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## Protocol II of the CARICOM Single Market and Economy: Implications for Banking and Finance

Enid Bissember's dissertation on Protocol II of the CARICOM Single Market and Economy

### Appendix 1

### Appendix 2

Both of these are important adjuncts to the paper as they relate to the banking and insurance services as they are affected in each of the CARICOM countries.

**PROTOCOL II  
OF THE CARICOM SINGLE MARKET AND  
ECONOMY  
IMPLICATIONS FOR BANKING AND FINANCE**

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## **Abstract**

The CARICOM Single Market and Economy is meant to confer rights and obligations on the members of the Community. This paper looks at the provisions of Protocol II which deals with the right of establishment provision of services and movement of capital and how financial institutions can position themselves to take advantage of the wider market created as a result of the widening of the regional market and the removal of obstacles to the movement of capital.

## **Introduction**

In 1989, Heads of Government of the Caribbean Community, decided to deepen the integration process. In so doing the decision was taken to create a Single Market and Economy (CSME), which, amongst other things, would allow for the unrestricted movement of capital among Member States. The establishment of a Single Market and Economy was one aspect of the Region's response to the challenges and opportunities presented by the changes in the global economy.

It was immediately apparent that the policy changes required could be accommodated with changes to the 1973 Treaty of Chaguaramas. A series of Protocols amending the Treaty of Chaguaramas were developed to facilitate the process, among them, Protocol II (now chapter 3 of the Revised Treaty) which deals with the Rights of Establishment, the Provision of Services and the Movement of Capital and sets out to remove barriers to the free movement of capital across the Region, treating it as one economic space.

The CSME was conceived to stimulate and facilitate increased competitive production in Member States to withstand the increasingly liberalized and globalized international environment, including competition in the regional market.

The general objectives of the CSME include the following: -

- i) Full employment of all the factors of production;
- ii) Improved standards of living and condition of work;
- iii) Accelerated, coordinated and sustained economic development;
- iv) Expansion of trade and economic relations with other Caribbean Countries, Central and Latin American Countries;
- v) The achievement of increasing levels of competitiveness;
- vi) Organisation for increased production.

The realisation of these objectives however, is dependent on the following:

- i) An integrated market for goods and services, taking advantage of access to all the Region's resources to achieve the goals of full employment, improved standards of living and accelerated and sustained economic development;
- ii) The integration of product and factor markets; and
- iii) Provision of supportive and facilitative infrastructure for the promotion of competitive production

With the decision to move toward a Single Market and Economy, a number of new areas had to be considered. These included:

- i) Adding the free movement of services to free movement of goods within the Common Market
- ii) Free movement of the factors of production including particularly, capital and labour
- iii) The right to establish businesses anywhere in the Community
- iv) Measures to encourage greater coordination of macro economic policies, monetary and fiscal policies for the convertibility and use of a single currency

- v) Support mechanisms including institutions and structures, which would attenuate any adverse impact or disadvantages to particular countries regions or sectors.

Part of the provision of the protocol is to facilitate the intra regional movement of capital to its most productive use. The region has witnessed some movement by both financial and non-financial firms, which is perhaps due to key policy changes by some regional governments following their structural adjustment programmes of the 1980s and 1990s. The incidences could also be attributed to a number of factors including events in the mid 1980's starting with the liberalization of the markets for both trade and services in a number of countries and the dismantling of the fixed exchange regime in Jamaica followed by Guyana and Trinidad and Tobago. It is also due perhaps to better profit potential created as a result of governments moving out of the productive activities and privatization of a number of previously state owned enterprises thereby opening opportunities for private sector participation including that of the financial services sector. It also increased commercial bank financing for private sector activities as government was borrowing less from the banking system.

