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CARIBBEAN REGION QUARTERLY BULLETIN

Real Growth remained weak during the first half of 2013 in The Bahamas, Barbados and Jamaica. On the other hand, Guyana and Suriname are expected to outperform the region with an average growth rate of 5% in 2013. There are some signs of recovery in Trinidad and Tobago, however, growth in the energy sector has not taken off yet.

SELECTED INDICATORS 2013, WEO PROJECTIONS	Real Growth Rate	Inflation (12 month change)	Public Sector Primary Balance	Current Account Balance (%GDP)	General Government consolidated Debt (%
1) Highly indebted					
Jamaica	0.6	8.3	7.5	-10.3	142.8
Barbados	0.5	-0.3	0.6	-6.1	72.3
2) Medium indebtedness					
Bahamas	2.7	2.0	-3.6	-13.7	56.5
Trinidad & Tobago	2.0	5.0	0.3	10.3	36.4
3) Low-debt or FSO countries					
Suriname	4.5	4.5	-1.4	3.9	20.0
Guyana 1/	5.5	6.0	-1.7	-14.1	61.3
Caribbean Average	**2.6**	**4.3**	**0.3**	**-5.0**	**64.9**

Source: WEO and national authorities.
1/ Most debt is on concessional terms

Summary of Recent Developments by Country

In The Bahamas, the government has emphasized its commitment to reduce crime given the latest worrying statistics. The fiscal consolidation plan, outlined in the 2013/14 Budget, was well- received by international investors.

In Barbados, economic output fell by 0.6% in the first half of 2013 due to major declines in its foreign-earning sectors, while the fiscal accounts continued to deteriorate during that period. The government has presented its Financial Statement and Budget Proposals for 2013, which targets net fiscal saving equivalent to about 4.8 percentage points of annual GDP by March 2015.

Guyana's economy is projected to grow 5.5% in 2013, driven by the traditional sectors (excluding sugar) and the expansion of public and private investment. However, the current account deficit could reach 15.4% of GDP this year as a result of lower sugar exports and falling gold prices.

In Jamaica, the recent IMF mission confirmed progress in meeting the program's structural and quantitative targets to end- June. The government is now focused on its growth agenda and will try to reduce the constraints to growth and facilitate new investments. Concerns include the possibility of increasing interest rates, growing imbalances in the external accounts, low international reserves levels, political resistance to reforms and increasing security conflicts.

In Suriname, the economy continues to perform well but there are increasing concerns regarding the recent expansive fiscal measures, particularly in light of the decrease in gold prices . Suriname joined the South Common Market (MERCOSUR).

Trinidad and Tobago's economic growth during the first quarter of 2013 was driven mainly by the non-energy sector. The government continues to encourage new oil and gas explorations following the release of new indicators confirming declining natural gas reserves. Crime statistics have been deteriorating in the last years.

Special Country Reports in this Issue…

What have been the main constraints to growth in past years?
In The Bahamas and Barbados, **financial access** remains an obstacle for the development of the private sector, in particular of small and medium-sized enterprises. Other challenges include **the high cost of energy and a loss of international competitiveness**. In Guyana, the export basket remains heavily weighted towards commodities such as gold with volatile prices. The major constraints identified by Jamaican firms are associated with **high tax rates** and **inefficient public administration. Crime, expensive electricity** and **lax business practices in the formal sector** have also affected Jamaican private sector growth in the last years. In the case of Trinidad and Tobago the most binding constraints to the development of the non-energy sector are related to **market inefficiencies,** while low labor productivity and high crime costs have also discouraged private investment.

In Suriname, we study the **informal sector evolution and what it means for fiscal performance.** Our findings indicate that the size of the informal economy fell after 2000, following fiscal and liberalization reforms.

Regional Report: Focus on Growth Priorities to Obtain Clear Policy Options: a Benchmarking Approach.

In this issue, we discuss a new methodology adapted from the OECD's 'Going for Growth' (GFG) exercise to identify **the main barriers to growth in the IDB-member Caribbean countries.** While it has some similarities to the Growth Diagnostic Methodology developed by Hausmann, Rodrick and Velasco, the main difference is that the GFG approach is concerned with comparability, by developing country benchmarks.

Preliminary results from using the GFG methodology showed that the business climate and the quality of infrastructure are the greatest barriers to growth in these Caribbean countries.

Highlights

The Bahamas received a positive rating from Moody's credit rating agency for its fiscal consolidation plan, as outlined in the government's 2013/2014 fiscal budget, which was presented on May 29, 2013.

Prime Minister Perry Christie emphasized his government's commitment to do whatever is necessary to reduce crime, given the worrying level of murders and other violent crimes that persist in the country.

Weakness in private sector growth continues, due in part to stringent bank lending requirements, high unemployment and a high non-performing loan portfolio.

Recent Developments

Economic output in The Bahamas remained subdued in the first six months of the year. Activity has remained below pre-crisis levels due to modest growth in the construction sector (attributed mainly to activity on the Bahamar hotel development) and weakened hotel performance in the tourism sector. Tourist arrivals in the first four months of the year advanced by 2.7% reflecting the 5.4% increase in sea arrivals, which offset the 6.8% decline in the air arrival component. Hotel performance to May - latest data available - indicated a 6.4% downturn in room revenue year-on-year owing to the softening in the daily room rate and the hotel occupancy rate.

The current account balance improved for the first quarter of 2013 (the deficit was cut by more than half) as the merchandise trade deficit revealed a decline in imports, while the surplus on the services account expanded. The surplus on the capital and financial account was reduced due to a fall in domestic banks' short term foreign liabilities and private loan financing. Offsetting these transactions were the direct investment inflows during the first quarter.

Private sector demand remains weak. A combination of stringent bank lending requirements, high unemployment and a high non-performing loan portfolio has resulted in continued softness in private sector lending. The private sector has identified the lack of access to credit as one of the top impediments to its growth and development. Meanwhile, enterprise surveys indicated that 83% of Bahamian firms use internal sources of finance for investment. Considering the smallness of the average Bahamian firm at 38 employees, and the limited financing vehicles available in the banking system, the broader development of the sector may be slow and uncertain.

Loan arrears remain persistently high at 21% of the total loan portfolio (versus 20% at end-December 2012). The ratio of non-performing loan arrears (arrears in excess of 90 days) grew by 4 basis points to 14.3% of total loans, resulting in overall rises in provisioning levels by the banking system over the first half of the year. The PLP Government's Mortgage Relief plan, which seeks to assist debtors facing foreclosure and those who have already lost their homes, originally estimated that it would assist about 1,100 debtors; however, less than 300 people qualified for the program. To date, no one has been assisted by the plan.

The improvement in unemployment to 14% in May 2013 from 14.7% last year was due to hiring in the construction and manufacturing sectors. The number of employed persons expanded by 1,925 persons, while the number of unemployed declined by 1,175 persons. The total labor force of 192,205 people grew by 1% in this period.

In June, Moody's credit rating agency gave The Bahamas a positive rating for its efforts at fiscal consolidation based on the government's 2014 fiscal budget, which was presented on May 29, 2013. The 2014 budget outlined details of the tax reform program, specifically its plan to establish a value added tax (VAT) in July 2014, alongside reforms in property taxes and improved tax collection methods. These measures are expected to result in a decline in recurrent outlays of 0.5% of GDP each year to reach to 19.1% by FY 2016/17. For capital expenditure, the Government will target an execution rate of 3% of GDP. Given a projected 4 percentage point of GDP increase in revenues from FY 2013/14 to FY 2016/17, the Government expects to run fiscal surpluses by FY 2016/17.

Currently, the deficit is still high. For the first ten months of the FY 2012/13 (ending June), the deficit broadened by $126 million to $391 million due mostly to lower revenue (by $66.1 million). There were declines in tax collections, particularly the international trade component. At the same time, spending increased by $40 million over the same period due to higher transfers to health care facilities.

There has been a marked increase in the threat of crime in The Bahamas. Preliminary data suggest that while crime against property has decreased overall, there remains a high prevalence of crimes against persons, particularly attempted rape. Between January to July 2013, there was a significant increase in

attempted rapes by 116%, (in comparison to the corresponding period for 2012). As of August 12, fifty-eight murders have been recorded for the year 2013. In the 2013/2014 Budget Communication delivered to Parliament on May 29, 2013, Prime Minister Perry Christie emphasized his government's "unflinching commitment to do whatever is necessary to reduce crime, the fear of crime and guarantee law and order in our society". Listed were several initiatives including Project Safe Bahamas; allocating $2 million in the mentioned Budget for the procurement of new police vehicles; the installation of CCTV in the downtown and over-the-hill areas; an allocation of over $8 million to the Police Force to increase manpower by over 450 officers in the last fiscal year; the tripling of the size of the Royal Bahamas Police Force recruitment and training class to 100 officers from the standard complement of 30 and the commencement of a five year process to invest approximately $175 million in the modernization of the marine fleet and harbor facilities of the Defense Force.

Table 1: Crimes in The Bahamas (2012-2013)

Crimes Against Person (All Bahamas)	2012	2013	% CHANGE
Murder	73	58	-20.5
Attempted Murder	13	5	-61.5
Rape	58	57	-1.7
Attempted Rape	6	13	116.7
Unlawful Sexual Intercourse	85	91	6.6
Armed Robbery	592	573	-3.3
Robbery	190	193	1.6
Attempted Robbery	20	17	-15.0
Crimes Against Property	**2012**	**2013**	**% CHANGE**
Burglary	161	151	-6.2
Housebreaking	1523	1201	-21.1
Shopbreaking	468	481	2.8
Stealing	960	977	1.8
Stealing from Vehicle	1328	1284	-3.3
Stolen Vehicle	655	624	-4.7
TOTAL	**6133**	**5726**	**-6.6**

Source: Royal Bahamas Police Force, Nassau, The Bahamas.

There were also measures to improve the justice system. The Minister of State for Legal Affairs announced that as a result of the stark increase in the rate of crime in the country, the majority of the twenty newly appointed judges would be assigned to the criminal court in order to eliminate the backlog and henceforth make swift justice a reality by holding hearings within 12 months of the committed crime. In some cases it takes very long for criminal matters to proceed from the Magistrate's Court to the Supreme Court and even longer to receiving a hearing date. It has been noted that there are over 50 cases that have passed the six-month period where 'judgements have not been rendered', but given the five criminal courts in operation, the capacity is for between 200 and 250 criminal cases to be heard within a year.

The trend is region-wide. According to the Caribbean Human Development Report 2012, homicide rates have increased substantially in the last 12 years across the Caribbean. Although The Bahamas was not included in this assessment, the country has experienced the same rising trend in criminal and violent activity over the last few years. The report recommends that governments revamp public institutions to tackle crime and violence while boosting preventive measures. In emphasizing the need for pan-Caribbean solutions to fighting crime, Prime Minister Christie highlighted that the security of the United States and Canada are also under threat and these countries should therefore "dedicate more resources to enable the region in fighting the scourge of crime", given the limited resources of countries in the region for this effort.

Important Issues for the IDB

In an effort to assist the government with tackling escalating crime in the country, the IDB is embarking on the preparation of inputs for funding a *Citizen Security and Justice Programme,* which will aid in the implementation of targeted social interventions as well as urban planning and development projects, while also strengthening the public sector's institutional capacity to respond to crime.

The Government of The Bahamas has also agreed to be a part of a technical cooperation (TC) aimed at assessing how crime and violence have become one of the main obstacles to human and economic development in Latin America and the Caribbean. The survey will also help increase public understanding of community violence and the ways in which it is inextricably linked to violence in the home. The first component of the TC will address this concern surrounding data, including the collection of primary data on crime and violence in The Bahamas, in collaboration with the Department of Statistics. This baseline empirical data will then be channeled into analysis for the Citizen Security and Justice Programme.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	1.8	2012	2.0	2011
Tourism arrivals (annual % change)	6.3	Dec-13	6.3	Dec-12
Exports (12-month growth)	6.6	Q1 2013	27.3	Q3 2011
Imports (12-month growth)	7.3	Q1 2013	13.9	Q3 2011
Private sector credit growth (%)	-1.5	May-13	-1.4	Feb-13
Inflation	2.0	Dec-12	3.3	Nov-12
Exchange Rate (End of Period)	1.00	May-13	1.00	Apr-13
Unemployment rate (%)	14	May-13	14.7	May-12

Growth in the private sector in The Bahamas remains weak and has been met with significant constraints. The private sector accounts for roughly 80% of GDP and employs over 70% of the work force in 2011. Reports from the same year indicate that most persons working in the private sector are employed in the construction, industry, finance, insurance, real estate, wholesale & retail trade industries. Small firms (5-19 employees) account for the largest number of private sector firms in The Bahamas at 46%. Most of these firms are sole proprietorships averaging 24.2 years in business. The majority of these firms are located in New Providence (Nassau) - the urban center -followed by Grand Bahama, the location of the nation's second city and the rest of the family islands (see Table 2).

Table 2: Financial Indicators for The Bahamas & LAC

Financial Indicators	The Bahamas	Small Firms (1-19 Employees)	Medium Firms (20-99 Employees)	Large Firms (100+ Employees)	LAC
Internal Finance for Investment (%)	83.1	86.4	71.8	94.6	63.2
Bank Finance for Investment (%)	11.7	9.7	20.2	2.2	20.3
Trade Credit Financing for Investment (%)	1.5	2.5	1	0	7.5
Equity, Sale of Stock for Investment (%)	2.2	1.4	2.6	3.2	4.3
Other Financing for Investment (%)	1.5	0	4.4	0	4.7
Working Capital External Financing (%)	28.5	33.1	21.5	26.8	43
Value of Collateral Needed for a Loan (% of the Loan Amount)	231.6	160	252.8	n.a.	197.3
% of Firms with Bank Loans/Line of Creidt	34.2	28.4	43.6	35	47.6
% of Firms with a Checking or Savings Account	97.6	95.7	100	100	92.9

Source: Enterprise Survey.

Prime Minister Christie's June 2013 statement indicated that there is a critical need for the involvement of the private sector in the further development of the economy – an involvement that is characterized as a social responsibility – underscoring the need to address the constraints to its growth and development. Given the integral role of financial investment in the growth and expansion of the private sector, access to finance remains one of the top constraints to growth of the sector. However, at present, the banks' portfolios in the country are inundated with loan arrears, totaling over 20% of total private sector loans. By category, mortgages account for over 10% of total arrears, while the commercial mortgage component has expanded to 4.2% in 2012 from 2.6% in 2008. This is a cause for concern as access to finance is as important as proper planning to ensure a firm's ability to expand its services.

Although the tourism and financial services sectors are leaders in economic activity in the country, for the most part, their growth is dependent on external forces. The impact of the 2008 Great Recession was arguably more pronounced on small- and medium-sized private firms in the country, resulting in a number of layoffs and business closures (the economy contracted by 1.3% and 5.4% in 2008 and 2009, respectively). To address the needs of Small and Medium-sized Enterprises (SMEs), the *SME Development Bill* was drafted to "promote, support and facilitate the development of Bahamian entrepreneurship by providing financial services and business development support to or for the benefit of SME's in all economic sectors throughout The Bahamas, for the purpose of greater participation of the SME sector in economic growth". This will be facilitated through the creation of an agency called SMEDA, which will be set up with IDB technical assistance. The Bill was passed in December 2012. Additionally, the Central Bank of The Bahamas is looking to issue a draft bill for the creation of a credit bureau before summer's end. This process may eventually lead to loan applicants with low risk profiles being able to access credit at reduced interest rates.

Clearly, national and regional initiatives to move the private sector growth forward will be crucial for economic development.

The Caribbean Growth Forum

The Regional Caribbean Growth Forum (RCGF), a private sector-led forum that was endorsed by the governments of the region and facilitated by multilateral and bilateral institutions, was hosted in The Bahamas on June 24-26, 2013, with participation from 15 countries, 200 regional and 150 national participants. The RCGF served three purposes:

1) It was an opportunity to take stock of the process so far, debate the way forward and deepen the discussions among working group representatives on the challenges and potential solutions identified;
2) It was an opportunity to disseminate the analytical work prepared for the dialogue;
3) It allowed for the engagement of policy-makers in a discussion on the long-term growth strategies for the countries and the region.
4) IDB's President Luis Moreno speech at the RCGF highlighted key approaches that the region must take to address the low growth, high debt scenario that is being experienced by many countries of the Caribbean. His message indicated that no longer can the region depend on external conditions for its growth. He stressed the need to export more by diversifying trading partners and exports; addressing the fiscal crisis through pro-growth fiscal adjustment; enabling more investments in infrastructure; developing stronger social safety nets; promoting higher levels of productivity and developing renewable energy

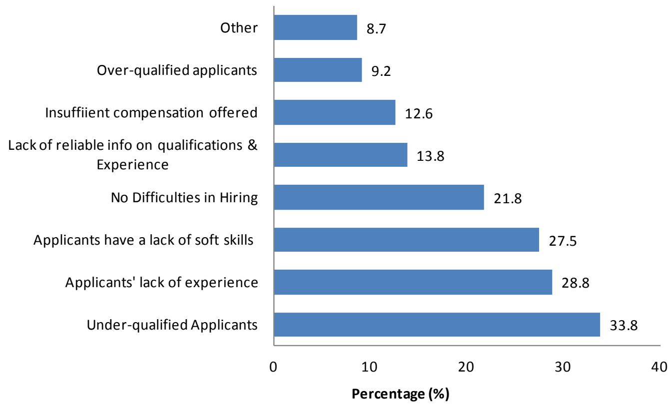
sources. He implored that these objectives could be realized through a grand agreement that would develop out of a consistent dialogue across countries, leading to 'broad accords and actionable plans' for growth and development in the region. He reaffirmed the IDB's support to assist with implementing strategies to improve growth and increase living standards for the Caribbean region.

The Bahamas delegation highlighted the importance of ensuring that SMEs in the country could take advantage of the opportunities created by the large amounts of foreign direct investment (FDI) that flow into the economy. The creation of the SMEDA, the SME Bill and the continued dialogue with stakeholders in the economy, are all ways to address the obstacles facing the private sector, particularly for SMEs in The Bahamas.

