

# DOMESTIC SAVINGS AND DOMESTIC BORROWING IN THE CARIBBEAN\*

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## 1. Introduction

Domestic savings is of critical importance for the achievement and maintenance of sustainable growth and development. This is particularly so for the developing countries where domestic borrowing is financing an increasing share of public sector expenditures as external capital flows continue to decline. This paper comparatively examines and analyzes the role of domestic savings and domestic borrowing in the financing of public sector expenditure in the selected Caribbean countries of Barbados, Guyana, Jamaica, and Trinidad and Tobago.

## 2. Domestic Savings in the Caribbean

The accumulation of savings is one of the most important prerequisites for economic development. Savings mobilization has, in recent times, become a peripatetic recommendation for development strategies. A macro-economic approach is usually used to indicate the amount of savings needed to complement whatever sources of funds may be available.

Domestic savings can be divided into (1) public sector savings (government savings plus retained profits of public enterprises), and (2) private sector savings. Public sector savings has assumed growing importance as a source of development finance in developing countries. During the past two decades public investment has increased nearly everywhere and the expectation that public sector savings will assist in financing future public expenditure is evidenced in most of the economic policy frameworks of the Caribbean countries.

However, the importance of a continuous and expanding flow of private savings for financing both private and public expenditure is also recognized throughout the Caribbean, and the need to take measures aimed at increasing the rate of private savings is stressed. Thus, the importance of raising the rate of private savings for financing development expenditure is obvious, but the question is still through what policies and mechanisms can this be achieved. The situation will vary from country to country and the financial organization will have to be adapted to local conditions.

In essence, what is being stressed here is that there is little meaning in discussing

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\* The views expressed by the author are entirely his own and not necessarily those of the United Nations.

"mobilization of savings" without specifying not only all the policy targets to be fulfilled, but also the policy means to be used. 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 composition. With respect to development policy, 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, what is of interest are the possibilities of affecting both the size and composition of savings (Hope, 1980).

Table 1 exhibits gross domestic savings for the four countries in this study. The ratio of gross domestic savings to gross domestic product is an indicator of internal resource mobilization. With the exception of Jamaica, all of the countries recorded moderate increases in their savings ratios during the 1960s and 1970s. However, in the 1980s, none of the countries were able to record sustained increases in their savings ratios and, in Barbados, the domestic savings ratio has never exceeded 20 percent.

Table 1

GROSS DOMESTIC SAVINGS IN THE CARIBBEAN, 1960-88  
(Percentage of Gross Domestic Product)

Country	1960 - 70	1970	1975	1980	1985	1986	1987	1988
Barbados	4.2	7.0	9.2	19.3	19.3	16.0	15.0	16.0
Guyana	13.9	22.2	33.0	19.3	12.9	20.9	21.7	17.0
Jamaica	20.4	27.4	15.4	13.6	14.7	20.7	22.9	19.0
Trinidad & Tobago	4.9	27.0	45.1	42.1	24.5	18.4	18.0	21.0

Sources: World Bank, *World Tables 1988-89 Edition* (Baltimore: Johns Hopkins University Press, 1989); and United Nations Development Programme, *Human Development Report 1991* (New York: Oxford University Press, 1991).

To increase gross domestic savings in the Caribbean, given the declining economic progress in most of the countries, necessarily implies increases in revenues or decreases in public expenditure (Hope, 1982). However, attempts should be continued to maximize private sector savings through encouragement of savings from households. This can be done through two mechanisms primarily.

First, assurance should be given by the various Caribbean governments against loss of savings due to inflation. Or better still, a major effort should be made by the authorities

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to curb inflation. A most important deterrent to household saving is inflation. Inflation is, in effect, a tax on savings (World Bank, 1990). Most households, particularly savers of small amounts, have no satisfactory means of protecting their 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 developing countries. 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 (Hope, 1987). In Trinidad and Tobago, it was found that real interest rates do have a significant influence on savings behaviour (Watson and Ramlogan, 1991). Furthermore, higher rates of interest will tend to encourage a more economical use of capital and thus diminish the deficiency of resources for development. 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 (Polak, 1989). 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 all developing countries. Moreover, the combination of inflation and low deposit rates has contributed significantly to capital flight.

