

The Need for Caribbean Cooperation in a Globalizing World

Address delivered by Emsley D. Tromp, President of the Bank van de Nederlandse Antillen on the Occasion of the Multi-National Business Conference at Maho Beach Resort St. Maarten November 8, 2002

Ladies and gentlemen,

INTRODUCTION

It was with a great deal of pleasure that I accepted the invitation to speak at this conference. I think the organization of this conference, attended by government leaders, ministers, members of the American Congress, CEOs of the Caribbean and American companies, and other distinguished guests, provides a unique opportunity to fulfill the themes of the conference: "Working together for expansion and growth," "Exploring creative investment opportunities," and "Building synergistic partnerships." As I see it, Mr. Chairman, the objective of this conference is to look for ways and means to improve the lives of our citizens. By focusing on partnership-- both inter and intra islands and with our main trading partner, the United States-- we hope to create an environment conducive to growth and, hence, alleviate poverty.

Ladies and gentlemen, against the background of an ever globalizing world, it is fitting to portray the road ahead of us as a journey into the future. Historically our countries have served as a way station for weary seafarers who had weathered many storms but not yet reached their final destination. I think choosing Saint Martin as our meeting place provides a unique opportunity for us to reflect on the challenges we face as a region and to chart a common course for the future.

In this ever increasing globalizing world, a tri-polar world economy seems to be emerging:(1) the EU with its ambitious agenda of enlargement; (2) the NAFTA heading south with the Free Trade Area of the Americas ; and (3) the Asian market. Given our geographical location, our natural partner is the Americas. Therefore we have to pursue policies that enable us to benefit primarily from this expanding market. Given the nature and size of our economies, I think our approach has to be collaborative. I will elaborate on this point later in my address.

I gave my address the title: "The Need for Caribbean Cooperation in a Globalizing World." Allow me to start by saying that most countries in the Caribbean are constrained by the size and openness of their economies. On the one hand, we are highly susceptible to external shocks because of the openness of our economies. On the other hand, the smallness of our economies provides us with the opportunity to respond quickly to international developments if the right policies are pursued. Examples of recent international developments and shocks that adversely impacted our economies include the erosion of preferential market access to the European Union; the establishment of NAFTA; the terrorist attacks on the United States; the nontransparent adverse classification of supervisory structures of most Caribbean jurisdictions by the G-10 countries in the wake of the Asian crisis; and, of course, the recurrent natural disasters.

To reduce our vulnerability, we need to broaden our economic base and pursue the appropriate policies. By that, I mean, we have to (i) pursue sound macroeconomic policies, (ii) have a safe and sound financial system, (iii) promote good governance, and (iv) promote educational achievements. These policies are consistent with sustainable development. They also form a basis for cooperation among countries in the Caribbean.

Ladies and gentlemen, I would like to elaborate on the implications of the size of our economies in a globalizing world environment. Then I will try to shed some light on the inter-relationship between the size and nature of our economies and their ensuing vulnerability.

I will then conclude with some remarks about the need for broader and deeper cooperation and partnerships in the region if we are to achieve the goals of sustainable economic growth and the alleviation of poverty.

IS SMALLNESS DELETERIOUS TO GROWTH?

It has long been clear to policymakers in the Caribbean region that our economic development is constrained by our size. The smaller the home markets, holding other things constant, the smaller the business operations. Given the nature of the production process, the result is diseconomies of scale, leading to higher production costs and an unfavorable competitive position. Both the public and private sectors are affected by these diseconomies of scale.

The provision of public goods and infrastructure is usually characterized by indivisibility. This has two implications for small economies. First, the costs of public services per capita are higher than in larger economies, and second, the

government may be forced to provide various goods and services --often at subsidized rates-- that would typically be offered by the private sector in larger economies.

Private sector activities may also be hindered by the smallness of domestic markets. This is particularly the case for non-tradable goods and services that depend entirely on the domestic market. However, the production of tradable goods and services also is affected by smallness to the extent that it relies on inputs from the non-tradable sector. In addition, the tradable sector could realize economies of scale in the export of a narrow range of products, but this will become highly susceptible to external shocks. It becomes therefore imperative to pursue the right policies to reduce this vulnerability.

Because small economies are more susceptible to shocks, financial institutions will demand higher risk premiums, thereby raising the cost of borrowing for the private sector. Moreover, the small size of the labor market limits the range of available skills, pushing up the price of scarce skills. On the supply side, employment alternatives are limited, which promotes a brain drain of highly-skilled workers and causes high social costs for low-skilled workers when industries have to restructure.

Although the size of the economy does not impede growth, size becomes a constraining factor to growth. In a globalizing world with blurring markets, the size issue should be relegated to a footnote. But this is true only when firms established in small countries have access to markets beyond their borders. If this is not the case, then the reverse is true. The traditional response was to erect trade barriers to correct for the size problem. Those trade restrictions tended to protect capital-intensive importables, reduce returns to labor, lead to overvalued exchange rates, and reduce profitability of tradables and turn terms of trade against the poor.

