



**GROUND RULES FOR REGIONAL INTEGRATION –
LESSONS FROM PLANNING FOR THE CARICOM SINGLE
MARKET AND ECONOMY**

For presentation

by

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1. Introduction

Mr. Chairman, I wish first of all to congratulate CEMLA for choosing so important a topic as regional integration for discussion at this conference. I am grateful as well for the opportunity to make some remarks on behalf of the countries in my constituency. As you know Mr. Chairman, the majority of countries in my constituency are about to enter a Single Market and Economy. Therefore, this discussion affords us the opportunity to share our experiences with integration to date as well as to learn from the experiences of our neighbours in this hemisphere.

Most of the world's functioning integration movements can be found in the western hemisphere. These include the Central American Common Market (CACM), which dates from 1960, the Andean Pact, Caricom (which groups many of the English-speaking Caribbean territories), Mercosur and the North American Free Trade Area (NAFTA). Apart from Europe, therefore, no other area has accumulated as much experience and as wide a knowledge base on matters of regional integration as Latin America and the Caribbean.

2. Some Definitions

Economic or regional integration can be described as a process whereby participating countries reduce or eliminate barriers to trade among them. At first, integration was motivated by a desire to increase the volume of merchandise trade between countries. However, with the passage of time and under the influence of the World Trade Organisation efforts at freer trade have been extended to services as well.

As with most acts of human endeavour, economic integration can be defined by the intensity or degree of the actions involved. Thus the most basic form of integration is preferential trade arrangements which simply provide for reduced barriers to merchandise trade. A good example of this was the British Commonwealth Preference

Scheme established in 1932 by the UK along with current and former members of the British Empire.

The next stage in regional integration is the free trade area whereby all barriers to merchandise trade among members are removed, while each country may retain barriers on trade with third party countries. NAFTA is perhaps the best modern example.

The customs union is a third stage which, in addition to the removal of trade barriers, harmonises trade policies (for example, the establishment of common external tariffs) with non-member countries. Caricom, Mercosur, the Andean Pact and the CACM are good examples of customs unions.

The stage immediately beyond a customs union is called a common market which has the additional features of complete mobility of labour and capital. This is the stage which has been achieved by the European Union and the stage to which Caricom is now aspiring.

A final stage in the regional integration process is the economic union. In this stage monetary and fiscal policies are fully harmonised. This is often complemented by some form of political union. This is a goal of the European Union as a region but a good country example of an economic union is the United States of America.

If the schema which I have just outlined is accurate, it means that by year-end, all of the countries in this hemisphere will be in groupings which are at different stages of the integration process. The FTAA is a work in progress; we are yet to find out how it will evolve. A pertinent question here is whether the FTAA can easily assimilate countries which are at different stages of integration. There are other interesting questions. Do the various stages which have been reached represent the most efficient or optimal choices for the respective groups? Should they all be aspiring to the final stage of the integration process which is full economic union?

3. Theoretical Aspects

Several authors have written about the benefits to be derived from regional integration. In the literature the benefits are analysed under static and dynamic welfare effects.

Among the static effects are the processes of trade creation and trade diversion. Trade creation occurs when domestic production in a member country is replaced by lower-cost imports from another participating country. As long as all the countries' economic resources are fully employed, welfare increases because the identification of national comparative advantage results in greater specialisation.

Conversely, trade diversion exists where lower-cost imports from outside the grouping are replaced by higher-cost imports from a member country. Trade diversion is therefore welfare reducing, since output by more efficient low-cost producers outside the group is replaced by output by less-efficient high cost members.

As long ago as 1976 a paper published in the Journal of Development Studies established the presence of both trade creation and trade diversion among the member countries of the CACM. Trade creation was evident in Honduras and Costa Rico while trade diversion existed in Guatemala, El Salvador and Nicaragua. It would be interesting to find out whether this categorisation has changed over time.

No analysis of this nature has been done in the Caricom region, but anecdotal evidence would suggest that trade creation effects are present. For example, some Barbadian manufacturers have had to close down as a result of increasing imports of lower cost goods from Trinidad and Tobago. Given the structures of trade liberalisation it is unlikely that trade diversion exists to any significant degree.

There are other static welfare benefits as well. These include the savings which accrue to member states from the reduction in the need for customs administration. Then there are the terms-of-trade effects which arise because trade creation leads to a reduction in

the collective import demand of the group. One also has to take into account the greater or enhanced bargaining power which comes from being in a regional grouping.

