

Message by Sir K Dwight Venner, Governor, ECCB
On the Economic and Financial Situation in the Eastern Caribbean Currency Union (ECCU)
(19 October 2001)

Fellow Citizens of the OECS

I have been requested by the members of the Monetary Council, the highest decision making body of the Eastern Caribbean Central Bank, to address you on the economic and financial situation in the Eastern Caribbean Currency Union in the aftermath of the tragic events at the World Trade Center in New York and at the Pentagon on September 11th, 2001.

Those events have changed in an irrevocable way the state of the world while at the same time painfully illustrating how interdependent the international community is. One apparently isolated event in the nerve center of the financial world has deeply affected the entire international economy. The global nature of the international economy is being emphasized and reemphasized with each major event and we in the Eastern Caribbean must, with some urgency, adjust to the fact that this is now the reality of our 21st century existence.

In this address I will review not only our current problems but also the fundamental issues which affect our economic performance and progress. I will also look at the measures, both short term and long term, which our governments are seeking to put in place at the OECS and national levels.

It must be clearly emphasized that while we are in a very serious crisis there is the opportunity to make fundamental changes to support our development efforts both now and in the future. This we must do with urgency.

Prior to the events of September 11th the international economy led by the United States of America was already experiencing major difficulties. The U.S. experienced growth of 0.2% in the first quarter of 2001, which is a marked fall from the performance in 2000 when growth rates at times exceeded 4%. The Japanese economy has been stagnating for most of the past two years with growth rates at or below 1%. Europe as well has experienced significant declines and the U.K. had a growth rate in the first quarter of 1.4%.

The economies of the ECCU are small and open and are affected by the performance of the industrialized economies from whom most of our tourists, direct foreign investments, foreign aid, and remittances come, and which provide preferential markets for our major export commodities namely, sugar and bananas.

Consequently, the performances of the ECCU countries also weakened considerably in the first half of this year compared to 1999 and 2000, when the growth rates were 4.3% and 2.9% respectively. Based on preliminary data for the first six months of 2001, GDP growth was provisionally estimated at 0.4%. The sectors that contributed to this decline were tourism, bananas and construction whose performances declined significantly from the previous period.

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This poor economic performance manifested itself in increased fiscal deficits, higher levels of debt and increased unemployment due to lay offs.

This situation will worsen significantly following the events of September 11th and the commencement of military operations on the 7th of October. The following sectors, it is reasonable to expect, will be seriously affected by these events:

1. Tourism - This sector could be seriously affected by the fear of flying and the difficulties, which have directly affected the aviation industry. The start of hostilities and the advisories to American citizens could also have a significant impact on the upcoming tourist season.
2. The Financial Services Sector - This sector was already under severe pressure with challenges from the FATF, OECD and the FSF.
3. Insurance - The costs of these catastrophies would result in increases in the cost of insurance to both householders and businesses.
4. Oil - The price of oil is a very sensitive factor in business and personal costs and while oil prices are now low, a long conflict would have an impact on this factor.

These factors could put further pressure on the economies of the Currency Union, which are already experiencing great difficulties.

It would be no exaggeration to state that our countries are now facing some of the most demanding challenges in our recent economic history. The challenges emanate from both without and within our borders, defined in the strictly geographic sense. I stress geographic to assert that we can draw a distinction between our geographic and economic boundaries and suggest that both can be shifted to accommodate the adjustment and transformation necessary in the face of the new economic and financial circumstances. This shift is urgently required at this time.

We are faced with two fundamental problems namely globalization at the external level and our small size at the domestic level. Globalization is a fact of life and we will have to contend with it in a constructive manner. Its impact on us can be seen in the following areas.

1. In agriculture, the banana industry has been seriously affected by the new trading regime as exemplified by the WTO.
2. In industry the establishment of new trading regimes, in this case NAFTA, led to the loss of some of our industries to Mexico.
3. In the case of the financial services sector, which we have already alluded to, the apparent requirement to establish international standards has had a significant impact on that sector.

