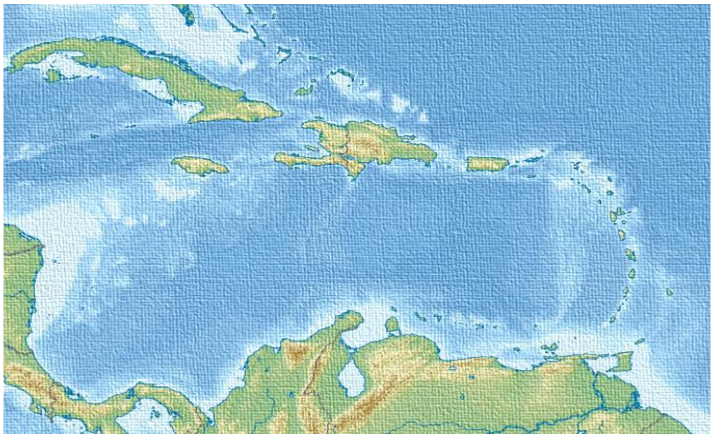

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Economic Commission for Latin America and the Caribbean

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Caribbean Outlook 3

Economic recovery and repositioning in the era of COVID-19

Introduction

The economies of the subregion were hard hit by the COVID-19 pandemic, particularly those dependent on tourism. As a result, the Caribbean has seen a reversal of the hard-won gains achieved in growing their economies and reducing unemployment and inequality. The inflation stemming from pandemic supply chain disruption, which has been exacerbated by the war in Ukraine, has made the sustained uptick in economic performance beyond pre-pandemic levels unlikely, notwithstanding strong growth estimates for 2021 and 2022.

The last two years have taught the region that continued ‘business as usual’ is no longer an option for advancing sustainable development. As such, recovery and repositioning of the economies must take place in all sectors for the subregion to thrive.

The pandemic exposed many areas requiring thoughtful consideration throughout the region, including fragile health systems, a pressing need for national and regional interconnection, and the need to diversify the economic base and to invest in capital services that promote self-reliance and decent work.

Despite currently prevailing efforts, significant and substantial issues remain. The subregion faces converging multidimensional vulnerabilities that create a perfect storm of cumulative challenges.

Key recommendations:

- **Develop innovative financial instruments to provide long term funding for green and blue industry projects, for disaster-proofing its economy and for economic restructuring**
- **Caribbean governments should support the launch of the Caribbean Resilience Fund (CRF)**
- **Improve efficiency with which limited funds are used**
- **Invest in technology accumulation and human capital development**

This convergence has occurred precisely as debt accumulation and servicing costs have narrowed the fiscal space. The narrowing of the fiscal space was exacerbated by COVID-19 and unavoidable climate event-related expenditures to support the economy, such as the 2021 eruption of the La Soufrière volcano which caused significant damage and losses in Saint Vincent and the Grenadines, Saint Lucia and Barbados.

As the region continues to experience the residual effects of the pandemic and pursues efforts to adjust to the new normal, governments must focus on building resilience in the face of increasing economic, social, and environmental shocks. Thus, economic restructuring is necessary to create an environment conducive to dynamic economic expansion in the near and medium term. Within this context, successful economic restructuring, requires an industrial policy designed to increase international competitiveness and foster increased productivity. It should also leverage improved technology, knowledge, and workforce skills, and facilitate greater intersectoral linkages and attendant improved access to decent jobs.

There must be a system of innovation, with input from both private and public sectors, that is linked to the productive system. This should cover a range of areas including competitiveness policies, trade and inward foreign direct investment (FDI) policies, policies to foster innovation, human resource training, upgrading the tourism sector, and small and medium enterprises (SME) development. In addition, industrial policy should aim to reduce constraints facing business expansion through several strategies, including trade facilitation and logistics improvement.

Background

COVID-19 restrictions stalled normal economic activity in the subregion, especially those driven by tourism services. Indeed, the decline in economic activity in 2020 excluding Guyana was -13.1% (see table 1). Further, many individual countries saw declines greater than ever experienced in modern times. While average economic growth has been positive in the two years since the start of the COVID-19 pandemic, incomes still lag below 2019 values. During 2021, most of the subregion economies expanded, with average growth rising to 5.1% (3.5%, if Guyana is excluded). For 2022, growth is projected at 10.4% and 4.6% respectively, with and without Guyana. These growth rates, the highest achieved in more than a decade, are actually due to normalization of economic activity and a low comparison base rather than true growth dynamics.

