GROWTH DIALOGUE WITH SOCIAL PARTNERS

2017

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Growth Dialogue

with Social Partners

1 March 2017

Sir Cecil Jacobs Auditorium, ECCB Headquarters, St Kitts

Welcome to the:

GROWTH DIALOGUE WITH SOCIAL PARTNERS

The Eastern Caribbean Currency Union (ECCU) is at a critical juncture coming on the heels of the economic difficulties of the recent past and a future pregnant with uncertainty occasioned by, inter alia, derisking and geopolitical developments such as Brexit and Trumpism.

In this moment, the collective leadership of our region must find common cause, stand tall and take collective action to defend our vital economic interests and advance the well-being of our people especially our youth.

The Growth Dialogue creates a unique opportunity for Social Partners to engage the Monetary Council (the highest decision making body of the ECCB) on the all-important issue of economic growth under the theme "*Working Together to Achieve Higher and More Inclusive Growth in the ECCU*", and to forge beneficial relationships and build strategies in becoming more competitive and successful.

Thank you for investing your time and ideas as we collectively seek to elevate the growth trajectory and enhance the development outcomes of our region.

Best wishes for an enjoyable and successful Dialogue.

Timothy N J Antoine
Governor, ECCB

MCDONALD BENJAMIN

McDonald Benjamin is Operations Advisor for Latin America and the Caribbean at the World Bank. He recently returned to Washington following four years as the World Bank's Country Manager in the Dominican Republic. Earlier in his 20-year career with the World Bank, he worked as the Bank's Country Program Coordinator for 15 countries in Western and Southern Africa; Sector Manager for Social Development for Latin America and the Caribbean; Country Manager for Ecuador, and Financial Sector Coordinator in the Philippines. His work experience ranges from financial sector inclusion to social development, country strategic analysis and program management, and he has worked in countries ranging from East Asia and the Pacific to South Asia, North Africa, Sub-Saharan Africa, Latin America and the Caribbean. Prior to joining the World Bank, he was Professorial Lecturer at Georgetown University and Advisor to the Ambassador of Dominica in Washington DC. A US citizen born to a Dominican father and German mother, he is fluent in six languages: English, French, Spanish, Portuguese, German and Italian. He holds a PhD in Economics from Georgetown University in Washington DC, with a focus on microfinance, and a Bachelor's Degree in Philosophy, Politics and Economics from University of Oxford.

SANDRA C.A. FERGUSON

Sandra C.A. Ferguson is from Grenada and has worked in the NGO sector in Grenada for over 20 years as Economic Project Officer, Programme Manager and Secretary-General of the Agency for Rural Transformation (ART). She is currently the Chair of the umbrella network of indigenous development NGOs, the Inter Agency Group of Development Organisations and represents the organisation on several national committees and other organisations such as the Grouping of Civil Society Organisations. She is a graduate of the Faculty of Agriculture, University of the West Indies; pursued post graduate studies in *Caribbean Agricultural Development* at the Universite Antilles- Guyane, Guadeloupe and in *Development Studies* at the Institute of Social Studies, The Hague.

JULIAN MONROSE

Julian Monrose is currently the Principal of the St Aloysius R.C. Boys' Primary School. Mr. Monrose has been involved in many social, community and sporting organizations and has served them in several capacities. He has served the St. Lucia Teachers' Union as President, First Vice President, Branch Representative for Castries, Shop Steward, and member of several internal committees.

Mr. Monrose has represented SLTU at many national and regional workshops, local meetings, negotiations for salary and conditions of work for teachers, and at regional and international meetings. He is now the longest serving President, having served the organization in that capacity for the past twelve consecutive years,

Through Mr. Monrose's representation of the St. Lucia Teachers' Union he was elected Founding Vice President of the St. Lucia Trade Union Federation and currently serves the organization as its President. As President of the Federation, he has been the lead Negotiator for Wages and salaries on behalf of Public Servants.

At the regional level, Mr. Monrose has for three consecutive Biennial Conferences served the Caribbean Union of Teachers (C.U.T.) as Chairman of the Resolutions Committee. He served the organization as 3rd Vice President and Chairman of the Sports Committee and later as the 2nd Vice President with responsibility for Industrial Relations. He is currently the President. Mr. Monrose has facilitated regional workshops on behalf of Education International and the Caribbean Union of Teachers.

Mr. Monrose has served as a member of the Board of Governors of the Sir Arthur Lewis Community College, the National Insurance Corporation Board and two of its subsidiary companies, the St. Lucia Minimum Wages Commission, National Training Advisory Board, and the Board of the National Skills Development Centre (NSDC) among others.

Mr. Monrose is a qualified teacher and holds a B.Sc. In Sociology and Management (Double Major) and Masters in Project Management. He is an Accredited Director with the Institute of Chartered Secretaries and Administrators (Canada).

MARK S. CHRISTMAS

Rev. Mark S. Christmas was born on the island of St. Kitts in the Federation of St. Kitts and Nevis. He began to be involved in Church Work at an early age, having been a member of the Boy's Brigade (2nd St. Kitts Company). During his teenage years, he was actively involved in his congregation and circuit as a Junior Choir member, a Sunday School Teacher, a Junior Steward, various positions in the Youth Fellowship and Circuit Lay Youth Secretary. Having both Moravian and Methodist roots, he also became involved in Ecumenical Work in the St. Kitts Christian Council serving on the Ecumenical Youth and Ecumenical Pastoral Relations Committees as a denominational representative.

In September 2000, Mark entered the United Theological College of the West Indies for ministerial formation and pursued a Diploma in Ministerial Studies and also a Bachelors of Arts Degree in Theology at the University of the West Indies. He graduated in the year 2004.

Rev. Christmas is now an itinerant Presbyter in the Methodist Church in the Caribbean and the Americas, having served as Circuit Minister in the Nassau and South Eleuthera Circuits (2004-2007), as Superintendent in the Andros Circuit (2007-2010) and the South Turks and Caicos Islands Circuit (2011-2016) in the Bahamas/Turks and Caicos Islands Conference. He also served as the Secretary of the said Conference (2012-2016). He is now serving as the Superintendent of the St. Kitts Circuit with direct pastoral charge of the Wesley, Hope Chapel, Challengers, St. Johnston, and Cayon Congregations. He is also the present Chairman of the St. Kitts Christian Council.

ALLISTER MOUNSEY

Allister Mounsey is a Macroeconomist at the Organisation of Eastern Caribbean States (OECS). He has published with various professional journals in areas of labour economics and finance. He has worked as a Researcher at the University of the West Indies as well as an Economist at the Eastern Caribbean Central Bank.

AINE BRATHWAITE

Aine Brathwaite is one of two lead consultants with A J Business Solutions supporting small to medium-sized businesses in building sustainable and profitable enterprises through the provision of training in professional development skills.

Having worked in a variety of sectors including education, public relations, a cottage industry, retail, tourism and printing across Jamaica, Guyana, Saint Lucia and Grenada in both private and public sectors, Aine has a range of practical knowledge which she now employs to serve her clients.

Her company has facilitated change management training for staff of major companies in Grenada. In early 2015 she competed and won one of 15 slots to become accredited to deliver the Women Innovators in the Caribbean (WINC) Accelerator Programme. She is also the official trainer to the Grenada Hotel and Tourism Association.

Aine's commitment to the business sector and to national development can be seen in her continued activity in various organisations. During her tenure as President of the Grenada Chamber of industry and Commerce from 2011-2014, she championed the cause of the small business and was responsible for drawing a significant number of small businesses into the Chamber.

She has represented the private sector at the Social Partners Forum in Grenada in 2014 and currently serves as Deputy Chair of the Grenada Tourism Authority. She has also represented the private sector on the Grenada IMF Monitoring Committee and is the first Vice President of the OECS Business Council. She has also spearheaded voluntary services in the areas of the environment, social development and mental health issues.

Aine holds a first degree from the University of the West Indies and post-graduate Diplomas in Education from the University of Guyana and Management Studies from the University of the West Indies.

IAN DURANT

Ian Durant is currently Deputy Director of the Economics Department of the Caribbean Development Bank (CDB), and was previously an Economist in the Bank. He has done research on debt sustainability and debt restructuring and has worked on policy-based loans for Caribbean countries that involved debt restructuring. Prior to joining CDB, Ian worked in the Research Department of the Central Bank of Barbados. He also worked at the Caribbean Regional Technical Assistance Center (CARTAC) as Macroeconomics Adviser, where he managed technical assistance and capacity building in the area of macroeconomic programming and policy. Ian has a B.Sc. from the University of the West Indies, Barbados, and a M.Sc. from the University of Birmingham in the United Kingdom.

AGENDA

GROWTH DIALOGUE WITH SOCIAL PARTNERS

AGENDA

WEDNESDAY, 1 MARCH 2017 Sir Cecil Jacobs Auditorium

9:00 am – 9:10 am	**Welcome and Opening Remarks**	**Hon Gaston Browne** Chairman, ECCB Monetary Council
9:10 am – 9:20 am	**Setting the Stage: Growth and Employment in the ECCU**	**Timothy N J Antoine** Governor, ECCB
9:20 am – 10:00 am	**PANEL I – Challenges and Opportunities for More Inclusive Growth in the ECCU**	**Aine Brathwaite** Vice President, Business Council, Grenada **Julian Monrose** President St Lucia Trade Union Federation **Sandra Ferguson** Chairperson, Inter Agency Group of Development Organisations, Grenada **Mark Christmas** Chair, St Kitts Christian Council
10:00 am – 11:00 am	**DISCUSSION**	
11:00 am – 11:15 am	**BREAK**	
11:15 am – 11:45 pm	**PANEL II – Developing Partnerships for Higher and More Inclusive Growth in the ECCU**	**Allister Mounsey** Macro-Economist, OECS Commission **Ian Durant** Caribbean Development Bank **McDonald Benjamin** Adviser – LCROS, World Bank
11:45 am – 12:45 pm	**DISCUSSION**	
12:45 pm – 2:15 pm	**LUNCH**	
2:15 pm – 3:15 pm	**WORKING GROUPS**	Group 1 – BMOD Meeting Room Group 2 – ECIB Meeting Room Group 3 – Meeting Room I Group 4 – Meeting Room II Group 5 – Meeting Room IV Group 6 – Maltin Moving Conference Centre Group 7 – Maltin Moving Conference Centre Group 8 – HRD Meeting Room
3:20 pm – 4:09 pm	**Reports from Working Groups**	Group Spokesperson
4:09 pm – 4:39 pm	**Summary of Key Takeaways and Conclusion**	**Hon Gaston Browne** Chairman, ECCB Monetary Council

BRIEFING/BACKGROUND DOCUMENTS

Competitiveness

Prepared for Growth Dialogue
1 March 2017

EASTERN CARIBBEAN CENTRAL BANK
ST KITTS

1. Definition Statement

1.1 Introduction

The Member Countries of the Eastern Caribbean Currency Union (ECCU) are especially vulnerable, given their inherent structural characteristics which include inter alia: small physical size and/or small populations giving rise to small economies. Other characteristics include: variability/volatility in growth and extreme susceptibility to natural disasters. Their growth performance has been uneven over the last three decades due to factors that range from the need to reinvent themselves after the end of a preferential trade regime with Europe in the 1980s to the occurrence of growth debilitating natural hazards. After growing faster than the rest of the world in the 1980s at an annual average rate of 6.0 per cent, the ECCU countries have experienced a significant growth slowdown since the 1990s, with annual growth rates of 2.0 per cent or less on average. Except for the period 2004 to 2008, economic growth in the ECCU has been on a declining trajectory in spite of substantial investments in the physical capital infrastructure. One of the explanations for the current low growth rate, is the region's lack of competitiveness.

1.2 Definition and Measurement of Competitiveness

The definition of competitiveness is one adopted from the **Global Competitiveness Report (GCR, 2014-2015)**[1] The authors define 'global competitiveness' as; "the set of institutions, policies, and factors that determine the level of productivity of a country. The level of productivity, in turn, sets the level of prosperity that can be reached by an economy. The productivity level also determines the rates of return obtained by investments in an economy, which in turn are the fundamental drivers of its growth rates. In other words, a more competitive economy is one that is likely to grow faster over time."

According to the GCR: "the concept of competitiveness involves both static and dynamic components. Although the productivity of a country determines its ability to sustain a

[1] Global Competitiveness Report 2014 -2015 pp. 4 (Professor Klaus Schwab, World Economic Forum, Professor Xavier Sala-i-Martin, Columbia University.

high level of income, it is also one of the central determinants of its return on investment, which is one of the key factors explaining an economy's growth potential."

Productivity and competitiveness are multi-dimensional and driven by a multiplicity of factors, ranging from Adam Smith's theories on specialization and the division of labour to more neoclassical approaches which emphasize investment in physical capital and infrastructure. More recently, interest in other mechanisms such as education and training (social capital), technological progress, macroeconomic stability, good governance, firm sophistication, and market efficiency have taken prominence as contributors to competitiveness.

To capture the interaction of all of these factors in assessing the level of competitiveness in a number of selected states, a **Global Competitiveness Index (GCI)** was tabulated providing a weighted average of different components, each measuring a different aspect of competitiveness. Essentially, measuring competitiveness and productivity through the GCI involved the grouping of the components of competitiveness into **12 pillars**. They include:

1. Institutions
2. Infrastructure
3. Macroeconomic environment
4. Health and primary education
5. Higher education and training
6. Goods market efficiency
7. Labour market efficiency
8. Financial market development
9. Technological readiness
10. Market size
11. Business sophistication and
12. Innovation

Another major indicator of global competitiveness is the **World Bank's Ease of Doing Business Report 2017**. A high ease of doing business ranking signifies that the regulatory environment is more conducive to the starting and operation of a local firm, while a low ranking signals the converse. Improvements in relative competitiveness are signified by an increase in the individual rankings over time. An indicator of the competitiveness of ECCU member countries is how high the countries rank on the index and the movement in their ranking over time.

2. Assessment of Recent Developments

The results of the GCI, which surveyed **144 countries** globally, revealed that the top 10 most competitive countries covered under the survey were: (i) Switzerland, (ii) Singapore, (iii) The United States of America (iv) Finland; and (v) Germany, (vi) Japan, (vii) Hong Kong (viii) Netherlands, (ix) United Kingdom and (x) Sweden.

The highest ranking Caribbean country in the CGI is Barbados at No. 55 and out of the top ten ranked countries from Latin America and the Caribbean on the survey, Barbados ranks at No. 4 behind Chile, Panama and Cost Rica[2]. For reasons not disclosed, the territories of the ECCU were not included in the survey which may be due to the paucity of data. The lack of representation on the index for at least the last three years highlights weaknesses in the systems for the compilation and dissemination of information that are yet to be fully resolved. Therefore, a comprehensive method of assessing competitiveness for the ECCU territories would be to first compile the applicable data so as to objectively assess the region's comparative position.

Another indicator of the level of competitiveness, the World Bank's Ease of Doing Business Report, provides additional insight on how well the region may be doing relative to its global competitors. In the most recent ranking **(2017 edition)** of the Report, using data valid as at 1June 2016, out of a survey of **190 countries**, the countries which recorded the most conducive regulatory environment were: (i) New Zealand, (ii) Singapore, (iii) Denmark, (iv) Hong Kong, (v) Korea, Rep, (vi) Norway, (vii) United Kingdom, (viii)

United States of America, (ix) Sweden and (x) Macedonia, FYR.

The top 10 most competitive economies in Latin America and the Caribbean: (i) Chile (ii) Panama (iii) Cost Rica (iv) Barbados (v) Brazil (vi) Mexico (vii) Peru (viii) Columbia (ix) Guatemala and (x) Uruguay.

Of the member territories of the ECCU, the global rankings in descending order were; **Saint Lucia (86), Dominica (101), Antigua and Barbuda (113), St Vincent and the Grenadines (125) St Kitts and Nevis (135) and Grenada (138).** These rankings are mediocre at best with Saint Lucia being the highest ranked territory in the region and Grenada recording the lowest ranking. The relative lack of competitiveness as indicated by the ranking is further underscored when the rankings in the **2017 report** are compared with the previous year (See Appendix, Table 1). In the **2016 report,** the rankings were as follows; **Saint Lucia (77), Dominica (91), Antigua and Barbuda (104), St Vincent and the Grenadines (111), St Kitts and Nevis (124) and Grenada (135).**

The relative deterioration in the rankings suggests that the territories of the ECCU have become relatively less competitive as measured by the World Bank survey. The same pattern has been observed in the **2015 report** relative to rankings in the 2016 report confirming the view that compared to other global respondents, the region has been relatively slow in implementing the needed reforms. Some may argue, that the inputs for the ease of doing business are ill suited for the region and may not accurately represent the state of affairs in the region. Although such concerns may be valid, they do not minimize the utility of comparing the region's relative competitiveness/ease in establishing businesses with that of its global competitors.

3. Challenges and Policy Options

3.1 Challenges

(1) The absence of any representation of the countries of the ECCU on the **GCI** is not an encouraging indicator of the state of readiness of member countries to compete internationally. The non-inclusion on the GCI suggests that the problem of lack of competitiveness is perhaps **not being properly diagnosed due to the inadequacy in the compilation or dissemination of relevant data or information.** Irrespective of the reason, this current state of affairs, precludes the region from pro-actively addressing the issues that inhibit its competitive state. If the adage holds true "what gets measured, gets done", then the lack of comprehensive data for one or all of the 12 components for the ECCU territories highlights the perceived disadvantage that the region faces in the race to be competitive.

(2) If greater traction in addressing issues of competitiveness is not achieved, the result could be the **implementation of policy measures that fail to adequately address the issues of the region's which exacerbates the ECCU ability to effectively compete, hence a perpetual low growth trap**.

(3) One of the major components of competitiveness identified in the CGI is **institutions**. Institutions speak to the legal and administrative framework within which individuals, firms, and governments interact to generate wealth. There is **ongoing concern about the state of the regions' institutions which govern the production and distribution of economic rents**. Examples of these perceived deficiencies manifest themselves in the form of concerns about administrative transparency (governance), issues related to respect for property rights, excessive bureaucracy and the independence of the judicial system, to cite a few examples. The resolution of these inadequacies, real or imagined, would quickly redound to the enhanced responsiveness of the ECCU territories to global changes, as the quality of institutions has a strong bearing on competitiveness and growth.

(4) **Higher Education and Training**, represents a significant challenge, not from the perspective that that there are insufficient opportunities for skills enhancement, but there is inflexibility in the current education system which renders it unresponsive to the training needs of the populace.

(5) The absence of **meaningful participation of the private sector** in policy formulation is another major impediment to enhanced competitiveness in the ECCU. The underrepresentation of the private sector in the policy making apparatus of the public sector is a major impediment to economic growth and development. In many instances the private sector perceives its role as relegated to the periphery of the policy making apparatus.

(6) Other inhibitors to global competitiveness include; technological **readiness,** comprising issues such as the rate of internet penetration, and the use of new technologies. Issues such as inefficient goods and labour markets also constitute significant constraints to global competitiveness, as well as the perennial problem of small market size.

3.2 Policy Options

(1) **Data and Information:** The requisite investment in statistics is imperative if the issues impeding growth and competiveness in the ECCU are to be properly diagnosed. Resources devoted to building an improved data management and information system should be regarded more as an investment rather than an expense. Regularly scheduled censuses and surveys must be part of deliberate policies of member states.

(2) **Policies**: National and regional governments of the ECCU can benefit from lessons learned through observing the several policies that pivoted the leading competitive countries to their present pinnacles. Policies geared towards infrastructure, transportation, business development, productivity and exports expansion can be adopted or adapted across the ECCU to make the region a more competitive place globally. Specifically, addressing the various shortcomings in the legal and regulatory system of the ECCU and the vigorous enforcement

of laws and codes of conduct which have long been legislated are necessary and crucial first steps. Additionally, a firm resolve to adhere more closely to long-standing rules which govern public service and all of civil society will go a long way in signaling the regions' readiness to do business in conformance to global standards.

(3) **Institutions:** There is a need to develop and implement proper oversight and transparency with respect to national and regional institutions and parastatals. The establishment of rules which govern public service and all of civil society will go a long way in signaling the regions' readiness to do business in conformance to global standards.

(4) **Education and Training:** The present configuration of our educational and training institutions requires that emphasis be placed on the demand for education rather than on the supply. The key performance indicators should not be focused merely on regularly monitoring the amount invested in education and training, but more on measuring the output generated from the investment in education. There is need for more responsiveness to the indicators from market surveys that reveal a deficit in the provision of technical and vocational skills. Initiatives should be taken to give equal status to TVET and academia, and reforms should be made in education planning to address the paucity of technical and vocational skills while moderating the over-supply of academic training. Opportunities for apprenticeship and mentoring should also accompany initiatives to raise the profile of TVET.

(5) **Full participation of the Private Sector:** There should be deliberate and well planned modalities for the enhancement of the private sector's role as an engine of growth whether as the lead innovator, employer, foreign exchange earner or the co-partner with governments as in public-private-partnership for national and regional development. An effective way of filling this gap in policy crafting is the establishment of national and regional **Think Tanks**. By this we mean, 'organizations, institutes, corporations, or groups that conduct research and engage in advocacy in areas such as social policy, political strategy, economy, science or technology issues, industrial or business policies,

or military advice'. The establishment of such organizations could foster a more inclusive approach to crafting the vision and eventual action plan that will constitute the road map for country development. These think tanks should be comprised of persons from a broad cross-section of civil society including public and private sectors, as well as representatives from other non-governmental organizations.

(6) **Technological readiness:** Policies need to be designed and implemented to ensure the technological readiness for the seamless interaction of these nation states with the global environment. This need for conformity and compliance with global platforms are critical for the purposes of communications and international commerce. Cost effective means of communications for training and financial transactions are germane for ensuring the optimum business environment.

(7) **Other structural issues/pillars**: Implementing reforms in the labour and goods markets reflect the need to induce flexibility in the labour market through appropriate training as well as in the goods market through the identification of comparative advantages in specific goods and services. The need to give focused attention to the evolving single financial and economic space should be a driving force to mitigate the major challenge of **'small market size'** which impacts competitiveness in the ECCU and the acceleration of ongoing efforts to eventually graduate the region to a full-fledged Economic Union.

APPENDIX

Table 1

ECCU
Work Bank Ease of Doing Business Report Ranking

	2017	2016	2015
Antigua and Barbuda	113	104	89
Dominica	101	91	97
Grenada	138	135	126
St Kitts and Nevis	135	124	121
Satin Lucia	86	77	100
St Vincent and the Grenadines	125	111	103

Employment

Prepared for Growth Dialogue
1 March 2017

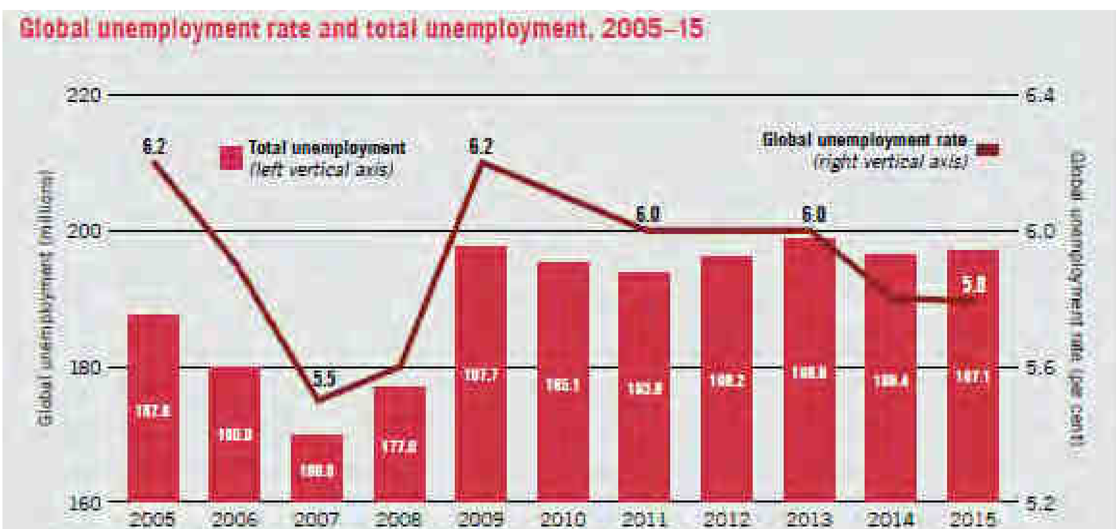
EASTERN CARIBBEAN CENTRAL BANK
ST KITTS

1.0 Definition Statement

1.1 Global Context

Consequent to the structural weaknesses in the global economy, coupled with current uncertainties, global employment is being adversely impacted. Figure one (1) shows that total global unemployment has been on an upward trajectory since 2007 and increased by 0.7m to an estimated 197.1m by end 2015. According to the ILO, the global unemployment rate stood at 5.8 per cent at the end of 2015. and forecasts are for increases of 2.3m and 1.1m in the number of persons unemployed in 2016 and 2017, respectively (See Appendix 1). Additionally projections up to 2020 show declining global labour force participation rates, largely attributable to cyclical and structural factors.

Figure 1: Global Unemployment



Source: ILO - Global Employment and Social Trends 2016

1.2 Definition of Unemployment

In the economics context, unemployment is defined as a situation where someone is actively seeking for a job, but not able to find one. The Bureau of Labour Statistics (BLS) simplifies the definition as people who do not have a job, but have been looking for one over the last four weeks. If one is laid off temporarily and waiting to be called to return to a job, the BLS counts this individual as unemployed. There are different types of unemployment, mostly classified by the underlying cause of one's joblessness. The unemployment rate is generally calculated as the number of persons unemployed divided by the size of the labour force. The labour force comprises of all persons from the ages of 16 and over who are either employed or unemployed.

1.3 The Employment Situation in the ECCU

The ECCU is by no means insulated from global developments, particularly due to its openness. The USA, one of the main trading partners has been experiencing declining yet sticky unemployment over the last 6 years, averaging a little above 7.0 per cent. From 1948 to 2016, the US unemployment rate has averaged 5.8 per cent, reaching an all-time high of 10.8 per cent in November 1982. The economic situation in the USA following the recent global financial crisis took a toll on its unemployment rate. Employment conditions in the ECCU have worsened over the last three decades. Unemployment rates have more than doubled in some instances (See Figure 2). On average the ECCU's unemployment rate has moved from 15.9 per cent in 1980 to 21.8 per cent in 2015. In Saint Lucia, the largest economy in the union, the jobless rate grew from 17.2 per cent in the 1980s to 20.6 per cent three decades later. Data available for Antigua and Barbuda show a change from 5.8 per cent in the 1990s to 10.1 per cent, twenty years later. On the contrary, Anguilla and St Kitts and Nevis both experienced long-run declines in their jobless rate. Anguilla moved from 7.2 per cent in the 1990s to 1.5 per cent in 2008. During that time, the economy of Anguilla was experiencing a construction boom, with growth averaging 12.6 per cent in the five years prior to the crisis in 2008. St Kitts and Nevis recorded a declining jobless rate from 12.4 per cent in the 1980s to 5.1 per cent in 2008.

Figure 2: ECCU Unemployment

Unemployment in ECCU	1980/81	1991/92	2000/01	2001/02	2008/09	2010/11	2015/16
ANGUILLA	n/a	7.2	6.7	7.8	1.5	n/a	n/a
ANTIGUA AND BARBUDA	n/a	5.8	8.4	7.0	4.0	10.1	14.1
DOMINICA	18.3	9.9	11.6	13.9	14.0	n/a	23.0
GRENADA	18.0	13.9	9.9	9.9	32.5	n/a	28.9
MONTSERRAT	13.0	n/a	n/a	13.3	13.7	n/a	n/a
ST. KITTS AND NEVIS	12.4	n/a	n/a	4.0	5.1	n/a	n/a
SAINT LUCIA	17.2	n/a	18.9	18.9	20.6	20.6	24.1
ST. VINCENT AND THE GRENADINES	16.5	19.8	21.2	21.1	18.8	n/a	18.8
ECCU Average	15.9	11.3	12.8	12.0	13.8	15.4	21.8

2.0 Assessment of Recent Developments

Labour force data for all the ECCU countries with the exception of Saint Lucia and to some extent Grenada are unavailable for an in-depth analysis. In Saint Lucia, the only country which conducts annual surveys, the rate of unemployment has been above 20 per cent for the last six years. The last population census for the other ECCU countries showed five of the eight countries recorded double digit unemployment rates. The results of the 2015 labour force survey showed that for Grenada an unemployment rate of 28.9 per cent was recorded a decline from 32.5 per cent from the previous survey. The latest available data from labour force surveys for Dominica, St Vincent and the Grenadines and Antigua and Barbuda indicate unemployment rates of 23.0 per cent, 18.8 per cent and 14.1 per cent, respectively. These rates are way above the average global level for the past five years, which is just below 6.0 per cent. Over the last 5 years ECCU growth as a region has averaged 1.5 per cent, which is insufficient to create any impetus to the employment situation. Whether unemployment can be addressed effectively without robust economic activity is a question for serious consideration in the discussion on growth.

3.0 The Challenges and Policy Options

i. The lack of complete data for thorough analysis of important policy issues. This situation makes it rather difficult to analyze developments in unemployment in this region. The ECCU countries are severely constrained by the capacity of the individuals available to design and execute labour market surveys and censuses.
ii. Low growth is a major setback for this region. Given the low level of economic growth, the unemployment situation is compounded. Structural issues in the regional labour market have made it very difficult for employment in the region.
iii. There is a mismatch between the skills demanded and that supplied. Based on developments in the education system, the new entrants into the labour market do not possess the requisite skills for the jobs available.
iv. Every year the work force is increasing, but the ability by the private sector to create jobs has not been enhanced due to growth challenges in the economy. As a result of the growing labour force, the level of unemployment continues to rise.

v. Expenditures on programmes to mitigate social impact has resulted in increased fiscal and debt implications to the relevant member states governments while not improving unemployment significantly.

4.0 Policy Options

The ECCU represent a heterogeneous mix of countries as it relates to the stage of development therefore there can be no single formula for addressing the diverse employment requirements in each country. Well designed and coordinated programmes for the whole ECCU needs to be developed based on empirical research and consultations with all target communities given the diverse needs and different stage of development noticeable in each country. The following policy options are being proposed for consideration:

1. Regularly timed censuses and labour surveys in each ECCU member states with a view towards getting data for proper analysis of trends in employment to facilitate appropriate policy responses to unemployment.
2. To identify, select and have trained a cadres of persons who will have the capacity to undertake the design and execution of labour market surveys and censuses.
3. Formulation of growth policies, which are targeted specifically to remove the structural issues, related to the most at risk groups and to decrease the unemployment situation in the ECCU.
4. Formulate and execute educational curriculum and adult education processes similar to the Dual VET system of Germany to remove the mismatch between the skills demanded and that supplied. Revamping the education system so that the new entrants into the labour market will possess the requisite skills for the jobs available.
5. Formulate and execute jobs creation avenues to counter the increasing work force by instituting private sector friendly legislation and regulations and special concessions to businesses that create jobs in the economy.
6. Assign budgetary allocations to adequately service the requisite expenditures on programmes that are likely to boost employment and mitigate social, fiscal and debt implications to the relevant member states governments.

7. Government needs to partner with the private sector towards infrastructural development to facilitate the growth process. For these countries to achieve a sustainable growth rate of at least 5.0 per cent as mandated by the Monetary Council, structural reforms are necessary.

Table 1

Unemployment rate and total unemployment: Trends and projections 2007–17

		Unemployment rate, 2007–17 (percentages)				Millions, 2015–17		
	2007–14	2014	2015	2016	2017	2015	2016	2017
Global estimates and major country groupings								
WORLD		5.8	5.8	5.8	5.7	197.1	199.4	200.5
Developed economies		7.1	6.7	6.5	6.4	46.7	46.1	45.3
Emerging economies		5.5	5.6	5.6	5.6	135.3	137.7	139.1
Developing economies		5.5	5.5	5.5	5.5	15.1	15.6	16.1
G20 Economies		5.5	5.4	5.4	5.3	123.9	124.3	123.8
G20 Advanced economies		7.3	6.8	6.6	6.5	42.2	41.2	40.2
G20 Emerging economies		4.9	4.9	4.9	4.9	81.7	83.1	83.6
EU-28		10.2	9.4	9.2	9.1	23.2	22.7	22.2
EU-19		11.6	10.9	10.7	10.4	17.5	17.1	16.7
ILO subregions and country details								
Arab States		10.1	10.1	10.2	10.2	5.3	5.5	5.6
Saudi Arabia		5.9	5.8	5.7	5.7	0.7	0.7	0.7
Central and Western Asia		9.1	9.2	9.4	9.4	6.8	7.0	7.1
Turkey		9.9	10.3	10.5	10.4	3.0	3.1	3.1
Eastern Asia		4.5	4.5	4.5	4.6	42.1	42.4	42.7
China		4.6	4.6	4.7	4.7	37.3	37.7	38.1
Japan		3.5	3.3	3.2	3.1	2.2	2.1	2.0
Korea, Republic of		3.5	3.7	3.5	3.4	1.0	0.9	0.9
Eastern Europe		6.8	6.9	7.0	6.9	10.2	10.3	10.1
Russian Federation		5.2	5.8	6.2	6.1	4.4	4.7	4.6
Latin America and the Caribbean		6.4	6.5	6.7	6.7	19.9	21.0	21.2
Argentina		7.3	6.7	6.9	6.7	1.3	1.4	1.4
Brazil		6.8	7.2	7.7	7.6	7.7	8.4	8.4
Mexico		4.9	4.3	4.1	4.0	2.5	2.4	2.4
Northern Africa		12.5	12.1	11.8	11.6	8.8	8.8	8.8
Northern America		6.3	5.5	5.1	4.9	10.0	9.3	9.0
Canada		6.9	6.9	6.8	6.8	1.4	1.4	1.4
United States		6.3	5.3	4.9	4.7	8.7	7.9	7.7
Northern, Southern and Western Europe		10.7	10.1	9.9	9.7	21.8	21.4	21.0
France		10.3	10.6	10.4	10.0	3.1	3.0	2.9
Germany		5.0	4.6	4.6	4.7	2.0	2.0	2.0
Italy		12.7	12.1	12.0	11.5	3.0	3.0	2.9
United Kingdom		6.1	5.5	5.4	5.5	1.8	1.8	1.9
South-Eastern Asia and the Pacific		4.3	4.4	4.3	4.2	15.1	15.2	15.1
Australia		6.1	6.3	6.3	5.8	0.8	0.8	0.7
Indonesia		5.9	5.8	5.7	5.6	7.3	7.3	7.3
Southern Asia		4.2	4.1	4.1	4.0	28.8	29.1	29.4
India		3.5	3.5	3.4	3.4	17.5	17.5	17.6
Sub-Saharan Africa		7.3	7.4	7.5	7.5	28.2	29.4	30.4
South Africa		24.9	25.1	25.5	25.7	5.1	5.3	5.4

Source: ILO Unemployment Report 2016

The Social Dimensions of Growth

Prepared for Growth Dialogue
1 March 2017

EASTERN CARIBBEAN CENTRAL BANK
ST KITTS

1.0 DEFINITION STATEMENT

The social dimensions of growth are critical areas of inquiry as they speak to the efficacy of growth outcomes in alleviating many social ills including lack of access to health and education, unemployment, gender equity, income inequality, poverty and crime. These are all key issues that the ECCU member countries are currently grappling with and as such, the need for appropriate and well calibrated policies to alleviate these social pressures are of paramount importance. As Sir Arthur Lewis stated, the advantage of economic growth is not that wealth increases happiness but that it increases the range of human choice.

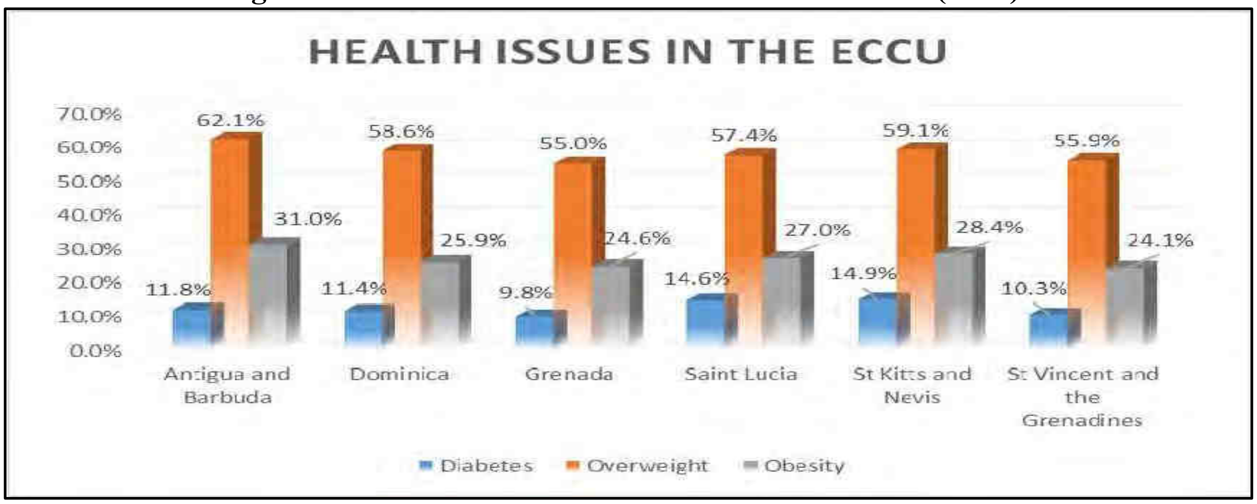
For the purpose of this research note, the dimensions of social justice that will be explored are health, education, poverty and crime as it is believed that these form the nucleus of the challenges hindering the upward mobility and broader development of the ECCU region. These will be explored within the backdrop of real average GDP growth declining from 4.5 per cent per annum in the five years prior to the global economic and financial crisis to approximately 1.5 per cent over the five-year period 2011 to 2015.

2.0 ASSESSMENT OF RECENT DEVELOPMENTS

Health

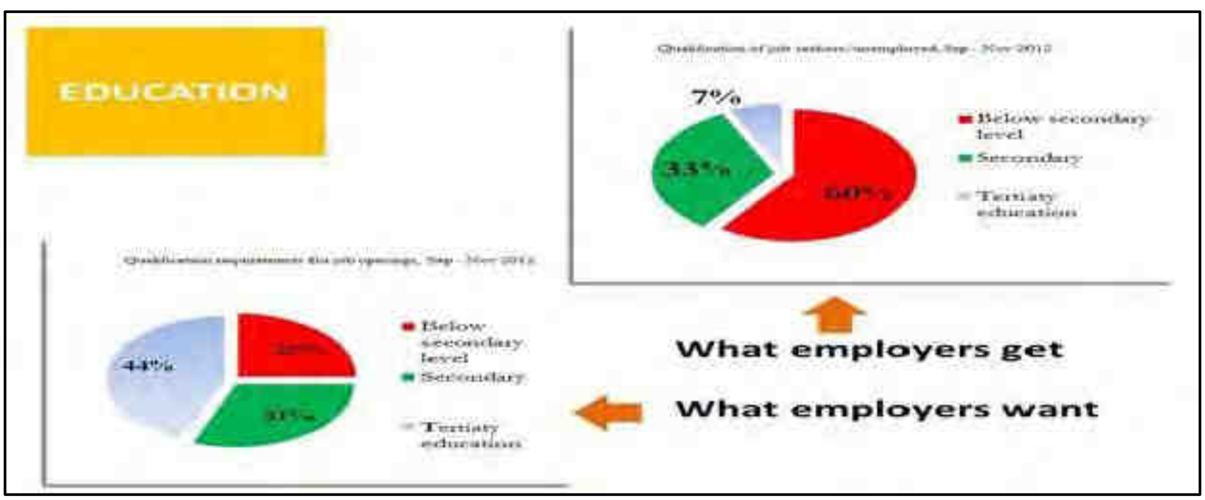
While human capital is a clear determinant of economic growth, only recently has health's role in this process become a focus of serious academic inquiry. It is in this vein that countries in the ECCU must pay attention to the current health situation in the countries. As at 2015, ECCU residents had an average life expectancy of 74.6 years. However, the incidence of non-communicable diseases is becoming an ever present threat to the livelihoods of ECCU residents and the overall productivity of the region. Figure 1 shows that in six of the ECCU member countries diabetes affects approximately 12.1 per cent of the population. What is even more troubling being that more than 50.0 per cent of the population in each of the six independent countries in the ECCU are overweight, with Antigua and Barbuda being the highest at 62.1 per cent and Grenada being the lowest at 55.0 per cent. Obesity is also quickly becoming another major health concern, with approximately 26.8 per cent of the population in the region being classified as obese. This phenomenon is largely explained by the increasing sedentary lifestyles among ECCU residents, coupled with a lack of exercise and greater consumption of high calorie fast foods and sweets. The ECCU member countries have also had to contend with mosquito-borne diseases such as Zika and Chikungunya in recent times. These diseases have a direct impact on the productivity of the region's human capital as well as its tourism product which could be negatively affected by US advisories to travellers to ECCU member states.

Figure 1: Incidence of Non-Communicable Diseases (2016)



Source: World Health Organisation – Diabetes Country Profiles 2016

Figure 2: Education Mismatch in Saint Lucia (2012)



Source: Dr Didacus Jules – Jumpstarting the economy: What Saint Lucia needs to do now!

Education

On a related matter, the issue of education and training requires that emphasis be placed on the demand for education rather than on the supply. While the region regularly monitors the amount invested in education and training, limited work has been done in measuring the output generated from the investment in education. Much emphasis is placed on academia, while market surveys reveal a deficit in the provision of technical and vocational skills. This mismatch in the provision of education and training has been identified for some time, however, little has been accomplished in removing the stigma associated with technical and vocational education training (TVET). Therefore, initiatives should be taken to give equal status to TVET and academia, and reforms should be made in education planning to address the paucity of technical and vocational skills while moderating the over-supply of academic training. Opportunities for apprenticeship and mentoring should also accompany initiatives to raise the profile of TVET.

Poverty

One of the desired outcomes of broad economic growth is the reduction of poverty and indigence in the society. On this front, the ECCB member countries have generally fared well. Specifically, all countries for which data are available recorded a decline in the level of indigence between 2002 and 2009, with Anguilla recording virtually no indigence in 2009. Indigence rates for that year ranged from 0.0 per cent (Anguilla) to 3.7 per cent (Antigua and Barbuda). Likewise, poverty indicators showed significant improvement for Anguilla and Dominica, while modest deterioration was observed for Grenada and Saint Lucia over the same period.

With respect to the distribution of income, represented by the Gini coefficient[1], Anguilla and Dominica appear to have experienced some deterioration as their scores increased over the review period. Grenada and Saint Lucia on the other hand showed some improvement in this area. Based on the data, 2009 income was most equitably distributed in Grenada with a Gini coefficient of 0.37, while Antigua and Barbuda reflected the least equity with a score of 0.48. Lastly, unemployment rates generally fell during the pre-crisis years (2002 to 2009) in most member countries, with the lowest rate being recorded in Anguilla (1.5 per cent). However, a marked increase was observed for most member countries post-crisis, with Grenada and Saint Lucia recording the highest rates at 28.9 per cent and 24.1 per cent, respectively as at 2015. Based on the available data, only Anguilla, Montserrat and St Kitts and Nevis posted unemployment rates below 10.0 per cent as at 2015.

Table 1: Key Poverty Indicators for the ECCU

Country	Indigence Rate		Poverty Rate		Gini coefficient[1]		Unempl. Rate		Unemployment Update	
	2002	2007/2009	2002	2007/2009	2002	2007/2009	2002	2007/2009	Rate	Year
Anguilla	2.00	0.00	23.00	5.80	0.31	0.39	8.00	1.50	1.50	2007
Antigua and Barbuda		3.70		18.30		0.48		4.00	14.10	2015
Dominica	15.00	3.10	39.00	28.80	0.35	0.44	25.00	14.00	23.00	2015
Grenada	12.90	2.40	32.10	37.70	0.45	0.37	17.50	24.90	28.90	2015
Montserrat									6.50	2011
St Kitts and Nevis		1.00		21.80		0.40	5.60	5.10	6.50	2009
Saint Lucia	7.10	1.60	25.10	28.80	0.50	0.42	15.70	13.00	24.10	2015
St Vincent and the Grenadines		2.90		30.20				18.80	18.80	2015

Source: Country Poverty Assessments, Labour Force Surveys, Population and housing census

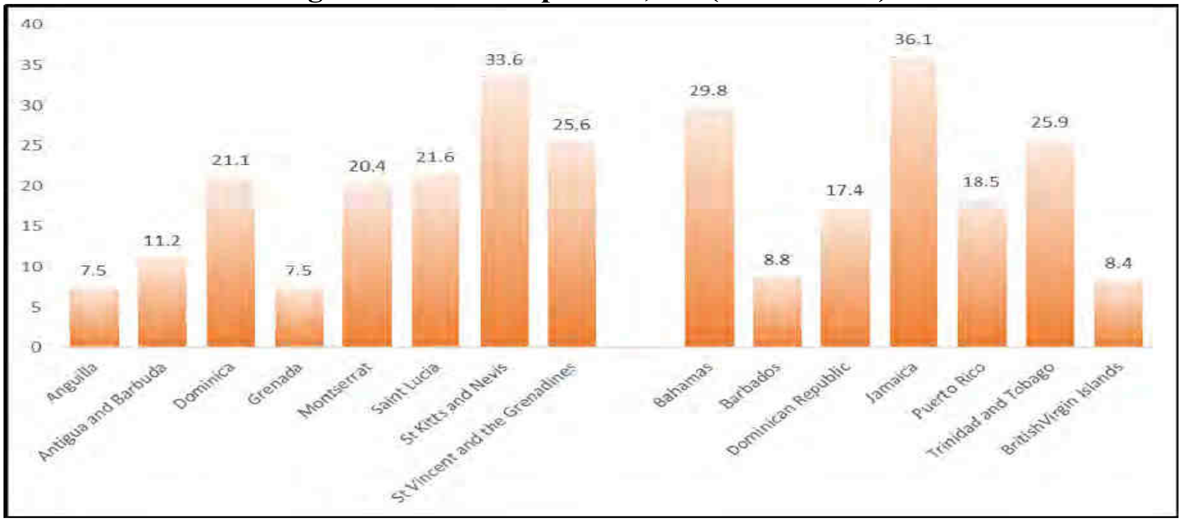
[1] Gini coefficient measures the inequality among values of a frequency distribution, for example, income levels. A Gini coefficient of zero expresses perfect equality, where all values are the same (for example, where everyone has the same income). A Gini coefficient of 1 (or 100%) expresses maximal inequality among values.

Crime

As the literature on modernisation and development confirms, modernisation has contradictory effects. On the one hand, it enhances economic growth and living standards. On the other, it fosters social mobility that may widen the gulf between rich and poor, thereby heightening the sense of relative deprivation among marginalised groups. This appears to be one of the drivers of crime in the region, as the benefits of growth seem not to be equally shared among the populace. In addition, the global economic and financial crisis is seen to be a contributor to the divergent trends in income levels between the rich and poor.

In the past decade, ECCU member countries have seen an escalation in the incidence of violent crimes, ranging from 7.5 per 100,000 in Anguilla and Grenada to 33.6 per 100,000 in St Kitts and Nevis. This is a worrisome development, in that it not only fosters social instability and uncertainty, but also potentially retards the growth of the tourism and allied sectors, critical for attracting foreign exchange, creating jobs and fostering growth. In addition, efforts to stimulate greater private sector activity and entrepreneurship are likely to be stymied.

Figure 3: Murders per 100,000 (2012 – 2014)



Source: United Nations Office on Drugs and Crime

3.0 CHALLENGES AND POLICY OPTIONS

3.1 CHALLENGES

Health

- The manifestation of a wide spectrum of maladies across the ECCU indicates that not sufficient attention is being paid to the current health situation in the countries.
- The incidence of non-communicable diseases negatively affects inhabitants' livelihood and productivity.
- Diabetes in particularly affects 12.1 per cent of the ECCU population and is considered a real threat.
- Obesity is observed in over 50.0 per cent of participants in six countries.
- There is an urgent need to put preventative measures in place to minimise the mosquito borne diseases such as Zika and Chikungunya in the OECS.
- Decreases in productivity related to health can adversely affect the tourism product.

Education

- The economic competitiveness of the ECCU is imperiled by the quality and quantity of suitably qualified candidates for the varied job opportunities across the OECS.
- There is manifest insufficiency in conditions to ensure a world-class workforce.

- A Saint Lucia study shows that in every area of qualification, the requirements of the private sector are grossly underserved by those in various education brackets; this is similar to all countries across the OECS.
- Not enough emphasis is placed on the demand for education rather than a focus on the supply.
- While much emphasis is placed on academia, market surveys reveal a deficit in the provision of technical and vocational skills.
- There is a mismatch in the provision of education and training
- Not enough opportunities available for apprenticeship, mentoring and accompany initiatives to raise the profile of TVET.

Poverty

- Empirical evidence show increase in poverty and indigence in the society across the OECS.
- Poverty and indigence is not uniformed across the OECS so the response needs to be multidimensional and cost effective.
- Poverty is correlated to unemployment so responses must take both into account concurrently.

Crime

- Studies show social mobility may widen the gulf between rich and poor, thereby heightening the sense of relative deprivation among marginalised groups.
- Benefits of growth seem not to be equally shared among the populace.
- ECCU member countries have seen an escalation in the incidence of violent crimes, ranging from 7.5 per 100,000 in Anguilla and Grenada to 33.6 per 100,000 in St Kitts and Nevis.
- Social instability and uncertainty, potentially retards the growth of the tourism and allied sectors.

3.2 POLICY OPTIONS

Health

- The design and implementation of policies to identify, track and mitigate the manifestation of a wide spectrum of maladies across the ECCU.
- The design and implementation of policies to identify, track and mitigate the manifestation

of non-communicable diseases which negatively affects inhabitants' livelihood and productivity.

- The design and implementation of policies to identify, track and mitigate the manifestation of Diabetes which presently affects 12.1 per cent of the ECCU population and is considered a real threat.
- The design and implementation of policies to identify, track and mitigate the manifestation Obesity has been observed in over 50.0 per cent of participants in six countries.
- The design and implementation of policies to identify, track and to put preventative measures in place to minimise the mosquito borne diseases such as Zika and Chikungunya in the OECS.
- The design and implementation of policies to identify, track and mitigate the incidences of decreases in productivity related to health which can adversely affect the tourism product.

Education

- Policies, programmes, strategies and tactics developed to enhance economic competitiveness of the ECCU;
- A critical rethink of the region's education strategy, one that seeks to more closely balance the needs of the private sector, while improving on the learning experience through greater integration of information and communication technologies (ICTs) in the classroom.
- The retraining of teachers as they adapt to and utilise the new technologies in imparting knowledge to students.
- Investing greater resources should be placed on lifting the profile of technical and vocational programmes.
- Place more emphasis on the demand for education and on the supply.
- Increase in the provision of technical and vocational skills through education and training such as TVET

Poverty

- Conduct regular surveys and periodic censuses to monitor and generate empirical on poverty and indigence in the society across the OECS.
- Develop and institutionalise multidimensional and cost effective approaches to poverty reduction.

- Develop and implement concurrent poverty and unemployment targeting approaches.

Crime

- Establish processes to ensure social mobility to minimise the gulf between rich and poor, thereby mitigating the sense of relative deprivation among marginalised groups.
- Ensuring that the benefits of growth are equally shared among the populace.
- Establish policies and processes to ensure that ECCU member countries reverse the escalation in the incidence of violent crimes.
- Develop and implement policies that reduces social instability and uncertainty that potentially retards the growth of the tourism and allied sectors.

PRESENTATIONS

MICRO-SMALL-MEDIUM ENTERPRISE DEVELOPMENT IN THE CARIBBEAN:

TOWARDS A NEW FRONTIER

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CARIBBEAN DEVELOPMENT BANK

PURPOSE

"The purpose of the Bank shall be to contribute to the harmonious economic growth and development of the member countries of the Caribbean (hereinafter called the Region) and to promote economic cooperation and integration among them, having special and urgent regard to the less developed members of the Region".

Article 1 - agreement Establishing the Caribbean Development Bank

MISSION STATEMENT

CDB's Mission is to be the leading catalyst in the reduction of poverty through the inclusive and sustainable development of our BMCs' by mobilising development resources in an efficient, responsive and collaborative manner with accountability, integrity and excellence.

ACKNOWLEDGEMENTS

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Alana Goodman and Linda Cordeaux provided the legal services required of the project; Andria Murrell saw to the end to end Administrative support while Klao Bell-Lewis oversaw the design and finish of the publication.

It is our hope that policymakers and other stakeholders will find much value in this study in charting the development of the regional MSME sector.

Dr. Justin Ram
Director, Economics Department
Caribbean Development Bank

ACRONYMS AND ABBREVIATIONS

ABIA	Antigua and Barbuda Investment Agency
ACCA	Association of Chartered Certified Accountants
ADB	Asian Development Bank
ADE	Agency for the Development of Enterprises
AFI	Approved Financial Institution
BDS	Business Development Services
BELTRAIDE	Belize Trade, Investment and Development Agency
BEST	Belize Enterprise for Sustainable Technology
BMC	Borrowing Member Country
BNTF	Basic Needs Trust Fund
BSA	Business Support Agency
BSE	Barbados Stock Exchange
BSO	Business Support Organisation
B2B	Business to Business
BUSOS	Business Support Services, Suriname
CAIC	Caribbean Association of Industry and Commerce
CAIPO	Companies and Intellectual Property Office
CARDI	The Caribbean Agricultural Research and Development Institute
CARIB-CAP	Caribbean Micro Finance Capacity Building Project
CARIRI	The Caribbean Industrial Research Institute
CCI	Culture and Creative Industries
CCMF	Caribbean Centre for Money and Finance
CDB	Caribbean Development Bank
CDF	Caribbean Development Fund
COSTAATT	The College of Science, Technology and Applied Arts of Trinidad and Tobago
CPEC	Caribbean Programme for Economic Competitiveness
DFC	Development Finance Corporation

ACRONYMS AND ABBREVIATIONS

ECA	Export Credit Agency
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
ECGS	Enhanced Credit Guarantee Scheme
ECSE	Eastern Caribbean Securities Exchange
EDU	Enterprise Development Unit
EIB	European Investment Bank
ERMFP	Enterprise Risk Management and Financing Programme
EXIM Bank	Export Import Bank
FAO	Food and Agriculture Organisation of the United Nations
FG	Forward Guidance
FIT	Foundation for International Training (Toronto)
GARDC	Gilbert's Agriculture and Rural Development Centre
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GIZ	German Foundation for International Development
GOB	Government of Barbados
GNI	Gross National Income
GOTT	Government of Trinidad and Tobago
IADB	Inter-American Development Bank
ICT	Information and Communications Technology
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IICA	Inter-American Institute for Cooperation on Agriculture
ILO	International Labour Organisation
IMA	The Institute of Marine Affairs
IMF	International Monetary Fund

ACRONYMS AND ABBREVIATIONS

IPO	Initial Public Offering
ISMEA	Israel Small and Medium Enterprises Authority
JAMPRO	Jamaica Promotions Corporation
JBDC	Jamaica Business Development Corporation
JDB	Jamaica Development Bank
JEA	Jamaica Exporters' Association
JNSBLA	Jamaica National Small Business Loan Company
JSE	Jamaica Stock Exchange
KAB	Know About Business
KKF	Chamber of Commerce and Industry, Suriname
KIBS	Knowledge-Intensive Business Services
KPI	Key Performance Indicator
LAC	Latin America and the Caribbean
MGI	McKinsey Global Institute
MFIs	Microfinance Institutions
MIDA	Micro Enterprise Development Agency
MIIC	Ministry of Industry, Investment and Commerce
MoE	Ministry of Education
MORI	Mona Office for Research and Innovation
MSE	Micro and Small Enterprise
MSME	Micro, Small and Medium Enterprise
MSTEM	Ministry of Science, Technology, Energy and Mining
MSTTE	Ministry of Science, Technology and Tertiary Education
MGS	Mutual Guarantee Schemes
NCB-J	National Commercial Bank Jamaica
NCST	National Commission on Science and Technology
NCC	National Competitiveness Committee

ACRONYMS AND ABBREVIATIONS

NCDs	Non-communicable diseases
NDR	Negative deposit rates
NDP	National Development Plan
NEDCO	National Enterprise Development Corporation
NGO	Non-Governmental Organisations
NIF/CF/SME	National Insurance Fund Credit Facility for SMEs
NIHERST	National Institute of Higher Education, Research, Science and Technology
NIS	National Insurance Scheme
NIS	National Innovation System
NPL	Non-performing loan
NPRF	National Pension Reserve Fund
NTMA	National Treasury Management Agency
OECD	Organisation for Economic Co-operation and Development
OGDS	OECS Growth and Development Strategy
PADF	Pan American Development Foundation
P2P	Peer-to-Peer
PSAR	Private Sector Assessment Report
PPP	Public-Private Partnership
PPP	Purchasing Power Parity
PVO	Private Voluntary Organisation
QE	Quantitative easing
ROCIP	Registry of Companies and Intellectual Property
ROSCA	Rotating Savings and Credit Association
SBAJ	Small Business Association of Jamaica
SBDC	Small Business Development Corporation
SEDU	Small Enterprise Development Unit
SFD	Sector Framework Document

ACRONYMS AND ABBREVIATIONS

SGSRE	School of Graduate Studies, Research and Entrepreneurship
SIYB	Start and Improve Your Business
SLISBA	St. Lucia Industrial and Small Business Association
SMEs	Small and Medium Enterprises
SRC	Science Research Council
KKF	Koop van Koophandel en Fabrikatie (Suriname Chamber of Commerce & Industry)
TEPA	Trade and Exports Agency
TOC	Table of Contents
TRLF	Trade Receivables Liquidity Facility
TTBS	Trinidad and Tobago Bureau of Standards
TTSE	Trinidad and Tobago Stock Exchange
TVET	Technical and Vocational Education and Training
TOR	Terms of Reference
UFXInt	Unsterilised FX intervention
UK	United Kingdom
USA	United States of America
USD	United States dollar
USAID	United States Agency for International Development
UTech	University of Technology
UTT	The University of Trinidad and Tobago
UWI	University of the West Indies
WEF	World Economic Forum
WEO	World Economic Outlook
WIPO	World Intellectual Property Organisation
ZIRP	Zero-interest-rate Policy


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CONTENTS

Dollars ($) throughout refer to United States dollars (USD) unless otherwise specified.

EXECUTIVE SUMMARY

BACKGROUND

The Micro, Small and Medium Enterprise sector (MSME) accounts for the majority of private enterprises in the Caribbean, and contributes more than 50% to Gross Domestic Product and employment. The sector also contributes significantly to female employment, poverty reduction and social stability. Nevertheless it remains a sector that is largely under-supported.

SYNOPSIS OF THE STUDY

The purpose of the thematic study on Micro, Small and Medium Enterprises in the Caribbean is two-fold: 1) to assess the status of the MSME sector based on a review of the sector in eight borrowing member countries (BMCs) of the Caribbean Development Bank (CDB): (Antigua and Barbuda, Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago, St. Lucia and Suriname); and 2) to highlight critical MSME development challenges and propose a structured approach to addressing those challenges. The study adopts a holistic approach which is detailed in the three tier approach to sector development presented in Chapter 1. The study also advocates, where possible, joint Caribbean approaches to MSME sector development.

MAIN FINDINGS

Weaknesses in the Regional Life Cycle System of Financing

The study points to significant weaknesses in the regional Life Cycle System (LCS) of financing which has nurtured MSME growth in member countries of the Organisation for Economic Co-operation and Development. While Jamaica and Trinidad and Tobago are further advanced in terms of the development of the LCS, the system is significantly weak in most of the other BMCs.

Substantial Gaps in the Policy and Regulatory Frameworks

The Study points to substantial gaps in the policy and regulatory frameworks. Many countries have outdated policies. In some cases, policies have not been reviewed in more than ten years. In addition, there are often important policy gaps, including voluntary rather than compulsory registration of enterprises; lack of fiscal incentives for MSMEs; no time bound development plans and targets for the sector; and lack of key progress indicators. Product quality enforcement is often weak or non-existent.

Weak Technical Support

The provision of technical support to MSMEs, whether by public or private sector institutions, is generally weak and inadequate. In part, this is due to weaknesses in the institutions themselves because of the lack of financial and human resources. As a result, the extent of the outreach by these institutions is often very limited, with services provided to a very small percentage of MSMEs.

Weaknesses in Regional Innovation Systems

Regional innovation systems are often in the embryonic stage of development and characterised by a scattering of independent research institutions. With significant budgetary and human resource limitations, there is limited scope for support to MSMEs to help them to become competitive and to grow through productivity enhancing innovation.

RECOMMENDATIONS

Below is a synopsis of the main recommendations generated by the study.

Chapter 1: Optimal Development Path for the MSME sector.

1.1 The three-tier approach to MSME development;

1.2 Adoption of a standard definition and classification for MSMEs across the Caribbean;

1.3 Extension of the information gathered by business registries from MSMEs;

1.4 Engagement in more in-depth MSME research and development;

1.5 Analysis of expenditure by MSMEs, and contribution to employment and exports;

1.6 Definition of a new policy direction;

1.7 Exploration of avenues to strengthen Business Service Organisations' (BSO) delivery capacity;

1.8 Increased focus on innovation and enhanced productivity (First Floor Issues), especially in the services sector and those subsectors with good export prospects, such as creative industries, offshore education, and health tourism.

Chapter 2: Improving MSME Access to Finance

2.1 Develop training programmes aimed at improving the financial management capacity of MSMEs;

2.2. Expand the range of financial products available to MSMEs;

2.3 Introduce tax reforms that allow formal MSMEs to retain a larger share of their profits and cash flows;

2.4 Increase the adoption of tax reforms that shift the burden of taxation away from direct taxes to indirect taxes;

2.5 Introduce labour reforms that allow MSMEs to be more flexible in terms of hiring and firing labour;

2.6 Create stronger tax incentives to increase financial intermediation and encourage MSMEs to seek out alternative forms of investment funds;

2.7 Improve the enabling environment for access to credit;

2.8 Overcome the limitations of domestic markets by: a) promoting and fiscally favouring export growth of MSMEs; and b) increasing the use of ICT "information access" mechanisms to facilitate greater business intelligence with respect to external markets;

2.9 Introduce regulatory reforms that would allow Accredited Financial Institutions (AFIs) and Microfinance Institutions (MFIs) to take deposits, and offer an expanded range of financial products to their MSME clients;

2.10 Increase the inclusiveness of credit unions in terms of affording them access to SME financial programmes as development finance institutions (DFI) recipients - including funding, credit guarantees and technical assistance in risk management;

2.11 Put in place legislation that would encourage the adoption of Mobile Banking solutions;

2.12 Examine the feasibility of establishing Mutual Guarantee Schemes in the larger Caribbean countries; and

2.13 Create incentives to encourage the informal sector to formalise their businesses.

Chapter 3: Improving Regional Regulatory and Policy Frameworks

3.1 Refocus the regulatory and policy frameworks towards increased efficiency and effectiveness in facilitating expansion of a strengthened and more sustainable, productive and competitive MSME sector.

3.2 Pursue the establishment of a business-friendly environment as a top priority;

3.3 Focus on private sector funding of innovation initiatives;

3.4 Improve worker productivity;

3.5 Increase Information and Communication Technology (ICT) usage by MSMEs;

3.6 Grow entrepreneurship culture through education reform;

3.7 Improve trade facilitation;

3.8 Develop a model MSME policy as a guide for the Region; and

3.9 Articulate an MSME development strategy.

Chapter 4: Strengthening Institutional Support Frameworks

4.1 Promote technical cooperation among Caribbean Registries;

4.2 Disseminate information with respect to policy, legislative and regulatory frameworks within the Region;

4.3 More effective promotion of CDB services to MSMEs;

4.4 Improve private, public sector collaboration and enhance institutional strengthening for capacity development:

4.5 The creation/establishment of a public-private partnership network should be explored between selected microfinance institutions, Business Development Agencies

(BDAs) and Business Service Organisations (BSOs) to facilitate a larger flow of domestic resources into MSME growth and expansion; and

4.6 Develop online training programmes for MSME development.

Chapter 5: Nurturing Innovation in the MSME sector

5.1 Countries committed to innovation should complete the establishment of national innovation systems (NISs);

5.2 The Caribbean should re-think its innovation orientations from an R&D manufacturing industry focus to one that is primarily driven by or linked to services;

5.3 Operational frameworks for supporting innovation should articulate clearer support for MSME investment in the export sectors that offer strong opportunities for innovation in the Caribbean; and

5.4. A roadmap to support the development of an innovation eco-system should be developed.

INTRODUCTION

APPROACH

The approach consisted of the following key actions:

1. Development of two questionnaires – one for interviews with the MSME stakeholders in the CDB member countries and the other for gathering statistical data from specialty financial institutions serving MSMEs. These instruments, attached as Appendices 2a and 2b, were:

    a. pilot tested and refined into a standardized set of questions for use as the uniform Interview Guide for in-country visits;
    b. used to gather specific product information and performance statistics from selected financial institutions serving MSMEs in six countries; and
    c. contributed to improved data gathering and report-writing efficiency;

2. Development of a list of key institutions and persons to interview in each of the eight CDB-targeted member countries.

    Interviewed were Ministers and Permanent Secretaries responsible for Trade, Industry and Commerce as well as senior personnel in other Ministries and in the Development Banks, Departments of Statistics and Company Registries in all eight countries.

    Executives in business support organisations, financial institutions, as well as national, regional and international development agencies, were also interviewed. The list of persons interviewed from 96 organisations is presented at Appendix 3.

DEFINITION AND DATA CHALLENGES

1. MSME sector definition and size: One of the most elusive challenges in assessing MSME development is the categorising of this business group into uniformly acknowledged "size" categories.

    In addition to the fact that some countries are at different stages of development and therefore maintain independent classifications of the sector, much of the research that has preceded this study – mostly by the World Bank, the International Development Bank (IDB) and the International Labour Organization (ILO) – has used different criteria to those informally adopted by some BMCs in their local research or classification metrics.

    The consultants offered their own categorisation of MSMEs to each interviewee in order to facilitate region-wide tracking and comparability, but noted that there is considerable inconsistency in the country-level classifications of MSMEs. They also drew attention to the fact that, by global standards, almost all formal businesses in the Caribbean would be classified as medium, small and micro enterprises (MSMEs) – with possibly 1% being categorised as "large".

2. Multi-dimensional data limitations: Overall, enterprise data is not classified in national statistics in terms of business size. Information is usually available on a sector basis e.g. manufacturing or services.

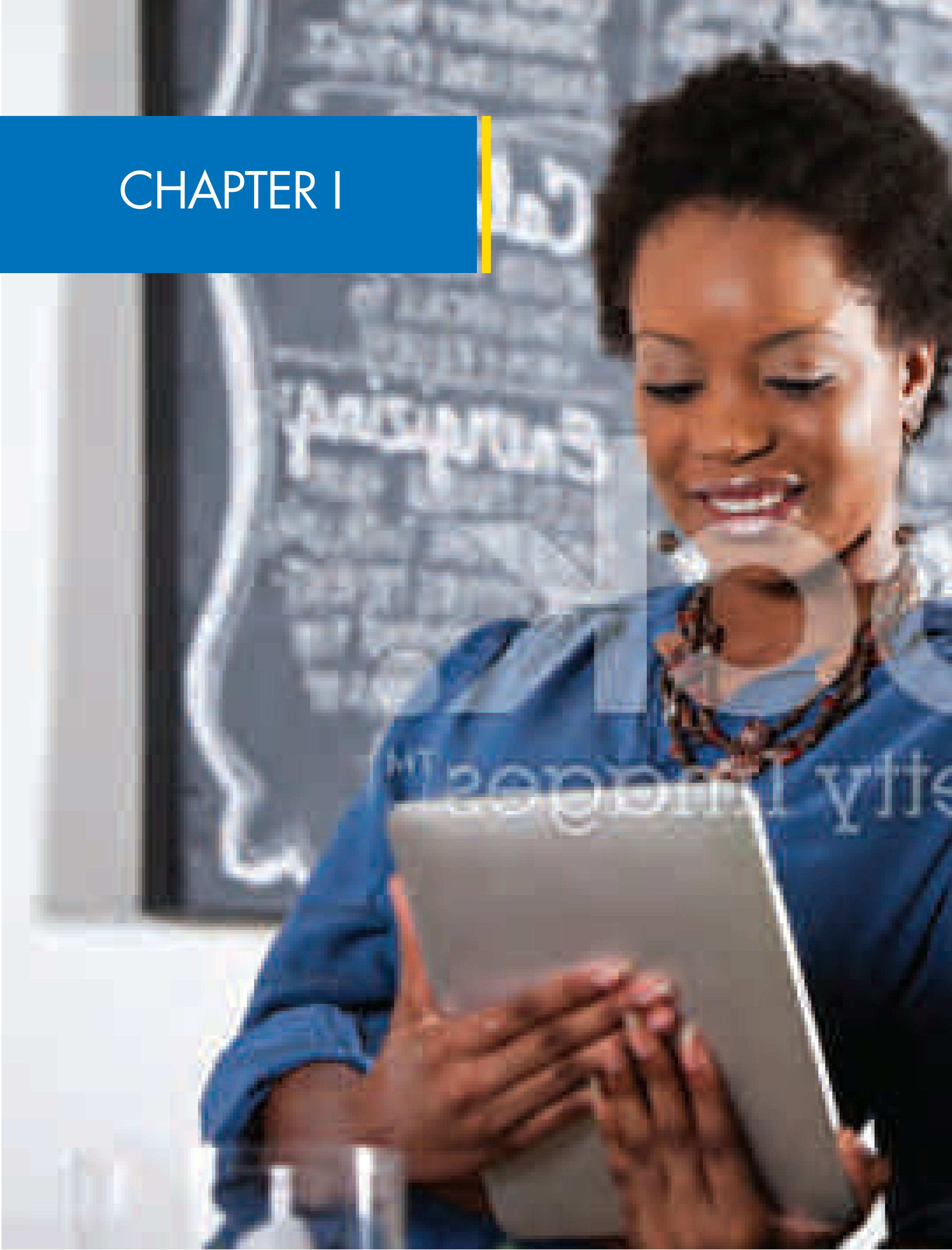
    But, apart from inferences that can be made from national business registration office data, there is limited access to actual MSME data, besides the data generated via special surveys or selective one-off studies.

Also, there is limited up-to-date information on the relative scale of support provided via technical assistance programmes although snapshots can be obtained on a periodic basis. Similarly, export data is not stratified according to business size, and the contribution of SMEs to economic development is not well documented across the Bank's borrowing member countries (BMCs). In some countries there is selective data on gender and largely anecdotal, evidence-based information on levels or types of innovation, as variously defined. Business viability information is lacking, especially data on the failure rates of business at the lower end of the MSME spectrum.

Because of these limitations, there was reliance on business registration information and selective banking and technical assistance delivery data as provided by the institutions interviewed. That information was reinforced with the findings generated by international donor agency studies on the Caribbean MSME sector.

3. MSME Development and Poverty: Notwithstanding, the growth of the MSME sector in the region, high poverty levels have persisted throughout the Caribbean – and unemployment has been elevated to levels exceeding 10 - 20% of the workforce in recent years, Trinidad and Tobago being the exception at 3.2% according to its Central Bank's yearend 2015 results. Interviews with knowledgeable stakeholders and several studies confirm that MSMEs, like remittances, constitute a major source of escape from indigence and abject poverty for thousands of citizens. However, the challenge with monitoring MSME impacts on poverty lies in the absence of data combined with the deliberate reluctance of the informal and micro enterprise sectors to provide economic information on their activities.

CHAPTER I



REGIONAL
MSME SECTOR PROFILE

CHAPTER I: REGIONAL MSME SECTOR PROFILE

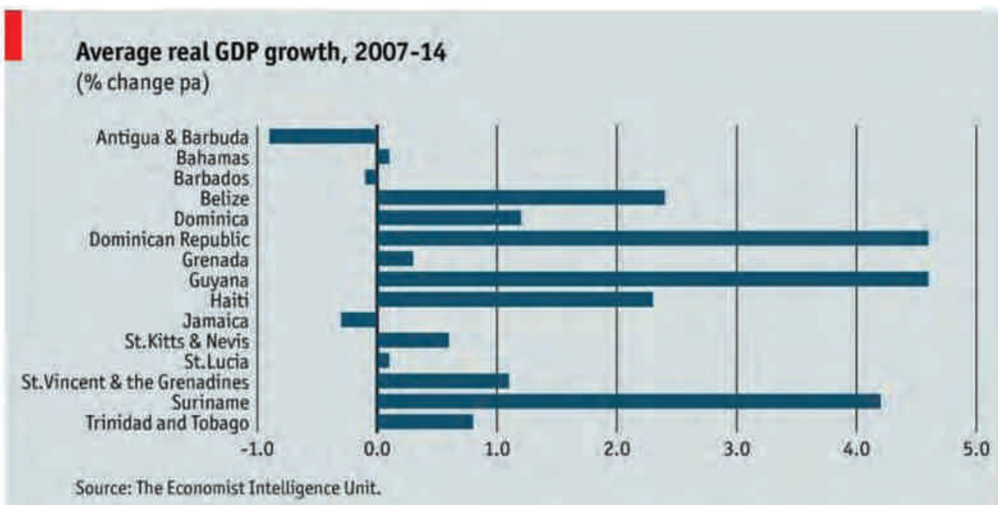
1.1 GLOBAL ECONOMIC TRENDS & EFFECTS ON CARIBBEAN COUNTRIES

Global economic trends have always influenced the direction and pace of economic and social development in Caribbean countries. In particular, the consequences of the 2008 global financial crisis have had pronounced effects on the Region's MSMEs. It is estimated that MSMEs constitute between 70% and 85% of the number of enterprises, contribute between 60% and 70% of GDP and account for approximately 50% of employment in the Caribbean. Notwithstanding the absence of firm data, indications are that the MSME sector is a significant contributor to income generation and poverty reduction[1].

1.1.1 Anaemic Economic Performance

Figure 1.1 (below) provides a snapshot of the prolonged impact of the Global Financial Crisis on the Caribbean's GDP growth between 2007 and 2014. Notably, the tourism-based economies in this study (Antigua and Barbuda, Barbados, Jamaica and St. Lucia) grew, on average, by less than one-tenth of 1% annually. In contrast, the resource-based economies (Belize, Guyana, Trinidad and Tobago, and Suriname) grew, on average, by more than 2% annually[2].

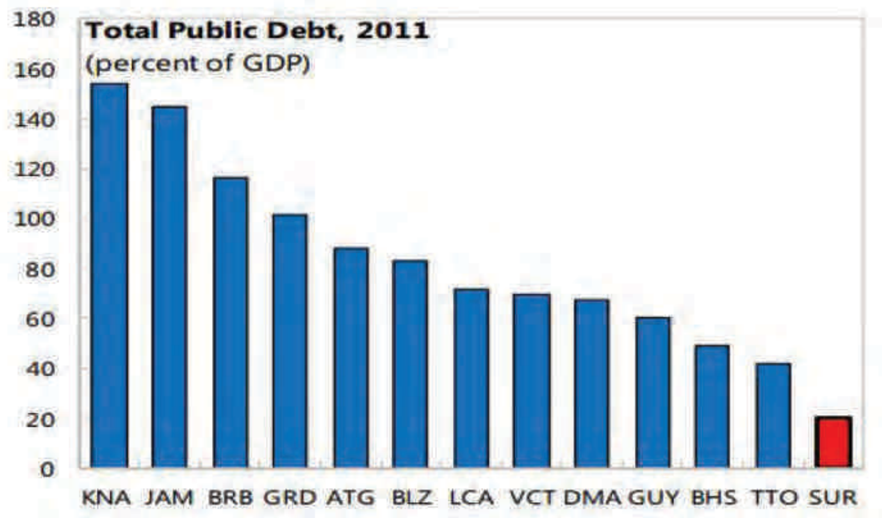
Figure 1.1: Average Real GDP Growth (2007–2014)



[1] The International Labour Organisation (ILO), Small Enterprise Development in the Caribbean, 2000, p.3-5. According to ILO, MSMEs account for over 90% of enterprises globally. (ILO, MSMEs and the Global Economic Crisis, 2009, p.10.) |
[2] The exception is that Trinidad and Tobago grew, on average, by 0.8% annually.

Moreover, with the exception of Trinidad and Tobago and Suriname, the other six countries reviewed in this study are all burdened with high Debt to GDP ratios as depicted in Figure 1.2 (below). Of the 13 countries listed, only Trinidad and Tobago and Suriname had debt to GDP ratios less than 50%. Consequently, six of the eight countries that are part of this study have had to implement home-grown or IMF-supervised structural adjustment programmes, partly because of the anaemic growth of the global economy since 2008. By March 2016, Suriname was about to embark on an IMF programme for financial support, as a result of the combined fallout from the global decline in oil prices, a lacklustre international market for its minerals exports (i.e. gold, bauxite), and weak fiscal management. The net effect of these structural realignment programmes is reduced purchasing power of both businesses and consumers in most of these economies – a factor that has adversely affected the viability and survival of MSMEs.

Figure 1.2: Total Public Debt (2011)



Source: Suriname Central Bank Presentation "The Economy in Suriname 2011-2012", May 2012 and IMF Report No.12/281, May 2012

1.1.2 The New Normal?

In its 2014 Annual Report, the CDB stated that, "preliminary estimates indicate that the economic recovery in the region continued in 2014, with 16 of CDB's 19 BMCs reporting growth during the year, driven mainly by tourism and construction services. With continued increases in income in major source markets, improved airlift capacity, a shift in cruise itineraries from the Mediterranean to the Caribbean and intensified marketing by BMCs, the resurgence in regional tourism gained momentum, and most destinations recorded increased visitor arrivals. There was similar improvement in the construction sector, driven mainly by tourism-related foreign direct investments. Some BMCs noted an upturn in commercial and residential building, as well. Increased activity in the construction industry was also stimulated by public sector capital investment in several BMCs. In some cases, this was boosted by unanticipated reconstruction work following weather-related challenges and/or pre-election spending. Conversely, further declines in international commodity prices in 2014 adversely affected mining and quarrying output among the main regional producers of gold, bauxite and petroleum; the latter were also constrained by supply-side issues. Outturns in respect of manufacturing and agriculture were mixed".

Going forward, the economic headwinds may be more formidable than anticipated. For example, Barbados, which experienced very strong tourism performance in 2014–2015, saw its GDP grow by less than 1% in 2015. Likewise, Jamaica experienced GDP growth of only 0.5% over the same period despite a relatively robust tourism season. The International Monetary Fund's World Economic Outlook (WEO) of January 2016 entitled "Subdued Demand/Diminished Prospects", suggests that the robustness of future global economic growth continues to be uncertain.

The Fund is less confident in early 2016, than it was in mid-2015, about the prospects for global economic growth. In 2015, global economic activity remained subdued. Growth in emerging market and developing economies—while still accounting for over 70% of global growth—declined for the fifth consecutive year, while a modest recovery continued in advanced economies.

Three key transitions continue to influence the global outlook: 1) the gradual slowdown and rebalancing of economic activity in China away from investment and manufacturing toward consumption and services; 2) lower prices for energy and other commodities; and 3) the prospect of a gradual tightening in monetary policy in the United States in the context of a resilient U.S. recovery, as several other major advanced economy central banks continue to ease monetary policy.

Overall growth in China is evolving broadly as envisaged, but with a faster-than-expected slowdown in imports and exports, in part reflecting weaker investment and manufacturing activity. These developments, together with market concerns about the future performance of the Chinese economy, are having spillovers to other economies through trade channels and weaker commodity prices, as well as through diminishing confidence and increasing volatility in financial markets. The IMF's relatively cautious expectations are already being echoed in the United States, where stock markets in early 2016 began to display signs of volatility with small but progressive contractions in the major indices – reflecting US concerns that the global economy may be again weakening.

Should economic growth in the global economy continue to be skittish, this will have renewed negative knock-on effects on the Caribbean – and on the prospects and fortunes of the region's MSME sector.

1.2 MSMES AND MACROECONOMIC DEVELOPMENT

1.2.1 Size and Growth of the Global MSME Sector

The International Finance Corporation (IFC) and the McKinsey Global Institute (MGI) estimated that there are there are 420 to 510 million MSMEs worldwide, of which 9% are formal SMEs (typically registered businesses with 5-250 employees) and 80-95% are in emerging markets[3]. A 2010 study of 132 countries carried out by the IFC, entitled "Micro, Small, and Medium Enterprises Around the World: How Many Are There, and What Affects the Count?", highlights the following characteristics of the sector in those countries:

1. There are 125 million formal MSMEs in this set of economies, including 89 million in emerging markets;
2. Formal MSMEs are more common in high-income economies, but in low and middle-income economies, MSME density (number of MSMEs per 1000 persons) is rising at a faster pace;

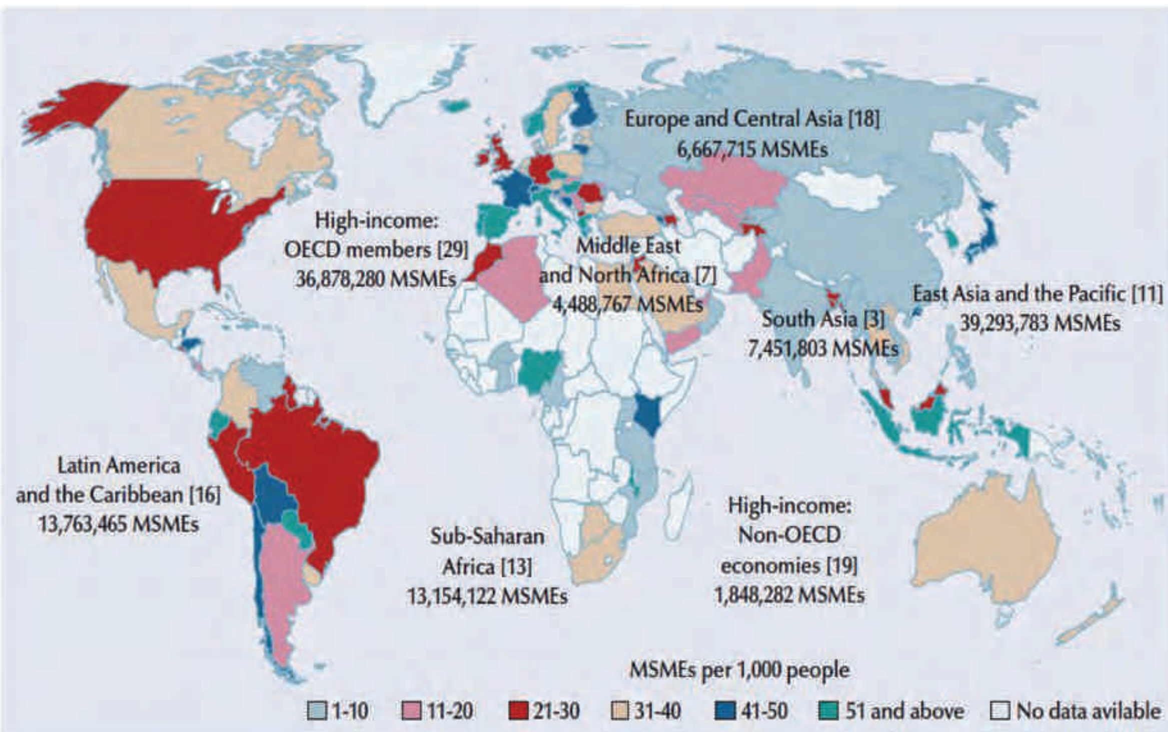
[3] MSMEs included in the IFC-McKinsey database do not include farmers or sole proprietorships REFERENCES NEEDED

3. There is significant variance in the countries' definitions of MSMEs. Around a third of the countries covered define MSMEs as having up to 250 employees;
4. Formal MSMEs employ more than one-third of the world's labour force, but the percentage drops significantly with income level;
5. MSMEs are more likely than large firms to identify access to finance as their biggest obstacle;
6. In economies with a higher percentage of firms with no formal credit, MSME density is lower;
7. A larger informal sector is associated with lower formal MSME density;
8. Measures of barriers to firm entry and exit, such as the minimum capital requirement and the recovery rate in case of bankruptcy, are also associated with lower formal MSME density (number of MSMEs per 1,000 people).

Figure 1.3 (below) provides a visual summary of MSME density in 116 developed and developing countries in major economic zones across the globe.

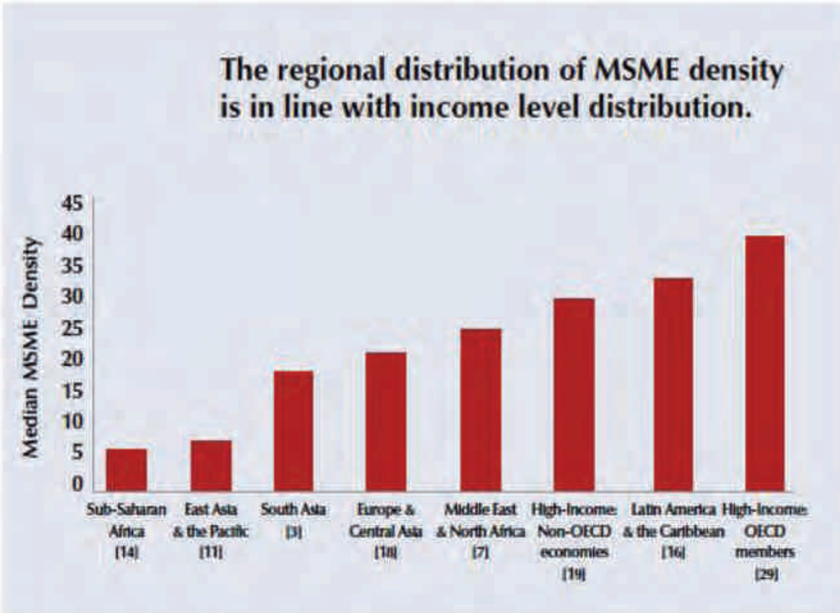
According to the IFC report, on average, there are 31 MSMEs per 1,000 people, across the economies covered. The countries with the highest formal MSME density are as follows: Brunei Darussalam (122 per 1,000 people), Indonesia (100), Paraguay (95), the Czech Republic (85), and Ecuador (84). Overall, economies with higher income per capita tend to have more formal MSMEs per 1,000 people. However, on a regional basis, Latin America has the second highest level of MSME density in the world although the Caribbean region has a relatively low level of MSME density (see Figure 1.4 below).

Figure 1.3: MSME Density



Source: International Finance Corporation, Micro, Small, and Medium Enterprises Around the World, 2010.

Figure 1.4: MSME Density by Region



Source: IFC, Micro, Small and Medium Enterprises Around the World: How Many Are There, and What Affects the Count? 2010

Figure 1.5 Growth Rates Regionally

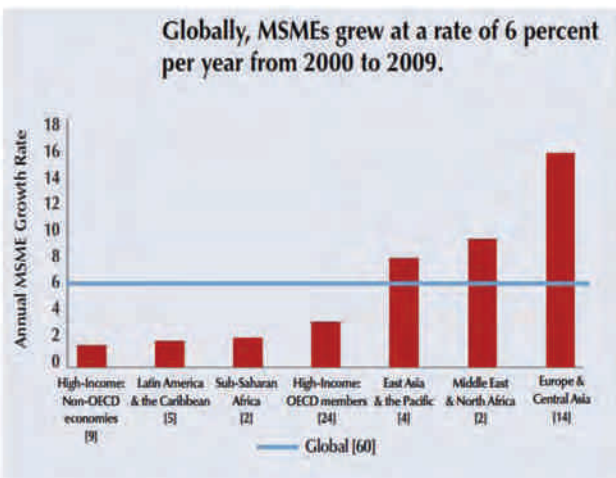
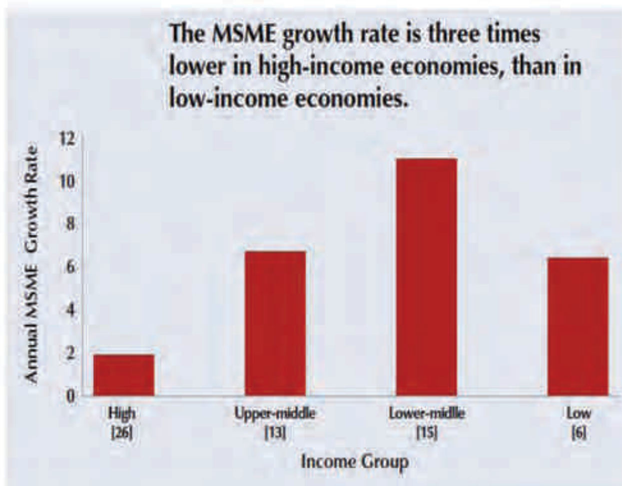


Figure 1.6 MSME Growth Rates by Income Groups



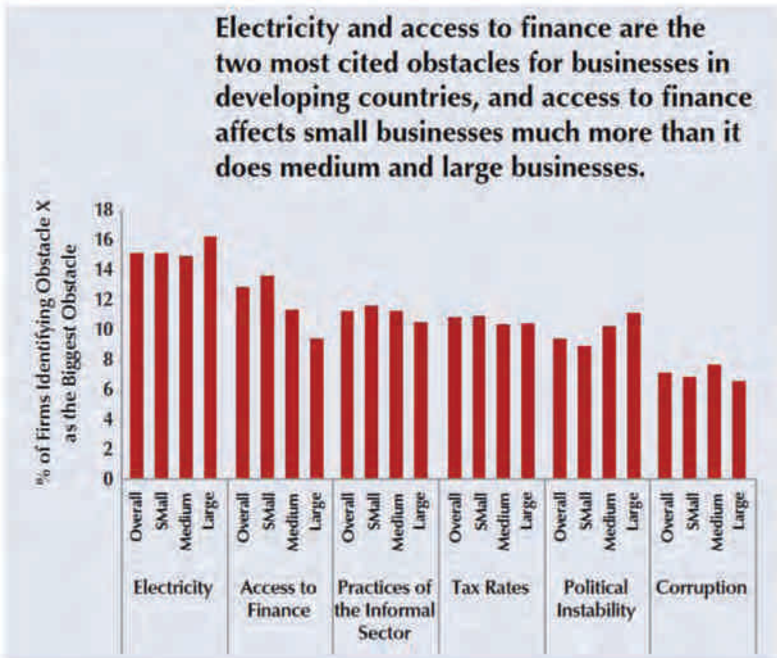
Source: IFC, Micro, Small and Medium Enterprises Around the World: How Many Are There, and What Affects the Count? 2010

1.2.2 MSME Challenges

When presented with a list of 15 possible obstacles, electricity and access to finance were the two most cited by businesses in developing countries (See Figure 1.7). It is important to emphasise that firms of different sizes rank obstacles differently.

Access to electricity is a significant constraint overall and affects small, medium, and large enterprises alike. However, more small and micro businesses list access to finance as their biggest obstacle than do medium enterprises. Fewer large firms see it as their biggest obstacle.

Figure 1.7: Six mostly commonly cited obstacles by firms in 98 countries



Source: IFC, Micro, Small and Medium Enterprises Around the World: How Many Are There, and What Affects the Count? 2010

1.3 THE REGIONAL MSME SECTOR

Regional governments and development organisations have been formally engaged in small business development since 1983. These early efforts gained traction after major donors such as United States Agency for International Development (USAID), Canadian International Development Agency (CIDA) and German Foundation for International Development (GIZ) initiated multi-country enterprise development programmes in partnership with executing agencies (for example, the Pan American Development Foundation (PADF), Foundation for International Training (FIT) and the CDB), culminating in the declaration by the CARICOM Heads of 1988 as "The Year of Small Business".

During the past three decades, national governments, multilateral and bilateral development institutions, NGOs and PVOs have been supporting SME development with a varied menu of grants and concessional loans administered in-country in the form of special credit lines and loan guarantees, firm-level business development training, business plans development, counselling and on-site technical assistance, and fiscal incentives such as tax holidays for early-stage companies. This section highlights some of the major trends noted in the regional performance of the MSME sector and efforts made to improve performance, with emphasis on the eight targeted CDB (BMCs. However, it is necessary to begin this discussion with a regional definition of MSMEs.

1.3.1 Regional definition and classification of MSMEs

Examination of numerous international publications revealed that over 60 classifications for small and medium-sized enterprises are in use worldwide. Definitions of what constitutes an MSME vary quite widely from country to country and even within single countries.

Much depends on the character of the respective host country and the peculiarities of its own corporate sector, from which a relative measure of an MSME is made, sometimes on a rather arbitrary basis. Some countries distinguish between a micro and a small enterprise, while others subsume microenterprises under their SME umbrella definition; yet others refer to micro and small enterprises as MSEs.