At a more general level, we are involved in major negotiations to participate in international trading arrangements. The most prominent of these are the WTO, the FTAA and the former LOME Agreement now the COTONOU Agreement between Africa, the Caribbean, and the Pacific, (the ACP) and Europe.

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Our domestic economies are small and extremely vulnerable to external shocks and natural disasters such as hurricanes and volcanoes.

While our fundamental structural problem of very small size is clearly not insurmountable, it must be recognized and appropriately dealt with. The economies of scale of administration, production and marketing are major challenges to us as we seek to compete in a globalised world economy.

The question then becomes: *Given the size of the population and land mass, what do we expect to provide by way of a standard of living and quality of life for our citizens within the current geographic spaces, which are our nation states?*

The answers to this question are both visionary and numerical. Visionary in the sense that we have to look forward twenty to twenty-five years and visualize what kind of society we would like to live in at that time or leave to the next generation. Numerical in the sense that we must take stock of our present circumstances, especially this crisis, to account for what actual and potential resources we have available to overcome our current difficulties and lay the foundation for our future progress.

One conclusion which can be drawn is that with small populations and scarce natural resources we must use what we have in the most efficient and effective manner. Another way of putting it is that a small population has to have the highest possible skill levels, as well as social and political consensus, to make up for its numerical deficiencies.

Within this generalized framework we must now look briefly at the positions of both the public and private sectors.

With respect to the governments, the question is: *Can they supply a full service to their citizens given the resources available?* This, of course, will depend on the range of services and who will pay for them. There are two extreme options in terms of payment. At one extreme the government can bear the full costs, that is, no cost recovery, and at the other the citizen can pay the full cost, that is, full cost recovery. There are a number of arrangements between these two points but the government in our experience usually absorbs the full cost. The end result is that in the case of the ECCU countries, governments' expenditures are extremely high in relation to the size of their populations.

Governments have a number of options with respect to covering cost and providing better services. They can:

- a) Have a programme of cost recovery;
- b) Outsource the service to private contractors;
- c) Share the provision of the service with other OECS countries, as provided for in the OECS Treaty.

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In the case of the private sector the critical issue would be the size of the domestic market for the goods and services produced. This would be determined by the size of the population and the per capita income of the country. The important questions in this instance would be:

Given the size of domestic markets, is there enough domestic competition to ensure that innovation and efficiency become the yardstick for successful business enterprises?

How do firms feel about competing in a global environment with such a small domestic population and natural resource base?

What kinds of alliances can firms make within their countries, across the Currency Union, the region, and with external entities to participate in the global economy?

I make these points to emphasize the fact that in the face of our current situation, our governments and the private sector will have to rethink their roles if we are to successfully overcome our present difficulties and lay a platform for our future progress.

The governments of the ECCU, even prior to the events of September 11th, had been taking steps at both the national and currency union level to deal with the problems of our declining economic performance. The OECS Authority has met three times for the year, twice in special sessions to deal with these matters. The Monetary Council has met twice and will be meeting again on the 26th of October. This crisis has, of course, added a greater sense of urgency for the implementation of strategic policies at both the Currency Union and national levels. One of the fundamental issues, which has been emphasized by the Heads of Government, is that the solutions to our problems would be more sustainable at the OECS level.

There is already in place governance arrangements at the OECS through the Treaty of Basseterre of 1981, the ECCB Agreement of 1983, and the West Indies Associated States Supreme Court Act (1967). In addition, there is close collaboration and joint cooperation in the fields of civil aviation and the regulation of telecommunications. There are also OECS projects in Education, Health, the Environment, Solid Waste Disposal and Trade. The OECS Treaty itself identifies seventeen areas in which the member countries should coordinate, harmonise and pursue joint policies of which nine have been successfully pursued.

