The Development of Equity Markets in the Caribbean

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THE DEVELOPMENT OF EQUITY MARKETS
IN THE CARICOM CARIBBEAN

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A noticeable feature of Caribbean economies has been our slowness in developing substantial corporate enterprises capable of competing in the international market place. With hardly any exceptions, even our largest firms operate behind high protective barriers. This to be contrasted with the fantastic economic progress of Taiwan, South Korea, Singapore and Hong Kong. Starting from an even lower economic base than the Caribbean, they have not only achieved "take-off", in the Rostovian sense, but are driving hard towards maturity. Taken as a whole, the Caribbean is economically worse off than it was in 1970, and in one or two individual cases, worse off than in 1960.

It is hardly contestable now that, even after discounting cultural characteristics, the relative success of the "four tigers" derives from the choice of the development paradigm which they adopted. All of them pursued a government orchestrated market- and export-oriented strategy. Starting with a programme of "industrialization by invitation", they were quick to "learn the tricks of the trade", and soon had substantial indigenous firms flourishing side by side with the multinationals. Most significantly, all four of them have developed vibrant Stock Exchanges. Indeed, some New York based mutual funds specialize in stocks traded on their stock markets. Their success confirms the well grounded principle that the development of a viable stock market is a sine qua non of economic growth in capitalist or mixed economies.

The economic failure of CARICOM in the 1970's and 1980's derives from two main factors: (1) the failure of the economic models utilized and (2), the political failure of the integration process. As we shall see, both of these factors have inhibited the development of equity markets; the underdevelopment of equity markets, in turn, has stifled corporate growth and exerted a tremendous drag on economic development in the region.

The economic strategy of Caricom governments in the 1970's rested substantially on two paradigms, the Marxist paradigm and the "depen-dence" paradigm. The Marxist paradigm, invoked by Guyana and Grenada, called for nationalization of the means of production and the "minia-turization" of the private sector. The Cooperative Republic of Guyana succeeded so well that it came to own and control about 80 per cent of the formal Guyanese economy. Grenada fitfully pursued the Marxist-Leninist path of state ownership of the productive sector. The "dependence" paradigm, pushed by the New World School of the University of the West Indies, identified dependence on the metropolitan economies as the root cause of Caribbean underdevelopment and recommended "delinking" from the metropoles and "occupation of the commanding heights of the economy". The Jamaican Government acquired shares in the dominant alumina-bauxite industry, nationalized public utilities, a commercial bank, hotels and other enterprises, and went into state export and import marketing. The Trinidad and Tobago Government required the indigenization of some foreign owned enterprises and nationalized others, including oil, and soon found itself with the outright or partial ownership of over 60 companies. Both the Marxist and "dependence" strategies favoured the omnicompetent state, and were hostile to the development of the private sector. Furthermore, by stressing "indigenization", they promoted inward-looking, rather than the outward-looking strategies favoured by the "gang of four".

Caribbean territories pursued these strategies with differing degrees of fervour. The Bahamas, Barbados and the OECS, generally speaking, made only limited forays into state ownership. In spite of pious pronouncements to the contrary, the resulting "ideological pluralism" disrupted progress towards regional integration, breaking the region into even more disparate units, each one huddled behind a series of non-tariff defences - exchange controls, import licensing, work permits, alien land holding laws, maritime laws and others.

The climax came with suspension of the free trade provisions of the Caricom Treaty and the collapse of the promising Caricom Multilateral Clearing Facility. These unfortunate developments stifled any tendency towards production sharing and pooling of financial resources - two prerequisites for the promotion of region-wide enterprises and a regional equity market.

Fortunately, the clouds have begun to lift. Not only has the Marxist paradigm palpably failed in the Caribbean, but its tenets are under revision in the Kremlin itself. The "dependence" school also finds itself in disarray. Privatization is the order of the day and the Guyanese are wooing foreign investors. Meanwhile, the OECS contemplate political union, and Mr. Michael Manley has been calling for the integration of Caricom Stock Exchanges.1 The time is ripe for us to consider the further development of equity markets in the Caricom Caribbean.

