10 and over
Barbados, Guyana, Trinidad and Tobago, St. Lucia, St. Vincent, Dominican Republic, Malta, Mauritius, Singapore	The Bahamas, Belize, Jamaica, Anguilla, Antigua, Dominica, Montserrat, St. Kitts/Nevis, Iceland, Netherlands, USA

- Less countries in the region reflected ICOR of less than 10.
 - Suggests that these economies required lower investments to generate the same increase in capital as the other regional economies.

Financial Savings for Selected Caribbean Countries: 1981-1997

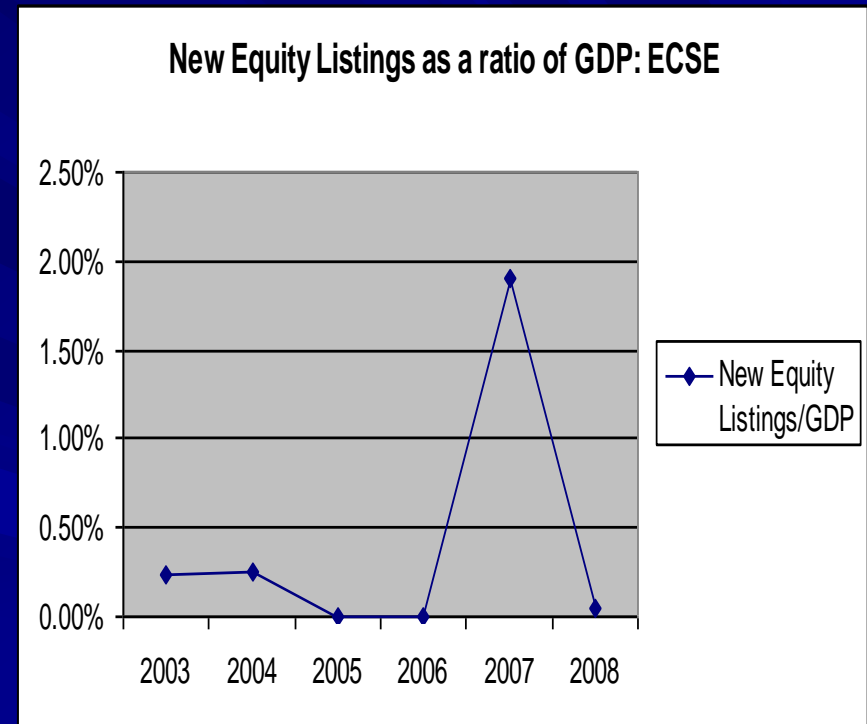
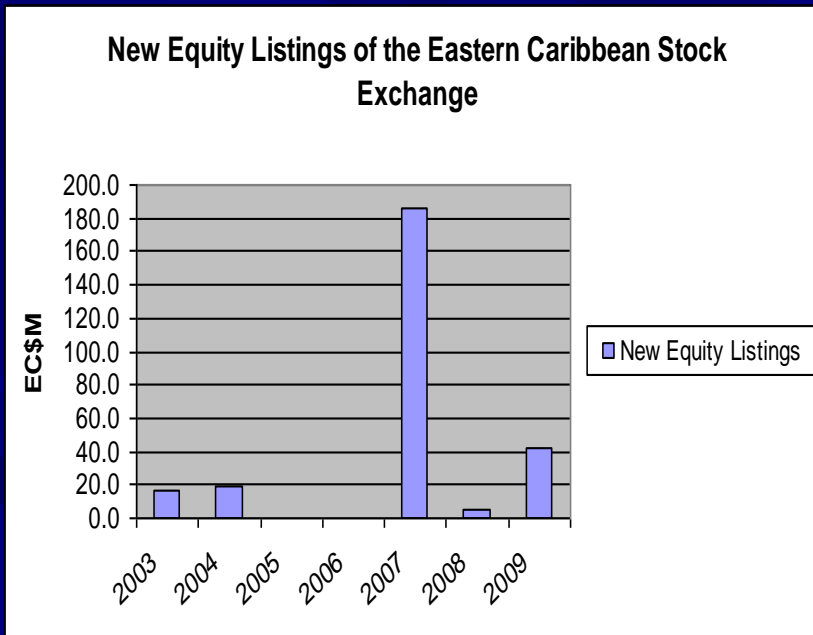


