



**THE CARIBBEAN QUEST:
DIRECTIONS FOR THE REFORM PROCESS**

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Port-of-Spain, Trinidad and Tobago

INFORMATION PAPER

United Nations Economic Commission for Latin America and the Caribbean (ECLAC)
United Nations Development Programme (UNDP)
Inter-American Development Bank (IDB)
Association of Caribbean States (ACS)

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THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

Rationale for the conference

The pace of political and economic change is accelerating rapidly, globally and within the Caribbean region. The early reform process of the 1980s and 1990s is now being deepened and widened and will give rise to a 'second wave' in public policy management. New solutions are being formulated to meet the rising challenges in the business of development and changes in the political economy of Caribbean societies.

In times of great change, leaders need an understanding of the current situation, a clear vision of the future, and the ability to think strategically, negotiate effectively, and consider long-term consequences of particular courses of action. Policy makers and government managers need the technical skills to promote policy change and the resolve to see it happen, while executives of public interest organizations need to be knowledgeable about policy choices and adopt innovative approaches in response to paradigm shifts in social and economic thinking, and create institutions and instruments for the governance process.

The "imperatives of adjustment" provided the policy rationale for the 1980s and 90s. The manifestation of present and future objectives requires the development of a strategic programme of action to ensure that the external and internal components of economic development strategies can be integrated into a continuing platform for change. It is hoped, that this process will work towards that synthesis, and provide a strategic framework for sustainable structural and institutional change for the Caribbean in the global economy.

The conference will provide a forum for an exchange of ideas among researchers at the university, policy makers in government and executives of the public interest in society, as participants ponder on points of departure from present prescriptions. As such, the conference will focus on the shaping of new development perspectives within the context of "second generation" strategic issues. This search for directions in the reform process, dictated as it is by the performance, pitfalls and prospects of Caribbean society, is indeed a Caribbean Quest.



THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

WEDNESDAY 25 JUNE 1997

0830-0945

Opening session

Opening remarks: *Mr. Jan Jacques Van Eyndhoven*, Resident Coordinator, United Nations System Activities

Welcome: *Mr. Lancelot Busby*, Officer-in-Charge, United Nations Economic Commission for Latin America and the Caribbean.

Remarks: *Mr. Miguel Ceara-Hatton*, Director, Association of Caribbean States.

Mr. Frank Maresca, Representative, Inter-American Development Bank.

Opening address: His Excellency, The Honourable Basdeo Panday, Prime Minister of Trinidad and Tobago

Feature address: Re-envisioning the reform process: A State-society synergy perspective - *Peter B. Evans*, Professor of Sociology, University of California, Berkeley, and Director, Economic Development Working Group, American Academy of Arts and Sciences.

1000 - 1230

SESSION 1: THE STATE OF STRUCTURAL REFORM IN THE CARIBBEAN- *After a decade of reforms in the Caribbean, what comes next? Are we now in a phase of macroeconomic volatility? What are the coping and accumulation strategies to overcome the emerging policy crisis?*

Chair: *Winston Dookeran (ECLAC)*

Presenters: **Economic developments in the Caribbean: An analysis of recent performance and policies** - *T. Harker (ECLAC)*

Macroeconomic management: Is it working? - *Bertus J. Meins (Inter- American Development Bank)*

Growth, savings and capital formation in a rapidly changing environment: Challenges facing Caribbean policy makers - *Ramesh Ramsaran* - (University of the West Indies)

External economic performance: Is it sustainable? - *Shelton Nicholls* - (University of the West Indies)

Open markets for increased Caribbean competitiveness - *Hermann von Gersdorff (World Bank)*

1230 - 1400

Lunch

1400 - 1700

SESSION 2: SOCIAL PROCESS FOR CARIBBEAN DEVELOPMENT - *Adjustment policies have given rise to a complexity of pressures in the social economy and have also raised critical issues in the areas of environmental management, communication strategies, gender and equity issues. Public policy has retreated from an active state involvement, and in some ways may have 'passed the buck' to the social partners. Would it help? Is the time not now for radically different approaches, and is there need for a new social development framework?*

Chair: *Wendell Mottley (Credit Suisse First Boston Corporation)*

Presenters: **Building and using social capital: A state-society synergy approach** - *Peter Evans (University of California, Berkeley)*

Social capital and economic policy - *Karl Theodore (The University of the West Indies)*

Strategies for poverty reduction in the Caribbean: How to be effective? - *Neville Duncan (University of the West Indies)*

Which globalization: Opening spaces for civic engagement - *Bhoendradatt Tewarie (The University of the West Indies)*

THURSDAY 26 JUNE 1997

0830 -0930

SESSION 3: INFORMATION AND GOVERNANCE

Chair: *Lancelot Busby* (ECLAC)

Presentation: **Information requirements for strategy change - *Fay Durrant*** (Association of Caribbean States) and Caribbean Documentation Centre, ECLAC

Keynote address: **Demanding a supply of good government: A coalition for reform of the State? - *Merilee S. Grindle***, Edward S. Mason Professor of International Development, Harvard University

0930 - 0945

Coffee break

0945 - 1200

SESSION 4: POLICY CHANGE AND STRATEGIC THINKING - *In the management process for change emphasis is now going into new frontiers of development and towards specific strategies that will build momentum for change in a global economy. Strategic thinking therefore is a tool that must be consistently applied. How can we identify these strategic opportunities and plan to make use of them? Will the politics rise to the demands of development?*

Chair: *Sarath Rajapatirana* (The World Bank)

Presenters: **Policy implementation: Meeting the organizational challenge - *Gary J. Reid*** (The World Bank)

Missing elements in strategic policy making: Are we clear about them? - *Arthur A. Goldsmith* (University of Massachusetts)

Strategic planning of institutional reform: Improving policy outcomes through more accountable structures - *William Ascher* (Duke University)

New implementation challenges: A flexible specialization paradigm - *Auliana Poon* (Caribbean Futures Ltd.)

1200 - 1330

Lunch

1330 - 1630

ROUND TABLE: NEW DIRECTIONS IN THE POLITICAL ECONOMY OF THE CARIBBEAN - *Why do some governments work and others do not, and why do some countries fail and others succeed? Structural adjustment implies changes in the political system, shifts in the relative power structure of societies, and political business cycles that sustain 'forward expectations'.*

Chair: *Trevor Harker* (ECLAC)

Presenters: **Challenging the State: Crisis and innovation** - *Merilee S. Grindle* (Harvard University)

'Unshackling' the private sector: A second generation agenda - *Sarath Rajapatirana* (The World Bank)

The integration movement in the Caribbean at crossroads: Towards a new approach of integration? - *Uziel Nogueira* (Institute for Latin American Integration)

Trading places: The future for preferences - *Demetris Papageorgiou* (Enterprise Research Institute for Latin America)

Global framework for policy reform: How do we use it to manage development? - *Wendell Mottley* (Credit Suisse First Boston Corporation)

Caribbean development: The premises of an emerging agenda - *Winston Dookeran* (ECLAC)

1630 - 1700

CLOSING SESSION

Chair: *Frank Maresca* (IDB)

Closing remarks: *Winston Dookeran* (ECLAC)



THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

Presenters

William L. Ascher

William Ascher is Professor of Public Policy Studies and Political Science, Duke University and is currently Director of Duke's Center for International Development research. Prior to his current position he held many senior positions including Director, Sanford Institute of Public Policy, Duke University, Durham NC. His research interests are in the areas of strategic planning and forecasting, Latin American development and politics and resource economics. He is the author of several books including *Scheming for the Poor: The Politics of Redistribution in Latin America* (1984) published by the Harvard University Press.

Winston Dookeran

Winston Dookeran is Senior Economist at the Economic Commission for Latin America and the Caribbean (ECLAC). His current research interests encompass the analysis of the effects of structural adjustments programmes in Caribbean countries in an attempt to identify new paradigms for development. He is a former fellow at the Center for International Affairs at Harvard University where he edited *Choices and Change: Reflections on the Caribbean* (1996) published by the Inter-American Development Bank. Winston Dookeran was the Planning Minister in the Government of Trinidad and Tobago. He is a graduate of the London School of Economics and Political Science, London University. In 1991 he was awarded an honorary Doctor of Laws degree from the University of Manitoba, Canada.

Neville C. Duncan

Neville C. Duncan is currently Acting Director of the Institute for Social and Economic Research, The University of the West Indies, Mona, Jamaica. A political scientist, Dr. Duncan has widely researched and published on Caribbean government and politics, political economy, poverty, community empowerment, and non-governmental organizations, and on issues of international relations. His ongoing research is focussed on

Caribbean International Relations issues, Good Governance and Community Development. More recent publications include *Mechanisms of Impoverishment: The Role of Bretton Woods Institutions and Recommendations of Caribbean NGOs*; and *Caribbean Integration: The OECS Experience Revisited*. He has undertaken considerable scholarly work in governance, poverty and community development and has had consultancies with IDB, World Bank, UNICEF, ECLAC/CDCC, CARICOM, OXFAM and NGOs.

Fay Durrant

Ms. Fay Durrant is Director, Budget and Administration at the Association of Caribbean States. Ms. Durrant is a specialist in the areas of information and communication technology policies, assessment of social reforms and communication participation in policy making. She was previously Senior Program Specialist with the International Development Research Centre (IDRC) where she was responsible for providing technical assistance and financial support to development programs in Latin America and the Caribbean. She has also worked with the CARICOM Secretariat and with ECLAC. Among her many publications are *Assessing the impact of information on policy formulation*, presented to FID/INFO'95, Havana, Cuba, 1995 and *Information for Policy Formulation: Latin America and the Caribbean* (IDRC) 1995.

Peter B. Evans

Peter B. Evans is currently Professor of Sociology at University of California, Berkeley, Director of the Economic Development Working Group of the American Academy of Arts and Science's Social Capital and Public Affairs Project, and Advisor to the World Bank group preparing the forthcoming 1997 World Development Report *The State in a Changing World*. He has worked on the political economy of development in Latin America, Africa and Asia for over 30 years. His research and writing address the comparative political economy

of developing countries, with a focus on industrialization and the role of the state. His current research interests include the link between social capital and economic development. His recent publications include an edited volume entitled *State-Society Synergy: Government and Social Capital in Development* (1997) and *Embedded Autonomy: States and Industrial Transformation* (Princeton University Press 1995).

Arthur A. Goldsmith

Arthur Goldsmith is Professor of Management, University of Massachusetts, Boston. Professor Goldsmith has published widely on global, economic and management and issues and has consulted for several international development agencies. His most recent articles have appeared in *International Review of Administration Science*, *World Development*, *Journal of Development Studies*, and *Development and Change*. He has studied at Boston University, the University of New Hampshire and Cornell University, where he received his Ph.D. with a dissertation on "The politics of rural stagnation ... and agrarian change in Jamaica". During the 1988 academic year he was a Visiting Scholar at the Harvard Institute for International Development. Professor Goldsmith's latest book *Business, Government, Society: The Global Political Economy* was published in 1996.

Merilee Grindle

Merilee Grindle is a specialist on the comparative analysis of policy-making, implementation and public management in developing countries. She focuses much of her attention on issues of policy change and reform leadership. Her most recent book "Challenging the State: Crisis and Innovation in Latin America and Africa" focuses on the paradox of states which have been weakened by economic and political crisis just as their capacity to encourage development and provide for effective government is most needed. A political scientist who received her Ph.D. from MIT, her current research analyzes the impact of the state and its policies on economic and political development. At the Kennedy School of Government she teaches courses on the politics of development and poverty

alleviation policy. At Harvard Institute of International Development, she has contributed to projects on rural development, public sector reforms and agricultural policy in developing countries. In addition, she has participated in a project to design and implement graduate degree programmes in public policy in Singapore and Bolivia. She has consulted for the World Bank, the U.S. Agency for International Development, the Inter-American Foundation, the Overseas Development Council and the United Nations.

Trevor Harker

Trevor Harker is Regional Economic Adviser at the Economic Commission for Latin America and the Caribbean. His research interests range from analysis of sustainable development policies and their impact on Caribbean economies to the implications of the liberalization of these economies in light of changing global trends. He is author of *Cuba - Some comments on the Economic Adjustment Process* - FESCARIBE, Editorial Nueva Sociedad (1996). Trevor Harker has worked with the Ministry of Foreign Affairs, Jamaica where he was Deputy Director, Economics-Foreign Policy, Multilateral Institutions. He attended the University of the West Indies, Columbia University and received his M.A. Economics from Boston University.

Bertus J. Meins

Bertus Meins is currently the regional economic advisor for Central American and Caribbean countries at the Inter-American Development Bank (IDB) and has also served as the IDB's representative in Jamaica. His research interests has been in the Caribbean and Central American economies and one of his most recent publications has been *Adjustment, Reform and Growth in the Caribbean*, published in *Choices and Change: Reflections on the Caribbean* (1996). Prior to joining the IDB he served in the Ministry of Finance and the Ministry of Foreign Affairs in the Netherlands and was the Executive Director in the International Fund for Agricultural Development in Rome.

Wendell Mottley

Wendell Mottley is Senior Advisor at the Credit Suisse First Boston Corporation. He is currently engaged in financing issues of economic development in the both the public and private sectors. Formerly, he was Minister of Finance in the Government of Trinidad and Tobago where he was responsible for deepening the structural adjustment measures in the Trinidad and Tobago economy, which included a privatization programme, stabilization in foreign exchange and budgetary accounts and the development of a policy framework for structural change. Wendell Mottley is a graduate of Yale University and Cambridge University where he studied economics.

Shelton Nicholls

Shelton Nicholls is currently Lecturer in the Economics Department, University of the West Indies, St. Augustine Campus, Trinidad and Tobago. He has published in the areas of economic modelling, time series analysis and economic integration. He is joint author of *Modelling and Forecasting Caribbean Economies Problems and Challenges* in (1996) published by the Caribbean Center for Monetary Studies. Dr Nicholls is a graduate of the University of the West Indies and received his Ph.D. in Economics from the University of London (Queen Mary College).

Uziel Nogueira

Uziel Nogueira is Director a.i., of the Institute for Integration of Latin America and the Caribbean (INTAL), having previously been Senior Integration Economist responsible for preparing integration/trade related reports and Regional Technical Cooperation projects in Central America and the Caribbean. Dr. Nogueira has published articles in economic, social and energy issues in Latin America and the Caribbean. Among these are the preparation of *Labour Relations in The Context of Economic Integration* (IDB) in 1995 and preparation of the Caribbean chapter of the *Annual Integration Report* of the IDB in 1996. Dr. Nogueira received his Ph.D. from the Department of Economics and Natural Resources at the Michigan State University.

Demetris Papageorgiou

Demetris Papageorgiou is an associate at the Enterprise Research Institute for Latin America. Until recently, he was an Economic Adviser with the World Bank, where he was Chief of the Country Programs division for Brazil, Peru and Venezuela and earlier Chief of Trade and Industry for the Brazil Department. He directed and co-authored the *World Bank Comparative Study on Trade Reforms* and also co-edited a volume of essays on trade liberalization. He has also held various assignments in the research and development policy analysis departments of the World Bank prior his work in the Operations department of the institution.

Auliana Poon

Auliana Poon is currently Managing Director of the Caribbean Futures consulting practice in Trinidad and Germany which specializes in strategic action planning and competitive strategies for tourism policy and development. She is the author of *Tourism, Technology and Competitive Strategies* (1993) published by CAB International and received her D. Phil degree from the University of Sussex, England. She is also a graduate of the University of the West Indies. Auliana Poon has undertaken assignments in South and Southern Africa, the Indian Ocean, South Asia, Singapore, the United States as well as the Caribbean including Cuba. Her most recent book is *Tourism Policy and Strategy for South Africa* published in 1996.

Sarath Rajapatirana

Sarath Rajapatirana is currently Economic Advisor in the Operations Policy Department in the World Bank. Prior to this assignment he was Division Chief for Trade and Industry and later Trade Policy Adviser in the Latin America and Caribbean Region. His current interests are in regulatory reform and the political economy of reform in which area he has published his latest book, *Trade Policies in Latin America and the Caribbean: Privatization, Progress and Prospects* (1997) published by The International Center for Economic Growth. He directed the World Bank's *Macroeconomic Comparative Study of Developing Countries* with a group of distinguished academics.

He was director of the 1987 World Development Report, a member of the World Bank Economic Review editorial board. Before joining the World Bank, he was Chief of Money and Banking Research in the Central Bank of Sri Lanka. He was educated at the University of Sri Lanka and the University of Minnesota and was a Fulbright Scholar to the United States.

Ramesh Ramsaran

Ramesh Ramsaran holds a Ph.D in Economics from the University of the West Indies and is currently Reader at the Institute of International Relations, The University of the West Indies, St. Augustine, Trinidad. His current research interests centre on fiscal and monetary policy, the movement of capital and the role of domestic and foreign savings in economic development. He is the author of several books on Caribbean development. Among these are *The challenge of Structural Adjustment in the Commonwealth Caribbean* (Praeger, 1992) and *The Monetary and Financial System of the Bahamas* (I.S.E.R., UWI, 1984). His most recent work *An Introduction to International Money and Finance* (Macmillan) is forthcoming in 1997.

Gary Reid

Gary Reid is a Fiscal Economist working in the World Bank's Latin America and Caribbean (LAC) region. He is currently engaged in Task Managing public sector modernization projects in Trinidad and Tobago, Ecuador and Bolivia, and providing support to similar projects in a number of LAC countries including Jamaica and Peru. His recent dissemination of work in this area includes presentations at the World Bank's "Government Reorientation: New Thinking on Administrative Reform" held in February 1997, the Bank's Economists' Week, October 1996, the American Society for Public Administration Annual Meetings, July 1996 and the World Bank's annual Public Sector Management Symposiums, December 1995 and 1996. He holds a Ph.D. in Urban Planning from Harvard University and joined the World Bank in 1991, having previously been an Associate Professor in the School of Public Administration at the University of Southern California.

Bhoendradatt Tewarie

Bhoendradatt Tewarie is currently the Executive Director of the Institute of Business (IOB) of the University of the West Indies, Trinidad. He is also chairman of the National Institute of Higher Education, Science and Technology (NIHERST). His current interests lie in communication strategies for economic development and in the processes for human resource management and development. He is a former Minister of Industry and Commerce in the Trinidad and Tobago Government during the period when structural adjustment measures were being initiated and implemented. Dr. Tewarie received his Ph.D. from the Pennsylvania State University where he was also a Visiting Scholar. He also attended the Northwestern University and the University of Chicago and was a Fulbright Scholar to the United States.

Karl Theodore

Karl Theodore is Senior Lecturer, Department of Economics, at the University of the West Indies (UWI), where he is also the Co-ordinator of the Health Economic Unit (HEU). His present research interest has been on the social implications of adjustment in Caribbean economies and in examining issues of poverty and social security in structural adjustment programmes. He was Dean, Faculty of Social Sciences, UWI and is a consultant to the World Bank on matters relating to the economics of the health sector. He is a graduate of the London School of Economics and received his Ph.D. in Economics from Boston University.

Herman von Gersdorff

Herman von Gersdorff is Senior Economist at the Latin American and the Caribbean Region, World Bank. His professional experience includes: Private Sector Development Specialist for the Andean Countries and the Caribbean (World Bank); Country Economist for Trinidad and Tobago, Guyana, Belize, and the OECS (World Bank); Economist (ECLAC); Professor for Project Evaluation (Instituto Tecnológico Autónomo de México); Program Officer (UNIDO); Professor for Price Theory (Universidad de Chile); Professor for Price Theory (Universidad del Norte, Chile). He was educated at the University of Chicago and the University of Cologne, Germany.

THEME PAPER

THE CARIBBEAN QUEST: NEW DIRECTIONS IN THE REFORM PROCESS

Structural change, as an issue of strategic importance to Caribbean economies, has engaged the minds of academics, policy makers, as well as economic and social planners for well over a decade. Structural adjustment programmes have been adopted in many Caribbean countries, however, the workings of these economies are yet to experience sustained economic growth with equity and the pace of political change is accelerating rapidly, globally and also within the Caribbean region. The early reform process of the 1980s and 1990s is now being deepened and widened and is about to give rise to a "second wave" in public policy management. Now there are rising challenges in the business of development.

The conference - **The Caribbean Quest: New Directions for the Reform Process** - is aimed at increasing understanding of Caribbean development and at facilitating the development of a strategic framework for sustainable structural and institutional change for the Caribbean in the global economy. Some of the vital questions which will be addressed by the Conference are:

- *Have economic reforms in the Caribbean increased macroeconomic stability in the region?*
- *How can fiscal and monetary policy be used to help reduce macroeconomic volatility?*
- *How has economic growth been affected by reform and what are the prospects for accelerated growth in the future?*
- *Is the region's export performance sufficient to sustain economic growth?*
- *What can be done to promote the more rapid, efficient and equitable accumulation of savings and investment in physical and human capital?*
- *How has reform affected unemployment and poverty?*
- *What can be done to ensure that all groups in society benefit from economic growth?*

In short, what the ECLAC Conference will be seeking to address are three fundamental questions:

- *Are the reforms producing stability?*
- *Are the reforms producing growth?*
- *Will the growth be shared?*

The following paper is divided into four sections. In Section One, we look at the background to the implementation of structural adjustment programmes in the Caribbean. Drawing on the work of Bertus Meins ("Adjustment, Reform and Growth in Caribbean economies"), we examine, in some detail, the rationale for reform strategies in the Caribbean, the components of the strategies and the performance of the policy reform programme. We also examine expectations that are still to be realized. In Section Two, we examine issues in Caribbean social development. We focus, in particular, on the social dimensions of adjustment: education and health care, employment and real wages, and poverty eradication. In Section Three, we examine the programme for policy change and strategic thinking and focus, in particular, on the "missing ingredients" for Caribbean economic development. In Section Four, we look at the issue of new directions in the political economy of the Caribbean and also offer some concluding comments.

SECTION ONE

Rationale for reform strategies in the Caribbean

After a decade of reforms in the Caribbean, what comes next? Are we now in a phase of macroeconomic volatility? What are the coping and accumulation strategies to overcome the emerging policy crisis?

Structural adjustment packages were first implemented in the Caribbean region during the late 1970s as a result of the need for countries to deal with short-term balance of payments difficulties. The IMF structural adjustment package focuses on macroeconomic adjustment and usually incorporates the following measures:¹

- Devaluation of the official exchange rate;
- Stringent anti-inflation policy involving:
 - control of bank credit through an increase in interest rates and reserve requirement ratios;
 - reduction in the fiscal deficit through curbs on government expenditure, in particular, government spending on the social services - which, in turn, reduces the social safety net;
 - increases in public sector prices and increases in taxes;
 - dismantling of price controls;
- Financial liberalization and removal of import restrictions;
- Opening up the economy to foreign direct investment.

Background to the external debt crisis

During the last decade, the region's economies underwent a formidable transition. External debt grew substantially, slowing down international growth rates and investment propensities, thereby decreasing the demand for Caribbean goods and services and diverting capital flows. These circumstances led to external current-account fluctuations and fiscal disequilibria. Exports and imports diverged widely, creating a regional trade gap of almost \$1 billion per annum between 1983 and 1993. At no point in the last decade has there been a regional current account surplus.

As a result of increasing current account deficits, government borrowing abroad from the IMF increased substantially. The region's consolidated external debt, which averaged 35 to 40 percent of GDP during the 1970s, increased rapidly with the onset of the 1980s, climbing to around 70 percent of GDP by 1987-1988. However, as stabilization and liberalization efforts began to bear fruit and structural reform measures shifted the role of engine of growth and innovation from public enterprise to the private sector, private capital flows increased substantially causing a steady reduction in the debt to GDP ratio to 55 percent of GDP by 1988.² Nevertheless, a number of Caribbean economies experienced difficulties in meeting their external debt servicing obligations, most notably Jamaica, the Dominican Republic, Guyana, Haiti, and Trinidad and Tobago.

As a consequence of having large external deficits, many Caribbean economies have been forced to devalue their official exchange rates, including the Dominican Republic, Guyana, Jamaica, Trinidad and Tobago and Suriname - all of which have gone through the traumatic experience of unduly delayed and substantial devaluations. Such devaluations have, in most cases, induced substantial short-term inflationary consequences.³

There are considerable economic costs associated with maintaining overvalued exchange rates and these include missed export and job-creation opportunities as well as missed opportunities to diversify the exports and job base.

The components of reform strategies

As a result of the myriad of negative external shocks (growing debt, increasing balance of payments deficits, decline in terms of trade, and recession in developed economies), as well as the adaptation of unsuccessful development strategies, the Caribbean region has been forced to undertake a number of substantial reforms. In this regard, a number of policy recommendations which together form an integral system for stimulation of economic recovery have been advocated to reinvigorate dormant and suppressed market forces. These policies have come to be known collectively as the Washington Consensus.⁴ The Washington Consensus emerged as the consensus most acceptable to multilateral institutions, such as the World Bank and the IMF, policy research institutes,

macroeconomic and development scholars as the policies which would be most effective in restoring internal and external equilibria while ensuring sustainable economic growth. The Washington Consensus consists of the following policy prescriptions:

- **The elimination of fiscal deficits:** Fiscal deficits should be no larger than 2 percent of GDP (in exceptional circumstances) and should favourably be converted to surpluses. Recourse to inflation tax should generally be avoided as a means of financing fiscal deficits. Moreover, there is need to ensure that debt is not allowed to accumulate, as this will create a drain on the country's financial resources.
- **Need to prioritize fiscal expenditure:** Fiscal expenditures should be directed towards areas with high economic rates of return and away from low efficiency areas. In particular, there is need to ensure that capital expenditure is increased, while recurrent expenditure is reduced to manageable levels.
- **Tax reform:** This involves lowering marginal tax rates to reduce fraud and evasion and to improve the economy's incentive structure as well as the tax administration. It would also involve broadening the tax base.
- **Financial liberalization:** Preferential interest rates for privileged borrowers are to be eliminated. The goal is to have only market determined interest rates in existence.
- **Exchange rate:** There is need to keep the exchange rate at a sufficiently competitive level to induce rapid growth of non-traditional exports. In most cases, this will necessitate devaluing the country's currency so as to achieve equilibrium in the real exchange rate.
- **Trade liberalization:** As macroeconomic conditions are altered, quantitative restrictions are to be replaced by tariffs which will be progressively reduced. This is necessary so as to eliminate the export bias which exists in Caribbean economies and to enable them to overcome their import substitution orientation.
- **Direct foreign investment:** The legal and procedural barriers to foreign direct investment should be abolished; equal treatment should be accorded to both domestic and foreign investors.
- **Privatization:** It is generally more efficient to have state enterprises transferred to private ownership as this will allow for greater efficiency as well as enable the state to focus its scarce fiscal and human resources and management skills on its core functions.
- **Deregulation:** Regulation which impedes firm entry and restricts efficient competition should be abolished. Regulations should concentrate on environmental protection, labour, safety and prudent supervision of the financial sector.

- **Property rights:** The legal system should ensure that property rights to the private sector, the informal sector, micro-businesses, and foreign direct investors are secure, as this will stimulate productive investment.

The Washington Consensus is now part of the orthodox literature. There are now clear signals that there is need to re-envision the reform process as there are now paradigm shifts in social, economic and political development that are still to be realized.

Performance of the policy reform programme

Several of these reform measures have been implemented, in many instances with positive results. As Bertus Meins notes, the most outstanding example has been Guyana which teetered on the brink of disaster in the mid 1980s, but has made a remarkable turnaround since the introduction of its economic recovery programme in 1988. In Meins' view, "the results so far have lagged behind expectations, basically because the prescribed reforms were not completed fully or in a timely manner, not implemented in the proper sequence or were simply overtaken by unforeseen external shocks."⁵ A striking example of this is Trinidad and Tobago which was forced to float its currency in April 1993, resulting in a nominal depreciation of one third. This sizable depreciation was the result of the strong increase in aggregate demand which came as a result of the oil price increase of 1990, which caused the terms of trade to increase by 20 percent and which led to a more than 25 percent increase in imports.

Fiscal deficit

One of the useful lessons to be learned from the era of excessive fiscal deficits is that these are highly inflationary and ultimately self defeating because of the limited opportunities for long-term external financing. Fiscal deficits often induce excess domestic demand which translates into additional imports. This increase in imports may lead to a deterioration of external balance, leading to a fall in reserves and, given the usual hesitancy to correct exchange rates, a currency overvaluation which in turn inhibits exports and may place the economy at risk of sliding into a recession.

Savings and investment

The Caribbean region has made substantial headway in attracting foreign investment. This increase in savings can be attributed to improved fiscal policies and incentive structures, a reduction in unnecessary government interference in the economy, more outward-oriented trade policies, and the removal of red tape for investors. However, additional measures need to be taken to bring investment back to at least 20 percent of GDP in these countries.

Supply-side measures

Regional countries have made substantial headway in removing obstacles to private investment, both local and foreign. Positive private sector response to improved incentives for export-oriented activities is noticeable. However, the labour market continues to be a problematic area as far as removal of institutional obstacles are concerned. The Caribbean region is slow to adopt structural changes in its labour market. As long as these institutional obstacles exist in the labour market, regional organizations will fail to reach the high efficiency standards required for successful international competition, and will risk becoming extinct in the long term.

The medium-term outlook

The international environment is characterized by positively stronger global competition, the creation of strong trade blocs, the globalization of international enterprises and donor fatigue. Caribbean economies will be forced to make a number of structural changes if they are to survive and progress into the twenty-first century. Jamaica, for instance, will have to concentrate on improving the consistency of its macroeconomic policies, whereas the Dominican Republic and Guyana will need to devote a substantially larger share of their budgets to investment in human resources, including health care and education. Trinidad and Tobago, on the other hand, will need to concentrate on overcoming its Dutch disease. It will also be necessary for it to take a hard look at supply side measures and adopt a policy framework conducive to the rapid growth of non-traditional exports.

Expectations that are still to be realized

"While the future holds formidable challenges for the Caribbean, the region's remarkable resilience in the adverse international climate of the 1980s and its ongoing recovery suggest its potential to overcome future adversity as well."⁶ There is a definite need for a more forward and outward looking strategic orientation aimed at defining niches in the international market of goods and services where the region can successfully compete. In this regard, the region will be forced to meet a number of medium-term challenges that are critical to its long-term prosperity. In particular, the region will have to:⁷

- (a) Ensure that the modernization and reform processes are economically viable;
- (b) Promote social and distributive equity, including between generations;
- (c) Assist the private sector in increasing its price and non-price competitiveness;
- (d) Improving the investment climate for the private sector by removing unnecessary controls and institutional obstacles;

- (e) Assisting the regional private sector in reaching a state of up-to-date preparation to meet global competitiveness;
- (f) Attracting the most appropriate technologies to bolster the region's competitiveness and adequately protect the environment;
- (g) Support a comprehensive investment effort to bring the region's human resource base up to par with the emerging competitive challenges;
- (h) Define the most appropriate future regional and supra-regional trade linkages, given the rapid emergence of trade blocs;
- (i) Consolidate democratic structures through political consensus building and the promotion of good governance;
- (j) Establish an optimal size and role for State enterprises by moving it away from productive activities and reassigning the implementation and managerial capacity to areas where intervention by the State is indispensable such as health care, education, social safety and environmental protection.

SECTION TWO

Issues in Caribbean social development

Adjustment policies have given rise to a complexity of pressures in the social economy. Public policy has retreated from an active State involvement, and in some ways may have 'passed the buck' to a widened definition of social partners. Would it help? Is the time not now for radically different approaches and a new social development framework?

As Ramesh Ramsaran notes, structural adjustment has come to be associated with "suffering and hardship - high prices, devaluations, unemployment, scarcities, lower wages, high taxes, increasing utility rates, deteriorating social amenities and public services."⁸ Generally it has brought about a falling standard of living, and has generated crime, social tensions and a deteriorating social and economic situation. The policy prescriptions advocated by the IMF have been stringent and have consequently generated a great deal of unpopularity because of the reduction in incomes and the disruptions in lifestyles which have followed in their aftermath.

Poverty eradication

Recent World Bank estimates put the poverty levels in the Caribbean at 38 per cent of the total population, with levels ranging from 12 to 42 percent. Most disturbing, however, is the fact that these levels represent increases over levels of poverty 10 and 15 years ago. Although the majority of Caribbean countries are rated as having either high or medium Human Development Indices, the region is experiencing a rising trend of poverty. Most of the countries have experienced low or negative economic growth rates during the 1980s and 1990s, and as a result have suffered overall declines in per capita GDP, in real wages and in social sector expenditure.

General living standards have declined and poverty has increased. Essentially, these declines have been the result of deteriorating economic conditions, and the region's lack of competitiveness. They have also reflected government policy responses which have not been sufficiently sensitive to their poverty generating impacts. In addition, governments have found it increasingly difficult to sustain public expenditure, especially for human resource development and other basic social services. Consequently, standards of education, health care, safety nets and social infrastructure have been eroded as resources diminished.

As the World Summit for Social Development (WSSD), (held in Copenhagen, Denmark 6-12 March 1995) concluded, the eradication of poverty cannot be accomplished through anti-poverty programmes alone but requires democratic participation and changes in economic structures in order to ensure access to resources, opportunities, and public services for all. As such, governments must, of necessity, be prepared to undertake policies geared to the more equitable distribution of wealth and income.

The attainment of sustained development that is people-centred depends on the outcome of a multiplicity of initiatives taking place at different levels and sectors of a society. Poverty eradication is the end result of sustainable human development. A successful directional plan of action should, therefore, seek to identify issues and actions in relation to: (a) addressing factors contributing to impoverishment or social inequities; (b) strategies for sustained economic growth and the promotion of productive employment for poverty eradication; (c) meeting basic human needs of all: access to social services; (d) empowering communities: promoting strategies for sustainable livelihoods; (e) formulation of integrated social and economic strategies for poverty eradication; and (f) structural and institutional mechanisms for effective poverty eradication.

The central elements of a successful poverty eradication attempt should include: investment in human resources, productive employment at fair wages, technical progress and consensus building.⁹ The critical thesis of the approach is that the objectives of growth and equity must be advanced simultaneously rather than sequentially. They must be approached as a single task. To achieve economic growth with reasonable improvement in equity, each country must make efforts not only to provide its modern sectors with a greater productive capacity, but must also raise the productivity of lagging ones as well. Governments must, therefore, ensure that poverty issues are systematically addressed with visible effect.

Education and health care

Both education and health care have, to some extent, been adversely affected by the structural adjustment programmes which have been implemented. As regards health care, increasing numbers of households have less money to maintain nutritional standards, less disposable income to pay for health care and less from which to make contributions to pension and health insurance schemes. However, as Bertus Meins notes, between 1980 and 1992, health indicators have improved throughout the region, with the exception of crude death rates in Guyana.¹⁰

However, a similar positive conclusion cannot be extended to the education sector as fiscal austerity has forced governments to rationalize education expenditures, both current and capital. Guyana has been the country most adversely affected by its structural adjustment package in this regard as recurrent expenditure was reduced from 5.6 percent of GDP in 1986 to 2.2 percent in 1992 as a result of the need to service both external and internal debt. As a result of the implementation of these measures, Guyana's educational achievements record witnessed a severe decline.

It should be noted, however, that in order for future competitiveness and social cohesion to increase it will be necessary to increase education expenditures as there are high rates of return associated with education in the long term. Thus, a high public and private priority needs to be accorded to education.

Employment and real wages

However, there are other ways in which structural adjustment has affected the social sector, apart from health and education. The most notable among them being its effect on employment and real wages. Real wages have plummeted in many Caribbean countries including Barbados, Trinidad and Tobago, Guyana, Jamaica, the Dominican Republic, and Suriname.

The rising unemployment rate for the region may very well be the result of an increase in the levels of underemployment, the growth of the informal economy or the result of a decrease in the number of hours worked per employee rather than the laying off of workers by businesses.¹¹ Estimates of the size of the informal sector go as high as 37 percent of the labour force, and even these estimates probably undercount the involvement of women. Most importantly, as a result of the decline in real wages and employment, the real purchasing power of both public and private sector salaries have fallen. In other words, an increasing number of our Caribbean people have descended into poverty. Needless to say, the social dimensions of the adjustment process requires considerable attention unless the medium-term gains become lost in social polarization and strife. As such, the recent erosion of social expenditures in most regional budgets is of great concern.

SECTION THREE

A programme for policy change and strategic thinking

In the management process for change emphasis is now going into new frontiers of development and towards specific strategies that will build momentum for change in a global economy. Strategic thinking is, therefore, a tool that must be consistently applied. How can we identify these strategic opportunities and plan to make use of them? Will the politics rise to the demands of development?

The question must therefore be asked: "How do we, within the context of structural adjustment, identify strategic opportunities and plan to make the most suitable use of them?" Without doubt, it is necessary to make a shift in focus in order to achieve growth following the adjustment process. In order to do so effectively, it would be necessary to move beyond the first generation of reforms: macroeconomic policy, trade reform, financial reform and privatization and to focus on second generation reforms. These second generation reforms would encompass, as Nancy Birdsall points out, three key elements: exports, education and enabling government, which she describes as the missing ingredients for the Caribbean.¹²

According to Birdsall, the benefits of rapid export growth in East Asia have been considerable and can be emulated by developing countries, like the Caribbean. This is because the growth of exports encourages the rapid growth of employment and eventually wages, which raises the demand for labour and contributes to the relative equality of incomes.¹³ Exporting may also create a second advantage in that it forces countries to be globally competitive, thereby generating rapid productivity gains.

The second key variable which Birdsall alludes to is education. Education needs to be accorded a high priority as it contributes not only to wage and productivity growth but also to fertility decline, which makes higher investment in education per child possible.

The third and final element Birdsall refers to in her list of second generation reforms is an enabling government. In her view, government should be viewed not as an engine of growth but as an enabler or catalyst of private sector growth. In particular, governments need to create a predictable and reliable environment for investors, and thus an environment friendly to the business sector.

However, as far as the region's performance in these sectors is concerned, the region's performance has not been as favorable as it should be. With respect to exports, the region's excessive reliance on traditional, primary exporting commodities has made Caribbean economies more vulnerable to terms of trade decline, to Dutch disease, in the case of Trinidad and Tobago, and to vagaries of protection as practiced by the industrialized countries of the North.¹⁴ It is, therefore, critical, as Birdsall argues, for Caribbean economies to diversify their exports, and to concentrate on services, on tourism and on value-added natural resource based exports in order to take advantage of their relatively well educated labour force.

With respect to education, Birdsall has pointed out that most Caribbean countries have a distinguished record of attention to the social services, including education. The rates of secondary school enrolment in Trinidad and Tobago and Barbados (85 percent in both countries in the late 1980s) have been impressive vis-a-vis the rest of Latin America (where rates are 50 percent).

In terms of health care, which is another form of human capital development, the region has made considerable progress. The under-five mortality rate in Trinidad and Tobago and Jamaica is the lowest for the entire Caribbean region.

In Birdsall's assessment, then, education and human capital investment in general look fairly good. However, Caribbean education, though good in comparison with the rest of the developing world, is at risk. In many Caribbean countries, public expenditures on education have decreased and the quality of education has declined as a result of decreases in the proportion of public expenditure being spent on in-service teacher training, books and the maintenance of infrastructure. Thus there is a need to ensure that the dramatic decline in the quality of education that has occurred in Guyana is not repeated in other Caribbean territories.

The final element in the series of second generation reforms which needs to be addressed is that of enabling government. As Birdsall has emphasized, government needs to be seen "not as the engine of economic growth, or as the caretaker of the population - but as the enabler or the catalyst for the private sector to operate effectively in every respect."¹⁵ What this means effectively is that while the initial stabilization reforms may be politically difficult, they are technically more straightforward than the second round of deeper reforms which are more complex and more demanding institutionally.

The second round of reforms which Birdsall alludes to involves a two-part agenda. The first part of the agenda is the need to reduce the government's role by eliminating government-owned monopolies and reducing government intervention which inhibits private sector investment. The second part of the agenda is the strengthening of government's role by improving its regulatory capacity, its judicial institutions, and its ability to establish and enforce the rules which are essential to a sound, stable climate and which are conducive to private sector investment.

To accomplish these goals, three major strategies need to be implemented: namely, privatization, deregulation and openness to foreign direct investment.

As most economies which have engaged in privatization have learnt, privatization requires a strong government in order to ensure that private monopolies do not simply replace public monopolies with all the costs this entails. As Birdsall comments, "privatization is more than a technical procedure: it requires building a political and social consensus around removing the State from certain activities, as well as defusing concerns about who will gain and lose from privatization."¹⁶

Deregulation is also a necessary requirement of the agenda of reforms. However, deregulation may prove to be disruptive for the labour market as most Caribbean economies have a very rigid entitlement structure which inhibits private investment, reduces efficiency and exacerbates problems of inequity by reducing employment opportunities.

The third strategy which needs to be implemented as part of the agenda of reforms is that of opening up the economy to foreign direct investment. The problem which exists is that while most Caribbean economies appear open to investment, most are not. In Trinidad and Tobago, for instance, restrictions on foreign direct investment have precluded investors from more than 25 sectors, including management services, land development, tire treading and the manufacture of cement blocks.

As a final strategy, Birdsall recommends that Caribbean governments should deepen reform of the State, as this will "reduce further the government's involvement in productive sectors where private initiative can be more effective and enhance government's role as an effective manager of the enabling environment. This is the key to higher rates of investment, and thus higher employment and growth."¹⁷ What is needed is not big government, but one which is an enabler of the private sector.

Also, as Sarath Rajapatirana notes, "Economic development during the last thirty years provides a continuing experiment from which important lessons can be learned. These lessons are both positive and negative, from economies that have succeeded and others that have failed. Among the former, the East Asian economies provide valuable lessons that cannot be ignored by policy makers in other parts of the world."¹⁸ In Rajapatirana's view, the success of the East Asian economies poses two essential questions for Caribbean countries. Firstly, what policies led to the recorded and undisputed success of these East Asian economies? Secondly, how relevant is that experience to Caribbean economies, not only in terms of their domestic policy environments but also their external environment, such as the prospects posed by NAFTA.

Generalizing from the success of seven East Asian Newly Industrializing Countries (namely, Hong Kong, Singapore, South Korea, Taiwan, Indonesia, Malaysia and Thailand) and Japan, Rajapatirana states that economic success within a post-structural environment requires:¹⁹

- Low rates of inflation;
- The maintenance of a relatively stable and competitive real exchange rate;
- The ability to sustain Balance of Payments positions, to meet payment obligations and avoid Central Bank financing;
- Rapid rates of export growth;
- Fiscal discipline as evidenced by the containment of deficits;

- High rates of private sector investment fueled by a high savings rate;
- High rates of Foreign Direct Investment, so as to transfer appropriate technology, generate employment, create labour force training opportunities and generate foreign exchange;
- High educational attainment levels as evidenced by increases in the coverage and the quality of education, especially at the tertiary level;
- Growth in Total Factor Productivity: This refers to growth independent of increased inputs - growth associated with efficient allocation, technological catch-up, increasing returns, and organizational changes;
- Efficiently functioning labour markets which are capable of matching the needs of industries with the preferences of the labour force.

All of the above factors must work together in tandem and are critical elements for economic success to take place.

SECTION FOUR

New directions in the political economy of the Caribbean

The failure of certain economies to attain growth and equitable development while undertaking a programme of structural adjustment may be due to a variety of factors. As Ramesh Ramsaran notes, structural adjustment is not a simple notion but is rather “the outcome of a complexity of forces operating in the world economy and the inability at the national level to devise appropriate development structures and policies.”²⁰ In Ramsaran’s view, structural adjustment implies the failure of governance at the national level. It also suggests the adaptation of unsuccessful economic development strategies and policies as well as economic and political mismanagement. Moreover, it is the outcome of an inequitable relationship between developed and developing countries as the power of international financial institutions, such as the World Bank and the IMF, substantially outweighs that of developing country economies.

The failure to progress on the economic front may also be due to “incompetent government planning and public administration, the abuse of power, the misuse of resources, corruption, patronage, discrimination and poor judgement.”²¹ Connected with this is the idea that when governments engage in macroeconomic mismanagement, there is the propensity to use the IMF and World Bank as convenient scapegoats to blame for the harsh macroeconomic measures, which the governments themselves may have helped to make inevitable through mismanagement and corruption.

Without doubt, the efficacy of structural adjustment packages are far from conclusive. In Ramsaran's view, "Structural Adjustment needs to be an exercise in political economy but it has not yet evolved to that stage."²²

In this connection, what is of fundamental importance is the need to minimize the cost of adjustment and to devise means of sharing the burden of adjustment more evenly. There are no simple rules for managing the adjustment process. Indeed, a number of factors will impinge on the successfulness of the adjustment process including the nature of the economy, the style of politics, the perceptions of creditors and the structure of society.

Although it is still undecided whether the adjustment process in the Caribbean has been successful or not, there is little doubt that adjustment in the future will require "changes in the political system, shifts in the relative power structure of societies and political business cycles that sustain forward expectations."²³ As Winston Dookeran notes "the world we now inhabit will likely call for constant adjustment; but if the foundations of social life are not to be further eroded, this process must be countered with a 'high energy politics...capable of repeated basic reform,' involving intensified public participation and democracy. The State must be redesigned, but not eliminated." Also, as Callaghy points out "contrary to free market mythology, the State has always played a central role in economic development ...[and] economic adjustment in the Third World today requires a balanced tension...between the State and market forces."²⁴ Moreover, as Dookeran asserts, "There will be winners and losers; to address this situation, government must be strong enough to manage the transition and alter the opportunity structure, so that lower and middle income groups will not bear disproportionate burdens."²⁵

The politics of institutions that set policy is a key factor in the process of change. What is needed is a new approach to macroeconomic management. In this respect, it is necessary to note that many important lessons can be learned from the recent programme of structural adjustment implemented in Suriname. Most noteworthy is the fact that a strategic programme for the region will require:²⁶

- (a) Formulating a programme for structural changes;
- (b) Developing a Strategic Trade Policy;
- (c) Modernizing the financial sector;
- (d) Implementing a programme for privatization;
- (e) Focusing on social capital, poverty alleviation, and human development;
- (f) Tackling the institutional issues in governance and development;
- (g) Designing a Business Expansion and Industrial Restructuring Programme;

- (h) Promoting an ACS accord on investment principles;
- (i) Improving relations between the ACS and Europe.

What emerges from all of this is the overwhelming need for a strategically planned approach to change, the need to sustain forward expectations and the need to search for new directions in the reform process. As Winston Dookeran notes, "The agenda before us is enormous, but we can neither succumb to the forces of history, nor surrender to the new vulnerabilities that will surface in the path ahead. Our resilience must be founded on our own sense of our Caribbean identity, with an enduring commitment to confidence in our future."²⁷

CONCLUSION

The Caribbean region, according to Bertus Meins, is not doing as well as it could or should. In his view, "too much tension still prevails between public and private sectors, between employees and employers, between export orientation and import substitution, and last, but not least, between the desire to preserve current standards of living and the economic imperative to devote resources to generating productive employment for future generations."²⁸ Scarce public sector management should be used to solidify the preconditions for sustained economic growth instead of being overly committed to stabilization.

As a final note, it is necessary to take into account the comments of Ramesh Ramsaran when he observes that there is a distinct need for developing countries to appreciate that there are costs to be paid for mismanagement and the failure to fully use their human and physical resources. The responsibility for better economic management and for improving the standard of living of the population depends largely on the combined efforts of the government and the governed. Moreover, economic hardship may persist even in the absence of borrowing from multilateral donors.²⁹ Hence, it is necessary for governments to guard against the temptation to blame the IMF or the World Bank for economic problems which mismanagement, fraud and graft may have helped to create. However, one needs to be cognizant of the fact that structural adjustment policies are not instituted within the context of a just world order.

Structural adjustment policies have emerged as the result of the inequitable relationship which exists between the developed and the developing world. Thus, it is necessary to make attempts to ensure that as the world economy becomes increasingly integrated, the Caribbean region must take a final hard look at the policies, conditions, regulations and institutional arrangements which would ensure future growth and allow for the achievement of sustainable development.³⁰

Moreover, as Winston Dookeran notes, "These are trying times for the Caribbean. Old certainties and models are falling away, but new sustainable ones have yet to take their place. As a consequence, we are embarked on a quest for a new identity for the Caribbean, an identity that will allow it to realize wider international economic and political space and greater autonomy. The defining moment for the Caribbean has not yet arrived; in the meantime, much work remains to be done, and many challenges to be met. What is at stake is no less than the region's viability in the new economic and political order of the twenty first century."³¹

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ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

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THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

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CARIBBEAN DEVELOPMENT: THE PREMISES OF AN EMERGING AGENDA

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Caribbean Development: The Premises of an Emerging Agenda

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Table of Contents

| | |
|---|-----------|
| Introduction: The Caribbean as an open frontier | 1 |
| THE CHANGING PERSPECTIVES | 2 |
| Objectives of Development | 2 |
| Regionalism and Multilateralism | 3 |
| The Issue of Sovereignty of the Nation State | 4 |
| Political systems are undergoing stress | 4 |
| Size is not an issue | 5 |
| Is adjustment sufficient? | 6 |
| THE EMERGING FRAMEWORK | 7 |
| Open Regionalism | 7 |
| The Rise of Regional Economies | 7 |
| The "flying geese" metaphor in economic growth | 8 |
| The Missing Link in Economic Progress | 10 |
| New integration agenda | 11 |
| Competitiveness and Competition Policy | 12 |
| MANAGING POLITICAL TENSIONS | 13 |
| Political business cycle - "backward looking expectations" | 13 |
| Is the Westminster System under stress? | 14 |
| The Caribbean Regional Security System | 15 |
| Move away from the traditional position of protest diplomacy | 16 |
| DEVELOPMENTS IN CARIBBEAN EXTERNAL AFFAIRS | 16 |
| From Multilateralism to a Multitrack Trade Policy | 16 |
| The Bridgetown Declaration - US Caribbean Summit | 18 |
| Green Paper on Relations between the European Union and the ACP countries. | 20 |
| CONCLUSION | 22 |
| Changing roles in a changing world | 22 |
| Forward Expectations | 23 |

CARIBBEAN DEVELOPMENT: THE PREMISES OF AN EMERGING AGENDA

Introduction: The Caribbean as an open frontier

Haitian anthropologist, Michel-Rolph Trouillot once described the Caribbean as an open frontier where harmony and discord work together, where the boundaries of culture are not easily defined, and where memories of 'roots' refuse to allow the past to be silenced or the society to be canceled . . . a reminder of Europe's distant history of centuries-old rivalries and war time conflicts.

A place where the old and new worlds meet, where African, Asian and European peoples have converged and where the East-West and North South fault lines sometimes surface. Truly, an issue of identity, yet a silent yearning for a common Caribbean stand, even perhaps a Caribbean State. "The peoples of CARICOM and their Governments must no longer think in narrow terms of a "Commonwealth Caribbean" but in wider terms of a "Caribbean Commonwealth," declared the West Indian Commission, in their 1992 report *Time for Action*².

Two years later in the search for new economic and political space, the Association of Caribbean States (ACS) was set up with membership of all countries whose shores are washed by the Caribbean Sea. Cuba is a member. The United States is not. The platforms defining Caribbean economic and political space over the last forty years include the triangular trade of the pre-independence period, the era of multinational corporations and United States hegemony, and more recently the IMF-World Bank structural adjustment programs. Out of this framework came theories of exploitation, neocolonialism and marginalization, and the export of protest diplomacy. There followed heavy moral and political overtures for protection, special consideration, aid, trade, and investment support from the developed world.

This approach may have been acceptable in the 1960's and 1970's, given the state of development-thinking and the geopolitical structure of the world economy in that period, but it is no longer sustainable. For decades, the plantation economy of the hinterland has adjusted only to persistent low-level equilibrium, resulting in low levels of employment and incomes. Although the region's resource-based industries were integrated into the global economy, this resulted in economic enclaves within the domestic economy, without sufficient development benefits. Caribbean countries remain highly sensitive to exogenous factors, such as shocks, exchange-rate manipulation and crisis, all of which can adversely affect their critical foreign exchange, their largely export-driven public revenues, and their competitiveness.

The financial and economic geography of the world have altered and have facilitated new flows of international capital. Now there is an increasing divergence between political and economic boundaries. There are now no privileged spaces. Yet, there is a high demand for Caribbean countries to create a new generation of exports to reduce the cost of doing business and to expand its production frontiers. How? And What are the options?

2. The West Indian Commission, *Time for Action: Report of the West Indian Commission*, (Barbados: Wildey, 1992)

Two further questions recur: Is our development strategy correct? Is our understanding of world politics insightful?

THE CHANGING PERSPECTIVES

Objectives of Development

Caribbean development, always challenged by the dichotomy between growth and development has been premised on the argument that growth is a necessary condition for development. Now the sequence may have changed as development has become a necessary condition for growth. What then did we and do we mean by development. In previous decades, development was seen as simply increasing GDP. Stiglitz³ argues that today, economists and planners have "a broader set of objectives in mind: the focus is on democratic development, on sustainable development, and on increases in living standards". As economists have long recognized, GDP accounting can no longer adequately capture changes in standards of living. The improvement of education and health care, the abatement of pollution, and the generation of externalities must all be taken into account if we are to arrive at a meaningful estimation of living standards. There has been a change in thinking about development strategies: a change in objectives.

