

**The Planning Institute of Jamaica  
(PIOJ)**



***'Creating Investment Opportunities for the  
Growth & Development of the Region's  
Capital Markets in a Globalized  
Environment'***

**Contributing to**

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on  
Investment & Capital Markets

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## **INTRODUCTION**

Prime Ministers, Ministers, distinguished Ladies and Gentlemen, it is indeed flattering to be asked to speak on such an occasion. But, it is not an easy assignment. The main difficulty lies with finding a suitable topic which allows me to follow the maxim: be short, be sensible, and then sit down.

The conference organizers have assembled a great team of excellent participants to explore the prospects for creating regional investment opportunities in the new global environment. The last thing they would want is someone trying to give definitive conclusions in a turgid lecture. I will therefore confine myself to making a few comments on the present context of Caribbean development; the recent coming into being of the CSME; some of the implications of that development; and end with a look at the prospects for the Jamaican economy and some of the reforms that the region needs to pursue.

## **THE CSME**

The coming into being of the CSME on January 1, 2006 is the culmination of a long and somewhat difficult set of negotiations in which Jamaica, led by our outgoing Prime Minister, played a seminal role. Integration, of course, is a long term process and not an event. Indeed, what happened on January 1, 2006 was just the start of the single market phase. The more difficult part, the putting in place of the single economy component, has not started in a serious way.

The CSME is coming into being at a time of very rapid economic, structural and technological changes that are embodied in the phenomenon referred to as globalization. These changes, particularly the adjustments in trade regimes, are having profound effects on the Caribbean. They are making whole industries and sectors non-viable. They are making the skill content of much of our labour force obsolete. These changes are threatening the way of life of large segments of the Caribbean population. We must, as a region, respond positively and creatively to this new reality if we are to survive and prosper. This conference is a small contribution to that response.

How we respond to global changes is a determining factor in our development as a region. Global changes are not entirely negative developments to be resisted. A recent, publication: "The Jamaica Human Development Report 2005," sought to highlight both the challenges and the opportunities in this historic process. One of the profound conclusions of the study is: economies that have undertaken the

needed reforms and are sufficiently integrated into the global trading system, stand a better chance for faster growth than the ones that are lagging on these two fronts.

Other studies have pointed to the fact, (indeed the experience of Latin America during the last decade and a half has shown), that simply carrying out reforms and waiting on the market to generate investments and job creation is not enough. A proactive approach to development is required. Even with the necessary reforms in place and the appropriate degree of integration, the state has to actively seek to attract investment by partnering with the private sector, both local and foreign. At times, governments even have to anticipate the market and move ahead of the private sector players in the creation of institutions, the building of infrastructure and the development of the necessary human capital.

To a large extent, the CARICOM/CSME project was built in anticipation of the requirements of the local private sector. It was conceptualized around a particular vision of the future that our leaders had. In fact, the Integration Project was largely driven by the political and intellectual elites of the Caribbean in the early days. The initial driving force was political, not economic. The drive towards the more economic aspects of integration accelerated after the demise of the federal experiment in the early 1960s.

The global environment that we must confront today has a decidedly political dimension. The so-called “war on terror,” following the 9/11 attacks on the US, has cost small economies dearly, in many ways, and often with no clear direct benefits.

Many members of CARICOM have had to expend significant sums to secure our ports and airports, diverting resources from urgent development goals. Much of these investments came at the insistence of the more developed countries and without much assistance from them. Let me hasten to say that some of these investments have been useful in combating the international drug criminals whom we are fighting simultaneously. So between the war on terror and the war on the international criminals, we have had to divert a significant amount of financial and intellectual capital that would otherwise have been used to put us in a better position to combat the negatives of globalization and take advantage of the opportunities. The increased spending on security and the failure of developed countries to honour pledges on trade and aid, is making it very difficult for some countries in the region to meet the Millennium Development Goals.

