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The Acting Chair's Concluding Remarks
Caribbean—Selected Regional Issues
Executive Board Seminar 07/3
September 26, 2007

Directors welcomed the opportunity of today's seminar to discuss the policy implications of increasing economic integration in the Caribbean region, with a particular focus on issues related to financial integration, tax incentives and investment, and trade preference erosion. They saw the seminar as a useful complement to bilateral surveillance of Caribbean countries, and indicated that such seminars could usefully be held again in the future.

Directors noted that the historically open nature of Caribbean economies has served the region well, and has contributed to achieving relatively high per capita income levels. They commended the region's favorable macroeconomic performance in recent years, including the strong recovery of economic growth and the sizeable reduction in inflation. The strong commitment in Caribbean countries to social development and equitable growth has contributed to notable progress in the areas of health, education and poverty eradication. Nonetheless, Directors observed that the Caribbean's limited economic diversification, persistently large current account deficits and high public debt render the region vulnerable to swings in global economic and financial market conditions. In addition, the region is heavily exposed to natural disasters, in particular hurricanes.

Against this backdrop, Directors considered increased regional cooperation to be a key element of the Caribbean strategy to make the most of globalization and address the challenges it entails, and they welcomed the initiative to establish the Caribbean Single Market and Economy (CSME). Directors noted, in particular, that regional integration can help the Caribbean overcome some of the limitations imposed by size and compete effectively in the global economy. At the same time, Directors underscored the continuing need for action at the national level to strengthen the foundations for sustained regional growth and reduce vulnerabilities. They were encouraged that some countries had taken advantage of favorable economic conditions to strengthen public finances and reduce debt earlier in the business cycle. However, in countries where efforts have waned more recently, it will be important to accelerate the pace of debt reduction, as this will also be key to freeing up resources for social priorities and to create room to respond to future shocks.

Directors considered that closer integration of the Caribbean's still largely segmented financial markets can be expected to help generate higher economic growth by improving access to credit and lowering interest rate spreads. However, more integrated financial markets will also allow shocks to spread across borders more rapidly and pose greater regulatory challenges, especially with large financial conglomerates operating across different industry segments and in several countries. In light of this, Directors highlighted the importance of continued efforts to strengthen macroeconomic policies in order, in particular, to create policy flexibility; to ensure that market-based monetary instruments are developed and effectively implemented; and to improve coordination among national regulators and strengthen region-wide oversight of financial institutions. They welcomed ongoing steps towards these objectives.

Directors noted that, while the Caribbean countries' heavy reliance on tax incentives may help attract investors, they are costly in terms of foregone revenues. Directors observed that other efforts to attract investments may be more effective for the region as a whole, and pointed in this connection to factors such as institutional quality, infrastructure, and governance, as important determinants of FDI. In light of this, and recognizing the intense competition for global investment funds which the region faces, Directors encouraged Caribbean policy-makers to weigh carefully the costs and benefits of tax exemptions and consider reducing them if possible; to step up efforts to improve other determinants of investment; and to make remaining tax incentives more cost-effective. Regional cooperation and coordination could play a particularly useful role in facilitating progress along these lines, although today's discussion also pointed to some of the challenges in ensuring effective cooperation in this area.

Directors recognized that the erosion of preferential access to European markets for bananas and sugar entails significant losses for several Caribbean countries. As the implied annual transfer from the preferential schemes was very large in some cases, the inferred output and revenue costs of its erosion is considerable. Furthermore, social costs to rural populations are likely to be large even in cases where the macroeconomic impact is more limited. Depending on country circumstances, the strategy to address this difficult challenge will need to involve carefully targeted social safety nets to alleviate the impact on affected vulnerable groups; efforts to raise the efficiency of existing banana and sugar industries, where viable; and transition away to new economic activities, in countries where production is unlikely to be competitive even after significant efforts and investments. Directors also emphasized the importance of timely disbursement of aid and concessional assistance committed in support of countries' adjustment and restructuring efforts.