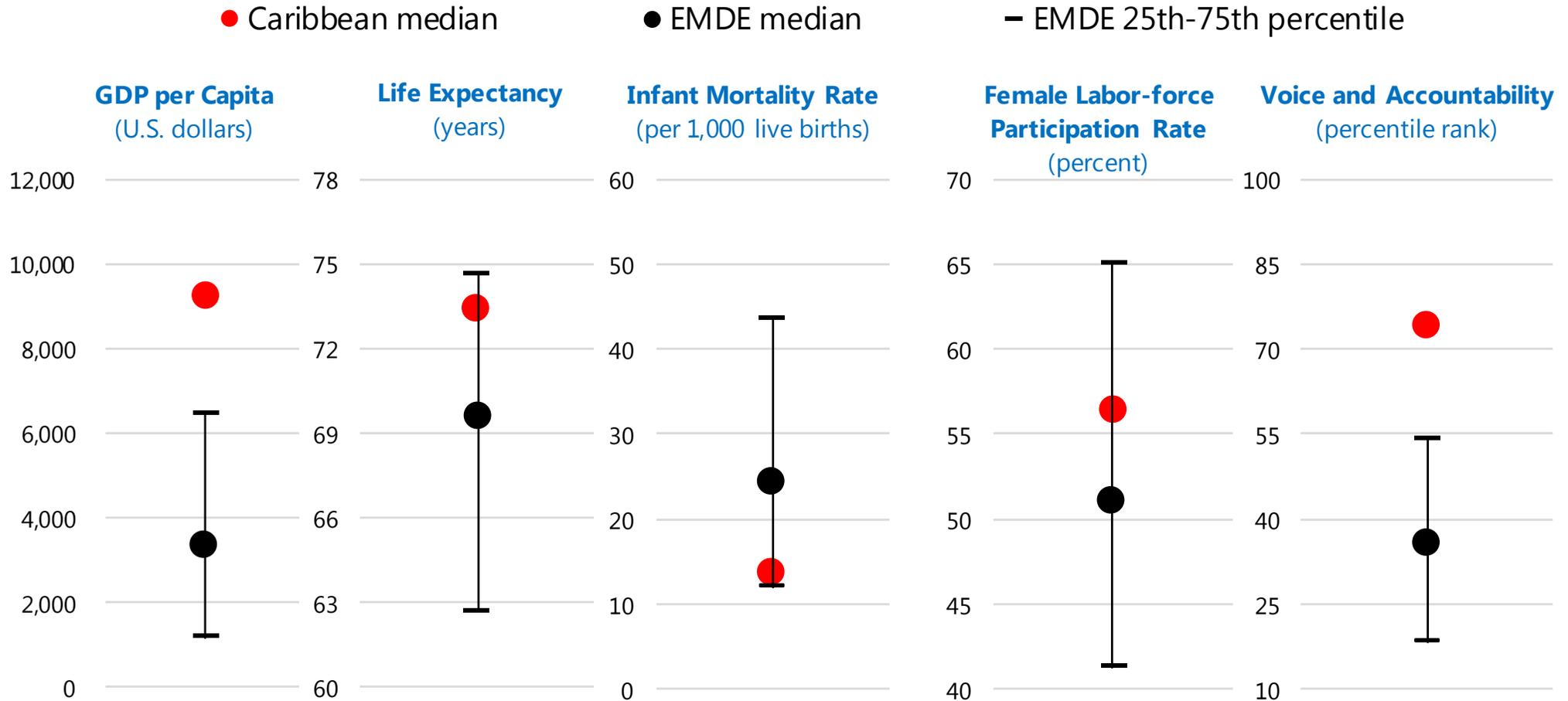


# **THE CARIBBEAN CHALLENGE: STRENGTHENING GROWTH AND RESILIENCE**

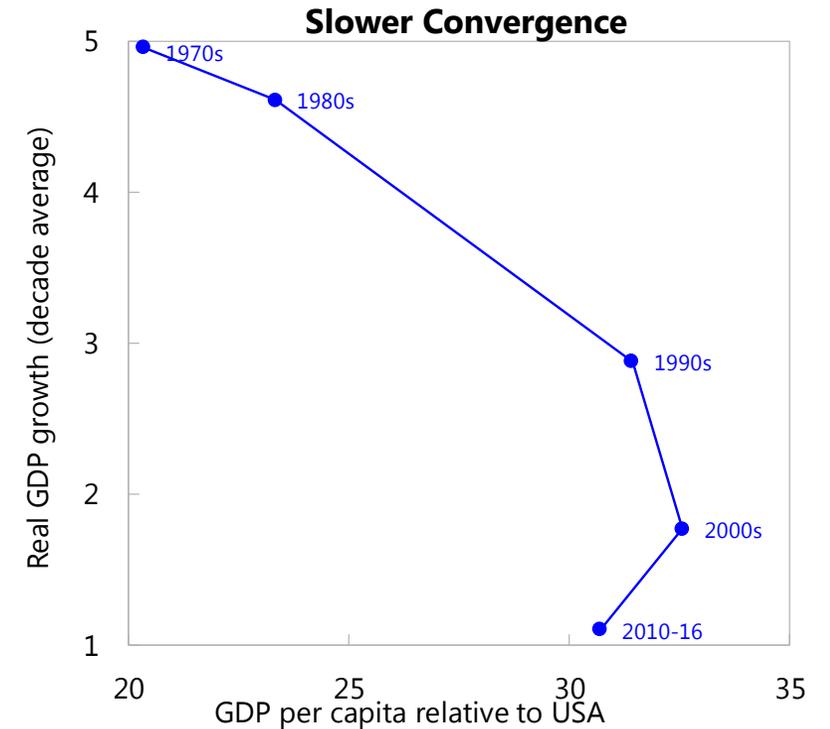
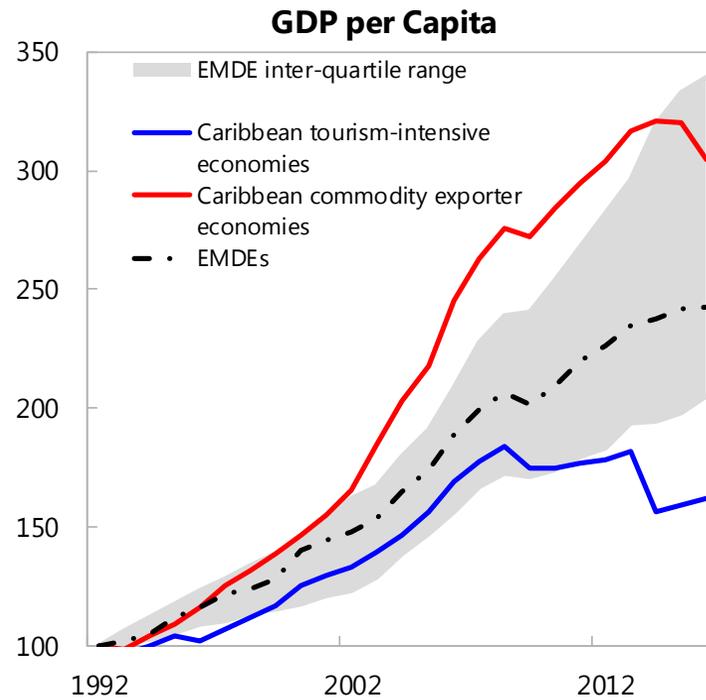
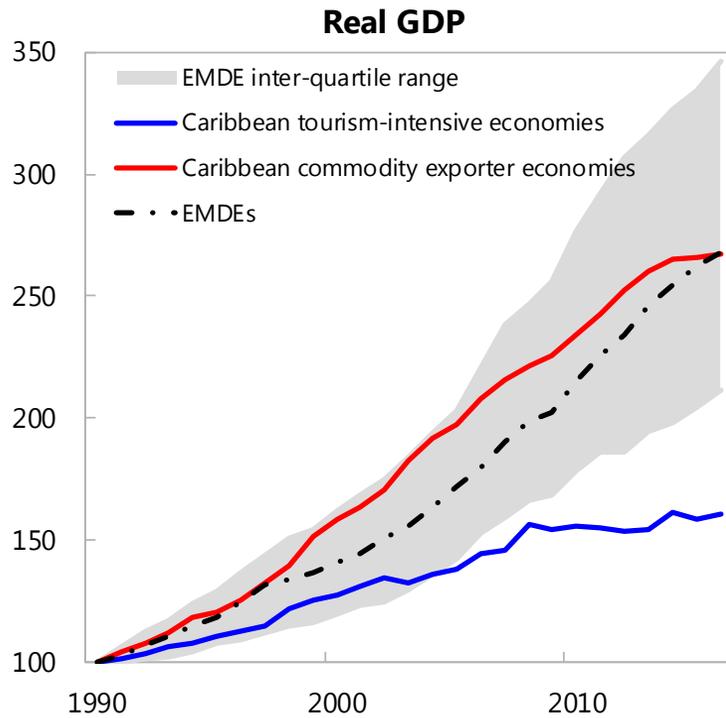
Adlith Brown Memorial Lecture  
November 6, 2018

# The Caribbean has made significant strides...

## Demographic, Economic, and Social Indicators 2015 or latest available



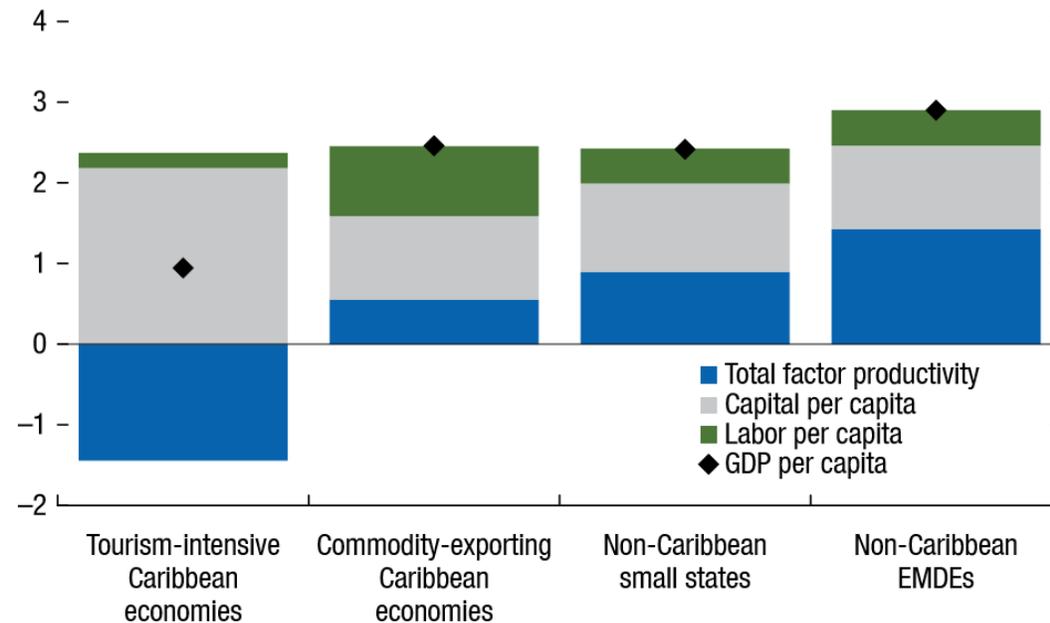
# ... but real GDP has lagged since the 2000s for tourism-intensive economies.



