PRIVATIZATION AND MONETARY DEVELOPMENT IN THE EASTERN CARIBBEAN

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Within recent years the concept of privatization has been increasingly emphasized on the economic and political agenda. In the Caribbean there has been, within recent years also, a great deal of discussion about monetary development; the nature of the monetary development has been centered on a common currency for the Caribbean and a common central bank.

In this paper we will discuss privatization and monetary developments in the Eastern Caribbean. The Organization of Eastern Caribbean States, OECS, will be the area of study. The main parts of the paper will be on (a) a brief review of some ideas which underpin privatization and the rationale for state-owned enterprise; (b) a brief discussion of monetary development and privatization in the OECS and (c) the relevance of privatization in the monetary development in the OECS. Finally, in the conclusion, we advance some ideas about the adoption of privatization on a structure and in an environment that are not adequately prepared for free-market strategies and principles.

I. Privatization: Merits and Reassessment

Much of the "new" political thrust of privatization was developed in the 1980's when Ronald Reagan was President of the USA. and when Margaret Thatcher was Prime Minister of Britain. After the political thrust, privatization as an economic item was again put on the political agenda. Two decades ago, there was a significant level of interventionist policies in the world economies. Many state-owned

enterprises (SOEs) were created around the world – both in the developed and the so-called developing countries.

The SOEs are today considered dinosaurs in terms of their lack of momentum relative to economic growth and efficiency. As the developed word goes, so the developing world tries to go. Today privatization is the buzz world in the developed world. In like fashion, privatization has taken on a decided momentum in our part of the world. What is privatization and why is everybody talking about it?

Privatization refers to the transfer of ownership from the public sector to the private sector. The transfer can take many forms. Most common among those forms are the public sector divestment of state enterprises through sale, contracting out, deregulation, denationalization or leasing out.

The sale of public assets to the private sector is the most obvious of all of the shifting of power from the public sector to the private sector. But, as many researchers have shown, privatization also involves the public sector contracting out a given task to the private sector; for example, garbage collection may be contracted out to the private sector.

Likewise, there maybe deregulaltion where the public sector opts to break the rule which regulates the running and functioning of a given state-owned enterprise and turns it over to the private sector. Ostensibly, when an enterprise is turned over to the private sector, the removal of the rules will enable the enterprise to run more efficiently.

There is also denationalization in which the principal or dominant interest of the public sector is relinquished or turned over to the private sector.

What is the rationale for this great move towards privatization? Fundamentally the economic rationale for privatization is one of efficiency. Most state-owned enterprises are seen as impediments to growth, development, efficiency and effectiveness. Foremost among these implicit modes of rationale are (1) allocative efficiency (2) productive effective and (3) non-market efficiency. When market imperfections exist which is normally the case when the public sector operates an enterprise, allocative efficiency is presumed to develop when privatization is put into effect. Since there can be no first or second best rationale for public sector involvement in a perfectly competitive system, allocative efficiency is presumed to be the best situation.

Productive efficiency, the second feature stemming from privatization, refers to resource utilization. Specifically, when public enterprises are run by the public sector, it is assumed that the enterprises carry excess manpower, and their utilization of resources is inefficient and wasteful. In addition, since there is no one-to-one relationship between the owner/manager and controller of the enterprise and the work force, there is a tendency for the managers to have no incentives to maximize resources efficiently.

Finally , it is assumed that privatization tends to avoid non-market inefficiencies and promote non-market type efficiencies. For example, it is assumed that private firms tend to attract qualified, skilled and highly-motivated personnel. The public sector, on the other hand, tends to attract run-of-the mill persons who use the public sector as the feather-bed in which to do minimum work for maximum pay.

Linked to the above notions of inefficiencies in the public sector and the supposed benefits of privatization are two theories: the "theory of political interference" and the "theory of property rights. The theory of political interference stems from the idea that the public sector is normally designed to improve resource allocation. However, the public sector developments which result from the government's intervention are invariably the pet peeves, whims and fancies of individuals or interest groups. Public sector interventionist polices may be the manipulative public policy of private persons. As Lawrence W. Lovik (1987: 28) notes, ". . . . public choice theory reveals that the problem of special interest issues combined with the rational ignorance effect prevents ideal public policy results from being realized."

In the theory of property rights, the idea is that the public sector employees and managers allocate assets which belong to the taxpayer. They are not concerned about the taxpayer burden or the proper, adequate allocation of scarce resources. On the other hand, when the enterprise is in the private sector the manager or decision-maker is beholden to the public. He is more concerned as a decision-maker in this case, since his economic livelihood depends on the survival of the enterprise. The theory of property rights states that State-Owned Enterprises tend to be inefficient because it is systemic to the culture and nature of such enterprises to be bureaucratic. The customer is the one who bears the burden, not the manager. In privatization the manager will bear the burden. These two theories posit views which contend that privatization is better than public sector/state ownership.

