



Caribbean Corner

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[2015 Caribbean Forum](#)

Caribbean Matters at the IMF. The International Monetary Fund maintains a strong partnership with the Caribbean region, with dedicated country teams in its Western Hemisphere Department's Caribbean I and II, and Latin Caribbean Divisions.

With a total population of 40 million and a cumulative land area of just over 1 million sq miles, the region consists of multiple island nations in the Caribbean Sea and the surrounding coasts. Its people are a macrocosm of ethnic groups from four continents. Mostly tourism- and natural resources-based, the Caribbean economies were hard-hit by the unwinding global financial crisis, and most experience low growth, high public debt and vulnerability to natural disasters. These island states are very diverse in income levels. In 2013, GDP per capita (PPP) ranged from US\$32,037 in The Bahamas to US\$1,315 in Haiti.

For audiences within and outside of the IMF, the **Caribbean Corner** provides a communication platform three times a year for the institution's work on the region.

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Tropical Storm Erika: Message from the Caribbean Corner Editorial Team

The Caribbean Corner Editorial Team has been shocked and saddened by the tragic loss of life and injuries sustained in the devastation caused by Tropical Storm Erika. The Team expresses its heartfelt condolences to the families of those who died and wishes a rapid recovery to those injured. May the strength and resilience of the Caribbean people carry them through this catastrophe.

INTERVIEW

Interview with Sir K. Dwight Venner, Governor of the Eastern Caribbean Central Bank

By Wayne Mitchell, IMF Resident Representative

On July 31, 2015, IMF Resident Representative for the ECCU countries Wayne Mitchell interviewed the ECCB Governor Sir Dwight Venner in his office about recent economic and policy developments in the ECCU, the economic challenges facing the region and the ECCB's relationship with the IMF.

The ECCU region was hard hit by the global financial crisis. What lessons should economists and policymakers have learnt from this difficult episode?

The global crisis exposed the structural deficiencies in our economies – small size, openness, and vulnerability to international economic shocks and business cycles. It also revealed weaknesses in our policy frameworks and our inability to respond adequately to crises. For instance, we didn't have any safety nets to protect the vulnerable nor the fiscal space to undertake counter cyclical policy. Efforts to alleviate the situation through spending exacerbated the debt situation.

Clearly there are fundamental issues which we have to address in the post crisis era. The first step is to strengthen the policy making framework and architecture, taking into consideration normal as well as abnormal economic events, and establishing appropriate policy responses. We also need to strengthen our statistical systems so that we have adequate and reliable information to support diagnostic assessment and inform policy formulation.



Governor Sir D.K. Venner (left) and Wayne Mitchell (IMF)

it is economically feasible and leads to efficiency gains. But just look at what the Regional Government Securities Market has achieved for member governments. So a lesson we need to learn and assimilate is that we have to expedite the implementation of the Treaty of Basseterre to achieve administrative and operational efficiency through regional integration. The pace of progress has been too slow.

Lastly, we need sustainable and high growth of at least five percent in the medium to long term to create better job opportunities and reduce our vulnerabilities. A concerted effort is required to establish industrialization policies supportive of export-oriented production of goods and services and to diversify our economies. This also requires harnessing a critical mass of activities through regional integration so that we can be competitive beyond the currency union. It is a hard sell but people have to get accustomed to the idea that the only way we can overcome small size and grow sustainably is by looking outwards.

The global crisis exposed the structural deficiencies in our economies – small size, openness, and vulnerability to international economic shocks and business cycles. It also revealed weaknesses in our policy frameworks and our inability to respond adequately

Secondly, we need to address the shortcomings of small size, particularly high unit costs of operations, through more effective integration. For example, we can lower the cost of government operations and improve efficiency by having a regional revenue authority responsible for revenue collections. Critics focus on whether this is politically desirable rather than on whether

This will not happen by osmosis. Governments will have to be more effective and proactive in facilitating the transformation and reorientation of the private sector and providing critical public investment and infrastructure while pursuing fiscal sustainability. Hard choices and discipline in policy implementation will be required to achieve this.

The nexus between the private sector and the financial sector needs to be improved. We need a financial system that provides adequate financing for start-up businesses, and appropriate incentives to facilitate production rather than consumption.

So the operations of those three sectors – the state, the private sector and the financial sector – and how we reorient the three of them are the key to unlocking growth in the region.

An efficient and effective state that proactively facilitates the transformation and reorientation of the private sector, provides public investment and infrastructure, and is fiscally sustainable is required.

What are the prospects for a healthier banking system in the ECCU? What needs to be done to improve or increase the private sector's access to finance?

The new Banking Act provides a strong legal, regulatory, and supervisory framework for the operations of banks in the ECCU. Importantly, it also provides a single resolution mechanism and resolution authority and a common safety net that will in time include deposit insurance. This integrated oversight framework is the logical extension of an integrated banking system that would help contain systemic risks and curb moral hazard.

Our goal is to have a strong banking system in the ECCU that is not at high risk of becoming a drain on public resources. The amalgamation or mergers of the indigenous banks and the increase in capital must take place for that to happen. We've heard the criticism that individual national banks should be preserved. I give the example of the Bank of Nova Scotia which started in the province of Nova Scotia in Canada in the 1830's. It has merged with other banks and expanded so that today it operates in multiple countries with a massive branch network including in the ECCU region. Our indigenous banks must do the same to operate effectively and safely in the region.

The challenge of providing the private sector with access to finance also highlights a deficiency in our financial system. The commercial banks that stand alone in each island have insufficient capital and inadequate risk

management capabilities to provide appropriate products and services to the private sector. The same is true of development banks in the region. This is why amalgamation is critical to repositioning both types of banks so that they can be more effective. Commercial

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banks need to partner with other entities such as enterprise or venture capital funds and development banks that can provide other structured financial products and technical assistance, reduce their risk exposure, and increase the chances of success of start-ups in the export-oriented sectors. Successful start-ups and going concerns should be in a much better position after this to access short term financing from commercial banks.

Broadening the range of financial instruments and sources such as factoring and leasing has a greater chance of improving firms access to credit when combined with efforts to encourage private sector development through industrial policies. I mentioned this earlier. Governments must have proactive and effective policies to direct and transform the private sector.

The ECCB has had a long relationship with the IMF. What can be done to make things more effective?

We have had a long and very good relationship with the Fund. They've provided us with technical assistance on a range of issues and collaborated with staff on research and on workshops to strengthen the capacities of member countries. However, there was a very tense situation that occurred with the onset of the financial crisis and coincided with a change in the staff of the Western Hemisphere Department at the Fund. Fortunately we have come to a common understanding after undertaking diagnostic assessments and they, together with the CDB and World Bank, have assisted us with the crafting of the new Banking Act and resolution frameworks. I think having gone through this process we now all have an understanding and appreciation for the issues, mutual respect for each other and our respective capacities.

CARIBBEAN OUTLOOK

Caribbean growth recovery is expected to continue amid lingering vulnerabilities

By Saji Thomas and Marcio Ronci

The emerging economic recovery is expected to continue, even though external and fiscal vulnerabilities remain high in several economies. After growing 2.5 percent in 2014, the Caribbean economy is expected to expand by 2.2 percent in 2015. However, downside risks to growth emanating from the strengthening US dollar, the opening up of Cuba and a possible disruption of PetroCaribe financing could pose significant policy challenges for securing a sustained economic recovery.

