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Publisher's Note

The *Economic Review* is published three times a year in June, September and December, by the Central Bank of Barbados. It is prepared by the Bank's Research Department and contains articles of research undertaken at the Bank. In addition, we welcome contributions of a non-technical and empirical nature on economic and policy issues in the Caribbean. Book reviews and surveys are also welcome. All submitted papers are reviewed by the Editorial Committee* and external referees.

Articles and correspondence regarding the Review should be addressed to:

The Administrative Editor
Economic Review
Central Bank of Barbados
P.O.Box 1016
Bridgetown
Barbados
Tel: (246) 436-6870
Fax: (246) 427-1431
E-mail: cbb.lib@caribsurf.com
Website: www.centralbank.org.bb

***The Editorial Committee**

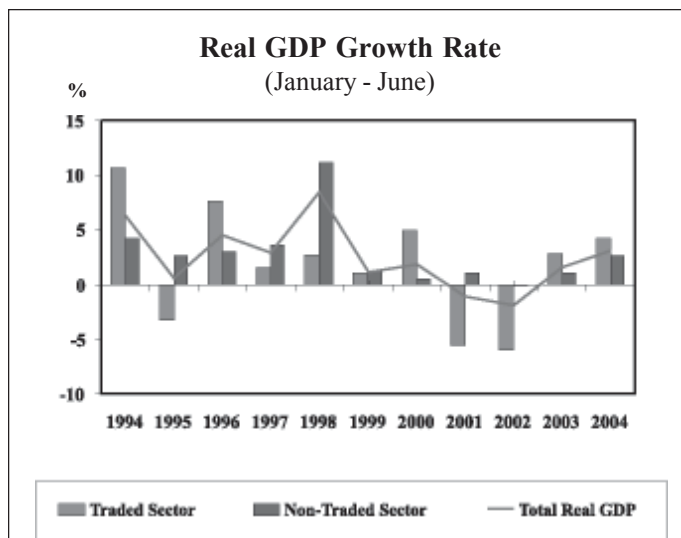
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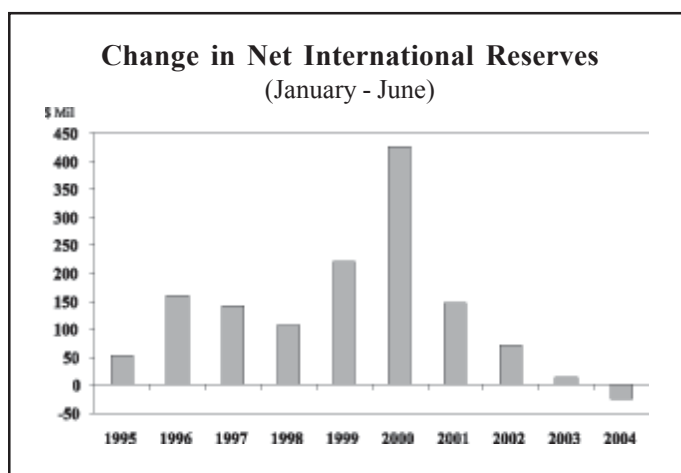
Review of Economy

During the first six months of 2004, the Barbadian economy grew by an estimated 3.1%, doubling the growth rate in the comparable six-month period of 2003. The traded sectors expanded by approximately 4.2%, fuelled principally by a strong tourism performance. The increase of 2.6% in non-traded output was more broad-based with transportation, storage and communications and wholesale and retail trade being the major contributors. Despite the robust growth in tourism and higher net long-term capital and financial inflows, the net international reserves (NIR) of the monetary authorities decreased, largely because of strong import growth and sluggish domestic exports. Inflows of long-term capital and the expansion in real economic activity contributed to the rapid accumulation in bank deposits, which continue to outpace the rate of new lending by commercial banks. This outturn, coupled with the reduction in the minimum securities requirement, kept the level of excess liquidity at around the same level as at the end of December 2003. Notwithstanding the available liquidity in the banking system, the Government reduced its borrowing from domestic entities.

The main sources of growth during the half-year were tourism, boosted predominantly by significant rises in both long-stay and cruise visitors during the first quarter, and transportation, storage and communications, as well as wholesale and retail trade, and to a lesser extent, utilities production. The introduction of competition in the cellular market and the heightened activity at the ports contributed to the higher rates of growth in the non-traded sectors. In contrast, the production of raw sugar declined for the fourth consecutive year and overall output in the manufacturing industry remained depressed. The rate of retail price inflation rose gradually to 0.9% at the end of June 2004 from slightly above zero percent one year earlier, whilst the unemployment rate for the second quarter fell by about two percentage points to 9.6%.



Between the end of December 2003 and June 2004, the NIR declined by \$25.1 million, as the first-quarter boost of \$35.9 million was erased by net reserve outflows of \$60 million in the second quarter. In the corresponding six-month period of 2003, the NIR rose by \$13 million, whilst over the five-year period 1998 to 2002, an average half-yearly increase of \$94.8 million¹ was recorded. The principal contributors to the reduction in the NIR during the review period were significant imports of both consumer and capital goods and



¹ This figure excludes the capital market borrowings made in the second quarters of 1999 and 2000, valued at \$150 million and \$200 million, respectively.

lackluster export receipts. In addition, since the introduction of the second-tier reserve system² in July 2002, institutions have been using foreign reserves for investment abroad, thereby, reducing the NIR of the monetary authorities. Notwithstanding the net loss of foreign reserves, the liquid foreign assets at the end of June 2004 totalled approximately \$1,480.4 million, which were sufficient to cover 32.3 weeks of retained imports, compared with 33.4 weeks at the end of June 2003.

The excess liquidity ratio was 20.9% at the end of June 2004, which was slightly below the level as at the end of December 2003. The reduction in the minimum securities requirement in the first quarter, which made the \$200 million previously held in government securities available for use by the private sector, contributed in part to this outturn.

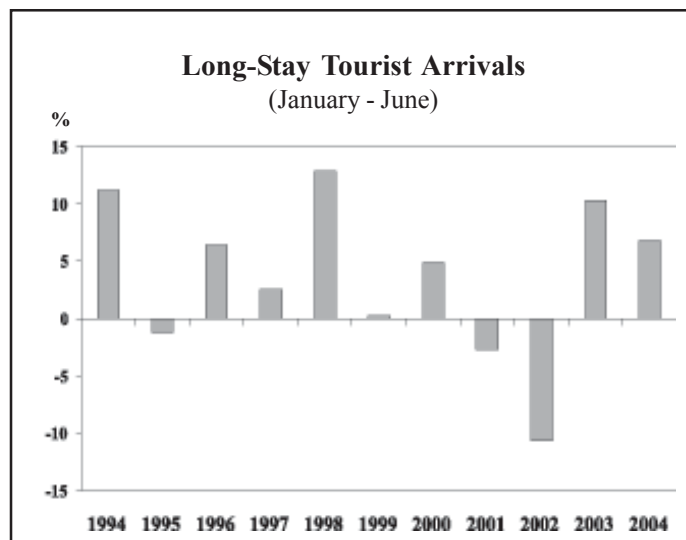
The overall estimated surplus on central government operations was approximately \$44.1 million for the first six months of 2004, in contrast to a deficit of \$39.2 million in the corresponding period of 2003. The surplus reflected mainly higher indirect tax revenue and lower on-budget capital spending.

Production, Prices and Employment

Tourism

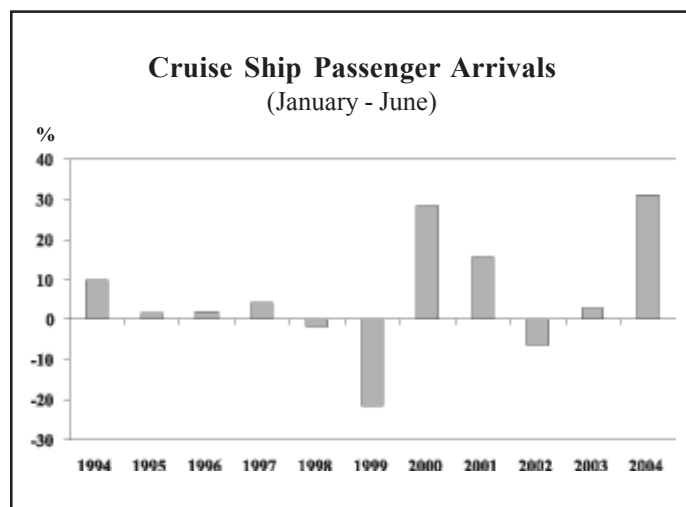
Between January and June of 2004, tourism value-added is estimated to have expanded by 10.7%, principally due to a strong first quarter performance. The total number of long-stay visitors increased by 6.8% or 19,351 persons to end at 279,435 persons. In the first quarter, arrivals of stay-over visitors rose by 11.5%, but the expansion in the second

² The second-tier reserve system is a programme in which certain entities are allowed to invest funds overseas with the approval of the Central Bank, under the guarantee that such funds will be repatriated *when requested*. These funds can be sourced either directly from the foreign exchange market or from the reserves of the Central Bank. Approximately \$130.6 million had been invested abroad by June 2004.



quarter was just 1.9%, compared to growth of 19.2% in the corresponding quarter of the previous year.

For the first six months of 2004, arrivals from Canada expanded by 12.4%, while the number of persons travelling from the UK and US grew by 8.2% and 3.1%, respectively. The performance of the UK and US markets reflected an expansion in the availability of seats by major airlines from these destinations, while the Canadian market benefitted from



greater traffic from Toronto. Long-stay visitors from Trinidad and Tobago and other CARICOM countries increased by 4.9% and 19.6%, respectively over the review period, partially due to the hosting of sporting events. While tourists from Germany increased by 0.6%, stopover visitor arrivals from Continental Europe contracted by 8.8%.

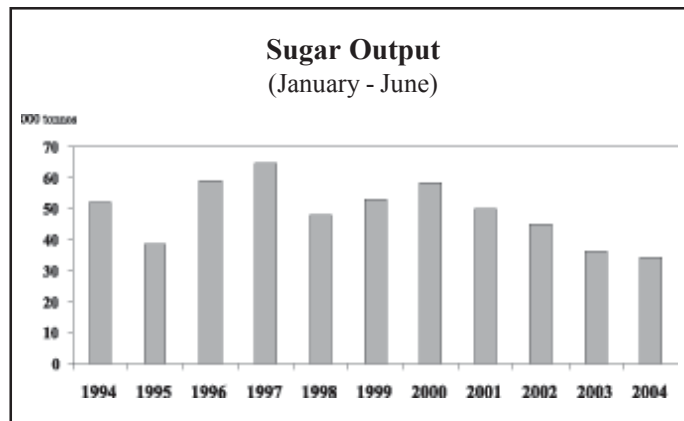
Cruise ship visitor arrivals rose by 31.1% for the first six months of 2004, compared with growth of 2.7% in the first half of 2003. In particular, the second quarter increase of 30.8%, which was the highest growth rate in the second quarter since 2000, occurred mainly as a result of the addition of two cruise liners during the summer period. A total of 329 ships docked at the Bridgetown port in 2004, or 58 ships more than in 2003.

Manufacturing

Output in the manufacturing industry decreased by 0.6% in the first six months of this year, following a contraction of 1.0% in the comparable period one year ago. Value added in the manufacturing industry has been declining since 1999, with the exception of 2002, when a marginal increase of 1.8% was recorded. Overall manufacturing output was constrained by reductions in the production of two of the major sub-sectors - food processing (5.4%) and the other manufacturing category (2.3%). Nevertheless, there were some positives in the industry, as output of beverages rose by 1.6%, while production of chemicals, electronic components and non-metallic mineral products grew by 27.2%, 18% and 4.5%, respectively, following declines in the corresponding period of 2003.

Agriculture and Fishing

Due to poor weather conditions during the harvesting period, the sugar industry produced 34,357 tonnes of sugar, approximately 5.4% or 1,967 tonnes less than that of 2003. This was the fourth consecutive year that output of raw



sugar has decreased. The production of raw sugar has now declined by a cumulative 49.7% over the last four years. During the six-month period under review, output of the non-sugar agriculture industry fell by an estimated 5.6%, in contrast to an expansion of around 4% in the same period of 2003. Fish catches contracted by 22.0%, while milk production decreased by 8.2% during the review period. In contrast, chicken production rose by an estimated 7.7%, following growth of 5.2% in 2003.

International Business and Financial Services

For the first half of 2004, one hundred and seventy-three new licenses were issued in the international business and financial services industry, some twenty-eight more than those granted for the corresponding period of 2003. International business companies accounted for one hundred and thirty-six of the new licenses, up from one hundred and twenty-six in the same period one-year prior. Twenty-nine societies with restricted liability were established during the period under review, along with six new exempt insurance companies, which was double the number licensed during the January to June period last year. During the review period, the number of new registrations of offshore banks fell from fourteen in 2003 to two in 2004.

