

**THE FINANCIAL STRUCTURE IN BARBADOS 1950 - 1990:
A SURVEY**

by

**CLEVISTON HAYNES
CENTRAL BANK OF BARBADOS**

February 1995

**THE FINANCIAL STRUCTURE IN BARBADOS:
A SURVEY**

INTRODUCTION

The process of financial intermediation is entrenched in the Barbadian economy. Public confidence in financial institutions has contributed to the level of social and economic development and is reflected in the relative stability of the economy. Since the end of the second world war, the financial system has undergone significant changes, resulting in increased accessibility to financial institutions and improved mobilization and allocation of resources. The size of the financial sector has expanded in relation to the real economy, while the dominance of commercial banks has receded with the emergence of new instruments and institutions. However, despite these gains in the intermediation process, by the 1990s the financial system was still unsophisticated by international standards. Financial institutions remain so specialized that the competition needed to improve efficiency and stimulate innovation is absent. In addition, the stock and bond markets are still in the embryonic stage of development and offer only a limited range of investment opportunities.

This paper provides a descriptive survey of the spread of financial intermediation in the Barbadian economy between 1950 and 1990. Section I examines the state of financial sector, contrasting it with level of development in the pre-1950 period. Sections II, III, IV, and V trace the gradual evolution of the financial system. The four distinct phases in these sections correspond to the four decades of this period, enabling an analysis of institutional changes, their rationale and their impact on the financial system. Section VI provide some reflections on possible areas of financial sector development in the future.

1. The Financial Structure in 1990

By developing country standards, the Barbadian economy has performed well over the past forty years. Size and a limited resource base has left the economy very open and vulnerable to adverse external influences. However, the economy has grown by an estimated 2% per annum, enabling a substantial rise in the standard of living. Expansionary fiscal policy supported by foreign investment and a strong export drive in tourism and manufacturing provided the initial stimulus for growth. More recently as foreign investment flows slowed, there has been increased reliance on external borrowing by the public sector to finance growth in the non-traded sectors (See Table I).

Table I

Economic and Monetary Indicators (1950 - 1990)

	1950	1960	1970	1980	1990
Population ('000)	209.0	234.0	239.0	249.0	258.0
Per Capital GDP (US\$)	164.0	268.0	606.0	3,084.0	5,747.0
External Debt/GDP ¹ (%)	-	14.8	10.4	14.4	32.0
M ₁ /GDP ² (%)	16.6	19.4	23.0	16.6	18.7
M ₂ /GDP ³ (%)	34.8	36.8	69.7	53.7	65.3

Sources: Barbados Statistical Service Abstract of Statistics 1969
Central Bank of Barbados Annual Statistical Digest 1993
World Bank World Tables 1991 edition

- Notes:
- ¹ Data excludes unguaranteed private sector debt. In 1990 this debt was approximately 5% of GDP.
 - ² Narrow money (M₁) is defined as currency plus demand deposits at commercial banks.
 - ³ Broad Money (M₂) is defined as narrow money plus interest bearing liabilities of residents at commercial banks.

The domestic financial system has played a significant role in both phases of economic activity. Most economic transactions are monetized and the system has proved to be a relatively efficient conduit of funds between savers and spenders. The institutional network, consisting of a Central Bank, several commercial banks, a growing complement of non-banks and fledgling stock and bond markets, mobilizes adequate levels of resources for the provision of short, medium and long term finance.

Unlike in many developing countries, the system is predominantly private sector owned as Government has limited its direct involvement in the financial sector to a few specialized institutions. Apart from the Central Bank, Government's only interests in the sector were the sole locally owned commercial bank, a general insurance company and four specialized non-banks engaged in lending for agriculture, housing¹ and industry and small business. However, given the strategic areas of government's involvement and the business which they attract from other government entities, these institutions account for a disproportionate share of financial sector activity².

