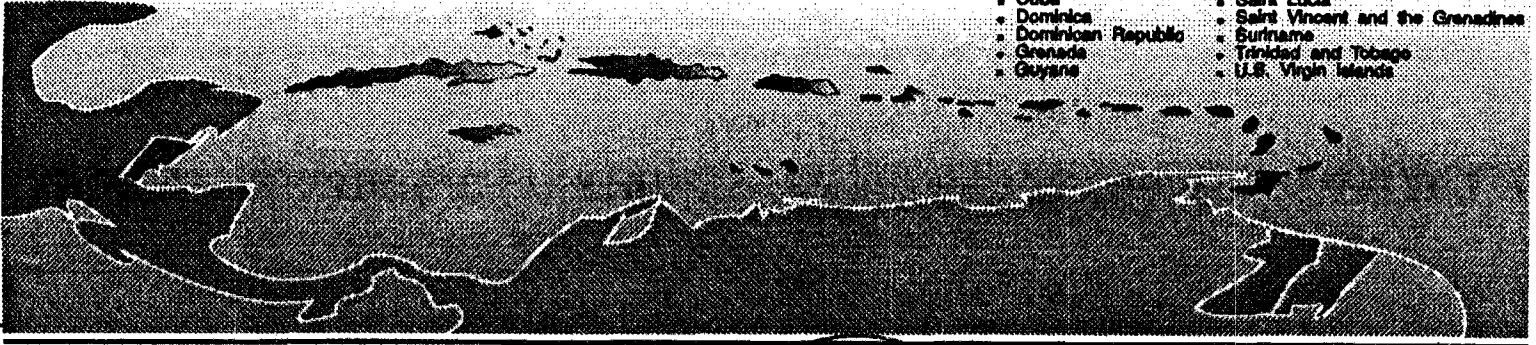




- Antigua and Barbuda
- Aruba
- Bahamas
- Barbados
- Belize
- Br. Virgin Islands
- Cuba
- Dominica
- Dominican Republic
- Grenada
- Guyana
- Haiti
- Jamaica
- Montserrat
- Netherlands Antilles
- Puerto Rico
- Saint Kitts and Nevis
- Saint Lucia
- Saint Vincent and the Grenadines
- Suriname
- Trinidad and Tobago
- U.S. Virgin Islands



