Beyond the Crisis: Recovery in the Caribbean

The Caribbean Development Bank (CDB) is working with other major regional and international institutions to bring about sustainable economic recovery in the Caribbean. On March 15 senior managers from the CDB met in St. Lucia with senior regional leaders and U.S.-based financial experts for a roundtable discussion on the impact of the financial crisis on the English-speaking Caribbean economies and where to go from here. Attending were:

Dr. Compton Bourne
O.E., President,
Caribbean Development Bank

P. Desmond Brunton
Vice-President (Operations)
Caribbean Development Bank

Dr. Denny Lewis-Bynoe
Director, Economics Department
Caribbean Development Bank

Alessandra Alecci
Vice President, Sr. Analyst,
Sovereign Risk Unit, Moody's

Isaac Anthony
Permanent Secretary/Director
Ministry of Finance, St. Lucia

Surya Bhattacharjee
Vice-President, Latin America
Debt Capital Markets,
BNP Paribas

Eric-Vincent Guichard
Chairman and CEO
Gravitas Capital

Dr. Maurice Odle
Economic Advisor to the
Secretary General, CARICOM

Craig Leon, Moderator
Institutional Investor

"Borrowing member countries are looking increasingly to the CDB as a first resort lender."
Dr. Compton Bourne
Caribbean Development Bank

Photos by Mike Toy

The global crisis has left no region unscathed. The effects have been significant for the Caribbean economies and their trading partners, negatively impacting public finances, construction, agriculture, offshore finance, tourism, and remittances, and most importantly the livelihood of the Caribbean people. How has the CDB's role in finding long-term solutions affected its own credit rating?

Alessandra Alecci, Moody's: Our rating of the CDB is AAA. Key underlying issues include strong support from both borrowing member countries (BMCs) and non-borrowing members, a solid capital structure with a high paid-in capital portion, and conservative balance sheet management. And of course the CDB's preferred creditor status, highlighted by the CDB's excellent performance despite serious economic difficulties faced by some of its BMCs in the past few years, such as Belize, Dominica, Grenada, and most recently Jamaica. The CDB plays a very special role in the region, often as sole provider of funding to both the government and private sector in some smaller countries. We don't see any pressure on the AAA rating, though we do see challenges to the CDB'S role. Structural reductions in public debt just about everywhere else during the economic book that preceded the crisis seem to have bypassed the Caribbean, where debt levels steadily increased for most countries.

Going forward, we are likely to see much slower growth in the developed economies, which serve as the main markets for Caribbean tourism and services, while remittances and foreign direct investment in all likelihood will be lower. Intense regulatory scrutiny on the international financial sectors could mean that the growth model of several Caribbean countries needs to be reconfigured. Given these challenges, besides additional funding the CDB can provide significant policy guidance in terms of insuring that debt levels in the Caribbean countries will be reduced or remain sustainable, so that they would be able to deal with another shock if one were to materialize.

This Sponsored Roundtable was prepared by the Special Projects Department of *Institutional Investor*.

Will the CDB be providing significant policy guidance to ensure that debt levels are reduced, or at least remain sustainable?

Compton Bourne, CDB: Indeed, our BMC's medium-term capital and short-term funding needs have increased to cope with the global crisis. Many are in the early stages of fiscal reforms which have yet to bear full fruit. This causes transitional difficulties, so we are positioning ourselves to meet part of those funding requirements since most have limited access to Washington-based lending institutions. Our borrowing members with the heaviest debts will receive policy-based loans (PBLs) aimed at restructuring their debt, minimizing the debt service burden on current government revenues, and reducing debt-to-GDP over time.

Desmond Brunton, CDB: When the OECD introduced the issue of tax havens we were able to argue our case for differential tax regimes. We need to do the same with respect to the offshore financial services sector, which represents a major source of public sector revenue in some of our member countries. We may need to adjust to the new regulatory environment, but we have to ensure that we maintain our presence in the sector.

We also need to provide policy advice that facilitates risk management to withstand the external shocks to which small economies are vulnerable. Because of the nature of our economies, our major management tool is fiscal rather than monetary.

Denny Lewis-Bynoe, CDB: Countries in this region are also uniquely vulnerable to natural disasters, which impacts debt. The loss of preferences in bananas and sugar, a pre-crisis challenge, signals the need for urgent economic diversification to improve macroeconomic performance and achieve development objectives. Yet because of external pressures we have fewer options, such as developing the offshore sector. One of the CDB's less publicized roles involves offering technical expertise to confront macroeconomic challenges and bringing together critical thinkers through workshops and seminars to address all aspects of our economic and social development challenges, as well as broader environmental issues.

What specific challenges are St. Lucia and other countries in the region facing?

