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Finance for Firms

Options for Improving Access and Inclusion

IDB | IDB Invest

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Regional Overview: Finance for Firms—Options for Improving Access and Inclusion

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Introduction

This edition of the Caribbean Economics Quarterly (Q2-2022)[1] focuses on firms' access to finance. The report begins by considering both the nature and history of the region's financial sector development, highlighting some key measures of financial access and adequacy. It then leverages enterprise survey data developed by the Compete Caribbean partnership[2] to assess legacy and emerging challenges facing firms from across the region. Newly available data from the end of 2020 are compared with a previous vintage of the surveys from 2014, providing important insights into how circumstances have evolved, especially considering the COVID-19 shock to businesses and economies across the region.

The analysis suggests that (i) financial sectors and firms across the Caribbean face outsized challenges, particularly when compared to peers across the globe; (ii) the COVID-19 crisis appears to have further constrained access to finance; (iii) smaller firms appear to face more significant hurdles than larger firms; and (iv) women-owned and/or operated firms face more severe challenges with respect to financial access than other firms across the region.

This report focuses on both challenges and solutions. It also highlights some of the many interventions that the IDB Group—particularly IDB Invest—has undertaken across the region, leveraging the institution's technical expertise, financial resources, and cross-country experience to catalyze existing and new sources of finance to help accelerate financial sector deepening and economic development.

As always, this edition of the Caribbean Economics Quarterly also includes individual country sections that provide a deeper country-focused review of related considerations.

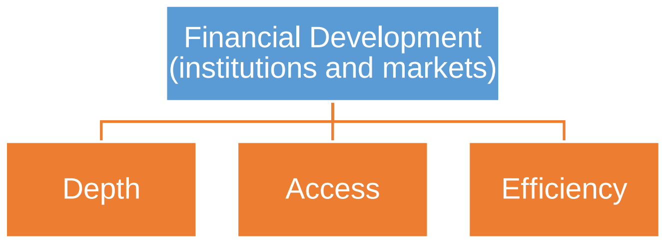
[1] The analysis in this periodical covers six Caribbean countries that are part of the IDB Caribbean Country Department: The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.

[2] Surveys referenced in this publication include the (i) Compete Caribbean 2014 Productivity, Technology, and Innovation in the Caribbean (PROTEqIN) Survey; (ii) Compete Caribbean 2020 Innovation Firm Performance and Gender (IFPG) Survey; and (iii) the 2022 Compete Caribbean Innovation, Firm Performance and Gender Issues in the Caribbean dataset. Compete Caribbean is a partnership of the IDB, Foreign, Commonwealth & Development Office (FCDO), Caribbean Development Bank (CDB), and the Government of Canada. "Innovation, Firm Performance and Gender issues in the Caribbean dataset". Other publicly available data are also referenced. See https://www.competecaribbean.org/proteqin-ifpg-datasets/.

Financial Development Defined: Depth, Access, and Efficiency[3]

Financial institutions and markets fulfill several critical functions in modern economies, including (i) enabling transactions across space and over time, thus facilitating division of labor and specialization in the economy; (ii) pooling savings and intermediating them to enterprises and households in need of external funding; (iii) screening borrowers and their projects and monitoring them, thus deciding where society's scarce resources are being invested; (iv) reducing liquidity risk for savers by allowing them ready access to their funds while investing the same resources for long-term purposes; and (v) enabling cross-sectional and intertemporal risk diversification. This report focuses on financial development in six Caribbean countries, with a particular focus on firms' access to finance—one of the three broadly acknowledged pillars of financial development: depth, access, and efficiency (Box 1).

Box 1. Financial Development—Selected Subcomponents and Indicators



	FINANCIAL INSTITUTIONS	FINANCIAL MARKETS
DEPTH	• Private sector credit (percent of GDP) • Pension fund assets (percent of GDP) • Mutual fund assets (percent of GDP) • Insurance premiums, life, and non-life (percent of GDP)	• Stock market capitalization to GDP • Stocks traded to GDP • International debt securities, government (percent of GDP) • Total debt securities of corporations (percent of GDP)
ACCESS	• Branches (commercial banks) per 100,000 adults • Tellers per 100,000 adults	• Percent of market capitalization outside of top 10 largest companies • Total number of issuers of debt (domestic and external, nonfinancial corporations, and financial corporations)
EFFICIENCY	• Net interest margin • Lending-deposit spread • Non-interest income to total income • Overhead costs to total assets • Return on assets/Return on equity	• Stock market turnover ratio (stocks traded/capitalization)

Source: Beck and Mooney (2021).

[3] This and other sections of this report draw on Beck and Mooney (2021).

Financial Development and Access: The Cornerstones of Development

Empirical evidence on the relationship between financial depth and growth points clearly to a positive role in the economic development process. There is strong evidence that deeper and more efficient financial systems help increase growth and reduce poverty and income inequality. While an exhaustive survey of the literature is beyond the scope of this report, some of the most relevant findings are outlined below (drawn largely from Beck and Mooney 2021).

Growth Performance

An expansive literature has documented a positive relationship between financial and economic development—particularly with respect to incomes. Specifically, countries with higher levels of financial development (as measured by private credit as a proportion of GDP) experience higher per capita income growth rates over the long run.[4] This relationship holds even after controlling for reverse causation (i.e., faster-growing economies having a higher demand for financial services) and third factors driving both financial development and growth. The positive relationship between financial and economic development is strongest among middle-income countries (Rioja and Valev 2004a, 2004b).

The positive impact of financial development on output growth comes mainly through more effective resource allocation and higher productivity growth, rather than through capital accumulation, and more through enterprise than household credit.[5] This is confirmed by an expansive literature using micro-data that shows that financial deepening has positive effects on firm-level innovation and entrepreneurship, with a disproportionally beneficial effect for small and medium-sized enterprises.[6]

Job Creation

There is increasingly significant evidence that financial deepening can help create jobs. For example, at the aggregate level, Pagano and Pica (2012) show a positive and significant relationship between financial development and job creation in developing countries. For the United States, Beck, Levine, and Levkov (2010) and Benmelech et al. (2011) show that branch deregulation and consequent financial liberalization led to decreases in unemployment and increased labor market participation, especially among low-skilled workers. Gine and Townsend (2004) show for Thailand that financial liberalization has contributed to migration of subsistence agricultural workers into urban salaried jobs.

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[4] See Levine, Loayza and Beck (2000) and Beck and Levine (2004). See Popov (2018) for a survey of empirical literature.

[5] See Beck, Levine and Loayza (2000) and Beck et al. (2008).

[6] See Ayyagari, Demirguc-Kunt and Maksimovic (2008), Beck, Demirguc-Kunt and Maksimovic (2005), Beck, Demirguc-Kunt, and Laeven and Levine (2008).

Income Inequality and Poverty

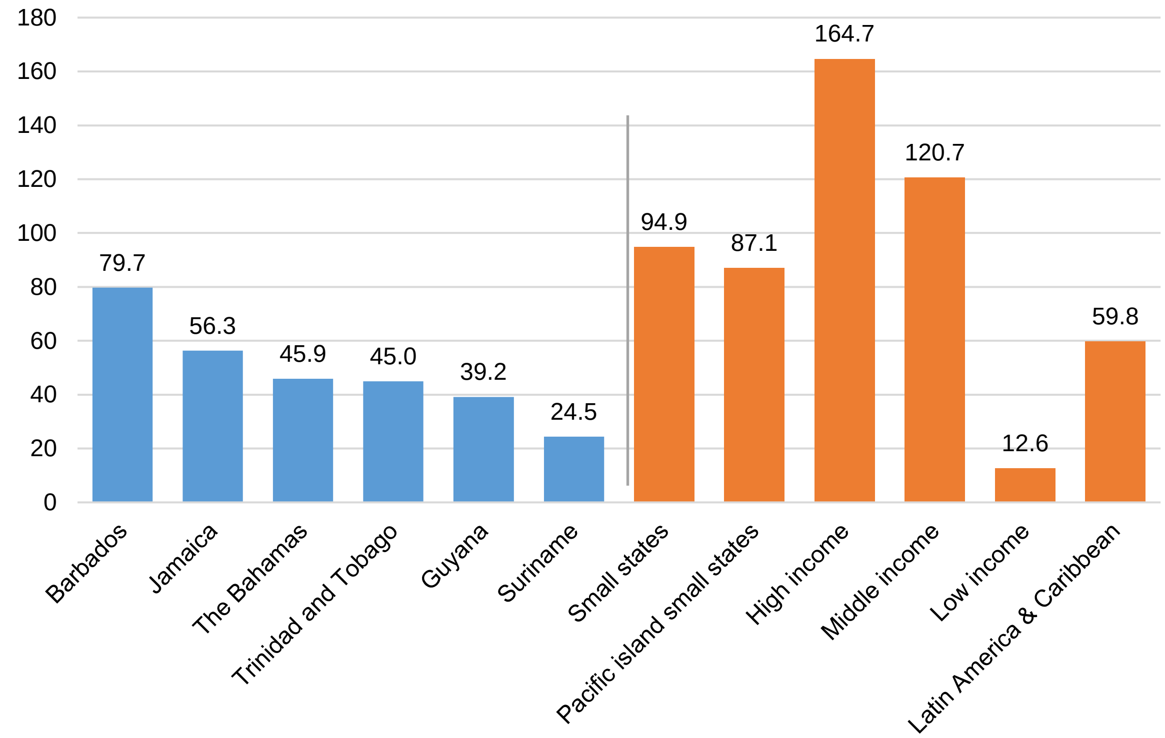
There is also increasing evidence that financial development can help reduce income inequality and poverty rates. Beck, Demirguc-Kunt, and Levine (2007) and Clarke, Xu, and Zou (2006) show a negative relationship between financial development and income inequality, while Beck, Levkov, and Levine (2010) show a negative relationship between financial liberalization and income inequality in the United States. Gine and Townsend (2004) and Ayyagari, Beck, and Hoseini (2020) show a negative relationship between financial development and poverty in Thailand and India, respectively. Evidence also suggests a negative association between financial development (again measured by private credit to GDP) and the growth of extreme poverty—that is, the share of the population living on less than US$1 per day. As shown by Beck, Demirguc-Kunt, and Levine (2007), this relationship is robust to controlling for reverse causality and omitted variable bias. As in the case of finance and growth, the relationship does not necessarily come through a larger share of the population with access to credit, but rather from financial deepening resulting in labor and product market effects that positively affect the poorer segments of the population.

Financial Depth in the Caribbean in Historical and Comparative and Perspective

The latest available data on the ratio of domestic private credit to GDP—the most common indicator of sector depth[7]—ranges from as high as about 80 percent for Barbados, to as low as about 25 percent for Suriname (Figure 1).[8] The six Caribbean countries analyzed here compare poorly with the average for both high-income and middle-income countries, which stood in 2022 at 165 percent and 121 percent, respectively.[9] The countries also fare poorly when compared to the regional Latin American and Caribbean average. Only Barbados has a deeper financial sector than the regional average of 60 percent. Country size does not seem to be the determining factor, since the six countries are also all below the average for small states, globally, as well as Pacific Island small states.

[7] Domestic credit to the private sector refers to financial resources provided to the private sector by financial corporations—such as through loans, purchases of nonequity securities, trade credits and other accounts receivable—that establish a claim for repayment. Financial corporations include monetary authorities and deposit money banks, as well as other financial corporations for which data are available (including corporations that do not accept transferable deposits but do incur such liabilities as time and savings deposits). Examples of other financial corporations are finance and leasing companies, money lenders, insurance corporations, pension funds, and foreign exchange companies (definition from World Development Indicators database).
[8] Based on World Bank and International Monetary Fund data.
[9] Income groups are defined per the World Bank's definition. As of 1 July 2021, low-income economies are defined as those with a GNI per capita of US$1,046 or less; middle-income economies are those with a GNI per capita between US$1,046 and US$12,695; and high-income economies are those with a GNI per capita of US$12,695 or more.

Figure 1. Private-Credit-to-GDP Ratio, 2020 or Latest Available (Percent)



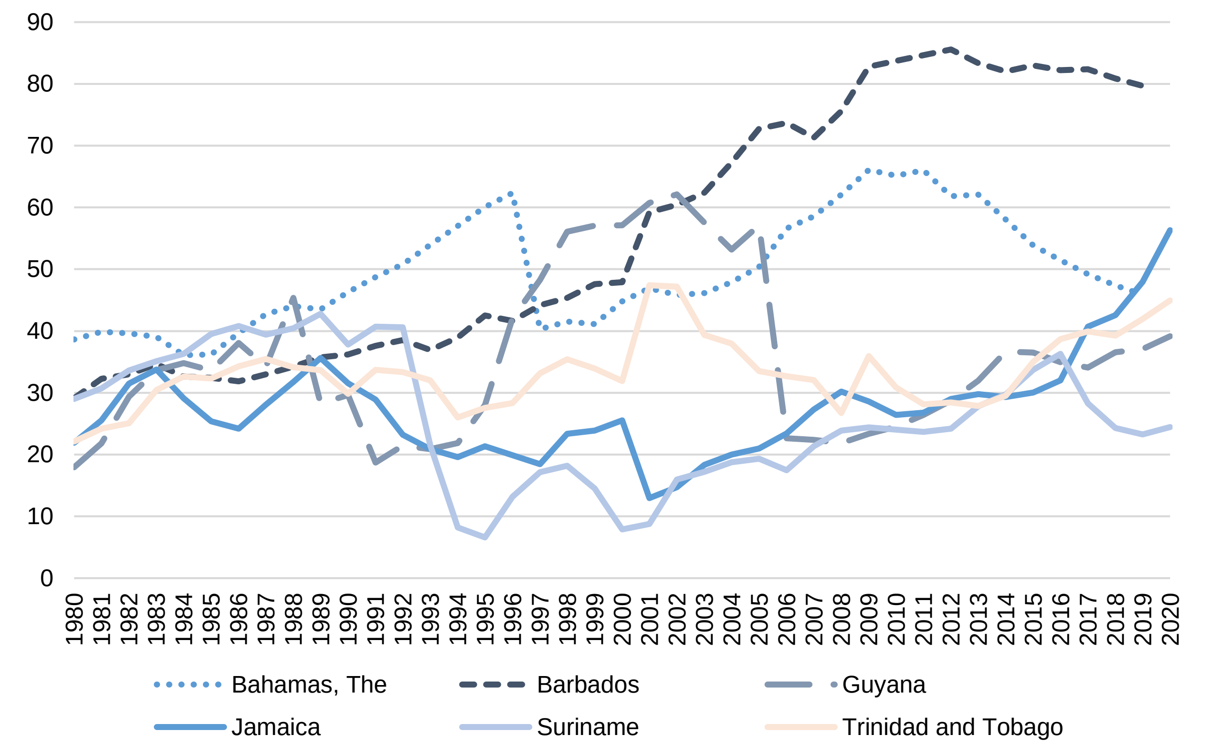
Source: World Bank, World Development Indicators.
Note: Data for Barbados and The Bahamas are for 2019. Low-income aggregate data are for 2015.

Some countries have seen the pace of deepening accelerate considerably since the 1980s, while other countries' financial sectors have remained stagnant or experienced considerable volatility in terms of credit capacity. For example, Barbados has experienced rapid private credit growth (measured as a proportion of GDP) since the 1980s. Jamaica has seen the credit market grow appreciably since about 2016, coinciding with successful economic reforms and rapid public debt consolidation after years of decline.[10] In Guyana, Trinidad and Tobago, and Suriname, market depth has oscillated significantly owing to fluctuations in both the numerator and denominator of this ratio. However, credit market development has stalled since 1980 for Suriname (Figure 2).[11]

[10] In the case of Jamaica, a lack of fiscal discipline, high public debt, and resulting difficulties in maintaining continuous access to external credit markets forced the Jamaican government to rely on domestic financial markets—particularly the banking system—to meet a large proportion of its funding needs. Given the limited size of the domestic credit market, this heavy reliance resulted in a crowding out of private financing, as banks and other lenders allocated most of their credit capacity to the government. See Mooney (2018) for more information.

[11] For a deeper discussion of country-specific factors, see Beck and Mooney (2021), Gauto and Mooney (2020), Giles Álvarez and Mooney (2020), and Mooney (2018). Also see the country sections of this Bulletin.

Figure 2. Private Credit to GDP Ratio, 1980–2020 (Percent)



Sources: World Bank, World Development Indicators; International Monetary Fund, *World Economic Outlook*; and authors' calculations.

Financial Sector Structure and Nonbank Finance

As discussed above, financial systems consist of different segments, often centered at their core around deposit-taking institutions and other credit providers, with public capital markets and contractual savings institutions representing more evolved segments of the system. While different segments may serve a variety of clients and purposes, their functions in terms of intermediating savings and managing risks for the economy are similar. As economies develop, the structure of the financial system also develops (Beck and Mooney 2021). At basic levels of financial development, banks dominate the financial system, focusing on payment, short-term deposit, and short-term lending services. As financial systems deepen, other segments arise, including insurance companies and other private nonbank intermediaries. At a later stage, public equity and debt markets develop.

This sequencing has also been observed in the Caribbean countries, to varying degrees. All six countries analyzed here have stock exchanges of reasonable size relative to GDP (Figure 3, panel a), though they are highly concentrated in terms of the number of issuing firms, and they tend to be illiquid—that is, market capitalization (value of all outstanding shares) relative to GDP

tends to be relatively high, while turnover ratios (trading volume relative to market capitalization) are very small (in the single digits) relative to regional or middle-income country averages (Figure 3, panel b). In 2020 (latest available data), stock market capitalization in Trinidad and Tobago (91 percent of GDP), Jamaica (85 percent), Barbados (64 percent), and The Bahamas (48 percent) compared well with the Latin American and Caribbean average.

Figure 3a. Stock Market Capitalization/GDP, 2020 (Percent)

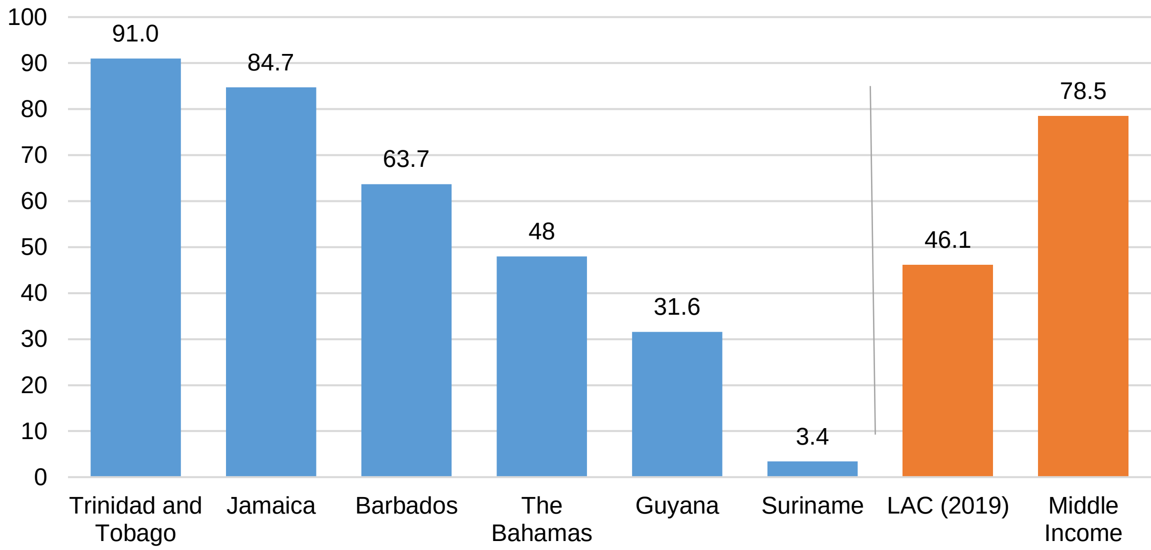
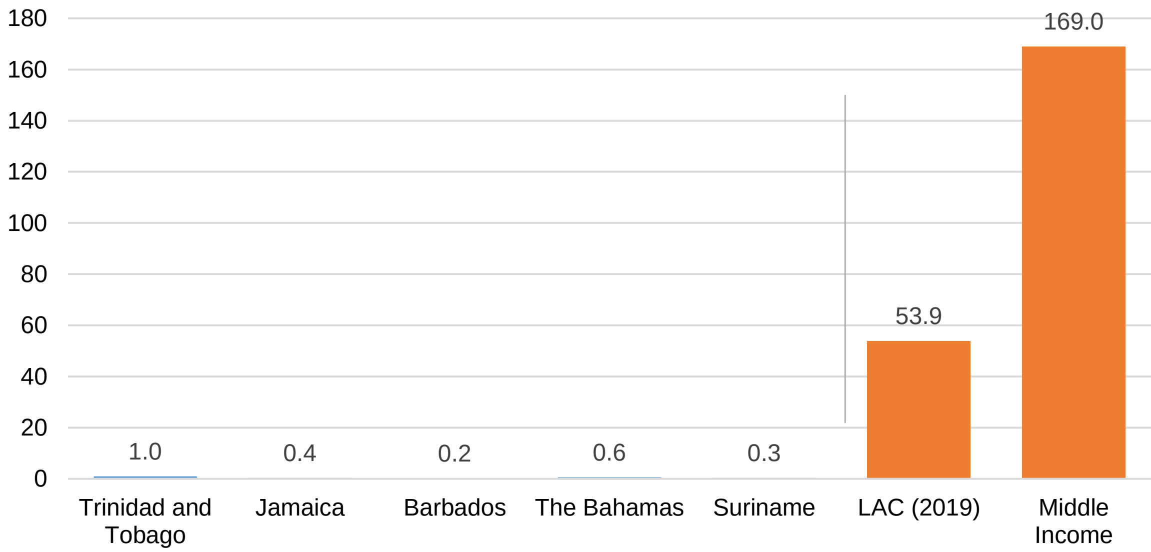


Figure 3b. Turnover Ratio, 2020 (Percent)



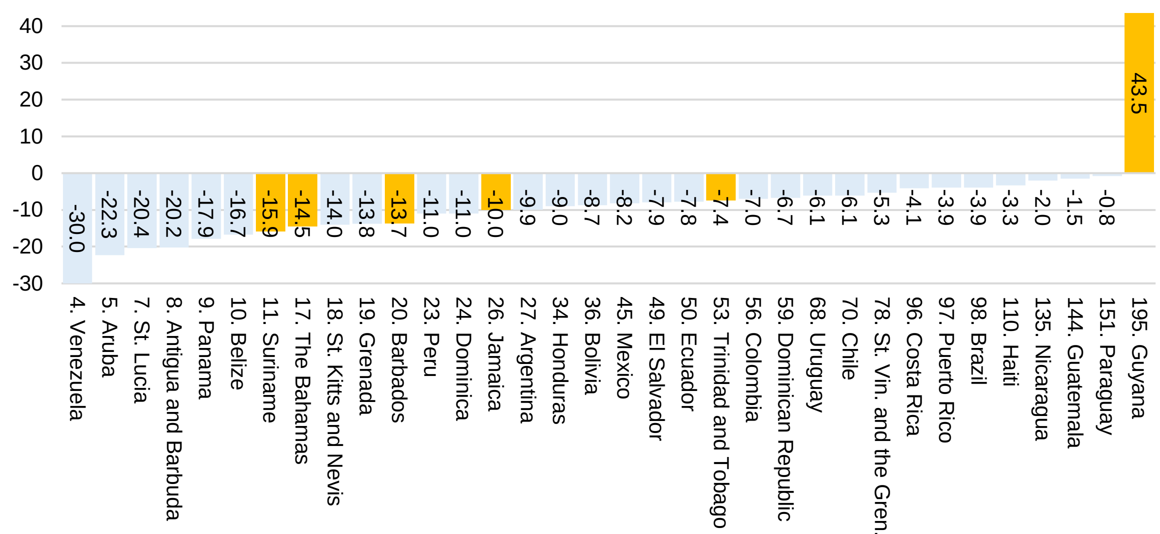
Sources: World Bank, World Development Indicators; and country sources.
Note: LAC: Latin America and the Caribbean.

COVID-19 and Finance in the Caribbean

Latin American and Caribbean Economies Have Suffered the World's Deepest Shock

Before focusing on the survey data regarding firms' access to finance, it is important to review the overall macroeconomic context during which the survey was conducted. The economic crisis associated with the COVID-19 pandemic was an extreme outlier in terms of the speed and depth of the shock, and it affected Latin American and Caribbean economies more severely than any other region in the world. Out of 195 countries globally for which consistent data were available, 11 of the 20 most significant negative shocks to real GDP growth in 2020 were from Latin America and the Caribbean (Figure 4). Ironically, the world's-fastest growing economy was also from the region—Guyana's recent resource discoveries drove 44 percent growth in 2020. The severity of the shock was amplified for the region given many countries' preexisting vulnerabilities and economic structures—particularly for those Caribbean economies that are dependent on tourism. That said, the sharp recession would have been worse had it not been for policy actions taken by governments in the region, as discussed in earlier editions of this periodical. As the region recovers in 2022 and beyond, it is important to note that sharply rising commodity prices, driven to a large degree by the war in Ukraine, imply a high degree of uncertainty regarding economic prospects.

Figure 4. The COVID-19 Shock to Growth: Caribbean Economies Among the World's Worst Affected (Percent change in real GDP for 2020)



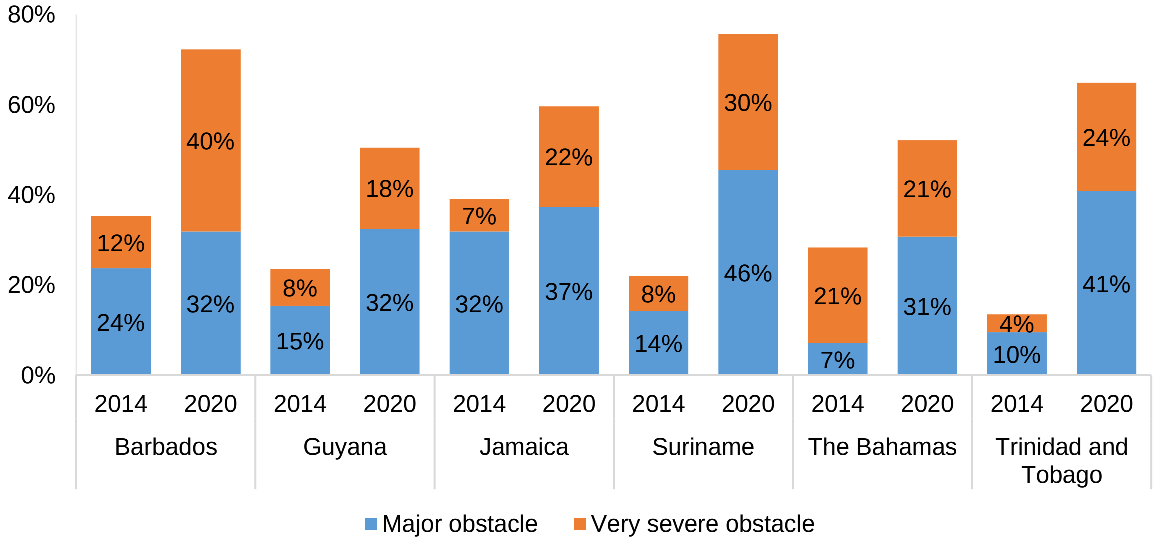
Source: Authors' calculations based on data from the International Monetary Fund's April 2022 *World Economic Outlook.*
Note: Latin American and Caribbean countries ranked by severity of shock compared to 195 countries globally.