In most cases, the definitions provided pertain to formally registered businesses, and exclude small-scale, informal family enterprises.

Figure 1.8: Indicators used among International, Regional and Local Sources

Indicator	International	Regional	Local
Number of employees	✓✓✓	✓✓✓✓✓✓	✓✓✓✓✓
Annual sales	✓✓		✓✓✓✓
Registered capital		✓	✓
Total assets	✓✓		✓✓
Total credit facilities			✓✓✓✓✓
Qualitative indicators	✓		✓

Source: USAID 2007

In Figure 1.8 above, USAID illustrates 6 indicators applied by various agencies in 2007 to classify MSMEs. The number of employees was the indicator most cited. In Appendix 5 there are 35 definitions and categorisations identified in 23 Caribbean territories and 9 used by nine multilateral development organisations. This illustrates the extensive diversity, divergence and conflicts in the definitions and classifications attributed to MSMEs among Caribbean jurisdictions and international agencies serving the region.

Following are the three (3) measurements most consistently used in selecting MSME beneficiaries in the Caribbean region:

1. **Assets:** MSMEs rarely have a precise estimate of the value of their fixed assets, and generally minimize them in environments where substantial asset taxes are imposed. Some government agencies evaluate fixed assets and land, while others use only fixed assets, thereby complicating cross-country comparisons.
2. **Employment:** Defining an MSME by the number of employees provides key data on the scale of its operations. This does not mean, however, that the larger an enterprise the more employees it will have.
3. **Turnover:** In general, the volume of turnover of a business is a more appropriate measure of its relative size than the number of employees or the value of assets. In Caribbean MSMEs, where profits, assets deployed and employees are often blurred by tax considerations, it is argued that annual sales constitute the single best measurement of business size. The pattern and rates of turnover also reflect functional and behavioural attributes. Only the most superficial of business services would not require an understanding of an entity's sales in order to be effective.

Mindful of the mediocre experience over the past 30 years with implementing development and credit programmes and with gathering empirical data for policy-related research, it was concluded that saving and creating sustainable jobs constitutes the single most important result desired from future investments by donors and governments in MSME development. **Therefore, for data collection and comparability across the CARICOM Single Market and Economy (CSME), employment was accepted as the most workable basis for a uniform definition and classification of MSMEs.** At issue is whether this information is systematically collected by governments.

After considerable discussion with stakeholders across the egion, the following simplified MSME typology was recommended for regional adoption:

- Micro: 1-5 employees;
- Small: 6-15 employees;
- Medium: 16-50 employees.

1.4 REVIEW OF MSME SECTOR CHALLENGES

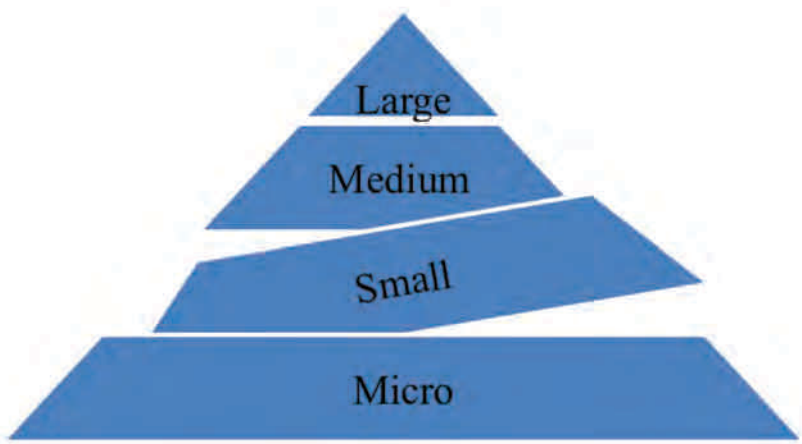
1.4.1 Sector size

A major continuing problem is poor coordination between the Registries of Companies and Intellectual Property (ROCIP); the Social Security/ National Insurance Boards; and the Departments of Statistics in collecting, generating, analysing and disseminating reliable data on MSMEs. Empirical data gathered from these State agencies suggest that as at December 2015, some 200,000 registered and at least 550,000 informal MSMEs were operating in the eight countries studied, and that a region-wide surge in business formation occurred during the triennium ending 2015.

This surge seems to have been occasioned by:

- the quest for self-employment opportunities among unemployed youths and women;
- anticipation of securing petty and other short-term government contracts; and
- growing interest among employed persons to earn a second income.

Figure 1.9: Pyramid Distribution of Private Sector Businesses



1.4.2 MSME Sector Informality and Challenge

Much has been written on the inherent and imposed challenges facing small businesses; very little has been published on the successes they have achieved, with minimal support from the formal sector. Yet, this sector continues to create and expand employment opportunities; develop entrepreneurship skills; utilise local materials; and enhance market opportunities. It is the desire for economic survival and upward social mobility that fuels the largely unmet demands from the MSME sector throughout the Region, for information, financing and business development assistance. Whereas this is by far the largest and fastest growing component of the Private Sector - from Belize in Central America through the archipelago to Guyana and Suriname in South America - it is disparate, fragmented and disorganised; known for deficiencies in the quality, consistency and range of its products and services; and for weaknesses in packaging, costing and pricing, technology usage, and management/worker know-how. Micro and small entrepreneurs (MSEs) display high levels of individualism; clustering while encouraged, is still at a nascent stage. Additionally, unlike larger businesses, they do not have a common, unified voice in any of the BMCs.

Their sheer numbers make it difficult for service provider organisations to cope with the demands for assistance. Registered or not, they remain largely underserved and "informal", hence generally perceived as not part of the private sector by the established business community.

1.4.3 Policy response

While the importance of MSMEs has been lauded in official speeches, in budget presentations and in political party manifestos, a clear and comprehensive policy statement on the Government's working agenda for the development, modernisation, expansion or regulation of this sector was found in only three of the eight countries visited. The Ministers of Trade, Industry and Commerce in Antigua and Barbuda, Barbados and St. Lucia indicated that no policy was in place to guide government's agenda for and interface with the MSME sector. Only Belize, Jamaica and Trinidad and Tobago had Cabinet-approved MSME policies in place. The Barbados Minister indicated that a Draft Small Business Policy had been developed to "an advanced state of readiness for imminent Cabinet discussion". Because of its inadequacies, the regional policy framework generally does not contribute significantly to the fostering of a culture of competitiveness and growth among MSMEs.

Nor does it give equity or parity in the provisions for indigenous business when compared to the concessions awarded to foreign-owned businesses. Only Trinidad and Tobago [Enterprise Development Policy, September 2014], Belize [Act - Cap 282, 2000], Antigua and Barbuda [Small Business Act No. 24 of 2007] and Guyana [No. 2 of 2004], among the eight BMCs, have sought to legislate fiscal, monetary and developmental benefits specifically for this sector during the past ten years.

Clearly MSME Entrepreneurial development is not a major regional policy focus. Registration is voluntary, militating against credible data capture and effective sectoral planning by assigned agencies, successful outreach by supporting state agencies, and growth and sustainability of the membership-based BSOs. Furthermore, in the current policy and regulatory vacuum, very few alternative directions or developmental initiatives have been identified or adopted by the established private sector to improve competitiveness among MSMEs, in spite of the avowed recognition by some corporate leaders, of the significance of MSMEs as vital service providers and consumers of their goods and services.

1.4.4 Institutional Infrastructure

Despite the deficiencies noted above, the activities of central government ministries and departments, state boards and public sector corporations impact, to a varying albeit not significant degree, growth in the MSME sector. In each of the 8 BMCs, the government and various international donor agencies have provided some resources for MSME development, with contrasting and varying levels of enthusiasm and support from the established private sector in the countries under review. The allocation of resources to improve productivity in MSMEs through state and non-state intermediaries over the past 2 decades has reached less than 10% of MSMEs. Additionally, governments have forged partnerships with private BSOs, development banks and commercial banks in support of MSMEs.

However, overlapping mandates, competition for government financing and donor resources continue to characterise both state agencies and the private BSOs responsible for MSME business development. In Barbados, fifteen BSOs were identified as unable to become self-sustaining or independent without persistent government and donor funding. Additionally, with few exceptions, the BSOs are fiercely individualistic and resist efforts at closer synergies through consolidation. Therefore, the reach, sufficiency and quality of their business development services remain limited, and their capacity to become effective advocates for the MSME sector is compromised by their financial dependence on the political directorate. As a result, no recognised national forum is in place that provides an opportunity for MSMEs to exercise leadership and to participate meaningfully in the national decision-making process, even though they constitute the largest component of the private sector.

Moreover, the "one stop shop" promise of 1988 - The Year of Small Business remains undelivered. Unfriendly procedures, archaic forms and processes, nuisance fees, multiple stops, long delays for routine decisions, and insensitive customer care render the average citizen's experience with public sector offices a costly waste of productive time. The failure by successive governments to remove these bureaucratic bottlenecks in the public service continues to frustrate the ease of pursuing business opportunities, and force smaller enterprises to operate informally and sub-optimally.

The institutional framework for effective planning, implementation, co-ordination and evaluation of activities in the MSME sector is therefore in need of bold but purposive modernisation and strengthening.

1.4.5 Inadequate access to financial resources

An underdeveloped financial services industry, dominated by commercial banks, restricts the overall scope for MSMEs to grow and expand. The commercial banking sector, dominated by overseas banks, regards MSMEs as high risk; does not finance start-up enterprises (that is, enterprises up to 3 years in operation); and typically requires the payment of high interest rates and more than 100% encashable security for loans.

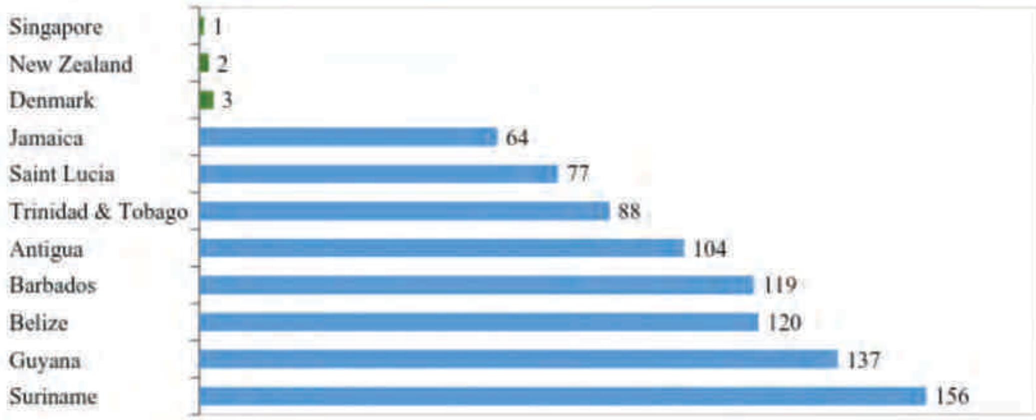
1.5 THE COMPETITIVENESS CHALLENGE

1.5.1 Global Competitiveness Rankings

The Global Competitiveness Report produced by the World Economic Forum is the most comprehensive assessment of national competitiveness worldwide. It assesses the competitiveness of 144 economies, providing insights into the drivers of their productivity and prosperity. For 2014-2015, Barbados ranks 55th (down from 47), Jamaica 86th (up from 94), Trinidad and Tobago 89th (compared to 92); Suriname and Guyana trail at 110 and 117, respectively. Typical drawbacks affecting the performance of these Caribbean countries include:

1. Tax rates;
2. Weak infrastructure;
3. Bureaucratic red tape;
4. An inadequately educated workforce;
5. Inadequate access to finance;
6. Weak capacity for innovation; and
7. Corruption.

Figure 1.10: 2016 Ease of Doing Business Rankings: BMCs vs Top 5 Countries



Interestingly, economies that rank well on the 2016 "Ease of Doing Business Report" published by the World Bank, also score well on the "Global Competitiveness Index", as illustrated by Figure 1.8 above. Making sound choices for building economic competitiveness of MSMEs is critical to economic growth, employment generation and poverty reduction. Based on the foregoing analysis, it is clear that the CDB's BMCs face significant challenges in improving the competitive position of the business community and raising the standard and quality of life of their citizens.

1.6 OPTIMAL DEVELOPMENT PATH FOR THE REGIONAL MSME SECTOR

1.6.1 Three-Tiered Approach

Based on the foregoing analysis, it is recommended, for reasons of adequacy and comprehensiveness, that regional MSME development strategies adopt the three-tiered approach effectively implemented in Singapore, Korea, Western Europe, Costa Rica and other successful countries during the past two decades:

a) First Floor: support at the first floor, focusing on productivity and product quality enhancements among MSMEs, will strengthen competitiveness, job creation and GDP growth.

b) Second Floor: strengthen the efficiency and effectiveness of organisations and other intermediary structures providing developmental and other services to the sector.

c) Third Floor: formulate enabling policies, legislation and strategies thereby improving the business friendly environment for MSMEs.

While not adhering strictly to the order of priorities listed above, the study adheres substantially to the structure of the approach proposed above. Chapter 2 focuses on the issue of access to financing, a Second Floor issue and one considered a primary issue among regional MSMEs.

Chapter 3 focuses on the quality of the policy and regulatory framework (Third Floor), while Chapter 4 discusses strengthening the efficiency and effectiveness of organisations providing developmental and other resources to the sector (Second Floor). Chapter 5 discusses the issue of innovation and productivity enhancement (First Floor).

CHAPTER II:

MSME ACCESS TO FINANCE

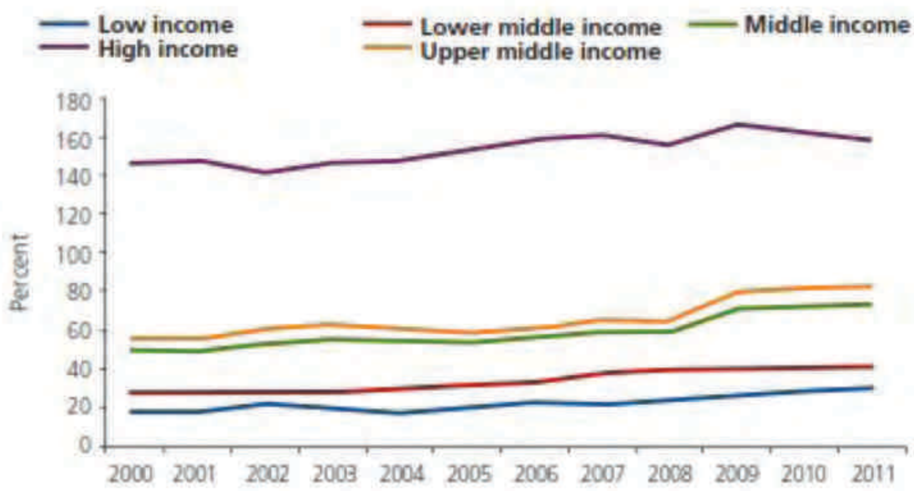
CHAPTER II: MSME ACCESS TO FINANCE

2.1 SME ACCESS TO FINANCE GLOBALLY

The private sector's access to finance, measured as a proportion of GDP, is often used as an indicator of financial sector efficiency[4].

Figure 2.1 shows that the ratio of private sector domestic credit to GDP globally has been increasing in all country income levels, but it is still very low in developing countries when compared with high-income countries.

Figure 2.1: Ratio of Domestic Credit to GDP Globally



Source: WorldBank Group

Much of the divergence between developing and developed countries, in terms of access to finance can be attributed to the contributions of formal and informal MSMEs to GDP in developed vs. developing countries. SMEs contribute a sizable share to formal GDP — 49% on average in high-income countries and 29% on average in low-income countries (Figure 2.2 below).

The contribution of SMEs to employment and GDP in developing countries seems comparatively modest, but estimates suggest that the informal sector, which consists essentially of very small businesses, accounts on average for 48% of the total labour force and 37% of GDP in developing countries. The corresponding percentages for developed countries are much lower, at 25% of the total labour force and 16% of the GDP (Figure 2.3).

[4] In this chapter, SMEs are businesses with less than 250 employees: with "micro" being less than 10 employees, "small" being 10–49 employees, "medium being 50–249 employees and "large" more than 250 employees.

Figure 2.2: Formal SMEs in GDP

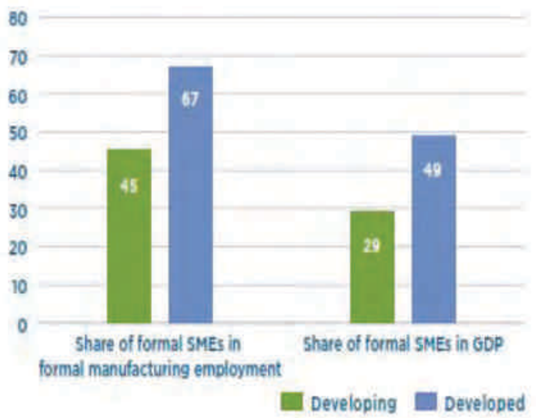


Figure 2.3: Informal Sector in GDP

Source: IFC, Scaling Up SME Access to Financial Services in the Developing World. International, October 2010

Arguably, one of the differences in the relative contribution to GDP by the formal sector lies in the differences in access to credit. The reasons include SME life cycle investment accommodation by the financial system. Stronger financial management, less information asymmetry, higher levels of banking and financial sector competitiveness, stronger adherence to operating and product standards, and better supply chain management all lead to more predictable operational cash flows.

But a primary reason often overlooked in developing countries is that government policy to support SME access to credit is much more comprehensive and more deliberate in developed markets.

Table 2.1 (below) shows the degree of comprehensiveness of credit coverage adopted by 19 Organisation for Economic Co-operation and Development (OECD) governments with respect to policies to: 1) improve bank credit intermediation via direct interaction with commercial lenders; 2) improve bank credit intermediation via central banks; and 3) promote alternative sources of credit by governments.

As the table shows:

- Germany and Spain have activated 9 of 11 possible options;
- All 19 countries have loan guarantee schemes;
- 18 of the 19 countries also offer export finance support to the private sector;
- 14 of the 19 are engaged in direct lending with private sector support; and
- 13 of the 19 provide direct loans to SMEs.

The information is significant for two reasons: first, it is often mistakenly assumed that many of these schemes are interventionist and therefore reminiscent of older and now "broken" models of economic development; second, it is also assumed that developed countries do not intervene in credit markets as deliberately as these options suggest. However, globally some instruments are more extensively used than others. In 2003, there were more than 2,250 guarantee schemes in over 100 countries. Moreover, credit guarantees can amount to a significant portion of national GDP as is the case in Italy and Portugal. But it is in Asia that the volume of outstanding guarantees amount to the highest share of GDP: 3.6% in Chinese Taipei, 6.2% in Korea and 7.3% in Japan.

It should be noted that not all of the instruments in Table 2.1 have equal or substantial impact on SME access to credit. But collectively, they have been noticeably effective in alleviating SME financing constraints, especially in severe credit contraction periods as experienced when the global financial crisis occurred in 2008.

Table 2.1: Policy Measures to Improve SME Access to Credit in OECD Countries

	Policies to improve bank credit intermediation - Government					Policies to improve bank credit intermediation - Central Banks		Policies to promote alternative sources of credit - Government			
	Loan Guarantee schemes	Lending targets	Export Finance Support	Credit Mediation / Code of Conduct	Credit Registry	Bank funding schemes	Securitization Support	Direct lending 100%	Direct Lending with private sector involvement	Peer-to-Peer Support	Retail Bond Markets
Canada	✓		✓					✓	✓		
Chile	✓				✓			✓			
Czech Republic	✓		✓		✓				✓		
Denmark	✓		✓					✓	✓	✓	
Finland	✓		✓					✓			
France	✓		✓	✓	✓			✓	✓	✓	
Germany	✓		✓	✓	✓		✓	✓	✓	✓	✓
Ireland	✓	✓		✓				✓	✓		
Italy	✓		✓		✓			✓	✓		✓
Japan	✓		✓			✓	✓	✓	✓		
New Zealand	✓		✓	✓							
Portugal	✓		✓		✓				✓		
Serbia	✓		✓					✓			
Spain	✓		✓	✓	✓		✓	✓	✓	✓	✓
Sweden	✓		✓					✓	✓	✓	
Switzerland	✓		✓								
The Netherlands	✓		✓						✓	✓	✓
UK	✓		✓	✓		✓			✓	✓	✓
United States	✓		✓					✓	✓	✓	

Source: Central Bank of Ireland, Policy Measures to Improve SME Access to Credit: A Survey, 2015

Some of the financing mechanisms being used in OECD countries are illustrated in the following examples:

1. **Credit Guarantee Schemes.** The Irish SME Credit Guarantee Scheme (CGS) offers a government guarantee on 75% of losses incurred by lenders. The guarantees are limited to SMEs in specifically targeted categories. It is intended to address market failure affecting commercially viable businesses in two specific situations – namely, where businesses have insufficient collateral, and where businesses operate in sectors with which the banks are not familiar. Borrowers using the scheme must pay a 2% premium above the interest rate to the Department of Jobs, Enterprise and Innovation. The scheme can cover a maximum of EUR150 million (mn) annually over a three-year horizon.

Japan has one of the strongest CGS systems globally. The first Japanese Credit Guarantee Corporation (CGC) was founded in 1937 in Tokyo by the local government, commercial and industrial associations, and financial institutions. By 2008, there were 52 CGSs, distributed in the 47 prefectures and 5 metropolitan cities across the country.

The size threshold of eligibility to guarantees varies by industry. In manufacturing, SMEs are eligible for guarantees if they have less than 300 employees, whereas for the retail sector the size upper threshold is set at 50. An additional criterion for eligibility exists. This relates to the maximum capitalisation allowed for the SME of 1 mn yen (EUR 9,410) per employee. More than one third of Japanese SMEs are supported by CGCs.

2. **Mutual Guarantee Schemes (MGS).** These schemes are essentially private sector owned and managed versions of the predecessor (public sector) ones. Italian mutual guarantee schemes (Confidi) are among the most important schemes in Europe.

   Almost 1 million Italian SMEs are members of a MGS. Guarantees granted by Italian MGSs account for 41% of all guarantees issued by European CGSs and 1.4% of Italian GDP. The coverage ratio typically amounts to 50% of the loan volume. The first Italian mutual guarantee scheme was created spontaneously by entrepreneurs in the late 1950s to increase their bargaining power vis-a-vis banks and to improve their access to finance. Despite numerous reorganisations and mergers over the last 50 years, Confidi have maintained their mutuality character, i.e., entrepreneurs are both members and shareholders of the institutions and are often heavily involved in their management. The mutuality character is codified into law as at least 20% of the MGS' capital endowment must come from affiliated firms. In contrast, Spanish Mutual Guarantee Societies are a special type of limited liability society that has two types of shareholders: 'participatory members', who subscribe some shares against the guarantee service (about 86,000 SMEs in 2011) and 'protective members', who include local authorities, banks, chambers of commerce and other relevant entities. Typically, guarantees by MGSs in Spain cover 100% of the bank loan.

3. **Direct Government lending of Public-Private Funds.** In Ireland, combined public-private funding for the SME sector has been in existence since 2013 through three funds – one which provides credit and two that provide equity. These funds were conceived by the National Treasury Management Agency (NTMA) with the National Pension Reserve Fund (NPRF) acting as cornerstone investor: 1) the SME equity fund of EUR 300–350 mn of which EUR 125 mn is provided by the NPRF; 2) the SME credit fund of EUR 450 mn into which the NPRF has injected EUR 200 mn; and 3) the SME turnaround fund of EUR 100 mn of which EUR 50 mn comes from the NPRF which will invest close to the point of insolvency – with potential for successful restructuring[5].

4. **Export Credit.** The composition and emphasis placed on various components of export credit varies from country to country. The EXIM Bank of the United States favours extending export credit insurance to SMEs (USD 3.2 billion and 83 per cent of authorizations to SMEs in 2012) over loan guarantees (USD 2.1 billion) and direct loans (USD800 mn). In contrast, in 2012-13, UK Export Finance supported exports and investments overseas through loan guarantees to banks with an aggregate value of GBP 2.2 billion versus GBP 1.6 billion in credit insurance. Meanwhile, KfW IPEX bank in Germany, in cooperation with a private financial institution, Northstar Europe S.A., favours direct lending to SMEs of EUR 500,000–EUR 5 mn, tied to deliveries and granted to the exporter. In all these cases, the Export Credit Agency (ECA) charges interest on a loan or a commission on intermediation[6].

[5] It is not known whether the NPRF is insured | [6] Excerpted from "Policy Measures to Improve SME Access to Credit: A survey". Central Bank of Ireland.

5. **Peer to Peer (P2P) lending.** The matching of retail investors with borrowers on internet-based platforms, i.e., P2P lending, is a nascent but growing channel of non-bank funding for SMEs. P2P grew in prominence in the middle of the past decade in the United States.

   The dominant market participants are Lending Club and Prosper, which have lent USD 2 billion and USD 550 mn respectively since their inception. Both focus mainly on unsecured consumer lending. Platforms in the UK such as Funding Circle and Zopa have lent GBP 135 mn and GBP 355 mn respectively, with the former focusing on SMEs and the latter on consumer lending. However, these markets are extremely small when viewed relative to SME lending markets of USD 606 billion and GBP 170 billion respectively.

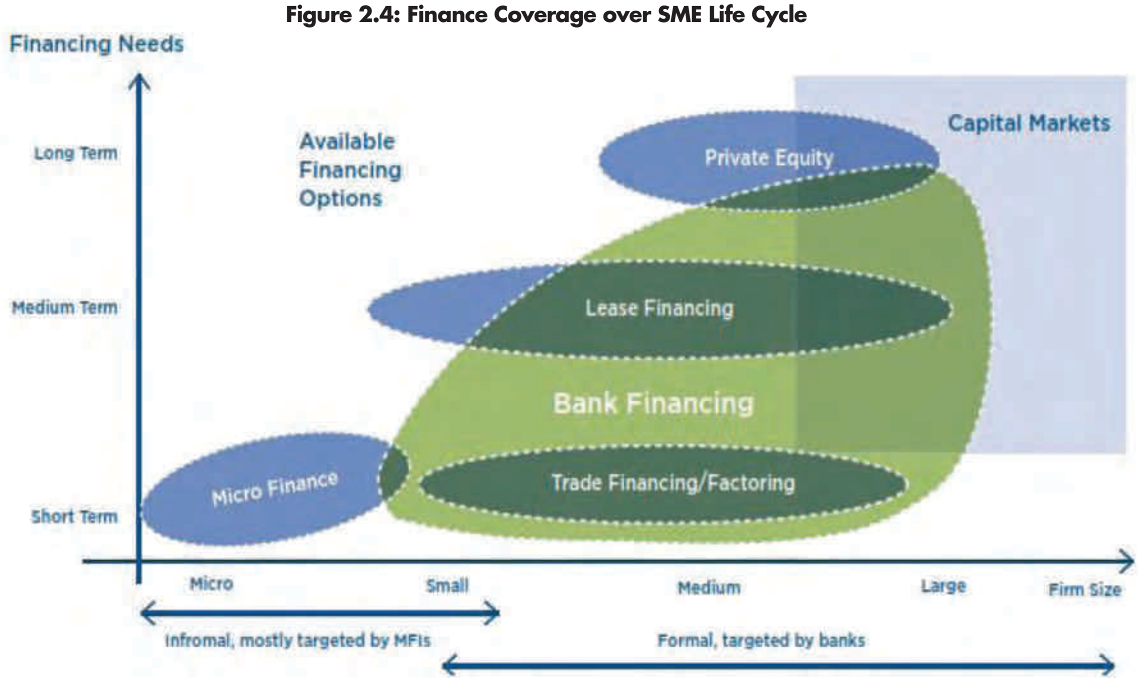
   In smaller markets like Ireland, the P2P lending market remains minuscule, with Linked Finance being the only platform, and currently having facilitated only EUR 400,000 in funding to SMEs as of June 2013.

Overall, each of these mechanisms has associated risks, which need to be carefully managed to assure their integrity and sustainability over time. For this reason, it would be prudent for those Caribbean countries that lack such schemes to first identify best practice principles before embarking on similar policies and/or specialty financing programmes in the region.

2.2 LIFE CYCLE SYSTEM

It is axiomatic that the life cycle system of financing MSMEs "from cradle to large-scale growth" is more efficiently and effectively aligned in developed countries than in developing countries. The primary reasons are that: 1) the OECD financial sector operates at high levels of integration and competitiveness; 2) the system is supported by appropriate enabling legislation; and 3) government policies are more strongly supportive of the sector's development, and therefore more sensitive to eliminating financing bottlenecks that may occur from time to time. Figure 2.4 provides a visual overview of the life cycle system of financing for SMEs as they evolve from nascent businesses to small, medium-sized and larger entities.

Figure 2.4: Finance Coverage over SME Life Cycle



Source: IFC, Scaling Up SME Access to Financial Services in the Developing World, International Finance Corporation, October 2010

The financing life cycle for SMEs often begins with a combination of micro-finance and personal funding provided by the entrepreneur from savings or resources obtained from family and/or friends. As the business expands, the SME obtains modest levels of new financing to support growth – usually through personal loans obtained from a bank, credit union or SME loan facility. As the SME matures into a well-established medium-sized firm, further growth is increasingly funded by medium-term bank loans and by specialised financing instruments such as loan guarantee schemes; factoring (discounting of receivables); lease financing; and export credit.

If the SME evolves into a large business, it may opt to meet the regulatory requirements for issuing an Initial Public Offering (IPO) on a publicly traded capital market and/or raise additional investment capital via venture capital (equity investment) mechanisms. As the large firm grows, stock market investments replace almost all debt previously incurred. Thereafter, the firm could opt to offer independently traded credit instruments such as bonds – moving away almost entirely from the banking system and essentially becoming its own "self-financier".

As this process evolves, innovation, governance, transparency and company performance become the driving forces behind the firm's sustainability as a business. But increasingly, the firm's value is also exposed to external vulnerabilities such as variations in national and global economic growth, commodity shocks, political instability in strategic regions of the world, and swings in general investor confidence. The preceding life cycle processes do not always apply to all firms on a linear basis. In some instances, risky and unconventional product ideas are funded with highly specialised private equity funds or venture capital at nascent stages of an SME's development. In some sectors, young firms are launched with government research grants, especially in the USA and in Israel. In other cases, some large firms choose not to "go public", and remain closely held, highly profitable private concerns. Also, because of the nature of the business, some firms seek out loan guarantees, export credit and trade financing at much earlier stages in the operational life cycles.

Other companies (e.g., Apple, Facebook, Google, and Uber) leapfrog the incremental SME life cycle system, and have adopted accelerated strategies aimed at securing substantial amounts of equity to help establish and ensure rapid dominance of their industry sectors.

2.2.1 How supportive is the financial life cycle system of Caribbean MSMEs?

Table 2.2 (below) presents the regional availability of the various financial instruments and mechanisms identified in Figure 4, Financial Coverage in the SME Life Cycle. The table provides a snapshot of the most significant mechanisms in the finance market in each of the eight countries. The consolidated findings from this analysis are as follows:

1. Integration of the SME financial life cycle is greatest in Jamaica and Trinidad and Tobago. But even in these countries, life cycle coverage is still not as complete as it could be – especially for SMEs that would want to transition from medium to larger businesses. This is because access to factoring, lease financing, credit guarantees, mutual guarantee funds, and equity financing and capital markets is variable. For instance, lease financing is available in Trinidad and Tobago on a (firm-by-firm) selective basis but not prevalent in Jamaica. However, generally, larger companies have better access to financing – from commercial banks and via equity financing on the two respective stock exchanges in both countries.

2. The logic of the stock exchange is that bank depositors would have an alternative vehicle for their savings, and that growing businesses

would be able to access funds at costs that are lower than bank lending rates. However, in the Caribbean, stock market development and growth is mixed. The Barbados Stock Exchange (BSE) is the third largest stock exchange in the Caribbean and its market capitalisation is around USD 2.75 billion. Only twenty companies are listed on the market, and many are only traded a few times a year. For example, shares in The West Indian Biscuit Company Limited have not traded since August 2014. There are also many days when no trading takes place. The securities listed on the BSE are a composite of government bonds, corporate debentures and shares in businesses that mainly operate in the consumer goods and financial services industry.

A few of those firms are cross-listed on other regional and international exchanges. Sagicor Financial Corporation, which trades on the London Stock Exchange, and Trinidad and Tobago Cement Limited, which trades on the Trinidad and Tobago Stock Exchange (TTSE), are examples of such companies. In Jamaica, more than 45 companies that operate in the finance, communications, manufacturing, retail, real estate and tourism industries are listed on the Jamaica Stock Exchange (JSE), making it one of the Caribbean's largest, most liquid and sector-diverse stock exchanges. Shares on the JSE trade for only three and half hours each day. The JSE, which dates back to 1968, has played a critical role in the development and growth of Jamaica's private sector. To date, the market capitalisation of the JSE is just over USD 3.3 billion. Also, there are 23 companies listed on Jamaica's Junior Stock Exchange.

The Trinidad and Tobago Stock Exchange (TTSE) has 45 equities and 32 bonds listed, and is the largest exchange in the region. The market capitalisation of the exchange is more than USD 17 billion. The total value of the TTSE has been growing in recent years. Also, a junior stock exchange for SMEs was recently launched by TTSE, but there are no listings or market capitalisation as yet. In Guyana, there are 4 firms that trade, but only one (Trinidad and Tobago Cement Limited) is actively traded. Also, only 12 companies are listed on the Eastern Caribbean Securities Exchange (ECSE).

These listed securities are a composite of government bonds, financial institutions, and utility companies. Overall growth has been mixed. In 2015, the JSE grew by 97.4% (against the backdrop of Jamaica's improved economic climate in 2015 which boosted investor confidence); the BSE by 10.5%; and the TTSE by 1%[7]. Overall, there is a clear need for regional (capital) market integration to achieve greater depth and greater dynamism in these markets. For instance, to date, only the Trinidad and Tobago and Jamaica markets are being strengthened to facilitate SME growth via introduction of junior stock exchanges and the size of some markets (e.g. the OECS and Guyana) is too small to expect stronger activity over time[8].

Life cycle options are deficient in the smaller countries where key aspects of an evolutionary financial system are still missing. For instance, there are no factoring, lease financing, credit guarantee, venture capital, or vibrant capital markets in the OECS market.

[7] Source: Sagicor Mutual Funds. Investment Commentary. December 2015. | [8] Jamaica had already introduced a Junior Stock Exchange, and Access Financial Services Ltd. is registered on that exchange. But the number of registered companies is less than 25 and the exchange's buoyancy is mainly a factor of the tax-free status afforded to companies that trade on the exchange.

Barbados does benefit from donor-funded mezzanine financing instruments managed by the Central Bank of Barbados (CBB), but uptake and overall impact are modest at best.

3. However, all eight countries provide support to the MSME sector. Jamaica's is perhaps more inclusive and comprehensive than the others. In Jamaica, the MSME "assistance" portfolio includes: the Development Bank of Jamaica (DBJ), with direct lending to SMEs and wholesale lending to Approved Financial Institutions (AFIs), including Micro Finance Institutions (MFIs); specialty call-for-proposal projects such as Start Up Jamaica and Ignite; angel investor funds; direct incubator and support services offered by the Jamaica Business Development Cooperation (JBDC); the Micro Enterprise Development Agency (MIDA); the National Insurance Fund Credit Facility for SMEs (NIF/CF/SME); and loans to SMEs by the Jamaica National Small Business Loans Company (JNSBLC). Only three of the eight countries have Credit Bureaus (Guyana, Jamaica and Trinidad and Tobago) and only one (Jamaica) has an electronic registry for moveable collateral. Also, Jamaica has updated its insolvency laws and is actively working on improving both its Doing Business Rankings and its rankings on the Global Competitiveness Index (GCI) via a National Competitiveness Council (NCC).

4. Feedback from institutions in countries where credit bureaus exist suggests that it is too early to determine the degree to which that mechanism is influencing MSME access to finance. All of the credit unions and commercial banks interviewed confirm that credit histories are helping to alert lending institutions to the financial discipline and integrity of loan applicants. This improves the risk analysis of lenders, but bureau information is not the only assessment criterion that is used to approve/reject projects.

5. In addition to the inconsistency in country provision of life cycle financing options, some countries lack supportive legislation to facilitate the offering of a broader range of financial services to borrowers. For instance, in some countries, (for example, Jamaica), mobile banking could be constrained by the absence of requisite laws and regulations.

Table 2.2: MSME Life Cycle Financing in Eight Caribbean Countries

COUNTRY	Specialty Micro & SME Financiers	Banks offering ST Loans	Trade Finance	Lease Finance	Equity Finance	Capital Markets	Comments
ANTIGUA	Fast Cash, NDF, Community First & St. John's CUs. Development Bank	7 banks: ACB, RBC, Scotiabank, CUB, ECAB, CIBC, RBTT, RBC. No credit bureau or deposit Insurance	Done by banks for selected clients. ECCB offers ECGS	Not available	Not available	Not available but there is an OECS Eastern Caribbean Securities Exchange; 12 companies	Incomplete SME life cycle finance system. MFIs less than 10% of market. Banks very liquid.
BARBADOS	CUs: Publ-Workers, COB, BWU; Fund Access, Enterprise Growth Fund Ltd (EGFL)	5 banks: Scotiabank, CIBC First Caribbean, Republic, RBC, Bank of Butterfield. No credit bureau.	Provided selectively by banks. Central Bank offers ECGS.	Provided by some banks e.g. Republic Finance and Trust (RFTC)	Available for BIDC under the BIF. Also from BGFL.	BSE is small market (20 firms) with infrequent trading.	Incomplete integration of SME life cycle system. Deposit Insurance in place for banks only.
BELIZE	B.E.S.T. + 14 CUs: Most dominant: St. John's, La Immaculada LICU) St. Xavier, Toledo Teachers CU, Holy Redeemer CU	6 banks: Belize Bank, Belize Bank Int; Scotiabank; Atlantic Bank. Heritage, FCB. "Credit Masters" Credit bureau DFC in Central/North Belize	Done by banks for medium to large clients only	Not available	Not available	Not available. Utility companies are the only listable entities.	Incomplete SME life cycle finance. MFI funds reach less than 10% of market. Banks very liquid.

Table 2.2: MSME Life Cycle Financing in Eight Caribbean Countries cont'd.

COUNTRY	Specialty Micro & SME Financiers	Banks offering ST Loans	Trade Finance	Lease Finance	Equity Finance	Capital Markets	Comments
JAMAICA	JNSBLC JBDC Access Financial Services Ltd., Ignite, Start Up MIDA, DBJ 33 Credit Unions	6 banks: Scotiabank, NCB, Citibank, FCIB, First Global, RBC. 33 JCCULL credit union members 2 Credit Bureaus. Collateral Registry	Available from DBJ. Selective factoring. EX-IM Bank Small Business Discount Facility	Not readily available	5 VC funds launched by DBJ. Angel investor funds	JSE has 45 listed companies. Junior Exchange has 23 listed companies and offers tax incentives for SMEs to grow	Relatively integrated system but specialty funds reach less than 10% of SME market. Depositor Insurance in place for all CUs.
GUYANA	SBB: small loan guarantee fund + grants. SBDFT microloans Credit Unions	6 banks: GBTI, Baroda, Scotiabank, Republic, Citizens, Demerara; 2 with SME units. 28 CUs. 1 Credit	Available from commercial banks but no export finance	Not available	Not available	GASCI has 13 listings on the exchange but with only one active company (TCL)	Low integration and incomplete SME life cycle finance system. Average loan rates at 15% approximately.
TRINIDAD & TOBAGO	NEDCO, FUNDAID, 10+ Credit Unions e.g. Eastern, COPOS, Neal & Massy, TATECO, Venture.	6 banks: Scotiabank, First Citizens, Republic, RBC Royal, Baroda, IBL Bank DFC. 1 Credit Bureau serves banks, FIs, MFIs.	Available from banks. EXIM Bank leads Export Financing.	Limited availability at some banks.	VC industry existed prior to 2008 but VC is almost non-existent in Trinidad and Tobago today.	TTSE has about 45 listed companies and a market cap of $17 billion – highest in the region. Junior exchange for SMEs designed but not yet fully operational	Integrated system with strong export orientation. But MFI funds reach less than 10% of the MSME market. Depositor Insurance in place for all banks and (private) for some CUs.
ST. LUCIA	Development Bank. Fast Cash. Laborie, Choiseul & Mon Repos CUs, AXCEL Finance.	5 banks: Scotiabank, RBC, FNB, Bank of St. Lucia, FCIB. No credit bureau or deposit Insurance in place	Available from banks, Laborie CU and CU League.	Not available	Not available	Not available but there is an OECS Eastern Caribbean Securities Exchange; 12 companies listed.	Low integration and incomplete SME life cycle finance system. MFI funds reach less than 10% of market. Banks very liquid.
SURINAME	Suriname National Development Bank (NOB) with 1) Credit Guarantee Fund to local banks, 2) Micro Credit Fund and 3) Agricultural Credit Fund. 5 micro finance lending institutions including Stichting Seva Micro Finance Institute; SuriTrust, De Schakel Credit Union, GODO Cooperative Bank, Trust Bank. Apex funds from Micro Kredieten Programme. Credit available from Hire Purchase retailers: Combemarkt, Savers Paradise, and Ebro	9 Banks: De Surinaamsche Bank (DSB), RBC, Hakrinbank, Surinaamse Volkscredietbank, Landbouwbank, Surinaamse Postspaarbank, Finabank, Surichange Bank and Cooperatieve Spaar- en Kredietbank Godo G.A., 28 savings and credit unions. Draft legislation prepared in 2012 by Central Bank to establish a Credit Bureau but not established by end of 2015	Trade Guarantees for SMEs via DSB funded under the Trade Finance Facilitation Programme Agreement (TTFP) between DSB and IADB.	Some financial leasing available from commercial banks – but on a selective basis. Also available from private firms for equipment leasing.	Not available formally but may be available privately due to dominance of natural resource industries (e.g. gold mining)	The SSE is sporadic: open for trading twice a month it uses a manual trading system. Although only 10 companies are listed, total market cap has growth from SRD$145 million to SRD$1.29 billion between 2003 and 2011. The SSE functions without a Securities Exchange Act.	Life cycle MSME finance system not well integrated. Selective specialty financing offered by some players in the banking system. However, access to finance is better than otherwise thought.

NOTES:

This is a life cycle table showing the evolutionary availability of finance as SMEs grow. Column 1 refers to the provision of/ access to micro finance and SME credit - both of which are provided by specialty institutions such as micro finance entities and others. Column 2 "ST" means, "Short Term".

MFI/AFI lending accounts for less than 10% of total loans, advances and overdrafts made in most countries, because the MFIs a) are specialised lending organisations, b) do not have a deposit base, and c) are therefore dependent on reflows and externally-sourced funding to lend to borrowers.

2.3 MSME ACCESS TO FINANCE IN THE CARIBBEAN

MSME access to finance in the Caribbean can be split into two categories: 1) access to finance for microenterprises, and 2) access to finance for SMEs.

2.3.1 Micro Entrepreneur Access to Finance

While commercial banks and credit unions offer personal loans to individuals, in recent years micro finance institutions (MFIs) have been targeting and channelling specialised micro loans to this sector throughout the Caribbean. Nonetheless, it was difficult to determine the degree of loan coverage of the micro enterprise sector on a national basis. One reason is that there is no central source of information on the sector nationally or regionally and none of the countries interviewed could provide empirical data on the size of the sector.

As an indicator of the scale of MSME lending operations, as of 30th April 2014, the Caribbean Micro Finance Alliance (CMFA) had 24 participating lending institutions as members in nine Caribbean countries including: Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, St. Lucia, Suriname and Trinidad and Tobago. The combined CMFA member portfolio indicated that there were 447,352 active clients and that the gross loan portfolio was USD 295 mn with an estimated 27,000 clients. The active gross microcredit loan portfolio as at the end of April 2014 was USD 26.4 mn. However, it is important to note that two credit institutions – JN Small Business Loan Company in Jamaica with 14,000 loans annually, and IPED in Guyana with 4,500 loans annually, account for 18,500 or 68% of the total Caribbean loan portfolio.

A May 2014 IDB Multilateral Investment Fund (MIF) study, by EA Consultants Inc., of four of the eight countries researched i.e. Belize, Guyana, Jamaica and Suriname, revealed the following profile of the sector:

Table 2.3: Micro Entrepreneur Profiles from a Survey of 656 Enterprises in Four Countries

	AVERAGE	STD. DEVIATION
Average years in business	8.8	0.57
Average monthly business sales (USD)	989	386
Net margin of "good" performers (% net revenue over sales)	48%[6]	6%
% Services[7]	33%	7%
% Commerce	48%	9%
% Manufacturing	23%	6%

Source: IDB/MIF, "Building Up Business: Micro Enterprise Demand for Credit in the Caribbean," May 2014

The report revealed new facts about the micro finance market in the Caribbean region[9]:

1. **Savings orientation.** Nearly all micro entrepreneurs surveyed saved. Business needs were the most common reason for saving. A majority saved in formal accounts, while Rotating Savings and Credit Associations (ROSCAs), i.e. sou sou or "throwing hands", were used to varying degrees in each country. Saving and borrowing are not mutually exclusive and most borrowers also saved. This strong savings culture may actually create less incentive for seeking loans for business investment. The practice contrasts strongly with many Latin American countries, where low-income members of the population typically save at low rates (and mostly informally) and often borrow instead to finance their needs.

2. **Preference for low-cost, flexible financing in every country.** Low costs and flexibility were respondents' top priorities for financing. They want low interest and fees, repayment schedules that match their cash flows, and some lenience for late payments. Respondents' borrowing and saving methods reflected these preferences. Perceptions about which providers matched these preferences varied, though informal financing methods usually ranked higher than formal institutions on important dimensions.

3. **Risk aversion.** Many micro entrepreneurs were cautious or pessimistic about business prospects, and have experienced slow sales since the global economic crisis of 2008, particularly in Jamaica. Even where economic growth has been more buoyant, micro entrepreneurs were cautious, perhaps due to their lack of enterprise skills. This attitude bolstered reliance on savings and discouraged borrowing for fear of difficulty with repayment, even among respondents who could benefit from a micro loan.

4. **Information asymmetries.** Many micro entrepreneurs were unfamiliar with microcredit products or providers, or did not even know what microcredit was. Others held mistaken beliefs and generalisations about products and providers that prevented them from seeking accurate information. There is therefore a need to explain and promote micro finance more clearly to the micro entrepreneur community.

5. **Supply-side constraints.** While micro entrepreneurs' preferences and perceptions are important factors in uptake, major supply-side constraints also hinder outreach. The cost per loan is high – often at interest rates that exceed 25% per annum compared with bank loans at 12% - 17% per annum. Also, populations are dispersed, and some institutions are unwilling to risk capital on expansion and outreach. But generally, MFI collateral requirements are lower than commercial banks' levels and are often limited to re-saleable or marketable assets owned by the borrower.

The institutional usage by borrowers and savers of the 656 entrepreneurs surveyed by EA Consultants was even more revealing (see Table 2.4 below). Firstly, commercial banks–not Micro Finance Institutions (MFIs)–were the dominant lenders to micro entrepreneurs. Secondly, banks are the main savings mechanisms for that group. Thirdly, micro entrepreneurs are much more innovative in accessing finance than would have been thought. They not only access funds from banks and MFIs but from friends, suppliers, use of credit cards and from ROSCA schemes. Fourthly, most MFIs are not offering savings products although: 1) the JN Small Business Loans Company encourages its borrowers to open savings accounts with its parent company, Jamaica National Building Society (JNBS); and 2) the credit union system which is non-collateralised, requires borrowers to be savers before they can be eligible for small (personal) loans[10].

[9] From "Building Up Business: Micro Enterprise Demand for Credit in the Caribbean". May 2014 | [10] Credit Unions use the savings and investment accounts of depositors as collateral for loans.

Finally, the proportion of borrowers who are also savers in the banking system is extraordinarily high (63%). These savings are almost always used as collateral for working capital or term loans by the banks.

Table 2.4: Institutions Usage by Borrowers and Savers

INSTITUTION TYPE	% OF TOTAL BUSINESS BORROWERS	% OF TOTAL HOUSEHOLD BORROWERS	% OF TOTAL SAVERS
FORMAL			
Bank	35	34	63
Cooperative/credit union	11	11	15
MFI	13	2	-
Credit card	3	2	-
INFORMAL			
Friends/family	19	21	2
ROSCA	4	3	29
Moneylender	4	2	-
Supplier credit	24	33	-
Pawnshop	1	2	-
Home	-	-	37

Source: IDB/MIF, "Building Up Business: Micro Enterprise Demand for Credit in the Caribbean", May 2014

These findings suggest that the MFIs are falling short of addressing market challenges in significant ways: most MFIs offer singular products when opportunities exist for multiple product offerings (e.g. saving accounts, debit cards, special ROSCA-type saving products, online services, etc.). Therefore, one policy recommendation is that MFIs should be allowed by the central banks (that regulate the overall financial system) to offer savings products to their borrowers. The inference that market coverage by MFIs is less than ideal is substantiated by the data in Table 2.5 (below). The EA Consultants estimated total market size for micro loans in the four countries surveyed is as follows:

Table 2.5: Estimates of the Market for Micro Credit Loans

	% OF ALL INFORMAL WORKERS	RANGE (# OF PEOPLE)
Belize	42%	7,408 - 10,733
Guyana	27%	18,842 – 28,929
Jamaica	17%	54,667 – 95,307
Suriname	19%	10,602 - 15,707
TOTAL	**25%**	**91,518 – 150,676**

IDB/MIF: "Building Up Business: Micro Enterprise Demand for Credit in the Caribbean" , May 2014

If the total amount of loans provided by the 24 MFI members of the Caribbean Micro Finance Alliance (CMFA) is 27,000, this is approximately 17.9% to 29.5% of the total market size of 91,518–150,676 persons in Belize, Guyana, Jamaica and Suriname, i.e., of those persons actually needing a loan[11]. Therefore, if the number of potential borrowers in other Caribbean countries is added to the market size of these four countries then the 27,000 active loans provided by the CMFA is likely to be less than the 17.9% metric computed above since the total number of persons needing loans would be greater than the 91,518–150,676 range for the four countries in Table 2.5.

2.3.2 SME Access to Finance in the Caribbean

It is difficult to pin down the degree of SME access to finance in the Caribbean primarily because loans to this group are not formally recorded in the statistical records of any of the eight countries surveyed i.e. by the Central Bank, by the commercial banks and credit unions or by the national statistics departments. Instead, they are subsumed by the Central Banks' classification of "Loans and Advances" (L&A). That data include loans to foreign investors and loans to larger businesses in each country. Also, while credit union lending is growing, on average, at a rate of at least 10% a year (in the Eastern Caribbean) those metrics are not reflected in Central Bank data. Nonetheless the L&A data provide a reasonable indicator of loan trends to SMEs, since small and medium businesses account for a significant proportion of both GDP and the overall number of loans in each country. A detailed analysis of access to finance in each of the eight BMCs is provided in Appendix 4: SME Access to Finance in eight BMCs. The findings for this analysis are highlighted in Table 2.6 below. It is important to emphasise that the Table reflects Loans and Advances to the Private Sector as defined by the Central Banks of the eight BMCs. There is some degree of overlapping of the databases since L&A data includes personal loans and loans for (personal) mortgages. However, it is impossible to separate the data primarily because both categories of loans influence directly the level of business carried out by the private sector, i.e. personal loans lead to purchases from MSMEs, and mortgages lead to the contracting of MSMEs for various aspects of the construction process (e.g. land clearing, block-making, electrical, plumbing, etc., by MSMEs).

Table 2.6: Average GDP Growth and Average L&A Growth in Eight BMCs

Country	Average GDP growth	Total L&A Growth: 2009 - 2015	Average L&A Growth	Rating
Guyana	4.5%	119%	20%	Excellent
Suriname	4.2%	72%	18%	Excellent
Trinidad	0.8%	19%	4%	Average
St. Lucia	0.2%	13%	2.5%	Average
Belize	2.4%	7%	2%	Poor
Barbados	-0.2%	4%	< 1%	Poor
Jamaica	-0.4%	-3%	Negative	V. Poor
Antigua	-0.8%	-8%	Negative	V. Poor

Source: The Economist Intelligence Unit (Average GDP growth) and Central Banks in 8 BMCs

[11] These estimates exclude the loans already being provided by alternative financiers such as commercial banks and credit unions. It is assumed that the total loan book of 27,000 loans is reflective of very short term loans to the micro enterprise sector and that the demand for loans estimated by EA consultants is also of a short term nature.

The Table shows that there has been considerable variability in Access to Finance in the eight BMCs: Access has been exceptional in Guyana and Suriname, notwithstanding those countries' relatively poor rankings under Getting Credit in the most recent (2016) Doing Business Rankings. The Table also reveals that access to credit improved modestly in Trinidad and Tobago - although that country was the first BMC to introduce a credit bureau. Access was poor to very poor in four of the eight BMCs – Belize, Barbados, Jamaica (despite Jamaica's gains on Getting Credit under the Doing Business Rankings) and Antigua.

What is driving these divergences? The answer is the average economic growth rate of each BMC. Again, the table reveals that GDP growth was strongest in Guyana and Suriname and weakest in Barbados, Jamaica and Antigua. As revealed in Appendix 4, Jamaica experienced contractions of as much as 24% in its L&A in 2010 and 17% in 2012 – mainly as a result of the severe economic challenges which that country encountered during those years.

The lesson learned is relatively obvious - MSMEs in countries that experience robust economic growth will have more favourable access to credit than in countries where economic performance is poor or lacklustre – even in those countries (e.g. Trinidad and Tobago and Jamaica) where Doing Business reforms such as credit bureaus and electronic moveable collateral registries have been established to improve MSME access to finance. Also, constraining factors such as levels of collateral requirements and interest rates are not as significant in explaining performance as economic growth - Guyana's collateral requirements, at approximately 200% are among the highest in the region, but the growth in its L&A still out-performed the other seven BMCs. In contrast, the collateral requirements in Barbados were the lowest of the BMCs (see Table 2.6 below), but that country still performed poorly in terms of the average growth in its L&A between 2009 and 2015. A second lesson learnt is that Doing Business Rankings do not always correlate with an improved business environment – in this case access to finance. Nonetheless, the findings should not be interpreted to mean that MSMEs, generally, do not have difficulties accessing financing in BMCs – but only, that in countries with above average rates of economic growth, access to finance would appear to be more readily available to MSMEs, than it is in countries that are experiencing sustained economic contraction.

2.3.3 Bank liquidity and SME demand

The findings indicate that the demand-supply equation is more complex than the micro-level analysis of the financial sector would suggest.A December 2014 newsletter of the Caribbean Centre for Money and Finance noted that, with an inordinate amount of unutilized lending capacity in banks, excess liquidity had reached troubling levels. For instance, on March 31, 2014, total liquid assets of Jamaican commercial banks were USD754 mn, of which USD181 mn were in excess of the legal (minimum) liquidity requirement. Such large amounts of unused lending capacity in the Caribbean is explained by several factors. One factor is weak demand for credit by potential customers deemed to be creditworthy by the banks. The insufficiency of credit demand is itself the result of protracted anaemic economic growth, business closures, higher than usual levels of unemployment, and job redundancies in many Caribbean economies.

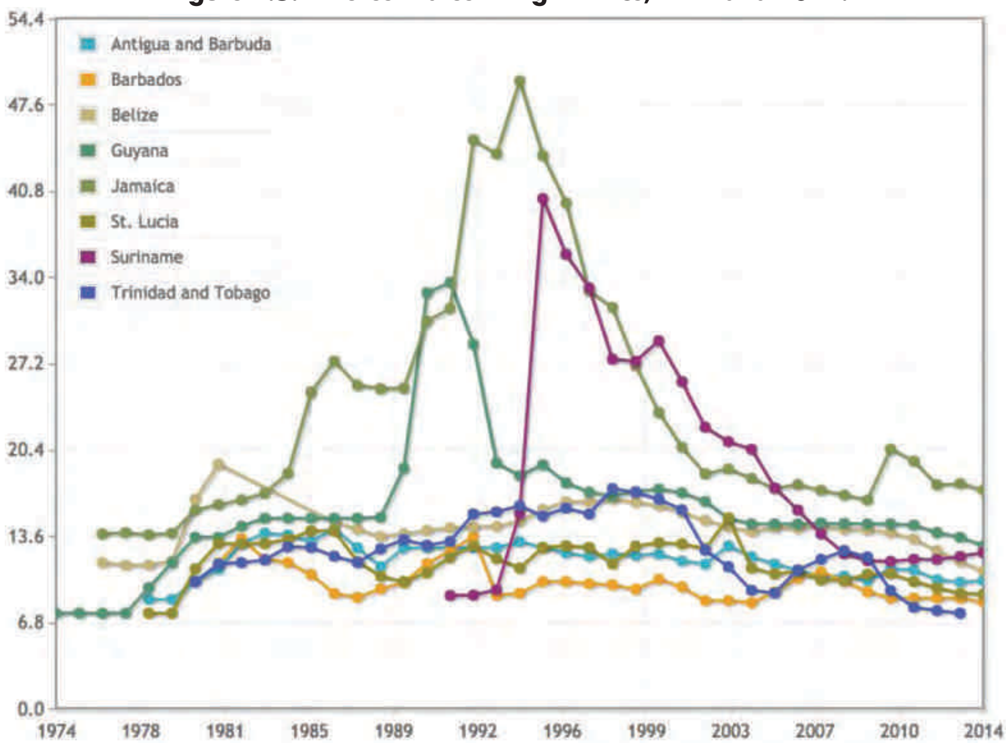
Another factor is an increase in loan delinquencies, mainly as a result of the initial impact of the global economic crisis and its lingering effects on Caribbean tourism and other service exports, real estate markets, and household capacity to service personal debt. Some commercial banks estimate that non-performing loan (NPL) levels exceed 15% in the Eastern Caribbean and 9% in Guyana. Faced with substantial increases in the proportion of delinquent loans, commercial banks have raised their credit assessment standards and have become more risk averse. The result is that bank loans have either declined or have expanded incrementally.

In contrast, bank deposits have increased quite substantially in many Caribbean countries since 2011. The exceptions are the ECCU members and the Bahamas, where collectively bank deposits decreased, but at a slower rate than bank loans. In effect, loan supply capacity measured by bank deposits is growing faster than loan absorptive capacity[12]. For instance, in Guyana, the commercial banks are lending as much as G$110 billion of total deposits of G$248 billion, or about 44% of their deposit base to Government, via investments in Treasury Bills that generated interest at 2.67%–3.78%, substantially lower than the 9%–15% loan rates charged to consumers and SMEs[13]. On the demand side, the underserved SME sector is incapable of accessing those funds because of: 1) information asymmetries, i.e., missing borrower creditworthiness information, linked to the absence of credit bureaus; and 2) limited capacity of the sector to put together projects that meet bank-lending criteria (i.e. financial statements, asset quality, borrowers' financial integrity from credit bureau information, cash flow statements, collateral requirements, etc.). Such constraints are compounded by limited growth in consumption spending – and, with the exception of Trinidad and Tobago and Guyana, low levels of exports by SMEs generally. Consequently, SMEs are caught in a revenue trap –with limited upside potential in domestic markets. Access is also made more difficult by the relatively high levels of collateral required by banks, at a time when the secondary markets for liquidated assets are especially weak and bankruptcy laws are mostly outdated.

2.3.4 The Cost of Capital Issue

Figure 2.5 (below) highlights interest rate trends in the 8 BMCs between 1974 and 2014:

Figure 2.5: Interest Rates in Eight BMCs,1974 and 2014.



Source: World Bank, World Development Indicators (Last Updated April 23, 2013).

[12] The Liquidity Problem in Caribbean Commercial Banks. The Caribbean Centre for Money and Finance. 2014. | [13] See: http://www.chrisram.net/?tag=guyana-stock-exchange.

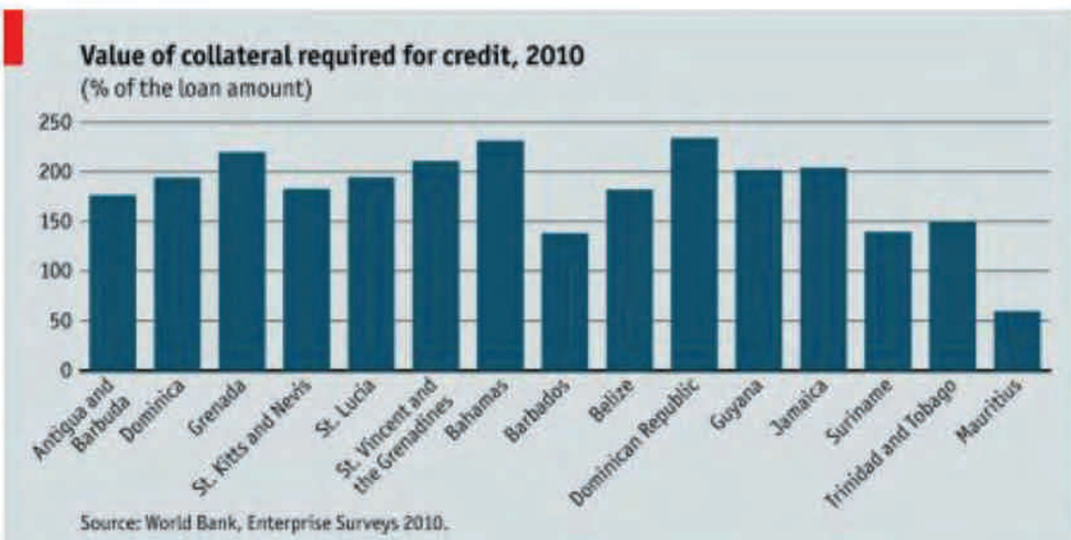
As Figure 2.5 clearly shows, lending rates in the Caribbean have been trending downwards in some countries since 1999. Only Suriname's have trended upwards since 2007. But on average, they are still very high when compared with loan rates in more developed countries. In 2014, average lending rates varied from a low of 7% in Trinidad and Tobago to a high of approximately 17% in Jamaica – although Jamaica's lending rates have been on the decline in 2015. Also interest rates in the OECS and Barbados have seen recent declines, partly as a result of Central Bank policies aimed at increasing the intermediation of commercial banks in weak domestic markets. The Eastern Caribbean Central Bank reduced its minimum deposit rate from 3% to 2% and the Central Bank of Barbados has eliminated minimum deposit rates altogether. Lower interest rates should help MSMEs. They also make commercial bank lending more attractive to MSME borrowers when compared with the lending rates of MFIs – which usually exceed 15% throughout the region. In addition, it should be noted that lower interest rates reduce bank profitability–a concern that has led to a recent increase in fees being charged on depositor accounts by commercial banks.

2.3.5 The Collateral Issue

It is well known that the capacity to meet commercial banks' collateral requirements is a key deciding factor in MSME access to finance. Table 2.7 (below) provides a snapshot of collateral requirements in most Caribbean countries. One reason for such high requirements is the absence of a robust secondary market for fixed assets. Therefore, banks over-compensate and demand high levels of collateral.

Another reason is that, in some Caribbean countries, banks are not allowed to auction off collateralised property at values that are lower than the minimum levels stipulated by law (e.g. in Barbados and in Grenada). This restricts the liquidation of collateral in cases where offers made by bidders are below the minimum levels (e.g. below 67% of the market value of the assets). A third reason is that Central Bank prudential regulations stipulate that banks must secure adequate cover (i.e. collateral) for their loans.

Table 2.7: Value of Collateral as a Percentage of Loan Values



Source: World Bank, World Development Indicators (Last Updated April 23, 2013).

The collateral issue also reflects the absence of adequate (alternative) financial intermediation. A presentation on "Moving Beyond Collateralised Financing" by Ram Ramesh at the 1st Caribbean Competitiveness Forum in Trinidad and Tobago noted that there was limited intermediation for venture capital; angel funding; IPO funding; and government subsidies i.e. the alternatives to collaterised finance[14].

Logically most banks would prefer to engage in lending activities that maximise their interest income and return on (loan) assets employed. However, overall 1) the economic outlook is mixed but not yet buoyant enough to engender stronger confidence in the near term future; 2) many MSMEs are not bankable enough to encourage an expansion of bank lending – despite the deliberate development of Small Business departments or service units introduced within many banks; and 3) the MSMEs' own business prospects are equally dampened by insignificant growth in consumer demand within the region.

2.3.6 The MSME productivity challenge in the Caribbean

In terms of access to finance, the issue of MSME productivity is important because low levels of productivity result in lower cash flows. This impedes the capacity of MSME borrowers to repay and to access new loans from the financial system. For instance, the purchase of new equipment tends to improve productivity since it increases output per hour worked. But low MSME productivity (and consequent reduced cash flow) limits capacity to upgrade equipment through loans. The challenge is to break the vicious cycle of low productivity, low revenue flows and the inability to access funding. There are four inter-connected approaches to addressing the MSME productivity challenge in the Caribbean:

1. **Adoption of international standards:** The adoption of quality assurance standards by the MSME sector will improve operational efficiency and therefore productivity. The CARICOM Regional Organisation for Standards and Quality (CROSQ) has published a regional standard entitled "Requirements for Good Management Practices for Micro, Small and Medium Enterprises" which was approved by the Council for Trade and Economic Development (COTED) on February 9, 2010. Guyana's National Bureau of Standards, attempting to introduce the Standard to Guyana's MSMEs without fiscal incentive support, is finding that MSMEs are reluctant to adopt such practices.

2. **Deliberate promotion of export sector development:** This will incentivise increased levels of productivity in local businesses. Exporting is associated with the reallocation of resources from less efficient to more efficient plants. In the aggregate, these reallocation effects are quite large, making up over 40% of total factor productivity growth in the manufacturing sector in the United States. The positive contribution of exporters even shows up in import-competing industries and non-tradable sectors. The overall contribution of exporters to manufacturing productivity growth far exceeds their shares of employment and output[15].

3. **Establishing supply chain linkages between large businesses and MSMEs:** The development of value chains that integrate backwards into the MSME sector will force smaller firms to improve their productivity – so that they may become and remain viable suppliers to larger firms. It is important to recognise that the development of MSMEs – in a region of mostly inward-looking private sector activity, is also dependent on the linkages established between larger firms in-country and

[14] See "Moving Beyond Collateralized Financing: Alternative Models based on Case Studies for the Regional Private Financial Sector". Ram Ramesh, CEO, Trinidad and Tobago International Financial Centre. Undated. | [15] From the National Bureau of Economic Research Paper No. 7135 "Exporting and Productivity", by Andrew B. Bernard and J. Bradford Jensen. May 1999.

the MSME sector. Such linkages increase the productivity of MSMEs, because larger firms have refined their operations to be productivity and output-driven. Examples of such firms include Sandals in the tourism sector, and Massey Stores in the retail sector. Both groups of firms have established clear performance standards which local suppliers (mostly MSMEs) have to meet. As a result, MSMEs have had to increase and align their levels of productivity with international norms.

4. **Increasing productivity in infrastructure and in the services sector:** Cutting the time frames for doing business will enhance enterprise productivity, because improved logistics will save MSMEs both time and money. The IDB report, "The Age of Productivity:

   Transforming Economies from the Bottom Up", emphasised two related points: 1) that too many resources were under the control of MSMEs in most of the LAC region, i.e. relative to larger firms; and 2) that infrastructure development/ expansion was key to returning to more sustainable productivity levels in the foreseeable future.

   However, the report also observes that productivity gaps between the USA and developing countries are the highest in services. Since services account for more than 60% of employment in developing countries, that sector is increasingly dragging down aggregate productivity. The study emphasised that increasing productivity in the services sector is key to boosting economic growth and reducing poverty in the LAC region.

2.4 FINANCING CHALLENGES FACING THE MSME SECTOR

2.4.1 Policy Measures to improve Access to Credit

The financing challenges facing the MSME sector can be partly explained by the gaps between policy measures to improve access to credit in the OECD countries and the BMCs. Table 2.8 (below) provides a synopsis of policy measures in 19 OECD countries compared with the policies in the 8 BMCs analysed in this study.

Table 2.8: Gaps in Policy Measures to Improve MSME Access to Credit – OECD vs. BMCs

Mechanism	OECD	BMCs	Comment
1. Loan Guarantee Schemes	100%	50%	OECD very strong
2. Lending targets	0%	0%	Not applicable
3. Export Finance support	89%	63%	Selective in BMCs
4. Credit: code of conduct	32%	0%	Not used in BMCs
5. Credit Registry	37%	37%	Recent in 3 BMCs
6. Central Bank schemes	10%	25%	Barbados and OECS
7. Securitization support	16%	0%	Not used in BMCs
8. Govt. direct lending schemes	53%	100%	Initiated in all BMCs
9. Direct lending +private sector	68%	0%	Not in BMCs
10. Peer to Peer Support	42%	0%	Not yet in BMCs
11. Retail Bond Markets	26%	0%	Very small in BMCs

Source: Policy Measures to Improve Access to Credit (Central Bank of Ireland 2015) and Consultants' findings in BMCs

As the Table shows, the main differences between the OECD countries and the BMCs are that: 1) all of the OECD countries ensure that they offer loan guarantee schemes to MSMEs; 2) the OECD countries tend to combine or bundle public and private sector loan programmes; and 3) there is a higher level of government initiated direct lending in the BMCs. These differences strongly suggest that the BMCs should focus on introducing and/or expanding their loan guarantee schemes on a national basis as a top priority. However, these are not the only policy measures that need to be addressed (see also 2.5 Improving MSME Access to Finance in the Caribbean).

2.4.2 Addressing Informality

The prevailing view of the informal sector is that it stimulates enterprise development, and makes invaluable contributions to social stability. While most developing countries view business informality positively, the McKinsey Global Institute (MGI) data on research conducted in Brazil (2006) and Mexico (2014), and the IDB "Age of Productivity" report suggest that the growth of informality can: 1) adversely affect the viability of the SME sector; 2) fragment the sectoral structure of business; 3) infuse excessive levels of imports and price competition; and 4) significantly impede the attainment of reasonable productivity gains and consequently, GDP growth rates of emerging and developing countries[16]. The challenge facing the Caribbean is two-fold: how to foster the development of enterprises, but also reduce business informality, i.e. the exponential growth of the informal sector, simultaneously.

Formalisation should be a priority from a public policy and private sector perspective. It can lead to higher tax revenues; better quality jobs; access to new markets, suppliers, and clients; more reliable supply chains; and higher rates of productivity, to name a few examples.

Registered firms have better access to technology and human capital. By complying with the law, the firm has better business predictability and may avoid situations where paying fines or bribes is the norm to stay in business. Formal firms may also access the judicial system for any contract enforcement procedures. Furthermore, formal firms have better access to credit, especially in some countries where a tax identification (ID) or registration certificate is needed to open a bank account. This is the case in most Caribbean countries.

There are two well-known approaches to addressing informality:

1. **Improving the enabling environment:** Making it easier for the informal sector to register businesses, to pay taxes, and to comply with regulations will improve the prospects for formalising the sector. Evidence shows that reducing corporate tax rates and simplifying the paperwork for registration and tax compliance help to increase the formal organisation and consequently, the efficiency of SMEs. One-stop shop services for registration and tax payments, and offering business support services to newly registered entrepreneurs have also been found to be highly effective. In 2011, in Brazil, a total of 1.9 mn micro-entrepreneurs had formalised via an online portal one year after it was launched[17].

2. **Incentives to formalise the informal sector:** The options include free training incentives, simplified tax structure, labour market reforms, and access to government procurement business. For example, Jamaica uses an Employer Tax Credit– which lowers the effective tax rate from 25% to 17% for SMEs to encourage SMEs to operate in the formal sector and generate employment as well.

[16] See "How Brazil Can Grow" and "A Tale of Two Mexicos" both by MGI. | [17] See "Formalising the informal sector", https://www.innovationpolicyplatform.org/content/formalising-informal-sector

Asian countries that have joined the ranks of the wealthy nations or dramatically narrowed the gap with them have not had a serious informality problem. Japan, Singapore, South Korea and Taiwan all benefited from relatively small tax and regulatory burdens as well as from strong legal and law-enforcement systems; so did Western countries in the early stages of their development. The corporate tax rate was only 4% of GDP in the United States in 1913, for example, when it had reached Brazil's current stage of economic development. Brazil's corporate tax burden is now nearly 25% of GDP[18].

According to an International Finance Corporation (IFC) report, converting informal businesses into formal SMEs is a complex and difficult challenge[19]. Based on 15 informal sector surveys by World Bank Enterprise Surveys (WBES), the main reasons that firms are not registering their business are: 1) lack of information on how to register an enterprise; 2) time taken to complete the registration process; 3) taxes that must be paid by registered businesses; and 4) the lack of perceived benefits from formalisation. Studies have also indicated that high entry costs; strict labour regulations; lack of access to resources such as land, credit and taxes; as well as complicated registration procedures are also important factors that contribute to low rates of formalisation.

Experiments and interventions in Bangladesh, Bolivia, Peru and Sri Lanka show that simplifying business registration channels, reducing registration costs, and providing greater information on the benefits of registering a business have proven to have little effect on increasing the formalisation of firms.

Nevertheless, some firms found formalisation to be advantageous because it permitted the enterprise to sell goods and services to the government and/ or other registered businesses – a strategy that is now being adopted by the Guyana Government in its 2016 budget and exists in Jamaica under the MSME policy adopted by the Ministry of Industry, Investment and Commerce (MIIC).

Other measures that could be more effective are centred on co-opting larger private sector businesses into formality solutions. Some examples include:

1. **A micro distribution and retail model:** A number of corporate clients in the manufacturing, service, and wholesale sectors—such as Coca Cola in East Africa, Grupo Martins and Tribanco in Brazil, and Mi Tienda in Mexico—are working with small and informal firms using a micro distribution and retail model. The business model relies on co-opting smaller businesses into the distribution system. Because small retail outlets have financial and managerial capacity constraints, large corporations have also included a set of training and coaching initiatives to better educate business entrepreneurs. In addition, some have created specialised financial solutions such as inventory purchases on credit to ease the access to finance constraints that small and informal firms face to operate and finance their working capital needs. Imperceptibly, these processes integrate informal MSMEs into formal SME practices and behaviour.

2. **Mobile Banking and e-transaction platform:** A second model includes the use of mobile and e-transaction platforms to reduce the transaction costs that financial intermediaries face when trying to reach small and informal businesses. Examples include FINO PayTech (FINO) in India, which deploys field agents to enrol consumers in rural and semi-urban regions of India and conducts low-cost electronic transactions.

[18] See "Reigning-in Brazil's Informal Economy" by The McKinsey Quarterly, Web exclusive, January 2005,by Joe Capp, Heinz-Peter Elstrodt, and William B. Jones Jr. | [19] "Closing the Credit Gap for Formal and Informal Micro, Small and Medium Enterprises" IFC. 2013

Its service model relies on the provision of biometric smart cards used for saving accounts and transferring funds, point of sale terminals, and accounting and management information systems. FINO has a client base of 27 banks, 15 government entities, and four insurance agencies. Other examples include YellowPepper, which is a leading mobile financial network in Latin America and the Caribbean, and which has over 3.6 mn monthly users in nine countries, conducting 18 mn financial and informational transactions per month. The YellowPepper business model has relied on mobile banking solutions, enabling banks to deliver financial services via mobile phones,m-wallet solutions obtained via a pre-paid account accessed using the mobile device, and business to business (B2B) products which facilitate mobile payments and collections between large corporate clients such as Coca Cola and SABMiller and their suppliers, distributors, and retailers.

Such strategies are still underdeveloped in the Caribbean. However, there are positive signs that mobile banking and e-transaction platforms are about to be expanded in the region. In February 2016, Transcel Limited in Jamaica, announced that the government-backed mobile money product under development for the micro sector will hit the market in July 2016. Transcel indicated that it has raised USD 2 mn for the roll-out and the technology company's expansion into other Caribbean markets, possibly with JMMB Group and/or Republic Bank of Trinidad and Tobago. The Mobile Money for Microfinance or M3 initiative is a project of the Development Bank of Jamaica, which has taken on Transcel and National Commercial Bank, Jamaica (NCB) as partners[20].

3. **Small business banking solutions:** The most common challenges that financial intermediaries face when servicing small and informal firms include poor customer knowledge, lack of skills and literacy of MSME owners, low profitability, lack of collateral, assets, credit history, and land registry certificates, among others. However, financial intermediaries in various developing countries have been able to overcome these barriers through creative means including cash flow based lending, introducing psychometric tests to identify higher ability entrepreneurs, and leveraging leasing solutions when the firms do not have any collateral or assets to pledge in exchange for investment financing. Other banks, such as Türk Ekonomi Bankasi, Standard Chartered Bank and ICICI Bank, are using nonfinancial advisory services, such as financial literacy and business operations training, face-to-face or web seminars, web portals and e-learning courses. They also offer specialised small business consulting services to increase the capacity of the firm, strengthen the client/bank relationship, and determine which firms and what sectors are lower lending risks.

Offering such non-financial services is increasingly becoming an interesting opportunity for banks looking to strengthen the long-term bank-client relationship, while greatly benefiting and strengthening the capacity of the SMEs receiving these services.

In this regard, the Caribbean is not far behind. Republic Bank in Guyana hosts business seminars in poorer communities. It also hosts a five-week Commercial Customer Business Programme in collaboration with the Arthur Lok Jack School of Business in Trinidad and Tobago. The programme takes commercial customers through various training modules on finance, human resources, marketing and innovation.

[20] Given the viral nature of new ICT "convenience services" the opportunity should not be lost to include a formalisation incentive package offered by Government that is institutionalised within the M3 project.

The bank promotes the use of the IFC Business Toolkit as an online business guideline service for MSME customers. Republic Bank is a partner with the Small Business Bureau Credit Guarantee Programme in Guyana, which offers a 40% credit guarantee and caps the interest loan rate at 6% to eligible SMEs. The bank also lends to the Small Business Development Finance Trust which on-lends those funds to micro entrepreneurs in various sectors of the economy.

4. **The supply chain model:** Finally, supply and value chains can be used as a private sector model to provide market opportunities for informal firms. (Note: This has already been highlighted as an MSME productivity solution under section 2.3.6 above). Large corporations, notably in the extractive industries, power, tourism and hospitality, agribusiness and forestry and telecommunication sectors, want reliable and standardised supply chains for the production and distribution of their products and services. Several multinational companies have prerequisites for companies that become part of their value chains that involve, among others, having a registered business. This presents a great opportunity for MSMEs to participate in larger value chains.

   Currently, a supply chain model is being implemented in Jamaica under the World Bank-funded Foundations for Competitiveness and Growth Project, which includes a component aimed at supporting MSME capability via provision of funding to SMEs to support supply chain learning through commercial interactions with larger Jamaican firms.

These four examples of strategies aimed at advancing the formalisation of very small firms are useful ideas for further consideration by Caribbean countries. However, the findings from the EA Consultants study for the IDB would suggest that a first logical step would be for MFIs to: 1) increase the range of financial services and products that they offer to micro entrepreneurs; and 2) strengthen their capacity to deliver such services including ways to collaborate with larger financial institutions. In that regard, the approach used by the Jamaica Small Business Loans Company of encouraging their micro borrowers to establish banking relationships with the Jamaica National Building Society (JNBS) is highly commendable. With regard to broadening the range of financial services and capacity building, the MFIs would have to continue to strengthen their own institutional/product delivery capacity via such programmes as the Caribbean Micro-Finance Capacity Building Project (CARIB-CAP), the IDB-funded project aimed at enabling Caribbean MFIs to improve financial performance and outreach.

Finally, deliberate information dissemination on the benefits of business registration should not be overlooked as a strategy to increase formalisation and access to finance. Many small businesses are actually unaware of the advantages of formalising their commercial activities and need to be sensitised about the pros and cons of formal registration. Such benefits could include access to: 1) government contracts, 2) grants, and 3) government-funded loan guarantees schemes. Other initiatives could include improvement in land/property registries, lower taxes, and reforms to labour laws that make it easier to hire and lay off workers, given that the latter two factors (i.e. high taxes and cumbersome labour laws) have spurred exponential growth in informality in the recent past.

2.4.3 Addressing SME financial literacy weaknesses

Of all the factors that impact SME access to finance in the Caribbean, perhaps the most important one to address is the acute deficiency of SMEs in providing lenders that dominate financial intermediation in the Caribbean, i.e. commercial banks, with adequate evidence that their businesses are being well managed and that their ideas for growth and credit have been especially well thought through. The evidence that supports this prioritisation is especially strong.

First, the findings of an IDB study on "Access to Finance for Productive Development in Jamaica" in April 2015 clearly points to the dearth of SME capacity as the primary reason why SMEs are having difficulties accessing finance from the system – whether from banks, credit unions or micro finance institutions.

Second, interviewees in this study in all of the eight countries surveyed – commercial banks, credit unions, micro finance institutions, development banks, and government and private sector-funded business support organisations –all point to SME business management deficiency as the primary reason why investment finance is difficult to come by. Consequently, there is a need to strengthen the capacity of lending institutions to guide potential clients in the development of stronger financing management systems in their businesses.

Third, the financial system, including micro finance institutions, is now more acutely aware of the benefits of financing bankable projects because successful MSMEs can become profitable long-term clients. Consequently, the signals (or criteria) that those institutions look for, focus on the capacity of the potential borrower to manage successfully his/her business affairs.

Fourth, the problem is not availability of capital. Most financial institutions have considerable excess liquidity and are aware that they are facing extended periods of excess liquidity in the future. Therefore, they are genuinely keen to lend funds to SMEs, notwithstanding the former's ultra-conservative screening processes and collateral requirements. Moreover, banks are already "on board". As noted elsewhere in this report, the study found that most of the larger banks have or plan to establish special SME departments or units to strengthen their own capacity to process SME financing requests and manage such loans more effectively.

Finally, expanding Government-funded loan capital for lending to MSMEs will be difficult. Most Caribbean governments are increasingly cash-strapped, primarily because of their excessive debt burdens and low economic growth. Therefore, at least over the short to medium term, they are unlikely to be in a position to increase either: 1) public sector procurement; or 2) their contributions to specialty loan funds sufficient to influence the SME finance market substantially. However, some countries, like Trinidad and Tobago and Jamaica, have increased the level of resources to special financial mechanisms like the National Enterprise Development Company (NEDCO), the Development Bank of Jamaica and the Small Business Development Corporation[21].

Commercial banks control at least 67% of the loans market and, from a risk management perspective, are acquiring the expertise to help MSMEs upscale their businesses as they grow. Consequently, a modest increase in loan volume from commercial banks is likely to have a much larger impact on access to finance than from other financial intermediary mechanisms, such as development banks, because the latter group is operating with a much smaller client base and with significantly fewer loan resources.

2.5 FINANCIAL LITERACY OF SMES

2.5.1 Approaches and Strategies to Improve Financial Literacy of Caribbean SMEs

Various public and private sector institutions are already serving the SME capacity building market. These include specialty programmes offered by development banks such as the Development Bank of Jamaica (DBJ); investment promotion agencies, such

[21] It should be noted that, in the case of Jamaica, most of the increase in funding for lending and/or for technical assistance support has come from international donor agencies like the IDB, World Bank and the European Union.

as the Grenada Industrial Development Corporation (GIDC); donor-funded projects, for example, Caribbean Export and Compete Caribbean; government-funded agencies, such as JBDC; private sector business development services, for example, Action Coach, and established educational institutions. Accordingly, the first step in approaching the capacity building challenge is to "map" the existing resources that are being deployed to help SMEs and to identify niche areas that are not being served by such programmes. Any proposed solutions should also take into consideration: 1) the lessons learned from prior related initiatives, and 2) opportunities to leverage existing capacity-building efforts that are currently producing above average results.

Therefore, the approach should be one of additionality rather than of (risking) a possible duplication of effort that may complicate rather than streamline existing capacity building efforts. The perspective of the IDB study on "Access to Finance for Productive Development in Jamaica" is that "to solve the (capacity) problem, a well-designed, well-funded, properly-marketed and effectively-executed training and capacity building programme for businesses is required. It should be designed in a manner that affords struggling, necessity-driven entrepreneurs the opportunity to participate, and at the same time attracts opportunity-driven entrepreneurs by virtue of the benefits to be gained from the offerings".

The IDB study postulates that "an Open University concept could be utilised, wherein trained educators, communicators and business facilitators could be hired to create online teaching modules in critical areas such as accounting/record-keeping, corporate governance, human resource management, etc. These modules could utilise video lessons, along with step-by-step learning aids that are designed in a manner that shows entrepreneurs in a practical way what is to be done and how it will benefit their firms. Although a few short face-to-face sessions would be useful, the pedagogy should rely heavily on self-learning and asynchronous delivery techniques, to allow entrepreneurs to learn at their own pace in the available time. The added benefit is that these materials would continue to be open to business even after the programme is finished". The study adds that a variety of approaches could be used to incentivise participation, including the provision of recognised certificates upon completion of the programme. However, there is some ambivalence about the "completion of certificate" requirement because such an approach implies complexity and possibly failure – two factors that could diminish the attractiveness of the programme to the smallest SMEs, some of which will obviously struggle to complete the programme successfully. Such an approach could give the programme a "bad" or daunting reputation.

For example, attempts by the Guyana Bureau of Standards to introduce CARICOM SME certification standards to the private sector have met with considerable resistance by the sector itself, partly because of "fear of failure".

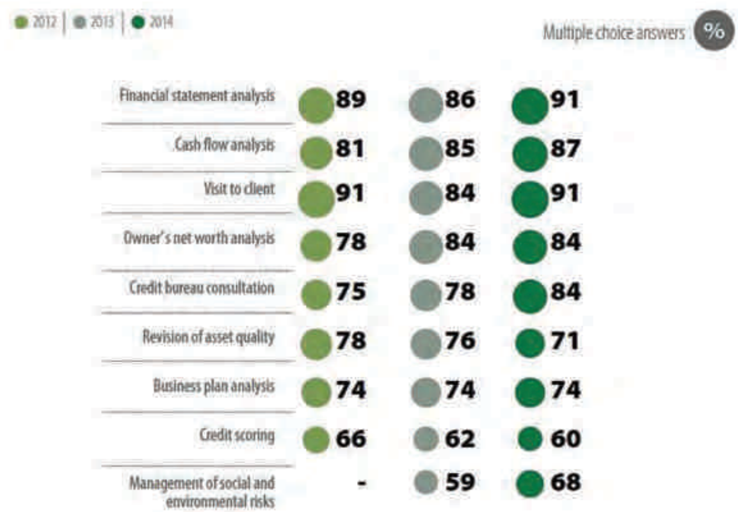
The programme could be promoted as capacity building that would make SME projects bankable and/or investable to the financial system i.e. where suitable forms of financing could be accessed. To that end, it should be delivered as part of a partnership with private financiers (both credit and equity), with a proviso that all participants would be guaranteed an opportunity to make funding pitches to groups of well-placed financiers. Also, there would be related opportunities for synergies to be created between the programme and established institutional initiatives. For instance, Republic Bank in Guyana and the Jamaica National Small Business Loan Company are moving toward a system of online loan application. It is possible that such (loan) systems may be integrated into the training (business plan) modules of the capacity building programme. Also, if the opportunity to borrow is linked to a minimum certification standard, such a prerequisite would encourage MSMEs to take the related training seriously. Furthermore, opportunities could also be explored to fuse the programme with the M3 (mobile money for microfinance) project, which is scheduled for launch in mid-2016.

Marketing and the degree of institutionalisation of such a programme within an integrated fabric of registration, business start-up and access to finance would have to be carefully addressed. Innovative mass media advertising using successful local and regional business people would help. An emphasis on app usage and text messaging to capitalise on widespread mobile phone usage could be established. To be more revolutionary, all registered companies and business name owners could be given free introductory course materials as an incentive to access the training programmes, and the courses could be provided as a fee app as one of the incentives to informal businesses to register. For effective leveraging, such a venture would best be delivered through partnership with a number of public and private agencies, including but not limited to development banks, credit unions, business support service organisations and donor-funded projects in each country. Based on capacities developed and successes to date, one of the leading business support entities – with appropriate capacity – could be appointed as executing agency for such a project.

Obviously, technical assistance would be required for the design of all areas of such a programme, including online learning resources, delivery methods, marketing, IT infrastructure, and capacity building for the executing agency. Consequently, financial assistance would be required for the design phase. However, the project's operating budget should be self-financing in that the main beneficiaries (i.e. the lending institutions and governments) should be prepared to contribute to the operating costs of such an agency since they would be the primary beneficiaries[22].

To be relevant, the proposed capacity building programme should focus on developing SME training modules that address the nine priorities listed below (i.e. financial statement analysis, cash flow analysis, physical business organisation/visit to client, owner's net worth articulation, credit bureau registration, articulation of asset quality, business plan analysis, and management of social and environmental risks). Consequently, banks and other financial institutions would have to be actively involved in designing curricula.

Figure 2.6: Loan Analysis Procedures used by Banks and % of Bank Usage



Source: "Banks and the Missing Middle": 7th Regional Survey 2014. MIF of the IDB Group

[22] The CDB consultants acknowledge the contribution of the IDB consultant who developed the ideas for the Small Business Open University highlighted in this section of the Study.

There are also other options worthy of consideration. Not all SMEs will need a mandatory or fixed number of business development training modules. Therefore, Government could consider using "sweetener" tax incentives that allow SMEs tax write offs of 150% of expenditures made on business management capacity training that meets the curricula requirements of the financial system.

While this might appear to be a direct SME subsidy, the upside is that the financial system will make more loans to the sector, increase its profitability, and pay more taxes to government on interest income earned from the SME loans, partially or completely offsetting the tax subsidy inducement offered to MSMEs.

Additionally, this should boost the delivery of training services by the private sector itself. Governments can promote more strongly the inclusion of business management training into donor-funded projects aimed at the sector by donors such as the World Bank and the IDB. To ensure that the programme is deliberately relevant to the needs of financiers it should address the following priorities as articulated by commercial banks[23].

2.5.2 Improving MSME Access to Finance in the Caribbean

The preceding review of MSME access to finance has led to the following conclusions, in summary:

1. **Questionable growth prospects and now additional non-economic challenges to be addressed:** At the macroeconomic level, the Caribbean is still facing strong headwinds over the short to medium term. The global economy, after more than five years of highly creative policy measures to boost growth, is still in a relatively fragile state.

2. **Inward focusing private sector:** The Caribbean private sector is struggling to cope with a number of commercial challenges, primarily in markets and in the rapidly evolving structure of the tourism sector. Notwithstanding the recent return to strong tourism growth, the sector itself has lost its competitive edge on a global scale and returns on investment (in tourism) are not nearly as robust as they used to be.

3. **Absence of critical business enabling environment/access to finance support measures:** In the region, only Guyana, Jamaica and Trinidad and Tobago have introduced reforms aimed at improving the Doing Business "Getting Credit" indicators – namely the establishment of credit bureaus – and in the case of Jamaica, an electronic registry for moveable collateral.

4. **Formal financial sector dominance and control:** The Caribbean's retail financial sector has adopted increasingly stringent screening processes for private sector and consumer access to bank credit – even when faced with above average levels of excess liquidity in the system. The commercial banks still have, by far, the largest market share of the financial market. Therefore, strategies aimed at unlocking those resources have to be a top priority if the Caribbean is to advance SME growth beyond the incremental level. Such strategies, e.g. Credit Guarantee Schemes and MSME training in financial literacy, are highlighted under the specific recommendations below.

5. **Less than optimal MSME policies and strategies:** In recognition of the access to finance challenges which SMEs face, some but not all governments have developed SME policies to lay out a clearer strategy to strengthening the

[23] See: "Banks and the Missing Middle" 7th Regional Survey 2014. Multilateral Investment Fund of the IDB Group. The loan analysis procedures in Figure 2.6 above are based on a survey of 110 small, medium and large banks conducted in 19 different LAC countries, including Jamaica, in 2014 by the Multilateral Investment Fund (MIF).

sector's contribution to economic development. The Region faces two challenges: 1) the general lack of comprehensive policy frameworks; and 2) in terms of additionality –and relative to the overall size of the private sector at country levels– all of the national MSME support programmes are operating at incremental impact levels primarily because most countries have categorised their MSME development initiatives as "projects". This means that such interventions are not actually being assimilated into the larger institutional support framework for MSMEs. Overall, countries concentrate on establishing and using special delivery mechanisms or projects.

In contrast, however, their policy design and implementation framework (credit bureau legislation, national credit guarantee legislation and programmes, tax policies and training policies and incentives, etc.), could be much more effective at unlocking MSME access to credit. However, these are not being developed by the relevant government entities.

6. **Yet, there are still promising signs on the MSME horizon.** These include the increase in training services being utilised by MSMEs, the formal alignment of commercial banks with the sector via establishment of MSME Units and Departments, the introduction of credit bureaus in some countries, the increased access to technology that MSMEs now have, and the more direct access to foreign markets afforded by the World Wide Web.

The preceding findings and conclusions establish the rationale or platform upon which the ensuing recommendations to enhance MSME access to finance are based.

