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FOCUS

Magazine of the Caribbean Development and Cooperation Committee (CDCC)

CARIBBEAN ECONOMIES

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ABOUT ECLAC/CDCC

The Economic Commission for Latin America and the Caribbean (ECLAC) is one of five regional commissions of the United Nations Economic and Social Council (ECOSOC). It was established in 1948 to support Latin American governments in the economic and social development of that region. Subsequently, in 1966, the Commission (ECLA, at that time) established the subregional headquarters for the Caribbean in Port of Spain to serve all countries of the insular Caribbean, as well as Belize, Guyana and Suriname, making it the largest United Nations body in the subregion.

At its sixteenth session in 1975, the Commission agreed to create the Caribbean Development and Cooperation Committee (CDCC) as a permanent subsidiary body, which would function within the ECLA structure to promote development cooperation among Caribbean countries. Secretariat services to the CDCC would be provided by the subregional headquarters for the Caribbean. Nine years later, the Commission's widened role was officially acknowledged when the Economic Commission for Latin America (ECLA) modified its title to the Economic Commission for Latin America and the Caribbean (ECLAC).

Key Areas of Activity

The ECLAC subregional headquarters for the Caribbean (ECLAC/CDCC secretariat) functions as a subregional think-tank and facilitates increased contact and cooperation among its membership. Complementing the ECLAC/CDCC work programme framework, are the broader directives issued by the United Nations General Assembly when in session, which constitute the Organisation's mandate. At present, the overarching articulation of this mandate is the Millennium Declaration, which outlines the Millennium Development Goals.

Towards meeting these objectives, the Secretariat conducts research; provides technical advice to governments, upon request; organizes intergovernmental and expert group meetings; helps to formulate and articulate a regional perspective within global forums; and introduces global concerns at the regional and subregional levels.

Areas of specialization include trade, statistics, social development, science and technology, and sustainable development, while actual operational activities extend to economic and development planning, demography, economic surveys, assessment of the socio-economic impacts of natural disasters, climate change, data collection and analysis, training, and assistance with the management of national economies.

The ECLAC subregional headquarters for the Caribbean also functions as the Secretariat for coordinating the implementation of the Programme of Action for the Sustainable Development of Small Island Developing States. The scope of ECLAC/CDCC activities is documented in the wide range of publications produced by the subregional headquarters in Port of Spain.

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Barbados	Saint Kitts and Nevis
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Dominican Republic	Suriname
Grenada	Trinidad and Tobago
Guyana	

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DIRECTOR'S DESK:

CARIBBEAN ECONOMIES

In 2015, the world economy experienced economic growth of three per cent. While such growth was positive, it was relatively lower than the growth rates commanded in 2013 and 2014, which stood at 3.2 per cent and 3.4 per cent respectively. This dampening of economic growth was largely influenced by the precipitous decline in international commodity prices, which have caused the contraction in economic activity in several emerging economies.

This issue of the Focus critically examines issues impacting on the growth and sustainable development of Caribbean economies. Low commodity prices, over the mid 2014 to the third quarter of 2015, have impacted the Caribbean islands differently. The commodity exporters, more specifically the oil exporters (Suriname and Trinidad and Tobago), have been plunged into economic recession as a consequence of what seems to be an emerging new normal of low oil prices. As regards the service economies, low oil prices have impacted these favourably, resulting in 1.6 per cent growth in 2015 and an estimated 2.5 per cent growth in 2016.

Apart from the bearish commodity price outlook, 2016 was also characterised by positive strides in global sustainable development and commitment to climate change action. Indeed, since their adoption by the UN General Assembly last September, the Sustainable Development Goals (SDGs) have succeeded the Millennium Development Goals (MDGs) to become the new benchmark for development effort over the next 15 years.

The SDGs, though broader in scope, still maintain fundamental MDG objectives, significantly the elimination of extreme poverty, and inequality by 2030. National governments are expected to align their development plans to the SDGs, and to develop strategies to implement them.

Furthermore, progress has also been made in the area of climate change. The landmark Paris Agreement adopted at the Twenty-first Conference of the Parties (COP21) in December 2015, entered into force on November 4, 2016. Countries have agreed to work to limit global temperature rise to well below 2 degrees

Celsius, and to strive for 1.5 degrees Celsius. The Paris Agreement recognizes the multi-level nature of the climate change problem, and seeks to pool efforts of all stakeholders in pursuit of climate change mitigation and adaptation action.

For the Caribbean region, the Paris Agreement may act as a crucial driver for the scaling up of climate change action. Furthermore, ECLAC has taken the lead in creating an avenue for Caribbean economies to increase access to global climate change finance to build green industries, improve efficiencies, and strengthen their resilience to climate change.

The Caribbean region is also grappling with high public debt. In fact, the goods providers experienced an average debt to GDP ratio of 55 per cent by 2015; while the service providers' debt to GDP ratio was over 70 per cent the same year. Given the challenge of high debt and the difficulty Small Island Developing States (SIDS) face in accessing climate change finance, ECLAC has proposed a debt buyback scheme for the Caribbean. This plan would be brokered through the Green Climate Fund (GCF), to purchase the debt of the countries. The recipient countries would in turn allocate their previous debt service payments to a Resilience Fund, which may be used to finance climate change adaptation and mitigation projects.

In the financial sector, 2016 also saw the restriction of correspondent banking relationships (CBRs) of banks in the Caribbean subregion. This practice by the large multinational banks is termed "de-risking", since it restricts business relationships with clients or category of clients considered to be "high-risk". In

this regard, ECLAC is currently studying the 'de-risking' phenomenon, with a view to assessing its economic impact not only on the financial sector but on the spill-over into the real economy, particularly on export-based production of goods and services.

We are also examining the impact on the Caribbean of the unanticipated decision by referendum for the UK to leave the European Union. This unexpected 'yes' vote triggered immediate short term negative effects on the British economy; in the aftermath of the vote, the pound depreciated by just under 12 per cent; the prices of securities linked to the UK declined; and Britain saw a reduction in its sovereign bond credit rating from Standards and Poor, and Fitch.

