

The Eastern Caribbean Currency Union Economic Review 2007
Presented by Sir K Dwight Venner, Governor, ECCB
22 January 2008, ECCB Headquarters, St Kitts

Introduction and Background

We are entering a period of great uncertainty which will present challenges to all countries in the international community, and in particular those such as ours which are small, open and vulnerable. Several events of great international significance have had and will continue to have a major impact on the world economy.

Among these are:

- The dramatic increases in the price of oil which surpassed the \$100 a barrel mark in the first days of the new year, this is almost double the price of a year ago.
- Increases in the price of food, most notably, the 80 per cent increase in the price of wheat, a major staple from which bread is made, and
- The continuous slide in the value of the US dollar against other international currencies, the dollar having fallen some 10 per cent against the Euro in 2007.

These events underpin the environment in which we begin this most critical of years. However, we must not be daunted by these unprecedented circumstances which are global in character and present problems and challenges to all the countries of the world.

Suffice it to say, that it is our individual and collective responses to these circumstances and challenges that will determine the future of our countries and of future generations.

Since 1990, the ECCU countries have experienced a moderate to average rate of growth, between 2 per cent and 3 per cent. This is a step down from the 1980s when growth averaged 6 per cent.

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The growth performance of the currency union has also been quite volatile over the period 1990 to 2007. This is however consistent with the very small size of both population and land space of our countries; their openness to international trade and prices; and their vulnerability to external shocks and natural disasters.

In most of our countries, the rates of growth have not been substantial enough to absorb significant portions of the labour force, leading to high levels of unemployment and poverty, and rising levels of income inequality.

The vulnerability of our economies has been manifested in several ways, including:

- The impact of the erosion of trade preferences on our major agricultural export commodities, sugar and bananas.
- The steep fall in foreign exchange receipts from the tourist industry and in the overall growth rate following the events of September 11, 2001.
- The almost complete devastation of the economies of several of our member states at various times over the period, as a result of natural disasters such as volcanic eruptions and hurricanes.

A major consequence of these events has been a deterioration of the fiscal situation and the build up of public sector debt, as governments sought to respond to these circumstances with very limited domestic resources.

That we have managed to survive and even progress is due, in no small measure, to the resilience of our people and the institutions we have carefully created and nurtured at both the OECS and national levels.

The three main institutional arrangements at the regional level are:

- The Court of Appeal;

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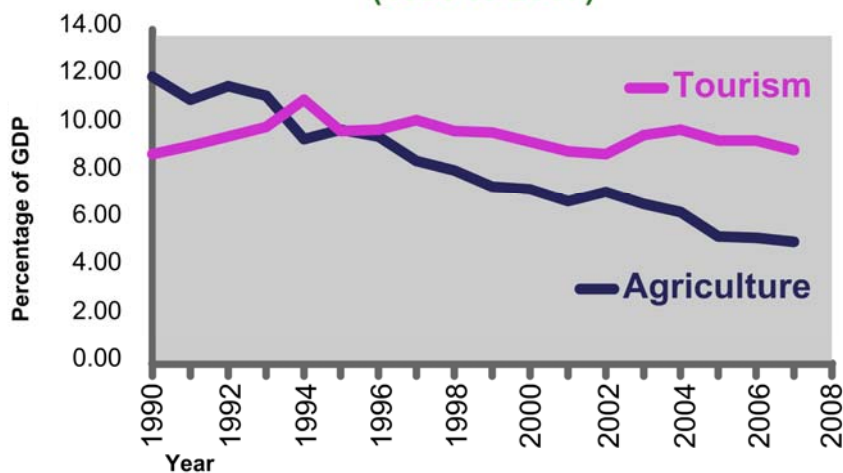
- The Treaty of Basseterre which created the OECS; and
- The Agreement establishing the Eastern Caribbean Central Bank.

Other significant arrangements involve joint regulation of banking, securities exchanges, civil aviation and telecommunications; joint procurement of pharmaceuticals; joint diplomatic representation; and close functional cooperation in a number of important areas such as education, health, tourism and sports.

The OECS and the ECCU have created an identity for themselves which is now internationally recognized and equated with successful experiments in the field of regional integration.

Since 1990, our economies have undergone substantial structural changes with tourism and services surpassing export agriculture as the leading foreign exchange earners. This has presented further challenges as the need for new and different skill sets, work practices, infrastructure, and incentives became evident in the evolving economic environment.

Contribution of Agriculture and Tourism To GDP
(1990 to 2007)



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The Economic Performance of the ECCU in 2007

The economic performance of 2007 is very closely linked to the performance in 2006, which represented the peaking of the growth performance of the ECCU countries, after starting from ground zero in 2002, following the events of September 11, 2001.

Preparation for the ICC Cricket World Cup (CWC) in 2007 started in the previous year and was driven by the construction of hotels and playing facilities. The result was a growth rate of 6 per cent in 2006. Following the conclusion of the CWC in April 2007 growth declined and has been provisionally estimated at 5 per cent in 2007.