## **ROLE OF NEW TECHNOLOGY DEVELOPMENT**

The 9/11 attacks did more than pre-empt financial resources; they diverted attention from the most important event of 2001. That event took place on February 12 of that year. It is the date on which the whole human genome was published. That event represents the single most significant scientific accomplishment in the last 500 years. In my view it is far more important than the development of the printing press by Gutenberg in 1540. The unravelling of the human DNA has the potential to completely transform every aspect of our existence in a relatively short period of time. [Our genetic code consists of 3 billion letters (ATCG – the very large DNA molecule broken down into four elements) and this code is replicated twice within each one of our hundred trillion cells]

Why is this great leap forward in the biological sciences so significant? Each plant, animal, or bacterium carries its entire genetic code inside almost every single one of its cells

The rapid development in genetics combined with the use of powerful computers is making the cost of sequencing a gene fall dramatically. In 1974, Monsanto, one of the giants in genetic research, estimated that it cost US\$150 million to sequence a single gene, today the cost is below US\$50. As costs collapse

knowledge and patents explodes. This means that regions like the Caribbean can afford to participate in this scientific revolution. We need not be spectators.

The science now allows us to understand and change the size, shape, colour, texture and flavour of plants and fruit. Bananas and potatoes can be grown to vaccinate one against cholera, hepatitis, and diarrhea. Medicines are now being grown in tobacco plants.

The technology exists today to break the genetic code of the sugar cane plant and make it possible to grow bigger plants with more sucrose, maybe using less land and water over a shorter time. What holds for the sugar cane plant also holds true for banana or any other crop grown in the region. If the scientific break-through comes for these crops it is likely to be in one of the developed countries including Brazil or India where huge investments in science and technology are taking place. All this could make our struggle with the Europeans over the reform of the Sugar Agreement and the banana trade fade into insignificance.

For those who have not been keeping abreast of the monumental revolution taking place in bio-technology, and therefore see my comments as far-out, I draw your attention to the “glowing green pig” that was developed in Taiwan and shown on television last week. That patented pig has the potential to help solve many health problems in human beings.

You may well ask: Why is he telling us about glowing green pigs at a conference of Caribbean business and political leaders? The answer is simple; we have to focus on the threats we face and the sources of wealth creation of the future. We need to know what the major companies in the food and commodity businesses are doing. Will they drive us out of the commodity business? Can we partner with them? Should we invite them to invest in the region? Should we invest in the stocks of global companies operating in these fields?

These are very serious questions that, anyone charged with the responsibility of planning the future must contemplate. Our universities and research institutions need to step up to the next level to help guide policy makers in these critical areas for the future.

During the drafting of Jamaica's strategy for the sugar industry for submission to the EU we contemplated the following issue. If by some divine miracle, we were able to convince the European Union to do the decent thing and compensate the ACP sugar producers for the proposed unilateral change of the treaty governing sugar, and they gave Jamaica a cheque for Euro 500 million, would the Planning Institute advise the government to put it all back into sugar or would we advise them to put it in a fund to diversify out of sugar? The majority of the answers, which came from people under the age of 35, would surprise some and disappoint others. What would be your answer?

At the heart of our deliberations on this matter was the issue of where the technological and business trajectories are headed.

### **THE VALUE OF CARICOM**

Our Caribbean civilization has been built on an infrastructure of preferences and protectionism. This approach to development was replicated in the Treaties governing the Caribbean Community as we sought to create a Free Trade Area (FTA). Essentially, trade blocks are built on the assumption that by discriminating against others outside of the block, members of the community will increase their welfare. The theoretical foundation for the establishment of a Free Trade Area is rooted in Jacob Viner's 1950s study of trade diversion and trade creation. In this model, there are at least three countries, and everything occurs in a world of "second-best" in the sense that distortions and policy interventions are present in every outcome we consider. We should also note that many of the alleged costs and benefits occur in areas that the economics profession is fairly weak in understanding: growth, technology transfer, culture, and politics.

If, as a result of a preferential-tariff reduction, imports from a partner displace higher-cost local production, real resources are saved in satisfying domestic consumption and the local economy benefits accordingly. This is trade creation.

Alternatively, if the preferences allow partner supplies to displace those from non-members that would otherwise have been purchased because they were cheaper when both faced equal tariffs, the domestic economy ends up paying more real resources for imports and loses, accordingly. This is trade diversion.

