Ewart Williams: Restoring competitiveness and growth in the Caribbean

Feature address by Mr Ewart Williams, Governor of the Central Bank of Trinidad and Tobago, at the 4the Biennial International Business, Banking and Finance Conference, University of the West Indies, St Augustine, 22–24 June 2011.

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Salutations:

Let me first of all thank the sponsors for their kind invitation to deliver the feature address at this 4th Biennial International Business, Banking and Finance Conference. The organizers need to be commended for bringing together such an excellent group of academics and practitioners from the region and further afield to exchange views with us on – many hot-button economic issues. This forum is particularly timely since our Caribbean economies find themselves at a critical ***inflection-point***, with the legacy of the international financial crisis not yet behind us and with our region facing a global environment, which in many ways is markedly different from what obtained at the beginning of the last decade.

A few days ago in its mid-year World Economic Outlook assessment, the IMF warned that the global economy had run into a speed-bump arising from greater than anticipated weakness in US economy and renewed financial volatility arising from concerns about the depth of fiscal challenges in the euro area periphery – particularly, the Greek debt problem. The IMF report noted that although emerging market economies in Asia and Latin America continue to experience robust growth, they are now facing the risk of over-heating with inflation increasing at a faster rate than could be explained by rising commodity and food prices.

Our Caribbean economies are still digging themselves out of the global crisis of 2008 and unfortunately the recovery of the region is lagging behind that of other developing countries. This most recent slide is, however, part of a longer-term trend in which countries in the region have not been keeping pace with growth rates in emerging markets around the world.

According to the World Bank statistics, in 1980, the Caribbean's average per capita income was twice as high as the average for developing countries; today it is only a third higher. Countries in the region have been growing at an average rate of 2 per cent per year while small island states have been growing at an average rate of 3.6 per cent per year, roughly the average for the world economy.

As we seek to reverse this trend and address the challenge of long-term viability, the region faces the reality that it has lost some comparative advantage at a time when the global economy has become less friendly. The following examples are worth noting:

(i) First, the traditional preferences for bananas and sugar are now practically at an end and the region still finds itself unable to compete with lower-cost producers;

(ii) Second, foreign aid flows to the region (with the exception of Haiti) have all be dried up;

(iii) Third, while Caribbean tourism continues to be a viable brand, the region is facing stiffer competition from Asian destinations and will experience even greater competitive pressure when Cuba is fully opened up (as it could in the not too distant future); and

(iv) Fourth, the prospect of continued high unemployment in the US and the UK for the next 2 – 3 years will have implications for workers' remittances which are very important to some Caribbean economies.

To add to these exogenous factors, most countries in the region already have unsustainably high debt burdens, which limit the extent to which government spending could lead the recovery.

One could argue that Trinidad and Tobago represents an exception from this theme, given our energy resources, our stronger public finances and our much lower public debt burden which gives us more room to manoeuvre. We should be careful however of pushing that argument too far since (i) our proven energy reserves are fast dwindling (though some experts think that prospects for new discoveries are high); and (ii) our fiscal space is being steadily reduced, the more the private sector activity remains subdued and government steps in to lead the recovery. While public sector indebtedness is still at a comfortable level, it too is increasing rapidly to meet the high cost of the CLF/CLICO bailout.

Let me put our (Trinidad and Tobago's) challenge in another context which further underscores the problem. In the period 2002–2006, real GDP increased at an annual rate of close to 10 per cent based on an annual growth of 16.7 per cent in the energy sector and 5.6 per cent per year in the non-energy sector. Energy sector growth was based on higher oil production and on the expansion of the downstream production capacity – particularly Atlantic LNG Trains 2, 3 and the M5000 Methanol plant. The current prospects are for a continued decline in oil production (until there are new finds) and except for planned Melamine plant (the AUM), no significant increase in downstream capacity is envisaged over the next few years, this would imply that energy sector growth would revert to lower, more sustainable levels leaving the non-energy sector to carry more of the medium-term growth burden. This makes a credible diversification strategy not merely a policy option but an urgent necessity.

The bottom line is that the entire region needs to embark on a new private-sector-led growth strategy to ensure medium-term economic viability.

Clearly, each country in the Caribbean faces its unique challenges in terms of its capacity to spur private sector investment. For example, the pre-conditions for attracting investment in the extractive industries in Trinidad and Tobago, Guyana and Suriname are different from the steps that are needed to promote investment in the on-shore sectors. And these are different from what is needed to promote tourism investment in Barbados or in the OECS. ***There are however some common challenges and some common approaches which are worthy of consideration by all the countries in the region***.

