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Finance and Development in the Caribbean: Threats to the Link

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ABSTRACT

The aftermath of the global financial crisis of 2007/2008, followed by threats of de-risking and issues surrounding correspondent banking, provide a convenient context for researchers and policy-makers to reconsider the role of the financial system in advancing growth and development in the Caribbean. This article reviews the literature on the link between finance and economic growth and development, and considers major constraints which hinder the ability of the sector to make a greater contribution to both. It then discusses possible solutions to constraints and de-risking, which are available to policy-makers to ensure that the sector makes an even greater contribution to Caribbean economic development.

Keywords: Caribbean, finance, banking, development, policy, de-risking

Since independence, most countries in the Caribbean have experienced some degree of growth and development. This is partly borne out by the middle-income standing of several countries in recent Human Development Reports of the United Nations Development Programme (UNDP). Indeed, the reports count the Bahamas, Barbados, and Trinidad & Tobago among countries in the category of High Human Development.

Nevertheless, several Caribbean economies still remain structurally undeveloped—some may even say underdeveloped. This is partly evidenced by sustained periods of generally weak macro-economic fundamentals, including high debt, slow or negative growth, and poor social conditions, often related to high unemployment.

To the extent that the Caribbean can be described as relatively developed, one might ask, what role has the financial sector, or commercial banking in particular, played in this development? To help answer this question, it is useful to turn to the regional and international literature.

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The literature has established that banking and, more broadly, finance, plays a critical role in growth and economic development, which is about the overall quality of life, and the financial sector is presumed to contribute to the quality of life or the standard of well-being of the population whatever the structure of the economy—service—or commodity-oriented. Well-known studies by Goldsmith (1969), Fry (1995), and Levine (1997) attest to this. Indeed, after reviewing several studies which highlighted the role of finance in growth, and those that excluded or downplayed its importance, Levine found that "the weight of evidence suggests that financial systems are a fundamental feature of the process of economic development and that a satisfactory understanding of the factors underlying economic growth requires a greater understanding of the evolution and structure of financial systems" (Levine 1997, 690).

Based on cross-country research, the World Bank also found that "countries that build a secure institutional environment for financial contracts, making it possible for banking and organized securities markets to prosper, will see their efforts bear fruit in the fight against poverty" (World Bank 2001, ix).

On this question of the influence of finance on growth, the author shares Levine's view that:

> theory and evidence make it difficult to conclude that the financial system merely and automatically responds to industrialization and economic activity, or that financial development is an inconsequential addendum to the process of economic growth (Levine 1997, 720).

This statement is likely to be true of the developed world, as it is of the Caribbean. Much of the work that has been done supports this thesis of finance influencing or even "causing" growth, not only in large developing countries in Asia, Latin America, and Africa, but in small economies as well. Work on the Caribbean by Bourne (1988), Wood (1993), and Birchwood (1997) confirms this. Seetanah, Ramessur, and Rojid (2009, 132) also found that indicators for financial development in twenty island economies showed "a positive and significant effect on the level of economic growth and are in line with the literature".

Specifically, finance has played an important part in the economic development of the Caribbean through the mobilisation

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of savings; the allocation of funds; the monitoring of managers and households; and transforming risk through aggregation and enablement (World Bank 2001).

However, while most researchers and practitioners seem to agree that finance has played some positive role in Caribbean economic development, some have questioned aspects of that role. Major criticisms have focused on the interest rate spread, lending rates, commercial bank portfolio allocation, and relatedly, low risk-taking by financial institutions. Some studies such as the World Bank's *Ease of Doing Business* report, Holden and Howell (2009), and Khadan (2016) have found that access to finance is a major constraint to business development, and therefore, to further growth in the region.