Isaac Anthony, St. Lucian Government: Across the region, revenues have declined substantially. At the same time, expenditure has remained fairly high to provide much needed social safety net programs. Clearly, governments need a fiscal policy stance that boosts revenues and controls costs while maintaining sustainable debt levels. In St. Lucia, the economy contracted some 5.2 percent in 2009, more than we actually expected, and when you go across the region the story is essentially the same. Regional demand for CDB financing has increased, even from countries which historically have not been heavy borrowers. Thus the need for the bank to ramp up its capital. OECS countries, through the Eastern Caribbean Central Bank, have prepared an eight-point stabilization and growth program to address critical areas such as public sector investment, analyzing which major projects we absolutely need to generate growth. A key policy imperative is to engage the private sector to accelerate implementation of pipeline projects that have come to a halt.

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Caribbean Development Bank

Maurice Odle, CARICOM: We have set economic convergence targets to achieve financial stability, with the ultimate aim of forging a monetary union, a single currency. Our countries realize they should adhere to a fiscal deficit of 3 percent of GDP and a debt stock of 60 percent of GDP, though many have failed. In terms of public vs. private sector, the liquidity levels in our economies are so high that I don't see crowding out by the public sector. If you look at institutional investors, insurance companies and pension funds, most of their assets are held abroad rather than loaned to regional governments, which is one reason why a major insurance company had the liquidity problems that resulted in a bailout by the relevant government last year. Recently, the private sector has not been predisposed towards undertaking infrastructure activity, such as in Guyana, where we have seen dependence on the public sector to provide drainage and irrigation for the rice and sugar projects.

Does the CDB see itself as a lender of first or last resort? And does the bank have the capital ratio needed to take on more risk?

Bourne: BMCs are looking increasingly to the CDB as a first resort lender, and we are seeking a substantial increase in the bank's authorized capital. We are also widening our membership, and Brazil's request to join the CDB was accepted. Yet our original

objectives remain intact: to accelerate social and economic regional development, provide capital intermediated mainly overseas for the investment needs of the countries, and foster economic integration. Our mandate has expanded tremendously over the years to help prepare countries for natural hazard shocks through insurance programs, paying attention to the resilience factor. Responding to short-term issues, such as Jamaica's financial sector restructuring or implementation of the OECS eight-point stabilization program, is of critical importance because the long-run and short-run are tightly linked.

Working from the trenches, the CDB can represent the region's economic interests to the rest of the world, including to international financial institutions. I recall a discussion with President Preval of Haiti, who said that more than the CDB's money, Haiti needs the CDB's voice. Our Basic Needs Trust Fund, a program for social and economic development driven at the community level with participatory decision-making, has no parallel anywhere else in the world.

Brunton: The overarching objective of the CDB is still poverty reduction through sustainable social and economic development, though the instruments for implementation have evolved. We are a development organization, not a relief organization, and as a small institution we focus in the areas where we have real competitive advantage. The CDB has an understanding of this region like no other multilateral. We leverage our intellectual capital and connection to the region while trying to convince policy makers to adopt prudent policy directives. In Haiti, we are closely involved in longer term development.

How do the markets view the CDB?

Surya Bhattacharjee, BNP Paribas: The CDB has plenty of market access as an AAA borrower; the CDB will, of course, need to maintain the appropriate capital structure over time to get efficient funding, particularly if it intends to increase its financial presence in the region. More importantly, though, the market looks to the CDB for its regional leadership in producing structural changes in its BMCs. This will be key for keeping down not only the CDB's funding cost but also for bringing down the cost and increasing the volume of available capital for the lower-rated credits in the region. Investors are currently saying, "I can lend, but I want to see structural support, accountability and sustainability." The CDB has a senior role to play here.

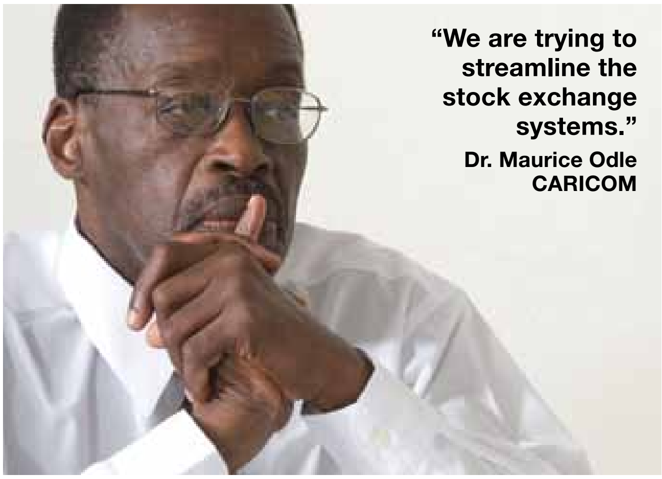
What has the crisis revealed about the region's ability to cope?

