BANCO INTERNACIONAL BANCO MUNDIAL PARA RECONSTRUÇÃO E DESENVOLVIMENTO

en breve

June 2005 No. 73

A regular series of notes highlighting recent lessons emerging from the operational and analytical program of the World Bank's Latin America and Caribbean Region

A TIME TO CHOOSE:

CARIBBEAN DEVELOPMENT IN THE 21ST CENTURY

Sanjay Kathuria, Mustapha Rouis, Michael Corlett, James Hanson, Rina H. Oberai, Kevin Tomlinson, Elizabeth Ruppert Bulmer, Andreas Blom, Abhas Jha, Camille Nuamah and Logan Brenzel

The Caribbean at a Crossroads

The Caribbean region is at a development crossroads and its member nations must take significant and concrete steps to improve productivity and competitiveness and face up to global competition if they are to accelerate or even maintain past growth, says a new World Bank report[1]. By taking such steps, they will reposition themselves strategically as an emerging trading bloc for goods and services; without such action, they risk growing economic marginalization and erosion of many of the social gains of the last three decades.

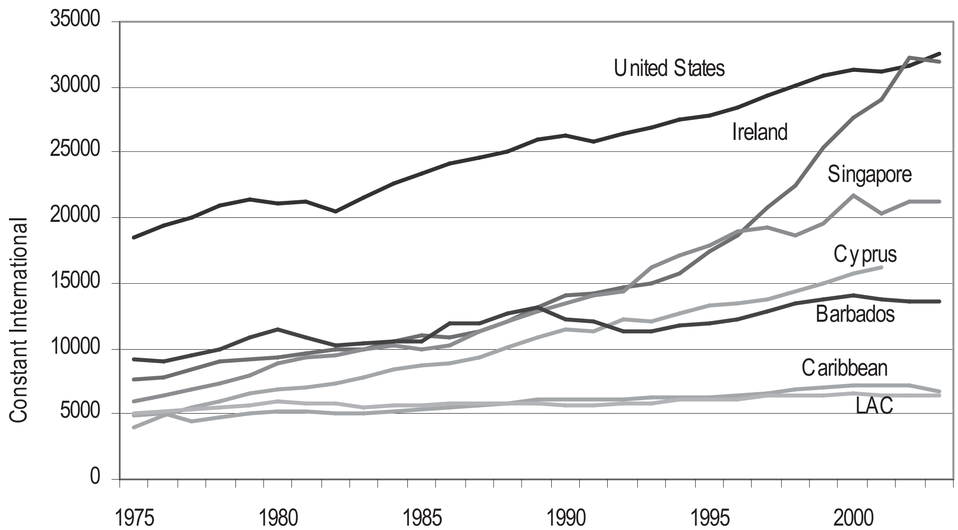
Facing the Challenge

Despite a number of significant challenges, the Caribbean has continued to see a sustained growth in per capita incomes, with most countries achieving middle income status and high levels of human development. These achievements reflect many of the positive endowments that the Caribbean countries[2] have been blessed with, including favorable locations and excellent climates, virtually no hinterlands, the advantage of the English language in most countries (Spanish, French, and Dutch in other cases), an early targeting of universal primary education, strong traditions of democratic participation and political stability , and a significant degree of regional integration despite significant differences in economic and social characteristics.

Yet, as the 21st century begins, the abiding impression is one of underfulfilled potential and concern for the sustainability of past accomplishments. Figure 1 tells its own story—the overtaking of even the Caribbean's highest income countries such as Barbados (and Antigua and Barbuda), by small and comparable countries like Singapore, as well as Ireland and Cyprus, whose economic strategy was centered around achieving international competitiveness.

