THE DEVELOPMENT OF THE BARBADIAN FINANCIAL SYSTEM: 1966 -1990

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Abstract

The evolution of financial systems in developing countries reflects their diverse political and economic histories. Barbados and other Caribbean countries, under colonial rule until after the Second World War, enjoyed relative financial stability but their financial systems suffered from colonial neglect. With the attainment of political independence from the United Kingdom in 1966, Barbados established its Central Bank in November, 1972.
The aim of this paper is to provide a succinct account of the development of the financial system of Barbados during the perid 1966 to 1990. Both a quantitative assessment of financial development and a discussion on the institutional composition will be provided. Restricting the coverage to the period 1966-1990 allows us to assess the role of Government initiatives in shaping the institutional composition of the financial system in the immediate post-independence years. A number of highlights emerged from the analysis. First, consistent with Goldsmith (1969), as the Barbadian economy developed there was an increasing share of non-bank financial institutions in relation to the total assets of the financial system. Second, the changes in the institutional structure of the financial system have been due, in large measure, to the initiatives of Government in establishing and encouraging a wider array of institutions and instruments to broaden the scope of financial intermediation for economic development. Third, the shift in economic policy created a demand for new financial services and institutions, thereby enhancing the importance of financial intermediation.

1. Introduction

The evolution of financial systems in developing countries reflects their diverse political and economic histories. Barbados and other Caribbean countries, under colonial rule until after the Second World War, enjoyed relative financial stability but their financial systems suffered from colonial neglect. With the attainment of political independence from the United Kingdom in 1966, Barbados established its Central Bank in November, 1972. The Barbadian financial system underwent significant change during the first twenty-five years after independence due in large measure to the initiatives of Government in establishing and encouraging the growth of indigenous institutions to broaden the scope of financial intermediation for economic development. Indeed, Government policy reflected the authority’s acceptance of the increasingly popular view that financial development is important and leads to economic growth – the supply–leading phenomenon [see Wood (1993), Craigwell, Downes and Howard (2001) and Iyare and Moore (2011) for empirical evidence confirming the supply-leading phenomenon in the Barbadian economy].

The aim of this paper is to provide a succinct account of the development of the financial system of Barbados during the period 1966 to 1990. Both a quantitative assessment of financial development and a discussion on the institutional composition will be provided. While previous works have dealt with the institutional aspects [Worrell and Prescod (1983), Haynes (1997)] and quantitative assessment [Howard (1989, 2006)] of the Barbadian financial system, not enough emphasis has been placed on identifying and discussing the range of factors contributing to the process. This paper, therefore, seeks to extend the literature by examining the major factors contributing to the institutional development of the financial system in Barbados, particularly the role of Government policy and actions. Restricting the coverage to the period 1966–1990 allows us to assess the role of Government initiatives in shaping the institutional composition of the financial system in the immediate post-independence years.

The remainder of the paper is organized as follows: section 2 provides a review of the literature on the importance of the financial system; section 3 deals with the quantitative assessment of financial development; the changing institutional structure is the focus of section 4, commencing with the Monetary Authority followed by the commercial banking industry and the non-bank sector; and section 5 provides a concluding summary.

2. The Importance of the Financial System

It took some time before economists recognized that financial systems might play an essential role in the development process. As Shaw (1973) commented "this theme (that the financial sector of an economy does matter in economic development) is excluded from dominant traditions of theory and practice in economic development. Some development theory seems to be designed for a barter world. In other models, finance is passively adaptive and its deepening is a by-product of accelerated growth in real things. There is a doctrine that ranks financial deepening among obstacles to development and recommends financial repression. That guiding beacon of development practice, the Plan, gives scant heed to finance in the usual case." However, a consensus has emerged from the numerous theoretical and empirical writings on the relationship between money, finance and real development in the last forty years that the financial system is pivotal to the growth of economic activity [see, for example, McKinnon (1973), Shaw (1973), World Bank (1989), Levine (2005), Iyare and Moore (2011)].

In the course of economic activity, the financial system performs many important functions. In the early analysis of Gurley and Shaw (1956, 1960) financial intermediaries, through economies of scale in the collection of information and portfolio management, transmutate the financial claims flowing from borrowers to lenders in order to satisfy simultaneously the portfolio preferences of the separate deficit and surplus economic units.[1] The real importance of the financial system in this analysis is that it allows for greater diversification of risk than is possible under direct finance [Hellwig (1991)]. By making funds available to entrepreneurs in excess of their financing capabilities, financial intermediaries contribute significantly to an increase in investment activities.