In Barbados, there has been no apparent effort to localise the financial services sector and only in the insurance industry have dominant privately owned indigenous institutions developed. The

¹There are two government agencies providing long term housing finance. The Barbados Mortgage Finance Company (BMFC), which accepts no deposits, is funded by housing bonds and the National Insurance Scheme (NIS), and lends for low and middle income housing. The trust division of the Barbados National Bank (BNB) accepts deposits and may lend for residential and non residential purposes.

²While this observation is not intended as a value judgement on government activity it must be noted that these institutions often finance inefficient enterprises in the public and private sectors. The high level of delinquency at government banking financial institutions could have long-term implications for the economy. A measure of the degree of inefficiency is given by the fact that between 1992-94 Government issued bonds equivalent to 11% of 1993 GDP to liquidate principal and accrued interest on non performing loans at Government institutions.

presence of internationally acclaimed banks may have helped to strengthen confidence in the financial system, but, until recently, these banks appear to have been slow to modify financial instruments and to introduce technological advances to improve customer service.

The current structure of the financial sector is in direct contrast to that of the pre-1950 period. Up until that time, the financial system, represented largely by foreign commercial banks, served mainly as a store of savings and a source of short term working capital for the agricultural and mercantile community. Now there is a more varied institutional network providing more opportunities for investment and for capital accumulation outside of traditional sectors.

The Central Bank is at the apex of the financial system, directing monetary policy and regulating financial institutions. However, prior to the introduction of the Financial Intermediaries Regulatory Act of 1992, the Bank was concerned that it had limited scope in dealing with non-banks which could be registered under the Companies Act without regard to their capacity to serve as financial institutions.

Commercial banks still remain the dominant form of financial institution, a reflection of their historic role in the financial system and the variety of services which they provide. By 1990, there were seven banks operating a forty-three branch network. The single British bank, the three Canadian and the Barbados National Bank dominate. Of the other two banks³, one is owned by a regional life insurance company. It has a relatively small network and has not been able to make a significant penetration of the domestic market.

³In 1993, the local insurance company, the Barbados Mutual Life Assurance Society, took over the assets of the failed Bank of Credit and Commerce International.

While banks remain the main institutions for deposits funds, nonbanks are playing an increasingly larger role in the system. The structure of non-banks is broad, consisting of insurance companies, finance companies which provide mortgage and non-mortgage funds, government owned development finance institutions and indigenous credit unions. In addition to deposit sources, government has tapped the NIS and various domestic and external loans to finance the activities of the Barbados Development Bank and the BMFC.

The bond and stock markets complement the traditional financial institutions. Secondary markets to trade bonds and stocks are now in their infancy and trading on both markets is relatively thin. The size of fiscal deficits in recent years has increased the availability of government paper but there is no evidence that these instruments rank high in institutional portfolios. Given limited alternative investment opportunities and few new stock offerings, the possibilities of using the stock exchange as a means of broadening stock ownership and increasing trading activity are yet to be realized.

II. The Pre-expansion Phase: 1950-1959

There was no particular deepening of the financial system during this decade. However, to understand the financial system during this period requires some appreciation of its evolution since the 1830s. Society in the pre-emancipation period required no financial institutions as the economic system did not need much cash and merchants performed the role of suppliers of short term credit. In addition, in an era where metals served as currency, there was no local issue in Barbados. Instead, until the second half of the 19th century, Spanish and Portuguese coins

were used as the local medium of exchange in the face of English restrictions on the export of their own currency (Greaves 1952)⁴.

In 1837 a Royal Charter enabled the Colonial Bank to set up the first formal financial institution with the authority to issue its own notes. Interestingly, the Barbados Government did not issue its own currency until 1937 and then for a short period only, as the British Caribbean Currency Board (BCCB) was set up in 1951 to take over the currency issuing functions in the Eastern Caribbean.

New institutions sprung up immediately in the new 'society'. For example, while the Colonial Bank had note issuing authority, initially its loan function was severely restricted by the terms of its charter. In this context, the indigenous West India Bank, a conservative reaction to the power of the Colonial Bank, was influential in the 1840s before it collapsed with the financial crisis in England of 1847-48. After this Karch (1979)⁵ argues that the Barbados Mutual Life Assurance Society (1840), another indigenous financial institution, became the dominant intermediary during difficult times. A local Savings Bank was also formed during this period to mobilize savings.

