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# FINANCING DEVELOPMENT IN ST. LUCIA 1964-1989

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Over the past twenty five years St. Lucia has moved from being one of the most backward of caribbean territories to one which is recording high rates of growth and shown the possibility of attaining some measure of economic viability. This is in itself an interesting case as St. Lucia is a very small state with a physical size of 238 sq miles and a population of 144,000 (1988) and consequently all the constraints attributed to very small size.

We therefore propose to analyse the financing of its development over the last quarter century to see if there are any factors of significance which have a bearing on the Country's progress.

The paper will take the following sequence. Firstly, a description of St. Lucia and a brief chronology of its economic history, followed by an outline of its recent economic progress, secondly, an analysis of the small size of the country and the consequences for its development, thirdly a brief discussion of some of the literature on finance and development, fourthly, an analysis of the financing of development in St. Lucia, and finally, some thoughts on future developments.

St. Lucia is a slightly pear shaped island lying between Martinique and St. Vincent in the Caribbean Sea. The island is of volcanic origin and is characterised by a mountain range passing through the centre which literally divides the country into two halves, a northern and a southern. The terrain is generally mountainous and rugged with three large valleys and two flat plains and the northern and southern tips of the island being the flattest areas. This topography has had a significant impact on the cost of development of the country particularly with respect to the provision of infrastructure. An interesting feature however is that despite its volcanic origin the island has several excellent white sand beaches which have made Tourism a very important sector.

The economic history of the island has been characterised by its dependence on a series of singular economic activities ranging from the economic activities associated with the provision of military installations in the long rivalry between the British and French for such a strategic outpost.
The traditional plantation production of cane sugar which finally ceased completely in the early 1960's.

The use of port Castries, the Capital, as a coaling station when the port laid claim to being the seventh largest in the World. The massive reconstruction of Castries with British assistance after two fires destroyed the town completely in the 1940's and 1950's.

The use of St. Lucia as a military base by the Americans during the Second World War.

The rise of the Banana Industry in the mid 1950's to be the major economic activity of the country up to the present time.

The growth of the Tourist Industry in the late 1960's to provide a second sector of some significance.

The rise of a manufacturing sector in the 1970's under the umbrella of the Carifta/CARICOM arrangements to provide a third sector of some importance to the economy.

This chronology of the country's economic history is indicative of two factors, firstly, the variety of economic activities which have taken place in St. Lucia on a relatively large scale, and secondly, the fact, when they are examined in detail, that they were financed externally. What the discourse does not reveal is the dominance of mercantile activities allied to the externally oriented activities and the accumulation of capital by the mercantile community. This is revealed by both the defects of expenditure/investment in commercial and domestic buildings and the purchase of land as well as the build up of financial assets in the financial intermediaries which were established over time as a result of the export/import orientation of the economy.

The first bank to be established was the Colonial Bank, later to become Barclays Bank D.C.O. to be followed nearly a century later by a local bank promoted by the local mercantile community, the Cooperative Bank.

These were followed by the Canadian Banks, the Royal Bank of Canada, the Bank of Nova Scotia, and the Canadian Imperial Bank of Commerce. Chase Mahattan, an American Bank put in a brief appearance in the 1970's, before pulling out and the final bank to be established was the National Commercial Bank, a wholly owned government institution.

The insurance companies are next in importance. They were established mainly as agencies by the mercantile community to facilitate their primary activities.

At the end of 1988 there were twenty five (25) insurers registered to transact insurance business in St. Lucia, of which four were local, fifteen caribbean and six from outside of the region. These companies between them collected $31.4 million in 1987.

There are four Mortgage and Finance companies in St. Lucia, Barfincor, a subsidiary of Barclays Bank PLC, The St. Lucia Mortgage and Finance Company Ltd., jointly owned by the Commonwealth Development Corporation and the Government of St. Lucia, Rodney Bay Mortgage Finance Company Ltd., and the General Finance Corporation.

The Government established the St. Lucia Development Bank in 1980 by bringing together two existing institutions, the Housing Bank and the Agricultural Credit Bank.

The Credit Union movement is quite vibrant and is mobilising a significant amount of resources in the rural districts and any organised public units like Civil Servants, Teachers and Policemen.