This paper addresses the provisions of protocol II and how financial institutions can position themselves to benefit from economies of scale by operating across the region. As a result of the free movement of capital across the region financial institutions will be inclined to seek strategic alliances in order to remain competitive. The first part of the paper is an introduction to the issue; part two looks at Chapter Three of the Revised Treaty, formerly Protocol II, making mention of the restrictions that have been identified for removal. The third part of the paper presents some indications of opportunities that may be available to the banking sector cross border. Part four briefly mentions the frequency of entry in the financial sector. The final section briefly addresses some policy implications of the movement of firms cross border and the benefits of the protocol. The fourth section briefly addresses the issue of cross border acquisition as an attractive opportunity and the final section presents some brief observations and concludes the paper.

## **II) Chapter Three (Protocol II)**

Protocol II entered into provisional application in July 1998, at which time countries had not yet removed all restrictions to the free movement of capital. A team of consultants was contracted to undertake an assignment aimed at the identification of the restrictions to facilitate early removal by Member States. Such restrictions when removed are expected to result in the free movement of capital across the Region. When fully implemented, Protocol II could provide an important and significant stimulus to the cross-border investment process and eventually the overall economic development of Member States. Protocol II however needs to be complemented by the other key elements and in particular that dealing with the free movement of labour. That is because in order for non residents and/or firms controlled by non nationals to conduct business in a number of member states work permit and company registration requirements are necessary. This is seen as a restriction which affects the effective operations of certain categories of financial institutions, especially those requiring highly skilled and specialized labour which might be difficult to source from host locations.

Capital, by its very nature is scarce and mobile therefore there must be some inducement for it to remain in any one particular locale. Already, the restrictions to the free movement of capital have been identified and Member States have established programmes for their removal in addition to those in respect of the Right of Establishment and the Provision of Services.

The programmes took effect from 1<sup>st</sup> March 2002 and restrictions will be removed in phases ending December 2003, 2004 and finally December 2005. **The last identified impediments should be removed by 31 December 2005, the date given for the long-term removal of restrictions.**

### **Right of Establishment, Provision of Services and Movement of Capital**

Of direct relevance to bankers, is Protocol II, which deals with the Right of Establishment, Provision of Services and the Movement of Capital. It sets out to

remove barriers to the free movement of enterprises across the Region, treating it as a single economic space.

Whereas the CARICOM arrangement was originally centred on the free trade in goods, in July 1998, Protocol II was signed by Member States, thereby ushering in a free trade regime in services. Under this protocol, Member States are required to remove all restrictions relating to trade and services. To the extent that Protocol II makes provision for the free movement of capital, right of establishment and the provision of services across the Region, an additional stimulus is provided to the cross-border investment process.

In order to give effect to the Single Market and Economy, it is expected that capital would be required to move freely across the Region, going to where the returns are greatest.

Capital and investment flows across the Region can take any number of forms and can be accommodated by policy makers using different means. However, internationally, the acknowledged four modes of supply of services are:

- |        |                             |
|--------|-----------------------------|
| Mode 1 | Cross-border trade          |
| Mode 2 | Consumption abroad          |
| Mode 3 | Commercial presence         |
| Mode 4 | Movement of natural persons |

Most services are not readily tradable in the traditional sense, and so tend to be mainly delivered by mode 3, commercial presence. However the technological revolution is reducing the non-tradability of a number of services, including financial services. Traditionally commercial banking services were delivered by commercial presence usually by having an office or representative office in the location where the service is to be consumed. There are a number of examples of this mode of supplying banking services to the market in the Region both by foreign-service providers and more recently by intra regional firms as well. The most notable examples are by banks from Trinidad and Tobago penetrating other regional markets. The presence of commercial banks from Trinidad and Tobago is not confined to any particular area of the Region, as branches of financial institutions from that country can be found in both MDCs

and LDCs within the Region. Additionally where branches do not exist there are arrangements in place for those markets to be serviced from other locations within the region. An arrangement, which is quite similar to that employed by the foreign banks that operated in more than one country, prior to the entry of regional banks in the cross border financial market.