Financial intermediaries may act as leading agents in development by helping to identify entrepreneurs with the best and potentially most profitable ideas and products, and supplying finance to these projects [King and Levine (1993) and Drzenick-Hanonz, Mia and Herrera (2009)]. By facilitating innovative activities, financial intermediaries therefore foster a faster growth in economic activity. The view that financial institutions may constitute leading sectors in economic development through the supply of initiative and enterprise, in addition to finance, was central to the earlier writings by Gerschenkron (1962), Patrick (1966) and Cameron (1967) on the industralisation process of European economies. In Gerschenkron's analysis, bank prominence in industrial finance was a consequence of economic backwardness. He asserts that countries like Germany and Italy in the late nineteenth century suffered from a scarcity of capital, as well as entrepreneurship, so bank initiative and bank finance was an invaluable substitute.

Another strand of the literature focuses on the role of financial intermediaries in overcoming informational problems in financial markets, thereby achieving a more efficient allocation of resources [Diamond (1984), Mayer (1988)]. In Diamond's analysis, the function of financial intermediaries is that of delegated monitoring. Through delegated monitoring, financial intermediaries can economize on monitoring costs and efficiently separate ownership from management of the firm. According to Merton and Borde (1995), this results in specialization in production because of the principle of comparative advantage. Mayer (1988) asserts that financial intermediation with a close relationship between the bank and firm may provide a mechanism of commitment to a long-term relationship which is otherwise difficult. Such a relationship, with an element of confidentiality and mutual trust among parties, allows the intermediary to reduce information and incentive problems to a tolerable level. As a result, firm managers are better able to plan investments over a longer term horizon.

Financial institutions may also serve as a disciplinary mechanism on management of firms. In cases where the equity of firms is in the form of shares which are freely traded on a stock market, underperforming assets are subject to a takeover or a merger with a subsequent change in management in order to improve the financial performance of the acquired firm. The possibility of such action may serve as an incentive for managers to pursue policies to safeguard the efficiency of the firm's operations.

In some financial systems it is the suppliers of debt finance who may have effective control over managers and who can ensure that the firms' assets are efficiently used. For example, in the case of Japan, bank ownership of companies and representation on their boards allow banks to intervene where company performance reveals this to be necessary. Such a "main bank" system also allows banks to assume a leading role in organizing rescue operations for failing companies [Corbett (1987), Sheard (1989), Aoki and Patrick (1994)].

[1] The terms surplus and deficit economic units were coined by Gurley and Shaw (1956, 1960) and refers to savers and investors (units seeking to expand their holdings of real assets beyond the limits of their net worth), respectively.

The financial system also facilitates internal and external trade through the provision of credit and guaranteeing payments. A modern and efficient payment system is vital for the proper functioning of an economy. The financial system is therefore important in fostering a country's competitiveness and growth potential.

Finally, financial institutions provide specialised services, for example, insurance, property management and other financial services. Insurance provides a very important economic benefit: in allowing economic agents to undertake substantial investment in property, machinery and stock compilation without any fear of loss through accidents, it drastically reduces the uncertainty in production and exchange.[2]

Thus, the financial system contributes to economic growth by improving the volume and productivity of investment. By assessing which managers and which projects are most likely to yield the highest returns, and monitoring the activities of borrowers, financial intermediaries ensure that resources are used efficiently. Also, financial intermediaries can play an important role in reallocating assets through corporate restructuring. In the course of financial activity, the savings of the economy are increased and rendered highly mobile, less burdensome liabilities are imposed on businesses and at the same time, the risk facing savers are reduced through diversification.

3. Quantitative Assessment of Financial Development

The financial system in Barbados in 1990 was bank-oriented.[3] It consisted of a wide range of private and public financial institutions (Figure 1). The Central Bank in many respects acted as an umbrella organisation to the other institutions. It was responsible for setting the regulatory framework under which the other institutions operate. Commercial banks dominated the financial system, mobilizing the greatest proportion of domestic savings and being the largest lenders. From the early 1960s there was an increasing diversification among financial institutions in Barbados.

Financial development is a multi-dimensional concept. It refers to the increasing weight of financial transactions in the economy as well as to an expansion of the array of financial instruments and institutions. Quantitative evidence of financial development in Barbados is presented in Table 1 and Table 2. The tables indicate that the growth of the Barbadian financial sector over the review period was quite impressive: the ratio of real financial assets to gross domestic product increased from 0.55 in 1965 to 0.97 in 1974, and by 1990 reached 1.43. Also, as Table 2 indicates, there has been an expansion in the array of financial institutions with the non-banking sector increasing in size and economic importance relative to commercial banks.

The financial deepening phenomenon observed in the Barbadian economy was, in part, the consequence of transactions between financial institutions themselves. The Financial Layering Ratio – ratio of intra-financial sector assets to total financial assets of the financial system – increased from 0.1 in 1973 to around 0.16 in 1990.[4] Also, of particular importance has been the role played by Government policy. The Government established a number of indigenous institutions which made a useful contribution to the accumulation of financial assets throughout the post-independence period. The share of Government institutions in all financial assets increased from 22% in 1973 to around 30% in 1990, largely due the expansion of the National Insurance Board and the extension of Government's efforts to include commercial banking and general insurance business. In addition, Government policy encouraged the growth of private non-bank institutions to broaden the scope of financial intermediation for economic development. In Trinidad and Tobago, the importance of Government initiative was also observed: "for the most part, however, institutional and structural change has been driven by deliberate policy action rather than market signals. The Central Bank has played a major role in engineering structural change" [Crichton and De Silva (1988) p. 125].