This spurt did not serve as a catalyst for the proliferation of new institutions as the level of development of the economy and the distribution of wealth probably mitigated against faster expansion. Institutional development in the post emancipation colonial period was demand

determined with the result that there existed three foreign commercial banks, an indigenous commercial bank, a government savings bank, two agricultural banks and life and general insurance companies by 1950. In addition, small householders, whose access to formal financial systems was severely restricted, devised their own savings schemes and invested in small friendly societies.

By 1950, the financial system was attracting almost 50% of GDP in deposits (Table II). This level of mobilization despite the traditional nature of the economy and the absence of a wide range of formal deposit taking institutions reflect an already impressive level of monetization in the agriculture based economy and a strong savings ethic. The low interest rates and the high portion of demand deposits in total savings suggest deposits were used to facilitate transactions demand and as a store of value during this period. The savings Bank was restricted to pay 3% for its deposits and in the size of deposits which it could accept. Commercial Banks also faced restrictions on the size of deposits on which interest could be paid, necessitating adjustments over the years to reflect the growth of savings.

Interestingly, the data suggests a very low level of currency holdings by the Barbadian public which, if true, would run counter to conventional thinking on the nature of financial savings during the primitive stages of economic development. However, it must be recalled that the common use of currencies between the islands almost certainly meant that the circulation was severely understated.

⁴"Money and currency in Barbados;" *The Journal of the Barbados Museum Historical Society*, 1952.

⁵*The Transformation and Consolidation of the Corporate Plantation Economy in Barbados: 1960-1977*.

By the end of the decade the savings process via financial institutions had not intensified as the deposit-GDP ratio remained below 50%. Despite the decentralization of its operations by Barclays and the entry of the Bank of Nova Scotia in the second half of the decade, the ravages of Hurricane Janet, economic contraction in 1958 and the floating of sizeable debenture by government seemed to have stalled the institutional savings process. Commercial banks continued to account for about two-thirds of deposits during this period while the savings bank took up almost all of the remainder.

While deposit growth slowed after 1955, there was a marked shift in the extent of bank lending. In 1950, of the deposits mobilized within the domestic economy, only about 40% were loaned out domestically (See Table III). Instead commercial banks and the savings bank invested their balances abroad. However, commercial banks' loan activity increased substantially in the second half of the 1950s when they were over 70% loaned up. After 1957 the Barbados Savings Bank also raised the local investments portion of its portfolio, reaching almost 30% in 1959 when government issued debentures to help finance its capital works program.

Table II

Monetary Liabilities in Barbados (1950 - 1990)
EDSE Million

	Commercial Banks	Friendly Societies/Credit Unions ¹	Savings Bank	Trust Companies ²	Finance Companies ³	SIAB/BNB-AD	Deposits Currency	Deposits/GDP	Banks' Deposit Share	Currency/Deposits
1950	22.5	0.2	10.4	-	-	-	31.1	48.6	65.8	3.8
1955	38.6	0.2	14.7	-	-	-	53.5	52.1	66.4	7.9
1960	41.0	0.1	19.5	-	-	-	60.6	48.3	62.2	8.0
1965	71.5	0.4	17.6	-	-	-	89.5	56.6	72.5	9.2
1970	180.4	0.6	17.8	2.0	-	-	198.8	68.6	90.8	10.8
1975	359.9	1.4	25.7	19.8	-	-	406.8	57.2	91.5	10.6
1980	738.1	4.7	-	69.2	12.6	11.1	840.9	54.7	87.8	12.1
1985	1,090.1	32.0	-	148.2	22.8	39.1	1,332.2	61.1	81.8	9.3
1990	1,738.6	143.0	-	320.3	40.6	57.7	2,340.2	78.9	74.2	7.6

Sources: Statistical Service, Abstract of Statistics

Central Bank of Barbados, Annual Statistical Digest

Notes:

- 1 An insignificant level of double counting is captured in the data.
- 2 Exclude foreign currency deposits after 1975; before 1975 such balances are insignificant.
- 3 In the 1950s and 1960s friendly societies were the dominant informal deposit institutions; their deposits were subject to seasonality.
- 4 Small levels of deposits held on demand by these institutions are excluded.