For the Caribbean, there was speculation that the Brexit could result in negative spill-over effects on international trade; tourism; remittances; and development cooperation. This edition of Focus will explore the likelihood of lasting impact of Brexit.

ECLAC is poised to play a role in the provision of technical support to Caribbean economies, to help them address these current, as well as emerging, economic challenges, as the region strives to build a sustainable and prosperous future. I trust you will find this edition a compelling read.

Yours in Focus

Diane Quarless



THE CARIBBEAN DEBT CHALLENGE SINCE THE GLOBAL CRISIS OF 2008 AND CONSEQUENCES

Dr. Dillon Alleyne

This article examines the high debt burden in the Caribbean since 2008 and considers its sources and implications for medium term growth. The accumulation of debt is not itself an issue as many countries have been able to use debt financing to achieve long term development. The challenge arises when the debt burden is unsustainable, meaning that the countries are unable to stabilise their debt and meet new borrowing requirements while posting positive growth.

The Caribbean finds itself in circumstances of persistently high debt, reduced global demand for its exports and little prospect for accessing concessionary finance. In these circumstances, unless there is some debt relief, Caribbean countries could remain in the high-debt low-growth spiral in the foreseeable future. The next section examines the evolution of the debt since the global crisis and compares the Caribbean's debt profile with that of other Small states.

THE EVOLUTION OF CARIBBEAN DEBT

When the debt profile of the region is examined for the period 2008-2015, two things become clear. Firstly, the debt to GDP ratio has increased for the Caribbean despite fiscal consolidation efforts aimed at increasing revenue and constraining expenditure.

Secondly, there is considerable variation between the debt burdens of the services versus the goods producers in the region and not all countries face the same constraints. On one hand, the goods producers, as observed in Figure 1, have stabilised their debt to GDP ratio at about 50 per cent, although in the last two years their debt to GDP ratio has increased in light of falling revenue from commodity exports. On the other, in 2013, the services producers posted a debt to GDP ratio in excess of 81.8 per cent. This has subsequently fallen slightly in light of adjustment efforts

either under the IMF or through home grown adjustment programmes. When the Caribbean debt burden is compared with that of the rest of small economies (ROSE) the situation appears to be unique as the latter have a lower average debt burden. However, their average debt to GDP ratio has increased after 2010, which suggests that all small states have been experiencing negative external shocks.

THE HETEROGENEITY OF THE DEBT STRUCTURE

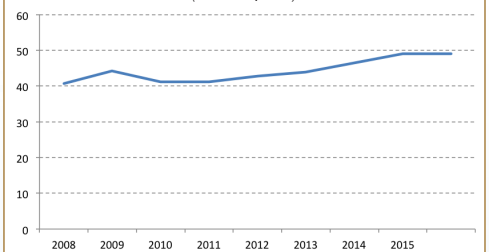
Apart from the variation in debt burden between the service and good producers, there are other differences in the debt profile of member states worth mentioning.

To illustrate, while the average debt to GDP ratio for the region was 71 per cent in 2015, six countries had debt to GDP ratios between 78 and 139

per cent of GDP. At the same time, three countries had ratios between 62 and 77 per cent with the rest falling beneath this threshold. Among the most indebted countries relatively large primary surpluses are required to stabilize the debt and this itself may be stifling growth.

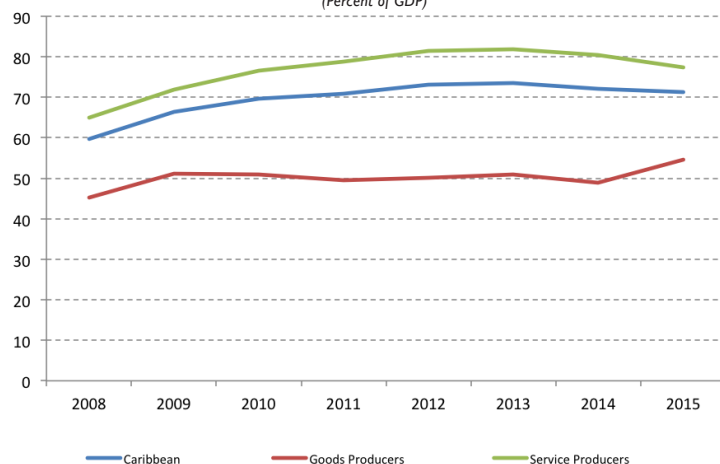
In the figure below the relative size of the external and domestic debt is reported. The external debt requires foreign exchange for the repayment of principal and interest with such rates

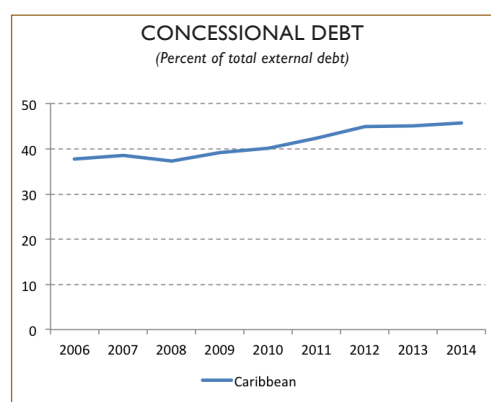
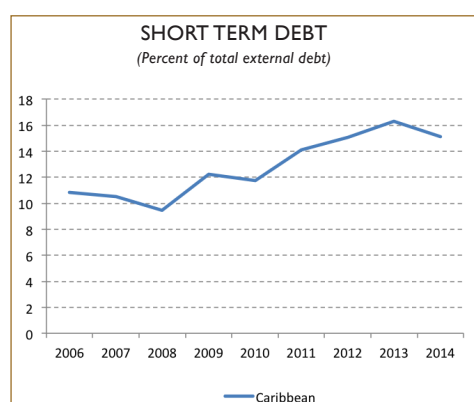
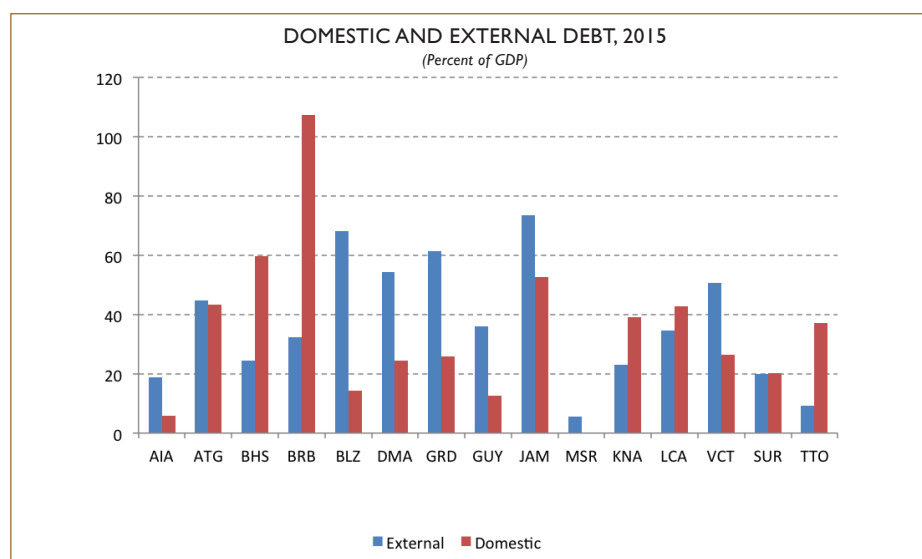
ROSE TOTAL PUBLIC DEBT AVERAGE, 2008-2015
(Percent of GDP)