The decisions taken and the actions contemplated at the OECS and national levels, if fully carried through, form the basis for an effective response to the current crisis and a framework and foundation for future growth and development.

I will now outline the series of decisions taken, recommendations made and actions contemplated at both the OECS and national levels.

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1. Governance and Decision-making Arrangements

Both the OECS Authority and Monetary Council have made strong recommendations and taken decisions on a system of governance and decision-making at the OECS and national levels to ensure effective policy making and implementation.

At the OECS level, the Authority is the highest political body. It has been agreed that it would meet on a more regular and systematic basis to provide and monitor the process of closer integration and to coordinate the response to this crisis. The Monetary Council will be responsible for the monetary and financial policies of the Currency Union as set out in the ECCB Agreement.

At the national level three arrangements have been recommended:

- a. A Cabinet Committee on Economic Policy;
- b. A National Economic Council;
- c. A Tripartite Committee.

Most governments have already put in place or begun to have variants on these arrangements. We would like to urge governments to complete the process by the end of October so that a comprehensive policy framework would be in place across the OECS as soon as possible.

A brief word is necessary on the above arrangements. In the case of the special cabinet arrangements, most governments have adopted the process but the system needs to be institutionalized for strategic purposes and for consistency. The National Economic Councils are intended to serve as the basis on which consensus on economic policies can be built through close interaction with the social partners.

The third arrangement, the Tripartite Committees are to be very specialized, comprising the government, the trade unions and the private sector with an agenda that includes four specialized areas, namely, wages, prices, employment and productivity. There must be social consensus on these issues if we are to progress. Wages and prices cannot exceed productivity if our societies are to progress. Productivity on the other hand must be shared equitably according to some agreed formula between workers and employers. The bottom line is that in the final analysis the standard of living of a country depends on the competitive production of goods and services.

2. Monetary and Financial Policies

In this time of great uncertainty the population and the business community must have some instrument or institution that gives a sense of confidence and credibility. For us in the ECCU that instrument would be our currency, the EC dollar. In recent months, and particularly since the events, there has been some speculation in a few circles about the soundness of our currency. I would like to set the record straight.

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The EC dollar has been pegged to the U.S. dollar at EC\$2.70 to U.S.\$1.00 since July 1976, that is twenty-five years in July this year. In July the Monetary Council met and reaffirmed the peg at its original rate. The arguments in favour of the peg were extremely convincing and remain so even after the recent events:

- a) The peg has been very robust and has come through many major crises over the years, including two oil crises, recessions in the U.S., natural disasters, and dramatic falls in the production of bananas.
- b) The backing of the currency is at a very high level. Whereas the legal minimum backing is 60% of foreign reserves the current backing moved from 95% to 97% during the course of the last four months. In effect this means that every E.C. dollar in circulation is backed by 97 cents U.S.
- c) Our foreign exchange reserves translate into above three months of imports, which is above the norm stipulated by the IMF.
- d) A regular check is made on the external competitiveness of the E.C. dollar by looking at the real effective exchange rate. Using an index of 100, our outer limit is 110. The real effective exchange rate is now at 105.
- e) The decision to devalue the EC dollar is not a simple one and requires the unanimous agreement of all members of the Board and the Monetary Council. Both bodies at their recent meetings have reaffirmed the current arrangements.
- f) According to our analyses, which are in agreement with those of the IMF and the World Bank, and confirmed by the experiences of countries in our region which have had significant devaluations, this would not be the correct policy option for us at this time.

The Monetary Council has mandated the Central Bank to develop money and capital markets throughout the Currency Union and the situation here is as follows.

The following markets are being developed:

- a) An Inter-Bank Market for liquid funds among the commercial banks, which from 16th October will be completely determined by the supply and demand for funds.
- b) A market for stocks and shares which will be incorporated on the 19th October 2001.
- c) A Regional Government Securities Market which will be established in February 2002 starting with Treasury Bills.

