

Can Medium-Term Economic Recovery in the Caribbean be Accelerated?

On April 6, Caribbean economists, financial analysts, business leaders, and a tourism/aviation expert met in Nassau, the Bahamas, to outline the road to economic recovery in the region. Participants strategized about proactive solutions and inward links to offset vulnerability to lackluster economic performance in the US and Europe, the Caribbean region's principal markets. Trade-offs between diversification and strengthening core businesses were explored, while the importance of remittances for investment, policy-based lending, and private-sector-led integration were viewed as integral to accelerating growth in the Caribbean.

Participants:

Warren Smith

CDB's director of finance and acting vice-president, who assumed the presidency of the Bank on May 1, 2011

Olga Kalinina

Director of Sovereign Ratings at Standard & Poor's (S&P)

Vincent Vanderpool-Wallace

Senator and Minister of Tourism & Aviation from the Bahamas

Eric-Vincent Guichard

Chairman & CEO of Washington, DC-based Gravitas Capital Advisors

Dennis Morrison

Senior Director of the Jamaica Bauxite Institute

Denny Lewis-Bynoe

Director of the CDB Economics Department

Carl Howell

the CDB's Country Economist

Craig Leon of

Institutional Investor served as moderator.



Warren Smith
Caribbean Development Bank

Moderator: Can you provide an overview of the Caribbean region, and the basis of the CDB's AAA rating?

Olga Kalinina, S&P: We have all witnessed the severe impact of the global crisis on the Caribbean. In terms of the rating impact, however, only three out of our nine ratings in the region, namely, Barbados, The Bahamas, and Jamaica, were downgraded. There were no crossovers into non-investment grade. We still maintain five ratings in the investment grade category, which starts at BBB-. We put a positive outlook on Montserrat's BBB- rating. Countries in the non-investment grade category such as Grenada and Belize maintained their credit ratings, Jamaica returned to a B- rating after a default in 2010, and commodity exporter Suriname improved its rating outlook despite the crisis.

We believe that the next economic cycle will bring us lower medium-term growth, rising interest

rates, higher fiscal debt, less liquidity and much less fiscal flexibility compared to the last cycle. Attracting foreign direct investment (FDI) will be a challenge, in terms of general appetite and affording tax and investment incentives that Caribbean sovereigns relied on in the past in competing for FDI.

About CDB. Since we first rated the bank in 2004, its rating has been AAA with a stable outlook. Its main strength is strong capitalization and shareholder support, reaffirmed by the 2010 general capital increase. Compared to the other multilaterals, the CDB has the highest share of new paid-in capital as a share of the announced capital increase, of 22 percent. That's real money and a credit positive; the rated multilateral with the next highest share, is CABEL, at 7 percent. Another factor is its well-performing portfolio and preferred creditor status. Impaired loans are minimal and the bank has never written off a loan. The bank's knowledge and understanding of the borrowing member countries

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(BMC's) is extremely important. After all, in some smaller jurisdictions the CDB is the only lender. An 80 percent increase in loan approvals and 54 percent increase in disbursements in 2010 over 2009 is indicative of the bank's important role in supporting the region's recovery. A lot of the recent lending was done through the policy-based loans (PBL's), in tune with policy challenges in the region.

Warren Smith, CDB: The recapitalization of the CDB is integral to our credit risk management strategy. From inception, we've fought for a high level of cash equity versus callable capital because our lending base is concentrated geographically and is therefore a highly correlated risk.

We are here to respond to regional needs, which are subject to volatility. With the onset of the recession, many BMC's were shut out of capital markets. Some turned to short-term financing from domestic financial institutions and foreign banks operating domestically, many of whom ran out of headroom very quickly as exposure limits were exceeded. Some lacked access to the IDB or the World Bank, so the only game in town was the CDB. Fortunately, we had the foresight to develop PBL's, which when you strip away the glitz and glamour, are a form of budgetary support underpinned by a matrix of policy reform measures.

Moderator: How can service-dependent Caribbean economies ramp up economic growth?

Vincent Vanderpool-Wallace, Tourism & Aviation Ministry, Bahamas:

The Caribbean is the most tourism-dependent region in the world, and The Bahamas, as far as we are concerned, is the most underperforming destination in the region compared to our potential. We have more islands, more beaches, more territorial waters than the rest of the Caribbean combined, yet Nassau and Paradise Island, which account for a mere 2 percent of the land mass, are what most people think of as The Bahamas. Why haven't we developed the other 98 percent? The answer is simple. It is the lack of low cost, high quality, high-frequency inter-island air and sea transportation. This is a problem we are fixing with some urgency.