Despite the presence of commercial banks and other non-bank financial institutions from other Member States across the Region, there are still some obstacles to the free movement of capital and also to the right of enterprises to establish outside their home base. Among the restrictions that have been identified as having negative impact on the free movement of capital are those relating to the ownership of real property, exchange control regulations and others relating to the financial services sector. Some of these are administrative while others are legal and yet there are others that are regarded as prudential and it is felt that modification and/or removal should serve to encourage intra regional investments in both real and financial assets.

The identified restrictions include, but not limited to the restrictions contained in the Banks and Financial Institutions Act/ legislation, which sets the guidelines (including the local presence requirement) under which banks, including new entrants, must operate. Also having a restrictive effect is the Alien Landholding Legislation, which negatively impacts on the ability of non-nationals to own real property outside of their home base unless specific permission is granted.

Once the identified obstacles to the free movement of capital are removed, the Region might witness an increase in cross-border investment flows and perhaps the establishment of more intra regional firms than already exist. The Region might even see the creation of a truly CARICOM transnational corporation financed by regional financial resources.

It should be noted that already, the restrictions to the free movement of capital have been identified and Member States have already designed a timetable for their early removal.

As mentioned earlier, one of the most likely direct impacts of the protocol is that, restrictions on the movement of capital among Member States may be reduced or eliminated altogether. Despite this, however, it is not anticipated that the implementation of Protocol II will result in a scramble to establish cross-border banking or other commercial operations. That is, because for years Caribbean firms have been extending their operations cross-border, taking advantage of the opportunities created by the wider market created as a result of the integration process.

Private sector driven cross-border activity has spontaneously developed, particularly over the last decade, as a result of market forces. In a recent study<sup>1</sup> by the CARICOM Secretariat, it was found that there are a number of examples of cross-border operations, particularly in manufacturing / distribution and the financial services sectors. For example, although data on the true extent of CARICOM cross-border investment by both financial and non financial firms is not readily available, in a sample of thirty-nine companies with cross-border operations, thirty-three had their head offices in the MDCs. The source countries were Trinidad and Tobago, Barbados, Jamaica, Guyana, Antigua and Barbuda, St Vincent and the Grenadines and Saint Lucia with 16, 10,6,4,1,1,and 1 respectively in the other CARICOM countries. Most of the CARICOM outflows had the OECS as their destination. Portfolio flows, another area of interest to commercial banking, are slowly developing across the region.

In the area of financial services, there are some countries, which still have restrictions, which, if not removed, would hinder the effective and efficient cross-border participation of all Member States.

Commercial banks have been very active in the establishment of cross-border operations, and banks from Trinidad and Tobago have been the main beneficiaries, having established their presence in a number of other countries utilizing different modes of entry as given below.

### **Frequency Of Entry In The Financial Sector**

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<sup>1</sup> Caribbean Trade and Investment Report 2000

Banking has always been an important industry in the economic development of countries. In the Caribbean there are banks from Trinidad and Tobago in a number of other member States. In 2002 there were 94 banks in the region of which 39 were locally owned and 10 CARICOM owned. The remainder being owned by foreign entities mainly from North America.

In the post-independence period, a number of countries in the Caribbean, notably Guyana, Jamaica and Trinidad and Tobago, felt it necessary to restructure their financial system in an effort to make the banks more responsive to the needs of the local economy. Since then, a number of changes have taken place and there are three kinds of banks existing side by side. In the first place are those that are foreign owned, second are those that are locally owned, and finally the regionally owned ones.

