



**THE GROWTH OF THE SERVICES SECTOR IN THE ECCU<sup>1</sup>ECONOMIES:  
IMPLICATIONS FOR FINANCING**

**By**

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**ABSTRACT:**

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In an effort to account for the observable declining performance of the traditional exports sector, and the increasing importance of tourism and related services in the ECCU, this paper seeks to determine whether there is empirical evidence of restructuring from a “weighted economy” to a “weightless economy”; to map the growth in the goods and services sectors; to identify the emerging services segments with high export potential; and to evaluate the extent to which commercial bank financing is directed towards the viable services segments. An analysis of the sectoral allocation of credit suggests an under-supply of credit to the high value/high risk services segments. This suggests that commercial banks may be risk-averse to non-traditional services activities deemed to be risky, and points to a need for supplementary financing options for the high value/high risk services activities.

**Keywords:** Services, finance, commercial banking, bank behaviour

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<sup>1</sup> The member countries of the Organization of the Eastern Caribbean States (OECS) are Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St Kitts and Nevis, Saint Lucia and St Vincent and the Grenadines, and associate member British Virgin Islands (BVI). The OECS Authority is the highest decision-making body of the OECS. The Eastern Caribbean Currency Union (ECCU) comprises all member countries, excepting the BVI. They share a common central bank, the Eastern Caribbean Central Bank (ECCB). The Monetary Council is the highest policy-making body of the ECCB.

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## I – Statement of the Problem

The conventional wisdom is that economic growth in the ECCU countries revolve around tourism with agriculture and manufacturing functioning as support sectors (Andrew (1992), Adrien (1996), (Thomas (1998) and Williams (1998)). Some 207 economic actors surveyed the Caribbean Regional Programme for Economic Competitiveness (CPEC), ranked tourism and related services as the single most important sector for ensuring the viability and competitiveness of the economies of the ECCU in a liberalized marketplace (CPEC, 2004).

With four of its Member countries (Anguilla, Antigua and Barbuda, Montserrat and St Kitts and Nevis) highly dependent on the tourism industry, policy makers are concerned with the capacity of the eight small and vulnerable economies (SVEs) in the economic union for sustaining economic growth in a highly competitive global economy. Moreover, the OECS experience suggests that in a bank-centric environment, monetary and credit policies are only functional in the context of the growth imperative, and that money and capital market initiatives are only suitably undertaken in the context of an appreciation of the dynamics of the real sector. Consequently, the OECS Authority has committed itself to the establishment of an OECS Economic Union in the near term to accelerate the pace of development.

Are commercial banks in an agency market attracted to igniting the real sector, particularly non-traditional economic activities? What is the appropriate money and capital market structure to ignite the reconstituted real sector?

This paper seeks to answer two critical questions. Firstly, is there evidence to suggest that the services sector is the driver of the ECCU economy? Secondly, is there an under-supply of credit to services segments with high potential for growth? Insofar as the BVI (a British Overseas Territory) is not part of the monetary arrangement, the study is confined to the ECCU economy.

The next section of the paper discusses the literature review. Section III undertakes an audit of the ECCU economy. The macroeconomic potential of the services sector is evaluated in section IV. Section V analyses the direction of commercial bank credit. Section VI concludes the paper and offers some policy recommendations.

## II. Literature Review

The services sector is so diverse that it challenges a collective definition (ISER, 2003:5). Riddle (2005:7) differentiates between infrastructure services (utilities, construction and transportation); trade services (wholesale, retail, hotels and restaurants); and embodied services (films, books, computer software). The value-added of the services sector is largely under-stated because a significant amount of “services exports are essentially embedded service inputs that influence the nature of a final export product or output, thus enhancing the quality or delivery value” (CAIC, 2004:8). The General Agreement on Trade in Services (GATS) characterises services with respect to mode of supply. Services that are supplied across borders without the movement of the consumer or the provider, such as distance education; services that are consumed by movement of the consumer into the country of the supplier; services that are provided through the establishment of a presence into the host country; and services supplied by a service provider who moves into a host country market for a short period (International Trade Centre 2000: 16, 17). *In this paper, we classify all economic activities other than agriculture, mining and manufacturing as services.*

### *The weightless economy*

Danny Quah (1997) defines the *weightless economy* as the sum of activities whose values do not lie in a physical end-product. Examples are intellectual property such as ideas and designs, computer software, entertainment products, telecommunications and other ways to transmit information. These are often referred to as dematerialised products or intangibles. In some cases where the end product assumes a material nature, as in the case of Nike shoes, the revenue is not generated purely by the raw material embodied in the shoes, but by the culture associated with them.

The weightless economy is also described in the literature as the knowledge economy, the intangible economy and the immaterial economy. The services sector is so diverse that it challenges a collective definition (ISER, 2003:5). Riddle (2005:7) differentiates between infrastructure services (utilities, construction and transportation); trade services (wholesale, retail, hotels and restaurants); and embodied services (films, books, computer software). The value-added of the services sector is largely under-stated because a significant amount of “services exports are essentially embedded service inputs that influence the nature of a final export product or output, thus enhancing the quality or delivery value” (CAIC, 2004:8). The General Agreement on Trade in Services (GATS) characterises services with respect to mode of supply. Services that are supplied across borders without the movement of the consumer or the provider, such as distance education; services that are consumed by movement of the consumer into the country of the supplier; services that are provided through the establishment of a presence into the host country; and services supplied by a service provider who moves into a host country market for a short period (International Trade Centre 2000: 16, 17). *In this paper, we classify all economic activities other than agriculture, mining and manufacturing as* Activities defined in the weightless economy fall into four groups. First, there is information and communications technology (ICT) and the Internet. Second, intellectual property which includes patents, copyrights, brand-names, trademarks, advertising, financial and consulting services, health care and education. The third group consists of electronic libraries and databases including new media, video entertainment and broadcasting. The fourth element comprises biotechnology, traditional libraries and databases, and pharmaceuticals. These four groups of activities constitute the fastest-growing sectors in modern economies - whether measured in value added or employment and job growth. The wealthiest individuals make their money almost entirely from activities in the weightless economy. Firms in information and communication technology dominate global stock markets in terms of capitalization.

How can small island-states like the ECCU with narrow knowledge and skills bases succeed in a *knowledge economy* that demands the constant innovation or application of appropriate information technology?