Notes: Commodity exporter economies are Belize, Guyana, Suriname, and Trinidad and Tobago. Tourism-intensive economies includes all other Caribbean countries.

# Why ? weak TFP is the main factor

**Contributions to Average GDP Growth per Capita, 2000–15**  
(Percent per year)



Source: Authors' calculations.

Note: Figure reports results for commodity-exporting Caribbean economies and tourism-intensive economies, non-Caribbean small states, and non-Caribbean EMDEs. EMDE = emerging market and developing economy.

A DIAGNOSTIC

---

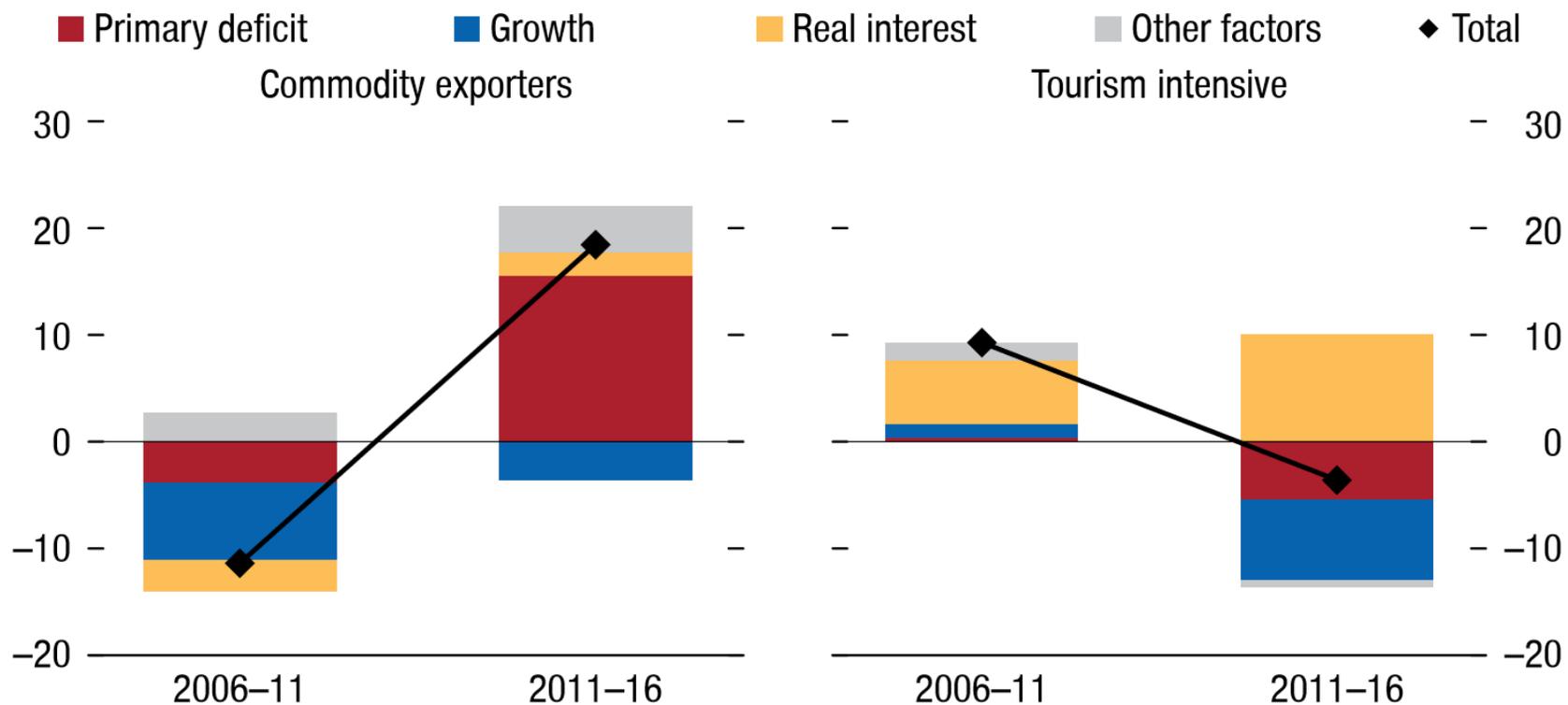
## *Caribbean stuck in cycle of high debt and low growth*

- Structural factors leading to weak growth and reinforced by high debt creating a vicious cycle !!
- Why elevated debt levels ?
  - Rapid increase in debt driven by large deficits in “bad times” but not offset by savings in “good times” – deficit bias !
  - Deficits in Bad times also reflect impact of natural disasters
  - In addition, pervasive tax incentives contribute to large deficits
  - Weak expenditure control; SOEs significant fiscal risk

# Why high Debt ? Post-Crisis T-I and Commodity Exporters - Two different tales but Fiscal weakness common !!

## Debt Accumulation Decomposition, 2006–16

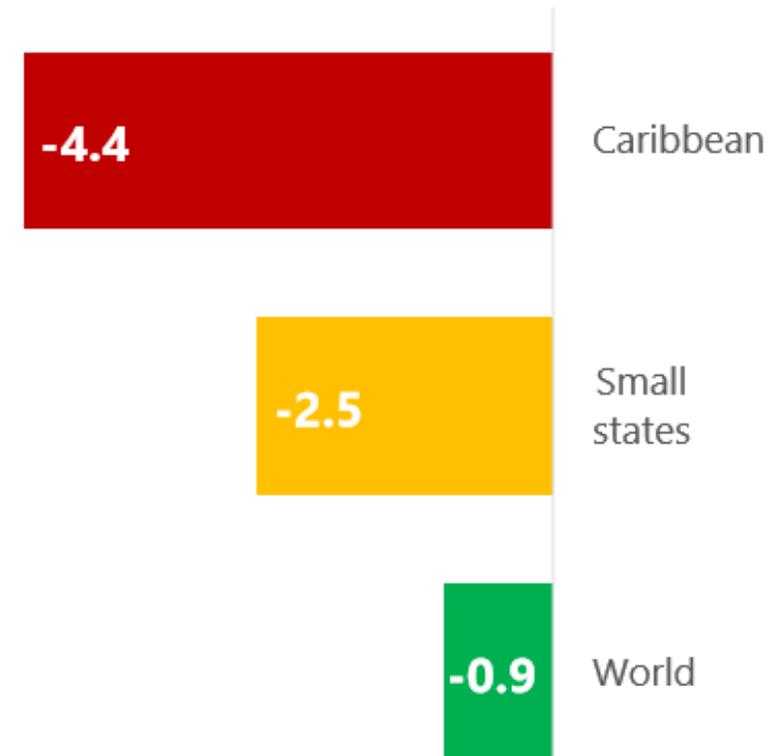
(Percentage points of GDP)



# Why high debt ? Natural disasters are macro-critical

- Have massive economic and human costs
  - Take a deep toll on growth prospects
  - Erode fiscal cushions
    - Higher fiscal deficits/debt
  - Huge reconstruction costs crowd out scarce resources to:
    - Meet development objectives
    - Reduce debt to sustainable levels
  - Climate change to intensify these risks

Cumulative Effect on Real GDP of an Avg. Hurricane After 7 Years

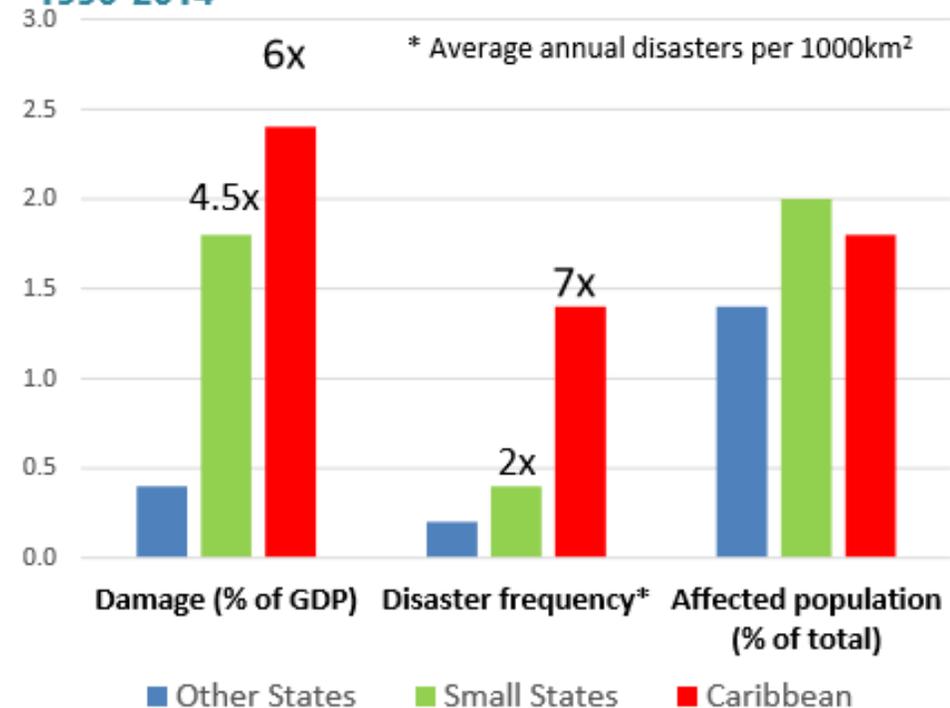


Source: EM-DAT; and Acevedo (2017).