Table III

Financial Institution Lending (1950 - 1990)
BD\$ Million

	Commercial Banks ¹	Barbados Development Bank	SIAB/BNB-AD	Trust Companies	BMFC	Finance Companies	Credit Unions	Total Loans	#
1950	12.6	-	0.1	-	-	-	-	12.7	4
1955	16.6	-	0.4	-	-	-	-	17.0	8
1960	39.7	-	0.7	-	-	-	-	40.4	7
1965	59.0	-	0.8	-	-	-	-	59.8	8
1970	170.0	0.8	1.2	-	1.5	-	0.3	173.8	4
1975	293.7	4.1	5.5	13.3	14.0	-	1.0	331.6	5
1980	536.1	23.2	40.7	71.5	33.3	12.0	4.1	720.9	7
1985	803.1	97.3	119.4	123.5	55.5	26.3	31.0	1,256.1	3
1990	1,145.5	94.6	180.7	330.1	90.1	39.5	142.0	2,022.5	4

Sources: Statistical Service, Abstract of Statistics
Central Bank of Barbados, Annual Statistical Digest

Notes: ¹ After 1975 loans to financial institutions excluded to minimise double counting of flows

Insurance companies were the most significant non-bank during this period. While an absence of data prevents us from accurately measuring their role in the economy, the ratio of life insurance premium income to GDP may have been quite high (2½-3%).⁷ The loan portfolio probably had very little impact on overall lending.

III. The Expansion Phase: 1960-1969

By all indicators this was an extraordinary period of economic and financial development. The economy grew by 3.5% per annum, raising income and the demand for financial services. Led by Barclays, the commercial banks extended their branch network and competition was heightened by the arrival of two American banks (See Table IV).

Table IV

Bank Expansion 1950 - 1990

	1950	1960	1970	1980	1990
Commercial Banks	4	4	6	7	7
Bank Branches	3	6	26	43	43

Source: Central Bank of Barbados

Deposits grew by 12.6% per annum and, perhaps even more critically, banks were by 1969 lending out 80% of their deposits. The booming tourism industry absorbed a significant share of the new lending but equally important was the introduction of consumer installment lending. This helped spur private consumption, deepen the intermediation process and quicken the pace of economic activity.

New institutions providing mortgage finance and the government owned Barbados Development Bank came on stream but were yet to make a significant impact. The data suggests that life insurance companies were taking premium income of about 3% of GDP, a high ratio given the level of development.

An important fallout of financial sector trends in the 1960s was diminished role of the Savings Bank. Its deposit base shrunk by almost 15% and its share of deposits fell from almost one third to less than 9% of overall deposits. This was a period of relative interest rate stability but the variety of services which banks could offer, including loans, must have influenced these patterns.

Of note is that the structure of deposits at banks underwent significant change, with the share of demand deposits declining from almost 50% to 29%. McClean⁶ attributes this shift to successful marketing by commercial banks for household savings.

IV. Change and Consolidation: 1970-1979

The establishment of the Central Bank of Barbados (1972) and the issue of a local currency (1973) represented the principal financial developments during this period. Following on similar decisions in the post independence era by Jamaica, Trinidad & Tobago and Guyana, these innovations represented an attempt to facilitate greater autonomy over the domestic financial system. The colonial system had been much criticised for the lack of discretionary power of the currency board and the dominant role of foreign commercial banks⁷. Greaves sums up the feeling when she notes that "money and finance have always been among the last affairs to pass under internal control when a colony moved to a fully self-governing status".