This broadened set of objectives leads to quite different development strategies. In sketching the outline of an agenda for economic development for the coming century, Stiglitz concludes that "it includes a wider set of objectives than development agendas of the past" and "a changing role for the state- a partnership between government and markets- that involves a catalytic role for government in helping to create markets." Social income, once seen as being produced by the state, can now be the product of the market, behaving within "an appropriate regulatory structure- what is required is not *deregulation* but *regulatory redesign*."

Policy matters and getting the prices is not enough. The state can create markets, they helped regulate markets, and they used markets to achieve their development objectives. The sequence of reforms can affect not only the performance of the economy in the short run, but also the momentum for the continuation of reforms. The simple lesson to emerge from this discussion is that incentives matter: that they matter in both the public and the private sector, that the government should make more extensive use of incentive mechanisms for guiding its own behaviour, and that government should take actions to improve the incentives within the private sector.

Development, as we recognize today, is more than the accretion of physical capital or of human capital. It also includes closing the knowledge gap between rich and poor economies. And it includes other transformations, such as those that result in the creation of social capital, the quality of growth rates and changes in the structure and behavior of economic organizations. Alberto

3. Stiglitz, Joseph, "An Agenda for Development for the Twenty First Century," The World Bank, Washington D.C., 1997.

Alesina⁴ asserts, based on a cross country data analysis, that countries with large public sectors and 'poor' institutions are gravely harmed in the development process. Now the external environment is an 'endogeneous' factor and influences significantly the political economy of 'high and low growth' in both advanced and developing countries. In Stiglitz's view, the coming decade will see enormous growth in the developing world and a reduction in poverty. It will be a struggle. The challenges are great, but the opportunities are enormous.

Regionalism and Multilateralism

The forces transforming the global environment are moving the international system in two seemingly contradictory directions. On the one hand, the world is moving towards multilateralism and global integration with strong commitment to open markets and international institutions. On the other hand, it is entering a new era of regionalism, as nations seek to guarantee their markets. Policies, strategies and institutions that are not in harmony with international regimes may not be tenable. The meshing of local policies with the external policy environment is an emerging issue which may have prompted Robert Putnam⁵ to design a 'two-tier framework' to analyse the domestic component of foreign policy.

The issue is more complicated with the resurgence of regionalism, as pointed out by Jagdish Bhagwati.⁶ The first round of regionalism collapsed in the 1960s, primarily because the United States was intent upon following a multilateral course. Now regional thrusts are seen as a stepping stone to multilateral goals, thus widening the interest of the regional agenda to go beyond trade and investment issues into matters of security, common regulatory systems, environment and labour standards, and institution building. This broadened agenda has set the stage for a new kind of 'moving integration' where the boundaries keep shifting, new frontiers keep emerging and the economic equations within the integration areas are changing. We are now in a dynamic integration process calling for a new model of integration.

In this re-thinking process, regionalism is not about developing 'self contained' blocs, it too must synchronize its formation in a global context. As Bhagwati noted "regionalism need not necessarily be a stumbling block towards a multilateral trading system". The World Trade Organisation is the most recent example of the evolution of a global institutional framework, a trend that poses major reform requirements to other international bodies in the field of development. Development banks are likely to face new demands for change in a more competitive global financial setting. Indeed, political leaders and other executives of the public interest can no longer define

4. Alesina, Alberto, "The Political Economy of High and Low Growth," The World Bank, Washington D.C., 1997.

5. For an analysis of the two level game of international relations and domestic economic and political policies, see Putnam (1988)

6. Bhagwati, Jagdish, "Regionalism and Multilateralism: An Overview," Discussion Paper Series No. 603 (April), World Bank, Washington D.C., 1992.

interests primarily in terms of their geo-political boundaries, but must increasingly do so in regional and global terms.

The Issue of Sovereignty of the Nation State

However, as difficult as integration might be, collaboration on agreed upon agendas and shared responsibility for the promotion of common interests does not mean that the nation state will disappear, or that national sovereignty will be lessened. Indeed this issue has sparked much debate in the Caribbean recently, as nation states in the region strive for common interest positions as a means of pooling their 'sovereignty' for wider regional and global trade-offs. Sovereignty as Keohane⁷ argues, is a twofold concept, incorporating both formal and operational sovereignty. As far as formal sovereignty is concerned, a state has "legal supremacy over all other authorities within a given territory, and is legally independent...except where it has accepted obligations under international law."

Operational sovereignty, on the other hand, involves "legal freedom of action." Nations sacrifice some operational sovereignty when they enter into international agreements, but they do so in return for reciprocal limits on the other states. If entered into wisely such agreements will increase economic well being at home and enhance government's ability to govern. The establishment of regional common interests and joint problem solving processes, far from limiting the state's power, therefore, may heighten national autonomy, particularly when these agreements are entered into with a view as to how one can benefit from a greater integration with the external world, while at the same time supporting the multilateral process.

Political systems are undergoing stress

Governments in both the developing and developed world are facing the increasingly difficult task of managing their national economies in order to improve macro economic performance, to provide increased levels of public investment for job creation, education and health care, and to develop policies and institutions that will address the issues of poverty and inequity, in an increasingly laissez-faire global environment. Political systems are undergoing stress, as the economic forces for integration outstrip their capacity to make the requisite political adjustments. They are likely to endure only insofar as they are able to adapt.⁸

In the Caribbean and other developing regions. This scenario is further complicated by structural adjustment policies, which many argue are undermining the conditions for development. Others fear that building the requisite regional institutions for addressing these problems will result in a loss of national identity and sovereignty. Furthermore, as regionalism is by definition

7. Keohane, Robert, "Sovereignty, Interdependence, and International Institutions," In Ideas and Ideals: Essays on Politics in Honor of Stanley Hoffman, Linda B. Miller and Michael Joseph Smith, Westview Press, Boulder, CO, 1993.

8. On this and related issues see Galbraith (1994)

discriminatory, economists and decision makers are concerned about the possible trade-diverting effects of the future regional landscape.⁹

Size is not an issue

We in the Caribbean have rationalized that our smallness constrains development, but in fact, size is not in itself an issue. The city-states of Hong Kong and Singapore have achieved high levels of prosperity and growth without significant natural resources, preferential trade accords, or proximity to the United States and European market. They determined their cultural strengths and built on them, developing policies and strategies that unleashed the micro-economic forces for growth, and complementing these with the macroeconomic framework. This was a matter of clear goals, skillful strategies, and sound policy making, not market size.

China, on the other hand, with its authoritarian government, large internal market and substantial resources, was unable to modernize its economy outside the global framework; nor have other large nations, including India, Indonesia, Brazil, Russia, Pakistan, Bangladesh, Nigeria, and Mexico, been able to do so, though many gave excellent resource bases.¹⁰ The point, then, is that the political and sociological legitimacy of the nation-state are not threatened by changes in operational sovereignty per se; rather, today's world requires that the nation-state cede more of its operational sovereignty, in order to hold its legitimacy and viability.

Is adjustment sufficient?

Since the oil crisis of the 1970s, the path towards development in many of the world's poorest countries has been hindered by deteriorating terms of trade for export commodities and inappropriate development policies. With these difficulties, countries had to restructure their economies along the lines of structural adjustment policies. These programs consist of both short- and medium-term measures for improving the overall economic situation by such means as cuts in public spending, contraction of the money supply, changes in import restrictions, devaluation of the currency, and the privatization of state enterprises. In general, this new orthodoxy views the market as the major

9. Examples of the confusion surrounding these issues are readily apparent. The MERCOSUR trade bloc (Argentina, Brazil, Paraguay and Uruguay), for instance which formed the world's second customs union in January 1995, will not establish a supranational court to settle trade disputes, as some members felt that it would reduce their sovereignty (see Foster 1994). Many in the US Congress—even those considered free-traders—were reluctant to pass the Uruguay Round (UR) legislation in late November-December 1994; they feared that the World Trade Organization (WTO), by eliminating the one-country veto and establishing tribunals to rule on trade disputes, would dilute U.S. sovereignty and force the changes in a wide range of U.S. environmental and labour laws (see Zuchoff 1994). In a recent nationwide referendum, Norway voted not to join the EU, feeling, at least in part, that its resource base was strong enough to keep foreign bureaucrats from interfering in its "internal" affairs. And the Caribbean Community Common Market heads of state were determined to keep its expansion under the ambit of elected governments, in part because they feared a devolvement of their sovereignty. In each case there were serious debates as to what constituted the national interests and how integration would affect national sovereignty.

10. See Wolf (1994)

instrument of reform, while the state is seen as the key obstacle to development.¹¹

The structural adjustment policy debate in the Caribbean has centered around the sequencing of measures and a time period for these policies to work, when it should have focused on substance. After a decade of adjustment, development still remains an elusive goal. This is largely a static model, based on two-dimensional premises that cannot be supported. The neoclassical policy prescriptions for "getting the prices right," such as reducing costs, getting the right technology, flexible exchange rates, and removing price controls and subsidies, are all well and good in themselves, but competition is a complex, dynamic phenomenon in which price is only a single element.

Moreover, while strict fiscal and monetarist measures may promote stabilization, they will not unleash the internal forces for change that will result in growth; and while the divestiture of state enterprises, for instance, may be necessary to balance the books, unless privatization takes place within a post-structural adjustment framework for development, it will not result in a new platform from which output, income, and well-being can be increased. Furthermore, such a framework must engender the dynamics for endogenous growth, so that the industrial structure of production may be transformed, creating new vehicles for the empowerment of peoples which will yield a high-level equilibrium and momentum for sustainable development.

Similarly, the measures for "getting the state out of the way" ignore the need for an enhanced state role in building meaningful regional institutions that will create and promote an environment of growth. The state is needed to enforce regulations, formulate and implement policy, build international linkages, forge collective public and private sector initiatives, and promote human resource development that will bring the disadvantage into the development process. The world that we now inhabit will likely call for constant economic adjustment; but if the foundations of social life are not to be further eroded, this process must be countered with a "high-energy politics... capable of... repeated basic reform", involving intensified public participation and democracy. Correcting economic accounts regardless of social costs can only destroy any basis for future growth.

The state's role in development must be redesigned, but not necessarily reduced. As Callaghy points out "contrary to free-market mythology, the state has always played an important role in development...[and] economic adjustment in the Third World today requires a balanced tension... between state and market forces"¹². While the international financial institutions are slowly coming around to this view, this is the formula in the developed world. Interventionist strategies such as incentives and subsidies, are at the core of East Asian development. Furthermore, while the structural adjustment paradigm depends on externally propelled growth, these movements are

11. The five basic strategies of structural adjustment programs include the reduction of domestic demand, resource allocation, the increase in foreign and domestic savings, and increased economic efficiency in the use of resources. (See Norton 1987; for specific economic measures see IMF 1986.)

12. Callaghy, Thomas M. 1989. Toward State Capability and Embedded Liberalism in the Third World: Lessons for Adjustment." In *Fragile Coalitions: The Politics of Economic Adjustment*, ed Joan M. Nelson. New Brunswick and Oxford: Transaction Books.

cyclical, as W. Arthur Lewis has pointed out, and there is nothing inevitable about the process.¹³

THE EMERGING FRAMEWORK

Open Regionalism

Regionalism is an inescapable feature of the landscape. Open regionalism encourages nations to form subregional trading blocs in ways that facilitate linkages with others, thus synthesizing the globalization and regionalisation trends. It allows for the open ended participation of its members in other trading arrangements and regional schemes, so that these various groupings will function as building blocs towards global accords and an open and transparent international economy.

Open regionalism is seen as a way of achieving a development model in which economic growth and social equity are enhanced simultaneously. Accordingly, the horizontal expansion of aggregate demand as a result of market integration would be compounded by vertical expansion of demand, owing to country level social integration. In this connection, integration agreements between countries not only may be compatible with the goal of steadily increasing international competitiveness but may also be instrumental in achieving it. Their purpose is to usher in a more open, transparent international economy. In other words, integration is seen as a building block of a future international economy free of protectionism and barriers to the exchange of goods and services.

The open regionalism approach should be designed with certain characteristics in mind; they should contribute to a gradual reduction of intraregional discrimination, to macroeconomic stabilization in each country, to the establishment of suitable payment and trade promotion mechanisms, to the building of infrastructure and to the harmonization or non-discriminatory application of trade rules, domestic regulations and standards. Moreover, the reduction of transaction costs and discrimination within the region could be reinforced by sectoral arrangements or policies to take advantage, in turn, of the synergistic effects of integration.

The Rise of Regional Economies

Kenichi Ohmae¹⁴ asks the question whether "nation states - notwithstanding the obvious and important role they play in world affairs - [are] really the primary actors in the world economy?" Indeed, as Ohmae suggests, it is doubtful whether, in today's world where economic borders are progressively disappearing, "nation states are the best window on the global economy; whether they provide the best port of access to it; whether arbitrary, historically accidental boundaries are

13. Sir W. Arthur Lewis, a leading West Indian economist, won a Nobel Prize for Economics in 1979.

14. Kenichi Ohmae's, The End of the Nation States: The Rise of Regional Economies, The Free Press, New York, 1995.

genuinely meaningful in economic terms; and, if not, what kinds of boundaries do make sense?" In other words, exactly what are "the sufficient, correctly sized and scaled aggregations of people and activities" with which to tap into the global economy.

As Ohmae notes, one way to answer these questions is to observe the flows of what he calls the four "I's": namely, Investment, Industry, Information Technology and Individual Consumers. Taken together, the mobility of these four "I's" makes it possible for viable economic units in any part of the world to attract whatever resources are needed for development. They need not look for assistance only to pools of resources close to home. Nor do they need to rely on the formal efforts of governments to attract resources from elsewhere and funnel them to ultimate users. This makes the traditional "middleman" function of nation states - and of their governments - largely unnecessary. Because all the global markets for the four "I's" work just fine on their own, nation states no longer have to play a market clearing role. Global solutions will flow to where they are needed without the intervention of the nation states. On current evidence, moreover, they flow better precisely because such intervention is absent.¹⁵

In essence, therefore, as Ohmae argues, "region states are economic not political units, and they are anything but local in focus. They may lie within the borders of an established nation state, but they are powerful engines of development because their primary orientation is toward - and their primary linkage is with - the global economy. They are, in fact, among its most reliable ports of entry." Indeed, what defines the region state is "not the location of their political borders but the fact that they are the right size and scale to be the true, natural business units in today's global economy. Theirs are the borders - and the connections - that matter in a borderless world."¹⁶

The "flying geese" metaphor in economic growth

Takatoshi Ito put forward a very interesting observation that the pattern of development takes place through a "flying geese" formation. Based on his study of East Asian countries, he concluded that the Asian economies are like a group of geese flying in V-formation. Japan, flying at the front, is flanked by Hong Kong and Singapore, followed by the Republic of Korea and Taiwan. Behind them are Malaysia and Thailand, the Philippines and Indonesia. The order of the formation is that of the stage of industrialization and per capita income.¹⁷

The argument is based on shifting comparative advantage. As rich countries shift their production to technologically advanced new products, lower value added versions of these products are produced by neighbouring less developed lower cost countries which, taken together, generates a dynamic process of development. As an example of this type phenomenon, one can look at Japanese

¹⁵. Ibid., p. 4.

¹⁶. Ibid., p. 5.

¹⁷. Takatoshi Ito, "What Can Developing Countries Learn from East Asian Economic Growth?" The World Bank, Washington D.C., 1997, p. 2.

investment behavior in East Asia in electronics and autos. Japanese investment behaviour in their manufacturing sectors shift from Japan in the late 1970s, first to Hong Kong, Singapore, Taiwan and Korea, then to Malaysia, Indonesia and now to China.

Is this pattern likely to be replicated in other regions of the world? In other words, would economic take-off now take place in clusters of economies rather than through national economies or satellite economies? In the new economic geography, the regional economy diverges from the established political boundaries, it now appears that it is the regional economy, not the national economy or even the satellite economy that will become the basic unit upon which a dynamic process for economic growth and development can be predicated.

Ito goes on to argue in his paper that for countries endowed with little natural resources, like Japan, Korea, and most East Asian economies, growth means industrialization. Two indicators of the level of economic development are agriculture's share of GDP and machinery's share in exports. As economic growth increases, a resource shift takes place to the manufacturing sector, and in this process the product composition of exports changes. Production and exports shift from textiles and light industrial products to more sophisticated goods such as machinery, steel and automobiles.

Is this sequencing appropriate for Caribbean industrialization? Empirical evidence of industrialization performance do not support this process of resource shift. The early thinking on this matter focused on the "value added" concept where more returns are being sourced from the existing resource use leading to downstream and linkage industries. As a result, specialization and resource shift were given lower priority in the development of industry in the Caribbean. According to Pantin,¹⁸ CARICOM developed an industrial allocation scheme to target specific "light industries" in the smaller Caribbean economies. This scheme has had limited results.

What is emerging is the distinction between a strategy for economic development based on the value-added idea as opposed to a strategy based on "resource shift." Many sunset industries in the Caribbean have been retained on the argument that new investment could diversify the outputs, and create a dynamic for growth based on the old expenditure patterns. To some extent, this explanation is attractive because of its political appeal. There are no real losers, only winners. The need for de-industrialization to proceed re-industrialization is clearly addressed in the "resource shift" idea where dynamic development will be sustained only through major shifts in national expenditure from "sunset" to "sunrise" industries.

Ito argues that the key lesson that can be learned from the experience of East Asia is to understand how incentives have worked in that environment, and the efficacy of government intervention in these economies.

In both respects, there was a common policy approach by the countries in the cluster region which facilitated the emergence of the flying geese formation in economic change. In this regard,

18. Pantin, Dennis, "Industrial Policy for CARICOM," ECLAC, December, 1995.

there are wide spaces in policy coordination among Caribbean countries, inspite of valiant attempts to establish common approaches in external trade matters and monetary cooperation. It would seem that the flying geese metaphor in a Caribbean context may require an integrated policy framework at both the policy and operational level. The framework must be based on new pillars of growth that are sustainable through the working of the market system, including perhaps the issue of a policy framework for the knowledge-based economy. This continues to remain a major challenge to the political economy of development in cluster economies.

The Missing Link in Economic Progress

In most Caribbean countries the first generation of reforms: macroeconomic policy, trade reform, financial reform and privatization are in process. The theme now is to make a permanent shift toward growth following adjustment. There is the need now to go beyond the adjustment process into an agenda of second generation reforms. The situation in each country differs. Trinidad and Tobago, for instance has embarked on a highly complex process of change that has not yet run its course. Will the present policy matrix sustain external balances and deepen the process of structural change? What are the key elements of a second phase program that will maintain a momentum for growth and development?

Nancy Birdsall saw the key elements, as the three E's: Export, Education and Enabling Government, which she described in her chapter as the missing ingredients for the economic success of the Caribbean. She argues that the growth of exports encourages the rapid growth of employment and eventually wages, which raises the demand for labour and contributes to the relative equality of incomes.¹⁹ Exporting may also create a second advantage in that it forces countries to be globally competitive, thereby generating rapid productivity gains.

The second key variable which Birdsall alludes to is education. Education needs to be accorded a high priority as it contributes not only to wage and productivity growth but also to fertility decline, which makes higher investment in education per child possible. The third element Birdsall refers to in her list of second generation reforms is an enabling government. In her view, government should be viewed not as an engine of growth but as an enabler or catalyst of private sector growth. In particular, governments need to create a predictable and reliable environment for investors, and thus an environment friendly to the business sector. Birdsall's "missing links," now perhaps part of the old orthodoxy, necessitates a development framework that will remove these missing links.

The growth of an economy depends on how stabilization efforts and structural reforms work in a particular setting. The environment takes into account the micro-economic behavior, the functioning of factor markets and the performance of the regulatory system. The interplay of micro-

19. Nancy Birdsall, "Adjustment, Reform and Growth in the Caribbean: The Missing Ingredient," Chapter 2 in Choices and Change: Reflections on the Caribbean, Winston Dookeran (ed.), Inter-American Development Bank.

and macroeconomics, says an ECLAC publication²⁰ is the new challenge to policy makers in the Caribbean and Latin America. Growth alone is not enough. There are also conditions on the micro-economic and systematic levels that are essential for creating externalities that will internalize the transformation process with a special objective of increasing the income of the poorest.

The setting goes beyond the national economy. The strategy to capture global technology flows, to be competitive in an integrated regional economy, and to respond to the global business cycle will determine the growth rate and the income level at which the economy may reach a 'steady state' equilibrium. That equilibrium may produce an externality that 'opens or close' the gap between private and social returns to investment, depending on how the management of social policy takes place. The missing challenge in strategic economic programming in many Caribbean countries are to design a logistics that will link:

- short run macroeconomics and medium-run growth;
- public institutions and the production and trade structure;
- micro and macroeconomics;
- the national and global economy;
- economic and social efficiency and political feasibility

This leads to the construction of an agenda for second generation reforms which in broad outline may cover, inter alia, the management of the public sector, a prospectus for 'unshackling' the private sector, choices and change in financial and monetary management and sustainable social programming.²¹

New integration agenda

The ECLAC study on Open Regionalism emphasizes two critical aspects of integration: one dealing with technical change and the other dealing with social integration. It argues that technical progress in integration requires government to play a catalytic role in Latin American and Caribbean economies in order to build appropriate business structures and information networks that are required to facilitate technological change. With respect to social integration ECLAC argues for a strategy that will change production patterns with social equity and in this respect outlined a series of measures in microenterprise development aimed at reducing marginalisation and increasing participation of lower income people in the actual business of development.

In the search for a new integration paradigm, three main pillars upon which such a

20. ECLAC, *Strengthening Development. The interplay of micro and macroeconomics*, (LC/G.1898(SER.26/3)) United Nations ECLAC, Santiago, Chile, March 1996

21. For a discussion of the second generation reform agenda, see Dookeran, Winston, *Policy Reform in the Caribbean: Choices and Change*, Institute for Development Policy Management (IDPM), University of Suriname, 1996.

strategy can be designed have been identified.²² The first is with respect to the search for external economies of scale. In the midst of a world that is now less dependent on physical resources and commodities, the identification of such industrial strategy remains a key area of enquiry. The development of geographically compact economies is another pillar where strategic niches can be built upon and corporate partnerships and alliances can be encouraged. The third pillar upon which the integration paradigm can be constructed is the search for extending the range of Caribbean economies so that regional capacity can be enhanced to play a competitive role in world commerce. These considerations along with the concept of dynamic integration alluded to earlier is but a starting point in the building of an integration approach.

Development in the Caribbean entails a comprehensive political economy of change, including the development of endogenous growth capacity to drive the economy. Only then can the region benefit from the new and flexible world economy, in which ends and means are readily adjusted to changing opportunities in different countries. This will require an integration model that transcends trade and converges at the institutional level, and facilitates backward and forward, macro- and microeconomic linkages. Eventually a virtuous cycle should be created, in which the region can expand its political space and gain greater negotiating strength in the international arena. Merging into a greater political-economic whole should help to free individual states from rent-seeking power bases, bring about greater economic efficiencies, and allow governments to concentrate on governance.

Sustainable development is an affirmative political-economic process, linking economic logic- the measures needed to pursue economic efficiency in both the international and domestic spheres-with political logic, in a synergism that allows them to reinforce one another. Merely opening the economy to the outside will not induce sustainable growth; to the contrary, it will result in further social and economic destabilization. As integration progresses and the state reduces its direct role in the economy, public policy will have an even greater impact on society. There will be winners and losers; to address this situation, government must be strong enough to manage the transition and alter the opportunity structure, so that lower-and middle-income groups will not bear disproportionate burdens. The government's challenge is to ensure that poverty issues are systematically addressed with visible effect.

Competition Policy

The issue of the competitiveness of the Caribbean economy has now emerged as a key requirement for the successful integration of these economies into the global economic system. Serious issues do arise in determining the path and process for improving competitiveness. These issues include matters of macroeconomic policy, changes in the structure of specific industries, the financing of infrastructure development, and institutional systems to promote competitiveness.

22. See Dookeran, Winston, "Preferential Trade Agreements in the Caribbean: Issues and Approaches," in Trade liberalization in the Western Hemisphere, IDB/ECLAC, Washington D.C., 1995.

In the new agenda for global trade, the issue of an international agreement on competition policy has emerged. The argument is that the elimination of trade barriers do not ensure that markets are genuinely contestable. The WTO currently does not require its members to meet binding obligations to implement competition policies. There is no entity responsible for ensuring that global markets are competitive. A single set of rules could, in principle, provide more coherence than the current system.

The negotiation of these rules cover a wide range of topics:

- elimination of antidumping and countervailing duties rules
- antitrust laws
- business practice that restrict market access
- creation of an international competition office
- implications for preferential tax treatments
- constraint on domestic competition policy
- competition rules may outlaw market sharing agreements

Whatever the agenda items, it is clear that an international competition policy will have direct impact on the trade and commercial practice, and will have differential effects on different groups of countries. It may well lead to the categorization of countries on the basis of their degree of integration with the world economy. It may be that the incremental approach to incorporating competition policy within the international trading system is likely to be the most feasible approach. The Caribbean region's framework for negotiations is now an urgent assignment.²³

MANAGING POLITICAL TENSIONS

Political business cycle - "backward looking expectations"

The political business cycle is now assuming a more explicit role in development programming. Does that cycle create 'backward-looking expectations' that constantly blur the choices for change? "Culture is not independent of politics and cultural integration is not a neutral process" asserts Caribbean social psychologist Ramesh Deosaran. And Charles Skeete talks about the reevaluation and separation between Caribbean unity and Caribbean diplomatic leverage. The political business cycle, once viewed as out of bounds in the armory of economists is now a critical issue in macro economic analysis for development. Political economy models are identifying the 'winners' and the 'losers' across generations and over dispersed interest as they search for 'operational compensation' vectors.

The politics of 'institutions that set policy' is a key factor in the process of change. A different

23. For a discussion of this, see Ostrey Sylvia, The Post Cold War Trading System, University of Chicago Press, 1997. Chapter 7.

approach to conflict resolution is emerging. Karen Walch took note of this as she searched for 'win-win' solutions and attempted to redefine the conflict situation in the context of joint problems. Sarath Rajapatirana looked East to the relevance of the East Asian experience, and saw great differences in the political economy, but pointed to important lessons for the region. He discounted the fears or hopes of NAFTA. Elena Suarez looked to Washington as 'economic prosperity in the Caribbean has been closely tied to the proximity of the US'. She concluded though that it is the depth of the reform agendas in the region that will determine the sustainability of economic prosperity.

Is the Westminster System under stress?

Political systems are undergoing stress, as the economic forces for integration outstrip their capacity to make the requisite political adjustments. Consequently, they are likely to endure only insofar as they are able to adapt. There is the fear that building the requisite regional institutions for addressing regional problems will result in a loss of national identity and sovereignty.

Anthony Payne notes that the emergent forms of politics in the post-independence Commonwealth Caribbean have been shaped by the historical legacy of British colonialism, that this inherited political order has been adapted to Caribbean conditions in a creative and distinctive way, and that the resulting system, which can be described as democratic, offers the region a workable, although far from flawless, basis on which to defend its political practice into the 1990s, and beyond.

Despite the dominance of the Westminster model, however, Arend Lijphart begs the question which form of democracy is the most suitable for countries like Grenada and others in the Eastern Caribbean area. His answer is that the consensus model of democracy, characterized by such features as power sharing, proportional representation, multipartism, and federalism - should be given serious consideration as the major alternative to the Westminster or majoritarian model, because most of the Eastern Caribbean countries are plural or deeply divided societies.

According to M.G Smith's conception of the plural society, a "plural society is one in which sharp differences of culture, status, social organization, and often race also, characterize the different population categories which compose it." Smith's definition is roughly similar to Lijphart's own definition, namely, that plural societies are "societies that are sharply divided along religious, ideological, linguistic, cultural, ethnic, or racial lines into virtually separate sub-societies with their own political parties, interest groups, and media of communication."

In Lijphart's view, because the Eastern Caribbean states tend to be deeply divided societies, the consensus model of democracy appears to be more suitable for them than the majoritarian model. Consensus democracy can almost be said to have been especially designed to manage the tensions inherent in such societies.²⁴

24. Arend Lijphart, "Size, Pluralism, and the Westminster Model of Democracy: Implications for the Eastern Caribbean," Chapter 12 in *A Revolution Aborted: The Lesson of Grenada*, Jorge Heine (ed.), University of Pittsburgh Press, 1990, p.336.

The Caribbean Regional Security System²⁵

Security is a highly contested concept with a variety of definitions and usages. However, it is generally considered as part of a country's "high politics." As some experts believe, non-military developments can pose genuine threats to long term security and the quality of life. Traditional concepts of sovereignty cannot cope with significant transborder flows of narcotics, money, AIDS, arms, and immigrants. However, no single country can combat these threats alone and new regional and international rules and institutions will be needed to cope with the non-military threats facing most nations. Moreover, not only are states no longer the only critical actors in the international arena, non state actors abound, and some of them wield considerable power, oftentimes more than states.

There are three structural and operational features of the still-transforming global environment with direct implications for the region:

- ▶ The changed structure of global military and political power.
- ▶ Alterations in economic relationships
- ▶ Policy reprioritization.

As Jorge Dominguez rightly observed, the Caribbean now has lesser military importance in world affairs. However, the end of the Cold War does not negate the strategic value of the Caribbean. The region's strategic significance is reflected in economic, geographic and communications attributes that have transcended East-West geopolitics. Also, the Caribbean is not only of strategic importance to states, but also to non-state actors, notably drug-barons.

As the relevance of military threats and military alliances declines, geo-economic priorities are becoming increasingly important in state actions. Edward Luttwak expects that both the causes and instruments of conflict will be economic. The megabloc phenomenon with its multiple implications occurs at a particularly unpropitious time for the region, given the significant impact of the global and regional turbulence, which includes depressed banana, bauxite, and sugar production, high public debt, and high unemployment.

The military-political changes caused by the end of the Cold War have had tremendous causal and consequential links to the third general feature of the new strategic environment that is critical to the Caribbean: policy reprioritization. Reprioritization by these countries is the result of several factors. These include budgetary constraints, economic recession, shifting foreign policy focus, the demand by domestic constituents for more attention to domestic concerns, and leadership changes which may cause policy revaluation. In tangible terms, this has meant reduced aid, aid reallocation, preferential trade readjustment, reduced foreign investment guarantees, and diplomatic downgrading of some Caribbean countries.

25. Griffith, Ivelaw, "Caribbean Security on the Eve of the Twenty-First Century," McNair Paper 54, Institute for National Strategic Studies, Washington D.C., 1996.

Move away from the traditional position of protest diplomacy

The Caribbean must accept the realities of the new global economy, and a policy environment must emerge to provide a development buffer zone, as we strive to emerge on a higher international platform. In this context, the establishment of the ACS can be seen, not as an integration process per se, but as an attempt to strengthen the region's negotiating position in international diplomacy. This poses an opportunity for the Caribbean to move away from its traditional posture of protest diplomacy towards a more affirmative stance, in which its vital interests are identified and promoted in anticipation of changing balances in world politics. Furthermore, it lends credence to the notion that a non-sovereign "regional state"—one which could exhibit the same sort of cooperation in world affairs that the Scandinavian countries often demonstrate, and perhaps move towards regional cooperation on economic policy matters, the funding policies of the international financial organizations, as well as cooperation in the United Nations and other multilateral organizations --may well be more appropriate to the conduct of international relations than the nation-state.

DEVELOPMENTS IN CARIBBEAN EXTERNAL AFFAIRS

From Multilateralism to a Multitrack Trade Policy

The term "globalization," first used in 1986, really reflects the investment surge of the 1980's. During the period 1985 to 1990, global investment averaged nearly 30 percent per year, four times the rate of world output and three times the rate of trade. Most of the investment was in capital and technology intensive sectors. Technology flows between the first and second half of the 1980s increased from a negative growth rate of 0.1 to 22 percent.

These outflows reflect underlying structural forces as the revolution in information and communications technology altered the production function of the firm and industries on an economy wide basis. The investment surge, fuelled by technology flows had a profound effect on the structure of world output and trade. At the same time, the movement toward new trading pacts accelerated.

U.S. trade policy, long rooted in the strong advocacy of multilateralism and the GATT shifted to a multilateral trade policy: multilateralism, regionalism, bilateralism and unilateralism. The U.S. trade policy continued to emphasize the need for a multilateral trading system leading eventually to the establishment of the World Trade Organisation. At the same time, track two of U.S. policy pursued further relations through regional arrangements like NAFTA and FTAA, as well as bilateral ones like the arrangements concluded with Israel and also CBI. The third track based on a unilateral focus on Section 301, and the expanded sequence 201 of 1988 will become a dominant aspect of the "trade politics" between the U.S. and Japan.

At the December 1994 Summit of the Americas in Miami, Florida, the democratic countries of the Western Hemisphere announced their intention to form a hemispheric free trade area to be known as the Free Trade Area of the Americas (FTAA). In particular, they committed to (1) begin

immediately to eliminate barriers to trade and investment, (2) conclude the negotiations no later than the 2005, and (3) make concrete progress toward the attainment of this objective by the end of this century.

In the absence of a single path to the FTAA, many alternative strategies are evolving simultaneously. Existing trade arrangements and the proliferation of new initiatives may either hinder or contribute to the eventual creation of an FTAA.

Existing bilateral trade agreements seek both to liberalize and facilitate trade. The proliferation of such agreements, however, has created a confusing array of rules of origin and regulation. This overlapping of agreements is likely to hinder trade rather than promote it. The simplification that is expected to result from a single FTAA would be a significant benefit.

Substantial economic liberalization has been achieved in the majority of countries in Latin America and the Caribbean. However, the state of preparedness to participate in and benefit from the FTAA varies widely.

However, as Richard Bernal²⁶ notes "By the early 1990s, a "new Latin America consensus" had emerged, based on competitive markets, macroeconomic stability through reduction of public sector deficits, opening of the external sector to foreign competition, and reducing the role of the state by privatization and deregulation. The extent of trade liberalization reflects a variety of structural economic features, policy orientations, and political perspectives. Further complications arise from limited and tentative political support for economic reform and liberalization, partly due to the fact these policies were prompted by the frustration with import-substitution and protectionism during the profound economic crisis of the 1980s. The circumstances in which the more complex stages of liberalisation must be implemented are made difficult by more unequal distribution of income and increased incidence of poverty that have accompanied economic reform and liberalisation. The recent experiences of Venezuela and Mexico reveal the fragility of the process."

Whether the Latin American and Caribbean countries are able to take advantage of access to the larger hemispheric market or to larger regional groupings to expand exports will depend on both governments policies and also on the readiness and ability of the private sector to compete effectively. Even where an economy has a comparative advantage it can be offset by the lack of a competitive advantage. Economic reform, liberalization, and adjustment are necessary preconditions for participation in the FTAA; trade liberalization, on the other hand, is a necessary but not sufficient condition. Governments must of necessity address the economic, social, and political difficulties of adjustment if the goal of hemispheric free trade is to be realized.

26. Bernal, Richard, "Paths to the Free Trade Area of the Americas," Policy Papers on the Americas, Volume VIII, Study 2, Centre for Strategic and International Studies.

The Bridgetown Declaration - US Caribbean Summit²⁷

The Bridgetown Declaration signed in Barbados on the 10th May 1997 between the United States and fifteen Caribbean countries was an attempt to strengthen cooperation in responding to challenges of the coming millennium. The Declaration recognises the important link between trade, economic development, security and prosperity in countries of the region. It therefore aims to improve the economic well being and security of all citizens, to defend and strengthen democratic institutions and to provide for social justice and stability.

As the Declaration notes, "As we enter a new century marked by rapid expansion and globalisation of finance and investment, production and commerce, driven by revolutionary developments in technology, we acknowledge the need for a new era in our partnership.[In this regard,] We note the increasing role of the human, technological and communication capacities required for operating in this new competitive international environment and the current reality in most Caribbean States and to accept the need for systematic, cooperative initiatives to strengthen the quality of their human resources and technological capacity."

Some of the key provisions of the Bridgetown Declaration can be categorised under Institutional and Policy Support and Resources to the Caribbean.(See Boxes 1.1 and 1.2)

With respect to trade matters, the Bridgetown Declaration pledges to enhance Caribbean-U.S. trade relationship by working jointly towards the further reduction of trade barriers between the United States and the Caribbean countries and endeavouring to refrain from introducing new import restrictions, consistent with World Trade Organisation (WTO) rules.

There has been a shift in U.S. trade policy which focuses not so much on Caribbean membership but on building transition space through CBI parity mechanism prior to the eventual establishment of FTAA. Many Caribbean countries which, therefore, had hopes of membership in NAFTA should take that out of their agenda based on the Summit Declaration.

Based on policy and institutional support, the most important proposal is for a Joint Annual Meeting between Foreign Ministers and U.S. Secretary of State. This is the first time that such a permanent mechanism is being proposed and could support a more sustained policy between the region and the United States. For many it is a welcome initiative but for the sceptics it may be seen as an instrument of a purely bilateral nature where U.S. interests will dominate over the Caribbean's interests outside the United States.

With respect to resource flows, the Communique calls for an increase in technical cooperation and called on the IDB to honour its eighth replenishment commitment to channel more funds to smaller economies including the Caribbean. In this respect, the Summit did not provide the confidence that there will be additional resource flows to the region. It merely underlines the existing

27. Bridgetown Declaration of Principles, Bridgetown, Barbados, May, 1997.

Box 1.1**Institutional and Policy Support**

The Caribbean region shares the common goal of achieving stable, sustainable economic development and widespread prosperity for all citizens in the region. To this end, the Declaration affirms the region's strong commitment to:

- ▶ internationally recognised labour standards and worker rights, especially freedom of association and collective bargaining;
- ▶ the empowerment of women to permit their full participation in the political and economic spheres, through fair access to education, health care and credit while recognising that addressing and preventing violence against women is an important step toward the goal of strengthening democracy;
- ▶ finding, at the earliest opportunity, a mechanism to facilitate rapid consultations on trade related issues;
- ▶ endorsing the recommendations of the Working Group on Smaller Economies to provide opportunities to facilitate the participation of the smaller economies during the negotiations and their effective integration in the FTAA, to make every effort to reduce the transitional costs and minimise dislocation to their economies during their implementation;
- ▶ encouraging the smaller economies in the Caribbean to consider the early implementation, to the extent possible, of internal adjustments which will enhance their ability to participate effectively in the FTAA.
- ▶ finding institutional mechanisms, including trade missions to encourage dialogue between the Caribbean and U.S. private sectors.

Box 1.2**Resource Flows**

The region welcomes the continuing commitment of the United States to assist Caribbean nations in their economic reforms by:

- ▶ seeking to support measures including technical assistance, in support of programmes that promote internal structural adjustment;
- ▶ the provision of technical assistance to Caribbean countries to support their economic diversification and in particular, to assist the OECS countries in pooling their resources in order to enhance the competitiveness of their products;
- ▶ facilitating the Caribbean's implementation of its Uruguay Round commitments. In so doing, the United States will initiate a three year grant agreement with Caribbean countries to provide technical assistance for trade liberalisation and trade and labour relations;
- ▶ the need for technical assistance to strengthen Caribbean human, institutional and infrastructural development necessary to assist in the development necessary to assist in the adjustment process and to enable them to participate meaningfully. In this regard, we urge Caribbean countries to analyze their particular circumstances and identify their specific technical assistance needs; and
- ▶ exploring ways by which current bilateral and multilateral debt management programmes can support adjustment efforts in highly indebted countries;
- ▶ joining in the call to the IDB to meet its eighth replenishment, to target 35 percent of Bank lending to smaller economies, including those in the Caribbean

resource situation, with the promise of some technical assistance. The Bridgetown Declaration would not alter in any fundamental way the economic relations between the Caribbean and the United States. Rather it opts for incremental change that will come about at the current pace of movement.

Green Paper on Relations between the European Union and the ACP countries.²⁸

In November 1996, the European Commission issued a long awaited Green Paper on "Relations between the European Union and the ACP countries on the eve of the Twenty-First Century: Challenges and Options for a new partnership." The Commission presented its Green Paper as a "discussion tool" whose aim is "to provide food for thought, trigger wide-ranging debate and pave the way for dialogue between those concerned by the expiry of the Lome Convention. It does not frame any formal proposals and the options put forward in no way predetermine the proposals that the Commission may table in due course."

The core hallmarks of the European Union's positions and the basis of the policy, according to George Huggins, and hence of negotiations appears to revolve around a number of tenets derived both from the main trends of political globalization and from the experience of Europe itself. These include:

- ▶ expanded role of the private sector vis-a-vis that of the State, with the State acting as a catalyst for development, and the private sector taking the leadership for development;
- ▶ institutional reform for improved public sector management and progress in private sector led growth among a clear line of democratic participation are a precondition for earning partnership;
- ▶ transparency and efficiency in the use of resources by ACP countries; both to ensure accountability to the European donor public and to promote development discipline;
- ▶ a shift towards a duality, at least, and certainly a stratification of ACP members: those likely to make it into the inner ranks of partnership, through reforms and successful private promotion and those that have severe difficulties in doing so. The EU proposes for the latter a heavy helping hand, assuming direct responsibility for carrying them along.

The first area of cooperation, i.e, the social and economic dimension, has two intertwined aspects: economic development and poverty alleviation. The main vehicle for economic development has been identified as the private sector. Indeed, a persistent reality of many ACP countries is the relatively low state of development of their private sector. However, it must be borne in mind that private sector led growth will not necessarily lead to social redistribution and reduction of

28. This section is based on George Huggins, "Green Paper on relations between the European Union and the ACP countries on the eve of the 21st century," ECDPM, 1997, and ECDPM, Synthesis of ACP Independent Comments on the Green Paper of the European Commission on 'Partnership 2000', ECDPM, 1997.

concentration and thus to development.

The second area of cooperation, the institutional and public sector dimension, is an essential element for the development of ACP countries and regional organisations. This area of cooperation should be the first priority, as it conditions both the development of the ACP countries and the efficiency of aid. However, it is how the institutional reform is carried out that will determine its success.

According to the ECDPM Synthesis of ACP Independent Comments on the Green Paper of the European Commission on 'Partnership 2000', three broad areas of recognition may be called for:

- ▶ the political will for sustainable development, with particular reference to the profound internal cultural, social, institutional and policy issues and with all the implications for internal restructuring and external space of the entire society;
- ▶ sustained moral, political, financial and other forms of support for the long process of poverty reduction, equal access by all sectors to resources and services;
- ▶ genuinely open democratic context of cooperation and participation.

The ACP response to these measures remains somewhat blurred. One of the key issues emerging in the deal so far is whether the ACP should be kept as a combined forum or should be broken down in its constituents parts -African, Caribbean, Pacific. Caribbean countries appear to support the continuation of the ACP forum, but are yet to work towards common cooperation goals that needs to be achieved on a wider global basis. A second issue facing this debate is the continuation of the preference arrangements and its compatability with the new world trading discipline reflected in the WTO. Recent decisions of the WTO to support the argument against Caribbean bananas is an adequate illustration of this incipient conflict.

Other issues that emerged in this debate relate to the question of political conditionalities working through issues such as human rights, environment and labour standards. When the LOME protocol was established they derived their motivation from the need to establish an equal union between the European and the ACP countries. Now, it would appear that the continuation of these protocols are predicated on a combined European foreign policy towards the Caribbean, Africa, and Pacific countries. In this sense, the new arrangements are more likely to be fitted to a European vision of its global presense than it is to add new life to an old partnership, not withstanding the call in the Green Paper for a new Partnership in the "Global 2000."

CONCLUSION

Changing roles in a changing world

Today, as trade matters in the Caribbean is faced with a built in agenda, the region has to identify its vital economic interests in the various concentric circles surrounding it. Apart from the WTO, FTAA, EU-ACP trade relations, the Caribbean has to contend with the Latin American options, including MERCUSOR and more recently the ACS. The ACS with a clear mandate of increasing trade and investment among its members have not been able to get an emerging consensus on *how*. CARICOM's call for a free trade area in the ACS is still some distance away from the expectation of other ACS members adding new concentric circles as CARICOM attempts to expand its geographical base. The waters are indeed murky. The question that must be brought to the fore at all times is whether the waves echo the past or signal a future.

These changing roles have left the region in a 'stand alone' position. Alan Henrikson talks about Clinton's Caribbean policy 'altering in nature but not in depth'. This is what President Clinton told Caribbean leaders at a meeting at the White House. President Castro's quick response to his exclusion from the Miami Summit was "we are not going to negotiate the normalization of our relations on the basis of concessions." Henrikson raises the issue "without Cuba, the Caribbean cannot be regionally integrated . . . yet with Cuba still under Fidel Castro's leadership, the Caribbean countries cannot acceptably negotiate as a region with the United States. The Caribbean's diplomatic charge is to resist 'protest diplomacy' and adopt a more affirmative foreign policy stand where vital interests are negotiated in the world councils.

Clearly in this changing world there are changing roles. Development financing institutions are also being challenged to a changing role. Is development banking in the Caribbean sensitive to the agonizing choices and anguishing changes that are being advocated for Caribbean development? I raise the question with great timidity, but also with an instinct that this question may soon arise. Already, development banks are being forced in the 'commercial' arena in national economies. Central bankers are facing new challenges in an era of 'floating exchange rates' and perhaps a return to currency boards. In the post-liberalization world, commercial banks have begun to restructure as changes in the financial markets are the result of global practices. Long term development finance is likely to be more accessible in the international private capital market.

The debate on 'conditionalities' has now shifted from the broad economic platform to micro-management and political concerns through the search for good governance. The effectiveness of development finance is now being questioned, particularly as the gap between delivery and expectations widens. The growing gap in the Caribbean between expectations and performance, and the rising tension between intention and reality, has widened the space between the art of politics and the discharge of governance. This is the politics of illusion, where yesterday's hopes remain unfulfilled, and new hopes emerge with little expectations that they would happen, or is it 'backward expectations'?

Forward Expectations

Poverty and social capital concerns, and the workings of the political system are now at the top of the political economy agenda in today's Caribbean. So too is the choice of international road

maps. Caribbean economist, Anthony Gonzales, recently stated that a free trade area between the European Union (EU) and the Caribbean 'would appear in the long term to be a superior instrument to most favoured nation treatment (MFN), Generalized System of Preferences (GSP) and the Lomé Convention. Trinidad and Tobago's Foreign Affairs Minister, announced his Government's intention to seek membership in MERCOSUR while maintaining its berth in NAFTA.

CARICOM, although it may have reached its limits and may have in economic terms 'come to a dead-end' may be widened beyond Suriname to include the Dominican Republic and Haiti. The ACS, like 'a medicine in search of a disease' is searching for its own platform. The process for the construction of the Free Trade Area of the Americas (FTAA) has commenced. There are now many road maps, and although still in outline stages, may inspire the mapping of possible blueprints. The growing divergence in our political and economic boundaries must contend, for groups of nations rather than the 'nation state' will now be the main actors in the conduct of international politics. Perhaps, the stage is set for the emergence of a different notion of the regional state as a vehicle for creating political and negotiating space in the international arena. Perhaps, Keohanes' distinction between 'operational' and 'formal' sovereignty may now be incorporated in the new theoretical framework for institutional behavior in the Caribbean region. A clear political statement which can be credible and effective may now be required so as to place the region's agenda in the global dialogue. It is in this context that we may look at a different notion of the regional state as the vehicle to achieve this goal.

In the post cold war era the geo-strategic role of the Caribbean has now been reduced and US interest in the region is based on specific concerns that fits into the US domestic political agenda. A recent Canadian foreign policy review has placed the Caribbean in a Latin American framework, and gone is the term 'special relationship', which at one time was used to describe the (British) Caribbean-Canada links. With the formation of the single market in Europe, as well as the enlargement of EU membership to include near and far Europe, and the strategic importance of the Mediterranean countries to the European Union, the Caribbean now has a lower priority in European foreign policy agenda. The link between the English-speaking countries of the Caribbean and the Commonwealth of Nations is now much weaker as common interests now diverge.

A society is largely defined by citizens who possess a common notion of their identity and a common loyalty to shared ideals. As we move into the next millennium, Caribbean society must create a new sense of civic identity in which people feel free to express themselves, speak their own languages, practice their cultural traditions and transmit these to their children, as they embrace common goals with the larger society. The agenda before us is enormous, but we can neither succumb to the forces of history, nor surrender to the new vulnerabilities that will surface in the path ahead. Today, the agenda before us has widened considerably. Covering the old issues of democracy, development, and integration, but at the same time responding to the new issues of sustainable development, good governance and a new integration paradigm for the region. Perhaps now more than before our resilience is being tested and sense of our own Caribbean identity is quickly changing. Our response must therefore be able to build an enduring commitment to confidence in the Caribbean future, that will at the same time retain a sense of Caribbean nationhood.

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THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

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CHALLENGING THE STATE

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CHALLENGING THE STATE

CRISIS AND INNOVATION IN
LATIN AMERICA AND AFRICA

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Challenging the state: a decade of crisis

The 1980s and 1990s posed great challenges to governments in Latin America and Africa. Deep economic crisis and significantly heightened pressure for political reform severely taxed their capacity to manage economic and political tasks. In fact, the era was a critical moment in which existing state-economy and state-society relations were challenged and, at times, redefined. This book is about the significance of these challenges and redefinitions for the capacities – institutional, technical, administrative, and political – that states in Latin America and Africa require if they are to encourage economic development and provide effective governance for their societies. It explores the roles that political leaders and institutions played in a decade-long drama of crisis and change.

There is little question that this period will be remembered as an era of crisis for countries in Latin America and Africa. An economic crisis, often rooted in development policies adopted in prior decades and greatly increased prices for oil in the 1970s, was precipitated in the early 1980s by a series of external shocks, principal among which were a sharp rise in real interest rates, a rapid decline in the availability of international credit, and a sharp fall in international commodity prices. As a consequence, external terms of trade became highly unfavorable for many developing countries, budget deficits escalated, and foreign debt burdens became unmanageable. International conditions as well as domestic policies explain these problems.

The impact of such conditions on developing country economies was extensive and often extreme. Per capita growth rates in GDP for all developing countries declined from an annual average of 3.4 percent between 1965 and 1980 to one of 2.3 percent between 1980 and 1989. For Latin American countries, per capita GDP growth averaged –0.6 percent for the decade and, for sub-Saharan Africa, it was –2.2 percent.¹ Economic stagnation and decline in real per capita income affected most countries in both regions. In many of them, the 1980s were referred to as the “lost decade.”

This economic crisis had major implications for the relationship between state and economy in large numbers of countries. Whether by choice or necessity, state leadership in the process of economic development was significantly reduced. Severe budget deficits and massive debt burdens led many governments to restrain or even halt public sector investments, cut operational budgets to the minimum, and reduce

the size of national, regional, and local bureaucracies. At the same time, state-led development strategies, which had been dominant in some countries as far back as the 1930s, gradually yielded to strategies that placed greater emphasis on market forces to generate economic growth. Such strategies implied efforts to liberalize trade and privatize a plethora of state-owned enterprises and public functions. While in most countries the state continued to be active and interventionist, its former ability to dominate the economy was sharply reduced.

Political crisis also characterized this era. Public protests, demands for greater democratic responsiveness, and regime transitions occurred throughout Latin America, Africa, Eastern Europe, Asia, and elsewhere. In Latin America and Africa, some twenty-four countries experienced at least one change of regime between 1980 and 1990. In Latin America, all such changes were transitions to democratic regimes. In Africa, the 1980s witnessed a succession of military coups, but by the early 1990s, there was an equally impressive spate of transitions to competitive electoral regimes.² In almost all countries in both regions, an invigorated civic society pressed for greater presence in political arenas and policy discussions. Increasingly, civic society was characterized by the burgeoning of opposition parties, community level movements, and voluntary associations, as well as by an increase in public debates, media criticism of government, and competitive elections. This heightened political mobilization, debate, and electoral activity expanded public contestation over issues of policy and governance.

These political challenges, coupled with the impact of economic crisis, had clear implications for the relationship between state and civic society. In particular, this was a period of increased vulnerability for political leaders and entrenched political institutions. Often, economic stagnation or decline went hand in hand with widespread questioning of regimes in power and a generalized delegitimation of the state as an agent of economic growth. Many political leaders saw their coalitions of support fall apart or become seriously fragmented under the resulting strains. Moreover, the policies adopted to respond to the economic crisis meant that governments became less frequently the providers of investment capital, services, and benefits and more often the enforcers of unpopular stabilization and structural adjustment measures.

Economic adjustment policies diminished the political centrality of the state by encouraging the privatization of publicly managed activities, liberalization of economic interactions, and curtailment of other traditional state functions. Austerity, privatization, and liberalization, in addition to the increased power of international financial agencies to monitor government performance, meant that political leaders had fewer material resources with which to reward supporters and maintain coalitions. Many policy interventions of the decade also imposed at least short-term hardship on broad sectors of the population; countries varied greatly in public tolerance for such measures, but disenchantment with government in general and political leaders in particular was widespread.