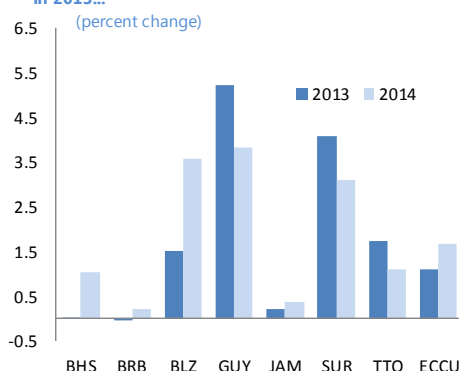
Real output growth for the Caribbean region in 2014 was stronger than expected at about 2.5 percent, up from 1.9 percent in 2013. Most of the tourism-based economies recorded a strong recovery in 2014, supported by tourism and construction. The commodity exporters had less buoyant growth following the significant drop in the oil and other commodities prices. IMF staff's preliminary projections indicate that the Caribbean region is expected to expand by 2.2 percent in 2015, reflecting stronger growth in trading partners, lower fuel prices and further pick-up in tourism and construction. Inflation is expected to remain subdued in 2015, on account of low international commodity prices.

Signs of higher growth are welcome but unevenly distributed, and public finances remain under strain—with many countries' primary balances too low to assure debt sustainability

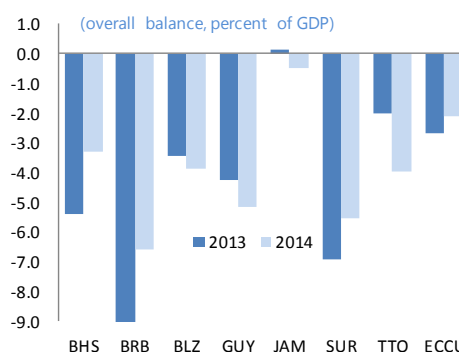
Public finance vulnerabilities are being addressed, yet they remain under strain. Primary balances have improved in many countries, but in most cases are still insufficient to ensure debt sustainability. On average, the tourism-dependent economies carry a debt burden in excess of 85 percent of GDP. In the ECCU, fiscal vulnerabilities are compounded by acute financial fragilities, as non-performing loans continue to be high. The slow pace of banks' balance sheet cleanup in the ECCU has contributed to a contraction of credit to the private sector in many economies. Most ECCU members have passed revised legislation to strengthen the framework for bank supervision and regulation and asset-quality reviews have been conducted.

The lower oil-prices are expected to help improve the external balances of the tourism-dependent economies. The average current account deficit for these economies was around 13 percent of GDP in 2014 and is projected at about 10 percent for 2015. In the commodity exporting Caribbean, current account deficits are lower but expected to widen to about 7 percent of GDP in 2015.

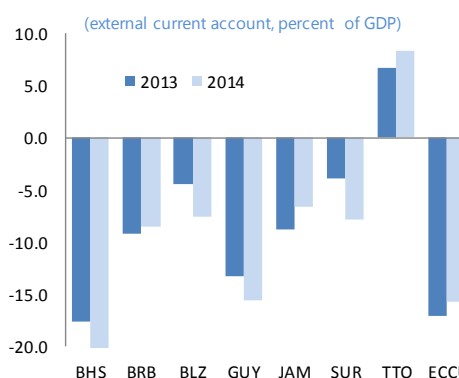
Caribbean growth was 2.5% in 2014, up from 1.9% in 2013...



... public finances continue to be under strain, and ...



... external imbalances remain large.



Sources: IMF World Economic Outlook, and desk estimates.

Challenging policy environment

The challenges remain salient as governments try to secure a sustained economic recovery and at the same time respond to people's demands for more inclusive growth and better quality public services. Commodity exporters in the region – Belize, Guyana, Suriname, and Trinidad and Tobago – also face new challenges as they cope with declining tax revenues resulting from the sharp drop in energy prices and other commodities, and will require fiscal measures to make up for revenue shortfalls. Tourism-based economies have to address their persistent low competitiveness related to the Caribbean's relatively high domestic cost levels, which could rise further as the region's pegged currencies appreciate in line with the U.S. dollar. Moreover, some of the destinations could possibly lose market share as Cuba opens as a potential tourist destination for the U.S. In addition, there may be financing risks for countries under the PetroCaribe agreement if Venezuela's ongoing economic crisis disrupts PetroCaribe oil supplies.

The need to enhance competitiveness is now more pressing with the rising of U.S. dollar and the opening of Cuba. To raise competitiveness, Caribbean countries need to align wage increases with productivity, reduce energy costs by improving the efficiency of the energy sector, and further improve the quality of the infrastructure and public services. Given the fiscal constraints, governments in the region will have to rely more on private investment to make the necessary investments, which will require improving the business environment.

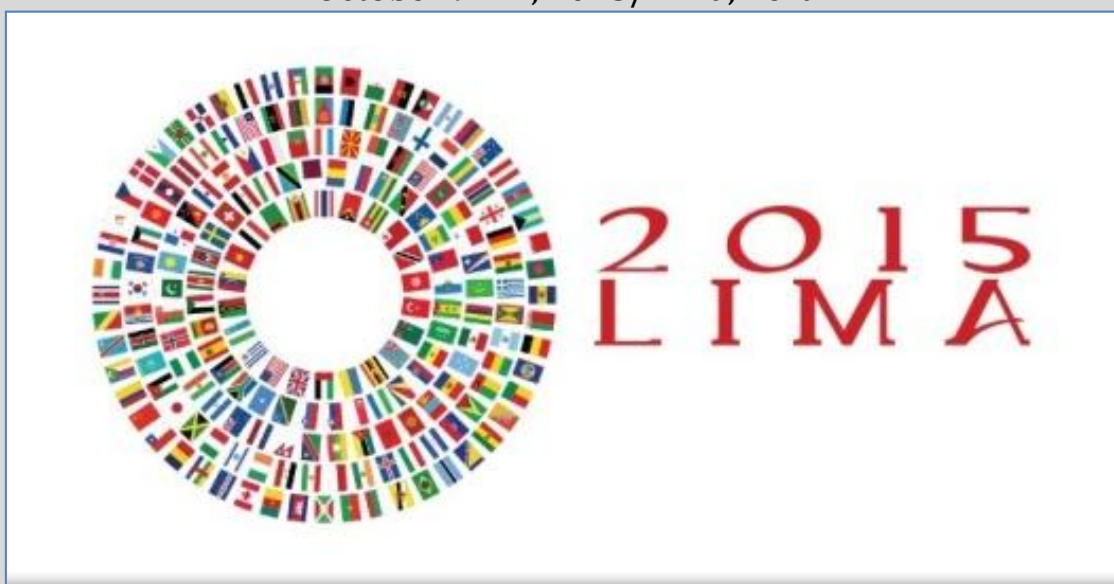
Lower public deficits would help to reduce external current account deficits and restore external competitiveness. To the extent possible, authorities should take advantage of the economic recovery to reduce fiscal deficits and put public debt on a sustainable path. Current lower imported fuel prices provide some respite to tourism-based economies and the authorities should use this opportunity to make necessary adjustments to their economies. The negative effects of policy tightening on growth can be mitigated by carefully redirecting scarce budget resources away from current spending toward growth-enhancing public investment. Phasing out tax exemptions and eliminating fuel subsidies by replacing them with better targeted programs to the poor could also help further improve public finances. Structural reforms such as civil service and public pension systems should be considered to improve long term fiscal balance.

The need to enhance competitiveness is now more pressing with the rising of U.S. dollar and the opening of Cuba.

