



Antigua & Barbuda



Bahamas, The



Barbados



Belize



Dominica



Grenada



Trinidad & Tobago

The Eighteenth Adlith Brown Memorial Lecture

"Foreign Exchange Rates: Again?"

by

Professor Compton Bourne, PhD, O.E.



Caribbean Centre for Monetary Studies



Guyana



Haiti



Jamaica



St. Kitts & Nevis



St. Lucia



St. Vincent & Grenadines



Suriname



Dr. Compton Bourne is President of the Caribbean Development Bank and recipient of Guyana's highest honour, the insignia of Order of Excellence (O.E.).

Dr. Bourne has had a distinguished academic career as a specialist in monetary and financial theory and policy at the University of the West Indies (UWI) and rose rapidly from the position of Lecturer in Economics at the Mona Campus in 1975 to Professor of Economics at the St. Augustine Campus in 1981. Based on his sterling performance in the academe, he was promoted to the position of Pro-Vice Chancellor Planning and Development and eventually to Pro-Vice and Campus Principal of the St. Augustine Campus in 1996.

Dr. Bourne served as Coordinator of the Regional Programme of Monetary Studies, now the Caribbean Centre for Monetary Studies, on two occasions (1973-1979 and 1984-1987) and continues to be an active contributor to public policy formulation in the Caribbean Region. He has consulted for and advised the Inter-American Development Bank, the World Bank, USAID, the CRNM and the Southern African Countries Union. In addition, he has held important positions on boards of a number of national and regional institutions including the Central Bank of Trinidad and Tobago, UNESCO, the Caribbean Studies Association and the Caribbean Academy of Sciences, to name a few.

Dr. Bourne has also published ten books and over a hundred refereed papers, research reports and advisory memoranda along the full spectrum of economic and social policy. These publications have addressed difficult issues such as trade negotiations, debt management, education, health, financial policy, macroeconomic management and exchange rate policy.



Caribbean Centre for Monetary Studies

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EIGHTEENTH ADLITH BROWN MEMORIAL LECTURE

“FOREIGN EXCHANGE RATES: AGAIN?”

Professor Compton Bourne, PhD, O.E.

**Delivered on November 14, 2002
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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). She subsequently completed her Master's (with distinction) as well as her Doctorate 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, firstly, the Caribbean Public Enterprise Project and secondly, in 1980, the Regional Programme of Monetary Studies. In this period, she was also promoted to the position of Senior Research Fellow and in 1982 to the position of Acting Deputy Director - a position which she held until her death. These latter years demonstrated most her capacity for intellectual leadership and for creative management.

Adlith revelled in the realm of ideas. It is therefore understandable that she was fast developing a reputation for being an outstanding economic theorist as her writings attest. Indeed, she was an ideal person to co-ordinate the 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 Regional central banks had to cope.

Each year an eminent Caribbean scholar is invited to deliver the Memorial Lecture, during the Annual Monetary Studies Conference of the Caribbean Centre for Monetary Studies (CCMS), in tribute to the life and work of Adlith Brown.

"FOREIGN EXCHANGE RATES: AGAIN?"

by

Professor Compton Bourne, PhD, O.E.

President, Caribbean Development Bank

It is a great honour and privilege to be able to deliver the 18th Adlith Brown Memorial Lecture. Adlith was a well-loved friend and highly respected colleague. I first met her in 1970 and throughout the remaining years of her life she never failed to impress with an exceptional graciousness and charm. For all her natural gentility, Adlith Brown was a formidable intellect, whose penetrating insights enriched not only her own contributions, but also those of many of her contemporaries. Her death, just when her career had entered into the phase of high growth, was a major loss to Caribbean economics. She had a very strong interest in international economics and in the interplay between international economic relations and economic development. Perhaps for this reason, she would not have minded the subject of this Lecture.

