THE VIABILITY OF THE OECS STATES
STATEMENT BY
THE PRESIDENT, MR. WILLIAM G. DEMAS
TO THE BOARD OF GOVERNORS
AT THE ELEVENTH ANNUAL MEETING
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I. PRELIMINARY REMARKS

Mr. Chairman, Honourable Premier, Honourable Ministers, Distinguished

Governors, Observers, Guests:

I am happy to be attending the Eleventh Annual meeting of the Board of Governors of the Caribbean Development Bank here in the hospitable country of Antigua, where the First Meeting of the Board was held ten years ago.

We all know that Antigua, under the forceful leadership of its distinguished veteran Premier, is second to none among the borrowing member countries of the Bank and the Member States of the Caribbean Community (CARICOM) in its commitment to national development and integration at both the sub-regional and regional levels. We cannot overlook an act of crucial historical importance - that the original three-country CARIFTA Agreement was signed at Dickenson Bay, Antigua.

I have to note with sadness the passing of the late Dr. the Honourable Eric Williams, former Prime Minister of Trinidad and Tobago and former Governor of our Bank for that country. I will not seek to add to the many tributes paid to him from all over the Caribbean - except to record his outstanding contribution in both thought and practice to West Indian nationalism and Caribbean Integration and his resolute and steadfast identification at all times with West Indian and Caribbean interests - as evidenced, for example, by his country's financial support for our Bank and particularly of its less developed member countries.

II. INTRODUCTION

The Annual Report of the Bank for the year 1980 indicates the continuation of satisfactory levels of performance of our institution both as a Bank and as a Development Agency. I will merely draw your attention to the record level of disbursements for the year. I leave it to you to study the Report as closely as you usually do.

In this Statement I will confine myself to discussing briefly certain aspects of the development of the seven Leeward and Windward Islands in the 1980s. By the end of this year, five of them will be independent and no doubt the other two will achieve that status in a year or two. They will shortly be deepening, extending and rationalising their ongoing efforts at integration and cooperation through the formation of the Organisation of Eastern Caribbean States (OECS). They have always constituted a coherent sub-group within both the Bank and CARICOM.

These countries constitute a majority of the less developed member countries of the Bank and, in accordance with the Bank's Charter, their development deserves special attention. What I have to say should also have some relevance to the other less developed members of the Bank.

I begin with some remarks which seek to clarify the concept of viability of these countries and which make the point that viability can be achieved by a combination of planning and action at the national, sub-regional and regional levels.

I will then discuss some key development issues relevant to national efforts at development.

This will be followed by an examination of the role which sub-regional and regional integration and cooperation can play in promoting national development.

I shall end with a brief look at some of the implications of my analysis of the abovementioned issues for external aid and technical assistance to the countries of the sub-region.

III. CONCEPT OF ECONOMIC VIABILITY IN THE OECS COUNTRIES

The starting point must be the well-known fact that the seven countries are very small in size, with populations ranging from 120,000 in St. Lucia to 12,000 in Montserrat and with land area ranging from 305 square miles in Dominica to 39 square miles in Montserrat. They have a combined population of 520,000 and a combined land area of 1,150 square miles. These countries can only be described as "micro-states".

At the same time, per capita incomes, although not extremely low by the standards of the world's poorest countries, tend to be somewhat less than the average for the middle-income countries of the Third World - although the Physical Quality of Life Index (PQLI) - which brings together measures of life expectancy, literacy and infant mortality rates - is about the same as that for the world's middle-income group of countries. In short, the seven countries are lower-middle-income developing countries with a rather high PQLI level.

It is also very well-known that, because of their very small size, these countries face certain serious constraints to their development:

a. very small size of markets for industrial production;
b. very limited range of natural resources;
c. diseconomies of small scale and lack of "critical mass" in public administration and in economic and social overhead capital. Such diseconomies of scale lead to high per capita cost of both public administration and economic and social infrastructure;
d. inadequate levels and narrow range of trained human resource skills;

e. grossly inadequate national savings - income cases reflecting itself in consumption levels that are higher than total production as measured by the Gross Domestic Product (GDP);
f. extreme external economic and financial dependence - including in some cases the receipt of grant-in-aid to balance their recurrent fiscal budget; and
g. susceptibility to natural disasters (mainly hurricanes, floods and volcanic eruptions) which devastate the entire countries because of their very small size.

These constraints can be summarised as absence of economic scale and lack of "critical mass" in many activities which bear on economic and social development.

A further complicating factor during the 1980s lies in the expected increases in the rate of growth of the labour force consequent on the likely reduction of emigration opportunities.

In addition, the islands suffer from lack of flexibility and adaptability of their internal production apparatus in face of adverse economic developments of external origin. This fundamental constraint of under-development also has to be overcome in addition to the constraints peculiar to very small size already mentioned. In this respect, as in so many others, the seven Leeward and Windward Islands are microcosms of the relatively larger borrowing member countries of the Bank. Both groups of countries have economies that remain fragile and highly vulnerable to adverse external economic developments - the hallmark of underdevelopment.

Naturally, the question of the economic and financial viability of these very small economies always lurks in the background -like a spectre constantly haunting the West Indian consciousness.

Let us begin by noting that in a certain sense the question of economic viability of a country is a non-issue, if by viability we simply mean the ability of a formally sovereign State and its people to survive. This is surely possible.

The real issue is whether the level of living to which the people of the State can reasonably aspire can be achieved on a sustainable basis, without "excessive" external financial and economic and therefore probably political dependence and loss of effective (as distinct from formal) sovereignty.

