"Is the OECS Economic Union a Viable Option for St Kitts and Nevis in the Context of Globalisation and the Advent of the CSME?

3rd Lecture in the Public Education Programme, University of the West Indies

Delivered by Sir K Dwight Venner, Governor, ECCB,
University Centre, St Kitts, March 10, 2005

Ladies and Gentlemen

We meet in what could only be described as a defining moment for St Kitts and Nevis and the rest of the OECS in particular, and the CARICOM in general, as we seek to respond to the fundamental changes which are taking place in the international system on one hand, and the domestic circumstances which confront us on the other.

It is of vital importance that all members of our community, the government, the private sector, trade unions, civil society and the public at large understand the changes that are occurring, the choices we have to make, and the consequences of these choices. This would involve the carrying out of research and the gathering of information on these issues and the wide dissemination of and discussion on them.

Each sector and each country will have to define and elaborate on their general and specific interests, and be prepared to enter into discussions and negotiations with other parties to come up with common compromise, and strategic positions which will lead to progress for all.

To get a comprehensive view of the situation we must start, so to speak, from where we sit by examining our particular and, if you like, peculiar situation in the most objective way possible. This means that we must set up an objective model devoid of party politics, subjective impressions and historical prejudices.

We must then carefully examine the regional and international environment in which we exist. Finally, we must very carefully and objectively examine the options we have both domestically and between various kinds of external associations.

St Kitts and Nevis is probably one of the smaller states in the international community with a population of 41,830, and a physical size of 104 square miles. It has a Gross Domestic Product of EC$984.4 m and per capita income of EC$17,577. The balance of trade shows exports of EC$161.5 m and imports of EC$383.4 m, giving rise to a deficit of EC$221.9 m. This is ameliorated somewhat by the inflow of tariff receipts, direct foreign investment and remittances.

For us in the OECS, it is always interesting to compare our basic statistics among ourselves, and with other small, medium-sized and large countries. Another interesting factor has been the comparison of our basic resource endowments with our expectations. This poses a particular dilemma for us in the Caribbean because of our system of liberal democracy and our geographical position in the Western Hemisphere. Being in the Western Hemisphere, our choice of a standard of living is more aligned with that of North America and not Sub-Saharan Africa or Bangladesh. Our liberal democratic systems lead to governments having to make very generous gestures to remain in power, as opposition parties raise the bar with new promises in order to unseat them.

A certain dynamic is then unleashed which could and has in many cases led to a certain level of instability in the public finances and the economy. I now speak in a generic way about all OECS economies of which St Kitts and Nevis is very representative.

The structural issues of small size lead to a concentration of resource use, high unit cost and diseconomies of scale, high levels of risk and low negotiating capabilities with third parties or groups of countries. The point can be illustrated by using a number of very real examples. However, one which is most revealing, is an analysis of the population in relation to the capacity to supply critical services for itself. If you take the total population and subtract all of those who are under seventeen (17) and over (60) you will arrive at the potential labour force. Further subtractions can be made for the sick and those who are incarcerated. There is usually a certain level of unemployment and in some cases substantial underemployment. Having arrived at a proxy for the active labour force, one then has to evaluate the education and skill levels of that group.

The numbers we arrive at from a population total of 42,000 in St Kitts and Nevis and even 150,000, as is the case in St Lucia is very small. This labour force is responsible for the total output of the country. The country is able to enjoy a certain lifestyle based on what it produces. The conclusion from this analysis is that the smaller the population, the more highly skilled it needs to be, as well as technologically advanced in order to have very high levels of output.

Since the domestic market is so small, then most output has to be exported. The structure of our trade patterns ends up being extremely skewed with exports being highly concentrated in one or two sectors, and imports being very widely spread over a very large range of consumption, intermediate and capital goods. Being export competitive, therefore, is vital to the existence of such small economies. Cost factors, however, loom large because of economies of scale and scope.

