Ewart S Williams: Issues in Caribbean economic development

Address by Mr Ewart S Williams, Governor of the Central Bank of Trinidad and Tobago, at the Sir Arthur Lewis Institute of Social and Economic Studies (SALISES) Conference, Port-of-Spain, 27 March 2007.

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Good morning ladies and gentlemen, the title of my presentation as shown in the programme is somewhat misleading. In fact, I would like discuss a few issues viz: the economic development challenges facing the region; the proposition that economic integration – specifically the CSME – is a necessary condition for meeting the region's economic and social objectives and the role that savings and financial integration needs to play in the process.

A convenient point of departure for my presentation is the theme of the recent and much-quoted World Bank study entitled: *"A Time to Choose – Caribbean Development in the Twenty-First Century"*. The study's theme is that "as the twentieth century begins, the abiding impression (with respect to the Caribbean) is one of unfulfilled potential and concern about the sustainability of past accomplishments". The report notes correctly that over the past three decades, Caribbean economic development has lagged behind that of similarly small and comparable countries like Singapore, Ireland and Cyprus. The study argues pointedly that the main reason for this is that while these countries based their economic strategy on improving competitiveness, the Caribbean sought to depend disproportionately on the exploitation of our natural resources (in the case of Trinidad and Tobago) and ill-advised reliance on preferential arrangements for our main products – sugar and bananas.

It is an interesting thesis and even if a bit over simplified, has a lot of truth to it. In 1975, the Caribbean as a whole was more or less in line with Ireland, Singapore and Cyprus, in terms of GDP per capita. By the turn of the century, Ireland and Singapore were way ahead of the region, and with per capita incomes almost twice the region's highest per capita country – the Bahamas. [And it is not only in terms of per capita income, the disparity exists on a range of development indicators]. Indeed, Ireland is ranked number 4 in The Human Development Index: Singapore is number 25, and the highest Caribbean country Barbados is at number 31.

What happened in the interim? To address this question, let us first examine the economic performance of the region in the last three decades.

The story of the Caribbean is that of steadily declining growth in per capita GDP. In the 1970s, the annual average per capita growth rate in the region was 3.9 percent; this rate declined to 2.2 percent in the 1980s and to 1.9 percent in the 1990s. This pattern was marginally better than that of Latin America. However, it was lower than the average rate of growth of "all small island states" in the world and at the other extreme, emerging Asian countries grew at nearly three times the pace observed in the Caribbean.

Almost all the countries in the Caribbean region suffered declines in per capita incomes in the 1980s. In many cases, the poor growth performance continued in the 1990s. A notable exception is, of course, Trinidad and Tobago, where the implementation of economic policy reforms and the resurgence of world oil prices led to a resumption in per capita growth.

Since 2000, real GDP growth in the Caribbean has improved somewhat and per capita incomes have risen marginally. In Trinidad and Tobago, high oil prices and expanding capacity have led to a near-doubling in per capita incomes in the period 2000-2006. In the rest of the region, the recent surge in economic growth has been driven by increasing construction of infrastructural and tourism facilities related to preparations for the 2007 Cricket World Cup.

(Lest I be misunderstood), let me clarify that the reality of declining per capita growth in the three decades to 2000 does not negate the progress that has been achieved by the region during the period. This progress could be seen in the evolution of the universally accepted indicators of development such as, income, health, education and life expectancy.

In terms of income, for instance, all the countries of the region, with the exception of Haiti and Guyana, are classified as middle income countries or higher, with per capita incomes ranging from an average of US$6,000 for the OECS to US$18,900 for the Bahamas. The Caribbean ranks high on the Human

Development Index, relative to other developing and emerging market countries. The region's average literacy rates are very high and life expectancy at birth is high at nearly 70 years. On the other hand, poverty rates in the region are also high, averaging nearly 30 percent and income inequality, while not severe as in South America, is significant.

Given where we are, what are the main economic challenges facing the region. While it can be argued that these are many, I would like to select three. The first is the **loss of preferential arrangements** and the need to restructure our economies to meet the current global trading environment; the second is the critical importance of achieving **higher productivity levels** and the third relates to the need to **strengthen fiscal positions and reduce the public debt burden**.

First, the loss of preferential arrangements

Declining aid flows and the transition from traditional agriculture, as preferential access to European markets is eroded, continue to constitute a major economic challenge. These two developments are taking place at a time when exogenous shocks (be it high oil prices, 9/11, or natural disasters) have become more common place and at a time when Governments are facing strong political mandates to improve social and economic conditions.

