

THE ROLE OF SAVINGS IN THE FINANCING OF ECONOMIC DEVELOPMENT IN THE CARIBBEAN

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1. Introduction

The financing of economic development has always posed a problem for the less developed countries and the Caribbean is no exception to that. What is the peculiar problem of « finance »? Fundamentally, it is the problem of using the fiscal system, on both the expenditure and tax side, to capture resources for the purposes of the development programme.

It is obvious that any positive government programme costs money and requires the raising of revenue. Promotion of economic development is no exception; indeed, short of war, it can be one of the most expensive activities in which governments today engage. Hence, the overriding issue becomes that of the mobilisation of resources, to an optimal point, for the achievement of socio-economic development.

Development finance and the development process are inextricably intertwined through the use of fiscal policy. The fiscal capacity of a country can be evaluated on both macro and micro bases. The former looks at the determinants of taxation capacity by means of indicators such as national income or product, foreign trade, value-added in manufacturing, etc. However, such macro measures of tax capacity are in reality only measures of past tax effort, and a description of past tax effort offers no necessary conclusions about potential sources of future taxation.

Consequently, a second somewhat innovative micro approach to tax-capacity estimation that examines various potential tax bases has been developed. Consideration is given to the bases for personal income, business income, property, general sales, excise, and foreign trade taxes. Both the size and growth of these tax bases are treated, and tax rates are applied to them to determine the potential yields that might be obtained with tax rates achieved on similar bases on comparable countries. The procedure results in an estimate of the extent of unused tax potential, which can be exploited to finance a shift toward prodevelopmental public expenditures.

However, in trying to raise the necessary funds to finance development, care has to be taken that it does not result in inflation or further aggravate the existing inflation. Following Lipton, we can look at the possibilities of raising development finance by non-inflationary means¹. The cash value of the total output of a country (Y) consists of

¹ See Michael Lipton, « Financing Economic Development » in Dudley Seers and Leonard Joy (eds.) *Development in a Divided World* (London: Penguin Books, 1971), pp. 231-269.

consumer goods and services made and bought at home (C), investment goods made and bought at home (I) and exports (X). Thus, we have

$$Y = C + I + X \quad [1]$$

The value of output, (Y), is paid out as wages and distributed profits to all the producers, or left as undistributed profits with companies or nationalised industries. All of this money, (Y), has to be spent on home-produced goods and services (C) or on imports (M), or else saved by the government (Sg) as a surplus of tax over government current spending, or by private persons or firms (Sp) as a surplus of income over spending and income tax. Symbolically, this can be represented as follows:

$$Y = C + (Sg + Sp) + M \quad [2]$$

By combining equations [1] and [2] we obtain equation [3].

$$I = (Sg + Sp) + (M - X) \quad [3]$$

Equation [3] says that the value of a country's investment is equal to the sum of two types of financial resources. These are domestic savings (governmental and private), and foreign savings. Further, any increase in any one of the components of investment finance will increase total investment only to the extent that it does not decrease other components. For example, if the government increases public saving (Sg) by a bigger profits tax, there is bound to be some fall in private saving (Sp) since firms and receivers of profits distributed as dividends must use more of their revenue to pay tax, and thus have less left to save. They are likely to meet some of the tax by cutting spending, so that the fall in Sp is not likely to be as big as the rise in Sg, and total investment should go up; even if it does not, the rise in Sg may improve the composition of investment, which can increase total investment later.

The crystal clear point made from the foregoing discussion is that planners must be able to estimate the effects of fiscal decisions on the sources of total investment finance, not just on the public budget. Though the budget plays an important part in translating the expenditure and finance decisions on an annual basis, fiscal policy embraces all government transactions which have as their objective the support of general economic policy. In a developed country, fiscal policy very largely operates on the expenditure side of the account. In a less developed country the main emphasis of general economic policy is on growth with sufficient stability to prevent recurrent crises which would cause development to slow up or even regress, and hence give rise to losses on investments already made.

Developing countries tend to differ, from one country to another, in their development

finance structures. The reason for this dissimilarity lies in the fact that there are alternative techniques for mobilising the economic surplus — for eliciting savings and allocating them to investment. In its full detail, the list of alternative processes for putting saving to the service of selected investment is very long. However, the list may be compressed into two major classes. There are (i) processes of internal finance, and (ii) processes of external finance. In the former, the government draws on domestic savings. In the latter, the government draws on the savings of foreigners. This paper discusses the role of national savings in the financing of economic development in the more developed Caribbean countries - Barbados, Guyana, Jamaica and Trinidad and Tobago.