This article discusses these criticisms and examines what changes might be made to the financial architecture to advance financial inclusiveness and growth in the region. However, these discussions, though important, pale in comparison to the current issue of de-risking by multinational banks, which now threaten to sever critical financial connections between small Caribbean economies and the developed world. According to a Financial Stability Board (2017) survey of forty-eight jurisdictions, small states in the Caribbean and the Pacific were the most affected over the period 2011–2016 by the withdrawal of correspondent relationships. Main challenges identified were money laundering, terrorism financing, and tax evasion. These have ramped up risks and the costs of surveillance, regulation, and compliance which, in turn, now threaten the very viability of some Caribbean financial institutions, if not their economies.

Specifically, the global financial crisis, which originated when the bubble in the US real estate market burst in 2007, exposed weaknesses in governance, regulation, and in the supervision of bank and non-bank financial institutions in the developed and developing world. These weaknesses, which are still evident today, have impacted the region because of the interconnectedness of the Caribbean and the developed economies through trade and investment, but also because of the interconnectedness of multinational financial institutions with the region, either through branches or through correspondent financial relationships.

If, as Stiglitz (1998, 56) concluded, "the financial system . . . is the key to economic development", then several questions arise.

Can the financial system, in its present form, stave off the threats and can it be expected to continue to make a contribution to Caribbean economic development? If it can, then at what cost? What should be done to attract more funds into presumably new and profitable areas of the economy? If the small size of these economies increases the cost of services which banks offer, what can be done to ameliorate this situation? What do higher compliance costs mean for regional banks and their customers? Answers to some of these questions will be provided below, in the hope that they will raise awareness of the serious threats facing the region, and assist in crafting more appropriate policies and institutions for the financial sector. The rest of this article defines the constraints to a greater impact by the financial sector on growth and suggests possible solutions and policy guidelines.

Defining the Constraints

The financial sector in the region is fairly developed and characterised by a mix of multinational and local, banking and non-banking financial institutions, which cater to a wide range of corporate, government, and consumer activities. In terms of assets, commercial banks are the dominant institutions in the financial sector, which includes development banks, stock exchanges, merchant banks, insurance companies, credit unions, unit trusts, and regulatory bodies. According to the Caribbean Centre for Money and Finance (2016) commercial banks' total assets to GDP for CARICOM territories averaged 81.1 percent of GDP, followed by insurance companies, 19.8 percent, and credit unions, 6.6 percent of GDP.

Individual regional economies are, for the most part, dominated by one or two sizeable economic sectors—energy and mining—in the case of the larger territories, and tourism, in the case of most of the smaller territories. These tradable sectors, because of their relatively large scale and large capital demands, are financed mainly by equity and a few large multinational institutions, some with representation in the Caribbean. Multinational banks have been in the region since the nineteenth century. Arguably, therefore, the Caribbean's financial sector has been fairly liberalised from inception.

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Indigenous banks—public and private—play an important role as well, especially in the provision of working capital and in the supply of day-to-day payments, retail loans, and other services. Loans granted by commercial banks (indigenous and foreign) in the region do not follow a strict and common classification. Nevertheless, an examination of central bank data from various territories indicate that generally, consumer loans, including mortgages, accounted for about 50 percent of total loans, private sector or business lending 40 percent, and loans to the public sector 10 percent. Loans to the distribution sector normally constitute the largest share of business loans. That commercial banks' portfolios generally reflect the size and structure of the regional economies should not be surprising. There are exceptions, however. For example, in Trinidad & Tobago, although the hydrocarbon sector accounts for more than a third of GDP, the share of commercial bank loans to that sector averages three to four percent. Funding of the hydrocarbon sector is largely through foreign direct investment. It must be emphasised that both the private and public sectors in the Caribbean borrow externally as well. This is not because locally based banks are somehow disinterested in lending, but the sheer size of the financing needs of multinationals and even governments rule them out.

While credit unions have a high population penetration ratio of some 40 percent in the region, their share of deposits and loans remains small. According to Edwards (2014) they "must look inwards and recognize that their collective performance during the 2005–2014 decade has been sluggish and low in impact."