Thus, a decade or more of profound economic and political crisis in Latin America and Africa had an equally profound impact on the nature of state

involvement in economic development and on the power of the state directly to shape modes of collective and individual political behavior. In this regard, the period is similar to development crises of the 1930s and 1940s in Latin America and the 1950s and 1960s in African countries. Just as in those earlier periods, more recent crises encouraged disarray among existing economic and political forces and simultaneously opened up space for new definitions of the role of the state in development, new policy departures, new political coalitions, and new scope for political leadership and institutional innovation. And, just as the crises of earlier periods are important in explaining the economic and political relationships that emerged and characterized the next several decades, so responses to this new era of crisis are the basis on which state-economy and state-society relations in many countries will be constructed for the next several decades.³

STATES AND STATE CAPACITIES: DEFINITIONS AND ISSUES IN THE LITERATURE

In this book, I am concerned with how economic and political crises in Latin America and Africa affected dimensions of state capacity that are important in defining relationships among state, economy, and society. This question, explored at a general level for eight Latin American and eight African countries, is assessed in greater depth through the specific experiences of Mexico and Kenya. For these two countries, I expand the analysis to consider how state leaders and political institutions influenced and responded to the pressures that altered the ability to regulate the economy and respond to civic society. The experiences of Mexico and Kenya shed considerable light on how state-economy and state-society relationships are contested, negotiated, and reconstituted at critical historical moments.

In this analysis, I understand the state to be a set of ongoing institutions for social control and authoritative decision making and implementation.⁴ The state is conceptually distinct from both economy and society, with inherent interests in expanding its scope for autonomous action, asserting control over economic and social interactions, and structuring economic and social relationships. These interests derive primarily from the state's concern to establish and maintain internal and external security, to generate revenue, and to achieve hegemony over alternative forms of social organization.⁵ The ability to achieve security, raise revenue, and assert autonomy and control, however, is profoundly influenced by economic conditions and degrees of social mobilization, as well as by the legitimacy and internal cohesion of the state itself. States are therefore frequently engaged in contesting the right and capacity to make and implement authoritative decisions that structure economic and social interactions. In this regard, the state is a moving target, "defined by contention along its boundaries and among politicians and bureaucrats who, in competing for office and influence, rework social and economic conflict into political terms."⁶ States are not monolithic and contention along

boundaries is often combined with contention among branches and levels of government, agencies, and diverse bureaucratic interests.

States assume empirical reality through regimes that attempt to establish political order, set terms for political interaction, allocate leadership positions and power resources, and determine the representation of interests within decision-making contexts.⁷ Regimes attempt to negotiate and impose formal and informal rules about how the state will relate to the economy and to the society; durable and legitimate regimes have greater capacity to achieve these goals than do those that are less institutionalized. Within the context of regime structures, political leaders create or maintain coalitions of support to achieve particular policy goals and may seek to use them to expand the scope of autonomous action for the state. In turn, political institutions allocate position and power resources that affect the ability of such leaders to act on their preferences and achieve their goals. These institutions are also subject to contestation over their structures and roles and can change over time to reflect different degrees of autonomy and strength:

As already indicated, economic and political crises had a destabilizing effect on existing state-economy and state-society relations throughout Latin America and Africa, and in many ways, the capacity of states to encourage economic development and maintain social stability was severely undermined. Nevertheless, these crises opened up increased space for deliberate efforts to craft new relationships between state and economy and to redefine relationships of power and accountability with society. They provided opportunities for state elites to mobilize support for new strategies of national development and strengthen the state's capacity to assume newly defined roles.⁸ In considering the cases of Mexico and Kenya, the influence of specific political leaders with particular economic and political goals looms large in the explanations of crisis and change. So, too, do the ways in which institutions structure power relationships and allocate political resources that can be used to shape both economic and social agendas. The 1980s and 1990s presented governments with difficult challenges, but this book indicates the extent to which they also provided expanded scope for innovation.

The concept of state capacity provides the organizing theme for this analysis. In recent years, considerable scholarly attention focused on the state as political scientists, economists, and political economists debated its definition, assessed its strength and relative autonomy from groups and interests in national and international arenas, and discussed the role it should play in development.⁹ Inevitably, these discussions, along with heightened concern about the causes and consequences of economic and political crisis, fostered questions about state capacity; considerable evidence accumulated during the 1980s to suggest that states varied widely in their ability to set the terms for economic and political interactions and to carry out the functions assigned to them.¹⁰ The notion of state capacity, long assumed to be an inherent characteristic of "state-ness," became more frequently a matter of theoretical concern and empirical assessment.¹¹

Growing theoretical interest in state capacity was encouraged by shifting paradigms in development economics. This field, which in the 1950s and 1960s pioneered

work on market failures and the rationale for state intervention in developing country economies, began by the mid-1970s to focus on government failures, that is, the ways in which public action can distort markets and create disincentives for productive investment and behavior.¹² State intervention in the economy through regulatory mechanisms, investment, marketing boards, and parastatal industries soon became central in explaining the economic stagnation and imbalances experienced by a wide range of countries. A prominent view among neoclassical economists and political economists pointed to the state as the single most important impediment to economic development – an “invisible foot” corresponding to the “invisible hand” of the market, an economic predator, and an arena for encouraging directly unproductive activities (DUPs).¹³

Indeed, a new orthodoxy of market liberalism emerged in development economics and was widely subscribed to by academics and practitioners in the 1980s. Embedded in the new consensus, at least initially, was a strong strain of anti-statism, a theme also emphasized in political science by public choice analysts.¹⁴ Extensive state intervention in the market and a series of government failures were shown to be a logical consequence of a close alliance between rent-seeking public officials and rent-seeking economic interests. In turn, radically diminishing the size and scope of state intervention was the clearest way to end rent seeking and to encourage more dynamic economies. At an operational level, this perspective implied the need to disband marketing boards and parastatal organizations, diminish regulatory constraints, and strengthen the role of the private sector in investment decision making. For many economists, the notion of a minimalist state replaced that of the developmentalist state of prior decades.

The vehemence of the neoclassical attack on the state cooled somewhat by the late 1980s, however. Thoughtful observers noted that state minimalism could be carried too far.¹⁵ While the general tone of the attack on the state by development economists remained negative – and considerable empirical evidence accumulated to support their views – literature in economics and political economy raised increasingly insistent questions about the appropriate role for the state in economic development. States were important in the process of development, analysts argued, because states alone could provide a set of conditions essential to economic development – law, order, effective macroeconomic policy, infrastructure development, investment in human capital, enhancement of equity.¹⁶ Renewed interest in state capacity and the relationship between state and economy also encouraged scholars to pay greater attention to institutional structures and how such institutions affect the course of economic development. The research of “new institutional economists,” for example, suggested that western capitalist economies developed in the wake of institutional innovations to ensure the rights of private accumulation and the sanctity of contracts among economic agents.¹⁷

Increasingly, analysts emphasized the importance of the type and quality of state intervention rather than its quantity, the capacity of the state rather than its size. Thus, a number of researchers who sought to uncover the secret of the East Asian “success stories” found significant evidence that the actions and policies of develop-

ment-oriented states were central to generating high and sustained growth rates.¹⁸ In several of these countries, strong, centralized, interventionist, and authoritarian states were specifically credited with engineering economic growth through state policies for investment, trade, and social control. State capacity to set institutional structures conducive to economic growth, to manage macroeconomic policy, and to carry out basic public functions thus became important in explaining the differential history of states that developed and states that stagnated economically.¹⁹

Scholarly attention also focused on changes occurring in civic society. Empirically, analysts noted that an often weakened, less pervasive, and at times delegitimized state opened up considerable room for redefining and renegotiating traditional forms of state-society relations. This space was increasingly occupied by varieties of civic associations pressing demands on the state or seeking greater autonomy to find solutions to collective problems without the threat of state intervention and control.²⁰ In Latin America and Africa, the decade witnessed the emergence and strengthening of groups pressing for democratic structures of government and more equitable and participatory forms of decision making. At times, local communities and non-governmental organizations responded to an apparent loss of state presence by attempting to find grassroots solutions to economic and social problems as well as by making collective demands on government at local, regional, and national levels.²¹ Responding to the liberalization of economic activities, some private sector groups began to eschew traditional corporatist or clientelist relationships with the state and became more insistent as pressure groups and lobbyists in policy making.

Several currents in social science literature attempted to define the nature of these efforts to establish new political relationships between state and civic society.²² For example, literature on redemocratization and authoritarian transitions focused attention on the emergence or reemergence of political parties, labor unions, and economic groups that characteristically form the basis for political mobilization in democratic societies.²³ Related work on regime transitions pointed to concerted efforts among politically relevant actors to form pacts around agreements about the rules of the game for political and policy contestation.²⁴ Still other scholars focused on "new social movements" in which citizens identified common interests that transcended traditional categories of class, interest, or clientelism, coalescing around alternative identities such as community membership, ethnicity, greenness, or gender.²⁵

This literature posed several possible outcomes of renewed political vigor in civic society. For example, a significant body of research pointed to the role of civic associations in opposing the state, particularly in non-democratic settings.²⁶ Common to much of this literature was the emphasis on protest and contestation. In this regard, civic society was credited with a range of efforts to oppose and transform authoritarian regimes, to lay the basis for multiparty systems where no-party or one-party regimes held power, and to open up policy-making processes to public input. The importance of contestation was less evident in literature that defined the ends of state-society interaction as that of negotiation and bargaining. This literature emphasized the formation of horizontally based interactions with representatives of

the state and pointed to efforts to use negotiation rather than petitioning as a form of extracting resources. The movement toward a political culture of citizenship, stressing rights and obligations, as opposed to one based on clientelism, stressing dependent relationships, was identified in this literature.²⁷

Interest in the social impact of economic stagnation and fiscal austerity led other scholars to concentrate on efforts of various civic groups to substitute for the state. Many analysts of African political economy focused on the widespread corruption, exploitation, and brutality of some regimes and explored how those most vulnerable to economic and physical exploitation responded to such conditions. They identified a common pattern of disengagement from the state whereby individuals, households, and groups withdrew or tried to avoid contact with officials and organizations representing it.²⁸ The emergence of parallel markets, black markets, and the informal economy were widely documented forms in which disengagement characterized economic interactions.²⁹ Less well-documented but increasingly noted were forms of political disengagement such as the emergence of "parallel governments" in which local communities, at times abandoned by state institutions that had formerly provided social welfare services, sought to provide these services for themselves.³⁰ This literature pointed to the creativity and vitality of efforts at collective problem solving among communities, ethnic groups, and religious or voluntary associations, providing a positive view of the capacity for grassroots organization and supporting a growing literature on the importance of grassroots democracy, self-government, and autonomy.³¹

Literature on contesting, negotiating with, or substituting for the state focused attention on the ways in which citizens attempted to increase their power and autonomy relative to the state. As part of this larger critique of authoritarian modes of political organization and research on emerging forms of political organization, the concept of state capacity was broadened to include characteristics of political representation, conflict resolution, and administrative openness and fairness. Political scientists and others argued that capable states had to be responsive to the demands and pressures of societal groups and to be able to mediate social demands and maintain institutions that were effective in resolving conflict. The concept of governance, referring in part to the political and institutional development of a country and its capacity to achieve and maintain good government, was increasingly used to denote a state's capacity to tolerate and even invite political pluralism.³²

As suggested in the foregoing paragraphs, diverse literatures converged on the notion that states must have certain kinds of capacities if they are to be effective in managing tasks of economic and political development. The first column in Table 1.1 presents a set of characteristics widely asserted to be those that capable states ought to have. A capable state is one that exhibits the ability to establish and maintain effective institutional, technical, administrative, and political functions, as these characteristics are defined in the table. Theoretically, states that exhibit these characteristics should be well-equipped to manage tasks essential to economic and political development.

Table 1.1 *State capacity: theory and predictions*

| Theory | Predictions |
|---|---|
| Capable states ought to have: | Hypothesized condition after a decade of economic and political crisis: |
| Institutional capacity | |
| Authoritative and effective "rules of the game" to regulate economic and political interactions. Ability to assert the primacy of national policies, legal conventions, and norms of social and political behavior over those of other groupings. | Decreased authority and legitimacy of government. Weakened ability of states to set authoritative standards for individual and group behavior. Increased conflict over "rules of the game" for economic and political interactions. |
| Technical capacity | |
| The ability to set and manage effective macroeconomic policies. A cadre of well-trained economic analysts and managers. Well-staffed and appropriately placed units for policy analysis. Important role for technical input and information in decision making. | Increased numbers, visibility, and influence of economic technocrats, economic ministries, and policy analysis units. Increased presence of international technocrats in national policy making. Tension between technocratic and participatory policy making. |
| Administrative capacity | |
| Effective administration of basic physical and social infrastructure. Ability to perform basic administrative functions essential to economic development and social welfare. | Weakened administrative ability to deliver basic services and carry out normal functions of government. Decreased ability to mediate social and economic demands within administrative contexts. |
| Political capacity | |
| Effective and legitimate channels for societal demand making, representation, and conflict resolution. Responsive political leaders and administrators. Societal participation in decision making. | Increased vitality of civic society and lessened responsive capacity of state leaders and managers. Decreased capacity of state elites and political institutions to mediate conflict. Tension between increased technocratic decision making and responsiveness to societal demands and participation. |

STATE CAPACITY: HYPOTHESES AFTER A DECADE OF CRISIS

Much of the analysis that produced a multidimensional definition of state capacity centered on what states ought to do to manage dynamic and sustained economic development and what political characteristics ought to define good government.³³ Rarely did issues of how more capable states emerge or change over time get addressed, resulting in considerable gaps between concerns about "what ought to be" and "what is" in a realistic appraisal of state capacity. In fact, persistent crises

of the kind that characterized many Latin American and African countries in the 1980s and 1990s could significantly affect existing abilities to set the terms for economic and political development. In the second column of Table 1.1, I summarize a series of general hypotheses about how crisis can affect institutional, technical, administrative, and political capacities.

The first set of hypotheses relates to the impact of crisis on the institutional capacity of states, that is, the ability of states to set and enforce the broad sets of rules that govern economic and political interactions. Of concern here are institutions such as legal norms governing relationships among economic agents, constitutional and administrative rules setting standards for the behavior of public servants, constitutional dictums governing relationships among state organizations, and electoral systems and procedures for holding public officials accountable for their actions. Similarly important is the ability to ensure the primacy of national policies, legal codes, and norms of social and political behavior over those adhered to by sub-national groupings.³⁴ To what extent have the convergence of economic and political crises undermined existing capacity to set and enforce such rules and to ensure the stable functioning of authoritative institutions?

At a general level, I hypothesize that economic crisis combined with increased political challenges to existing regimes weakened the legitimacy and coercive capacity of state institutions and laid bare the inadequacy of systems for regulating property rights, enforcing contracts, controlling official corruption, setting boundaries on the use of coercion, and other basic institutional functions. In many countries, then, contention over policy issues frequently incorporated more basic disagreements about the rules of the game for resolving economic and political conflict. Of course, many states lacked effective rules and coercive capacity in the pre-crisis period, but the dual impact of economic and political crises raised the visibility of the need for authoritative institutional structures at the same time that it weakened the capacity of many states to provide them.

A second set of generalizations relates to changes in the technical capacity of states, defined here as the ability to manage macroeconomic policy and analyze economic policy options more generally. I hypothesize that, for many countries, the pressures of economic crisis and the need to negotiate more effectively with international financial agencies during the 1980s and 1990s increased technical capacity in macroeconomic analysis and management. Ministries of finance, central banks, and national planning institutes often became more powerful players in setting economic policies and negotiating agreements with multilateral and bilateral agencies and domestic economic groups. Policy analysis units also became more widespread and influential in government. Similarly, technocrats and policy analysts increased in number and became more visible in decision-making arenas; at times they were able to use their access to data and analysis to increase their power vis-à-vis domestic economic interests opposed to policy change. Equally important was the increased presence of international techno-

crats in national policy discussion. Such changes can alter how policy decisions are made and who participates in decision-making processes. In some cases, for example, technocratic decision-making styles were noted to conflict with the more open, participatory styles pressed for by politically mobilized groups.³⁵

A third set of issues concerns the administrative capacity of states and how it was affected by deep budgetary and personnel cuts that resulted from stabilization efforts. Administrative capacity refers to the ability of states to deliver goods and services such as public health and education, provide physical infrastructure, and carry out the normal administrative functions of government, such as revenue collection, necessary economic regulation, and information management. This is a critical capacity for governments because it affects the ability of private economic agents to achieve their goals and the ability of government to satisfy basic needs demanded by civic society. I hypothesize, however, that the administrative capacity of many states declined due to austerity budgets, declining civil service performance, and heightened political conflict. Thus, after a decade of crisis, many governments may have increased their abilities in macroeconomic management while losing valuable capacity to respond to public needs, develop human resources, maintain investment, and provide essential sectoral and infrastructural services.

A fourth set of issues relates to the impact of greater political pluralism on state capacity. Political capacity, as used here, refers to the ability of states to respond to societal demands, allow for channels to represent societal interests, and incorporate societal participation in decision making and conflict resolution. It refers to the effectiveness of everyday interactions between government and citizens, rather than to the broader rules of the game that comprise institutional capacity. How effective are governments on a day-to-day basis, in response to conflict, demand making, and opposition? How good are they at problem solving? Many states moving from authoritarian modes of political control to more open ones lacked channels of access for more pluralistic demand making and representation and the means for negotiating and resolving conflict with an invigorated civic society. As suggested earlier, the confluence of economic and political crisis diminished the capacity of state leaders to command adherence to traditional norms of civic behavior or to purchase allegiance through beneficial policies or clientelistic distribution of public resources. Demands for policy responsiveness nevertheless increased. States were thus under heightened pressure to respond to diverse interests and mediate overt societal conflict, but their capacity to do so may have diminished.

These sets of interrelated questions about the impact of economic and political change on the institutional, technical, administrative, and political capacity of states are broad. Nevertheless, the impact of crisis on state capacity is only part of the task undertaken in this book. As suggested earlier, how states respond to the challenges of crisis and its implications for various dimensions of state capacity is critical to understanding how state-economy and state-society relations can be reformulated at critical historical junctures.

RESPONDING TO CRISIS

Crises of the kind experienced in many developing countries in the 1980s and 1990s opened up increased space for redefining existing relationships between the state and the economy and society. But states do not respond in disembodied ways to the challenge of crisis. Instead, those who hold political power and have access to political resources must use the conditions created by crisis to mobilize coalitions of support, promote new visions of economic and political development, and alter the constraints they face in achieving these visions. Political leaders differ significantly in their interest in promoting economic and political change as well as in the skills they bring to these tasks. They also differ in access to resources enabling them to spearhead change. These factors are important in explaining divergent outcomes in the state's response to economic and political crises.

Concrete actions of state leaders to alter existing economic and political relationships are supported or hindered by political institutions that determine the availability of strategic resources, coalitions of support, and capacity to exert power over other actors and institutions. The presidency as an institution, for example, can have considerable influence on the ability of incumbent leaders to act on their preferences because the position itself provides more or fewer strategic advantages and greater or lesser legitimacy. In the case studies of Mexico and Kenya to be explored later in this book, for example, the institution of the presidency provided a range of advantages to incumbents that allowed them to centralize great power for the pursuit of their economic and political goals. Similarly, the bureaucracy as an institution can allow for greater or lesser degrees of social control and more or less responsiveness to policy pronouncements. Both Mexico and Kenya had relatively well-institutionalized public bureaucracies that increased the capacity of state leaders to set the terms for policy making and implementation. In addition, political parties, as institutions that act at the boundaries between state and society, can enhance or diminish the capacity of the state to redefine critical economic and social relationships. Dominant parties in Mexico and Kenya expanded state power to control the extent of social mobilization.

Clearly, then, the ability of states to respond to the heightened space – and risk – created by crisis conditions is likely to vary widely. It will depend on economic exigencies and constraints, the strength of pressures for economic and political change from domestic groups and international actors, legacies of a variety of historical and policy experiences, the legitimacy, coherence, and strength of state institutions, and the goals and skills of state leaders.³⁶ In terms of the dimensions of state capacity that are of interest here, a series of questions focus attention on the degree to which political leaders and institutions take advantage of the increased space created by crisis to pursue changes in state–economy and state–society relationships.

To what extent, for example, were there efforts by state elites and political institutions:

- To reassert *institutional capacity* by defining and negotiating new rules to govern economic and political behavior and forging new institutional structures and asserting their predominance over prior rules of behavior?
- To take advantage of increased *technical capacity* by developing and implementing alternative strategies for economic development, increasing the insulation of economic policy making from domestic rent seekers, or altering the policies that shape the behavior of economic interests in society?
- To compensate for weakened *administrative capacity* by experimenting with alternative production and service delivery mechanisms, introducing effective programs to compensate for the social costs of adjustment, or increasing public sector efficiency?
- To increase *political capacity* to mediate and resolve conflict and respond to societal demands by enhancing the problem-solving skills of government, incorporating new groups into decision making, allowing for increased political participation and local level problem-solving, and finding ways to increase technical input into decision making without compromising opportunities for wider participation?

Such activities significantly influence the performance of national economies and the political integration of society by encouraging the adoption of new definitions of the role of the state, altering opportunities available to private economic agents, and affecting the ways in which citizens relate to government and engage in efforts to influence policy outcomes. They also affect the extent to which new definitions of state-economy and state-society relations become embedded as enduring patterns for pursuing economic development and distributing political power.

CHALLENGE AND RESPONSE: THE SCOPE OF RESEARCH

In preceding pages I outlined a series of hypotheses about dimensions of state capacity and how they were affected by economic and political crisis. In Chapter 2, I begin to assess these hypotheses using data from sixteen countries in Latin America and Africa. The chapter describes the nature of the crises and provides a general analysis of their causes. It assesses the origins of these crises in international and domestic contexts. It considers the impact of crisis on four dimensions of state capacity for the same set of sixteen countries, exploring the extent to which the hypotheses present a useful analysis of the institutional, technical, administrative, and political capacities of states during a decade or more of economic stagnation and political turmoil. The chapter indicates the extent to which long-entrenched relationships among state, economy, and society were torn asunder by the depth and duration of economic decline and political upheaval.

Chapters 3 through 7 present an analysis of one country from each region to consider not only the nature of economic and political crises and their impact on state capacity but also the ways in which political leaders and institutions shaped

responses and influenced how state-economy and state-society relations were redefined. The case study countries, Mexico and Kenya, are not compared directly. Their colonial histories are distinct and struggles for independence marked them in different ways. The conditions and timing of economic and political development diverge. Kenya's economy is more agrarian and rural than Mexico's and its political history as an independent state is much shorter. The international contexts of the two countries also differ significantly, as does the size of their economies, territories, and populations.

Despite such significant differences, they were selected as case studies because, in relation to their own regions, they shared some important characteristics that enhanced their utility for analysis. First, they each presented relatively successful examples of sustained economic growth. Prior to the 1980s, Mexico stood out among Latin American countries for having achieved a relatively strong record of economic growth that was sustained over several decades. In Africa, Kenya had achieved a similar distinction for sustained growth. They had each adopted a development model based on state capitalism and import substitution. Expanding industrial, agricultural, and commercial sectors and considerable foreign investment also characterized the economic development of the two countries. In considering the impact of economic crisis, then, I am able to consider the extent to which sustained crisis can undermine even relatively effective state-economy interactions.

Second, both Mexico and Kenya developed relatively strong and effective states in their respective regions and experienced sustained political stability. In continents wracked by political upheaval, regime changes, and polarizing tendencies, both countries achieved centralized political and administrative control in prior decades and a generally legitimized set of institutions to manage conflict resolution. Civilian authoritarian regimes characterized each country. In considering the impact of political crisis, these similarities facilitate description and analysis. Moreover, their relatively strong state structures provide greater scope for assessing the impact of crisis on dimensions of state capacity than would be the case in countries with states that had failed to develop effective control over their domestic economies and societies. States that were initially stronger and more institutionalized are also in a better position to influence the restructuring of state-economy and state-society relations than would be the case with historically weak and unstable states.

Third, political institutions in these two countries provided state leaders with a wide range of resources should they attempt to influence the restructuring of state-economy and state-society relations. In each case there was an established tradition of a strong presidency with both constitutional and charismatic authority. Mexico and Kenya also had relatively strong bureaucratic institutions for policy development and management, providing state leaders with considerable ability to intervene in the market and in society.³⁷ Similarly, both countries had multiclass, integrative, and clientelistic political parties that were used as instruments of political control. In Mexico, of course, the Institutional Revolutionary Party (PRI) was the dominant party among several, while the Kenya African National Union (KANU) in Kenya was the only legal party from 1982 through late 1991. Nevertheless, political control

and mechanisms for distributing government largesse were effectively institutionalized through the clientelist networks of a dominant party in each country. The presidency, the bureaucracy, and the parties in Mexico and Kenya were affected significantly by the economic and political challenges of the 1980s and 1990s and their strength and legitimacy dropped to historically low levels. However, the resources available to presidents in both countries remained considerable, their state bureaucracies did not collapse as did those in some other countries, and the political machinery of the party organizations remained significantly intact.

Like other countries in their regions, Mexico and Kenya faced major economic problems in the 1980s. Mexico's was by far the most dramatic and painful. In 1982, the announcement that the country could no longer service its international debt triggered an era of debt crisis that had reverberations around the world. Its efforts to adjust were therefore apparent earlier than Kenya's and the extent to which it embarked on a sustained commitment to stabilization and structural adjustment was much more marked. Kenya's economic crisis was slower to emerge and was taken less seriously by its leaders, despite increasing pressure from international financial institutions. Chapter 3 presents an overview of the economic problems of these two countries.

Pressures for political liberalization that confronted these two relatively strong states are also assessed in Chapter 3. By the mid-1980s, many analysts of Mexico's development were predicting the demise of the PRI-dominated political system under the strain of increased civic activism and much heightened criticism of government. In Kenya, the late 1980s witnessed an extensive mobilization of opposition to government and a national struggle to force the introduction of multiparty elections. In both countries, the mobilization of civic associations was vibrant.³⁸ These organizations were simultaneously seeking newly defined space in which to contest political and economic issues, demanding greater responsiveness from the state, seeking ways to negotiate with state agencies, and, at times, withdrawing from interaction with the state. In each case, the challenge to the authority, legitimacy, and problem-solving capacity of the state was clear. By 1988 in Mexico and 1993 in Kenya, long-established relationships between the state and economy and the state and society had ceased to define the realities of economics and politics.

Against this overview of the challenges to the state created by economic and political crises, Chapter 4 initiates the analysis of state capacity in Mexico and Kenya. The chapter focuses on institutional capacity; it assesses the extent to which the authoritative role of the state in setting and enforcing the rules of the game for economic and political interactions was altered as a result of crisis. It assesses rules to regulate interactions among economic agents such as property rights and contracts and those that relate to the power of civic society and the accountability of public officials such as electoral and representational systems. In periods prior to the 1980s, Mexico and Kenya had developed relatively strong institutional capacity. But the history of these two countries underscores the extent to which such capacity can wax and wane over time; authority and legitimacy can be contested and undermined

as well as developed. The chapter also indicates the extent to which the actions of political leaders and institutions affect the timing and content of efforts to redefine important rules for economic and political interactions. Ultimately, however, new rules must be accepted as appropriate and legitimate by those who will be subject to them. Strengthening institutional capacity, therefore, requires creating the basis for social consensus and consent.

In Mexico, economic deregulation, changes in property rights in the countryside, and the reassertion of presidential power are cases in formal and informal rule redefinition considered in Chapter 4. In each of these areas, political leaders and institutions were principal protagonists. The experience of Mexico reaffirms the extent to which crisis can diminish the institutional capacity of the state but also open up opportunities for developing alternative rules that restore its authority. In Kenya, the authority and legitimacy of the state reached perilously low levels in the early 1990s and the redefinition of rules was hotly contested. The chapter explores changes to the constitution, the extent of presidential power, economic liberalization, and privatization as arenas of contention over who would determine the rules and how they would be enforced. In the cases of Mexico and Kenya, the preferences and strategies of political leaders, as well as the resources available to the presidency, the bureaucracy, and the party, affected the outcome of contestation, but the degree of acceptance of new rules was only partly determined by these actors and institutions.

Chapter 5 assesses changes in the technical capacity of the two governments and the implication of these changes for developing and managing economic development policies. More specifically, the chapter focuses on central economic ministries and agencies in Mexico and Kenya and asks to what extent the technical capacity of these organizations was altered through crisis and affected by the actions of political leaders. Data on change and its consequence are derived primarily from organizational histories, the changing relationships of technical units and technical advisors to high level decision makers, the emergence of technocrats in positions of influence, and changes in the structure of presidential advisory units, staffs, and cabinets.

This chapter details the extent to which technical capacity changed and the extent to which state leaders encouraged technical input into decision making. Mexico provides a clear-cut case of increased technical capacity and use of that capacity in policy making. In Kenya, on the other hand, the state lost technical capacity. Policy making about the economy became more capricious and less informed by technical analysis. In explaining these divergent experiences, the goals and strategies of political leaders are critical. The chapter indicates clearly that technocratic influence is derivative of political power. Mexico's leaders empowered technical experts in policy arenas; Kenya's did not.

The administrative capacity of the state in Mexico and Kenya is explored in Chapter 6, primarily through an assessment of public expenditures for health, education, and public works and changing priorities within ministries responsible for social and physical infrastructure. In both countries, budgets for health and roads suffered serious declines; education budgets were expanded in Kenya but slashed in Mexico. More generally, conditions for public sector workers declined significantly,

particularly in Kenya, and the capacity to carry out normal functions of government suffered.

Within this context of weakened administrative capacity, a number of experiments were undertaken to test the potential for doing "more with less." There were, for example, efforts to increase efficiency and to reallocate resources within sectors to protect the most vulnerable. In addition, in Mexico, decentralization in health and education, community-based services, and contracting out of physical infrastructure development and maintenance were important efforts to deal with the impact of crisis and the implications of austerity for the ability to deliver basic services. These innovations are assessed in the chapter. In Kenya, user fees in health and education, a reorganized education structure, and reallocation of resources for roads are also considered. New modes for delivering basic services became more acceptable in both countries. Nevertheless, the administrative capacity of the state remained low. Despite innovation, poorly funded and badly managed ministries remained impediments to the more effective delivery of social and physical infrastructure. In fact, in this area, the impact of the goals and strategies of political leaders and the resources available to political institutions were less influential than for other dimensions of state capacity. Implementation remained the weakest link in state-sponsored efforts to alter state-economy and state-society relations.

Chapter 7 addresses the issue of the changing capacity of state elites and institutions in Mexico and Kenya to respond to increased demands for responsiveness, representation, and participation. Traditionally, the state in both countries had been effective in channeling and controlling political behavior. On a day-to-day basis, political conflict was managed through the distribution of state resources and patronage and through elaborate systems of cooptation and control. But economic crisis robbed political leaders and institutions in both countries of the resources formerly used to cement relationships between state and civic society.

This chapter addresses the relationship between diminished political capacity and more open and pluralistic practices of governance. The ability of new voices and new demands to be heard, of political parties to represent interests in society, and of citizens to participate in meaningful elections are among the issues considered. The case studies suggest that, in contrast to other dimensions of state capacity, political capacity does not respond directly to the actions of political leaders and institutions. Rather, such capacity is a result of contestation between state and civic society within specific arenas and over specific issues. I assess how political institutions – primarily the presidency and the political parties – responded to changes in the nature and extent of political mobilization and the degree to which they were forced to accommodate new voices, new demands, and new forms of participation. These experiences indicate the extent to which the political capacity of the state is dependent on the political capacity of civic society.

The question of the extent to which governments in Mexico and Kenya were able to respond to the challenges of crisis is considered more broadly in Chapter 8. In these two countries, and in a large number of others in Latin America and Africa, deep and sustained economic and political crises clearly challenged the state to

strengthen, reform, or reinvent itself. Their leaders and institutions were challenged to assume formative roles in establishing new ways for the state to interact with the economy and society. In assessing how state leaders and political institutions in Mexico and Kenya managed and at times reinterpreted the institutional, technical, administrative, and political tasks of government, this chapter suggests the nature and range of opportunities available for political leadership in moments of crisis. It also provides insight into the constraints set by leadership goals and existing economic and political structures on the potential for innovation. The divergent experiences of Mexico and Kenya suggest that political leadership and structures of political control can be simultaneously part of the problem and part of the solution to building more efficient, effective, and responsive states.

Chapter 8 also explores the role of ideas in reshaping state-economy and state-society relations. The importance of ideas – and the use of those ideas in providing strategic vision and creating new coalitions of support – about the role of the state in development and the relationship between government and citizen is central to explaining outcomes in Mexico and Kenya. Chapter 8 builds on the country case studies to provide a series of generalizations about political and institutional leadership and “the power of public ideas” in economic and political reform.³⁹ In addition, the cases of Mexico and Kenya raise important issues about the relative merits of authoritarian and democratic systems in establishing the bases for efficient, effective, and responsive states. The case of Mexico provides evidence of the extent to which concentrated resources of power can speed the introduction of change, but the case of Kenya is a powerful reminder of the equally great extent to which power can be abused in authoritarian systems. Indeed, the changes that occurred in Mexico were often introduced with little concern for the participation and representation of societal interests and carried out in ways that limited the capacity of citizens to hold public officials accountable for their actions. In concluding this book, I suggest that while change may be more difficult to introduce in democratic contexts, it may ultimately result in states with greater legitimacy, accountability, and responsiveness.



THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

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NEW IMPLEMENTATION CHALLENGES - A FLEXIBLE SPECIALISATION PARADIGM

by

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1
2
3
4
5
6
7
8
9
10

Table of Contents

| | |
|---|-----------|
| EXECUTIVE SUMMARY | 3 |
| OLD STRATEGIES OF DEVELOPMENT ARE OBSOLETE | 4 |
| A "LONG WAVE" APPROACH TO DEVELOPMENT | 5 |
| MEANINGFUL PARTICIPATION IN THE FIFTH WAVE | 9 |
| THE FLEXIBLE SPECIALISATION PARADIGM | 13 |
| FLEXIBLE SPECIALISATION - TWO EXAMPLES | 16 |
| A TIME FOR ACTION | 20 |

Executive Summary

Import Substitution Industrialisation and even Export Promotion Industrialisation strategies of development are obsolete. Import Substitution Industrialisation has not developed the level of industry, employment, investment and entrepreneurship as promised: many infant industries have simply not grown up. With its lack of focus and direction, export oriented manufacturing has also failed to ignite the economies of the Caribbean: the shift from the domestic market to the demanding and highly competitive export barriers in themselves; there has been little research and understanding of what export markets wanted; what they were willing to pay; where the competition came from; and what was needed to compete.

This paper briefly analyses the development of the Caribbean economy through the 'Long Wave' perspective. It argues that the first three waves of development bypassed the Caribbean; the fourth wave marginally involved the Caribbean through import substitution and the exploitation of its natural resources; and that the Caribbean cannot afford to miss the fifth wave. A strategy of **flexible specialisation** is proposed - a strategy that promises to maximise involvement of the Caribbean in the Fifth Wave.

The essence of flexible specialization is being narrowly specialised and simultaneously having the flexibility to move with the market as demand changes. The strategy of flexible specialization is by nature export oriented (although not exclusively so) and implies an environment of open competition. It argues for the full and complete opening of the sector or segment in question.

Key to the successful implementation of strategy of flexible specialisation are: the selection of focus sectors/niches for development; the development of the eight key sector-related capabilities:

- education and training;
- management;
- design;
- production;
- marketing;
- networking;
- regulatory environment;
- research and development; and
- supporting institutions.

Also critically important are the development of flexible production capabilities to respond to changing market conditions and; networking locally, regionally and internationally to provide inter and intra firm dynamics and to source materials, information and market intelligence data; and continuous innovations to always stay ahead of the game.

The strategy of flexible specialisation is elaborated using two examples: one from the manufacturing sector (garments) and one for the services sector (environment).

Old Strategies of Development are Obsolete

Import Substitution Industrialisation and even Export Promotion Industrialisation strategies of development are obsolete. Import Substitution Industrialisation has not developed the level of industry, employment, investment and entrepreneurship as promised: many infant industries have simply not grown up; many have gone out of business; many firms born in this era have neither the will nor the capacity to penetrate export markets; and local consumers (the ones who ultimately pay) have generally been loaded with over-priced goods and poor quality.

With its lack of focus and direction, the attempt at export oriented manufacturing has also not enjoyed the levels of success that one might have expected. Many wrongly assumed that one simply had to shift current production into export markets, without regard for what the export markets wanted; what they were willing to pay; where the competition came from; and what was generally needed to compete. Successful export firms tended to be few and far between, the product of extraordinary talent and entrepreneurship and generally not on the level or scope that would lead to any major development of the local economy. In addition, successful exporters found themselves very alone, with the institutions, government policies, training institutions, and not in support of them. There has generally been a lack of focus or specialisation with respect to the export thrust as well as general lack of capacity and flexibility to move with the market.

This paper argues for a new approach to development - an approach based on the principles of flexible specialisation. The paper will examine the role of the Caribbean in world development, taking a 'long wave' perspective; we will examine the key implications of the Fifth Wave (Information and Communication Technology) for the Caribbean and argue that the Caribbean needs to take a leadership role in this Fifth Wave of development.

The strategy of flexible specialisation is elaborated using two examples: one from the manufacturing sector (garments) and one from the services sector (environment).

A "Long Wave" Approach to Development

The 'long wave' approach is an important tool in analysing and understanding the development of the world economy as well as the potential role that the Caribbean can play.

This analysis will show that the first three waves of development bypassed the Caribbean; the fourth wave marginally involved the Caribbean through import substitution strategies, and the exploitation of its natural resources; and that the Caribbean cannot afford to miss the fifth wave.

Five waves of development

World development is characterized by five distinct waves of development, where certain industries, countries and key materials predominated. Through these five waves, the world has seen the centres of influence move from Britain, Germany and the USA, to Japan today. The progression of these five waves - their time frames, description, main carrier branches and leading countries, is traced in figure I overleaf.

Key to the movement of the world economy through its five successive waves of development is the existence of a particular input or set of inputs which are low cost and available in almost unlimited supplies over long periods and which, moreover, have clear potential for use in many products and processes throughout the economic system (Freeman and Perez, 1996). These characteristics held for steam-powered transport in the Victorian Boom; low cost steel in the electrical and heavy engineering period; and oil in the last Fordist mass production wave. Today, microelectronics - progenitor of the fifth wave, is the driving force of the world economy.

The First Three Waves of Development bypassed the Caribbean

The first wave of development (the 'industrial revolution' 1770-1840), with Britain in the lead, bypassed the West Indies. At the beginning of the first wave in the 1770 and 1780s, sugar was king and the sugar profits of the West Indies helped to fuel the growth of Britain's industrial revolution. However, at the time, slavery was in place and the industrial revolution largely bypassed the majority of the West Indian population. Slavery was abolished at the ending of this first wave (1834-1838) in most English-speaking islands.

The second wave - coal and transport (1830-1890), also lead by Britain, bypassed the West Indies. This was the era of the rise of the free peasantry in the Caribbean and the very early beginnings of colonial government of the free peoples and the beginning of Indian indentureship. The focus of the colonial government at the time was on the development of institutions and infrastructure and preparation of the former colonies for self-government. Production continued to be largely 'muscovado-biased', wherein the Caribbean existed to "import what it consumed and export what it produced". Production was based on primary, low value exports such as sugar, coffee, cocoa, citrus, bananas. All manufacturing activities

took place in Britain - the mother country. It was commonplace to find that the West Indies, a producer of cocoa and sugar, imported chocolates for local consumption.

The third wave (1880s to 1940s) also bypassed the Caribbean. This period was marked by migration of the local population to work in the Northern countries with some settling in the UK and USA. Labourers were also enticed away to build the Panama Canal, some islands became locations of USA army bases (for example Trinidad). Possibilities for the oil and bauxite sectors in Trinidad and Jamaica respectively were beginning to be explored. Labour leaders began to be heard and the movement toward self-government was in train.

The Caribbean played a marginal role in the fourth wave

The Caribbean really began to play a role in the global economy during the fourth wave - an involvement that was primarily natural resource-based - from the development of the tourist industry in the 1960s, to the development and exploration oil and mineral resources (oil in Trinidad, bauxite in Jamaica and gold in Guyana).

Some manufacturing activity, mainly in food processing, garments, assembly (automobiles in Trinidad) and light manufacturing industries (furniture, footwear and leather goods) began to be developed. The production focus in the manufacturing sector was mainly on the domestic market - substituting and sometimes replacing imported items. Many of the companies took advantage of protected markets and generous tax incentives and many multinational subsidiaries and brand names were utilized.

Despite the manufacturing thrust for the domestic market, the real dependence of the Caribbean was on export sectors (oil in Trinidad, bauxite in Jamaica and increasingly tourism in Barbados, Jamaica, Tobago and the OECS islands). Rather than wean the economy away from its dependence on foreign exchange (importing what it consumes and exporting what it produces), the manufacturing sector continues to be a larger consumer of foreign exchange, as all inputs would usually have to be imported (for example parts for assembly of appliances and motor vehicles, fabrics for garment manufacture, machinery, tools, etc.). With foreign exchange as the lifeblood of Caribbean economies, it was not long before the import substitution strategies began to run into difficulties.

It is therefore not surprising to find today that for most successful exporters, the potential to earn foreign exchange was a main factor in their decision to export. In addition, many of the key foreign-exchange-consuming activities (mainly distributive trades and completely-knocked-down assembly operations) are shifting considerable resources into foreign-exchange-earning sectors (principally tourism). Consider that the two most dynamic tourism entrepreneurs in the Caribbean tourism industry (John Issa and Butch Stewart) were mainly involved in the distribution of automobiles and appliances in Jamaica. Even the large Neal and Massy conglomerate (assembling cars one once one of its main activities) is placing its bets on tourism.

In the fourth 'mass production' wave (1940s to 1990s), Caribbean islands made considerable strides in self-government and some islands gained independence in

Table 3.1 Information technology leads the fifth wave

| Character | Waves | | | | |
|--------------------------|---|---|---|---|---|
| | First | Second | Third | Fourth | Fifth |
| Time frame | 1770s and 1780s – 1830s and 1840s | 1830s and 1840s – 1880s and 1890s | 1880s and 1890s – 1930s and 1940s | 1930s and 1940s – 1980s and 1990s | 1980s and 1990s – 2040s and 2050s? |
| Description | Early mechanization | Steam power and railway | Electrical and heavy engineering | Fordist mass production | Information and communication technology |
| Main carrier branches | Textiles Textile machinery Iron-working Trunk canals Turnpike roads | Steam engines Steam ships Machine tools Railways World shipping | Electrical engineering Electrical machinery Cable & wire Heavy engineering Heavy armaments Steel ships Synthetic dye stuffs Electricity supply | Automobiles, trucks tractors, tanks aircrafts Motorized warfare Process plant Synthetic materials Petrochemicals Highways, airports Consumer durables | Computers, software Electronic capital goods Robotics Telecommunications equipment Optical fibres Digital communication networks Services, tourism |
| Key factors | Cotton | Coal | Steel | Oil | Microelectronics |
| Leading countries | Britain | Britain | Germany | USA | Japan |

Source: Freeman and Perez, 1988; *Caribbean Futures*, 1991a.

the 1960s. The University of the West Indies was established and has achieved a high standard of excellence and many nationals received higher-level training at top British and other institutions; there has been a considerable focus on primary and secondary education, with the Caribbean region achieving one of the highest rates of literacy among the developing world; considerable strides have been made on the social front in the areas of housing and medical care.

The 1970s also witnessed a period of nationalization of banks and other industries (for example the hotel sector in Jamaica) and the development of state enterprises (national gas companies, and petrochemicals, bauxite, tourism). Trinidad was fortunate to possess oil resources and benefited considerably from the four-fold increase in the price of oil in the 1973-74 period.

Still, the fourth Fordist mass production wave largely bypassed the Caribbean. There was peripheral involvement in this wave, mainly along the lines of import substitution and assembly type industries which were mainly subsidiaries of multinational corporations - corporations that were leading the fourth wave in their own countries. A comparative assessment of the role played by the Caribbean and the strategies pursued through the four waves of world development and opportunities for the future, is provided in Table 2 overleaf.

Today, it is increasingly clear that Import Substituting Industrialization has not 'delivered the goods'. The growing instability of many of the currencies and of the region, the brain drain, the fall in the basic standards of living, the growing austerity measures imposed by the International Monetary Fund (IMF), the World Bank (IBRD) and other lending institutions, growing unemployment and poverty are testimony to this failure.

At the time (the 1950s to the 1970s), the Caribbean had very little choice but to become marginally associated with the fourth wave. It was simply 'common sense' to follow the Import Substitution Model of Development, as did Latin America and other parts of the developing world. The Caribbean at the time had little choice but to respond to the global outreach of multinational corporations - to set up joint ventures and other branch plant subsidiaries of international organizations. Today, the Caribbean certainly has a choice!

Today, circumstances have considerably changed. A new paradigm is beginning to take shape - a paradigm of information technology, flexibility, specialization and focused production - a paradigm that is consumer-driven - a paradigm based on skills and knowledge - intensive production - a paradigm based on networks - a paradigm that promises new-comers and small size enterprises special advantages.

The fifth wave opens new vistas for the Caribbean

The fifth wave - the wave of the future - will take the global economy from the 1980s well into the next millennium. The fifth wave is driven by Information and Communication Technologies (ICT). It is critically important that the Caribbean does not miss this wave.

The fifth long wave is traced from the 1980s and 1990s and could last well into the 2030s and 2040s. It is as yet too early to tell when this wave will end or what will be the character of this wave. Historically, however, these waves tend to last between forty and sixty years. This fifth wave, is also known as the 'Information

Table 3.2 The old and new 'best practice' compared

| Characteristics | Mass production | Flexible production |
|--------------------------|--|--|
| Production concept | Mass production | Flexibility, specialization |
| Products | Limited range of standardized products Mass markets | Product variety and specialization 'Niche' markets, customization |
| Style of operation | Standardized routines and procedures 'There is one best way' Single top-down line of command | Flexible systems/adaptable procedures 'A better way can always be found' Widespread delegation of decision-making |
| Manning and training | Labour as a variable cost Market provides most trained personnel People to fit fixed positions | Labour as human capital Much in-house training and re-training Variable posts, adaptable people |
| Equipment and investment | Dedicated equipment Each plant anticipates demand growth Strive for economies of scale | Adaptable/programmable flexible equipment Organic growth closely following demand Choice or combination of economies of scale and economies of scope |
| Production programming | Stocks held 'just in case' Tolerance on quality and rejects | Stocks delivered 'just in time' Strive for 'zero defects' and 'zero rejects' |
| Markets and customers | Manufacturers dominate retailers Producers dominate users Mass advertising | Retailers dominate Producers and users have two-way relations Firm rather than product advertising |
| Competitive strategy | Full capacity utilization Cost cutting and over-production Stockpiling and markdowns | Innovation Diversification Market segmentation |

Source: Perez, 1986; UNDP/UNIDO, 1987; Poon, 1990.

Age'. It is marked by the rapid diffusion of microelectronics, computer and communication technologies throughout every country, industry, office, home, and life on the whole.

The fifth "Information and Communication Technology" (ICT) wave is brought about because of a number of limitations of the old mass production paradigm. Such are: the dis-economies of scale and inflexibility of dedicated and assembly line and process plant which could now be partially overcome by flexible manufacturing systems; 'networking' and 'economies of scope'; limitations on energy and materials intensity are now partially overcome by electronic control systems and components; limitations of hierarchical departmentalisation are overcome by 'systemation'; 'networking' and integration of design; production and marketing.

The two fundamental driving forces of the this fifth wave are the technologies on the supply side (rapid advances in technology, widespread applicability and declining costs) and the consumers on the demand side (more sophisticated consumers, with more income and effectively demanding more choice and better quality).

The main carrier branches of this wave are computers, electronic capital goods, software, telecommunications equipment, optical fibers, robotics, flexible manufacturing systems, ceramics, data banks, information services, digital communications network and satellites. Other sectors growing rapidly from a small base are third generation biotechnology products and processes, space activities and fine chemicals (see Table I).

The organization of firms in this second wave and the related forms of cooperation and competition are networks of large and small firms based increasingly on computer networks and close cooperation in technology, quality control, training, investment planning and production planning ('just in time' rather than 'just in case'), and similar structures offering internal capital markets.

Meaningful Participation in the Fifth Wave

The fifth wave - the Information Age - is driven by Information and Computer Technologies (ICT). It is critically important that the Caribbean does not miss this wave.

The Caribbean can play a dynamic role in the fifth wave. To do so, the vision of the Information Age must be taken on board, its full implications must be grasped, and resources must be regionally harnessed (both at public and private sector levels) in developing and implementing appropriate "flexible specialisation strategies".

The Information Age brings with it a number of critical implications - implications which must be carefully considered in determining the future direction of the region. Some of the key implications are drawn out below.

Technology Application is Key

One of the key considerations in preparing the Caribbean for the Information Age is that the technology for information manipulation and communication of all forms are already well-developed and readily available. Prices are falling and are expected to fall even further. The production of hardware is becoming less and less significant in the value creation process (just look at the price of computers today).

Today microelectronics are cheap and widely available. So pervasive are microelectronics applications that no society, home or office will escape its impact. Microelectronics are at the core of computers, computer numerically controlled machine tools, robotics, computer-aided design, telecommunications infrastructure, telephones, videos, games, toys, data processing, space missiles and myriad other applications. Computers are increasingly becoming a way of life - a tool for enhancing productivity in all sectors of the economy, a generator of new goods and services and a creator of new leisure pursuits.

The key to value creation in the information age - the fifth wave - is the use and application of these computers and communication technologies to generate new and enhanced services across all sectors.

This means that excessive focus on the development of physical goods (for example, trying to produce the computer) must be shifted. Strategies for the widespread diffusion and application of information technologies to enhance the productivity of the agriculture and manufacturing sector as well as the public sector, must be developed and implemented. Support services such as software, systems development and enhancements will be necessary both to facilitate the application of computers to products, processes and services as well as to generate export services in their own right.

For the Caribbean, the implications of the new computer and communications wave for the Caribbean are clear:

- a) Focus efforts on applying and using the technologies; and
- b) Develop the human resources to carry out and develop new applications.

This strategy of "applying the technology" veers sharply from the old import substitution focus which would lead the Caribbean to import machinery, equipment and completely knocked down parts to manufacture or assemble computers locally.

Services become more important

Services take on a larger share of the value-creation process in all industries and everywhere. The ideal information-intensive production organization now links design, management, production and marketing into one integrated system - a process of systemation. Firms organized on this new basis, whether in the computer industry such as IBM, in the clothing industry, such as Benetton or in the tourism industry, such as Sandals and Superclubs, can produce a flexible and rapidly changing mix of products and services.

The strategic focus of successful companies, therefore, is no longer based on production alone. Competitive advantage is based on taking the correct "make or buy" decisions and networking intelligently with other producers and service companies.

Services account for an increased proportion of the value of any product. Services are no alternative to manufacturing industries but are more and more becoming a necessary complement to any successful product.

In a world of atomized markets and the resulting demand for more flexibility, the service of getting the right product to the right person at the right time is at least as valuable as the product itself. For example, in the Jamaica Banana Producer's Subsidiary in Wales, which produces fresh-pressed orange juice and fresh-sliced mangoes, the transportation of the fresh juice daily to customers all over the UK is as important as 'manufacturing' the juice itself. Providing services is critical to the success of any product.

Pure manufacturing, therefore, is becoming increasingly obsolete. It is the linkage of design, production and marketing that is increasingly important. Case studies of successful Caribbean exporters (as part of a study for the *West Indian Commission* in 1991) revealed unambiguously that the control of their marketing was a large determinant of their success. Take the example of Sandals and Superclubs, the local holiday chains in Jamaica which have their established marketing offices in the USA and have sales forces (one to two dozens strong each) that work throughout the North American market, selling and educating and distributing their Jamaican vacations. It is not surprising that these companies achieve over 90% hotel occupancy year round and possibly realize some of the highest net rates in the whole industry.

For the Caribbean, therefore, the issue is not one of focusing on manufacturing or services. There is no choice to be made. Both are critically important. The key imperatives of this development for the policy environment are to:

- * create the conditions necessary for these services and manufacturing to be developed and integrated; and
- * focus on the development of the services sector.

The Key to Export Success is Competitive Advantage.

Comparative advantage in production is increasingly obsolete. Comparative advantages are no longer natural, but increasingly man-made, brought on by the mastery of science and technology. As the cost of production accounts for a smaller and smaller proportion of the value of a product, comparative advantage is decreasing in importance. In addition, technology is changing so rapidly that comparative advantage may be here today and gone tomorrow.

Strategies pursued by the companies concerned may be more important determinants of where production should take place than factor prices (for example cheap labour). Benetton provides an example of this. While most European retailers buy textiles in the Far East to achieve low prices, Benetton pursues a strategy of quick response to market demand and produces all products in Europe to achieve extremely short lead times. The Benetton advantage is not a cost advantage but a market and distribution advantage, based on satisfying changes in consumer demand as closely and quickly as possible.

Increasing Importance of Global Networking

Wealth creation is based on entrepreneurial activity. To be successful in global markets the entrepreneur must be able to acquire and use the best resources available globally. As activities become more and more specialized, global networking becomes increasingly important. Through global networks, it is possible to obtain access to attractive markets, up to date technology, and information vital to the success of products.

