A PROPOSAL FOR

A CARIBBEAN INDUSTRIAL FINANCE FACILITY

FOR SMALL SCALE ENTERPRISES (CIFFSSE)

GERALD ALTER

FEBRUARY 27, 1979

TECHNICAL SUPPORT
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SUMMARY AND CONCLUSION

1. This report, based on a relatively brief study and visits to a number of countries in the Caribbean, evaluates the institutional mechanisms available for channeling resources, domestic and foreign, into the non-agricultural directly productive sectors. Study of documents and consultations with a wide array of knowledgeable people leads to the conclusion that the availability of finance is not the most important factor limiting investment in the priority sectors.

2. Nevertheless, there are some countries in the region where favourable factors have been operating to attract investors into the sectors, or where recent reverses in government economic policy now permit the latent demand for loanable funds to find its expression in increased demand for domestic term finance and the associated command over foreign exchange and import licenses when partially financed from abroad. St. Lucia, Antigua, Barbados, and Belize appear to fall in the first category, Guyana and Jamaica in the second.

3. The financial gap causing most concern is the limited availability of medium fixed term finance to small scale enterprises, which can be roughly divided into two sub groups, experienced small enterprises and inexperienced. The former have a higher net worth and some experience as borrowers from commercial banks, although they usually have limited competence in new fields such as manufacturing. These enterprises, which have been given little attention by the government owned DFCs, have not been adequately served by the commercial banks who are not able or willing to extend term finance to these "high risk" enterprises. The commercial banks have not built up their capacity to appraise projects properly. The inexperienced business enterprises involve undue risks for the private banks; the DFCs established by governments have tried to close this gap but have not done so with any success in the LDCs which constitute a special problem because of their small market and the high cost of servicing such a market through a specialized institution (or one which has other high cost, high risk operations thrust upon it).

4. Lending to the inexperienced business group aspiring to enter or expand small businesses into manufacturing operations must remain the responsibility of the DFCs. These enterprises have had no experience with the commercial banks and will acquire it only slowly. External agencies must assist these efforts on a non-reimbursable basis and governments must be prepared, despite their tight fiscal situation in the LDCs, to contribute equity in a timely manner. Fortunately, the volume of business with this group is not likely to be large, depending as it does for the gradual accumulation of business experience on the part of business clients and a high level of organization, co-ordination, and management skills among the financial institutions and other bodies which will be providing technical assistance.

5. Primarily to meet the financial requirements of the experienced small scale business enterprise, a Caribbean Industrial Finance Facility for Small Scale Enterprises should be established in the CDB. This facility would operate through DFCs and a wide array of private financial institutions, particularly the commercial banks. These banks have a broad network of branches even in the LDCs and will be able to fill the financing requirements of the more experienced business enterprises at a much lower cost than would the DFCs. However, the DFCs also can be expected to participate, particularly in the MDCs.

6. The Facility would be available to extend rediscounts on term loans up to US $100,000 equivalent to enterprises which are below a certain net asset value, a figure yet to be determined. The private banks participating would take the full commercial risk. To be eligible to participate in a specific country of the region they would have to establish a project unit at the district manager or branch level capable of project appraisal, including the assessment of financial rates of return. The private bank would also have to include in its corporate plan a target figure for overall lending by the participating branch to the manufacturing sector.

7. Term loan rediscounts would be subject to review by CDB, or its agent in the case of some MDCs, but usually on a no objection basis after a breaking-in period. These rediscounts would be available to cover permanent working capital as well as fixed assets.

8. Interest rates would be high enough - 12% - to give financial intermediaries sufficient spread to encourage their participation but would bear a reasonable relationship to the costs of lending, the risks of lending to SSEs, and the advantages of medium terms (5 - 10 years) loans with grace periods sufficient to cover the period of construction and initial market penetration. With funds available from abroad on concessional interest rates governments and the CDB together could support business counseling and other services to SSEs.

INTRODUCTION

Achievement of the economic development objectives of the countries of the Caribbean region, including the provision of adequate employment opportunities, requires better mobilization of the human and financial resources of the countries of the region and the more adequate use of the external resources available to them.

A proper balance must be established between investment in economic infrastructure, social infrastructure, agriculture, tourism, and manufacturing. External capital channeled through the Caribbean Development Bank is playing an important role and can be increasingly effective in channeling both domestic and external resources into high priority investment.

This report is directed to establishing improved institutional mechanisms for channeling resources, domestic and foreign, into the non-agricultural, directly productive sectors.

The availability of finance is not the most important factor limiting the expansion of directly productive investment in these fields. It seems evident that there are many other constraints limiting such investment in all countries of the region.

