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Public Policy and Economic Growth: Some Insights into the Caribbean Experience

by

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Mr. Gilmore Hoefdraad, President of the Central Bank of Suriname, other Central Bank Governors and Deputy Governors, Government Officials, Distinguished Guests, Colleagues:

Let me begin by thanking Professor Compton Bourne, Acting Executive Director of the Caribbean Centre for Money and Finance for inviting me to do this lecture. Let me also express my appreciation to the President of the Central Bank of Suriname, an old friend and colleague, for having me as his guest. I wish to place on record the gratitude of myself and other participants to the Bank's officials for their courtesy and the efforts they have put into the planning and organization of this conference.

My contribution to this lecture series in honour of Dr Adlith Brown has been long in coming. The Annual Monetary Studies Conference, which is now an established institution, has been an integral part of my intellectual development. Some may say I am a product of this venerable institution that has served the region so well in terms of research, training and policy analysis. I have had the honour of serving as Coordinator of the former Regional Programme of Monetary Studies (RPMS) and as Executive Director of the Caribbean Centre for Money and Finance, the successor organization.

Adlith was a friend and colleague for many years. I first met her on the Mona Campus of The University of the West Indies where I had gone as a graduate student and later spent some time as a staff member of the then Regional Programme of Monetary Studies (RPMS). When she

assumed the position of Coordinator of the RPMS I returned to St Augustine, but our collaboration continued in a revitalized Programme that led to several publications and new research initiatives. Adlith was not only a scholar and teacher, but the very epitome of graciousness and affability. She brought a great deal to the RPMS, and her memory continues to inspire thinking that stands out in quality and originality.

Whether it is a command economy, a market economy or a mixed economy, public policy exerts a crucial influence on the creation and distribution of wealth. But public policy is not confined to the discipline of economics or the management of resources. It straddles a broad area which covers issues of a political, social and economic nature. It speaks to the integrity and efficacy of governance institutions, the functioning of administrative structures and the balance between social costs and social benefits. It not only encompasses the factors that influence the real and financial sectors, but all the institutional elements that affect the functioning and well-being of society. It defines national social and economic objectives, and also provides strategies, direction and the framework of incentives for governance in response to changes in the internal and external environment. But consistency, coherence and effectiveness are often lacking in formulation and implementation. There is good and bad public policy.

In recent years the private sector has been widely touted as the engine of growth in market driven economies but the quality and practice of public policy remain critical to economic performance. The nature of public intervention matters. Though public policy is only one factor affecting growth, the ideas and conduct of governments exert a significant influence on the behaviour of other stakeholders in the economy. In an essential sense public policy can make or break an economy. While drawing on lessons of the past, public policy and the corresponding institutional framework must constantly adapt to changing circumstances or they become an hindrance to change. In this discourse I intend to address only some aspects of public policy, in particular those relating to economic growth.

I have chosen this subject against the backdrop of the vast differences in economic performance among countries in various parts of the world and the enormous shifts taking place in the distribution of global economic power. In this dynamic setting there are serious questions about whether Caribbean countries can maintain present living standards, much less improve them. Social divisiveness fostered to some extent by a destructive brand of politics, the loss of trade

preferences, the decline of traditional exports, the lack of economic diversification, highly uncompetitive economies, increasing dependence on food imports, low savings rates, high levels of public debt and falling levels of foreign aid create a daunting challenge for these states. Yet it is difficult to discern an objective and unemotional discussion on the economic concepts traditionally used to define the problems, or the relevance of current strategies in the context of the changes sweeping the world and the vast accumulation of knowledge and experience. The revolutionary developments in non-western cultures have opened new vistas and created major cracks in economic thinking emanating from the traditional centres of economic power. There are different paths to the Promised Land.

In presenting my thoughts tonight on the Caribbean growth experience I use the following sequence. I begin by offering some tentative views on the evolving concept of the state. In the second section I outline the development objectives and the prevailing economic structure in the early post-independence years. I follow this by discussing broad economic strategies pursued and economic performance since the 1960s. In the fourth section I look at developments in saving and investment trends. In the fifth section I outline some salient issues connected to foreign savings, in particular borrowing and the public debt, aid and foreign investment.

Introduction

As an indicator of overall economic performance, economic (or GDP) growth occupies an eminent position in policy analysis. The concept, however, is associated with a high degree of elusiveness and does not often give us a complete picture of developments taking place in an economy. An economy may be growing, but key variables may be moving in undesirable directions. From experience there are many things we can say about growth. For example:

1. It is unpredictable.
2. It is driven by economic and non-economic factors.
3. It may incur social and environmental costs.
4. The economy may grow or decline in spite of government efforts.
5. Growth is not necessarily development. Put differently, it may not lead to the transformation of the economy or to a higher standard of living for the general population.

6. It may not lead to greater employment or improve the distribution of income.
7. Our knowledge of the growth process is increasing every day, but it is far from complete. We have difficulty explaining why Brazil has been taking off since the 1960s, but is still on the tarmac; why Argentina with all its resources moves from crisis to crisis; or why Taiwan and Singapore with little natural resources are Tiger economies, while well endowed countries like Belize, Suriname and Guyana are so low down on the development scale. That ladies and gentlemen is my point of departure.

The deep and continuing crisis in the global economy has drawn increasing attention to the relationship between public policy and the expansion of income and employment. But that relationship is a complex and changing one, shaped by history and circumstances. In the early post-war years central planning in Eastern Europe demanded a highly authoritarian state which has now largely given way to more democratic arrangements. In other western industrial countries a strong welfare function took root, and that state too is under fiscal pressure. In the 1960s perceptions of market failure, under-development and nationalist sentiments prompted strong government intervention in the economy. Since the 1980s with the emergence of debt and fiscal problems, the interventionist state, guided by the doctrine of the Washington-based international financial institutions, has largely become a regulator and facilitator. Of course, we also have examples of captured states, ruled by unpopular or illegal regimes on the basis of force or support provided by foreign governments for strategic or economic reasons.

The collapse of the Soviet Union and Eastern Europe in the late 1980s/early 1990s provided a major boost to the idea that deregulation and unfettered market forces held the key to financial and economic development; that was until 2008. But history has shown that growth can take place under a variety of political and economic arrangements. China and the United States for example, are of different political persuasions, but China has the second largest economy and the largest foreign currency reserves in the world and is also the world's largest trading nation. One might add that it is also the United States' biggest creditor. All the high performers come from different backgrounds in terms of history, culture, and tradition, and embrace different views of the market. There are some things, however, common to all of them, and we would come back to these.

The state is not a private entity and it constantly has to juggle the interests of the public and private sectors in the presence of a range of competing pressures emanating from the structure of the society and the demands of external agencies. It constantly has to make choices that straddle growth imperatives and welfare functions. For example, some believe that efficiency and income distribution should be treated separately, while others argue that they need to go hand in hand. Also, given the finite nature of resources, there is a legitimate question over whether exploitation should be aimed at maximising present consumption or should take into account the needs of future generations. The poor often see the state as representing the interest of the rich and business classes, while others question whether the Robin Hood role of the state has a moral basis. Should the state discriminate between rich and poor in the provision of goods and services (let us say education and water) is a question that rears its head in discussions on increasing fiscal deficits and burgeoning subsidies. In many countries the lack of a proper discourse on the role of the state in a mixed economy has created an environment of confusion and ambivalence in the formulation of public policy.

Based on experience we know, or ought to know, that the issue is not about a large state or a small state; a right-leaning state or a left-leaning (a socialist) state; or even an interventionist state. Current domestic and global challenges require a more effective and caring state, capable of responding to a dynamic environment and providing a conducive framework for economic change. **Why some states grow while others stagnate or regress has nothing to do with miracles, luck or divine intervention.** Some of the richest countries in the world in terms of resources are among the poorest. Others less endowed have blazed a path to wealth in three to four decades based on a combination of locally designed policies, capital accumulation and technology where vast advances have been made in food production, in energy, in health and medicine, in communications, and in transport. One of the tragic features of the modern world is that many states capable of doing better, are imploding or stagnating, because of internecine warfare arising from racial, tribal and religious differences, or from struggles for state control. Man-made disasters have compounded those resulting natural phenomena.

OVERVIEW

The countries of the Caribbean region have not done as well as the fast growing countries of East Asia, but they have not done as badly as sub-Saharan Africa. Jamaica and Trinidad and Tobago recently celebrated 50 years of independence from colonial rule. Barbados and Guyana are four years short of 50. The experience of other CARICOM countries as independent states range from 29 for St Kitts-Nevis to 39 for The Bahamas. Suriname is somewhere in between having achieved statehood some 37 years ago. A major consideration driving the independence movement besides the psychological lift that accompanies statehood was that it would bring additional capabilities to transform the colonial economy and improve the standard of living. The power to shape their own economy and political arrangements, and to access aid and loan funds were attractive prospects. One effect of the replacement of the colonial powers by national governments was a considerable rise in expectations. If all went well a stable and progressive society was expected to emerge from the diverse and competitive social groupings. Independence was expected to unlock powerful synergies long suppressed by colonialism. The new flags, anthems and national currencies were really incidental. Some would disagree. Independence also warranted an enormous expansion in state bureaucracy. Not unexpectedly, political independence raised issues of size, economic viability and survival in a world dominated by large states. There was no blueprint to follow. A narrow resource base, highly open economies, small markets, dependence on foreign trade and foreign investment, and specialization in primary production provided the basis for immense speculation on development possibilities. Their reality as mini-states or island economies in some cases located in a zone prone to natural disasters introduced a challenging dimension to the debate. Notwithstanding the political optimism, the future was uncertain.

Interestingly, some of the remaining small British dependencies such as Anguilla, the British Virgin Islands, the Turks and Caicos Islands and the Cayman Islands enjoy per capita income and employment levels higher than those of the independent Caribbean states (Bourne 2010). Not surprisingly, this fact, combined with other issues such as crime and debt, often invite comments to the effect that political independence has not enhanced the economic prospects or the quality of governance in the independent countries to the extent expected. Was the case for independence overstated? Or, were the Caribbean countries, like many others elsewhere, simply

unable to put together all the political and economic elements in a framework capable of reducing strife and meeting the post-independence challenges with the effective use of human and physical resources? Fifty years by today's reckoning is not young. In fifty years a country must be giving strong indications of the kind of nation it is going to be, and the base of the future economy should already be apparent.

A prevailing view in the early post independence years was that poverty and underdevelopment were not a natural state of affairs, (they were man-made) and they could be overcome by will and proper policies. Despite differences among CARICOM countries, a perusal of the early post-independence plans reveals many common economic objectives which have been repeated in annual budgets and other documents over the years. Among them are:

1. Achieving higher GDP growth rates and improving the standard of living for the general population.
2. Reducing poverty, inequality and unemployment. In some cases full employment was embraced as a goal.
3. Developing a more resilient and self-reliant economy by diversifying the economic base and export structure to counter the adverse terms of trade effect. To this end, high emphasis was placed on the growth of the manufacturing and tourism sectors.
4. Reducing dependence on imported food by reorganizing and modernizing the agricultural sector. Food security was seen as an essential objective.
5. Strengthening the local economy by developing greater inter-sectoral linkages, particularly among manufacturing, tourism and agriculture.