I am not saying that the seven islands can entirely dispense with foreign assistance on concessional terms, with trade concessions granted by the developed countries, and with foreign private investment and technology flows in fair terms. It is recognised in the discussions on the New International Economic Order

(NIEO) that developing countries generally, and in particular disadvantaged developing countries such as the small developing island economies, will need special concessions and special development opportunities from the international community for at least the remainder of this century. The issue is one of degree - whether the present "excessive" degree of external financial and economic dependence can be significantly reduced by the end of this decade. To a somewhat less severe extent this is also the problem facing the relatively more developed borrowing member countries of the Bank and of CARICOM.

The fundamental requirement of viability is a process of sustained increases in production and productivity in all sectors of the economy in a reasonably balanced way. In other words, can the agricultural, industrial and tourism sectors of these islands grow on a sustained basis at the rates required to give the people of the State within a reasonable time-frame the level of living to which they can realistically and reasonably aspire? I have no doubt that the answer is yes.

For one thing, it is generally agreed that the potential for significant increases in production for import-substitution at the national, sub-regional and regional levels as well as for exports to extra-regional markets exists in all three sectors and in many of the islands such potential also exists in some subsectors such as forestry, fisheries, agro-industry and renewable sources of energy.

For another, there is no doubt that the countries could also achieve a higher degree of conservation of traditional imported hydrocarbon energy.

And third, no one doubts the great potential for significant improvements in all the islands in the quality of the human resources through considerable increases in levels of training of all types and at all levels.

A higher level of national economic management and planning than in other developing countries is required to overcome the many disadvantages of very small size of both population and land area and so realise the full production potential of these islands. These disadvantages can be partly overcome through increasing the level and range of trained manpower available; better management in both the public and private sectors; a greater degree of entrepreneurship in the private sector; and more effective efforts to mobilise domestic financial resources for domestic investment.

Not least, there is the fundamental point that in these countries the national development effort can be complemented and reinforced by appropriate planning and actions at both the sub-regional and regional levels and this can do much to ease the constraints of very small scale and absence of critical mass in most areas of relevance to national development.

Finally, an argument by analogy may be introduced here. I am aware of the shortcomings of such arguments from a strictly logical point of view. But at least they can sometimes have the merit of suggesting certain possibilities; and this is all that is intended here.

Although Barbados is smaller in land area than some of the individual Leeward and Windward Islands (with its population about one-half that of the combined population of the seven Islands), it has a per capita income about three and one-half times that of the average of the seven countries and PQLI quite close to that of many developed countries. It has also been able to realise its production potential in all sectors to a much greater extent than the individual Leeward and Windward Islands. While I do not hold the popular view that Barbados has very limited natural resources, the fact is that this small West Indian country has been able to achieve a high per capita income and PQLI, is able to meet many of the basic economic and social needs of its people and has a national savings ratio which finances a reasonable proportion of both public and private sector investments.

If Barbados has been capable of such economic and social progress, there is no reason why the seven Leeward and Windward Islands, acting as far a possible as a sub-group and within the framework of CARICOM could not achieve a similar degree of economic and social progress over the next two decades by appropriate development policies and approaches - particularly in the field of trained manpower, economic management, the encouragement of savings in the public and private sectors, and the promotion of entrepreneurship in the private sector.

It should, however, be noted that Barbados, in spite of its remarkable economic and social progress during the last two and a half decades, still has to tackle the fundamental problem of underdevelopment facing all the Caribbean and many other Third World countries - particularly those that are small in size and/or have a narrow range of natural resources, whatever their level of per capita income or PQLI - namely, a fragile and vulnerable economy and the consequent need for its production apparatus to become more flexible and resilient in the face of adverse economic developments of external origin.

IV. NATIONAL EFFORTS AT DEVELOPMENT

a. <u>Establishment of a Framework for Systematic Development Efforts (or National Planning)</u>

The countries need to plan more effectively for sustained expansion in production and productivity, for more equitable distribution of income (largely through the creation of productive employment) and therefore for increased living standards for all the people. Already about five of the countries have small planning agencies.

Planning should not be viewed as an imposition by the Government of a rigid set of controls and regulations on the national economy. Rather, it should be viewed as establishing a framework for more systematic national development efforts. This entails:

i. setting up sensible development objectives and priorities and the formulation of a mutually consistent set of national development policies and associated sectoral programmes and projects fitted into the resources expected to be available;
ii. the elaboration of a public sector investment programme for a three to five-year period, with matching financial and other resources;
iii. wherever data permit, the making of some rough "indicative" projections of private sector investment and output with certain specific important projects being identified; and
iv. specific policies, measures and procedures to stimulate and encourage investment in high priority projects by the local and foreign private sectors.

Moreover, national plans and public sector investment programmes should be "rolling" plans and programmes where every year the plans and programmes are carried forward by one year. This permits flexibility and adequate response to changing circumstances (including those in the outside world as well as those resulting from local natural disasters) without abandoning a logically consistent and systematic framework for development.

There are three important beneficial results which can flow from such a systematic approach to development in the islands. The first is the imparting of a sense of direction and coherence to the entire development effort of the country. The second is that external aid for the financing of specific development projects could make a better contribution to the overall development of the country. Third, such a systematic approach could be used to influence and convince donors of what the real sectoral needs and gaps are and to obtain their coordinated assistance. The same is also true for external technical assistance and training of personnel. The needs in these two areas could be much better identified within the frame-work of a systematic approach to development. Indeed, external financial assistance, technical assistance and training efforts could all have a greater impact on development within such a framework. Indeed, for ex-ternal assistance to be effective, the country must have a clear idea of where it is going and what it wants.

Public sector investment programmes should be balanced as between the directly productive sectors, economic infrastructure and social infrastructure.

