

Addressing Constraints to Growth and Development in the Caribbean



Compton Bourne, CDB President

On April 7th, private sector leaders and financial and development specialists met with senior management of the Caribbean Development Bank (CDB) in Kingston, Jamaica to discuss strategies for Caribbean economies to emerge stronger from the global economic downturn. Participants also explored the evolving role of the AAA-rated CDB in helping position the region for recovery, taking into consideration G20 resolutions, increased regional capital requirements and fiscal challenges.

Participating from the CDB were Dr. Compton Bourne, O.E., President; P. Desmond Brunton, Vice-President (Operations); and Dr. Denny Lewis-Bynoe, Director of Economics. Guest participants were Richard Byles, President and CEO, Sagico Jamaica; Eric-Vincent Guichard, Chief Investment Officer, Gravitas Capital; Dr. Wesley Hughes, Director General, Planning Institute of Jamaica; Minna Israel, President, RBTT Bank Jamaica Ltd.; and Dennis Morrison, Senior Director, Jamaica Bauxite Institute. Craig Leon of *Institutional Investor* served as moderator.

Moderator: What are the main challenges facing the Caribbean region?

Compton Bourne, CDB: Several factors are at play here. One is the downturn in export earnings in three critical industries: tourism; bauxite mining and alumina production in the case of Jamaica; and petroleum and natural gas in the case of Trinidad and Tobago. This clearly puts a foreign exchange squeeze on countries, affecting public revenues and making it difficult for regional governments to make counter-cyclical expenditures normally warranted in times like these.

The other set of problems is reflected in the potential fall in domestic demand, which would affect domestic enterprises that cater to local and regional markets, such as Trinidad and Tobago's manufacturing sector. Depending on the severity of the global recession, a fall in income levels could affect the banking sector through deterioration in asset quality, which can be handled proactively to minimize any fallout. The CDB is focusing on expanding funding to Caribbean Community (CARICOM) member countries to relieve fiscal pressure and assure a sustainable flow of funds for productive investment.

The Washington Consensus, a set of 10 policy reforms for Latin America adopted by international financial institutions in 1989,



At left: Wesley Hughes, Planning Institute of Jamaica; and Compton Bourne, CDB. At right: Denny Lewis-Bynoe, CDB.

pretty much said that if developing countries had a problem, it must be the consequence of their own economic mismanagement. Today there is a change of perspective. Rescue measures, whether for Europe or the US, allow for a larger government role in steering the economy directly rather than by remote control.

Dennis Morrison, Jamaica Bauxite Institute: The collapse in the international market for most commodities, in our case alumina, will pose serious difficulties in terms of Jamaica's foreign exchange for this year and next, though the sector accounts for only 5 percent of GDP. Bauxite production volumes are going to be halved this year from 2008. To deal with cash flow difficulties, companies have put a halt on investment, and we do not foresee a reopening of closed bauxite plants sooner than 18 to 24 months.

Tourism right now is about containing costs short-term, and maintaining the largest possible share of existing business. In Jamaica we still have increased numbers, even if expenditure is down. Though still small, there is also a positive trend in intra-Caribbean tourism.

Moderator: How does this compare with the 1970s crisis?

Wesley Hughes, Planning Institute of Jamaica: In the 1970s it was about stagflation and rising unemployment, along with governments having to cut expenditures dramatically and raise interest rates. This time around is more politically palatable because the entire world is calling for governments to spend more and lower interest rates. What you see now is a typical Keynesian response, which is a bit more popular in the short run.

Governments must reduce their appetite for debt, which means curbing expenditure, reducing deficit spending and lowering debt stock.

Minna Israel, RBTT Bank Jamaica Ltd.: International credit has dried up for the Caribbean. Credit spreads have widened, and correspondent relationships with larger banks overseas have been significantly reduced.

