



Institutions and the Legal Framework for Business Development in the Caribbean

**Private Sector Development
Discussion Paper #3**

**Paul Holden
Hunt Howell**

**Inter-American
Development Bank**

**Institutional Capacity
and Finance Sector**

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Table of Contents

Introduction	2
The Institutional Framework for Competitiveness in the Caribbean	4
Property Rights	4
Land	5
Movable Property	6
The Legal System	7
Court Administration	9
Judicial Independence	10
Contract and Judgement Enforcement	10
Business Regulation	11
Registration and Licensing	12
Stamp Duties, Regulatory Fees, and Other Charges	14
Incentive Structures	16
Competition Policy	17
Governance	18
Ethics and Corruption	18
Law and Order, and Security	19
Public Policy Effectiveness	20
Policy Initiatives to Improve Institutional Framework in the Caribbean	20
Legal and Regulatory Reforms	20
Public–Private Sector Consensus-Building on Competitiveness	21
Regional Cooperation	22
Regional Registries	22
A Regional Arbitration Center	23
Further Research and Documentation	23
Conclusion	24
References	25

Introduction

Research shows that long-term sustainable growth depends on the quality of a country's institutions. Without well-functioning institutions, education and training policies are less effective and factor markets cannot function efficiently. Similarly, without well-functioning institutions, infrastructure investment, macroeconomic stability, and trade reform do not lead to competitive, growing economies. Financial systems, which are a central element in funding new investment, do not function effectively in a weak institutional environment. In short, strong institutions are a central determinant of the ability of economies to compete and to grow.

Institutional development, transaction costs, and growth are inextricably related. Douglass North, one of the pioneers in identifying the importance of institutions, notes that “institutions exist to reduce the uncertainties involved in human interaction.” North stresses the relevance of a “transaction cost theory of exchange” in which “the costliness of information is the key to the costs of transacting, which consist of the costs of measuring the valuable attributes of what is being exchanged and the costs of protecting rights and policing and enforcing agreements. These measurement and enforcement costs are the sources of social, political, and economic institutions” (North, 1990: 27)¹. North points out that in the United States some 45 percent of GDP is devoted to transacting (and this has risen from 25 percent over the past century). Typically, institutions in lower income countries are far weaker than they are in high income countries and often weaken the impact of reform initiatives, something that Kuczynski and Williamson (2003), for example, claim reduced the impact of “Washington Consensus” type reforms in Latin America.

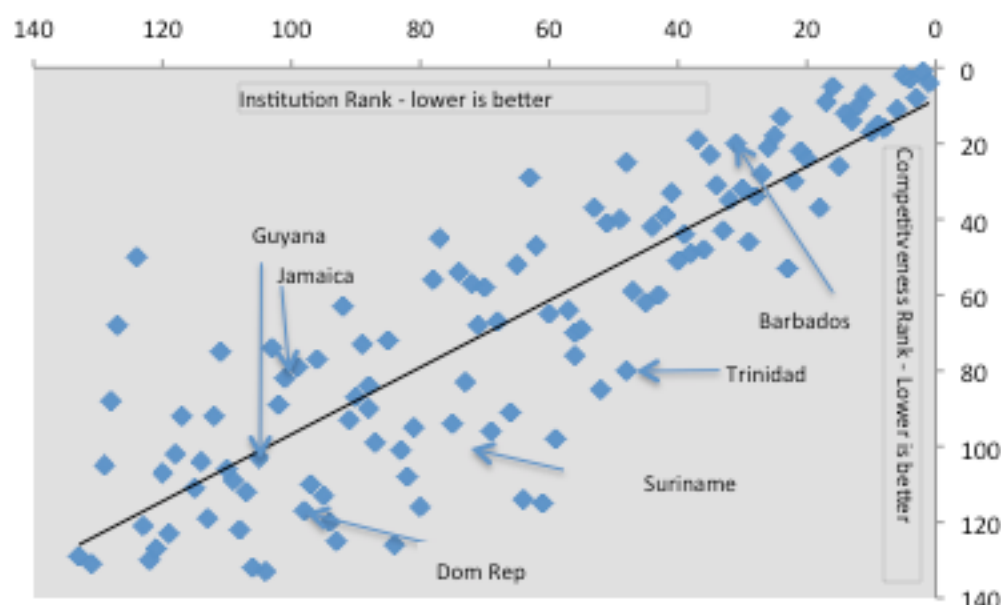
The influence of institutions, which consist of property rights, the commercial legal system, the regulatory regime, and informal norms or business practices, pervade every aspect of the way businesses are organized, the way they deal with each other, and their interactions with government.² Institutions determine transaction costs faced by investors and entrepreneurs and the incentives that influence how economic activity is organized. They centrally impact the effectiveness of economic reform and development policies.

There is further evidence regarding the importance of institutions in promoting competitiveness. Figure 1 plots the public institutions score from the World Economic Forum's *Global Competitiveness Report* (WEF, 2006) against the overall Global Competitiveness Index. The relationship between institutions and competitiveness is strong and positive.

¹ North built on the work of another winner of the Nobel Prize for Economics, Ronald Coase, who made a similar observation in 1937 to the effect that “(...) when it is costly to transact, institutions matter” (Coase, 1937).

² For example, William Easterly (2004) shows that many of the so-called pillars of economic reform simply do not work in the absence of well-functioning institutions and incentives that direct entrepreneurial and business efforts into activities that enhance productivity (i.e., competitiveness).

Figure 1: Competitiveness and Institutions



Source: WEF, 2009.

Markets function most effectively when transaction costs are low.³ When the costs of transacting are high, the result is significant friction within the economy, limiting development and slowing the growth of private businesses, which will be less willing to enter contracts and to buy and sell goods and services.⁴ When it is costly to negotiate, draft, fulfill, and enforce contracts; to gather information; to resolve disputes; or to observe laws or regulations, the incentives to build formal firms are reduced. Since transaction costs are essentially a tax on transacting, fewer firms will be formed, increasing the incentives for informality. A well-functioning institutional framework therefore minimizes distortions in economic transactions and keeps the cost of transacting low.

This paper discusses the ways in which legal, regulatory, and governance institutions affect business competitiveness in the Caribbean region through their effect on transaction costs, contracting, firm organization, and formality versus informality.

³ Transaction costs are “the costs of doing business” or “the costs of using the market.” They are not related to factor inputs, goods, or services, but are, rather, the costs of using the mechanisms of production and exchange. They can be viewed as the friction in the economic system. The higher the costs, the larger the wedge between buying and selling prices and the greater the loss of efficiency in resource allocation. Transaction costs place a “wedge” between buying and selling prices.

⁴ An example would be how the cost of buying and selling property makes the labor market less efficient. If, for example, a property owner needs to sell his or her property to take a new job but the costs for the transaction are high, the property sale might not occur and the job opportunity may be foregone. Cumulatively this can have an enormous impact on competitiveness.

The Institutional Framework for Competitiveness in the Caribbean

The institutional foundation for doing business in most countries in the Caribbean is weak. As Figure 1 shows, most Caribbean countries for which data are available do not rank highly in terms of their comparative institutional quality. Property rights are protected only for the more prosperous, commercial legal systems are not suited to modern globalized business practices, regulations raise the cost of doing business, and weak governance negatively affects the socio-political environment, increasing the risks of investment.

