Tenth Adlith Brown Memorial Lecture

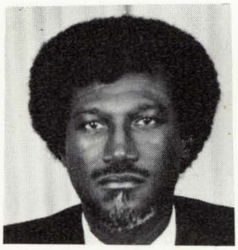
INSTITUTIONAL CHANGES IN THE PROCESS OF NATIONAL DEVELOPMENT

A CASE FOR THE ROLE AND INDEPENDENCE OF CENTRAL BANKS

By

K. Dwight Venner

Caribbean Centre for Monetary Studies



K. Dwight Venner, an economist, is currently Governor of the Eastern Caribbean Central Bank, a position he has held since December 1989.

Mr. Venner was educated at the University of the West Indies in Mona, Jamaica where he obtained both a Bachelor of Science, and a Master of Science Degree in Economics. He served as a Junior Research Fellow at the Institute of Social and Economic Research at the University of the West Indies and then as a lecturer in Economics from 1974 to 1981.

Prior to his appointment as Governor of the Eastern Caribbean Central bank, he served in the position of Director of Finance and Planning in the St. Lucia government between November 1981 and November 1989.

He has written articles in the areas of Monetary Economics, International Economics with special emphasis on Economic Integration and Economic Development.

Caribbean Centre for Monetary Studies

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Tenth
ADLITH BROWN
Memorial Lecture

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Delivered on
November 23, 1994 at the XXVI Annual Conference of the
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FOREWORD

The publication of this edited version of the **Tenth Adlith Brown Memorial Lecture** delivered by Governor Dwight Venner of the Eastern Caribbean Central Bank at the 1994 Annual Conference of Monetary Studies, has been unavoidably delayed but its message is, in every respect, still very relevant today. Perhaps even more so, now that the region is once again focusing on the issue of increased monetary integration, possibly including the establishment of a Common Caribbean Currency and a corresponding Monetary Authority.

As the CARICOM nation approaches the next millennium, the relevance of many of its existing institutions is being increasingly questioned. Our small independent states are under increasing pressure, on all fronts, with their viability being persistently threatened by globalisation and the anticipated removal of trade and other preferences, hitherto available. In these circumstances, a discussion on the role and functions of a critical institution such as a Central Bank is as important as the very institution itself. That such a vital institution - the apex of a nation's financial system, itself the economic nerve centre - would need unfettered room and capacity to competently discharge its central mandate, should hopefully become less and less in question as the Caribbean increasingly matures as a regional entity.

It is in this context, therefore, that the Caribbean Centre for Monetary Studies is delighted that Governor Dwight Venner has now been able, via this paper, to more permanently share his thoughts with the region and beyond, on such a topical and germane issue.

Laurence Clarke
Executive Director
Caribbean Centre for Monetary Studies
July 1, 1997

Adlith Brown

The Adlith Brown Memorial Lecture honours the memory of Dr. Adlith Brown, Coordinator of the then Regional Programme of Monetary Studies from 1980 to 1984.

Although born in Jamaica, Dr. Brown could truly have been described as a Caribbean woman. Her sense of regionalism was nurtured on the Mona campus of The University of the West Indies where she did her undergraduate work for the B.Sc. (Economics) offered by the University. She subsequently completed her Master's (with distinction) as well as her Doctorate degrees at McGill University.

Adlith returned to teach at the University (St. Augustine Campus) in 1969 and in 1971 was transferred to the Mona Campus where she taught Monetary Economics in 1976 and was one of the main anchors of its research programmes. She coordinated first the Caribbean Public Enterprise Project and from 1980 the then Regional Programme of Monetary Studies. In this period she was also promoted to Senior Research Fellow and in 1982 to the position of Acting Deputy Director, which she held up to her death. These latter years demonstrated most her capacity for intellectual leadership and for creative management.

Adlith revelled in the realm of ideas. It is therefore understandable that she was fast developing a reputation for being an outstanding economic theorist as her writings attest. Indeed, she was an ideal person to coordinate the then Regional Programme of Monetary Studies, given her passion for regionalism, her intellectual standing and her understanding of the process and problems of policy-making with which her colleagues in the central banks had to cope.