# Natural disaster risk more acute: Increasing damages with higher frequency

- 324 of 511 disasters that hit small states in 1950-2016 was in Caribbean
- Disasters are more frequent and costly in the Caribbean, even compared to other small states
- Caribbean is among the top-25 most vulnerable region in terms of disasters per capita or land area

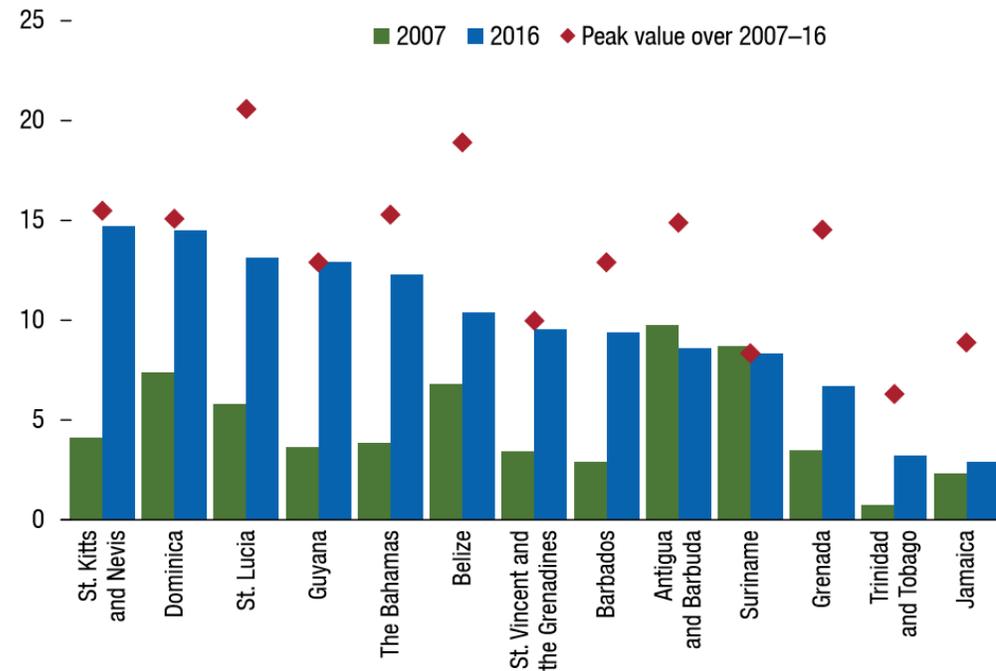
**Average Annual Effects of Natural Disasters, 1990-2014**



Source: IMF 2016 (Small States paper) and staff calculations.

# High NPLs significant risk to debt sustainability !

**NPLs by Country**  
(Percent of total loans)

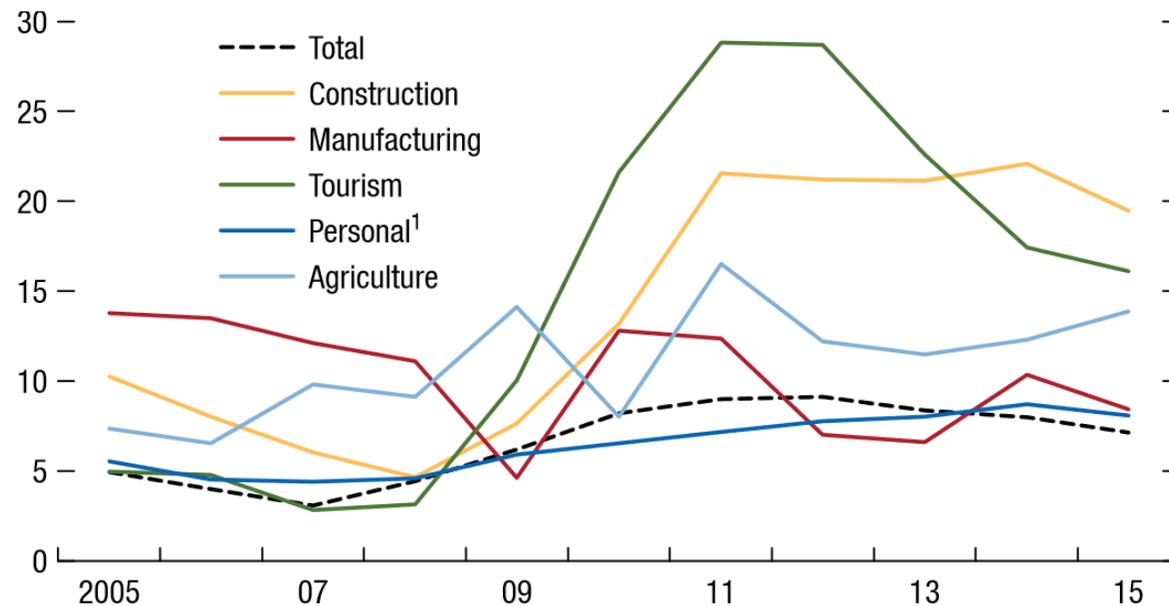


Sources: Country authorities; World Bank, *World Development Indicators*; and IMF staff estimates and calculations.

Note: NPL = nonperforming loan. The latest available data for Suriname are for 2015.

# NPLs concentrated in tourism and construction

## Caribbean NPLs (Percent of loans)



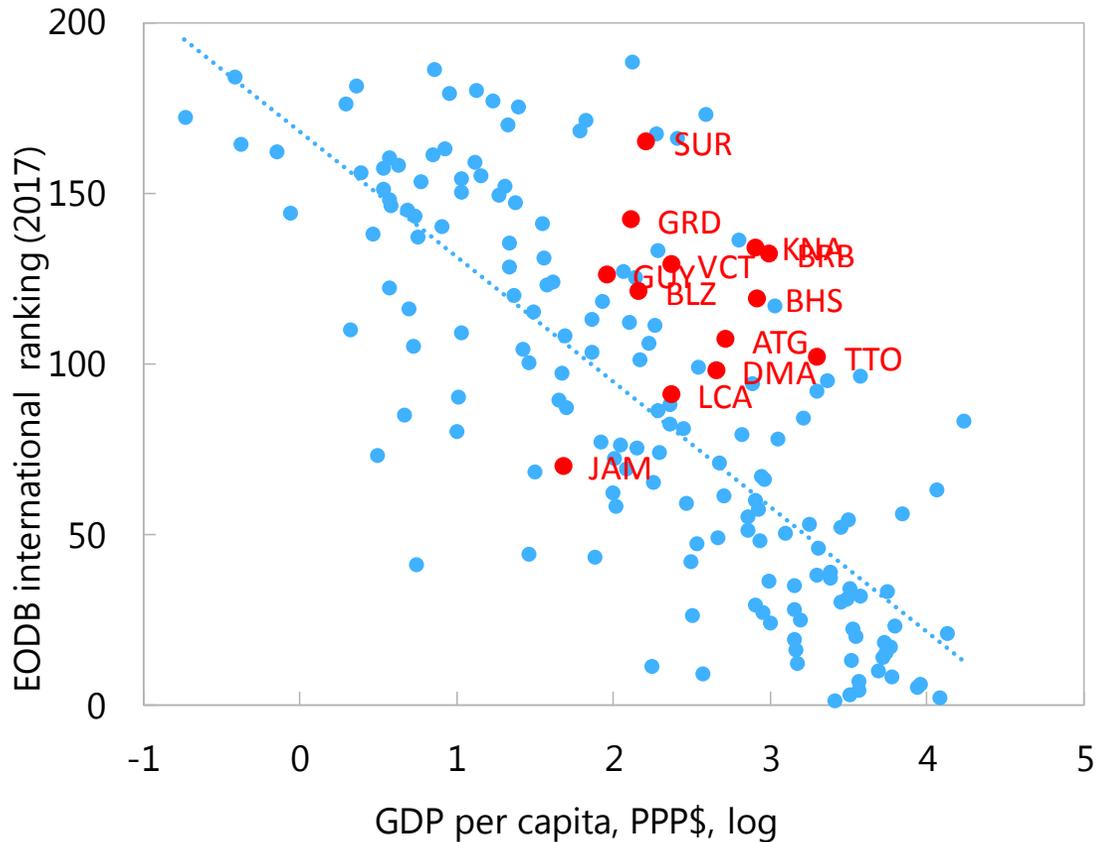
Sources: Country authorities; and IMF staff estimates and calculations.

Note: Calculated as ratio of the sum of nonperforming loans (NPLs) for all countries (in US\$) to the sum of loans for all countries (in US\$); by sector and total; in percent. Calculations exclude Suriname and The Bahamas due to data unavailability.

<sup>1</sup>Personal loans include real estate and mortgages.

# Growth impediments: structural factors are key !

## High Costs of Doing Business



Source: World Bank and IMF Staff Calculations.