There were others, perhaps less important. Underlying all these objectives, however, was a conviction that for political independence to make sense it had to be reinforced with greater economic self reliance. The post-colonial economy, it was felt, needed to be built on greater local participation and ownership, and development policies came to embrace various degrees of nationalistic sentiments. The countries in the region were not really interested in being in any ideological camp, even in the height of the cold war which had a deep influence on aid dispensation. They generally would have described themselves as non-aligned. Nationalism is now more subdued and the concept of sovereignty has been greatly revised. Interestingly, four or five decades ago not much was said about the

quality of the society Caribbean countries wished to construct, or the values that should guide the drive to material development. This was taken for granted. Increasing levels of crime and indiscipline, endemic corruption and declining competitiveness seems to have a strong correlation with economic growth and performance in the Caribbean.

On some objectives we have made progress; but in a number of areas we have fallen short. The main economic objectives have not been supported by a consistent set of policy initiatives capable of effecting change in a rapidly changing environment. There is a great deal of disagreement on how much of the Caribbean failure can be attributed to smallness and structural features, exogenous shocks, natural disasters, corrupt and incompetent administrations or simply bad policy and poor use of resources. What distinguishes one performer from another is often the choice of policies and the political and economic path embraced. The early vision of development has been elusive, and in some ways regional economies have become weaker and more dependent and vulnerable. With the decline of traditional activities the faith placed by some states on offshore banking as a strategy of development seems to be highly misplaced, given the position taken by the developed countries. As we shall see later growth has deteriorated since the 1960s while foreign exchange earnings continue to be centred around a few activities, and the objective of greater food security remains a dream. Because of the dependence on imports for food, consumer goods and intermediate and capital goods, foreign exchange is the fuel that drives these economies.

But there have been some accomplishments. Life expectancy has increased. The number of years people are expected to live now varies between 70 and 77 years in CARICOM countries compared to over 80 in developed countries. Per capita real income has also been increasing. The most recent figures provided by the UNDP range between just over \$ US3000 (ppp) for Guyana to over US\$ 23,000 for Trinidad and Tobago and the Bahamas. The average for the ECCU which is without mineral resources, is around \$9000 which is higher than that of Guyana, Jamaica, Suriname and Belize—countries with greater physical and mineral resources (St Kitts-Nevis and Antigua are significantly above the ECCU average of US\$9000). These figures would put the Caribbean in the upper lower-lower middle income group. The average for the Latin American/Caribbean region is around US\$10,000 which is above the US\$ 2000 for Sub Saharan

Africa but way below the \$ 30,000 for most developed states. The United States, Hong Kong and Singapore are associated with figures above US\$40,000. Leichenstein with \$84,000 and Qatar with \$107,000 are in a league of their own. These figures are rounded and are based on PPP methodology and constant dollars.

Per capita income we know does not tell the full story of development. In several countries of the region (Guyana, Belize, Grenada, Dominica, St Vincent among them) the number of persons living below the poverty line exceeds 30% of the population. Among the better placed are the Bahamas and Barbados with less than 15%. The distribution of income is an important indicator of changes in well-being. The most recent estimates of the Gini coefficient which measures income inequality range from 0.23 for the British Virgin Islands to over 0.50 for the Bahamas and St Vincent. The others range between 0.3 and 0.5 (Bourne, 2010). Theoretically the coefficient can vary from zero (complete equality) to one (complete inequality). The smaller figures would represent less inequality. The problem with the Gini coefficient, however, is that two countries with the same coefficient may have different distributions of income.

- The UNDP has a broader development index which includes indicators relating to education and health, and ranks countries in four categories: 'very high human development', 'high human development,' 'medium human development' and 'low human development'. The mean years of schooling in the countries with very high human development is 12 years on average, compared to eight to nine in CARICOM countries. The expected years of schooling in the developed countries is about 14 compared to 13 in CARICOM countries.
- In its 2011 Human Development Report which looks at 187 countries, only Barbados (ranked 47) is in the first 50 which are regarded as countries with very high human development. Most of the other CARICOM countries, ranked between Bahamas at (53) and Belize at (93) are in the second tier, i.e. the high human development group. In the medium development group are Suriname (104) and Guyana (117). With most of them ranked in the first 100, one can argue, with some temerity, that CARICOM countries have done moderately well, given their size and resources, and challenges from natural disasters.

Two critical areas which reflect the quality of growth policies is the level of unemployment and the inflation rate. The first is related to poverty and the distribution of income. The second to the value of money, money income and competitiveness. There are many developing countries in the world with unemployment rates exceeding 30% of the labour force. The developed and some of the fast- growing economies have shown a capacity to achieve five to six per cent, which can increase to unusual levels in recessions, as is happening at the moment. Eight per cent for the US or UK is considered unacceptable. Caribbean countries fall between these two extremes, but like other developing countries their unemployment is more structural than cyclical, the latter being more amenable to government pump-priming.

Employment rates have fluctuated between 75 % and 95 % of the labour force. One of the features of these economies is the frequent fluctuation of the unemployment rate. In the Bahamas it ranged between 7% and 16 % over the last two decades. In Barbados the figure dropped from an average of over 20% in the 1992-95 period to 7.4% in 2007 but has been increasing since, reaching 11.2% in 2011. In Belize the figure increased from 9% in 1994 to 14.3% in 1998, then fell to 8.2% in 2008, but has since increased to over 20%. In Jamaica the unemployment rate has averaged 11.4 % since 2003 compared to 15.6% for the period 1991 to 2002. In Trinidad and Tobago the un-employment rate has been declining since the early 1990s from an average of over 18% to less than 6% since 2006. The nearest any country has come to full employment in recent years is Trinidad and Tobago. But this latest figure of 5.8% reflects the government funded make-work programmes which appear to cater for a special group which includes the unskilled, the un-read, single mothers and people with criminal records who would find it difficult to find work in the private sector.

While it is common to speak of growth and employment as happening together, growth does not necessarily create employment, or for that matter improve the distribution of income. The factor proportion in the fast growing sectors may be biased in favour of capital. In Trinidad and Tobago, for instance, the petroleum sector currently contributes 45 % to GDP but employs only 3.2% of the employed labour force. On the other hand construction (including electricity and water) which contributes 7% to GDP, currently provides work for 16 % of the employed labour force. A major drawback of the high productivity sectors in any economy is that the level of remuneration in these sectors tends to have a demonstration effect on the lower productivity

activities and this has implications for growth, employment and competitiveness for the economy generally, in the absence of policies linking wages to productivity. It is one of the themes in the Dutch disease argument.

With the exception of certain years when there were large spikes in the inflation rates of Guyana, Suriname and Jamaica, the region has had a history of relatively stable prices over the last two decades. Certainly price increases have not run into hundreds or thousands percentage increases per year or per month as has happened in some Latin American countries where the national currency was changed or abandoned in favour of the US dollar. In the Bahamas, Barbados and Belize the inflation rate has averaged less than 5% per year over the last two decades. This speaks well in a situation where these countries are dependent on imported food and fuel in various degrees. With respect to Guyana, Jamaica and Suriname, the figure averaged 10, 19 and 60 % respectively. In the years since 2001, the rate has dropped significantly compared to the 1990s decade. Trinidad and Tobago was somewhere in between with around 6.5%.

Inflation can be used as a tax, but because of its effect on the value of money, wages, savings and competitiveness, inflationary policies have a high economic, social, and even political cost. Persistent increases in prices over a long period can lead to the unraveling of monetary and financial systems, and even social upheavals. Inflation can come from several sources. Among them are fiscal deficits and monetary expansion, taxes, import costs, structural constraints and devaluation or depreciation of the national currency. It is not always possible to disentangle the various influences. It is noticeable, however, that the countries with fixed exchange rates (viz. Barbados, Belize, the ECCU, and the Bahamas) have lower inflation rates than the countries with more flexible systems. Trinidad and Tobago operates a highly managed system. Some jokingly say a fixed float. Periods of high inflation rates in Guyana, Suriname and Jamaica are associated with large and rapid depreciation of the national currency, and one can conclude that this was a major influence on domestic prices. The higher prices for imported inputs and the price wage spiral may have wiped out the intended advantages for greater competitiveness, assuming that the necessary supply elasticities existed. When one looks at the export structure of Jamaica and Guyana (and you might add Suriname since the mid-1990s) it is difficult to identify the resource reallocation effects that the depreciation of the national currencies were intended to trigger. What is very noticeable are the wounds that have been inflicted on the national currency as a medium

of exchange or as a store of value. Devaluation or depreciation is a double-edged sword that can cut both ways, but in the wrong circumstances it may cut only one way

Pre- independence and background

In the 1950s, Caribbean economies were dominated by agriculture, mainly export crops which commandeered the best lands. In 1954, for example, agriculture accounted for 28 % of GDP in Guyana, over 40% in the Windward and Leeward Islands, 19% in Trinidad and Tobago and 20% in Jamaica. Manufacturing, which largely revolved around the processing of sugar and by-products, contributed 12% in Guyana, 20% in Barbados, 8% in the Windward Islands, 12% in the Leeward Islands, 13 % in Trinidad and Tobago and 14% in Jamaica. Mining was the largest sector in Trinidad and Tobago accounting for 30% of GDP.

By the early 1960s when Jamaica and Trinidad and Tobago achieved their independence this basic structure had not changed much. The oil sector in Trinidad and Tobago and the traditional uncompetitive export sectors dependent on preferential marketing arrangements for survival continued to be the major foreign exchange earners. Some have argued that the continuation of these arrangements in the post –independence period may have delayed the modernization of the agricultural sector.

With the help of incentive legislations in the 1950s and early 1960s, a light manufacturing sector had started to emerge and by 1960 had overtaken agriculture as a contributor to national output in Jamaica. In Trinidad and Tobago the same trend was emerging. In both these economies the mining sector was beginning to loom large and would subsequently come to have a dominant influence. Even before the economy could get off the block the Jamaican government had already taken a very pessimistic view of agriculture. I quote from the Five Year Independence Plan 1963-1968, p.16, published in 1963. “In spite of considerable effort towards encouraging and assisting agriculture in the past ten years, and the existence of favourable demand conditions both locally and in some respects abroad, agricultural output in general has failed to show the significant increases which were expected.” This Plan, incidentally was more about projects and targets than about policy. In Jamaica, agriculture declined from 13% of total output in 1962 to 6 % in 2009. Corresponding with this trend the share of the mining sector also declined from 10% in 1962 to an average of 4% in recent years. In 2009 the service sectors contributed over 80% to

real value added. In Trinidad and Tobago, agriculture's contribution fell from 12 % to 0.5 % over the same period. The energy sector has a pervasive influence in this country accounting for over 40% of GDP in recent years. The same trend with respect to agricultural decline has been taking place in other Caribbean countries. In Barbados, agriculture's share in GDP fell from over 25% in the early sixties to less than 5% in recent years. In Belize and Guyana, agriculture makes a more substantial contribution to GDP accounting for more than 10% and more than 20%, respectively.

In all the countries, agriculture's decline has taken place against stated policy. Action has not backed up the rhetoric. In Trinidad and Tobago, for example, The Draft Third Five Year Plan 1969-1973 envisaged a more diversified economy by the early 1980s with full employment and more economic decision-making being located internally. I quote: "Diversification is to be achieved through a break-through in domestic agricultural, livestock and fishing production, while yields per acre of traditional export crops such as sugar, cocoa and citrus increase; through the development of exports of manufactures on a large scale to regional and world markets; and through a socially controlled expansion of the tourist industry". In the 1960s the indications were that Trinidad and Tobago was well on this path. Domestic agriculture flourished to the point where by 1970 Trinidad and Tobago was almost self sufficient in a number of food products. And then came the oil boom of the 1970s providing a graphic example of what some call the resource curse, or the Dutch disease.

