Financing Development Projects by Commercial Banks in the Caribbean with Special Reference to Trinidad & Tobago by Neil Rolingson

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FINANCING DEVELOPMENT PROJECTS BY COMMERCIAL BANKS IN THE CARIBBEAN WITH SPECIAL REFERENCE TO TRINIDAD AND TOBAGO.

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PREFACE

This paper seeks to outline the financing of development projects by commercial banks in the Caribbean with special reference to Trinidad and Tobago.

The approach taken is a case study approach where the credit policy for financing business enterprise by Republic Bank Limited and its subsidiaries over the period 1950 - 1989 is detailed.[1],[2]

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[1] Republic Bank Limited is the nation's oldest Bank, having maintained a presence in the country for some 153 years, first as Colonial Bank, and then as Barclays Bank D.C.O. In the early 1970's Barclays divested a portion of its share ownership resulting in a change of name to Barclays Bank Trinidad and Tobago Ltd. This was further reduced in the early eighties whereby Barclays shareholding was further reduced to 41%; the name of the Bank was then changed to Republic Bank Limited. By the end of August 1989, Barclays would have divested its total shareholding in Republic Bank making it a fully locally owned Bank.
The modern day Republic Bank has the largest retail banking network in the local banking system, with assets of over 2 billion TT dollars and a diversified lending portfolio involving all sectors of the local economy. It has thus been able to maintain its high profile in the local financing system a profile which it acquired when prior to the advent of Central Banking, it performed the functions of bankers to the Central Government.

[2] The period 1950 to the present represents a period of rapid political, social and economic change in Trinidad and Tobago. The period has seen the political development of the country from colonial status, to political independence, and the attainment of republican status. This political development has had implications for the social development of a nation which prior to the 1950's did not have a tradition of self government. Up to the 1970's the same could have been said for the

This overall period has been subdivided into three distinct periods of development in Trinidad and Tobago, which periods were shaped by three distinct phases in Government policy toward industrial development. These are (a) the period 1950 - 1970 where industrialization was shaped by the Pioneer Industry Act, and a number of light manufacturing, assembly type industries were spawned; (b) the period 1970 - 1980, when the nature of industrial activity was driven by the availability of a windfall of petro-dollars; (c) the period 1980 to the present time when attempts to resume economic and industrial growth are being encouraged without the availability of large government surpluses.

The paper seeks to show that Bank policy with regard to funding industrial projects changed over the period as a response to changes in industrial policy of the Central Authorities, to the extent that such lending policy played an important role in the implementation of Government policy.

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country's economic development, when the taxation revenues from the petroleum sector heightened by escalating world petroleum prices fuelled an economic boom. The financial institutions' development paralleled the economic and social development of the country.

CHAPTER I

1950 -1972

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CHAPTER 1 : 1950 - 1972 : The Aid to Pioneer Industries Act 1950.

This act was incorporated in 1950, with the prime purpose being "to encourage the establishment and development of new industries in the colony and to make provision for the granting of certain relief from customs duty and income tax to persons establishing factories in connection with such industries and for purposes incidental to or connected with any of the foregoing purposes."[3]

In its original form the act specified pioneer industries as diverse as glass and glass products, manufacture of wooden packages, brewing of beer, time recording instruments, stock and poultry feeds, molded industrial rubber and plastic products, and the spinning etc. of cotton, and electroplating. Later on industries such as motor vehicle assembly, food processing were added to the list of pioneer industries.

Incentives to pioneer industries included relief from customs duty for a period of five (5) years; relief from income tax for a period of five (5) years. It also involved restrictions on the ability of the enterprise to hire non-local expertise and

[3] Aid to Pioneer Industries Act, 1950

spelt out penalties for reneging on the original plans for establishing industry, by potential beneficiaries of pioneer status.