Constraints to finance making a greater contribution to development might be categorised by the availability of finance; the cost of finance; and by factors on the demand side. The first constraint to be considered is the availability of finance, credit or other intermediation services. Finance is usually available to most traditional and relatively profitable sectors or activities. However, if Caribbean economies are to grow and diversify into other areas, then finance must be available to a wider range of business activities and entities. This has to do more with a broadening of the financial sector, and addressing demand side constraints, and less to do with commercial banks themselves.

The reality, though, is that some sectors have not been able to attract financing, including some non-traditional service sectors

and activities, agriculture, and small and medium-sized enterprises (SMEs). Further, a perennial criticism from several quarters is that many “good” ideas fail to get the appropriate funding because banks are reluctant to take the requisite level of risk.

In the case of the latter, one must acknowledge that research and development projects are risky and unlikely to show positive results in the short to medium term. Accordingly, such activities, regardless of sector, are unlikely to attract bank funding, if only because of the relatively shorter term horizons of commercial banking and the naturally high-risk nature of such activities. This situation speaks to the need for initiatives that would reduce risks and promote the establishment of appropriate financial products or institutions as identified in Holden and Howell (2009).

Some will argue that the high level of liquidity in Trinidad & Tobago and other countries in the region suggests that funding is available, but the banks will counter that potential borrowers do not possess the criteria to attract the requisite finance. While these arguments are understandable, they do not help the situation, which is to get funding to a broader range of activities that can help transform Caribbean economies.

Agriculture is one sector that is sizable in territories such as Guyana, and of considerable importance to the region, but many feel it does not attract the amount of lending that it should. The reality is that, because risks of natural disasters, pests, etc. are so high in this sector, banks fear capital can be lost and often refuse to lend, oftentimes, regardless of the lending rate. Commercial banks are in the business of lending and will lend to any sector or individual that can demonstrate an ability to repay the loan under agreed terms. This way of lending leads to a particular structure of their loan portfolios, that is, only sectors which demonstrate a reasonable rate of return will get funding. Understandably, not all sectors will manifest the identical level of risks and returns, but those that do not stand a chance of becoming profitable will not receive funding, notwithstanding the sector’s perceived importance to economic development. Government has an important role here, which is far broader than simply direct lending.

The second constraint to financing certain sectors and activities is the cost of it. It is often argued that bank lending rates are too high. High lending rates and fees generally derive from the cost of doing business, including banking business in the

Caribbean. The greater the difficulty in establishing and doing business, the more costly business operations are likely to be. No Caribbean country features in the first fifty countries in the World Bank's *Ease of Doing Business* report.

Many voices in the region correctly lament the relatively high cost of doing business in this part of the world. Various reports, including the World Bank's *Ease of Doing Business* report, identify factors which lead to higher costs, including crime, enforcement of contracts, and the length of time it takes to get permits and to register property. It is not often recognised that these relatively higher costs of doing business in this region also impact banks and other lending institutions themselves, as these operate in the same business environment as their customers.

Loan rates in the region are often compared to those in developed economies. This comparison will always be questionable or inappropriate because of their different economic realities. Worrell (1996) is among those who question the comparability of small Caribbean banks with large multinationals. Indeed, he argues that "banks in small Caribbean economies cannot expect to match the operational performance of large financial institutions in industrial countries" (Worrell 1996, 6). Nevertheless, Holden and Howell (2009), in comparing real lending rates, find that when adjustments are made for the rate of inflation, real rates in Barbados and Trinidad & Tobago, for example, are comparable to those in the US and Canada. This observation must not be interpreted to mean that there isn't room for efficiency improvement in the Caribbean. In any case, competition with large multinational banks and non-banks helps to ensure that rates are competitive. Nevertheless, the challenges of small size should be taken into account in any comparison of Caribbean loan rates of interest with those of the developed world.

While size of country is one factor determining the level of lending rates, for the reasons advanced above, it is not the only one. Generally, loan rates are higher in riskier countries—small or large—so that rates can vary considerably amongst countries in the region, or for argument sake, among various customers within the same country. This is precisely why a country's risk rating by Moody's and Standard & Poor's is taken so seriously. Lending costs must of necessity take into account a myriad of risks, including market, reputational, political, etc. For example, according to

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UNECLAC's *Economic Survey of the Caribbean* (2016), the lending rate in Jamaica in 2015 was 14.5 percent, compared to 6.77 percent in Barbados. Also Holden and Howell (2009) point out that, among Caribbean territories, Jamaica had the highest real loan rate while some of the smaller territories showed lower rates.

