STATEMENT BY
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You have before you today the Second Annual Report of the Bank, as approved by our Board of Directors, which gives an account of the activities of the Bank during the year 1971. I am glad to have this opportunity of saying a few words about the economic background against which we are operating, since this conditions both what we do and whether we shall succeed or fail.

It is no secret that our economic situation is rather patchy. Mining is our only really prosperous industry, but while mining contributes significantly to incomes in Trinidad, Jamaica and Guyana, especially through the public revenue. It provides very little employment indeed. All our other industries expect to be subsidised in one way or another; tourism and manufacturing by exemptions from taxation and by government loans or guarantees; and agriculture by low interest rates and heavy expenditures on agricultural research and education. In the territories with minerals the revenues provided by the mines keep everything else afloat. In the territories without mines, the economy is kept going by various forms of taxing industries with one hand and subsidising them with the other.

Apart from minerals, our basic industries are in poor shape. Agriculture is a dying industry. Cocoa, cotton and arrowroot have been disappearing from our list of exports. The banana output is falling. Imports of food grow by leaps and bounds every year. Sugar, after some years of decline, has received a new shot in the arm from the recent increase in prices, but still does not expect to be able to fill its quotas. Manufacturing grows, but rather slowly by comparison with other less developed countries, where growth rates of 10 to 15 per cent per annum are common. In consequence we are much less advanced in import substitution than the countries of Asia or Latin America, and are only just beginning to be aware of the rapidly growing world trade in a wide variety of diversified light manufactures other than garments.

The sad consequence of this relative stagnation, as we all know only too well, is rising urban unemployment. Our young people are deserting the countryside and flocking into the towns. Some find work in the tourist industry; others in our rapidly expanding public services - as teachers, nurses, policemen, soldiers or clerks; or in the industries where we "take in each other's washing" – shopkeeping, hairdressing, television and similar commercial services. But the growth rate of our basic industries is not adequate to support our continually rising populations and we have record unemployment rates, especially among the young. This situation is very much in the public eye because of its dangerous political potential. But it is also an agonising human problem, in its own right, that so many of our youngsters, on leaving school, may tramp the streets for a whole year or two before finding their first job. No one of us deserves happiness while this condition lasts.

If we are to change this situation we must first understand it. Why is our economy not able to provide full employment? The simple answer is, because our money costs of production are too high in relation to world prices. Potential investors are continually making feasibility studies with a view to starting new manufacturing industries, or extending agricultural output or building new hotels. Some of these come out on the positive side, especially in tourism and manufacturing, and so some new employment is created. But not enough come out right to absorb our labour force. Our costs are too high; if they were lower, more new industries would be started, and existing industries would expand faster.

Our governments recognise that this is the problem. This is why they are forced to offer the wide range of tax exemptions and other privileges which of course, reduce the benefit from such new enterprises as are actually started. But though our governments recognise the situation, our people do not. The man in the street has, instead, been taught, in the usual manner, to put all the blame on foreign devils. Unemployment is due, we are told, to the fact that foreigners control our economy. It is true that foreigners control much of our economy, and that this is both undesirable and unnecessary (I will return to this in a moment), but it is not true that this is why our costs are so high, or why we have so much unemployment. On the contrary, in our current situation, where we save so little and train so few of our own people, if there were fewer foreigners we would have even more unemployment. This is the reason why our Governments are constantly on the look-out for potential foreign investors; this, rather than any lack of patriotism on their part.

Our costs have become too high because our money incomes are determined for all economic activity by what the richest industries can afford to pay, namely the mines and the tourist industry, without regard to the productivity levels of other industries. In fact the expansion of the mines threatens to destroy all other economic activity, while itself providing an almost negligible amount of employment. Of course incomes in other industries have not reached the level of incomes in the mines, but they are always striving to get there. In the process, costs in other industries are raised beyond what productivity can support and the result is massive unemployment.

When one says of an economy that its money costs of production are too high in relation to world prices for it to be able to provide full employment, this is the classic definition of an overvalued currency. Nearly all West Indian currencies are heavily overvalued in relation to our foreign trade policies and our current levels of money income and productivity; this is the basic reason for our high and steadily mounting unemployment. It used to be considered immoral to make such a remark in these islands, since the preservation of our parity with sterling was regarded as the first priority of economic policy. But now that the British pound devalues regularly, and even the mighty US dollar has insisted on being allowed to fall, we are able to look at our own situation more objectively.