The National Insurance Scheme has proved to be a major source of funds and has become a dominant force in the financial system.

The financial system is regulated by the Eastern Caribbean Central Bank which is a Multinational Central Bank with eight participating territories, six of which are independent and the other two british colonies.

The financial system of St. Lucia can be described as being fairly simple and administered by the commercial banking system. It is undeveloped in terms of the variety of financial instruments and institutions geared towards the medium to long ends of the market. This undeveloped financial system has concentrated the financial assets at the short end of the market and has not therefore been sensitive to medium and long term financing requirements of the economy.

This raises some extremely interesting questions of supply leading or demand following theories of financial development which we will explore later in this paper.

The economy of St. Lucia in 1964 according to projections by H. Oneale, who undertook the first study of the country's

National Accounts was $30,475,000 (W.I) of which Agriculture contributed 15.7%. O'Lauglin remarked on the country's attainment of fiscal viability on recurrent account due among other things to the banana boom and its fiscal administration.

It is clear from an analysis of the intervening period that the economy of St. Lucia has grown and to a certain extent developed over the last twenty-five years fueled by the performance of the banana industry and injection of foreign inflows through direct foreign investment and foreign aid to the public sector.

The consistent thread throughout the period has been the attempt to improve and modernize the physical and social infrastructure. This has been clearly evident from the relatively massive expenditure on roads, electricity, water, telephones, airports and seaports.

The activity in this sector resulted in very high growth rates in the 1960's and 1970's. This was due in some measure to the fact that the starting base and the absorbtive capacity of the economy was low.

Growth rates began to taper off in the late 1970's with the advent of the second oil crisis and the political instability at the end of the decade. The problems were compounded by a devastating hurricane in 1980.

There has been a marked recovery between 1982 and the present although the growth rates have not matched those of the earlier period. The trend over the period however has followed a clear pattern of infrastructural development and the elaboration of three major productive sectors namely, Agriculture, Industry and Tourism. The Banana Industry still remains the major foreign exchange earner.

While the data for the period 1964-1988 is difficult to put together, particularly for the earlier parts of the period it has been possible to get some information for purposes of analysis.

Gross Domestic Product at current prices rose from EC$108 M dollars in 1975 to EC$470 M in 1988. Based on the scanty information available mainly from external agencies like the World Bank, it is felt that growth rates averaged between 10% and 11% in the earlier period, while latterly it has averaged 5%.

The rate of inflation has fluctuated significantly mainly in response to external factors. Between 1964 and 1969 the inflation rate averaged 2.86%. For the next seven years it averaged 14.62%, and for the next five 11.64%. The final seven years of the period is characterized by very low rates of inflation averaging 2.62%.

The level of employment in the St. Lucian economy has been very low. The economy has not been able to absorb all those willing to work at the going wage rate although there has been a significant number of people who value leisure as oppposed to employment. At the sectoral level in agriculture and fisheries this is particularly marked where less than a full weeks work can satisfy basic consumer needs plus a few luxuries. However, there is a significant problem at the level of recent school leavers and among young girls and women and which can be described as structural.

The Foreign Trade criterion over the period shows a greater rate of growth of Imports in excess of both Exports and Gross Domestic Product. This indicates quite clearly that the supply capabilities of the economy are not marked by the demand for consumer, intermediate and capital goods.

The early years of the period showed very poor Export performance. Exports were EC$11.17M in 1965 rose to a peak of EC$16.54M in 1969 and declined to EC$8.72M in 1970.

There was moderate growth between 1971 (EC$12.22 M) and 1973 (EC$19.23 M) and then fairly rapid growth up to 1980 (EC$124.20 M) when there was a fall due to the hurricane of that year. The 1980 levels were not attained again until 1983 after which there was accelerated growth with a decline in 1987 due to a prolonged drought which was however made up in the very next year 1988 (EC$312.00 M).

Imports however have experienced steady and in recent years spectacular growth. Imports were valued at EC$22.01 M; EC$54.58 M in 1970, EC$334.26 M in 1980 and EC$595.00 M in 1988. The trade gap has been financed mainly by foreign grants for capital projects and private capital inflows for construction of hotels, factories and a large oil facility.

