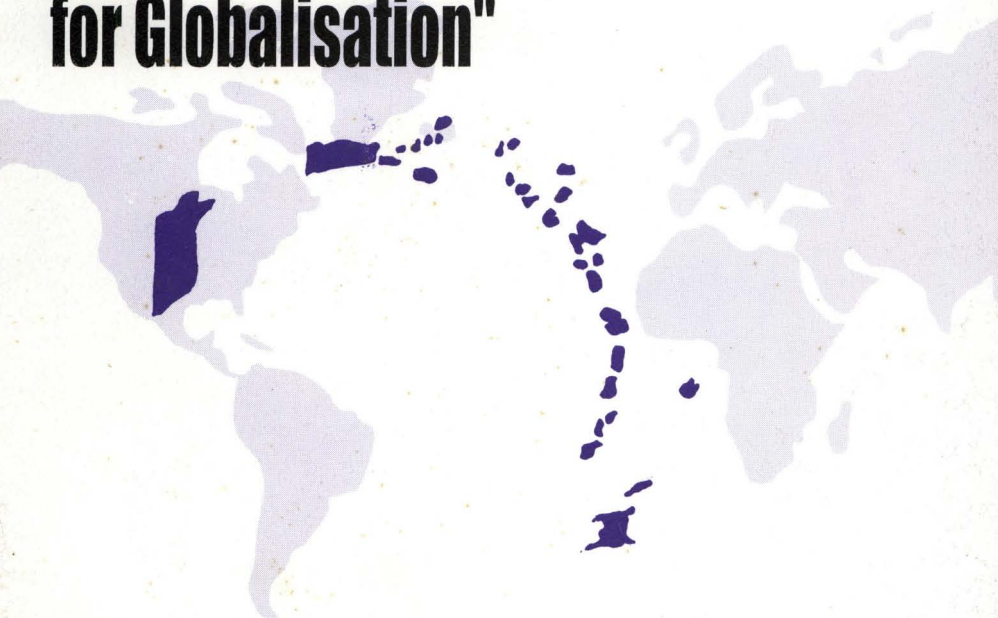


The XIII Adlith Brown Memorial Lecture

"The Urgency for Very Small States to Articulate Specific Strategies for Globalisation"

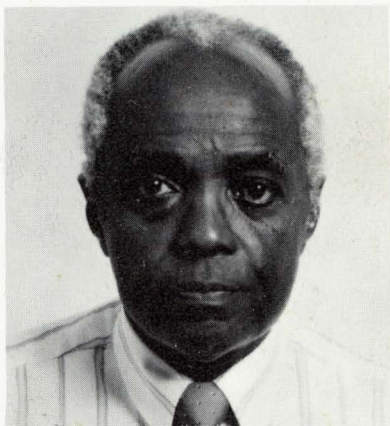


by **Clarence Ellis**



THE ADLITH BROWN MEMORIAL LECTURE SERIES

1. 1985 Bahamas **Courtney Blackman**
"A Heterodox Approach to the Adjustment Problem"
2. 1986 St. Kitts **Maurice Odle**
"Transitional Banks and the Problems of Small Debtors"
3. 1987 Belize **William Demas**
"Public Administration for Sustained Development"
4. 1988 Trinidad & Tobago **Edwin Carrington**
"The Caribbean and Europe in the 1990s"
5. 1989 Barbados **Bishnodat Persaud**
"The Caribbean in Changing World: We Must Not Fail"
6. 1990 Guyana **Karl Bennett**
"Monetary Integration in CARICOM"
7. 1991 Belize **Owen Jefferson**
"Liberalization of the Foreign Exchange System in Jamaica"
8. 1992 Bahamas **Havelock Brewster**
"The Caribbean Community in a Changing International Environment Towards the Next Century"
9. 1993 Trinidad & Tobago **Richard Bernal**
"The Caribbean Caught in the Cross Currents of Globalization and Regionalism"
10. 1994 Jamaica **Dwight Venner**
"Institutional Changes in the Process of National Development: The Case for an Independent Central Bank"
11. 1995 St. Kitts **Neville Nicholls**
"Taking Charge of Our Future Development"
12. 1996 Trinidad & Tobago **Richard Fletcher**
"After Four Decades of Economic Malpractice: What are The Options For the Caribbean?"
13. 1997 Barbados **Clarence Ellis**
"The Urgency for Very Small States To Articulate Specific Strategies for Globalisation"



Clarence Francis Ellis spent a substantial proportion of his early working life as a primary school teacher and rose to the position of Deputy Headmaster. He then embarked on an alternative academic career and entered the University of Leicester where he studied Economics and Economic Statistics. After a short spell in the British Civil Service as an Assistant Statistician, he enrolled at the London School of Economics and graduated with a Master's Degree in Economics.

He then joined the Bank of Guyana where he spent most of his professional life as an Economist, rising to the position of Deputy Governor. While retaining his post at the Central Bank, he functioned as Executive Head of a reformulated State Planning Secretariat in Guyana and was the senior officer in charge of monitoring budgetary and planning operations of the public sector in Guyana.

