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Capital Market Development in the OECS: *The Immediacy*

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Abstract:

In light of the need for countries in the Caribbean region to reform their financial sectors, especially countries in the Eastern Caribbean, it is imperative that there be alternative supportive endeavors for countries to buttress the role of the budgetary process. We contend that there is immediacy for the development of a genuine capital market aimed at providing alternative sources of funding for development in the region, and geared to reducing the overall dependence of governments on taxing and borrowing. Unplanned taxing and borrowing have had deleterious effects on the body economics of the microstates of the region. In this paper we assess the primacy of capital development in the Eastern Caribbean in the first section of the paper; in the second section of the paper, we look at the essentiality of capital development, given globalization; and in the third section of the paper we discuss the supremacy of capital market development and the associated funding from this type of development, as opposed to the long-established track of funding by governments. We conclude with some caveats, about capital development in small markets relative to seepage and leakage as they pertain to contagion.

Over the next few years, at least from 2004 to 2007, the year of the Cricket World Cup in the Caribbean, the countries of the Organization of Eastern Caribbean States, OECS, would all be striving to be on an accelerated economic strategy. Such a strategy in the OECS, or the wider Eastern Caribbean Currency Union, was clearly adumbrated in the Eastern Caribbean Central Bank **Economic and Financial Review** (volume 24, no. 1 March 2004:5). There it is noted that:

...(E)conomic activity in the currency union is projected to expand, influenced in part by the likely developments in the construction, hotels and restaurants and the agricultural sectors and (favorable) prospects for the global economy. Growth in construction activity is likely to be sustained, based on ongoing and new public

and

private sector projects to be implemented during the period.

In the case of once country, namely St. Kitts and Nevis, [in its recent (Labor) Manifesto, 2004:6:7], over the next five years, there will be a new thrust in tourism development along the following lines:

- Three major hotel developments early in the next (five years, that is between 2004-2009.);
- Construction of a second cruise ship pier, commencing in January 2005;
- Construction of two world-class golf courses, one at La Vallee, (outside of Sandy Point), and one at White Gate area (near Dieppe Bay).
- Along with these golf courses (there) will be hotel and villa developments and a marina;
- A thoroughbred race track, now under construction, will also be opened at White Gate;
- A Dolphin Park will be established on the South East Peninsular;
- In general, “over the next five years (2004-2009, the) Labor (Administration) will continue to gear...fiscal policy towards achieving...macro-economic objectives...that will lead to high levels of economic growth capable of sustaining a steady, continuous and sustainable improvement in the standard of living of ...(the) people...of St. Kitts and Nevis. (Manifesto, 2004:8).

The above developments are in addition to the multi-million dollar development of the Warner Park facilities which are being designed to be a sports complex aimed at facilitating cricket, soccer, athletics, etc. St. Kitts was one of the countries that won a bid for the Cricket World Cup in 2007.

I. The Primacy of Capital Development

If we allow for some of the *many slippages* in the typical Manifestoes, what the ECCB reported in its *Economic Review*, and what the Labor Government of St. Kitts and Nevis hinted at its Manifesto, will be very serious demanders of capital over the next five years. This suggests to us that the capital market development in the OECS and or the Eastern Caribbean Union has to assume a primacy of the utmost importance. Over the years the governments of the region have used the tax and borrow mechanisms to get necessary, though not sufficient, funds to promote development and economic transformation. While it is fair to say that some development and some transformation have taken place, the time has now come for countries to look to alternative means, if not sources, to promote their development. The signs are evident that the last few months of 2004 are harbingers for positive prospects for the years 2005 and beyond, certainly up to 2007. What better way to move away from old ways of generating funds than to put a capital market and its developmental features in place than now?

Domestic capital creation and development have some critical advantages over foreign sources of debt. At the moment, nearly all of the countries in the Eastern Caribbean are heavily into debt. For the ECCU as a whole the overall Central Government Debt to GDP was 888.9% in 2003. The ECCB 2003 Selected Indicators show that Central Government Debt to GDP was as follows for the eight countries that make up the Eastern Caribbean Currency Union.

Debt Range	Countries:
0.00 to 10.00%	1: Montserrat
10.00 to 50.00%	1: Anguilla
51.00 to 80.00%	2: St. Lucia and St.

Vincent and the Grenadines

81.00 to 100.00%	1: Grenada
101.00 to 130.00%	3: Antigua and

Barbuda, Dominica and St. Kitts and Nevis

The primacy of the further development of a capital market in the OECS is the fact that capital markets play essential roles in creating the necessary elements of economic growth, development and transformation. We say further development of the capital market, for at that moment there is a well-established, excellently functioning, but thinly traded capital market in the Eastern Caribbean. There is a dire need to expand this market, to deepen and strengthen it, and to place it at the center of the financial and capital development in sub region. In other words, that market has to assume more primacy.