However, there are some countries where in the short run removal of financial constraints - internal, external or both - can play an important role. In the future, other countries will join the group, sometimes because of transitory economic reverses, but over the long run because of (a) the progressive development of an industrial entrepreneurial, managerial, and investor group, (b) a better trained and industrially oriented labor force, (c) improvements in the administration of industrial incentive and promotion programs, (d) the better provision of technical assistance, market information, and other non-financial services to the manufacturing sector, (e) expansion of agricultural production, establishing a more adequate base for agri-industry, and (f) the development over time of a more effective transport system and other infrastructures.

Conscious private and public action is being taken in many countries and will hopefully be taken in others to accelerate the operation of these forces. The more these forces are successful, the greater will investment opportunities emerge in the non-agricultural directly-productive sectors. When such opportunities are expanded, financial constraints can be a major drag on economic development. Financial intermediaries which are capable of efficiently transferring funds from "surplus" households and business enterprises to "deficit" entities can contribute greatly to the development process, particularly if the financial institutions themselves have developed a system for identifying capable business enterprises having good investment projects.

This report is based on a relatively brief study and short visit to the region. During the study the author had access to a wide array of documents dealing with general economic problems and, in particular, financial problems. He consulted with government officials, private bankers, private manufacturers and their associations, and officials of external agencies. He visited Barbados, Guyana, St. Lucia, Dominica, and Antigua. A list of persons interviewed is contained in Attachment 1.

THE FINANCIAL SYSTEM

The economies of the region are mixed, with both the public and private sectors playing important roles. The countries vary greatly in this respect, however, with Guyana having assigned the most important role to the public sector.

This report is not directed to the important question of channeling financial resources to state enterprises, although many of the financial intermediaries, including private commercial banks, are involved in this process. We shall concentrate our attention on investment activity in the private sector, which is the dominant form in most of the countries of the region. All countries, including Guyana, are interested in expanding private investment in the non-agricultural directly productive sectors.

Both as collectors of private savings and as lenders to the private sector the private commercial banks, many of them foreign owned, are the most important financial institutions in the region. Traditionally, under the colonial system, they played a key-role in the development of the agricultural export sectors and the import trade. As the economics of the region have developed over the past thirty (30) years the commercial banks have entered many new fields, particularly tourism, manufacturing, and personal installment credit. Their involvement in the financing of food crops for domestic production has also increased, and efforts are being made to participate in the financing of small holder agriculture.

The private commercial banks have a long and broad experience in the region. In more recent years Canadian and U.S. banks have established offices in many of the countries of the region until now there are a large number of banks serving even the smaller territories. (See Attachment 2). Competition for loans and deposits has increased. Some of the newer banks establishing themselves in the region had more progressive management. This had an effect upon the other banks operating in the region.

While changes have taken place, the banks, with their heavy dependence on domestic deposits with a maturity of one year or less and with the volatility of deposits associated with high dependence on external trade and capital movements, have been reluctant to extend medium and long term loans. Moreover, with the limited development of the manufacturing sector, it was considered more prudent to reserve whatever medium term lending was available to the real estate and installment sector categories.

More important, the experienced, training and organization of the banking sector had so long been oriented toward the distributive sectors, it was not easy for the banks to shift rapidly to the newer sectors, particularly manufacturing.

In manufacturing and tourism, the banks continued to focus on short-run liquidity analysis, which given an edge to the well established larger business enterprises with excellent credit records. Small and medium scale enterprise in these "high risk" sectors were not easy to incorporate into the banks' clientele. Bank staffs have not been trained to assess projects in this area, although it must be recognized that their knowledge of the business community gives them a head start compared with newer institutions without broad contacts.

Partly in response to the real and partly in response to the perceived limitations of the commercial banks many governments in the region have established development finance corporations (DFCs), industrial finance corporations, and the like. These institutions were established some years ago in the MDCs and only in the 70's in the LDCs. In some cases these governmental entities were designed to serve larger borrowers as well as small borrowers in the new sectors; sometimes they were designed to provide medium and long term finance not only to manufacturing but also to agriculture, students and housing. In a few instances separate financial corporations were set up to serve the very small manufacturing sector.

The experience with these institutions has been mixed, although virtually all have had serious financial problems. Governments have been reluctant and sometimes unable to provide equity capital sufficient to cover operational needs for even a few years ahead. Lending decisions have frequently been taken under political pressure.

Government financial institutions serving a broad spectrum of business clients must necessarily be extending loans to enterprises whose owners are among the more affluent members of the society. It is not easy to justify the losses incurred in lending to such enterprises in the region's current political environment. This makes it doubly difficult to rehabilitate and restructure the finances of government-owned institutions which find themselves with severe financial problems requiring the immediate injection of new equity capital and the provision of cash resources.