In the Caribbean, where non-banks and government-owned banks compete with private multinational and indigenous commercial banks, within territories and across the region, this charge of unduly high loan rates is difficult to substantiate. Central banks as regulators are not unaware of the benefits of competition and routinely play their regulatory role as they see fit, with legal and licensing powers and moral suasion at their disposal. In the author's view, however, there is room for a more effective role in the area of regulation, in the championing of property rights, and even in the promotion of new financial institutions, as some of them have done in the past.

Since deposit rates are relatively low in the region and loan rates high, interest rate spreads are wider than in the developed countries. Very often criticism is about the size of the spread. According to Randall (1998), relatively higher spreads in the region have more to do with higher operating costs, higher reserve requirements, the small size of markets, higher inflation, etc. If spreads reflect costs and risks, then they ought to be smaller in better performing economies. Indeed, one finds that spreads are indeed narrower in the better performing Caribbean economies than in the worst performing ones (Ramkissoon 2009). For example, an examination of economic data such as growth rates, GDP per capita and the Human Development Index (HDI) ranking over long periods shows that the Barbadian economy has performed better than the Jamaican economy (Ramkissoon 2002; Thomas and Serju 2009). According to UNECLAC's *Economic Survey of the Caribbean* (2016), the spread in Jamaica was 15.3 percent compared with 6.35 percent in Barbados. This observation on the differential in rates and spreads indicates that there is some "science" to the regime of lending rates and interest rate spreads across the Caribbean.

The World Bank argues that "small financial systems underperform. They suffer from a concentration of risks: the smaller the financial system, the more vulnerable it is to external shocks and the less able its financial system is to insulate or hedge those shocks" (World Bank 2001, 19). In general, it is these

drawbacks in the Caribbean which largely account for relatively higher lending rates and spreads.

In the same vein, Randall (1998) and the World Bank (2001) argue that small financial systems have higher operational costs and do not benefit from scale economies. This means that small size is a constraint to lower lending costs, which translates into correspondingly higher lending rates. It stands to reason that, in general, the smaller the population and the economy, the higher the cost of services, *ceteris paribus*. Small states, with their individual financial systems, can be expected to have higher operational costs than larger entities which derive economies of scale. Different legal jurisdictions and inadequate ICT infrastructure across more than a dozen small islands and territories mean that the logistics of organisation and delivery of banking services will typically be more costly.

A recent study by Birchwood, Brei, and Noel (2016) identified and quantified the impact of several variables discussed above, with respect to interest rate margins in Central America and the Caribbean. In their regression results, market power, operating costs, and non-performing loans stand out as having a positive and significant effect on bank margins. Reform must seek to limit and reverse these effects.

The current threat of the withdrawal of correspondent bank relationships, or de-risking, which now faces the Caribbean translates into even higher costs of doing business in the region and represents a direct threat to bank profitability (Erbenova et al. 2016). The Common Reporting Standard (CRS), a global measure developed by the Organization of Economic Cooperation and Development (OECD), threatens to add even more costs to the business of regional financial institutions. In short, the costs of surveillance, compliance, and regulation are so high that multinational banks are considering that it may be best to not do business with several territories in the region, rather than be fined by their regulators and/or operate at a loss. Indeed, an ECLAC researcher warns that the de-risking strategy "if unchecked, [this practice] runs the risk of undermining investment and economic growth in the sub-region and compromising the ability of many economies to achieve the SDGs" (Skerrette 2016, 10). Not surprisingly, new challenges such as cyber-crime and de-risking

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now not only threaten to raise the cost of banking in the region but threatens the very availability of finance.

