Negotiating The Export Economy

Opening Remarks by ECCB Governor
K Dwight Venner

Honourable Prime Minister Dr Keith Mitchell and Mrs Mitchell; Sir Alister McIntyre; Representatives of Commercial Banks, Distinguished Guests, Ladies and Gentlemen, Good Night.

My remarks tonight will fall into two parts. In the first part I will put the theme of this Ninth Annual Meeting with Commercial Banks in perspective, and in the second I will introduce tonight's illustrious presenter of the Third Sir Arthur Lewis Memorial Lecture, Sir Alister McIntyre.

The theme for this year's meeting is appropriately *'Banking Soundness and Macroeconomic Stability'*. We meet against the background of one of the most serious international financial crises since the end of the Second World War. The collapse of the financial systems and in some cases the economies of the countries of East Asia, the most dynamic part of the international economy prior to this; and the locus of thirty years of uninterrupted growth, have been traumatic.

The crisis has spread beyond the region to affect the entire international system and has given some urgency for a sustainable solution. This is critical for us as bankers for the simple reason that banking systems, even before this crisis, have been severely affected by the changes in the international financial arena.

The international financial system has grown at a phenomenal rate during the last decade in both the volume of transactions and the speed with which funds are transmitted across borders because of the tremendous advances in technology. One measure of this is the massive volume of foreign exchange transactions which average some $1.3 trillion dollars per day.

The flows of foreign direct investment and portfolio investment have also grown substantially. Net private direct investment increased from $84 billion in 1994 to $138 billion in 1997. Net portfolio investment rose from $8.7 billion in 1994 to $42.8 billion in 1997.

The distribution of these flows has been very uneven with at least 40 per cent going to the East Asian countries followed by a substantial amount to Latin America. This indicates to some extent the uneven development of countries and their financial sectors as well as the perceived future prospects of these countries by the investment community.

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In fact the events preceding and following the Asian crisis points to the preponderance of the herd instinct in the investment community as creditors and investors vie with each other to be in the latest fashionable location.

Other critical issues of some significance are the complexity of financial instruments, (derivatives, etc), the multi functional roles of financial institutions, and the mega mergers which are taking place in the financial industry.

The volume, speed of movement, concentration on location, complexity of instruments and aggregation of assets have led to increased fragility and volatility in the international financial system. The system has simply moved too far ahead of a regime of rules and regulations which could ensure its stability and orderliness.

We have moved from a system, the *Bretton Woods System,* anchored on fixed exchange rates, to another based on (to a large extent) freely floating exchange rates which have, to some extent, contributed to the current high levels of volatility. The question is:- *Is there a system which while encouraging market participation, insulates the international system against the wild swings in currency values and stock prices which characterise the present situation?*

The record to date on the current system is very mixed as we have witnessed a number of crises since the demise of the *Bretton Woods System*.

A major issue has been serious misalignments of both the US dollar and the Japanese Yen, the two major trading currencies. This has led to major trading disputes and protectionist threats to the world trading system. It is also possible to chronicle a series of major crises starting with Mexico in 1982 and the ensuing debt crisis which engulfed Latin America. This was followed in chronological order by the stock market crash of 1987, the European currency crisis in 1992, Mexico again in 1994, and now the current Asian crisis. There has been as well, the collapse of some major institutions like the BCCI, Bank Herstraat, Barings, Drexel Lambert Burnham, for example, which, it can be argued, revealed serious deficiencies in regulatory systems.

The record of banking system collapses has also been significant and worrying as the IMF has revealed that two thirds of its membership have had serious banking crises in the last decade involving tremendous costs in recapitalisation and misallocation of resources. This should send a clear message to us in the ECCB Area about the possibilities of financial crises affecting us, and what we need to do to avert such crises.

Our currency and monetary arrangements have been in no small way responsible for ensuring the currency and financial stability of our countries. We have among ourselves established a common currency with a common central bank, with a quasi currency board arrangement. We have backed that currency with high reserve holdings and limited by law the ability to create money by deficit financing. This has resulted in a stable currency and consequential low levels of inflation.

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On the banking side, we have set high standards for entry and set prudential guidelines which are in accord with international standards. We also have rigorous standards of bank supervision. The absence of such standards has led to bank crises all over the world, the latest casualties being the banks in Asia. The citizens in our Currency Union have not in their lifetimes experienced episodes of currency and banking instability and have no conceivable notion of the trauma of such events.