Types of Foreign Exchange Rate Regimes

There are essentially two kinds of foreign exchange rate regimes within the Caribbean Community. The first is the pegged rate or adjustable peg regime to which most countries adhere; specifically, The Bahamas, Barbados, Belize, Suriname and the member countries of the Eastern Caribbean Currency Union (ECCU). Under a pegged rate regime, a country specifies its currency in a fixed relationship to the United States dollar and alters that rate only as a matter of deliberate economic policy. Transactors in foreign exchange are expected to buy and sell foreign currency at the official rate and cannot separately or jointly alter the rate. It is policy determined. In reality, foreign currencies are often traded at rates different from the official rate. Parallel foreign exchange markets develop and may sometimes marginalise the official market, Belize perhaps being a current case in point. Furthermore, by creating sustained and substantial disequilibrium in the official market, transactors jointly force changes in the official policy determined rate.

The other regime is the floating rate regime, to which Guyana, Jamaica and Trinidad and Tobago adhere. Within this regime, the foreign exchange rate is not set by official fiat. Instead, it is supposed to be the outcome of atomistic transactions and can vary at minute discrete intervals of time, that is, daily or even hourly. In reality, the economic

authorities sometimes intervene as a major player to influence the market rate and would also exercise 'moral suasion' (the euphemism for strongly worded advice) to financial institutions who are normally the market makers in narrow financial systems. Parallel markets in the sense of markets additional to an official market do not exist in floating rate systems, but this does not mean the non-existence of multiple sub-markets whose existence is due to differences in information costs and transaction costs, as instanced by the co-existence of a market centred around commercial banks and one centred around cambios.

Standard Arguments for Pegged and Floating Rate Regimes

The existence of different foreign exchange rate regimes within the Caribbean Community has been cause for learned comment, especially in respect of the implications for achievement of a Caribbean Single Market and Economy (CSME). One may be perhaps startled by the boldness of the claim by Worrell et. al. (2000) to have established "that there is a consensus of Caribbean intellectual opinion, popular opinion and political party support for exchange rates fixed to the US dollar", especially when less than one year later the Caribbean Trade and Adjustment Group (2001) concluded guardedly that "each country claims full satisfaction with the

system it presently operates and, in most cases, its retention has assumed the status of a political mantra".

In my opinion the debate is far from settled and positions taken are strongly correlated with the economy of origin of the Caribbean economist.

The arguments for the choice between floating and pegged rate systems have impeccable intellectual pedigree on both sides of the debate. One only has to invoke the names of James Meade, Milton Friedman and Robert Mundell. It may be worth recapping the arguments in their most modern versions. Proponents of floating exchange rate systems claim the following advantages for it:

- (1) insulation of the domestic economy from external shocks. External price and demand shocks in a floating rate system will be absorbed by changes in the nominal exchange rate rather than by changes in domestic incomes and employment as happens under the pegged rate system;
- (2) it is easier to change nominal exchange rates than to change the underlying determinants of the real exchange rate;
- (3) monetary policy can be set independently of foreign payments considerations. Inconsistencies

between domestic policy and the rest of the world would be reconciled by changes in the nominal exchange rate rather than by foreign exchange reserve changes which impact on domestic money stock;

- (4) monetary policy is more potent under floating rate regimes because changes in nominal exchange rates constrain the size of the import leakage; and
- (5) commitment to fixed exchange rates is self-denial of the use of an important expenditure switching policy instrument in the toolkit for simultaneous internal and external balance.

Advocates of fixed exchange rate systems have in turn advanced the following arguments and counter-arguments:

- (1) Floating rates systems are unstable whereas fixed rate systems are not. Instability may be the consequence of speculative behaviour by foreign currency transactors. (Friedman disputes this on the grounds that it implies irrational behaviour on the part of speculators). Instability may also result from lags in the response of export volumes to changes in exchange rates - the J-curve phenomenon;

- (2) The volatility of exchange rates by increasing risk would deter international trade and investment and would also be a disincentive to economic integration;
- (3) Fixed rate systems are a valuable constraint on economic authorities. They discipline fiscal policy and reduce the scope for expansionary monetary policy. Monetary discretion is a vice not a virtue as pro-floaters believe;
- (4) Fixed rates provide built-in economic stabilizers since the unaltered exchange rate is effectively a wedge between foreign prices and domestic prices and since external demand shocks are not allowed to spillover into domestic price shocks; and
- (5) Floating exchange systems would tend to accelerate the rate of domestic inflation because of ratchet effects associated with asymmetric domestic factor price adjustments.