If maintaining parity with sterling no longer has first priority in economic policy, what should? In general, economists dislike the very notion of priority; normally everything is important; we make marginal adjustments to equate our satisfactions all along the line. The notion of priority belongs to abnormal situations; to states of emergency; so if one is looking for priorities one has to seek them where the emergency lies. To my mind there is no doubt that the great emergency in our country is high and rising unemployment, especially among our young. To eliminate this should be the prior goal of all our economic policies, and whenever we hear or read any policy prescription, we should test it against its likely effect on the overall level of employment.

In many third world countries unemployment is an insoluble problem because there is a vast reservoir of rural labour pouring into the town faster than it can be absorbed. We are more fortunately placed, because our agricultural labour force is already much reduced down to 20 per cent in Trinidad and Barbados and to 30 per cent in Jamaica. Neither is our problem the Keynesian deficiency of monetary demand which engrosses the attention of the large, nearly self-contained industrial economies; ours is a small population, with access to vast markets. Given top priority, we could achieve full employment in about a decade, and my purpose this morning is to look at the principal elements of the solution. Of course we can and should make work immediately on public projects in order to give employment and income to our fellow citizens, while we set our economy in order. When I say "about a decade", I imply growth of wholly productive employment of about 4 per cent a year, reaching full employment in about ten years without further need for special make-work programmes. This is well within our capacity.

There is no easy solution. The notion of priority implies that some interests have to be sacrificed to a higher gain. As we run through the catalogue we shall find that everything is difficult. and, in political terms, most of the things which need to be done may seem to be impossible. This may indeed be the case. Arnold Toynbee tells us that 20 previous civilisations have moved to inevitable destruction, and it may well be that to solve the problems of the West Indies is beyond our human capability. I do not believe this to be so, despite the clear failures of recent decades. So I think it well worth our time to try to understand what we have to cope with, and what weapons are available to us.

I make no apology for raising these matters at a Governors' meeting, since the main purpose of our Bank is to promote investment and thereby reduce unemployment. Our Bank, too, is making feasibility studies every day, especially in agriculture, in industry and in tourism, and our Bank must surely fail unless the economic background against which we operate is favourable to our effort. We depend as much as anyone else on the pursuit of effective economic policies, so general reviews of this kind are part of the tradition of the Annual Meetings of banks.

Exchange Rates

Since the situation is that our exchange rates, trade policies. money incomes and productivity levels are mutually inconsistent, the problem can be solved, conceptually, by operating on any one of these four variables, In practice, no one of these, taken by itself, is capable of solving the problem within the feasible rates of change. We need to operate on all four, in mutual support.

Take first the foreign exchange rate. Gross overvaluation, such as most of us suffer from, cannot in practice be cured without some measure of devaluation. However, devaluation raises the cost of living, and so generates increases in money incomes which raise domestic costs. If the increase in domestic costs is proportionately as great as the fall in the rate of exchange, the devaluation achieves absolutely nothing.

Some rise in money incomes is inevitable, but the rise does not have to be as great as the devaluation. Whether it is or not will depend on the level of community discipline. There are countries which can devalue effectively, as shown by a considerable change in their balance of payments. There are also other countries which cannot devalue effectively because they lack the necessary discipline to keep money costs under control in the face of increased prices of imports.

Where the cost of living is closely related to the foreign exchange rate, as it is in our area, some countries try half-devaluation, i.e, a system of multiple exchange rates. Importers, for example, may continue to pay $4.80 for a pound, but exporters may be given say $4.80 for every pound they bring in thereby stimulating employment in the export industries without raising the price of imports. Some multiple systems are very complicated, having a separate exchange rate for each of several types of imports and exports, tourism and other services. Administration then becomes complicated, and evasion and corruption spread. Moreover, the cost of living cannot be insulated; any system which effectively increases import substitution is going to raise the cost of living; and any system which makes exporting more remunerative is going to raise domestic prices by increasing domestic demand. So multiple exchange rates afford only temporary relief; as domestic prices rise and evasion spreads, devaluation is ultimately inevitable.