One recommendation was that better information should be made available for investors. To modernize the capacity of public sector institutions, the 'Investment Working Group' of the RCGF recommended the creation of a physical and online investment manual. Subsequently, the Bahamas Investment Authority was successful in obtaining a grant from *Compete Caribbean* for financial and technical assistance towards this goal. This initiative will focus on developing a manual and an online portal for the Bahamas Investment Authority (BIA). Further, it will provide information and guidance to both local and foreign investors, with appropriate documentation and workflow that will also facilitate the submission of project proposals. This is intended to attract investment opportunities that are aligned with the investment goals of the country by providing potential investors, with easy access to information on the application processes through a more streamlined online system. Moreover, it will address several of the obstacles facing The Bahamas, as outlined in the World Bank Doing Business Report (2012), in which The Bahamas ranked 85th out of 185 countries.

Another important pillar in the RCGF was the one related to developing skills and productivity, and The Bahamas benefitted from a recent study on this matter. The Bahamas Department of Statistics, with technical support from the IDB's collaboration with the Chambers of Commerce and Employers' Confederation, gathered the 2012 *Wages and Productivity Survey (WPS)* with employers of more than 500 organizations across major industries in the country.

Figure 1: Percentage of Firms that reported the following Criteria as Difficult to Hiring (2012)



Source: Wages & Productivity Survey Preliminary Report.

General findings of the survey for The Bahamas revealed that challenges facing employers include finding candidates with the relevant skill sets while many people remain unemployed after the recent crisis (14.0% in 2013). Additionally, as new investments generate increasing manpower needs, responding to the skills shortage with a skills development strategy becomes a rising social and economic issue. The analysis of the first 2012 WPS also showed that employers value, but have trouble recruiting, job-specific skills, soft skills and basic numeracy and literacy skills. The lack of these skills in the labour force is an obstacle to productivity and limits workers' employability.

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The Bahamas: Selected Indicators

	2008	2009	2010	2011	2012E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-1.3	-5.4	1.0	2.0	1.8
Nominal GDP	-1.0	-5.3	-1.3	4.8	3.5
Inflation (end of period) - Central Bank	4.6	1.3	1.4	3.2	1.9
Inflation (end of period) - IFS	4.5	1.5	1.5	1.0	n.a.
External Sector					
Exports of goods and services	10.4	-14.7	-2.6	19.0	9.6
Imports of goods and services	1.5	-18.9	1.1	12.9	7.3
Current Account (percent of GDP)	-14.9	-10.5	-10.5	-14.0	-16.0
FDI (percent of GDP)	11.6	9.4	12.0	14.9	7.3
(In percent of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government	2008/09	2009/10	2010/11	2011/12	2012/13
Revenue and Grants	16.5	16.8	18.2	16.2	18.5
of which: tax revenue	14.1	14.3	16.4	16.2	16.7
Current Expenditure	17.7	18.0	19.3	19.6	20.1
Capital Expenditure and Net lending	3.3	3.2	3.5	4.4	1.5
Primary Balance	-1.0	-0.9	-1.1	-2.1	-3.6
Overall Balance	-4.5	-4.4	-4.7	-5.9	-5.9
Debt Indicators					
Central Government Debt	38.5	43.9	43.9	45.7	49.3
Central Government Debt over Revenues	233.0	261.1	247.9	263.0	289.7
External Public Debt (end of period)	5.3	9.1	11.8	12.9	12.8
External debt service as percent of exports of goods and services			11.2	8.1	7.5

Source: Department of Statistics, Central Bank of The Bahamas and IMF WEO April 2013.

BARBADOS

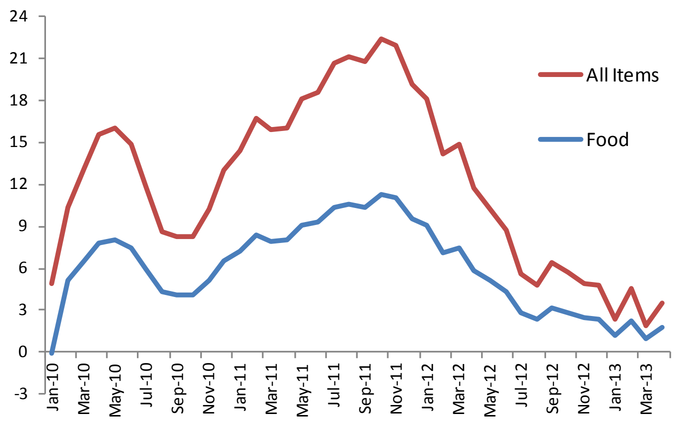
DISAPPOINTING GROWTH AND MORE AUSTERE MEASURES

Recent Developments

Barbados' macroeconomic performance worsened as the economy contracted in the first half of 2013, with major declines in its foreign exchange earning sectors – tourism and international business and financial services (IBFS). Data from the Central Bank of Barbados showed that economic growth fell by an estimated 0.6% between January and June of this year, following no annual growth in 2012. Tourism output declined by 1.4% for the first six months of 2013 as total long-stay arrivals fell by 7%, while earnings dropped by 3%. Barbados' tourism sector has been struggling to regain its pre-financial crisis market share given the slow recovery of its main source markets which has resulted in reduced seating capacity from major airlines and subdued visitor spending. The contraction of the IBFS sector was due in part to the uncertainty created by recent international developments and the weakened domestic economy. Although the number of new licenses issued to IBFS entities increased by 8% up to May, renewals fell by 14%. This sector also faces an uphill battle given the new laws enacted by the Foreign Account Tax Compliance Act (FATCA).

Other foreign exchange earning sectors remained depressed amid weak demand in the global economy. Activity in the agricultural and agro-processing sectors contracted by 11% and 2%, respectively, for the first six months of the year compared with the same period last year. Sugar production declined by 29% given a reduction in both hectares reaped and yields per hectare. Non-sugar agriculture fell by 2% mostly on account of a fall-off in milk and chicken production. There was no major improvement in the non-traded sector.

Figure 1: Inflation: not a current concern...



Source: Central Bank of Barbados.

Highlights

Barbados growth remained subdued in the first half of 2013. Economic output fell by 0.6% between January and June due to major declines in its foreign-earning sectors.

Following a widening in the fiscal deficit to 9.4% of GDP in the first quarter of FY2013/14, the government will have to take immediate austerity measures

Standard & Poor's revised the outlook on its long-term rating on Barbados to negative due to the wider fiscal deficit and the current account risk.

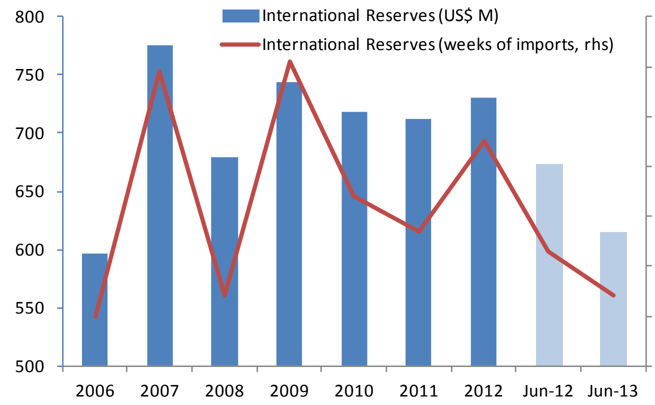
As weak economic conditions linger, the unemployment rate remained high at 11.5% as of March 2013. Given reduced volatility in oil prices, the inflation rate has trended downward since 2011, falling from 9.5% in that year to 4.5% in 2012, and to 2.7% by June 2013. These rates compare with an annual average of 3.5% between 1990 and 2010 (see figure 1).

The reserve position deteriorated sharply, reflecting the lackluster performance of the economy (Figure 2). International reserves were relatively unchanged for most of the first three months of 2013, but fell by US$99.5 million at the end of the second quarter of 2013 given reduced inflows in net long-term private capital. At the end of June 2013, foreign reserves stood at US$615.4 million (equivalent to 16.4 weeks of import coverage), which compares unfavorably to an annual average of US$697 million over the period 2005-2012. The external current account deficit for the first six months of 2013 was 6.3% of GDP, approximately 3.6 percentage points worse than for the comparable period in 2012. Though reserves remain well above the internationally accepted level of 12 weeks of imports, it is expected that the foreign exchange position will worsen for the remaining six months of the year. Therefore, immediate action is needed to mitigate any further decline so as to avoid any balance of payments crisis, as experienced in 1991. The weakened external position also creates additional pressure on the country to devalue its fixed exchange rate against the US dollar.

The fiscal position worsened, forcing the government to take immediate austerity measures. The fiscal deficit-to-GDP ratio for the first quarter of fiscal year 2013/14 widened to 9.4%, up from 6.2% during the first quarter of FY2012/13. Collection of taxes remained weak as total government revenue declined by

8%. Moreover, the government was unable to contain current expenditure, which grew by 3%. Financing for the deficit was achieved mainly through the commercial banks, the National Insurance Scheme (NIS) and private non-banks. Consequently, the debt-to-GDP ratio rose to 90.4% by the end of the first quarter of FY2013/14 (123.4% including the NIS).

Figure 2: The Reserve position continues to deteriorate



Source: Central Bank of Barbados.

The authorities have been open about the need to undertake a fiscal adjustment. The details of the 19-month fiscal consolidation adjustment period, commencing September 2013, were presented in the Financial Statement and Budgetary Proposal for this year on August 13. It underscores the need to undertake a US$200 million fiscal adjustment by the end of fiscal year 2014/15 if the exchange rate parity is to be maintained. The combined revenue and expenditure measures are expected to achieve a net saving of US$205.4 million by March 2015. In particular, significant returns are expected from a reduction in transfers to statutory bodies (US$100 million), the municipal solid waste tax (US$24.7 million), the fiscal consolidation tax (US$21 million), and the domestic asset tax on commercial banks (US$15 million). The adjustments are expected to have the greatest impact on the middle-income households. However, the estimated burden is considered to be relatively small in relation to previous budget measures.

One of the main concerns emanating from the budget is the ability of Government to implement these measures (more specifically on the expenditure side). There were also many areas that have not been addressed fully, such as efficiency in the public sector, the benchmarking for services and other enabling areas for business development, and the utilization of public-private partnerships (PPPs). All these are critical for the sustainability of growth and development. Nonetheless, the direction of the budget has reenergized the confidence levels of investors and has opened dialogue for further discussion with financiers on taking the country forward.

Issues for the Bank to Watch Out For...

The International Monetary Fund conducted a comprehensive review of Barbados' financial services sector. The team was in Barbados July 1 – 17 for the country's third financial sector assessment programme (FSAP). The previous two evaluations were completed in 2002 and 2008. On both occasions, the local financial services sector was deemed to be well-regulated and generally compliant with the international standards established by the Basel Committee on Banking Supervision (BCBS) and the International Association of Insurance Supervisors (IAIS). The findings of the FSAP will help inform the IMF's Article IV mission scheduled for September of this year. The IDB is expected to approve the Fiscal and Energy Programmatic Loans by the end of the country's fiscal year (March 2014).

Standard and Poor's (S&P) lowered Barbados' outlook to 'negative' and warns of possible downgrade. S&P rating services revised its outlook on its long-term rating on Barbados to negative from stable due to the wider fiscal deficits and the persistent current account deficits. The report states that the country risks further downgrade from its already junk status rating if the twin deficits dilemma is not reversed. S&P did however highlight the strength of the political system given the strong social contract (Social-Private Partnership). A further downgrade by Moody's and S&P this year will have an adverse effect on the terms available for new commercial debt.

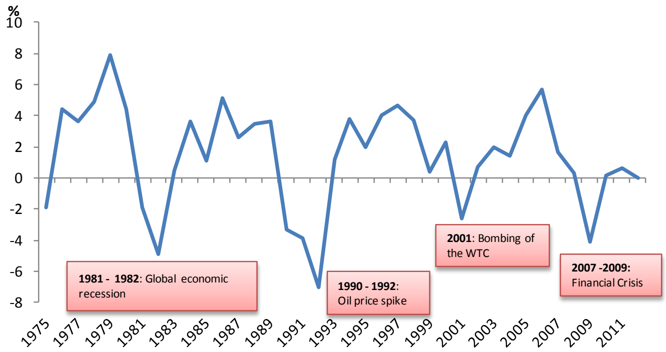
High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	-0.6	Jun-13	-0.4	Mar-13
Tourism arrivals (annual % change)	-6.8	Jun-13	-8.9	Feb-13
Exports (12-month growth)	-10.1	Jun-13	-9.4	Mar-13
Imports (12-month growth)	-4.3	Jun-13	-4.0	Mar-13
Private sector credit growth (%)	-4.0	Jun-13	-1.1	Dec-12
Inflation	2.7	Jun-13	3.3	Mar-13
Exchange Rate (End of Period)	2.0	Aug-13	2.0	Jun-13
Unemployment rate (%)	11.5	Mar-13	11.6	Dec-12

Barbados' Economy Profile[1]

As a small open economy, Barbados has a production base that concentrates on a few goods and services – mainly tourism and the international business and financial services sector. Since independence in 1966, Barbados performed economically well and had one of the highest standards of living in the Western Hemisphere. Barbados retained a high *Human Development Index* ranking since 1990 although its position declined gradually over the years.[2] The country also has a reputation for social and political stability,[3] and has maintained a fixed exchange rate to the US dollar of BDS$2 = US$1 since 1975.

Historically, Barbados depended on sugarcane cultivation and related activities. However, in the 1980s, the economy gravitated more towards light industries and tourism. Today, tourism accounts directly for 12% of GDP and as much as 40% of GDP when indirect spillovers into construction, real estate, and retail are considered. Tourism earnings represent the bulk of total export earnings (on average 43%). It is therefore the main driver of foreign exchange, economic growth and sustainability of the economy. However, this sector is highly exposed to external shocks given its high concentration on three major source markets - the U.K., the U.S, and Canada.

Figure 3: Real Growth In Barbados



Source: Central Bank of Barbados.

Before the 1990s, the growth rates of real GDP in Barbados compared favorably with those of the Latin American and Caribbean (LAC) countries. In subsequent decades, Barbados experienced a slowdown in economic growth and lost its comparative advantage with the rest of the LAC region (Downes 2004), partially associated with the loss of price competitiveness. Since the 2007-08 financial crisis, the Barbadian economy struggled with the challenge of slow growth. In the last five years, real GDP growth averaged -0.6% (see Figure 3). Although low growth is related to the weak global economic conditions, questions can be raised with respect to the country's international competitiveness.

Table 1: Comparing Growth Rates

Countries	1980s	1990s	2000s	Post-Crisis (2007-2012)
Barbados	1.8	0.6	0.9	-0.2
Latin America & Caribbean	2.1	2.9	3.5	3.7
Emerging Countries	3.5	3.6	6.2	6.2
World	3.2	3.0	3.8	3.5

Source: Staffs' calculation based on IMF, WEO.

Given the conundrum of low growth by international standards (table 1), this note attempts to identify the most binding constraints to economic growth in Barbados by adopting the Hausmann, Rodrik and Velasco (2005) growth diagnostic framework.[4] This method is widely used by various researchers and allows policymakers to prioritize reforms so that the constraints are relaxed. The discussions below consider the constraints of low social returns, micro risks, macro risks, and poor access to finance. Various indicators were used to determine if these factors were partially responsible for the impediment of economic growth.

Low social returns

The level of social returns is affected by human capital, infrastructure, and geography. A highly skilled population and a productive workforce are important factors if sustainable growth is to be realised. Despite Barbados' high level of education and a literacy rate of 99.7%, average productivity growth was only 0.7% between 2000 and 2010. This could be partially attributed to the poor utilization of educated persons and the loss of trained professionals to more competitive markets. It is therefore not surprising that the social rates of return on education were found to be low for Barbados. Gill (2013) noted that the heavy subsidization of education has resulted in private returns being much greater than social returns. Therefore, one may argue that, apart from the limited fiscal space, this provides sufficient justification and support for the recent removal of subsidies on tuition fees for Barbadian students come academic year 2014/15. Another option for

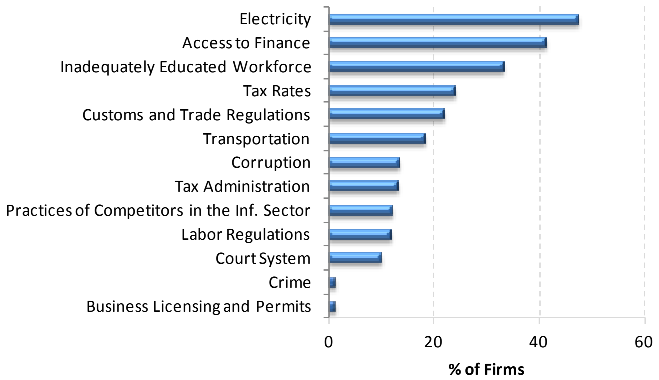
1 This note provides a summary of the IDB report on: Barbados Growth Diagnostic 2013.
2 Barbados ranked 20th and 38th in 1990 and 2012, respectively.
3 Barbados was ranked 15th by Transparency International on the Public Sector Corruption Perception Index.

4 See paper for discussion on methodology.

consideration is to cap expenditure on transfers and subsidies to the institution and finance the areas that are most developmental to the country. These measures could improve social returns and address one of the main constraints in the business environment that was identified by Enterprise Surveys - an *inadequately educated workforce*.

As it relates to infrastructure, about 43% of Barbadian firms indicated that electricity was a major constraint to doing business (Figure 4). World Bank and IDB research has shown that a lack of access to affordable and reliable energy is one of the biggest impediments to growth in the region: energy costs are about four times those prevailing in North America. Barbados' overreliance on imported fossil fuels has become one of the island's major drains on foreign reserves, as on average US$350 million is spent annually on imports.

Figure 4: Constraints to Business



Source: The World Bank 'Doing Business'.