Source: International Monetary Fund World Economic Outlook Database, October 2015
NOTE: ROSE = rest of small economies

CARIBBEAN TOTAL PUBLIC DEBT, 2008-2015
(Percent of GDP)





subject to change over time. At the same time, the internal debt keeps interest rates high and diverts investment from productive activities, since government instruments may be more profitable for investors. In the case of The Bahamas, Barbados, Saint Kitts and Nevis, Saint Lucia and Trinidad and Tobago the share of domestic debt is relatively large while for most other countries the external debt is a significant share of the total.

Debt service costs for the region are also significant since high debt increases risks to creditors who in turn impose a higher risk premium on borrowers. In terms of debt service relative to revenue, while Jamaica is

an extreme case with 62 per cent,¹ a number of countries have high debt service payments to revenue ratios. These include Barbados (55 per cent), Antigua and Barbuda (51 per cent), and Saint Vincent and the Grenadines (33 per cent).

The debt repayment is more immediate depending on the proportion of long term versus short term debt² and the amount of concessionary³ finance that countries can access.

The figures above suggest that short term debt has been rising for the Caribbean since 2008. In addition, concessional debt to total external debt has not grown between 2008 and

2013. The fact is, however, that most Caribbean countries are not eligible for concessional finance because of their middle income status. It is for this reason that a majority of countries have a sizable portion of debt owed to the private creditors, whether external or domestic. Examples of these are Barbados, Belize and Jamaica.

THE SOURCES OF DEBT ACCUMULATION

In order to properly address the high debt overhang and stimulate long term growth, it is important to determine the factors that influence debt accumulation in the Caribbean since the global crisis of 2008.

Five key factors are identified here.

First, Caribbean growth rates have been sluggish and this has meant a lower capacity to generate revenues for debt service. Slow growth has been the result of lower tourism receipts in the case of the service producers, and more recently lower commodity prices in respect to the commodity producers. In addition, FDI flows to the region have also been declining and only a few sectors have been able to attract significant FDI inflows. This has impacted negatively on production, employment and consumption resulting in overall meagre growth, which cannot significantly reduce the debt burden over the medium term. In fact, except for 2014, the growth rate across the Caribbean has been less than 1.8 per cent.

► (continued on page 13)

¹ Additional interest payments were also made in this year.

² Short term debt (per cent of external debt) - Short-term debt includes all debt having an original maturity of one year or less and interest in arrears on long-term debt. Total external debt is debt owed to non-residents repayable in currency, goods, or services. Total external debt is the sum of public, publicly guaranteed, and private nonguaranteed long-term debt, use of IMF credit, and short-term debt.

³ Concessional debt - Concessional debt to total external debt stocks. Concessional debt is defined as loans with an original grant element of 25 percent or more.



AN EXAMINATION OF THE POSSIBLE IMPACT OF BREXIT ON CARIBBEAN ECONOMIES

Sheldon McLean

There is no disputing that the political and economic uncertainty that has accompanied the United Kingdom's (UK) 23rd June 2016 referendum vote to leave the European Union (a phenomenon aptly referred to as Brexit) has dampened global confidence, and weakened a nascent global economic recovery.

The magnitude of the negative economic shock that Brexit has had on the global economy, as well as on the economic and political dynamic of the European Union (EU), the world's second largest economy, cannot be ignored. The unexpected 'yes' vote has introduced an additional downside risk to the global economy, unsettling global financial and commodity markets alike - prompting the IMF to revise its July 2016 baseline for global growth in 2016 downwards by 0.1 per cent relative to April.

In the aftermath of the "leave" vote, the pound sterling depreciated by just under 12 per cent; share prices have fallen, and Britain is projected to head into recession during the last quarter of 2016. In addition, the rating agencies Standard and Poor and Fitch have both sought to downgrade Britain's credit rating, and there is anticipation of a significant slowing of economic activity in the medium term.

There has also been considerable uncertainty with regard to the structure and orientation of the new relationship between the UK and the EU that will eventually emerge. This will be largely dictated by the exit-conditions that the former can negotiate. The extent to which this will directly impact the Caribbean is at this stage uncertain. However, given the historical relationship between the UK and the Caribbean, Brexit has most definitely introduced some key unknowns into the mix. Will the rest of the EU treat with the Caribbean in the same way, particularly with regard to the flow of European Development Fund (EDF) resources, in the absence of the UK? Will the UK offer a commensurate share of development resources if EDF allocations to the Caribbean were to decline in the short-term? Will the subregion be in a position to negotiate a trade agreement, which provides no less favourable market access to the UK as currently enshrined in the Economic Partnership Agreement between

CARIFORUM and the EU?