After leaving Guyana, he spent a year at the Massachusetts Institute of Technology as a student in the Department of Urban Studies and Planning. He then served for four years as an adviser to the Governor of the Eastern Caribbean Central Bank, later representing CARICOM countries as Alternate Executive Director at the World Bank, and as an Executive Director at the Inter-American Development Bank.

Subsequent to the latter appointment, Mr. Ellis worked as a consultant in economics primarily for the CARICOM and the OECS Secretariats, as well as the Caribbean Centre for Monetary Studies.

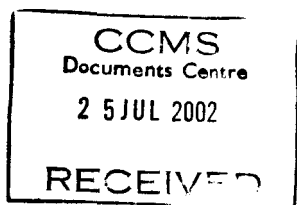
 **Caribbean Centre for Monetary Studies**

Established under the joint auspices of the Central Banks of the Caribbean Community and the University of the West Indies.

THIRTEENTH ADLITH BROWN MEMORIAL LECTURE

**THE URGENCY FOR VERY SMALL STATES
TO ARTICULATE SPECIFIC STRATEGIES
FOR GLOBALISATION**

Clarence Ellis



**This is the revised text of a lecture given on October 28, 1997 at
the XXIX Annual Conference of the Caribbean Centre for
Monetary Studies of the University of the West Indies,
St. Augustine, Trinidad and Tobago**

© CARIBBEAN CENTRE FOR MONETARY STUDIES

Thirteenth ADLITH BROWN Memorial Lecture

Clarence Ellis

**Delivered on October 28, 1997
at the XXIX Annual Conference of the
Caribbean Centre for Monetary Studies (previously
Regional Programme for Monetary Studies)
at the Central Bank of Barbados,
Bridgetown, Barbados**

**CARIBBEAN CENTRE FOR MONETARY STUDIES
THE UNIVERSITY OF THE WEST INDIES
ST. AUGUSTINE, TRINIDAD AND TOBAGO**

ISBN: 976-620-100-5

The Late Dr. Adlith Brown

The annual Adlith Brown Memorial Lecture honours the memory of Dr. Adlith Brown, Co-ordinator 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 from 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 co-ordinated 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 of being an outstanding economic theorist as her writings attest. Indeed, she was an ideal person to co-ordinate 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 Conference of the Annual Monetary Studies, now sponsored by the Caribbean Centre for Monetary Studies, is designated the **Adlith Brown Memorial Lecture**.

The Urgency for Very Small States To Articulate Specific Strategies For Globalisation

Clarence Ellis

Opening Remarks

I feel distinctly honoured and privileged to be asked to deliver this lecture tonight on the occasion of the XXIX Annual Conference of Monetary Studies. In the spirit of **Dr. Adlith Brown's** contribution to the monetary programme of the central banks, I would like to state at the very outset that there is an underlying ideology in these remarks. It is an ideological objective with which, I think, Dr. Brown would have agreed.

Underlying Ideology

My comments tonight are directed to a consideration of that elusive objective of securing economic independence in CARICOM. By economic independence I mean the state of development in any country when the majority of the people wish to stay at home. People stay at home for several reasons. Among them are those relating to relatively high income levels and diversity in economic opportunities. By the first test of relatively high incomes, The Bahamas and Barbados have reduced their out-migration rates considerably. By the second test of diversified economic opportunities, all CARICOM countries are in jeopardy of continuing to lose many of their best young people.

A state of economic independence must also provide hope to the bottom fifth to a third of the people in all our CARICOM countries who face economic destitution. Even in Barbados where the level of equity has reached such

high standards as would place Barbados at the position of 25th in the world in the Human Development Index, policies and institutions are necessary to empower those people at the bottom rungs of the society to participate in the export activities that the country is pursuing.

Sir Neville Nicholls, President of the Caribbean Development Bank, was passionate when I once interviewed him, about the need for our economic strategies and policies to embrace the welfare of those struggling to escape poverty. Sir Neville's stress and his concern reminded me of what a Deputy Head Master told me when I was a qualified professional teacher in a primary school. He said, as he observed me teaching, that my salvation rested on the success with which I brought along the weaker students. The bright ones, he reminded me, would learn despite the teacher. The weak ones learn because of the teacher. In a similar manner, the weaker members of our CARICOM countries require policies directed at teaching them professional, craft and business skills of which our societies are in short supply.

If programmes to teach these skills are made widespread, we can, in one or two generations, eradicate poverty. What we need to bear in mind is that poverty is perpetuated inter-generationally. Poor mothers and poor fathers parent poor youth. Programmes directed at educating poor youth are often ineffectual because the social conditions in the homes of those young people tend to nullify the tuition and training of the youth programmes. To eradicate poverty, programmes have to be directed at poor parents at the same time as efforts are made to educate poor youth. When I taught in a primary school, it was the poor parents who came hurling at me to refrain from punishing their children. Research done in Barbados has highlighted the weak educational capacities of small business people. If this is the case in Barbados with the best education system in CARICOM, you can imagine what it is in other CARICOM countries. It is for reasons such as these that we are faced with the inter-generational perpetuation of poverty.