The government-owned DFCs which operate in the LDCs of the region have particularly serious problems calling for immediate solution. These problems have been thorougly analyzed in a recent study commissioned by U.S. AID, "Employment Generation Through Industry and Commerce," particularly Vol. III, Business Analysis and Systems Information Corporation, undated. The countries covered include the Leeward and Windward Islands and Belize. While these DFCs suffer from a wide range of deficiencies, they have an underlying weakness stemming from the limited size of the markets served, present and projected, and the relatively high costs of serving such markets through specialized credit institutions.

THE NATURE, INCIDENCE, AND MAGNITUDE OF THE FINANCIAL GAP

In evaluating the financial system serving non-agricultural directly productive enterprise in the region it is useful to distinguish among three groups of borrowers: (1) largë and experienced enterprises, both domestic and foreign, which may or may not have their experience in directly productive sectors but which have gained the full respect of the commercial banks and have and excellent credit record, (2) small scale enterprises controlled and/or managed by persons with some business experience, usually no record of performance in manufacturing, but with contact with commercial banks as borrowers, (3) small scale enterprises with little if any business experience, being promoted by persons having only little net worth and no experience in borrowing from the commercial banking system.

Enterprises in both of the last two categories will be called small scale enterprises (SSEs) in this report.

Large Enterprises

This first group is served well, having access in the commercial banks not only to short term working capital loans but also medium term finance for covering their fixed capital requirements. Most of these enterprises are able to obtain five (5) year term loans and many are able to repay on the basis of a 10-year amortization schedule with high probability of renewal for another five years at the expiration of the first five-year (5) term.

The interest rate on these term loans is not necessarily fixed, the lender frequently having the option to increase the rate at the beginning of each year, depending on market conditions. Most of these borrowers enjoy prime interest rates.

The larger foreign and domestic enterprises in this group also have access to foreign capital via their banks for medium term export credit for capital equipment.

Domestic enterprises in this group or the domestic partners of foreign enterprises would presumably have greater difficulty in mobilizing the equity contribution which would be required in a booming investment environment, but there are regional institutions having the authority to provide such requirements (CDB and CIC).

With respect to this first group, when the individual investment project would call for resources in a volume beyond the capacity of a single commercial bank in the area, there are regional and international sources of term finance and equity, including the CDB, IDB, IBRD, and IFC. If projects require even longer terms than the commercial banks can provide, these institutions are available for meeting the needs of large undertakings. This is true even for countries in which, because of perceived country credit risks, foreign private credit is not generally available. The recent IFC investment in Guyana is the most notable example.

Many of the firms (including foreign enterprises) capable of entering the export markets fall in this first group. There is a growing consensus in the region that the expansion of manufacturing oriented to exports is very important in the near term for creating employment opportunities and easing balance of payments constraints. If promotional activity already initiated in many of the countries of the region and designed to attract foreign enterprises meets with success, there could be a substantial increase in the demand for loan funds by this first group. In some fields - hotel construction for example - recourse for a substantial part of investment funds to local financial institutions is customary. It was not possible for the author in the time available to evaluate the potential gap. Hotel construction, however, has not been taking place on a large scale in the last few years. Foreign enterprises of the type attracted to the region are accustomed to lease rather than construct factory buildings. The ongoing program of financing industrial estates will presumably take care of these needs.

The CDB will wish to keep under continuing review the financial needs of this first group of business enterprises, but no financial gap of consequence is apparent than cannot be filled by the direct action of the CDB itself or allied regional and international financial institutions. Joint or parallel financing arrangements with commercial banks and other institutions should be considered if the need arises. This need could emerge if credit conditions abroad should tighten simultaneously with an investment boom in the region. The CDB should be expected under such conditions to help close the financing gap which even enterprises in the first group would experience.

Experienced Small Scale Enterprises

The availability of term finance to this second group is limited, particularly for new enterprises in the manufacturing sector or enterprises having significant expansion programs. It is difficult to assess the volume of unsatisfied legitimate demand which existing financial intermediaries have been unable to supply because of their own inadequacies. It seems to be the consensus of most people consulted, including representatives of these enterprises, that except in a few countries in the region the volume of legitimate unsatisfied demand is not large.

The commercial banks are vulnerable in not modifying their practices to be in a better position to serve this group, but it is generally recognized that the non-financial constraints summarized in the Introduction are overriding in most of the countries of the region. The DFCs for the most part have concentrated on the SIC program serving the third group.

Assistance in project identification and preparation, as well as administrative improvements in the incentive system, are particularly important for this group.

Those small firms in this group already in the manufacturing field and recognized to have a high level of business competence and adequate collateral are probably doing reasonably well in obtaining access to credit on reasonable terms, so long as overall credit conditions in the country concerned are not tight.