By 1970 Pioneer Industries accounted for some 30.5 million dollars in new investment with employment for 3,200 persons.[4]

Apart from the Pioneer Industries Act, The Hotels (Development Encouragement) Act was the other piece of legislation which determined the nature of business opportunities during this period. This Act sought to "encourage the extension of the hotel industry in the Colony by granting relief in respect of customs duties and excise duties to persons who expend monies on the construction and equipment of hotels in the colony and for purposes connected therewith or incidental thereto."[5]

The Act allowed for the granting of licenses to individuals and Corporations wanting to construct or equip a hotel in order to import duty free, building materials and fixtures necessary for such construction. This act was further updated in 1963 to include tax benefits for a period of five to ten

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[4] Government of Trinidad and Tobago, Budget Speech 1972, Government Printery, Trinidad and Tobago, 1972.

[5] The Hotels (Development Encouragement) Act.

years; accelerated depreciation of equipment; and a capital allowance in respect of approved capital expenditure which could be set off against the profits of the hotel. Further tax relief was provided in terms of a carry over of losses from the tax exempt period, tax exemption on dividends and on interest from approved loans.

Barclays Bank played a major role in the financing of enterprise attracted by this type of incentive. The main tools were effected through the Barclays Overseas Development Corporation, and the Bank itself through its normal facilities.

The Barclays Overseas Development Corporation (BODC) commenced operations in Trinidad in 1946 with the approval of the Governor in Council of exemption from the need for a license under the Moneylender's Ordinance. Its principal business was the provision of development finance in those overseas developing countries in which Barclays Bank D.C.O. operated.[6] This finance consisted in the main of equity finance in selected enterprises, although some loan financing was incorporated in the overall package for the project. The Corporation was prepared to invest up to £50,000 in

[6] Internal Bank documents.

the equity of any one company with the expectation of a yield of 10% with prospects of growth.

By January 1964, the loan and equity portfolio of the BODC read like a directory of new commercial enterprises in Trinidad. Its loan portfolio of £940,500 consisted of finance for enterprises as diverse as soft drinks, printing and publishing, wine making, petrochemicals, services to the oil industry, hotels, food processing, and furniture manufacture. Its equity portfolio of £151,250 consisted of equity in enterprises such as distribution, construction, manufacture of beer, petrochemicals, and shipping. By mid 1970 this portfolio had also expanded to include tyre manufacture.

Collateral requirements for this type of financial support varied from mortgages over real estate, debenture over fixed and floating assets, corporate and personal guarantees, ordinary shares in the enterprise supported, insurance coverage on property.

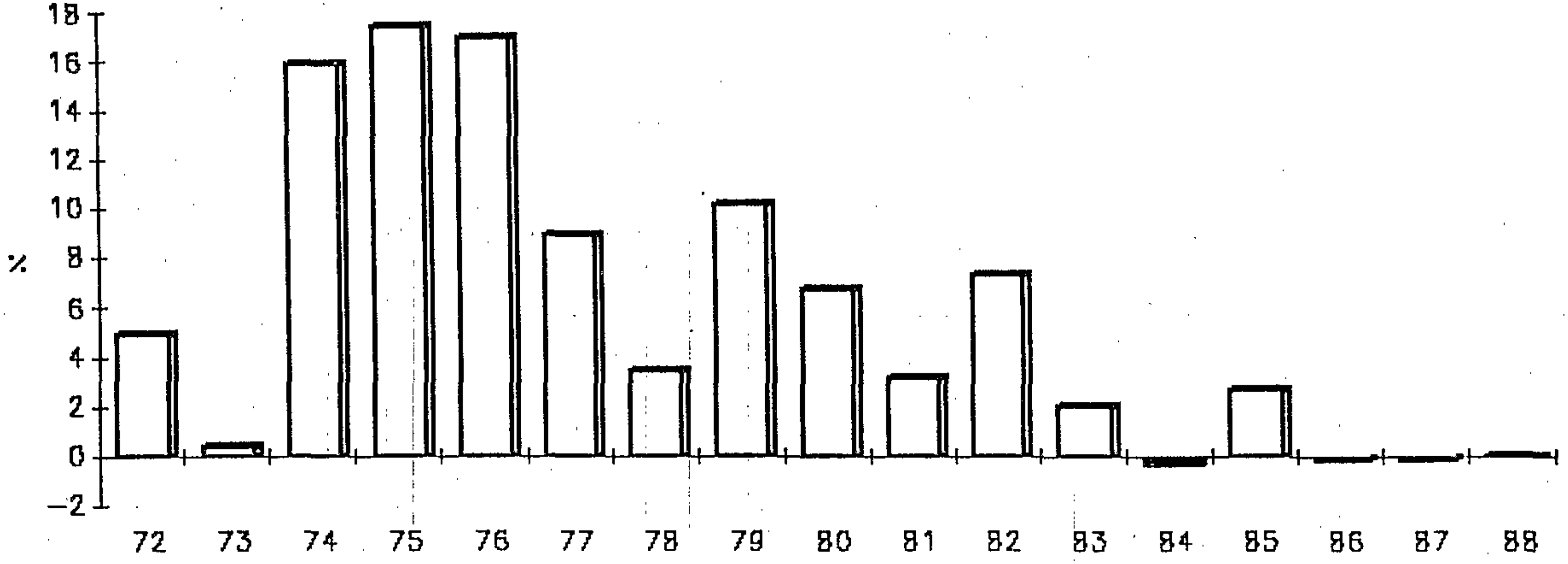
Interest rates up to 1970 were linked to the Bank of England rate, with a commitment commission for undrawn funds. Funds for financing projects were borrowed from the London banking system and unlent to the overseas territories.