The tax base of small countries is by definition small, and the citizens of small countries have to pay, on average, higher taxes than larger countries, which can spread the taxes over a larger number of people. The level of efficiency in the use of resources in small countries must therefore be higher in small countries in order for their productive sectors to be competitive. The cost of infrastructure is reflected in higher debt servicing and therefore higher taxes. If one assumes that the private sector naturally has to carry higher tax burdens than individual citizens, then this is then reflected in their costs and in their competitiveness.

This brings me to one of the two fundamental points I would like to make on this occasion. It is simply this, the government can only provide services which are paid for by its citizens, that is, the tax payers. When the government provides a service it can proceed along several paths. Firstly, it can charge the full cost recovery, that is if the service cost $40 to provide, then that will be the fee. Secondly, it can outsource the service to be provided by a private firm. In this case, the full fee will also have to be paid unless the government provides a subsidy. Thirdly, the government can provide the service free of charge.

In the cases of the subsidy and no charge, the question can then be asked, *who pays?* The simple answer to that is, the taxpayer. There is no free lunch. The dynamics of this issue resides in the fact that whenever the public service receives an increase in salaries, the cost of the service increases.

A corresponding factor, of course, is the cost effective delivery of this service in order to support the competitiveness of the economy. Governments have found themselves by default, and because of the pressures of the multiparty competitive political system, taking on much more than they can afford to. This is even more possible given the vulnerability of our economies to natural disaster, hurricanes, and income volatility. Physical and social safety nets are very costly as the insurance cost when spread over small populations is very high. This springs from two factors. Firstly, in a very small physical space any external shock will affect the whole system. Hurricanes will devastate the whole island and economic activities are so concentrated that they will be completely destroyed. Also, in a mono-crop or mono-activity economy, any change in external arrangements such as the removal of trade preferences, as in the case of sugar and bananas will have a significant impact.

The picture we have portrayed of a small country, St Kitts and Nevis, if you like, is one of great vulnerability to outside shocks, leading to a concentration of economic activities, high unit costs of operation, and a population dynamic which makes it difficult to provide management for both the public and private sectors, and makes the provision of government services a very high-cost venture.

What are the external circumstances faced by St Kitts and Nevis and the other small countries in the OECS. The general name for these circumstances is **Globalisation**. Globalisation is not a particularly new phenomena as certainly, in the late 19th century and up until the First World War, there was a significant amount of movement of not only goods and capital but also people throughout the international system. This came to an abrupt halt in 1913 and this movement of goods and capital did not resume until the 1950s. Major technological changes in means of communication such as containerisation and the use of large ships and aircrafts to transport both goods and passengers,

and the increasing use of computers and telecommunications to transmit both information and specifically finance across countries, led to a fundamental change in the nature of globalisation.

The flow of finance across borders has been simply stupendous. In the area of foreign exchange trading, this currently amounts to over a trillion and a half dollars a day. The speed and the magnitude of these and other flows of commercial bank lendings, portfolio purchases, and direct foreign investment have increased and improved the allocation of resources on a global basis. However, there has been a very significant downside from increased volatility and the many financial crises, in both developed and emerging markets.

There has been a very significant lessening of barriers to trade in goods through the reduction and removal of both tariffs and quotas. The rise of the multinational corporation and the increasing concentration of production through mergers and acquisitions in such critical sectors as banking and finance, defense and aerospace, oil, mineral production, telecommunications and commodities, such as forestry, is now a feature of the global economy.

The spread of brands such as Coca Cola, Toyota, McDonalds, Sony, and Microsoft, all over the globe, in a very sublime way, is how much of the world sees globalisation, that is, from the consumers point of view. The wherewithal to buy these goods at locations all over the world is depicted by American Express, Visa and Mastercard. The vehicle for delivering goods quickly are represented by FEDEX and DHL.

The production side is represented by the increasing importance of production and supply chains which farm out the production of various components of a commodity to locations which produce at lowest cost and highest quality. The NIKE brand, for example, has pioneered this kind of operation. Given the increasing openness and interdependence of the global economy, there is a constant striving for improved efficiency, competitiveness and market share by the formation of larger and larger entities at the firm or enterprise level, at particular locations in countries, and through groupings of countries.