For the new firms in manufacturing, difficulties are being encountered. It is not easy for such firms to obtain credit on adequate terms, including a long enough period of grace on principal repayments to ease the cash flow during the start-up and initial market penetration period. The banks are not so ready to grant five to ten year loans to this group, and the renewal of overdraft facilities in the case of a credit squeeze is more in doubt.

Given the difficulties which these enterprises face even when reasonably well managed, it is important for them to have access to permanent working capital on a medium term basis. This is seldom provided either by the commercial banks or the DFCs.

Strengthening of financial mechanisms to serve the needs of this second group appears to be important principally in Antigua, Barbados, Guyana, Jamaica, and St. Lucia.

Given the lags that are inherent in any process of institutional improvement, it is wise to move with some speed. Over the medium term, enterprises in this second group have an important role to play in creating employment opportunities at many different levels of skills and in giving upward mobility to business groups now in the third category.

Inexperienced Small Scale Enterprises

It is even more important that this third group have access to term finance, with perhaps even longer maturities and periods of grace. The financing gap created by the needs of this group is, however, probably the least of all of the groups for both the short and medium term. While it is important from a social and political point of view to build institutions capable of helping this group, finance as such is the least of the constraints.

This group must gradually gain business experience, access to training, and many forms of technical assistance which take much time to organize and to deliver.

Providing finance to this third group on appropriate conditions is very costly in itself. Even more important, it requires a high level of organization, coordination, and management skills among the financial institutions and other bodies which will be providing technical assistance.

The risks associated with lending to this third group are so great that profit-seeking financial institutions can seldom be induced to participate in programs serving the group even under credit guarantee programs. It is usually not politically feasible to charge the interest rates required to cover costs, including the charges required to build up reserves to cover the high rate of default which must be expected on such loans.

There is no evidence that private banks operating in the region can be expected operationally to deal with enterprises in this third group.

THE EXTERNAL GAP AND RELATION TO DOMESTIC FINANCING GAP

Many if not most of the countries in the region have, over the past few years suffered from balance of payments deficits on current account in excess of foreign capital inflow. Foreign exchange reserves were declining and domestic deposits of the banking system declined since 1972, if measured in constant prices, in virtually all countries.

However, bank liquidity almost everywhere is at a high level. There is little felt need by the banking system for additional domestic resources. Bankers became restrictive in the region when the ratio of loans to deposits exceeds 80%. As shown in Attachment III, 1978 figures which were readily available indicate ratios in excess of 80% in St. Vincent, Antigua, St. Lucia, Belize and Barbados.

The banks tend to treat their branches in each of the members of the ECCA as separate entities, without transferring funds from surplus to deficit branches. Only one of the banks, it appeared, has an Eastern Caribbean currency pool for effecting limited transfers. Moreover, the private banks are not prepared to increase their foreign liabilities to countries outside the region, being reluctant to accept the exchange risks involved and being faced with capital control restraints in some capital exporting countries. The banks in Barbados appear to be the only ones in the region with a substantial net debit position abroad.

Consultations with the commercial banks do not fully confirm the impressions gained from Attachment III. This may simply reflect that the data on loan deposit ratios in 1978 are not representative of the current picture. The banks generally report an easier liquidity position than is reflected in this table. The table as it stands suggests that if economic expansion continues, liquidity problems could easily arise in many countries at an early date.

The demand for loan funds by conventional bank borrowers has not been great in the last few years. Up to now, the major dynamic sectors in loan portfolios have been in personal loans, real estate loans, and in lending to the public sector. It is in these fields also where the banks have lent most on a term basis (three years or more).

There are three countries where the overall demand for domestic loans by the private sector now seems to be in excess of the capacity to supply resources: St. Lucia, Belize and possibly Antigua. In addition, Barbados and St. Vincent may soon join this group. In some of these cases, the demands of the public sector for bank funds may be beginning to encroach upon availability to the private sector.

In two of the other countries of the region - Guyana and Jamaica - rationing of foreign exchange and import licenses has directly restrained the demand for domestic financial resources by the banking system.

In Guyana, the private sector has been depressed also by other government policies which until recently at least, did not contribute to business confidence. The recent issuance of a private investment code requested by the private business community has set the stage for a serious dialogue on key elements of government policy affecting the private sector. If term finance were available, carrying with it corresponding external resources and import license approvals, there is evidence that the private manufacturing sector could be given a push. The commercial banks and the Cooperative Agricultural and Industrial Development Bank both expressed confidence on this score.

In Jamaica, a foreign exchange shortage compounded by excessive government borrowing from the banking system, including the central bank, has also led to a situation where the banks have considerable liquidity but limited demands for funds. The manufacturing sector has been greatly depressed until recently, with an average annual decline of about 4% per annum in industrial output from 1973-1977.