Each year the Open Lecture at the Annual Conference of Monetary Studies, now sponsored by the Caribbean Centre for Monetary Studies, is designated the ***Adlith Brown Memorial Lecture.***

INSTITUTIONAL CHANGES IN THE PROCESS OF NATIONAL DEVELOPMENT

A CASE FOR THE ROLE AND INDEPENDENCE OF CENTRAL BANKS

Mr. Chairman

I feel very honoured to have been invited to give the **Tenth Adlith Brown Memorial Lecture.**

There are three main reasons for this. Firstly, Adlith was a very close friend and colleague of mine in the Social Sciences Faculty, who I could always call on for advice and encouragement in what were sometimes very trying times on the Mona Campus of the University of the West Indies. She was also a close friend of my parents, having stayed at our then home in Grenada on the obligatory voyage UWI students made on the Federal boats in those halcyon days of West Indian unity, prior to the demise of the Federation.

Secondly, this (1994) is the 25th Anniversary of my graduation from the University of the West Indies at Mona, during which time I have "progressed" in the opinion of some well wishers, from being a Research Assistant in the Monetary Studies Programme, to a Lecturer in the Department of Economics, Director of Finance and Planning in the Government of St. Lucia, to my current position as Governor of the Eastern Caribbean Central Bank.

This has been a period full of insights and new learning experiences and I look back with a certain amount of satisfaction, thankful for the guidance of my teachers and mentors, as well as the many colleagues and friends who in many ways influenced and informed my views of the Caribbean, and my decision to play whatever role I could in its development.

I refer to people like Sir Alister McIntyre, who has been a tower of strength, and George Beckford, whose feeling for and confidence in the people of the region is up to this day a source of inspiration. There was the intellectual influence of Clive Thomas, Havelock Brewster, Norman Girvan, Owen Jefferson, Lloyd Best and Kari Levitt. Other colleagues in this era were Compton Bourne, Adlith Brown, Steve DeCastro, DeLisle Worrell, Frank Alleyne, Trevor Farrell, Simon Jones-Hendrickson, Mark Figueroa, and my close personal friend of many years, Claremont Kirton.

The above represent my intellectual influences and associations. In my post-Campus career, there have been three special influences: a group of scholar administrators among whom were William G. Demas, Alister McIntyre, Noel Venner, Pat Robinson, Frank Rampersad and Courtney Blackman; a group of regionalists comprised of Vaughan Lewis, Swinburne Lestrade, Roderick Rainford, John Compton, James Mitchell, and Fitz Francis; and my two closest colleagues, Marius St Rose, and Verley Harrison, both of the Class of 1969, who have had a particular influence on me in terms of their pragmatic approach to problems and "can do" attitudes, as well as their absolute reliability; traits which I can assure you have been absolutely vital to my post-Campus career. These traits are the solution to the perennial Caribbean problem of effective and efficient implementation of policies, programmes and projects, which have constrained our development over the years.

Thirdly, we are now at a veritable watershed in our economic history, as the world turns, so to speak, and makes its way inexorably towards the 21st Century. The international system has changed fundamentally and irreversibly over the last five years in a way which has prompted one analyst, Francis Fukuyama, to speak about the "end of history". This, however, is not the end of history, but the beginning of a new epoch which will require new, concerted responses from a Caribbean exhausted by structural adjustment, cynical about its political arrangements, and unclear about its place in the "New World Order".

It is this third reason which has led me to sub-title my lecture as follows: "From Political Independence to the Independence of Central Banks - Will This Panacea Bear Fruit?"

The lecture will take the following sequence: firstly, an introduction to the institutional and policy parameters of decision making and implementation practices in the region is presented.

Secondly, some observations are presented on the rationale and experience of central bank independence;

Finally, the Caribbean experience and options for the role of central banks in the development process are anlysed and set out.

DECISION-MAKING AND IMPLEMENTATION PRACTICES

The institutional arrangements for national development have undergone fundamental changes from independence to the present time, in keeping with the change in circumstances and paradigms in reference to the role of the state. On obtaining independence, Caribbean states faced two major related problems. These were: (a) The provision of employment; and (b) the need to improve the standard of living of the mass of the population.

These were linked to the attainment of rapid economic growth, which was constrained by the mismatch between our scarce resources, and our growing populations. Additionally, our economies were historically locked into an economic structure which severely circumscribed the flexibility and optimal use of our resources.

The independence of our countries was intended to provide us with greater degrees of freedom to deal with these problems at all levels, including the international. This was critical, as even though the countries had previous responsibility for their own internal affairs, including the economy, the capacity to engage in external economic relations opened new opportunities in the areas of trade, aid, foreign investment and the transfer of technology, which required the apparatus of an independent state.