GENERAL
 LC/CAR/G.477
 22 April 1996
 ORIGINAL: ENGLISH

**STRENGTHENING DEVELOPMENT. INTERACTIONS BETWEEN MACRO
 AND MICROECONOMICS**
 A summary, with comments on the Caribbean

24 JUN 1996



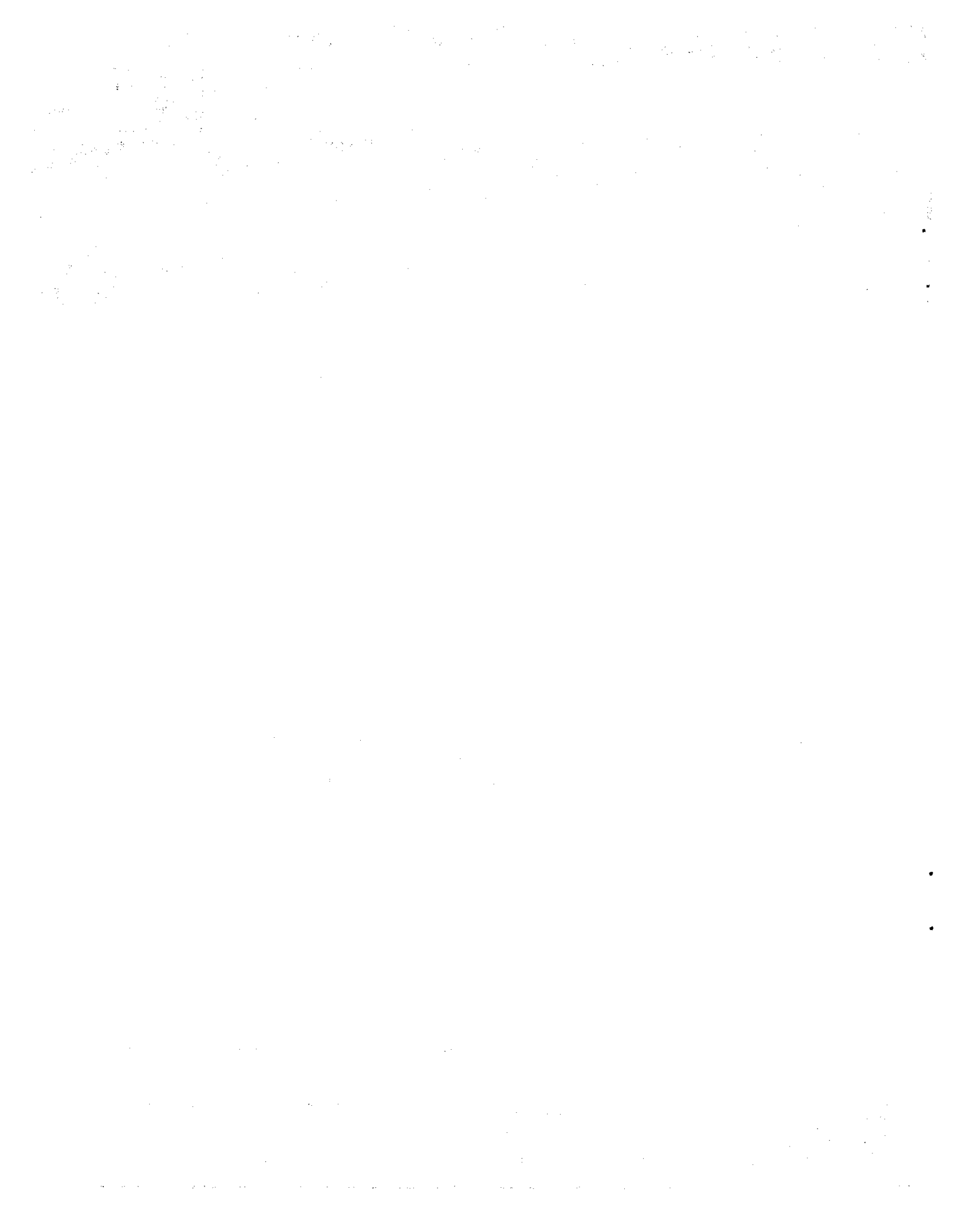


TABLE OF CONTENTS



INTRODUCTION		1
PART ONE: PERFORMANCE ASSESSMENT		1
I. Economic reforms		1
II. Macroeconomic stabilization		2
A. External adjustment		2
B. Capital flows		3
C. Recovery and stabilization		3
D. Fiscal adjustment		3
E. External capital and stability		4
F. The new macroeconomic panorama		4
G. Employment and social equity		4
III. Changing microeconomic patterns		5
IV. The savings and investment panorama		5
PART TWO: GUIDELINES FOR PUBLIC POLICY		6
V. Macroeconomic management for combining stability and growth		6
A. Macroeconomic policies		6
B. Technical progress, employment and growth		7
C. Export-led growth		8
VI. Policies for strengthening competitiveness and productive development		8
A. Criteria for public sector intervention in the productive process		8
B. The regional debate on productive development		8
C. Determinance of systemic competitiveness; and		
D. Development of systems of innovation		9
E. Export promotion policies		10
F. The role of cooperation in strengthening the entrepreneurial base		10
G. Promotion of competition and regulation of monopolies		10
VII. Policies to improve savings, investment and financial development		11
A. Promoting national savings		11
B. Creating a climate favourable to investment		12
C. Financial policies to boost development		12
CONCLUSIONS		12



900012195 - BIBLIOTECA CEPAL

INTRODUCTION

This document is intended to provide member countries of the Caribbean Development and Cooperation Committee (CDCC) with a brief summary of the substantive working paper prepared for the twenty-sixth session of the Economic Commission for Latin America and the Caribbean (ECLAC), entitled, "Strengthening Development. Interactions between macro and microeconomics". It also provides brief comments about specific Caribbean characteristics, where appropriate, to alert the reader where some nuance might be added to the general tenor of the paper.

The rationale for this ECLAC substantive paper is, taking into consideration the decade and a half of structural reforms in the region, to present both a report of process and a number of recommendations regarding it. Therefore, the ECLAC paper presents, in its first part, a description of the economic reforms applied in the region in the last decade and a half. In the second part, a set of suggestions to improve their effectiveness and maximize their results is attempted.