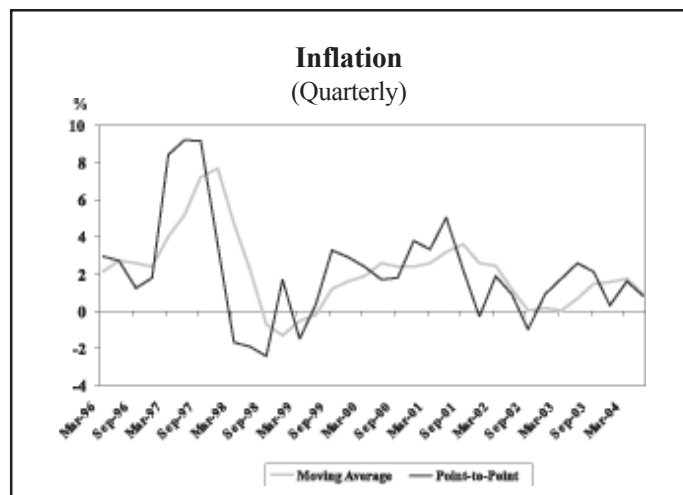
Non-Traded Sectors

Between January and June 2004, construction activity fell by an estimated 0.5%, following growth of 5.1% in the corresponding period of the previous year. Wholesale and retail trade, benefitting from the improved tourism outturn and increased domestic demand, expanded by an estimated 4.1%, after rising by 3.0% in the same period one year ago. Higher output was also recorded in the transportation, storage and communications industry, principally due to continued growth in imports and, to a lesser extent, stronger demand for telecommunications services brought about by the liberalisation of the telecommunications market. The business and other services industry grew by around 2.9%, while output of electricity, gas and water rose by 2.4%, which was slightly above the previous year's figure. The mining and quarrying industry contracted by 0.6%, as the 1.6% decline in oil production was offset by higher quarrying output.

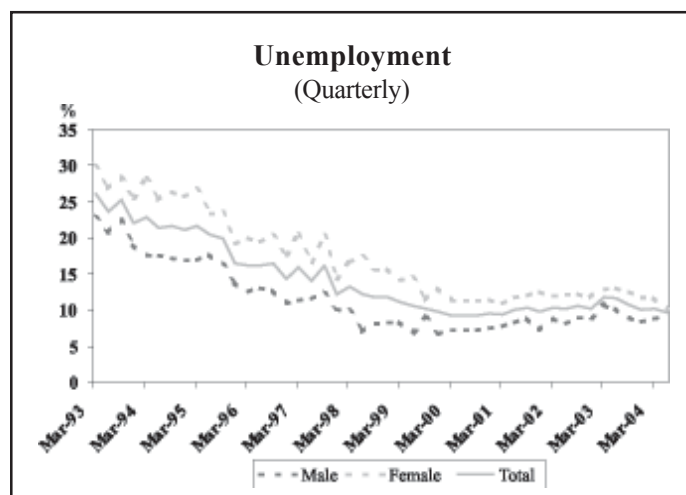
Prices and Employment

For the first half of the year, Barbados continued to experience a relatively low rate of inflation. The moving average rate of inflation for the twelve months ending June 2004 was approximately 0.9%, or about 0.2 of a percentage point above the level at the end of June 2003. The categories of the retail price index that registered increases were food (3.1%), medical and personal care items (2.4%) and transportation (2.1%). These increases were, however, partially offset by declines in the prices of fuel (6.0%), alcoholic beverages and tobacco (2.2%), household operations and supplies (2.0%) and clothing and footwear (0.2%).

An increase of 5,400 persons in the number of employed persons contributed to a decline in the unemployment rate. For the second quarter of 2004, the unemployment rate was estimated at 9.6%, a reduction of two percentage points



from the corresponding period of the previous year. The rate of unemployment for males and females fell by approximately 1.0 and 3.1 percentage points, from June 2003, reaching 9.2% and 10.0%, respectively. The most significant job gains were recorded in general services, finance, insurance and business services and transportation and communications.



Financial Sector

Deposits

For the first six months of the year, total domestic deposits were up by 11.0% to \$5,457.7 million, compared to a decline of 0.4% in the corresponding period of 2003. The faster rate of deposit growth was stimulated mainly by the overall expansion of economic output. During the January

to June period, significantly higher deposits were registered for private individuals (\$188.2 million), business firms (\$118.6 million), statutory bodies (\$20.9 million), and other economic agents (\$7.1 million).

Credit

Commercial bank credit to the non-financial private sector advanced by an estimated 5.5%, following a

Summary Accounts of the Banking System (\$ Million)

	2002				2003				2004	
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar. ^R	Jun. ^P
Net International Reserves	1,623.4	1,606.1	1,570.6	1,711.3	1,940.3	1,929.3	2,053.1	2,087.1	2,169.1	2,244.4
Monetary Authorities	1,482.1	1,485.3	1,441.3	1,366.4	1,358.3	1,379.2	1,513.0	1,503.3	1,539.3	1,478.2
Commercial Banks	141.3	120.8	129.3	344.9	582.0	550.1	540.1	583.8	629.8	766.2
Net Domestic Assets	2,004.9	2,133.6	2,157.2	2,186.4	1,944.5	1,973.9	1,976.0	2,086.8	2,231.4	2,386.2
Credit to Public Sector	(98.2)	(3.8)	160.9	347.7	350.3	332.1	322.6	480.8	294.2	367.4
Central Government (net)	229.2	390.7	553.2	654.4	641.8	680.4	657.7	722.7	659.7	707.2
Rest of Public Sector	(327.4)	(394.4)	(392.3)	(306.7)	(291.6)	(348.3)	(335.1)	(241.9)	(365.5)	(339.7)
Credit to Rest of Financial System	148.1	250.4	238.4	167.1	143.6	144.3	145.5	155.6	161.2	160.9
Liabilities to Other Financial Institutions	349.9	359.2	374.0	403.8	378.5	372.6	362.6	390.1	403.3	416.1
Credit to the Non-Financial Private Sector	2,506.9	2,513.5	2,442.0	2,599.2	2,592.6	2,590.7	2,564.4	2,622.6	2,702.0	2,766.3
Liabilities to the Non-Financial Private Sector	3,628.3	3,739.7	3,727.8	3,897.7	3,884.8	3,903.1	4,029.1	4,173.9	4,400.5	4,630.6
Currency in Circulation	318.1	321.1	321.1	337.5	329.3	341.1	339.0	329.0	342.3	345.9
Demand Deposits	895.9	926.7	905.5	1,096.6	1,053.6	1,009.6	1,121.4	1,200.3	1,273.1	1,432.1
Time Deposits	399.1	417.3	384.0	345.9	347.7	341.1	333.4	313.2	374.6	362.7
Savings Deposits	2,015.4	2,074.6	2,117.2	2,117.7	2,154.2	2,211.0	2,235.3	2,331.5	2,410.5	2,490.0
MEMO										
Domestic Deposits	4,183.2	4,417.7	4,360.6	4,524.7	4,430.0	4,505.1	4,751.7	4,917.1	5,278.1	5,457.7
Liquid Assets	1,459.9	1,471.4	1,436.5	1,365.5	1,356.9	1,382.2	1,518.7	1,504.9	1,533.0	1,480.4
Loans & Advances	2,771.5	2,876.2	2,792.8	2,910.3	2,811.0	2,801.0	2,793.2	2,867.0	2,950.0	2,974.3

Source: Central Bank of Barbados

R: Revised

P: Provisional

contraction of 0.3% in the previous year. The upturn in lending was primarily due to a commercial bank increasing its holding of a corporate bond, which was issued to acquire a controlling interest in another commercial business enterprise. In addition, lending to the personal sector grew by 3.7%, while the borrowings by the transportation and construction industries rose by 21.5% and 14.1%, respectively. Loans to statutory bodies also increased by 30.1%, due to the borrowings of the Barbados National Terminal Co. Ltd. to assist with the construction of new terminal facilities.

Liquidity and Interest Rates

At the end of June 2004, the excess liquidity ratio was 20.9%, which was just below the 21.8% rate at the end of December 2003. The three-month treasury bill rate fell from 0.64% to 0.35% at the end of June 2004, owing to the continued excess demand for these securities. Between December 2003 and June 2004, the weighted average rate on total loans declined by 18 basis points to 9.98% and the weighted average deposit rate fell to 2.53% from 2.55%.

Commercial Banks' Excess Cash (BD\$'000) (End of Month)

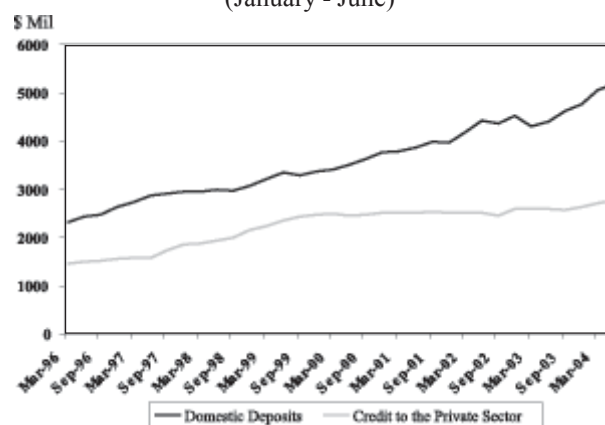
Period	2001	2002	2003	2004
January	114,664	152,370	322,771	512,099
February	139,937	220,974	367,840	498,999
March	77,458	208,026	325,459	382,460
April	128,134	294,952	428,860	409,251
May	134,072	382,413	443,985	466,436
June	124,185	368,351	368,147	387,385
Average	119,742	271,181	376,177	442,772

Source: Central Bank of Barbados

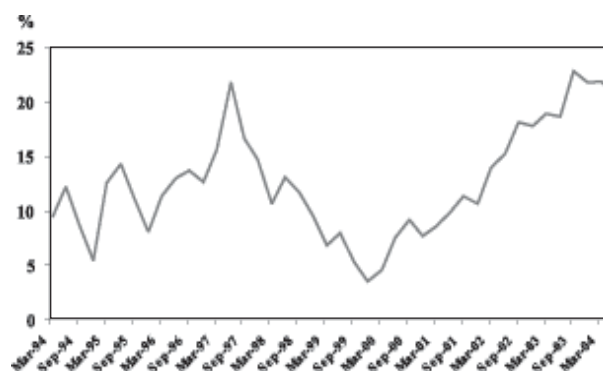
Government Securities

The total amount of treasury bills outstanding at the end of June 2004 was \$580.1 million, unchanged from end June 2003, as the issues of treasury bills that matured during the period were rolled over. Furthermore, no government savings bonds were issued during the first half of the year and the nominal value of these bonds remained at \$107.3 million.

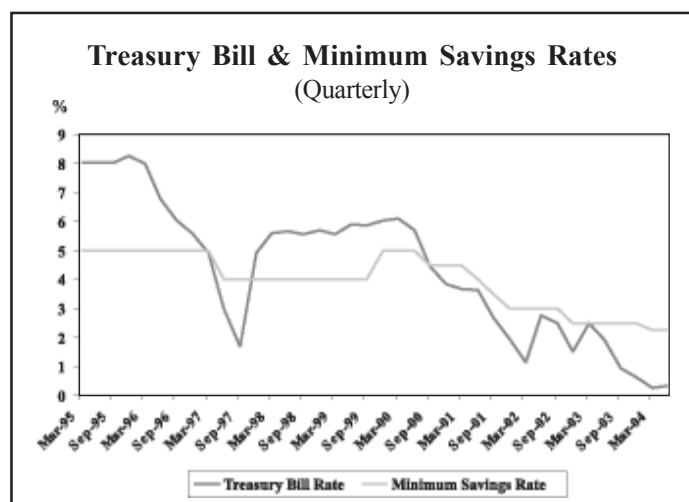
Comercial Banks' Domestic Deposits & Credit to the Private Sector (January - June)



Excess Liquidity Ratio (January - June)



Total holdings of debentures and treasury notes amounted to \$2,067.6 million, the nominal value of the sinking funds for total Government debt rose by \$44.5 million to reach \$403.2 million at the end of June 2004.