The period since 1982 can be divided into two separate parts. Firstly, 1982 to 1985 which can be described as a period of economic stabilisation in which growth was restarted and the public finances brought into balance. Secondly, 1985 to the present which can be described as a period of continuing structural adjustment in which growth accelerated, the combined public sector including the Central Government recorded large surpluses, the foreign debt as well as domestic debt was brought under control, the tax system was simplified and rationalized to give increased incentives to the private sector, the industrial relations climate improved, and the environment for structural transformation was established. The next step with respect to the policy initiatives has clearly been identified as the creation of financial instruments and institutions to foster further growth and development.

The possibilities for further growth and development given the thrust in the financial sector will be constrained in St. Lucia by the question of size.

St. Lucia by both of the criteria used to measure size, namely physical size and population is an extremely small state. Of the 238 Sq miles and approximately 150,000 acres of land only 15,000 is considered to be of prime quality for Agriculture. There are no valuable minerals known to be present in commercially viable quantities and there does not exist within St. Lucia at this point in time the technological or financial capacity to fully exploit the resources of the sea in the Exclusive Economic Zone.

With respect to the population this is too small and demographically skewed to exploit a full range of multi-sector activities. When the total population of 144,000 is examined closely 55% can be classified as dependent, that is either over 65 or under 15, while 15% - 20% of the total population is supplying the labour power, entrepreneurial capacity and effective demand to drive the domestic economy.

This explains why external demand and external resources are so critical to the economy.

The other criteria used to measure size, that is, per capita incomes, can be misleadingly high in cases where the two primary factors are so low thus disqualifying the country from concessional sources of funding from IDA.

The per capita cost of infrastructural development are extremely high and could not be financed on terms other than concessionary ones. Their effective use can only be assured by external demand as for example with the building of an international airport aimed at encouraging the Tourist Industry.

The size and complexity of such investments makes it very difficult for small countries to finance them and as such their development efforts can be easily thwarted.

The problem is that these are not one shot projects but are a range of infrastructural projects which include Airports, Seaports, Electricity, Water and Sewage, Roads and Telecommunications which are vital but costly in an island of 238Sq. miles and with a population of just over 100,000. The physical and geographic configuartion of the island, mountainous and with a high rainfall, the dispersion of the population and its dependent nature make the establishment and maintenance of infrastructure a very expensive undertaking.

Another critical factor is the impact of St. Lucia Exports and Imports on Global Trade. Exports of EC$312,000 M are infinitesimal on a global scale and St. Lucia's position of her primary export, bananas, is not a significant part of world trade in this commodity. In fact she has to be associated with the other islands of the Windwards, Grenada, St. Vincent and the

Grenadines, and Dominica, in order to fulfill their quota to the protected market in the United Kingdom. As for her imports the quantities ordered are so relatively small that there is no influence on suppliers. St. Lucia is therefore not only extremely small but extremely open and vulnerable as well.

We now come to a review of the literature on finance and development. The works that would seem to be most relevant to this area of discussion are those of Gurley and Shaw, Raymond, Goldsmith, Shaw/McKinnon, Thirlwall and Fry. In more recent times a statement by the Research and Policy Committee of the Committee for Economic Development has attempted to make major recommendations on the subject area. Thirdly, the World Bank in its most recent World Development Report has placed major emphasis on Finance and Development.

The recent emphasis on finance and development is consistent with the view now current that market forces and the private sector are the major ingredients in the thrust for development. The role of the state as a catalyst for development is being de-emphasized and the role of the market as a more efficient allocator of resources is being re-emphasized. It is being claimed that the financial system is uniquely connected with the market system and that its biggest contribution to development is its ability to increase efficiency.

The crux of the argument in putting the monetary and financial system at the centre of development theory does not derive from its well accepted virtues of a medium of exchange but from the decentralization of decision making by productive units and the easy spread of information through monetary and financial instruments. The increase in the quantity and variety of these instruments can be a catalyst for further growth in the real sector which in turn provides the basis for the issue of more financial instruments. The flow of securities across international boundaries further increases the possibilities of intermediation and the financing of development. projects and entrepreneurial activities conducive to growth and development.