The Failure of Manufacturing

The inability to develop a strong and competitive manufacturing sector has been one of the most glaring failures of Caribbean economic policy. The import and export structure provides the evidence. Little has been made of the potential offered by local raw materials and skills existing in the various countries. In the 1960s a group of distinguished UWI economists advocated the rationalization of the region's natural resources and the integration of Caribbean production structures as the preferred approach to economic integration. Implicit in this idea was the need to produce goods with high local value that could form a vibrant export platform. What has happened is now history. Caribbean politicians apparently saw this approach as conflicting with their newly won sovereignty as independent states, and while they did not completely dismiss the idea, they did not embrace it either. Instead they opted for national import substitution which put

them in competition with each other and which, because of the strategy adopted, proved to have little employment or export potential. The whole integration exercise in the Caribbean has been an exercise in futility. Regional policies in critical areas remain incomplete or deficient.

The strategy adopted to develop a manufacturing sector was common to many developing countries. Import substitution revolved around the infant industry argument which requires the new plants or industries to be protected from imports in their early years of growth through the imposition of tariffs, quantitative restrictions and licensing arrangements. This was supposed to be a phase on the road to export development. Eventually the infants were supposed to grow up and face competition. This transition took place in some of the faster growing economies.

In the Caribbean and in several other developing countries protection became a permanent part of the economic culture providing little incentives for export development. Small markets, however, do not have the same attraction as large markets. To get around the restrictions and to keep their share the local market traditional suppliers contrived with local business groups to undertake local packaging and assembly of goods previously imported in whole form. The strategy was almost irrelevant to the greater use of local raw materials and the creation of forward and backward linkages. Low local value added has made it difficult to sell many of these goods in markets in which the Caribbean countries have negotiated access. In fact the sector turned out to be a net loser of foreign exchange. There were other consequences. The closing of the local market and absence of competition led to the production of high price/ poor quality goods and limited choices for the consumer. Consumers paid a heavy price for the provision of a few jobs. The economic transformation process also seems to have become critically paralysed.

Caribbean policy-makers place a great deal of emphasis on markets as a stimulus for development. But markets by themselves are not sufficient to instigate exports. Market opportunities must go hand in hand with other measures. Over the years we have had access to major markets including the European market under the various ACP conventions, the US under the CBI and Canada under CARIBCAN. We can add to this a number of bilateral agreements with Latin American countries. In all these agreements for goods to qualify for entry they must meet a local value-added criterion. Markets are useless if your production base is deficient and

you do not produce competitively things that people want to buy. In Europe for example, the Caribbean lost its original share of the European market, because apart from traditional primary products, there was nothing else to offer. The failure in not developing a responsive and flexible production platform left these countries unable to take advantage of promising market opportunities.

In a 1950 article Sir Arthur Lewis stated that the “case for rapid industrialization in the West Indies rests chiefly on overpopulation” (Lewis, 1950). The argument was that there were too many people on the land and jobs needed to be created elsewhere. This would also increase productivity in agriculture which he felt should be developed alongside industry. Expanding incomes in the agricultural sector, he argued, would provide a market for industrial goods.

Experience has shown that even if people leave the agricultural sector en masse productivity does not automatically increase. Changes in organization and application of modern technologies have a critical role to play. Both production and productivity have been falling in agriculture, as the resources tied up in traditional primary exports are diverted elsewhere. What is interesting is that both the share of manufacturing and agriculture in GDP has been declining. Besides the absence of an over arching policy, land tenure problems, access roads, marketing and price stabilization, irrigation infrastructure, agriculture finance and technical services have featured poorly in national budgets. The tendency to equate industry with development had a major effect on public policy. A proper land use policy does not exist in most jurisdictions. Large portions of land once under cultivation have been ceded to houses, malls, warehouses, administrative buildings and other miscellaneous uses. Domestic consumption and the tourist industry depend increasingly on imported food. Caribbean countries may not be able to produce all they consume, but the potential for greater production of basics like vegetables, ground provision, meat, fish, eggs, milk and rice is there.

There is a mistaken view that comes out of static traditional trade theory that if it is cheaper to import something than to produce it locally, you forego local production. Does that apply to agricultural products and other strategic goods? Can you tell that to the Americans and Europeans? The sugar industry has been destroyed in several Caribbean countries on that argument, completely ignoring its potential as a source of fuel and raw materials. Cocoa and coconut oil have long been vilified as dangerous for your health. This is not unrelated to the

neglect of the cocoa and coconut industries in the region which are fast approaching extinction. But now we are hearing about the benefits of dark chocolate and unsaturated fats. It is sometimes difficult to distinguish fact from propaganda, particularly when the latter originate in first world sources. Too often what Caribbean countries are given to rub, they end up eating. The inter-sectoral linkages embellished in development plans and annual budgets have not materialized. Interestingly, billion dollar industries have been built by foreign transnationals on raw materials (such as cocoa and coffee) obtained from developing countries, while the latter continue to subsist at the lower end of the production chain.

In Jamaica the share of manufacturing in GDP decreased from 13% in 1962 to 10.5 % in 2000 and has been declining steadily since reaching 8.3 % in 2009. The services sector now contributes over 80%. In Trinidad and Tobago the share of manufacturing fell from 12% in 1962 to 5% in 2009. In Guyana the sector which includes sugar and rice contributes about 10%. In the ECCU it is less than 5%.

Resource-based exports (including tourism, bauxite, oil, gas, bananas, gold and sugar) have been the main economic drivers in the post-independence period. The lack of diversification is reflected in the countries' export trade. Energy exports provide over 80% of Trinidad and Tobago's foreign earnings. Tourism dominates the ECCU group and provides more than half the foreign earnings in the union. In Guyana gold, bauxite, sugar and rice account for 75% of domestic exports. Bauxite and gold are of course wasting assets. In Belize food products account for over 60% of domestic exports and petroleum products another 25 to 30%. In Suriname, two products, alumina and gold, contribute about 80% to export earnings.

Economic Performance

Having said all this let us take a somewhat long view of the Caribbean's economic performance. The 1950s were equivalent to a boom period for some Caribbean countries. With the growth of crude oil production and refinery throughput in Trinidad and Tobago, total real GDP grew by 10% per year between 1955 and 1961, and this was made possible by a growth of almost 12% per year in the mining and refining sector. Capital formation rates averaged over 25% in the period. In Jamaica the economy grew by over 10% per year between 1954 and 1957 even with

the bauxite sector still in its infancy stages. By 1962 mining's contribution was 8.8 %, less than that of agriculture and manufacturing respectively.

The good fortune continued into the rest of the 1960s. In the 1960s real income in Caribbean countries grew on average by about four to five per cent annually. On average, per capita income increased by between two and three per cent per year. A few countries experienced per capita income growth rate in excess of three per cent per year. While this experience compared favourably with many of the developed countries, the fast growing countries in Asia were starting to open the gap with per capita growth rates of over 5% per year in most cases.

Though the Caribbean countries were going through a period of political uncertainty, the 1960s was a good decade for the Caribbean. As far as growth is concerned it was perhaps the best of the last five decades, except for the oil and gas boom experience for Trinidad and Tobago in the 1970s and again in the period 1998 to 2006. A stable international environment, favourable prices for major exports and the beginnings of import substitution laid a good groundwork for the post-independence economy.

The 1970s was a more difficult decade for the region. The sharp increase in oil prices benefitted Trinidad and Tobago as an oil producer but had a negative effect on most of the other Caribbean states. The Trinidad and Tobago experience with sudden wealth provides strong support for the resource curse argument, but also offers important insights into the poverty of public policy, even when the financial constraint is removed. Following an average growth rate of 2.9% per year between 1969 and 1973, the Trinidad and Tobago economy grew by 5.9% per year, between 1974 and 1982. In the nine year period between 1973 and 1982, recurrent revenues of the central government increased almost 15 times. Official reserves increased from TT\$221 million at the end of 1973 to over TT\$7 billion at the end of 1982 (a 30-fold increase). The country was temporarily rich with no economic compass. Though some saving took place, current and capital spending rose significantly to reflect the new revenue situation. The inflation rate increased from 9.2 % in 1972 to an average of 15.4 % between 1973-1983. The exchange rate also appreciated, with adverse implications for non-energy exports.

While the boom brought a measure of prosperity to the population, there were negative effects on the economy, particularly in respect to competitiveness and the relationship between real wages

and real property. Besides the effect on the exchange rate, Government spending led to significant wage increases in the public sector and the rest of the economy. Despite this the gap between the price of land and houses and the income of the lower and middle classes not only widened but has persisted into the post-boom years. The relatively low level of productivity in the farm sector made it difficult for farmers to match these increases resulting in the loss of workers and the abandonment of plantations. The number of persons employed in agriculture declined from 54,214 in 1975 to 39,300 in 1983. Real output in the sector fell by 30 % between 1972 and 1983. Perhaps the one saving grace from that period of good fortune was the initiation of a few energy based industries which now constitute the major pillar of the export platform. The opportunity to elevate the infrastructure of the country to first world standards was mindlessly frittered away.

Barbados, Belize, St. Lucia and Suriname still managed to grow at over two per cent per year in this decade. In Jamaica, however, the economy went into a slump and per capita income declined by almost one per cent per year in the 1970s. The Guyanese economy also decelerated from the previous decade. Simple import substitution in the region, centred largely on packaging and assembly activities, had started to slow down, and any potential as a net foreign exchange earner was clearly not evident. According to World Bank data, the Surinamese economy experienced buoyant growth in the 1960s and 1970s, but this trend was reversed in the following two decades

The 1980s decade was the debt decade or, as they called in Latin America, the decade of lost development. The drop in oil prices from the early 1980s had a catastrophic effect on the economic situation in Trinidad and Tobago where per capita income declined by over three per cent per year in this decade. An average annual growth rate of 5.9 % between 1974 and 1982 was followed by seven years of decline. Between 1982 and 1989 both the current account and the overall account of the balance of payments went into deficit. Foreign exchange earnings and government revenue plummeted. Instead of cutting spending, the savings of the boom years was used to finance the annual deficits. Net foreign reserves dropped from TT\$7.7billion at the end of 1981 to TT\$285 million at the end of 1987. The unemployment rate increased from an average of 10% in 1980-1982 to over 20% in the late 1980s. Borrowing both by the central government and state enterprises increased in the boom years partly because it was easy to

borrow, and continued in the lean years. The public debt (internal and external) increased from TT\$2.9 billion in 1981 (17% of GDP) to TT\$7.4 billion at the end of 1986 (43% of GDP). Advances from the Central Bank had reached its limit. In order to reschedule its foreign debt the government entered into a 14-month Stand-by arrangement with the IMF in early 1989. Following this agreement one detected a greater urgency to rationalize the state enterprises sector which had grown since independence with no clear objective, and had become a major burden on the central government. The whole approach to state ownership suddenly changed.

There was some small growth in the Barbadian economy but per capita income declined in Suriname, Jamaica and Guyana. Foreign investment flows and the development of the tourism industry had a significant impact on members of the Eastern Caribbean Currency Union (ECCU) who experienced per capita income growth of between four and five per cent a year – higher than that of more developed countries but lower than that of the fast growing Asian economies.

As we entered the 1990s the performance gap between the fast growing countries of Asia and the rest widened further. The Asian per capita income growth of over four per cent per year was more than double that of the developed countries and was significantly higher than that of most other developing countries. In the region, Guyana, Suriname and Trinidad and Tobago recovered from the previous decade, but economic performance in most ECCU countries declined significantly. Jamaica's poor performance in the 1980s continued into the 1990s. Guyana's per capita income growth rate increased sharply, while that of Belize, Barbados and the Bahamas attained moderate levels of less than two per cent. Trinidad and Tobago was again the recipient of good fortune, as the driver shifted from oil to natural gas. The price of natural gas increased from US\$2.1 mmbtu in 1998 to an average of US\$7.8 mmbtu between 2005 and 2008.