If the Caribbean chooses to address MSME access to finance constraints, then it must focus on the ones that would unleash SME development "across the board" by identifying a limited number of issues to be worked on now, leaving the longer-term issues to be addressed at a later time. Such an approach avoids over-planning the development of all of the possible institutional solutions.

The specific recommendations are as follows:

2. **Develop training programmes aimed at improving the capacity of MSMEs** to address financial management of their operations in line with financiers' information needs. This is the main challenge that MSMEs face – the capacity to demonstrate that management of their businesses and resources are "information based" and that they have institutionalised such approaches to running their operations on a day-to-day basis.

2. **Expand the range of financial products available to MSMEs.** Governments should expand the range of financial products offered to MSMEs along similar lines to those offered to MSMEs by OECD countries[24]. This can be achieved by accessing and re-deploying previously under-tapped institutional funds such as the NIS and the proposed Dormant Account Scheme in Jamaica. The most important mechanism to create/expand is Credit Guarantee Schemes. The reason is, that apart from MSME financial management literacy, MSMEs have limited collateral capacity, and that limitation is one of the main reasons why they experience difficulty in accessing loans from the financial system.

[24] The Small Business Bureau (SBB) in Guyana, supported by IDB funding, is an example of how a credit guarantee system can work for very small MSMEs in that country.

Also, given the limited scope for domestic market expansion in most countries, export support programmes similar to those managed by the Trinidad and Tobago EXIM Bank (factoring, export insurance etc.) are the second most important financing mechanism to develop in all Caribbean countries.

3. **Introduce tax reforms that allow formal MSMEs to retain a much larger share of their profits and cash flows.** Increased cash flows will improve MSME attractiveness to local financiers. Admittedly, such reforms may be more difficult in some countries than in others, partly because of the stringent fiscal circumstances in many Caribbean countries.

4. **Increase the adoption of tax reforms that shift the burden of taxation away from direct taxes to indirect taxes** and deliberately lower the tax rates for MSMEs. This would improve MSME "formality" and reduce administrative inefficiency of the tax system generally.

5. **Introduce labour reforms that allow MSMEs to be more flexible in terms of hiring and firing.** Apart from taxation, this is the second most important reason why informality thrives in the Caribbean private sector.

6. **Create stronger tax incentives to increase financial intermediation and encourage MSMEs to seek out alternative forms of investment funds** (other than bank loans) via such mechanisms as the Junior Stock Exchange in Jamaica. This would strengthen the Finance Life Cycle for MSMEs.

7. **Improve the enabling environment for access to credit** by: 1) introducing Credit Bureaus in countries that still do not have them; 2) opening up credit bureau information access to foreign financiers so that alternative funding sources such as crowdsourcing, angel investments and P2P investments can become more available to Caribbean MSMEs; and 3) upgrading bankruptcy laws to allow insolvent companies to return to the financial systems more quickly than is currently allowed under outdated bankruptcy laws. All three initiatives will improve the bankability of MSME project proposals in the region.

8. **Overcome the limitations of domestic markets by promoting and fiscally favouring export growth of MSMEs and by increasing the use of ICT "information access" mechanisms.** An excellent example of information access is T&T's "Made-in-TnT" portal, which promotes more than 400 products in 19 product categories online.

   Overall, both measures will increase the growth and income generating prospects for MSMEs that would be operating in an expanded global market place. This should improve the bankability of MSME projects to local financiers.

9. **Introduce regulatory reforms that would allow AFIs and MFIs to take deposits and offer an expanded range of financial products to their MSME clients.** This would strengthen the AFIs and MFIs and allow them to be more creative on the supply side of the Access to Finance equation.

10. **Increase the inclusiveness of Credit Unions in terms of affording them access to SME financial programmes as DFI recipients,** including funding, credit guarantees and technical assistance in risk management.

11. **Put in place legislation that would allow each Caribbean country to adopt Mobile Banking** solutions at every level within those societies. Like MPESA in Kenya, this should improve MSME productivity substantially.

12. **Examine the feasibility of establishing Mutual Guarantee Schemes** in the larger Caribbean countries. As noted earlier in this study, such schemes have worked reasonably well in European countries that have a high proportion of formal SMEs (e.g. Spain and Italy). Accordingly, their potential viability should be examined in the Caribbean region.

13. **Create deliberate incentives to encourage the informal sector to formalise their businesses.** One very clear conclusion arising from the preceding analysis is the need to change the incentive structure/ policy in favour of formality, increase training, and increase access to financing. Attractive incentives through very good, well thought out policy can make a significant difference. These include low cost and readily available ICT-designed or app-based training programmes and fiscal incentives to training providers to develop more relevant courses aimed at MSMEs.

The preceding recommendations are mostly policy-based. The reason is that such an approach would enable more comprehensive coverage in addressing the "access to finance" challenge in the Caribbean. The first two recommendations (i.e. improving MSME financial literacy and expanding Credit Guarantee Schemes) are the ones that are likely to have the greater impact on improving Access to Finance.

2.6 REGIONAL COLLABORATION TO IMPROVE FINANCING OPTIONS

The challenge with attempting to establish regional collaboration to improve financing options for MSMEs is that each BMC's financial system is legally, and therefore operationally, independent of the others.

Therefore, there is limited scope for adopting financing initiatives on a regional basis, e.g. a regional credit bureau, or a regional credit guarantee scheme. Also, when recent experiences of larger institutions like CLICO are considered, the history of regional financial integration has been questionable, mainly because of the absence of standardised regulatory requirements for such institutions that are legislated at country level. This is not to conclude that financial sector integration is not possible, since this has been achieved by the ECCB in the OECS sub-region. But as regional experience has demonstrated, Caribbean-wide regional integration is a much more complex challenge and is proceeding too slowly to warrant inclusion of a similar recommendation in this study.

Nevertheless, there is considerable scope for copying over initiatives that have been tried and tested in one or other BMCs. In that regard, the collaboration challenge is relatively simple. How can the region establish an information-sharing mechanism whose primary objective and purpose would be to increase the knowledge of policy makers with regard to the development of financing options across the region? Perhaps the most effective way to encourage regional collaboration on improving access to finance is to establish a benchmarking system that allows the various countries to:

1. Compare their suite of financial products offered to MSMEs;

2. Highlight institutional initiatives and strategies being undertaken in each country to improve MSME access to finance;

3. Publish the Doing Business Rankings and Global Competitiveness Index ratings along with steps being taken to address key "access to finance" reforms and the competitiveness challenge;

4. Highlight special programmes that have been introduced in some countries to address the MSME financing challenge (e.g. Ignite and Start Up Jamaica);

5. Provide examples of donor-funded programmes that have supported supply side improvements such as the MIF-funded Enterprise Risk Management and Financing Programme (ERMFP) aimed at adjusting Scotiabank's SME loan appraisal processes in Jamaica;

6. Provide examples of legislative reforms used to introduce new enabling environment mechanisms aimed at improving MSME access to finance in the region.

Examples include: a) Jamaica and Trinidad and Tobago MSME Policies; b) the consolidation of the business registration system into a "Superform" in Jamaica; c) the regulatory guidelines governing the establishment of Junior Stock Exchanges in Jamaica and Trinidad and Tobago; and d) the legislation used to establish credit bureaus in both countries – along with reforms aimed at upgrading the status of insolvent firms in Jamaica and St. Kitts-Nevis.

Such an approach would allow countries in the region to:

1. Identify and propagate "good practices" already being used in the region by some countries;

2. Establish a benchmarking system on "Access to Finance" for all countries that is updated at least once annually;

3. Copy over solutions already used by some countries to improving their Competitiveness and access to finance;
4. Replicate donor agency policies that have been effective in supporting reforms in the MSME and financial sector (e.g. IDB and IMF reform-inducing policies in Jamaica)

A benchmarking project would require the support of country governments, leading private sector agencies at country and regional levels (e.g. MSME and MFI Alliances, CAIC, the Caribbean Business Council, etc.), and the main development agencies involved in providing country-specific support in the areas of competitiveness and MSME development.

Such a project would have to be designed by co-opting the BMCs to contribute to its objectives, purpose and scope, and to articulate its operating agenda and performance targets. Most importantly, it would establish the basis for information-sharing and regional collaboration on many MSME-related development issues.

CHAPTER III

REGIONAL
POLICY AND REGULATORY FRAMEWORKS

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3.1 GAP ANALYSIS OF THE ADEQUACY OF THE ENABLING FRAMEWORK

While successive governments have repeatedly acknowledged the significant contribution of MSMEs to social and economic development over the past decades, MSME policy and regulatory frameworks and implementation remain unimpressive.

3.1.1 MSME Policy Framework inadequacies

The study indicates several gaps and mismatches between best practice and the prevailing status quo. Some of these are highlighted below in Table 3.1, for example:

- Only Belize, Jamaica and Trinidad and Tobago have in place dedicated MSME policy and regulatory frameworks and strategies;
- Whereas 4 of the 8 countries have MSME-specific legislation in force, only Antigua's was less than 10 years old;
- Jamaica's Business Names Act dates back to 1934 and St. Lucia's Act was passed in 1998;

It should be noted that even where policies and strategies, acts and regulations exist, concerted implementation –so necessary for realising the enabling climate for a viable MSME sector – has generally not been pursued. Lack of sustained political will; frequent changes in political administrations; and, above all, limited programmatic resources voted in the national budgets, account for this inertia.

Belize appears to have been the exception to this practice, as successive governments since 2000 have sought to address the 'productivity dilemma' through sustained investments in MSME financing and technical assistance.

Table 3.1: The Policy, Legislative & Regulatory Framework for MSMEs and Supporting Lead Institutions in 8 CDB Borrowing Member Countries

COUNTRY	POLICY	STRATEGY	SECTOR ACT	Lead TA AGENCY & FI
ANTIGUA & BARBUDA	None	None	Small Business Development Act, No. 24 of 2007. Small Business Regulations, 2007; Investment Authority Act, No. 15 of 2006.	Enterprise Development Unit/ Antigua and Barbuda Investment Agency (ABIA). Finance: Development Bank
BARBADOS	None [January 2016 Draft]	None	Small Business Development Act, CAP 318C 2002 Fiscal Incentives Act (Amendments), Sep. 1998.	Barbados Industrial Development Corporation (BIDC). Finance: Fund Access, Barbados Central Bank

Table 3.1: The Policy, Legislative & Regulatory Framework for MSMEs and Supporting Lead Institutions in 8 CDB Borrowing Member Countries cont'd.

COUNTRY	POLICY	STRATEGY	SECTOR ACT	Lead TA AGENCY & FI
BELIZE	MSME Policy and Strategy, (March 2012 Report)	Entrepreneurship Strategy, July 2014	Belize Trade and Investment Development (BELTRAIDE) Services Act - Cap 282, 2000. [Draft MSME Development Act, March 2012].	BELTRAIDE/SBDC Finance: DFC, BEST.
GUYANA	None	None	Small Business Act, No. 2 of 2004	Small Business Bureau, Ministry of Business Finance: Development Bank
JAMAICA	MSME & Entrepreneur-ship Policy, February 2013 [14th Draft]	MSME & Entrepreneurship Policy, February 2013	Business Names Act (1934)	Jamaica Business Development Corporation (JBDC) & HEART Trust / NTA. Finance: Development Bank of Jamaica (DBJ).
ST. LUCIA	None Industrial Policy January 30, 2001: focus onmanufacturing	None	Trade and Export Promotion Act (TEPA) Act, No 16 of 2013. Micro and Small Scale Business Enterprises (Amendment) Act No. 6 of 2009. Micro and Small Scale Business Enterprises Act, Cap. 13.19 (1998).	Small Business Development Centre (former SEDU) launched 2014: MSEs. Commerce & Industry Department: Medium size. TEPA: Export-oriented. Finance: Development Bank (SLDB)
SURINAME	None A Private Sector Policy only	None	None	Suriname Business Centre (SBC) and KKF: MSMEs. Microenterprise Finance: Suri-Trust
TRINIDAD & TOBAGO	Enterprise Development Policy, September 2014.	Ministry of Labour & Small Microenterprise Strategic Plan 2011-2015.	None	NEDCO: MSME development. EXIM Bank finances Exports, ADB supports Agri-finance, NEDCO for Microfinance.

3.1.2 Gaps in the Policy Framework

The following gaps have been identified:

1. The Companies Acts are largely silent on the needs of MSMEs for developmental support.

2. Registration and de-registration of businesses (names and companies) are deemed voluntary, at the discretion of the entrepreneur, in contrast to the French and Dutch-Speaking Caribbean, e.g. Suriname, Martinique, Guadeloupe, Sint Maarten, Aruba or Curacao, where formal registration is compulsory and membership of the Chamber of Commerce is automatic.

3. The Fiscal Incentives and Hotel Aid Ordinances provide substantial incentives and concessions to businesses; however, micro and small enterprises (MSEs) are generally ineligible, because they either do not satisfy the value-added criteria or lack the resources to present satisfactory investment plans.

4. Customs laws provide for the conditional exemption of duties. However, whereas farmers and fishers generally enjoy such relief on imported inputs, benefits to MSEs –particularly in the manufacturing and services sectors– are usually extended on a discretionary and ad-hoc basis, with Cabinet approval given only after long delays and complicated procedures.

One notable exception is the Antigua and Barbuda Investment Authority (ABIA) whose performance has been rated 'exceptional' by local stakeholders, thanks to regulations entrenched in the ABIA Act.

5. While the removal of tax rebates on credit union shares has been accepted in Trinidad and Tobago, Barbados and St. Lucia, taxation on their assets (via sunset legislation in Barbados) and on surpluses (hinted by the Government of Grenada) should also be rescinded, if credit unions are to invest significant financial and technological resources as partners with the State – alongside the Development Banks/DFCs – in increasing access to serviceable credit by a larger number of viable MSMEs.

6. The enactments for the various Bureaus of Standards in the eight countries visited and their attendant policies, still advocate voluntary standards, a major drawback to economic competitiveness. Adherence to quality standards is not enforceable in most industries. The absence of legislation that obliges the producer, processor and purveyor of tradable goods and services to be liable for any defects or deficiencies has been explained away by firstly, the notion of allowing market forces (including consumer choice) to dictate, and secondly, the prohibitive costs of policing the entities concerned.

7. Existing laws in all countries directly and/or inadequately impact the development of MSMEs. Yet, there is a marked absence of enabling legislation deliberately crafted to facilitate the expanded provision of technical assistance, training, advocacy and other sources of institutional support clearly necessary for small and micro businesses to survive and grow.

8. With the exception of Antigua and Barbuda and St. Kitts-Nevis, no CDB BMC has legislated fiscal and monetary benefits specifically for the MSME sector during the past 10 years. Attempts are being made in Barbados and Jamaica to update their legislation.

9. In Belize, one of the more progressive jurisdictions, the Policy and Strategy Report (2012) observed that "there are eight (8) major legislative measures providing fiscal and operational benefits to companies. There is none specific to MSMEs." The Belize Companies Act, Chap 250 (Revised 2000) makes hardly any reference to the peculiarities of small businesses. The BELTRAIDE Services Act, Cap 282, 2000 is vocal on trade, investment and export development functions, but mentions "small business" only once, in respect of the composition of the Board of the Council (Section 5).

Therefore, it is evident that current policy and regulatory frameworks do not encourage a culture of inclusion for all businesses, irrespective of size, sophistication or scope; nor do they recognise or provide adequately for the special needs and value-added potential of MSMEs. **Achieving completeness in the design of the national policy and regulatory frameworks is therefore a major issue to be resolved.**

3.2 REVIEW OF REGIONAL BEST PRACTICE POLICY AND REGULATORY FRAMEWORKS

3.2.1 Guyana Small Business Act, No. 2 of 2004

The Act defines the sector, and provides for the establishment and administration of a Small Business Council; a Small Business Bureau; and a Small Business Fund. It commits government "to use its best endeavours to ensure" that MSMEs procure at

least 20% of goods and services required annually by Government, similar to the 25% set aside by the Antigua and Barbuda Act. The Council is required to prepare and submit each year to the Minister a Small Business Procurement Programme.
However, this benefit has only been recently highlighted by the new Guyana Government.

The Act requires that 4 of the 11 members of the Council be representatives of the small business sector and owners of enterprises in their own right [Section 3(1)]. This augurs well for inclusiveness. The mandate and responsibilities of the Council are set out in Section 5. They include:

1. Bringing issues that affect MSMEs to the attention of government planners and policy makers;
2. Quarterly reporting to the Council on the uptake of procurements and fiscal incentives by approved MSMEs;
3. Provision of current statistics on small businesses; and
4. A register of all small businesses approved by the Minister for funding, fiscal incentives and/or technical assistance.

While the latter two provisions speak to improving data collection, a major challenge and requirement for improved policy making, in order to improve the quality and flow of available MSME data to all, there is a need for greater clarity in respect of the functional interface between the Small Business Bureau, the Registry of Companies and all other service provider organisations in Guyana.

The accountability requirements for resources provided are extensive, when compared to the Barbados, Antigua and St. Lucia Acts. For example:

- The Minister must receive the audited accounts of the Development Fund; the performance report of the Small Business Bureau and the Fund; and updates on any other project within five months, after the end of the financial year;
- The Council must also submit at the end of each financial year a Small Business Policy and Administrative Reform Agenda to the Minister, who must present it to the National Assembly within 60 days of receipt [Section 4].

Apart from covering the expenses of the Small Business Bureau, the resources of the Fund may be used for supporting access to finance by MSMEs –"non-financial services and assistance to help small businesses improve their productivity and competitiveness," and provide subsidies to BSOs, NGOs and other organisations supporting the sector [Section 7(1)]. Section 12 assures that "a small business shall be eligible for every applicable fiscal incentive under the law". Adherence to the spirit and provisions of the Act and its attendant Regulations would certainly impact favourably on the performance of the Small Business Bureau and other organisations providing services to the MSME sector.

3.2.2 Belize Enabling Policy (2012) and Strategy (2014)

The Belize agenda seeks to improve the response capability and the capacity for institutional strengthening of MSMEs by:

1. Enhancing the entrepreneurship support ecosystem;
2. Promoting collaboration between the public and private actors in the national entrepreneurship ecosystem;
3. Promoting entrepreneurial financial support through diverse non-refundable, promotion, warranty, fiscal and credit instruments;
4. Encouraging business creation; and
5. Strengthening entrepreneurship training within the education system.

Belize's policy identifies five pillars as vital for developing a strong entrepreneurial culture:

1. Education;
2. Industry Support;
3. Financing Flows;
4. Institutional Infrastructure; and
5. Mentality and Culture.

These are given emphasis in the Strategy, under four headings: legislative and regulatory framework; increased flow of capital; market access and competiveness; and education and training. The matrix below indicates the linkages between these focal points –as key performance indicators (KPIs), and the policy-regulatory framework. The absence of a Small Business Development Act and regulations is the missing link in an otherwise enabling framework.

The major features of the Belize Policy, Strategy and Strategic Plan (Table 3.2) are:

1. It offers customized incentives that can create business opportunities for serial entrepreneurs (multi company); retired entrepreneurs (with vast experience); intra-cluster entrepreneurs; young entrepreneurs (with talent); public employees and officers (retirement plan or extra income generation); and entrepreneurs without experience (vulnerable population, facing extreme poverty).

2. It recognises the need for differential approaches in serving micro-enterprises, which operate largely in the informal sector and need extensive education, mentoring and coaching, and SMEs, which tend to be more organised and have a greater need for capital.

3. It requires establishment of an MSME Development Fund supported by an annual allocation of not less than US$0.5 mn by the Government of Belize; donations from local and international institutions or foreign governments; monies accruing to the fund from investment, loan or other income; loans and grants obtained from national, bi-lateral and multilateral sources; and any other contributions.

   A Grant Scheme is to be established to issue grants to support investments in ICT; alternative energy; and certification to approved technical standards. Financing must be accompanied by mentoring, hand-holding and counselling programmes delivered by BSOs, and networking among micro enterprises.

4. A portion of the MSME Development Fund is to be set aside annually for equity and loan financing of approved MSME projects, based on rules determined by the Council. Loans shall be made to enterprises operating in the following sectors:

   a. Agriculture, including fishing;
   b. Agro-processing;
   c. Manufacturing, including forestry;
   d. Tourism and related services;
   e. Repair and maintenance;
   f. Information and Communication Technology (ICT); and
   g. Crafts and Cottage industries.

Table 3.2: Policy and Regulatory Framework – Belize

COUNTRY / COMPONENT	BELIZE		
COMPONENT	STRATEGIC PLAN	LEGISLATION	POLICY
LABOUR		Labour Act, August 1st 1960	
MSME	National MSME Policy and Strategy		National MSME Policy and Strategy
ST&I	Strategic Plan 2012-2017: "Integrating energy, science and technology into national development planning and decision making to catalyze sustainable development"		
FISCAL		• Fiscal transparency and responsibility regulation, 2010 • Income and business tax act, 2000	
FORMALIZATION		Business name act Chapter 247, December 31st 2000	
ENTREPRENEURSHIP			
COMMERCIAL SOCIETIES			
COMPETITIVENESS	National Export Strategy		
MICROCREDITS	National MSME Policy and Strategy		
ACCESS TO CREDIT	National MSME Policy and Strategy	Bank and financial institution act, December 31st 2000	

Green: There is an entrepreneurship fostering policy, legislation or strategic plan approved.
Yellow: Entrepreneurship fostering policies, strategic plans or legislations are in the approval process.
Red: There is no entrepreneurship fostering policy, legislation or strategic plan approved.

5. A matching legislative framework, driven by an MSME Development Act, that will stimulate and sustain the sector by:
   a. Defining an MSME and establishing guidelines for development and regulation of the sector;
   b. Creating an MSME Policy and Strategy implementation organ to be called the "Belize Agency for the Development of Enterprise (ADE)";
   c. Introducing an MSME category in the national accounts so that data on the sector can be collected and disseminated;
   d. Providing an array of fiscal incentives specifically for MSMEs; and
   e. Reducing the bureaucracy and paperwork in accessing credit so that microcredit applications should not exceed one page. The turnaround time for microfinance approvals should not be more than three days.
6. Business development services are to aid in the improvement of entrepreneurship knowledge, acquisition of business skills and access to technical assistance. Inclusion of entrepreneurship in primary and secondary education and training of university students in business management is intended to improve the relevance of the education curriculum.
7. In addition to increasing information sharing and promoting ICT penetration among MSMEs, successful and innovative entrepreneurs will be showcased in mass and social media as role models.
8. Finally, the proposed ADE –as a statutory or at least a semi-autonomous body under the Ministry of Trade, Commerce and Industry– will play the lead role in implementation of the policy, legislation, strategy and strategic plan. As a vital support institution, it is expected to be adequately resourced by Central Government and would not become self-financing at the expense of the sector.

Table 3.3: Strategic Initiatives – Belize

SUMMARY OF STRATEGIC INITIATIVES: BELIZE			
Name of the Pillar	**Objective**	**Strategy**	**Strategy Description**
Support Industry	To strengthen the entrepreneurial support industry.	Incubation Programs	To create and strengthen institutions that develops business incubation processes.
		Innovation Labs	To promote innovation through supporting spaces that favors the strengthening of innovative entrepreneurship (innovation labs).
Financing	To promote the development of the entrepreneurs financing chain for entrepreneurs with diverse non-refundable, promotion, guarantees, and tax credit instruments.	Seed Capital	To create and strengthen financial vehicles such as seed capital, pre-seed capital, entrepreneurship microcredit.
		Tax Incentives	To create a regulatory framework to ease and promote the creation of financial instruments, guarantees and tax exemptions for entrepreneurs.
Institutional Articulation	To promote spaces for collective action between public and private actors in the national entrepreneurship ecosystem.	Strengthening National Entrepreneurial Networks	Creation and strengthening of an entrepreneurship network through technical committees that design and consolidate the National Entrepreneurship Policy.
		Joint Structure Ecosystem	To develop a platform in the cloud that facilitates the communication between the actors of the ecosystems and the entrepreneurs.
Mentality and Culture	To Encourage entrepreneurial thinking in citizens to stimulate the creation of new firms.	Disseminate entrepreneurial success Stories Nationally	To create spaces and methodologies to inform and inspire the people on successful business stories.
		Media Campaigns	To use the media in order to promote the importance of entrepreneurship.
Education System	To strengthen the entrepreneurship as a cross axis in the education system.	Transfer of Entrepreneurship Model to primary and secondary education	To implement models, methodologies and tools to foster entrepreneurship in primary and secondary education.
		Training for Trainers	To develop training and coaching programs for trainers training.

Source: BELTRAIDE, CENPROMYPE- NEXUS 2014.

Table 3.3 above illustrates how the five pillars are articulated across the policy objectives, strategy and strategic description in the current Belize agenda for MSME development. The Belize approach to regulatory and policy modernisation is particularly outstanding for the importance it attaches to entrepreneurial education both in the primary and secondary school system, and as a key ingredient of the programmes aimed at existing and hopeful business owners and operators. Any policy, strategy or law is only as sound, however, as the capacity of the apparatus put in place for its implementation.

A direct result of Belize's MSME Policy and Strategy has been the emergence of the Small Business Development Centre (SBDC), which has been pivotal in promoting business awareness and providing training and mentorship to entrepreneurs across the country. Deliberate strengthening of the SBDC as a full-fledged quadrant within the BELTRAIDE complex, alongside EXPORTBelize, BelizeINVEST and BTEC, will strengthen Belize's progress to become a best practice jurisdiction for enabling MSME competitiveness and growth.

3.2.3 Jamaica MSME Policy and Strategy (2013)

The Micro, Small and Medium Enterprise and Entrepreneurship Policy, produced in May 2013 by the Ministry of Industry, Investment and Commerce (MIIC) following extensive consultation and research, provides a good example of an attempt to develop a comprehensive legal and policy framework for MSME development. It is presented as "the intervention framework that offers coordinated, coherent and targeted support to the sector in an effort to expand its contribution". Unlike the Belize Policy, it highlights the need to lead the process of internationalizing the sector by strengthening Jamaica's bilateral, regional and international economic and trade relations and the promotion of local and foreign investments in certain areas. It combines a timeless policy statement and a time-bound implementation strategy.

Its goals are very specific and far-reaching:

1. A strong focus on this sector as a key part of Jamaica's vision to go global and become a developed nation;
2. Increasing capacity building and business awareness around available support and resources for MSMEs (e.g. an online database, expanded technical assistance and mentorship);
3. Special focus on creative industries which are less explored but growing and full of potential (e.g. fashion, music, animation);
4. Inclusion of entrepreneurship education in all institutions and at all levels; and
5. Establishing standards for certification and accreditation.

Like Belize's BELTRAIDE, Jamaica's MIIC is seeking to foster a deep-seated Culture of Entrepreneurship and Innovation across Jamaica as a platform for transforming the economy. The introduction of entrepreneurship in the curricula of all primary, secondary and tertiary institutions is a game-changing strategy. Knowledge and skills transfers are contemplated in such subjects as Business Planning, Cash Flow Projections, Management, Bookkeeping, Marketing and Customer Service. The Strategy caters for the creation of an online directory of available technical assistance and training resources - including consulting firms, tertiary institutions and BSOs - on an MSME business news web portal, another vital construct for capacity building. A structured Mentorship Programme seeks to utilise entrepreneurs, senior executives and business professionals with proven track records in their fields, to volunteer as mentors, supported by facilities for online business counselling.

The policy gives special focus to the creative industries (film, music, animation, fashion, etc.) which are seen as possessing strong linkages with various sectors of the economy and having the potential to create wealth for a wide range of MSMEs. Their export potential is also substantial, as acknowledged by respondents from the OECS Commission and Barbados.

The Jamaica Policy also acknowledges the lack of supply of "adequate and serviceable credit" from financial institutions and the limited options available to small businesses. The strategies, similar to those distilled in Table 3.4 below, place emphasis on recognizing non-traditional collaterals such as inventory, accounts receivable and intellectual property.

Table 3.4: Jamaica MSME Policy Oobjectives and Strategic Actions

MSME POLICY OBJECTIVE	SUBORDINATE STRATEGIC ACTIONS
Encourage business formalization in the MSME sector.	Encourage the formation of business clusters as a means of developing the MSME Sector.
Create an enabling institutional and legislative framework to aid the development of creative enterprises.	Enact new enabling MSME legislation with supportive tax and other incentives and coordinate & strengthen the key public and private sector institutions.
Increase the market share for goods and services produced by MSMEs.	Increase the competitiveness and market access of goods and services produced by MSMEs through standards, certification and accreditation.
Increase the level of technical skills/capacities in the MSME sector.	Implement a structured Mentorship Programme for the sector. Increase the marketing and communication skills of MSMEs. Assist viable MSMEs experiencing losses or insolvency to restructure. Provide on-going informational support to MSMEs.
Build an internationally competitive labour force that will bolster productivity performance.	Implement standards and competency-based training and certification for workers and owners in target industries. Promote greater use of the Internet/ICT and of energy efficient practices among MSMEs.
Foster innovation among MSMEs through greater supply of and demand for ICT products and services.	Foster a culture of innovation through more productive use of science and technology and R&D among MSMEs.

Cross-cutting issues addressed by the Policy include:

1. Collaboration among Governments, associations representing MSMEs, and trade associations, to foster greater social capital among MSMEs through various programmes;
2. Special emphasis on the attainment of equality of opportunity between men and women in the development of all spheres in which MSMEs operate;
3. Youths, rural communities and persons with disabilities are also given special attention through a number of proposed strategies to promote and increase the level of self-employment via entrepreneurial activities;
4. Strategies to protect the environment; and
5. Collection and dissemination of reliable data and information on MSMEs.

For good planning and effective tracking of quantitative and qualitative results, Key Performance Indicators (KPIs) like Critical Success Factors are a very important policy and management tool that should become standard fare in use by MSME development practitioners.

The Jamaica Policy and Strategy document goes beyond the parameters set by the Belize instruments by defining specific measurable outputs to underpin its KPIs; ten of these are as follows:

1. Increase the number of formally registered MSMEs by 10% each year;
2. Improve the technical skills of 100 MSMEs per annum;
3. Reduce the processing time for business registration by 60% by 2015;
4. Increase the number of MSMEs securing loans by 20% by 2020;
5. Increase the number of MSMEs utilizing ICTs by 30% by 2020;
6. Increase the number of MSMEs utilizing R&D in their business operations by 75% by 2025;
7. Introduce Entrepreneurship in the curricula of all primary, secondary and technical institutions by 2020;
8. Ensure Jamaican firms are innovative and competitive by 2030;
9. Promote and secure equity and equality of opportunity which enable women-owned and family-owned businesses to be effective economic actors in the MSME sector; and

10. Promote and secure equality of opportunities among MSMEs.

For completeness, an Evaluation and Monitoring Methodology is built into the planning and implementation processes required by Jamaica's comprehensive roadmap for transforming the enabling eco-system for MSMEs. Delivery of the policy, strategy and planned outputs as summarised above is entrusted to the Jamaica Business Development Corporation (JBDC) which will lead the training of MSMEs, with support from other key entities such as the national training agency (HEART Trust/NTA).

3.3 FURTHER ENHANCING MSME FRAMEWORKS IN THE CARIBBEAN

Based on the foregoing analysis, it is clear that an imaginatively designed, robust and multi-pronged MSME Policy and Regulatory Framework is an urgent necessity if governments are to become more effective in developing and sustaining MSME sector growth. However, in addition to the formulation of the appropriate frameworks to incentivise the establishment and growth of MSMEs, it is very clear that, given the very difficult economic challenges facing Caribbean economies, there is need to enable refocusing of the sector towards greater competitiveness though increased productivity and innovation.

3.3.1 Vision 2025

The consensus vision for a business-friendly environment must be premised on the overriding priority of developing and growing a competitive MSME sector by international standards, so that it can contribute to the creation of quality employment, and improve the quality and range of goods and services available to domestic and overseas markets. The new policy direction must be driven by a collective vision of the future inspired by a **new paradigm and framework for the sustainable growth of globally competitive MSMEs in various industries across the region.** The core objectives of this Common Enabling Policy and Regulatory Agenda for MSMEs in the Caribbean Region are noted below.

3.3.2 Innovation

Policy and financial support for innovation is generally not available to MSMEs. UNESCO notes that agencies dedicated to science, technology and innovation are lacking in Antigua and Barbuda, Belize, Dominica, Grenada, St. Kitts and Nevis, St. Lucia and Suriname: "Given the small size of many Caribbean economies, a regional innovation system could prove an effective solution". The Economist Intelligence Unit observes likewise: "…coordination between business, academia and government is essential, but government funding for innovation policy is generally low in the Caribbean, and thus most innovation and competitiveness strategies are funded by international donors. Ideally funding should come from the private sector which is more efficient in stimulating applicable innovation."[25] Imperatives for Caribbean innovation are detailed in Chapter 5, but they are woven into each of the recommendations below.

3.3.3. Improving Worker Productivity

An enlightened, skilled and motivated workforce is another major theme that should underpin the new Policy and Regulatory framework. Hands-on training and in-factory counselling are vital support

[25] Source: Private Sector Development in the Caribbean - A Regional Overview. YEAR?

services required by MSMEs, especially those producing for international markets. More detailed recommendations on improving productivity are presented under the ICT and R&D policy recommendations below.

3.3.4 Increasing the use of Information and Communication Technology (ICT) among MSMEs

A critical path to strengthening productivity and extending market access lies in increased ICT penetration.

Priority initiatives are:

1. Provision of ICT training opportunities for MSME workers and owners;
2. Enhancement of the legal and regulatory frameworks for telecommunications sector development;
3. Establishment of an independent and capable oversight entity for ICT sector development to ensure the maintenance of competitiveness in the industry and enhanced consumer access;
4. Provision of adequate ICT infrastructure especially with regard to broadband development;
5. Expansion of ICT education in schools.

The following recommendations were offered by Regional Executives of the Telecommunications industry:

- MSMEs have to take internet access more seriously. Smaller businesses tend to opt for the lower speed/more affordable internet packages, which limit their ability to exploit the available technologies.
- The mobile platform along with business applications (apps) is also widely available but small businesses use their smartphones mainly for calls and messaging as opposed to using them for business operations. Good practice examples include a small recruiting agency in Jamaica that uses an app to capture business card information via the phone that feeds straight into its database.

  Another medium-sized business is planning to equip its mobile sales team with the capacity to complete application forms on mobile devices instead of using paper; this facilitates automatic information capture and faster processing. Other useful app types include accounting (e.g. QuickBooks), sales tracking (e.g. salesforce).
- Training on how to use these apps is important so that business owners have a chance to learn best practices.
- Through regional public-private partnerships, ICT incubators should be established that encourage the development of 'home-grown' apps made especially for Caribbean businesses.
- The Caribbean should also explore crowd funding/kick starter funding specifically for ICT-enabled innovation.
- Use of card machines can improve growth of MSME sales. However, MSEs may need support from governments, their trade associations and financial institutions in expanding the use of portable point of sale and card machines.
- A Universal Hub is desirable and the technical knowledge, support structure and connectivity to create such a hub. However, there is need for persons to administer the roll out; manage the operations; and commit to supporting it (i.e. trainers, lecturers and sponsors). Training would be a very key part of this offering and online training videos/self-paced learning would be a great option for MSMEs.
- Social media should be exploited and businesses should receive hands-on training on the social media best suited for their business type. Many options exist (e.g. Facebook, Instagram, Pinterest, Reddit and Tumblr). More Caribbean MSMEs should also be exposed to migrating from operating as "bricks and mortar" institutions to online businesses, thereby reducing overheads while broadening their client outreach.

In addition to global successes cited in Chapter 2 (e.g. the EXIM Bank's "Made in TnT' web portal), these recommendations strengthen the case for replicating the policy instruments already initiated by the Jamaica MSME Policy (discussed in sub-section 3.4.3 above). Establishing the regional online university, technical resource directory and information/news web portal will bring major benefits to traditional MSMEs (e.g. farmers, fishers, retailers and manufacturers) as well as to the non-traditional services and creative industries.

3.3.5 Growing the Entrepreneurship Culture through Education Reform

A new policy directive that inculcates greater ICT usage, financial literacy and entrepreneur knowledge content into the kindergarten, primary and secondary school curricula is overdue.

The ILO has developed a training package to teach entrepreneurship in vocational, secondary and tertiary schools, now used in 56 countries of which 18 have integrated Know About Business (KAB) into their national curricula. This follows the introduction of a new curriculum called startUP&go to more than 60 secondary schools in South Africa, designed to foster entrepreneurial attitudes and competencies. Subsequent assessments show that "learners taking the classes seem to be more interested in starting their own business after graduating from schools (a statistically significant increase of 4% as compared to the control group)"[26].

It is recommended that the new Entrepreneurial Studies syllabus include modules on ICT, Financial Literacy, Marketing, Management, Accounting and Innovation. The shift to Business Management should address the skills gaps in Tourism and Hospitality, Agricultural Science, Financial Services and Co-operatives at the supervisory, technical and managerial levels. Renewed emphasis on attracting more students to the vocational trades is also vital in view of the shortage of these skills.

Closer integration with the national TVET programmes will result in expansion of CVQ awards, in sync with the demand by industries for well-trained, skilled workers. As a result, it is anticipated that the brightest minds will be exposed to the rudiments of business and technology. The design of a public policy for entrepreneurial education integrated into every level of the educational system is a major policy and strategic shift that will boost emergence of a business culture, productivity and competitiveness within the Caribbean.

3.3.6 Trade Policy

Given the openness of Caribbean economies, BMC efforts to grow intra-regional trade must be accompanied by efforts to also expand trade into internationally competitive goods and services market. Trade policy priorities that will bring value to MSMEs include removal of inefficiencies in the system, building national and regional capacities and establishing harmonised and common regulatory frameworks.

Specific objectives must be:

- Increasing market access by maximising usage of current opportunities such as those in Canada and Europe; by negotiating new arrangements to new markets in emerging economies; and by assessing and addressing the constraints to future trading arrangements.
- Developing mechanisms for facilitating business and trade, including improving transportation. This demands supporting and facilitating achievement of the single economic space through the removal of the physical, technical, administrative and fiscal barriers to the movement of goods; enhancing trade and transport-related infrastructure and services; and other trade enhancing initiatives.
- Building capacity in the productive sectors points to the continuing need to overcome

[26] Ibid.

the significant human resource and technical challenges that limit BMCs' responsiveness and pace of implementation of their obligations under existing trade arrangements such as the CARICOM-EU Economic Partnership Agreement (EPA).

3.3.7 MSME Model Policy

Given the significant gaps in MSME policy and regulatory frameworks noted above, it is useful to at least identify the essential elements of a regional comprehensive policy and regulatory framework. These essential elements, while not necessarily exhaustive, are presented below:

(i) Roles of Key Institutions

1. Definition of MSMEs and the classifications by size, as set by the Policy;

2. Identification of the different public (for example, identification of a Single Ministry as the focal point for MSME development), private, non-state institutions involved in MSME growth and development, and clarification of the roles of each;

3. Provisions to ensure that representatives of the MSME sector are included in the appointments by the Minister to the Board of Directors and Advisory Committees on Enterprise Development, Productivity and Economic Competitiveness;

4. Clear formulation of the role of the Companies Registry, its mandate, functions and essential data requirements; clarification of relationship with the Statistics Department, the National Insurance/Social Security Corporation, and the Research and Development Units of the lead government agencies and of the BSOs;

5. Enforcement of compulsory registration for all businesses operating in any country, irrespective of age, sector or size;

6. Annual report to the Minister responsible for MSME development on the performance of the Sector;

7. Minimising bureaucracy by establishing a division within the central government Ministry to address the specific needs of MSMEs, including use of the Business 'Superform'.

(ii) MSME Capacity Building

1. Enhanced Capacity building by facilitating increased access by more entrepreneurs (especially women and youths) to online, web-based and other entrepreneurship courses and hands-on technical assistance in key subject areas (as listed earlier), but with a greater role being played by private sector expertise and BSOs;

2. Entrepreneurship training should be provided throughout the formal Education System, with ICT- based training maximised to ramp up learning in schools and in adult education/training for MSMEs workers. Amendments or revisions to the Education Act to ensure closer linkages between the goals of academia and the needs of the national and regional labour markets, including MSMEs' labour requirements;

3. Minimum certification/training/capacity building accomplishments should be prerequisites for accessing Government-supported BDS. For example, Action Coach is a small, Barbados-based consulting company that offers short intensive training for small businesses via an Australian franchise;

4. Provision of assistance to more MSMEs to improve the quality of their statements of financial position, cash flow, capital adequacy, proposal writing and managerial training in order to satisfy the objective requirements for commercial bank financing;

5. Quality assurance standards entrenched in the Bureau of Standards legislation making compliance with food safety, manufacturing, etc., obligatory and no longer voluntary.

(iii) Access to Finance

1. Facilitating increased access to credit unions and identified MFIs as affordable but sustainable, indigenous sources of finance, recognising the unsustainability of 30 year-old models e.g. retail lending by government banks, ministries and corporations; low/subsidised interest rates on loans to MSMEs;

2. Enable increased access by MSMEs and MFIs to an improved financial services system, by including an Electronic Registry for Moveable Collateral, a Credit Bureau and a Junior Stock Exchange;

3. Strengthen and activate innovative financing models that can reach at least 25% of all registered MSMEs, grow surpluses and achieve capital adequacy and sustainability;

4. Set out specific guidelines for the disbursement of relief, seed, angel and other grants to enterprises; and

5. Implement mechanisms that minimise the risks to financial institutions that provide credit to MSMEs, by removing the legal and bureaucratic constraints affecting the smooth enforceability of debt contracts.

(iv) Infrastructural Support Services

1. Institutional strengthening of infrastructural support service organisations (e.g. business support centres, incubators & ICT Parks);

2. Institutional strengthening of specific BSOs registered with the Ministry, including consolidation of some entities and revised mandates for others to achieve effective delivery of needed services including business training, research and development at lower per capita costs; and

3. Access to online training.

(v) Fiscal Incentives

1. Establish the objective criteria for accessing Fiscal Incentives e.g. tax holidays, duty free imports, exemptions from the VAT and company tax;

2. Listing of specific export goods and services targeted for expansion such as creative industries; ICT exports; specific agriculture products with clear presentation of the appropriate supporting initiatives and incentives for expansion;

3. Fiscal incentives that support export growth, foreign exchange earnings and increased technology usage by MSMEs;

4. A reduction in taxes to ease working capital constraints for businesses, and stimulate demand among consumers. Many of these measures are applicable to enterprises of all sizes but can be particularly beneficial to MSMEs.

(vi) Monitoring and Evaluation

1. Inclusion of a robust KPI based Evaluation and Monitoring System for MSME programmes;

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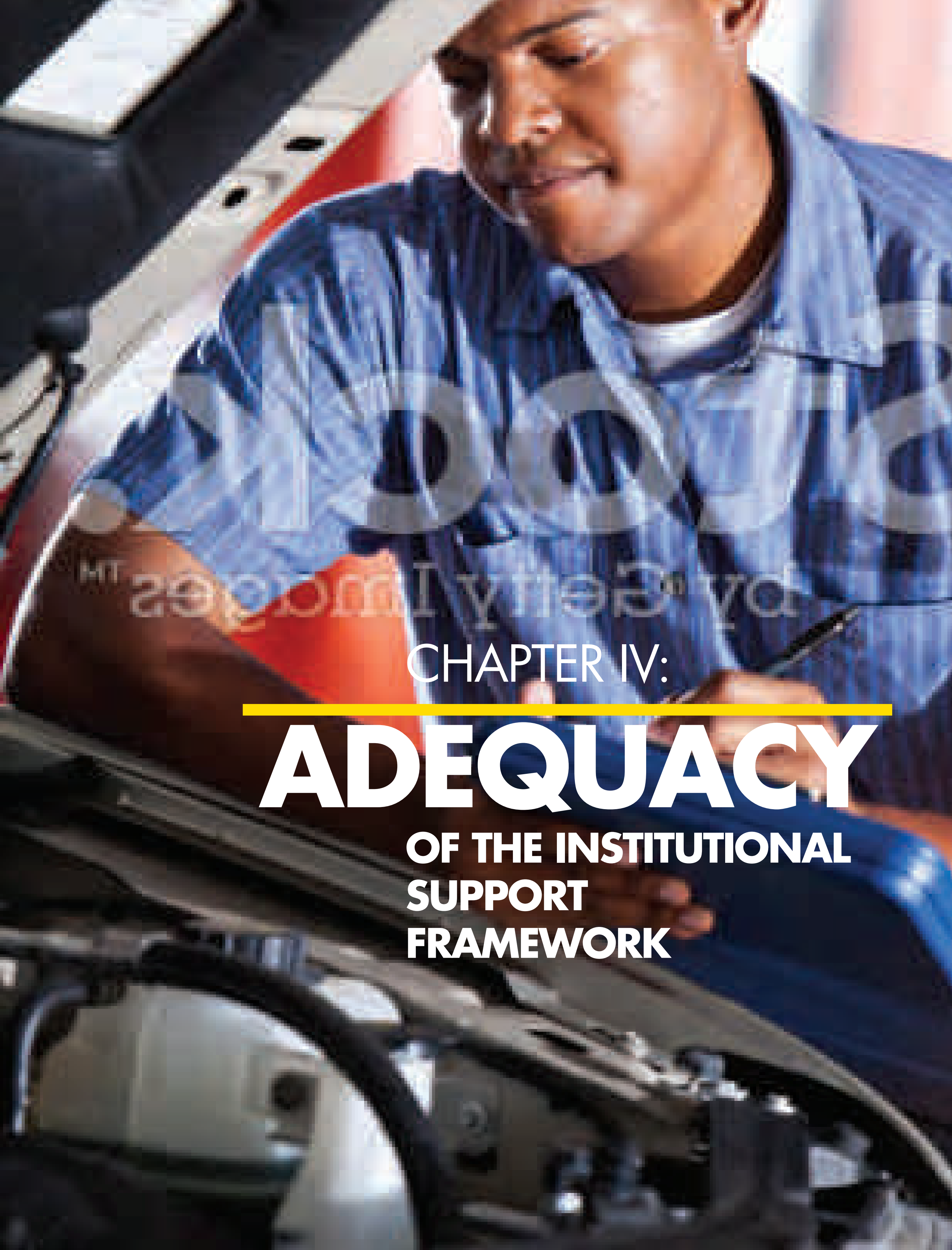
2. Reporting to the Minister of the core Ministry on the output/outcome results per the KPIs for MSME development at the three tiers of implementation: (i) productivity and quality enhancements; job creation and contribution to GDP (First Floor); (ii) strengthening the efficiency and effectiveness of intermediary organisations – BSOs, financial intermediaries etc. (Second Floor); and (iii) impact of the policy and regulatory initiatives (Third Floor).

3. Inclusion of risk analysis and management strategies which identify important risks to Policy implementation (e.g. lack of commitment, inadequate skills and knowledge, financial constraints, economic downturn, etc.) and offer mitigation approaches.

Finally, whereas each policy must reflect regional and international best practices, it must also be crafted to be responsive to the needs of the sector and the actual business environment in each country. The new Act and the Regulations should be passed into law early, avoiding the typical lags and delays associated with the legal drafting and review processes.



CHAPTER IV:

ADEQUACY

OF THE INSTITUTIONAL SUPPORT FRAMEWORK

CHAPTER IV: ADEQUACY OF THE INSTITUTIONAL SUPPORT FRAMEWORK

Having outlined the importance of a comprehensive and robust enabling regulatory and policy climate for the growth of MSMEs (i.e. the "Third Floor"), it is necessary to assess the adequacy and scope for modernisation of the state and non-state organisations that service the growth and developmental needs and demands of the MSMEs ("Second Floor").

Overall, there are several agencies per country providing critical support services to the MSME sub-sector, with very limited financial and personnel resources and hence severe capacity constraints. Additionally, there is considerable duplication of roles, replication of programmes, protection of "turf", with evident variances in delivery capability and sustainability. The analysis below focuses on both the public and private institutional support frameworks.

4.1 PUBLIC SECTOR INSTITUTIONAL FRAMEWORK

4.1.1 Governing Ministry

A strong central ministry is a key coordinating factor leading the governance of the MSME eco-system towards competitive growth and expansion. However, only in Barbados and Trinidad and Tobago has the MSME sector been assigned as a distinct portfolio to a Cabinet minister. It is recommended that one Ministry be given the overarching responsibility for the development and expansion of the Private Sector, inclusive of MSMEs. This portfolio should envision a single Ministry, mandated to serve as the focal point and central hub for implementing the national strategy and action plans, thereby increasing MSME productivity, creating jobs and growing incomes. This Ministry should collaborate effectively with all private sector players; become the exemplar for business-friendly service; facilitation and supervision; and stimulate closer co-operation among the various public sector agencies.

4.1.2 State-run BDS providers

Interviews with MSME stakeholders during the in-country visits and their observations of the public sector agencies providing business development services to the sector generated several perspectives on the need for reorganisation and strengthening, as follows:

1. The "one stop agency" promised by most governments since the 1990s has not materialised. Most MSME operatives continue to find it difficult to access user-friendly information; are often unclear as to "whom to approach for what;" and have to contend with time-consuming processes and forms resulting in loss of business hours and productivity. A minority of regular clients, who are accorded priority status within the available resources, or who "know the ropes", benefit from training, coaching, promotion and/or advice offered by different entities.

2. Whereas business owners and prospective entrepreneurs are usually directed to the lead state agency for MSME development assistance, the extent to which the latter is resourced is a function of the national priority accorded to this

sector; ministerial influence in securing annual budgetary support; and the agency's success in mobilising complementary external funding. Across the BMCs under review, variations were noted in their range of service offerings; internal systems; staffing and sphere of operations/ reach:

a. **The National Enterprise Development Corporation (NEDCO), Trinidad and Tobago,** operates a network of 11 entrepreneurship development centres country-wide, including Diego Martin, Arima, San Fernando, Point Fortin and Tobago. It has a fully staffed Corporate Business Unit in St. Augustine that performs Research and Development functions, and also targets business services to students at the University of the West Indies and the University of Trinidad and Tobago. NEDCO has been effective in providing start-ups with coaching sessions, and has been delivering entrepreneur and business management training, counselling and technical assistance to thousands of existing entities by combining in-house coordinators and technical staff with a roster of subject specialists on-call. It also operates a National Integrated Business Incubation System (IBIS). Its small grants and loans (ranging from TT$50,000 to $250,000[27]) facility has been highly subscribed for more than 15 years. With the economic downturn, government funding has been significantly reduced and the corporation has no experience in mobilising or managing donor funds, having been 100% government funded since its inception.

b. **The Jamaica Business Development Corporation (JBDC)** leads MSME development on Government's behalf, and is mandated to articulate and implement the MSME Policy approved by Cabinet and cleared through Parliament. It employs 105–120 Business Development Officers who perform business model appraisals; guide entrepreneurs to formalize their businesses; and help businesses to get through required regulatory processes. Its incubator system accommodates resident and non-resident businesses.

   JBDC partners with banks and large companies to leverage financial and technical assistance resources, including accessing the Development Bank's (DBJ) "Ignite" Programme which provides grant funding of up to JD4 mn[28] per client on a call for proposals basis by registered businesses under 4 years old and undertaking innovation projects across all sectors. It also teaches business plan development throughout the rural parishes, using a Mobile Clinic; and engages consultants to upgrade business plans; package products; or conduct market surveys. However, by JBDC's analysis, **80% of the businesses in the parishes have never done a business plan and only 14% have business bank accounts, indicating that there is possibly a substantial capacity deficit on the part of JBDC and/or a lack of awareness on the part of potential beneficiaries.** This alarming statistic triggered a Ministerial Task Force which assessed the financing system for MSMEs in Jamaica.

c. **SBDC-BELTRAIDE, Belize** employs five members of staff to service huge demands from over 30,000 registered and informal micro and small enterprises (MSEs) over vast terrain. The Unit is effectively led; proactive in using ICT and social media;

[27] US$1 currently trading at TT$6.30 | [28] US$1 currently trading at J$120

and strong on partnering, networking with financial institutions; proposal writing; and management of donor projects. As in the case of JBDC, there are clearly substantial capacity deficits in serving the needs of the MSME sector. If given additional institutional resources, the SBDC will be able to reach a larger clientele through accelerated implementation of the deliverables in its approved MSME Policy and Strategy.

d. **In St. Lucia,** a somewhat different model is at work as compared with Jamaica and Belize. Three principal agencies serving designated segments of the MSME sector report to the Ministry of Commerce, Business Development, Investment and Consumer Affairs:

- The Trade and Exports Agency (TEPA) provides development support to exporters, export-ready firms and potential exporters. It also administers grants to approved businesses;
- The Commerce and Industry Department assists medium-sized firms especially in the manufacturing and services sectors with on-site advice, facilitation for concessions and other off-site support.
- The SBDC (known as SEDU up to November 2014) is the GOSL's lead agency for business development knowledge and expertise. It offers "a more holistic approach to the development of the Micro and Small Enterprise (MSE) sector in St. Lucia, with the core mission being to help businesses become globally competitive by providing long-term consulting, training, financing and market research solutions that create real economic impact."[29]

However, the latter two agencies experience regular shortfalls in programme funding, while SBDC staffing is admittedly inadequate. A recent consultancy recommended that SBDC should be merged with the more proactive TEPA. However, this in itself would be inadequate to meet the needs of the MSME sector in the absence of adequate human and financial resources.

d. The Enterprise Development Unit (EDU) of Antigua and Barbuda's Investment Authority has been viewed as a model agency for business development in the OECS sub-region. However, since the change of administration in June 2014, the ABIA's role and operations have been lessened, and enterprise development grant funds are being channelled through the Ministry of Finance.

Table 4.3 below indicates that in each of the eight BMCs at least one lead government agency is in place with the mandate to implement the policy direction and related legislation; promote the use of fiscal incentives; disseminate needed information; and extend development services to the MSME sector, including training, coaching and mentoring.

[29] www.commerce.gov.le/

Table 4.1: Eight CDB BMCs - MSME Enabling Policy and Institutions Matrix

Country	National MSME Policy in Place	Enabling MSME Legislation in place	Strategic/Annual Plan Produced & in force	Active Ingredients in Enabling Framework								
				Registry of Certified MSMEs Functioning	MSME Support Unit in Government	BDS Support (Info, Training, TA, Counsel)	MSME Advocacy prominent	Access to Credit/ Finance *(State)*	Access to Credit/ Finance *(Non-State)*	Preferential Public Procurement decreed	Trade and Export Promotion	Compliance with Standards enforced
CDB BORROWING MEMBERS												
Antigua and Barbuda	x	√ (2007)	x	x	√	√	x	√ (Low)	√	√	x	x
Barbados	x	√ (2002)	x	√	√	√	√	√ (Low)	x	x	x	x
Belize	√		√	√	√	√	x	√	√	x	√	x
Guyana	x	√ (2004)	x	√	√	√	x	√	x	√	x	x
Jamaica	√	x	√	√	√	√	√	√	√	√	√	√
St Lucia	x	√ (1998)	x	√	√	√	x	√	x	x	√	x
Suriname	x	x	x	√	√	√	√	√	√	x	x	x
T&T	√	x	√	√	√	√	x	√ (Low)	x	√	√	√

As a result of successes in Central and South America, The Organisation of American States is providing technical assistance to Barbados, Jamaica, Guyana and St. Lucia in strengthening harmonised adoption of its Small Business Development Corporation (SBDC) model.

5. Notwithstanding the potential dislocation in institutional arrangements triggered by changes in political administrations, indications are that most governments will continue to work with the MSME sector through one department or corporation designated as the national lead agency for non-financial enterprise development. This has proven to be more efficient in utilising scarce public sector resources than multiple channels serving MSMEs with overlapping interests. However, in most cases, there is clearly a need for significant ramping up of human, financial and technical resources within public sector BSOs in order to accelerate MSME sector growth and development. In other words, there is urgent need for substantial institutional strengthening.

4.1.3 Rwanda State Agencies

The Rwanda Development Board (RDB), the lead BSO, has embarked on a highly transformative process particularly with respect to regional institutional capacity building, enhancing the efficiency and effectiveness of government support institutions in the provision of business services, and is potentially an example of substantial relevance to the Region. In 2011, RDB took a strategic decision to involve private operators in the management of its Business Development Centres (BDC), utilizing a private-public-partnership (PPP) model, whereby Government retains ownership of the BDCs' assets, and the private operator assumes responsibility for all expenditures.

Four private operators entered into contract with the RDB to manage all 30 district BDCs as follows:

- Africa Development Consultants (ADC): Eastern Province and Kigali City;
- Rwanda Telecenter Network (RTN): Northern Province;
- Agence de Fiscalité, Comptabilité et Courtage (AFICCO): Southern Province
- Business Development Fund (BDF): Western Province.

The developmental services provided by the district BDCs include, but are not limited to:

- Entrepreneurial Development –training entrepreneurs to develop essential skills for professional development; this helps participants to identify, develop and implement business ideas.
- Business Registration –encouraging commercial registration for companies to reduce informality and facilitate closer rapport with the business community by start-up businesses. This service is already in place in eight Centres and will be extended to others.
- Skills Training, Business Advice and Counselling form an important part of daily BDC activities. Participants vary from new entrepreneurs with minimum skills needing general assistance to established businesses to skilled operators in need of specialised knowledge or a specific intervention.[30]

Replication of the foregoing business services model and the delivery structure from post-conflict Rwanda potentially can make a positive and significant difference in expanding the capacity and reach of state agencies and BSOs in the Caribbean.

[30] http://www.rdb.rw/departments/export-development-and-business/business-development-centre.html

4.1.4 Decentralised Government Support via P-P-P – ISRAEL

Another example worthy of note is that of The Israel Small and Medium Enterprises Authority (ISMEA), which was created in 1993 as a partnership between Government ministries, economic organisations and the public. Its main objectives and functions are:

- To promote and implement policies that encourage small and medium-sized businesses and to create tools for assisting them;
- To coordinate all of the institutions and bodies engaged in encouraging small and medium-sized businesses;
- To establish local, regional and professional support centres for entrepreneurs and businessmen and to support and guide them in their activities; and
- To promote the establishment of funds and other financial instruments to assist these businesses.

Programmes and initiatives established by Government include:

- 26 Business Development Centres with 10 Branches operating country-wide, created through the SBA;
- The Israel Export Institute which operates a support centre for small and start-up exporters to increase sales volumes in international markets;
- The Nitsos Programme which focuses on creative growth management and operates facilities employing 10–250 workers; and
- The Governmental Loan Guarantee Fund to assist small businesses through the reinvestment of capital and new investments.

In addition to the provision of advice and training through Development Centres, ISMEA provides courses and workshops especially designed for new businesses.

4.2 RECOMMENDATIONS

4.2.1 Recommendations – State Agencies

1. The core role of the Government lead agencies should be to coordinate the work of the various agencies, and establish funds and other financial instruments to assist the MSMEs.

2. Mindful of the size and continuing growth of the informal sector and building on the successes already achieved, it is recommended that the lead agency in each country:
   - strengthen its capacity to plan, coordinate and evaluate implementation of an increased flow of development initiatives to the sector;
   - collect data/information on critical MSME indicators (number of enterprises in each subsector; age of enterprises; number of enterprises leaving and entering a particular sector; Profitability; Cash Flow; Debt; annual revenue; access to business training, access to finance, number of persons employed, markets to which goods and or services sold (domestic and/or external)) etc. Collection of necessary MSME data is an absolute requirement for improved policy, regulatory formulation and the construction of appropriate institutional infrastructure. The provision of such information annually should be tied to incentives (tax incentives, access to government contracts, etc.) in order accelerate formalisation of the sector;
   - establish an automated database and management information system, with at least one competent Research and Development Officer on staff, as at NEDCO and JBDC;

- provide the Minister responsible with timely and measurable quarterly indicators and analysis on progress made versus set targets and goals; and
- target at least 25% of the MSME populations for business development support within five years.

3. It is recommended that governments be dissuaded from continuing or initiating lending activities through government agencies. Issuing small grants to assist or reward innovators and high performers is acceptable, once based on strictly applied, transparent criteria. However, money lending is the specialised business of licensed or registered financial institutions. Not only does lending detract from the Government's primary focus on providing technical services, but government agencies are not designed to conform to good practice processes in loan screening; securing collateral;, disbursing; tracking; and collections.

4. Engagement of competent private sector firms or networks in PPPs, similar to the Rwanda BDCs, can increase the quantum and range of resources invested in growing the sector; reduce Government expenditure; increase its revenue; and enable the lead agency to focus its energies on higher-end policy refinement; strategy and law enforcement; results-based coordination; sector oversight and planning.

The extent to which each participating agency is deemed to have met or exceeded the ILO's EESE reform methodology will be pivotal to its credibility as the competent authority for driving transformation of the MSME sector. Effective implementation of the activities recommended above will demonstrate that better organised, purpose-driven and productive public BSOs can contribute substantially to reducing constraints by:

- strengthening the management depth, business know-how and self-confidence of more MSME owners;
- improving productivity, efficiency and innovation levels within client enterprises;
- enabling more MSME products and services to penetrate competitive markets, through effective application of expertise provided;
- enhanced synergies and merger/consolidation encouraged among existing private and state agencies; and
- significant improvements in the quality of data generated.

4.3 INSTITUTIONAL CAPACITY – PRIVATE SECTOR BUSINESS SUPPORT ORGANISATIONS

Private Sector BSOs through Training and Educational Services seek to improve trainees' theoretical knowledge, technical skills and attitudes. Their impact is generally increasing as business owners appreciate the importance of new knowledge and contacts to growing their businesses. Whereas full cost recovery is not the norm, MSMEs are now more disposed to invest in employee and management training than a decade ago. However, the lack of full cost recovery can pose a challenge to the sustainability of private sector BSOs, especially in the absence of public sector and/or donor funding.

Marketing Assistance has become a critical demand to increase SME visibility and market access. Trade fairs, trade missions, sale of packaging materials, expansion of international contacts and the introduction of certification for marketed produce have become vital services. The ability to access market intelligence is critical to business success in the new liberalised trading environment. Internet usage and smart phones have become crucial resources for business, as increased use of ICT and social media are providing notable efficiency gains and market growth for both progressive entrepreneurs and service providers.

Generally, one-on-one counselling, hands-on technical coaching and on-the-job attachments are more effective in transferring knowledge, skills and behaviour change, but are more time-consuming and costly. The challenge here is to persuade MSME owners to adopt preventive and early detection measures, instead of seeking help when conditions have significantly deteriorated. Advocacy and Representation are also critical BSO services requiring development. Lobbying for the interests of the sector in the public domain, as well as in the corridors of power require excellent communication skills, reliable research capacity and a good network of contacts. Enlightened companies tend to place a high premium on paying for good advocacy services.

4.4 EXAMPLES OF PRIVATE SECTOR BSOS

4.4.1 UPstart Caribbean - Barbados

UPstart Caribbean's mission is to become the regional leader in public education and advocacy campaigns that excite and economically empower citizens - especially youths and women - to become business owners and social entrepreneurs. The use of an online campaign featuring the dramatised adventures of "Betty", a female entrepreneur, won Silver in the 2016 American Advertising Federation (ADDY) Awards. The 30-second series of video business tips chronicle the fictional adventures of Betty as she writes her business plan; expands sales; and formulates a strategy to deal with competition.

In addition to appearing on Facebook, YouTube and www.upstartcaribbean.com, the audio versions of the webisodes were broadcast on 2 popular radio stations.[31] UPstart Caribbean is a novel movement advocating a culture of support for entrepreneurship.

4.4.2 The $20 BEF (FLOW) Challenge - Barbados

The Barbados Entrepreneurship Foundation (BEF) was established in 2010 from a vision to make Barbados the World's #1 Entrepreneurial Hub. The BEF launched the $20 Challenge to inspire and generate high interest among young students, in particular, about the idea of entrepreneurship. The BEF aims to bridge the gap between learning in school and entrepreneurship by providing an opportunity to students for real life business experience, under the guidance of experienced entrepreneurs. The BEF's $20 Challenge is an annual entrepreneurship competition intent on sparking the spirit of entrepreneurship among 4th and 5th form students in secondary schools across Barbados. It operates as follows:

- Students are loaned $20 to start a business;
- Students are coached through the ins and outs of entrepreneurship by a $20 Challenge Ambassador;
- The Contest runs for ten weeks; and
- The students present their businesses to a panel of judges.

The BEF is led by Peter Boos, Chairman Emeritus of Ernst & Young Caribbean, and a group of local and international entrepreneurs called the E-Team. The BEF structure comprises five main pillars: finance, government policy, mentorship, business facilitation, and education and talent. The $20 Challenge is an initiative of the Education and Talent Development Pillar which is co-chaired by Keith Miller and Derek Browne.

Other Projects include:

- Angel Investor Network;
- Classroom to Boardroom;
- Mentorship Mingle;
- Business Mentorship Portal; and
- WiFi Project.[32]

[31] http://www.upstartcaribbean.com/learn/about-upstart/, http://www.upstartcaribbean.com/resources/roadmap-to-success-show/, http://www.loopnewsbarbados.com/content/young-barbadian-entrepreneurs-win-silver-american-awards | [32] http://bef20dollarchallenge.org/, http://www.barbadosentrepreneurshipfoundation.org/20-challenge-winners/

4.4.3 MSME Alliance - Jamaica

Formed in 2000, this is an alliance of MSME Associations intent on improving the e-business environment for MSMEs through timely information sharing and effective advocacy. The Alliance provides member associations and affiliated businesses with knowledge to enhance their businesses and sustainability over time, from information acquired via attendance at key stakeholder meetings with the Ministry of Industry, Investment and Commerce (MIIC); the Partnership for Transformation; and other organisations. Information provided on policies, laws, regulations and upcoming projects is circulated by email to elicit feedback and to make suggestions for change. Initiatives by support institutions (e.g. HEART-NTA, the DBJ and JAMPRO) are also highlighted and shared with its membership.

Current plans include a committee on Access to Finance; a quarterly magazine to feature sector initiatives; and rating the quality of MSME development support provided by prominent State-subsidised agencies.

Fundamental areas of technical support identified by the Alliance for Government and donors' attention are:

- How to prepare contracts;
- How to track your money;
- How to respond professionally to requests for quotations;
- How to deal with insurance (e.g. employers' liability; goods in transit; employees' liability; and general insurance for a business);
- Clustering or "grouping" to get best deals from insurance and other companies; and
- How to pressure larger businesses that take up to and over six months to pay MSMEs who think they have no recourse but to wait patiently.

4.4.4 Public-Private Sector Collaboration for MSME Development – KKF Suriname

In November 2003, supported by a CIDA-CPEC institutional strengthening sub-project (2003-2005), the Suriname Chamber of Commerce and Industry (KKF), a large private sector body comprising membership of both large companies and SMEs, produced its 2004-2007 Development Strategy seeking to "promote a culture of enterprise". The following is a synopsis of KKF's strategic objectives for SME development:

- An environment that promotes the growth and development of all enterprises, particularly small and medium enterprises (SMEs), identified as the most important providers of employment;
- A tax system that stimulates rather than discourages enterprise;
- Increased awareness among entrepreneurs with respect to international trade trends and enhanced capacity to take advantage of trading opportunities;
- Removal of legal and non-legal barriers affecting the business community; and
- Strengthening of KKF's technical and financial capacity, including the establishment of a One Stop Window to facilitate domestic and foreign investors in accessing the required information and completing the required forms for conducting new business in Suriname; establishment of an online Trade Registry; and formation of a KKF subsidiary, Business Development Foundation (BUSOS), to advance business and trade development services on a fee-for-service basis and to mobilise external funding for enterprise development.[33]

It should be noted that unlike the common practice in many Caribbean jurisdictions, as a Chamber of Commerce and Industry uniting both SMEs and large enterprises, KKF plays a very strong advocacy role

[33] Source: Suriname Chamber of Commerce and Industry, Policy 2004-2007.

on behalf of the private sector as a whole, and is a model worthy of emulating across the Region. Such a framework would impart considerable strength to the regional MSME sector which, in the main, is representationally weak. BUSOS was established as a Foundation in 2002 with the mandate to drive the Strategic Plan and strengthen KKF, by delivering value-added business support services in a commercially sound manner. BUSOS has an 11-member Ddirectors and its President sits on the board of the KKF. Project implementation was timely and as a result:

1. Since January 2006, the One Stop Window–an updated comprehensive database as part of the KKF's Information System–has been in place, linked to automated systems in related Government agencies. The time taken for acquiring business licences has been reduced considerably through a simplified KKF-assisted process. Business licences are now being issued by the Ministry of Development and Planning and the (rural) District Commissioners within 30 days. All other licenses are issued within a fortnight by the Chamber.

2. The KKF is the official Registry of all businesses. The Trade Registry captures comprehensive data of all companies in Suriname.

3. BUSOS produces and manages trade fairs and donor projects; develops proposals; and coordinates training activities. It organises activities relating to financial services sector modernisation, including new bank and credit union products.

4. A Small Enterprise Financing programme, co-funded by the IDB and the HAKRIN Bank, has been implemented by KKF-BUSOS.

Key factors which have contributed to the success of BUSOS as a best practice development centre are:

- Operating in a commercially sound manner to ensure long-term financial viability of its operations;
- Delivery of relevant training and technical support programmes to members and non-members;
- Negotiation and delivery of several donor agency-funded and private sector projects that bring value to KKF members and other customers;
- Building effective networks and linkages with organisations throughout the Caribbean and beyond; and
- Continuous management of national trade fairs, exhibitions and missions.

In 2016, BUSOS continues to operate as an efficient, responsive, self-sustaining development organisation that serves the needs of MSME entrepreneurs throughout Suriname. The sustainability of BUSOS is a point worthy of note. This is due to the fact that while it charges fees for its services, these reportedly are not high and hence affordable. Resolution of the issues of financial capacity and sustainability of regional BSOs is one that needs to be urgently addressed if the MSME sector is to grow and thrive.

Other private sector organisations providing business services to MSEs in Suriname are industrial associations, the Suriname Business Forum and Vocational Training Centres. Membership of the business associations comprises both large firms and SMEs, and provide business development services to their membership. This training is often done in collaboration with the donor community, for example, ILO, CARICOM and other organisations. The training focuses on ICT development; research and development; business clustering; certification; human resource management; and market intelligence, for example, with respect to CARICOM and the EU.

The Suriname Business Forum (SBF), established as a PPP to advance public and private sector dialogue in relation to policy, similar to the Jamaica MSME Alliance, is another institutional development worthy of emulation in the Caribbean with respect to advocacy on behalf of MSMEs.

In 2006, the SBF established the Suriname Business Centre (SBC) to provide online business services to its membership. SBF/SBC is sponsored by the EU. IntEnt, a Dutch funded NGO, also provides business service support to newly established enterprises.

It provides training and coaching on business plans; marketing studies; and implementation plans. It also monitors the progress of startups. Suriname notably also has organisations specifically for support to business women, another institutional development worthy of replication in the Caribbean. These are the National Movement for Women; the National Movement for Women Entrepreneurs and the Foundation for Management and Women's Organisations, which provide advice, assistance, training, project development services, and technical assistance to enhance business productivity.

4.5 RECOMMENDATIONS

1. Policy-makers and the heads of lead agencies should include the private sector (firms, trainers, consultants, institutes and trainers) in the design and delivery of all awareness-building; policy and law reform; training and technical assistance programmes to grow entrepreneurship and modernise MSMEs.

2. Public-Private-Partnerships take numerous forms, but they bring knowledge, expertise and vital information while widening the pool of investment resources for developing more MSMEs. The KKF-BUSOS partnership is a Caribbean model for sustainability that other BSOs may emulate and build on.

3. Business development and product marketing approaches that make maximum use of social media and ICT, appeal more to youths, women, immigrants and other demographics, while keeping costs affordable.

4. Advocacy is a crucial strength that BSOs should develop. Rather than seeking to 'be all things to all people' with limited resources, at least one organisation per jurisdiction should be identified to assume that role. KKF-BUSOS is a good example of successful advocacy. The national lobbying capacity of Jamaica's MSME Alliance should be strengthened as a pilot project, for subsequent replication.

4.5.1 Online Training and Development

The case has been extensively presented for making optimal use of high-speed internet facilities to leverage greater business opportunities at regional and global levels.

Internet-based educational material, business training and certification have been in vogue for at least 15 years. Webinars, for example, are a convenient and low cost means of diffusing knowledge, concepts and experiences to interested global audiences. MSME owners, managers and employees should be encouraged, trained and assisted to utilise their computers and hand-held devices to obtain more practice to address business-related issues.

4.5.2 Free Facebook Training

Blueprint currently provides free online training (on a 24-hour basis) to any entrepreneur, in the skills required to movehis/her business forward. It has more than 50 eLearning modules:

- MSMEs should master the tools to get the most from Facebook;
- MSMEs can learn at their own pace with free eLearning modules;
- They can learn when and where they want, on or off mobile.[34]

4.5.3 Caribbean Business Portal

The establishment and management of a Business Portal linked to the Regional Hub has also been recommended.
This would resolve the longstanding constraint of information asymmetry faced by MSMEs in every BMC, resulting in expanded business contacts and transactions for the entrepreneur. Additionally, Chambres De Métiers et L'Artisanat (Chambers of Trades and Handicrafts; Martinique and Guadeloupe) can be a very useful source of training and business services.

These Chambers of Trades and Handicrafts have been providing information training, technical assistance, marketing and representation to their members for over 40 years; both have achieved ISO 9001 certification. A significant portion of their services delivery is processed via the internet, and is aimed at accompanying artisans in all stages of professional advancement –business creation; training; business development, etc. Both websites provide free translation and enjoy constantly high global traffic. [35]

Now that Martinique has joined the OECS Member States, the opportunities for regional co-operation in business development and trade, utilising information and communications technology-based training modules and consultations, have expanded. Closer collaboration within the Francophone and Anglophone Caribbean will also benefit the budgets of the government agencies and BSOs in the CDB BMCs, by releasing national resources to attend to other crucial business development needs.

[34] https://www.facebook.com/blueprint?_rdr | [35] http://cma-martinique.com/, http://www.cmarguadeloupe.org/

4.5.4 Towards an appropriate regional institutional infrastructure

Further to the recommendations made in section 4.3 above to improve the value-for-money offerings of the current BSOs and state agencies serving at the national level, a complementary structure and approach that can create synergies by tapping into the resources of capable regional organisations and projects seem logical. All initiatives proposed here will have direct outcomes beneficial to the MSMEs themselves:

1. The governance and operations of all support organisations and agencies require supervision. Conducted regionally, and utilising globally accepted criteria, emphasis should be placed on performance monitoring, ranking and disseminating quality information on a predictable frequency in respect of:
   - Ministries and lead agencies in transforming their policy, legislative and regulatory framework;
   - non-financial service providers in delivering training and technical assistance; and
   - financial institutions and related mechanisms in enhancing access to finance.

   The related publication/report will also highlight innovations at all levels of MSME activity. This will keep regional policy makers, legislators and service providers informed and accountable and will motivate them to set positive examples in MSME development.

2. Extensive institutional strengthening is imperative so that Business Support Organisations (BSOs) can benefit from modern business development training and certification. The internal systems of each should be upgraded to meet the growing demands of new entrants. Shared resources and services, amalgamations and mergers, where suitable, with other like-minded but strategic organisations will increase their sustainability.

3. A public-private partnership network should be explored between selected MFIs, Business Development Agencies (BDAs) and BSOs to facilitate a larger flow of domestic resources into MSME growth and expansion. Using Barbados and Belize as pilots, a nexus of 3-4 large credit unions and Fund Access in Barbados.
   Likewise a linking of the four largest credit unions in Belize, BEST, DFC and BELTRAIDE, is also envisaged. With competent pre-screening and post loans assistance performed by competent staff in the BSOs and BDAs, the credit unions will be assisted in setting up special desks or units that specialise in MSME loans. The credit unions' savings-driven and value-chain lending methodologies, already practised in Peru, Kenya, Poland and Brazil can be replicated in the Caribbean.

4. The CIDA-CPEC Regional Model (1999-2005)
   The CIDA-CPEC Programme, completed 10 years ago, has been an effective institutional arrangement for enhancing productivity and competitiveness in Caribbean MSMEs, by building technical capacity, financial sustainability and institutional resilience in selected public agencies, private sector firms and their trade associations at regional and national levels.

   The CIDA-financed Caribbean Programme for Economic Competitiveness (CPEC), implemented 62 sub-projects in six key economic sectors across 15 CARICOM countries (including Suriname and Belize). MSMEs as well as the public and private sector agencies serving them, were by far the major beneficiaries of the human resource development; trade expansion; and institutional strengthening outputs of this highly successful programme.

The St. Lucia-based Regional Office of CPEC exceeded all its contractual obligations by strengthening the capacities of:

- 1,900 large, medium and small companies across the six economic sectors of focus: Tourism, Forestry; Financial Services; Agriculture and Agro-industry; Manufacturing; and Construction;
- over 360 Government agencies, academic institutions, private sector associations and civil society networks; and
- 29,151entrepreneurs, regulators, managers, supervisors, technicians and line workers, approximately 51% of whom were females.

Twenty-four pieces of standards-driven legislation drafted by the Project, were also approved by various governments. Fifteen policy statements and sector strategies were produced, utilizing exhaustive stakeholder discussion, and presented for Cabinet approval, including:

- Tourism Development in Guyana, Suriname, Antigua-Barbuda;
- Visitor Safety and Security in Trinidad and Tobago, Jamaica, Barbados, St. Kitts-Nevis and Dominica;
- Strengthening the skills base and product quality in Construction in seven East Caribbean countries;
- Fisheries Development in Jamaica and Guyana; and
- Financial Services Modernisation and Expansion in Dominica.

It is strongly recommended that the Region attempt, at this juncture, to re-instate a similar programme focused particularly on the strengthening of public and private sector BSOs and training in selected MSMEs.

CHAPTER V: NURTURING INNOVATION IN THE MSME SECTOR

CHAPTER V: NURTURING INNOVATION IN THE MSME SECTOR

5.1 WHAT IS INNOVATION?

5.1.1 Multiple definitions

Wikipedia quotes a definition of innovation as "a new idea, or more-effective device or process", but goes on to say, it can be viewed as "the application of better solutions that meet new requirements, unarticulated needs, or existing market needs. This is accomplished through more-effective products, processes, services, technologies or business models that are readily available to markets, governments and society. The term "innovation" can be defined as something original and more effective and, as a consequence, new, that "breaks into" the market or society".[36]

The World Bank Institute, using a somewhat broader definition in its 2010 report "Innovation Policy for Developing Countries", points out that innovation means technologies or practices that are new to a given society. This means that innovations can be imported and not necessarily created internally. They need not be new in absolute terms. Moreover, management guru, Peter Drucker claimed that "Innovation is the specific function of entrepreneurship, whether in an existing business, a public service institution, or a new venture started by a lone individual in the family kitchen. It is the means by which the entrepreneur either creates new wealth-producing resources or endows existing resources with enhanced potential for creating wealth."

5.1.2 Sources of Innovation

Peter Drucker in his 1985 book "Innovation and Entrepreneurship" lists seven sources of innovative opportunity. They are referred to as: 1) the unexpected, 2) incongruity, 3) process need, 4) industry and market structure changes, 5) demographics, 6) changes in perception, meaning and mood, and 7) new knowledge. In almost all of the preceding examples, innovation is researched-based. It is driven by inquisitiveness to find unique ways to do things differently – shorten the time frame for a given task; increase the accessibility of decision-making information; create and improve product usage; introduce new services; and improve the packaging and delivery of services. The engine of innovation is therefore a culture of inquisitiveness and inquiry that becomes pervasive in society.

Today, there are four main types of innovation, most of which are ICT-based or influenced:

1. Process Innovation. This involves new and deliberate organisational attempts to change production and service processes. Example: Expedia.com and Trip Advisor.com. (It is important to note that these examples are ICT-based innovation solutions.)
2. Product Innovation. This is the introduction of a good or service that is new or has been significantly improved with respect to its characteristics or intended uses. Product innovation is also a key factor for successful market entry in models of creative destruction and Schumpeterian growth. Example: Apple computers and Kindle.

[36] https://en.wikipedia.org/wiki/Innovation

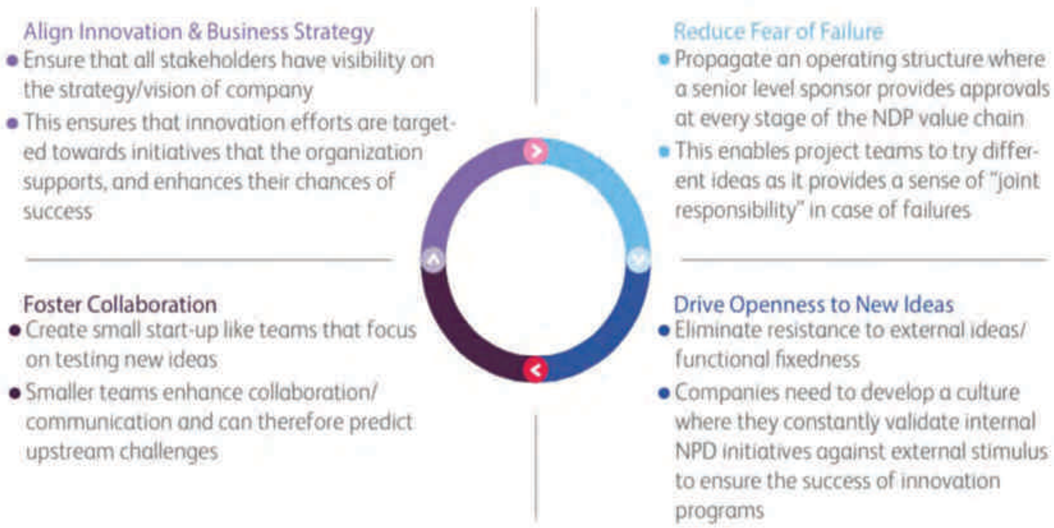
3. Social Innovation. The creation of innovative activities and services that are motivated by the goal of meeting a social need and are predominantly developed and disseminated through organisations whose primary purposes are social. Example: Kickstarter, Facebook.

4. Management Innovation. The invention and implementation of a management practice, process, structure or technique that is new to the state of the art and is intended to further organisational goals. Example: FedEx, Walmart, Carnival Cruise Lines.

5.1.3 The Structured Approach

In the organisational context, innovation may be linked to positive changes in efficiency, productivity, quality, competitiveness and market share. Recent research findings highlight the complementary role of organisational culture in enabling entities to translate innovative activity into tangible improvements. In addition, organisations can improve profits and performance by providing work groups with the opportunities and resources to foster creativity while performing core tasks. The guidelines for organisational innovation are summarised in Figure 5.1 below:

Figure 5.1: Guidelines for Adopting Innovative Processes at Organisational Level



Source: Innovation Management se. Innovation Without Borders: Six Best Practices to Improve Innovation Success Rates.[37]

Innovation by businesses is achieved in many ways, with much attention now given to formal research and development (R&D) for "breakthrough innovations". R&D helps in developing patents and other scientific innovations that lead to productive growth in areas such as industry, medicine, engineering, and government. Yet, innovations can be developed by less formal on-the-job modifications of practice, through exchange and combination of professional experience and by many other routes.

[37] NPD = new product development

However, the more radical and revolutionary innovations tend to emerge from R&D, while more incremental innovations may emerge from practice. However, there are many exceptions to each of these trends.

An important and obvious innovation driver is customers buying products or using services. Increasingly, firms are incorporating users in focus groups (user-centred approach); working closely with so-called lead users (lead user approach); or users might adapt products themselves.

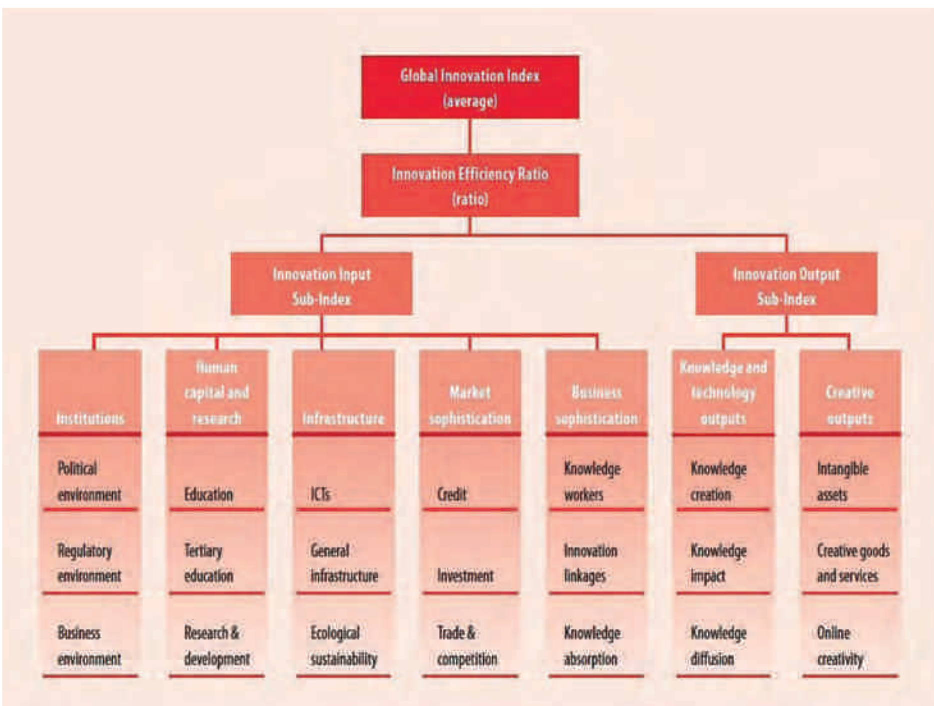
5.2 BEST PRACTICES IN MSME INNOVATION

Best practices in SME innovation are mainly attributed to the models used to support innovation in the USA. However, the country of reference for emerging economies is Israel, but both sets of practices are well advanced, and are therefore difficult to relate to from a developing country perspective.

The Global Innovation Index (GII) is the point of reference for best practices in innovation across the developed and developing world. GII relies on two sub-indices: the Innovation Input Sub-Index and the Innovation Output Sub-Index, each built around pillars. Five input pillars capture elements of the national economy that enable innovative activities: 1) Institutions; 2) Human capital and research; 3) Infrastructure; 4) Market sophistication; and 5) Business sophistication.

Aditionally, two output pillars capture actual evidence of innovation outputs: 6) Knowledge and technology outputs and 7) Creative outputs. Each pillar is divided into sub-pillars and each sub-pillar is composed of individual indicators (79 in total). Sub-pillar scores are calculated as the weighted average of individual indicators; while pillar scores are calculated as the weighted average of sub-pillar scores. The framework is revised every year in a transparent exercise to improve the way innovation is measured. The methodology used is highlighted in Figure 5.2 below.

Figure 5.2: Methodology used to Establish Rankings on the GII



Source: Global Competitiveness Index 2015

There were 141 countries ranked in the 2015 Global Innovation Index (GII). The top five are Switzerland, the United Kingdom, Sweden, the Netherlands and the United States of America (USA) in that order.

Only four of the eight countries surveyed in this study are ranked on the GII. The rankings are as follows:

Table 5.1 Ranking of Selective Caribbean Countries on World Innovation Index 2015

Country	World Ranking	Regional Ranking (LAC)
1. Barbados	37th	1st
2. Trinidad and Tobago	80th	11th
3. Guyana	86th	12th
4. Jamaica	96th	15th

Source: Global Innovation Index Rankings 2015

The other four countries i.e. Antigua, Belize, St. Lucia and Suriname, are not ranked on the index.

Two main policy strands form the core of present innovation policy. On the one hand, there is a need to improve the framework conditions for innovation. These conditions include the business environment, access to finance, competition, and trade openness, as captured in the Innovation Input Sub-Index of the GII model. On the other hand, nations also need dedicated innovation policies, targeting both innovation actors and the linkages among them. Such policies include collaborative research projects, public-private partnerships, and clusters. High-income countries follow a set of dedicated supply and demand-side innovation policies. This entails creating a strong human capital and research base that includes research infrastructures; sophisticated firms and markets; innovation linkages; and knowledge absorption that fosters innovation outputs as captured by the GII.

Under this second strand, direct support for business R&D and innovation is provided in the form of grants, subsidies, or indirect measures such as R&D tax credits. Universities and public research organisations are funded via across-the-board or more competitive funding mechanisms. In addition, there is also renewed interest in demand-side measures.

This interest is evident while using classic instruments such as public procurement, as well as testing out new approaches to promote innovation specific to overcoming key societal challenges in fields such as clean energy and health.

Another new policy development is the focus on creating an "innovation culture" with businesses, students, and society at large. This is meant to spur greater entrepreneurial activity and to achieve a better public appreciation of the role of science and innovation. The design of proper metrics and evaluation strategies of policies is also emphasised. Moreover, formulation and measurement of innovation policies is increasingly treated as a science in its own right. Notwithstanding these developments, finding the right combination between demand and supply measures, and between public and private funding for innovation, remains largely a trial-and-error endeavour.

Although it is tempting to think so, a simple migration of policy mixes developed in high-income countries to developing countries, is unlikely to bear fruit. The reasonis mainly that innovation policies and institutions need to be context-specific, reflecting the extensive heterogeneity and varying trajectories of countries.

Accordingly, a number of differences between developed and developing countries need to be emphasised in this report:

First, the framework conditions for innovation are more challenging in developing countries. Beyond macroeconomic challenges, this often manifests itself in poorer infrastructure; weaker product, capital, and labour markets; and weaker education systems. Ineffective regulatory set-ups that do not provide the proper incentives to innovation are often anobstacle.

Second, for sheer budgetary reasons, the capacity to finance, coordinate, and evaluate a large package of innovation policies is constrained in developing countries. While arguably all components of innovation policy dimensions seem important, tough priority setting isneeded. This is certainly a significant challenge in the Caribbean. Moreover, in the context of developing countries, the innovation policy coordination between various local, regional, and national levels of government is often even more demanding than it is in developed nation states.

Third, the industrial structure of most low- and middle-income countries is usually different, with a greater reliance on agriculture, the extraction of raw materials (Trinidad, Guyana and Suriname), and too few—mostly low-value-added— manufacturing activities (e.g., food processing, textiles), as well as an increasing reliance on services industries such as creative sectors, tourism, transport, and retail activities.Micro- and small businesses play an above-average role for the broader economy potentially for innovation too. Given the structure of the Caribbean's private sector, this is likely to be the case in this region as well.

Fourth, country- or sector-specific exceptions aside, innovation capabilities in developing countries are typically less advanced than those in developed countries.

In developing countries, the human resource base remains comparatively weak. In the Caribbean, the brain drain is persistently high; and innovation actors and linkages between them are usually weaker than in developed countries. Furthermore, public research organisations are usually the only actors engaged in research and often operate in an isolated fashion without links to the real economy, while firms tend to have a low absorptive capacity. In the formal sector, improvements in maintenance, engineering, and quality control, rather than fresh R&D investment, tend to drive innovation.

Also, sources of learning and innovation frequently result from foreign direct investment (FDI), or more frequently, acquisition of technologies developed abroad. Firms tend to have a low absorptive capacity and do not interact with scientific institutions or science more broadly. Therefore, collaborating with external partners in innovation, generally remains an important challenge for companies in developing countries.

5.3 THE MSME INNOVATION LANDSCAPE IN THE CARIBBEAN

5.3.1 Current Status

This section examines the current status of the innovation landscape for MSMEs in the four Caribbean countries that are ranked on the Global Innovation Index: Barbados, Trinidad and Tobago, Guyana and Jamaica. It should be noted that the issue of improving the Access to Finance component has already been addressed in Chapter 2.

In Barbados, the commitment to innovation is embedded in that country's Human Resource Development Strategy 2011–2016 under Chapter 6.0 –Enhancing Research, Innovation and Entrepreneurship. In that regard, the Government of Barbados (GOB) has taken the view that "innovation and entrepreneurship are grounded in the application of scientific research principles to solving, social, economic and development challenges".[38]

[38] Section 6.1 Science, Innovation and Entrepreneurship, page 62 of the Barbados Human Resource Development Strategy 2011–2016.

The GOB has recognised the importance of investments in research, innovation, and entrepreneurship as providing a competitive advantage in an increasingly global economy. This priority is underlined in Goal 2 of the National Information and Communication Technologies Strategic Plan of Barbados (2009-2015). This goal envisions support for innovators, for development and research of technology infrastructure, and the development of technical and entrepreneurial skills.