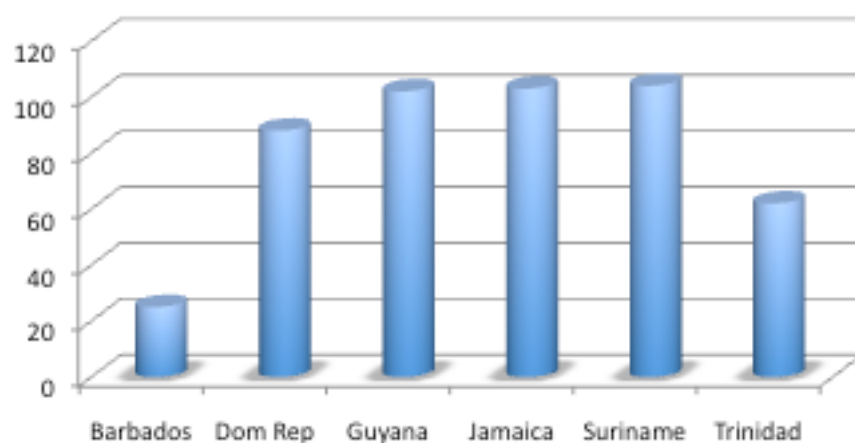
Property Rights

Property rights are the foundation of competitiveness (Acemoglu, Johnson, and Robinson, 2004).⁵ For productivity and competitiveness to be maximized, assets must be easily tradable so that they receive their highest value. Without strongly entrenched property rights, many transactions in both goods and financial markets do not occur. If investors and entrepreneurs cannot use assets in activities that maximize returns, or if the protections provided by institutions raise the prospect of investments being lost, investment will not occur. If assets cannot be freely bought and sold, they will not be acquired by those who can use them most productively. The weaker the system of property rights, the fewer the number of investors who will engage in economic activity that uses such assets.

Figure 2 illustrates the strength of property rights in the region. While some of the countries rank relatively well, these measures are probably misleading. For example, Jamaica has a score that compared favorably with other countries in the Caribbean and ranks well above Latin America but poorly relative to high-income OECD countries (Australia; Austria; Belgium; Canada; Czech Republic; Denmark; Finland; France; Germany; Greece; Hungary; Iceland; Ireland; Italy; Japan; Korea, Rep.; Luxembourg; Netherlands; New Zealand; Norway; Portugal; Slovak Republic; Spain; Sweden; Switzerland; United Kingdom; and United States). Nevertheless, as noted in the Jamaica *Private Sector Assessment*, “loss from theft and corruption represents a fundamental threat to property rights and, thereby, to private sector development” (Holden and Holden, 2004). Two constraints prevent Jamaica’s government from taking more action to protect property: insufficient police resources and insufficient public prosecutor resources for crime prosecution.

⁵ There are three types of property rights: (1) fixed property rights in lands and buildings; (2) movable property rights, which allow the pledging of chattels as security for loans; and (3) intellectual property rights that protect inventions, patents, and copyright.

Figure 2: Caribbean Ranking of the Strength of Property Rights



Source: WEF, 2009.

Land

Clearly defined property rights in land are necessary for long-term economic development. For the most extensive example of evidence and advocacy, see Hernando de Soto (2000). Most industrial countries have strongly protected property rights, particularly for immovable property, and well-functioning land markets. Financial markets that support the purchase and improvement of property exist in virtually all the industrial countries and constitute a major portion of the assets of their financial systems. Secure property rights for fixed property encourage investment in land and buildings, support financial market development, and promote more equal distribution of wealth.

Many economic benefits result from well-defined and secure title to fixed property, including greater incentives for the maintenance of and investment in property, and the reduced probability of long-term environmental degradation. Secure rights tend to be associated with higher investment, more intensive farming, and a stronger commitment to preserve the integrity of natural resources.⁶ The ability to use land as collateral both enhances financial market development and promotes greater investment. In particular, titled land that has secure registration generally has a much higher market value. While this is not sufficient for a well-functioning financial system, insecure property rights unambiguously reduce financial system development.

Societies where property rights are secure and ownership widespread tend to have a more equitable distribution of income and wealth. Rights in fixed property have as their foundation the legal system. Without effectively functioning laws, records, and enforcement mechanisms, property rights are not secure. This in turn hampers the development of an effective property market. A good system of fixed property:

- Secures ownership and property rights,
- Develops and encourages property transactions,
- Allows properties to be mortgaged.

⁶ Farming investment typically requires a five- to 10-year time horizon, even for payback on fertilizer.

Institutions and the Legal Framework for Business Development in the Caribbean

Mortgages become financial instruments, which promotes financial market development through the evolution of markets in mortgage paper. Caribbean countries have largely avoided some of the direct consequences of the global financial crisis because they have not used many of the more exotic financial instruments that are experiencing distress in most OECD countries.

The system for registering land in Jamaica especially discriminates against the poor because it is prohibitively expensive for poorer Jamaicans to register and title their land (Holden and Holden, 2004). The result is that people live in houses that have been in their family for generations but that lie on “unimproved land.” They pay nominal ground rent to the owners of the land, but the costs of purchasing the land and transferring it to the owners is prohibitive. Transfer fees and commissions can consume up to 25 percent of the value of the transaction. As a result, a large portion of land holdings, particularly among the lower income strata, are informal.

Land in the Bahamas, as in other previously British colonies, is held under one of two main tenure regimes: (1) private real property held by individuals as freehold or (2) Crown Land held in trust on behalf of the Bahamian people. Most land (70 percent) is held as Crown land, which can be divested either by a short- or long-term lease agreement or through a rent-to-buy agreement, the latter being the beginning of the complicated and poorly understood process to eventually obtain private ownership title. Freehold land is secured by deed of conveyance of rights to real property, which may, but is not required to be, recorded in the Registry. There is no parcel-based cadastral map, which results in disputes over boundaries and uncertainty regarding ownership. The Registry records transactions in chronological order and is based on the names of the persons involved. As a result of these deficiencies, according to recent studies, the rights to at least 15 percent of all parcels, whether leased or owned, are in dispute.

The similarly antiquated land tenure system in Guyana also impedes outright ownership, with requests for title taking two or more years to process. As a result, most land is held through 25-year leases, which has severely constrained the use of land as collateral for loans. In Suriname, land tenure is further complicated by conflicts between national law, traditional laws, and user rights, exacerbated by an inadequate state mechanism for resolving disputes. In urban residential areas, for example, informal ownership is still prevalent on publicly owned lots. Land use approvals in Trinidad and Tobago are slow because the process depends on inconsistent and outdated policies that neglect to acknowledge current realities.

Land titling and registry in Barbados has undergone recent reforms leading to relatively rapid transactions of four-and-a-half to nine months; however, the system of is still antiquated and the registry is only partially automated, thus contributing substantially to delays. Furthermore despite some progress toward greater objectivity and transparency in the 1990s, land use decisions are still closely controlled by the government, ostensibly for the purpose of preserving agricultural and open areas in light of considerable population pressure on the small island. However, the application of the land use criteria has not been uniformly objective and charges of favoritism are still raised. The system is also inefficient in that transaction costs can be as high as 26 percent of the value of the property, comparable to those in Jamaica.

Movable Property

The fundamental economic feature of collateral and the distinguishing trait of a secured lending system lies in allowing borrowers to pledge collateral to a lender as security for a loan easily and at low cost. To do this, the framework for movable property rights has to function well and must include laws governing the pledging of movable assets, associated institutions (in particular, the

Institutions and the Legal Framework for Business Development in the Caribbean

registries), and enforcement mechanisms that allow creditors to repossess the pledged assets at a low cost in the event of default.

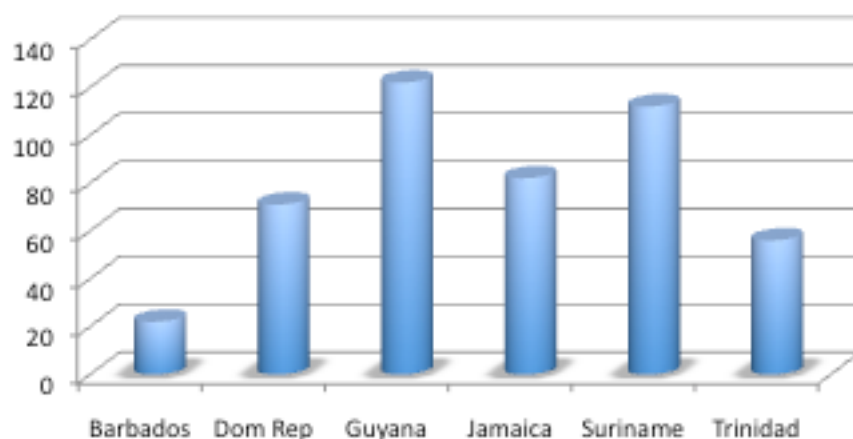
The Legal System

An effective, low-cost legal framework governing business transactions is central to the smooth and efficient functioning of the private sector. Such a framework also makes the legal system more available to smaller businesses and reduces incentives for informality. A modern commercial legal framework increases opportunities for all sections of the community.