With respect to institutions, the Eastern Caribbean Home Mortgage Bank (ECHMB) has been successfully established and has paid dividends in its last two years of operation. We will shortly be concentrating our efforts on establishing two new institutions, the Eastern Caribbean Unit Trust and the Eastern Caribbean Enterprise Fund.

On the matter of interest rates this is engaging the attention of the Council and the Bank. This is a very complex matter and one can note that in spite of nine rate cuts in the U.S. the

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economy has not yet responded, while in Japan interest rates are practically zero. We have to take into consideration the impact not only on borrowers, but also on depositors, the banks, and the entire economy.

3. Fiscal Policy

It is in the area of fiscal policy that the governments have been most active. Many governments have taken steps to contain expenditure in the public service and there has been agreement to cap such expenditures in others in order to reduce fiscal imbalances. All governments are now setting up the mechanisms for putting in place appropriate adjustment measures in accordance with the recommendations of the Monetary Council.

At the OECS level in addition to the ongoing measures there are three particular initiatives, which will be pursued with urgency.

- (a) On the revenue side, the Monetary Council has established a Commission on Tax Reform and Tax Administration which will carry out a comprehensive review of our revenue systems and make the appropriate recommendations. This Commission will be chaired by Sir Alister McIntyre.
- (b) On the expenditure side the OECS Secretariat, the ECCB, CDB the Ministries of Finance and the World Bank are now engaged in a comprehensive Public Expenditure Review, which will lead to recommendations on the most effective expenditure programme for the governments.
- (c) The Heads of the Ministry of Finance and the Central Bank have established a Regional Debt Coordinating Committee to review and advise on the management of the public debt to ensure that countries achieve and maintain the ratio set by the Monetary Council.

4. Social Safety Net

The member states of the OECS will be having discussions with the World Bank on the creation of social safety nets to provide for the most vulnerable members of our communities.

5. Production

The current crisis gives us a unique opportunity to review the structure of production, distribution and marketing of goods within our geographic boundaries, and externally. Taking the OECS as a single economic and financial space gives us a chance to broaden the production base and establish a platform for effective participation in the CARICOM single market and economy and beyond. Our analyses suggest that this process should be based on multi-destination tourism and multi-country production.

The OECS Authority has delegated the responsibility for dealing with the tourism industry to the Prime Minister of St Kitts-Nevis, the Hon. Dr. Denzil Douglas. It is our recommendation that agriculture, industry and services should have similar treatment. Suffice it to say that in the weeks ahead action will be taken to bring together the productive sectors throughout the OECS.

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6. Aid Coordination

It is clear that the OECS countries will need external assistance to get through this crisis and to establish a platform for future growth and development. The OECS Secretariat, the ECCB, the UNDP, the CDB, the World Bank and the donor community have been meeting over the course of the year to improve the coordination and delivery of aid to the countries.

These discussions are very advanced and an urgent meeting will be called to evaluate the situation and agree on the kind and quantum of assistance, which will be required. Effective coordination will be required among the governments on this issue. This is what makes the governance and decision making arrangements at the OECS and national levels so important.

Fellow citizens, in conclusion, it is very important that all of us in the OECS realise that we are in a crisis situation which will require sacrifice, fortitude, clear thinking and consensus across our societies and among our islands. All elements of our society need to rally together to address with urgency our common problems. The private sector, the trade unions and civil society must come together to discuss with openness and candour how we are to deal with the challenges we face and not leave them solely to our governments.

Governments, of course, have to lead, but the rest of the society must play its part by trying to achieve consensus for the good of our nations. In crisis we are able to test the mettle and character of individuals, communities and nations. I believe that this crisis gives us the opportunity to be united within each island and across the OECS.

This is necessary and urgent as we strive for political, economic and social development, and attempt to make our way successfully in a highly competitive, rapidly changing and increasingly dangerous world.

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