Natural disasters and climate change hinder growth possibilities through the loss of capital, labor and land. Barbados, being the most easterly of the Caribbean islands, is susceptible to coastal beach erosion along the west and south coast and cliff instability along the east coast, as well as inland flooding in low lying areas.[5]

Micro Risks

One of the main determinants of private sector development is the existence of an enabling business environment. Barbados was ranked favourably to other small economies in the World Governance Index (WGI) for political stability, corruption, government effectiveness, rule of law, regulatory quality, and voice and accountability. In spite of this, there is a high level of bureaucracy in areas of registering property, protecting investors, and enforcing contracts.

Government failures through a distortionary tax system can also adversely impact growth. Tariffs are relatively high on most categories of goods imported into Barbados, which thwart growth through higher production costs and reduce price competitiveness. Moore (2012) noted that the average applied tariff on all products in 2007 was 17%, compared to about 10% among similar developing countries. However, labour-employer relations have proven beneficial for Barbados' development through the Social Partnership, which comprises the government, the private sector and the trade unions.[6]

Macroeconomic Risks

Although low growth is mostly related to the weak global economic condition, doubts about the adequacy of the country's international competitiveness have resurfaced. Growth in domestic exports was only 3% over the five-year period of 2008-12 compared with 9.7% in the previous five-year period. Growth in tourism output declined over the past 3 decades, averaging 2.8% in the 1980s, 0.7% in the 1990s, and -0.8% in the 2000s, reflecting a decline in market share of visitors to the region. A protracted period of low growth comes as no surprise, given the lack of finance to refurbish aged infrastructure and the loss of competiveness through high inflation.

The public finances of the country also deteriorated in recent years. The fiscal deficit as a ratio of GDP averaged 7% over the last 5 years, rising to as high as 9% in 2010/11. Government responded by reducing capital expenditure by 60% between 2008/09 and 2011/12 (which could be detrimental for long-run growth), by removing some tax allowances and by increasing the tax rate for VAT. Regardless of these measures, the public sector is plagued with many structural problems that need to be addressed (Reyes-Tagle, 2012).[7] Consequently, the rising debt burden also presents a threat to sustainable growth. According to Greenidge et al. (2012), debt levels above 56% tend to negatively affect GDP in the Caribbean. With a public debt to GDP ratio (including NIS) at 123% and rising, Barbados will require drastic efforts to return the country's debt metrics to more sustainable levels. A large and rising government debt coupled with persistent budget deficits and a low national

5 See the IDB report "Promoting the Evolution of Climate-Resilient Coastal Management in Barbados"

6 The partnership was developed to improve productivity and increase efficiency during the early 1990s recessionary periods, and has allowed the country to rebound without having to devalue its currency.

7 The structural problems include a weak tax administration, too many tax exemptions and weak procurement rules.

savings rate highlight some significant weaknesses that can affect the future capacity of the country to undertake the necessary investments to boost its competitiveness performance.

Access to Finance

One key element in the growth process of an economy is adequate financial development. Research has shown that financial constraints can result in increased sensitivity in investment (Agca and Mozumdar, 2008). In Barbados, firms have access to finance from various financial and non-bank financial institutions (credit unions, insurance companies). Despite the high liquidity in the financial system and the various funds established by the government (Fund Access and the Energy Smart Fund), many businesses have identified access to finance as one of the main hindrances to doing business. This can be explained by the lack of knowledge on the existence of these funds and the bureaucratic hurdles to access the funds. Furthermore, the high collateral requirements limit access to credit, especially for small and medium sized enterprises. It is critical for the country to identify areas in which such impediments can be mitigated as a 1% fall in firm liquidity is likely to reduce long run growth in Barbados by between 0.3% and 0.6% (Moore et al. 2009).

Conclusion

The analyses above highlight Barbados' main challenges with regards to growth, summarized in table 2. These are: access to finance, over-reliance on fossil fuels, and lack of international competitiveness. In order for the country to achieve sustainable growth, it is pertinent to address issues of high tariffs, high energy costs, structural problems of the public sector, and low productivity, among others. The report also identified a need for product diversification so that the country is less vulnerable to external shocks.

Table 2: Strength, Weaknesses, Opportunities & Threats for Barbados

Strength/Opportunities	Weaknesses/Threats
High literacy rate	Inadequately skilled workforce
Social partnership agreement	Access to finance
Stable financial system	Lack of energy alternatives
Stable governance	Loss of price competitiveness
Low crime rates	High level of bureaucracy
	Limited fiscal space and rising debt
	Natural disasters and climate change

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Barbados: Selected Indicators

	2008	2009	2010	2011	2012E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	0.3	-4.1	0.3	0.8	0.0
Nominal GDP	-3.1	1.2	-3.4	1.6	4.1
Inflation (end of period)	8.1	3.6	5.8	9.5	4.5
Unemployment	8.1	10.0	10.8	11.2	11.6
External Sector					
Exports of goods and services	10.0	-24.5	8.3	16.3	-2.5
Imports of goods and services	-6.9	-22.4	13.3	10.8	18.9
Current Account (percent of GDP)	-11.2	-7.1	-6.1	-11.6	-4.8
International Reserves (USD Mill)	679.7	744.4	717.7	711.7	730.05
International Reserves cover (weeks)	16.4	21.1	18.4	17.7	19.5
(In percent of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and Grants	29.9	26.4	26.8	29.3	27.5
Current Expenditure	32.1	32.0	34.4	32.6	33.5
Capital Expenditure and Net lending	2.9	2.0	1.6	1.4	1.3
Primary Balance	-0.5	-2.6	-3.2	1.5	-0.8
Overall Balance	-5.1	-7.6	-9.1	-4.6	-8.0
General Government Balance	-0.8	-6.0	-3.9	-4.4	-4.0
Debt Indicators					
Central Government Debt	53.3	63.2	72.0	79.3	85.6
Central Government Debt over Revenues	178.3	239.2	268.2	270.5	311.8
External Public Debt (end of period)	22.8	27.2	31.9	31.9	30.2
External debt service as percent of exports of goods and services	5.7	7.0	16.7	6.6	6.8

Source: Central Bank of Barbados, IMF WEO April 2013.

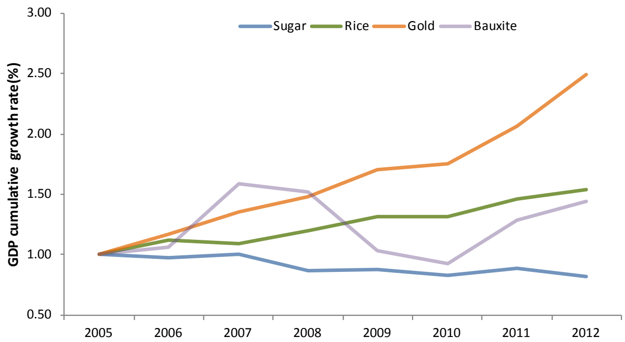
GUYANA A STRONG PERFOMANCE BUT DOWNSIDE RISKS REMAIN

Growth continues to outpace that of its neighbors.

Guyana's economic growth remains poised to outpace its Caribbean counterparts in 2013, despite a slump in mineral prices. Economic activity continues to expand at a steady pace on account of the strong performances in the non-sugar sector and foreign direct investment, and domestic credit expansion. Authorities also anticipate construction and large public investments to maintain the growth momentum.

In 2013, sugar registered a dismal first crop due to various issues plaguing the industry. The production level was 48,000 metric tonnes, its lowest yield on record. The first crop was 62 percent of the target quantity and is far lower than the 67,299 metric tonnes produced last year. The dismal performance was a result of a culmination of issues plaguing the industry: (i) the low productivity in the Guyana Sugar Corporation (GUYSUCO), (ii) failure to effectively integrate the Skeldon Modernization Project – which continues to operate 30 percent below its installed capacity, (iii) failure of private farmers to respond to government incentives to increase cultivation to supply the new factory, and (iv) poor weather conditions that hamper scheduled land preparation, cultivation and harvesting. **GUYSUCO must produce at a minimum 192,000 tonnes of sugar to adequately meet the EU quota and other market requirements.** With a deficit of 22,000 metric tonnes from the first crop, and given the state of the industry, this is unlikely to be achieved. Potential action by authorities to secure these markets may include sugar imports to fill gaps in each quota.

Figure 1:GDP and main economic sectors 2005-2012



Source: Authors' Calculations. Note: 2005=1

The recent decline in gold prices has been a cause for concern, given that high prices provided the catalyst for the expansion of the mining sector. Gold prices have been falling steadily since their all-time record of US$1,895/oz in September 2011, and reached less than US$1,400 in mid-2013. This implies a record quarterly loss. If the drop in prices continues, the impact on Guyana's booming gold mining sector will be significant, given recent contributions to GDP, which has seen economic activity expand at record levels, and the fact that it is a reliable source of foreign exchange. Authorities have responded with outreach to medium and small scale miners and associations to discuss the various issues and impacts of the volatility in gold prices on the local economy. Gold has been the motor of the economy since 2005, growing by 250% since then.(See Figure 1).

Highlights

Guyana' economic outlook remains strong on the backdrop of its seventh year of economic growth in 2013. The economy is projected to grow by 5.5 percent, primarily driven by strong performances in the traditional sectors (excluding sugar).

Despite this performance, important downside risks persist such as inefficiencies in sugar production and falling gold prices. Moreover, the fiscal and external deficits have widened substantially according to the latest available data.

Possible changes in the terms of the PetroCaribe program with Venezuela could also have an important impact on Guyana's debt service and external accounts.

Prospects in the rice industry remain high given the extension of a one-year export agreement with Venezuela. This should result in 210,000 metric tonnes of rice worth US$130 million, being shipped to Venezuela. The rice agreement is part of the PetroCaribe agreement, a concessional trade arrangement that allows Guyana to repay part of its oil debt to Venezuela through commodity exports. It provides for Guyana to ship 140,000 metric tonnes of seed paddy at a price of US$520 per metric tonne and 70,000 metric tonnes of white rice at US$800 per metric tonne this year. These lucrative prices have been partly responsible for the sharp increase in national production as well as the progressive growth in annual rice exports to Venezuela, from 20,000 tonnes in 2005, when the agreement was initiated, to the contracted 210,000 tonnes this year.

Access to the Venezuelan market, which currently absorbs 66 percent of rice production, has implications for the growth of the industry. The delay in signing the PetroCaribe agreement, which has been extended each year since 2005, stemmed from the recent change of government in Venezuela. This caused concern among rice farmers, whose paddy rice was accumulating as millers were either refusing to purchase it or were offering extremely low prices (on average, US$260 per metric tonne); this resulted in crop losses and significant cash flow problems that impaired farmers' ability to meet outstanding financial obligations. Despite these setbacks, authorities project the rice production to surpass the record level of 422,057 metric tonnes set in 2012.

Fiscal Developments

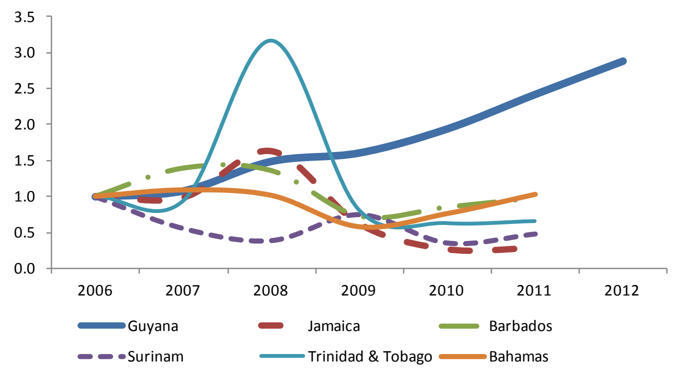
The central government deficit amounted to 4.9 percent of GDP in 2012 and is expected to rise to 5.9 percent in 2013, which is somewhat high. This result was attributed to higher wages for public sector employees, higher transfer payments, such as subventions for operating expenses for the Guyana Power & Light (GPL) and the Guyana Sugar Corporation Incorporated (GUYSUCO), and rising debt services.

The authorities have implemented a new national minimum wage for private sector employees. The new wage level has been fixed at G$35,000 (US$175) per month based on a 40-hour week, from Monday to Friday. This move is expected to benefit approximately 31,000 private-sector workers despite being 7 percent below the public sector minimum wage. However, this development could have a one-time impact on the inflation rate, which currently is projected to increase to 3.7% in 2013 (from, 3.5% in 2012). As a result of higher labor costs for businesses, consumers will face higher prices for goods and services.

External Sector Developments

The current account deficit is expected to widen in 2013 by 13.7 percent (approximately 25.4 percent of GDP) given the combined effects of lower sugar production and falling mineral prices. Additionally, the impact of higher import costs for food and fuel, and material imports related to large scale investment projects will place further pressures on the current account.

Figure 2: Cumulative FDI growth rates: 2006-2012



Source: Authors' Calculations. Note: 2005=1

Guyana recorded US$294 million in foreign investment flows in 2012 and is projected to surpass US$330 million in 2013 despite the tapering of record high mineral prices. Investment activity in Guyana remained strong (Figure 2). The impact of the financial crisis on FDI activity in Guyana has been limited given the government's robust public/private investment program in transportation, energy and other infrastructure projects. However, the mining sector remains the largest outlet for FDI interest in Guyana.

To pay attention to

Guyana avoided international sanctions over a money-laundering law deadline. On June 6th, the Caribbean Financial Action Task Force (CFATF) granted Guyana a six-month extension to the deadline for implementing revised legislation to combat money laundering. If Guyana does not take specific steps by November 2013, then the CFATF will identify Guyana as not taking sufficient steps to address its deficiencies and will call upon its members to consider implementing counter measures to protect their financial systems from the ongoing money laundering and terrorist financing risks emanating from Guyana. The specific steps required are primarily legislative, including amendments to a range of laws that will be taken to the House as one Bill.

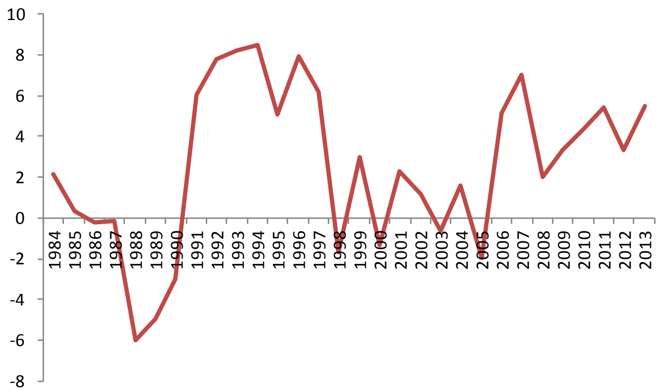
There has been some progress in plans to reduce electricity costs. The Northern Arc power infrastructure integration project won support from four companies: N.V. Energiebedrijven Suriname (EBS); Électricité de France (EDF); Centrais Elétricas Brasileiras S.A. (Eletrobras); and the Guyana Energy Agency (GEA), which will collaborate in the technical, economic and environmental aspects of the interconnection study. This initiative supports one of the objectives of the IDB's country strategy for Guyana which is to implement a sustainable low-carbon energy framework for reducing the cost of electricity.

Announcements from Venezuela to tighten the terms of PetroCaribe could have an important negative impact on the external balance of Guyana. The program provides implicit external financing equivalent to almost 5% of GDP. The Venezuelan president, Nicolás Maduro, has been meeting with the heads of state of member countries of PetroCaribe in recent weeks. Mr. Maduro has announced that he is seeking to tighten the terms of the PetroCaribe agreement. The original agreement allows beneficiary countries to pay for 40 percent of oil shipments within 90 days (either in cash or in goods of equivalent value). The remaining 60 percent is to be repaid in 17-25 years, with an annual interest rate of just 1 percent. Mr. Maduro is seeking to raise the interest rate to 2-4 percent which has the potential to negatively impact Guyana's debt service costs.

High-Frequency Macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	4.8	2012	5.4	2011
Exports (12-month growth)	23.6	2012	27.4	2011
Imports (12-month growth)	11.6	2012	24.7	2011
Private sector credit growth (%)	24.7	2012	23.1	2011
Inflation	3.5	2012	3.3	2011
Exchange Rate (End of Period)	204.80	2012	203.75	2011

Economic growth in Guyana has been very volatile and characterized by marked periods of high growth, followed by long periods of stagnation (see Figure 3). Real growth averaged only 0.3 percent during 1998 and 2005. However, since 2006, Guyana has been experiencing a moderate growth expansion with an average growth rate of 4.4 percent and the medium-term macroeconomic outlook remains positive according to the IMF. Guyana's economy even showed some resilience during the 2008 crisis. **This year, the economy is expected to grow by 5.5%, outperforming the Caribbean region and most Latin American countries.**

Figure 3: Real GDP



Source: IMF, WEO April 2013.

The last full growth diagnostic study, Armendariz, et. al. (2007), tried to identify the most binding constraint to economic growth in Guyana during the period of stagnation (1998-2005), applying the growth diagnostics methodology developed by Hausmann, Rodrik and Velasco (2005).

The authors found that the most binding constraint to growth during the period 1998-2005 was the poor appropriability of returns on private investment, which hampered capital accumulation, innovative activities and productive diversification of the economy. The authors considered that this situation was explained primarily by a weak institutional framework. **The study concluded that severe microeconomic risks and political instability have significantly hindered the pace of structural transformation.** Moreover, coordination and information failures in the discovery of new export activities were binding constraints of a second-order. **Low levels of sophistication of Guyana's export basket, and its peripheral location in the product space have constrained export growth and structural transformation.**

In this section, we try to understand whether or not the recent growth performance is related to previous obstacles being removed, and identify which are the constraints that remain most binding and could thus affect long-term growth in Guyana going forward.

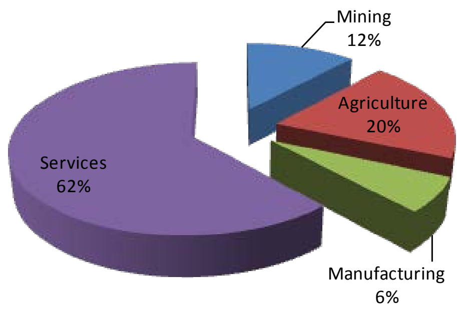
Poverty

It is generally not possible to determine whether growth over the last 3 decades was pro-poor in Guyana. Poverty statistics have not been updated since the 2006 Household Survey, although data until then show that growth coincided with poverty reduction in the 1990s. Poverty declined between 1992 and 1999 from 43 to 36 percent, and remained around 36 percent during the period of stagnation (1998-2005). Insufficient data regarding the experience in the last few years preclude a determination of whether the recent growth expansion was followed by poverty reduction in Guyana.