Some commentators are more persuaded by the dynamic benefits from customs unions. The first is the increased competition which ensues because of the widening of markets for goods, services, capital and other resources. A second dynamic impact comes through economies of scale as domestic producers often merge their operations in order to achieve the critical mass which would enable them to compete with third-country firms. The third dynamic effect follows naturally from the previous two; it is the resulting stimulus to investment in response to expanding opportunities for business. Finally, there is the greater possibility for enhanced utilisation of resources which is both necessary for, and is a natural corollary to, a well-functioning integration movement.

According to information published by the World Bank in 2000¹, per capita GDP in Latin America and the Caribbean only grew more quickly than in Sub-Saharan Africa and East-Asia and the Pacific Islands when comparisons are made for seven regions in the world over a 40-year period.

Yet, in listing the strategic priorities for accelerating growth in Latin America and the Caribbean², the World Bank hardly makes any specific mention of, or ascribes any importance to, regional integration as a means of accelerating economic development. The list includes:

- consolidating macroeconomic stability;
- promoting quality investment in human development;
- accelerating the region's financial development;

¹ Ferranti, D., G. Perry, I. Gill and L. Serven, 2002, Securing our Future in a Global Economy, The World Bank.

² Burki, S. and G. Perry, 1997, The Long March: A Reform Agenda for Latin America and the Caribbean in the Next Decade, The World Bank.

- improving the legal and regulatory environment for private sector development; and
- enhancing public-sector efficiency and governance.

I believe that a deepening of the regional integration process can do much to help our countries achieve many of these goals. However, it will take some experimentation before each trade group can identify the arrangement which will bring it the most benefits. Caricom has concluded that it has benefitted as much as it can from a customs union and is now establishing a common market.

4. The Caricom Single Market and Economy

I will now deal more directly with the Caricom Single Market and Economy, giving the background to its establishment and highlighting some of the problems and major issues which have been encountered along the way.

Attempts to integrate the economies of the English-speaking Caribbean countries date back over a half of a century. In 1950, most of the British colonies, as they were then, started to use a single currency which had a fixed relationship to the pound sterling. Between 1958 and 1962, there was actually a political federation of the countries involved. This experiment failed because it attempted to move directly to the highest stage of integration – which involves the political dimension – before it had firmly rooted itself by going through the various stages which came before. For example, the Federal Government had no jurisdiction over tax collection; a lack of financial control is a major stumbling block in any political union.

After a few of the larger economies had achieved political independence from Britain, they again began to admit to the merits of integration and formed the Caribbean Free Trade Area or CARIFTA in 1967. This initiative helped to expand regional trade for a period but could not withstand the foreign exchange difficulties which some members started to experience in the late 1970s. Caricom was created in 1973 and has made

significant strides in reducing tariffs, as well as enhancing regional co-operation in several important areas. Unfortunately, under Caricom, regional trade has not expanded markedly and economic growth has been anaemic. Caricom was also inadequate to deal with the challenges which were being posed by the new trade liberalisation process. It was these circumstances which influenced the decision of the Caribbean countries, in 1989, to establish the Caricom Single Market and Economy or CSME.

Conscious of the tremendous challenges brought on by globalisation for small economies, Caricom countries became increasingly purposeful about the establishment of a single market and economy in the past decade. Interest in the single market and economy was renewed and CARICOM countries worked assiduously to establish a single economic space within the region.

In order to make the CSME as responsive as possible to the changed circumstances of the 21st Century, a decision has been taken to fundamentally change the arrangements under which Caricom operates, as follows:

1. Restructuring the Organisational and Institutional Arrangements.
2. Removal of restrictions on the right of establishment, the provision of services and the movement of labour and capital.
3. The promotion of Industrial Policy, in particular enhancing the region's competitiveness in the manufacture of goods.
4. The enhancement of Trade Policy with respect to issues such as Rules of Origin, Common External Tariffs and co-operation in customs administration and safeguards.
5. The promotion of an Agricultural Policy with emphasis on internationally-competitive and environmentally-sustainable procedures and technologies.
6. Instituting a Transportation Policy which emphasises the need for safe, adequate and internationally-competitive transportation modes.

7. Assisting disadvantaged countries, regions and sectors to become economically viable and competitive.
8. Instituting a Policy on Competition, Consumer Protection, Dumping and Subsidies.
9. The Establishment of the Caribbean Court of Justice which would protect individual and institutional rights within the context of a clearly-defined dispute settlement mechanism.

In their attempt to establish the CSME, the English-speaking countries have encountered all or many of the problems which have been faced by other groups. However, it is necessary to underscore a number of important considerations which may make the CSME unique among regional integration movements and may have compounded these difficulties.

The first is that these countries constitute the smallest integration movement in the world both in terms of population, landmass and gross domestic product. Only the South Pacific islands and a few land-locked African and European countries have similar demographics and economic structures. Their small size makes Caribbean economies highly open to international, economic developments and very vulnerable to macroeconomic and natural shocks.