Much of the recent abortive discussion in the West Indies springs from the conviction that these territories do not have the necessary social discipline to devalue the currency effectively, with the result that devaluation would raise money incomes in the same proportion, and so have no effect on the level of employment. Actually no country can escape devaluation forever if its other economic policies are driving it in that direction. If it persists in clinging to a rate which gets more and more out of line, the change, when it comes is mammoth, as recently in Ghana. And if then its social discipline is inadequate, devaluation becomes an annual (or now in some case monthly) event, instead of a small adjustment to be made once or twice in a decade.

I do not know how much social discipline is possible in the West Indies, but other elements have also been in the back of our minds, three of which are erroneous. One is the belief that devaluation would move the terms of trade against US; which is true of tourism, but rot of our visible imports and exports. Another is the pre.Keynesian idea that the foreign exchange rate must be correct if the foreign exchange reserves are not diminishing. The balance of payments can balance at any exchange rate, at the expense of employment. One has therefore to determine where one's priority lies. A third thought, which we have retained from the nineteenth century, is the orthodox longing to duplicate the phenomena of the gold standard, by hook or crook. Actually, the orthodoxy among international bankers is coming steadily to be the reverse of this; namely that the appropriate relationship between the world's major currencies in our day is one of continuous floating. I am not arguing that currencies should float, or that we must do what other people do. But I do believe that we should try to cleanse our minds of the brainwashing of nineteenth century economic orthodoxies.

Foreign Trade Policy

As I have said, devaluation is not the only remedy. But if one is convinced that it will not work, one must then put even more effort into the other three possible solutions. The principal objectives of devaluation is to cut imports and increase exports. This can also be approached in other ways.

There is great scope for reducing imports. We import too much fish, meat, animal feedingstuffs, maize, cotton, vegetable oils, footwear, textiles, and light metal manufactures, to take just the leading items of which we could produce substantially more at home. CARIFTA enables us to export more to each other, and is an essential part of our effort to reduce imports from the outside world. We cannot solve our problem simply by reducing imports, partly because our natural resource base is inadequate, and partly because a growing population with a rising level of living is bound to put continuous pressure on imports. We cannot reduce imports absolutely. but we can over a transition period prevent imports from rising as fast as national income.

Since imports are bound to grow absolutely, our exports must also grow. The future for our agricultural exports is most uncertain. These have depended on special preferences and quotas in the UK, Canada and the USA whose continuance is increasingly in doubt; this will continue to be a major area of diplomatic activity. Our tourist industry still has great possibilities, especially if we can tap the mass tourist market, but growing hostility towards this trade on the part **of** our intellectuals casts a shadow of doubt over its future. The only sphere which offers us unlimited possibilities is world trade in manufactures. We continue to exaggerate the difficulties, and to over-emphasise the garment industry. As for the difficulties, one should note that Hong Kong ships half its manufactured exports to the United States and gets beyond tariffs and quotas, although its wage level and transport costs are substantially higher than ours. The opportunities outside textiles are immense. Hong Kong got its first electronics factory in 1961, with 54 workers; now employs more than 40,000 in this trade; has also huge numbers in plastics, toys and many other light industries. Why did this happen there and not here? World trade in manufactures is enormous, and has doubled every ten years; there is plenty of room for us if we try.

When an overvalued currency is keeping imports high and exports low, one can take counteracting measures to stimulate domestic production. The most important of these are the application of tariffs and quotas to imports, and the granting of subsidies to import substituting or to exporting industries. We have done some of this. We have a tariff system, but it was not designed to keep out imports, and our rates are low when compared with the rest of the third world. We also have a few quotas. Direct monetary subsidies to industry are rare, but we have various substitutes, including exemptions from taxation, and the free provision of government services. Looked at from the point of view of a policy to stimulate domestic production our trade armoury is rather amateurish, and clearly also not very effective.

Measures of this kind do little for exports; these depend on having an appropriate rate of exchange, since GATT frowns on direct money subsidies to exports. Quotas and tariffs can make an immense difference to production for the home market. However, like devaluation, they raise the cost of living, so this argument against the one is no less effective against the others, except that tariffs and quotas resemble multiple exchange rates rather than straight-forward devaluation. Given that one wishes to increase exports as well as to restrain imports, the current consensus of international opinion that foreign exchange policy should play a larger role in regulating foreign trade than tariffs or quotas or subsidies is probably correct. What cannot be right is to use neither instrument effectively.

