ENHANCING THE INDEPENDENCE OF THE CENTRAL BANK

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INTRODUCTION

The Central Bank is seen as one of the principal economic managers in a country. It is charged with playing a vital role to assist the nation State to reach the economic goals which it sets for itself. It functions in a highly sensitive and volatile environment and there is almost universal agreement that Central Banks should be assured of a substantial measure of independence of thought and action in their field of activity. In this region, in accordance with the prevailing development paradigm at the time of their establishment, the laws setting up Central Banks give them a number of specific powers, which include control over deficit financing by the Government, the management of the financial sector and the requirement to express an independent view on the external economic relations which the Government pursues from time to time. These powers are separate and apart from those which the Banks exercise in the superintending role which they play in the banker-client relationship between the Banks and the Governments.

Over the last decade, however, the tenure of Governors of Central Banks in certain countries has appeared to be tenuous, almost 'nasty, brutish and short'. Besides, the objective facts indicate that some of the Banks have not exercised adequately the independent powers of restraint on Government financing and this deficiency has been a material factor contributing to the economic malaise which afflicts some of the countries (the OECS excepted). Further, developments in the international financial arena have undergone change and these appear to weaken some of the assumptions which led to the determination of the scope and functions of the

Banks. The consequences of these new international developments are being enforced upon the Governments of the region by the conditionalities which the international financial institutions impose on them. Both internally and externally, therefore, the circumstances which attend Central Banks are in a state of flux.

These changing circumstances require countries in the Caribbean to revisit the concept of the scope of independence of action allowed to these Central Banks and come to terms with the emerging realities and the changed development paradigm. This Paper seeks to initiate some discussion on this contentious issue.

Much of the Paper addresses the international financial system and the derived new economic policy which Governments in the region have been persuaded to adopt. But certain peripheral comments are also included in order to disclose fully any biases which inform the approach. The perceptions which are projected are, in the main, informed by the circumstances in Trinidad and Tobago; but they should have some applicability in other countries.

However, the underlying thesis which is being projected is that the contextual situation in which the functions of Central Banks in the region were defined has undergone significant change. These changes have originated at the international level but the impact of the changes on the policies and practices of both the Governments and the Central Banks has been magnified by the increasingly pervasive effect which the international financial institutions have imposed on their borrowing members. In these circumstances, it is necessary to review the institutional arrangements which were set in place in an era gone by.

DIVISION OF FUNCTIONS

I start from the perspective that, at the level of the nation State, the underlying objective of development policy in its many facets - fiscal, monetary, human development, environmental improvement and the others - is to establish and entrench a basis for a sustainable improvement in the quality of life of the citizens and a distribution of the benefits of development among the economic agents in a manner which satisfies the canons of social justice in the society. In this kind of construct, the important variables by which development should be measured and, a fortiori, to which development policy should be directed are - production and productivity, the levels of real consumption, real income distribution, employment rates, the proportion of the population subsisting below the poverty line, the state of food security, housing and health conditions, the adaptability of the population to meet the changing economic environment in which it will be expected to operate and the general quality of life. Variables such as the exchange rate, interest rates, the integrity of the thrift institutions and the size and structure of the external debt are, however, critically important as indispensable mechanisms to support efforts to reach the targets for the real variables which the nation prescribes for itself. We need to get back to basics and the Central Banks have a role to play in that regard; for the reality is that we are in danger of forgetting these imperatives.

The text books tell us that policies affecting the real and money variables are two blades of the same pair of scissors so that we do not know, and should care less, which blade cuts the cloth. In practice the conventional view has been that the real economy, i.e., the producing and consuming entities in the society, is the primary economic motor with the financial sector playing the supportive role; that the exchange rate is determined by the relative level of productivity in tradeable goods in the domestic economy vis-a-vis the rest of the world and that, under freely competitive conditions, the rate of interest would be a product of international levels of interest adjusted by a factor which reflects the durability of the exchange rate as perceived by the players in the financial market, the rate of inflation being one of the important factors.