Public Sector

Revenue

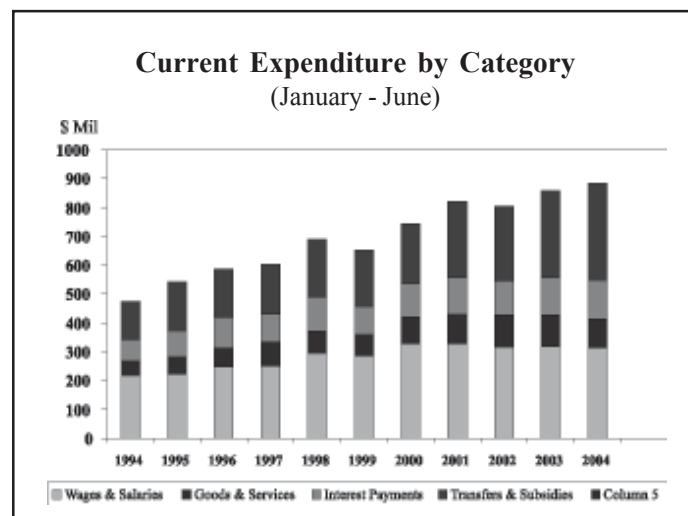
Total revenue grew by approximately 5.2% to \$1,039.2 million, as the higher indirect tax intake outweighed the fall-off in direct tax receipts. Total indirect taxes rose by 17.6% to \$596.6 million, fuelled primarily by greater revenues from VAT, excise taxes and import duties. Excise taxes and import duties expanded by 50.7% and 30.7%, respectively, mainly due to the higher level of motorcar imports. Additionally, VAT receipts were up by 11.3%, owing to the increase in economic activity and vigorous import growth. In contrast, direct tax receipts fell by 3.0%, on account of a reduction in personal and corporate tax revenues. Corporate taxes contracted by 4.2%, as a result of the scheduled reduction in the corporate tax rate from 37.5% to 36%, while the decline of 6.7% in the personal taxes can be linked to the rise in the tax allowance threshold, as well as the reduction of the lower personal tax base by 2.5 percentage points to 20%.

Property taxes rose by 19.3%, following a fall-off of 8.5% in the same period of 2003. Non-tax revenue and grants shrank by \$25.1 million to \$41 million, compared to a decrease of around \$15 million last year.

Expenditure

Total government expenditure contracted by 3.1% (\$31.9 million) between January and June 2004. Transfers and subsidies rose by a further 12.1% (\$36.3 million), after an increase of 15.8% a year ago (due to high transfers to the Barbados Community College and the Barbados Tourism Authority). Following a rise of 1.3% in expenditure on wages and salaries in the previous year, a 2.6% decrease was registered for the period January to June 2004, and outlays on goods and services contracted by 4.7%. Interest payments remained virtually unchanged, as the marginal increase in foreign interest outlays were offset by a small reduction in domestic interest payments.

Over the six-month review period, on-budget capital expenditure decreased by 34%, after a decrease of 32.9% in the corresponding period one year earlier, reflecting the winding down or completion of several major public sector projects, such as the Hilton Hotel.



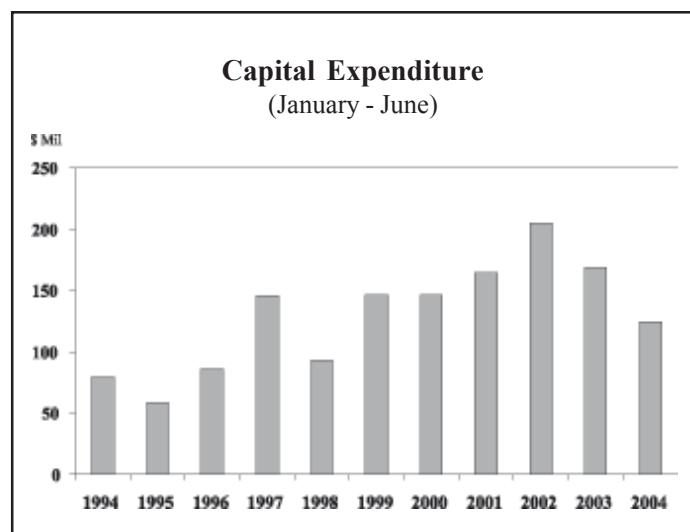
Government Operations
(January - June)
(\$ Million)

	2000	2001	2002	2003 ^R	2004 ^P
Total Current Revenue	903.3	936.2	914.8	987.1	1039.2
Tax Revenue	851.9	872.8	833.7	921.7	998.2
<i>Direct Taxes</i>	365.0	409.4	365.5	414.3	401.7
a) Personal	174.2	182.2	186.0	202.2	188.5
b) Corporate	136.1	157.1	122.9	161.7	154.9
c) Levies	6.1	10.9	8.7	4.7	6.3
e) Property	32.5	37.9	29.4	26.9	32.0
f) Other	16.1	21.3	18.5	18.8	19.9
<i>Indirect Taxes</i>	486.9	463.4	468.2	507.4	596.6
a) Consumption	0.5	0.0	0.0	0.0	0.0
b) Stamp	7.1	7.5	5.6	6.6	8.3
c) VAT	260.3	257.5	263.0	283	314.8
d) Excises	86.9	82.7	59.4	69.1	104.1
e) Import Duties	69.4	57.4	79.3	77.3	101.0
f) Hotel & Restaurant	0.4	0.3	1.0	0.4	0.0
g) Other	62.3	57.9	59.9	71.5	68.4
Non Tax Revenue & Grants	51.4	63.4	81.1	66.1	41.0
Current Expenditure	743.1	819.4	803.9	857.9	881.3
Wages & Salaries	327.8	329.1	314.3	318.6	310.3
Goods & Services	92.8	99.7	113.9	109.6	104.5
Interest Payments	115.0	128.5	116.0	130.0	130.6
External	36.0	53.1	56.4	49.8	50.4
Domestic	79.0	75.4	60.5	80.1	80.1
Transfers & Subsidies	207.5	262.0	258.9	299.7	336.0
Current A/C Balance	160.2	116.8	110.9	129.2	157.9
Capital Expenditure	146.2	164.2	201.7	168.8	111.6
Net Lending	2.9	10.9	2.0	0.1	2.2
Total Expenditure & Net Lending	892.2	994.4	1,003.6	1,027.1	995.1
Overall Balance	11.1	(58.2)	(88.8)	(40.0)	44.1

Source: Central Bank of Barbados and Accountant General

R: Revised

P: Provisional



Financing

With government operations resulting in an estimated fiscal surplus, there was an increase in the net domestic financing of \$71.6 million. At the end of the period, Government was a net depositor of \$72.9 million at the Central Bank, while lending to Government by Commercial Banks stood at \$79.4 million. While financing by the National Insurance Scheme and private non-banks, amounted to \$20

Government Financing

(\$ Million)

	January-June				
	2000	2001	2002	2003 ^R	2004 ^P
Domestic Financing	(213.6)	49.2	105.0	40.1	71.6
Central Bank	(352.5)	(46.2)	105.8	38.3	(72.9)
Commercial Banks	40.3	23.1	61.0	(9.3)	79.4
National Insurance Scheme	71.6	22.4	33.6	39.9	20.0
Private Non-Bank	41.6	33.1	(22.0)	44.5	48.7
Divestment	0.0	52.2	0.0	0.0	0.0
Other Public Sector	(3.4)	(14.5)	0.0	0.0	0.0
Other	(11.0)	21.0	(73.4)	(73.3)	(3.6)
Foreign Financing (net)	201.4	8.3	16.2	0.1	(27.5)
Capital Markets	200.0	0.0	0.0	0.0	0.0
Project Funds	21.9	29.7	21.0	37.2	16.0
Policy Loans	0.0	0.0	0.0	0.0	0.0
Amortisation	(20.7)	(21.4)	(37.3)	(37.3)	(43.5)
Divestment	0.0	0.0	0.0	0.0	0.0
Total Financing	(12.0)	57.5	88.8	40.0	(44.1)

Source: Central Bank of Barbados and Accountant General

R: Revised

P: Provisional

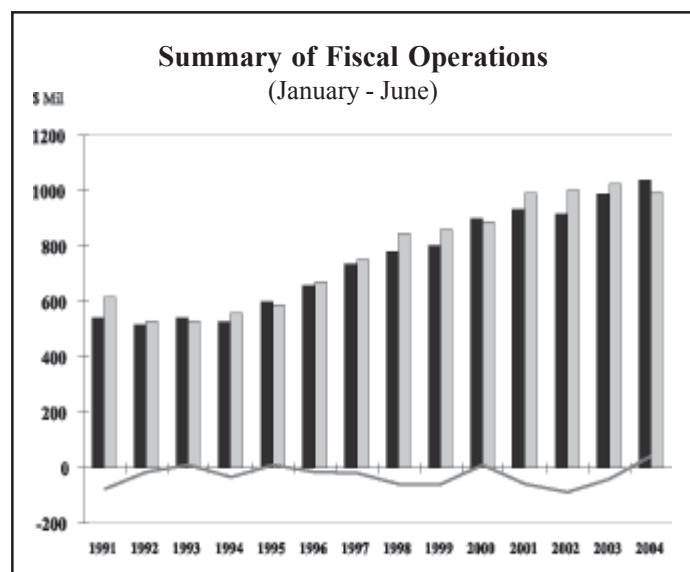
million and \$48.7 million, respectively. Net foreign financing stood at (\$27.5) million, as project fund inflows of \$16.0 million were overshadowed by \$43.5 million in amortisation payments.

Foreign Trade and Payments

Current Account

During the first six months of 2004, the current account of the balance of payments registered an estimated deficit of \$87 million, approximately \$79 million greater than the deficit for the corresponding period of 2003. The deficit was due primarily to the sizeable expansion in retained imports, which outweighed increased earnings from tourism and falling domestic exports.

Retained imports surged by 19.1%, on account of robust growth in both consumer and capital goods. For the period under review, imports of consumer goods rose by 19.9%, following growth of 6.4% in the comparable period last year,



Balance of Payments

(January-June)

(\$ Million)

	2000	2001	2002	2003 ^R	2004 ^P
Current Account Balance	43.5	43.5	6.4	(7.8)	(50.4)
Merchandise Trade	(659.2)	(664.2)	(631.0)	(749.1)	(931.0)
Total Exports (BOP basis)	243.4	244.7	206.7	(232.5)	233.0
<i>Domestic Exports</i>	217.3	200.9	180.1	184.7	182.0
Sugar	52.2	44.0	37.7	41.0	38.9
Elec. Comp	18.9	19.8	13.7	12.4	14.7
Chemicals	26.2	21.5	20.9	20.5	20.1
Food/Beverages	43.3	44.5	44.8	41.2	40.3
All Other	76.7	71.1	63.0	69.7	67.9
Total Imports (BOP basis)	968.5	969.6	889.5	1036.9	1225.6
<i>Retained Imports</i>	1012.2	997.3	930.7	1075.1	1280.7
Consumer Goods	408.2	403.2	392.4	412.8	495.2
Capital Goods	238.4	217.8	198.5	240.4	314.1
Intermediate Goods	362.0	372.8	336.5	418.5	465.8
Miscellaneous Goods	3.6	3.5	3.4	3.4	5.5
Services (Net)	710.8	712.5	662.5	775.3	873.9
Travel Credits	835.8	847.9	772.1	889.5	997.7
Other	90.3	82.6	88.8	103.2	108.5
Investment Income (net)	(81.4)	(95.8)	(99.7)	(114.7)	(111.6)
Transfers (net)	73.3	91.0	71.5	80.7	81.7
Capital and Financial Account	445.5	95.1	134.3	144.8	167.1
Long term	376.5	116.9	52.1	56.8	107.2
Public Sector	217.8	(2.3)	(29.2)	(19.8)	8.1
Private Sector	158.7	119.2	81.2	76.7	99.1
Other	42.6	(22.7)	3.2	1.9	26.7
Short-term	26.5	0.8	79.0	89.9	33.3
Errors & Omissions	(33.3)	5.8	(68.4)	81.2	40.6
Balance for Official Financing	455.7	144.3	72.0	218.2	157.3
Official financing (net)	0.0	0.0	0.0	0.0	0.0
IMF	0.0	0.0	0.0	0.0	0.0
Other Fin. Inst.	0.0	0.0	0.0	0.0	0.0
Adjusted by					
Foreign Assets of Commercial Banks	30.2	2.2	0.8	205.2	182.4
IMF Resources	0.0	0.0	0.0	0.0	0.0
Numerical Discrepancy	0.0	0.0	0.0	0.0	0.0
Reserve movements (CBB basis)					
(-Increase/+Decrease)	-455.7	-144.3	-72.3	-218.2	-157.3
Change in NIR (IMF basis)					
(-Increase/+Decrease)	-425.5	-146.5	-71.2	-13.0	25.1

Source: Central Bank of Barbados

R: Revised

P: Provisional

owing mainly to higher ‘food and beverages’ and motorcar imports. As a result of an expansion in the importation of cellular phones and substantial equipment imports by a local utility company, capital goods imports grew by 30.7%. Additionally, the estimated rise in oil prices over the first six months of the year, coupled with the sustained expansion in construction imports, led to growth of 11.3% in purchases of intermediate goods.