Table 1: Real GDP growth rates, 2020–2022 (Percentages)

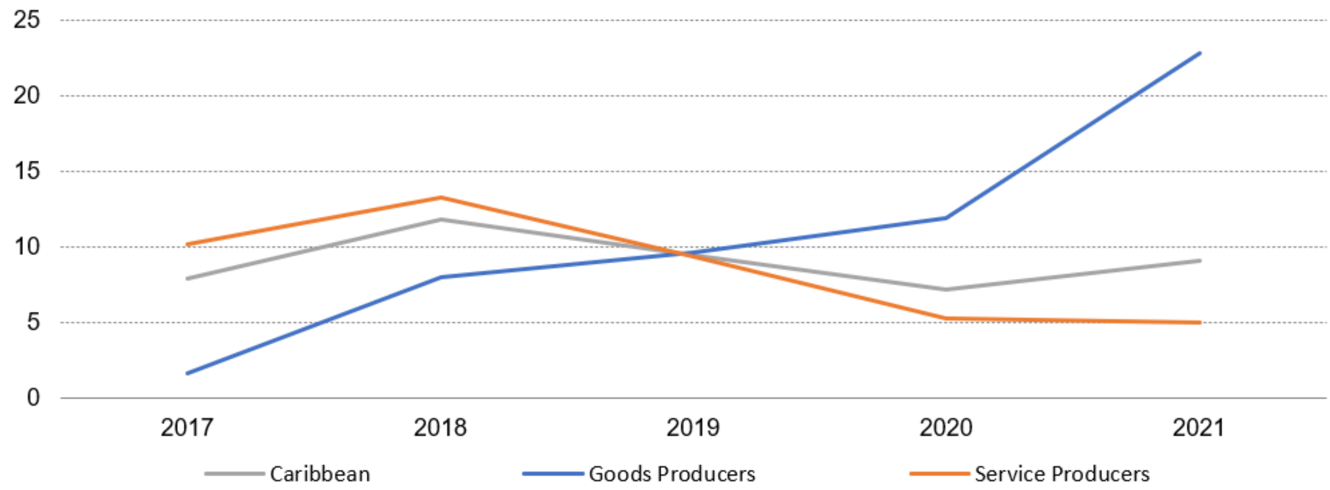
	2020	2021	2022
Caribbean	-9.2	5.1	10.4
Goods producers	-1.6	3.8	15.5
Service producers	-15.9	6.5	5.4
Caribbean excluding Guyana	-13.1	3.5	4.6
Goods producers ex. Guyana	-9.4	-0.3	3.5
Latin America and the Caribbean	-6.9	6.5	2.7

Source: Economic Commission for Latin America and the Caribbean on the basis of official figures.

Most of the individual economies are still smaller than they were pre-pandemic and are not expected to surpass 2019 levels until 2023 or 2024 —assuming the global situation becomes more favourable. Compared to the wider Latin America and the Caribbean, the subregion experienced a deeper contraction in 2020 and a slower rebound in 2021. In 2022 however, the growth of the Caribbean (excluding Guyana) of 4.6% will surpass the 2.7% growth projected for Latin America and the Caribbean.

Despite these numbers, there exists some downside risks to the subregion. These include high inflation caused by pandemic supply chain issues, made worse by increased energy and food costs resulting from the Russia-Ukraine war; higher borrowing costs as the Federal Reserve System of the United States of America increases interest rates; and reduced tourism demand. There is also, the potential for the return of restrictions if a more virulent variant of the COVID-19 virus emerges to become dominant. Inescapably, in the absence of repositioning and diversification of the subregion's economies, there is likely to be a return to the pre-pandemic trend of low growth rates. Thus, economic restructuring is necessary to create an environment conducive to dynamic economic expansion in the near and medium-term.

Figure 1: Foreign direct investment inflows for the Caribbean (Percentage of GDP)



Source: Economic Commission for Latin America and the Caribbean on the basis of official figures.
Note: Data excludes Barbados and Suriname for 2021.