With respect to firms and enterprises, a large number of firms, in terms of their gross sales, are larger than individual countries when comparison is make with the GDP of those countries. In many countries there are large conurbations where production is concentrated. Such locations are found in Tokyo, Sao Paulo, New York City, Mexico City, Shanghai, Bombay, Los Angeles, Buenos Aires, Seoul and Rio de Janeiro.

With respect to countries, there is an increasing tendency for finance capital to move to large countries or groupings of countries. By way of size, the largest economies in the world are the United States, Japan, Germany, the United Kingdom, France and China. China with its population of one billion and an economy which is growing between 9 and 10 per cent per annum is now drawing both finance and resources from the rest of the world at such a rate that it is having a marked impact on the global economy.

As trade regimes become more liberalised in both goods and services, competition between firms and countries will increase. This is already being responded to by cross-border alliances between firms and an increasing number of bilateral and regional trading arrangements between countries.

The European Union is the premier regional arrangement which now comprises twenty-five countries and has endeavoured, through integration, to maintain its bargaining power in trade matters in relation to the USA. In Asia, there are a number of cross country trade arrangements some of which involve only regional countries, and others which have the USA and other Pacific nations as participants. In Latin America and the Caribbean, and in Africa, regional groupings are seen as one strategy of managing the process of globalisation.

There are specific issues, which affect our countries in this new era. They are -

- The erosion of trade preferences through the implementation of new trade regimes, WTO, FTAA, EFA, CSME;
- The adoption of new standards and codes adapted by international institutions which have had an effect on our embryonic off-shore financial sector;
- The impact of terrorism which could have an effect on our main foreign exchange earner, tourism;
- The impact on the price of oil of the demands by China and India, and the turmoil in the Middle East;
- The performance of the US and international economies, and their impact on the local economy;
- The impact of high interest rates and currency movements of the US dollar vis-à-vis other major currencies on our domestic economies.

In the light of these global circumstances, both general and specific, what are the options facing St Kitts and Nevis and by extension the other OECS countries in this defining movement. There are five options or choices facing us –

- To operate in splendid isolation;
- To open up completely to the international economy;
- To be absorbed into a large hemispheric country;
- To raise the level of participation in the OECS to that of a full economic union with all that this option implies in terms of shared sovereignty;
- To be an integral part of the CSME as a single unit.

These options include two extreme and polar positions, that is, splendid isolation and complete openness. The option of being absorbed into a large hemispheric country, such as, the United States, Canada or Venezuela may or may not be a practical option given the preferences which both parties have. The two regional choices can be complementary depending on the choice of sequence. The first option which is put forward to indicate an extreme choice presumes that St Kitts and Nevis would match its resources with its wants and not depend on the rest of the world for finance, goods or services. The illustrations we presented, particularly with respect to exports and imports would indicate that this is not a viable option.

The other polar extreme complete openness would or could result in the flooding of the St Kitts and Nevis market by goods, services and labour from outside in a way that would apply an extreme shock to the polity, the economy and the society. While globalisation would tend to lead in that direction, it is clear that even major economies like the USA which are much more capable of withstanding such shocks, are not exactly rushing to establish such an open regime.

In the case of absorption into a large country – USA, Canada or Venezuela – even if the population of St Kitts and Nevis were in full support of this option, the countries listed, I suspect, would have serious misgivings in the context of the geopolitical repercussions of such an arrangement.

We next come to the CSME which involves the removal of substantial restrictions between the countries of the CARICOM in the movement of goods, services, capital and labour across regional borders. The critical question then relates to *St Kitts and Nevis’ participation either as a single entity or a member of a consolidated OECS Economic Union bloc.*

Let me address the issue in this way. All matters involving economic exchanges in this new dispensation, whether it is globalisation or the CSME require economic and negotiating capacity. Economic capacity can be defined in terms of large domestic markets, a high level of domestic output, and good economic policies and management. Negotiating capacity requires a skilled cadre of political, public service and business actors who have clearly defined goals and principles and are supported by a societal consensus on these goals and principles.

