

Marion Williams: What is in store for the Barbadian economy as we enter the CSME

Address by Dr Marion Williams, Governor of the Central Bank of Barbados, to the Barbados Employers Confederation, St Michael, 16 March 2005.

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Mr. Chairman and President, Dr. Hensley Sobers; Members of the Executive Council; Mr. Harry Husbands, Executive Director, Barbados Employers Confederation; Ms. Shirley Farnum, Permanent Secretary, Ministry of Labour and Social Security; Mr. Vincent Burnett, Deputy Chief Labour Officer; Mr. Raul Harris, Executive Director, Barbados Chamber of Commerce and Industry; Mr. Trevor King, Executive Director, TVET; distinguished guests, ladies and gentlemen.

I am pleased to have the opportunity to speak to the employers of Barbados at this BEC's annual luncheon on the topic of the CSME. I am, however, a little alarmed that you may be expecting something of a crystal ball address and that I will be in a position to tell you what is really in store for us under CSME.

Let me say that economics is about probabilities and economists will never say they are sure about anything in the future. They will advise that there is a high, low or medium probability of an event occurring or that certain outcomes are likely.

I am afraid that is precisely what you are about to hear from me.

One of the basic reasons for the creation of the CSME was that it had become clear that the future for small countries and small entities in the rapidly globalising world was becoming increasingly difficult. In negotiations, organisations have little time and patience for dealing with a myriad of small countries. Secondly, if one wants to be heard, it was very clear that size made a difference to the willingness of others to listen. The significance given to your view is greater when you are larger and you are therefore able to have somewhat more negotiating influence. In addition, if you can trade without barriers in a single economic space the possibility of growth and expansion is enhanced and the hurdles, legal, administrative, regulatory, etc. are lessened. As a single market we can now offer our members better terms of operating, and greater freedom from barriers than we offer any third country. For these reasons the Caribbean had very little option but to form itself into a single market. We have created a greater single economic space and a greater market for ourselves in which we are the beneficiaries.

As you are aware, the requirements for the proper functioning of the CSME are the removal of restrictions on the free movement of goods, services, persons and capital and the right of establishment. The intention is to reduce the economic vulnerability of regional economies by providing an avenue to expand trade and investment opportunities, thereby lowering consumer prices and improving standards of living across the region. Enhanced levels of competitiveness should result from the extension of the gains of specialisation in production and should fortify the region's position in the global economy.

There will, however, be losers and gainers. CSME will influence all spheres of economic activity across Barbados, potentially translating into significant gains for the more efficient business entities. It has already contributed to the demise of some of the less efficient companies. The financial transactions that underpin the free movement of goods and services will intensify with greater trade, facilitated by the removal of capital account restrictions in some countries. However, the gains are expected to offset the losses, and should lead to better resource allocation and a net welfare-improving outcome for the country, and without doubt for the region as a whole.

We have already removed the barriers to trade in goods and services. We have made some strides in the removal of barriers to movement of persons, but there is a long and difficult road ahead here as witnessed by the frequent dialogue on this topic. In terms of financial liberalisation, we have removed the barriers to the movement of capital in the form of equity capital but there are other areas of financial liberalisation to be addressed.

The Productive Sectors

At the sectoral level; to date, the integration process under CSME has proven to be especially challenging for some industries in the Barbadian economy. Already, there has been a contraction in output of the manufacturing sector and a deterioration of the current account position. Efforts to bring Barbadian businesses up to international standards will therefore necessitate a restructuring of their production processes, with a possible redirection of resources to those areas where the country may have a demonstrated comparative advantage. It is easy to speak in general terms of restructuring production processes but those on the ground need to translate this into actual implementable changes in production. Some of the weaker entities have already dropped out as a result of competition, and it is important now that we nurture the remaining entities – presumably the more competitive ones - and assist them in holding their own in the more open environment. Several suggestions have been tabled to assist the manufacturing sector in becoming more competitive. These include the development of specialty products, particularly those that command higher prices in the international market and an emphasis on higher value-added products.