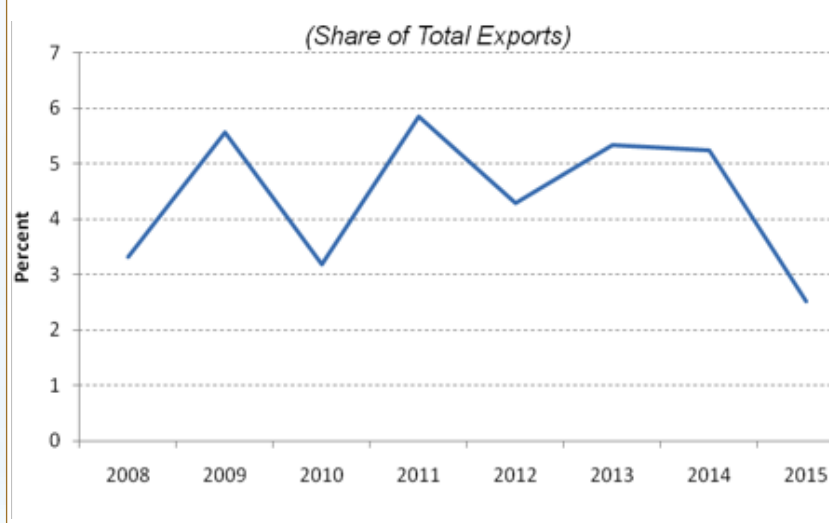
While at this juncture it is exceedingly difficult to predict what will ultimately occur, there has been wide-spread speculation about far-reaching pernicious effects of Brexit on Caribbean economies. This article attempts an examination of the real and potential impact of Brexit on these economies, touching on the four critical areas of trade, tourism, remittances and development finance, where many believe these countries will be most severely affected.

CARIBBEAN-UK TRADE AND ECONOMIC RELATIONS: THE BREXIT FACTOR

The reality is that the direct economic relationship between the UK and Caribbean economies has been waning for some time.

The UK's significance as a major trading partner of the Caribbean is currently in decline. Indeed, subregional merchandise exports to the UK contracted from US\$ 840.8 billion in 2008 to US\$ 13.1 billion in 2015. The UK presently accounts for a mere 2.5 per cent of total Caribbean goods exports (2015) (figure 1). Of these exports, fish, fish products and beverages collectively account for 55 per cent; and sugar, sugar preparations and honey, account for 6 per cent. This suggests that not only has the value of Caribbean exports to the UK fallen, but it has become increasingly concentrated in a narrow range of primary agricultural and agro-industrial products. More pointedly, using the IMF's Brexit scenario it has been estimated that Brexit

FIGURE 1
CARIBBEAN EXPORTS TO THE UK, 2008-2015



would impact negligibly on Caribbean exports to the UK (IDB, 2016). Guyana is expected to be the most vulnerable to a possible contraction in UK import demand.

Furthermore, although the UK remains the subregion's leading market for goods and services exports to the EU, the Caribbean's trade complementarity with the rest of the EU has increased steadily since 2000. This lends support to the intuition that opportunities to diversify the subregion's exports into other EU economies have been on the rise and are currently largely unexploited. It is noteworthy, however, that the Dominican Republic has successfully taken advantage of Economic Partnership Agreement (EPA) trade provisions and has expanded exports to the EU, in particular to the UK.

It is uncertain when exactly the UK will trigger Article 50 of the European Union Treaty, which governs the process for withdrawal from membership in the Union. The UK will then be expected to negotiate its terms of disengagement during the ensuing two years. The President of the European Commission's intimation that Britain should not expect an arrangement where it has no more obligations but keep privileges, points to the likelihood of a "hard" rather than a "soft" exit. The latter could see the UK possibly maintaining membership in the EU Single Market and Customs Union. What is certain is that when the UK leaves the EU, EPA provisions governing CARIFORUM's access to the UK market will cease to be applicable to subregional exports and Most Favoured Nation (MFN) duties will be re-instituted. This will put several key sectors such as rum, sugar, rice, food and beverage and creative industries at risk.

It may therefore be useful for the Caribbean to initiate dialogue with the UK towards establishing an alternative trade arrangement, that provides duty free-quota free access not dissimilar to that currently enjoyed under the EPA, which can be applied upon the UK's exit from the EU. An EPA-plus market access and development cooperation agreement can then be considered once

the UK leaves and the landscape of UK-EU relations is known.

WILL BREXIT TRULY IMPACT CARIBBEAN TOURISM?

There is also speculation that the Caribbean's tourism sector is particularly vulnerable to the short-term economic effects of Brexit. Rising costs accompanying the depreciation of the Pound Sterling; forecast slower economic growth; and reduced consumer confidence are expected to dampen British travel abroad.

Moreover, lower global economic growth precipitated by uncertainty introduced by Brexit may also serve to slow tourist outflow. Nevertheless, the UK remains an important source market for The Bahamas, Barbados and Jamaica. In this regard, it is noteworthy that the UK dominates tourist arrivals (accounting for over 36 per cent of total arrivals in 2015) for Barbados; and is seen as an important growth segment for Jamaica. In fact, growth in UK tourist arrivals to Jamaica during the first quarter of 2016 considerably outstripped that of North America.

Ultimately, the Caribbean economies with the requisite policy, strategic and structural approach can work together to minimize the deleterious impact that Brexit is predicted by many to have on the regional tourism industry. It should also be considered that tourist arrivals to the Caribbean have been relatively more sensitive to changes in airlift than to changes in the real exchange rate. This is particularly the case for high-end markets such as The Bahamas, Barbados, and Jamaica. A more likely outcome in the short-term will therefore be small, but in not insignificant contractions in UK tourist arrivals to Barbados, and to a lesser extent Jamaica as the UK economy continues to adjust.

A DISCUSSION ON THE IMPLICATION FOR REMITTANCES

Caribbean economies have emerged as exporters of qualified labour. As a result,

remittances have increasingly made a discernible contribution to GDP, fuelling increased household consumption and reducing current account of the balance of payments in many regional economies.