Domestic exports decreased by about 1.5%, in comparison to the rise of about 2.6% in 2003. The outcome stemmed primarily from a decline in the exports of sugar and other manufacturing and a slight rise in electronic components (\$2.3 million), following a decline in the first half of 2003, which offset losses in exports of food and beverages (2.0%) and chemicals (1.8%). Given the upswing in tourism activity, travel credits grew by 12.1%, following a 13.9% upturn in the corresponding period a year ago.

Capital and Financial Account

The external capital and financial account recorded its sixth consecutive first half surplus (\$167.1 million) in 2004, the largest since 2000 (\$445.5 million), and approximately \$22.9 million more than the surplus from January to June last year (\$144.8 million). For the period under review net long-term public capital inflows totalled \$8.1 million, in contrast to net outflows of \$19.9 million for the first half of 2003, when the Government of Barbados repaid a loan on behalf of Hotels and Resort Ltd. Moreover, net private sector inflows increased to an estimated \$99.1 million at the end of June 2004 or about \$22.5 million more than the net inflows recorded in the corresponding period of 2003. The inflows were primarily to tourism, real estate and the utility companies. Miscellaneous outflows were estimated at \$49.2 million, with a significant portion constituting pre-shipment financing for the sugar industry.

Regional Economic Developments

Overview

Benefiting from a resumption in international travel, real economic activity in the region was generally higher than in the first quarter of 2003. In the Bahamas and Jamaica, two of the major tourism-based economies, long-stay arrivals were up by 13.2% and 6%, respectively. Higher crude prices contributed to growth in Trinidad and Tobago, but led to an overall increase in inflation in Jamaica and the deterioration in the external current accounts of most regional economies.

The Bahamas

The performance of the Bahamian tourism industry in the first three months of 2004 was further strengthened by the recovery in US household income. Total visitor arrivals rose by 13.2% or 1.4 million persons, in comparison to the 1.1% increase during the same period last year. This outcome was occasioned by a 15.6% surge in the number of cruise ship passengers, reflecting the introduction of new cruise lines calling at Bahamian ports. Air arrivals also experienced an upswing (7.9%), building on the marginal increase of 0.3% during the similar period one year ago.

The Bahamas’ central government fiscal deficit improved from B\$46.0 million to B\$26.7 million. This development occurred on account of a 14.6% expansion in capital revenue, which was boosted by the sale of Government’s equity holdings and property income-related non-tax receipts.

Due to a double-digit expansion in imports, the external current account deficit for the first quarter of 2004 widened to B\$21.0 million from a deficit of B\$6.9 million in the corresponding period one year prior. With higher domestic demand leading to a 17.3% increase in imports, the trade

deficit rose by nearly one-fourth and outweighed the 18.9% improvement in net service receipts that resulted from accelerated net tourism inflows. On the other hand, a small surplus of B\$2.4 million was recorded on the capital and financial account, following a deficit of B\$45.5 million in 2003, owing to a reduction in short-term outflows through the banking sector.

Total resident deposits held in commercial banks at the end of March 2004 grew by 3.7%, in comparison to an increase of 1.9% in the January to March period of 2003. Higher deposits were registered for both private individuals and business firms. On account of an upturn in private sector lending, total commercial bank loans rose by 3%, following marginal growth one year earlier. At the end of March 2004, the weighted average rate on loans and overdrafts declined to 11.8%, while the weighted average interest rate on deposits rose to 3.9%.

Guyana

Due to unusually high levels of rainfall, agricultural output in Guyana contracted during the first quarter of 2004. Sugar production fell by 3.4% to 89,487 tonnes, after a rise of 9.4% in 2002. Similarly, rice production plummeted by 51.0% or 57,566 tonnes, following a significant increase of 64,304 tonnes in the same period of 2003. Bauxite production also declined (11.8%) during the review period to reach 241,444 tonnes at the end of February 2004. Conversely, gold output was considerably higher than in January to March of 2003, principally because of an increase in refining by the Gold Board. As a result of lower prices for clothing and miscellaneous items, the 12-month moving average rate of inflation moved from 6% at the end of March 2003 to 5.7% at the end of March 2004.

During 2003, a weakened fiscal position was reported by Guyana's central government. The fiscal deficit was estimated at G\$1,061.1 million more than in the comparable

period of 2002, and was financed principally by the domestic banking system. Current revenue rose by G\$792.5 million, on account of increases of 4.2% and 2.6% in tax and non-tax revenue, respectively, while current and capital expenditure expanded by G\$1,853.4 million and G\$1,174.7 million, respectively.

The external current account deficit for 2003 improved by 20.7% to US\$84.1 million, as a relatively faster growth in exports outpaced the expansion in imports. The surplus on the capital and financial account of the balance of payments declined by 36.2% to US\$54.9 million during the period under review. At the end of December 2003, net international reserves fell by US\$7.2 million to US\$176.2 million.

The minimum savings rate on deposits at the end of March 2004 was 3.5%, approximately 0.75 of a percentage point below the rate in the previous year. Similarly, the commercial bank's lending rate fell from 15.6% at the end of December 2003 to 15.1% at the end of March 2004. Total resident deposits were up by 4.0% at the end of the period under review, owing to higher deposits by private non-bank financial institutions, business enterprises and individuals. Conversely, fall-offs in lending to business enterprises, individuals and private non-bank financial institutions resulted in a 4.4% contraction in overall bank lending.

Jamaica

Most of the leading indicators of economic performance suggested that there was an expansion in economic activity during the first quarter of 2004, the seventh consecutive quarterly expansion. Economic growth emanated from both the goods producing and services industries. Due to higher capacity utilisation, value-added in the mining industry is estimated to have improved by 10.7%, compared to growth of 4.1% and 5.6% respectively in the same period of 2003 and 2002. The tourism industry recorded growth in excess

of 6.0% during the period under review. Cruise ship and stopover passenger arrivals increased by an estimated 7.5% and 1.5%, respectively, on account of an expansion in the number of ships calling at Jamaican ports and more stopover passenger arrivals from European and Canadian markets. As a result of high international commodities and domestic utilities prices, the twelve-month average rate of inflation at the end of March 2004 was 12.9%, almost double the figure in the corresponding period of 2003.

Provisional data suggest that between January and March 2004, central government operations resulted in a surplus of J\$5,611.3 million (1.2% of GDP), approximately J\$2,079.3 million above the targeted figure. The improved fiscal outturn stemmed from strong revenue flows during the first quarter. Total revenue surpassed the budgeted amount by J\$6,133.7 million during the three-month period, on account of flows from tax and capital revenues.

Between January and November 2003, Jamaica's external current account deficit worsened by 8% to US\$9,368 million, as higher imports were partially offset by an expansion of travel inflows and a decrease in transportation outflows. The surplus on the capital and financial account contracted by US\$357.7 million to US\$443 million.

At the end of March 2004, the average rate on savings deposits was 8.3%, or 0.1 of a percentage point lower than the rate at the end of December 2003. The average lending rate declined from the end of December 2003 by 0.2 of a percentage point to 25.4% at the end of March 2004. Total loans increased by an estimated J\$3 billion, as a result of significant lending to government services, tourism, manufacturing, construction and land development, transportation, storage and communication as well as individuals. The 9% expansion in total deposits may be

attributed to greater deposits by business firms, individuals and other financial institutions.

Organisation of Eastern Caribbean States

Economic activity in the Eastern Caribbean Currency Union during the first quarter of 2004 continued to improve. The major contributors to the overall growth were the tourism and construction industries. The construction industry increased due to on-going public and private sector projects, as well as those implemented during the period under review. Total visitor arrivals to the currency union rose by 9.1% to 982,634 with expansions recorded for both stay-over and cruise ship passengers. The recovery in the economies of the union's source markets, the Caribbean tour by the English cricket team, the continued refurbishment and enhancement of the hotel plant, along with a surge in cruise ship traffic were the main contributors to the growth in visitor arrivals. The increase in activity in these two industries promoted positive effects in most of the other areas of economic activity, especially the wholesale and retail trade and transportation industries.

During the first three months of 2004, the combined current account fiscal deficit fell from EC\$54.3 million to EC\$17.6 million, principally due to higher growth in tax receipts. As a result of ongoing improvements in tax administration, new fiscal measures and expansions in the economies of the currency union, current revenue rose by 13.1% over the review period. Current expenditure, on the other hand, grew by 5.3% on account of the impact of measures implemented in Dominica under the IMF supported Stand-By Arrangement and Poverty Reduction and Growth Facility (PRGF) and a 3.4% dip in transfers and subsidies.

A sharp increase in imports resulted in a 3.6% deterioration of the external current account to US\$592.2

million at the end of December 2003. Imports were up because of higher imports of construction-related materials and telecommunications equipment, while a fall in domestic exports reflected declines in receipts from electronic components and sugar exports. Similarly, the capital and financial account worsened by 6.8%, as decreases in portfolio investments and lower central government capital transfers outweighed higher direct investments.

Loans and advances grew by 0.5% during the first quarter of 2004, as increases in lending to the personal sector, professional services and tourism were partially offset by declines in credit to manufacturing, government services and agriculture. Total resident deposits at commercial banks rose by 4.1% to EC\$10,969.8 million, as higher deposits were registered for most categories. The minimum savings deposit rate and all the major interest rates remained unchanged.

Trinidad and Tobago

Between January and March 2004, economic activity in Trinidad and Tobago grew by to an estimated 0.7%, compared to 1.5% in the corresponding period one year earlier. As a result of disruptions in the labour market and unplanned maintenance at one company, output in the energy industry declined by 2.1%, while the non-energy industry expanded by 1.6%. Between January and March of 2004, total stopover arrivals in Trinidad and Tobago were 115,284 with approximately 48% of these originating from the US, 31% from Europe, 14% from Canada and the remainder from a diverse group of other countries.

The rate of inflation for the twelve months ending March 2004 slowed to 3.0%, in comparison to 4.2% for the same period of 2003. In the first three months of 2004, the unemployment rate was measured at 10.2%, down from

11% in the comparable period one year prior. The lower rate of unemployment resulted from the faster contraction in the labour force, which outweighed the decrease in the number of persons employed.

Trinidad and Tobago's central government recorded an improved fiscal surplus of TT\$1,835.0 million during 2003, as growth in current revenue outperformed the expansion in current expenditure. The elevation in current revenue was mainly the result of greater receipts from the oil sector and higher income taxes, while an expansion in wages and salaries, as well as transfers and subsidies explained the increased current expenditure. With the improvement in government's fiscal position, there were reductions in both net domestic and foreign financing during the review period. Trinidad and Tobago registered a current account surplus of around US\$917.4 million, on the balance of payments as energy exports surged, due to higher petroleum prices. The capital and financial account balance, however, deteriorated as a result of increases in commercial bank outflows, other private outflows and a reduction in direct investment.

At the end of February 2004, deposits held at commercial banks and total loans expanded by 10.3% and 2.8%, respectively. Additionally, the ordinary savings rate on deposits rose by 0.9 of a percentage point to 2%, and the prime-lending rate remained at 9.5%, where it has been since October 2003.

International Economic Developments

Overview

Buoyed by the strong expansion in the US and China, the global economy rose during the first six months of 2004. Increased activity in the US benefited from higher levels of private investment and exports, due to the weak US dollar,

while China registered more value-added at industrial enterprises.

However, inflationary pressures stemming from higher oil prices, threatened to stifle global growth prospects. As a consequence, most central banks tightened their monetary policy stance during the period.

Industrial Economies

Economic output in the US remained strong in the first half of 2004. Real GDP grew by 4.9% due predominantly to expansions in gross private domestic investment and exports of goods and services. As a result, the rate of unemployment at end June 2004 was 5.6% or 0.8 of a percentage point lower than the rate at the end of the corresponding period of 2003. The rate of inflation was 3.2%, compared to 2.2% one year earlier, due mainly to high energy prices. Consequently, the Federal Open Market Committee raised the Federal Funds Rate by 25 basis points, after maintaining it at a record low of 1.0% for the last eleven months.

After recording relatively slow growth in economic activity for the first quarter of 2004, the Canadian economy strengthened in the second quarter and recorded an overall increase of 3.3% during the first six months of 2004. This outturn was primarily fuelled by robust foreign and domestic demand for Canadian products. High crude oil prices, coupled with the stringent conditions in the North American gasoline markets, resulted in a 2.5% rise in the 12-month rate of increase in the total consumer price index. The Canadian unemployment rate at the end of the review period was 6.8% or 0.4 of a percentage point below that of last year's. After appreciating for ten years and reaching its peak of CAD \$1.30 against the US dollar in January 2004, the Canadian dollar fell to a low of CAD \$1.40 during the

first half and by the end of June was trading at CAD \$1.36 to one US dollar.