This kind of thinking provided a rationale for effecting the division of responsibility in areas of economic management between the Central Government and the Central Bank, the latter being the primary agent in the area of monetary policy, although it performs certain other functions tangentially related to monetary policy as well. Indeed, in the case of the Central Bank of Trinidad and Tobago, Terrence Farrell has reminded us that "its functions include bank supervision, or more accurately supervision of financial institutions, foreign exchange budgeting, advice on external financing and debt operations and exchange control, which latter involves vetting of technology contracts, analysis of investment projects and the regulation of all outflows and inflows of foreign exchange". [T.W. Farrell, Central Banking and Developing Economy - A Study of Trinidad and Tobago, 1964-1989, p.1].

At the international level, the thinking also provided a part of the theoretical justification for the decision which the international community took in the 1970's to remove controls on the movement of capital internationally and to introduce a system of floating exchange rates under which the parity of currencies would be determined by the demand for and supply of currency, both being trade related.

However, the action of freeing up capital movements and currency level parity determination has created a dynamic of its own and this has impaired the validity of the underlying assumption. In consequence, the area over which individual Central Banks can now act, and the kind of flexibility which they have for action, appear to be undergoing qualitative change. In the light of this, there is already emerging, even among the Group of Seven, a view that either the international system should be brought under greater surveillance or that the functions which the Central Banks perform should be reexamined. Such a need must be even more acutely felt, and acted upon, in countries on the periphery.

The definition of the role which Central Banks should be structured to play must be undertaken in the context of the environment in which national decision making is carried out. It is the reality that the international context is now qualitatively different from that which prevailed when the legislative powers were accorded to the Central Banks. But perhaps of equal importance is that the kind of economic strategies and policies which Governments of the region are now being persuaded that it is in their interest to pursue, has undergone major change. It is therefore necessary, in any reexamination of the functions which a Central Bank in a small developing country should be structured to deliver, to start from an understanding of this new environment.

For these reasons most of this Paper addresses the developments on the international financial markets and the derived consequences for the shape and form of the economic policies to which the Governments are committing themselves. Against that background, we suggest some conclusions which may be drawn and which have implications for the role which Central Banks should be structured to play. We deal first with the international scene, after which the derived consequences for national economic policies are examined. In the light of the sea-change created in these two areas, a position for the Central Banks will be briefly examined.

INTERNATIONAL DEVELOPMENTS

Among the factors adduced at the international level in favour of financial liberalization was that unrestricted market forces would operate and that, as a consequence, capital flows would move to countries in response to opportunities for investment, thereby achieving a broad equalization of rates of return on assets; that interest rates would be determined by real market conditions and that, in consequence, countries which had good opportunities for investment would be able to access savings in excess of their own while countries with excess savings would have an opportunity for investment greater than that available to them otherwise; and finally, as a result of all these and other factors, current and overall balances would move towards an equilibrium situation. National Central Banks would therefore operate within known guidelines in taking domestic action on their financial variables in order to ensure that the country would derive benefit, in the form of either income or capital inflows, from the interplay of real and financial forces operating across national boundaries.

The developments in the financial sector [see in particular UNCTAD's Trade and Development Reports 1987-1990] however suggest that, since the original decision was taken, a number of unforeseen and unplanned developments have taken place and these have given rise to certain consequences which appear to vitiate the underlying assumptions. Among those which appear to be significant are the following:-

(i) currency has substantially detached itself from real flows and has become another traded commodity. Since the removal of restrictions on capital movement and the introduction of floating exchange rates, international banking has grown by about 20% per year, almost twice the rate of growth of world trade (12%) and of world output in current prices (10%). Between 1972 and 1987, world trade increased by about US$2,500 billion whereas international banking expanded by US$4,000 billion. Money is now a commodity and threatens to go the way of all commodities since the 1970's, and in that area, the poorest countries and the poorest people have been the main losers. They are likely to be the main losers in the currency area as well;

(ii) according to UNCTAD, "the main activity of financial markets has become not so much to intermediate between ultimate savers and investors, allocate resources on the basis of asset valuation reflecting long term risks and profits . . . but rather to create short term opportunities for speculation in misaligned asset valuations. The new regime has created greater scope to generate and/or propagate speculative disturbance" [Trade and Development Report, 1990, p. 106. See also Financial Liberalization: The Key Issues, Yilmaz Akyuz, Discussion Paper No. 56, p. 29, UNCTAD, 1993];

(iii)capital flows across national boundaries now have relatively little to do with investment and in fact there is a predominance of speculation over enterprise in the movement of capital [ibid. p. 116]. This appears to apply equally as between new private capital inflow as well as the return of flight capital.