### *Growth in services*

The theories which explain the growth of services purport that services are income-elastic so that demand increases with a rise in income; the services sector expands with the increasing integration with the goods sector; there is an increasing tendency for households and firms to improve efficiency by outsourcing services; and developments in technology tend to increase the exportability of services (Charles, 1994:4).

Studies done in the United States of America (Fuchs and Baumol in Inman, 1985), in Japan (Saxonhouse in Inman, 1985) and in Britain (Briscoe, 1976) established that productivity in the services sector tends to lag behind that in the agricultural and manufacturing sectors. The conventional wisdom is that productivity in the services sector tends to lag behind that of the goods sector partially because a large range of services is labour-intensive.

With respect to services exports, some theorists (Sapir (1985) and Hindley (1988)) have questioned the applicability of conventional trade theory to trade in services. Services include all activities other than agriculture, mining and manufacturing and most of these activities are intangible and non-storable (Hill, 1977). Some services are embodied in the supplier and require the physical proximity of the supplier and user, while some can be disembodied from the supplier and traded independently as in the case of goods (Bhagwati (1978)). For example, consulting services, life insurance business and architectural design could cross the borders of the importing and exporting countries. In addition, Sapir (1985:29) noted that despite the general applicability of the Ricardian theory of comparative advantage to trade in services, some services are produced in close proximity to the market, in which case the transactions take place among residents of the same country.

With respect to tourism services, market efficiency theories argue that outward-bound travel is influenced by push factors, some of which are cultural in nature, and visitors are attracted to destinations which offer them a rich cultural experience (pull factors). Medina (2003:354) noted that “cultural products are in high demand,” as the tourist’s travel choices are influenced by the attributes of the tourist destinations. Some tourists are motivated by “*wanderlust*” or “*sunlust*” (Gray, 1970); some are driven by the desire to escape and relax (Crompton, 1979); and some others choose environments that allow them to function at the optimal level of stimulation (Berlyne, 1960). Bright lights, entertainment and endless excitement are attractive to the “*Action Seeker*” who is motivated by a carefree lifestyle free of commitment, as well as to the “*Drifter*”, the “*Thrill Seeker*” and the “*Explorer*” who crave for excitement, risk, and freedom (Levinson, 1996). Proponents of the benchmarking thesis identify a set of attributes that increases the attractiveness of a tourist destination. These include the level of pricing, accommodation services, availability of facilities and activities, access to local transport and communication, hospitality and customer care, and the level of health and environmental cleanliness.

Tourism services in the ECCU have tremendous potential for growth but are relatively uncompetitive. The increasing popularity of the destination nonetheless, strongly suggests that with efficient planning, the region could significantly improve the value-added in the industry. Attractive beaches, gorgeous tropical setting, a therapeutic environment with its peace and tranquillity, and a rich and lively cultural life are major pull-factors considered by visitors who choose the ECCU as a holiday destination. For the islands of the Eastern Caribbean “customer satisfaction is regarded as a measure of performance and one of the greatest sources of competitive advantage” (Kozak, 2002:500).

### *Finance and growth*

Economists and economic historians are divided on the importance of the financial system for economic growth, and are engaged in a lively debate on the nexus between financial intermediation and economic growth (Schumpeter (1912); Joan Robinson (1952); Lucas, (1988); Meir and Seers, (1984)). While there is no consensus with respect to the direction of causation, most economists are in agreement with respect to the link between finance (savings, investment and credit) and economic growth and development. Patrick (1966) identified and labelled the

two possible directions of causality between financial development and economic growth as *supply-leading* and *demand-following* hypotheses. McKinnon and Shaw (1973) related financial intermediation to observed differences in growth in developing and developed countries.

Where the financial sector is spurring growth, activity in financial institutions tend to reflect developments in the real sector, that is, changing consumption pattern and savings behaviour of households as well as an increasing demand for financial services (Gurley and Shaw (1995). Lewis (1970) argues that the volume of savings mobilised in a system partly depends on the geographical spread of savings institutions - as people tend to save more when the savings institutions are close to them. Levine (1993) argues that finance facilitates economic growth through capital accumulation and technological innovations. He suggested that the financial sector must facilitate the trading, hedging, diversifying and pooling of risks; efficiently allocate financial resources; mobilise savings and facilitate international trade.

### *Methodological Issues*

The services sector is largely unknown because its diversity challenges a collective definition. This is why trade in services was only recognised by multilateral trade rules in the late 1990s (International Trade Centre, 2000). Data availability is the greatest research concern in under-developed tourism markets like the ECCU. There are considerable production and export activities in the services sector, which go unrecorded and un-quantified. The policy prescription in this study would have been enhanced with a detailed survey of all activities other than agriculture, mining and manufacturing in order to assess the degree of domestic involvement in the sector and the exportability of services.

The primary data source of this study was the “*Yellow Pages*” of the telephone directories of the countries of Anguilla, Antigua and Barbuda, Dominica, St Kitts & Nevis, St Lucia and St Vincent and the Grenadines (for the period 1989 and 2004). For certain services segments, where the listings were apparently limited, telephone surveys were done with public and private sector agencies to supplement the information in the telephone listings. *We use changes in the number of services firms listed in the Yellow Pages of the OECS Telephone Directories as an indicator of the growth trend in the services sector.*

Secondary information were derived from the ECCU Secretariat Study, *OECS Services Trade Policy Framework* (Dorothy Riddle, 29 June 2005); the Tourism Global Inc. study; “*The Caribbean Accommodation Sector as a Consumer of Locally Produced Goods and Contributor to Government Revenues*”; the World Bank/Swedish Development Study, *Offshore Education in the OECS* (September 2004); the Institute of Social and Economic Research Survey, *Export Capabilities of the Services Sector in Trinidad and Tobago – A Statistical Assessment* (2003); and the Caribbean Regional Negotiating Machinery study, *The Cultural Industries in CARICOM: Trader and Development Challenges*, (Keith Nurse, 2005).

However, the absence of critical information and the non-existence of disaggregated data, restrict our understanding of the services sector in the ECCU. These measurement difficulties limit the analyses and conclusion of the study. A suitable economic impact assessment would call for the use of sophisticated tools and analyses that are not possible given the data limitation.