The environment at the time of independence was marked by the ideological and geo-political rivalry of the great powers, East and West, which, while providing opportunities for choice, posed substantial risks as well. The socio-political conditioning of our political and administrative elites, however, was more attuned to London and Washington than to Moscow; besides which are geographically situated in the Western Hemisphere.

The choice of development paradigms posed by the regional surrogates of the two persuasions, Cuba and Puerto Rico, was therefore not a real choice, since we had in fact embarked on the policies of the Puerto Rican model since the early 1950s.

The work of Sir Arthur Lewis, in particular the, **Industrialisation of the British West Indies**, the so called "Industrialisation by Invitation" model, was instrumental in leading us in this direction for which he was at first soundly excoriated by the "Plantation School" of Lloyd Best, although he was rehabilitated by members of that "School" in the late 1980s. The success of the model in the newly industrialised countries of Asia, particularly Taiwan, is a source of much intellectual curiosity, given the relative economic circumstances of those countries and some of our own states in the early 1960s.

The need for a more activist state was inevitable, as the void in the economic structure of these countries was of such magnitude and the demands for improved standards of living so insistent that no elected body could depend on "laissez-faire" approaches to provide solutions to what had become intractable problems.

The state, therefore, had to chart policies and establish institutions which could frontally assault the problems of massive unemployment and social degradation. This was not out of line with the prevailing wisdom of the time because Keynesian economics, in which an activist state was a pivotal factor, had been responsible for the recovery from the Great Depression. While there was a distinct difference between a developed country which had idle capacity and an under-developed country in which capacity had to be created, this still called for more government action in what could only be described as massive market failure.

The historical evolution of the economy would also call for strong state action to change the rigidities in the productive structure, and to engineer the economy away from its high dependence on primary agricultural commodities towards secondary and tertiary activities. These would provide new employment opportunities and earn foreign exchange to import capital, intermediate and consumer goods which were critical to the process of economic development.

The activities of the state will be briefly assessed under three headings:

(a) Structural Policies;
(b) Fiscal Policies; and
(c) Financial Policies.

Structural Policies

As indicated above, the need for structural change was paramount among the objectives of our governments at independence. Political independence was to be translated into economic independence through the creation of a diversified and competitive economy with a new and dynamic industrial sector. The high expectations of the population at independence dictated that the social and economic problems of the day should be confronted and resolved within a finite time frame, encapsulated by the electoral time span of a series of five year mandates, the current one being the most important.

This led to two related approaches: (a) The formulation of Five Year Development Plans; and (b) The creation of parastatal bodies and statutory authorities to move certain activities outside the permanent bureaucracy so that implementation of plans, programmes, and projects could be expedited.

The development plans were all conceived within a macroeconomic framework emphasising growth and employment, but could best be described as comprehensive sectoral plans addressing the restructuring and development of Agriculture, Industry, Manufacturing and Tourism as the major economic activities; Physical Infrastructure such as Roads, Bridges, Airports, Seaports, Water and Sewerage, Electricity and Telephones and Social Infrastructure, primarily in the areas of Education and Health.

The industrial sector, however, was singled out as the main engine of growth and development. It was assigned a special role for meeting employment by attracting foreign investment and the associated technological and managerial expertise that presumably came with it, as well as the capacity to penetrate external markets.

Lewis' approach to the issue as set out in his **Industrialisation of the British West Indies**, is systematic and sequential. In his treatise, agriculture could not absorb the surplus labour in the society and solve the unemployment problem. Therefore manufacturing had to take on this role. His was not an Agriculture or Industry position, but in fact required an efficient agricultural sector to be successful. He, however, had to debunk the prevailing wisdom that developed countries had an absolute comparative advantage over underdeveloped ones in the production of manufactured goods. His major contribution was to illustrate that the latter had a comparative advantage in the production of those goods which required large amounts of labour in their manufacture.

Lewis then spells out the various sequences in the process, starting with simple labour intensive production and then moving to successive layers of higher sophistication as cheap labour becomes scarce. A critical factor was the creation of a local capitalist class which, in participating in the process, could learn "the tricks of the trade." This in a nutshell, is a caricature of the Taiwanese economy.