There is no denying the perverse geo-politics of the trade preferences issue – the fact that developed countries argue strongly for freedom of markets while they are reluctant to eliminate their own large agricultural subsidies or their harsh restrictions on freedom of labour. Be that as it may, it is difficult to deny that some Caribbean countries have not exactly taken advantage of the long period of preferential market access to increase productivity in the sugar and bananas sector.

It is largely our fault that after all these years the estimated cost of producing and exporting sugar in Guyana and Belize – the lowest cost Caribbean producers, is 50 to 60 percent higher than **that of the higher cost free market** exporters. Similarly in bananas, the Caribbean countries are the highest cost producers in the world, rooted in low land productivity and high labour and transportation costs.

Given the impending further erosion of preferential arrangements for sugar and bananas, in the next five years, few (if any) of the current regional exporters will be able to export profitably. This means that if exports are to be maintained, government subsidies to cover losses could rise to unsustainable levels.

This brings us to the imperatives of economic restructuring:

With the current open trade regime, the challenge for the Caribbean is to quickly develop new high productivity sectors that could drive the region's developmental thrust. The reality in the Caribbean is that the regional agricultural sector will find it difficult to be globally competitive for the same reasons that affected sugar and bananas. Similarly, labour intensive manufacturing can no longer compete internationally given the region's relatively high wage structures and the rise of China as a major exporter of manufactures.

However, the examples of Ireland, Singapore and Cyprus have shown that small economies can be competitive in many service sectors and in niche manufacturing.

Whatever sectors we target for attention, we must engage in a concerted push to improve productivity. It is not easy to measure productivity for the economy as a whole. However, notwithstanding the measurement problems, various estimates for the Caribbean economies show gains in productivity in the 1980s, followed by a sharp decline (in productivity) in the 1990s. One apparent reason for the decline in the 1990's is the **lower productivity of both public and private investments** (which, in the smaller economies, have been concentrated in the declining agriculture sector, or in tourism, a sector which is now in a mature phase and likely to produce smaller productivity gains).

A second factor that could have led to declining productivity is **migration**.

The economics of Migration is a complicated phenomenon. At one stage of our history, we saw migration as a safety valve against possible social explosion arising from high unemployment. Migration has also benefitted our economies to the extent that remittances have become a major contributor to foreign exchange receipts in the region. In contrast to these positives, however, the evidence suggests that Caribbean migration has represented a brain drain which has weakened the skills base and capacity of regional economies. The excessive emigration of skilled labor not only creates immediate gaps in the labour force, which affects productivity, but also means that resources invested in education and training do not benefit the region as intended.

The third challenge that, in my view, regional economies will need to address in the quest for self-sustaining growth and development is the need to deal with chronic fiscal imbalances. For many countries in the region, these imbalances, which have largely resulted from excessive government spending, have led to a build-up in public debt to unsustainable levels. According to IMF data, seven (7) Caribbean countries are among the ten (10) most indebted countries in the world. In general, public debt to GDP ratios of 50 to 60 percent of GDP are considered high. However, six Caribbean countries (St Kitts and Nevis, Jamaica, Dominica, Antigua and Barbuda, Grenada, Belize and Guyana) have debt ratios between 95 and 160 percent of GDP.

Guyana is one of the world's highly indebted countries, identified by the multilateral institutions for special treatment under the HIPC programme. In the last two years, two of the regional countries – Dominica and Grenada have needed external debt restructuring. A third, Belize – is in the process of debt restructuring.

High public debt hurts growth as resources that should be devoted to productive expenditure and social programmes are redirected to debt servicing. Moreover once high public debt sets in, it could be self-reinforcing on account of high debt servicing costs. The two options available to highly indebted countries are debt restructuring (as discussed above) or the generation of high primary surpluses as in the case of Jamaica. Even though Jamaica has generated primary surpluses in the range of 8-13 percent of GDP for many years, public debt has continued to rise because of high interest costs and low growth.

Regional integration (CSME)

The region sees the implementation of the CSME as an essential element of any strategy to further the development of the regional economies. I finally agree with that position. The current integration model is what CY Thomas describes as one of **open regionalism**, based on an outward-looking market-oriented framework in which the private sector is expected to take the lead. As you know, the CSME covers, inter alia, the liberalization of trade in goods and services, the free movement of labour and capital, a regional strategic sectoral plan, the adoption of a harmonized investment code and the development of a regional capital market. The first phase of the model – the Caribbean Single Market, formally went into effect in the first half of 2006. The second stage – the implementation of the Single Economy now has a target date of 2009.