## Heat Map: Characteristics Relevant for Growth and Prosperity (Ranking across country groups)

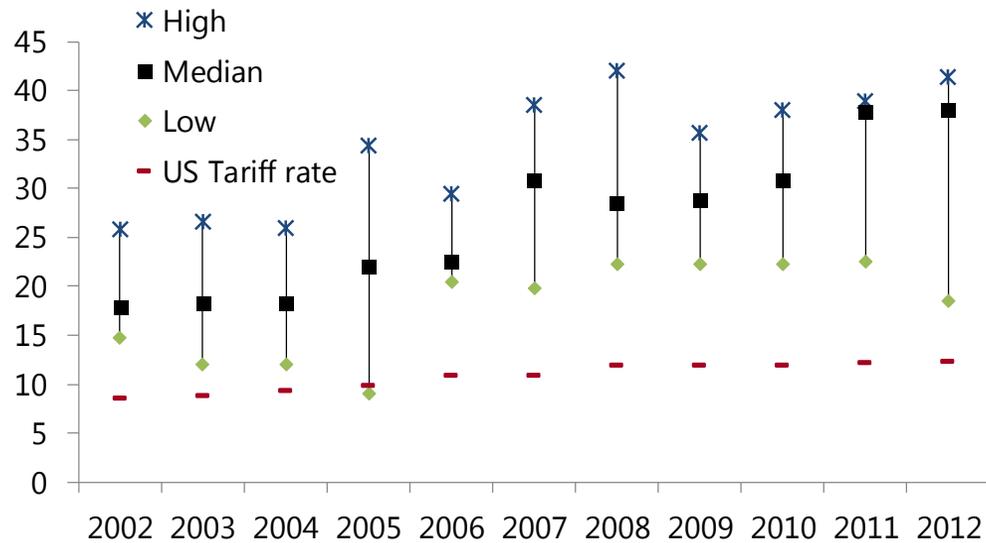
|                        | Tourism-Intensive<br>CRB Economies | Commodity Exporter<br>CRB Economies | Non-CRB small states |
|------------------------|------------------------------------|-------------------------------------|----------------------|
| Violent Crime          | Orange                             | Orange                              | Green                |
| Emigration             | Red                                | Red                                 | Yellow               |
| Skilled Emigration     | Red                                | Red                                 | Yellow               |
| Human Capital          | Orange                             | Green                               | Orange               |
| Natural Disasters      | Red                                | Orange                              | Yellow               |
| Government Debt        | Red                                | Yellow                              | Yellow               |
| Taxation               | Yellow                             | Yellow                              | Light Green          |
| NPLs                   | Red                                | Orange                              | Orange               |
| Ease of Doing Business | Yellow                             | Orange                              | Orange               |
| Competitiveness        | Light Green                        | Red                                 | Orange               |
| Bureaucracy            | Light Green                        | Yellow                              | Orange               |
| Regulatory Quality     | Light Green                        | Orange                              | Orange               |
| Rule of Law            | Light Green                        | Orange                              | Light Green          |
| Control of Corruption  | Green                              | Orange                              | Light Green          |
| Trade Openness         | Yellow                             | Light Green                         | Light Green          |
| Trade Tariff           | Red                                | Orange                              | Yellow               |
| Trade Connectivity     | Orange                             | Orange                              | Red                  |
| Gvc Participation      | Yellow                             | Red                                 | Yellow               |
| High-Tech Export Share | Orange                             | Red                                 | Light Green          |
| Export Diversification | Orange                             | Red                                 | Red                  |

Note: Red = less favorable ranking; green = more favorable ranking.

# Energy costs are high and volatile in the Caribbean

## Caribbean Residential Electricity Tariffs (2002-2012) <sup>1/</sup>

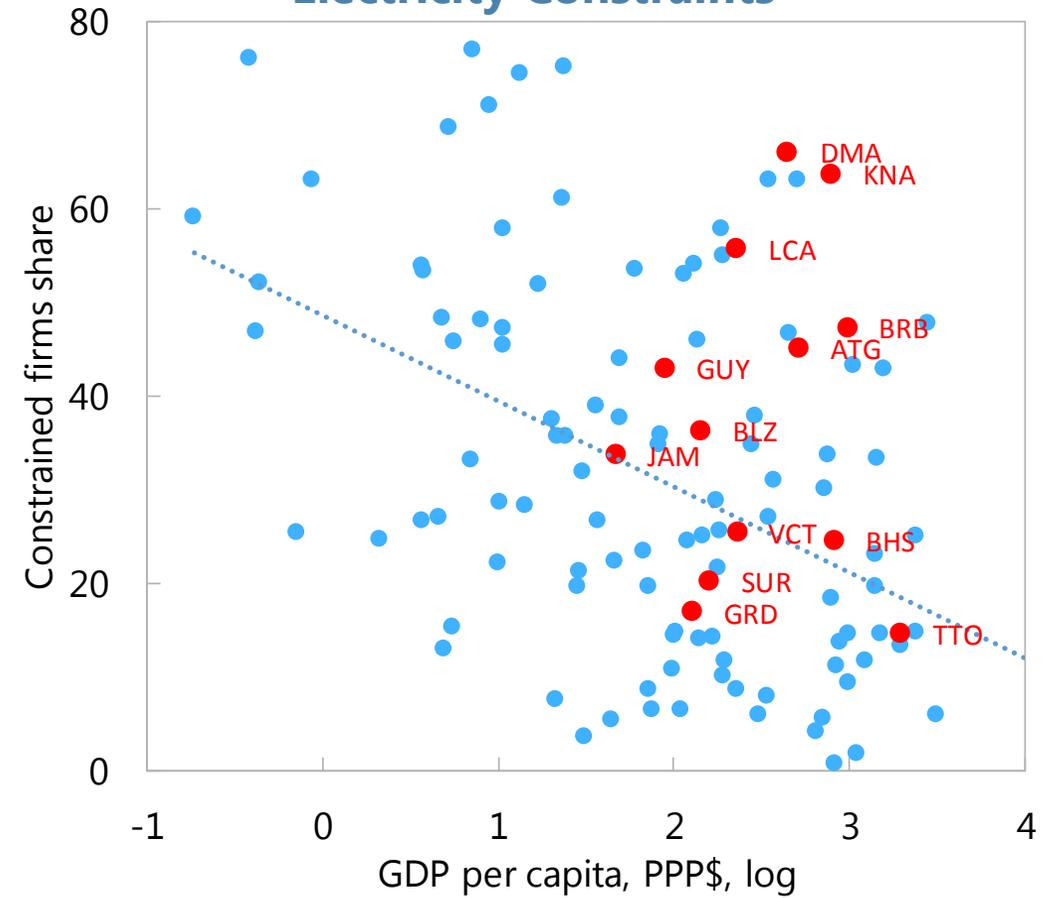
(In US ¢/kWh)



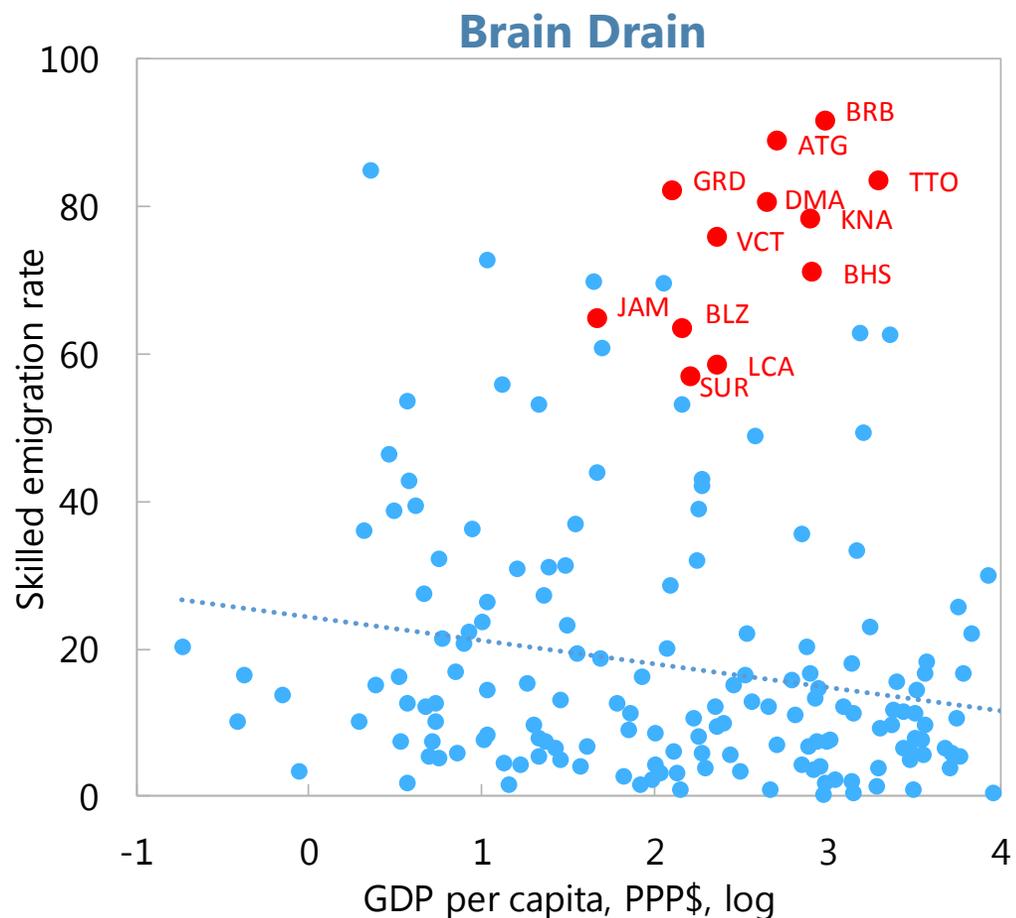
<sup>1/</sup> includes data for the Bahamas, Barbados, Belize, Dominica, Grenada, Jamaica, St. Lucia and St. Vincent and the Grenadines; limited data available for Antigua and Barbuda and Nevis; excludes Trinidad and Tobago and Suriname

Source: CARILEC Tariff Survey (2012) and U.S. EIA database.