### III. Audit of the ECCU Economy

#### *The Structure of the ECCU Economy*

The ECCU economy has undergone structural changes in the last twenty years. Services have accounted for more than three-quarters of the growth in the 1980s, 1990s and 2000s. The contribution of agriculture to GDP declined from 14.3% in the 1980s to 6.5% in the 2000s, and the sector has been declining in importance since the 1980s. *Industry*, largely powered by activity in the construction and real estate sectors, remains an important contributor to GDP, accounting for 6.0% in the 1980s and 6.8% in the 2000s. Services have had a disproportionate share of ECCU economy since the 1980s, contributing on average 81.9% of GDP in the last twenty years. *Non-government services* have been growing at a declining rate since the 1980s, but the sector has accounted for an increasing disproportionate share of GDP since the 1980s. The sectoral share of GDP was 61.0 % in the 1980s, 69.3% in the 1990s and 71.5% in the 2000s (Table 1).

This apparent restructuring in the ECCU economy reflects changes in the world economy. Services have had the locomotive effect on the global economy since the 1980s. Trade in agricultural products declined steadily, from 42% in 1950 to 8% in 1995, while trade in services expanded steadily, from 10% to 53% over the same period. Trade in traditional agricultural products is projected to decline to about 5% in 2010, while trade in services is estimated to increase to about 60% in the same period (Ruthven, 1997:24). The services sector experienced robust growth that outpaced the performance in the overall economy in Canada, Germany, Japan, the United Kingdom and the United States during the 1990s (OECD, 2000).

*Table 1: Sectoral Composition of GDP and GDP Growth, 1980-2006*

	Share of GDP (%)			Avg Growth Rates (%)		
	1980s	1990s	2000s	1980s	1990s	2000s
<b><i>Agriculture</i></b>	<b>14.3</b>	<b>10.2</b>	<b>6.5</b>	<b>3.0</b>	<b>-1.3</b>	<b>-1.6</b>
<b><i>Industry</i></b>	<b>6.0</b>	<b>5.0</b>	<b>6.8</b>	<b>8.1</b>	<b>3.7</b>	<b>4.5</b>
Mining & Quarrying	0.6	0.9	0.9	14.6	3.0	6.6
Manufacturing	5.4	6.6	5.9	6.9	1.5	1.8
<b><i>Services</i></b>	<b>79.7</b>	<b>84.8</b>	<b>81.3</b>	<b>6.0</b>	<b>3.8</b>	<b>3.1</b>
Government Services	18.7	15.5	15.2	4.6	1.9	2.6
<b><i>Non-government Services</i></b>	<b>61.0</b>	<b>69.3</b>	<b>71.5</b>	<b>6.6</b>	<b>4.8</b>	<b>3.2</b>
Wholesale & Retail	9.7	10.6	7.5	5.4	3.8	1.8
Electricity & Water	2.9	3.8	4.6	7.4	7.0	3.4
Construction	8.3	9.8	9.6	9.0	4.2	5.1
<b><i>Hotel &amp; Restaurant</i></b>	<b>8.2</b>	<b>9.2</b>	<b>9.4</b>	<b>6.9</b>	<b>4.6</b>	<b>2.3</b>
Transport	9.9	8.4	9.5	7.5	3.2	3.2
Communications	4.2	8.6	9.5	14.4	9.8	2.7
Bank & Insurance	6.9	9.3	8.6	8.0	6.5	4.5
Real Estate & Housing	6.7	5.5	8.7	3.0	2.2	2.7
Other services	4.2	4.1	4.1	4.9	4.2	2.4

Source: World Bank, 2005; ECCB, 2007

Services make up about 60% of global economic activity, but only 20% of global trade. Annual services exports were valued at US\$2.5 trillion. Many services (such as most medical services, some financial services and personal services like haircuts) cannot be traded internationally.

Instead of exporting, financial institutions often establish a foreign presence and sell from there.<sup>2</sup> Services are becoming more internationally tradable with improvements in communications technologies. The processing of some companies' payroll is in another part of the world rather than in-house – this implies that a services export sale has occurred.

Growth in services has been in double digits since 2003. Europe accounts for over half of all services exports and North America for about 20%. Recently the strongest growth in services trade has been in the emerging markets, with China and India as the largest exporters. Although services exports in those countries more than doubled since 2001, India has outpaced China, with exports exceeding \$50 billion in 2006. In China, growth has been particularly strong in transportation services, whereas in India growth has been strongest in commercial services, especially R&D and consulting services (Export Development Canada, July 26, 2006).

### *Contribution of tourism services to GDP*

*Tourism services* impact a range of economic activities in the ECCU. Despite the 9.4% contribution to GDP in the 2000s, developments in wholesale and retail trade, transport, communications, real estate and banking and insurance are directly or indirectly related to activity in the tourism industry. A study commissioned by the Caribbean Hotel Association entitled, *The Caribbean Accommodation Sector as a Consumer of Locally-Produced Goods and Services and Contributor to Government Revenues* (Tourism Global Inc., 2006) quantifies what Caribbean accommodation establishments (hotels and other properties) spend yearly supporting the economic well-being of workers, local entrepreneurs, professionals, service providers, other economic sectors and government's revenues.<sup>3</sup> The properties surveyed paid an overall 18.83 per cent of their annual turnover in taxes in 2005. This contribution was equivalent to about US\$15.1 per room, per day. The hotel sector provided direct entrepreneurial opportunities in at least fourteen (14) areas identified including taxi service, water sports, spas and beauty salons, gift and craft shops, and restaurants. The study concluded that stay-over tourism is a consumer of a vast variety of goods and services ranging from finished buildings, through foodstuffs to a range of services including banking, insurance, legal and cultural services. The industry is a major consumer of utilities and a significant consumer of local vegetables and dairy products. Some 50% of manufactured items are locally or regionally sourced, with bread, soft drinks, uniforms and printing leading the way.

Insofar as the tourism industry appears to have a locomotive effect on a range of economic activities, for *analytical* purposes we adopted four working definitions of tourism services. First, we define *tourism services* to include activities at hotels and restaurants. Second, we define *tourism ancillary services* to include activities of direct providers such as tour operators and dive shops. Third, we refer to *tourism support services* to include the professional services which provide legal, administrative, management, technical and consulting support to the industry. Fourth, we refer to the *stay-over tourism drivers* to include the recreational, cultural and sporting activities that are currently used as crowd-pullers to fill hotel rooms.

