Caribbean SIDS Regional Preparatory Meeting
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Kingstown, St. Vincent & The Grenadines

Session 3

Resource Mobilization and Concessional Financing for Caribbean SIDS

9 August 2023, 9am – 11am

Background Note

Introduction:

Highly indebted countries in the Caribbean have been impacted by a perfect storm in the last few years. This stems from a four-pronged crisis that has constrained their ability to mobilize sufficient affordable financing to advance their development. These storm factors are the COVID-19 pandemic, the disruption of supply chains, the war in Ukraine and its attendant fallout and monetary tightening and deglobalization at the international level. These shocks have necessitated higher spending by already highly indebted countries. Therefore, the subregion will need to mobilize significant affordable financing to achieve its priority goals under the SAMOA Pathway and SDGs. To reach the scale of financing required, the subregion will need to mobilize more domestic resources from its commercial and development banks, stock and venture capital markets. This could be supported by innovative mechanisms such as the Caribbean Resilience Fund (CRF), the Bridgetown Initiative and the Multidimensional Vulnerability Index (MVI).

Strategies and Instruments for Scaling Financing for Development in Caribbean SIDS

Given the extent to which the financial constraint continues to limit investment in growth-producing activities and climate change adaptation, there is a need for rethinking how to unlock appropriate sustainable finance. This challenge requires a sea of change in the

Caribbean's approach to financing development both at the domestic, regional and international levels.

As has been proposed by the UN Conference on Financing for Development, domestic financing is the main source of development financing. It is therefore critical that Caribbean SIDS design policies and strategies to optimize the mobilization of domestic funds. The focus should be on incentivizing and removing bottlenecks to the flow of traditional sources of funding complemented by improved fiscal management to generate current savings where possible or at least to reduce the level of borrowing. Undoubtedly, with the private sector as the engine of growth, private finance is critical to achieving the priority goals under the SIDS programme of action.

Commercial banks which dominate the financial system in the subregion will need to contribute more to development financing. Nevertheless, to incentivize them to do this there is the need for improved credit ratings to determine the real value of businesses, lower reserve requirements by Central Banks and the normalizing of the use of moveable assets as collateral for loans. Alongside commercial banks, stock markets and venture capital funding are important to fund projects with the highest rates of socio-economic returns.[i]

The Caribbean Resilience Fund (CRF)- an innovative financing vehicle

The ECLAC-initiated CRF will be a special-purpose financing vehicle that addresses the need for climate financing and structural transformation in Caribbean SIDS. The Fund will focus on key niches to channel its impact and effectiveness. The value added of the Fund include: helping to fill the gap in affordable climate finance; investing in region-wide, properly scaled projects in resilience building and leveraging and coordinating funding from key partners. The goal is to have a nimble Fund with an uncomplicated disbursement mechanism to expedite project implementation.

To promote medium to long-term development, the CRF will provide financing for viable projects green energy, water management, agriculture and food security, sustainable tourism, disaster risk management and pooled risk mitigation insurance. The accent will be on projects that promote climate change adaptation and mitigation. The CRF will leverage linkages and synergies to raise resources by collaborating with partners including the CARICOM Development Fund (CDF), Caribbean Development Bank (CDB), the IADB, the Development Finance Corporation (DFC), the Green Climate Fund, and the Adaptation Fund among other financiers. For resilient infrastructure, in particular, there is a clear business case for increased private investment, as the UN has indicated that there is a $6 return for every $1 invested. Currently, the full details of the structure and modality of the CDF have not been fully worked out, but the hope is for these to be ironed out as soon as possible to make the fund fully operational.

The Bridgetown Initiative (BI): creating a more effective global financial system

The Bridgetown Initiative calls for a reformed and reimagined global financial system that delivers on the promise of the SDGs. The vision is for a more nimble and representative financial system, primed for tackling global poverty, inequality, climate change and biodiversity loss, among other key issues. The Initiative puts forward key priority actions that range from the short-term to the long-term that would provide affordable financing at scale to highly indebted developing countries facing the overlapping crises of unsustainable debt, the impacts of the pandemic, slow growth, high inequality, natural disasters and the climate crisis.

In the short-term, the BI calls for OECD countries to fast-track the re-channeling of $100 billion of Special Drawing Rights (SDRs) to the Poverty Reduction and Growth Trust and the Resilience & Sustainability Trust. To enhance the development impact of the reallocations the BI calls for the IMF to suspend surcharges on the funds for two to three years and to restore the enhanced access limits provided during the pandemic to the Rapid Credit Facility and Rapid Financing Instruments. Second, the BI calls for better strategies to restore debt sustainability. Key measures include: developing a common framework to speedup debt relief and cancellation. A key proposal is the need for zero-cost, net present value neutral natural disaster clauses in lending contracts to liberate resources for rehabilitation and reconstruction in the Caribbean and other SIDS in the event of a disaster. The BI also advocates for full capitalization of the UNFCCC Loss and Damage Fund to $100 billion per year. Alongside this, there is the need for an easy disbursement mechanism to enable Caribbean SIDS to readily access the Fund.