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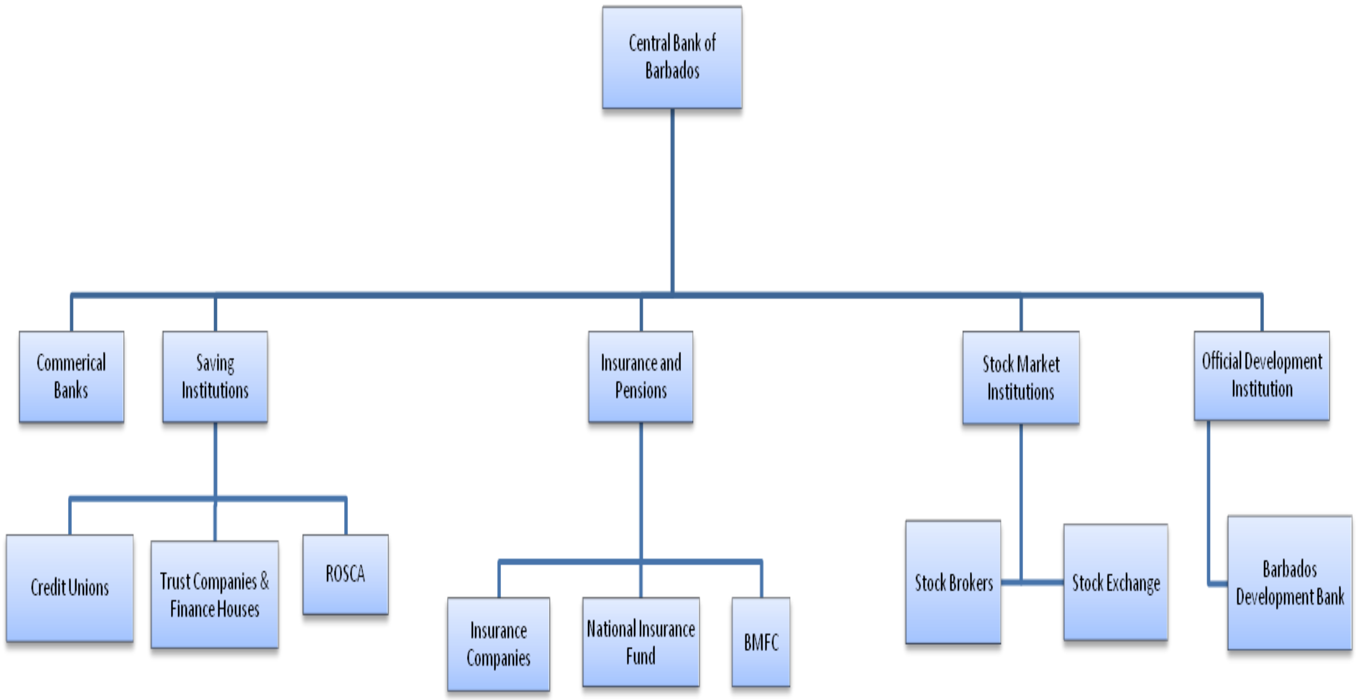
[2] Accidents refer to events such as fire, burglary, hurricanes and other perils as opposed to unexpected fluctuations in the demand for products.

[3] It is commonplace to make the distinction between "market" and "bank" oriented financial systems. The size of equity markets and bond markets, the equity holdings of institutions and individuals, and gearing ratios of the corporate sector are often used as distinguishing characteristics. Within this framework, Barbados can be regarded as a bank-oriented financial system [see Demirguc-Kunt and Levine (1999) and Levine (2000) for a useful discussion on bank-based and market-based financial systems].

[4] Source: Central Bank of Barbados, Annual Statistical Digest, 1991.

FIGURE 1: A Schematic Representation of the Barbadian Financial System



Key: ROSCA – Rotating Savings and Credit Association
BMFC – Barbados Mortgage Finance Corporation

One of the major findings of Goldsmith (1969) in his comprehensive study on the theory of financial structure was that economic development is associated with a declining share of banks and an increasing share of non-banking financial institutions in relation to both the assets of all financial institutions as well as total financial assets. In Barbados, the share of commercial banks in the total assets of the financial system declined steadily from 73.4% for the period 1965-1969 to 48.1% for the final review period (Table 2). At the same time, the share of non-banking financial institutions increased from 12.2% in the period 1965–1969 to its highest level of 37.1% between 1985 and 1990.[5] The share of insurance companies in the total assets of the financial system showed a decline during the early 1970s but rose steadily since 1974, reaching a level of 9.7% for the period 1985–1990 (Table 2).