However, it must be pointed out that, at least in Guyana with its small private sector, increases in gross domestic savings would have to come primarily from the public sector. However, the performance of government savings in that economy has been less than impressive as shown in Table 2. 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 1971-75 period, Barbados 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 increased steadily in the 1970s due to the buoyancy of petroleum revenues. However, in the 1980s, Barbados was the only country of the four not to record negative government current savings.

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Table 2

CENTRAL GOVERNMENT CURRENT SAVINGS, 1970-89  
(Percent of Gross Domestic Product)

Country	1970	1971-75	1978	1979	1980	1985	1989
Barbados	1.9	1.1	4.0	3.1	2.8	0.5	4.5
Guyana	3.0	4.3	- 9.4	- 5.6	- 9.7	- 36.1	- 37.2
Jamaica	0.9	1.3	- 2.4	- 4.0	- 7.7	- 1.0	4.0
Trinidad & Tobago	3.6	6.6	16.0	16.0	21.4	2.6	- 2.2

Source: Inter-American Development Bank, *Economic and Social Progress in Latin America* (Washington, D.C.: IDB, Several Years).

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 other sources. 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 all public enterprises. This would require, among other things, that these enterprises be either privatized or 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 recognized to be a potent instrument for achieving important economic and social objectives in developing countries. One of the primary objectives of fiscal policy in developing countries 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.

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 while, on the other hand, it may serve to raise the rate of savings in the economy.

### 3. Domestic Borrowing in the Caribbean

Domestic borrowing results in the creation of domestic debt. Domestic debt can be defined simply as money a government owes to its own citizens in its national currency. Domestic borrowing in the Caribbean, as shown in Table 3, is achieved through bank advances, treasury bills and bonds, debentures, the issuing of savings certificates and savings bonds, and locally registered stock.

Table 3

CENTRAL GOVERNMENT NET DOMESTIC BORROWING, 1970-89  
(Percent of Gross Domestic Product)

Country	1970	1975	1976	1978	1980	1985	1989
Barbados	4.1	2.0	6.8	-0.7	0.5	0.2	0.4
Guyana	3.6	1.6	26.2	14.5	24.6	45.0	34.9
Jamaica	2.6	7.0	15.9	6.7	4.0	0.2	-3.0
Trinidad & Tobago	4.0	-0.2	-1.1	0.3	-7.9	3.3	5.1

Source: Same as for Table 2.

Central government borrowing to meet the expenditure on public capital formation represents deficit financing. The concept of deficit financing is taken here to result from the excess of public capital formation over and above any surplus of genuine government revenue left after covering other (non-capital) government expenditure. Thus defined, an increase in the government deficit — whether due to an increase in public capital formation or a reduction in genuine government revenue or an increase in other public consumption of goods and services — forms an additional claim against the available resources in the economy.

When public borrowing occurs, a debt instrument is created. Whereas taxation constitutes a method of forced savings, public borrowing is a device to utilise a substantial part of voluntary savings for financing the expenditure of the public sector and functions as an instrument of resource mobilization. The issue, therefore, is one of reducing the resource gap. This can only be done by increasing the level of domestic savings, as discussed before, or reducing the rate of growth of private and government consumption.

Public borrowing does have some advantages, however. It generates additional pro-



ductive capacity in the economy which would not have been possible in its absence. To the extent that it is used as an instrument to mobilize savings, which would otherwise have gone into non-productive activity, it becomes a positive instrument of economic growth. Table 4 indicates the extent of the financing of central government overall surplus or deficit through domestic borrowing. Actually, it is mostly deficit financing since only Trinidad and Tobago in 1980, and Jamaica in 1989, had an overall surplus during the 1970-89 period.