Deteriorating Financial Access in the Caribbean

Despite the breadth and depth of policy measures and their relative success in averting corporate and financial sector defaults across the region, new data from surveys sponsored by the IDB and partner agencies suggest that firms across the Caribbean saw a considerable deterioration in access to credit and related products at the end of 2020.[12]

As detailed in Figure 5, for most Caribbean countries the proportion of firms surveyed that reported access to credit as a significant barrier to their operations and activities increased between 2014 and 2020—in some cases, considerably. It is worth noting that the 2020 survey is based on responses solicited in December 2020, which was the most uncertain and severe stage of the COVID-19 crisis. As a result, it is likely that some of these constraints would have eased since then as economies and borders have reopened. That said, other economic and financial concerns have emerged since 2020, including the global acceleration of inflation driven in part by commodity price shocks and supply-chain issues (IDB 2022). Similarly, after a period of extraordinary policy intervention and accommodation, governments and central banks throughout the world have begun unwinding emergency stimulus measures, while simultaneously tightening rates and financial conditions to fight rising prices. In this context, firms in the Caribbean and elsewhere now face new and increasingly severe financial headwinds.

Figure 5. Survey-Reported Barriers to Financial Access for All Firms, 2014 vs. 2020
a. Barriers to Credit Access (e.g., Collateral Requirements)



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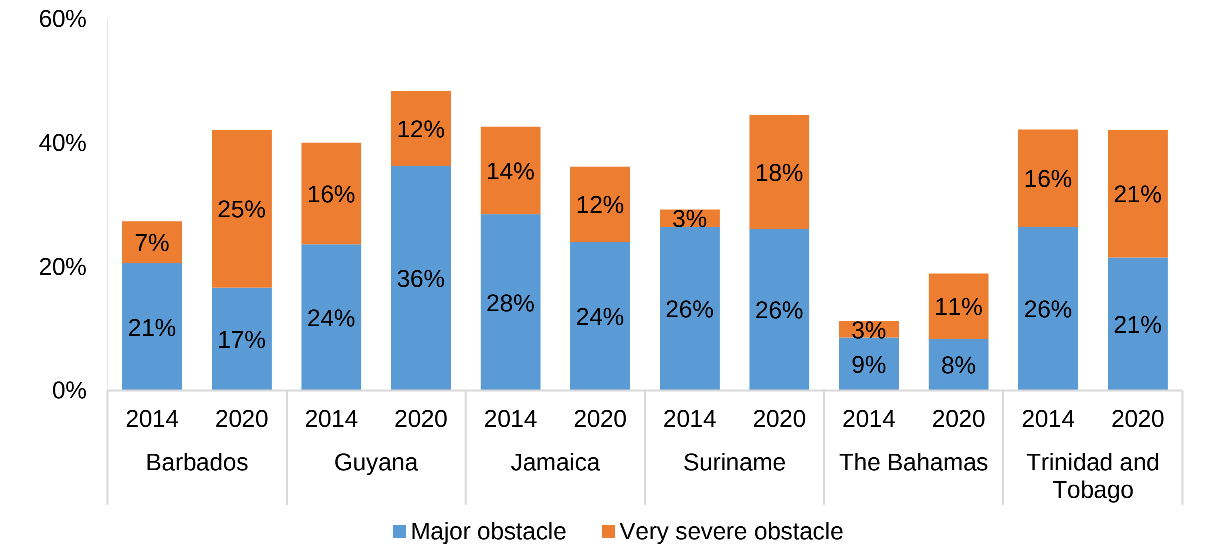
[12] Compete Caribbean, a partnership of the IDB, the Foreign, Commonwealth and Development Office (FCDO), Caribbean Development Bank, and the Government of Canada, sponsored surveys of firms in 2014 and 2020. The former survey was the 2014 Productivity, Technology and Innovation in the Caribbean (PROTEqIN) Survey and the latter was the 2020 Innovation, Firm Performance and Gender (IFPG) Survey.

b. Barriers from Cost of Credit (e.g., Interest Rates)



Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG).

Firms surveyed in each of the six Caribbean economies analyzed here reported a tightening of financial conditions with respect to access to credit. As illustrated in panel a of Figure 5, at end-2020, 76 percent of firms in Suriname and 72 percent of firms Barbados reported issues such as significant collateral requirements driving major or very severe obstacles to their performance and ability to do business. This is up from 22 percent and 35 percent, respectively, reported in 2014. Similarly troubling developments are also reported for the other countries. As highlighted in panel b of Figure 5, firms from most countries across the region also report a deterioration of conditions based on the cost of credit. Over 40 percent of firms in Barbados, Guyana, Suriname, and Trinidad and Tobago reported high interest rates as a significant barrier to their operations in 2020. For most of these countries, these concerns became more acute between 2014 and 2020. The only country for which firms in aggregate reported this being less of a constraint in 2020 than in 2014 was Jamaica, though even there, 36 percent of businesses flagged this as a concern.

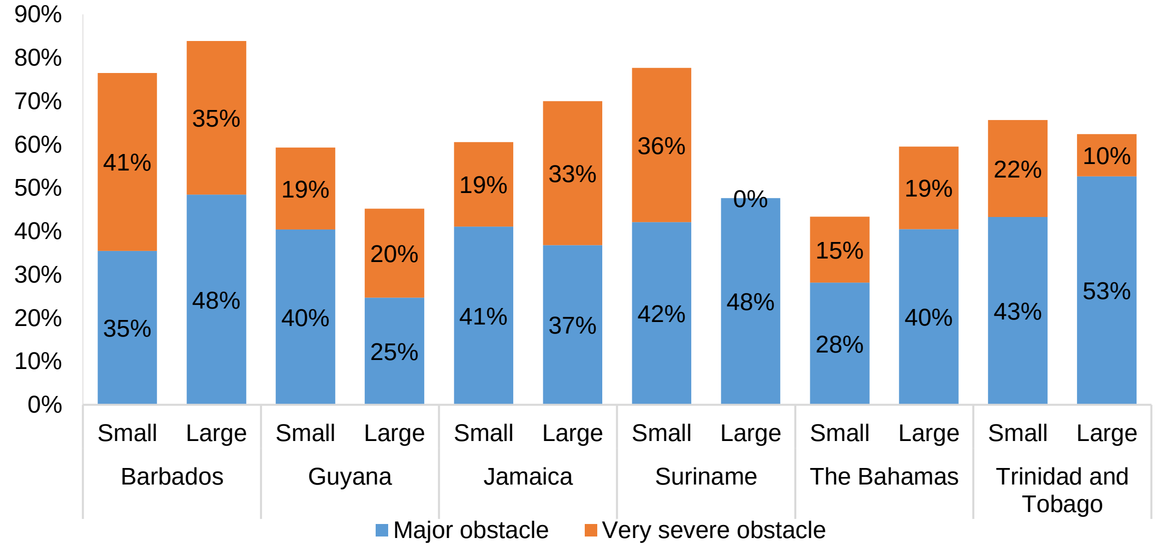
Access to Finance by Firm Size

A deeper dive into the data for end-2020 also highlights the degree to which access to finance seems to have adversely affected different categories of firms. The evidence appears mixed in terms of access to credit driven by high collateral requirements, with small firms (i.e., those with less than 20 employees) reporting more severe difficulties than larger firms in Guyana, Suriname, and Trinidad and Tobago (Figure 6, panel a). Responses were more consistent in terms of barriers driven by high costs of credit, with small firms from five of six economies

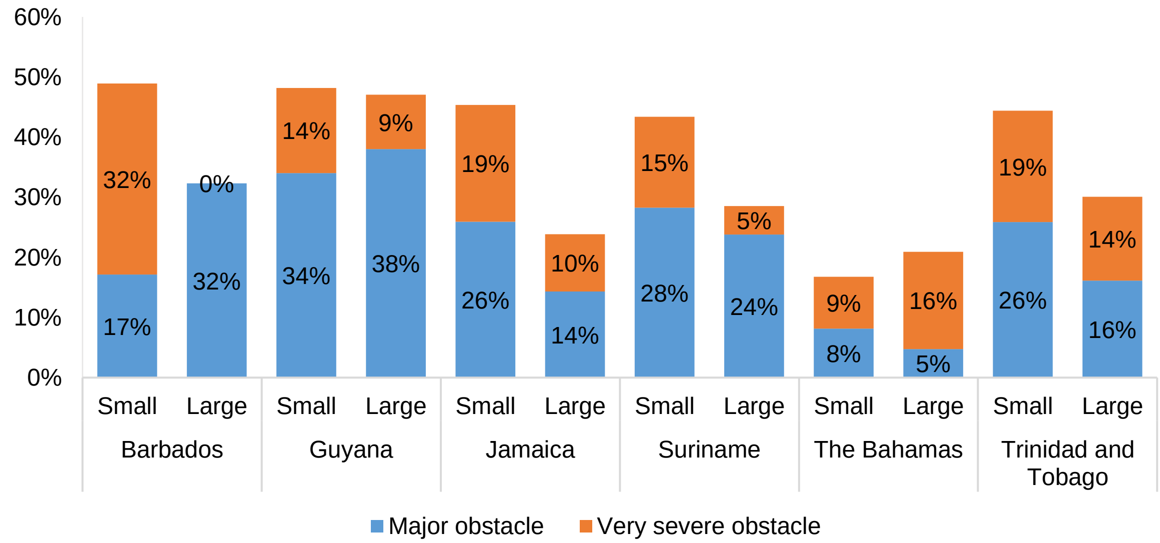
reporting more severe challenges than large firms. Only large firms in The Bahamas reported more severe constraints than smaller enterprises.

Figure 6. Survey-Reported Barriers to Financial Access for Firms by Size, 2020

a. Barriers to Credit Access (e.g., Collateral Requirements), by Firm Size



b. Barriers from Cost of Credit (e.g., Interest Rate) by Firm Size



Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG).

Access to Finance Based on Gender

Survey evidence suggests that women-owned and women-led firms (WOFs)[13] face greater financial constraints than other firms. Over the last 20 years, WOFs report having accessed approximately 20 percent of the volume of all short-term credit granted, defined as loans with maturity less than three years. This is consistent with the share of these types of companies in the Caribbean, and includes lines of credit, overdraft facilities, and credit cards. However, WOFs only accessed 1.3 percent of medium-to-long-term loans (by volume) granted in the same period. Loans allocated to these firms are also of lesser value, on average, than those allocated to other companies. The average size of a short-term loan granted to WOFs was US$163,497. This amount lags the average granted to other firms of US$215,227. However, this difference can be partially explained by the fact that WOFs in the sample are about half as large, on average, in terms of the number of employees. That said, in terms of medium-to-long-term loans the average loan size was about one-tenth the value (US$156,178) for WOFs than for other firms (US$1.54 million)—something that cannot be explained by the average number of employees.

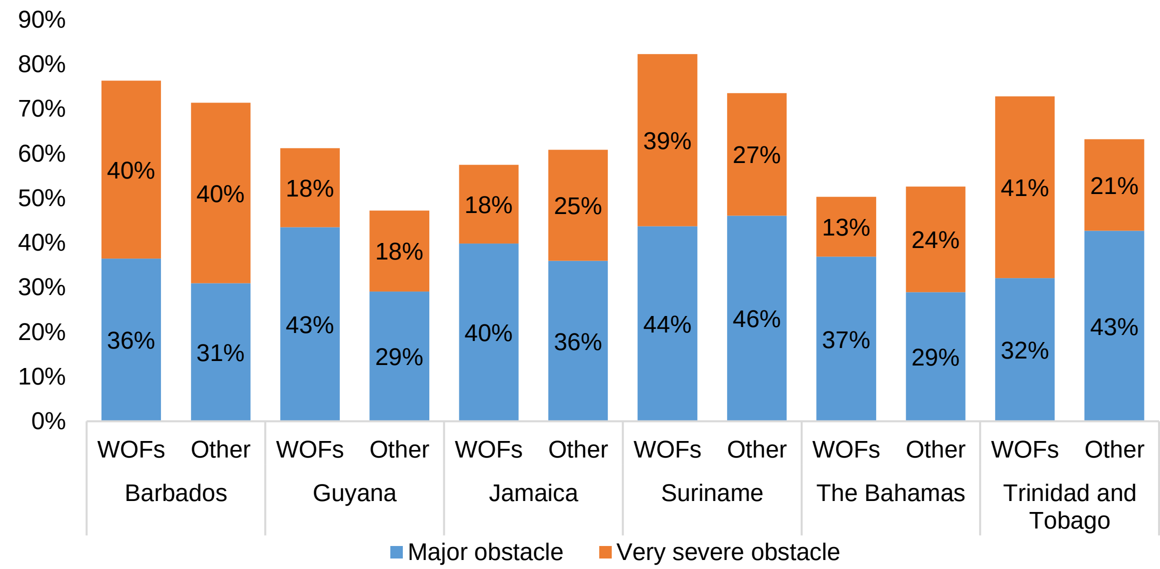
Not surprisingly, two-thirds of WOFs report access to finance as a major or severe obstacle to their business. In this respect, Guyana, Suriname, and Trinidad and Tobago have the largest gaps between the proportions of WOFs and other firms with this view (14, 10, and 9 percentage points (pp), respectively). In most Caribbean countries, more than half of WOFs report that financial costs (i.e., interest rates and collateral) were either a major or a very severe obstacle for growth (Figure 7).

Approximately 39 percent of WOFs in the Caribbean (excluding the Organisation of Eastern Caribbean States) view required collateral as a major or severe obstacle to doing business. However, responses are heterogeneous within the region. The countries where more WOFs cite the cost of finance as a major obstacle to business (relative to other firms) include Guyana, Jamaica, and The Bahamas. Of these countries, the largest disparity between women-owned/women-led firms and other firms is in Jamaica (10 pp) followed by Guyana (9 pp) (Figure 7, panel b). Interestingly in some of countries where more WOFs cited access to finance as a major obstacle (Barbados and Suriname), the cost of finance is a less prevalent obstacle relative to other firms. For example, 76 percent of WOFs in Barbados cite access to finance as a barrier, but only 36 percent cite the cost of finance as a barrier. This finding suggests that important deterrents of women-owned and women-led firms' access to credit could be the structuring and terms of loans (e.g., tenor), securing enough collateral, or a lack of the business capacity necessary to successfully apply and obtain business loans. Trinidad and Tobago is a separate case—while its overall reported prevalence for the cost of finance as a barrier is very close to other firms (41 percent), 37 percent of WOFs diagnose this barrier as very severe—the highest proportion in the region.

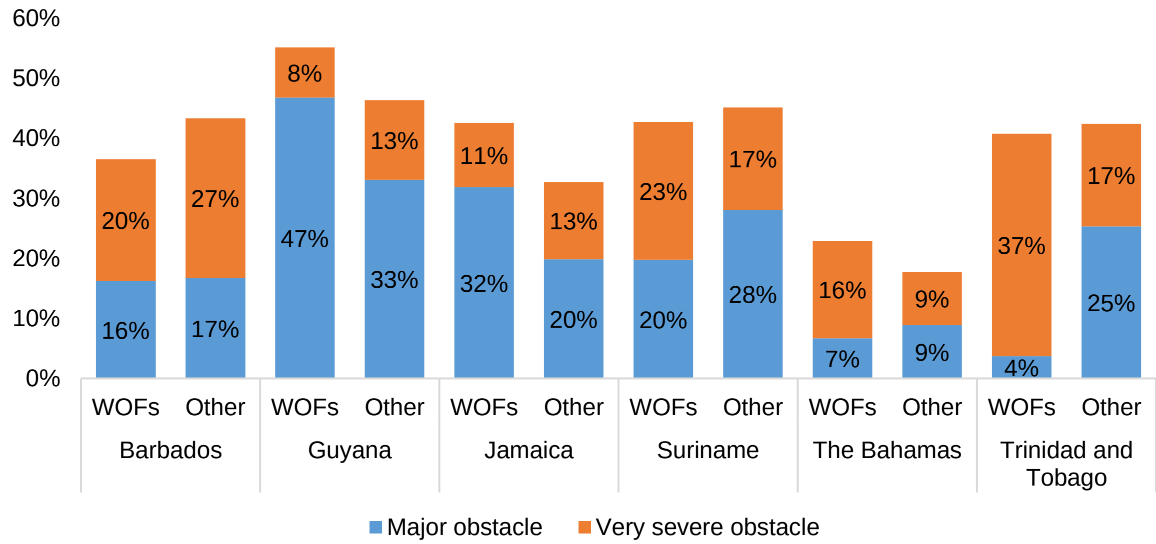
[13] WOFs are firms that are entirely or predominantly owned by women, and includes firms that are equally owned by omen with a woman as top manager/CEO.

Figure 7. Severity of Survey Reported Barriers to Financial Access by Gender, 2020

a. Barriers to Credit Access (e.g., Collateral) by Gender



b. Cost of Finance (e.g., Interest Rate), by Gender

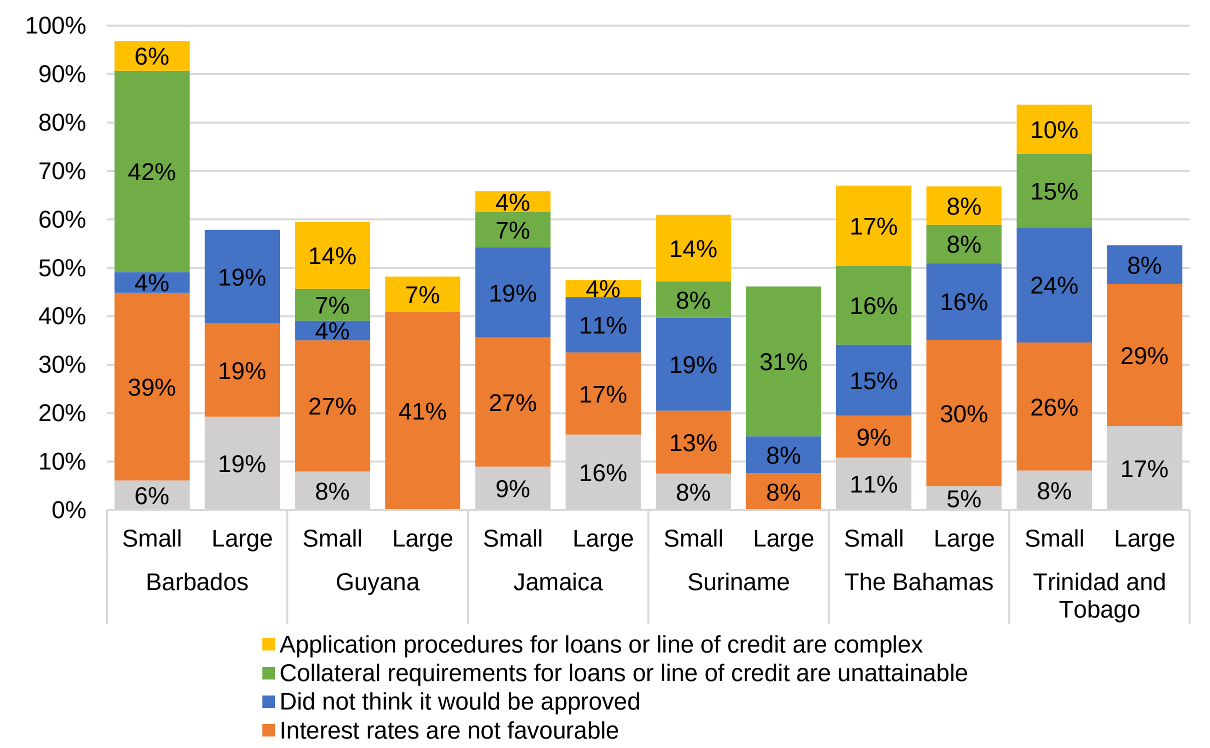


Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG). Note: WOFs: women-owned and women operated firms.

Broader Impediments to Financial Access and Inclusion

Other survey questions provide information on the more specific factors that discourage firm owners from even attempting to apply for a loan. Figure 8 highlights the fact that at the end of 2020, the most significant barriers to financial access for most economies across the region corresponded closely with those highlighted by the World Bank (2014), particularly (i) the cost of finance (interest rates); (ii) collateral requirements; (iii) doubts about the prospects for loan approval; (iv) complex application procedures and requirements; and (v) in some cases, financing requirements or maturity preferences of firms not being compatible with lender preferences. While the emphasis on each barrier differs across countries and the size of firms, the message is consistent across all jurisdictions—the lack of financial access is driven by multiple factors that will require actions and policies across several policy and private sector areas. This will demand concerted efforts by governments, banks, and firms in each country, as well as support from external partners to help design strategies and catalyze new funding sources both from within and abroad.

Figure 8. Survey-Based Reasons for Not Applying for Credit by Firm Size, 2020

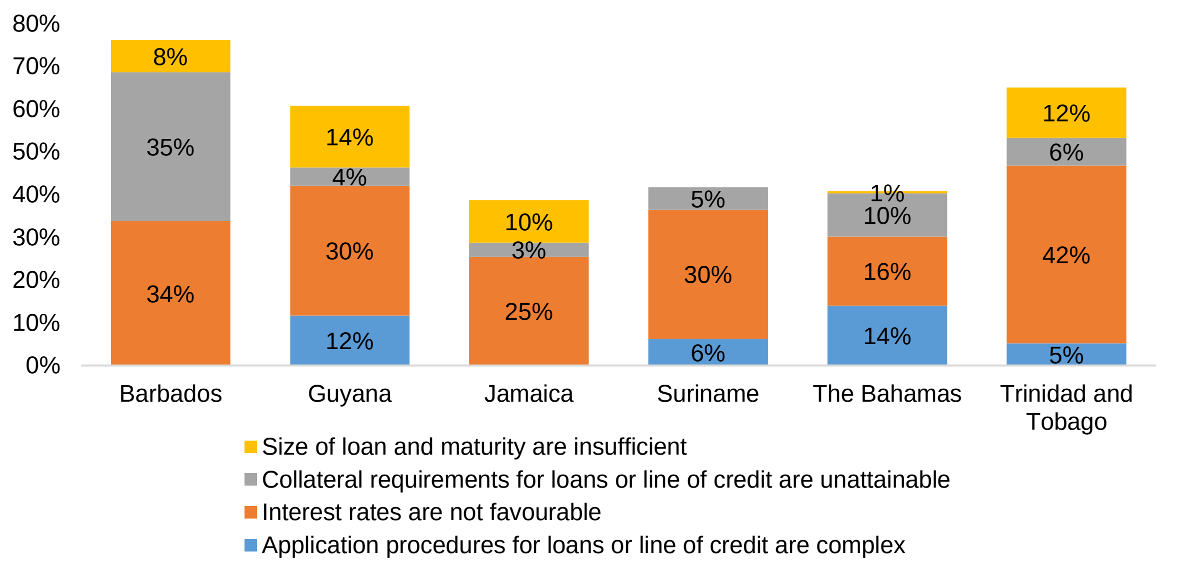


Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG).

Women-Owned and Women-Led Firms

High interest rates are the main reported reason why WOFs decide not to apply for loans (31 percent, on average), with the highest level in Trinidad and Tobago (42 percent). Other reasons are the collateral required, the size of the loan, and insufficient maturity. Across the region, approximately 11 percent of WOFs cite collateral requirements as the reason for not applying for loan, which is consistent with the findings shown below regarding high levels of required collateral in the region, particularly in countries where this is reported as a major or severe constraint (i.e., Barbados, where more than a third of women-led and women-owned firms report that high collateral requirements are the main reason they do not apply for a loan, despite needing financial resources—Figure 9). On the other hand, 7 percent of WOFs say that the size of the loan and maturity are insufficient, which speaks to the difficulties of faced by the local financial system to lend at the maturities required to finance capital investment. In turn, these challenges could affect smaller firms more, as they tend to remain dependent on banks (versus other forms of financing) more frequently than larger companies. Complex application processes are mentioned by 5 percent of WOFs as a reason not to apply for a loan. However, there are within-region differences: The Bahamas had the highest percentage of respondents citing complex application procedures among WOFs (14 percent).

Figure 9. Reasons Cited by Women-owned and Women-led Firms for Not Applying for Credit



Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG).

Improving Financial Access: Policy and Market-Based Interventions Needed

As noted above, small firms report more restricted access to finance than large firms. This lack of finance can be a constraining factor for these firms to grow and prosper. There are many potential sources of finance for micro, small, and medium-sized enterprises (MSMEs), but these may be limited or not easily accessible in Caribbean markets. Though the ecosystem for finance is relatively broad, MSMEs experience barriers to access at all stages of their lifecycle given the increased risk profile of investing in this segment of the market. In many of the markets, there is a scarcity of early-stage investment options and commercial banks offering growth and mid-stage financing, as those banks prefer retail lending or collateralized lending to well-known companies with a strong track record. Other options are limited or have structural constraints to development, such as leasing options that are often constrained by the lack of a secondary market for resale of repossessed equipment.

Governments, development finance institutions ("DFIs"), private equity and venture capital funds, commercial banks, credit unions, microfinance institutions, insurers, leasing companies, and institutional and individual investors all have a role to play in improving financial, gender, and social inclusion. These counterparts can unlock capital and deliver innovative financial solutions, while other players can guide MSMEs on how best to navigate this complex ecosystem of financial players. Governments and DFIs can offer solutions that effectively serve to increase options, while de-risking the segment for some of the other ecosystem players.

For DFIs, expanding financial inclusion should increasingly become a key aspect of their value proposition. DFIs, such as IDB Invest, the private sector institution of the IDB Group, offer numerous instruments geared towards increasing the availability of long-term financing to support the growth of MSME lending or increase access to housing finance for middle- and lower-middle-income families and individuals. DFIs, also support the development of capital markets. In addition to deepening the financial system and increasing a country's resilience to the reversal of capital flows during periods of instability, capital markets help mobilize domestic savings for financing long-term investment, reducing dependency on external borrowing. For private sector issuers, bond issuances provide a more diversified base of financing and can provide better financial terms (longer maturities, more efficient pricing, and larger ticket sizes).

Access to Finance Solutions

IDB Invest's support to MSMEs leverages partnerships with local financial institutions, nonbank financial institutions, anchor companies, and other actors in the ecosystem, with the aim of delivering a greater development impact and achieving economies of scale. Interventions include senior and subordinated loans to financial institutions (both secured and unsecured), and equity investments to contribute to the development of the private equity ecosystem for growth-oriented and blended finance. These are powerful tools that use concessional financing for high-impact development-related investments where risks are too high for commercial finance alone. Blended finance also provides financial flexibility, as it allows for multiple types of interventions, ranging from performance grants to equity, debt, and risk mitigation instruments. These solutions are often

paired with advice and investment management solutions to recipients of concessional finance. Box 2 provides some specific examples of IDB Invest interventions.