In such programmes the quality, rationale, economic and social justification, utilisation and priority attached to each investment and how it relates to existing assets and other new investments are all critical. Thus, for instance, proper preventive health care could have more meaning and usefulness than construction of a well-equipped and fully staffed modern hospital. Similarly, the use of existing school buildings through the introduction of a two-shift system would be more meaningful and less costly in terms of capital expenditure than the construction of new schools.

In this Statement, it is not my intention to go into the content of sectoral production programmes. But I wish to draw attention to the importance of proper planning in the Energy sector - a sector which is of crucial importance to all oil-importing developing countries during the next two decades. Planning in this sector involves "national energy accounting" (that is, the collection of information on a country-wide basis on the sources and uses of all forms of energy); rigid conservation practices including appropriate pricing policies; the close examination of the economies of various alternative sources of primary energy for generating electricity; and the systematic search for both conventional and alternative renewable sources of energy.

Different types of public sector projects ought to be financed in different ways. Thus, directly productive projects - that is, projects in Agriculture, Industry, Energy and Tourism - and self-liquidating economic infrastructure projects - for example, ports, airports, electricity, telecommunications (as well as certain "social" projects such as housing, water and sewerage) -should be financed on a loan basis. In the case of these directly productive and self-liquidating infrastructure projects, the governments could borrow soft and make the funds available to the project at commercial rates. On the other hand, social and non-self-liquidating projects such as public health programmes, hospitals, schools, etc., should be financed on a grant basis. Whatever the sources and nature of financing, the government should ensure that its overall public sector investment programme is balanced and optimal and within the country's financing and debt-servicing capacity without putting severe strains on its fiscal position.

Although the Bank will continue its emphasis during this decade on the financing of the productive sectors and directly supportive infrastructure projects, the Bank would be prepared to work with governments and other donors in evolving balanced development programmes which donors, institutions and borrowers could realistically respond to.

But it cannot be emphasised too strongly that it is not enough to have a well-conceived and balanced public sector investment programme consisting of specific high priority projects. It is also necessary that such projects be backed up by the right policies and the right operating climate such as availability of trained and trainable labour, various kinds of incentives for different sectors of production, entrepreneurial drive and a properly functioning streamlined public sector with simplified and expeditious procedures.

The issue of entrepreneurship is a key one. Since the seven islands are greatly lacking in entrepreneurship, it is necessary to stimulate the local private sector in various ways. One way is to develop government policies and procedures favourable to the development and exercise of entrepreneurship. But, particularly in the case of the small-scale and medium-size local private sector, it would be necessary for the governments to go further and to facilitate new risk investment in production instead of distribution of imported goods by providing what may be termed the "functional equivalents" of the various attributes of entrepreneurship - project identification and preparation; the provision where necessary of "venture capital" and the creation of industrial "extension" services aimed at improving management, supervision of workers, cost accounting, access to the right technology, plant layout, and advice on domestic, regional and export marketing. Such industrial "extension" services could be provided for all the islands by a Pool of Experts.

At the same time the local private sector must increasingly turn from distribution to production of goods and services and learn to become more self-reliant over time vis-a-vis both the government and the foreign private investor. In other words, no local private sector worth its salt should seek to become pampered by the government or to have its legitimate role in national development performed preponderantly by foreign private investors.

The local private sector would also not really be self-reliant and dynamic if, as is the case in so many of the islands, it possesses large tracts of unused or otherwise underutilised land - a classic example of lack of entrepreneurial drive. As we shall see later, perhaps the answer to this particular problem might have to be found in a more effective system of land taxation.

I emphasise the local or national private sector since the seven islands would find it difficult to develop genuine national economies if the bulk of private investment were always to come from overseas. Once more the very difficult problem of stimulating local entrepreneurship presents itself in this context.

Foreign private investment is certainly needed. But there are two problems here. One is the local ability to distinguish between unscrupulous and often sinister "modern buccaneers" who are merely out to exploit or "rip off" the country in the crudest possible way rather than to contribute to its genuine development. Why does this type of charlatan infest the West Indies so much as against other areas of the developing world? I must confess that I do not know the full answer; but perhaps this may be yet another instance of micro-states being peculiarly vulnerable to foreign predators of all types.

The other problem is the need to ensure that the country makes the most advantageous arrangement with the genuine foreign investor.

In both these areas, a high degree of vigilance and access to information on the part of the governments of the seven islands is required. Here, training of local personnel by impartial United Nations bodies such as UNIDO, the UN Centre on Transnational Corporations and UNCTAD to improve their negotiating capacity on foreign investment and the transfer of technology should be very useful.

The final issue in this section of my Statement concerns the relationship between the government and other groups in the society in systematic efforts at development (or national planning). For such efforts to have meaning, there would have to be widespread participation of the public in the planning process in terms both of formulation and implementation. Thus, the local private sector, the trade unions, farmers, women and youth must be involved at all stages in the process. One advantage of this is that it should facilitate not only the identification and preparation of projects of all sizes and in all sectors of the economy and in all parts of the countries, but also serve to mobilise enthusiasm and commitment at all levels to national development.

b. <u>Attaining and Maintaining Fiscal Balance</u>

I define fiscal balance as the ability of the central government in particular and the public sector in general (that is, both the central government and the government-owned public utilities and other enterprises) to generate a surplus on current account on a sustained basis. The level of the surplus (or public sector savings) should as a rough benchmark be at least 5% of GDP, the exact level being dependent on the size of the public sector in relation to the whole economy and the amount of contribution which the public sector has to make in the financing of its capital expenditure programme.

Historically, most of the seven States have consistently generated deficits on current account, with such deficits being financed initially from recurrent grant-in-aid from the UK Government and increasingly now by borrowing from the domestic commercial banking system and to a lesser extent from the Eastern Caribbean Currency Authority (ECCA) and from the various IMF financing facilities. Finally, and most unfortunately, increasing use is now being made of the funds generated by National Social Security Schemes, with inevitable adverse consequences for the future viability of the Schemes in terms of meeting their legal obligations to contributors.