Most English-speaking countries in the Caribbean are based on the Common Law system. St. Lucia and Guyana have hybrid systems, with French civil law heavily influencing the legal system in St. Lucia and Roman-Dutch law influences the system in Guyana. Suriname's laws are based on the Roman-Dutch system. Also Hindu, Muslim, and Indian law influences the legal systems in those countries where there was large immigration from sister colonies in Eastern Asia.

Until recently, the final court of appeal for most of these countries was the Judicial Council of the British Privy Council. The Caribbean Court of Justice (CCJ) was inaugurated in April 2005 and is now recognized as the final court of appeal by 12 countries. The CCJ rendered its first judgment in October 2005 and some 24 additional opinions since then. In early 2009 cases included commercial disputes involving a multinational Caribbean-wide cement company. Lower courts, in descending order, consist of a court of appeals at the country level; a high court; and magistrate courts, petty sessional courts, and coroners' courts. Within this general structure there are specialized courts and tribunals at all three levels in such areas as family, divorce, juvenile, gun, administrative, and revenue justice. Commercial courts have been created in some countries as part of this framework (Dina, 2007).

Figure 3: Caribbean Countries Ranking in the Effectiveness of the Legal Framework



Source: WEF, 2009.

Figure 3 shows the ratings of the efficiency of the legal framework in five Caribbean countries done by the World Economic Forum. Barbados ranks highly in the ratings and is approximately equivalent to the high-income OECD average, although the court system there is notoriously slow, albeit fair, in rendering verdicts. Three other countries rank above the Latin American average, but Guyana compares unfavorably with the rest of the Caribbean, as well as Latin America.

Institutions and the Legal Framework for Business Development in the Caribbean

It follows that countries and regions in which the legal system functions effectively have an advantage in terms of encouraging investment, both local and foreign, over those countries where the law is opaque, slow, and costly. Typically, in weak legal environments, some lawyers with special knowledge of the commercial legal systems are able to charge fees that rival those of top law firms in the industrial countries, based on their particular specialized knowledge. This greatly raises the cost of doing business in the countries in the Caribbean, discouraging foreign investment and making the law too costly for sole proprietorships and small businesses. As a result, the Caribbean countries have less potential to benefit from globalization while not being exempt from many of the costs.

Weakly drafted or nonexistent laws also reduce competitiveness. Specific commercial laws in Caribbean countries are often based on those of former colonial administrators and in many cases are close copies of laws existing prior to independence. The result is that laws governing the operation of businesses and the related practices and rules surrounding court proceedings are a mixture of the old colonial-era laws and practices as well as those passed or modified in the post-independence era. In the area of commercial law, the mother country has usually modernized its legislation in response to changing times. However, many ex-colonies have not updated their commercial legal frameworks, leaving them at a serious competitive disadvantage when dealing with countries with advanced legal systems.

Guyana, for example, had no clear legal framework for investment until 2003–04 when two critical pieces of legislation were approved. Prior to that, policymaker discretion led to widespread suspicion that some investors received unfair advantages over others, thus discouraging investment in general. In Suriname, the government directly controls much productive activity through state-owned enterprises, and it imposes outdated and cumbersome procedures and regulations on the remaining formal-sector, private businesses.

Since the benefits that derive from pledging collateral are enormous, a sound bankruptcy law should not delay or diminish the collection of secured loans in bankruptcy. For example, the legal framework for bankruptcy in Jamaica provides for the separation of assets that are pledged to secure loans from other assets in bankruptcy proceedings. In Jamaica, secured creditors have priority. This feature includes land as collateral as well as goods sold on credit under a bill of sale or the company charge. The World Bank “doing business indicators” ranks Jamaica as among the best systems of bankruptcy in the Latin American and Caribbean (LAC) region. But, this ranking does not reflect discussions with legal practitioners in Jamaica, who complain that the system is slow, inefficient, and costly. A recent report (Holden, 2009) identifies at least five separate legal forms for pledging collateral that are in common use in Jamaican business practice, each of which has its own peculiar trappings. As a result, a lawyer is almost always needed to ensure the validity of a loan agreement. The system in Jamaica discriminates against individuals and sole proprietorships because the company charge, one of the most powerful forms of pledging collateral for financing, is limited to incorporated companies. Analysis also illustrates that the system presents some important drawbacks, such as use of a court-appointed rather than a creditor-appointed trustee, the fees charged by the trustee, uncertainty in the law about how much power the receiver has to dispose of assets, and priority of tax and labor obligations over those to the secured creditor.

In Guyana, the cost of bankruptcy proceedings represents 42 percent of the value of the property (estate), and the procedure takes an average of two years. In spite of problems, the process in Jamaica is relatively efficient, with only 18 percent of the value absorbed in legal and other expenses and an average of 1.1 years. Suriname requires an average of five years for a bankruptcy proceeding at an average cost of 30 percent of the value of the property, while in St. Lucia, proceedings take about two years and cost an average of nine percent of the property value. There is

Institutions and the Legal Framework for Business Development in the Caribbean

no data available for the other Caribbean Community (CARICOM) countries. By way of comparison, in Singapore, a small open economy, bankruptcy proceedings take less than 10 months and consume only one percent of the value of the property.⁷

Besides a good system of commercial laws, the transparency and efficiency of the courts as well as enforcement of judgments are essential for the effective functioning of the commercial legal framework. This requires impartial independent judiciaries, good court administration to keep delays to a minimum, and an adequate system of enforcement.

Court Administration

While comprehensive data are not available, efficiency in hearing cases appears to be weak in the region. Many businesses report that court administration is a burden to those using the commercial legal system. For example, Barbados, where the courts are considered fair and impartial, has serious backlogs in its court system that result in excessive delays, thus reducing the effectiveness of legal recourse. Delays are caused by a lack of adequate management systems in scheduling cases, arising in part from the antiquated practice of attorney-driven rather than judge-driven case management as well as poorly trained and insufficient court staff. Backlogs can be partly attributed to the large percentage of cases that require full-scale trials, which is just the reverse of the United States, Canada, Australia, and the United Kingdom, where over 90 percent of all civil actions are settled before trial.

In Suriname, on average, the courts deliver judgments only after three to four years of deliberation, due in part to a lack of judges and also to a legal framework that is vague on the balance of power between the judicial, legislative, and executive branches of government. A similar situation exists in Jamaica, where getting to court can take years, or even decades.

When formal court procedures do not function effectively, arbitration and other alternative dispute resolution (ADR) mechanisms provide a lower cost alternative. One of the advantages of ADR is the ability to use arbitrators, mediators, and adjudicators who have specialized knowledge. However, with the possible exception of Trinidad and Tobago, none of the countries in the Caribbean region have a modern arbitration framework. Major challenges are:

- Making cross border arbitration awards enforceable in other countries in the region.
- Allowing summary judgement of arbitration awards.
- Specifying who can arbitrate disputes and who is the authority for dispute resolutions.
- Establishing a consistent set of rules for which disputes are arbitrated. The United Nations Commission on International Trade Law (UNCITRAL) has developed rules for arbitrating commercial disputes, thus providing a well-known international standard. Countries in the Caribbean region could adopt many provisions of this standard.
- Establishing clear rules for appointing arbitrators in the event that the parties do not agree. This suggests that there needs to be an appointing authority. (The possibility of a regional arbitration center is discussed later in this paper.)
- Setting the initial fees for arbitral proceedings and maximum rates to be charged.

⁷ Business failure is an essential part of the process of “creative destruction” that leads to dynamic companies, employment creation, and growth. The economies where most net jobs are created are those that have the highest rate of business failure. When unsuccessful companies go out of business, resources that are being used inefficiently can move to activities that will yield higher rates of return.