Though economic restructuring in the subregion can revitalize economic activity, bringing it closer to the path of sustainable long-term growth, sourcing adequate and affordable development financing remains a two-pronged challenge for the region—quantity and quality. First, with respect to quantity, access to finance is inadequate to the challenge of creating a dynamic, competitive, and sustainable economy. Secondly, the quality of finance, measured by cost, term structure, scale, and efficiency of use are inadequate.

Domestic finance is often an important vehicle for funding development, particularly the Sustainable Development Goals (SDGs). Additionally, even before the pandemic, the region confronted a deficit of long-term, affordable, sustainable financing for high-impact economic, social and environmental projects. This included insufficient finance for the restructuring of key segments of tourism, agriculture and light manufacturing. These conditions hinder productive efforts, especially in the critical export sector, starved of finance for successful enterprise upscale. Consequently, as the region develops a post-COVID-19 financing strategy, both factors —quantity and quality— should be tackled simultaneously, to ensure financial arrangements work for development.

Access to finance for economic restructuring

Foreign direct investment (FDI) is a vital source of development finance in the subregion. FDI not only provides funding, often for long-term projects in key sectors such as tourism, mining, agriculture, telecommunications and power generation, but is also a critical source of technology transfer, management, organizational know how and marketing that enables access to foreign markets. The varied benefits of FDI have led to countries competing for inflows with a range of fiscal and non-fiscal incentives. In the last five years, FDI to CARICOM States averaged only US$ 263.7 million per year.

Moreover, excluding Guyana, a major recent recipient due to the exploration for and production of oil, FDI inflows for the subregion averaged a mere US$ 129.8 million. Indeed, without Guyana, inflows of FDI declined by 13.7% in the last five years. Also, FDI accounted for only 9.1% of GDP in 2021 (figure 1). This suggests the region may be losing its attractiveness, in favour of other regions, to direct investors in tourism, industry and other sectors.

Innovative financing mechanisms and vulnerability measures

With most of the subregion unable to access concessional financing, innovative financing mechanisms are necessary for advancing the region's development initiatives. ECLAC has made progress advancing a Caribbean Resilience Fund to provide long-term, affordable financing for climate and economic resilience building, debt relief and liquidity enhancement to achieve sustainable debt levels in the subregion. The resilience building pillar aims to raise substantial funding to finance high impact climate adaptation and mitigation projects, including resilient infrastructure, green energy, and transportation. The debt restructuring and liquidity enhancement facility will assist countries with debt restructuring and reprofiling, as well as liquidity management operations. The aim is to extend maturity structures to up to 20 years and reduce servicing costs by 50% in selected countries, while providing for new debt to be guaranteed by the Development Financing Institutions (DFIs) as a means of crowding in private creditors to scale up development finance to the subregion. ECLAC envisages that the CRF could be established over the period 2023–2024.

A complementary mechanism to cope with economic shocks, is the state-contingent debt instruments (SCDIs). These instruments, particularly the natural disaster clause or hurricane clause includes in the contractual terms of a sovereign's debt, the ability of the creditor to defer payments of interest and principal in the event of a disaster that meets minimum levels of

Mechanism for economic recovery

Normalization of economic activity will likely see economies of the subregion rebound from the COVID-19 shock. Yet, improving upon sluggish long-term growth trends requires industrial restructuring. Industrial or economic restructuring refers to a shift in an economy's production structure increasing the share of domestic value in existing products and activities, and the number of activities contributing to total output. This also develops and strengthens intersectoral linkages and increases production of high value-added, customized products and services capable of commanding higher returns in export markets. Production in the subregion's economies is typically concentrated in a narrow range of activities geared towards a small number of partners. The narrow range of products and export partners creates greater vulnerability to terms of trade and other economic shocks.

For successful economic restructuring, an industrial policy designed to increase international competitiveness through increased productivity, usually requires the use of improved technology, knowledge, and workforce skills, greater intersectoral linkages and attendant improved access to decent jobs. There must be a system of innovation, with input from both private and public sectors, that is linked to productive systems. Modern industrial policy should focus on those activities that have positive spill overs to additional sectors and activities (Stiglitz 1999). This should cover a range of areas including competitiveness policies, trade and inward FDI policies, policies to foster innovation, human