Belize (31 per cent), Suriname (19 per cent), The Bahamas (19 per cent) and Jamaica (8 per cent) were the leading destinations for remittances inflows into the Caribbean in 2015. Understandably, there is also considerable concern that slower economic growth coupled with the declining value of the pound may lead to a considerable fall in remittances inflows from the UK. However, the UK's significance as a source of remittances for the Caribbean has been trending downwards with only Barbados (23 per cent) and Jamaica (14 per cent) having a share of total remittances originating from Britain in double digits. Given the changing dynamic of many Caribbean economies, the intuition is that any impact of Brexit on remittances may be negligible and primarily restricted to Barbados, Guyana and to a lesser extent Jamaica. This has been supported by recent work undertaken by the IDB.

► (continued on page 12)



SUPERCYCLE: THE RISE AND FALL OF COMMODITY PRICES IN THE CARIBBEAN

Machel Pantin

While the Caribbean is currently associated with sun, sea and sand tourism, many of the islands began their colonial history as commodity exporters – specifically, agriculture. Although several have evolved into service exporters with severely diminished agricultural sectors, a few have continued or even developed other commodity export industries.

The Caribbean economies which currently depend on commodity exports are: Belize, which produces petroleum, citrus, sugar and bananas; Guyana, which produces bauxite, gold, sugar and rice; Suriname, which produces gold, oil and rice; and Trinidad and Tobago which produces crude oil, natural gas and natural gas products.

THE RISE

Throughout the first decade of the 21st century, Caribbean commodity-driven countries experienced an economic boom as a result of the “Commodity Supercycle”, a trend in which international prices for several commodities began increasing steadily and simultaneously.

The Commodity Supercycle, which began in 2000 and continued until 2012,

can be attributed to a number of reasons. One of the primary drivers of the commodity supercycle was the unprecedented rate of growth of emerging economies around the world at the turn of the century. Growth among the BRIC economies, namely, Brazil, Russia, India and, in particular, China, served to increase global demand and boost commodity prices. Over the last decade, China became the world’s largest consumer of commodities (Moran, 2015), purchasing not just for use, but for stockpiling as well.

In addition to supply and demand factors, as well as the financial decision of investors worldwide also played a major part in determining commodity prices. Following the collapse of housing prices in the US and other western markets in the mid 2000’s, investors looked to commodities as a more stable means of investment. Oil prices rose as a result of speculation

following tension in the Middle East and fears of declining reserves. After the global financial crisis 2007-2008, the US dollar effective exchange rate decreased, financial markets grew less stable and investors sought a more stable source of wealth, leading to gold prices climbing steeply after 2007.

Figure 1 illustrates the trends in commodity prices from 2000 to 2015 and includes forecasts for 2016 and 2017.

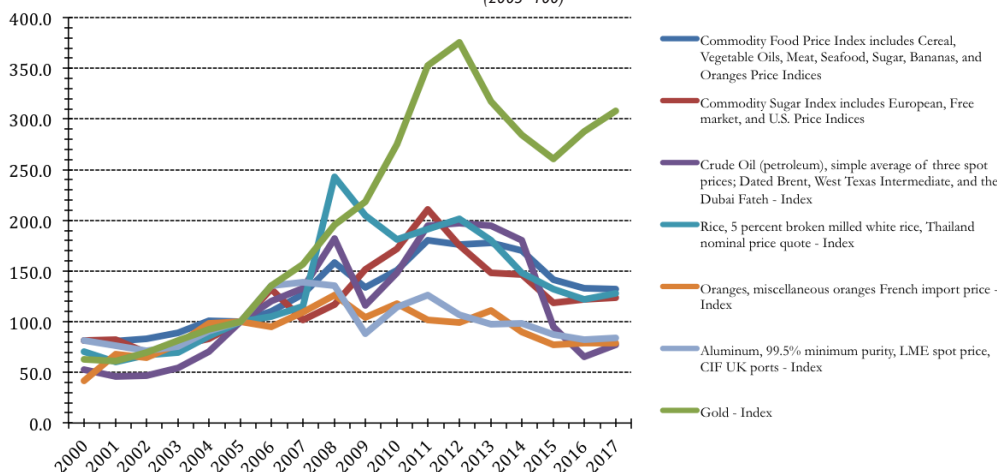
THE EFFECT ON THE CARIBBEAN

The four Caribbean commodity exporters leveraged the international surge in commodity prices to achieve sustained positive economic growth over the last decade and a half, averaging 3.5 per cent annual growth from 2000 to 2016.

In comparison, the “service producers” whose economies are based primarily on tourism and other service sector production, averaged to 1.8 per cent growth over the same period. The average current account balance for the goods producers grew from -8.7 per cent of GDP in 2000 to an average surplus of 7 per cent in 2006, bolstered mainly by very strong surpluses in Trinidad and Tobago, and contracting deficits in Guyana. From 2000 to 2015, the average current account balance among the goods producers was -3 per cent of GDP, compared to -17.8 per cent for the service producers.

Suriname and Trinidad and Tobago achieved excellent fiscal performance over this period, particularly before the global financial crisis. Suriname

FIGURE 1
COMMODITY PRICE INDICES
(2005=100)



measured fiscal surpluses in five out of the eight years from 2001 to 2008, and averaged a fiscal surplus of 0.6 per cent of GDP. Trinidad and Tobago performed even better, recording fiscal surpluses in seven years over the same period, and averaged a fiscal surplus of 3 per cent of GDP.

THE FALL

All cycles, even Supercycles, have their troughs, and the boom has gradually come to an end for these commodity producers, as international prices began falling in 2012.

The fall, like the rise in these commodity prices, was also due to several reasons. The global price of agricultural commodities and metals began declining in 2011 as a result of slowing economic growth in China. The international gold price fell because of a softening of interest by investors in gold as an asset to hedge against inflation; the price per troy ounce fell by 30 per cent from 2011 to 2014. Oil prices, however, remained elevated until the first half of 2014, before falling dramatically.