PART ONE: PERFORMANCE ASSESSMENT

I. Economic reforms

From the late 1940s to the early 1970s, the region achieved remarkable economic expansion patterned after a model with the following features: it was based on primary sector exports, a protected industrialization aimed to cater to domestic demand, the expansion and growing sophistication of private consumption and of government spending. The debt crisis of the 1980s and its evolution showed clearly the weaknesses of this model, notably the lack of an endogenous technological dynamic and the fiscal weakness. The reforms thereafter encompassed not only policies on a macroeconomic level, but reached also the very structure of the markets, institutions and economic agents. In spite of national specificities, a general trend was clear. New policies included macro stabilization policies, among them monetary and fiscal discipline, fiscal reform, trade liberalization, greater roles for market mechanisms, which included deregulation of labour and financial markets and privatization, and the encouragement of private investment, both domestic and foreign. The greater role of market signals leads to an almost complete disappearance of sectorial incentives and industrial policies. The development model as a whole changed, and the government's role in it was limited to assuring a stable macro environment, sending the right signals to the market and acting when market failures appeared.

Of course, specific, concrete reform strategies depended on the necessary degree of adjustment, the availability and amount of foreign resources (essentially public), the specific political, social and institutional conditions and also on the political considerations regarding the costs and benefits associated with the reforms. These various conditions also explain the very dissimilar results and degrees of comprehensiveness and success of the reforms.

Caribbean countries have also been implementing wide-ranging adjustment policies since the early 1980s. These policies included tighter monetary and fiscal policies as well as trade liberalization

and privatization policies. These new policies replaced those previously implemented for many years and which were characterized by the wide use of complex systems of controls including exchange and interest rate controls, selective credit controls and restrictions on trade and foreign investment. In some cases, both Central Government activities and State-owned sectors expanded quickly, and State-owned companies carried out wide ranging functions in the management of national economies and also in the productive sectors. These policies, combined with major international developments in the 1970s, resulted in strong economic disequilibria in some of the countries. For example, in Jamaica and Guyana, the first and second oil price shocks, declines in the prices of their primary commodities and rapid increases in their international debt required severe structural adjustment policies with negative effects on their economic performance in the 1980s. The smaller Caribbean countries of the Organisation of Eastern Caribbean States (OECS) implemented appropriate policy responses and achieved relatively high rates of growth. However, the preferential market access that these countries' exports enjoyed helped their strong performance.

II. Macroeconomic stabilization

A. External adjustment

The period 1982-1990 was marked by negative net external transfers for Latin America valued at 3.2 per cent of GDP, on average. In the second period, covering 1991-1994, Latin America received net positive transfers, valued at 1.5 per cent of GDP, on average. During the first phase, the main policy aim was to achieve a balanced current-account, through trade surpluses and undervalued currencies intended to assure profitability in the exporting sector and to reduce imports. This implied a reduction of the domestic demand and, in some cases, increased government indebtedness to sterilize the surpluses. During the second phase, the objective was to finance the balance of payments with capital inflows that enabled growing current account deficits. In this stage, the exchange rate was market-set and influenced by the level of inflows.

The level of debt, the availability of external resources, the ratio of transfers to exports revenues, the changes in terms of trade, the initial degree of integration, the fiscal domestic situation all generated different paths of external adjustment for different countries.

The net financial flows of bilateral and multilateral finance to the Caribbean, which were largely positive in the 1970s, experienced substantial decreases in the 1980s. Net private financial flows also decreased. Nevertheless, debt grew rapidly in those countries experiencing disequilibria. The debt servicing obligations of Jamaica and Guyana and their impact on the balance of payments and fiscal positions of these countries further complicated their adjustment programmes. After 1991, strong growth resumed in Guyana, though it remained sluggish in Jamaica.

B. Capital flows

The external financial constraints facing the region were relaxed in the late 1980s, following the application of the Brady Plan. The resumption of capital inflows, allowed some countries to incur in current account imbalances beyond sustainable levels, increased their vulnerability to external shocks and limited their policy options, due to the need to "sterilize" the inflows -i.e., to prevent them from adversely affecting domestic monetary policies, and causing a strengthening of several regional currencies. Nevertheless, the growth of exports and the resumption of inflows seemed to be a long-term tendency.