This relatively definitive position suggests that Barbados, although heavily dependent on Services, has opted to take the educational/ scientific approach to innovation policy, rather than emphasise user-experience innovation as the driving force behind its innovation agenda. The position is reinforced by the Government's statement that "through the HRD Strategy, Government envisages the enhancement of science, technology, and innovation policies to facilitate the fostering of a culture of research and innovation from as early as primary and secondary school, through to tertiary level education. To achieve this, emphasis will be placed on reinvigorating science education at all levels of the education system, as well as building human capacity in science, technology, research, and innovation through a system of education, lifelong learning, professional development and training which will involve the enhancement of the functions of several associated agencies".[39]

The commitment to innovation is supported through the following mechanisms:

1. BDS3 mn committed to the University of the West Indies over three years to support the development of a research programme at the postgraduate level;
2. The intent to create science and technology parks, and the harnessing and exchange of information along with enhancement of knowledge management systems;
3. A focus on innovation in agriculture on the basis that a high level of development can only occur if there is close cooperation and interaction between scientists, extension advisers, growers, and agriculture-related industries;
4. USD $2.5 mn set aside in 2003 for the Innovation Fund, managed by the Enterprise Growth Fund Limited that provides seed capital in the range of USD 12,500 -125,000 to assist entrepreneurs with the implementation of commercially viable project ideas. The fund was also used to coordinate the National Innovation Competition, which encouraged management and other personnel to think outside the box in enhancing the competitiveness of their businesses.
5. Enhanced policies and programmes, which target the SME sector and provide incentives to drive more extensive use of research, development, and innovation. This includes enhancement of the national innovation competition to ensure that more innovative products and services reach the realization stage, and are ready for export and development of a programme for the implementation and marketing of innovative products and services.
6. The leveraging of ICT-related research-oriented activities including the continued development of linkages with the Caribbean Knowledge Learning Network (CKLN), which supports the development of national research and educational networks.

[39] Ibid.

Barbados owes its high ranking to its ranked status Pillars "business sophistication" and "institutions". According to the IDB 2014 country PSAR, Barbados was ranked second in terms of technological readiness within the benchmark group of countries in 2013-14, largely owing to high Internet penetration rates and availability of technologies.

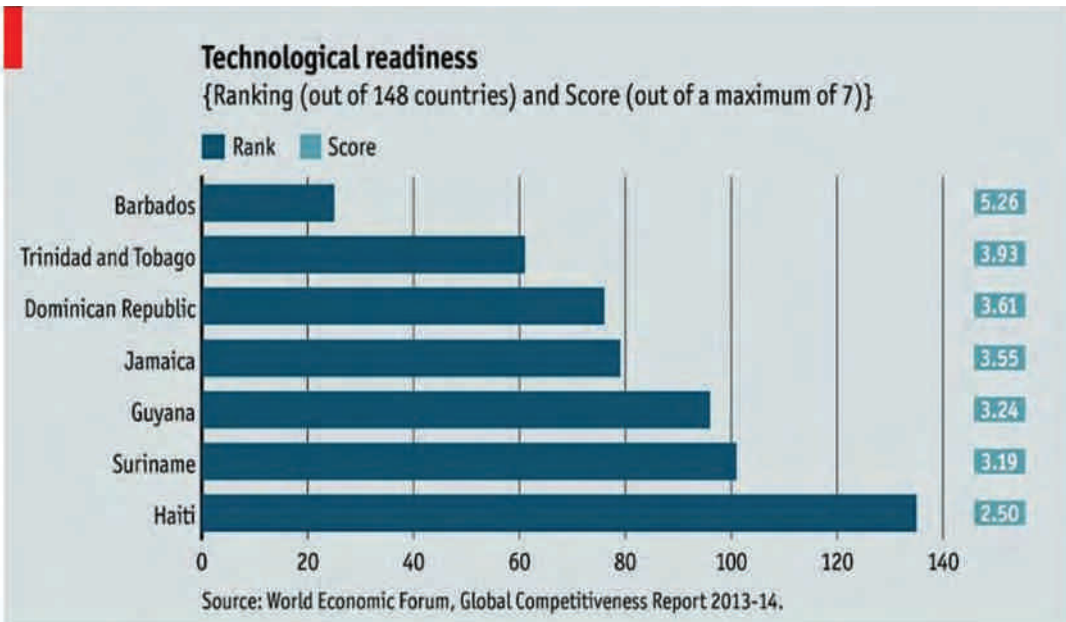
The Technology Readiness Index, compiled by the World Economic Forum (WEF), is based on indicators of the availability of the latest technologies, firm level technology absorption, foreign direct investment and technology transfer, Internet use, broadband Internet subscriptions and Internet bandwidth.

Relative to its benchmark group, Barbados had the largest proportion of firms with their own website.

The only indicator in the index on which Barbados lagged behind its peers was that for the use of technology licensed from foreign companies. This may suggest that there is scope for greater collaboration with overseas firms.

Figure 5.3 below highlights Barbados' technological readiness – relative to that of other Caribbean countries.

Figure 5.3 Technological Readiness



Companies in Barbados have access to technological platforms that can enhance the efficiency of their enterprises. On the downside however, corporate investment in innovation lags significantly behind investment in technology. In terms of company spending on Research and Development (R&D), Barbados was ranked 78th out of 148 countries in this category in the WEF's 2013-2014 Global Competitiveness Report.

It should be noted that the modest level of investment in innovation is not a result of limited availability of appropriately skilled personnel, as Barbados boasts the highest scores for availability of scientists and engineers among its benchmark group of countries. Given the importance of services in the domestic economy, this could suggest that R&D expenditure may not accurately capture the extent to which firms are innovating.

However, the low level of R&D expenditure does reflect the dependence of local firms on the domestic market, and is an area in which further policy support is required.

One of the driving forces behind Barbados' alignment with R&D innovation is the National Council for Science and Technology (NCST), which promotes the assimilation and adoption of science in a lecturing and debating series; dissemination of S&T information; popularization of science; and an annual Caribbean Youth Science Forum (CYSF). NCST publishes "The Monitor" through which Science and Technology (S&T) professionals are given the opportunity to publish articles on similar topics. Also, since 1998, NCST has been hosting biennials of "Sci-Tech Xpos" for students to showcase their research efforts in this field.

Overall, while such initiatives have fuelled the shift toward applied priority technologies such as solar power usage through joint ventures between UWI and foreign private firms, there is no integrated innovation policy or strategy and the impact in Barbados has been modest at best.

In Trinidad and Tobago (T&T) there have been systematic attempts to develop a cohesive approach to Innovation since 2001:

- In 2001, a National Task Force on Science, Technology and Innovation Policy produced a report on the subject of a national innovation policy.
- In 2004, the then Ministry of Science, Technology and Tertiary Education (MSTTE) developed a Draft Policy on Science, Technology and Innovation.
- In 2005, a seminal paper was presented at a conference in Peru[40]. At that time, the Vision 2020 Sub-Committee on Science, Technology and Innovation (STI) had proposed that Trinidad and Tobago develop a National System of Innovation (NIS), with the application of knowledge to production as itsfocus;
- In 2006, the National Institute of Higher Education, Research, Science and Technology (NIHERST) created a similar report.
- A draft national policy on science andtechnology was developed in 2007 by NIHERST.

Since Independence, Trinidad and Tobago has been steadily building institutional capacity. The number of STI based institutions in the country substantiates this commitment –the University of the West Indies (UWI); the University of Trinidad and Tobago (UTT); the College of Science, Technology and Applied Arts of Trinidad and Tobago (COSTAATT); the Caribbean Industrial Research Institute (CARIRI); Trinidad and Tobago Bureau of Standards (TTBS); the Caribbean Agricultural Research and Development Institute (CARDI); the Institute of Marine Affairs (IMA); NIHERST etc.

But the challenge was that not enough attention was being paid to stimulating the demand side for knowledge in the productive sector, i.e. in local firms and in the productive sectors. In 2005, a National Innovation System (NIS), as a dynamic interconnected system with interaction, learning, linkages and information flows, was seen as central to success. The key pillar of this strategy was intended to be the creation of an independent National Council on Science, Technology and Innovation (NCOSTI) that would be the NIS conductor, bringing the players together (i.e. Institutions, the Firms, Government, NGOs, Policies and other enabling instruments). But even if a relevant institution were actually assigned responsibility for leading and directing innovation research effort, the underlying constraint was that the manufacturing sector had "near zero investment in R&D" and that Government investment in R&D was very low (about 0.13% of GDP).

[40] See: "Building a National Innovation System for Trinidad and Tobago – a Vision 2020 Perspective" by Clement K. Sankat of UWI.

Since then, T&T has made progress towards the development of an Integrated Innovation System, but that progress has been uneven. For instance, in 2008, the Government of Trinidad and Tobago (GOTT) decided to create its own version of Silicon Valley, by investing an estimated USD150 mn in the Caribbean's first Science and Technology Park, i.e. the Tamana InTech Park. This initiative has had mixed results, achieving far less to date than the level of investment would warrant. EtecK, which manages the Park, points out that Phase One of the 1,100-acre park facility is complete, and that spaces are available for ICT/BPO, high value manufacturing, clean technologies and business services.

However, a May 2015 World Intellectual Property Organisation (WIPO) study entitled "Integrating Intellectual Property into Innovation Policy Formulation in Trinidad and Tobago"[41] summarised the current status of the country's innovation system as follows:

- The innovation system of T&T is fragmented with little coordination among actors;
- Strategies tackling innovation are well drafted and ambitious, but have deficiencies in the translation into operative goals and activities;
- Overall innovation and intellectual property (IP) performance is low;
- One of the main reasons for low innovation performance is the "Dutch" disease. Success in gas exploration means that much of the competitive pressure and needs to invest in other sectors have been lifted/neglected;
- There are IP hotspots and positive deviants particularly in the creative sector, as well as in a small number of research institutes and firms;
- The level of integration of IP issues in the innovation system differs across institutions, but is generally rather low;
- There is little overall Intellectual Property Rights (IPR) awareness and also observable differences across industries;
- Business intermediaries seem to have little IP know-how and services;
- There is a lack of clarity as to ownership of research results and that has proven to be a barrier for commercialisation;
- Incentive systems for researchers at universities are based mostly on academic performance (publications), which is a barrier for IP-related commercialisation activities;
- There is no equivalent of the U.S. Bayh-Dole Act in the Caribbean. Enacted in 1980, the Act created a uniform patent policy among federal agencies that fund research, enabling small businesses and non-profit organisations, including universities to retain title to inventions made under federally-funded research programmes;
- There is a lack of trust in institutions, e.g. whether they would honour IP created by others;
- Access to finance and funding sources are an issue; and
- There is a shortage of legal Intellectual Property Rights services and expertise in the country.

While the study had an IP orientation, it implied that the overall system was not well organised; that there was limited knowledge about the use of IP in innovation activities; and that there was a lack of trust between institutions on intellectual property. Overall, then , these findings suggest that Innovation is still at a relatively nascent stage of development in T&T.

In May 2013, the Minister of Finance announced the Government's intention to develop a National Innovation Policy, and added that it would also finalise a new ICT plan for 2012–2016. Yet the challenge of creating an innovation culture remains daunting. Despite the progressive importance noted at senior policy and technical assistance levels, there is limited entrepreneurial exposure and use of innovation in T&T.

[41] "Integrating Intellectual Property into Innovation Policy Formulation in Trinidad and Tobago" by Alfred Radauer, Technopolis Group, Austria, for WIPO, 5th May 2015.

A study entitled "Towards Economic Diversification: A National Innovation System for Trinidad and Tobago" published in October 2013, was based on a survey of 100 business enterprises, and concluded that: 1) 86% of total early-stage entrepreneurial activity did not incorporate any new technology; and 2) 87% of enterprises were offering products that were not new to any of their customers, reflects the limited adoption of innovation in T&T.[42] Also, the National Innovation System (NIS) that was proposed in 2005 was still not yet established in 2013.

In 2014, the Inter-American Development Bank, in collaboration with the Government of Trinidad and Tobago (GOTT), established a project entitled "Support for the National Competitiveness and Innovation Agenda". The project has four components: 1) financing support for private sector innovation including support for innovation in existing firms, and assistance for business incubation and acceleration; 2) research and technology support including mission-oriented research carried out by academic institutions and the strengthening of technology transfer offices; 3) sector-specific innovation policies including support for innovation agendas in three priority industry clusters; and 4) institutional development and capacity building including capacity building in innovation policy at MPSLD and NIHERST.[43]

Also in September 2014, the Government announced the introduction of a TTD50 mn Innovation Fund to be utilised as matching grants for the innovation needs of companies. However, the Fund's effectiveness has not yet been assessed within its first year of operations. The Government also confers bi-annual awards, established in 2000, for innovative science and technology projects via NIHERST.

Such awards have included initiatives creating 1) a safe oil and water paint remover; 2) a music CD learning tool for CXC students; 3) a Smartphone Application for finding lost keys; 4) Mobile Osh Inspection App; 5) a biocatalyst for the removal of greenhouse gases; and 6) a drinking straw holder.

Guyana has one of the lowest GDP per capita, but stands out because of its relatively high ranking on the Innovation Index in Latin America and the Caribbean (12th). An early indicator of Guyana's status was its rankings on Innovation and Technology in the 2010 World Bank Enterprise Surveys.

Table 5.2: Comparative Innovation and Technology Status for Guyana

Indicator	Guyana	LAC	All Countries
Percent of firms with an internationally-recognized quality certification	29.5	16.3	18.1
Percent of firms using technology licensed from foreign companies	17.4	14.4	14.6
Percent of firms having their own website	46.1	42.1	45.6
Percent of firms using e-mail to interact with clients/suppliers	92.5	79.9	73.1
Percent of firms with an annual financial statement reviewed by external auditors	90.4	61.7	48.5

Source: World Bank. 2010 Enterprise Surveys (Guyana).

[42] See: "Towards Economic Diversification: A National Innovation System for Trinidad and Tobago, page 70 by Natasha Ramkissoon-Babwah. ACRN Journal of Entrepreneurship Perspectives, Oct. 2013. | [43] Various reports have been referenced to support this project including "Assessment of the National Innovation Ecosystem" and "Assessment of the Innovation System in Trinidad and Tobago" but these are deemed to be confidential documents and are therefore not available for reference or circulation.

For each of the five indicators, Guyana ranked higher than all LAC countries and also surpassed the average for all countries: i.e. percentage of firms with internationally-recognised technology quality certification; percentage of firms using technology certified from foreign companies; percentage of firms having their own websites; percentage of firms using email; and percentage of firms with audited financial statements (Table 5.2).

Guyana scored highly on the 2015 GII under the Pillar "business sophistication", in terms of both knowledge workers and firms offering formal training, and in terms of royalty and license fee payments. It also scored highly under the Pillar "creative outputs" in terms of national feature films as a percentage of total population and creative export goods as a proportion of total trade.

According to the 2014 IDB PSAR, Guyana is in the early stages of becoming a hub for the provision of business process outsourcing (BPO) services. Qualfon, the first company to provide such services in Guyana, employs over 1,700 people in a call centre, and plans to expand in the near term. Guyana offers an educated labour force that speaks English as its first language, and has competitive wage rates—factors taken into consideration by investors when deciding where to locate. Successfully expanding BPO services will require complementary investment in information and communications technology, as well as in research and development.

According to the WEF's Global Competitiveness Index (GCI), Guyana needs to invest in mobile broadband technology. The country also needs to take advantage of the opportunity offered by BPO services. This report suggests that an assessment of the specific needs of BPO firms and complementary services, be performed. This would identify gaps in infrastructure and know-how that need to be filled to enable Guyana to take full advantage of investments in BPO. The experience of other countries, e.g. Jamaica, indicates that a concerted effort to facilitate the expansion of the services sector requires the participation of both public and private actors.

Additionally, the information and feedback from innovation stakeholders in Guyana is limited. Lance Hinds, President of the Georgetown Chamber of Commerce and Industry, points out that "technology-driven knowledge management industries could be the cornerstone of [Guyana's] future". The Chamber's position is that ICT can transform lives in Guyana. Hinds noted that if the ICT plan is to be successful, it must be placed in a priority position in the overall plan for National Development. Therefore, it should be based on two fundamental pillars: 1) the growth of ICT as an independent sector; and 2) its application as a cross cutting component in other sectors. These include education, health, science innovation and creative industry.

Another potential area of innovation lies in Guyana's low carbon development strategy (LCDS), and its orientation towards innovation in agriculture. Local and international investors have given seed funding to establish a loan fund for development of low carbon enterprises, dubbed the Rupununi Innovation Fund. The United Kingdom's Department for International Development (DFID) has also launched a GBP 1.3 mn project to support growth in non-traditional agriculture and aquaculture.

The Science Unit of the Education Ministry, the National Centre for Educational Resources Development (NCERD), in collaboration with the Office of the President, has coordinated the development of a National Science and Technology Policy and Master Plan for the Socio-Economic and Environmental Advancement of Guyana. This was approved by Government in 2014. So far, draft science and technology indicators have been developed. However, Guyana has not yet established a cohesive framework for innovation overall.

Jamaica, was ranked 96th on the 2015 GII and 15th within the LAC region, and is addressing its innovation system from various perspectives. The core strategy and reference point for an innovation framework in Jamaica is the National Development Plan (NDP) – Vision 2030.

The plan addresses innovation in various sections, and includes a number of performance indicators. When the plan was completed in 2009, it included the following observations about innovation in Jamaica:

Low levels of investment in R&D. The country spends less than 1% of GDP on R&D, although it claims to have "path-breaking work" in agricultural research and has expanded the science infrastructure. Lack of a National Innovation System. Linkages between key players in the innovation process are weak or in some cases non-existent, when compared to innovation processes in the developed world.

Protection of Intellectual Property. Jamaica already has the basic legal framework for protection of IP. However, the framework has a number of weaknesses, including limited capacity of collection agencies and other institutions; high levels of piracy; and low public appreciation of the importance of IP rights.Limited role of government. The NDP states that the government could provide a greater catalytic role through adoption of ICT and e-government technologies, but that it lacks a specific vision or agenda for science and technology development.

Human Resource Development. The Plan points out that secondary school examination pass rates are particularly low in subjects that are critical for technological progress, including Mathematics and Sciences. Jamaica acknowledged that it had a low capacity for enquiry-based approaches to learning, and that scientific enquiry is not a core component of teacher training. Technology deployment and usage was curtailed by a combination of human resource factors including high illiteracy rates; loss of ICT skills due to migration; as well as low skill levels and high technology anxiety among the elderly.

Inadequate data on ICT industry The NDP calls for more data on ICT usage at macro and micro levels. The main strategic approach to addressing these constraints was to focus on the establishment of a world class National Innovation System (NIS) which was to include: 1) creation of finance and incentive mechanisms to attract research; 2) promotion of STI capacity formation and inward technology transfer; 3) creation of knowledge parks and centres of excellence; and 4) investment with the private sector in research infrastructure.

The institutional framework to support innovation is extensive. It includes: 1) the Ministry of Science, Technology, Energy and Mining (MSTEM); 2) the National Commission on Science and Technology (NCST); 3) the Science Research Council (SRC); 4) the Ministry of Education (MoE); 5) University of the West Indies (UWI) and UTech; 6) HEART Trust/NTA, the national training agency for vocational training; and 7) the Ministry of Industry, Investment and Commerce (MIIC), which oversees the work of the Bureau of Standards; the Jamaica Intellectual Property Office; and the Jamaica Business Development Corporation.

Other entities involved in promoting and facilitating innovation include: Start-Up Jamaica; the National Foundation for Development of Science and Technology; the National Innovation Awards; the Technology Investment Fund; and an R&D tax credit scheme operated by NCST. Also, the University of Technology (UTech) has a School of Graduate Studies, Research and Entrepreneurship (SGSRE) and an incubator facility at its Technology Innovation Centre. Likewise, UWI has a Mona Office for Research and Innovation (MORI).

Given such an extensive range of innovation-related support institutions, how well has Jamaica done in terms of actually fostering innovation nationally? In the 2015 GII, Jamaica scores highly under the Pillar "market sophistication" where it was ranked 11th in the world for Ease of Getting Credit. Other attributes include ease of starting a business under the "Institutions" Pillar; domestic resident trademark application under the "Creative Outputs" Pillar; and computer software spending as a percentage of GDP, under the "Knowledge and Technology Outputs" Pillar.

With a ranking of 79th out of 142 countries for technological readiness in the GCI, Jamaica is outperformed in this area by Barbados (25th), Trinidad and Tobago (61st) and the Dominican Republic (76th). Jamaica received a below average ranking overall for the innovation category (at 83rd) in the GCI. This is in spite of the fact that Jamaica has an above average ranking for the quality of scientific research institutes, at 48th. However, the 2014 IDB Private Sector Assessment Report (PSAR) on Jamaica, points out that to be competitive, Jamaican businesses must strive for higher levels of productivity, which can be attained through innovation and utilization of technology.

An October 2015 WIPO report notes that:[44]

- Jamaica has a very ambitious and complex overarching development strategy with 'Vision 2030' that tackles also the innovation dimension. However, the 'vision' may be over-ambitious and there are issues with respect to implementation, including the planned development of an S&T Strategy, which is delayed.

- Aside from the creative sector, overall innovation is low. There are IP hotspots in the creative sector, and also in some research institutes such as the UWI, and UTech. The nutraceutical industry, the app development and games/animation industries, as well as the upcoming logistics hub are fields of opportunities.

- The level of integration of IP issues in Jamaica differs across institutions, but is relatively low. There is little overall IPR awareness in the majority of institutions. However, the creative sector has strong IP awareness on copyright issues and a strong anchoring of IP topics.

- Linkages between research and industry, including incentives, are weak.

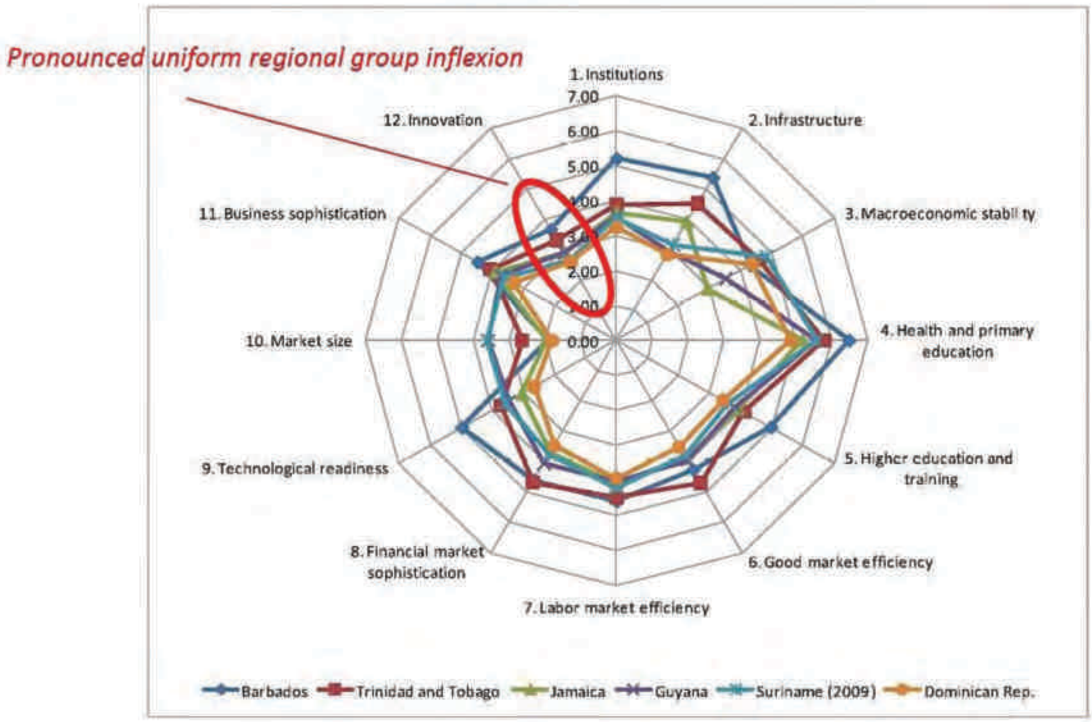
- Access to finance and funding sources is an issue, which is exacerbated by the tight public budgets and the current IMF requirements.

- Legal IPR services particularly in relation to patents and respective expertise are in limited supply.

These findings are corroborated in a 2012 presentation by the Digital Society of Jamaica –"Overcoming Barriers to Caribbean Innovation".[45] Overall, the capacity of Caribbean firms for innovation displays a marked inflection on the Global Competitiveness index as depicted in Figure 5.4 below.

[44] See: "Integrating Intellectual Property into Innovation Policy Formulation in Jamaica" by Alfred Radauer, Technopolis Group, Austria for WIPO. October 5, 2015. | [45] See: "Overcoming Barriers to Caribbean Innovation": Towards a Restructuring of the Innovation Payoffs" by Silburn Clarke. June 19 2012.

Figure 5.4 Caribbean Firm Capacity for Innovation in Six Countries



Source: World Economic Forum. Global Competitiveness Index 2010 and Silburn Clarke "Overcoming Barriers to Caribbean Innovation" June 2012

Regionally, innovation support has emerged, but is still relatively underdeveloped. There is no CARICOM Innovation Policy and the region's commitment to innovation is confined to a March 2007 policy paper on Science, Technology and Innovation for Sustainable Development sub-titled "Caribbean Regional Policy Framework for Action".

There are two main regional initiatives on innovation: 1) InfoDev's USD20 mn Entrepreneurship Programme for Innovation; and 2) Compete Caribbean's Innovation Challenge Fund. It was not possible to carry out an in-depth assessment of either programme. However, the IDB/Compete Caribbean has noted that its Innovation Fund has had limited effective coverage in the region to date.

5.4 MISSING LINKS IN THE APPROACH TO MSME INNOVATION

5.4.1 Industry or Services?

The most important finding on innovation in the Caribbean is that the region has attempted to adopt wholescale a techno-centric focus with respect to innovation rather than a more eclectic approach, which could lead to the application of more innovations in the economic and social sectors. It is very difficult to imitate the approach of developed countries to innovation without the matching resources (skills, finance, institutional infrastructure, etc.).

Therefore, the Caribbean needs to redefine its own innovation path.As the preceding innovation profiles of the four Caribbean countries listed on the Global Innovation Index reveal, all are orienting their innovation policies towards R&D and ICT development. Moreover, despite commitments to establish national innovation systems, each of the innovation strategies being pursued is still fragmented. In that context, the world is replete with lessons learned about R&D focused innovation.
Consequently, there are many reports on this subject that provide poignant examples of the strategic orientations of both developed and developing countries in this area.

In the 2014 study "Innovative Activity in the Caribbean: Drivers, Benefits and Obstacles", the authors conducted an econometric analysis of manufacturing firms based on the 2,771 firms interviewed in 2010 by the World Bank for Enterprise Surveys[46]. The findings were that:

1. There are indeed productivity differences, regardless of the definition of productivity, between innovative and non-innovative manufacturing firms in the region.

2. Firms not spending money on innovation tend to be less productive, although they are also more heterogeneous in their productivity.

3. While there are economies of scope, size appears to be less an obstacle to undertaking innovation in the Caribbean than in Latin America.

4. The fact that neither group of firms has patents or cooperate with other firms is worrisome – although this is not the only metric that can be used to evaluate innovation activity.

5. Foreign-owned firms are not more inclined than those domestically-owned to invest in innovation. This is probably because their innovative activities generally take place in their country of origin.

6. But in the Caribbean, larger, mostly foreign firms nevertheless introduce more innovative techniques than domestic ones, perhaps creating the opportunity of spillovers to local firms.

7. Investment in innovation appears to be as successful in the Caribbean as in Latin America, in the sense that it translates into the introduction of new products and/or processes.

8. Most importantly, new products and processes increase productivity in the region, and the return may be larger than in some, but smaller than in other Latin American nations.

Overall, the study showed that the benefits to investing in innovation in the Caribbean, are not too different from those found in much larger Latin America nations.

Such findings and lessons are valuable, but perhaps not the most appropriate points of reference to use as the basis for developing sustainable innovation frameworks in the region.

There are three main reasons for this:

1. First, the region's economic engine is driven by Services - not industry. With little exception, all of the region's economic statistics point to the increasing emphasis on services. In Barbados, services contribute up to 83% of GDP; in Jamaica, the sector accounts for nearly 80% of GDP.

[46] Impag Business School Working Paper Series. "Innovative Activity in the Caribbean: Drivers, Benefits and Obstacles" By Preeya Mohan, Eric Strobl, and Patrick Watson.

And even in petroleum-driven Trinidad and Tobago, it accounts for 42% of GDP (petroleum accounts for 45% of GDP). Furthermore, the region has been quite innovative in the provision of services – especially in offshore education (as in Grenada and the rest of the Eastern Caribbean) and in health tourism (as in the establishment of Health City in the Cayman Islands). Health tourism and offshore education represent potentially high-value sub-sector diversifications within a now maturing traditional tourism sector.

2. Second, while it is true that some countries still retain capacity for further manufacturing sector growth, the trend towards Services in almost all countries seems irrevocable and so the share of Services in GDP will continue to grow in the foreseeable future.

   Therefore, emphasis on service sector innovation is arguably more likely to offer greater value to the region than innovation in industry.

3. Third, Services have so far been pulling down the average productivity of the region – making the area less competitive than it needs to be[47]. This challenge is compounded by the fact that most of the sector consists of, and is served by MSMEs. This is of major concern – not just to the Caribbean – but to highly developed economies as well[48].

   In contrast, the OECD countries have found ways to infuse higher productivity into the growth of Services in those economies (e.g. Uber, Facebook, online training services, etc.)

Given the sheer scale of Service sector development in the Caribbean, it is logical that innovations in Services are likely to: 1) represent a better "fit" between existing capabilities and investments than in industry R&D, and 2) have much larger impacts, in terms of the contribution to future economic growth, especially since Services have been growing while Manufacturing has been on a downward trajectory for some time. It must be emphasised that focusing on Services Innovation does not exclude manufacturing or product development, since Services are intertwined with product development in numerous ways.

For example, an industrial engineer develops the technological basis for Fab Labs (services), but Fab Labs then need to be manufactured, and used by designers (services again), who produce custom made products (manufacturing again) which need to be marketed (services again).

To date, the evidence of MSME initiation and/or adoption of innovation practices in services have been positive but uneven:

1. In Dominica, it was discovered that there were 125 innovations between 2005 and 2009 in the tourism sector in product (55), marketing (39), process (24) and organisational management (7) - although Dominica does not even register on the Global Innovation Index.[49]

   In that country the innovations in services were largely successful, mainly because they were autonomously started from the bottom up, ensuring strong ownership and follow-though by the various project initiators, most of whom were young entrepreneurs.

2. There have been at least 12 cluster projects in the Caribbean region since 2005 – mostly funded by USAID. These include: a) value adding agricultural or agro-processing projects in Dominican Republic, Guyana, Haiti,

[47] See: "Innovation and the New Service Economy in Latin America and the Caribbean" by Luis Rubalcaba in June 2013, Baumol's Cost Disease, pages 9 to 13 of that report and "Is there a Caribbean Sclerosis"? by Ruprah et al. | [48] See: "The Past, Present and Future of Economic Growth by Dani Rodrik. Global Citizen Foundation. Working Paper 1, June 2013. | [49] See: "Innovation in the tourism sector: A case study from the Commonwealth of Dominica". Nia Cherrett for ECLAC. June 2011.

Grenada, the OECS region and in Jamaica; b) tourism projects in Jamaica; and c) an ICT project (EtecK) in Trinidad and Tobago[50].

Some projects (e.g. the Jamaica Cluster Competitiveness Project coordinated by JEA) have been much more successful than others (e.g. the Grenada Nutmeg SME Project coordinated by GIDC). The underlying reason for success or failure is the degree of elimination of ambiguity in the roles and responsibilities of participants in each cluster group. In contrast to the Dominican innovation projects, most of these cluster initiatives were driven from the "top", i.e. by donor-funded projects whose longevity did not extend beyond the various lives of the respective projects. Also donor support for cluster projects has since waned, and there is limited support for such initiatives today.

3. The use of pre-designed ICT services by the MSME sector is also producing positive results. Smaller hotels in the tourism sector, which account for most of the hotels in the sector, have moved away from travel agencies and instead have tapped into commercial websites like Hotels.com and Expedia to reduce booking fees for stay-over visitors. According to Expedia, room bookings for smaller hotels have increased by as much as 30%, and net revenue per visitor has actually improved in this sub-sector.

The IDB report "Innovation and the New Service Economy in Latin America and the Caribbean", identifies key lessons learned about Innovation in Services that are relevant to the region – especially because that sector is the dominant force in regional economic activity[51].

Elements that help promote innovation in all areas exist at the crossroads of sectoral innovation in service, service-oriented innovation activities in business, and service innovation co-production through specific services or a special use of services. Examples of these elements are the rapid emergence of knowledge-intensive business services (KIBS), and the development of new technology, together with the associated ICT services of particular importance to organisational innovation.

The importance of services in modern economies calls for the formulation of service innovation policies. Service innovation policies should address gaps in productivity and competitiveness, in the most important economic sectors.

Services can create new advantages for some developing countries, including those hosting offshoring services (e.g. in Barbados, Jamaica, and Guyana), and service outsourcing from developed economies. New and improved services can provide competitive advantages in countries that have traditionally concentrated on commodities or tourism. Service innovation can reinforce existing competitive advantages (e.g., better service logistics associated with commodities trading), and create new types of services (e.g. ICT off shoring services). However, such arguments may not suffice to justify public policies aimed at improving service innovation. Perhaps the strongest argument for the dismissal of a focus on Services Innovation is that "Industry is the key sector to promote". This argument is partly valid for countries that have already established strong industrial development strategies (e.g. Trinidad and Tobago). However, policy makers should consider promoting Services Innovation given that: 1) all manufactured products need innovative services such as design, marketing, logistics, etc.; and 2) the economies of the Caribbean are service-sector driven.

[50] Cluster Best Practices for the Caribbean": Private Sector Development Discussion Paper No.5. OTF Group. September 2010. |

[51] The exceptions are Trinidad and Tobago and Guyana and Suriname but even in those countries Services i.e. tourism is growing at an above average rate and is therefore likely to become far more important as an economic driver in the future than it is today.

Given the Caribbean's economic orientation, the absence of an emphasis on Services Innovation as a regional priority is glaring: For example the Caribbean Tourism Organisation (CTO) promotes the US billion dollar tourism sector, but puts limited focus on promoting innovative services that feed off or support that industry.

5.4.2 The Export Dimension and Opportunities for MSME growth

The opportunities for export growth by Caribbean MSMEs are especially strong for the adoption of innovative business solutions in Services, once idea-generating activities are actively fostered. There are three primary areas of possible exponential growth:

1. Culture and Creative Industries (CCI). The significance of these industries is highlighted in a December 2015 Ernst and Young (EY) report, "Culture Times – the first global map of cultural and creative industries", for the International Conference of Societies of Authors and Composers (CISAC). Interestingly, CCI revenues worldwide exceed those of telecom services (USD 1,570 billion globally). CCI employs 1% of the world's active population with the top three employers being visual arts, books, and music. Digital cultural goods are by far the biggest revenue source for the digital economy, and cultural production is young, inclusive and highly entrepreneurial. Also, creation is driven by small businesses and individuals, i.e. MSMEs, and generates agile and innovative employers. Most importantly for the Caribbean where youth unemployment is especially high, CCI contributes significantly to youth employment and CCI careers are open to people of all ages and backgrounds.

   In the Caribbean, the culture and creative industries are organic, robust and dynamic. Noticeably, CCIs function autonomously without "targeted" government support. Reggae, Steel Pan, Calypso, Carnival and other ethnic festivals, have emerged as highly innovative and sustainable products and services in their own right. International exposure and coverage are increasing exponentially as many aspects of Caribbean culture are cross-pollinating into other global settings (e.g. Nigeria, Uganda, South Africa and Japan). In recent years, new music genres have emerged in Grenada, Barbados and other parts of the region as well – organically through the cultural evolution of those societies.

2. Offshore education. The Caribbean, especially the Eastern Caribbean is now a well-established hub for offshore medical education. Recent years have witnessed the sale of 50% of St. Georges University for USD 750 mn to private investors in Canada. Increasingly, the industry now makes use of online lecturing services to address the specialty needs in its curriculum. The growth of the industry has been strong and will remain so – primarily because of the acute shortage of medical practitioners in North America and the aging of the Western World's population. However, MSMEs need to be more effective at leveraging this comparative advantage – possibly through ICTs – into: a) strengthening and diversifying its now conventional tourism products and services into health tourism, and b) increasing its international training offerings by them in non-medical services on an international scale.

3. Business Process Outsourcing. So far, Business Process Outsourcing (BPO) has been limited to the establishment of call centres around the Caribbean – initially in Jamaica but now in Guyana and in some Eastern Caribbean countries. However, the leveraging of this sub-sector into higher value added services remains largely untapped. The scope for MSME IT/ICT-related BPO services includes Application Services (application development and maintenance, system integration, IT infrastructure services such as help desks, data centre services, etc., and IT and network consulting).

They also include Engineering Services (upstream product engineering, downstream product engineering and software product development) and Business Process Services (horizontal processes such as call centres, human resource management, finance and administration, vertical processes such as banking insurance, travel, etc., and knowledge process outsourcing such as animation, data analytics, legal process and patent research). The reason why BPO is so important to Caribbean innovation is that: 1) MSMEs can develop direct or indirect support services to the sector in almost every area of activity noted above; and 2) the advancement of these types of ICT services in the Caribbean will strengthen the region's capacity for "idea generation" and therefore to innovate in other areas of business, such as the CCIs and offshore education and training.

Of course, there are other potential areas for MSME innovation – agro-processing, app development, advertising and marketing etc., but the three preceding sectors currently offer stronger opportunities for innovation growth. Recommendations on the prerequisites for fostering MSME participation in these sectors are highlighted under section 5.4.3 and section 5.4.5 advancing and re-Thinking the approach to innovation, below.

5.4.3 A Framework for Service Innovation Policies

Most Caribbean countries recognise the importance of service sector development, but there has been limited examination of the types of policies needed to foster service sector innovation, especially for MSMEs.[52] Essentially, there are three main policy approaches aimed at facilitating Services R&D and Innovation: a horizontal focus, a vertical focus, and a systemic policies approach. Each approach emphasises different orientations for R&D policy, innovation policy and non-innovation policy. But for MSMEs in the Caribbean, the main priority is the need to send policy signals that confirm that governments are encouraging and rewarding MSME innovation in services. Possible policy options are highlighted in Table 5.3 below.

Table 5.3 Options for Framework for Service Innovation Policies

Policies	Horizontal Approach	Vertical Approach	Systemic Approach
R&D policies	1. Open existing R&D programmes to service companies 2. Increase accessibility of existing R&D support schemes (to service providers) 3. Include Services in technological foresight and road mapping exercises 4. Include Service firms in policies aimed at improving industry/ sciences relationships	1. Support public R&D in services 2. Introduce vertical R&D programmes aimed at services sectors (tourism, business services, and public services). 3. Develop Service IPR instruments 4. Create dedicated centres and clusters for Service innovation 5. Increase role of the Humanities in Service innovation	1. Introduce service innovation elements in existing topics (R&D for ICT and related services) 2. Understand and support role for R&D services in innovation systems 3. Support Services R&D in hybrid firms 4. Pay attention to tech and non-tech R&D innovation in Services

[52] Some countries, like Jamaica, Trinidad and Tobago and Barbados have identified the creative industries as a sub-sector for innovation and others – like Grenada and other OECS countries, have facilitated offshore education investment. But such initiatives are not deliberately linked to Service Sector Innovation Policies, none of which have been established yet.

Table 5.3 Options for Framework for Service Innovation Policies cont'd.

Policies	Horizontal Approach	Vertical Approach	Systemic Approach
Innovation policies	1. Increase accessibility of existing Innovation support schemes to Service SMEs 2. Innovation management training and practices also geared toward Service sector firms 3. Mobility schemes (aimed at scientists and engineers) become inclusive of Service expertise	1. Introduce courses in services innovation management at Higher Education Institutions (HEIs) 2. Develop and activate awareness campaigns on services innovation 3. Identify services innovation role models 4. Develop innovation policies specific to priority service sectors (tourism, offshore finance, BPO) 5. Promote innovation in offshoring services	1. Ensure that business support services also support Services innovation 2. Use Knowledge Intensive Business Services (KIBS) 3. Increase transparency in KIBS markets 4. Develop insight into int'l competitiveness of Service functions 5. Cluster/network strategies that include Services 6. Govt. procurement to include Service innovation
Non-Innovation policies	1. Increase coverage of Services in regular and R&D and Innovation statistics	1. Use deliberate polices for fostering R&D and innovation in Services 2. Use regulations that might trigger Services innovation 3. Analyse offshoring in Services conditions	1. Use regulation and standardization to support innovation 2. Modify financial and credit systems to acknowledge intangible assets 3. Support policies aimed at increased entrepreneurship

Source: Adapted from "Innovation and the New Service Economy in Latin America and the Caribbean". L. Rubalcaba, June 2013.

Table 5.4 below provides a synopsis of examples of Service Innovation Policies in five successfully developed and developing countries.

Table 5.4 Options for Framework for Service Innovation Policies

Type of Economy	Country	Main Innovation Policy Characteristics
Developed Economies	Finland	Leading country in service innovation policies. Very innovative and dynamic policy. Specific programmes since 2001. SERVE programmes focus on promising service companies and pioneers on the markets; "Pioneers of Service Business 2006-2013, 224mil. Euros). Key areas from 2011: natural resources and sustainable economy; vitality of people; intelligent environments; business in global value networks, added value by solution-based services and intangible concepts, renewing services and production by digital means.
	Germany	Policy addressed to services, mainly linked to manufacturing industries. Export orientation. Specific programmes for service innovation. Huge support from industries. 2008 Programme "Innovation in Services," 15 m per year. Current focus on ICT related services, knowledge-intensive services, biotechnology, nanotechnology, hybrid services, utilizing technology and innovative service elements
Developing Countries	China	Decision to go for services and service innovation. 12th Five-Year Plan on S&T Innovation for Supporting Service Sector Development. Focusing on technological support, S&T innovation support, and industrialization of achievement of S&T for modern services. Priorities on producer services, emerging services, S&T services. Wide set of policies for supply and demand. Policy experimentation. First experimental actions related to tax deductions.
	Korea	Service R&D Promotion Plan developed in 2010. Service innovation mainly promoted through services R&D specific programmes: • Education R&D Programme (5 billion KRW, 1 Euro =1500 KRW) • Healthcare & Welfare Service R&D Programme (9 billion KRW (2012)) • Tourism & Contents Service R&D Programme (6 billion KRW (2012)) • Business Service R&D Programme (55 billion KRW (2012) • SME Service R&D Programme (20 billion KRW (2012)) • Public Service R&D Programme (5 billion KRW (2012) In this plan, the new growth high-value service industries were selected as target investment service areas.
	Jordan	Modernization of services sector programme: three years (2009-2011) with a budget of €16 million. Comprehensive policy development plan for services. Beneficiaries of the programme are private service sector enterprises—SMEs—relevant business associations, and public sector bodies. To assist Jordan to fully benefit from the opportunities of trade liberalization of services in the context of the GATS and the economic integration objectives of the Istanbul Protocol. Private Services Sector Development: Support to SMEs and Business Associations in the Services Sector (grant schemes for start-ups, loan guarantee, export credit guarantees and venture capital, risk capital fund, clusters). Institutional capacity building. Service policy building. All services are included but particular attention to knowledge-intensive services, creative and cultural services, tourism, engineering services and health travel.

Source: Adapted from "Innovation and the New Service Economy in Latin America and the Caribbean".
L Rubalcaba. June 2013

5.4.4 Conclusions about the Caribbean's Innovation Framework for MSMEs

The preceding findings on innovation in the Caribbean can be summarised as follows:

1. Generally, the larger and/or more developed countries are aware of the importance of innovation to future economic growth. However, basic support structures are incomplete and are not as well organized as they could be in terms of their comprehensiveness in supporting MSME innovation initiatives. In particular, Caribbean countries do not have the equivalent of the Bayh-Dole Act, which fosters collaborative research between educational institutions and MSMEs in the United States.

2. For the most part, Caribbean countries' innovation programmes are mis-aligned with regional economic trends, and development of innovation is seen much more as an industrial rather than a service sector initiative.

3. The importance of directing innovation support to Services cannot be over-emphasised. Although Services is the leading economic sector in the region, its low productivity is depressing overall productivity and competitiveness, which ultimately affects GDP growth. Therefore, innovation frameworks that are directed at this sector are exceedingly important mechanisms for addressing competitiveness and growth in the region.

4. There is no coherent roadmap for re-aligning Innovation policy towards Services Innovation. Essentially the region is almost at "ground zero" in terms of the establishment of a policy framework to support Services Innovation Policies.

5. Services Innovation is not going to emerge or happen simply because Services is the dominant sector in the Caribbean.

   A policy framework has to be developed and innovation in services has to be deliberately promoted and rewarded at national levels.

   Therefore, considerable work has to be done in communications and education to successfully restructure national innovation efforts towards Services.

Notwithstanding these observations, there are promising signs of a growing enthusiasm in the private sector – especially among younger entrepreneurs– for promoting their innovative ideas as sustainable business models. For instance, the innovative Ignite Project in Jamaica recently received more than 300 MSME responses to a Call for Proposals for creative and unique projects in Jamaica. But the re-thinking of Innovation Policy priorities, especially in support of MSME initiatives in Services, will require considerable technical assistance from international and regional donors, given the limited knowledge that is "on the ground" on this subject in the region.

Commercial progress is also being made at the business level. The Caribbean is experiencing growth in CCIs, in offshore education and in BPO services. There are also promising signs at the digital level. Bitt, the Barbados-based digital asset exchange/remittance channel/merchant-processing gateway, is the front-runner in the Caribbean's crypto-currency eco-system. It received USD1.5 mn from Avatar Capital, a Caribbean investment group based in Trinidad and Tobago. The Bitt Exchange is a cornerstone project for digital finance in the Caribbean. It facilitates trade between traditional and digital currency markets. According to Gabriel Abel, Bitt's CEO, "the company is creating the platform for very low cost international commerce and remittances between the people who need it most – the millions of unbanked and under banked citizens of the Caribbean".

Admittedly, similar initiatives that arise in other countries tend to be one-off success stories and are not yet representative of the outputs of cohesive national innovation systems.

Moreover, the Caribbean needs to pursue more vigorously the MSME opportunities that are linked to Offshore Education and to BPO services. In that regard, strong active policies need to be articulated to realise that goal (see Tables 5.3 and 5.4 above).

5.4.5 Advancing and Re-thinking the approach to Innovation

Three groups of recommendations emerge from this discussion on Nurturing Innovation in the MSME sector in the Caribbean.

1. Firstly, countries that are committed to innovation should complete the establishment of national innovation systems (NISs) and institutionalise those systems by integrating them into national development plans; national and sector strategies; and support programmes. The "tipping point" countries are Trinidad and Tobago and Jamaica. In that regard, it is critical that Caribbean countries consider the introduction of the equivalent of a Bayh-Dole Act – which would encourage local universities to engage in joint research initiatives with MSME investors and to retain or share title to the resulting inventions with the private sector.

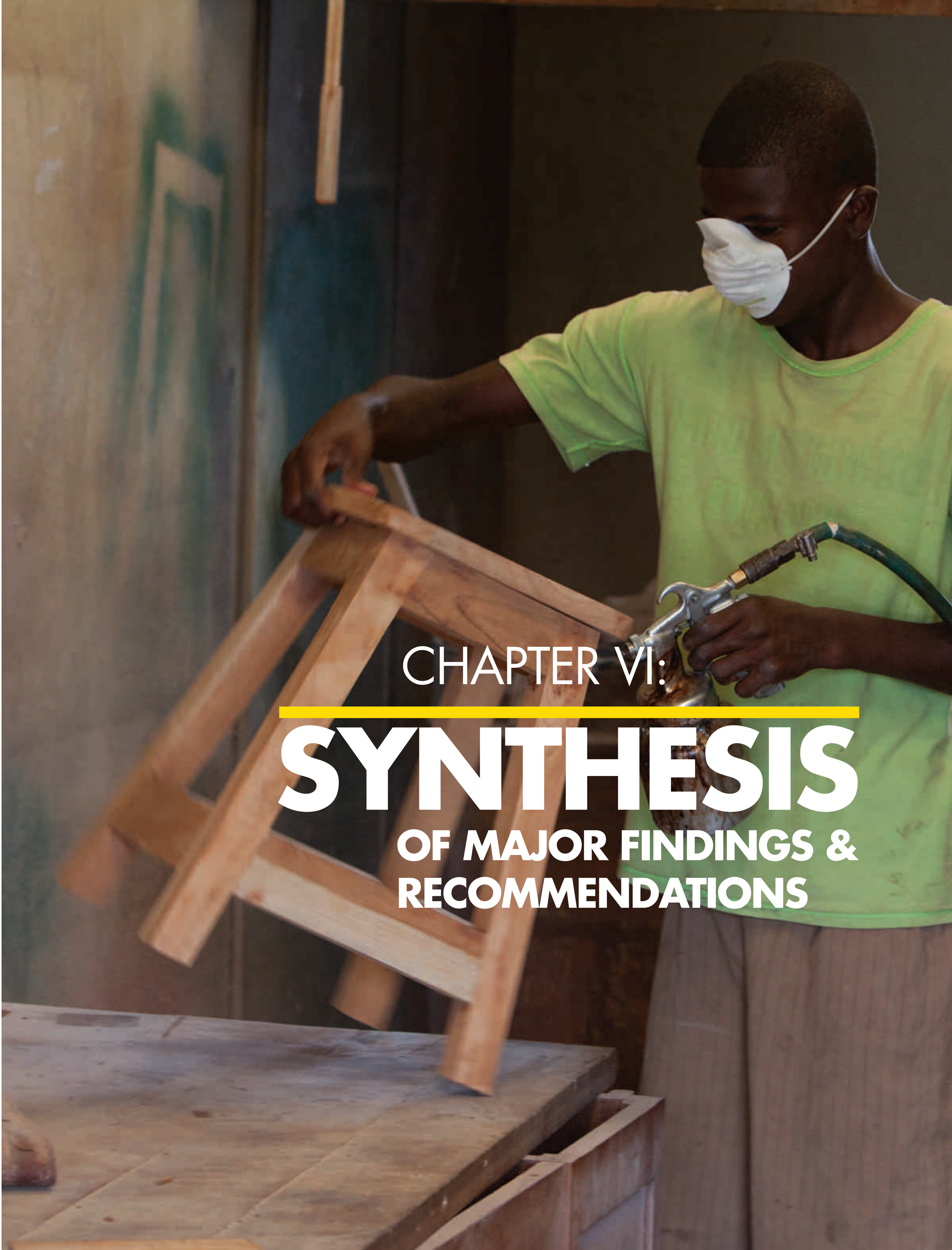
2. Secondly, the Caribbean should re-think its innovation orientations from an R&D manufacturing/industrial focus to one that is primarily driven by or linked to Services. This would include cultural and creative industries such as music entertainment, craft and service and product design. Jamaica, and to some extent Trinidad and Tobago, are both doing this – but without clear Services Innovation Policies or NISs. In other words, innovation in the Services sector needs to be highlighted as national priorities by the Caribbean governments and confirmed via deliberate articulation of service sector innovation policies.

3. Thirdly, operational frameworks for supporting innovation should articulate clearer support for MSME investment in sectors that offer the strongest opportunities for innovation in the Caribbean, for example: 1) Culture and Creative Industries; 2) Offshore Education; 3) Business Process Outsourcing.

   There are numerous issues still to be addressed. These include fiscal incentives to invest in training services and in creative education; access to financial resources; the introduction of international standards for training institutions; international certification systems for firms and employees; increased infrastructure capacity, such as Business Parks and broadband capacity; and ICT literacy for MSMEs. Such initiatives all need to be substantially expanded on a national basis. The implementation of such eco-systems will "signal" that the region's support for innovative initiatives in the foregoing sectors has been solidified and that MSMEs are being encouraged to orient their businesses in those growth areas. As noted earlier, the introduction of such policies needs to be effectively communicated to the MSME sector, to ensure that they are aware of the support that Governments are prepared to provide to their investments in the three sectors.

Based on the contents of the various Framework options presented in this study, it seems that the vertical approach in Table 5.3 would be the most relevant approach/framework option for many Caribbean countries – on the proviso that SMEs are increasingly exposed to/made eligible for support under deliberately designed innovation Support Schemes for the Services sector.

Also, on the basis of the profiles proffered in Table 5.4 above, it could also be concluded that the most appropriate model to investigate would be Jordan's because: 1) it includes the entire set of "starter" programme elements associated with a focus on Service Innovation in the Caribbean; and 2) the Caribbean has the institutional infrastructure in both the public and private sectors to develop a similar Services Innovation initiative.



CHAPTER VI:

SYNTHESIS

OF MAJOR FINDINGS & RECOMMENDATIONS

CHAPTER VI: SYNTHESIS OF MAJOR FINDINGS AND RECOMMENDATIONS

6.1 OVERVIEW

Chapter 6 provides a summary of the major findings and recommendations emerging from the research carried out in Chapters 1 through 5. This synthesis includes the main issues emerging from: 1) the MSME sector profile, 2) access to finance, 3) the regulatory and policy framework, 4) the institutional support framework, and 5) nurturing innovation in the MSME sector.

Each group of findings and recommendations is provided in sub-sections 6.2 to 6.6 below.

6.2 OPTIONAL DEVELOPMENT PATH FOR THE MSME SECTOR

Chapter 1, Regional MSME Sector Profile, provided a cascading overview of the regional MSME sector – beginning with a summary of global economic trends and their impacts on Caribbean economies, followed by a general overview of the MSME sector globally. These findings were used to chart an optimal development path for the sector over the next decade.

6.3 FINDINGS AND RECOMMENDATIONS

Chapter 1: Optimal Development Path for the MSME sector:

6.1.1 Use of a three-tiered approach to MSME development strategy. It was recommended that the MSME Development Strategy should adopt the three-tiered approach effectively implemented in Singapore, Korea, Western Europe, Costa Rica and other successful countries during the past two decades:

- First Floor: support at the first floor, focusing on productivity and product quality enhancements among MSMEs to strengthen competitiveness, job creation and GDP.
- Second Floor: strengthen and modernise the efficiency and effectiveness of organisations and other intermediary structures providing developmental and other services to the sector.
- Third Floor: formulating enabling policies, legislation and strategies thereby improving the business friendly environment for MSMEs.

6.1.2 Adoption of a standard definition and classification for MSMEs. A uniform typology for MSMEs across the Region will greatly facilitate consistency in the registration and analysis of MSMEs as a distinct growth sector. The recommendation is that microenterprises be classified as those with 1–5 employees; small enterprises as those with 6–15 employees; and medium enterprises as those with 16–50 employees.

6.1.3 Extension of the information gathered /coverage of business registries. A regionally interconnected Registration Network of Intellectual Property and Companies with the capacity for accepting online registrations should be established to accelerate the pace of MSME formalisation; with a wider set of indicators (for example, amount and source of capital, targeted markets, amount of employees and gender, etc.) to inform policy at the national and regional levels; to enable regional initiatives for sector development; and to improve the region's 'Global Competitiveness' and 'Doing Business' rankings.

6.1.4 Engagement in more in-depth MSME research and development. A specialised unit should be established within the state agency or ministry responsible for MSME development to conduct on-going sector research. The unit should interface with the registry and help provide reliable and current statistical and anecdotal data on the MSME sector to inform policy makers, planners and financiers.

6.1.5 Analysis of expenditure by MSMEs. CDB's BMCs should attempt to estimate annually the contribution of the MSME sector to GDP, specific sectors, employment, foreign exchange earnings, etc. This will allow the Region to establish the economic impacts and benefits of the MSME sector and to inform both new and modified approaches to MSME policy.

6.1.6 Establish a new policy direction. Government resources should concentrate on sector research geared towards enhanced policy formulation and implementation; quality standards enforcement; agency and programme coordination; performance monitoring and information dissemination; and liaison with donor agencies. In addition to promoting entrepreneurship development through a more equitable fiscal incentives regime and other initiatives, the new policy initiatives should embrace the shift towards concentration on "first floor" results (enhanced innovation, productivity, competitiveness).

6.1.7 Explore avenues to strengthen BSO delivery capacity. Numerous BSOs, both public and private, occupy the Second Floor (provision of developmental and other resources to MSMEs), in many cases performing valuable work. However, they face substantial constraints such as limited financial resources, weak internal capacity and resistance to organisational change.

Strategies for strengthening BSOs involved in business development and/or advocacy are addressed in Chapter 4.

6.1.8 Need for enhanced focus on innovation and enhanced productivity (First Floor issues), especially in the services sector and those subsectors with good export prospects such as creative industries, offshore education, health tourism, etc. Innovation strategies are discussed in Chapter 5.

Chapter 2: Improving MSME Access to Finance

6.2.1 Develop training programmes aimed at enhancing the capacity of MSMEs to improve financial management of their operations in line with financiers' information needs. This is the main challenge that MSMEs face –the capacity to demonstrate that management of their businesses and resources are "information based" and that they have institutionalised such approaches to running their operations on a day-to-day basis.

6.2.2. Expand the range of financial products available to MSMEs. Governments should expand the range of financial products offered to MSMEs in the BMCs along similar lines to those offered to MSMEs by OECD countries[53]. This can be achieved by accessing and re-deploying under-tapped institutional funds such as the NIS and the proposed Dormant Account Scheme in Jamaica. The most important mechanism is the creation/ expansion of Credit Guarantee Schemes. Apart from inadequate financial management literacy,

[53] The Small Business Bureau (SBB) in Guyana, supported by IDB funding, is an example of how a credit guarantee system can work for very small MSMEs in that country

MSMEs have limited collateral. This is another of the major reasons they experience difficulty in accessing loans from the financial system.

6.2.3 Introduce tax reforms that allow formal MSMEs to retain a larger share of their profits and cash flows. Increased cash flows will improve MSME attractiveness to local financiers. Admittedly, such reforms may be more difficult in some countries than in others, partly because of the stringent fiscal positions that many Caribbean countries currently face.

6.2.4 Increase the adoption of tax reforms that shift the burden of taxation away from direct taxes to indirect taxes. This would improve MSME "formality" and reduce administrative inefficiency of the tax system generally.

6.2.5 Introduce labour reforms that allow MSMEs to be more flexible in terms of hiring and firing labour. Apart from taxation, this is the second most important reason informality thrives in the Caribbean private sector.

6.2.6 Create stronger tax incentives to increase financial intermediation and encourage MSMEs to seek out alternative forms of investment funds (other than bank loans) via such mechanisms as the Junior Stock Exchange in Jamaica. This would strengthen the Finance Life Cycle for MSMEs.

6.2.7 Improve the enabling environment for access to credit by: a) introducing Credit Bureaus; b) opening up credit bureau information access to foreign financiers so that alternative funding sources such as crowdsourcing, angel investments and P2P investments can become more available to Caribbean MSMEs; and c) upgrading Bankruptcy laws to allow insolvent companies to return to the financial systems more quickly than is currently possible under outdated Bankruptcy laws. All three initiatives will improve the bankability of MSME project proposals in the region.

6.2.8 Overcome the limitations of domestic markets by: a) promoting and fiscally favouring export growth of MSMEs; and b) increasing the use of ICT "information access" mechanisms to facilitate greater business intelligence with respect to external markets. An excellent example of information access is T&T's "Made-in-TnT" portal, which promotes more than 400 products in 19 product categories online. Overall, both measures are likely to increase the growth and income generating prospects for MSMEs operating in an expanded global market place. This should improve the bankability of (export-oriented) MSME projects to local financiers.

6.2.9 Introduce regulatory reforms that would allow Accredited Financial Institutions (AFIs) and Microfinance Institutions (MFIs) to take deposits and offer an expanded range of financial products to their MSME clients. This would strengthen such institutions and allow them to be more creative in providing access to finance.

6.2.10 Increase the inclusiveness of Credit Unions in terms of affording them access to SME financial programmes as Development Finance Institutions (DFI) recipients –including funding, credit guarantees and technical assistance in risk management.

6.2.11 Put in place legislation that would allow each Caribbean country to adopt Mobile Banking solutions at every level. Like MPESA in Kenya, this should contribute substantially to improved MSME productivity.

6.2.12 Examine the feasibility of establishing Mutual Guarantee Schemes in the larger Caribbean countries. Such schemes have worked reasonably well in European countries that have a high proportion of SMEs (e.g. Spain and Italy). Their potential viability should be examined in the Caribbean region.

6.2.13 Create incentives to encourage the informal sector to formalise their businesses. Attractive incentives through very good, well thought out policy can make a significant difference. These can include low cost and readily available ICT-designed or app-based training programmes; fiscal incentives to training providers to develop more relevant courses aimed at MSMEs; simplified and lower tax rates (noted above); access to government contracts etc.

The preceding recommendations are mostly policy-based. The reason is that such an approach would afford more comprehensive coverage in addressing the "access to finance" challenge in the Caribbean. The following two recommendations (i.e. improving MSME financial literacy and expanding Credit Guarantee Schemes) are the ones that are likely to have the greatest impact on improving Access to Finance.

Regional Collaboration

An effective way to establish regional collaboration on improving access to finance is to establish a benchmarking system that allows access to information on MSME-related developments in the financial sector across the BMCs.

Chapter 3: Improving Regional Regulatory and Policy Frameworks

6.3.1 Refocus MSME Policy. The BMCs should refocus the regulatory and policy frameworks to promote greater efficiency and effectiveness in facilitating expansion of a strengthened and more sustainable, productive and competitive MSME sector.

6.3.2 Pursue the Establishment of a business-friendly environment as a top priority. The consensus vision for a business-friendly environment must be premised on the overriding priority of developing and growing a competitive MSME sector by international standards. In this way, the sector can contribute to the creation of quality employment, boost productivity levels, and improve the quality and range of goods and services available to domestic and overseas consumers and processors.

6.3.3 Focus on private sector funding of innovation initiatives. Government support and funding for innovation policy is generally low in the Caribbean, and thus, international donors fund most innovation and competitiveness strategies. Ideally, funding should come from the private sector also, which is more efficient in stimulating applicable innovation (also see recommendations under Chapter 5, below).

6.3.4 Improve worker productivity. Hands-on training and in-factory counselling are vital support services required by MSMEs, especially those producing for international markets. These include issues such as assessing and improving working conditions; workplace co-operation; quality management; occupational safety and health; time and cost management; customer care; and service excellence.

6.3.5 Increase ICT usage by MSMEs. Encourage and facilitate ICT training as an important enabler of enhanced productivity, increased domestic and external market penetration etc. Towards this end, several policy areas must receive attention for ICTs to become a sustained enabler of MSME economic growth and development. These priority areas are: a) appropriateness of the legal and regulatory infrastructure for ICT development (modernisation of the Telecommunications Acts and regulations in particular where necessary); strong regulatory frameworks that can lead to the establishment and maintenance of competitiveness within the sector and thereby maximise access to ICT services; and c) enhanced private sector investment, particularly in broadband infrastructure.

6.3.6 Grow Entrepreneurship Culture through Education Reform. A new Entrepreneurial Studies syllabus should include modules on ICT, Financial Literacy, Marketing, Management, Accounting and Innovation.

The shift to Business Management should address also the skills gaps in Tourism and Hospitality, Agricultural Science, Financial Services and Co-operatives at the supervisory, technical and managerial levels. Renewed emphasis on attracting more students to the vocational trades is also vital in view of the shortage of these skills in the Construction and other Industries. Among repeated suggestions for increasing knowledge transfers, stakeholders also recommended a regional initiative to digitise the delivery of MSME Training and Education (e.g. online, video-training, Webinars).

6.3.7 Improved trade facilitation. Trade policy priorities that will bring value to MSMEs include the removal of inefficiencies in the trading system; building national and regional trading capacities; establishing harmonised regulatory frameworks involving increased market access; building capacity in the productive sectors and the adoption of harmonised standards and practices.

6.3.8 Develop a Model MSME Policy as a Guide for the Region.
The policy should include but not be limited to: a) clarification of the different roles of government institutions (for example, identification of a single Ministry with overall responsibility for MSMEs), of private sector financiers and other non-state actors; b) identification of strategies for MSME capacity building and formalisation of the sector, including fiscal initiatives, eligibility for government procurement contracts etc.; c) formulation of strategies for improved MSME Access to Finance; d) institutional strengthening initiatives for public and private sector BSOs; e) establishment of a division within central government ministries to address specific needs of MSMEs including use of a registration "Super form"; f) facilitating increased access by more entrepreneurs (especially women and youths) to online, web-based training; g) entrepreneurship training provided throughout the formal education system etc.;[54] h) establishment of a set of Key Progress Indicators (KPI) by which to evaluate progress on the sector initiatives and for reporting to the Central Ministry; and i) inclusion of risk analysis, risk management and mitigation strategies.

6.3.9 Articulate an MSME Development Strategy. The strategy should focus on strengthening at least the following activities towards improved business performance: a) promotion of market access and competitiveness of MSMEs; b) enhancing the business and entrepreneurial skills of owners/managers; c) enabling MSMEs to access the resources needed to respond to economic opportunities; d) increasing the flow of capital to MSMEs; e) ensuring increased use of social media to promote enterprise culture and best practices; f) dissemination of programmes that encourage widespread public awareness of the definition, policies, laws and strategy; and g) encouraging innovation in domestic companies as a path to accelerated expansion.

Chapter 4: Strengthening Institutional Support Frameworks

6.4.1 Promote technical cooperation among Registries. Technical cooperation among the Registries in all CDB Member States is needed to improve the quality and currency of business data made available to researchers and planners. A computerised, all-inclusive Regional Business Register connecting the national registries is crucial for collecting and synthesising and researching reliable data on business registration within and across the CSME territories.

6.4.2 Disseminate information with respect to policy, legislative and regulatory frameworks within the region.

[54] For a full list of the contents or areas of coverage see section 3. 5.11 MSME Model Policies.

The governance and operations of all support organisations and agencies require supervision. Conducted regionally and utilising globally accepted criteria, emphasis should be placed on performance monitoring, ranking and on disseminating quality information on a predictable frequency in respect of: a) ministries and lead agencies in transforming their policy, legislative and regulatory framework; b) non-financial service providers in delivering training and technical assistance; and c) financial institutions and related mechanisms in enhancing access to finance.

6.4.3 The CDB should promote its services among MSMEs more effectively. The CDB's Private Sector Unit should take the lead in bringing the CDB's services closer to, not only governments, but also private sector intermediaries and many more MSMEs. The reason is that many of the BSOs and financial institutions are unaware of the role, purpose, structure, activities and achievements of the CDB's CTCS, BNTF and Private Sector Unit. Few are familiar with the activities of the CARTFUND and other projects linked to the CDB.

6.4.4 Improve private, public sector collaboration and enhance institutional strengthening for Capacity Development: The regional business development policy should deliberately encourage Public-Private Partnerships (PPPs) and more private sector service providers (professionals, firms and associations/BSOs) to sell affordable capacity building services to a larger proportion of businesses. Shared resources and services, amalgamations and mergers, where suitable, with other like-minded but strategic organisations, will increase their sustainability. Additionally, institutional strengthening and certification possibly through donor investments can lead to a stronger network of viable BSOs specialised as efficient, streamlined and effective providers of core services in the areas of Training, Technical Assistance/Coaching, Business Plan Development and other development services to increase MSME productivity. Towards this end, technical interventions by a regional or international development agency can prove cost-effective, especially by making maximum use of regional and international best practices. A combination of private, public and donor investments in training, marketing and enhanced production processes will lead to higher productivity levels within an increased number of MSMEs.

6.4.5 A public-private partnership (PPP) network should be explored between selected Microfinance Institutions, Business Development Agencies (BDAs) and BSOs to facilitate a larger flow of domestic resources into MSME growth and expansion. Using Barbados and Belize as pilots, a nexus between 3-4 large credit unions and Fund Access in Barbados and likewise between the 4 largest Credit Unions in Belize, BEST, DFC and BELTRAIDE is envisaged. With competent pre-screening and post loans assistance performed by competent staff in the BSOs and BDAs, the credit unions can be assisted in setting up special desks or units that specialise in MSME loans.

6.4.6 Develop regional online training programmes for MSME development.
A regional or international development institution can lead an initiative aimed at fostering the development of an online facility aimed specifically at MSME training for business development. The objective of this online facility would be to provide instant access to MSMEs, via mobile technology, of business training, toolkits and operating guidelines, especially in business management and financial literacy. Access to training information can be provided via a combination of apps and online videos that allow entrepreneurs to obtain needed information electronically.

Chapter 5: Nurturing Innovation in the MSME sector

6.5.1 Countries committed to innovation should complete the establishment of national innovation systems (NISs), and institutionalise those systems by integrating them into national development plans, national and sector strategies and support programmes.

In this regard, it is critical that Caribbean countries consider the introduction of the equivalent of a Bayh-Dole Act –which would encourage local universities to engage in joint research initiatives with MSME investors and to retain or share title to the resulting inventions with the private sector.

6.5.2 The Caribbean should re-think its innovation orientations from an R&D manufacturing industry focus to one that is primarily driven by or linked to Services. This would include cultural and creative industries such as music entertainment, craft and service and product design. Jamaica, and to some extent Trinidad and Tobago, are both doing this – but without clear Services Innovation Policies or National Innovation Systems (NISs).

Innovation in the Services sector needs to be highlighted as a national priority by Caribbean governments and confirmed via deliberate articulation of service sector innovation policies.

6.5.3 Operational frameworks for supporting innovation should articulate clearer support for MSME investment in the export sectors that offer strong opportunities for innovation in the Caribbean, for example: a) Culture and Creative Industries, b) Offshore Education, and c) Business Process Outsourcing. The issues to be addressed include fiscal incentives to invest in training services and in creative education; access to financial resources; the introduction of international standards for training institutions; international certification systems for firms and employees; increased infrastructure capacity such as Business Parks and broadband capacity and ICT literacy for MSMEs. Such initiatives all need to be substantially expanded at the national level. The implementation of such eco-systems will "signal" the Region's support for innovation in the three sectors.

6.5.4. A roadmap to support the development of an innovation eco-system should be developed – primarily because none of the BMCs reviewed in this study yet has National Innovation systems.

The roadmap should include: a) the reconciliation of innovation priorities with the national development planning system; b) the mapping of the current status of country-specific innovation eco-systems; c) the defining of the National Innovation System and d) assignment of institutional responsibility for leading the development of the innovation eco-system.

The roadmap should also lead to: a) the defining of sector level innovation priorities; b) the realignment of innovation support programmes in line with sector innovation policy; c) the establishment of a strong communications strategy and work plan that would ensure that government, the private sector and civil society are on the same "innovation focussed" page in terms of national and sector priorities; d) comprehensive promotion of Innovation Awards; and e) the establishment and implementation of a Monitoring and Evaluation (M&E) system to monitor progress in NIS implementation.

APPENDIX

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APPENDIX 2A: TEMPLATE - INFORMATION REQUESTS
3A - INTERVIEW QUESTIONS

SECTION 1: INTRODUCTION
1. How do you define MSME Development?
2. Do you believe that MSME is a priority here?
3. If "no". Why?
4. If "yes", why do you think MSME development is a national priority?
5. How has the development of MSMEs in (COUNTRY) evolved?
6. Do you believe that informal (unregistered) businesses should be formalised? Please explain.
7. a) What are the pros and cons of MSME development as it relates to entrepreneurship?
7. b) What are the pros and cons of MSME development as it relates to social justice?
7. c) What are the pros and cons of MSME development as it relates to Economic Growth and Development?
7. d) What are the pros and cons of SME development as it relates to Global Competitiveness?
8. Are you aware of, or are involved in, donor funding or government subsidies for MSMEs?
8. a) If yes, what are the benefits and the downsides? In what ways would you say that these public sector and donor interventions have helped to impact MSME growth, development and/or expansion?
SECTION 2: MSME SECTOR PROFILE
9. How do you define and classify MSMEs in (COUNTRY)? NOTE: For this Study, we classify MSMEs as follows: Micro : 1-5 employees; Small : 6-15 employees; Medium: 16-50 employees.
10. Should this definition and classification extend/apply to the wider Caribbean?
11. Allow me to share the latest Performance Statistics for Small Businesses in (COUNTRY). Would you agree that the specific economic indicators required to measure performance in a MSME should be: • Profitability – net profit margin • Liquidity – current ratio - assets/liabilities • Debt – accounts payable • Asset turnover – operating expense ratios • Employees - Number and levels.
12. Would you suggest any other major economic indicators of performance from global observations?
13. What, in your opinion are the strengths of the MSME sector?
14. What are the weaknesses?
15. What opportunities are available for MSMEs here?
16. What are the threats to this sector?
Please share your opinion on how the following factors affect MSME development in (COUNTRY) and in the wider Caribbean.

APPENDIX 2A: TEMPLATE - INFORMATION REQUESTS
3A - INTERVIEW QUESTIONS CONT'D.

17. Please share your opinion on how the following factors affect MSME development in (COUNTRY) and in the wider Caribbean.
Internal Factors:
17. a) Growth in consumption by customers (so growth in demand)
17. b) Scale of operations
17. c) Ease of Entry into production, markets
External Factors:
17. d) Enabling legislation/policy
17. e) Structure of business concessions, incentives
17. f) Support agencies and advocates
17. g) Unfriendly government bureaucracy
17. h) Obstruction from big business (land, space, input prices, utilities)
17. i) Labour market environment (permits, social security, filling vacancies, trade unions)
17. j) Information technology
17. k) Intellectual Property
17. l) Business Plans
17. m) Equity Investment/capitalisation
17. n) Collateral-based financing
Quality of programmes to address the following among MSME owners& operators:
17.o) Low education levels
17. p) Weak management capacity
17. q) Poor skills mix in service, marketing and finance?
17. r) Lack of continuity: failure of donor-funded MSME development projects to become institutionalised?
18. What is your vision of the MSME sector in 10–20 years, if the appropriate reforms are implemented?
19. In your view, does Government operate on a clear and integrated policy concept of its optimal role in the development of MSMEs?
20. Should government be the main driver of financial and non-financial support to MSMEs?
21. Does the current approach coincide with/support the need to build economic competitiveness?
22. What roles do you ascribe to non-government and private sector Business Support Organisations (BSOs)? Why?
23. On a scale of 1 (low)-10 (high), how would you rank (COUNTRY) in respect of the adequacy of access by the majority of MSMEs to financing?
24. Please share your opinion on what improvements are desirable in the following areas where MSMEs are concerned:
24. a) Collateral requirements?
24. b) Risk-based lending?

APPENDIX 2A: TEMPLATE - INFORMATION REQUESTS
3A - INTERVIEW QUESTIONS CONT'D.

24. a) Collateral requirements?
24. b) Risk-based lending?
24. c) Savings- based lending
24. d) Additional financial products desired?
24. e) Success rates of Government funded Revolving Credit Programmes?
24. f) Success rates of For-Profit Microfinanciers?
25. Generally, why do you think MSMEs experience difficulty in accessing finance?
26. Rank on a scale of 1 (low) -10 (high) the relative importance of the eight factors below in reducing/eliminating typical financial challenges:
26. a) Enlightened Bankers and other Financiers keen to grow MSMEs
26. b) Strong MSME management capacity
26. c) Growth-sensitive Tax systems
26. d) High interest rates & fees
26. e) Incentive regimes
26. f) Business Plans
26. g) Seed capital
26. h) Reliable technical coaching
27. Can you share with me examples of unique self-sustaining development finance initiatives that can be linked or replicated or adapted regionally?
28. Please share any planned or enacted Legislation and Policies in your country or elsewhere in the region that would encourage improved access to financing for MSMEs.
29. What role can regional bodies like the CDB play in improving the policy and legislative framework for same?
30. Are there any new and noteworthy MSME legislation, capacity developments, champions in your country for a stronger network of institutions supporting this sector? If yes, please share.
31. Please identify organizations/agencies that provide technical assistance to MSMEs, e.g.:
• Adoption of International Standards, • Best Practice Manuals, • Technology upgrades, • Quality Testing & Monitoring, • Worker Training and Certification, • Other ___________________

APPENDIX 2A: TEMPLATE - INFORMATION REQUESTS
3A - INTERVIEW QUESTIONS

32. Mindful that such services often present sustainability challenges, what national and regional institutional arrangements do you think, can be attempted to improve cost effectiveness?
33. What importance do you attach to stimulating innovation in order to strengthen this component of the Business Community?
34. How will information sharing help in this respect?
35. What other entrepreneurial approaches, do you believe, can impact future MSME development?
35. ANY OTHER COMMENTS appreciated.

APPENDIX 2B: FINANCIAL INFORMATION REQUEST

NAME OF INSTITUTION:______________________________

COUNTRY ______________________________

A. Lending Policies:

I. Does your Financial Institution have in place a specific policy and procedures document for Business Loans?

☐ Yes

☐ No

If yes, can you share a copy of this document with us?

☐ Yes

☐ No

II. If yes, can you share a copy of this document with us?

☐ Yes

☐ No

B. Statistics on Customer/ Mmember Products and Accounts:

1. Do you offer the following products/ services?
   Please provide information as at December 2015, if possible.

FACILITY	YES # of Clients	NO
Cheques		
Credit Cards		
Debit Cards		
ATM		
Bill Payment		
Remittances		
Loan Protection Insurance		
Life Savings Insurance		
Funeral Insurance		

II. Business Loans Portfolio Size & Quality (in US$):
Please provide information for years ending December 2014 & 2015, if possible.

a) Total number of Business accounts →
Percentage of Total Number of Client Accounts →
Number of *Non-Performing Business Accounts →
Percentage of total number of Business accounts →
*Payments in default 90 days and over.

b) Total value of Business accounts →
Percentage of Total Loan Portfolio value →
Value of Non-Performing Business Accounts →
Percentage of Business Sub-Portfolio value →

III. Business Savings & Deposit Accounts (in US$):
a) Value of all Savings Accounts held by Businesses →
Value of Total Savings Accounts held →

b) Value of all Fixed Term Deposit Accounts held by Businesses →
Value of Total Fixed Term Deposit Accounts held →

C. Pricing & Requirements for Business Loans:

Rates Range: _________
Applicable Fees: _________
Minimum Deposit: _________
Any other details/conditionalities: _________

APPENDIX 3: LIST OF PERSONS CONSULTED/INTERVIEW

COUNTRY	NAME	ORGANISATION
ANTIGUA (13 Persons)	Andrea Joseph - Senior Lending Officer Andre Marshal - Lending Officer	Antigua and Barbuda Development Bank
	Acres Stowe	National Development Fund
	Rohan W. Anthony – Statistician Aba Scotland - Statistician	Statistics Division
	Hon. E.P. Chet Greene – Minister Sandra Joseph – Permanent Secretary	Ministry of Trade, Commerce & Industry
	Karl Spencer – General Manager	Community First Cooperative Credit union
	Jamilla Gregory – Business Development Officer	Antigua and Barbuda Chamber of Commerce
	Ricki Camacho - Registrar	Intellectual Property Office
	Jacqueline Yearwood - Enterprise Development Director	Antigua and Barbuda Investment Authority
	Julianne Jarvis - Project Implementation & Dev't Officer	Coalition of Service Industries
	Nasel Phillip-Samuel – Project Officer	Ministry of Trade, Commerce & Industry
BARBADOS (26 Persons)	LeVere Catlyn – Financial Controller Judith Sarjeant - Business Innovation & Facilitation	Barbados Public Workers Co-operative Credit Union
	Misha Clarke - Project Manager	Barbados Coalition of Services Industries
	Aubrey Browne - Director Trevor David – Deputy Director	Barbados Statistics Service
	Patrick Kendall – Economist Consultant	Caribbean Development Bank
	Damie Sinanan - Senior Advisor Trade and Export Development	Caribbean Export Development Agency
	Steve Belle – CEO Norman Belgrave – Financial Controller Algernon Yearwood – Chief Operations Officer Joseph Holder – Loans Manager	City of Bridgetown Credit Union
	Kevin Hunte - Deputy Registrar, Companies	Companies and Business Registry Corporate Affairs and Intellectual Property Office (CAIPO)
	Tara Lisa Persaud - Business Climate Reforms Coordinator Celene Cleland-Gomez – Coordinator, Enterprise Innovation Challenge Fund (CIF) Wayne Elliott, Project Development Officer	Inter-American Development Bank - Compete Caribbean

APPENDIX 3: LIST OF PERSONS CONSULTED/INTERVIEW

COUNTRY	NAME	ORGANISATION
	Hamilton Roach – General Manager Michael Callendar - Credit & Project Manager Gerald Amos, Information Systems Manager	The Barbados Agency for Micro Enterprise Development Ltd. (FundAccess)
	Egbert Irving – Programme Manager	UWI Cave Hill School of Business
	Hon. Donville Inniss – Minister Philmore Best – Permanent Secretary Anderson Cumberbatch – Director, Business Development Unit	Ministry of Industry, International Business, Commerce and Small Business Development
	Jenson Sylvester – Director, Managed Services Jonathan Sylvester – Sales Engineering Manager	C&W Business
	Marina Taitt - Director Export and Business Dev't	Barbados Industrial Development Corporation
	Dr. Marcia Brandon	Caribbean Centre of Excellence for Sustainable Livelihoods
BELIZE (17 Persons)	Natalie Goff – General Manager Renan Gongora –Credit Delivery Manager Judith Leslie – Credit Administration and Loans Recovery Manager	Development Finance Corporation (DFC)
	Yvonne Hyde - CEO	Ministry of Economic Development
	Ruby Pascascio – Senior Projects Officer Nilda Sosa-Riverol - Manager	SBDC BELIZE
	Dennis Jones – Managing Director	Belize Enterprise for Sustainable Technology (BEST)
	Patricia Rodriguez	Belize Companies and Corporate Affairs
	Hugo Moguel - President Melanie Eiley - Admin/Accounting Officer	Coalition of Service Industries
	Kim Aikman - CEO	Belize Chamber of Commerce & Industry
	Corine Fuller - Manager Deanna Gomez - Business Dev't Officer	Belize Credit Union League
	Daisy Dawson - Manager Earl Arthurs - Accountant	St. John's Credit Union

APPENDIX 3: LIST OF PERSONS CONSULTED/INTERVIEW

COUNTRY	NAME	ORGANISATION
	Yadele Urbina - General Manager	La Immaculada Credit Union
	Clement Usher – General Manager	Holy Redeemer Credit Union
TRINIDAD & TOBAGO (13 persons)	David Marquez – General Manager Michelle Wallace - Finance Manager Yola Charles - Loans Manager	City of Port of Spain (COPOS) Credit Union
	Joy Francis – Manager Business Dev't	Trinidad and Tobago Manufacturers Association (TTMA)
	Julian Henry – CEO Curtis Mayers - Corporate Business Analyst	National Entrepreneurship Development Company (NEDCO)
	Brian C. Awang – CEO	Trinidad and Tobago Export-Import (EXIM) BANK
	Francis Sandy - Deputy Registrar	Registry of Companies
	Denise Dickson-Cunningham - Manager, New Business & Product Dev't Valerie Jack - Monitoring Officer	Trinidad and Tobago Agriculture Development Bank (TTADB)
	Kelvin Sargeant - Regional Specialist, Sustainable Enterprise Development & Jobs Creation	International Labour Organisation (ILO)
	Sharon Mark - General Manager Sherry McDonald - Financial Controller	Eastern Co-operative Credit Union
ST. LUCIA (14 Persons)	Hon. Emma Hippolyte – Minister Alison Plummer - Permanent Secretary	Ministry of Commerce, Business Development, Investment and Consumer Affairs
	Emmanuel Gerald – Director, C& I Junia Emmanuel-Belizaire - C&I Officer	Department of Trade and Commerce
	Barbara Innocent - Director, Small Business Development	Small Business Development Centre (SBDC)
	Edwin St. Catherine - Director of Statistics	Department of Statistics
	Gayle Devaux-Segovia – Director	NATMED Herbals
	Brian Louisy - Executive Director	Chamber of Commerce, Industry & Agriculture
	Paula James - Executive Director	St. Lucia Manufacturers Association
	Yvonne Agard - Executive Director	St. Lucia Coalition of Service Industries
	Ronald Charles - Executive Director	National Research and Development Foundation
	Gordon Charles – President	OECS Business Council

APPENDIX 3: LIST OF PERSONS CONSULTED/INTERVIEW

COUNTRY	NAME	ORGANISATION
	Levi Serieux - Business Lending Officer	Bank of Nova Scotia
	Priscillius Simeon - General Manager	Mon Repos Credit Union
JAMAICA (15 persons)	Donovan Wignal - CEO	MSME Alliance
	Hon. Anthony Hylton - Minister Andrene Collings - MSME Director	Ministry of Industry, Investment and Commerce
	Gillian Hyde – CEO	Jamaica National Small Business Loans Company
	Hugh Johnson - President	Small Business Association of Jamaica
	Orville Plummer - Project Manager	Heart Trust NTA
	Sandra Glasgow - CEO	Jamaica Exporters Association
	Jackie Mighty – CEO	City of Kingston Sodality Cooperative Credit Union
	Marjorie Straw - Project Manager	JAMPRO
	Valarie Viera – CEO	Jamaica Business Development Corporation
	Judith Ramlogan	Companies Office of Jamaica
	Edward Chin-Mook, President	Caribbean Association of Small and Medium Enterprises
	Martin Blackwood - General Manager	Portland Co-operative Credit Union
	Fitz Gerald Rowe - General Manager	St. Elizabeth Co-operative Credit Union Ltd.
	Terrence Cooper - CEO	CRIF-NM Credit Assure Ltd.
	Adrian Thompson – CEO	Credit Union Fund Management Company
GUYANA (17 Persons)	Nicole Prince Runuka - Registrar	Guyana Deeds Registry
	Abu Zaman - Branch Manager	Bank of Nova Scotia
	Ms. Roxanne Sumner – Senior Investment Facilitation Officer	GOINVEST
	Clement Duncan – Director Yonette Jeffers – Director	Guyana Manufacturers Association
	Lance Hinds – President	Georgetown Chamber of Commerce
	Ivor Coates – Statistician	Central Bureau of Statistics

APPENDIX 3: LIST OF PERSONS CONSULTED/INTERVIEW

COUNTRY	NAME	ORGANISATION
	Ramesh Persaud - CEO	Institute of Private Enterprise Development IPED
	Reshma Ramratan - Research Officer Jason Allicock - Economist II	Central Bank of Guyana
	Collin Dejouge - Corporate Manager Michelle Johnson - Marketing Manager Ian Grant - Senior Credit Officer Deborah Young - Senior SME Officer	Republic Bank
	Gillian Edwards - Manager	Small Business Bureau
	Evadnie Enniss - Director	Guyana Bureau of Standards
	Manjula Brijmohan - Executive Director	Guyana Small Business Trust
DOMINICA (2 Persons)	Mr. Sobers Esprit - Business Dev't Officer, Creative Industries Mr. Marlon Marie - Business Dev't Officer, ICT & E-Business	OECS Export Development Unit
ST. KITTS NEVIS (1 Person)	Daniel Arthurton - Advisor	Eastern Caribbean Central Bank
SURINAME (15 Persons)	Wonnie Boedhoe - Managing Director	NOB (National Development Bank)
	Rathan Kalka - Coordinator, Business Support Services and Coalition of Services Industries	Suriname Business Forum
	Anil Pardairt - Chairman Prija Soechitram - Legal Officer	KKF (Chamber of Commerce and Industry)
	Guilliano Koornaar - Manager, Economic Division Selvyn Bishop - Staff Member, Research and Planning	ABS (General Bureau of Statistics
	Edwin Watson - Chairman	GODO Credit Union
	Wigo Bilkerdjk - President	ASFA (Association of Surinamese Manufacturers)
	Montague McLeod - Director, Corporate Banking	Republic Bank, Suriname
	Maureen Badjoeri – CEO Clarence Tokromo - Micro Credit Coordinator Rocky Samidin - Business Banking	Trustbank (MSME financier)
	Kenneth Foe-A-Man - Director Amit Chanderangsingh - CUS Coordinator	Suriname Competitiveness Unit
	Hon. Sieglien Burlerson - Minister	Ministry of Trade and Industry

APPENDIX 4: ANALYSIS OF SME ACCESS TO FINANCE IN EIGHT BMCS

This appendix offers an analysis of SME access to finance in eight BMCs: Antigua and Barbuda, Barbados, Belize, Guyana, Jamaica, St. Lucia, Suriname and Trinidad and Tobago. It is based on a combination of: 1) original research carried out by the consultants, and 2) findings summarised in the IDB's Private Sector Assessment Reports (PSARs).

The OECS: Antigua and Barbuda and St. Lucia

Table A1 below, shows loans advances and overdrafts for Antigua and Barbuda and St. Lucia, recorded by the Eastern Caribbean Central Bank over the period 2009 to 2013[55]. The data reveal that loans, advances and overdrafts (LAO) contracted in Antigua and Barbuda by 8.4% during the five-year period. This contrasts with a 12.5% overall growth in St. Lucia over the same timeframe. The diverging numbers are understandable since Antigua was one of the hardest-hit high tourism economies after the global financial crisis of 2008, when its GDP egistered, on average 1% negative growth per year from 2008 to 2014. In comparison, St. Lucia experienced modest gains of 0.10% per year in GDP over the same period.

[55] Data adjusted by deducting loans and advances to 1) financial institutions and 2) government services .

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Table A1: Changes in loans and advances in Antigua/Barbuda and St. Lucia 2009 -2013

Country and Category	2009	2010	2011	2012	2013	Overall Change
Antigua and Barbuda:	2009	2010	2011	2012	2013	Change
Loans and Advances and Overdrafts		0.17%	-3.3%	-3.22%	-2.27%	-8.40%
St. Lucia:						
Loans and Advances and Overdrafts		3.27%	2.65%	6.62%	-0.45%	12.50%

Source: Eastern Caribbean Central Bank Financial Statistics Yearbook 2014

According to the Antigua and Barbuda Private Sector Assessment Report (PSAR) of 2014, that country is ranked 130th (out of 189 countries) in the World Bank's 2014 Doing Business (DB) report in the "getting credit" category. Addtionally, the local credit market is relatively inefficient when measured by the spread between lending and deposit rates. Given the important role played by finance in the development process, the country's poor DB ranking in terms of access to credit, represents a significant constraint to private sector development and growth.

Antigua and Barbuda is served by seven commercial banks and six non-bank financial institutions; however, at roughly 8 percentage points, it has one of the widest interest-rate spreads among its comparator group of countries, although the Seychelles, Guyana, Jamaica and Haiti have significantly wider spreads. Antigua and Barbuda has attempted to fill the credit void through the establishment of a national development bank, but the credit needs of the private sector significantly outstrip those available resources. Key policy interventions that are required include setting up a public credit registry and support for the establishment of a private credit bureau[56]. The lack of information on creditors means that risks are perceived as higher than they might otherwise be, and banks therefore demand higher interest rates and greater collateral. Legislative changes are also required to provide greater protection for creditors.

The St. Lucia 2014 PSAR, generated similar perspectives on that country's "getting credit" status. St. Lucia has a number of finance providers, including public-sector institutions such as the St. Lucia Development Bank (SLDB), whose mission is to facilitate enterprise and sustainable socio-economic development by providing accessible and affordable financial, technical and advisory services. However, according to the World Bank's Enterprise Survey (2010), 35% of businesses interviewed, cited access to finance as the biggest obstacle to doing business in St. Lucia. Private sector stakeholders interviewed, stated that finance was either difficult to obtain because of collateral requirements or too costly in terms of interest rates.

[56] There is a regional Credit Rating Agency, CariCRIS, but it rates regional debt markets and does not provide/cover individual credit ratings.

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At the end of 2010 bank deposits stood at over 92% of annual GDP and the ratio of bank credit to deposits was 122%, the highest in any of the comparator countries. Despite this high conversion ratio, the island was still ranked relatively low, at 130th (out of 189 countries), for ease of accessing credit, and only 24% of businesses had either a loan or line-of-credit services.

Business finance on the supply side has the perceived (higher) risk associated with providing loans to the small-business sector. While on the demand side, many entrepreneurs and small businesses lack the ability (in terms of record-keeping, constructing business plans and so on), to access available lending facilities. Moreover, St. Lucia's credit market is fairly inefficient when measured by the spread between lending and deposit rates relative to those in other Caribbean countries. At roughly 8 percentage points, the island has one of the higher interest-rate spreads of any of the comparator countries. Importantly it should, be noted that the reserve requirement level is set by the Eastern Caribbean Central Bank (ECCB) which suggests that the total funds available for lending are less than the amounts deposited. This may account in part for the high cost of finance in St. Lucia and the region by extension. However, in 2015 the ECCB opted to reduce the minimum deposit rate from 3% to 2%, a policy that could lead to gradual reductions in loan rates in ECCB member countries.

Barbados

Table A2 below illustrates the growth in loans, advances and overdrafts in Barbados between 2009 and 2013.