2. Savings as a source of development finance in the Caribbean

The formation of capital savings, is one of the important prerequisites to economic development. The mobilisation of savings has in recent years become a frequent recommendation for development policies. A macro-economic approach is often used indicating the amount of investment needed to increase the national output annually at a certain rate. If the proposed amount needed for investment is based on a calculated rate of gross domestic savings, this will not be enough to determine the amount of funds necessary for public and private investment unless the sources of these funds are identified. An overall estimate of resources expected to be available for investment must be supplemented by an indication of the sources of saving. Only then can one project the use of gross capital formations for investment in various areas.

Savings can be divided into (i) public sector savings (government saving plus retained profits of public enterprises) and (ii) private sector savings. Public sector savings has assumed growing importance as a possible source of development finance in the developing countries. During the past decade public investment has been stepped up nearly everywhere and the expectation that public sector savings will help in financing public investment is evidenced in most of the development plans. In these plans, estimates of financial requirements are divided into domestic sources and inflow of foreign funds. In a number of countries, like the Caribbean nations, public sector savings has been assigned a sizeable proportion of domestic resources. Thus the problem of public sector savings in the Caribbean is closely related not only to taxable capacity of the country but also to the trend of current public sector expenditure.

The importance of a continuous and expanding flow of private savings for financing both private and public investment is recognised throughout the less developed countries, and the need to take measures aimed at increasing the rate of private saving is stressed. Thus, the importance of raising the rate of private saving for financing development is obvious, but the question is through what policies and mechanisms can this be achieved². The situation will vary from country to country and the financial organisation will have to be adapted to local conditions³.

In essence, we are saying that there is little meaning in discussing « mobilisation of savings » without specifying not only all the policy targets to be fulfilled, but also the policy means to be used. Equalisation of income and equity considerations may be just as important in practical development policy as investments. We can only say, in general, that depending on the policy programme and the means to be used, it may be necessary to influence savings with respect to size as well as composition⁴. With respect to development programmes, the task will invariably be to increase the size of domestic savings and accordingly to stimulate the propensity to save, but nothing can be said, in general, concerning the composition of savings. In any case, however, we are interested in the possibilities of affecting both the size and composition of savings⁵.

Table 1 exhibits the gross national savings of the Caribbean for the period 1960-79. Cross national savings, on an absolute basis, changed unevenly in all of the countries. In Barbados, savings were negative in 1970 and 1972 and increased during the period 1974-79. In Guyana, gross national savings declined over the previous year's amount during the years 1971-73 and 1978-79. For Jamaica, national savings increased during 1970-73 and then declined consistently from thereon before increasing again in 1979. In Trinidad and Tobago, gross national savings have been most erratic. The country's national savings declined in 1971, increased in 1972, declined consistently during 1973-1975, and then increased again during 1978-79.

The ratio of gross national savings to gross domestic product is an indicator of internal resource mobilisation. Looking at the savings ratio for the four countries, as seen in

2 Jean van der Mensbrugghe, « Domestic Savings in Developing Countries », *Finance and Development* 9 (March 1972), pp. 36-39.

3 *Ibid.*

4 Kempe R. Hope, « Taxation in Developing Countries: A Case Appraisal of Guyana », *Bulletin for International Fiscal Documentation* 31 (November 1977), pp. 493-499.

5 Kempe R. Hope, « The Role of Domestic Savings in the Financing of Economic Development in Developing Countries », *Economic Affairs* 25 (November 1980), pp. 259-260.

Table 1

GROSS NATIONAL SAVINGS IN THE CARIBBEAN, 1960-79
(Millions of U.S. Dollars)

COUNTRY	1960 ^B	1970 ^A	1971 ^A	1972 ^A	1973 ^B	1974 ^B	1975 ^B	1978 ^C	1979 ^C
BARBADOS	12.5	-0.6	4.5	-2.9	29.8	17.4	25.6	157.0	157.0
GUAYANA	32.2	60.5	48.5	43.8	25.6	98.3	141.2	51.9	38.2
JAMAICA	279.5	189.3	394.1	478.5	649.3	465.2	423.8	57.7	129.8
TRINIDAD AND TOBAGO	43.9	369.5	350.2	379.3	185.5	102.3	95.4	161.2	166.0

Sources: Inter-American Development Bank, *Economic and Social Progress in Latin America* (Washington, D.C.; IDB, Several years); and United Nations, *Yearbook of National Accounts Statistics* (New York: United Nations, Several years).

