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THE CARIBBEAN AND THE GLOBAL CRISIS

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Entitled

Global Financial Crisis: Uncertain Recovery

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I. The Global Crisis

As is well known, there are several features of the global economic crisis: **First**, the degeneration of a sub-prime mortgage market crisis concentrated in a few industrialised countries into a global financial crisis immersing banks and other financial institutions in the United States of America (USA), Europe, Japan and to a lesser degree developing countries in Latin America and the Caribbean and Asia; **Second**, the onset of the global economic recession in the third quarter of 2008, manifested most strongly in the USA and the United Kingdom (UK) but also evident in all of industrialised Europe, Japan and China with spill-over effects on economic growth in emerging economies and low-income countries.

Third, massive loss of personal wealth and incomes in the USA and Europe; **Fourth**, substantial diminution of equity, major income losses and onset of bankruptcy in the corporate sector of the same countries, affecting major sectors and industries; **Fifth**, the collapse of international commodity prices and slower growth in global trade as world economic growth contracted and the speculative boom in commodity prices collapsed; **Sixth**, foreign exchange market pressure on the US dollar and the pound sterling resulting in depreciation of bilateral exchange rates with the Euro; **Seventh**, extraordinary claims on the fiscal revenues of the most affected industrialised countries for financing of domestic stimulus programmes and rescue packages.

II. Channels of Transmission

The global crisis is transmitted to the Caribbean through international trade in goods and services, capital flows and remittances. The Caribbean is particularly vulnerable to external economic shocks because of several economic features. There is an acutely strong degree of trade exposure indicated by very high ratios of foreign trade to GDP, concentration of exports on a few commodities and services including tourism and international financial services, and reliance on the markets of a few main trading partners in North America and Europe. Foreign direct investment is very important in many countries, being between 10% and 25% of GDP. Official development assistance, though decreasing in most of the Caribbean, is still a substantial source of development finance in some countries, notably Guyana, Haiti and the Eastern Caribbean. Migrant remittances also contribute substantially to some economies, especially Guyana, Haiti, and Jamaica where remittances have been as much as 20% of GDP. Remittances supplement household budgets considerably, thereby improving levels of living for many households. High public sector indebtedness is a problem in the Caribbean. Public external debt to GDP ratios in 2008 were in the range of 21% - 77%, except in the Bahamas and Trinidad and Tobago. When domestic debt is added, debt ratios exceed 100% in a few countries.

III. Impact of the Crisis

The tourism industry has been severely impacted because tourists are from the two regions experiencing the greatest fall in employment, incomes and personal wealth and credit contraction, i.e. the USA and Europe. The United Nations World Tourism Organisation reports a 1% decrease in global international tourist arrivals in the second half of 2008 and projects a 1% - 2% decline in 2009. The contraction has been greater in the Caribbean (around 2% in most countries and much higher in the Bahamas). The outlook for 2009 is a 7% - 10% decline in the main tourist destinations. Mining and energy industries have also been adversely affected. The collapse of international prices for oil and methanol, bauxite and alumina and steel and falling global demand has caused plant closures or cutbacks in production and employment in Guyana, Jamaica and Trinidad and Tobago. Construction activity has slowed considerably in response to postponement of investments in hotel plants and visitor condominiums, curtailment of domestic residential capital expenditures and reduction in public sector capital investment. The fiscal situation of governments has deteriorated. The balance of payments current account has also widened. Real economic growth declined in 2008 and negative growth is projected in 7 of 14 countries in 2009. The greatest economic contraction is expected in the Bahamas where a 4.5% decline is projected, Barbados 3.5%, Jamaica 2.6% and Antigua and Barbuda 2%. Because CARICOM countries are not high-growth economies, there is not a sizeable cushion for absorbing the external economic shock.

IV. Policy Actions

Several types of policy initiatives have been taken to minimise the spill-over effects of the global economic crisis on the Caribbean. Governments have undertaken counter-cyclical fiscal expenditure programmes (mainly of a capital investment nature in economic and social infrastructure). They have also provided tax reliefs and subsidies to selected industries, tourism in most cases, and to the personal sector. In some instances, too, governments have established selective lines of credit at national development banks. It is important that the adjustment measures seek not only to defend the economic status quo. Consideration should be given to strengthening trade competitiveness in already established industries such as tourism and agriculture so that the economies are well positioned to benefit from the anticipated return to global economic growth. Furthermore, the opportunity should be taken to re-evaluate and restructure those industries such as offshore finance which seem likely to experience trade regime change in the very near future.

V. Financing the Adjustment

Given the fiscal limitations of Caribbean governments, financing of the adjustment will depend on access to resources from regional and multilateral development banks and from international financial institutions.

The Caribbean Development Bank (CDB) has responded by approving policy-based loans to several countries to provide conditional budgetary support. It has accelerated its rate of approvals of infrastructure and disaster rehabilitation loans and grants. Counterpart requirements on Bank-financed projects have been selectively reduced. The CDB has also reduced its loan rates of interest. A few countries have accessed pre-crisis credit facilities of the International Monetary Fund (IMF). However, since these are quota-based, the amounts available are small ($6mn -$20mn) even with the new scope for doubling quota-based entitlements.

The G20 Summit on 2 April 2009 recognised the critical importance of providing development and stabilization resources and agreed to provide $850 billion (bn) of resources through the IMF and multilateral development banks " to support growth in emerging markets and developing countries by helping to finance counter-cyclical spending, bank recapitalisation, infrastructure, trade finance, balance of payments support, debt roll-over and social support." Within this framework, the Inter-Development Bank (IDB) has created a $6 bn emergency liquidity facility for commercial banks, expanded its credit for social safety nets, and increased the size of its trade finance facilitation programme. The World Bank has initiated a Global Food Response Programme and a Rapid Social Response Fund of $2 bn to be used for social safety nets, infrastructure, education and health. It has also established a Global Trade Liquidity Programme with a target of $50 bn sourced from international finance and development institutions, governments and private banks. In addition to expanding and reforming its existing liquidity facilities, the IMF has established a Flexible Credit Line in March 2009. Under present rules, the Caribbean would have little access to the new facilities in the World Bank and IMF. In particular, only IDA-eligible countries which comprise a minority can have access to the Rapid Social Response Fund and the Global Food Response Programme. The IMF Flexible Credit Line would also not be very accessible because countries are unlikely to satisfy pre-set criteria with respect to matters such as sound public finance, a record of steady sovereign access to international capital markets on favourable terms, capital accounts dominated by private flows, low and stable rates of inflation and a comfortable foreign reserves position. Given these limitations on access to much of the resources promised by the G20, there is clearly an unfinished agenda for the middle-income developing countries of the Caribbean. They need to focus their efforts on seeking a relaxation of the policies governing eligibility to the resources committed by the G20, in particular those under management by the World Bank and the IMF. They would be wise to seek the support of international development partners in this task.