Institutions and the Legal Framework for Business Development in the Caribbean

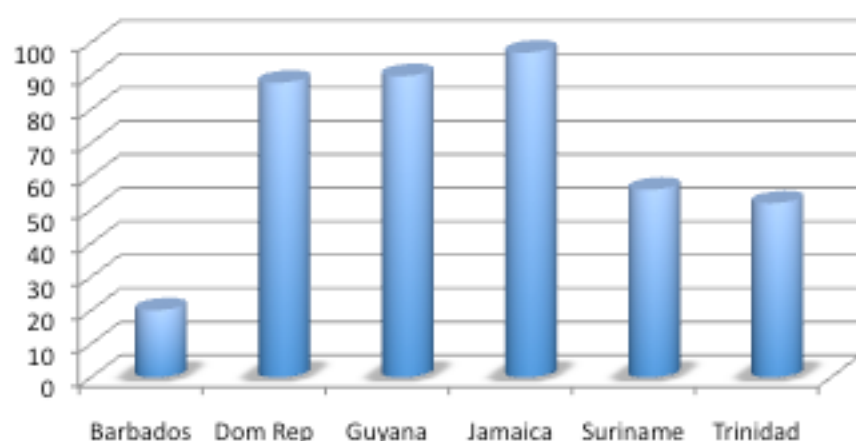
Trinidad and Tobago has fairly well developed ADR mechanisms, and the associated enforcement mechanisms are adequate, although not ideal. The Arbitration Act was last amended in 1981 and a related act was enacted in 1996 that gives effect in Trinidad and Tobago to the New York Convention on the recognition of Foreign Arbitral Awards. Also established in 1996 was the independent Dispute Resolution Center (DRC) that promotes the use of ADR and provides technical assistance for doing so to businesses and the public sector. Jamaica, however, has a weak arbitration framework, which functions primarily in the building industry and even then there are few cases heard per year.

Improving the competitiveness of the countries in the region will require updated ADR frameworks. Currently, contracts between international companies and those in the Caribbean often specify that arbitration will be held either in Miami or in London, which would greatly raise the costs of such hearings, thereby negating one of its primary advantages. Initiatives are underway to modernize ADR in the Caribbean countries, such as a bank-sponsored program in Barbados that will tailor a series of court-annexed ADR mechanisms for the justice system and establish a cadre of trained and certified mediators.

Judicial Independence

Courts in the Caribbean are perceived to be reasonably free of influence. Figure 4 shows the assessment of judicial independence for the five countries surveyed. Again Barbados heads the list and Guyana is at the bottom. The Caribbean average is substantially above that of Latin America.

Figure 4: Caribbean Countries Rank in Judicial Independence



Source: WEF, 2009.

Contract and Judgement Enforcement

All business transactions involve contracts. Competitive countries generally have legal systems that provide a strong mechanism for setting up and enforcing contracts, which in turn determines the costs of creating and refining these contracts. Lengthy contracts would be required for every deal if the parties involved could not rely on the legal system. For example, the Law of Sales governs the legal framework for exchange of goods. As part of providing the basis for commerce, sales law specifies the rights and obligations of parties involved in a contract. Countries in the Caribbean in general rely on Laws of Sales that are outdated and not suited to modern commerce. This puts local business at a competitive disadvantage because, when dealing with foreign buyers or sellers, the

Institutions and the Legal Framework for Business Development in the Caribbean

contracts are often written using the laws of the other countries. Smaller companies are often cut out of foreign commerce altogether because they cannot afford to engage in litigation outside the countries in which they are situated.

Competitiveness requires effective contract enforcement. Without such a system, the risks of doing business with strangers are enormous. Such risks also limit economic activity to a small geographic area and narrow the commercial circle. Gains from trade and specialization are thus limited since such credit relations expand slowly, only with personal acquaintance. By contrast, a good contract system permits negotiations at a distance, between parties that do not know each other well, which expands opportunity, increases competition, and improves economic efficiency. This opportunity requires well-designed legal systems that offer several ways to enforce contracts.

When transaction costs for seeking redress for breach of contract are low, commercial law can improve economic efficiency. Low transaction costs assist markets in separating economically efficient from inefficient firms, rewarding the former while penalizing the latter. High transaction costs promote unethical or illegal behavior, and increase the incentive for corruption. They also make breaching a contract less costly. Ethical firms will respond to the corrupt environment by either not entering markets or vertically integrating, even when it would be more efficient to deal with other firms. The ability of economic entities to engage in contracting with confidence is therefore fundamental to promoting productivity and competition. The enforcement of contracts promotes arms-length business relationships, both within a country and internationally.

In many developing countries, most businesses operate under informal commercial systems because the formal legal framework is costly to use. This limits the potential for business expansion since transactions only slowly evolve outside of existing business partners and clients. When businesses try to expand beyond such known boundaries, business contracts cannot be formally enforced and informal enforcement breaks down. The process of increasing competitiveness or productivity implies that businesses engage in transactions with an ever wider group of investors, suppliers, and customers. This in turn requires increasingly impersonal business dealings that are based on a foundation of law, governance, and the sanctity of contracts, which can be enforced in the event of default. Without this framework, investment and innovation (which lead productivity growth) and competitiveness are reduced.

Guyana has a poor environment for contract enforcement through judicial procedures. The delays average 661 days, and court and legal fees necessary to enforce a contract add on average 24 percent to the settlement amount. The business community in Jamaica also reports that getting judgments enforced is difficult. On average it takes 415 days and in some cases it can take several years to obtain restitution even on cases where final judgement has been rendered. Suriname and Trinidad and Tobago are the worst in the Caribbean in terms of time delays (1,290 and 1,340 days, respectively). In Singapore, it takes only 120 days and costs on average 15 percent of settlement.

Business Regulation

A well-functioning regulatory framework minimizes the costs of business formation, operation, and closure. The rules governing business entry and the different types of business organizations—ranging from sole proprietorships and partnerships to public corporations—are vital for encouraging entrepreneurship, investment, and business operations. However, regulation can sometimes reduce efficiency and thus competition, and distort markets. In many cases, regulations overlap and interact, which leads to the cost of the whole being greater than the sum of the parts.

Institutions and the Legal Framework for Business Development in the Caribbean

An important component of costs is the value of time spent by private individuals in complying with regulations. Governments frequently disregard the cost of time spent by private agents since the cost of that time is not directly reflected in government budgets. In addition, government decision makers frequently have an incentive to justify increased budgets and headcounts by extending regulation beyond what is required to meet public policy objectives. But this situation usually increases the privately borne compliance costs.

The issue of bureaucracy and regulation is pressing in several countries in the region. At the senior levels of government in some countries there appears to be acceptance that regulatory and process reform is needed. At the middle and lower levels of government, however, such recognition is weaker or entirely absent. The following table indicates the relative burden of government regulation in the Caribbean compared to other countries in the world. In general, the burden of government compliance in the five Caribbean countries is slightly less (higher score) than in the Latin America and Caribbean (LAC) countries (around 4 percent), but compared to the high-income OECD countries, regulations are much more burdensome (around 20 percent greater).

Table 1. Burden of Government Regulation

<u>Country</u>	<u>Score*</u>
Barbados	3.40
Guyana	2.53
Jamaica	2.71
Suriname	2.59
Trinidad and Tobago	2.96
<u>Simple Averages</u>	
Caribbean (5 countries)	2.84
LAC	2.63
World Average	3.08
OECD High-Income	3.91

* Based on GCR survey of complying with administrative requirements (permits, regulations, reporting) issued by the government in the indicated country.
(1 = burdensome, 7 = not burdensome)

Source: WEF, 2009.

A recent survey in Trinidad and Tobago found that senior executives have to spend up to 20 percent of their work time dealing with government officials, due in part to the lack of coordination between regulatory and government agencies. Government may interfere in labor relations, and the Retrenchment and Severance Benefits Act raises the cost of hiring and firing workers. In Barbados, the public sector is characterized by overcentralization of decision making and dependence on rigid regulations because management and functioning of the public sector have failed to keep pace with the growing size and complexity of the economy.