Trade has not worked as well as required for the Caribbean. Alongside, weak productivity growth, has been a subpar net exports performance in the subregion. Improved financing is key to scaling up export-ready activities, especially in non-traditional sectors such as the creative industries and high-end agro-processing to generate more foreign exchange. Nevertheless, as the BI notes, there is also the need for a fairer multilateral trading system that provides more policy space and differential treatment for SIDS, owing to their limited capacity.

The Multidimensional Vulnerability Index (MVI): Catalyst for a more just allocation of development Finance

The MVI when completed could provide a basis for greater equity and fairness in the allocation of global development finance. This could be the case, if it is considered as one of the key pillars in determining the graduation of countries from concessional finance based on their inherent vulnerability. It is well established, that although useful, per capita GNI is an inadequate measure for determining whether countries need concessional financing. The MVI provides an integrated index of the structural vulnerability of countries. Structural vulnerability relates to recurrent adverse exogenous shocks and stressors that reverse development gains. For the Caribbean key measures of structural vulnerability include the threat of natural disasters, fluctuations in export earnings and foreign direct investment (FDI), the high cost of borrowing on the international market and ecosystem depletion and biodiversity loss. All of these and others limit the development space in the subregion. The MVI is based on the principles of multidimensionality, universality, endogeneity, availability and readability, all of which cohere to make a fit-for-purpose index.

An important advantage of the MVI over GNI per capita is that it allows for a careful weighting of the indicators to reflect their relative impact on the vulnerability or resilience of countries. Further, it allows for the inclusion of a range of representative indicators such as fluctuations in export earnings, financial flows, exposure to natural hazards and extreme weather events and exposure to global health shocks, including pandemics.

Environmental Social and Governance (ESG)

The market for ESG assets has experienced a correction which now presents more realistic values that should entice investors (Moyo, 2023). Further, the market is now growing from $35 trillion in 2020 to $50 trillion in 2025. This should open an important opportunity for Caribbean countries to tap into this pool of funding.

Recommendations for Action: mobilizing more resources and concessional financing for Caribbean SIDS

Based on the situational analysis, key recommendations are proposed for mobilization appropriate finance at scale for development.

1. Strengthen the incentive framework to encourage commercial banks to increase lending for productive development activities in tourism, agro-processing and possibly green energy. This would require better project development and management by businesses, upgraded financial management to show the sales potential of their operations and an overall improvement in the business environment to ensure the viability of investment projects. Governments can contribute to this by creating better, more efficient administrative systems that reduce the time for delivering key services such as port clearance, business approvals and tax compliance.
2. Modernize and upgrade the capacity of domestic development banks to vet and monitor productive sector and social sector projects to ensure their profitability and viability. This would require a better mix of market-driven and social incentives, which ensures efficiency with equity and social purpose.
3. Caribbean governments should advocate strongly for the support and capitalization of the CRF as a unique special-purpose financing vehicle. The CRF should be championed as a vehicle to provide the space for funding for the kinds of activities that would reduce the subregion's dependence on future international support as it can facilitate higher long-term equitable growth.

4. Debt restructuring mechanisms should focus on providing adequate relief to enable indebted countries to achieve higher growth rates that could reduce their debt to GDP ratios and the need for future restructurings.
5. State-contingent debt instruments such as natural disaster clauses should be mainstreamed in debt contracts with Caribbean governments to provide much-needed relief and moratoriums on debt repayment after natural disasters such as hurricanes to enable affected countries to rebuild and recover.
6. Coming out of the Paris Financing Summit, the IMF should be pressed to deliver the $100 billion in SDRs for climate-vulnerable countries and for the World Bank to deliver on debt suspension for countries affected by climatic disasters.

Proposed Guiding Questions for the Discussions

1. What concrete actions can member countries take to secure lower borrowing costs on the international market, especially in the context of rising interest rates in major markets?
2. How can Caribbean SIDS best advocate for better trade deals, particularly special and differential treatment for key sectors in the wake of the potential distortionary effects of the US's Infrastructure Bill and Inflation Reduction Act?
3. Given the growing market for ESG funding, how can Caribbean SIDS position themselves to capture an optimum share of these funds?
4. What are some of the constraints and difficulties that regional banks face when engaging with international investors in addressing challenges faced by SIDS?
5. What kind of inter-agency collaboration exist amongst the development banks and how effective has it been?
6. Acknowledging that the World Bank and IMF have their own vulnerability indexes, what are their thoughts on the MVI and do they think that it can be incorporated into their systems?

[i] Socio-economic as distinct from purely economic returns are critical as in some instances, the social value of a project for instance, technological upskilling in education might justify its financing despite relatively lower economic returns.