During the period 1989-1992, the Caribbean experienced a slight increase in net multilateral flows but net bilateral loans and private flows became negative or deteriorated further, despite the increase in foreign direct investment to several countries in the subregion. Net remittances, on the other hand, more than doubled during this period boosting the current account position of the balance of payments of some countries. Moreover, the foreign direct investment flows were no longer concentrated in the petroleum and petrochemical sectors in Trinidad and Tobago but seemed to have spread to other countries like Jamaica, the Dominican Republic and Saint Lucia. In 1994, private inflows to Jamaica, of a short-term nature, required sterilization, therefore further burdening the country's fiscal account.

C. Recovery and stabilization

As a consequence of increased capital inflows, the region as a whole began to grow again in the early 1990s. Investment rates increased, as did productivity levels, which enabled the region to withstand currency strengthening without loss of competitiveness. Increased productivity was made possible by increased utilization of existing physical capital with a more modest workforce.

The smaller Caribbean countries of the OECS experienced relatively high rates of growth throughout the 1980s, averaging between 4 and 6 per cent. However, from 1990-1994 their growth rates seemed to have slowed somewhat. Other countries like Guyana, Trinidad and Tobago and Suriname registered negative rates of growth in the 1980s. For the period 1990-1994, most Caribbean countries seemed to achieve better economic performance, with the exception of Barbados, Cuba and Haiti.

D. Fiscal adjustment

Substantial fiscal adjustment was achieved in the region during the 1980s, mainly through expenditure reductions, since the recession limited the opportunities to increase fiscal revenues. Only during the 1990s was more comprehensive fiscal reform attempted, and this took place in conjunction with a resumption of external financing, the reduction of real interest rates, new privatization policies and the economic recovery itself.

Most Caribbean countries have experienced fiscal deficits in the 1980s but policies shifted toward improved public savings in the 1990s. The policies included attempts to reduce current consumption, restructure taxation systems and reform the public sector.

E. External capital and stability

Latin American experience has shown the need to attract long-term investment and to avoid the negative effects of excessive inflows of capital. These include real exchange rate appreciation and higher interest rates generated by the sterilization efforts. Some countries have already implemented specific policies aiming towards this, among them a limited and gradual balance of payments liberalization, but the most effective response seems to be a sustainable and credible fiscal adjustment, allowing for a certain critical level of government investment and creating the right macro environment.

Macroeconomic stabilization policies and market reforms implemented in the Caribbean seem to have contributed to the recent increases in foreign direct investment. Also, there seems to have been an increase in portfolio investment, mainly as a result of the privatization of State-owned enterprises. Inflows in the Caribbean do not seem to include speculative capital and do not seem to be large enough, so far, to unduly affect monetary supply in the beneficiary countries, except in the case of Jamaica as mentioned before.

F. The new macroeconomic panorama

The early 1990s show a different macroeconomic picture in the region as a whole: smaller public deficits, tighter monetary control, higher employment and investment rates. This, together with a more friendly external environment and the appreciation of the domestic currencies, generated lower inflation rates. The Mexican crisis, in late-1994, showed the danger of unstable short-term capital inflows, but it seemed not to have had any long-term impact on the region's favourable prospects.

In general, the macroeconomic environment in the Caribbean has improved in the 1990s, although Jamaica, Guyana and Suriname still display relatively high rates of inflation. One of the factors contributing to the better economic performance of the smaller Caribbean countries in the 1980s was their ability to maintain a stable macroeconomic environment, in part because of the discipline imposed by their joint central bank, the Eastern Caribbean Central Bank (ECCB). These countries seem to be continuing the same policies, in spite of major external changes which are likely to have profound effects on their future economic performance.

G. Employment and social equity

The crisis of the 1980s increased social inequalities in the region. The recovery in the 1990s has not so far brought about any remarkable improvements, either in terms of employment or social equity.

In the Caribbean, unemployment and poverty seem to be more pronounced in the larger countries suffering disequilibrium in the 1980s, such as the Dominican Republic, Guyana, Jamaica and Suriname, where Product decreased significantly, real wages contracted and many social support programmes were curtailed because of fiscal contraction. Policies are being implemented in most Caribbean countries to create employment and reduce poverty but these have had limited impact, so far.