By 1972, the BODC was actively seeking suitable lending opportunities with emphasis placed on agricultural developments, new and developing local industries, office and hotel development. It advised caution on the latter since it found that hotel development formed at that time a disproportionate proportion of its total loan portfolio, some 20% of all loans. Its main source of funds by this time was Barclays Bank, and as a result the Bank's Base rate replaced the Bank of England's rate. In 1972 this was 41/2%, with the quoted rate for a loan being 4% over Barclays rate with a minimum of 10% per annum dependent on the future trend of the base rate, the risk premium, and the attractiveness of the lending.

The tight liquidity conditions in Trinidad and Tobago in 1973[7] allowed the BODC to position itself as the provider of sterling loans on the basis of a guarantee on the part of the local Bank then called Barclays Bank of Trinidad and Tobago

[7] See Figure 1. for graphic representation of liquidity in the Banking System for the years 1972-1988. The graph measures the extent to which commercial bank reserves as a percentage of total deposit liabilities exceeded the required position as determined by the primary and secondary reserve requirements of the Central Bank.

FIGURE 1 :COMMERCIAL BANKS- EXCESS LIQUIDITY



Limited, for the local currency equivalent of the sterling loan outstanding at the rate of exchange prevailing on the date on which payment was due. The local Bank would thus be guaranteeing the commercial and exchange risks. BODC assumed the transfer risk, which they covered by the Investment Insurance Scheme of the then new Export Credit Guarantee Department of the United Kingdom , which covered inter alia failure to remit in sterling to the U.K. This cover carried with it certain criteria including - the loan must constitute at least 10% of the equity plus loan capital of the enterprise, with a minimum of £50,000; a minimum term of three years; new resources must be created as a result of the loan finance; and loans reserved for non-state enterprises.[8]

Interest rates quoted were 1/2% to 1% over the cost of funds, plus the cost of insurance cover (say 3/4%), the local bank negotiating fee, and the annual commission on the guarantee.

The above notwithstanding the BODC loan and equity portfolio declined during the decade of the seventies. As mentioned above in 1964 the total loan and equity portfolio amounted to some £1.1

[8] Internal Bank documents.

million. Six years later, a combination of debt retirement, sale of shares and the virtual absence of new and viable proposals,and eventually a conscious decision not to expand the portfolio was responsible for this.[9]

And just as the statutory climate might have been the trigger for the investments in the first place through the Aid to Pioneer Industries Act, and the Hotels (Development Encouragement) Act, the Finance Act of 1966, the Aliens Landholding Act and the Exchange Control Regulations of 1970 changed the operating environment for this type of foreign equity and loan financing.

In the first place, the Finance Act 1966 imposed inter alia a regime of withholding taxation on the interest and commission earnings, including commitment fees, arising out of loans granted. The level of taxation was 30%, although the subsequent signing of a double taxation agreement between the Governments of the U.K. and Trinidad and Tobago reduced the effective rate to 15%.