Productivity

A country which simultaneously maintains an overvalued currency and neglects to use tariffs, quotas or subsidies in adequate measure could achieve equilibrium with till employment only by reducing money costs; i.e., either by lowering money income per head, or by increasing productivity.

There is certainly immense scope for increasing productivity in the West Indies. Our sugar costs much more to produce than Australia's, although our wages are a small fraction of hers. We get 4 tons of bananas per acre instead of 12 tons; 300 pounds of cocoa instead of 1,000 lbs; 800 lbs. of maize instead of 4,000 lbs., and so on all along the line in agriculture. Equally in manufacturing industry we would sell all we could produce if our productivity equalled that of Hong Kong or Singapore.

Our deficiencies are partly of training, partly of organisation and partly of capital.

In terms of numbers, our biggest training gap is in agriculture, where we have hundreds of thousands of people working who have had no agricultural training beyond what they pick up from overseers. Our small farmers ought all to have gone to agricultural institutes. Of course they would then not be content to farm two acres; they would need from 25 to 100 acres, according to their abilities and crops; and this is what they should have, since no community can hope to build a decent standard of living on 2-acre farms, unless the land is wet enough to yield three crops of cereals or vegetables in a year. This brings us into organisation. Land reform, coupled with a great increase in the number of farm schools, is an essential ingredient in agricultural productivity.

We are equally badly served in manufacturing industry. To begin with, in the industrial countries, the child begins to play with mechanical toys at home from a very early age. By the time he is ten he is thoroughly at home with nuts and bolts and springs and the elementary principles of traction. We ought to use our primary schools to give our children what they do not get at home, by putting into the schools mechanical toys, simple tools, wood to work with and clay, and inserting periods of play into the curriculum during which our young may, through their own playful curiosity and manipulative experience, become familiar with concepts that are fundamental to later factory practice. We also need, as is obvious to everybody, much more occupational training in the ages running from 15 to 18, both in our ordinary schools, and also in special post-secondary institutes for mechanics, secretaries, para-medical personnel, and a wide range of technicians. Our shortages of personnel trained at this level are a major cause of low productivity.

It is also clear that much of our finest brain power runs to waste. We have a substantial university population but it is recruited almost entirely from our middle class. Since our middle class is still tiny, most of our first class brain power is still locked away in the social class whose children do not get beyond primary school. We worry about the brain drain into foreign countries, but there is a much greater waste of brains right here at home. We ought to improve our methods for finding the youngsters of poor families who have first class ability; we should enrich this ability with special attention, and make sure that it goes all the way through to the top of the educational ladder. We are failing to mobilise and train enough of our first class talent; this is a basic cause of our low productivity.

In addition to more skill, we must raise productivity by employing more capital per head. This is true not only of manufacturing industry but also of agriculture, which will not hold its labour force unless its productivity permits earnings comparable with those of urban occupations. We need an immense investment of capital, both to bring productivity per bead in line with money incomes, and also to create new opportunities for employment.

It is tempting to argue the contrary; that our industries are not under-capitalised but over-capitalised. One can always make work by reducing productivity; somebody said recently that if the automatic telephone system were scrapped and the United States returned to manual operation, it would take all the adult women in the country to handle the current volume of calls. I fully agree that we ought temporarily to go in for a lot of make-work projects to get our young people off the streets. Some such as housing, would also be very valuable in themselves. But make-work is not a permanent solution to our problems. Having limited natural resources we have to live by foreign trade, and we can compete in foreign markets only if our productivity matches our wage levels; since wages are almost certain to go on rising, productivity must keep rising too. Also, even in sheltered industries, our objective is to keep raising our standard of living, which means more output per head. While temporarily making work, we must keep our eyes all the time on the conditions required for attaining full employment with the highest productivity which our resources permit.

One of these conditions is a high level of domestic capital formation. Over and above what may be invested in mining, which employs so few, we need to invest about 20 per cent of gross domestic product every year if we are to approach and hold till employment.