The second feature is that, unlike most other regional integration movements, there is no contiguity among the units. From Belize in the north which borders Mexico and Guatemala, to Guyana and Suriname in the south whose neighbours are Brazil and Venezuela, these countries are separated from each other by water. Spatial separation breeds distrust and suspicion and is injurious to regional co-operation. It partly explains the failure of the earlier attempt at Federation in the English-speaking Caribbean as well as the reluctance of the British to become full members of the EU.

Thirdly, and perhaps, most importantly, the countries do not pass Mundell's basic test for integration – the existence of a high degree of intra-regional trade. The United

States of America, Canada and the EU are the major trading partners of most Caricom countries. The CSME experiment is therefore aiming to show that a high level of pre-existing intra-regional trade is not a necessary condition for a successful regional integration movement. However, since most Caricom countries are mainly high-cost producers, there is a possibility that a single market and economy could result in welfare-reducing trade diversion if domestic production replaces imports.

In Caricom, there are also some challenges with respect to asymmetric shocks. While the Bahamas, Barbados, Jamaica and the Eastern Caribbean islands depend heavily on tourism, Trinidad and Tobago and Guyana do not. Accordingly, a crisis in global tourism would impact quite differently on the various countries. Higher crude oil prices benefit Trinidad and Tobago, as a major producer of petroleum products, but constrain economic growth in other member countries.

The revised Treaty of Chaguaramas which defined the Single Market focused initially on the integration of financial services through the removal of restrictions relating to rights of establishment, the provision of banking and other financial services, the movement of capital and the movement of labour. Additional provisions relating to other sectors and to the movement of labour came much later. In the process of implementation it was recognised that greater harmonisation of legislative systems and supervisory and institutional structures and macroeconomic policies would need to be more closely coordinated.

Given the commitment to implementing these and other commitments, the Caricom Single Market and Economy should have been inaugurated in early 2005. However, as with all integration movements, there are major policy issues which have gotten in the way of smooth progress. As a result, while the Single Market will be established this year, the Single Economy will come on stream later. There are four issues that come to mind which have prevented faster progress on the Single Economy. These are exchange rates, labour mobility, capital account liberalisation and the Caribbean Court of Justice.

First to exchange rates. Caricom is (perhaps) the only integration movement in which the various units have different exchange rate regimes. At present, Jamaica, Guyana, Suriname and Trinidad and Tobago have floating exchange rates, reflecting the fact that these countries all produce goods which respond significantly to price changes. All the other currencies are fixed against the US dollar. Right now it seems unlikely that any of the countries in question will wish to change their exchange rate system.

On a typical day this week, rates of exchange against the US dollar have ranged from 200 national units in the case of Guyana, to 1 in the case of the Bahamas. The plethora of exchange rates is a reason for concern among regional and foreign investors. There is therefore a proposal that the Caricom Single Market and Economy is to be anchored by a monetary union, with a single central bank and common currency. The original intention was for the common currency, say the Caribbean dollar, to be fixed at par against the US dollar. This move was intended to gain credibility for the Caribbean dollar and simultaneously remove the exchange rate risk currently attached to investing in the various countries.

Given the present situation, in order to accommodate both fixed and floating exchange rates in the monetary union, an alternative to a single currency could be some kind of Exchange Rate Mechanism of the type the Europeans had in the early 1990s. Such a system would call for the various currencies in Caricom to be rigidly fixed against each other while at the same time floating against extra-regional currencies. So far this proposal has not gained acceptance among all policy-makers. The exchange rate issue therefore remains a stumbling block.

The liberalisation of goods and services within the region has not been without its challenges. In the Barbadian economy, for example, there has been a contraction in output of the manufacturing sector. Some adjustment must be expected in the new global trade environment characterised by trade arrangements such as WTO and NAFTA. However, there has been some dislocation in sectors in individual countries

resulting from the regional trade arrangement, even though the region as a whole may have increased the volume of intra-regional trade.

Labour mobility is also a highly contentious issue. There is a feeling in some Caricom countries that full labour mobility will mean that excess labour will flow to the relatively higher-income economies in the region – e.g. the Bahamas, Barbados and Trinidad and Tobago. The major issues here relate to the impact of full mobility on employment prospects for host nationals, as well as the implications for the provision of health and social services, housing, pensions, education and the physical infrastructure.

Some commentators have highlighted the fact that after the formation of the EU, labour from Southern Europe has migrated in their numbers to the more developed North; they have noted, as well, the response of some governments such as that in the UK. This is why Caricom governments are adopting a phased approach to this issue. Already, full mobility has been granted to University graduates, media personnel, musicians, sportspersons and artistes; other categories such as self-employed persons and entrepreneurs remain under review.

