THE DECOMPOSITION OF FINANCIAL INTERMEDIATION: THE CASE OF HAITI

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ABSTRACT

We provide an in-depth examination of the efficacy of financial intermediation in Haiti for the period 2010-2021 while developing a framework that can be applied to other economies. We show that decomposing financial intermediation into its two distinct functions, capital accumulation and capital allocation, produces more useful insights. Our application of this framework to Haiti indicates that Haitian banks struggle to efficiently carry out both functions, failing to meet demand for both deposit and credit services, even when controlling for economic conditions. While complex socioeconomic and political factors also contribute to economic stagnation in Haiti, we conclude that improving the ease of doing business could enhance bank incentives and increase the efficacy of the financial sector in facilitating economic growth.

Keywords*: Banking; Development; Haiti; Financial Intermediation; International Finance*

1. INTRODUCTION

For decades, economic growth in Haiti has lagged significantly behind neighboring Dominican Republic and the greater Latin American and Caribbean (LAC) region (see Figure 1a). On a per capita basis, gross domestic product (GDP) is virtually stagnant (see Figure 1b). As other developing economies around the globe show consistent growth, Haiti has been left behind.

While the reasons for economic stagnation are surely complex and multicausal, financial sector development has been shown to play a key role in economic growth (Demirgüç-Kunt and Levine, 2018). In the existing literature, the financial sector is often characterized only in terms of its size relative to GDP.

However, the size of any financial system ultimately depends on the efficient execution of two separate and distinct functions: the accumulation of capital and the allocation of capital. That is, the amount of credit that a banking system can provide is dependent on the amount of capital (e.g. deposits) that banks are able to accumulate.

In this paper, we decompose and examine the two distinct components of financial intermediation – capital accumulation and capital allocation – in a novel framework that can be applied to identify and diagnose inefficiencies in financial intermediation. We apply this framework to Haiti to determine whether and to what extent inefficiencies in financial intermediation hinder economic growth. While we focus on Haiti, the proposed framework may be applied to any economy.