A sound and well capitalized financial system is critical to provide credit to the private sector and improve the business environment in the region. The authorities will need to strengthen the legal and regulatory framework and enhance supervision. In the ECCU, progress toward resolving weak banks in an orderly and coordinated regional approach is urgently needed.

IMF-World Bank 2015 Annual Meetings

October 9–11, 2015/Lima, Peru



Web link: <https://www.imfconnect.org/content/imf/en/annual-meetings/2015-Annual-Meetings.html>

COUNTRY BRIEFS



St. Kitts and Nevis: Blazing Ahead Under Cloudy Conditions

By Ahmed El-Ashram and Judith Gold

St. Kitts and Nevis witnesses a turn-around in economic performance, in part owing to the successful Citizenship-by-Investment program.



View of the Frigate Bay area, St. Kitts and Nevis.

Photo: Wikimedia Commons.

In 2014, St. Kitts and Nevis registered its second consecutive year of rapid growth of about 6 percent, one of the highest in the Western Hemisphere. The fiscal outturn was also impressive. Tax revenues surged by 14 percent, while the overall fiscal surplus was 9.5 percent of GDP. Employment grew by a cumulative 23 percent since 2012, while inflation remained low at 0.6 percent at end-2014. This exceptional performance reflects both continued strong inflows under the country's Citizenship-by-Investment (CBI) program and adjustment and reform implemented under the country's Fund-supported home-grown economic program.

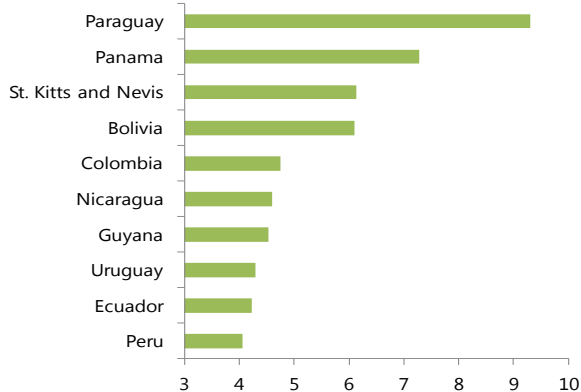
Facing dire macroeconomic conditions and an imminent debt crisis, the country sought IMF support in July 2011. By end-2010, public debt was one of the highest in the world at 159 percent of GDP. GDP had fallen by a cumulative 7½ percent since 2009 and the fiscal position deteriorated to a deficit of 7.5 percent of GDP.

The program supported by the IMF aimed to substantially strengthen the public finances, restore debt sustainability, and promote growth. Fiscal consolidation efforts placed emphasis on strengthening the tax administration and widening the tax base, while containing expenditures. The introduction of VAT at end-2010, the implementation of an excise tax and electricity tariff reform, and a freeze of the public wage bill had all significantly contributed to the fiscal adjustment. Moreover, comprehensive debt restructuring, including with external creditors, led to a substantial reduction in debt and debt service cost. An innovative debt-for-land swap with domestic banks trimmed the public debt ratio at end-2014 by around 35 percentage points (41 points using 2010 GDP). This, together with rapid GDP growth, brought public debt down to 79 percent of GDP at end-2014, half of that in 2010. Meanwhile, financial stability was safeguarded, including through the Banking Sector Reserve Fund (BSRF) established under the Stand-By Arrangement.

Notwithstanding substantial progress under the

Top 10 Growing Economies in the Western Hemisphere, (2013-2014)

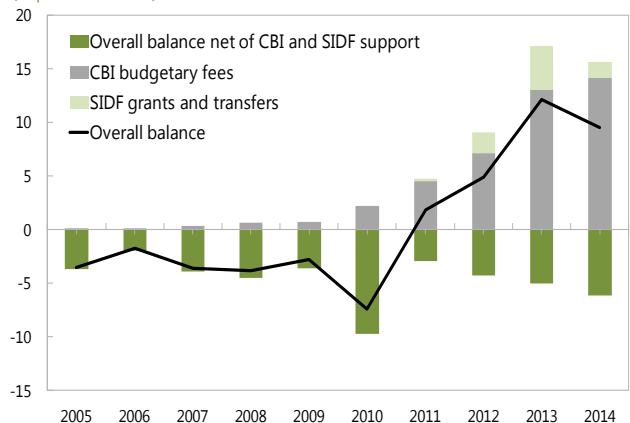
(GDP growth, in percent)



Sources: National Authorities, ECCB and IMF staff estimates.

St. Kitts and Nevis Fiscal Balance

(In percent of GDP)



Sources: St. Kitts and Nevis authorities and IMF staff estimates.

program, St. Kitts and Nevis owes much of the impressive turn-around of its economy to the dramatic surge of CBI inflows. The program, originally established in 1984, began to generate significant financial inflows starting in 2011 in the form of budgetary revenues, donations to the Sugar Industry Diversification Foundation (SIDF)—the country's National Development Fund—and private investments in real estate. In 2014, CBI revenues to the budget were 14 percent of GDP, with an additional 13 percent accruing to the SIDF. These resources have facilitated the financing of significant capital investments by both central government and the SIDF which, together with the FDI inflows to real estate, fueled a construction boom that largely underpinned the country's strong recovery. SIDF financing of sizeable social projects, in particular the People Employment Program, has further bolstered the recovery.

Despite high growth, policy challenges remain; chief among them is sustaining fiscal discipline.

Although the economic momentum remains strong, the outlook is less certain. Potential volatility of CBI inflows creates significant economic vulnerabilities. Increased competition from similar programs, regionally and internationally, and enhanced scrutiny by advanced countries may materially diminish flows in the future, reducing revenues to the budget and dampening growth prospects. The authorities are implementing significant reforms to enhance due diligence procedures and increase collaboration with other programs in the region. Other risks include natural disasters and slower growth in advanced economies that can reduce tourist arrivals. Reflecting these risks, growth is expected to moderate somewhat to 5 percent in 2015, and normalize at the regional average of 2.5 percent over the medium term.

On the policy front, challenges continue to prevail; chief among them is sustaining fiscal discipline. This will be critical in the short run, to prevent overheating pressures in the economy, and in the long run, to increase resilience to any loss of CBI income. The introduction of VAT and import duty exemptions on food and other items in late 2014 and early 2015 has weakened the tax base and introduced new risks to fiscal sustainability, requiring corrective action over the medium term to recover the loss in core revenues. Strengthening fiscal policies would also require an overarching framework to contain SIDF's quasi-fiscal spending, enhance its financial reporting and eventually integrate its accounts with the budget. Similarly, the large accumulation of financial assets by both the Central Government and SIDF, estimated at about 50 percent of GDP, requires a comprehensive strategy that considers options for their prudent management, including by more rapidly reducing the debt stock and investing large savings overseas, through a Sovereign Wealth Fund account, to alleviate excess liquidity in the domestic banking system. In the mean time, gains in debt sustainability achieved through the debt-for-land swap need to be cemented by developing a land use strategy that simultaneously fulfills national objectives and ensures the stability of the banking system over the long-run.

Securing the economic prosperity of St. Kitts and Nevis requires continuing focus on the tourism sector—the long-run propeller of growth. The tourism product can be further enhanced through effectively positioning new CBI developments to expand capacity and attract niche tourism. This should help support a smooth economic transition as the CBI investment cycle matures. Pressing ahead with structural reforms to improve the business environment, address the skills gap, and reduce energy costs would build a supportive environment for stronger private sector development.