Table A2: Changes in loans and advances in Barbados 2009 - 2013

Country and Category	2009	2010	2011	2012	2013	Overall Change
Barbados:	2009	2010	2011	2012	2013	Change
Loans and Advances and Overdrafts		-1.34%	1.46%	6.31%	-2.57%	3.69%

Source: Central Bank of Barbados online statistics 2016

The growth rates in loans, advances and overdrafts in Barbados, appear to be just as anaemic as those experienced in Antigua and Barbuda over the same period. Barbados, like Antigua and Barbuda, is also heavily dependent on tourism, a sector that, prior to 2014, had been performing quite poorly, especially in terms of stay-over visitors and the average spending levels by visitors over the same period. Between 2009 and 2013, loans and advances grew by an average rate of 0.92% per year, a sub-optimal growth rate for both the private sector and the local banking sector.

The 2014 Private Sector Assessment Report (PSAR) on Barbados observed that, since 1981, the interest-rate spread has generally widened, indicating a possible deterioration in credit market efficiency. Between 2009 and 2011, the spread increased sharply, as banks reacted to the initial deterioration in economic conditions, subsequently narrowing as the slump became more protracted. It is possible that the spread will contract further because of an April 2015 Central Bank policy decision to eliminate the minimum saving rate and to allow the market to determine both deposit and lending rates in the future.

APPENDIX 4: ANALYSIS OF SME ACCESS TO FINANCE IN EIGHT BMCS

Domestic savings play a key role in the availability of credit. At the end of 2009 bank deposits stood at over 90% of GDP, and rose to 105% in 2012, one of the highest ratios among the group of comparator countries. However, bank credit as a proportion of bank deposits stood at just under 50% in 2009, and 70% in 2013, among the lowest ratios in the Caribbean. This suggests that businesses in Barbados—and particularly small businesses, which lack the access to international credit markets that some larger firms enjoy—find it difficult to access credit, despite the availability of funds in the financial system. As highlighted under sub-section 2.3.3 Bank Liquidity and SME demand, business finance is both a supply and a demand problem. On the supply side, there is the perceived risk associated with providing loans to small businesses. On the demand side, entrepreneurs and small businesses may not be aware of the lending facilities that are available.

Both the private and public sectors have attempted to address these constraints on finance. Commercial banks are the main credit providers to both small and large companies, offering various types of facilities, such as traditional loans, overdrafts, leases, etc. Most commercial banks offer dedicated credit products aimed at small businesses. In addition to banks, there are a number of specialist institutions and funds that offer financing to specific target groups. Credit unions are highly active in the small business sector, and are particularly so in the informal sector. Although the regulations governing credit unions prohibit lending to companies, since many small businesses are not incorporated, credit unions can structure such lending as personal loans. This makes credit unions an important source of lending to small businesses.

The government has established a number of funds aimed at providing capital, in the form of loans or equity financing, to specific sectors. As noted elsewhere in this report, in 2002, the government enacted the Small Business Development Act, which provides a framework of activities aimed at supporting micro and small enterprises through incentives (fiscal and others) and technical support.

The Government of Barbados (GOB) has also developed a dedicated institutional framework to spur SMEs entrepreneurship through the Ministry of Industry, International Business, Commerce and Small Business Development. Section 4.3.5 of the "Barbados Growth and Development Strategy Document for 2013-2020" is dedicated to Micro, Small and Medium Sized Enterprise (MSME) Development. It highlights the government's commitment to provide greater access to capital for MSMEs, and to further promote their growth, productivity and revenue generation, and underscores the role that financial institutions play in promoting investments.

To this end, the GOB has initiated a number of dedicated funding initiatives, amounting to approximately USD80 mn , comprising: 1) the Enterprise Growth Fund Limited created in January 1998; 2) the Caribbean Financial Services Corporation; and 3) the Youth Entrepreneurship Scheme.Eeach entity has a specific sector allocation, such as tourism and small hotels investment, agricultural development, industrial investment and employment. Through the Central Bank of Barbados (CBB), the government also offers financing and guarantee schemes to support credit and export promotion. There are different types of schemes provided by the CBB, with the most important mechanism being the Enhanced Credit Guarantee Scheme (ECGS) and the Trade Receivables Liquidity Facility (TRLF).

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However, these schemes have had limited effectiveness in addressing SME financing needs, for the following reasons. First, their eligibility criteria have been sector or niche based, which is too narrow to support the comprehensive needs of SME financing. Second, their terms and conditions have not been sufficiently attractive for retail financial institutions to participate robustly. Third, their non-standardised requirements from one scheme to another, have created a perception with retail financial institutions, that applying for a guarantee is cumbersome. Fourth, there has been limited outreach with financial institutions and potential beneficiaries to develop a sustained pipeline. Finally, the practice of filing claims has created a perception with financial institutions that these can only be submitted once the company has been liquidated, a potentially contentious justification[57]. Moreover, in spite of the availability of various lending windows for tourism as well as for enterprises in the agricultural sector more than 30% of firms surveyed by the IDB for the 2014 PSAR indicated that access to finance was a "major" or "very major" obstacle to doing business.

Overall, there is a perception among interviewees that traditional financial institutions do not provide financing for start-ups or R&D investments, unless collateral is made available (for example in the form of vehicles, land or houses). There are many government-owned financing enterprises, including FundAccess and the Enterprise Growth Fund, that have arisen to fill the gap. However, owing to a lack of capital, these institutions often focus on small-scale finance. Consequently, their coverage of the total SME sector is often well below 20%, at best. Barbados, unlike other surveyed countries, such as Trinidad and Tobago and Jamaica, does not have a development bank or a credit bureau, and some interviewees pointed out that these were major deficiencies in the domestic financial system.

Jamaica

Jamaica, according the IDB 2014 PSAR, is ranked 12th (out of 189 countries) in the World Bank's 2015 Doing Business report for ease of getting credit. However, around 30% of firms identify access to finance as a major constraint, according to a 2013 countrywide, firm-level survey, funded by the Compete Caribbean Programme. The interest-rate spread of Jamaican banks in 2010 was the second highest among the comparator countries, being exceeded only by Haiti. Since peaking during the crisis and immediate post-crisis periods, spreads have been trending downwards.

The below-average performance of Jamaican financial institutions in mobilising and intermediating domestic savings, increases the importance of the availability of international funding. At 79%, Jamaica has a high ratio of international debt issues to GDP, compared with other countries in the region, suggesting that international bond issues are relatively heavily relied on as a source of financing by the country. However, only large private institutions use such financing instruments. MSMEs do not rely on international bond issues as a source of financing. Such firms are also less likely to receive credit from overseas banks.

[57] Lessons learned for the Barbados SME Guarantee Fund. The InterAmerican Development Bank. Undated.

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Institutions that serve to reduce information asymmetries, such as credit bureaus, are relatively new in Jamaica. With assistance provided under the Jamaica Competitiveness Enhancement Programme, the Credit Reporting Act was passed in October 2010, and the Credit Reporting Regulations that operationalize the Act were approved by parliament in January 2011. To date, Bank of Jamaica (the central bank) has licensed two credit bureaus to operate and both are now operational. In the absence of good credit information, banks and other financial institutions protect themselves through high collateral requirements. For MSMEs, the difficulty of gaining access to credit is compounded by a shortage of collateral. Only 27% of Jamaican firms had a bank loan in 2010. Among the comparator countries, only Namibia and St. Lucia had smaller proportions of firms accessing credit from banks. If Jamaican firms had easier access to international sources of credit, or to other domestic funding sources, this would not be a major constraint.

In 2013, Jamaica passed a law governing the creation of security interests in personal property, as one of several new pieces of legislation introduced to satisfy structural benchmarks under the four-year Extended Fund Facility approved for the country by the IMF[58]. Since the law was passed, both a public and a private moveable-collateral registry have been launched, with strong uptake from individuals and financial sector firms. It is expected that these registries will help to expand credit to micro-level firms, and will extend services to both lenders and borrowers, nationally and regionally. Table A3 below illustrates the growth in loans and advances in Jamaica between 2009 and 2014.

Table A3: Changes in loans and advances in Jamaica 2009 2014

Country and Category	2009	2010	2011	2012	2013	2014	Overall Change
Jamaica: Loans and Advances to Private Sector		-24.71%	-1.11%	-17.26%	24.70%	26.20%	-3.05%

Source: Bank of Jamaica online statistics 2016

The table shows that loans and advances by commercial banks to the private sector plummeted by almost 25% between 2009 and 2010, and by a further 17% in 2012, and then returned to growth of 24.7% in 2013 and 26.2% in 2014[59]. Such significant swings validate the private sector's identification of Access to Finance as a major constraint to development in that country. The overall growth rate in loans and advances between 2009 and 2014 was -3.05%. However, the more positive growth trends in loans and advances in 2013 and 2014 would suggest that Jamaica is "right-sizing" again as it begins the process of returning to economic growth following the negative consequences of the global financial crisis and the IMF Structural Adjustment Programme, which was still on-going at the time of this study.

[58] The need for secured transaction reform was reinforced under a GOJ Letter of Intent, Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (MOU) with the International Monetary Fund (IMF), of April 17th 2013. In that Memorandum and under its Growth Strategy the GOJ committed to an initial phase of reforms to improve some Doing Business indicators of which a secured transaction framework was a key part. | [59] Most recent data on Loans and Advances to the private sector, from Bank of Jamaica statistics, is for 31 October 2014.

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Guyana

For Guyana, the 2014 IDB PSAR points out that Access to Finance is an issue that was frequently mentioned during interviews for the PSAR as having a significant impact on private sector expansion. The most common criticism made by private sector leaders is that the banking sector is too liquid and does not provide enough lending to new businesses, thereby limiting investment and economic growth.

The banking sector's response to this criticism has been to argue, that banks assess risk and the availability of collateral (consisting exclusively of real estate) to make all their business-lending decisions, and that the result of this is that the portfolio of loans to the private sector is growing faster than the economy. The end result is that lending is expanding, but is not doing so quickly enough to satisfy demand for loans. Structural barriers, such as the lack of availability of registries of movable property, legal frameworks regulating the use of financial instruments, and limited property rights for miners and farmers, impose restrictions on lending to some clients.

But is this actually the case? As of May 2013, commercial banks held reserves 33% in excess of the level required by the Bank of Guyana (the central bank), which is currently set at 12%. As the economy has expanded and the banking sector has grown, excess reserves have increased, growing from 15% in 2011 to 22% in 2012. So the banks may be lending more to MSMEs, but the proportion of their deposits that is being invested in much lower interest-bearing government securities is increasing, suggesting that, on the demand side, the growth in bankable projects has not been in line with (commercial) bank criteria.

According to bankers interviewed, the traditional characteristics of the banks and their clients limit the expansion of credit to the private sector. In particular, they note that large and well-established businesses, especially in the services sector but also in manufacturing, are banks' preferred clients due to long-term established relationships.

A long-standing problem in Guyana, partly resulting from the economy's small size, is the concentration of loans to a few businesses—at the end of the first quarter of 2013, the exposure to the top 20 borrowers accounted for 15.9% of the total loan portfolio of the banking sector. New businesses find it difficult to borrow, in part because of the current structure of the banking system (which is small and is focused on lending to large companies), but also because in many cases such businesses lack appropriate collateral. Commercial banks require up to 150% collateral, and have cumbersome loan-application processes. This acts as a major constraint for small and medium-sized enterprises (SMEs). The (banking) regulatory system is biased towards the exclusive use of real estate as collateral, and the banking system offers only a limited supply of financial products such as leasing, factoring and the use of movable property as collateral.

Moreover, property rights over land are insecure in the most promising sectors of the economy, namely mining and agriculture, making it difficult for traditional commercial banks to lend to these sectors. Meanwhile, farmers lease land but cannot sell it, and a large proportion of land is subleased without a contract (illegally, as this is explicitly prohibited). Farmers cannot access bank finance under these conditions. So how supportive have commercial banks been in lending to the Guyana private sector? Table A4 below illustrates the growth in loans and advances in Guyana between 2009 and 2014.

APPENDIX 4: ANALYSIS OF SME ACCESS TO FINANCE IN EIGHT BMCS

Table A4: Changes in loans and advances in Guyana 2009 – 2014

Country and Category	2009	2010	2011	2012	2013	2014	Overall Change
Guyana: Loans and Advances to Private Sector		18.01%	23.10%	21.71%	14.19%	8.55%	119.15%

Source: Bank of Guyana 2016 data

As the table reveals, the growth in loans and advances to the private sector has been consistently higher than that of the other seven countries surveyed in this study. Moreover, according to Bank of Guyana data, total commercial bank loans grew, on average between 2006 and 2015, at a rate of 14.5%, while commercial bank credit to the private sector, which is a sub-set of total commercial bank loans, grew at 14.1% on average over the same period. This suggests that the banks have been building out their private sector loan portfolios in line with their general growth rates in overall loans.

What is also revealing is that by 2014, the total loans and advances to the private sector has more than doubled since 2009. While the data does not specifically stratify "loans to the private sector" from "loans to SMEs", it is quite possible that SMEs have had reasonable access to bank credit over the 2009–2014 period given that, apart from 20 larger firms, most of commercial bank lending in Guyana is to SMEs. To a significant extent the growth in bank loans is reflective of Guyana's above average GDP growth rates over the same period.

Belize

In Belize, the IDB 2014 PSAR points out that "the financial system is characterized as comparatively underdeveloped and also high-cost. The undeveloped and oligopolistic structure of the industry has led to significant challenges for businesses in terms of their access to finance".

As in many developing countries, bank credit is the main source of financing for large businesses, while credit unions and moneylenders in the informal sector tend to finance smaller investments and micro, small and medium-sized enterprises (MSMEs). The analysis in this section is based mainly on bank credit, given that loans for credit unions to business are usually classified as personal loans. The main issues emerging from consultations with stakeholders are access to finance and affordability of capital. Loans to businesses are available at high interest rates, with a collateral requirement that generally can exceed 175% of the value of the loan (see Table 2.13 under sub-section 2.3.3 Bank liquidity and SME demand, below). As is the case in other parts of the Caribbean – and generally in the developing world, micro and small businesses often lack appropriate collateral to back their financing needs and are therefore more credit-constrained than large businesses. Such conditions strongly suggest that the institutional remedies are that Government should give more consideration to establishing and/or significantly expanding Credit Guarantee Schemes to address the shortfall in MSME collateral capacity.

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So how well did the commercial banks support the private sector in Belize – in terms of loans and advances to them between 2009 and 2014?

Table A5 below illustrates the growth in loans and advances in Belize between 2009 and 20

Table A5: Changes in loans and advances in Belize 2009 – 2014

Country and Category	2009	2010	2011	2012	2013	2014	Overall Change
Belize: Loans and Advances to Private Sector		-2.31%	-0.24%	2.61%	2.43%	4.53%	7.07%

Source: Central Bank of Belize Statistical Digest 2014

As the table shows, there has been relatively insignificant growth in private sector borrowing from commercial banks in Belize over the five-year period. Loans and advances contracted slightly in 2010 and 2011 and returned to positive growth thereafter. However, on average, loans and advances grew by less than 2% annually, a metric that perhaps supports the private sector's claim of limited access to finance in that country.

Suriname

In Suriname, according to that country's 2014 PSAR, access to finance is an important bottleneck to private sector development in Suriname, and is recognised as such in the 2013-14 Global Competitiveness Report compiled by the World Economic Forum (WEF), and also by the World Bank in its Doing Business report (ranked 170th out of 189 countries for ease of getting credit). The financial sector is very small consisting of nine commercial banks, with a large concentration of lending and deposits at the three largest banks, RBTT Suriname (now Republic Bank), DSB and Hakrinbank. Both DSB and Hakrinbank are fully or partially owned by the government.

Credit to the private sector, at about 33% of GDP as at the end of 2012, is low by regional standards. Lending interest rates have remained relatively stable since 2008, averaging 11.8% between 2008 and 2013. Meanwhile, inflation fluctuated drastically in the same period, and so too did real interest rates. Indeed, real lending rates stood at negative 2.5% in 2008, then rose to 11.8% in 2009, before posting a negative rate again in 2011 (at 6%). The real lending rate stood at 10.1% in 2013.

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Anecdotal evidence collected in April 2012 indicates the pervasive practice of lending using real estate as collateral, as well as the only limited availability of factoring. Additional financial instruments that would deepen financial intermediation are not available. Such instruments might include the expansion of the market for government bonds, thereby promoting saving and investment by individuals and firms; leasing; secured transactions; and the revitalization of the stock exchange. We noted that the Suriname Stock Exchange (SSE) functions sporadically – trading only twice per month with only 11 listed companies and without a Securities Exchange Act. Also since the SSE is private, only brokers who are admitted by the Board are allowed to participate on the exchange on behalf of their clients. So how well has the banking sector done in providing credit to the private sector? Table 2.11 below illustrates the growth in credit to the private sector between the fiveyear period 2011 to 2015:

Table A6: Credit to the private sector in Suriname 2011 – 2015

Country and Category	2011	2012	2013	2014	2015	Overall Change
Suriname:						
Credit to the private sector (SRD millions)	3660.1	4228.9	4963.8	5407.4	6287.6	
% Change in credit to the private sector		15.4%	17.38	8.94%	16.28%	71.79%

Source: Centrale Bank van Suriname. Selected Macroeconomic Indicators 2011–2015

The table suggests that loans to the private sector have been relatively robust over the 2011–2015 period, with an average growth rate of approximately 18% annually. However, this trend is not aligned with the progressive contraction in GDP growth – which declined from 5.3% in 2011 to an estimated 1.5% in 2015[60]. But given that the economy is natural resource dependent, the growth in credit could be reflecting an increase in the level of investments in key sectors such as mining and agriculture[61].

Trinidad and Tobago

Findings from the 2014 Private Sector Assessment Report (PSAR) suggest that access to finance in Trinidad and Tobago for all companies, but especially for small and medium-sized ones in the non-energy sector, is limited. According to the Central Bank of Trinidad and Tobago, banking sector liquidity, measured as the ratio of liquid assets to total assets, stood at about 25% in 2011. However, the total stock of credit to the private sector is low, at only 29% of GDP in 2012 – which is close to a similar level in Belize.

[60] Centrale Bank van Suriname. Selected Macroeconomic Indicators 20112015 | [61] Similar findings were generated in "Are Banks in Suriname Conservative in Providing Access to Finance Surinamese Companies" by Weena Ajohia et al. of Kom University in 2012.

APPENDIX 4: ANALYSIS OF SME ACCESS TO FINANCE IN EIGHT BMCS

These indicators reflect two facts regarding the country's financial institutions. First, although liquidity is high, there is little appetite for risk-taking on the part of banks in terms of lending to private sector companies. Second, levels of financial intermediation are low, as banks prefer to keep their liquidity levels high rather than lending to firms that may face repayment difficulties for reasons beyond their control. Generally, banks consider it risky to lend to companies outside the energy sector, as such firms may find themselves unable to repay loans when external conditions change. Rather than being a problem arising from the management approach at individual banks or firms, this is a systemic issue, related to the existence in Trinidad and Tobago of an incentive framework for lending that does not facilitate financial intermediation. For instance, a presentation on "Moving Beyond Collateralized Financing" by Ram Ramesh at the 1st Caribbean Competitiveness Forum in Trinidad and Tobago noted that there was limited intermediation for venture capital, angel funding, IPO funding and government subsidies[62]. Nevertheless, interest rates in the country are low: in June 2014 the basic prime lending rate stood at 7.5%.

As noted in section 2.2 Life Cycle System and Table 2.2: MSME Life Cycle Financing in eight Caribbean countries, Trinidad and Tobago offers a relatively robust financial system that could bolster the progressive development of SMEs. The main weaknesses in the system are 1) the contraction of venture capital availability, the high non-performing loans (NPLs) of the National Enterprise Development Company (NEDCO), and the absence of an active junior stock exchange. The completeness of the Life Cycle financing system would be notably enhanced if the first mechanism (i.e. venture capital) is re-activated and the second (i.e. the junior stock exchange) becomes fully operational. We have noted that the idea of the junior stock exchange had been strongly promoted by the Chamber of Industry and Commerce in recent years. In that regard, the TTSE will establish a market for Small and Medium Enterprises (SME Market) and has drafted a Listing Agreement and Listing Requirements for companies interested in being listed in this market. To encourage SMEs to list, the T&T Government has legislated a 10% corporate tax rate, which is 40% of the normal rate of 25% for the first five years to SMEs listed on this market. They are required to raise capital on the exchange through IPOs with a minimum of 25 shareholders holding at least 30% of the company's share capital. To date, however, there have been no listings (yet) on the exchange, but this was the same pattern that the Junior Exchange exhibited in its first year in Jamaica.

Another major player in the financial sector is the EXIM Bank of Trinidad and Tobago, which offers a wide range of financial products to support exporters including post shipment financing (the equivalent of the factoring of receivables), pre-shipment financing (the equivalent of working capital financing), demand loan financing (for equipment upgrades), and export credit insurance (risk protection to exporters against payment default by foreign buyers). The EXIM Bank is owned by the Government of Trinidad and Tobago (GoTT) and facilitates export development, which is seen as a top priority by GoTT. According to its 2014 Audited Financial Statements, loans and other financial assets were USD 66.5 mn and accounted for 88% of total assets. Over time, the loan portfolio has therefore experienced consistent growth from USD 12 mn in 1975. How well has Trinidad and Tobago done in facilitating SME access to finance in recent years? Table A7 below summarised the allocations of loans and advances to the private sector over the six-year period 2009 to 2014.

[62] See "Moving Beyond Collateralized Financing: Alternative Models based on Case Studies for the Regional Private Financial Sector". Ram Ramesh, CEO, Trinidad and Tobago International Financial Centre. Undated.

APPENDIX 4: ANALYSIS OF SME ACCESS TO FINANCE IN EIGHT BMCS

Table A7: Loans and Advances (L&A) to the private sector in T&T 2009–2014

Country and Category	2009	2010	2011	2012	2013	2014	Overall Change
Trinidad and Tobago (TT$millions):	41244.6	39933.1	41975.5	44208.8	45855.2	49148	
% Change in L & A to private sector		-3.18%	5.11%	5.32%	3.72%	7.18%	19.16%

Source: Trinidad and Tobago Central Bank online statistics 2016

On average, commercial bank lending to the private sector grew by 3.83% per year for the five-year period. Although L&As show a strong increase in 2014, it is unlikely that this trend will continue into 2016, especially given the dramatic contraction in global oil prices – which is having negative consequences for the Trinidad and Tobago economy. Nonetheless loans to the private sector have been growing at a faster rate than T&T's lacklustre economic performance. In terms of GDP, the country has failed to achieve more than an average of 1% GDP growth between 2007 and 2014[63].

[63] See Chapter 1, Regional MSME Sector Profile, Chart 1. Caribbean GDP Growth between 2007 and 2014

APPENDIX 5: COUNTRY & DONOR DEFINITIONS OF MSMES BY PARAMETERS

1. CARIBBEAN COUNTRIES & Source document	EMPLOYEES	ASSETS (US$)	ANNUAL TURNOVER (US$)	NOTES
ANGUILLA	**N/A**	**N/A**	**N/A**	No Current Definition
ANTIGUA & BARBUDA Small Business Dev't Act No. 24 of 2007	Small/Micro: ≤ 25	Small: ≤ $1,111,110	Small: ≤ $740,740	The majority of small and micro businesses are owned by citizens of Antigua & Barbuda. No formal definitions for micro and medium businesses.
ARUBA Central Bureau of Statistics	Medium: < 50 Small: < 10 Micro: < 2	Info not available	Info not available	Info not available
BARBADOS Investment & Dev't Corporation	Small: ≤ 36	Small: ≤ $250,000	Small: ≤ $380,000	
BARBADOS Manufacturers' Association Small Business Association	Small: ≤ 25	Small: ≤ $500,000	Small: ≤ $1,000,000	
BARBADOS Small Business Dev't Act 1999	Small: ≤ 25	Small: ≤ $500,000 (paid-up capital)	Small: ≤ $1,000,000	No formal definitions for medium businesses. An enterprise is considered either small or large. Financial institutions have their own definitions.
BELIZE MSME Policy & Strategy, 2012	Medium: < 50 Small: < 20 Micro: < 5	Medium: ≤ $250,000 Small: ≤ $75,000 Micro: ≤ $25,000	Medium: ≤ $750,000 Small: ≤ $250,000 Micro: ≤ $50,000	Micro enterprises must be owner managed The majority of companies are SMEs.
BONAIRE	Medium/Small: ≤ 100	Medium/Small - ≤ $55,865 (private equity)		

APPENDIX 5: COUNTRY & DONOR DEFINITIONS OF MSMES BY PARAMETERS

1. CARIBBEAN COUNTRIES & Source document	EMPLOYEES	ASSETS (US$)	ANNUAL TURNOVER (US$)	NOTES
BRITISH VIRGIN ISLANDS (BVI)	Medium: ≤ 20 Small: ≤ 10 Micro: ≤ 5		Medium: ≤ $200,000 Small: ≤ $125,000 Micro: ≤ $25,000	
CAYMAN ISLANDS	Small: < 13 Micro: < 5		Small: ≤ $914,630 Micro: ≤ $340,870	Medium sized business is not defined
CURACAO	* Medium: ≤ 249 Small: ≤ 49 Micro: ≤ 9			*SME Definition proposed by the UN (2005). There is no consensus in Curacao
GRENADA Small Business Policy, 2010	Medium: ≤ 50 Small: ≤ 20 Micro: ≤ 5	Medium: ≤ $370,370 Small: ≤ $185,185 Micro: ≤ $37,040	Medium: < $740,740 Small: < $185,185 Micro: < $37,040	Borrowing Needs: Medium: < $185,185 Small: < $92,600 Micro: < $18,520
GRENADA National Small Enterprise Dev't Advisory Committee.		Micro: < $18,500	Micro: < $36,000	no formal definition of "micro" & "small business"
GUYANA	Small: ≤ 25 Micro: ≤ 5	Small: ≤ $9,036 Micro: ≤ $3,012 (equipment investment)	Small: ≤ $39,000 Micro: ≤ $37,030	Informal definition - discussions with shareholders revealed this consensus view
GUYANA Small Business Act, 2004	Small: ≤ 25	Small: ≤ $96,570	Small: ≤ $289,570	Is a registered Cooperative Society under the Coop Societies Act
JAMAICA MSME & Entrepreneurship Policy, 2013	Medium: ≤ 50 Small: ≤ 20 Micro: ≤ 5		Medium: ≤ $1,250,000 Small: ≤ $416,670 Micro: ≤ $83,333	
JAMAICA Micro & Small Enterprise Survey, 1996	Micro: < 10	Micro: < $5,480 (initial capital investment)		
JAMAICA Government's Industrial Policy		Small: < $82,192 (capital investment - excl land/building)		

APPENDIX 5: COUNTRY & DONOR DEFINITIONS OF MSMES BY PARAMETERS

1. CARIBBEAN COUNTRIES & Source document	EMPLOYEES	ASSETS (US$)	ANNUAL TURNOVER (US$)	NOTES
JAMAICA Micro Investment Dev't Agency (MIDA)		Micro: < $16,340 (excluding land/building)		
MONTSERRAT Micro & Small Business Bill 2013		Small - $185,185 or less Micro - $27,780 or less	Small - $370,370 or less Micro - $37,040 or less	
SABA				No Current Definition. Most businesses are small.
SAINT LUCIA '98 Income Tax Act # 11	Small: ≤ 50		Small: < $400,000	No formal definitions for medium businesses. An enterprise is considered either small or large.
SAINT LUCIA Micro & Small Scale Business Enterprise Act 19, 1998 (amended 2001, 2009)	Small: ≤ 50 Micro: ≤ 5	Small: ≤ $185,185 Micro: ≤ $27,780	Small: ≤ $37,037,000 Micro: ≤ $37,030	The majority of firms in St. Lucia are micro-businesses.
SAINT LUCIA Small Enterprise Dev't Unit	Small: ≤ 40	Small: < $200,000	Small: < $400,000	No formal definitions for medium businesses. An enterprise is considered either small or large.
SAINT MAARTEN			Medium: ≤ $674,150 Small: ≤ $337,000 or less; Micro: ≤ $100,800 or less	Many enterprises have fewer than five employees and little capital. SMEs are therefore classified based on gross turnover.
ST. BARTHELEMY 2008 Act	Medium/Small: < 250	Medium/Small: < $48,310,900	Medium/Small: < $59,190,500	
ST. EUSTATIUS				No Current Definition. Most businesses are smal

APPENDIX 5: COUNTRY & DONOR DEFINITIONS OF MSMES BY PARAMETERS

1. CARIBBEAN COUNTRIES & Source document	EMPLOYEES	ASSETS (US$)	ANNUAL TURNOVER (US$)	NOTES
ST. KITTS NEVIS SKN SB Policy and Act - circa May 2010	Small: ≤ 25	Small: < $370,370	Small: < $740,740	the composition of the board of directors is not controlled by a large company or subsidiary of a larger group
ST. VINCENT Small Enterprise Policy and Draft Small Enterprise Bill	Medium: ≤ 50 Small: ≤ 20 Micro:- ≤ 5	Medium: < $370,370 Small: < $185,185 Micro: < $37,040	Medium: < $740,740 Small: < $185,185 Micro: < $37,040	Borrowing Needs: Medium: < $185,185 Small: < $92,600 Micro: < $18,520
TRINIDAD & TOBAGO *Manufacturers' Association	Medium: ≤ 150 Small: ≤ 50	Medium: $240,000 - $800,000 Small: $20,000 - $240,000 (excludes Real Estate)	Small: $20,000 - $1,000,000 Medium:$1,000,000 - $2,400,000	*Suggested Definition
TRINIDAD & TOBAGO MSE Dev't Policy (2014-2016)	Small - ≤ 25 Micro - ≤ 5	Small - ≤ $230,770 Micro - ≤ $38,460	Small - ≤ $769,230 Micro - ≤ $38,460	
TRINIDAD & TOBAGO Section 1 8A - Corporation Tax Act Chapter 75:02		Small: ≤ $230,770		
TRINIDAD & TOBAGO Small Business Dev't Co.	Medium: ≤ 50 Small: ≤ 25	Medium: $50,001 - $240,000 Small: $15,000 - $50,000 (excludes Real Estate)	Medium: $120,001 - $1,000,000 Small: $20,000 - $120,000	
TURKS AND CAICOS MSME Development Ordinance, 2015	Medium: ≤ 25 Small: ≤ 19 Micro:- ≤ 5 dd	Medium: ≤ $2,500,000 Small: ≤ $1,000,000 Micro: ≤ $500,000	Medium: ≤ $2,500,000 Small: ≤ $1,000,000 Micro: < $250,000	Other Parameters: Medium: In operation for at least 10 years Small: < $92,600 Micro: < $18,520

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Taming Volatility:

Fiscal Policy and Financial Development for Growth in the Eastern Caribbean

WORLD BANK GROUP

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Taming Volatility:

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Macroeconomic and Fiscal Management Global Practice
Caribbean Countries Management Unit
Latin America and the Caribbean Region

WORLD BANK GROUP

Acronyms and Abbreviations

AMC	Asset Management Company
AML	Anti-Money Laundering
BAICO	British Insurance Company
CLI	CLICO International Life
CLICO	Colonial Life Insurance Company
CLF	Trinidad and Tobago based CL Financial Ltd.
ECAMC	Eastern Caribbean Asset Management Corporation
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern-Caribbean Currency Union
ECHMB	Eastern-Caribbean Home Mortgage Bank
EM	Emerging Market
FATCA	U.S. Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FINDEX	Household Financial Exclusion Challenge
FD	Financial Development
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IADI	International Association of Deposit Insurance
ICRG	International Country Risk Guidance
IFC	International Finance Corporation
IQ	Institutional Quality
IMF,	International Monetary Fund
IV	Instrumental Variable
LAC	Latin America and the Caribbean
LCR	Latin America and the Caribbean Region
NFA	Net Foreign Assets
NPL	Nonperforming Loans
OAS	Organization of American States
OECS	Organization of Eastern Caribbean States
OLS	Ordinary least square estimations
PCG	Partial credit guarantee
RGSM	Regional Government Securities Market
SIDS	Small-Island Development States
SME	Small- and Medium-Sized Enterprises
TFP	Total Factor Productivity
TOT	Terms of Trade
US	United States
WDI	World Development Indicator
WEO	World Economic Outlook

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Acknowledgments

This report was written by a team led by Francisco Carneiro, Lead Economist and Program Leader for the Caribbean Region at the World Bank, and Rei Odawara, Senior Country Economist for the OECS countries in the Macroeconomics and Fiscal Management Global Practice. The core team included Markus Brueckner, University of Queensland, Australia; Viktoria Hnatkovska, University of British Columbia, Canada; Ha Nguyen, Economist at the Macroeconomics and Growth Unit of the Development Research Group; Nadeem Karmali, Financial Economist, and Caroline Cerruti, Senior Financial Sector Specialist at the Finance and Markets Global Practice; Kirsten-Anne Elizabeth Roach, Junior Professional Associate in the Macroeconomics and Fiscal Management Global Practice; Leonardo Garrido, consultant, Robert H. Singletary, consultant and Meir G. Kohn, consultant.

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Executive Summary

This report assesses the sources of macroeconomic volatility in the Eastern Caribbean and discusses policy options to deal with the effects of volatility and that could have positive effects on long-term growth. In doing so, the report contrasts the performance of the member countries of the Organization of Eastern Caribbean States (OECS) with that of other developing economies in the Caribbean and other regions of the world. More specifically, the analysis focuses on the interplay between terms of trade volatility, fiscal policy (pro) cyclicality, and financial development on growth in the OECS region. By considering the interaction between these factors, the report investigates whether (i) an increase in volatility results in lower GDP growth; (ii) the negative impact of volatility on growth is more pronounced in less financially developed countries, and (iii) in countries where fiscal policy is more pro-cyclical.

Understanding the sources of macroeconomic volatility and how to deal with them is important for a region that is prone to face exogenous shocks. Economic growth rates in the OECS are now higher than in the recent past and this represents an opportunity for the region to strengthen its ability to manage the impacts of unexpected shocks. Output growth rates over the last three years are at a higher level than the average for the period 2009-13 period and there is hope that this growth momentum can be sustained. However, history suggests that the small, open economies of the OECS will remain vulnerable to considerable volatility stemming from terms of trade shocks. In the past, the region has been affected by a series of adverse events, including the erosion of trade preferences; the decline in official foreign assistance; turbulence in the business cycles of the countries that matter the most for the region in terms of tourism revenues and foreign direct investments; and recurrent natural disasters. With the incipient recovery, the OECS economies have an opportunity to build resilience to exogenous shocks.

The report is structured in four chapters that outline the main sources of volatility in the region and suggest ways to mitigate the impacts of that volatility on growth. Chapter 1 presents stylized facts associated with the growth performance of the Eastern Caribbean over the last 40 years. It contrasts the growth performance of the OECS with the rest of the Latin America region and shows that the two groups of countries have shown significant heterogeneity over the business cycle. The chapter also highlights some of the factors that might be responsible for the volatility of growth in the OECS, including the region's exposure to natural disasters, high debt, and adverse developments in the financial sector. Chapter 2 provides new evidence on output volatility and the cyclicality of fiscal policy in the OECS and discusses why countries are better off avoiding a pro-cyclical fiscal policy stance. Chapter 3 assesses the level of financial development in the region as well as the relationship between financial development, growth, and volatility. The chapter also explores critical policy options to strengthen financial development in the OECS. Chapter 4 assesses empirically the combined effects of terms of trade volatility, fiscal policy (pro) cyclicality, and financial development on growth in the OECS and other countries using two complementary modeling approaches. First, through an econometric model using panel data for 175 countries over the period 1980-2010. Second, by using impulse-response analysis based on a structural model of the business cycle in the OECS region.

Growth in Latin America and the Eastern Caribbean

While economic growth in the Latin America region has plummeted over the last five years, the economies of the Eastern Caribbean are showing signs of a growth rebound. With the end of the "commodity super-cycle", the Latin America region has been experiencing a significant growth deceleration for the last five years or so. Countries in the south of Latin America have followed a different cycle when compared with those in the north and the Caribbean. Since the beginning of the "great deceleration" in 2011, the commodity-dependent south has followed closely the business cycle observed in China. The countries in the north, on the other hand, have followed more closely the business cycle of the U.S., which has started to show signs of some recovery. In the Caribbean, however, the story is slightly different as growth rates are now much higher than immediately after the global financial crisis.

The close ties with the U.S. economy and its business cycle means that the OECS remains vulnerable to the fluctuations of output in the U.S. as well. Evidence presented in this report confirms that the economic performance of the small islands of the OECS is much more closely associated with developments in its main trade partners, especially the United States and the European Union, than with its peers in the Caribbean. Tourism is the single-most important industry for the OECS countries, ranging from 26 percent of GDP in St Vincent and the Grenadines to 74 percent of GDP in Antigua and Barbuda. Most of the tourists who visit the Caribbean with frequency come from the U.S. and Europe. As tourism is very income-elastic, when these two countries face a shock and the income of their residents drops, tourism trips to the Caribbean and elsewhere are likely among the first items to be cut. The pro-cyclicality of tourism is also mimicked by foreign direct investment (FDI) inflows, which have also been found to follow closely the business cycle observed in the U.S. economy.

The small size, degree of trade openness, and other intrinsic characteristics of the OECS economies have contributed to the volatility of economic growth in the region. This report finds that economic growth volatility in the OECS is higher than the average for the world. Although output volatility was more pronounced in the early half of the 1990s and more recently during the global financial crisis than it is now, several factors make the region prone to exogenous shocks that can be a source of volatility. These include small size, openness to trade, and the synchronization with major global growth poles (such as the U.S. and EU), as well as the region's exposure to natural hazards (such as hurricanes and severe storms and flooding, for example).

Output Volatility and the Cyclicality of Fiscal Policy

The large majority of developing countries, including the ones in the Eastern Caribbean, have yet to graduate from procyclical fiscal policies. Although the number of developing countries following a more procyclical fiscal policy stance has declined over time, they are still outnumbered by the more industrialized economies. In the Caribbean, and the OECS in particular, the majority of the countries also tend to follow procyclical fiscal policies. The reasons for such behavior are various. This could be due to frictions in international credit markets that might prevent countries from borrowing in bad times and forcing them to lower spending during recessions. It could also be seen as a signal of weak and underdeveloped institutions in governments where there is limited technical capacity to develop the means to save in good times to spend in bad times.

Governments should avoid reinforcing the business cycle because this behavior jeopardizes their ability to lean against the wind in periods of hardship. A pro-cyclical fiscal policy can hamper government efforts to reduce the effects of volatility on growth. In general, government spending can mitigate the negative effect that volatility has on growth if: (i) government spending is counter-cyclical; and (ii) its impact on output is positive. From a risk management point of view, a counter-cyclical fiscal policy can be useful for at least three compelling reasons. First, by leaning against the wind, governments can continue to provide goods and services and to maintain public investment even in the event of a drop in public revenues. Second, in a downturn, a countercyclical fiscal policy can help governments increase social assistance. Third, as witnessed during the global financial crisis of 2008-09, a countercyclical fiscal policy can help countries stimulate the economy and cope better with the effects of a prolonged recession.

Most of the OECS economies have adopted a fiscal policy stance that seems to exacerbate output volatility. That is, they tend to behave in a pro-cyclical way during booms and downturns. The only exception seems to be St. Kitts and Nevis which appears together with Trinidad and Tobago, and Belize, in the group of countries that show a counter-cyclical behavior in booms, which is a good indication that they are saving for rainy days. However, these countries still display a pro-cyclical behavior in downturns. In doing so, they tend to amplify upswings and worsen recessions – what Kaminsky, Reinhart, and Vegh (2004) termed as the "when it rains, it pours" phenomenon. This behavior is in stark contrast with that of the large majority of industrialized countries that have largely adopted a counter-cyclical or even a-cyclical fiscal policy stance.

The volatility of output observed in the OECS region is also present in many of its relevant macroeconomic aggregates. An assessment of the volatility of major macroeconomic aggregates, including interest rates, trade balance, terms of trade, investments, government spending, and net foreign assets (NFA), shows that all of them are volatile. The observed volatility in the OECS is quite high compared to developed economies and even compared to a few other developing countries. The highest GDP volatility is observed in Antigua and Barbuda and in Grenada. Interest rates are also quite volatile in these countries but the magnitudes are similar across them, with the exception of St. Lucia. The volatility of trade balance and terms of trade shows much more dispersion across the OECS countries. In this context, the report finds that the OECS countries exhibit very volatile business cycles, even compared to developing economies.

Financial Development in the OECS

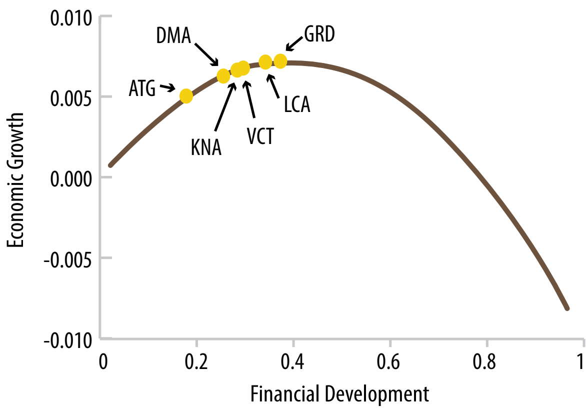
Financial development is an important driver of growth and can increase a country's resilience to external shocks and volatility. Financially developed economies find it easier to mobilize savings, share information, improve resource allocation, and implement more effective diversification and risk management strategies. In the OECS context of a currency board that provides for a monetary anchor, limited fiscal space, and GDP that is highly dependent on services, the role of the financial sector as a driver of growth is further enforced. Financial development also leads to financial stability to the extent that deep and liquid financial systems with more diverse instruments can help alleviate the impact of shocks. Financial development also helps countries to manage better the impact of terms of trade volatility, especially in the case of small, open economies such as in the case of the OECS.

The association between financial development and economic growth is well recognized in both the growth and finance literature. Economic theory suggests that well-functioning financial intermediaries and markets are the conduit to reduce information asymmetries, facilitate risk sharing and mobilize savings. This then leads to a more efficient resource allocation and, thus, may foster long-term growth. More recently, evidence points to a more complex relationship between finance and growth that may be non-linear or bi-directional depending on whether the financial market is equity or bank based.

In the OECS countries, there is clearly a non-linear association between financial development and growth as well as volatility. The analysis is this report has confirmed empirically the non-linearity in the association between financial development, growth as well as volatility for the OECS countries (Figure ES 1 and Figure ES 2). Using an index of financial development produced by the International Monetary Fund (IMF), our results are unequivocal that financial development impacts growth positively. However, this positive effect weakens at higher levels of financial development and then eventually turn negative portraying a bell-shaped relationship between growth and financial development. We have also confirmed the existence of a non-linear relationship between financial development and volatility. As a mirror image of the dynamics between financial depth and growth, financial development initially lowers volatility up to a certain point where it starts to create additional volatility (Figure ES 2).

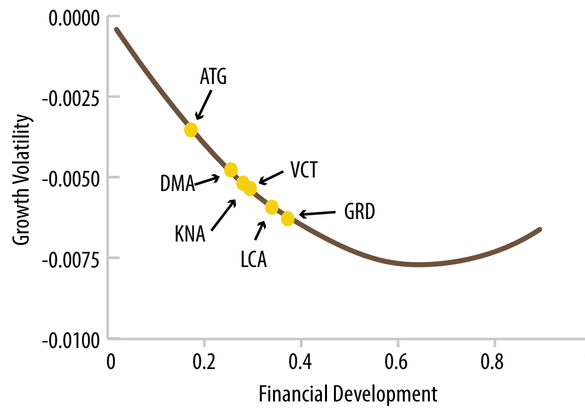
The OECS should continue to pursue ways to strengthen its financial sector as this will contribute to reduce volatility and create appropriate conditions for sustainable growth. In both charts above, the position of each of the six OECS countries is well before the inflexion point, beyond which further development of the financial sector may have detrimental effects to economic growth and volatility. Given the high level of credit to

Figure ES1 Growth & Financial Development



Source: Authors' own calculations using the financial deepening index developed by the IMF in Sahay and others (2015a).

Figure ES2 Volatility & Financial Development



Source: Authors' own calculations using the financial deepening index developed by the IMF in Sahay and others (2015a).

GDP, the OECS should strive to reorient its financial sector to improve its comprehensive level of financial development. This reorientation – on both the supply and demand side –will positively contribute to economic growth and stability.

To reorient financial development in the region to be more comprehensive, a number of challenges need to be addressed. Over the last decade, the OECS countries have made progress to further develop their financial systems. However, there is scope to reorient financial development in the region so that it less prone to high collateral-low productivity projects, less likely to create asset price bubbles and is able to contribute to enhancing economic growth and reducing volatility.

There are feasible policy options that could help reorient financial development in what that would contribute to lower volatility, higher growth, and a more effective fiscal policy. Improving savings instruments, strengthening the regional supervision of insurance, and establishing deposit insurance could all help economic agents better manage volatility. Restoring banking stability can reduce the systemic volatility that has emanated from the heightened stress that the banking sector has experienced over the past five years. The new Banking Act that has been passed provides the foundation for improved banking supervision and future consolidation. Developing long term finance for infrastructure and more housing in addition to developing tools for more effective SME finance against the backdrop of improvements to the enabling environment and credit infrastructure are critical for enhancing economic growth. Finally, this chapter highlighted the importance of reversing the short-termism in sovereign debt markets in the OECS and striving for a more active secondary market as a way to improve the efficacy of fiscal policy in the OECS.

The Effects of Volatility, Fiscal Policy Cyclicality, and Financial Development on Growth

Econometric estimates show that the negative effect of terms of trade volatility on growth is mediated by cross-country differences in financial development. Using an econometric model that includes an interaction term between terms of trade volatility and the GDP share of domestic credit to the private sector we were able to confirm that terms of trade volatility has a significant negative effect on economic growth; however at higher values of financial development the effect loses significance. We have also confirmed through our econometric model the results discussed above that the relationship between GDP p.c. growth and the GDP share of domestic credit to the private sector is an inverted U-shaped. The average marginal effect of financial development on economic growth remains, however, positive and significant.

Terms of trade volatility has a particularly large negative effect on economic growth in countries where fiscal policy is procyclical. This relationship was confirmed by the empirical results of the econometric model that includes an interaction term between the standard deviation of the terms of trade growth rate and the country-specific coefficients that measure the response of government spending to the business cycle. The coefficient on the interaction between terms of trade volatility is negative in all specifications. In addition, the results show that the coefficient on the interaction between terms of trade volatility, fiscal procyclicality, and the OECS indicator is significantly negative. Further, the interaction between terms of trade volatility and fiscal procyclicality is also negative and significantly different from zero. These results suggest that: (i) fiscal procyclicality exacerbates the negative growth effect of terms of trade volatility – for the OECS region and for other regions; and (ii) the mediating role of fiscal cyclicality is particularly pronounced in the OECS region. It is also noteworthy that the coefficient on the interaction between terms of trade volatility, financial development, and the OECS indicator is significantly positive.

A structural model of business cycles in the OECS confirmed that further financial development could help reduce volatility in the region. By using a complementary modeling approach, we have looked at the impacts of different types of shocks to fiscal policy in the presence of financial frictions on the economic performance of the region. Our simulations (based on impulse-response analysis) suggest that eliminating fiscal policy shocks could reduce the volatility of consumption and trade balance, but without the volatility of GDP. We also show that domestic financial markets development plays an important role in buffering the effects of interest rate shocks on the economy. Eliminating the working capital constraint, while keeping all shocks in place, for example, could reduce the volatility of GDP, consumption, employment and government spending significantly.

Directions for Policy to Reduce Volatility and Sustain Growth in the OECS

Moving toward a more counter-cyclical fiscal policy should be a priority for all the countries in the OECS. This will have particularly high payoffs in terms of reducing the adverse growth effects of terms of trade volatility in the region. One way of strengthening the region's ability to shift toward a more counter-cyclical fiscal policy stance would be through the adoption of fiscal responsibility laws and fiscal rules. These are widely recognized as effective mechanisms that can increase the discipline and credibility of the fiscal authorities. Not only would these policy tools help in making fiscal policy less pro-cyclical in the OECS, but they would also help the countries in the region to make significant progress in reigning in fiscal expenditures and implementing effective fiscal consolidation programs. The introduction of fiscal rules would need to be supported by expenditure reforms in the context of a medium term fiscal framework to signal the authorities' commitment to fiscal sustainability. Given that natural disasters are common across the region, OECS countries would do well to integrate the likelihood of a disaster in their fiscal programming exercises. Many countries in similar situations have benefitted from the parallel creation of an independent fiscal council that monitors macroeconomic projections underlying the budgeting process and the compliance with the fiscal rule.

This report argues that OECS countries can also draw on existing good practices on how to strengthen their fiscal positions and be better equipped to adopt counter-cyclical fiscal policies. Moving towards a full blown FRL, with or without a formal fiscal rule, requires some preparation and building technical capacity in order to design, implement, and monitor the new policy tool. There are some well-established good practices in that regard that could help the Eastern Caribbean states to become less procyclical. In addition to internalizing the likelihood of a natural disaster in their financial programming exercises, countries in the region should consider establishing savings funds with a strong institutional framework, a solid governance structure and clear operational rules for the allocation of the fund's resources. The proceeds accumulated in such a fund could be used for emergency situations, following a disaster or a protracted economic shock, for example. The OECS countries should also strive to ensure that fiscal policy guides the budgetary process and not the other way around; this could be done through the adoption of medium-term fiscal frameworks (MTFFs) and medium-term debt management strategies. Other policy options that could help Eastern Caribbean countries respond in a more symmetric way to the business cycle include, for example, expenditure ceilings, cyclical deficit targets, and rules-based stabilization funds.

Reducing volatility and sustaining growth will require more stable financial markets and stronger financial

sector institutions. This report discusses a few options for designing policies to help the OECS economies to achieve that objective. First, greater openness to international financial markets is important as it could help the OECS economies to hedge fluctuations in fundamental shocks, such as shocks to technology, terms of trade, and shocks associated to natural hazards. Second, greater openness must be accompanied by improvements in domestic financial markets and government's efforts to stabilize domestic risk-premium. By reducing the frictions in the domestic financial markets, these economies can cushion the negative effects of interest rate shocks on domestic economic activity, and achieve lower volatility. Third, if pro-cyclical fiscal policies induce higher country risk-premium in the international markets, governments of the OECS countries can stabilize their country's risk-premium by switching to counter-cyclical policies. Fourth, if government consumption is strongly complementary with private consumption, switching to an independent or counter-cyclical fiscal policy stance can reduce the volatility of consumption in the economy. All of these should have a positive effect on long-term growth.

To strengthen financial development in the region, a number of challenges need to be addressed. Over the last decade, the OECS countries have made progress to further develop their financial systems. However, there is scope for further financial development in the region. The report identified specific measures that can be adopted to further enhance financial sector development. A new Banking Act has been passed which provides the foundation for improved banking supervision and future consolidation, and the insurance sector would benefit from similar harmonization. NPL management should be strengthened, and if an AMC is adopted, its scope and nature should follow leading global examples. Financial access can be improved through better credit information tools and institutions that help to reduce the elevated levels of SME credit risk such as a guarantee scheme. Finally, there are legal and regulatory improvements in the secured transactions framework and in the foreclosure legislation that would greatly help the sector. Careful coordination across all of the above will ensure that a strengthened and more nimble financial sector is better able to provide for the needs of the economy of the OECS. Once the financial sector is strengthened in the region, a deposit insurance scheme can be developed to provide a formal financial sector safety net.

A summary of the main recommendations of the report are presented in Table ES 1.

Table ES1: This Report's Main Policy Recommendations

Policy Objectives and Strength of Policy Leverages	Priority Areas to Reduce Volatility and Buttress Growth
What Has Been Done to Strengthen Fiscal Discipline	**What Could Be Done to Make Fiscal Policy Less Pro-cyclical**
Grenada remains the only country in region to have adopted a rules-based fiscal policy framework and its example should be emulated in its neighboring countries.	A savings funds with clear operational rules for the allocation of the fund's resources could be a good complement to this initiative.
Many OECS countries have defined fiscal surplus targets, ceilings on public spending, or limits on debt creation, but the region remains largely vulnerable to natural disasters.	Countries in the region are strongly advised to include in their fiscal targets buffers to cover future disaster-related expenses.
Homegrown fiscal consolidation programs are being deployed across the region with a view to reign in expenditures and reduced debt.	Adoption of medium-term fiscal frameworks (MTFFs) and medium-term debt management strategies could help strengthen fiscal discipline and ensure that fiscal policy guides the budgetary process and not the other way around.
Fiscal policy remains largely pro-cyclical in the OECS.	Adoption of formal fiscal responsibility laws (FRLs) and/or fiscal rules and fiscal councils could help OECS countries strengthen fiscal discipline and move toward a more counter-cyclical fiscal policy stance.
What Has Been Done to Strengthen Fiscal Discipline	**What Could Be Done to Make Fiscal Policy Less Pro-cyclical**
The OECS has a regional sovereign debt market (RGSM) which has recently been de-materialized and is fully electronic.	There is a need to reverse the short-termism in the RGMS, strengthen the secondary market in order for fiscal policy to be more effective.
A new banking act has been passed which will reduce some of the systemic volatility that the recent banking stress has created	Restoring the stability in the banking sector will help reduce this systemic volatility. Further, improving savings instruments, strengthening the regional supervision of insurance, establish deposit insurance could all help reduce volatility
Financial development has not been growth focused in the OECS	The OECS needs to work on developing more long-term finance (including infrastructure and housing) and SME finance while working in parallel to improve the enabling environment and credit infrastructure. This will help reorient financial development to be more comprehensive and enhance economic growth

Chapter 1.
Growth In The Caribbean: Vulnerable And Volatile

Introduction

The Organization of Eastern Caribbean States (OECS) region has suffered the effects of the global financial crisis and is starting an encouraging recovery. Economic growth rates over the last three years are now higher than their average during the 2009–13 period and there is hope that this growth momentum can help the region reduce poverty faster than in the past. However, history demonstrates that this region remains vulnerable to considerable volatility. This volatility has many sources and can be manifested in different forms. In the past, the region has been affected by a series of adverse exogenous shocks, including the erosion of trade preferences; the decline in official foreign assistance; turbulence in the business cycles of the countries that matter the most for the region in terms of tourism revenues and foreign direct investments; and recurrent natural disasters. While there is optimism with the incipient recovery in the OECS, there is no reason to believe that the latent sources of vulnerability and volatility in the region have subsided.

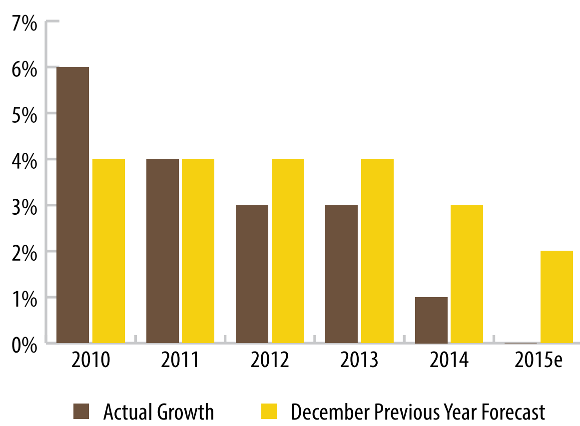
This chapter presents some stylized facts associated with the growth performance of the Eastern Caribbean over the last 40 years. In the first section, we contrast the growth performance of the OECS with the rest of the Latin America region and show that the two groups of countries have shown significant heterogeneity over the business cycle. Section 2 focuses on the main factors that explain the growth trajectory of OECS countries, including the role of Total Factor Productivity. Section 3 discusses some of the aspects that may have contributed to a history of growth vulnerability in the region and Section 4 highlights some factors that might contribute to the volatility of growth in the OECS, including the region's exposition to natural disasters, high debt, and adverse developments in the financial sector.

Growth in Latin America and the Caribbean – A Tale of Two Regions

Economic growth in Latin America has been on a downward spiral for the last five years. After several years of high commodity prices and strong regional growth during a period that was commonly referred to as the "commodity super-cycle," commodity prices have been decreasing since 2011, along with Chinese economic activity, weakening the region's terms of trade. As a result, the region has witnessed its most pronounced and long-lasting growth deceleration since 2009, the year that marked the height of the global financial crisis. The deceleration has frustrated most growth forecasts due to its magnitude (Figure 1.1) and seems to reflect underlying weaknesses in both aggregate demand and supply in an unfavorable external environment. While growth has decelerated across the region, the regional average has been dragged down by developments in Argentina, Brazil and Venezuela, which have had the highest rates of growth deceleration in the region and recorded their worst economic performances in decades (Figure 1.2).

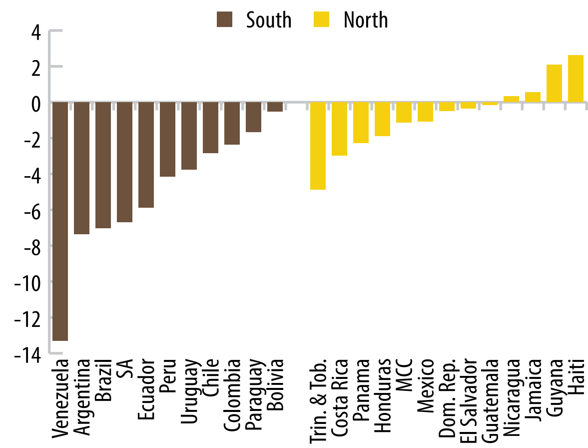
While growth has decelerated across the whole region, the countries in the south have followed a different cycle when compared to those in the north. The

Figure 1.1 Actual and Forecasted GDP Growth in LAC – 2010 to 2015



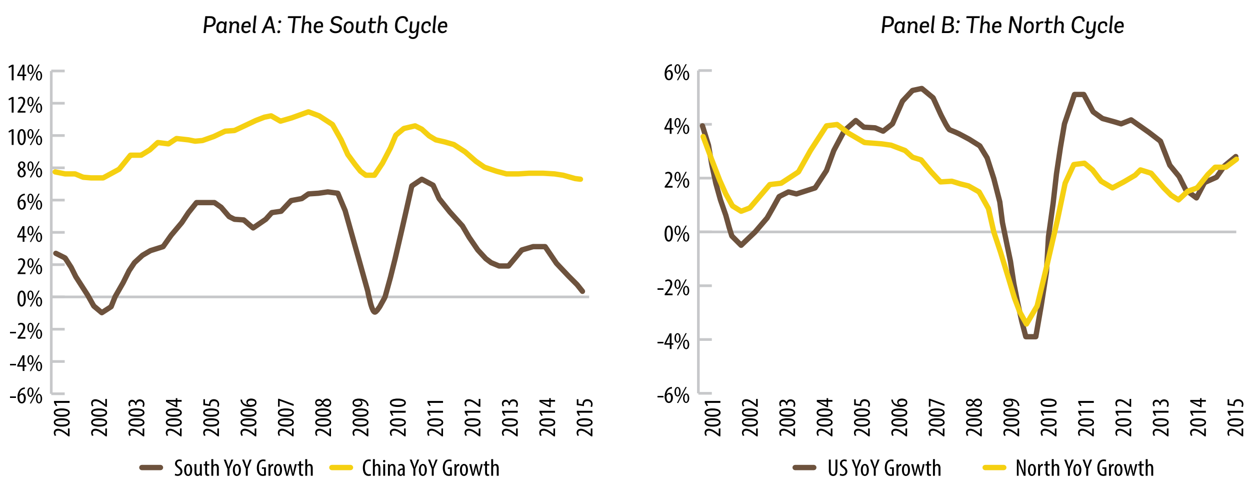
Source: LCR Chief Economist's Office estimates.

Figure 1.2 Growth Deceleration in LAC



Source: LCR Chief Economist's Office estimates.

Figure 1.3 Heterogeneity in Growth in Latin America

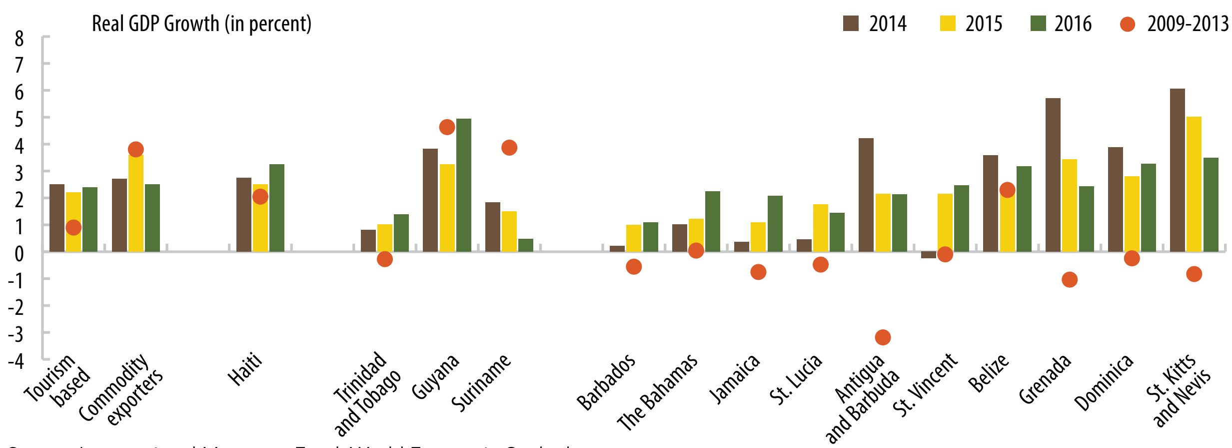


Note: Real GDP growth rates smoothed by the Hodrik-Prescott filter. South includes Argentina, Bolivia, Brasil, Chile, Colombia, Ecuador, Peru, and Uruguay. North includes Panana, Costa Rica, Dominican Republic, El Salvador, Guatemala, Jamaica, and Mexico. *Source*: LCR Chief Economist's Office estimates.

region's main commodity exporters, including, for example, Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, and Uruguay are concentrated in the south of Latin America. This is the part of the region which has been hit the hardest by the fall in global commodity prices (Figure 1.2). The countries in the north, including Panama, Costa Rica, Dominican Republic, El Salvador, Guatemala, Jamaica, and Mexico, among others, have also shown significant growth decelerations, but the magnitude of this phenomenon has not been as pronounced as in the south. What is interesting to note is that the north and the south have followed very different business cycles since the beginning of the "great deceleration" in 2011. The commodity-dependent south appears to follow closely the same business cycle as China's but with a much more pronounced drop in output in the recent period, even when compared with the growth slowdown observed in China. On the other hand, the north of South America seems to follow very closely the U.S. business cycle, but differently from what has happened in the most recent years in the south, growth seems to be recovering in the northern countries mimicking the pickup in the United States.

In the Caribbean, the story is slightly different from the rest of the region as growth has been much better

Figure 1.4 Caribbean Growth is Stronger Now than in the Past



Source: International Monetary Fund, World Economic Outlook.

now than in the past. Perhaps boasted by the recovery in the U.S. economy in the most recent years, the tourism-dependent economies of the region have shown growth rates in 2014–2015 that are much more robust than the ones observed over the 2009–13 period (Figure 1.4). More specifically, in 2014–15 the tourism sector was the main engine of growth in the tourism-intensive economies of the Caribbean (The Bahamas, Barbados, Jamaica, and the countries of the Eastern Caribbean Currency Union, ECCU), due to rising visitor arrivals (buoyed by the U.S. recovery). Tourism contributed to stronger-than-expected growth in these countries, except in the case of Jamaica, where a drought had deleterious effects on growth. The performance of the Caribbean commodity exporters (Suriname, Guyana, and Trinidad and Tobago), on the other hand, has been in line with that of the other commodity exporters from the south of Latin America where past growth has been higher than current growth. In addition, since 2011, there has been a positive terms-of-trade shock with the decline in commodity prices – one that turned sharper with the more recent decline in oil prices. The recent evolution of the terms of trade might be another important factor that could contribute to robust growth in the region.

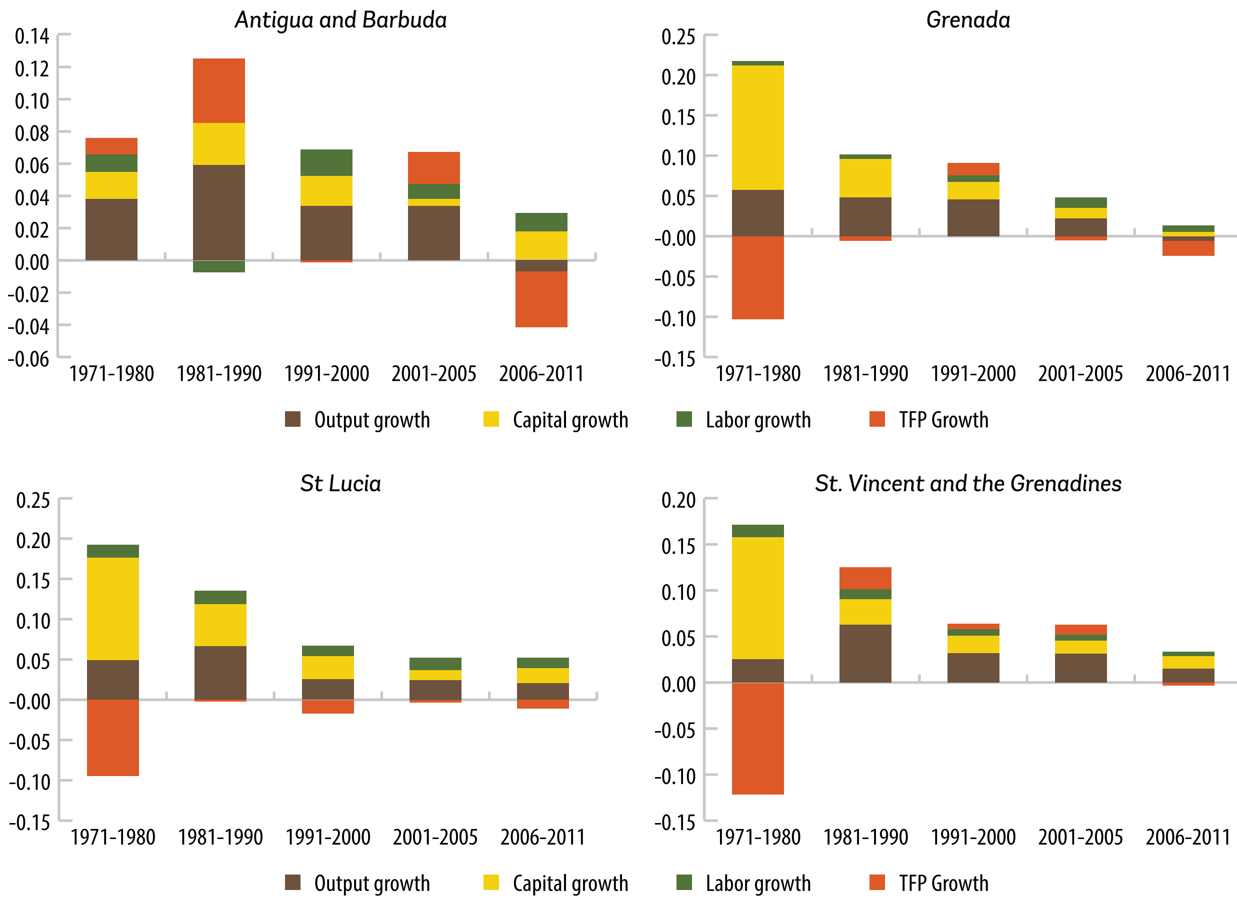
The Recent Economic Performance in the OECS

Historically, the economic performance of the members of the OECS has been particularly uneven. This is due to reasons that range from the need to reinvent themselves after the end of preferential trade agreements with Europe in the 1980s to the frequency of natural hazards. After growing faster than the rest of the world in the 1980s at an annual average of 6 percent, the OECS countries have experienced a significant growth slowdown since the 1990s with annual growth rates of 2 percent or less on average. More recently, the region was severely hit by the effects of the global financial crisis of 2008-09 because of their close ties with the economies of the U.S., Canada, and Europe which are their main source of tourist arrivals.[1] Some common challenges faced by the small economies of the OECS include exposure to frequent natural disasters; vulnerability to external shocks; high debt; and lack of economies of scale.

Total Factor Productivity (TFP) has been an important determinant of growth in the OECS over the last 4 decades but its importance has declined more recently. Results from a growth accounting exercise reveal that TFP explains the bulk of the variation in economic growth in the ECCU during the last 40 years (Figure 1.5). TFP's contribution to growth for the OECS on average has been declining after reaching its peak in the 1970s when it explained 86 percent of regional growth; this contribution has come down to just 8 percent in the early 2000s. The downward trend in TFP was mainly due to reduced productivity in Dominica, St. Lucia and more recently Grenada, with negative TFP growth observed in the cases of Dominica and Grenada (see Schipke et al. (2013)). More recently, however, a few countries in the OECS, including Antigua and Barbuda, St. Kitts and

1 See Kouame and Reyes (2015) for evidence of how the Caribbean's economic growth rates relate to those of key drivers of the global economy.

Figure 1.5 Output Growth Decomposition for Selected OECS Countries: 1971–2011



Nevis, and St. Vincent and the Grenadines, showed improvements in productivity growth between 2000 and 2005, but turned to negative TFP growth in the period that coincided with the global financial crisis (2006–11). While it may be difficult to precise the exact causes behind this trend, it might be the case that these countries were successful in gradually shifting towards more capital intensive tourism and away from labor intensive agriculture throughout the region during the first half of the 2000s and before suffering the impacts of the global crisis.

Updated data available for Antigua and Barbuda, Grenada, St. Lucia, and St. Vincent and the Grenadines reveal that TFP growth in the latter half of 2000s turned negative for all of these four countries. As pointed out by Barro (1998), negative TFP growth is hard to interpret because it suggests a decline in technical progress, reflecting a reduction in the efficiency with which the other factors of production are used either because of complementary factors or due to bad policies and weak institutions. Another explanation for negative growth is the underutilization of resources, such as capital and labor. Negative TFP growth in the latter half of 2000s could be caused by the underutilization of capital in particular, or resources in general, during the Great Recession.

The performance of the OECS economies appears to follow closely the economic performance of the United States and the European Union. In a recent paper, Kouame and Reyes (2015) studied the relation between growth in the Caribbean and some global growth engines, namely the United States, the European Union, Brazil, and China. They first assessed empirically the relationship between growth rates in the Caribbean and the global growth poles, and then tried to discern the effect of business cycle movements in the global growth poles on the Caribbean. They found a statistically significant and positive relationship between growth in the United States and the Caribbean, as well as between growth in the European Union and the Caribbean. The evidence of growth synchronization between Caribbean states with Brazil and China, however, was weak and not statistically significant. That finding is consistent with the good performance of the Caribbean, and especially the tourism-dependent economies of the OECS, in the most recent period.

A History of Vulnerabilities to Economic Shocks

Small states are subject to a number of vulnerabilities that can hamper their long-term growth. A recurring question commonly asked by those who live and work on small states is whether small economy states actually suffer from their smallness? Easterly and Kraay (2000) addressed this question head on and argued that there are good theoretical reasons to believe that they do. According to these authors, the provision of public services may be subject to indivisibilities that lead to increasing returns to scale, especially fiscal institutions and defense. They also raised theoretical arguments suggesting that increasing returns to scale in the private economy may be difficult to realize in small states and that small economies may also be at a disadvantage because their size prevents them from diversifying into a wide range of activities, making them more vulnerable to terms of trade shocks than large states. To complicate matters even further, many small states suffer from poor location in that they are remote and/or landlocked, and many are located in regions prone to hurricanes and volcanic activity. Easterly and Kraay (2000) argued further that public officials in small states may be much more likely to be subjected to conflicting pressures, and that it may be difficult to recruit a high-quality civil service given the limited pool of candidates in small states. In what follows, we briefly discuss some of the sources of these vulnerabilities.

The high synchronization of the region with the U.S. business cycles means that the OECS remains vulnerable to exogenous shocks. We were able to confirm this by calculating the average correlation of the change in GDP per capita (in constant 2005 US$) between OECS countries and the U.S. as well as the rest of the world between two consecutive periods, 1980-1999 and 2000–2014. The underlying assumption is that since OECS countries are very small, they are not expected to affect world GDP. The correlation, therefore, only reflects the impact of the world's economic volatility on the OECS countries. With the exception of probably Dominica, all other OECS countries' GDP per capita are highly correlated to the U.S and world output. The most vulnerable country is Antigua and Barbuda, with the correlation to the U.S. output of 0.66, which means that if the U.S. GDP were to drop by 1 percentage point in any given year, the GDP of Antigua and Barbuda would be expected to decline by 0.66 percentage point (see Table 1.1). The high correlation of Antigua and Barbuda with the US and world output might be related to the country's high dependence (the highest among the OECS countries – see Table 1.4) on tourism. While this high dependence represents an important source of vulnerability on the downward side of the business cycle, it also means that Antigua and Barbuda would be the OECS country standing to benefit the most from a growth acceleration in the U.S. economy.

The performance of the small islands of the OECS seems to be much more closely associated with external developments than its peers in the Caribbe-

Table 1.1: Correlation of OECS Real GDP Per Capita Growth with the U.S. and the Rest of the World (1980 to 2014)

Growth in real GDP per capita (constant 2005 US$)	1980–1999		2000–2014	
	World	USA	World	USA
Grenada	0.5	0.21	0.41	0.5
Dominica	0.1	0.11	0.24	0.07
St. Vincent and the Grenadines	0.24	0.15	0.13	0.21
St. Lucia	0.45	0.46	0.39	0.39
St. Kitts and Nevis	0.64	0.49	0.47	0.46
Antigua and Barbuda	0.38	0.44	0.68	0.66

Source: World Bank staff calculations based on World Development Indicators.

an and elsewhere. To put OECS' external vulnerability into perspective, we compare their external dependence with that of other Caribbean countries and other small islands. From Table 1.2, two observations are noteworthy. First, the correlation between growth in OECS' GDP per capita and the world's as well as the U.S.' appears consistently in the range between 0.55–0.65 over time. This suggests that the OECS's output growth is consistently dependent on world output. Second, OECS economies are significantly more dependent on the world than other Caribbean islands and other non-Caribbean small islands. This finding reinforces the view that OECS countries are more vulnerable to external economic shocks than their comparators.

The export performance of the OECS countries is also closely associated with the business cycles in the U.S. and the rest of the world. To gain a better understanding of the OECS's vulnerability to external shocks, we investigate three factors that could be responsible for this external dependence: export revenues, tourism revenues, and FDI inflows. In particular, we examine how dependent OECS export and tourism revenues are to the world and the U.S. GDP per capita. We start with an examination of the region's exports. Overall, we find that the OECS's export performance is positively correlated with U.S. and the world's GDP, with the exceptions of Dominica during the 1980s and 1990s, and St Lucia between 2000 and 2014. Among the other countries, St. Kitts and Nevis stands out as the country where export revenues are the most dependent on world GDP: its correlations to the U.S. and world GDP are 0.69 and 0.77, respectively (Table 1.3).

Tourism revenues in the OECS are highly vulnerable to external economic volatility. Tourism is the single-most important industry for the OECS countries. The total contribution of international tourism in 2011, for example, ranged from 26.2 percent (for St Vincent and the Grenadines) to 74.2 percent of GDP (for Antigua and Barbuda) (see Table 1.4). Tourism, unfortunately, is very income-elastic. That is, when income falls, tourism trips are likely among the first items to be cut in a household's budget planning. Not surprisingly, tourism revenues are highly vulnerable to external economic volatility. This can be seen from Table 1.5 which presents the correlation between the change in the log of real international tourism revenue per capita and world real

Table 1.2: Regional Comparison of Correlation of Real GDP Per Capita

Growth in real GDP per capita (constant 2005 US$)	1980–1999		2000–2014	
	World	USA	World	USA
OECS average	0.63	0.56	0.64	0.65
Other Caribbean	0.10	0.00	0.42	0.44
Other small islands	0.52	0.58	0.29	0.15

Source: World Bank staff calculations based on World Development Indicators.

Table 1.3: OECS' Export and World GDP

Growth in real export per capita	1980–1999		2000–2014	
	Growth in real GDP per capita World	Growth in real GDP per capita USA	Growth in real GDP per capita World	Growth in real GDP per capita USA
Grenada	0.240	0.256	0.22	0.08
Dominica	-0.248	-0.221	0.29	0.13
St. Vincent and the Grenadines	0.291	0.300	0.35	0.51
St. Lucia	0.270	0.165	-0.13	-0.02
St. Kitts and Nevis	0.436	0.491	0.69	0.77
Antigua and Barbuda	0.177	0.159	0.29	0.31

Source: World Bank staff calculations based on World Development Indicators.

Table 1.4: Travel and Tourism Contribution (2011, %)

	Direct Contribution to GDP	Total contribution to GDP	Direct Employment	Total employment	Exports
Antigua & Barbuda	17.8	74.2	18	69	74.4
Dominica	7.5	24.8	6.9	22.9	45.3
Grenada	7.3	24.2	6.8	22.4	66.7
St Kitts & Nevis	7.8	28.2	7.7	26.7	44.3
St Lucia	15.4	45.8	17.5	45.4	60.8
St Vincent & Grenadines	7.7	26.2	7.1	23.9	51.8

Notes: Direct contribution: Tourist transportation, food and leisure industries. Indirect contribution: capital investment in travel and tourism; government spending to support tourism, and supply chain effects.
Source: World Travel and Tourism Council; OECS; Caribbean Tourism Organization.

Table 1.5: Tourism and World GDP

Growth in real international tourism revenue per capita (2005 US$)	2000–2014	
	Growth in real GDP per capita World	Growth in real GDP per capita USA
Grenada	0.18	0.00
Dominica	0.23	0.05
St. Vincent and the Grenadines	0.29	0.48
St. Lucia	0.04	0.24
St. Kitts and Nevis	0.52	0.64
Antigua and Barbuda	0.31	0.29

Source: Authors 'own elaboration based on data from the World Travel and Tourism Council; OECS; Caribbean Tourism Organization.

GDP per capita between 2000 and 2014.[2] Table 1.5 reveals that international tourism revenues for the OECS are very dependent on the U.S.'s and world GDP. This is especially true for St. Vincent and the Grenadines, and St. Kitts and Nevis.

FDI inflows to the OECS are highly pro-cyclical with external developments. Figure 1.6 shows that FDI inflows to the OECS vary a great deal, ranging from 5 to 37 percent of GDP. Not only that, they are also highly dependent on the world economy (which serves as a push factor). In the boom time prior to the Great Recession (2000–2005), FDI inflows increased sharply for all OECS countries, peaking in 2006 and 2007. However, when the major growth poles suffered the effects of the Great Recession, FDI inflows to the OECS also collapsed sharply. Table 1.6 confirms the analysis with longer time series. It shows the correlation between the change in FDI inflows (as a share of GDP) and the change in the log of world real GDP per capita, as well as U.S.'s real GDP per capita, for the period between 1980 and 2014. Overall, we observe a positive correlation between the change in FDI inflows to the OECS countries (as a share of output) and real growth in real GDP per capita of the world and the U.S.

Differentiated performance among the OECS countries are evident. As shown in Figure 1.4, some OECS countries.

The Caribbean region has experienced low-long term growth despite large inflows of FDI. One would expect that foreign direct investment inflows should be associated with higher growth rates due to knowledge transfers and spillover effects. However, this is not the rule in the Caribbean region, and in particular in the service-oriented economies of the OECS. Antoine, de Piniés and Martin-Sanchez (2015) show that the service ori-

2 Unfortunately there were not enough data points for the 1980–1999 period to yield meaningful analyses.

Figure 1.6 FDI Inflows to OECS, Percentage of GDP

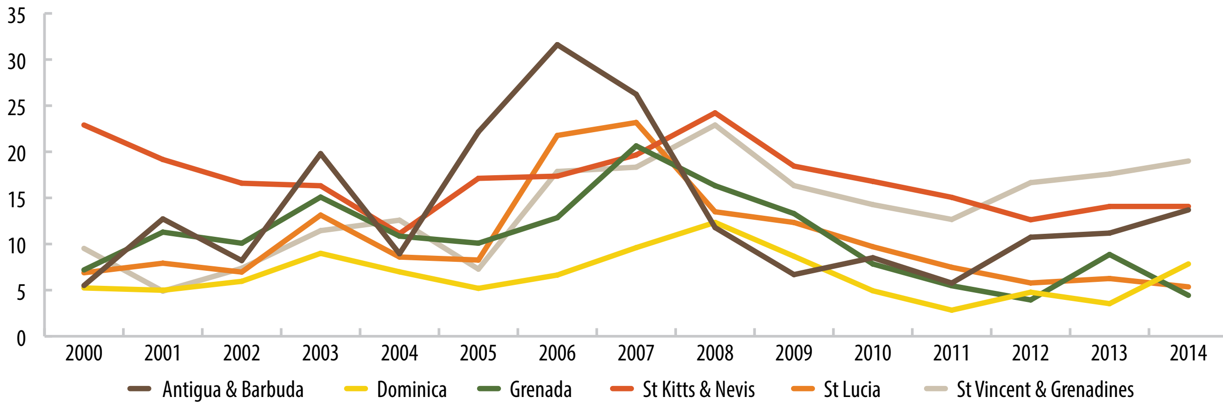


Table 1.6: FDI Inflows and World Output

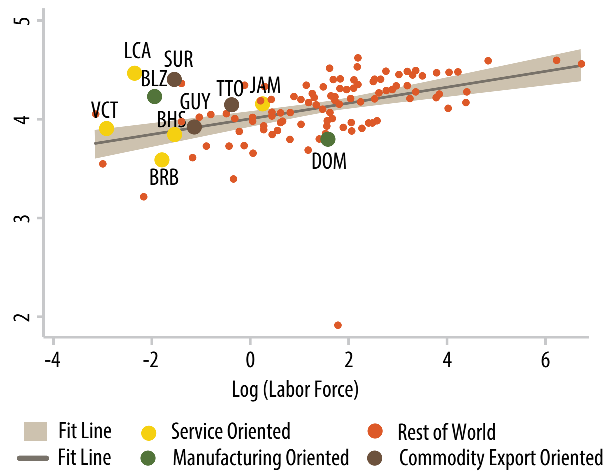
ΔFDI/GDP*100	Growth in real GDP per capita	
	World	USA
Antigua & Barbuda	0.24	0.143
Dominica	0.068	0.041
Grenada	0.057	0.082
St Kitts & Nevis	0.221	0.244
St Lucia	0.191	0.021
St Vincent & Grenadines	0.147	0.111

Source: Authors' own elaboration based on World Development Indicators.

ented economies of the Caribbean have received more foreign direct investment than other countries in the region but have not seen significantly elevated growth rates. According to these authors, this lack of positive growth spillovers from FDI inflows is associated with the small size of these economies. Figure 1.7 shows that the percentage of inputs of domestic origin in foreign affiliates, an indication for backward linkages, is higher for countries with larger labor forces. In addition, they note that the foreign firms investing in the service-oriented countries in the Caribbean tend to rely mostly on foreign technologies which they find is associated with a lower propensity for backward linkages. While this could be an indication that these economies do not have the skilled labor force required to develop backward linkages in more advanced services, Lederman and Lesniak (2016) do not find evidence in support of this argument and show that the small size of these economies is a more compelling reason behind this phenomenon (see Figure 1.8).

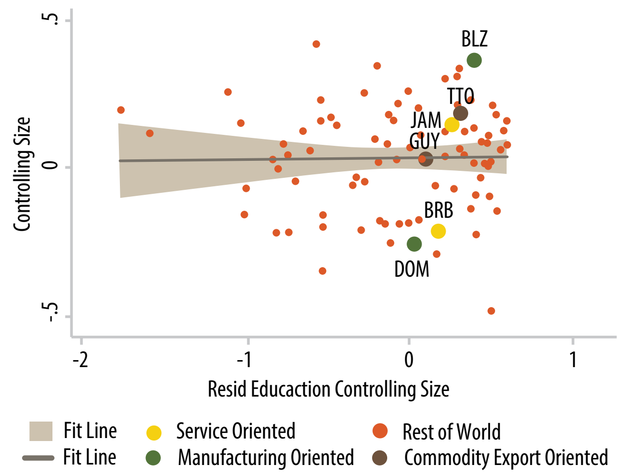
Along with other small economies, Caribbean countries also exhibit high levels of public debt relative to GDP. Figure 1.9 shows the median debt to GDP ratio in 2013 over several country groupings. While it is not entirely clear that debt is directly related to size, it is immediately apparent that the Caribbean stands out as a particularly high debt region. This may be partly related to the constant need to rebuild infrastructure after frequent natural disasters and partly due to the fact that government revenues as a share of GDP are consistently low. Haque et al. (2016) find that small states, in general, have accumulated public debt at a faster rate than larger countries. For example, over the more recent period, lower-middle and upper-middle income small states accumulated public debt at an average rate of 1.3 percent of GDP and 1.8 percent of GDP per annum, respectively, over 2009–2014. According to Haque et al. (2016), this compares to slightly negative debt accumulation for other states.

Figure 1.7 Backward Linkages Increase with Size



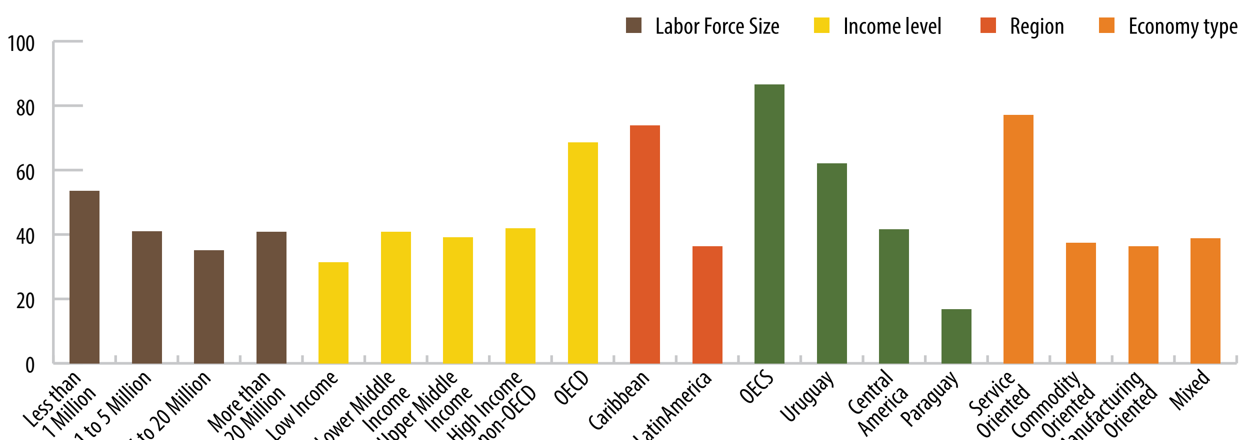
Note: Graph shows fit line of the follwing linear regression: Log(Percentage of inputs of domestic origin)= log(labor force) + error. The relationship is positive and statistically significant at the 1% level with a coefficient of .09. ***Source***: Antoine, de Pinies, and Sanchez-Martin (2015) based on World Bank Enterprise Survey, World Bank World Development Indicators database.

Figure 1.18 Partial Correlation Between Backward Linkages and Average Years of Education Attained Controlling for Labor Force Size



Note: Graph shows the fit line of an ordinary least squares regression. It is calculated by first estimating the following two equations: (1) Log(percentage of inputs of domestic origin)= log(labor force) + error1; (2) Log(average years of education)=log(labor force) + error2. Then the plot represents the regression of error1 on error2. This can be thought of as representing the relation between the % of domestic inputs a firm uses and the average years of education attained by workers in a country controlling for the size of the labor force. The relationship is positive with a coefficient of .01 but not statistically significant. ***Source***: Lederman and Lesniak (2016) based on data from Barro Lee Education Data set, World Bank enterprise Survey, World Bank World Development Indicators database, and author's calculations.

Figure 1.9 Government Debt in 2013



Notes: Bars represent the median value of the Gross Government debt to GDP ratio in 2013 for the grouping. Labor force groups are: less than 1 million, 1 million to 5 million, 5 million to 20 million, and larger than 20 million (upper border included in higher category). Country Income groups/levels defined as in the World Bank WDI. Caribbean includes: Antigua and Barbuda, The Bahamas, Belize, Barbados, Dominica, Dominican Republic, Grenada, Guyana ,Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, Suriname, Trinidad and Tobago, and St. Vincent and the Grenadines. OECS includes: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. Service Oriented Economies includes: Antigua and Barbuda, The Bahamas, Barbados, Dominica, Grenada, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. Manufacturing/Services oriented includes: Belize, Dominican Republic, and Haiti. Commodity Export Oriented includes: Guyana, Suriname, and Trinidad & Tobago. Latin America includes: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador. El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay, and Venezuela. ***Source***: Lederman and Lesniak (2016) based on data from the IMF World Economic Outlook database April 2015, and author's calculations.

The main drivers of public debt accumulation in small states appear to be rising fiscal deficits. Haque et al. (2016) present evidence showing that, for lower-middle income countries, debt accumulation is driven by larger primary deficits (3.2 percent of GDP compared to 1.9 percent of GDP for larger states) and slower growth (-1.6 percent of GDP, compared to -1.8 percent for larger states). While upper-middle income small state have run smaller primary deficits than larger countries, high existing debt burdens including significant commercial debt have led to a strong contribution from real interest rates (1.6 percent of GDP per annum, compared to slightly negative contribution for larger states). Haque et al. (2016) conclude that higher average primary deficits are associated with public debt accumulation across small states and that the impact of primary deficits dominates growth effects, with several small states experiencing reasonable rates of growth combined with increasing debt stocks in the presence of large primary deficits.

Small states also tend to accumulate external debt at a faster pace than larger countries. According to the evidence presented by Haque et al. (2016), lower-middle and upper-middle income small states accumulated debt at 1.1 percent and 2.9 percent of GDP per annum respectively, compared to debt accumulation of just 0.1 percent for larger countries. The major driver of increased external debt accumulation for small states was the size of the current account deficit (11.5 percent of GDP for lower-middle income small states, 10.4 percent of GDP for upper-middle income small states, and 5.6 percent of GDP for larger states). Slower growth in smaller states also exacerbated negative external debt dynamics.

Is Economic Growth Excessively Volatile in the OECS?

The OECS countries have suffered historically with volatility of economic growth. Economic growth volatility in the OECS has been higher than that observed in other groups of countries with similar characteristics such as other small states of the Caribbean, the broader group of small-island development states (SIDS), and Central American countries (Figure 1.10). Output volatility in the region was particularly pronounced in the early half of the 1990s and 2000s and then more recently during 2008–2010 as a result of the global financial crisis. This is not surprising given these countries' small size, high degree of openness, dependence on tourism from a not so diversified range of countries, and proneness to natural hazards which make them highly exposed to external shocks.

The most volatile countries in the OECS are Antigua and Barbuda and Grenada and to a lesser extent are

Figure 1.10 The OECS countries face higher volatility compared to regions with similar economies

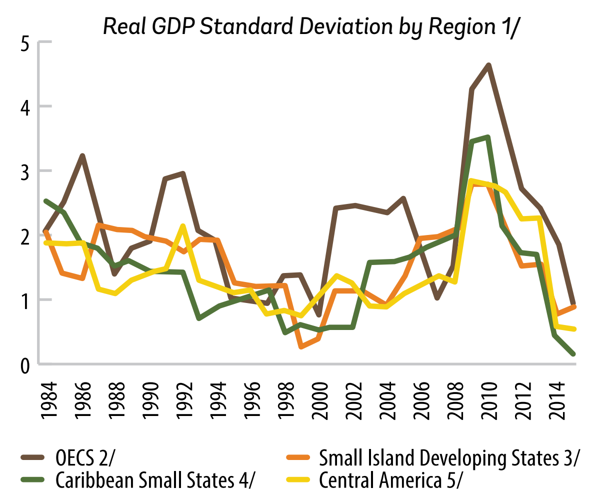
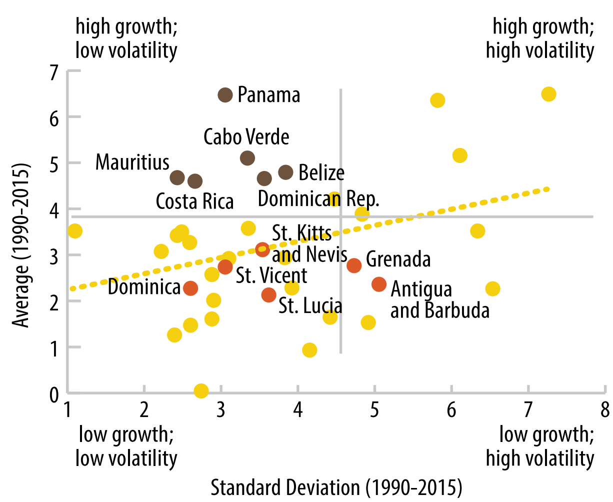


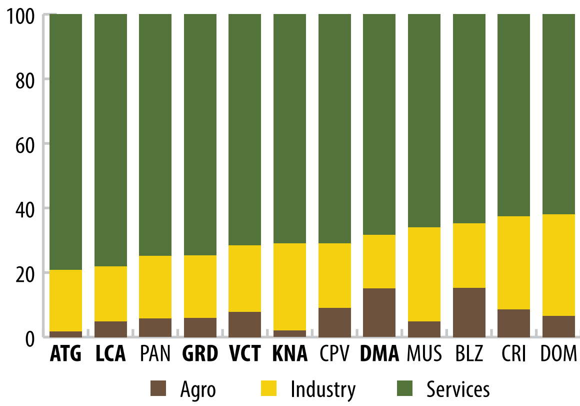
Figure 1.11 Growth Volatility in the OECS



Note: 1/ 5 year moving standard deviation; 2/ Antigua and Barbuda, Dominica, Grenada, St. Lucia, St. Kitts and Nevis, and St. Vincent and the Grenadines; 3/ Comoros, Djibouti, Fiji, Guinea-Bissau, Kiribati, Maldives, Marshall Islands, Mauritius, Micronesia, Fed. Sts, Palau, Papua New Guinea, Samoa, Sao Tome and Principe, Seychelles, Singapore, Solomon Islands, Timor-Leste, Tonga, and Vanuatu; 4/ The Bahamas, Barbados, Belize, Guyana, Suriname, Jamaica, and Trinidad and Tobago; 5/ Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama. **Source**: IMF; WEO and World Bank staff calculations.