III. Changing microeconomic patterns

The productive structure created by the previous development model did not have an endogenous technological dynamic and the factories built were usually too small to benefit from economies of scale. Foreign investment brought in technology, both productive and managerial, but reducing the number of producers, increasing the level of concentration and therefore decreasing the level of competition on the region's protected markets. In spite of that, Import Substitution Industrialization (ISI) developed a cadre with professional and technological qualifications. However, since the late 1970s, the international technological frontier began to expand at an increased pace, rendering obsolete the regionally chosen technical patterns, while the debt crisis destroyed the financing part of the model.

The new, more open, pattern of international integration increased the already highly dissimilar productive structure of the region, even on an intra-sectoral basis. As a rule, export-oriented activities and sectors were pro-active and adapted much faster, while sectors producing for the domestic market lagged. The new micro-structure, in an environment almost devoid of any industrial policy of a sectoral nature, included: (i) organizational changes on a firm level which included concentration, in terms of markets and product lines; reduced domestic linkages parallel to increased external ones and new relationship patterns with the work force; (ii) changes in the market structures and in their regulatory frameworks, deregulation and greater flexibility; (iii) changes in the sectoral composition of the Product.

Caribbean countries are still in the process of turning their economies in market-driven ones. This process has not gone far enough to have significant effects on production structures, except in so far as export processing zones have developed a capacity in garments and electronic parts. Nevertheless, it should be stressed that this strategy should be just a step in the direction of a general liberalization. The traditional economic activities are still dominant, leaving their vulnerabilities unchanged.

IV. The savings and investment panorama

Savings and investment rates in Latin America suffered acute contraction during the 1980s. Even after the recovery of the 1990s, savings have not achieved their pre-crisis levels in most countries.

The studies carried out on savings point out that: (i) adequate macro and institutional frameworks enhance savings; (ii) real interest rates are not a major factor for the savings rate, perhaps because the region's agents are liquidity constrained, but they do induce a more efficient capital allocation; (iii) the substitution between private and public savings indicate the need to increase their complementarity; (iv) additional savings may be useless if external constraints are present; (v) devaluations have an ambiguous effect on public savings; (vi) external savings may be complementary to domestic, but they must be prevented from financing consumption instead of investment.

On the other hand, the determinants of investment seem to be (besides the usual ones in the economic theory, such as the marginal productivity of capital, or the ratio of its shadow-price to its market price), the right, stable macroeconomic environment. The region's entrepreneurs seem to be extremely risk-averse and the stability and predictability of the indicators seem to matter much more than their levels. Other factors affecting investment are the characteristics of the financial markets and the availability of adequate infrastructure. Since most of the region's economies are now near their productive frontier, additional growth will depend basically on the investment rate. A growth rate considered adequate to reduce the region's social inequalities would be of around 6 per cent per annum. This growth rate implies, based on the assumptions used concerning the productivity level and the total capital stock, an investment rate of around 28 per cent of regional GDP, or full 7 points above the current average. The composition of the saving rate that would finance this, or the relative roles of private domestic savings, government domestic savings and external savings, must be sustainable. A too high imported component would not be sustainable on a long term-basis and would increase the external vulnerability of the region, which indicates that a larger increase in the domestic savings component would be a better strategy.

Gross investment has been high in the Caribbean. For example, it exceeded 30 per cent in Antigua and Barbuda, Dominica and Saint Kitts and Nevis in the 1980s. National savings, on the other hand, vary widely and have always been far short of investment needs. They averaged between 11 and 24 per cent of GDP in the 1980s. Average Gross Domestic Savings for the period 1990-1992 was between 10 and 31.8 per cent while Gross Domestic Investment was between 14.6 per cent and 45.8 per cent for the same period.

PART TWO: GUIDELINES FOR PUBLIC POLICY

V. Macroeconomic management for combining stability and growth

A. Macroeconomic policies

Once the production frontier is reached, that is, the maximum possible output achievable from the most efficient combination of the given amounts of labour and capital in an economy, a more

stringent, consistent macro-management is a necessary, but not sufficient, condition for long-term growth. By 1995, the region was nearing this state.