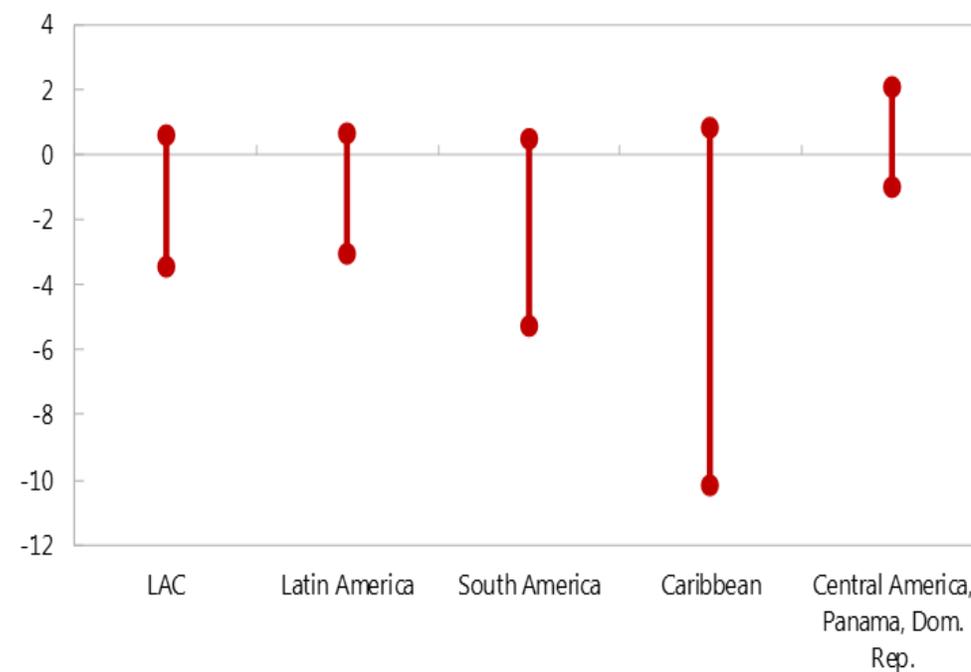
## Electricity Constraints



# Brain drain is a drag on growth despite positive effect of remittances

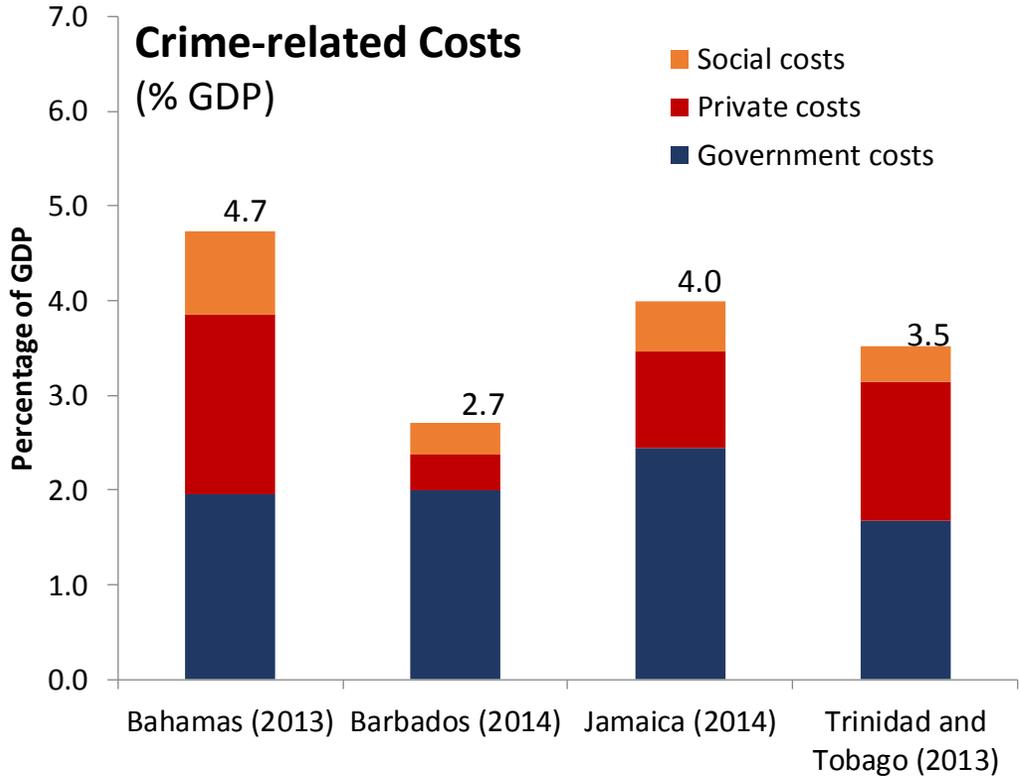
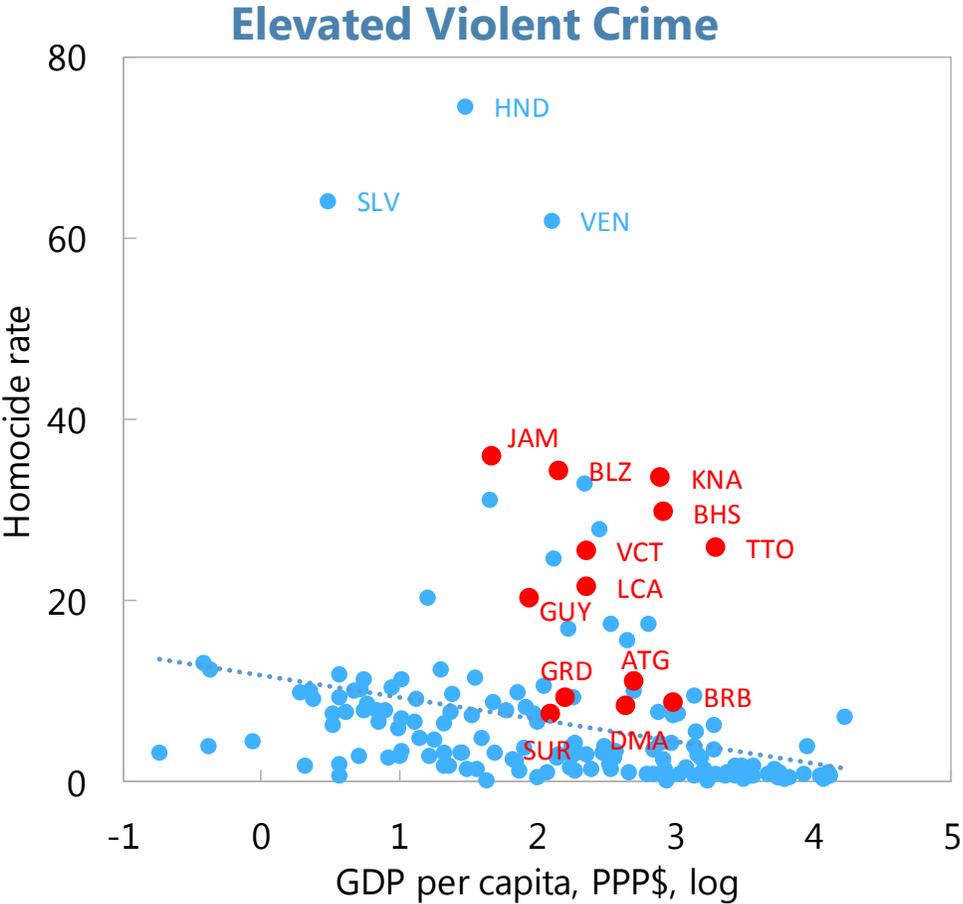


### Net Effect of Migration and Remittances on GDP Growth, 2003-13 (percent of GDP)



Sources: IMF Staff calculations

# Elevated crime rates impose significant costs on the economy



Sources: InterAmerican Development Bank

## *Self-reinforcing structural and macro impediments to growth*

### **Structural Impediments**

- Natural disasters
- Violent crime
- Brain drain
- High cost of doing business



### **Macroeconomic Impediments**

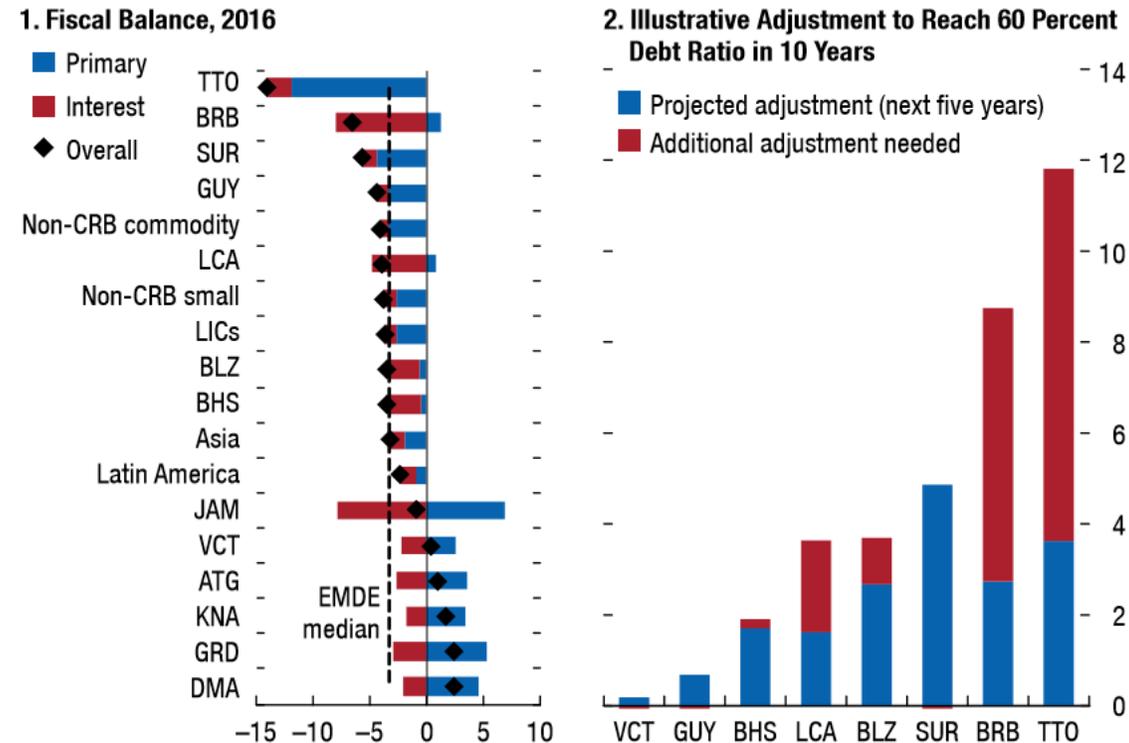
- Weak fiscal positions and elevated levels of public debt
- High non-performing loans

# BREAKING THE VICIOUS CYCLE OF LOW GROWTH AND HIGH DEBT

---

# Fiscal consolidation is needed to reduce debt; preserve stability

## Fiscal Balances and Adjustment Needs (Percent of GDP)



Sources: IMF, *World Economic Outlook*, and IMF staff estimates.