St. Lucia and St. Kitts and Nevis. Dominica and St. Vincent and the Grenadines, on the other hand, seem to experience the lowest levels of volatility in the region (Figure 11). It is also worth noting that the countries that exhibit the highest levels of volatility in the OECS are also the ones that are less diversified and that rely the most on services related to tourism as their major growth driver. By contrast, the countries which exhibit the lowest volatility in the region are those which have become more diversified and where the contribution of other sectors GDP growth, such as agriculture and industry, mainly construction activity, is also important (Figure 1.12).

Figure 1.12 Countries That Are More Diversified Have Higher Growth Rates and Less Volatility

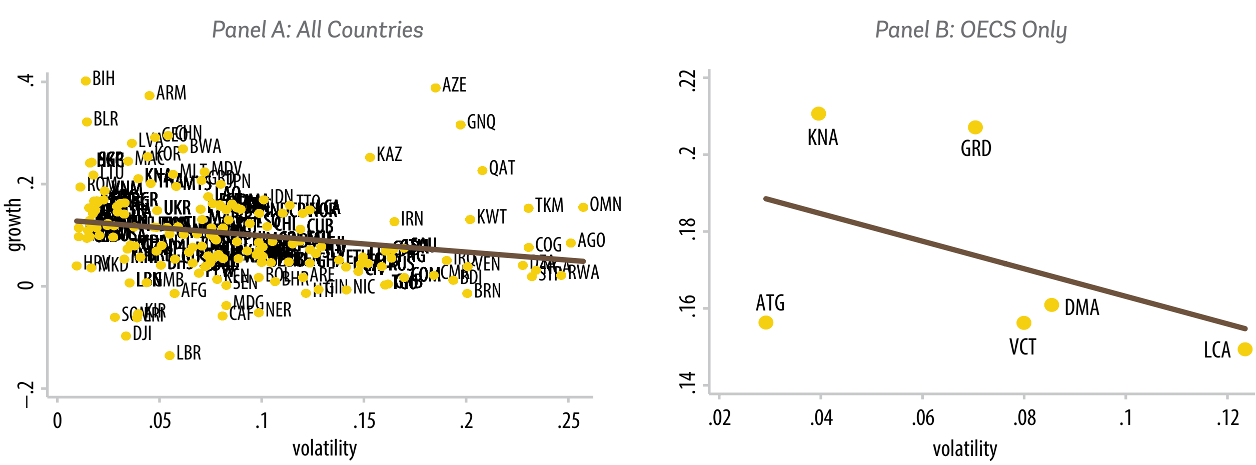


Source: IMF; WEO and World Bank staff calculations.

The relationship between terms of trade volatility and economic growth is negative for a large sample of countries, including the OECS. Figure 1.13 plots on the y-axis countries' average GDP per capita growth (over five years); on the x-axis is the standard deviation of the terms of trade growth rate (also computed over a five year period). We see from Panel A in Figure 1.10 that for a sample of 175 countries terms of trade volatility has a negative average effect on economic growth. The coefficient from a bivariate regression that corresponds to the plot in Panel A of Figure 1.10 is -0.31; this coefficient is significant at the 1 percent level (p-value 0.007). Panel B shows that a negative relationship between terms of trade volatility and economic growth is visible also within the sub-sample of OECS countries. The coefficient from a bivariate regression that corresponds to the plot in Panel B of Figure 1.10 is -0.36; thus it is quantitatively very close to the slope coefficient that emerges in Panel A. Statistically, we cannot reject the hypothesis that the slope coefficient in Panel A is equal to the slope coefficient in Panel B (t-value 0.91).

Nevertheless, growth volatility in the OECS, while substantially higher than the world average, is within the range of their comparators. Most notably, growth volatility for the OECS countries is in the same range of other small island countries throughout the previous decades (3.68 percent versus 3.70 percent in 1980s; 1.99 percent versus 2.03 percent in 1990s; 3.53 percent versus 2.87 percent in 2000s, and 2.42 percent versus 2.11 percent since 2011). Interestingly, OECS growth is more volatile than in other Caribbean countries in previous decades, but since after the Great Recession,

Figure 1.13 The Negative Relationship Between Economic Growth and Volatility

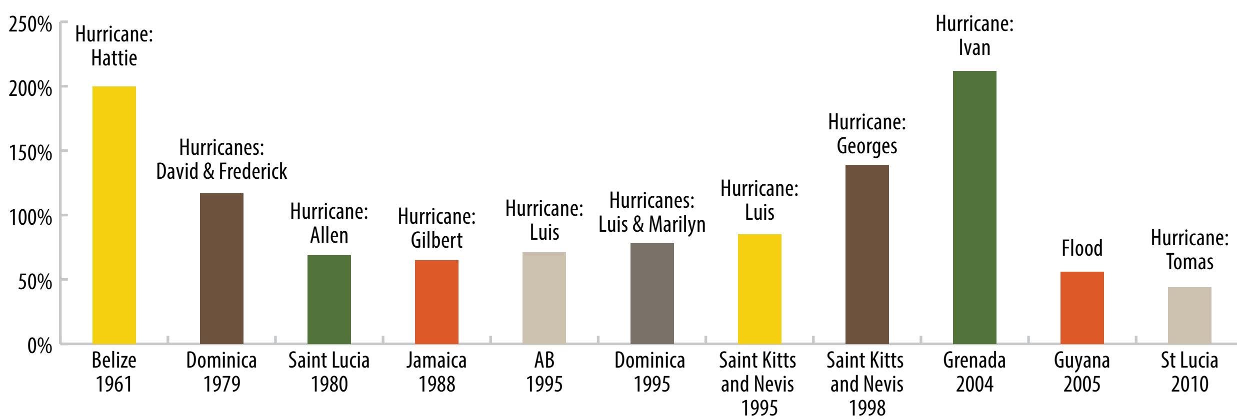


Source: Brueckner and Carneiro (2015).

Table 1.7: Growth Volatility, OECS

	1980–1999			
	1980-89	1990–99	2000–09	2010–14
Antigua and Barbuda	3.96	3.09	7.04	4.81
Dominica	3.78	1.80	3.44	1.85
Grenada	4.23	3.88	6.11	2.70
St. Kitts and Nevis	4.05	2.97	4.21	4.33
St. Lucia	10.27	6.48	3.86	1.17
St. Vincent and the Grenadines	4.00	2.61	3.60	2.06
OECS average	3.68	1.99	3.53	2.42
Other Caribbean	2.03	2.34	2.62	5.91
Other small islands	3.70	2.03	2.87	2.11
World average	1.32	0.84	1.91	0.73

Figure 1.14 Impact of Damages from Disasters are Significant



Source: EM-DMT.

other Caribbean countries suffered significantly higher volatility (5.91 percent versus 2.42 percent). The finding suggests that small islands, including the OECS, other Caribbean, and other small islands around the world, are facing significantly higher growth volatility.

Substantive exposure to natural disasters contributes to output volatility in the OECS. The region concentrates the countries in the world that are most exposed to natural hazards. Natural disasters such as hurricanes and tropical storms have seriously impacted the countries' growth performance by severely affecting the productive sectors of the economy, such as agriculture and tourism, and communities and households. Natural disasters have also added pressure on the fiscal position of the governments, exacerbating existing expenditure pressures, redirecting public resources away from long-run development plans and increasing indebtedness. Between 1993 and 2012, average OECS annual losses from natural disasters reached 4.3 percent of GDP. In addition, Hurricanes Ivan (2004) and George (1998) caused damages amounted to over 200 percent of GDP in Grenada and 140 percent of GDP in St. Kitts and Nevis, respectively (Figure 1.14).

The level of financial development is also believed to affect the impact that volatility has on economic growth. Recent studies suggest that beyond a certain level financial development may generate decreasing returns to growth and stability (Arcand, Berkes, and

Panizza (2012); Sahay et al. (2015a)). A few arguments might explain why this is so. One such view is that too much finance may increase the frequency of booms and busts thus increasing volatility and affecting economic growth negatively. Excessive availability of finance can also cause a diversion of talent and human capital away from productive sectors and toward the financial sector without a clear net positive impact on growth. Also, excessive leverage and risk taking can lead to increased economic and financial volatility, with potentially negative consequences for long-term growth, especially if regulation and supervision are inadequate (IMF (2003); Reinhart and Rogoff (2011); Sahay et al. (2015a) and (2015b)).

Financial soundness in the OECS region has deteriorated post crisis. A formal assessment of the impact of financial sector development on volatility and ultimately growth is presented in Chapter 4, but it is worth mentioning that the region has suffered with inadequate access to credit and the quality of the banking sector, especially after the 2008 global crisis. As a result of the economic slowdown following the crisis, nonperforming loans (NPLs) in the banking sector worsened, increasing to 18.0 percent of total loans in 2014 from 7.7 percent in 2008, and domestic banks have experienced losses region wide. Credit growth to the private sector continued to fall and since 2013 is now negative. Most of the credit tightening occurred in services (such as tourism-related services) although the highest share of loans are to individuals (54 percent) for acquisition of property and home construction and renovation, which has been increasing in recent years. Provisioning levels have increased for these NPLs but continues to provide inadequate coverage of bad debts and these are still below international standards for provisioning. Insufficient access to credit to the private sector, in particular small and medium enterprises in the tourism sector, has weakened the fragile recovery in the region and remain a challenge.

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Chapter 2.
Output Volatility and the Cyclicality of Fiscal Policy in the OECS

Introduction

There is a wealth of evidence on the pro-cyclicality of fiscal policy in industrialized and emerging market economies. The latter group is usually associated with a more pro-cyclical behavior of fiscal policy. That is, developing countries tend to orient government consumption and investment in the same direction as that of the cycle in general economic activity. In doing so, they tend to amplify upswings and worsen recessions – what Kaminsky, Reinhart, and Vegh (2004) termed as the "when it rains, it pours" phenomenon. Industrialized countries, on the other hand, are believed to behave largely in a counter-cyclical or even in a-cyclical fashion.[3]

In this chapter, we provide new evidence on the cyclicality of fiscal policy across countries placing a special emphasis on the Eastern Caribbean. This analysis is important and sets the stage for the following chapter where we test the hypothesis that a pro-cyclical fiscal policy in the context of weaknesses in the financial sector exacerbate the negative effects of output volatility on economic growth in the Caribbean and elsewhere. After this introduction, Section 2 discusses why countries are better off avoiding a pro-cyclical fiscal policy stance. Section 3 assesses how fiscal policy cyclicality differs in rich and developing countries and presents new evidence on the "when it rains it pours" phenomenon. Section 4 presents stylized facts on the cyclicality and volatility of key macroeconomic variables for the OECS countries. Section 5 discusses good practice policy options that could help the countries in the region to strengthen fiscal discipline and respond more symmetrically to the business cycle. Concluding remarks are discussed in Section 6. The chapter includes an appendix with methodological details of the econometric analysis used to investigate the main determinants of fiscal policy cyclicality.

Why Should Countries Avoid a Procyclical Fiscal Policy?

From a theoretical point of view, the pro-cyclicality of fiscal policy remains a puzzle. Governments should be able to exercise discretion and avoid making a bad situation turn worse. From that perspective, it does not seem to be optimal to exacerbate the business cycle by adopting an expansionary fiscal policy in booms and a contractionary fiscal stance in a downturn. In what economists call the neoclassical world, marked by less intervention of the state in the economy, the optimal fiscal policy stance is either a-cyclical (Barro (1979)) or counter-cyclical (Baxter and King (1993)). In contrast, in a Keynesian framework, in the presence of price and wage rigidity and a greater presence of the state in the economy, the optimal fiscal policy stance is counter-cyclical (Christiano et al. (2011) and Nakata (2011)).

3 Evidence on the pro-cyclical pattern of fiscal policy in developing countries was first found by Gavin and Perotti (1997) who showed that Latin American tended to adopt policies that were expansionary in good times and contractionary in bad times. Talvi and Vegh (2000) then showed that such behavior was far from being a trademark of Latin America alone as many other developing countries across the world espoused a pro-cyclical fiscal policy stance.

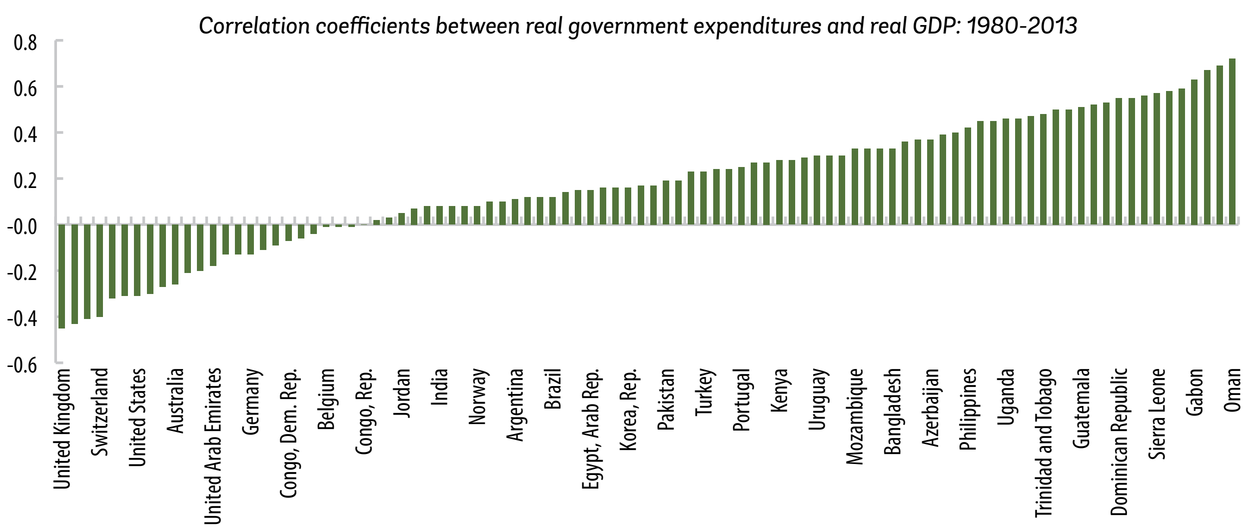
Irrespective of theoretical prescriptions, fiscal policy remains rather pro-cyclical in a number of countries. The reasons for such behavior are various. One explanation is that frictions in international credit markets might prevent countries from borrowing in bad times forcing these countries to lower spending during recessions (Gavin and Perotti (1997)). A pro-cyclical fiscal policy stance could also be seen as a signal of weak and underdeveloped institutions in governments where there is limited technical capacity to develop the means to save in good times to spend in bad times (e.g., Calderon and Schimdt-Hebel (2008)). Another explanation for pro-cyclical government expenditures relies on political economy reasons which suggest that during good times governments face political pressures and temptations to keep spending high and run fiscal deficits. In addition, delays in the implementation and execution of fiscal policies could contribute to fiscal policy pro-cyclicality.

A more recent strand of the literature has argued that the cyclicality of government spending depends on the quality of institutions. Alesina et al. (2008), for example, argue that the pro-cyclicality of government spending is related to corruption. Based on a sample of 83 countries during 1960-2003, they find that in democracies with higher levels of corruption government spending tends to be more pro-cyclical. The authors explain their finding through the lens of a political economy model where voters "starve the Leviathan" in order to reduce political rents. During a boom, voters demand more public goods and lower taxes in order to prevent corrupt politicians from appropriating tax revenues.

A very clear economic reason as to why governments should avoid reinforcing the business cycle is associated with their ability to lean against the wind in periods of hardship. In addition, a pro-cyclical fiscal policy can hamper government efforts to reduce the effects of volatility on growth. In general, government spending can mitigate the negative effect that volatility has on growth if: (i) government spending is counter-cyclical; and (ii) its impact on output is positive. For conceptual clarity it is useful to note that: (i) refers to the behavior of government spending, i.e. the response of government spending to the business-cycle; (ii) refers to the government spending multiplier, i.e. the effectiveness of government spending with regard to changing output in the short-run (and possibly the long-run). If government spending is pro-cyclical and the government spending multiplier is positive, this will then increase the variance of exogenous shocks which will tend to have a more negative effect on growth.

From a risk management point of view, a counter-cyclical fiscal policy can be useful for at least three compelling reasons. First, by leaning against the wind, governments can continue to provide goods and services and to maintain public investment even in the event of a

Figure 2.1 A Substantive Number of Developing Countries Follows a Pro-Cyclical Fiscal Policy



Source: Authors' own calculations based on the IMF's World Economic Outlook (WEO) for real GDP and for real government expenditures over the period 1980-2013. ***Note***: The information reported by WEO on real government expenditures refers to General Government Net Lending (GGXCNL) defined as the difference between General Government's revenues and expenditures.

drop in public revenues. Second, in a downturn, a countercyclical fiscal policy can help governments increase social assistance and insurance to a large number of citizens affected by more adverse macroeconomic conditions. Third, as witnessed during the global financial crisis of 2008-09, a countercyclical fiscal policy can help countries stimulate the economy and cope better with the effects of a prolonged recession (see World Bank (2014)). In that regard, as argued by Mollick et al. (2011), in the aftermath of the global financial crisis it became clear that the countries that weathered the effects of the crisis better were those that had followed some sort of concerted macro-fiscal responses that helped them build resilience to exogenous shocks. When the crisis hit, these countries were able to have more favorable access to credit in international financial markets, and resist speculative attacks. Not only they had stronger fundamentals entering the crisis, which allowed them to quickly deploy counter-cyclical fiscal policies, they were also better positioned to adopt exit strategies faster by raising interest rates, controlling domestic credit growth and reverting to more orthodox fiscal policies.

How Does Fiscal Policy Cyclicality Differ in Rich and Developing Countries?

A significant number of authors have documented a more pro-cyclical behavior of fiscal policy in developing countries. Industrialized countries, in turn, tend to behave largely in a counter-cyclical or at worst a-cyclical fashion (see Figure 2.1). An idea put forward by Kaminsky, Reinhart, & Végh (2004) was that, for developing countries, and in particular for upper middle-income countries, macroeconomic policies and in special fiscal policy tend to reinforce the business cycle. These authors coined this behavior as the when-it-rains-it-pours syndrome and we will shed some light on its relevance in the context of the Caribbean and the OECS further down below.

More broadly, emerging markets in Latin America and elsewhere have a long track-record of pro-cyclical government spending. Evidence on the pro-cyclical pattern of fiscal policy in developing countries was first found by Gavin & Perotti (1997) who showed that Latin American was much more expansionary in good times and contractionary in bad times. Talvi & Vegh (2000) then showed that such behavior was far from being a trademark of Latin America alone as many other developing countries across the world espoused a pro-cyclical fiscal policy stance.

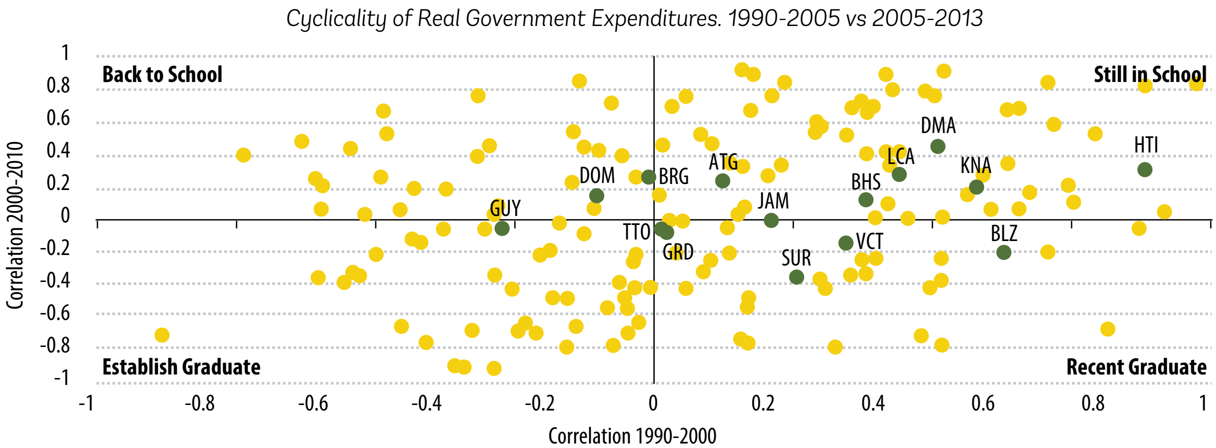
There is a number of different explanations as to why developing countries tend to behave in that fashion vis à vis industrialized economies. Some of the reasons most commonly found in the literature include credit constraints faced by developing countries, which would prevent them from raising money in international capital markets in bad times and would force them to adopt a contractionary fiscal policy in downturns Gavin & Perotti (1997). Political economy considerations would also seem to play a role as good times could encourage fiscal profligacy (Tornell & Lane (1999), Alesina & Tabellini (2005)).

A more interesting and elucidating exercise requires investigating whether countries that have followed a pro-cyclical fiscal policy have been able to switch to a more counter-cyclical fiscal policy stance over time. To address this question, we have constructed a proxy for fiscal policy cyclicality based on correlation coefficients for time series of real government expenditures and real GDP smoothed by the Hodrick-Prescott filter, following the same methodology as in Frankel at al. (2013). This allowed us to classify countries according to their ability to move from a pro-cyclical to a counter-cyclical fiscal policy stance. A negative (positive) correlation coefficient between the cyclical component of government spending and GDP indicates a counter-cyclical (pro-cyclical) fiscal policy stance. Figure 2.2 plots countries according to their "graduating classes", which are defined as follows:

i) Established graduates (EG) as those with counter-cyclical fiscal policies in the first and second periods;
ii) Recent graduates (RG) as those with pro-cyclical policies in the first period and counter-cyclical in the second;
iii) Still in school (SS) as those with pro-cyclical fiscal policies in the first and second periods; and,
iv) Back to school (BS) as those with counter-cyclical fiscal policies in the first period and pro-cyclical in the second.

The large majority of Caribbean countries, including the ones in the OECS sub-region have yet to graduate from procyclical fiscal policies. That is, they are either "still in school" or "back to school". Not surprisingly, most

Figure 2.2 Graduating Classes for Fiscal Policy Cyclicality



Note: Proxy for fiscal cyclicality based on correlation coefficients for time series of real government expenditures and real GDP smoothed by the Hodrick-Prescott filter. We use a sub-period, 1990-2010, from the overall 1980-2013 dataset because for many countries, data on real government expenditures and/or on GDP are missing, mostly for the early 1980s. Caribbean countries are highlighted in red.
Source: Carneiro and Garrido (2015) based on IMF's World Economic Outlook (WEO).

of the countries classified as "established graduates" are industrialized economies, as noted earlier (see Figure 2.1). In Figure 2.2, most of the countries in the upper quadrants are developing economies. Interestingly, a number of those in the "recent graduates" class are emerging economies. Among the Caribbean countries, Guyana is the only one which made it to the "established graduates" class. Grenada and Jamaica, which have been implementing fiscal adjustment programs under an IMF program, have made it to the "recent graduate" class along with Suriname, Belize, and St. Vincent and the Grenadines. Note, however, that these results are sensitive to the time period in which correlation coefficients are computed, as we discuss below.

The robustness of these results was tested by investigating whether the graduating classes changed significantly if the sample period was split in different points in time. We did this by running tests of structural break for the time series of real government expenditures for each country and splitting the sample when a structural break was identified (see Carneiro and Garrido (2015) for details). After following this approach we confirmed only one Caribbean country actually classified as an established graduate (Guyana) and 3-4 countries moving away from pro-cyclical to counter-cyclical policies, compared to 1-3 countries falling back into pro-cyclical fiscal policies.[4] When one looks at changes in correlation coefficients (not the Boolean classification of countries in graduating classes) the evidence on Caribbean countries moving away from pro-cyclical fiscal policies is more compelling under this country-specific approach. Twelve out of fifteen economies now show a declining correlation coefficient for the fiscal stance proxy (see Figure 2.3).

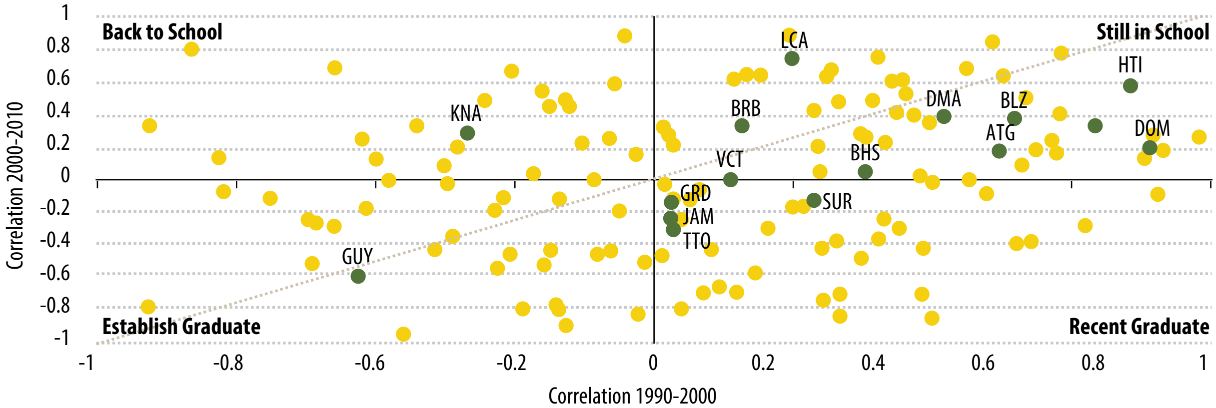
Does it really pour when it rains?

We make two implicit assumptions as to why countries might change their fiscal stance during booms and downturns. First, we consider changes as generally not random. That is, they are mostly associated to policy shifts within given administrations, which may or may not be politically motivated (as incumbent administrations tend to spend more ahead of elections), or across administrations after elections, influenced by ideological principles. Second, we assume that those changes are generally driven or motivated by observed trends in economic activity and not the other way around. This assumption is not uncontroversial. For instance, Rigobon (2004) argues that fiscal policy shocks drive output and not the other way around, while Ilzetzki & Vegh (2008), on the other hand, find causality running both ways.

Keeping these assumptions in mind we have re-computed correlation coefficients for the fiscal cyclicality proxy for 180 countries over the period 1990-2011 by differentiating what happens in fiscal policy in different parts of the business cycle. This is an important

4 Only Jamaica and Trinidad and Tobago are recent graduates under all filtering methods; and only St. Kitts and Nevis is consistently back in school for all methods.

Figure 2.3 Cyclicality of Real Government Expenditures under Country-Specific Year Breaks



Note: For this chart we use data for real government expenditures and real GDP covering 180 countries for the period 1980-2013. We also apply a criterion for splitting the sample, by country, at potentially different points in time based on potential structural breaks in (per capita GDP) data. The intuition is that changes in macroeconomic policies and performance generally reflect on changes in per capita income. A structural break on the series for the latter may be indicative of changes in fiscal stance. ***Source***: Carneiro and Garrido (2015) based on IMF, WEO.

exercise because it allows one to have an indication of the impact of fiscal policy (pro) cyclicality might have on output volatility, for example. Countries that are, on average, pro-cyclical in booms and downturns, would tend to exacerbate their business cycle; those that are counter-cyclical in both, booms and downturns, have a fiscal policy that contributes to stabilize the cycle.

Because countries may not always be pro-cyclical or counter-cyclical we have considered different scenarios. Whenever a country exhibits an average counter-cyclical fiscal stance in booms, and a pro-cyclical stance in downturns, other things equal, it will likely improve its medium to long term fiscal sustainability profile. A country that is pro-cyclical in booms and counter-cyclical in downturns would, ceteris paribus, deteriorate its fiscal sustainability profile.

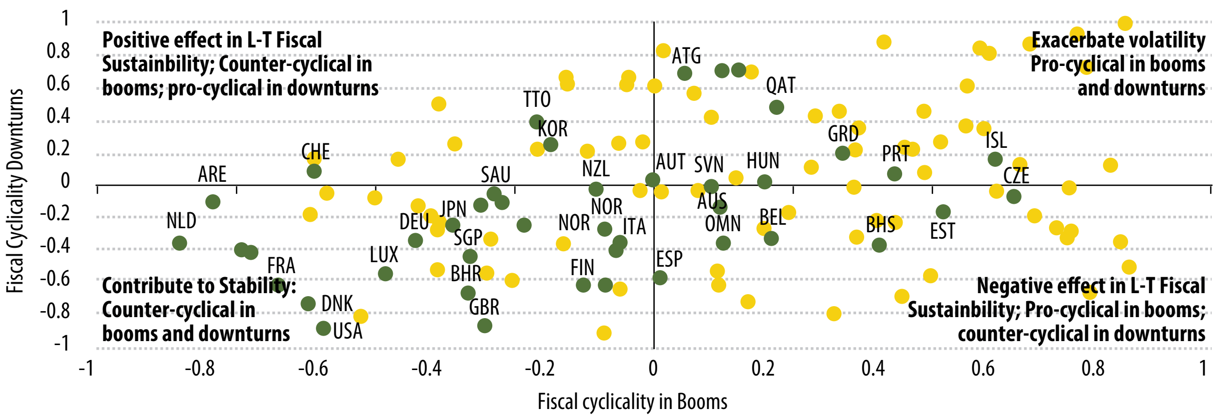
An interesting pattern emerges when we classify countries according to their fiscal policy stance over the different phases of the business cycle. Figure 2.4 plots the value of the fiscal stance proxy in periods of expansion (when the cyclical component of real GDP is positive) against that registered in downturns. We have identified high-income countries in red while developing economies appear in blue. By quadrants[5], we identify four groups of countries:

- *Upper right quadrant:* Those that exhibit pro-cyclical fiscal policies in both booms and downturns. Other things equal, such stance contributes to exacerbate output volatility. Not surprisingly, one finds many resource-rich economies in this category. In addition, many upper middle-income countries appear prominently in that group.
- *Upper left quadrant:* Those that exhibit counter-cyclical fiscal policies in booms and pro-cyclical fiscal policies in downturns. Other things equal, such fiscal behavior improves a country's fiscal sustainability profile.
- *Lower left quadrant:* Those that exhibit counter-cyclical fiscal policies in both booms and downturns. Other things equal, such stance contributes to stabilize output around its long-term trend. Expectedly, most of high-income countries fall under this category.
- *Lower right quadrant:* Those that exhibit pro-cyclical fiscal policies in booms and counter-cyclical fiscal policies in downturns. Other things equal, such behavior deteriorates a country's fiscal sustainability profile.

We have confirmed earlier findings that emerging and industrialized countries tend to behave in a different fashion over the business cycle. Most of the countries in the upper and lower right quadrants in Figure 2.4 are developing economies (in blue) and most importantly upper middle-income countries. In contrast to that, most of the high income countries appear on the upper and lower left quadrants with fiscal stances that largely contribute to long-term fiscal sustainability.

5 Initial debt levels might have a big impact on which quadrant a country ends up falling into.

Figure 2.4 Fiscal Cyclicality in Booms and Downturns (1990–2011)



Note: Proxy for fiscal cyclicality based on correlation coefficients for time series of real government expenditures and real GDP smoothed by the Baxter-King filter. *Source*: Carneiro and Garrido (2015) based on IMF's World Economic Outlook (WEO).

Some of these results may seem counter-intuitive but they actually reveal the benefits associated with fiscal discipline. For instance, one may be surprised to see Chile, a country that has earned a reputation of fiscal prudency and good overall macro management, in the fourth quadrant. As it turns out, Chile is, on average, for the period 1990-2011, moderately pro-cyclical in booms and markedly anti-cyclical in downturns. Their ability to sustain a strong fiscal position arises from having a system of buoyant tax revenues and the great contribution of the private sector to economic activity, so the country is able to register solid, positive fiscal balances both in booms and recessions with marked improvements in its overall fiscal stance. Compare this performance with that for Greece, for example, especially during the post-financial crisis period when it showed deteriorating fiscal balances, faster increase in expenditures relative to revenues, and poor economic performance, with an exacerbated contribution to volatility derived from a more pro-cyclical fiscal stance. With this, there is no doubt that Greece has yet to earn enough stars to join the same status as Chile's.

Most of the OECS economies have adopted a fiscal stance that seems to exacerbate output volatility. That is, they tend to behave in a pro-cyclical way during booms and downturns. The only exception seems to be St. Kitts and Nevis which appears together with Trinidad and Tobago, and Belize, in the "back to school" quadrant, where countries show a counter-cyclical behavior in booms, which is a good indication that they are saving for rainy days, but still display a pro-cyclical behavior in downturns (Figure 2.5). As members of the ECCU, the OECS countries can rely only on fiscal policy as an economic stabilization tool, which makes a counter-cyclical fiscal policy even more important to control output volatility.

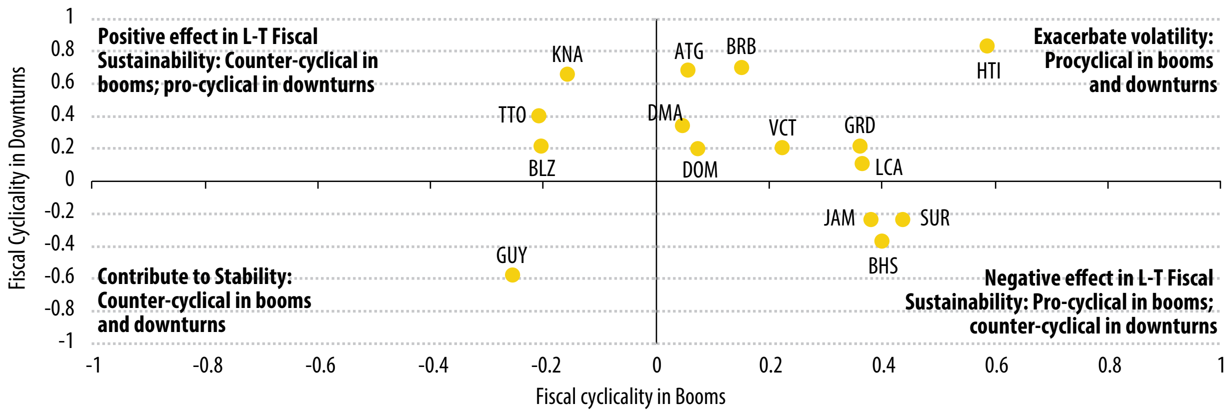
When we looked at the determinants of fiscal policy cyclicality, we found robust evidence of the relevance of institutional quality for a country's ability to move to counter-cyclical fiscal policies. The results are robust to different definitions of fiscal cyclicality, different sample periods, alternative ways of measuring institutional quality, and to the inclusion of other control variables in the estimations.[6] However, for the sub-sample of Caribbean countries, the evidence in that regard is more mixed. The three Caribbean countries that became more pro-cyclical (St. Kitts and Nevis, St. Lucia and Barbados) are among those with the highest improvement in institutional quality (see Figure 2.6).[7]

The importance of institutional quality as an important determinant of a country's ability to behave in a counter-cyclical way was confirmed after we addressed potential endogeneity concerns. Endogeneity concerns are common in the context of analysis involving institutional quality and other macroeconomic vari-

6 See Appendix for methodological details and Carneiro and Garrido (2015) for a full set of results.

7 Compare an average institutional quality index, based on the Kunčič (2013) dataset, equal of 0.54 (in a 0-1 scale; with higher values indicating better institutions) for the Caribbean countries relative to an average index equal to 0.39 for the sample of lower middle income countries and 0.56 for the sample of upper middle income countries in the period 1990-2000. The variance for Caribbean countries is 0.01. All countries, except Haiti have an initial IQ index of 0.4 or higher, and 10 out of 15 have initial IQ of 0.5 or higher.

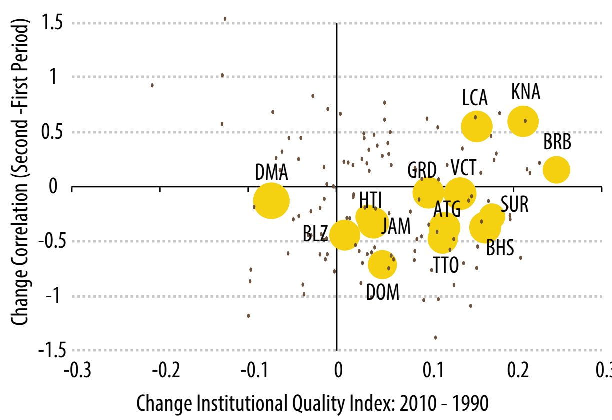
Figure 2.5 Caribbean Countries: Fiscal Cyclicality in Booms and Downturns (1990-2011)



Source: Carneiro and Garrido (2015) based on IMF's World Economic Outlook (WEO). ***Note***: Proxy for fiscal cyclicality based on correlation coefficients for time series of real government expenditures and real GDP smoothed by the Baxter-King filter.

ables because it may be difficult to establish the direction of causality. We addressed this issue by following the approach used by Acemoglu, Johnson, & Robinson (2001) to look for potential endogeneity problems (see Appendix 1 for methodological details).[8] We used alternative definitions of institutional quality (International Country Risk Guidance (ICRG) and Kunčič (2013)) and alternative fiscal stance proxies. Instruments for institutional quality are European settlers' mortality rates (in logs) and latitude. We have also added a set of controls, including financial depth, financial integration, debt to GDP ratios, government accountability, output volatility and the reserves to import ratio. Tables 2.1 and 2.2 show the results of ordinary least square estimations (OLS) and instrumental variable (IV) specifications under the alternative institutional quality (IQ) and fiscal stance proxies. In all cases we were able to find evidence of causality running from IQ to fiscal stance confirming the robustness of our results.

Figure 2.6 Change in Fiscal Stance Proxy vs Change in Institutional Quality Index



Note: A positive change in correlation indicates the country has become more pro-cyclical. The size of the bubbles indicate the initial quality of institutions. ***Source***: Authors' calculations based on IMF, WEO, and Kuncic (2013).

Pro-Cyclicality and Macroeconomic Volatility in the OECS

In what follows, we focus on stylized facts of the OECS economies for a number of key economic variables over the business cycle. In that regard, we document in detail the growth experience of OECS countries over the past several decades; the business cycle facts in these economies, such as the volatility of output, consumption, investment, trade balance, and real interest rates; the cyclicality of these variables with output and interest rate, as well as their persistence; and the properties of fiscal policy in these countries, with a particular focus on its cyclical characteristics.[9]

8 Acemoglu et al. (2001) provided an excellent framework for the analysis of institutional quality on current economic performance, by tracing historical relationships of European settler mortality to the type of settlements and quality of early institutions in former colonies, to current quality of institution and level of income. From their methodological point of view, the authors were able to identify a source of exogenous variation in institutions that affected a country's current per capita income.

9 All data are from the International Monetary Fund's World Economic Outlook (WEO) database and cover the period 1980-2014 at annual frequency. To transform the data into real terms, all nominal quantities are deflated by the GDP deflator. Interest rate is real lending rate obtained as the difference between the lending rate and the consumer price index (CPI) inflation rate. We also considered an effective interest rate on government debt computed as the ratio of general government interest expenditures and gross debt. The two rates are highly correlated, with the average correla-

Table 2.1: OLS and Two-Stage Least Square for Instrumental Variable Estimation regarding the effect of Institutional Quality on fiscal cyclicality stance without control variables

Dependent Variable is the Correlation Coefficient of Real Government Expenditures and Real GDP, 1990-2011 (Alternative filtering methods)

VARIABLES	OLS	IV	OLS	IV	OLS	IV	OLS	IV
	Hodrick-Prescott		Baxter-King		Christiano-Fitzgerald		Butterworth	
IQ: ICRG Avg. 1990-2011	-1.119*** (-7.096)	-1.284*** (-4.550)	-0.941*** (-5.771)	-1.170*** (-4.112)	-0.996*** (-6.056)	-1.017*** (-3.469)	-0.838*** (-4.951)	-1.039*** (-3.305)
Constant	0.718*** (7.633)	0.751*** (5.103)	0.618*** (6.351)	0.701*** (4.724)	0.651*** (6.636)	0.619*** (4.049)	0.530*** (5.249)	0.596*** (3.630)
Observations	123	71	123	71	123	71	123	71
R-squared	0.294	0.360	0.216	0.305	0.233	0.288	0.168	0.219
r2_a	0.288	0.351	0.209	0.295	0.226	0.277	0.162	0.207
F	50.36	20.71	33.31	16.91	36.67	12.04	24.51	10.93

Dependent Variable is the Correlation Coefficient of Real Government Expenditures and Real GDP, 1990-2011 (Alternative filtering methods)

VARIABLES	OLS	IV	OLS	IV	OLS	IV	OLS	IV
	Hodrick-Prescott		Baxter-King		Christiano-Fitzgerald		Butterworth	
IQ: Kuncic Avg. 1990-2011	-0.973*** (-5.805)	-1.429*** (-4.058)	-0.787*** (-4.595)	-1.292*** (-3.652)	-0.853*** (-4.998)	-1.233*** (-3.594)	-0.738*** (-4.231)	-1.143*** (-3.143)
Constant	0.611*** (6.642)	0.813*** (4.633)	0.509*** (5.405)	0.745*** (4.209)	0.547*** (5.844)	0.718*** (4.195)	0.455*** (4.749)	0.639*** (3.524)
Observations	145	84	144	83	145	84	145	84
R-squared	0.191	0.130	0.129	0.065	0.149	0.128	0.111	0.084
r2_a	0.185	0.119	0.123	0.0537	0.143	0.117	0.105	0.0724
F	33.70	16.47	21.12	13.34	24.98	12.92	17.9	9.881

Note:Instruments are log of settler mortality following Acemoglu, Johnson & Robinson (2001).
t-statistics in parentheses *** p< 0.01, ** p<0.05, *p<0.1

Government spending can mitigate the negative effect that volatility has on growth in different ways. This can happen, for example, if government spending is counter-cyclical, and when its impact on output is positive. For conceptual clarity it is useful to note that the first effect refers to the behavior of government spending, i.e. the response of government spending to the business-cycle. The second effect refers to the government spending multiplier, i.e. the effectiveness of government spending with regard to changing output in the short-run (and possibly the long-run). If government spending is pro-cyclical and the government spending multiplier is positive, then increases in the variance of exogenous shocks will have a more negative effect on growth.

Over the last 35 years or so, the OECS region recorded average positive growth rates albeit while keeping low investment levels. We begin by reporting the key properties of some of the variables that best characterize the region's economic performance. Table 2.3 presents the GDP growth rates for the OECS countries, the average real interest rate as well as the average investment and government expenditures as a share of GDP. We also report the net foreign asset (NFA) position of the OECS member countries. The OECS countries were growing at an average rate of 3 percent per year over the 1980-2014 period. The average interest rate was

tion across countries equal to 0.89. As a result, the stylized facts are very similar for the two interest rates, with the main difference being the lower average effective interest rate as compared to the lending rate. We choose to proceed with the lending rate, as it better reflects the cost of borrowing to the private firms. While this rate does not capture the cost of borrowing internationally for the domestic firms, the fact that it has very similar dynamics to the interest rate on government debt (both domestic and foreign) gives us some confidence in its appropriateness for our analysis.

Table 2.2: OLS and Two-Stage Least Square for Instrumental Variable Estimation regarding the effect of Institutional Quality on fiscal cyclicality stance with control variables

Dependent Variable is the Correlation Coefficient of Real Government Expenditures and Real GDP, 1990-2011 (Alternative filtering methods)

VARIABLES	OLS	IV	OLS	IV	OLS	IV	OLS	IV
	Hodrick-Prescott		Baxter-King		Christiano-Fitzgerald		Butterworth	
IQ: ICRG Avg. 1990-2010	-1.028*** (-3.903)	-1.650* (-1.926)	-0.732** (-2.586)	-1.178 (-1.394)	-1.130*** (-3.929)	-1.448 (-1.602)	-0.697** (-2.411)	-1.516 (-1.513)
Chinn-Ito Index of capital openness, average 1990-2011	-0.009 (-0.348)	0.021 (0.553)	-0.041 (-1.507)	0.009 (0.230)	-0.001 (-0.036)	0.005 (0.106)	-0.022 (-0.785)	0.034 (0.768)
Financial depth (M2 Ratio to GDP), average 1990-2011	0 (-0.295)	0.001 (0.462)	0 (0.046)	0 (-0.086)	0.001 (0.477)	0.002 (0.576)	0 (-0.297)	0.002 (0.513)
GDP volatility (Squared Cyclical Component of GDP), average 1990-2011(x)	36.180** (2.450)	78.034 (1.625)	33.693 (1.110)	105.036** (2.082)	0.376 (0.411)	-2.008 (-1.188)	27.232 (0.607)	185.837 (1.043)
Proxy for political Checks and Balances, average 1990-2011	-0.003 (-0.132)	0.002 (0.064)	-0.011 (-0.489)	-0.010 (-0.377)	-0.002 (-0.089)	-0.009 (-0.298)	-0.006 (-0.253)	-0.002 (-0.063)
Debt to GDP ratio, average 1990-2011	-0.001 (-1.106)	-0.001 (-1.593)	-0.001 (-1.118)	-0.002** (-2.440)	-0.001 (-1.142)	-0.001 (-0.766)	0 (-0.555)	-0.001 (-1.551)
Reserves to Imports Ratio, average 1990-2011	-0.012 (-1.595)	-0.019 (-1.599)	-0.007 (-1.058)	-0.019* (-1.696)	-0.001 (-0.221)	-0.015 (-1.228)	-0.006 (-0.793)	-0.024 (-1.782)
Constant	0.775*** (5.223)	1.016** (2.550)	0.616*** (3.694)	0.926* (2.382)	0.757*** (4.793)	0.946*** (2.389)	0.550*** (3.361)	0.949*** (2.032)
Observations	122	71	122	71	122	71	122	71
R-squared	0.342	0.428	0.258	0.432	0.249	0.349	0.187	0.296
r2_a	0.301	0.364	0.212	0.369	0.203	0.277	0.137	0.218
F	8.450	5.133	5.660	5.608	5.405	2.449	3.744	2.917

Note:Instruments are log of settler mortality following Acemoglu, Johnson & Robinson (2001).
t-statistics in parentheses *** p< 0.01, ** p<0.05, *p<0.1

at 7.22 percent, with the lowest average interest rate observed in Barbados at 5.72 percent and the highest average rate – in Antigua and Barbuda at 8.39 percent. Investment stood at 27 percent of GDP on average, while government expenditures at 30 percent of GDP across this group of countries over our sample period. All OECS countries had positive NFA, with the average NFA-to-GDP ratio equal to 12.6 percent. Thus, all these countries were net lenders to the rest of the world during 1980-2014, on average.

The region has seen high volatility in many of its relevant macroeconomic aggregates. Table 2.4 reports the percentage standard deviation of the key variables, as well as the relative standard deviation. It shows that all variables are quite volatile with the average real GDP volatility equal to 3.72 percent. This is quite high compared to developed economies and even compared to a few other developing countries (see Neumeyer and Perri, 2005). The highest GDP volatility is observed in Antigua and Barbuda and in Grenada. Interest rate is also quite volatile in these countries but the magnitudes are similar across them, with the exception of St. Lucia. The volatility of trade balance and terms of trade shows much more dispersion across the OECS countries, although the main result stands – the OECS countries exhibit very volatile business cycles, even compared to developing economies.

Consumption and government expenditures are more volatile in the Caribbean than elsewhere. As is commonly observed in the business cycles literature, investment is the most volatile variable among the expenditure components of GDP, with the relative volatil-

Table 2.3: Averages Values for Selected Key Macroeconomics Variables: 1980-2014					
	GDP growth	Int rate	Inv/GDP	Gov exp/GDP	NFA/GDP
Antigua and Barbuda	3.23	8.39	33.73	26.35	9.16
Barbados *	0.84	5.72	15.63	37.13	8.61
Dominica	2.71	6.94	20.20	32.34	14.82
Grenada	3.37	6.98	29.87	27.65	11.20
St. Kitts and Nevis	3.80	7.19	35.65	30.32	23.96
St. Lucia	3.52	7.94	24.85	26.24	2.60
St. Vincent and the Grenadines	3.50	7.34	25.70	27.79	18.07
Average	3.00	7.22	26.52	29.69	12.63

Notes: (*) We note that Barbados is not a member of the OECS region, nor the ECCU, but given its proximity and similarity with the OECS countries we have included it in the analysis. Int rate is the real interest rate computed as the lending rate minus inflation rate. Source: World Economic Outlook.

Table 2.4: Volatility of Key Macroeconomic Variables: 1980–2014							
	% Standard deviation				% Standard deviation of x / % Standard deviation of GDP		
	GDP	TB/GDP	TOT	Int rate	Inv	Gov exp	Cons
Antigua and Barbuda	5.38	6.98	6.76	2.87	3.42	2.64	4.56
Barbados	3.56	2.31	7.95	2.28	4.82	1.22	1.06
Dominica	2.49	6.17	4.03	2.90	6.88	3.96	2.82
Grenada	4.28	4.61	7.24	2.72	4.19	2.36	1.64
St. Kitts and Nevis	3.55	6.07	4.01	2.20	5.26	3.69	3.87
St. Lucia	3.63	5.04	6.20	3.23	4.07	1.46	2.50
St. Vincent and the Grenadines	3.11	5.32	6.04	2.63	3.33	2.50	2.17
Average	3.72	5.21	6.03	2.69	4.57	2.55	2.66

Notes: TOT is terms of trade; TB/GDP is exports minus imports over GDP; Int rate is the real interest rate computed as the lending rate minus inflation rate. All series (except trade balance, terms of trade and real interest rate) were log-transformed. To obtain the cyclical components of the key variables, they were Hodrick-Prescott (HP) filtered with the smoothing parameter of 100. Source: World Economic Outlook.

ity in the OECS countries equal to 4.6 on average. This number is comparable to that found for other countries. Government expenditures also exhibit higher volatility than GDP in the OECS countries by a factor of 2.55. This is in line with the findings in Male (2010) for developing countries. In contrast, in developed countries the ratio of volatility of government expenditure and GDP tends to be closer to 1. We found that the volatility of consumption in the OECS countries is strikingly high, equal to 2.66 times that of GDP volatility. This is quite high compared to both developing countries and developed economies. The highest consumption volatility is observed in Antigua and Barbuda and St. Kitts and Nevis, while the lowest – in Barbados and Grenada. In all OECS countries the relative volatility of consumption to GDP is well above 1.

The examination of the cyclical properties of the key variables reveals important insights. Table 2.5 reports the correlations between GDP and various macroeconomic aggregates. We notice, for example, that investment and private consumption are pro-cyclical, with the average correlations equal to 0.61 and 0.36, respectively. We also find that government expenditures are pro-cyclical with a correlation coefficient of 0.39. This finding confirms earlier results in the literature that developing countries tend to follow pro-cyclical fiscal policies. In addition, we find that interest rates in the OECS

Table 2.5: The Correlation of GDP with Key Macroeconomic Variables: 1980–2014

	Correlation of GDP with					
	Inv	Gov exp	Cons	TB/GDP	TOT	Int rate
Antigua and Barbuda	0.48	0.31	0.63	-0.44	-0.27	-0.33
Barbados	0.79	0.20	0.50	-0.33	0.39	-0.27
Dominica	0.56	0.65	0.23	-0.32	-0.23	-0.30
Grenada	0.56	0.49	0.32	-0.10	0.19	-0.21
St. Kitts and Nevis	0.65	0.38	0.04	-0.33	0.31	-0.32
St. Lucia	0.72	0.22	0.44	-0.27	-0.32	-0.55
St. Vincent and the Grenadines	0.55	0.52	0.38	-0.10	-0.08	-0.51
Average	0.61	0.39	0.36	-0.27	0.00	-0.36

Notes: TOT is terms of trade; TB/GDP is exports minus imports over GDP; Int rate is the real interest rate computed as the lending rate minus inflation rate. Source: World Economic Outlook.

Table 2.6: The Correlation of Interest Rates with Key Macroeconomic Variables: 1980–2014

	Correlation of Interest rate with						
	GDP	Inv	Gov exp	Cons	TB/GDP	TOT	Effective int rate
Antigua and Barbuda	-0.33	-0.30	0.04	-0.21	-0.08	0.00	0.79
Barbados	-0.27	-0.21	-0.17	-0.40	0.39	0.11	0.93
Dominica	-0.30	-0.50	-0.18	-0.22	0.72	0.43	0.87
Grenada	-0.21	-0.01	0.01	-0.35	-0.06	0.04	0.92
St. Kitts and Nevis	-0.32	-0.06	0.24	-0.37	0.03	-0.04	0.94
St. Lucia	-0.55	-0.53	0.02	-0.27	0.31	0.14	0.86
St. Vincent and the Grenadines	-0.51	-0.43	-0.23	-0.51	0.40	0.37	0.92
Average	-0.36	-0.29	-0.04	-0.33	0.24	0.15	0.89

Notes: TOT is terms of trade; TB/GDP is exports minus imports over GDP; Int rate is the real interest rate computed as the lending rate minus inflation rate. *Source*: World Economic Outlook.

countries are countercyclical – another important result that distinguishes the business cycles in developing countries – with the correlations ranging from -0.55 in St. Lucia to -0.21 in Grenada. With the currency board, an external shock generally translates into a decline in international reserves and monetary contraction that leads to an increase in interest rates. Lastly, we show that net exports are countercyclical, in line with the findings for developing economies in other studies.

Finally, we look at the correlation of real interest rates with various macroeconomic variables. The fact that real interest rates are countercyclical with GDP suggests that they may also be negatively correlated with investment, government expenditures, and consumption. Indeed, we find that this is the case for investment, where the correlation with interest rate is equal to -0.29, on average; and for consumption, where the correlation ranged from -0.51 in St. Vincent and the Grenadines to -0.21 in Antigua and Barbuda, with the average of -0.33. The correlation of the interest rate with government expenditures was close to 0, on average, although with a significant spread ranging from -0.23 for St. Vincent and the Grenadines and 0.24 for St. Kitts and Nevis (Table 2.6). Our finding that real interest rates are volatile and countercyclical in the OECS countries mirrors the results in Neumeyer and Perri (2005), Uribe and Yue (2006), and others for developing economies.

How to Make Fiscal Policy More Effective and Less Procyclical

Effective fiscal policies respond symmetrically to the business cycle and help countries build positive reputational capital. As this chapter has argued, discretionary fiscal policy is quite often applied asymmetrically over the business cycle. In that vein, many countries tend to raise government expenditures in a recession, but fail to lower it sufficiently in good economic times to balance the budget over the business cycle. This asymmetric response is thus associated with unsustainable growth in government expenditures and debt mostly because the increase in expenditures tends to impose permanent consequences on public finances. However, there are various options available for countries that seek a more balanced and prudent path for their fiscal policy, ranging from the adoption of fiscal responsibility laws (FRLs) to the adoption of fiscal councils. These options, when adopted effectively, help countries build reputational capital over time.

There are several aspects that need to be taken into account when a country considers adopting a fiscal responsibility law as a policy tool. First, FRLs by definition sacrifice discretion and replaces it by rules. The implication of this tradeoff is that it makes the careful design of fiscal legal frameworks extremely important. Rules can be rigid and can limit the ability of policy makers to adjust fiscal policy when needed to respond to changes in economic circumstances. If there are no provisions for such unforeseen circumstances in the FRL, governments may find it difficult to adjust in the face of an exogenous shock, for example. Second, the effectiveness of FRLs in supporting fiscal discipline strengthens with their successful implementation for extended periods of time and vice-versa. Third, to work effectively, a legal framework for fiscal responsibility requires adequate PFM systems aligned with the framework's level of sophistication (see van Eden, Khemani, and Emery Jr, 2013).

Fiscal rules represent another policy tool that has helped many countries to strengthen fiscal discipline and behave less procyclically. According to research by the IMF, fiscal rules have spread worldwide over the last 20 years or so (Schaechter, Kinda, Budina, and Weber, 2013). The more prevalent use of national fiscal rules reflects responses to different pressures on public finances and are now more prevalent in advanced and emerging economies. Factors that motivated their adoption range from reigning in debt excesses that resulted from banking and economic crises in the early 1990s (e.g., Finland, Sweden) and debt crises in Latin American countries (e.g., Brazil, Peru), consolidation needs to qualify for the euro area (e.g., Belgium), and more generally attempts to reduce trends of rising deficits and debts (e.g., the Netherlands, Switzerland). In some cases, the introduction of the rules coincided with large fiscal adjustments, in others (e.g., in Finland) it followed an improvement in fiscal positions to ensure continued fiscal discipline after the crisis.

It is common to find countries with more than one fiscal rule in place today. The trend to multiple fiscal rules is in part the result of the introduction of supranational fiscal rules, but also reflects decisions to broaden national fiscal rules arrangements, in particular in emerging economies. Adopting two or more fiscal rules also help to define the anchor for fiscal policy, and in that context having different rules could help a country address different policy objectives under particular economic circumstances. The most frequently used rules constrain debt and the budget balance, often in combination. In part, this reflects that supranational rules for members of monetary unions and the EU include these two types of rules, except the ECCU which only has a budget balance rule. Across national fiscal rules, expenditure rules are often combined with budget balance or debt rules to provide a greater anchor for debt sustainability. Revenue rules play a much more limited role, likely because they are less well suited to ensure the sustainability of public finances.

There are several reasons that make fiscal rules an attractive option for countries that seek to strengthen their fiscal discipline and manage better the business cycle. A significant weakness of fiscal principles and procedural rules is their lack of specificity about the actual fiscal policy stance a country should adopt. Numerical fiscal rules, however, provide a clear anchor for fiscal policy. Ideally, they determine, given the present economic and fiscal situation of the country, the levels at which fiscal aggregates should be set. Fiscal rules—in the ideal situation—can provide automatic and objective answers that would otherwise require a great deal of economic analysis, judgment, and political compromise. They thus decrease policy transaction costs and provide better fiscal outcomes.

It is important to embed flexibility in the design of either a FRL or a fiscal rule to enable governments to respond to unexpected events. As argued in a recent World Bank report (World Bank, 2013), pragmatism calls for the development of well-designed escape clauses in FRLs, allowing the fiscal rule framework to be waived or adjusted during exceptional economic circumstances. A second solution, combining rules and discretion, would be for the FRL to define the fiscal rules that must be adhered to but leave the numerical values to be determined by government on a recurring basis (van Eden, Khemani, and Emery Jr., 2013).

Countries that seek the path of fiscal discipline will inevitably have to develop a sound medium-term fiscal framework to operationally either a FRL or fiscal rule. An MTFF requires a more disciplined approach to fiscal policymaking by formalizing the development of a medium-term fiscal strategy and medium-term orientation within the budget process through a combination of (1) a medium-term macroeconomic framework that provides multiyear projections of macroeconomic variables such as GDP, inflation, exchange rates, and the balance of payments; (2) a framework that produces a set of multiyear targets or ceilings on fiscal aggregates, such as overall government expenditure, borrowing, and debt; and (3) identification of concrete policy measures that translate the projected overall resource envelope and the government's fiscal objectives into a set of credible and binding multiyear expenditure ceilings and policies.

In the Eastern Caribbean, there are non-binding supranational fiscal guidelines that establish fiscal principles that should be adopted by member countries. The fiscal guidelines of the Eastern Caribbean Currency Union (ECCU) members aim to put the countries on a path consistent with the reduction of their public debt-to-GDP ratios to 60 percent by 2020. ECCU members also had in place for some time an overall deficit target of 3 percent of GDP for which compliance was weak because of various shocks. This overall deficit target was dropped in 2006 and the level of the primary balance consistent with the debt target in 2020 has been used to guide fiscal policy, but it has not been strictly followed.

The experience of the ECCU countries with fiscal consolidation has been mixed and only more recently there has been a more explicit move to strengthen fiscal discipline in the region. Many ECCU countries have embarked on homegrown fiscal consolidation programs to reign in public spending, but the adoption of a rules-based fiscal policy framework remains rare in the region, with the exception of Grenada (see Box 2.1). In many instances, guided by the IMF or by virtue of necessity, ECCU member states have defined fiscal surplus targets, ceilings on public spending, or limits on debt creation, as a way to address concerns with debt sustainability and revenue shortfalls. For example, Antigua and Barbuda targeted a primary surplus of 3 percent of GDP under an IMF Stand By Agreement (SBA) in 2010; Dominica is currently implementing a fiscal adjustment equivalent to 6 percent of GDP over the next five years. Other common measures adopted throughout the region include negotiated wage freezes to control the growth and the size of wage bills, revision of tax holidays and tax exemptions to improve tax revenue collections, and enhanced monitoring of the operations and performance of state-owned enterprises (SOEs).

The OECS countries can draw on existing good practices on how to strengthen their fiscal positions and be better equipped to adopt counter-cyclical fiscal policies. Moving towards a full blown FRL, with or without a formal fiscal rule, requires some preparation and building technical capacity in order to design, implement, and monitor the new policy tool. There are some well-established good practices in that regard that could help the Eastern Caribbean states to become less procyclical. First, when establishing primary fiscal surplus targets, countries in the region are strongly advised to include in their targets buffers to cover future disaster-related expenses. Second, the creation of a savings fund associated with the fiscal buffers mentioned above could be a good and transparent way to discipline the use of these set-aside resources. This would require the development of a strong institutional framework and governance structure with clear operational rules for the allocation of the fund's resources. Third, the adoption of medium-term fiscal frameworks (MTFFs) and medium-term debt management strategies could help strengthen fiscal discipline and ensure that fiscal policy guides the budgetary process and not the other way around. Finally, pursue symmetric fiscal policy responses through the use of fiscal rules aimed at stabilizing macroeconomic shocks by adopting, for example, expenditure ceilings, cyclical deficit targets, and rules-based.

Box 2.1

Grenada's Rules-Based Fiscal Policy Framework

Grenada's fiscal responsibility law set an important step in the transition to a rules-based fiscal framework in the OECS region. In June 2015 Grenada's Parliament was the first in the OECS to approve a landmark fiscal responsibility law. The new legal framework establishes a 2 percent cap on real expenditure growth and a debt ceiling of 55 percent of GDP to be achieved by 2022. The framework includes escape clauses in the event of unpredictable shocks such as natural disasters, public health epidemics, and economic and financial crises.

The rule-based fiscal framework will be implemented in three phases.

Phase 1. Under the Government's homegrown program, a primary balance of 3.5 percent of GDP should be achieved by 2016, aiming to reduce the debt-to-GDP ratio and restore debt sustainability.
Phase 2. During Phase 1, the primary balance is maintained at 3.5 percent of GDP on average until public debt is lowered to 55 percent of GDP.
Phase 3. Once the debt target has been achieved, the debt is maintained at this level, while the primary balance is maintained at its debt-stabilizing level, currently estimated around 1 percent of GDP.

In addition, the rules-based fiscal framework contains guidelines on public sector wage negotiations, a ceiling on PPP-related contingent liabilities, and the use of CBI receipts. The law also sets a public wage-bill target of 9 percent of GDP, establishes a cap on PPP related contingent liabilities at 5 percent of GDP, and provides for a share of monthly Citizenship by Investment (CBI) inflows to be saved and used to finance future budgetary contingencies or natural-disaster and response efforts.

This framework is expected to provide a strong basis for counter-cyclical fiscal policy and enduring medium-term fiscal and debt sustainability. It is more binding than previous fiscal targets used by OECS member countries, which lacked clear operational guidelines and were not fully adhered to.

Source: Authors' elaboration based on IMF Grenada-Second Review under the Extended Credit Facility (June 2015)

Concluding Remarks

We have confirmed earlier findings in the literature showing that a number of developing countries have graduated from fiscal policy pro-cyclicality. In comparison with industrialized countries, however, developing countries tend to behave in a way that contributes to exacerbate the effects of the business cycle; that is, they tend to exhibit more often than industrialized economies pro-cyclical fiscal policies in both booms and downturns, contributing to exacerbate output volatility. This result coincides with the findings from Kaminsky et al. (2004) and represent additional evidence in support of the "when-it-rains-it-pours" phenomenon.

We have also shown that the business cycles in the OECS countries exhibit the properties that are typical of developing countries. In particular, these countries, very much like other developing countries, are characterized by (i) higher volatility of most macroeconomic variables when compared to other more advanced economies as exemplified, for example, by the volatility of the key variable affecting welfare – consumption – which is above the volatility of output in developing countries, but below output volatility in advanced economies; (ii) countercyclical real interest rates in developing countries as opposed to mildly pro-cyclical or a-cyclical real interest rates in advanced economies; net exports are also found to be much more countercyclical in developing countries relative to the developed economies; and (iii) fiscal policy is pro-cyclical, while it tends more frequently to be countercyclical in advanced economies.

A result worth mentioning is that we have also found evidence in support of the idea that institutional quality is an important determinant of a country's fiscal stance. This is an important finding that suggests that efforts to graduate from fiscal policy pro-cyclicality need to be accompanied by policy reforms that seek to strengthen the ability of countries to save in good times to generate fiscal buffers that could be used in bad times. In that regard, initiatives such as the establishment of fiscal councils and the adoption of fiscal rules, the development of sound debt management strategies that reinforce fiscal discipline, and the strengthening of macro prudential regulations appear to be necessary conditions for graduation from pro-cyclicality.

Finally, we have argued that the countries in the region would have much to gain in terms of their ability to respond in a symmetric way to the business cycle by following well-established good practices. While the adoption of full-blown FRLs and formal fiscal rules would be the optimal solution, fiscal discipline can be buttressed in the OECS by the adoption of intermediate but nevertheless good practice policy options. These would include (i) building fiscal buffers, that could be embedded in primary fiscal balance targets, to cover future disaster-related expenses; (ii) creating savings funds with a strong institutional framework and governance structure with clear operational rules for the allocation of the fund's resources; (iii) adopting medium-term fiscal frameworks (MTFFs) and medium-term debt management strategies to strengthen fiscal discipline and ensure that fiscal policy guides the budgetary process and not the other way around; and (iv) pursuing symmetric fiscal policy responses through the use of fiscal rules aimed at stabilizing macroeconomic shocks .

APPENDIX

Methodological Approach Used to Investigate the Determinants of Fiscal Policy Cyclicality

We begin by estimating equation (1) below (using a country panel fixed effects specification) linking the cyclical component of real government expenditures ($g^c_{i,t}$) to the cyclical component of real GDP ($y^c_{i,t}$) and a proxy for institutional quality ($IQ_{i,t}$) where we denote a given country by "i" in a given year "t". The interaction variable is meant to show how institutional quality increases (a positive sign for α_3, in the event of $\alpha_2>0$) or decreases ($\alpha_3<0$, in the event of $\alpha_2>0$) fiscal pro-cyclicality.

(1) $$g^c_{i,t} = \alpha_1 + \alpha_2 \times y^c_{i,t} + \alpha_3 \times (y^c_{i,t} \times IQ_{i,t}) + IQ_{i,t} + \eta_i + \varepsilon_{i,t}$$

We then expand the analysis by including the role of initial institutional quality ($IQ^{initial}_{i,t}$) and changes of the variable ($\Delta IQ_{i,t}$) in equation (2). One expects both signs of the parameters of the interaction terms included in the equation, α_3 and α_4, to be negative and significant in explaining the relationships between cyclical components of real government expenditures and real GDP (in the event of $\alpha_2>0$).

(2) $$g^c_{i,t} = \alpha_1 + \alpha_2 \times y^c_{i,t} + \alpha_3 \times (y^c_{i,t} \times IQ^{initial}_{i,t}) + \alpha_4 \times (y^c_{i,t} \times \Delta IQ_{i,t}) + \alpha_5 \times IQ^{initial}_{i,t} + \alpha_6 \Delta IQ_{i,t} + \eta_i + \varepsilon_{i,t}$$

As a next step, we added to this panel equation a vector Z of "q" additional controls to look for possible omitted variable bias problems. One expects to observe significant values for the institutional quality variable after controlling for the variables included in Z_q vector.

(3) $$g^c_{i,t} = \alpha_1 + \alpha_2 \times y^c_{i,t} + \alpha_3 \times (y^c_{i,t} \times IQ_{i,t}) + IQ_{i,t} + \alpha_q \times Z_q + \eta_i + \varepsilon_{i,t}$$

Finally, we tried a different approach with equation (4) by switching to a cross section specification where the dependent variable (ρ_i^{avg}) is the correlation coefficient of real government expenditures and real GDP for a given time period. The specification is first computed including the average value of the institutional quality variable (IQ_i^{avg}) for the same period as sole control, and then adding additional explanatory variables (vector Z). Again, the value for α2 is expected to be negative and statistically significant.

(4) $$\rho_i^{avg} = \alpha_1 + \alpha_2 \times IQ_i^{avg} + \alpha_q \times Z_q + \eta_i + \varepsilon_i$$

In all cases, we used alternative definitions of fiscal cyclicality, namely by applying different filters to smooth the series including the Hodrick-Prescott, Baxter-King, Christiano-Fitzgerald and Butterworth filters. The specifications were applied for the following periods and samples:

i) First, for the period 1984-2009, using the Frankel, Vegh, & Vuletin (2014) sample of real government expenditures and real GDP, as well as the set of controls identified by these authors, including the institutional quality proxy, based on the International Country Risk Guide (ICRG) data.[10]

ii) Next, for the period 1990-2011, using a sample of 180 countries and including the same controls defined by Frankel, Vegh, & Vuletin (2014). A problem we found was that of availability of data for the ICRG variable. In particular, the source includes information for 138 countries up to 2010 only. To get around this limitation, we considered an alternative proxy for IQ based on Kunčič (2013), which is available for 193 economies for the period 1990-2011. This is also motivated out of our interest to test whether results found by Frankel, Vegh, & Vuletin (2014) are robust to the choice of IQ variable and hold for a different (larger) country sample.[11]

10 While the data on real government expenditures and real GDP was kindly provided by Frankel, Vegh, & Vuletin (2013), we compiled the remaining information from the original sources.

11 An additional reason for using the Kunčič (2013) dataset is that it includes data on the IQ proxy for 14 out of 15 Caribbean countries that are of special interest in this research, whereas ICRG data only covers 6 of those countries.

iii) Third, we generated results for additional specifications, not included in Frankel, Vegh, & Vuletin (2014), and introduced additional controls.

Tables A3.1 and A3.2 show the results of econometric estimations that confirm the relevance of institutional quality as an important determinant of fiscal policy cyclicality. The full set of results can be found in Carneiro and Garrido (2015) and will not be repeated here. Our results show that IQ is strongly significant as an explanatory variable of movements away from cyclicality for all specifications using ICRG as a proxy for IQ and for all but one specification that rely on the Kunčič (2013) dataset, following Equation 1. When we separate the effects of initial IQ from changes in IQ (Equation 2) we observe that the former variable is strongly significant under all filtering methods when using ICRG as proxy for IQ, but less so in the specifications using Kunčič (2013) data. On the other hand, the latter specifications show higher statistical significance for the changes in IQ compared to the former. When the same panel specification was expanded to account for the role of additional controls (Equation 3), one can observe how robust the significance of IQ is when ICRG is used as a proxy under all filtering methods. The cross-country regression results for the period 1990-2011 through the estimation of equation (4) considers the correlation between cyclical components of real government expenditures and real GDP as a function of average IQ and average values for other controls, as in Frankel, Vegh, & Vuletin (2013). This specification also shows robust results for institutional quality under all filtering methods and for alternative IQ definitions.

Table A2.1: Panel Regression: Determinants of Cyclical Component of Real Gov. Expenditures (alternative filters). Additional Controls. Period 1984-2009

VARIABLES	Cyclical Component Real Gov. Exp.			
	1 HP filter	2 BK filter	3 CF filter	4 BU filter
Cyclical Component Real GDP, alternative filters (x)	2.899*** (8.337)	3.061*** (7.631)	1.940*** (7.280)	3.218*** (7.273)
Interaction Cyclical Component Real GDP filter and Institutional Quality (x)	-3.021*** (-5.042)	-3.042*** (-4.406)	-1.319*** (-3.218)	-3.222*** (-4.064)
Interaction Cyclical component of Real GDP and Chinn-Ito Index of Capital Openness (x)	0.086 (1.440)	0.099 (1.407)	0.043 (1.106)	0.100 (1.207)
Interaction Cyclical component of Real GDP and financial depth (M2/GDP) (x)	-0.003 (-1.230)	-0.005 (-1.505)	-0.003* (-1.888)	-0.004 (-1.040)
Interaction Cyclical component of Real GDP and Volatility (Squared cyclical component GDP) (x)	-5.571 (-0.319)	-5.200 (-0.208)	17.303 (0.848)	-8.466 (-0.294)
Interaction Cyclical component of Real GDP and Proxy Political Checks and Balances (x)	0.072 (1.437)	0.107* (1.791)	0.047 (1.380)	0.146** (2.086)
Interaction Cyclical component of Real GDP and Debt Ratio to GDP (x)	-0.005*** (-3.855)	-0.007*** (-4.443)	-0.005*** (-5.247)	-0.009*** (-5.527)
Interaction Cyclical component of Real GDP and Reserves Ratio to Imports (x)	-0.079*** (-5.777)	-0.065*** (-3.833)	-0.026** (-2.355)	-0.060*** (-3.035)
Institutional Quality Proxy	0.000 (0.001)	0.001 (0.049)	0.052* (1.953)	0.014 (0.823)
Chinn-Ito Index of Capital Openness	0.001 (0.590)	0.001 (0.466)	0.001 (0.479)	0.001 (0.785)
Financial Depth (M2 Ratio to GDP)	0.000 (1.513)	0.000* (1.750)	0.000* (1.904)	0.000 (1.444)
GDP volatility (Squared Cyclical Component of GDP)	-0.489 (-0.354)	0.278 (0.193)	0.443 (0.322)	0.201 (0.183)
Proxy for Political Checks and Balances	-0.001 (-0.332)	-0.001 (-0.513)	-0.003 (-1.382)	-0.000 (-0.262)
Debt to GDP ratio	0.000 (1.136)	0.000 (1.246)	0.000*** (5.493)	0.000*** (4.178)
Reserves to Imports Ratio	-0.000 (-0.604)	-0.000 (-0.849)	0.001 (1.046)	0.000 (0.008)
Constant	-0.010 (-0.707)	-0.013 (-0.911)	-0.060*** (-3.534)	-0.023** (-2.168)
Observations	1,952	1,768	1,768	1,768
R-squared	0.085	0.087	0.082	0.077
Number of ccode1	91	90	90	90
r2_a	0.0328	0.0302	0.0243	0.0195
F	11.41	10.60	9.863	9.272

Notes: t-statistics in parentheses. t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1 *** p<0.01, ** p<0.05, * p<0.1. (x) The filter used to compute the cyclical component of GDP is the same as that used for computing the dependent variable. ***Source***: Authors calculations.

Table A2.2: Cross country Regression. Fiscal Cyclicality Proxy under alternative filtering methods. 1984-2009. Role of Instit. Quality and Determinants

	Correl. Cyclical Component Real Gov. Exp. And Real GDP							
VARIABLES	1 HP filter	2 BK filter	3 CF filter	3 BU filter	4 HP filter	5 BK filter	6 CF filter	7 BU filter
Institutional Quality (from ICRG), average 1984-2009	-0.946*** (-6.420)	-0.763*** (-5.263)	-0.812*** (-5.267)	-0.645*** (-4.318)	-1.118*** (-4.460)	-0.883*** (-3.504)	-1.187*** (-4.515)	-0.778*** (-3.165)
Chinn-Ito Index of Capital Openness, average 1984-2009					0.001 (0.023)	-0.001 (-0.021)	-0.006 (-0.217)	-0.038 (-1.388)
Financial Depth (M2 Ratio to GDP), average 1984-2009					0.001 (0.566)	0.000 (0.367)	0.000 (0.408)	0.001 (0.833)
GDP volatility (Squared Cyclical Component of GDP), average 1984-2009 (x)					95.657** (2.109)	118.368* (1.925)	3.916* (1.971)	345.230** (2.294)
Proxy for Political Checks and Balances, average 1984-2009					0.029 (1.213)	0.027 (1.129)	0.038 (1.579)	0.061** (2.606)
Debt to GDP ratio, average 1984-2009					-0.001 (-1.386)	-0.001 (-1.577)	-0.002** (-2.292)	-0.002** (-2.362)
Reserves to Imports Ratio, average 1984-2009					-0.020*** (-2.706)	-0.013* (-1.671)	-0.017** (-2.195)	-0.014* (-1.851)
Constant	0.648*** (7.502)	0.567*** (6.652)	0.587*** (6.492)	0.476*** (5.433)	0.742*** (4.921)	0.627*** (4.133)	0.844*** (5.852)	0.459*** (3.088)
Observations	92	91	92	92	91	90	91	91
R-squared	0.314	0.237	0.236	0.172	0.413	0.313	0.364	0.334
r2_a	0.306	0.229	0.227	0.162	0.364	0.254	0.311	0.278
F	41.22	27.69	27.75	18.65	8.358	5.325	6.793	5.945

Notes: t-statistics in parentheses. t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1 *** p<0.01, ** p<0.05, * p<0.1. (x) The filter used to compute the cyclical component of GDP is the same as that used for computing the dependent variable. ***Source***: Authors calculations

Table A2.3: Panel Regression: Determinants of Cyclical Component of Real Gov. Expenditures (alternative filters and two alterntive proxies for Instit. Quality). Additional Controls. Period 1990-2013.

	Institutional Quality proxy is that of Kuncic (2013)				Institutional Quality proxy is ICRG			
	Cyclical Component Real Gov. Exp.							
	1 HP filter	2 BK filter	3 CF filter	3 BU filter	4 HP filter	5 BK filter	6 CF filter	7 BU filter
Cyclical Component Real GDP, Alternative filters (x)	1.025*** (3.853)	1.086*** (3.193)	0.825*** (5.193)	-0.191 (-0.614)	2.150*** (8.195)	2.653*** (7.004)	1.267*** (8.396)	2.130*** (6.005)
Interaction Cyclical Component Real GDP filter and Institutional Quality, Alternative filters (x)	-0.564 (-0.867)	-0.143 (-0.184)	-0.031 (-0.103)	1.812** (2.179)	-2.296*** (-4.404)	-3.092*** (-4.389)	-0.792*** (-3.628)	-2.274*** (-3.330)
Interaction Cyclical component of Real GDP and Chinn-Ito Index of Capital Openness, Alternative filters (x)	-0.042 (-0.794)	-0.070 (-1.104)	-0.014 (-0.822)	-0.058 (-0.892)	-0.007 (-0.155)	0.002 (0.035)	-0.035** (-2.142)	0.009 (0.145)
Interaction Cyclical component of Real GDP and financial depth (M2/GDP), Alternative filters (x)	-0.007*** (-2.884)	-0.007** (-2.547)	-0.002*** (-2.671)	-0.010*** (-3.668)	-0.008*** (-3.924)	-0.003 (-1.216)	-0.002*** (-2.612)	-0.008*** (-2.953)
Interaction Cyclical component of Real GDP and Volatility (Squared cyclical component GDP), Alternative filters (x)	-3.047 (-1.562)	-9.535* (-1.945)	-1.397** (-2.124)	4.028 (0.921)	1.705 (0.569)	8.989 (0.768)	-2.020*** (-2.770)	-2.993 (-0.697)
Interaction Cyclical component of Real GDP and Proxy Political Checks and Balances, Alternative filters (x)	0.007 (0.145)	-0.019 (-0.337)	-0.035** (-2.252)	-0.015 (-0.241)	0.013 (0.301)	-0.001 (-0.016)	-0.012 (-0.747)	0.019 (0.345)
Interaction Cyclical component of Real GDP and Debt Ratio to GDP, Alternative filters (x)	0.002** (2.380)	0.002** (2.021)	0.000 (0.251)	0.004*** (3.412)	-0.001 (-0.913)	-0.002** (-1.976)	-0.000 (-0.612)	-0.001 (-1.018)
Interaction Cyclical component of Real GDP and Reserves Ratio to Imports, Alternative filters (x)	0.004 (0.646)	-0.016 (-1.578)	0.006 (1.627)	0.006 (1.027)	0.005 (0.847)	-0.016 (-1.473)	0.008*** (3.290)	0.003 (0.493)
Institutional Quality Proxy	0.010 (0.244)	0.009 (0.198)	0.016 (0.345)	0.014 (0.460)	0.013 (0.476)	0.039 (1.273)	-0.069** (-2.037)	0.011 (0.532)
Chinn-Ito Index of Capital Openness	0.000 (0.064)	0.002 (0.801)	0.001 (0.275)	0.001 (0.338)	-0.001 (-0.320)	0.001 (0.241)	-0.002 (-0.677)	0.000 (0.030)
Financial Depth (M2 Ratio to GDP)	0.000*** (2.856)	0.000*** (2.584)	0.000 (1.146)	0.000* (1.708)	0.000** (2.536)	0.000** (2.345)	0.000 (0.562)	0.000 (1.348)
GDP volatility (Squared Cyclical Component of GDP), Alternative filters (x)	-0.804 (-1.485)	-0.684 (-0.732)	0.228 (0.505)	-0.287 (-0.668)	1.137 (1.499)	0.674 (0.592)	0.513 (1.572)	-0.129 (-0.404)
Proxy for Political Checks and Balances	-0.002 (-1.067)	-0.002 (-1.107)	-0.006*** (-2.627)	-0.001 (-1.028)	-0.001 (-0.457)	-0.001 (-0.815)	-0.003 (-1.060)	-0.001 (-0.649)
Debt to GDP ratio	0.000* (1.931)	0.000 (1.067)	0.000* (1.948)	0.000** (2.040)	0.000*** (2.864)	0.000 (0.381)	0.000 (1.635)	0.000* (1.719)
Reserves to Imports Ratio	-0.000 (-0.528)	-0.000 (-0.185)	0.000 (0.741)	-0.000 (-0.418)	-0.001 (-1.249)	-0.000 (-0.295)	0.000 (0.900)	-0.000 (-0.537)
Constant	-0.019 (-0.925)	-0.020 (-0.856)	-0.017 (-0.675)	-0.015 (-0.929)	-0.022 (-1.321)	-0.035* (-1.814)	0.034 (1.564)	-0.011 (-0.893)
Observations	2,538	2,318	2,538	2,538	2,264	1,978	2,264	2,264
R-squared	0.069	0.056	0.055	0.029	0.122	0.083	0.082	0.059
Number of ccode1	155	153	155	155	125	124	125	125
r2_a	0.00256	-0.0168	-0.0123	-0.0399	0.0643	0.0143	0.0224	-0.00244
F	11.70	8.577	9.213	4.782	19.63	11.11	12.72	8.900

Notes: t-statistics in parentheses. t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1 *** p<0.01, ** p<0.05, * p<0.1. (x) The filter used to compute the cyclical component of GDP is the same as that used for computing the dependent variable. ***Source***: Authors calculations

Table A2.4: 2-period Panel Country Regression. Changes Fiscal Cyclicality Proxy under alternative filtering methods. Role of Instit. Quality and Determinants. Instit. Quality proxy is that of Kuncic (2013) (*)

	Correl. Cyclical Component Real Gov. Exp. And Real GDP							
	1 HP filter	2 BK filter	3 CF filter	3 BU filter	4 HP filter	5 BK filter	6 CF filter	7 BU filter
Initial Correlation Real Gov. Exp-GDP, alternative filters (Avg. 1990-2000) (x)	-0.937*** (-10.292)	-0.837*** (-9.897)	-0.978*** (-11.085)	-1.028*** (-11.313)	-0.968*** (-10.561)	-0.848*** (-9.784)	-1.010*** (-11.300)	-1.016*** (-10.761)
Initial Institutional Quality (Avg. 1990-2000) based on Kuncic (2013)	-0.491** (-2.158)	-0.772*** (-3.781)	-0.482** (-2.122)	-0.464** (-2.022)	-0.440 (-1.010)	-0.681* (-1.742)	-0.340 (-0.783)	-0.454 (-0.987)
Initial Chinn-Ito Index of Capital Openness (Avg. 1990-2000)					0.001 (0.025)	0.006 (0.188)	-0.008 (-0.204)	0.027 (0.659)
Initial M2 Ratio to GDP (Avg. 1990-2000)					-0.002 (-1.494)	-0.002 (-1.186)	-0.003* (-1.717)	-0.002 (-1.375)
Initial GDP volatility (Squared Cyclical Component of GDP), alternative filters (Avg. 1990-2000) (x)					6.178 (0.316)	7.928 (0.597)	7.507 (0.396)	11.952 (0.713)
Initial Checks and Balances (Avg. 1990-2000)					-0.013 (-0.376)	0.000 (0.006)	-0.017 (-0.476)	0.001 (0.018)
Initial Debt to GDP ratio (Avg. 1990-2000)					0.000 (0.026)	0.001 (0.455)	-0.000 (-0.162)	0.000 (0.045)
Initial Reserves to Imports Ratio (Avg. 1990-2000)					-0.014 (-0.901)	-0.012 (-0.864)	-0.016 (-1.046)	-0.015 (-0.935)
Change in Institutional Quality (2000-2010 vs 1990-2000) based on Kuncic (2013)	0.224 (0.323)	-0.247 (-0.403)	0.009 (0.013)	-0.285 (-0.397)	0.613 (0.825)	0.386 (0.584)	0.295 (0.396)	0.048 (0.061)
Change in Chinn-Ito Index of Capital Openness (2000-2010 vs 1990-2000)					-0.003 (-0.058)	-0.006 (-0.134)	0.002 (0.053)	0.073 (1.459)
Change in M2 Ratio to GDP (2000-2010 vs 1990-2000)					-0.003 (-1.160)	-0.004* (-1.869)	-0.002 (-1.077)	-0.003 (-1.367)
Change in GDP Volatility, alternative filters (2000-2010 vs 1990-2000) (x)					8.767 (0.575)	30.415** (2.378)	4.395 (0.304)	11.544 (0.501)
Change in Checks and Balances (2000-2010 vs 1990-2000)					-0.062 (-1.265)	-0.045 (-1.018)	-0.058 (-1.167)	-0.075 (-1.441)
Change in Debt to GDP Ratio (2000-2010 vs 1990-2000)					0.000 (0.148)	0.000 (0.160)	0.000 (0.251)	-0.000 (-0.040)
Change in Reserves to Imports Ratio (2000-2010 vs 1990-2000)					-0.023** (-2.473)	-0.016** (-2.023)	-0.019** (-2.188)	-0.013 (-1.310)
Constant	0.212 (1.571)	0.368*** (3.036)	0.217 (1.613)	0.184 (1.367)	0.476** (2.019)	0.475** (2.237)	0.485** (2.046)	0.368 (1.490)
Observations	131	131	131	131	128	128	128	128
R-squared	0.456	0.437	0.493	0.503	0.531	0.507	0.564	0.563
r2_a	0.443	0.424	0.481	0.491	0.469	0.440	0.506	0.504
F	35.43	32.85	41.16	42.81	8.471	7.665	9.658	9.615

Notes: t-statistics in parentheses. t-statistics in parentheses. *** p<0.01, ** p<0.05, * p<0.1 *** p<0.01, ** p<0.05, * p<0.1. (x) The filter used to compute the cyclical component of GDP is the same as that used for computing the dependent variable. ***Source***: Authors calculations

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Chapter 3.
Comprehensive Financial Development for Growth and Lower Volatilty in the OECS

Introduction

Comprehensive financial development can be an important driver of economic growth and can increase a country's resilience to external shocks and volatility. Fully financially developed economies find it easier to mobilize savings, share information, improve resource allocation, and implement more effective diversification and risk management strategies. In the OECS context of a currency board that provides for a monetary anchor, limited fiscal space, and GDP that is highly dependent on services, the role of the financial sector as a driver of growth is further enforced. Comprehensive financial development also leads to less volatility to the extent that deep and liquid financial systems with more diverse instruments can help alleviate the impact of shocks. Comprehensive financial development also helps countries to manage better the impact of terms of trade volatility, especially in the case of small, open economies such as in the case of the OECS.

This chapter explores critical policy options to strengthen financial development in the region. In what follows, we first discuss the structure and evolution of the financial sector, in particular the banking sector in the OECS region over the past 15 years. Second, we assess the level of financial development in the region as well as the global relationship between comprehensive financial development, growth, and stability. We do this by using a comprehensive index of financial development recently created by the IMF that captures different aspects of financial development. The chapter concludes by exploring specific policy options that could help reorient financial development so that it could be supportive of; (i) lower volatility; (ii) enhanced economic growth, and (iii) a more effective fiscal policy.

The OECS Financial Sector: Large and Frail

The financial sector in the OECS is dominated by the banking sector and is large as a percentage of GDP. The region has a high level of credit and is overbanked: in 2015, banking sector assets represented 166 percent of the region's overall GDP. There are some 40 licensed commercial banks (among them, 13 are indigenous banks and 26 are branches or subsidiaries of foreign banks, primarily Canadian-owned). Total commercial banks' assets for the OECS amounted to US$10.4 billion as of December 2015 while total bank deposits stood at US$6.2 billion for the same period. Further, the number of commercial bank branches per 100,000 people is 27 in the OECS compared with a LAC average of just 20. The commercial banks are regulated by the Eastern Caribbean Central Bank (ECCB), and indigenous banks make up about half of the banking system as measured by assets, deposits, as well as loans.

The non-banking sector is gaining importance in the OECS with credit union membership on the rise. As of 2015, there were 51 active credit unions, which manage total assets of about US$880 million (13 percent of the region's GDP) and have a membership base of 304,699, which is just under 50 percent of the region's population. Credit union membership in the OECS is high as compared with other countries, and its membership increased steadily during 2001-10 despite a decline in the number of credit unions. Credit unions have come into prominence in light of stringent credit conditions in the banking sector following the global financial crisis. Its assets and deposits experienced steady growth, especially for 2005-10, a period over which its total asset size almost doubled. In particular in 2015, credit union assets account for as much as 44 percent GDP in Dominica. For Grenada, St. Vincent and the Grenadines, and St. Lucia, credit union assets vary between 14 to 16 percent of GDP.

The insurance sector in the OECS is relatively large and is characterized by regional conglomerates. The two major insurance companies are the Sagicor Financial Group and Guardian Holdings. Assets for the sector constitute approximately 17 percent of regional GDP. The January 2009 collapse of Trinidad and Tobago based CL Financial Ltd. (CLF) and related companies (such as CLF's insurance subsidiaries, the Colonial Life Insurance Company (CLICO), CLICO International Life (CLI), and the British Insurance Company (BAICO)) affected the Caribbean, but hit the OECS region the hardest because of its high exposure to CLICO and BAICO that was estimated at 15 percent of GDP in 2009.

Offshore financial sectors in the region have been developed as a means to increase fiscal revenues, while not taxing their population. The OECS member states have a relatively small share of worldwide offshore activity, while they offer financial services ranging from international banking for corporations and individuals, to FDI, to insurance. Within the OECS, Antigua and Barbuda and St. Kitts and Nevis have the most active offshore financial sectors. However the offshore sector has been under threat due to: (i) the OECD Global Forum to fight tax evasion; (ii) the Anti Money laundering (AML) regulation of the Financial Action Task Force (FATF); and (iii) more recently U.S. Foreign Account Tax Compliance Act (FATCA).[12]

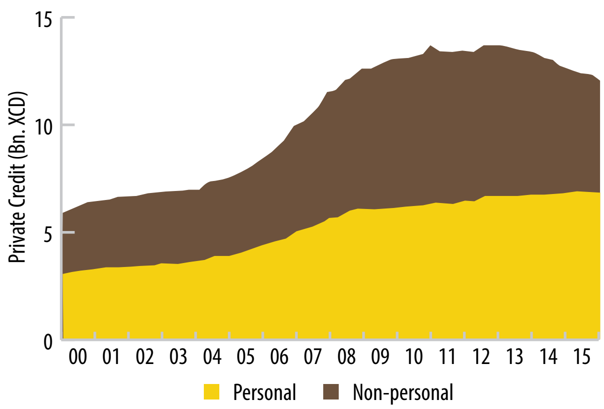
12 The original FATF Forty Recommendations were drawn up in 1990 aimed at combating the misuse of financial systems through money laundering. After several rounds, the revised FATF AML regulation addresses new and emerging threats. The FATF Standards have also been revised to strengthen the requirements for higher risk situations. The Foreign Account Tax Compliance Act (FATCA) is a United States federal law that requires United States persons, including individuals who live outside the United States, to have yearly reported themselves and their financial accounts held outside of the United States to the Financial Crimes Enforcement Network.