Government policies, including an over-valued exchange rate, frequent industrial disputes, growing concern in the private sector about the expanded activity of the public sector - all led to a poor private investment climate.

The government's current economic program addresses these issues. Partly in response to these efforts, external resources are being channeled by the World Bank into the commercial banking system and the government's Small Enterprise Development Corporation to meet the internal and external financial requirements of small scale enterprises, roughly the equivalent of the second and third categories of enterprises described above.

More generally, in small countries with an exceptionally high dependence on imports, as economic expansion generated by domestic investment takes place in advance of the growth of exports, there is particular need for domestic financing mechanisms in which the expansion of domestic and external capital resources proceed apace. Otherwise, the resulting deficit in the external current account balance will result in a contraction of external assets and a reduction in bank deposits, leading to a premature stoppage in the investment surge.

Government borrowing abroad during this phase can be expected to avert this outcome. There is much to be said for the volume of such borrowings to be responsive in part to the direct investment requirements of the private sector. The private banking system in the Caribbean area would appear to have a special role as an instrument for channeling such funds to the non-agricultural directly productive private sector.

THE PROPOSED NEW FACILITY

CIFFSSE

The proposal is to establish a Caribbean Industrial Finance Facility for Small Scale Enterprises ((CIFFSSE) in the CDB to channel through intermediaries financial resources into the small scale industrial sector in the region.

Government owned DFCs, the major entities now employed by the CDB, would have access to the new facility.

For the first time, a wide range of financial institutions in the region, including those private commercial banks prepared to accept a more developmental orientation in their operations, would have access to the CDB through the new facility, subject to the government of the country corcerned being willing to accept the obligation for converting local currency service payments into the foreign exchange specified in CDB loan agreements.

Eligible Enterprises

The intermediaries' clients would be restricted for the time being to the enterprises ((SSEs) included in the second and third categories described above. As at present these customers would not be expected to assume the risk of exchange rate devaluation, which would be absorbed by the government.

The precise definition of the enterprises to have access to the new Facility raises some difficult questions. There are many different definitions for SSEs employed in different countries and within countries for different purposes. The CDB has defined small enterprises, for purpose of its concessional interest rate programs, as enterprises whose individual owners or shareholders have a net worth of less than EC$150,000 (US$56,000). DFCs having access to their funds can make loans, however, with a maximum of US$100,000 to a single enterprise.

The recently established program for financing SSEs in Jamaica defines the equivalent of our category 3, "very small scale enterprises", as those having net fixed assets (excluding land and building) below US$20,000 equivalent. This is measured prior to applying for a sub-loan.

"Modern small scale enterprises", the equivalent of our category 2, are defined under the Jamaican program as enterprises with net fixed assets (excluding land and buildings) up to US$100,000 equivalent prior to applying for a sub-loan. Loans up to US$100,000 may be extended to "Modern small scale enterprises" and up to US$20,000 to "very small scale enterprises".

No information is available, even in Jamaica, concerning the asset characteristics of industrial borrowers from lending institutions. Until such information is obtained for various countries in the region, the CDB may wish to employ its present definitions, adding perhaps a net asset test for second category sub-borrowers. Where specific countries have a reasonable case for applying a slightly different test, CDB may well accept some variation.

CDB direct loans to the industrial sector would continue as at present, with consideration being given later to raising the maximum loan amount (now US$100,000) on sub-loans extended by specific intermediaries as experience demonstrates their competence in project appraisal.

Economic sectors or subsectors to be served by the new Facility would be determined largely by exclusions (distributive trade, consumer installment credit, specific manufacturing sectors which may suffer from excess capacity) until such time as the demand for credit in the priority sectors calls for a more discriminating approach.

If sector studies reveal the need for intensive promotion of specific fields, the credit institutions should be made aware of these conclusions. But it is probably not desirable to restrict their activities to such fields. If governments of specific countries of the region wish nevertheless to restrict the operation of the Facility to certain sectors or subsectors, the CDB may agree. CDB would take into account regional plans for the location of manufacturing enterprises in their review of loans.

Financial Institutions Eligibility and Procedures

All institutions having access to the Facility would have to meet certain tests. Private institutions, whether commercial banks, private development finance companies, or merchant banking affiliates of commercial banks, would have to be financially capable of accepting the full commercial risk on loans made with Facility resources. They would also have to be willing to establish either at the District Manager level or at the Branch level a Project Unit capable of appraising manufacturing projects. In addition, private financial intermediaries would be expected to include in their corporate plan for each year of their participation in the program a target figure (or portfolio percentage) for their total lending to the manufacturing sector. This feature of their corporate plan would be subject to CDB's review.