At the sectoral level the following are noteworthy:

- Construction activity increased by an estimated 9 per cent, that is below the 12 per cent recorded in 2006.
- Public sector activity focused on road development, airport improvements and low income housing.
- Value added in the hotel and restaurant sector, an indicator of tourism activity, increased but at a lower rate than in 2006.
- Value added in agriculture, particularly from the production of bananas and domestic crops, also declined due to hurricane damage.

A marked feature of the year 2007 was the steady upward movement of domestic prices. This was, by and large, a result of global increases in the prices of commodities such as oil, cement, steel and other building materials, and food crops such as wheat, corn, maize and soya beans.

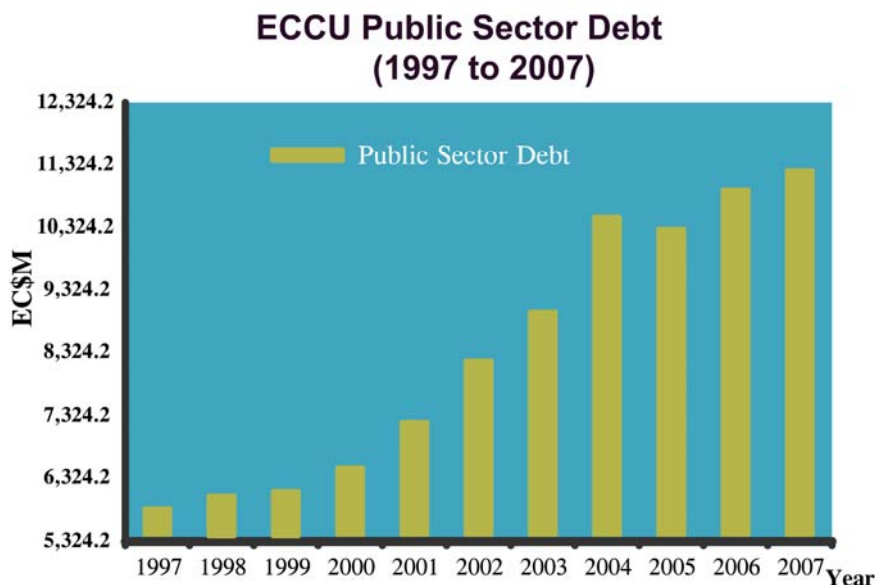
Other factors which had an impact on rising prices in the ECCU were:

- The continuing depreciation of the US dollar to which the EC dollar is pegged.
- Shortages of local agricultural produce due to storm damage; and

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- A scarcity of skilled labour in the construction industry, leading to higher labour costs.

The public sector debt to GDP ratio in the ECCU came down from 115 per cent at the end of 2004 to approximately 97 per cent at the end of 2007. This downward movement was directly associated with strong revenue growth facilitated by tax reforms. Public expenditures, however, continued to grow at a rapid rate and the region continues to be among the most highly indebted economies in the world.



The foreign reserve position of the currency union improved in 2007, relative to the performance in 2006, largely on account of the surge in foreign inflows to fund capital projects.

Monetary conditions remained favourable for economic expansion during 2007. The money supply grew at a steady pace, influenced, in part, by inflows of foreign capital, the expansion in economic activity as business confidence remained high, and a general easing of lending conditions by commercial banks to households.

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Domestic credit continued its steady growth during 2007, reflecting increased borrowing by both the public and private sectors.

Commercial bank liquidity declined, but remained at a relatively high level, while interest rates remained stable.

Prospects for 2008 and Beyond

As we look forward to the year 2008 and beyond, we need to conduct an audit of our current circumstances to determine the assets and liabilities, advantages and disadvantages, costs and benefits with which we start the new year.

Next, we must, by discussion and consensus at all levels of our society and across political and social barriers, come up with a vision to take us to the year 2020 and beyond. It would then be necessary to develop a strategy and an implementation programme to achieve this vision. There must also be a process of constant evaluation of the progress we are making so that we can adjust to changing circumstances.

The challenges which face us, for the most part, have their origins in the international environment; but this does not make us any less responsible for seeking ways of overcoming them or mitigating their impact on our economies and societies. The responsibility must be widely spread across our societies and communities. This means that in addition to the governments and opposition parties, the private sector, trade unions, civil society organizations, communities and individuals must participate in the process.

The historical experience of the second half of the twentieth century shows that the countries that experienced sustained growth and development, and that were able to reduce poverty and income inequality were those which had clear goals, a policy framework and architecture that allowed for strategic planning and implementation and

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achieved societal and political consensus. We now have an opportunity, given the challenges which confront us, to emulate such countries.

It can be argued quite convincingly that in a number of very critical areas we have made significant progress. We are officially regarded as middle income countries which is a substantial achievement for such small countries. Also, the United Nations Human Development Index ranks the countries in the upper middle to lower middle range.