It is apparent that each side claims that its preferred exchange rate regime is good for economic growth and stability and better assists countries in coping with external shocks. Not surprisingly, much of the differences in conclusions are not the result of failures in logic, but differences in critical assumptions about key economic issues such as financial capital mobility and wage and price

determination. For Caribbean economies, these assumptions are indeed very important. But, in addition, the nature of external shocks must also be taken into account. There is a world of difference between external shocks such as economic recession in the USA and German inflation, and external shocks such as the loss of European trade preferences.

Adlith Brown was impatient with purely theoretical analysis of economic issues. She would say: "Yes, yes! but how does that affect the price of coffee?" - coffee being her code for economic outcomes that matter, such as output, employment and incomes. In the same spirit tonight, I draw attention to the fact that now we have had almost a full decade of coexistent floating and fixity, and ask what conclusions can we draw from it. How have our economies performed under these two distinct regimes? Are there discernible differences in economic performance? How significant is a common currency or fixed cross-rates for the full achievement of a CSME?

Volatility of Floating Rates

The first question I address is whether floating rates have been volatile. For this purpose, a simple time analysis of the behaviour of yearly average market rates may seem to suffice. It is evident from the data on nominal market foreign currency

exchange rates for Guyana, Jamaica and Trinidad and Tobago portrayed in Figure 1 and Table 1 that there are significant annual variations of the local currency price of US dollars in Guyana and Jamaica, but not so in Trinidad and Tobago. Annual percentage changes averaged 24% in Guyana, 22% in Jamaica and 3% in Trinidad and Tobago between 1990 and 2001. The standard deviations - a measure of volatility - were 50%, 28% and 7%, respectively.

What explains the relative performance? It cannot be differences in monetary policy. The monetary authorities in Jamaica and Trinidad and Tobago did indeed predicate much of their policy on exchange rate objectives. In Jamaica, this took the form of active open market and interest rate policies; in Trinidad and Tobago, recourse was made to changes in legal reserve requirements and sales of foreign currency reserves. In Guyana, monetary policy was passive. However, as we have seen, there is nothing to choose between Guyana and Jamaica in respect of market volatility, while the Trinidad and Tobago experience is quite different. One possible explanation for the contrasting experiences is capital flows. Net capital movements in Trinidad and Tobago became positive and substantial from 1996 onwards, relieving excess foreign exchange demand pressures that emanated from the current account of the balance of payments.

It is important in profiling foreign exchange rate regimes to avoid exclusive attention to nominal bilateral exchange rates and to examine as well effective exchange rates. Nominal effective exchange rates are measured as the weighted average of bilateral exchange rates in recognition of the fact that a country typically has more than one important trading partner. Countries which peg their currency to the US dollar will nonetheless experience changes in their nominal exchange rates because of the variability of the US dollar rate for other currencies.

Table 2 provides a basis for comparison for two floaters (Guyana and Trinidad and Tobago) and the US dollar peggers. It is supplemented by Figures 2 and 3. Note that there is hardly any discernible difference in the trends of the nominal effective exchange rates for Belize and Trinidad and Tobago between 1993 and 2001 and for Guyana and Belize between 1992 and 1998. Nominal exchange rates are more volatile for Guyana than for the all US dollar peggers. However, Trinidad and Tobago, the other floater for which data are available is among the low volatility countries and exhibited considerably less nominal effective exchange rate volatility than Grenada.

It is necessary to go a step further in the time profiling of foreign exchange rates under the two systems. One needs to look at real effective exchange rates which measure the aggregate price competitiveness of countries. The real

effective exchange rate is the nominal effective exchange rate adjusted for relative movements in national prices. Figure 4 shows broadly upward similar time trends for Belize, Guyana and Trinidad and Tobago between 1993 and 2001. Barbados has a different upward trend as does Jamaica whose trend is steep. Figure 5 presents the profiles for the ECCU countries which have less of a pronounced trend of real effective exchange rate appreciation. The inclusion of these countries in the full set, nonetheless confirms the Caribbean Community tendency for real exchange rate appreciation since 1995, which implies a deterioration of price competitiveness. With the fuller set of comparisons, it is difficult to resist the conclusion that there is substantially more real effective exchange rate volatility among the floaters than among the US peggers, given the large standard deviations for Guyana and Jamaica and the fact that among the peggers only Barbados has a standard deviation greater than Trinidad and Tobago.