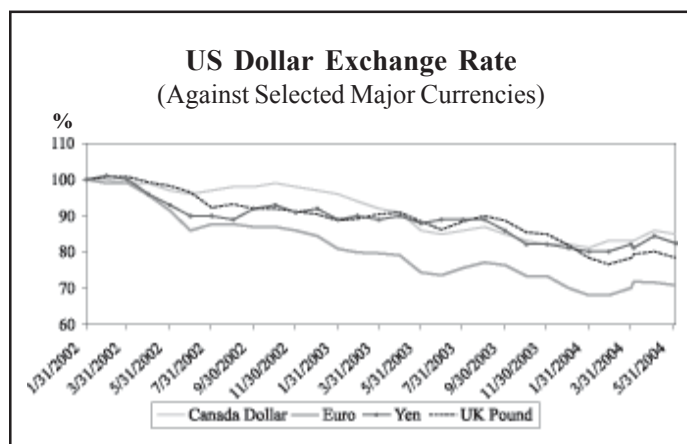
Primarily due to strong growth in the industrial and services industries, real economic activity within the Euro-area grew in the first quarter. The rate of inflation in the Euro-area increased to 2.5% in May 2004, mainly as a result of the overall rise in oil prices. However, the unemployment rate remained at 9.0%, and has been at this level since January 2003. Unlike most major central banks, the European Central Bank retained its accommodative monetary policy stance, leaving the main policy interest rate unchanged at 4.75%.

Economic activity in Germany rose by 3.2% in the first half of 2004, principally on account of an overall increase in net exports. The unemployment rate remained unchanged from 10.2% during the January to June period of 2003, while the rate of inflation for the twelve-months ending June 2004 was 1.7%, compared to 1.0% at the end of the corresponding period of 2003. Benefiting from increased consumer spending, real economic output in France strengthened by 1.5%. The unemployment rate at the end of April remained stable at 9.8%, as consumer prices rose to 2.7%, on account of higher costs for food and beverages.

Real economic activity in the UK expanded by 3.2% during January to June of 2004, compared to marginal growth of 1.9% in the same period one year prior. The rate of inflation at the end of June was 3.0%, up by 0.1 of a percentage point from the corresponding period one year earlier, fuelled by soaring house and energy prices. As a result, the Bank of England tightened monetary policy by increasing the "repo rate" from 3.75% at the end of December 2003 to 4.5% at the end of June 2004. The unemployment rate at the end of May of 2004 fell to 4.8% from 5% at the end of the comparable period one year ago. The pound sterling continued to gain strength, and at the end

of the first two quarters of the present year, £1.00 was equivalent to US \$1.83, in comparison to US \$1.66 in the corresponding period of 2003.

After more than a decade of economic stagnation, the world's second largest economy has been experiencing signs of sustained recovery for the first half of the year. Japan's positive economic outturn has been boosted mainly by an increase in final demand, exports and business fixed investment. Real exports increased by 3.3%, reflecting the expansion in other major economies, particularly the US and East Asia. Consequently, the employment situation has been steadily improving and the unemployment rate at the end of June 2004 was 4.6%. The rate of inflation rose by 0.4 of a percentage point in June to reach zero percent, owing to the hike in the price of petroleum products.



Note: The exchange rate data are monthly averages that are indexed to January 2002. Exchange rates are in foreign currency units per dollar.

Emerging Market Economies

On the back of a strong expansion in the value-added of industrial enterprises, China's economy grew by approximately 9.7% for the first half of the year, with the second quarter being the fourth consecutive quarter of growth. Consequently, trade flows continued to be relatively robust, with the total volume of imports and exports

increasing by 39.1%. China's foreign exchange reserves reached US\$470.6 billion, about US\$67.3 billion higher than at the beginning of 2004. At the end of June consumer prices increased by 5%.

After an economic downturn prompted by the outbreak of the Severe Acute Respiratory Syndrome (SARS) virus one year ago, economic growth was restored in Singapore. The intensification in economic activity was motivated by good performances in the manufacturing (18%) and services (11%) industries, both growing at the fastest rate since 1996. The hospitality, transportation and communication industries also benefitted from the resumption of international travel patterns after the SARS scare. The country's most vital industry - electronics - remained strong, due to elevated demand for semiconductors in the domestic and external markets. The only decline recorded for the first half of 2004 was in the construction industry (4.5%).

Brazil's economic recovery gathered momentum during the first six months of 2004, with exports being the principal driver of growth. The country's trade surplus surged to a record \$3.8 billion, as exports soared to \$9.3 billion, a 45% expansion over the same period last year, while imports increased to \$5.6 billion. The unemployment rate at the end of June 2004 was 11.7%, down 2.3 percentage points from June 2003. The inflation rate rose to 6.1%, exceeding the central bank's inflation target for the year by 0.6 of a percentage point, owing to increases in the prices of transportation and food.

Real gross domestic product in Argentina expanded by an estimated 9.9% during the first half of 2004, boosted mainly by higher spending on investment and consumption as well as an expansion in exports. Consequently, some improvement was registered in the labour market and the unemployment rate fell marginally at the end of June 2004. The rate of inflation declined by approximately 5.3 percentage points from last year to reach 4.9%.

Commodity Prices

As at the end of June 2004, the year-on-year change in commodity prices was estimated at 26.1%, about 11.4 percentage points above the level in 2003. The non-fuel commodities index was up by 21.6%, as copper prices soared to US\$2,689.1 per metric tonne, with this year's prices being the highest since 1997. Copper prices have risen this year because of high consumption in the US and falling inventories. The food index also registered a double-digit rate of growth, as banana prices almost doubled due to the weak US dollar and the accession of 10 new countries to the European Union. Fuel prices were up by 27.2%, owing to delays in restarting Iraq's oil production and low oil inventories.

Commodity Prices

Commodity Prices	Jun-03	Jun-04	% Change
All Commodities Index	115.8	146.1	26.1
Non-Fuel Commodities Index	79.4	96.5	21.6
Food	83.3	99.7	19.8
Sugar; EU (US cent/lb)	27.6	30.3	10.0
Bananas (US\$/metric tonne)	310.4	596.4	92.1
Rice (US\$/metric tonne)	203.6	244.2	19.9
Wheat (US\$/bushel)	131.35	154.7	17.8
Soybeans (US\$/metric tonne)	239.9	294.5	22.8
Metals	77.9	106.8	37.1
Aluminium	1,410.5	1,682.0	19.2
Iron Ore (US\$/metric tonne)	31.9	37.9	18.6
Copper (US\$/metric tonne)	1,685.1	2,689.1	59.6
Gold (US\$/fine troy ounce)*	356.4	383.3	7.6
Silver (US cents/troy ounce)*	455.6	588.1	29.1
Oil (US\$/barrel)	27.9	35.5	27.2

Source: IMF/World Bank Commodity Prices

P: Provisional

*: Up to May 2004



Regional and International Capital Markets

Caribbean Stock Markets

Barbados Stock Exchange (BSE)

Growth in activity on the BSE slowed during the second quarter of 2004, with moderate increases of 3.3% and 5.0% in the indices of the local and junior markets, respectively. Nevertheless, the local index reached its highest level on record, to close at 3,210.91 points at the end of June 2004. In spite of the cross-listed market index remaining unchanged for the second quarter, market capitalisation for cross-listed securities rose by 0.18%, to close at \$6,785.12 million.

Trading in eighteen of the twenty-four shares listed on the BSE during the quarter resulted in the local market capitalisation expanding by 10.89% to close at \$8,282.74 million on June 30, 2004. In the junior market, capitalisation rose by 3.89% to end at \$71.0 million, led by Sunbeach's rebound from its first quarter decline.

In April 8,729,764 shares crossed the floor, with Sagicor Financial Corporation and Almond Resorts Inc. being the volume leaders, with 5,004,827 and 2,275,234 shares traded respectively. This high volume for April accounted for approximately 67.0% of total shares traded for the second quarter.

In spite of an approximate 6.1 million decline in total shares traded for the month of May, Sagicor Financial Corporation remained the volume leader, followed by Cave Shepherd & Co. Ltd with 2,059,262 and 464,786 shares respectively.

The quarter ended with a further decrease in trading, as an aggregate volume of 1,635,921 shares changed ownership in June 2004. Sagicor Financial Corporation continued to dominate trading, while First Caribbean International Bank recorded the second highest volume of 145,239 shares traded.

There were three put-throughs on the BSE during the second quarter, two involving the shares of Sagicor Financial Corporation and one related to trading in shares of Light & Power Holding Limited.

BSE. Statistics

Index	Apr. 2004	May 2004	Jun. 2004
Local	3,088.2	3,126.1	3,210.9
Cross-Listed	1,950.4	1,950.4	1,950.4
Junior	1,461.7	1,460.7	1,395.2
MARKET CAP.			
Bds(\$M)			
Local	7,462.0	7,882.4	8,282.7
Cross-Listed	6,779.0	6,785.1	6,785.1
Junior	73.7	74.2	71.0

Source: Securities Exchange of Barbados

Barbados Mutual Funds

During the period under review, BNB Gift Trust Fund was the only mutual fund to record a decline in Net Asset Value (NAV). Similar to the first quarter, Roybar Investment Corporation and Fortress Caribbean Growth Fund were the top performers with NAV increases of 4.70% and 3.11%, respectively.

Mutual Fund	JUN 30 NAV (\$)	MAR 31 NAV (\$)
Roybar Investment Corp.	13.61	13.00
Fortress Caribbean Growth Fund	3.33	3.22
Mutual Global Balanced Fund	1.86	1.83
BNB Income Fund	1.23	1.22
BNB Capital Growth Fund	1.30	1.30
BNB Gift Trust Fund	0.99	0.98
CLICO Balanced Fund Inc.	1.20	1.17

Source: Securities Exchange of Barbados

Jamaica Stock Exchange (JSE)

Volume on the JSE index contracted by 4.93% to 94,718.41 points for the second quarter, with 21 companies advancing, 16 declining and 2 remaining unchanged. During the review period, the JSE peaked in April rising to 108,274.96 points, but fell in May, followed by a modest recovery in June. Capital & Credit Merchant Bank registered the best performance (+114.24%), while the worst performing company was Guardian Holdings Limited, which declined by 40.00%. In terms of sector performance, the banking & finance sector was the best throughout the quarter.

Trinidad & Tobago Stock Exchange (TTSE)

The TTSE recorded increases for the first two months of the second quarter, but decreased in June, to result in an overall 7.68% expansion for the quarter. Of the companies listed on the TTSE, 23 advanced, 7 declined and 2 remained unchanged. Capital & Credit Merchant Bank recorded the best performance (+150.00%), while the worst performer was Berger Paints Trinidad Ltd, which contracted by 47.90%,

in contrast to it being the leading company in the first quarter of the year. Across the board, the manufacturing sector and the banking sector were best performers for the period under review.

Emerging Markets

Emerging Bond Market Derails

De-leveraging in the emerging bond markets gathered momentum in the second quarter, as the prospect of higher interest rates and an unwinding of speculative positions increased. Partly as a result of this, emerging bond spreads widened by 61 basis points during the second quarter of 2004 and the Emerging Market Bond Index (EMBI) + index fell by 6.9%. In particular, the Brazilian debt component of the EMBI+ was the worst performer during the first-half of 2004. The sell-off in emerging market debt occurred despite generally improving macroeconomic fundamentals in most emerging economies.

After vigorous growth in the first three months of 2004, bond issuance activity in emerging markets waned somewhat

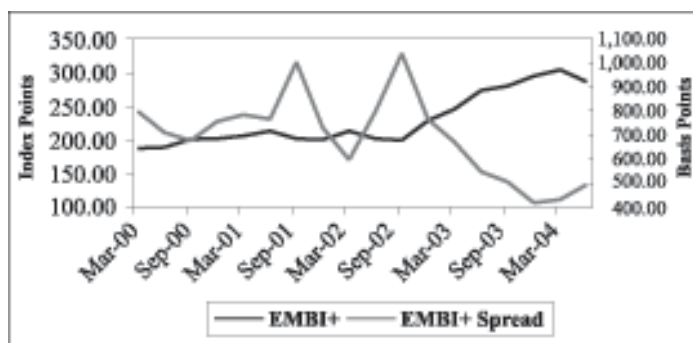
Top Ten Performing Companies* (Jan - Mar 2004)

Barbados	%	Jamaica	%	Trinidad and Tobago	%
Barbados Farms	38.9	Capital & Credit Merchant Bank	114.2	Capital & Credit Merchant Bank	150.0
McEneaney Alstons	9.2	First Caribbean Intl Bank Jamaica	96.1	National Commercial Bank Jamaica	38.0
Cave Shepherd	18.0	Pan Caribbean Financial Service	64.2	Grace, Kennedy & Co. Ltd.	26.6
First Caribbean Intl Bank	16.7	Hardware & Lumber	62.6	Caribbean Communication Network Ltd.	17.2
Goddard Enterprises Ltd.	15.4	Dyoll Group	59.3	JMMB Limited	16.3
Banks Holdings	11.9	Kingston Wharves	56.5	Prestige Holdings	15.7
Barbados Shipping & Trading	10.7	Salada Foods	53.9	ANSA McAl Limited	13.1
Barbados National Bank	5.8	Montego Freeport	32.4	Trinidad Cement Limited	10.6
Almond Resorts Inc.	3.2	Pegasus Hotel	22.2	Trinidad Publishing Co. Ltd.	9.1
West India Biscuit Co.	2.7	National Commercial Bank Jamaica	22.0	Ansa Finance & Merchant Bank Ltd.	8.3

* Based on share price appreciation

in the April to June period, reflecting increased risk averseness by investors, which limited funding options for emerging market issuers.

