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### The Regional Development Fund (RDF) and the Implementation of the CSME

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## I. INTRODUCTION: PURPOSE AND OBJECTIVES

This paper briefly examines key issues and options in the design of the Regional Development Fund (RDF), in the context of the objectives outlined for the Fund in the Revised Treaty of Chaguaramas (The Revised Treaty).

Article 158 of the Revised Treaty provides for the establishment of a Development Fund for the purpose of making financial and technical assistance available to disadvantaged countries, regions and sectors of the Caribbean Community.<sup>1</sup>

The participating member States of the Community recognised a need to deepen the integration of their economies and create a single economic space, in order to improve their chances of achieving sustained development in an increasingly competitive global economy. The Preamble of the Revised Treaty underscores the importance of achieving efficiency and international competitiveness in the production of goods and services, the unrestricted movement of the factors of production within the Community, nondiscriminatory access to the Region's resources by its economic agents and a sustained improvement in living standards.

However, the Revised Treaty recognises that a number of factors may compromise the ability of some member states to effectively participate in the deepening of the integration process. Those factors may have an adverse effect on countries from the outset, or may hinder their ability to adjust to the realities of deeper integration over time. They include deficiencies related to:

- resource endowments
- size
- economic development
- economic structure
- vulnerability

In recognition of the possibility that the integration process could bring about economic dislocation and make some countries or areas relatively worse off or exacerbate existing economic differences, a regime for countries, regions and sectors so disadvantaged was enshrined in the Revised Treaty. The regime includes special provisions for the LDCs (which are automatically defined as disadvantaged), and provisions for other countries, regions and sectors defined as disadvantaged because of the adverse impact of the operation of the CSME on their economies, or the impairment of resources resulting from natural disasters, or temporary low levels of economic development or being a Highly Indebted Poor Country (HIPC).

The Regime for Disadvantaged Countries, Regions and Sectors, provides a framework for mitigating the adverse effects on economic activity which disadvantaged countries may be experiencing as a result of one or more of the events or conditions described above (The Regime is

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<sup>1</sup> Article 3 of the Revised Treaty lists the Community's members as Antigua & Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts & Nevis, Saint Lucia, St. Vincent & the Grenadines, Suriname and Trinidad & Tobago. Arrangements are also provided for expanding the Community and Haiti has since become a member.

complemented in the Treaty by a Special Regime for Less Developed Countries). The framework includes, but is not limited to the establishment of a Development Fund as indicated above, to provide the necessary resources to assist disadvantaged countries through the adjustment period.

Economic progress, especially where the change is rapid, is inevitably associated with economic dislocation, particularly of business entities. Some industries will be in decline while others will be in the ascendancy. Specifically, it has long been recognized (Caves [2001]; Robson [1987]; Balass [1961]; Samuel & Boxill and Jason [2004]) that integration movements may create marked disparities in the levels of growth of output, income and employment among member countries, and that initial differences in the levels of development among countries may be exacerbated by trade and factor movements. It is to be expected that the structural changes envisaged by the Revised Treaty will give rise to economic dislocation, but the trick is to manage the change effectively and provide an appropriate environment for business entities and economic agents to adjust with a minimum of pain. The Development Fund was conceived as one of the instruments to help facilitate that process.

Assistance by the Fund under Article 157 can be of a direct financial nature or in the form of technical assistance in a wide range of areas and for a variety of purposes, including:

- (i) Direct financial nature
  - (a) grants or access to low-cost financing;
  - (b) preparation of project proposals for financing;
  - (c) performance guarantees and other guarantees to enterprises;
  - (d) accessing technology including information technology;
  - (e) product design or quality enhancement;
  - (f) factory design and market development.
  
- (ii) Technical assistance
  - (a) assistance to establish or upgrade national standardising bodies;
  - (b) assistance to countries to advance their diversification programmes;
  - (c) professional assistance in meeting obligations under trade-related agreements;
  - (d) assistance to establish institutions or centres for the training or retraining of employees as the case may require;
  - (e) provision of relevant expertise to formulate a legal policy framework conducive to fair trading and fair competition;
  - (f) professional expertise in espousing and defending claims arising in connection with the WTO Agreement and other trade-related agreements;
  - (g) professional assistance in preparing for disputes resolution arising in connection with trade-related agreements;
  - (h) professional assistance in preparing legislation.