The extent to which Caribbean entrepreneurs build links to their key export markets not only determines the competitive performance of the product or service they offer, but also the price they may be able to achieve and the value being created in the region. Global networking requires capital mobility. To gain access to markets it may be necessary to acquire or establish subsidiaries dealing directly with clients in the export markets.

Use Tourism to overcome entry barriers

Tourism needs to be used as the driving force of Caribbean economies in order to overcome production, entry and marketing barriers given that the tourism industry brings a market (about 20 million strong), and a negative image of the Caribbean is one of the barriers to entry in non-traditional markets (for example software, fashion, etc). The tourism industry can be creatively used to overcome these constraints. Tourism can:

- provide access to markets/brings a ready market to the product;
- provide the possibility of influencing taste patterns;
- provide an important ground for product launch and testing; and
- provide a ready basis for market research and market intelligence information.

The systematic utilization of tourism as an axial service will yield tremendous benefits to the region, far beyond the tourism industry.

UNECLAC - A Flexible Specialisation Paradigm

The Caribbean has to over-invest in human resources

The key to unlocking the opportunities which the information age brings is people - highly skilled and trained people who can identify opportunities, produce new or improved goods and services and who can gather, process, store, retrieve and apply information at all levels of the productive system. The single most important determinant of competitive advantage in this new information age is the skills level of the population.

The Flexible Specialisation Paradigm

The strategy of flexible specialisation takes full cognisance of the development of the world economy and the implications of the fifth wave. It proposes a framework of development that can secure not only participation in the world economy, but very importantly, ensures a leadership role in the Fifth Wave. In what follows, we will define the concept of flexible specialisation; identify its key success factors and finally compare it with the old 'best practice' of mass production.

Flexible Specialisation Defined

The essence of flexible specialization is being narrowly focused or specialised and simultaneously having the flexibility to move with the market as demand changes.

Specialization involves the identification of clear areas of specialization or niches within a particular sector. Specialisation refers to the niches within a sector rather than the sector itself. Careful choice of areas of specialisation is critically important to the success of flexible specialization strategies.

Flexibility is another key ingredient in the flexible specialization strategy. Many aspects of flexibility are important: flexibility to move with the market; flexibility to change as demand changes; flexibility to produce a wide range of products within the target area; flexibility to fill customer orders in a short time; flexibility to respond to the market 'just in time' rather than 'just in case'; flexibility through the use of general purpose, adaptable machinery; and flexibility through design, management, marketing, distribution and retailing strategies.

The strategy of flexible specialization is by nature export oriented (although not exclusively so) and implies an environment of open competition. It argues for the full and complete opening of the sector or segment in question.

Key Success Factors

Key to the success of this strategy is the development of capabilities in all activities related to the sector of specialisation and linking these activities in a focused manner to the sector in focus. Such related activities include:

- education and training;
- management;
- design;
- production;
- marketing;
- networking;
- regulatory environment;
- research and development; and
- supporting institutions.

The importance of simultaneously developing capabilities in these ten areas is not to be under-estimated. It is the current practice in the Caribbean that all of these activities that are supposed to support and dynamise the production process are currently disjoint sets. Education and Training institutions do not support the productive sectors (the tourism sector, for example, is one of the most naturally competitive and yet it is the weakest link in the UWI system). Research and development activities are generic at best and is ill-focused, not at all in line with the needs of the productive sectors.

Coordinated public and private sector actions are critical to the implementation of this strategy of flexible specialisation. The exact details of the strategy will have to be worked out through a consultative process involving the public sector, the private sector, non-governmental organizations, schools, and other experts and interested bodies. Each focus area will possibly need a lead agency - the exact form and structure of which will have to be detailed through the consultative process. This lead agency will have to provide the vision and stamina to coordinate, achieve and sustain the focus.

Key to the successful implementation of strategy of flexible specialisation are: the selection of focus sectors/niches for development; the development of the eight key sector-related capabilities (e.g. in marketing, production, research and development); the development of flexible production capabilities to respond to changing market conditions and; networking locally, regionally and internationally to provide inter and intra firm dynamics and to source materials, information and market intelligence data; and continuous innovations to stay always ahead of the game. Thus, the focused flexibility strategy is based on the following key principles:

1. Close collaboration between the public and private sectors;
2. Careful selection of focus areas;
3. Activation of the eight key production fronts;
4. Networking;
5. Implementation of flexible production; and
6. Continuous innovation.

Mass Production and Flexible Specialisation Compared

It is interesting to briefly compare the old mass production practices with that of flexible production (see table overleaf). Flexible production practices depart sharply from the old established principles of mass production.

There are key differences in the production for flexible specialisation and that of mass production. For example, in the areas of: technology used, work process and skills, payment systems, organization and management, markets and customers, suppliers and competitive strategies.

Flexible specialisation is driven by new information technologies, e.g. Flexible Manufacturing Systems (FMS), Computer-Aided Design/Computer-Aided Manufacture (CAD/CAM, Computers, Robotics, etc.). Flexible production practices are characterized by new managerial and organizational principles of scope economies, system gains, synergies, product differentiation, short production runs, customization, niche markets and design-intensity. Mass production concentrates on a limited range of standardized products while flexible specialization relies on

UNECLAC - A Flexible Specialisation Paradigm

product variety, specialization and niche markets. Mass production processes are energy-intensive, while those of flexible specialization are energy-saving and information-intensive. The markets and customers of mass production are different from that of flexible production as there is now domination of retailing and greater attention to the consumer.

Focus and flexibility go hand in hand. They veer sharply from the old import substitution strategies based on mass production, where limited ranges of cars and other consumer durables ensured that consumers had no choice but to 'take it or leave it'. Manufacturers dominated retailers. Producers dominated consumers and price governed competition.

Flexible production practices are characterized by new managerial and organizational principles of scope economies, system gains, synergies, product differentiation, short production runs, customization, niche markets and design-intensity. Mass production concentrates on a limited range of standardized products while flexible specialization relies on product variety, specialization and niche markets. Mass production processes are energy-intensive, while that of flexible specialization is energy-saving and information-intensive. The markets and customers of mass production are different from those of flexible production as there is now domination of retailing and greater attention to the consumer.

The competitive strategies of mass production are also different from that of flexible production - competition in mass production is through full capacity utilization, cost cutting, over production, stock piling and mark downs. Under flexible production, one competes through innovation, diversification and the building of competitive advantages.

As far as possible, old production should be rationalized and phased out to make way for the new. New technologies for computer aided design, for example, should form an integral component of the new production focus.

Flexible Specialisation - Two Examples

In what follows, we will provide two examples of flexible specialisation - one from the manufacturing sector (the garment industry) and one from the services sector (environment).

Garments

If Trinidad or Jamaica or Barbados decides to focus on the garment industry, a strategy of flexible specialization would first involve the identification of a particular focus, specialization or niche within the sector. When one considers the natural and competitive advantages of the Caribbean and the fact that there is a natural export market of tourists (more than 20 million tourists visit the region!), a focus on high fashion leisure (warm weather) garments for international and domestic market might be appropriate.

A strategy of flexible specialization would necessitate the coordinated and synergistic development of complementary value-creating activities, such as: design, training, research and development, production, marketing, management, market intelligence and global sourcing capabilities.

Government policies supporting the focus will need to aim at full duty-free importation of materials and equipment; encouragement of training of designers at home and abroad (not limit scholarships to areas of study not available locally, but to encourage training in the focused areas, whether training is available locally or not); negotiate duty-free access to international markets; allowing work permits for visiting designers; develop schools of design in collaboration with the private sector; encourage internships and tax breaks for companies which hire interns; encourage exchange programmes with schools and institutions abroad; establish regional qualification standards; encourage free movement of labour, capital and goods among Caribbean countries.

In the area of market intelligence, there is need for close monitoring of information on international design trends, international designers and sources of supply, price and quality of materials and machinery, market research on incoming tourists, new fabric and garment retail concepts, all Caribbean fashion designers located internationally, databases on major competitors, export opportunities in overseas markets.

In the area of marketing, the tourism industry can be used as a main vehicle for exports; there is need to create regional brands and designer names; participate in major trade fairs and international fashion events; establish regional distribution outlets in convenient visitor locations; work with tourism promotion agencies to feature local items of leisure fashion wear, which could form part of country and regional advertising campaigns; link fashion with music and carnival; market not just garments, but an entire experience, a look, a way of life (this could involve wooden, leather and shell jewelry which could complement the 'look'). All of these activities can be carried out in a coordinated manner to service the entire industry. As an example of innovative marketing in the tourism industry, the all-inclusive concept, "where all the good things in life are free", can be used to sell

leisure wear to visitors. In this concept, a client could pay one all-inclusive price for a week holiday, which includes room, all food, beverage, liquor, cigarettes, sports, entertainment, gratuities ... and clothes.

In the area of production, this could be organized along many lines - the details of which will need to be worked out at the firm level. As the Italy example has shown, it is possible to involve small craft producers both sub-contracting with larger companies or exploring sub-niches, for example high fashion swim wear for the extra-fat females.

Environment

The environmental services sector provides an excellent example of how the "focused flexibility" strategy can work. Here, some examples of the types of coordinated activities which will be involved on the eight key production fronts identified above (for example production, market intelligence and regulatory framework), will be given.

Production Activities in the Environmental Sector

The environment is mainly viewed as a problem and has not been identified as an industry or a viable area of production. The development of an environmental focus is not simply the development of an industry to recycle paper. It goes far deeper than this and involves an entire system of wealth-creating activities - from production to regulation.

Since it is not usual to consider the environment as an industry in which commercial "production" activities, can take place, it is useful to identify some of the "products" which can be produced as part of the region's focus on environmental production. Such include:

- Recycled products such as paper, tin, glass, etc.;
- Organically-grown agriculture produce;
- Eco-tourism services and facilities;
- Development of spas, stress management techniques and alternative medicine;
- Development and promotion of natural drugs and healing methods;
- International conventions, seminars, meetings on the environment;
- Environmental Impact Assessments for companies and countries;
- Environmentally-related Consultancy services;
- Management of National Parks and Protected areas;
- Export of "know how" of environmental conservation;
- The development and management of interpretation centres;
- Environmental research programmes and other training for export;
- Audio visual programmes on the environment;
- Accommodation and facilitation of visiting professors & researchers; and
- The identification, packaging, marketing and distribution of state of the art environmental technology, products and services

These are just examples of some of the ways in which caring for the environment can be an economically profitable venture. To have full impact, it is important that many of these productive activities take place simultaneously and across the region.

The whole idea of spawning an environmental industry, apart from the obvious concern for the environment, is to deal with the region's problems head-on, develop solutions and export these solutions to the rest of the world.

Focusing on building an environmental capability in the Caribbean is of vital importance. All is not well with the region's tourism industry as environmental problems are beginning to threaten its very existence. The building of an environmental industry on the back of the tourism industry can be a key strategy for export success.

Research, Development, Design and Experimentation for the Environmental Sector

In the area of research, development, design and experimentation, the activities related to the environmental sector could include the study and design of new waste disposal techniques and products, research on new materials, chemicals and other harmful agents, recycling technology, experimentation with different environmentally-friendly building designs and construction materials, organic fertilisers, environmental impact assessments, marine biology and other academic research, experimentation with plants for medicinal purposes, etc..

Market Intelligence and Networking for the Environmental Services Sector

For environmental industries, activities in this area will involve the monitoring of environmental trends, laws, new products and services, environmental policies of company and country policies, the environmental experiences of other countries. It will also involve global networking in the sharing of ideas and country experiences at conferences, trade fairs and visiting researchers; identifying, negotiating and acquiring appropriate technologies and accessing the results of research internationally. Specialist libraries and data bases, universities networking with one another, and an entire information network involving all bodies involved or related in some way to the environment focus will also need to be developed.

Marketing the Environment

Marketing activities are also important in the areas of regional tourism advertising and building the image of the region as an "eco-zone". It is not only important to carry out state of the art measures in environmental conservation. To reap the full market opportunities, the local population, the region and the world have to know about it. For example, how many people in Belize, the region or internationally know that Belize has the only jaguar reserve in the world and that nearly 40% of her entire land mass is protected. Embassies and trade missions abroad, among other agencies, have to be used as effective organs for disseminating this and other information internationally.

Public awareness campaigns on ecological issues and environmental conservation are of critical importance to the success of an environmental sector in the region. The environmental industry also offers key opportunities in environmentally-related films, media productions, books, magazines, etc., for export internationally.

In Europe today, with many consumers environmentally-aware, recycled products (and products with a re-cycled content) have a marketing advantage over non-environmentally-friendly ones.

With an environmental focus of the region, the entire Caribbean can have a competitive advantage and unique positioning in the global economy. The environmental sector is perhaps the only sector of "production" in which natural comparative advantages will have some marketability. But the whole idea of fostering an environmental industry is to complement the static natural resource advantages of the region (for example, tourism) with man-made innovations and, where appropriate, technologies.

The Caribbean, positioned as an eco-zone, and complemented by a rich culture and a tolerant and flexible way of life, can become the place on earth where one will want to live, work, play and be. Imagine the economic impact that this positioning will have in the areas of tourism, financial services (real estate), etc..

Training for the Environment

Education and training of environmental specialists in all areas are necessary. Training and awareness programmes in schools are also necessary. There is also the need to develop and enhance specialist institutions such as the Institute of Marine Affairs in Trinidad and Tobago. It is not that the focused environment strategy necessarily requires new companies or institutions to make it work. It involves a shift of focus of current agencies, activation of the regional population to back the initiative and the identification and development of a lead body with the vision to coordinate, achieve and sustain the focus.

Regulatory Framework for the Environmental Services Sector

The regulatory framework for the fostering of an environmental focus involves the development of tax and other incentives to encourage recycling firms in paper and other industries and to encourage other firms to adopt production technologies which are most environmentally-friendly, but which may be more costly; the phasing out of environmentally-destructive industries; the development of environmental standards and laws; the development of natural parks and other protected zones; the promotion of eco-tourism; the development of a system of policing parks and protected areas; imposition of fines for environmentally hazardous practices; develop incentives for companies to maintain and beautify the environment; the development of natural history museums, marine parks, identification and protection of rare bird and plant life, and above all, lead by example. Government departments, for example, can be encouraged to use recycled paper and take other actions which are consistent with the environmental focus.



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DEMANDING A SUPPLY OF GOOD GOVERNMENT: A COALITION FOR THE REFORM OF THE STATE?

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"The truth is that we have simultaneously too much state and too little state"
Joao Gilherme Merquior*

This quotation aptly sums up, with admirable brevity and insight, efforts of the last decade and a half to reform the state. "Too much state" refers to the extensive growth in the size and responsibilities of the state during the decades prior to 1980. Frequently, this growth resulted in stagnant and inefficient economies and political regimes that were unresponsive, authoritarian, and corrupt. "Too little state" points to the reality that large and intrusive states often showed little capacity to formulate policy, implement it, and perform routine administrative functions.

Beginning in the 1980s, efforts to reform the state in most developing countries focused on the issue of too much state and emphasized cutting down on the size, expense, and responsibilities of the public sector. Often referred to as first generation reforms, these changes were frequently undertaken at the behest of international financial agencies and under the guidance of economic technocrats. First generation reforms focused on stabilizing economies, liberalizing markets, privatizing state-owned enterprises, and downsizing public administration. They were undertaken primarily out of concern about the size and implications of fiscal deficits and in accord with a dramatic change in ideas about how economic development could best be

*"A Panoramic View of the Rebirth of Liberalisms." *World Development* 21, no. 8:1265.

achieved. During the same period, democracy advocates focused attention on the need to dismantle structures of control and corruption that had held discredited authoritarian regimes together. Both economic and political reformers were convinced that the state must shed functions in order to increase opportunities for dynamic growth and political freedom.

By the mid-1990s, however, these first generation reforms had been succeeded by a second generation of reform concerns--the concern with too little state. Governments, development professionals, and international institutions have all called for the creation of capable states rather than minimal ones. This perspective has emerged out of increased recognition that only states can provide conditions that are essential to both economic and political development. Only states, it is argued, can provide factors such as law, order, legitimate and authoritative institutions, and appropriate macroeconomic policy. Moreover, in most countries, states are needed to provide investment in physical and social infrastructure, in human capital development, and in the redress of deep-seated inequities. In addition, the policies designed and promoted by capable states can have a significant impact on opportunities to grow economically and ensure that the benefits of growth are broadly shared. Reducing states, second generation reformers argue, does not automatically make markets work well nor allow democracy to flourish. Indeed, the problems of too little state can be as stifling to development as those of too much state.

Second generation reforms call for three levels of innovation in the development of more capable states. First, they require the development of new institutions--more effective rules of the game for markets and political activities. Second, they require organizations within the public sector that are able to perform their responsibilities effectively and fairly. Third, they require the development of human resources within government that are well-trained, honest, productive, and professional.

The problem, of course, is that second generation reforms are much more difficult to put in place and sustain than are most first generation reforms. Most of the latter required that states simply shed functions and responsibilities; these kinds of reforms are often difficult to agree upon politically, but they are generally very easy to implement once decisions have been made to adopt them. Second generation reforms, in contrast, require institution building, organizational change, and human resource development. They require the development of new ways of behaving and responding to problems, and they require time, effort, perseverance, innovation, and effective management.

A Coalition for Reform

The difficulty of devising and implementing second generation reforms must be recognized. In many cases it will take a decade or more of concerted effort for such reforms to begin to produce recognizable results. During that time, change will often prove frustrating and will generate conflict and opposition. But the good news is that there is broad support for such changes that can assist reformers facing the difficult challenges of developing new institutions,

ensuring that organizations perform more effectively, and increasing the capacity of human resources within the public sector. This support comes in the form of several loosely defined groups demanding that governments become better at supplying efficiency, effectiveness, and responsiveness.

Among those most actively promoting the reform of the state are the *market reformers*. They are a transnational network composed of individuals and institutions such as the IMF and the World Bank and new technocratic public sector managers and private sector entrepreneurial elites in many Latin American and Caribbean countries, as well as academics, primarily economists.

Their argument is that markets do not work well unless there are clear rules of the game for economic interactions and effective institutions to set rules and regulate markets where market failures are likely to emerge. They also believe that the effective development of markets requires institutions that are capable of managing and resolving economic conflicts. As a result, they advocate reforms such as:

- Legal institutions to set rules about property rights and contracts, and to adjudicate economic conflicts;
- Central banks that have autonomy to set monetary policy;
- Rules for effective financial regulation;
- Systems to ensure fiscal control, such as workable budget and tax systems;
- Transparency in policy making as well as greater input of technical information in policy design and decision making;
- Investment in critically important physical and social infrastructure.

A second group concerned about the reform of the state are the *democratic reformers*. These are individuals and organizations who have been among the most active in forming international and national networks to promote change. This grouping often involves important sectors of civil society, international alliances of NGOS, private interest groups, human rights activists, and academics, usually with specialization in political science, law, sociology, or anthropology.

Their argument is that democracies cannot survive unless there are clear rules of the game and effective institutions for conflict resolution and the representation of interests, participation of citizens in policy discussions, and mechanisms to hold public officials accountable for their actions. Their concern is with the rights and obligations of citizens and the democratic legitimacy of the institutions of government. As a result, they advocate reforms such as:

- The development of judicial systems that protect basic human and civil rights and that can hold public and private actors responsible for their actions;
- Elections that are fair and electoral systems that operate with regularity and ensure the sanctity of the vote. As part of the concern for electoral reform, they also advocate campaign reform;
- Legislatures and mechanisms for popular consultation that effectively represent interests and allow for the development of consensus about how to deal with important national and local problems;
- Regional and local governments with greater authority and resources to respond to local needs.

Closely allied with the democratic reformers and some of the economic reformers are the *social reformers*. They have emerged within countries at the national, regional, and local levels and are joined at the international level by agencies such as the UNDP and other UN agencies and the Inter-American Development Bank.

Social reformers argue that governments must be responsive to the social needs of their populations if they are to survive and must deal with the question of inequity in the distribution of economic and political power, nationally and internationally. They are convinced that economies will not be able to sustain growth unless they are supported by educated and healthy human capital. They are similarly convinced that democracies cannot be sustained unless problems of poverty and inequity are dealt with. As a result, they advocate reforms such as:

- The reform of health and education ministries, infusing them with more resources, more effective management structures, and better trained and more professionally responsive personnel;
- Decentralizing the responsibilities of centralized social sector ministries;
- Developing innovative solutions to social service delivery issues such as various ways of contracting out to the private sector or non-governmental organizations or involving local communities in the provision of basic health and education services;
- Restructuring social security and pension schemes;
- Developing managerial talent for social sector service delivery;
- Promoting poverty-alleviation and income-generating programs to combat widespread poverty and unemployment.

The fourth “partner” in the coalition for the reform of the state is composed of what might be called the *sustainable developmentalists*. They are active at international, national, and local levels and are committed to greater environmental consciousness and local involvement in defining and pursuing development goals. They often link problems of poverty and population to environmental degradation. At times, they are allied with the social reformers and many of them look to the UNDP and a variety of international conservation and environmental groups for leadership or sponsorship.

The sustainable developmentalists argue that the state must take an active role in regulating the use of natural resources and protecting the environment and must work actively to alleviate poverty if development gains are to be maintained into the future. As a result, they support reforms such as:

- Regulatory institutions for the use of natural resources and protection of the environment;
- Efforts to value natural resources so that market-like institutions can be put in place to make conservation a rational choice for economic agents;
- The introduction of natural resource balances as part of national accounting systems;
- Concerted efforts to alleviate poverty through community-based development programs, alternative income-generating activities, and investment in health and education.

Joining the coalition and giving it added influence is a very large and diverse group--*fed-up citizens*. Their argument is very simple. They are fed up with corrupt and inefficient public sectors, fed up with politicians who promise much and deliver little, fed up with scandal, ineptness, evidence of inequity, and lack of responsiveness. In addition, many are frustrated with on-going stabilization and structural adjustment programs and feel imposed upon by the international financial agencies, the pace of globalization, and new ideologies and international lifestyles that they are not part of.

They want evidence of greater equity in the distribution of income, services, and political power, improved standards of living, and greater opportunities for participation if they are to be convinced that markets and democracy are appropriate for their countries.

The discontent of these citizens is considerably more powerful at the current time than it was even a decade ago because political systems in Latin America and the Caribbean have opened up, creating more space for advocacy and protest. Similarly, the development of the polling industry and much more active media have brought the state of public opinion more fully into the limelight and have made public sector leaders more aware of the state of discontent. In addition, civil society has experienced a resurgence in many countries and a variety of organizations, from unions and political parties to community betterment associations and green, ethnic, and religious groups, are more actively engaged in advocacy, representation of interests,

and protest than was the case in the past.

These reformist groups and networks are an incipient coalition. Its members are not necessarily fully aware of each other and the reform agendas of each differs in terms of emphases and priorities. They do not necessarily act in concert with each other. Nevertheless, they are in basic agreement that something needs to be done to make government more efficient, effective, and responsive. They agree that states are inherently important to the development process, and they also agree that the creation of more capable states--the development and implementation of second generation reforms--must be a high priority for government.

Politics and Ideas

Efforts to reform the state will, of course, invoke conflict and resistance. No doubt bureaucrats and the unions representing state sector workers will find many of the reforms objectionable and will try to stymie them. Political leaders may resist giving up control over patronage resources such as jobs and contracts. Elite beneficiaries of government largesse will not be pleased when their subsidies or protections of various kinds are curtailed.

The material interests of winners and losers are important in strategizing about how to pursue reformist initiatives. At the same time, however, the reform of the state in Latin America, the Caribbean, and elsewhere demonstrates the importance of ideas in promoting change. In the politics of promoting the reform of the state, ideas are important in at least five ways:

- First, ideas help identify and strengthen transnational alliances of reformers. For example, commitment to unifying ideas is the central element in international networks of NGOs concerned about poverty alleviation and human rights, just as they are important in cementing international alliances of those committed to market-oriented reforms or environmental conservation. These transnational alliances are important for the exchange of information, experience, and innovation, for the development of international standards and protocols, and for the financial support and political protection of reformers acting in hostile environments.
- Second, ideas are important in defining priorities for action. Thus, for example, market reformers agree on the need for macroeconomic stability prior to the pursuit of reforms focused on liberalizing trade; social reformers generally agree on the importance of education as a factor that promotes changes related to health, fertility, and income generation.
- Third, ideas held in common are important in the development of political pacts and agreements over legislation. They are the common thread that can bring diverse interests together to discuss contentious issues such as how to define the appropriate limits to the power of the state or what are acceptable tradeoffs between economic growth and environmental sustainability.

- Fourth, ideas are important for communicating to wider publics about the contents and rationale for reform. Thus, communication of ideas about human rights, poverty alleviation, or the benefits of markets can be important in generating electoral support for reformers.
- Fifth, ideas play an important role in the design of reform policies. For example, natural resource economists have developed policies for environmental sustainability based in microeconomic concepts of competition and incentives.

Clearly, in many cases, ideas are not fully independent of material interests. At times, in fact, ideas are little more than the “public face” of material interests. Nevertheless, it is also true that in current debates about the reform of the state, the effect of common ideas is to enhance advocacy networks, set priorities for action, cement alliances, attract support, and guide policy development.

Priorities and Debates

In general, current discussions about the reform of the state are laudable and important in pulling together a broad coalition of groups and networks around second generation reforms. But all will not be smooth sailing for the reform of the state, not only because of the real possibility of conflict and resistance, but also because of issues relating to the nature of reforms that are being advocated.

First, there is a problem of the priorities for reform. Discussions about the reform of the state generally invoke a long list of things that need to be done in order to make government more efficient, effective, and responsive. Each of the groups of reformers previously mentioned differs in terms of the concerns it has and the priority that it attaches to particular reforms. Sometimes, of course, the reformers will agree on activities that need to be undertaken, as when market and democratic reformers agree on the need to reform judicial systems or democratic and social reformers agree with sustainable developmentalists on the importance of alleviating poverty.

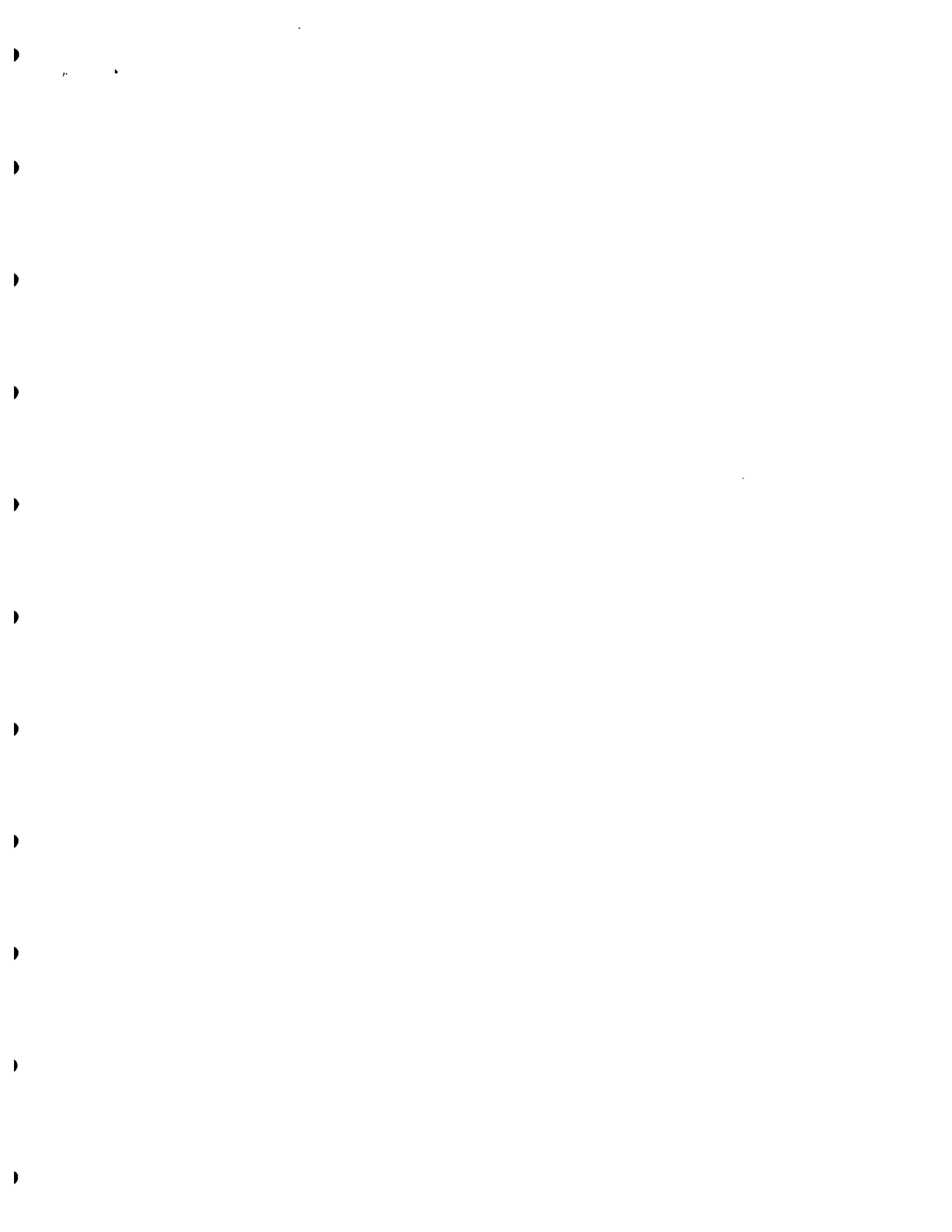
Nevertheless, given the very long list of things advocated to bring capable states into being, and given that not all reforms can be undertaken at the same time because of limitations of time, energy, skill, and solutions, priorities and sequences among reforms need to be debated, identified, and agreed upon. Currently, it is not at all clear that such debates and discussions are being held.

Equally important is the process of reform. At times, the reform of the state runs the risk of being seen purely as a technical problem with technical solutions. In this context, it is important to recognize that states are not technical artifices that can be created and recreated at will. They are the result of historical experiences, political conflicts and compromises,

philosophical and cultural traditions, international economic and political imperatives, and often, skilled statecraft.

If this is the case, then in addition to the discussion of what kinds of reforms are needed to create more capable states, societies need to be engaged in a broader kind of discussion about questions such as “What kind of state do we want?” “What kind of state do we need?” Not many such discussions have been undertaken.

This is part of the current challenge for those concerned about the problem of too little state: how to encourage a broad and deep public discussion about the role of the state in economic, social, and political development so that when specific reformist initiatives are undertaken, they are done within the context of a widely shared vision and understanding of the role, functions, and activities of the state and its relationship to the economy and to civil society.



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THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

25-26 June 1997
Port-of-Spain, Trinidad and Tobago

STRATEGIC PLANNING OF INSTITUTIONAL REFORM: IMPROVING POLICY OUTCOMES THROUGH MORE ACCOUNTABLE STRUCTURES

by

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A. INTRODUCTION

The shrinkage of the state was the first step in the crucial reform process occurring in Latin America and much of the developing world. These reforms to pursue efficiency and equity through the reduction of the size and direct involvement of the state have already generated positive economic results in many countries. Many Latin American economies have become more efficient as a consequence, and indeed more equitable in some respects. In my view, more needs to be done in this direction. Yes we already need to look beyond the shrinkage of the state to focus on the next set of problems in need of reform. I will argue that going beyond the issue of the size of the state brings us to questions of the structure of formal government policy-making, especially regarding the structures of public finance and the division of labor within government. The typical Latin American government is still a jumble of agencies created in an often ad hoc manner and marked by confused and overlapping

mandates and jurisdictions. These are not new issues, but until now they have been poorly analyzed and addressed quite ineffectively. These issues are central to the new agenda of international organizations, such as the World Bank and the Interamerican Development Bank, that are now focusing on “governance” and are increasingly insisting, through their funding decisions and loan conditions, that governments become more effective and accountable. Moreover, the democratization of Latin America poses both an opening for making the structural reforms to enhance accountability, and the risk that competitive electoral politics will tempt government leaders into even greater efforts to evade accountability through overly complex, confusing and therefore non-transparent structures and mandates. I will try to outline several principles for approaching the reform of policymaking structures that will avoid the usual problem of aimless structural change for the sake of appearing to make changes. The three principles are:

- bringing agency interests and the interests of the nation into congruence, so that the costs of negative consequences of agency actions are internalized by agency leaders and personnel.
- establishing clear-cut, narrower, exclusive, highly differentiated mandates for government agencies, in order to make this congruence feasible and to enhance accountability;
- increasing the discretion that government agencies enjoy in pursuing these mandates, both to enhance accountability and to create the incentives to induce responsible policymaking

and implementation.

Our background premise is that policy reform in the long run requires reform of formal policymaking structures. We view the policy process as the generator of policy outcomes. This may seem obvious, but it needs to be reinforced so that reformers do not presume that the only basic problem is that ill-intentioned or ill-informed actors pursue bad policies. We also need to remember that government agencies play an enormous role in establishing the specific content of government policies. The notion that officials within executive-branch agencies only implement the wishes of legislators and top executive leaders ignores the power of the implementors to interpret, refine and even subvert policy directives from above. The great discovery of the behavioral study of policymaking within the field of public policy is that we have to go beyond the insight of public administration theory that a mal-structured governmental structure will lead to inefficiency: we discover that only if government agencies are structured properly will they pursue the appropriate objectives.

I also want to introduce the argument that what we have learned over the past two decades of economic reform is that John Stuart Mill was right. Mill, after being castigated for so many years for being a "classical liberal" opposing the use of the productive process to pursue income equity and poverty alleviation, has been vindicated by two revelations about state intervention as practiced in most of Latin America in the post-World War II era. First, most state economic interventions and regulations in Latin America have had regressive income distributive effects. This should come as a surprise only to those naive enough to discount the fact that credit regulations, special tax treatments rationalized as stimulants to particular types of investments, tariff protections and other policy provisions that have been

targeted by liberalization reforms were enacted for the sake of, the wealthy and powerful. Second, the invocation of progressive distributional objectives (along with an assortment of other non-economic objectives) had been an extraordinarily effective way of reducing the accountability of top government officials for the regressive and inefficient actions they had undertaken. This approach reduces the pressure on government to address poverty alleviation the right way: through government investments into human capital formation, focusing on the health and education of the poor and the infrastructure necessary to make them more productive. Most of Latin America is woefully behind East Asia and Southeast Asia because of this failure.

Moreover, John Stuart Mill's approach to addressing distributional and non-economic objectives is remarkably modern in terms of its implications for transparency and accountability. The central budget is the legitimate locus of government efforts to alleviate poverty, defend the nation against outside enemies, enhance culture, etc. Only at the level of the central budget, the apex of the allocation of national resources for national interests, can the relative merits of devoting the nation's wealth be weighed holistically; only through the central budget can the "rates of return" for society be considered in a transparent and accountable way. By the same token, the central budget defines the resources that the top government officials place into the hands of each agency to pursue its mandate. The implication is that vague or mixed mandates make for vague and non-accountable pursuit of national objectives. It is fascinating that in developing an approach that could pursue both efficiency and whatever degree of equity emerged from the most visible political process, Mill also ensured the maximum transparency and accountability.

B. POLICY FAILURES AND THE LACK OF MANDATE CLARITY AND ACCOUNTABILITY

A few examples will clarify why this is important. Consider education policy. Latin American education systems are typically characterized by low quality, low teachers' salaries, regional inequities, obsolete curricula, and inequitable subsidies for the relatively wealthy students who make it into post-secondary educational institutions. At the same time, tax exemptions for family spending on education are both regressive in terms of their after-tax income distribution impacts, and deny the government the revenues that could be directed to spending for elementary, secondary and vocational schooling for lower-income children. Why do governments persist in these policies, which in an electoral democracy could be politically embarrassing to the top government leaders? First, government policies may be highly flawed in terms of their balance or the targets of their largesse -- for example in the overemphasis on tertiary education -- without even relatively well-informed citizens being in a position to know. It is easy to unfurl a positive banner for a bad cause. After all, who is opposed in principle to first-rate higher education? It is only in the holistic examination of opportunity costs that the over-emphasis on higher education is revealed as a poor policy. Second, even if accused of devoting too much money to subsidizing higher education, the ministry officials can counter that it has to take care of higher education, and whether it is devoting the right amounts is a matter of professional judgment requiring information and experience that is largely available to the ministry alone. Third, the "education mandate" is so spread across different governmental institutions that none is accountable for the outcomes. The legislature and the taxing authorities may be responsible for exemptions for family spending on education, as well

as the tax status of various types of educational institutions; the ministry is responsible for government spending and certification of programs and teachers; local authorities may be responsible for teacher placement; and so on.

In most Latin American countries, it seems obvious beyond any discussion that there should be a ministry of education with jurisdiction over education at all levels. Yet in Thailand there is a Ministry of Education for elementary, secondary, and teachers education; a separate Ministry of University Affairs for the rest of post-secondary education. Naturally, the two ministries clash over the boundaries of their jurisdictions, and even more so over budget. But that is precisely what we should wish to happen. There ought to be a cabinet-level and legislative debate on the balance between tertiary education and lower-level education; the press needs to be able to report on the debate and its consequences.

A second example is the imposition of penalties, sometimes going as far as expropriation of property, for violations of so-called "environmental rights." Since the 1960s, and in some cases even earlier, Latin American governments have been imposing restrictions on timber harvesting on private or communal lands, or making these forest lands into so-called "protected areas." Pragmatically, this has proven to be a foolish policy, because forest-users who lack the confidence that they can count on future opportunities to harvest trees will not devote effort to planting or nurturing them, and will often chop down trees despite the government's prohibitions. In terms of income equity, it is typically regressive because the traditional forest users are indigenous peoples or impoverished migrants; this has often been exacerbated by the governments' subsequent decisions to allow higher-income commercial logging firms to harvest on the lands transferred to state control. The real problem in this

case is that the invocation of “environmental rights” is often a pretext for the government to strip away the pre-existing user rights, without having to pay the users for the positive externalities that forest preservation had provided. Instead of waving the environmentalist flag and then exacting the costs from the forest users, the governments should determine whether the environmental ministry ought to have enough funds to either pay those with traditional user rights to desist from forest harvesting, or buy the user rights from them. Then the government ought to allow the environmental ministry to determine whether this particular use of its funds is the best use, given the other ways that the environment can be protected or enhanced.

A third pattern has been to provide tax exemptions or other benefits to businesses that undertake reforestation. In some countries, most notably Costa Rica, these programs have had very poor results, as the tax benefits are obtained so early in the reforestation cycle that the businesses are left with little incentive to nurture the trees long enough for them to survive, and in some instances natural forest has been torn out to make way for non-native species with little chance for survival. (Gonzalez, Alpizer and Munoz 1987; Lutz and Daly 1990; Ascher 1993b) Here again the environmentalist appeal is used, perhaps quite cynically, to rationalize a program with often highly negative environmental impacts. The common use of tax credits rather than direct payments in such reforestation programs is no accident; tax credits are less identifiable as government spending, although they amount to the same thing.

A fourth example is provided by Honduras, which in the mid-1970s established a hybrid forestry agency and state forestry enterprise called COHDEFOR. COHDEFOR's mandate to harvest Honduras' pine forests on a sustainable basis was reinforced by the agency's fiscal arrangement — since the entire budget aside from foreign grants was from its

own proceeds from harvesting, COHDEFOR officials realized that without pine forests, there would be no COHDEFOR and no pensions. Indeed, COHDEFOR soon began to restrict pine forest harvests to a sustainable level. Yet the agency's record of conservation of Honduras' broadleaf forests, and its social forestry efforts directed to the lowest-income people in and around the forests, were very poor. It seems clear that COHDEFOR the government forest conservation agency could not be expected to perform well in regulating COHDEFOR the forestry company. (Ascher 1993b)

Finally, consider the sorry state of general tax policy and tax administration in most Latin American countries. Taxation is used as an extraordinarily ambitious instrument: taxes are often designed with the claim that they can stimulate investment in particular sectors, encourage family spending on health and education, redistribute income, and even change the nature of corporate structures. These embellishments reduce the capacity of governments to collect revenues, while also inducing unproductive uses of resources. The two Latin American countries that have done the most to reform their tax structures, Chile and Colombia, have increased both the volume and the fairness of taxation through the stunningly simple approach of designing taxes to collect taxes. (Gillis 1988; Ascher 1988)

What do these cases have in common? They all involve ambiguous and muddled mandates, with little chance for a technical assessment of whether the policies and agencies are optimal. Is the education ministry's success in producing university graduates worth the failure to provide better and more thorough primary education? Is the conservation of existing forests worth the lower rate of forest development, and the poverty of families with traditional user rights in the forest? Is Costa Rican reforestation, albeit limited, worth the destruction of some

natural forest and the loss of revenues for the central treasury? Is the sustainability of pine harvesting in Honduras worth the loss of biodiversity and the neglect of low-income forest dwellers? Is the pursuit of various non-revenue motives through tax policy worth the sacrifice of the additional revenues that a straightforward revenue-maximizing tax system could collect? Agency mandates are currently structured in ways that make these questions extremely difficult to answer in a definitive fashion.

These cases also involve incomplete internalization of the costs of poor policy on the part of the responsible politicians and administrators. Inadequate primary education does not threaten the jobs of the officials in the education ministries; it rarely threatens the job of the minister of education. Environmental degradation does not typically impinge upon leaders and subordinates in forestry agencies, any more than it impinges on other citizens. By the same token, impacts on the poor hardly affect policymakers or bureaucrats under typical circumstances, and even the damage done by poor tax regimes rarely comes back to haunt the officials responsible for them.

C. PRINCIPLES OF ACCOUNTABILITY AND INTERNALIZING POLICY CONSEQUENCES

We can derive the following principles from such cases and from our diagnosis of their weaknesses:

1. Agency leaders and personnel should be held accountable for their performance in pursuing highly simplified, differentiated, single-objective mandates. Lest this principle seem obvious, it should be noted that it is completely opposite from the prevailing conventional

wisdom of "integrated" or "system" management, which attempts to give agencies jurisdiction over as many aspects of the activities and outcomes in a particular sphere or geographical area as possible. Here is the dilemma: The logic of requiring agencies to internalize the costs of their actions could be addressed by assigning an agency with responsibility to deal comprehensively with its programs and projects and their consequences. What this would imply for Honduras is that the state forestry enterprise would be responsible not only for harvesting timber, but also for maintaining the ecosystems of the areas where harvesting is undertaken. If the agency and its leadership could be rewarded or deprived according to the quality of its conservation programs, as well as its performance as a timber exploiter, then the agency could find an appropriate balance. In the very special circumstances of a top leadership that is ideologically committed to balance, such an approach could conceivably work. However, without this ideological commitment, a multiple mandate is likely to provoke a policy approach that sacrifices one or more objectives for the sake of the objective that serves the agency and its officials best. Experience seems to show quite clearly that agencies with multiple-objective mandates tend to put much greater emphasis on the objectives that most strongly enhance the agency's standing and resources.

2. Insofar as dynamic agency leaders are likely to be motivated by the desire to enhance the authority and standing of the agency, good performance should be rewarded by greater jurisdiction and greater budgetary discretion. Note that many so-called "performance contracts" are designed to accomplish this. (Nellis 1989) The possibility that an agency may expand its jurisdiction through good performance opens up very promising possibilities for introducing competition within government, whereby the better managed agencies will be

rewarded with more responsibility and more resources. This would not necessarily entail more elaborate and re-muddled mandates. Consider, for example, the more-or-less separate affiliate companies of Venezuela's state oil holding company, PDVSA. (See Coronel 1983; Randall 1987). Maraven, Lagoven and Petroven are all exploration and production entities that exploit somewhat different but partially overlapping areas of Venezuela's land and offshore oil areas. In the areas where two of the affiliates have facilities close enough for either to be able to explore and exploit a possible oil area, the mother company will award the exploration rights to the company with the stronger performance record. This simple arrangement makes PDVSA one of the few state enterprises in the world with an effective form of competition and incentives for efficiency and cost consciousness.

In the more typical case of a mainline government agency, it may not seem feasible or wise to provide budgetary discretion; after all, the central budget each year is supposed to cover the programmatic and administrative costs of the priorities chosen at the highest levels. However, there can be sensible arrangements whereby the agency can have a stronger guarantee that its budget for the following year will be predictably close to the medium-term (one- to three-year) budget planning that virtually all agencies undertake. There can also be sensible arrangements to allow well-performing agencies to enjoy greater latitude in how they allocate their budgets. Indeed, as mentioned below, this is essential for greater accountability and often for motivation.

3. Prioritization of objectives should be accomplished through the central budget, on the national, provincial, state or local levels, depending on how decentralized the provision of government services and regulation is in any given polity.¹ Other policies and sources of funds

should not be available to deploy for the pursuit of costly objectives other than through the central budget. Imagine this scenario: the state copper enterprise succeeds in getting the government to impose a huge tariff on imported copper, in order to keep the enterprise in business despite its own inefficiency and the poor grade of copper in the country. The enterprise, and its allies within the government, invoke national security, arguing that the nation can maintain its military preparedness, and its potential to engage in an extended war, only if some of its copper needs are supplied domestically. The finance ministry, lured by the prospect of collecting more import revenues, may endorse this argument if the state enterprise pushes for tariff protection rather than a direct treasury subsidy. Now, in this case the merits of the national security claim are difficult to assess in a way that would be beyond argument or appeal. Surely having a domestic source of copper, all other things being equal, is better than not having it at all; surely there is some probability, though possibly quite small, that a war could last long enough, and the cut-off of copper imports would be severe enough, for the domestic stockpile to make a difference. But is this worth the deadweight loss to the economy of severely distorting copper prices and the waste of resources entailed in spending \$2 to produce a pound of copper worth \$1? Is this the most cost-effective way to enhance the nation's security?

As long as the state copper enterprise is mandated to contribute to national security, the problem is unresolvable without intra-governmental conflicts and politically costly judgments. Yet consider this alternative: the state copper enterprise, denied direct subsidies from the central budget and tariff protection, has no mandate other than to earn revenues from copper production — and by extension to avoid losses. If it can produce copper only at above-world

market costs, it has no alternative but to approach the defense ministry to determine whether that ministry would be willing to devote some fraction of its budget to keep the state enterprise in business in order to produce a part of the nation's copper needs. If the defense ministry — the only entity mandated to pursue national security — decides that this use of defense funds is better for national security than, say, more missiles or soldiers, then the ministry should happily support the state copper enterprise. The defense ministry's decisions will be monitored and debated in the cabinet, the central budget agency, and the legislature; the ministry will have to make a compelling argument for or against supporting the copper production option. There would be no muddling of multiple objectives on the part of the copper enterprise; its task and performance criterion would be simply to produce copper as efficiently as possible without running a loss. (For elaboration of this strategy, see Aharoni and Ascher 1991)

4. Agencies must be accorded sufficient discretion for their leaders and rank-and-file personnel to be legitimately held accountable. Discretion serves two crucial functions. First, it is essential for meaningful accountability. Criticism of judgment is sensible only if policymakers can exercise their judgment. Accountability for simply carrying out specific orders is an almost trivial form of accountability. Second, discretion is a powerful incentive for many of the most desirable agency leaders. Competent agency heads want to have enough rope to either hang themselves or show off their competence and dynamism.

D. SUPPORTING PERSPECTIVES:

The principles outlined here reflect a remarkable convergence of thinking from at least

five major approaches for understanding policy reform.

Rent-Seeking Theory. The complexity and non-transparency of current structural arrangements allow government and state officials to provide rent-seeking opportunities at acceptable political costs (for a review of the premises of rent-seeking theory, see Tollison 1982). If we think of government leaders as actors who are trying to pursue a complicated set of objectives of increasing their political power, possibly gaining personal economic benefits, and pursuing assorted programmatic goals, we can appreciate that the need to maintain a minimal level of political credibility will mitigate against the pursuit of venal or programmatic objectives at the expense of sound policy. The Costa Rican case mentioned above is a case in point. The Costa Rican government was able to enrich certain private businesses, some of them with no experience in the forestry sector, by covering a transfer with the misleading cloak of a false environmental campaign. The public was not in a position to evaluate either the costs of the reforestation program or its ineffectiveness. Yet when World Bank studies revealed the weaknesses of the program and its ulterior motives the Brazilian government abandoned it. The same thing happened in Brazil when the subsidies for cattle ranching in the Amazon were shown to be embarrassingly non-productive. (Browder 1989)

Now, one of the arguments in favor of the shrinkage of the role and size of the state has been that the efforts by governmental and state actors to capture rents would be foiled by eliminating or reducing the scope of economic activities in which the state had direct involvement. And it is certainly true that the privatization of many state enterprises and the liberalization of trade have eliminated some of the most egregious ways that the state has captured wealth that otherwise would have been enjoyed by the population beyond the state

sector. Nevertheless, rent-seeking and rent-capture have never been the exclusive province of state actors; they often entail exchanges among government, state and private actors. Thus the now more-visible problem, previously eclipsed by egregious direct state actions, is that government agencies can engage in self-aggrandizing and rent-seeking behaviors through mechanisms other than direct state actions.

The most extreme case comes from outside of Latin America, but it points to the possibility in Latin American countries as well. The case is Indonesian forestry, where the President's office and the Forestry Ministry have conspired to allow politically-beholden private-sector groups to capture vast natural-resource rents, especially in the timber sector. Private loggers pay a small fraction of the value of the timber they are allowed to remove from public lands. In turn, these private actors devote part of their gains to political and development initiatives that the President wants but is unwilling to finance through his own government budget. (Ascher 1993a) In essence, the national patrimony is being siphoned off, incidentally at great and avoidable damage to the forests, to pursue objectives that the fiscal authorities regard as inadvisable. In short, the Indonesian government is not directly involved in these timber operations, but nonetheless manipulates timber policy in heavy-handed if not directly interventionist ways. The obvious implication is that rent-seeking does not evaporate with the removal of the state from direct economic activity; the potential remains in the government's capacity to regulate, set prices, and grant concessions to particular private actors.

Principal-Agent Theory. The second converging model is the principal-agent theory. When policymaking challenges are characterized by uncertainty and vague mandates,

policymakers and administrators often take advantage, consciously or unconsciously, by pursuing policies that indulge their own interests and ideologies. This is the famous “principal-agent problem”: the policymaker or administrator has interests that diverge from those of the principal, namely the people. Principal-agent theory is most advanced in the sphere of business administration rather than public administration. What can governmental reform borrow or adapt from the private sector approached to overcome principal-agent problems?

The principal-agent problem in business can be addressed in three basic ways: bringing the incentives of agents into congruence with those of the principals; increasing the sanctions against agents for taking actions that do not serve the principal; and increasing monitoring to reveal when agents take such actions. In the governmental and state spheres, the usual approach has been to increase monitoring and punishments. Yet this is where government and state are often (though not always) very weak. This is because:

- a) The monitored officials often have superior information and technical expertise, making it difficult for evaluators to determine whether a principal-agent problem exists;
- b) Performance evaluation is extremely difficult in the public sector, where the objectives of both principals and agents are much more complicated than the profit- or income-maximizing objective that predominates in the private sector. Therefore the lack of a single “bottom line” to evaluate the performance of a government agency with multiple objectives makes it much more difficult to establish its behavior as suboptimal. Consider the task of evaluating the performance of the armed forces of a particular country. If the complete mandate of the armed forces is to provide national security, the armed forces’ levels of

preparedness and effectiveness of actual operations can be assessed with a relatively high degree of technical agreement. One can still engage in both technical and philosophical debates over which profiles of preparedness are superior to others, yet the task is vastly simpler than trying to evaluate whether the armed forces are performing optimally if their tasks include promoting economic development, educating the population, building infrastructure, and so on.

c) The monitoring officials often themselves are engaged in deviating from the actions that would enhance the interests of the nation -- from the perspective of the lower-level policymaker or administrator, the "principal" may be one or more of these individuals who pose their own principal-agent problems;

d) The capacity to punish is often highly circumscribed by civil service protections as well as by less formal political protection.

e) Because of multiple-objective mandates, many public or state officials have "multiple principals," whom the clever official can play off against one another. (Aharoni 1982) When an action that can be criticized from the perspective of its efficacy for pursuing one objective can be defended by invoking another objective, and when one ministry can be brought in to protect an agency from the wrath of another, the politically astute agency head can often avoid accountability even if all the objectives are rather poorly pursued.

These are all rather well known limitations, raising the question of why government structural reformers have not focused as much as they should on the first approach, namely to bring greater congruence of interests between the government or state officials and the interests of the nation. The plausible explanations are both surprising and illuminating. First, the

dominant Weberian-Wilsonian conception of executive-branch officials as merely implementors of policy makes the need for appropriate incentives seem highly questionable. If they merely carry out orders, why do they need to be cajoled or motivated to do anything but fulfill their job responsibilities? Second, the Weberian-Wilsonian conception of the rights and obligations of government officials and civil servants does not recognize the legitimacy of providing them with anything beyond their salaries and the satisfaction of discharging their responsibilities. Therefore acknowledging that public servants have interests at all, beyond the minimal interests of a loyal employee, is rather alien to the prevailing conception of good government. This is a fundamental difference in perspectives about what is permissible for government reform. In a sense, Realpolitik is regarded by many governmental and non-governmental actors as inappropriate in addressing intra-governmental politics, because public servants are regarded as lacking standing as political actors.