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<sup>2</sup> These are called foreign affiliate sales, but they amount to exports just the same. The same is true for some services outsourced.

<sup>3</sup> The survey was conducted among the membership hotels of CHA in nine CARIFORUM countries - Antigua and Barbuda, Bahamas, Barbados, Dominican Republic, Dominica, Jamaica, Saint. Lucia, St. Kitts & Nevis, and Trinidad & Tobago, as well as in the United States Virgin Islands.

### *A Taxonomy of the ECCU Services Sector*

In the global marketplace, the fastest growing services segments are cafes, restaurants and catering, tourism and hospitality, recreational, entertainment and cultural services, health services, business services, financial services, information technology and telecommunications, and knowledge industries. With respect to the ECCU economies, foreign exchange earnings from bananas (the major traditional export) fell by 40 per cent in the 1990s, while earnings from tourism and foreign direct investment (FDIs) rose by about 40% and 35% in the same period (ECCB, 1996), suggesting the emergence of a service economy.

The growth of the services sector is largely driven by rapid developments in information and communication technology, the free flow of factors of production across borders, the dismantling of trading restrictions and the increasing tendency for foreign firms to outsource services from low-priced markets. *We use changes in the number of services firms listed in the Yellow Pages of the OECS Telephone Directories as an indicator of the growth trend of the services sector* (see Table 2). Since 1989 services, involving database management, and information services using satellite, diskettes, compact discs and videos, have grown in importance.

The traditional services have expanded significantly with increasing demand, and new services have sprung up in several markets. The options in the accommodation sector range from small bed and breakfast to all-inclusive properties, to timeshare arrangements in hotels, villas and condominiums. The *tourism ancillary services* are becoming increasingly sophisticated, with bridal/wedding services and events management at the upper end of the market.

The number of listed service firms increased by 88% to 48,870 in 2004 from 25,970 in 1989. The number of hotel and other accommodation properties grew by 56% between 1989 and 2004, from 560 to 871. Large hotels, most of them, branches of international chains, dominate the stay-over sector.

Among the related services, transport services are among the fastest growing segments. Between 1989 and 2004 the number of listed firms moving people or cargoes by land, sea and air more than doubled. With the liberalisation of the telecommunications sector in the late 1990s, the number of service providers increased to 124 in 2004 from 47 in 1989. Mergers and acquisitions have accelerated the modernisation of the financial system and have created stronger institutions and fewer service providers (Table 2).

The number of listed information service providers increased by 748%, from 56 investors in 1989 to 475 in 2004, reflecting high demand for skills in data processing and transmission, software development, computer programming, and information system design and management.



Table 2: Growth of Services Activities in the OECS: 1989 and 2004

Service Classification	Service Segments	1989	2004	Change 1989 -2004	% Change
Construction/engineering Services	Architectural, construction & engineering companies, real estate companies	17,668	30,937	13,269	75
Tourism & related services	<b>Hotels &amp; other properties</b>	560	871	311	56
	<b>Ancillary Services</b> – Restaurant & caterers, art & crafts, art galleries, dive shops, tour operators, events management and wedding services.	1,152	2,042	890	77
		1,712	2,913	1,201	70
Recreational, cultural & sporting services	Gaming, sports bars, competitive sporting activities, water sports, adventure sports, sailing	57	136	79	139
	<b>Cultural services:</b> Art societies, theatres, performing groups, musical groups, performers, film and recording companies	64	96	32	50
		121	232	111	92
Transport services	Airline companies, air cargo services, shipping companies, shipping agencies, taxi services, travel agencies, car rental agencies, ground transport companies	5,577	12,127	6,550	117
Health & wellness services	Private hospital services, nursing homes, surgery & recuperative services, eye care services, health & beauty services, beauty saloons, health foods & centres, fitness centres, therapy services.	144	565	421	292
Communications services	Telecommunication services, printing services	47	124	77	164
Educational services	Private preschools, private secondary and tertiary schools, technical schools, computer training	20	148	128	640
Information services	Data processing & transmission, database management, internet services, online services <b>Computer &amp; software services</b> - Software development, computer services, computer programming, computer networking, systems management, graphics and designing, installation, internet cafes	56	475	419	748
Financial services	<b>Financial Intermediaries</b> – banks, insurance, credit unions etc	302	290	(12)	(4)
	<b>Offshore Services</b> – offshore banks	47	47	0	0
Professional & business services	<b>Accounting services</b> - Payroll, invoicing, full contract accounting, superannuation administration (pension management), money transfers	32	81	49	153
	<b>Consulting services</b> – advertising, management, planning, business, investment, computer, financial, insurance, human resource, marketing, security, telecommunications, information, engineering	107	241	134	125
	<b>Legal Services</b> – Law Firms	137	324	187	136
		276	646	370	134
Cleaning Services	Office, industrial, environmental, laundry & dry cleaning	31	76	45	145
<b>Total Number of Firms</b>		<b>25,970</b>	<b>48,870</b>	<b>22,900</b>	<b>88</b>

Source: Telephone Directories &amp; Telephone Surveys

The recreational, cultural and sporting services are becoming increasingly important as a sub-sector particularly for the stay-over tourism sector. Activities in that sub-sector include music festivals, theatrical performances and film production (Table 2). Nurse (2005) identified 178 performing artists in the Eastern Caribbean, which represented 18 per cent of the performing arts organisations operating in CARICOM. The 178 providers included professional dance artists (47), professional theatre artists (47), theatre companies (15) and dance companies (21).