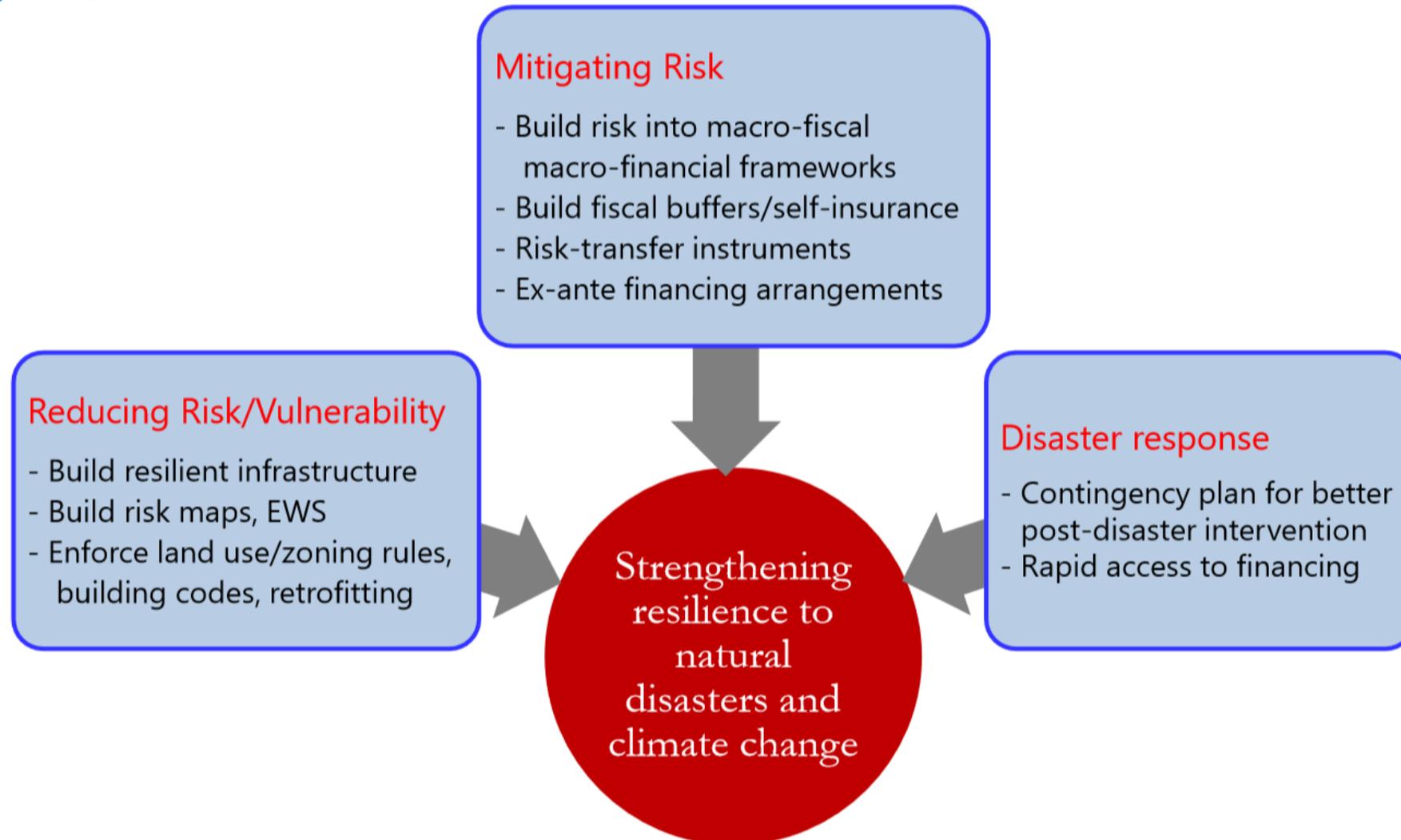
Note: CRB = Caribbean; EMDE = emerging market and developing economy; LICs = low-income countries. Planned adjustment based on April 2017 IMF *World Economic Outlook* projection for the primary fiscal surplus. Figure omits countries with no planned or estimated need for increases in the primary fiscal surplus. Data labels in figure use International Organization for Standardization (ISO) country codes.

## *And fiscal discipline must be sustained*

### **Strengthen Policy Frameworks and institutional capacity:**

- Medium-term macro-frameworks; build natural disaster risks into frameworks
- Explicit fiscal responsibility framework – Fiscal Rule – Set long term fiscal target and establish an operational target
- Strengthened supporting fiscal institutions – Enhanced PFM; Fiscal Councils (?)
- Restructure SOEs (including privatization); enhance oversight of SOEs – minimize fiscal risks.
- Transparent fiscal reporting

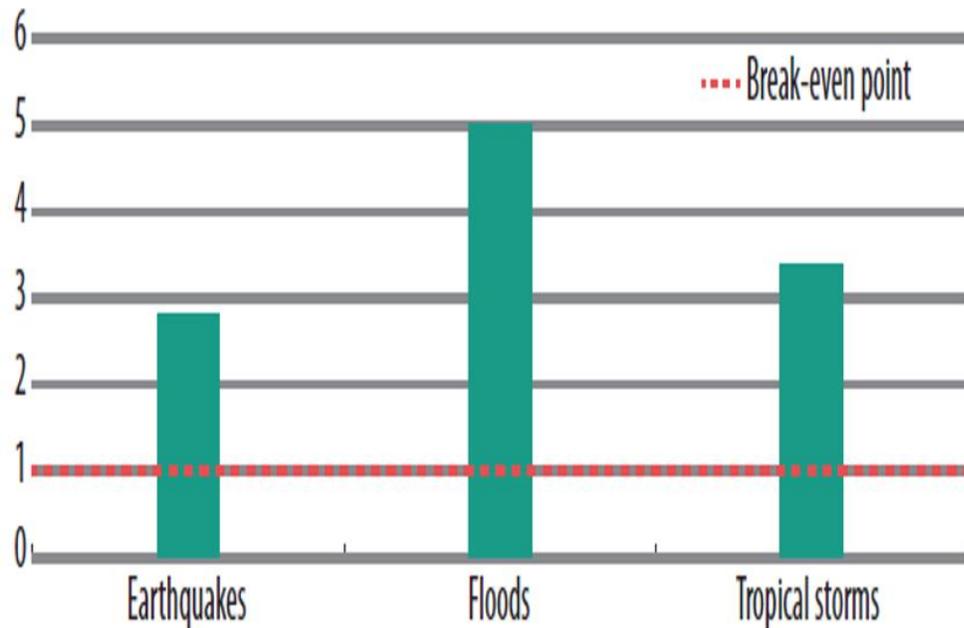
# Lower debt risk ! Build Resilience to Disasters/Climate Change: Better Preparation, Risk Mitigation, and Response



# Ex-post response → Ex-ante response

## Does it pay to prepare?

An ounce of prevention is worth a pound of cure!



Source: World Bank 2013b.

Note: Chart depicts the cost-benefit ratio of measures to reduce damage from various types of natural disasters.

- Preparing for disasters more cost effective than responding after the fact!
- But:
- Despite clear benefits of preparation, countries perennially underinvest in risk reduction/prevention

# Remove obstacles to NPL resolution; increase credit supply, support growth and reduce risks to debt: multifaceted approach needed!

## 1. Banks' Survey

(Percentage of respondents citing a given factor as one of the top three obstacles for NPL resolution)



## 2. Authorities' Survey

(Percentage of respondents citing a given factor as one of the top three obstacles for NPL resolution)



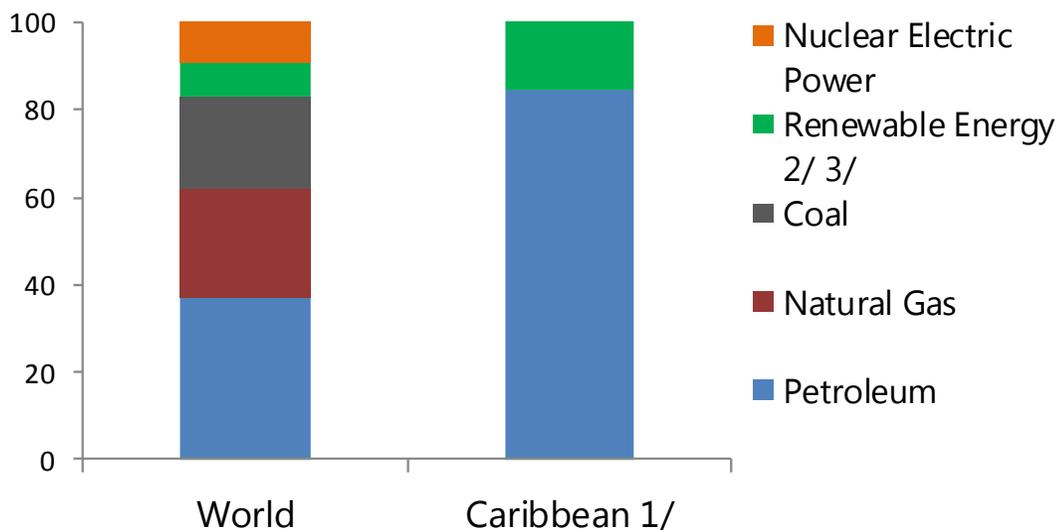
Source: IMF staff survey of national authorities and banks.

Note: NPL = nonperforming loan. The figure summarizes responses to a question asking respondents to name top three obstacles to NPL resolution. Panel 2 combines responses from The Bahamas, Barbados, Belize, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, and Trinidad and Tobago.