Among the aims of an efficient set of macro policies are: (i) increase, in a sustainable, long-term manner, the output and the productive factors' (capital and labor) utilization rate; (ii) increase capital accumulation; (iii) increase productivity, via an increase in the productive factors' quality and an increase in the efficiency of their allocation.

Passive macroeconomic policies, those that just respond to external shocks, generate stop-and-go growth patterns, with only cyclical, static, increases in productivity restricted to the ascending part of the economic cycle. This produces an unstable capacity utilization rate with subsequent adjustment problems, internally reinforcing the external crisis. Instability could lead to increased inequality and encourage speculation, instead of production. To prevent these effects, a set of consistent active policies relating to the exchange-rate, monetary policy, fiscal policy, incentives policy, etc. can be used, with the objective of coordinating long-term development with short-run adjustment. The danger of an inconsistent set of policies, that add distortions to the economic structures, must be carefully avoided. Adjustment programmes based on a single variable, like a "nominal anchor" for the price level, usually a fixed exchange rate with a major currency, or excessively dependent upon short-term private external capital inflows have these features. They may call for other complementary policies, like the creation of stabilization funds that "sterilize" external price fluctuations, a gradual liberalization of the capital account and the use of temporary surcharges on export revenues.

Most Caribbean countries have implemented policies to stabilize their economies and improve incentives for private sector development. These policies seem to be beginning to yield encouraging results, despite occasional policy uncertainties or reversals. These uncertainties and reversals should be resisted to ensure that adjustments are sufficiently responsive to major changes in the external or internal environment. It is through sustainable fiscal and balance of payments positions, low inflation rates and liberal trading policies that the countries of the subregion will add flexibility and efficiency to their economies.

B. Technical progress, employment and growth

Rapid, sustainable growth is the only way to reduce social inequalities and generate jobs. The region is in a situation that enables it to achieve quick technological progress, since: (i) the gap is still large between many of the region's economic activities and the international technological frontier; (ii) natural resources are still available that could be processed with adequate technology and entrepreneurial spirit; (iii) some technological capabilities generated in the previous development phase can still be utilized; (iv) a relatively qualified work force is available. But in order to turn possibility into reality a systemic effort encompassing productive agents from the major economic sectors and a general increase of the saving and investment rates is necessary. Only in this way will growth rates be fast enough to also counteract the increase of the capital/labour rate. An increase in systemic productivity would imply: (i) an increase in the linkages between the modern sectors and the

rest of the economy; (ii) a spread of technological progress to backward sectors; (iii) improved human capital; and (iv) improved physical capital.

It is estimated that Caribbean countries are enjoying rapid improvement in factor productivity and that 68 per cent of their real GDP growth between 1979 and 1990 was due to total factor productivity growth. Nevertheless, the application of suggestions mentioned in the previous paragraph will contribute further to the improvement of productivity growth.

C. Export-led growth

Accelerating growth also implies a higher degree of integration into the international economy. This means growth rates of exports, and also imports, far above the current levels achieved within the region. To achieve this, a diversification effort away from the traditional export products and sectors to more sophisticated, dynamic, higher value-added activities is necessary.

Caribbean countries' integration into the global economy is already very high, judged by the fact that trade ranged from 154 per cent of Product in Antigua and Barbuda to 62 per cent in Trinidad and Tobago. Export-led growth is accordingly particularly relevant to Caribbean countries which, because of their small domestic markets, are highly dependent on the international markets to achieve economies of scale.

VI. **Policies for strengthening competitiveness and productive development**

A. Criteria for public sector intervention in the productive process

Active policies in Latin America are justified for several reasons. The first is the generalized and increasing productivity differential between the region and the developed world, which is 3-5 to 1 for labour and between 2-3 to 1 for Total Factor Productivity (TFP). Second, is the fact that this very gap, paradoxically, could enable a NIC-like fast growth process. Third, the static nature of the latest productivity increases in the region. Fourth, the continuing dependency on primary commodities exports, products with very unstable international prices. Fifth, the existence of incomplete and imperfect markets and a low-level linkage within the region's economies. Sixth, the limited learning capability in the region.

Most of these characteristics apply equally to the Caribbean countries, although data would suggest a different -smaller- productivity gap.