The capital programmes on the other hand have been financed by capital grants, mainly from the traditional donors (Canada and the UK) and increasingly now from grants and soft loans from non-traditional donors and lenders such as the European Development Fund (EDF), Trinidad and Tobago, Venezuela and, last but not least, the Bank.

Two technical points arise in relation to the definition of "capital" or "development" expenditures in these countries. The first is whether the need for "deferred maintenance" and reconstruction of government overhead capital assets such as roads, schools, hospitals, clinics, etc., brought about by a tight fiscal situation in the past should be regarded as falling under recurrent or capital expenditure. The pragmatic view is that initially, while the country is trying to correct its situation of fiscal imbalance, such expenditures should be regarded as of a capital nature and eligible for external capital assistance on a grant basis. The second issue is whether development expenditure on a vital programme such as Agricultural Extension Services should be regarded as current or capital. Again the same pragmatic approach should be taken.

Why should current surpluses in the public sector be generated? The first answer is that the system of recurrent grant-in-aid is being phased out and it is therefore no longer an option.

The second answer is that governments which have fiscal deficits and succeed in getting capital grants from donor countries for social projects such as schools and hospitals are almost certain to incur in future even bigger current deficits because the creation of such new facilities would in future give rise to the need for higher recurrent expenditure associated with the operation and maintenance of such facilities.

Thirdly, borrowing, whether local or external, to meet recurrent expenditure or to create assets which are not revenue-earning is not prudent since debt is accumulated and has to be repaid while no provision is being made for revenue-earning assets, the income from which can be used to meet these obligations.

Fourthly, local borrowing to finance such expenditures pre-empts resources which might otherwise be available for use by the productive private sector, thus serving to depress overall economic activity in the medium and long term.

Fifthly, such actions are inflationary and/or harmful to the balance of payments as they involve spending of financial resources while no marketable goods and services are being produced.

Sixthly, some local contribution to the financing of capital expenditure projects ensures the commitment of governments to the efficient and speedy implementation of such projects and subsequently to their economical operation and maintenance.

Finally, it is necessary to reiterate the fundamental point that the bigger the share of the public sector in the economy, the higher must public sector surpluses on current account be.

The answer to this situation of public sector deficits is that revenues must be gradually increased, recurrent expenditures rationalised and, where feasible, reduced and administration of both expenditures and revenues be made more efficient. (It should be noted parenthetically that while recurrent expenditures could be reduced over time by gradually reducing public sector employment, they cannot often be reduced in the short run - except by the unintelligent method of maintaining certain vital programmes by retaining personnel but cutting essential supplies such as materials for road maintenance and consumables for schools and hospitals).

The ratio of Central Government revenue to GDP in the seven countries was, on average, 26% over the period 1974 to 1978. It should be stressed that this compares favourably with the position in many of the world's lower-middle and middle-income developing countries. In this situation the recurrent budget deficit tends to reflect diseconomies of very small scale and lack of critical mass in administration and economic and social overhead capital because of limited population.

The fundamental answer to the problems of fiscal balance is to increase production of goods and services in all sectors of the economy so that, at any given ratio of taxation to GDP, economic growth would automatically result in higher tax revenues in both financial and real terms, with "real" revenues growing pari passu with "real" growth in production. It should be noted in passing that the need for this becomes greater where IMF

Extended Fund Facility medium-term credits are made available to these countries and are used for current budget support.

But in addition other steps can and should be taken.

The first remedy is an improvement in the efficiency of assessment and collection of existing taxes. I am convinced that this can best be done on the basis of a Common Service in Tax Administration for the group of seven countries.

The second remedy is to give serious thought to the introduction of new taxes, including Land and Property Taxes and Taxes on Capital Gains arising from the transfer of land, thus helping to encourage the use of idle or underutilised land. Consideration should also be given to increasing the effectiveness of taxation of income and similar flows from foreign companies operating in the countries. This is possible without diminishing the incentive for such investments.

A third approach would be to make the structure of taxation on the consumption of goods and services more "progressive" in that the more luxurious and "inessential" the good or service, the higher the percentage rate of tax. (The scope for this might sometimes be diminished through its possible effect in encouraging smuggling).

Above all, it cannot be too strongly emphasised that, to the extent that Public Utilities make deficits in their current operations, such deficits would have to be financed ultimately from tax revenue. So that an important aspect of improving the fiscal balance is that all Public Utilities and other Public Enterprises should be made self-financing and able to earn surpluses as early as possible. This will also have the obvious effect of increasing public sector savings in the economy.

On the expenditure side, "zero-based" budgeting could be introduced, with very good justification having to be given for every dollar of budget allocation requested by every Ministry or spending agency.

An essential problem in relation to fiscal balance is the problem of the inexorable increase of wages and salaries for public sector employees to meet increases in the cost of living - in large measure deriving from increases in the prices of imported goods and services.

Let me say categorically that seeking to "index" the money incomes of all sectors in the community or of any particular sector, where increases in the cost of living derive wholly or mainly from increases in import prices, is to court economic disaster. In both the MDCs and LDCs, the simplistic approach of seeking to justify increases in wages and salaries on the grounds of increases in the cost of living has no basis in strict economic logic - even if from a practical point of view an increase of 1% in the cost of living might have to be accompanied by a ¼% or 1/3% increase in wages and salaries. Putting the matter in somewhat more technical terms, one cannot hope to be compensated for a drop in real national income resulting from a deterioration in the terms of trade. Everyone in the community must share the drop in real income under these circumstances.