An interesting fact concerning local or indigenous ownership of commercial banks is that the number has been radically reduced from what it was at the start of the 1980s and even in the 1990s. Those that remain, however, especially those in Trinidad and Tobago are remarkably stronger than they were and are capable of competing not only in their domestic market but both regionally and across the rest of the Caribbean. Another interesting case of the ownership structure of banks in the Region is that local ownership predominates in the larger territories. In the case of Barbados, Guyana and Suriname approximately 56% of the banks are either locally or regionally owned, in Jamaica it is about 62% and in Trinidad and Tobago it is getting close to 85%. The two largest banks in Trinidad and Tobago which are locally owned and are on a regional expansion path acquiring banks and shares in banking institutions throughout the region. These banks are competing effectively with both the long established foreign owned banks and other established banks in the cross border market. Between the two they have branches and subsidiaries in nine (9) other Member States and a number of other non-CARICOM Caribbean countries as well. Regionally owned commercial banks can be found in a number of the OECS countries<sup>2</sup>, mainly branches or subsidiaries of either the RBTT Bank Ltd or

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<sup>2</sup> Antigua and Barbuda, Grenada, St Kitts and Nevis, St Lucia and St Vincent and the Grenadines

the Republic Bank Trinidad and Tobago. The liberalization of the financial services sector in the region has created opportunities, not only for banks and other financial services providers, but also for non financial firms to set up operations capitalizing on the easier access to the domestic financial markets. There are three modes of cross border entry into the banking sector by regional banks:-

- i) Acquisition , where a controlling interest is purchased in an existing bank as an alternative to setting up a “Greenfield” establishment
- ii) The incorporation of a new entity as a wholly owned subsidiary to provide additional banking services to a country or part of the region for example in the OECS sub region
- iii) Minority equity participation

Along with commercial banking there is a fair amount of cross border investment in the insurance industry. Of the thirty nine selected companies with cross border operations 5 are in the insurance industry.

The Caribbean financial institutions crossing borders seem to prefer the acquisition route to that of a true merger, since the latter would require the sharing of company names, brand names and senior executive positions, and the compromising of corporate strategies, etc. Some examples of acquisition in the banking sector by two particularly aggressive companies are as follows:

- i) The acquisition by RBTT Holdings Limited, in April 1996, through Caribbean Banking Corporation Limited, of 94 per cent majority interest in the Nevis Cooperative Bank;
- ii) The purchase in 1997 of a 51 per cent share in the National Bank of Industry and Commerce of Guyana, under that country's privatisation programme, by the Republic Bank of Trinidad and Tobago;

- iii) The purchase in 1996 of a 51 per cent shareholding in a National Commercial Bank of Grenada Limited by the Republic Bank of Trinidad and Tobago;
- iv) The 50 per cent participation by RBTT Holdings in the Grenada Bank of Commerce in June 1997. The share has since been increased to 60 per cent;
- v) The 2000 purchase of the operations of Union Bank in Jamaica by the RBTT Bank of Trinidad and Tobago;
- vi) The 2001 entry into Suriname of the RBTT Bank of Trinidad and Tobago; and
- vii) Late 2002 purchase of GNCCB by National Commercial Bank Guyana Limited a subsidiary of Republic Bank of Trinidad and Tobago of the shares in Guyana National Cooperative Bank.
- viii) The soon to be completed purchase of 57% of shares in the Barbados National Bank Inc by Republic Bank of Trinidad and Tobago.

In the non-bank financial sector as well as the non-financial sector, acquisition is also a very important strategy for cross-border penetration. For example, Trinidad Cement Limited (TCL) acquired Arawak Cement of Barbados and, via the privatisation route, a controlling interest in the Caribbean Cement Company of Jamaica, resulting in that company becoming the largest cement producer in the CARICOM region. In 1998, the TCL chairman articulated the company's strategy as follows:

***“The group more recently moved closer to its objective of becoming a truly Caribbean enterprise with the acquisition of the Jamaica Government’s 43 % shareholding in Caribbean Cement Company Limited, as well as the listing of Trinidad Cement Limited’s share on the Securities Exchange of Barbados and the Jamaica Stock Exchange ... our expansion in cement production has been through capacity acquisition.... There are few, if any, opportunities for***