Box 2. IDB Invest: Examples of Interventions

-JMMB Bank Partnership

In Jamaica, small and medium-size enterprises (SMEs) generate 80 percent of jobs, thereby contributing significantly to the country's GDP, poverty alleviation, female employment, and social stability (Ministry of Industry, Investment and Commerce 2022). The JMMB Group's strategy is to add value to its SME clients through the provision of financial partnership, resources, innovative financial solutions, and a network throughout these businesses' life cycles. The aim is to provide the necessary support for growth and to fill gaps that currently exist in the financial sector. IDB Invest has partnered with JMMB to provide a US$35 million unsecured loan with a five-year tenor to support the growth of its SME lending portfolio. In addition to the IDB Invest loan, an additional loan of US$35 million was mobilized by IDB Invest from global microfinancing impact investors—BlueOrchard, Symbiotics, and responsAbility. The partnership will also see IDB Invest supporting JMMB in the development and implementation of an environmental and social management system, in addition to which IDB Invest will provide advisory services to bolster internal capacity and a gender action plan to ensure that JMMB's human capital strategy attracts and retains the best talent pool. JMMB has a culture of inclusion, working especially with women and women-owned entrepreneurs, and the plan will ensure equal access to opportunities. See https://idbinvest.org/en/projects/jmmb-bank-partnership

-Republic Bank Caribbean Partnership

IDB Invest provided Republic Bank with a US$75 million unsecured subordinated loan to support its capital structure by increasing its Tier-2 capital with a tenor that is not available in the local market. The funds are being used to finance the bank's digital integration process and increase the size of its retail portfolio by providing SME and housing loans. The project is complemented by a parallel unsecured subordinated loan from the International Finance Corporation. See https://idbinvest.org/en/projects/republic-bank-caribbean-partnership

-Portland Caribbean Fund II COVID-19 Facility

IDB Invest has provided a US$10 million senior loan to Portland Caribbean Fund II (PCF II) to support its portfolio companies impacted by COVID-19. PCF II is a 2014 vintage growth equity fund with over US$200 million in commitments. IDB Invest is an existing limited partner in the fund, which is fully invested in 10 investments across several key industries and countries in the Caribbean and Latin America. The severe economic impact of the pandemic on these tourism- and commodity-dependent economies decimated traditional funding sources, widening the access to finance gap. The IDB Invest loan facility will indirectly protect the approximately 20,000 employees of the fund's portfolio companies and will include gender, diversity, and inclusion training to develop capacity-building programs among its investees, promoting best practices on diversity in its human capital and value chains. As a result, PCF is expected to apply the Women's Empowerment Principles tool to all investee companies and develop

gender, diversity, and inclusion plans for the sub-borrowers. See https://idbinvest.org/en/projects/portland-covid19-facility

-SEAF Caribbean SME Growth Fund

IDB Invest has invested US$10 million in equity in the SME Growth Fund, which aims to provide risk capital to growth-oriented companies in the English-speaking countries of the Caribbean Common Market (CARICOM). Such capital has become more scarce than ever due to the COVID-19 pandemic. The project's primary objective is to promote the growth and productivity of the growth-oriented Caribbean companies that generate positive development results through their business activities. By combining equity financing and strategic expertise, the SME Growth Fund is expected to boost the companies' local and regional expansion as well as their operational efficiency, contributing to job creation, productivity increases, and integration in the Caribbean region. Additionally, by supporting the entrance of an experienced fund manager into the region, the proposed investment will contribute to the development of the Caribbean's private equity investment ecosystem. In addition to a US$10 million equity investment described above IDB Invest has approved a US$10 million blended finance loan to provide debt financing for climate change adaptation and mitigation and post-disaster recovery projects in the SME Growth Fund's portfolio companies. Up to 30 percent of the blended finance loan can be onlent to eligible subprojects in local currency. See https://idbinvest.org/en/projects/seaf-caribbean-sme-growth-fund

-Banco Promerica – Dominican Republic

This proposed transaction consists of a subordinated loan (Tier II capital) to Promerica of up to US$10 million that includes a committed and an uncommitted tranche. The project will support Promerica's capital structure by increasing its Tier II capital base and will promote the growth of its SME portfolio. The project is the first in the Dominican Republic that is part of the Financing Initiative for Women Entrepreneurs (We-FI), an international alliance that aims to unlock financing and access to markets for companies owned or led by women. With financing from We-Fi, IDB Invest will provide performance-based incentives and advisory services to support Promerica's efforts to grow its portfolio of women-led SMEs. See https://idbinvest.org/en/projects/promerica-dr-subordinated-debt

Capital Market Development

IDB Invest uses partial credit guarantees both in local currency and U.S. dollars that act as a credit enhancement to meet local institutional investors' risk appetite and rating requirements and subscribes to bond issuances that act as a "seal of quality" to boost investor confidence. Partial credit guarantees can be the critical element for firms that would otherwise not be able to issue bonds on the market. For example, the Trinidad and Tobago Mortgage Finance Company Ltd. Capital Market Development: Project consists of a partial credit guarantee of a mortgage-secured bond issuance of up to TT$670 million by the Trinidad and Tobago Mortgage Finance Company Limited (TTMF) and placed in Trinidad and Tobago. TTMF, a residential mortgage financing company based in the country, will use the proceeds of the issuance to originate home financing products for low- and middle-income segments of the population (See https://idbinvest.org/en/projects/ttmf-idb-invest-housing-partnership for more information).

Partnerships for Finance

Finally, development finance institutions can crowd-in investors by mobilizing finance in the form of loan participations, co-financing arrangements (parallel loans, equity investments, and capital market issuances), unfunded participations (purchased credited insurance and unfunded risk participations) and guarantees of debt instruments. In some cases, transactions may also be structured to include so-called “B bonds” that are issued to institutional investors, thus expanding the investor base. Through its mobilization efforts, IDB invest can provide clients access to larger financing packages.

Box 3. Examples of Recent IDB Sovereign Interventions

Lending

Credit Enhancement Program for Micro, Small and Medium Enterprises (The Bahamas). The ongoing project supports the credit enhancement facility of the Small Business Development Corporation (SBDC), as well as institutional development of the SBDC. This loan is complemented by a technical cooperation and the IDB Lab project listed in Box 4. See https://www.iadb.org/en/project/BH-L1046

Global Credit Program for Safeguarding the Productive Sectors and Employment (Barbados). The objective of this operation is to support the sustainability of the Micro, Small and Medium Enterprises (MSME) to maintain employment and economic activity in Barbados in response to the crisis caused by COVID-19. The specific objectives are: (i) to support the short-term financial sustainability of MSME; and (ii) to promote the economic recovery of MSME through access to productive financing. See https://www.iadb.org/en/project/BA-L1051

Boosting Innovation, Growth and Entrepreneurship Ecosystems, Contingent Credit Line for Investment Projects (CCLIP) (Jamaica). The objective of the CCLIP line is to transform the Jamaican private sector by fostering productivity and innovation, through a series of loans. The general objective of the first individual operation is to promote sustainable and robust growth among startups and MSMEs in Jamaica. This includes the creation of a Venture Capital Fund. The loan series is also being complemented by a non-reimbursable investment grant. See https://www.iadb.org/en/project/JA-L1085

Technical Cooperation

Implementation of a Secured Transaction Regime and Business Framework (Guyana). The objectives of this Technical Cooperation are to improve the business climate of Guyana through the implementation of secured transaction framework that improve access to credit and create a green business practice framework, to promote a sustainable business environment. Under this TC, it is expected that access to finance for businesses and individuals will be widened, and Guyana will be able to foster economic activities without degrading its environment. See https://www.iadb.org/en/project/GY-T1141

Knowledge Products

Numerous studies have been prepared on access to finance by the Caribbean Country Department and sector specialists of IDB. Examples include: Laura Giles-Alvarez and Henry Mooney, 2020, *Financial*

Inclusion: A Diagnostic for Barbados; Victor Gauto and Henry Mooney, 2020, *Review of Financial Development and Inclusion for Guyana—Assessment and Options for Reform*; Henry Mooney, 2018, *Jamaica Financial Development, Access and Inclusion—Constraints and Options*; Thorsten Beck and Henry Mooney, 2021, *Financial Development in the Caribbean* (book chapter); and Shreshta Chotelal et al, 2022*, Financial Inclusion and Fintech in Suriname.* All available at: https://publications.iadb.org/en

Policies, Innovation and Sovereign Financing

DFIs also have an important role to play in other areas. Policy reforms, innovation and government investment are all key elements to unlocking access to finance. The sovereign side of the IDB Group the innovation "lab" of the IDB Group deploy knowledge, technical cooperation, and financial services to work on all these fronts. On the knowledge front, research products cited in this report are a good example. Box 3 provides recent examples of financing and technical cooperation undertaken in the Caribbean by the sovereign side of the IDB Group, while Box 4 provides recent examples of IDB Lab's work.

Box 4. Examples of Recent IDB Lab Interventions

Accelerate Bahamas!. The Accelerate Bahamas project aims to improve the entrepreneurial and innovation ecosystem in The Bahamas by increasing access to finance and advisory services to SMEs through the establishment of a Fintech platform to mobilize capital. See https://www.iadb.org/en/project/BH-T1071

Institute of Private Enterprise Development Limited (IPED) - Green Finance for Renewable Energy and Energy Efficiency for MSMEs (Guyana). The project's objective is to finance Renewable Energy/Energy Efficient (RE/EE) technologies for MSMEs that complement, reduce the usage of, or substitute unreliable supplies of energy and displace energy from fossil fuels. The operation is structured as a technical cooperation. Note that a green finance technical cooperation was also recently approved for Trinidad and Tobago. See https://www.iadb.org/en/project/GY-T1150

Innovating Social Sector Financing (Jamaica). The project objective is to improve access to finance for Social Entrepreneurs and NGOs through the creation of a virtual environment that mimics a Stock Exchange and is supported by block chain technology to record and measure proof of impact. The project is structured as a technical cooperation grant. See https://www.iadb.org/en/project/JA-T1176.

Term Finance SME TT Limited (Trinidad and Tobago). The project will enable MSMEs to more easily and rapidly access the credit they need to expand their operations and sales, focusing mainly on expanding and perfecting the online, customer-centric business model for MSME lending, piloted by SME TT since January 2020. Once consolidated in Trinidad & Tobago, it is expected that SME TT will subsequently begin lending operations in Guyana, Jamaica, Barbados, and Saint Lucia over a 5 to 6-year timeframe.

Conclusions

Despite progress in terms of financial deepening in several countries over recent years, financial sectors in the six Caribbean economies analyzed in this report lag countries at similar levels of income and development around the world. Even before the COVID-19 crisis, firms across the region reported significant impediments to financial access driven by, inter alia, high borrowing costs, collateral requirements and other security enhancements, complex application procedures, and other related concerns. Many of these hurdles seem to have become more binding because of the global pandemic. Smaller firms, and those owned and/or operated by women, report even higher-than-average impediments to securing credit than their peers. Given the strong and compelling evidence of the importance of financial access and inclusion for broader development goals, these and related findings underscore the pressing need for countries in the region to focus attention—both public and private—on overcoming these challenges.

In terms of policies and reform priorities, there are many potential implications flowing from this work. Previous IDB research focused on these and other related challenges has put forward the following conclusions:[14]

- **Macroeconomic Stability and Policy Prudence:** The first priority of any government wishing to create an enabling environment must be to ensure low and stable inflation, as well as fiscal prudence to avoid crowding out private credit. Similarly, policy predictability will also provide added confidence to those who would both lend and borrow, as well as invest, in local businesses and capital markets.
- **Availability of Credit Information:** High collateral requirements and the costs of borrowing have been reported as significant impediments to financial deepening and access. Measures such as the development of centralized credit registries and bureaus, as well as other mechanisms for risk information gathering and sharing, would support improved counterparty credit risk assessment and management. This would allow banks to reduce their need for credit enhancements (e.g., collateral and guarantees), extend maturities, and broaden the base of potential borrowers at lower costs.
- **Property Rights and Insolvency Procedures:** Ensuring that a country's regulatory and judicial frameworks can provide both creditors and debtors with greater confidence in terms of property rights, contract enforcement, and the process of resolving insolvency would help accelerate financial development and improve access to credit. These are institutional areas where several Caribbean countries fall short of international benchmarks.
- **Credit Sector Competition:** Regulatory and other reforms aimed at stimulating healthy competition in the banking sector are important to ensure that credit can be provided at reasonable costs—one of the key hurdles identified by many firms in the region. If implemented without compromising financial stability or prudential standards, an adequate

[14] In particular, see Beck and Mooney (2021).

level of regulation aimed at fostering competition could encourage broader use of credit by individuals and SMEs, with benefits for all sectors of the economy.

As discussed in detail in country sections below, while other country-specific issues are also clearly relevant (e.g., informality, crime and disorder, etc.), focusing on progress on these four critical topics could help countries across the region achieve their full potential in terms of financial sector development. This would, in turn, support broader and more adequate access to finance for both small and large firms, households, and marginalized populations—particularly for women and the firms that they own and operate—, which would help many Caribbean countries improve the lives of their citizens in a more inclusive and sustainable way. Country sections that follow provide more information on the specific reform agenda for each country.

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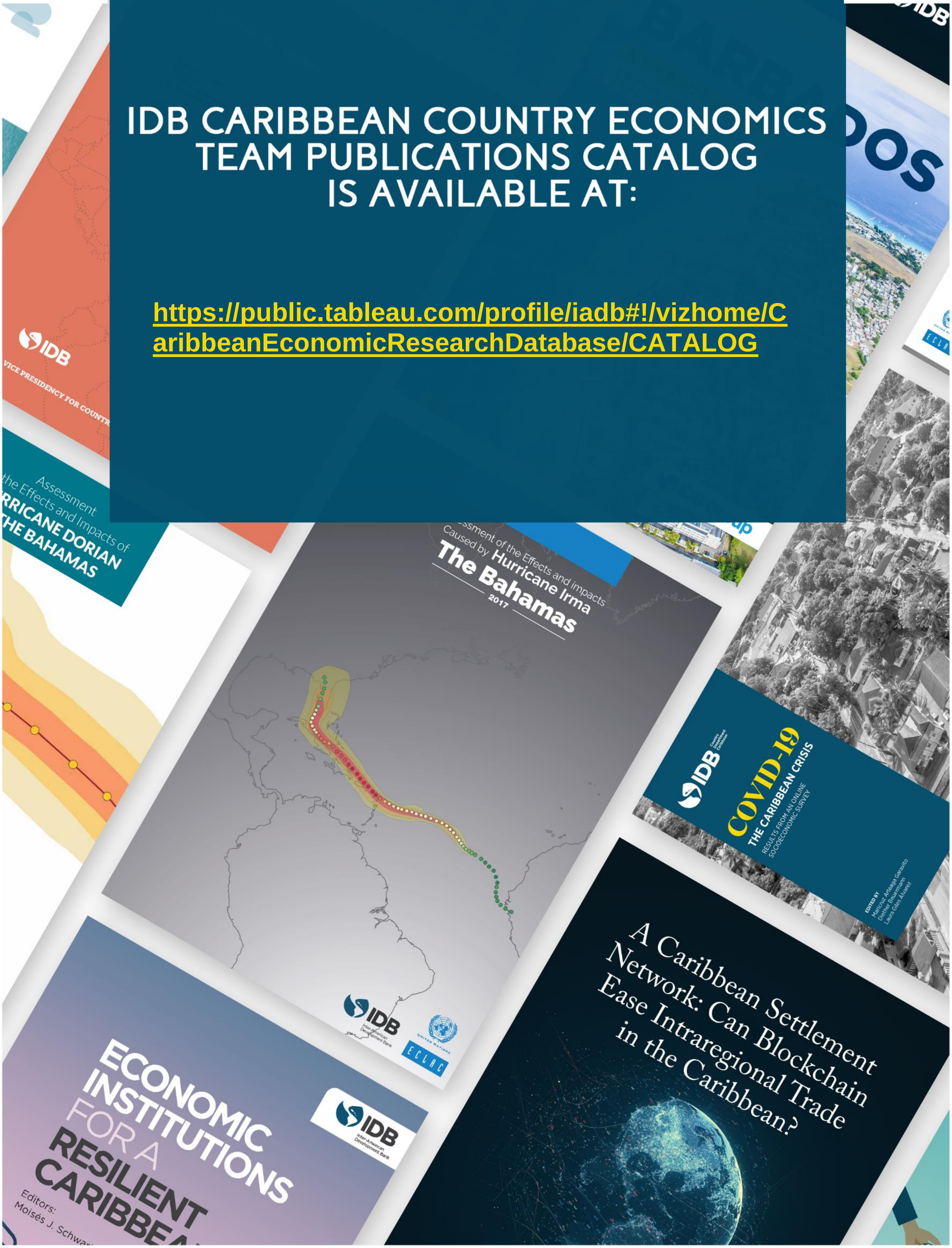

COUNTRY SUMMARIES

The Bahamas

Khamal Clayton and Cloe Ortiz de Mendivil

Macroeconomic Context

Like many of its tourism-dependent peers, especially in the Caribbean, The Bahamas has been recovering from a pandemic-driven economic crisis that saw its GDP drop by 23.8 percent in real terms.[15] In 2020, tourist arrivals declined by 75 percent as borders closed globally,[16] but then rebounded to 30 percent of pre-pandemic levels in 2021.[17] Travel receipts in 2021 were 53 percent of those in 2019, which suggests that although there were fewer travelers, they were spending more (IMF 2022). As of the end of February 2022, preliminary figures show that over 723,000 visitors arrived in the first two months of the year, which represents 57 percent of arrivals in the same period of 2019 and suggests that it may take additional time for tourists to return.[18] However, the relaxation of COVID-19 testing protocols in March 2022, including the removal of the obligatory rapid antigen test on the fifth day after arrival, should further encourage the return of international visitors.

Although the recovery of the tourism sector has been slow, GDP is projected to return to its pre-pandemic levels in 2024, despite the difficult macroeconomic situation. According to the April 2022 edition of the International Monetary Fund's (IMF) *World Economic Outlook*, The Bahamas is expected to continue borrowing to cover its continuous fiscal deficits. The fiscal deficit in FY2020/2021 is currently estimated at US$ 1.35 billion, more than six times larger than the pre-pandemic level (i.e., FY2018/2019), and 50 percent larger than the deficit in FY2019/2020. The fiscal deficit is expected to be almost four times its pre-pandemic level in FY2021/2022.[19] The most recent IMF Article IV Report notes that the government will continue to have high financing needs that will be met using both local and international capital markets (IMF 2022). Consequently, public sector debt as a percentage of GDP is projected to be at 94.8 percent, an increase of almost 50 percent since FY2018/2019 but a decrease of almost 15 pp from FY2020/2021.

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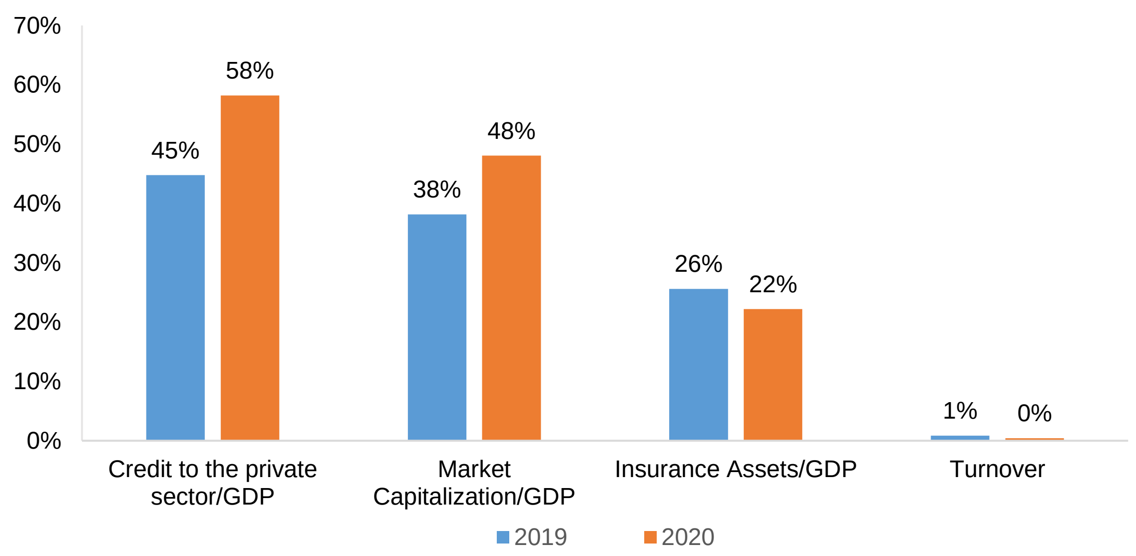
[15] See Advance Estimates for GDP: March 2022.
[16] See Bahamas Visitor Arrivals 2019.
[17] See Bahamas Visitor Arrivals 2022.
[18] Ibid.
[19] The fiscal year in the Bahamas runs from July 1 to June 30.

Financial Sector Depth, and Nonbank Finance

With a GDP per capita in purchasing power parity terms that reached US$38,832 in 2019, The Bahamas is both a high-income country and the richest borrowing member of the Inter-American Development Bank (IDB). Despite being a high-income country, the share of private credit and market capitalization to GDP is less than a third of that of the country's peers. Before the pandemic, private credit and market capitalization were 45 percent and 38 percent of GDP, respectively. Due mostly to a sharp GDP contraction, those shares rose to 58 percent and 48 percent, respectively, in 2020 (Figure 1). Insurance assets also dropped in absolute terms.

Figure 1. The Bahamas: Financial Development Indicators, Selected Years (Percent)



Sources: Central Bank of The Bahamas, Quarterly Economic Review (December 2021); Bahamas International Securities Exchange, Annual Statistical Report 2021.
Note: Credit to the private sector is based on the balance sheets of domestic banks, and market capitalization includes ordinary preferred shares.

Distribution of Domestic Bank Credit

Domestic credit in The Bahamas is allocated, in order of size, to consumers (i.e., loans held by households including mortgages), the public sector, and the commercial sector. Households held almost three-quarters of total domestic bank credit in 2021, while the public and commercial sectors accounted for 14 percent each (Table 1). Regarding the composition of credit to commercial sectors, construction and distribution dominate, followed distantly by tourism, fisheries, and agriculture. The distribution of bank credit across sectors remained surprisingly

unchanged even during the pandemic when businesses, particularly in tourism, were most affected. Furthermore, despite the push towards producing food locally, both the agriculture and fisheries sectors have also received negligible shares of financing from domestic banks.

Table 1. The Bahamas: Share of Domestic Bank Credit by Sector (percent)

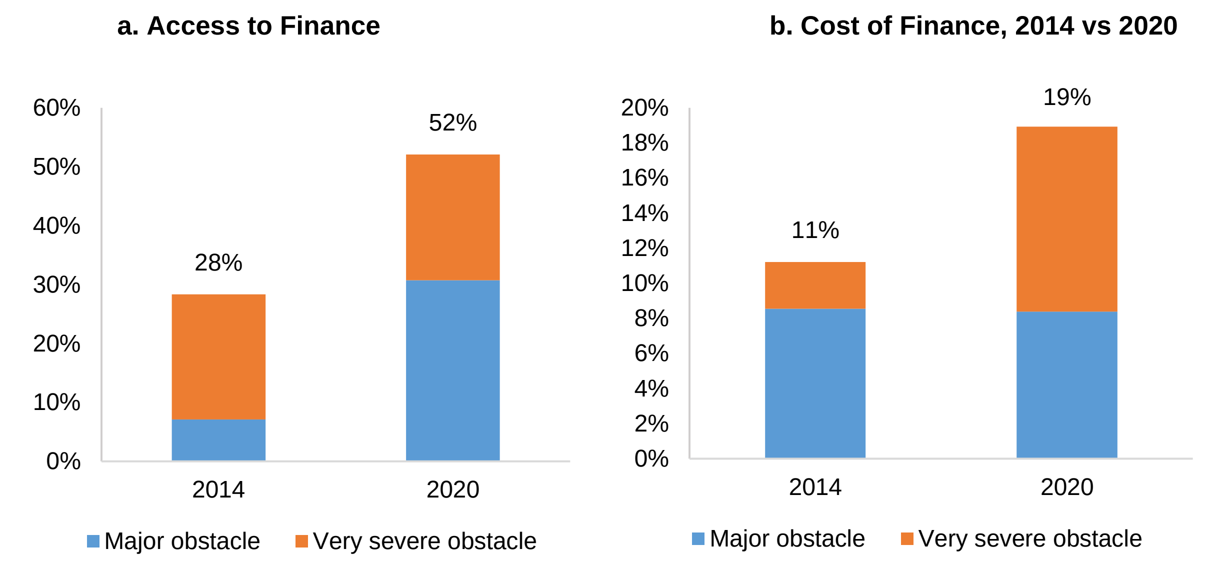
Sectors	2018	2019	2020	2021
Personal/Consumer	75%	73%	72%	72%
Commercial	12%	15%	13%	14%
Tourism	0.2%	0.2%	0.2%	0.2%
Agriculture	0.1%	0.1%	0.1%	0.0%
Fisheries	0.0%	0.0%	0.0%	0.1%
Distribution	3.7%	4.1%	4.0%	4.5%
Construction	4.4%	4.5%	4.6%	5.0%
Other	4%	6%	4%	4%
Public sector	13%	12%	15%	14%
Public corporations	3%	4%	1%	1%
Government	10%	8%	13%	13%

Source: Central Bank of The Bahamas, Quarterly Economic Review (December 2021).

Financial Access and Cost

Although the share of credit as a percent of GDP, has stayed relatively steady for the last five years, access to and the cost of finance, especially during the pandemic, has worsened drastically since 2014. In 2014, 28 percent and 11 percent of Bahamian firms said that access to and the cost of finance were major or very severe obstacles, respectively, according to Compete Caribbean's Productivity, Technology, and Innovation in the Caribbean (PROTEqIN) Enterprise Survey (Figure 2). By December 2020, these figures almost doubled to 52 percent and 19 percent respectively, according to Compete Caribbean's Innovation Firm Performance and Gender (IFPG) Survey. The decrease in the perceived access to and cost of finance is not surprising considering the unique macroeconomic conditions and the fact that domestic banks were broadly tightening their balance sheets in preparations for expected defaults and increase in nonperforming loans.

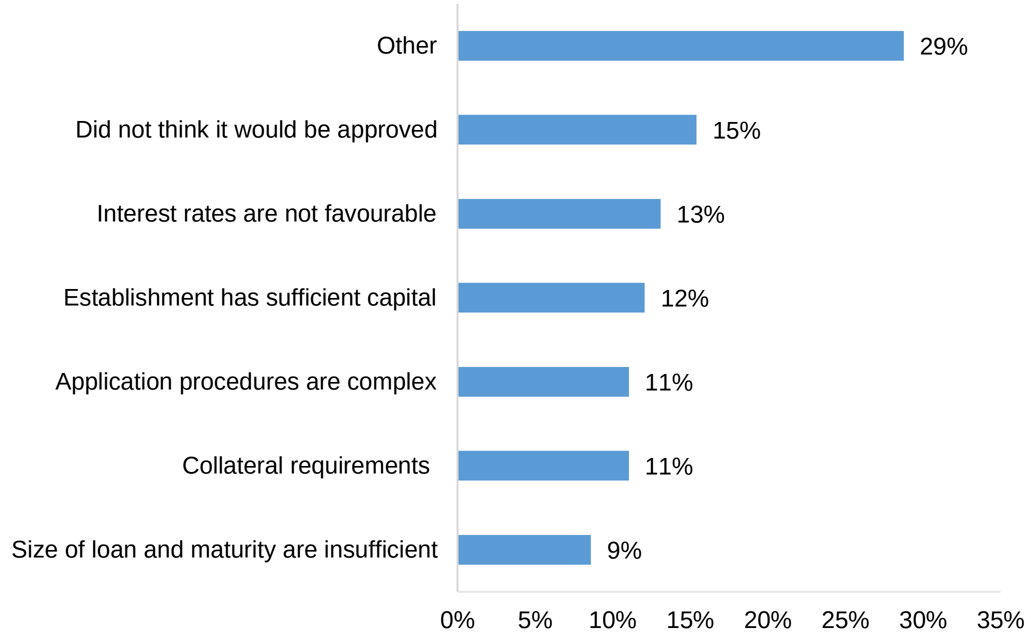
Figure 2. The Bahamas: Responses to the Question: Is Access to/Cost of Finance an Obstacle to Your Firm's Operations? 2014 vs. 2020 (Percent)



Question: Please rate each one of these factors as obstacles that can affect the current operations of your establishment.
Source: Compete Caribbean, 2014 Productivity, Technology, and Innovation in the Caribbean (PROTEqIN). Enterprise Survey and 2020 Innovation Firm Performance and Gender (IFPG) Survey.