It should be carefully explained to the public sector employees that if they were to be fully compensated for increases in the prices of imported goods and services, this would make life more difficult for other persons not so compensated, would reduce public sector savings, would cause the emergence of inflationary and balance-of-payments pressures and would, if anything, worsen the present and future employment situation.

All of this stands the best chance of being done within the framework of a general Incomes Policy (which is admittedly politically difficult).

c. Mobilising National Savings and Minimising External Debt

The seven countries have traditionally had low savings ratios. In 1965 the ratio of consumption to GDP for all the countries was 92.8%. This ratio increased to 111% by 1971 and in 1978 was estimated to have fallen back to 97.6%. In the sub-group as a whole only 2.4% of GDP was saved. This is a somewhat alarming state of affairs in countries where per capita incomes range from US$450 to US$800.

The ratios of investment to GDP in the LDCs have been recently around 28% to 30%. This is a reasonable rate of capital formation. The financing of this level of investment came from four principal sources:

i. savings of foreigners made available to governments as grants;
ii. savings of foreigners lent to the public and private sectors (including nearly all the loans from the Bank);
iii. savings of foreigners who engage in direct foreign investment in hotels, manufacturing enterprises; etc.; and
iv. savings of nationals resident abroad who remit funds to create capital formation at home - for example building of homes.

Thus nationals at home hardly contribute anything to the financing of investment and the dynamics and basis of economic growth were both of external origin.

This state of affairs is inherently unsustainable if the countries hope to become more self-reliant. Can a country which strives for political independence and the maintenance of its effective sovereignty be so extraordinarily dependent on external sources for financing investment?

Whatever may be the answer, it is clear that this state of affairs is undesirable and should be urgently reviewed. Some traditional benefactors appear to be poised to cut back their aid - at least in real terms.

Difficulties in traditional donor countries are not only affecting migration opportunities but also the ability of migrants already there to remit funds. Moreover, the longer the migrants stay abroad, the weaker their ties with relatives at home and the less feeling of obligation to them. And the prospects also point to a reduction of opportunities for emigration.

The only answer is that the countries themselves must generate a reasonable level of savings so that a reasonable proportion of investment could be locally financed.

In any event, traditional and new foreign donors are increasingly, particularly within the context of the Caribbean Group, coming to use performance as a criterion for the availability of aid.

Moreover, the easy availability of foreign savings destroys local initiative to make the necessary efforts and sacrifices required for genuine national development.

Let me stress that I am not advocating the cessation of reliance on foreign aid and foreign private investment. I am simply saying that the present balance between foreign savings and national savings needs to be adjusted. This could well mean reasonable increases in foreign aid and foreign private investment in real terms accompanied by substantial increases in the levels of locally financed investment.

There are many ways of increasing the levels of national savings.

At the public sector level, I have already alluded to some means; but in a mixed economy the public sector alone cannot mobilise all the savings required for development. It can, however, devise appropriate policies and establish a framework to induce progress in this direction, since the personal and corporate sectors have to contribute to the savings mobilisation effort.

Life insurance is an obvious source of personal savings. But Social

Security or national Insurance Schemes are also helpful. Bond Issues to attract both sources of local savings could be used to finance part of the cost of productive or self-liquidating government development projects and so reduce the need for contracting external indebtedness.

Adopting realistic interest rate policies which will encourage saving flows and which do not allow the saver to so blatantly subsidise the investor or the intermediating mechanism should be areas worthy of examination.

In particular, the situation in which low or negative "real" interest rates (that is, taking account of inflation) on savings deposits in the commercial banks, coupled with high operating "spreads" charged by these banks, need more investigation by the authorities.

The payment by governments of lump-sum retroactive salaries and wages during periods of heavy spending such as Christmas is obviously undesirable. This practice not only reduces the potential for maximising savings by government employees but also has an adverse effect on the international reserve position of the country. One would think that both savings institutions and government itself would offer incentive packages to try to convert these back payments into savings. Why could not governments offer to make such retroactive payments in the form of governments offer to make such retroactive payments in the form of government bonds which could be converted at any time by the holder for the purposes of home building or improvement and provision of his or her children's education? Such bonds could be provided with other attractive features such as higher interest rates and tax incentives.

Because of the presence of financial intermediaries, the financial savings of one group may not necessarily be converted into productive investment or indeed any investment at all. This seems to be the case in the seven countries where the commercial banks, which are the main financial intermediaries, tend to channel financial savings mobilised from one group to support the imported consumption patterns of other groups. Such patterns take the form of lending to the personal sector for hire purchase credit, to the distributive trades for financing imported consumer goods and to the government sector for meeting current account budget deficits. Thus, the commercial banking system is predominantly geared inadvertently or otherwise to financing of imports.

Consequently, the onus is on the authorities not only to mobilise financial savings but also to ensure that a large proportion of these are converted into long-term productive investments rather than into unsustainable levels of consumption, a large part of which takes the form of imported goods and services.

The governments themselves are not blameless. Savings mobilised through Social Security Schemes in a number of cases are channelled directly into financing the public sector deficit or what would not appear to be priority or productive public sector investment.

It is imperative that, instead of the major assets of these Schemes being lent to the Government for such purposes, they should be placed in loans to viable productive projects which can service the debt from internal cash generation, while at the same time increasing productive activity and employment creation.

Even if the level of national savings is sharply increased, there will always be need for the countries to contract external debt - either directly held by the government or guaranteed by it. Certain broad guidelines can be presented here.

First of all, external debt should as far as possible be contracted to finance the direct and indirect foreign content of the capital cost of projects which are productive, self-liquidating and either foreign exchange-earning or saving. Where this is so, the project could service its foreign exchange liability and hence minimise the need for drawing on whatever foreign exchange reserves may be available. On the other hand, social capital expenditure should increasingly be financed from budget surpluses or from grants from donor countries, or from some combination of the two.