## II. SUGGESTED CRITERIA FOR AN EFFECTIVE FUND

Clear criteria under which a development fund is to be operated, should underpin a well-functioning fund designed to achieve the purposes set out in the Revised Treaty. The following minimum criteria are suggested:

- (a) Clear eligibility criteria for receiving assistance from the Fund.
- (b) Independence/autonomy of the Fund.
- (c) Long-term sustainability.
- (d) Ownership by CARICOM, given the nature of the Fund as an instrument for fostering the cohesion of the integration movement.
- (e) Flexibility/ease of accessibility to the resources of the Fund, with appropriate resource allocation and disbursement rules.
- (f) Appropriate criteria for changing the status of member countries, re their eligibility.
- (g) Sufficiency of resources. The size of the Fund should be large enough to make an impact.
- (h) A clear statement on whether or not grants, loans or both by the Fund would be permissible. This would make a difference to the design of the Fund and to its placement in an existing or new institution.
- (i) Strong, effective management.
- (j) Cost effectiveness in the operations of the Fund.

### III. ELIGIBILITY

Articles (1), (2), (4) and (5) of the Revised Treaty, define disadvantaged countries, regions and sectors and provide the means (in general terms), for modifying the status of a disadvantaged country.<sup>2</sup>

In essence, disadvantaged countries are defined as:

- (a) the following Less Developed Countries (LDCs):
  - (i) Antigua and Barbuda
  - (ii) Belize
  - (iii) Dominica
  - (iv) Grenada
  - (v) Montserrat
  - (vi) St Kitts
  - (vii) St Lucia
  - (viii) St Vincent and the Grenadines
  
- (b) member states that may require support measures of a transitional or temporary nature because of:
  - (i) natural disasters; or
  - (ii) the adverse impact of the CSME on their economies; or
  - (iii) temporary low levels of economic development; or
  - (iv) being a Highly Indebted Poor Country (HIPC), designated as such by the relevant inter-governmental organization.

Paragraph (a) above specifically identifies eight Less Developed Countries as “disadvantaged countries”. Article (5) of the Revised Treaty authorises the Conference of Heads of Government to modify the status of a member state by majority decision. This means that countries on list (a) above can be removed from that list of disadvantaged countries, or other countries placed on the list by the Conference. The Revised Treaty does not identify the criteria for changing the status of countries. Such criteria would have to be determined, but might include: economic size; economic diversity (measured by the degree of product concentration and the export ratio); natural resource base; the extent of infrastructural development, including physical, financial and institutional (i.e. administrative and technical capacity); human resource development, including access to adequate health, educational and housing facilities and the extent of structural unemployment (as a proxy for poverty, income inequality and the under-utilisation of resources).<sup>3</sup>

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<sup>2</sup> Haiti has since become a member of CARICOM.

<sup>3</sup> Some of these measures are currently used by CDB in its evaluation of its members economies.

Paragraph (b) above identifies other circumstances under which member states are considered to be “disadvantaged countries”. Again, the criteria for establishing the status of countries are not specified. However, it is clear that under (b), countries are considered to be disadvantaged if they require support of a transitional or temporary nature under certain specified circumstances. The important point here is that countries are expected to grow out of their disadvantaged state with the assistance of special support measures.

The term “disadvantaged regions” is defined in the Revised Treaty as:

- (a) regions within Member States experiencing economic dislocation from the operation of the CSME; or
- (b) regions that may require special support measures of a transitional or temporary nature by reason of:
  - (i) impairment of resources resulting from natural disasters; or
  - (ii) temporary low levels of economic development.

“Disadvantaged sectors” is defined as:

- (a) sectors of the economies of Member States in which economic enterprises experience dislocation from the operation of the CSME; or
- (b) sectors that may require special support measures of a transitional or temporary nature by reason of natural disasters, whereby the loss in the sector causes social and economic disorder.

It is to be noted that dislocation caused by the operation of the CSME and social and economic disorder caused by natural disasters, are the only circumstances under which a sector is defined as disadvantaged.

The sense conveyed in the definitions of “disadvantaged” is that, in addition to dislocation caused by the operation of the CSME (and aside from natural disasters), the broader condition of low economic development is an important consideration in determining “disadvantage”. In the particular case of defining “disadvantaged countries”, both temporary low levels of economic development and the pre-existing condition of the Less Developed Countries are included.

