Structural Change And Development In The Eastern Caribbean Currency Union (ECCU)
By
Sir K Dwight Venner
(December 2001)

The Eastern Caribbean Currency Union (ECCU) now faces formidable challenges to re-establish the bases for economic growth and development in a rapidly globalising world which has suffered a major shock.

Prior to September 11th the economy of the United States had already been in decline and the economies of the ECCU were in secular decline. Growth rates in the 1980s had averaged 6% based on the performance of the Tourism and Banana industries. The 1990s and the year 2000 have witnessed a significant decline in economic performance.

Two factors are responsible for this; firstly, and more immediate the removal of preferences for our major agricultural economies, the flattening of growth in the tourism industry and the frequent occurrence of natural disasters.

The more fundamental causal factor however, was the underlying structural imbalance of the island economies. This was manifested by the small size and fragmentation of economic units and the low productivity, utilization and flexibility of the factors of production.

The markets for factors of production as well as commodities and services are underdeveloped in each island and even more so across the Currency Union. This underdevelopment of markets is due in the first place to their small size and the consequent tendency for monopolies and oligopolies to form naturally. It is also due to the over compensation exhibited by economic actors in their attitude towards risk. It is also reinforced by the absence of the externalities which are possible in large markets, leading to higher transactions costs.

The net result is that both on the side of potential borrowers who desire to produce goods and services for the domestic market, and for lenders, there are rigidities in the system which lead to actions which are low growth instead of high growth.

The commercial banks as holders of the highest levels of savings and finance capital have portfolios which naturally mirror the narrowness both in volume and diversity of the economic base.

This limitation is manifested by the allocation of finance to agriculture, industry and services, the sectors which produce foreign exchange, as opposed to those which absorb foreign exchange. This imbalance can also be seen from the number of workers employed in the foreign exchange earning sectors as opposed to the other sectors.

This structural imbalance on its own would lead to a low growth scenario. It is compounded by the low levels of factor productivity in land and labour.

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The question is how do we address these fundamental issues at the country and currency union levels. The issue hinges on the enlargement of markets and the productive utilization of factors at both the country and currency union level. It is my submission that the two become indistinguishable if a high growth scenario is to be possible. The answer lies in what we now call multi-destination tourism and the multi-country production of goods and services across the entire currency union.

This approach would change the entire structure of these economies with new incentive regimes leading to a more competitive environment, access to more lending, labour, capital and management for production, lower transaction costs and higher externalities. A critical issue to be understood is that we are not speaking about simply adding factors across countries but instead an organic change in the relationship of productive agents across countries.

The initial dynamic for this has to come from our leading foreign exchange earner, tourism which has two critical attributes. Firstly, it enlarges the market by increasing the population but not the need for social services. The additional population is higher income with the capacity to open markets in their place of residence. Their consumption demands at different points in time can lead to an enlargement of our markets. This has the potential for forward and backward linkages in agriculture and industry as well as the offshore finances, telecoms, and cultural services. The critical issue would be to remove the impediments both legal and administrative to economic activities across geographic boundaries.

There is the need for an approach to the creation of a production, marketing and distribution network which spans the currency union and which would enlarge markets both within countries and across the geographic space which is the OECS.

While transportation and telecommunication facilities are obvious, a more critical issue lies in the organization and structure of firms and industries. One can only speak about tourism, bananas, sugar, cocoa and nutmegs. With the exception of tourism and bananas, they are very small. The firms in these industries again with the exception of tourism are very small. There is no critical mass of firms in these industries which form clusters which allow economies of scale and lower transaction costs. One must therefore ask the question what kind of firm structure would deliver the basis for high output and productivity. The choices before us are multinational firms, large national firms, small and medium size firms.

I would like to challenge the commercial banking community to engage with us and the governments in a very constructive discussion on the future of the real economy and the structure required to increase output and productivity.

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We as a Central Bank have taken the route that the development of the financial system across the entire currency union is the forerunner and precursor of this new economy.

The concept of the single financial space as the unrestricted flow of finance, across financial institutions and instruments is the paramount expression of the vision we have. A single currency makes the creation of unified markets a very real possibility.

With respect to markets there is the Inter Bank Market (IBM) which was followed by a regional market for secondary mortgages, then one for equities and in February a Government Securities Market (GSM).

In the case of institutions the Eastern Caribbean Home Mortgage Bank (ECHMB), the Eastern Caribbean Securities Exchange (ECSE), which will be followed by the Eastern Caribbean Unit Trust (ECUT) and the Eastern Caribbean Enterprise Fund (ECEF). The legal and accounting infrastructure is being laid for accommodating this new financial space.

The traditional institutions, bankers, insurance companies, credit unions etc will have to adapt to these new circumstances. New institutions will spring up to fill the lacunae created by this new arrangement.

We describe the approach as the development, integration and regulation of the financial system in the ECCU. It parallels and to a certain extent, leads the development of the new structures in the real sector.

The argument is as follows. The concept of entrepreneurship must be enlarged to inspire and secure the change in the structure of the productive sectors and lead to new poles of growth. There is first of all policy entrepreneurship in conceiving through brainstorming, analysis and wide ranging discussions the vision of the new productive structures.

Secondly there is financial entrepreneurship in identifying the financeable elements of the vision which can initiate the process. These will be the lead actors or pioneers who would inspire imitators.

Thirdly, there are entrepreneurs in the real sector who will see new opportunities in the enlarged spaces made available to them.

Consideration here must be given to the scale and scope of the firm and the industry. One possible model is the import-export firm from Japan and the East Asian countries. This would seem to fit the concept of multi-country production and also given the possibility of inserting our economies into global commodity chains.

All of this has to take place within an OECS/ECCU governance structure which provides for an institutionalized policy-making framework at both the sub-regional and national levels.

The clarity of the policies and their coordination within and across the ECCU would facilitate the critical interaction with the regional and international environment. This would allow us to access resources on terms favourable to ourselves from these external sources.

In the final analysis we can overcome the problems of size and secular decline but it will require clear policies and consistent implementation.