In consequence, UNCTAD's analysis led it to conclude that the behaviour of exchange rates in the 1980's cannot be systematically explained by variables generally cited as their determinants, i.e., interest rates, relative price levels and trade and current account balances. Interest rates have, on the whole, also remained relatively high and this has impacted adversely on investment, primary commodity prices and employment levels.

These developments, which do not equate with the initial underlying assumptions, have not been wholly beneficial to the world community at large, although certain sections of it have become very rich as a result. They have also enforced a deflection of attention from the real variables in the economy to short term financial swings and this deflection is shaping the attitude of the international financial institutions in their approach to the development process. This is abundantly clear from the policy framework which the international institutions prescribe; it is illustrated in their prescriptions for interest rates, a policy which can be predicated only on an assumption of galloping inflation and the consequent currency depreciation, the drying up of investment and the further pauperization of the poor, these being considered of little consequence from the perspective of the institutions.

International observers have drawn attention to some of the negative outfalls of these developments, among which are the following:-

(i) in the industrialized countries, aggregate incomes have grown enormously during the period of financial liberalization and floating exchange rates; and financial institutions, through growth, acquisitions and mergers, have become very large indeed, wielding enormous political and economic power. But income inequality in these countries has worsened and chronic high rates of unemployment have become an accepted (although unacceptable) feature of their landscape with the consequent growth in crime normally associated with the ghettos when young people cannot find productive things to do;

(ii) the disparity in the distribution of world income as between the industrialized and the developing countries has become even larger in relative terms than it was before. Thus, for example, whereas in 1970 the per capita incomes of the upper 20% of the world population, who live in the industrialized countries, were about thirty (30) times the per capita incomes of the poorest

20% of the world population who live in the developing countries, in 1992, the ratio had grown to almost sixty (60) times as high. The new world development paradigm, which is being piloted by the new financial system, is serving to increase world inequalities both within and between nations;

(iii) the mechanism of exchange rate determination which the new order has installed has also served to entrench capital flight from the developing to the developed countries as a regular feature of the experience of the former. It was the postulate in the literature that capital flight from the developing countries was associated with the untenable efforts of the authorities to maintain fixed exchange rates in the face of their inability to control internal inflation. We are now, however, confronted with a situation where, notwithstanding what the authorities do with regard to inflation control, the speculative currency market will determine what the exchange rate should be, regardless of what the authorities do in the short term. In effect, therefore, the exchange rate could assume an existence independent of the internal action which the authorities take, a point which assumes greater significance in view of the long lead time involved in informing the operatives on the financial markets of the activity being undertaken in the real economy.

It cannot go unnoticed that even in Trinidad and Tobago, capital flight over the period 1986-1991 (for which the errors and omissions component in the balance of payments is used as proxy) enlarged the current account deficit of the balance of payments by 48%.

Indeed, it is not unlikely that much of the reported private capital inflow into certain developing countries, notably Mexico and Chile, represents a partial return of flight capital, a process which assures speculators of a double gain; for such flight capital, if reintroduced as loans, is entitled to be expensed; and the returning capital, coming after a significant depreciation of the currency, can acquire a larger amount of fixed assets than they could before the flight, because domestic asset values tend to lag behind the rate of currency depreciation;

(iv) in the new development paradigm which the international financial institutions are enforcing on developing countries, and in the context where these institutions, through purpose and default, are requiring deficit countries to bear the full burden of adjustment, the deficit countries are thrown back on monetary, and indeed interest rate policy, to correct imbalances while seeking in vain to maintain a stable rate of exchange. But the exercise of interest rate policy in these countries carries, as one of its costs, the reduction of investment and an increase in unemployment, since interest rates have to be raised to levels which cannot be absorbed in the market place. This has been the experience in many Latin American and Caribbean countries, and is already emerging in Trinidad and Tobago.