Gurley and Shaw have had a tremendous impact on the theory of financial development through their major work "Money in a Theory of Finance" In what they state quite clearly as being a theoretical study of finance they have brought together the various elements of the financial system into a systemic whole and subjected them to analysis in terms of demand, supply and market conditions. This broad approach brought into perspective the wide range of financial aspects and institutions which are affected by and in turn affect the need markets for current output, real wealth and labour services. Gurley and Shaw's work was heavily influenced by the work of Raymond Goldsmith who developed an extensive array of data on saving and financial intermediaries. Goldsmith has linked financial structure together through what he calls the financial interrelations ratio, that is, the quotient of the aggregate market value of all financial instruments in existence in the country at a given date to the value of its tangible net national wealth. His research indicated that a country's financial superstructure grows much faster than the infrastructure of national product and national wealth as it developed. Also, that the main determinant of the relative size of a country's financial superstructure is the separation of the functions of saving and investing among different economic units and groups of them.

The work of Edward Shaw on the benefits of financial liberalisation have had a substantial influence on recent policies on financial development. Shaw postulates that it is distortions and restrictions placed on an economy by government which leads to what he describes as shallow finance. This inhibits growth and development and keeps the economy in stagnation.

Shaw advocates the removal of these distortions and restrictions which will encourage financial deepening in the form of the accumulation of financial assets. This process is growth inducing.

Ronald Mckinnon's work is of the same genre as Shaws and emphasizes the market response to the liberalisation of the financial system. Shaw and McKinnon's use as the empirical evidence for their views, the rapid growth in the newly industrialising countries where rapid growth has been accompanied by a large increase in the volume and sophistication of financial markets.

The moot question however as posed by Hugh T. Patrick in his own work is whether finance is supply leading or demand following? Will the financial infrastructure have to be put in, in order to facilitate growth or will the financial institutions and instruments arise spontaneously to fill niches in the system?

Maxwell Fry in his work reviews Keynesian, McKinnon-Shaw, and Neo-structural Development models and also subjects them to econometric testing. His exposition provides an excellent summary of the work in the post Shaw-Mckinnon period and the increasing emphasis placed by the international monetary institutions on the role of the financial system in development.

The Research and Policy Review Committee of the Committee for Economic Development and the World Bank have in 1988 and 1989 respectively put out authoritative documents on finance and development. The former report took as its point of departure the international debt crisis and points out courses of action for both industrial and developing countries to follow both domestically and externally to get growth going again in the developing world. The World Bank's - World Development Report 1989 goes back to the basic premise that finance matters, reviews the evolution of financial systems and as expected comes down on the side of more liberalised financial systems.

This way brief notation on the literature indicates two things (a) the increasing emphasis which has been placed on the role of the financial system and (b) the emphasis on the market determination of such critical financial variables as the interest rate.

We come now to the financing of development in St. Lucia over the review period.

The financing of development in St. Lucia over the period 1964-1989 has always flowed from the activities of the Central Government. The basic point of departure has been the budgetary policy which has always emphasized a surplus on the recurrent account which could then be used as a contribution to infrastructural development. The state therefore adopted the clear principle of a sound fiscal structure and self financing as the basis on which development financing should proceed. This stance allowed the state to have some measure of control over the direction of its development programme particularly when such a programme was fairly well designed. The data indicates that from 1964 to 1979 the central government finances recorded surpluses on recurrent account, deficits between that date and 1985 when a small surplus was achieved. The size of the surplus has increased significantly up to 1989.

The capital budget and the Public Sector Investment Programme have expanded significantly over the review period as the State has sought to lay down the infrastructural and institutional framework for growth and development. Public expenditure increased on roads, harbours, airports, and water in the area of physical infrastructure and schools and health facilities with respect to social infrastructure. The whole process was streamlined with the establishment in the late 1970's of the Caribbean Group for Cooperation and Economic Development which brought together the traditional donor countries and the beneficiary territories of the region. The Public Sector Investment Programmes were rationalized to reflect a division into:

(1) Economic Services

(2) Social Services

(3) General Public Services

(4) Financial Investments

The CGCED sought to increase the flow of concessionery finance to the region as well as to increase the absorbtive capacity of recipient countries. It also had as one of its imputed objectives improving the policy formulation framework in the region. The impact of this institution on development financing in St. Lucia has been marked. The Public Sector Investment Programme in 1989/90 will total approximately EC$102.4(M) up from EC$70.9(M) in 1986/87; with the major emphasis being on Economic Services which absorbed between 70% and 80% of the total over this period. The size of the PSIP has to be seen in relation to the central government's totals of expenditure and revenue as well as the Gross Domestic Product. The basis of continued and expanded growth in the St. Lucian economy has been on the basis of a well formulated and executed PSIP.