Formidable challenges lie ahead. While poverty has declined in the past, it remains high in many countries, including Haiti, Guyana, the Dominican Republic, and several OECS countries. Unemployment, particularly youth unemployment, is a major issue, with severe implications for poverty and income distribution, as well drug trafficking and addiction. Migration is a double-edged sword, but its large scale in the Region serves as a reminder that many educated people lack access to significant economic opportunity. All this means that improving the rate and quality of growth is crucial, given the linkages between pro-poor growth and poverty reduction and employment. Another challenge is coping with natural disasters and economic volatility, highlighted once more during the 2004

Figure 1: Per Capita Incomes (PPP) 1975-2002



Source: World Development Indicators (WDI)

hurricane season. Still another challenge is reducing crime, which is affecting the larger islands and increasingly the smaller ones, impacting the social fabric as well as investment and growth, and contributing to increased migration.

Meeting these challenges is complicated by the massive increase in public debt experienced over the last few years—the Caribbean now has the dubious distinction of having many of the most indebted countries in the world. High debt makes the countries even more susceptible to volatility, increases the risks associated with macro instability and compromises growth prospects.

Fortunately, the challenges are not insurmountable, and can be dealt with, with the central plank being a focus on sustaining and improving growth and competitiveness.

Improving and Even Sustaining Growth Will Require a Significant Shift in Policy

World economic history shows that sustained growth demands sustained improvement in productivity. In the Caribbean, on the other hand, productivity growth has declined, and the underlying determinants of growth have been of declining importance over time. To improve or even sustain past growth, productivity growth needs to improve, which means a renewed focus on the fundamental drivers of growth. Add to this the prospects in traditional activities such as sugar, bananas and tourism, which highlight the need for diversification and productivity increases to offset high wages. Some diversification has already taken place, including in niche manufacturing and various service sectors, but this process needs to be accelerated to reverse the growth decline of the 1990s in a sustainable way.

The challenges in this process are often particular to the small Caribbean states. Given their size, many traditional manufacturing activities are ruled out. Their proximity to North America and migration keeps wages high and reduces the availability of skilled workers for the domestic market. Small size and openness have resulted in high government expenditures, which put a premium on government efficiency in regulation, delivering services and taking investment decisions. Caribbean countries are also disaster-prone, and this has affected capital accumulation and exacerbated the output volatility that small countries experience. Small size also puts a premium on cooperation among nations, in this case exemplified by the push towards the Caribbean Single Market and Economy (CSME), and tackling the difficult political issue of national sovereignty.

Keeping this context in mind, policies for sustained, poverty-reducing growth in the Caribbean that help to improve productivity and increase output diversification, can be summarized under several major themes, namely:

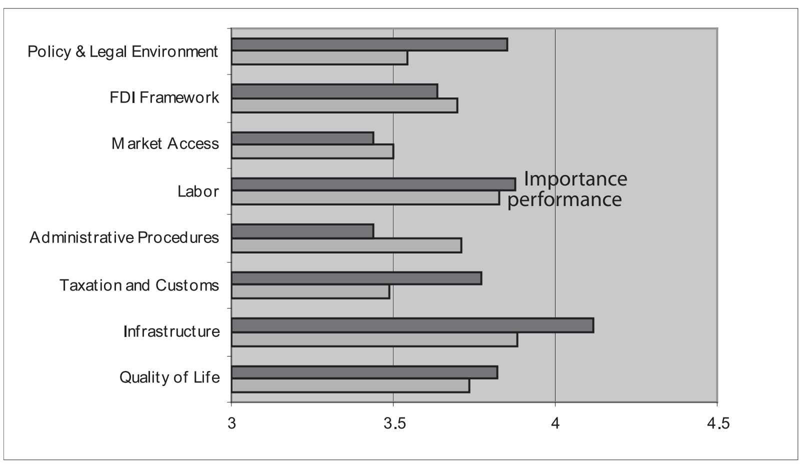
Improving macro stability. Underpinning future growth in the Caribbean, as elsewhere, will be improved macroeconomic stability. Fourteen Caribbean countries are among the thirty most indebted countries in the world, and this exacts a toll on sustainable growth and worsens expectations about macro instability. A trajectory of debt based on trends over the last few years is not sustainable for most countries. By the same token, improvement of the debt profile will have significant payoffs, especially for Jamaica, St. Kitts and Nevis, Grenada, Antigua and Barbuda, and Belize. (Dominica suffered from a debt crisis and restructured its debt in 2004). In general, improving macro stability will require improved primary surpluses through better expenditure management and, to a lesser extent, reducing tax incentives and taxing the informal sectors; reducing public debt relative to GDP; improving the quality of privatization where appropriate and reducing the takeover of contingent liabilities; and, given that many of the problems arise from high public investment, prioritization and increased efficiency of public investment.