First, this paper will enunciate the role of equity markets in a theory of finance and development. Secondly, we will review the various measures so far taken or contemplated by Caricom authorities to promote equity markets in their respective countries and in the region. The third section of this paper will report on the status of formal equity markets in Barbados, Jamaica, and Trinidad and Tobago. Fourth, we will identify those obstacles which still stand in the way of a regional market in equities. Fifth, we shall outline some proposals for accelerating the achievement of a viable regional equity market and conclude with some reflections on the possibilities of a regional Stock Exchange.

EQUITY MARKETS IN A THEORY OF FINANCE AND DEVELOPMENT

If there is one thing we know about economic development it is that investment must increase relative to consumption as a proportion of the national income. Investment, in the words of John Maynard Keynes, is the engine of growth. Investment is made possible through savings. According to our own Sir Arthur Lewis, we cannot explain any industrial revolution "until we can explain why savings increased relative to the national income".2 Economic development, then, is about accelerating the rate of capital formation.

Capital formation implies investment expenditures over and above the level required to offset the depreciation of existing capital goods. A firm may confine the extent of its capital expansion program to the limits of its retained earnings. More often than not a firm's expansion program is accomplished through borrowing from other firms and households which have surplus funds at their disposal. The credit transaction is usually carried out through the intermediation of the financial institutions which comprise the financial market. The function of financial markets is to facilitate the transfer of savings from surplus units to deficit spending units, which are then enabled to invest more than they have saved.

The investment decision, then, as Professor Hyman Minsky aptly puts it, is "a decision both to acquire tangible assets and to emit financial liabilities (including the implicit emission of liabilities by way of retained earnings)".3 Professor Albert Hart and Peter Kennen make essentially the same point when they observe that "the growth of debt is a counterpart of economic growth."4

As an economy develops, the gestation period of investment projects tends to lengthen and the pay-back period to become more extended. Surplus lending units must therefore be persuaded to hold the liabilities of deficit spending units over longer and longer maturities - up to thirty years in the case of government and corporate bonds and indefinitely in the case of equities. The incentive for them to do so is greatly increased if, in the event of some contingency, the liabilities of the deficit spending units can be readily liquidated without significant loss of value - i.e. if the securities held by the surplus unit are liquid.

In this respect, J. G. Gurley and E. S. Shaw make an important point in their paper, "Financial Aspects of Economic Development". They argue that the Keynesian model

> ...is not an efficient instrument for studying economic development in either its real or its financial aspects. On the side of goods, the model is inefficient because it does not allow for the effects of investment and of growth in the labor supply on output capacity. Once these effects are admitted ... investment appears in a dual role.. As an element in effective demand, it is an economic stimulant, but as an increment in capacity its effects

> may be depressing. On the side of finance, the Keynesian model is inefficient because it does not allow for the effects of spending and deficits on debt and on the financial capacity of spending units to sustain their spending. Deficits, like investment, leave an economic residue. In the case of deficits, the residue is debt and a change in financial capacity.5

Their charge that Keynes failed to take account of the residue of additional capacity and debt is unfair. Keynes' model assumed an economy in a temporarily depressed state, but with considerable idle capacity and with mature financial markets capable of absorbing any likely increase in debt. However, their insight that deficits, like investment, leave an economic residue is most important in the case of developing countries with limited production capacity and poorly developed financial markets. They highlight the fact that each wave of real investment makes an imposition upon the capacity of the economy to sustain the liquidity of the additional debt created by that investment. They describe this as the "financial capacity of the economy".

In this respect, financial markets need not only be wide, but deep as well, if they are to sustain the liquidity of thirty-year bonds and perpetual equities. The institution of the stock market in the U.S.A. is not primarily important as a source of new capital. The vast proportion of new capital investment derives from retained earnings, commercial banks and corporate bonds. Between 1958 and 1966, net new issues of corporate stocks in the U.S.A. in no year exceeded three billion dollars during a period in which net investment funds averaged $33 billion. Between 1982 and 1987 the net supply of credit issued through financial institutions other than new corporate stock was $8.6 trillion, while net issuance of corporate stock was a negative $260 billion.