The first decade of the 21st century ended in the middle of a raging global crisis with no end in sight. In the developed countries declining income has been accompanied by increasing unemployment, increasing debt, budgetary deficits and redirection of spending over a broad front. The impact of the global crisis is also being felt in developing countries with the same consequences. In the Caribbean, the impact has varied from country to country. The tourism-dependent economies have been severely affected. Barbados and Jamaica grew by about one per cent per year in this decade. In the ECCU growth, though positive, dropped further from the previous decades. In the others the growth rate has varied from two percent in Guyana to over

five per cent in Suriname and Trinidad and Tobago. Towards the tail end of the decade economic performance in almost all the countries deteriorated markedly.

In the five decades between 1960 and 2010 the Jamaican economy is estimated to have grown by less than two per cent per year and per capita income by about 0.7%. If we leave the 1960s out the growth rate since 1970 would be less than one per cent and per capita income growth close to zero. Between 1960 and 2010 the Trinidad and Tobago economy grew by about 3.4% per year and per capita income by about 2.3%. In the same period the Guyanese economy is also estimated to have grown by less than 2% per year and per capita income by about 1%. In the four decades since 1970 the Barbadian economy has grown by close to 2.6% per year and per capita income by about 2.2%. If the 1960s are left out the picture would become bleaker. In terms of growth Belize and the ECCU have done relatively better since 1980 experiencing growth of between 3 and 4% per year. The average figures, it should be noted, hide serious difficulties in particular decades.

In the 1960s per capita GNP in Trinidad and Tobago and the Bahamas was higher than that of the Republic of China, South Korea, Hong Kong, Singapore and Taiwan. Per capita income in Barbados, Belize, Guyana, Jamaica and Suriname though lower than that of Singapore and Hong Kong, was higher than that of South Korea, Malaysia and Taiwan. By the year 2000 the picture had changed dramatically. The per capita income for Hong Kong, South Korea, Singapore and Taiwan had exceeded that of all Caribbean countries including the Bahamas, Barbados and Trinidad and Tobago. Per capita income for the Asian Tigers and other peripheral countries such as Malaysia and Thailand was growing at between 3 and 5% per year, while the Caribbean was struggling to achieve 2% a year. What on earth happened in four decades?

The World Bank publication of 1993 (*The East Asian Miracle*, Oxford University Press, 1993) made some interesting observations. The first is that there is no single "East Asian model" of development. While there are some policies common to all of them, each experience is country-specific shaped by national ideas and institutions modified to deal with particular problems. Second, a lot of what the Asian countries were doing was also being done by other developing countries, except, of course, the Asian countries were doing them better. **There was no supernatural force at play, as implied in the word miracle.** Policies and incentives were carefully monitored for their effectiveness and discarded or modified when they did not work or

achieve their targets. The import substitution strategy, for example, which lacked design and implementation in a large number of developing countries, morphed into an export-led strategy as infants were nurtured into global players. The protection of domestic import substitutes was short-lived, as countries adopted more open trading regimes **to earn rather than save foreign exchange**. There were different degrees of dependence on foreign investment which was strategically used to attract technology. The depth and scope of government intervention also varied. In a nutshell, getting the basics right and sound policies explain the high growth rates in Asia. “Private domestic investment and rapidly growing human capital were the principal engines of growth. High levels of domestic financial savings sustained...high levels of investment. Agriculture, while declining in relative importance, experienced rapid growth and productivity improvement...Some of these economies also got a head start because they had a better-educated labour force and a more effective system of public administration.” (World Bank, 1993).

I don't think I have to say much on what went wrong in the Caribbean. Two salient features of the Asian experience are the long period over which they have been able to sustain unusually high growth rates and the global positions they have achieved as exporters of manufactured goods. These achievements came out of conscious policies and repositioning in response to global restructuring. In the Caribbean, the inability to achieve greater diversification and export development reflects failures over a wide front. The inability to grasp the significance of an integrated Caribbean production structure at a particular moment in time opened the way for insular development, and was a critical turning point in the evolution of the Caribbean economy. Weaknesses in the substance and implementation of policy, dysfunctional institutions and the inefficiency in public spending are an integral part of these failures. Development and the pursuit of self reliance require a change in culture and governance. The encouragement of inventions, the adaption of technology, and a greater linkage between scientific research and local problems have not received the attention they deserve. There are reports and studies on almost every single problem. But there is a big difference between what is enunciated on paper and what is practiced. New activities and innovative ways of doing things in response to global challenges have encountered strong resistance in old habits and thinking. The failure to appreciate the critical role of saving and investment in the early stages of development helps explain low saving and investment rates. Policies to reduce or change the composition of imports are nowhere evident.

Capital formation is hampered by the continued leakage of financial and human resources. External factors and developments continue to dictate domestic social and economic conditions in increasingly significant ways. In this sense nothing has changed. Increasing the public debt to plug the holes is a short term panacea fraught with dangers. Most Caribbean countries are carrying debt levels which are neither prudent nor sustainable more on this later.

Growth and Development Theory

There is an enormous literature on what causes growth and why some countries grow faster than others. Every discipline has its own brand of theory and speculation. But we must distinguish between pure growth theory and the musings associated with growth and development. The early post-Keynesian scholars were concerned with steady- state growth in an advanced economy in the context of the European recovery effort. The Harrod-Domar model which sought to answer some questions left hanging by Keynes envisaged output increases as a linear function of increments to the real capital stock. Critical in this model was the rate of saving and investment and not technical progress. A fixed capital- output ratio (the capital coefficient) and a fixed propensity to save were also central pillars. Contributions followed from scholars like Robert Solow, N. Kaldor, L. Pasinetti and T.W. Swan. Basically what they tried to do was to remove some of the rigidities of the H-D model by focusing on things like technical progress, the distribution of income and variations in the saving and production functions which originally allowed little room for substitutability and flexibility. These models rested on very special assumptions. The debate among growth scholars in the early post-war years quickly lost focus and degenerated into a concern with “esoteric issues”, to quote Amartya Sen in the introduction to his 1970 collection of essays on growth economics

Because of the assumptions and the focus on a select list of quantifiable variables, these models drew heavy criticisms from an emerging group of writers concerned with development in poor countries. They argued that the problems in the so called depressed or underdeveloped areas were qualitatively different and were more about development than growth. A fundamental challenge was their inability to incorporate the socio/political or cultural factors that enable countries to rise above physical and resource constraints. Development often requires psychological, cultural, habit and attitude changes which common drivers of development fail to recognize or capture. And which policymakers are often unable to understand or instigate. The ongoing convulsions in

the United States and Europe may be telling us that, perhaps, the world needs less economists and bankers, and more psychologists and psychiatrists.

Sir Arthur Lewis' book, *The Theory of Economic Growth* (published in the mid-1950s) was a major intervention and a signal contribution to our understanding of growth and development. The book was a graphic portrayal of the development challenges facing governments in poor countries. He did not take savings as a given. In direct response to the concerns over the role of savings, Sir Arthur was emphatic. The "central problem in the theory of economic growth", he stated, "is to understand the process by which a community is converted from being a 5 per cent to a 12 per cent saver-with all the attitudes, in institutions and in techniques which accompany this conversion". He did not rule out the use of foreign savings to break the vicious circle of poverty,

But many of the writers on development in the 1950s and 1960s were obsessed with their own pet theories, and the period is replete with naïve and simplistic views of how to transform underdeveloped economies and overcome poverty. The stages of growth theories, the big push argument, balanced versus unbalanced development, transformation with unlimited supplies of labour were based on heroic assumptions that for the most part assumed away the development problem. Some of these were known more for their elegance than their usefulness. Theoretical insights were drawn largely from the history and experience of the developed countries. Raul Prebisch and the Latin American thinkers saw industrialization as the way out of poverty and the answer to the terms of trade problem. They soundly rejected any attempt to use static international trade theory to make a case for continued specialization in primary production in Latin America.

Several lessons have emerged since the early 1960s. One is that given the differences between countries in terms of history, culture, size and resources, one should be careful in generalizing the development problematique. The other was that countries can grow for a variety of reasons and that growth and development were not the same thing. The 2006 UN *World Economic and Social Survey* (p.126) puts it slightly differently. "It is difficult to pin down exactly what institutional 'quality' and what forms of good governance should be pursued in order to support growth processes. Such features appear to be inherently country-and context specific." A second concern relates to the growth of GDP and per capita income which have come to be regarded as

major indicators of economic performance. We now know from experience that growth and development are not synonymous. An economy can grow for a variety of reasons. Commodity booms are one of them. Large foreign investment flows are another.

There is the related question of sustainability which William Demas addressed very eloquently in his *Economics of Development in Small Countries* published in 1965. Demas addressed the question of size and sustainability of small size, and suggested that small size provided special constraints to **structural transformation** which he advanced as the main criterion of development, and not per capita income. He also saw it as the necessary condition for self-sustained growth. Demas' concept of **structural transformation** relates to qualitative changes in the structure and functioning of the economy, and is therefore quite different from the **structural adjustment** term used by the International Financial Institutions in reference to policies aimed at correcting internal and external balances in the short to medium term. In fact structural adjustment was a cover for a new generation of intrusive conditionalities that were aimed more at stabilization and the restoration of free markets than development. Taking a more optimistic view of the prospects for development in small states, Lloyd Best in a brilliant review of Demas' work, argued "that economic development is a problem of management—of timing, sequencing and manipulation in an unending effort to perceive or create, and in any case, to exploit a multiplicity of little openings and opportunities". This was written long before the World Bank's, The Asian Miracle was published. The Latin American thinkers had developed their own ideas. They saw underdevelopment as the result of foreign penetration and linkage to an exploitative international economic system. Development was seen as the regaining of economic sovereignty and the establishment of more equitable systems of income and wealth.

While many useful analytical concepts and insights have emerged from the development literature there is no unique development solution or standard formula that could be applied to all situations. We know the history of the one size fits all approach to adjustment. We also know the difficulties associated with the unqualified application of liberalization policies to situations where markets and institutions don't work or hardly exist. Models and theories, however elegant and internally consistent, do not necessarily make good policy. The fact that many resource-rich countries have remained poor and others less endowed have become rich has down-played the importance of natural resources and traditional factors of production and elevated the importance

of policy. Productivity growth assisted by technological innovations also helps to explain the stellar performance of the fast growing Asian countries with their limited resource base.

A great deal of the thinking in the 1950s and 1960s revolved around the shortage of finance. While it was recognized that other factors contributed to development, capital held the key to the transformation process. The influence of the capital-driven models was readily apparent. Not surprisingly foreign aid and the need to increase domestic savings featured prominently in official reports. Some advocated an aid programme on the scale of the Marshall Plan for Europe after the Second World War. Foreign investment and grants were supposed to fill the gap between domestic investment and national savings. That was the rationale for aid. It was even assumed that there was a fixed relationship between capital and output (the capital-output ratio) and this could be used to determine capital requirements, given the desired growth rate of output. All the socio-cultural difficulties of development were assumed away. The writing of development plans was a popular pastime in the early post-independence years because it was believed that certain levers could be state-manipulated and the private sector could be induced to support government objectives. Plans were also statements to define financial requirements, including aid. In a democratic setting where central planning was not possible indicative planning was the next best thing. But even that concept has receded in the post-1980s drive to downplay the state and exalt the market, which before 2008 some thought had magical powers.