Fortunately, the Caribbean banking sector is relatively conservative and models the Canadian banking sector, which is rated number one in the world today. We haven't seen any significant exposure to subprime mortgage assets, mainly because the region has a high equity component in most mortgages and loans. Though we did see some contagion from the recent debacle of CLICO and Stanford, central banks stepped in right away and contained it. The regional financial sector remains very sound and solid.

Richard Byles, Sagicor: We run the risk of going into this crisis weak and coming out weaker in a tougher, more competitive world with greater scrutiny.

“The global crisis is an opportunity to be tough on the deficit.”

Richard Byles, Sagicor

My principal concern is sovereign debt. Jamaica has so much sovereign debt that a default would take us beyond what we saw during the banking crisis of the 1990s. We must focus on the business of fiscal discipline, where the virtuous circle starts to get the economy back on stable footing. It would allow for lower interest rates, lower inflation, and confidence in the exchange rate. The global crisis is an opportunity to be tough on the deficit, which bleeds away all of our investment capital and crowds out other opportunities for growth.

Denny Lewis-Bynoe, CDB: This crisis presents a perfect opportunity for government to look at its interface with the private sector and to create an enabling environment that facilitates business activity.

Many Caribbean countries were already grappling with pre-conditions to this crisis. In this environment where you have natural disaster shocks, the government's response is going to be fairly resource-intensive. Add the vulnerability posed by an integrated global financial system, and you understand the challenges faced by regional governments are not simply a matter of reducing fiscal deficits.

The issue of competitiveness is also key; we need to ensure that our labor markets are sufficiently flexible.

Eric Guichard, Gravitas Capital: I see remittances as a significant opportunity for public-private sector partnership, directing those resources to productive use, and an effective response to the cost of capital issue. The banks clearly would be the key player.

Morrison: The period of economic crisis should be used to plan for increased integration of the tourism sector with the rest of the economy because in recent years this sector has become less integrated with other sectors. Substantial investment in the

To lower energy costs: “Privatize the energy sector.”

Eric-Vincent Guichard, Gravitas Capital

Authority of Jamaica, which generates more than enough revenues to cover its costs and service its debts. There’s room to put other enterprises on the same footing.

We also have to continue investing in improved physical infrastructure to create the platform for resumed growth when the international situation normalizes.

Moderator: What can be done to lower energy costs?

Guichard: Privatize the energy sector. The reality is that energy is capital-intensive, and the solution, purely driven by the unifying factor of economics in scale, is integration, especially in a small community like the Caribbean. The CDB could play a significant role.

Desmond Brunton, CDB: The Bank is very engaged in the question of energy efficiency and renewable energy sources. We are

working with the Inter-American Development Bank (IDB) to do an energy-pricing audit, particularly in the Eastern Caribbean.

While oil prices will continue to influence the sustainability of alternative energy, progressive public policy can direct investments in areas it considers important. Barbados has achieved 60 percent to 80 percent conversion to solar water heating in homes through fiscal incentives. A number of smaller countries including Nevis and St. Lucia are investigating geothermal energy potential, while the German development arm GTZ has been investigating mini-hydro and wind energy in the Eastern Caribbean.

Information and Communication Technologies (ICT) are an investment opportunity and an advantage for the region in terms of time zone and scale. They can also help to reduce energy costs and efficiency in other sectors.

Lewis-Bynoe: Young people are very tuned into the information age, and we need to capitalize on it, because it is the one area where scale and size are less important.

Bourne: In addition to cost considerations there is the climate change agenda. Environmental considerations are also driving the search for alternative energy.

Moderator: Are you concerned about the G20 stance on tax havens?

Brunton: This is the potential elephant in the room. It may not affect Jamaica, Barbados or Trinidad, but if the G20 countries go ahead with removal of tax havens and their services, we could have some failed states. In the British Virgin Islands, around 70 percent of public sector revenue is based on the offshore financial sector; in Cayman, the figures are similar.

Guichard: The G20 are looking at these tax havens as a way to plug their massive budget deficits and reflate their economies. Though the strength of the headwind is significant, the legislative process that leads to these decisions is porous, and it would behoove the region to lobby the process to defend the offshore positions.