What, in summary, are features of market failures as they relate to State-Owned enterprises? What underpin SOEs? Why are they not popular? And why the new move to privatization?

Gayle and Goodrich (1990:9) have shown that six interactive reasons and consequences of market failures could be advanced as the rationale for state-owned enterprise:

(a) imperfectly distributed information
(b) notable negative externalities, such as substantial oil spills within sensitive systems
(c) inadequately safeguarded merit and public goods, such as natural defense, clean air and clean water
(d) involuntary unemployment
(e) real demand efficiencies, arising from skewed patterns of income and wealth distribution
(f) natural monopolies (where one firm will be more effective in supplying an area rather than several firms).

Those are the points which underpin the rationale for State-owned enterprises. If we are to believe the new thrust, privatization will remedy the situations in an economy that are caused by the inefficiencies in the State-owned enterprises. The question, therefore, is to what extent these features still obtain in the OECS, and to what extent, specifically, can their remedies aid in the monetary development in the OECS?

II Monetary Development and Privatization in the OECS

Within the last few years the question of monetary developments in the Caribbean and its specific translation in the OECS has centered on a common currency and a common Central Bank. A number of authors have advanced views regarding the merits and demerits of the common currency and the Common Central Bank. One main idea that has gotten much attention is the need for the entire Caribbean region to have on super currency for the entire region and one Central Bank such as the multi-country Central Bank of the OECS: the Eastern Caribbean Central Bank. The role of individual country currencies is not very explicitly developed, to our way of thinking. Furthermore, there has not been any clear-cut measures regarding exchange rate regimes among the countries. To date, therefore, none of the authors has advanced a solid view relative to the merit of a common currency.

The common Central Bank, a la the ECCB, is proposed on the supposed strength of the ECCB in maintaining levels of cohesion, advancing growth and keeping the wolves of devaluation at bay in the the OECS. But, on reflection, the strength of the ECCB, great and commendable though it is, is a strength by default not necessarily be design. It takes a unanimity to agree on a devaluation of the EC dollar. Given the political culture of the region, no such unanimity has emerged--hence this lack of unanimity is the driving wedge that keeps the EC dollar from following the devaluation route.

No less a person that DeLisle Worrell in a 1989 paper to the Caribbean Studies Association, noted:

Central banks in small open economies find themselves frustrated at every turn in attempts to regulate the amount of finance . . . Central banks try to influence economic performance by changing the amount of finance or its allocation, but the means at their disposal are not effective . . ."

In the OECS, in particular, Lucilla Lewis (1990), on reflecting on the direction of monetary policy for the ECCB also agrees that the "economic and financial structure of the region . . . severely impairs the ability of the ECCB to control the money supply, and makes it difficult (for the ECCB) to influence price stability and ultimately development in the sub-region." (Lewis, 1990: 13).

Lewis argues, and we confer, that the ECCB is on target in much of what it is doing in the developmental aspects of assisting in the transformation of the OEC economies. But, she notes, the ECCB has to adopt some more far reaching measures if it is to go beyond its current level of involvement. Lewis (1990:13) notes that the measures include:

(1) A higher profile of the ECCB in each off-shore territory
(2) Measures aimed at increasing equal competition in the commercial banking sector
(3) Quantitative and qualitative controls
(4) A fostering (of) the coordination of monetary and fiscal policy as the area level
(5) A more direct developmental role.

Over the years, we have stressed all of these points with different degrees of emphasis. All points, except point two, have been our concern. In a general way point two, regarding increasing equal competition in the commercial banking sector, could be extended to cover increasing the level of privatization in the entire banking sector in the OECS. By this privatization we mean privatization as it applies to the ECCB and the banks in the OECS.

If privatization is the savior that will bring all of the strong benefits to the body economic, then we can argue that the ECCB's involvement in monetary development will benefit from privatization. Here we use privatization in the broad and profound sense as described by Larry V. Ellis (1987: 142, note 1). "Privatization is used here to mean the elimination of all regulations regarding the nonfraudulent activities of financial intermediaries as well as the removal of the Central bank and monetary policy, generally, from the monetary system."