Some Departure from Current Orthodoxy

These are problems which are deeply entrenched in the metropolis as well. They are not addressed in those countries because they have implications for the struggle between social classes. We should be very wary, therefore, when we are offered developed country solutions to the eradication of poverty. It is not likely that poverty eradication practitioners from developed countries can tell us much when they find it impossible to eradicate poverty in their own countries.

It is this very scepticism that I ask that you bring in the Monetary Studies Programme to the theories and research activities that you will be discussing and developing. Adlith loved such scepticism and would wish to see it constantly applied. One major underlying theme of my remarks is that we are vastly ignorant of the micro-foundations of the macro-economic policies and models that we design. To some extent, that is the result of the way we have been taught. **Professor Frank Hahn** has made the observation that:

It is a consequence of intellectual coarseness and not of Keynes that university syllabuses are so frequently divided into water tight macro-and micro-economic courses. Even if it is granted that in the manipulative, one might almost say the arithmetical stages of Keynesian economics, relative prices play a subordinate role, it is after all the cases that Keynes argues that the actions of agents in markets would not result in the equilibrium posited by his predecessors. It is hard to see how this very important proposition is to be understood without micro-theory. (**Hahn, 1984: 64**).

If we examine the macro-theorising that we pursue, we will find that little attention is given to the specific ways in which our micro-units behave. We tend to assume that they ought to behave, and will behave, as in developed

countries and are surprised when our macro-economic projections are disappointing.

The water-tight distinction which we tend to make between micro- and macro-economics is carried over into our theorising in monetary economics and real sector economics. There is a preoccupation with monetary theory that tends to ignore what **Professor Basil Moore** calls the “causal interdependence” between monetary and real sector developments (**Moore, 1994: 133**). Recently, at a Liquidity Management Seminar at the Caribbean Centre for Monetary Studies, **Dr. Courtney Blackman** made a very important statement that our political leaders and government officials should ponder seriously. Blackman said that:

Policy makers have failed to address serious real sector issues and have spent far too much time on the concerns of the financial sector. If the real sector can be motivated to perform, then financial instruments, like exchange and interest rates, will attain the desired levels (**Blackman, 1996: 14**).

At the same seminar, **Dr. DeLisle Worrell** made a similar plea for a better balance in policy design. His remarks were as follows:

The danger we face is that of placing too heavy a burden on the monetary policy instruments that are available to us. We should regard them merely as devices to buy time to address the fundamental problem which is determining the balance of payments (**Worrell, 1996: 20**).

In similar vein, **Professor Paul Davidson** had long ago written the following:

If the desire for capital goods is weak because of poor long term expectations and/or a lack of confidence in the future, then easily obtainable finance will not, by itself, do the trick. If, on the other hand, the desire for investment is strong,

the banking system and financial intermediaries can play an essential role in providing funds on terms which investors deem attractive (**Davidson, 1972:362**).

The challenge which the central banks and the Monetary Studies Programme face, therefore, is that of recognising that efficiency in economic management is not divisible and separable. The new wave for the independence of the central bank, for example, should be concerned with the intimate interdependence between monetary and real sector policies. Merely washing central bank hands clean by establishing independence is not a solution to the deficiencies of decision making that lead governments to pursue disastrous policies. Central banks have to help governments to overcome the deficiencies in their decision making systems. It is not enough for central banks to claim that they have efficient decision making systems and not make them available to governments.

How this interdependence is to be established without compromising the integrity of the central bank decision making system will vary according to the dynamics in each country. Pulling out a universal formula drawn by the Multilateral Financial Institutions from the Federal Reserve Bank of the U.S.A. or the Bundesbank in Germany is not the answer. Governments have, of course, to accept the disciplines thereupon imposed on them by central banks in the various ways in which interdependence is pursued. And therein lies the problem. Since governments are sovereign, they tend to assume dominance in all matters. But it is much better to accept the dominance of central banks in financial matters than to abandon sovereignty altogether when the IMF is called in.

Critical Assessment of Economic Theory

The difficulties that we face in resolving these problems is, in part, the result of borrowing too uncritically from mainstream economic theory. We have not sufficiently challenged mainstream theory with the critiques of

alternative models. We are not bold enough to develop, as **Joan Robinson** once advised, a habit of mind that would “eschew fudging, respect facts and admit ignorance of what WE DO NOT KNOW” (**Robinson**, quoted by **Harcourt, 1986: 96**).