Second, government leaders who might be in a position to structure agency mandates and incentives pose their own principal-agent problem: they have their own political interests to pursue and defend. The same ambiguities of mandates and poor information that provide flexibility of agencies to pursue their own interests also provide top government officials with both a way to evade accountability and their own flexibility to pursue their preferred agendas.

The limitations of applying private-sector remedies for principal-agent problems in the public sector are also illuminating. (See Downs and Larkey 1986). The main thrust of overcoming the principal-agent problem in business is to make arrangements such as commissions, stock options, employee ownership, etc. that yield the greatest financial payoffs to the agent when the principal realizes the highest profit. The obvious problem is that

governments and publics rarely have profit maximization as their major (let alone only) objective; nor do agency officials. For a very limited set of governmental functions, such as exploiting non-renewable natural resources, perhaps the nation's objective ought to be to maximize revenue, and therefore the government agency in charge of resource exploitation ought to be rewarded by the right to retain a certain proportion of the profits — a commission as it were, one of the most effective instruments for reducing principal-agent conflicts. Yet in the general case the set of objectives of nations and governments is obviously not a simple matter of maximizing financial profit.

Externality Theory. A very similar logic emerges from considerations of the phenomenon of externalities, first made prominent by public finance theories (Pigou 1919) and later by the current approaches to preventing environmental damage. The argument, borrowed from approaches to preventing private actors from undertaking actions that impose costs that remain “external” to that actor, is that public officials somehow must “internalize” the costs of the inappropriate policies that they formulate and implement. The internationalization approach to dealing with private-sector externalities, for example through pollution charges, has been quite effective and efficient. The public sector analogue, then, is that public officials need to regret when the public, or various publics, suffer.

This principle can be both simplistic and terribly unfair unless it is qualified carefully. Officials should not be crucified for unavoidable failures, nor for mistakes based on decisions made out of appropriate motives. The issue is that public officials acting out of motives other than public interest need to regret these actions. Exhortation is clearly not enough; the incentives for public officials must be consistent with the public interest, and this typically

requires that decisions and practices against the public interest be judged as poor performance, and that agencies acting against the public interest face institutional costs. Here, again, structural reformers will appreciate this insight only if they are willing to accept that government agency personnel make policy.

Bureaucratic Politics. Overlaying partisan politics and policy politics is the struggle among agencies to gain power, financial resources, security, standing, and discretion. To a certain degree, bureaucratic politics gives rise to the motivations to expand jurisdictions, claim broader mandates, create mechanisms to control funds off-budget, and enlist support from outside of the government through rent-seeking arrangements. The importance of bureaucratic politics is that it reveals many of these phenomena to be as much the extension of intra-governmental warfare as genuine efforts to tackle policy problems. The legitimacy of a defense ministry's claim that it has a mandate to educate the population is put into question when we consider the quite natural desire of the armed forces to justify a bigger budget, just as we may be skeptical of the claim of an education ministry that it deserves a bigger budget in order to contribute to military preparedness by producing better-educated conscripts.

Operations Research. Finally, it is worth citing the principle from operations research concerning the match between the number of objectives and the number of instruments. Even if the agency heads and subordinates have only the best of intentions to implement the policies and objectives of the higher-level authorities, the pursuit of multiple objectives by a single agency violates the simple rule that a tool cannot be efficiently designed to do more than one thing extremely well. A hammer that is also a screw driver is likely to be neither a very good hammer nor a very good screw driver. The failures we have seen in many countries' tax

policies from pursuing too many objectives, and the failures in conservation and efficient forest extraction by the hybrid state agencies like Honduras' COHDEFOR illustrate this point vividly.

E. CONCLUSIONS: FAIRNESS AND POLITICAL FEASIBILITY

Two high-level political issues must be addressed to conclude this analysis: the normative complications of the reform strategy I have been recommending, and the practical considerations of how to accomplish a reform that restricts the maneuvering of top government officials.

The normative question is whether centralizing the spending and subsidization decisions within the central budget process is defensible when those in charge of the process are themselves irresponsible, ill-intentioned, or otherwise inappropriate agents for the nation as principal? We can even push the issue one step further: Is it defensible to place so much allocative power on the conventional fiscal apparatus even if it were completely responsive to the "public's wishes" but the public (or at least the public that counts politically) is eager to create economic injustices or squander the nation's wealth? In other words, what is the remedy for an irresponsible principal? We often hear appeals from admirable agency officials that they would like to help neglected groups, or clean up the environment, or pursue worthy development projects, or keep some financial resources away from the pressure groups that often seem to dominate the budget outcomes, if only they had a way to wrest control over some resources from the central budget authorities. My response is simply that while it is true that the central budget process can produce outcomes that a particular observer may regard as

horrible, this is a risk of both conventional budgetary allocation and off-budget subsidization.

We certainly have no way of knowing, a priori, whether the scoundrels who wish to take advantage of off-budget slush funds are better or worse than the scoundrels who wish to pervert the central budget. The one thing we do know is that the latter type of scoundrel is more likely to be taken to task for his sins. As policy scientists, the most we can do is to suggest arrangements wherein bad or selfish decisions are more likely to be punished.

Moreover, if an open, fully-debated, transparent budget fight among popularly-elected representatives yields a bad budget, the reforms necessary to turn the situation around are much deeper (including probably fundamental changes in political attitudes and possibly in the nature of representation) than any fiscal manipulations could accomplish.

Finally, what are the political obstacles to acting on the insight that as long as top government officials are highly prone to influence from rent-seekers, transparency is a great boon for both efficiency and equity? If deviations from service to the nation need to be visible before they can be discouraged, how can the very politicians who often benefit from their capacity to evade accountability be induced to make the administrative changes that would heighten transparency? From a rather cynical political economy perspective, we have to acknowledge that muddled mandates, over-complexity, and off-budget sleight-of-hand benefit presidents and prime ministers as much as bureaucrats.

The basis for optimism is the same insight that accounts for why the British political system became more democratically open even though the decisions to expand suffrage had to be made by the political class that would stand to lose the most from diluting their hold on power: the competition among elites. Examination of many cases of off-budget maneuvers and

problematic claims based on shaky mandates reveals that for every high-level official or politician who is using these machinations, there is another official or politician with an interest in opposing it. In short, while bureaucratic politics is one source of the problems we wish to root out, bureaucratic politics also reveals the allies for efforts to accomplish these reforms. In Indonesia, for example, the major allies of the non-governmental organizations fighting to reform inappropriate forestry policies are the finance ministry and the national planning agency! These strange bedfellows are joined by the interest in preventing the presidency and the forestry ministry from diverting resources into the hands of the President's private-sector allies, thus bypassing the central treasury. The finance ministry and planning agency, with the additional backing of multilateral and bilateral funding agencies, have had some success in reforming these policies.

Finally, international organizations can play a major role in tipping the balance in favor of transparency. They not only have strong capacity to require governmental transparency, they can embarrass governments that try to hide suboptimal policies behind nice rhetoric. Certain international organizations also have some power to impose conditionalities for structural change.

In short, the fact that structural distortions in agency arrangements and policymaking processes reflect political strategies at the highest levels does not mean that those who would maintain these distortions are the only ones with significant power. The more these distortions are themselves made transparent, the easier it is to mobilize the coalitions for reform.

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Notes

1. Thus our principle does not imply centralization of all activities under the national government operating through its central budget. Government actions and responsibilities that ought to be undertaken by sub-national governments should follow the same logic of making expenditures at that level consolidated enough such that a healthy discourse can be held and the resulting actions are clear enough for public officials to be held accountable for their actions and the results.

EXTERNAL ECONOMIC PERFORMANCE
AND THE NEW GLOBAL AGENDA

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INTRODUCTION

The traditional national income accounting model for an open economy and its various modifications provide us with a useful scheme for classifying economic sector activity. This framework gives a conceptual picture of how transactions between domestic and foreign agents affect or impact on savings, the money supply and output. The external sector within the context of this paper will refer to those transactions which take place between domestic and foreign economic units and encompass the wide gamut of international trade in goods and services, the payments system required to support these transactions and the rules and regulations which transcend all international transactions and which allow for the orderly conduct of trade and payments. Figure 1 provides a useful taxonomy of the main components of the external sector.

FIGURE 1
MAIN COMPONENTS OF THE EXTERNAL SECTOR

| EXTERNAL SECTOR | |
|---|--|
| COMPONENTS | PERFORMANCE INDICATORS |
| International Trade (i, ii, iii, vi) | Exports, Imports, Deficits, Surpluses, Balance of Payments |
| Payments system (ii) | Exchange Rate Policies, Reserves, External Debt, Capital Flows |
| Rules & Regulations | Uruguay Round, NAFTA, Preferential Arrangements (LOMÉ, CBI, CARIBCAN) |

Several generations of Caribbean and international scholars have noted the important contribution of the external sector to sustained development and progress in the Caribbean. The importance of this sector is best captured in St. Cyr's five (5) axioms or

propositions as to how Caribbean Economic systems work. It is useful to remind ourselves of these propositions since they capture the critical role that external economic performance plays in the growth of Caribbean economies.

- Axiom 1: Closure leads to Economic Stagnation and to social, political and cultural regression.
- Axiom 2: A boom in export staple production provided that it derives from a volume expansion can be a source of prosperity.
- Axiom 3: Caribbean type economies must, for prosperity rely on a thriving export sector and an expanding residentiary sector.
- Axiom 4: Caribbean economies must participate more actively in global economic affairs.
- Axiom 5: Small Caribbean economies must point their residentiary sectors towards the promotion of services (the arts, festivals and sports)

SECTION 1: PROFILE OF CDCC COUNTRIES

The group of countries covered by the UNECLAC¹/CDCC² comprises Antigua and Barbuda, the Bahamas, Barbados, Belize, Cuba, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname and Trinidad and Tobago.³ The majority of these countries are also members of the Caribbean Community (CARICOM) and the recently formed Association of Caribbean States (ACS). This economic grouping is by no means homogeneous and displays wide variation in land mass, population and per capita gross domestic product.

¹ United Nations Economic Commission for Latin America and the Caribbean.

² Caribbean Development and Co-operation Committee.

³ The group also includes the associate member states of Aruba, the British Virgin Islands, Montserrat, the Netherlands Antilles and the US Virgin Islands.

Table 1: Land Acreage, Population and Per Capita GDP of the CDCC Territories

| Country | Land Area (Km Sq.) | Population (Thousands) Mid-Year (1993) | Per Capita GDP (1993) |
|-----------------------------------|--------------------|---|-----------------------|
| Antigua and Barbuda | 442 | 67.5 | 5,540 |
| Bahamas | 13,935 | 268 | 10,308 |
| Barbados | 431 | 259 | 5,592 |
| Belize | 22,965 | 203 | 2,255 |
| Cuba | 110,860 | 11,050 | - |
| Dominica | 750 | 72 | 2,246 |
| Dominican Republic | 48,442 | 7,620 | 715 |
| Grenada | 345 | 89 | 1,903 |
| Guyana | 214,970 | 816 | 644 |
| Haiti | 27,750 | 6,893 | 205 |
| Jamaica | 11,424 | 2,495 | 1,563 |
| St. Kitts/Nevis | 269 | 40.3 | 3,791 |
| St. Lucia | 616 | 150 | 2,676 |
| St. Vincent and the Grenadines | 388 | 114.2 | 1,732 |
| Suriname | 163,265 | 447 | 883 |
| Trinidad and Tobago | 5,128 | 1,278 | 4,049 |

Source: Reports of the various Statistical Offices.

Guyana, Suriname, Cuba and the Dominican Republic account for approximately 70% (489, 095 square kilometres) of the total land acreage of the CDCC countries. Cuba, the Dominican Republic, Haiti and Jamaica are the largest territories based on population size while members of the OECS grouping have significantly smaller populations. The majority of countries of the CDCC group are relatively small both in terms of land mass and population size when compared to other countries in Latin and Central America.

The last column of Table 1 presents per capita Gross Domestic Product (GDP) for the various territories. A cursory glance at the column shows the great disparity in the basic standard of living between the various economies. The figures vary from US\$10,308 in the case of the Bahamas to US\$205 for Haiti. The World Development report ranks the majority of these countries as middle/low income earners with the exception of the Bahamas, which is ranked among the high level income earners. Whereas Table 1 gives a relatively broad picture of the economy, Table 2 provides greater detail on the sectoral origin of the Gross Domestic Product in the various territories. The results from this table

are quite interesting and worthy of further elaboration since they provide some insight into the main sectoral contributions of components of the GDP in the various CDCC territories.

Table 2: Sectoral Origin of the Gross Domestic Product
(Percentage of Total GDP)

| Country | Year | Agric | Mining | Manuf | Elec & Water | Constr | Distr | Transp | Hotel & Rest | Fin | Govt |
|--------------------------------|------|-------|--------|-------|--------------|--------|-------|--------|--------------|------|------|
| Antigua and Barbuda | 1993 | 4.1 | - | 2.4 | - | 9.5 | 9.9 | 7.5 | 13.7 | - | 16.9 |
| Bahamas | 1986 | 4.5 | 10.3 | - | - | 3.0 | 26.2 | 10.9 | - | 12.2 | 17.1 |
| Barbados | 1994 | 6.4 | 0.6 | 8.8 | 3.4 | 6.6 | 19.1 | 8.1 | 15.5 | 18.0 | 13.4 |
| Belize | 1992 | 20.6 | 16.5 | - | - | 7.6 | 16.8 | 11.9 | - | - | - |
| Cuba** | 1989 | 15.4 | - | 46.0 | - | 9.3 | 8.0 | 8.0 | - | - | - |
| Dominica | 1993 | 20.5 | 0.8 | 8.4 | 4.0 | 7.7 | 11.3 | 18.2 | 2.8 | 14.9 | 18.4 |
| Dominican Republic | 1994 | 12.6 | 2.5 | 18.4 | 2.1 | 9.5 | 11.8 | 9.6 | 5.8 | 5.1 | 8.9 |
| Grenada | 1992 | 13.9 | - | 5.6 | - | 10.5 | 13.0 | 3.6 | 7.6 | - | 21.6 |
| Guyana | 1993 | 28.3 | 12.2 | 12.3 | - | 6.5 | 4.9 | 5.6 | - | 8.3 | 14.5 |
| Haiti | 1992 | 36.7 | 0.1 | 11.0 | 0.9 | 4.5 | 16.2 | 2.0 | - | 7.4 | 16.8 |
| Jamaica | 1994 | 8.0 | 9.3 | 18.5 | 4.5 | 8.9 | 21.3 | 11.4 | - | 23.9 | 6.7 |
| St. Kitts/Nevis | 1993 | 7.2 | - | 11.6 | - | 12.1 | 13.2 | 7.1 | 10.2 | - | 17.3 |
| St. Lucia | 1993 | 10.8 | - | 7.4 | - | 8.5 | 15.3 | 6.3 | 10.4 | - | 13.1 |
| St. Vincent and the Grenadines | 1993 | 16.0 | - | 9.1 | - | 10.8 | 13.5 | 7.5 | 2.6 | - | 16.4 |
| Suriname | 1991 | 11.1 | 4.0 | 10.0 | 7.3 | 5.5 | 15.3 | 6.9 | - | 10.1 | 28.5 |
| Trinidad and Tobago | 1993 | 2.4 | 23.7* | 8.5 | 1.9 | 7.6 | 15.5 | - | 8.7 | 13.1 | 11.3 |

Sources: EIU country profiles (various years) and national accounting reports of the various territories where available.

* includes oil exploration, production and refining.

** represents global social product.

Agriculture is the most significant contributor to value added in the economies of Guyana (28.3%), Haiti (36.7%), Belize (20.6%) and the OECS territories of Dominica (20.5%). It makes a substantial contribution to domestic production in Cuba (15.4%), the Dominican Republic (12.6%), St. Vincent and the Grenadines (16.0%), Grenada (13.9%) and St. Lucia (10.8%). Mining and Quarrying are important contributors in Guyana (12.2%), Jamaica (9.3%) while the Petroleum sector (23.7%) is the backbone of the economy of Trinidad and Tobago. The Manufacturing sector is quite important to the

economies of the Dominican Republic (18.4%), Jamaica (18.5%) Guyana (12.2%) and Haiti (11.0%) and within recent years, has been increasing in importance in some of the smaller CDCC countries. In addition, the services sector has also been growing as a major contributor to value added in all the economies. In Antigua and Barbuda and Barbados, the tourism sector accounted for 13.7% and 15.5% of total GDP in 1993 and 1994, respectively. Meanwhile, financial services contributes approximately 23.9%, 18%, 14.9% and 13.1%, respectively to value added in Jamaica, Barbados, Dominica and Trinidad and Tobago.

The major export markets for the products of the CDCC countries are shown in Table 3. In 1994, over 40% of the exports of Trinidad and Tobago, Jamaica, Haiti, the Dominican Republic and Belize were sold in the US market while CARICOM was a major export market for the products of the smaller territories of St. Vincent and the Grenadines, Grenada, Dominica and Barbados. However, because of the US imposed trade embargo against Cuba, that country exports very little to the US market and instead the bulk of its exports have been directed to markets in Canada and Eastern Europe. Notwithstanding the fact that the United Kingdom has had strong historical ties with the majority of CDCC countries, its importance as an export market has declined over time for most countries in the Caribbean Basin. It, however, remains a significant market for the products (largely bananas) of the smaller OECS territories and Belize.

With respect to imports, the United States is the most important trading partner for the majority of CDCC countries (see Table 4). Indeed, in 1994 over 30% of all imports into Jamaica, Haiti, Belize, Barbados, the Dominican Republic, Suriname and Trinidad and Tobago originated from the United States. Although Grenada depended on the US market for just over 20% of its imports in 1994, the largest share of its imports (40%) originated from its CARICOM neighbours. In the case of Cuba, however, the bulk of its imports come from Latin America (27.5%), China and the Eastern European territories (65%).

Table 3: Exports to Main Trading Partners (1994)
(% of Total)

| Country | UK | USA | CAN | JAPAN | LATIN AMERICA | CARICOM | OTHER |
|------------------------------|------|------|------|-------|---------------|---------|-------|
| Antigua & Barbuda | - | - | - | - | - | - | - |
| Bahamas | 7.3 | 30.5 | 5.0 | 1.8 | 3.9 | 0.15 | 51.4 |
| Barbados | 14.2 | 20.6 | 7.1 | 0.64 | 1.3 | 43.2 | 12.9 |
| Belize | 30.1 | 44.0 | 7.0 | - | 8.4 | 3.5 | 7.0 |
| Cuba | 1.2 | - | 11.5 | 4.6 | 3.0 | 0.6 | 82.1 |
| Dominica | 31.3 | 8.4 | 1.2 | 1.2 | 6.0 | 25.3 | 26.6 |
| Dom. Republic | 2.9 | 46.5 | 4.8 | 2.1 | 7.4 | 1.1 | 35.2 |
| Grenada | 14.3 | 25.0 | - | - | 17.8 | 17.8 | 25.1 |
| Guyana | 22.4 | 23.9 | 32.8 | 2.2 | 1.1 | 5.1 | 12.5 |
| Haiti | 1.2 | 71.2 | - | - | 2.5 | - | 25.1 |
| Jamaica | 11.4 | 43.9 | 9.5 | 1.3 | 4.1 | 3.8 | 26.0 |
| St. Kitts/ Nevis | - | - | - | - | - | - | - |
| St. Lucia | - | - | - | - | - | - | - |
| St. Vincent & the Grenadines | 16.8 | 4.2 | - | 13.4 | 2.5 | 25.2 | 37.9 |
| Suriname | 5.9 | 10.3 | - | 5.6 | 15.1 | 1.2 | 61.9 |
| Trinidad and Tobago | 3.4 | 50.2 | 0.5 | 0.7 | 13.5 | 17.2 | 14.5 |

Sources: IMF Direction of Trade Statistics Yearbook (1995)
EIU Country Profiles and Country Reports (1995)
Annual Statistical Digests (Individual Countries)

Table 4: Imports from Main Trading Partners (1994)
(% of Total)

| Country | UK | USA | CAN | JAPAN | LATIN AMERICA | CARICOM | OTHER |
|------------------------------|------|------|------|-------|---------------|---------|-------|
| Antigua & Barbuda | - | - | - | - | - | - | - |
| Bahamas | 1.8 | 26.5 | 0.45 | 21.2 | 4.7 | 0.14 | 45.2 |
| Barbados | 9.1 | 33.4 | 4.9 | 4.4 | 8.5 | 23.4 | 16.3 |
| Belize | 7.3 | 53.3 | 2.3 | 1.2 | 22.0 | 3.9 | 10.0 |
| Cuba | 2.3 | 0.2 | 3.1 | 1.2 | 27.5 | 0.7 | 65.0 |
| Dominica | 7.9 | 15.8 | 3.9 | 3.4 | 5.6 | 13.0 | 50.4 |
| Dom. Republic | 1.3 | 41.5 | 1.0 | 6.3 | 26.7 | 1.3 | 21.9 |
| Grenada | 10.0 | 21.7 | 1.7 | 3.3 | 5.0 | 40.0 | 18.3 |
| Guyana | 10.8 | 29.2 | 1.0 | 4.3 | 18.5 | 19.7 | 16.5 |
| Haiti | 2.8 | 50.2 | 0.9 | 0.6 | 24.9 | 0.4 | 20.2 |
| Jamaica | 4.2 | 52.3 | 2.8 | 3.7 | 16.7 | 5.8 | 14.5 |
| St. Kitts/ Nevis | - | - | - | - | - | - | - |
| St. Lucia | - | - | - | - | - | - | - |
| St. Vincent & the Grenadines | 7.4 | 23.9 | 1.1 | 2.8 | 6.2 | 9.1 | 49.5 |
| Suriname | 3.7 | 33.2 | 0.7 | 3.5 | 16.1 | 14.6 | 28.2 |
| Trinidad and Tobago | 8.8 | 42.0 | 3.8 | 2.9 | 24.7 | 4.0 | 13.8 |

Sources: IMF Direction of Trade Statistics Yearbook (1995).
EIU Country Profiles and Country Reports (1995).
Annual Statistical Digests (Individual Countries).

Table 5 presents detailed data on the principal exports and imports of selected CDCC countries while Table 6 indicates the major export products of these territories. Agricultural and Natural Resource based products are the dominant exports of the CDCC countries. Bananas are the principal exports of Dominica, Grenada St. Vincent and the Grenadines and St. Lucia. This crop accounts for an average of 40% of the exports of these territories. Sugar is the dominant export of Barbados, Cuba, Guyana and St. Kitts/Nevis but is also of importance in the Dominican Republic and Jamaica. The export of natural resource based products is generally quite important for some of the larger CDCC territories. For instance in 1994, over 40% of the exports of Trinidad and Tobago consisted of mineral fuels while exports of alumina represented 44.7% and 75.6% of total exports for Jamaica and Suriname in 1992 and 1991, respectively. Meanwhile, Bauxite was also a significant export product for both Jamaica (8.4%) and Guyana (22.1%). In

the case of manufactured goods, the main manufactured exports of countries of the CDCC group are clothing, handicraft and chemicals. The foregoing analysis indicates that agricultural products - bananas and sugar - are the main export products of a large number of the CDCC territories especially those belonging to the OECS group. The larger territories of Trinidad and Tobago, Jamaica, Guyana, Cuba, Suriname and the Dominican Republic depend mainly on mineral based products and to a lesser extent on the export of light manufactured items.

Table 5: Principal Exports and Imports of Selected CDCC Countries

| Country | Principal Exports | % of Total Exports | US\$ val millions | Principal Imports | % of Total Imports | US\$ val millions |
|---------------------------|--|--|--|--|--|--|
| Antigua & Barbuda (1991) | | | | Manufactures Capital Goods Food Chemicals & fuels | 26.5 14.1 68.5 14.3 | 69.6 36.9 179.7 37.4 |
| Belize (1993) | Sugar Garments Citrus Concentrates Fish Products Bananas | 29.0 14.2 9.8 9.2 8.4 | 41.5 20.3 14.0 13.2 12.1 | Machinery Food Fuels Chemicals Other Manufactured | 27.7 20.0 13.3 10.3 35.6 | 67.8 49.0 32.5 25.1 87.0 |
| Cuba (1994) | Sugar Minerals Marine Products Fruit & Vegetables Pharmaceuticals | 49.1 13.5 6.5 2.5 8.2 | 600 165 80 30 100 | Food, Beverages & Tobacco Raw Materials Fuels & Lubricants Chemicals Machinery & Transport | 17.0 3.3 29.3 6.4 19.4 | 720 140 1240 270 820 |
| Dominica (1994) | Bananas Soap | 46.8 28.5 | 55.37 33.66 | Manufactures Capital Goods Food Chemicals & Fuel | 24.2 25.8 23.8 9.1 | 28.5 30.4 28.1 10.7 |
| Grenada (1992) | Nutmeg & Mace Bananas Cocoa | 14.5 14.5 13.0 | 2.9 2.9 2.6 | Manufactures Capital Goods Food Chemicals & Fuels | 19.4 15.2 35.5 10.5 | 21.2 16.6 38.9 11.5 |
| Guyana (1993) | Sugar Gold Bauxite Rice Shrimp | 27.0 24.2 22.1 8.0 2.8 | 111.3 99.8 91.1 33.0 11.4 | Capital Goods Other Intermediate Goods Consumer Goods Fuels & Lubricants | 34.9 26.6 21.3 16.7 | 169.3 128.9 103.1 80.8 |
| Haiti (1993) | Coffee Cocoa Essential Oils Manufactured Product Handicraft Manufactures | 0.8 0.07 0.5 4.4 0.2 | 0.66 0.06 0.4 3.56 0.16 | Food, Beverages & Tobacco Hydrocarbons Oils & Fats Chemicals Manufactures Machinery & Transport Equipment | 17.5 11.9 3.4 4.0 5.7 2.4 | 46.7 31.9 9.0 10.6 15.1 6.4 |
| Dominican Republic (1994) | Ferro-nickel Raw Sugar Gold & Silver Coffee Cocoa Tobacco | 28.6 18.5 3.0 9.9 8.8 2.8 | 181.1 117.1 18.9 62.7 55.5 17.6 | | | |

Source: Various EIU Country Profiles & Reports

IMF Direction of Trade

Table 5 (cont'd)
Principal Exports and Imports of Selected CDCC Countries

| Country | Principal Exports | % of Total Exports | US\$ val millions | Principal Imports | % of Total Imports | US\$ val millions |
|------------------------|--|------------------------------------|---|--|---|--|
| Jamaica (1992) | Alumina Bauxite Sugar Bananas | 44.7 8.4 7.8 3.8 | 471.1 88.8 82.5 39.6 | Food Other Consumer Goods Fuels Other Raw Materials Construction Materials Transport Equipment Other Capital Goods | 6.0 10.3 20.9 52.7 5.7 10.4 9.0 | 106.6 160.5 324.9 818.2 88.8 161.5 139.0 |
| St. Kitts/Nevis (1992) | Sugar & Molasses | 37.4 | 12.2 | Manufactures Capital Goods Food Chemicals & Fuels | 20.7 19.2 29.0 10.4 | 20.2 18.7 28.3 10.1 |
| St. Lucia (1992) | Bananas | 55.8 | 68.5 | Manufactures Capital Goods Food Chemicals & Fuels | 27.4 13.9 35.2 1.3 | 74.4 37.6 95.5 3.6 |
| St. Vincent (1992) | Bananas | 48.4 | 37.5 | Manufactures Capital Goods Food Chemicals & Fuels | 24.7 21.1 21.9 12.3 | 33.1 28.3 29.3 16.5 |
| Suriname (1991) | Alumina Aluminum Shrimp Rice & Products Bananas | 75.6 11.6 8.8 5.8 2.6 | 261.7 40.1 30.4 19.9 9.1 | | | |
| Barbados (1992) | Sugar, Molasses & Rum Chemicals Electrical Components Clothing | 26.2 13.3 13.1 3.7 | 41.4 21.0 20.7 5.9 | Machinery Food & Beverages Other Consumer Goods Construction Material Chemicals Fuels | 17.9 21.1 10.9 6.2 6.8 6.4 | 83.0 98.2 50.8 28.8 31.5 29.8 |
| Trinidad & Tobago | Mineral Fuels Chemicals Manufactured Goods Food (include sugar) Beverage & Tobacco | 49.8 27.5 12.6 5.1 2.1 | 933.1 515.4 235.8 95.4 30.9 | Food Manufactured Goods Machinery & Transport Equipment Chemicals | 15.1 21.2 29.8 13.7 | 171.2 240.5 338.2 155.8 |

Source: Various EIU Country Profiles & Reports.
IMF Direction of Trade.

Table 6: Major Export Products of CDCC Countries by Product Group

| GROUP | PRODUCT | MAIN CDCC EXPORTERS |
|--------------------------------------|---|---|
| Agricultural Products (non-tropical) | <ul style="list-style-type: none"> • Essential Oils/Fats • Fish/Shrimp | <ul style="list-style-type: none"> • Cuba • Belize, Suriname, Guyana |
| Tropical Agricultural Products | <ul style="list-style-type: none"> • Beverages • Spices (Nutmeg, Mace) • Rice, Tobacco • Sugar • Bananas • Fruit & Vegetables | <ul style="list-style-type: none"> • Trinidad & Tobago • Grenada • Suriname, Guyana, Dominican Republic, Trinidad and Tobago • Belize, Cuba, Guyana, Dominican Republic, Jamaica, St. Kitts/Nevis, Barbados • Antigua & Barbuda, Dominica, Grenada, St. Vincent, Jamaica, Suriname • Cuba |
| Natural Resource Based Products | <ul style="list-style-type: none"> • Mineral Fuels • Alumina/ Bauxite/ Aluminum • Gold/ Silver/ Mineral Ores | <ul style="list-style-type: none"> • Trinidad & Tobago • Jamaica, Suriname, Guyana • Guyana, Cuba, Dominican Republic |
| Manufactures | <ul style="list-style-type: none"> • Clothing/ Garments • Handicraft • Chemicals | <ul style="list-style-type: none"> • Belize, Barbados • Haiti • Trinidad & Tobago |

SECTION 2: THE NEW EMERGING GLOBAL TRADE AGENDA

The decade of the 1990s will now present developing countries with several new and difficult challenges which are quite different from those which existed hitherto. The final pillar of global institutional reform has now been established. Indeed, the conclusion of the Uruguay Round has witnessed the formation of the World Trade Organization which now completes the global institutional 'trilogy'. This institutional trilogy will dominate, co-ordinate and manage all global economic matters in the ensuing years. The main features of this recently concluded round of negotiations include:-

- The establishment of a new international discipline for trade in services comparable to that for GATT products

- The establishment of new rules for the protection of intellectual property
- Bringing trade in agricultural products under the discipline of GATT rules
- The integration of developing countries, in a more complete way, into the GATT system by the elimination of certain exceptions
- The establishment of a new and revised set of rules for dispute resolution

Most countries in the Caribbean Basin have participated in the Uruguay Round and details on their accession along with the signatories to the GATT 1994 are presented in Table 10. The round has been hailed in many quarters of the developed world as a major triumph for the multilateral trading system and ushers in a new trade philosophy for the twenty-first century. The Director-General of GATT has described the conclusion of this round as *"a defining moment in modern economic and political history"* and *"one of the greatest trade agreements in history, whose benefits span entire continents and a wide range of trade sectors alike"*.

Table 10: CDCC membership in GATT (Accession dates)

| COUNTRY | ACCESSION DATE (AS OF APRIL 1994) | SIGNATORIES TO GATT 1994 |
|--------------------------------|--------------------------------------|--------------------------|
| Antigua and Barbuda | March 30, 1987 | J.A.E Thomas |
| Bahamas* | - | |
| Barbados | February 15, 1967 | Warwick O. Franklin |
| Belize | October 7, 1983 | Jean Tamer |
| Cuba | January 1, 1948 | Cabrisas Ruiz |
| Dominica | April 20, 1993 | - |
| Dominican Republic | May 28, 1950 | Federico Cello |
| Grenada | February 9, 1994 | - |
| Guyana | July 5, 1966 | M Shree Chand |
| Haiti | January 1, 1950 | - |
| Jamaica | December 31, 1963 | P Robertson |
| St. Kitts & Nevis | March 24, 1994 | - |
| St. Lucia | April 13, 1993 | Edwin Laurent |
| St. Vincent and the Grenadines | May 18, 1993 | - |
| Suriname | March 22, 1978 | R.B. Kalloe |
| Trinidad and Tobago | October 23, 1962 | Ralph Maraj |

Source: Compiled by author from GATT (1994): *GATT Activities: An Annual Review of the Work of the GATT* and various GATT documents.

* The Bahamas, as of April 1994, has not acceded formally to the GATT although the GATT has been applied *de facto* pending final decisions on the country's future commercial policy.

A number of agreements, decisions and declarations have been adopted and a list of the main agreements is outlined below:-⁴

- *The Multilateral Agreement on Trade in Goods (Annex 1A)*
 - *General Agreement on Tariffs and Trade 1994*
 - *Agreement on Agriculture*
 - *Agreement on the Applications of Sanitary and Phyto sanitary Measures*
 - *Agreement on Textiles and Clothing*
 - *Agreement on Technical Barriers to Trade*
 - *Agreement on Trade-Related Investment Measures*
 - *Agreement on Implementation of Article VI of the GATT 1994*
 - *Agreement on Implementation of Article VII of the GATT 1994*
 - *Agreement on Preshipment Inspection*
 - *Agreement on Rules of Origin*
 - *Agreement on Import Licensing Procedures*
 - *Agreement on Subsidies and Countervailing Measures*
 - *Agreement on Safeguards*
- *The General Agreement on Trade in Services (Annex 1B)*
- *The Agreement on Trade-Related Aspects of Intellectual Property Rights (Annex 1C)*
- *Understanding on Rules and Procedures governing the Settlement of Disputes (Annex 2)*
- *Trade Policy Review Mechanism (Annex 3)*
- *Plurilateral Trade Agreements (Annex 4)*
 - *Agreement on Trade in Civil Aircraft*
 - *Agreement on Government Procurement*
 - *International Dairy Agreement*
 - *International Bovine Agreement*
- *Ministerial Declarations and Decisions*
- *Understanding on Commitments in Financial Services*

⁴ See GATT (1994).

The successful conclusion of the round⁵ is expected to strengthen the multilateral trading system by providing clearer and more consistent rules for (i) the application of a variety of trade policy measures; (ii) reducing discriminatory effects of regional arrangements; (iii) achieving a substantial degree of tariff liberalization and thereby encouraging greater multilateral free trade and (iv) linking the various agreements within a formal institutional framework subject to the integrated dispute settlement mechanism.

2.2: Implication of the Removal of Trade Barriers and Related Matters

2.2.1 *TARIFFS and NONTARIFF BARRIERS*

Several new tariff commitments have been achieved in the Uruguay Round. The ad-valorem average trade weighted tariffs will be reduced by 40% in the industrialised countries while 44% of imports of industrial products by the developed countries will be duty free. In addition, there has been a significant increase in the overall level of tariff bindings. Developing countries participated actively for the first time in the negotiations on tariffs and made several concessions which have impacted positively on the overall level of tariff bindings.

Table 11 presents a breakdown of the percentage of tariff bindings for different regions of the world. Both the developed and transition economies have committed themselves to bindings of 99% and 98%, respectively of their tariff lines while developing countries have agreed to bind 73% of their tariff lines. When the bindings are disaggregated by region, then both North and Latin America (including the CDCC countries) have bound 100% of their tariff lines compared to 82% for Western Europe and 68% for Asia. On an individual country basis, the round has seen significant increases in binding commitments in Australia (100%), New Zealand (100%), Singapore (73%) and in countries of the

⁵ See UNCTAD (1994).

English-speaking Caribbean (100%). Table 12 presents evidence of tariff reductions by industrial sector of imports into industrialised economies that emanate from developing countries. On average tariffs have been reduced by 30% for all industrial products but there is little uniformity across the broad spectrum of imports. The largest reductions have occurred in metals (60%), wood, pulp, paper and furniture (65%), non-electric machinery (68%), and manufactured articles (63%).

Table 11: Bindings of Tariff on Industrial Products

| Country Group | Number of Lines | Import Value (US\$ bn) | Per Cent of Tariff Lines Bound | | Per Cent of Imports under Bound Rate | |
|-----------------------|-----------------|------------------------|--------------------------------|---------|--------------------------------------|---------|
| | | | Pre-UR | Post-UR | Pre-UR | Post-UR |
| Developed Economies | 86,968 | 736.9 | 78 | 99 | 94 | 99 |
| Developing Economies | 157,805 | 350.5 | 21 | 73 | 13 | 61 |
| Transition Economies | 28,962 | 34.7 | 73 | 98 | 74 | 96 |
| By Selection Region:- | | | | | | |
| North America | 14,138 | 325.7 | 99 | 100 | 99 | 100 |
| Latin America | 64,138 | 40.4 | 38 | 100 | 57 | 100 |
| Western Europe | 57,851 | 239.9 | 79 | 82 | 98 | 98 |
| Central Europe | 23,565 | 38.1 | 63 | 98 | 68 | 97 |
| Asia | 82,545 | 415.4 | 16 | 68 | 32 | 70 |

Source: Smeets (1995, p. 96)

Table 12: Industrial Economies: Tariff Reduction by Sector on Imports from Developing Countries

| Product Category | Trade US\$bn | Pre-UR Average Tariff | Post-UR Average Tariff | Reduction (%) |
|---|--------------|-----------------------|------------------------|---------------|
| All Industrial Products (excluding Petroleum) | 176.8 | 6.9 | 4.8 | 30 |
| Textiles and Clothing | 35.1 | 15.7 | 13.2 | 16 |
| Metals | 21.4 | 2.6 | 0.8 | 69 |
| Mineral Products | 16.6 | 2.8 | 2.1 | 25 |
| Electric Machinery | 16.6 | 5.2 | 2.8 | 46 |
| Leather, Rubber, Footwear, Travel Goods | 15.9 | 8.1 | 5.5 | 32 |
| Wood, Pulp, Paper and Furniture | 10.3 | 4.3 | 1.5 | 65 |
| Fish & Fish Products | 7.4 | 7.0 | 4.9 | 30 |
| Non-Electroc Machinery | 27.7 | 3.4 | 1.1 | 68 |
| Chemicals & Photographic Supplies | 6.0 | 6.4 | 3.9 | 39 |
| Transport Equipment | 7.1 | 4.4 | 3.2 | 27 |
| Manufactured Articles n.e.s. | 12.6 | 6.0 | 2.2 | 63 |

Source: Abreu (1995, p. 57)

These reductions were below the average for textiles and clothing (16%), mineral products (25%) and transport equipment (27%). Although these reductions appear to be significant, tariff levels were already quite low in several of the product categories in the developed countries. It is important to note that in the context of textiles and clothing - an important sector for Barbados, Belize and to a lesser extent, Jamaica⁶ - there has been little radical alteration of the tariff structure in developed countries.

**Table 13: Developing Countries: Tariff Reduction by Sector
on Imports from Developing Countries**

| Product Category | Trade US\$bn | Pre-UR Average Tariff | Post-UR Average Tariff | Reduction (%) |
|---|-----------------|-----------------------------|------------------------------|------------------|
| All Industrial Products (excluding Petroleum) | 42.6 | 10.0 | 7.1 | 29 |
| Textiles and Clothing | 6.3 | 13.4 | 10.0 | 25 |
| Metals | 5.6 | 10.7 | 8.2 | 23 |
| Mineral Products | 3.3 | 6.6 | 5.1 | 23 |
| Electric Machinery | 9.3 | 7.5 | 4.9 | 35 |
| Leather, Rubber, Footwear, Travel Goods | 2.4 | 7.7 | 5.6 | 27 |
| Wood, Pulp, Paper and Furniture | 2.9 | 7.9 | 5.9 | 25 |
| Fish & Fish Products | 0.8 | 13.0 | 4.3 | 67 |
| Non-Electroc Machinery | 4.8 | 10.7 | 7.1 | 34 |
| Chemicals & Photographic Supplies | 4.2 | 12.6 | 9.4 | 25 |
| Transport Equipment | 0.6 | 18.7 | 14.6 | 22 |
| Manufactured Articles n.e.s. | 2.3 | 11.2 | 7.6 | 32 |

Source: Abreu (1995, p. 66)

**Table 14: Developing Countries: Tariff Reduction by Sector
on Imports from Industrial Economies**

| Product Category | Trade US\$bn | Pre-UR Average Tariff | Post-UR Average Tariff | Reduction (%) |
|---|-----------------|-----------------------------|------------------------------|------------------|
| All Industrial Products (excluding Petroleum) | 199.8 | 14.9 | 10.7 | 28 |
| Textiles and Clothing | 8.5 | 18.7 | 13.5 | 28 |
| Metals | 20.9 | 16.1 | 10.9 | 32 |
| Mineral Products | 13.8 | 8.5 | 6.7 | 21 |
| Electric Machinery | 33.9 | 14.5 | 9.6 | 34 |
| Leather, Rubber, Footwear, Travel Goods | 3.9 | 15.8 | 10.8 | 32 |
| Wood, Pulp, Paper and Furniture | 7.8 | 10.8 | 7.8 | 28 |
| Fish & Fish Products | 1.2 | 20.4 | 6.6 | 68 |
| Non-Electroc Machinery | 43.2 | 15.3 | 11.2 | 27 |
| Chemicals & Photographic Supplies | 31.7 | 16.0 | 10.6 | 34 |
| Transport Equipment | 17.3 | 20.7 | 15.3 | 26 |
| Manufactured Articles n.e.s. | 17.8 | 11.5 | 9.6 | 17 |

Source: Arbcu (1995, p. 63)

⁶ Jamaica has benefitted somewhat from special provisions under the 807 provisions.

Table 13 presents evidence of tariff reductions by industrial sector of imports into developing countries from other developing countries while in Table 14 shows tariff reductions on imports from developed countries. A comparative examination of these tables reveals that there is very little difference between tariff reductions on imports from developing countries to those from industrialised economies. Although these tariff reductions are quite similar their impact on trade flows may be quite different depending on the initial level of Pre-Uruguay round tariff structures as well as on the values of import elasticities.

Given that the US, Japan, Canada and Europe have been the most important export markets for the CDCC countries, it is appropriate to attempt a brief examination of the reductions in the trade-weighted tariffs for the main CDCC export products in the markets of the Quad⁷ countries. Tables 15, 16 and 17, present tariff reductions in the Quad countries for non-tropical agricultural products, tropical agricultural products and natural resource based products and manufactures. In respect of tropical agricultural products, average tariffs on imports from developing countries will be reduced by 45.5% in Canada, 42.6% in the European Union, 37.2% in Japan and 41.1% in the United States. However, these reductions may not be that significant given the fact that average tariff especially in Canada and the United States are already quite low. In contrast, average tariff rates in both the European Union and Japan will still be relatively high for rice and tobacco - products which are important for Guyana and Trinidad and Tobago, respectively - despite the reductions of 38.2% and 15%, respectively. A similar case exists for fruits and nuts. In the case of the natural resource based products, average tariff levels will be reduced by 41.8% in Canada, 18.9% in the European Union, 43.1% in Japan and 22.5% in the United States. Here again these reductions, though large, are not all that meaningful since average tariff rates are already quite low. For clothing, tariff reductions were largest in Japan (29.2%) and Canada (28.2%). Both the United States and the European Union have not altered in any significant way their Pre-Uruguay round tariff structures.

⁷ This term refers to Japan, Canada, the European Union and the United States.

2.2.2: Agriculture

The results of the negotiations on agriculture provide a framework for the long term reform of agricultural trade and domestic support policies and are expected to lead to improved predictability and stability for importing and exporting countries alike. Generally the agreement covers the commitments that the member territories are to undertake on market access, domestic support and export competition; the agreement on sanitary and phyto-sanitary measures; and the ministerial decision concerning least developed and net food importing developing countries.

(a) Market Access

In respect of market access two critical changes were introduced, namely, (a) conversion of non-tariff barriers to tariffs (tariffication) and (b) the binding⁸ of all tariffs. The new rules stipulate that all measures (including quantitative import restrictions, variable levies, minimum import prices, non-tariff measures maintained through state trading enterprises, voluntary export restraints) affecting imports of agricultural products will have to be converted into bound duties from the date of entry into force of the agreement and that no new tariff measures are to be introduced. These new tariffs along with all existing tariffs are to be reduced by 24% over a ten-year period by developing countries and 36% over a six year period by developed countries.⁹ Thus the developing countries have been allowed to reduce tariffs at a slower rate. The reductions have been calculated on a simple average basis with a minimum reduction of 15% per tariff line for developing countries and 10% for developed countries. The recent report of UNCTAD notes that for important agricultural sectors, the tariffication process has resulted in *"the establishment of tariff rates that may prove to be as prohibitive as the non-tariff barriers they replaced, often reaching levels in the major developed countries, in the range of 200-500 per cent ad-valorem."*

⁸ This binding implies that tariffs cannot be increased without negotiations with trading partners.

⁹ These reductions are founded on a 1986-88 base.

In respect of the agricultural sector, several offers were made by the CDCC countries in respect of bound ceilings on agricultural products. In the majority of cases the tariffs on products in Annex 1 of the Agreement on Agriculture were bound at a base rate of 100% although higher offers were submitted for sensitive products. The bindings on sensitive products were generally set at rates in excess of the Common External Tariff (CET) allowing most of the CARICOM group of CDCC countries to increase the CET to the bound ceilings if the need arose. Table 18 presents details on the bound ceilings for items in Annex I as well as details on the number of sensitive products bound as well as the ranges over which the bindings apply.

Antigua and Barbuda offered to bind all items in Annex 1 at a base rate of 100% except for vegetables, coconuts, bananas, citrus fruits, margarine and aerated beverages which were bound at rates ranging from 107% to 220%. Barbados offered to bind all items in Chapter 1-24 at a base rate of 100% and submitted exemptions for approximately 42 product items, the most important of which included live poultry, pork and pork products, milk and cream, eggs, vegetables, beet and cane sugar, and orange juice. These were bound at rates ranging from 110% to 223%. Belize has offered 100% ceiling bindings on all items in Annex 1 of the Agreement on Agriculture with notable exceptions in the case of meat (fresh, chilled and salted), leguminous vegetables, bananas, fresh fruit, rice, cane sugar, and orange juice. These latter products were bound at rates ranging from 70% - 110%.

Cuba, the Dominican Republic and Suriname have submitted tariff ceilings on items in Annex 1 of the Agreement on Agriculture of 40%, 40% and 20%, respectively. Cuba has submitted some 45 exceptions which have been uniformly bound at a rate of 150% while the Dominican Republic has submitted no exceptions list for agricultural products. Suriname has submitted a relatively short list of exceptions with bindings ranging from 8.5% to 17%.

Both St. Lucia and St. Vincent and the Grenadines have agreed to bind all items in Annex I of the Agreement on Agriculture at a base rate of 100% and have submitted relatively detailed list of exceptions with bindings ranging from 103% to 250%. The larger territories of Trinidad and Tobago, Jamaica and Guyana, like their Caribbean counterparts have agreed to bind items in Annex I at a rate of 100% with very few exceptions.

Table 18: MFN Tariff Bindings of CDCC Countries (Agricultural Products)

| Country | Schedule | Binding Ceiling | Implementation Period | Number of Products Bound and Ranges | Other Duties and Charges |
|--------------------------------|----------|-----------------|-----------------------|-------------------------------------|--------------------------|
| Antigua and Barbuda | XCVII | 100% | 1995 | 32 [107%-220%] | - |
| Barbados | XCIV | 100% | 1995 | 42 [110%-223%] | [70%-230%] |
| Belize | C | 100% | 1995 | 37 [70%-110%] | 106 ^a |
| Cuba | IX | 40% | 1995 | 42 [40%] | - |
| Dominica | CVIII | 100% | 1995 | 45 [150%] | - |
| Dominican Republic | XXIII | 40% | 1995 | - | - |
| Guyana | CXII | 100% | 1995/2004 | 5 | 40% |
| Jamaica | LXVI | 100% | 1995 | - | 80% |
| St. Lucia | CXXI | 100% | 1995 | 73 [107%-250%] | - |
| St. Vincent and the Grenadines | CXXII | 100% | 1995 | 39 [103%-133%] | - |
| Suriname | LXXIV | 20% | 1995 | 9 [8.5%-17%] | - |
| Trinidad and Tobago | LXVII | 100% | 1995 | 7 [106%-110%] | 15% |

Source: Compiled from GATT documents.

To facilitate the implementation of tariffication in sensitive product areas, a special treatment clause was introduced into the Agreement on Agriculture which allows a country, under certain strictly defined conditions, to maintain import restrictions up to the end of the implementation period. These are as follows:-

- Imports of a given product comprise under 3% of domestic consumption in the base period
- No export subsidies have been applied to the imported product since 1986
- Any production restrictions that are applied to a product are applied only to the primary agricultural product and not to any worked or prepared products
- For Products designated as having special treatment under non-trade concerns such as environmental or food security measures
- A minimum access level is set at 4% of domestic consumption and is increased by 0.8% per year to reach 8% of domestic consumption over a six-year period

Moreover, the agreement includes a special and differential clause which applies when a primary agricultural product is the predominant staple in the traditional diet of developing countries. Both Japan and Korea have utilized this waiver to maintain temporary protection of their rice markets.

(b) Domestic Support

The next major element of the Agreement on Agriculture concerns the reduction of support to domestic producers of agricultural products. The agreement has adopted the concept of an Aggregate Measure of Support (AMS) which covers all support provided either on a product-specific or non-product specific basis that does not qualify for exemption. The major exemptions apply to (i) subsidies which are deemed to have a minimum impact on trade or "de-coupled" from domestic production (Green Box provisions); (ii) certain government assistance measures to encourage agricultural and rural development in developing countries; (iii) cases in which domestic support constitutes less than 10 per cent of the total value of production for developing countries or 5% for developed countries;¹⁰ and (iv) direct payments under production limiting programmes.¹¹ The industrial countries are to reduce the total AMS by 20% over 6

¹⁰ This applies as well to the value of individual products.

¹¹ These items are excluded from the calculation of the AMS provided that (a) they are based on fixed areas and yields, (b) they constitute 85% of the base level of production and (c) any payments for livestock reduction are calculated on a per-animal basis.

years¹², the developing countries by 14% over a ten year period while least-developed countries are not required to undertake any reductions during the implementation period.

It is important to recognize that the Green Box policies which are excluded from the calculation of the AMS refer to those policies which cause no distortions in trade or production and include the following:-

1. General policies encompassing Research and Development; environmental and product specific programs; pest and disease control measures; training facilities and courses; extension and advisory measures; inspection services (including health and safety standardization); marketing and promotional advice and infrastructural services.
2. Public stockholding for food security purposes.
3. Domestic food aid.
4. Decoupled income support.
5. Payments for relief from natural disasters.
6. Payments under regional assistance programmes
7. Government financial participation in income insurance and income safety net programmes.

(c) Export Subsidies and the "Peace Clause"

The use of export subsidies has been one of the contentious issues affecting trade in services. The agreement on agriculture has attempted to define clearly the list of subsidies falling under reduction commitments. This list includes the provision of direct subsidies including payments-in-kind to a firm contingent on export performance; sale or disposal for export by government of agricultural products at a price lower than that charged for the same product in the domestic market place; provision of subsidies aimed at reducing the costs of marketing exports of agricultural products including handling, upgrading,

¹² The US is to reduce its support from US\$23b to US\$19b, the European Union from ECU 73b to ECU 61b and Japan from YEN 4,800b to Yen 1,900b. See GSR and Associates (1995).

other processing costs; cost associated with international transport and freight and internal transport and freight charges on export shipments (Article A). Budgeting expenditures and export subsidies are not to exceed 64% of the base year total (1986-90) in each of twenty-two product categories while the volume of goods benefitting from subsidies is not to exceed 79% of base-period levels. Developing countries need only reduce expenditure by 24% and volume by 14% over ten years. Food aid is exempt from the reduction disciplines.

In a bid to provide countries with an incentive to accept the new commitments on domestic support and export subsidies, the Due Restraint provisions (Article 13) require that green box policies be non actionable for purposes of countervailing duties and GATT challenges.

The negotiations on agriculture have been the most challenging for the round and have brought greater predictability to agricultural trade. Given the planned reductions in preferential tariffs for bananas and sugar and rice, exports of these products from the CDCC countries are likely to face greater competition in markets in the United States from low cost producers in other developing countries.

SECTION 3: NEW ISSUES

3.3.1 THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

Generally, the term trade in services applies to transactions that cover a range of diverse fields that include distribution, tourism, banking, insurance, transport, and telecommunications. In the GATS, services are defined to include the service in any sector except those supplied in the exercise of governments function. From the outset, the United States has been the prime initiator of the GATS while the developing countries

have been more skeptical and suspicious of the motives behind the agreement. Rom (1994) noted that the cautious approach of developing countries was based on two critical reasons. First, developing countries believed that GATT had no authority to deal with the subject which was already being considered by UNCTAD. Second, there was a fear that developed countries would exploit their willingness to relax restrictions on trade in goods in order to pressure developing countries to make concessions and commitments in the field of services. In short, therefore, the developing countries attempted as far as possible to separate the framework for trade in goods from that for trade in services. The negotiations on services covered issues relating to the definition and measurement of services, the analysis of existing services arrangements and the broad principles that govern the operations of the agreement. Despite many difficulties, major elements of the services agreement were eventually hammered out. The architecture of the GATS is founded on the following critical pillars:-¹³

- The framework Agreement which defines the obligations accepted by members
- Eight Annexes, which address horizontal (movement of natural persons to provide services) and sector-specific matters
- Schedules of specific commitment that member countries have made which apply to service sectors, sub-sectors, and activities

In addition, there are a number of Ministerial Decisions which detail the modalities for on-going discussions on both horizontal (movement of natural persons) and sectoral (professional services, financial services, maritime transport, and basic telecommunications). Indeed, there is a substantial amount of unfinished business as regards liberalization commitments and rule-making for the services sector.