Belize's Energy Sector: Challenges and Opportunities

By Marcio Ronci

Belize has seen steady economic growth and increasing demand for energy in recent years. But high energy costs and fossil fuel dependence, vulnerability to weather and oil market developments, and antiquated energy infrastructure continue to be obstacles to higher and sustainable growth. The government is building a nationwide strategy to promote energy efficiency in all sectors and developing dependable domestic renewable sources of energy.

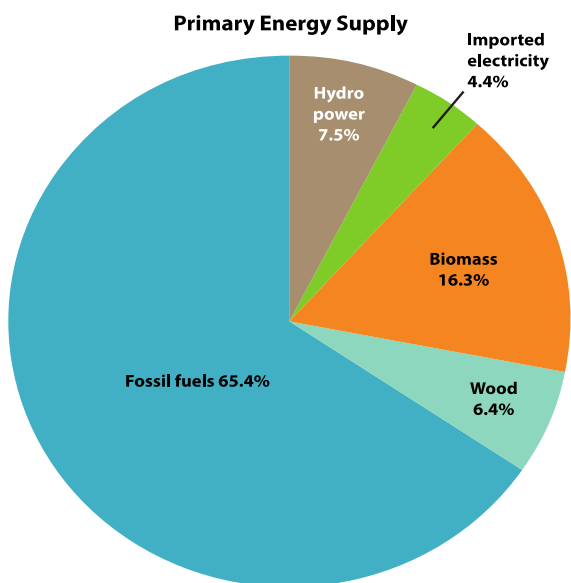
Energy matrix and efficiency

Belize relies heavily on imported fuel for its energy. The primary energy sources comprise imported fossil fuel, imported electricity, hydroelectric power, and biomass

from sugarcane bagasse. The shares of wind and solar energy are negligible. In 2010, the main consumer of energy was the transport sector (47 percent of total energy consumption), followed by the industrial sector (27 percent). The residential, commercial, and service

sectors accounted for the remaining energy consumption. All refined oil products (gasoline, diesel, kerosene, and aviation gasoline) are imported from Venezuela under the PetroCaribe Agreement and transported to Belize via ocean tankers. Small quantities of gasoline and diesel are also imported from neighboring countries

Belize is still highly dependent on fossil fuel for its energy needs.



Sources: Belize National Energy Policy Framework, 2011.

In terms of energy efficiency, Belize’s energy use has remained relatively stable at about 4,000 BTUs per unit of GDP over 1980-2012, well below the Caribbean average of 12,000 BTUs per unit of GDP. Belize’s energy efficiency also compares well with Central American countries. Nevertheless, further improving Belize’s energy efficiency would be a cost effective strategy to meet the country’s increasing energy demand.

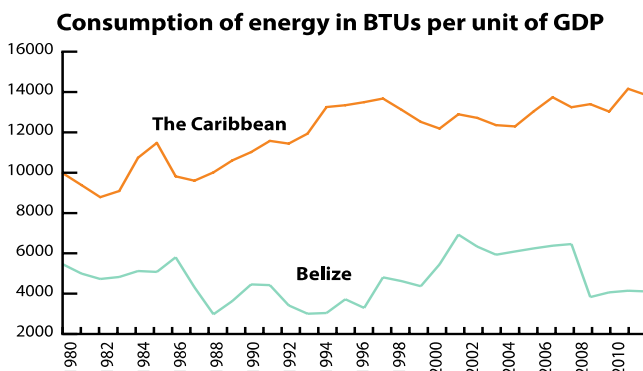
Electricity sector

Electric power is essential for promoting economic growth, particularly in the two most important sectors of the economy (tourism and agribusiness). Electric power generation is provided by a number of independent suppliers, including Mexico. In 2012, 45 percent of the electricity generation output was purchased on the spot market from Mexico’s Federal Energy Commission (CFE). Electricity distribution is mainly through a 115 kV transmission line that covers the entire northern and western sections of the country, and the southern areas of the country are partly covered by a 69 kV transmission line. The national grid connects all the districts and is interconnected with Mexico, although the national grid does not reach all parts of the districts. In some remote locations, consumers self-generate electricity. In 2011, the government nationalized BEL, acquiring 70 percent of its shares. Currently, BEL is the sole buyer of electricity from public and private producers and the only distributor of electricity to final users. BEL’s capital investment projection is estimated at US\$74 million over 2012-15.

The Public Utilities Commission (PUC), created in 1999, regulates tariffs and the quality of the electricity service. It also grants licenses for generation, transmission, and distribution, and ensures that all reasonable electricity needs are met.

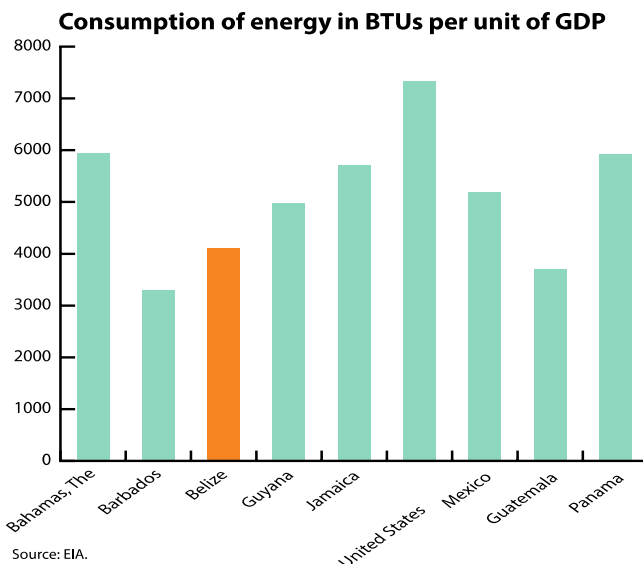
In general, Belize’s electricity rates—which are high by U.S. and Latin American standards but low by Caribbean standards—fairly reflect economic costs, and are not subsidized. The average electricity tariff was broadly stable at about 0.22 US\$/kWh from 2007 to 2012. Since 2012, the average tariff in Belize has been reduced to 0.20 US\$/kWh as result of cheaper electricity from Mexico and fossil fuels. The price is mainly determined by generation costs and BEL’s transmission and distribution costs, which includes taxes. Generation costs are determined by the electricity generation mix, which mainly comprised CFE’s imports, low-cost hydroelectric energy, and cogeneration using biomass. However, these hydroelectric resources greatly vary depending on rainfall, and the electricity imported from Mexico (CFE) is tied to the international price of crude oil. Compared with the region, Belize’s transmission and distribution losses are not substantial at 15 percent. Although BEL seems to be operating at

Belize use of energy per unit of output has remained below the Caribbean average.



Source: EIA.

Belize consumption of energy per unit of output also compares well with other countries.



Source: EIA.

acceptable levels, it could improve its financial and operational (technical) performance. In addition, Belize could foster private investment in the electricity sector in order to achieve competitive generation costs and lower average tariffs.

Challenges and opportunities

In 2011, the government developed the National Energy Policy (NEP), which contained an extensive list of policy recommendations to address the problems of the energy sector in Belize. The NEP's two main strategies are promoting energy efficiency in all sectors of the economy (transport, industry, and commercial and residential buildings) and developing dependable domestic renewable sources of energy for both electric power and transportation. Implementing the national energy strategy will be a challenge given Belize's financial and capacity constraints. The success of the strategy will depend vitally on private sector participation and investments.