Understandably, with the right to establish anywhere in the region, industries will gravitate to locations with abundant resources, with low energy costs and competitive wages. High production costs, related to high wage rates, and a dearth of abundant natural resources place Barbados at a disadvantage vis-à-vis its CARICOM counterparts, in the production of most goods. This means that higher levels of productivity will be required of Barbados. It also suggests that we may have to look at our capital - labour ratios and retool our enterprises to make greater economies and make greater use of state-of-the-art equipment.

At the same time, where Barbadians see the opportunity for operating competitively elsewhere in the Caribbean, they should seize it. This option is now open to potential investors. We know, on the ground however, that there are tremendous challenges and that nationalism is still very strong in the Caribbean, despite CSME, but these are hurdles that we will have to cross. Meanwhile, investors wanting to enter into the wider Caribbean should do so as long as the competitive environment and the prospects are good, provided of course, it is affordable at the macro level.

On the other hand, Barbados has always been a strong supplier of services. A well-educated workforce, good infrastructure and a favourable business environment, can translate into significant gains in the provision of services, and many entities have already moved to supplying their services cross-border. We have seen it in the construction sector especially. In addition, consultancy services of every form and description have been provided to the rest of the Caribbean by Barbadians for decades. We must not, however, believe that because we may have a comparative advantage in services – and I say, “may” – that the competition is any less stiff than it is in the trade in goods. We must compete here as aggressively as we compete in any other sector. In addition, as globalisation overtakes regionalism, we have also to simultaneously compete with the entry of companies from third countries outside the region in the provision of services. The technology permits it and it will be very difficult to exclude them. We ignore them at our peril.

Employment

With labour set to move freely within the region under the CSME, the implications for the employment situation in Barbados have come under increasing focus. While production is expected to gravitate towards lower-wage jurisdictions, labour would theoretically be attracted to higher-wage jurisdictions, of which Barbados is generally acknowledged to be one. This would indicate a potential surplus of supply over demand in the Barbadian job market, at least in the short-run, which could push down wages. However, it should also be noted that, at least in theory, the integration of regional labour markets should ensure that over time, equilibrium is reached between labour supply and demand across the region.

A number of other factors could affect the analysis, such as the comparative cost of living in Barbados as opposed to other regional jurisdictions. Furthermore, given that the categories of labour currently being allowed to move under the CSME are those principally with higher skill levels, with which Barbados is perhaps more heavily endowed than other jurisdictions, it is possible that there could be a net outflow of labour from Barbados – provided Barbadians are prepared to accept lower wages elsewhere.

The External sector

The contraction in activity in the productive sectors also has implications for the external account of the country. This is particularly worrying to the extent that the fall-off in production is being accompanied by a significant rise in retained imports from the region. Indeed, the steady deterioration in Barbados' export performance has its genesis in the provision of duty-free access for CARICOM goods from the early 1990s and the resulting increase in competition in the domestic market, which seemingly impaired local producers' export capacity. Imports in particular from Trinidad have grown tremendously. However, judging from the shopping of Barbadians in Trinidad, shoppers are buying, not only Trinidad-produced goods. If this is so, then we may have to ask ourselves why is it not possible to purchase these goods directly – is it sourcing? Surely we have a reputation for being a nation of traders!

The challenge for our balance of payments is further compounded by the liberalisation of the capital account required under CSME. The removal of exchange control restrictions on capital account transactions within the union essentially constitutes a removal of restrictions with the rest of the world, given that some other countries within the Area do not have exchange controls on extra-regional capital transactions.

However, in the absence of capital controls, capital flight is possible where there is a differential between the domestic interest rate and interest rates abroad. Unbridled outflows could therefore put the maintenance of Barbados' current fixed exchange rate regime at risk. Consequently, while capital account liberalisation process is ongoing, we are proceeding cautiously with regard to certain types of transactions in order to avoid any significant disruptions arising from unregulated short-term capital flows.