The Aliens Landholding Act 1969 imposed limits on areas of investment by foreign individuals and corporations, (for example investments in

[8] Ibid.

agriculture were prohibited), and required the obtaining of licenses for the existing equity portfolio of Barclays Overseas Development Corporation and similar type foreign equity funding operations, such as the Commonwealth Development Corporation, and the Commonwealth Development Finance Corporation.

The Exchange Control Regulations placed a limit on the quantum and timing of remittances of interest and capital repayments on loans, on dividend payments on equity investments, and on other commissions such as commitment fees. They caused a complete overhaul of the administration of the BODC operation, to the extent that the focus of the operations of the BODC in Trinidad appeared to shift from seeking out new projects, to operating as efficient a system as possible to remit funds to the U.K.

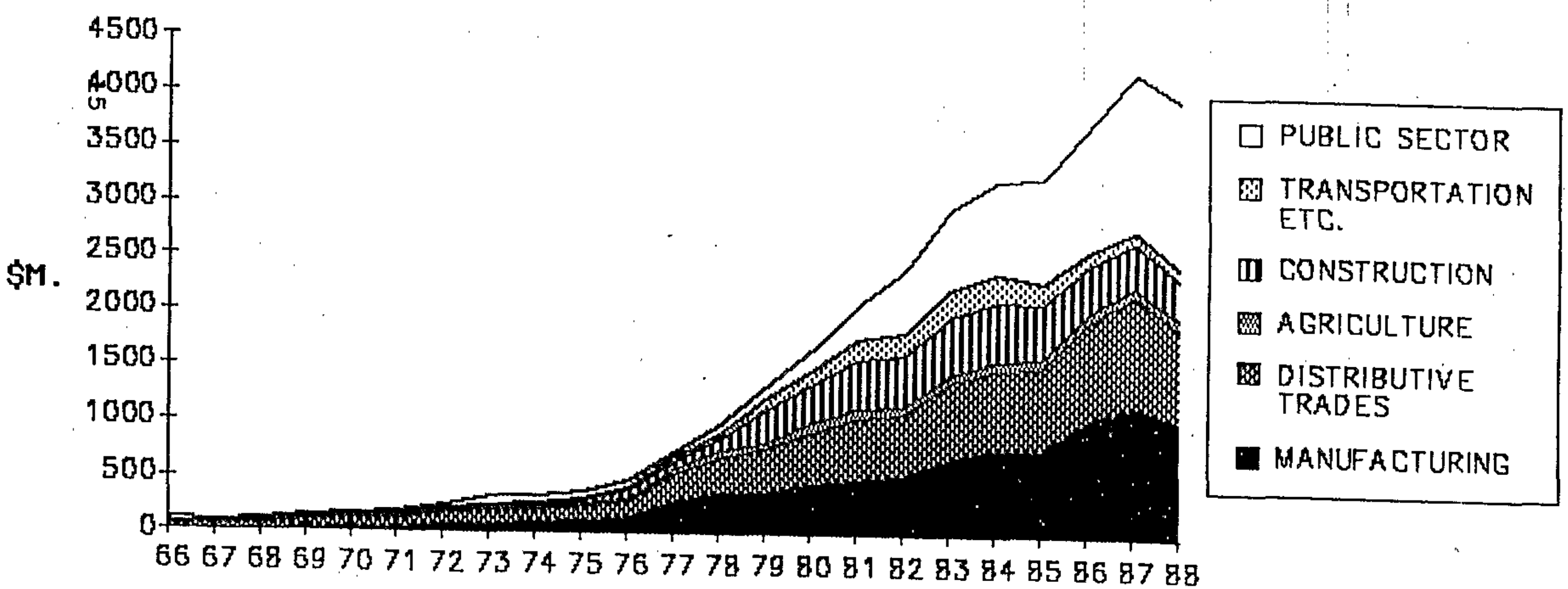
It could therefore be surmised that the changed regulatory and statutory environment might have been one of the major contributory factors to the reduction of a loan and equity portfolio of the BODC.