(^A) Millions of 1973 Dollars.

(^B) Millions of 1976 Dollars.

(^C) Millions of 1980 Dollars.

Table 2, it can be gleaned that in 1979, with the exception of Trinidad and Tobago, the coefficient declined in all of the countries. In Barbados and Guyana the registered decreases exceeded five percentage points over the 1978 ratio. During the period 1975-79, the savings ratio was higher than 25 percent in Trinidad and Tobago only. This can be explained as being due to the country's general improvement in its internal resource mobilisation effort and the increased revenues resulting from its oil exports. A long-term analysis of the changes in the savings ratios during 1960-74, based on a comparison of the five year averages for 1960-64, 1965-69 and 1970-74, shows that there was no sustained increase in the savings ratios of the four countries during the entire fifteen year period. Barbados, Guyana and Jamaica achieved savings ratios in the last five year period that were below those of the initial period.

Increases in gross national savings in the Caribbean, given the declining private sector activity in most of the countries, necessarily implies increases in revenues or decreases in public expenditure. However, attempts should be continued to maximise private sector savings through encouragement of savings from households. This can be done through two mechanisms primarily.

First, assurance should be given by the governments against loss of savings due to inflation. Or better still, a major effort should be made by the authorities to curb inflation. A most important deterrent to household saving is inflation. Most households, particularly savers of small amounts, have no satisfactory means of protecting their

Table 2GROSS NATIONAL SAVINGS IN THE CARIBBEAN, 1960-79
(Percentage of Gross Domestic Product)

COUNTRY	1960-64 ^A	1965-69 ^A	1970-74 ^A	1975	1978	1979
BARBADOS	4.0	5.2	2.6	9.3	11.1	5.4
GUAYANA	15.9	14.3	15.3	30.3	15.2	9.1
JAMAICA	23.0	24.1	21.3	14.9	14.9	12.8
TRINIDAD AND TOBAGO	17.7	15.6	20.1	25.2	N.A.	40.1

Sources: Same as for Table 1; and Table 1.

^(A) Average.

savings from depreciation due to inflation. When prices have risen steadily, the will to accumulate savings is undermined and eventually destroyed. Once assurance is given against loss from inflation, the will to save can be quickly restored.

The second mechanism relates to the use of interest rates. There is a tendency to underestimate the beneficial effects of a high rate of interest in LDC's. The savings rates of interest need to be raised. A higher rate of interest will induce the public to further increase its savings and to hold more of its savings in the form of deposits and bonds, rather than in hoards of foreign exchange which is already very scarce in the Caribbean. In Guyana, for example, higher interest rates in 1979 resulted in increased savings deposits. Furthermore, higher rates of interest will tend to encourage a more economical use of capital and thus diminish the deficiency of resources for development. This argument can be further supported through recent studies which have shown that the major part of households' savings are in the form of claims on financial institutions. Households clearly prefer to hold their savings in the form of claims on financial institutions rather than in the form of direct claims on the government and corporate sectors. Hence, any further incentives provided by these financial institutions, in the form of higher interest rates, will tend to increase the volume of household savings. It is reasonable to pay a high rate of interest to attract savings, for savings have a high value in less developed countries.

However, it must be pointed out that, at least in Guyana and Jamaica with their shrinking private sector, increases in gross national savings would have to come primarily from the public sector. However, the performance of government savings in both economies has been less than impressive as shown in Table 3. Except in Trinidad and Tobago, all of the countries had deficits in their current accounts as a percentage of

gross domestic product during the 1970's. As an average during the 1972-76 period, Jamaica had the lowest ratio of government current savings as a percentage of gross domestic product. In contrast, in Trinidad and Tobago government current savings as a percentage of gross domestic product has been steadily increasing since 1972 due to the buoyancy of petroleum revenues.