No less interesting are the emerging differences in real effective exchange rates among members of the ECCU. Some ECCU countries have evidently been subject to episodes of real foreign exchange rate appreciation and associated loss of price competitiveness to which they are constitutionally incapable of responding by changes in the nominal market exchange rate. One foreign exchange rate for all does impose real costs on some in a currency union.

Macroeconomic Performance

Let us turn now to comparative macroeconomic performance focusing on economic growth, unemployment, inflation, money stock growth and government budgetary balance.

Dealing first with economic growth, there is a mixed record for floaters and fixers over the decade. Guyana's real growth [measured by constant price gross domestic product (GDP)] averaged 3.5% and Trinidad and Tobago's 2.6%, which were both faster than several peggers, as shown in Table 3 (and presented graphically in Figures 1 and 2). Jamaica experienced an average growth of 0.7%. The mixed record with constant price GDP is confirmed by reference to per capita growth rates (Table 3, Column 3).

Moreover, volatility of economic growth was no more pronounced among floating rate countries than among pegged rate countries. All countries experienced significant economic growth volatility measured by the standard deviation of annual percentage changes shown in Table 3, column 2. However, the volatility index for Jamaica and Trinidad and Tobago is considerably smaller than those for Antigua and Barbuda, Barbados, Belize, St. Lucia and St. Vincent and the Grenadines. Guyana has the highest economic growth volatility, while Belize, Barbados and St.

Vincent and the Grenadines are next in decreasing order of magnitude.

The inference I would draw from that statistical picture is that there is nothing to choose between floating rate countries and pegged rate countries on the basis of economic growth performance. Additionally, since it is evident that there was considerable variation in economic growth among ECCU countries, one must also conclude that the existence of a currency union does not guarantee homogenous economic growth within the Union.

Turning next to unemployment, certain features are evident despite the notorious patchiness of official unemployment statistics. From Table 4 it can be seen that unemployment rates trended downwards in many countries. Furthermore, countries with higher unemployment rates are to be found among peggers (Belize, Grenada, St. Lucia and St. Vincent and the Grenadines), as well as among floaters (Jamaica and Trinidad and Tobago).

Given the concern of both exchange rate camps, that is, advocates of fixed rate systems and advocates of flexible rate systems, with price level consequences of foreign exchange rate regimes, I now draw attention to data on consumer price inflation. Figure 6 provides an indication of fairly similar inflation rate trends for The Bahamas, Barbados, Belize,

Guyana and Trinidad and Tobago between 1994 and 2000. The similarity for the first three countries goes back a further two or three years. No such commonality of patterns is evident for the ECCU countries. An inspection of Figure 7, Table 5, and Charts 3 and 4 which are based on decadal averages provide a little more insight on inflation experiences. Among the floaters, Jamaica is at an extreme with a decadal average inflation rate of 26%, while Guyana and Trinidad and Tobago are at 22% and 6%, respectively. These arithmetic mean rates of inflation are all greater than those for pegged rate countries. However, inflation volatility in two of the ECCU countries (Antigua and Barbuda and St. Vincent and the Grenadines) exceeds inflation volatility in two other Caribbean Community countries (Bahamas and Belize) which again raises the question of whether currency unions do contribute to price stability. There are also significant volatility differences within the ECCU.

Because of the openness of these economies, developments in the external sector are critical influences on macroeconomic performance. These countries are subject to tremendous volatility in their terms of trade - no less so among peggers than among floaters. They differ significantly, however, in their balance of payments experiences. The current account balance on goods and services as a percentage of GDP averaged negative 23% for Guyana, close to negative 22% for St. Kitts and Nevis and negative 18% for Grenada

and St. Vincent and the Grenadines. Jamaica, also a floating rate country, with negative 3% is in the same deficit category as peggers such as Belize (5%), Antigua and Barbuda (4%) and The Bahamas (7%). St. Lucia, a pegger, with negative 12% is around the middle of current account deficit countries. Barbados and Trinidad and Tobago are the only two countries with current account surpluses, marginally so in both cases (1.6% for Barbados and 0.5% for Trinidad and Tobago).