Emerging Market Bond Index and Spread
(Mar 2000 - Jun 2004)



Downturn in Emerging Equity Markets

Activity in emerging equity markets was also affected by the prospect of higher interest rates as both Latin American and emerging-Asian markets registered significant declines during the second quarter, a turn-around from the buoyant

performance in the first quarter of 2004. The three worst performers were Argentina's Merval index, China's Shanghai index and South Korea's Seoul index, which fell by 21.3%, 19.7% and 10.8%, respectively. In particular, the dismal performance of the Shanghai index was also adversely affected by the Chinese authorities' efforts to curtail credit growth in order to cool off an overheating economy. The Philippines PSE and Chile's IPSA indices bucked this trend, to record increases of 10.9% and 1.7%, respectively.

Broad Based Decline in Emerging-Currencies

During 2003 investors favoured emerging-market currencies because of the higher interest rates in the emerging economies than in the United States, and forecasts of a weaker US dollar. However, as expectations of US economic growth and the pace of increases in the Fed Fund rates changed during the first half of 2004, the dollar strengthened and emerging market currencies became less attractive. As a result, there was a broad-based decrease in these currencies during the second quarter of 2004, with the Indonesian Rupiah depreciating the most (9.8%), followed by the Brazilian Real (6.6%) and the Thai Baht (4.2%).

Emerging Equity Market Indices

Country/ Region	Index	Mar-04	Jun-04	% Ch
Argentina	Merval	1,201.7	945.5	(21.3)
Brazil	Bovespa	22,142.3	2,148.9	(4.5)
Chile	IPSA	1,458.9	183.0	1.7
Mexico	IPC	10,517.5	1,081.8	(2.2)
Venezuela	Caracas	26,579.7	2,585.2	(4.9)
Latin America				(6.3)
China	Shanghai	1,741.6	1,99.2	(19.7)
Hong Kong	Hang Seng	12,681.7	1,285.8	(3.1)
Indonesia	Jakarta	735.7	732.4	(0.4)
Malaysia	Kuala Lumpur	901.9	819.9	(9.1)
Philippines	PSE	1,424.3	1,579.4	10.9
Singapore	Straits Times	1,858.9	1,838.0	(1.1)
South Korea	Seoul	880.5	785.8	(10.8)
Thailand	SET	647.3	646.6	(0.1)
Taiwan	Weighted	6,522.2	5,839.4	(10.5)
Asia				(2.3)

Emerging Market Currencies

Country/ Region	Index	Mar-04	Jun-04	% Ch
Argentina	Peso	2.9	3.0	(3.5)
Brazil	Real	2.9	3.1	(6.6)
Chile	Peso	612.4	636.0	(3.9)
Mexico	Peso	11.1	11.5	(3.2)
Venezuela	Bolivar	1,917.6	1,917.6	0.0
Latin America				(3.4)
China	Yuan	8.3	8.3	0.0
Hong Kong	Dollar	7.8	7.8	(0.1)
Indonesia	Rupiah	8,564.0	9,400.0	(9.8)
Malaysia	Ringitt	3.8	3.8	0.0
Philippines	Peso	56.2	56.1	0.1
Singapore	Dollar	1.7	1.7	(2.6)
South Korea	Won	1,147.3	1,155.5	(0.7)
Thailand	Baht	39.3	40.9	(4.2)
Taiwan	Dollar	33.0	33.8	(2.3)
Asia				(1.9)



Trade Update

Cont'd from June 2004 Economic Review

The Singapore Issues

The WTO member-countries decided at the 1996 Singapore Ministerial conference to set up three new working groups: on competition policy, on trade and investment, and on transparency in government procurement. In addition, they instructed the WTO Goods Council to look at possible ways of simplifying trade procedures, an issue also known as trade facilitation. These four policy areas, dubbed “the Singapore issues”³, have become embroiled in a great deal of controversy, which has polarised the WTO membership along developed–developing lines. Developed countries feel that these issues are critical to creating an environment wherein international trade in goods and services can flourish. Developing countries see them as yet another burden to add to their already onerous international obligations.

1. Government Procurement

Government Procurement refers to the purchase of goods and services by government agencies for their own use. In the context of the WTO, government procurement has hitherto been effectively omitted from the scope of the multilateral trade rules, in the areas of both goods and services. However, there is a growing awareness that procurement of products and services by government agencies for their own purposes represents an important share of total government expenditure and thus has a significant role in the domestic economy. According to the WTO Secretariat, “discriminatory” government procurement procedures and practices can lead to “distortions in international trade” and, with government procurement estimated to represent between 10-15% of world GDP, many

of the major players in the global economy and the WTO are anxious to become providers of these goods and services within the multilateral trading system. As with the proposed competition policy and investment agreements, this initiative has encountered some resistance from developing countries.

Government Procurement and the WTO

Efforts to bring government procurement under internationally agreed trade rules began during the Tokyo Round of Trade Negotiations. Consequently, the first Agreement on Government Procurement was signed in 1979 and entered into force in 1981, but was later amended in 1987, then extended in scope and coverage with effect from 1 January 1996. The new Government Procurement Agreement (GPA) is a plurilateral Agreement, which means that not all members of the WTO are bound by it, only those that choose to be. It establishes an agreed framework of rights and obligations among its parties with respect to their national laws, regulations, procedures and practices in the area of government procurement.

The cornerstone of the Agreement is the principle of non-discrimination. In respect of the procurement covered by the Agreement, government parties to the Agreement are required to give the products, services and suppliers of any other Party to the Agreement treatment “no less favourable” than what they give to their domestic products, services and suppliers and not to discriminate among goods, services and suppliers of other Parties. Furthermore, each Party is required to ensure that its entities do not treat a locally established supplier more favourably than another locally established supplier on the basis of degree of foreign affiliation or ownership and do not discriminate against a locally established supplier on the basis of country of production of goods and services being supplied. In order to ensure that the basic principle of non-discrimination is followed and that access to procurement is available to foreign products, services and suppliers, the Agreement lays heavy emphasis on procedures for providing transparency

³ This update explores the final two of the Singapore issues – Government Procurement and Trade Facilitations.

of laws, regulations, procedures and practices regarding government procurement.

Apart from the GPA, work in the WTO on government procurement also includes work on transparency in government procurement and government procurement in services. The latter is handled by the working party on GATS rules, established by the Council for Trade in Services with responsibility for negotiations on government procurement of services. On the issue of transparency in government procurement, at the Doha 4th Ministerial, members agreed that negotiations would take place after the Fifth Session of the Ministerial Conference and would build on the progress made in the Working Group on Transparency in Government Procurement, taking into account participants' development priorities, especially those of least-developed country participants. The intention was to limit negotiations to the transparency aspects and therefore not restrict the scope for countries to give preferences to domestic supplies and suppliers. Furthermore, a commitment was made to ensuring adequate technical assistance and support for capacity building both during the negotiations and after their conclusion.

Government Procurement and Developing Countries

Often, governments seek to achieve certain domestic policy goals through their purchasing decisions, such as promotion of local industrial sectors or business groups. This is a common practice among developing countries, which explains why most of them are not signatories to this Agreement. Indeed, government procurement practices in many developing countries are inextricably linked to their development strategy generally. For the more advanced countries, government procurement is of less strategic importance and so, not surprisingly, they are the main signatories to this Agreement and the driving force behind the inclusion of government procurement on the WTO agenda.

Admittedly, there has been an attempt made by the group of industrialised countries (US, Canada and the EU) to

recognise the special circumstances of developing countries and so to encourage them to be part of the Agreement, which allows for special rules for developing countries. The Agreement recognises the development, financial and trade needs of developing countries, in particular least-developed countries, and allows special and differential treatment in order to meet their specific development objectives. According to this Agreement, the development objectives of developing countries should be taken into account in the negotiation of coverage of procurement by entities in developed and developing countries. However, this statement is somewhat loosely worded, which means that developed countries are not bound to offer such special treatment.

Prospects for a Multilateral Government Procurement Agreement

Members therefore remain divided on the need for a multilateral GPA. Most developed countries are eager, while developing countries remain cautious, preferring to keep the agreement plurilateral in nature. It is difficult to anticipate how this situation could be resolved.

2. Trade Facilitation

Trade facilitation is often defined as “the simplification and harmonisation of international trade procedures”, with trade procedures being the “activities, practices and formalities involved in collecting, presenting, communicating and processing data required for the movement of goods in international trade”. This definition relates to a wide range of activities such as import and export procedures (e.g. customs or licensing procedures), transport formalities, as well as payments, insurance, and other financial requirements.

Sometimes these procedures can represent significant barriers to trade. The WTO Secretariat estimates that the losses that business suffers through delays at borders, complicated and unnecessary documentation requirements

and lack of automation of government-mandated trade procedures in many cases exceed the costs of tariffs. This is reinforced by an APEC study, which estimated that clearing the red tape at country borders would generate approximately twice as much growth in GDP as tariff liberalisation would. Trade facilitation was therefore brought into the foreground of trade issues, as the international business community increasingly expressed concern for greater transparency, efficiency, and procedural uniformity of cross-border transportation of goods. Of all the “Singapore issues”, it enjoys the most broad-based support among WTO Members, at least in principle.

Trade Facilitation and the WTO

Work in the area has been carried out by organisations such as the United Nations Council for Trade and Development (UNCTAD), the United Nations Economic Commission for Europe (UNECE) and the World Customs Organisation (WCO) for several decades, but it has become a WTO issue now because the cost of moving goods remains high while other trade-related costs are falling. Indeed, steadily growing volumes of trade, the fall in tariff levels to an all-time low after the conclusion of the Uruguay Round and the availability of modern technology to significantly improve the management of cross-border trade and distribution of goods, have all combined to create a strong interest in trade facilitation. Consequently, the issue was added to the WTO agenda in December 1996, when the Singapore Ministerial Declaration directed the Council for Trade in Goods to undertake exploratory and analytical work, drawing on the work of other relevant organisations on the simplification of trade procedures, in order to assess the scope for WTO rules in this area.

Strictly speaking, however, trade facilitation has been on the WTO agenda before, though not explicitly. Specific elements connected with the simplification and harmonisation of trade procedures are already contained in the WTO legal framework, e.g., in Articles V, VII VIII and X of the GATT

1947. Similar provisions are found in the Agreements on Customs Valuation, Import Licensing, Pre-shipment Inspection, Rules of Origin, Technical Barriers to Trade, and the Agreement on the Application of Sanitary and Phytosanitary Measures. The Singapore Ministerial Conference simply gave the WTO the mandate to take a more comprehensive look at trade facilitation. It was agreed that careful attention would be given to minimising the burdens on delegations, especially those with more limited resources, and to coordinating meetings with those of relevant UNCTAD bodies. In addition, the technical cooperation programme of the WTO Secretariat was made available to developing and, in particular, least-developed country Members to facilitate their participation in this work.

In the Doha Development Round – so named because of the focus on developing countries’ concerns –member nations were scheduled to begin negotiating commitments on trade facilitation. However, the talks ended prematurely, in part due to a stalemate over whether to initiate negotiations on trade facilitation and the other three Singapore issues. Members did agree to further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area, and to negotiating after the Fifth Session of the Ministerial Conference. In the meantime, the Council for Trade in Goods was mandated to review as appropriate, clarify and improve relevant aspects of Articles V, VIII and X of the GATT 1994 and identify the trade facilitation needs and priorities of members, in particular developing and least-developed countries. The WTO also committed to ensuring adequate technical assistance and support for capacity building in this area. Going forward, some members have suggested a two-track approach to negotiations, in which nations will work toward implementing current standards and requirements while creating the next generation of facilitation measures applicable to e-commerce and global corporations.

