



## **The World Today**

### **Four questions for Regional Integration I**

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During the last two years I have been involved in an exercise to help in the preparation of a Single Development Vision for the Caribbean Community and an implementation road map for the completion of the Single Economy. I propose to reflect on some of the issues facing the Caribbean Single Market and Economy (CSME) project through a five part series. I have organised these reflections in the form of four questions/sets of issues:

1. What are the limitations of an economic integration project that relies mainly on the operation of market mechanisms to achieve its goals?
2. What are the limitations of an integration project that is concerned mainly with the economic aspect of integration?
3. What are the limitations of an integration project which attempts to achieve its objectives mainly through the inter-governmental mode of cooperation?
4. What are the limitations of an integration project that is undertaken mainly in response to external pressure?

Today's article will look at question 1 with a focus on free movement of factors of production specifically labour and capital.

## **What is the CSME?**

The CSME was designed on the principle of 'Open Regionalism' where market integration would take place simultaneously with opening the economies to the Rest of the World. It is a fairly advanced form of integration in that free movement of goods and services is to be accompanied by free movement of factors of production and a common or at least harmonized policy environment.

The creation of a single economic space is meant to serve as a basis for increasing exports to extra-regional markets as a result of improvements in efficiency due to integration of factor markets, formation of regional firms, and attraction of foreign investment. It is not generally appreciated that the appropriate measures of the impact and benefits of the CSME are the growth of intra-Caribbean investment and foreign investment, labour flows and service provision and ultimately of exports to extra-regional markets. To focus exclusively on intra-regional trade in goods runs the risk of missing the point.

From this point of view the CSME is very much still a work in progress. The legal and institutional framework has been established as a result of a long and somewhat cumbersome process. The customs union, free movement of goods, services, capital and certain categories of skilled labour exists in law but there are several exceptions, and many administrative issues to be resolved, before we can say that they are really in effect. Anyone who has tried to move, work, or set up a business in another state can tell you that what exists on paper is one thing and that what exists in practice is another; and that politicians say one thing while officials do their own thing. Let me refer here to some issues regarding the movement of labour, service providers and capital.

## **Free movement of labour**

A decision has been taken to extend the five eligible categories of university graduates, artists, cultural workers, media workers and sportspersons to teachers, nurses, and domestic workers. In theory self-employed service providers are also eligible to seek work in all member states. The categories so entitled number in the hundreds of thousands in member states. However, there are major hurdles to be overcome: issues of certification of the eligible categories; issues of entitlement to and the availability of, housing, education, health and social benefits in receiving countries.

There are concerns about security and drug trafficking and the spread of epidemic diseases such as HIV/AIDS. There is the matter of contingent rights of dependants. These issues need to be addressed as a matter of urgency and appropriate arrangements to be set in place if they are not to become a source of frustration and/or tension within the Community.

### **Free movement of capital**

Turning to the movement of financial capital, this is linked to the issue of monetary union and exchange rate regime. Barbados provides a useful example in the difficulties associated with this issue.

Barbados maintains restrictions on the outward movement of capital, which must also act as a deterrent to inward movement. Barbados is committed to removing these restrictions by the end of 2007; but it must be recognised that capital controls has been one of the key instruments in the maintenance of that country's fixed exchange rate, which is one of the foundations of the social contract. This in turn underlies the maintenance of Barbados's international competitiveness and its continuing ability to attract both domestic and foreign investment.

To remove this element in the interest of free intra-regional movement will create an additional source of pressure on the exchange rate and increase the vulnerability of the economy to the effects of short-term capital movements or financial shocks. An additional burden of responsibility for exchange rate stability will be placed on fiscal and monetary management. This is already the case, of course, but it is a matter of degree.

One might even question whether a fixed exchange rate regime such the one Barbados has is feasible in the absence of some degree of capital controls.

Another option for a country in Barbados' position is to explore the feasibility of freeing capital movement between itself and other members of the Community while maintaining capital such controls with the rest of the world. In theory this is what Barbados proposes to do. This will be difficult for any one country to achieve because of the 'fungibility' of financial capital (i.e. money can be moved out via another member state that has free convertibly). On the other hand it should be possible in the context of a regional currency union with a regional monetary authority which administers capital controls between the Community and the rest of the world.

Hence, the existence of a common regional currency would probably be the most important single step to give practical effect to the free intra-regional movement of capital. The case for capital controls in this context turns very much on the case for a fixed exchange rate regime for the region as a whole, or at least a managed adjustable exchange rate; that is, not leaving the exchange rate to the so-called free play of market forces. A free exchange rate exposes the economy to sudden unstable movements of short-term capital that have little to do with underlying economic conditions and much to do with market outlook and can reflect 'crowd behaviour'.

I am a firm believer in such a regime for the region. The experience of currency liberalisation in countries like Jamaica and Guyana has in my opinion been nothing less than disastrous. It is true of course that these disasters have as much or more to do with poor fiscal and monetary management prior to liberalisation as with liberalisation itself.

Liberalisation has made fiscal and monetary policy hostage to exchange rate policy and inflation policy. In fact, this is the case for economic policy as a whole. The authorities have seen further erosion of their already limited economic room to manoeuvre. Of course this is also the case for the countries with fixed regimes; but again this is a matter of degree. The question of freeing intra-regional capital movement

therefore leads to the question of what kind of exchange regime is appropriate to the CARICOM Single Economy.

Regarding business enterprises, legal restrictions have in theory been removed, but private sector spokespersons complain noisily about administrative and informal restrictions on the setting up of businesses in several countries. For example, Jamaican businesspersons complain about informal barriers in Trinidad and everybody complains about Barbados. There is still a perception that government agencies are more receptive to extra-regional investors than to our own people, a hang-over from the days of Industrialisation by Invitation, no doubt. Such formation of Pan-Caribbean firms as has taken place such as Grace Kennedy, RBTT and the like is said not to have been due to the removal of restrictions but to the normal processes of cross-border investment (although it might be the case that these firms are positioning themselves in anticipation of the completion of the CSME).

Next week I will take a look at the completion of the Single Economy.