Leading Sectors…

The sectoral composition of Guyana GDP shows that the services and mining sectors (more recently) have led the country's economic recovery. They are followed by the agriculture, forestry and fishing sector. In the last five years, the services sector's contribution to real GDP growth was continuous in both nominal and relative terms. It grew at an annual average rate of 5.8 percent and accounting for approximately 61.8 percent of the total real GDP during 2012 (Figure4). The main drivers of growth within the services sector were Transportation and Storage (with an average real growth rate of 8.7 percent), Financial and Insurance activities (9.2 percent) and Information and Communication (9.2 percent). These sub-sectors benefitted from a spur in domestic consumption as well as foreign and domestic investments over the past years. The mining sector continues to be an important contributor to the economy in 2012, accounting for 11.8 percent of GDP and growing at an average real rate of 6.7 percent. The agricultural sector comprised almost 20 percent of GDP (including the sugar sector's contribution of 3.7 percent to GDP and the rice sector's contribution of 2.7 percent of GDP). In 2012, the manufacturing sector contributed 6.6 percent of GDP.

Figure 4: Composition of Gross Domestic Product, 2012



Source: Bank of Guyana and Minister of Finance of Guyana.

What role did social returns play in the growth recovery?

Geography

Despite there being no clear evidence that Guyana's geography has prevented the economy from growing, the country's vulnerability to natural disasters, the high concentration of productive activities on the coast, and costs associated with delivering public services to remote locations continue to be perceived as a challenge for the country.

Infrastructure

The information and communication sub-sector has been growing steadily since 2006 and the government has identified this sector as poised for growth. Energy costs could become a constraint in the future as Guyana is an oil dependent country. To address this, the government has been encouraging the development of new sustainable energy resources, for example biofuels, and solar energy. Solar photo-voltaic energy systems are being used in hinterland communities and there is a project for the construction of a 13.5 MW Wind Farm.

Human Capital

Guyana faces key human capacity constraints, despite a growing focus of government expenditures on the education sector. One of the main challenges affecting the education sector is the issue of education quality. Also, an important proportion of skilled workers migrate from Guyana (Mishra, P. 2006). Indeed, the gap between the skills of domestic workers and what is required for the country's development will be more difficult to fill if the brain drain of highly-skilled Guyanese continues at current rates.

Appropriability

Armendariz et al (2007) concluded that government appropriability was a binding constraint to growth. Since then, the following programs and initiatives have taken place:

1) Public Sector Modernization Programme was directed towards improving and increasing the capacity of the country to generate social and other relevant data.
2) Public Management Modernization Programme was formally launched in 2005 and sought to improve public management efficiency, transparency, and government accountability. Three components of the project focused on 1) strengthening public service management; 2) developing mechanisms to support semi-autonomous agencies and statutory bodies to be more responsible and accountable, 3) coordinating the state reform processes.
3) Fiscal and Financial Management Programme: initiated in 2004 focused on improving a) tax policy and administration, particularly for widening the tax base, among other tax reforms; b) public financial management especially for developing regulations for new laws; and c) audit and fiduciary oversight seeking to strengthen parliamentary committees.
4) Modernization of Justice Administration System commenced in 2007. It sought to enhance the investment climate and rights enforcement in Guyana through improved public sector governance.
5) The Competiveness Programme works within the framework of Guyana's National Competitiveness Strategy (NCS) to enhance the economic competitiveness of Guyana's economy through greater private investment, exports and employment. The Program's specific objectives are to help strengthen the institutions for public-private dialogue on competitiveness and to help improve the business environment for private investment and export development.

Micro Risks

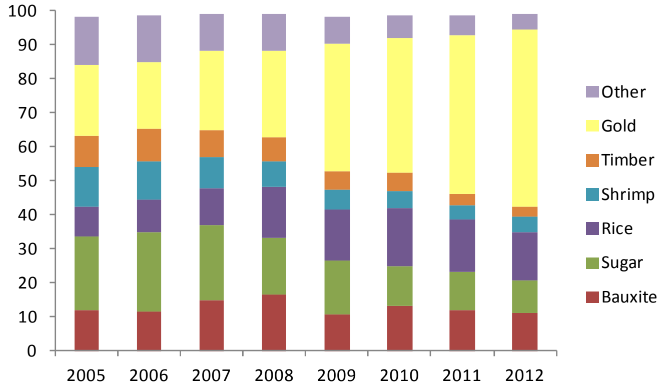
The county's performance across commonly used governance indicators remained below the world average, but showed some improvement with respect to 2006 values. For example, Guyana ranked 109 over 144 countries in the 2012/13 Global Competitiveness Report developed by the World Economic Forum. The country is behind Barbados, Trinidad and Tobago and Jamaica, and only ahead of Suriname. In 2006, the country was ranked 113 in the same report. Moreover, there were also improvements according to the World Bank *Doing Business* Survey, regarding the sub-indices of Paying Taxes, Trading Across Border and Enforcing Contracts. In the 2013 Doing Business Survey, Guyana was ranked 114 out of 175 compared with a ranking of 136 out of 175 countries in 2006.

External Vulnerability

The country continues to rely on a few primary commodities and the composition of the export basket has remained virtually unchanged since 2006. Merchandise exports accounted for approximately 90 percent of total exports during the period

2006-2012, out of which rice, sugar and bauxite (referred to as traditional exports) representing 43 percent of total merchandise exports. The non-traditional merchandise exports (including gold, shrimp, timber, fish and rum) accounted for approximately 49 percent the total during that period. Importantly, **the share of gold exports has been increasing in the last three years**, reaching 52% of total exports in 2012 (Figure 5). However. higher dependence on gold revenues could increase external risks, in particular if we consider that gold prices have been falling recently.

Figure 5: Export Basket composition(% of Total Exports)



Source: Bank of Guyana.

Financial Access

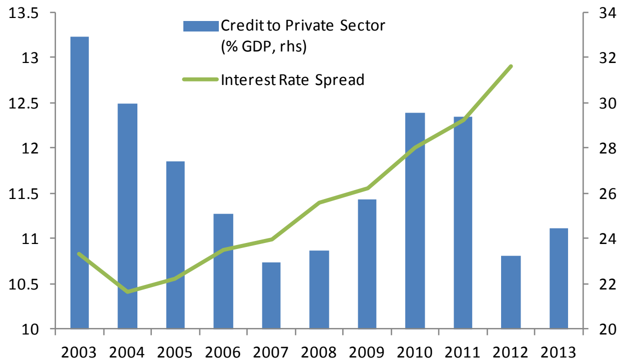
External

Guyana has benefitted from significant Foreign Direct Investment (FDI) inflows during the early 1990s primarily as a result of the privatization of several large public entities. However, there was a reduction of these inflows between 1998 and 2005 as the privatization process came to an end and the economic performance deteriorated. Foreign Direct Investment recovered between the period 2006 and 2010, surpassing the levels reported in 1990. In addition to the foreign investments, the country also benefitted from large inflows of remittances over the last five years.

Domestic

Domestic credit expanded between 2007 and 2011 by over 1 percentage points of GDP, and remains around 11-12 percent of GDP. All the major sectors of the economy benefitted from higher loans and advances from the commercial banks (Figure 6). The most significant beneficiary of credit from the commercial banks was the services sector. However, financing costs remain high and commercial banks continue to maintain high interest rate spreads.

Figure 6: Credit to Private Sector and Interest rate Spread



Source: Bank of Guyana.

Conclusion

Although further analysis is necessary, government effectiveness has increased and seems to have led to efficiency gains that improved the processes necessary for doing business in Guyana. This section shows that since 2005, low appropriability restrictions were mostly addressed with liberal reforms directed at removing micro risks, and further strengthening macroeconomic management.

However, the export basket remains as concentrated as in the period 1998-2005 and has become heavily weighted towards commodities such as gold, with volatile prices. Local financing costs remain high and are a binding constraint for spurring growth in the short- and medium term.

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Guyana: Selected Indicators

	2008	2009	2010	2011	2012E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	2.0	3.3	4.4	5.4	4.8
Nominal GDP (LC Mill)	349475	359549	400922	460108	511337
Inflation (end of period)	6.4	3.7	4.5	3.3	3.5
External Sector					
Exports of goods and services	14.8	-0.8	14.6	25.8	18.4
Imports of goods and services	19.9	-6.8	17.9	25.1	13.6
Current Account (percent of GDP)	-13.2	-8.5	-10.7	-16.4	-15.7
FDI (percent of GDP)	9.3	8.1	9.9	9.9	10.8
(In percent of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government					
Revenue and Grants	25.4	27.2	26.0	26.5	27.9
Current Expenditure	20.0	19.5	18.8	19.8	21.1
Capital Expenditure and Net lending	5.4	7.7	7.2	6.7	11.1
Overall Balance	-3.8	-3.7	-2.9	-3.2	-6.2
Debt Indicators					
Central Government Debt	62.9	67.0	68.0	69.3	72.1
Central Government Debt over Revenues	247.3	246.7	261.7	261.6	n.a.
External Public Debt (end of period)	43.7	45.9	46.1	48.6	54.2
External debt service as percent of exports of goods and services	2.1	1.8	2.6	3.0	n.a.

Source: Central Bank of Guyana, IMF WEO April 2013.

Meeting the macroeconomic targets

The approval of the Extended Fund Facility (EFF) with the IMF has given Jamaica some relief. Short term macroeconomic risks have fallen as the government is showing commitment to the macroeconomic framework supported by the EFF.

The business confidence index for the second quarter showed an improvement for Jamaican firms. The index of business confidence increased to 101.4 in the second quarter of 2013 from 95 in the first quarter of 2013 and 91.4 in the second quarter of 2012. The IMF agreement and the expected shift in economic policies to foster competitiveness are likely reasons for the improvement. However, the consumer confidence index remains depressed at 99.7 in the second quarter 2013, compared to 111 a year earlier.

Jamaica is progressing on the IMF program. Following the August 2013 EFF review mission, it was announced that policy implementation thus far under the program has been strong and structural reforms are progressing. In addition, Jamaica met all quantitative targets of the IMF program up to June. The first review will be subject to approval by the IMF's Board sometime around the end of September 2013.

A major challenge for Jamaica is to restart and accelerate economic growth. Jamaica's economy has been contracting since the first quarter of 2012. However, meeting the IMF targets through fiscal consolidation alone would be challenging and painful for a population that has been so adversely affected by the recession. As such, the EFF supports the Jamaican growth strategy. Besides structural reforms to reduce constraints to growth, the government is working to facilitate strategic investments, including the establishment of Jamaica as a logistics hub. The government is implementing the growth agenda and has started the reform process in some areas, such as in taxation and in improving the ease of doing business.

Jamaica's economy continues to be highly vulnerable. Uncertainty remains given the challenging structural reforms and quantitative targets that have to be met as part of the IMF program. Also, the currency has depreciated 10% since the beginning of 2013, leading to uncertainty about the future evolution of the JM$. As a result, interest rates face upward pressure and investors have little appetite to increase their holdings of JM$-denominated debt. The structural imbalance of the external account is also worrisome for the medium to long term.

Highlights

The recent IMF mission confirmed progress on the end-June structural and quantitative targets of the country's Extended Financing Facility program with the IMF. These will be considered by the IMF's Board by the end of September 2013.

The fundamental reforms required to reach the program targets could meet with political resistance. However, GOJ is aware that failure to reach them and remain on track with the EFF would entail substantial downside risk.

Anxiety over the vulnerable macroeconomic situation remains elevated, making the outlook susceptible to shocks and a sudden loss of confidence.

The government's reform agenda aims at reducing structural constraints to economic growth, supporting the implementation of the fiscal consolidation program and protecting the vulnerable groups.

The fall in international reserves has been contained but they remain below desirable levels. Net reserves declined from over US$2 billion in April 2011 to US$900 million as of end-July 2013, which is below BOJ's minimum threshold of US$1.2 billion to cover short-term foreign liabilities. The decline has been the result of interventions by the Central Bank of Jamaica (BOJ) to stabilize the exchange rate and reduced private and official inflows. Official inflows in the short- to medium-term would be required, as it will take some time for foreign direct investment levels to recover or private capital flows to materialize.

Jamaica still benefits from relatively low interest rates. Treasury bill auctions immediately after the national debt exchange in February 2013 were 5.25% for the 30-day rate, the lowest level in over 30 years. Recent Treasury bill auctions yielded slightly higher levels – 6.2% and 7.4% for the 30-day and 90-day maturities, respectively—but still low given the current context. However, without a strong boost in investor confidence, rates could continue to climb, which would be detrimental to fiscal sustainability. Almost 40% of Jamaica's domestic bonds (equivalent to around 20% of direct public debt), have a variable interest rate.

The medium-term fiscal framework targets a primary surplus of 7.5% of GDP from FY2013/14 onwards. In the short term, the challenging increase in the primary surplus will be based on both additional expenditure restraint and revenue measures, but deeper, structural measures are required to reach medium-term sustainability—such as the full implementation of the

comprehensive tax reform and a sustainable trajectory for public sector salaries and pensions.

The economic program supported by the EFF is challenging. High primary surpluses have to be maintained over an extended period of time. Without an ongoing clear commitment to the EFF, external vulnerability could lead to capital flight putting pressure on both the exchange rate and international reserves.

Jamaica's public debt remains among the highest in the world, at over 140% of GDP. Even after the debt exchange and the current historically low interest rates, interest payments alone will absorb almost 30% of government's revenue in FY2013/14. The medium-term macroeconomic framework supported by the EFF projects a decrease of debt-to-GDP to around 100% by March 2020.

But long-term challenges will remain…

The economic weakness since the start of the world economic recession has taken a toll on the population. Unemployment has been continuously increasing from 9.4% in 2007 to 16.3% as of April 1, 2013. The unemployment rate is higher for women (21.3%) and youths aged 14-24 (38.5%). The last increase in the unemployment rate was caused by a spike in job-seekers as employment remained constant, indicating that persons stepped up their efforts to seek work. One possible reason for the increase in the workforce may be the need for additional household income as result of wage pressures by employed workers.

Security continues to be a major concern in Jamaica. There has been a reduction in homicides from very high levels since 2010, partly attributed to the restriction of gang operations by the State security forces. The Government is making efforts to dismantle informal governance arrangements but some areas remain volatile.

Jamaica participated in the Caribbean Growth Forum and is showing commitment to the growth agenda. The working groups of the national chapter identified key actions in the areas of logistics and connectivity, investment climate and skills and productivity. The implementation phase of these action plans will commence in September 2013 and will continue over a period of 12-18 months.

The reforms embedded in the EFF, the protection of poor and vulnerable groups as well as the implementation of the government's growth agenda offer various opportunities for the IDB and other development partners to provide technical and financial support to the government.

In summary, Jamaica is showing commitment to the IMF program, which should restore some level of market confidence. This and its continued focus on the growth agenda could lead the country towards much needed macroeconomic stability.

Issues to Watch Out for

The IMF Board is expected to discuss the first review under the EFF by the end of September. Indications are that the quantitative targets and structural benchmark for the end of June test date have been met.

Jamaica has been working on a comprehensive tax reform for many years. The tabling of the charities and the omnibus tax incentive bills for the end of September, which are also structural benchmarks under the EFF, are the first, major milestones for an overhaul of the tax system.

Investors still shy away from domestic GOJ debt as they await the performance of the Jamaican government in upcoming EFF reviews.

High-Frequency Macroeconomic Indicators				
	Last data	Period	Prior data	Period
Annual GDP growth (%)	-0.9	Q1 2013	-0.9	Q4 2012
Inflation (Quarterly)	1.1	Q2 2013	2.7	Q1 2013
Net International Reserves (USD Mill)	929.7	Jul-13	1003.0	Jun-12
Exchange Rate (End of Period)	101.86	Jul-13	101.38	Jun-13
Unemployment rate (%)	16.3	Apr-13	14.2	Jan-13

Source: BOJ, IMF and STATIN.

The Puzzle

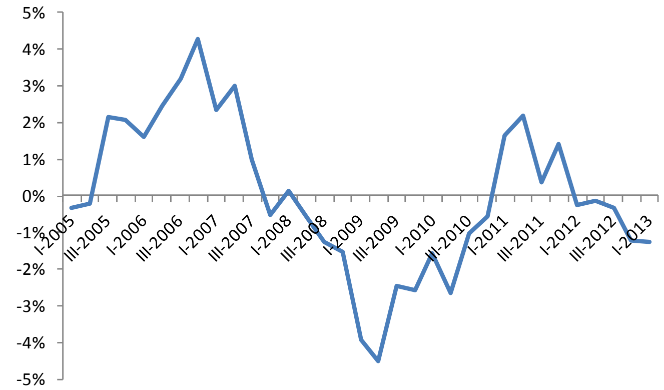
Jamaica has several advantages compared to other Caribbean countries. It is close to the US both in terms of geographical distance as well as cultural and language proximity, its high number of skilled migrants reflects a competitive education system and, central for a tourist destination, its artists and athletes make Jamaica a well-known icon in the Caribbean. However, in spite of these advantages Jamaica has failed to achieve consistent growth over the last decades.

Jamaica has grown at an average of 1.5% since 1980 with the highest rate of 7.7% achieved in 1987. Over the same period, Jamaica's economy contracted in 9 of the 32 years, with the longest cycle being after the 2007/08 global financial crisis. This lackluster performance has been consistently below Latin America and the Caribbean (LAC) – only Haiti had lower average growth than Jamaica. As a result, Jamaica is today poorer on a per capita basis than it was in 1990.