The critical importance of the stock market is that it sustains the liquidity of trillions worth of common stock accumulated by the public for over one hundred years. The accumulated market value of shares on the U.S. Stock Market exceeds $2.5 trillion, more than half the G.D.P. of the United States. The ability of firms to finance new investment from retained earnings also derives from the existence of the stock market. Shareholders are prepared to forego current dividend payments in return for the prospect of capital gains, which are predicated upon a flourishing stock market.

The absence of adequate financial capacity also explains the strong bias towards consumption in developing countries. The illiquidity of medium and long term corporate, and even of government securities, is a disincentive for surplus economic units to hold the long term debt needed to support capital investments. This situation favours deficit spending units who are willing to finance consumer goods through the emission of short-term liabilities. It is fair to say that sustainable growth in a mixed economy is unlikely in the absence of an effective stock market. This, in turn, explains much of our dependence on foreign sources for investment capital.

But the most important long run benefit of a formalized market for equities is the increased sense of participation in wealth-creating activities brought about by the wider distribution of stockholders in the society. The fact that over fifty million Americans have investments in stocks or in stock mutual funds and that over 130 million participate in the stock market indirectly through pension funds, life insurance companies, or other financial institutions, goes far to explain why the U.S.A. is one of the most politically stable societies in the world. Indeed, the most important political success of Margaret Thatcher's strategy of privatization in the U.K. has been the transformation of millions of "workers" into bourgeois property owners.

MEASURES TO PROMOTE THE MARKET FOR EQUITIES IN CARICOM

Except for the Bank of Guyana, all Central Banks in the region have been involved in the deliberate development of money capital markets as charged by their statutes. In Jamaica, Trinidad and Tobago, and Barbados, these efforts eventually culminated in the formation of formal Stock Exchanges. In The Bahamas, Belize and the OECS the process has been less advanced. There are indications that the Bank of Guyana may, in the not too distant future, be motivated to follow the lead of its neighbours.

The standard approach to the development of financial markets is to start with the promotion of the money market. The Central Bank requires commercial banks to hold a stipulated proportion of their assets in government treasury bills and makes a market, as far as is possible, for commercial banks wishing to improve the liquidity of their portfolios. The key to the success of this exercise is for borrowing governments to accept interest rate levels which reflect demand and supply conditions in the money markets. The next step is to improve the marketing of medium and long term government paper. Here again the commercial banks are required to hold some proportion of their assets in longer term paper, but the most important potential buyers are Life Insurance Companies, for whom long-dated government paper is an important element of their portfolio as required by supervisory authorities to be invested in domestic assets.

As we shall see in the following section, the formal establishment of a Stock Exchange has usually required special legislation facilitating the timely transfer of securities from sellers to buyers, providing incentives for companies to list, and regulating the conduct of players on the stock exchange. In this exercise Central Banks have usually played a catalytic role as promoter, provider of start-up funds, accommodation and sometimes of nuclear staffing.

To supplement the specific legislation establishing the Stock Exchange, several other legislative and administrative measures are necessary. These vary according to local circumstances and government objectives. These measures may be divided into those designed to stimulate the supply of equities and those which are designed to stimulate the demand for equities.

The supply of equities depends first of all on the existence of companies eligible for listing on the stock exchange. Once a minimum number of eligible companies exists, they can be motivated through appropriate incentives to list on the Stock Exchange. Publicly held companies are naturally inclined to list; some privately held companies, as seems to be the case in The Bahamas, may avoid the risk of the dilution of ownership.

One of the motivations of the indigenization programme of Trinidad and Tobago in the 1960's, was to stimulate the increased ownership by nationals of the shares of foreign companies. In nationalizing foreign companies, Government contemplated the later sale of some shares, at least, to nationals. The indigenized commercial banks, in particular, have become important sources of tradeable equities. Previously the parent corporations traded on their national stock exchanges and were unavailable to Trinidad and Tobago resident nationals.