It may be inferred from the economic growth rate statistics presented earlier that some countries coped better than others with external trade shocks. Noticeably, a floating rate country like Guyana did no worse than a pegger like St. Kitts and Nevis.

It is appropriate to deal now with monetary and fiscal behaviour, bearing in mind that advocates of fixed exchange rate systems claim the advantages of monetary stability and fiscal discipline. For the first four years of the decade, the nominal money stock expanded faster in Guyana and Jamaica than in pegged rate countries such as The Bahamas and Barbados and Belize (Figure 8). After 1994, there is closer correspondence of the rates of monetary expansion. Trinidad and Tobago, the other floating rate country, was always in the cluster with the pegged rate countries over the decade. It is evident also that there are spikes in the monetary expansion rates for some peggers, specifically Barbados in 1996, The

Bahamas in 1999 and Belize in 1999. Furthermore, the monetary expansion rates for Barbados and The Bahamas exhibit moderate upward trends.

Since it is difficult to establish fundamental differences in monetary behaviour on the basis of trends in the gross money stock, an examination of monetary velocity (through the ratio of money stock to GDP) would assist. Figure 9 describes the time pattern of M/Y for the 1990-2000 period. The close similarity of behaviour is revealed by the density of the annual M/Y statistics for the 1990-98 period. Basically, none of the countries exhibited a tendency towards monetary expansion. After 1998, there is a tendency for divergence. Barbados, Belize and Guyana (two peggers and one floater) seem to have embarked on expansionist paths, while Jamaica and Trinidad and Tobago remained with stable money policies.

Fiscal discipline is commonly indicated by a government's current account balance or the overall fiscal balance. According to some credos, zero or surplus balances are a virtue; deficits are a sin. The decadal average record for fiscal balance as a percentage of GDP is presented in Table 6. Every country, except Belize and The Bahamas, shows decadal average overall fiscal deficits. Guyana, with an overall fiscal deficit of 9.2% of GDP stands out at one extreme and St. Lucia with an overall fiscal deficit of 0.3% is at the other extreme. On this count, Guyana among the floaters

would be interpreted as exhibiting significant fiscal indiscipline, but so would Barbados, Dominica and St. Kitts and Nevis among the peggers. It is worth remarking, that, of the 12 countries, 6 had overall fiscal deficits in each of the 11 years covered, 3 had overall fiscal deficits in 10 years, 1 in 8 years and 2 in 7 years.

Because overall fiscal deficits are often driven by the "pure" motive of capital formation and economic growth, a less stringent standard for fiscal discipline may be based on fiscal current account balance. The decadal averages (also shown in Table 6) are mainly zero or positive, i.e. show average current account balance or surpluses, with the exception of Guyana (-1.5%) and St. Kitts and Nevis (-0.3%). Some ECCU countries have sizeable average surpluses as percentages of GDP, in particular St. Lucia (5.6%), and St. Vincent and the Grenadines (3.3%). Belize's surplus is 3.8%. However, the decadal averages do not tell the whole story. Several countries experienced repeated current account deficits as well as unbroken runs of those deficits. The three floaters each had current account deficits in 4 of the 11 years, with maximum runs of 4 years (1996-99) in Jamaica and 3 years (1990-92) in Guyana. In contrast, Antigua and Barbuda was in deficit 9 times with a maximum run of 6 years (1990-95), Barbados 6 times with a maximum run of 6 years (1990-95), St. Kitts and Nevis 4 times with a maximum run of 3 years (1999-2001) and Dominica and Grenada 3 times each,

with maximum runs of 3 years. Belize, St. Lucia and St. Vincent and the Grenadines had no current account deficit episodes during the decade.