The OECS has a regional capital market that remains underdeveloped. The Regional Government Securities Market (RGSM) was established in 2002 for the primary issuance of government debt securities for 8 ECCU member countries to create a single regional financial space for government debt. Since the establishment of the RGSM, the holding of sovereign debt across borders has also increased. The increased exposure of banks to sovereign debt increases their liquidity and solvency risks of other governments than their own. Only five of the eight member countries – Antigua and Barbuda, Grenada, St. Lucia, St. Kitts and Nevis, and St. Vincent and the Grenadines – have thus far issued securities in the regional market, with St. Lucia and St. Vincent and the Grenadines being the most active issuers. However, the ECCB has not succeeded in creating a proper sovereign debt market, as there is no secondary markets, and as a result financial institutions buy and hold debt to maturity. Secondary market activity in government securities has also been precluded under the RGSM on account of a broker/dealer system that is not conducive to secondary market trading. There is also an Interbank Market and Repo Market administered by the ECCB and Eastern Caribbean Home Mortgage Bank (ECHMB) which also comprise of the long term debt capital market.

Before the 2008 global financial crisis, credit in the OECS expanded rapidly that was not supported by underlying economic growth. The banking sector in the OECS expanded rapidly in the early 2000s due to a credit boom during the run-up to the 2007 Cricket World Cup, and rapid credit expansion to the public sector to help finance governments' public sector investment programs. Between 2003 and 2008, credit to the private sector across the OECS grew at an average annual rate of 13.7 percent, as show in Figure 3.1 and Figure 3.2. In St. Lucia private credit to the private sector grew at 19 percent a year. Over 50 percent of this credit was for the acquisition of personal property and the growth of lending for services also grew sharply. The high prevailing level of credit to the private sector to GDP (which reached 85 percent in 2013) combined with GDP growth of only 1.4 percent annually between 2003 and 2013, was not sufficient to support this level of credit growth. This then led to a deterioration in asset quality.

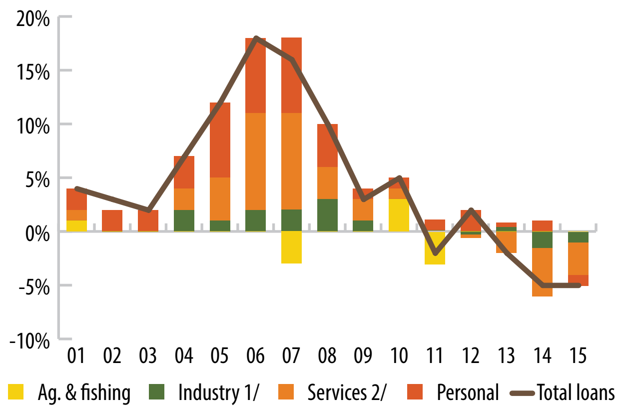
At the onset of the global financial crisis, economic activity contracted sharply leading to a sudden increase in non-performing loans. After a significant

Figure 3.1 Private Sector Credit



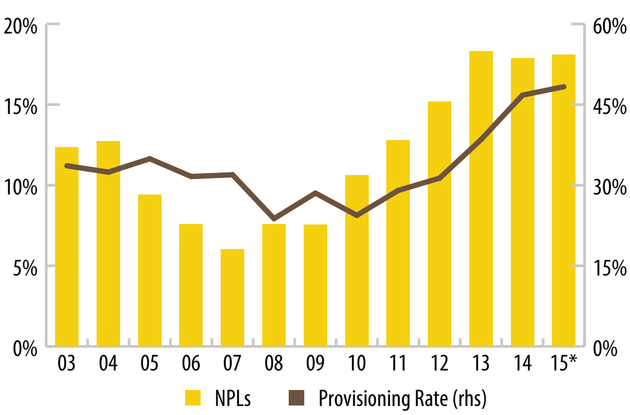
Source: ECCB.

Figure 3.2 Private Sector Credit Growth



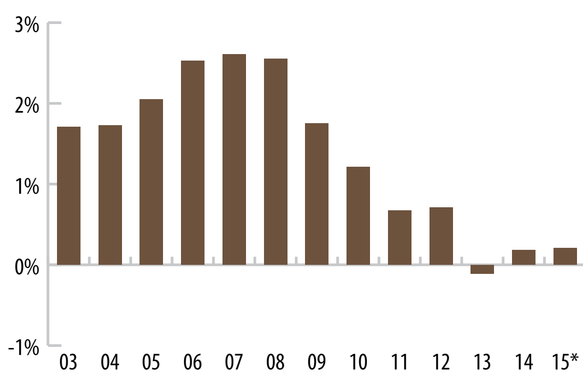
Source: ECCB. 1/ Includes manufacturing and construction. 2/Includes distributive trades, tourism, entertainment, transport, public utilities, professional services, and financial institutions.

Figure 3.3 NPLs & Provisioning



Source: ECCB. Data from 2015 is from September 2015.

Figure 3.4 Return on Average Assets



Source: ECCB. Data from 2015 is from September 2015.

credit expansion to the private sector during 2000-07, regional economic activity experienced a sharp contraction as a result of the 2008 global financial crisis. This has put significant stress on the banks' balance sheets and exposed vulnerabilities in the banking system. Credit growth to the private sector continued to fall and since 2013 is now negative (Figure 3.3). Most of the credit tightening has occurred in services (such as tourism-related services) although the highest share of loans are to individuals (54 percent) for acquisition of property and home construction and renovation, which has been rising in recent years.

As a result, there has been a deterioration in asset quality evidenced by a sharp increase in the share of nonperforming loans (NPLs) in the regional banking sector. Commercial banks' NPLs rose from 7.7 percent in 2008 to 18.0 percent in 2014 (see 3.3). The over-extension of credit proved to be unsustainable, and a credit overhang has been created. Protracted foreclosure processes which in some countries require judicial reviews have meant that the NPLs have remained on bank's balance sheets for the past six to eight years. Although provisioning levels have increased for these non-performing loans, these are still below international standards for provisioning. As show in Figure 3.4, the deteriorating asset quality has weighed down significantly on profitability.

The new Banking Act has now been passed in each of the eight OECS member states, and this provides the framework for improved supervision and reso-

lution, if needed. Important efforts have been made to improve the regulatory and supervisory framework. The new Banking Act, which is harmonized across the ECCU, has strengthened the regulatory and supervisory frameworks, including by introducing higher minimum capital requirements, a more effective resolution of failed banks, and a stronger depositor protection. Looking ahead, the currency union will need to operationalize the new Banking Act towards enhanced supervision and eventually strive to implement risk-based supervision and Basel II regulation for banks and non-banking financial institutions.

Against this backdrop and the efficiency of the sector, there is need to build a stronger banking and financial system that will be able to contribute towards growth and reducing volatility. In addition to the high number of branches per capita, commercial bank costs structures in the OECS are expensive. The average 2014 cost-to-income ratio at the indigenous banks in the OECS is 79 percent, which is well above the emerging market average of 45 percent. This combined with the level of NPLs suggests that efforts towards strengthening and consolidating the sector will significantly aide its ability to contribute towards growth and development.

Financial Development in the OECS: A Partial and Incomplete System

The ratio of credit to GDP and credit growth have recently been questioned as their comprehensiveness of measuring financial development, as they may not capture the ability of financial sectors to contribute towards growth and reducing volatility. The previous section showed that commercial bank assets and credit in the OECS expanded rapidly in the 2000s. However, high bank credit to the private sector may be a misleading indicator to measure financial development. For a country with a relatively high credit to GDP ratio, for instance, financial depth alone may only be a necessary but not sufficient condition to guarantee financial development. More importantly, if credit is not used for productive purposes, it can contribute to financial sector instability. Or it could have a limited contribution to economic development through excessive personal lending or in the creation of asset price bubbles. This section assesses the current level of financial development in the OECS region from the perspective of a more comprehensive measure of financial development. This measure captures depth, access, as well as efficiency.

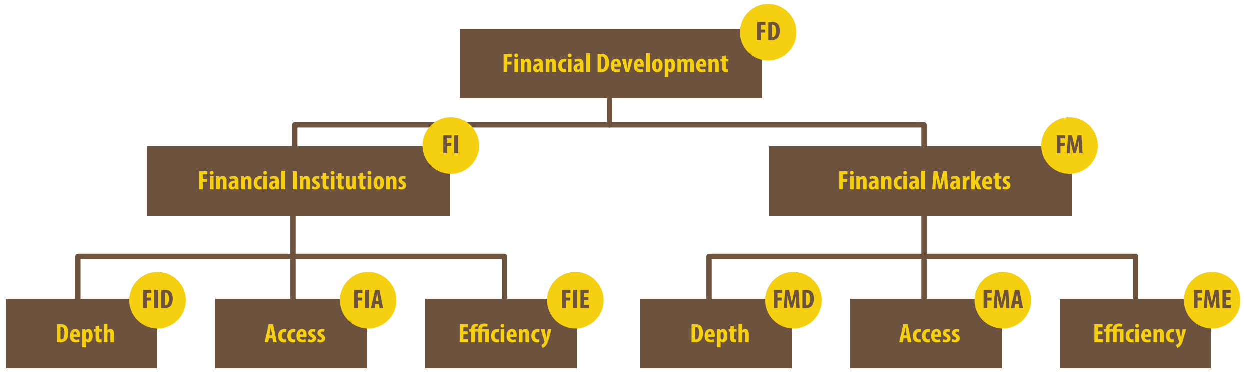
We use a comprehensive index of financial development that captures the multidimensional components of financial sector development. Traditionally, the literature has used the ratio of private credit to GDP as a proxy to measure the level of financial development. However, this indicator does not fully capture the full set of financial sector attributes, such as development of non-bank financial sector which consists of pension funds, credit unions, insurance companies, mutual funds, or securities markets. Over the past decade, however, the non-banking financial sector has significantly contributed to the overall financial sector development in the Latin America and the Caribbean. This is also true for the OECS. The IMF's newly constructed comprehensive index of financial development (Sahay et al. (2015)) – the Financial Development (FD) Index - aims to capture different aspects of financial development rather than relying on a single proxy, such as, credit to GDP. The index consists of two major components: financial institutions and financial markets. Each component is broken down into three sub-components: depth, access, and efficiency (see Figure 3.5).[13]

Although the OECS scores well in the credit-to-GDP ratio, its index of comprehensive financial development is low. Figure 3.6 shows the credit to GDP ratio for the OECS as well as key comparator countries and country groupings.[14] Compared to the LAC and Emerging Market (EM) average, which are each 47 and 49 percent, the OECS is well above these two benchmarks. The OECS indicator is above both the level in Slovenia and Sri Lanka. However, as Figure 3.7 shows, the level of its comprehensive financial development as measured by the index construction referenced above, is lower than these country groupings and peer countries. The index is scaled from 0 to 1, and the higher the index the better the level of financial development: the U.S. scores 0.8, for example. The OECS scores 0.30 on this index, while the LAC average is 0.31. Compared to the comparator countries and regions, the OECS scores much lower, the difference in score between the

13 These subcomponents are constructed based on a number of underlying variables that track development in each area. The database includes 123 countries for 1995-2013.

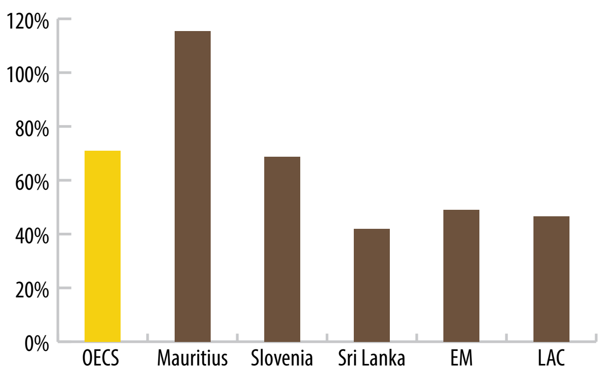
14 The rationale for selecting these comparator countries are: (i) Mauritius for its tourism and service-based economy (though Mauritius does have a large offshore financial sector that is aggregated in domestic measures; (ii) Slovenia for a small open-economy that was able to navigate the financial crisis through careful fiscal management, and (iii) Sri Lanka for a service-based economy that has been able to increase SME lending over the past two decades.

Figure 3.5 Components of the Financial Development Index



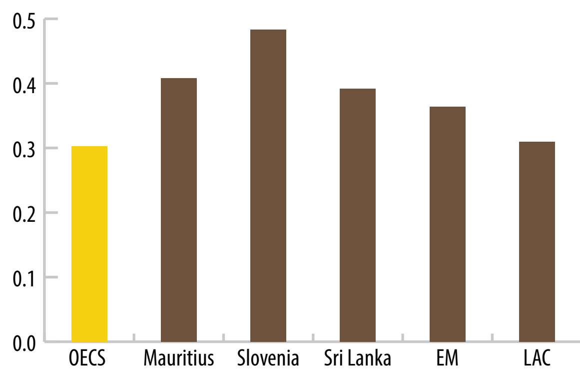
Source: Sahay et al. (2015a).

Figure 3.6 Private Credit to GDP



Source: WDI (2015).

Figure 3.7 Financial Development Index



Source: Sahay et al. (2015a).

OECS and Slovenia is 0.18, which is approximately one standard deviation of the 2013 index across the world.

With reference to the components of the comprehensive financial development index, the OECS performs less well in the financial market indicators. Figure 3.5 shows the composition of the financial development index used herein. As expected, the OECS performs well in the depth of financial institutions measure, as one of inputs to this sub-measure is private credit to GDP. However, in financial intuitions in the areas of access and efficiency it performs less well. The main factor that lowers the score of the OECS is the financial market scores. These are measures of the demand side – including the levels of equity and debt market developments.

The relationship between financial development and economic growth is well recognized in both the growth and finance literature. Economic theory suggests that well-functioning financial intermediaries and markets are the conduit to reduce information asymmetries, facilitate risk sharing and mobilize savings. This then leads to a more efficient resource allocation and, thus, may foster long-term growth.[15] A large empirical literature provides evidence that financial development matters for growth. However, there is less consensus as to whether the effect is mainly due to banks, stock markets or both. The "finance-led growth" hypothesis states that financial development exerts a positive and causal effect on real economic output. This is mainly supported in cross-country studies that focus on bank development proxies.[16] When stock market development is also considered, either the direction of causality becomes

15 See (Greenwood J. a., 1990), (Levine R. , 1991), (Bencivenga, 1991), (Greenwood J. a., 1997) and (Blackburn, 1998).
16 (King, 1993), (Levine R. N., 2000), (Calderón, 2003) , (Christopoulos, 2004), (Rioja, 2004) and (Loayza, 2006).

Figure 3.8 Growth & Financial Development

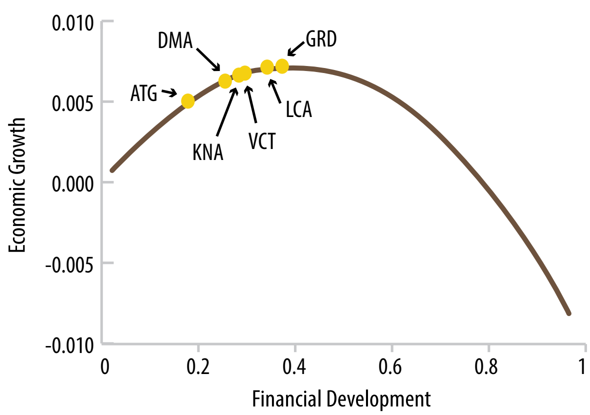
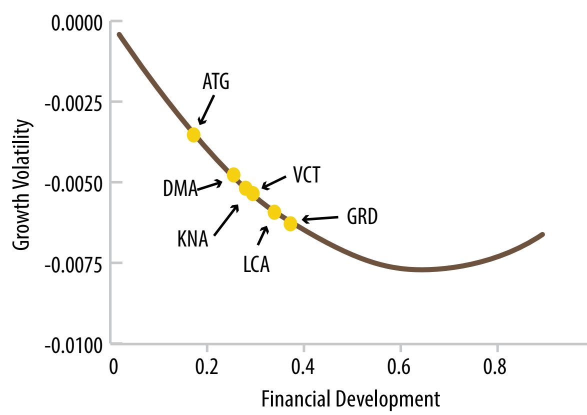


Figure 3.9 Volatility & Financial Development



Source: Authors' own calculations using the financial deepening index developed by the IMF in Sahay and others (2015a). Note: The curve in Figure 3.8 shows the predicted effect of financial deepening on growth for each level of the index, holding fixed other controls. The curve in Figure 3.9 shows the predicted effect of financial deepening on growth volatility, holding fixed other controls. Growth volatility is measures as the standard deviation of GDP growth rates over a five-year moving average.

more difficult to assess or the impact of banking sector development on growth is negative.[17]

More recently, evidence points to a more complex relationship between finance and growth that may be non-linear. Sahay et al. (2015a) develop a new and broader measure of financial development and find that the effect of financial development on economic growth is bell-shaped. The authors also present evidence that increased financial development is positively related to economic growth at lower levels of financial development, but that economic growth is weakened at higher levels of financial development. Cecchetti and Kharroubi (2015) show that an exogenous increase in finance may disproportionately benefit high collateral/low productivity projects and affect total factor productivity growth negatively. These authors also show that, in a model with skilled workers and endogenous financial sector growth, skilled labor will tend to absorb labor talent with the financial sector growing more quickly at the expense of the real economy. Based on these findings, the authors conclude that financial growth may disproportionately harm financially dependent and R&D-intensive industries.

The level of financial development has also been shown to affect the level of volatility in an economy. Aghion et al. (2010) identified a transmission channel through the existence of credit constraints in the economy. In the absence of financial frictions, long-term investment is believed to be counter-cyclical because the cost of long-term investment is lower in recessions. Moreover, Carneiro and Hnatkovska (2016) argue that when domestic financial markets are under-developed, domestic households and firms face binding financial constraints that become tighter in bad times, and this could amplify the effects of interest rate fluctuations on domestic activity. To the extent that higher volatility leads to lower investment rates, output and consumption, it will result in lower economic growth and welfare.

Following the literature above, the non-linear relationship between comprehensive financial development and growth as well as volatility also holds for the OECS countries. We have confirmed empirically the non-linearity in the association between comprehensive financial development, growth as well as volatility for the OECS countries (Figure 3.8 and Figure 3.9). Using the FD index, our results are unequivocal that comprehensive financial development impacts growth positively. However, this positive effect weakens at higher levels of comprehensive financial development and then eventually turn negative portraying a bell-shaped relationship between growth and financial development. We have also confirmed the existence of a non-linear relationship between comprehensive financial development and volatility. As a mirror image of the dynamics between financial depth and growth, financial development initially lowers volatility up to a certain point where it starts to create additional volatility (Figure 3.9). Given a low FD index of 0.3 for the OECS on average out of 1.0, this suggests that there are additional net benefits to be de-

17 (Beck, 2004), (Shen, 2006), (Arcand, 2012).

rived amongst OECS countries from strengthening their financial sector in order to foster economic growth and lower volatility, given the minimal scope of policy design.

The results above strongly demonstrate that there is sufficient room for the OECS to improve its comprehensive financial development, which will in turn contribute positively to economy growth and in reducing volatility. In both Figure 3.8 and Figure 3.9 the position of each of the six OECS countries is well before the inflexion point, beyond which further comprehensive development of the financial sector may have detrimental effects to economic growth and volatility. Given the high level of credit to GDP, the OECS should strive to reorient its financial sector to improve its comprehensive level of financial development. This reorientation – on both the supply and demand side –will positively contribute to economic growth and stability. The subsequent section explores specific policy options to reorient financial so that it could be more supportive of: (i) lower volatility; (ii) enhanced economic growth, and (iii) a more effective fiscal policy.

Entry Points to Reorient Financial Development in the OECS

To reorient financial development in the region to be more comprehensive, a number of challenges need to be addressed. Over the last decade, the OECS countries have made progress to further develop their financial systems. However, there is scope to reorient financial development in the region so that it less prone to high collateral-low productivity projects, less likely to create asset price bubbles and is able to contribute to enhancing economic growth and reducing volatility. This section discusses entry points across three areas: (i) reducing volatility; (ii) enhancing economic growth, and (iii) effective fiscal policy.

Reorienting Financial Development to Reduce Volatility

More comprehensive and reoriented financial development can significantly contribute to volatility reduction in two main areas in the OECS. The first is through financial instruments and institutions that are volatility reducing. Better and more sustainable savings instruments, a stronger insurance market and the development of a deposit insurance scheme can all contribute to reducing volatility. The second is through restoring the stability of the banking sector itself. As shown above, the sector has come into a period of stress – and this has directly increased volatility. Tackling the source of the stress directly can help reduce volatility in the region.

Financial Instruments and Institutions for Volatility Reduction

It is well noted that financial instruments such as savings and insurance, and institutions such deposit insurance help economic agents better manage shocks and smooth consumption. This sub-section provides an overview of savings, insurance and deposit insurance in the OECS to understand the policy options that can be adopted to reorient financial development towards improved volatility reduction.

The cost of financing is largely determined by the bank lending rate. As we have seen, banks are the principal source of financing for larger enterprises in the OECS. For smaller enterprises, too, bank lending is important: directly and also indirectly as a source of financing for the firms that provide them with trade credit. The ECCU has a statutory minimum savings rate that all regulated entities must pay to savings deposits. In a competitive market, the bank lending rate is equal to the cost of lending. The cost of lending consists of the cost of the necessary funds—for simplicity, we will take this to be the rate the bank pays on deposits—and on other costs. In a competitive market the 'spread'—the difference between the lending rate and the deposit rate is equal to the sum of these other costs. If the market is not competitive, banks will be able to raise their lending rates and/or lower their deposit rates, and the spread will be larger than the sum of the costs.

If the demand for loans increases then both the lending rate and the deposit rate will rise. If the supply of deposits increases then both the deposit rate and the lending rate will fall. An increase in 'other costs' will cause the spread, and so the lending rate, to increase. In the ECCU, this simple picture is altered by the imposition of the Minimum Savings Deposit Rate (MSDR). This is a regulation that sets the minimum rate that banks may pay on savings deposits. Its level is determined periodically by the Monetary Council of the ECCB. The MSDR was changed most recently in April, 2015, when it was lowered to 2% from 3% (where it had been since August 2012).

The effect of MSDR is that by setting the deposit rate at a level above the market-clearing rate it creates an excess supply of funds. The supply of deposits at that rate is greater than the demand for loans at that rate plus the spread. The difference between the two is 'excess liquidity'—funds the bank is borrowing but unable to lend profitably.

The MSDR has two effects on the lending rate. The first is direct: if the lending rate is the deposit rate plus the spread, and if the spread is unchanged, then raising the deposit rate to the level of the MSDR will raise the lending rate. The second effect is indirect. The excess liquidity created by the MSDR represents a fixed cost to the banks: they have to pay interest on funds they take in but are unable to lend profitably. This increase in fixed costs increases the spread, further raising the lending rate, reducing the amount of lending and exacerbating the excess liquidity. A study by the ECCB found empirical evidence of this effect. Of course, the MSDR will have these effects only if it is above the market-clearing rate. If it is below the market-clearing rate, it will be irrelevant and have no effect at all.

The decrease in the demand for loans and the increase in the supply of deposits should have led to a significant fall in the rate on savings deposits. In the United States, the rate on savings deposits fell, in the same period, to close to zero and has remained there ever since: today, the average rate on MMAs (a popular type of savings deposit) is 0.11%. The market-clearing rate in the OECS today is probably similarly close to zero. So a MSDR of 2% is effective, and it is probably raising the lending rate by significantly more than 2% by creating excess liquidity.

This is an example of 'financial repression' and the precise motivation for the MSDR is unclear. Perhaps it is a politically popular subsidy for savers or an extension of the welfare system. Perhaps the MSDR is a way of bailing out the national social security schemes which deposit a large part of their funds in the banks. Nevertheless, the MSDR is an example of the broader phenomenon of 'financial repression'—the suppression of market-driven financial activity as a result of government involvement in the financial system and of poor management of government finance. The effects of financial repression in general are to raise borrowing rates for the private sector and to reduce the availability of financing.

Although the MSDR is good for savers in the short–run, it has and will have deleterious long-term effects on the financial system, and less distortionary savings instruments and sustainable welfare programs should be developed for the OECS population. Savings instruments should not be held captive to the remainder of the financial system – as this too can actually increase systemic volatility. Rather less distortionary instruments are needed – perhaps even Unit Investment Trusts – to access foreign markets domestically could be developed. From the welfare perspective, more targeted programs should be developed to the extent that the MSDR plays a strong welfare role.

In addition to changes to the savings market, strengthening regulation is critically needed in the insurance sector. Drawing the lessons from the failure of CLICO/BAICO, a new insurance law was drafted in 2013. One innovation of the law is to create a single financial space, that is insurance companies would get a single license to operate in the 8 ECCU countries. In return they would have to increase their minimum capital and be subject to stronger prudential standards. The bill provides the supervisory with stronger corrective action and intervention powers. The insurance bill was drafted together with the bill establishing a single supervisor for non-bank starting with insurance: Eastern Caribbean Financial Services Commission (ECFSC). The purpose is to optimize supervisory resources and make them more efficient and better able to supervise multi-country insurers. However the insurance bill faces opposition from small insurers, which would face a consolidation process, and the bill on the single non-bank supervisor has encountered opposition from the country supervisors. Both bills should be urgently approved to ensure financial soundness and more efficient supervision.

The overcrowding of financial institutions has adverse implications for supervision and harmonizing this should be a long term goal. The reality of eight different jurisdictions means that the required supervisory apparatus is subject to an 8 times multiplier effect, being applied to a number of licensees that is already much larger than necessary. Based on data provided by the ECCB, the 61 regionally licensed insurers actually comprise a group of 161 separate registrants because most of the insurers are licensed in more than one of the eight jurisdictions (see Table 3.1). The creation of a single non-bank supervisor should also be considered,

Table 3.1: Number of Insurers

Country/ Region	Population	No. of insurers	Insurers per 100,000
ECCU	600,000	61	10.17
Bahamas	383,054	29	7.57
Barbados	283,380	26	9.17
Belize	351,706	15	4.26
British Virgin Islands	32,680	1	3.06
Trinidad	1,354,483	24	1.77
UK	64,559,135	911	1.41
Puerto Rico	3,548,397	54	1.52
Canada	35,543,658	233	0.66
Panama	3,867,535	28	0.72
Germany	80,970,732	560	0.69
Jamaica	2,720,554	18	0.66
Dominican Republic	10,405,943	31	0.30

Source: Individual country Insurance Commissions, WDI.

and made a long term goal. In 2013, as a lesson learned from the failures of BAICO and CLICO, the ECCU countries agreed to set up a single non-bank supervisor for insurance, credit unions and offshore businesses, which would start with insurance. In addition, the quality of supervision of credit unions is uneven across countries, and a regional body could implement the best practices in the least advanced countries. These changes in harmonized supervision, will help strengthen the insurance market particularly, and by doing so will contribute to a reduction in volatility.

The lack of an explicit financial safety net is a glaring gap from both the stability and depositor protection perspective. The OECS countries are amongst the few middle-income countries without explicit deposit insurance.[18] Instead they have an implicit guarantee on the deposits, which, in the absence of fiscal space, is not fully credible. The tight fiscal situation severely constrains the governments' capacity to underwrite the deposit base. In addition, the provision of emergency liquidity assistance by the ECCB is restricted by the currency board. Therefore it is critical that the foundations for a formal deposit insurance scheme should be put in place once the system has been sufficiently strengthened, and could even be used as an incentive for banks to strengthen their balance sheets.

A new deposit insurance scheme should follow the International Association of Deposit insurance (IADI) elements, in addition to precluding legacy issues from affecting the new scheme. The IADI essential elements for an effective deposit insurance provide an excellent framework for devising new schemes. The four elements are: (i) limited but credible limits for insured deposits; (ii) adequate funding for the deposit insurer and explicit back-up funding to allow the fund to respond to a number of institution failures at once; (iii) an effective public awareness campaign to make sure that depositors know the rules on coverage and are aware of the extent of and limits to existing compensation arrangements, and (iv) an effective deposit insurance system requires certain prerequisites including the presence of a working supervisory framework and good coordination among all members of the financial safety net. Finally, in the context of the ECCU it must be the case that legacy issues do not impair the viability of the scheme.

Restoring Banking Sector Stability to Reduce Volatility

The banking sector is currently in a position of instability, and restoring the stability of the banking sec-

18 Out of the 28 middle-income countries without explicit deposit insurance, 6 are in the OECS (WB staff calculations form Demirgüç-Kunt, Kane, & Laeven (2014)).

tor will itself contribute to reduced volatility. In the aftermath of the financial crisis, the banking sector in the OECS has experienced a period of prolonged stress. Given its size, this stress has increased volatility in the region. This has been manifested by increased NPLs, lower profitability, higher bank fees and three resolved banks over the past five years. Addressing this very stress will contribute to more comprehensive financial development and reducing volatility.

The new Banking Act is a significant legislative improvement across the ECCU and its operationalization will be critical for the future stability of the region. As of early 2016 all eight member countries of the OECS have now passed the new Banking Act. This is very welcome as it provides the foundation for a stronger banking sector. This has strengthened the regulatory and supervisory frameworks, including by introducing higher minimum capital requirements, a more effective resolution of failed banks, and a stronger depositor protection. Looking ahead, enhancing and establishing supervisory procedures to meet the new legislation will be critical to underwrite the stability of the banking system and thereby reduce volatility that has been created from banking sector weaknesses.

The diagnostic work to assess the strength of the banking system has now been completed, and commensurate supervisory as well as regulatory actions will be required to strengthen the commercial banking system. An extensive diagnostic exercise was undertaken to assess the degree and spread of commercial bank strengthening needs. Now that this has been completed, a comprehensive strategy is now needed to collectively buttress the foundation of the financial sector. Given the prevailing efficiency and business models of the sector, a focus on consolidation and leaner commercial banks will augur well for both the strength of the banking system as well as its ability to serve the needs of the economy.

Aside from strengthening the banking system, a number of key steps have been taken to better manage future NPLs. In the long run, a stronger insolvency framework will be a key enabler to helping banks better manage collateral collections. However foreclosure is last resort and yields the lowest recovery rates, and therefore efforts should also be made to help the system consider liquidation, receiverships and reorganizations within the insolvency frameworks. There is incipient reform in St. Lucia and St. Vincent and the Grenadines along these lines, and this should be regionalized. Further, when fully operationalized, the new Banking Act will reduce NPLs classification challenges and raise loan loss provisioning standards. Finally, the new Appraisal Institute that has been established, that will harmonize real estate appraisals across the region and reduce arbitrage. On the other hand, provisions should be assigned to debtors (rather than to loans), with more frequent reviews and cash flow analysis to determine categories; in addition provisioning levels should be more stringent, while write-off standards could also be strengthened.[19]

For current NPLs, more concerted efforts will be required to swiftly dispose of and thereby recognize these losses. The World Bank has recently released a toolkit for public asset management companies (AMC).[20] An AMC is a statutory body or corporation that assumes the management of distressed assets and strives to recoup the public cost of resolving them. Other options are to improve the framework for debt enforcement so as to facilitate the enforcement of collateral. This goes beyond insolvency reform but does take considerable time, as demonstrated in Latvia. On the other hand, if distressed assets are confined to limited number of institutions, special purpose vehicles can be established as a subsidiary of the bank or its holding function in order to work out the distressed assets. A final option is to attract private distressed asset funds. These usually have a minimum size threshold (and are therefore not suited to small loan sizes) and require higher rates of return. They do, however, require no public funds and are usually more expedient than public agencies.

The World Bank public AMC toolkit highlights important preconditions that must be in place. Public AMCs require assessing whether there exist the conditions to ensure that the objective of the effective management and sale of distressed assets through a public entity. The preconditions relate to (i) a commitment to comprehensive reforms, (ii) a systemic problem and public funds at risk, (iii) a solid diagnostic and critical mass of impaired assets, (iv) a tradition of institutional independence and public accountability, and (v) a robust legal framework for bank resolution, debt recovery, and creditors' rights. The analysis of nine case studies of AMCs in the toolkit shows that AMCs have a mixed track record.

19 For instance a prudential requirement that after a certain time past due the loan be written off; or raising risk-weights on impaired assets beyond a certain vintage.

20 World Bank (2016) Public Asset Management Companies: A Toolkit

AMCs are costly to establish and to operate; therefore their costs and benefits should be assessed carefully before they are established.

A regional Asset Management Company (AMC) could help clear the vast amount of NPLs. A regional public AMC would offer various advantages including:

- Address the lack of scale and depth of property markets at the national level: a regional AMC would be able to bundle loans from different banks and countries to facilitate their sale to investors.
- Address constraints in country insolvency and foreclosure legislation: the regional AMC has been granted special powers to expedite the management of bad loans, which draw on the most advanced country legislation and would benefit all the ECCU region.
- Ensure transparency: the regional AMC has been set up as a statutory body owned by all governments. It would be subject to strong transparency requirements and the scrutiny of all country Parliaments.
- Minimize corruption: the distressed asset management business is prone to corruption. A regional body would be less prone to local political interference and pressures from the banks.
- Attract specialized expertise: a regional institution with a critical mass of assets would be more able to attract international and expert staff than a local one. Currently there is very limited expertise in distressed asset management in the ECCU.

As of early 2016, Eastern Caribbean Asset Management Corporation (ECAMC) Agreement was signed by seven OECS member countries[21] and the ECAMC legislation had been passed in seven territories.[22] This legislation provides for: time bound safeguards that limit the period for purchasing assets and a fixed sunset clause; financial safeguards for initial equity, a leverage ratio; a minimum capital ratio of 2 percent; and, a dual mandate: for the AMC to (i) purchase NPLs from solvent institutions; and (ii) act as a receiver and thus managing NPLs of insolvent institutions. This in addition to its special powers to expedite the management of bad loans, which draw on the most advanced country legislation and would benefit all the OECS region.

21 Antigua and Barbuda, Dominica, Grenada, Montserrat, St Kitts and Nevis, St. Lucia and St Vincent and the Grenadines.

22 St. Lucia which await assent, Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat and St Vincent and the Grenadines.

The outcome of the process of managing and resolving existing NPLs should be favorable if the right tools to address existing NPLs are used. International best practice has shown that resolving NPLs is tricky, especially once political economy implications are considered. What is critical is that the management and resolution of existing NPLs is swift and non-reversible. This could be a combination of a public AMC, working with private distressed asset funds as well as improving the framework for debt enforcement. Provided that these tools are designed well, have sufficient scale and use public resources efficiently, the banking sector and the inherent volatility therein would strongly benefit from the removal of this heavy strain on its balance sheet.

Reorienting Financial Development for Enhanced Economic Growth

As has been shown above, the financial sector of the OECS is overly reliant on the high collateral low productivity model and is prone to asset price bubbles, and therefore needs to reorient towards more comprehensive financial development for achieving enhanced economic growth. This section covers three areas that could help reorient financial development and support growth: (i) long-term finance; (ii) SME finance, and (iii) the enabling environment and credit infrastructure.

Long-Term Finance

The scarcity of long-term credit in developing market economies is recognized as an obstacle to productivity growth and a source of volatility which further hampers growth. Investments in infrastructure, factories and equipment, new housing and commercial business, research and development and education are all necessary to expand the productive frontier. Firms and households need to fund these investments through financial markets. The scarcity of long-term credit is one of the most important impediments to the operations of firms in emerging markets; rollover risks prevent borrowers from undertaking long-term investments with short-term loans which in turn negatively affects productivity.[23] Scarcity of long-term financing has also been argued to increase the pro-cyclicality of investment, amplifying macroeconomic volatility and lowering growth. According to the 2014 Financial Development Barometer, 75 percent of respondents indicated

23 (Demirgüç-Kunt, 1999), (Schiantarelli, 1997), (Schiantarelli F. a., 1997) , (Jaramillo, 2002), (Almeida, 2009)

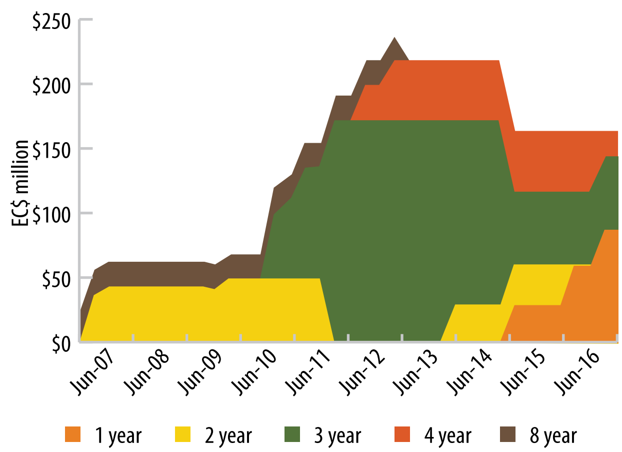
that low use of long-term finance in their countries was primarily a supply problem.[24] Extending the maturity structure of financing is at the core of sustainable financial development.

Banking systems are the main providers of long-term financing to the private sector around the world. Long-term funding is typically defined as debt (loans or bonds) over one year maturity (following the definition of fixed investment in National accounts). The Group of 20 (G-20, 2013) defines it, however, as debt of over 5 years maturity. Equity, as it is not repayable, can also be considered long-term finance. Firms around the world obtain most of their funds to fund fixed assets from banks, regardless of their size. While firms in high income countries raise more long-term and debt from capital markets that firms in developing countries, over 60 percent of their investments is funded by bank loans. Households' main long term investment, housing, is also overwhelmingly funded by banks. Capital markets are also important indirect source of long-term financing to the extent they fund banks provision of long-term credit through purchases of long-term bank bonds and equity or through investments in long-term deposits in the case of pension funds and insurance companies.

In the OECS there is a need for more long-term finance for infrastructure and housing finance. Given the region's susceptibility to natural disasters, the disaster risk mitigation (DRM) agenda is steep. Long-term financing is required for such projects. However, the market for infrastructure finance is not very well developed. Granted it is a small market, however given the amount of liquidity in the market it would be worth exploring to what extent long-term infrastructure projects can be securitized either by banks or the capital markets. However, in housing more has been done through the creation of the Eastern Caribbean Home Mortgage Bank (ECHMB).

Over most of its existence the ECHMB has acted as a liquidity provider for mortgage lending. The ECHMB's stated objective is promoting the development of the secondary mortgage market within the Member States. Its principal activity is buying and selling mortgage loans on residential properties, in order to develop and maintain a secondary market in these instruments. As such, the Bank aspires to be the principal provider of

Figure 3.10 ECHMB Bonds Outstanding by Tenor



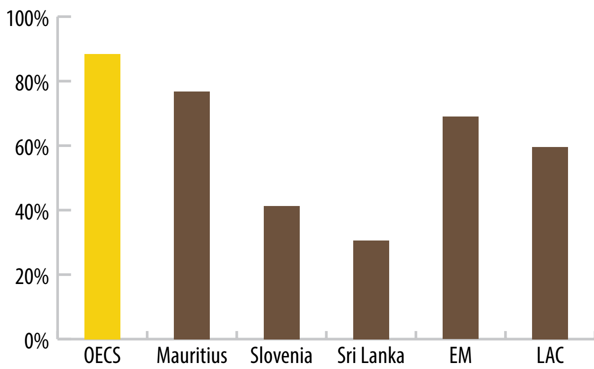
funding liquidity for the Primary Lenders. Only recently has the ECHMB sold back mortgages. Thus for most of its existence the ECHMB has not operated as a two-way liquidity buffer, instead it has only generated liquidity. The ECHMB's operations are by definition limited to the mortgage market. While the Primary Lenders may have recycled the funds received from sales of mortgages into other lending lines, providing general liquidity to the banks is not part of the ECHMB's mandate.

Of late, the same patterns of moving to shorter tenors hold true for the ECHMB as it does for the sovereign debt market, although on a smaller scale and involving fewer tenors. ECHMB began its bond funding in early 2008 using a combination of 8-year and-2 year debt. Beginning in mid-2011 it shifted to using 3-year and 4-year debt. Then in late 2013 it moved to using 1-year and 2-year maturities. The overall picture is a shift to short-term bonds, with the attendant lower rates. Lately the ECHMB seems to be relying on 1-year securities almost exclusively.

Therefore the long-term finance agenda needs to be reinvigorated to enhance economic growth. One clear departure from the high collateral low productivity model is greater long-term finance for productive uses. This is both for banking as well as the capital markets. Indeed, it is worrisome that the capital markets for sovereign debt have become more short term. Efforts to develop infrastructure finance, improve the ECHMB mandate and the market for housing as well as work on long terms corporate financing will help to reorient financial development into being more com-

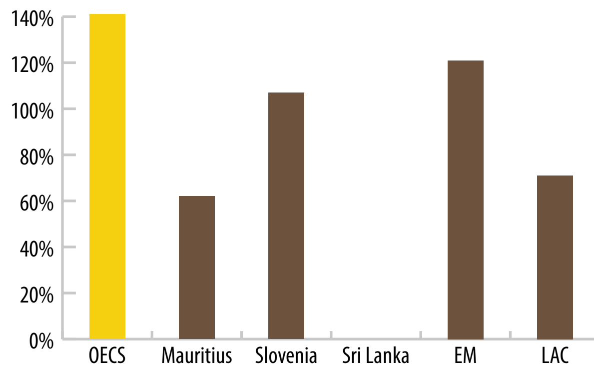
24 Financial Development Barometer. www.worldbank.org/financialdevelopment.

Figure 3.11 Loans Requiring Collateral



Source: OECS (2014 Compete Caribbean Survey), Mauritius (2009 Enterprise Survey), Slovenia (2009 Enterprise Survey), Sri Lanka (2011 Enterprise Survey), EM and LAC are Enterprise Survey averages 2009-2011.

Figure 3.12 Collateral Value to Loan (%)



Source: OECS (2014 Compete Caribbean Survey), Mauritius (2009 Enterprise Survey), Slovenia (2009 Enterprise Survey), no data for Sri Lanka, EM and LAC are Enterprise Survey averages 2009-2011.

prehensive and thereby contribute to enhanced economic growth.

SME Finance

Credit markets for Small- and Medium-Sized Enterprises (SME) are notoriously characterized by market failures and imperfections, and this is the case in the OECS as well. These include information asymmetries, inadequacy or lack of recognized collateral, high transaction costs of small-scale lending and perception of high risk. This is also because commercial banks are restricted by the central bank in types of collateral they consider to be acceptable. In weak informational environments, commercial banks traditionally display a preference for consumer lending which is perceived as less risky. As can be seen in Figure 3.1 and Figure 3.2 the stock of credit has begun to decrease over the recent past. This decrease has affected non-personal lending more than personal lending.

One main structural challenge in SME lending in the OECS is represented by the over reliance on collateralized lending. Given that lending to SMEs is risky, many financial institutions require collateral. However, when the lending culture becomes over collateralized, then few economically viable projects get funded as lending decisions are over determined by the quality of the collateral, and less so on the strength of the business plan. Figure 3.10 and Figure 3.11 show the percentage of granted loans that require collateral and the collateral value to loan value for loans to enterprises. In 2014, 88 percent of loans to enterprises (including large enterprises) required collateral in the OECS. This is much higher than the LAC average of 60 percent. Further, loan size in the OECS have much larger discounts with respect to the underlying collateral. In 2014, the collateral to loan value was 144 percent. This certainly reflects the same concern about inflated asset prices, however the data from other peer countries and regions shows that for its level of income, this ratio is very high.

The second structural challenge in SME lending is the complete lack of credit information systems. Information asymmetries contribute to higher credit spreads and lower financing for SMEs. The OECS neither has credit bureaus nor credit registries. This lack of information on borrowers is a key structural challenge. In fact all six OECS countries have a global rank of 152 out of 185 countries in the World Bank's getting credit indicator of its Doing Business rankings, and this is primarily due to no credit bureau or registry coverage, but also because of creditor rights (Figure 3.13).

More recently, there have been signs of a cyclical stress in intermediation to SMEs as a result of the financial crisis and the subsequent increase in NPLs. The prevailing trends from Figure 3.1 and Figure 3.2 show that credit has begun to contract across the OECS. As asset quality has deteriorated and in the context of poor information on borrowers, financial institutions have pivoted their portfolios towards personal lending. Figure 3.2 shows that the only lending segment that experienced positive credit growth in 2012, 2013, and 2014 was personal lending. Interviews with financial institutions have confirmed that credit risk for SMEs has now increased as a result of the past experience of SME portfolios.

There is a risk that this cyclical stress could further worsen the structural challenges in SME lending if left unaddressed. This evolving credit market imperfections requires attention, and there is a small possibility that SMEs financing comes to stall, which would have worrying consequences for economic growth and job creation. Some initiatives have already been attempted, however a review of 11 regional and national interventions (mainly grant-based) showed that they suffered implementation and funding challenges, and have been unable to fully close the gap.[25]

As the engines of economic growth, countries respond in four main ways to addressing such market imperfections. The first is through liquidity support, the second through directed lending, the third through building credit infrastructure and the fourth through guarantee schemes. Given the lack of fiscal space, the limited number of state banks and no historical precedent of directed lending, as well as the level of liquidity in the system suggests that the latter two would be instruments to consider to reverse the tide of credit away from SMEs. This would directly help in the reorientation of financial development towards being more comprehensive, and contribute to enhanced economic growth.

On credit guarantees, the World Bank has recently released a set of principles as well as necessary pre-conditions that are required when setting up such schemes. Partial credit guarantee (PCG) schemes provide third-party credit risk mitigation to financial intermediaries with the objective of increasing access to finance for SMEs. This is done through the absorption of a portion of the lender's losses on the loans made to SMEs in case of default, in return for a fee from the financial institution. The appeal of PCGs is partly due to the fact that they typically combine a subsidy element with market-based arrangements for credit allocation, therefore leaving less room for distortions in credit markets than more direct forms of intervention such as state-owned banks. The recently released principles provide sixteen guidelines to maximize their success.[26]

There is a continued need for training and upgrading of skills of SMEs to help facilitate their financing. A short 2015 World Bank survey of SMEs across the OECS showed that 40 percent of firms lacked business plan development skills. There is a critical gap in that many financial institutions do not have the full expertise to assess credit for SMEs, while many SMEs do not have the requisite training or skills in accounting or business planning to secure financing. There are a number of regional initiatives which have shown promise – including the Organization of American States (OAS) Small Business Development Centers, the OECS Commission's Competitive Business Unit as well as the recent due diligence conducted by the German Savings Bank. It is important that these efforts are harmonized and coordinated with the supply side instruments chosen to address the evolving credit market imperfection for SMEs.

Enabling Environment & Credit Infrastructure

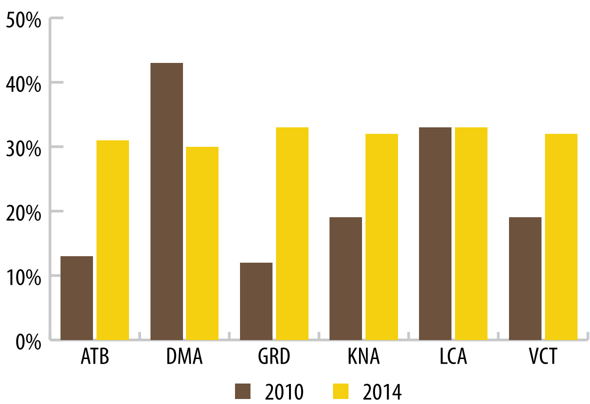
Access to financing remains a key obstacle for enterprises across the OECS, despite the high number of institutions and the high level of credit to GDP. Between 2010 and 2014 the percentage of enterprises that report access to finance as the main obstacle to doing business has increased from an average of 23 percent of 28 percent. Figure 3.12 shows the number of firms in each OECS country reporting access to finance as their main obstacle. This has increased in every country except for Dominica. Figure 3.13 shows that obtaining credit remained an important deterrent to the business environment in the Doing Business surveys of 2007 and 2015. For all the countries in the region, their ranks have worsened – this is a result of other countries improving their credit bureau and registry coverage as well as their depth of credit information.

Credit reporting systems are critical components to reduce information asymmetries and allow lenders to more accurately evaluate risks. Good and reliable information can eases the adverse selection problem and lower the costs of credit for good borrowers. For example in Egypt, the average percent of sub-standard loans decreased by 0.94 percentage points between 2009-11

25 Dominica Small Business Unit, Dominica Youth Business Trust, Waitukubuli Entrepreneurs Lévé, Dominica Women Entrepreneurs Fund and Startup Stars: Youth Special Fund ,Grenada Industrial Development Corporation Technical Assistance ,Grenada Ministry of Agriculture & Fisheries Lending Program, Grenada Small Business Development Fund, St. Lucia National Competitiveness and Productivity Council, Antigua Small Business Credit Guarantee Scheme, ECCB Eastern Caribbean Enterprise Fund, and the ECCB Export Credit Guarantee Scheme

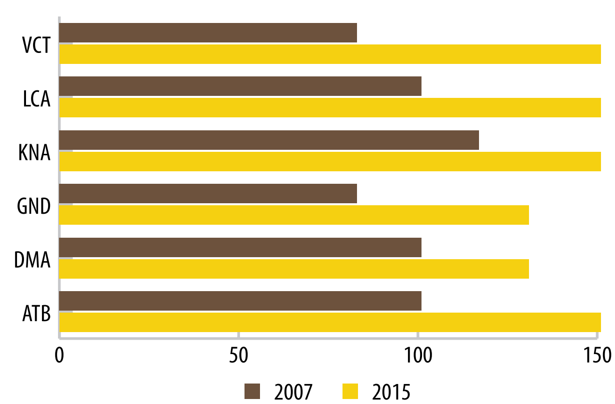
26 World Bank (2015) Principles for Public Credit Guarantees

Figure 3.13 A2F Main Constraint (%)



Source: 2010 Enterprise Survey and 2014 Compete Caribbean Survey.

Figure 3.14 DB Getting Credit Ranks



Source: World Bank Doing Business Survey.

after credit bureau was established in 2007. Further there is evidence that this information can also increase credit volumes and improves access to credit. Data show that there are 89 percent higher approvals in cases where full-file information sharing exists, 11 percent higher approvals where information is collected from traditional and non-traditional lenders; and in another case 12 percent more firms have access to bank financing when a credit bureau exists.[27] Finally, these systems support the introduction of credit scoring and automated underwriting, which lowers lender's operational costs and improves profitability.

A draft credit reporting bill has been prepared for the OECS region and once passed this can facilitate the beginning of a new credit bureau. Although the legislation is ready, it is important to finalize a thorough consultation process to share the changes that this new legislation will bring. As with any new legislation there are uncertainties and these need to be fully understood before embarking on its implementation. Given the OECS member states are small island economies, maximizing scale through the development of a single registry for the entire union is certainly preferable. Further, ongoing financial literacy and awareness raising for the general public and for all other stakeholders should be perused.

The second pillar of credit infrastructure is secured transactions which provides greater flexibility in loan transactions and in the property that can be used as collateral. In well-functioning markets this can increase the credit capital available in the local economy, creating a virtuous legal / economic environment. If the collateral registries also include movables, this allows SMEs to use movable assets – which comprise of 80 percent of SME assets in general – as collateral for a loan. There is evidence that this can increase the competitiveness of domestic economic actors: in China, the total number of commercial loans involving movable assets grew by 21% per year over 2008-2010, in comparison to a flat rate over the preceding period.[28]. Finally, secured transactions provides certainty and transparency in the priority of creditors (including insolvency proceedings) and certainty in the rights of third parties, reducing risk and cost of credit.

There is an ongoing initiative in St. Lucia on the legal framework for movable secured transactions that could potentially be regionalized. As with the importance of any credit reporting system to be regional, so is the case for secured transactions. An OECS-wide secured transactions initiative could build on the work that has already commenced in St. Lucia. This could begin with the development of an OECS legal framework to support the implementation of a modern system of financing secured by movable assets, or the drafting and harmonization of local legal frameworks. Other options could include the possible development and design of an OECS security interest registry, and the building of local capacity to benefit from the new system, including stakeholder training.

27 Love and Mylenko (2003): Credit Reporting and Financing Constraints, World Bank Policy Research Working Paper 3142, October 2003; Barron and Staten (2003): The Value of Comprehensive Credit Reports: Lessons from the U.S. Experience.

28 Secured Transactions Advisory Project in China. IFC Advisory Services. International Finance Corporation. 2012.

On non-movable secured transactions – land – there is a need to work on land reform across the OECS and this could have substantial impacts for the financial and non-financial sector. Land reform is lengthy, cross-cutting and is not politically straight forward. However there is a strong need to harmonize and digitize land registries. The OECS has both a registered system and an unregistered system. A registered system provides conclusive evidence of the holders of rights in a particular property. While an unregistered system does not provide conclusive evidence of land ownership. In four territories there is a cadastral system (Anguilla, Antigua, St. Lucia and Montserrat), in St. Vincent and the Grenadines there is a deed system, while in Dominica and St. Kitts and Nevis, and Grenada there is conveyancing.

The last pillar of credit infrastructure is insolvency and creditor and debtor rights, and data from Doing Business 2016 show that reorganizations present the best proceedings of insolvency. Studies have shown that effective insolvency reform is associated with: lower credit costs; increased access to credit; improved creditor recovery; strengthened job preservation; promotion of entrepreneurship, and other benefits for small businesses.[29] Insolvency is often associated only with foreclosure, but there are four possible proceedings of insolvency: foreclosure, liquidations, receivership and reorganization. Data from Doing Business show that recoveries are 79 percent in reorganizations and only 30 percent in foreclosure.

In St. Lucia there are efforts underway at reforming the insolvency framework and the OECS would benefit from regionalizing this initiative. The new legislation addresses insolvency regulation of corporates, SMEs (such as sole proprietorships) and individuals. The new law is intended to be a model for the whole OECS region and beyond, and follows many practices already initiated by Jamaica and Trinidad & Tobago. Once the law is passed, outreach and training will need to be conducted to ensure effective implementation. Regionalizing this initiative across the OECS and ensuring coherence with the secured transitions reform would contribute greatly to the progression towards the single financial space.

29 Araujo, Ferreira and Funchal (2012), Gamboa-Cavazos and Schneider (2007), Armour, Hsu and Walters, (2012), Gine and Love (2010) and Frisby (2007).

Reorienting Financial Development for Effective Fiscal Policy

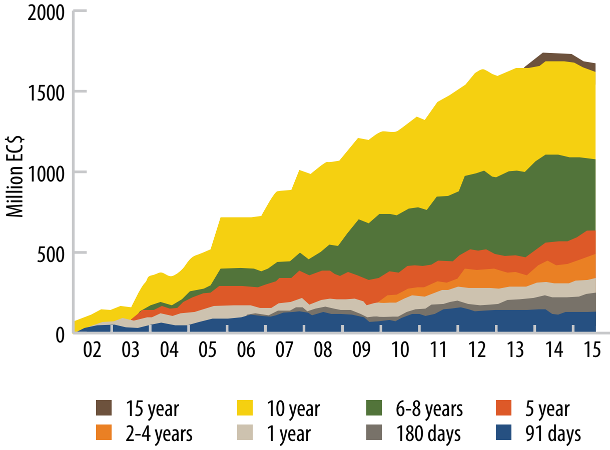
There is an important link between financial development and fiscal policy: sovereign debt markets. Around the world, governments finance fiscal deficits through public borrowing from the financial markets. The effectiveness of fiscal policy from this perspective depends on two key variables. The first is the interest rate of public debt and the second is the tenor of public debt. The confluence of financial market development and macroeconomic variables (such as inflation, country risk, and economic growth) determine the range of these two variables. Low interest and longer tenor debt allow governments to attain cheaper (in present value terms) public finance and facilitate better planning of medium to long terms public finance.

The Regional Government Securities Market (RGSM) handles both the primary market (offerings) and secondary market (trading) of the debt instruments issued by the OECS Member States. Today, five jurisdictions participate: Dominica, Antigua and Barbuda, Grenada, St. Lucia and St. Vincent and the Grenadines. The RGSM handles both treasury bills (91 days to 1 year maturities) and treasury bonds (maturities up to 10 years). The market was established in November 2002 and utilizes the ECSE's fully electronic platform. Auctions and trading are performed through the ECSE's trading system with transactions cleared and settled through its depository / registry subsidiary.

At first glance the government securities market offers a variety of tenors in growing numbers. Using auction data provided by the RGSM we have calculated the amount of government securities issued and outstanding through the ECSE, for all participating countries combined. Figure YY shows outstanding government securities in excess of EC$ 1.6 billion, divided fairly evenly among the tenors. This would seem to indicate a wide choice of investment maturities. Indeed focusing on the outstanding tenor amounts over the nearer term (i.e., the last 5 years) reinforces the idea that there are a variety of longer term tenors available.

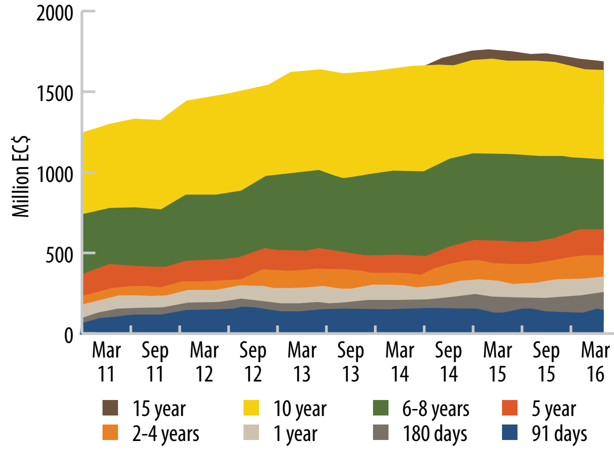
However, if one focuses on the levels of recent offerings among the available tenors it is clear that only a minimal amount of longer-term securities are being issued. The vast majority of auctions conducted on the RGSM are to rollover existing short term T-Bills (91 and

Figure 3.15 RGSM Outstanding by Tenor (2002-2015)



Source: RGSM.

Figure 3.16 RGSM Outstanding by Tenor (last five years)



Source: RGSM.

Figure 3.17 Amounts Issued 2011-2016

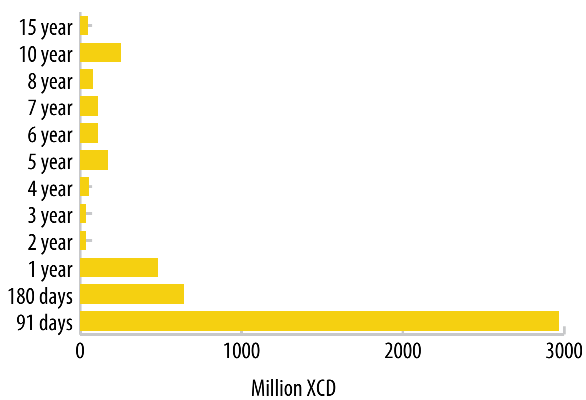
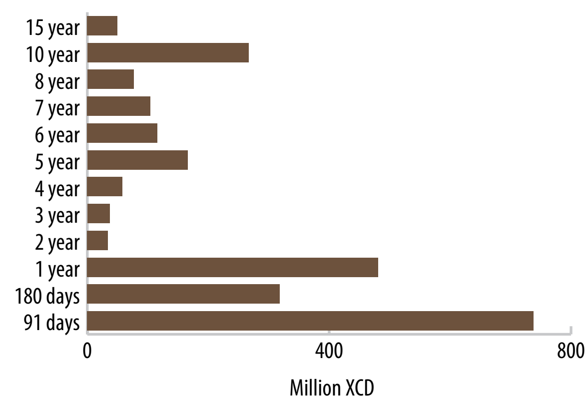


Figure 3.18 Amounts Issued Adjusted for Short-Term Rollovers 2011-2016



180 day securities and 1 year maturities). Even adjusting the offering amounts to recognize the rollover nature of the shorter-term offerings it is still clear that there a few medium- to long-term securities being created. The 'inventory' of longer-term government securities is not growing appreciably.

Ignoring, for the sake of the argument, that some of the offerings of 2-year to 10-year bonds were to roll over previous longer-term debt, the total amount issued between 2011 through 2016 for these tenors has been EC$ 925 million. This compares to EC$ 5.1 billion in idle funds within the banks themselves, or 18%. It is clear that, even under the most generous analytical terms, the amount of offerings of longer-term government securities cannot be expected to absorb the excess liquidity in the banking system alone. This also ignores the investable instrument needs of the credit unions, insurance companies, and pension funds (both Pillars I and II, and the private schemes).

This impression of a short supply of longer-term securities is borne out by a comparison of the secondary trading in OECS government securities compared to the available amount outstanding. In a developed capital market, short-term securities are known as "buy and die paper". This means that the investor purchases the securities for investment, holds until maturity, and then perhaps purchases again in the rollover issuance. One does not expect much if any secondary market trading in T-Bills (91 days to 1 year). The opposite is true for longer term maturities. It is expected that there is a positive correlation between the time left to maturity for any given security and the level of secondary trading in that security. In other words, the longer the remaining maturity the more secondary trading expected.

Deviating from this norm, the secondary market for OECS government securities shows almost no turnover in government securities for all tenors. Again, while this might be expected for T-Bills, it is contrary to the normal market dynamic for longer term bonds. The investors buying T-Bonds intend (at least today) to buy and hold. The turnover rates for T-Bonds are extremely low compared to standard expectations; and thus the data reinforce the idea that longer-term government securities are in high demand / short supply for the financial sector's needs. Once acquired they are not traded out again in the secondary market.

Therefore, reversing the recent trend towards issuing shorter term securities and further developing the secondary market will have material effects on the efficacy of fiscal policy. Public debt markets have a range of policy levers and comprise of many stakeholders. Nevertheless exploring options that will lengthen the yield curve across the Member States and also lower interest rate profiles can provide enhanced stability to both the private and public sectors. With more predictable estimates of the cost of public debt, policy makers will be able to secure cheaper financing (in present value terms) and be better able to plan medium to long term public financing needs.

Conclusions

This chapter begun by identifying the economic weaknesses that emanate from a large and frail financial sector. With banking assets at 166 percent of the region's GDP, the banking sector is indeed large. Insurance assets, the number of insurers as well as the size and number of credit unions also point to a large non-banking sector as well. Further, the aftermath of the 2008 financial crisis has put a strain on the banking sector. Asset quality has deteriorated and as a result bank profitability as well as credit growth have suffered. It would be remiss to conclude that, given the size of the sector, that further more comprehensive financial development is not warranted.

Through the exploration of a multidimensional measure of financial sector development, the results found in the literature of a non-linear relationship for financial sector development with growth and volatility were confirmed by adding the OECS countries. Following the approach in Sahay et al. (2015) it was shown that each of the OECS countries lies below the inflection point for economic growth and for volatility. This implies that reorienting financial sector development to be more comprehensive can contribute to reducing volatility, enhancing economic growth and facilitating more effective fiscal policy. This is particularly salient in the context of the currency board that anchors the exchange rate, the limited fiscal space as well as the service-based economies and implies that the financial sector is critical for continued economic growth and the enhanced management of risks.

Finally, the chapter identified policy options that could help reorient financial development. Improving savings instruments, strengthening the regional supervision of insurance, and establishing deposit insurance could all help economic agents better manage volatility. Restoring banking stability can reduce the systemic volatility that has emanated from the heightened stress that the banking sector has experienced over the past five years. The new Banking Act that has been passed provides the foundation for improved banking supervision and future consolidation. Developing long term finance for infrastructure and more housing in addition to developing tools for more effective SME finance against the backdrop of improvements to the enabling environment and credit infrastructure are critical for enhancing economic growth. Finally, this chapter highlighted the importance of reversing the short-termism in sovereign debt markets in the OECS and striving for a more active secondary market as a way to improve the efficacy of fiscal policy in the OECS.

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Chapter 4.
The Effects of Volatility, Fiscal Policy Cyclicality, and Financial Development on Growth

Introduction

This chapter assesses empirically the impacts of terms of trade volatility, fiscal policy (pro) cyclicality, and financial development on growth in the Eastern Caribbean. By considering the effects of the interaction between terms of trade volatility and fiscal pro-cyclicality we intend to gauge (i) whether fiscal pro-cyclicality exacerbates the negative growth effect of terms of trade volatility; and (ii) whether the mediating role of fiscal policy cyclicality is particularly pronounced in the OECS as compared to other countries. This is an important policy discussion for a region that adopts a strong peg against the U.S. dollar since this arrangement limits considerably their ability to respond to shocks.

The main message from the analysis is that a more counter-cyclical fiscal policy stance and further financial development can mitigate the adverse growth effects of terms of trade volatility in the OECS region. We were able to arrive at this conclusion by using complementary empirical modeling strategies. First, in section 2, we follow Brueckner and Carneiro (2015) and estimate an econometric model using panel data on GDP per capita, financial development, and government spending for a sample of 175 countries over the period 1980-2010. These data are available from the Penn World Tables and the World Development Indicators. With this modeling strategy, we were able to benchmark the behavior of OECS economies against other countries in the world. Second, in section 3, following Carneiro and Hnakovska (2016), we used the results of a structural model of the business cycle in the OECS to simulate the impacts of fiscal policy pro-cyclicality and financial frictions on growth and other relevant macroeconomic aggregates for the region. Section 3 summarizes our results and discusses some directions for policy.

Empirical Approach

Our results are derived from a simple econometric model that represents the behavior of our variables of interest on growth. Our working hypotheses are that: (i) an increase in terms of trade volatility results in lower GDP growth; (ii) the negative impact of volatility on growth is more pronounced in less financially developed countries; and (iii) in countries where fiscal policy is more pro-cyclical. The econometric model for testing hypotheses (i)-(iii) is:

Growthit = ai + bt + αVolatilityit + β(Volatilityit*FDi) + γ(Volatilityit*Procyclicalityi) + φlnGDPit-1 + eit

where Growth is the change in the natural logarithm of real GDP per capita in country i between period t and t-1. Volatility is the country-specific standard deviation of external economic. Following Rodrik (1998), we will use the standard deviation of countries' terms of trade as the measure of externally induced economic volatility. FD is a measure of financial development. Following the finance literature, our main measure of financial development is the GDP share of domestic credit to the private sector. Further, the chapter will present estimates where FD is instrumented by legal origin.[30]

30 The law and finance literature, see, for example, La Porta

In our empirical approach, Procyclicality is a measure of the extent to which government spending responds to business-cycle variation in GDP. Formally Git=θiGDPcyclit. The parameter θ captures the pro-cyclicality of government spending. That is, if θ is positive, then government spending increases when the cyclical component of GDP is positive (meaning, when GDP is above trend). We obtain data on θ from Frankel et al. (2013). Frankel et al. (2013) provide values of θ for a sample of 93 countries; we will use this data in the estimation of equation (1). In order to maximize coverage of countries when estimating equation (1), we apply the methodology of Frankel et al. and Carneiro and Garrido (2015) to generate values of θ for countries not covered by Frankel et al. (2013).[31]

In order to estimate the model and test our working hypotheses, we need to modify the original equation slightly. Differentiating equation (1) with respect to volatility yields:

(2) d(Growth)/d(Volatility) = α + β*FDi + γ*Procyclicalityi

In practical terms, this modification implies that for hypotheses (i)-(iii) to hold then the three coefficients in equation (2) will be negative, or $\alpha<0$, $\beta<0$, $\gamma<0$.

In addition, in order to examine whether the coefficients α, β, and γ differ for the Eastern Caribbean, we need to augment the econometric model:

(3) Growthit = ai + bt + α1Volatilityit + β1(Volatilityit*FDi) + γ1(Volatilityit*Procyclicalityi) + (α2Volatilityit + β2(Volatilityit*FDi) + γ2(Volatilityit*Procyclicalityi))*OECSi + φ1lnGDPit-1 + e1it

where OECS is an indicator variable that is unity if countries are part of the Organization of Eastern Caribbean States. Note that α2, β2, and γ2 capture the differences in effects that the variables of interest have on economic growth in OECS countries. This can be seen from differentiating equation (3) with respect to volatility:

(4) d(Growth)/d(Volatility) = α1 + β1*FDi + γ1*Procyclicalityi +(α2 + β2*FDi + γ2*Procyclicalityi)*OECSi

(5) d(d(Growth)/d(Volatility))/dOECSi= α2 + β2*FDi + γ2*Procyclicalityi

Table 4.1 provides a list of the variables used in the econometric analysis and their data sources. Table 4.2 shows bi-variate correlations. Summary statistics of the variables' first and second moments can be found in Table 4.3.

Graphical Analysis

A graphical examination of the data shows a negative relationship between volatility and economic growth. Figure 4.1 plots on the y-axis countries' average GDP per capita growth (over five years); on the x-axis is the standard deviation of the terms of trade growth rate (also computed over a five year period). We see from Panel A in Figure 4.1 that for a sample of 175 countries terms of trade volatility has a negative average effect on economic growth. The coefficient from a bivariate regression that corresponds to the plot in Panel A of Figure 4.1 is -0.31; this coefficient is significant at the 1 percent level (p-value 0.007). Panel B shows that a negative relationship between terms of trade volatility and economic growth is visible also within the sub-sample of OECS countries. The coefficient from a bivariate regression that corresponds to the plot in Panel B of Figure 4.1 is -0.36; thus it is quantitatively very close to the slope coefficient that emerges in Panel A. Statistically, we cannot reject the hypothesis that the slope coefficient in Panel A is equal to the slope coefficient in Panel B (t-value 0.91).

Regression Results

The econometric results suggest that countries with lower terms of trade volatility tend to have systematically higher GDP per capita growth. Table 4.1 reports estimates of the average effect that terms of trade volatility has on economic growth, based on a static panel

et al. (1998), has documented that countries' legal origin is an important determinant of cross-country differences in financial development. La Porta et al. argued that common law ensures a greater protection of private property (relative to civil law). Protection of private property is paramount for investment and the development of the financial sector. La Porta et al. document for a cross-section of countries that financial development is significantly higher in countries with common law.

31 The econometric model includes country fixed effects, ai. These fixed effects capture time-invariant country characteristics that affect economic growth, i.e. variables related to history and geography. Note that the country fixed effects account for the linear effect that FDi and Procyclicality have on economic growth. The time fixed effects, bt, capture common shocks that affect countries' GDP per capita growth in a given time period.

Figure 4.1 Economic Growth and Volatility (Cross-Country Relationship)

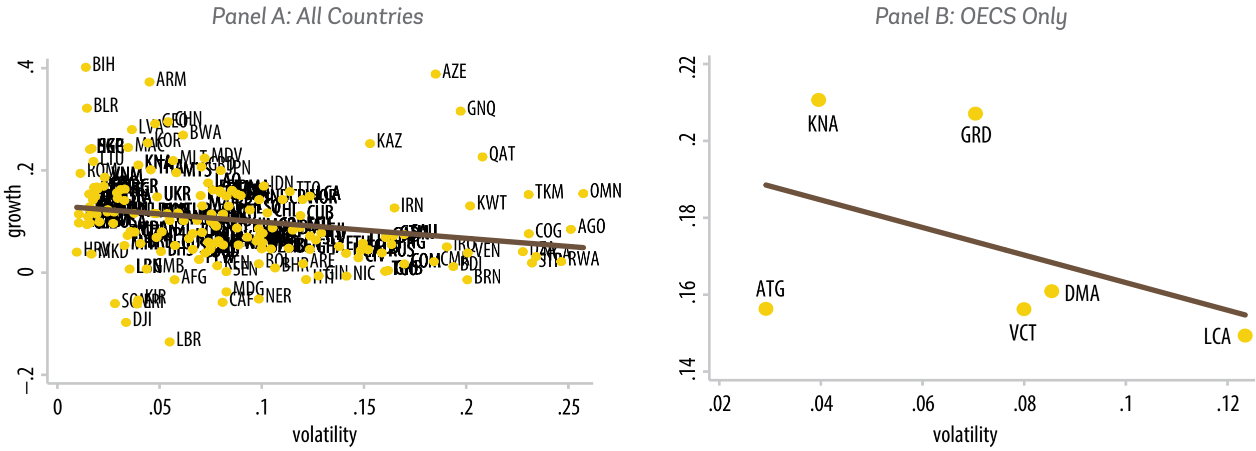


Table 4.1: Economic Growth and Volatility (Average Effect, Static Model)

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.44*** (0.08)	-0.34*** (0.08)	-0.10 (0.10)	-0.01 (0.09)	-0.05 (0.09)
Terms of Trade Growth					0.11*** (0.03)
R-Squared	0.06	0.15	0.06	0.12	0.15
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

Table 4.2: Economic Growth and Volatility (Average Effect, Dynamic Model)

Dependent Variable is:	GDP per capita Growth					
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS	(6) SYS-GMM
Terms of Trade Volatility	-0.39*** (0.08)	-0.33*** (0.09)	-0.10 (0.09)	0.04 (0.09)	0.00 (0.09)	-0.02 (0.07)
Terms of Trade Growth					0.10*** (0.03)	0.08*** (0.02)
R-Squared	0.01**	0.00	-0.05	-0.15***	-0.15***	-0.17
Lagged GDP per capita	(0.01)	(0.01)	(0.04)	(0.05)	(0.05)	(0.11)
Country Fixed Effects	No	No	Yes	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

data model. Column (1) reports unconditional estimates; column (2) adds to the regression time fixed effects; column (3) includes in the econometric model country fixed effects; and column (4) shows estimates based on an econometric model that includes both time and country fixed effects. Model specifications that do not include country fixed effects, i.e. columns (1) and (2), show a significant negative average relationship between terms of trade volatility and economic growth. The coefficient of -0.34 suggests that the cross-country relationship between terms of trade volatility and economic growth is sizable. For example, the model predicts that economic growth is lower by around 0.6 percentage points per annum when taking a country from the 25th percentile (0.034) of terms of trade volatility to the 75th percentile (0.125).

The average negative relationship between economic growth and terms of trade volatility holds for different specifications of the econometric model. Table 4.2 shows that a dynamic model yields similar results to the static model that was estimated in Table 4.1. The dynamic panel model includes the lag of GDP per capita on the right-hand side of the estimating equation; a negative coefficient on lagged GDP per capita means that there is a convergence. In columns (1) and (2) we see that the coefficient on lagged GDP per capita is not significant. Hence, there is no cross-country convergence in GDP per capita; this is a well-known result (see, for example, Mankiw et al., 1992). Columns (3) and (4) show that there is significant convergence of GDP per capita to country-specific steady states. This can be seen from the negative coefficient on GDP per capita in the model specifications that include country fixed effects. The estimated coefficient on lagged GDP per capita in model specifications with country fixed effects suggests that the per annum convergence rate to country-specific steady state is around 3 percent.

The results for the OECS region follow the same pattern as the results for the rest of the world. In order to explore whether the average relationship between terms of trade volatility and economic growth is different for the OECS region the econometric model is augmented to include an interaction term between terms of trade volatility and a dummy that is unity for countries that belong to the OECS. Table 6 reports the estimation results from this augmented econometric model. The main finding is that there is no evidence that the average relationship between terms of trade volatility and economic growth is significantly different for the OECS region. This is true regardless of whether or not country fixed effects are included in the econometric model.[32]

Additional estimates show that the negative effect of terms of trade volatility on growth is mediated by cross-country differences in financial development. Table 4.4 reports estimates from an econometric model that includes an interaction term between terms of trade volatility and the GDP share of domestic credit to the private sector. Following the finance literature (La Porta et al., 1998), we use variation in the GDP share of domestic credit to the private sector that is predicted by British legal origin. As an additional variable we use distance to the equator in order to generate variation in the GDP share of domestic credit that is exogenous to economic growth.[33] From columns (1) and (2) of Table 4.4 we see that the coefficient on terms trade volatility is around -0.7 and significant at the 1 percent level; the interaction term between terms of trade volatility and the GDP share of domestic credit to the private sector is around 1.6 and significant at the 5 percent level. These values imply that at median levels of financial development (GDP share of domestic credit to the private sector equal to 35 percent), terms of trade volatility has a significant negative effect on economic growth; however at higher values of financial development the effect loses significance.[34]

Financial development has a positive effect on economic growth on average. This can be seen from the coefficient on the GDP share of domestic credit to the private sector. The relevant coefficient is around 0.2 and is significantly different from zero at the 1 percent level, see columns (1) and (2). This is in accordance with the finance literature where it is found that a greater GDP share of domestic credit to the private sector is on average growth enhancing. Sahay et al. (2015) present evidence that the growth effect of financial development may be non-linear. Indeed, we see from columns (1) and

32 Note that in columns (3)-(5) the model does not explicitly include the OECS dummy; this is because the country fixed effects fully take into account the average growth of OECS countries.

33 Both British legal origin and distance to the equator have a highly significant positive effect on the GDP share of domestic credit to the private sector. The F-statistic on the joint test that British legal origin and distance to the equator have no significant effect on the GDP share of domestic credit to the private sector is 34.77; British legal origin and distance to the equator explain about one-quarter of the variation in the sample of countries' average GDP shares of domestic credit to the private sector.

34 The interquartile range of the GDP share of domestic credit to the private sector predicted by British legal origin and distance to the equator is [0.25, 0.46].

Table 4.3: Economic Growth and Volatility (Is the Effect Different in the OECS?)

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.44*** (0.08)	-0.34*** (0.08)	-0.10 (0.10)	-0.01 (0.09)	-0.05 (0.09)
Terms of Trade Volatility*OECS	0.48 (0.39)	0.34 (0.32)	0.19 (0.73)	-0.05 (0.37)	-0.16 (0.42)
OECS	-0.02 (0.03)	-0.04* (0.02)			
Terms of Trade Growth					0.11*** (0.03)
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

Table 4.4: Economic Growth, Financial Development, and Volatility

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility [A]	-0.68*** (0.17)	-0.71*** (0.16)	-0.33 (0.25)	-0.30 (0.20)	-0.38* (0.19)
Terms of Trade Volatility*Credit-to-GDP ratio [B]	1.60** (0.63)	2.17*** (0.58)	0.69 (0.96)	1.28 (0.89)	0.89 (0.66)
Credit-to-GDP ratio	0.26*** (0.06)	0.23*** (0.06)			
Terms of Trade Growth					0.08*** (0.02)
Test [A]=[B]=0, p-value	0.00	0.00	0.16	0.33	0.12
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

(2) of Appendix Table 1 that the relationship between GDP p.c. growth and the GDP share of domestic credit to the private sector is an inverted U-shaped. The average marginal effect of financial development on economic growth remains, however, positive and significant. Further, we have explored using the index of financial development developed in Sahay et al. (2015); this yields results similar to those presented in Table 7, see Appendix Table 2.[35]

Terms of trade volatility has a particularly large negative effect on economic growth in countries where fiscal policy is procyclical. This is shown in Tables 4.5 and 4.6. Table 4.5 reports estimates from an econometric model that includes an interaction term between the standard deviation of the terms of trade growth rate and the country-specific coefficients that measure the

35 The index of financial development developed in Sahay et al. (2015) measures depth (size and liquidity of markets), access (ability of individuals to access financial services), and efficiency of financial markets and institutions (ability of institutions to provide financial services at low cost and with sustainable revenues, and the level of activity of capital markets).

response of government spending to the business cycle. Table 4.6 reports estimates from an econometric model that includes in addition to the interaction between terms of trade volatility and fiscal procyclicality an interaction term between terms of trade volatility and financial development. The coefficient on the interaction between terms of trade volatility is negative in all specifications. In Table 4.5, it is significantly different from zero in specifications that include country fixed effects (columns (3)-(5)). If country fixed effects are excluded, see columns (1) and (2), the interaction between terms of trade volatility and fiscal procyclicality is individually

Table 4.5: Economic Growth, Fiscal Procyclicality, and Volatility

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility [A]	-0.46*** (0.08)	-0.38*** (0.08)	-0.12 (0.09)	-0.02 (0.09)	-0.03 (0.09)
Terms of Trade Volatility*Fiscal Procyclicality [B]	-0.31 (0.28)	-0.32 (0.23)	-0.75** (0.30)	-0.68** (0.27)	-0.66** (0.28)
Fiscal Procyclicality	-0.00 (0.03)	0.01 (0.03)			
Terms of Trade Growth					0.10*** (0.03)
Test [A]=[B]=0, p-value	0.00	0.00	0.04	0.04	0.06
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

Table 4.6: Economic Growth, Financial Development, Fiscal Procyclicality, and Volatility

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.46*** (0.08)	-0.37*** (0.18)	-0.38* (0.21)	-0.06 (0.21)	0.05 (0.22)
Terms of Trade Volatility*Fiscal Procyclicality	-0.52* (0.24)	-0.41* (0.21)	-0.70** (0.29)	-0.67** (0.27)	-0.67** (0.27)
Terms of Trade Volatility*Credit-to-GDP ratio	0.55 (0.56)	0.37 (0.51)	0.98 (0.65)	0.16 (0.61)	-0.30 (0.66)
Fiscal Procyclicality	0.04 (0.04)	0.01 (0.01)			
Credit-to-GDP ratio	0.27*** (0.05)	0.20*** (0.05)			
Terms of Trade Growth					0.10*** (0.03)
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

not significantly different from zero; however, the F-test rejects the null hypothesis that the interaction term is jointly equal to zero with the linear effect that terms of trade volatility has on economic growth. In Table 4.6, we see that the interaction between terms of trade volatility and fiscal procyclicality is significantly different from zero in all specifications.

The difference in effect of terms of trade volatility on economic growth across differences in countries' fiscal procylicality is sizable. For example, according to the estimates in column (5) of Table 4.6, for a country at the 25th percentile of fiscal procyclicality the implied marginal effect (standard error) of terms of trade volatility on economic growth is 0.04 (0.20); for a country at the 75th percentile the corresponding marginal effect (standard error) is -0.36 (0.21).

Finally, the OECS region shows a strong negative interaction between terms of trade volatility and fiscal policy pro-cyclicality. The estimates reported in Table 4.7 speak to the question of whether the mediating role that fiscal (counter-)cyclicality and financial development have with regard to the effect of terms of trade volatility on economic growth differ for the OECS region. Specifically, Table 4.7 reports estimates from an econometric model that includes, in addition to the variables in Table 4.6, two further interaction terms: one interaction term is constructed as the interaction between terms of trade volatility, fiscal procyclicality, and the OECS indicator; and another interaction term that is constructed as the interaction between terms of trade volatility, financial development, and the OECS indicator. The coefficient on the first (second) interaction term gives the difference in the mediating role of fiscal procyclicality (financial development) for the OECS region. Table 4.7 shows that the coefficient on the interaction between terms of trade volatility, fiscal procyclicality, and the OECS indicator is significantly negative. Further, the interaction between terms of trade

Table 4.7. Economic Growth, Financial Development, Fiscal Procyclicality, and Volatility: Heterogeneity OECS

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.46*** (0.19)	-0.37*** (0.18)	-0.38* (0.21)	-0.07 (0.20)	0.03 (0.22)
Terms of Trade Volatility*Fiscal Procyclicality	-0.43* (0.25)	-0.42* (0.21)	-0.70** (0.29)	-0.67** (0.27)	-0.60** (0.27)
Terms of Trade Volatility*Fiscal Procyclicality*OECS	-1.95** (0.77)	-2.22*** (0.64)	-72.01* (42.04)	-78.00*** (15.37)	-73.01*** (26.31)
Terms of Trade Volatility*Credit-to-GDP ratio	0.55 (0.56)	0.36 (0.51)	0.99 (0.65)	0.17 (0.61)	-0.08 (0.64)
Terms of Trade Volatility*Credit-to-GDP ratio *OECS	1.76** (0.86)	2.07*** (0.62)	9.07 (10.56)	15.08*** (4.05)	12.66* (6.73)
Fiscal Procyclicality	0.04 (0.04)	0.04 (0.03)			
Credit-to-GDP ratio	0.27*** (0.06)	0.20*** (0.06)			
OECS	0.03* (0.01)	0.01 (0.01)			
Terms of Trade Growth					0.12*** (0.03)
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

volatility and fiscal procyclicality is also negative and significantly different from zero.

These results suggest that: (i) fiscal procyclicality exacerbates the negative growth effect of terms of trade volatility – for the OECS region and for other regions; and (ii) the mediating role of fiscal cyclicality is particularly pronounced in the OECS region. It is also noteworthy that the coefficient on the interaction between terms of trade volatility, financial development, and the OECS indicator is significantly positive. The interaction between terms of trade volatility and fiscal procyclicality is not significantly different from zero. The results in Table 4.7 thus suggest that counter-cyclical fiscal policy and financial development can mitigate the adverse growth effects of terms of trade volatility in the OECS region.

Impulse Response Analysis

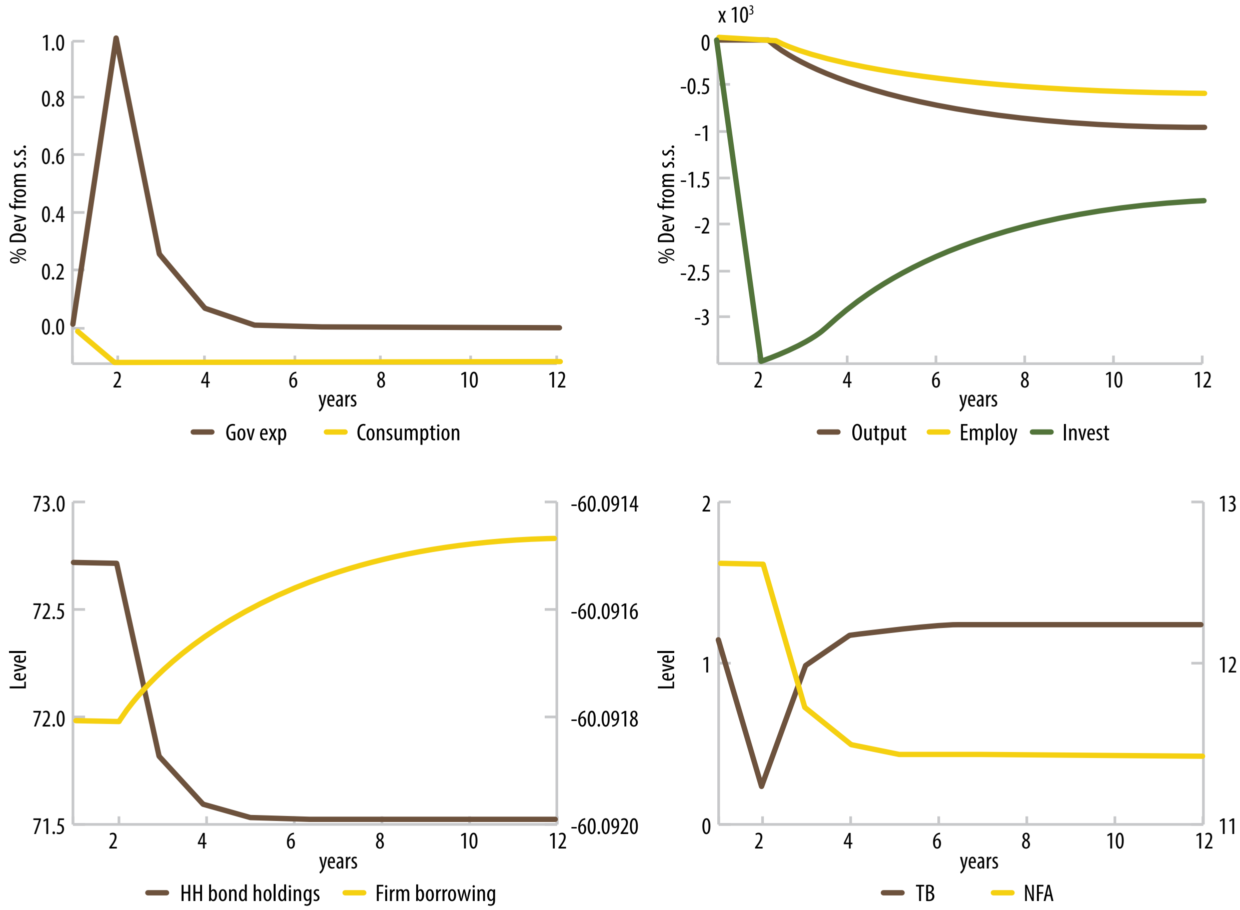
We have also investigated the role played by financial frictions and different fiscal policy stances for the transmission of shocks to economic activity in the OECS region by means of a structural model of business cycles. By using a complementary modeling approach, we have looked at the impacts of different types of shocks to fiscal policy in the presence of financial frictions on the economic performance of the region. The analysis is based on a theoretical structural model developed by Carneiro and Hnatkovska (2016) as a background paper for this report. The details of the model are omitted here for simplicity, but we highlight its two key features. The first is that domestic financial markets are subject to a friction – firms have to pay a share of the bill for the factors of production before production takes place and revenues are realized. This creates a need for working capital by firms. The second key feature of the model is the presence of a fiscal authority. It levies lump-sum taxes and uses the tax revenues to provide public consumption/investment. In the model, public expenditures have different cyclical properties. These two features of the model generate transmission channels through which real interest rates and fiscal policy shocks affect the level of economic activity.

Our objective is to evaluate the expected impact of different fiscal policy stances on macroeconomic aggregates. We start with the case in which fiscal policy is a-cyclical. That is, where government expenditures are independent of the fundamental state of the economy. In this case we allow for both independent country risk and induced country risks, i.e. country risk that arises endogenously in response to changes in fundamentals. In the second case, we study the effects of the fiscal policy that is procyclical to the economic conditions. Here we are again interested in the possible interaction between fiscal policy and country risk, so we consider both independent and induced country risk scenarios. In what follows, we use impulse response analysis to understand the linkages in the model and the effects of various model features. In particular, we study how the key macroeconomic aggregates respond to one-time shocks to productivity, government expenditures and risk-premium.

We start by considering the effects of government spending shocks under a-cyclical fiscal policy. The simulations in Figure 4.1 show that an increase in government expenditures has a contractionary effect on the economy, with all macroeconomic aggregates declining following the shock. The largest decrease is experienced by private consumption which falls by 0.05 percent after a 1 percent increase in government expenditures. The responses of output, employment and investment, while all negative, are more muted. These dynamics can be understood by looking at how firms and households adjust their borrowing/lending behavior in response to shocks. When government expenditures increase, it causes a decline in household's lifetime income, leading to a fall in consumption. Since consumption decline is smaller than the fall in household's disposable income due to consumption smoothing, savings must fall as households decrease their bond holdings. Firms, faced with lower demand, cut down on employment and investment, and thus borrow less from the international markets. With lower employment, GDP also declines. Due to increased household borrowing, both trade balance and net foreign assets (NFA) deteriorate.