The original intent of the Trinidad and Tobago Government to divest shares in favour of its nationals was not diligently pursued. However, with the rapid deterioration of the national finances, the Robinson Administration has embarked on a policy of privatization which should considerably increase the number of enterprises eligible for listing on the Stock Exchange.

The Seaga Administration, for ideological as well as pragmatic reasons, also embarked on a program of privatization which contributed to a revival of interest in the Jamaican Stock Market. In December 1986 a highly successful issue of National Commercial Bank stock encouraged many new investors to enter the market. In 1987 Government unloaded more of its holdings in the Caribbean Cement Company, although only 72% of the offering was taken up. In 1988 Government made a successful divestment of part of its holdings in Telephone of Jamaica.

The Central Bank of Barbados has sent forward to Government proposals for the establishment of a Venture Capital Corporation which would invest in the equity of new and promising companies. The proposed Corporation would eventually become eligible for listing on the Stock Exchange.

One technique of stimulating the demand for equities is to reduce the risk to investors through participation in unit trusts. In Jamaica the initiative to establish unit trusts was taken by the private sector; in 1981 the Trinidad and Tobago Parliament passed legislation establishing the Unit Trust Corporation. This Corporation, which became operational in 1982, celebrated its fifth anniversary during 1987 with a symposium entitled "Trinidad and Tobago Unit Trust Corporation - A Project in Economic Democracy". During 1987 gross unit sales of the Corporation rose 83.1 per cent to TT$22.7 million, from the level of TT$12.4 million in 1986. The Corporation increased investments in equity by TT$7.8 million and held shares in twenty-one companies at year end, one less than a year earlier. The maximum holding by an investor was also increased from 40,000 units to 200,000 units, thereby enabling large institutions to participate more effectively in the fund.

In recent years both Barbados and Jamaica have offered incentives to investors in equity. Tax payers in Barbados benefit from a maximum BDS$10,000.00 tax write-off on investment in new equity issues. Unfortunately, the 50 per cent dividend tax credit previously available to investors has been reduced to 15 per cent. Effective 1988, Jamaican companies expanding their equity base from their own profits through the issue of bonus shares instead of distributing dividends, are entitled to a tax credit equivalent of 25 per cent of the value of the bonus shares issued out of profits subject to tax in that year, provided that the value of the bonus shares does not exceed 50 per cent of that year's after tax profits. All three existing Caricom Stock Exchanges have conducted extensive public relations programmes to attract potential investors into the stock market.

The Bahamas, the OECS and Belize are still in the early stages of capital market development. Their markets for government paper are still primitive. In each country the Central Bank is currently embarked on capital market programmes to improve the functioning of their financial markets. The possible participation of the OECS in the Securities Exchange of Barbados has been mooted.

EXISTING STOCK EXCHANGES

The Securities Exchange of Barbados

The Act establishing the Securities Exchange of Barbados (SEB) was passed on October 11, 1982. However, the Exchange did not commence trading until June 12, 1982. The SEB has received considerable financial and other support from the Central Bank of Barbados in whose building it occupies rent-free offices. The purposes of the Exchange as set out in the Act are:

(1) to provide a public securities market to promote commerce by creating a facility for dealing in securities in Barbados;

(2) to maintain a reliable and reputable securities market for the protection of the investing public of Barbados;

(3) to enable the facility created by this Act to form and operate, by itself or with others, a company to deal in securities until such time as the market in Barbados is mature enough to support itself; and

(4) to provide such other exchange services as the commercial and industrial needs of Barbados might require.

Purpose (3) represents an interesting innovation. To enhance the liquidity of stocks traded on the Exchange, legislators made provision for the Exchange to set up a marketing company which would deal in securities. In fact, it was the Central Bank of

Barbados that set up the Barbados Securities Marketing Company (BSMC) which holds its own portfolio of securities and performs, in some degree, the role of what the Americans describe as a "specialist" and the English used to call a "jobber". It is anticipated that the BSMC will be wound up when the Exchange is deemed mature enough. That day will be long in coming.