There may be many reasons for this unsatisfactory state of affairs. At least a partial explanation may very well lie in the conclusion which Dharam Ghai drew that - "the concentration of economic power (in the hands of the transnational enterprises, financial agencies and a handful of industrialized countries) has not been accompanied by a corresponding shift in their political and social responsibilities for global welfare or in their accountability to the peoples of the world. This imbalance is one of the greatest challenges facing the world community in the 1990's and into the next century" [Dharam Ghai, Structural Adjustment, Global Integration and Social Democracy UNRISD, 1992, p.7]. The reality which has to be addressed is that, partly because of the poor sequencing of economic actions and partly as a result of the application of the ceteris paribus rule where the players, both within and between nations are not equal, the domination of the financial market by a group of oligopolists exposes nation States, and the people in these States, to the full adverse effects of oligopoly in its pristine sense and must inexorably lead to social disintegration at the global and the national level.

SOLUTIONS PROPOSED

These problems of global social disintegration can only get worse as the Group of Seven, and the international financial institutions which they control, yield increasingly to the pressures generated by the financial speculators and the transnational enterprises. But when they do, it is difficult to see what room is left for the exercise of monetary policy in any country, let alone a small developing country.

It is this perception which has led many to propose a refurbishing of the global machinery for managing the closed shop into which world financial system is now coalescing. Such refurbishing should, it is argued, include -

(i) the establishment and effective operation of a system of multilateral surveillance over both creditor and debtor countries;

(ii) a return to stable exchange rates. UNCTAD has stated categorically that "there is now widespread recognition that the floating exchange rate system has failed to promote sustainable current account balances and that there is a need to move to a more stable system of exchange rates [ibid. p. 133]; and, more fundamentally,

(iii) establishment of institutions which have a global reach. In short, the liberalization of capital movements, and the associated pressures to remove barriers to trade and to integrate the global economy, must be supported by a mechanism to cope with imperfections in the market. There is now no such mechanism in place. Diaz Alejandro was particularly sensitive to this need when he adverted to the negative consequences of a policy of the early liberalization of capital, "with the highly mobile factor, capital, causing extreme oscillations, privatized banking systems failing, and Governments being forced by foreign pressure to guarantee loans". [Gustav Rainis in 'Carlos Diaz-Alejandro, economist and prophet', IDB July 1993, p. 7]. But the world has taken the step of freeing the capital account. In order to be consistent, it should move to the Keynesian solution of a World Central Bank if the benefits of globalization are to be shared globally. This is the prescription of the internationalists.

However, in the context of the existing world power structure in which there is a single political superpower, and three economic superpowers, there is little likelihood of an early international agreement leading to the establishment of a world central bank. Even a return to stable exchange rates within somewhat wider bands than existed before is problematic; and effective multilateral surveillance of the performance of large national economies has been discussed and accepted as a principle by the Group of Seven, but with no intention of implementation.

The principal international financial institutions are not agreed on any need for even reexamining the relevance of the existing international financial system. But it follows equally that Governments and the Central Banks at the periphery, and in this region in particular, must be guided by political realities and shape their actions in a manner which would provide the minimal safeguard to the welfare of the citizens whose interests they were established to subserve. This emphasises the need to be particularly cautious in accepting the dictates of these institutions as they set out to prescribe the limits of Governmental and Central Bank action in the determination of national economic policy. We turn to this subject briefly.

THE NEW ECONOMIC POLICY

Under the dictates of the international financial system, some of the countries of the Caribbean, notably Jamaica and Trinidad and Tobago, have espoused a new development paradigm which has, as its stated purpose, the "release" of the economic agents from the controls which the bureaucracy imposes and the exposure of the economy to the full blast of economic and political forces operating at the international level. The paradigm now in vogue contains a number of special features, among which are the following:-

(i) a rapid elimination of the insulation available to domestic producers in manufactured goods, services and agriculture, this being achieved by an accelerated dismantling of quantitative restrictions and a rapid reduction in import charges to reach 20% or less by 1997. This projected rate of removal of the insulation stands in sharp contrast to the arrangements which the industrialized countries have concluded among themselves and with other countries whose interests they wish to uphold; ✓