Registration and Licensing

Businesses are formalized by going through a registration process that serves two primary economic objectives. First, a business should establish a certain domicile with the public so that it can be located legally for the purpose of contract enforcement or in case of damages, such as not paying taxes, owing penalty fees for improper waste management, or owing a tort claim. Notices delivered to that address are considered “delivered” under the law. Second, business registration designates

Institutions and the Legal Framework for Business Development in the Caribbean

which officials in the firm have the power to enter into obligations, thereby ensuring that contracts, both formal and informal, are binding and enforceable.

One aim of legislation governing the formation of companies should be to make the process as rapid and inexpensive as possible to encourage formal business formation and discourage the informal operation of businesses. If registration costs are high and formality does not bring benefits in the form of access to credit or more secure contracting, the incentive to register is reduced. This is exactly the situation for many businesses in the Caribbean region that choose to operate informally because of the high costs and low benefits of formality.

In most countries in the region, processes surrounding registration are difficult. Jamaica approved a new Companies Act in 2004 that corrected many of the deficiencies of the seriously outdated predecessor, which was based on the English Companies Act of 1948. The new act allows for much greater flexibility in registering businesses; however, it is still ambiguous in some areas and overly prescriptive in others. Paper forms are processed manually, and the fees and commissions are high—equivalent to several months of per capita income. In addition, businesses can only be registered in the capital city.

In addition to registration procedures, virtually all countries in the world have licensing requirements for businesses. Businesses need to be registered in a company registry to be formal; however, to operate they also frequently require licenses, the type of license being determined by the type of business. Often, licenses must be obtained from authorities at several different levels of government. One justification for licensing revolves around the presumption that regulations can cope with problems that free markets do not manage well, such as pollution and asymmetric information. Licensing is also justified on the grounds that it imposes order and certainties onto free markets that many policymakers find desirable. For example, licensing specific types of businesses, such as those that handle food, ensures that safety standards are observed and that the public is protected.

However, the beneficial effects of licensing can be offset by several factors, including the following:

- Licensing regulations often focus on inputs into the process rather than the ultimate aim of encouraging business and growth.
- Licensing requirements often result in the agencies that grant the licenses becoming wrapped up in the process rather than the more general goal of allowing businesses to be established and compete.

Many countries in the Caribbean have extensive licensing requirements that greatly raise the costs of formality. In four CARICOM countries for which data are available (Guyana, Jamaica, Suriname, and Trinidad and Tobago), the number of procedures required ranges from 14 to 19, and more importantly the number of days required to carry out these procedures ranges from a low of 194 days in Guyana to a high of 395 days in Suriname (World Bank and IFC, 2009).⁸ Suriname exemplifies the complex end of the spectrum: business licenses are valid for only three years and it takes about two years to complete all the procedures needed to obtain the license, thus most firms are continuously applying. Along with many other requirements, such as sanitation approval, in most

⁸ It should be noted that Belize, the other major English-speaking country for which data are available, performs much better on this indicator than its CARICOM peers, with only 12 procedures, requiring 66 days. This compares favorably to Singapore at 11 procedures requiring 129 days. Interestingly, several of the smaller counties that make up the OECS also perform quite favorably on this index.

Institutions and the Legal Framework for Business Development in the Caribbean

cases the government must approve the firm's reasons for operating each time they apply. Jamaica's licensing requirements are also onerous. A program to simply identify regulations, licenses, and permits for the building industry has taken two years and resulted in manuals documenting procedures totaling several hundred pages for the building industry alone. Clearly, reforming regulation is a huge task.

Box 1. Telecomm Licensing Requirements in Barbados

In Barbados, licensing requirements for telecommunications hindered competition and kept prices high. However, in 2001, the government negotiated a Memorandum of Understanding with the incumbent provider, bringing to an early end the provider's monopoly license. Since then, the Fair Trading Commission has been wrestling with objections raised by the incumbent to reductions in its grip on the local market. By the end of 2004, in response to competition, the incumbent had reduced its high-speed Internet access rates by 22 percent, and in early 2005, the three major competitors in the mobile market reduced their long-distance rates by almost 50 percent. These changes can be attributed to new legislation and a regulatory environment that supports competition. The continuing transformation of Barbados' telecommunications market will depend on the independent regulator's ability to oversee the incumbent (Schmid, 2001).

A related requirement that raises transaction costs unnecessarily is the mandated use of fully qualified professional surveyors, lawyers, engineers, etc. to validate and/or approve transactions even in routine cases where a less qualified, and less expensive, paraprofessional would be more than sufficient. The requirement to use these services was often included by representatives of these groups in the enabling legislation in Parliament. For example, in Jamaica, a fully qualified lawyer must be retained for most real property transactions, whereas in England a specially created class of paraprofessionals, called specialist conveyancers, are entitled to handle routine land transfers. Obviously the professional bodies have a vested interest in the status quo and would oppose any change, even if the change benefited the country more broadly by lowering unnecessary transaction costs. Any relaxation of professional training requirements needs to be balanced against the inherent technical complexity of the transaction at hand, but just as this issue has been successfully addressed in the United Kingdom, the United States and elsewhere, requirements for professional services in contract preparation and execution can be better articulated in the Caribbean countries as well.

Stamp Duties, Regulatory Fees, and Other Charges

Legal charges on contracts can take many forms. The costs of the various contractual arrangements necessary for the registration, operation, and dissolution of a business are one class of charges that can deter potential formal sector enterprises even before they start. For example the registration fee for a small, closely held company in Jamaica is over J\$20,000 (approximately US\$320), which is the equivalent of more than a month's per capita income. Annual filing fees add another J\$4,000. Contracts with suppliers, buyers, and workers also involve fees charged by government agencies and fixed-rate commissions charged by lawyers, engineers, surveyors, and other professionals. While useful as revenue generating measures, these fees raise the cost of doing business and constitute one of the many deterrents mentioned above. Of equal importance, although not typically accounted for, is the time cost of delays while businesses comply with all their contractual obligations. These opportunity costs, in terms of the disruption to normal business activity, can be as much as the financial costs.

Stamp duties and transfer taxes are levied on a wide variety of transactions, such as leases, bonds, bills of lading, insurance policies, travel tickets, bank withdrawal slips, customs warrants,

Institutions and the Legal Framework for Business Development in the Caribbean

deeds, powers of attorneys, property settlements, share transfers, patents, mortgages, and licenses. Often these fees were originally conceived as revenue raising measures, but they rarely constitute a major source of income for governments, which have diversified to rely on value added taxes, income tax, and other more broad-based and equitable forms of raising revenue. In Jamaica, stamp duties and transfer taxes account for less than 4 percent of total revenue.

These duties can, however, be a significant burden on formal-sector businesses for three reasons. First, the laws that impose the duties are often extremely complex and open to wide interpretation. Ambiguities in the law require interpretation by lawyers specialized in the area, who often charge first-world fees since many of their clients are trans-national companies trying to do business in the Caribbean. Second, the complexity of the transactions gives the enforcement officials broad discretion in interpreting the laws and their application in each case. Aside from generating obvious opportunities for corruption, this complexity and ambiguity leads to uncertainty and delay in determining the duties that a business will have to pay. Since time is money, these delays can substantially raise transaction costs even if all parties involved are entirely well intentioned and honest. Finally, the duties themselves are often high and discourage all but the most essential transactions, which can, for example, affect the kind of financing a company will seek. Instead of a share issue or a loan secured by collateral, a company may settle for a non-optimal, lower level of self financing (e.g., retained earnings).

In Jamaica, for example, eight separate steps are required to comply with the Stamp Duty Act on property transfer, including waiting for a possible revaluation of the transaction. Because of the legal complexities and ambiguities, as well as the lack of a liquid market for many of the items to be transferred, Jamaica has 15 full-time officials charged with determining “fair” valuations for the 600 to 1,000 real property transactions per year that are challenged.