The BODC's operations during this period complemented the operations of the Bank. For where as BODC was prepared to involve itself in longer term financing, the bank provided shorter term financing facilities to the "pioneer" industries. These facilities ranged from establishing of bonds and letters of credit for the purchase of equipment, flexible financing for the working capital requirement, the discounting of bills for collection to improve cash flow, the operation of C.F.C. accounts for designated exporters.

The Bank's lending portfolio ranged from support for the garment industry, the petroleum industry especially in terms of financing their on going operations here in Trinidad, light manufacture e.g. plastic and paper products, appliance manufacture, tyre manufacture, furniture manufacture, hotel development, and the like. [10]

[10] It is not possible to give specific figures as to the extent of the support from Republic Bank during this and subsequent periods given the highly competitive nature of our banking system. Suffice it to say however that BODC was a major source of equity and loan financing and the banking requirements of this presence was fully met by the Barclays banking network. Figure 2 shows the extent of support for industry from the Banking system over the period 1966-1988.

FIGURE 2 :COMMERCIAL BANKS: OUTSTANDING LOANS



CHAPTER 2

1973 - 1982

The second major industrialization thrust of the Government of Trinidad and Tobago occurred as a result of changes in the local economic environment originating from outside the economy, more than deliberate investment policy. It resulted from windfall increases in revenue accruing to the Central Government coffers as a result of the two massive increases in the price of petroleum, the main source of export earnings for the country. So that whereas at the start of the decade, one experienced a price of oil of the order of US$2-$3 per barrel of oil, by the end of the decade one was talking about a price in excess of US$ 30 depending on the quality of the crude exported.

For example, in his 1976 Budget presentation, the Minister of Finance recorded the increases in revenue from oil:

"In 1973 the revenues from oil amounted to $109 million, increasing from $59 million in 1965 and $73 million in 1970. The revised estimate for 1975 shows a revenue from oil of $1,184.2 million,almost 50% higher than the total oil revenue over the eleven years 1963-1973 of $786 million. Before 1973 oil taxes constituted a declining percentage of total revenues-29 per cent in 1965, 23 per cent in

1970, 23 per cent in 1973. In 1975 they were 70 per cent of total revenues."[11]

The increased revenues gained from the taxation of this oil production signalled the start of an ambitious plan for investment in petroleum based and natural gas based heavy industry, large infrastructural and office building projects, increased wages and salaries within the public service, and in general an increased level of demand for goods and services by the private corporate, public corporate, central government, and individuals. In some cases the resulting shortages, occasioned by this excess demand, drove up prices resulting in an accelerated inflation, excess liquidity in the banking system, and possibly the misallocation of available financial resources into consumption activities both within and without the economy. As a matter of fact private sector activity consisted mainly of the provision of services to the public sector investment thrust, and to the satisfaction of the increased demand for imported consumption items, resulting from the sustained increase in disposable

[11] Government of Trinidad and Tobago, Budget Speech 1976, Government Printery, 1976.

income during the period and the beneficial exchange rate which facilitated the satisfaction of these acquired tastes.

In like manner banking activity and bank lending to industry was altered to meet the demands of a changed market.

In addition, in order to expedite the implementation of the new industrialization policy the government sought to institute measures to bypass the traditional bureaucracy, especially with regard to the access to and use of foreign management skills and expertise, and the onerous tendering procedures, the government instituted what became known as the "government to government arrangements". With this approach, the local authorities sought to approach a foreign government directly in order to structure an umbrella arrangement through which the foreign government would sponsor the implementation of a particular project.[12]

These arrangements were seen as providing the following benefits to Trinidad and Tobago:

> "1. Once an overall umbrella agreement has been negotiated between the

[12] Government of Trinidad and Tobago, Budget Speech 1979, Government Printery, 1979.

Governments, the contracting of firms and the mobilization of such firms would take a fraction of the time that is now needed. This may not appear to be a significant point, but there are instances that now exist where the appointment of a consulting firm using the traditional method of open competition and Central Board procedure, etc. has taken more than a year in some cases as much as two years.

2. The active lobbying with its undercurrents of corruption would be avoided.

3. The particular firm would be subject to pressures both from the particular agency as well as its individual government.

4. Special arrangements relating to matters such as taxes, duty free importation on equipment, etc. could be more easily handled.