In the Caribbean, the process never produced a viable and competitive industrial sector for a variety of reasons. For instance, the high incidence of protection for what were essentially import-substituting industries, the small size of domestic markets, the non-transferability of technology and skills, and the eclectic and unplanned approach to the development of the industries as opposed to single firms.

The structural/sectoral approach was facilitated by the establishment of a slew of public corporations in such areas as Agriculture, Industry, Tourism, Finance, Public Utilities etc, which marked the increasing incursion of the state into the economic life of the countries of the region.

In retrospect, governments have come in for harsh criticism from the international financial institutions for such actions. However, it is easy to be critical when applying 20/20 hindsight and present day paradigms to historical situations. No doubt there have been serious policy mistakes and failures when state actions went to what were obvious extremes, based not so much on economic rationality, but on ideological persuasion. However, it would be unfair to criticise the governments of the day for attempting to fill serious gaps in the production and economic systems in order to meet the legitimate needs of a dispossessed population. It must also be pointed out that the international institutions were very supportive of these development thrusts in the 1950s and 1960s, with financing for infrastructure and the support of state actions to combat market failure.

Fiscal Policies

With respect to fiscal policies, the colonial system had emphasised a balanced budget, given the minimalist role envisaged for the state. The new dispensation, however, put considerable pressure on both the recurrent and capital budgets. The state became the employer of first and last resort as it attempted to keep its promise to tackle the unemployment problem. The need for infrastructure to attract both foreign and domestic investment put tremendous pressure on the capital budget, as did capital spending in schools, hospitals, health centres and community facilities; and the increase in debt service payments became marked as the level of borrowing required to sustain capital expenditure grew significantly. It was fairly obvious from this juncture that at some time in the future there would be a fiscal crisis of the state.

Financial Policies

We next come to monetary and financial policies and here we see an attempt to put in place a system representative of what would exist in a developed economy. This is consistent with what is known as the "Gap Analysis", that is, if the institutions which are consistent with the concept and notion of a developed financial system are not in place, they must be created. In the literature, this approach has been described by **Hugh T. Patrick (1966)** as "Supply Leading" or "Demand Following". In the first instance, institutions are created in advance of, or in anticipation of the demand for their services and in the second they are established in response to strong market signals.

In the region we have to a large extent followed the first approach that we inherited at independence; a highly skewed and underdeveloped financial system comprised of the following elements:- (a) a currency board system; (b) a dominant foreign commercial banking system; and (c) a limited variety of non-bank financial intermediaries.

The task of reconstructing and developing the financial system fell to the newly established central banks which replaced the currency boards. The major objective was to improve the availability of credit through stronger regulation of the dominant commercial banking sector and by the establishment of new institutions such as development banks, merchant banks, trust companies and stock exchanges.

Over time, specific policies towards commercial banking evolved which took the following forms: (a) Local participation in the share capital of foreign banks; (b) outright purchase of these institutions; and (c) the establishment of new institutions, some of which were completely government-owned.

The efforts aimed at restructuring the financial system have led in most cases to an imbalance between this sector and the real sector. This is easily understandable given the fact that the financial sector was always the most modern and technologically absorptive part of the domestic economy. As a consequence the revolution in information technology and automation, plus its attraction for the products of the secondary and tertiary educational system, has given it a considerable comparative advantage over the rest of the economy. This is compounded by the fact that most Caribbean economies are highly monetised. Finance is not an end in itself, however, and this mismatch needs to be corrected if there is to be diversified and sustained economic growth in the region.

In summary, we have the paradox of a reasonably sophisticated and competitive financial system out of sync with low technology, highly protected, poorly managed, real sector enterprises in a macroeconomic environment increasingly subject to capricious external shocks.

CENTRAL BANKING

The central banks have found themselves in the untenable situation, given the above, of having to finance fiscal deficits, regulate the banking system, and maintain the internal and external value of the currency, all at the same time. In such circumstances, the role and function of central banks in the Caribbean, like central banks the world over, have become very important as perceived by policy makers, the financial markets and the public at large. They have, therefore, emerged as vital institutions whose capacity to influence the process of development indicates that they represent a clear and present danger to the stable functioning of the macro-economy. It is for this reason that there have been such strident calls for the independence of central banks.