So far we have considered as constraints the availability or supply of finance and the cost of finance or credit. As in any market, demand conditions are important, too, in determining price. In other words, while finance for particular activities might be limited, or the cost in the form of the lending rate and other charges might be high, funding might become available or the lending rate might be lower, if the borrower can find ways to improve the efficiency, and therefore the level of credit worthiness, of his business. In the author's view, this side of the business is not given the attention that it deserves.

Poor record-keeping, business management and planning in general, on the part of some operations, result in poor financials, which in turn hinder proper analysis of the loan proposal. As a result, the credit risk might be higher because of a lack of borrower information and the resulting lending rate higher than normal. This is found even in some of the larger firms in the Caribbean, but more so in SMEs (Khadan 2016, 55). Significant improvement here holds great potential for business expansion and financial intermediation. The growth of a more appropriate and effective financial sector is constrained by a range of issues, which affect the availability, as well as the cost, of finance on the supply side. If anything, these constraints seem to have worsened. But there are critical issues on the demand side, and economy-wide as well, not the least of which concern SMEs, existing businesses and start-ups. Some of these issues are looked at next. If addressed, they can be expected to have a greater impact on growth and development in the Caribbean.

Toward Possible Solutions and Policy Guidelines

While finance has played a positive role in the development of Caribbean economies so far and although new challenges abound, further growth in the region might be enhanced by making credit available to new and existing enterprises across economic sectors; reducing as far as possible the cost of credit, partly through more stringent risk reduction and risk management strategies; and by promoting action that would make small and emerging businesses much more credit worthy, such that they will more easily attract credit, either from banks, non-banks, the capital market or even emerging fintech firms.

Let us begin with the supply of credit. If lending is unavailable for certain activities it might very well be that commercial banks, or credit unions for that matter, are not the appropriate institutions to assume such risks. A perhaps extreme example is that of an untried and untested project for which the borrower has no experience and is not willing or able to provide any equity. The appropriate lending institution cannot be a bank, given that banks depend on depositors' funds for lending and not on risk capital. The same applies to a credit union. This absence of appropriate institutions is lamented by Ramkissoon (2009) and also by James, who argued that the limited success of Caribbean countries to develop "a sufficient range of appropriate financial institutions to achieve the desired reallocation is quite costly in terms of lost opportunities to raise the standard of living" (James 2006, 3).

In line with the analysis of Gambacorta, Yang, and Tsatsaronis (2014), it seems to be the case that, while traditional commercial banking took the region up to this point, it is time that more advanced and complementary market institutions be established or strengthened to take Caribbean economies to a new and higher level of economic growth and development.

Policy makers should pursue the establishment of appropriate institutions that will, among other things, take particular risks in providing alternative forms of finance. For example, a stronger capital market allows for equity and bond financing which are complementary to bank lending. A single regional capital market is likely to be more efficient than the existing few stock exchanges. A regional venture capital company is long overdue, as it would supply yet another type of funding that banks cannot provide. While attempts have been made with venture capital companies in Trinidad & Tobago, for example, Holden and Howell (2009) argue that the lack of a market for easy exit of investors is a major limitation. The author does not believe that this is insurmountable. It stands to reason that, with new and effective institutions, not only will the competitive environment be improved, with the likelihood of narrower bank spreads, but also, no one institution would be called upon to bear all the risks as these would be better spread among a larger set of financing institutions.

While several studies, perhaps inadvertently, seem to equate banking with finance, a more recent and insightful study by Gambacorta, Yang, and Tsatsaronis (2014) made the distinction

between banks and markets, where the latter are defined to include equity and bonds. They argue that banks and markets define the financial structure of any country and are all-important for economic growth, but only up to a point. These authors find that banks are particularly useful to lower income countries because they provide inexpensive risk management for standardised risks and can compensate for weaker institutions. As countries evolve and their financial needs become more elaborate, markets are better able to provide products tailored to specific users. Thus, as economies mature, increasing the demand for a broader set of risk management and capital-raising tools, they can benefit from a legal and regulatory environment that supports market-based activities.