Bourne: Since the harmful tax competition initiative last time around, most Caribbean countries improved their regulatory



At left: Eric-Vincent Guichard, Gravitas Capital; and Richard Byles, Sagicor. At right: Minna Israel, RBTT Bank; and P. Desmond Brunton, CDB.

regime to levels acceptable to the OECD countries. But there is non-homogeneity; some jurisdictions need to restore credibility by doing what they committed to do a few years ago to have success with lobbying efforts.

Moderator: How has regional integration progressed?

Hughes: Integration has largely been a project of the elite, with limited direct benefit for the broad mass of the population. Until the benefits of trade, education and travel start flowing across the region, we will continue looking north.

Bourne: Smaller entrepreneurs are inevitably hurt by non-tariff trade barriers, such as customs regulations. Until governments put their money where their mouth is and remove them, we will have difficulty generalizing the benefits of integration beyond large enterprises. Irrespective of government policies, more integration has taken place over the last 25 years than acknowledged in official data.

Morrison: The Caribbean has not organized to grasp opportunities for growth in construction services from investment activity in the region. Trinidad and Tobago has engineering and other construction skills; Jamaica has skills, but none on their own has the critical mass to undertake sizable investment projects. Many small companies need to agglomerate their skilled engineers, architects and electricians to bid successfully on major capital and construction projects.

“Addressing the needs of weaker, underprivileged members is critical.”

Compton Bourne, CDB

though benefits from insurance inflows are small.

Bourne: While we cannot prevent the onset of natural events like hurricanes and excessive rainfall, we can manage their impact. We need to invest in drainage and in sea defenses so that economic and social consequences are less severe. Insurance becomes very expensive if you don't make the necessary adaptations.

Moderator: What are key steps to moving forward?

Byles: To emerge stronger, we have to do three things right: open investment in energy, address social indiscipline and improve education. None of this is short-term but we need to make the effort.

Israel: As we plan for growth, which will come, we will miss a great opportunity if we do not develop a communication network to educate the public on financial literacy and how to save money, as is being done in Asia. In addition, we can use the opportunity to tighten our legislation on non-banking entities to ensure proper regulation.



Dennis Morrison, Jamaica Bauxite Institute

Morrison: This is critical as the Caribbean's low growth rates relative to other regions like East Asia reflect the region's low savings and investment rates.

Bourne: One of our principal roles in relation to the current crisis and the G20 decisions to increase liquidity is to help Caribbean countries have greater access to funding. The Rapid Social Response Fund and the Global Trade Credit Liquidity Facility will help facilitate exports and finance foreign trade. While few Caribbean countries qualify as beneficiaries, accessing those resources quickly would let the CDB concentrate on social safety net requirements for non-eligible borrowing member countries.

The Bank also has to increase direct and joint lending with regional commercial banks and other multilateral banks, using our AAA rating to mobilize funds on better terms and continue efforts to expand membership. The replenishment of our Special Development Fund, financed by both our borrowing and non-borrowing member countries, which are Canada, Germany, Italy, China and the UK, was 60 percent larger than our last four-year cycle.

Israel: In addition to stimulating growth, commercial banks have to find innovative ways to help our corporate and individual clients stay afloat. These include providing moratoriums on loans so that they pay interest only, or payment waivers. We recognize that as a financial institution we must do what we can to help customers over this difficult period.

As part of fiscal discipline, people are rightsizing, becoming more efficient and taking out the fat that's in an organization.

Bourne: We need to bear in mind that the largest component of cost is labor, and is as much a labor union issue as it is a management issue. The way forward is not reducing wage rates or even reducing labor force size, but having people do the work they are paid to do. As the late Trinidadian economist Lloyd Best said, "Many are employed but few work."

Addressing the needs of weaker, underprivileged members of Caribbean societies is critical. Much of the CDB's own work emphasizes the social dimension of development as an instrument, not simply a benefit. ■