Trends in Saving and Investment

Whatever the arguments over the factors explaining fast growth rates in Asian countries, the one thing they all have in common is that they have been saving and investing over 30% of their respective national income. China's rate has been over 40% in some years.

In the Caribbean, saving and investment rates vary from country to country and from year to year. Not surprisingly the debt levels also vary. Foreign investment flows can also influence rates of capital formation. Generally the gross investment rates tend to be higher than the saving rates. In most countries the average savings rate is less than 20%. In the ECCU the gross investment rate has averaged over 30% of GDP over the last two decades with national savings financing about half of that and foreign savings the rest. What is interesting to note, however, is that the Gross National Savings ratio declined from an average of about 20% in the 1990s to 12% over

the last decade, making the investment level increasingly dependent on foreign capital. In Belize, the investment rate has averaged 23% since 1990 but the gross domestic savings rate has fluctuated between 7% and 25% averaging some 15% over the last two decades. In Guyana the catastrophic fall in income between 1976 and 1990 (GDP declined at an average rate of 2.6% per year) coincided with an average gross national saving rate of 5.6% per year. That rate has increased slightly since, but in recent years foreign savings have financed over 50% of gross investment. In Barbados the gross savings rate has averaged about 15% in recent years with foreign savings contributing about 40% to gross capital formation. In Suriname an average growth rate of 5% in recent years has been associated with investment and savings rates of over 25%. In Trinidad and Tobago the average gross national savings rate of 25% has exceeded the investment rate- unlike the situation in the other countries. Interestingly, the public sector debt both in absolute terms and as a percentage of GDP has been steadily increasing reaching almost 40% in recent years.

Savings are influenced by a variety of factors which are best understood when the savings aggregate is broken down into the three traditional categories: government savings, household or individual savings and corporate savings. In the interest of time I would deal with some selected issues relating to government savings and household savings. I start with government savings. A few countries (among them Barbados, Belize, Guyana, St. Lucia, St. Vincent and Suriname) have small savings in the current account. In recent years almost all Caribbean countries operate with overall deficits ranging between 2 and 8 percent of GDP. In the face of dwindling grants, almost the entire capital budget is financed by borrowing from both local and foreign sources. As we shall see shortly some Caribbean countries are among the most highly indebted in the world.

In discussing public finance there is always controversy over definitions of concepts. Let us take the current account, where we tend to regard all spending items as consumption. There is an argument, and one not without merit, that some expenditures such as salaries paid to doctors and teachers are of a capital nature, and should be treated as such. I do not want to get into a discussion about definition tonight. I would be tempted to put amortization payments in the current account to get a better idea of the level of current savings.

Fiscal Policy

Fiscal policy receives a great deal of attention because it covers all aspects of government functions relating to allocation, distribution and stabilization. Government operations have a deep influence on the macro-economic environment. The level and structure of taxation, the composition of expenditure, the level of public sector savings, the size of the deficits and the way they are financed all impact on parameters which determine whether production capacity expands or contracts. Incentives to work and to invest, development of physical and human capital and the debt legacy to future generations, are linked to the quality of fiscal practice and ultimately to growth. Despite arguments to the contrary, governments in developing countries have a special role to play, particularly in situations where the private sector is dysfunctional or underdeveloped.

Governments need money and with the decline of grants and soft loans they rely critically on internal sources for funds. Grants vary from year to year and do not have the same significance in all the countries of the region. In Guyana, for example, external grants as a percentage of capital expenditure increased from about 16 % in the early part of the 2000 decade to over 30% in 2008 and 2009. In the ECCU current grants amount to around 2% of current revenue, but capital grants have financed about quarter of the capital programme in recent years.

Tax revenue accounts for more than 90% of recurrent revenue in Caribbean countries. The share of non-tax revenue varies from country to country Tax revenue as a percentage of GDP varies across the region. At the lower end, the figure for the Bahamas (which does not have personal or corporate taxes) is about 16-17 percent. Antigua and Anguilla also have a tax ratio below 20%. In the middle range (i.e. 20-25%) are the Eastern Caribbean Currency Union (ECCU), which has an average of 20 %, and Guyana, Suriname and Belize. In the upper range (i.e. 25-30%) are Barbados, Jamaica and Trinidad and Tobago. In the ECCU region, though the average is about 20 %, the ratio varies from country to country in a range of 16 to 22 %. Non- tax revenue and grants could add another 2% - 6% in certain cases.

How have tax systems in the Caribbean performed over the last two decades? In most cases total tax revenue has grown roughly in line with nominal GDP. In Belize, for instance, the tax ratio in recent years increased by one or two percentage points over the 21 % average of the early

1990s. In Suriname, the figures I have point to a decline from over 30% in the mid-1990s to an average of 20 to 21 % in the last decade. In Guyana there was also some variation in the trend, the figure declining slightly from over 30% in the first half of the 1990s but started increasing again from 2004. In Jamaica the figure has fluctuated between 22% and 30% since 1990. In Trinidad and Tobago there was a clear increasing trend, the average ratio moving from 23% in 1990-1995 to almost 30 % in 2006-2010. For the ECCU as a whole the ratio of 20% has varied very little over the last two decades. There is no clear trend in the Bahamas ratio which has fluctuated in the narrow range of 12 to 18 %. The tax base and the tax rates are not the only factors affecting the tax take. The efficiency of the tax systems, the efficacy of tax administrations and the difficulty of taxing the self- employed and those engaged in the informal sector can undermine the tax effort. Caribbean governments are particularly inept at taxing the self- employed.

Given the openness of Caribbean countries and the dependence on exports, revenue can be quite volatile. Oil sector contributes over 40% to recurrent revenue in Trinidad and Tobago. The Trinidad and Tobago government pins the entire budget on the price of oil and gas .Oil revenues increased from TT\$20 billion in 2007 to TT\$30.5 billion in 2008. In the following year, ie 2009, it fell to TT\$ 15.9 billion or by almost 50%. Not surprisingly, recurrent expenditure kept on rising. The unpredictable destruction of production capacity by natural disasters can also wreak havoc with the public finances. In such situations it is the capital account that often suffers, with a negative impact on growth.

The tax system is used to raise revenue, but is also an instrument to influence effort and investment. The structure of taxation also has distributional effects which growth and poverty policies can't ignore. In most countries of the region indirect taxes make a larger contribution to the total tax package than direct taxes. In the ECCU, for instance, taxes on income, and property contributed 25% to total revenue in 2010 compared to 34 % for taxes on domestic goods and services and 41% on taxes on international trade. Clearly any reduction in trade taxes would have serious implications for these countries. In Guyana the proportion is 60% for indirect taxes and 40 % for direct. In Barbados over half of tax revenue comes from taxes levied on goods and services including imports. The situation is different in Trinidad and Tobago where indirect measures in 2010 accounted for less than half of non-oil revenue and almost 25% of the total tax

take. Trade taxes account for about 5% of tax revenue. A number of countries in the region have substituted a value-added tax for other fiscal measures, which the authorities feel is more difficult to evade and is more productive. Whether this has made the system less progressive and more regressive is difficult to say in the absence of evidence. The need for revenue and widespread evasion seems to have overridden concerns about the regressive nature of indirect taxation.

What determines the level of taxation in any country is an interesting question. A mix of political and economic objectives determines the level of taxation. The political system where governments are freely elected by people is one factor. How the government sees its role and the cost associated with the depth of its intervention is another. Different governments have different ideas about the scope of their functions.

What is an optimal level of taxation is another question. If we do an international comparison of tax/GDP ratios we would find that the figure varies widely from country to country. In Singapore, Peru, Paraguay, Zambia, Chile, Hong Kong, China, Costa Rica and India the ratio is less than 20%. The US, Switzerland, Venezuela, Mexico, South Korea and Japan are associated with rates of 25-30 %. Portugal, Brazil, Canada, Botswana and the UK are in the 30 to 40% range. Many of the developed countries, such as Sweden, Germany, France, Italy and Finland have rates of over 40%. These figures include social security contributions.

There is a limit on the extent to which the state can tax without affecting effort or investment. The ability of any government to operate high tax systems depends critically on transparency in terms of where the revenue is going and the ability of taxpayers to associate themselves with specific benefits. Pensions and high quality medical and health services rank high among these benefits

There is some discussion in the literature on the question of whether the level of taxation determines the level of expenditure, or does expenditure determine the level of taxation? There is clearly an upper limit to taxation. The theoretical limit is total national income or total GDP. For policy purposes it should be the point where tax policy begins to have a negative effect on investment and effort. Borrowing removes some of the pressures to increase taxes but there are

limits to borrowing. If the aim is to keep tax levels within reasonable limits that do not impair effort or investment expenditure restraint is essential.

Public Expenditure

Tax revenue and current expenditure tend to be very closely related. In the absence of grants, tax revenue will define the level of current expenditure. Countries are not prone to borrow to finance current spending which is associated with consumption rather than investment.

Recurrent revenue is under constant pressure to increase because of the increasing costs associated with the procurement of goods and services, increases in the wages and salaries, transfer payments and debt servicing. In most cases the growth of recurrent expenditure has outstripped the growth of recurrent revenue. Governments often have to walk a thin line between distributive concerns and the needs of stabilization and long term development. In democracies where political parties are competing for power, capitulation to populist demands is a common phenomenon, even when such demands are difficult to accommodate. Elections are rarely about policies but about emotion and who could offer more. The price for fiscal indiscipline usually comes much later.

In most cases public expenditure (current and capital) is about 30% of GDP. The figure would vary depending on the size of the capital budget or unusual changes in recurrent revenue. As a percentage of current expenditure, wages and salaries vary widely across the region from 18-20% in Trinidad and Tobago to over 30% in Guyana, Jamaica, Belize, and Barbados, and to over 40% in the Bahamas and Suriname and the ECCU. Transfers and subsidies have been increasing in many countries ranging from less than 15% in Belize and Suriname to around 25% in the ECCU, to over 30% in the Bahamas and Barbados, and over 50% in Trinidad and Tobago

Interest payments on the public debt have become a major item in the recurrent budget of some countries. The most recent data show interest payments amounting to 40% of recurrent expenditure (over 10 % of GDP) in Jamaica, close to 20% in Belize, less than 10% in Suriname and around 12% in the ECCU. In Guyana the share fell from almost 30% in 2000 to 6% in recent years, reflecting the drop in the external debt as a result of the debt write-offs.

Overall fiscal deficits are now common to all Caribbean countries. In Jamaica and Guyana these deficits as a percentage of GDP have averaged over 5% in the last decade. Trinidad and Tobago with a surplus averaging 4.3% of GDP between 2003 and 2008 shifted to a deficit averaging 3.4% between 2009 and 2011. The projected deficit for fiscal 2012-2013 is 5.7%. In the ECCU group fiscal deficits have averaged over 3% in recent years. Overall deficits have long been a feature of the fiscal operations of Barbados and Belize.

The growth of the public debt is a major issue in a number of Caribbean countries. By convention only interest payments are included in current expenditure and amortization doesn't come into the picture until we look at total expenditure. So that the few countries which show some small savings in the current account, may in fact have no savings if total debt service (i.e. interest payments and amortization) is set off against recurrent revenue.

Interest payments vary from less than 2% of GDP in Suriname, 3- 5% of GDP in Barbados, St. Lucia, St. Vincent and Belize to 9-10% in St. Kitts-Nevis. In this latter country, interest payments account for over 20% of current expenditure. In Jamaica interest on the public debt amounted to 42% of recurrent revenue and 38% of recurrent expenditure in fiscal 2010/2011. Two items (wages and salaries and interest on the public debt) amounted to more than 80% of recurrent revenue.