Can anyone in this room or in these islands imagine going to sleep at night and thinking that their savings would not be safe and sound in the bank in the morning? Could you imagine standing in long lines waiting to receive your funds from a bank in distress, not knowing whether any money would be left when you got to the teller? This is the situation in many countries today. This was the situation in some local banks in Jamaica recently. In many countries, including our own, there is this myth that it is the banks' money that is at risk. The truth is, it is the public's money placed on deposit with the banks that is at risk. This, of course, places grave pressure on governments to make good the public's losses. The government, however, raises its finances by taxes so we are back to the public again.

I have given you in a nutshell the reasons for having sound banking systems. Systems in which licensing sets the proper standards, where prudential guidelines are followed and the supervision of banks is rigorously carried out.

Another threat to bank stability is a weak currency. In this jurisdiction the trauma of high inflation has not been our experience. We cannot imagine the absolute confusion of hyperinflation. What do you do when the currency becomes literally worthless? In Indonesia the devaluation of the rupiah by 40 per cent effectively reduced the national wealth of the country and put millions of people below the poverty line. I make these points simply to illustrate some of our achievements in these difficult times and to warn against complacency, and to encourage policies and attitudes which can assist in maintaining stability and foster growth and development.

It is with a deep sense of pride that I introduce this year's presenter of the Sir Arthur Lewis Memorial Lecture, Sir Alister Meredith McIntyre of Grenada. One can say that he is a direct descendent of Sir Arthur in his chosen profession and in the way his career has progressed.

Sir Arthur was our first economist and as he himself admitted, the first in so many things that he had to remember that what he did would affect those who came after him. He carried the profession to its ultimate height when he received the Nobel Prize, adding Economics to cricket as a field in which West Indians excelled internationally. He was the first Vice Chancellor of an independent University of the West Indies which established itself as a leading centre of tertiary education throughout the world. He was the first President of the Caribbean Development Bank. He was both in his writings and actions, a fervent believer in a United Caribbean. He blazed a path for us all to follow.

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Sir Alister is one of the leading contemporary economists in the area of international economic policy making, a fact brought out by his appointments in the UN system and which his lecture tonight will attest to.

He was the Secretary-General of Caricom in which position he led the way in negotiating the landmark Lome Agreement that has been acknowledged as one of the finest hours of West Indian economic state craft.

He has just retired as the Vice Chancellor of the University of the West Indies, where he breathed new life into that institution. He is like Lewis, by thought and deed, a fervent believer in a united Caribbean.

The question must be asked - *How do we produce such outstanding men from these little rocks in the Caribbean Sea, and why do these men all believe in the united destiny of these rocks?*

Another question which could be asked is - *Could Sir Alister* <u>*not*</u> *be a believer in a unified Caribbean?* The answer would be a resounding <u>no</u>. He was, after all, born in the land of Marryshow, that outstanding protagonist of West Indian unity, and he attended a school whose school song ended with the following verse:

> *And when boyhood days are over,*
> *Our motto will still remain,*
> *For only by earnest endeavour,*
> *The highest we will attain,*
> *A truly Great West Indies,*
> *Be this our constant aim,*
> *Surmounting insular boundaries,*
> *A people in more than name.*

I give you an Economist, Scholar, Administrator, Caribbean Man and West Indian Patriot, **Sir Alister McIntyre**.

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Lecture

By Meredith Alister McIntyre

I begin by congratulating the Eastern Caribbean Central Bank (ECCB) and in particular its dynamic Governor, Dwight Venner, on initiating this series of lectures in honour of the late Sir Arthur Lewis, by several criteria the most distinguished West Indian of the century. By honouring his memory in this way, the Bank is contributing towards improving intellectual discourse in the Organisation of Eastern Caribbean States (OECS), a most laudable objective. This is taking place at a time when the citizens of the OECS, and indeed of the Caribbean as a whole, need to familiarise themselves with a wide range of issues which, for better or worse, will increasingly impact on their lives and livelihood.

My generation of students made Sir Arthur Lewis our role model. We read all of his writings, marvelling at his scholarly productivity. We enjoyed reading and listening to his debates with his contemporaries, not surprisingly taking his side in them; and we followed his approach to economics - not as an esoteric subject to be buried in elegant mathematical models - or at least not that alone. Economics was a tool to be used in the solution of practical problems, in conjunction with the other disciplines in the social sciences, and to be informed by an historical perspective.

I myself was particularly impressed by Sir Arthur's style of writing - clear, succinct prose devoid of jargon. Sir Arthur's purpose was to be understood by the layman so that the citizenry could engage in debate on the economic issues of his time. Judging by the worldwide sale of his books and the demand for him to speak in most of the world's capitals, he largely succeeded in bringing a liveliness and practicality to his subject, and very many people thought they were benefiting from that.