Mutual Funds and Commercial Bank Deposits in Trinidad and Tobago



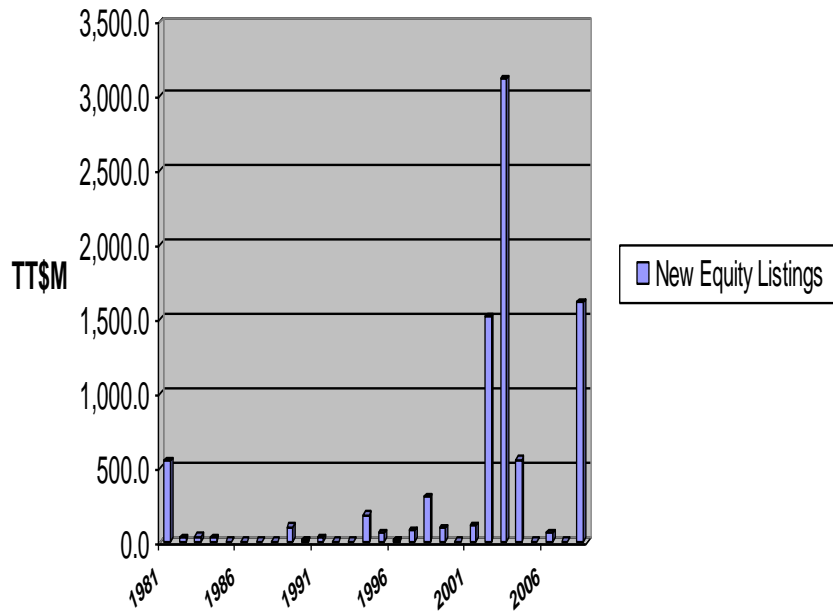
Importance of the Stock Market

- Relatively low level of equity is raised by firms on the stock markets.

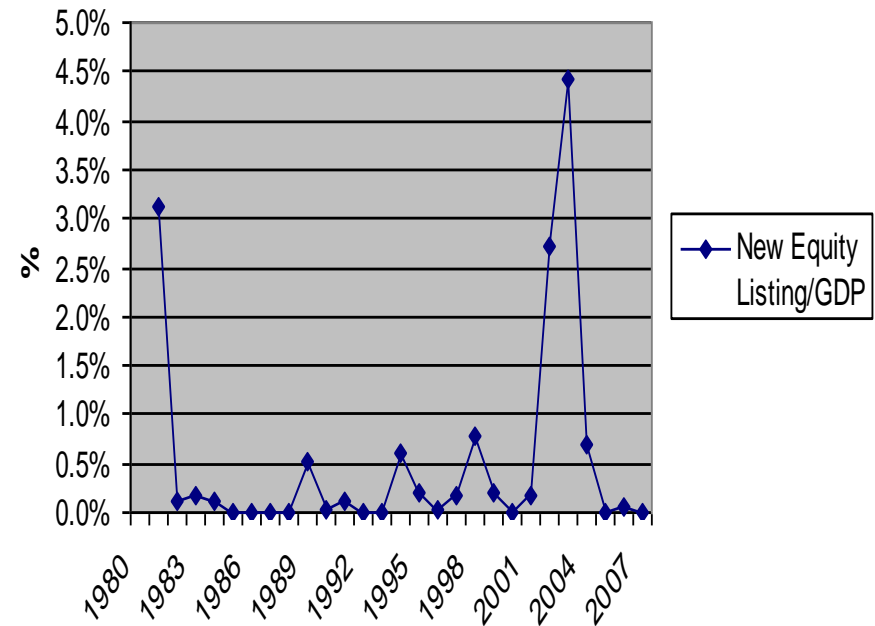


Importance of the Stock Market (Cont'd)