Trade facilitation and Developing Countries

While there is across-the-board agreement on the necessity for trade facilitation, developing countries are not enthusiastic about negotiating a multilateral agreement of trade facilitation commitments. It has been argued that trade facilitation measures would benefit developing countries the most because in these countries the inefficiencies are sometimes more costly to industries than are tariff barriers. However, developing countries argue in turn that they do not have the resources necessary to update their customs procedures to more modern technological standards. They are also reluctant to take on additional legal obligations that may increase their exposure to disputes. If members insist on creating standards through the WTO, developing countries such as Brazil, Jamaica, and Zimbabwe ask that the agreement be a list of voluntary guidelines, or an agreement focused on capacity-building, rather than a legally-binding, rules-based agreement. Some developing countries, such as India, even suggest that trade facilitation remain a national, bilateral, or regional concern.

Taking into consideration the qualms of developing countries, the WTO is currently offering significant technical assistance and capacity building in conjunction with negotiations. A workshop on Technical Assistance and Capacity Building on Trade Facilitation held in May 2001 specifically discussed the needs of developing countries, the

existing programs of support, and the efficacy of capacity building methods.

Prospects for a WTO Trade Facilitation Agreement

This is likely to remain a contentious issue, as most developing countries, faced with serious resource constraints, are wary of adding to their burdens. Meanwhile the US and other developed countries are continuing to push hard to include trade facilitation on the agenda.

Until recently, there had been little or no progress made on any of the issues on the agenda, after talks broke down at the fifth Ministerial Meeting in Cancun, Mexico. Ultimately, however, it was recognised that, as a package deal, the Singapore Issues risked being sidelined in WTO negotiations or, worse yet, could result in the collapse of the entire Doha Round. Consequently, the latest discussions in the WTO have centred on unbundling the package to focus on delivering agreements on trade facilitation as part of the single undertaking in 2005. A compromise might therefore be in the offing, with developed countries showing a willingness to shelve negotiations on the other issues in the interim, while developing countries are signalling that they may back down from their original refusal to negotiate on any of the Singapore issues, provided that meaningful progress is made on their concerns in other areas.



Saving, Investment, Growth and the Impact of International Financial Liberalisation in the Caribbean

by Carlos Holder* and Kevin Greenidge**

Abstract

The Caribbean countries have over the last two decades implemented policies aimed at liberalising their financial systems especially the capital accounts and exchange controls, mostly as part of economic stabilisation and structural adjustment programmes. In recent times, there has been an acceleration of the process to accommodate the creation of the CARICOM Single Market and Economy (CSME). This paper attempts to ascertain the effect of the financial liberalisation process on saving, investment and, by extension, economic growth in the Caribbean for the period 1979-2001. The methodology involves including an international financial liberalisation indicator variable, previously developed by Belford and Greenidge (2001), in a standard growth regression. The impact of the liberalisation variable is evaluated within a panel framework. The results indicate that the process of international financial liberalisation has not contributed to economic growth in these economies and in some cases has had a negative effect. There have however been gains in terms of saving and investment but this has not been translated into faster GDP growth.

1. Introduction

International financial liberalisation (IFL) is often suggested as a means of increasing economic growth. By the opening up of the economy to the free flow of international capital, growth is ensured through higher levels of investment and saving and by a greater supply of credit for consumption. It is on such premises that international institutions like the International Monetary Fund (IMF) have over the last two decades advocated financial liberalisation as a dominant policy paradigm and have encouraged developing countries, including Caribbean countries, to embark on a process of opening up to the international

economy and the lifting of restrictions on domestic financial institutions.

The experiences of countries with IFL have been less encouraging and in most cases have led to financial fragility and crises (for example, Latin America and East Asia) and which, as a result, undermined their economic growth. Although the literature varies as to why financial liberalisation has 'failed' in these economies, there is general agreement that its impact depends significantly on the level of development and institutional characteristics of a country. In developing countries, the increases in capital inflows often lead to an appreciation of the domestic currency and adversely affect the trade balance. Furthermore, in countries where the financial systems are underdeveloped, IFL can make them crisis-prone.

This study examines the impact of IFL on investment, saving and growth in the Caribbean and, perhaps before proceeding further, it is best to define what is meant by IFL as opposed to financial liberalisation. Financial liberalisation is more than the lifting of capital controls. In essence financial liberalisation consists of three dimensions: first, to open up a country to the free flow of international finance; secondly, to remove controls and restrictions on the functioning of domestic banks and other financial institutions so that they can be integrated in the world's financial markets; and thirdly, to provide autonomy from the government to the central bank so that its supervisory and regulatory role vis-à-vis the banking sector is dissociated from the political process of the country. These measures are not necessarily contemplated in the order listed above, but they represent the ultimate goal of financial liberalisation. IFL relates to the first dimension and can perhaps be best viewed as a subset of financial liberalisation.

The remainder of this paper is organised as follows. The next section reviews the theoretical and empirical literature on the topic while section 3 examines some modelling and estimation issues. The results are presented in section 4 and section 5 contains some concluding remarks.

* Mr. Carlos Holder is a Deputy Governor of the Central Bank of Barbados.

**Mr. Kevin Greenidge is a Senior Economist in the Research Department of the Central Bank of Barbados.

2. Review of Literature

2.1 Theoretical Arguments

There is a considerable body of literature, which postulates that financial liberalisation leads to economic growth through its effect on savings and investment. This theory is based on the McKinnon-Shaw thesis and has been given much currency by the Washington consensus. In principle the McKinnon-Shaw thesis suggests that financial repression retards savings, lowers investment quality and hence growth. The Neo-structuralists critique of the McKinnon-Shaw thesis focuses on non-institutional finance and argued that low interest rates and higher credit towards priority sectors would increase investment and economic growth. This argument has been given great credence by Stiglitz and others.

The literature also suggests various channels through which increased IFL can enhance economic growth. For one, capital flows can lead to faster economic growth by augmenting the domestic investment rate. In open-economy versions of neoclassical growth models, capital flows from capital-rich to capital-poor countries where the marginal product of capital is higher. This results in an increase in the rate of capital accumulation and growth in the poor country. This channel stresses the role of net capital flows and relies very much on the assumption that these flows will augment domestically-financed investment, rather than crowd it out.

Benefits from IFL could also come from better utilisation of available domestic savings rather than from net inflows of foreign savings. These benefits are typically associated with foreign direct investment, but could also arise with other types of capital flows. For example, foreign investment could increase competition in the host economy, thereby making domestic firms more efficient. It could also lead to transfers of technology and/or skills.

Another channel through which IFL could have a positive influence on growth is through the benefits of portfolio diversification. The increased opportunity to diversify risk can boost growth by inducing a shift toward investment in

projects with higher expected returns. In turn, higher rates of return can deliver faster economic growth by encouraging higher savings and investment. This issue of risk diversification is discussed extensively in the literature on stock markets and their influence on growth (e.g. Levine, 1991; Bencivenga, Smith, and Starr, 1995). Well-functioning stock markets can also help to ease, risk associated with returns, as well as liquidity risk. Liquid equity markets make long-term investment more attractive because they allow savers to liquidate quickly and cheaply if they need access to their savings, while allowing companies to enjoy permanent access to capital raised through equity issues. Additionally, through its role of providing longer-term, more profitable investments, liquid markets improve the allocation of capital and thereby increase economic growth.

Another theoretical link is through the reduction of capital market imperfections. Hubbard (1998) and Gilchrist and Himmelberg (1998) posited that in economies where capital markets are imperfect and financial constraints exist, external finance will be more costly than internal finance, and investment will be sensitive to cash flows. In such cases, IFL can affect growth by reducing capital market imperfections, thereby lowering the external finance premium. Additionally, the improved efficiency that this brings to the stock market can have a positive influence on resource allocation and investment. Furthermore, as stock markets become more liquid, agents may have greater incentives to expend resources in researching firms (Boot and Tacher, 1997).

Well-functioning stock markets may also lead to growth by stimulating greater corporate control and by facilitating takeovers, as discussed by Stein (1988). In addition, it makes it easier to tie managerial compensation to stock price performance (Jensen and Murphy, 1990), hence enhancing managerial incentives and thereby boosting resource allocation.

The case for opening up to the free flow of international capital is predicated on the assumption that capital markets are efficient. However, in the presence of distortions such as information asymmetry, moral hazard and herding on the

part of foreign investors, capital flows can be destabilising. Furthermore, in countries with underdeveloped capital markets and banking systems that are more oligopolistic than competitive, such destabilising effects are more pronounced and may not only impede but can also reverse growth.

2.2 Empirical Evidence

Most of the empirical studies, which have attempted to ascertain the relationship between IFL and economic growth, have employed a standard growth regression modified by the inclusion of some measure of IFL. The following is a summary of some of the most influential empirical papers in this area.

Klein and Olivei (1999) estimated the effect of IFL on economic growth. They defined capital account openness as the number of years when the capital account of the particular country was free of any restrictions. They found that capital account liberalisation had a substantial impact on output growth and concluded that capital account liberalisation positively affects economic growth in highly industrialised economies. However, they argue that there is little evidence of capital account liberalisation promoting financial depth, and therefore economic growth in developing countries. As a result, they propose that policy reforms in developing countries should require capital account liberalisation to come at a late stage, when adequate institutions and sound macroeconomic policies are in place.

Edwards (2001), utilising a measure similar to IFL employed in our study, came to the conclusion that while IFL boosted economic growth, the effect is limited to the relatively developed countries in the sample. The interaction term between liberalisation and per capita GDP enters positively, indicating that the effect of a more open capital account increases with the country's initial level of development. Furthermore, the coefficient on the openness index is negative, suggesting that an open capital account may in fact have a negative effect at low levels of development.

At the micro level, using firm level data from 30

countries, Demircuc-Kunt and Maksimovic (1996) argued that firms with greater access to more financially developed stock markets grow at a faster rate than those without such access. They further noted that when banks relaxed interstate branching restrictions, real per capita growth rates are accelerated.

Bekaert, Campbell and Lundblad (2001) introduced an IFL indicator to the standard growth model by taking a simulated sample and by randomly dating the time at which each country removed its financial restrictions, generated the financial liberalisation indicator. They found that the liberalisation coefficient was positive and significant and concluded that financial liberalisation increases the growth rate of real per capita gross domestic product by 1.1 percent.

Perhaps the most widely cited study in the literature is that of Rodrik (1999). He concluded that there is no evidence in the data that countries without capital controls have grown faster, invested more, or experienced lower inflation. Capital controls are essentially uncorrelated with long-term economic performance once other determinants are controlled for. He utilised data for a sample of 100 developed and developing countries, and controlling for other determinants of growth, regressed growth in per capita GDP on capital account openness. Openness for each country is defined as the number of years during the sample period when the country's capital account was free from any restrictions (as measured by the binary indicator). He found no association between capital account liberalisation and growth. He further tested the hypothesis that capital account convertibility might have had beneficial effects in countries with strong institutions and uncovered no evidence for this in the data.

Rodrik's results supported those of Kraay (1998), who undertook a more comprehensive examination of the effect of capital account liberalisation on investment, growth and inflation. The link between capital account liberalisation and growth was found to be weak. Furthermore, there is weak evidence for the hypothesis that capital account liberalisation is successful in countries with a strong financial sector and a good policy environment.

The empirical results suggest that the link between IFL and economic growth may be at best weak and that it appears to depend on the country's level of development. The higher the initial level of development of the country, not only in terms of its institutions but also the size and sophistication of the capital markets, the higher is the probability that the country can benefit from further IFL. This brings the debate full circle as to what should be, if any, the prerequisites for successful IFL. In this regard, Fry (1997) proposes a number of prescriptions. Firstly, adequate prudential regulation and supervision of commercial banks, implying some minimal levels of accounting and legal infrastructure. Secondly, a reasonable degree of price stability. Thirdly, fiscal discipline taking the form of sustainable government borrowing requirements that avoid inflationary expansion of reserve money by the central bank either through direct domestic borrowing by the government or through the indirect effect of government borrowing that produces surges of capital inflows requiring large purchases of foreign exchange by the central bank to prevent exchange rate appreciation. Fourthly, profit – maximising, competitive behaviour by the commercial banks. Fifthly, a tax system that does not impose discriminatory explicit or implicit taxes on financial intermediation.

Even when these conditions are met, governments should not undertake all their liberalisation measures at the same time. They should strategically plan policies, which are likely to minimise the disruptive effects of financial liberalisation while allowing the economy to benefit from opportunities available in the global market.

3. Modelling and Estimation Issues

3.1 Measuring IFL

Previous financial liberalisation indicators were limited to a measure of economic openness, such as exports plus imports as a percentage of GDP or financial development in the form of broad money as a ratio to GDP. Such proxies are aimed at capturing a country's overall level of financial

liberalisation, and are perhaps more an indicator of financial development. This is an important point to stress since this study looks at IFL as opposed to full domestic financial liberalisation, which in essence consists of three processes. First, to open up a country to the free flow of international finance, secondly, to remove controls and restrictions on the functioning of domestic banks and other financial institutions so that they get properly integrated as participants in the world's financial markets; and thirdly, to provide autonomy's from the government to the Central Bank so that its supervisory and regulatory role vis-à-vis the banking sector is dissociated from the political process of the country, but such independence must be balanced with an appropriate level of accountability. Our investigation is with the first stage and its effects.