Redefining the role of the public sector. In general, a large government that does not deliver services commensurate with the high tax level that supports it (along with the large debt that raises concerns of a crisis), tends to dampen private sector-led growth. Redefining the role of the public sector would involve seeking greater cost efficiencies in key government expenditures through greater private sector involvement and regional cooperation, including in the provision of education and health services; increasing reliance on the private sector to provide infrastructure services, such as airports and air services; and in power, using an independent regional regulator to regulate private provision. Action along these and similar lines would

reduce the crowding out by the Government of private sector employment and investment, by reducing the growth and even size of public employment.

Improving the investment climate for private-sector driven growth and reorienting it away from being subsidy-driven. Productivity of investment has fallen significantly in the 1990s, which will affect the incentives for private investment including Foreign Direct Investment (FDI). In addition, there is increased global competition for attracting FDI flows. Going forward, the challenge for the Caribbean is to maintain and even increase private investment rates, to make this investment more productive, and diversified. It is important therefore that the investment climate gives the right signals and encourages higher quality and more productive private investment. Rather than focusing on generous tax incentives, countries should focus on building a sound overall investment climate that attracts higher quality investment and creates increased spillovers and linkages with the domestic economy (see Figure 2).

Figure 2: Ratings of the Investment Climate in the Caribbean



Note:
Importance rating scale: 3 = moderate importance, 4 = major importance, 5 = critical importance;
Performance rating scale: 3 = neutral, 4 = good, 5 = excellent

This would include addressing problems of high taxes and inefficient customs clearances, skill shortages in some countries (an increasingly important issue for knowledge-based production structures), improving specific aspects of infrastructure, setting in place a regional investment promotion center to provide information and catalyze a process of harmonizing investment and clearance procedures. One specific example of high payoffs is the growth increase in Haiti estimated in our projections, arising from improvements in infrastructure in a country where much of the infrastructure is highly deficient. Of course, all countries have many specific deficiencies in infrastructure and addressing these would have investment and growth payoffs.

Enhancing the quality and effectiveness of human resources and enabling knowledge-based growth. Learning outcomes are very mixed within each Caribbean country, and not commensurate with the resources devoted to them. This impacts the quality and learning capability of the labor force. In many countries, the initial momentum in the build up of skills has been lost. Also, enrollment in tertiary education is very low in most countries except Barbados and the Dominican Republic. In addition, training is often not based on market demand. These skill problems are exacerbated by the high rates of migration. The quality and skill mix of human resources, along with other factors such as inadequate linkages between universities and firms, have led to under-investment in new product areas.

Targeting human resources would require improvements in the quality of primary and secondary education to improve learning skills and better address the needs of increasingly knowledge-based sectors of the economy At the same time there is a need to increasing the supply and quality of tertiary education. Specifically, increasing private sector provision of tertiary education and asking students to pay more of the cost of public tertiary education (to reduce net cost of public education) through higher tuition fees, a more open environment for tertiary education, improved student loan systems and targeted scholarships for the poorest. To reduce distortions in the labor market and make labor more cost-effective there is a need to separate the financing and supervision of training from provision, and to involve firms more in training decisions; and to align public compensation policies more closely with merit and productivity.

Articulating a pro-active trade agenda. A trade regime that induces more competition would help foster entrepreneurship, improve the investment climate as well as the quality of FDI. This would include negotiating an orderly dismantling of preferences, including on sugar and bananas, in return for enhanced technical and financial assistance from development partners; reducing external tariffs to reduce the losses from trade diversion; empowering the Regional Negotiating Machinery to represent the region at all trade negotiating forums; taking action to reduce dependence on import revenues by accelerating the pace of planning or implementation of VAT or other domestic tax systems; and negotiating to improve market access in services, especially in the temporary movement of labor.

