

Sir K Dwight Venner: The ECCU economic review 2005

Presentation by Sir K Dwight Venner, Governor of the Eastern Caribbean Central Bank, at the ECCB Headquarters, St. Kitts, 12 January 2006.

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Good Evening Fellow Citizens of the Eastern Caribbean Currency Union

On behalf of the Monetary Council, Board of Directors, Management and Staff of the Eastern Caribbean Central Bank, I bring you Greetings and Best Wishes for the New Year.

I welcome this opportunity, once again, to address you on the economic performance of the Currency Union during the past year, and to share with you the Bank's views on the prospects for this year.

The year 2006 will be one of the most defining periods in the lives of the people of the OECS and the wider English speaking Caribbean. The reason for this is simple. It lies in the wide variety and great intensity of the challenges we will face as very small states in a rapidly changing regional and international environment.

There will be tremendous challenges for us in how our political, economic and social institutions exercise their capacity to respond to new and unexpected circumstances in a global environment, in which each national entity places its interests before those of others.

In fact, recent circumstances, most notably the negotiations on access for our bananas into the European Union clearly indicate that our small size does not evoke much sympathy in international economic relations. This should make it abundantly clear to us that we need to proceed into the future with an increased sense of realism, objectivity and clarity.

It is, therefore, perhaps more than symbolic that in 2006 we will be celebrating the 25th Anniversary of the signing of the Treaty of Basseterre. This treaty of cooperation between our countries has been in very large part responsible for their survival and growth over the intervening years.

It is also important to note that we have been working on revisions to the Treaty, and that these will reflect our considered responses to the changes which have been taking place in the domestic and external environments.

The year 2006 will witness some very specific events and circumstances which will require new and strategic responses from us as individuals, families, business firms, trade unions, civic organisations, countries and as a closely connected group of countries, that is the OECS.

The major challenges in the international arena will come from the new trading regimes which are now being negotiated under what is called the DOHA round. The major issues involved would be liberalisation in the trading of agricultural commodities and services. These will have a major impact on the future prospects of our economies for which we will have to be prepared.

The Caribbean Single Market and Economy (CSME) will in all probability come into existence during the course of the year. This arrangement will pose a major challenge for the OECS countries as deeper forms of integration are proposed, which will require substantial structural and institutional changes at the political and economic levels for their successful participation.

These events are, and will be taking place against the backdrop of a world economy which experienced significant growth in 2005 and by all accounts will continue to do so in 2006. The economy of the United States has continued to grow at an average rate of 4 percent despite significant trade and fiscal imbalances; the Canadian economy is experiencing a boom due to its thriving commodities sector; the United Kingdom and European Union economies are experiencing moderate growth; and Japan has experienced a major upsurge of growth after a decade of stagnation.

However, it is the two most populous countries in the world, China and India, which continue to experience explosive growth rates and are having a major impact on the world economy.

The threats to this expanding global economy continue to be international terrorism, rising interest rates, high oil prices, and the management of the twin deficits being experienced by the US economy.

A growing global economy is vital for the progress of our small economies as the prospects for our leading foreign exchange earner, tourism, depends on continued and sustainable global growth.

On the domestic front, there are significant economic and social challenges, which our countries will have to confront in 2006 before they become endemic and completely out of our control.

On the social front the following seem to stand out -

- Increasing levels of crime and violence
- The apparent state of social alienation of the young male population
- Higher levels of drug use and abuse
- Higher levels of HIV/AIDS infection.

With respect to the economic issues, the new year finds a number of our countries facing major challenges.

- Dominica is working with an IMF programme in response to a severe fiscal crisis. This programme has been successfully managed by the Dominican authorities to date, and has resulted in a reversal of the fiscal situation, and a return to positive growth.
- Grenada is still recovering from the devastation of hurricane Ivan and is emerging as a model of post disaster recovery through the role and function of the Agency for Reconstruction Development.
- Antigua and Barbuda is at the beginning of a painful process of restructuring its public finances. This has involved critical policy decisions on the revenue and expenditure sides which should restore fiscal balance and confidence in the economy.
- Three countries, Antigua and Barbuda, Dominica and Grenada are in the process of carrying out comprehensive debt restructurings to reduce their debt to GDP ratios.
- St Kitts and Nevis has taken the bold step to close the sugar industry in order to address the country's high debt to GDP ratio.
- All countries are confronted by fiscal and debt imbalances due to the high per capita cost of government, small populations; inelastic tax systems; and the excessive demands placed on governments in liberal democratic systems with competitive party politics.