Let us begin by considering one of the contributions that Keynes made to economic theory. When Keynes was arguing, as Frank Hahn is suggesting, that the actions of economic agents would not result in general equilibria, he attacked the assumption that everything was eventually substitutable for everything, and cleverly argued that the demand for money was different. The demand for money was, in substantial part, a demand for coping with uncertainty. To develop a model which was consistent with the restoration of general equilibria, that is, with the restoration of full employment, he pulled investment out of the system where everything was substitutable for everything and made investment exogenous to the system.

Sir John Hicks, a Nobel Prize Winner, just as cleverly restored endogeneity to the system with the ingenious construction of the IS-LM framework. Everything within the model was once again dependent on everything.

However, in 1976 and 1977, Sir John Hicks recanted. He noted that:

These equilibrists did not know that they were beaten.... they thought that what Keynes had said could be absorbed into their equilibrium system. (**Hicks, 1976** quoted by **Davidson, 1991: 27**).

In another reference to what he considered his earlier mistake, Hicks said:

In spite of all that has happened to that particular piece of theory i.e. (IS-LM)-the further elaborations at the hands of Samuelson, of Debreu, of so many others... the time came when I felt I had done with it. I could see that it was nonsense. (**Hicks, 1977** quoted by **Davidson, 1991: 28**).

I sometimes hope that we in CARICOM will say the same. But although the inventor of IS-LM says it is nonsense, the economics profession holds on to it dearly and is increasing the stress on complete endogeneity in macro-economic and growth models.

Samuelson's elaborations to which Sir John Hicks referred were indeed elegant. He tried to make economics a hard science like physics by advancing three axioms. The first was that money was neutral over the long term. The second was that Keynes' difficulty with uncertainty could be overcome by projecting knowledge about the future from what has happened in the past and from what is happening now. The third axiom was that of gross substitutability. Everything is indeed eventually substitutable for everything.

In some work which I have done for **Dr. Laurence Clarke**, I have argued strenuously that uncertainty is endemic in CARICOM countries and that money, in these parts, is never neutral, neither over the short term nor the long term.

Every year, the Eastern Caribbean, Jamaica and The Bahamas face the likelihood of natural disaster from hurricanes. They have been facing these disasters from time immemorial. The governments, the businesses and the people have to put money aside for these eventualities. The need to do so is highlighted dramatically by the situation in Montserrat. Perhaps, because the economies are so open, Keynes' demand concerns about the non-neutrality of money are not as important as in the more closed system that Keynes had in mind. But the openness of the economies emphasizes, on the supply side, the importance of the demand for foreign exchange. In these circumstances, the demand for money is affected by the uncertainty that the value of domestic money will be maintained in terms of foreign exchange. To construct models for CARICOM countries therefore, on the assumption that uncertainty could be reduced to determinable probabilities is, in Joan Robinson's terms, a fudge. But, in large measure, that is precisely what is being done. Whenever we are tempted to use the Rational

Expectations Hypothesis in our economic reasoning for CARICOM countries, we should ask ourselves whether we are not extending that fudge too far.

The second critical assessment of the Samuelsonian system is that of the substitutability assumption. That drives the prediction, for example, that export production can be made to take the place of import substitution. **Dr. DeLisle Worrell** has always been sceptical of that prediction. "Small countries," Dr. Worrell argues, "need not be concerned about incidental "anti-export bias" which might arise from justifiable tariff policy. The import substitutes which become profitable as a result [of that tariff policy] account for such a trivial proportion of human and financial resources that they do not inhibit investment in export production." (**Worrell, 1989**).

That was indeed an insightful observation. If we ask ourselves what production stimulus tariff reductions have brought on the economies, the answer is, very little. Only in Trinidad and Tobago, is there enthusiasm for the trade liberalisation policies that were pursued under the Structural Adjustment Programme. And Dr. Worrell's assessment, with which I agree, is that the comparative advantages there derive from the capital stock built during the oil boom and from the relatively lower price of energy.

This whole issue of substitutability, as admitted by mainstream economists such as **John Williamson** and **Mohsin Khan**, is that it cannot be assumed and must be established empirically. When we are dealing with mono- or duo- or trio-economies, the presumption is that elasticities of substitution are low or non-existent. Any changes that will come about as a result of changes in relative prices (as when tariffs are lowered) would result from new investments and not from switches in existing production. Again quoting from Joan Robinson, she notes that:

At any moment, the stocks of means of production in existence are more or less specific. The level of output may be higher or lower with the state of demand but there is little play in the composition of output. Changes in the adaptation of resources

to demand can come about only through the process of investment. (Robinson, 1978: xii).

Substitutability therefore is over the long term. A World Bank Project Completion Report admits that the period over which this substitutability can be expected to be in evidence in Trinidad and Tobago is as much as ten years. Given this long time period and the importance of assessing success, one would expect that there would be a statistical system in place to measure the investment response to these policy changes. It is the World Bank itself that states, in another document on the Private Sector, that the information for such assessments just does not exist. One might add, attempts to provide the data are also not being made.

Some Macro-economic Measurement Deficiencies

Such measurement of investment that we do pursue employs a methodology that is primitive. We measure investment by the method of commodity flow. The Bahamas which is a relative newcomer to national income statistics does it differently, by reference to the sources of investment.