# Removing structural impediments to growth :Diversifying the energy matrix to shield prices from oil fluctuations

## Primary Energy Consumption by Source and Use

(In Percent of Total)



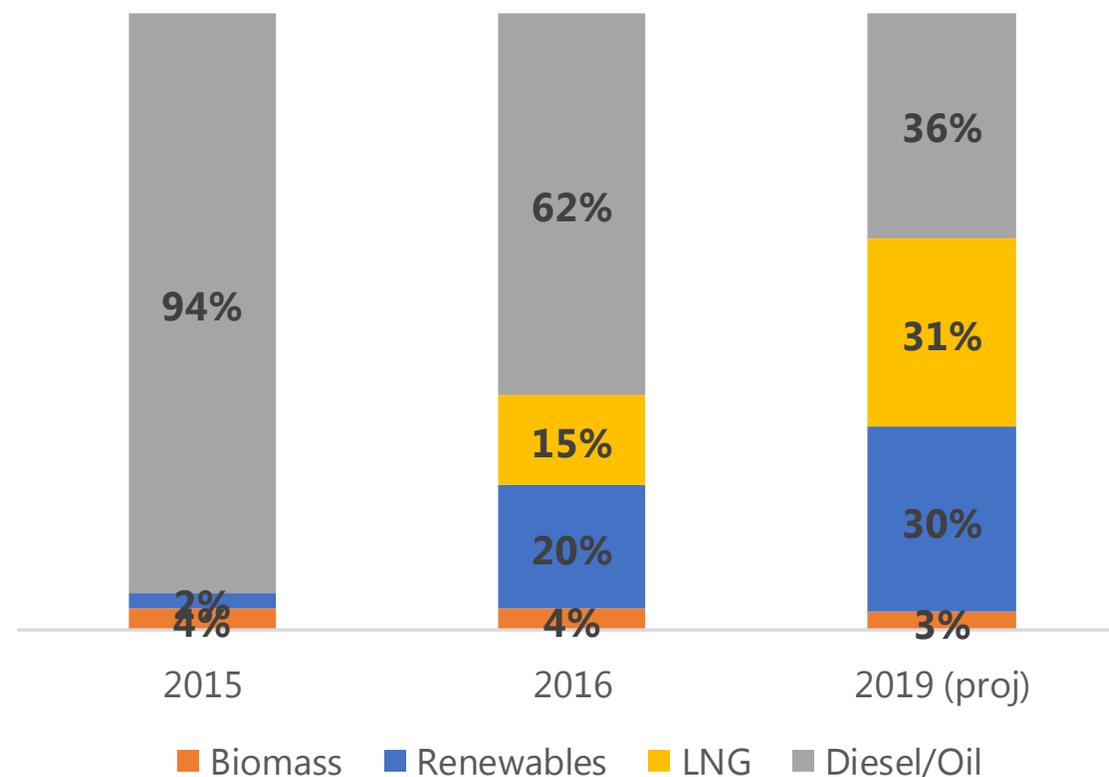
1/ Excludes T&T and Haiti

2/ Includes hydroelectric power, geothermal, solar/PV, wind, and biomass

3/ For the Caribbean, renewables include hydropower and biomass

Source: EIA; IDB: and IMF staff Calculations

## Jamaica: Energy Generation Matrix



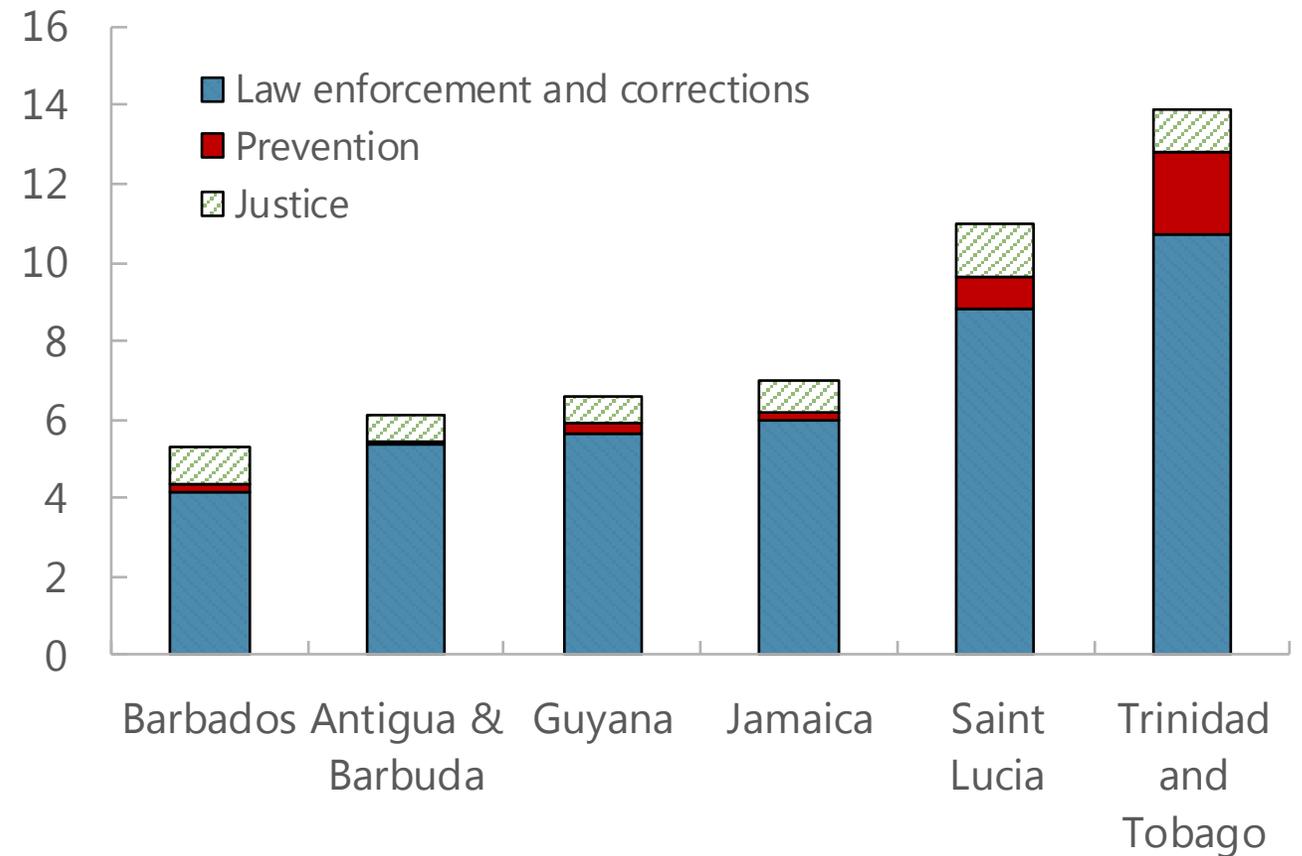
Sources: Jamaica Ministry of Science, Energy and Technology and IMF Staff calculations

## Tackling Crime helps growth: An integrated solution is necessary

- **Increase payoffs to legal activities**
  - Raising returns to education
  - Increasing formality
- **Prevention**
  - Parenting and mentoring programs
  - Vocational programs for youth
  - Urban renewal programs
- **Deterrence**
  - More effective policing
  - Swift criminal justice systems
  - Better targeting (data)

### Government Expenditures on Security

(% total government expenditure)

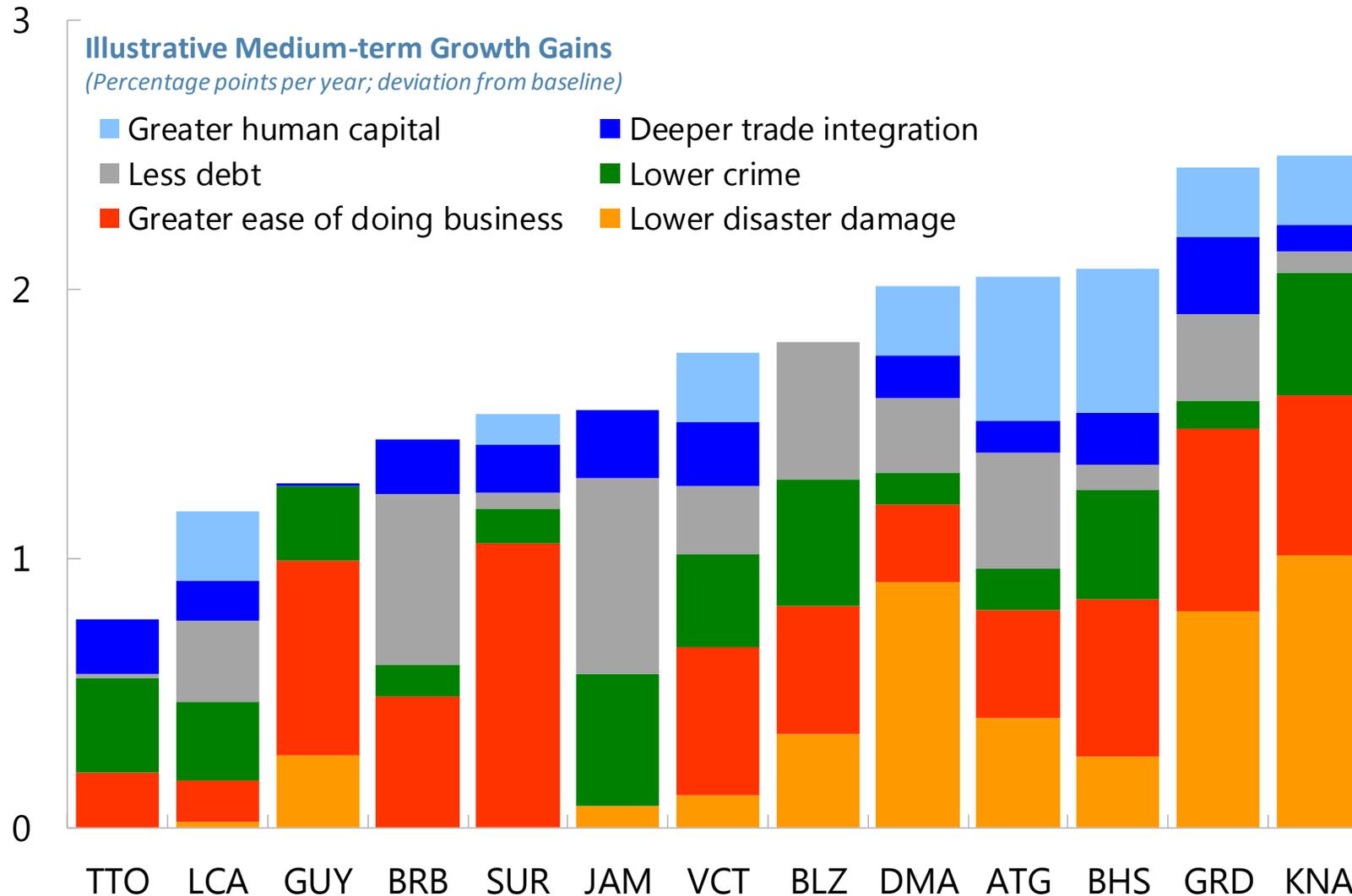


Source: 2012 Caribbean Human Development Report

## *Deeper Regional Integration has clear growth benefits !*

- Case for deeper economic integration remains strong – alleviates constraints of small size
- Empirical studies suggests that Caribbean integration process has been successful in fostering intra-regional trade. At the same time, intra-Caribbean trade has plateaued in recent years.
- Benefits of integration constrained by significant “implementation deficit” – capacity weaknesses and coordination failure ?
- Recent simulations (IMF) point to large potential gains from the completion of the CSME agenda, with most of the gains coming from reduction of remaining restrictions on movement of services, and factors of productions