The monetary developments in the OECS are not developments which follow the privatization route that we have outlined. But it is quite conceivable that we can follow the arguments of Black (1970), Fama (1980) and Hall (1982) in advancing the terms of reference of privatization in the banking system, and specifically in the ECCB. Ellis (1987) synthesizes the main issues which center on the privatization of money. The Ellis taxonomy informs our thinking on the question of privatization and monetary developments in the OECS -- or what will happen if ECCB and the OECS banks all go private? Black (1970: 9-20) contends that money as is conventionally viewed is compatible with a financial system that adheres to laissez-faire. Fama (1980: 39-52) outlines an accounting system when a competitive banking system operates portfolios. Depositors hold cash against those portfolios and competitive returns are paid. Hall (1982: 1552-1556) notes that the government does not have to control the stock of money in order to control price. "It only seems that money stock control is necessary for price level control because society chooses to quote prices in the unit of the medium of exchange." (Ellis, 1987: 136)

Greenfield and Yeager (1983: 302-315) extend the Black-Fama-Hall (BFH) arguments into the BFH system. GH contend that their BFH system is efficient and stable unlike the modern-day version of fiduciary systems. Core to the BFH system is Fama's view that money as a unit of account can, and should, be separated from money as a means of exchange. This notion which is peculiar to economists of the New Monetary Economics (NME) according to Hall (1982) could be termed the "separability" argument between money as a medium of exchange and money as a unit of account.

A variation of the NME theme is that which is termed the Austrain Free Banking (AFB), see Ellis (1987:136). The AFB has two versions of the privatization of money. Hayek (1978) suggests one version wherein private enterprises will issue their own banknotes and deposits. The enterprises will maintain the value of the notes in some numeraire bundle of commodities. The enterprises will be auctioneers in the market clearing of the relative price of the notes. It is possible that in the Hayekean system, each enterprise will have a different unit of account.

White (1984), in looking at free banking in Britain between 1800 and 1945, posits another version of the AFB. In his case private enterprises issue currency and deposits following Hayek's example. However, there will be one common unit of account. This unit of account will be the medium of exchange. "Notes and deposits would be convertible in a designated amount of space." Ellis (1987: 137)

Finally, there is an approach to privatization of money as developed by Wallace (1983: 1-7). The main thrust of Wallace's view, known as the "legal restrictions theory" (LRT), is that the government has

an artificial role in the monetary system. The role is one of legally restricting private financial intermediation.

In considering monetary developments and privatization in the OECS, we can take note of the various approaches to privatization of money and postulate a scenario. Should the ECCB exist? Or what will happen if the ECCB goes private?

Even though the ECCB pursues many policies, its principal monetary policy is the control of the money supply in a way that will permit it to "manage" the price level and stabilize output. The ECCB, like other central banks in small open economies, has difficulties in controlling the money supply. Central banks in large economies have similar drawbacks.

Hall (1982), Wallace (1983) and Ellis (1987) all contend that the definition of money is a function of regulatory and institutional features of an economy at a given time. This means that money changes with changing times. In such a scenario, the control of the money supply becomes a rather precarious and whimsical point of development.

It should be obvious, therefore, that given the inadequacy of the Central Bank to perform its principal function, adequately, the call for privatization looms even larger. In a fully privatized system, there would be no need to control the money supply. As Ellis (1987:141) notes, when "the privatization of money is (considered), no economic justification exists on grounds of efficiency or stabilization, for a central bank or a monetary authority." If privatization is possible in central banking, then there could be some relevance of privatization to central banking and all banking in the OECS.

III. Relevance of Privatization in Monetary Development in the OECS

What is the relevance of privatization in monetary developments in the Caribbean and specifically in the OECS? Privatization is at the level of a magician, as far as developments are now concerned. In the Caribbean when and where companies are desperately short of cash, the decision-makers are opting for privatization. But can this magical privatization work in the OECS? Are there necessary and sufficient conditions in the body economies of the OECS showing that privatization, as is presently conceived, will work? What monetary developments are in place that will engender privatization? What monetary developments will have to be in place to facilitate privatization?

In a practical sense, monetary developments in the OECS are already in the sphere of privatization. The commercial banks and the insurance companies are all, practically speaking, private institutions. What is left are Development Banks and the Central Bank. If the Eastern Caribbean Central Bank (ECCB) and the development banks go private, what will be the advantage to the economies of the OECS? Will the people in the region benefit? Will the governments benefit?

These questions presuppose that monetary issues as currently interpreted under the auspices of the ECCB are not efficiently and effectively implemented. If, for discussion purposes, we assume that the ECCB is not operating at its optimal level, the privatization formula would then have to be put into effect. We have no reason to support the contention that the ECCB is operating at a sub-optimal level. But if we assume it were, the question is, what type of monetary development

would be appropriate for a private Central Bank in a multi-country region that is public-sector biased?

Presumably the Central Bank will be owned by private individuals who will run the enterprise for their own interest. Historically, the central Bank of England, the Bank of England, was a private influential institution before the state intervened to ensure that the Bank's interests were in sync with the state's interest. If the ECCB were to be privatized it would be going backwards from a public sector enterprise to a private sector enterprise.