What should one make of these observations? First, if occurrences of current account fiscal deficits are a measure of fiscal indiscipline, floaters have done marginally better than peggers - they have had fewer instances of deficits and the runs have been shorter. Second, within the ECCU, fiscal deficits are not unusual. Saints and sinners share the same roof. The Eastern Caribbean Central Bank (ECCB) as the monetary authority for the ECCU has little power to contain fiscal expansion by its members countries. True enough, the ECCB has control over its own lending to member countries. However, recourse by member countries to commercial creditors inside and outside of the currency union is an option exercised frequently by expansionist governments, sometimes with devastatingly adverse consequences.

Exchange Rate Systems and the CSME

The view has often been forcefully expressed that the coexistence of floating and pegged rates are inimical to the realisation of the CSME. In 1992, CARICOM Heads of Government committed to the achievement of monetary union which entails a common currency under a fixed exchange rate system. Five convergence criteria were

specified for achievement of monetary union. These pertained to the ratio of foreign reserves to imports, the inflation rate, fiscal balance as a percentage of GDP, the stability of exchange rates, and GDP growth. By the end of 2000, nearly all eligible countries had either satisfied the criteria or tended towards their satisfaction. Nonetheless, technical opinion among the Region's central banks is that monetary integration is neither feasible nor an appropriate response to the global challenges faced by the Region (TECHNICAL TEAM 2001). Their conclusion is that the creation of the CSME should be the priority and that in the meanwhile countries should pursue independent monetary arrangements consistent with internal price stability and macroeconomic balance. Implicit in this conclusion is the view that exchange rate fixity within the Region is not necessary for achievement of the CSME.

Two aspects of the CSME can be the focus of our attention here. One is the CSME as a trading space for goods and services; the other is the CSME as a unified production space. The first implies full and unfettered movement of goods and services in response to price, quality and income. The other implies full and unfettered movement of factors of production in response to factor prices and profit opportunities. The first aims at maximising the market demand at the regional level for producers located anywhere in the CSME's geographical space. The second aims at

maximising production efficiency by optimising factor use and generating economies of scale and scope.

It is easy to accept on a theoretical basis that floating exchange rates may affect transactions in goods and services. Floating rates generate uncertainty about future monetary values of transactions with effects on the behaviour of transactors, to a degree dependent upon their risk preferences and their access to hedging solutions. However, vagaries of practice in application of foreign exchange controls systems, usually a feature of pegged exchange rate systems, also create uncertainty and, where corruption emerges, impose unexpected transactions costs.

Hedging solutions to exchange rate risks are not cost-free, therefore uncertainty avoidance raises transactions costs of trade settlements. Whether these costs are quantitatively significant is an empirical matter. In the Caribbean they could be minor in comparison with other transactions costs. Among the other transactions costs, increasing elements in regional trade and payments are commercial bank charges for cross-border transactions even within the ECCU, non-tariff barriers, bureaucratic delays and foreign exchange controls endemic to pegged rate systems.

Turning to the production aspects of the CSME, a popular argument is that pegged rate systems are favourable to capital

flows, while floating rate systems are not. The former is free of uncertainty with respect to domestic currency values of rates of return. However, this argument is vitiated by several considerations. First, investors would base their decisions on exchange-rate adjusted rates of return. Second, exchange rate hedging devices may be employed to cope with uncertainty generated by exchange rate variability. Third, there are other more powerful obstacles to capital mobility. These include foreign exchange controls and unpredictable shifts in them. The Bahamas, Barbados, Belize and the ECCU member countries maintain barriers to the free movement of capital within the Caribbean Community in non-fulfilment of Protocol II. Some other obstacles are non-harmonisation of corporate laws and regulations, deficient corporate reporting and information systems, regulatory wedges between national stock markets and xenophobic market behaviour by local business and political interests.

Regarding labour as a production factor, it is doubtful that exchange rate uncertainty is an obstacle to labour mobility in the Caribbean Community. Certainly, labour tries to move despite the co-existence of pegged and floating foreign exchange rate systems, from floaters to floaters, from floaters to peggers, from peggers to floaters and from peggers to peggers. However in all such situations, there are regulatory barriers, notably restrictive work permit systems. It is noteworthy that even within the ECCU, free movement of

labour is yet no more than a policy goal weakly subscribed to by some members of the currency union. Other real obstacles to labour mobility are the lack of portability of pensions and social security benefits, lack of mutual recognition of labour market qualifications, and discriminatory housing and schooling practices by host countries.