The private financing institutions would be provided with external resources by the CDB through re-discounting of term loans. Such re-discounts should be subject to a review on a no objection basis, or for comments only, after a number of loans (say 5 to 10) have been accepted for re-discount and it has been determined that the project unit set up to appraise projects is working satisfactorily. Private institutions would be expected to carry out financial rate of return calculations for all loans submitted for re-discount.

Unless the projected ex factory price at which a product is to be sold in the domestic market is significantly above the import price (say more than 25%), economic rate of return calculations should not be necessary. If such calculations are necessary they should be undertaken by CDB. Collaboration between the commercial banks and the CDB will be greatly facilitated by the fact that most District Offices of the banks are located in Barbados.

Term loan re-discounts should cover permanent working capital as well as fixed assets of SSEs. Consideration should be given to restricting the financing of permanent working capital to those enterprises expanding their fixed assets (with or without the use of borrowed funds for this purpose) and to those enterprises requiring additional working capital to effect a major increase in capacity utilization (e.g. adopting a double shift).

Re-discounts would be subject to a maximum percentage of the loan. The maximum percentage could go up to 100% so long as the total contribution by the lending institution is not in excess of, say, 70% of the total cost of the project. (Consideration may be given to reducing this maximum percentage of the loan in the case of countries likely to have continued excess liquidity in the banking system for a sustained period. It is, however, doubtful that participation by the banks would be widespread anyway in such a situation).

The private banks will be taking the full commercial risk, except in countries where a credit guarantee program is available to them. Jamaica has such a program, which is being strengthened at this time, and Barbados is planning to institute such a program soon. (Barbados already has in operation an export credit guarantee program). The CDB may wish to observe the experience under these two programs before considering whether the LDCs should have such facilities.

Private financial institutions participating in the program would be provided with re-discounts at a rate in the 8% range, which is somewhat above the rate of interest on their longer maturity time deposits. The banks will not have to incur the administrative expenses of mobilizing additional deposits. This should permit them to extend term loans at rates of interest in the 12% range. This is 3 or 4 points above current prime short term loan rates, not an unreasonable differential taking into account the risks and costs of lending to SSEs on a longer maturity basis.

Such interest rates would not penalize SSEs unduly, given the reduced drain on cash flow resulting from longer terms and extended grace periods. A few percentage points more in interest rates does not produce a significant difference for the labor intensive manufacturing concerns likely to be set up. It will in fact tend to discourage capital intensive enterprises, which is desirable in view of the need to create employment opportunities.

If it is not feasible to increase interest rates for all enterprises to the same level, perhaps 12%, a lower rate, say 10% or 11%, which is above the rate now being charged under the SIC program, should be applied to the inexperienced small scale enterprises. This, if nothing else, is likely to exclude the commercial banks from participating in this part of the program.

It is expected that external resources would be available to the CDB for channeling to financial institutions serving SSEs in the LDCs and MDCs at concessional interest rates (3% and lower) and on a long term basis. This would mean that even after providing a suitable margin for the lending instituttions there might be a total spread between the financial cost and the re-discount rate of between 5 and 7 percentage points, to be divided between the CDB and the governments. The government will no doubt wish to be compensated for taking the foreign exchange risk, which in the case of the recent World Bank loan to Jamaica is 1% added on to the interest rate.

In any case, a substantial margin should be available to the CDB, to the government, or to other institutions for helping to support business counseling and other services to be provided SSEs. Loan repayments could revolve in the CDB in the case of private institutions, and may be permitted to revolve in public financial institutions.

Government owned financial intermediaries would also participate in the program, perhaps without being required to absorb the full commercial risk, since they have government support. Government DFCs could also be provided with higher margins if funds could continue to be made available at current levels.

Special Problems of LDCs

In the LDCs, government financial intermediaries servicing the industrial sector are in extreme financial difficulties, as documented in the report by Business Analysis and Systems Corporation cited above. Given the small size of the market for term loans by the industrial sector and the high cost of their operations in each of the small countries of the Caribbean, the report sees no way for these DFCs to become financially sound even if they undergo widespread reforms. In fact, many of the required reforms would result in increased costs, hopefully leading to more effective operations and reducing the risk of default on loans. But even so, the analysis leads inexorably to the conclusion that the small island economies cannot afford the direct financial losses that even a relatively efficient small DFC would sustain so long as its scope is limited to term loans.

The BASIC report concludes that the DFCs themselves or the larger government institutions into which they would be incorporated should expand the scope of their operations to include commercial banking functions, including the acceptance of deposits and the extension of short term credit.

For these institutions, whether in their present form or in their expanded form, the CDB would have to evaluate carefully the rehabilitation programs proposed by the government shareholders in the DFCs. If satisfied by the rehabilitation program the CDB could qualify the institution for participation.