In Barbados, stamp duties are payable in a number of situations, including transfers of real estate and shares (1 percent), leases (1 percent), and mortgages (B\$5 of the first B\$500, and B\$3 on each subsequent B\$500). In addition there is a land property transfer tax. Until 2007, this tax was significant, at 5 percent for citizens and permanent residents, and 8 percent for vendors who were neither citizens nor residents. Purchasers who were neither residents nor citizens paid 10 percent in addition to the vendor’s payment. In 2007, the property transfer tax rate was reduced to 5 percent with certain exemptions on sales below B\$125,000 (Lowtax.net).

Stamp duties and transfer taxes vary substantially in the OECS countries. Antigua imposes a vendor’s tax of 2.5 to 5 percent and a purchaser’s tax of 2.5 percent on the transfer of real estate, with the purchaser paying an additional 5 percent if they are alien. St. Lucia charges an annual tax of 0.25 percent of the value of the commercial property and a stamp duty of 5 percent on the market value when the vendor is St. Lucian and 10 percent when they are alien. Charges in Grenada are similar but lower. Dominica imposes a number of fees, including an assurance fund fee of 1 percent of the value of the land, a judicial fee of 2.5 percent, and a vendor’s tax of 2.5 percent, as well as stamp duties of 2.5 percent for the vendor and 4 percent payable by the buyer, unless the latter is alien, in which case an additional 10 percent land holding license fee is charged. St. Kitts and St. Vincent impose stamp taxes of 12 and 10 percent, respectively, on the transfer of real estate, with an additional 10 percent for sale to aliens.

Incentive Structures

Many countries in the Caribbean have comprehensive and complex incentive policies. Foreign investors are given tax holidays and trade incentives (in the form of relief from import duties) to encourage them to locate in the country. However, while it might seem obvious that countries in the region need to compete to attract what many consider to be a limited investment pool, such policies often have the perverse effect of creating a “race to the bottom,” with each country struggling to outdo others in offering more attractive inducements to foreign investors to locate there. Experience around the world has not been salutary in terms of the long-term effects of incentives, the impact of which has mostly proven to be negative.

A comprehensive analysis of private sector development issues in Jamaica (Holden and Holden, 2004), which has over 200,000 different incentives, pointed out that rather than encouraging growth as they were intended, incentives have led to distorted resource allocation, low productivity of investment, and high unemployment. Jamaican incentives included lengthy tax holidays and relief from import duties. The incentive scheme has led to a strong bias against local employment because it encourages capital-intensive investment. Those who promote incentives often overlook the fact that special privileges in one sector or for one type of investment constitute a tax on those sectors or investments that are not awarded incentives. In this regard, incentives discriminate substantially against local investors, who are often viewed by governments as captive because their futures are tied up with the country. By contrast, incentives are offered to foreign investors, ignoring the evidence that they often abandon their investments when incentives run out. Incentives also penalize smaller firms because, in virtually all cases, incentives favor larger, more capital-intensive companies. This especially distorts the system for local companies since capital is scarce but labor is an abundant resource in the Caribbean.

Investment incentives severely distort investment and resource allocation decisions, and there is reason to believe that the net effect on economic growth is negative. The argument typically used to justify incentives is that other countries offer them and therefore, to compete, they have to be available. However, studies of investment decisions reveal that companies first decide where they want to locate and then attempt to gain additional advantage by seeking incentives (Farrell, Remes, and Schulz, 2004). Furthermore, countries that offer incentives are typically those where it is difficult to do business. These countries appear to be acknowledging the challenges by offering incentives to induce investors to locate there. It would be far better, however, to introduce reforms to the business environment to make doing business low cost and simple. Many countries in the Caribbean have natural advantages, and if reforms of the business environment sharply reduced the costs of doing business, incentives would be completely unnecessary.

Suriname has a high tax burden and high tax incentives. Its corporate income tax rate of 36 percent is countered by a 2001 Investment Law that offers very attractive incentives for projects in favored sectors while the remaining sectors are burdened with the full tax. At the macro level this policy does not appear to have contributed to growth since the average investment ratio during the 1998 to 2003 period was almost 22 percent of GDP while growth averaged only 2.3 percent.

In Barbados, tax holidays are granted to tourism-related investments, but these investments might well have been made anyway. In other areas, incentives to attract investors who are “incentive shopping” have resulted in these investors either disappearing once the incentive period ends or transforming themselves into “new” firms, thus qualifying for incentives again. Further illustrating the arbitrary nature of the incentives regime, Invest Barbados reports pressure to extend tax holidays as the original 10-year period comes to an end, and in some cases extensions have been made to 15 years.

Institutions and the Legal Framework for Business Development in the Caribbean

The pattern of incentives for approved industries prevails in OECS countries as well. St. Vincent offers incentives for hotel construction and extensions as well as for specific tourism projects, leaving room for discretion in interpretation. As in many jurisdictions, offshore financial companies are completely exempt from tax. Grenada, St. Lucia, and Dominica offer tax holidays of up to 10, 15, and 20 years, respectively, for hotel construction or expansion. In St. Kitts, manufacturers receive a 10- to 15-year tax holiday, and hotels of less than 30 bedrooms are exempt from income tax for five years, while hotels of more than 30 and 200 bedrooms are exempt for 10 and 20 years, respectively. Small hotels of less than 10 rooms, which typically are relatively labor intensive and generally have greater backward linkages to the local economy, enjoy no duty relief on imports, while larger (more capital-intensive) hotels are eligible for this benefit. The OECS countries also offer generous tax holidays of 10 to 20 years for enclave industries exporting outside of CARICOM.

Competition Policy

A competition policy may be necessary in cases where markets are not competitive. In general, such a policy aims to:

- Prevent collusion among enterprises to fix prices and control entry.
- Regulate firms that have monopolies or very dominant market positions. These could include some natural monopolies, such as power generation, ports, and airports. Where telecom providers are licensed, regulation could be needed to ensure inter-connectivity, service coverage, and service quality.
- Prevent predatory behavior, such as lowering prices to drive out competitors, then subsequently raising prices.

Many countries in the Caribbean have some form of competition policy; however, they are frequently hampered by lack of trained personnel and inadequacies in the legal framework for implementing the policy. An IDB study of competition and regulation in Jamaica concluded that “it is apparent that Jamaica has a general problem concerning the lack of certainty created by the coexistence of new native institutions and the British tradition legislation. Even though general concepts about regulation exist, many of them are solved through negotiations, ex post interpretations, and so on” (IDB, 2003).

As indicated in the following table, antitrust policy in the Caribbean is somewhat worse than in the LAC countries and is distinctly below the world average. Furthermore it is substantially worse than in the OECD high-income countries. Suriname and Guyana stand out with the least effective antitrust policies, while Barbados and Jamaica fare relatively well and in fact exceed the world average.

Table 2. Effectiveness of Antitrust Policy

<u>Country</u>	<u>Score*</u>
Barbados	3.9
Guyana	3.7
Jamaica	4.1
Suriname	3.1
Trinidad and Tobago	3.4
<u>Simple Averages</u>	
Caribbean (5 countries)	3.64
LAC	3.48
World Average	3.97
OECD High-Income	5.48

*Based on GCR survey of antimonopoly policy in indicated country. (1 = lax and not effective at promoting competition, 7 = effective and promotes competition)

Source: WEF, 2006.

Governance

Conceptually, governance consists of many interlinked factors that together make up a framework that allows enterprises, investors, and entrepreneurs to engage in activities that enhance competitiveness. It can also extend to the way that firms operate, with corporate governance becoming an increasingly discussed topic.

Some dimensions of governance include:

- Formal rule-bound governance, which applies to the rules, processes, and organizations that determine the relationship between the state and businesses (although the concept could be extended to all citizens). Essentially, these factors derive from many of the issues that have been discussed in this paper—laws, judiciaries, property rights, and so on.
- The credibility of policies implemented by political authorities regarding enterprise. Large swings in policies relating to taxation, regulation, the legal framework, and so on increase the risk of investment.
- The quality and honesty of bureaucratic agencies, which affects the ability of businesses to operate and to compete. As a general rule, the potential for dishonesty is highest when regulations are pervasive and opaque. A further point, however, is that if government agencies administer bad regulation effectively, the impact on competitiveness might be worse than inefficient administration.