Recent Performance

Jamaica is among the countries most strongly affected by the global economic downturn (see Figure 1). Since the recession started in the end of 2007, Jamaica has contracted in 17 out of 22 quarters. In line with the timid recovery of the world economy, Jamaica experienced economic growth in 2011, just to turn negative again since the beginning of 2012. The deep and long recession has had important effects on Jamaica's socio-economic development, reflected in part in the recent decline in Jamaica's Human Development Index rank from 83rd to 85th out of 185 countries. Similarly, the unemployment rate increased from a low of 9.4% in 2007 to over 16% as of April 2013 and the current poverty rate is estimated at around 20%.

Figure 1: Q/Q GDP growth at constant JM$, 2005-2013



Source: Statin.

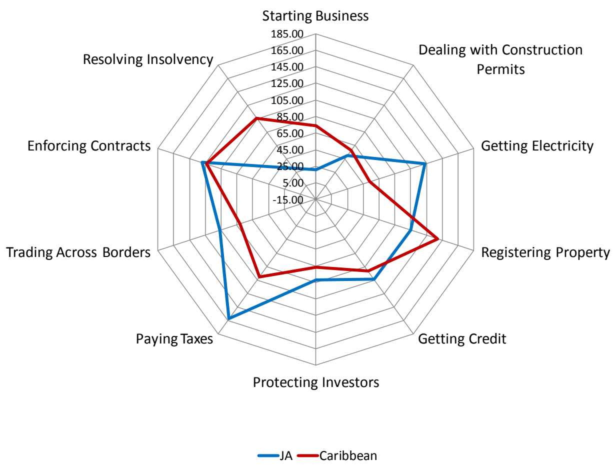
In addition to the weak situation of the world economy, the uncertainty surrounding Jamaica's economic situation also contributed to the contraction. In to the absence of a credible sustainable macroeconomic framework since the stalling of the 2010 IMF Stand-By Agreement, the economy had been falling over the last 5 quarters. With the EFF advancing, the government's focus is thus shifting towards economic growth.

The discussion above indicates that low growth is not a recent phenomenon in Jamaica. In line with the government's commitment for structural reforms to reduce impediments to growth, we will explore potential reform areas that would support Jamaica's development.

What do businesses say?

Jamaica has performed poorly in the various surveys that assess the country's level of competitiveness and business climate. Jamaica is ranked overall 90th out of 185 countries in the Doing Business survey and 76th out of 144 countries in the Global Competitiveness Survey.

Figure 2: Ranking on *Doing Business* topics, 2013



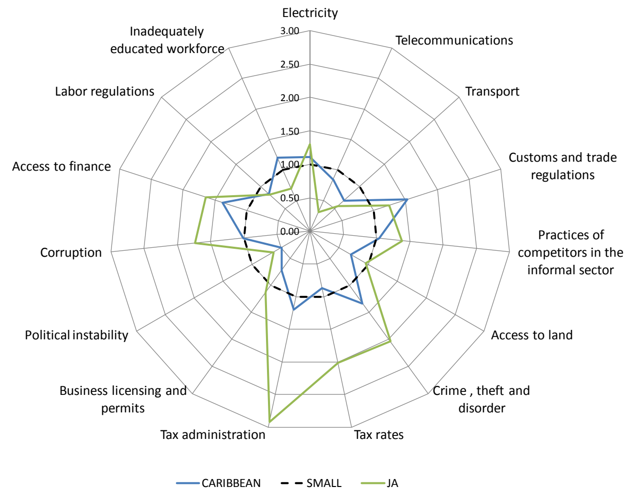
Source: World Bank Doing Business Survey.

The 'Doing Business' survey compiles rankings in major areas of conducting business. Since its inception, the indicator related to 'paying taxes' comes up as a major weakness in the Jamaican business environment (Figure 2). In spite of an improvement between 2012 and 2013 Jamaica is still ranked 163 out of 185 countries on this indicator. According to the report, the total tax rate, the hours per year it takes to pay them and the payments per year are all major drains on businesses. Other important areas where Jamaica obtains a low rank include getting

electricity (123rd), trading across boarders (106th) and getting credit (104th).

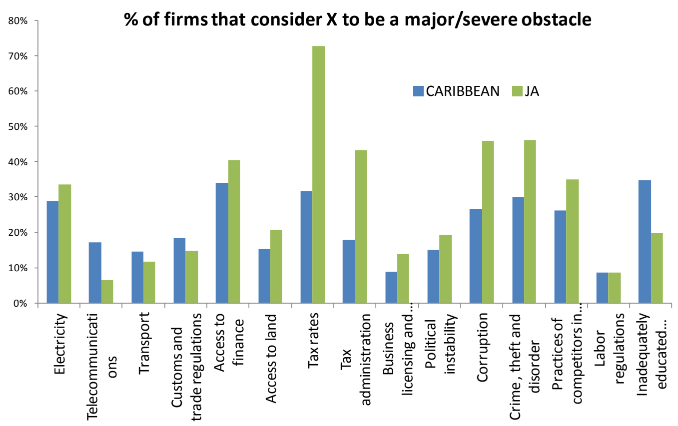
Another relevant survey to gauge the business climate is the World Bank's *Enterprise Survey*, which asks firms whether specific factors are obstacles to the current operation of their firm. Compared to the Caribbean and other small economies, Jamaica's tax system again stands out as a major concern for businesses (Figure 3). In addition, Jamaican firms consider more factors as 'major' or 'severe' obstacles relative to other countries: of the 15 areas mentioned in the survey, more than a third of firms surveyed in Jamaica identified 7 factors as major or severe obstacles to growth (Figure 4).

Figure 3: Which are the obstacles to firms' operations?



Source: World Bank Enterprise Survey
Notes: Share of firms that respond major or very severe obstacle, normalized to small economies.

Figure 4: Factors highlighted as constraints to growth



Source: World Bank Enterprise Survey.

Other factors stood out as obstacles to business, but not the skill level of the workforce. Besides the complicated tax system, and the high tax rate, other factors highlighted as major obstacles to business operations were crime, corruption, the high cost of electricity, poor access to finance and high informality. By extension, these hamper growth of the private sector. However, less than 20% of firms stated that the availability of an adequately-trained workforce was a major or severe obstacle to growth, unlike the results for the other IDB-member Caribbean countries where an adequately trained workforce came up as a major constraint (excepting Barbados).

The government of Jamaica seems to be focusing on the right areas, if one assesses the specific measures of the authorities' reform agenda against the constraints found in the two surveys discussed above. A major pillar of the EFF is the comprehensive tax reform, which seeks to produce an efficient tax system and remove existing distortions. In terms of improvements to the business climate, multiple initiatives have been initiated to tackle this area, including the National Competitiveness Council and the Caribbean Growth Forum. Work is also being done in the area of access to finance, specifically for small and medium enterprises. There are also continued efforts to fight crime, as well as projects which attempt to reduce the cost of energy.

Conclusion

A 2011 World Bank study on Jamaica[1] identified crime, poor human capital and micro risks such as taxation as major constraints to growth. The results from the Doing Business Indicators and the Enterprise Survey portray a similar picture. Major reforms are needed to facilitate the work of the private sector. Jamaica faces important challenges, particularly the need for fiscal restraint. In addition, many of the factors adversely affecting growth are related or self-reinforcing, so addressing issues like a high tax burden or high crime in the absence of growth is a formidable challenge. As such, the government of Jamaica should support growth by facilitating business and improving competitiveness. In this regard, reform initiatives with a focus on monitoring and implementation like the *Caribbean Growth Forum* will serve as an excellent avenue to ensure the successful completion of their objectives.

[1]Jamaica Country Economic Memorandum: 'Unlocking Growth' World Bank, 2011

Jamaica: Selected Indicators

	2008/09	2009/10	2010/11	2011/12	2012/13E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	-1.7	-2.6	-0.6	1.3	-0.3
Nominal GDP	12.0	8.1	7.8	5.9	7.8
Inflation (end of period)	12.4	13.3	7.8	7.3	9.0
Exchange Rates (end of period)	88.8	89.5	85.7	87.3	98.9
External Sector					
Exports of goods and services	-5.9	-19.1	-0.1	6.2	2.9
Tourism (percent of exports)	33.5	43.2	44.7	47.1	45.6
Imports of goods and services	0.5	-30.3	8.2	17.4	-3.5
Current Account (percent of GDP)	-18.7	-7.6	-8.9	-14.8	-11.6
Treasury Bill rate (%, end-of-period)	21.5	10.5	6.5	6.2	5.8
(In percent of GDP, unless otherwise indicated, on a calendar year basis)					
Central Government					
Revenue and Grants	27.0	27.1	26.4	25.5	25.5
Budgetary Expenditure	34.4	38.1	32.8	31.9	29.5
Primary Balance	4.9	6.1	4.5	3.1	5.4
Budget Balance	-7.4	-11.0	-6.5	-6.4	-4.0
Public Sector Balance	-9.3	-12.4	-7.0	-6.4	-5.6
Debt Indicators					
Public Sector Debt	126.4	139.5	141.3	143.7	147.2
Public Sector Debt over Revenues	468.4	514.1	536.1	563.7	n.a.
Foreign Currency Public Debt (end of period)	71.6	80.5	83.3	81.4	76.0
External Interest payments as percent of exports of goods and services	9.3	12.1	11.5	10.4	n.a.
International Reserves					
Net International Reserves (USD Mill)	1629	1752	2553	1777	884
Gross International Reserves (Weeks of G&S Imports)	13.7	18.4	23.4	17.8	<12

Source: MoFP, BOJ, STATIN, IMF and own calculations.

Highlights

Suriname continues to grow, but further fiscal tightening is required to achieve medium-term targets and to correct recent slippage.

President Bouterse dismissed three Ministers: The Ministers of Public Works; Education; and Zonal Planning, Land and Forestry Management.

With the aim of strengthening its continental ties, Suriname joined the South Common Market (MERCOSUR).

The government signed an open-skies agreement with the United States.

Recent Developments

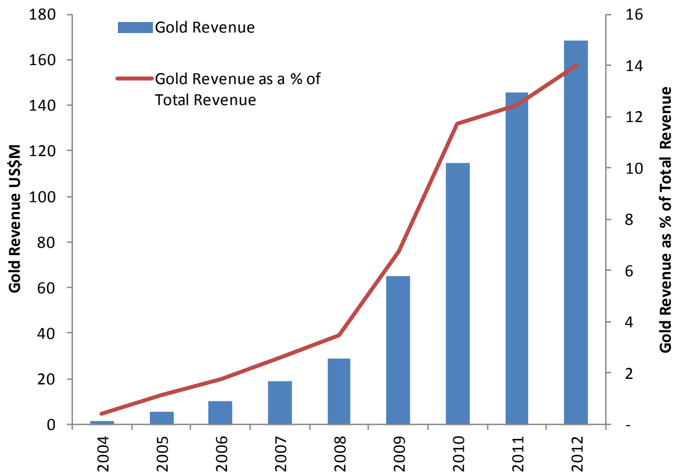
Macroeconomic fundamentals remain strong, with continued growth expected in 2013, but there is slippage. The International Monetary Fund (IMF) projects GDP growth for 2013 to be about 4.7 percent. Inflation levels as of March 2013 were the lowest for 3 years. IMF recently released the preliminary conclusion of its 2013 Article IV Mission, noting that the economy continues to perform well and is stable but cautions fiscal prudence in light of falling gold prices. The government's plan to issue a US$500 million bond can increase uncertainty given the declining gold prices, although revenues from the investment are expected to increase in the long term. The fiscal position weakened with a 10-percent wage increase for public workers in December 2012 and higher capital expenditure during the first quarter of 2013. The IMF encourages the government to continue its commitment to reduce fiscal expenditures and increase revenues, particularly through the implementation of the value-added tax.

Suriname and Guyana joined the South Common Market (Mercosur). Mercosur is an economic and political agreement among five countries in South America: Brazil, Argentina, Venezuela, Uruguay, and Paraguay. Bolivia is an assessing member close to being signed as a full member. Mercosur is a customs union that aims to promote free trade and integration among its members. Suriname's entry into the union is another step in the country's path to forging economic and political ties with neighboring countries outside of traditional partnerships. Also, Suriname hosted the seventh summit of UNASUR which is made up of Argentina, Bolivia, Brazil, Colombia, Chile, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela. Brazillian President, Dilma Rousseff attended. Paraguay's membership was formalized. The summit addressed the development of a strategic vision for Unasur, the institutional strengthening of the secretariat as well as the establishment of working groups on human rights and youth affairs.

President Bouterse dismissed three of his Ministers and reshuffled his Cabinet during the second quarter of 2013. The Ministers of Public Works; Education; and Zonal Planning, Land and Forestry Management were replaced. This is the second time within the past twelve months that the President renewed part of his Cabinet of Ministers. Members of the three-party coalition, of which the President is the head, called for the President to explain why he dismissed the ministers.

The National Assembly approved two large gold-mining deals. Despite the recent fall in gold prices, Suriname is proceeding with two new mining projects that aim to expand operations and increase revenue. The Assembly approved sovereign participation in the US$700 million *Iamgold* expansion gold deal and in the US$800 million *Surgold* project. The recent decline in gold prices has raised concerns over the profitability of the projects, but the companies' websites report that the average cost of production is around US$650, making the projects still profitable at the current US$1,300 price of gold. Gold contributed US$168 million in 2012, about 14 percent of total revenues.

Figure 1: Gold Revenues 2004- 2012



Source: Central Bank of Suriname and IMF.

Staatsolie, the state oil company, is considering the construction of a US$250 million ethanol plant. Using a sugarcane production and mill design, the company will supply electricity to Nickerie by 2016, and sugar production should start by 2018. Staatsolie estimates that it can produce around

40,000 metric tons of sugar per year, a quarter of which will meet local demand.

The energy sector is moving forward with a carefully considered integration strategy. Brazil, Guyana, French Guiana, and Suriname are developing a series of projects in which the four countries will improve power generation mainly through hydroelectric capacity—collectively called the *Arco Norte*. The Arco Norte, with the support of the Inter-American Development Bank (IDB) and Eletrobras—a large Brazilian electric utilities company—will explore the feasibility of interconnecting transmission systems and will identify viable sources of renewable energy in response to growing power demand in the subregion.

Suriname signed an open-skies agreement with the United States, formalizing liberalization of the two countries' aviation relationship. The Open Skies Agreement will be implemented upon an exchange of diplomatic notes between the governments, confirming that all necessary internal procedures have been completed. The Open Skies Agreement creates opportunities for strengthening the economic partnership between the United States and Suriname through closer links in transport and trade. Open skies agreements permit unrestricted air service by the airlines of both countries between and beyond the other's territory, allowing airline management to determine how often to fly, the kind of aircraft to use, and the prices to charge. This agreement will strengthen and expand trade and tourism links between Suriname and the United States, benefitting U.S. and Surinamese businesses and travelers by expanding opportunities for air services and encouraging vigorous price competition by airlines. Meawhile, Brazil initiated steps to establish an open-skies agreement with CARICOM. Therefore, Suriname stands to benefit from this prospective arrangement as well.

Suriname is expanding its focus on private sector development and is engaging private and foreign investors by improving its business procedures. Competitiveness Unit Suriname (CUS), together with the Suriname Business Forum are becoming more visible and active in private sector development. Suriname is attempting to progress on the Doing Business Index and on the Competitiveness Index with the implementation of its reforms program. In the coming months, Suriname will focus on completing an action plan and strengthening the CUS unit. Meanwhile the Central Bank of Suriname continues moderninising the financial sector for improving access to finance.

Suriname implemented its national health insurance system, looking to grant low-income citizens access to better health care. The scheme is available to all children younger than 18 years of age to enjoy free health care countrywide. This implementation is the first step in the government's plan to introduce a nationwide health care and pensions scheme scheduled to be rolled out in 2014.

The IDB and Suriname: What to Expect

The IDB Board approved the US$100 million financial sector program in June 2013. The Bank also recently approved a technical cooperation to finance the feasibility study into developing the Arco Norte project, in addition to an operation to finance a regional study to analyze the potential for natural gas use in the Caribbean. The IDB's remaining program for 2013 consists of one investment loan in energy for US$25 million and three policy-based lending operations: (a) revenue policy administration for US$20 million in December 2013, (b) agriculture for US$15 million, and (c) energy for US$10 million in November 2013. The Caribbean Economics Team-Suriname continues work on growth analytics, and the effects of commodity price changes. The Programming and Portfolio Review mission is scheduled to take place in early September 2013.

High-Frequency Macroeconomic Indicators

	Last data	Period	Prior data	Period
Annual GDP growth (%)	4.0	2012	4.2	2011
Tourism arrivals (annual % change)	20.5	Feb-13	7.9	Jan-13
Exports (12-month growth)	16.1	Q4 2012	9.5	Q1 2012
Imports (12-month growth)	12.2	Q4 2012	14.4	Q1 2012
Private sector credit growth (%)	2.4	Q1 2012	3.4	Q4 2011
Inflation	3.6	Jun-13	2.6	May-13
Exchange Rate (End of Period)	3.35	Jul-13	3.35	Jun-13
Unemployment rate (%)	10748	2010	12616	2009

APPROXIMATING THE INFORMAL ECONOMY IN SURINAME

Practically Everywhere?

On any day in one of our Caribbean cities, we can meet a friendly but unregistered taxi driver, a hairdresser who operates from his or her comfortable living room, or a school teacher who gives extra lessons on a breezy verandah after the school day. In another part of town, some white collar workers, like doctors, lawyers, or accountants perform services and do not record them for tax purposes. These individuals conduct business outside of the formal sector—in the shadows—in the informal economy. The incidence of these informal activities affects policy choices and their results. Therefore, understanding the structure and magnitude of the informal sector is crucial when an administration undertakes reforms. As Suriname aggressively reforms its economy, we explore how the country's informal sector has evolved over the past 30 years and what it means for fiscal performance.

Why is the Informal Economy Important?

Academics, politicians, news media, and households define *informal economy* differently, and this disagreement could be problematic. Because we are motivated to understand the implications of the informal sector on growth, development, and fiscal performance in Suriname, we consider the informal economy as the subset of the economic activities that its agents hide to avoid paying taxes.