It is now clear that those inward looking policies only led to allocative inefficiencies and adversely affected the general welfare. This overview serves to demonstrate that the Caribbean nations with small economies and imperfect access to the world markets must create economies of scale to reduce cost levels and increase competitiveness. We must pursue pro-growth policies such as openness to trade, institution building and prudent fiscal and monetary policies. Clearly, this can be attained only through closer cooperation and collaboration among the Caribbean nations.

THE INTERRELATIONSHIP BETWEEN SIZE AND OPENNESS

In addition to diseconomies of scale, our countries are highly susceptible to external shocks. Various factors contribute to this vulnerability.

First, our geographical location makes us prone to natural disasters, particularly to hurricanes and volcanic activity. These disasters are recurrent, and they affect a large portion of our population and infrastructures. In some cases, economic damages have exceeded annual GDP. Clearly, the capacity of national authorities to cope with the costs of reconstruction of such catastrophes is limited.

Second, the openness of our economies --as defined by imports and exports of goods and services as a percentage of GDP which averaged 85% in the 1990s-- entails a high degree of vulnerability to external shocks. This is aggravated by the concentration of exports in a narrow range of products and markets. The impact that the terrorist attacks on the United States had on our tourism industry serves as a clear example.

Third, many Caribbean countries have pegged their exchange rate to that of our main trading partner the United States. The benefit of this policy regime has outweighed its cost. Nonetheless, the burden of adjustment to external shocks under this regime falls on domestic income, which may translate into prolonged recession and unemployment.

Fourth, fiscal policy in small economies also is very vulnerable to external shocks, especially when the country is dependent on trade tax revenues and official assistance. During the last decade, official capital flows and development assistance showed a declining trend in the Caribbean. This development has created particular difficulties for the smaller and poorer Caribbean countries not able to attract compensating private capital flows.

To mitigate the effects of diseconomies of scale and the high degree of vulnerability to external shocks, broader and deeper cooperation between the countries in the Caribbean region is a viable and indeed an inevitable strategy. This strategy is not new to the region. Various forms of cooperation already exist. Of particular importance are the Caribbean Community (CARICOM), the Association of Caribbean States (ACS), and the Organization of Eastern Caribbean States (OECS).

CARICOM is the most ambitious form of cooperation in the Caribbean. Established in 1973 CARICOM aims to deepen the cooperation in the Caribbean Free Trade Association into a Caribbean Common Market with a common

external tariff. The ultimate objective is to develop CARICOM into a Caribbean Union. In this respect, the development of CARICOM has similarities with the European Union. Presently, CARICOM consists of 15 member countries, predominantly of the English-speaking Caribbean.

ACS is a more recent and broader form of cooperation between Caribbean countries. Established in 1994, ACS focuses on cooperation in trade, tourism, and transportation. Full members are the countries forming CARICOM and the Spanish-speaking countries in the Caribbean region, for a total of 25 countries. Associate members are the Dutch and French territories in the Caribbean, while the British and American territories are eligible to apply for associate membership. Thus, the ACS potentially encompasses the entire Caribbean region.

Finally, the OECS consists of seven small English-speaking island states in the Eastern Caribbean forming a successful monetary union with a common currency that has a fixed peg to the US dollar. All members of the OECS are also members of CARICOM.

Given the overlap of these three main organizations of cooperation in the Caribbean, I think one of our future challenges will be the gradual amalgamation of the three into one umbrella organization. Within certain limits, member countries should be free to choose in which forms of cooperation they want to participate, given their specific interests and circumstances. This approach is followed by the European Union, where not all member countries participate in the monetary union with a single currency. Usually, when cooperation in a certain area proves successful, more members will join, thus gradually deepening integration. In my opinion, one coordinating body with different groups of members cooperating in specific areas of interest should be the ultimate objective of regional cooperation and will serve best to strengthen the Caribbean's position in a globalizing world.

We have covered quite a bit of territory. Therefore I want to leave the organizational aspects of closer cooperation with these observations behind, and turn to the potential benefits of further integration and the efforts to be made for realizing these objectives.

TOWARD CLOSER COOPERATION IN THE CARIBBEAN

There is a Chinese saying that: "The journey of a thousand miles begins with the first step." I suppose that the wisdom of that proverb is borne out by the tasks ahead of us.

One of the most important benefits of closer cooperation in the Caribbean region is market expansion through the elimination of trade barriers. The creation of a common Caribbean market for goods, services, labor, and capital will significantly reduce the diseconomies of scale that companies face in our individual countries. Under these conditions, successful domestic companies can expand their activities in the region through mergers, acquisitions, and strategic alliances, thereby creating strong and competitive regional companies. In this respect, the region can be a stepping stone to global activities. As an added benefit, a common Caribbean market will be more attractive for foreign investors, thus creating employment and strengthening economic growth. The creation of regional companies in combination with the free movement of labor can also help to reduce the discrepancies between demand and supply in our labor markets. In particular, it will be easier to keep and attract high-skilled workers given the wider career opportunities in a regional market.