The decline in oil prices, though rapid, was heralded by the shale oil revolution in the United States. The emergence of shale oil, which is the product of technological advances in oil and natural gas extraction, led to the United States becoming the largest producer of oil and natural gas in the world by 2013 (US Energy Information Administration (EIA), 2016). In October 2014, the Organization of the Petroleum Exporting Countries (OPEC), decided not to cut oil production to keep prices up in the face of increasing output from the United States. Oil prices consequently fell by 65 per cent from June 2014 to December 2015.

The effect on the commodity producing economies of the Caribbean has been substantial. Economic growth is stalling: Belize's economy is expected to contract in 2016 for the first time since 1983; Trinidad and Tobago has entered its third straight year of negative growth in 2016; and Suriname's economy contracted in

2015 and in 2016 it is projected to shrink by 10 per cent.

The decreased revenue from commodity exports directly impacts the fiscal and current account balances of these economies. The fall in the price of oil has seen Trinidad and Tobago's energy sector revenue fall by 71 per cent from fiscal 2014 to fiscal 2016 and its fiscal deficit almost double, from 2.6 per cent of GDP to 5.0 per cent. Trinidad and Tobago's long standing currency quasi-peg to the US dollar weakened in 2016 and several commercial banks have resorted to rationing foreign exchange. Belize's worsening fiscal position has pushed public debt to over 80 per cent of GDP; it is projected to rise even further. Suriname, which has probably been hit the hardest by falling commodity prices, saw its bauxite refinery shutdown in late 2015, and its international reserves dwindle to just two months of export cover, leading to currency devaluation in 2015 and 2016.

Citizenry of these economies have had to cope with fiscal adjustment measures, and severe inflation in the case of Suriname. Conversely, Guyana has managed to maintain strong GDP growth, and to keep its public debt relatively low. Nevertheless, Guyana remains the country with the lowest GDP per capita in the English speaking Caribbean.

THE FUTURE

The future for commodity prices looks cautiously optimistic. The prices for several commodities are expected to rise in 2017. Oil prices are expected to strengthen from an average of US \$43 per barrel in 2016 to US \$55 in 2017, largely because of an agreement by OPEC members made in September 2016 to limit production, the first cut since 2008.

Agricultural commodity prices are expected to increase in 2017, due mainly to higher energy prices. The price of gold has been increasing, on account of the delayed interest rate increase by the US Federal Reserve. The possibility of

an interest rate increase in December 2016 provides a downside risk to the gold price prospects. Aluminum prices fell in 2016, but are expected to grow in 2017 and beyond.

The projections imply some improvement for Caribbean commodity exporters, but nowhere near the growth that was seen in the last decade. The recent discovery of oil in Guyana and the opening of a new gold mine in Suriname should provide more opportunities for growth in these countries. However, these economies would be well served by seeking to diversify their export base to reduce their reliance on limited international commodity markets. Spreading production and exports across a wider mix of sectors would greatly increase economic resilience.

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“DE-RISKING” AND ITS IMPLICATIONS FOR THE CARIBBEAN ECONOMIES

Nyasha Skerrette

Across many Caribbean economies, the financial sector is one of the largest contributors to GDP thereby playing a central role in economic growth and development of the region. In many regional economies the financial services sector has emerged as a key pillar of economic diversification efforts.

It is not surprising that with such a strong economic footprint as well as its increasing contribution to the economic resilience of Caribbean economies, much focus has been placed on developing this sector and on safeguarding it against negative external shocks. However, for such development to be fully realised, important challenges will have to be addressed. In this context, the “de-risking” strategy currently being imposed on financial houses in the subregion presents a significant threat to a number of Caribbean economies. Left unchecked, this practice runs the risk of undermining investment and economic growth in the subregion and compromising the ability of many economies to achieve the SDGs.

WHAT IS THE “DE-RISKING” PROBLEM?

One of the most critical challenges faced by financial institutions in the Caribbean over the last few years has been an increasingly apparent trend being adopted by large global banks that serve as correspondent banks to local financial institutions to sever limit or terminate their correspondent banking relationships (CBRs) with these local or regional banks (respondent banks).

In general, this practice is considered to be a form of “de-risking”, which typically describes situations where financial institutions terminate or restrict business relationships with clients or categories of clients considered “high-risk”. Based on preliminary surveys conducted by the World Bank, the Caribbean region is among the most severely affected by the strategy of de-risking.

CBRs involve a global financial institution (FI) providing banking services to a local or regional FI and its customers. Local and regional banks are particularly dependent on such relationships to be able to offer customers foreign denominated loans and deposits and make payments and clear services in foreign currencies. However, following the global financial crisis of 2007-2008, national and international regulatory bodies have been imposing on all banks stricter regulatory standards with respect to prudential requirements, anti-money laundering/combating the financing of terrorism (AML-CFT), tax information exchange, and sanction violations.

A more recent example of such regulations is the issuance of final rules under the United States Bank Secrecy Act (BSA), which is an attempt by the Financial Crimes Enforcement Network, a bureau of the US Department of Treasury, to clarify and strengthen customer-due-diligence requirements for FIs. These rules went into effect as of 11 July 2016. Under these updated regulations, FIs would be required to “conduct ongoing monitoring for the purpose of maintaining and updating customer information and identifying and reporting suspicious activity”.

Ultimately, these rules require FIs to know their legal-entity customers, regardless of where those entities are formed. This means that FIs would need to require other fiduciaries with whom they conduct business, to put in place robust AML/CFT/customer due-diligence (CDD) frameworks to ensure customers are transacting legal business. Global banks recognize that implementation of such regulations should not be taken lightly

given the strong message being sent for major violations. In 2016, bank fines extended to as much as US\$ 8.9 billion for violation of the International Emergency Economic Powers Act and the Trading with the Enemy Act.

The response of correspondent banks to these increased stipulations, tax transparency requirements and stiffer sanctions has been to aggressively lower the overall risk exposure of their portfolio by terminating bank-to-bank relationships and/or closing accounts for certain classes of customers deemed to be high risk. For these correspondent banks, the cost of complying with standards and accompanying penalties for oversights or mistakes are very high. Violating the regulatory requirements also carries reputational risks. In essence, the risk-benefit ratio of potentially high costs and low profitability is driving the cessation of correspondent banking services.