During the 1970s and 1980s important changes were made in the way a number of countries conducted their monetary policy. Among the reasons for this, in many developed countries, was the fiscal incapacity characterised by large budget deficits, which left monetary policy as a major instrument of economic policy. Whether it was by influencing the money supply or the interest rate, central banks became critical to the policy-making nexus, as government borrowing literally crowded out the private sector. Monetary policy, therefore, was used to affect either the price or the volume of credit. There are limitations in this arrangement as indirect measures such as these take effect with a lag and the transmission mechanism which ultimately leads to increased incomes and output is, if not controversial, certainly subject to different interpretations by various schools of thought.

The historical evolution of central banks as bankers primarily to the sovereign has placed this institution in the unenviable position of being lender of last resort not only to the commercial banks, but also to the Government. The unification of the note issue, which is another traditional role of the central bank, gave monopoly powers of issue to these institutions and accentuated their privileged position in the financial system.

The pivotal role of the central bank, therefore, places it in a position vis-a-vis the constitutional authority of the day, namely, the central government, in which there is an inherent conflict of interest between the two institutions. The state in a competitive party political situation has short term goals of stimulating growth and creating employment, while the central bank has more medium to long term goals in the maintenance of price stability. This time-inconsistency problem is the one upon which hinges the issue of the independence of central banks.

How is this problem to be handled in modern democratic societies with freely elected officials who have to answer to the voters at regular intervals? How does a body of unelected officials abrogate to itself the power to create money, and for whose good? In any event the form this independence should take would have to be enshrined in legislation and who is it that comprises the legislature?

Tenets of Independence

This clearly brings us to the question of 'form' versus 'function' and the specific manifestation of central bank independence, as seen through the eyes of various analysts who are now working in this area. **Cukierman, Webb, and Neyapti (1992)** have isolated four variables which they use to code the legal independence of central banks. They are:-

(a) The appointment, dismissal and term of office of the chief executive;

(b) the policy formulation cluster which concerns conflict resolution between the executive branch and the central bank over monetary policy and the participation of the central bank in the budget process;

(c) the objectives of the central bank; and

(d) limitations on the ability of the central bank to lend to the public sector; such restrictions limit the volume, maturity, interest rates and conditions for direct advances and securitised lending from the central banks to the public sector.

The results were interesting if somewhat obvious. Central banks in which the legal term of the chief executive officer is longer and the executive branch has little legal authority in appointment or dismissal, were judged to be more independent than those which were not thus constituted. Central banks which have wider authority to formulate monetary policy and to disagree with the Executive Branch in cases of conflict were classified as more independent than those which did not.

With respect to central bank objectives, price stability was given the highest ranking as opposed to other objectives which were in conflict with it. In the case of central banks lending to the public sector, those with tighter limits were adjudged to be more independent.

These, however, are juridical scenarios and may sometimes be evident in form but not actuality. In the final analysis a legislative body has the ability to reverse itself if public sentiment is not strong or if the public is not well educated on the issues.

We must, therefore, see the independence of central banks within the oft debated context of 'rules' versus 'discretion', as well as the historical politico-economic circumstances of the society. The core of the debate, according to Manuel Guitian of the IMF, is to establish what, if anything in the monetary sphere should be decided by rule and what if anything should be left to the discretion of the policy makers.

In setting the scenario for this analysis it is common in the profession to acknowledge "the analytical relationships between monetary and credit developments on the one hand, and the evolution of nominal variables in the economy, in particular, of the national income or domestic price level (and the exchange rate or the balance of payments) on the other" **(Guitian, 1994)**.

As Guitian further points out, there is an extensive body of work on this matter. However, despite the clarity of the theoretical work, its empirical consistency is doubtful, given the presence of uncertainty and the lags in transmission, particularly in the short run.

In practice, therefore, the need for policy predictability is a matter of great importance. To quote Guitian on this issue, "The underlying philosophy is that in a setting in which not only economies are subject to unpredictable shocks but where the short run effects of policies are difficult to ascertain, *ex ante*, the best approach is to prevent the implementation of monetary policy from adding to the uncertainties. In a nutshell, the gist of the argument is to assert that the predictability of policy should help offset the unpredictability of the environment." This is a crucial argument in making the case for the independence of central banks, since a predictable and consistent monetary policy can be implemented much easier by an institution which is not subject to the influence of the electoral cycle or whimsical changes in policy to address perceived short term objectives.

The capacity to acquire and maintain independence is therefore rooted in :-

(a) the standing of the institution itself; and

(b) the social and historical milieu of the country.

