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# Introduction

**Roland Craigwell, Kevin Greenidge and Marion Williams**

The process of financial markets liberalisation in Barbados has been gradual and has extended over the past 15 years. It is generally recognised that liberalisation of financial markets and the development of active capital markets should proceed simultaneously if a country is to benefit from greater synergies. Consequently, efforts are being made to accelerate the development of capital markets in Barbados. Other Caribbean countries, such as Trinidad and Tobago and Jamaica, have liberalised their systems much more rapidly than Barbados.

This book, titled **Aspects of Financial Liberalisation and Capital Market Development in the Caribbean**, provides an analysis of the likely influences of liberalisation in the Caribbean region on financial stability, maintenance of the exchange rate, international reserves, the development of the financial sector, competition and economic growth. It is anticipated that financial liberalisation will lead to acceleration in the development of the money and capital markets.

The book is divided into ten chapters, including the introduction. Chapter 2, by Kevin Greenidge and Chris Milner, discusses the literature on financial liberalisation and the progress made in implementing liberalised systems in the Caribbean over the past 15 years. Of considerable interest is the development of an index of financial liberalisation, which indicates that the pace and the order of liberalisation in the various Caribbean economies considered, differed significantly over the period. Countries in the developed and developing world typically proceeded with external financial liberalisation after or alongside the liberalisation of the domestic financial sector, but never before. The sequencing of liberalisation in the Caribbean tended to follow that convention.

Chapter 3, also authored by Kevin Greenidge and Chris Milner, deals with the impact of financial liberalisation (domestic and international) on economic growth, paying particular attention to the view that the link between financial liberalisation and economic growth depends on the country's internal level of development, measured by robust indicators of financial development and trade liberalisation. The empirical model is estimated for Barbados, Jamaica and Trinidad and Tobago using a time series approach based on dynamic ordinary least squares (DOLS).

The results are quite diverse: financial liberalisation has a negative long-run effect on real output in Barbados, while its influence on Trinidad and Tobago's output is positive, although after controlling for investment and financial development, it was found that financial liberalisation did not significantly raise long-run output levels in Trinidad and Tobago. The findings reveal that financial liberalisation had no significant impact on the equilibrium level of output.

In Chapter 4, Kevin Greenidge and Alvon Moore, using DOLS, look at the effect of financial liberalisation on financial development in Barbados, Jamaica and Trinidad and Tobago. As in Chapter 4, the results were quite different for the three countries evaluated. For Barbados, both international and domestic financial liberalisation had a positive impact on the rate and equilibrium level of financial development. However, for Trinidad and Tobago, only domestic financial liberalisation had long and short-term positive effects on financial development. In contrast, the analysis for Jamaica failed to reveal any significant relationship between either domestic or international financial liberalisation and financial development in the short or long run.

Chapter 5, by Daniel Boamah, Roland Craigwell, Darrin Downes, Kevin Greenidge and Travis Mitchell, investigates the macroeconomic impact of capital account liberalisation on private capital inflows in certain Caribbean countries and the extent to which such inflows would have translated into higher investment. The stylised facts suggest that there is an upward shift in private capital flows after capital account liberalisation and a consequent rise in investment levels. However, rigorous econometric analysis only supported the first hypothesis in the case of Jamaica and Trinidad and Tobago. The findings for Barbados and Guyana point to a negative relationship between capital account liberalisation and private capital inflows, which presumably reflects increased outflows following the easing of capital account restrictions. With regard to the second hypothesis, the evidence upholds the notion that private capital flows complement private investment in Barbados, Guyana and Trinidad and Tobago, but not in the case of Jamaica where greater private capital inflows were associated with a decline in private investment.

Chapter 6, by Roland Craigwell, Darrin Downes and Kevin Greenidge, discusses the demand for international reserves in Barbados over the past three decades. The results from the empirical model estimated suggest that in the long run the demand for reserves is positively related to real national income, the propensity to import and a liberalisation measure constructed to capture the level of restrictions on capital account transactions, supporting the writers' *a priori* reasoning. The impact of the average propensity to import has the strongest influence on net international reserves (NIR), followed closely by real national income. Unexpectedly, net lending to the central government by

the Central Bank and the variability in reserve holdings were found to have negative relationships with the demand for reserves.

Chapter 7, by Winston Moore, assesses the impact of the growth of debit cards on the commercial banks' payments and settlement systems. Costs are seen as an important factor for commercial banks and a great deal of attention is paid to this in utilising the methodology for forecasting the likely use of debit cards. A conservative forecast suggests a rise in debit card transactions to $4 million per year by 2010 using one technique, or $7 million a year using a less conservative approach. The author's analysis also focuses on the incentives of commercial banks vis-à-vis promoting offline debit cards as compared with online debit cards. The study posits that this payment method has the potential to become the most important means of payment in Barbados.

Chapter 8, by Roland Craigwell, Channel Maxwell, Stacia Howard and Tracy Maynard, examines the extent of competition in Barbadian banks, as measured by their profit-maximising comparative static properties. The study analyses the factors influencing the change in the degree of competition over the period 1990-2004. The results show that increases in economic activity and the deregulation of loan rates resulted in higher levels of competition in the commercial banking industry in Barbados and implied that with the gradual liberalisation of loan rates, commercial banks were now in a position to use loan rates as a competitive tool. However, market concentration, the inflation environment, mergers and acquisitions and the growth of the mutual funds industry did not appear to significantly affect the degree of competition. It was suggested that the implementation of CARICOM Single Market and Economy (CSME) and likely cross border corporate lending would impact on the level of competition in the future.

Chapter 9, authored by Marion Williams, looks at the motivation for derivatives trading and the likely scope for the development of an active derivatives market in the Caribbean. The paper notes that derivatives markets thrive on well- developed money and capital markets, which are not present in the Caribbean. In addition, the author contends that developing a derivative market in the Caribbean would require the authorities to weigh the possible speculation and greater risk-taking behaviour against the need for a framework of mitigating risk in cross border transactions. The paper also discusses the consequences for fledgling markets of the recent increase in global oversight of the derivatives market and the concern of regulators in developed markets about the implications of a failure of counterparties to fulfil their obligations. It was suggested that the high cost of failure compared with the advantages to be gained from limiting downside risks, should be carefully weighed.