5. Attractive financing packages could be negotiated with the individual country.

6. Relevant training programmes, involving the movement of nationals to

the particular foreign country could be more easily organized.

7. Difficulties with a particular firm could get the attention at the highest level.

8. Through careful choice of the country and the firm, specialist skills of the highest calibre can be obtained.

9. The country and its citizens could benefit from cross fertilization of different technologies.

10. No one country would dominate the commercial, financial and technological activities of Trinidad and Tobago. For example, this situation would avoid the situation that has developed in the motor car assembly industry, where at this point in time, Trinidad and Tobago is almost completely locked in with a technology from a single country which unfortunately has an appreciating currency which is in turn a major cause for rising costs of vehicles.

11. The development of political goodwill on an international basis which would hold Trinidad and Tobago in good stead

when it moves into the international marketing community.

12. The possibility of including reciprocal agreements relating to goods being produced in Trinidad and Tobago for export to these various countries.

13. It will inhibit the growth of local commission agents who, for a percentage but without providing any identifiable services, represent foreign firms of engineers and contractors."[13]

The government detailed an implementation programme of priority infrastructure projects under these arrangements. These included construction projects e.g. buildings,airports, a deep water harbour project, roads, public housing, and the like. Countries detailed for arrangements were Austria, Canada, France, Netherlands, Sweden, West Germany, United Kingdom.

These government to government arrangements required not only the negotiating skills for arriving at the best deal, but also the financial capability on the part of the local banking system to deal with the new types of banking services

[13] Ibid.

required by the new players. In addition Republic's international connection worked to the mutual benefit of both parties, and facilitated the implementation of the policy as laid down by Government.

For example in one major construction project involving a large foreign contractor, the Bank provided advance payment guarantees, and performance bonds for the life of the project on behalf of the contractor. In another project pertaining to infrastructural works in the Energy Sector, in addition to providing guarantee facilities such as a performance bond, a general bond for delivery of goods prior to payment of duty, and an immigration bond, equipment and working capital financing was provided for the project by way of term loan and overdraft facilities.

Apart from this the banking system's major activities during this era included real estate, distributive trades, construction, transportation (especially heavy duty trucks and the working capital financing requirements of BWIA the national airline).

Republic Bank had also by this time formulated a detailed policy for lending to agriculture. The

Bank rationalized an increasingly important role for the agriculture in a scenario of high prices for local and imported food during this period; it also isolated a major constraint as the shortage of labour to the agricultural sector, a shortage that could be remedied by mechanization and automation. It therefore positioned itself for this financing option with a long term perspective in mind for the eventual development of agriculture.[14]

This policy was responsible for the Bank's positioning as the foremost lender in the poultry industry at all levels of activity within this sector, as well as for financing pioneering efforts in hydroponics, fresh water fish farming, and micro-propagation.[15]

The Bank, with a full time agricultural adviser on its staff, was also able to provide the technical back-up to the farming community with publications in diverse subjects such as fish farming, sheep and goat production, and hydroponics.

The establishment of the Agricultural Development Bank (A.D.B.) at this time facilitated also a number

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[14] Internal Bank Documents.

[15] Again here competitive pressures forestall our ability to publish specifics as to the quantum loaned as a result of this policy.

of joint financing projects in poultry, hydroponics, sawmilling, pork processing.

The A.D.B. by the end of this period had expanded its activities so as to become the major financing institution for agriculture. Its slow response to farmers' financing needs however created lending opportunities to Republic in terms of providing bridge financing, and more importantly seeking to retain the more progressive prospects for its own portfolio.

Also at this time the Banking system participated in a major way in the formation of a joint venture project with the government of Trinidad and Tobago. This project saw the formation of the Development Finance Corporation, an institution established to provide equity finance and other development capital to enterprise.

Apart from these new areas of activity, Republic Bank continued to provide traditional support in the booming construction industry, utilizing its international connections to facilitate foreign contractors in the tendering procedures, setting up operations, working capital requirements, and repatriation of payments and fees, during this period.

In addition as the newly established export oriented energy based industries came on stream the Bank was able to look after their short term working capital needs, their cash management needs both local and foreign, and the financing of other temporary shortfalls on capital expenditure that might have occurred during this early start up period.