In these dark economic times when fiscal pressures mount, the informal economy is under scrutiny as authorities worldwide consider new sources of revenues. Size matters, and in the case of the informal economy, it matters immensely because it represents a significant loss of tax revenues for the state. Informal activities distort the accuracy of national statistics and challenge social protection. A large informal economy reduces integrity and trust in public institutions. Therefore, the size of the informal economy can make an important difference for tax policy: Governments could modify their tax regime and menu of taxes either to increase the overall tax yield of the formal economy or to reduce leakage through the informal economy.

How to Estimate the Size of the Informal Economy

We follow an econometric (currency-demand) approach to estimate the size of the informal economy for three reasons. First, given the recent improvements in data quality in Suriname, we needed an approach that had the least—but most robust—data requirements. Second, Suriname is very cash-based. There are few ATMs and points-of-purchase, and the financial sector is not very sophisticated. Last, we wished to follow Tanzi's (1983) approach that assumes tax avoidance as the main cause of a cash-based informal economy.

Modifying Faal's (2003) method, we build a vector error-correction model to estimate the size of the informal economy. In this model, the demand for currency is driven by income, the tax rate, interest rate, inflation rate, and noncash liquid money. We specify a general dynamic error-correction model that takes into account the short-term effects and long-term equilibrium of the series.

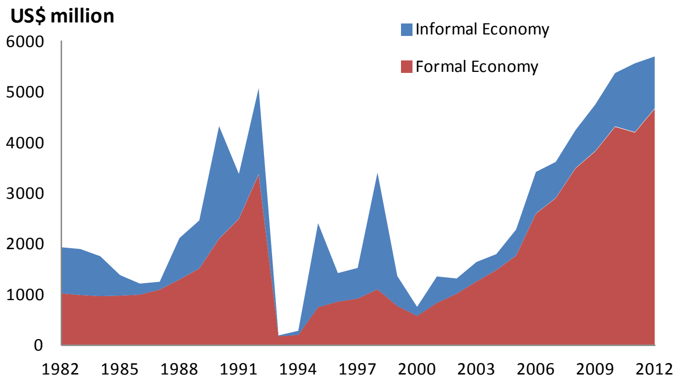
We estimate the real demand of currency with an ordinary least squares regression and then systematically drop the most insignificant variables one at a time to find the most significant and stable reduced-form specification. The model maintains a strong explanatory power. We find that tax rates influence demand for currency in the short- and long-term. This finding confirms our assumption that the informal economy is strongly driven by tax evasion, given that cash is the primary means of transaction in the informal sector. We then estimate the size of the informal demand for currency in Suriname by taking out tax variables. In other words, we remove the effect of the tax rate on the currency demand and thus obtain the demand for currency (in the absence of a tax burden).

The difference between the estimated demand for currency with and without tax variables will be the estimated demand for currency that is needed for the informal economy, at time *t*. We then calculate the size of the "formal money," which is the difference between the M1 money supply, the sum of the total currency in circulation and demand deposits, and our informal currency in circulation. We find the velocity of formal money by dividing the real official gross domestic product (GDP) by the total formal money. Assuming that the velocity of informal money is the same as the velocity of legal money, we can estimate the size of the underground economy of Suriname.

Coming Out of the Shadow—The Size Is Apparent

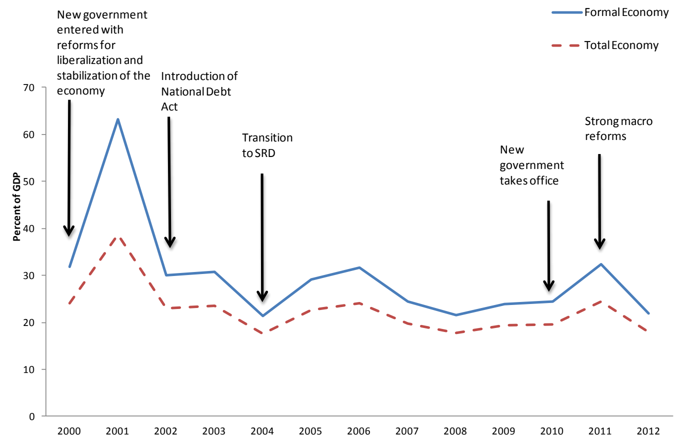
Do these results make sense? When we juxtapose our results against a timeline of political and economic events, they seem to tell a story.

Figure 2: Nominal Size of the Informal and Formal Economies in Suriname, 1982-2012



Source: Central Bank of Suriname and Authors' calculation.

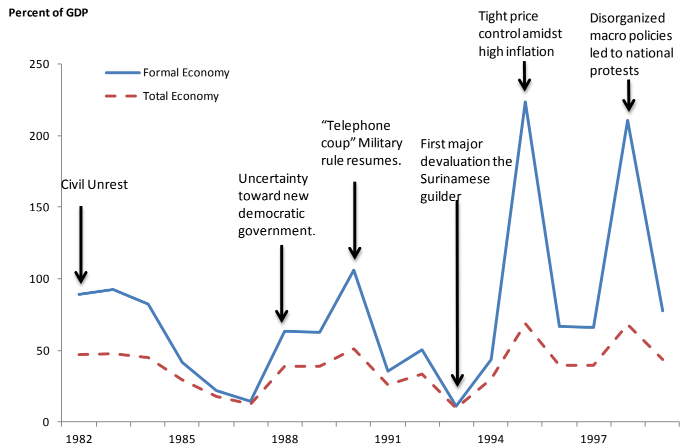
Figure 4: Historical Events and the Size of the Informal in Suriname, 2000-2012



Source: Central Bank of Suriname and Authors' calculation.

Throughout Suriname's history, political changes precipitate macroeconomic uneasiness, which, in turn, affect the growth of the informal sector. Figure 2 shows the evolution of the size of the informal economy compared with the formal sector. Figures 3 and 4 map out the timeline of economic and political events to the changes in the size of the informal economy. The informal economy grew larger than half of the country's reported GDP during the periods from 1982 to 1984, 1988 to 1990, and 1995 to 1999. During these periods, the large informal economy reflected mostly the changes in the government and the mistrust of public institutions as a result of civil instability. In contrast, during times of political and macroeconomic stability, the size of the informal economy fell.

Figure 3: Historical Events and the Size of the Informal Economy, 1982- 1999



Source: Central Bank of Suriname and Authors' calculation.

The informal economy increased to 93 percent during the military coup d'état and the transition into the military government in the early 1980s. During 1988–1990, a constitutional government was created and dismissed. Then, the informal economy stayed at around 40 percent until the hyperinflation that began in 1994, during which the informal economy increased to 224 percent of the official GDP in 1995. The size of the informal economy dropped as soon as the authorities liberalized the exchange rate and loosened price controls. In 1998, uncoordinated macroeconomic policies led to nationwide protests and another spike in the informal economy, to 211 percent of GDP. In 2000, a new government entered as the old one ended prematurely because of civil unrest in previous years, and the informal economy fell as the government began the liberalization and stabilization of the economy. The public uncertainty toward the future actions of the new government likely explains expansion of the informal economy in 2001, but as the government introduced the National Debt Act and various liberalization reforms, the informal economy dipped to 30 percent. It declined further in 2004 when the official currency transitioned from the Surinamese guilder to the Surinamese dollar.

The size of the informal economy remained fairly flat until 2010, and again, we see a spike in the following year to 32 percent of GDP, from 24 percent. As the current government introduced strong macroeconomic reforms, the informal economy fell to its lowest level since the introduction of the Surinamese dollar.

We estimate tax evasion by applying the average tax rate to the size of the informal economy. **We observe that tax evasion grew with the expansion of the informal economy—even larger than actual tax revenues in 1995 and 1998.** Since the period of political unrest and economic instability, tax evasion has decreased drastically—stabilizing at around 5 percent of GDP after 2001—but still a sizeable amount, which could make the difference between a deficit and surplus for the government.

Keeping the Shadow Down

The sun casts the shortest shadows when it is brightest and shines directly overhead, usually at midday. We can analogize this phenomenon to managing the size of the informal economy. Here, let us imagine that the set of transparent macroeconomic, legal, and political frameworks represent the sun. When policies are most stable (bright) and provide light for conducting transactions, agents can predict (see) more clearly, and the informal economy tends to disappear. In the case of Suriname, we observe that during times of political and macroeconomic uncertainty, the size of the informal economy spikes. Likewise, the informal economy declines when the administration acts to (a) make policies more transparent, (b) reduce distortions to the macroeconomic framework, and (c) limit contagion from the political processes.

The informal economy cannot be completely eliminated, but Suriname needs to create an environment that discourages its growth and that incentivizes formalization. Our findings indicate the existence of a large informal economy in the 1980s and 90s that fell after 2000 when strong economic reforms begin to take place. Therefore, the government must continue to strengthen its macroeconomic policies to reduce the informal economy. The changes in the size of the informal economy after 2000 compared with those of the previous two decades have shown that fiscal and liberalization reforms have long-term effects on reducing the size of the informal economy. We hasten to point out too that the strictness of our definition of the informal sector does not allow our methodology to capture some activities, for example illegally mined gold that is monetized outside of Suriname. In future exercises, we will employ complementary routines to delve more deeply into other aspects of evasion and the informal economy that are not covered here.

Because Suriname's debt path may approach an inflexion point, clear fiscal targets must be defined. Creating a supportive business environment will incentivize businesses and entrepreneurs to function in the formal sector. A comprehensive reform of the tax system to a consumption-based tax, such as the value-added tax, will broaden the tax base and make it difficult for informal transactions to take place. By our definition, once a transaction is taxed, it belongs in the formal sector. A transition to a more flexible exchange rate regime may prevent the spikes in the informal economy. These macroeconomic policies are likely to further reduce the size of the informal economy in Suriname and make it comparable with the levels of Organisation for Economic Co-operation and Development countries.

(To read the full draft paper, please email cet@iadb.org)

Suriname: Selected Indicators

	2008	2009	2010	2011	2012E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	4.1	3.5	4.5	4.2	4.7
Nominal GDP	26.2	-3.1	13.2	25.8	11.94
Inflation (end of period)	9.4	1.3	10.3	15.3	3.4
Exchange Rates (end of period)	2.75	2.75	2.75	3.3	3.3
(In percent of GDP, unless otherwise indicated, on a calendar year basis)					
External Sector					
Exports of goods and services	53.4	68.2	54.3	64.5	63.1
Imports of goods and services	62.2	60.7	62.7	73	68.8
Current Account	9.6	-1.1	1	0.4	-0.2
Gross International Reserves (USD Mill)	666	763	785	987	1,209
Savings and Investment					
Private Sector Balance	5	1.9	9.6	4.7	-0.6
Public Sector Balance	1.6	-2.4	-3.1	0.9	0.5
Savings	6	3.3	1.8	6.9	6.3
Investment	4.4	5.7	4.9	6	5.8
Central Government					
Revenue and Grants	31	36.4	25.8	26	25
Total Expenditure	29.1	35.3	28.2	25.2	24.5
Primary Balance	2.2	-1.2	-2.3	1.8	1.4
Overall Balance	1.8	-3	-3.6	0.9	4.0
Consolidate NFPS balance	1.8	-3	-3.6	0.9	0.5
Debt Indicators					
Total Public Sector Debt	18	18.5	21.6	19.1	18.6
Public Sector Debt over Revenues	65.6	61.5	81	73.3	74.4
External Debt (end of period)	10.4	8.3	8.7	7.6	10.3
Domestic Debt (end of period)	7.6	10.2	12.9	10.8	8.3
External debt as percent of exports of goods and services	15.7	15.8	14.5	17.3	18.9

Source: Based on IMF Article IV Country Report and Central Bank of Suriname

Recent Developments

The domestic economy showed some signs of recovery in the first quarter of 2013. Real GDP grew by 1.6% in the first quarter of the year relative to the previous year; this was driven by the non-energy sector, in particular construction and manufacturing. The energy sector grew by 0.5% in the same period, mainly due to a 1.9% increase in natural gas sales. The Ministry of Energy and Energy Affairs expects that the trend will continue into the second quarter of 2013 with a 3% increase in natural gas sales. However, maintenance work planned for September in the energy sector could reduce the speed of economic recovery for 2013.

This follows subdued growth in 2012. The latest estimation of Trinidad and Tobago Central Statistical Office showed that economic growth for 2012 was 1.2 percent. However, these projections could be revised downwards; as the preliminary figures of the Central Bank Quarterly GDP Index suggest, overall growth may have been lower, close to 0.2 percent.

- **The energy sector's performance continues to be lackluster.** It contracted 1 percent during last year. The weak performance of the sector is associated with production stoppages at British petroleum (BPTT) and British Gas (BGTT) facilities and some downstream energy companies. Maintenance operations took longer than inititally envisaged, resulting in a reduction of total crude oil and natural gas output and affecting refining and petrochemical activities. In 2012, crude oil and natural gas production fell 10.8% and 0.3% respectively.
- **On the other hand, the non-energy sector showed moderate growth,** driven by the financial and distribution sector that grew by 6.1% and 1.4%, respectively. The worst performing non-energy sector was agriculture, which contracted by 4.9%, but it is relatively small. Although many programs have been implemented to increase agriculture production, adverse weather conditions negatively affected sweet potato, cassava, dasheen bush and watermelon farms.

The economic outlook for 2013 is more optimistic. The energy sector is expected to register positive growth in 2013 due to fewer stoppages for maintenance and the revival of natural gas production. Moreover, the government will also try to boost growth through the implementation of major public infrastructure projects under the Public Sector Investment Program (PSIP) and through the Public-Private- Partnership (PPPs) initiative.

Highlights

During the first quarter of 2013, the non-energy sector grew by 2.5%, outperforming the energy sector that recorded a marginal increase of 0.5% during the same period.

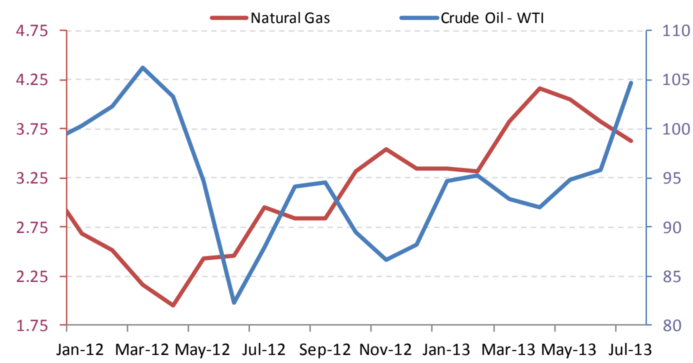
The authorities continue encouraging new oil and gas exploration after an audit indicated that in 2012 proven natural gas reserves declined 1.1%.

The government of Trinidad and Tobago has showed an increasing concern regarding deteriorating crime statistics.

The government continues to encourage new oil and gas explorations. The government of Trinidad and Tobago has agreed to resume discussions with the government of Venezuela regarding the sharing of the Loran-Manatee Field which crosses the maritime boundary of both countries. According to the authorities, the Loran-Manatee field has ten trillion cubic feet (tcf) of recoverable gas of which 2 tcf belong to Trinidad and Tobago. The last audit of Trinidad and Tobago's natural gas reserves indicated that in 2012 there was a decline of 1.1% in proven reserves, now standing at 13.1 tcf. The rate of decline has remained steady in the last years.

Prospects for higher oil and gas exports will depend on global developments. Since the beginning of the year, crude oil and natural gas prices have increased 18% and 8% respectively. However, natural gas prices dropped 6% from June due to an increase in available stocks (Figure 1).

Figure 1: Natural Gas and Crude Oil Price



Source: Bloomberg.

In 2012, the current account surplus decreased to 5.5% of GDP compared to 12.3 percent of GDP in 2011. The smaller surplus in the current account was the result of a smaller trade surplus compared to the previous year. Exports fell by 13.1 percent. Petroleum exports as a share of total exports decreased to 81.4 percent from 85 percent in 2011. Trinidad and Tobago's government is engaged in discussions with the Chinese authorities in order to establish direct trade of Natural Gas between the countries.

Inflation and unemployment remain stable.

Headline inflation accelerated in June but core inflation remains low and stable. Annual inflation slowed to 6.8% in June from 11% a year ago, but showed an increase from the 5.6% reached the previous month. Food price inflation also moderated to 12.6% after a peak of 28% in May-2012 with some minor month-to-month fluctuations. Core inflation (excluding the volatile food and energy components) remained low at 2.2%. The Central Bank of Trinidad and Tobago expects annual inflation to reach 5.8 percent in 2013, assuming no weather-related setbacks. The recent increase in international food prices could also create inflationary pressures and volatility.

The latest employment indicators showed that the unemployment rate fell to 4.9% in the second quarter of 2012 from 5.8% in the same period of 2011. Unemployment rates decreased in construction, wholesale and retail trade industries. Data on retrenchment notices also suggest that employment figures continued improving in the second half of 2012. The energy sector accounted for 3.5% of total employment.

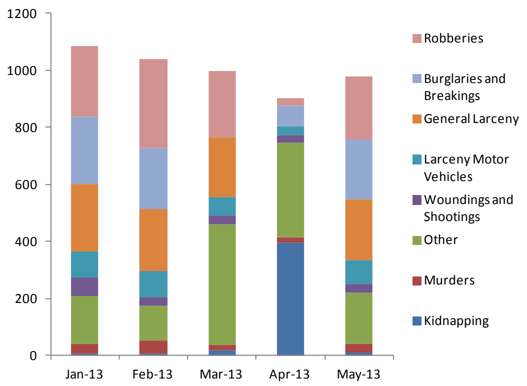
Crime concerns are increasing in the region

Crime statistics have deteriorated in Trinidad and Tobago over the last year. Crime incidents increased around 30% from 2011 to 2012 (Figure 2).

Last September, the United States signed an agreement to provide the Government of Trinidad and Tobago with USD 1.2 million for security assistance programs. The objective of the agreement is to strengthen Trinidad and Tobago's capacity to increase citizen security, juvenile justice, youth development, military and police professionalism, and drug trafficking and crime investigation.

