SUPPORTING ECONOMIC TRANSFORMATION

The COVID-19 pandemic in the Caribbean: exposing existing economic vulnerabilities

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Key messages

- The Caribbean faces an unprecedented economic shock from COVID-19 as demand for its major export service (tourism) has collapsed. In response, many countries have initiated fiscal stimulus packages, some with support from international donors.
- However, many countries in the region are already heavily indebted and, while the effects of the current shock must be mitigated, more systemic issues also require tackling. Countries should avoid increasing their debt service obligations and instead secure debt for resilience swaps in order to build resilience to natural disasters, confront the imminent threat of climate change and build the climate-resilient infrastructure needed to boost trade and export diversification.
- G20 members must acknowledge the need for specific measures to assist small states to adapt to the global pandemic; this includes the role of remittances, for which costs of transfer must be reduced.

Introduction

The COVID-19 pandemic is once more providing eloquent testimony on the vulnerability of the Caribbean to shocks, affecting every single economy in the region and trading partners. It is exposing acute economic vulnerabilities in Caribbean economies and requires both a coordinated response to deal with immediate effects and a need to tackle systemic issues related to the international trade and finance architecture.

The Caribbean region is among the most vulnerable on the planet to shocks, including those associated with natural disasters and climate change. This is because of its high concentration on a limited number of export sectors to drive growth. The region is arguably the most tourism-dependent of the globe and will see massive losses in this sector, affecting millions of lives and livelihoods. This comes after a stellar performance last year, with 31.5 million stay-over arrivals (half of them from the US). The drastic reduction in tourism will have a major adverse impact, not just on big business but also on taxi drivers, small shop owners, artistes, small-scale suppliers to hotels and the hundreds of thousands who work in hotels across the Caribbean. There is a risk of a greater number of Caribbean people falling into poverty.

The vulnerability of the Caribbean tends to be seen through the lens of natural disasters, given the increasing intensity and frequency of natural disasters associated with climate change: Hurricanes Maria and Irma in 2017 were responsible for Dominica losing more than 226% of GDP. However, the international system has so far failed to assist the region to confront these inherent structural vulnerabilities. Accessing finance remains challenging. Debt levels and servicing costs as a share of total trade are high. Moreover, families remain penalised by high costs associated with remittances. These issues, combined with the effects of the global pandemic and ensuing recessions, present a severe test for governments in the region. While policy responses have included stimulus packages to bolster tourism and other sectors, more systemic issues must also be confronted.

Economic and social costs

Looking ahead from April to December, a 50% decline in tourism arrivals will result in estimated losses to GDP ranging from 4% in Trinidad and Tobago to 20.3% in Barbados and 26% in The Bahamas. Given the scope and scale of the economic shock – where entire countries in the region are in some form of total shutdown – the road to recovery will be long and hard. The current crisis is about not only the tourist dollar but also other sectors, such as oil, where new producers such as Guyana have entered the market at a time when it is witnessing a near collapse in prices.

A silver lining for families in the region relates to the flow of remittances. According to the World Bank, last year, Haiti received close to $3.2 billion; Jamaica an estimated $2.3 billion; and Guyana approximately $300 million from this source. However, massive layoffs already taking place in key remittance countries will affect this steady stream of resources. A sustained contraction in these economies could have a major impact on the flow of precious remittances for

Caribbean families. The cost of remittances continues to be unacceptably high. Precious dollars are being diverted into transaction costs instead of going to poor families. The G20 and the international financing system have recognised the need to help bring these costs down but progress has been mixed. According to the World Bank's recent survey on the prices of remittances, the percentage cost of sending $500 from the US to Jamaica averages 6.4%, and to Guyana 7.1%. While this does not seem costly at first glance, when one looks at the total value of remittances going to Jamaica and Guyana on an annual basis, which stood at $2.3 billion and $300 million, respectively, in 2019, the amount of funds lost is staggering, especially when considered over a 10-year period. While some international banks have reduced costs of borrowing, the cost of transferring deserves urgent attention now by the G20 as it meets this week. Globally, cutting costs by 5% could save $16 billion a year – resources urgently required.

Fiscal stimulus

Notwithstanding the challenges, governments in the region have made efforts to address the threat to lives and livelihoods posed by COVID-19. Some countries have introduced some form of support to their economies and the most vulnerable people. These include The Bahamas, Belize and Trinidad and Tobago. Based on a preliminary assessment by ODI, the average stimulus package to respond to the pandemic for small countries like those in the Caribbean averaged 1.8% of GDP. In comparison, the average support package for G20 countries averages around 8.1% of GDP.

The room for manoeuvre in the region is limited because, in addition to being small and vulnerable economies, many countries in the Caribbean are also extremely indebted. The average debt-to-GDP ratio exceeds the international benchmark of 60% in 11 countries in the region, according to CDB. Therefore, borrowing at market rates will further increase our debt, which are already unsustainable. Small states, some of which have a public debt to GDP ratio of over 100%, are simply unable to invest in long-term solutions that can build resilience because of the constraints of debt servicing.

Building resilience

While the immediate need is to jumpstart economies, the future requires the building of resilience. We must secure a sustainable structural economic transformation trajectory. In order to achieve this, finance is vital, but it should not lead to further debt. Both the Commonwealth and the Economic Commission for Latin America and the Caribbean have proposed a variant of a debt swap for climate action for the region (the Climate Adaptation Swap Initiative) whereby, instead of repaying external debt, an arrangement with external creditors for the equivalent amount owed is used for climate action. This allows for investment in climate action while simultaneously relieving highly indebted Caribbean countries from the burden of continued servicing of their crippling debt burdens, which increase with every natural disaster in a constant disaster–debt cycle.

Confronting systemic issues

Policy work must now be translated into an action agenda, with the requisite political capital invested to achieve progress. The region must collectively address issues within the current system of country classification for international financing. There must be reform of the access criteria to concessional finance, with ex-ante flexibility in lending. Caribbean countries except for Haiti are largely classified as either middle- or high-income countries, and therefore ineligible for concessional financing from international financial institutions. However, this classification is flawed. With a single Category 4 or 5 hurricane, a generation of development gains can be lost within hours. These annual occurrences of natural hazards provide powerful testimony on the inadequacy of a classification system where per capita income plays such an important role.

The Caribbean, along with another major SIDS region, the Pacific, should form an alliance focused on securing grant financing for 'vulnerable countries', to address the catastrophe created by COVID-19. Votes at the UN and elsewhere should be used in a more strategic manner, with support for candidates for the UN Security Council, especially those that have influence in the OECD and international financial institutions, forthcoming only if specific commitments are made on these matters.

When G20 ministers meet this week to consider trade investment and tourism, they must give credence to the overwhelming economic dependence of SIDS on services trade; this includes remittances, for which the costs of transfer must be reduced.

The Caribbean faces some of the highest trade costs in the world, which can be reduced through investments in climate-resilient infrastructure. Securing debt swaps for climate action could assist in building the climate-resilient infrastructure needed to boost trade and export diversification, therefore reducing economic vulnerability.

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