According to the IFPG survey, conducted mostly in December 2020, more than 99 percent of surveyed Bahamian businesses indicated that they would not be applying for a bank loan or a line of credit. Only 12 percent of these firms believed that they had sufficient capital (Figure 3). The remainder did not apply for credit for several reasons, including collateral requirements (11 percent), unfavorable interest rates (13 percent), and complex application procedures (11 percent). Micro-, small-, and medium-size enterprises (MSMEs) are particularly vulnerable to these concerns because they are less likely to have a dedicated team or person to handle complex loan applications (which may also include Know-Your-Costumer requirements), more likely to be asset-light (especially in an economy that is service-oriented), and more likely to be seen as risky and thus warrant higher interest rates. Operationalizing the credit bureau to offer business credit reports would go a long way to reducing collateral requirements, decreasing approved interest rates, and broadly increasing the confidence of approval for (at least some) MSMEs. However, The Bahamas' only credit bureau offers credit reports for businesses that have or had a credit facility with a partner institute as recently as April 2018. Therefore, this narrow requirement may limit the scope of businesses that need financing but only have substantial, creditworthy relationships with utility companies, contracts with suppliers, and/or long-term rental agreements.

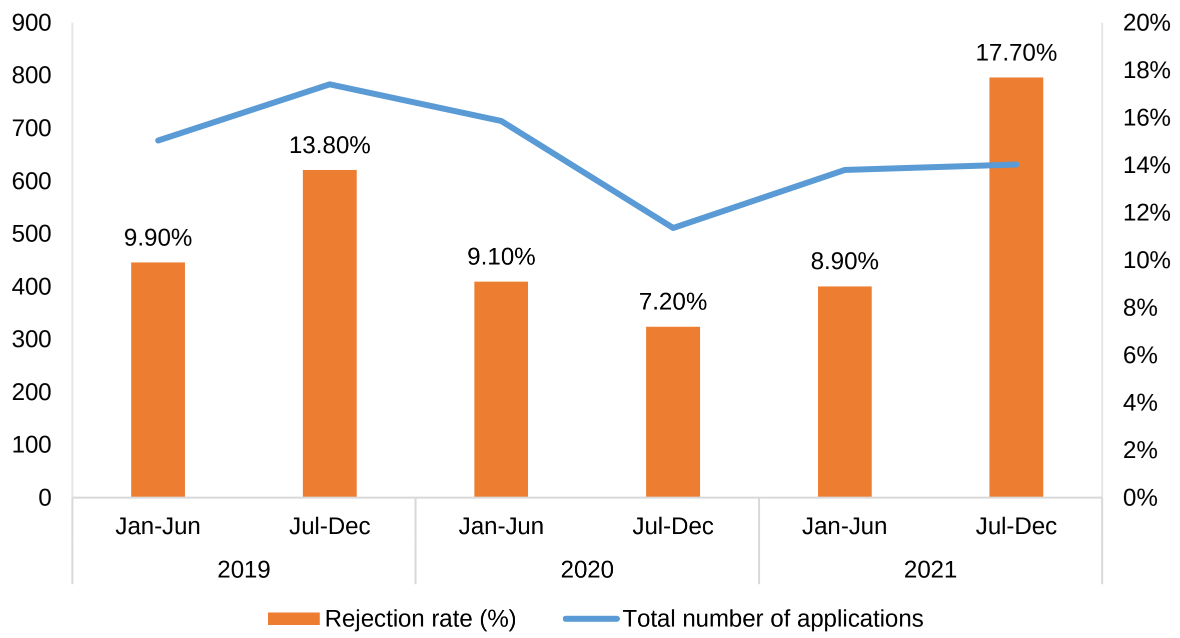
Figure 3. The Bahamas: Reasons for Not Applying for Loan or Line of Credit, 2020, (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender (IFPG) Survey (https://www.competecaribbean.org/proteqin-ifpg-datasets/).
Note: The survey question was: For your last fiscal year, have you applied for or requested any of the following? Borrowed (loan or line of credit) from private commercial banks, If no, why not?
Less than 1 percent of respondents applied for a loan and their response was marked as N/A and not shown above.

According to the Central Bank of The Bahamas' biannual Bank Lending Conditions Survey (BLCS), applications and rejection rates for loans decreased in 2020, especially in the second half of the year. The rejection rate and number of applications in that second half of the year, was almost half the rate in the same period in 2019 (Figure 4). Since 2020, the most common reason for rejecting applications was insufficient collateral and, in the second half of 2021, almost 60 percent of rejections were for this reason. It is possible that during the pandemic, firms that were more confident in approval chose to apply while weaker firms delayed their application until the following year, when there was a spike in rejections.

Figure 4. The Bahamas: Commercial Loan Applications



Source: Central Bank of The Bahamas, Bank Lending Conditions Survey.

Capital Markets

Beyond debt, MSMEs face difficulties raising funding through equity markets because The Bahamas International Securities Exchange (BISX) expects market capitalization of at least US$1 million or US$400,000 for companies wishing to list equity or debt, respectively.[20] The BISX also requires that firms provide the last three years of audited financial statements. As of 2021, there were only 28 firms trading either preference or ordinary shares on the exchange.[21] Of note, the BISX also trades debt instruments. Additionally, for the last two years, there have only been two corporate debt instruments listed. On the other hand, as of 2021, at least 90 percent of the face value of the debt instruments listed on the BISX, valued at over US$4 billion, belong to the Bahamian government, which is not far behind the value to the equity listed at over US$5 billion.[22] In the first quarter of 2022, when the Bahamian government sought to raise over US$1 billion on the BISX, six of its seven offerings were either almost fully subscribed or oversubscribed.[23] By

[20] See BISX Listing Rules

[21] See BISX Listings.

[22] The Bahamian government listed 220 Bahamas Registered Stock with a value of $3.6 billion in 2020 – see Bahamas Government Begins Trading Its National Debt via BISX.

[23] See Market Brief Q1 2022.

listing its debt on the BISX, the government has contributed to the deepening of the capital markets, and showed that there is appetite for Bahamian debt. Therefore, beyond raising equity, companies have an additional avenue for financing, and can follow their government's lead in raising new and listing existing debt through the BISX. Nevertheless, participation of Bahamian corporate debt has lagged, which raises concerns of "crowding out" by the public sector, but also presents the opportunity for the government to share its expertise and experience with its private sector counterparts.

Geographic Concentration of Finance

Approximately 70 percent of The Bahamas' population lives on New Providence and over 98 percent of commercial loan applications came from that island from July to December 2021, according to the BLCS survey.[24] Between July 2020 and July 2021, there were no applications from the Family Islands.[25] Additionally, this trend is likely to worsen, as there are long-standing reports of banks closing branches in the Family Islands (IMF 2019a). In this context, credit unions, which have a relatively strong physical presence in the Family Islands, and the Bahamas Postal Service, which has a bank component, could play a more important role in the provision of financing. Therefore, there is a pressing need to diversify access to finance across all islands. The government, in response, has supported the roll-out of the Sand Dollar, one of the world's first digital currencies, and the use of digital wallets, which will be key tools in its financial inclusion strategy, especially in the Family Islands. However, uptake of the Sand Dollar, by both businesses and consumers, has been slow and ongoing educational campaigns are fundamental to raise awareness.[26]

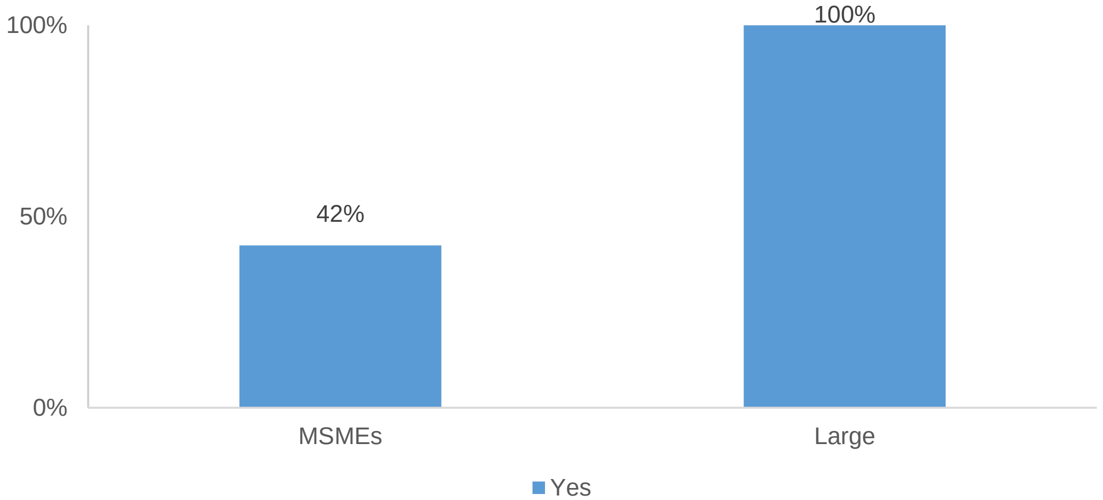
Limited Expertise

Both the IFPG and BCLS surveys, as well as the BISX listing requirements, indicate that a common obstacle to accessing finance is complex application procedures. The procedures require a team of experienced accountants and lawyers. However, most MSMEs are not able to access capital markets because their financials are not audited (Figure 5). Additionally, the lack of audited statements also means that banks are more likely to be cautious when evaluating MSMEs, especially if collateral values are difficult to verify. Moreover, in the last few years, The Bahamas has been successfully and aggressively updating anti-money laundering/combating the financing of terrorism (AML/CFT) regulations and laws to be compliant with international norms. The country has been delisted from the blacklist maintained by the Financial Action Task Force in late 2020 and the European Union in early 2022. As a result, The Bahamas has improved its ability to identify the final destination or end-user of financial services and products. One unintended effect may be that MSMEs find the processes, such as Know-Your-Customer forms, to be onerous. Consequently, the Small Business Development Center (SBDC) could play a role

[24] See BCLS Survey (July-December 2021).
[25] See BCLS Survey (July-December 2020) and BCLS Survey (January-June 2021).
[26] According to the Central Bank of the Bahamas, as of March 2022, only 339,000 Sand dollars are in circulation, or less than 0.07%.

in organizing workshops to provide additional training on financial literacy and accounting. Furthermore, the SBDC could be an avenue to connect entrepreneurs with the extensive network of accounting, legal, and financial management expertise that exists as The Bahamas is a major offshore financial center.

Figure 5. The Bahamas: Audited Financials of Micro-, Small-, and Medium-Size Enterprises (MSMEs) vs Large Firms, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender (IFPG) Survey (https://www.competecaribbean.org/proteqin-ifpg-datasets/).
Note: The survey question was: Did this establishment have its annual financial statements checked and certified by an external auditor?
MSMEs defined as entities with less than 100 full-time employees; large firms are defined as having 100 or more employees. Total full-time employees = 100% * full-time employees + 50% * part-time employees + 50% * seasonal employees.

Taxation

On January 1, 2015, The Bahamas introduced a value added tax (VAT) on goods and services. Currently at a 10 percent rate, the VAT applies to fixed fees related to loans, including those for businesses and commercial mortgages, but interest and principal payments are excluded.[27] Since the VAT also applies to intermediation services as well as services provided by lawyers and accountants, the additional tax burden can incrementally accumulate for MSMEs. The VAT on financial and legal services also applies if attempting to access capital markets, such as the BISX, for either bonds or equity. Although such VAT payments can be credited against output, for the VAT for services and goods sold by businesses or refunded where an excess occurs, businesses need to apply directly for the credit or refund and may be subject to an audit review. Therefore,

[27] See VAT Guidance on Financial Services.

benefits of contracting an auditor are further compounded for businesses wishing to reduce their cost of accessing finance. Furthermore, the use of collateral to secure loans also incurs a stamp duty of 1 percent on the loan itself, which is another fixed up-front cost for MSMEs (IMF 2019a). Therefore, consideration should be given to making MSMEs exempt from stamp duty and VAT when seeking financing.

In The Bahamas, businesses are required to have a business license to operate and are subject to taxes based on turnover. If turnover is less than US$50,000, there is a flat tax of US$100, but if turnover is above US$50,000 the turnover tax rate can vary between 0.5 and 1.25 percent.[28] Since 2018, if turnover is less than US$100,000, this license is free.[29] Additionally, businesses with turnover above US$100,000 are expected to register and charge for the VAT,[30] and they must have their financial statements certified.[31] For MSMEs, this can be particularly burdensome because up to the annual US$5 million threshold, businesses must do quarterly VAT reports. Although firms can then also benefit from VAT refunds for inputs, this would also subject them to potential audits. Over the last two years, only 63 percent of MSMEs and 44 percent of large firms indicated that they had applied for business licenses.[32]

Although the current rate of corporate taxation in The Bahamas is 0 percent, on July 1, 2021 the country joined the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. This framework proposes a two-pillar solution to address a number of global tax challenges. Of particular note, the second pillar advocates for a global minimum corporate income tax of at least 15 percent by the end of 2023 for multinational entities that have gross annual revenue of at least €750 million (OECD 2021). Although this pillar exempts pension funds and investment funds that are ultimate parent entities, and due to the high turnover requirements, the vast majority of Bahamian businesses would likely not be impacted. However, this pillar could affect multinational hotel chains, banks, insurance companies and some offshore financial entities that operate in The Bahamas. Further research would be needed to see if this change would impact access to and the cost of finance provided by impacted financial institutions, particularly banks, and insurance companies.

Offshore Financial Banking and Foreign Direct Investment

In 2020, total balance sheet assets of the international banking sector, also known as "offshore banking", were approximately US$153.3 billion. This figure is more than 10 times the annual pre-pandemic GDP of The Bahamas. Although the contribution of offshore banking to government revenues of The Bahamas is negligible—amounting to less than 0.7 percent of government revenue in 2016— the direct wages as well as demand for goods and services contributed an

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[28] See Business license FAQs.
[29] See License fees waived.
[30] See VAT FAQs.
[31] See Business license certification requirement.
[32] In the IFPG survey, Businesses were asked "Over the last two years, did this establishment submit an application to obtain: an operating license".

estimated 4.3 percent of GDP in 2016 (IMF 2017). Nevertheless, there is potential for these "offshore" assets to play a more active role in the Bahamian economy, especially in the provision of much needed financing. Since 2018, the fisheries industry has received almost no credit from domestic banks yet, according to the Bahamas Investment Authority (BIA), this sector is reserved specifically for Bahamian nationals.[33] Furthermore, like the fisheries sector, agriculture has received negligible financing from the domestic banking industry, but, with respect to food security, only agro-industries, mariculture and food processing are explicitly listed by the BIA as areas targeted for international investors.

Although one of the main avenues for offshore entities to participate in the real economy is through the BISX, which allows international investors, as discussed earlier, it is limited in the scope of securities offered. Broadly, there are regulatory barriers that limit the direct participation of non-Bahamian entities. Foreign direct investment requires the approval of the BIA and large foreign investments require the approval of the National Economic Council, which includes members of the Cabinet and thus may also be susceptible to lobbying by local interests.[34] Decisions can take on average 60 days, and the process would benefit from increased transparency.[35] Additionally, non-Bahamians need a permit to buy land.[36] Both requirements discourage investments in land-intensive sectors, such as agriculture, by non-Bahamians. Furthermore, due to strict foreign exchange controls to maintain the current currency peg, international banks are not allowed to invest in domestic securities, are only permitted to hold Bahamian dollar balances for the purpose of paying local expenses[37], and are not allowed to have Bahamian customers (IMF 2019). On the one hand, these restrictions are important because they maintain a separation between the domestic and offshore banking sectors, which allows the latter to enjoy less rigorous regulatory requirements, and ensures that the Central Bank is better able to manage currency flows. However, the disadvantages are that it is difficult for these onshore firms to invest locally without becoming domestic banks, and thus losing several of the key privileges, such as privacy and confidentiality, that attracted them to The Bahamas in the first place.

Nevertheless, there is an opportunity to find creative means to allow offshore entities to participate more closely in the Bahamian economy while maintaining their offshore status and privileges. For example, no Bahamian company in the IFPG survey indicated that it had received any private equity financing. Yet, not only is there a need for financing, but traditional means of financing are inadequate for a variety of reasons such as collateral requirements, size of financing, and terms of financing. As of 2017, there were approximately 800 investment funds with over US$85 billion in assets, and many of these funds are familiar with complex and non-traditional financial instruments such as venture capital and private equity (IMF 2019b). Therefore, these entities not only have the capital, but also possess the expertise and interest. One potential avenue of exploration would be connecting promising nonbank financial institutions, such as those involved

[33] See Sectors reserved for Bahamian Nationals
[34] See 2021 Investment Climate Statements - Bahamas
[35] See Establishing a business in The Bahamas
[36] See Application for the Permission to purchase real property
[37] See Trade Financing - Bahamas

in private equity, with offshore financial entities interested in investing locally. These offshore financial entities would invest with approval from the Central Bank to ensure that inflows of foreign currency are adequately regulated, while local Bahamian investment funds, unhampered by rules targeting non-Bahamians, can invest freely. However, for this to occur, substantial regulatory reform and government support would be needed to create this narrow yet potentially valuable bridge between the real economy and the offshore financial sector.

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Barbados

Cloe Ortiz de Mendivil

Macroeconomic Context

Barbados has been hit hard by the COVID-19 pandemic. The country's lack of economic diversification and high dependency on tourism resulted in a real GDP drop of 14 percent in 2020. Although recovery was initially expected in 2021, the economy only grew 0.7 percent. However, in the first quarter of 2022 real GDP increased 11.8 percent year-on-year.[38] That said, total tourist arrivals were only 55 percent of those recorded in the same period of 2019, and hotel occupancy rates were around 70 percent, compared to above 80 percent prior to the pandemic. This could speak to a combination of longer stays and a contraction of the stock of available rooms.

In 2021, unemployment followed a decreasing trend and reached 10.9 percent in the last quarter, down from an estimated peak of over 20 percent. This was the result of a reactivation of the private sector and of temporary employment programs put in place by the government. Inflationary pressures are elevated due to increases in international prices of food and energy and the fact that Barbados relies heavily on imports. Inflation in March 2022 rose 9.3 percent compared to the same month a year prior.

The fiscal stance in Barbados had been deteriorating for two decades, and debt buildup led to the announcement of a debt restructuring process in 2018. The country entered an Extended Fund Facility program with the International Monetary Fund (IMF) and progress was remarkable until the pandemic hit. Recognizing the unprecedented nature of the shock, the IMF was very flexible in adjusting quantitative targets and structural benchmarks. The debt-to-GDP ratio in FY2021/22 stood at 131.9 percent, which is below the peak of 158.3 percent achieved prior to debt restructuring. The primary fiscal deficit stood at 1.4 percent, slightly above the 1 percent target. To the extent that the effects of the pandemic fade and the government remains committed, strong fiscal surpluses are expected. The introduction of procedural fiscal rules in 2021 and the commitment to pass fiscal rule legislation further down the road will help achieve and maintain fiscal discipline. International reserves, which were at critical levels prior to the pandemic, are now strong at US$1.5 billion and 36 weeks of import cover. However, the current account deficit continues to widen, and closed 2021 at 10.9 percent of GDP.

Overall, the macroeconomic outlook remains uncertain and depends heavily on the evolution of the pandemic, the resolution of international conflicts and disruptions to value chains, the ability

[38] In February 2021 there was a month-long lockdown due to a spike in COVID-19 cases, which makes the base of the comparison one of the lowest points of activity in Barbados. Average revenue per room fell 8 percent in the first quarter of 2022 compared to the same period in 2019.

of the economy to adapt to a changing environment, and the continuous commitment of the government to push the reform agenda and maintain adequate fiscal performance.

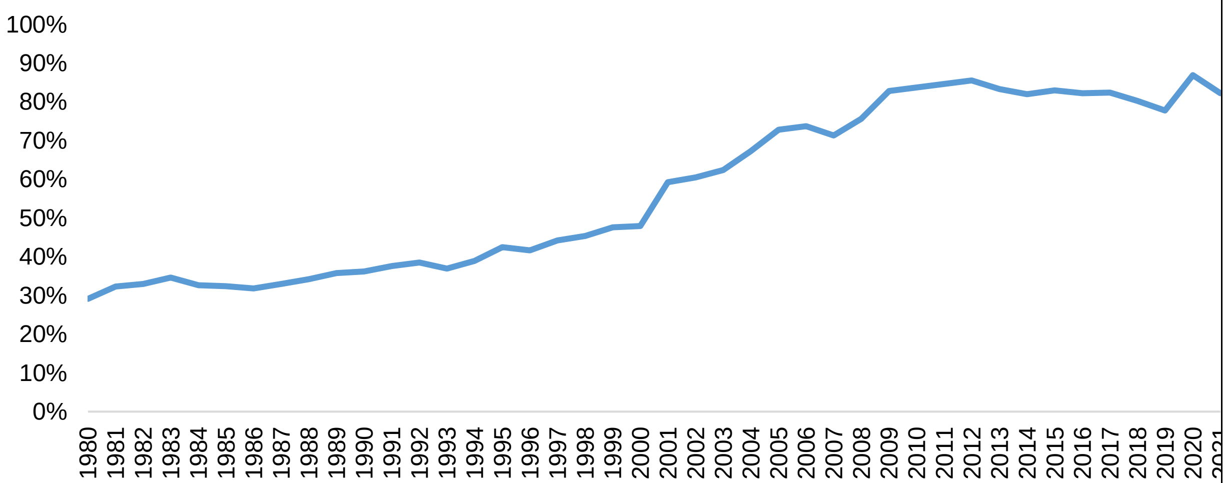
Financial Depth

Financial depth is often measured as private sector credit to GDP. In Barbados, this metric was 82.2 percent in 2021, the highest among the six Caribbean countries covered in this Bulletin.[39] Although the ratio has increased from the 77.8 percent recorded in 2019, the movement is due to lower GDP, and credit to the private sector in dollar terms actually decreased 2.4 percent. To give some historical perspective, during the 1980s and 1990s, financial depth grew very moderately, but in the first decade of the 2000s it took off before plateauing in the second decade (Figure 1, panel a). While from 2000 to 2009 average annual growth was 5.9 percent, from 2010 to 2019 it averaged -0.6 percent, which coincides with a deceleration of the economy (Figure 1, panel b).

All commercial banks in Barbados are subsidiaries of foreign entities. Correspondent banking relationship requirements have become more complex in the last decade due to concerns over anti-money laundering and counter-terrorism financing regulations. Complying with international regulations has increased operating costs and lowered the appetite for risk, thus decreasing access to finance, especially for smaller and/or riskier clients.[40]

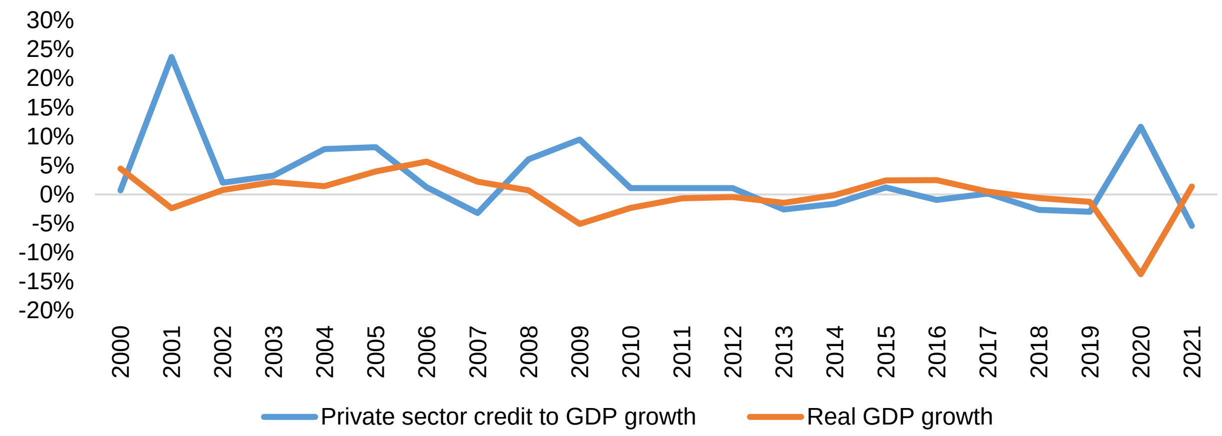
Figure 1. Barbados: Private Sector Credit Growth and GDP (Percent)

a. Credit to the Private Sector as a Share of GDP



[39] For a more complete discussion on financial inclusion and access, see Giles and Mooney (2020). The six countries are The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.
[40] See Beecher, Bissessar, and Julien (2018) and IMF (2018).

b. Financial Deepening and Real GDP Growth Rate



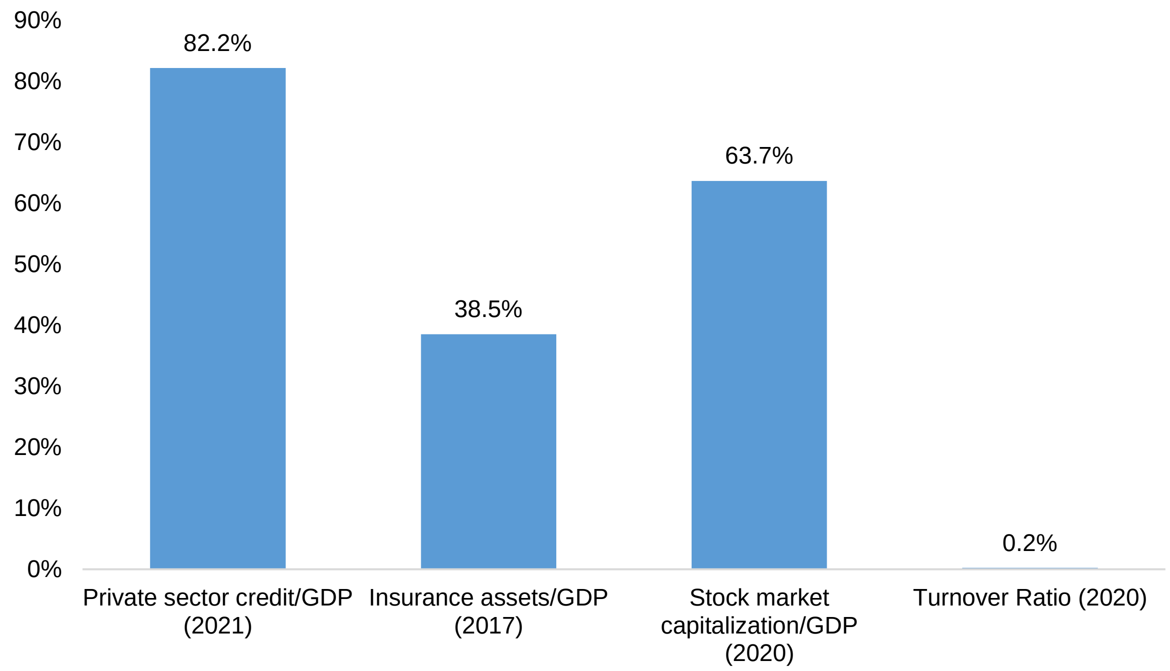
Sources: World Bank, World Development Indicators; and International Monetary Fund, April 2022 *World Economic Outlook.*

Financial Sector Structure and Nonbanking Finance

Regarding other dimensions of the financial sector, Barbados also stands out in insurance assets to GDP. The latest available data point to a ratio of 38.5 percent in 2017 (Figure 2), the highest in the region. However, the development of the stock market is limited, and capitalization is 63.7 percent of GDP, well below the ratio for Trinidad and Tobago, which more than doubled since 2000. Surprisingly, the turnover ratio is the lowest in the region at 0.2 percent, which points to very limited liquidity.[41]

[41] The turnover ratio is defined as the total value of shares traded as a percentage of average market valuation.