In all of the LDCs covered in the BASIC study, government contributions to the DFCs equity would have to be increased and government cash contributions placed on a regular basis consistent with cash flow requirements. The poor fiscal position of these governments is well known. The period of grace on amortization payments owed to the CDB by the DFCs is beginning to terminate. It would be prudent, both for the CDB and for the governments concerned, to minimize the risk of further financial loss in DFC lending to private enterprise.

In the LDCs the private banks are able to serve borrowers in the second category at a much lower cost. They have a cadre of experienced staff which has yet to be created in the DFCs. The incremental costs of expanding their activities in this field will be much lower than if the DFCs undertake the task. Branch offices exist for administering the loans and many common facilities can be shared.

In the LDCs the governments should be encouraged to continue to confine the DFCs to the group of borrowers described in the third category. The total volume of operations for this group is low, and sub-loan approvals in 1977-78 were actually lower than in 73-74 in constant prices. While the cost of operating with the borrowers is high and will involve a negative spread, the total volume of costs, including allowances for bad debts, is probably within the financial capacity of governments, taking into account the low cost of funds from the CDB, the availability of external grants for financing project appraisal and technical assistance activities. The financial problems of the DFCs in the LDCs arise to a large extent out of other non-industrial programs with which they have been saddled.

Concentrating the attention of the government-owned DFCs on the smallest, least experienced business enterprises would meet a high priority need incapable of being met by the private banking system.

MDCs

In Jamaica, the government owned development bank JDB is facing serious financial and institutional problems. The CDB is already assisting JDB in overcoming these problems. JDB has been an important source of loans to enterprises in the first and second categories.

Pending the solution of JDB's financial and institutional problems, it has already been determined by the Jamaican government to pursue the course recommended here.

The CDB will have to decide, when its work with JDB has advanced further and after consultation with the Jamaican Government, whether the JDB should be given access to the proposed Facility. In the meantime, the World Bank has provided the commercial banks and SEDCO with the external resources which are believed to be required. If the CDB establishes the new facility supplementary resources would be available if required. CDB could easily modify its mode of operation and channel resources to the commercial banks and SEDCO through the government institutions created to serve under the World Bank loan.

Barbados. The Barbados Central Bank has developed a new credit guarantee scheme designed to give further encouragement to the commercial banks to provide loans to small enterprises in virtually all business sectors, including manufacturing. The guarantee program does not apply to institutions where the government is already covering credit risks. Any two of the following three criteria must be met for enterprises to qualify:

(1) Total capital less than BDS.$100,000.

(2) Annual sales less than BDS.$500,000.

(3) Number of employees less than 36 persons.

It can be assumed that most small enterprises qualifying for coverage under the program would also qualify under the tests adopted for the new Facility. It would be very desirable for the CDB to have further discussions with the Barbados authorities concerning the participation of the commercial banks in the new facility. Their participation would greatly enhance the practicability of the commercial banks operating in the Eastern Caribbean and Guyana setting up a strong project unit in their District Offices located in Barbados.

In addition, the Barbados Development Bank would most likely qualify for access to the new facility if the Barbados Government would facor such a course. The signs of recovery in the Barbados economy have encouraged the BDB to draw up quite an ambitious program. They expect to obtain the foreign exchange component of this program BDS.$21 million) from external agencies, including the CDB.

While the BDB extends loans to small enterprises it has recently stated that in the light of the experience gained concerning the constraints in financing this type of lending "funds for lending to this sector must be specially provided and from BDB's viewpoint must be additional to regular lending or be established as a special programme". The CDB's new facility could well complement domestic arrangements for serving small scale enterprises via the BDB, as well as via the commercial bank. BDB would be particularly appropriate for dealing with the third category enterprises.

It should be noted that BDB has recently strengthened its financial position, cutting its deficit by over one-half. Its break-even portfolio size, which is estimated at just over BDS.$16 million, is to be reached during the fiscal year 1978-79.

Guyana. As noted above, the unsatisfied demand for medium and long-term credit is substantial, not because of a domestic liquidity squeeze or a private investment boom but because for the first time in many years the private sector is gaining some confidence in the future.

Some long-deferred projects are ready to go forward. Medium term credit channeled through the private commercial banks under government auspices would reinforce the initial steps taken by the government to restore confidence of the private sector.

Some of the commercial banks, despite their present liquidity, would welcome an opportunity to participate in a program for SSEs which would provide foreign exchange to their clients for imported equipment and imported components of intermediate products and raw materials.

Advantage could be taken in Guyana, as in Jamaica, of the country's exchange shortage and import licensing stringency, to expand the scope of commercial bank involvement with SSEs to include medium term credit on appropriate terms.