The simulations of shocks in productivity show an overall improvement in the economy. The impulse responses to a 1 percent positive productivity shock under a-cyclical and pro-cyclical fiscal policy stances are shown in Figures .4.3a and 4.3b. We also include impulse responses under the scenario with induced country risk-premium in the figures. Under the procyclical fiscal policy, an increase in productivity triggers a rise in government expenditures. Focusing first on the direct effects of productivity shocks, we see that a rise in productivity that is persistent has relatively standard

Figure 4.2 Impulse Responses to a 1% Positive Shock to Government Expenditures



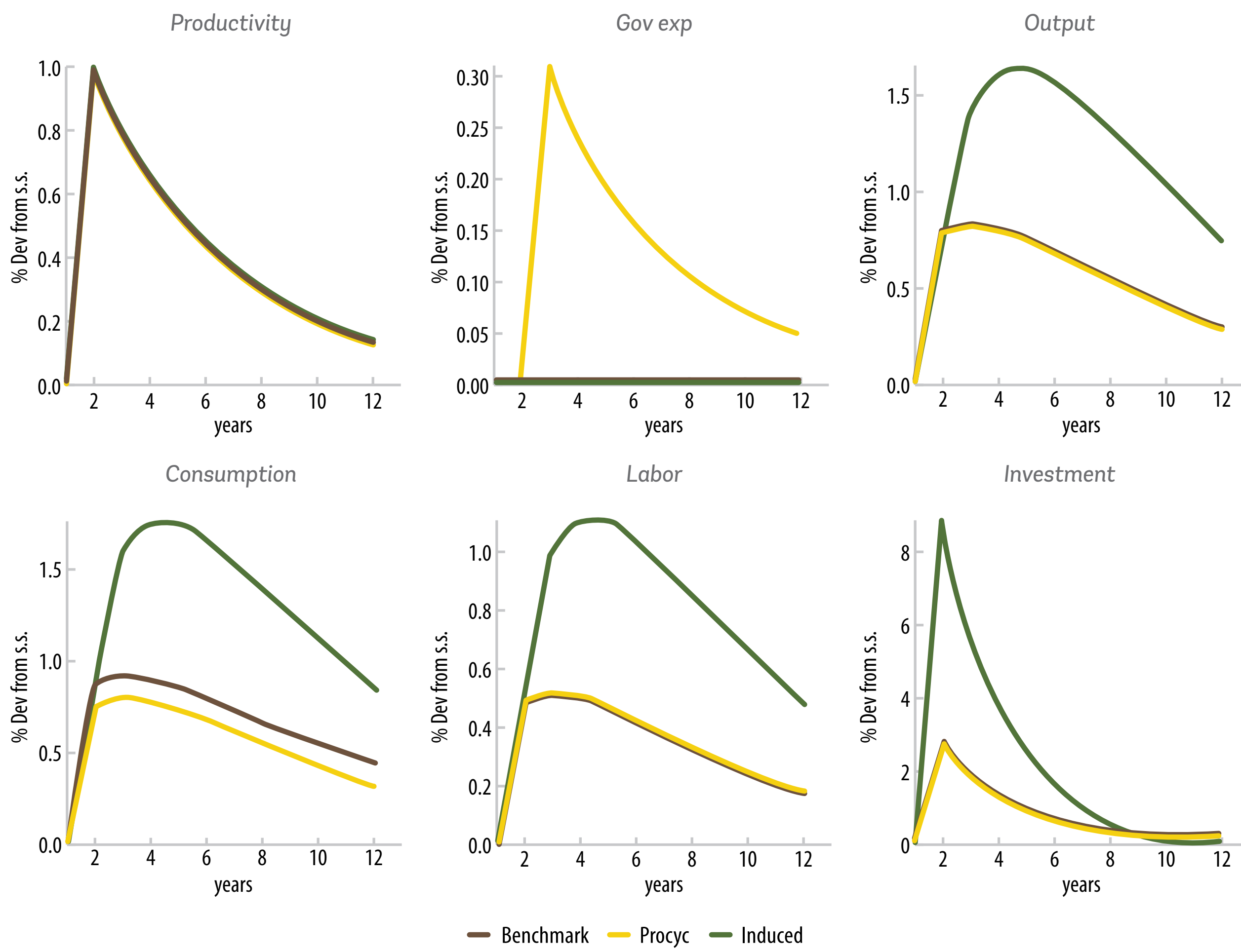
Note: Impulse responses are computed under benchmark parameterization.

effects – it leads to an expansion in the economy with employment, investment, consumption and output all rising. Higher productivity raises the return to capital and labor, so firms want to increase employment and investment. However, to hire more workers, firms must finance a larger working capital, so firms' borrowing goes up. This can be seen in Figure 2b, which displays impulse responses of agents' asset holdings/borrowing, trade balance and NFA position. Since returns to investment increase following a positive productivity shock, households reduce their savings in international bonds and invest more in domestic enterprises. The outcome of these adjustments is that the trade balance worsens and NFA position declines.

Under a procyclical fiscal policy, the adjustments of the economy in response to a positive productivity shock are very similar. The key difference lies in the dynamics of consumption, household savings, and trade balance. When the increase in productivity is accompanied by a rise in government spending (pro-cyclical fiscal policy), the response of household consumption is more muted. This is because an accompanying increase in government expenditures curtails the rise in the disposable income of the households after productivity improvement. This limits the resources available for consumption and investment. As a result, households must lower their savings by more under the procyclical fiscal policy, leading to a larger deterioration in the trade balance and NFA in the economy. Thus, procyclical fiscal policy acts to curtail the effects of productivity shocks on consumption, by amplifying the effects of these shocks on savings, net exports and NFA.

The magnitude of the impact of a positive productivity shock in the economy depends on the follow on impacts on the country risk premium. Next, we turn to the effects of productivity shocks when they also de-

Figure 4.3a Impulse Responses after a 1% Positive Productivity Shock: Macro Aggregates

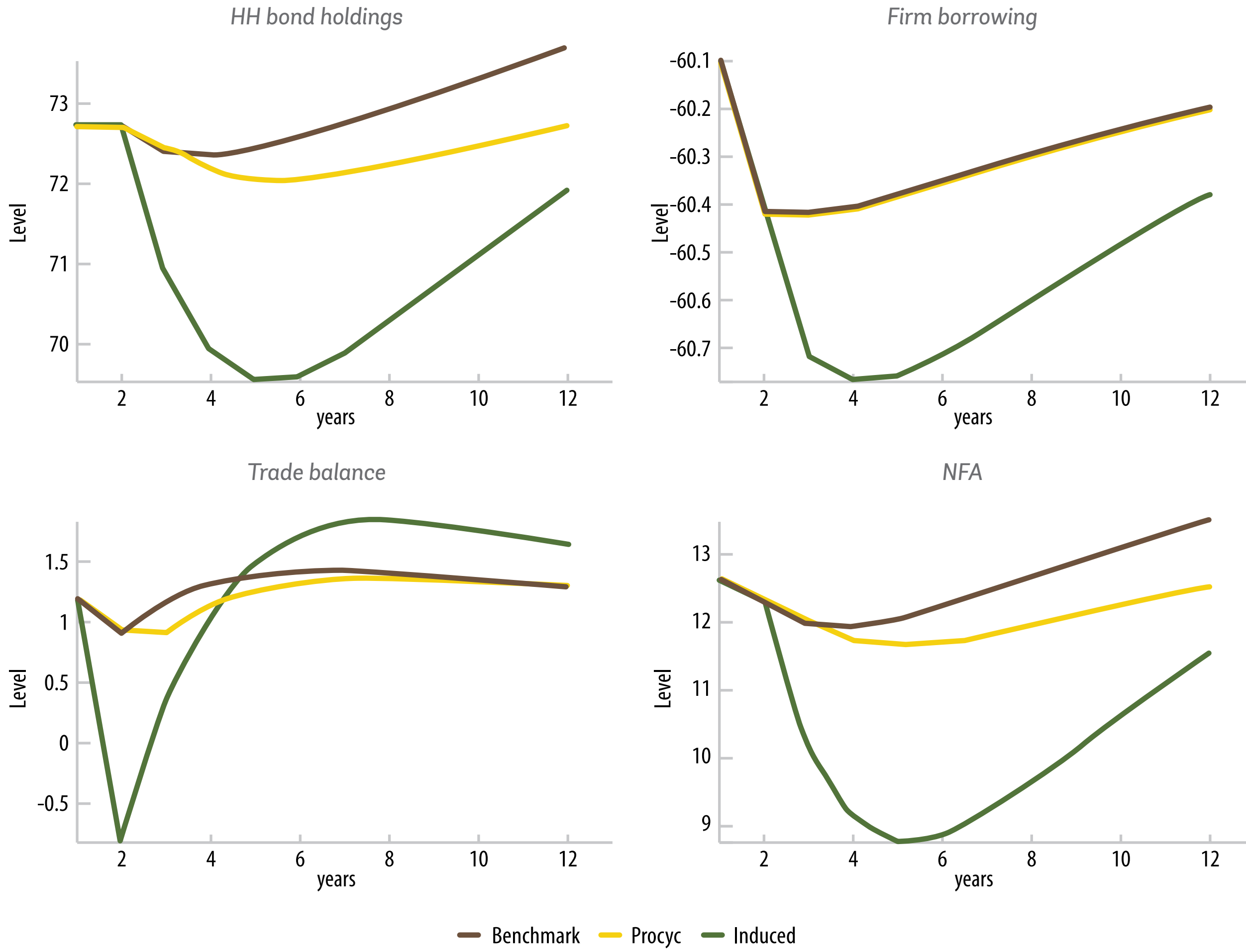


Note: Impulse responses are computed under benchmark parameterization.

termine the risk-premium in the economy (i.e., induced risk premium). The responses of various variables to a productivity shock in such a case are shown as green dash-dot lines in Figures 4.3a and 4.3b. Under this scenario, an increase in productivity has the same effects as described above, except an increase in productivity also triggers a fall in country risk-premium, which in turn provides an additional boost to the economy. Indeed, with induced risk-premium, all macroeconomic aggregates experience a greater expansion relative to the scenario with independent risk-premium. This occurs because lower risk-premium reduces the interest rate faced by domestic agents, encouraging additional borrowing by firms and a greater reduction in savings (bond holdings) by households. As a result, both employment and investment are scaled up significantly. Not surprisingly, the deterioration in the NFA position and trade balance (in fact, trade balance goes into deficit) is larger with induced risk-premium. Overall, in the presence of endogenous country risk-premium, the effects of productivity shocks on the economy are amplified.

Lastly, the effects of a shock to domestic interest rate arising as a consequence of a shock to the international interest rate tends to have a contractionary effect on the economy. Figure 4.4 presents the responses of key variables. A rise in the international interest rate triggers an increase in the domestic interest rate which raises the cost of borrowing for working capital for domestic firms. Therefore, they reduce borrowing, cut employment, which in turn lowers output. Consumption also declines and this fall exceeds the drop in output. This is an important result of the model as it shows that fluctuations in the interest rate can help account for the high volatility of consumption in the OECS countries. The increase in interest rates also induces higher

Figure 4.3b Impulse Responses after a 1% Positive Productivity Shock: Financial Variables



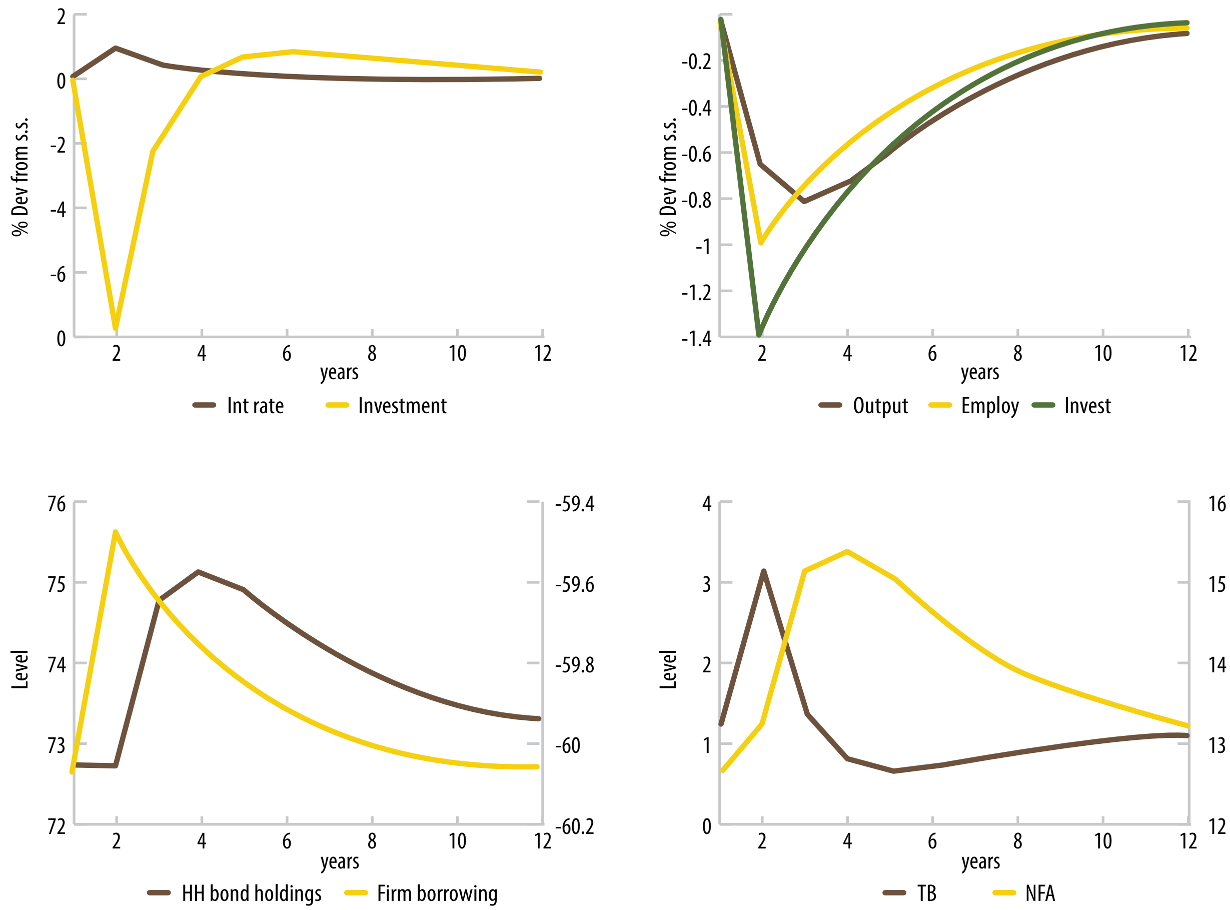
Note: Impulse responses are computed under benchmark parameterization.

savings by domestic households, whose bond holdings rise; and discourages investment. As a result, trade balance improves and so does the NFA.

We now turn to the evaluation of the contribution of various shocks, financial frictions and fiscal policy to the business cycles of the OECS countries by means of several numerical experiments. In our first experiment we assume that both fiscal policy and country risk-premium are a-cyclical, or independent of the state of the economy. This version is the benchmark case. In the second experiment we consider the case of independent fiscal policy, but assume that country risk-premium is endogenous to productivity. The third experiment assumes pro-cyclical fiscal policy and independent risk-premium. The last, experiment studies the case where both fiscal policy and country risk-premium respond to productivity changes. In each case, the standard deviation of productivity innovations, , is set so that the volatility of GDP in the model matches the average volatility of GDP in the OECS countries.

In all experiments we simulate the model economy for a random sequence of shocks to productivity, government expenditures, international interest rate and country risk-premium. We then obtain the volatilities and comovements among the key aggregates from this simulated data and contrast them with the actual data and across various versions of the model. When simulating the model, we treat model series in exactly the same way as the data. In particular, we simulate 45 years of data and remove the first 10 years to reduce the effects of initial conditions. This gives us model series of the same length as in the data. All series, except interest rate and trade balance are log-transformed and HP-filtered with a smoothing parameter of 100. Volatility

Figure 4.4 Impulse Responses after a 1% Positive Shock to International Interest Rate



Note: Impulse responses are computed under benchmark parameterization.

and comovement statistics are then computed on each model series and averaged across 1000 simulations.

The benchmark model replicates the volatilities of the macro variables in the OECS data quite closely. As it can be seen from panel 1.a in Table 4.3, the model matches the volatilities of GDP, interest rate, investment, and government spending because these moments were targeted in the calibration. But we did not target the volatility of consumption and trade balance: while the model comes very close to replicating the volatility of TB to GDP ratio it under predicts the volatility of consumption in the OECS countries. At the same time, it is important to note that the model yields consumption that is more volatile than GDP, in line with the data facts for the OECS countries (as seen in stylized facts discussed in Chapter 1 of this report). Under a pro-cyclical fiscal policy, the model with all shocks (panel 3.a) predicts lower volatility of trade balance and consumption. The reason for this lower volatility is the counteracting effect that government expenditures have to productivity changes under the procyclical fiscal policy (see impulse responses in Figure 4.2a).

Next we consider a scenario in which country risk-premium is endogenous to productivity changes. This is shown in Panel 2 in Table 4.3 under the label of "Induced country risk". Here, we calibrated the standard deviation of innovations to all shocks such that we replicate the volatility of GDP, interest rate, and government spending. All other parameters are set to their baseline values. We find that with induced risk-premium, the volatility of all non-targeted variables increases relative to the benchmark scenario. For instance, the percentage standard deviation of investment goes up from 4.57 in the benchmark model with independent risk premium to 7.74 under induced risk premium, rising by 70 percent.

Table 4.8: Simulated and Actual Business Cycles in the OECS Countries: Volatilities

	% Standard deviation			% Standard deviation of x % Standard deviation of GDP			
	GDP	TB/GDP	Int rate	Inv	Gov exp	Cons	Employment
OECS data	3.72	5.21	2.69	4.57	2.55	2.66	n/a
Independent fiscal policy							
1. Independent country risk							
(a) all shocks	3.72	4.79	2.69	4.57	2.55	1.40	0.89
(b) no z shocks	1.81	4.46	2.69	7.09	5.25	2.03	1.44
(c) no G shocks	3.72	3.89	2.69	4.57	0.00	1.39	0.89
(d) no R*, D shocks	3.20	3.17	0.00	3.20	2.96	1.11	0.62
2. Induced country risk	3.72	6.55	2.69	7.74	2.55	1.41	0.94
(d) no R*, D shocks	1.91	2.89	0.00	3.16	4.97	1.11	0.62
Procyclical fiscal policy							
3. Independent country risk							
(a) all shocks	3.72	4.68	2.69	4.57	2.55	1.31	0.89
(b) no z shocks	1.81	4.58	2.69	7.09	5.61	2.03	1.44
(c) no G shocks	3.72	3.89	2.69	4.57	1.02	1.31	0.89
(d) no R*, D shocks	3.20	2.99	0.00	3.20	2.96	0.97	0.62
4. Induced country risk	3.72	6.49	2.69	7.74	2.65	1.35	0.94
(d) no R*, D shocks	1.91	2.89	0.00	3.16	5.15	0.95	0.62

Source: Authors' calculations.

Similarly, employment volatility goes up by 5.2 percent, while the volatility of net exports rises by 37 percent. This is because the effects of productivity shocks on the economy are amplified in the presence of endogenous risk-premium due to the presence of working capital constraint.[36]

Lastly, we present the cyclical properties of key variables with the real interest rate. An important finding in the OECS counties data was that real interest rates are strongly countercyclical with main macroeconomic aggregates. Table 4.5 shows that the model reproduces this result quite closely. In particular, in the benchmark scenario (panel 1.a), real interest rate commoves negatively with investment, consumption and employment. The correlation with net exports is positive. The signs of the correlations remain unchanged both under a procyclical fiscal policy and with induced country-risk scenario. Also note that the correlation between interest rates and government expenditures is close to zero both in the data and in the model.

Several important results from this alternative modeling strategy can be emphasized. First, counter cyclical fiscal policy curtails the effects of productivity shocks in the economy, and reduces the volatility of consumption and net exports. Second, if risk-premium responds to the changes in the economy's fundamentals, the effects of productivity shocks on the economy are amplified through the working capital channel, and therefore the volatility of key macro aggregates rises. This amplification effect would disappear if there was no spillover from productivity to country risk-premium or if there was no need for working capital.

We have also isolated the contribution of various shocks to the overall volatility in the economy re-computed volatilities and correlations in the model while sequentially eliminating shocks to productivity, government expenditures, and interest rate shocks (international interest rate and country risk-premi-

36 The increase in volatility due to endogenous risk-premium is similar under the pro-cyclical fiscal policy, with the exception that consumption volatility is affected more.

um). The results are presented in panels b, c, and d of Tables 4.3, 4.4, 4.5. Without productivity shocks (panels b of Table 4.3; 4.4; 4.5), volatilities of several variables are significantly reduced relative to the benchmark case with all shocks. For instance, GDP volatility declines from 3.72 percent when all shocks are present) to 1.81 percent when productivity shocks are switched off, implying that productivity shocks account for about 51 percent of GDP volatility in the Eastern Caribbean economies. Volatility of net exports also declines when productivity shocks are eliminated from the simulations, although the decline is more muted. Specifically, productivity shocks account for about 7 percent of volatility in next exports. In contrast, the volatilities of investment, consumption, employment, all rise when productivity shocks are eliminated. Similarly, the negative correlation between trade balance and GDP, and interest rate and GDP become exaggerated without the productivity shocks. Taken together, these results suggest that these shocks are important in explaining the business cycles in the OECS economies.

Given the importance of productivity shocks in the OECS countries, it becomes necessary to better identify the sources of these shocks. As we argued before, the productivity shocks in the model find a broad correspondence to shocks in the data – these include technology shocks, shocks to the terms of trade, unexpected changes in weather conditions, etc. Panels c) of Tables 4.3, 4.4, 4.5, report the business cycles statistics from simulations where shocks to government expenditures are eliminated. Without government spending shocks, the volatility of trade balance is reduced by 20 percent (from 4.79 percent to 3.89 percent) and the volatility of consumption also decreases. Lastly, we simulate the model without interest rate shocks (both to the international interest rate and country risk-premium) and report the resulting statistics in panels d) of Tables 4.3, 4.4, 4.5. Eliminating shocks to the interest rate lowers the volatility of all variables, except government spending. For instance, the percentage standard deviation of GDP declines from 3.72 percent to 3.20 percent — a 14 percent reduction; consumption volatility declines by 21 percent, while employment and investment volatili-

Table 4.9: Simulated and Actual Business Cycles in the OECS Countries: Comovement with Interest Rate

	Correlation of Interest rate with				
	Inv	Gov exp	Cons	TB/GDP	Employment
OECS data	-0.29	-0.04	-0.33	0.24	-0.36
Independent fiscal policy					
1. Independent country risk					
(a) all shocks	-0.68	-0.01	-0.70	0.61	-0.77
(b) no z shocks	-0.87	-0.01	-0.97	0.65	-0.97
(c) no G shocks	-0.68	0.00	-0.70	0.75	-0.77
(d) no R*, D shocks	-0.01	0.00	0.00	0.00	0.00
2. Induced country risk	-0.41	-0.01	-0.81	0.36	-0.84
(d) no R*, D shocks	-0.02	0.01	-0.02	0.00	-0.02
Procyclical fiscal policy					
3. Independent country risk					
(a) all shocks	-0.68	-0.01	-0.74	0.63	-0.77
(b) no z shocks	-0.87	-0.01	-0.97	0.64	-0.97
(c) no G shocks	-0.68	-0.01	-0.74	0.75	-0.77
(d) no R*, D shocks	-0.01	0.00	0.00	0.00	0.00
4. Induced country risk	-0.41	-0.03	-0.83	0.37	-0.84
(d) no R*, D shocks	-0.01	0.0	-0.00	0.00	-0.00

Source: Authors' calculations.

ty each decline by about 30 percent, and the volatility of trade balance drops by 34 percent. We should note that the majority of this decline in volatilities in accounted for by the absence of risk-premium shocks. For instance, eliminating just the default risk (and allowing for the shocks to the international interest rate) reduces the volatility of GDP by 8 percent, the volatility of consumption by 15 percent and employment volatility by 20 percent.

In the absence of interest rate shocks, the cyclical properties of the key variables in the economy are also affected. That is, the co-movement between GDP and consumption, investment and employment all increase above their data counterparts; the trade balance becomes less countercyclical than in the data; and the negative correlation between the interest rate and GDP, consumption, and investment disappears. We interpret this result as supportive of the importance of interest rate shocks in explaining the OECS business cycles.

The changes in volatilities and correlations are even more pronounced when we consider the scenario with induced country risk-premium. This case is summarized in panels 2.d) and 4.d) of Tables 4.3, 4.4, 4.5. Eliminating interest rate shocks when risk-premium is determined by domestic fundamentals leads to a 49 percent reduction in GDP volatility. Again, the majority of this reduction is accounted for by eliminating the shocks to risk-premium. Similarly, without interest rate shocks, consumption volatility in the OECS countries would decline by 21 percent, employment volatility by 33 percent and investment volatility by 59 percent.

The volatility of GDP declines when either productivity or interest rate shocks are eliminated. In contrast, the volatilities of consumption, investment and employment rise when productivity shocks are absent, while those volatilities decline in the scenario without interest rate shocks. The differences in the behavior of consumption, investment and employment in the two scenarios can be understood through the lens of agents' risk-sharing opportunities in the model. Consider first a productivity shock. In response to such a shock, households and firms can borrow/lend in international markets at a given interest rate, which allows them to smooth out the effects of the shock. The shocks to interest rate are harder to smooth out since they directly affect the cost of borrowing for working capital, and no other mechanisms for risk-sharing are available to the agents. As a result, these shocks make OECS economies more volatile.

We have assessed how the business cycle is affected by shocks to the financial sector channel. We did this by simulating the effects of a smaller value for the parameter that determines the size of the working capital requirement – parameter φ. Table 4.6 presents the results for volatilities and correlations in the case where only 50% of the labor cost has to be paid in advance (φ=0.5); and the case in which no labor cost has to be paid in advance (φ=0). In both cases we keep all other parameters unchanged at their benchmark values given in Table 5. To quantify how the business cycle properties change with φ in Table 4.6 we report the volatility of the key aggregates relative to their respective volatilities under the benchmark model scenario with φ=1.

In a scenario with independent fiscal policy and a shock to interest rates, the volatility of GDP increases. In panel 1 of Table 4.6, when φ=1 the model generated volatility of GDP and investment that was very similar to that found in the OECS data. Similarly, it was able to replicate the negative comovement between GDP and trade balance, and between GDP and the interest rate. When the working capital parameter φ is reduced to 0, the volatility of GDP, consumption, employment and government spending, all decline significantly. For instance, GDP volatility is reduced by 14 percent, while that of consumption by 24 percent, and employment – by 30 percent. Similarly, the correlation coefficient between output and interest rate turns from being large and negative to being positive. The same is true for the correlation between consumption and interest rate. Trade balance also becomes much less countercyclical, but its volatility rises (by around 20 percent relative to the benchmark case with φ=1). This is primarily driven by higher volatility of investment.

In the absence of financial sector shocks, it becomes easier for firms to adjust to productivity shocks. These changes occur because without the working capital requirement, the negative impact of interest rates on labor demand of firms is eliminated. As a result, it becomes easier for firms to adjust employment and investment in response to productivity shocks. This leads to higher volatility of employment, investment and, therefore, trade balance. At the same time, firms' employment decisions become less sensitive to interest rate shocks when φ=0, which lowers the volatility of

Table 4.10: Sensitivity Analysis: Working Capital Requirement

	% Standard deviation of x / % Standard deviation of x, benchmark						Correlation between			
	GDP	TB/ GDP	Inv	Gov exp	Cons	Employ	GDP,R	GDP,TB/ GDP	Cons,R	Inv,R
1. Independent fiscal policy										
φ=0.5	0.90	1.05	1.36	0.62	0.84	0.80	-0.20	-0.21	-0.44	-0.69
φ=0	0.86	1.19	1.70	0.36	0.76	0.70	0.06	-0.05	0.05	-0.70
2. Procyclical fiscal policy										
φ=0.5	0.90	1.07	1.36	0.62	0.84	0.80	-0.20	-0.27	-0.46	-0.69
φ=0	0.86	1.21	1.70	0.36	0.78	0.70	0.06	-0.07	0.05	-0.70

Note: The table reports the volatility of various aggregates relative to the volatility of the corresponding aggregate under the benchmark parameterization of φ=1. All other parameters are set to their benchmark values given in Table 5. Source: Authors' calculations.

employment in the model. The second effect dominates and employment volatility is reduced with lower φ. Volatility of investment, however, unambiguously rises.

Conclusions and Directions for Policy

This chapter has assessed the effects of terms of trade volatility on real GDP per capita growth in the OECS and other regions of the world. A key conclusion from the analysis is that counter-cyclical fiscal policy and stable and well developed financial markets and institutions will have particularly high payoffs in terms of reducing the adverse growth effects of terms of trade volatility in the OECS region. As discussed in greater detail in chapter 2, one way of strengthening the region's ability to shift toward a more counter-cyclical fiscal policy stance would be through the adoption of fiscal responsibility laws (FRLs) and/or fiscal rules. These are widely recognized as effective mechanisms that can increase the discipline and credibility of the fiscal authorities. Not only would fiscal rules help in making fiscal policy less pro-cyclical in the OECS, but they would also help the countries in the region to make significant progress in reigning in fiscal expenditures and implementing effective fiscal consolidation programs. The introduction of fiscal rules would need to be supported by expenditure reforms in the context of a medium term fiscal framework to signal the authorities' commitment to fiscal sustainability. Given that natural disasters are common across the region, OECS countries would do well to integrate the likelihood of a disaster in their fiscal programming exercises. Many countries in similar situations have benefitted from the parallel creation of an independent fiscal council that monitors macroeconomic projections underlying the budgeting process and the compliance with the fiscal rule (see Amo-Yartey et al., 2012). Although it is not an official fiscal council, the member countries of the ECCU have fiscal targets, agreed under the ECCU Eight Point Stabilization and Growth Program in 2009. The problem is, however, that these targets are not binding.

We have also shown that macroeconomic aggregates in OECS are quite volatile, with consumption exhibiting higher volatility than GDP. We also find that in these economies real interest rates are very volatile and strongly countercyclical with GDP and other macroeconomic aggregates. Similarly, fiscal expenditures also show significant volatility, but are pro-cyclical with GDP. In that context, our simulations suggest that eliminating fiscal policy shocks could reduce the volatility of consumption and trade balance, but without the volatility of GDP. Eliminating shocks to interest rates, however, could reduce the volatility of GDP by 14 percent, and the volatility of consumption by 21 percent. We also show that domestic financial markets development plays an important role in buffering the effects of interest rate shocks on the economy. Eliminating the working capital constraint, while keeping all shocks in place, for example, could reduce the volatility of GDP, consumption, employment and government spending significantly. For instance, GDP volatility would be reduced by 14 percent, while that of consumption would decline by 24 percent.

These results suggest a few directions for designing policies to help reduce the volatility experienced by

the OECS economies. First, greater openness to international financial markets is important as it could help the OECS economies to hedge fluctuations in fundamental shocks, such as shocks to technology, terms of trade, and shocks associated to natural hazards. Second, greater openness must be accompanied by improvements in domestic financial markets and government's efforts to stabilize domestic risk-premium. By reducing the frictions in the domestic financial markets, these economies can cushion the negative effects of interest rate shocks on domestic economic activity, and achieve lower volatility. Third, if pro-cyclical fiscal policies induce higher country risk-premium in the international markets, governments of the OECS countries can stabilize their country's risk-premium by switching to counter-cyclical policies. Fourth, if government consumption is strongly complementary with private consumption, switching to an independent or counter-cyclical fiscal policy stance can reduce the volatility of consumption in the economy.

APPENDIX

Appendix Table 1. Non-Linear Effects of GDP Share of Domestic Credit to Private Sector

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.20 (0.17)	-0.19 (0.35)	-0.88 (0.60)	-0.96** (0.45)	-1.05** (0.46)
Terms of Trade Volatility*Credit-to-GDP ratio	-1.29 (2.74)	-0.82 (2.62)	5.05 (4.05)	6.51** (3.22)	6.52* (3.56)
Terms of Trade Volatility*Credit-to-GDP ratio squared	3.63 (4.45)	3.43 (4.45)	-7.61 (5.97)	-9.15* (4.77)	-9.17* (5.59)
Credit-to-GDP ratio	0.69** (0.28)	0.79*** (0.26)			
Credit-to-GDP ratio squared	-0.59 (0.40) (0.06)	-0.82** (0.40) (0.36)			
Terms of Trade Growth					0.08*** (0.02)
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

Appendix Table 2. Financial Development Index from Sahay et al. (2015)

Dependent Variable is:	GDP per capita Growth				
	(1) LS	(2) LS	(3) LS	(4) LS	(5) LS
Terms of Trade Volatility	-0.70*** (0.19)	-0.74*** (0.17)	-0.32 (0.27)	-0.30 (0.22)	-0.21 (0.23)
Terms of Trade Volatility*FD Index	2.42** (0.98)	3.29*** (0.93)	0.93 (1.44)	1.81 (1.34)	1.07 (1.31)
FD Index	0.42*** (0.09)	0.36*** (0.26)			
Terms of Trade Growth					0.10*** (0.03)
Country Fixed Effects	No	No	Yes	Yes	Yes
Time Fixed Effects	No	Yes	No	Yes	Yes

Note: The method of estimation is least squares. Huber robust standard errors (shown in parentheses) are clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

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WORLD BANK GROUP

PROCEEDINGS

DEVELOPMENT OF AN ECCU GROWTH ACTION PLAN

Prepared for Growth Dialogue
1 March 2017

EASTERN CARIBBEAN CENTRAL BANK
ST KITTS

Contents

DEVELOPMENT OF AN ECCU GROWTH ACTION PLAN

1.0 RECOMMENDATIONS

The recommendations are premised on the ultimate outcome of best service to the ECCU's citizenry. For the purposes of this ECCU Growth Action Plan we take guidance from global studies and frameworks which point to the fundamental fact that the scope of work breakdown structure, components and deliverables must "*translate into broad based improvements in the general living standards that touch all citizens rather than a fortunate few"* a quote taken from the World Economic Forum Inaugural Inclusive Growth and Development Report 2015.

The Inclusive Growth and Development Framework consists of seven pillars namely:

i) Education and Skills Development
ii) Employment and Labour compensation
iii) Asset building and entrepreneurship
iv) Financial Intermediation of Real Economy Investment
v) Corruption and Rents
vi) Basic Services and Infrastructure
vii) Fiscal Transfers.

We chose the Global Competitiveness Index thematic areas which clearly defined areas of binding constraints to the ECCU's growth and development.

In order of priority, the key thematic areas are ranked as follows:

i) Institutions;

ii) Human Resources Development: where most persons place labour market efficiencies as well so those were included under this topic;

iii) Financial Market Development;

iv) Infrastructure, Macroeconomic and Goods Efficiency Markets (see Appendix 1 for detailed table with key thematic areas and the convergence of consensus from the reports from the breakout sessions of the Growth Dialogue).

We have used Infrastructure as the fourth thematic area for the first action plan for the 2017 - 2019 period. We use the infrastructure because it emerged as a consensus area with the Caribbean Growth Forum and it relates directly to the many challenges related to our air, sea and land transportation problems which are always prevalent in our region.

Critical to the success of this ECCU Growth Action Plan are the following:

i) The ECCB will serve as the interim leader of this process as the Revised Treaty of Basseterre puts the Growth Agenda as the direct remit of the Economic Affairs Council of the OECS Commission.

ii) There are three critical partners the Member States, the OECS Commission and the ECCB; where there is the need for legislative cover; the Member State will expeditiously lead in this regard.

iii) Where there are issues emerging from the Growth Dialogue that are not priorities of the ECCB's Strategic Plan or the OECS Commission's work priorities they will be scheduled where reasonably practical to respond to the needs of the social partners.

iv) The ECCB, The OECS Commission and the Member States must identify focal point individuals to implement the action plan.

v) Budgetary allocation would be required from the ECCB, the OECS Commission and the Member States if this work is to be effective and efficient.

2.0 KEY MESSAGES

i) The Growth Dialogue provided several opinions and perspectives which will best serve the constituents of the ECCU only if the parameters chosen allow for specificity, measurability, achievability, and results that can be projectised according to specific time schedules.

ii) There was a consensus among attendees that the Growth Dialogue was timely and topical. They welcomed the opportunity to participate.

iii) The presence of the social partners, leaders of opposition and governments to discuss common purpose represents a new frontier in maturity across the ECCU.

iv) Key roles and responsibilities must be identified and pursued vigorously; for example:

- a) Governments must ensure that the necessary personnel and financial resources are present to implement the action plan.
- b) The ECCB and the OECS Commission must be at one with the growth targets and other macro factors
- c) The youth should have a greater role in subsequent Growth Dialogue.
- d) The social partners must ensure that the necessary data and information which are critical to evidence based decision making is provided adequately and in a timely manner

v) Each attendee at the Growth dialogue must have a representative who meets periodically to advance, update and monitor the action plan.

vi) This action plan must be Workable unlike other outputs from previous meetings.

3.0 KEY COMPONENTS OF THE ECCU GROWTH ACTION PLAN

i) Convene meeting of social partners in all countries.

ii) Identify key thematic areas to be pursued for the biennium 2017-2019

- a) Institutional strengthening at the regional and National levels namely:

- OECS Economic Union
- OECS Growth and Development Strategy
- Growth Dialogue Action Plan
- OECS Business Council
- Institutionalise Public Outreach on Common Policies Programme across the ECCU

iii) Establish the contributions of each country to ECCU

   a) Growth and Jobs Targets

iv) Building Human Resources Capacity by revamping the Educational System

   a) Development of a dynamic and responsive Educational System to meet the diverse human resources development needs of the OECS:
   b) Development of the business ecosystem and productivity led and economically competitive firms;
   c) Development of a skilled human resource,
   d) Development of an enabling environment which facilitates "Doing Business;"
   e) Standards institutions to ensure compliance with international standards of trade, grades and standards.
   f) The presence of advocacy consumer and producer organisations

v) Financial Markets Development

   a) Amalgamation of banks and credit unions for efficiency and effectiveness.
   b) Strengthen Capacities of Development Banks to finance development across the ECCU
   c) Rationalise Micro-finance institutions to maximise efficiency while minimising administrative costs.
   d) Provide additional financial services to maximise the number of possible business cycles while minimising financial hardships of individuals and firms

vi) The establishment or development where necessary of the regional and national infrastructure for reliable and sustainable Air, Land and Sea transportation

4.0 PROPOSED NEXT STEPS

The next steps would be focused on the following three areas:

(a) Growth Dialogue Action Plan

- i) Approval of the Growth Dialogue Action Plan;
- ii) Dissemination of Growth Dialogue Action Plan to all attendees;
- iii) Invite any comments and suggestions which could be helpful for the next year's meeting;
- iv) Convene meeting between ECCB and the OECS Commission leadership;
- v) Identify team composition for the implementation of the Action Plan.

(b) In-Country Rollout and Action Plan Implementation

- i) Convene national consultation in each member state;
- ii) Identify national steering committee and all strategic partners;
- iii) Agreement on the prioritised thematic areas and processes within each country;
- iv) Discuss and agree on the implementation schedule;
- v) Monitor and evaluate the implementation;
- vi) Report on the implementation.

(c) Preparation for the Next Growth Dialogue in 2018

- i) Collate databases developed during the inaugural meeting;
- ii) Review and place for institutionalisation lessons learnt from the first meeting;
- iii) Schedule periodic meetings of the Planning Committee.

Detailed Work Plan to Action Plan is provided in Appendix 2.

5.0 SYNOPSIS OF THE GROWTH DIALOGUE

5.1 Executive Summary

As part of the initiative to forge consensus on a plan of action for addressing growth, competitiveness and employment in the ECCU, a Growth Dialogue with Social Partners was planned and executed by the Monetary Council on 1 March 2017 at the ECCB Headquarters in St Kitts. The member countries of the ECCU, the ECCB and the OECS Commission are working on a framework to transform the economies and it is therefore an opportune time for deliberations with the key social partners (Opposition parties, trades and labour unions, the church, civil society organisations, the business sector and the youth).

At this time, the collective leadership of our region is seeking to find common cause, stand tall and take collective action to defend our vital economic interests and advance the well-being of our people especially our youth.

The Growth Dialogue sought to create a unique opportunity for Social Partners to engage the Monetary Council (the highest decision making body of the ECCB) and their strategic partners in development the OECS Commission, CDB and the World Bank on the all- important issue of economic growth under the theme “Working Together to Achieve Higher and More Inclusive Growth in the ECCU.”

The objectives of the Growth Dialogue were to *inter alia;*

- Address the economic decline in the Eastern Caribbean Currency Union (ECCU) over the last two decades and establish a pathway to the ECCU's pre-crisis economic performance levels.

- Active participation from social partners to identify the key challenges which they presently face and identify opportunities which can be prioritised into key deliverables for a ECCU Growth Action Plan.

- To ensure that the ECCU Growth Action Plan is specific, measurable, actionable, results focused according to realistic timelines.

The Chairman of the Monetary Council, Prime Minister Dr Gaston Browne of Antigua and Barbuda served as Chairman of the whole Dialogue.

The Governor set the stage by presenting an overview of the economic performance of the ECCU from the pre-crisis to the post crisis period. He mentioned that ECCU's growth has lagged behind its peers from Latin America and the Caribbean and other Small Island Developing States. He noted that the critical sectors of tourism and agriculture, although crucial for long term growth were being outperformed by the non-tradeable sectors of personal and social services. The converging headwinds of high unemployment, low productivity and the absence of critical tools for evidence based monitoring further exacerbates the situation. He spoke about the region's need to improve its growth record, its competitiveness and its standing on the global stage according to the Doing Business rankings. The Governor concluded by posing three (3) questions for consideration:

i) What will it take to attain and sustain a growth rate of five (5) percent per annum in the ECCU?

ii) What will it take for the ECCU to break into the top fifty (50) percent the ease of doing Business over the next five (5) years?

iii) How can the ECCU generate 60,000 jobs over the next eight (8) years?

There were two panel discussions in the morning session. The first panel featured four presenters representing the Business Sector, the Trades and Labour Unions, Civil Society and the Christian Council who presented their views on the critical constraints to more inclusive growth in the ECCU and their proposed solutions for transformation and sustainability. The second panel discussion allowed the key development partners (OECS Commission, CDB and the World Bank) serving the ECCU to articulate recently published works or ongoing programs aimed at changing the growth trajectory for the ECCU. A period for questions and discussions followed each panel discussion.

In the post luncheon period all of the attendees were divided into groups which were diverse in their composition to allow at least person from each social partner group to be included. There was representation from a Permanent Secretary of Finance, trades and labour union leader, civil society, youth, the church, the private sector and the resident representatives of the ECCB. Two other groups; one with membership of all the Opposition members and the other with the Prime Ministers, other government representatives and other multilateral organisations convened and deliberated on the two plenary sessions and several relevant briefs and published reports.

In the breakout sessions, the appointed rapporteur captured the deliberations in the stipulated format which included the twelve thematic areas of the Global Competitiveness Index and the seven Inclusive Growth and Development Frameworks.

5.2 Welcome and Opening Remarks

The Chairman, Prime Minister Gaston Browne of Antigua and Barbuda welcomed the participants and invited Reverend Mark Christmas to offer the invocation.

His opening remarks highlighted the following:

- The aim of the Growth Dialogue was to address the economic decline in the Eastern Caribbean Currency Union (ECCU) over the last two decades.

- The ECCU's economic performance had not returned to the pre-crisis level and low growth had been associated with increased unemployment, high poverty levels and economic stagnation.

- Active participation from social partners was crucial to forge consensus on a plan of action for addressing growth in the ECCU.

5.3 Setting the Stage: Growth and Employment in the ECCU

Governor of the ECCB, Timothy N J Antoine, presented an overview of the economic performance of the ECCU from the pre-crisis period to the post crisis period. He highlighted the following:

i) The ECCU's growth rate had not returned to pre-global financial crisis levels and was lagging its peers in Latin America and the Caribbean and other Small Island Developing States (SIDS) such as Singapore and Mauritius.

ii) Non-tradeable sectors such as personal and social services were growing faster than tradeable sectors. The tradable sectors such as tourism and agriculture are critical for long term economic growth and development.

iii) The ECCU continued to record high unemployment and low productivity. The ECCU needed to generate 60,000 jobs to achieve single-digit unemployment by 2025. Some ECCU territories were not yet conducting labour surveys, which are critical for the monitoring of employment in the region.

iv) The Eastern Caribbean Central Bank's (ECCB) vision for the ECCU consisted of seven (7) components, which the Governor highlighted as part of the thrust toward sustained economic growth and single-digit unemployment.

v) The four main strategic priorities identified to help the ECCU achieve its financial, economic and development goals are:
   - Financial Stability;
   - Growth, Competitiveness and Employment;
   - Fiscal and Debt Sustainability; and
   - Enhancing Organisational Effectiveness.

vi) The ECCU recorded growth over the last three years. While the outlook for ECCU growth was positive, the desired levels of productivity and employment were neither high nor fast enough to attain the projected growth.

vii) The ECCU's competitiveness, as reflected by its average ranking of 116 in the World Bank's 2016 Doing Business Report, required improvement. The ECCU's target is to attain an average ranking of 50.

viii) Challenges to the ECCU's competitiveness included high average wages, lack of innovation, high energy costs, difficulties in starting businesses and accessing credit.

5.4 Panel 1: Challenges and Opportunities for More Inclusive Growth in the ECCU

The first panel featured four presenters, representing the Business Sector, the Trade and Labour Unions, Civil Society and the Christian Council, who presented their views on the critical constraints to growth in the ECCU and their proposed solutions for transformation and sustainability. A short period was allowed for questions from the attendees.

A. Presentation on "Working Together for Inclusive Growth and Development" by Ms Aine Brathwaite, Vice President, OECS Business Council

The presentation centered on issues related to the private sector. Ms Brathwaite highlighted the following:

i) The current structure of the private sector in the Organisation of Eastern Caribbean States (OECS) was fragmented and there was considerable diversity in the level of evolution among many private sector organisations. Consequently, some of those organisations are under resourced in terms of financial resources, human capital and infrastructure.

ii) The private sector was challenged to develop its research capacities to substantiate their positions better on national, regional and extra-regional matters that impacted the ECCU.

iii) With the current structure of the private sector in the member states, the rate of progress was grossly inadequate to ensure a consistent and sustainable path where the private sector could contribute to policies impacting growth and development in the ECCU.

Recommendations

Ms Brathwaite presented the following five (5) recommendations to improve growth in the ECCU:

i) ***Conduct a census, survey or an assessment of the number of existing entrepreneurs or businesses comprising the formal and informal economy or sectors***. With the informal sector, some businesses were not registered, consumers were not adequately protected, there was loss of government revenue and employment statistics were not accurate. A business model that represented sectorial and national focal points needed to be implemented.

ii) ***Register businesses with a business support organisation such as a chamber of commerce***. These business support organisations can, in turn, provide the policy recommendations to the ECCU governments. This will also foster the development of skills, creation of regional and international networks, information sharing and the improved collection of critical data to enhance the private sector's role as the engine of economic growth.

iii) ***Focus on the role of the OECS Business Council as a regional private sector body for contribution to the formulation of policies at the sub-regional and regional levels***. It was noted that government policies did not promote competition and there was poor fiscal management by some ECCU governments.

iv) ***Invest in inclusive innovation with the use of technology to leverage communication in a cost effective manner, thereby creating real value as ideas are implemented***.

v) ***Provide support of social enterprises to build communities, especially in the rural areas, create employment and generate revenue***.

B. Presentation on 'Working Together for Inclusive Growth and Development' by Mr Julian Monrose, President, St Lucia Trade Union Federation

Mr Monrose presented on the Perspective of the Trade and Labour Unions. He referenced the United Nation's Declaration of Human Rights and highlighted that the concept of inclusive growth was about improving people's living conditions through equality, opportunity and participation by the entire population.

In addressing the challenges to inclusive growth in the ECCU, Mr Monrose specified the following factors:

i) **Political**

- The high levels of divisiveness, partisanship, and incompetence of some governments needed to be addressed as they were impediments to inclusive growth.

- National issues such as education and job creation were politicised, hence the policies of former governments were sometimes scrapped by the new government administrations, thus undermining development.

ii) **Economic**

- Transformation of specific sectors such as the agricultural sector was required. For example, consideration could be given to the agro-processing of fruits to reduce wastage.

- Adjustments to improve the ease of doing business for all business owners regardless of size.

- Access to finance to enable people to start businesses and break down barriers to investment.

iii) **Social**

- Implementation of strategies to address:
  a) The high level of crime;
  b) The high levels of poverty; and
  c) The distrust between employers and employees.

iv) **Natural**

- The high vulnerability of the ECCU countries to natural disasters which can be a major setback to development.

C. Presentation on 'Working Together for Inclusive Growth and Development' by Ms Sandra Ferguson, Chairperson, Inter Agency Group of Development Organisations, Grenada

Ms Ferguson stated that inclusive growth had broader objectives than increasing income and Gross Domestic Product (GDP). She indicated that inclusive growth:

i) Must reduce poverty, unemployment and income inequalities;

ii) Must be translated into human development, increased well-being and participation of the masses and the most marginalised in decision making regarding the economy; and

iii) Promotes the sustainable use of natural resources and engenders protection from climate change.

She provided an overview of the ECCU as SIDS and outlined the following challenges and opportunities related to inclusive growth in the ECCU:

a) High levels of poverty and unemployment and increasing inequality;

b) The need for community economic empowerment for sustainable livelihood and employment creation to promote inclusion and participation;

c) The citizenship by investment (CBI) programmes whereby some ECCU territories were being bought and sold and which were more beneficial to external parties;

d) Identification of the community's natural, cultural and other assets and matching them with emerging opportunities;

e) The need to fully implement the OECS Economic Union to widen the economic and financial space towards greater economies of scale and scope given the small size of the individual ECCU economies;

f) Increasing the production and consumption of local food to reduce the high level of food imports;

g) Investment in a healthy and productive work force for the future by establishing school feeding programmes and formulating school nutrition and health policies. This would help to reduce the high level of non-communicable diseases among the productive age population and younger populations;

h) The need for more affordable and reliable transportation for increased trade and economic opportunities, movement of people across the region, and integration and co-operation. One case in point was the need for greater support of the Windward Islands banana industry by obtaining a more appropriate freight service to facilitate the trade in bananas;

i) Appropriate technology such as the use of labour saving devices for land preparation; and

j) Use of cheaper alternate sustainable energy sources such as solar energy.

In general, Ms Ferguson related that inclusive growth should be driven by:

i) A ground-up approach to ensure participation of all citizens to foster a sense of ownership and build capacity; and

ii) A clearly defined and shared vision of what development at the national and regional levels encapsulates.

D. Presentation on 'Working Together for Inclusive Growth and Development' by Reverend Mark Christmas, Chairman, St Kitts Christian Council

Reverend Mark Christmas delivered on the topic from a religious perspective. He highlighted that:

i) The church's basis for studying economics was the belief that the whole world belonged to God who was concerned about the entire wellbeing of humanity;

ii) The church was likewise concerned about the spiritual and physical wellbeing of people;

iii) The struggle for emancipation inspired the emergence of regional establishments such as CARICOM and the Caribbean Conference of Churches;

iv) The presentation was based primarily on the book 'Emancipation Still Comin' by Reverend Canon Kortright Davis of Antigua and Barbuda.

The Reverend highlighted the four (4) following challenges which he suggested could be transformed into opportunities in the ECCU:

1) Territorial ownership and control

- The region's long history of battles of conquest and domination had been modernised into different patterns and alliances coupled with problems such as poverty, crime and violence and cultural alienation.

2) Insularity

- The populace of the various ECCU territories may be unwelcoming to individuals relocating due to the perception that persons were coming in to "tek over".

- Despite the challenges, therein lay the opportunity for the church to reiterate the need to create a living; build communities that rise above national and personal agendas; and facilitate the inclusion and participation of the marginalised.

3) Political climate of the region

- The political climate of the territories had played a major role in the push towards more inclusive growth. However, it had been a limiting factor due to the inherited tribalism and divisiveness of partisan politics.

4) Social ethics

- The member states had been challenged by specific ethical issues because of legislative, behavioural and economic factors.

- These ethical issues included, but were not limited to, gambling, sex and sexuality, drug abuse, legalisation of marijuana, HIV/AIDS, abortion, use of social media, capital punishment and family law (divorce, children, and common law unions). The church was expected to contribute to the discussion on these issues.

E. *Discussion Points of Panel 1*

The following are key points from the discussion on the topics that the first four (4) panelists presented:

- A tripartite arrangement should be established whereby the government, private sector employers and other social partners such as trade unions and churches could work together and have social dialogue/collaboration towards increased productivity in the ECCU.

- Consultation and discussion should be held at the sub-regional level and should be duplicated at the national level similar to the social construct and protocols of Grenada and Barbados, respectively. Grenada has a social construct whereby various social partners meet monthly to discuss issues related to the country's progress. This ongoing dialogue has helped to address concerns of mistrust amongst stakeholders.

- A monitoring committee should be established to promote the convening of regular meetings with stakeholders and to ensure that the trade unions were allowed to make their contributions.

- The issue regarding the movement of people throughout the region was hindering development. An alternative arrangement/mode of transportation was needed.

- Furthermore, improvements were required to make the process of the screening and certification of skilled persons more efficient.

- The role of LIAT in the ECCU's development should be examined and leveraged.

- The inefficiencies of the public service system were hindering the growth of Micro, Small and Medium Enterprises (MSMEs). Hence, the public sector should be reviewed towards implementation of a performance management system whereby the best performing employees receive the best remunerations, as done in Singapore.

- The role of the church in the developmental process should also be considered.

- Further analysis by territory was needed to identify the strategic action plans at the national level that should be implemented for the ECCU to achieve the targeted growth rate of 5.0 percent by 2030 and creation of 60,000 jobs by 2025. Also, a determination should be made regarding whether the creation of 60,000 jobs was realistic and whether the targeted growth could be attained in one territory or be spread across the ECCU.

- Social and economic development were interrelated, hence there was a need to assess the impact of crime, natural disasters (such as hurricanes) and diseases (such as Zika) and for the ECCU to implement strategies to mitigate those threats.

- Skills forecasting was required to facilitate the education and training of citizens in preparation for jobs that would be created. In this way, specialised skills would have to be sourced.

- Given their role as representatives of employees, trade unions should be considered distinct from civil society and be allowed to contribute to the discussion on the economy. However, when trade unions spoke out, they were sometimes victimised or referred to as economic terrorists.

- The discussion on growth must include the sustainable generation of revenue, notwithstanding the heavy reliance of some ECCU territories on CBI programmes.

- Social, infrastructural or economic development was futile unless it was sustainable. In light of the region's limited resources, greater emphasis should be placed on agricultural development through the promotion of agricultural products, locally and regionally.

- Politicians should discontinue the policitising of national issues as that was counterproductive.

- Critical data at the national level were still inaccessible to the public.

- The media and the ECCB should play a vital role in ensuring the truthful presentation of the economic performance of the ECCU.

- Victimisation or political cleansing (including termination of employment) due to one's affiliation with a political party should be discontinued as that prevented inclusive growth and national development.

- Since there could be no lasting success without succession, attention should be paid to the transformation of the society by including the youth in the discussion on national issues. The youths were the primary change agents given their high level of energy, drive and creativity and vision and technological propensity.

- The people of the Caribbean diaspora should also be engaged as powerful change agents with untapped potential for the transformation of the society.

- The problems being experienced in the ECCU stemmed from the people not realising their true identity, including their salient characteristics, cultural traditions and productive values. Greater focus on the promotion/development of those intangible assets would contribute to increased efficiency and productivity.

5.5 Panel 2: Developing Partnerships for Higher and More Inclusive Growth in the ECCU

The second panel discussion allowed the key development partners serving the ECCU to articulate recently published works or ongoing programmes aimed at changing the growth trajectory for the ECCU.

A) *Presentation on 'The OECS Growth and Development Strategy' by Mr Allister Mounsey, Macro-Economist, OECS Commission*

Mr Mounsey presented on *The OECS Growth and Development Strategy (the Strategy)* which was approved at the 58th meeting of the OECS Authority in November 2013. He highlighted the following:

i) The Strategy was developed as a framework for the implementation of a short term action plan for growth and development.

ii) The Strategy's broad goal was sustainable development through increased resilience. That included an average level of economic growth of 4.0 per cent and a reduction by 25.0 per cent in the average rate of unemployment by 2026.

iii) Key challenges included decreases in the rates of real GDP growth, export of goods and services, foreign direct investment and an increase in public sector debt.

Solutions for changing the trajectory of growth in the OECS can be enhanced through:

a) Creation of opportunities for greater investment;

b) Reviewing and, where necessary, recalibrating the tax structure towards growth enhancement;

c) Repositioning the OECS regionally and internationally as a place for doing business;

d) Revitalising exports by implementing strategies to develop the various productive sectors of the economy such as tourism, agriculture and manufacturing;

e) Containing real wage increases to reflect levels of productivity; and

f) Full implementation of the Economic Union.

Four opportunities were proffered for the short to medium term:

i) Tourism is accepted as the key driver for economic growth; it is therefore important to find the right linkages between the tourism sector and other productive sectors.

ii) The importance of the ECCU leveraging its position in terms of trade as a tool for growth, throughout CARICOM and the OECS;

iii) The improvement of the transportation linkages between the islands as a priority; and

iv) The greater focus on the OECS' Youth Strategy that is parallel to the Growth and Development Strategy, and incorporate other issues such as social and gender equality.

B) *Presentation by Mr Ian Durant, Deputy Director, Caribbean Development Bank*

Mr Durant's presentation focused on a 2016 CDB study, "Micro, Small and Medium Enterprise Development in the Caribbean: Towards A New Frontier", which was conducted in eight (8) of its borrowing member countries (BMC) to assess the critical challenges faced by MSMEs development in the Caribbean. MSMEs in the eight (8) borrowing member countries (BMC) surveyed accounted for 70.0 to 85.0 of enterprises and contributed over 60.0 to 70.0 per cent of GDP.

The four main challenges and accompanying recommendations are as follows:

i) Difficulty in accessing finance although the banks were extremely liquid. This was reflected by the lack of venture capital, angel financing and other forms of financing for startup businesses.

The following were recommendations to address this challenge:

a) Development of training programmes to help MSMEs to improve financial management and provide the financial information that is required by potential financiers;

b) Strengthening of non-banks such as credit unions and microfinance institutions to increase their ability to offer loans and other financial products to MSMEs; and

c) Establishment of credit guarantee schemes for MSMEs.

ii) Substantial gaps in the regulatory and supervisory framework. This included a lack of up to date policies related to MSMEs and a lack of fiscal incentives for MSMEs compared to what was available for larger domestic/foreign enterprises.

Recommendations to address this challenge included:

a) Upgrade policy and regulatory frameworks to make them more comprehensive in terms of the requirements for the development of the MSME sector;

b) Upgrade legislation to facilitate faster resolution of bankruptcies; and

c) Refocus the policy and regulatory frameworks on enhancing the sustainability, productivity and competitiveness of the MSME sector.

iii) Inadequate technical support to MSMEs. The MSME sector was generally unorganised with little advocacy for its development. Further, public and private sector business support organisations (BSOs) for MSMEs were significantly under-resourced in terms of finance and personnel.

Recommendations to address this challenge included:

a) Development of online training programmes for MSMEs;

b) Pursue of public/private cooperation in BSOs to enable increased institutional capacity to serve MSMEs; and

c) Development of partnership between the BSO for MSMEs and financing institutions to enable greater access to credit for MSMEs.

iv) Significant weaknesses in national and regional innovation systems as there was no broad coordinated approach.

Recommendations to address this challenge included:

a) Complete the establishment of national innovation systems (NIS);

b) Provide greater support to innovation by MSMEs, especially in the export sector;

c) Focus innovation efforts on sectors with significant opportunities for export development;

d) Support other initiatives to enhance labour productivity; and

e) Growth of an entrepreneurship culture through educational reform.

C) *Presentation on 'Taming Volatility: Fiscal Policy and Financial Development for Growth in the Eastern Caribbean' by Mr McDonald Benjamin, Adviser, The World Bank*

In his presentation, Mr Benjamin highlighted the following:

i) There was a negative relationship between economic growth and volatility. The average economic growth rate over time was therefore lower where the level of volatility was higher. High volatility was associated with lower economic growth, making it riskier for investors and making it more difficult for countries to service debt and finance education and other social and economic developmental programmes.

ii) Economic growth in the OECS had been more volatile than in other comparator countries. That volatility resulted from the policy on financial development and pro-cyclical fiscal policies of the OECS member states, excluding Grenada, throughout their business cycle. A countercyclical fiscal policy approach should be taken to facilitate social assistance and economic stimulus in economic downturns.

iii) Other contributing factors to the region's volatility included challenges in the financial sector, external factors such as the performance of economies like the United States of America and frequency of occurrences of natural disasters.

Recommendations to boost growth and lower volatility:

a) Reforms to make fiscal policy more counter-cyclical and deepen financial sector development;

b) Establishment of a savings fund with clear operational rules for the allocation of the fund;

c) Inclusion of buffers in fiscal target to cover future disaster-related expenses;

d) Development of medium term debt reduction strategies;

e) Restoration of banking sector stability including the introduction of deposit insurance;

f) Strengthening of fiscal discipline and ensuring fiscal policy guided the budgetary process; and

g) Adoption of formal fiscal responsibility laws to strengthen fiscal discipline and move towards a more counter-cyclical fiscal policy stance.

D) *Discussion Points for Panel 2*

The following are key points from the discussion on the topics the last three panelists presented:

1) The issue of access to credit impacted the ranking of countries in The World Bank's Doing Business Report. However, some of the factors that were taken into consideration were not within the purview of the incumbent government.

2) Some ECCU territories were attempting to address the issue of lack of access to credit for investment and other initiatives by providing venture capital for investments in MMSEs through the CBI programmes.

3) Developmental plans should place greater emphasis on the mental/spiritual/psychological health of the people of the ECCU. Opportunities should be provided for training in counselling, social work and psychology to ensure the overall wellbeing of students in schools and to help counter social ills such as the demasculinisation of males and youth violence which were impeding the region's progress.

4) There was uncertainty about whether GDP was the most appropriate measure of growth for the region. It was recommended that social issues should also be factored into the measurement of growth, making the dialogues with social partners more critical.

5) In light of the fact that the ECCU was competing regionally and globally; each territory needed to educate its people on issues related to investment in regional development given the inclination to be more supportive of businesses of foreign investors than of businesses that are owned by local or regional investors.

6) Politicians should be excluded from the dialogues with social partners; other social groups could be added.

5.6 Reports from Working Groups

For the breakout sessions, all attendees were divided into groups that were diverse in composition to allow at least person from each social partner group to be included. There were nine breakout groups in total. The first seven groups comprised of representatives from the Ministries of Finance, Trade and Labour Unions, Civil Societies, Youth Organisations, Christian Councils, Private Sector and the ECCB Agency Office. One of the two remaining groups had representatives from the Opposition Parties and the other; the Prime Ministers, other government representatives and multilateral organisations. The various groups deliberated on the plenary sessions and several relevant briefs and published reports.

In the breakout sessions, the appointed rapporteur captured the deliberations in the stipulated format which included the 12 thematic areas of the Global Competitiveness Index and the seven Inclusive Growth and Development Frameworks. The Global Competitiveness Index Thematic Areas are as follows:

i) Institutions
ii) Infrastructure
iii) Macroeconomic
iv) Health and Primary Education
v) Higher Education and Training
vi) Goods Market Efficiency
vii) Labour Market Efficiency
viii) Financial Market Efficiency
ix) Technological Readiness
x) Market Size
xi) Business Sophistication; and
xii) Innovation

The Seven (7) Inclusive Growth and Development Frameworks are:

i) Education and Skills Development
ii) Employment and Labour compensation
iii) Asset Building and Entrepreneurship
iv) Financial Intermediation od Real Economy/Investment
v) Corruption and Rents
vi) Basic Services and Infrastructure
vii) Fiscal Transfers

5.7 Summary of Key Takeaways

The following are the deliberation and consensus priority areas as agreed by the various groups and these were presented to the Chairman who reported 12 thematic areas to the final plenary.

A. *Group 1: Prime Ministers and Government Representatives, OECS Commission, Martinique Prefecture Representative, CDB and The World Bank*

The group focused on all of the thematic areas, but reported on the key objectives of the Monetary Council which were articulated in the Growth Dialogue Concept Note. Their observations are as follows:

1) To develop a programme for addressing the constraints to growth, competitiveness and employment in the ECCU;

2) Through meaningful discussions arrive at a consensus on the main challenges to growth and development faced by all social partners;

3) To forge consensus on the priorities amongst the key challenges faced by constituents of the ECCU and identify opportunities for growth and transformation.

4) Prioritise the challenges and opportunities into key thematic areas to facilitate the development of an ECCU Growth Action Plan.

5) Develop a framework and methodology for implementing the deliverables identified in ECCU Growth Action Plan for all countries of the ECCU.
6) Develop a process for monitoring, evaluating and reporting on the implementation of the ECCU Growth Action Plan for the hereafter Annual Growth Dialogue Summit with social Partners.

The three main themes reported on were as follows:

1) Institution Building: This in the context of the OECS Economic Union provided a forum to "bring people together for exchange of views" by various constituents.

2) Consensus around some key action points to take forward to raise the trajectory of growth, competitiveness and employment for the short medium and long term.

3) Generate a ECCU Growth Action Plan with deliverables for operationalisation over the two to three years.

The thematic areas which were highlighted were:

a) Human Resources Development with special reference to education and skills development as well as productivity;

b) Financial Market Development; and

c) Business Sophistication.

Group 1: Summary of Recommendations

1) Need for more Entrepreneurship

2) Reinvent our Education System
    a) Early childhood - 0-5years
    b) Primary – focus on skills instead of subjects; change mindset to entrepreneurship and innovation and to greater abilities in management and greater worker productivity
    c) Tertiary – ensure supply of skills meet needs through entrepreneurship and innovation.

3) Look at refining or aligning Economic Models to facilitate greater growth.

4) Scale up investment in the territories to ensure growth.

5) Partnership of the State with the Private Sector to facilitate growth.

6) Resolve to get all countries of the OECS listed in the top 50 of the Doing Business Listing.

B. *Group 2: Opposition Parties*

This group focused on the thematic areas of:

1) Goods Market Efficiency
2) Financial Market Development
3) Institutions
4) Macroeconomic Factors
5) Technological Readiness

The discussion focused on the need to provide the enabling environment to ensure market efficiency. The need for financial market development was seen specifically in the context of facilitating access and availability of finance by entrepreneurs. A call was made for the development of institutions of governance where they don't exist and the effective functioning of those that are already on the statute books. Attendees were encouraged to take the Revised Treaty of Basseterre seriously by working speedily towards the free movement of people across the member states. A call was made to have the Eight Point Stabilisation Plan be monitored and evaluated for its effective ness as a growth enabler.

The opposition members requested that their concerns with respect to loose fiscal responsibility arrangements in some countries be rectified. They also requested that the apparent deficits in transparency, accountability and credibility be halted.

Challenges Identified:

i) Lack of technical competences in staff for many small businesses i.e. they may have a good idea but no experience in management.

ii) Lack of strategic interventions by government to lend support to small businesses.

iii) Political victimisation and divisiveness instigated by various governments.

iv) Failure of institutional frameworks for planning and development.

v) Lack of genuine engagement by governments.

vi) Failure to identify an institution or agency to drive the growth agenda; what will be the organisational alignment to get the desired results?

vii) Need to set up an OECS Development mechanism to put in place institutional arrangement for growth

Group 2: Summary of Recommendations

1) **Secure organisational alignment** - perhaps through the OECS Commission. Drew on the example of the legislative arrangement establishing the ECCB. The Revised Treaty of Basseterre already has provisions to expand the role/function of the OECS. Setting up an institutional framework is futile without a source of funding. ECCB is tasked inter alia with facilitating growth. To what extent can we use the EECB to drive the growth without putting the backing ratio under pressure and adversely impacting the currency union? (Ref Article 41:2). Bottom line is that legislative support is required.

2) Need to identify the specific sectors to drive the growth agenda and how do we determine which member states are best positioned to leverage growth in each area; how do we apportion resources? The ECCU needs a concrete development plan.

3) Identify or develop a business model to finance development, business imperatives of commercial banks do not align naturally with the ECCU's development agenda.

4) Develop a diagnostic approach to identify the true change agents in each country. The answer may lie in the young people. How do the ECCU begin to get them involved?

How do the ECCU secure fit for purpose education and access to technology and innovation?

5) Systematically engage the OECS citizens in the diaspora; leverage their skills, personal wealth as well as their networks. How do we move beyond just remittances?

6) Encourage and enhance governance through respect for the rule of law which must be rigorously applied. Concerns with conflict of interest must be addressed proactively and in a sustained manner.

C. Discussions – Group 3

This group focused on the thematic areas of:

1) Business sophistication
2) Goods Market Efficiency
3) Human Resources Development
4) Institutions
5) Macroeconomic Factors
6) Infrastructure

Challenges identified:

i) Negative impact of party politics
ii) Overdependence on government (Culture of entitlement/reward)
iii) Movement of goods and people across the region

Group 3: Summary of Recommendations

1) Patriotism inculcated through the school syllabus of civic responsibility (teaching in Schools);

2) Code of Ethic institutionalised and enforced as an integral part of the Governance system of the Government and parastatal bodies;

3) Strengthening of Civil Society;

4) Development of the Private Sector and Entrepreneurship by providing supporting enabling policies and business support institutions and programmes;

5) Evaluate and remedy the Human Resources Development problem starting with Education;

6) Commission a review of Government Policies (Needs Assessment) for their relevance, and functionality in the current circumstances;

7) Identify, develop and implement improved regional transportation (air and sea); systems which presently significantly limit the growth potential of the ECCU. Additionally, effect measures which significantly impact a reduction of cost of travel by air and sea;

8) Establish trade facilitation processes, programs and focal points within each member territory of the ECCU.

D. Discussions - Group 4

This group focused on the thematic areas of:

1) Goods Market Efficiency
2) Financial Market Development
3) Institutions
4) Macroeconomic Factors
5) Technological Readiness

Challenges identified:

i) Lack of data from Member States.

ii) Cultural Hindrances including the resistance to changing and working together across the region.

iii) Ease of Doing Business
   a) Difficulties in doing business with each other in the region
   b) Lack of and access to finance

Group 4: Summary of Recommendations

1) Educating the public on the importance of data collection and the value of use of data; in combination with trust building among stakeholders to accept and understand data.
   i) Developing a central repository of Big Data which can be tapped into when necessary by any member state
   ii) Enforcing legislation for more regular data collection

2) Dialogue and open communication to sensitize stakeholders on their respective roles in nation building
   i) Adoption of the Grenada Social Partners model amongst other ECCU member states

3) Mandating the need for businesses to join a business support organisation through legislation
   i) Using the Ease of Doing Business as a guide to remove barriers for investors both nationally and internationally, and to assist generally with improving business culture for locals as well as foreigners
   ii) Creation of a Regional Development Fund to finance Small and Medium enterprises (SMEs).

E. Discussions - Group 5

This group focused on the thematic areas of:

1) Institutions
2) Infrastructure
3) Goods Market Efficiency
4) Financial Market Development
5) Macroeconomic Factors

6) Technological Readiness

7) Human Resources Development

Challenges identified:

i) Transportation / Access

ii) Productivity

iii) Strengthening Human Resource

Group 5: Summary of Recommendations

1) Facilitating the Movement of Goods and People in the OECS and the wider CARICOM Region
   a) Conduct Situational and Cost-Benefit Analysis of LIAT with the objective of improving service or resolving the ongoing problems/complaints (route, cost, passenger load etc.)
   b) Explore alternate transportation system in a collaborative manner (OECS, CARICOM)
   c) Improvement in service (customer service and general)
   d) Promote the agenda of intra-regional travel (Regional Tourism)
   e) Promote a keener awareness of OECS integration which will produce a spirit of community and strengthen functional cooperation

2) Establish some sort of guidelines to define, support and measure productivity
   a) Task for pay orientation
   b) Support to MSME's
   c) Easy access to credit
   d) Marketing and Entrepreneurial expertise
   e) Investment in technology
   f) Think tanks for R&D (e.g. of Ministry of the Future in S. Korea)
   g) Enforce process for documentation (data / statistics)

3) Improvements in health care and nutrition

4) Strengthening our education and social systems to underpin our growth strategy

5) Enhancing ICT (incubators for youth in technology and critical thinking)

F. Discussions - Group 6

This group focused on the thematic areas of:

1) Institutions
2) Infrastructure
3) Goods Market Efficiency
4) Financial Market Development
5) Macroeconomic Factors
6) Technological Readiness
7) Human Resources Development

Challenges Identified

1) Human Resources and Educational system
    a) Improper use of human resources
    b) Education system which is not meeting the needs of the business sector
    c) Work ethic which leaves much to be desired especially as it relates to productivity
    d) The quality of labour force is not equipped to meet practical needs
    e) There is a variance between the Demand vs the Supply of candidates for the labour force
    f) Education should be seen in a balanced way and the true scope of Technical and Vocational Education and Training (TVET) evaluated
    g) Teaching methods which lacks creativity or arouse students' interests

2) Lack of reliable regional Transportation
    a) Flawed Logistics
    b) High and increasing cost
    c) Uncertainty as to the present deployment of the most appropriate technology

3) Investment – lack of sufficient education and awareness on the availability of investment opportunities

   a) Government is not really a source of investment
   b) Domestic private sector does not have the required resources for making the commitment for investment
   c) Foreign investors look mainly at weak labour laws, and labour force productivity
   d) High cost and inefficiency of telecommunications
   e) High cost of energy

Group 6: Summary of Recommendations

1) Education

   i) Recalibration of education system – reorient the way the children are taught and encourage more problem solving, searching and asking questions from an early age. Also develop more internship programs
   ii) Vested Interest and embedded culture – there is a need for all parties (parents, teachers, policy makers) to have a vested interest to change, and take the bold move to make the culture changes necessary

2) Investment

   i) Reform to Financial Intermediation Systems for ease of access, transparency and evidence based funding
   ii) Improve Investment climate for investors and the clientele they serve

3) Transportation

   i) Give serious consideration to improved logistics of persons and products with respect to air and maritime transportation.
   ii) Explore more cost effective ways to conduct interregional trade

4) Appropriate Technology should be used to ensure the use of equipment, tools and techniques that utilise the new frontiers of technology.

G. Discussions – Group 7

This group focused on the thematic areas of:

1) Human Resources Development
2) Innovation
3) Institutions
4) Infrastructure
5) Goods Market Efficiency
6) Financial Market Development

Challenges Identified:

i) A lack of focus on Technical and Vocational Skills at the local level. This results in less available manpower for other industries. The absence of an apprenticeship programme hinders the development t individuals in these areas. (Higher Education and Training)

ii) Financial aid or support for development is limited or absent.

iii) Intra-regional transportation – OECS Distribution and Transportation Company – similar companies (Infrastructure)

iv) The Role of agriculture as a growth enhancer in the ECCU economy is not being maximised.

Group 7: Summary of Recommendations

1) Education
    i) Refocus the education system to be more demand driven and include TVET and apprenticeship programmes and partnership with the private sector.
    ii) Sharing region wide the St Kitts and Nevis Model for TVET.
    iii) Closer collaboration on the goal of education in the region. Focus on developing world class citizens

iv) Analytical skills should be emphasised in the delivery of education in the region. Effectively incorporate technology as a working tool for the citizens of the region.

v) Private sector should be proactive and interested in investing in the skills and training development of their employees.

vi) Productivity should be an integral part of all worker organisations with positive reinforcements and rewards for achieving and surpassing benchmarks during tripartite negotiations.

vii) The German's Dual System of vocational Education and Training (Dual VET) system offers a workable template which can be piloted in the Financial sector.

2) Agriculture

i) Systematic reorganisation and investment in sustainable agriculture to facilitate food security, health and wellness and to create further linkages within the economy.

ii) Encourage and facilitate Intra-regional trade to aid with the reduction of the expanding food import bill across the ECCU.

iii) Agriculture can provide significant absorption capacity for both skilled and unskilled employees.

iv) Pursue, at the national level, the best practice of environmental responsibility through the development of natural resources. This will lead to development of growth within the local economies.

v) The use of diverse forms of technology (drip irrigation, various forms of hydroponics, and aquaculture) now offers real options for increasing food security, foreign exchange earnings, and a wide variety of wholesome and non-genetically modified food.

3) Intra-regional Trade and Transportation

i) Further development of the logistics, connectivity and infrastructural framework which was suggested by the Caribbean Growth Form (CGF) to maximise areas such as logistics and cost efficiency.

ii) More efficient air and sea transportation

H. Discussions - Group 8

This group focused on the thematic areas of:

1) Macroeconomic
2) Business Sophistication
3) Institutions
4) Human Resources Development
5) Financial Market Development

Challenges Identified:

i) Each island makes decisions individually rather than collectively, despite having conferences such as the Growth Dialogue. The information coming out of meetings such as the growth forum are generally not filtered down to the wider society.

ii) Lack of implementation of recommendations and accountability.

iii) Inefficiency of importing/exporting mechanism (in terms of time and money) which makes it difficult to do business.

iv) The attitude toward agriculture is negative as a result of the sector being too traditional; hence, unattractive particularly to young people.

v) Shortage of skilled workers in the labour force in important areas. Possible mismatch of skills demanded as compared to those readily supplied.

vi) The education system teaches students by rote rather than eliciting their enquiring and learning abilities.

vii) Current environment and policies limit access to credit.

viii) Appropriateness of financing. Commercial banks may not be suited to giving the type of credit that is being demanded.

Group 8: Summary of Recommendations

1) Make efforts to make a wider cross sections of the constituents educated and aware by inviting technocrats from various ministries to attend such conferences.

2) Duplicate this conference on a national level.

3) The integration process/ creation of a single financial and economic space should be advanced through iterative processes of education and piloting of initiatives in all countries.

4) Governments could encourage students to study at the University of the West Indies in order to promote regional integration.

5) There should be an adequate monitoring and evaluation mechanism in countries.

6) Better project management knowledge and skills development across the ECCU.

7) Improve transparency nationally and region wide.

8) Ensure the formal role for civil society in the monitoring and accountability process.

9) Streamline the processes to make it more efficient.

10) Modernise and reform including privatisation.

11) Make the agricultural sector less traditional and more modern to alleviate the unemployment problem.

12) Market locally produced goods as a part of a healthy living lifestyle.

13) Use the education system to modernise agriculture.

14) Review and reform of education system.

15) New meeting ensure that enough time is given to allow participants to discuss issues. Politicians dominated the forum. The format of the Growth Dialogue should be relooked. Perhaps another day could be added to allow social partners more time.

I. Discussions – Group 9

This group focused on the thematic areas of:

1) Infrastructure
2) Business Sophistication
3) Institutions
4) Human Resources Development
5) Innovation

Challenges Identified:

i) Establishing achievable targets such as the following:

   a) 5% growth per annum by ECCU territories

   b) Creating some 60,000 new jobs over the next five years

   c) Instituting reforms which enables all of the OECS countries to achieve standings in the top 50 of the Doing Business Report

ii) Developing an environment which are robust enough to offset the headwinds of activities which originate in the developed countries such as:

   a) Unannounced return of deportees,

   b) Sanction and stigmatising the ECCU's offshore banking in the name of de-risking and fears related to the existing citizen by investment programmes (CBI).

Group 9: Summary of Recommendations

1) Private sector driven growth, facilitated by government policies.

2) Create buy in across successive governments, responsibility of social partners presents here for a call to action; local forums to ensure continuity. Legislation to ensure inclusion of social partners to ensure accountability.

3) Reduce the cost of travel. The concentration of job growth irrelevant in an economic union, but constrained by cost of facilitating movement, reduce/remove travel taxes.

4) Implement education reform which can adapt to the needs of the economy 20 years in the future. For example, education that can create jobs that could support the green economy.

5) Develop the creative and sports sector.

6) Create an environment for the growth of a regional IT sector.

7) Create an independent ECCU organisation which holds government to fiscal responsibility or change the composition of the Public Accounts Committee to include competent, independent stakeholders to improve its functionality

APPENDIX 1 Key Thematic Areas

THEMATIC AREAS	BREAK OUT SESSIONS GROUPS									TOTAL
	I	II	III	IV	V	VI	VII	VIII	IX	
INSTITUTIONS *Development in accordance with good governance principles for sustainability e.g. Economic Union*		√	√	√	√	√	√	√	√	**8**
HUMAN RESOURCES DEVELOPMENT a. *Health and Primary Education* b. *Higher Education and Training*	√		√	√	√	√	√	√	√	**8**
FINANCIAL MARKET DEVELOPMENT *Access and availability of funds from a well regulated space with appropriate regulatory and supervisory powers with up to date international best practices for compliance*	√	√		√	√	√	√	√		**7**
INFRASTRUCTURE *The establishment, development for air, land, sea transportation, utilities, roads, logistics and connectivity*			√	√	√	√	√		√	**6**
MACROECONOMIC *Matters of economic management, fiscal, pro-*		√	√	√	√	√		√		

THEMATIC AREAS	BREAK OUT SESSIONS GROUPS									TOTAL
	I	II	III	IV	V	VI	VII	VIII	IX	
growth policies for scarce resources utilisation										**6**
GOODS MARKETS EFFICIENCY *Supply chain, value added, consumer health and safety, Market research and consumer satisfaction*		√	√	√	√	√	√			**6**
LABOUR MARKETS EFFICIENCY *Availability of numbers of skilled persons, adequacy in skills, professionalism, accreditation and productivity*					√					**1**
TECHNOLOGICAL READINESS *The willingness and ability of the widest reach of beneficiaries to access and utilise technology for increased safety, security and functionality of business processes*		√		√	√	√				**4**
BUSINESS SOPHISTICATION *The business environment which makes it easy to conduct business, with the necessary policies, business support organisations, tools and*	√		√					√	√	**4**

THEMATIC AREAS	BREAK OUT SESSIONS GROUPS									TOTAL
	I	II	III	IV	V	VI	VII	VIII	IX	
techniques and technologies										
INNOVATION *Moving in harmony with business innovations, research and development for making business tasks and management less onerous*							√		√	**2**
MARKET SIZE *An ever-present sensitivity to the need for critical mass for business profitability and sustainability*				√						**1**

APPENDIX 2 - WORK PLAN

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
1. That there is a strengthened and functional Economics Affairs Council with Regional Integration Focal Point to implement the following: a) OECS Economic Union; b) OECS Growth and Development Strategy c) Growth Dialogue Action Plan d) OECS Business Council	i. Establish National Focal Points for Regional Integration	• How many National Focal Points for Regional Integration have been established and operational	• OECS Authority • Monetary Council • Economic Affairs Council • Member States Parliaments • Labour unions • Private Sector • Churches • Youths • Civil Society Organisations	2017	
	ii. Ensure legislative cover for carrying out programmes	• Number of member states effectively using the Revised treaty of Basseterre		2017	
	iii. Provide required budgetary support for effective implementation of programmes	• Status ads to budgetary allocation for implementation across member states		2017-2019	
	iv. Create at least 70% awareness of the purpose and benefits of the OECS Economic Union	• Surveyed results of the level of education and awareness across the ECCU of: ○ OECS Economic Union; ○ OECS Growth and Development Strategy ○ ECCU Growth Action Plan ○ OECS Business Council		2017-2019	
	v. Create a region wide familiarity with the purpose and benefits of the OECS Growth and Development Strategy			2017 – 2019	
	vi. Create a region wide familiarity with the purpose and benefits of the ECCU Growth Action Plan			2017- 2019	

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
	vii. Create a region wide familiarity with the purpose and benefits of the OECS Business Council as the private sector representatives.			2017-2019	
	viii. Establish operational frameworks for the regional integration activities	• Number of functional teams • Records of the level of regional and national "buy in" and support level and deliverables completed.	• National Team • OECS Commission Rep. • ECCB Representative • Parliamentary representatives • Other representatives ○ Labour unions ○ Private Sector ○ Churches ○ Youths ○ Civil Society Organisations		
	a) Identify priority areas for each period e.g. for Growth, Competitiveness or Employment	• Number of priorities identified for the ensuing year;		June 2017	
	b) Constitute programme champions regional and national	• Number of programme champions identified at regional and national levels;		July- August 2017	

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
	c) Establish teams and deliverables	• Status on establishment or operations;		July- August 2017	
	d) Issue clear terms of reference on each deliverable			July- August 2017	
	e) Convene regularly to ensure implementation	• Attendance records of team work activities;		2017 - Ongoing	
	f) Identify and implement two regional integration initiatives per year e.g. free movement,	• Number of integration initiatives identified for implementation:	• National Team and Other co-opted persons.		
		○ Free movement technical sessions		July 2017	
		○ Lectures on the OECS Economic Union		July 2017	
		○ Common Hurricane Responses programme		July 2018	
		○ Common coastal environmental protection programme		July 2018	
2. That the Growth Dialogue Action Plan is implemented in a sustainable manner across the ECCU	i. Establish National implementation teams for the Action Plan.	• Establishment, attendance records, support level and deliverables completed.	Representatives from: • OECS Commission;	June 2017	

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
			• ECCB; • Member governments; • Opposition parties; • Private Sector; • Civil society; • Churches; • Youths; • Trades and Labour Unions		
	ii. Schedule deliverables for the ensuing year for implementation region wide.	• Number of deliverables scheduled, started, state of completion, impacts region wide		July 2017	
	iii. Implement deliverables in each country.	• Number of deliverables scheduled, started, state of completion, impacts nationally		July 2017 – January 2018	
	iv. Report on Implementations schedule of the Action Plan	• Reporting done to sector, party, national parliaments and regional organisations		July 2017- January 2018	
3. That a Public Outreach on Common Policies Programme be institutionalised across the ECCU	i. Establish a core committee with national focal points.	• Status on formation of the core committee,	Representatives from: • OECS Commission; • ECCB; • Government Information Systems • Opposition parties; • Private Sector; • Civil society; • Churches; • Youths; • Trades and Labour Unions • Sundry media	April –May	

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
	ii. Design and develop a comprehensive Public awareness and education programme using all media	• Status of completeness and comprehensive scope of the outreach programme based on constituent inputs and feedback		May – June	
	iii. Launch National Public Outreach on Common Policies via Video Conference with Quarterly VC meetings of Growth Dialogue attendees.	• Establishment, attendance records, support level and deliverables completed.		July- August	
	iv. Schedule deliverables for targeted common policies for the ensuing year for implementation.	• Number of deliverables scheduled, started, state of completion, impacts region wide		August 2017 – January 2018	
	v. Implement year round deliverables in each country.	• Number of deliverables scheduled, started, state of completion, impacts nationally		October 2017 – Jan 2018	
	vi. Report on Implementations schedule of the Outreach Programme	• Reporting done to constituents, sectors, industries, national parliaments and regional institutions			
4. That Common Policies Units established or strengthened in each member state (Grenada or CGF Model	i. Launch National Public Outreach on Common Policies.	• Establishment, attendance records, support level and deliverables completed.	• Representatives from: • Government Information Systems • Opposition parties; ○ Private Sector; ○ Civil society; ○ Churches; ○ Youths; ○ Trades and Labour Unions ○ Sundry media organisations	May – June	

THEMATIC AREA #1 - INSTITUTIONS

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
	ii. Schedule deliverables for targeted common policies for the ensuing year for implementation.	• Number of deliverables scheduled, started, state of completion, impacts region wide		July- August	
	iii. Implement deliverables in each country	• Number of deliverables scheduled, started, state of completion, impacts nationally		August 2017 – January 2018	
	iv. Report on Implementations schedule of the Action Plan	• Reporting done to constituents, sectors, industries, national parliaments		October 2017 – Jan 2018	

THEMATIC AREA #2 – HUMAN RESOURCE DEVELOPMENT

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
1) Development of a dynamic and responsive Educational System to meet the diverse human resources development needs of the OECS through:					
a) Development of the business ecosystem and productivity led and economically competitive firms,	i) Institutionalise on the job training, certification and accreditation for the workers in ECCU key sectors	1. Number of persons from the key sectors who have received on the job training, certification and accreditation.	Individuals, firms, Chambers of Commerce, Business Associations, Coalition of services providers, ECCB		

THEMATIC AREA #2 – HUMAN RESOURCE DEVELOPMENT

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
b) Development of a skilled human resource,	i) A refocused, reoriented education system which incorporates technical and vocational education as a mainstream part of the curriculum.	2. Number of programmes being piloted which incorporates technical and vocational education as a mainstream part of the curriculum.	Tertiary institutions, Technical and Vocational schools,		
c) Development of an enabling environment which facilitates "Doing Business;"	i) National policies harmonised with regional reforms implemented in a systematic and programmed way to improve standing in the Doing Business ratings in the ECCU.	3. Number of harmonised programmes with regional and national support from labour, employers and governments to improve the standing of ECCU member states to below the top 50 in Doing Business ratings.	ECCU Member Governments National Reform Management Offices		
d) Standards institutions to ensure compliance with international standards of trade, grades and standards.	i) Establish where non-existent and improve existing ones with appropriate staff, equipment and financing.	4. Number of functional Bureau of standards offering services in the ECCU	Bureaus of Standards, Ministries of Finance, Trade, World Intellectual Protection Office (WIPO)		
e) The presence of advocacy consumer and producer organisations	i) Establish where non-existent and improve existing ones with appropriate staff, equipment and financing for growth and transformation in the member states	5. The number of advocacy consumer and producer organisations established or being developed across the ECCU.	Consumer Cooperatives, Producer cooperatives, Ministry of Cooperatives, Single Regulatory Organisation for Cooperatives		
f) Strategically operationalise cluster development, accelerator, incubator and innovation centres in collaboration with national tertiary institutions.	i) Establish where non-existent and improve existing ones with appropriate staff, equipment and financing	6. Listing of cluster development, accelerator, incubator and innovation centres.	Business Support Organisations, International Organisations, Government Ministries		
g) The presence of trade facilitation mechanisms; logistics, supply chains, distribution and travel institutions such as the (ODTC).	i) Establish where non-existent and improve existing ones with appropriate staff, equipment and financing	7. Listing of the presence of trade facilitation mechanisms; logistics, supply chains, distribution and travel institutions such as the (ODTC),	Competitiveness Business Unit (CBU), formerly Export Development Unit of the OECS, Caribbean Export Development Agency (CEDA), ODTC, Brokers, Business Enterprises Commercial Banks.		

THEMATIC AREA #3 – FINANCIAL MARKET DEVELOPMENT

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
1) Provide access and availability of finance for modernisation and growth through national and regional business support institutions such as:					
a) Capitalised and fully functional Eastern Caribbean Export Guarantee Scheme Company (ECECGSC)	i) Complete public education and awareness, incorporation and launching of the ECECGC to finance SMEs	8. Number of pipeline companies assessed and enlisted in the programme	ECECGC Board, Staff, its Financiers and client firms		
b) Amalgamated and modernised Credit Unions.	i) Complete public education and awareness, facilitate the amalgamation and modernisation of credit unions for financing growth through SMEs	9. Volume and value of business transacted though the credit union for selected time periods.	Credit Union Board, Staff and its shareholders, and regulators.		
c) Rationalise Micro-finance institutions to maximise efficiency while minimising administrative costs.	i) Enlist business support organisations to partner with microfinance institutions to provide technical support to contracting SMEs	10. Volume and value of technical assistance service provided by business support services to micro finance institutions.	SRUs, NBFOs, Member Governments of the ECCU, and clients		
d) Well governed, adequately-funded Development Banks to serve the developmental role in the regional growth agenda	i) Properly diagnose for efficiency and effectiveness, augment identified human and other resources gaps, make offerings to the public in a manner accessible and transparent to all SMEs.	11. Volume and value of business transacted though the Development Banks by enterprises, sector or industry.	Member Governments of the ECCU, Development Banks Boards, their SMEs clientele.		
e) Providing factoring and lease services to maximise the number of possible business cycles financial hardships of individuals and firms by providing.	i) Establish where non-existent and improve existing opportunities for trade facilitation mechanisms in the areas of factoring and leasing.	12. Number of leasing and factoring companies providing services in the ECCU. Monitor and evaluation reports circulated to stakeholders	Investors, Leasing and factoring companies, SMEs, SRUs, Development Banks, Development Boards, International financial Institutions (EIB, IFC, CDB)		

THEMATIC AREA #4 - INFRASTRUCTURE

MAIN OBJECTIVES	ACTIVITIES TO BE UNDERTAKEN	KEY PERFORMANCE INDICATORS	COLLABORATING PARTNERS	TARGET DATE FOR COMPLETION	COMMENTS
1. The establishment or development of the regional and national infrastructure for reliable and sustainable **Air t**ransportation	i) Agree on a core committee with national focal points	13. Documented status of establishment and convening of meetings by this committee	OECS Commission, ECCB, OBC,		
	ii) Conduct situational and Cost-Benefit analysis of LIAT with a view towards improving the service, resolving ongoing problems/ complaints (route , cost, passenger and load)	14. Did the cost benefit analysis get done and the status of progress with the deliverable			
	iii) Identify a group to explore alternative system in a collaborative manner; OECS and CARICOM	15. Was the group to explore alternative systems formed and what is the status of progress with the deliverable;			
2. The establishment or development of the regional and national infrastructure for reliable and sustainable **Sea** transportation	i) Review the various sea transportation projects with a view to choosing one as a pilot and as means to facilitate regional trade				
	ii) Review the various sea transportation projects with a view to choosing one as a pilot and the means to facilitate regional travel for the people				
3. The further development of the regional and national infrastructure for reliable and sustainable delivery of **telecommunications** services	i) Initiate advocacy through regional and national collaboration to present case to ECTEL and NTRCs to improve costing and efficiency of telecommunications in the ECCU.				
4. The further development of the regional and national infrastructure for reliable and sustainable **logistics and connectivity**	i) Contact and survey				

APPENDIX 3

PLANNING COMMITTEE

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APPENDIX 4

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APPENDIX 5

ACRONYMS

BDS:	Business Development Services
BMC:	Borrowing Member Country
BNTF:	Basic Needs Trust Fund
BSA:	Business Support Agency
BSO:	Business Support Organisation
B2B:	Business to Business
CAIC:	Caribbean Association of Industry and Commerce
CARDI:	The Caribbean Agricultural Research and Development Institute
CBI:	Citizenship by Investment
CCI:	Culture and Creative Industries
CCMF:	Caribbean Centre for Money and Finance
CDB:	Caribbean Development Bank
CDF:	Caribbean Development Fund
CGF:	Caribbean Growth Form
DFC:	Development Finance Corporation
MSM:	Micro, Small and Medium Enterprises
NIS:	National Innovation Systems