Moreover, during the CARICOM Conference on July 2nd, Prime Minister Kamla Persad-Bissesar also suggested that a regional think-tank should be established to examine multiple security threats that the region is facing. The main security threats include the infiltration of porous borders by organized crime, the increase of small arms possession and the increase in drug and human trafficking.

Figure 2: Reported Crimes



Source: Trinidad and Tobago Police Service.

Issues to watch out for

The Trinidad delegates brought a set of important contributions to the Regional Caribbean Growth Forum meeting. Energy issues were at the forefront, with proposals to reduce possible barriers to smaller investors in petroleum production, but also policies to create incentives for non-oil activities such as Tobago tourism, small businesses and maritime logistics. The proposals were grouped around the seven growth pillars of the current national development plan: Tourism, Food Sustainability, ICT, financial services, culture and the creative industries, and Maritime industries. See website at https://sites.google.com/site/cgftrinidadtobago/

Underlying many of the plans will be improved opportunities for the inclusion of the private sector in development, starting with a pilot program to build social infrastructure projects in the health sector. The financing will be established under a public-private partnership (PPP) model, supported by the IDB.

High-frequency macroeconomic Indicators	Last data	Period	Prior data	Period
Annual GDP growth (%)	1.6	Q1 2013	1.0	Q4 2012
Tourism arrivals (annual % change)	-13.8	Dec-10	-5.7	Nov-10
Exports (12-month growth)	-13.1	Q4 2012	-12.1	Q3 2012
Imports (12-month growth)	-4.7	Q4 2012	13.9	Q3 2012
Private sector credit growth (%)	3.0	May-13	2.0	Dec-12
Inflation	6.8	Jun-13	5.6	May-13
Exchange Rate (End of Period)	6.39	Jun-13	6.44	Jun-13
Natural gas production (% yoy change)	2.1	Q4 2012	3.3	Q3 2012
Unemployment rate (%)	4.9	Jun-12	5.4	Mar-12

TRINIDAD AND TOBAGO IDENTIFYING BINDING CONSTRAINTS TO GROWTH

Despite lackluster growth in recent years, TT's performance has been one of the best in the region, in large part due to the spectacular growth of the energy sector in the last 20 years.

Nonetheless, Trinidad and Tobago's GDP growth remains one of the most volatile of the Caribbean region as a result of the country's dependence on the energy sector and consequent high vulnerability to price shocks. According to the latest Central Bank figures, in 2012, the energy sector accounted for 44% of GDP, 86% of exports and 54.5% of fiscal revenues. These levels are in line with the trend of the last years.

The lack of dynamism of the non-energy sector has raised questions regarding the sustainability of the country's long term growth. Many studies have tried to address these questions in order to establish a ranking of priorities for policy makers. This section discusses the conclusions of recent studies regarding growth constraints to Trinidad and Tobago, **evaluating whether those constraints remain binding given the most recent data**. Finally, the section concludes with the main areas on which the IDB should focus in order to promote sustainable long-term growth in the country.

Previous Studies on Trinidad &Tobago Growth Diagnostic

The most recent study (Artana et. al. (2007)) characterizes Trinidad as a dual economy with an under-performing non-energy sector and considerable volatility. The authors apply the growth diagnostic methodology proposed by Hausmann, Rodrick and Velasco (2005) to identify the most important barriers to greater growth. They focused on the non-energy sector and used a local survey of 500 firms to determine the perceived constraint to growth from a business perspective. The authors observed that Trinidad has the features of a "dual economy": while the energy sector is a source of self-financed investment, the benefits of large investments in the sector did not easily spill over to the rest of the economy. The authors suggest that the transfers from the petroleum sector to the non-energy sector through various government subsidies may exacerbate volatility in that sector, as well as contribute to its underdevelopment because it discourages productivity.

The study concludes that most of the binding constraints affecting Trinidad and Tobago's non-energy sector growth lie in the "lack of opportunities" in the growth diagnostic tree. Trinidad and Tobago underperforms relative to countries with similar income levels in terms of education, infrastructure and social indicators. Some of the resulting outcomes identified by the authors are low profitability, lack of human capital and poor infrastructure. Moreover, the authors suggest that the main challenge of T&T's government is to develop a strong countercyclical fiscal policy in order to reduce the output volatility, which will help them sustain long-run growth.

Table 1: Contribution of the Energy Sector

	2012	Ave 2007-11
% GDP	43.7	44
% Fiscal Revenues	54.3	54.3
% Exports	81.4	86.4
% Employment	3.5	3.4

Source: Central Bank of Trinidad and Tobago.

In a previous study by Rojas-Suarez and Elias (2006), the authors underscored the importance of fostering conditions that promote the development of a competitive non-energy private sector. They grouped the recommendations into four areas: 1) the promotion of greater labor market flexibility; 2) the reduction of trade restrictions in order to facilitate export diversification; 3) the provision of adequate infrastructure to maximize firms' performance; and 4) enhancing the efficiency of institutions that promote private sector business.

More recently, Sookam (2012) evaluated the economic sectors that were constrained by skill deficits in T&T, and identified the emerging sectors which have the potential to deliver sustainable economic growth and jobs across the country in the medium-term. The study concluded that the sectors with growth potential but skill constraints are agriculture exports, medical and health care, tourism and light manufacturing. The emerging sectors identified were advanced manufacturing, renewable energy and creative industries.

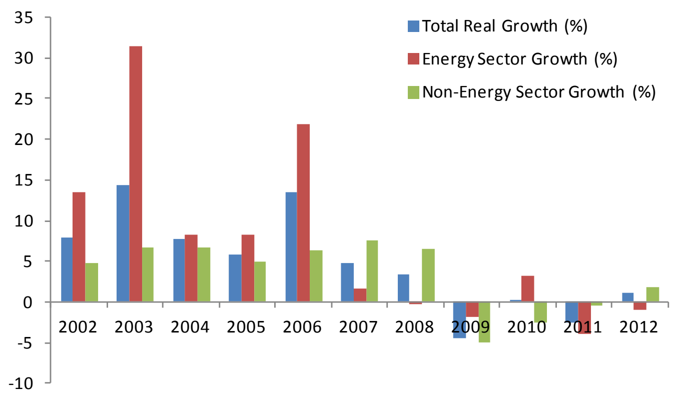
What has changed in the last five years?

Most previous studies were written at a time when Trinidad and Tobago was growing at a high rate, driven mainly by its energy sector. This has not been the case in the last years where growth has remained subdued in both sectors.

The preliminary figures for 2012 show that real GDP growth was 1.2%. The energy sector decreased 1% as result of prolonged maintenance operations by energy companies that led to lower output of crude oil and natural gas. Refining activities and production of petrochemicals were also affected. In contrast, the non-energy sector grew by 1.9% due to an expansion of the finance and distribution sector.

In order to analyze whether the better performance of non-energy sector is just an exception or a new trend, we consider whether the constraints highlighted by Artana (2007) remain binding.

Figure 3: Real Growth in Trinidad and Tobago



Source: Central Bank of Trinidad and Tobago.

Financial Constraints

The high levels of global liquidity suggest that credit availability is not a binding constraint to growth. Financing costs have remained low during the last five years, real interest rates have been negative and local credit supply has not changed. Nonetheless, the collapse of CLICO likely affected confidence in the system, while uncertainty by investors—as in most other countries hit by the global recession—has reduced the demand for credit.

Social Returns

Recent indicators do not suggest a marked improvement in human capital over the last five years (although these types of indicators tend to change slowly over time). The latest numbers show that the labor force with secondary education is 63% of the total, almost the same as that in 2007. However, there has been a small increase in the labor force with tertiary education to 11.1% from 9.5%.

Some education indicators are fairly decent, but the issue seems to be the matching of skills and the productivity of labor relative to the demand. The quality of education in Trinidad ranked 40 over 144 countries in the Global Competitiveness Report (GCR) of the World Economic Forum,[1] and the government of Trinidad and Tobago included in its 2013 budget that 16% of expenditures will be directed to education and training.

Table 2: 2013 Global Competitiveness Indicator for T&T

GCI Trinidad and Tobago	2012-13	1- year ago	5-years ago	Change
GCI Total Index	84	81	84	
1) Institutions	91	82	92	=
Organized Crime	121	117	122	=
2) Infrastructure	55	53	69	better
3) Macroeconomic Environment	19	57	16	worse
4) Health and Primary Education	55	60	62	better
5) Higher Education and Training	71	64	70	=
6) Goods Market Efficiency	106	104	75	worse
7) Labor Market Efficiency	110	87	62	worse
8) Financial Market Developments	60	49	45	worse
9) Technological Readiness	60	52	66	better
10) Markets Size	107	111	102	worse
11) Business sophistication	84	67	77	worse
12) Innovation	104	86	82	worse
Worst in ...				
Business costs of violence and crime	139	135	125	worse
Best in ...				
Investor Protection	24	20	15	worse

Source: GCI Report.

Infrastructure Constraints

According to the 2012 *Global Competitiveness Index* (GCI) Report, infrastructure capacity in Trinidad and Tobago improved with respect to 2007, but deteriorated relative to the year-earlier report (see table). Infrastructure concerns are related to the port quality and the availability of flights. Moreover, the quality of port infrastructure needs significant investments in order to serve the growing demand of the country: in 2011 alone port traffic increased 6%. Access to internet has increased steadily, though, from 32.7% in 2007 to 55.2%in 2011.

In 2013, the government of Trinidad and Tobago plans to invest $7.5 billion or 4.5% of GDP in the Public Sector Investment Program (PSIP). This program includes new and ongoing infrastructure projects (such as new roads and drainage programs, the construction of health facilities, the development

[1] Although these indicators are based on perception surveys, rather than comparable performance tests in math and science.

of port facilities such as the new port at La Brea, and the construction of 18 police stations). Nonetheless, execution of investment projects in T&T typically suffer delays due to low implementation capacity.

Appropriability and business conditions

The greatest problems in the area of business climate are low labor productivity and the high cost of crime. Although T&T continues to perform better than other countries when we consider investment barriers, ranking 24th in terms of protection to investors, perceptions have been deteriorating in the last five years. In addition, the burden of customs procedures for importers remain too high compared to similar economies. Moreover:

> As with other Caribbean countries, labor market efficiency remains a binding constraint to growth; moreover, cooperation in the labor-employer relation is low. In 2013, Trinidad and Tobago ranked 110 in Labor efficiency in the GCI Report, worse than in 2007 when the country ranked 62 (See Table 2).
>
> The high cost of violence and crime remains one of the main constraints for business competitiveness. Negative perceptions seem to have increased from 2007 according to the GCI Report. The government has recognized the need to reduce the incidence of crime and its negative impact on economic growth. The current government's main strategies to reduce crime are: (i) strong law enforcement; (ii) sustained social interventions; and (iii) strengthening the criminal justice system,

Tourism

Tourism continues to be an underdeveloped sector in Trinidad and Tobago. Although past development plans, including the recent Caribbean Growth Forum, identified tourism as a growth driver and a source of diversification, there have been few major domestically-led initiatives to jump-start this sector. An IDB-led initiative to increase tourism from southern Brazil could help spur demand. The island of Tobago would be the main area to develop.

Recently, the government has established The *Trinidad and Tobago Tourism Business Development Limited* as a corporate body to administer the Tobago Tourism Development Fund. It is hoped that this Fund will provide support to the tourism sector in Tobago.

Conclusion

The analysis shows that many of the binding constraints found by Artana et. al. (2007) are still present. In particular, market and labor efficiency remain low compared to similar income countries. High levels of crime have become an additional risk for new business opportunities. Many of these challenges have been identified by participants of the Caribbean Growth Forum, national chapter. Go to:
https://sites.google.com/site/cgftrinidadtobago/

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Trinidad and Tobago: Selected Indicators

	2008	2009	2010	2011	2012E
(Annual percentage changes, unless otherwise indicated)					
Real Sector					
Real GDP	3.4	-4.4	0.2	-2.6	1.2
Nominal GDP	28.0	-30.8	8.3	14.5	7.0
Inflation (end of period)	14.5	1.3	13.4	5.3	7.2
External Sector					
Exports of goods and services*	41.1	-50.5	21.9	33.0	-13.1
of which: oil and natural gas*	47.3	-51.8	18.8	34.7	-16.8
Imports of goods and services*	24.6	-27.1	-6.8	46.2	-4.7
Current Account (percent of GDP)	30.3	8.5	20.2	12.3	5.5
FDI (percent of GDP)	7.5	3.7	2.7	3.3	5
(In percent of GDP, unless otherwise indicated, on a fiscal year basis)					
Central Government**					
Revenue and Grants	34.3	29.0	34.1	32.6	32.0
of which: energy revenues	19.6	14.3	17.6	18.8	17.4
Current Expenditure	21.1	27.7	28.9	28.6	28.7
Capital Expenditure and Net lending	5.8	6.3	5.0	4.8	4.5
Primary Balance	9.1	-2.4	2.7	1.2	0.6
Overall Balance	7.3	-5.0	0.1	-0.8	-1.2
Consolidate NFPS balance (incl. CLICO)	8.0	-9.0	-3.9	0.0	-0.3
Debt Indicators					
Public Sector Debt^	21.5	30.6	35.5	33.4	39.3
Public Sector Debt over Revenues	62.7	105.5	104.1	102.5	122.8
External Public Debt (end of period)	5.3	7.7	6.7	6.4	6.7
External debt service as percent of exports of goods and services	0.9	4.4	1.0	1.2	1

Source: Central Bank of Trinidad and Tobago, 2013 Article IV Press Release, IMF WEO April 2013.

* refers to annual change in Value (USD Million)

** FY 2012 refers to October 2011-September 2012

^ Non Financial Public Sector Debt. Excludes debt issued for sterilization and since 2012 it includes debt increase due to issue to CLICO debt holders

The Caribbean Quarterly Bulletin

REGIONAL SUPPLEMENT: FOCUS ON GROWTH PRIORITIES TO OBTAIN CLEAR POLICY OPTIONS.

An important question over the past few years in the Caribbean has been, not only how to jump-start growth, but also how to boost labor productivity and address underlying long-term structural weaknesses that may have contributed to the current macroeconomic malaise. Nonetheless, progress on charting action plans has been slow in large part due to unavailability of reliable and comparable data and information for analysts. **This regional section discusses a methodological approach under consideration at the IDB Caribbean Department that may help move the process forward while engaging policy-makers in the region.** It is adapted from a methodology developed by the Organization for Economic Cooperation and Development (OECD) for advanced economies which publishes the analysis in their 'Going for Growth (GfG)' publication every year[1].

The Growth Diagnostic Methodology (GDM): how does it compare to the Growth Benchmarking Methodology (GfG)?

The Growth Diagnostic Methodology (GDM) approach (Hausmann, Rodrick and Velasco 2005)[2] has been used in many countries in Latin America and the Caribbean. More recently it was used to identify the binding constraints to growth in the Caribbean region as a whole, given the small size and similarities of these economies (DFID, 2008).[3] The DFID study admits that the lack of time series and benchmark data, particularly in the service sectors, did not allow a systematic approach of the GDM at the regional level. However, based on common patterns across countries, the study identifies the following main constraints: (i) the legacy of government as a 'Master Strategist' in the Caribbean, which supports chosen industries through distortionary tax policies and a high level of public involvement in the economy, leading to the support of sectors that are not always the most competitive; and a fragmented private sector that is untrusting of the public sector and has limited or no innovation and entrepreneurship capacity. Other constraints identified were: (ii) a narrow export base, limited to a few commodities and services; (iii) low labor productivity, in part due to the significant brain drain of qualified labor to advanced economies; and (iv) high public indebtedness.

Another more traditional approach of Growth Diagnostics is a World Bank study, which discusses the trends in growth in the Caribbean since the decade of the 1980s (including OECS countries), where the countries are divided into 'slow' and 'fast' growers. The study calculates total factor productivity, which for many of the countries declined in the 1990s[4]. For the growth diagnostics it examines three areas: Macroeconomic Environment indicators, Public Institution Indicators and Microeconomic Efficiency indicators. While there are deficiencies in the former two, the paper considers trade barriers and distortionary taxation as the greatest impediments to competitiveness and growth, as these factors offset the advantages the Caribbean economies have of being very open.

These results are in the same vein as the preliminary results found using the benchmarking (GfG) approach discussed below, in part due to the similarity of the approaches. Both methodologies try to identify just a handful of barriers to growth that are empirically comparable across countries and are concrete enough to be useful for policy-makers. Moreover, while they are more flexible in terms of specification demands than econometric studies, the relationships among the variables are based on those already identified in the theoretical and empirical growth literature.

The GDM and GFG methodologies have one important difference. Whereas the GDM uses an induction process to identify and characterize barriers to growth, the GFG methodology keeps the policy indicators simple, and measurable *de jure*. For example, the GFG may find a specific labor market regulation to be a binding constraint for growth in country x, given its performance relative to other countries; but the GDM may consider that it is not important because *de facto* that regulation is not being applied in that country. This is because the GFG methodology is concerned with comparability (thus the idea of benchmarking), whereas the GDM is concerned with characterizing the uniqueness of a particular barrier in that country.

The Going for Growth Methodology: a first pass at the Caribbean

The benchmarking exercise for the Caribbean is aimed at collecting, presenting and disseminating indicators on how Caribbean countries compare with each other and non-regional benchmark countries regarding indicators of labor productivity, labor utilization, and the business environment. In focusing on these three areas, the exercise borrows from the OECD's Going for Growth (GFG) methodology, which identifies performance

[1] See latest issue: "Economic Policy Reforms 2013: Going for Growth", OECD.

[2] Hausmann, R., D. Rodrick and A Velasco, 2005, "Growth Diagnostics," John F. Kennedy School of Government, Harvard University.