WHY IS DE-RISKING A PROBLEM FOR THE CARIBBEAN?

This “de-risking strategy” has come at a cost for many Caribbean countries, affecting both clientele and certain classes of business.

So far, FIs in The Bahamas, Barbados, Belize, The Eastern Caribbean Currency Union (ECCU), Guyana, Jamaica and Trinidad and Tobago have reported the termination of CBRs. Indeed, the International Monetary Fund (IMF), as of May 2016, recorded at least 16 banks in the region across five countries as having lost all or some of their CBRs. The correspondent banks are located primarily in the United States, Canada,

and to a lesser degree, Europe and the Caribbean. Table 1 below highlights the negative impacts of de-risking on respondent banks across the Caribbean, as assessed by various sources.

In Jamaica, a leading bank no longer accepts foreign instruments and remittances from money service businesses. The Bahamas has seen a negative impact on the Money or Value Transfer Services sector as well as certain business lines such as credit card payments, clearing and settlement, international wire transfers and remittances. There has also been increased scrutiny of their CBRs which has led to temporary disruptions of corresponding banking services. Several of the seven banks in Belize have reported terminations of their CBRs by US correspondent banks, including the Central Bank of Belize. This has led to displacement of customers to other banks or increased customer complaints about the inability to access their funds.

Across the ECCU and Barbados, increasingly rigid regulatory rules have been imposed on Canadian correspondent banks, requiring them to know their clients' customers. The effects have been particularly significant for international business companies (IBCs) or offshore companies, as entire business lines have been closed or had restrictions imposed on existing operations. In some instances, wire transfers have been held for several days awaiting verification of the recipient. In others, IBCs have been forced to wait several weeks beyond the normal verification period to open local accounts or have had their requests to open accounts rejected unless the IBC has a direct relationship with or is known to the correspondent bank through a subsidiary. Even former prime rate customers have

seen their accounts terminated or saddled with burdensome restrictions. In Guyana, the value of foreign correspondent transactions has declined by 27 per cent, while several entities in Trinidad and Tobago have been "unbanked".

In the face of increased pressures on CBRs, respondent banks across the region have sort to temper the effects of lost services by securing replacement CBRs, obtaining limited assistance from Central Banks for foreign payments, and closing local accounts with high risk customers. However, in some cases, CBRs have proved irreplaceable, resulting in lost business for many banks, the inability of certain sectors to conduct business, and adverse effects on remittance receipts. In the instances where replacements or alternative arrangements have been found, it has come with a huge price tag. Consequences include excessive time and cost of finding replacements, newly imposed minimum thresholds to maintain accounts, higher cost for establishing new CBRs being passed on to clients and restrictions or terminations of certain clients to maintain access. In the midst of these adjustments and despite AML/CFT compliance maintained by most Caribbean respondent banks, the overall cost of compliance continues to be a significant challenge.

Of even greater concern than the actual loss of CBRs is the potential risk of businesses or clients excluded from the financial system seeking less regulated and less transparent channels to conduct transactions. This exposes the system to a reduction in transparency of financial flows as well as increased risk of money laundering and terrorist financing. Beyond the effects on the financial system is the

impact of excluding the Caribbean's global financial and trading system on economic growth and poverty alleviation. This has the potential to compromise the region's ability to achieve the United Nations 2030 Agenda for Sustainable Development. Indeed, the ramifications of wholesale de-risking for the Caribbean are far-reaching.

THE WAY FORWARD

Various international and regional parties have conducted preliminary assessments/discussions of the "de-risking" phenomenon. However, a more comprehensive examination of the causes and implications of de-risking is required with focus on quantifying the economic impact on the region.

In this regard, in late 2016, ECLAC embarked on a pilot project, in select Caribbean countries, aimed at capturing the primary and secondary market effects of de-risking needed to quantify the economic impact of the de-risking phenomenon.

Moving forward, further clarification of regulatory expectations coupled with capacity building to bolster the regulatory and supervisory framework in line with international standards would be beneficial to local and regional banks. One way this can be achieved is through a regional mechanism aimed at facilitating closer dialogue between local and regional respondent banks and global correspondent banks. This approach allows for a better understanding of regulations such as AML/CFT policies and provides assistance in improving the requisite systems and procedures. Moreover, it is imperative that Caribbean economies seek to establish national AML/CFT risk assessments and national action plans with a view to identifying and remedying inherent weaknesses in their systems.

► (continued on page 12)

TABLE 1
IMPACT OF DE-RISKING ACROSS THE CARIBBEAN

Impact	Bahamas	Barbados	Belize	ECCU	Guyana	Jamaica	Trinidad and Tobago
Correspondent banking relationships terminated	X	X	X	X	X	X	X
Money or Value transfer services terminated	X					X	
Off-shore sector accounts terminated or services restricted		X		X			
Decline in foreign correspondent transactions					X		
Class of customers unbanked							X
Increased information on client's customers required		X		X			

Source: International Monetary Fund and Caribbean Centre for Money and Finance

“DE-RISKING” AND ITS IMPLICATIONS FOR THE CARIBBEAN ECONOMIES

Considerations must also be given to strengthening of mechanisms for correspondent banks to conduct effective customer due diligence. Further, in a working paper prepared by Central Bank Governors across the region, it was suggested that “global regulators and international standard setters address the complexity of regulations and risk exposures which contribute to bias in the incentive structure against certain classes of business”. Correspondent banks should also consider alternatives to severing CBRs. For example, correspondent banks should consider placing credit or other limits/conditions on respondent banks, instead of employing a wholesale de-risking approach which results in the termination of CBRs with solid long-term clients or the rejection of new

business, because the client’s risk profile is no longer accepted. In the event that the relationship must be severed, more time should be given to respondent banks to establish replacement CBRs and reasons should be provided as to why they are being de-risked.