Central banks build the capacity to achieve and sustain their independence, whether *de facto* or *de jure*, by the quality of their work and the standing of their chief executive. The professional standing of the institution in its various specialised areas is the basis on which its independence and autonomy are founded. Central banks must engage in focused and fundamental research which must be accessible to major economic and financial interests as well as the public at large.

The regulation of the financial system is another area in which the expertise and the authority of the central bank must be pervasive and effective. Management of the payments system is yet another facet of the central bank's activities in which its technical expertise can have a major impact on the financial system and enhance the influence of the institution.

The standing of the chief executive in the community and the influence of his speeches and pronouncements can establish a clear view on important matters of public policy. The importance of price stability, for example, can be injected into public discourse by the speeches of the chief executive and the publications of the central bank until it becomes a matter which various economic interests and the public become sensitive to and use as a yardstick for assessing the economic wellbeing of the nation.

The social and historical climate in which the independence can be found is probably best exemplified by the Bundesbank, described by **David Marsh** in his book entitled, **The Most Powerful Bank Inside Germany, (1992)**. The Bundesbank has been given the role of maintaining the value of the Deutsche Mark without reference to the government. The historical circumstances of debilitating hyperinflation in post-war Germany have made domestic price stability the most important policy objective in that country. The Bundesbank is regarded by the German public as the principal upholder of that policy and has a strong mandate to exercise its powers to maintain monetary and price stability.

Another interesting case is New Zealand, where there has been an accord between both political parties to make price stability the only objective of the central bank. The government has signed an undertaking with the bank, making the governor responsible for achieving this objective and giving the bank the capacity to pursue it without interference.

Many countries around the world are seeking to make their central banks legally independent as a response to the increasing current policy perception that this is the only way that price stability can be achieved and maintained.

The interesting feature of this phenomenon, for such it is, is that it is clearly a societal response to the ravages and uncertainty wrought by hyperinflation. The trend can be reasonably correlated by the duration and effects of the hyperinflation, with some countries in extreme cases opting for currency board systems (for example, Argentina). In Jamaica as well, calls have been made for a reversion to currency board status and the literature on this particular institution has increased by leaps and bounds in recent years.

In my view it all goes back to **predictability** and the establishment of a matrix of well defined rules which will govern the actions of the monetary authorities. These clearly have to be acceptable to the main economic actors and allow some measure of discretion in case there is an event so drastic that new rules are required to deal with the threat to the economic system.

It is also prudent to remember that there is no such thing as 'absolute independence'. The case of the reunification of Germany is the one which proves the point most eloquently. The Bundesbank did not favour the one to one conversion of the Ostmark to the Deutsche Mark, but it was overruled by the Government on the grounds of the greater importance of national unity at that juncture. This was a very trying time for an institution accustomed to having its way on issues of this kind.

A fairly similar point about adjusting to political realities can be made with respect to another relatively powerful and independent central bank, the US Federal Reserve. The Federal Reserve must constantly observe the rules of the game with respect to the relationship it has with the two major elected components of the American body politic, the President and the Congress.

One circumstance which does seem to favour the independence of central banks is whether they operate in a country with a federal or a unitary constitution. Federal constitutions seem to be propitious for the existence of independent central banks if you take the Bundesbank and the Federal Reserve as being among the most independent of such institutions. The negotiations leading up to the establishment of the European Central Bank would also seem to suggest that this entity would have a fair degree of autonomy. Such would also be the situation in the case of the Eastern Caribbean Central Bank, Dr. Courtney Blackman's model of what an independent central bank in the region should be.

It would seem that in a multistate context, the degrees of freedom for independent policy initiatives by the central bank have a greater chance of success than in the case of a unitary state.

THE CARIBBEAN CONTEXT

What has been and what currently is the situation in the Caribbean? We have come full circle, so to speak, from political independence to the independence of central banks, and the last twenty-five years have witnessed a marked shift in political and economic philosophies. The excesses of the activist state have been recognised and we have come to the stage of assessing the policy levers we have at our disposal. May I suggest from my experience over the past thirteen years that the basic parameters of economic policy are fairly clear and revolve around strong fiscal policies, and if not an independent central bank, a fairly autonomous one. We have gone our separate ways in this region in terms of political and economic objectives to our own detriment.

Politically, we have lost the opportunity, thus far, to create a supra-regional state stretching from Belize to Guyana across the Caribbean archipelago, and in the process severely circumscribed the negotiating power of what could have been a viable entity.