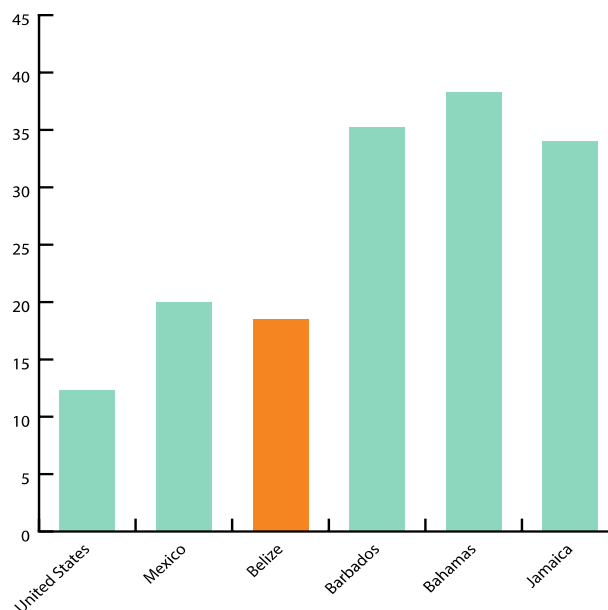
In 2012, the Ministry of Energy, Science, Technology, and Public Utilities released its National Strategic Plan for 2012-2017. The plan is ambitious and aims at improving energy efficiency and conservation across all sectors (transport, industry, and commercial and residential buildings) by reducing per capita energy intensity of at least 30 percent by 2033. It also aims at reducing the country's dependence on imported fuels by 50 percent by 2020, from one million barrels to one-half million barrels, by increasing the production of domestic renewable energy resources, and by improving energy efficiency and conservation.

The National Energy Policy's two main strategies are promoting energy efficiency in all sectors and developing dependable domestic renewable sources of energy.

Improving energy efficiency can generate significant gains in reducing energy costs. Belize should reduce technical and commercial losses in electricity transmission. BEL is upgrading the electric power grid, which will help to reduce transmission losses as well as making electric power more reliable. Also, the government is looking into improving efficiency of energy consumption in buildings, particularly among heavy consumers such as hotels and manufacturing. Ways to promote more efficient use of energy in buildings would include introducing new building energy efficiency codes, promoting energy auditing, and retrofitting existing buildings with more efficient lighting and cooling systems. A major energy saving project that the government and BEL are considering would replace street lighting by more

Belize electricity rates are lower than Caribbean countries, but still about 50% higher than the U.S.

Electricity rates, 2012, US cents/kWh



Source: CARILEC and EIA.

efficient LED lighting. To promote efficiency in transportation, the government will have to update road and ports infrastructure.

Two promising sources of renewable energy in Belize are wind and biomass. The country has both offshore and onshore wind resource potential. The National Renewable Energy Laboratory of the U.S. estimated in 2008 that the country had 737 km² of moderate to excellent wind resource potential (class 3-7 wind) at 50 m. A study carried out for the government estimated the undeveloped hydroelectric potential of the country to be approximately 75 to 100 MW. Currently traditional biomass accounts for 14 percent of total electricity output, and it could be substantially increased in a relatively short time. According to Belize Co-Generation Energy Limited, the country has additional bagasse resources that could be used for electricity generation. The government is also looking into possible use of biomass fuel for transportation.

In order to meet the growing demand for electricity and reduce dependence on imported electricity and fossil fuels, the PUC issued a request for proposals (RFP) for new generation capacity in 2013 to increase by 40 percent the current electric power installed capacity of 156 MW. The RFP called for the addition of 50MW of firm generation capacity (biomass, hydro, or fossil fuel) and 15MW of intermittent renewable generation (most likely wind) to be installed in Belize between 2013 and 2023. Six proposals were selected and PUC is negotiating the terms of the contracts.



New ECF Arrangement for Haiti: “There Can Be no Stability Without Growth”

By Lawrence Norton and Wayne Camard

On May 18, the IMF Executive Board approved a new three-year arrangement under the Extended Credit Facility (ECF) for Haiti of about US\$70 million. This ECF follows another arrangement approved shortly after Haiti’s January 2010 earthquake.



Haiti rebuilds: The Highest Court (Cour de Cassation) new building and children’s school day.

Photos: Haiti Ministry of Communication (left); Carol Ann Petersen (right).

On May 18, the IMF Executive Board approved a new three-year arrangement under the Extended Credit Facility (ECF) for Haiti of about \$70 million. This ECF follows another arrangement approved shortly after Haiti’s January 2010 earthquake.

The freeing of additional resources from the energy sector, coupled with improvements in public financial management included in the program, should greatly enhance the government’s ability to attack poverty.

The program after the earthquake focused on maintaining macro-stability in the context of high aid inflows. Since then, Haiti has seen four consecutive years of positive per capita growth, but the economic recovery has been slower than expected, and aid has subsided. Thus, the new program places greater stress on structural reforms to boost growth, without abandoning the stability achieved during the earlier program. “There can be no stability without growth” is a refrain heard both from Central Bank (BRH) Governor Charles Castel and from Finance Minister Wilson Leau. Key programmed reforms are aimed at boosting competitiveness and at maintaining buffers to cushion against potential shocks.

In the last fiscal year under the previous program, the authorities spent some 4 percent of GDP on energy subsidies, half as tax expenditures on fuel prices at the pump, and half in subsidies to the state electricity company. The new program aims to take advantage of lower oil prices to recover most of these subsidies, which go overwhelmingly to the top quintile of the income distribution. The authorities have been able to maintain pump prices and to adopt an automatic domestic fuel pricing mechanism to protect fiscal revenues from fluctuations in international oil prices. On electricity, the program aims to increase revenue through improved billing and collection, to reduce the two-thirds of electricity production for which the utility is never paid, and to rationalize purchases from independent power producers, ensuring that the benefits of lower oil prices are passed on to the utility.

The freeing of additional resources from the energy sector, coupled with improvements in public financial management included in the program, should greatly enhance the government’s ability to attack poverty. On June 18, when the Association of American Chambers of Commerce in Latin America (<http://www.aaccla.org/>) held its Annual Meeting in Haiti, President Martelly told delegates that “Haiti is open for business.” The new ECF is expected to play a crucial role in fulfilling these expectations.

ON THE RADAR

Smaller States and Large Fiscal Adjustments: Recent Experience

By Dominique Simard, Constant Lonkeng, and Genevieve Lindow

High public debt levels challenge many smaller states, notably in the Caribbean. The article analyzes recent debt reduction episodes in small states.

The Caribbean includes some of the world's most highly indebted countries (measured by debt to GDP ratios). The region's debt challenges stem from the cost of natural disasters, gaps in fiscal management, loss-making public enterprises, and sub-par economic growth. Lowering public debt to sustainable levels will require boosting growth over the medium-term, by eventually permitting a shift of scarce budgetary resources from interest payments on public debt to more productive government outlays.

Some of the commonly proposed options for governments seeking to reduce public debt levels are not always viable. There may be limited scope for directly lowering the stock of debt through buybacks, restructuring or conversion. Moreover, the middle-income status of many Caribbean countries prevents their eligibility for debt relief under the Heavily Indebted Poor Countries/Multilateral Debt Relief Initiative (HIPC/MDRI) initiatives—although some have benefitted from other forms of debt relief, including through the Paris Club. High growth, inflation tolerance, and/or financial

repression are also not currently practical options.