The role of the Central Bank was felt immediately as its establishment coincided with liquidity problems in the banking system, rising inflation and a weakening external position (see Haynes and Holder (1989)⁸). The Bank introduced reserve and securities requirements on banks to cut the supply of loans to the private sector and finance the growing size of fiscal deficits,

⁶Money and Banking in the Eastern Caribbean, 1975:ISER.

⁷McClean argues that the East Caribbean Currency Authority (ECCA) which replaced the BCCB behaved in this way and did not represent a significant improvement in monetary arrangements. Two aspects of ECCA's behaviour which received criticism and which disappeared with the establishment of the Central Bank were the need for the currency to be partially backed by reserves and strict limitations on the extent of government borrowings from the monetary authority.

⁸'Monetary and Fiscal Policy in Barbados 1970 - 1985' in Economic Adjustment Policies for Small Nations: Theory and Experience in the English Speaking Caribbean ed. DeLisle Worrell and Compton Bourne (1989) Praeger.

manipulated interest rates and with the aid of selective credit controls attempted to regulate the flow of credit to consumption oriented sectors. In addition, the scope of exchange controls was extended to cover the sterling area and banks were mandated to seek Central Bank permission before borrowing to onlend in the domestic economy.

By the end of the period, the Central Bank was diverting 25% of bank deposits away from lending to the private sector (Table V). Double digit inflation and strong domestic demand forced interest rates up but, rates returned to normal levels by the end of the decade. In real terms, interest rates were negative for most of the period, reflecting the view that a high interest rate strategy would destroy the productive sectors but would not mobilise additional resources as suggested by the theoretical literature. In addition, there was concern that banks would collude if allowed to set interest rates freely. Government also benefited from this low rate strategy evidenced by the treasury bill rate which did not exceed 5% in the second half of the period. While economic activity strengthened during the second half of the decade, the high inflation rates may have impacted on financial intermediation. This is reflected in a decline in deposits in real terms, and in the rise in the currency-deposit ratio to double digits for the entire period.

More critically, there was the substantial increase in the availability of government paper, a result of growing fiscal imbalances (see Table VI). By 1979 government issues represented nearly 20% of GDP, almost half of which were held by commercial banks. However, it is clear that the bond issues diverted funds that would previously have entered the deposit stream and contributed to the reduction in the deposit - GDP ratio.

Table V**Interest Rates, Inflation and Reserve Ratios (1965 - 1990)**
(%)

	1965	1970	1975	1980	1985	1990
Reserve Requirements						
Cash	-	-	6.0	8.0	8.0	8.0
Securities	-	-	9.0	17.0	19.0	22.0
Interest Rates						
Savings	3.0	4.5	7.0	5.0	4.0	5.5
Bank Rate	-	-	7.5	7.0	13.0	13.5
Treasury Bill Rate	n.a.	7.1	4.0	6.2	4.6	8.1
Inflation	3.1	7.8	20.3	14.4	3.9	3.1

Source: Central Bank of Barbados, Annual Statistical Digest

Commercial banks continued to dominate the intermediation process, a development exaggerated by the conversion of the Savings Bank into a full banking facility in 1978. The process of extending the branch network slowed and one bank had closed five of its branches by the end of the decade. One of the American banks also ceased operations but given that the other three American banks followed in the 1980s, this may simply reflect the difficulty faced by new banks in penetrating the market. However, of the non-banks, the trust companies engaged primarily in mortgage lending became more effective in mobilizing medium term funds, in part the result of the surpluses made available by the National Insurance Fund which had been established in 1968.

Table VI**Bonds Outstanding (1960 - 1990)**
BDS\$(Million)

	Treasury Bills	Debentures/ Treasury Notes	Savings Bonds	Government Guaranteed	Total Claims	Claims/GDP (%)
1960	-	12.1	-	-	12.1	10.1
1965	1.5	16.0	-	-	17.5	13.3
1970	6.9	29.0	-	-	35.0	10.9
1975	56.9	82.4	-	-	139.3	19.9
1980	164.2	130.6	-	15.9	310.7	20.9
1985	405.0	154.7	6.9	67.9	634.5	29.1
1990	506.2	341.2	34.6	101.3	983.3	32.2

Sources: Central Bank of Barbados Annual Statistical Digest

V. The Growth of the Non-Banks: 1980-1989

The 1980s was marked by the entrenchment of the nonbanks in the financial system. Their deposit share more than doubled, reaching 25.8% in 1990 in comparison to just over 12% in 1980. Their contribution to loan supply was even more significant, accounting for over 43% of all loans compared to 25.7% in 1980.