Another major issue is the environment, as these small states which are increasingly dependent on tourism, have to find the resources to deal with the problems of waste disposal, coastal erosion, and the constant threats of hurricane and volcanic activity.

One major event that will bring all of these issues together and focus our attention in 2006 will be the Cricket World Cup due to be staged in 2007. In 2006 we will have to complete all of our infrastructural and commercial arrangements, many of which are very large to host this important event.

We must, however, review our 2005 performance before we look forward to 2006 to determine the strategies we should pursue in order to ensure that we will have successful outcomes.

The Currency Union experienced growth in 2005, estimated at 4 per cent which was approximately the same as in 2004. This growth was attributed to a sharp expansion in public and private sector construction activity, partly due to the preparations for the Cricket World Cup 2007. Increased activity in wholesale and retail trade, transportation and communications, and the banking sector, also contributed to growth in 2005.

The performance of tourism in 2005 was somewhat weaker than in 2004. Stay over arrivals to the currency union as a whole declined marginally, mainly due to the lingering effects of hurricane Ivan on Grenada. However, most of the other countries recorded increases in stay-over arrivals. The number of cruise visitors declined, but this followed a record level of cruise passengers in 2004.

Output in the agricultural sector, which on average contributed 6.4 per cent of GDP in 2004, declined significantly in 2005 due to the weak performance of the traditional export crops. Production of bananas, sugar, nutmegs, and cocoa fell sharply.

The rate of inflation in the currency union for 2005 has been provisionally estimated at 3.5 per cent. This is explained by a surge in the international price of oil and other commodities such as cement, steel, lumber and other building materials.

In the monetary sphere, the ECCB paid particular attention to its objectives of maintaining currency and financial stability in the currency union.

The low rate of inflation ensured the maintenance of the purchasing power of the currency, while the high level of foreign exchange reserves enhanced the external stability of the EC dollar.

The banking system experienced growth in its assets, as well as an increase in capital and high levels of liquidity. No threats to the stability of the financial system emerged in 2005.

As we have highlighted at the beginning of this presentation, the year 2006 will pose significant challenges to policy makers in the Currency Union. There is expected to be very positive activity during the year, particularly in the construction sector. However, our horizons must extend beyond the next 18 months to two thousand and ten. This is necessary because we will have to manage our economies, which will be subject to a significant upturn in growth in 2006/2007 to bring them into soft landings and sustained growth in the period to 2010.

Beyond this, the United Nations has set the year two thousand and fifteen as the date for the achievement of the Millennium Development Goals.

Our success in achieving the objectives we have set for ourselves would be dependent on the following:

- The appropriate policy and management framework given our particular circumstances;
- The highest level of integration among the OECS countries that the political and social traffic can bear;
- Our capacity to utilise the two conditions above to successfully insert ourselves in a sequenced and strategic manner into the international economy.

This must, of course, given our democratic traditions, be based on the widest level of consensus among the citizens of the entire OECS.

The economic history of the last half of the twentieth century has shown quite conclusively that it was countries with good policies, as opposed to abundant natural resources that achieved the highest levels of sustained economic growth.

This is a clear indicator and a substantial encouragement for the countries of the OECS to develop a strategic approach to economic policy making and the management of our economies. The three critical elements which need addressing are:

- Public Sector Transformation
- Private Sector Development
- Financial Sector Development.

These three have to be addressed within a policy framework and architecture, which must be clearly outlined and institutionalised at the country level as well as the OECS level. This will involve setting clear and measurable goals and objectives, identifying the range of policy instruments available, and creating arrangements to deliver high quality, accurate and timely information for decision making. Monitoring, review and evaluation mechanisms, and agencies must also be aligned to support the process.

The biggest challenge in this process would be coordination, collaboration and alignment at both the country and currency union levels.

There are quite a number of good policies which have arisen from recent work by local, currency union and international agencies, but the lack of synchronization continues to minimize the tremendous impact these can make on both the local and regional economies.