(ii) a telescoping of a package of reform involving simultaneous action on the fiscal balance of payments, the debt structure and the external trade regime, a combination which can only result in increased unemployment and a thinning of the real economy. The imperative of proper sequencing over a period of time and with adequate guideposts, forms no part of the regime, notwithstanding the clear need for such an approach as is evidenced by the experience of the Southern Cone countries in the 1970's;

(iii) the removal of restrictions on capital movements. Current payments have long been free in the region;

(iv) an exchange rate which will be determined by international market forces in which speculators lead the way;

(v) an interest rate regime determined by "market forces" which in effect means a combination of fluctuating international levels of interest rates, plus a speculative market assessment of the exchange risk factor in which developing countries will be put in the high risk category, plus a domestic profit margin for the financial houses which, even under the most favourable conditions, will pass on to their borrowers the diseconomies of small scale production. The resulting impact on the investment and production regime in a country is not accorded any weight in the equation. It should be noted in this regard, that some observers are of the view that "despite widespread claims for efficiency of financial markets, financial liberalization in many countries in recent years has generated more costs than benefits" [Yilmaz Akyuz, op cit., p. 37]. But Akyuz went on to argue, on the basis of empirical evidence drawn from Latin America and Middle East countries, that "there is often a need for deposit ceilings and intervention in the money market in order to stabilise interest rates and asset prices and prevent excessive risk taking in the financial sector" [op cit. p. 37]. It is well known also that the relative stability with growth which both Japan and Germany have been able to achieve derived support from the authorities keeping some control over financial variables and thus deflecting attention from short term gyrations to the requirements of long term growth. This stands in sharp contrast to the hands-off attitude which the monetary authorities of the region are being required to adopt as part of the conditionalities;

(vi) a rapid retreat by the Government from an active participation in industrial and commercial enterprises, leaving the way clear for the modernizing influence of more efficient private capital, especially private foreign capital which, it is advised, can be relied upon to establish the underpinnings of sustainable economic development, the evidence of which may very well emerge, but only some time in the future in countries with small domestic markets and wage levels significantly above the subsistence margin;

(vii) the sharing with all the citizens the cost of providing certain basic services including health, education and water; and

(viii) a structural change in the taxation system under which direct taxes would be reduced in the expectation that savings and investment would increase, the public revenue gap being filled by regressive indirect taxation. Only a small proportion of the population benefits from the former; the lower income groups bear the brunt of the latter.

There has been inadequate analysis in the region of the social consequences of the new development paradigm, particularly in the context where implementation is exogenously determined. Dennis Pantin's analysis done for the manufacturing sector was particularly revealing and John Spence and others have attempted an overview for the agricultural sector. The technocrats in Government may have a view, but they are correctly muzzled. The Central Banks have been coy in making comments and it has fallen on the Caribbean Development Bank to raise some of the concerns. The most cursory examination of the new policy will reveal that its inherent regressivity is likely to be destabilizing. But an overall assessment is necessary, one which would attach weights to the economic variables and arrive at an assessment of the applicability of the World Bank maxim of "the maximum pain in the shortest period", answering at the same time the question, 'pain for what purpose'? Besides, there is a burgeoning literature on the subject, especially from UNCTAD and UNRISD which is raising warning flags about the new development paradigm, especially for the developing countries. The region may well derive benefit from a dissemination of this literature in policy propositions.

The experience of countries which have shaped their economic policy according to the dictates of the model has been mixed. The consensus of opinion emanating from the international financial community is that countries such as Mexico, Colombia and Chile have made impressive strides and now appear to be firmly set on the road to growth. Their industries, buttressed by a substantial infusion of private foreign capital, are deemed to be well able to cope with international competition, with the consequence that employment levels can be expected to rise rapidly some time in the future, although it is possible to raise concerns about real living standards deriving from inflation rates of 3% per month.