Investment in physical infrastructure, education and health are widely viewed as key areas for economic transformation. A sound infrastructure and a healthy and educated work force serve as a springboard for both public and private sector development. In the Caribbean, investment in transportation, bridges, roads, water, power, telecommunication and sanitation have depended heavily on governments, many of them with little savings and limited capacity to borrow. Because physical infrastructure has a long gestation period, the returns on expenditure are not immediate. Pressure on the finances of government also comes from the fact that some services (e.g. water, electricity and public transportation) are provided at highly subsidized costs.

Two major criticisms that have been leveled against the performance of Caribbean governments are: (1) Too little development has taken place in rural areas where most of the poor reside; and (2) governments have not been able to encourage private sector investment on a scale sufficient

to make government capital expenditure worthwhile. A third observation sometimes made is one with an ideological slant. It has been argued by some that government spending has been too biased in favour of infrastructure. It is argued that given the history of the private sector in the region, there is need for a different model envisaging a greater share of public spending into directly productive investment in partnership with the private sector. This may generate profits which could be used to help service the public debt. A mix of investment in production activities and infrastructure is necessary to maximize returns from infrastructural investment.

By some indicators, Caribbean countries have done well in the field of educational and health development. Public spending in these areas compares well with those in the developed and fast-growing economies. Public spending on education as a % of GDP varies between 3.5 and 7 % for most countries of the region. Compare this with 3.5% for Japan, 4.6 % for South Korea and 5.5% for the United Kingdom and the United States. With respect to spending on private and public health, the Caribbean figures are even more impressive. In 2007-2010 the proportions ranged between 4.4% and 8.2% with an average of about 6%. Compare this with 6.5% for South Korea, 4.1% for Malaysia, 6.0% for Mexico and 7.7% for Chile. Most of the developed countries ranged between 9 and 11%. The US is in a league of its own with a 17% figure.

Education and health services have not been neglected. The problem is that because of a variety of factors, the returns on these investments have not been what they should be. In the case of health, shortage of hospital space, lack of maintenance of buildings and equipment, poor management of health facilities, an inadequate number of trained professionals, unrealistic levels of wages and salaries, shortage of critical drugs, have contributed to the poor quality of the health services. In the case of education, the salient problems relate to the relevance of the curricula to the needs of the economy, insufficient number of trained teachers at every level, the failure to stream students in line with their inclinations and talents, and inadequate attention to technical and vocational training. In the case of some disciplines theoretical training ought to be more strongly linked to practice. There is a strong case for free education, but free education at the tertiary level should be linked to public service and governed by a means test and systematic performance monitoring.

The migration of nationals trained at the public expense has taken place at great financial and economic cost to the state. We have the untenable situation in the Caribbean where huge

amounts of public funds are channeled into education at all levels to create human capital that contributes to the development of other countries, while the functioning of local systems depend on the importation of doctors, nurses, engineers, teachers and other professionals. Some who are in a position to know contend that the public service in many Caribbean countries are in a weaker position today than in the pre-independence years. A contributory factor to this situation is the politicization of key institutions in the administrative structure and the failure to use merit as a basis for appointment. More imaginative measures are needed to recoup some part of the cost being in the education project. More than that, however, attention needs to be given to the objective conditions (e.g. the working environment) which force professionals to migrate, in the hope of reversing the trend.

The migration issue is not a simple one. The migration is associated with both costs and benefits. The general argument for migration is that it allows workers to move to more productive employment thereby enhancing world income and welfare. It fills a skills need in the destination countries and generates revenue for the source country. Between 1995 and 2010 remittance flows to developing countries grew six-fold reaching US\$ 372 billion in 2011. Remittances sent home to migrants are three times the size of Official Development Assistance (ODA) and are expected to grow by about 7 to 8 % per year. Poor economic performance in the developed countries, natural disasters of the type that recently hit the East Coast of the United States, high unemployment and pressures in the industrial countries to curb migration may dampen that figure.

In the 1950s and 1960s migration from the Caribbean consisted largely of unskilled persons. There was less complaint because it relieved some of the pressures associated with high unemployment rates and poverty. The increasing component of trained and highly educated people in the migrant pool attracted by higher wages and better working conditions is now seen as a brain drain, notwithstanding the significant contribution of remittances to the local economy. In 2009 remittances as a proportion of GDP amounted to 17.3% in Guyana, 15.4 % in Haiti and 13.8 % in Jamaica.

Crime and Security

Spending on crime prevention both in the public and private sectors has increased in all countries in the region. Despite improvement in the standard of living, crime has emerged as a major problem in almost all Caribbean countries. Gangs are now a common part of the crime profile. Allocating a significant part of the budget to education, including free education and training programmes, has not prevented the emergence of a growing pool of illiterates and unemployables who have placed some Caribbean countries among the most violent in the world. Modern communications have enabled criminals to become more skilled and organized. Those who have chosen a way of life outside the law are able to acquire weapons far superior to those owned by the state police. The low detection rate is a reflection of the widening gap in capability between law breakers and the security forces. The negative impact on the tourist trade and investment climate is a growing source of concern. More than that, the social order is coming under threat from a growing sub- culture and Governments are under enormous pressure by the law- abiding public to reduce the crime rate which has links to a highly organised transnational drug trade. One explanation for the growing pool of unemployables is that it is more rewarding to indulge in crime than to go to school or acquire a skill. A partial solution, as some governments see it, is to pay people not to commit crime. But this is capitulation and not a solution.

The infrastructure to treat with crime is taking an increasingly larger share of national budgets. The prison population seems to be rising at a faster rate than the general population. The demand for more and larger gaols, more modern anti- crime technology and equipment, more vehicles, more courts, more judicial officers, more police and more prison officers is now common place. Politicians and state officials need constant security. The role of the police and prison officials has assumed increasing importance requiring better remuneration and working conditions. Crime is also having an economic impact on businesses and households. The demand for security services and equipment has mushroomed into a major industry. The burgeoning crime rate will not only command an increasing proportion of public revenue but poses a direct threat to the development effort.

Reducing Poverty

Reducing poverty has become an important part of government rhetoric in all developing countries, particularly following the adoption of the Millennium Development Goals by the United Nations, in 1993. The international community is monitoring these goals, but is saying little about the estimated 40 to 60 billion US dollars required to achieve them. In the Caribbean, the incidence of poverty varies from country to country. A large part of the poor have no skills. Some have a criminal record which militates against employment in the private sector. Some governments in the region have tried to mitigate the situation with controversial make-work programmes which function as a kind of dole system to unskilled persons, single mothers and people who would find it difficult to find a job in the private sector. Because of the wages paid in relation to the required effort, this attracts persons who are capable of working elsewhere. While these programmes may have some social value, their economic value and cost generate a fair amount of controversy. One effect is that they draw labour away from the other sectors, thus creating an artificial scarcity which tends to keep labour costs at a higher level than they should be. Such programmes have assumed an element of permanence in government budgets, and serve as a redistributive mechanism directed to social upheavals and extreme poverty.

Competitiveness

The impact of government spending and management tend to show up in areas which define the competitiveness of a country. In its 2012-2013 Report The World Economic Forum ranked 144 countries in terms of their competitiveness based on a number of selected indicators. Not surprisingly, some of the world's fastest growing economies are in the first 30. These include South Korea, Taiwan, Malaysia, Singapore and China. Brazil is ranked 53 and India 56. The Caribbean's best performer is Barbados, ranked 44. Trinidad and Tobago is ranked at 84, Jamaica at 114, Guyana 109, and Suriname at 114. Last year Belize was ranked 123 out of 142. While Caribbean countries are ahead of Venezuela, (126), Trinidad and Tobago, Jamaica, Suriname and Guyana are behind potential trading partners like Chile, Brazil, Mexico, Peru and Uruguay.

A number of indicators are used to gauge productivity. Among them are institutions, infrastructure, the macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labour market efficiency, financial market development and technological readiness. Barbados performs fairly well in most, but is ranked 134 under the macroeconomic environment criterion. Suriname and Guyana are among the least competitive of Caribbean countries ranking between 79 and 128 under the various criteria. Trinidad and Tobago does fairly well in some areas (e.g. the macro-economic environment where it is ranked 19) but does very poorly in goods market and labour market efficiency where it crosses the 100 mark ranking.

In the area of what has been termed efficiency enhancers (this includes higher education and training, goods market efficiency, labour market efficiency, financial market development, and technological readiness), Barbados is ranked number 49, followed by Jamaica at 80, Trinidad and Tobago at 83, Guyana at 109 and Suriname at 124. Singapore is ranked number 1 as it does in the basic requirements section which includes institutions, infrastructure, macroeconomic environment, health and primary education. With respect to industrial relations the laws in the Caribbean are archaic. The prevailing practice is to adjust wages and salaries in relation to time or inflation, or what other sectors are receiving without too much reference to relative productivity. This has to change. In terms of labour market efficiency Trinidad and Tobago is ranked at 110. Yet disruptions to production are instigated with astonishing frequency in relation to matters that often have little to do with wages or working conditions. This takes place even when the economy is stagnant and the country's major trading partners are in recession. Despite the large number of public holidays and attractive leave provisions in industrial agreements, the attitude to work is appalling in some sectors. Industrial peace is critical in defining the investment climate. We must find new ways to involve workers in the production process which allows them to share in rewards as well as the risks. Caribbean governments and people are slow in coming to terms with what is required to survive in an increasingly competitive global economy.

The Role of the State

The role assumed by the state has fiscal implications. Following independence the state in many developing countries assumed an explicit development function in addition to its other normal or

core activities. The perception was that normal market inducements were not sufficiently powerful to induce the private sector to engage in risk taking or developmental activities on the scale required for economic change. In many states localization was a national objective, driven both by political and economic imperatives. To this end, the state played a pivotal role in taking charge of the 'commanding heights' of the economy and in many cases became saddled with large numbers of enterprises which it could not manage. The state grew in size and became a major source of employment and dispenser of patronage. Corruption also increased. Under state ownership management and productivity became major issues as state enterprises became increasingly dependent on central government funding. The competition for state resources increased with an expanding range of welfare functions responding to populist pressure. The accumulation of debt by the central government and the state companies commanded an increasingly larger share of budgetary resources already stretched to cover increasing welfare programmes.

Since the 1980s strong views have emerged on what the state should or should not do. Following the structural reforms associated with the debt crisis of the 1980s, the position adopted by the International Financial Institutions and enunciated in the Washington Consensus was that the state should be a facilitator and regulator and the private sector (local and foreign) should drive growth. That was the new mantra. Global liberalization and deregulation policies also served to erode the power of the developmental state. In many cases the quality of the state bureaucracy and key administrative institutions were already deteriorating, thus raising further questions about the effectiveness of the state as an institution of change. A more open world economy offers both challenges and opportunities, but without a diversified and competitive economy foreign exchange crises are likely to occur with greater regularity.

The Public Debt

The public debt is a contentious issue in both developed and developing countries. In most countries of the world the debt/GDP ratio has been increasing over time. Among the developed countries where the ratio has crossed 100 per cent are the United States, Italy, Japan and Greece. In several other European countries (such as France, Germany and the UK) the ratio is over 80%. Unlike the 1980s when the debt problem revolved largely around developing countries the debtor profile today is more inclusive.