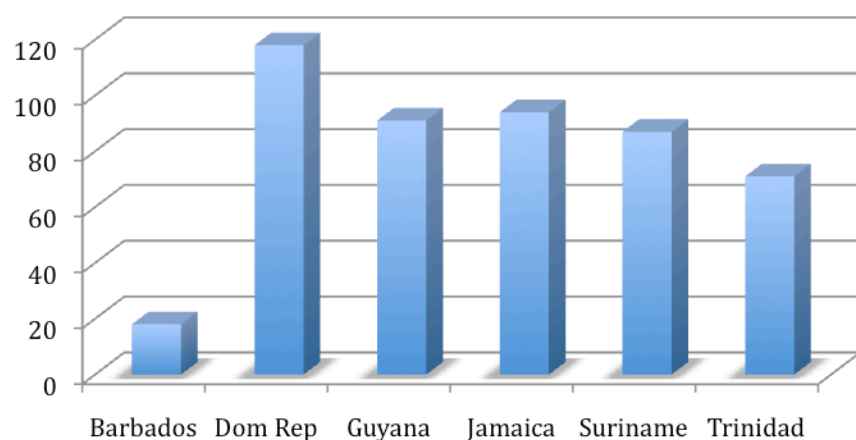
Ethics and Corruption

The preceding section discussed in some depth issues of property rights, the legal system, and regulation. The evidence is strong that these issues are centrally related to competitiveness and growth. While the discussion focused on the microeconomic effects of poor legal systems, over-regulation, and weak property rights, there are other pernicious outcomes.

Institutions and the Legal Framework for Business Development in the Caribbean

For example, opportunistic behavior is a frequent consequence of weak legal systems because unethical conduct is rarely punished. As a result, a system of “transacting without trust” evolves in which the spirit of contracts is often honored only in the breach. Such behavior reinforces informality, shortens time horizons, and encourages firms to restrict business activities to close associates, thus limiting the ability of countries to take advantage of the positive aspects of globalization. An earlier section of this paper emphasized the importance of extending time horizons. Weak institutions shorten time horizons and destroy competitiveness.

Figure 5: The Ranking of the Ethics of Firms in the Caribbean



Source: WEF, 2009.

Figure 5 shows a rating of the ethical behavior of firms, a measure of opportunism in business conduct. The Caribbean ranks poorly when compared with high-income countries of the OECD and is even slightly below Latin America.

Law and Order, and Security

Law and order are a fundamental requirement for investment and entrepreneurship to flourish. Loss from theft and corruption represents a threat to property rights, private sector development, and competitiveness. Problems in maintaining law and order have adverse effects on business activity for a myriad of reasons that involve higher costs to control or avoid the consequences of crime. For example, increased costs include stronger physical establishments, burglar alarms, insurance, private security patrols, and alarm systems. It is also necessary to adopt complex and circuitous systems to avoid crime, prevent theft, and increase physical security. Moreover, there is the cost of lost business opportunities since crime makes many business operations prohibitively risky (e.g., operating or transporting through remote areas, staying open late at night, engaging in modern retail operations where customers have access to stock). The essence of the impact of crime is that it constitutes a further tax on business.

In Jamaica, for example, it has been calculated that the cost of crime is equivalent to nearly 4 percent of GDP (World Bank, 2004), excluding the amount businesses spend on security. Additionally, firms spend on average 2 percent of their turnover on security costs. Since there are

Institutions and the Legal Framework for Business Development in the Caribbean

fixed cost components of this, the impact falls disproportionately on smaller businesses. Essentially, crime acts as a substantial tax on business activity.⁹

In most countries, problems with the police are partly addressed by using private police. But laws governing private police must balance their effectiveness with the protection of civil liberties. Problems with public prosecutors are addressed by permitting private citizens to bring criminal charges before a court. Private crime prosecution is also a potentially important step in curbing corruption, since the government itself may limit the public prosecution of corrupt officials. See Inter-American Development Bank's 2006 report *Jamaica, A Private Sector Assessment* for a complete discussion of the situation in that country.

Public Policy Effectiveness

State-owned enterprises are usually created to address some perceived market failure or social need. They are rarely profitable and often end up costing the treasury more than direct social expenditures to address the same issue directly would have cost. They also tend to become empires unto themselves, with limited accountability to their nominal shareholder, while at the same time fulfilling politically useful functions in terms of employment, targeted investment, and implicitly subsidized product sales and/or domestic input purchases.

Policy Initiatives to Improve Institutional Framework in the Caribbean

Clearly, institutional weaknesses are negatively affecting competitiveness in the Caribbean. Following is a discussion of the need for reforms, as well as areas for further research work regarding the CARICOM countries.

Legal and Regulatory Reforms

Given the paucity of analysis of the legal framework for doing business in the Caribbean, it is difficult to do more than make general statements regarding the directions that reform should take. Only in Jamaica has there been any attempt to analyze the commercial legal framework. The conclusions were that, in many areas, Jamaica's laws are outdated and unsuited for modern business practices. In addition, use of the legal system is costly and beyond the reach of all but the larger companies. One consequence is the very large informal sector in the Jamaican economy.

One option for legal reform in the Caribbean would be to draft model laws that could then be used as the basis for changing individual country laws. This approach carries with it the danger of wasting resources, however. On the one hand, having common laws in the areas delineated in earlier parts of this paper has substantial benefits—arbitration is a particular area where common provisions could benefit the region. If all countries adopted similar privacy and consumer protection provisions regarding credit information, at one stroke, barriers to the provision of regional credit information would be greatly reduced. In this sense, commonality of legislation could provide substantial advantages.

On the other hand, laws that evolve within a common law framework are not the same as model legislation. Trying to draft model laws in such areas as company law, that take into account

⁹ A rule of thumb is that profits should be 10 percent of turnover. A 2 percent of turnover cost of crime amounts to a 20 percent tax on profits.

Institutions and the Legal Framework for Business Development in the Caribbean

the idiosyncrasies of the region, risks wasting resources that would be better spent reforming company law in several countries at the same time, taking into account the unique institutions and needs of each country.¹⁰ This approach requires taking into account the existing legal framework, local institutions, and local ways of doing business. Any reform should examine each current legal requirement, the procedural steps it encompasses, and its costs and benefits. New provisions can then be drafted that minimize compliance costs in both time and money. Existing processes and laws can rarely be superimposed on different economic and cultural environments with much chance of success—they must be tailored to work within the norms and constraints of the country.

The issue of precedent and legal capacity of practitioners and judges also needs to be factored into reform, however. Building a homegrown law from scratch tests the ability of the legal community, perhaps past the breaking point. And a completely new law still requires the building up of precedent, however well drafted it might be. Therefore, identifying and adapting laws that are based on modern best practices and that have relatively recently been modernized and where a body of precedent exists is an option worth considering. This, however, is different from drafting a model law for the region.

Reform of bureaucratic process is also needed; however, merely trying to improve existing processes is counterproductive. An alternative approach would be to introduce a “sunset clause” into the application of regulation. This would require all departments to justify all their regulations in writing by a particular date. In the event that convincing justification is not forthcoming, or if it is not provided at all, the regulations would lapse. Whatever method is chosen, analysis of regulations governing business is urgently needed. A first step that donors could initiate would be cataloguing business regulations, both at the central government level and the local level for the larger countries in the region.

In many countries, competition policy must be implemented within legal contexts that have important deficiencies. In most countries, there is an urgent need for the legal framework for regulation and competition to be examined.

Public–Private Sector Consensus-Building on Competitiveness

The best and most comprehensive reviews of impediments to a country’s or group of countries’ competitiveness will have little practical impact if there is no means to implement the recommended reforms that emerge from the analyses. Implementation of most reforms requires public sector leadership, although the private sector can be a very effective force when its views are coordinated and well articulated. Similarly, labor can also take the lead. In any event, the long-run success of most important reforms in a democratic society depends on agreement, or at least acquiescence, of the affected stakeholders.