The countries in the OECS and indeed in the Caribbean have to veer away, or more bluntly, more away from the over-exposed taxing and borrowing. Our view does not lend itself to the argument that these two features of fiscal policy should be eliminated. Our view suggests that these features should be minimized and that the capital market should be depended upon, beginning over the next three to five years. With Cricket World Cup as a signature piece in the region in the year 2007, now may be the best time for countries to be bold and assume other risks in the development process. It is time for countries and leaders of the region to strike out and incorporate other forms of financing outside of traditional financing methods.

The development of other methods such as the dreaded derivatives that dreaded, creative, approach to financing and investing; the incorporation of venture capitalists, angels and others are worthwhile considering as a means of putting in place ways and means of minimizing the role of the public sector in carrying forward the overwhelming burden of state development. It must be made very clear, however, that we are not advocating a minimalist role for the state. The state must play, must continue to play, a critical role in the new dispensation of capital market development. The responsibilities of those who are going to develop the capital market have to be such that authority and responsibility go hand in hand. This is where government has to continue to play its critical role. Government's role as a regulatory agent is of central moment.

Capital markets have long been associated with scams, market failures, scoundrels, bubbles, dot bombs, and the rest. Hence, as we advocate that capital markets should assume primacy, we have to do so in the context of the oversight

responsibility of the government or the regulatory feature of some other supervisory agency.

Having said that, there is a need for the Government Securities Markets in the region, especially in the OECS, to get going in full force. The OECS has gone a long way in institutionalizing such a market. The Regional Government Secretaries Market (RGSM) has now made it possible for the governments of the sub-region to borrow on the market. While this is a step up, in that government paper is now widely available in the region, it still has its limitation. It is still the government that is the driving force. If there are speculative bubbles or if fiscal mismanagement assumes an overbearing position, then the RGSM would still be at risk and, in train, the economy would be at risk. So, in an overview, the Regional Government Secretaries Market is only phase one in an overall thrust to a full capital market development.

In whole or in part, especially given the world's headlong thrust into globalization and liberalization, there is a need for sub-regional economies to get on the train of developing their capital markets. This is not a fad. This is anticipating a reality and positioning economies to capture the salient features of what it will take for development to run smoothly or, at the very least, for development to be devoid of the many lumpiness associated with the influx of capital such as those noted by ECCB and the Manifesto of the St. Kitts and Nevis Labor Party.

II. The Essentiality of Capital Market Development

One of the most important features of our push for capital market development rests on the need for a more coordinated, sophisticated approach to networking the capital markets in the Caribbean region. The need to link up all of the stock markets in Jamaica, Trinidad, Barbados and the Eastern Caribbean, is essential now, more than before. One powerful feature about the suggestion lies in the fact that the Eastern Caribbean Stock Exchange (ECSE) is one of the most sophisticated stocks exchanges in the region, and indeed in the world. Settlements are made in time "t plus 1." The level of sophistication augurs well for the sub-region and for the Caribbean as a whole.

At the moment the Eastern Caribbean Stock Exchange is thinly subscribed and thinly traded. But this statement could be made for all of the stock exchanges in the region. The stock exchange in Barbados, for example, is a mere figment of the imagination in terms of capability. This is where the combination and networking of all the stock exchanges will be of paramount importance.

This suggestion about the regional link-up is not new, indeed there is some degree of cross-border trading and this has been true for over ten years. What is crucial is the fact that many banks and other financial intermediaries, such as insurance companies, and the like, and have been moving up and down the chain of islands. Specifically, the banks of Trinidad and the insurance companies of Trinidad and Barbados have been moving aggressively in the economic space of the Eastern Caribbean. The central rationale for this movement is the stability of the Eastern Caribbean dollar, pegged as it is to the US dollar.

At the moment the Eastern Caribbean Market is the market place for all the large countries of CARICOM: from Jamaica to Barbados and especially Trinidad and Tobago. But as these businesses, banking institutions and insurance companies move into the ECCU, they are moving in with some capital, and they are underwriting debt, including "sovereign debt" in the OECS. No doubt this is commendable from the point of view of the lenders but such debt is one-to-one, is external to the sub-region, even though internal to the region, and of the importance, there is no secondary market for most of this kind of debt. We shall return to this issue of secondary market later.