The method pursued by The Bahamas is not difficult. It is merely tedious. Investment by the Government can be obtained from the Budget. From the private sector, investment data can be obtained from the returns of the firms to the Inland Revenue Departments and to the Statistical Departments. To the extent that housing investment from households takes place outside of the finance of private sector firms, direct methods of measurement are necessary.

Instead, in the rest of CARICOM, investment is measured by adding a margin to the flow of construction materials. The method is primitive not only because it is difficult to estimate the margin but because the flow of construction materials to repairs and maintenance can vary from year to year.

I raise this issue because it is at the heart of the micro-macro distinction and the unwillingness to give

sufficient attention to micro-economic behaviour. Later when I come to look briefly at our micro-conditions some more, I will stress that assumptions that economic and bureaucratic units are maximisers are inappropriate. We are often "satisficers" and are constrained from maximising by what **Herbert Simon** called "bounded rationality" This is an important concept. It earned Herbert Simon a Nobel Prize in economics for his work on advancing its analysis. **Milgrom and Roberts** define bounded rationality as that condition that puts limitations on human mental abilities and that prevents people from foreseeing all possible contingencies and from calculating their optimal behaviour. Bounded rationality may also include those notations on human language that prevent perfect communication of those things that we know (**Milgrom and Roberts, 1992: 596**).

Rationality, in respect of the methodology for collecting investment statistics, is certainly bounded by sub-optimality in our data collecting systems and by the poor communications between us as professionals in respect of the advantages of improving the system. For example, we do not write papers on investment data collecting methodology. Nor do we compare the merits of investment data that provide us with reliable estimates of gross and net investment, even though it is only net investments that will tell us whether substitutability is increasing. In other words, papers on these topics are not as prestigious as papers on monetary theory, even though a lot of the conclusions of the monetary economics papers are spurious because the data on investments are so poor.

To a large extent, we are inundated with investment data that are over-estimated, that consequently lead to under-estimated levels of consumption and to over estimated levels of savings. Some improvements may be forthcoming because the IMF is now mandated to improve data-bases in all countries for better interpretation of their own surveillance activities. And since a substantial reason for our statistical data is to supply the IMF and the World Bank with the data they need, we will do so when those agencies require us to do so.

This is what I think worried **Dr. Adlith Brown**. Why could we not widen the bounds of our rationality by ourselves with, say, a session at this Conference on the question of data-bases? Why does the Monetary Studies Programme view the CARICOM Statistics Conferences as distant events?

The bounds apply not only to investment statistics but to such vital data as:

- (a) employment by industries;
- (b) wage levels in the various industries (as indicators of any trends towards Dutch disease);
- (c) independent estimates of the gross domestic expenditure (to serve as a check on the output estimates);
- (d) distributions of national income between wages and salaries, profits, interest, rent and depreciation; and
- (e) income distributions (as measures of equity).

These bounds apply not because there are no statisticians. I can assure you that there are excellent statisticians employed to shuffle administrative paper instead of applying their talents to areas where they can enlighten us as to what is going on in our economies.

A Better Understanding of the Micro-Foundations of Macro-Economic Policy

A part of my thesis is that the bounds apply, and will continue to apply, because we do not know enough about the micro-economic units which constitute our economic environment. It is amazing how economic management improves when we know more about what is going on in our micro-economic units. It is my belief that the recent collapses in Mexico and South East Asia are the result of insufficient knowledge of what is happening in the micro-economy. You will note that there has been no equivalent collapse in Singapore or South Korea or Taiwan. Those three countries take their statistical details very seriously.

The reluctance to be diligent about knowledge of micro-economic behaviour, as those comments imply, is not only a CARICOM weakness; it is endemic in the Third World. **Professor Clive Thomas**, in reviewing technological dimensions of development policy, noted about 20 years ago that as basic a practice of inventorising a country's natural resources and of developing training related to the appropriate technologies was not usually established (**Thomas, 1974: 201-202**). This neglect is carried over into other areas where inventorisation should be pursued as a basis for policy. We do not know what we have and we often do not bother to find out.

Professor Ronald Coase, a Nobel Prize winner, widens the criticism to developed countries as well. In stressing the importance of institutions related to:

- (a) providing information;
- (b) negotiation of contracts;
- (c) monitoring of contractual arrangements; and
- (d) empowering the courts to enforce contracts,

Coase said the following-

The neglect of [these] aspects of the [Economic] system has been made easier by another feature of modern economic theory—the growing abstraction of the analysis, which does not seem to call for a detailed knowledge of the actual economic system or at any rate has managed to proceed without it... . What is studied is a system which lives in the minds of economists but not on earth. I have called the result “black board economics”... . The ex-communist countries are advised to move to a market economy and their leaders wish to do so, but without the appropriate institutions, no market economy of any significance is possible. If we knew more about our economy, we would be in a better position to advise them. (**Coase 1992**, quoted by **Stein, 1994: 1833**).