The mapping of trade creation and diversion to economic welfare is very difficult to establish but they need to be studied since increasing welfare is the goal of trade policy. Very little work has been done to quantify the economic benefits of CARICOM to the people of the region; we simply assume that it is good. My economist friends at the UWI know that this is not good enough. There are many research papers and Ph.D. theses waiting to be written about Caribbean economic trade policies to help guide future decisions.

I know that calling for the matter to be studied and quantified is likely to be a sensitive subject. I am even likely to be criticised as being anti-regionalist. This is because outside of trade, there is not much else that holds the economic base of CARICOM together. Therefore, doing something that may question the reason for the entire project may be seen as threatening.

However, I think we owe it to ourselves to fully explore the sources of costs and benefits, to understand the degree of trade creation and diversion and their channels of causation.

The call for a deeper understanding of the benefits and costs of trade is based on the expectation that trade disputes is likely to dominate future CARICOM relations. If there is any doubt, one should pay attention to the reports coming out of the 20<sup>th</sup> COTED Ministerial meeting in Guyana last week, and the comments of the Prime Minister of Trinidad and Tobago about oil. There was a lot of haggling and threats about oil, rice and flour. At least two of these items are heavily weighted in the baskets of the poor.

There was no dispute, and there is not likely to be any, about high technology goods and services – items in the basket of the rich.

This is a reflection of the fact that CARICOM produces very little high value products as the region's production base has not changed sufficiently over the years; commodity production still dominates. This is one of our major challenges. We must reduce the proportion of commodity output in our total production if the region is going to successfully compete on the global market. We must produce goods that the higher income consumers of the world demand.

## **JAMAICA'S REFORM EFFORTS**

Over the last decade and a half, Jamaica has undertaken many of the major economic reforms and infrastructural developments needed to modernize the economy and to integrate it into the world economy. This process coincided with major challenges in the management of the macro-economy as the country experienced a major financial crisis during the last half of the 1990s, costing close to 40 per cent of GDP. The crisis was ultimately brought under control by the government's decision to assume the bad debt portfolio of the failed banks and insurance companies in the main. The assumption of that debt still complicates macroeconomic management today, and is pre-empting resources that could otherwise be used for productive investment.

The crisis was exacerbated by slow growth in the economy in the latter half of the 1990s, as very restrictive monetary policies was part of the crisis resolution arsenal.

The complications and uncertainty generated by the necessary reforms caused the usually cautious domestic business sector to become even more so. A rapidly changing environment, buffeted by domestic policy changes, global challenges, and a tight macroeconomic environment is unlikely to inspire a domestic business sector that is dominated by small risk-averse family firms.

As a result of the general local and global economic conditions, the local economic players pull back resulting in a period of slow economic growth.

With the resolution of the crisis, the completion of much of the reforms, the putting in place of the necessary infrastructure – roads, water supplies, port expansion, airport modernization, modern telecommunication systems, stabilization of the macroeconomic environment, along with the active wooing of investors, Jamaica is witnessing a major investment led resurgence of its economy. Much of this is in the form of foreign direct investment (FDI). Indeed, Jamaica is seeing rates of FDI not experienced in nearly 40 years.

Much of this investment growth is taking place in the tourism, mining and infrastructure areas. We are also now beginning to see greater levels of activity by the domestic business class. This has to be encouraged or we run the risk of repeating the experience of the 1950s and 1960s when Jamaica attracted significant foreign capital but insufficient domestic private investment. We failed to create the needed explosion of small and micro businesses to complement the large scale foreign projects. As a result, once the major foreign investment flow slowed or stopped, the momentum in the local economy was lost.

To have sustainable growth in the local economy, we must ensure domestic capital is stimulated. This will require us to maintain a stable macroeconomic environment, and reducing the cost of entry and exist for businesses.