About two countries in the OECS have made extra-regional moves and have gone to the world capital markets to borrow. Grenada was able to borrow millions of dollar on the international financial market. While this is a grand move on Grenada's part, it would have had more advantages to the region of the millions were sourced in the Caribbean region with the benefits accruing to the people of the Caribbean region.

One of the main issues in the essentiality of the capital market development is

the need for confidence. The public sectors in the region have to exude more confidence and they have to show that when people invest in their paper that risks will be lower than if they had to go to other markets. That is not to say that all of the risk profiles will be eliminated. Some investors will continue to be risk lovers, risk neutrals, and risk averters.

The capital market is the epitome of the stock market or stock exchanges. For the most part capital markets/stock markets/stock exchanges are seen as tools of capitalism and capitalists. In the 1960's and the 1970's a proposal such as ours would have been DOA-dead on arrival. Then the episodic philosophical view was anti-capital. But today when countries in the region require tremendous quantum of capital injections in their economy the question is, where do we go from here?

Privatization of state-owned enterprises may be one of the ways to get state capital on the market. In the OECS there are many government-owned businesses which may be better served economically- that is from an efficiency point of view- if they were privatized. Even though the OECS stock market is a nascent stock market, the more dominant businesses in the respective countries are listed or are contemplating listing. The beauty about such a development lies in the strength that they could give to a move of denationalization and privatization of government-owned business. More persons will have access to equity- ownership of businesses in the region, and there would be less of the clique-mentality of stock ownership and stock offering.

But, there is one main challenge. For many strong advocates of the retention of state-ownership, privatization tends to free-up government property and put it into the hands of the privileged view, the top one-percenters in the state. This, to the anti-privatization cadre, is an anathema. One cannot be cavalier with this idea. Safe to say when governments adopt privatization rules it may be instructive that there be set asides for mass-participatory ownership in the new public issues. In this way as wide a participation in the equity of the businesses will be "guaranteed."

The capital market development that we are suggesting is not a charitable movement. Our suggested is pinnacle on the need to see capital available in the

region; to see capital available at lower costs; to encourage greater efficiency in the delivery of capital to the region, and finally to ensure that the multitude of capital projects that the region plans to undertake over the next five years are given the light of day in their realization.

Our view would be to see the states of the sub-region develop an essentiality whereby their loan-finance portfolio are linked to capital markets. Their debt instruments should be reduced over time as they move to the capital markets. Ricardo and Keynes who made fortunes in the stock market never gave any economic groundings in their works of the central moment of the stock market in economic development. But it is clear that well run capital markets and stock markets have been essential to economic development.

Too often people see stock markets and poorly run capital markets as crap shoots, casinos and the rest. But they fail to recognize that even under these seemingly unappealing conditions, capital is raised. Furthermore, there is no reason to believe that capital markets are structured on the skeleton of greed and avarice. Greed and avarice are not part of the genetic codes of capital markets.

One thing is clear. The countries in the region, and the OECS in particular, need capital to jump start, and to push their economies along given growth trajectories. For many years the countries' economic performances have almost been asymptotic to the natural versus warranted growth. Now the states want to accelerate development. Concomitant with the CARICOM Single Market and Economy must be a capital market. There must be something to note that all of the leading economic countries of the world have well-run, well-regulated, well-established stock markets and capital markets. There are crevices, niches and sometimes scars and abrasions, as some business leaders perform in the capital markets. ENRON, Computer Associates, Halliburton, in the USA, to name a few, come to mind.

Despite these aberrations, capital markets still provide a reasonable and sound alternative to the continuing reliance of governments on taxation and borrowing. One note to consider in the essentiality of capital markets is the role that Caribbean nationals in the Diaspora could play. Many nationals in the Diaspora have access to

capital, have capital, and are using that capital to develop other areas. Regional governments linked to regional capital markets may want to tap in the wealth of their nationals abroad.

In the USVI, for instance, there are over 8,000 Kittitians and Nevisians. That number is 80% of the population of Nevis. Given the per capita income of the USVI which is about \$35,000, and assuming that Kittitians/Nevisians have 80% of this amount, it suggest that conservatively, there is over US \$2.4 million as a market to tap for one country's overseas population. This is not a figure to be overlooked.

Regional countries cannot continue to finance growth and development from funds from abroad-funds which funds are disassociated from their own efforts. Given the nature of the politico-economic philosophies today, many international financial institutions are tight-fisted in their lending to our part of the world. Thus our call for capital market development must be seen as timely.

In our discussion of the shifting of equity from the public sector to the private sector, and all of the concerns that such a shift may be into the hands of a select few, these must still be a situation where in the capital market liquidity is guaranteed. In secondary markets whether they are for primary securities, government securities or some combination thereof, securities must be freely traded. The primary market is the company or institution issuing the shares to the public. The secondary market is the alternative market where confidence is associated with buying/selling securities from/to a third party.