Elsewhere in the economy, the Bank's lending exploded in the distributive trades, in consumer lending, as rapidly rising incomes and an overvalued exchange rate fostered a rapid growth in consumption.

As the oil boom period came to an end and government funding ability became tighter, the central government increased its requirement for direct foreign borrowing. Through its international connections the Bank was able to finalize a number of packages. These included the financing of aircraft engines for B.W.I.A.

In summary therefore the experience of the Bank during the oil boom was one of developing international contacts especially for the servicing of the Construction industry, facilitating the construction and start up of the energy based export industries, and attempting to keep up with the financing requirements of an overheated economy, in a situation of excess liquidity[16], and double digit inflation.

[16] See figure 1.

CHAPTER 3

1983 to the present

CHAPTER 3 : 1983 to the present : The Post Boom Years

In the course of the presentation of his 1983 Budget Speech the then Minister of Finance set the tone for the changed economic circumstances that were to befall Trinidad and Tobago:

> "The fact is that the Trinidad and Tobago economy is on the threshold of a very difficult period. Growth buoyant revenues and a high level of activity in the domestic economy have been based on petroleum. While the boom was on, the taxation of oil companies provided a ready source of fiscal revenues, savings and foreign exchange, and also facilitated the growth of consumption such as we have experienced in recent years. But, Mr. Speaker, an oil dependent growth process requires an ever increasing level of oil revenues in order to sustain its momentum. Regretfully this is not the forecast."[17]

The frenetic economic activity of the oil boom period was suddenly brought to a halt by the

[17] Government of Trinidad and Tobago, Budget Speech 1983, Government Printery, 1983.

plummeting of international oil prices, and from a situation of surplus and expansion, the economy found itself in a scenario of internal and external deficit and contraction.

This new scenario was being acted out not only at the public sector and central government level, but also at the private corporate sector, and the household sector.

In terms of financial sector activity, the situation changed from one of sourcing and delivering financial services for the increasing appetites of the three sectors, to one of, first of all, introspection in terms of a deteriorating loan portfolio, and then finding creative ways of restructuring loan packages for those enterprises that seemed to have possibilities for survival. The continued deterioration of the economy especially with regard to its external account eventually warranted an approach to the International Monetary Fund, thus subjecting the economy to the accelerated and simultaneous implementation of a number of demand management polices. These changed circumstances saw the need for a number of merchant banking activities. Republic Finance and Merchant Bank Limited (FINCOR), the merchant banking arm of Republic Bank was among the first institutions to identify and deliver services to satisfy these new needs.

FINCOR previously BARFINCOR, was incorporated in 1972. Its initial activity consisted of the provision of long term commercial and residential mortgages, sourced from short and long term fixed deposits raised from the public at large. By 1982, FINCOR'S activities had expanded to include the management of consortium/syndicated loans for the large construction and other projects of the boom period. FINCOR also ventured into the New Issue/Share Registration field with the increased stock market activity of this era, and in mid 1982 introduced factoring to its gilt edged customers in the distributive trades.

By 1986, FINCOR widened the base of its activities to establish itself as market leader in the management and underwriting of long term securities on behalf of both the public and private sector. In the following year, this type of activity was enhanced to include variations such as leveraged leases, and the arrangement of project financing packages especially for large Government projects. The following is a list of bond issues managed by FINCOR in its new thrust:

NAME OF SECURITY	DATE	AMOUNT
Gov't of Trinidad & Tobago, Floating Rate Notes 1987 - 1994	25.4.86	TT$200m.
Associated Brands Limited 12% Secured Bonds due 2006.	31.7.86	TT$25m.
Caroni (1975) Limited Guaranteed Floating Rate Debentures due 2001	26.9.86	TT$200m.
The Home Mortgage Bank Secured Floating Rate (Tax Free) Bonds due 2002	29.1.87	TT$25m.
The Home Mortgage Bank Secured Floating Rate (Tax Free) Bonds due 2002 (Second Issue)	26.2.87	TT$25m.
Gov't of Trinidad & Tobago, Floating Rate Notes 1988 - 2002	23.3.87	TT$145.31m
Gov't of Trinidad & Tobago, Floating Rate A Notes 1988 - 1997 Floating Rate B Notes 1988 - 2002	15.10.87	TT$100m
Gov't of Trinidad & Tobago, Project Financing	15.11.88	TT$285.3m

Gov't of Trinidad & Tobago,	JUNE 1989	TT$206.7m.
Floating Rate Bonds A,B,C,D.	AUG. 1989	
	NOV. 1989	
TOTAL ALL ISSUES		TT$1,112.26m.