**Table 3: CARICOM Performing Arts Organizations: 2005**

	<i>Professional Dance Artists</i>	<i>Professional Theatre Artists</i>	<i>Theatre Companies</i>	<i>Dance Companies</i>	<i>Venues</i>	<i>Others</i>	<b>Total</b>
<b><i>Barbados</i></b>	36	16	9	7	8	35	<b>111</b>
<b><i>Bahamas</i></b>	63	na	na	6	4	10	<b>83</b>
<b><i>Guyana</i></b>	23	30	5	10	5	na	<b>73</b>
<b><i>Jamaica</i></b>	75	92	13	9	12	70	<b>271</b>
<b><i>OECS</i></b>	47	47	15	21	28	20	<b>178</b>
<b><i>Trinidad</i></b>	76	95	8	65	16	25	<b>285</b>
<b>Total</b>	<b>320</b>	<b>280</b>	<b>50</b>	<b>118</b>	<b>73</b>	<b>160</b>	<b>1,001</b>

Source: Nurse (2005)

#### **IV. What is the Potential of the Emerging Services Segments?**

An economic shift is becoming evident in the ECCU countries. Following “green gold” in the first half of the 1980s, foreign exchange earnings from export agriculture in the 1990s fell by 40%, while earnings from tourism and offshore business rose by 40% and 35% respectively (ECCB, 2000). The ECCU is rapidly becoming a major destination for offshore education. In 2006, of the 37 offshore medical schools in the wider Caribbean, 13 operated in the sub-region. The World Bank (2005) noted that “the ECCU has already demonstrated a comparative advantage in the area of off-shore education. Currently, there are an estimated 11,000 offshore students enrolled in these schools, half of which attend schools in the ECCU. Indeed, the two largest medical schools serving the US market are in Dominica and Grenada.”

##### *Importance of tourism-related services*

Economists divide services trade into three categories, namely commercial services (everything from engineering services to call centres to banking), transportation services (shipping, handling, logistics) and travel (tourism). In the ECCU, most service activities are developing around the *tourism ancillary services*. The tourism product is being diversified. Apart from the traditional stay-over and cruise tourism, retirement tourism, health and wellness tourism, convention tourism, faith tourism, festival tourism and sport tourism are becoming crowd pullers to fill hotel rooms.

In Dominica, ecotourism (nature tourism) is rapidly expanding and providing opportunities for small operators such as lodge owners, guest houses, mountain cottages, guides, cottage industries, specialty outfitters, suppliers, tour buses, local restaurants, craft shops. A number of activities are being developed as part of the niche market of

ecotourism. These include special spa facilities, fitness centres, health resorts, mountain resorts and herbal and diet centres. The natural beauty has proven to be a filmmaker's paradise<sup>4</sup>. Several producers have found the following as ideal facets for filmmaking: the jungle and swamp locations, grasslands, mangroves, reed and mudflats, lush virgin rainforests, cascading rivers, waterfalls and freshwater lakes, boiling lakes, black and golden sand beaches, towering mountains and the Creole architecture,.

The film industry is growing in significance in Dominica and Saint Lucia. Dominica is perhaps in the frontline, having shot nine films including the *Seventh Sign* by tri-star Picture (1987); the *Orchid House* by BBC Channel 4 (1991); *Pirates of the Caribbean – Dead Man's Chest* (2005); and *Pirates of the Caribbean – at World's End* (2007). The filming of *Pirates of the Caribbean- Dead Man's Chest* injected an estimated US\$18m into the local economy in six months and generated jobs for over 500 persons (Nurse, 2005).

The *recreational, cultural and sport services*, particularly the stay-over crowd-pullers (*sport tourism* and *festival tourism*) are growing in importance. Cricket creates a boom in the countries when the region hosts competitive teams (particularly Australia and England)<sup>5</sup>. Tourism receipts increase significantly in Antigua and Barbuda, Grenada and Saint Lucia during the cricketing months. For example, tourism receipts for April 1995 and 1999 (when the West Indies cricket team played Australia at the Antigua Recreation Ground) totalled EC\$75m and EC\$76m respectively, while receipts for the month that followed (May) totalled EC\$52m and EC\$50m respectively (Peter Adrien, 2002:11).

*Festival tourism* makes a significant impact on the stay-over tourism sector, increase government revenue, and generates employment and sectoral linkages. The Saint Lucia Jazz Festival which has grown from an average of 9,000 patrons in the 1990s to 12,000 in the 2000s, has become a multi-million dollar venture (Table 4). The annual international attraction generates significant economic activity during the tourism off-season.

Table 4: *St Lucia Jazz Festival: Festival Tourism Economic Impact*

	1998	1999	2000	2001	2002	2003	2004
Arrivals	9,929	9,909	11,041	8,421	11,203	12,164	12,553
Visitor Exp. (US\$M)	14.1	13.9	14.8	12.0	12.5	17.3	na

Source: Nurse (2005)

#### *Potential for services export*

ECCU service suppliers export some sixty-five (65) different types of services to CARICOM and forty-two (42) to extra-regional markets (OECS Secretariat, 2005:4). Table 5 shows the market penetration by national suppliers.

<sup>4</sup> Most ECCU countries have their own film commission which provides support services for film producers. *Pirates of the Caribbean* was first shot in St Vincent and the Grenadines and Dominica. The Hollywood feature films *Dr Doolittle*, *Superman III* and *White Squail* were filmed in Saint Lucia.

<sup>5</sup>Excessive regulations and administrative bottlenecks prevented the ICC Cricket World Cup 2007 from making a significant impact on the economies of the host countries.

Table 5: Main Non-CARICOM Export Markets for OECS Services Exports

Services exported to:	Services Exported from:				
	Antigua & Barbuda	Dominica	St Kitts	Saint Lucia	St Vincent & the Grenadines
Canada	*	*	*	*	*
France	*	*	*	*	*
Germany	*	*	*	*	*
Italy	*	*	*	*	*
Korea, Rep. of	*	*	*	*	*
Netherlands	*	*	*	*	*
United Kingdom	*	*	*	*	*
United States	*	*	*	*	*
<b>No of markets</b>	<b>15</b>	<b>33</b>	<b>32</b>	<b>21</b>	<b>12</b>

Source: *OECS Services Trade Policy Framework*, 29 June 2005, pp. 38-39

### *Contribution to employment creation*

The services sector utilises more human capital than natural capital. This accounts for the relatively low productivity in that sector, but makes the sector an important source of employment creation. Job creation has been influenced by technological advancements,