[5] Howard (1989) observed a similar phenomenon in the Barbadian context.

Table 1
Institutional Composition of Financial Assets at Year End, 1974 – 1990

(BBS $million)

Type of Institution	1974	1978	1982	1986	1990
Central Bank	84.4	176.1	378.8	417.1	510.3
% of Total	13.6	16.0	18.0	13.9	11.6
Commercial Banks	397.8	610.8	1016.1	1420.2	2037.6
% of Total	64.3	55.4	48.2	47.3	46.2
Insurance Companies	38.2	84.4	207.0	344.3	598.0[p]
% of Total	6.2	7.6	9.8	11.5	13.6
National Insurance Board	60.3	126.1	249.9	384.6	513.2
% of Total	9.8	11.4	11.8	12.8	11.6
Trust Companies	12.5	45.8	137.1	193.1	377.0
% of Total	2.0	4.2	6.5	6.4	8.5
Credit Unions		2.3	7.6	36.4	125.9
% of Total		0.2	0.4	1.2	2.8
Finance Houses				37.8	50.3
% of Total				1.3	1.1
Mortgage Companies	14.0	21.9	44.0	62.8	91.1
% of Total	2.3	2.0	2.1	2.1	2.1
Development Bank	11.2	34.8	67.4	103.7	107.7
% of Total	1.8	3.2	3.2	3.5	2.5
Total (Nominal)	618.4	1102.2	2107.7	3000.0	4411.1
Total (Real Financial Assets)	618.4	735.8	831.8	1048.2	1260.3
Real Gross Domestic Product	640.4	712.4	748.0	822.0	879.1
Real Financial Assets ÷ Gross Domestic Product[a]	0.97	1.03	1.11	1.28	1.43

Notes: p = provisional
[a]The financial assets are deflated by the retail price index and gross domestic product by the GDP deflator, both with a base year of 1974.

Source: Central Bank of Barbados, Annual Statistical Digest, 1991; Barbados Cooperative Credit Union League Limited, Annual Reports.

Table 2
Relative Sizes and Importance of Financial Institutions (percentages)
Periodic Averages

Indicators	1965-1969	1970-1974	1975-1979	1980-1984	1985-1990
CBA/TA	73.4	69.0	57.0	49.9	48.1
NBFA/TA	12.2	20.1	27.0	32.6	37.1
ICA/TA	9.5	7.2	7.9	9.6	9.7
CBA/GDP	86.2	79.4	64.0	61.4	68.6
CBLA/GDP	56.9	55.9	40.9	38.4	39.8
NBFA/GDP	14.4	23.1	30.3	40.1	53.0
ICA/GDP	11.2	8.3	8.9	11.8	13.0

Notes: CBA – commercial banks' assets; NBFA – assets of non-banking financial institutions; ICA – assets of insurance companies; TA – total assets of financial system; CBLA – commercial banks' loans and advances; GDP – gross domestic product (at factor costs).

Source: Central Bank of Barbados, Annual Statistical Digest, 1991; F. Alleyne, "A Critical Evaluation of the Impact of Credit Union Activity upon the Social and Economic Development of Barbados: 1961-1983", Bulletin of Eastern Caribbean Affairs, Vol. 11, Nos. 4 & 5, September – December 1985; Table 1.

The relative decline in the size of commercial banks in Barbados does not necessarily mean that they have declined in economic importance. Crude indicators of their economic importance are the ratio of their assets to national income and the ratio of loans and advances to national income.[6] The results presented in Table 2 indicate that commercial banks reached their highest level of economic importance during the period 1965–1974, a period with some degree of competition in the banking industry.[7] The results also indicate a steady increase in economic importance of non-banking financial institutions; the ratio of non-banks' assets to gross domestic product increased from 23.1 percent for the period 1970–1974 to 53% during the final period of analysis. Further, the ratio of the assets of insurance companies to national income increased during the last decade, reaching a level of 13% for the period 1985–1990.

The growth in the relative size and economic importance of non-banks is attributable to a number of factors. One factor is the changes in the productive organisation of the economy which altered the requirements of both surplus and deficit units. Whereas banks in less developed countries during the review period tended to provide a particular type of service to depositors and investors, non-banks provided a more varied stream of services, catering for the needs of almost every type of potential saver or investor. Other important factors include deficiencies in certain areas of commercial banks' operations, organisation of social security, implementation of tax systems which generate incentives to personal and corporate saving, and favourable regulatory treatment.[8]

The analysis of the financial superstructure in Barbados over the period 1965–1990 has revealed some interesting results. Firstly, there was a process of financial deepening during the post-independence period. Secondly, the commercial banks, although declining in size and economic importance relative to non-banks, remained the dominant financial institutions in Barbados. Finally, the Government played an important role in altering the structure of financial intermediation in Barbados.