If one puts the argument in this way, then large countries do have an advantage over smaller ones in terms of economic capacity with respect to large markets and potentially large domestic output. Small countries may redress some of this disadvantage by having good economic policies and management practices, as well as negotiating capacity. St Kitts and Nevis and the other OECS countries would seem to be severely disadvantaged in most of these areas making their participation in the CSME and other arrangements such as the FTAA, a very challenging proposition, and their ability to respond to globalisation, a matter of grave concern.

Again, I say, this is a defining moment for us in St Kitts and Nevis and the other members of the OECS as we seek to identify and define our interests first of all, and then decide on the strategies that we must undertake to achieve these objectives.

With respect to the CARICOM and the CSME, the group of countries constituting the OECS is a net importer of both goods and services, and has to export both commodities and services to third countries in order to acquire foreign exchange and incomes to buy such imports. Unfortunately, unlike the EU, there is no compensating mechanism for redistribution to support the development efforts of the OECS countries, and to balance the trade inequalities in the region.

This is a very serious problem and could lead to much resentment in the countries of the OECS, particularly if there is no freedom of movement of labour to allow for some sort of adjustment. The argument which is being advanced is quite simple. The best option for St Kitts and Nevis and the other countries of the OECS is to access the CSME as a unified bloc so that they can advance their interests through enhanced economic and negotiating capacity.

The associated argument is that the CSME's success depends on the prior or parallel establishment of a consolidated and coherent OECS entity. Both historical and contemporary circumstances combine to support these arguments. The fragmentation of the Caribbean region into separate sovereignties following the demise of the West Indies Federation led to the smallest states, the OECS having to delay their independence and then to establish sub-regional arrangements, which were given concrete expression in the Treaty of Basseterre (1981).

There has been an apparent conceptual approach in the OECS which, given their very small size, is characterized by a very conscious effort to support regional initiatives. This is quite different in the larger countries which always seem to think they have other options. The Treaty of Basseterre embraces the ethos of this sentiment, and a serious reading of the Treaty is very illustrative of the intentions and means by which the countries are expected to advance the welfare of their peoples.

The Preamble, as well as Annex A, which is the Agreement establishing the East Caribbean Common Market, speak volumes regarding the intent and method of implementation.

First, the Preamble, which states clearly the **affirmation** to achieve economic and social development for their peoples as enunciated in the Agreement establishing the Eastern Caribbean Common Market. It offers a strategic approach to critical issues as set out in the following:

" … Inspired by a common determination to strengthen the links between themselves by ***uniting*** *their* ***efforts*** *and* ***resources*** *and establishing and strengthening common institutions which could serve to increase their bargaining power as regards third countries or groups of countries;…"*

It finally expresses a fundamental resolve in the phrase " … *Determined to satisfy the legitimate aspirations of their peoples for development and progress; …"*

It is important to note, contrary to some misconceptions, that the OECS Treaty is not antagonistic to wider regional movements, and sought to incorporate them or actively solicit their cooperation.

Article 2 (4) states *"Any other States or territories <u>in the Caribbean region</u> may apply to become Full or Associate Members and shall be admitted as such by a unanimous decision of the Authority. The nature and extent of the rights and obligations of Associate Members shall be determined by the Authority."*

This clause applies to any Caribbean state, which could include Barbados, Trinidad and Tobago, Guyana and Jamaica. It is not a discriminatory clause.

Let us speculate that the current OECS members decided collectively to undergo a radical adjustment and transformation process and achieved a 10 per cent per annum real compounded growth rate over the next five years, while the CSME and other regional arrangements made no progress. *Would this dazzling growth performance influence Barbados, and Trinidad and Tobago to apply for membership in the OECS, or to have some closer arrangement on a bilateral basis?*

This shocking speculation is made simply to assert that there may be, other things being equal, a potential growth dynamic within a collective OECS Economic Union, which could accelerate the current rate of economic growth and transformation of the individual economies. This may place the OECS and the rest of CARICOM in a much stronger economic position.

The fact of the matter is that the ECCU has achieved some basic economic objectives which can provide a platform for growth and development. In the monetary sphere they have achieved a stable currency, low inflation, and a safe and sound banking system. A programme of money and capital market development is now seeking to put in place institutions and markets to create a single financial space.