However, the experience in other countries, notably Jamaica, Venezuela and Trinidad and Tobago, is not as reassuring. In these and perhaps other countries -

(i) the social fabric is being torn apart as the population reacts adversely to the increasing youth unemployment, the price increases associated with the devaluation of the currency, the rise in interest rates, the increased burden of the cost of social services and the consequent burgeoning proportion of the population living below an ascetically drawn poverty line;

(ii) there is no conclusive evidence as yet that the policy of reducing direct taxes and allowing interest rates to rise has stimulated savings for fixed investment of the income-generating-employment creating type. Indeed, notwithstanding McKinnon and others, the hypothesis that positive real interest rates are a stimulus to savings seems to be on the verge of disproving itself internationally. [See Akyuz op cit. for references]. Conversely, high and variable interest rates, especially where these are combined with uncertain exchange rates, have kept real investment at very depressed levels in developed and developing countries alike and proves the point that stability of interest rates and asset prices are essential for long term investment. In Trinidad and Tobago the net savings ratio over the period 1986 - 1991, when interest rates have been high by historical standards, has been a derisory 3.5% of GDP;

(iii) in at least one developing country, Trinidad and Tobago, there appears to be some disenchantment in official circles over the response which the local private sector is showing to the economic environment being created through the application of the new economic policy;

(iv) the behaviour of the exchange rate in this part of the world shows that the trade-off between the rate of interest and the level of the exchange rate is at best tenuous and perhaps non existent because we have not been able, and are unlikely, to attract portfolio capital. For example, interest rates in Jamaica and Venezuela were raised to exceedingly high levels, with attendant adverse effects on agriculture and manufacturing, but this did not stop the decline in the exchange rate:

(v) the so-called globalization of world markets is yet to be manifested on a global scale. There is as yet no concrete evidence that agricultural subsidies in the industrialized countries are being reduced or that the non tariff barriers on the manufactured goods which the industrialized countries impose on their imports from developing countries are being reduced. In 1990, 28% of these imports were subject to barriers, an increase from the 26.5% which prevailed in 1980. It has been estimated (by UNCTAD) that the export earnings which the developing countries could not realise because of these restrictions were larger than the gross flows of funds from the developed to the developing countries.

None of this emerges with clarity in the official literature in the region or in the statements emanating from Government circles from time to time. Indeed the population is fed the outpourings from those whose interests lie in perpetuating the system for their own benefit. The "most unkindest cut of all" is that when the international financial institutions dictate their prescriptions, the Governments are expected to announce that the prescriptions are their own policies. This is a most unhealthy arrangement for social stability, as the experience in Asia, Africa and Latin America so liberally warns. But social stability is the prerequisite for economic planning.

All of this suggests a need for an independent on-going assessment of economic policy which will place the national issues in their national and international context. It is against this background that we must define a role for the Central Banks in peripheral countries.

We believe that the Central Banks have a critical role to play because, although they are part of the establishment which guide and shape economic activity in a country, they are not part of the executive. Indeed, the underlying assumption guiding their establishment in countries which adopt the Westminster system of Government is that the Central Bank is independent of the executive, and is the ears of the decision making apparatus, keeps a close relationship with the real economy as manifested in the experiences of the financial sector, but maintains an adequate distance from it in order to be able to exercise a countervailing power in economic regulation. Such a function is of critical importance in small countries which do not have the benefit of an informed financial Press and in which the other economic sectors are poorly served in terms of objective analysis. Besides, by their very nature, the Central Banks must be major repositories of national and international information on which sound national economic policy can be developed after an active debate.

DEFINING A ROLE FOR CENTRAL BANKS

Bringing together the main points mentioned earlier, we need to take due note of the fact that -

(i) in the area of monetary policy, a large part of the decision making authority, especially interest rates, exchange rates and the transborder movement of savings, has been preempted by the private international banking system. Small developing countries are particularly vulnerable to this evolving trend. Policies in these countries cannot be predicated on the assumption that "what is good for General Motors is good enough for us"; and

(ii) the international financial institutions have preempted the role of being the principal agents determining the kind of economic policy which borrowing countries can espouse and implement, and it is not clear that these institutions attach equal importance to the requirements of the people of the region as they do to genuflecting to the dictates of the increasingly oligopolistic forces which control the world economy.

The consequence of these is that it is no longer clear that, under the paradigm the welfare of the population of any developing country, or indeed any country for that matter, can be the principal preoccupation of national policy makers. This is the context in which one has to define a role for the Central Bank.