Where is this to come from? We are already excessively dependent on foreign investment, and unless we save more, we can solve our employment problem only by depending even more on foreign capital. This is a subject much overgrown with confusion. We are being fed with many slogans "black power," "ending neo-colonialism," "controlling our own destiny," "vesting our resources in the community" and so on. But if we are to provide employment for our young people we must either save out of our own incomes, or else depend on foreign capital. The precondition for realising all these comforting slogans is a much higher level of domestic saving; unless one is willing to sacrifice the employment of the poor to the chauvinist sentiments of well-paid intellectuals.

What has gone wrong? At our level of national income per head, that is to say excluding the earnings of foreign firms, we ought to be able to save nearly 20 per cent of national income, but we are nowhere near this figure. The strategy of inviting foreign investment which we have followed over the past two decades presupposed that we would use the occasion of the increase in national income which would result, to increase quite sharply the ratio of domestic savings. We would thereby first become self-sufficient in capital, and thereafter be able to buy the foreigners out. We have indeed had very substantial increases in income per head during these twenty years, such that by now we should no longer need foreign capital, except for major developments in mining. Jamaica seems to have seized the opportunity to raise its domestic savings ratio, but most of our other territories have let the opportunity pass by, and are proportionately as dependent on foreign saving now as they were when real income was only half as high.

Why have we wasted our substance in this way? In the first place, in so far as personal consumption goes, we are still a thriftless people. We are all trying to keep up with the Jones' and living to the limit of our borrowing capacity. In this we differ from say the average Japanese, who saves 20 per cent of this personal disposable income; but we are not very different from other third world people. Personal saving is low in the developing world, and will expand only as new standards of values and new institutions stimulate habits of thrift.

For this reason it is widely recognised that the secret of capital formation in poor countries, whether socialist or capitalist, is to have a high level of public saving, that is to say a wide gap between the public revenue and public expenditure on current account; in other words a substantial budget surplus, as well as substantial profits by public enterprises. This is effectively the only way to rid ourselves of dependence on foreign capital in the near future.

You will recognise of course how far we are from this. Many of our governments have no budget surplus at all, and in most the public enterprises are run at a loss, so that they are a drain on savings in other sectors, rather than a source of saving. The enormous expansion of the public revenues which has occurred over the past twenty years has been matched by an equal expansion of public expenditure on current account. Our population grows so fast that the budgets for schools, hospitals, prisons, housing subsidies and other government services are simply insatiable. On top of this, independence on a retail basis has brought a superstructure of overseas representation and continual attendance at international meetings which eats up a lot of money. Our governments are just as spendthrift as our people. So public saving fails us just as badly as private saving.

In the circumstances I see no immediate reduction in our dependence on foreign capital; on the contrary a substantial increase if any substantial inroad is to he made into current unemployment. But I would hope that we are capable of learning and could now set ourselves goals of saving, private and public, which will enable us to get ourselves out of this frightful situation within the next two decades. I call the situation frightful, partly because foreign capital is expensive; partly because the dependence is to some extent self-perpetuating, since a substantial proportion of saving comes from profits; and partly because it is politically explosive, since the slogan-makers emphasise the remuneration of the foreign capital which gives us employment, rather than our own failure to save out of the personal incomes and public revenues which the investment generates. We could have got ourselves out of this situation during the last two decades if we had tried. We shall have no excuse for failing to try during the next two decades.

Money Income

Finally we come to our fourth variable, money income per head. Money costs are a function of money income and productivity, and could be kept constant if productivity rose as fast as money income per head. Unfortunately this is almost impossible to achieve without control of money incomes. Annual increases in productivity are normally in the range of 2 to 4 per cent, whereas annual increases in money income per head tend to range much higher. Overvaluation cannot be rectified merely by increasing productivity; it calls also for restraint of money income.

This problem is universal in Western type democracies. It does not exist in the Communist countries, because there the unions have no bargaining power; the governments fix both wages and prices. A large number of third world countries, especially in Africa and Asia, have also got around the problem by clipping the powers of trade unions. Western democracies are almost without exception launched on the same road, under different names 'incomes policy," "guidelines," "wage freeze'," "Phase II"' and so on. It is highly improbable that the West Indies will escape having to adopt the sorts of laws and institutions which so many other kinds of countries seem to have found inevitable.