Figure 2. Barbados: Financial Development Indicators (Percent)

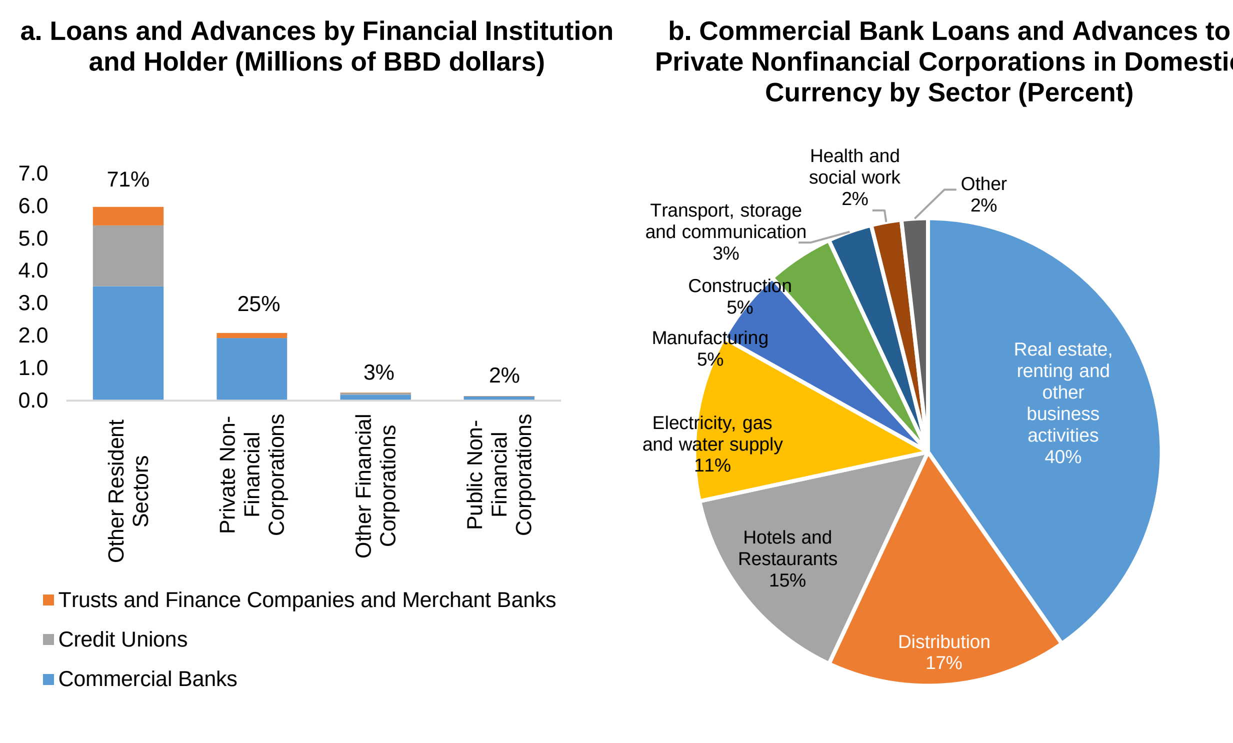


Source: World Bank, World Development Indicators.

As for the distribution of credit by type of holder, households absorb most of the credit, and although credit is provided mainly by commercial banks, credit unions also play an important role (Figure 3, panel a). Private nonfinancial corporations account for one-fourth of total credit, while other financial corporations and public nonfinancial corporations represent 3 percent and 2 percent of total credit, respectively.

Credit to nonfinancial corporations is heavily concentrated in real-estate-related activities, for which loans and advances accounted for 40 percent of the total in March 2022 (Figure 3, panel b). Other important sectors are distribution (17 percent) and hotels and restaurants (15 percent).

Figure 3. Barbados: Distribution of Credit by Type of Holder, as of March 2022



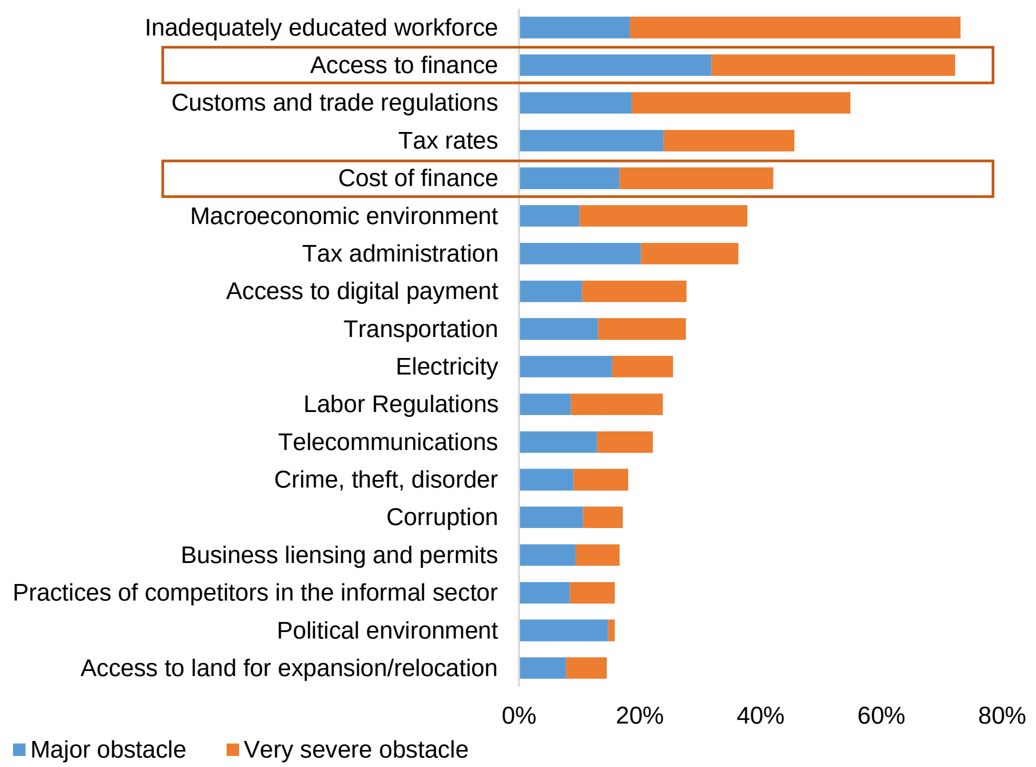
Source: Central Bank of Barbados.

Financial Access for Businesses

Compete Caribbean's 2020 Innovation Firm Performance and Gender (IFPG) Survey provides information on the perception of Caribbean firms about the main barriers to conducting business. In Barbados, access to finance was reported as being a major or very severe obstacle by 72 percent of respondents, and it is their second main concern, right below an inadequately educated workforce (Figure 4). The cost of finance also affects conducting business, according to 43 percent of surveyed firms. It is remarkable that in both cases concerns have increased since Compete Caribbean's 2014 Productivity, Technology, and Innovation in the Caribbean (PROTEqIN) Survey. Access to finance was then reported as a major or very severe obstacle by 35 percent of respondents, and the cost of finance by 27 percent. This trend could be explained by financial entities being less willing to take risks due to the global crisis caused by the pandemic and, therefore, more stringent requirements to apply for financing.

Access to finance varies with firm size, with smaller firms facing more difficulties. In 2020, only 25 percent of small firms reported having active short-term loans (either a line of credit, an overdraft facility, or a credit card), and 19 percent reported having medium/long-term loans. On the other hand, 52 percent and 18 percent of medium-size firms had short and medium/long-term loans, respectively, while the respective figures were 100 percent and 48 percent for large firms.[42] Companies were also asked whether they had applied for new lines of credit to commercial banks during the last year, and only 11 percent did so. Reasons for firms not to apply for loans also vary according to the size of the company. The main obstacle for small and medium-size firms is not being able to meet collateral requirements (42 percent and 57 percent of firms not applying for loans, respectively) (Figure 5). Second, they complain about unfavorable interest rates (39 percent of small and 23 percent of medium-size firms). Large firms do not face the issue of not having sufficient collateral, but either they did not need a loan, the size and maturity were not appropriate, interest rates were not favorable, or they did not think the loan would be approved.

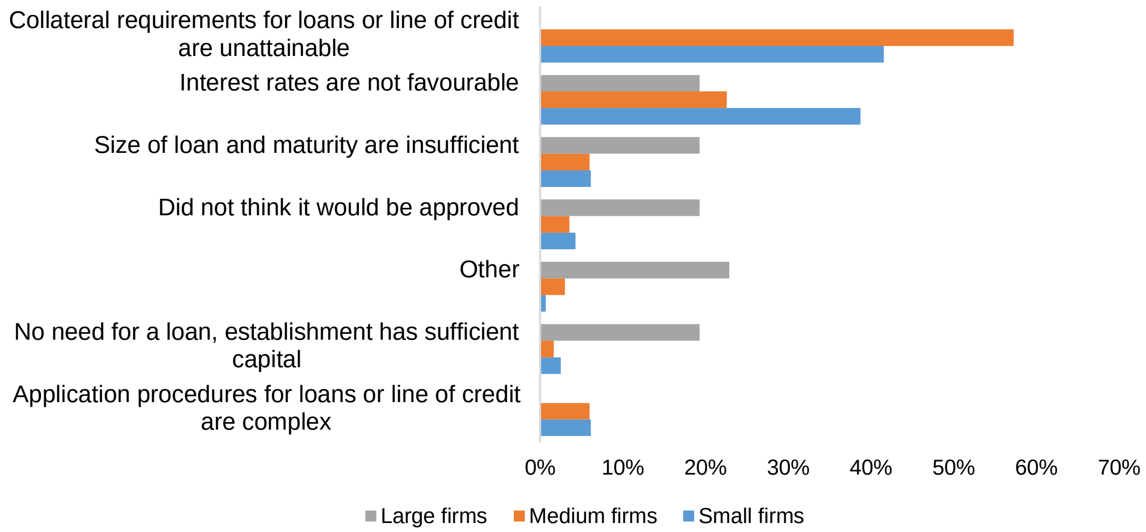
Figure 4. Barbados: Main Obstacles that Affect Business Operations, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey.
Note: The question (number C5) asked was: Please rate each one of these factors as obstacles that can affect the current operations of your establishment.

[42] Small firms are defined as having less than 20 employees, medium firms between 20 and 99 employees, and large firms 100 employees or more.

Figure 5. Barbados: Reasons for Not Applying for Financing, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey.
Note: The question asked (number I3) was: For your last fiscal year, have you applied for or requested any of the following types of financing? If no, why not?

Regulatory Developments

Parliament enacted the Fair Credit Reporting Act in December 2021. The act calls for the (i) creation of a regulatory environment to promote the development of a fair credit reporting system, (ii) development of a regulatory framework for the use of such data, and (iii) secure keeping of persons' private data collected by the credit bureau and related matters. Credit information providers include financial institutions, hire purchase offerors, utility companies, and government departments. The Central Bank of Barbados will be the regulator. The information shared will be used to determine an individual's or a company's creditworthiness given the amount of debt obligations. This personal data will be kept secure and a local credit score system will be introduced. The legislation will also facilitate cross-border credit reporting to allow information to be used outside of Barbados. The government announced the rollout of a public campaign to educate individuals and small businesses about the system in 2022. The creation of a credit bureau will have a positive impact on access to financing both for individuals and companies, since financial institutions will have access to information that allows for risk assessment. The careful implementation and full operationalization of credit agencies is therefore crucial for the success of this legislation.

Overall, although the financial system in Barbados is developed compared to other Caribbean countries, there is much room for improvement vis-à-vis other countries of the same income level.

Access to credit remains limited for small firms, which hampers their drive for innovation and growth. Efforts to reach unserved segments of the market—both at the household and company levels—coupled with financial literacy initiatives, could go a long way towards including those now excluded from access to financial instruments.

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Guyana

Victor Gauto

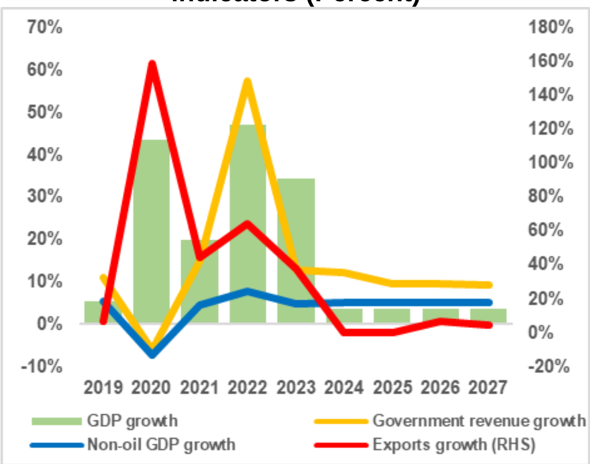
Macroeconomic Context

Guyana's macroeconomic context is one of a booming economy, with oil production driving growth in exports, GDP growth, government revenues, and expenditures in the medium term. Oil production also continues to drive medium-term prospects based on production with two floating, production, storage, and offloading (FPSO) vessels. The value of oil exports increased from US$1 billion in 2020 to US$3 billion in 2021 and is expected to continue increasing in the medium term. The growth of exports of goods and services is expected to average 77 percent in 2020–2023 and then fall in 2024, though these estimates will be updated once new FPSOs begin oil production by 2025. GDP growth is expected to average 36.3 percent over 2020–2023 before stabilizing to 3.7 percent over 2024–2027. Government revenues declined by 6 percent in 2020 but are expected to recover to an average annual growth of 24 percent over 2021–2024 (Figure 1).

Since oil production began in 2020, the real economy has re-balanced significantly. In 2020, the first full year of oil production, GDP growth reached 43.5 percent, and it is expected to grow by 47.5 percent in 2022. In 2021, GPD growth moderated to 19.9 percent. For its part, the non-oil economy contracted by 7.3 percent in 2020 and grew by 4.6 percent in 2021. In 2022, the non-oil economy is projected to grow by 7.7 percent, driven by growth in agriculture, mining (not including oil), and construction. Agriculture and gold production contracted in 2021 but are projected to grow by 8.9 percent and 12.2 percent, respectively, in 2022. The manufacturing and construction sectors are expected to grow by 14.3 percent and 10.5 percent, respectively, while the large services sector is projected to grow by 3.8 percent (Figure 2).

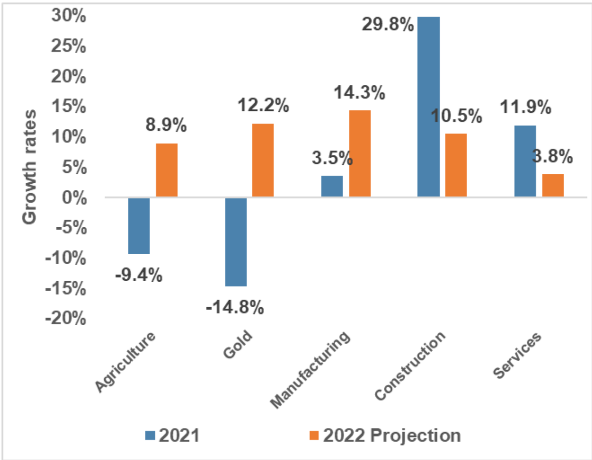
In summary, the new oil economy has rebalanced as follows: oil and gas are estimated to represent 59.7 percent of GDP in 2022, followed by services at 16.7 percent (down from 40 percent in 2019), agriculture at 10 percent (down from 25 percent), and gold production at 4 percent (down from 11 percent). Oil production's contribution to GDP growth was 51 percent and 17 percent in 2020 and 2021, respectively, and is projected to be 43.3 percent in 2022. Five more oil discoveries were announced in Guyana in early 2022, increasing the estimate of recoverable resources from approximately 10 billion recoverable oil-equivalent barrels in late 2021 to nearly 11 billion oil-equivalent barrels in April 2022.

Figure 1. Guyana: GDP Medium-term indicators (Percent)



Sources: International Monetary Fund, April 2022 *World Economic Outlook*, and 2019 Article IV; and estimates by the author.

Figure 2. Guyana: Real GDP Growth (Percent)



Source: Ministry of Finance Budget Speech, 2022.

Financial Depth

In this context of a booming economy, access to finance will be very important for the non-oil economy to leverage opportunities in agriculture, tourism, real estate development, and business process outsourcing. One standard measure of financial sector development is financial depth, often measured as credit to the private sector as a share of GDP. This measure has been climbing steadily in Guyana, increasing from 22 percent in 2009 to 39 percent in 2020. The average credit-to-GDP ratio for the six Caribbean countries analyzed in this Bulletin is 48 percent,[43] while the average for Latin America and the Caribbean is 59.8 percent, suggesting there is potential for credit to continue expanding in Guyana, especially in the current context. From a historical perspective, there has been a high degree of volatility of this indicator over the last 40 years (Figure 3). Periods that stand out are the early 1990s, when the credit-to-GDP ratio fell to a low of 18 percent in 1991; and the early 2000s, when the ratio reached a high of 60 percent before falling once again to slightly over 20 percent in the mid-2000s. It is likely that macroeconomic instability and external factors played a role in some of this variability, considering that the 1980s were characterized by a growing government role in productive activities such as sugar and bauxite, and price controls that deterred private sector development. This contributed to falling GDP levels, growing levels of public debt, high levels of inflation, and depleted international reserves.[44]

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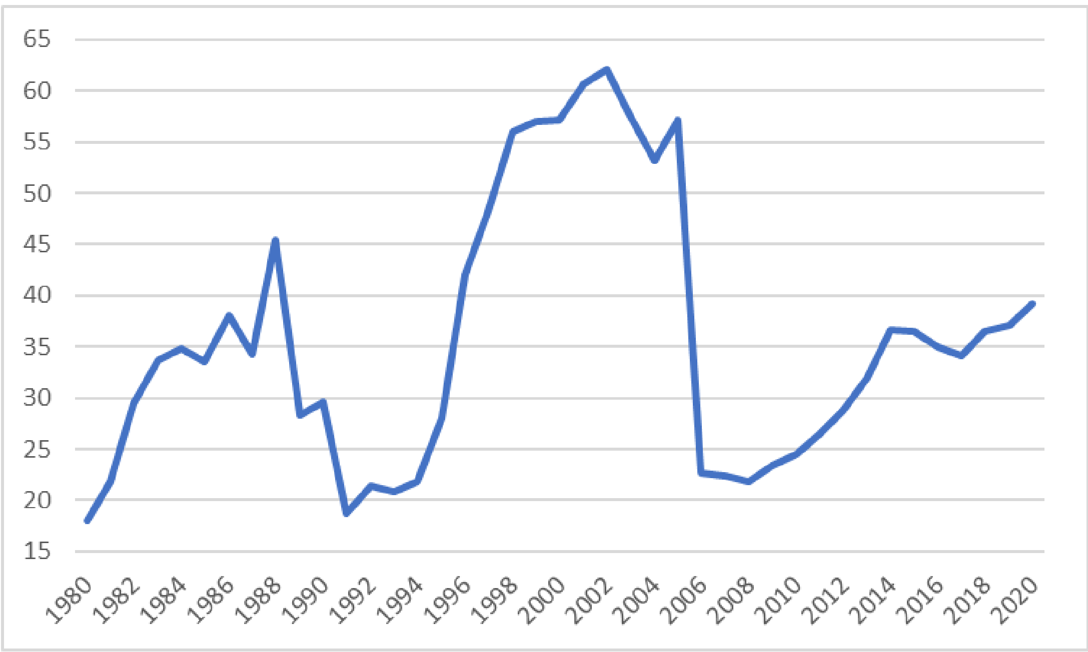
[43] The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

[44] International Monetary Fund, 1996, Guyana: Recent Economic Developments and Selected Issues, available at www.imf.org/en/Publications/CR/Issues/2016/12/30/Guyana-Recent-Economic-Developments-and-Selected-Issues-1731

In the late 1980s the government implemented an Economic Recovery Program that introduced market-oriented policies, leading to a recovery. In the 1990s, GDP growth averaged 7 percent for most of the decade, reflected in booming levels of credit-to-GDP ratios, which once again fell in the mid-2000s. Guyana suffered significant damage from floods in 2005, with economic damage estimated at 60 percent of GDP, followed by a context of global recession in 2007–2008. Following the global recession, credit to GDP grew through 2014, when there was a global commodities price shock, slowing GDP growth and very likely also limiting credit growth.

Figure 3. Guyana: Credit to the Private Sector as a Share of GDP (Percent)



Source: World Bank, World Development Indicators.

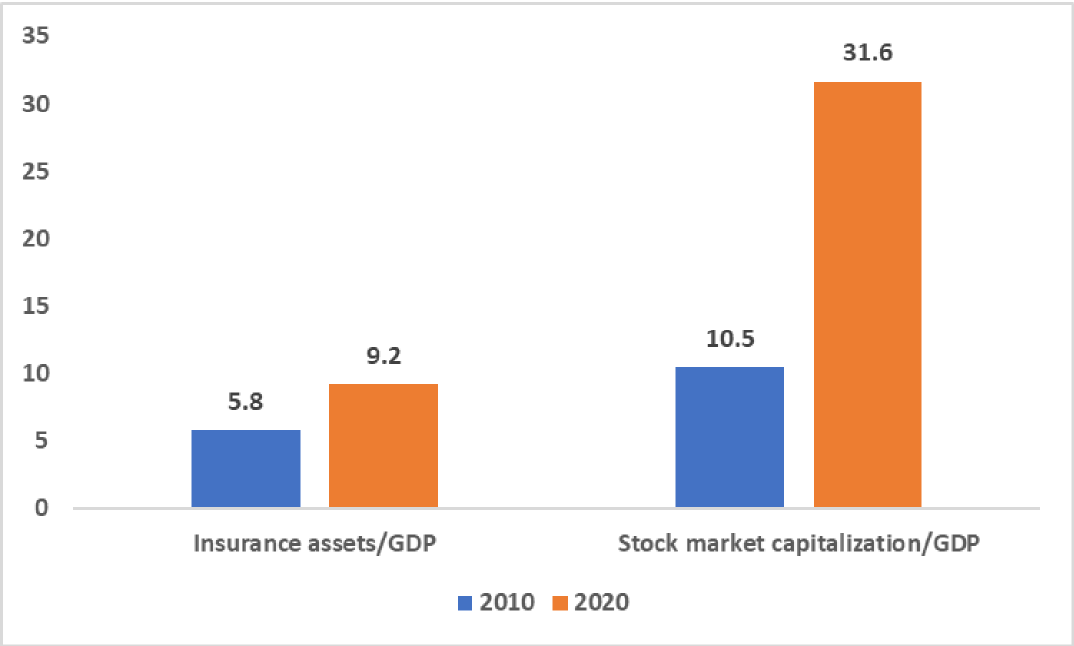
Financial Sector Structure and Nonbank Finance

There are other dimensions of financial sector development showing that Guyana's financial sector is relatively small. Guyana's insurance-assets-to-GDP ratio increased from 5.8 percent in 2010 to 9.2 percent in 2020 (Figure 4). As mentioned in the Regional Overview of this Bulletin, other Caribbean countries have relatively larger insurance sectors, with the Caribbean average for six countries being 19.5 percent in 2020. That level is similar to that of eight selected Latin American countries averaging 9.6 percent.[45] In terms of stock market capitalization, which evaluates the overall value of the stock market, Guyana reached 31.6 percent in 2020, below the

[45] The selected countries are Brazil, Panama, Peru, Suriname, Trinidad and Tobago, Mexico, Costa Rica, Chile, Colombia, and Argentina.

Caribbean average of 53.7 percent and that of the selected Latin American countries of 37.4 percent, according to the World Bank, Global Financial Development database and the Guyana Stock Exchange.

Figure 4. Guyana: Financial Development Indicators (Percent)



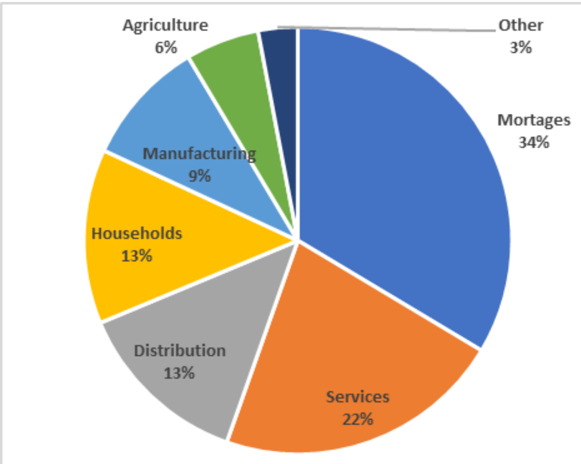
Source: World Bank, Global Financial Development Indicators.

The Bank of Guyana regulates six commercial banks and six nonbank financial institutions, among other financial firms. The nonbank financial institutions include deposit-taking institutions focused on mortgage loans and non-deposit-taking financial institutions such as trust businesses, a stock brokerage, and a finance company. The financial system's lending to the public sector is reported in net terms, which is the difference between total lending less total deposits. As a reference, the financial system's total net lending to the public sector was 9 percent of total lending to the private sector in March 2022. It is estimated that total lending to the private sector was approximately 10 percent of GDP in March 2022, mainly because GDP had grown so much since 2020. The largest category of lending to the private sector is mortgage loans, which account for 34 percent of total private sector loans, followed by business services and distribution. Household credit accounts for 13 percent of lending to the private sector, while mining, within "Other," accounts for 1.4 percent of total loans (Figure 5).

Private sector credit growth recovered in 2021, after growth rates had fallen following the onset of the COVID-19 pandemic in 2020. Credit growth had reached 11 percent year-over-year in April 2020 amid the start of oil production in December 2019. Since the pandemic, it fell to a low of 1.8

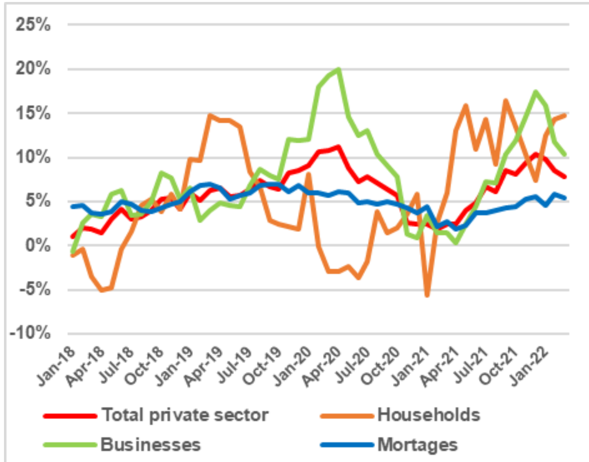
percent year-over-year in February 2021 before recovering to 10.4 percent in December 2021. Of the three major lending categories, lending to businesses recently experienced the most growth, reaching 17 percent in December 2021. Household credit at the end of 2021 had a growth rate of 7 percent after growing an average of 13 percent from April to November 2021. Mortgage lending has had a moderate recovery, closing 2021 with a growth rate of 5.5 percent, the highest growth rate in all of 2021, and increasing to 5.8 percent in February 2022 (Figure 6). Businesses make up most of the private sector lending portfolio, accounting for 52 percent of total loans, followed by mortgages at 34 percent and households at 13 percent.

Figure 5. Guyana: Shares of Credit to the Private Sector by Economic Activity (Percent)



Source: Bank of Guyana Statistical Abstract, March 2022.

Figure 6. Guyana: Private Sector Credit Growth by Major Economic Activity (Percent)



Source: Bank of Guyana Statistical Abstract, March 2022.