The Bahamas introduced our Companion Fly Free program last year and sold over 450,000 room nights in a year. We call it the crack for the hotel industry, because now they refuse to get off it. During the financial meltdown in November 2008, we experimented with Spirit

Airlines offering \$99 roundtrip airfares including taxes from Florida. Never before and never since has Spirit Airlines had more hits on its website. We offered the same fare each way from New York in May 2009 with another carrier and got the same result, so we're not talking about the theoretical effects of low cost airfare, we're talking fact.

In the same vein, we must make it easier to travel and book that travel between islands. There are eight scheduled carriers in the Bahamas but they are invisible to the world because they are not in the GDS system, and of 280 hotels licensed here, only about 40 can be booked electronically.

As for financial services, there is new optimism for its continued growth and development. We now have Tax Information Exchange Agreements with 25 countries, which represents a substantial increase in one year following what the rest of the world expects of The Bahamas as a sophisticated financial services center. There is clearly an increase also in the range and quality of high quality services in the sector, befitting our perceived status, especially as regards our legal and accounting services.

Carl Howell, CDB: The issue of offshore financial centers is ticklish, given the stance the large countries have taken. You don't have full control, and engaging in the appropriate tax information exchange agreements sometimes isn't enough. Some countries including Trinidad and Tobago have decided to stay away from that game and are seeking instead to position themselves as international business centers.

Dennis Morrison, Jamaica Bauxite Institute: State/private sector alliances are critical to blow away restraints to investment activity. This is the best time because you get goods and services cheaper at the bottom of the business cycle than you would at the top of the cycle; professionals and other experts are more available, and you're more likely to meet your completion dates. Celebration Jamaica, a continuation of Palmyra Resorts in Montego Bay, is taking this approach as capital costs are attractive. The new Montego Bay Secrets Resorts development had this experience at the height of the recession in 2009.

Jamaica, as a producer of bauxite and alumina, needs to undertake investment to lower energy costs and modernize plant capacity to remain in business, much less expand. Happily, since November 2008, alumina and aluminium prices have doubled, but oil prices have also gone up.

Denny Lewis-Bynoe, CDB: To transition from the current cycle to the



Carl Howell
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Dennis Morrison
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next, we need to look more carefully at each country's experience and their binding constraints, because what works for the Bahamas is not necessarily right for Barbados in terms of product offering or proximity to markets. Yet there are commonalities, such as the need for training and better use of technology. The CDB has undertaken a number of capacity building initiatives, particularly in the area of macroeconomic management. CDB is supporting an e-government initiative to improve the interface of governments with the private sector.

Smith: The IDB recently produced an important document, "One Region, Two Speeds." Any comments on how the crisis has affected the region when we disaggregate it, and any suggested policy responses?

Howell: Just as some smaller planes cannot take off against strong headwinds, so the smaller Caribbean economies are struggling to take off during the current economic crisis. Let's look at Dominica: a small population, limited financial and human capital, and a difficult topography. To assist that country to expand its production frontiers, we have to look at skills development, and ensure that what they've got to sell is value for money. Once in Jamaica, I had Internet trouble and was diverted to an operator in Poland for assistance. Countries need to take advantage of information and communications technology to propel growth. Even relatively diversified Trinidad and Tobago is still seeking to expand its economic base. While the two-speed observation is on target, we must zero in on core attributes, particularly in relation to the quality of policies and institutions that drive each country's growth outcomes.

Eric Guichard, Gravitas Capital: A paradigm shift has just occurred in this discussion. We have tended to get caught up in the conventional wisdom that tourism is too narrow a focus and that diversification is the holy grail of economic stability. Instead, as shown by the Bahamas example, you need to assess the value proposition of your core industry. It would seem that a business/economics approach to development policy formulation is the most effective approach to crafting policy. Combining that with policy experimentation leads to better policy choices. This approach is portable from tourism to other parts of the economy.

In the region, there are two speeds, the big islands of Trinidad & Tobago, Jamaica and Barbados and that of the smaller islands of the Eastern Caribbean (OECS). The latter is still struggling with a structural impediment in public policy formulation that constrains the adoption of a problem-solving approach. Moreover, a growing consensus to

eliminate barriers to regional financing of various projects was dead on arrival because some key policy makers viewed financial integration as a systemic risk transfer mechanism.

Kalinina: Much-talked-about diversification is not a panacea, in my opinion. If one tries to reinvent the economic structure and invest in new sectors without addressing existing inefficiencies in the traditional sectors, this will not work. You've got to fix the infrastructure, address skills issues, ramp up training, cut red tape, think about alternative sources of energy, enhance cooperation between different sectors and support effective private/public sector dialogue. Sometimes crisis situations bring out the best solutions and inventions.

Morrison: The critical task is assisting governments with factors that make a difference to investors. In Jamaica and in other countries, a critical constraint is the inefficiency of the physical planning and the approvals process. If an investor wants to develop a tourist resort in Hanover, Jamaica for example, the government needs to respond on a timely basis with physical development plans for the area, density regulations, drainage constraints, and the issues on beach control. Yet in periods of tight fiscal constraints, governments tend to pull resources from activities vital to move the investment process forward. We also have to close the information gap relating to the business opportunities that can be generated from the broadening and deepening of linkages between tourism and the rest of the economy.

