

CARIBBEAN CONNECT

SYMPOSIUM

CARICOM SINGLE MARKET AND ECONOMY

ADJUSTMENT AND TRANSFORMATION: REGIONAL DEVELOPMENT FUND

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Introduction

The Revised Treaty of Chaguaramas provides for a Development Fund to provide financial or technical assistance to disadvantaged countries, regions and sectors. Since the Treaty became effective, considerable effort has gone into operationalising the Fund, and it now appears that agreement has been reached on its main features. A number of issues still remain to be addressed, but arrangements have been agreed to deal with them.

What I want to do is to talk a little bit about the Fund, setting out the evolution of the main features that have been agreed so far, and then try to put it into the overall regional integration context. I am very mindful of the fact that we are at the end of three long days, and I will keep this as short as possible consistent with the need to cover the issues.

Fund Features

It has been agreed that the Fund will be a separate legal entity established by Charter. Enabling and recognition legislation will need to be passed by all participating countries to give effect to the Fund, and there will be need for a Headquarters Agreement between the Fund and the country in which its operations are based.

In an effort to reduce overheads and to make the operations learning curve less steep, it has been agreed that CDB will be approached to house the operations of the Fund, and to provide operations services on an as-required, cost-recovered basis. There would be need for the Fund to have a small permanent staff of its own. Overall policy direction and management oversight will be provided by a non-resident, small, Board of Directors, appointed by the COFAP in consultation with the Community Council and COTED, those three Organs of CARICOM being the ones responsible for the economic integration and economic development aspects of the integration movement.

The size of the Fund has initially been set by Heads of CARICOM Governments, meeting earlier this year in Trinidad & Tobago, at US\$250m, with US\$120m coming from CARICOM member countries, and with the balance to be sought from the region's development partners, the regional private sector, and other sources. Of that US\$120m, US\$20m is expected to come as a one-time contribution from the Trinidad & Tobago Petroleum Fund, while the remaining US\$100m will be subscribed by the participating countries, including Trinidad & Tobago.

The Fund is to be authorised to provide both loans and grants to eligible countries, and the agreed arrangements do not exclude the use of the Fund to provide interest subsidies, as has been recommended by one well-known student of Caribbean development. I will come back to this aspect a little later.

Issues

Turning now to the items still on the table, it would easily be appreciated that the issue of country contributions has been one of the main areas for discussion over the last year or so. The Revised Treaty contemplates that member countries would make contributions to the Fund, without excluding the possibility of funding coming from other sources. The region's Development Partners have been clear in their position that they would be willing to make a contribution to the Fund, but were waiting to see what contribution the region was prepared to make to its own development first.

Simulations were done with a number of contribution formulae, ranging from basing contributions among the participating states (and I need to point out here that we are talking about full CARICOM members which are part of the CSME except Montserrat, so that Haiti and The Bahamas are excluded as well) on

- (a) shares of regional per capita income
- (b) shares of regional GDP
- (c) proportions of Central Government current revenue
- (d) the formula for financing the CARICOM Secretariat

For various reasons none of these approaches was considered acceptable by all parties. It now appears that we have agreement in principle through the use of a formula which applies the CARICOM Secretariat formula to some countries, which applies a second formula which combines the effects of GDP, per capita income and shares of intra-regional trade to other countries, with the resulting financing gap to be filled with a further contribution from the Petroleum Fund. It is likely that contributions by some countries will need to be made in instalments, taking account of their individual fiscal situations. The extent of the spread of the contributions over time and the reliability of their flow will obviously affect the impact of Fund operations.

A second issue to be resolved involves the purposes for which the Fund is to be used, and the priorities to be attached to the intervention possibilities. And here we begin getting into the context for Fund operations. The Revised Treaty sets out a variety of purposes for which the Fund is to be used, which I will come to in a moment, and the Fund itself is part of the regime for disadvantaged countries, regions and sectors that is set out in the Revised Treaty, the regime itself having been conceived in recognition of the fact that member countries are entering the integration process in various states of "readiness". I use "readiness" as a catch-all phrase for differences in economic structure and performance, differences in physical and institutional infrastructure capacity, differences in the range and depth of human resources capacity, and differences in size, all of which impact on the capacity to identify and take advantage of opportunities to grow and develop.

A country is disadvantaged if:

- (i) it is a less developed country as described in Article 4 of the Revised Treaty;
- (ii) it requires special support measures of a transitory or temporary nature by reason of:

Impairment of resources resulting from natural disasters;

The adverse impact of the operation of the CSME on its operations;

Temporary low levels of economic development;

Being a HIPC country.

A region is disadvantaged if:

- (i) it experiences economic dislocation from the operation of the CSME;
- (ii) it requires special support measures by reason of:

Natural disaster impairment;

Temporary low levels of economic development.

A sector is disadvantaged if:

- (i) enterprises in the sector experience dislocation as a result of CSME operation;
- (ii) losses in the sector caused by natural disaster result in social and economic disorder.

I have spelt these out to indicate the range of justification for claims on the use of Fund resources, having regard to the size of the Fund that is currently contemplated, and having regard to the use of part of the available resources in the form of grants. There is clearly going to be an impact on sustainability.

But the situation goes further than this. The issue is only mentioned briefly in the Preamble to the Revised Treaty (and parenthetically I should note that the Preamble is essential reading since it sets out in clear and unambiguous terms the objectives of the integration movement), but the issue of cohesion of the integrating group is absolutely critical, as is borne out by the various official statements over the last six months. So that where financing or technical assistance is required for the continued smooth operation of CARICOM in order

to prevent the emergence or continuation of what Prime Minister Arthur calls a "coalition of unequals", the resources of the Development Fund is an obvious point of focus.