B. The regional debate on productive development

Market-opening has not, by itself, eliminated the region's productivity differential. This fact has generated a still unfinished regional debate that asks if the current re-specialization process will lead to a more balanced development pattern or to one that will keep the traditionally heterogenous

regional productive structures. It enquires about its effects on growth and social inequalities, and whether the resulting allocation of resources is really the optimum one.

The adjustment process has dramatically reduced the number of available development policy tools. The remaining ones are supposed to be neutral and horizontal, that is, non-discriminatory. They are prescribed only in the face of market imperfections and externalities. But, since, as noted above, consistent macro-policies are necessary, but not sufficient, condition for long-term growth, the need for institutions, regulatory structures and an adequate, consistent set of incentives and specific development policies is also recognized. Nevertheless, active policies must be considered together with the dangers and high costs of government intervention, clearly demonstrated from the region's recent past.

Market failures, including the existence of externalities, should be carefully handled so that policy failures are not substituted for market failures, as they have been so often in the past in the Caribbean region.

- C. Determinance of systemic competitiveness; and
- D. Development of systems of innovation

The determinant factors of competitiveness have changed from labour costs and natural resources availability to the quality of the workforce and the technological capability of firms. Competitiveness depends in a great degree on the existing regulatory and incentives framework and on the systemic sophistication and integration achieved in a society. An advisable combination of macro-meso-micro actions to enhance this would be: (i) to keep a stable macro environment and a stable incentives framework; (ii) increase both savings and investment rates, parallel to a deepening of both financial markets and financial institutions and a boosting in their responsiveness; (iii) develop a national innovation system, creating networks encompassing all relevant agents, governments, universities, research institutions, firms, investment banks, etc.; (iv) apply incentives for an adequate human-capital accumulation; (v) strengthen private sector-agents, specially small and medium enterprises; (vi) development of an adequate physical capital infra-structure; (vii) implement horizontal, unified development policies, compatible with international commitments; (viii) creation/regulation of legal frameworks and institutions to promote and regulate competition.

Regarding item (iii), a national innovation system, the network and the series of positive feedbacks generated between its components, governments, universities, research institutions, firms, investment banks, etc., is simply non-existent in most of the region, since technology is externally supplied. Its development, sharing, risks and resources among government and private sources, is a basic need, but without going to the extreme of privatizing research. As previous experience has shown, in an activity with such a high degree of externalities, the market is not an adequate institution to correctly evaluate all its costs and benefits. The formation of a basic scientific/technological infrastructure, strongly linked to the private sector is, however, essential. Activities of technical "extension" to private firms are a great component of it, since they increase the general demand for innovation. The increasing qualification level of the work force is also crucial, since it makes the

whole productive structure more flexible and prepared to adjust to ever-changing market conditions. The components of education and training must be decided in such a way to recognize supply/demand requirements, involving all relevant agents, workers, firms, governments, educational institutions. This is fundamentally linked to the structure of the educational sector, which must be able to cater for this demands. Complying with international standards is also a step in this process, besides the fact that this is also necessary for a greater degree of international integration.

These suggestions apply equally to the Caribbean and would assist the countries in developing the necessary capacity to adapt to the rapid technological changes which are taking place and are likely to continue in the future. However, because of small size, there might be practical limits on the capacity to generate indigenous solutions.

E. Export promotion policies

Support to exports is justified by several factors: the need to counteract the still prevailing anti-export bias of the previous development model, the pull-effect to other economic activities, the reduced scale of the domestic market and the learning opportunities abroad. The need of an active policy is justified by the tendency of the domestic firms to concentrate on a limited set of traditional, vulnerable products. Besides financial and tax incentives, this support must also have an institutional dimension in the fields of information and productive networking. Internationalization implies the need to create alliances with foreign partners and to invest abroad, along the lines of productive chains, heightening also for the firms the need to up-grade exports to more sophisticated, higher value-added products. This, plus the need to adapt to the new sets of international rules regarding export support practices, means that the official institutions in the area must undergo a serious reform.

Caribbean countries have made significant progress in reforming their trade policies. However, they are still applying relatively high import tariffs, combined with other trade restricting measures which may be maintaining a bias against exports, notwithstanding the fiscal and other incentives which are now widely afforded to Caribbean exports. Caribbean exports are still dominated by the traditional export products and diversification into other products may be hampered by the existing trade and other incentive policies. Further reform of these policies would therefore be useful.