Deepening regional integration. The one cross-cutting theme that recurs throughout the report relates to the potential for significant gains through deeper regional integration. Accelerating the implementation of the CSME, especially in those aspects related to free trade, free movement of labor, cooperation in education and training, regional standards and accreditation, tax harmonization, and harmonizing investment procedures, would improve competitiveness of the region as a whole, and make it a more attractive investment destination. While there are already many examples of regional institutions, such as UWI, the Caribbean Court of Justice, and several within the OECS, a major thrust is now required to push the boundaries of the integration agenda, and to tackle the related, politically sensitive issues of national sovereignty.

Besides acting to improve sustainable growth prospects, the region needs to cope with natural disasters in a more proactive and collective manner. The Caribbean, especially the OECS countries, stand out as the most hazard prone in the world, with a very high frequency of violent windstorms. While they have built up resilience to such disasters, this could be strengthened further by improving the macroeconomic environment, by improving growth and diversification, by improving insurance including catastrophe risk insurance for those most vulnerable, by pooling capital market risk and improving building practices.

Conclusion

This is a large agenda, and one that requires considerable political will and leadership. The opportunities are great, but time is short and implementation will be key. Going forward, Caribbean governments, rather than creating expectations about the continuation of preferences or donors flows, should engage all stakeholders – civil society, the private sector, trade unions, the media, donors, and each other – in a dialogue and partnership on the challenges and opportunities of new sources of growth and competitiveness. Business as usual will no longer suffice.

Notes

1 "A Time to Choose: Caribbean Development in the 21st Century", Caribbean Country Management Unit/ Poverty Reduction and Economic Management Unit, World Bank, April 2005, Report No. 31725-LAC (See Box).

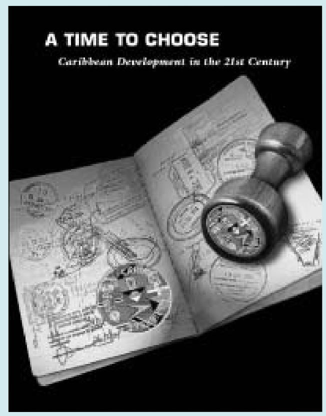
2 In the study, the included countries are the OECS group—Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, as well as The Bahamas, Belize, Barbados, Dominican Republic, Guyana, Haiti, Jamaica, Suriname, and Trinidad and Tobago.

About the Authors

This note was extracted from the full report. The latter was prepared by a team of Bank staff led by Sanjay Kathuria, and included a core team consisting of Mustapha Rouis, Michael Corlett, James Hanson, Rina H. Oberai, Kevin Tomlinson, Elizabeth Ruppert Bulmer, and Andreas Blom.

A New Report

According to the flagship 15 country report, **A Time to Choose: Caribbean Development in the 21st Century** the region needs to move beyond decades of reliance on traditional markets and trade preferences to swiftly diversify into new sources of growth, exploiting its natural advantages of location, environment, political stability and democratic traditions. Citing the examples of Ireland and Singapore, the report argues that small economies, despite their size, can be competitive in many sectors, particularly in niche marketing.



The report, which draws upon extensive consultations with governments, private sector and civil society, recommends that countries work together to negotiate an orderly dismantling of preferences in return for increased technical and financial support, arguing that trade preferences, combined with subsidies, have yielded less than optimal results for the Caribbean nations. In just 15 years, the region's share of European and North American imports have fallen from 0.71 percent in 1985 to 0.27 percent by 2000.

"Now is the time to choose a new development path in the Caribbean to meet the challenges of the 21st Century," said **Caroline Anstey, World Bank Country Director for the Caribbean.** *"Innovation and adaptability will be key moving forward, but so too will be political will and the commitment to collectively leverage regional benefits. There are some exceptional examples of both domestic entrepreneurship and domestic-international partnerships cited in the reports so we know it can be done. What this study proposes is a menu of options to open the door and then invite the private sector in."*

Download the Report at:

http://www.worldbank.org/caribcrossroads