Edwards (2014) believes that the credit union movement can do far better than it has done in the past and argues that an "aggressive pursuit of economic competitiveness must, therefore, replace the incrementalist approach to business growth. The strategic goal awaiting this region is to increase the average credit union share of national financial markets from the longstanding 3–10% to 15–20% before the year 2020" (Edwards 2014, 369). If this is to happen at all, then a far more comprehensive delivery and modern regulatory architecture is necessary.

While a wider range of financing institutions can be helpful, one must be careful that they are indeed appropriate for the task at hand. For example, it is sometimes proposed that, for various reasons, particular institutions, apart from commercial banks, should be the ones to provide equity, loans or both. Among institutions identified are pension funds, national insurance funds, credit unions, or government itself (Theodore 2009). But the question arises: if experienced lending institutions, such as commercial banks, shy away from high lending risks, are the institutions identified above, better equipped to lend? For example, is it appropriate for pension savings to be subject to the vagaries of high commercial risks? One needs to be careful in passing on too high and unclear risks to institutions that might be ill-equipped to bear them.

The current group of indigenous, foreign, and government banks and other financial institutions seem adequate to meet the more traditional needs. There are no services that are effectively demanded—that is, that customers are willing to pay for—that the existing financial institutions cannot provide. If some financial

services are unavailable in the region, the reason might have to do with either the lack of regional infrastructure, such as a modern information and communication backbone, or the prohibitive costs of providing these services, which are not unrelated.

SMEs may find it much easier to access funding if they address internal shortcomings, such as training in the preparation of cash flow statements, human resource management and marketing. While much is said about these activities, too little has actually been done. This training might usefully form part of a major collaborative and sustained policy effort by governments, the financial sector, and the business community across the region. Multilateral institutions can play a significant role here as well and there are some signs that this is beginning to take place.

If the supply of loans is skewed towards a few profitable sectors in the region, this is largely reflective of the demand side, which is based on the structure of the economy and/or signals of the macroeconomic environment. In other words, loans are generally granted to sectors or activities that can repay them. Most will argue that this is as it should be. The truth is that one will hardly find existing lending capacity sitting idle alongside rising and effective loan demand. Managing high liquidity in the region is indeed a challenge, but generally has not usually been a reason for poor lending decisions as a whole. If economic development through a more diversified range of global businesses is the goal, then the solution is a suitable macroeconomic framework that stimulates effective loan demand across a wider range of viable businesses. This macroeconomic framework should include an appropriate exchange rate regime, low inflation, fiscal stability, clear market signals, incentives that reward effort, and very importantly, a strong, dynamic, small and well-resourced public sector.

Some critics argue that there is an unmet demand for funding in some areas, such as agriculture or new ventures, and that whatever challenges reside on the demand side could easily be addressed if we get the supply "right". This is not always the case. For one thing, there is need to clarify the demand, to see exactly what type of funding is being demanded and at what interest rate. Is the demand for equity, loan funds, trade finance, venture capital, or some combination of these? Is it for short- or long-term funds? A careful consideration of these demands must be undertaken if appropriate solutions are to be found.

Traditionally, governments have sought to meet perceived demands by establishing development banks with little success. For example, agricultural development banks (ADBs) do play a limited role in the region. However, for one reason or the other, such banks, or more broadly defined, public development banks have not done especially well. Eslava and Freixas (2016) argue that such banks, of which ADBs are a subset, generate positive externalities but may not attract credit under normal lending criteria. Even if positive externalities can be derived, the pressure on governments' fiscal accounts can be too burdensome and unsustainable. In the case of agriculture, in particular, support by governments, in the form of direct lending, is likely to be far less successful compared to intervention with respect to physical infrastructure such as flood prevention, irrigation, research, land titles, trade, and supportive agricultural policies.

Now, let's look at the cost of credit. The lending rate applicable to any enterprise includes operational costs and the level of risk which the lender associates with the particular venture. In order to measure that risk, the lender solicits and seeks to collect information on that business. To the extent that adequate information is unavailable, the loan might be turned down or be inappropriately risk-rated. The latter can lead to a lending rate that is higher than warranted. SMEs are typically weak in the provision of financial and other data. In this context, credit bureaus and formal risk rating of SMEs using available data can lead to greater access to funding by these businesses.