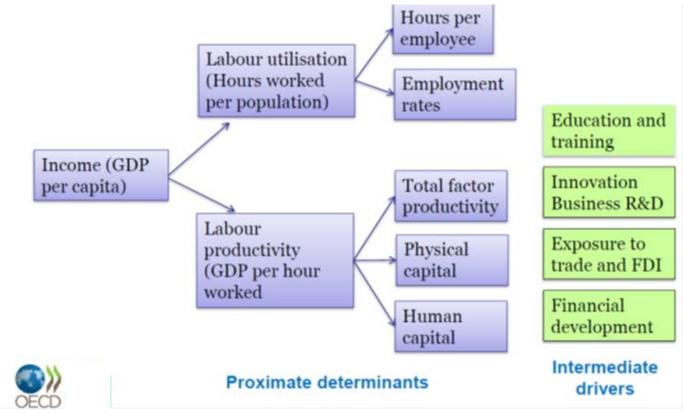
3 "Binding Constraints in the Caribbean", DFID Department of International Development and OTIF Group, May 2008

[4] Kida, Mizuho, (2005), "Caribbean Small States--Growth Diagnostics", note from PREM Small States Initiative, The World Bank

and policy gaps in those areas with a view to boosting real incomes in lagging member countries so they can converge to the levels of their richer peers[5].

The implicit model behind the GFG exercise is the standard growth model. The methodology conceptually decomposes output per worker of a country into labor productivity (a quality measure) and labor utilization (a quantity measure), which in turn can be further decomposed into proximate determinants (see the graphical depiction in figure 1). These are, for the case of labor utilization: employment levels and hours worked. For the case of labor productivity, the typical growth accounting factors: physical capital, human capital and total factor productivity. In turn, we know that aspects such as education and training, innovation and business research, openness to trade and foreign investment, as well as stable financial development are the intermediate drivers of this growth, that somehow impact the more proximate determinants in various ways well-documented in the economic literature. Policies that directly boost the intermediate drivers or the proximate determinants will be beneficial for economic growth. These can be described as a set of policy indicators.

Figure 1: Implicit Simplified Model behind OECD's 'Going for Growth' Exercise



For their exercise, the OECD has identified a set of 'policy indicators' for their member-countries, given these factors. In other words, they find measurable indicators over which the authorities can have an influence on the growth process. They then match each 'policy indicator' with the 'performance indicator' that it portends to influence, the simplest being growth of output per worker.

The policy and performance indicators are then compared to a benchmark. The comparisons allow benchmarking countries to identify gaps in their performance in the key micro-drivers of real incomes, and differences in their policy stance relative to those in benchmark countries. The comparisons provide a starting point for considering corrective measures to narrow performance and policy gaps.

Why benchmarking?

The standard way of approaching growth issues is to run regressions which include the country in question, and highlight the deviations from the average. However, many of the Caribbean countries in the regression may have very different economic structures and in some sense are thus not 'comparable'. Benchmarking allows for better comparability.

Benchmarking is more tractable and therefore more practical. The framework includes knowledge sharing of performance and policies related to productivity in the countries being analyzed. Dissemination of this knowledge could help stimulate further research and public discussion on differentials in productivity and real incomes across the Caribbean region and relative to levels in benchmark countries. It could also contribute to the analysis of policies that lead to those differentials.

There are some risks to benchmarking, but we believe the design of this exercise will mitigate those risks. First, countries may resort to 'score-maximizing', in which policy-makers attempt to boost an indicator to improve their ranking without a thoughtful discussion of the underlying weakness. However, this is more common for indicators where countries are ranked globally on one or a few indicators (such as the Global Competitiveness Indicators). In the GFG exercise there is no ranking, just a focus on the main barriers. Second, there is the potential pitfall of extending the use of benchmarking from a diagnostic tool that identifies differences in performance, to one that prescribes the same policy solutions to all countries. However, just because a policy was successful in one country does not mean that it will be in the other, In the GFG exercise, successes in other countries should be looked at as possible options but not necessarily wholly transferrable to another institutional structure.

The severe information constraints continue to be a concern for this exercise, as for any analytical work on Caribbean countries. An issue for any growth exercise in the Caribbean is the lack of reliable, consistent and detailed data. When data are available, for example, from the World Bank's 'Doing Business,' results are

[5] See "Economic Policy Reforms 2013: Going for Growth", OECD.

based on opinion surveys and not on factual data. With the possible exception of Jamaica, national accounts statistics are of poor quality as a result of severe under-funding of data-gathering activities and implicit or explicit restrictions on the funding of these activities. Some governments prefer not to gather certain data, or severely restrict the dissemination of data to third parties or the public.

Preliminary results for Benchmarking Productivity & Real Income in the Caribbean

Preliminary results of the benchmarking study for the six Caribbean countries members of the IDB —The Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago (T&T) confirm that the business climate and infrastructure quality are the greatest barriers to growth. These can have an impact primarily on labor productivity. Indeed, the GFG methodology emphasizes labor-related indicators[6]. This is consistent with recent literature on growth in the Caribbean, which increasingly identifies low factor productivity, and particularly labor productivity, as the key determinant of sluggish growth and adverse income differentials[7].

The benchmark country/groups chosen were the average of other small economies, a group of non-regional benchmark countries with population less than 3.5 million.[8] These are, in turn, divided in two types: those that mostly rely on tourism activities and those that mostly rely on commodity exports. The first group is used to benchmark the performance in Barbados, The Bahamas, and Jamaica; while the second group is used for Guyana, Suriname and Trinidad & Tobago. Results using Mauritius as a benchmark are similar but not reported here.

The choice of the indicators depend on the extent to which their inclusion is supported by the literature, case studies, and diagnostic exercises on Caribbean productivity and growth, as well as by the availability and comparability of indicators across countries[9].

The benchmarking exercise reveals all the performance and policy indicators that are lagging behind their corresponding benchmarks (see graphs in Figures 2 below). The graphs show the problematic performance/policy pair (plotted in red) that are contained in the lower-left quadrant for every country graph. This quadrant indicates that the country is below the benchmark in both performance and the degree of policy progress for that indicator, and thus gives a first clue about the problematic areas requiring attention.[10]

The results show that the high tax burden on businesses is a common factor detrimental for investment and economic growth among tourism-dependent countries in the Caribbean[11]; while for the group of commodity exporters, 'procedures' and 'time to register a property' affects importantly the level of FDI in Suriname. 'Quality of electricity supply' and 'business cost of crime' detriments productivity in Guyana; and 'procedures and time to register a property' affects private investment in T&T.

Looking Forward: A policy tool for the Caribbean

There are ongoing plans at the IDB to adopt the methodology developed by the OECD to the member countries. This project would help carry forward the work on growth and benchmarking in the Caribbean in two ways.

- **First, it would focus on key factors that contribute to real GDP per capita,** such as labor productivity, labor utilization, the business environment, and the micro-drivers associated with each. In doing so, work on the proposed methodology would supplement other efforts to re-balance the analysis and discussions on Caribbean growth toward the underlying, structural factors that drive the behavior of firms and labor market participants. While macroeconomic factors are also important, there is already an ample supply of detailed macro-analyses that assess comparative performance in those areas.

- Second, by assembling and disseminating all available information on labor and the business environment that influence productivity, the methodology could **promote knowledge-sharing and sharpen the analysis of differentials in productivity and real incomes within CARICOM, as well as between CARICOM and**

[6] See "Economic Policy Reforms 2013: Going for Growth", OECD.
[7] See, for example, ECLAC, 2012, Craigwell and Warner, 2003, Downes, 2003, Thacker, Acevedo, et al, 2012, and Thomas and Serju, 2009.
[8] Current analysis done by the Caribbean Economic Team at the IDB show that particular macroeconomic issues arise when economies have less than 3.5 millions of people. We use this group of countries as benchmarks given the economic similarities shared with the Caribbean countries, particularly regarding the size issue.
[9] The exercise uses a range of sources for indicators that are comparable, current, and credible. Indicators derived from perceptions will be used sparingly and in cases where statistics on a key policy area are unavailable. Sources include the World Bank, UNDP, ILO, Penn World Tables, the WEF, and Caribbean statistical resources.

[10] Indicators are normalized by using cross-country standard deviations; those with normalized values higher than 1.5 standard deviations are selected.
[11] However, not all firms are affected as many have generous tax exemptions and tax waivers, although these are nonetheless distortionary.

benchmark countries. In sum, a focus on quantitative indicators of labor and the business environment, comparative analysis, and more public discussion can contribute to a deeper understanding of income differentials and a sounder basis for policy action. Depending on the availability of data, the methodology could also help enhance the analysis of gender and sectorial aspects of the labor market.

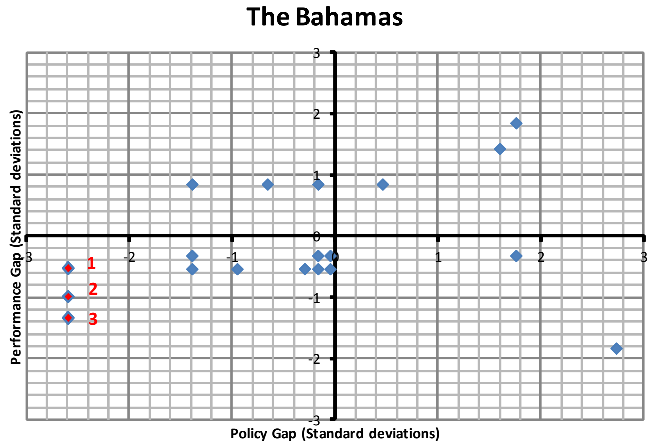
The contribution of the exercise will depend on the extent to which concerns in the literature about the application of benchmarking can be addressed. Priorities include close collaboration with country representatives and ensuring that successful policies in benchmark countries are adapted to the conditions and implementation capacity in the benchmarking countries. Regarding the methodology, since benchmarking is indicator-based, the credibility of the exercises will depend on the availability and reliability of indicators, their comparability with those of other countries, and the extent to which their association with productivity is established. Qualitative assessments to supplement the indicators will be essential given the diversity of the region and the unevenness of the data.

The benchmarking exercise, once established, would be done in consultation with member countries (including their productivity councils or equivalents and the business sector) and institutions such as The Caribbean Growth Forum, CARICOM, the Caribbean Development Bank, and the University of West Indies. Following these discussions, a benchmarking exercise for the region could be initiated, perhaps through a pilot on one of the countries. The tool could then begin to evolve into a useful new analytical and policy supplement for addressing the overarching challenge of improving productivity, growth, and income inequalities in the Caribbean.

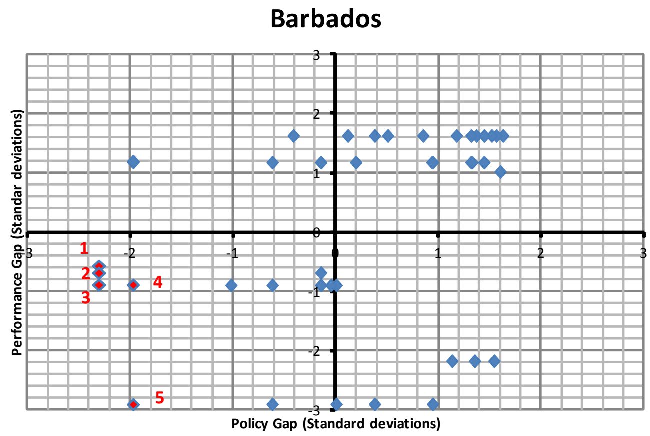
Conclusions

Policy-makers need concrete issues for discussion and clear policy options to make decisions that will foster economic growth. The GFG methodology focuses the problem to two or three challenging areas and is less data-intensive that other econometric approaches traditionally used. Thus, by presenting periodic snapshots of how economies compare with respect to their respective benchmark in terms of labor and business environment performance and policies, a Caribbean exercise could help promote policy changes to narrow differentials and raise real incomes in lagging countries[12].

Figures 2: Performance and Policy Indicators: Tourism Dependent Countries.



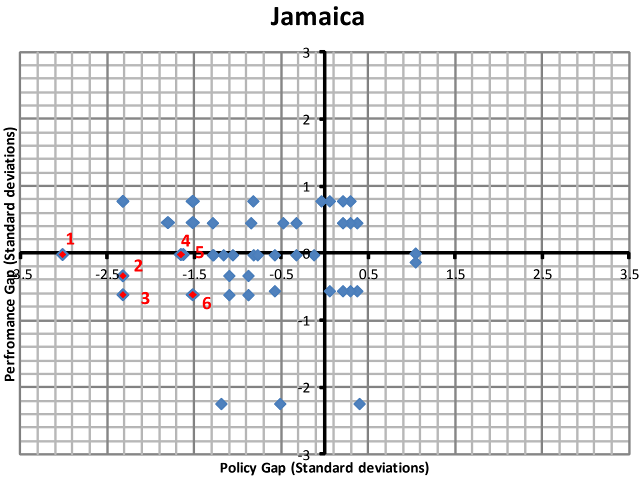
Note: Numbers correspond to the following ordered pairs: 1.- (Total Tax rate; Total investment growth in 10 years) / 2.- (Total Tax rate; Per worker GDP growth in 10 years) / 3.- (Total Tax rate; Per worker GDP growth in 5 years)



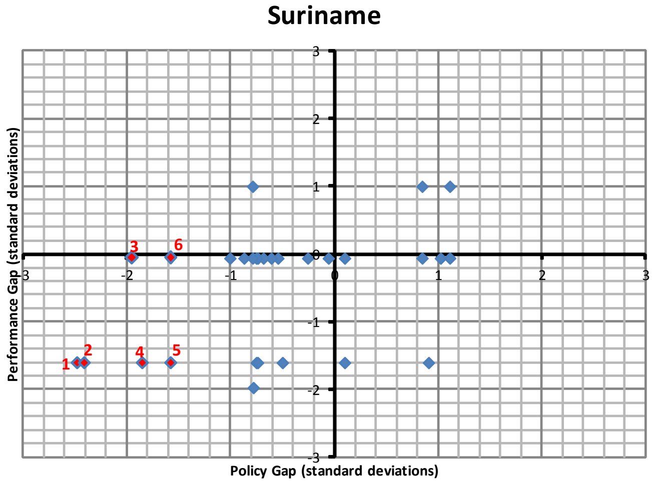
Note: Numbers correspond to the following ordered pairs: 1.- (Total Tax rate; Per worker GDP growth in 10 years) / 2.- (Total Tax rate; Per worker GDP growth in 5 years) / 3.- (Total Tax rate; Total investment growth in 10 years) / 4.- (Time to register a property; Total investment growth in 10 years) / 5.- (Time to register a property; Total investment-to-GDP ratio in 20 years)

[12] More details can be found in: "**Policy Benchmarking for Productivity and Growth: Review and Proposed Framework for the Caribbean"**, by M. D'Acosta, K. Melgarejo and V. Mercer-Blackman, Technical Note No. IDB-TN-578, August 2013.

REGIONAL SUPPLEMENT: FOCUS ON GROWTH PRIORITIES TO OBTAIN CLEAR POLICY OPTIONS.

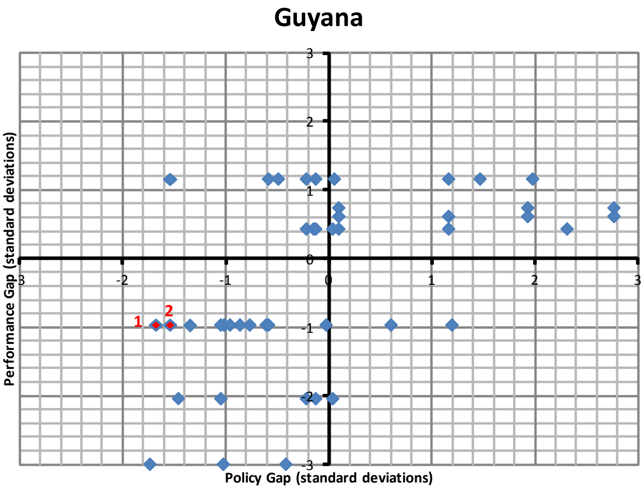


Note: Numbers correspond to the following ordered pairs: 1.- (Business costs of crime and violence; GDP per worker 2010) / 2.- (Total Tax rate; Per worker GDP growth in 10 years) / 3.- (Total Tax rate; Per worker GDP growth in 5 years) / 4.- (Quality of math and science education; GDP per worker 2010) / 5.- (Fixed broadband Internet subscriptions; GDP per worker 2010) / 6.- (Company spending on R&D; Per worker GDP growth in 5 years)

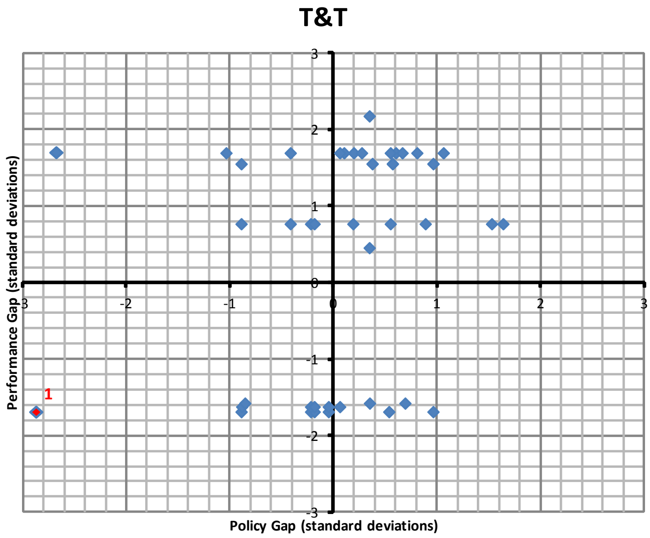


Note: Numbers correspond to the following ordered pairs: 1.- (Procedures to Start a Business; FDI growth in 10 years) / 2.- (Time to register a Property, FDI growth in 10 years) / 3.- (Internet access in schools; GDP per worker 2010) / 4.- (Business impact of rules on FDI; FDI (% GDP) in 10 years) / 5.- (Company spending on R&D; FDI (% GDP) in 10 years) / 6.- (Company spending on R&D; Per worker GDP growth in 5 years)

Figures 3: Performance and Policy Indicators: Commodity Dependent Countries.



Note: Numbers correspond to the following ordered pairs: 1.- (Quality of electricity; GDP per worker 2010) / 2.- (Business costs of crime and violence; GDP per worker 2010)



Note: Numbers correspond to the following ordered pairs: 1.- (Procedures to register a Property; Total investment growth in 10 years)

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