The basic argument underlying the identification of the specific disadvantaged countries in the Revised Treaty rests, in all likelihood, on the recognition that the economies of some countries are at the outset significantly weaker, smaller, less diversified, less competitive and more vulnerable than others (Lestrade, S [1981] and Samuel, Wendell & Ian Boxhill [1997]), and that they cannot overcome those constraints without financial and technical support. Additionally, a cohesive regional market could not be effectively achieved without targeted support to help those countries participate more fully in the regional market and grow out of their disadvantaged state.

The issue of identifying the regions and sectors within (or across) countries for the purpose of providing them with resources, also has to be considered. The best approach in the case of

“disadvantaged regions,” might be to include them in “disadvantaged countries” and leave it up to the country concerned to design appropriate programmes for the region and apply for funding as a disadvantaged country.

Regarding “disadvantaged sectors,” the question arises as to whether any restrictions ought to be imposed on lending to particular sectors or for particular kinds of operations, and also whether the Fund could lend to individual businesses.

Given the broad-based nature of development, particularly in the context of the creation and expansion of a single market, perhaps the Fund ought not to be restricted in the kinds of operation which it can finance. It should, therefore, be allowed to finance virtually any developmental activity, including basic physical infrastructure, institutional strengthening, rural development, urban renewal, environmental protection, etc. It could target sectors and sub-sectors comprising large, small and medium-sized enterprises and the encouragement of the entrepreneurial spirit, or it could be focussed on promoting social inclusion and developing an integrated labour market.

Member States, local government bodies, autonomous public sector bodies and private sector entities (such as businesses, universities, foundations, NGOs and community groups), should be eligible for Fund resources. However, where funding is provided to entities other than Member States (including businesses, NGOs, foundations, community groups and autonomous public sector institutions), such funding should not be used for commercial purposes. Fund resources could be used, *inter alia*, for education and training, consumer protection (and the dissemination of information associated therewith), research and development and the creation of awareness of the goals, objectives and activities of economic sectors and the Caribbean Community. Fund resources should not be made available to individual private sector businesses or public sector entities which operate in the commercial sector (to prevent bias and undue competition with the private sector).

The exceptions should be for venture capital purposes (with the Fund taking a stake in the enterprise) and pilot start-up projects which fall within national strategic plans and to which normal commercial funding is not available. In any case, the RDF could channel such resources through local development finance institutions, commercial banks and finance houses. Such resources could be made available on a concessionary loan basis and wherever possible, matching funds from the enterprise could be encouraged.

#### IV. SIZE, FUNDING AND SUSTAINABILITY

The size of the Development Fund would depend on a number of factors. Firstly, the functions which the Fund would be expected to carry out would be a major consideration. If its resources are to be available not only for adjustment necessitated by dislocation caused by the operation of the CSME, but also for addressing problems related to temporary low levels of economic development, natural disasters and pre-existing economic conditions as allowed for in the Treaty, the larger would be the pool of required resources.

Secondly, whether the focus is on a single overarching function or is spread across many functions (e.g. addressing the issue of dislocation, improving cohesion, meaningfully financing programmes aimed at redressing (temporary) low levels of economic development and supporting measures designed to restore economic viability after natural disasters), the Fund should be sufficiently well endowed to have a meaningful impact.

Thirdly, the question of size is not unrelated to the method of financing and the cost to those who provide the Fund with resources. The creation of the Single Market and Economy is expected to improve the standard of living and quality of life of the people of the region as a whole, over time. However, it is not a free ride. Regional commitments, including the Development Fund when it is operationalised, have to be funded and CARICOM governments have to take effective ownership of the instruments which they create. Donors may assist in the provision of resources to the Development Fund, but they would expect Caribbean governments to make a substantial financial contribution to the Fund (particularly in the current climate in which the Caribbean is not seen as a priority in the provision of development assistance).

Yet, the fiscal resources of CARICOM States are stretched and substantial contributions are unlikely from existing revenues. Additional revenue (i.e. from additional levies/taxes) can be raised, but it may come with real economic and political costs. The ultimate size of the Fund may be determined in part by the fiscal resources which governments are willing to commit, and by the extent of donor contributions. Given that the Fund can provide technical as well as financial assistance as established in the Revised Treaty, the private sector of the region can play a meaningful role in contributing to its resources.

In determining the functions which the Fund is expected to perform, as well as its size, the role of the Caribbean Development Bank (CDB) should be taken into account to prevent duplication.