F. The role of cooperation in strengthening the entrepreneurial base

An internationalization process implies the need to create or develop stronger links between the public and private sectors and between the private sector agents themselves, since this would ease the difficult process of external projection.

G. Promotion of competition and regulation of monopolies

Competition is an essential component of productive development. It must be understood as a way to improve the aggregate welfare of a given society. Means to increase it are: (i) deregulation

of already competitive markets; (ii) regulation of markets where there are natural monopolies or market imperfections, like externalities; (iii) deepening and broadening incomplete, underdeveloped markets. Item (ii) is a particularly difficult and timely one, because of the questions arising from the privatization processes in the region and the lack of a consensus on the most appropriate regulatory procedures, due to questions of asymmetric information and moral hazard. Whenever this is economically feasible, former State monopolies must be broken up into their component activities before privatization, avoiding the creation of private monopolies, and the regulatory procedure chosen, which must be clear and transparent, must aim to enhance investment and technological development. They must also enable basic universal access to the services/products supplied.

Despite efforts aimed at the liberalization of markets in the Caribbean, these remain relatively highly regulated and both private and public monopolies still exist in some of the countries. Deregulation and other policies to improve competition in these markets are especially important in the Caribbean where because of the small size of the market monopolies and their attendant inefficiencies are easily introduced.

VII. Policies to improve savings, investment and financial development

A. Promoting national savings

The policy chosen must aim to promote all the different components of domestic savings: First, to increase private savings through means other than real interest rates, due to the low regional responsiveness to real interest rates. This could be done by institutional mechanisms, like heightening saving mechanisms linked to home-ownership, reforming the pension-funds from a "pay-as-you-go" public system to a capitalized, private one. This would also solve a long-term problem of future State liabilities, albeit at the cost of causing some short-term increases in expenditure, since the State is supposed to finance the costs of the transfer from one system to the other. Means should also be explored to increase savings by firms, by transferring taxes from firms to individuals. The total final effects of this last measure are uncertain, however, due both to the likely reduction in individual private savings and the higher effectiveness for firms of direct incentives to investment. Second, to increase public savings by consolidating fiscal balance on a permanent basis. Here we assume that increased public savings are not going to be offset by reduced private savings. Additionally, we should try to minimize the external savings component, since it could reduce domestic savings and be channeled to consumption, not investment.

An examination of average domestic savings and average domestic investment reveals the inadequacy of savings in the Caribbean. The countries of the subregion therefore depended heavily on foreign savings to finance investment and enhance their economic performance. In general, gaps between investment and savings tended to be larger in the smaller Caribbean countries. Policies to promote domestic savings are, therefore, necessary and the implementation of the suggestions above may help in that regard. In the implementation of policies to promote savings, it would be useful to take into consideration the weak link between interest rates and savings since this seems to have

been found to be true in the experience of the countries of the Caribbean, as it was in the case of Latin America. The experience in the subregion also shows that there is a trade-off between domestic saving efforts and foreign savings mobilization and this should be addressed.

B. Creating a climate favourable to investment

As pointed above, the best single incentive to investment is a stable macroeconomic framework, with clear, correct signals from the government regarding the fundamental indicators. Reconstruction of the neglected regional infrastructure, in partnership with the private sector, would also be desirable where possible. These suggestions are also relevant to the Caribbean

C. Financial policies to boost development

A fully functioning financial sector, that efficiently intermediates resources between savers and lenders is essential, but all the elements that lead to this must also be addressed, starting, one more time, with a stable, adequate, macroeconomic framework. This implies: (i) policies of financial deregulation and liberalization, to deepen financial markets; (ii) policies aiming to create financial institutions in incomplete markets, for example segmented financial markets for small and medium-sized enterprises in the region; (iii) adequate policies of prudential regulation and supervision, to avoid systemic crisis and to maintain confidence in the soundness of the national financial system.

There is scope for a more efficient and more advanced intermediation system in the Caribbean. The suggestions made would assist in improving the financial system making it better able to respond to the development needs of member countries.

CONCLUSIONS

The whole set of suggestions presented are all relevant for the Caribbean. Nevertheless, some historic and structural specificities of the subregion might justify adding some nuances to the general recommendations, taking into consideration the expertise available inside the ECLAC Subregional offices.

•
•
•
•

•
•
•
•