The sources of development finance for small developing countries tend to be highly restricted. Because of the difficulties in borrowing in international capital markets these countries tend to rely more heavily on loans from multilateral and bilateral sources which in any event are associated with softer terms than market loans. This does not mean that countries do not borrow from private sources when they can, despite the harder terms. Besides the question of size, the middle income countries have greater difficulty accessing concessional funds. One of the issues involving the international financial institutions arises from the concern of whether these institutions are making a net positive contribution to resource flows to developing countries, or are they contributing to their precarious financial positions. Let us take the venerable World Bank. In six of the eight years between 2001 and 2008 the net flow to Latin America and the Caribbean was negative. The net outflow was US\$2.5 billion for the period. Out of the eight years the flows from the IMF was negative in three years and zero in two. The net outflow from the region for the eight year period was US\$ 12.9 billion. Another issue relates to the policy conditionalities attached to assistance from the international financial institutions and their impact on national development objectives. Based on experience, serious questions have been raised about whether some of these conditions improve or worsen social and economic conditions.

In most countries of the region the public debt has been growing at a faster pace than GDP. In Barbados, for example, the debt/ GDP ratio increased from 65% in 1990 to 118% in 2010. In Jamaica where the domestic debt accounts for more than half the public debt, the ratio has averaged 116% over the last two decades. In the ECCU region, the debt ratio increased from 36% in 1990 to 83 % two decades later. Within that group the experience varies from country to country. In St. Kitts- Nevis, for example, the ratio moved from 90% in 2001 to 200% in 2010. In Belize the external debt ratio jumped from 33% in 1990 to 85 % in 2010.

The domestic debt and the foreign debt are associated with different kinds of concerns. Earlier we looked at the implications for the budget. The foreign debt service requires foreign exchange which at crucial times could be in short supply. In 2010 85 % of Belize debt stock was foreign as compared to over 40% for Jamaica, 70 % for Guyana and 30% for Barbados. Though the accrued debt service for Jamaica has been declining, in 2009 the outstanding external debt amounted to

over 100% of exports of goods and services. The debt (accrued) service ratio averaged 13% over the period 1999 to 2009.

Does the growth of the public debt assist or hinder development. There is a view that up to a point foreign borrowing can have a positive impact on growth. Foreign resources can complement local savings and if these flow into projects that expand production and export capacity, managing the public debt should not be an issue. Very often, however, the terms of repayment may change, or the project does not turn out as intended, or takes a longer time to complete or make its impact. The government's financial situation may also change radically if commodity prices fall or a natural disaster intervenes. But because of the ramifications of default, the debt service receives high priority, even at the expense of social programmes. Let us look at the experience of a few Caribbean countries

In Guyana real GDP fell by 30% between 1976 and 1990. Over the same period the outstanding foreign debt increased by more than four times, the debt/GDP ratio moving from 82 % to 740 %. The foreign debt continued to grow until 1995 when it crossed US\$ 2 billion for the first time, but with the debt write offs kicking in, a declining trend set in until 2008, with the figure starting to increase again in the following years. Guyana and Haiti were then the only two Caribbean countries to benefit from the Highly Indebted Poor Countries Initiative (HIPC). The economy is estimated to have grown by 3.5% per year between 1990 and 2010, but debt remains a major issue. The domestic debt increased tenfold in the period. The public sector gross debt has averaged around 60% in recent years.

In Jamaica, real income declined by almost 1% (0.8) per year between 1970 and 1980. In the following decade (1980 to 1990) the rate increased to 2.4% per year. Despite this, real GDP in 1993 was almost the same as that of 1973 (20 years earlier). In the 1990s the economy failed to grow. In the decade since 2000 the economy has grown by about 1% per year. In the four decades since 1970 the economy has grown by less than 1% (0.6%) per year. The first decade following independence when the economy grew by over 5% a year seems to have been a major aberration. While the economy was declining or stagnating the public debt was exploding. While as a share of GDP the external debt declined from 98% in 1990 to 54% in 2009, in absolute terms it grew from US\$ 4.1 billion in 1990 to almost US\$ 8 billion in mid- 2010. Multilateral

and bilateral sources accounted for about half. The internal debt has grown faster than the external debt, the internal debt /GDP ratio increasing from 33% in 1990 to 70% in 2009.

In February 2012 Moody Investors Services downgraded Belize government bond rating from B3 to Caaa1 out of concern for the government's ability to service its debt. In June of the same year there was a second downgrade from Caaa1 to Ca. In August 2012 Standard and Poor followed Moody's in downgrading Belize's sovereign debt, following the government's inability to meet its service obligations. The Belizean economy is estimated to have grown by over three percent per year over the last two decades, but per capita GNI (US\$ 5,812 ppp in 2011) was still below that of most other Caribbean countries. The public debt has been growing faster than GDP. The external /debt GDP ratio increased from 32% in 1990 to 72% in 2010. If the internal debt is included the latter ratio would rise to 85%. The foreign debt owed to commercial banks rose from B\$1.6mn (0.7% of the total) in 1987 to 1.1 billion (55 % of the total) in June 2010.

There is often a slim line between a comfortable debt position and the decline into crisis. Even with good debt management a government may find itself in a position where debt servicing becomes very difficult because of movements in interest rates and adverse conditions affecting foreign exchange earnings and public revenue. The choice is often between servicing debt or reducing capital and even social expenditure which can have a negative effect on growth and poverty alleviation. In a number of countries there is a close correlation between high debt levels and low growth rates and deteriorating social conditions. Because of the reaction of creditors and rating agencies governments place a very high priority on meeting debt obligations, but the fiscal or foreign exchange resources may simply not be available. Debt write offs have assisted many countries, but the policy of multilateral institutions like the IMF and the World Bank not to reschedule debt under any circumstances does not help in international relief efforts.

Foreign Aid

Foreign aid or foreign assistance was initially intended to promote development and bridge the gap between rich and poor countries. Over the years aid has evolved into many forms such as grants and low cost loans, debt write- offs, technical assistance, emergency assistance, food aid and preferential trading agreements, and therefore it is difficult to argue against its importance. The contention between donors and recipients has been around the amount of aid, its distribution,

its administration and its efficacy. While many think that aid has not had the intended impact, there is still a role for it in international development, particularly in the poorest countries with highly underdeveloped infrastructures. The World Bank uses an income benchmark of US\$1.25 (ppp 2005) and US\$2.00 (ppp 2005) a day to gauge trends in international poverty. What these figures represent or what they can buy in various parts of the world I have no idea. Under both benchmarks the number of poor people in the world declined between 1981 and 2008. With respect to the \$2.00 benchmark the number of people living on less than \$2.00 a day fell from 2,585 million in 1981 to \$ 2,471 million in 2008. The greatest drop was in China. In sub-Saharan Africa, however, the number of people increased from 288 million to 562 million.

In the 1950s and 1960s there was intense discussion in official circles over the amount of aid it would take to break out of what came to be known as the vicious circle of poverty. The UNCTAD had dubbed the 1960s the first development decade and proposed that the developed countries should aim at transferring 1% of their national income to developing countries as financial assistance. This covered both official and private capital flows. The 1% target received endorsement from the Pearson Report published in 1969, but for the second development decade it was proposed that official development assistance should increase from 0.39% of GNP to 0.7% of GNP. That remains the present target.

For the 1970s dubbed the second development decade, there was a proposal that the developed countries should transfer 0.7% of their GNP as Official Development Assistance to poor countries. While many OECD countries accepted the target in principle, commitment to a time frame for implementation was not given. The effort of major donors has declined over time. The performance of some of the Development Assistance Committee (DAC) members of the OECD in respect of ODA in the last 40 years can be gleaned from the following figures. We compare the average ratio for the 1960s with the average for the period 2000 to 2009. For the US it declined from 0.5 to 0.16; for the UK from 0.48 to 0.40; for Germany from 0.40 to 0.33 and Japan from 0.24 to 0.22; France from 0.87 to 0.41. On the other hand for Denmark, Sweden and Norway the ratio increased from an average of less than 0.25 % to almost one per cent. The performance of the Netherlands and Canada also improved.

What are the prospects for aid? To begin with aid has its detractors. Some believe there is no link between aid and growth or aid and development. Others argue aid has a negative effect on

domestic savings. Still others feel that for aid to have an impact, there must be a good policy environment. I need not tell you where that has led. Against this background, and taken up with their own economic difficulties, the rich countries have become more discriminating with their aid and now focus on the poorest and neediest. The abrogation of preferences has already changed the production profile in Caribbean countries. The European Community has recently signaled to its former colonies that it is reviewing its aid policy with a view to focusing on the neediest. The use of per capita income as an index of development or need puts the Caribbean in a particularly difficult position, given their position as upper lower/lower middle status. To qualify for assistance at present from the International Development Association (IDA), the soft loans window of the World Bank, per capita GNI must not exceed US\$ 1,175 (2010 dollars). The rule excludes some very small islands and currently 81 countries are eligible for assistance. It is estimated that some 1.8 billion people survives on income of US\$2 or less. If the rule were to be strictly applied most CARICOM countries would find it difficult to qualify.

All the knowledge we have acquired in the post-war period about development and the issues associated with the concepts of size, vulnerability, sustainability and per capita income seem to have gone through the window. The tenuous basis on which Caribbean economies rest and the possibility that the revenue base can be turned into turmoil by developments in one sector, or that the entire production plant of a country can be destroyed by a single event is apparently too difficult for international decision makers to grasp. An article published by William Easterly and Aart Kray in **World Development** in 2000 (“Small States, Small Problems? Income, Growth and Volatility in Small States”) concluded that small states “have perhaps received excessive attention from the literature” and there is “no significant difference in performance between large and small states”. The inference being drawn is there is no special case for assistance to small countries. The question was never about whether small states can grow, but about their ability to sustain development in the face of domestic economic constraints and persistent external shocks. There are differences between large and small states. A reading of Demas’ book would have been of considerable help to the authors, but nowhere is he mentioned. In fact looking at the references I had problems detecting reference to a single Caribbean scholar.

Foreign Investment

Foreign direct investment constitutes one of the most important components of what we refer to as foreign savings. It is also one of the major drivers in global economic change. In 2011 inward flows amounted to US\$1.5 trillion, 45 % of which went to developing countries. China attracted US\$124 billion, despite rising wages and production costs. The Latin American and Caribbean region received US\$ 217 billion most going to countries with high growth rates, large and expanding consumer markets and abundant resource endowments. In the Caribbean, direct investment has flowed largely to the resource based activities such as tourism, mining and energy and the financial sector. Average annual flows of foreign direct investment to Latin America and the Caribbean between 2001 and 2009 were more than four times that of net loans. Among CARICOM countries (not counting the offshore centres) Trinidad and Tobago is by far the largest recipient of FDI, with a stock of some US\$18 billion in 2011, the overwhelming share being in the petroleum industries.

The policy on foreign investment has changed considerably since the 1960s. In the early post independence years developing countries took the view that key sectors of the economy (the nationalists called them the “commanding heights” of the economy) could make a greater contribution to development by being under national control. Some foreign-owned enterprises were nationalized, and foreigners were forbidden from operating in certain sectors. Some of these governments were labeled as socialist or communist. Many of the companies acquired were losing concerns and underwent little change even after being acquired by the state. Patronage and mismanagement led to increased dependence on the central government. In the case of Trinidad and Tobago the nationalistic fervour, as mentioned earlier, was fueled by the oil boom resources of 1974 -1981 period. By 1982 the government was participating in some 66 enterprises, 34 of which were wholly-owned by the state. In Guyana employment in the state enterprises sector as a percentage of total public sector employment increased from 57.5 % in 1980 to 72 % in 1990, reflecting the growth of the state enterprises sector

Following the emergence of the fiscal and debt crisis of the 1980s and the adoption of structural adjustment programmes, the policy towards foreign investment underwent a radical change as the private sector, both local and foreign, were deemed to be the new drivers of growth. With many countries competing for foreign investment and pursuing the same policies of more open

trade and capital liberalization policies the competition has intensified. Large markets, the availability of resources and a skilled and efficient work force, give some countries a particular advantage. But policies and the investment environment are important determinants. There are major challenges facing Caribbean countries. Their low positions in the Global Competitiveness Index point to incredible inefficiency which requires political, economic and cultural shifts of enormous magnitude.