Meanwhile, many Caribbean, not to mention Latin American, countries have a tradition of mistrust between the labor, academic, public, and private sectors on business environment issues dating back to colonial times. The political process is often of limited usefulness in achieving consensus on competitiveness issues because it is typically arcane and too specialized to capture the attention of the voters; thus discussion can become very uninformed and partisan. Also, implementation of long-term solutions can become caught up in election-cycle politics. The 2007 election campaign in Jamaica is a case in point. Each party tried to outdo the other with promises of

¹⁰ Experience in Latin America and Eastern Europe shows that in many countries where legal reform has been based on model laws, the change has had little benefit.

Institutions and the Legal Framework for Business Development in the Caribbean

tax breaks and other fiscal inducements for investment, while at the same time each side professed concern about budget deficits and the debt overhang.

Formation of high-level public–private–labor forums or council is one means of achieving the required stakeholder consensus on reforms designed to improve the business environment. The public part of the forum would include senior elected officials with the understanding that the life of the panel transcends the electoral cycle to provide continuity both as a forum for discussion of needed reform and as a body to develop consensus on and influence the implementation of these reforms. Overcoming the traditional mistrust between the interested groups is hard, and examples of success in the region are limited. One such example, despite all its shortcomings, is the Social Partnership in Barbados. Other more ad hoc and specialized forums have been formed elsewhere. A very useful exercise would be to identify initiatives to form such forums over the past decade or so in as many countries in the region as possible and to document the challenges they addressed, how long they remained active, the influence they had on bringing about change, and how they achieved the consensus necessary to do so. The objective would not necessarily be to find great success stories but rather to learn what has been successful and what has not so that those lessons can be applied to future attempts at creating and sustaining such public–private–labor forums. In Guyana, an IDB initiative has assisted in the creation of a competitiveness council that includes representatives from government, business, and labor. While it is too early to judge the long-term impact of the council, early indications are promising.

Since the 2007 election in Jamaica, the new government has taken an active interest in promoting public–private dialogue. In November 2007, the government hosted a National Planning Summit (NPS), and since then, a proactive NPS Monitoring Board has followed up on the priority initiatives identified at the summit. The Board has a Secretariat that provides technical support and follow-through on directives from the Board. In parallel to the NPS initiative, lead private and public sector organizations have also been reviving an earlier “Partnership for Progress” coalition in the form of a new “Partnership for Transformation.” In December 2008, the first meeting of the newly formed “Social Partnership Consultative Committee,” hosted by the Ministry of Finance, established that the Partnership would be a forum for improving the social and economic environment in Jamaica between the government and key social partners. Most importantly, the initiative has explicit Prime Ministerial commitment, including the support of the same technical secretariat, lodged in the Office of the Prime Minister, that backstops the NPS Monitoring Board. In fact, the NPS initiatives and those of the Partnership for Transformation are expected to become increasingly aligned in the future (Collister, 2009).

Regional Cooperation

Each Caribbean country is unique and any policy initiative must take these differences into account. However, there are important areas where regional collaboration, with the concomitant adjustments in the respective national legal and regulatory frameworks, could yield substantial benefits. Following are two such initiatives, the implementation of which could also benefit the broader movement toward a CARICOM Single Market and Economy (CSME). Nevertheless, the political difficulties in completing agreements that allow regional synergies to be achieved should not be underestimated.

Regional Registries

Regional registries would provide information across the region and would thereby allow for sharing of information that could reduce business risk. By having registries operate regionally, many of the problems that exist in individual countries could be obviated, which is especially important with

Institutions and the Legal Framework for Business Development in the Caribbean

respect to issues of capacity and cost. Skills and facilities that are not available in most countries in the region could be provided economically at the regional level. It would also reduce the cost to individual countries of maintaining the information, since there are substantial fixed costs. Having a common information base, particularly if it is also accessible from the United States, would provide substantial benefits to financial institutions that might be concerned about borrowers absconding to other Caribbean countries or to the United States.

A Regional Arbitration Center

If arbitration laws were reformed, there is potential to establish a Caribbean arbitration center that could arbitrate disputes throughout the region. Such a centre could provide services to smaller businesses online and via email. Other tribunals could be localized and arbitrators could travel to the place of business of the parties for all transactions. However, to be effective, arbitration laws in the Caribbean countries would have to be harmonized.

Further Research and Documentation

In most countries in the region, much work remains to be done on analyzing institutional challenges that negatively affect the private sector and competitiveness.

As noted above, business law, including property rights, is deficient in most countries both because it often relies on outdated models from the ex-colonial powers and also because it has been incompletely or ambiguously crafted. This in turn has led to increased use of the courts or extra-judicial (ADR) proceedings that in turn are themselves outdated and thus ill prepared for the case load, resulting in costly delays before settlement. These deficiencies have led to widespread avoidance or evasion of the system and a return to the informal sector of the economy. A survey of the legal systems in the respective countries that measured each against best practice benchmarks such as "...a good contract system permits negotiations at a distance at low cost between parties that do not know each other well..." (Holden and Holden, 2004: 44) would provide much useful information not only for improving the laws in each country but for harmonizing them between countries as part of the CARICOM and CSME initiatives.

The costs and benefits of distinct business licensing procedures deserve to be quantified in several countries because this could provide support for specific reforms in the face of opposition from entrenched interests.

Another issue related to transaction costs and legal reform is the requirement that specialized professional experts, such as architects, lawyers, engineers, surveyors, etc., be used to implement or approve specific aspects of a business transaction. Often a paraprofessional would be sufficient or the procedure could be done away with entirely. Documentation of these requirements in the various countries, an estimate of their direct (professional fees) and indirect (time lost) costs compared to their alleged versus real benefits would provide very useful groundwork for reform in this area. While stand-alone, country-specific analyses would be useful, a multi-country survey would have the added advantage of comparing costs and benefits of these requirements across the region.

As part of the survey of legal systems or as a stand-alone exercise, more comprehensive documentation should be carried out on the status of ADR mechanisms in each country and their strengths and weaknesses compared to generally recognized international best practices. The study should also weigh the advantages and disadvantages of making piecemeal country-specific improvements as opposed to promoting a region-wide subscription to a regional ADR center.

Institutions and the Legal Framework for Business Development in the Caribbean

Further work is also needed to document other issues related to institutions in the region. For example, there is little analysis of competition policies in Caribbean countries, even though this is central to the issues of productivity and competitiveness. This work is required urgently. Similarly, the institutional weaknesses that restrain the development of financial markets and the analysis of property rights are also deficient. Documentation of needed work is required urgently and should begin as soon as possible.

Tax policy and practice throughout the region is widely known to be discriminatory and distortionary. In some countries, such as Jamaica, the impact of the taxation system on business practice has been well documented, both qualitatively and quantitatively (Holden and Holden, 2004). Similar analyses of tax incentives and the resulting impact on effective tax rates are needed for other Caribbean countries. The exercise would also document: (1) labor intensity and backward linkages to the domestic economy of each group of businesses; (2) the economic, as distinct from financial, profitability of firms in each group; and (3) the implications for domestic economic growth and equity of the tax incentive regimes in the selected countries. Such an analysis would provide guidance and support for tax incentive reform efforts throughout the region.

Stamp duties and transfer taxes are particularly irksome to businesses and often of marginal value as revenue sources for governments. These levies can be based on ambiguous and arbitrary criteria, thus are open to interpretation and appeal. This raises transaction costs for honest, formal-sector businesses that have every intention of complying with regulations, and it drives less conscientious business owners to simply evade the taxes. A comparative analysis of the stamp duty and transfer tax requirements in a representative sample of countries, as well as documentation of some countries' efforts at reform in this area, would do much to set the stage for rationalization, and hopefully reduction, of these taxes. Such an analysis would have to take government revenue requirements into account and take note of alternative, lower transaction cost and less distortionary revenue sources.

Conclusion

The quality of a country's institutions lies at the heart of the goal of improving competitiveness. The countries in the Caribbean have a substantial way to go before their institutions fully support the increasingly complex activities that rapid globalization requires for them to compete effectively. More secure property rights for both fixed and movable property, modernized laws and registries, reduced regulation, and lower transaction costs all require urgent attention if the competitiveness of the economies of the region are to improve.

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