Table 6: Employment: Five-year Growth Rates, 1980 – 2003

	85/80	90/85	95/90	00/95	03/00
<b><i>Tourism &amp; Ancillary</i></b>					
Hotels	12.62	23.79	8.40	35.56	7.11
Other Properties	7.70	13.30	27.75	7.57	3.95
Restaurants	27.65	2.68	16.21	26.81	-1.65
Dive shops	1.78	23.43	9.07	3.38	-6.03
Gifts Shops	25.64	20.96	79.51	61.68	9.99
<b><i>Growth Rate</i></b>	<b>13.02</b>	<b>16.74</b>	<b>15.77</b>	<b>43.40</b>	<b>11.57</b>
<b><i>Tourism &amp; Support</i></b>					
Airlines	13.46	4.52	70.27	22.22	7.53
Travel Ag.	3.06	11.88	55.75	27.03	10.16
Car Rental Ag.	3.50	11.36	55.99	69.19	74.31
Transport Com.	18.57	133.86	4.56	39.62	-3.32
Construction Co.	8.26	8.35	10.54	47.49	12.56
Real Estate Ag.	20.77	57.84	67.63	20.65	3.86
<b><i>Growth Rate</i></b>	<b>8.65</b>	<b>19.55</b>	<b>13.94</b>	<b>46.53</b>	<b>20.30</b>
<b>Growth in sectoral Employment</b>	<b>10.96</b>	<b>18.04</b>	<b>14.92</b>	<b>44.85</b>	<b>15.66</b>

Source: Computed from CSOs and other Estimates.

advancement in education, labour mobility, the increasing tendency by larger firms to out-source work from small suppliers, and contracts to providers in other countries where labour costs is lower (Charles, 1994). Since the 1990s, service firms have been the primary creators of employment in the global economy, accounting for more than 90% of new jobs (OECS Secretariat, 2005:7). In 2003 the number of persons employed in

*tourism* was 93,757 compared with 37,182 in 1980, suggesting that the absorptive capacity of the industry more than doubled in the last twenty years. In 2003 the number of persons employed in *tourism and ancillary services* (48,011) and *tourism support services* (45,746) were almost three times the number in 1980 (ECCB, 2006).

Employment in *tourism and ancillary services* grew at an average rate of 22.2%, reflecting persistent high absorptive capacity of gift shops, hotels and restaurants. Labour absorption was also strong in the *tourism support services* segment. Job creation was driven by real estate agencies, transport companies and car rental agencies. Employment in the construction sector mushroomed between 1995 and 2000, but the rate of growth slowed in 2002-03. The reduced rate of growth in the 2000-2003 period reflected the sectoral adjustment following the stagnation in economic activity in 2001 (Table 6).

In the transition from the weighted to the weightless economy, a number of services activities are growing in importance. First, the legal, accounting and consulting services are the leaders in the business and *professional category*. Second, there is a blurring of the boundaries of the *recreational, cultural and sporting services* and the stay-over tourism industry. Sport, festivals and related cultural events are becoming pull factors for selling the large stock of hotel rooms since the 2007 Cricket World Cup, while the film industry holds remarkable potential for select economies. Third, information and communication technology has flourished and is acting as a springboard for the competitiveness of the health and social services.<sup>6</sup> Table 7 identifies the range of services with the greatest potential for growth, job creation and foreign exchange earnings.

Table 7: Services Segments with Low Hanging Fruits

<i>Classification</i>	<i>Services Segments</i>
Tourism services	Villas, condominiums and time shares
Tourism ancillary services	Restaurants and catering services, sightseeing & tours, dive shops and art galleries.
Recreational, cultural & sporting services	International meets, sport bars, regattas, music festivals, performing arts and film production.
Health & wellness services	Recuperating services, surgical, restorative, body care.
Professional and Services	Consulting, legal, accounting, engineering, property management, security and cleaning services.
Information & communication services	Data processing and internet-related services.
Education services	Offshore education services, day care, private tuition.
Financial services	Money transfer services & internet banking.

### **Section V – Access to Commercial Banking Credit**

Given the relatively under-developed nature of the capital market, and the liquidity in the banking system, commercial banks remain the major financiers in the ECCU economies. In this bank-centric environment, is the commercial bank system fuelling the growth of the services sector? Does the leading sector enjoy adequate access to commercial bank

<sup>6</sup> St Lucia is leading the way in medical tourism with a sound medical infrastructure, with skilled doctors working in high quality facilities. The medical costs are one third of costs in the US. The luxurious spa is experiencing higher growth than the other services segments. Le Sport is one of world's top spa resorts.

credit? Is there an under-supply of credit to the services segments with the growth potential?

The direction of commercial bank credit in the last 17 years confirms the decreasing importance of the *weighted activities* and the increasing importance of the *weightless activities*. *Non-government services* have been the major beneficiary of commercial bank credit. While loan disbursements to agriculture and manufacturing have been on the decline, credit to the non-government services has grown at an increasing rate.

Between 1990 and 2007, the share of credit to agriculture and manufacturing averaged 3.2% and 3.1% respectively compared with 39.3% for *non-government services* (Table 8).

Table 8: Commercial Bank Credit to economic sectors, 1990 - 2007

Sectors	Share of Credit (%)						Percentage Point Change				
	1990	1995	2000	2005	2006	2007	95/90	00/95	05/00	06/05	07/06
<b>Agriculture</b>	<b>2.98</b>	<b>2.78</b>	<b>3.14</b>	<b>4.07</b>	<b>3.38</b>	<b>2.89</b>	<b>-0.19</b>	<b>0.35</b>	<b>0.93</b>	<b>-0.69</b>	<b>-0.49</b>
Fisheries	0.30	0.19	0.21	0.15	0.13	0.11	-0.11	0.02	-0.06	-0.02	-0.03
Mining & Quarrying	0.48	0.48	0.28	0.33	0.38	0.33	0.00	-0.20	0.05	0.05	-0.06
Manufacturing	4.88	4.50	2.94	2.22	2.08	1.90	-0.38	-1.56	-0.72	-0.14	-0.19
<b>Services</b>											
Government Services	8.37	8.73	9.18	8.78	10.07	10.31	0.36	0.45	-0.40	1.29	0.23
<b>Non-Government Services</b>	<b>41.03</b>	<b>42.11</b>	<b>38.21</b>	<b>36.31</b>	<b>37.64</b>	<b>40.74</b>	<b>1.08</b>	<b>-3.90</b>	<b>-1.90</b>	<b>1.33</b>	<b>3.09</b>
Wholesale & Retail	14.57	15.57	12.04	9.89	8.72	7.25	1.00	-3.53	-2.16	-1.17	-1.47
Tourism	8.04	9.56	7.69	7.03	8.29	9.91	1.52	-1.87	-0.65	1.25	1.62
Entertainment	1.00	1.07	1.24	0.90	0.92	0.90	0.06	0.17	-0.33	0.02	-0.03
Professional & Other Services	3.34	4.67	6.26	6.74	8.07	8.99	1.34	1.59	0.48	1.33	0.92
Utilities	2.02	2.33	2.34	2.30	2.76	4.08	0.32	0.01	-0.05	0.47	1.32
Transport	4.26	2.80	2.77	1.94	2.09	2.22	-1.46	-0.04	-0.82	0.14	0.13
Financial Institutions	0.99	1.19	1.42	1.72	1.37	0.96	0.20	0.23	0.30	-0.34	-0.41
Construction	6.80	4.91	4.46	5.79	5.42	6.44	-1.89	-0.45	1.34	-0.37	1.02
<b>Personal</b>	<b>41.96</b>	<b>41.20</b>	<b>46.05</b>	<b>48.13</b>	<b>46.30</b>	<b>43.74</b>	<b>-0.75</b>	<b>4.84</b>	<b>2.09</b>	<b>-1.83</b>	<b>-2.56</b>
Acquisition of Property	22.96	24.12	24.84	27.28	26.98	24.09	1.17	0.71	2.45	-0.30	-2.89
Durable Consumer Goods	7.60	4.79	5.38	3.84	4.25	4.43	-2.81	0.59	-1.55	0.42	0.18
Other Personal	11.40	12.29	15.83	17.01	15.07	15.21	0.89	3.53	1.19	-1.95	0.15