An important sub-text issue here is whether the Fund is a compensation instrument or an instrument for regional structural transformation. This is important if only because one of the region's major development partners has publicly stated that it will contribute to a transformation fund, but not to a compensation fund, and one of our Prime Ministers has taken issue with that position, indicating that compensation for the effects of CSME is critical.

The quick answer is that separating the two will always be difficult. The longer answer is in the Preamble, and I recognise that I here I run the risk of using language that may not be politically correct, or of advancing a proposition that may not find universal favour. And it is the clear statement that the objective behind regional integration is to transform and restructure the separate participating economies of the region into a single economy that is globally competitive and capable of meeting the development needs of the region's population. The more successful the integration movement the less recognisable, in historical terms, will be its constituent parts. One would not be able to speak of the "individual economies" in the same way that we now do. And there will be an increasing issue to be addressed in relation to overheads and duplication of services (economic efficiency). And efficient management of the system as a whole will become an issue: an issue which has been an important undercurrent in the discussions and presentations here over the last three days. Far-reaching economic restructuring and transformation will unavoidably involve concomitant social and political change. Dislocation is an essential part of restructuring and transformation. Part of the problem is that the word "dislocation" carries with it undesirable baggage. The issue is not so much compensation for dislocation as assistance both in facilitating restructuring for improved performance, and support in making the changes as painless as possible for all the actors involved.

Another aspect of the issue is that dislocation, restructuring, transformation, whatever the guise in which the process of change manifests itself, even growth, requires adjustment. There are a variety of mechanisms through which the adjustment will come. One way involves the physical relocation of industry, and associated changes in the spatial distribution and movement of the other factors of production, particularly labour, and in shifts in the composition of trade. Please note that physical relocation of industry may mean just that, physical relocation, or it may mean expansion, the establishment of subsidiaries elsewhere, or even closure. Labour may move of its own volition, to take advantage of better opportunities elsewhere. Highly mobile services provision may become increasingly important. Finance may be used as a critical part of the adjustment process, depending on its availability. The issue is that the Development Fund should be seen as only one of a number of adjustment

mechanisms. But if we do that we are tempted back into my proposition of taking the Revised Treaty Preamble at its face value.

Perhaps part of the issue is that we have not yet fully stated the objectives of the integration movement.

But the issue of Fund priorities is being addressed in two ways. Firstly, a Committee drawn from COFAP Ministers will meet to set the priorities for the Fund, and to give appropriate directions to the Board of Directors. Secondly, the issue of Fund sustainability will be reviewed after operations commence, and this could well result in arrangements for its replenishment.

A third issue involves the ways in which Fund resources might be used, as opposed to what it might be used for. The immediately available choices are grants, loans, and interest subsidies. The public sector of many countries in the region is experiencing substantial fiscal difficulty, and public debt levels are high, with debt servicing being a major burden, so that grants are naturally very attractive. The problem with grants is that when you give it away it is gone, and a new grant requires new resources. Loans are, on the face of it, preferable, since the funds can be recycled. But loans on commercial terms are unattractive, and are not in keeping with the objectives of a development fund; and loans on concessional terms, with the associated low interest rates, and long grace periods and repayment terms, would have almost similar outcomes as grants in terms of resources recycling, at least in the first 25 years of Fund operation. The implication, then, is that a grant or concessional loan fund would need effectively to be of large size (effectively meaning not necessarily large at the outset, but subject to ongoing replenishment) to have meaningful impact.

This has led Havelock Brewster to propose using the development fund to subsidise interest payments on loans obtained from creditors, effectively leveraging those resources. Rough calculations suggest that US\$100m could provide 3 percentage point interest subsidy grants (CDB's public sector rate is currently 6.25% and World Bank and IDB rates are lower) for between US\$400 and US\$700m in loans, depending on assumptions about loan terms and disbursement patterns. The issues here would be that:

Countries would need to borrow;

The development fund would still need replenishment;

Country borrowings would be subject to the normal lending arrangements of the particular creditor institution.

The overall issue is the size of the Development Fund as currently proposed in relation to country need probabilities. Two issues here. Firstly, some countries might decide not to seek access to the Development Fund, thus increasing the

volume of resources available to others. Secondly, the Development Fund is not the only source of development financing available in the region, and probably should not be used when other more sustainable sources can do the same job effectively. Clearly, duplication should be avoided.

Where are we now? Awaiting direction from the CARICOM Secretariat that all countries are fully on-board with the financing formula. We at CDB expect that the Finance Minister Committees will be established and will proceed with their tasks, and we will then seek resources to fund the details of operationalisation.

Regional Development Agency

I am supposed to say a little bit about the Regional Development Agency. All I can say is that a RDA has been proposed whose function would apparently involve all those tasks identified in the Revised Treaty having to do with the disadvantage regime. As I understand it, all the tasks would be brought together in one place, and the Agency would work in close collaboration with the Development Fund, with CDB, with the region's development partners in addressing the range of issues, including that of cohesion, and would play a coordination and mobilisation role.

Clearly, these are functions of the CARICOM Secretariat.

The issue, it would then seem to me, to be whether the Secretariat, with its existing structure and staffing can deliver on these requirements, assuming I have got them right; whether the Secretariat would need appropriate upgrading; or whether these operations should be hived off in a satellite agency, which would, in any case, need to work very closely with the Secretariat.

I am afraid that I am not able to take this issue further at this time.