The stark reality for the Caribbean is that the cost of doing business in the region is too high. Rising costs from several directions now threaten profitability of financial and other types of business. Appropriate measures of bank profitability include the rate of return on assets (ROA) and the rate of return on equity (ROE), not the absolute dollar value of profits, as is commonly believed. The Caribbean Centre for Money and Finance (CCMF) notes in a recent report that the regional weighted average ROA fell from 2.7 percent in 2008 to 0.3 percent in 2014, and the ROE from 17.2 percent to 5.0 percent over the same period (CCMF 2015). This trend does not augur well for the region, as one likely outcome of this is fewer financial institutions.

The response by multinational banks to high regulatory and compliance costs in both the developed and developing world is to

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raise the cost of correspondent and other services to the region, and to even sever relations in some cases. These actions are negatively affecting key areas of regional support and growth, including remittances, trade, and offshore business. Therefore, solutions to these constraints are critical if lending rates and charges are to fall or if these financial services are to be provided at all. Since possible solutions are multi-dimentional, involving several key players in and out of the region, stakeholders need to address these challenges together. Several initiatives at the national, regional, and international levels are currently in train, but must be comprehensive and well-coordinated.

Policy must ideally embrace the entire set of institutions and practices that comprise the sector, including credit unions, insurance companies, banks, trusts, pension funds, the capital markets, etc. This broader view of the financial sector might allow for a more holistic approach to finance, hopefully revealing practical solutions, and closing gaps such that borrowers and lenders can grow. Banks cannot, by themselves, prudently take the level of exposure that some projects require. Complementary financing from other sources is needed. In this context, the work of Gambacorta, Yang, and Tsatsaronis (2014) is extremely relevant—the structure of the particular economy and of the financial sector must be viewed in a dynamic way by policy makers. Specifically, the sector will only contribute to further economic development if the financial markets themselves grow in line with, or even lead, as the stage of economic development advances.

Comprehensive regulatory oversight, including a proper governance structure across institutions and countries, is critical for a properly functioning financial system. The failure of the Trinidad & Tobago insurance conglomerate, CL Financial Holdings, CLICO and the Hindu Credit Union are cases in point. Other countries, notably Jamaica, have had their own misfortunes in this area. Indeed, such failures represent some loss in confidence in traditional financial institutions and a direct threat to the link between finance and development. It should be clear that policy makers are not without blame in these costly and far-reaching misadventures.

Policy makers must identify the factors under their control which keep bank costs unduly high and seek to reduce or mitigate them. For example, they may wish to find alternatives to high and

non-remunerative reserve requirements as tools of monetary policy. To the extent that the cost of regulation is to be borne by regulated institutions, these must be reasonable and not exacerbate the already high costs of doing business.

To the extent that scale economies are not derived by small financial institutions in small territories, regional policy must make regional and international banking and financing much easier. Advancement in technology is a definite advantage in this endeavour, and the emergence of fintech firms in emerging economies which combine finance with the latest technology is making this a reality (Bank for International Settlements 2015). While there have been some success by traditional lenders in this area, much more needs to be done to improve the risk and delivery infrastructure, such as data collection and e-banking for example. This is very much in line with the vision for CARICOM's Single Market and Economy.

On the demand side, where many challenges lie, there is need for programmes, policies, and instruments that address the risk constraints of borrowers and that aggressively promote financial inclusion. In particular, strengthening of property rights and training for small and medium-size enterprise (SMEs) will go a long way toward making that sector better equipped and more attractive to lending from existing financial institutions. Several commercial banks already operate in this area but more needs to be done. In the case of agriculture, any action which reduces the risk of natural and man-made disasters can bring rich rewards. As indicated above, attention to land titles, testing laboratories, proper irrigation and praedial larceny come to mind. Several of these constraints, if attacked at the economy-wide level, can bring benefits to the sector, thereby making it much more bankable.