Experience teaches certain lessons. One is that a government cannot get away with simply freezing the existing distribution of income. Even in comparing one wage with another, some wages are too low, whether in relation to the cost of living, or because more recruits are needed in some expanding industries or occupations. A wages board must have a philosophy of relative wages, and flexibility to put it into effect. If it is to have moral authority, it must show that it recognises wrongs and is in the forefront of trying to rectify them; and not just waiting until strikes are threatened. Besides wage differentials, the ratio of wage income as a whole to national income is also of general concern. Every year when government, employers and unions meet to bargain about wages, the government is expected to say what it is going to do by way of taxation or provision of schools or other social services as the unions' price for acceptance of wage restraint. Attempts at wage control which do not embody an active policy to improve the distribution of income are bound to fail within the democratic context.

It follows, secondly, since changes in income distribution are required, that control of money incomes is more politically feasible if Output per head is rising than if it is falling. Then it is possible for everybody to be better off, some more so than others. Attempts to make some much better off at the expense of worsening the position of others always lead to a breakdown of society and to bloodshed. Redistribution of income and vigorous economic growth must go together.

Incomes policy faces greater difficulties in the West Indies than it does in Europe or North America. One difficulty is that imports enter to a greater extent into the cost of living here than there. A rise in the price of imports, whether due to market forces or due to devaluation, raises the cost of living, and has to be accommodated by higher money incomes. The cost of living need not rise by as much as the price of imports, but to prevent this requires smart footwork on the part of the authorities; a quick raising of wages in response to rising prices, combined with maintaining a differential between foreign and domestic prices. For a wages board, lagging behind or giving too much are equally disruptive policies.

A second difficulty is that some foreign owned industries can afford to pay much more than other industries. As we have seen, this is one cause of our troubles, since in doing so they destroy more employment in the other industries than they create in their own. If they are not allowed to pay higher wages there must be some other way of ensuring that an appropriate part of the wealth they create accrues to nationals of the country. The appropriate way is to charge what the economist calls a "rent," which may take the form of a royalty, or of special taxation on extractive industries. As oil-producing and copper producing countries have shown, there are many devices by which a government can get an adequate share of profits without having to pay excessive wages to the workers of one industry at the expense of employment in other industries.

Our third special difficulty is that it is not as easy here, as it is in Europe and North America, to squeeze those at the top and in the middle on behalf of those at the bottom. This is because of their greater mobility. We can squeeze those who live on rents, whether of land or ores, because they cannot take these natural resources away. But we cannot both attract foreign capital and exploit it; we can exploit what has been already invested, but will then inevitably discourage new investment. We can also not so easily exploit our professional classes nurses, doctors, engineers and so on as we used to, because, with the relative lifting of colour barriers all over the world, these can now get better jobs in other countries; better not just in money, but since our social and political climates are hostile to professional people, better also in working conditions and in job satisfaction.

Taking all this together, an incomes policy is just as necessary in this part of the world as it is elsewhere, but needs even greater sophistication if it is to work without curtailment of democratic liberties. If we fail to make it work, we may easily become one of those countries where the currency has to be devalued every month.

Conclusion

My theme is easily summarised. It is that our economic policies lack a crucial element: namely measures to bring our money costs into line with international prices. All of us who are concerned with making new investments and creating new employment and this is what the Caribbean Development Bank is all about are operating with our hands tied behind our backs because, in this crucial aspect, economic policies inhibit investment, and are inadequate to cope with this basic cause of unemployment.

Unemployment is our most important problem. We have mesmerised ourselves into thinking that it cannot be solved, and is therefore something that we have to live with, but this cruel resignation is unnecessary. We have not one solution, but four, corresponding to the four variables in the situation; the rate of exchange, foreign trade policy, productivity and incomes policy. We need more positive action on all four, since the feasibility of success through any one depends on what is happening simultaneously to the other three. Nothing here is politically easy; but to say that the solutions are politically impossible is either to doubt the West Indian genius for self.government, or more likely to assert that some other interest must have higher priority.

Social discipline is not genetically determined. It derives from history; but history changes every day, being altered by learning and adaptation. What is true is that we cannot adopt bold policies until they are widely understood; and they cannot be widely understood unless they are frequently discussed in public. And so I am glad to have the opportunity of making this contribution to public discussion today.