The financing of the PSIP as indicated has been by surpluses on the government's budget, donor financing and commercial bank borrowing.

With respect to donor financing the British as the traditional source of funding have been involved in Road Construction, Water Development, Banana Development, Agricultural Diversification and Security (Police, Coast Guard).

The Canadians have been involved in Water Development, Education, Fisheries and Airport Development. The USAID has been involved in Road Construction and Basic Human Needs Projects.

The European Development Fund has been involved in the Educational Sector, Feeder Roads, Agricultural Engineering and Drainage, and Rural Development. The Japanese as the newest donors have contributed signficantly to the Fisheries Sector.

St. Lucia however, like most of the other islands of the OECS are turning more and more to the Caribbean Development Bank for loans on concessional and ordinary terms to finance its development programme. The CDB is financing a significant part of the infrastructural projects either by itself or in conjunction with the donors or multilateral institutions like the IBRD and the OPEC Fund. St. Lucia between 1970 and 1981 received US$48.6 M from the CDB or 8.3% of Loans approved, an amount only exceeded by Jamaica and Barbados.

The Government of St. Lucia has sought to facilitate the development process by establishing institutions for providing finance to specific sectors. The Housing Bank and the Agricultural and Industrial Bank were established first as separate entities and then merged into the St. Lucia Development Bank. The National Commercial Bank was established to influence the pattern of commercial banking and most recently the St. Lucia Venture Capital Fund was set up to provide equity financing to small and medium enterprises.

The National Insurance Scheme established more than a decade ago is also viewed as part of the combination of institutions which acting in conjunction with the Ministry of Finance attempt to influence the patterns of saving and investment. These institutions have been established with technical assistance through the donor community and the multi-lateral institutions and in the case of the St. Lucia Development Bank still have a very close relationship with the external institutions.

One point of interest which is central to the process of financing development in St. Lucia is the use of money from the commercial banks. From time to time the central government and the Statutory Bodies have resorted to the use of the commercial banks for very specific projects. This has been the case with port development and the redevelopment of the Castries Waterfront.

In these cases speed was needed in the execution of the projects and the bank financing could be assessed on terms that were not onerous. This however is not the norm as St. Lucia like the other islands of the OECS does not fully qualify as fully eligible for commercial financing.

This has given rise to some controversy as in the mid 1980's the World Bank management attempted to graduate the OECS countries from the IDA because of their per capita incomes which were higher than the cut off point for IDA eligibility. This placed these countries in a very awkward position where they are not eligible for IDA or IBRD financing nor were credit worthy according to World Bank criteria. This decision would have further impaired the countries' access to concessional funds if bilateral donors had also accepted their graduation. The issue was resolved with the date for graduation being put back to 1991. With the backlog of infrastructural projects remaining to be done in St. Lucia and the other islands even 1991 is a pre-mature date for graduation of these countries from access to concessional resources.

The flow of direct foreign investment has contributed substantially to the growth of the St. Lucian economy. This flow has been mainly in the Tourism and Manufacturing sectors where generous fiscal incentives have encouraged private foreign investors. The policies of the governmet have been similar to those of most Caribbean Islands in terms of the scale and scope of these incentives but the infrastructure and favourble economic performance of the St. Lucian economy has been an added incentive.

The country has managed to attract a major investor in the Hess Oil Company of the United States which established a facility in the late 1990's and early 1980's. This facility was of such a magnitude in relation to the other investment flows that it commanded a separate entry in the balance of payments tables.

Foreign investment and ownership are particularly marked in the Tourism Sector where because of the large scale of financing involved, external financing has been dominant.