For countries with only limited means to lower their public debt through buyback, restructuring or conversion, this leaves strengthening the fiscal position as the most viable option. Smaller states undertaking a large fiscal consolidation would be expected to suffer less output loss from the adjustment than would larger states, given their lower fiscal multipliers (Amo-Yartey and Turner-Jones (2014)). This is because smaller economies are more open, with a narrower production and export base and a greater

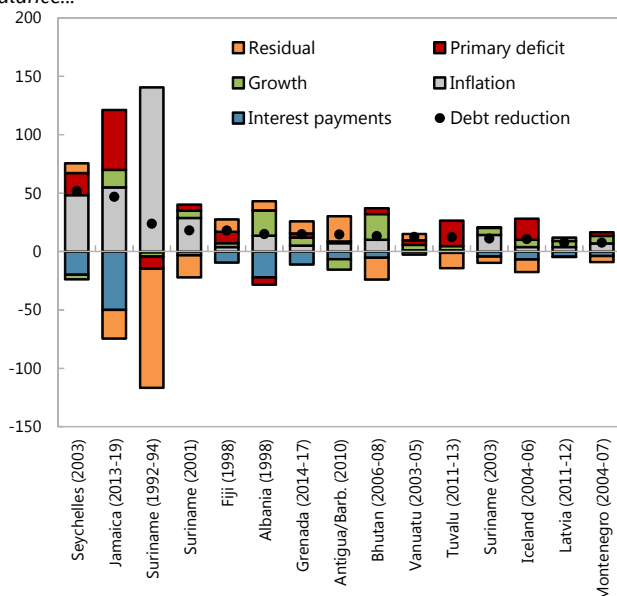
Reducing the wage bill seems to be the most promising strategy for lasting fiscal adjustment.

reliance on imports. The higher import leakage from fiscal adjustment in smaller states implies that the burden of a fiscal contraction tends to fall more on imports and less on domestic production than in larger states.

International experience from successful debt reduction episodes of smaller states shows that adhering

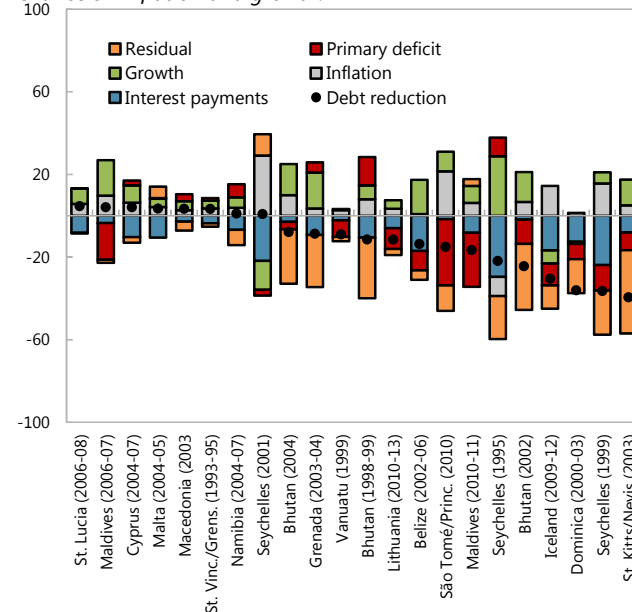
Success: Contribution to Debt Reduction 1/ (percent of GDP)

Successful cases tend to be associated with increasing the primary balance...



Non-Success: Contribution to Debt Reduction (percent of GDP)

...while unsuccessful cases tend to be associated with more reliance on inflation and growth.



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

1/ The cases of Grenada and Jamaica are as currently projected under their respective programs. They are benchmarked against these comparator countries given the envisaged size of the debt reduction.

to strong primary fiscal surplus objectives is critical for achieving lasting gains in debt reduction. In contrast, the unsuccessful debt reduction episodes seem not to have relied as much on generating primary surpluses. This finding clearly emerges from our study, which examines the thirty percent largest cases of fiscal consolidation, from 1990 to 2014, for non-oil exporting smaller states (population no greater than 3 million) that did not undergo a debt restructuring or did not receive debt forgiveness.

The study includes all episodes of fiscal consolidation defined to start with an improved primary fiscal balance (budget revenue less non-interest budget spending) by one percentage point of GDP or more and last as long as the primary fiscal balance does not deteriorate from the previous year. Fiscal consolidation is deemed successful if a country's debt to GDP ratio remains lower four years following the year preceding the fiscal consolidation episode. Out of 35 cases in which countries started to improve their primary fiscal balance, 14 successfully reduced their debt ratio 4 years out, and 11 of these cases featured a cumulative improvement in the primary balance over the 5-year period.

Reducing the wage bill in percent of GDP seems to be the most promising strategy for a lasting successful fiscal consolidation. This result is based on comparing the distribution of countries' adjustment of their key fiscal variables (expressed as a ratio to GDP) during the fiscal consolidation episode, for each of the successful and unsuccessful groups. While most countries in both groups raised their tax revenues during the adjustment period, successful episodes tended to be linked to a larger

reduction in the wage bill, combined with less compression in the non-wage current primary spending.

These results underscore the importance for countries consolidating their budgetary positions to pay attention to the quality of their fiscal adjustments as well as their magnitudes. In that regard, meeting a given primary balance target by containing the wage bill, including through structural reform of the public service, would provide additional space that would help limit necessary cuts in non-wage primary expenses (for instance, budgetary outlays for infrastructure investment and social transfers for the poor). In turn, sparing non-wage primary spending would help prevent a sharp reversal of the budgetary position in later years—tilting up the trajectory for public debt—as public expenditure pressures mount to address unmet needs.

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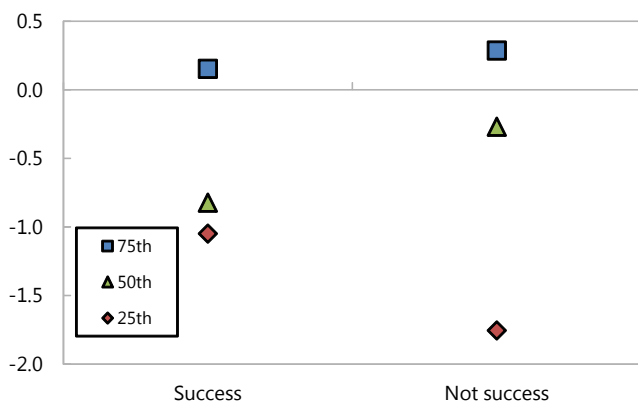
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Wage Bill

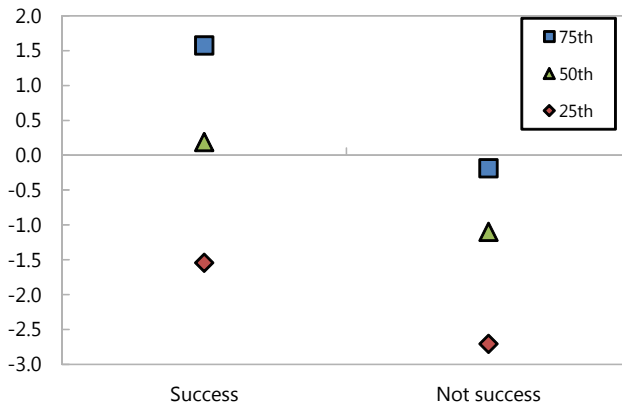
(change during consolidation episode, percentage points of GDP)
The distribution of successful debt reduction cases is shifted more towards a sharper reduction in the wage bill relative to unsuccessful cases...



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Other Current Public Expenditure

(change during consolidation episode, percentage points of GDP)
...while the distribution of successful cases is also shifted more towards an increase or a smaller cut in other current public outlays.





Correspondent Banking Challenges in the Caribbean

By Jacques Bouhga-Hagbe

The potential loss of correspondent banking relationships could destabilize financial systems and economic activity in the Caribbean.