Would the privatization of the ECCB be similar to the privatization of the Banco de Chile? In that case, Banco de Chile, a large commercial bank, was privatized through a mechanism called "popular capitalism" (Nankani, 1990:4) Small investors were sold shares to ensure that the average man could participate in the capitalist process. On the other hand, there could be privatization along the lines of "labor capitalism"-- that is the sale of shares of a firm to the employees of a firm. This was the case of the privatization of ECOM, the Chilean goverment-owned computer firm (Nankani, 1990:44). This is also the case of AVIS, the largest U.S. car rental agency. Pueblo, the supermarket chain was a combination of employees and management buy-out.

If ECCB assumes any of the given forms of privatizations identified above, it may do so because it wants to be more efficient, to operate more regionally, to operate more globally, or simply to push its operations on the production possibility frontier as opposed to operating below the frontier. Whatever the desire, the far more, principled questions would be, what will be the relevance of privatization to the monetary developments in the region? What will be the appropriate

role of the state in this new thrust? What regulatory function will the state be permitted to play?

If privatization of the Central Bank and monetary institutions is to work effectively, paradoxically, there will have to be a role for the state--the public sector. The public sector will have to ensure that the privatization of the monetary developments and institutions takes place in a manner such that competitive forces lead to efficiency. The protective umbrella of the public sector is necessary in privatization because many public sector firms may not be able to withstand the rigors of the market place.

Our discussions, thus far, presuppose that the ECCB really could be privatized. Furthermore, we are assuming that privatization will improve the efficiency of the monetary system. Admittedly, our assumptions are heroic. One only has to consider the debacle in the USA with Savings and Loans Associations--the so-called "S and L crisis" and the extravagance and questionable banking dealings of the Bank of Credit and Commerce International, to raise the issue of the relevance of privatization in the banking system--or privatization of monetary developments.

Finally, privatization of the banking system in the OECS could bring with it an assorted set of negatives. For example, relevant though the privatized system may be, there could develop "mergermania" among banks to the disadvantage of the public. There could also be industrial ownership of banks such as obtains in Japan. This separation of banking houses from other entrepreneurial houses is often times beneficial to the economy. In the final analysis, therefore, while

privatization may be relevant to the monetary development and the banking system in the OECS, there seems to be a role for the state.

Conclusion

Privatization is an issue and idea whose time has come. With the "collapse" of socialist and "communist" regimes in eastern Europe and the long-awaited convergence of socialism and capitalism, advocates of the free-market are now in full stride. In this paper we touched on some questions about privatization and monetary developments. Specifically, we posed the question of a likely scenario of the ECCB and its financial "links" going private. Even if we consider the very strong views for privatization as put forward by Hayek, Fama, and others, caution cannot be abandoned in the privatization of monetary systems in small open economies.

In its latest World Development Report 1991, the World Bank discusses the move to a "market-friendly approach to development." "Competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services," notes the report. It is gratifying to observe, though, that the report makes this fundamental point. "(M)arkets cannot operate in a vacuum--they require a legal and regulatory framework that only government can provide." (World Bank News, vol. x, No. 27: 1-2).

After privatization is implemented, the public sector still has a role to play. The government or public sector has to marshal the forces to see that the privatized entities deliver what they promise to deliver. Privatization must be country-specific. In the Eastern Caribbean where the private sector is not fully developed, a headlong march into

privatization unfettered by governmental oversight, could lead to economic chaos.

The mere transference of a public entity to the private sector is no guarantee that efficiency will be engendered or that efficiency will be improved. We need to look at the society, analyze the cases in point, discuss and debate the nature of the societal norms and mores of the entities in question before the bastian of privatization could be opened. In the Caribbean where the state has played a fundamental role in the dynamics of growth and development, it will be difficult to say that privatization will usher in that hoped–for efficiency. In the Eastern Caribbean, if the ECCB were to be privatized in the context of a common currency and a common central bank, the panacea of privatization may be more deceptive than productive.

The road to privatization is strewn with many obstacles. Foremost among these obstacles is the political will. Economic activity and finance in small economies are integrally linked to the government budget and to government activity. If central banks are privatized, this activity will be partially removed from government control. Technically, therefore, a privatized central bank would be similar to government giving up power. This is one axiom of power that cannot be accepted. Governments do not give up power. As Andic so correctly notes,"privatization can succeed only when the private and public sectors collaborate in creating a political-economic atmosphere that in conducive to privatization." (Andic, 1990: 35)

The issue of privatization and monetary developments in the OECS is not mere speculation. It has some merit. Meritorious though the idea is, decision-makers should not be deluded into thinking that all of the

inadequacies of banking and central banking will be solved if the ECCB goes private.

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