4. Changing Institutional Structure

(i) Monetary Authority

The Barbadian economy displayed all the characteristics of a pure colonial monetary dependence prior to the establishment of its Central Bank in November 1972: the monetary system of Barbados was integrated into the monetary system of the United Kingdom via the Sterling Exchange Standard[9] and the main financial institutions were foreign-owned and controlled to the extent that financial decisions did not reflect the needs of the domestic economy.[10]

The British Caribbean Currency Board and the Eastern Caribbean Currency Authority (ECCA), which preceded the Central Bank, functioned as regional monetary bodies. These institutions acted merely as automatic money changers and their legal framework prevented them from functioning in ways which could promote economic development of the region. The regulations governing investment policy formally prohibited the Currency Boards from investing in the territory's own local securities and hence the bodies engaged in an unreasonably high degree of foreign lending (mainly low yielding, short-dated U.K. securities). Further, the Currency Board and ECCA possessed no discretionary powers which would have allowed them to influence the activities of commercial banks. For example, the ECCA was unable to use bank rate policy to influence commercial bank interest rates in the territories in which it served [See Thomas (1972) and McClean (1975) for a detailed discussion]. Thus, with the attainment of political independence, the Governments pursued monetary reform in order to better promote economic development of the region. The first central bank in the region was established in Jamaica in 1962 followed by banks in Guyana and Trinidad and Tobago in 1966, and Barbados in 1972.

[6] One should note carefully that these summary measures give no indication of the efficiency of the operations of the financial institutions, especially from a developmental viewpoint.

[7] For a discussion on the nature of this competition, see Saunders and Worrell (1978).

[8] A discussion on the importance of the various factors comes in the next section.

[9] Under this arrangement, an expansion of currency in Barbados had to be backed by an inflow of Sterling of equivalent amount. This ensured that the currency in the colonies of the British Commonwealth was in effect similar to currency circulating within the United Kingdom.

[10] Katz (1956) described International banking as follows: "there is no reason to assume that the Head Office operates their branches as independent units working to any rigid rules regarding cash or liquidity ratios. Their management is probably more akin to that of a branch bank operating in the same country as the Head Office."

The Central Bank of Barbados commenced operations with the pivotal central banking mandate to safeguard and ensure monetary and financial stability, whilst seeking to promote economic development. The presence of the Central Bank was immediately felt with the issuance of a new currency in 1973. The establishment of the Central Bank came at a time of economic difficulty for Barbados: liquidity problems in the banking system, inflationary conditions and a weakening external position occasioned by the major shocks to the international economy during the early 1970s. The Central Bank's response was to utilize monetary policy techniques in the form of reserve and securities requirements on banks, manipulation of interest rates and selective credit controls in order to regulate the flow of credit to consumption oriented sectors [Haynes (1997)].

The Central Bank has the power to create money through lending to Government. The utilization of this facility to finance Government budget deficits has on occasions during the review period had an adverse impact on the functioning of the economy, notably in 1981 and again in the 1990-91 period.

The Central Bank's role in promoting financial stability extended to the supervision of the activities of financial institutions. The initial focus was on commercial banks but as non-banks gained prominence in the financial system, the reach of the Central Bank widened with the enactment of the Financial Intermediaries Regulatory Act of 1992. Prudential regulation was necessary to ensure that commercial banks acted judiciously in the management of its business in order to protect the financial system against systemic and other risks.

The Central Bank performs other important roles including maintaining external reserves to safeguard the external value of the Barbadian dollar, administering the country's exchange control regulations, issuing and making a market in Government securities, promoting a sound financial structure, acting as a banker to Government and commercial banks, and providing advice to Government.

(ii) Commercial Banks

Commercial banking began in Barbados with the establishment of the Colonial Bank (later to become Barclays Bank) in 1837. The banking system is dominated by banks which are branches of large firms headquartered in the United Kingdom and Canada; of the six banks present in Barbados in 1990 five were foreign-owned and accounted for 35 of the 40 banking offices and over 80% of bank deposits. The foreign-owned banks were the Barclays Bank PLC, Bank of Nova Scotia, Royal Bank of Canada, Canadian Imperial Bank of Commerce and Caribbean Commercial Bank. Indigenous banking began in 1978 with the establishment of the Barbados National Bank.