***'greenfield' plant construction, in the cement business in the Caribbean***<sup>3</sup>

Another example of the importance of the acquisitions strategy is reflected in the 1998 Annual Report of Neal and Massey, which stated that:

***"The group continues to maintain its strategy of pursuing new business opportunities both locally and internationally through alliances and acquisitions and to improve the profitability of existing business through increased market share, improved productivity and by strengthening our competitive advantage."***<sup>4</sup>

A third example is the Ansa McAl Group of Trinidad and Tobago, which, in 1998, acquired 60 per cent of West Indies Glass Company Ltd. of Jamaica in a joint venture arrangement with J. Wray & Nephew Ltd., which controls the other 40 per cent. The same Ansa McAl Group has made a number of acquisitions in other Caribbean countries, including a 47.49 per cent holding in both Consolidated Finance of Barbados and Stokes and Bynoe Ltd. of Barbados.

Some of the acquisitions that occurred in the Caribbean will present opportunities for the financial firms to innovate in order to provide services to those entities thus increasing the range of products and services.

The firms in the three examples mentioned can all be considered as conglomerates or even CARICOM transnationals.

Liberalization is occurring not only among CARICOM States but, also, between the Caribbean region and the rest of the world. It is therefore crucial for regional entities to increase their competitive advantage in order to compete effectively. What might also occur is consolidation of the operations of small domestic institutions in order to achieve a critical mass, in order to overcome diseconomies of small scale. If cross-border mega mergers and acquisitions can be allowed in the developed world, then a case can be made for selective consolidation of domestic enterprises (downsizing of the labour force notwithstanding) in the small-scale environment of the Caribbean, so as to be able to cope with global competition.

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<sup>3</sup> TCL Annual Report

<sup>4</sup> Neal and Massey annual report

## **Some Indications of Opportunities that may be Available to the Banking Sector across the region**

The creation of the CSME, though not a panacea, does have the potential to provide some benefits to the banking sector in the Region. The perceived benefits are not only for the larger more highly capitalized bank on an expansion path but also for those small under capitalized banks, which might be in need of capital injection. Among the opportunities for banks in general are:

- i) The opportunities to provide increased cross border banking services to the Region utilizing the provisions under Protocol II
- ii) A larger market to tap for savings and investment
- iii) Access to an increasingly sophisticated customer base across the Region and embark on innovative financial instruments to serve the market
- iv) Opportunities to become involved in innovative trade financing for the CSME

Other areas where the banks may wish to become involved in include the provision of banking and financial services to the migrant skilled labour force that have migrated in response to the free movement of labour initiative. The creation of the CSME may also result in overall cost savings to those institutions that cross borders as a result of economies of scale in areas such as technology etc

## **Benefits of the Protocol**

Chapter Three (Protocol II) is expected to confer a number of benefits on CARICOM nationals and institutions. In determining benefits one needs to isolate the ability to exercise rights from the results that are derived from the exercise of the rights. In this regard the following benefits are suggested:

- i) Optimal allocation of all the Region's resources
- ii) Increased output of goods and services through better allocation of resources
- iii) Access for national producers to entire CARICOM Market in first instance and to market opportunities further afield

- iv) Enhanced competitiveness of Regionally produced goods resulting for the programmes to be implemented for the benefit of the productive sector
- v) Net positive impact on the profitability of the financial system
- vi) Increased opportunities for CARICOM Nationals for investment, service provision and employment in new CSME environment
- vii) Further opportunities to expand operations across the Region

### **Observations and Conclusions**

As the CSME gathers further momentum countries are beginning to realize that there are both opportunities and challenges and have agreed to the removal of identified restrictions to the free movement of capital across the region. The success of the single market and economy depends to a large extent on the ability of investors to have access to capital on competitive terms wherever they decide to set up operation within the Common Market. As such the Chapter has the potential to confer benefits to a wide cross section of community stakeholders. Policy makers in the financial industry are therefore urged to take advantage of the opportunities so created.