Several factors account for this expansion. First, the weakness of the sugar industry finances raised demand for funds from the agricultural division of the Barbados National Bank. While the BNB-AD raised its own funds, especially from other government institutions, it relied heavily for additional financing from the Central Bank's discount scheme and its own commercial division.

Secondly, the Barbados Development Bank pursued an aggressive lending policy in the early part of the 1980s which led to a quadrupling of its loan portfolio. Later it experienced high levels of delinquency and it is perhaps significant that this period of lending coincided with a contraction in manufacturing output.

Third, Central bank regulations on the banking sector encouraged the growth of non-bank institutions providing consumer oriented lending. While finance companies were unable to significantly penetrate the market, in part because of restrictions under the Rate of Interest Act and in part because of the failure of one such institution, credit unions expanded rapidly in number, membership and assets. Their growth was facilitated by tax incentives which encouraged membership. In addition, with government allowing 100% of interest deductibility, mortgage lending institutions, including insurance companies, substantially increased their lending. As a result, lending to individuals absorbed about one third of all institutional credit. This represents a major shift from the position four decades earlier.

While the market shares of banks dropped sharply during the 1980s, their loans and deposits still increased by 8% and 9% respectively. Given the low rates of inflation, this represents significant growth for banks. Under the fiscal stimulus of the latter half of the 1980s, deposit growth recovered and the deposit - GDP ratio peaked at 79% in 1990. This strengthening occurred despite the trebling of the stock of public sector paper in circulation, about 40% of which was held by commercial banks.

VI. Reflections

The relationship between the performance of the economy and the financial system was important, particularly during the latter part of the period. Wood (1993)⁹, examining the causal relationship between financial development and growth for the period 1946-1990, found that the financial sector did not exert a significant influence on economic activity between 1946 - 1968. However, his results suggest that after 1968, there was a bi-directional relationship in which the financial sector impacted on and was affected by economic growth.

The ongoing contribution of the sector to sustained economic growth will hinge in the future on sound macroeconomic policies. The experience of the early 1990s in which the economy has contracted and the foreign exchange position weakened, emphasises the need for a strategy oriented towards investment in foreign exchange earning sectors. In the past, banks have been criticized for their conservatism, and reluctance to engage in long-term lending for the foreign exchange earning sectors and with the creation of the Barbados Development Bank, it seems that private sector financial institutions have missed an opportunity to carve out a niche in this market. While the failure of the Barbados Development Bank to recover on many of its loans has tended to reinforce commercial banks' judgement on the viability of new risky ventures, future long-term growth will depend in part on financial sector innovation in providing long-term lending.

⁹Financial Development and Economic Growth in Barbados: Causal Evidence' Savings and Development Vol XVII p. 379.

The financial system will need also to become more competitive. As the size of the financial sector expands, the more critical the need to improve operating efficiency and enhance long-term growth prospects. Given the fragmented nature of the financial system, competition has been quite weak and the cost of intermediation quite high¹⁰. Technological change, liberalization¹¹ and the prospects of new indigenous institutions should result in increased competition between institutions. Barbadian regulators, who have faced only one financial institution failure since 1981, will be confronted by new challenges.

¹⁰Howard, M. and Haynes C. (1991) 'Financial Efficiency, Intermediation Costs and the Regulatory Framework' mimeo Central Bank of Barbados.

¹¹Financial Sector liberalisation is reflected in the abandoning of selective credit controls, reduced interference in the setting of loan rates and marginally lowered reserve requirements since 1991.