One of Sir Arthur's principal areas of interest in economics was the world economy. This led him to study inter alia the comparative growth of countries over time, and their success or lack of it in international trade. From the very beginning his work on the Caribbean focussed on deficiencies in our performance in international trade. He argued very forcibly that the countries of the region should focus upon developing exports as their engine of economic growth. That view remains as valid as it was when he first articulated it over 40 years ago.

The debate that ensued, in which I myself participated, between the respective merits of export-propelled growth vis a vis import substitution, has turned out to be a non-debate. Further reflection and experience have shown that countries, especially small countries, that have succeeded in the world have done both: sustained dynamic growth in exports alongside efficient local production in substitution or in replacement for imports.

In the world economy today, one emerging trend is for countries to export what they import, by bringing in from abroad raw or semi-finished materials, parts and components to which they add value locally and then export them. Two decades ago, we were intensely critical of these activities described as '*finishing touch*' industries; although there was some merit in the criticism, since those industries at the time neither transferred technology nor skills to the local economy on a sustained basis. We are wiser today about making blanket condemnations of industries based on imported inputs. We are wiser because of the growing interdependence, which is spreading throughout the world economy. Many manufactured goods now consist of parts and components that are sourced from several countries. We are becoming accustomed to the idea that a product is not made by a single country, but typically through a network of subsidiaries and affiliates located in different parts of the world.

Countries have to change their perceptions about developing exports. They have to search for market niches, which often involves becoming part of producing and marketing networks spread across companies and countries. The old idea of developing one's product on a stand-alone basis and marketing it through an overseas distributor or agent is becoming passe, and no longer the standard practice in international trade. In other words, international trade today is less about selling exports and buying imports from countries. It is more about integration into the global economy and positioning oneself within networks of companies and firms whereby one's own companies and firms can become part of chains of adding value to production and marketing processes stretched across several companies and countries.

The essence of trade and related economic growth is transformation - broadening the base of production by developing new products or improving existing ones. A country's economy must therefore become part of the momentum of world production and growth. If one is stuck producing the same goods and services over time, one's economy will be characterised by slow growth and stagnation. The basic questions that one must ask about one's economy are: what new goods and services are we producing? What improvements have been effected in producing existing goods?

The interdependence and dynamism of world trade have altered beyond recognition the arrangements which countries make among themselves to provide access for each other's exports. The classical form of trade agreement was one which provided for the mutual reduction or elimination of customs duties and other cross-border barriers to trade. Accordingly, Caricom countries have benefited for a considerable period of time from trade preferences, historically with the United Kingdom, transformed later into a series of conventions with the European Union. Caricom has also maintained a preferential trade agreement with Canada (CARIBCAN), has been accorded special access to the US market through the Caribbean Basin Initiative (CBI), and more recently, negotiated preferential trade agreements with Venezuela and Colombia. Within the region itself, Caricom and the OECS include arrangements for preferential trade among their members.

At the global level, several Caricom countries on independence acceded to the General Agreement on Tariffs and Trade (GATT) which accorded them Most Favoured Nation (MFN) treatment on their exports to all other GATT countries. This has been absorbed into the new and much more comprehensive arrangement for a World Trade Organisation (WTO).

Historically, these agreements and arrangements pertained to tariffs (i.e. custom duties). More recently they have been extended to include non-tariff barriers to trade such as import quotas and licensing, and price distorting measures such as export subsidies and dumping.

A number of developments in the world economy have transformed the factors that determine the international competitiveness of countries. In the time available, I can only give a few examples of them. One is the growth of intra-firm trade as against inter-firm trade. If trade consists of exchanges between subsidiaries and affiliates of a single company located in different countries, this permits the practice of *'transfer pricing'* whereby the company decides where it is most advantageous to declare its profits and accordingly, arranges the prices at which one entity within the company in a particular location sells to another entity in a different country. Such uncompetitive pricing behaviour can be dealt with through national competition policy, which provides a basis for agreements among countries to outlaw such practices. However, governments, in developing countries are just developing the capacity to deal with it.

Transfer pricing is merely one illustration of a wide range of uncompetitive practices, which have made competition policy a major aspect of trade agreements, and competition law a growing area of legal practice. Another development in the world economy is the central importance of knowledge in production and trade. Companies having a knowledge advantage in a particular process or product, endeavour to protect it through copyrights and trademarks. These are sometimes infringed by companies in other countries which produce counterfeit products, often involving a small change to the name of the product, its packaging, and so on. Intellectual property has therefore become a very pivotal feature of trade agreements between countries.