The banking industry in Barbados in 1990 conformed (and still conforms) to the theoretical requirements of oligopoly: only a few firms in the industry so that the actions of one can affect the profits of the others; bank loans and deposits are homogenous commodities and the number of banks is restricted by barriers to entry like financial regulations and the dominant market position of established banks. Under existing legislation (Banking Act 1963) commercial banks, unlike some non-bank financial institutions, were required to obtain licences from the Minister of Finance to operate and to hold minimum capital requirements on the commencement of business. Banks were also required to maintain a reserve fund after incorporation and must obtain the permission of the Minister of Finance as to terms relating to transfer of assets, consolidations, amalgamations, etc. [Williams (1988)] Other regulations applied through the Central Bank Act. These related to powers of inspection and reserve requirements; regulation of interest rates, maximum amounts of credit and minimum security for advances and similar forms of credit. Such extensive legislation was likely to deter entry to the Barbadian banking market (which is minuscule relative to those cases usually considered in the literature).

Further, the close attachment of established banks to clients, obtained through long-lasting relationships made it extremely difficult for entrants to gain a sufficient share of the market to be profitable [Zephirin (1990)]. This was indeed the case with three American banks which were established (at different times) during the period 1968 to 1971, and a fourth one in May 1974. These American banks, though introducing some measure of competitive behaviour, never gained a solid foothold in the market and by the early 1980s they all ceased operations.

Table 3 shows the trend in branch banking over the review period. The period of the 1960s and 1970s was a very dynamic one for the banking system, with a more than eight-fold increase in bank branches in the island. From a high of 50 in 1982, the number of branches declined to 40 in 1989, as a number of banks consolidated their operations during the 1980s.

The increase in the spread of bank offices has particular economic significance. "Other things being equal, the larger the proportion of the population that has access to bank facilities (and the larger the share of financial assets passing through the hands of bankers), the more effectively the banking system can discharge its functions" [Lewis (1970)]. Expansion of banking offices increases the ability of the banking system to mobilze national savings[11] and enhances the "roles of the banking system as a cost-efficient source of working capital to productive enterprises; that is, making working capital available at lower cost than self-finance alternatives, and as an efficient mechanism for domestic and international payments" [Bourne (1988 p.38)].

Table 3: Distribution of Bank Offices and Density Measures: 1959 – 1989

Year	No. of Banks	No. of Offices	Population (000s)	Population per Bank Office (000s)
1959	4	6	231	38500
1969	5	22	250	11364
1973	5	41	240	5854
1978	7	48	248	5167
1982	7	50	250	5000
1989	7	40	250	6250

Source: United Nations, Monthly Bulletin of Statistics, September 1966, 1989; United Nations, Demographic Yearbook, 1961; 1986; H. Codrington and A. Coppin, "The Financial Structure and the Allocation of Credit in Barbados, 1977–1987", Social and Economic Studies, Vol. 38, No. 4, December 1989; and survey data.

The emergence and subsequent growth of the multinational corporate structure of the banking industry can be explained by a number of economic factors. One of the underlying reasons is that finance tends to follow trade. The Barbadian economy evolved from a pure plantation economy in its early years to a fairly diversified economy by the year 1990. Indeed, from an economy dependent on agriculture with emphasis on sugar cane up to the mid-twentieth century, deliberate economic policy since the attainment of independence in 1966 resulted in the emergence of new industries and sectors like Manufacturing, Tourism and Financial Services. This shift in economic policy, strongly influenced by Lewis' (1950) development model familiarly termed the Puerto Rican Model or Industrialisation by Invitation, resulted in a substantial increase in foreign direct investment and an expansion in international trade. The substantial changes in the productive organisation of the economy introduced additional risk, thereby increasing the importance of financial intermediation. The commercial banks responded favourably to the increased demand for financial services, partly because there was the inherent fear that, in a highly competitive international banking system, failure to protect the business of foreign subsidiaries of its prime customers might, in the course of time, lead the parent firm of these foreign subsidiaries to shift globally their huge business to other large international banks.

The evidence indicates that there is a direct relationship between the growth in commercial bank operations, an increase in foreign direct investment and an expansion in international trade.[12] Between 1969 and 1979, the number of bank offices more than doubled, reaching 48 by the end of the period. Correspondingly, during the period 1970 to 1979, the volume of international trade reached its highest periodic growth rate of around 2% (in real terms) and net capital inflows (mainly direct investment) averaged $26.7 million per annum.[13] Similarly, the contraction of commercial bank operations during the 1980s occurred alongside a decline in international trade and foreign direct investment.

The Non-Bank Sector

The post-independence period saw a significant growth in the non-banking financial sector.

[11] The empirical evidence on branch proximity suggests that increased branch proximity has raised national savings significantly in Asian Developing countries [see Burkner (1980) and Asian Development (1985)].

[12] Writing on U.S. banks, Moore (1963) observed a similar relationship. He noted that during the 1920s when trade and investment were expanding, U.S. banks expanded abroad. However, during the 1930s when world depression and the drive toward autarky contracted world trade and investment, there was a corresponding contraction of the international activities of U.S. banks. For a further discussion of this point, see Huertas (1990) and Casson (1990).

[13] Source; Central Bank of Barbados, Balance of Payments, 1983 and Annual Statistical Digest, 1983.