The Exchange is administered by a Board of six Governors elected by the members. Members may be either corporations or individuals and include all the commercial banks. As of December 31 1987, there were 13 companies listed on the Exchange. For the period June 12 to December 31 1987, 1,536,865 shares changed hands at a purchase price of BDS$3,563,546. Over the same period, the value of the original ten listings rose in value from BDS$243 million to BDS$387 million at year end. Even more encouraging is the fact that the fees earned by SEB were meeting its operating costs by the end of 1987. Trading activity slowed during 1988 when 1,480,057 shares were traded with a value of $4,168,646, and no additional companies were listed. The Exchange commenced trading in the government guaranteed Sugar Industry bonds in 1988.

The Jamaica Stock Exchange

The Jamaica Stock Exchange was incorporated with limited liability in September 1987 under the Companies Act of Jamaica and commenced operation in February 1969.

Its principal objectives are:

(1) to promote the orderly development of the stock market and a Stock Exchange in Jamaica;

(2) to ensure that the stock market and its broker-members operate at the highest standards practicable;

(3) to develop, apply and enforce rules designed to ensure public confidence in the stock market and its Broker-members;

(4) to provide facilities for the transaction of stock market business; and

(5) to conduct research, disseminate relevant information and maintain local and international relationships calculated to enhance the development of the Jamaican stock market.

Stock holding is restricted to broker-members who trade both as agents and as principals. In the latter capacity, certain restrictions apply to transactions between a broker and his own client. Provisions exist for associate membership, without trading privilege, by financial institutions such as trust companies and merchant banks. The Broker-members comprise the directors of the Exchange, with the right to exercise all the powers of directors under the Companies Act of Jamaica. The Exchange is governed by a Council to which the directors delegate their powers subject to the regulations of the Articles of Memorandum of Association of the Company. Although independent of the Central Bank, the Exchange's General Manager and staff are all seconded from the Central Bank.

Three types of stock are dealt on the Jamaican Stock Exchange: (1) Ordinary/Common Stock, (2) Preference Stock, and (3) Debentures/Loans Stocks. Government Bonds are not listed but are traded principally by Broker-members in an over-the-counter market regulated by the Bank of Jamaica. Subject to certain exceptions for commercial banks, only Broker-members of the Jamaica Stock Exchange are allowed to deal in Government Bonds with the Bank of Jamaica.

The listing of securities on the Exchange is in the absolute discretion of the Council which may delegate such powers to a duly appointed committee. The minimum requirements for listing of a company's securities are:

> Total issued share and loan capital of $200,000.00 or more; the share capital portion being not less than $100,000.00. In the case of ordinary shares/stock, a minimum of 100 shareholders holding in their own right not less than 20% of the issued ordinary capital (such percentage being not less than $50,000.00 nominal value) excluding the holding of one or more controlling share/stock holder(s).

TABLE 1

TRANSACTION DETAILS - 1977/85

	No. of Transactions	Volume (000's)	Value (J$000's)	Closing* Index	Change over previous year
1977	458	2,185.0	1,293.3	38.87	-10.40
1978	546	13,818.1	10,092.6	41.59	+2.72
1979	390	4,833.0	2,216.6	53.71	+12.12
1980	476	7,390.5	5,100.9	66.58	+12.87
1981	803	4,198.4	3,332.3	152.23	+85.65
1982	1375	5,541.9	10,155.8	211.16	+58.93
1983	1566	5,185.3	9,829.4	240.38	+29.22
1984	2117	9,744.3	26,017.3	461.10	+220.72
1985(June)	1115	8,334.0	24,849.8	484.55	

*Base (June 1969) = 100

All time high: 516.99 (March 21 1985)
All time low: 35.84 (Feb.10 1978)

The Trinidad & Tobago Stock Exchange

An informal Securities Market existed in Trinidad & Tobago for over twenty years prior to the opening of the Trinidad & Tobago Stock Exchange. This informal market took on much greater significance when Government, as a matter of policy, decided to localize the foreign owned commercial banking and manufacturing enterprises. These were required to divest and sell a majority of their shares to nationals.