New Equity Listings of Trinidad and Tobago Stock Exchange

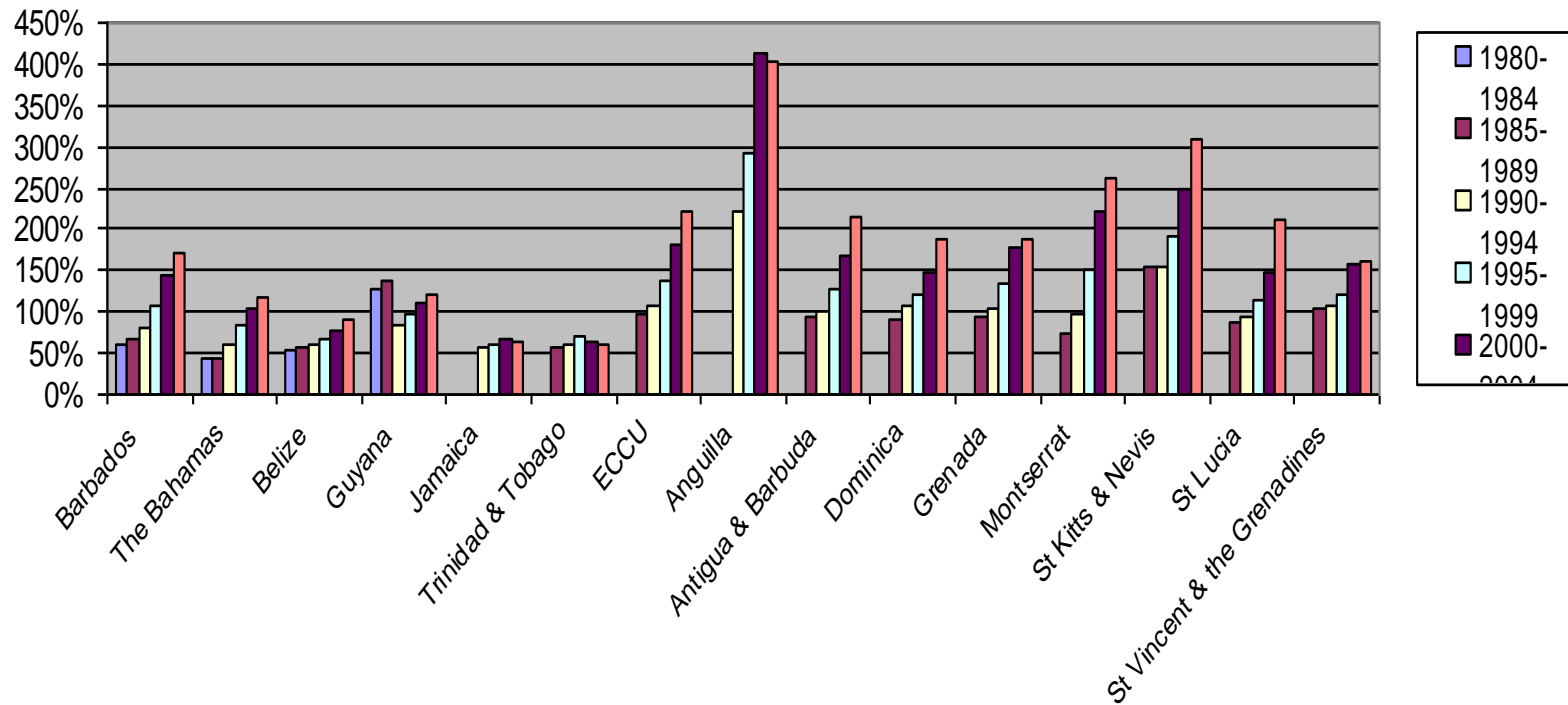


New Equity Listings as a ratio of GDP: Trinidad and Tobago



Deepening of Commercial Banking in the Caribbean

Commercial Banks Assets as a ratio of GDP



Areas for Future Research

- Need for sectoral studies to be undertaken concerning the relevance of bank financing to the development of the dominant sectors of GDP
- Studies critically analysing the role and importance of Non Bank Financial Institutions.
- Further work on Development Banking.

Areas for Future Research (cont'd)

- Need to examine the demand for bank financing in various sectors and the need for working capital.
- Critical analysis of other avenues of financing development.
 - The role of credit unions and cooperatives
 - Search for Financial innovations
 - Alternative Microfinancing schemes
- Data intelligence.
 - Data architecture
 - More work on micro data

Concluding Remarks

- High Investment and foreign savings ratios for Caribbean economies.
- Low domestic savings ratios and economic growth rate are a feature of Caribbean economies.
- High dependence on foreign savings.
- Commercial Banks Loans are skewed in favor of a few sectors.