A number of new financial institutions – National Insurance Board, Trust Companies, Mortgage Companies, Finance Houses, Credit Unions and Cooperatives, Rotating Savings and Credit Associations, and the Securities Exchange – were established and there was an expansion in the Government bond market and the operation of insurance companies.

Insurance companies became increasingly important in the process of financial intermediation, accounting for 13.6% of the financial assets of the financial system in 1990, and the ratio of their assets to gross domestic product increased to 13% for the period 1985-1990.[14] Like the commercial banking industry, the insurance industry is characterized by a multinational corporate structure. However, by the end of the review period locally-owned and controlled companies, including the Government-run general insurance company had made considerable progress. The emergence and subsequent development of the multinational corporate structure in the industry can be traced to the expansion of multinational corporations in the region with the shift in economic policy in the late 1950s and 1960s. The companies provided general insurance business for the overseas enterprises and life-insurance protection for the expatriate personnel, with the logical extension to local businesses and individuals. Thus, according to Odle [(1972) p. 69], "the expansion overseas of insurance companies was therefore a product of both conservatism and adventurousness."

The success enjoyed by life insurance companies can be explained by the favourable tax treatment of premiums and their speed of response to the demands for investment products through the marketing of a variety of fixed and variable rate policies. The growth of endowment policies suggested that individuals viewed insurance not so much as a source of possible funds for one's dependents in the case of premature death, but rather, as a way of making medium and longer-term savings, while securing additional benefits, for example, mortgages. Also, the increased demand for housing and consumer durables resulting from increases in real income levels and the expansion of indigenous businesses stimulated the growth in the general insurance industry.

The move to industrialisation in Barbados necessitated the establishment and continual expansion of special institutions engaged in medium and long-term financing, since commercial banks favoured short-term loans and overdrafts for less risky projects.[15] The Barbados Development Bank was one such institution, established in 1963. The Barbados Development Bank, which at the time was the most noteworthy "supply-leading" institution in Barbados, used funds contributed from general Government revenues, the Central Bank, sales of National Development bonds to the public and long-term borrowings from regional and international institutions.[16] Hence, it was a major source of foreign exchange for development purposes and of long-term finance.

The establishment of the Government-run social security scheme in 1967 was hailed as a landmark in the search for improvements in workers' welfare, and since then the National Insurance Fund (NIF) has contributed significantly to the overall social and economic development of Barbados. The financial assets of NIF increased from $17.1 million in 1968 to $60.3 million in 1974, an annual real growth rate of 23.4%.[17] Subsequent growth in the financial assets of NIF was facilitated by increased levels of employment, as manufacturing and tourism played more prominent roles than before.

Trust companies, affiliates of foreign commercial banks, were established in the early 1970s as commercial banks moved to diversify their loans portfolio in order to exploit a growing housing market. Trust companies emerged as important institutions in the financial system; their financial assets increased from $12.5 million in 1974 (2% of all financial assets) to $377.0 million (8.5% of all financial assets) in 1990.[18] The Barbados Mortgage Finance Corporation (BMFC) was another specialized house finance institution. It catered mainly to middle and lower income groups and was financed mainly by long-term loans, especially from NIF. The 1980s saw the introduction of finance houses, providing loans mainly for the lease/purchase of vehicles and equipment. Although they performed an important role, catering to the types of credit demands not adequately met by commercial banks and other financial institutions, their small size limited their contribution to national spending.

[14] Source: Tables 1, 2, on pages 8 and 9, respectively

[15] For a detailed discussion of commercial bank credit policy during the review period, see Wood (1994a) and Howard (2006).

[16] These included the Caribbean Development Bank, World Bank, Inter-American Development Bank and the European Investment Bank

[17] Source: Central Bank of Barbados, Annual Statistical Digest, 1983.

[18] Source: see Table 1 on page 8.

Credit unions and cooperative societies showed significant growth during the 1980s. Although they remained small relative to commercial banks and insurance companies, they increased in numbers from 27 in 1980 to 47 in 1990 with total membership moving from 5,705 to 37,587 and total assets from $5.5 million to $153.3 million in the same period.[19] Apart from mobilizing domestic savings by facilitating certain relatively untapped sources of savings, these institutions diverted savings away from commercial banks because of the easier credit conditions, whereby emphasis is placed on availability rather than the cost of lending; simple bureaucratic structures and personalised service; and some Government incentives. Savings with credit unions were allowed as claims against income tax liabilities. The growth in credit union activity was also facilitated by favourable regulatory treatment [see Williams (1988) and Codrington and Coppin (1989)].