The contractual framework established by the GATS addresses four modes of supply,

- **Cross-border supply** of services from the territory of any one member into that of another (i.e. no physical movement of supplier or customer)
- **Consumption abroad** - freedom of resident of a member state to purchase services in the territory of another member

¹³ See Hockman (1994), Hockman and Sauve (1994) and Sauve (1995) for fuller discussions

- **Commercial presence** - freedom of opportunities of foreign suppliers to establish, operate or expand a commercial presence (branch, agency or wholly-owned subsidiary) in the territory of another member
- **Presence of Natural Persons** - freedom of opportunity for the entry and temporary status in the member's territory of foreign individuals supplying the service

Under the MFN rule (Article II of GATS) each contracting party is expected to accord immediately and unconditionally to service and service providers of any other party, treatment no less favourable than that which it accords to like services and service providers of any other member country. The Agreement recognizes, however, that MFN treatment may not be possible for each service activity and provides for exceptions in the Annex on Article 11 exemptions. These exemptions are in principle to be reviewed within five years and should last no longer than ten years after the agreement enters into force. The conditional MFN treatment reflects the concern on the part of the service representatives in industrialized countries that unconditional MFN will allow competitive industries located in countries with restricted policies to benefit from a sheltered market while 'free-riding' in the markets of the more open countries. Indeed this concern was most noticeable in telecommunications, financial services, maritime transport, audio-visual and air transport services. There was much unfinished business in the negotiations on financial services, basic telecommunications and maritime transport. Negotiations in financial services are to be concluded within six months of the entry into force of the WTO while those for basic telecommunications and maritime transport are to be concluded by April 30 and June 30 1996, respectively. The GATS also covered several additional issues which are outlined as follows:-

- Article III requires all members to establish enquiry points to provide specific information concerning laws, regulations and administrative guidelines affecting trade in services
- Member territories are also expected to establish disciplines to ensure that qualifications requirements, technical standards and licensing procedures are based on objective and transparent criteria and are no more burdensome so as to restrict the supply of a service by other members

- Monopoly or oligopoly is allowed in the supply of services provided that governments ensure that such firms do not abuse their position and act in a manner inconsistent with the commitments under Article II
- Members are required to remove restrictions from international transfers and payments on current transactions except if taken to safeguard the balance of payments. In such cases the safeguard should be temporary and non-discriminatory and should be phased out progressively as the Balance of Payments situation improves
- Article (XIV) provides members with the legal cover to take measures to safeguard public morals, order, health, security, consumer protection and privacy

Many of the obligations in the agreement are only triggered when a member schedules a specific commitment. According to Hoekman (1995), negotiators in the GATS chose to pursue a "hybrid" of positive and negative listing to the scheduling of specific commitments¹⁴. Signatories to the GATS first decided which service sectors were subjected to market access and national treatment disciplines and then specified the conditions and limitations on market access and national treatment that would apply by the various supply modes. Entries of "none" in the schedules imply that members commit themselves not to have measures that violate market access or national treatment while "unbound" signifies that no commitments have been made for any particular mode of supply.

The major service categories are elaborated in the Annexes to the GATS and broadly correspond to the classification adopted by the GATT Secretariat which lists twelve broad sector (see Table 19), namely, Business, Communication, Construction and Engineering, Distribution, Education, Environment, Financial, Health, Tourism and Travel, Recreation, Cultural and Sporting Services, Transport and Other. The CDCC countries have made binding commitments in a number of these sectors although the majority of the commitments relate to Business, Financial, Tourism and Health Services. The Dominican

¹⁴ The list is positive as regards to the determination of sectoral coverage of market access and national treatment commitments but negative with respect to the maintenance of measures that violate national treatment or market access disciplines.

Republic, followed by Jamaica, Trinidad and Tobago, and St. Lucia, has scheduled the widest range and number of offers among the CDCC countries.

The Caribbean region has been a major importer of producer and consumer services, especially in the areas of transportation, education, health and foreign travel. Some countries in the region have been actively involved in the export of services but this has been confined, by and large, to tourism.¹⁵ Entertainment services have been increasing in importance in several of the CDCC territories but more so in Jamaica with its reggae music and Trinidad and Tobago with calypso and the steelband. Unfortunately there is little by way of detailed information on the contribution of this service to value-added in these territories.

The Agreement on Services presents many challenges for the CDCC countries. The first of these relates to modifications of commitments in light of unforeseen developments. The agreement stipulates that countries wishing to modify or withdraw a commitment are required to (i) notify the Trade Council for Services three months in advance of the modifications; (ii) wait until three years from the time the commitment entered into force before they can withdraw or modify any commitments (iii) enter into negotiations with every member that requests it to ascertain whether compensatory adjustment has to be provided (iv) wait to make the adjustment until compensation is adequately determined by the arbitration process. Given that the CDCC countries are only now waking up to the importance of services they may therefore find it quite difficult to change commitments as their economies evolve. In reality such changes may take a significant amount of time before they are introduced and may involve compensation which CDCC countries may be least able to afford.

Second, the Agreement is biased towards favourable treatment that should be given by the purchasing member country to the supplying member.¹⁶ It does not require suppliers of

¹⁵ This sector is an important contributor to GDP in Barbados, the Bahamas and several of the OECS territories.

¹⁶ See Rom (1994, p29) for this argument.

the service to extend MFN treatment on a nondiscriminatory basis to purchasing members. Given that most of the Caribbean countries are presently purchasers of services, they may find it more difficult to exercise control over powerful transnational suppliers from developed countries who enter their markets.

3.3.2 TRADE-RELATED INTELLECTUAL PROPERTY RIGHTS

Since its inception in 1947, the GATT made provisions for the protection of intellectual property rights, though in a rather limited way. Article IX for instance, established that trade marks and other marks of origin were not to be used in a manner that would hamper international commerce. Article XX of the GATT 1947, placed the adoption or enforcement of measures necessary to secure "the protection of patents, trade marks and copyrights and the prevention of deceptive practices" among the general exception in GATT. These measures were therefore not bound by GATT disciplines. Indeed, the agreement (GATT 1947) did not require from its contracting parties the adoption of minimum standards of protection. Several international treaties have been concluded on IPRs (e.g. the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Work) and most of these are administered by the World Intellectual Property Organization (WIPO).

The developed countries especially the United States were quite unhappy with the performance of the WIPO whose membership was not universal and which they felt lacked the effective powers to discipline signatories in cases of non-compliance.¹⁷ On account of its perception of WIPO, the United States attempted to garner support initially for IPRs by raising the issue of counterfeiting at the Toyko round. In July 1979, the US and the EC presented a joint proposal to the GATT as to how imports of counterfeit goods could be discouraged. An appended version of this proposal was endorsed by Canada and Japan

¹⁷ Interestingly, WIPO argued that the USA had made very little effort to reform how the organization functioned.

and submitted to GATT in 1982. Developed countries therefore ensured that the issue of IPRs was brought squarely to the attention of the GATT.

Tremendous debate between the North and South surfaced when the US presented a proposal to the Preparatory Committee of GATT for the inclusion of IPRs in the GATT. A group of ten developing countries¹⁸ led by Brazil challenged the inclusion of IPRs on the grounds that the Paris convention provided an adequate international mechanism for dealing with the issue and therefore the WIPO should be responsible for such matters. Indeed, developing countries considered information as a key factor in their development efforts and were opposed to any international system of IPRs that could impede the flow of information, reduce their access to new technologies and affect their long-term development. In addition, developing countries, were concerned about the prospect of trade retaliation in cases where their protection of IPRs seemed inadequate.

The inadequacy of international arrangements for IPRs together with mounting pressures from domestic pharmaceutical and designer clothes industries prompted the US to take action at the domestic level. In 1988, the US introduced the issue of IPRs into its domestic trade legislation making the violation of IPRs actionable under section 1303 (special 301) of the Omnibus Trade and Competitiveness Act of 1988. Special 301 allows the US trade representative (USTR) to investigate a wide variety of perceived "unfair" trade practices on an expedited basis.¹⁹ In particular, it requires the USTR to undertake a review of the intellectual property practices of US trading partners each year, within thirty days after the national trade estimates report is issued. The USTR is required to identify those countries which deny adequate and effective provision of IPRs or fair and equitable market access to US persons who rely upon intellectual property protection. The USTR places perceived offenders on a priority watch list or on a watch list. Those countries

¹⁸ These countries included Argentina, Brazil, Cuba, Egypt, India, Nicaragua, Nigeria, Peru, Tanzania and Yugoslavia.

¹⁹ See Evans (1994) for a full exposition.

placed on the priority watch list are the ones which are deemed to have the greatest potential (actual or perceived) impact on US products. The USTR then seeks to negotiate a bilateral agreement with the offending country. If this fails and the offending country maintains its policies, the USTR is authorised to impose retaliatory measures such as increasing duties or imposing restrictions on imports.

The Agreement on TRIPS²⁰ is composed of seventy-three articles and is subdivided into seven constituent parts dealing with:-

1. General Provisions and Basic Principles- these define the scope of the obligations, the relationships between the agreement and existing intellectual property rights conventions as well as the concepts of national treatment and most-favoured nation treatment as applied to IPRS.
2. Specific standards concerning several instruments of IPRS protection and guidelines for the control of anti-competitive practices in licencing IPRS.
3. Guidelines for the enforcement of IPRS.
4. Disciplines on the procedures and formulations required for the acquisition and maintenance of IPRS.
5. Criteria for Transparency and provisions for dispute prevention and settlement.
6. Transitional arrangements.
7. Institutional arrangements and final provisions for execution of IPRS.

The agreement establishes minimum standards based on existing conventions concerning the availability, scope and use of IPRS and covers copyrights and related rights, trademarks, geographical indications, industrial designs, patents, layout designs and integrated circuits, trade secrets and anti-competitive practices in contractual licenses. Computer programs (software) and data compilations are to be protected as literary works under the Berne Convention. Title-holders of computer programs and cinematographic works will also have the right to authorize or prohibit the commercial rental to the public of originals or copies of their copyright works. Performers will also receive protection

²⁰ See Braga (1994) for a fuller discussion.

from the unauthorized recording and broadcast of any of their live performances. Copyright, other than that for photographs and works of art, will be protected for a minimum of 50 years from publication, but broadcast copyrights will be accorded a minimum of 20 years.

In respect of trademarks, the agreement strengthens the protection of well-known trademarks. Owners of well-known trademarks will be allowed to challenge similar marks in a bid to deter speculative registration. The term of protection between registration and renewal of the trademark should be no less than seven years. A registered trademark may be cancelled if not used for a period of three uninterrupted years. Furthermore, the agreement prohibits the use of foreign trademarks in conjunction with a local mark as well as compulsory licensing.

Article 22 requires each member to provide the necessary legal means to prevent the use of a geographical indication which misleads the public as to the true place of origin of the good. Additional protection for geographical indications for wines and spirits is provided for in Article 23 even when these are followed by appropriate qualifications.

Patents have been at the heart of the debate on TRIPS between developed and developing countries. The main areas of difficulty revolved around limited coverage in terms of products or processes, short terms of protection, the broad scope for compulsory licensing and ineffective enforcement.²¹ The agreement allows for a twenty-year protection for almost all inventions (products or process) in all fields of technology. Certain exceptions are granted from patentability if their commercial exploitation is prohibited for reasons of public order or morality. Exemptions are also permitted for diagnostic, therapeutic and surgical methods and for selected biological processes.

Developing countries have been granted a period of five years from the date of application by which time their laws, regulations and practices must be brought into conformity with

²¹ See Braga (1994 p. 391).

the new obligations. These countries have also been quite concerned with the potential use of IPRS to hamper the transfer and diffusion of technology. Article 40 recognizes the possibility that licensing practices may have anti-competitive effects and allows member countries to counter such practices with appropriate measures with the proviso that these measures be compatible with other provisions in the Agreement. The Article also provides for a system of bilateral consultations between member countries to provide access to information for the evaluation of anti-competitive practices and to avoid arbitrary enforcement of remedies against these practices.

The greatest challenge facing developing countries in respect of the TRIPS Agreement is the fact that substantial changes to domestic legislation will have to be guaranteed. Many developing countries in the CDCC group will have to extend protection to include pharmaceuticals and chemical products as well as for the protection of computer software.

In the Caribbean, both Jamaica and Trinidad and Tobago in their attempt to gain accession to NAFTA signed bilateral treaties with the US which established a framework for the revision of domestic legislation. These "hurried" attempts may not have given these CDCC members sufficient time to study and prepare appropriate legislation for TRIPS.²² Thus Jamaica and Trinidad and Tobago may have already committed themselves to certain types of legislative reforms and may not be able to take *de facto* advantage of the transitional period granted in the TRIPS Agreement.

A second difficulty which arises in the context of the Agreement on TRIPS relates to the control of anti-competitive practices. Both Braga (1994) and Jackson (1994) have observed that the language of Article 40 is essentially prescriptive and provides no precise definitions of anti-competitive practices. This vagueness may encourage developed countries to persist in obstructing the transfer of relevant technology to developing

²² This point was gleaned from discussions with Taimoon Stewart of ISER and is also contained in the chapter on TRIPS which she wrote for the GSR Associates and ISER (1995) study.

countries. As such, frictions over technology transfer and diffusion are likely to intensify with the implementation of the TRIPS accord.

3.3.3 TRADE-RELATED INVESTMENT MEASURES (TRIMS)

Trade related investment measures (TRIMS)²³ are essentially those measures adopted by host nations which place conditions on a company, usually a TNC, such that the operations of the company are conducted in a manner that is consistent with the specific objectives of the host countries. With the increasing attention placed on the globalisation of production and trade, the use of such measures was a major source of dispute between developed and developing countries. Developing countries have traditionally seen these measures as ideal for promoting specific objectives relating to technology transfer, industrialisation and export expansion. In addition, they have been employed to curtail the abuse of monopolistic power by transnational corporations. On the contrary, the perceived wisdom in developed countries is that TRIMS are generally second-best instruments which generate welfare-reducing trade distortions.

The right to tailor investment policies to meet national development strategies was enshrined in the 1948 Havana Charter as part of the operating rules of ITO. However, investment was subsequently placed on the back-burner until the Uruguay Round negotiations. The dispute brought by the United States against Canada's Foreign Investment Review Act in 1982²⁴ provided the catalyst for the inclusion of investment measures in the Uruguay Round. This dispute revealed the lack of coverage of international investment within GATT.

²³ These include local equity requirements, licensing requirements, remittance restrictions, foreign exchange restrictions, manufacturing restrictions, transfer-of-technology requirements, domestic sales requirements, local content requirements, trade balancing requirements, product mandating requirements, manufacturing requirements and export performance requirements. See Greenaway (1990) for a detailed classification of TRIMS.

²⁴ This dispute was initiated under GATT Article XXIII.

The negotiations mandate granted to the TRIMS group was to examine the applicability of existing GATT articles to the trade effects of investment measures and to elaborate where necessary further provisions to avoid such trade effects. The United States, Japan, the EEC and Nordic countries submitted written proposals on TRIMS.²⁵ The submissions by both the US and Japan proposed in essence an international investment regime that would establish rights for foreign investors and reduce constraints on transnational corporations. These submissions also identified a number of regulatory performance requirements which were deemed to have trade-distorting effects, the most important of which included local content requirements, domestic sales requirements, technology transfer requirements and manufacturing requirements.

The US lobbied in the negotiations for an outright ban on the most trade-distorting TRIMS as well as for a general framework for the incorporation and control of all TRIMS other than those that were banned. Although the EEC was in agreement with the need to examine TRIMS under the GATT framework, it was more concerned with the inclusion of only those TRIMS which had a direct effect on trade.²⁶ The EEC was not in favour of the inclusion of technology transfer, licensing and local equity requirements which they felt were part of domestic industrial policy and would therefore not be addressed by GATT without impinging unduly on national sovereignty²⁷.

Developing countries regarded TRIMS as non-border issues of domestic policy and therefore not within the remit of the GATT. Indeed, developing countries underscored their need for foreign direct investment and the need to maintain certain investment measures or performance requirements which were necessary to channel foreign investment in ways that were consistent with their national development policy objectives.

²⁵ See Puri and Brusick (1989).

²⁶ These were local content requirements; manufacturing requirements; export performance requirements; product mandating requirements; trade balancing requirements; domestic sales requirements; restrictions on access to foreign exchange and limitations on component shares in final manufactured products.

²⁷ See EIU (1994) for this point.

The Agreement on TRIMS does not introduce any new obligations but reaffirms existing GATT disciplines relating to national treatment (Article III) and prohibits the use of quantitative restrictions (Article XI). An illustrative list annexed to the agreement identifies two TRIMS - local content and trade balancing requirements - as being inconsistent with Article III and three others - trade and foreign exchange restrictions along with domestic sales requirements - as constituting quantitative restrictions (QRs). Industrial economies are required to phase out the GATT inconsistent TRIMS in two years while developing countries and least developed countries are allowed longer periods of five and seven years, respectively. A standstill clause prevents members from intensifying existing TRIMS during the transition period if this is deemed necessary to maintain equality in the face of disadvantages already experienced by established investors who are subject to TRIMS. The Agreement also calls for the establishment of a TRIMS Committee to monitor the implementation of the TRIMS Agreement and requires members to notify the committee within ninety days of the entry into force of the WTO of those TRIMS which are inconsistent with the WTO. The TRIMS Agreement is to be reviewed within five years of its entry into force by the Council for Trade in Goods.

The present TRIMS Agreement is likely to have few negative implications for countries in the CDCC group since it has not added any major obligations and still leaves the regulation of investment measures in the hands of the host nation. However, behind the present agreement lurks several substantial issues which represented the real crux of the negotiations. These issues relate to multilateral rules on international investment, regulation of the behaviour of transnational corporations and the treatment of TNCs by host nations. A related and open question which is still unresolved concerns the design of appropriate rules²⁸ for international competition and competition policy. Developing countries for a long time have sought to regulate the practices of TNCs largely through the Set of Multilaterally Agreed Principles and Rules for the Control of Restrictive Business Practices (1980) and the Code of Conduct on the Transfer of Technology

²⁸ These rules in general refer to policies that affect the contestability of markets.

(1981). This matter is likely to occupy center stage when the TRIMS Agreement is reviewed.

SECTION 4: THE NEW GATT AND THE WORLD TRADE ORGANIZATION

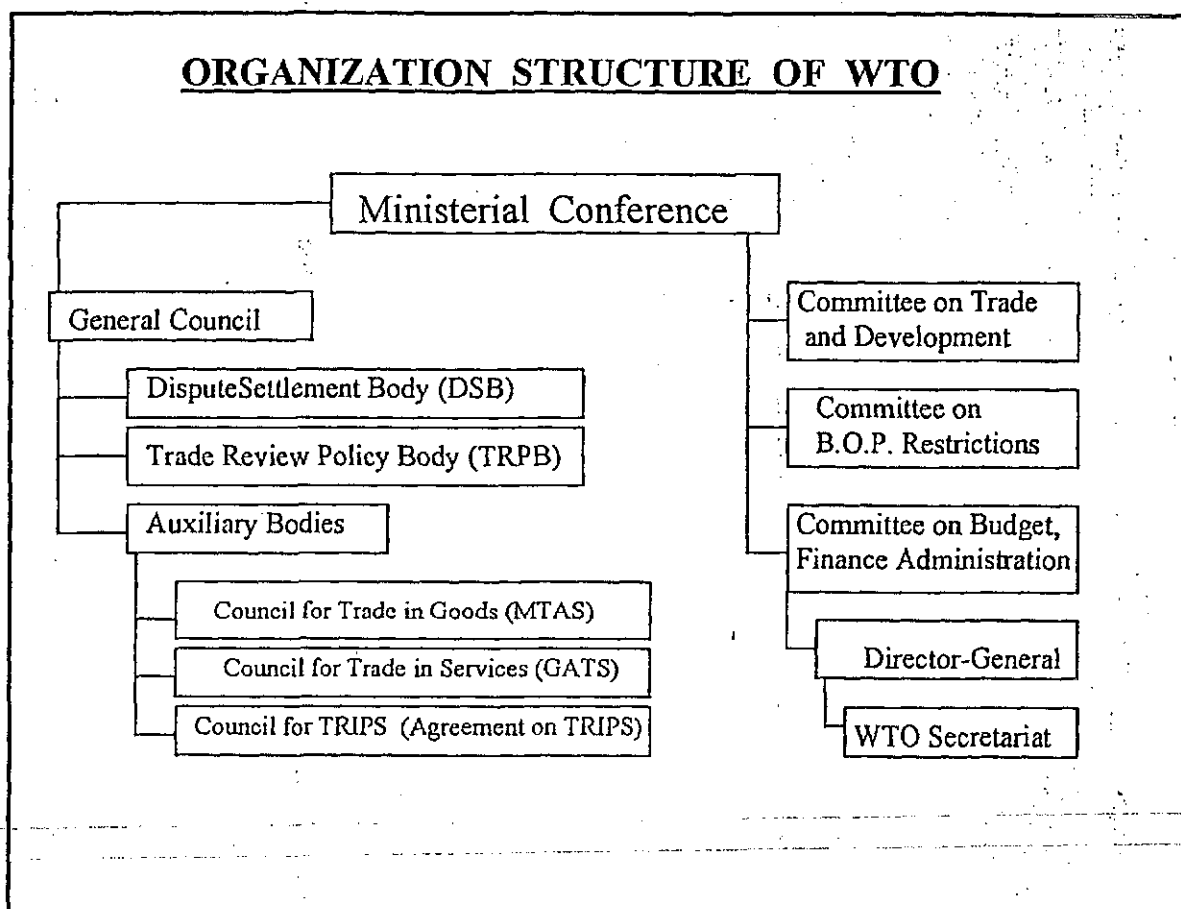
(a) Structure Of The World Trade Organization

Article III of the Marrakesh Agreement outlines the main functions of the World Trade Organization which are to facilitate the implementation, administration and operation of the Uruguay Round Agreements and to administer the Dispute Settlement Understanding (DSU) as well as the Trade Policy Review Mechanism. The WTO consists of two main institutions namely, a ministerial conference²⁹ composed largely of representatives of all WTO members and a General Council which will sit beneath the ministerial council and will conduct the affairs of the WTO between Ministerial meetings. The General Council will discharge the functions of the Dispute Settlement and Trade Review Policy bodies. In addition a series of auxiliary councils have been created and will operate under the guidance of the General Council. These Councils will be specifically charged with overseeing the functioning of specific agreements. The Council for Trade in Services will oversee the GATS Agreement; the Council on Trade in Goods will oversee the Multilateral Trade Agreements (Annex 1a) while the Council for Trade Related Aspects of Intellectual Property Rights (TRIPS) will oversee the Agreement on TRIPS. These Councils will establish their respective rules of procedure and any subsidiary bodies subject to the approval of the general council.

The Ministerial Council will establish three broad committees - Trade and Development, Balance of Payments Restrictions and Budgets, Finance and Administration - to carry out the functions assigned to them by the Agreement and any additional functions deemed

²⁹ This Council must convene at least once every two years.

appropriate by the General Council. The Conference will also appoint a Director-General who shall oversee the staffing, duties and conditions of service of the Secretariat as well as present annual budget estimates and financial statements to the committee on Budget, Finance and Administration. An organizational chart of the structure of the WTO is presented in Figure 2.



Note: Design extracted from responsibilities assigned in Articles IV-VII of the Marrakesh Agreement.

(b) Dispute Settlement Body

Several countries were dissatisfied with the Dispute Settlement System under the GATT, especially the long delays, inconsistencies, uncertainty and inadequacy of enforcement. Indeed, on some occasions there was a tendency on the part of certain countries to resort to unilateral trade measures to address international trade issues. The Enhanced Dispute

Settlement System required a mechanism that could be more transparent, predictable and consistent and would underpin the framework of trade rules created by the negotiators. One of the distinctive features of the Uruguay Round is the attempt to promote an improved settlement system by developing a more legalistic approach³⁰ to the settlement of disputes. The new approach contains the following³¹

- Greater detail on the procedures to be adopted in the event of a dispute between members of the WTO.
- Strict time scales for the progress of a dispute settlement procedure.
- An improved system of Panels for Dispute Resolution
- An Appellate tribunal consisting of persons with demonstrated competencies in international law, international trade and the Covered Agreements

These new features are expected to discourage the tendency of certain countries to resort to unilateral trade measures to address international trade issues. They are also intended, following past practices of GATT to place an obligation on parties to desist from launching Dispute Settlement Procedures on unsatisfactory grounds.

(c) Mechanics of the DRM

In the event of a dispute among any two member of the WTO, dispute resolution begins with the complaining member's request for consultations with another member.³² If the consultations fail, the complaining member may request in writing adjudication by a panel, which must fix the timetable for deliberations on the complaint once members have agreed on the composition as well as the terms of reference of the panel. The panel is expected to

³⁰ The DRM essentially involves an orientation towards legal proceedings in which rates are rigorously applied rather than negotiated.

³¹ See Kohona (1994) for a useful discussion

³² Article 4 requests that the WTO member to which the request is made should, in principle, reply to the request within ten days after its receipt and that consultations should commence within thirty days.

submit its final report within than six months and should not exceed nine months. Unfortunately, no sanctions exist if deadlines are not observed. Once the panel has completed its report, it is passed to the Dispute Resolution Body (DSB) which automatically accepts it unless it decides by consensus to table it or unless one of the disputing parties appeals to the Appellate Tribunal. The Appellate Body will number only seven persons, three of which will serve on a case.³³ This Body may only consider questions of law and is expected to submit its report in sixty days. This report, like those emanating from panels, is subject to automatic acceptance except by consensual rejection.

Following the issuance of the first report by the panel or the appellate body, the member which has transgressed is allowed a limited time (thirty days) to indicate how it plans to implement the report. If the implementation plan of the transgressor does not satisfy the complaining member, then the complaining member may call for and will receive a panel to examine the issue. If the panel concludes that the implementation plan of the transgressor is not satisfactory, the complaining member may seek authorization to suspend benefits - subject to automatic approval by the DSB. The transgressing party retains the right to call for a panel to examine whether the suspension is in line with the original harm suffered. It should be recognized, however, that not all disputes follow the panel procedure. Indeed some of the Uruguay Round Agreements contain special procedures which do not involve panels. The majority of these involve some type of expanded conciliation procedure before a body containing government representatives.

A critical question that arises is whether the DRM mechanism will work successfully for CDCC countries involved in disputes with industrial nations. One of the main weaknesses in the provisions covering the Appellate body is the lack of a rule that restricts the participation of appellate members that may be affiliated to a government involved in the dispute. Although Article 17(3) of the DSU rules out appellate body members "affiliated with any government" the preparatory committee to the WTO decided on December 6 1994, that the requirement of Article 17(3),

³³ Members of this body will be nominated for a period of four years and may be re-appointed.

*"would not necessarily harm rule out persons, who, although paid by a government, serve in a function rigorously and demonstrably independent from that government"*³⁴

It is therefore quite possible for the interests of CDCC countries to be ignored by appellate members working indirectly in the service of another government. The avoidance of such a circumstance would require that a representative panel of experts be selected so that the interests of developing countries could be adequately served.

CONCLUSIONS AND RECOMMENDATIONS

The conclusion of the Uruguay Round establishes a new trade structure for the global economy in which several new issues have been brought under GATT discipline. Twenty eight separate accords were concluded covering, inter alia, textiles, services, agriculture TRIMS and TRIPS. A significant amount of time and attention was devoted to drafting of more comprehensive rules to guide dispute settlement, and for the assessment and use of safeguards, anti-dumping measures, and subsidies and countervailing duties. One of the significant achievements of the round is the creation of the World Trade Organization which is now charged with the responsibility of overseeing fair and free trade between countries. This body will be managed by a Ministerial Conference and a General Council which will discharge the functions of the Dispute Settlement as well as the Trade Review Policy bodies. The fact that the WTO is likely to work in tandem with the International Monetary Fund and the World Bank effectively ensures that world economic affairs will be managed by institutions which are directly under the control of the super powers. CDCC countries must therefore lobby effectively to ensure that their voices are clearly heard in the new dispensation. The round has resulted in significant reductions in tariff barriers in developed countries and an overall increase in the level of bindings in developing countries. The majority of CDCC countries still depend heavily on one or a few agricultural or mineral products. Bananas, sugar, rice, oil, bauxite, alumina and clothing constitute the main stay of several countries of this group. These countries have generally

³⁴ Cited in Vermulst and Driessen (1995, p.145).

agreed to reduce both agricultural and industrial products and have agreed to bind the majority of their tariff and non-tariff lines. These planned reductions in tariff and non-tariff barriers are likely to have two main effects. The first of these is lower prices for both exports and imports while the second is increased competition from producers in other developing countries.

In respect of textiles and clothing, the developed countries have offered very little by way of tariff and non-tariff reductions. It is also quite evident that the long transitional period granted to phasing out the multifibre agreement can give developed countries sufficient time to implement new forms of protectionism. Indeed, one form of protectionism which is already rearing its head, relates to the use of environmental discrimination.

Unfortunately, the tariff reductions achieved in these sectors will result in little overall benefit for these small countries of the CDCC group. Indeed, the failure to achieve fully diversified economies may prove to be a major disadvantage in both the short and long term. The latent intention of the United States and other Developed countries especially Japan and the European Union, was to create a multilateral environment that would facilitate the expansion of trade in service and service-related activities - activities in which they already possess both a comparative and competitive advantage - thus ensuring the continued growth of their economies in the 21st century. It is interesting to note that while the United States runs a major deficit on its merchandise trade balance, its services trade balance has been enjoying a rising surplus. CDCC countries that have participated in the round need to be especially concerned therefore with the new issues negotiated in the round, especially services, as well as the forthcoming negotiations which will focus on the environment and competition policies. Service industries constitute over 50% of the GDP in most CDCC countries and will surely be among the growth industries of the 21st century. The present GATS agreement is still largely unsettled with negotiations in financial services and telecommunications being postponed for future deliberations. An agenda for action in CDCC countries must consider:-

- The establishment of efficient and well coordinated information systems to generate the requisite data on market access restrictions and regulatory regimes in force across the CDCC grouping and in the wider world community. Such a system needs to pay specific attention to (i) the number of service providers in each sector, subsector and activity; (ii) the quantity of service output per activity; (iii) laws prohibiting market access by sector (iv) proportion of foreign participation by sector, sub-sector and activity.
- Review of domestic legislation across CDCC countries with a view to developing a set of consistent regulations on IPRs. If this is not done, countries may leave themselves open to bilateral pressures from the US, Japan or Europe
- Detailed investigation of labour standards and competition policy and investment measures across CDCC territories in preparation for upcoming negotiations
- A thorough investigation of the Dispute Resolution Mechanism and the selection of a panel of experts who may be in a position to serve on the DSP Panel or Appellate Body
- Commissioning of a detailed empirical study to gauge the potential economic fortunes of CDCC members

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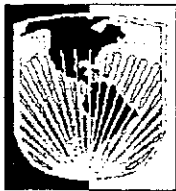
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***INTER-AMERICAN DEVELOPMENT BANK
REGIONAL OPERATIONS DEPARTMENT II***

MACROECONOMIC MANAGEMENT: IS IT WORKING?

**Presented to the Conference on
the Caribbean Quest: New Directions for the Reform Progress**

**Port of Spain, Trinidad & Tobago
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**by Bertus J. Meins
Regional Economic Advisor**

This paper reflects personal opinion of the author, which may not necessarily coincide with those of the Inter-American Development Bank, its Board and Management, or its Member States

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CONTENTS

| | | |
|-------|---|----|
| I. | Introduction | 1 |
| II. | Regional Policy Frameworks in Historical Perspective | 2 |
| III. | The Return to Stability and Sustainable, but not Adequate, Growth | 5 |
| IV. | Lessons from the Mexican Crisis | 8 |
| V. | Lessons from the Development Thinking and Practice Conference | 9 |
| VI. | The New Latin American Consensus | 12 |
| VII. | Recent Country Experiences in Central America and the Caribbean | 13 |
| VIII. | Concluding Remarks | 24 |

MACROECONOMIC MANAGEMENT: IS IT WORKING?

By Bertus J. Meins¹

I. Introduction

The two oil price shocks of the 1970s had an important impact on global growth and income distribution: they required strong adjustment measures around the world to combat the resulting inflationary forces. The U.S. decided to contain the inflationary impact basically with monetary policy alone. The resulting spike in interest rates smothered the economic growth momentum in the early 1980s. Countries in nearby regions, especially in Central America and the Caribbean, that have such extensive financial and trade relationships with the U.S., suffered substantially from lower growth and export absorption by the U.S.

After a period of high external capital absorption due to the recycling of OPEC surpluses through the Western banking system, these countries were also hit hard by the spike in international interest rates that sharply increased the real burden of their external debt, as well as by the subsequent drying up of new capital inflows. The eventual result was a profound internal and external crisis, a decade of negligible growth, and sharply higher unemployment and poverty incidence.

This confluence of unfavorable factors, and their longevity, forced all governments in the region to thoroughly review the adequacy of their strategic policy mix in the light of the new circumstances. The eventual outcome of this process, that initially entailed aspects of trial and error, has been positive, albeit rather uneven as far as individual countries are concerned.

This paper will focus on the smaller economies of the Caribbean and Central America because of their comparability. All have relatively small economies and a high degree of openness. Virtually all also depend to some extent on export of commodities. These factors create a special vulnerability to external shocks, be they market disruptions, international interest rate rises, or sudden changes in the terms of trade. Effective macroeconomic management is therefore essential at all times to reduce economic volatility and thereby improving the potential for sustained economic growth. This paper aims at identifying those policy mixes that so far have proven to be effective in the economic environment of Central America and the Caribbean.

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II. Regional Policy Frameworks in Historical Perspective

The events of the late 1970s and the first half of the 1980s once again demonstrated the need for consistently sound macroeconomic management, lest governments get overwhelmed by the consequences of major, unexpected external events that can threaten a country's standard of living for a long time to come. While we can easily agree on policy changes in the abstract, the practical question is: what mixture of macroeconomic measures is appropriate for what event, how can one be better prepared in the future, and how is one to distribute the eventual cost and pain?

The great Caribbean statesman and economist, Sir W. Arthur Lewis, while speaking at the second Annual Meeting of the Board of Governors of the Caribbean Development Bank in St. Lucia on April 21, 1972, somehow seems to have had a premonition of things to come: he explicitly referred to the failure of mining to provide adequate employment in Jamaica, Trinidad and Guyana, the poor shape of regional agriculture, and the slow pace of growth in manufacturing compared with other developing countries. He explicitly warned against the possible dire consequences of the high cost levels in the Caribbean region. These were already in his time forcing regional governments to offer tax exemptions and other privileges to newcomers, which reduced local benefits from these enterprises. He recognized that while governments realized this dilemma, the people did not: they were encouraged by populist leaders to "put all the blame on foreign devils".

Sir Arthur also recognized already then what later became infamous as the Dutch Disease, as he stated that "the expansion of the mines threatens to destroy all other economic activity, while itself providing an almost negligible amount of employment. In the process, costs in other industries are raised beyond what productivity can support, and the result is mass unemployment". He predicted at the time that there was no easy solution: in fact, it took the Netherlands a decade of deep policy adjustments and social pain to convert the Disease into what has now become the Dutch Wellness.

Sir Arthur's prescriptions for tackling the structural weaknesses of his beloved Caribbean countries were rather straightforward: they included using exchange rate corrections in cases of gross overvaluation, as well as foreign trade policy, to stimulate exports and restrain imports; reductions in money incomes or incomes policy (which he believed was hard to implement in the regional context); and productivity increases. In short, he already had identified the core of the building blocks for what was to be called macroeconomic adjustment policy since the early 1980s.

Implicitly he already then must have foreseen the future demise of the import substitution model that was still much en vogue throughout Latin America and the Caribbean, although it did result in strong economic growth driven by rapid industrialization in the 1960s and 1970s.

History now places the start of the external debt crisis in September 1982, when Mexico during the Annual Meeting of the Bretton Woods institutions in Toronto, declared its incapacity to honor its debt servicing obligations. However, smaller countries such as Costa Rica already experienced severe financial turbulence at an earlier date, while for others the date of reckoning was initially postponed by the concomitant commodity boom. The immediate effect was one of shock and paralysis: governments did not have immediate policy prescriptions for how to tackle the multiple problems facing them, skeptical electorates were not easily persuaded that the threat of a systemic failure required painful adjustment measures, and the international banking community which had followed its herd instinct and lent to developing countries on a massive scale in its eagerness to profitably recycle the OPEC surpluses, did the only logical thing at the time: they stopped lending to emerging economies. The result was severe fiscal and balance of payment imbalances, stagflation, lots of confusion, and an abrupt interruption of the development process throughout the region.

The period 1982-1987 has entered economic textbooks as the period of Adjustment by Default. Initially, unorthodox adjustment policies were tried out by Argentina, Bolivia, Brazil, Mexico and Peru. These basically focused on creating substantial trade surpluses to free up resources to deal with the debt servicing obligations. Unfortunately, the ir successes were short-lived. By the mid-1980s spiraling fiscal deficits and the ensuing hyper inflation underlined the failure of these attempts.

By 1987 the period of Adjustment by Design began: often aided by the multilateral institutions governments returned to more orthodox adjustment policies that included fiscal austerity, trade reform, policy reforms, and ending the import substitution model and instead adopting an export-led growth model. By the end of the decade these policy combinations were termed the Washington Consensus by John Williamson, a name that he now admits was a misnomer: it was neither Washington inspired, nor a complete consensus. It was something that progressively emerged from experiments with orthodox economic policies in Latin America and the Caribbean, building on policy mixes that turned out to work.

The following 10 commandments formed the backbone of the Consensus:

- fiscal discipline: a primary surplus and overall deficits contained below 2 percent of GDP;
- tax reform: broadening of the tax base and reducing marginal tax rates to reduce fraud and tax evasion; progressively reducing the fiscal dependency on import duties;
- public expenditure priorities: towards areas with high economic returns to improve future growth and income generation, such as law and order, health and education, sanitation and infrastructure;
- financial liberalization: strengthening the financial system, improving regulatory frameworks and supervision, deepening capital markets, stimulating competition, making pension systems actuarially sound;

- exchange rates: unified exchange rate at sufficiently competitive level to stimulate non-traditional exports;
- trade liberalization: quantitative restrictions to be replaced by tariffs, which are to be reduced progressively to the 10 to 20 percent range;
- foreign direct investment: domestic and foreign investors essentially to be treated equally;
- privatization: concentrate State on core functions by leaving running enterprises and utilities to the private sector;
- deregulation: abolish regulations that impede the entry of new firms or that stifle competition: concentrate on environmental protection, labor safety and supervision of the financial sector;
- property rights: provide secure property rights and land titles to all, including small farmers.

The progressive implementation of combinations of these policy prescriptions, often with the help of the multilateral institutions, eventually did have positive results. By the end of the 1980s fiscal deficits had been strongly reduced, both exports and imports grew rapidly again, capital inflows were picking up, and international reserve levels were building up in most countries. While some would like to portray this consensus list a final rejection of Keynesian economics and an embrace of Neo-Liberal policies with many supply side elements, trying to label these policy shifts may miss the point here. The shifts did not form part of a doctrinaire strategy that tried to change the fundamentals of our societies. Instead, in most cases they were conceived in the trial and error period of the 1980s, and progressively adopted by governments of different signature, sometimes constituting a clear break with policy stances adopted during earlier times by the same regional leaders.

While the Consensus did advocate developing and using market forces rather than denouncing, repressing or distorting them, it did not include other articles of neo-liberal faith such as slashing government expenditures to balance budgets, identifying fiscal discipline with a balanced budget, calling for overall tax cuts to prep up the economy, and denouncing tax increases to redistribute income as plunder. It also did not prescribe either firmly fixed or free-floating exchange rates, nor did it call for the abolition of capital controls, or competitive currencies, or argue that the money supply should grow at a fixed rate.

Therefore, it makes more sense to approach the Consensus as a pragmatic and incremental response to the challenges of the times, instead of a deliberate, premeditated change of policy direction to promote new ideologies, or favor new constituencies. By removing the onus of doctrine we can now free ourselves to pragmatically look for additions and refinements that render us a policy mix suitable for the specific policy challenges of small and open emerging economies.

III. The Return to Stability and Sustainable, but not Adequate, Growth

The restoration of internal and external stability and sustainable growth had to wait until the early 1990s in most cases, especially in war-torn Central America, but also in the Caribbean, that still experienced a growth crisis in the period 1991-93, essentially because of stagnation in the tourism industry in the Bahamas and Barbados, and an economic reorientation in Trinidad and Tobago. So far in the 1990s the English-speaking Caribbean region produced an average real growth rate of just 1.1 percent per annum, or virtually zero in per capita terms. Including the Dominican Republic, Haiti, and Belize would bring real growth to around 2 percent per annum, basically because of the strength of the Dominican recovery after a steep recession in 1990. The causes and consequences of this insufficient growth experience, as well as possible remedies, will be subject of further discussion in the continuation of this paper.

The big disappointment of the adherents of the Consensus was that, although it was instrumental in bringing back macroeconomic stability and restore the growth momentum, it could not deliver, on its own, the much broader policy goal of adequate per capita growth, reduction of unemployment, and eradication of poverty. Which were the essential elements still missing in the strategy? What about the recoil from the financial crisis in Mexico at the end of 1994? Or, maybe, was there a change of paradigm in the first place?

Starting with the latter, there obviously was a paradigm shift in the sense that rather stealthily, but unmistakably, the globalization process has taken center stage, this time around truly worldwide. Therefore it is often being blamed as the main culprit of today's economic and social problems, which I believe to be incorrect, for the following reason: contrary to popular belief, globalization is not at all a new phenomenon. A century ago the world in some respects was an even more open marketplace that it is today. For many countries the ratio between external trade in goods and services and GDP was higher then, capital flows were virtually uninhibited under the gold standard, and the movement across borders of persons in search of a new destiny was much less restricted and contested. However, what is different now is that technology and information are the driving forces, and transportation modalities are so much faster and affordable, so that competition becomes truly global now, while the time for reacting to changes and new challenges is so much shorter.

Without a doubt this globalization process forms a formidable challenge to both Central America and the Caribbean because of existing deficiencies in infrastructure, human resources, transportation modes, market access, and limited global orientation of management in the private sector. The latter may also still be unduly protected behind its borders with import duties and non-tariff barriers, especially in the case of Panama, the Dominican Republic, Belize and Haiti. As these obstacles have to be broken down under the GATT-WTO negotiated timetables, such industries are facing an uncertain future at best, unless they can find strategic alliances that can help them become cost-efficient and export oriented.

The challenge of globalization is to stay ahead in the game, both in terms of price and non-price competitiveness. Technology (and the subsequent reduction in communication, information, transportation and production cost) makes globalization feasible, but only continued global trade liberalization can make it work. Different cultures and political systems may wish to approach these challenges in different ways, and some governments (like many citizens) may be tempted to go slow on change. However, we have to realize that after downsizing (some say rightsizing) the public sector, it is left with a reduced potential for shaping the course of events. That function has increasingly shifted toward corporations that operate daily on a global scale, and which set the standards for efficiency and productivity, technological renewal, and labor remuneration, whether we like it or not.

At this point I would like to refer to another observation of Sir W. Arthur Lewis in his book on the industrialization of the West Indies during his tenure as Professor of Political Economy at the University of Manchester. After rejecting both laissez-faire economics and mystical views on industrialization and international specialization he stated:

“Or, again, the fallacy that countries cannot thrive importing raw materials, processing them, and exporting the finished product, a fallacy which is all the more surprising since this is how such countries as Britain, the Netherlands and Japan have prospered for many decades. It is this fallacy which causes West Indians to think of industrialization primarily in terms of processing local raw materials, when in many cases the processing of imported raw materials offers much greater prospects of success”.

Obviously he foresaw the future of export processing, that now has become such a dynamic growth and labor absorbing factor in the Dominican Republic and Jamaica in our region, based on their most abundant production factor, namely labor. In both cases the public sector, after priming the pump with infrastructure, education and training, has now largely ceded the initiative to the private sector.

On the other hand, the role of the public sector has become much more important in other crucial areas, such as setting the rules of the game, regulating, supervising, and protecting where necessary, and fostering social progress. At the national level there is an important role for government to assure that the population at large is academically prepared, but also that the fruits and opportunities are equitably shared, so that a socially coherent society can be preserved, and its citizens receive adequate protection from predatory practices, corruption and environmental degradation.

The Mexican crisis was a wake up call for all those who believed that business cycles have now been overcome and external shocks can easily and timely be accommodated with timely domestic policy corrections only. Why did the Mexican crisis happen? Basically because the desire to increase the growth performance of the economy, and the foreshadows of NAFTA which boosted foreign investment, induced an increase in aggregate demand that created an import boom insufficiently compensated by increasing exports. The result was a

deficit of around 8 percent of GDP on the external current account, three years in a row, despite the absence of fiscal deficits. Because of insufficient reduction in local inflation, real effective exchange rates kept appreciating, which made restoration of the external equilibrium increasingly difficult. Political events added to pressures on interest rates and induced capital flight. In addition, the successive increases in short-term interest rates by the Federal Reserve made Mexico relatively less attractive as an investment locus. Still, foreign investors were willing to climb aboard the private lending bandwagon, but increasingly so in short-term, dollar-indexed, bonds. However, unnoticed by many observers, Mexico had gradually depleted its reserves and by late 1994 the situation became untenable so that Mexico was forced to devalue the peso strongly despite earlier assurances to the contrary: the Tequila crisis was a fact. But now, three and a half years later, Mexico is back on track with 5 percent real growth in 1996 and 4 to 5 percent projected for 1997, basically thanks to persistently prudent macroeconomic policies, a remarkable expansion of exports and a relative compression of imports in the wake of a steep recession in 1995.

However, for Central America and the Caribbean countries which have seen their CBI preferences erode since the inception of NAFTA, this recovery in Mexico was bittersweet: exports to the U.S. of agricultural produce, and export processing products faced increased price competition from Mexico, whereas Mexico also sharply improved its value for money performance in the globally competitive tourism industry. In addition, there are indications that some planned investments in export processing and tourism were diverted away from Central America and the Caribbean towards Mexico. The final result: despite some improvement, the last two years have been unsatisfactory in terms of real growth in both Central America and the Caribbean, although the U.S. economy kept growing strongly. The cost factor that was such a central concern to Sir Arthur Lewis in 1972 is therefore back on the front burner for the entire Caribbean Rim region, requiring creative solutions.

One crucial factor, however, cannot rapidly be provided with either multilateral or bilateral support, namely local entrepreneurship. The educational and cultural value systems of our societies either produce enough of this scarce commodity, or one has to accept the fact that this crucial element for growth and renewal will have to be procured from abroad, at considerable cost. Past experience in the region with public sector entrepreneurship of corporations and utilities has not been sufficiently successful to justify further experiments beyond infra-structural support. The globalization process requires well-equipped and independent professionals to manage corporations and utilities to enable them to deliver the best product — be it goods or services such as electricity, telecommunications, transportation, water and sanitation, or port and airport facilities — around the clock at the lowest possible cost for all. In a global system where the winner tends to take it all, insufficiently competitive goods and services will eventually be pushed out of the market, or worse, if used as essential inputs for other goods and services, may cause irreparable damage to the survival chances of potentially viable activities.

IV. Lessons from the Mexican Crisis

Some practical lessons from the so-called Tequila crisis for the international community of states and organizations were summarized succinctly in an article by U.S. Deputy Secretary of the Treasury Lawrence Summers, published in *The Economist* of January 5, 1996:

1. International capital mobility makes sound policies essential.
2. Unsustainable policies eventually cannot be sustained.
3. Prudent emerging-market governments should treat capital inflows as transitory, but capital outflows as permanent.
4. Increasing sophistication in capital markets requires high rates of savings essential for healthy development.
5. Long-term investment promotion (both domestic and foreign) is essential.
6. Red alert is required if current account deficits surpass 5 percent of GDP, particularly if financed short-term.
7. Although persistent fiscal deficits increase the likelihood of external current account deficits as well (twin deficits), the latter can also become untenable without the former.
8. Transparency is essential to well-functioning international capital markets; timely and correct qualitative and quantitative information is needed to maintain confidence.
9. There is an established need for enhanced IMF emergency financing capacity (GAB).
10. There is no substitute for continuing economic integration if the reform momentum in developing countries is to be sustained.

Taken together, these prescriptions form a consistent set of prudent policies and external support facilities, that once put in place, should contribute to reducing the volatility in the regional economies. This reduced volatility will boost the confidence levels of investors and domestic savers alike, and thereby contribute to enhancing the potential for future sustainable growth and employment creation.

They also stress the fact that, because regional economies are increasingly open, both in terms of flows of goods and services, as well as capital flows, individual governments have reduced degrees of freedom to follow unorthodox policies with regard to macroeconomic management: there would be immediate negative repercussions from the capital markets.

In addition, the call for continued regional integration has become much firmer lately: MERCOSUR added Chile and Bolivia as associates while Peru is interested in entering, the Andean Pact added Panama after losing Peru, the Central American Common Market is integrating while bilateral free trade arrangements have been signed with Mexico, Colombia and Venezuela, and CARICOM has been expanded with Suriname, while the Dominican Republic obtained observer status and Haiti is pressing for accession talks.

V. Lessons from the Development Thinking and Practice Conference

Elements of good governance took center stage during the Development Thinking and Practice Conference, held at the IADB Headquarters on September 3-5, 1996. The general tenor of this conference was that the recuperation in Latin America and the Caribbean from the ravages of the 1980s is still far from complete. Although major headway has been made in restoring macroeconomic stability, growth has not been adequate given the demographic dynamism (less urgent in the Caribbean than in Central America), and deep-rooted unemployment and poverty problems. Despite some recent improvement, domestic saving and investment levels are still way out of line with those required to achieve a sustained 6 percent real growth rate that the participants agreed is necessary to address the fundamental ills of the region.

There is no magic wand to take care of all these problems in one grand design: both traditional macroeconomic stabilization measures and country-specific interventions at meso- and micro-levels were deemed necessary, as are institutional reforms and sharply higher investment in human capital and physical infrastructure (both major victims of the budget cuts in the 1980s). The conference concluded that the globalization trend reinforces the need for rapid productivity increases, export orientation (only those firms will eventually survive that can successfully survive on global markets), and rapid adaption to technological change. This requires a better educated, disciplined, and more flexible labor force, and labor laws geared towards the future, not the glorious past.

The conference noted some valid social reasons for the recent backlash against reforms in Latin America. There are strong indications that the current income distribution in much of South and Central America and in part of the Caribbean is out of line with the rest of the developing world, especially with fast-growing East Asia, as can be derived from Table V-1. Excessively skewed income distribution is increasingly recognized as an obstacle to economic growth, productivity, saving and investment propensities, social progress, and eventually to the social and political cohesion of the regional societies. Possible remedies range from promoting higher growth, better education (called the great equalizer in the long term) and labor training, financial sector strengthening, social security improvements, all easily acceptable to mainstream economists and politicians. However, the conference also stressed the need for more interventionist government policies, such as promoting collective bargaining in wage negotiations, and more equitable, progressive taxation, including taxes on wealth and inheritance. The latter because it is becoming more evident that initial conditions with regard to ownership of marketable assets (including land), are determining to a considerable extent whether individuals are likely to fall victim to poverty at some point in their life cycle.

The conference also agreed on the need to break the vicious circle of premature incorporation of youth in the labor market, a phenomenon especially prevalent in South and Central

America, determined by the need for additional family income. This leads to very limited accumulation of human capital, resulting in underemployment or access to dead-end, low-paying jobs. Decentralization turns out to be much more effective not when the government disappears, but rather when it plays an active role in improving local government and empowering the civil society.

With regard to labor market strategies for employment creation the conference proposed:

- increasing flexibility and strengthening of social actors;
- redesigning and enlarging social protection;
- fostering international competitiveness, mainly through increasing productivity, as nominal labor costs are already comparatively low in the region.

Especially in the case of Central America and the Caribbean region emigration to the U.S. has always acted as a safety valve with regard to excess supply of labor on the local labor markets. In return, expatriate workers send home family remittances that have become a staple for social improvement throughout the region, but especially in El Salvador (where they represent 12 percent of GDP, and the Dominican Republic, where they run at 6.5 percent of GDP). However, recent anti-immigration legislation in the U.S. is partly closing this safety valve and income generator, and is already exerting a negative impact on family remittances to El Salvador. So there is both reason for concern, and for enhancing self reliance, basically by adopting growth fostering policies to the full extent.