Liberalisation also has implications for the independence of monetary policy. Whereas, domestic economic circumstances might indicate the need to keep interest rates low, if regional rates are high, in the context of an open capital account, then there is more pressure to raise rates in order to keep money at home, even though the domestic cost situation would suggest that interest rates be kept low so as to reduce the cost of operations of businesses.

On the other hand, many of the changes associated with the CSME, e.g. the enhanced ability of companies to establish a commercial presence anywhere in the region, could result in increased capital flows into Barbados, provided that we maintain and encourage an attractive investment climate. We have already seen this inward flow with respect to the banking system.

Under the CSME regime, current trends in the financial sector are likely to be reinforced, in that the cross-border provision of financial services, as well as the integration of financial markets, will become even more of a reality. This should produce a number of benefits for consumers: widening the range of financial services available to consumers, lowering the cost of these services and generally promoting competition and greater efficiency in the day-to-day transactions taking place within the Barbadian economy. However, full advantage can only be taken of these benefits in the context of full liberalisation. It will therefore be important to judge how far and how fast that liberalisation process can take place without creating domestic disruption and excessive loss of foreign exchange reserves.

The spate of mergers and acquisitions which have taken place in recent years have been influenced by the need for corporations to benefit from economies of scale. With large corporations now dominating almost every sector in the field of finance, regulators will have to guard against any attempts by financial institutions to abuse the rights and privileges associated with the CSME by engaging in anti-competitive practices. However, with consolidated supervision and policy harmonisation forming an integral part of the CSME process, it is anticipated that this potential problem should be kept at bay.

Mergers and acquisitions have been more evident in the banking and insurance industries – it may abate but I do not think that it is over. At the level of securities trading, I expect to see continuing strong activity. Hopefully, within the next year or two, we will see greater harmonisation of the stock exchanges in the region, where there are similar listing rules, similar take-over criteria and, most importantly, trading from a single book.

I consider that the establishment of a single stock exchange creates the opportunity for the development of a Caribbean numeraire currency. Certainly, if there is one book there should be one currency in which transactions are denominated. If we do nothing about it – it will be the US dollar – by default. If we take a conscious step to create a regional numeraire currency – and it could be of

equivalent value to the US dollar so as to eliminate any conversion difficulty when we actually do create a single transactions currency in the region.

I think also that the use of a regional credit rating agency will become increasingly important. We already have one in the Caribbean Information and Credit Rating Services (CARICRIS). In order to encourage surpluses in the country to be invested in deficit countries it will be important that potential investors know the value of their investment. The recently established regional rating agency will help to establish the value of corporations across the region so that an investor in Barbados can more easily rely on specialists in the field to value the quality of companies and the strength of the balance sheet of companies – say – in St. Lucia or Dominica.

A number of steps of this kind to set up institutions which facilitate regionalism are being taken both by governments, government related institutions and by the private sector. These are the kinds of tripartite initiatives which we need to ensure that the appropriate framework for the smooth functioning of the CSME is properly enabled.

In order for the CSME to function effectively, there is a need to harmonise, and I would go so far as to say, “unify”, the rules and guidelines governing the conduct of businesses across the region. The CARICOM Secretariat has started with the financial sector and has framed a Financial Services Agreement. This is a very important step as it sets out guidelines within which the sector should operate. However, we will need to do more to minimise and, preferably, eliminate the differences in our legislation, and in our criteria for establishment in the various sectors, in order to eliminate regulatory arbitrage and reduce corporate legislative shopping within the Caribbean.

I strongly feel that our Chambers of Commerce across the region must be strongly involved in the process. This means, by implication, our Employers Confederation as well. I believe that this is why the distinction is made between the single market and single economy. Yes, we can more quickly become a single market – however, in order for us to see ourselves as a single economy our economic and corporate rules and legislation will need to be more closely harmonised. In a sense, we are fortunate, in that the basis of our system is British – though in recent years many countries have modelled themselves on Canadian legislation - that is, the English-speaking Caribbean. However, harmonisation within the French and Spanish-speaking Caribbean will be a little more complex.