To effect this policy two institutions were set up - the (1) Capital Market Issues Committee, established by the Minister of Finance in July 1970 to oversee developments in the primary market, and the (2) Call Exchange (an association of dealers in stocks), which was organized in August 1975 under the tutelage of the Central Bank to monitor activities in the secondary market.

Parallel to this development in the public sector was the rapid development of private sector institutions, such as trust companies and stock-broking firms, to satisfy the demands of investors in both the primary and the secondary markets.

With a reasonably well developed infrastructure in place and a corresponding increase in the securities business, the decision was taken to establish a centralized securities market so as to facilitate the orderly development of the domestic capital market. The Securities Industry Act of 1981 formalized the securities market in Trinidad & Tobago. This Act was proclaimed on October 23 1981, and the Stock Exchange formally opened on October 26 1981, under the auspices of the Minister of Finance.

The affairs of the Exchange are managed by a Board of Directors consisting of nine individuals. The composition is as follows:

(1) two members appointed by the Minister of Finance;

(2) two members who are stockbrokers; and

(3) two members elected by all listed companies.

The Board of Exchange is responsible for policy direction and normally takes or confirms all strategic decisions related to the Exchange. These decisions reflect the provisions of the Securities Industry Act, the Listing Requirements, and the Rules and Regulations of the Exchange. There are the Quotations Committee, the Membership Committee, and the Commission and Dealings Committee. The latter, in turn, delegates the conduct of the day to day operations of the Exchange to the General Manager.

The Board of Directors decides, through the Quotations Committee, which securities may be listed and traded on the Exchange. On the recommendation of the Commissions and Dealings Committee, the Board may delist or suspend trading in a Committee. Through the Membership Committee the Board has the right to examine the financial condition and modus operandi of member firms. It also has the right to discipline members for violation of the Exchange rules through temporary suspension, or outright expulsion from the Exchange.

The two principal classes of shares traded on the Exchange are common stock and preferred stock. Trading in government securities is conducted under the aegis of the Investment Division of the Central Bank. At its opening in October 1981, the number of listed companies was 35, with an issued share capital of TT$415.4 million. By November 1982 the number listed had risen to 40 with issued share capital of TT$527.9 million. Between October 1981 and

December 1982, listed companies raised additional capital of TT$144 million and the total market value of the securities of listed companies increased from TT$2,291.5 million to TT$3,605 million, an increase of 573%. However 1982 was to prove the peak year; trading declined sharply in 1984 and steadily thereafter.

TABLE 2

CAPITAL MARKETS: SECONDARY MARKETS TURNOVER*
(Excluding Trade in Treasury Bills)

	PUBLIC COMPANIES				GOVT. SECURITIES		
	No. of Trans-actions	Vol. of Shares Traded (000)	Market Value ($000)	Composite Price Index	No. of Trans-actions	Nominal Value ($000)	Market Value ($000)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1982	28,736	90,280	556,597	n.a.	195	63,706	62,244
1983	25,836	71,553	362,216	71.6	207	131,610	140,224
1984	18,557	53,665	182,973	59.6	176	66,326	66,494
1985	11,124	48,476	138,563	49.1	196	132,213	134,218
1986	9,994	84,950	186,038	38.3	134	41,339	40,269
1987	6,508	68,742	90,629	39.9	n.a.	n.a.	n.a.

*Data refer to the double transactions of buying and selling

OBSTACLES TO THE FURTHER DEVELOPMENT OF EQUITY MARKETS IN THE CARIBBEAN

The quickening trend away from state ownership removes an important ideological obstacle to the development of equity markets in the region. The more private enterprises there are, the larger the potential supply of listable equities. There are also signs that the traditional hesitation of the Black majority to enter business and to hold equity is diminishing. This is especially noticeable in Barbados where the call is for Black economic enfranchisement. However, substantial obstacles to the deepening of equity markets still remain in the Caricom Caribbean.