With our feet placed, at last, on the ladder of development we should not consider slipping off as an option. Hence, the urgent reason for a strategic approach to the challenges which now confront us.

The increases in oil and food prices, steel and other building materials, and the depreciating US dollar are problems being faced by all countries except, in the case of high oil prices, by the oil producing countries.

Since we all have the same basic problems it will be difficult to plead special circumstances in our case. The bottom line is that we will have to lower our costs, adjust our expenditures, reallocate our assets to more highly productive activities and increase our productivity.

A sense of realism must be brought to bear on our economic and commercial activities. Let us take for instance increases in the price of oil. Neither our societies nor our governments have any direct influence on this matter. The ECCB's Monetary Council took a decision that the price must be passed through to the consumer, but with cognizance being taken of the situation of the most vulnerable groups in our societies.

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The argument was simply that there are two budget constraints which face us. At the individual level, if the price of a commodity goes up, persons on a fixed income must either consume less or substitute some other commodity for it. At the government level, if the authorities decide to provide a subsidy this has to be funded by tax receipts which the citizens will have to pay, assuming that the government does not have any independent source of revenue outside of the tax system.

The punch line to this argument is that government can only provide services if it has a source of revenue. However borrowing, which is a legitimate government activity, has to be repaid and simply commits future generations to repay the debt incurred by the present one.

The various elements in our societies including the government, business community, the financial sector, trade unions, civil society groups and individuals must recognise their basic responsibilities in the development process.

The governments of the OECS, noting the success of the arrangements they have already entered into as a regional collective and the advantages of furthering and deepening this process, have agreed in principle to the creation of an OECS Economic Union. This would, if pursued fully, considerably widen the economic and financial space, lower the unit costs of both public and private sector activities and increase the negotiating capacity of our countries.

Freedom of movement of citizens throughout this new arrangement will be critical not only for the usual economic reason of facilitating adjustment but, more importantly, for giving them the sense of belonging to a larger entity.

Our vision of the OECS is that it should be an area of peace, stability and tranquillity where service is excellent and society exists in a clean and pristine environment. This

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means that we have to construct for ourselves new political and economic arrangements, at the OECS and national levels, that will allow us to adjust to both domestic and external circumstances and transform our economies and societies into vibrant and competitive entities.

At the ECCB, we are determined to play our part in achieving the stability and development of our societies and economies. We have committed ourselves to the stability of our currency which, having maintained its parity to the US dollar for the last thirty-one (31) years has provided an anchor of certainty and credibility in very uncertain times.

In the area of financial sector development, we are now in the process of establishing the long-awaited Eastern Caribbean Enterprise Fund which will provide venture capital and debt facilities, as well as technical assistance for existing and start up enterprises.

There is an urgent need in our countries for the emergence of a new *entrepreneurial class* consisting of individuals who will set up small to medium size enterprises in the areas of information technology, finance, scientific, cultural and high-value services.

The approach in addressing this need must be based on the fundamental premise that, in a small country with a small population, the labour force and the society must have the highest levels of appropriate education and skills to boost productivity, competitiveness and incomes.

We must reorient the educational system and curricula to provide the human resources required to operate a modern economy which is internationally competitive.

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We must provide scholarships for talented students to attend leading institutions in the areas of business and technology, so that they can have access to the networks and supply chains which now dominate the global economy.

We must support specific management and leadership programmes at recognised institutions for young and promising individuals who are interested in politics, administration and business. Such a cadre of individuals is urgently required to lead and facilitate our development.

We must create institutions within the OECS which can provide research and development as well as consultancy and management services to entrepreneurs.

We must support programmes such as the Junior Achievement programme for schools which will inculcate a spirit of entrepreneurship and technical skills in our young people.

We must provide appropriate technical and vocational education and mentorship for the increasing number of young males who need to be included in the economic process.

We must expand programmes such as the savings and investment courses initiated by the ECCB to give a wide cross section of society, particularly those already in the work force, access to new knowledge and broader vistas as to what they can accomplish in the new economy.

We must encourage the establishment of investment clubs in which groups of people can consolidate their financial and technical resources to invest in ongoing businesses and to start new ones. A breakthrough in this area will result in a major change in our business culture and economic environment.

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Conclusion

In conclusion, I make the observation that, in reading all of the budget speeches presented during 2007 in our member countries, I was struck by the fact that the issues and problems identified by our ministers of finance were so strikingly similar. The proposed responses were also very much aligned, whether the issue was to be addressed collectively at the OECS/ECCU level or individually in each country.

I make this point simply to state the obvious, that we need to pool our resources in a more dynamic and purposeful way and place greater emphasis on the coordination and implementation of our policies, programmes and projects, both within our countries and between our countries.

We stand on the threshold of a period full of challenges, excitement and opportunities. Let us demonstrate to the world that despite our small size, we can achieve international standards in the management of our economies and societies, and that we are worthy members of the international community.