CONCLUSION

The Caribbean manifests a fair degree of economic development and the financial sector has contributed to that growth and development. This has not come without a fair degree of criticism of the dominant commercial banking sector. It seems, though, that many in the region have taken the role of the financial system in economic development for granted—even those employed in the sector itself. However, new and emerging demands, financial

exclusion, rising costs, and recent events associated with de-risking threaten to constrict and even sever the link between finance and economic development. Urgent attention to the adequacy of the existing financial infrastructure and its linkages to the wider economy is needed, if gains are not to be lost and growth further threatened.

There is no doubt that with improvements on the supply side, the financial system can contribute to stronger growth. Attention to existing constraints can improve the availability of finance to existing and potential or excluded borrowers. Reform of existing financial institutions and the establishment of new ones should complement the role of the dominant commercial banks in the supply of financial services. In this process, the use of emerging technologies can bring services to unfunded ideas and unbanked segments of the Caribbean population.

The cost of doing business in the region, as mentioned, is already too high and in the financial sector, these costs often translate into high lending rates and outright rejection of proposals in some cases. Concerted attention to the promotion of regional banking infrastructure and a reduction of these costs, partly through technological adaptation, can lead to a more impactful financial sector.

Specifically, threats to de-link regional entities and economies from remittance flows, trade, and other financial arrangements with the developed world, due to rising costs, are a real and present danger. Policy makers are by now keenly aware of these threats. The cost of providing these services is likely to rise as a result of the need to comply with regulatory authorities in and outside the region. Quick and concerted action is necessary, not only to comply, but to find the solutions that can help to keep the cost of finance down and make financial services more inclusive and profitable enough for both borrowers and lenders.

Central banking authorities and Ministries of Finance are primarily responsible for ensuring that the policy framework is evolving in such a way that finance makes a maximum contribution to economic development. Broadly speaking, those responsible for policy formulation and implementation must ensure that they are adequately equipped with the expertise and foresight of the possibilities of finance in the unique circumstances of small, open economies. Time is of the essence.

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المنارة للاستشارات

Mots clés: Changement structurel, politiques fiscales, politiques macroéconomiques, endettement, changement climatique

Finanzas y Desarrollo en el Caribe: Dmenazas al Enlace

Ronald Ramkissoon

La repercusión de la crisis financiera mundial de 2007/2008, seguida de amenazas de disminución de riesgos y problemas relacionados con la banca corresponsal, proporcionan un contexto conveniente para que los investigadores y los legisladores reconsideren el papel del sistema financiero en el avance del crecimiento y el desarrollo en el Caribe. Este artículo revisa la literatura sobre el vínculo entre las finanzas y el crecimiento económico y el desarrollo, y considera las principales limitaciones que obstaculizan la capacidad del sector para hacer una mayor contribución a ambas. A continuación, analiza las posibles soluciones a las limitaciones y el riesgo, que están disponibles para los responsables de las políticas para garantizar que el sector haga una contribución aún mayor al desarrollo económico del Caribe.

Palabras clave: Caribe, finanzas, banca, desarrollo, política, eliminación de riesgos.

Finances et Développement dans les Caraïbes: Les Menaces au lien

Les conséquences de la crise financière mondiale de 2007/2008, suivies des menaces de réduction des risques et des problèmes de correspondance bancaire, fournissent un contexte pratique aux chercheurs et aux décideurs pour reconsidérer le rôle du système financier dans la promotion de la croissance et du développement dans les Caraïbes. Cet article passe en revue la littérature sur le lien entre la finance et la croissance économique et le développement, et considère les contraintes majeures qui entravent la capacité du secteur à apporter une plus grande contribution à la fois. On discute ensuite des solutions possibles aux contraintes et à la réduction des risques, qui sont à disposition des décideurs politiques pour s'assurer que le secteur contribue encore plus au développement économique des Caraïbes.

Mots-clés: Caraïbes, finance, banque, développement, politique, atténuation des risques

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