Low Incomes

A fundamental obstacle, of course, is low incomes. Where incomes are relatively low, the sums available for investment in equities are limited. The scope for investment in equity was highest in the MDC's of Caricom. Unfortunately, incomes in the hitherto oil-rich Trinidad and Tobago have slipped rapidly in recent years; Jamaica's GNP has been drastically cut; that of Barbados has stagnated, while Guyana has become the second poorest nation in the Caribbean.

However, one is shaken by Professor Karl Bennett's estimates of capital flight from the Caricom Caribbean over the period 1976-1985.6 He estimates that from 1977 to 1985, US$132 million fled from Barbados, US$228 million left Guyana and US$506 million flowed out of Jamaica. His estimate of capital flight from Trinidad and Tobago between 1976 and 1984 is US$1059 million. The suggestion is that, given an appropriate institutional framework and government policies which inspire confidence in the domestic economy, substantial funds would be available for investments of all types.

Critical Mass

To explain the slow development of the market for equities in Caricom, we must invoke the concept of "critical mass". The larger the number of buyers and sellers in a market, the more actively they trade, the greater is the liquidity of the assets being traded and the more willing are investors to enter that market. Unfortunately, ideological pluralism and insularity have combined to create financial compartments within CARICOM, each too small to support a viable stock market. However, if Singapore, with a population of only three million, can develop a vibrant Stock Exchange capable of attracting foreign investors, then it is just possible that the integrated equity markets of Jamaica, Trinidad and Tobago, Barbados, the OECS, The Bahamas and a recapitalized Guyana, with a population of over five million and natural resources far outstripping those of Singapore, might jointly achieve the critical mass required for a viable stock exchange operations.

The concept of critical mass also applies to the potential size of enterprises. Currently less than one hundred enterprises are listed on the three existing Stock Exchanges. Very few of these are large enough to compete effectively in the international market place. In a world of global production-sharing and global marketing, Caricom enterprises have been fenced in by restrictions which severely impede region-wide operations.

There is a glimmer of hope on the horizon. Only within the last year the minimal requirement for a regional Stock Exchange - the Caricom Enterprise Regime - was approved by all member states. The Caricom Enterprise has "full legal personality in every Member State in which it is registered as such, as if it were a company incorporated and registered under the general statutes relating to the incorporation, registration and management of companies." Each Member State undertakes to grant to a Caricom Enterprise registered in its territory "terms no less favourable than are accorded to any other similar enterprise of that Member State ... " in areas required for its effective operation. The Caricom Enterprise Regime implicitly allows qualified companies to be listed on any Caricom Stock Exchange; thereby opening the door for a regional market for equities.

Regional Economic Environment

Another obstacle is the unfavourable environment for business operations within the Caribbean. It is certainly easier to conduct business between Barbados and the U.S.A. than between Jamaica and Trinidad and Tobago - not to speak of Guyana at all. Exchange control regulations of remarkable complexity inhibit capital flows between the Member States of Caricom; import licensing restrictions, theoretically for monitoring purposes only, have slowed regional trade to a trickle; the intra-regional payments system - CMCF - has collapsed; Barbadian fishermen are fined for catching flying fish in the waters off Trinidad and Tobago; double taxation agreements exist between Barbados and Canada and between Barbados and the U.S.A., but not between Barbados and any other Caricom State; and Member States alter their exchange rates and other economic variables without the slightest consultation with each other. In fact, the degree of harmonization or trade and macroeconomic policy is closer between the OECD countries and Japan than among Caricom Member States, theoretically bound by the Treaty of Chaguaramas.

Technical Considerations

Off all the obstacles, the technical aspects of the integration of equity markets in Caricom are by far the least formidable. In fact, the stock markets of the major financial centres of the world are already effectively integrated. The following are the essential features of a viable Caricom Stock Exchange.