# Reinvigorating Growth in the Caribbean: Structural Reforms payoff!



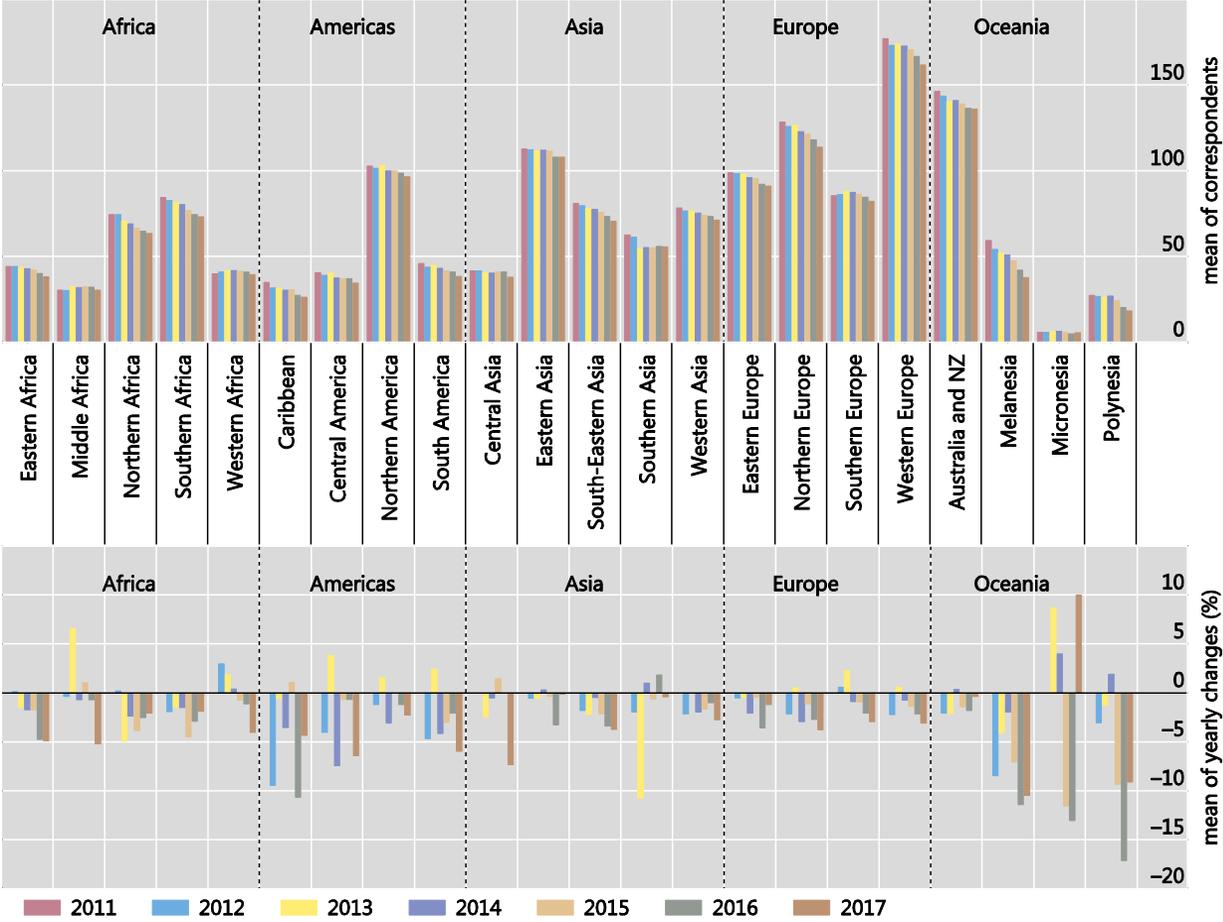
Sources: IMF Staff calculations

# New Policy Issues: (i) Risks to CBRs

- Why is this important ?
  - CBRs enable a range of crucial transactions and services, including the execution of third-party payments such as wire transfers and credit card transactions, trade finance,
  - Risks emerged Post Global crisis ! banks reduced their involvement in less profitable and riskier activities worldwide, including correspondent banking.
- Underlying drivers ??
  - advanced economy regulators' attempts to strengthen prudential regulations and enhance economic and financial stability;
  - their concerns about tax avoidance, money laundering, and terrorist financing; and
  - business decisions by correspondent banks in a new macroeconomic environment characterized by low interest rates and increased costs of regulatory compliance.

# While the Caribbean had some of largest CBR declines since 2011, it is now among the regions where the decline decelerated in 2017 compared to 2016 for USD CBRs

Average number of counterparty countries by region  
(Yearly average number)

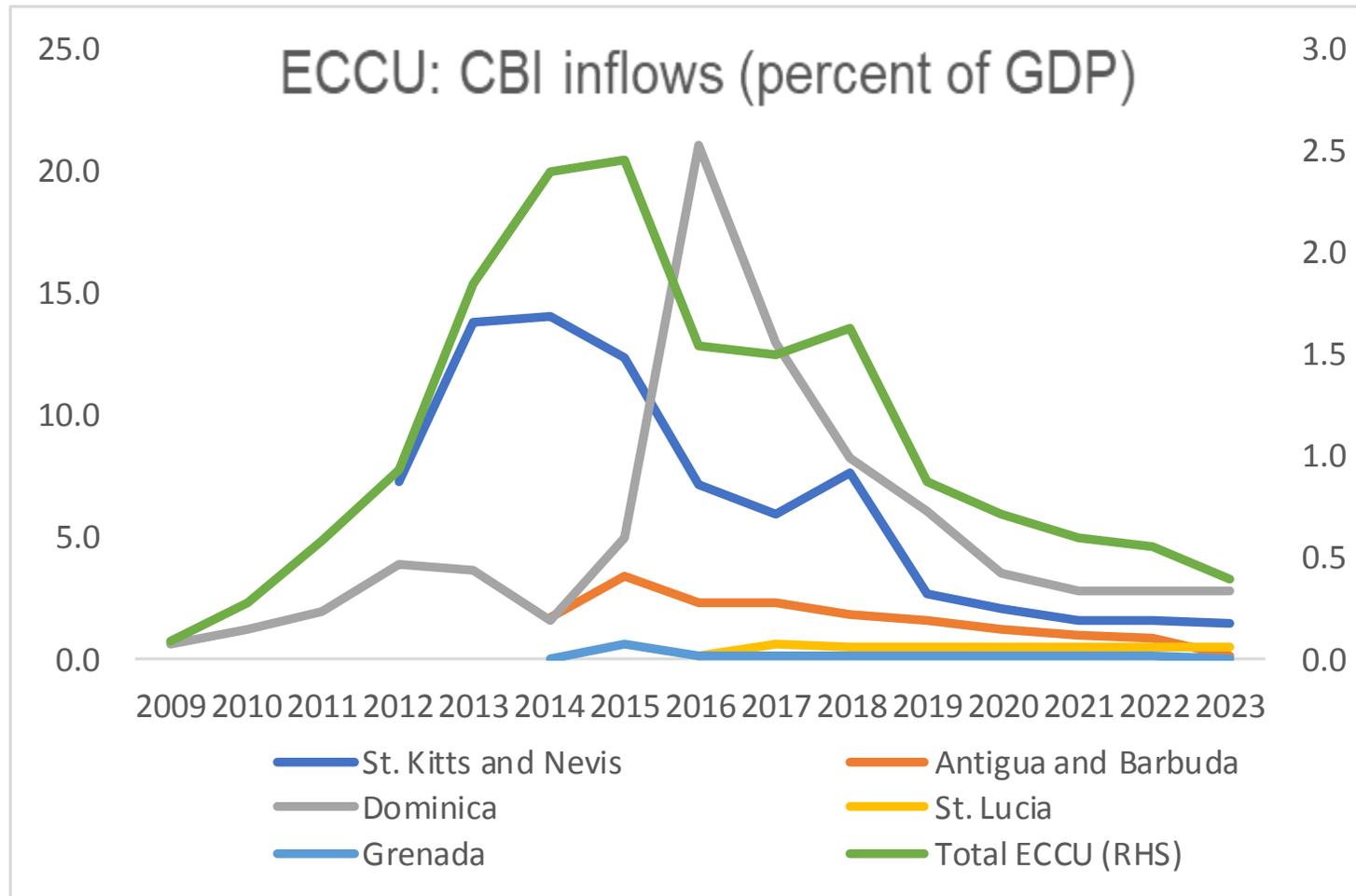


Source: SWIFT BI Watch, National Bank of Belgium.

# The overall macroeconomic impact is broadly contained. However,

- (i) CBR fees, transaction times, and customer due diligence costs have increased significantly in many countries and
- (ii) services and clients perceived as being of higher risk by correspondent banks—money transfer and check-clearing services, the gaming sector, firms involved in the citizenship by-investment programs, and credit unions—have not fully recovered CBRs
- Efforts must be sustained to limit the risk of further loss of CBRs including strengthening of AML/CFT frameworks
- Some countries have also embraced Fintech in response to the threat of CBR withdrawals. A few countries may be exploring launching cryptocurrencies, or digital versions of their national currencies, while others have engaged with private sector companies to explore the wider economic benefits of blockchain technology.

# New policy Issues (ii) Managing CBI Inflows



# CBI flows uncertain over the long-term: Prudent Framework needed

- Prudent fiscal management – not used to finance recurrent expenditures
- Build fiscal buffers including to natural disasters; fiscal savings (resilience fund)
- Investment in resilient infrastructure
- Reducing high public debt in highly indebted countries; (especially in cases where debt-service cost exceeds the potential rate of return on savings)
- Transparent reporting of all CBI revenues and CBI supported expenditures through the annual budget; and
- Rigorous due diligence of the process for citizenship applications is essential to preserve the credibility of CBI programs

## *Conclusions and Key Takeaways*

- **Macro stability is necessary but not sufficient**
  - Thin fiscal buffers to serve as shock absorbers
  - Strengthen macro fundamentals and fiscal sustainability
  - Strengthen financial sector – lower macro-financial risks
  - Minimize risks to CBRs
  - Prudently manage CBI revenues; reduce debt, strengthen resilience to natural disasters
  - Structural reforms are key to achieving stronger, sustained and resilient growth
- **Addressing structural impediments: Need multipronged approach**
  - Energy costs
  - Ease of doing business
  - Crime
  - Strengthen resilience to natural disasters
  - Deeper regional economic integration