
CHAPTER 9

Conclusion

The economic prospects for the Caribbean in the 1990s are not very encouraging. Only a small proportion of the region's population enjoys an enhanced standard of living. The largest countries are the least prosperous and the most crisis-prone. The prosperous smaller countries lack a diversified export base and therefore the capacity to sustain growth in the face of economic cycles and potential competition. High unemployment rates prevail in most countries. There are one or two cases of disintegration of formal markets, breakdown of essential services and alienation from the political decision making process.

Nonetheless, the Caribbean does have resources which may be turned to better advantage. Countries have generally high standards of health and education and they enjoy a relatively well-developed infrastructure. The region has a significant amount of natural resources. It is close geographically to what for countries of small size is a virtually unlimited market in North America; and countries generally enjoy a strong democratic tradition.

Caribbean economic performance may be improved upon by marrying a better mix of stabilisation policies with a deliberate export promotion strategy. The stabilisation programme should be a mix of the orthodox and the heterodox, respecting the peculiarities of small open economies, safeguarding human and physical resources needed for long-term growth and avoiding excess of government intervention. The export promotion strategy should include: tax policy; funding for export research and development; human resource development; and a national mobilisation for the export drive.

Small open economies cannot transcend the limits imposed by the external economic environment – for example, interest rates, the flows of foreign investment, fluctuating prices of tradables and slow economic growth in world markets – but they may do a great deal to improve the benefit they extract from that environment.

The Orthodox Stabilisation Package

The content of orthodox stabilisation packages – those carrying the Bank/Fund imprimatur – changed for the better in the eighties. They now reflect greater sensitivity to the development of human resources and infrastructure, factors which determine the prospects for long-term growth (Williamson, 1990). Provisions for such services still tend to be something of an “add-on”. They do not

feature centrally in the design of the stabilisation programme, which still centres on global fiscal and financial balances. The orthodox design also fails to account for small country characteristics, for example in its fixation on the official exchange rate and its concern about the over-protection of import substitutes. The principal virtue of the orthodox policy is its emphasis on fiscal rectitude.

An emphasis on fiscal policy in economic adjustment packages is entirely appropriate for Caribbean countries: the quality of the fiscal programme sets bounds on all other outcomes. However, existing tools for fiscal management must be deployed together in a more explicit framework, and the operational budget needs to be conceived over longer than the usual one year. Taxation, spending and financing should be linked to specific goals for investment in exports, the development of infrastructure, improvement in human capital, changes in relative prices, the distribution of income and aggregate demand. Economists should offer decision makers a choice of alternative scenarios, quantifying the fiscal measures and their effects.

Monetary policy is little more than an alternative name for deficit finance: the size of the government financing requirement is the only discretionary monetary variable available to the authorities. This needs to be recognised explicitly, so that policy makers do not spend time on credit controls, reserve requirements and other ineffectual measures. Their task is to ensure that domestic interest rates do not stray from the trend of international rates.

The nominal exchange rate is endogenous, except when foreign exchange reserves are accumulating continuously over time. Recommendations for changes in the official rate are correct insofar as they imply movement toward the endogenous rate. The link between the real exchange rate and the nominal rate depends on factor proportions and on factor and product price reactions. There are two channels through which the reaction takes place: wage-price interactions and interactions of external demand and supply. We cannot confidently say that the link between the nominal and real rates is either strong or dependable.

An emphasis on the interest rate as an allocative mechanism is, fortunately, misplaced. The interest rate is locked into the international financial system by the mobility of capital, so policy makers would have no influence on allocation if interest rates were the key instrument. However, the solution to inadequate supply of finance, capital flight and other financial scarcity problems is an increase in the productivity of investment so that production becomes internationally competitive. That solves the problem of supply and allocation of finance at a stroke, by providing what for a small economy is an unlimited amount of foreign finance to supplement the domestic supply.

Government should provide a regulatory framework that ensures orderly transactions and offers comfort to the public about the probity and soundness of the financial system. Selective price interventions are necessary because of the pervasiveness of monopolies and oligopolies. However, relatively few items are so undifferentiated that price intervention can be made to improve resource allocation, and government must be sure to confine its attention to those. There should be guidelines for price changes as circumstances dictate.

Export Promotion

The orthodox package, with the amendments suggested, is missing an essential element – a policy for stimulating investment. This study recommends an official investment promotion strategy, strictly limited to exports, not as a substitute for adjustment, but as a complement. The strategy should focus on institutional effectiveness, organisational efficiency, enhanced skills and human resource development for exporting. Government should provide responsive leadership, itself identifying activities for priority, but supporting export successes or promising new exports. Government should be ready to re-order its priority list in the light of actual enterprise performance in the export sector.

The Understated Assumptions

The tools available to economists leave us short of a viable policy prescription for economies in deep crisis. The resolution of their problems depends on social and political changes about which economics has nothing to say (that is not facile, that is). Among the elements which contribute to their prospects are: the terms on which outstanding external obligations are settled, a question of international political economy; the nature and stability of the domestic political process, which determines whether policies will be sustained for the time needed to have beneficial investment effects; the quality of leadership, with leaders of spirit and ability opening up a wider range of possible options; and the balance of social forces and interest groups, which determine how strong and malleable are the coalitions for and against productive economic policies (Nelson and contributors, 1989).

A Summing Up

Some Caribbean countries are in such dire economic straits that as economists we have no useful recommendations for stability with growth. There are too many prior conditions which are social and political in nature. For economists, this is unsettling, but it is the only realistic conclusion. For other countries the way forward would seem to be a revised version of the orthodox strategy, with heavier emphasis on the rich possibilities for fiscal policy, and with the important addition of a strategy for accelerating investment in export activities.

The main ingredients of the strategy for stabilisation with growth are:

- (a) a conservative fiscal policy in the medium term – this might require a balanced budget or borrowing to finance government's investment programme, depending on the circumstances;
- (b) counter-cyclical fiscal policy in the short run – it is dangerous to persist with such policies for several years in a row;

- (c) a tax and expenditure mix designed to secure acceptable levels and distribution of social services and the development and maintenance of the social structure;
- (d) a strong tax incentive bias towards exports;
- (e) government expenditure to develop export market niches complemented by a national export promotion programme;
- (f) an official exchange rate which is kept in line with the endogenous rate determined by the credibility of fiscal and monetary policies and by the supply and demand for foreign exchange; and
- (g) interest rates that are held in line with international interest rate trends.

This strategy is not assured of success; much depends on international economic circumstances and on the skill with which policies are implemented. Nonetheless, it seems the right course for success; it can cement a future of sustained growth for countries not suffering a payments crisis, even if the external environment does not improve, and it should situate others to take best advantage of any favourable circumstance that offers.