The indices of IFL for the CARICOM countries used in this study were first developed in Belford and Greenidge (2001) and are presented in Table 1. The authors utilised the detailed qualitative information in the IMF's Annual Report on Exchange Arrangement and Restrictions to generate an index for each country, which reflects changes in financial liberalisation policies, and captures both capital and current account restrictions and regulations. For more details on the construction and consistency of the indices with the economic experiences of the individual territories, see Belford and Greenidge (2001).

3.2 A Caribbean Growth Model

Following the approach of Bynoe-Lewis and Craigwell (1998), a typical Caribbean growth model includes the following explanatory variables; government consumption as a percent of GDP, foreign direct investment, gross domestic investment, gross international reserves and population growth rate.

Government consumption as a ratio of GDP is used as a proxy to measure the impact of government policy on economic growth. It is assumed that this variable includes expenditures that do not directly affect productivity, but entails distortion of private decision-making. It is expected that

distortionary government policies will have a negative effect on economic growth, since government policies such as distortionary taxes lead to a higher level of government consumption which in turn leads to a lower level of per capita output, thus a slower growth rate.

Foreign direct investment was observed to be the main form of capital inflows in many of these CARICOM countries. These investment resources are directed toward improving infrastructure mainly in the tourism sector, and as a result, it is expected that foreign direct investment should have a positive impact on growth rates in the region.

Caribbean governments have envisioned that greater investment, in areas such as education, health and transportation, will lead to an increase in both physical and human capital stocks and hence the rate of economic growth. Given that a decline in a country's foreign reserves reduces its ability to import goods and services essential for production and impedes its ability to honour foreign debts, both of which retard economic growth, an improvement in the country's international reserve position should contribute to higher rates of growth.

Finally, an increase in population growth is likely to have a negative effect on per capita growth, since an expansion in the number of persons in the non-working age group exerts greater pressure on social services, such as health and education, resulting in limited availability of resources. Also, Sarel (1992) argues that a rise in population growth diverts efforts into child rearing instead of expanding worker productivity.

When the financial liberalisation index is added to these standard growth variables, its impact on economic growth is expected to be positive based on evidence presented earlier.

3.3 Estimation Procedures

The growth model was estimated using panel data analysis. This approach was chosen against individual regressions based on an examination of the variation coefficient for the individual explanatory variables over time and across countries, which revealed that the variability in

the individual variables across countries is larger than the variability over time. Therefore, in accordance with Barajas et al (1988), a panel approach is more appropriate.

To account for the differences, such as the level of economic development, social norms and infrastructure among CARICOM countries, a fixed-effects model was applied. A F- Test (see Green, 1993) was used to determine between the fixed – effects specification and a common intercept model. In addition, to deal with possible issues of endogeneity with regards to growth, investment and saving, the model was estimated with two-stage least squares using the lagged variables as instruments.

The data used are of annual frequency and span the period 1979 to 2001. The statistics for real GDP and population were obtained from the International Financial Statistics (IFS) CD–Rom (April 2003). Reserves in months of imports, gross domestic and foreign direct investment were all taken from the World Bank's Development Indicators CD – Rom. These variables were then deflated by real GDP.

4. Results

The results from the growth model are presented in Table 2. All the variables are significant and the signs are in agreement with the growth literature. Foreign direct investment as a percentage of GDP was found to have a positive impact on growth. In Caribbean countries such inflows allow for an increase in GDP growth by creating jobs, increasing exports, bringing new management and production techniques and by adding to investable resources and capital formation. Government consumption as a percentage of GDP enters the model with a negative coefficient and is consistent with the pro-market view that growth in government consumption constrains overall economic growth through distortionary fiscal policy. Gross domestic investment had a positive impact on growth. This implies that domestic investment in critical areas such as education, health and infrastructure promotes economic growth. As expected, gross international reserves impact positively on growth, signifying that countries with higher

levels of reserves are more likely to have faster growth. Also in accordance with prior expectations, both the population growth rate and the rate of inflation had a negative effect on GDP growth.

The inclusion of the IFL index added to the explanatory powers of the model and was supported by a likelihood ratio test. The results show that at the regional level the effect of IFL on economies was significantly negative. This is perhaps because much of the major changes towards IFL in Caribbean countries took place at a time when those economies were not yet ready to deal with the implications. In fact, much of the process of liberalisation really got underway during the early 1990's, mainly as a result of the countries engaging in IMF stabilisation and structural adjustment programmes, designed to restore economic growth. The adoption of such policies was in an effort to liberalise the domestic financial systems of these countries and, in some cases, included the lifting of restrictions on capital flows and the floating of exchange rates.

At the individual level, seven of the eleven CARICOM countries under study had insignificant financial liberalisation coefficients (see Table 3). This implies that the process of liberalisation has not contributed to economic growth in those territories. For four of the countries, financial liberalisation had a negative effect on growth; these are Grenada, Jamaica, St. Vincent and the Grenadines and Trinidad and Tobago, with Jamaica having the largest impact. The Jamaican case is the most pronounced, and understandably so, because it was amidst poor economic conditions - excessive fiscal deficits, accelerating inflation, high interest rates and macroeconomic instability along with poorly capitalised and supervised financial institutions – that the country embarked on rapid financial liberalisation in 1991. The need for macroeconomic stability and well-functioning economic, social and legal institutions in order to benefit from financial liberalisation has been stressed in the literature as a significant difference between developing and developed countries. Developing economies simply do not have the required institutional structure to efficiently handle large movements of capital. Edwards (2001) concluded that the benefits of

financial liberalisation are manifest only after the country in question has reached a certain degree of development including a sophisticated capital market.

The impact of IFL on the saving – GDP ratio has been positive and significant for all the countries except Guyana. This, along with the previous results, would suggest that although opening up of the economies have resulted in increased financial assets, this has not been translated into real assets. In other words, the vehicle(s) needed to make this conversion, mainly developed capital markets, are not available.

A similar result is obtained for investment. IFL has impacted positively on the gross domestic investments to GDP ratio. Nevertheless, this has not translated into increased GDP growth. In fact, a plot of the GDI to GDP ratio shows a downward trend for most of the countries. One possible explanation is that the increased domestic investment is taking place in less productive areas and therefore not boosting the rate of growth of GDP.

5. Conclusion

This paper addresses the impact of IFL on saving, investment and growth. The conclusion of the study is that the process of liberalisation has not contributed to growth in these economies and in some cases had a negative effect. However, the fact that it led to high saving/GDP and investment/GDP ratios would suggest that the problem was in the process. That is, embarking on a rapid liberalisation path without first ensuring that the appropriate linkages and institutional framework were in place to handle the increased financial flows. The lesson is that liberalisation of the financial sector, in particular the capital account, must and should be preceded by certain conditions. After these pre-conditions are met, governments need to liberalise slowly to ensure that the transitional costs are minimised. Such pre-conditions would include; a practice of fiscal discipline, efficient prudential regulations of financial institutions to limit currency exposures and a reasonable degree of macro-economic stability.

Table1 Indices of International Financial Liberalisation

	Antigua & Barbuda	Barbados	Belize	Dominica	Grenada	Guyana	Jamaica	St. Kitts & Nevis	St. Lucia	St. Vincent & the Grenadines	Suriname	Trinidad & Tobago
1979	11.0	6.0	7.0	6.5	6.5	5.5	4.5	-	7.0	6.5	6.5	5.5
1980	11.0	6.0	7.0	7.0	6.5	5.5	4.5	-	7.0	7.0	6.5	5.5
1981	11.0	6.0	7.0	7.5	6.5	5.5	4.5	-	7.5	8.0	6.5	5.5
1982	11.5	6.0	7.5	7.5	6.5	5.5	4.5	-	7.5	8.0	6.5	5.5
1983	11.5	6.0	8.5	7.5	6.5	5.5	5.0	-	7.5	8.0	6.5	5.5
1984	12.5	6.0	8.5	7.5	6.5	6.0	5.0	7.0	7.5	8.0	6.5	5.5
1985	12.5	6.0	8.5	7.5	6.5	6.0	5.0	8.0	7.5	8.0	6.5	5.5
1986	12.5	6.0	8.5	7.5	6.5	6.0	5.5	8.0	7.5	8.0	6.5	5.5
1987	12.5	6.0	8.5	7.5	6.5	6.0	6.0	8.0	7.5	8.0	6.5	5.5
1988	13.0	6.5	9.0	8.0	7.0	6.0	6.5	8.5	8.0	8.5	7.0	6.5
1989	13.0	6.5	9.0	8.0	7.0	6.5	6.0	8.5	8.0	8.5	7.0	6.5
1990	13.0	6.5	9.0	8.0	7.0	7.5	6.5	8.5	8.0	9.0	7.0	6.5
1991	13.0	6.5	9.0	8.0	7.0	8.5	13.0	8.5	8.0	8.5	7.0	6.5
1992	13.0	6.5	9.0	8.0	7.0	11.0	13.0	8.5	8.0	9.0	7.0	7.5
1993	13.0	6.5	9.0	8.0	7.0	11.0	13.0	8.5	8.5	9.0	7.0	13.0
1994	13.0	7.5	9.0	8.0	8.0	11.5	13.0	8.5	8.5	9.0	7.5	13.0
1995	13.0	7.5	9.0	8.0	8.0	12.0	13.0	8.5	8.5	9.0	7.5	13.0
1996	13.0	7.5	9.0	8.0	8.0	12.0	13.0	8.5	11.5	9.0	7.5	13.0
1997	13.0	7.5	9.0	9.0	8.5	13.0	13.0	8.5	11.5	9.0	7.5	13.0
1998	13.0	7.5	9.0	9.0	8.5	13.0	13.0	9.0	11.5	9.0	7.5	13.0
1999	13.0	7.5	9.0	9.0	8.5	13.0	13.0	9.0	11.5	9.0	8.0	13.0
2000	13.0	7.5	9.0	9.0	8.5	13.0	13.0	9.0	11.5	9.0	8.0	13.0
2001	13.0	8.0	9.0	9.0	8.5	13.0	13.0	9.0	11.5	9.0	8.0	13.0

Table 2 Growth Regression

Column 1	Column 2
Foreign Direct Investment	1.783 (.8813)**
Government Consumption	-3.969 (1.941)**
Gross Domestic Investment	3.134 (1.888)*
Gross International Reserves	0.229 (0.144)*
Population	-1.1007 (0.078)***
Inflation	-0.2683 (0.1229)***
Gross National Savings	0.5024 (0.1050)***
IFL (IFL)	-0.7918 (0.4532)*
R ² (with IFL)	0.6581
R ² (Without IFL)	0.5897
Log likelihood (with IFL)	582.94
Log likelihood (without IFL)	-600.05

Notes: White's heteroskedasticity consistent standard errors given in brackets

***means significant at the 1% level

** means significant at the 5% level

* means significant at the 10% level

Table 3 The Impact of IFL

Country	Growth	Savings	Investment
Antigua & Barbuda	-0.5177 (0.3377)	0.9475 (0.2048)***	0.1129 (0.0203)***
Barbados	0.0622 (0.8970)	0.7971 (0.2769)***	0.005 (0.0203)
Belize	-0.1798 (0.3329)	1.5397 (0.1826)***	0.0509 (0.0099)***
Dominica	0.1538 (0.2473)	1.0936 (0.1661)***	0.0263 (0.0102)***
Grenada	-0.65498 (0.3761)*	1.5515 (0.1824)***	0.0753 (0.0101)***
Guyana	-0.1034 (1.3084)	-0.6495 (0.6759)	0.0641 (0.0212)***
Jamaica	-1.2620 (0.5897)88	1.5344 (0.1385)***	0.0201 (0.0144)*
St. Kitts & Nevis	0.3668 (0.4193)	2.0069 (.2229)***	0.0734 (0.0114)***
St. Lucia	-0.00206 (0.236)	1.0082 (0.1889)***	0.0311 (0.0078)***
St. Vincent & The Grenadines	0.6958 (0.095)*	0.6835 (0.3415)**	0.0362 (0.0136)***
Trinidad & Tobago	-0.6340 (0.3176)**	0.9080 (0.1574)***	-0.0177 (0.0104)*
Observations	175	175	175
Adjust R2	0.6189	0.7876	0.9929
Durbin Watson statistics	2.072	1.7376	1.4604
Determinant residual covariance	5.58E+17	1.05E+13	5.24E-16

Notes: White's heteroskedasticity consistent standard errors given in brackets

***means significant at the 1% level

** means significant at the 5% level

* means significant at the 10% level

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