Central Government savings in the Caribbean has been extremely volatile, except in the case of Trinidad and Tobago. The savings of Caribbean central governments have an important role to play in the accumulation of both total public sector savings and gross domestic savings. This is so because of the increasing scarcity of funds from the internal financial institutions. This increased savings performance will require careful budgetary management by the various Central Governments as well as a reduction in the dependence of the public corporations on the Central Governments for both current and capital transfers. The reduction of the dependence of the public corporations on the Central Government would require that measures be taken to improve the net earnings of the public enterprises. This would require, among other things, that these enterprises be managed efficiently and be allowed to charge prices that would enable them to earn profits which could then be invested in accordance with government policies. In effect, it means prudent fiscal policy.

Fiscal policy is now widely recognised to be a potent instrument for achieving important economic and social objectives in developing countries. One of the primary objectives of fiscal policy in LDC's is to raise the ratio of savings to national income so that the rate of net investment could be stepped up without the danger of inflation. As the role of the public sector expands, public savings undoubtedly assumes further importance and it becomes necessary to reorient fiscal policy to generate sizable surpluses in the public sector.

In as much as the main sources of public sector savings are taxes and surpluses of public enterprises, it may be taken to represent collective compulsory savings by the community, as distinguished from voluntary savings by households and private corporations. Public savings has a dual role to play. On the one hand, it constitutes a convenient source of finance for public investment; on the other hand, it may serve to raise the rate of savings in the economy.

Table 4 shows the contribution of national savings to the financing of gross domestic investment in the Caribbean. This is obtained by dividing the savings coefficients by investment as a percentage of gross domestic product. The resultant ratio provides an indication of the share of net external resources in the financing of gross investment.

The ratio of national savings to gross domestic investment in the Caribbean showed considerable annual fluctuations during 1973-79. National savings did not exceed gross investment during all of the individual years of the period in any country. Nevertheless, Trinidad and Tobago achieved a savings surplus in individual years during 1974-79. Barbados, Guyana, and Jamaica were, to one extent or another, dependent on foreign capital for financing investment in recent years.

The longer term trends in the relationship between savings and investment during 1960-74, based on a comparison of averages for the five-year periods of 1960-64, 1965-69 and 1970-74 shows Jamaica with a sustained decrease in the averages, Trinidad and Tobago with sustained increases, and Barbados and Guyana with uneven changes. Furthermore, Trinidad and Tobago showed the strongest growth in domestic financing in the region during the past decade and seems likely to continue to do so with her increasing oil revenues.

3. Conclusions and policy issues

An increasing volume of savings needs to be mobilised in the Caribbean. However, this can only be done when the rate of voluntary savings is progressively increasing. This means, therefore, an encouragement of voluntary savings. One aspect of that encouragement is to tap the enormous reservoir of rural savings that is seemingly hoarded in the Caribbean because of lack of access to financial institutions. The generation of savings is, admittedly, a function of income and wealth, but the existence of

Table 3
CENTRAL GOVERNMENT CURRENT SAVINGS, 1970-79
(Percent of Gross Domestic Product)

COUNTRY	1970	1971	1972	1973	1974	1975	1976	1978	1979
BARBADOS	1.9	1.1	3.3	0.8	-2.5	-0.1	-0.2	4.0	3.1
GUAYANA	3.0	-0.4	2.7	-3.5	7.4	14.0	-5.7	-9.4	-5.6
JAMAICA	0.9	2.0	—	0.2	2.6	1.6	-4.0	-2.4	-4.0
TRINIDAD AND TOBAGO	3.6	1.3	0.5	2.1	16.1	17.3	17.4	16.0	16.0

Sources: Same as for Table 1.

financial intermediaries may contribute to raising the savings ratio by providing a convenient form of savings⁶.

Voluntary savings by households accumulate as either residual (discretionary savings) such as bank deposits and government and corporate securities or as long-term contractual savings such as insurance policies, pension funds or payments on mortgage loans. Households as "surplus" units are potentially capable of providing the national economy with financial resources directly as well as indirectly. As such, one of the major tasks confronting the developing countries and their governments is to encourage and facilitate the economy's monetisation for the benefit of productive savings accumulation. Understandably, the purpose of these efforts is to discourage unproductive hoarding of physical goods such as real estate, livestock, precious metals and so on which have traditionally made up the bulk of savings in rural areas⁷.

In the Caribbean where private savings are clearly not sufficient to match the needs of development, public savings also automatically assumes importance and it becomes necessary to reorient fiscal policy to generate sizable surpluses in the public sector.

