



Session I. Regional Integration: Leveraging Common Institutional Arrangements Across the Caribbean

Deeper economic integration within the Caribbean has been a regional policy priority since the establishment of the Caribbean Community (CARICOM) in 1973, with the goal to transform the region into a borderless community that pools resources and exploits opportunities that could not be achieved individually. However, slow progress in institutional integration has hindered economic integration in the region, creating skepticism about the benefits of the full integration process. This session will explore whether and how progress in institutional integration—through harmonization and rationalization of institutions and greater cooperation in functional policy area—could provide the needed scale and boost to regional integration.

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Panelist 1: Irwin LaRocque, Secretary General of CARICOM

Panelist 2: Mia Mottley, Prime Minister of Barbados

Panelist 3: Gervase Warner, CEO of Massy

Panelist 4: David Lewis, Vice President, Manchester Trade Limited, Inc.

Panelist 5: Humberto López, Acting Vice President, Latin America and the Caribbean Region, The World Bank

I. Background

Deeper regional integration has been a long-standing objective for the Caribbean.¹ The persistent interest in this quest led to the establishment of the Caribbean Community (CARICOM) in 1973, with the goal to address the constraints of small size on development, share the cost of common services, and pool bargaining power in international fora. Changing global conditions and the rise of globalization prompted the political leadership to seek a deeper form of integration by establishing the Single Market and Economy (CSME) in the early 2000s through the Revised Treaty of Chaguaramas. The CSME provisions focused on forming a free trade area, a customs union, a common market with free movement of capital, skilled labor, goods and services, and an economic union with coordinated sectoral and macroeconomic policies.

¹Al Hassan, Burfisher, Chow, Ding, Di Vittorio, Kovtun, McIntyre, Ötker, Santoro, Shui, and Youssef (2019), "Is the Whole Greater than the Sum of its Parts? Strengthening Caribbean Regional Integration," IMF Working Paper (forthcoming).

While significant progress has been made, the implementation of regional integration initiatives has been slow, with only 57 percent of the actions required to establish the CSME completed. The customs union and common market stages remain incomplete with significant nontariff barriers (NTBs) to trade and divergent tariff rates applied to extra-CARICOM trade, while poorly harmonized regulations and duplication of processes continue affecting intraregional labor movement. Little progress has been made in harmonizing/coordinating policies to support a single economic space, with continued restrictions on capital mobility, and lacking harmonization and coordination of investment codes, tax incentives, and macroeconomic policies. This implementation deficit has created increasing skepticism within the region about the likelihood and benefits of completing the CSME.

The CARICOM leadership recently took decisions to reinvigorate the integration momentum. At the November 2018 Special Eighteenth Meeting of Heads of Government on the CSME as well as the Thirtieth Intersessional Meeting of Heads of Government in February 2019, key decisions were taken, including those in the St Ann’s Declaration on CSME, to decisively move forward with implementation of the CSME agenda in critical areas, such as free movement of labor, harmonizing markets and institutions to avoid duplication, and a more formalized and structured mechanism for engagement with the private sector and labor. At the 2019 IMF/World Bank Spring Meetings seminar on *Caribbean Regional Integration*, the Caribbean authorities called for accelerated efforts in this direction, with a well-defined roadmap and timelines. It is important to capitalize on this momentum.

This background note documents the evolution of regional integration within CARICOM and discusses possible ways to move forward, with a focus on three main concepts of integration: *institutional integration* (defined as the outcome of joint policy decisions taken by regional inter-governmental fora designed to affect the depth and breadth of regional integration); *economic integration* (captured by the convergence of various indicators of monetary, real, and financial integration); and *functional cooperation* (in areas including, e.g., stability, security, environment, or managing natural disaster shocks). The note discusses the key impediments to institutional integration and argues that greater efforts to remove these impediments and push forward integration in key functional areas can be a way forward for CARICOM integration.

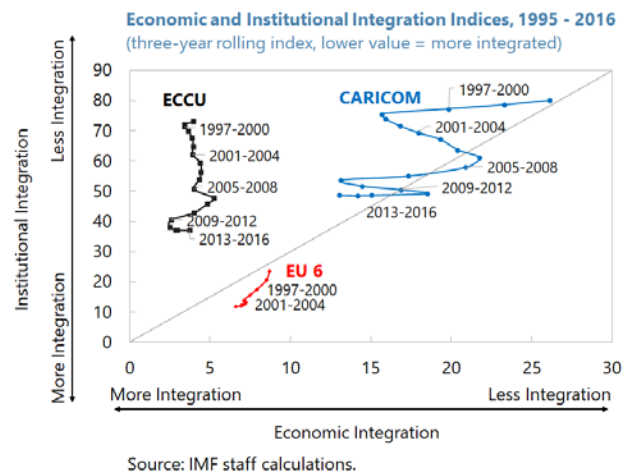
II. The Evolution of Regional Integration within CARICOM