Table 4

CENTRAL GOVERNMENT OVERALL SURPLUS OR DEFICIT FINANCED BY NET DOMESTIC BORROWING, 1970-89  
(Percent for Gross Domestic Product)

Country	Surplus or deficit					Net domestic borrowing				
	1970	1971-75	1980	1985	1989	1970	1971-75	1980	1985	1989
Barbados	-1.0	-4.5	-3.1	-5.0	-0.8	4.1	3.8	0.5	0.2	0.4
Guyana	-6.6	-13.4	-30.8	-53.7	-46.8	3.6	4.2	24.6	45.0	34.9
Jamaica	-5.1	-7.4	-17.4	-4.0	0.2	2.6	5.0	4.0	0.2	-3.0
Trinidad and Tobago	-3.3	-3.8	6.3	-5.7	-4.1	2.8	2.2	-7.9	3.3	5.1

Source: Same as for Table 2.

Public borrowing can mobilize an increasing volume of resources only when the rate of voluntary savings in the economy 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 financial intermediaries may contribute to raising the savings ratio by providing a convenient form of savings (Hope, 1987).

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 Caribbean countries and their governments is to encourage and facilitate monetization for the benefit of productive savings accumulation. Understan-

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dably, 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 areas (Holbik, 1979). This, in turn, will reduce the persistence of a very narrow ownership structure of the domestic debt where, for both the long-term and the short-term debt, ownership is concentrated among financial institutions and governmental or quasi-governmental agencies. Holdings by non-financial enterprises and by individuals are relatively minimal.

Except in Jamaica, debentures seem to represent the preferred share of assets in the domestic debt of the Caribbean. During the late sixties to the present, debentures have been averaging more than half of the total asset structure of the domestic debt. In Jamaica, locally registered stock comprises the majority of the assets of that country's domestic public debt. Private holdings, in all of the countries, of the short-term domestic debt are almost entirely confined to the commercial banking industry. The treasury bill market, for example, can be described as a bilateral monopoly with the monetary authorities being the sole sellers and the commercial banks the sole buyers thus resulting in two primary consequences. The first is that transactions are determined largely on the basis of strength of need and the second is the near impossibility of transferring the debt to third parties.

#### 4. Conclusions

The generation of savings is admittedly a function of income and wealth. However, in the Caribbean where private savings is clearly not sufficient to match the needs of development, public savings 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 expenditure and, on the other, 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.

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The role of savings is rather basic to any public finance process. Savings magnitudes determine 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 of the savings in the Caribbean is not being channelled in the right direction (Hope, 1986). 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 placed on mobilizing domestic savings, which connotes both an increase in the domestic savings rate and the channelling of existing and new savings into uses that will increase the rate of economic growth.

Mobilizing 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 mobilized 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 mobilized through these institutions. Therefore, further large scale mobilization of savings for public sector finance through public borrowing is dependent, to a large measure, on the development and extension of financial institutions into the rural areas.

Organized rural money markets may influence households' savings behaviour in several ways (Adams, 1978). 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, organized 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 realized by the households to divert more of their income to savings-investment activities.

Domestic borrowing in the Caribbean, particularly in Guyana and Trinidad and Tobago, has been increasing in recent years. This is so because of the scarcity of funds in the international financial markets and the now stringent rules for external borrowing. Domestic borrowing is a form of deficit-financing which is usually defined as the financing of a created gap between public revenue and public expenditure or a budgetary deficit. The method of financing resorted to being borrowing of a type that results in a net addition to national outlay or aggregate expenditure and that points to the crux

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of the problem. In practice, it is far easier to let current expenditure rise than to bring about sizable increases in revenue which usually means increases in taxation. Proposed increases in taxation often have to be justified to the legislature or to the public at large. It is that prospect of justification that deters such government action and makes deficit financing attractive.

The policy of deficit financing adopted by Caribbean governments has resulted in considerable inflation. However, it has also transferred some resources from the private consumption sector to the public sector for investment purposes thus resulting in forced savings due to the reduction of private consumption. But, it has also further increased the internal public debt and the increasing competition between the public and private sectors for available financial resources from the domestic financial system will, inevitably, lead to some crowding out of the private sector with its negative multiplier effects.

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## Abstract

*This paper examines and analyzes the role of domestic savings and domestic borrowing in the financing of public sector expenditure in the selected Caribbean countries of Barbados, Guyana, Jamaica, and Trinidad and Tobago. The policy conclusions advocate the need for and the means for effecting increased savings mobilization and points to the hazards of deficit-financing through domestic borrowing.*