In Guyana, a Small Industries Corporation, which has serious financial and institutional problems, has been abolished by the government and its functions have been taken over by the Guyana Cooperative Agricultural and Industrial Development Bank. The management of the newly expanded institution is satisfied that a large demand for credit exists, but it was not possible to obtain a breakdown by size of loan or asset size of borrower.

In early March the IDB is sending a mission to Guyana to examine this new instituion, which formerly did not operate in the industrial field. It would be desirable for the IDB mission to be aware of the CDB's special interest in assessing the new institution as a potential customer of the new facility for SSEs.

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Mr. Charles, Chairman of the Dev. Corp. and Industrialist

BANKS OPERATING IN BARBADOS, EASTERN CARIBBEAN, GUYANA & JAMAICA

	No. of Banks	
BARBADOS		
Bank of Novia Scotia	7	
Barbados National Bank	4	
Barclays Bank International Limited	14	
Canadian Imperial Bank of Commerce	9	
Chase Manhattan Bank	1	
Citibank N.A.	3	
The Royal Bank of Canada	8	
ANTIGUA		
Canadian Imperial Bank of Commerce	1	
Bank of Nova Scotia	1	
Antigua Co-operative Bank	1	
The Royal Bank of CAnada	1	
Barclays Bank International Ltd.	3	
DOMINICA		
Barclays Bank International Limited	3	
National Commercial & Development Bank	1	
Banque Antillaise	1	
The Royal Bank of Canada	1	
GRENADA		
Barclays Bank International Limited	2	(+ 3 agencies)
Canadian Imperial Bank of Commerce	2	
Bank of Nova Scotia	1	
Grenada Co-operative Bank	1	
Grenada Bank & Trust Compan	1	
The Royal Bank of Canada	3	
ST. KITTS		
Barclays Bank, St. Kitts, Nevis, Anguilla	3	
Bank of America N.T. & S.A. Anguilla	1	
BAnk of Commerce St. Kitts	2	
St. Kitts, Nevis, Anguilla National Bank Ltd. St. Kitts & Nevis	3	
The Royal Bank of Canada	1	

ST. LUCIA

Barclays Bank International Limited	7	
Canadian Imperial Bank of Commerce	2	
Bank of Nova Scotia	3	
Chase Manhattan Bank	1	
St. Lucia Co-operative Bank Limited	1	
The Royal Bank of Canada	2	

ST. VINCENT

Barclays Bank International Limited	5	
Canadian Imperial Bank of Commerce	1	
Bank of Nova Scotia	1	
National Commercial Bank of St.Vincent	1	
The Royal Bank of Canada	1	

GUYANA

Barclays Bank International Limited	2	(+ 1 sub branch)
Bank of Baroda	1	
Chase Manhattan Bank	1	
Bank of Nova Scotia	1	
Guyana National Cooperative Bank	10	
The Royal Bank of Canada	5	(+ 2 sub branches)

JAMAICA

Bank of Nova Scotia	52	
National Commercial Bank	45	
Royal Bank	16	
Citibank N.A.	8	
Workers' Savings & Loan Bank	11	
Bank of Commerce	14	
Jamaica Citizens Bank	6	
First National Bank of Chicago	5	
Bank of Montreal	3	

RATIO OF LOANS TO DEPOSITS OF COMMERCIAL BANKS IN CARIBBEAN REGION

LDCs	Loan Deposit Ratio
Antigua 1/	1.00
Dominica 1/	.79
Grenada 1/	.70
Montserrat 1/	.66
St. Kitts-Nevis-Anguilla 1/	.78
St. Lucia 1/	1.07
St. Vincent 1/	.88
Belize 2/	.96
MDCs	
Guyana 3/	.47
Barbados 4/	1.01
Jamaica 5/	.73

1/ September 1978, Commercial Banking Statistics of ECCA, Research Department.

2/ December 1977, derived from BASIC report, Vol.III, Tables 14 and 16.

3/ November 1978, Bank of Guyana Statistical Bulletin. Guyana commercial banks are subject to quantitative credit ceilings which permitted them in 1978 to exceed the December 1977 credit total for the private sector by only 5% in current prices.

4/ It would appear that commercial banks in June 1978, were in a tight position. Nevertheless, they enjoyed a comfortable reserve position, including large excess holdings of stipulated government securities.
(Source: Central Bank of Barbados, Economic & Financial Statistics, August 1978).
This may simply be a reflection of the ability of the banks in Barbados to borrow abroad.

5/ Refers to September 1977, derived from World Bank Report No. 1951a-JM, "Small-Scale Enterprise Development Project" June 15, 1978.

NOTE: It may be possible to project deposits when the World Bank current economic study on the countries in the region is made available.