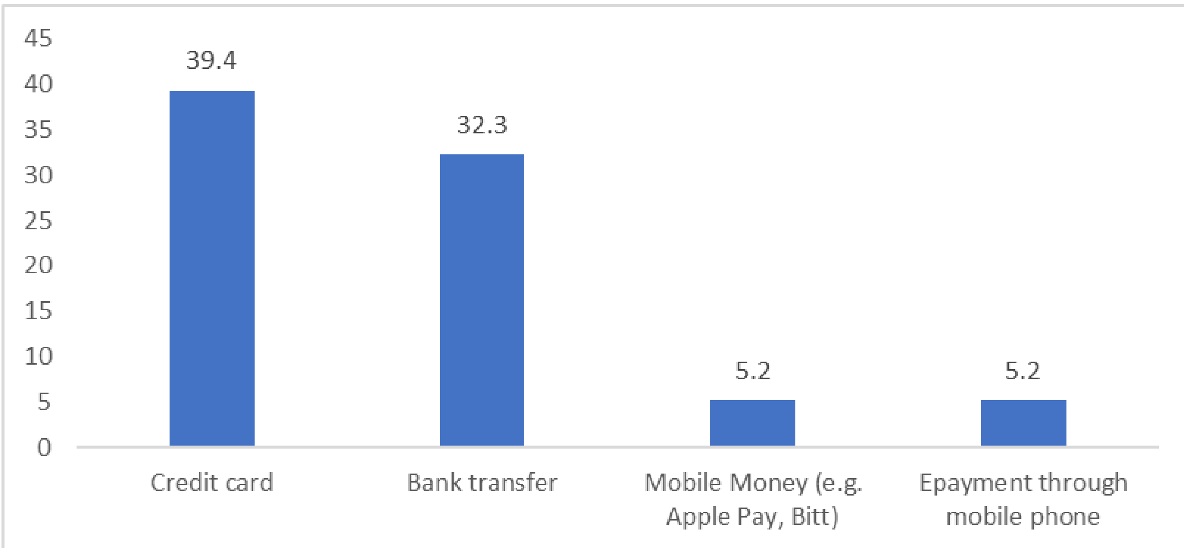
Financial Access for Businesses in Guyana

The most recent enterprise survey conducted in Guyana and the Caribbean – Compete Caribbean's 2020 Innovation Firm Performance and Gender (IFPG) Survey – provides insights into how firm owners view their needs for access to credit and what the key obstacles are that they face in accessing that credit. In addition, these recent data can be compared with an earlier Compete Caribbean survey, the 2014 Productivity, Technology and Innovation in the Caribbean (PROTEqIN) Survey. It should be noted that 2020 was a terribly difficult year economically due to the pandemic, and this may have had large effects at the firm level both in terms of entrepreneurs' reported needs and actual business outcomes.

Like some other countries in Latin America and the Caribbean, Guyana is gradually progressing towards including more technology in the financial system as more private sector companies introduce services for electronic bank transfers, online bill payment services, and mobile money accounts. The business environment has traditionally been cash-based, and that is reflected in some of the IFPG Survey results. Of 155 firms surveyed in Guyana, less than half reported

accepting payments by credit cards. About a third mentioned accepting bank transfers, while very small shares reported accepting payments from mobile money apps or electronic payments through a mobile phone (Figure 7).

Figure 7. Guyana: Share of Firms Surveyed that Reported Using Non-cash Payments (Percent)

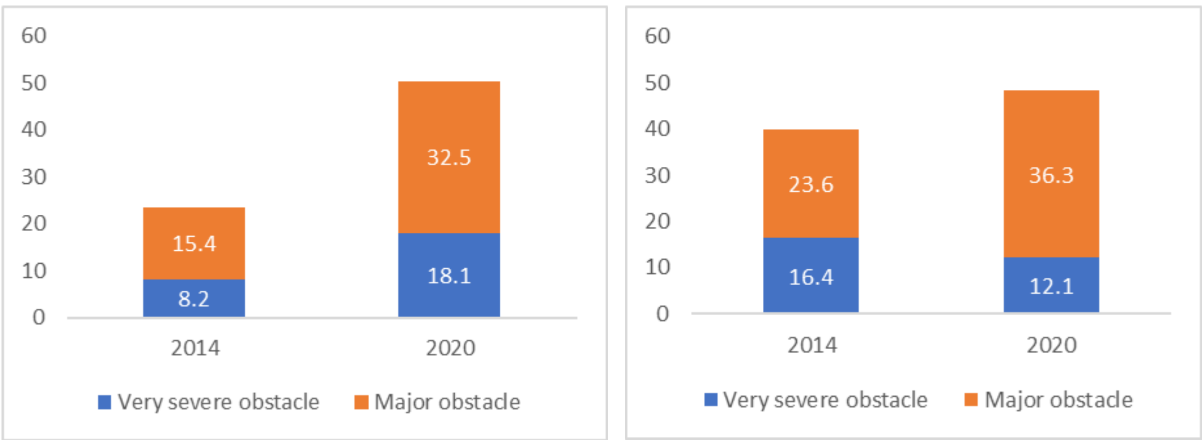


Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey.

As part of the survey, firms were asked to rate the "obstacles that can affect the current operations of your establishment." The item "access to finance (e.g., collateral)" was increasingly reported to be either a major or very severe obstacle between 2014 and 2020. The share of firms reporting collateral to be a major obstacle increased from 15.4 percent in 2014 to 32.5 percent in 2020, while the share of firms reporting it to be a very severe obstacle increased from 8.2 percent in 2014 to 18.1 percent in 2020 (Figure 8, panel a). "Cost of finance (e.g., interest rates)" was cited in 2020 as a major or severe obstacle by 48 percent of firms – higher than the 40 percent figure in 2014 (Figure 8, panel b). The 2020 survey reported average interest rates in Guyana were 11.8 percent compared to the Caribbean average of 13.3 percent. However, lending rates have declined in Guyana since the survey and averaged 9 percent in 2021.

Figure 8. Guyana: Responses to the Question: Is Access to/ Cost of Finance an Obstacle to Your Firm's Operations? 2014 vs. 2020 (Percent)

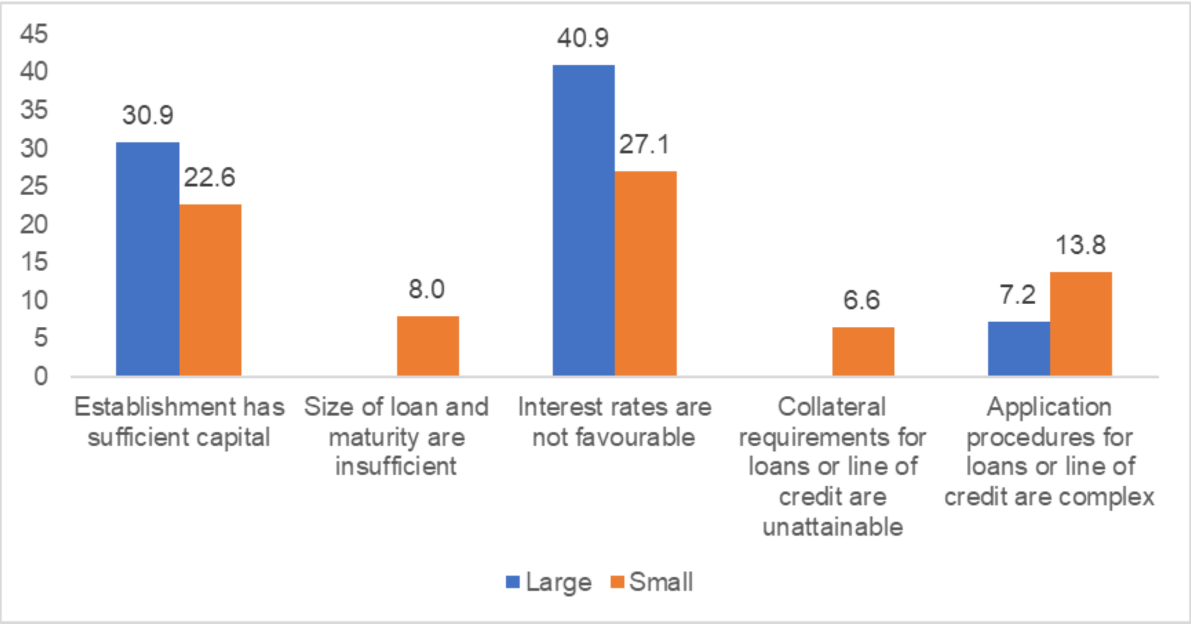
a. Access to Finance (e.g., Collateral) **b. Cost of Finance (e.g., Interest Rates)**



Sources: Compete Caribbean, 2014 Productivity, Technology, and Innovation in the Caribbean Enterprise Survey and 2020 Innovation Firm Performance and Gender Survey.

The 2020 survey also asked firms to report the reason why they did not even apply for a loan or line of credit in the previous year (2019). A significant share of both small and large firms had similar responses. The most frequent responses were either that the firm "had sufficient capital" or "interest rates were not favorable." Among large firms, 40.9 percent reported that the interest rates were not favorable, and 30.9 percent reported having enough capital, while 27.2 percent of small firms identified interest rates as a challenge and 22.6 percent mentioned having enough capital. A smaller share of small firms mentioned other reasons for not seeking loans, such as the complexity of loan applications, loan sizes being insufficient, or challenges with collateral requirements (Figure 9).

Figure 9. Guyana: Reasons for Firms to Not Apply for a Loan or Line of Credit from a Private Commercial Bank, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey.

Policy Agenda for Financial Development

With Guyana's current economic boom, the financial sector stands to benefit from further development and from helping the private sector capitalize on new business opportunities. Growth of credit to the private sector was increasing significantly before the pandemic struck and is currently growing at close to pre-pandemic levels. Supporting financial deepening could go a long way towards facilitating more investment and employment, thus increasing household incomes.

For institutional development, one policy development the government is planning is to issue longer-term bonds in addition to Treasury bills, which are currently used for both monetary and fiscal policy (Ministry of Finance 2021–2022 Public Debt Policy). Having a dedicated long-term public debt instrument could contribute to diversifying financial sector investments and channeling financial liquidity into interest-generating securities, diverting resources from non-interest-generating excess reserves held at the Bank of Guyana. This could support financial depth and increase competitiveness in the sector.

Finally, the role of technology and digitalization has been a significant factor impacting financial sector development and improving financial inclusion. In this regard, the Bank of Guyana has made progress implementing the National Payments System Strategy, which identified the

challenge of developing the necessary infrastructure to integrate payment services across providers. The Bank of Guyana completed implementation of the Guyana Real Time Gross Settlement System (G-RTGS) and Guyana Central Securities Depository (G-CSD) in 2021, which are payment systems that support the financial sector's ability to efficiently execute interbank payments, reducing the need for cash payments (Bank of Guyana, Annual Report 2021). To further expand digitalization, supporting the interoperability of cards across banks and point-of-sale terminals could further improve efficiencies and reduce cash-based payments.

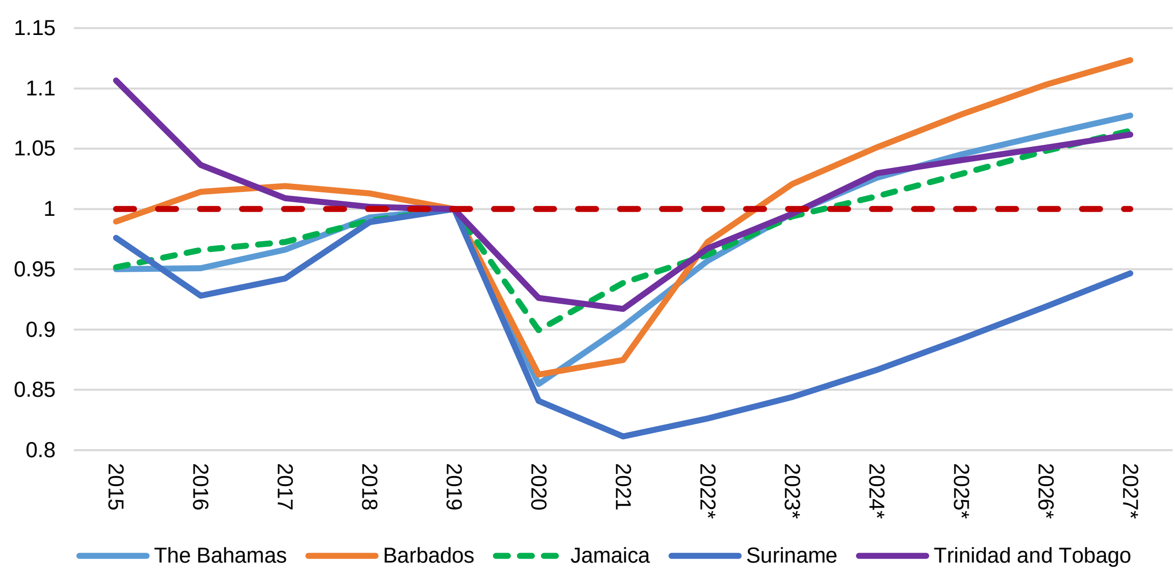
Jamaica

Monique Graham, Anna-Kaye Walters, and Henry Mooney

Macroeconomic Context and Developments

After an unprecedented shock in 2020—real GDP fell by about 10 percent that calendar year (Figure 1)—Jamaica's economy has begun to move towards recovery. As discussed in our previous Caribbean regional reports, the main driver of the shock from COVID-19 was the loss of tourism, which accounts for a large proportion of output, employment, and export revenues in Jamaica. Looking forward, the recovery of the tourism sector, normalizing external demand conditions, and the lifting of domestic travel and related restrictions should continue to support a robust pace of recovery. The May 2021 Quarterly Bulletin discussed surveys of global tourism experts, most of which highlighted expectations that the tourism sector would return to 2019 levels of activity by 2023/2024. Against this backdrop, the latest available government and cross-country estimates suggest that real GDP will return to pre-crisis levels (i.e., end-2019) by about 2024 (Figure 1), which is in line with trajectories for most of the other Caribbean economies analyzed in this report.

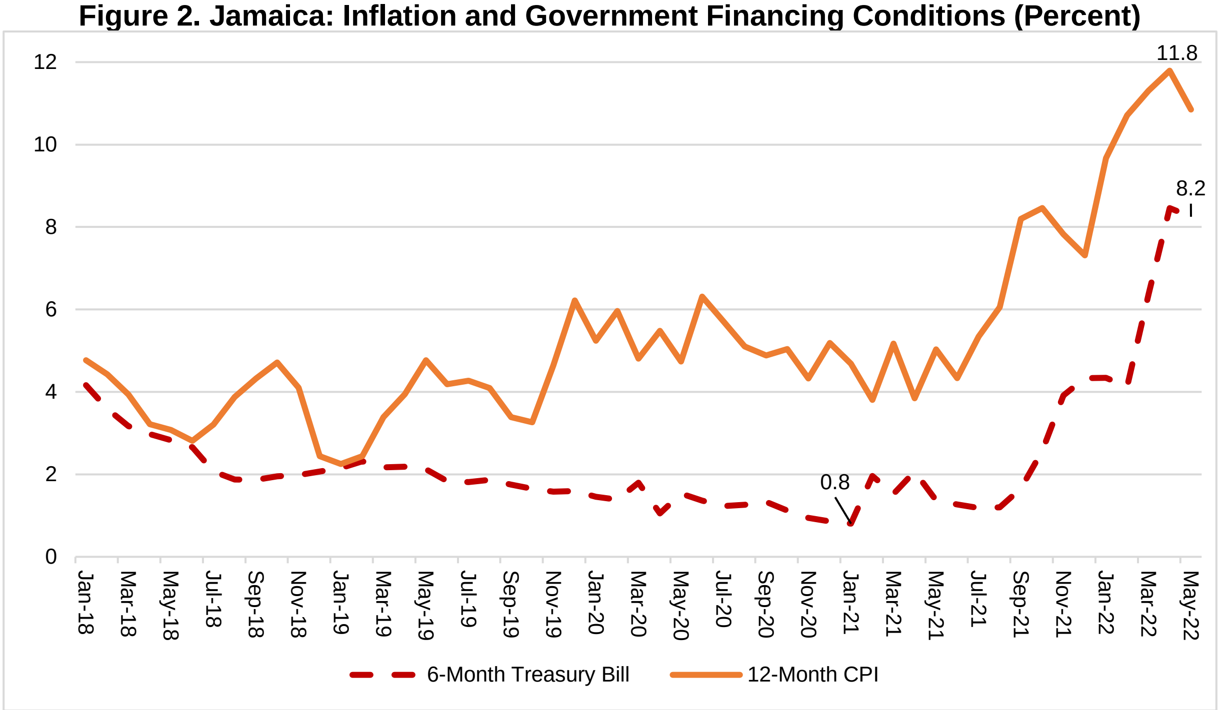
Figure 1. The Caribbean: Timeline to Economic Recovery—Shock to Real GDP and Projections (Percent; real GDP at end-2019 = 1)



Source: Authors' calculations based on data from the International Monetary Fund's April 2022 *World Economic Outlook.*
Note: (*) = projection.

One lingering and increasingly significant consequence of the crisis for Jamaica's economy is a rapid rise in inflation and its implications for domestic financing costs and conditions. This phenomenon has been amplified by the conflict in Europe's impact on food and fuel prices. As is true for most countries around the world, Jamaica's rate of inflation has risen rapidly since early 2021—from about 4 percent (year-over-year) in April 2021 to almost 12 percent by May 2022 (Figure 2). This has prompted the Bank of Jamaica to undertake a number of policy actions to address rising prices and related expectations, resulting in an increase of the policy rate by 450 basis points between September 2021 and May 2022. This has affected local borrowing costs, as highlighted by the rapid increase in yields on Government of Jamaica Treasury securities. For example, six-month Treasury bill yields increased from about 0.8 percent in January 2021 to over 8 percent by May of 2022 (Figure 2). The same phenomenon has also affected corporate and household borrowers, resulting in tighter domestic conditions.

Figure 2. Jamaica: Inflation and Government Financing Conditions (Percent)



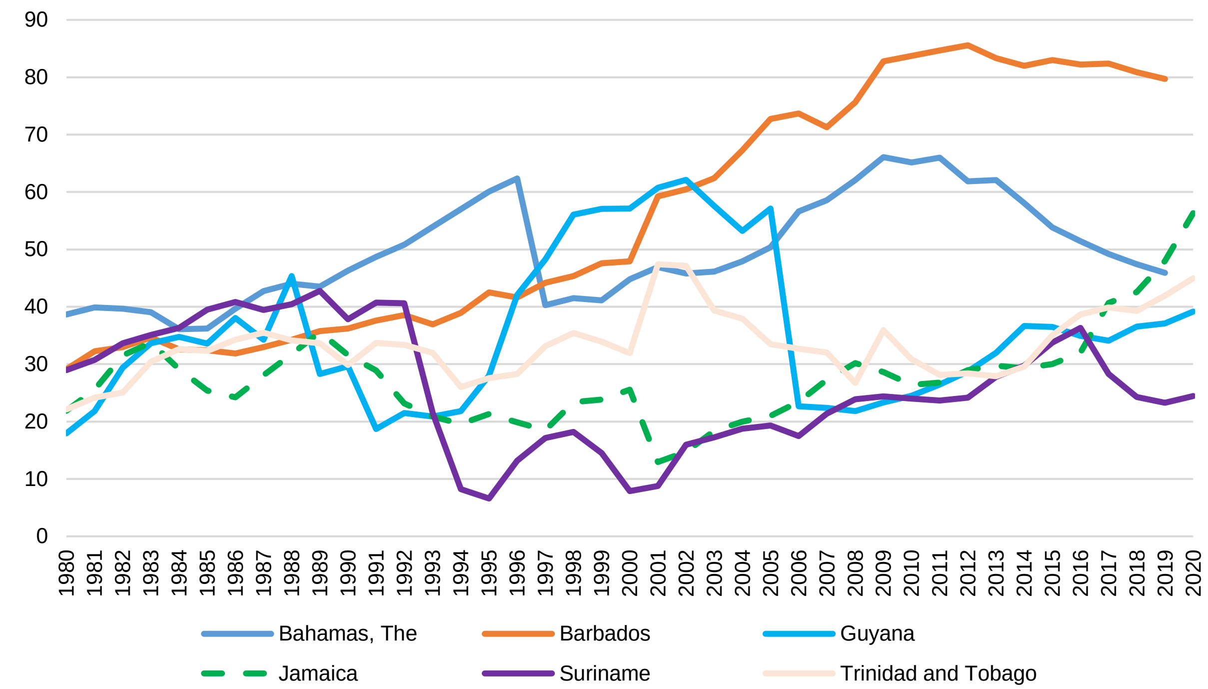
Source: Authors' calculations based on Bank of Jamaica data (latest available).
Note: CPI: consumer price index.

Finance in Jamaica: Strong Progress, but Challenges Remain

Against this backdrop, this report focuses on financial development, access, and inclusion across the Caribbean. Jamaica has made tremendous progress in recent years with policy reform, macroeconomic stabilization, and financial development. Successful transformation of fiscal and

monetary policies and institutions has led to nearly a decade of falling debt levels, lower government financing requirements, and more stable and predictable exchange and interest rate conditions. This has set the stage for historically rapid private sector financial deepening, with the ratio of private credit to GDP increasing from about 26 percent in 2010 to over 56 percent by 2020 (Figure 3).[46] This was the most rapid pace of credit deepening over the past decade of any of the six Caribbean economies analyzed in this report.[47] As detailed in a related publication on financial sector development in Jamaica[48], a key reason for this has been successful fiscal consolidation that has driven a drastic reduction in government borrowing as a share of total domestic credit.

Figure 3. Jamaica vs. Peer Countries: Credit to the Private Sector 1980–2020 (Percent of GDP)



Sources: World Bank, World Development Indicators; International Monetary Fund, April 2022 *World Economic Outlook*; and authors' calculations.

[46] Domestic credit to the private sector refers to financial resources provided to the private sector by financial corporations—such as through loans, purchases of nonequity securities, and trade credits and other accounts receivable—that establish a claim for repayment, The financial corporations include monetary authorities and deposit money banks, as well other financial corporations for which data are available (including corporations that do not accept transferable deposits but do incur such liabilities as time and savings deposits). Examples of other financial corporations are finance and leasing companies, money lenders, insurance corporations, pension funds, and foreign exchange companies.

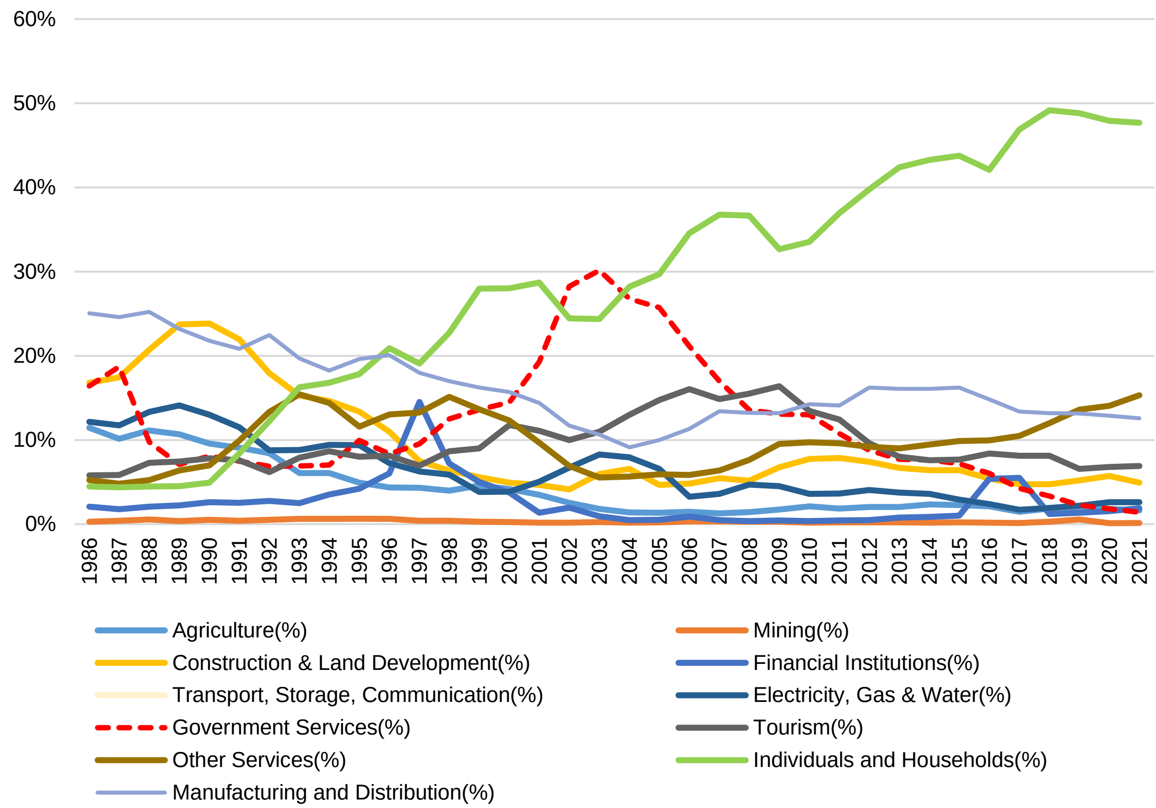
[47] The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

[48] Mooney. 2018. Jamaica Financial Development, Access and Inclusion: Constraints and Options. IDB Policy Brief No. 301.

In this context, the evolution of credit allocation in Jamaica is telling. In the late 1980s, government borrowing accounted for almost 20 percent of all bank loans (a subset of total private credit, mentioned above), while credit to private individuals accounted for less than 5 percent. By 2003, government borrowing peaked at about 30 percent of all borrowing, causing a further contraction of credit to other sectors. In the past decade, fiscal consolidation and the diversification of public funding sources reduced the government's share of bank lending to about 1 percent (2021), enabling a rapid increase in private sector credit and investment. By 2021, almost half of total bank credit took the form of loans to individuals and households (Figure 4). Tourism and other services, as well as manufacturing sectors, have also made important gains with respect to access to bank credit.[49]

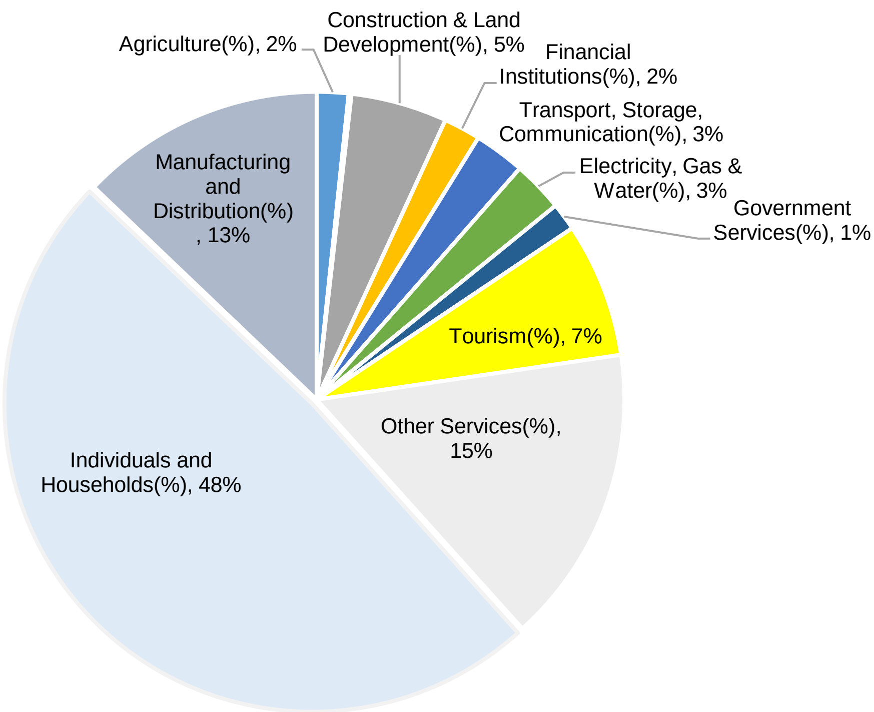
Figure 4. Jamaica: Commercial Banks' Total Loans and Advances by (Percent)

a. Commercial Banks' Total Loans and Advances by Sector, 1986 to 2021



[49] "Other services" sectors include distribution, food, and beverages (excluding tourism), entertainment, professional and other services, and services provided to overseas residents.

b. Commercial Banks' Total Loans and Advances by Sector, 2021



Source: Bank of Jamaica.