Source: Eastern Caribbean Central Bank

The decline of the traditional agricultural sector is reflected in a -0.19 percentage point change in the period 2006/2007 compared to 0.49 percentage point change in the period 1990/1995. Credit to *non-government services*, on the other hand, has grown at an increasing rate since 2005 (Table 8).

Are *tourism services* adequately financed? The three largest beneficiaries of commercial bank credit are distributive trades, tourism and construction. Loans to these three segments grew at an average rate of 8.9%, 8.4% and 5.6% respectively. However, while loans for tourism have risen at an increasing rate since 1995, credit for distributive trades have grown at a decreasing rate, and disbursements for construction have fluctuated. The growth of the tourism industry has depended heavily on access to foreign direct

investment (FDI) and commercial banking credit. FDI has been a major source of financing of economic activity in the region since the 1970s. While the rate of growth has declined in the post-1989 period with the shift in investment flows from north/south to north/north, FDI remains the principal source of external capital in the Caribbean. Between 1986 and 1990 FDI inflows more than tripled, with the major portion used for financing telecommunications and tourism development (Williams and Williams, 1998). FDI financing for tourism accounted for 39.1% in 1997, increased to a high of 61.8% in 1999, and fell to 44.0% in 2000 and to 38.4% in 2001, the latest year for which comparable data are available (Table 9).

*Table 9: FDI Flows by Sector, 1997-2001  
(Value in EC\$m & Percentage share)*

	1997		1998		1999		2000		2001	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Total	744.8	100	877.0	100	913.9	100	897.1	100	831.6	100
Agriculture	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Manufacturing	52.1	7.0	1.0	0.0	3.0	0.3	7.7	0.9	0.0	0.0
Tourism	291.3	39.1	479.7	54.7	564.9	61.8	394.5	44.0	319.5	38.4
Others	401.4	53.9	396.3	55.3	346.0	37.9	494.9	55.1	512.1	61.6

Source: ECCB 2003.

*Table 10: FDI Inflows and Commercial Bank Credit to Tourism*

<i>Sources of Funds</i>	1990	1995	2000	2001	2002
FDI Inflows (EC\$m)	512.5	617.5	897.1	831.6	747.9
Commercial Bank Loans	294.6	443.9	648.7	636.7	624.1
<b>% of CB/FDI Inflows</b>	<b>57.5</b>	<b>71.9</b>	<b>72.3</b>	<b>76.6</b>	<b>83.4</b>

Source: Eastern Caribbean Central Bank

While tourism has depended largely on FDI inflows for financing capital expenditure, small and medium-sized properties have depended heavily on commercial bank for financing both capital projects and operations. Commercial bank financing increased from 57.5% of FDI inflows in 1990 to 76.6% of FDI inflows in 2000, reflecting the increasing importance of commercial bank financing in a bank-centric environment.

How much access do the tourism-related services (that is, *tourism ancillary services*, *tourism support services* and the *tourism drivers*) have to commercial bank credit? According to Table 8, the share of credit to *professional and other services* averaged 6.3 per cent between 1990 and 2007. However, the value of loans to management, consulting, legal, accounting, engineering and medical firms has risen at an increasing rate since 1990, reflecting the growing importance of these services. The frontline service providers are those that provide support services to the tourism industry, particularly legal and management firms. Commercial bank lending to the *tourism ancillary services* and the *tourism drivers* – recreational, cultural and sporting activities) is masked by limitations associated with the *Classification of Credit by Economic Activity* (CCEA) which guides loan underwriters in classifying disbursed loans. From Table 8, it would be observed that loan disbursed for *personal use* has averaged 14.5% of total bank

credit since 1990. In the sub-category ‘other personal’ is lumped all loan disbursements for other personal uses that are not explicitly defined elsewhere in the guide to the CCEA. This sub-category would most likely include disbursements to *tourism ancillaries* or the *tourism drivers*<sup>7</sup>.

However, it must be borne in mind that the commercial banking system (particularly foreign banks)<sup>8</sup> does not seem to have an appetite for lending to small and medium-sized businesses. Jack (2005) noted that there are several barriers prohibiting businesses access to commercial bank credit. These include, the “low risk appetite of commercial banks”, prudential guidelines set by the central bank, information asymmetries that exist between creditors and potential borrowers.

Moreover, commercial bank credit market conditions surveys done by the ECCB in 2005 and 2006 suggest that commercial banks may be risk-averse, and that business loan applications that are deemed too risky are heavily scrutinised with respect to the viability of the project and the adequacy of equity, collateral and cash flow.

*Table 11: Loan Applications Rejected by Type\*: 2005 & 2006*

<i>Basis for denial</i>	<i>Consumer</i>	<i>Mortgage</i>	<i>Business</i>
Incomplete proposal	129	23	36
Inadequate equity	193	130	123
Project not financially viable	99	40	102
Inadequate collateral	518	61	95
Inadequate cash flow	612	80	64
Inappropriate management	27	6	17
Poor credit history	659	67	33
Other	17	9	2
	<b>2,254</b>	<b>416</b>	<b>472</b>

Source: ECCB. \*Information not available on volumes of allocations

Although the total number of loan application is available, it does appear from Table 11 that in the assessment of business applications, variables such as profitability and security are heavily weighted.