If the Fund is to play a meaningful role in assisting the disadvantaged countries as the CSME progresses, it will have to be sustainable. Donor grants to the Fund will never be under the control of the region, but government contributions would have to be reliable and sustained through time. One approach would be to find an automatic mechanism for providing resources to the Fund, but it is to be noted that attempts over the years to provide such a mechanism for the budget of CARISEC and other institutions in the region have met with little success. It should also be noted that, should such a mechanism be agreed in this instance, other regional commitments which require a reliable and sustained source of funding could hardly be ignored.

The issues of sustainability and size are also related to the question of whether the Fund will provide loans or grants to countries, regions and sectors. It seems sensible not to limit the Fund's operation unnecessarily, but to allow it to provide both loans and grants. It would perhaps be harder to sustain

the Fund's income if mainly grants are provided by it. The provision of more loans by the Fund could make sustainability easier and may require just an initial contribution to the Fund by Member States.

Table 1 gives a concrete, though somewhat arbitrary example of the impact on the fiscal revenue of Member States, using the approach employed in the European Union, where contributions are made on the basis of GDP and range between 0.3% and 0.6% of GDP. If the principle that all CSME members must make a contribution (however small) to the Fund, is adopted, and the disadvantaged countries were to pay 0.1% of GDP (or 0.4% of fiscal revenue on average) into the Fund (given their economic condition), while the remaining members contributed 0.5% of GDP or (2% of fiscal revenue on average), this would amount to around US\$149 million per annum. Table (1) shows the impact on the individual disadvantaged countries as presently constituted in the Revised Treaty and the impact on the other countries as a group. If a target of US\$250 million were set initially, then US\$101 million would have to be raised from other sources, including donors. It is to be noted that weak fiscal positions of most Member States since the mid-1990's have impaired their ability to make even modest contributions out of existing revenue.

**Table 1**  
**DEVELOPMENT FUND: POSSIBLE FORMULA FOR CARICOM CONTRIBUTIONS**

	(2002) GDP Current US \$m	0.1% or 0.5% of GDP US \$m	Fiscal Revenue US \$m	Fund Contribution To Fiscal Revenue (%)
1	2	3	4	
Disadvantaged States (0.1%)	3,740	3.740	925	0.4
Antigua & Barbuda	721	0.721	141	0.5
Belize	928	0.928	209	0.4
Dominica	258	0.258	73	0.4
Grenada	401	0.401	103	0.4
Montserrat	38	0.038	11	0.3
St Kitts & Nevis	356	0.356	109	0.3
St Lucia	677	0.677	166	0.4
St Vincent & the Grenadines	361	0.361	113	0.3
Other States (0.5%)	29,063	145.315	7,116	2.0
<i>Grand Total</i>	<i>32,803</i>	<i>149.055</i>	<i>8,041</i>	<i>1.9</i>

Source: CDB [2004]

The issue of sustaining the Fund over time suggests that a significant proportion of the inflows (including replenishments), should be automatic. The question of whether or not the Fund is to provide Grants or Loans or both, is also pertinent. Addressing the latter question first, it would make sense to give the Fund maximum flexibility by allowing it to provide both grants and loans.

However, the need for a Fund arises in part because of the polarisation which can occur in integration movements (CARICOM being no exception), where business and economic activity gravitate towards those areas which already have a dynamic advantage, while the disadvantaged areas become even more depressed. A fund, *inter alia*, provides the means for transferring

resources from the areas or countries made better off by the integration process, to those made worse off. It would be iniquitous and would impose an undue burden on the disadvantaged countries to provide them largely with loan-based financing. It could also retard the process of cohesion, so necessary in the creation of an integrated market. Most of the disadvantaged countries defined in the Revised Treaty also carry a heavy debt burden and may be unable or unwilling to add to it. A loan-based fund could frustrate the achievement of the Fund's objectives.

However, the ability of the Fund to provide loans to disadvantaged countries should not be entirely excluded. Any loans could be concessionary and could be made available for specific purposes (say, for joint ventures with the private sector or foreign entities or at a later stage in a country's progress towards becoming a non-disadvantaged country).

A fund which provides mainly grants should have an appropriate and self-regenerating income stream, such as proceeds from a levy. The income stream could also be supplemented with contributions and grants (i.e. inflows) from donors, governments and the private sector.

There have been several attempts in the past to link the contributions which Member States have to make to fund the CARICOM Secretariat to a levy, usually a levy on total imports or extra-regional imports<sup>4</sup> with the proceeds owned by CARICOM. Such efforts have not been successful to date, as Member States have been reluctant to agree to such a measure.

