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BANKING LIQUIDITY AND ECONOMIC GROWTH

by
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18 OCTOBER 2004 - **" … it is necessary to considerably strengthen the banking system to increase liquidity …Banks should become the basic component of the investment process and be the initial partners with enterprises to foster their development…"** - My interpretation of an excerpt from the report by the President of Republic of Uzbekistan, Mr. I.A. ??rimo, at a session of the Interdepartmental Coordination Council on reform and investments in January 1999.

The Governments of some countries in the Caribbean, more recently Barbados, Trinidad & Tobago and Jamaica, frequently refer to the vision of their attainment of first world status as an island economy by 2010, 2020 or whatever. I am reminded of the adage 'Vision without Action is mere fantasy; Action without Vision is folly; Neither Vision nor Action reeks of irresponsibility; Vision and Action induce synergy' (Basil Springer - August 1993). What must we do to combine the vision with action.

The appellation of first world status may be accorded a country that has demonstrated sustainable success in a combination of the following factors, for example, democracy, care for our fellow human beings, appreciation of the finer things in life, human development index, education and economic output. Singapore is an example of an island economy that has been accorded first world status.

Two primary indicators of the success of that status are tertiary output per capita (the percentage of secondary school leavers going on to achieve tertiary education) and gross domestic product per capita (a measure of the output of the productive capacity of the country). I have observed globally that these two statistics are highly correlated in the sense that countries with lower levels of tertiary output per capita have lower GDP per capita and countries with higher levels of tertiary output per capita have higher have a higher GDP per capita. In fact we may argue that there is a causal relationship between the two and that in order to have the opportunity to gain higher GDP per capita we must first pay attention to increasing the tertiary output per capita. In addition, to move from where we are today at a GDP per capita on average over the countries in the English speaking Caribbean of US$3000 to US$25000 per capita (as in the case of Singapore or over US$30000 in OECD countries), steady growth in the productive capacity of the economy is required.

This steady growth can only be achieved if there is sustainable growth in business activity and in turn this requires an increase in deal flow (the rate at which business projects are presented to financial institutions for investment). This of course is the principal reason for CBET's existence.

In the Uzbekistan example above there was need to strengthen the banking system to increase liquidity. In Barbados, in particular, there is considerable banking liquidity. Interest rates are at an all time low, yet there is a challenge to convert this banking liquidity into economic growth. In order to do this, bankers must be innovative and recognize that banking liquidity is the basic component of the investment process. Bankers must partner with entrepreneurs to foster the development of their enterprises.

A recent experience has revealed that necessary ingredients to ensure that steady growth in the productive capacity of the economy is achieved include, flexibility in designing financial instruments, a smart partnership between the banker and the entrepreneur and an understanding that development is achieved by the collective success of individual businesses.

There was a discussion in Barbados recently about monopolies. It was observed that de jure monopolies get there by dint of legislation but there are de facto monopolies that get there by dint of significant effort, good fortune, inheritance and/or money. The entrepreneurs behind de facto monopolies must be praised for their initiative, but it should also be recognized that, if left unchecked, it might exacerbate the wealth divide (the gap between the rich and the poor).

In order to mitigate this wealth divide, government policy must evolve to ensure that diligent entrepreneurs without inheritance, good fortune and/or money are given the opportunity to develop. The commercial banking system is governed by the central bank which therefore has the responsibility to create an environment aimed at converting banking liquidity into economic growth. Central banks have a strong research capability, the output from which can inform government policy as to how the banking system should operate. For example, the Eastern Caribbean Central Bank is currently in the throes of developing an Eastern Caribbean Equity Fund specifically to stimulate the economies of the Eastern Caribbean.

I am a promoter of the concept of 'Management as Collateral' which recognizes that the reason why businesses fail is because of a management weakness. It would therefore seem sensible in addressing the risk of business failure, to first of all aggressively promote management development and ensure that it is a necessary component, as necessary as capital, in the launching or resuscitating of a business enterprise. With good management systems in place the risk of failure will be mitigated and banking institutions can modify their collateral policies to protect against the risk of failure.

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