On one view, given the decision by the Governments to remove controls on capital movements, and taking into account the policies being espoused in the region on interest rates and international trade, and the response so far of the Central Banks to this turn of events, the kind of independent role envisaged when the Central Bank was established as an agent of economic change does not appear to have objective justification any longer. The international financial institutions are in the driver's seat in most fiscal and monetary matters. Under the present scenario, the regulation of the thrift institutions, which Central Banks now undertake, can be quite readily taken over by a Division of a Ministry of Finance; the issue and redemption of currency can be assumed by a Currency Board which can also be structured to undertake those of the money market operations of the Government which the Government cannot handle through the bureaucracy; and the Government banking business can be handled by the commercial banking system in a manner fully consistent with the private sector ethos which is now in vogue with Governments and international financial institutions alike. In short, within the framework of the new development paradigm which the international financial institutions have established for countries in the region, notwithstanding claims to the contrary which Governments make, the Central Banks in the region at least can be seen as no longer necessary in the system which they have created.

This view would probably be anathema to an audience of Central Banking personnel. But it is necessary to contemplate it nevertheless because it enforces an examination in the countries of the region of the systems which are necessary to optimise the contribution which a Central Bank can make to enhancing the welfare of the people of the country in the narrowing field in which it, and indeed the Governments, are now allowed to act.

In looking at the matter from this standpoint, it will be salutary, first, to alert Central Bankers to the disquiet which many of the social partners feel over the perceived excessive domination which the international financial institutions exercise over policy formulation and execution in this part of the world, over the double standards which these institutions apply in their dealings with big and small countries, and the apparent willingness of Governments to acquiesce in their dictation. This is not, ex ante, a myopic view; it derives from an appraisal, albeit inadequate, that other people are not always the best judges of what is good for us. In monetary matters, there will be greater confidence if the regional financial institutions gave us their considered view.

Second, even under a system where a country could exercise some control over its external payments system, it was always recognised that excessive money creation would be damaging to the exchange rate. The risk is even greater where all controls are lifted; the real economy feels the full backlash. It is necessary therefore to ensure that the money creation propensities of the Governments are held firmly in check within the limits which prudent economic management will dictate. But prudent management must also be guided by the fact that an economy, a Government or a business enterprise can absorb small, even cumulative small, changes in their behaviour patterns without traumatic effects; large random shocks are, however, very difficult to cope with and tend to be self perpetuating.

Third, while it has to be accepted as a datum that the international banking system, (until effective multilateral surveillance machinery is established to monitor its activities) will continue to introduce speculative gyrations in the exchange rates, especially in small developing countries which cannot effectively protect their exchange rates through market operations, (and even some of the very large countries have recently found such protection to be extremely costly), there is a need to establish machinery which would at least temper internal speculation against the exchange rate and modulate the effect on the domestic economy of the changes in this rate which are generated through speculative activity abroad.

Fourth, it is worrying that the empirical evidence of the experiences and practices in other countries, whose financial, economic and human infrastructures are similar to those in the region, is not brought to bear on policy determination in the region. This is particularly relevant in the case of the financial variables. Indeed, a detailed analysis of the correlation between the financial variables and the real economy has not yet gone past the work of Farrell and Worrell.

Finally, in the formulation and execution of policy, due account must be taken of the fact that if the import regime, the interest rate system, the exchange rate system, the external payments system on current and capital account, and the food security system are subject to determination by external bodies, then economic development policy in the country will in fact be put on autopilot at low altitude or turbulent weather and the level of employment will have to absorb the full backlash. Some of the Governments of the region have persuaded themselves that this is the route to go; they may very well be correct although they do not appear ready to persuade the population to accept the political consequences of it. The population is likely to feel reassured, one way or the other, by another view. This view could come from the Central Banks, but its mandate needs to be enlarged.

In this kind of situation, the appropriate course of action would appear to be not only not to abolish the Central Bank and redistribute its functions, but rather to enlarge the area over which the Bank, as a major economic agent, would be enabled to play an independent role and be relied upon to project an independent view. However, in order that this should be possible, the existing institutional arrangements, which in effect assume an adversarial system among several partners in the economic arena, need to be changed as they are unequal to the task. I believe that the Central banks of the region need to address the question and express a view on the development model which the countries of the region are being driven to adopt and the consequences which, in their view, the model holds for the social stability of the countries of the region. In a sense, this is built-in into the arrangements for the division of functions, a division which recognises the unity of the whole. The Banks, in my view, have an obligation to tell us as they see it.