The integration model is fundamentally sound in that it seeks to address the principal constraints that have led to regional economic under-achievement over the past three decades. One cannot argue with the reasoning that, greater integration within the CARICOM region, on several fronts, could be a critical input in improving competitiveness. For example:

- regional trade liberalization (which is essentially in place) should result in a reduction in the cost of inputs and contribute to the rationalization of production;
- labour mobility within the region has the potential to improve skill and wage arbitrage;
- co-ordinated investment promotion could make the region more attractive for foreign investment and reduce the fiscal cost attached to expensive and sometimes wasteful tax concessions; and • regional planning could facilitate the exploitation of production integration opportunities, through clusters of economic activities.
- The CSME model also presents opportunities for joint marketing in extra-regional markets, joint research and development, and joint purchasing arrangements.

While this is the framework, it is no secret that, implementation of many of the critical provisions of the CSME has lagged. For example, the impact of trade liberalization has been reduced by the large number of exemptions from the common tariff reduction scheme. Free movement of labour so far has been limited to a small group of employment categories though further progress in this area is on the cards; agreement on the liberalization of trade in services has been slow in coming and there have been problems in implementing the rights of establishment which is pivotal to unlocking the potential of the regional private sector.

But the CSME faces other challenges. The implementation of the programme is going to require considerable financial resources, the exact quantum of which has not yet been determined. Funds need to be found for financing new regional institutions: to fund compensatory mechanisms : to finance national and regional public infrastructure and to finance the activities of the regional private sector, which ultimately will be the engine of growth and development.

While many of the regional institutions are being funded from contributions made by existing member states, there is some concern that many Governments, face an acute insufficiency of fiscal resources and will be hard pressed to take on new commitments. Moreover, the willingness of the region's traditional bilateral and multilateral partners to go beyond current funding levels is uncertain. To say the least, the desirability of depending on extra-regional bilateral donors to fund regional institutions is a delicate matter.

The Caribbean Development Bank has played a pivotal role over the years in financing infrastructural development and social programmes in the region. A significant increase in the Bank's resources will be required if the development thrust envisaged by the Single Economy programme is to be attained.

It is widely accepted that the benefits of regional integration are often asymmetrically distributed among participating countries. This inevitable outcome therefore requires that compensatory and/or corrective mechanisms form a necessary and prominent feature of the CSME. A Regional Development Fund is envisaged to be part of these compensating arrangements.

The current proposal is for a Fund of US$250 million – US$120 million of which is to be contributed by member states with the remainder being sought from the region's development partners. This will be another financing gap that needs to be filled.

And finally, regional development in the context of the CSME will require new and expanded private sector financing mechanisms.

Over the past several years we have seen increasing integration of the regional financial system. Much of this integration has come through cross-border ownership of financial institutions. However, by and large, despite ample liquidity the financial system has made only a limited contribution to regional development through a reduction in the cost or an increase in the availability of financing for business investment.

If the private sector is to play the pivotal role earmarked for it, regional private financial institutions need to adopt more innovative and more supportive financing strategies. One cannot over-emphasize the need for appropriate mechanisms to finance small and medium sized firms that are the likely candidates for niche manufacturing. We will also need to expand the availability of alternative financing options such as leasing and venture capital.

Undoubtedly, the evolution of the financial sector in the direction envisaged would need to be accompanied by enhanced regional regulation and supervision to minimize the risk of cross-border contagion.

The final piece of the financing puzzle should come from the further development and integration of the regional stock market. A first step, involving the cross-listing of twelve securities has already been taken. The next step is the establishment of an integrated regional stock exchange where all member states are linked electronically for the trading in bonds and equities. A fully integrated regional stock exchange would allow firms to have access to a wider market for raising risk capital. In turn, this would allow the productive sectors to become more productive internationally.

In conclusion, the implementation of the Single Economy could put the Caribbean region once more on the verge of a new development thrust. If the region is to remain competitive in the global economy, it will need to reconfigure its production structures and raise its level of productivity. But the integration process will require significant financial resources, the source of which is not yet clear. Even if external financing is forthcoming, what is certain is that the region will need to increase its level of savings and improve financial intermediation in order to fund its long-term developmental objectives. **This is a matter of the greatest urgency since time is not on our side.**