Financial Sector Structure and Nonbank Finance

As economies develop, the structure of financial systems becomes more advanced. For example, stock markets expand and become more liquid, and insurance sectors become more diversified, fueling investment and savings in an economy. Jamaica has made considerable progress regarding these dimensions of finance. For example, Jamaica's stock market capitalization increased from about 35 percent of GDP in 2010 to almost 85 percent of GDP in 2020 (Table 1). By this measure, Jamaica's stock market was ample compared to other countries in Latin America and the Caribbean for which data were available—behind Trinidad and Tobago, but ahead of major economies like Chile, Brazil, and Mexico.

Table 1. Stock Market Capitalization to GDP (Percent)

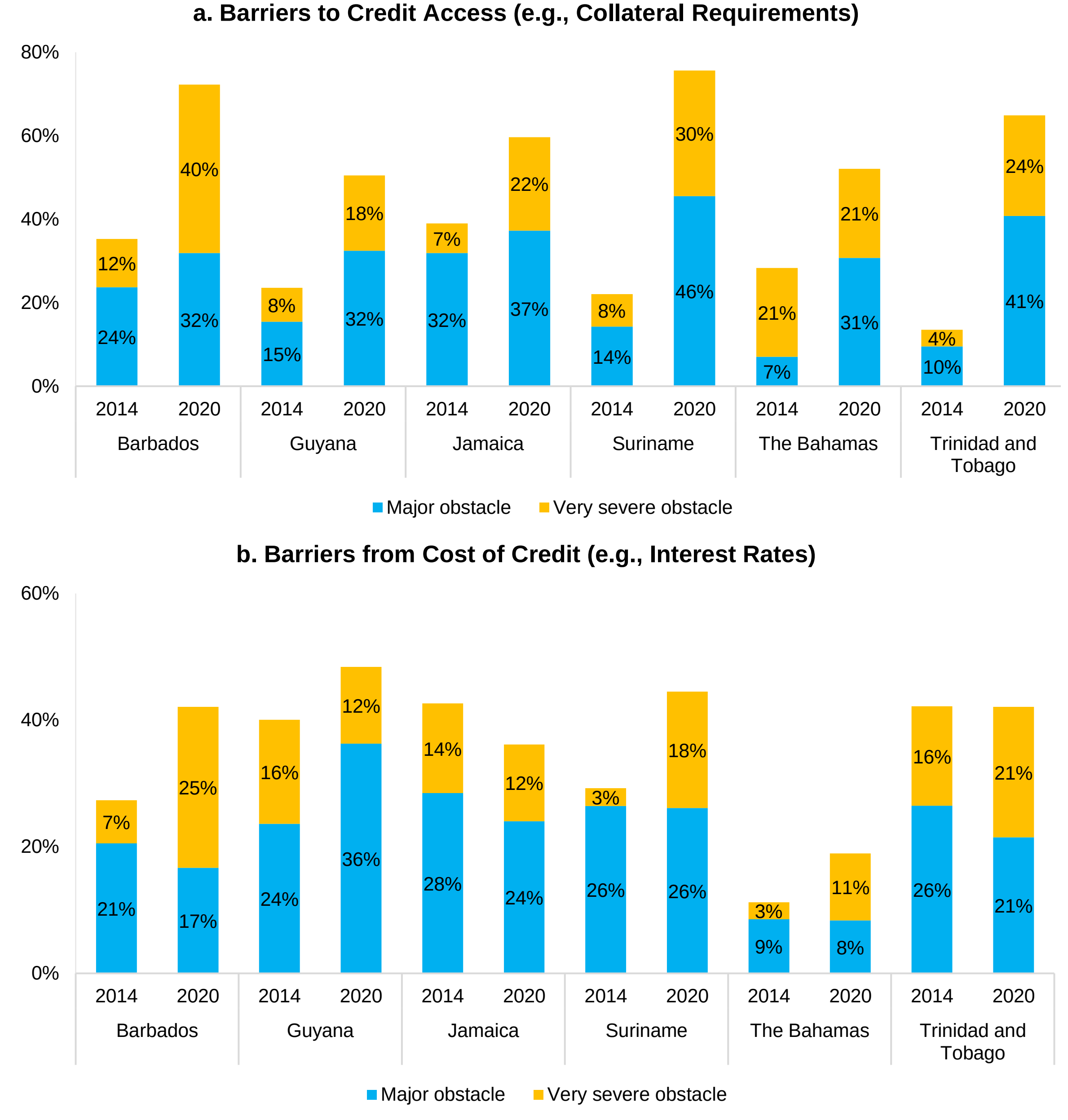
Country	2000	2010	2020
Canada	103.5	134.2	160.7
United States	147.4	115.3	194.9
Trinidad and Tobago	41.9	55.7	91.0
Jamaica	39.4	29.4	84.7
Chile	77.6	156.4	73.0
Brazil	34.5	70.0	68.4
Barbados	55.8	48.3	63.7
Bahamas, The	..	28.8	48.0
Peru	18.8	70.1	43.1
Colombia	34.7*	72.8	39.2
Mexico	17.7	43.0	37.1
Guyana	na	10.5	31.6
Panama	22.7	28.4	26.3
Argentina	16.1	15.1	8.8
Suriname	..	14.4**	3.4***
Costa Rica	3.0	3.8	3.1

Sources: World Bank, World Development Indicators and Global Financial Development databases; and authors' calculations.
Note: Latest available data: (*) 2005, (**) 2014, (***) 2021.

Financial Access for Businesses in Jamaica

As detailed in the Regional Overview of this report, while aggregates are helpful, the views and experiences of individual borrowers are important to understanding financial access and inclusion. Despite progress at the aggregate level detailed above, IDB-sponsored surveys suggest that Jamaican firms suffer from appreciable constraints that appear to have become more acute during the COVID-19 crisis. For example, in 2014, approximately 40 percent of Jamaican firms reported barriers to credit access (e.g., from collateral requirements) as major or severe obstacles to growing their businesses. In 2020, the proportion of firms reporting these challenges had risen to about 60 percent (Figure 5, panel a).

Figure 5. Barriers to Access / From Cost of Credit for Firms, 2014 vs. 2020 (Percent)

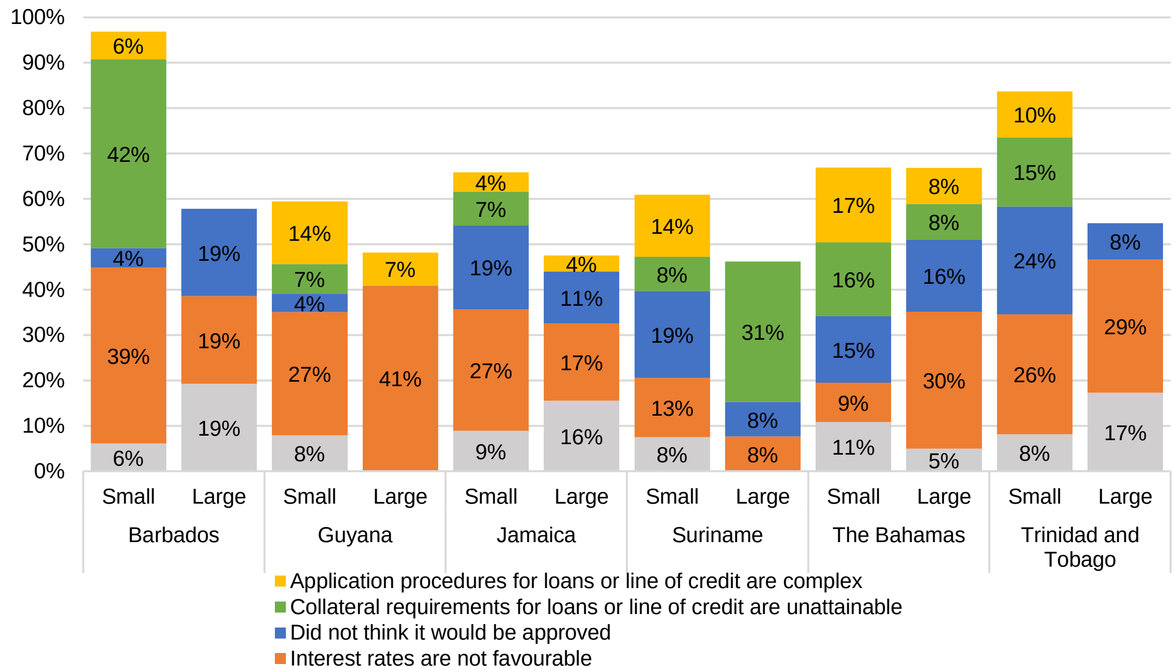


Source: Compete Caribbean, 2014 Productivity, Technology, and Innovation in the Caribbean Enterprise Survey and 2020 Innovation Firm Performance and Gender (Survey).

Firms reporting the cost of credit as a major or severe obstacle actually fell from about 42 percent to 36 percent of firms between 2014 and 2020 (Figure 5, panel b), in line with the reduction in domestic policy rates and financing costs observed through early 2021 (just after the survey was completed at end-2020). However, it is likely that rising policy rates driven by inflation have caused borrowing costs to increase dramatically for firms, just as they have for the government, suggesting that this issue remains a significant concern. Similarly, as shown in Figure 6, smaller firms report this to be a more significant concern than larger ones.

Credit access and related costs were only two of many issues reported by Jamaican firms as barriers to financial access. As highlighted in Figure 5, at end-2020, concerns over complex application procedures, the incompatibility of firm borrowing needs with bank preferences (e.g., regarding loan size or maturity), and broader skepticism regarding their ability to secure credit from providers were also cited as major barriers by both small and large enterprises. As discussed in this report's Regional Overview, these responses are consistent with barriers to financial access and inclusion observed in other parts of the world, as highlighted by cross-country research undertaken by the World Bank.

Figure 6. The Caribbean: Reasons Cited by Firms for Not Applying for Credit by Firm Size, 2020 (Percent)



Source: Authors' calculations, based on Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey (IFPG).

Conclusions

Jamaica's successful and sustained reform efforts over the past decade have resulted in many positive outcomes for the economy and citizens. Beyond supporting faster and more inclusive growth, the reforms have laid the foundation for more rapid financial development, as evidenced by rapid financial deepening, more access to credit for nongovernment entities, and the availability of new and more plentiful sources of finance for corporates, including from equity markets. However, as discussed in this country chapter, the experiences of many enterprises suggest that access to finance remains a major obstacle to investment, innovation, and faster development.

Looking forward, both public and private sectors in Jamaica should focus on removing remaining obstacles to accessing credit. This process must include close coordination between financial sector operators and the government to ensure that economic policies are consistent with economic stability, that business sector and financial regulations do not inhibit investment and the entry of new sources of capital, and that external resources can be catalyzed to help meet the funding needs of local entrepreneurs and businesses. Support from external partners will also be beneficial in providing both expertise and resources, while at the same time bolstering investor confidence.

Suriname

David Rosenblatt

Macroeconomic Context.

Suriname is emerging from a deep economic crisis. From the 2015 decline in commodity prices to the mid-2020 elections, slow or negative growth and persistent fiscal and external deficits characterized the economy. The COVID-19 shock was combined with a full-blown balance of payments crisis, a decline of GDP of nearly 16 percent (IMF 2022), and a maxi-devaluation of the official exchange rate in September 2020, with the value of the currency declining from 7.5 Surinamese dollars (SRD) per U.S. dollar to 14.2 SRD per U.S. dollar.[50] With a substantial share of public debt denominated in foreign currency, the central government's debt-to-GDP ratio soared to 148 percent at the end of 2020 (IMF 2022). The economy is estimated to have declined by a further 3.5 percent in 2021, and the exchange rate ended 2021 at 20.8 SDR per U.S. dollar, with consumer price inflation of nearly 60 percent. Clearly this has been a highly unfavorable macroeconomic context for financial sector development.

During 2021, the government implemented important policy reforms, reducing the fiscal deficit and moving to a floating exchange rate that has stabilized in the range of 20 to 21 SDR per U.S. dollar. These reforms were conducted during negotiations with the International Monetary Fund (IMF), culminating in the approval of a three-year Extended Fund Facility in late December of 2021. Reforms and an incipient economic recovery are easing the burdens on a stressed financial system, but further progress is needed, as will be discussed below.

Financial Depth

One standard measure of financial depth is credit to the private sector as a share of GDP. In 2020, this measure was about 25 percent for Suriname. As noted in the Regional Overview of this report, by this measure, Suriname has the shallowest financial system of the six Caribbean countries covered.[51] From a historical perspective, there has been a high degree of volatility of this indicator over the last 30 years in Suriname (Figure 1). Without entering into a detailed economic history, macroeconomic instability probably played a role in the instability of financial depth. In the 1980s, high fiscal deficits, financed by printing money, were balanced by price controls to avoid high inflation. When price controls were no longer feasible in the early 1990s, high inflation led to a demonetization of the economy and consequently a relative shrinking of the financial system (Braumann and Shah 1999). Macroeconomic stabilization and improved mining output at the start of the 2000s was followed by the commodity price boom.

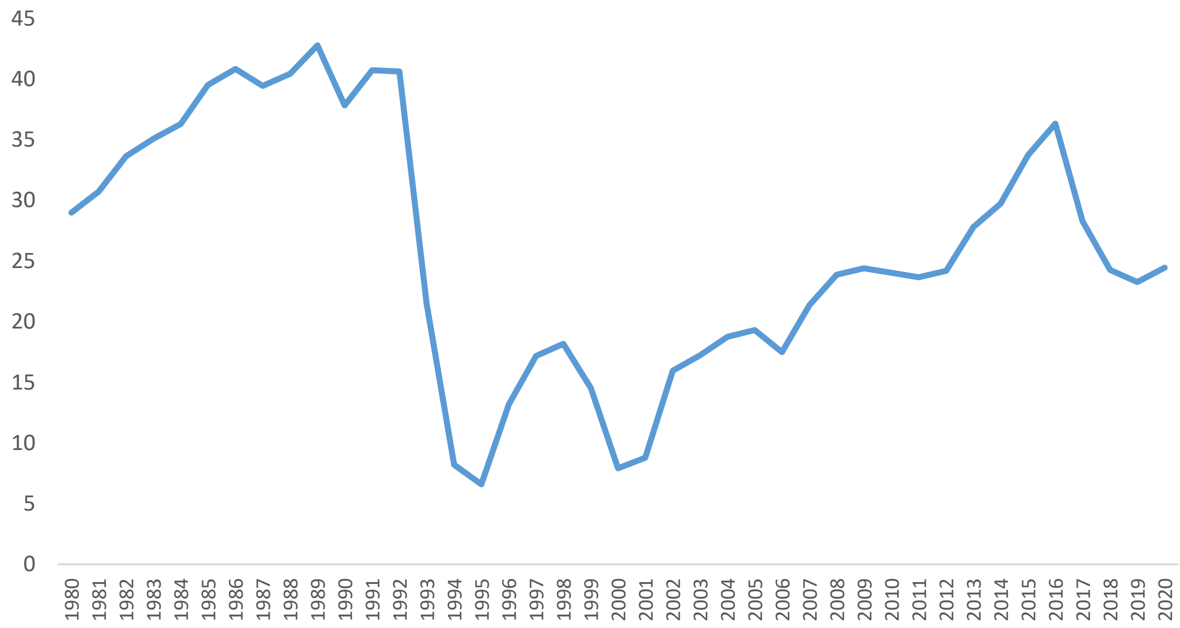
These macroeconomic conditions favored an expansion of the financial system, albeit with somewhat high and persistent dollarization or euroization, especially on the deposit side of banks'

[50] See Khadan (2021).

[51] The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

balance sheets. As noted above, in more recent years, the commodity price shock, combined with an unstable macro framework and subsequent devaluations and inflationary episodes, set the stage for a contraction of the private credit-to-GDP ratio. There was also a direct relationship between the banking system's access to foreign exchange reserves and dwindling official reserves at the Central Bank in the lead-up to the macroeconomic crisis and debt default.[52]

Figure 1. Suriname: Credit to the Private Sector as a Share of GDP (Percent)



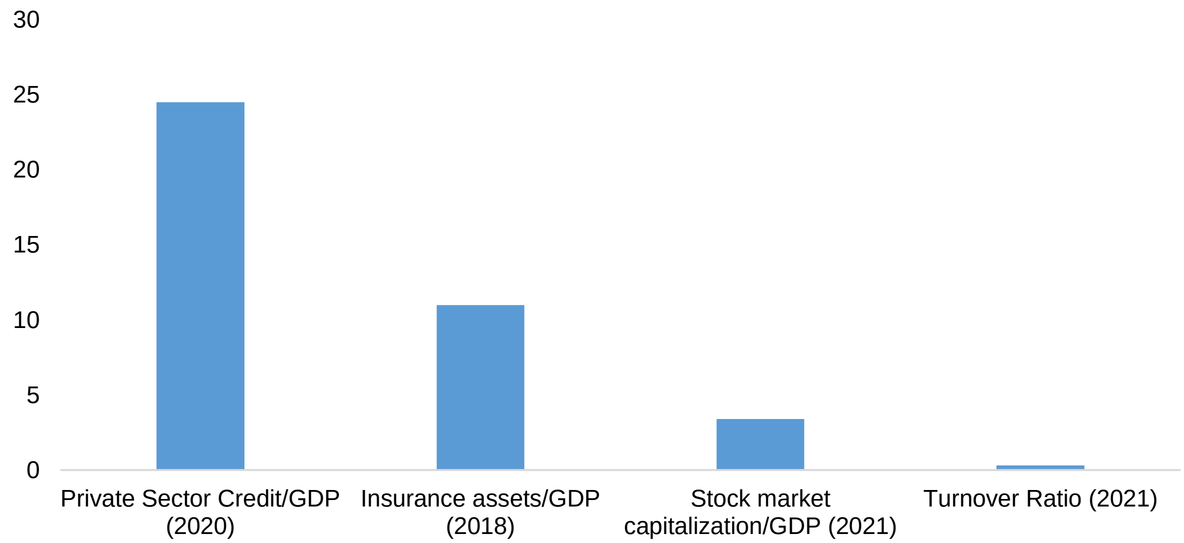
Source: World Bank, World Development Indicators.

Financial Sector Structure and Nonbank Finance

Suriname's financial sector is relatively small in other dimensions as well. Data presented in the Regional Overview of this report reveal that Suriname has the smallest insurance sector and lowest level of stock market capitalization, with the latter in the single digits (Figure 2). The turnover ratio – the total value of shares traded as a percentage of average market valuation – is also extremely low, indicating limited liquidity. The insurance sector is also relatively small, though it has more than doubled as a share of GDP compared to the 5 percent of GDP in 2009.

[52] There is a vast literature on the opposite line of causality in which a financial crisis is the proximate cause of the macroeconomic crisis, including the classic case of the subprime mortgage crisis in the United States in 2008–2009.

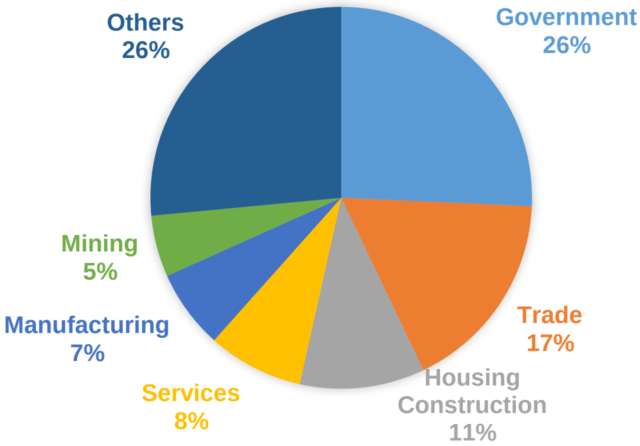
Figure 2. Suriname: Financial Development Indicators (Percent)



Sources: World Bank, Global Financial Development Indicators; and Central Bank of Suriname (https://www.cbvs.sr/images/content/publicaties/Wisselkoersen/2021/Koerslijst/Maandoverzicht2021/ExchangeRatesDecember2021.pdf)

The banking system's lending portfolio is also heavily exposed to the public sector (Figure 3). Other factors limiting greater expansion of credit to the private sector are that banks are suffering from high levels of nonperforming loans (about 12 percent of total loans); three small banks are undercapitalized according to regulatory norms; and one systemically important bank is borderline in terms of meeting its capital requirements (IMF 2022).

Figure 3. Suriname: Shares of Bank Credit by Economic Activity, 2021 (Percent)



Source: Central Bank of Suriname (2021).
Note: "Others" includes Agriculture, Fisheries, Forestry, (Non-housing) Construction, Utilities, Transport, Storage, and Communication. Data are for March 2021.

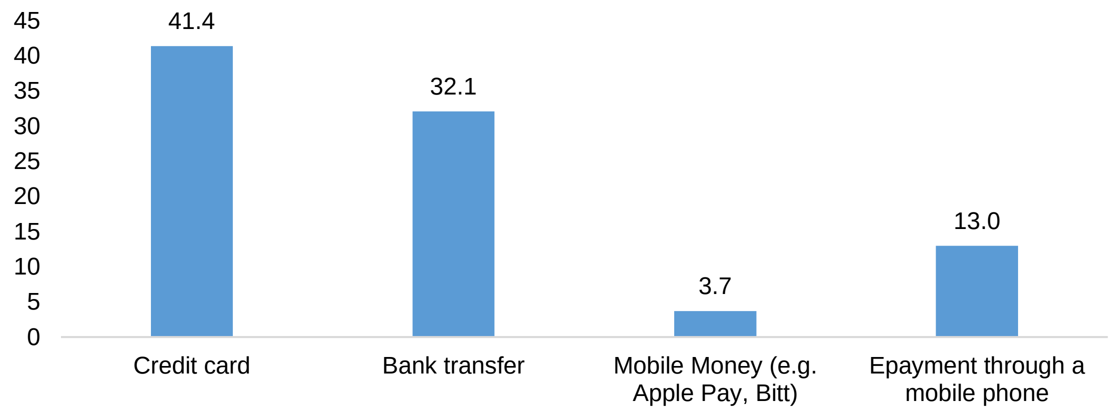
Financial Access for Businesses in Suriname

The most recent enterprise survey conducted in Suriname and the Caribbean—Compete Caribbean's 2020 Innovation Firm Performance and Gender Survey (IFPG)—provides insights into how firm owners view their needs for access to credit and what they report as their key obstacles to accessing credit. In addition, one can compare these recent data with an earlier survey, Compete Caribbean's 2014 Productivity, Technology and Innovation in the Caribbean (PROTEqIN) Survey. It should be noted that 2020 was a terribly difficult year economically due to the COVID-19 pandemic and macroeconomic crisis, and this may have had large effects at the firm level both in terms of entrepreneurs' reported financing needs and actual business outcomes.

In addition to access to credit issues, there appears to be a fundamental payment system issue in Suriname. For daily transactions, cash, rather than more efficient electronic means of payment, remains a key payment method. For example, for the 162 Surinamese firms included in the 2020 IFPG Survey, less than half said that they used credit cards for transactions and only a third accepted bank transfers (Figure 4). A much smaller proportion accepted mobile apps or electronic payments through a mobile phone.[53]

[53] See Chotelal et al. (2022) for a discussion of the scope for FinTech solutions to Suriname's access to finance challenges.

Figure 4. Suriname: Share of Firms Surveyed that Reported Using Non-cash Payments, 2020 (Percent)

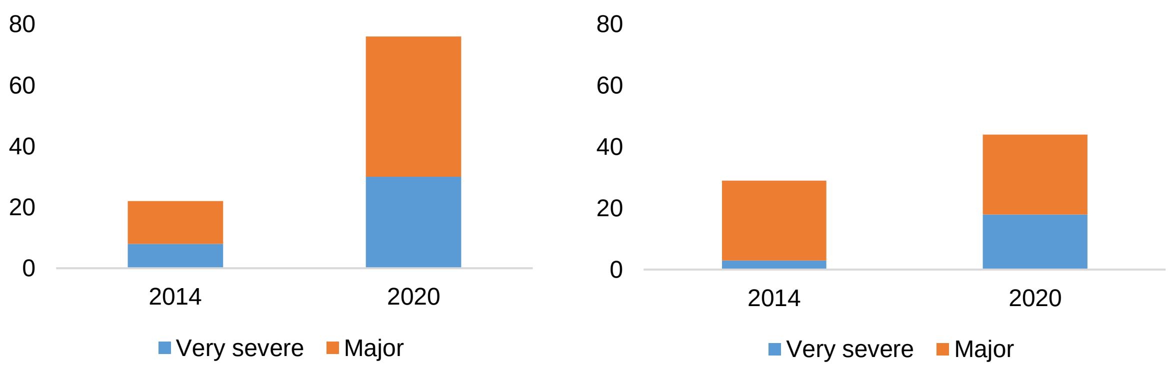


Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender (IFPG) Survey.

As part of the survey, firms were asked to rate the "obstacles that can affect the current operations of your establishment." "Access to finance (e.g., collateral)" was reported to be either a major or very severe obstacle by 76 percent of firms in 2020, representing a large increase from the results of the 2014 survey (Figure 5, panel a). "Cost of finance (e.g., interest rates)" was classified as a major or severe obstacle by 44 percent of firms – a substantial increase compared to 2014 (Figure 5, panel b).

Figure 5. Suriname: Responses to the Question: Is Access to/Cost of Finance an Obstacle to Your Firm's Operations? 2014 vs. 2020 (Percent)

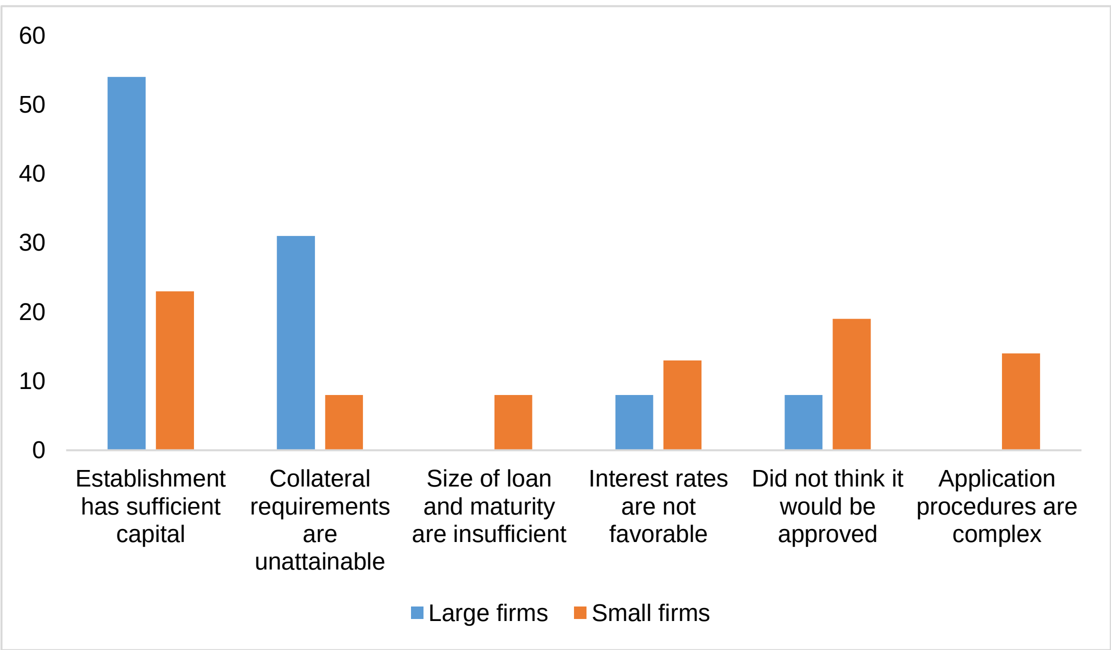
a. Access to Finance (e.g., Collateral) | **b. Cost of Finance (e.g., Interest Rates)**



Sources: Compete Caribbean, 2014 Productivity, Technology, and Innovation in the Caribbean (PROTEqIN) Enterprise Survey and 2020 Innovation Firm Performance and Gender (IFPG) Survey.