Capital account liberalisation is a requirement for accession to the Caricom Single Market and Economy but currently, Barbados, the Bahamas, Belize and the East Caribbean islands have exchange controls. For these countries the issue revolves around the implications of capital account liberalisation for their ability to maintain the fixed exchange rate regime. The fixed exchange rate has been the anchor of macroeconomic policy in these economies and there is social consensus on retaining it. The countries are also mindful of the crisis in South East Asia during 1997 because the earlier removal of exchange controls had left the authorities with no way to detect, in a timely fashion, the speculative outflows which precipitated the economic meltdown. Some analysts have even wondered whether full capital account liberalisation is necessary to achieve the goals of the Single Market and Economy. The bottom line is that full liberalisation has not yet occurred.

Then there is the Caribbean Court of Justice. This Court is to replace the British Privy Council as the final Court of Appeal and will also be an original Court in the Caricom Single Market and Economy. As stated earlier, this body is important to dispute settlement and the preservation of rights. However, to date, although the Court has been inaugurated, only a handful of Parliaments have ratified its establishment. Some legal analysts have even questioned the constitutionality of the Court. There is also some disquiet among some sections of the populace as to whether the Caribbean Court of Appeal will dispense justice as impartially as the British Privy Council. Since it is inevitable that there will be legal disputes within the group, it is necessary to have the Caribbean Court fully accepted throughout this region as soon as possible.

There is a view that many of these issues, as well as others, would be better managed if there were some kind of supra-national body which could set goals and implement policy for the region as a whole. In the European Union, this is the role currently undertaken by the European Parliament, the Council of the European Union and the European Commission.

The Caricom Secretariat was not set up to function in the same way as the organs of the EU and is powerless to deal with a number of crucial issues. This is why a restructuring of institutions has high priority. The issues which could benefit from enhanced multinational decision-making include economic convergence, a stabilisation fund and the distribution of the benefits from integration.

Since 1992, the Caricom countries have established convergence criteria for accession to a monetary union. These criteria, which bear some resemblance to those established by the European Union, relate to exchange rate stability, the fiscal deficit, debt service capacity, inflation and foreign exchange reserves. However, there has been no systematic policy on what the various countries should do to achieve these targets. There is often a disconnect between the political intention and implementation of agreed policies at the national level. It has been suggested that this problem could be solved if a supra-national decision-making body was managing the process, providing the

necessary link between the political consensus and national policy-making. The same line of reasoning can explain the failure, to date, of the countries to establish a stabilisation fund which could be accessed by countries facing short-term payments imbalances or fiscal difficulties.

A supra-national body would speak as well to another issue of importance to integrating economies – the distribution of the gains from integration. In Caricom at present, Trinidad and Tobago has the strongest economy. Revenues from petroleum are more stable and predictable than foreign exchange earnings from the sale of sugar, light manufacturers, bauxite or tourism services on which the majority of the other countries depend. Add to this a stable exchange rate (a managed float) and cheap energy costs and it is easy to see why Trinidad and Tobago exports have saturated Caricom markets. The Trinidad and Tobago capital market has also been able to accommodate some capital requirements from the region. Moreover, Trinidad and Tobago commercial banks and other companies have bought interests throughout the region. In like manner, given its good social and physical infrastructure and high educational attainments, Barbados could be a leading provider of services.

It will not be in the interest of the group for any country or set of countries to absorb the vast majority of the benefits from the Single Market and Economy. Resources and capital would naturally gravitate to these growth points, causing social and demographic pressures to build. In the resource-starved regions resentment and frustrations would begin to undermine political stability. There must therefore be funds available to raise living standards in the poorest countries and a mechanism to manage their entire process. In this regard, a Development Fund is being discussed and it is hoped that it will be a beneficiary of the institutional strengthening which is being proposed.

Mr. Chairman, I trust that I have been able to provide a fair assessment of some of the dynamics of regional integration in our area. Whether we like it or not, the countries in this part of the world are being swept along by the winds of change at the global level. We have no choice but to prepare ourselves for whatever challenges and opportunities

come our way. The integration movements in the region have to continually devise ways to deepen the process with a view to raising the long-term trend of growth to a new level. Caricom has determined that the Caribbean requires a different approach to integration, in this case a Single Market and Economy. To date, the preferred sequencing seems to be free trade in goods and services, free movement of capital, the establishment of a development fund for managing countries disadvantaged during the adjustment period, a single currency, an arbitration court and a supranational authority. It is my hope that deeper regional integration, in whatever form, will be in the interest of all our countries.

I thank you.