Secondly, countries should try as much as possible to seek to raise loans in a currency in which there is a fixed or stable parity with the local currency so as to minimise the "foreign exchange risk".

Thirdly, consideration should be given to the financial terms of the loan - that is, the grace and repayment periods, the method of repayment (for example, foreign currency, local currency or barter arrangements), the interest rate on the loan and other financial costs such as supervision and commitment fees, etc. On the other hand, short-term loans - and particularly such loans denominated in foreign currency - at high interest rates should be scrupulously avoided. To resort to such borrowing can in a few years create tremendous fiscal and balance-of-payments problems for the country. While accommodation may initially be available from ECCA, these problems will soon arise.

A careful analysis should be made of hidden costs and hidden benefits associated with a loan. Thus, for instance, apart from the usual benefits associated with softer borrowings from multilateral lending institutions (such as the Bank), there are additional benefits associated with technical competence in project design, preparation and appraisal which these institutions provide. Thus, a development lending institution tries to ensure that the project is properly prepared and appraised and will make a positive contribution to, and bring about lasting development in, the economy. Further, and this is not often realised, the lending institutions may impose conditions to facilitate achievement of the full developmental benefits in terms of improvement in the economy (for example, competent management, adequate levels of staffing, the need for the project to generate financial surpluses and the easing of price controls by governments so as to provide more incentives to production). What is more, the lending institution can allow itself to be used as a scapegoat when politically unpopular decisions are imposed - for example, the raising of public utilities tariffs. (I may add that the Bank does not mind being used as a scapegoat in these circumstances!)

At the present time, the level of external public debt (or publicly guaranteed debt) of the seven islands which stands at US$68 million, gives no cause for concern as it represents only 19% of GDP while annual debt service is only 1.4% of exports of goods and non-factor services. The only concern in some cases is that the debt was contracted to finance the creation of infrastructure which may not necessarily have been self-liquidating.

d. Increasing Absorptive Capacity

Absorptive capacity has two dimensions. The first is well-known and refers to the capacity of a country to quickly implement capital and operating programmes required for continuous growth and development.

The second is just as important. It refers to the ability to utilise existing assets more fully and productively. The first part of the concept is what donors and lending institutions are principally concerned with. But the other part of the concept should be of greater interest and more importance to the country.

Another factor to be borne in mind is closely related to the country's goals. Thus, a country with little interest in improved standards of living for its people might have a very limited problem with absorptive capacity, while a country with significantly more financial and manpower resources but with ambitious goals can have a serious absorptive capacity constraint.

Obvious but essential ingredients of absorptive capacity are the availability of qualified and appropriate skills; capacity for management and organisation; some basic (but not necessarily complete and perfect) economic and social infrastructure; and entrepreneurship. It is therefore basically a question of the existence of trained manpower, management and organisation, some infrastructure and entrepreneurship.

A sustained increase in absorptive capacity is something that can only be achieved in the medium and long term. However, apart from the need to establish the groundwork now to obtain this objective, there are other short-term measures which can be used to effect some improvement in this situation.

These include better organisational arrangements by the Government with regard to the Project Cycle - such as setting up of a small Project Unit in either the Ministry of Finance or Planning which would coordinate and expedite the execution of projects and receive regular reports on project implementation and report regularly to either a Cabinet sub-committee or to the full Cabinet, as the case may be. The staff of this Project Unit should also have some familiarity with project identification, preparation and appraisal. It should also ensure that appropriate personnel from relevant ministries and government agencies should participate fully in the project preparation and appraisal being done by the funding agency. The Bank itself is now financing, along with IDB and EDF, training in all aspects of the Project cycle through its Project Administration Training Unit.

The unavailability of appropriate skills at existing rates of remuneration has often been cited as contributing to the difficulty of recruiting the necessary expertise.

On the other hand, it has been argued that to raise the level of remuneration of persons with skills in various technical fields such as engineering, agronomy, accounting, management, etc., can put severe pressure on public sector current expenditure by exciting demands for similarly higher levels of remuneration by all other groups in the public sector.

The situation is not, however, all that bad since professionals probably need job satisfaction as much as they need adequate levels of remuneration and the former can, to a large extent, substitute in part for the latter. Another approach might be to give short-term contract appointments to such persons in scarce supply.

Thirdly, external agencies could be requested to "top up" the salaries of such persons for a specific period of time. But this again is likely to be followed by demands from the rest of the public sector for adjustment in their own salaries financed by the public sector itself. This situation would be sustainable only if over a period of time the government could succeed in reducing the numbers employed in the public sector through attrition and a deliberate policy of not filling vacant inessential posts while the productivity of public sector employees is actively encouraged.

Finally, such scarce persons can be obtained through the establishment of Pools of Experts and Common Services organised on a sub-regional or regional basis. This point will be further developed shortly.

Relevant training programmes can also help in upgrading the level of manpower. But a word of caution should be sounded. A number of institutions and donors, including the Bank, have in recent times recognised the need for training and have been making training opportunities available to the countries, particularly in project-related areas. Although the Bank has been trying with some success to coordinate such training efforts, the present circumstances under which training now takes place have serious shortcomings - principally stemming from the lack of systematic approaches.

First, the ease of availability of such training reduces the perception by participants of the importance of the training. In some reported cases, persons are recommended not because their jobs require the specific type of training involved or there is the intention to deploy the trained person in an area appropriate to the training received, but merely because it provides a reward and break for long-serving and loyal public servants.

Secondly, given the limited availability of personnel, such training opportunities can serve to worsen the existing staff shortage.

It is therefore imperative that governments evaluate, on a case-by-case basis, the need to take up the various training offers, ensure that the most capable and relevant person is recommended and that the person trained will be placed in a position to use the training received to make a real contribution to improved performance and output.