A number of major banks have recently either terminated their correspondent banking relationships (CBRs) with many banks in the Caribbean, or have threatened to discontinue them. In global banks' communications to affected banks, the reasons for the termination of the relationships may not be fully articulated, making it particularly difficult for affected banks to seek replacement correspondents. It is believed that this phenomenon is emerging as an unintended consequence of several factors, including the enforcement of stricter global regulatory standards such as on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and prudential regulations. As a result, some customers, business lines, markets and jurisdictions are evidently being perceived as too risky and costly in terms of compliance, and are therefore

The loss of correspondent banking relations could be disruptive to the banks and to economic activity in the Caribbean.

being cut off by global banks. Already at least 10 banks in the region in five countries have (as of June 2015) lost all or some of their CBRs, including two central banks. In at least one country, local banks that have already lost major CBRs are of systemic proportions, with assets amounting to more than half of the domestic banking system's total assets or about 50 percent of GDP. In other Caribbean countries, the affected banks so far are either not systemic or have other ongoing CBRs. Nonetheless, the potential loss of vital CBRs has emerged as a major risk for all Caribbean banks. Outside the Caribbean, there is evidence that similar "de-risking" is also taking place in regions such as the Middle East and North Africa.

The loss of CBRs could be disruptive to the banks and to economic activity in the Caribbean. All international transactions conducted through the affected banks (which now have to use other local banks that still have CBRs, including local central banks) are potentially affected. These include the processing of financial instruments (i.e., cash, checks, money orders, wire transfers, credit and debit cards, and letters of credit) that are critical for key

international transactions such as remittances, tourism, trade and foreign direct investment. Such disruptions affect local banks' incomes directly as they lose significant revenue-generating businesses, but also indirectly, at least on a temporary basis, they hit the economy as a whole and therefore banks' customers. Even when some local banks manage to maintain their CBRs as others lose theirs, they may not have the capacity to process a sudden increase in the volume of new transactions, especially wire transfers, coming from other local banks that lost their CBRs. This can result in significant delays in the processing of these transactions.

The wholesale cutting loose of entire classes of customer, without taking into account ... their level of risk or risk mitigation measures for individual customers within a particular sector, is not in line with the FATF standards.

The impact of the loss of CBRs in the Caribbean has been contained so far, partly because of measures taken by Caribbean authorities. In countries where concerns were the greatest in early 2015, new arrangements that have been put in place with the support of central banks and major credit card companies seem to be working as international financial transactions have not been disrupted as initially feared. The banks that lost their CBRs are sending their customers to other banks to do wire transfers. The central banks can process banks' cash documents and wire transfers using their own CBRs, though the increasing volume of these new transactions will likely pose a challenge. In other Caribbean countries, specific measures have yet to be taken to address the loss of CBRs as disrupted transactions can be processed by other banks, including through branches or subsidiaries of foreign banks. Some concern arises though in some cases where affected banks have had to replace traditional correspondent banks with other banks that are not household names. In other cases where termination has been threatened, local banks improved significantly the speed and quality of their replies to requests for information by external regulatory authorities. And in a

broader response to the issue, Caribbean authorities are working toward stronger national financial systems and AML/CFT frameworks.

In its [October 2014 statement](#), the Financial Action Task Force (FATF) noted that the wholesale cutting loose of entire classes of customer, without taking into account, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector, is not in line with the FATF standards. It emphasized that de-risking can introduce risk and reduce transparency into the global financial system, as the termination of CBRs has the potential to force local financial institutions and persons into less regulated or informal channels. It also pointed out that moving funds through regulated, traceable channels facilitates the implementation of AML/CFT measures. The FATF expects

financial institutions to identify, assess and understand their money laundering and terrorist financing risks and take commensurate measures in order to mitigate them. This does not imply a “zero failure” approach, but instead a [“risk-based” approach](#).

IMF staff is already engaging national and international partners—including the Federal Reserve, the World Bank, FATF, the Financial Stability Board, and the Arab Monetary Fund—to encourage a proportionate application of international standards on AML/CFT and to raise awareness on related spillovers to other countries. An IMF staff discussion note (SDN) is expected to be issued in 2016, including policies that countries could implement to reduce the likelihood of losing CBRs. The position and recommendations of the IMF Executive Board will likely follow the SDN.

Adeus e Obrigado Sr. Nogueira Batista

By Jacques Bouhga-Hagbe and Issouf Samake



The IMF bid farewell to Mr. Paulo Nogueira Batista, who was its Executive Director from 2007 to 2015, representing many countries, including in the Caribbean.¹ With his departure, his constituency lost an eloquent and tenacious representative, and low-income countries and small states lost a relentless ally. In particular, he has been passionate about ensuring fair treatment for all IMF member countries, noting that, “for surveillance to be effective, it is imperative that it be even-handed and unbiased so as to gain traction and legitimacy.” He supported the doubling of access limits on the Funds’ lending to low income countries and the reform of

the concessional framework to ensure that the Fund can respond more effectively to the diverse needs of low-income countries. As a member of the Executive Working Group on small states, he played a key role in reshaping the Fund’s engagement with these members. He believed that providing high quality technical assistance is crucial to the Fund’s role as a trusted advisor, and that the Fund needs to be attentive to country’s particular circumstances. Mr. Nogueira Batista has been appointed vice-president of the BRICS New Development Bank in Shanghai, China.

Prior to joining the IMF, Mr. Nogueira Batista held various positions in Brazil, including Under Secretary for Economic Affairs in the Ministry of Planning; Advisor to the Minister of Finance; Head of the Center for Monetary and International Economic Studies of the Getúlio Vargas Foundation in Rio de Janeiro, Brazil; and Professor in the Economics Department of the same Foundation in São Paulo, Brazil.

¹ Brazil, Cape Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago.

IMF- Western Hemisphere Department Annual Forum

The 2015 High Level
CARIBBEAN
Forum
September 3-4
Frigate Bay, St. Kitts

Web link: <http://www.imf.org/external/np/seminars/eng/2015/caribbean/>

IMF CAPACITY BUILDING

CARTAC: Setting a Solid Foundation for Phase V, Steering Committee and Stakeholder Strategy Events, June 1-2, 2015

By David Kloeden, CARTAC Coordinator

CARTAC's Steering Committee and stakeholders met in Barbados over June 1-2, 2015 to take stock of work over the past year, and to chart a course for the next five year cycle. These meetings were particularly important to assess achievements, identify priorities and challenges, and outline a strategy going forward.

The Caribbean Regional Technical Assistance Center (CARTAC) Steering Committee and stakeholders met in Barbados over June 1-2, 2015 to take stock of work over the past year, and to chart a course for the next five year cycle. These meetings were particularly important to assess achievements, identify priorities and challenges, and outline a strategy going forward.