Eric-Vincent Guichard, Gravitas Capital: Coming out of the crisis, the fissures and oversights in the financial sector have been exposed. Also laid bare was a lack of coordinated policy among the various sovereigns. As opposed to taking a collaborative response to the crisis, many focused on protecting their own interests. The perception that economic integration is nothing more than a structure that transfers systemic risks needs to be addressed. Transparency must be incorporated into any structure designed to deal with future crises. I'm also curious about the progress of harmonization laws, which in the future might help the region develop a coordinated policy response.

Odle: Free trade is the ultimate harmonization instrument that underpins the regional integration process. The CARICOM Financial Services Agreement is on the table for signature by member states. If such an instrument had been in place years ago, we might have been spared some of the worst excesses that took place with the recent crisis. We are trying to harmonize legislation in the securities sector, and streamline the stock exchange systems in Jamaica, Trinidad, Barbados and the OECS, so that instead of cross-listing and cross-trading we have one regional stock exchange that will offer economies of scale. Also we need to think about how to boost intra-Caricom trade, and pool our resources to increase local content such as food in the tourism development matrix, and reduce our $3 billion import bill.

What role can the CDB play in recovery?

Alecci: The CDB's ability to provide funding is increasing. In addition, the CDB should provide significant policy guidance in terms of insuring that debt levels in the Caribbean countries will be reduced or remain sustainable, so that they would be able to take another shock if one were to materialize.



Bhattacharjee: As I was suggesting earlier, making use of the CDB's influence to encourage structural improvements in the Caribbean region is probably even more important than providing capital right now. For the moment, the markets are full of liquidity and investors don't know what to do with the cash they have on hand. But as one of the more influential institutions in the region, the CDB needs to help position the region for potentially much-lower liquidity conditions in the future. This goes back to encouraging regional and sovereign policies that are sustainable. I believe that this is the main issue to address as the Caribbean works toward economic recovery.

How important is further development of the offshore financial sector (OFS)?

Anthony: St. Lucia entered the OFS at a relatively late stage, but made a significant investment in the necessary infrastructure. Based on the OECD ruling, we are required to achieve 12 tax information exchange agreements to avoid being blacklisted. But it does not end there; we must make the required investments despite constantly shifting goal posts, and not all countries are ready to sign. Diversifying into a sector under threat of being derailed is a difficult challenge.

Lewis-Bynoe: The Caribbean region is being treated as a tax and regulatory haven, even though we have countries on OECD's white list, meaning they have implemented the internationally agreed tax standard. Meanwhile France has established is own list outside the OECD initiative. In other words, regardless of their status, countries in the Caribbean region are grouped and perceived negatively as a result. This is why we need regional lobbying on this matter with the kind of strong leadership that we had during the previous OECD harmful tax initiative.

Bourne: The key difference now is that the US has joined the set of countries that are resisting tax competition. And it is not just a sector that provides one service; it has different configurations in different countries, such as providing company registration like the state of Delaware, or wealth management and asset protection for wealthy and not-so-wealthy individuals like the Channel Islands. The global crisis provided an opportunity for large OECD countries to gang up on small countries, ignoring their own similar structures.

What regional policy reforms are needed, within the context of changing outside factors?

Brunton: The future for reducing fiscal pressures while maintaining public sector investment programs is through public/private partnerships (PPPs). In some countries in the Region, we have longstanding examples in tourism and industrial investment where government provides land and the private sector injects capital.

Guichard: PPPs also work with respect to health services and education, with delivery quality and substance above and beyond what you get when they are handled by the public sector alone. But when capital is in short supply, it's important to create structures that facilitate remittance flows into those investment opportunities. And there is a resilience character of remittances. Even in crisis they drop off significantly less than foreign direct investment.

Lewis-Bynoe: Remittances used for consumption are an integral part of the whole economic cycle. We need consumers as much as we need producers. We need to do a better job at managing our limited resources. Regional governments need to pay particular attention to tax reform initiatives to maximize the tax take, enhanced debt management, and better targeting of social expenditures.

Bourne: First, rather than facing a future where public administration is large in terms of sheer employment, we need to re-engineer government services so that the public expenditure budget is smaller without necessarily lowering salaries. Second, we need to streamline the provision of many services, particularly judicial administration, to create a more positive environment for business decision-making. Third, we should be thinking of economic diversification less in terms of sectors and more in terms of industries, products and markets at the micro level. If we make that shift, we will likely see more opportunities and greater scope for resilience to external economic shocks. ■