When money is seen as determining the terms in which contracts are written and when money has to be

held to meet the contingencies of incomplete contracting, it becomes evident that stability in the value of money helps to reduce the costs of incomplete contracting. This introduces a business contract dimension to arguments about the value of money. Discussion in these terms requires the use of the disciplines of both law and economics for a better understanding of business behaviour. The value of money, as considered by these wider dimensions, depends on the capability of the economy to produce a wide diversity and large quantities of goods. Domestic money value is therefore enhanced when the legal sphere to which the money applies is strengthened by monetary integration arrangements because of the potential claim to a larger flow of goods and services from an integration movement.

These are real world complexities that the businessman faces when choosing between alternative currencies to write contracts. Unfortunately we cannot advise on these issues because we know too little about the future values of currencies. In these areas, we have been far too abstract and can rightly be accused of being blackboard economists.

Another example of blackboard economics is our neglect to think of the firm, as an organisational entity, that can often research prices, arrange production activities, negotiate contracts and enforce their terms at a cheaper cost than markets can do. That is why firms exist. In very many situations, firms are more efficient at coordinating production than markets.

When the firm is studied in these terms, it is seen internally as an institution of non-market interactions which can attempt cost minimisation either by being authoritarian or liberal in its human relations. As **Harvey Leibenstein** suggests, and as Dr. Laurence Clarke in his doctoral thesis stresses, organisational efficiency, sometimes called X-efficiency, may be more important than market efficiency. The emphasis in the X-efficiency analysis is on the non-market interactions. Leibenstein notes that:

[X-efficiency considerations] clearly imply that standard micro-economics with its intense focus on market behaviour (monopoly, oligopoly, etc),

whatever its value at that level, cannot enable us to understand economic development fully. **(Leibenstein, 1989: 1362).**

If developed economies are neglectful of the study of institutional dimensions associated with contracting, CARICOM countries are woefully inadequate in respect of the X-efficiency dimensions of our farms, businesses, factories, seaports, airports and public institutions. In farming, for example, although we have the Agriculture Faculty of the University of the West Indies, the Caribbean Agricultural Research and Development Institute and the Caribbean Food Corporation, all residing in close proximity in Trinidad and Tobago, not a single farming system analysis was used in the agricultural sector adjustment programmes for Trinidad and Tobago. Despite the urgency of the banana problem, appropriately sized banana farming models, as sustainable systems, have not been developed for the farmers in the Windward Islands. The high productivity of Menonite agriculture in Belize has not been researched for possible adaptation in the rest of CARICOM. We forget that analyses that stress prices and costs, outside of the contexts of specific farming systems, do not embrace these X-efficiency dimensions. Rationality, as we earlier saw, remains bounded and optimisation is not achieved. The World Bank, the World Trade Organisation (WTO), the U.S.A. and the Latin Americans critique the banana problem from the standpoint of the efficiency of the banana markets without giving adequate consideration to improving the X-efficiency of the Windward Islands and Jamaican banana farms. This has led to confusion as to what solutions should be pursued.

Dr. Arnold McIntyre similarly laments "the absence of empirical research at the micro-level on the export sector. Studies using firm specific-level or industry-data to test alternative propositions or review export performance were virtually non-existent." **(McIntyre, 1995: 165).**

And yet, we have recommended (myself principally among the "we"), that tariffs be reduced to achieve efficiencies in the export sector without knowing whether the ills are primarily institutional inefficiencies, market

inefficiencies or X-inefficiencies. We were hoodwinked by the World Bank that market inefficiencies and institutional inefficiencies were the problems. As I indicated earlier, Dr. Worrell impliedly argued against the recommendations by reference, at the macro-economic level, to the scale of the import substituting operations in the total economy. My contention here is that there is a serious analytical flaw at the micro-economic level. The lesson here is that macro-economic policies, whether monetary or otherwise, should not be designed without a better understanding of their micro economic foundations. And those micro-economic foundations must include, most importantly, considerations of organisational inefficiencies, referred to here as X-inefficiencies.

In CARICOM, we have shifted to an uncritical acceptance of the market without examining the complex relationships of markets to institutions and to business organisations.

The Need for Strategic Frameworks

It is clear that we are not optimising in CARICOM. Some CARICOM countries have done well. The Bahamas has a per capita income of about U.S.\$12,000, while Antigua and Barbuda has reached U.S.\$7,000 and Barbados exceeds U.S.\$6,000. Guyana's per capita income is measured at about U.S.\$500 but the gross domestic product is so under-recorded that that estimate could be doubled or increased by even more. In the 1960s, Singapore and Jamaica had equivalent per capita incomes. Today the per capita income of Singapore is about U.S.\$20,000 while that of Jamaica is slightly in excess of U.S.\$1,500.