Here again we must emphasise the importance of systematic national planning which would include a determination of what manpower resources are available, when they will become available, what bottlenecks exist and how they can be eliminated or minimised, etc. Training, however well-intentioned, outside the framework of a national plan, is likely to be of little benefit to the country.

V.

VI. SUB-REGIONAL AND REGIONAL EFFORTS AT DEVELOPMENT

We have seen that national planning (or, if you wish, systematic efforts at national development) is a must. But particularly in these micro-states, there is also considerable scope for a pooling of resources and efforts through planning and action at both the sub-regional and regional levels.

Given the background of extremely small size, diseconomies of small scale, absence of critical mass in many areas, limited markets, land area and human resources in all of the LDCs of the Eastern Caribbean sub-regional and regional approaches in a number of activities are obviously desirable.

Already there exist sub-regional institutions and activities such as WISA, ECCM, ECTA, a common Court of Appeal and a Common Directorate of Civil Aviation. The East Caribbean Common Market (ECCM), which envisages a very high level of economic integration among the islands (virtually amounting to an Economic Union), and WISA are to be consolidated and upgraded in the form of the proposed OECS. This would further expand areas of coordination, common policies and joint actions by providing a framework for Common Services, Pools of Experts, joint external representation, harmonisation of foreign policies and joint approaches to Tourism and Investment Promotion. The OECS would be a major step forward in promoting coordinated development, availability of scarce high-level manpower and increased external bargaining power and therefore greater effective (as distinct from formal) sovereignty of the member states of the subgroup. Moreover, the Treaty envisages that in all relevant areas sub-regional efforts and actions will be set within the framework of the wider Caribbean Community.

At the regional (CARICOM) level there is the Caribbean Community itself and its associate institutions such as CFC, WISCO, LIAT, UWI, CARDI, CXC and the Bank itself. In addition, we should be reminded that the Treaty of Chaguaramas establishing the Caribbean Community provides a Special Regime providing special concessions and special development opportunities for the relatively less developed countries which, with one exception (namely Belize), will all soon become members of the OECS.

We can now give some examples of coordination and cooperation at both the sub-regional and regional levels which would involve greater benefits and/or lower costs for the seven islands than a single-country approach.

The extremely small domestic markets of the islands create the necessity for the promotion of industrial development on a sub-regional and regional basis.

The ECCM Industrial Allocation Scheme (already in effect but in need of refinement) and the possible formulation and implementation of a sub-regional Agricultural Development Programme for the seven islands, within the framework of the CARICOM Regional Industrial Programming effort and the Regional Food Plan, respectively, are cases in point. Moreover, exports of both manufactures and non-traditional agricultural products to extra-regional markets can and will be facilitated by joint actions at both the sub-regional and regional levels.

In the very costly fields of external representations and the promotion of Tourism and Foreign Investment, the benefits of joint approaches at both the sub-regional and regional levels are manifest.

Almost by definition, air and sea transportation - sub-regionally, regionally and internationally - is an area which is a must for coordination at both OECS and CARICOM levels in the interests of saving costs and maximising benefits.

Yet another example of the beneficial effects of integration and coordination at the sub-regional level is the ECCA, the scope of which it is proposed to increase shortly. An increased scope for this institution serving the entire sub-region is potentially rewarding.

It is rewarding because seven separate sovereign or soon-to-be sovereign States will be collaborating in one sub-regional monetary institution which will have many of the characteristics of a Central Bank. This presents a great challenge to the LDCs of the ECCM.

It would be particularly rewarding in that, given the almost universal misuse of Central Banks by governments in Third World countries facing financial difficulties, with its ruinous effects on the economy, the checks and balances which would be needed to prevent the excessive printing of money by a sub-regional monetary institution would be inherent in the new arrangements, as would be the significant economies involved in the pooling of foreign exchange reserves and in the employment of high-level staff. Seen in this light, there is virtue rather than disadvantage in a multi-national Monetary Authority or Central Bank operating at the sub-regional level.

I would also wish to observe that the often alleged difficulties in the operations of a multinational Central Bank or upgraded Monetary Authority - while real - might not really be all that great to the extent that the provisions of the ECCM Agreement which, when fully implemented, would create a very high degree of economic integration among the Member States, virtually amounting to an Economic Union.

In the financial field too, critical mass might be achieved if, under the ECCM Agreement, the seven countries attempted, where feasible, to mobilise savings on a sub-regional as well as on a national basis.

There are other areas which could well benefit from being organised as Common Services in the sub-region. These include a Naval Security Service, Audit, Statistics, Income Tax Administration, Customs and Excise Administration, Forestry, Fisheries, Veterinary Services, Land Surveying, Training in Management and Public Administration, Agricultural Research and possible

Agricultural Extension Services.

There is also scope for Pools of Experts in such areas as Energy, Agronomy, Engineering, Accounting, various specialised aspects of development planning, etc. Expertise in Energy is required at both the sub-regional and regional levels.

The cost and financing of these Common Services and Pools of Experts are of course a source of concern to the participating States. Here, there is need for very clear thinking.

We must distinguish sharply between Pools of Experts and Common Services.

A Pool of Experts is constituted when a rather small number of persons with expertise scarce in the sub-region is recruited by the sub-regional organisation and services of these persons are made available for work on sub-regional plans, programmes and projects and for work with national governments at the request of those governments.

The pools of experts concept differs sharply from an approach to external donors for individual experts from time to time on a case-by-case request basis. In this latter situation, there is not sufficient focussing on regional and sub-regional sector programmes and projects. It merely constitutes normal technical assistance.

A Pool of Experts need not duplicate national efforts. Although in practice there could be some duplication, the whole point of establishing Pools of Experts is to acquire in the region or sub-region expertise which is in scarce supply or non-existent in the individual islands.