Table V-1

**INTERREGIONAL COMPARISON OF INCOME DISTRIBUTION, SAVING,
INVESTMENT AND GROWTH**

| | Income Distribution | | | GDP Growth % | Gross Dom. Invest. as % of GDP | | Gross Dom. Saving as % of GDP | |
|--------------------------------|---------------------|--------------------------------------|-------------------------|------------------------|--------------------------------|---------|-------------------------------|---------|
| | (Observation Year) | Ratio Top 20% + Bottom 20% of Income | Income Share of Top 10% | Annual Average 1980-93 | 1980/89 | 1990/93 | 1980/89 | 1990/93 |
| C.A. & Caribbean | | | | | | | | |
| Guatemala | (1989) | 30.0 | 46.6 | 1.7 | 13.5 | 15.9 | 9.9 | 9.9 |
| Panama | (1989) | 29.9 | 42.1 | 1.3 | 18.2 | 20.7 | 21.7 | 22.4 |
| Honduras | (1989) | 23.5 | 47.9 | 2.9 | 18.0 | 25.1 | 13.0 | 19.1 |
| Mexico | (1984) | 13.6 | 39.5 | 1.6 | 21.9 | 22.3 | 25.1 | 18.4 |
| Nicaragua | (1993) | 13.2 | 39.8 | -1.8 | 21.4 | 18.7 | 5.2 | -7.6 |
| Dominican Republic | (1989) | 13.2 | 39.6 | 2.8 | 23.6 | 20.3 | 18.3 | 15.7 |
| Costa Rica | (1989) | 12.7 | 34.1 | 3.6 | 25.6 | 27.9 | 19.3 | 23.2 |
| South America | | | | | | | | |
| Brazil | (1989) | 32.1 | 51.3 | 2.1 | 20.8 | 19.7 | 23.2 | 22.0 |
| Chile | (1992) | 18.3 | 45.8 | 5.1 | 18.2 | 28.6 | 19.6 | 28.3 |
| Colombia | (1991) | 15.5 | 39.5 | 3.7 | 19.8 | 18.6 | 20.6 | 21.4 |
| Peru | (1985-86) | 10.5 | 35.4 | -0.5 | 24.6 | 17.1 | 25.0 | 15.0 |
| Venezuela | (1989) | 10.3 | 33.2 | 2.1 | 21.3 | 17.8 | 25.5 | 23.1 |
| Bolivia | (1990-91) | 8.6 | 31.7 | 1.1 | 11.2 | 14.5 | 10.4 | 7.9 |
| US & Western Europe | | | | | | | | |
| UK | (1988) | 9.6 | 27.8 | 2.5 | 17.6 | 16.5 | 17.4 | 14.8 |
| US | (1985) | 8.9 | 25.0 | 2.7 | 19.4 | 16.3 | 17.4 | 15.3 |
| Switzerland | (1982) | 8.6 | 29.8 | 1.9 | 25.9 | 25.3 | 25.7 | 27.9 |
| France | (1989) | 7.5 | 26.1 | 2.7 | 20.9 | 20.3 | 20.6 | 21.2 |
| Canada | (1987) | 7.1 | 24.1 | 2.6 | 21.6 | 19.2 | 23.4 | 18.4 |
| Germany | (1988) | 5.8 | 24.4 | 2.6 | 20.4 | 22.6 | 23.5 | 24.0 |
| Sweden | (1981) | 4.6 | 20.8 | 1.7 | 18.8 | 17.3 | 20.2 | 19.1 |
| Netherlands | (1988) | 4.5 | 21.9 | 2.3 | 20.2 | 20.9 | 23.8 | 25.6 |
| East Asia | | | | | | | | |
| Malaysia | (1989) | 11.7 | 37.9 | 6.2 | 30.6 | 35.0 | 33.1 | 34.5 |
| Singapore | (1982-83) | 9.6 | 33.5 | 6.9 | 38.1 | 40.4 | 41.8 | 47.1 |
| Hongkong | (1980) | 8.7 | 31.3 | 6.5 | 29.0 | 28.4 | 30.8 | 31.7 |
| Thailand | (1988) | 8.3 | 35.3 | 8.2 | 29.9 | 40.7 | 26.5 | 35.0 |
| Philippines | (1988) | 7.4 | 32.1 | 1.4 | 22.5 | 22.5 | 21.0 | 17.0 |
| Korea | (1988) | 5.7 | 27.6 | 9.1 | 30.2 | 36.7 | 33.6 | 35.8 |
| Indonesia | (1990) | 4.9 | 27.9 | 5.8 | 29.1 | 29.1 | 31.9 | 31.3 |
| Japan | (1979) | 4.3 | 22.4 | 4.0 | 29.6 | 31.7 | 31.6 | 33.5 |

Source: IBRD World Development Report 1995, Tables 2, 8 and 30 and IBRD World Tables 1995

VI. The new Latin American Consensus

As far as improving the region's growth potential is concerned, John Williamson, the chronicler of the Washington Consensus, proposed during the conference replacement of the original list of Consensus commandments with a more updated one. This was partly in response to the insufficient growth generated so far in the region, and partly in response to experience with the power vacuum that sometimes was left by a retreating public sector, which had created more opportunity for corruption by insiders who could outsmart weak supervisory institutions, thus diminishing the checks and balances that characterize civilized societies. Therefore Williamson now favors "a policy shift away from cutting back a state that had become bloated, to strengthening a number of key state institutions, whose efficient functioning is important for rapid and/or equitable growth".

This new Latin American Consensus should entail "strengthening of essential functions of the state; heightening of supervision to counter corruption, such as through independent central banks and new local variants of the Securities and Exchange Commissions; bolstering institutions, such as the legal, and judiciary branches, the police force and local government; and targeting social spending where it is most needed". For the new LAC Consensus Williamson proposes the following updated set of policy prescriptions:

- increase savings, inter alia by maintaining fiscal discipline; inadequate savings can at best stifle economic growth, and at worst cause economic collapse;
- reorient public expenditure, inter alia toward well-directed social expenditure;
- reform the tax system, inter alia by introducing an eco-sensitive land tax;
- strengthen banking supervision;
- maintain a competitive exchange rate, abandoning both floating and use of the exchange rate as a nominal anchor;
- pursue intra-regional trade liberalization; the recently warming relations between the Central American Common Market, CARICOM, and Andean Pact countries are encouraging examples;
- build a competitive market economy, inter alia by privatizing and deregulating, including the labor market;
- make well-defined property rights available to all;
- build key institutions like independent central banks, strong budget offices, and independent and incorruptible judiciary, and an agency to promote productivity improvement;
- increase spending on education and redirect it to primary and secondary levels.

In virtually all regional countries the multilateral institutions are assisting governments to implement reforms in some of the above-mentioned areas (see Table VII-4), but the pace of reform is often less than expedient, nor is the coverage complete and consistent. Nevertheless, as illustrated by recent improvements in investment and savings fundamentals, more dynamism is gradually emerging, so that higher growth rates are feasible in the medium term. However, to make the transition towards the goal of 6 percent sustained growth, many reforms aimed at unleashing private sector initiative, and removing policy and infra-structural obstacles to growth, still remain to be implemented.

VII. Recent Country Experiences in the Central American and Caribbean Regions

To provide some tentative clues with regard to the degree of success of recent macroeconomic management in Central America and Caribbean countries, this chapter will review the regional performances with regard to real growth, the twin (fiscal and current account) deficits, export dynamism, savings and investment, real effective exchange rates, inflation, and unemployment trends. Subsequently these crude indicators of policy success or failure will be extended further in two tables which present some commonly used criteria for sustainability of the development process. These tables can function as a report card to compare individual country performance with neighboring countries, and to identify areas for improvement. Like a normal report card, however, these tables do not pretend to capture all activities that may matter, nor do they establish relative weights. The latter vary from country to country, and from period to period. However, as the most recent time period is being compared with the average of a extended earlier periods, some indication of the relative degree of success can be derived from the direction of the indicators.

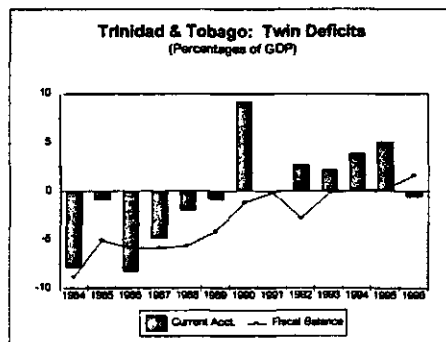
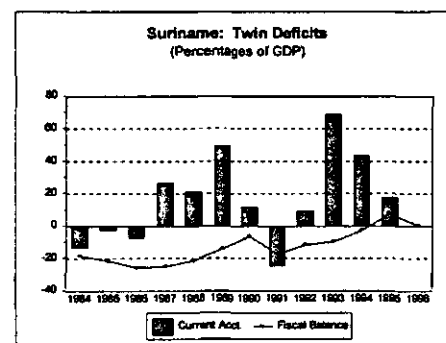
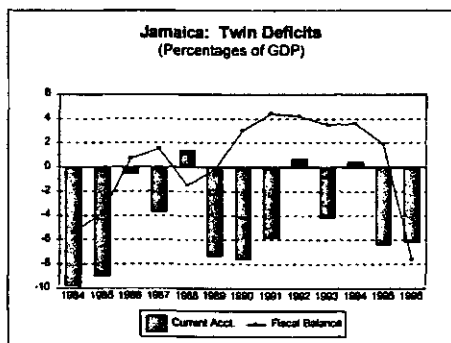
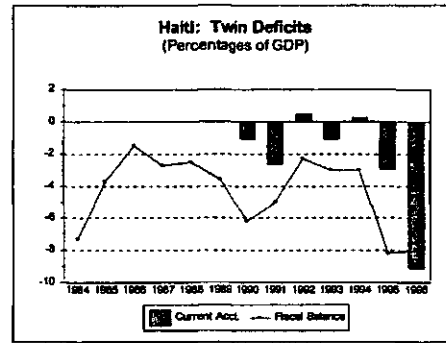
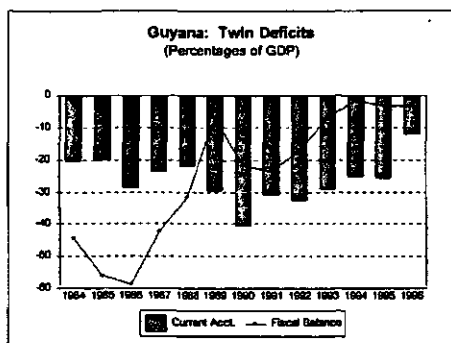
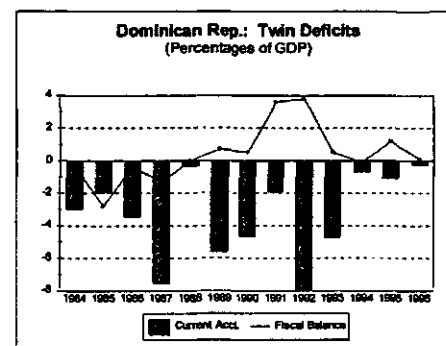
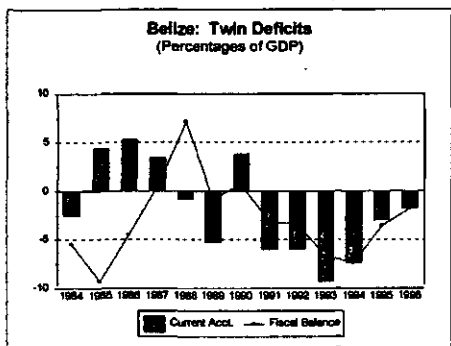
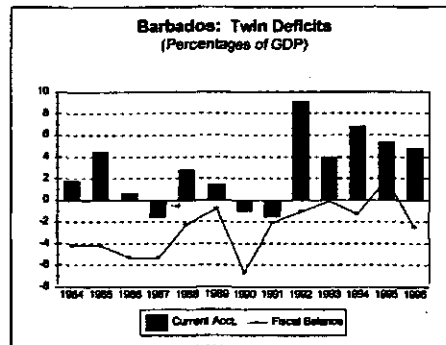
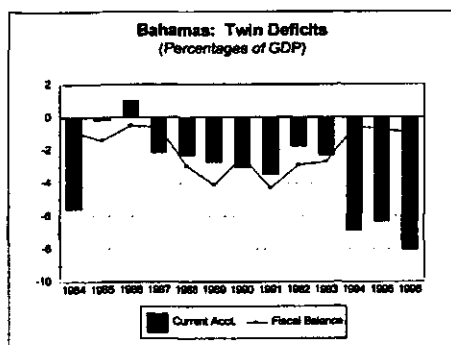
**Table VII-1: Real GDP Growth in Selected Caribbean Countries
(Percentages, at 1990 Constant Prices)**

| <i>Countries</i> | <i>1981-85</i> | <i>1986-89</i> | <i>1990-94</i> | <i>1995-96</i> | <i>1996</i> |
|-----------------------|----------------|----------------|----------------|----------------|-------------|
| Bahamas | 3.4 | 2.7 | -0.5 | 1.4 | 2.0 |
| Barbados | -0.3 | 5.4 | -1.4 | 3.4 | 4.4 |
| Belize | 0.5 | 9.4 | 5.6 | 2.6 | 1.5 |
| Dominican Republic | 1.0 | 5.1 | 2.2 | 6.1 | 7.3 |
| Guyana | -3.4 | -4.2 | 6.9 | 6.2 | 7.3 |
| Haiti | -1.0 | -0.5 | -6.8 | 3.3 | 2.0 |
| Jamaica | 0.1 | 4.8 | 2.0 | -0.5 | -1.5 |
| Suriname | -0.2 | 1.1 | -1.1 | 7.2 | 7.3 |
| Trinidad & Tobago | -3.2 | -3.2 | 0.9 | 2.5 | 2.6 |
| Unweighted Average | -1.1 | 2.3 | 0.9 | 3.6 | 3.7 |
| Idem, Central America | 2.1 | 2.0 | 3.9 | 3.3 | 2.5 |

Source: IDB:ESDB

From this table it is evident that the growth performance in the region has been rather uneven, and that it took until the mid 1990s before reasonable growth rates were restored, except in the case of Jamaica that continues to struggle, and currently has to address structural weaknesses in its financial system. The most remarkable performance during the last two years has come from the Dominican Republic, Guyana and Suriname, all of which recently engineered rather profound improvements in their macroeconomic policy stance. The table also shows that, despite the marked growth improvement in 1995-96, the regional growth average is still nowhere near the 6 percent -- or because of the lower population growth of the region vis-à-vis Central America, 5 percent -- needed to make a substantial dent in un(der)employment and poverty in the region.

The Caribbean Region: Twin Deficits



In graph VII-1 the twin deficits (fiscal deficit and the external current account deficit) are depicted. This graph is intended to show the magnitude of the imbalances, their direction, and — most importantly — whether or not these imbalances tend to coincide, or reinforce each other. The graphs clearly show the marked improvement that the respective twin deficits, between which there exists an arm-length relationship, recently have undergone. This was especially the case in the Dominican Republic, Haiti and Suriname, and once again, improved macroeconomic management has been a major contributor.

Belize, a country that traditionally had very prudent fiscal policies, ran into serious fiscal problems from 1991 to 1995, but was able to turn the tides by 1996, basically by cutting current expenditures, that is reducing the public sector payroll. Remarkable fiscal discipline was displayed by the Dominican Republic throughout the last decade, albeit at the cost of lowly social expenditures. However, the real come-back case was Guyana, which from the mid-1970s onwards until as recently as 1992 was running double digit fiscal deficits, which it was able to contain to just 2.6 percent of GDP on average from 1994 to 1996.

Haiti, on the other hand, is still struggling with excessive fiscal deficits, which require urgent attention lest they become destabilizing. Similarly, Jamaica's relaxation of fiscal policy in 1996, which sharply contrasted with its tight monetary policy stance, resulted in a return to deficitary spending after six years of fiscal surpluses in an effort to reduce its external debt exposure. Most of the 1996 fiscal deficit, however, was related to a \$180 million rescue package for the financial sector. In the meantime, especially since 1994 Jamaica has experienced a rather steep increase in its domestic debt which, apart from causing high domestic interest rates, places a large burden on future budgets.

Export, export diversification, and saving and investment (as well as investment in human capital) are the forces behind improved growth performance as the East Asian Tigers and the industrialized world have convincingly demonstrated. So far, the regional export performance has been sub par when compared with Latin America as a whole, as demonstrated by Table VII-2. Also, the volatility in the region's export performance has been rather high, especially in Barbados, Guyana, Haiti, and Suriname. In addition, recent research has revealed that those countries that are successful in their export diversification efforts, have realized higher and less volatile economic growth, and have been able to outperform others with regard to human development indicators (the causal relationship yet to be determined).

Table VII-2. Caribbean Region: Export Growth Performance 1970-95
(Goods & Non-Factor Services: Annual Average Real Growth Rates)

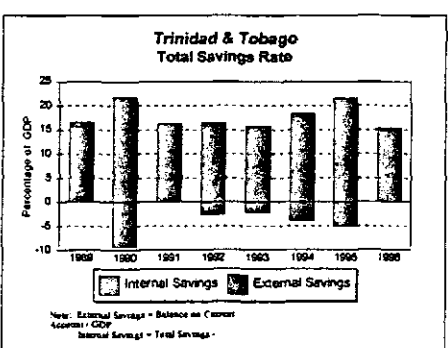
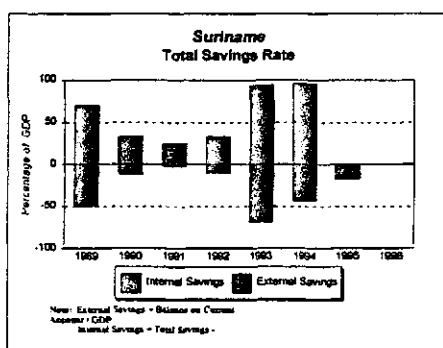
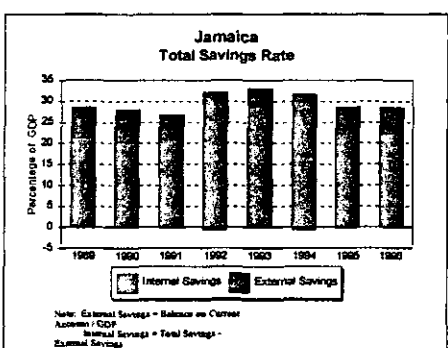
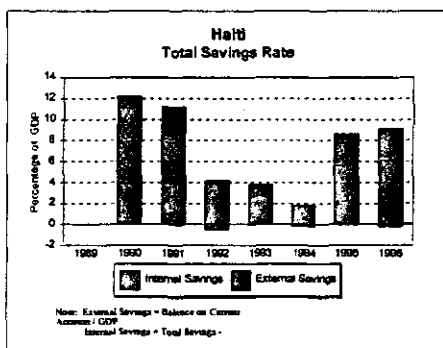
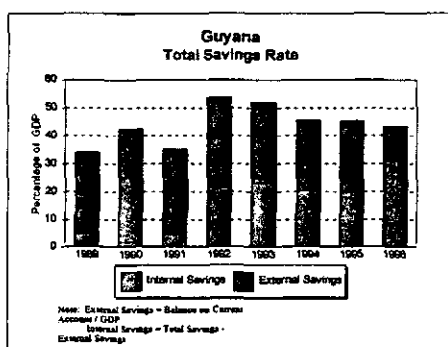
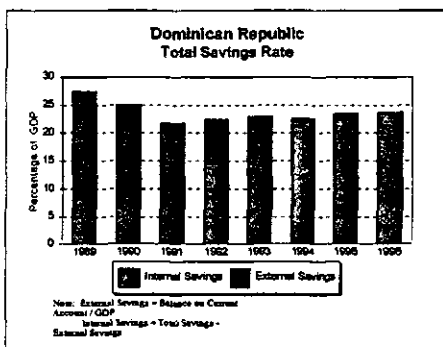
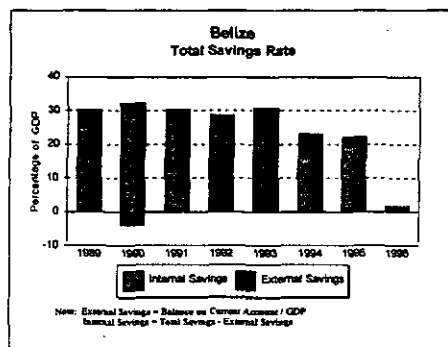
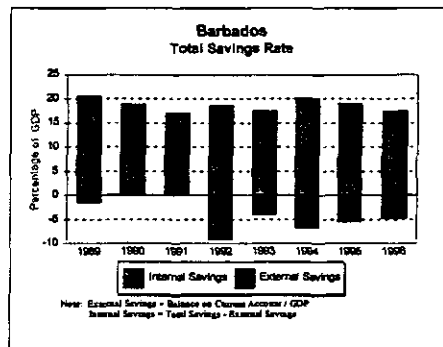
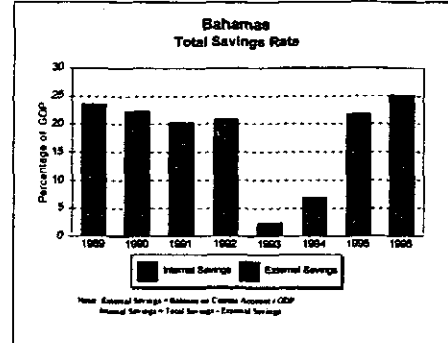
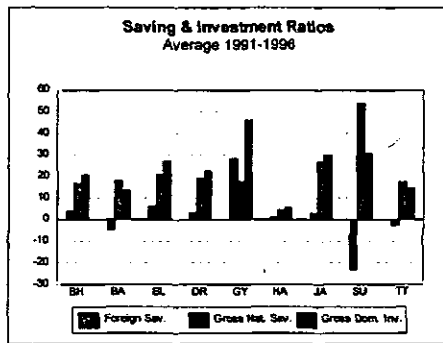
| <i>Countries</i> | <i>1970-80</i> | <i>1980-90</i> | <i>1990-95</i> |
|---------------------|----------------|----------------|----------------|
| Bahamas | n.a. | n.a. | n.a. |
| Barbados | 6.1 | -0.8 | 0.4 |
| Belize | n.a. | 7.9 | 3.0 |
| Dominican Republic | 8.1 | 1.1 | 4.4 |
| Guyana | -2.4 | -4.0 | 13.6 |
| Haiti | 10.1 | -2.8 | 9.5 |
| Jamaica | -0.2 | 5.0 | 5.2 |
| Suriname | 2.7 | -8.8 | -14.3 |
| Trinidad & Tobago | 1.8 | 0.8 | 2.2 |
| P.M.: Latin America | 4.3 | 4.9 | 6.4 |

Source: IDB-ESDB

Graph VII-2 offers a tentative insight in the regional savings and investment trends, at least as far as national account data series are complete, which was not the case in the Bahamas, Belize, Haiti and Suriname. Striking features are first the high degree of disparity of saving and investment efforts: in Guyana, Jamaica and Suriname gross domestic investment to GDP ratios surpassed 30 percent between 1991 and 1996, most likely because of the relative importance of capital-intensive mining operations in these countries. Low investment averages were scored, on the other hand, in Barbados, Haiti, and Trinidad and Tobago, whereas the tourist destinations Belize, the Bahamas, and the Dominican Republic turned out to be intermediate investors during the observation period. Here it is interesting to see that despite relatively low investment ratios Barbados and Trinidad and Tobago have been able to return to intermediate real growth levels, suggesting an improvement in the efficiency of their investment effort (thus a reduction in their incremental capital-output ratios).

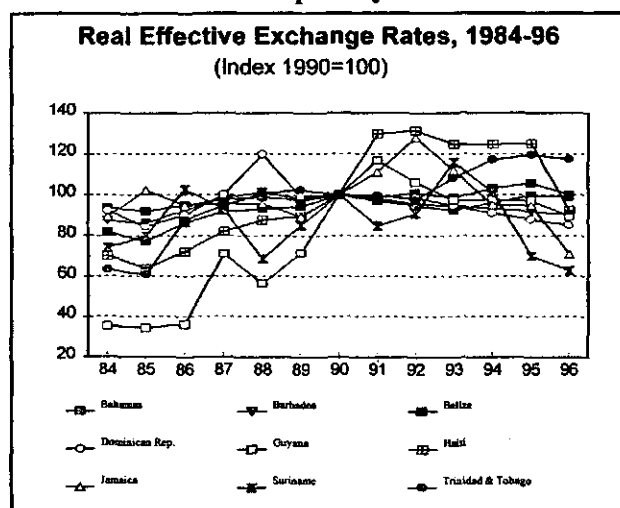
As far as internal savings efforts are concerned, very low scores are recorded in Haiti and Suriname, whereas also The Bahamas, Barbados and Trinidad and Tobago turned out to be nimble savers. Jamaica, Guyana and the Dominican Republic were in the higher savings brackets, the latter two with recently improving rates. Barbados and Trinidad and Tobago attracted negative foreign savings in recent years due to sizeable external current account surpluses. Guyana and Haiti, on the other hand, have consistently been heavy users of foreign savings.

The Caribbean Region: Saving and Investment

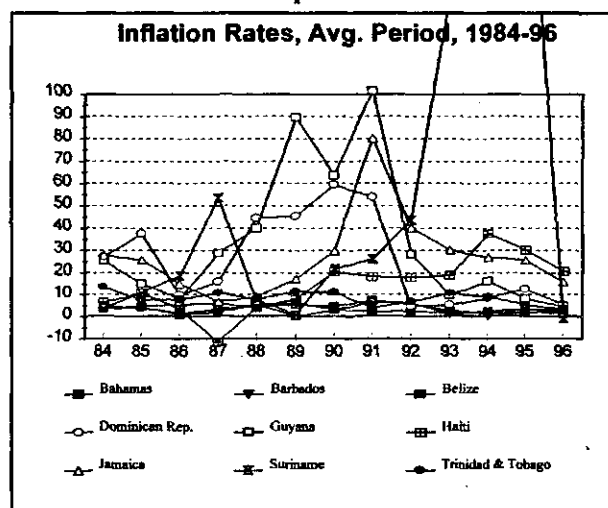


The real exchange rates (REER: that is nominal exchange rates corrected for relative inflation differences between trading partners using trade volumes as weights) are important policy instruments for influencing countries relative competitiveness. Using 1990 as the base year, Graph VII-3 shows that the Bahamas and Belize experienced very limited change in their REER's. But Barbados, the Dominican Republic, Guyana and Haiti (the latter after 5 years of depreciation), experienced a moderate appreciation vis-à-vis 1990. In the last few years, Jamaica and Suriname (the latter after a period of massive nominal devaluations), saw a strong real effective appreciation of their currencies, while only Trinidad and Tobago's currency remains depreciated compared with 1990. The result, regional exporters are complaining about loss of competitiveness, especially since the Mexican devaluations.

Graph VII-3



Graph VII-4



As exchange rates can substantially influence inflation rates, the appreciation tendency of regional currencies doubtlessly contributed to the strong decline in regional inflation rates since the early 1990s (see Graph VII-4). In the late 1980s and early 1990s especially Suriname, Guyana, the Dominican Republic and Jamaica experienced elevated inflation levels, whereas Suriname experienced hyper-inflation between 1992 and 1995, before banning inflation in 1996 with orthodox stabilization measures. During 1996 the average inflation levels of 7 of the 9 countries remained below 8 percent, while only Haiti and Jamaica had double digit inflation levels. In the aggregate, regional inflation levels in 1996 were the lowest in a decade.

Table VII-3. Caribbean Region: Timing of Reforms by Country, 1986-96

| <i>Type of Reform:</i> | 86-87 | 88 | 89 | 90 | 91 | 92 | 93 | 94 | 95 | 96 |
|-------------------------|----------|----|----|----|----------------|-----------|----|----------------|----------------|----|
| Stabilization | DR JA | | | DR | | GY, JA | | | SU | |
| Trade Liberalization | JA | GY | TT | DR | | BA | | BE HA SU | | |
| Tax Reform | | | | | | | JA | BE | | |
| Financial Sector | GY | | | TT | DR | JA | | BH | BA BE HA | |
| Privatization | JA | | | | BE JA GY | BA | | TT | | |
| Labor Reform | | | | | | | | | | |
| Pension Reform | | | | | | | | | | |

Source: IDB-IPES 1996

Table VII-3 gives an overview of the reforms so far undertaken by Caribbean countries. It shows that the highest incidence took place in economic stabilization efforts, trade liberalization, financial sector reforms, and some privatizations. The countries that had the highest score in terms of number of reforms were Jamaica, Guyana and the Dominican Republic, with Trinidad and Tobago, Belize and Barbados in the mid range, and Suriname, the Bahamas and Haiti as late reformers. However, labor reforms and pension reforms so far have been avoided in the region, but will have to be faced in the near future.

As far as privatization is concerned, between 1990 and 1995 Belize (2.5 percent of GDP), Guyana (1.7 percent), Trinidad and Tobago (1.6 percent), and Jamaica (1.5 percent) were the front-runners, followed at a long distance by Barbados (0.7 percent of GDP). For Latin America as a whole revenue from privatization amounted to 0.8 percent of GDP over the same period.

Table VII-4 shows the regional unemployment trends of the last 9 years, based on officially published data. Although the series are rather spotty in some cases, the level of unemployment is high compared with other regions in Latin America. Also, the trends are rather diverse: of three fixed exchange rate countries the Bahamas and Barbados had unemployment peaks in the early 1990s, with subsequent improvements, but Belize's unemployment has consistently, and rather sharply increased during that period. Jamaica's current crisis in the export processing industry has caused a substantial loss of employment in 1996, whereas the construction activity caused by strong foreign investment in the hydrocarbon downstream sector has helped reduce Trinidad's jobless rates by 4 percentage points since 1993.

Table VII-4. Caribbean Region: Recent Unemployment Trends

| <i>Countries</i> | <i>88</i> | <i>89</i> | <i>90</i> | <i>91</i> | <i>92</i> | <i>93</i> | <i>94</i> | <i>95</i> | <i>96</i> |
|--------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Bahamas | 11 | 12 | 12 | 12 | 15 | 13 | 13 | 11 | 12 |
| Barbados | 17 | 17 | 15 | 16 | 22 | 24 | 22 | 20 | 16 |
| Belize | | | | 4 | | 10 | 11 | 13 | 14 |
| Dominican Republic | 18 | 19 | 19 | 19 | 20 | 21 | 16 | 16 | 17 |
| Guyana | | | | | 12 | 11 | | | |
| Haiti | | | | | | | | | |
| Jamaica | 19 | 17 | 16 | 16 | 16 | 16 | 15 | | 20 |
| Suriname | | | 16 | | 17 | 16 | | | |
| Trinidad & Tobago | 21 | 22 | 20 | 19 | 20 | 20 | 19 | 17 | 16 |

Source: IDB-ESDB, CP and SEP 1997

In the final tables VII-5 and VII-6, an application is given of 10 much-quoted sustainability benchmarks that by themselves do not guarantee adequate economic growth, but should contribute to improved growth performance by reducing macroeconomic volatility, and improving the country's capability to withstand unforeseen external shocks, such as rising interest rates and falling terms of trade. As mentioned earlier these benchmarks should be interpreted as indicative norms for desirable ranges, but their relative weights will vary from country to country and from period to period, depending on the country's most pressing constraints.

These selected benchmarks, which express a strong personal preference (if not bias), entail:

- fiscal deficit, ideally not to surpass 2 percent of GDP
- fiscal revenue, ideally in the range between 20 and 30 percent of GDP
- external current account deficits, ideally not to surpass 3 percent of GDP
- international reserves, not to fall below 3 months of import coverage
- consumption to GDP ratio, ideally not to surpass 75 percent of GDP to promote savings
- investment ratio, ideally in the 25 to 35 percent of GDP range to foster the growth capacity
- real effective exchange rate, not to appreciate more than 2 percent per annum
- external debt service, not to exceed 25 percent of total exports
- inflation, not to exceed 10 percent (above 8 percent seems to create distortions: IMF)
- last but not least, real growth should remain positive on a per capita basis.

To this list should be added ideally also domestic debt, as well as consistent improvement in income distribution and poverty incidence. Unfortunately, at this moment no region-wide consistent data series in these areas are available, so that they remain outside the scope of this paper.

The use of a matrix of sustainability criteria should be seen as an analytical tool that facilitates comparison of one country over different time periods, and/or comparison of different countries at the same, or different times. Neither of the criteria should be taken too absolutely, or too mechanistically. Some of the criteria may be too strictly formulated in some cases, whereas others may be very close to the margin. In some cases data may not be available, or very reliable in the first place. In addition, there may be very valid reasons for a country to have significant variations in certain variables or indicators during a certain time frame. Thus, there is no substitute for in-depth country knowledge. Nevertheless, the matrix may be a valuable analytical tool for the study of macroeconomic trends in the region.

The sustainability criteria matrix for the Central American region (Table VII-5) shows very tentatively an improvement over time for the region as a whole, when 1995 is compared with the average for 1990-94. It shows that Costa Rica has the highest overall score of 6 out of 10, but that 5 countries have scores of 5 out of 10 (Belize, El Salvador, Guatemala, Nicaragua and Panama). It also reveals that in 1995 5 out of 7 countries had satisfactory scores for fiscal deficit and (ex post) external debt service ratios, whereas 6 countries reached positive economic growth on a per capita basis (but as indicated earlier, not of a sufficient magnitude).

For the greater Caribbean region the sustainability matrix (Table VII-6) shows very substantial improvements towards fiscal balance (except in the case of Haiti and Jamaica), and even three countries with a fiscal surplus over 1995-96. Furthermore, there was some improvement in the external current accounts (5 out of 9), and modest improvements in international reserve adequacy, as well as in ex post external debt service ratios, real per capita growth of the economy, and a substantial improvement in inflation. However, as a counterpart to the inflation improvement 5 out of 9 regional countries experienced a more than marginal appreciation of the real effective exchange rate, and thus some real loss of external competitiveness. This was especially the case with Haiti, Jamaica and Suriname.

The best overall score over the period 1995-96 was realized by Barbados (8 out of 10), Trinidad and Tobago (7), and Belize (6), whereas the Dominican Republic and Guyana scored 5 each. The matrix also reveals that, not surprisingly, of all the regional countries Haiti still seems farthest away from sustainable economic trends.

TABLE VII-5

Sustainability Benchmarks

| | Fiscal (NFPS) Deficit 1/ (Max. -2% GDP) | | Fiscal (NFPS) Revenue 1/ (20-30% GDP) | | BOP Current Acct. Deficit (Max. -3% GDP) | | Reserves / Imports 2/ (Min. 12 Wks.) | | Consumption 3/ (Max. 75% GDP) | | Investment 3/ (25-35% GDP) | | REER 4/ Appreciation (Max. -2% p.a.) | | External Debt Service (Max. 25% XGFS) | | Inflation 5/ (Max. 10% p.a.) | | Real GDP Growth/Capita (Min. 0) | |
|-------------|---|------|---|------|--|-------|--|------|-------------------------------------|------|----------------------------------|------|--|-------|---|------|------------------------------------|------|---------------------------------------|------|
| | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 | 1990/94 | 1995 |
| BELIZE | -3.9 | -4.1 | 24.7 | 22.6 | -4.6 | -5.0 | 11.7 | 8.5 | 78.8 | 82.1 | 28.3 | 22.3 | 1.1 | 4.1 | 7.9 | 11.4 | 2.1 | 3.2 | 1.7 | 0.9 |
| COSTA RICA | -1.7 | -2.1 | 27.6 | 29.3 | -5.9 | -2.1 | 20.8 | 18.4 | 77.1 | 76.0 | 27.9 | 27.0 | 2.8 | -4.4 | 19.0 | 17.6 | 18.2 | 23.2 | 2.4 | 0.1 |
| EL SALVADOR | -2.0 | -0.1 | 13.6 | 16.1 | -1.8 | -2.9 | 14.4 | 13.0 | 97.3 | 96.7 | 17.0 | 19.5 | -4.5 | -6.0 | 23.2 | 12.3 | 13.7 | 10.1 | 3.8 | 4.1 |
| GUATEMALA | -0.8 | -0.7 | 8.9 | 8.4 | -4.5 | -4.1 | 17.8 | 12.0 | 91.0 | | 15.8 | 15.4 | -3.9 | 3.1 | 16.6 | 9.9 | 16.9 | 11.8 | 1.1 | 1.9 |
| HONDURAS | -5.8 | -2.0 | 28.1 | 31.5 | -8.1 | -7.1 | 6.1 | 9.1 | 78.0 | 74.1 | 27.7 | 32.7 | 4.7 | -10.1 | 32.8 | 27.3 | 18.4 | 29.5 | 0.3 | -0.1 |
| NICARAGUA | -4.7 | -1.9 | 25.3 | 30.8 | -25.1 | -27.7 | 8.5 | 8.3 | 106.2 | 95.2 | 20.6 | 26.8 | 4.2 | 12.1 | 52.6 | 44.3 | 153.1 | 10.0 | -2.7 | 0.4 |
| PANAMA | 0.6 | -0.6 | 30.8 | 30.7 | -9.2 | -8.0 | 5.2 | 5.9 | 77.4 | 78.3 | 21.6 | 22.0 | 2.9 | 3.1 | 5.1 | 3.1 | 1.1 | 1.0 | 4.8 | 1.1 |

Sources: IDB, IMF, WDT.

* WITHIN RANGE: GREY
OUTSIDE RANGE: RED

1/ Overall Deficit and Current Revenue. Belize and Guatemala : Central Government. Others: Non-Financial Public Sector.

2/ Imports of Goods (FOB). Ratio expressed in weeks.

3/ Refers to Total Consumption and Total Investment at current prices. Calculated as a percentage of GDP (local currency) at current prices.

4/ End of period. (Geometric) Average REER calculated from index (1990=100). A minus sign (-) indicates an appreciation of the local currency.

5/ Average annual inflation. Average inflation calculated as geometric mean over relevant period.

Table VII-6

SUSTAINABILITY BENCHMARKS

| | Fiscal (C.G.) Balance 1/ (Max. -2% GDP) | | Fiscal (C.G.) Revenue 1/ (20-30% GDP) | | BOP Current Acct. Balance (Max. -3% GDP) | | Reserves / Imports 2/ (Min. 12 Wks.) | | Consumption 3/ (Max. 75% GDP) | | Investment 3/ (25-40% GDP) | | REER 4/ Appreciation (Max. -2% p.a.) | | External Debt Service (Max. 25% XGFS) | | Inflation 5/ (Max. 10% p.a.) | | Real GDP Growth/Capita (Min. 0) | |
|----------------|---|-------|---|-------|--|-------|--|-------|-------------------------------------|-------|----------------------------------|-------|--|-------|---|-------|------------------------------------|-------|---------------------------------------|-------|
| | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 | 1990/94 | 95/96 |
| BAHAMAS | -2.6 | -0.9 | 17.0 | 19.4 | -3.5 | -7.2 | 7.9 | 6.7 | 89.1 | | 20.8 | 23.5 | -0.8 | -1.6 | 4.4 | 4.5 | 4.3 | 1.7 | -2.1 | -0.1 |
| BARBADOS | -2.3 | -0.3 | 29.9 | 30.4 | 3.5 | 5.1 | 13.4 | 16.1 | 83.1 | 86.5 | 14.5 | 13.3 | -1.4 | -1.5 | 14.4 | 10.0 | 3.3 | 2.2 | -1.6 | 1.9 |
| BELIZE | -4.3 | -2.7 | 24.8 | 22.6 | -4.9 | -2.4 | 11.8 | 11.0 | 78.8 | 82.1 | 28.4 | 22.3 | 0.6 | -1.3 | 8.2 | 12.5 | 2.3 | 3.1 | 2.7 | 0.5 |
| DOMINICAN REP | 1.7 | 0.7 | 14.5 | 14.5 | -4.0 | -0.6 | 7.5 | 4.9 | 82.6 | 79.0 | 23.0 | 23.6 | -1.9 | -3.3 | 12.6 | 9.5 | 23.9 | 8.9 | 0.1 | 4.0 |
| GUYANA | -14.1 | -3.2 | 34.1 | 33.7 | -31.5 | -18.8 | 21.9 | 27.6 | 66.6 | 61.8 | 45.8 | 44.4 | -0.5 | -4.2 | 41.6 | 17.0 | 40.1 | 6.3 | 6.0 | 5.0 |
| HAITI | -3.9 | -8.1 | 5.8 | 7.1 | -0.8 | -6.0 | 2.8 | 13.3 | 106.0 | 114.2 | 6.5 | 8.8 | 4.5 | -12.9 | 6.2 | 54.5 | 22.3 | 25.3 | -9.0 | 1.1 |
| JAMAICA | 3.7 | -2.9 | 29.7 | 34.2 | -3.3 | -6.2 | 9.9 | 13 | 74.7 | | 30 | 28.5 | -1 | -12.7 | 27.8 | 21 | 40.1 | 20.6 | 1 | -1.5 |
| SURINAME | -9.5 | 3.9 | 23.5 | 36.2 | 21.7 | 8.9 | 47.6 | 21.7 | 60.9 | | 29.1 | | 0.3 | -20.5 | | 9 | 90.5 | 82.5 | -1.5 | 6.7 |
| TRINIDAD & TOB | -0.9 | 0.9 | 27 | 28.5 | 3.6 | 2.2 | 16 | 10 | 74.1 | 70.1 | 14.2 | 16 | 3.2 | 0.2 | 25.2 | 14.5 | 8.2 | 4.3 | -0.2 | 1.4 |

Sources: IDB, IMF, WDT.

*WITHIN RANGE: GREY
OUTSIDE RANGE: RED

1/ Refers to Overall Deficit and Current Revenue (as a percentage of current GDP) of the Central Government. Haiti: Refers to Non-Financial Public Sector.

2/ Imports of Goods (FOB). Ratio expressed in weeks.

3/ Refers to Total Consumption and Total Investment at current prices. Calculated as a percentage of GDP (local currency) at current prices.

4/ End of period. A minus sign (-) indicates an appreciation of the local currency.

5/ Average annual inflation. Average inflation calculated as geometric mean over relevant period.

VIII. Concluding Remarks

The foregoing suggests a fairly high degree of success of recent macroeconomic management in the region in terms of return to stability, despite the ripple effects of the Tequila crisis, and resumption of sustained growth. In some of our countries continued improvement in the growth performance is observable, but region-wide growth in the last two years still remains between 1.5 to 2.5 below the norm required to make serious inroads in ingrained un(der)employment and poverty.

It is ominous that this growth deficit persisted despite exceptionally high growth rates in the region's main market, the U.S., and exceptional growth rates in the Dominican Republic (on the strength of tourism and agriculture), and Guyana and Suriname (based on exploitation of tropical forests and non-renewable mineral exploitation). Hence the need to continue deepening structural policy and institutional reforms so as to better prepare the countries for the challenges posed by the upcoming trade liberalization measures agreed with GATT/WTO, and the ongoing process of globalization.

It is obvious that an early solution to the current financial crisis in Jamaica should foster economic recovery by removing current obstacles to domestic saving and investment. But it also would require a solution to the mushrooming internal debt, a problem not unlike the one facing Costa Rica. Haiti should be able to grow at a much faster pace once it is able to implement structural reforms that would trigger substantial bilateral and multilateral support for new investment in human resources and infrastructure. Suriname's remarkable growth rates in the last two years basically recovered the loss of 1993-94, and thus may taper off somewhat in the medium term, as may Guyana's where the reform process enters a more mature phase.

The Bahamas, Barbados and Belize are the three countries in the region that (together with Panama) consistently have forgone using the exchange rate as a vehicle to foster export growth and contain imports. Not surprisingly, in the case of the Bahamas and Belize this has recently led to low economic growth and tightening international reserves. The interesting case, however, is Barbados, because it has stuck to a tight fiscal policy, and a stringent incomes policy, combined with more dynamic marketing activities. So far, these policies have been rather successful, albeit aided by some fiscal policy relaxation in 1996. Especially the strong performance of the sectors producing tradable goods and services in Barbados was a noticeable feat that shows that alternatives to producing high volume, low value added productions can be successful in the region.

All in all, there is still considerable scope throughout the region for improving both the fiscal and the balance of payments situation, as well as for making the private sector, and the utilities, more agile and cost-effective. As the case of Barbados shows for the tradable goods and services sectors, and Jamaica, and the Dominican Republic as well as Barbados in the tourism industry, effective promotion can be a powerful marketing tool. Strengthening the domestic private sectors with joint ventures and strategic alliances or marketing arrangements, and bringing the utilities, as well as the transportation facilities, at their highest levels of technical and economic efficiency, is another one.

Unlike Central America, the Caribbean region has a fairly mature demographic profile, with population projections showing that around the year 2010 the dependency ratio (defined as the ratio between the dependent age brackets of 0-14 plus 60 and above, divided by the potential labor force age of 15 through 59), which had been consistently declining since 1970, will start rising again as more persons reach retirement age. This will have substantial long-range financial consequences, often beyond the current fiscal capabilities. Therefore, an urgent review of the actuarial soundness of regional pension systems is highly recommendable. A privatized and personalized pension system like the one much earlier adopted by Chile, an example already followed by other Latin American countries, may be opportune.

Such a system might also be instrumental in developing local or regional capital markets, which could further be supported by continued reforms of the local banking systems, including adequate regulation and supervision, and strengthening competition. There is ample scope for improving the efficiency, effectiveness, and customer responsiveness of the local banking systems: improvements should enhance the local savings and investment propensities, and reduce the cost of doing business, and therefore contribute to a higher growth dynamism.

Both investment and exports — and especially a well-balanced export diversification and marketing program — are key instruments for fostering economic growth, as are investment in human capital, productivity enhancement, and productive infrastructure, all of which should therefore be prioritized.

Finally, it is of paramount importance that all avenues be explored for creating a larger economic space for the Central American and Caribbean regions, whether it be accession to NAFTA, NAFTA-parity, CARICOM/CACM/Andean Pact cooperation, or alternative free trade arrangements. Such arrangements should help the region to establish economies of scale and get out of productions with little value added or with shrinking markets. Accepting the likelihood that the region will remain a medium-high cost environment should encourage the productive sectors to actively identify those productions and services, and market segments, that can generate higher value added. Making the transitions early in the game is going to be an essential prerequisite for improving the region's external competitiveness. Non-price competitiveness factors and marketing should therefore also receive the highest possible attention. The globalization process opens opportunities as well as challenges, and the best prepared stands to gain the most.

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THE CARIBBEAN QUEST: DIRECTIONS FOR THE REFORM PROCESS

25-26 June 1997
Port-of-Spain, Trinidad and Tobago

GLOBAL FRAMEWORK FOR POLICY REFORM: HOW DO WE USE IT TO MANAGE DEVELOPMENT

by

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Global Framework for policy Reform: How do we use it to manage Development

If a swimmer wishes to cross a river he had better know the direction of flow. This simple advice is well applied to Caribbean countries as they seek to manage developments in the new global environment. Islands are by their nature insular. Regrettably this circumstance is not related to geography only. Every Caribbean island feels itself to be the central hub of some trade route, unique paradise on earth, or home of the third brightest intellect on earth. These attitudes, open or implied, shape our view of the external reality, causing us to deny reality in the first instance, and then to be painfully slow in responding to the rapid-fire and monumental changes sweeping the Globe.

In the course of this paper, I propose first to make a reality check on the Global Framework as it affects the Caribbean. Then, I will emphasize the importance of a widespread program of public education to address the implications of this reality. I next deal briefly with the results of the "structural adjustment" policy prescriptions in the Caribbean. And finally, I will offer some suggestions to further development prospects using a wider regional framework.

Globalisation is a description of the phenomenon of a complex set of factors at work in today's world. Primary among these factors is the permeability of borders for information, capital and labour which is making the political structures of nation-states increasingly obsolescent. The fact that internal political structures continue to cleave to outmoded principles for organizing and channeling Globalisation is having the most revolutionary influence on our lives, businesses, Governments and societies. Because the Caribbean has been enmeshed in the global trading system for so long with its monocultural exports, it is even more vulnerable to the strong currents of Globalisation.

Globalisation is not, however, an altogether recent phenomenon. Certainly, we in the Caribbean, can recall our history of being buoyed up and then let down by the world markets for sugar, cocoa, bananas, oil and bauxite. Then since World War II, we have seen the establishment of a number of global institutions: The UN, IMF, and World Bank and the growth of the Global corporations. Names such as Tate & Lyle, Amoco, Hilton, Alcoa, McDonalds and Geest have become household words in the Caribbean. But Globalisation is not only about economics and politics. It is about the instant capacity of CNN and BBC to share the latest information with the whole world as readily as gossip travels in Trinidad. It is also about the adoption of a world urban culture symbolized by Coke, McDonalds and Nike.

The truly modern impetus to Globalisation has been the capacity of technological innovation to accelerate its spread at exponential rates. People, goods, capital, ideas are subject to almost instantaneous diffusion. Technology now permits the massing, manipulation and transmission of information around the globe at the speed of an electron. Production, consumption, trade, finance, environmental problems, social concerns, are all globalizing at an astonishing pace. An oil spill or a drought in one place no longer has an isolated effect but can precipitate world price changes and new migration patterns. All this has fundamentally changed the ways of doing business.

When we talk about the global framework for policy reform, there are several components which are identifiable. Some examples of the new global architecture with strong relevance to the Caribbean are:

Global competitiveness

A Darwinian ethic of the fittest shall survive now rules among nations and among global corporations. Nations compete for development projects, for capital inflows, and for jobs. Corporations compete to be the global low cost producer, for dominance of the global market and to maximise shareholder value through global expansion. Nations and corporations have become positioned along a spectrum of winners and losers. The head of Yale's School of Management, Dean Jeff Garten notes: "Over the next ten years, shall emerge ten new economic powerhouses: China; Taiwan; Korea; Malaysia; Thailand; Indonesia; India; South Africa; Mexico; and Brazil." The Caribbean along with most of Africa are among the losers.

Indeed, exacerbated inequality of outcome has become a hallmark of the new Globalisation. Winners and losers among nations; Winners and losers among corporations; Chiquita banana vs. Wind-ward Island bananas where the winner takes ALL the spoils; and widening income inequality among citizens within nations. Everywhere social strain is evident.

Global Capital Markets

There has developed a vast fast-fluid world private capital market headquartered in New York, London and Tokyo. This is perhaps the most significant aspect of Globalisation for emerging markets including the Caribbean. Yet the Caribbean is grossly unsophisticated in accessing the global capital markets. Table I shows Net Capital Flows to Developing Economies from 1981-1996. Note the static amount of Aid flows; but the large increases in portfolio investments and Foreign Direct Investments (FDI). FDI is expanding by a multiple of approximately 10 in the last decade and was more than 100 billion US dollars in 1996. Portfolio flows have also increased dramatically but as demonstrated during the Mexican peso crisis, they can be dangerously unstable. Table II shows Net FDI to Major Recipients in Developing Countries. China is by far the largest beneficiary. Sheer size coupled with 8-10 per cent growth does make a difference in terms of bargaining power! Mexico is second with 7.2 billion dollars which is a reflection of the huge investment inflows concomitant with NAFTA membership. Some of the Mexican investment is at the expense of the Caribbean, especially Jamaica. (Trade & investment diversion) Note Trinidad's 516 million boosted by gas investments, and Jamaica's 116 million in 1996.

How countries shape their policies to win direct foreign investment and access the private capital markets in support of corporate and infrastructural development requirements is now a matter of major importance. Too many Caribbean countries have a public service and Central bank infrastructure geared to accessing capital from the Washington multilaterals and foreign aid and are totally innocent in their dealings with the capital markets. T&T though has a better record than others in this respect.

Global Labour markets

The corollary of the globalization of the capital markets has been the development of a universal market for labour (de facto) driven by business response to the requirement to be globally competitive. Acting in conjunction with freer trade, capital has been moving in unprecedented amounts to the developing countries of the Pacific Rim where it combines with cheaper skilled labour to produce an ever larger share of the world's manufactures. (See Table II.) This fact has gutted Trade Unions' capacity to act in the developed countries to extract better wages. It explains the sour view that the U.S. Labour Movement has of free trade, and of NAFTA in particular. Labour has sold the U.S. Congress the notion that Globalisation, Free Trade, NAFTA have led to the impoverishment of the American worker. The present American mood is one of short term political gain maximisation. (The euphemism is triangulation) Because of this surly Congressional mood, I am pessimistic about the prospects of NAFTA expansion, NAFTA parity or CBI extension despite whatever private assurances President Clinton might have given Caribbean leaders.

Open Reciprocal Trading Arrangements

Progressive market openings are now culminated in the watch-dog World Trade Organisation. It was a ruling of this organisation that denied long term preferential access for Caribbean bananas to Europe. It is ironic, if not hypocritical that the U.S. in particular continues to urge smaller countries to jump on the free trade bandwagon while continuing its agricultural subsidies and keeping its markets closed to products that can be viably exported from those countries. Far from taking comfort in this apparent hypocrisy, we in the Caribbean must recognize, as I said earlier that the conflict between Globalisation and parochial national imperatives is a drama for every country. We must join with other developing countries and continue to put pressure to reduce subsidies and other trading inequalities but we must not pretend that we have the same power to resist. Remember what I said about inequality of outcome. I think people call this "Realpolitik".