The savings of the public sector in the Caribbean has a dual role to play. On the one hand it constitutes a convenient source of finance for public investment and, on the other hand, it may serve to raise the role of savings in the economy. If public savings represents a genuine addition to private savings, it enables the countries to step up capital formation beyond the limits set by autonomous and induced savings performed by the private sector. It is essential to bear in mind, however, that the rate of savings in the economy is raised through public savings only if private savings is not correspondingly reduced thereby, and public revenue and public savings are increased at the expense of private consumption.

The role of savings is rather basic to any development finance process. Savings magnitude determines the extent of foreign financing required. As such, increasing the rate of domestic savings is considered to be of first importance in most discussions of economic development. However, much savings in the Caribbean is not being channelled in the right direction. Instead, it is being put into socially unproductive uses rather than being invested to yield a future income stream. As such, some emphasis must be

6 R.J. Bhatia and D.R. Khatkhate, "Financial Intermediation, Savings Mobilisation, and Entrepreneurial Development: The African Experience", *IMF Staff Papers*, 22 (March 1975), pp. 132-158.

7 K. Holbik, "Development Finance and Financial Intermediation in Developing Countries", *Journal of Economic Development*, 4 (July 1979), pp. 189-217.

placed on mobilising domestic savings, which connotes both an increase in the domestic savings rate and the channeling of existing and new savings into uses that will increase the rate of economic growth.

Mobilising domestic savings in the Caribbean necessarily entails an attempt to tap rural savings. A large volume of savings originates in the rural sector, but these savings cannot be mobilised through taxation because a portion of the income in the rural sector does not flow through monetary channels. Most of the financial institutions in the Caribbean are concentrated in the urban areas and urban savings are mobilised through these institutions. Therefore, further large scale mobilisation of savings for development finance through public borrowing is dependent, to a large measure, on the development and extension of financial institutions into the rural areas.

Organised rural money markets may influence households' savings behaviour in several ways⁸. On the one hand, they may augment the households' liquidity pool through credit. The additional liquidity allows rural households to maintain consumption which would otherwise be disturbed by uneven income flows. Credit further allows households to make major purchases of consumer durables and large productive capital goods. On the other hand, organised rural money markets may provide households with additional savings-investment activities by offering various types of financial savings instruments. If these instruments provide positive real returns to the households, they may induce the households to convert some of their excess liquidity into financial savings. This may increase the average rate of return realised by the households on their savings portfolio and induce the households to divert more of their income to savings-instrument activities by offering various types of financial savings instruments.

LE RÔLE DE L'ÉPARGNE DANS LE FINANCEMENT DU DÉVELOPPEMENT DANS LE CARAÏBE

RÉSUMÉ

Dans les pays du Caraïbe il y a un volume croissant d'épargne qu'il faudrait mobiliser. Mais, puisque on peut faire cela seulement quand le taux d'épargne volontaire

8 Dale W. Adams, « Mobilising Household Savings Through Rural Financial Markets », *Economic Development and Cultural Change*, 26 (April 1978), pp. 547-560.

augmente, il faut avant tout favoriser l'épargne volontaire. Une voie possible c'est de toucher à l'énorme réservoir d'épargne rurale tésaurisée du fait que les paysans n'ont pas d'accès aux institutions financières. Naturellement c'est le niveau du revenu et la richesse qui engendrent l'épargne, mai la présence d'intermédiaires financiers peut contribuer à augmenter le taux d'épargne si ceux-ci sont à même d'offrir des instruments appropriés.

La plus grande partie des institutions financières des pays du Caraïbe se concentre dans les zones urbanisées et c'est par l'intermédiaire de ces institutions qu'on mobilise l'épargne urbaine. Une nouvelle expansion de la mobilisation de l'épargne sur grande echelle dépend, donc, essentiellement du développement et de l'expansion des institutions financières dans les zones rurales.

Les marchés du crédit organisés ruraux peuvent affecter le comportement des ménages dans le domaine de l'épargne. D'un côté, ils peuvent augmenter la liquidité des ménages avec le crédit, ce qui leur permettrait d'acheter plus de biens durables et de biens d'équipement pour la production, et d'autre part, ils peuvent pourvoir les ménages de nouvelles formes d'épargne-investissement en leur offrant des types différents d'instruments d'épargne financière. Si ces instruments donnent des bénéfices réels aux ménages, cela pourrait les pousser à convertir une partie de leur liquidité excédentaire en épargne financière.