1. The progress of institutional integration within CARICOM has been slow and incomplete, suggested by the evolution of an index of institutional integration. The index, constructed based on progress in completing the five stages of the process: a free trade area, a customs union, a common market, an economic union, and total economic policy integration, suggests that CARICOM integration has proceeded in several waves, with periods of integration followed by slowdowns in progress. Since the launch of the CSME, the CARICOM has made significant progress in establishing the common market, particularly in free movement of goods

and services. However, issues with full implementation of the facilitation of travel regime, harmonization of processes for movement of skilled nationals, capital market integration and NTBs remain. There are also impediments to the effective functioning of key regional institutions. For instance, the CARICOM *Competition Commission* to ensure fair competition has been established, but the legal and institutional framework for enforcing the rules of competition at the national level remains to be initiated in several states. The *Caribbean Court of Justice*, with prime responsibility for interpreting and applying the Revised Treaty of Chaguaramas, is vital to the functioning of the CSME, but it has been established only in a few member states as an appeals court. Integration within the Organization of Eastern Caribbean States (OECS), a sub-region of the CARICOM, has advanced faster, with free movement of labor and services within the OECS and supranational institutions tasked with policy harmonization.

2. The degree of economic integration within CARICOM also lags other well-integrated regions. An overall index of economic integration, which measures the degree of regional trade and financial integration as well as the convergence of various indicators of monetary, real, and financial integration,

suggests that divergence of key macroeconomic variables across CARICOM has fallen over time, but the fall has slowed down or even reversed recently, partly reflecting the different impact of external shocks on tourism-dependent CARICOM countries vis-à-vis commodity exporting members. The evolution of economic integration along with institutional integration suggests that economic integration has been affected by the slow and incremental progress in institutional integration. Although CARICOM is moving in the right direction in both dimensions, the region has a long way to go compared to other well-integrated regions.



3. The slow pace of regional integration reflects a combination of economic, institutional, and political economy factors, as well as resource and capacity constraints.

The lack of a regional body with powers and accountability to effect decision making and of tools to transform community decisions to binding laws are key impediments. A decision-making process based on unanimity principle under which each member retains its sovereign authority has also hindered progress, especially when combined with inadequate resources and technical expertise, and lacking prioritization needed to draft and ratify laws and secure public support for the decisions made.² Misalignment of incentives for integration add to these institutional

² In contrast, the European Union (EU) does not require unanimity for decisions to be approved and relies on qualified majority voting. The Council of the European Union (one representative from each member state) and

constraints, with large up-front costs of implementing the necessary measures against the potential benefits for trade, growth, or employment that are perceived as uncertain, potentially uneven, or materializing over a longer horizon. Differing export and production structures, diverging economic fortunes across commodity- and tourism-based economies, and diverse income and development levels add to misalignment of national interests, making harmonization of economic and structural policies a challenge. The slow progress with institutional integration and harmonization of legal and administrative frameworks has, in turn, hindered implementation of the essential components of the CSME and undermined economic integration.

4. Can CARICOM move towards firmly establishing the CSME and deeper integration without embracing supranationalism? The current reliance on intergovernmental cooperation, a key factor affecting the implementation of CSME actions, means that unless governments are prepared to accept a level of supranationalism, effective functioning of key regional institutions will be impeded. Failing to bring in supranationalism to the integration process means that full cooperation will not occur unless member states are convinced of the benefits of integration and focus their efforts on aligning national incentives with the interests of the region.

III. Benefits of Further Integration and the Way Forward

5. Addressing the common challenges facing the Caribbean requires a regional approach that rests on greater integration and policy coordination. Despite their different economic sizes and development stages, the Caribbean economies face common external shocks and structural impediments to growth. IMF staff's quantitative analysis suggests that further liberalization of trade and greater labor mobility in the region can generate significant growth benefits. For instance, reducing the high NTBs and trade costs within the region and vis-à-vis non-CARICOM trading partners can generate trade expansion and welfare gain for all members, and help restructure economies from contracting to expanding sectors, resulting in a net employment gain across the region.³ Further labor market integration could improve factors and skills allocation, including by helping to limit the pervasive brain-drain, thus increasing the region's labor productivity and long-run potential growth.

6. How can CARICOM harness these economic benefits from integration? The observation that institutional and economic integration go hand in hand suggests that the region should focus its utmost attention to understanding and addressing the key impediments to progress in **institutional integration**. These could include:

the European Parliament (directly elected by voters in each member State) together exercise authority in specified areas that binds member states. All decisions are defined as European Directives and automatically have the force of EU law, and member states are required to incorporate them into national law.

³ Model simulation suggests that a 25 percent reduction in NTBs and trade costs could bring \$6 billion welfare gain for the CARICOM, or 7.6 percent of the region's GDP in 2018.