Accessing commercial bank financing appears to be difficult for small establishments because of the increasing cost of investment capital for risk-based undertakings. This has serious implications in light of the fact that “commercial banks dominate the system with 66% of the market share; pension funds control 16%; insurance companies account for 5%; credit unions command 4% and foundations and finance companies 3% each” (Adrien, 2004:4).

*The limitations associated with the classification of credit by economic activity and the credit market conditions survey do not allow us to make a conclusive statement with*

<sup>7</sup> Just as the national accounts are being rebased to reflect the changing structure of the economy, the Central Bank’s Classification of Credit by Economic Activity is being reviewed to make it more reflective of changes in structure of the economy.

<sup>8</sup> The Eastern Caribbean banking system is really an agency market with 27 of the 38 licensed banks being branches of foreign banks.



*respect to commercial bank behaviour.* We cannot determine whether there is an under-supply of commercial bank credit to the emerging services segments. However, there is evidence to suggest that banks limit disbursements to the high-value/high-risk activities, and many of the tourism ancillary activities are financed by development foundations and credit unions.

## **VI. Conclusion and Policy Recommendations**

The services industry is the major contributor to GDP in the ECCU and tourism is the leading activity. *The commercial banking system is the primary financier of economic activity. However, developments in the real sector, particularly in relation to the increasing importance of services activities, suggest that heavy dependence on commercial bank credit could limit the growth of certain high-value but high-risk services segments with low hanging fruits.*

What then are the financing options for the emerging real sector? What should be done to ensure sustainable financing for tourism and other services? Attempts are being made to develop the money and capital markets in order to supplement the credit services offered by commercial banks. The proposed Eastern Caribbean Enterprise Fund (ECEP) and the enhancement of the development banks, development foundations and credit unions are the subjects of policy makers.

### *(i) The Eastern Caribbean Enterprise Fund (ECEP)*

The Eastern Caribbean Enterprise Fund (ECEP) should be the proposed vehicle for business incubation, and for guaranteeing access to risk capital to the emerging services sector. Most of the high-value/high-risk service firms in the ECCU can be classified as micro-enterprises or small and medium enterprises (SMEs). Many of the service providers in the *recreational and cultural industries* are micro producers that demand small loans and pledge minimal assets as security. Credit market surveys suggest that commercial banks place low priority on high-risk small scale economic activities. Consequently, many loan applications are rejected for inadequate information, poorly detailed business plan, insufficient managerial training and experience, poor credit history and inadequate collateral. When loans are approved, conditions are very prohibitive and moratoriums are not offered to facilitate gestation period.

The ECEP should serve as the mechanism for mobilising grant fund or low-cost capital for on-lending at affordable cost to development banks, foundations and credit unions. The enterprise fund, with the mandate for developing the export sector, should also supply equity and debt financing for business revitalisation and expansion; provide business advisory and consultancy services; coordinate the provision of technical assistance and market research; and offer a facility for venture capital.

Given the reality of the ECCU macro and fiscal economies, the sustainability of this financial platform is highly dependent on access to a broad-base stakeholdership including financial institutions, development agencies, governments and private sector organizations. Moreover, sustainability will demand prudent investment management in order to guarantee a realistic return on investment, to ensure the long term a viability of funds.

*(ii) Development Banks and Development Foundations*

During the 1970s and 1980s, the Caribbean state became active in the marketplace. National commercial banks, development banks, development foundations, credit unions, building societies and social security schemes (SSS) were established to encourage domestic capital formation.

*Development Banks* are significant financiers of development projects. They were established to extend credit to enterprises involved in productive activities, particularly financing business, educational, housing and agricultural projects. Their mandate was to package projects for SMEs for funding by commercial banks and other development agencies, and to guarantee up to 80 per cent of loanable funds for enterprises which lacked the required collateral.

The *National Development Foundations* (NDFs) were set up to supply short-to-medium-term funds mainly to micro and small businesses. NDFs were neither to do retail banking or mortgage underwriting nor to compete with commercial banks and development banks in the wholesale credit market. They were to be the prototype vehicles for micro credit with specialised skills in micro-business development, micro-credit underwriting and debt collection.

Unfortunately, most development banks and foundations, bedevilled by governance, management and financial problems, have virtually lost their way. Loss of access to grant funds has exacerbated their problems. Recently there has been an over reliance on the Social Security Systems (SSS) as suppliers of low-cost funds.

Apart from the inability to source soft financing they are faced with the following challenges:

- Delinquency at all DFIs are very high; assets could be overvalued given the high level of non-performing loans (NPLs); inability to make requisite loan loss provisions, and low level of recoveries.
- Low level of growth in loan portfolio and significant reduction in interest income has led to operational loss in some institutions.
- Inability to supply the increasing demand for small business loans given the existing liquidity pressure.
- There is mismatch between cost of operations and the pricing of services. Administrative costs continue to increase while lending rates are not risk-weighted.
- The DFIs suffer from capacity problem, having being unable to attract adequate trained managerial and technical workers in a competitive market.

Despite the attending problems, development banks and national development foundations should be re-engineered into their original mandates to transform them into functional supplementary financing windows for the emerging real sector.

*Development banks* should be enhanced to (a) assist in transforming business ideas into viable projects, provide business training, and underwrite small and medium-sized enterprises; and (b) to package small and medium-sized business projects for funding by commercial banks, and guarantee a percentage of loans where viable business ventures lack the required collateral.

*Development foundations* should become the primary financier for micro enterprises. The enhancement programme for these institutions should include technological development for businesses, micro credit underwriting and debt collection.

*(iii) Credit unions*

Coming out of the recommendations of the Moyne Commission Report, *credit unions* were established to nurture the economic democracy of the un-bankable population. They were to supplement the retail-banking services of the commercial banking system. Initially they specialised in consumer lending to captive markets, but increasing sophistication and changing market demands have forced them into micro financing and mortgage underwriting for which they lack the requisite technologies.

Should credit unions be equipped with the requisite micro-credit capability, these financial cooperatives would be ideal windows for extending micro credit to entrepreneurs in their common bond.

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