The bond and stock markets complement the traditional financial institutions as sources of finance for the private and public sectors, and as alternative types of financial assets. While the Securities Exchange of Barbados (SEB) was established in June 1987, activity on the bond market had already started with the issuance of Government securities. The value of Government issues was $35.9 million by 1970, representing 9.9% of gross domestic output. Over the review period there was a significant increase in Government bond issues; the value of claims against the Government reached $882.0 million by 1990 representing 25.6% of gross domestic product (Table 4). Almost half of these Government securities were held by commercial banks mainly as a result of statutory requirements.

TABLE 4

Bonds Outstanding: 1970 – 1990
(BDS$ million)

Year	Treasury Bills	Debenture/ Treasury Notes	Savings Bonds	Total Claims	Claims /GDP (%)
1970	6.9	29.0	-	35.9	9.9
1975	56.9	82.4	-	139.3	17.1
1980	164.2	130.6	-	294.8	17.0
1985	405.0	154.7	6.9	566.6	23.5
1990	506.2	341.2	34.6	882.0	25.6

Source: Haynes (1997)

The final formal financial institution established during the review period was the Securities Exchange. Prior to the establishment of the Securities Exchange, limited trading of shares was done in an informal manner. Shares were either sold in settlement of debt or traded informally by Trust Companies and Solicitors who assembled willing buyers and sellers. However, the illiquidity of the corporate shares and the high transactions costs acted as barriers to vigourous trading in shares under this unstructured framework. Long and Veneroso (1979) noted that "in countries where there is no stock market, equities more closely resemble real assets than financial assets." The motivation behind the setting up of the SEB was the desire to broaden the range of assets available to potential savers and encourage the raising of investment funds through new issues, rather than borrowing, in order to stimulate the growth of new ventures and to reduce the high debt-equity ratios of enterprises. It was expected that the Exchange would introduce greater efficiency in the trading of securities and maintain a reliable and reputable securities market for the protection of the investing public of Barbados. Politically, the Exchange, by facilitating a widening of the base of private capital ownership, was seen as a vehicle through which some degree of economic democracy could be achieved in Barbados.[20]

The Government played some part in promoting the growth of share ownership and encouraging equity financing; a tax on the appreciated value of shares was abolished, and new share purchases and the issuance of bonus shares made tax exempt since 1978. Property transfer taxes on shares passing through the Exchange were lifted in the budgetary proposals of April 1987 in order to remove the burden of added costs on the transfer of share ownership. Further, Worrell (1989) noted that the Income Tax Regulations made provisions for individuals to receive credit for taxes paid by the firm on earnings from which they receive dividends.

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[19] Source: Barbados Cooperative Credit Union League Limited, Annual Reports.

[20] For a discussion on the issue of economic democracy in Barbados, see Beckles (1989)

However, despite Government's efforts and the launching of an educational programme to help promote the exchange, a number of institutional and other factors have inhibited the development of the stock market [see Wood (1994b, 1998) for a discussion].

Rotating savings and credit associations (ROSCAs), commonly known as meeting turns, were very active in Barbados during the review period.[21] This popular form of informal finance has a simple organizational structure: a small number of individuals form a group and select a leader who periodically, for example weekly, fortnightly or monthly, collects a given amount (a payment) from each member; the money collected is then given in rotation to each member of the group. In the common form of ROSCAs existing in Barbados, the loans are interest free and the amount a member receives is equal to the total amount expected to be paid by the member over a cycle of payments.[22] In most ROSCAs, the leader receives no special benefits besides getting the first payment (or turn). The success of ROSCAs depends crucially on the honesty of members; ROSCAs, like credit unions, usually comprise members from social or work organizations, or a particular geographical locale. The popularity of ROSCAs among low- and middle–income groups shows that individuals like to make short-term savings even under difficult circumstances.

5. CONLUSION

This paper examined in some detail the development of the Barbadian financial system during the twenty-five years after the country gained independence from the United Kingdom in 1966. A number of highlights emerged from the analysis. First, consistent with the findings of Goldsmith (1969), as the Barbadian economy developed there was a declining share of commercial banks and an increasing share of non-bank financial institutions in relation to the total assets of the financial system. This phenomenon is indicative of the significant institutional changes, especially in the non-bank sector.

Second, the changes in the institutional structure of the financial system have been due, in large measure, to the initiatives of Government in establishing and encouraging a wider array of institutions and instruments to broaden the scope of financial intermediation for economic development.

Third, the shift in economic policy resulted in changes in the productive organisation of the economy, increase in international trade and improved incomes for Barbadian workers. These developments created a demand for new financial services and institutions, thereby enhancing the importance of financial intermediation.

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[21] ROSCAs have various aliases: for example, Tandu in Mexico, Syndicate in Belize, Kye in Korea [see World Bank (1989) p. 114]. For a discussion on the characteristics of ROSCAs and their role in mobilizing domestic savings in LDCs, see Adams and de Sahonero (1989) and Jerome (1991).

[22] A cycle of payments is the number of payments which must be made (by each member) to enable each member of the group to obtain a loan (turn) of equal amount.

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