A further feature of world trade is the growing importance of trade in services as against that of goods. In the last 10 to 15 years trade in services has tended to grow faster than that of goods, and accounts currently for close to one quarter of world trade. Apart from tourism, among the fastest growing services are financial services, especially offshore financial services; telecommunications and information; culture and entertainment; professional services, notably accounting, legal, design, engineering, and medical services. Here, the obstacle to trade involves not so much tariffs and non-tariff barriers, but restrictions on establishing a commercial presence in the importing country, and the movement of natural persons to the importing country to supply the service.

Closely linked to services is investment, where barriers to the free flow of risk capital over national boundaries include more favourable treatment to national investors as against foreign investors; the treatment of some foreign investors better than others; and imposing performance requirements, whereby the foreign investor has to satisfy the local authorities on several criteria before approval is given for the investment. Such criteria typically include the extent to which nationals will be employed, the use of local raw materials and services, and the export of a given percentage of the product. Foreign investors will also typically want guarantees about their freedom to repatriate their profits and their initial investment.

Another area of increased importance is environmental and worker standards. Governments are expected to take appropriate steps to ensure that their production and trade are environmentally friendly, and that the relevant ILO conventions and other international worker standards are being observed.

An important issue in the contemporary period is trade litigation and therefore the need for an acceptable mechanism for the settlement of trade disputes. We have recently become acquainted with this problem as a result of the banana controversy, but we must be fully prepared for the eventuality that we shall face trade disputes on a broader front in the years to come.

Having regard to the multifaceted nature of trade relations, expertise in international trade now covers a much broader range of disciplines than hitherto. Gone are the days when a trade agreement could be negotiated by a handful of trade and customs specialists. Today, it is not uncommon to find delegations from countries consisting of a large and varied number of experts sometimes running into the hundreds. This poses a gnawing problem for small countries with limited expertise, who can be easily out-manoeuvred by the range and depth of the negotiating capacity representing other parties to the negotiation.

This issue is further complicated by the fact that countries have to engage in several negotiations simultaneously. In the case of Caricom, we are currently engaged in negotiations with the rest of the African, Caribbean and Pacific (ACP) countries in working out a successor convention to the Lome Convention with the European Union (EU); participating in the negotiation of a Free Trade Area of the Americas (FTAA) with the other countries in the Western Hemisphere; and engaging also in global negotiations taking place in the WTO. In 1999, this will include negotiations on agriculture; on services, especially financial services; and preparatory work towards the New Millennium Round. By any standard, this is a very substantial amount of work.

Recognising their limited capacities, the Caricom countries agreed to approach this task jointly and to set up the necessary machinery for the purpose. At the political level, this consists of the Prime Ministerial Sub-Committee on External Negotiations, and inputs from the Caricom Ministerial Council on Trade and Economic Development. At the technical level is a Regional Negotiating Machinery (RNM) Unit headed by a Chief Negotiator and a very small core staff of eight professionals located in London, Kingston and Bridgetown.

We have had to put a research capacity in place since several of the subjects coming up in the negotiations are little known in the region. We shall also be training a cadre of university graduates, so that five to ten years down the road the region will have a cadre of negotiators and policy analysts to deal with the problems coming up then. This is my particular responsibility in the RNM. Turning to the negotiations themselves, Lome, Caricom or to be more correct CARIFORUM - which includes the Dominican Republic and Haiti - is represented on ACP teams of Ministers and Ambassadors who will undertake the actual negotiations. The Chief Negotiator and his team will prepare policy briefs and draft negotiating mandates for the use of the appropriate groups.

With regard to the FTAA, nine negotiating groups have been established as well as a Consultative Group on Small Economies. In Caricom we have set up, under the leadership of the Chief Negotiator, a College of Negotiators, consisting of a Lead Negotiator in each Negotiating Group plus an alternate. The idea of a College is intended to convey the team spirit which will characterise the work of all of the negotiators. Since there are synergies and linkages between the different negotiating groups we have to ensure consistency and complementarity in the work being done in each group.

In case you are thinking that all of this is extremely complicated, let me assure you that it is! The plain fact of the matter is that to be a successful exporting country in the world today, one has to get a firm grip on a number of interrelated technical issues which will define whether countries can sustain an internationally competitive position or not.

The removal of the barriers or impediments to trade that I have described above, is merely part of the overriding requirement that countries should maintain a market economy with minimum regulation or intervention by the government in that economy.

This is based on the often unstated premise that societies consist of equally endowed individuals by way of education and assets, who can be left free to exercise their own choices to consume, to save, to invest, and to work. We know however, that the societies in which we live are a far departure from this model. In our countries serious inequalities, of which critical poverty is a part, continue to be a major constraint on the exercise of free choice as the model conceives. And what exists nationally also prevails internationally in the vast differences in wealth and income that continue among the developed and developing countries in the world.