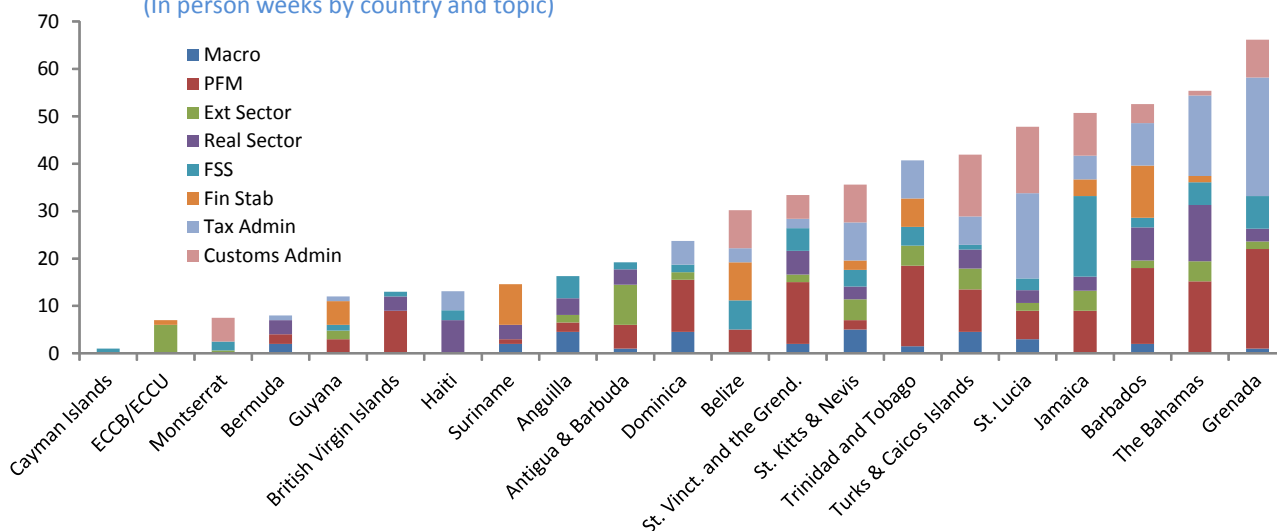
The Steering Committee and stakeholders confirmed the important role that CARTAC plays in the region. FY15 was the busiest year to date for CARTAC. All member countries received TA from CARTAC with Grenada, Bahamas, Barbados, Jamaica, and St Lucia being the five biggest beneficiaries with much accomplished across all key areas.

Since its founding in 2001, CARTAC has evolved from a joint IMF-United Nations Development Program initiative, to a fully-fledged member of the IMF's network of nine [Regional Technical Assistance Centers](#), while at the same time retaining its strong regional ownership and identity. Its current phase scheduled to end in April 2016 has now been extended until end-2016 to utilize remaining financing.

The June 1, 2015 Steering Committee, chaired by Governor Brian Wynter (Bank of Jamaica), was attended by donors, member countries, and IMF representatives. Proceedings included several presentations and active discussions, including on the findings and recommendations of the independent evaluation. Further, the continued role of Barbados as host country for CARTAC was formalized by the signing of a Memorandum of Understanding between Minister Sinckler (Minister of Finance and Economic Affairs, Barbados) and the IMF.

David Kloeden (CARTAC Program Coordinator) reported on TA delivery in the region. He showed that work in public financial management is yielding results with progress across all Public Expenditure Financial Accountability (PEFA) indicators where CARTAC is active, and the macroeconomic and financial stability programs are now firmly established. With the successful implementation of the VAT in Bahamas, and a VAT planned for Suriname, work in this area is nearing completion. Fifteen CARTAC member countries (including the eight members of the Eastern Caribbean Currency Union) are taking significant steps in the implementation of revised capital standards (commonly known as Basel II),

CARTAC: Summary of TA Delivery, FY 2015 (May 2014–April 2015)
(In person weeks by country and topic)



Source: CARTAC.

which will significantly strengthen their resilience, and enhance the supervisory and regulatory capacities of regional regulators to meet international standards.

The region member countries' representatives shared their experiences of working with CARTAC. Ms. Rosamund Edwards (Financial Secretary, Dominica) outlined the role of CARTAC in building Dominica's capacity to undertake the structural adjustments needed as part of an earlier IMF program – the results of which can still be seen today. For example, a macroeconomic policy unit was established, which is still in place. Ms. Nancy Headley (Acting Permanent Secretary of Finance, Barbados) highlighted the timeliness and responsiveness of CARTAC technical assistance, as well as its role in support of Barbados' fiscal consolidation program over the past year (notably the monitoring of state owned enterprises, and fiscal rules), and the three year fiscal frameworks which will be rolled out in the larger spending ministries.

The recent independent evaluation was discussed, and found to be balanced and well researched. It contained many recommendations including: the need to ensure smooth transitions between phases; adopting a more programmatic approach in planning and delivering of technical assistance; and enhancing the focus on multi-disciplinary work. Donors welcomed the strengthened approach to results based management, with the appointment of an RBM Advisor, as part of the resident advisor complement.

The June 2 Stakeholder Strategy event, opened by Governor DeLisle Worrell (Central Bank of Barbados), expanded participation to include the newest cohort of CARTAC interns (due to take up their positions at institutions across the region, including two at CARTAC itself).¹ Mr. Trevor Alleyne (WHD) identified the main

challenges facing the region, which set the context for CARTAC's priorities going forward. The discussions that followed led to a broad consensus that the scale of CARTAC operations was appropriate, both in terms of the volume of technical assistance and training delivered, and in terms of the areas covered. Nonetheless, some adjustments at the margins to address emerging demands were needed,² with a greater focus on strengthening the pool of regional expertise, to facilitate, over time, CARTAC's transition to becoming a wholly regionally-owned institution. Member countries, despite fiscal pressures, indicated their willingness to maintain their annual contributions to CARTAC, and the key donors (Canada, the European Union and the United Kingdom) confirmed their commitment to continue financing.

The closing panel, chaired by Governor Brian Wynter (Bank of Jamaica) on behalf of Governor Gilmore Hoefdraad (Central Bank of Suriname) reiterated the ongoing criticality of CARTAC in helping the region tackle the challenges faced by small, mostly middle-income states that include low growth, extreme vulnerability, productivity impediments, large fiscal deficits and high debt. While CARTAC will continue to support the strengthening of institutions and policy making capacity in its traditional areas, additional opportunities were identified to further enhance CARTAC's effectiveness, and ultimately contribute to growth and macroeconomic stability in the Caribbean.

¹ The interns are a group of 12 post-graduate economics students that CARTAC places over the summer in regional central banks as well as at CARTAC for work experience and research.

² Possibilities of extending CARTAC work into other areas of Fund expertise were discussed such as ALM/CFT, tax policy, legislation drafting by LEG, international tax issues, etc.

IMF Publications and Recent Country Reports on the Caribbean Economies

1. Antigua and Barbuda

Antigua and Barbuda: Staff Report for the 2014 Article IV Consultation and Second Post-Program Monitoring-Press Release; and Staff Report; IMF Country Report No. 15/189. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43087.0>

2. The Bahamas

The Bahamas: 2015 Article IV Consultation-Press Release; and Staff Report; IMF Country Report No. 15/203. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43125.0>

3. Grenada

Grenada: Second Review Under the Extended Credit Facility, Request for a Waiver of a Performance Criterion, Request for Modification of Performance Criteria and Financing Assurances Review-Press Release; and Staff Report; IMF Country Report No. 15/193. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43098.0>

4. Haiti

Haiti: Staff Report for the 2015 Article IV Consultation and Request for a Three-Year Arrangement Under the Extended Credit Facility; IMF Country Report No. 15/157. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43020.0>

Haiti: Selected Issues; IMF Country Report No. 15/158. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=43022.0>

5. Jamaica

Jamaica: Eighth Review Under the Arrangement Under the Extended fund Facility and Request for Waiver for the Nonobservance of Performance Criterion and Modification of Performance Criteria; IMF Country Report No. 15/150. <http://www.imf.org/external/pubs/cat/longres.aspx?sk=42995.0>

6. International Monetary Fund

International Monetary Fund, 2015: Macroeconomic Developments and Selected Issues in Small Developing States. <http://www.imf.org/external/pp/longres.aspx?id=4954>