Public confidence in the integrity of the security dealers, the markets and the governments will ultimately be the feature that will make or break primary markets, secondary markets and overall capital markets. Today, many countries in the region have Social Securities Funds which are used or abused as the case may be. For the most part the Funds are solvent. But, according to some actuarial studies the Funds are not optimizing their potential. It is our view that funds of Social Securities could provide another plank on which capital markets could be developed or expanded in the region. Social Security funds can give a filip to capital markets. Of course, there will have to be the essential and critical supportive services to protect the Social

Security Funds. Financial regulatory oversight must always be in place in all capital markets.

III. The Supremacy of Capital Market Funding versus The Old Approach

Why move to capital markets? Why this approach versus the old approach?

A great deal has been said and written about the way e-business, e-commerce and e-government will change the pace of development in the Caribbean regions. We have to get on the bandwagon. To date Bermuda is the only country that has taken the proverbial ball by the horns and moved into this space. We are of the view that ICT is supreme in capital markets. Its operation in the Capital Market will expedite development options at a faster pace than contently obtains. Today, Bermuda has an Electronic Transactions Act (ETA) that essentially removes "all barriers to companies entering into electronic commerce. Bermuda's approach has technologically neutral regime suitable for international businesses and ordinary consumer alike." (Hickson, 2004).

Our motive for considering the development of the capital market is that there is no impounded time frame for the region to do all that it wants to do. Of the regional decision-makers do not move the regional expeditiously, economies could be set back several years. It always takes longer to build back up when something is broken down. According to reports from ECCS, "In six of the territories (ECCU) unsatisfactory credit to total credit remained well in excess of the ...tolerable limit." (Governor's Report for the Monetary Council). Admittedly, the small size of the financial institution in the OECS is problematic. This is where collaboration and cooperation will keep financial institutions and keep the capital market in the long run.

Incomplete information about the sequence of events in the capital market could be one of the problem that may affect the supremacy of the capital market over the traditional ways of raising money. But there non-observabilities would have to be factored in the capital market. In fact the very nature of a fully functional capital market suggests that non-observabilities and asymmetric features would tend to zero in the long run.

One of the enhancing factors of a capital market is the intend consistency

around which information is presented. The current situation of governments borrowing and taxing lends itself to a plethora of problems. The borrowing is problematic; this is supposed to be earmarked and revenue-linked. But it seldom is. The taxing is of times not fiscally neutral. And in for many other times the taxes are nuisance taxes. The many heads not enough revenue relative to the administrative costs associated with collecting the revenue.

Using the language of control theory, we can ask, would capital markets be better? And the obvious answer would be yes. Should capital markets target the level of development in the economies? Again our answer must be yes. Yes because we could use measurable indices such as the capital to output ratio to do more accurate planning when capital is source in capital market.

Capital comes to region, currently, on an ad hoc, piece-meal basis. We are passive and reactive recipients of capital in the OECS. We do not go out and seek investment. Investment comes to us. A regional capital market will procure the necessary framework and mechanism for the availability of capital. Better planning should be possible.

Under normal circumstances it is easier to evaluate poor planning ex-post than ex-ante. How, you may ask, can we anticipate what the lack of capital will or will not do? Well, given anecdote evidence, we can contend that if capital is not available, we have a general idea that economic growth will be hampered. Economic growth will not be at its optimum is adequate capital is not available. What the OECS plans to do over the next five years requires adequate capital. And it is our contention that the present government approach and the lukewarm private sector approach will not cut the mustard.

Conclusion

In conclusion we wish to make abundantly clear that there is a need for the capital market to be developed in the Caribbean, particularly with the OECS. But while we talk about the primacy of the market the essentiality of the market and the supremacy of this market of the traditional financing by government, some caveats are in order. There is always the likelihood that there could be seepages in the

system. In other words, no system is completely airtight. Given the nature of our economies, the porous nature of our systems and borders, the length of time that things take to get off the ground, may be our goal of a rapidly developing capital market may be a dream. One hopes that it is not a dream deferred. Finally contagion from economies and systems could have a Gresham-like impact on a capital market in the region. While bad money may not drive out good money, bad economic conditions may cause contagion effects and force long deferment of a fully developed capital market. We admit that there are some inconclusiveness to our proposal; however, its absence, in this age and this time tends to encumber far more deleterious effects than if it were to be instituted with all of its portfolios. And certainly, it will be a step from the contemporary mode of governmental/state developmental, ad hoc financing.

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