One challenge faced by the entire region is the need to reverse the decline in productivity and competitiveness which has occurred in recent years. The most egregious example of our competitive disadvantage is the banana industry, where the yields of our major producers – St. Lucia, Jamaica or Dominica - range between 20 – 25 per cent of the most efficient Latin American producers. But there are numerous other examples. For example the 2011 "Doing Business Report" (published by the World Bank and IFC) ranks 183 countries in terms of their business facilitation environment. Among all countries, Jamaica and Trinidad and Tobago – the two largest CARICOM members – were ranked 81st and 97th, respectively. Suriname was ranked 161st. For the sub-category "registering property"; eleven of the thirteen countries had a ranking greater than 105 for the sub-category "closing a business" and five of our CARICOM countries tied for the lowest ranking in the world.

The Global Competitive Index for 2010–2011 shows Barbados ranked at 43rd and the rest of the Caribbean ranked between 84th (Trinidad and Tobago) and 110th among 139 countries.

One explanation for our lack of competitive edge is the fact that the Caribbean is lagging behind in terms of access to information technology and affordability. In 2008, it was estimated that broadband penetration in the region was below 8 per cent compared with over 30 per cent in OECD countries. World Bank data also indicate that the cost of broadband services in the region is close to three times the price in the US and seven times the price in the UK.

Technology played an important role in the take-off of Singapore, Cyprus, Mauritius and other successful small economies by making business and government services more efficient. A concentrated focus on technological development will greatly facilitate business competitiveness in the region.

In addition to business facilitation, regional governments could contribute to the resurgence of the private sector through disciplined management of the public finances. And this has many aspects. Obviously, one important aspect is ***avoiding sizeable fiscal deficits*** so as not to crowd out the private sector and to contain public debt burdens.

Good public sector management also implies allocating sufficient resources to infrastructural development, education and health – areas that are critical for private sector development. In many cases, a business-friendly government expenditure policy could imply difficult socio-political trade-offs involving expenditures on subsidies and transfers. As I noted earlier, several countries in the region already have excessive debt burdens which sometimes force expenditure adjustments to fall disproportionately on critical public investment.

In our university councils, we are at pains to underscore the importance of UWI as a regional university. Regionalism is even more important in our economic sphere and deeper regional integration is absolutely critical for our economic survival.

In delivering the William Demas Memorial Lecture last month, the Managing Director of the World Bank put her finger on this delicate issue as follows:

> "*From my experience in Africa, (she said), I appreciate very well the sensitivities around deeper integration. At first glance, it might well seem that whatever one country wins, another loses. Free movement of people, for instance has created concerns in all regions that are seeking deeper integration. But regional integration is the only viable way to create scale for your economies.*"

We absolutely need to move beyond pious statements and seriously pursue what C. Y Thomas calls a model of "***Open Regionalism***", based on an outward-looking market-oriented framework in which the private sector is expected to take the lead. In addition to the liberalization of trade in goods and services, this model involves 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.

Greater integration along these lines could be a critical input in improving competitiveness. For example:

- 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;
- regional planning could facilitate the exploitation of production integration opportunities, through clusters of economic activities; and
- the integration model also presents opportunities for joint marketing in extra-regional markets, joint research and development, and joint purchasing arrangements.

If the focus of our regional development strategy is the private sector, the sector would need to undergo a cultural re-orientation. Foreign direct investment to the region has been on a steady decline over the past several years. While policy changes may help to reverse this decline, countries should also think about diversifying their targets for investment promotion, with the BRICs registering the fastest growth in the global economy they must be potential sources of foreign direct investment. So also must be Brazil.

Some people feel though that our domestic private sector needs to be more aggressive, to get beyond their comfort zone, and to be more prepared to take risks. This is of utmost importance since the country is depending on our entrepreneurs to expand, create jobs and contribute to the general welfare.

In this context, there is a case for targeted partnerships between the private sector and government to enhance international competitiveness, to identify and promote opportunities for greater economic diversification and to develop new export markets. These partnerships should also incorporate tertiary educational institutions that must be at the center of our efforts to promote research and development.

Unfortunately, I have spent my entire time outlining the many challenges that the Caribbean economies face in their quest for sustainable growth over the medium-term. But these challenges are not destiny and difficulties can become opportunities for change. Our region is at a cross-road of opportunity where the right combination of leadership, vision and commitment is needed to overcome a plethora of challenges. I am convinced that closer regional integration must be part of the solution and then we would need partnerships between the public and private sectors and other stakeholders including labour and our tertiary education. We need all hands on deck.