The survey also asked firms to report the reason why they did not even apply for a loan or line of credit in the previous year (i.e., 2019). An important share of large firms (54 percent) stated that it was because they had sufficient capital (Figure 6). However, only 23 percent of small firms reported that this was the case. For small firms, the reasons were varied: cost, capital requirements, and application procedures were all reasons cited by small firms for not applying for a loan. It is important to note that this question asks firm owners about their experience in the previous year, while the questions asked for Figure 5 correspond to the current year. It is quite likely that the need for external financing increased for many firms from 2019 to 2020, as the macroeconomic context situation deteriorated.

Figure 6. Suriname: Reasons for Large and Small and Firms to Not Apply for a Loan or Line of Credit from a Private Commercial Bank, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender (IFPG) Survey.

Policy Agenda for Financial Development

As mentioned above, there are continued financial stability concerns in Suriname that need to be addressed as part of a longer-term strategy for financial development and greater private sector access to finance for investment. Under the auspices of the IMF program, the Central Bank is working on asset quality reviews of banks to assess vulnerabilities. The government is also working on legislation that would strengthen the crisis resolution and banking oversight frameworks. One of the longstanding risks continues to be lending in foreign currency to firms that are not exporters, an issue that will need to be addressed.

Given Suriname's history, improvements in the overall macroeconomic framework will be helpful in providing the macro stability conducive to financial sector development. Ongoing reforms in fiscal and monetary policy are encouraging in this regard.

Looking ahead, technology could play a role in greater financial sector development in the future as the financial system emerges from underlying fragilities. There is scope for FinTech in Suriname, and Chotelal et al. (2022) lay out some of the requirements for its greater use. Foundational infrastructure such as electricity and broadband connectivity is one area for improvement. Financial literacy in the country is relatively high, on average, but there are regional and demographic disparities in financial literacy that would need to be addressed.

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Trinidad and Tobago

Victor Gauto

Macroeconomic Context

Trinidad and Tobago is an oil and gas-dependent economy whose economic and fiscal performance is driven by the energy sector. In 2020, GDP fell by 7.9 percent and was originally projected to fall further in 2021 by 1 percent. However, more recent estimates suggest there may be a slight recovery in 2021, with a GDP growth rate of 0.9 percent for January to September 2021. GDP growth is expected to recover by 5.5 percent in 2022. Both recoveries in 2021 and 2022 are supported by higher levels of exports. The volume of Trinidadian exports fell by 25 percent in 2020 and recovered significantly in 2021 by 28.7 percent. That recovery is expected to continue in 2022, with a growth rate of 28.2 percent. Thereafter, export growth rates are projected to fall to an annual average rate of 4.7 percent over 2023–2025. GDP growth is projected to grow moderately at an average 1.9 percent over 2023–2027. Similarly, government revenue fell in 2020 and is expected to recover by 20 percent in 2022 (Figure 1).

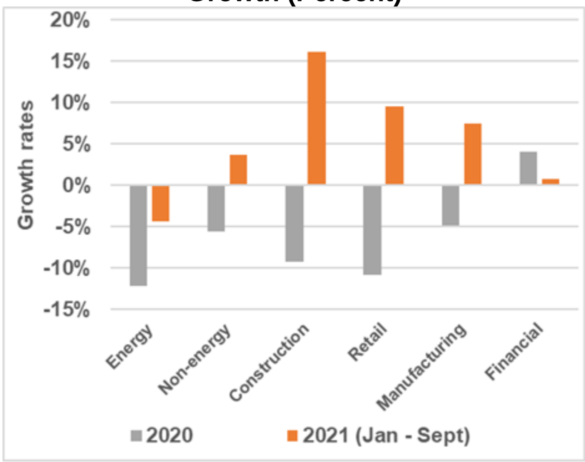
Economic activity improved in several sectors during the first three quarters of 2021. The energy sector was estimated to have a smaller decline (by 4.4 percent) from January-September 2021 compared to 2020 (12.2 percent). The non-energy sector recovered in 2021, growing by 3.6 percent from January-September 2021 compared to a contraction of 5.6 percent in 2020. Within the non-energy sector, the construction sector, wholesale and retail trade, and manufacturing benefited from large recoveries, growing by 16.1 percent, 9.5 percent, and 7.4 percent, respectively (Figure 2). The energy sector accounts for about 32 percent of the economy. The manufacturing sector accounted for 16.5 percent of GDP in 2020, of which 7 percent was petroleum and chemical products. Trade and repairs accounted for 23.5 percent of GDP, and the services sector for about 35 percent of GDP, of which the largest subsectors were public administration and financial and insurance activities at 9.5 percent and 8 percent of GDP, respectively (Bank of Trinidad & Tobago, Review of the Economy 2021).

Fiscal balance indicators improved in early 2022**.** The government's Budget Mid-Year Review in Parliament highlighted significant improvements in Trinidad and Tobago's fiscal position, as the economy benefitted from the global context of higher energy prices. First, the government's fiscal balance through April 2022 was a surplus of approximately US$290 million (about 1 percent of GDP), instead of the originally projected deficit of US$840 million. Second, higher-than-expected levels of GDP for the third quarter of 2021 contributed to closing FY2021 (October 2020 to September 2021) with a debt-to-GDP ratio of 77 percent, rather than the projected 87 percent. The debt-to-GDP ratio then fell further to 72 percent of GDP in April 2022.

Figure 1. Trinidad and Tobago: GDP Medium-term Indicators (Percent)

Source: International Monetary Fund, April 2022 *World Economic Outlook.*

Figure 2. Trinidad and Tobago: Real GDP Growth (Percent)



Source: Central Bank of Trinidad and Tobago, Annual Economic Survey 2021.

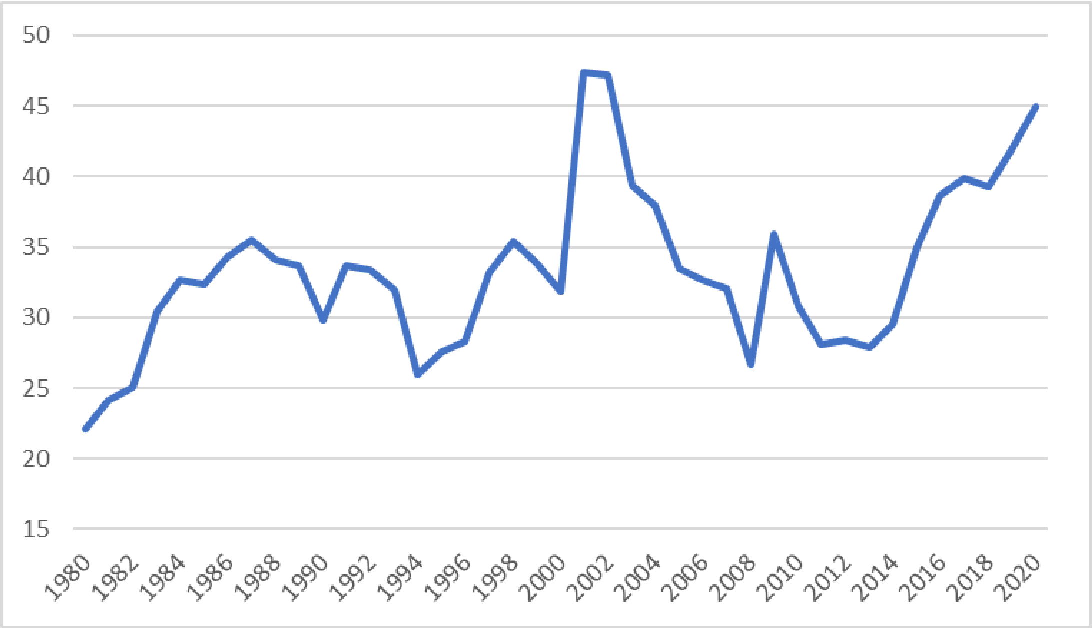
Financial Depth

A standard measure of financial sector development is financial depth, often measured as credit to the private sector as a share of GDP. This measure has climbed steadily in Trinidad and Tobago from 27 percent of GDP in 2008 to 45 percent in 2020. The average credit-to-GDP ratio for the six Caribbean countries analyzed in this Bulletin is 48 percent,[54] while the average for Latin America and the Caribbean is 59.8 percent, suggesting that Trinidad and Tobago has potential for further financial development and expanding access to finance.

From a historical perspective, some level of volatility of this indicator can be observed, especially beginning in the 2000s (Figure 3). Periods that stand out include the early 1990s, when the credit-to-GDP ratio fell to a low of 26 percent in 1994, and the early 2000s, when the ratio quickly reached a high of 47 percent in 2001 before falling to lows of 28 percent in 2008 and 2011–2014. It is likely that policy developments and external factors played a role in some of this variability, given that Trinidad and Tobago is significantly exposed to oil price shocks. For example, the early 1990s were significantly affected by a fall in oil and gas production and low oil prices, leading to a small recession in 1993, when credit to GDP fell. On the other hand, GDP grew by an average of 8 percent over 1996–2006, when the energy sector began to significantly expand with natural gas production, which may partially explain the peaks of credit to GDP in the early 2000s. Falling energy prices in the midst of the global financial crisis in 2007-2009 affected Trinidad, when GDP contracted by close to 5 percent in 2009. Since 2013, the credit-to-GDP ratio has been growing.

[54] The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

Figure 3. Trinidad and Tobago: Credit to the Private Sector as a Share of GDP (Percent)



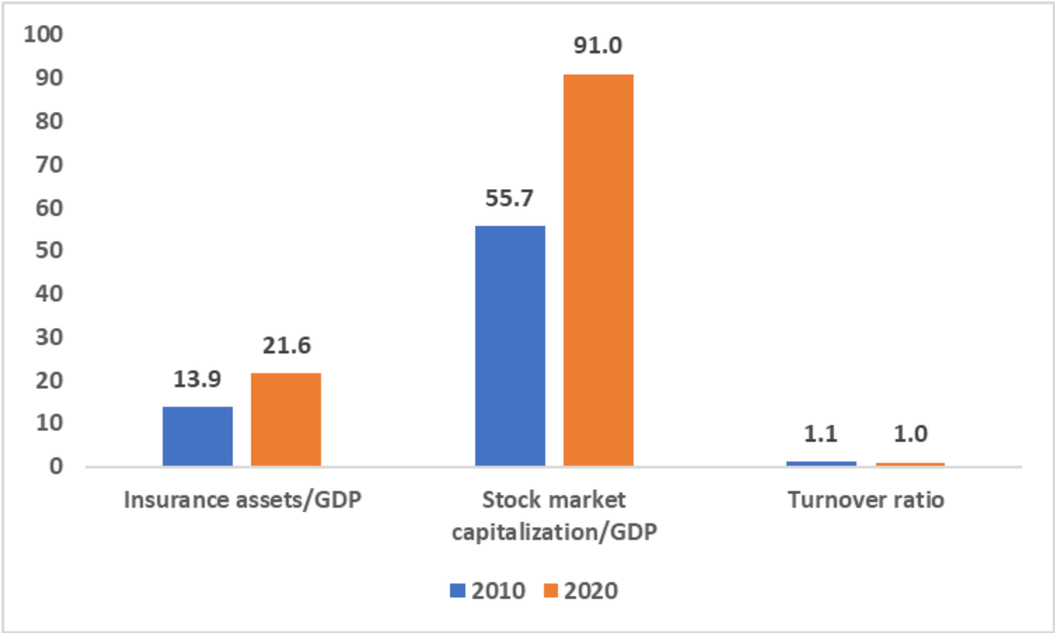
Source: World Bank, World Development Indicators.

Financial Sector Structure and Nonbank Finance

There are other dimensions of financial sector development showing that Trinidad and Tobago's financial sector is advanced relative to some Latin American and Caribbean countries. The insurance-assets-to-GDP ratio increased from 13.9 percent in 2010 to 21.6 percent in 2020. As mentioned in the Regional Overview of this Bulletin, other Caribbean countries have slightly smaller insurance sectors, with the average being 19.5 percent in 2020, higher than that of eight selected Latin American countries, which average 9.6 percent.[55] In terms of stock market capitalization, which evaluates the overall value of the stock market, Trinidad and Tobago outperforms regional peers, reaching 91 percent of GDP in 2020, well above the Caribbean average of 53.7 percent and the average of the selected Latin American countries of 37.4 percent, according to the World Bank's Global Financial Development Indicators. Finally, where Trinidad and Tobago lags the selected Latin American countries is in the turnover ratio – the total value of shares traded as a percentage of average market valuation – indicating limited liquidity (Figure 4). The turnover ratio in Trinidad in Tobago is 1 percent compared to 25 percent for the selected Latin American countries.

[55] The selected countries are Brazil, Panama, Peru, Suriname, Trinidad and Tobago, Mexico, Costa Rica, Chile, Colombia, and Argentina.

Figure 4. Trinidad and Tobago: Financial Development Indicators (Percent)



Source: World Bank, Global Financial Development Indicators.

The banking system's lending portfolio mostly supplies consumer and business loans, which account for 46 percent and 41 percent of total lending, respectively. Lending to the government is a smaller share, accounting for 13 percent of total loans in 2021. Of the loans to businesses and consumers, the largest category is mortgage loans, which account for 38 percent of total loans followed by consumer loans for activities such as motor vehicles and home improvement. Finance and real estate, distribution, and other business services are also relatively large categories within business loans, while consumer refinancing accounted for 5 percent of total bank loans at the end of 2021 (Figure 5). Nonperforming loans were relatively low, at 3.3 percent in the same period, while the capital adequacy ratio was 17 percent, above the regulatory benchmark of 10 percent. As part of the COVID-19 pandemic response, the Central Bank extended a new moratorium on the regulatory treatment of loans benefiting from deferred payments or rate reductions from May to September 2021[56].

Private sector credit growth gradually improved in 2021 after growth rates had fallen since the onset of the pandemic in 2020. Quarterly credit growth rates had averaged 5.8 percent year-over-year in 2020 but slowed significantly, contracting by 0.5 percent in March 2021. Private sector credit growth then moderately recovered to 1.7 percent in December 2021.

[56] https://www.central-bank.org.tt/core-functions/supervision/covid-19-response-updates

Private sector lending can be broken down into three major lending categories. Mortgage lending for both consumers and businesses had the highest growth rates before the pandemic but slowed to almost 4 percent in December 2021, the lowest growth rate over the last two years. Credit growth for businesses contracted by 3.2 percent in March 2021, but has experienced the fastest recovery, reaching 2.7 percent in December 2021. Finally, consumer lending growth rates were the weakest during the pandemic, contracting by 4.4 percent in June 2021 and continuing to contract through December 2021. Mortgage lending was the largest category, making up almost 40 percent of private sector lending, followed by businesses at 34 percent and consumers at 28 percent.

Figure 5. Trinidad and Tobago: Shares of Credit to the Private Sector by Economic Activity

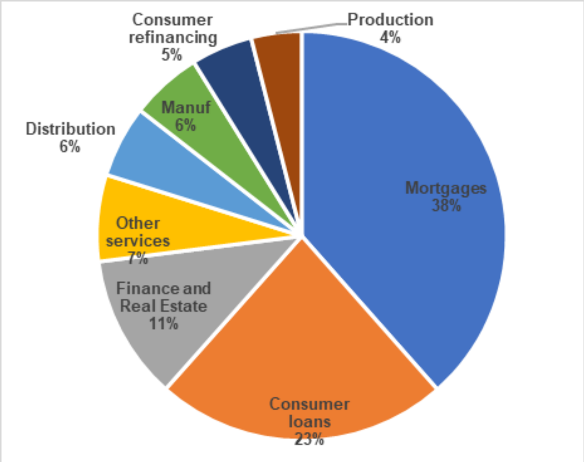
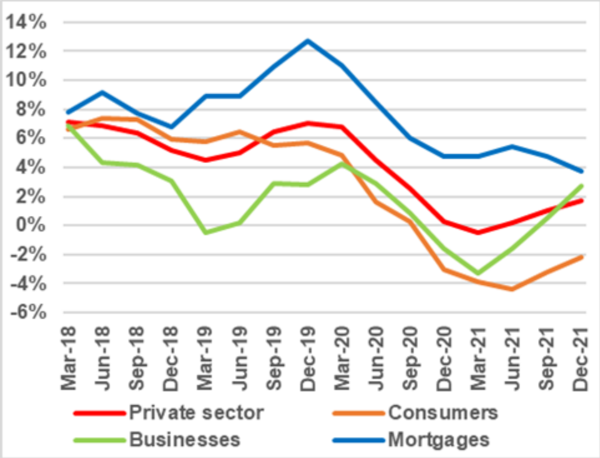


Figure 6. Trinidad and Tobago: Private Sector Credit Growth by Major Economic Activity



Source: Central Bank of Trinidad and Tobago

Financial Access for Businesses in Trinidad and Tobago

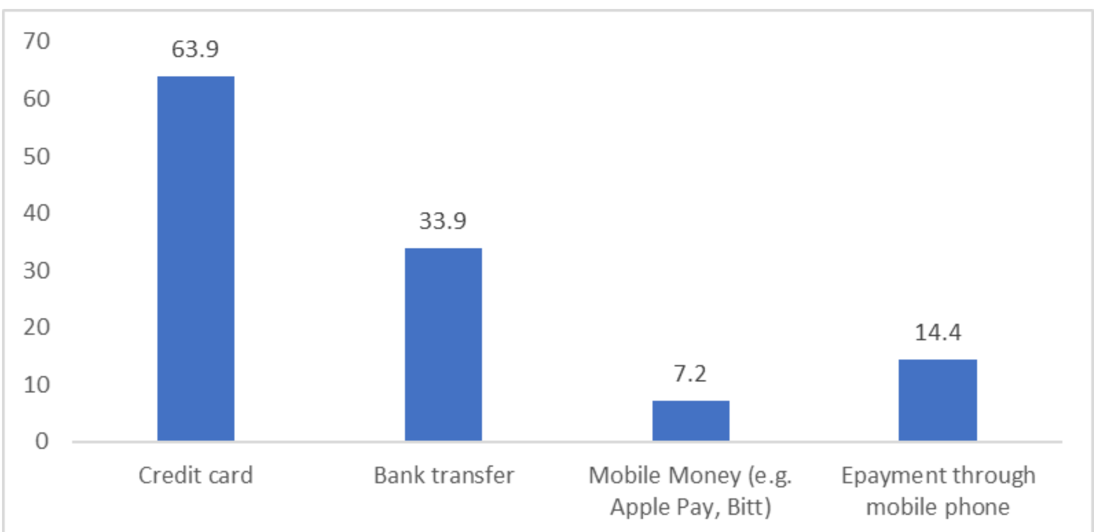
The most recent enterprise survey conducted in Trinidad and Tobago and in the Caribbean – Compete Caribbean's 2020 Innovation Firm Performance and Gender Survey (IFPG) – provides insights into how firm owners view their needs for access to credit and what the reported key obstacles are to access credit. In addition, one can compare this recent data with an earlier survey, Compete Caribbean's 2014 Productivity, Technology and Innovation in the Caribbean (PROTEqIN).

The role of technology is increasingly important for financial sector development, and it appears to have had some uptake among businesses for receiving payments. For daily transactions, cash remains the largest means of payment, rather than electronic means. For example, for the 180 Trinidad and Tobago firms included in the 2020 IFPG survey, over 60 percent said that they accepted credit cards for transactions but only about a third accepted bank transfers. A much smaller proportion accepted mobile apps or electronic payments through a mobile phone (Figure

7). These dynamics suggest there could be additional challenges to electronic payments, such as cost or the availability of point-of-sale terminals and the market structure of the card processing sector.

As part of the survey, firms were asked to rate the “obstacles that can affect the current operations of your establishment.” The item “access to finance (e.g., collateral)” was reported to be either a major or very severe obstacle by 65 percent of firms in 2020, representing a large increase from the results of the 2014 survey (Figure 8, panel a). “Cost of finance (e.g., interest rates)” was classified as a major or severe obstacle by 42 percent of firms – which is the same as the share of firms that claimed the same challenge in 2014. However, the share of firms identifying interest rates as a very severe obstacle increased in 2020 relative to 2014 (Figure 8, panel b). The 2020 survey reports average interest rates were 12 percent in Trinidad and Tobago compared to the Caribbean average of 13.3 percent, as shown in the Regional Overview of this Bulletin. Moreover, weighted average commercial bank lending rates declined in Trinidad and Tobago from almost 8 percent in September 2019 to 7 percent in December 2021, according to more recent data from the Central Bank of Trinidad and Tobago.

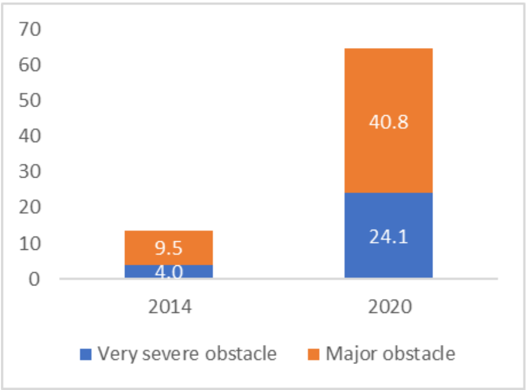
Figure 7. Trinidad and Tobago: Share of Firms Surveyed that Reported Using Non-cash Payments (Percent)



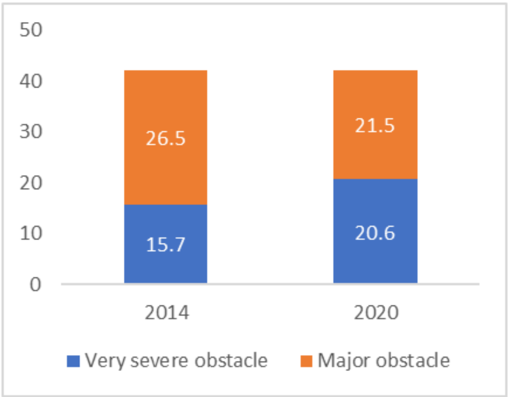
Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender) Survey.

Figure 8. Trinidad and Tobago: Responses to the Question: Is Access to/Cost of Finance an Obstacle to Your Firm's Operations? 2014 vs. 2020 (Percent)

a. Access to Finance (e.g., Collateral)



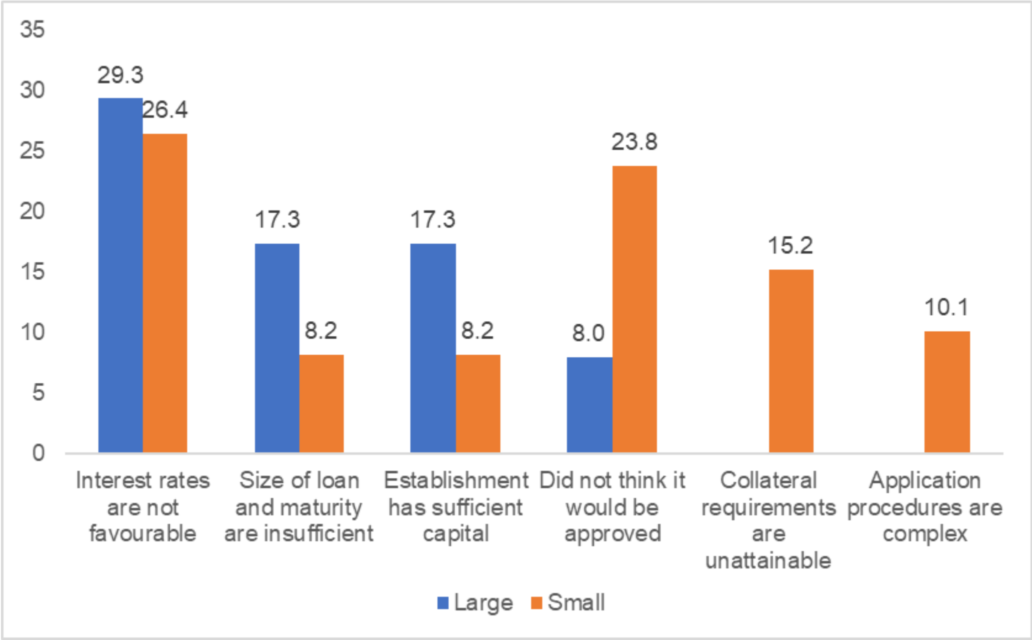
b. Cost of Finance (e.g., Interest Rates)



Source: Compete Caribbean, 2014 Productivity, Technology, and Innovation in the Caribbean Enterprise Survey and 2020 Innovation Firm Performance and Gender Survey.

The survey also asked firms to report the reason why they did not even apply for a loan or line of credit in the previous year (2019). Almost a third of large firms stated that it was because interest rates were not favorable, and almost the same share of small firms reported the same reason. Other reasons large firms gave for not applying for a loan included that the size or maturity of the loan was insufficient or that their firm had enough capital. For small firms, a large share reported that they did not think the loan would be approved, collateral requirements were unattainable, or the application procedures were too complex (Figure 9). It is important to note that the survey questions were based on firms' activities before the pandemic. It is quite likely that the need for external financing increased for many firms, affecting firm needs after the start of the pandemic.

Figure 9. Trinidad and Tobago: Reasons for Firms to Not Apply for a Loan or Line of Credit from a Private Commercial Bank, 2020 (Percent)



Source: Compete Caribbean, 2020 Innovation Firm Performance and Gender Survey.

Policy Agenda for Financial Development

Overall, the financial system in Trinidad and Tobago has absorbed the risks posed by the COVID-19 pandemic, maintaining capital adequacy ratios above regulatory benchmarks and low levels of nonperforming loans. An important component for financial sector development and for increasing access to finance is promoting financial inclusion. In this respect, the country has the Trinidad and Tobago Financial Centre (TTIFC), which is charged with developing the sector and pursuing the objective of becoming a cashless society as well as a digitally enabled financial services hub by 2023. Some key initiatives in this regard include conducting a financial inclusion survey, developing financial inclusion strategies, and creating a roadmap charting the way forward. The implementation of the E-Money Issuer Order in 2020 allowed the FinTech sector to provide services similar to those of banks. The TTIFC has also introduced initiatives to facilitate opening bank accounts, by implementing guidance for the banking sector to allow more flexibility and simplicity in the application of Know-Your-Customer (KYC) rules, fundamental for financial inclusion. Further along the digital front, the Joint Fintech Steering Committee launched the Regulatory Innovation Hub, where the private sector has engaged on e-money initiatives and crypto-currency. The Central Bank also has an initiative for having a regulatory sandbox, which would test innovative business ideas and financial products under the regulator's supervision, though this is still under development.

In terms of promoting financial stability, another pillar of financial sector development, the Central Bank improved risk-based supervision of the insurance industry by implementing the Insurance Act in 2021. The banking sector adopted the more stringent and risk-sensitive Basel II/III standard when the new Financial Institutions (Capital Adequacy) Regulations were approved in May 2020. Consequently, the capital adequacy ratio was raised to 10 percent from 8 percent. Another set of measures of the Basel II/III standard for leverage ratios and liquidity coverage ratios was delayed due to the pandemic and is expected to be implemented in 2022.

Finally, the government is undertaking legislative reform to address challenges to ensure compliance with international standards for anti-money laundering and combatting of terrorism financing, and tax for transparency, as Trinidad and Tobago is identified as a ‘high risk’ country by the EU with respect to the Anti- Money Laundering/Counter.

Country
Department
Caribbean

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