Closer regional cooperation in such areas as transportation, telecommunication, and financial services will greatly facilitate regional business development and economic growth. In the area of transportation, we need more intraregional shipping routes to support the growth and expansion of intraregional trade and business links. Furthermore, the Caribbean region still lacks sufficient intraregional air connections, and many Caribbean airlines are losing money and struggling for survival.

Closer cooperation between our regional airlines through strategic alliances and, ultimately, the establishment of one Caribbean carrier can contribute to significant cost savings and improve air connections in our region. Better connections at competitive rates also will support tourism.

In the area of telecommunication, our regulatory authorities need to collaborate closely to promote the further liberalization of the telecommunication services markets and adequately regulate the market monopolies that tend to develop in this sector. This approach will stimulate the provision of state-of-the-art services at competitive prices, something that is especially important for the development of ICT services such as e-commerce, which is a promising sector for further diversify our economies.

Finally, more intensive collaboration is needed in promoting the free flow of capital in the Caribbean region. This will contribute to broader and deeper financial markets and to the development of regional financial institutions, resulting in a wider range of financial instruments at lower costs. Some financial institutions already are implementing regional

strategies. An example is the expansion of the Royal Bank of Trinidad and Tobago in various Caribbean countries. Free flow of capital also will facilitate the development of a Caribbean stock exchange through the integration of national stock markets. A regional stock exchange will (i) promote the movement of capital across the region, (ii) increase investment opportunities for regional as well as non regional investors, (iii) provide alternative sources of credits to regional firms, and (iv) ultimately contribute to the development of a single Caribbean market and economy. Some progress has been made within CARICOM to integrate the stock markets of member countries, but we have to persist in our efforts across the entire region in order to be successful.

Ladies and Gentlemen, the road to Caribbean integration is marred by many obstacles, among them the large differences in per capita income and the various stages of development of our countries, which hamper the deepening of regional cooperation and integration. To overcome these obstacles, we need a strategy with four goals:

1. Macroeconomic convergence

This convergence should be attained through the coordination of our individual macroeconomic policies directed at meeting common agreed-upon targets. These targets should include import coverage ratios, ratios of budget deficits and public debt, inflation rate, interest rate and exchange rate stability.

2. Harmonization of regulatory frameworks and good governance.

This harmonization comprises a wide range of policy areas such as standards for prudential regulation and supervision of the financial sector, foreign investment regulations, labor standards, product and professional standards, and tax harmonization to mention just a few. Tax harmonization should include a regional code on tax competition and limiting the extension of tax holidays to attract foreign direct investment to prevent the erosion of our tax bases.

3. Human capital development.

A well-educated and skilled labor force is a critical success factor for regional integration and effective competition in a globalizing world. Regional cooperation between universities and training and research institutes can create economies of scale and attract high-quality staff to produce a labor force that meets the skills demanded by the business sector and the government.

4. Close cooperation between the public and private sectors.

Regional integration must be a joint effort of the public and private sectors. The public sector should develop and implement policies that stimulate strategic change and promote alliances between private firms that will lead to the formation of dynamic and competitive productive linkages in the Caribbean region.

Ladies and gentlemen, globalization is an irreversible process. It is a reality we must learn to deal with. It provides opportunities as well as threats to our economies. The most effective way to deal with globalization is to pursue policies that reduce our vulnerabilities. This can be achieved by acting as an effective and competitive trading bloc. With this approach, we can reduce the threats and risks of globalization and benefit from its challenges and opportunities. Globalization compels us to unite, to integrate our domestic markets and economies into one competitive regional market and economy.

Moreover, by acting as a bloc, we will be able to better promote our interests in international forums, such as the Free Trade Area of the Americas and the World Trade Organization. Looking ahead and making use of the presence here of distinguished members of the US Congress I would like to make the following point. The Caribbean has always been an important market for the United States and conversely, the US for the Caribbean. If the United States is to make good on its promises to open its markets to the Caribbean, US policies have to recognize our unique characteristics. Equating policies designed for more advanced economies to our small economies ignores critical aspects of our island economies. Recognizing our unique characteristics admittedly may make the rules more complicated. Nevertheless, I believe that such treatment will help to align US policies more closely with our opportunities.

Ladies and gentlemen, this conference provides an excellent opportunity to make further progress toward the integration of the Caribbean region and, hence, toward seizing the opportunities of globalization. I hope this will be the beginning of a lasting and fruitful cooperation among Caribbean nations that will lead to strong partnerships, creative investment opportunities, and sustainable economic growth for the region.