Household Savings

With respect to individual or household savings I wish to offer a few observations on the policy environment. Per capita income and interest rates are among the leading determinants of household savings. Individuals save for a variety of reasons, and even with a zero nominal or negative real rate of interest savings are likely to grow over time if per capita income is increasing. In almost all countries of the region, total bank deposits as a percentage of GDP has been increasing, though at different rates. In Barbados the ratio almost doubled between 1990 and 2010, while in Trinidad and Tobago it moved from around 40% to almost 60% and in Belize from about 40% to 70% over the same period. In the ECCU the proportion increased from 70% to over 100%. In Guyana and Jamaica the trend was not as emphatic. At present the bank deposit ratio ranges from less than 50% in Guyana to over 100% in Barbados. In most jurisdictions, individuals account for about half of bank deposits.

The fact that individuals and other entities would save even in the face of zero or negative interest rates puts financial intermediaries in a particularly advantageous position that allows them greater flexibility in the determination of the interest rate spread. In Trinidad and Tobago in recent years the weighted loan rates has averaged 10% while weighted interest on deposits has averaged 2%, giving a spread of about 8%. The inflation rate has averaged around 7% in the last ten years. With respect to foreign currency transactions both the deposit rate and the loan rate tend to be lower than that in the local currency markets, but that has not stopped local deposits from growing. In Barbados the weighted loan rates since 2000 has averaged 10.5 % compared to 3.6 % for deposits, a spread of 6.9%.The inflation rate has been averaging 4.4% in recent years. In recent years the average weighted loan rates in Jamaica have been in the region of 20% compared to 5 to 6 % for time deposits (which has been declining). For all categories of savings

the weighted rate fell from about 7% in 2009 to 3% in 2010/11. The inflation rate in Jamaica has averaged 11% since 2000. Generally, inflation rates are higher than deposit rates

Among the factors that influence the interest rate spread are liquidity, the demand for loans, competition and unremunerated reserve requirements. In a May 1997 Report, the IMF had this to say about the Trinidad and Tobago situation. "The banking industry in Trinidad and Tobago presents a mixed picture with regard to competitiveness. None of the six banks is large enough to exercise monopoly power. However, their relatively small number, absence of new entry over many years, the large interest rate spreads, and record profits suggest a degree of monopolistic market power. This situation makes the banking system appear financially strong but it carries a hidden cost for the rest of the economy by keeping the cost of capital high and the incentive for financial savings low. "Needless to say the banks were not very happy. But the Fund, perhaps quite inadvertently, raised an interesting question on the relationship between a few powerful banks and a large number of disorganized savers, many of them lacking financial savvy or preferring to save with a commercial bank rather than less trustworthy institutions subject to official oversight of a highly dubious quality. In that situation can we honestly say that the interest rate is market determined? Are savers being held to ransom? Deposits amount to more than 60 % of the assets of the banking system, yet it is the shareholders who enjoy the profits.

The state of liquidity exerts a heavy influence on interest rates, but the market is not perfect and in the interest of development and social justice the Central Banks should not exclude their intervention on mistaken notions of market principle or theoretical grounds. Short term policies have long term consequences. Low nominal or negative interest rates and high inflation are a recipe for disintermediation. Repression not only comes through dictum or pronouncement, but through unwritten consent. Smart savers would be inclined to move from financial assets to tangible assets. Too much of that trend is not in the interest of development. Some may even feel more comfortable with a low interest foreign account than with a low interest local account. Though interest rates on foreign currency deposits tend to be lower than their counterparts in the local currency market, there has been a phenomenal growth in foreign currency deposits. In 2009 foreign currency deposits as a % of total deposits ranged from less than 5% in Belize and the Bahamas to around 30% in Guyana, Jamaica and Trinidad and Tobago and to over 50% in Suriname.

Saving is critical to the development of self reliance. Countries that do not save or who squander their savings become easy prey for foreign predators. To sustain the saving habit one can easily make a case for a minimum interest rate policy, which can be adjusted to meet various levels of liquidity. Interest rates must be viewed not only as the cost of loans but also as a reward to savers. A low or negative interest rate policy on deposits may enhance the profit position of financial institutions. To the extent that it makes possible low interest loans for consumer spending, savers are being used to subsidize spenders. For retirees and pensioners who rely on their savings for survival, a low or negative interest rate policy for them would mean consuming their capital. They can quickly join the ranks of the new poor, or the increasing number of state dependents.

Another factor affecting household savings is confidence. The developments in Jamaica in the 1990s and the recent collapse of a major credit union and a large financial conglomerate in Trinidad and Tobago tell us that even if a financial institution is licensed by the state it does not follow that it is under the strict supervision of the regulatory authorities who may be hampered from doing their job for a variety of reasons. The CLICO collapse in Trinidad and Tobago not only sent ripples throughout the Caribbean but could have brought down the Trinidad and Tobago financial sector in the absence of a massive government bailout. Can we assume a situation where the government did not have the wherewithal to intervene? The CLICO disaster was in the making for years, and was essentially a regulatory failure for which the Ministry of Finance and the Trinidad and Tobago Central Bank must take full responsibility. CLICO and the Hindu Credit Union were allowed to breach every tenet of good financial management, with the apparent collusion of the auditors and the influence of politicians on the conduct of the regulatory bodies. Financial institutions should be prohibited from making contributions to political parties. Confidence once lost is not easy to regain.

Since their initiation, Central Banks in the region have gained some experience and they need to review their original mandate which came out of models with little relevance to Caribbean circumstances. As far as liquidity management is concerned they now have a better idea of what works and what does not work. The existence of high liquidity in some jurisdictions and low levels in others at particular times reflects the lack of a regional framework that could lead to a more rational use of savings and better returns for savers. Central banks have been taking over

responsibility for regulation of the financial sector, but they ought to be more proactive in a number of other areas. Central Banks are regarded as the lender of last resort for commercial banks, but in today's circumstances they must take an interest in economic fairness and the quality of service being dispensed to the public. The Central Bank carries a heavy responsibility for the inflation rate and the exchange rate. But so does the government in the exercise of fiscal policy. It makes absolutely no sense for the Governor of any Central Bank to stay on the sideline and occasionally pelt stones at any Minister of Finance to demonstrate his independence. What is required are channels for regular discussions to resolve differences in views. After all they are supposed to be working for the same government. I have always wondered about where the independence of the Central Bank begins and where it ends. I think Central Banks should go outside their narrow operational confines and luxurious surroundings and have a greater input in the formulation of policies that drive the real sector where in fact some of the inflation and instability originates. In other words they should be more doers than reporters. The Pontius Pilate kind of attitude does not work anymore. The Central Banks have an enormous bureaucracy which can do a lot more to help the governments they serve. It irks me when I see Central Banks and international financial institutions (IFIs) telling the public that the economy will grow by 0.2 % in the next quarter or decline by 1% in the following year. Given the frequency of revisions, I think most now know this is high class guessing. This kind of forecasting is not going to influence anybody.

Concluding Remarks

In the last five decades, there has been a steady improvement in living standards in almost all Caribbean countries, but the conditions that made that possible have largely disappeared. The global environment today is quite different from that of the 1950s and 1960s. The political and economic landscape has changed in fundamental ways. The high degree of trade, exchange and capital controls of the early post war years has given way to more liberal policies to which development policy must adapt. The days of preferences are over leading to a significant decline in high cost primary exports. Not only have markets become more open and competitive, demanding more efficient production, but the climate for aid has shifted against middle income countries. High levels of public debt which already put severe strain on public revenue and

foreign exchange earnings will make it more difficult to borrow. The sovereign debt in some countries has already been downgraded several times.

I am not sure the average citizen in the Caribbean understands the implications of these realities. Not many take an interest in what is happening in Sub-Saharan Africa, or in Greece or Spain or for that matter in the rest of Europe. The post-independence Caribbean experience points to the need for action at several levels. At the top of the list is the recognition that there is a synergism between economics and politics which can be a powerful force in economic management. A strong economy is generally buttressed and encouraged by a strong society. The two go hand in hand. Caribbean nations are in the formative stages and cannot afford continual tensions threatening the social fabric and undermining the economic effort. There must be some consensus by all political parties and interests groups with respect to long term goals and development. On fundamental things we cannot change course every five years. Politics in the region has not developed in the sense of providing a more secure framework for development. Political Parties are not only separated by views and perspectives, but by pathology shaped by race, class, special interests, culture and vision. This leads to the syndrome of power at any cost, and winner takes all. The political constitutions that became operational at the time of independence may have served their initial purpose but need to be revisited. The concentration of power in the hands of one person or a group of persons is a dangerous and unproductive arrangement. Constitutions must explicitly recognize the unique nature of multi-ethnic and multicultural societies by providing comfort and genuine safeguards for their rights to participate in the national decision-making process and sharing in the fruits of progress. Innovations must come not only from technology, but from the desire for meaningful popular involvement and participation. Democracy, particularly in small societies, must be inclusive drawing on the strength and abilities of all citizens. Of course, an alternative model is a benevolent dictator eschewing all the luxuries of democracy.

The second issue has to do with the failure of the post-independence economic strategy, and in particular the inability to develop a competitive manufacturing sector. The new thinking must envisage a greater balance between agriculture and industry and the production of goods and services with greater local value added, as well as exploring the opportunities in the knowledge based industry. One must be extremely careful in interpreting temporary spurts in GDP growth

or increases in luxury imports (such as cars) as signs of economic development. The same should be said of high employment rates fueled by government make-work programmes.

Another issue calls for increasing efficiency both in the public sector and the private sector. The positions of Caribbean countries in the Global Competitiveness Index reveal a great deal. They speak directly to incredible inefficiency and resource wastage, notwithstanding significant public spending in critical areas like health and education. The computer age has made little difference to the functioning of many government departments and firms in the private sector. The application of basic technology in solving day to day problems is a major challenge. Time is a resource and an enormous amount of it is wasted in accomplishing the simplest task. A great deal more attention needs to be paid to the relationship between inputs and output in the production process. Ignoring the issue of productivity in relation to wages and salaries has the potential to bankrupt both the private sector and the government. We cannot depend on foreign investors and aid donors to bankroll the consequences of ineffective policies and poor management.

In most countries of the region a high proportion of domestic investment is being financed by foreign savings. In certain countries a significant part of revenues and foreign exchange are being used to service debt which may take years to pay off. This has a crippling effect on government operations. Despite the debt relief assistance given to some countries, the public debt continues to grow. Sometimes new borrowing is undertaken simply to service old loans. A greater effort has to be made to increase national savings and use them more effectively for investment. The key to this is a proper interest rate policy and the development of a vibrant money and capital market, at both the local and regional level, with an innovative range of financial instruments that could straddle the gap between short term liabilities and long term investment. Weaknesses in financial oversight systems have to be rectified urgently to generate a higher level of public confidence. These decisions require will rather than rocket science.

Timing in economics, as in everything else, is important. Countries with far less resources that were behind us are now ahead of us. The so-called miracle economies in East Asia have their beginnings in the 1960s. Singapore became an independent republic in 1965. Almost all of them came from a background of conflict, instability and poverty. The Caribbean has much to commend it in facing the challenges of the 21st century, but must be bold in abandoning political institutions and economic strategies that do not work and adopting others that offer greater hope.

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