We therefore put forward for consideration a package of measures set out hereunder which may approximate what the evolving situation requires:-

(i) The Central Banks should reexamine the limits of money creation which are now enshrined in their enabling Acts and determine a level which, in their judgment, would be minimally inflationary. This new limit should be precribed in law and the Central Banks should comply, and require compliance, with the law. In saying this, it is recognised that the Central Bank Acts of the region now prescribe such limits, most of which are now honoured in the breach. The point being advanced is that the limits should be reexamined in the light of the new situation prevailing and the new ratios which now guide decision making and that the Central banks should be buttressed in their efforts to make these ratios stick.

(ii) In the context where the import regime is exogenously determined, the Central Banks should propose that they be given independent monetary power to regulate import payments in relation to the requirements of supporting a desired level of the exchange rate and without having to vainly raise interest rates to levels which will destroy the propensity to invest in tradeable goods production. Import deposit schemes and monetary devices, other than reserve requirements which increase interest rates, to regulate the volume of import payments should be added to the reserve requirements powers which the Central Banks exercise over the banking system. The reality is that if the Governments are made to surrender all controls over imports and at the same time are unwilling to face the consequences on the real economy of the depreciation in the exchange rate, then some delaying mechanism needs to be available to cushion the impact.

(iii) The Central Banks should decide, and have the power to regulate, the level of interest rates in the country. The policies which the Inter American Development Bank, the International Monetary Fund, and the World Bank are seeking to impose in the region are unacceptable and indefensible as they will stultify the development process and destroy agriculture. It remains my view, on the other hand, that the margins which the commercial banks are now demanding on their loans are a mechanism for transferring their own inefficiencies into the bankruptcies of their borrowers, the losses from which they will seek to recoup later through increasing the spreads between interest paid and interest demanded. The Central Banks must be prepared to use some of their several powers to effect a regulation of such margins because I hold that it is inequitable that the cost of brankruptcies should not be shared between the financiers and the equity holders. More generally, the Central Banks should take on board the emerging position that stability of interest rates and asset prices is essential for an efficient financial system and that this "constitutes a strong case in favour of controlling interest rates as well as bank lending" [Akyuz op cit. p. 18].

(iv) The Central Banks should establish new machinery to manage, or modulate, the effect of changes in the exchange rate on the real economy and such machinery should incorporate the commercial banks. To this end a Committee of bank presidents, meeting in camera under the leadership of the Central Bank, is one of the new institutions which the present situation requires and this should be formally instituted.

(v) Perhaps the most important change required is that the Central Bank should be better equipped institutionally and legally to play an independent role in the economic management of the country. This calls for at least two structural changes:-

(a) the Governor of the Central Bank should be appointed after consultation undertaken through the Parliamentary system. Such a change is necessary to give the bank the kind of clout which it requires if it is to be able to express a view which may not fully accord with that of the Government of the day. The present arrangement does not convey to the man in the street that the Bank is truly independent of the Government. [Nothing in this should be interpreted as expressing any concern whatsoever over the technical quality of the Governors of the Central Banks in the region; all of them have been and are excellent people. It is the system which is being addressed];

(b) the Central Bank should by law be required to make a report on a six monthly basis to, and appear before, a Committee of Parliament constituted to deal with the economic situation and the economic management of the economy.

It will be facile to assume that even the minimal institutional changes which are proposed above will be easy to achieve in the absence of a concerted demand from analysts, professionals and the media for the availability of another view. However, the reality is that the institutional arrangements which delimit the activities of Central Banks, certainly in countries of this region, respond to an era now long past. Things have changed significantly since that time and the developing countries need to reexamine the institutional arrangements which were put in place in the previous era. There is now a need for another view, rooted in hard professionalism, to enable countries such as those in the region to have even a minimum chance of evading the steamrollers from the North. The Central Banks are the logical candidates to play this role because they have accumulated the intelligence base and the national respect to do it. The institutional machinery framing their activities should therefore either be modernised or the Banks will be anachronisms and should therefore be eliminated.