Lewis-Bynoe: The CDB is supporting the Inter-American Development Bank's Compete Caribbean initiative along with other donors. This program looks at the cost and ease of doing business in the region. It drills past the macro to a micro-level assessment of real obstacles. Then we can help governments address those issues. Guyana and Belize both did fairly well in the crisis because of their diversified economies and strength in agriculture, while Guyana's growth was partly related to elevated gold prices. St. Lucia and Jamaica fared well with tourism, and the Bahamas, Turks & Caicos, and the British Virgin Islands have started to do well since 2010.

Vanderpool-Wallace: There is no question that in the recent past, commodity-based economies have performed better than tourism-based economies in the region. But this need not remain so. In the case of The Bahamas, all of the investments that we are making



Denny Lewis-Bynoe
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today are setting us up to become a highly differentiated, multiple-island destination. We intend to become the Greek Islands of the Western Hemisphere, where you get off an airline or a cruise ship and move among these islands via fast ferries and other airlines with the greatest of ease.

Guichard: There is yet another needed paradigm shift. Western Union, the UN, the World Bank, and the US State Department have been tracking the explosive growth of remittances from the West to emerging markets. Some sources suggest that the Caribbean receives in excess of \$10-15 billion in remittance flows per annum, growing at an average of 10-12 percent, including 2008. These flows far outweigh FDI and official development aid combined. Conventional wisdom seems to suggest that these person-to-person flows are used by recipients for subsistence purposes. The reality, as recently revealed by a George Washington University study of Western Union data, is that a significant portion is motivated investment flows. The key challenge is to channel diaspora flows into reliable, transparent, well-structured investment opportunities that lead to development. The study also shows that this can be achieved through diaspora bonds and web-based solutions that offer access to public-private partnerships in infrastructure, health care, agriculture and tourism.

Moderator: Where does regional integration fit on the agenda?

Smith: This generation does not appear to be imbued with the ideological fervor for regional integration of the previous generation, but seems to be more interested in regional approaches that achieve results. A regional solution could be one such case in point. High fuel costs are pervasive across the region, impacting the competitiveness of traditional industries while limiting the possibility of new industries being created. Both Dominica and Nevis have substantial geothermal potential, and with current technology, this power can be transported using undersea cables. If these renewable energy sources are developed, these small Caribbean territories would become net earners while benefiting from cheaper energy, which would render existing industries more competitive and creating the basis for diversification into new industries. Significant reductions in the cost of energy would accrue to Barbados, St. Lucia, and St. Vincent and the Grenadines if the much talked-about natural gas pipeline from Tobago were to be built. We need to move from concept to implementation.

To bring skill levels up while driving down the cost of delivering quality



Vincent Vanderpool-Wallace
Minister of Tourism & Aviation,
The Islands of the Bahamas



Eric-Vincent Guichard
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education, we at the CDB are working on an exciting project with the University of the West Indies, called Single Virtual University Space. It uses technology to link the entire university system plus off-campus territories so that a student can sit in St. Lucia or anywhere else in the region and pick courses from the three campuses without having to go to the individual countries.

Vanderpool-Wallace: During my years at the Caribbean Tourism Organization, we got 30 countries and 33 Caribbean hotel associations to agree unanimously on a Caribbean audio logo, which was the sound of a steel pan, and to agree that all Caribbean destinations and private sector companies would carry the Caribbean logo in all their advertising. When the day comes that we all follow on that commitment, the voice of the Caribbean would be louder than any destination campaign in the world without having to spend a single dollar. We are confident that this region, for tourism promotion purposes, can become the United States of the Caribbean wherein unity does not require unanimity. And we are confident that it can become so through regional tourism organizations and cemented by government. By cooperating the Caribbean becomes a bigger deal, but we have to include the French, the Spanish, the Dutch and the English, reflecting the variety that is the Caribbean.

Moderator: What should the CDB's main focus be in its interface with BMC's in 2011?

Smith: All countries are coming out of this recession with baggage in the form of serious fiscal deficits. Despite making great sacrifices to widen social safety nets, poverty levels have increased. Our flagship poverty reduction program is the Basic Needs Trust Fund, a demand-driven, small community-based development program. It emphasizes the financing of very small infrastructure projects, health care centers, and among other things, skills-training for local people.

The CDB also has to work with countries to ensure their policies position them to catch the next wave of international economic growth by providing financing consistent with those policies. We cannot provide all the necessary resources, but as a small financial institution that purports to understand Caribbean problems, we must sell to financial institutions and multilaterals the case for working with the CDB and these countries. Ultimately, we must create the conditions for sound economic growth to sustain a reduction in poverty. ●