Economically, we have failed to achieve the integration of our production resources as spelled out by **Brewster and Thomas** in their 1967 publication, **The Dynamics of West Indian Economic Integration.** We have also fragmented the currency arrangements which had existed from 1949 to 1972 in the Eastern Caribbean.

The situation in the monetary sphere has been marked by the splitting of the region into two types of exchange rate regimes, namely, the 'floaters' and the 'fixers', as I like to call them. The 'floaters' have arrived at this position, in my view, by their inability to eschew the use of the printing presses to finance deficits and to follow prudent fiscal policy. There is an 'iron law' in open economies such as ours that posits a one to one correlation between deficit financing and a deterioration of the balance of payments. It is, therefore, not a viable policy to pursue, other things being equal, and can only lead, as it has, to the devaluation of the currency. The devaluation of a currency in this region is equated with economic failure. It certainly, in our open economies, leads to inflation, whose containment in this new dispensation is the major objective of central banks.

The argument for central bank independence or the establishment of clear rules given the temptation to indulge in deficit financing, is therefore conclusively made in the regional context.

Credibility and Consistency

As a result, the state is left to singularly craft a policy based on fiscal balance and structural reforms in the real economy. The major issues which are involved in this scenario are 'credibility' and 'consistency'.

Policies must be credible and predictable, in a situation where most things are in flux, and must be consistently pursued over time to ensure that they do in fact gain credibility. The 'fixers' are in that position of having gained credibility but this must be carefully maintained with adherence to sound fiscal and monetary policies. The 'floaters' must attempt to arrive at a credible exchange rate and maintain it over time.

We have in recent times discussed the question of a Caribbean monetary union and some work has been carried out on this issue. The matter does require our attention from the standpoint of the economic future of the entire region and how we intend to address the problem of our competitive insertion into the international economy. Like the Europeans, we have reached the stage in our integration movement where we must move beyond trade and functional cooperation to the integration of production and financial systems.

We had in the Caribbean Community envisaged a number of stages and criteria through which we could seek to establish a single currency in the region. The idea was to have convergence by at least 1999. The floating of the Trinidad and Tobago currency and slippage in Jamaica and Guyana have sidelined the matter for the time being, and the concept of the convertibility of regional currencies is now being advanced instead of the notion of a single currency.

This will require the same conditionalities as those for establishing a common currency, and will influence the process of convergence in the region. It will, however, lead to a test of confidence in the acceptability of regional currencies in states where they are not legal tender.

A CARIBBEAN CENTRAL BANK

What form would a Caribbean Central Bank take, that is, if it were to become a reality?

I would suggest with the modesty associated with practical experience that it be patterned after my own institution, the Eastern Caribbean Central Bank.

The decision making structure is headed by a Monetary Council consisting of the Minister of Finance of each participating government, with the Chairman being rotated annually.

The Board of Directors similarly consists of representatives from each country, drawn from both the public and private sectors. There are some fundamental rules which are similar to the entrenched clauses of a constitution. The following are worth noting:

(a) Any change in the exchange rate can only take place on the unanimous decision of both the Board and Council;

(b) the currency in circulation and other demand liabilities must be backed by a minimum of 60% foreign securities. Changing this also requires a unanimous decision;

(c) credit to the government is clearly circumscribed by rules; and

(d) the participating governments place all their foreign exchange earnings in a common pool which can only be accessed by the exchange of domestic currency for the foreign exchange in the pool.

When one thinks of the facility at (d), thoughts of the massive amount of foreign exchange which has come into regional coffers from oil, bauxite, tourism, manufacturing and export agriculture remind us of what could have been if we had a regional foreign exchange pool.

As an institution with the capacity to carry out technical work of the highest order, a Caribbean Central Bank would not only receive its independence by statute, but cement it by technical and professional excellence.

The establishment of a common Caribbean currency and a corresponding monetary authority would lead to the effective integration of regional money and capital markets, and the increased capacity to raise domestic savings and attract foreign capital. The stability, growth and development that result would justify the decision in political and pragmatic terms, as it would allow us to respond with confidence to the changes in the international system which are now upon us.

CONCLUSION

In conclusion, I would like to thank you for your patience and assure you, on behalf of this generation of Caribbean central bankers, of our commitment to strong and progressive institutions, either singularly, or more hopefully in a regional monetary entity.

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