1. Format

The existing Stock Exchanges would have to be federated. Provision would be made for the OECS, Guyana, Belize, and The Bahamas to join the system when they establish their own Exchanges. Caricom enterprises could be listed on any or all Exchanges. The partial model would be that of the U.K. where in 1965 the regional stock exchanges of England, Ireland and Scotland were united to form the Federated Stock Exchange of Great Britain and Ireland.

2. Centralized Clearing System

A centralized clearing house would be required for the prompt settlement of transactions involving mutually listed stocks and for the accurate maintenance of records.

3. Communications

A communications system linking the three Exchanges would have to be set up. It would involve overseas telephone lines connecting the trading floors of each Exchange, with computerized display units permitting real time display of market information. With the recent advances in computer and telecommunications, the linkage would be neither difficult nor prohibitively expensive.

4. Shift from Call to Auction Market

All three existing Exchanges are essentially Call Systems - with the Trinidad and Tobago Exchange incorporating some elements of an auction. A pure call system would be difficult to operate with players so widely dispersed. The computerized telecommunications system required to link the Exchanges also provides the basis for a continuous auction system, allowing for trading both on and off the floor.

5. Exchange Control

The successful operation of a Caricom Stock Exchange requires that the investors of any Member State be free to purchase any shares listed on any participating Exchange. Investors would also expect automatic settlement of transactions between investors from different Member States. Member States would need to grant blanket exemption from exchange control for all transactions resulting from the operations of a Caricom Stock Exchange.

6. Standardized Listing and Reporting Requirements

Minimal listing and reporting requirements would have to be established and standardized for all participating Exchanges.

7. A Common Unit of Account and Settlement

In the absence of an international currency market for the continuous determination of the relative value of Caricom currencies, a common unit of account, probably the US dollar, would have to be established for the valuation of stocks listed on more than one participating Exchange. The US dollar might also serve as the unit for the settlement of intra-regional transactions.

8. Surveillance

A Caricom Stock Exchange would have to be supervised by some external authority. Because of their experience in bank supervision, the regional central banks might be assigned the "watch dog" duties which the Securities Exchange Commission performs in the U.S.A.

RECOMMENDATIONS AND CONCLUDING OBSERVATIONS

The recommendations emerging from the above discussion of the development of equity markets in the Caricom Caribbean may be summarized as follows:

1. Exchange Control barriers between Member States should be removed, immediately with respect to transactions in equities, and completely by the end of 1990.

2. Alien land-holding restrictions and any other barriers to property ownership by Caricom citizens in other Member States should be abolished.

3. The free movement of capital, enterprise, and technical and professional skills should be institutionalized within CARICOM.

4. Double taxation treaties should be negotiated among Caricom Member States and tax policies harmonized as far as possible.

5. Import Licensing arrangements with respect to Caricom trade should be abolished.

6. Collaboration between Caricom Member States on exchange rate and other macroeconomic policies should be resumed and discussions commenced towards eventual monetary union.

7. The privileges of the Caricom Enterprise Regime should be extended to all enterprises owned and controlled by Caricom residents.

8. Caricom Governments should divest themselves of commercial enterprises as soon as the "infant industry" principle has lost its validity.

9. The OECS should seek listing for their eligible enterprises on the Securities Exchange of Barbados.

10. Caricom Member States should commence discussions towards the integration of regional Stock Exchanges within five years.

If embarked upon, a region-wide Stock Exchange would take Caricom States well past the point of no return towards full economic integration. Member States would soon learn that the concessions required to bring it about were not so costly after all, and indeed brought substantial benefits to them both individually and collectively.

On the other hand, failure to "Caribbeanize" our equity markets would condemn us to reliance on fragmented and primitive financial institutions and seriously jeopardize our future growth. Saddest of all it would exclude us from the growing cast of players in the unfolding drama of the internationalization of capital markets and the emergence of a global economy.

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February 28 1989

NOTES

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