The implications of the CSME for employers as Human Resource professionals are many. It will be important that HR departments work within their organisations to ensure that high standards are set and that excellence is rewarded, for it is through this process that the good candidates show their worth and the entire level of performance is lifted. Rewarding mediocrity in the same way that we reward high performance, breeds complacency and leads to low levels of productivity. We have to keep on lifting the bar so that employees know what is expected of them. In this way, our workforce will be able to hold its own and retain their jobs against the competition in the face of free movement of labour. It is a well-known fact that those who emigrate are usually those who are willing to work hard. Barbadians must be aware of this, and instead of trying to keep them out, they must be prepared to work harder.

I take the opportunity here to speak of training. In the context of CSME, our training must be futuristic. We need to look not only at where our firms are today, but where they wish to be and how they get there. If productivity requirements mean greater state-of-the-art equipment, then we must train persons in these fields. I constantly say that we are technologically challenged. When the high-tech gadgets which we buy fail – there seem to be a few people who can fix them. HR trainers must therefore be conscious of the training requirements which will make us globally ready – if we are globally ready we will be CSME ready. We will need to use the Internet more, use journals - find the right areas where training is being delivered, and encourage investment in training. This is the one sure way in which our labour force can be prepared to compete in CSME. If you aim for the skies you may land in the treetops. Aim or the treetops you not may get off the ground.

I am aware that employers and especially human resource professional will wish to focus on the issue of culture assimilation within enterprises, and on the application of ground rules which are based on giving the best candidate the job – especially where in today’s environment, that candidate may not be a Barbadian national.

However, we have always had to deal with these issues, so this is not new. My only advice is that the most important challenge facing Barbados is to improve its competitiveness. I believe that if employers and HR professionals focus on this they will get the desired responses from their employees.

In some organisations the development of pay-for-performance appraisals are being considered. This may, at first, appear to have nothing to do with CSME. However, it has to do with motivation, hence it has to do with getting the best, getting the best employees means improving our competitiveness – so we are back to what is good for us in order to flourish within CMSE – improved competitiveness.

We will all need to put systems in place that will ensure that our employees aim for high levels of productivity, this will include reducing work stoppages, reducing absenteeism and a closer control of wage costs. This, coupled with the nurturing of a culture of greater entrepreneurship, will be the key to getting the best out of CSME.

Already, given the reduction in the rate of tax from \$40,000 to \$37,500 and other tax related concessions, there is likely to be a significant increase in disposable incomes. Last year, there was a tremendous surge in spending. Net domestic assets of the banking system, which comprise credit to government and credit to the private sector, rose by 50%. We are looking at a situation where disposable incomes will rise even further in 2005 because of the tax benefits that have been given. Ask yourselves “Is there really scope for giving wage increases on top of that? What will happen to disposable incomes? What will happen to spending?” I hesitate to incur the wrath of the unions, but I am an economist and the numbers stare me in the face. I suggest that you put in to your employees that we put Barbados first and that competitiveness is very important – for the good of themselves and future generations.

Conclusion

In conclusion, there are several steps still to be taken to ensure that CSME becomes the opportunity which we are convinced it can be for Barbadians. However, not all of these initiatives are in the laps of the officials. Yes, the further liberalisation of the external capital account is. However, the restructuring of the productive sectors to make them more competitive is another major challenge facing the country going into the CSME, and it requires a combined effort. With judicious action at the policy-making level, and with the support and input of the public sector, these challenges can be met. On balance, the CSME can produce net benefits to the Barbadian economy by providing a harmonised framework for policy formulation, as well as a larger market, with greater opportunities for employment, investment, production and trade. One that will provide Barbados with the economic and bargaining power necessary to combat external threats and overcome resource constraints.

However, what's in store will, to a large extent, depend on our willingness to seize the opportunities presented to us. We can chart our future in CSME – not one sector or group alone – but with every group, sector and organisation determining what it wants and setting out to get there.

What is in store for us in CARICOM will be largely determined by the efforts we make and by the initiatives we take to influence the outcomes we want.