Specifically, Jamaica will have to continue to pursue reforms in the following areas:

1. Our elaborate system of incentives - which creates significant distortions.
2. The financial market - to improve the collateral framework as a way of increasing lending.
3. Legal changes - to induce the development of a credit bureau.
4. Further tax reforms - to reduce the burden on formal businesses by simplifying the system and reducing transaction costs.
5. Reducing the level of regulations to encourage formalization of businesses.

These reforms would assist greatly in consolidating the growth momentum, now underway, by strengthening the capacity of domestic firms to operate on a more competitive basis.

The need to encourage domestic investment must be complemented by measures to deepen domestic ownership. This is a requirement across the region. A sustainable economic environment must be built on a broad cross section of the population having an ownership stake in the society.

The stock markets of the region are fairly underdeveloped and the level of share ownership low. This situation needs to change by deliberate efforts to develop

the capital markets. Indeed we need to encourage the development of a regional stock market.

### **PRE-CONDITIONS FOR A CARICOM REGIONAL STOCK EXCHANGE**

The Governor of the Central Bank of Trinidad and Tobago, Ewart Williams, in a recent paper outlined a number of preconditions for such a market. These include:

1. Electronic trading needs to be the accepted norm and must envelope the best technology to facilitate dealers, traders and retail investors who are the players in the market.
2. All trading members must have symmetrical access and information to shares and other products within a unified framework of rules.
3. Company laws and accounting standards have to be standardized and synchronized to allow comparability across all member states.
4. Securities legislation must be harmonized and must include provisions for regulation, supervision, monitoring and evaluation along with an oversight body to make the legislation enforceable.
5. Both the number of listings and the range of financial instruments must increase in addition to a rating system for companies and debt instruments since participants will have access to non-national listings and products.
6. Integration of the Central Securities Depositories (CSDs) of the various countries to allow automated cross-border clearance and settlement.

7. A massive regional education campaign to make the CARICOM citizenry aware and informed along with a training programme and a regional cadre of excellent, efficient and effective primary dealers and market-makers.

Although satisfying these pre-conditions is necessary, the extent to which a regional market can be successfully implemented is dependent, according to Williams, on the quality of the macro-economic policies in the participating countries. The tax policies in the region will also exert an important influence on savings and investment behaviour. In other words, the infrastructure to support a regional capital market now needs to evolve quickly. The CARICOM Single Market and Economy (CSME) and the Caribbean Court of Justice (CCJ) are important building blocks for a CARICOM Regional Stock Exchange (CRSE).

The stock markets of Barbados, Jamaica and Trinidad & Tobago continue to offer only a limited range of product offerings and are characterised by low liquidity and low turnover. The turnover ratio, which is one of the measures of liquidity, for the three major Caribbean exchanges is approximately 4 per cent which makes them highly illiquid, especially when compared to countries such as the UK and the US with average turnover rates of 70 per cent; Singapore with 84 per cent; and even a Latin American neighbour, Argentina, with 25 per cent.

So, while the Caribbean exchanges are performing well in some respect, given the size of the aggregate market, they are also underperforming in other key

areas because of lack of diversification and the absence of a consolidated regional market. The areas in which there is underperformance provide compelling reasons for the formation of a *real* regional exchange. The first reason is that such an entity would allow firms much more breadth in terms of raising long term capital and this would facilitate the international competitiveness of the productive sector.

## **CONCLUSIONS**

'Regionalism' as a project has not fired the popular imagination of the Caribbean people; the question that flows from this must be, why? Is this because it has largely been a project of the intellectual and political elite? This question needs to be fully explored; answers need to be found; and corrective action needs to be taken. Part of the reason may be because much of the debate is about abstract governance and governmental matters with not much concentration, or at least not much communication about deliberations on the real day-to-day issues of the people. People have not been fully convinced about how all these changes will improve their lives.

The four main points I want you to take from my presentation are:

1. We urgently need to do the research to show the costs and benefits of trade within CARICOM.
2. The region needs to focus on investments that will help to transform the economic base with science and technology playing a leading role.

3. Increased emphasis must be placed on broadening asset ownership by a wider cross section of the population across the region
4. The region must engage the world economy undertaking the reforms that will boost investments and growth to allow for the production of the high value added goods that the world demands.

Thank you for your attention