But there is another big difference between Singapore and any counter-part in the Caribbean. It is in the difference in capital stock. A large part of the fragility in CARICOM is due to our low levels of capital accumulation in terms of infrastructure, housing, educational institutions, factories, human capital and foreign reserves. In the area of capital stock accumulation, we have a far way to go and this is most glaringly so in Guyana.

Singapore has shown that small territories can survive in today's global economy, but they will do so best when they can produce from the vantage position of a plentiful stock of capital, including human capital. Too much of our income is still the result of the rental value of our natural resources—sun, sand and sea, forests and mining activity.

If our human capital is to be enhanced, it will be necessary to keep our people at home. That is what Singapore, South Korea and Taiwan did. This is what causes **Havelock Brewster** to refer to the advantageous social capital position in Barbados as compared with that of Jamaica. It is the human capital dimension that also depresses economic fortunes in Guyana. Continuous migration weakens the efforts at the accumulation of what Havelock Brewster refers to as social capital.

These observations link to those that I made at the beginning of this lecture, to keep our people at home if we wish to be independent. If there is not sufficient economic space in every CARICOM country, there certainly is space in CARICOM.

The task, however, is to conceive of ways to achieve the appropriate balance in economic policy as the earlier quotes by Dr. Blackman, Dr. Worrell and Professor Davidson recommended. How do we overcome, in this information age, the lamentable gap in macro-economic data that I itemised and the weaknesses in analyses in respect of micro-foundations?

Since we have the people and the intellect to produce the necessary information and the policies, we need the stimulus. At last year's Monetary Studies Conference, at the ceremony honouring **William Demas, Lloyd Best** sought to attribute the fragmentation in CARICOM to the lack of regional political parties. However, it is my view that we should consider the fragmentation within each territory before bringing the wider fragmentation in CARICOM into purview.

In the first place, fragmentation within territories results from the naive perception that the Westminster model of democracy means polarisation between opposed political groups. In the developed democracies, major

national issues are not generally pursued as matters for political competition.

In CARICOM countries, issues like taxation policy are held hostage to party political rivalry when it is clear that these are areas requiring a national consensus because of the long-term implications of the contracts to which we referred, when considering institutional inefficiencies.

I am not unaware of the vast change in our political culture to achieve consensus on national issues. But it is counter productive to development to spend years studying a tax system, putting new taxes in place and then changing those taxes overnight because a new government is in place. It is similarly counter-productive to deny a country an efficient tax system because the Government fears the Opposition will take political advantage of such a system. It is also wasteful of the little social capital we have to exclude a substantial part of the population from production and management because of political labelling. It is quite conceivable, as Professor Clive Thomas has long ago argued, to compete as alternative political teams for managing a developmental process that is consensually agreed to. That is democracy at a far more enlightened level than the stagnating and debilitating revolving doors arrangements to which we tend to be reduced.

The second source of fragmentation is even more subtle and results from our uncritical acceptance of market theories and endogenous growth models with their implications that we should not "pick winners" in our formulations of development strategies. There are CARICOM economists who argue this free market approach with greater fervour than those in the World Bank.

The fragmentation that this leads to is one of incoherence in development strategies and a preparedness to await the "animal spirits" of investors in an ex-plantation environment that does not have domestic entrepreneurs, with a tradition of expanding exports of non-plantation commodities. In the meantime, the World Bank quietly proceeds to "pick winners" for us in its investment and employment promotional activities as it quite correctly should do in small country situations such as ours. In the

Eastern Caribbean, the emphasis of the World Bank promotional activities in investment and employment is in the informatics industry and in the services sector.

The weakness in the approach, however, is in its focus and in its methods. In small countries such as ours, the formulation of a development strategy should involve everybody—the Government, the Private Sector and the Trade Unions, that is, the Social Compact or Contract as it is called in Barbados. Since this is a national issue that, like taxation, should not be subject to party political rivalry; the Opposition Parties should be involved. In order to avoid Professor Frank Hahn's "intellectual coarseness," and Professor Clive Thomas' observations about poor inventorisation, the natural resources should be inventorised, the micro-economic conditions researched and the macro-economic data bases improved.

There is no need to await final results in this research activity before formulating investment plans since the research activity should be an on-going process. However, a more comprehensive approach is more likely to widen 'bounds of rationality' as the richness of the resource availability is identified and the detailed knowledge of the state of micro-units is revealed.

More importantly, development strategies in today's competitive world should deliberately include investment prospects where dynamic comparative advantages are considered. The technological and educational requirements for these prospects have then to be factored into the human and physical capital programmes. The university structure should be reconceived to cater for these educational and technological needs. The radio and television and distant teaching infrastructure can be developed like the Open University in the United Kingdom to bring education in crafts, business skills, farming and services to those at the lower rungs of society, so that they too can export. Since no single CARICOM country can provide these facilities, the CARICOM region as a whole should allow for cost savings in the provision of these facilities by planning for them regionally rather than nationally. In addition to the monetary argument earlier

advanced as a strong reason for integration, this approach to develop dynamic comparative advantages is a compelling reason for integration.