A levy linked to nominal imports would be sustainable and would provide an automatic income flow, provided that the proceeds are owned by CARICOM. Using total imports would be preferable to intra-regional imports, as the latter would be too small a base and would be contrary to the spirit of the integration movement. Using Extra-regional imports alone would be considered to be discriminatory by the rest of the world.

Many countries are contemplating reducing or phasing out import duties. A levy based on domestic consumption or value-added could be applied instead. In either case, since existing revenue streams are usually committed well into the future, any levy to support the RDF would probably have to be additional.

A levy is not the only means of financing the Fund and the following list provides a variety of complementary methods:

- i. A levy on aggregate imports into the Community, the proceeds of which are to be legally owned by the Community as a whole.
- ii. Voluntary contributions by CARICOM Member States, over and above any levy imposed in the Member States.
- iii. Contributions by the private sector within CARICOM.
- iv. Contributions by the private sector outside of CARICOM.
- v. Contributions by multi-lateral institutions.
- vi. Concessionary loans from multi-lateral institutions (e.g. the IDB may have funds for the development of regional integration).
- vii. Concessionary loans from the private sector within and beyond the Community.
- viii. Concessionary loans from donor governments.

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<sup>4</sup> See La Corbinière [2004] for a brief overview of those efforts.

- ix. Grants by donor governments, including, potentially, those under new collaborative arrangements being considered by the EU for their outermost regions (e.g. the French Antilles). Such grants would have implications for procurement, management of resources and their attendant costs.
- x. Market borrowing, including possible borrowing by CDB on behalf of CARICOM (given CDB's ability as a highly rated institution, to borrow on favourable terms).
- xi. Possible contributions by CDB from its grant or other resources.

## V. LOCATION, GOVERNANCE AND MANAGEMENT

The Development Fund can be set up as a special window of an existing institution, or as a separate legal entity. The former approach would save costs and could provide synergy with the existing institution, providing the existing institution has a broadly similar ethos. The latter approach would give the Fund an opportunity to have its own identity and determine its own policies and direction, and it could be established in a manner perfectly suited to the purpose and objectives of the Fund in the context of the CSME.

Another approach which would allow the Fund autonomy while saving on some costs and leaning on the experience of an existing institution (presently operating in a related field), is to set up the Fund as a separate legal entity located at the existing institution and drawing on the latter's experience (for example, in the areas of planning and programming, intervention criteria, procedures and pre and post evaluation approaches, knowledge of the region, etc).

The Caribbean Development Bank is the one regional institution with the background, technical capability and developmental perspective to be the "home" of the Fund. However, some would question the need for a separate entity providing funding to the Region (particularly if it were to be located at CDB), when CDB was set up to finance the development of the Region (including the integration process). In this context, the rationale for a Fund separate from CDB, is that the Fund will not be a broad development finance institution as such, but would have a very specific focus having to do with achieving the objectives of the CSME. The other arguments in favour of a legally separate Fund presented above would also apply. Of course, the impact of the Fund on CDB's own character and the extent to which the work of the two entities became indistinguishable, would have to be observed over time.

It should also be recognised that the decision making structure of CDB involves a wider body of persons than CARICOM and that in theory, CARICOM's priorities may not coincide seamlessly with those of CDB. This would be of particular importance if the Fund were to be operated as a window within CDB.

The Caribbean Community of nations has a responsibility to take ownership of the Fund, not least because of the pivotal role that it can play as a cohesive force in the development of the CSME. In addition, given the changing priorities of the donor community, it would be short-sighted of the Caribbean Community not to design a fund based fundamentally on self reliance with donor assistance, rather than the other way around. Taking ownership implies setting up a Fund which is financed in the main by Regional resources, with a governance structure to suit.

## VI. CONCLUSION

This summary paper examined some of the key issues and options in the design of the Regional Development Fund (RDF), in the context of the objectives outlined in the Revised Treaty of Chaguaramas (The Revised Treaty). The issues were considered under five broad headings: purpose and objectives; suggested criteria for an effective fund; eligibility; size, funding and sustainability and location, governance and management. The key points raised are that the Fund must be large enough to make an impact on the financing of adjustment in the disadvantaged countries, its own resources must be sustainable, the Region must have real ownership of the Fund which in turn must be governed/operated to achieve the objectives set out in the Revised Treaty.

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