Accordingly, at both the national and international levels, governments should take steps to reduce these inequalities and certainly avoid their increase. Yet, it is a sad fact that on the whole, the gap between developed and developing countries has tended to increase, even though until the onset of the Asian financial crisis last year, some developing countries, principally in South East Asia, were growing very rapidly.

It is therefore somewhat simplistic to argue that, apart from the very poor countries in the world, termed the Least Developed Countries, all other countries should be treated equally in international trade. That there should be what is described as a level playing field.

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It is undeniable that freer and more open trade can ultimately work to the advantage of all countries, but it has to be structured in a way that allows the less advanced countries to catch up.

The maturation of an economy takes time. It takes time to build the essential elements for adaptability and resilience, so that the economy can shift with comparative ease from one activity to another, and can develop the capability for producing a continuing stream of improved and new products. That requires the development of a strong technological base, and a cadre of highly trained and experienced entrepreneurs and managers, who can spot opportunities at home and abroad, and put together profitable projects to take advantage of them.

Countries should not delay in pursuing the build-up of a technological base, and in putting in place arrangements for educating and training a critical mass of entrepreneurs, managers and technologists. But this cannot be accomplished overnight.

The countries of the Caribbean are trying to do precisely that. Perhaps one might say that they are not moving fast enough or the scale of the effort is too small. If these are valid criticisms, they point to an area in which not only governmental efforts should be stepped-up, but also in which the public should get more involved in contributing to the national effort, and in which external donors could provide more support in the form of capital and technical assistance.

Trade agreements with developed countries should therefore provide for *'asymmetrical phasing'*, namely giving developing countries, participating in agreements with developed countries, longer periods of time to assume the different obligations under the agreement. This may require a measure of differentiation between individual developing countries or categories of them. There is heterogeneity among the non-Least Developed developing countries which may require attention in this regard.

Particular consideration should be given to the situation of small vulnerable economies, that by definition have limited scope for adjustment and diversification, and are especially vulnerable to external shocks and natural hazards.

The question of vulnerability to external shocks has been highlighted by the Asian financial crisis. The South East Asian economies had been doing exceptionally well in terms of diversifying their production and exports, and building a capacity for transformation. The financial crisis, which started originally in Indonesia, spread relatively quickly to the neighbouring countries and its effects are being felt as far afield as Europe and North and Latin America.

The spread of the crisis has engendered a new debate about the links between trade and financial liberalisation in an era of globalisation, and about the need for contingency arrangements to offset the tendency towards financial contagion when a crisis breaks in a country or in a part of the world. This idea is not too different to the suggestion made by the Caricom countries, that as part of the FTAA, a Regional Integration Fund should be set up to mitigate the imbalances in the benefits accruing from the freeing of trade between the larger and more developed member countries and the smaller and less developed. In the current context, it may be useful to raise this matter again.

There is unfortunately a tendency in some quarters, fortunately confined to a minority, to depict developing countries as mendicants, always on the look-out for trade concessions and economic aid from the developed. This is at substantial variance with the record. In the Caribbean for instance, despite the existence of substantial unmet developing needs, a great deal has been done over the past two to three decades to build national capacities for economic growth. Witness the levels of per capita income and of human development that have been achieved. Consider the extraordinary growth that has occurred in tourism, the bulk of which has been the product of local and regional initiatives and entrepreneurship. At the governmental level, strenuous efforts have been made to contain inflation and associated deficits in government budgets and in the balance of payments.

We are not there yet. Most governments still have some way to go in reducing fiscal deficits and improving the efficiency of the public sector. Complaints about deficiencies in educational and health services and the physical infrastructure are legion. Accordingly, there is no room for complacency. But equally, we have a basis for asking our trading partners to give us time. With their understanding and help we can advance further along the road towards transformation and international competitiveness and in time assume appropriate obligations in the EU/ACP grouping, in the Western Hemisphere, and in the global community.

In closing, may I suggest that despite its complications, you should try to take a continuing interest in the negotiations, which will shortly begin. Many of the subjects being dealt with may be of direct interest to you or to the community as a whole. Whatever the situation, the place of the Caribbean in the global community will be defined over the next five years or so. So we must succeed in getting the right framework for our development. Your interest, your support, will count in achieving that success.

I thank you for the hearing that you have given me this evening. My colleagues and I will keep in touch with you in the period ahead, and will be very encouraged by your interest in and responses to our efforts.

I thank you.