ABSTRACT

BANKING DISTORTIONS IN THE FINANCIAL STRUCTURES OF POST-WAR ECONOMIES

(The Experience of Jamaica, Korea, Trinidad and Tobago and the U.S.A.)

This study assesses the evolution of the banking system in the financial structures of selected economies in the post-war years 1960 through 1980. In an examination of Jamaica, Korea, Trinidad and Tobago and the United States of America, the study identifies and speaks to the emergence of a largely financial phenomenon which it calls 'financial asphyxiation.' This phenomenon is deemed to exist when, contrary to orthodox theory and historical experience, the banking subsector (central and commercial banks) systematically at the margin, commands a larger share of the financial system, despite markedly less efficient incremental operational performance than non-banks. Thus, in time, the banking system succeeds in stifling or 'asphyxiating' the healthy evolution of the non-banking system, introducing into the financial system major distortions, that are readily transmittable to the economy at large.

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A theory of financial asphyxiation formulated in the study, attributes the phenomenon to a complex of largely non-market factors and some finds/evidence of empirical support. In the empirical investigation,
the study identifies the occasional presence of the financial asphyxi-
tion phenomenon in all four of the economies, especially the United
States. The most overwhelming determinate factor appears to be
government, whose role in and influence over the financial system of
most economies appears to be not only substantial but usually highly
skewed in favour of their banking systems. Another factor appears to be
inflation, itself largely government driven.

In terms of the impact of the phenomenon, the costs to economic
welfare in the survey countries is estimated at as much as two percent
of their annual Gross National Product, often being higher. Thus, the
resultant distortive economic effects are quite significant and deserv-
ing of urgent remedial responses.

With specific reference to the Caribbean economies (the Caricom
region), the study concludes that policy responses for this financial
sector imperfection must necessarily center around a comprehensive
program of financial innovations and reforms designed to radically
deepen the 'lukewarm' process of indigenization and integration now
obtaining in the region's financial systems. Central to these reforms
must be an increasing role for the private sector, given the sustained
and significant roles of the public sector in the first post-
independence phase of the indigenization and integration efforts in
these economies--factors themselves partially responsible for the
presence of financial asphyxiation. In this context, some specific
thoughts are presented covering the years 1987-2002.