Regional Groupings

Working simultaneously as a subset of globalism is Regionalism. Large trading blocks such as NAFTA, EEC, Mercosur, and APEC have developed leading to inter-block trade, but more so to very large growth in trade within each block. The jury is still out as to whether internal block trade is trade diversionary or not and whether therefore regionalism is ultimately a threat to globalism. Jamaica is an example of a Caribbean country that has suffered from diversion. That country's rapid expansion in garment contracting has been stalled at least in part on account of diversion to Mexico, a NAFTA member.

Like it or not, this is the poignant reality of the new global architecture. It is efficient; it generates huge amounts of wealth; its out-turn is inequitable; and its spread is irreversible.

If we are to take that global framework and use it to our advantage, our first task is political. Every citizen and Caribbean institution must become aware of the reality and the detailed implications

flowing therefrom. For too long we have lived in denial. Denial that the preferential trading system would come to an abrupt end; that our Governments could keep our markets closed for another decade; that increasingly the new sources for development had become foreign direct investment and the world capital markets. We should not that there has been considerable criticism of the efficacy of World Bank lending and concerted pressure to move that institution away from direct lending and more into strengthening its Guarantee Programmes. Denial of reality has caused us to lose valuable time in preparing our societies for the inevitable. According to *Euromoney Magazine*, Barbados gets zero out of five for its handling of its debt image, and zero out of five for its positioning to access the international private capital markets. Further evidence of our ill preparedness: respected international relations specialist, Henry Gill has stated unequivocally that not one CARICOM country has assembled the full time expertise to negotiate trade agreements.

Deregulation and structural adjustment programmes have been the first line policy response for equipping our societies to cope with the demands of globalisation. In large measure, these programmes contribute to macro-economic stability which is a necessary but insufficient condition for sustainable development. Our Caribbean management of these programmes has been uneven. Trinidad and Tobago is probably at the most advanced stage having achieved a large measure of stability. The major unfinished business in Trinidad and Tobago is public sector reform and national pensions. Barbados has kept a pegged exchange rate and achieved stability by taking the adjustment in its labour market. Guyana is making good progress, but must now make payments on its huge debt after Paris Club writedowns. The OECS are entering an age of great difficulties. Antigua and Grenada have no income taxes or VAT and are therefore unduly dependent on Customs revenues in an era of market openings. Grenada, Dominica, St Vincent and St Lucia are just beginning to feel the affects of the banana debacle. Until 1995, Jamaica had been making solid progress. Since then however, major problems have developed in the indigenous financial sector and the Jamaican Government's decision to back stop the sector has already cost a three per cent budget deficit in 1996; threatens to be much wider in 1997; thereby risking Jamaica to yet another round of inflation, devaluation, and capital flight, hardly the conditions to attract the favourable attention of the capital markets and direct foreign investment.

When we enquire why so many countries fail, it's because so many of them never get to the starting gate. But let us assume that we have got there: that we have come to grips with global reality; that we have met most of the precursor conditions: an open competitive economy; macro-economic and socio-political stability; investor friendliness. How from there do we use the Global architecture to build for sustainable development?

This I believe to be a matter of vision and leadership based on a proper and pragmatic understanding of our island situations and how their potential best fits in the global economy.

Barbadian leadership is clear on this issue. Barbados shall be a world class service economy primarily driven by tourism and offshore financial services, attaining developed country status in 25 years.

In Trinidad and Tobago we have a globally competitive gas economy. But it suffers the disadvantage of being extremely capital intensive and by itself incapable of drawing a sufficiently large part of the rest of the economy (especially the unemployed) into its modernizing hub. An additional motor is required.

Tourism has been so proposed. After consistent effort by the last three Governments, the tourist economy still sputters. Recognizing that a paradigm shift is required, the present Government is proposed to seed hotel construction with the proceeds from privatization as well as spurring development by granting casino licenses. Casinos may not be the draw that they were however because of the large number of new outlets on Indian reservations in the US as well as Cruise-ship gambling. The fact that our competition in casinos is not internal but offshore again highlights the effects of globalism and the need for us to keep a wide angled lens on our development paths.

We have no choice but to persevere with tourism. But I strongly suggest that we loop to our manufacturing sector within a wider regional context. There are two examples of successful outcomes to the regional approach that I briefly draw to your attention: Ireland and Mexico. Ireland won independence from Britain as late as 1922. Until recently it was backward, insular and drained by emigration of its best talent as we have been. But Irish leadership seized on its membership of the European Community and sold its citizens the concept that they were first citizens of a wider Europe. Secure in this vision, Ireland grabbed every European Subsidy to upgrade its human resources and manufacturing plant. Its major cities were put through major face lifts to reinforce the image that despair was done and a bright future lay ahead. At present it is not only that Ireland has one of the fastest growing and lowest unemployment economies in Europe; but Irish art and culture thrives. Advertisements in the New York Times appeal for Irish talent to return home. The spirit of Ireland lives.

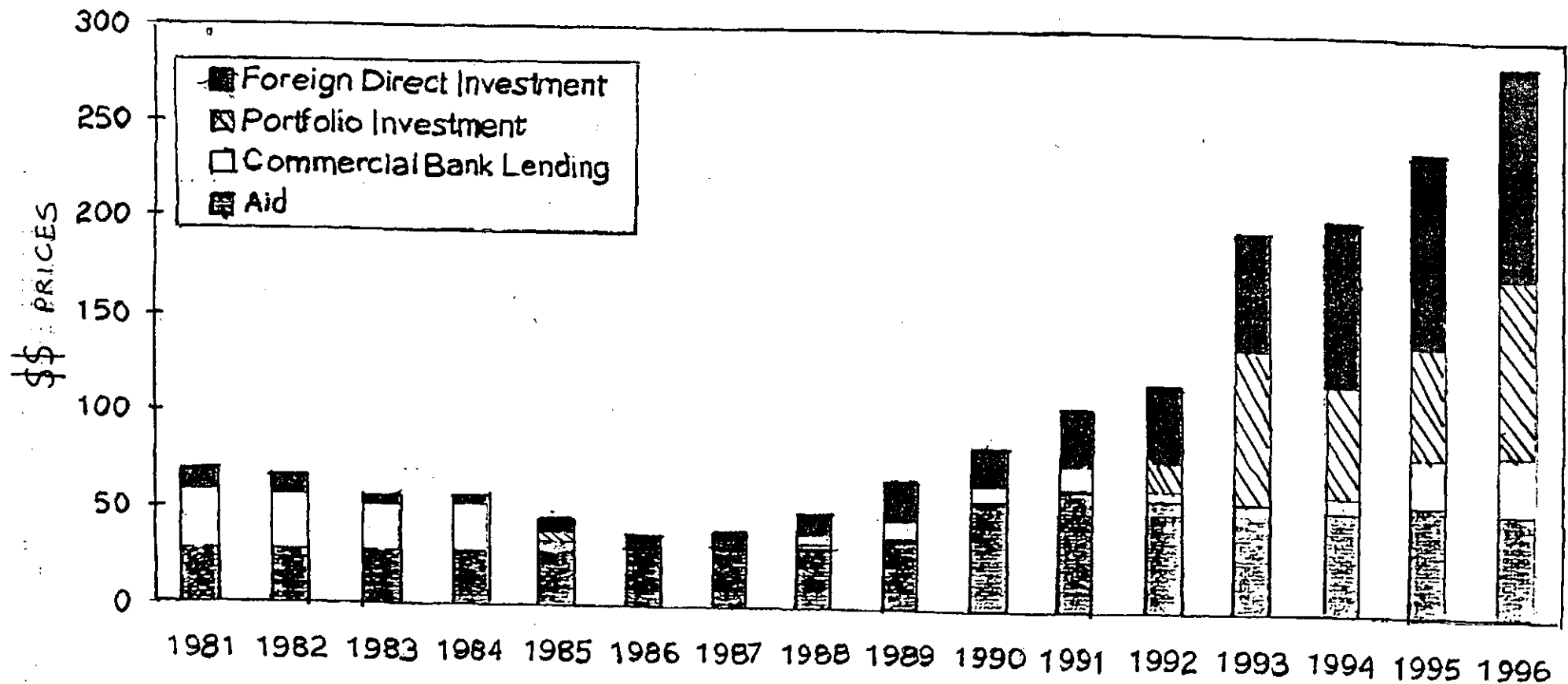
Since becoming a NAFTA member, Mexico's Foreign Direct Investment is running at approximately 7.2 billion US dollars p.a., second only to China. Annually exports from the Maquilladora factories on the U.S. border are 36 billion dollars. One border town, Tijuana increased its employment by 118,000 in 1996 alone!

To me, these examples suggest that in the global economy, countries can no longer afford to assume that competitive sustainable economies can be achieved within marrow sovereign boundaries. Consistent large trade surpluses with our CARICOM partners are attracting barriers to Trinidad's manufacturers even within the relatively small CARICOM "home" market. We must make the logical next few advances in regionalism.

The first step requires Trinidad and Tobago to use all its diplomatic skills to bring the Dominican Republic and Haiti into full CARICOM membership within 18 months and Cuba as soon as possible thereafter. These countries have a combined population of 26 million persons and GDP of 27 million US dollars. Success in these markets could keep our existing manufacturers healthy for another five years.

TABLE 1

Net Capital Flows to Developing and Transition Economies (in 1996 US \$ prices)



Sources: FIAS calculations based on World Bank and IMF data.

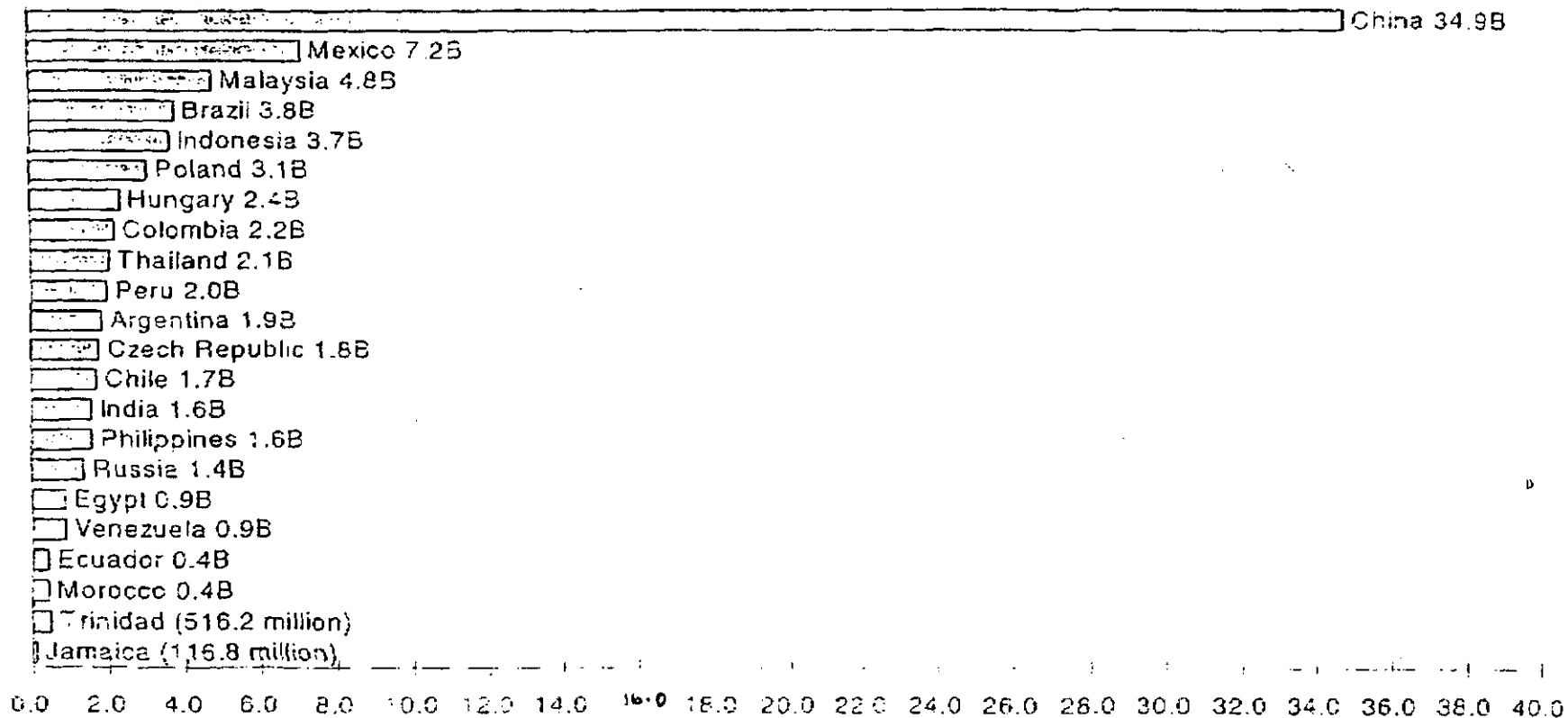
CREDIT FIRST
SUISSE BOS

TABLE 2

Net Foreign Direct Investment to Major Recipients in Developing and Transition Countries

Average 1993-1996 Inflows

(US\$ Billions)



**CREDIT
SUISSE** | **FIRST
BOSTON**

HA/PPT/Global Proj Finance/Jamaica.PPT (7) 5/15/97 18:42

It will take more, however, to encourage a wave of new investments and new employment creation. Even now we must advance the next wave of regionalism. Trinidad and Tobago has a strong incipient manufacturing sector. And it was the potential to become a mini Maquilladora that caused this country to seek early NAFTA membership. Because that process is now so clouded, we must look south instead. Brazil has a land area greater than the continental USA, and a population of 162 million. With its large and well developed agricultural, mining, manufacturing, and service sectors, Brazil has South America's largest GDP by far and has the potential to become a major player in the world economy. In addition to light consumables like footwear, Trinidad imports increasingly large amounts of Brazilian iron ore. North East Brazil is potentially a huge market for our gas and fertilisers. This might just be the start we need to leverage our manufacturing sector (especially steel and potentially aluminum) to become an efficient sub component of Brazil's based on an efficient regional infrastructure and our attractively priced energy. To realise such a vision, Trinidad and Tobago must again draw an expanded CARICOM into the regional integrative processes taking place in South America. At the political level, we should explore associate membership in Mercosur as Chile has done. And thereafter actively promote Caribbean integration into the regional energy, telecommunication and transport infrastructure now being planned and constructed in South America. The expectation is that by becoming part of such a regional infrastructure our industry will realise wider synergies which, combined with our existing advantages, especially our energy and human resource skills, will generate maximum value added in service of the South American and ultimately global markets. Only then, would our long apprenticeship in infant industry and minuscule CARICOM have ended.

The early policy reforms in response to the global framework--the structural adjustment agenda, were hard on the population but relatively straightforward in execution. This next phase in policy reform will demand the highest leadership and international diplomatic skills if it is to be successfully executed. The social strains already self evident in our societies demand no less bold an agenda.

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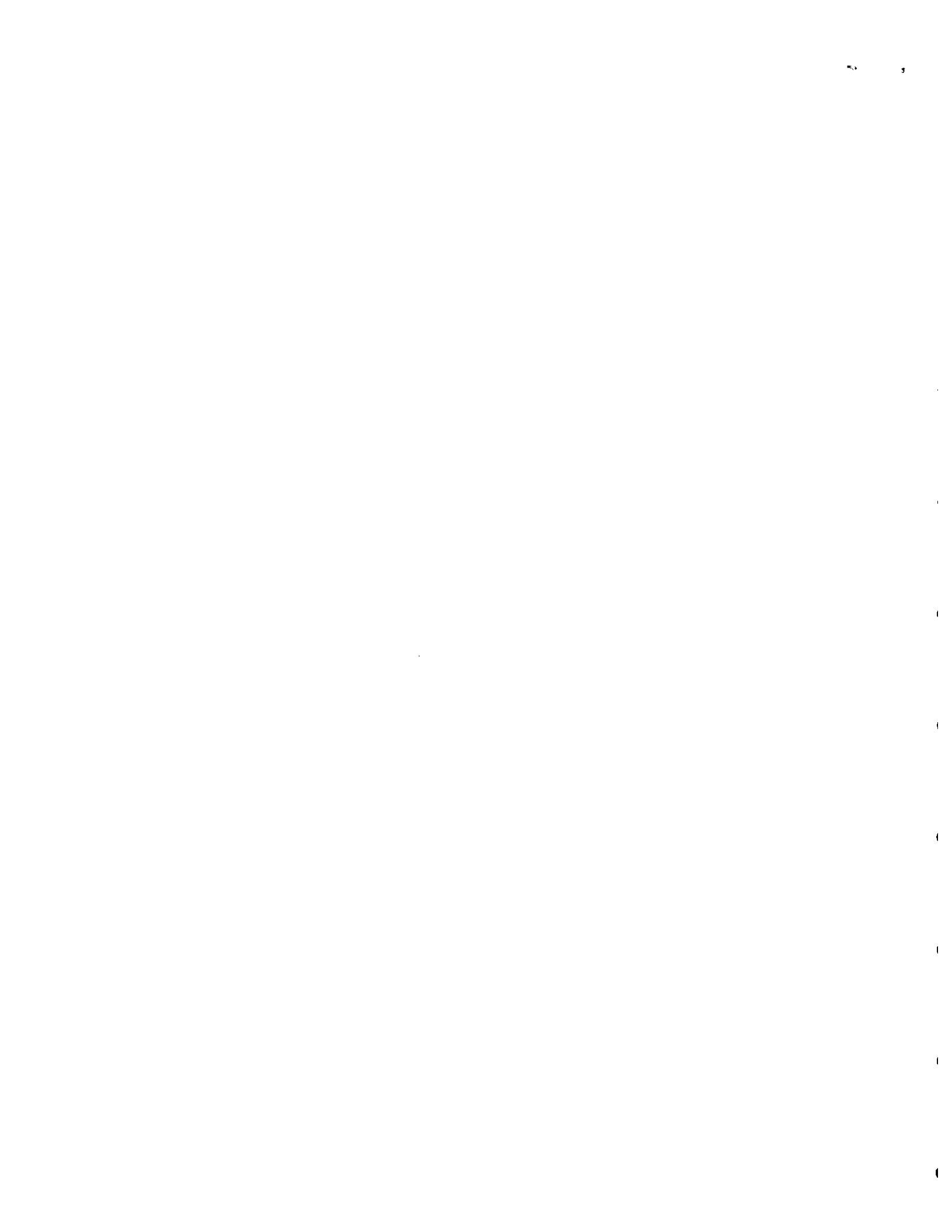
EMERGING ECONOMIC ISSUES IN LATIN AMERICA: A SECOND GENERATION AGENDA

by

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I. Introduction

Starting with Chile in 1973 and then with many other countries in the decade from the mid-1980s, most countries in Latin America embarked on episodes of economic reform which in many cases were quite radical. Inflationary, inward looking and distortionary policies were, in the most part, abandoned. They were replaced by fiscal probity which reduced the chronically high inflation rates that were a characteristic of the region. Trade reforms removed quantitative restrictions and lowered and simplified tariffs. Financial reform removed financial repression. Exchange rate restrictions were replaced by policies that often included full convertibility and large scale privatizations reduced state ownership in most countries. Elsewhere [Holden and Rajapatirana, 1995] we have characterized reform programs. Those that involve changes in macroeconomic variables, we described as *first generation reform*.¹ They prepare the ground work for creating the conditions for *second generation reforms*, or reforms at the microeconomic level which are needed to make the changes brought about by the first generation reforms sustainable.

Second generation issues focus on removing impediments to the shifting of resources in response to improved incentives. They increase an economy's ability to withstand external shocks. They more strongly define property rights. They reform institutions by making their role more automatic than discretionary in order to reduce the probability of disequilibrium induced by policy reversals or other endogenous developments. The second generation agenda also relates to increased concerns regarding income distribution, small and medium sized enterprises and decentralization and power sharing between the central government, provinces and municipalities.

A second generation reform agenda sets out to address a focus of criticism arising from Washington Consensus type reform, namely that the benefits of the process only accrue to relatively small numbers of the 'power elite'. Whether or not this perception is in accordance with the facts, there is no doubt that institutions in Latin America do not adequately support many activities that function as a matter of course in the more developed world. Insecure property rights, inadequate dispute resolution mechanisms, stifling regulation, and poorly functioning legal systems conspire to stack the deck against upward mobility and the diffusion of wealth and power. Simple political economy considerations dictate that the present value of the gains to reform needs to be larger than the present value of income from existing policies and that these gains are so distributed that wide and enduring support for the policies that have been put in place can be sustained. This implies the need to assure that the gains from reforms are widely distributed, that the gainers are made sufficiently strong to support continuing reform and the vulnerable groups in society are protected during the reforms. The second generation agenda is aimed at securing the sustaining and supporting political economy ethos that leads to the initiation, acceptance and maintenance of reforms over time.

¹ Also referred to as "The Washington Consensus."

The paper is divided into six sections. Following the introduction, Section II recounts the host of policy reforms undertaken under the first generation agenda and the outcomes of these reforms. Section III describes the unfinished elements of the first generation agenda. Section IV places second generation issues within an overall reform strategy, while Section V develops some specific elements of the second generation agenda. Section VI gives conclusions.

II. First Generation Reforms and Outcomes

There has been a pattern to the recent reform and stabilization efforts. They started with Chile in the early 1970s and were implemented from the mid 1980s onwards in most other Latin American countries. Reform tended to be followed by recovery, then subjected to stress, which needed a correction, which was then followed by post reform sustainability. Chile, which has had the longest period of time for reform to have shown results, appears to have completed the first generation reforms well and put the economy on a self sustaining path but it now needs to complete the second generation agenda.

In the mid eighties, most countries in Latin America were in the throes of severe macroeconomic disequilibrium. Starting with the Mexican debt crisis of 1982 and continuing through most of the 1980s, inflation had become rampant with Argentina, Brazil, and Bolivia experiencing hyperinflation. Current account deficits had become unsustainable. Nearly all countries, with the exceptions of Colombia and Uruguay, had suspended debt service payments. Unemployment was widespread. Real wages had plummeted in most countries despite indexation. Appreciated exchange rates, biases arising from import restrictions and softening world prices, combined to keep export revenues low and declining. Imports came to be severely restricted to accommodate the falling exports and to generate surpluses to pay off the high external debt that had been accumulated and capital flight was large.

Financial markets were severely controlled; interest rates were fixed administratively and selective credit controls were widely used which resulted in severe financial market repression in many countries. There were some exceptions. Indexation of financial instruments allowed for market determined interest rates in Brazil. In the late 1980s, Uruguay maintained an open capital account to encourage foreign capital inflows that made interest controls non-viable. Chile was recovering from its severe financial and banking crisis, with the state taking over many of the non-performing assets and forcing the commercial banks to adjust their portfolios to more viable positions.

This period of crisis brutally exposed the non-viability of the inward oriented strategies followed by many Latin American countries. The success of other developing countries such as those in East Asia following outward oriented policies also demonstrated that the region needed a different paradigm of development. The crises triggered reforms ranging from macroeconomic stabilization and adjustment policies to incentive reforms and privatization. Table 1 summarizes the experience with the reforms over this period.

Table 1. Patterns of Reform in Latin America; 1975 - 1996

| Country | Reform | Recovery | Stress | Correction | Post-Reform |
|-----------|--------|-----------|--------|------------|-------------|
| Argentina | 1991 | 1991-1993 | 1994 | 1995-1996 | |
| Bolivia | 1985 | 1988-1990 | | | |
| Brazil | 1994 | 1994-1995 | 1995 | | |
| Chile | 1975 | 1976-1980 | 1981 | 1982-1985 | 1986-1997 |
| Mexico | 1988 | 1991-1993 | 1994 | 1995-1996 | |
| Uruguay | 1990 | 1991-1994 | | 1995 | |
| Venezuela | 1989 | 1990-1992 | 1993 | 1994-1995 | |

Source: Inter-American Development Bank, Annual Report 1996 and authors' estimates.

The main issue is how to make the stabilization and macroeconomic adjustment stick, or in other words, to lead to a higher and a stable steady state growth. Many analysts believe that only Chile has achieved such a steady state by completing the first generation reforms and accomplishing some of the second generation agenda. However, the large majority of Latin American countries have yet to achieve this status as evidenced by the sharp reductions in activity and the instability that was the result of the "Tequila shock" when Mexico found itself unable to meet its short term dollar denominated Tesobonos. The crisis spread to Argentina, which experienced a strong adverse shock, leading to high unemployment and zero GDP growth. The aftershocks of the Mexican peso crisis clouded the economic performance of the whole region, especially Brazil. It points to the vulnerability of the economies when even first generation reforms are not fully realized. In Mexico's case the lesson is that the country was not able to keep its fiscal accounts in balance, a problem that was greatly magnified by large amounts of highly volatile short term debt and the underlying weaknesses in the commercial bank portfolios. The good news is that despite the stresses and with some outside assistance, Mexico, Argentina, and Brazil, did not abandon their first generation reforms. Mexico received a US\$40 billion infusion of resources from the US, the IMF, and the World Bank. Argentina held steadfast to its convertibility plan. Although Brazil did increase some tariffs for revenue purposes, the main elements of its reform agenda remained in place.

Most Latin American countries have progressed rapidly toward opening up their economies although not all countries liberalized their trade regimes at the same time or to the same extent. Chile again led the way, followed by Bolivia, Argentina, Mexico, Peru, and Uruguay. Most countries in Latin America are more open today than anytime in their post-world war history. As a result both imports and exports have grown rapidly. For example, except for Mexico and Argentina in 1995, imports grew at 9% on average in the last five years. Similarly, exports grew at about 7-8% during the decade and the composition of exports changed towards manufactured goods. The increase in exports was supported to some extent by the regional trading agreements. One example of exceptional growth in bilateral trade is between Colombia and Venezuela. Not all the increases in such trade have been beneficial, since the sources of imports are not lowest

cost. This entails some trade diversion and created new forms of protection arising from the enforcement of "rules of origin." In joining the GATT and its successor, the WTO, the countries have agreed to further reduction in tariffs and the adoption of WTO rules with respect to exceptional protection, such as anti-dumping, safeguards, and countervailing duties.

As a result of the trade reforms, a majority of the countries in the region have low tariffs, a very low incidence of non-tariff barriers and no exchange controls on current account transactions. Among the 27 countries in the region, average tariffs fell from 44.6 percent during the mid 1980s to 13.1 percent by 1995. Only seven countries have average tariffs over 15 percent. And only two countries apply maximum tariffs over 100 percent to a small number of goods, mostly agricultural goods, to protect farmers. Only Brazil, Mexico, and El Salvador have non-tariff barriers affecting more than 5 percent of their imports.

This integration with the world economy has had tremendous implications for productivity in these economies and has provided a guard against macroeconomic excesses. Overly expansionary policies quickly manifest themselves in a loss of international reserves and give signals to policy makers that restraint is warranted.

Financial repression was common place in Latin America in the 1980s. However, in most countries financial reforms have focused on reducing or eliminating directed credit programs, letting interest rates be market determined, lowering reserve requirements and introducing regulations that lead to prudential management of banks. In addition, many banks have been privatized. These reforms have gone the farthest in Chile, Peru, and Argentina.

Privatization and the adoption of neutral regulatory environments that have broken the link between ownership and regulation have been widespread. These reforms have been adopted to increase competition in the non-tradable sectors, where trade liberalization does not result in more competition. Privatization was undertaken on a large scale in Mexico, Argentina, Peru and Paraguay, but was more limited in Uruguay, Ecuador, Brazil, and Venezuela. Sales of government assets have ranged from telecommunications privatizations in Mexico, Argentina, Venezuela, and Chile to the privatization and downsizing of railways in Argentina and power generation and port services in Uruguay. Since privatization often results in private operators obtaining monopoly positions, a framework for regulation had to be developed in most countries in the region. The state has become the regulator rather than the owner.

Structural reform of rigid labor markets that exist in many Latin American countries has been limited. For example, in Argentina entrenched labor unions were a powerful block against reforms, and have strongly resisted attempts to change labor legislation. However, recently progress has been made towards changing some of the more distortionary rules. A similar situation exists in Uruguay, where some progress has been made in labor market reform. Reform has languished in many other countries, however. More typically, governments have tried to come to an understanding with the labor movement that exchanged job security and promises of future benefits for current wage restraint. Mexico is an example, where a "Pacto," or understanding with the labor unions to restrain their claims for wage increases was implicitly exchanged for the assurance that as the economy recovered following reform, labor would be

extended a share of the benefits arising from increased productivity. In many countries, including the successful reformers such as Chile, labor has begun to demand more than what have been promised to them from the reforms. Similar opposition has arisen in many parts of Latin America, from Ecuador to Argentina, and from Brazil to Venezuela.

As far as institutional aspects of the first generation agenda is concerned there has been little progress. For example, independent Central Banks, which can resist political pressures to inflate from Ministries of Finance or Treasuries, are not common and exist only in Chile, Colombia, and Argentina. Few countries have achieved reform in the institutions that govern their international trade. Argentina, Colombia, Chile, and Peru have made some changes in the direction of ensuring that their trade policy institutions reflect national rather than sectoral interests by removing the responsibility of trade policy making from sector ministries. But even in these cases, sector interests have remained influential. For example, Colombia has introduced agriculture protection through a system of price bands and minimum prices, a policy that is now emulated by the other partners in the Andean Pact.

III. Unfinished Elements of the First Generation Agenda

In spite of the widespread nature of the reforms, many countries in Latin America remain vulnerable. External macroeconomic shocks such as terms of trade or interest rate disturbances are inevitable as countries become more integrated with the world economy. However, many countries in the region are also vulnerable to policy induced or endogenous shocks which have their origin in fiscal expansions, as was the case in Mexico in 1994. At the same time, countries such as Brazil continue to have difficulties in controlling fiscal excesses, particularly those arising from state government spending. A similar situation exists in Argentina, where in the past, budget deficits of state governments have been routinely financed by the central bank or the federal government. In other cases, as in Uruguay, fiscal situations been improved through such transitory measures as using the monopoly position of public enterprises to benefit from improved world market prices in their monopoly imports. Thus there is no assurance that permanent fiscal discipline has been achieved. In addition, there are contingent claims on many governments in Latin America arising from unfunded social security liabilities. The problem is especially acute in Uruguay, Mexico and Colombia.

There is as yet no evidence that the permanent budget constraint that governments have to face has been dealt with systematically in the region. In most cases, reductions in government deficits have come from revenue increases rather than through cuts in permanent expenditures. In many cases the improved revenues are transitory, either generated from the once and for all realization of funds from the sale of public assets or through short term improvements in the terms of trade. Weak fiscal policy could therefore still introduce instability and cause endogenous shocks. Furthermore, with the return to democracy, fiscal discipline often weakens as elections approach, as was dramatically demonstrated in Mexico, and noticeably but less dramatically in Costa Rica, Colombia, and Ecuador.

In trade the unfinished agenda relates to reducing protection further and reducing the variance in tariffs to achieve more uniform rates. In addition, the exceptions given to different activities must

be reduced and institutions established which are more sector neutral in policy making. There is also the danger that additional trade barriers could emanate from the rules of origin requirements of regional trading agreements. Further elements of the unfinished trade agenda include fulfilling obligations signed under the Uruguay Round not only with respect to reducing protection and binding tariffs, but also in adopting WTO rules with respect to exceptional protection.

In finance, improving the supervisory and prudential rules and creating conditions that are necessary for the emergence of long-term financial instruments are top priorities of the unfinished agenda. Supervisory and prudential regulation is in a rudimentary state in most countries in Latin America. Regulatory authorities are not in a position to monitor the quality of bank assets and as a result many banks carry assets that are non-realizable. In Uruguay, for example, commercial banks have been ordered by the Central Bank to lend to enterprises that are experiencing serious financial difficulties. As a result, many banks carry assets that are non-performing, which makes the banking system highly vulnerable to shocks. A similar situation is to be found in Bolivia, Colombia, and Mexico. State owned banks in Argentina are also extremely weak. In addition, inadequate laws related to collateral have seriously hampered development of financial systems in Latin America. These are discussed in detail in the section on the second generation agenda.

In privatization, most public assets have been divested in the countries that have been in the forefront of reforms as, for example, in Chile, Argentina and Peru. However, in the majority of countries there are many public assets that could be owned by the private sector. Uruguay has resisted the privatization of telecommunications. Brazil continues to own large parts of public utilities and many other activities that could be better run by the private sector, such as petroleum and sugar production.

A similar unfinished agenda exists in making key institutions of public policy such as Central Banks, trade institutions and regulatory bodies less vulnerable to political pressure. Institutions must anchor the reforms in such a way that they give assurance to the markets and to the business community that they not be the cause of endogenous shocks to the economy and that they will react in predictable ways to external shocks. So far serious progress in institutional reform has been achieved only in Chile.

IV. The Second Generation Agenda and Reform Strategy

Second generation issues relate to property rights, the legal system, and institutions. Most of them have public goods characteristics and therefore involve the state. Thus a key aspect of the second generation agenda is how to define and structure the role of the state. In the past, many of the problems that arose in the region could be traced to the excess intervention of the state in some areas of economic life and its near total absence in others. The second generation agenda therefore begins with a re-evaluation of the role of the state in the economy. In the past, the state in Latin America has over-extended itself in areas of regulation and control of economic activity. At the same time it seriously neglected its fundamental role in proper macroeconomic management, maintaining law and order, assuring property rights, and providing basic services such as public utilities, education, health, and other public goods. Some form of these

interventions is appropriate either because of the lack of markets or because of the failure of the private sector to engage in these activities. In addition the state has the obligation to provide equal opportunities to the citizenry who do not have the financial means to acquire education or physical assets to raise their living standards.

While the role of the state differs in different environments, there is by now common agreement that its presence was too pervasive in Latin America. In the 1930s and 1940s doubts about the ability of the capitalist system to deliver basic services and an ethos favorable to a state-centered paradigm of development evolved in the LAC Region. During the 1950s, this paradigm received the intellectual support from the Economic Commission for Latin America and the Caribbean under the leadership of Raul Prebisch and Celso Furtado. The Structuralist school of economic development expounded by such economists as Ragnar Nurkse, Dudley Seers, and Hans Singer championed industrial development behind protectionist walls. In such a paradigm, the state becomes powerful not only because it can acquire monopoly and non-contestable power in an economy but also by default through over-regulation of those sectors of the economy that remain in private hands. An example of the acquisition of power by the state in the region can be seen in the state takeover in many countries of infrastructure such as railways, power, and telecommunications that had been in the hands of the private sector. Regulation become so pervasive that private entrepreneurs who were operating in these sectors virtually handed their assets over to the state because they could not bring adequate returns. This tendency to over-regulate was enhanced by the emergence of military dictatorships in the region.

Thus the first aspect of the second generation agenda is to re-define the role of the state to:

- let it undertake those activities that are public goods or quasi public goods;
- ensure that regulation leads to competitive solutions;
- exit from those activities in which it has no comparative advantage.

Democracy demands that the power of the state be a residual that is harnessed for the public welfare. With the return to democracy in Latin America this limited and focused role can be achieved. Privatization of activities better performed by the private sector, reducing the arbitrariness of policy making and separating ownership from regulation are essential elements in the re-definition of the state.

The second aspect of the second generation agenda is the need to clearly delineate the rules that govern contracting and to define property rights. In Latin America, rights for both movable and fixed property are poorly defined, which raises transactions costs, discourages investment and hinders financial development. The intricacies and lack of clear resolution of commercial law and the difficulties of enforcing contracts tends to concentrate economic power and reduce upward economic mobility. The legal system is itself deficient for the efficient conduct of business. Legal processes take time and outcomes of litigation are biased against business. The lack of proper recording systems and of acquaintance of judges with the law relating to commercial transactions makes the business environment costly.

Related to these issues is the need for attention to the conditions in which small and medium sized businesses operate. Firms in Latin America tend to be large and long lived. Compared with say the United States, there appear to be few examples of small businesses growing into powerful enterprises. Conditions governing business formation, regulations governing small business operation and in particular the evolution of financial markets that can finance the growth of business are all part of the second generation agenda.

The third aspect of the second generation agenda relates to the addressing of income distribution and poverty reduction. The crises that led to the first generation reforms may have created larger burdens of adjustment on some segments of society that formerly had received various subsidies such as the urban industrial workers. While a major part of the subsidies has been appropriated by the middle class, the cuts in domestic expenditures have fallen disproportionately on the poor, who have either little or no ability to protect themselves when prices are adjusted to international levels. These effects are compounded when expenditure on primary education and health are cut. The second generation agenda has to address this issue of targeting expenditures to the more deserving segments of the society when they come under stress during periods of adjustment. It is no accident that the best means testing for the provision of these services is found in Chile, which was the earliest to undertake reforms and preserved the policy regimes put in place following the return to democracy.

The fourth aspect of the second generation agenda is the balance in power sharing and the roles of the central government and the states, provinces, and municipalities. Such power sharing ensures that decisions regarding resource allocation and administration are made by the parties who are the most affected. However, the capabilities of sub-national governments are often hampered by the paucity of skilled officials. In addition even when the economy has been reformed at the national level, vestiges of controls can remain at the local level and prevent the achievement of gains from reform being fully realized. Therefore the second generation reform agenda has both to raise the competence of local government as well as to redefine its role in local regulation.

The fifth aspect of the second generation agenda relates to the political economy of macroeconomic adjustment, policy reform, and institutional change. The main issue here is how to assure sustainability of the new paradigm. Under the new order, activities of the state reflect its comparative advantage, the economy becomes integrated with the world economy, property rights are clearly defined and policy making is made more automatic through institutions that are insulated from day-to-day political influence. However, this agenda cannot be carried out without inducing changes in the political economy equilibrium. In the large majority of the cases, policy change was possible because there were crises that allowed or even forced governments to undertake reforms that were in the national interest. Crises allowed the break-up of old coalitions and the formation of new ones that were prepared to support reform. These coalitions probably cannot exist in the medium to long term if there is no conscious effort on the part of the government to develop support for the next generation of reforms that can lead to a steady state growth path. While trade, financial, and regulatory reforms will help to raise income and employment in the short to medium run, a sustained coalition is needed to achieve such an agenda in the long term. When a short run coalition (the "pacto") was formed between

government and labor in Mexico in late 1980s it implied that labor would acquiesce in a lower rate of growth of real wages and would help to achieve the increase in productivity that the government was seeking. But when the 1994 crisis hit, real interest rates rose to inordinate levels and the unemployment rate increased sharply thereby undermining the contract. When it does not anticipate gains, labor refuses to acquiesce. Thus second generation reform cannot be achieved without a long term coalition of broad elements of society. Without it, economies can progress for short while and experience a recovery of growth, low inflation, and improved employment, but these achievements can be reversed either due to external shocks or through endogenous events related to the bad policy. Once the confidence of the public is broken, it is difficult to achieve the second generation agenda.

V. Some Specific Elements of the Second Generation Agenda

The shift from relying on the state to decide on the allocation of resources to relying on markets to perform this task naturally focuses attention on the set of rules that govern the working of markets, and whether they successfully create an environment which produces:

- efficient conditions for assembling capital—be it physical, financial, or human
- a clear definition of property rights
- equality in the administration of laws in civil disputes
- the efficient enforcement of contracts

Property Rights

Secure individual property rights are the foundation of an efficient market economy. The multiple effects of secure property—the motivation to invest effort and resources to obtain and improve property, to put it to productive uses and to freely sell it—have often been underestimated as factors in the development of a free market system, particularly among the poorer sections of the society.

The exchange of property on the market requires formalized titles, which can be obtained and exchanged with relative ease. In many Latin American countries, a very large percentage of rural and urban real estate property is not titled. This lack of a clear definition of property rights has a disproportionate impact on smaller businesses and on start-up finance. In particular, owners of small businesses are frequently unable to use property as collateral for credit from formal financial institutions. In addition, property registration procedures are costly and time-consuming. Excessive fees for registration and for the mortgaging of real estate, due in some cases to a strong oligopoly of public notaries, raise costs and inhibit the development of mortgage markets, one of the most important sources of finance of small business start-ups in North America.

The absence of a property market in which dwellings can be freely titled, bought and sold with comparatively low transactions costs also has a negative effect on the functioning of labor markets. If occupational title is the sole basis of ownership, workers have only a restricted area in

which they can seek employment. If jobs become available in areas which would require relocating dwellings, the costs of taking such employment are very high. Frictional unemployment is therefore probably much larger in Latin America than in the industrialized world.

Anomalies in the law governing property have other negative effects. For example, in many countries in Latin America, the government owns all sub-surface resources regardless of the ownership of the land. This has a negative effect on mineral exploration—the incentives to explore private land are greatly weakened if the government has the right to whatever is found.

Property Rights and Financial Repression

Poorly defined property rights also have a profound impact on the operation of financial markets. The inability to pledge movable property—business assets such as inventory, machinery, and accounts receivable—has resulted in severely underdeveloped financial markets. Comparing the financial systems in industrial countries with those in Latin America, it is apparent that first, a broad array of specialized financial intermediaries does not exist at all in most countries in the region. Second, commercial banks which predominate in the financial sectors² of all countries in Latin America lend only to large, well-established firms. Since all sources of funds except equity, retained earnings and trade credit are unavailable to smaller businesses that wish to expand, they cannot grow as fast as they would if financial markets were more developed. Decisions regarding which technology to adopt in production or how much inventory to hold or whether to expand does not depend on the track record of the people running the business and their ability to convince lenders that the ideas are sound. Rather it depends on personal circumstances and specifically on the owner's real estate holdings. The alternatives available to entrepreneurs whose personal asset holdings are not large are limited and have profound efficiency consequences for their businesses and more generally for the allocation of resources and the distribution of income [Fleisig, 1996].

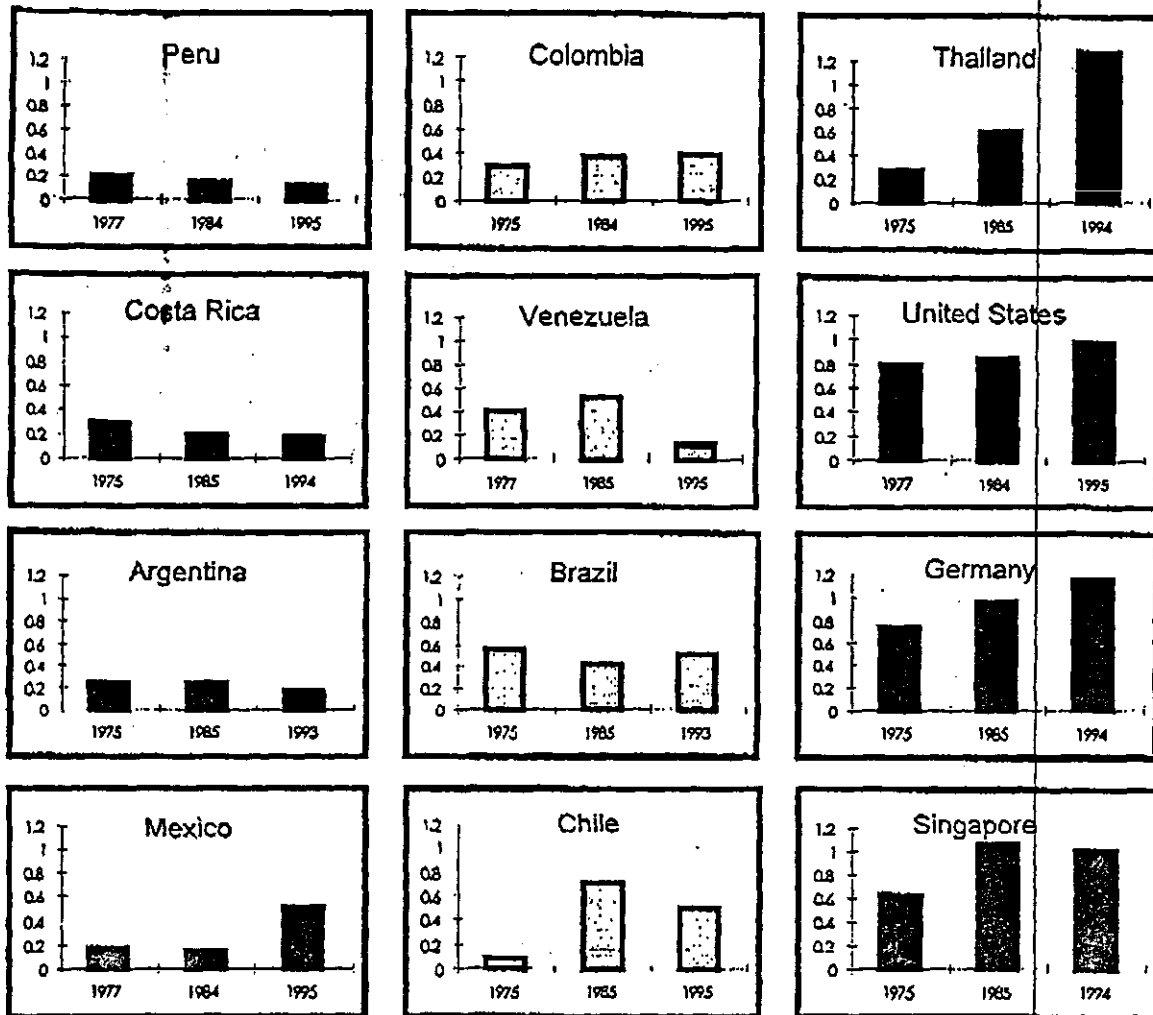
The extent of financial repression in Latin America can be seen from Chart 2 which shows the ratio of credit to the private sector provided by the financial system in various countries. In the two industrial economies illustrated—Germany and the United States—outstanding credit to the private sector equals or exceeds GDP; that is the outstanding credit to the private sector is equivalent to at least one year's output of the economy. There is a similar picture in the two Asian economies represented—Singapore and Thailand—where the rapid growth of credit mirrors the high growth rates registered by both countries.

Countries in Latin America stand in dramatic contrast. Even after several years in which the amount of credit granted by the banking system grew rapidly, in no Latin American country did credit from the banking system to the private sector exceed 50 percent of GDP at the end of 1994. In many countries in the region, the ratio was far lower. In Peru and Argentina which implemented the most rapid and radical reforms, the ratio of credit to GDP is around 20 percent

² In the United States lending of non bank financial intermediaries to the private sector is the equivalent of nearly 70 percent of GDP. In most Latin American countries, it is less than one percent of GDP.

even after several years of rapid growth. It is hard to believe that high growth rates can continue without substantial expansion of financing of the private sector. The picture is similar in

Chart 1: Ratio of Credit to the Private Sector to GDP in Selected Countries



Columbia, Venezuela, Costa Rica and to a lesser degree Mexico, Chile and Brazil. It reflects an astonishing degree of financial underdevelopment and reflects an urgent need for secured transactions reform [Holden, 1996].

Commercial Codes

Although many of the commercial codes of Latin American countries require reform, many of the most significant impediments to small business development emanate from enforcement:

- a) **Interpretation of the law.** The courts remain overly timid and rigid in their interpretation of the law, bound to commercial transactions defined explicitly in the Code. Although judges are often granted discretion to look to commercial custom when

adjudicating cases involving new types of commercial transactions, their reluctance to set precedents prevents commercial actors from engaging in such transactions. Unless judges are confident enough in their authority to depart from the Code and are cognizant enough of modern commercial arrangements to do so responsibly, the Code remains underutilized.

- b) **The inadequacy of related laws.** In one extreme case, for example, the law governing the public certification of documents dates from 1859 and requires that documents be handwritten by a notary. In other cases, lack of clarity and contradictions between related laws, decrees and ordinances promulgated over the years increase legal uncertainty.
- c) **The lack of independence from the legislative and executive branches.** A manifestation of this problem is the low prestige of badly paid court judges. This leads to negative selection and encourages corruption.
- d) **Court structure and court procedures.** In many countries, no specialized commercial courts exist nor is out-of-court arbitration and conciliation instituted, increasing the burden of dispute resolution on the main court system and exacerbating the length and cost of obtaining justice. In other cases, court organization is highly inefficient and often requires bribes to expedite cases. Such delays and costs in the legal enforcement of contracts constitute a significant impediment to the expansion of impersonal contracting.

The negative impact of these factors falls disproportionately on SMEs, whose transactions are too small to merit the effort required to deal with inefficient legal structures.

Labor Laws

In most Latin American countries, organized labor has, through processes of negotiation and political pressure similar to the lobbying of large enterprises, obtained a number of protection benefits forged into laws, in some cases right up to the Constitution. Some of the corresponding policies affect conditions of employment directly, like severance pay or reducing the length of the work week. Other policies have been designed to affect the compensation of work, like minimum wage legislation, rules regarding union formation or centralized wage setting. Action to affect work conditions included pension requirements, health care and safety standards. Social overhead costs in formal enterprises range from 30% to 80% of the base salary, discouraging formal employment and providing incentives for informal employment arrangements. Overall, such rigidities have detrimental social consequences, excluding a majority of the labor force from its benefits and encouraging informality.

Tax Laws

In many Latin American countries tax laws are complicated and expensive to comply with. In Brazil, Stone, Levy, and Paredes [1992] conducted interviews with small entrepreneurs and discovered more than 50 federal, state and municipal taxes, some of which require monthly contributions. Such complexity, further compounded by arbitrary enforcement, encourages

evasion. In many Latin American countries, formal small businesses establish double bookkeeping, one for the tax authorities to minimize the tax burden, and another which corresponds to reality. If, on top of such complexity and inconsistency, marginal tax rates are high, that honesty is penalized.

A first step to facilitate formal integration of SMEs would be the creation of a simpler overall tax system. The Bolivian tax reform of 1986, for example, succeeded in reducing the chaos of taxes to seven basic ones and prohibited the creation of new ones which were not in accordance with the principles of the new tax system. A second, equally important step is the creation of a tax enforcement mechanism, which employs committed, well-paid professionals. Such measures must be part of a wider civil service reform, which increases the credibility in the performance of the public sector and therefore the disposition of economic agents to pay taxes. A third step, finally, involves simplifying taxes for SMEs and adjusting the tax burden to their economic capacity.

Business Licensing

The famous empirical study by the Instituto Libertad y Democracia in Lima under the leadership of Hernando de Soto [1989] has shed light on the costs of formal business registration by small enterprises: it took 289 days to fully comply with all formal requirements to set up a small firm. In practice, it is not necessary to comply with all these formal requirements to start a business and there is a large gray zone of non-compliance that reaches right up to large enterprises. In addition, "fixers" exist in many Latin American countries who, for a fee, will deal with bureaucratic problems. Still, other empirical evidence [Tokman 1992] shows that formality is substantially discouraged by the cumulative effect of regulatory requirements of different public agencies. In many Latin American countries, business licensing can be simplified substantially with a number of fairly straight forward reforms.

A second area of reform concerns the simplification of presentation of publicly certified documents to different agencies. Finally, business registrations should be modernized, maintained and publicly accessible.

Government Reform

Many of the issues discussed in the preceding paragraphs involve actions by the State. Although views regarding the appropriate role of government in the economy may differ, there seems to be a broad consensus that before the reforms began to be implemented in Latin America, most governments in the region had assumed roles for themselves that were far too extensive. As a result, interference by the state in economic life was pervasive with strong adverse effects on efficiency and productivity. Much of this remains. Although state owned enterprises have been sold in many of the countries in the region, numerous regulations and restrictions remain that impinge on economic life. At the same time, however, public goods necessary for the efficient conduct of business transactions are missing. The insecurity of property rights discussed at length earlier in the paper is a reflection of government failure. The state has a comparative advantage in supplying these and other public goods. In Latin America, most states fail

abysmally at doing so. At the same time, the lack of transparency promotes opportunistic behavior by government officials that is manifested in corruption in many countries.

Yet there is no agreed upon model for reform of the state. There are reasons to believe that the radical approaches to governmental reform adopted by such countries as New Zealand may not be applicable in Latin America. In particular, the relative underdevelopment of political and institutional frameworks in the region could make the methods used by the reforming industrial countries ineffective. Instead, there appears to be little alternative to first improving the basics of public administration—effective planning and budget systems, personnel control and improved reporting, accountability and transparency which is the first step towards professionalizing the public service. Without this step, further attempts at state reform are probably doomed to failure.

VI Conclusions

A number of important lessons can be drawn from Latin America's reform experience over the past ten years. Excessive and improper government intervention restrains private sector activity more than it can help to support it and ultimately damages efforts to promote development. Although much progress has been made in reaching macroeconomic stability and in implementing financial and trade reform, the business environment is fragile and susceptible to damage by misguided policies. The region faces new challenges in addressing the second generation of private sector development issues—especially those related to the role of the state, to institutional structures, and to property rights.

The transition to steady state growth is not easy, it requires more effort to anchor the reforms. The process will not be an easy one. Only a participatory, locally anchored, common effort has a chance to mobilize the required forces to implement reforms, often against powerful constituencies or with the benign neglect of important actors. It goes beyond traditional ideas of reforms, to take into account property rights, the legal system, institutions and political economy aspects of managing a economy. It is equally important that reforms are well-devised and implemented, if they are not to create further uncertainty for investors, small and large. Improving the economic environment is a demanding task that requires the full attention of policy makers, the public administration and private sector representatives. The fundamental importance of "getting the basics right"—macroeconomic stability, clear and consistently enforced rules and property rights for better functioning markets, steadily improving human capital and infrastructure, increasing savings and investment—has been highlighted by the success of the highly performing East-Asian countries. The aggregate affect will have far greater affects on economic development in Latin America than any direct promotional measures.

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