A very critical missing element is the capacity to manage, both within the public and private sectors. This management issue must be addressed with great urgency if we are to attain our objectives. A special project for management training and orientation must be fashioned to treat with this issue at the earliest.

The size of these countries poses major problems with respect to economic viability. Markets are very small and the cost of administration per capita is very high. Even with the best policies in place, the

potential for the production of goods, which are internationally competitive is limited if each country did not have access to the international economy.

Access is limited, however, by capacity and capacity is constrained by size. It is for this reason that the OECS countries have chosen to engage in deeper forms of integration. The countries have proposed to upgrade the Treaty of Basseterre to encompass an Economic Union, which is the highest form of integration, short of full political integration.

The OECS countries already have a very high level of integration, far superior to that of the wider CARICOM. This is manifested in the following:

- A common court;
- A common currency and central bank;
- A common stock exchange;
- Common regulatory arrangements in the areas of -
 - *Commercial banking*
 - *Civil aviation*
 - *Telecommunications*
- Close functional cooperation in the areas of
 - *Health*
 - *Education*
 - *Environment*
 - *Sports*
- Common procurement of pharmaceuticals
- Joint overseas representation in Ottawa, Brussels and Geneva

Further deepening of the integration process will have the following advantages:

- Increased economies of scale in administration, production, marketing and distribution;
- The spread of risks across a number of countries instead of a single one;
- The increased capacity to negotiate with third countries or groups of countries.

Deepening the integration process in the OECS will allow us to access and manage the CSME process much better than we could as single states. This is critical for the success of the CSME as a deeply integrated OECS is a necessary, though not a sufficient condition for the success of this arrangement.

The CSME is a vital stepping stone for our strategic integration into the international economy, but we must be able to establish and assert our specific interests at the level of the CSME, so that these interests could be robustly represented beyond the region and into the international arena.

Economic development is not an end in itself, but is reflective of improvements in the economic, social and human conditions within nations and across the international community. The international community through the United Nations, and as expressed in the Millennium Development Goals, has taken responsibility for improving the human condition on planet earth. This, however, does not absolve individual nations and communities within nations from making efforts on their own behalf. In fact, the whole concept of development means increased self reliance and increased choices for individuals, communities and nations.

For the individual citizens of the OECS this means acquiring education, skills and attitudes which makes us marketable in a global economy. It also means acquiring information that will allow us to make important economic and political choices about our own circumstances, and those of our countries and region. We must be able to understand and contribute to the policy choices that our governments have to make, and to participate in the formation of public opinion on important issues.

Our private sector must acquire the managerial and technical skills, as well as the innovative impulses to participate in business ventures within their own countries, the currency union and beyond. The

bottom line for the private sector must be the production of the highest quality products, whether commodities or services, at the lowest cost, with excellent customer service.

Moreover, with the removal of trade and other restrictions, the domestic market will not be easy to distinguish from the international, and so to survive all standards of competitiveness will have to be international.

Our governments are faced with some very difficult decisions and choices which they cannot make effectively without the inputs of the citizens and the private sector. This is the nature of our liberal democratic systems which have served us well over these years.

The questions and issues revolve around responses to the fiscal and debt challenges confronting very small states; the high price of oil which affects the entire economy; the provision of the appropriate enabling environment to facilitate private sector growth, investment and productivity; the provision of social and administrative services to the community at least cost and highest value (including social safety nets for the very poor and the indigent); the maintenance of law and order to protect lives and property; the capacity to negotiate with third countries or groups of countries with respect to access to markets for exports and financial services as well as the acquisition of technology.

To address these issues effectively, it must once again be emphasized that the governments should establish a comprehensive policy framework with the appropriate reporting and accountability requirements, technical capacity and; consultative arrangements.

The other major issue will be to decide, given the high cost and scarcity of management resources in each country, whether governments should -

- (a) Perform these functions jointly, that is, at the OECS level in an act of shared sovereignty, or
- (b) Perform them singularly at the member state level.

As we discuss and make plans for our own economic union this choice will become fundamental to our deliberations.

The OECS countries have made significant strides over the years and must now confront the rapid changes in the regional and international systems by making major and decisive choices. We have the choice of going forward together as we have in the past with limited collective arrangements, or deepening our cooperation to respond to a rapidly changing environment. We have now reached in the OECS the point of the famous quotation by William Shakespeare -

"To be or not to be that is the question."