The financing from concessionary external sources, direct foreign investment and the foreign exchange brought in primarily by the major export earner bananas has provided through its initial impact and related developments the basis for further financing of development. The commercial banking system in recent years has been highly liquid and due to the apparent lack of feasible projects has chanelled this liquidity into housing and real estate development as well as the financing of consumer durables.

The build up of this liquidity can be seen from the increase in Commercial Bank Liabilities from $319 M in December 1983 to $781 M in June 1989. Total deposits rose from $244 M in December 1983 to $661 M in June 1989. The respective increases in time and savings deposits over the period were, Time Deposits from $116 M to $302 M and Savings $88 M to $250 M.

On the asset side Loans and Revenues increased from $230 M to $506 M while the Foreign Assets of the Commercial Banks rose from $27 M to $133 M. Let this attest to the tremendous build-up of liquidity in the system.

An analysis of the Loans and Advances however reveals that the traditional pattern of bank financing had not been altered despite the availability of such large financial surpluses. Loans to Agriculture doubled but from a bar base of $7 M in December 1983 to $15 M in June 1989. It has been claimed by many bankers that the important banana industry became self financing as farmers realised large profits on their operations. Also, new entrants into the Sector sought financing from the St. Lucia Development Bank instead of the Commercial Banks.

The Manufacturing sector experienced an increase in advances from the Commercial Banks of very small magnitude from $17 M to $21 M. The Banks have claimed in this case that there are not sufficient viable projects in the industrial sector. There is in fact an apparent dearth of entrepreneurs but strenuous efforts are being made to rectify this through the work of the National Research and Development Foundation and the Small Business Assistance Programme of the St. Lucia Development Bank.

The Tourism Sector however has received a much larger allocation of financial resources ranging from $24 M in 1983 to $50 M in 1989. This sector has been showing tremendous growth potential with occupancy rates being at record levels for the last few years. The commercial banks which were very reluctant to lend to this sector originally have completely changed their attitudes in recent times.

The Distributive Trades and Personal Loans have still ranked very high with the former moving from $41 M in 1983 to $73 M in 1989. The personnel sector however has been characterised by the phenomenal increase in lending for House and Land Purchase which moved from $41 M in 1983 to $135 M in 1989. This performance is a reflection of the growth in the banana sector as well as the governments infrastructural programme and has reinforced the growth process as well as having a significant impact on the level of employment. The loans to the personal sector in Aggregate moved from $95 M in 1983 to $246 M in 1989.

The indications are that the economy is going through a period of rapid growth, and that financing is avilable for development but that bankable projects in the productive sectors are not getting the attention they should either through lack of collateral or project refinement. The build up of savings and time deposits is also indicative of the dearth of alternative financial instruments. This is consolidated by the fact that private individuals and firms have shown a preference for government securities like Treasury Bills and Bonds which offer better interest rates. This suggests an increasing interest sensitivity on the part of savers at most levels of the society.

The process of financial development is now at a critical stage. The question to be answered is whether market forces left to themselves will lead to the development of new and relevant instruments and institutions or whether the state should step in and provide these facilities as well as guiding the process in a particular direction. There is no doubt that while market signals are important the economic structure and system in St. Lucia is too small to allow the effective play of market forces to lead to anything but distorted financial and economic development. The experience in St. Lucia is that development has been state led both in the real and financial sectors and that the private sector has followed in the wake of these innovations.

The domestic financial system has not intermediated the financial resources of the country in the direction of medium to long term investments except in times of excess liquidity. Very large investments have been foreign financed and they have come to rely on the domestic system for working capital. Donor financing has brought large sums into the Country which has added to the systems liquidity but this has not subsequently been intermediated into the productive sectors. It is clear therefore that the financial system has to be carefully analysed and restructured to meet the needs of the country.

This has to be the case as the domestic system has to become a bigger contributor to the post of investible resources and their efficient allocation.

In conclusion, it can be said that the financial system has been externally oriented in terms of its ownership structure and the areas it financed. There has however been a movement towards greater local involvement in the financial system with the objective of orienting the system to entertain more development objectives. The process will no doubt continue with the involvement of both the public and private sectors.

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