Even if generalist skills in certain areas exist in the islands, the Pools could be established to attract specialist skills which may be lacking in the individual countries and could be made available to national governments in their planning and implementation efforts.

There will, of course, be additional costs of setting up Pools of Experts. The principle of external assistance (which could come from some of the relatively more developed CARICOM countries, as well as external donors) on a tapering-off basis over a period of time is a sound one. Yet, at the end of the period of external support, the costs would have to be met by the islands. But there is a strong presumption that the benefits in development would exceed the new costs assumed by the former beneficiaries. And to the extent that the Pools of Experts are effective and, along with other national development policies and regional and sub-regional approaches to development, levels of production and productivity are increased, the individual governments should, in most cases, be able to absorb the additional cost after the tapering-off of external assistance.

A Common Service exists where there is a structured organisation at the sub-regional or regional level established for the discharge of a set of functions normally carried out by a department or agency of government or a government-owned commercially-run enterprise.

A truly Common Service need not in most cases involve duplication between the sub-regional or regional and national levels. Either a Common Service should replace pre-existing national services (although it may be possible to have a small nucleus at the national level to facilitate communication between the staff in the Common Services and the national government). Or a Common Service is established where there is no national service because of the country's inability or reluctance to afford such a service. Examples here are UWI, CXC, WISCO, LIAT, CARDI, the WISA Court of Appeal, a Naval Security Service, etc.

On the surface, there will no doubt be an increased budgetary burden in establishing new Common Services. But on analysis it turns out that the burden is not entirely a real one. It simply means that before its establishment as a sub-regional or regional Common Service, a service vital to development or to the public interest or welfare was not available to the individual countries because they simply could not afford it on an individual basis and is now available on a common basis at lower cost to the individual countries. Moreover, the same argument made about the ability of governments to replace sources of external financing because of the impact of the service on economic growth which applies to Pools of Experts also applies to Common Services.

VII. SOME IMPLICATIONS FOR EXTERNAL AID AND TECHNICAL ASSISTANCE

I will end by pointing to some of the implications of the foregoing analysis for external aid and technical assistance to the member States of the OECS.

First and foremost, since viability can be obtained by a combination of efforts and actions at the national, sub-regional and regional levels, external institutions and donors (including the Bank) should support efforts and actions, programmes and projects, at all three levels. It is true that sub-regional and regional projects in production and sea and air transportation sectors which involve equity ownership by more than one government are in many cases rather difficult to get off the ground. Nevertheless, special efforts with such projects should continue to be made by donors and lending institutions. Only as a very last resort should national projects involving only the country in which the resources is located or which forms the major market for the product should be funded; but they should be so shaped as to leave the door open for other countries to join at a later stage.

Second, external bilateral aid donors should not neglect the financing (through grants) of social infrastructure projects. The Bank clearly should not be expected to finance such projects.

Third, in view of the still critical recurrent deficit situation in the most seriously affected countries, capital grants for reconstruction and deferred maintenance of basic economic and social infrastructure which are non-self-liquidating -such as main and secondary roads, hospitals, health centres and schools - should not be neglected in external assistance. This is also true for certain vital development programmes such as Agricultural Extension Services.

Fourth, external aid, technical assistance and support for training can be most productive within a framework of systematic development efforts at the national, sub-regional and regional levels.

Fifth, systematic approaches to national development efforts (or, if you will, national planning) provide the best framework for the organisation of external aid and technical assistance efforts. In other words, the country must know clearly why it wants each capital, technical assistance and training project proposed; and it can only know this within the framework of coherent and mutually consistent national policies, programmes and projects.

Sixth, there must be more effective coordination among donors of external aid, technical assistance and training facilities to the islands concerned. Again, clear-cut national objectives, priorities, policies, programmes and projects could be of considerable assistance in the coordination of the external aid effort.

Seventh, greater familiarity with the capability as regards all aspects of the Project Cycle will be an important result of improved national planning and could increase absorptive capacity significantly.

Eight, donors should seek to ensure the availability of capital grants or loans on extremely soft terms for reconstruction of national productive and infrastructure assets destroyed or severely damaged by national disasters such as hurricanes, floods and volcanic eruptions without reducing their "normal" development aid to the island or islands concerned.

Ninth, donor countries and lending institutions should seek generally over time to obtain financing by the island governments themselves of a certain percentage of the cost of projects financed by then so as to encourage:

a. greater national commitment by the recipient to the projects being assisted at both its implementing and operating phases;
b. greater national saving and more local self-reliance; and
c. in the case of projects financed by soft loans, to reduce gradually the build-up of external debt.

Finally, an assessment of performance of individual countries will have to encompass a much broader range of issues than mere increases in national savings and the elimination of current budget deficits. The development of systematic approaches to national planning and policies, clear priorities as well as efficient and speedy project implementation and, not least, the nature of the changing external environment facing the particular country at any point in time will also have to be taken into account.

VIII. CONCLUDING OBSERVATIONS

Mr. Chairman, Honourable Premier, Honourable Ministers, Distinguished Governors, Observers, Guests:

The road to economic viability of the OECS States will be arduous. The difficulties should not be underestimated. At the national level very high standards of planning and economic management, involving the constant taking of difficult political decisions, are required. At the sub-regional and regional levels resources and efforts in many areas have to be pooled. Vision, statesmanship and a constant readiness to compromise their apparent immediate national interests are required of the political decision-makers of the seven countries; for by so doing the States can achieve a greater degree of effective sovereignty and meaningful development through the closest possible association with their partner States in the OECS and in the Caribbean Community in coordinating development activities and in harmonising external policies and actions.

But what other ways are open to the seven islands for the attainment of economic viability?