Although the future of correspondent banking in the Caribbean is uncertain, progress lies in a collective, coordinated approach on the part of all stakeholders with the primary goal being to maintain a stable financial system. ■

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AN EXAMINATION OF THE POSSIBLE IMPACT OF BREXIT ON CARIBBEAN ECONOMIES

A CONSIDERATION OF THE IMPLICATIONS FOR DEVELOPMENT COOPERATION

The Caribbean has been given assurances that financial resources committed under the 10th and 11th EDF(s) will not be affected by Brexit. However, without the UK presence to advocate the interests of its former colonies, there is no telling how development assistance from the EU will be affected when the Cotonou Agreement expires in 2020.

At commercial, technical and political levels, the Caribbean has relied on the UK’s support to promote and defend its interests with the EU. The UK was seen as playing a pivotal role in securing the Accompanying Measures for Sugar Protocol Countries (AMSP) provided by the EU to the 18 ACP countries which traditionally exported sugar to the EU, in response to its Sugar Regime Reform (2005) which threatened their sustainable development.

The EU-funded Caribbean Rum Sector Programme, which reduced the industry’s dependence on bulk exports, improved its competitiveness, and assisted the Caribbean rum producers in moving towards higher-value branded products, represents another example of the success of the UK’s lobbying efforts within the EU on behalf of the region.

There should also be cognizance that Caribbean economies having “graduated” to middle-income status may be deemed ineligible for concessionary development finance. Caribbean middle income countries may also be negatively impacted by EU decisions on EDF allocations to their national and regional indicative programmes in the future. Furthermore, the EU has recently begun to demonstrate the early signs of a shifting preference for treating with the Caribbean within the EU-CELAC framework. This too may have negative implications for development cooperation resources that accrue to

the subregion in the medium to long-term, particularly in the absence of the UK as an advocate on behalf of the Caribbean.

CONCLUSION

The uncertainty surrounding the UK’s membership in the EU is not likely to have the far-reaching short-term spill-over effects on Caribbean economies initially anticipated.

The economic impact of negative shocks on exports to the UK; tourism; and remittances should be nowhere near what was predicted in the immediate aftermath of the ‘yes’ vote, and will likely be isolated to a few economies in each instance. However, it has highlighted the need for the Caribbean to focus more determinedly on building its economic resilience in the medium-term, as well meaningfully preparing for its trade and integration into both a Europe absent of the UK and a stand-alone UK economy. ■

► (continued from page 5)

THE CARIBBEAN DEBT CHALLENGE SINCE THE GLOBAL CRISIS OF 2008 AND CONSEQUENCES

Secondly, due to declining competitiveness, as evidenced by a large and persistent current account deficit, governments have been forced to be employers of last resort. This means that recurrent expenditures have been maintained to prop up employment especially among the service-based economies. At the same time, the expenditure adjustment has been made on the capital expenditure side which affects investment and ultimately, growth. In addition, significant efforts at fiscal consolidation while helping to reduce the debt burden also create a drag on economies that need stimulation through government expenditure.

Thirdly, the limited fiscal space has made it difficult for governments to invest in much needed infrastructure, which in small open economies is vital for private sector expansion. In addition, the private sector has remained risk averse and credit expansion has been largely with respect to consumption related activity

Fourthly, the Caribbean has had to pay on average higher risk premiums on new borrowing, which means higher borrowing costs despite a global low interest rate regime existing since 2008.

Fifthly, some member states have had to face a variety of natural disasters which have disrupted production, especially with respect of tourism

and related activities, and have added to the borrowing requirements of member states to fund reconstruction and rehabilitation.

On the assumption that aggregate demand will continue to be low over the medium term, the question is how can the Caribbean overcome the debt challenge and meet its obligations under the SDGs? A number of institutions including ECLAC have suggested that the size of the debt burden is too great to be addressed with orthodox fiscal adjustment policies alone since high primary surpluses stifle growth. In fact, Jamaica and a few other countries have employed debt exchanges and expenditure cuts plus tax increases to address the problem, but the burden had actually risen on average.

ECLAC has suggested that a strategy aimed at debt reduction and structural reforms will free fiscal space and at the same time, allow countries to grow in the medium term. The initiative promotes a debt buyback scheme with an appropriate discount for multilateral, bilateral and private debt, brokered through the Green Climate Fund (GCF). The Fund would purchase the debt and countries would then channel their discounted debt service payments through a Resilience Fund which, with appropriate management, would endorse projects that have a climate resilience impact. The green industries would be targeted as a vehicle to effect structural change.

This is a credible strategy that could generate buy in from a variety of creditors as it reduces default risks, improves the financing mechanism for climate adaptation project, and most importantly, creates greater fiscal space which can be used to stimulate growth

CONCLUSION

While the immediate challenge is the high debt burden, Caribbean economies have to become more competitive in the long run to be able to generate robust growth.

Given their vulnerability to climate change, growth must also help to build resilience, increase employment and reduce poverty and inequality. In addition, careful fiscal management is required to avoid the region being placed in such straightened circumstances in future. ■

RECENT AND UPCOMING MEETINGS

2017

JANUARY

15 - 18 January 2017

United Nations World Data Forum (WDF) will be hosted by Statistics South Africa - Cape Town, *South Africa*

17 - 20 January 2017

World Economic Forum Annual Meeting will be held in Davos-Klosters - *Switzerland*

30 - 31 January 2017

The Sixth ECOSOC Youth Forum will be held in New York City - *United States*

List of Recent ECLAC Documents and Publications

Listed by Symbol Number, Date and Title

No. LC/CAR/L.500

May 2016

Evaluation report of the Training workshop on energy efficiency and renewable energy policy in the Caribbean

No. LC/CAR/L.506

October 2016

Series and Perspectives: A framework for Caribbean medium term development

No. LC/CAR/L.507

December 2016

Series and Perspectives: Economic Survey of the Caribbean 2016 - economic recovery in the Caribbean: The dichotomy of goods and service economies

No. LC/CAR/L.508

January 2017

Report of the Caribbean seminar on women's empowerment and migration in the Caribbean



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