The Corporation also obtained its full merchant banking licence, thus enabling it to develop its capability in this area to meet the challenges posed by the difficult economic circumstances. This also enabled the corporation to change its name to reflect this status to Republic Finance and Merchant Bank Limited.

As the country implements its adjustment programme, and as the traditional sectors realign their activities to suit the new circumstances, and new sectors and new areas of activities emerge, Republic Bank and its subsidiaries, continue to satisfy the new development finance needs in accordance with declared Government economic policy.

FIGURE 4 :MONEY SUPPLY:ANNUAL GROWTH

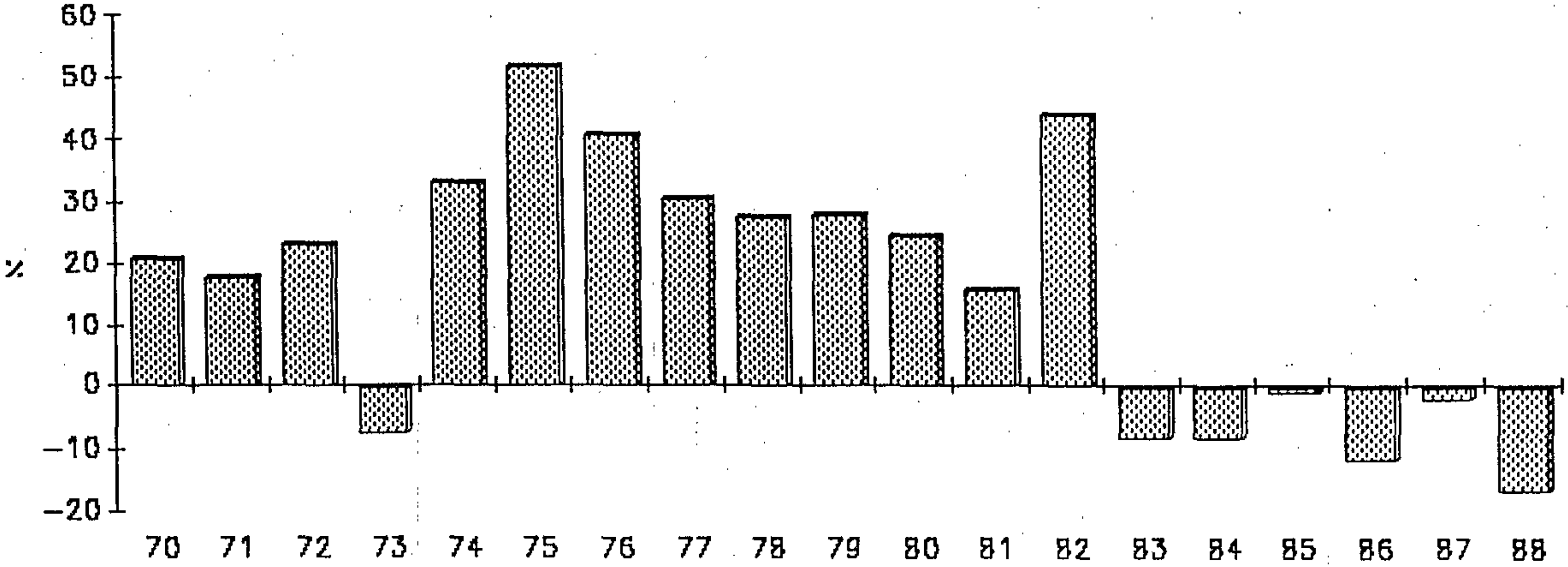

FIGURE 3 :COMMERCIAL BANKS: OUTSTANDING LOANS %