- *Appropriate institutional and governance mechanisms:* In reflecting on the CSME architecture, the EU experience with appropriate institutional and governance mechanisms to make community decisions, such as qualified majority voting instead of unanimity for decision making, and the closer integration observed within the OECS sub-region, where the creation of some supranational institutions has helped better coordination and harmonization of policies and institutions, could provide valuable insights.
- *Alignment of incentives:* National and regional efforts could focus on aligning national interests with those of the region, supporting these efforts with convincing evidence on the potential benefits from further integration. Well-structured, adequately resourced, and accepted mechanisms would be essential to provide safety nets and financial and capacity support to those states that could be disadvantaged by further integration to ensure that benefits from integration are widely shared.
- *Addressing resource and capacity constraints:* CSME implementation is a highly complex undertaking both at national and regional levels. Significant technical support and access to low-cost financing are crucial. As called on recently by regional leaders, the Caribbean Development Fund (CDF) has a pivotal role to play in mobilizing resources to support the region's stepped-up efforts to implement the outstanding elements of the CSME agenda and addressing social and economic disparities that may be caused by CSME actions.

7. Could integration through functional cooperation provide a “low-hanging fruit” to build momentum into the integration process? Some of the key challenges facing the Caribbean region transcend national boundaries, calling for regional solutions. Addressing challenges such as ensuring financial stability in increasingly more interconnected financial systems, building resilience to more frequent and severe climate risks, or containing violent crime, can be viewed as a regional public good that calls for collective action and cooperation by individual nations. Such cooperation can be particularly fruitful where it can resolve collective action failures that encourage harmful competition and result in “race-to-the-bottom” situations. At a time when momentum for economic integration needs to be accelerated, close cooperation in these areas can help demonstrate benefits of coordinated action and serve as a building block to the ultimate goal of full integration. Some examples are:

- *Advancing policy coordination in the financial sector:* A coordinated approach with effective information sharing and home-host supervisory arrangements and harmonized resolution frameworks is essential to limit regulatory arbitrage, respond to financial stress, and safeguard financial stability, including for cross-border institutions. Progress in these areas, along with effective AML/CFT regimes, can also help address the loss of correspondent banking relationships (CBRs) and persistent weakness in asset quality. A regional distressed-asset market and reduced data gaps through effective information sharing are also key in this regard.
- *Building resilience to natural disaster and climate risks:* In a region highly vulnerable to frequent and costly natural disasters, collaborative solutions could aim at building resilience to climate risks, by pooling resources and capacity, building on the positive experience with

facilitating speedy recovery and reconstruction after disasters and with mitigating financial costs of disasters through the Caribbean Catastrophe Risk Insurance Facility (CCRIF). A unified Caribbean has also a better chance of acquiring necessary financing from development partners, raising its voice on climate mitigation policies, and mitigating, adapting to, and building resilience of their economies to climate risks.

- *Fighting crime*: The high rates of violent crime impose a serious social and economic burden on the region. CARICOM has taken significant steps to deal with crime, but limited national budgets continue to favor ex-post response through law enforcement, as opposed to ex-ante management of crime risk. Collaboration could focus on both preventive and response efforts, pooling regional resources and information, standardizing legal and institutional frameworks, enhancing intraregional labor mobility to create jobs and disincentivize crime, and safeguarding border security.
- *Avoiding a race to the bottom*: Regional cooperation can be particularly fruitful in areas where it can facilitate solutions to collective action problems that can encourage harmful competition, including to attract FDI through excessive tax incentives. Close cooperation on, and harmonization of, tax incentives can help safeguard fiscal revenues and limit potential adverse effects on fiscal sustainability, growth, and development. Similarly, developing a regional approach to manage Citizenship-by-Investment (CBI) programs can improve their long-term viability and prevent a race to the bottom by relaxing rules to attract inflows, which would undermine, in turn, fiscal sustainability and integrity of the programs.

8. The whole can be greater than the sum of its parts. While the small size and scale of the Caribbean economies, and the associated supply-side constraints, may potentially limit how much benefit can be extracted from economic integration in the form of regional value chains, acting as a group, through more concrete progress with **functional cooperation** and/or **institutional integration**, can enhance the scale, with benefits likely exceeding what can be gained by acting individually. Regional and global development partners, the private sector, and civil society should join these efforts, to coordinate, advocate, and support the actions, including through funding and technical assistance to make sure that benefits of integration are shared across the region. A regionally integrated Caribbean should also have a better chance to advance toward a globally-integrated Caribbean to take advantage of global value chains—that is, regional integration should be a means to an end, and not the end-goal.

IV. Issues for Discussion

1. Should regional integration remain as a priority for the Caribbean countries in the global context? What are the main benefits and costs of closer integration?
2. What are the main impediments to institutional integration within CARICOM? Can countries align their national interests using rules-based mechanisms without

- compromising sovereign autonomy? If not, how can they bring to the integration process the benefits that could be obtained from more supranationalism?
3. Do you see functional cooperation in areas such as financial stability, building resilience to climate risks, containing crime and coordinating tax incentives as “low hanging fruits”? Are there other areas that regional cooperation should focus on?
 4. How do you see the private sector’s role in pushing forward regional integration?