There is no reason why, in this scenario, the Eastern Caribbean countries cannot embrace more than informatics and services. The future for the islands could include agriculture, marine products, food processing, cosmetic manufacture, textiles and garments manufacture, wicker furniture manufacture, ceramics and handicraft manufacture, the manufacture of electrical and electronic components and more. The point at issue here is that this should not be a selective bureaucratic process conducted without reference to the micro-economic conditions and without the involvement of the Social Compacts.

Separate country Social Compacts should get together in a regional group with the assistance of the CARICOM Secretariat and the Caribbean Development Bank to conceive the prospects of cross-border investments, labour movements and input-output supply arrangements. This achieves the integration that Lloyd Best is seeking from regional political parties without being unduly bureaucratic and without being removed from the detailed knowledge of the actual economic systems that Professor Ronald Coase reminds us to make the bases of our analyses.

Time is not on our side in this kind of effort. It is, to my mind, the only basis on which we can sensibly negotiate freer trade agreements with NAFTA. A less specific strategic framework will be based on assumptions appropriate for large and developed countries where production functions are vastly superior and capital structures so much more advanced as to make their production systems far more resourceful.

If we do not wake up to this subtle fragmentation of our efforts that derives from this naive avoidance of picking winners, we will find ourselves in a situation where the winners will be picked for us anyhow. Our agriculture and our industry will be consigned to a little heap of activities producing for the regional market and the services that we export will lack dynamism, because we will not have built the technological infrastructure for perpetual improvements in the processes.

The monetary counterpart of this effort is to improve our understanding of the role that commercial banks now take in the finance of investment. This means that we should have a greater knowledge of the details of investment and the extent to which such investment has been and can be financed from sources internal to the firms.

The research should be so designed that the behaviour of firms and of financial institutions should be the major focus of our study. The emphasis on financial instruments, to the neglect of behavioural models of the financial institutions themselves, is a surface activity similar to that of insecurely based macro-economics. Some of this research work will not be reducible to beautiful mathematical abstractions. But we must remember that relevance and not elegance should be our criterion for appropriateness in economic analysis. It is painful to read Sir John Hicks' words that he considered his analytical structure nonsense, but to recognise that we continue to use it because it is elegant. It will call for courage to rid ourselves of some established habits of thought but we will certainly do so if we extend research in the directions that I have suggested tonight.

POSTSCRIPT

E. Scott Myers in a review of **A. M. Kamarck's** *Economics and the Real World* Philadelphia, University of Pennsylvania Press, Oxford, Blackwell, 1983 noted the following:

He [Kamarck] deplores the low status assigned by mainstream economists to data collection and particularly to the refinement and perfection of national accounts.... and "the drift in economics from consideration of real problems to scholasticism," attributing it to the career pressures that encourage work on articles that emphasize technical virtuosity over time consuming work on real-world problems. And to be relevant, economic theory, data models and the interpretation of models must correspond more closely to the real world. (**Journal of Economic Literature, Dec.'85**).

References

- Blackman**, Courtney (1996). "Monetary Management in Liberalising Environments" in L. Clarke and H. Leon (eds.), *Liquidity Management in Liberalising Economies: Some Experiences from the Caribbean*, The Caribbean Centre for Monetary Studies, University of the West Indies.
- Davidson**, Paul (1972). *Money and the Real World*, Macmillan. Davidson, Paul. 1991. *Controversies in Post Keynesian Economics*, Edward Elgar
- Hahn**, Frank (1984). *Equilibrium and Macroeconomics*, MIT Press.
- Harcourt**, G.C. (1986). *Controversies in Political Economy* (edited by O.F. Hamouda), New York University Press.
- Leibenstein**, Harvey (1989). "Organisational Economics and Institutions as Missing Elements in Economic Development Analysis" in *World Development*, Vol 17, No. 9.
- McIntyre**, Arnold M (1995). *Trade and Economic Development in Small Open Economies*, Praeger.
- Milgrom**, Paul and John **Roberts** (1992). *Economics, Organization and Management*, Prentice Hall.
- Moore**, Basil J. (1984). "The demise of the Keynesian multiplier" in *Journal of Post Keynesian Economics*, Vol 17, No.1.

Robinson, Joan (1978). "Foreword" in Alfred S. Eichner (ed.), *A Guide to Post Keynesian Economics*, M.E. Sharpe, Inc.

Stein, Howard (1994). "Theories of Institution and Economic Reform in Africa" in *World Development*, Vol.22, No.12.

Worrell, DeLisle (1989). *Economic Policies and Prospects in the Caribbean*, Institute for International Economics, unpublished.

————— (1996). "Liquidity Management: Some Policy Issues" in L. Clarke and H. Leon (eds.), *Liquidity Management in Liberalising Economies: Some Experiences from the Caribbean*, The Caribbean Centre for Monetary Studies, University of the West Indies.

Thomas, Clive Y. (1974). *Dependence and Transformation*, Monthly Review Press.