The issue of economic union is now being addressed and this will be a fundamental advancement when placed in conjunction with the single financial space. Economic Union is at the upper levels in the hierarchy of integration arrangements. The literature sets the following levels in this hierarchy:

- A *Free Trade Area* where goods are not subject to restrictions between member countries;
- A *Customs Union* in which the members apply a common external tariff to third countries;
- A *Common Market* in which there is the free movement of the factors of production;
- *Economic Union* in which there is the coordination of economic policies;
- *Full Political Union* which could either be a Unitary State or a Federation.

The OECS countries have virtually free movement of goods, and virtually free movement of capital through the ECSE and the RGSM, a common currency and central bank, which implies the coordination of monetary policy. The status of the OECS, therefore, lies somewhere between a Common Market and an Economic Union.

The situation, therefore, is that if the impediments to the creation of the single financial space are removed, and freedom of movement of labour is legislated, then the OECS countries would have created a new economic entity with command over more natural resources, and having a larger collective market size. Coordination and peer pressure would result in better policies, other things being equal. Negotiating capacity would be increased and the attraction of both private capital and loans on much better terms would be real possibilities.

The concept of such a new entity would require a notion of a domain which had distinctive qualities. The objectives set by the OECS Heads of Government in 2002 of growth, 6 percent; unemployment of less than 6 per cent; poverty of less than 6 per cent; the maintenance and improvement of the Human Development Indices and economic transformation could be placed in the context of individual targets by each country.

The economic union as an identifiable entity could then establish the range of policy instruments that would facilitate the achievement of these objectives. These would span the areas of **monetary, fiscal, trade, international economic relations, income, structural, social and environmental.** All these policies require coordination with each other in order to be effective. New political arrangements will be required in the economic union and single financial space for the realisation of our economic goals.

Economic transformation is the major objective, and this will require at both the country and union level, a convergence of policies. At both levels, an improved allocation of resources will be essential for increased output.

The establishment of an Economic Union, and the creation of a single financial space create a viable option for St Kitts and Nevis, and the other countries of the OECS. The enlargement of the economic space, which adds significantly to output and domestic market size, and locks in the convergence and coordination of policies, will provide a better platform for economic transformation than the current circumstances permit.

The trajectory that one could see unfolding would be the consolidation of the tourism industry as the lead sector across the economic union with multi-destination tourism being a critical element of the tourism strategy. The tourism sector would create linkages across the economic union with agriculture, light manufacturing and handicrafts being the major beneficiaries. Information and communication technology would be a critical element of the strategy both as a supporter of other industries and a dynamic sector in its own right.

Finance will be the critical innovative sector as we proceed with our programme of money and capital market development. The Eastern Caribbean Securities Exchange is slated to be the cutting edge instrument for placing the economic and currency union in the forefront of the drive for sustained economic growth. It is now the de facto regional exchange with the objective being to move from the currency union, into the CARICOM and then into the international community.

The Exchange is now attracting significant interest in the wider region and beyond even before the economic union and single financial space have been established. The prospects would, therefore, be quite promising when the supporting arrangements are put in place.

The OECS Economic Union would be the most critical institution to increase the promise of the CSME. The OECS would serve as the pilot for successful integration arrangements and would solve what economists refer to as the large number problem in the CARICOM. That is, fifteen states would become eight, and the new OECS bloc would be large enough to command some leverage over the process. The Trinidad and Tobago manufacturing sector exports 60 per cent of its products to the OECS as a whole, which provides substantial employment in that country. The OECS would be in a position to negotiate reciprocal arrangements with Trinidad and Tobago.

Also, in negotiating with third countries, a consolidated OECS would increase the bargaining power of the CARICOM, as well as its capacity to draw resources from the rest of the world.

In conclusion, it would be fair to say that the joint and collaborative arrangements we have committed to, have been successful and enhanced our prospects for stability and development. The time is now appropriate for another leap of faith to safeguard the future development of our countries. **OECS Economic Union is probably the only viable option that we have at this time, as we advance towards the CSME.**

K Dwight Venner

Governor

10 March 2005