A very pertinent consideration when addressing the subject of exchange rate systems and the CSME is how much weight should be given to economic transactions with the rest of the world. This is the issue to which allusion was made by the central bank technicians.

Let us approach the issue this way. Suppose all Caribbean Community countries peg to the US dollar at a single fixed rate (thereby having a *de facto* common currency), and suppose further that they abolish foreign exchange controls among themselves. Then the reasonable expectation is that capital flows would respond to cross-border differentials in interest rates, profit rates and tax rates within the currency union. But there is no reason to assume that capital flows would cease to be responsive to differentials in these same variables with respect to the rest of the world. What would the union do under such circumstances? Maintain foreign exchange control with respect to the rest of the world? This may not be a real option if the currency union is itself part of a larger economic bloc which predominates in the currency

union's capital movements or in the context of global financial market liberalisation. If exchange controls are not a feature of the new currency union regime, does it then make better sense to float? This is a question that I think requires close examination.

One additional point before I conclude. Intra-CARICOM trade is presently about 13% of total trade of the Community. Does it make sense to determine the exchange rate system on the basis of intra-regional trade considerations or on the basis of total trade, which means in effect extra-regional trade considerations?

Conclusion

This lecture reviewed the behaviour of foreign currency exchange rates within the Caribbean Community with a view to establishing what performance differences existed among countries with floating rate systems and countries with pegged rate systems during the past decade. With the exception of Jamaica, there is no tendency for effective exchange rates to appreciate substantially more in floating rate countries than in the pegged rate countries. However, real effective exchange rate volatility is more pronounced among the floaters. The real effective exchange rate behaviour of all countries reveals an underlying gradual loss of international price competitiveness.

There is considerable diversity in macroeconomic performance among floaters and peggers. My conclusion, based on the statistical review of their performance over the 1990-2000 period is that there is nothing to choose between floating and pegging on the basis of economic growth performance and unemployment rates. Inflation rates are decidedly higher among the floating rate countries and inflation volatility is also greater. Extreme trade shocks affect all Caribbean Community countries. No distinction can meaningfully be made between floaters and peggers with respect to their ability to cope with quite substantial external trade shocks. The monetary behaviour of non-ECCU countries was basically non-expansionary for most of the 1990s. Since 1998, however, one floater (Guyana) and two peggers (Barbados and Belize) adopted an expansionary stance. Fiscal discipline is not a strong point between both floating rate countries and pegged rate countries. If anything, floaters have shown more fiscal discipline than peggers in the Caribbean Community.

The choice of an exchange rate system, or more specifically currency union, is of second order significance for the realisation of the CSME. The major obstacles to an integrated market for goods and services and for factors of production and capital are to be found not in transactions costs and uncertainty attached to floating rate systems, but in foreign exchange controls, regulatory barriers and

institutional weaknesses. Major transformative forces in the global economic environment, such as regional economic areas or trade blocs and global liberalisation of trade in goods and services and movement of capital also suggest that the choice of foreign exchange regimes by Caribbean Community countries should not be made principally on the basis of CSME objectives.

Fundamentally, the foreign exchange rate debate should not be allowed to distract us from the real problems of economic growth and development. There are two words missing from the title of my lecture. I will add them now: "Foreign Exchange Rates: Again?? Get Real!". I believe that Adlith Brown would have approved.

Table 1

**Arithmetic Mean and Standard Deviations
of Percentage Changes in Market
Foreign Exchange Rates : 1990-2001**

<i>Country</i>	<i>Mean</i>	<i>Standard Deviation</i>
<i>Guyana</i>	23.6	49.7
<i>Jamaica</i>	21.7	27.7
<i>Trinidad and Tobago</i>	3.5	7.4

Source: *Computed from data in IMF Financial Statistics Yearbook*

Table 2

**Arithmetic Mean and Standard Deviations
of Percentage Changes in Nominal and Real Effective
Exchange Rates: 1990-2001**

<i>Country</i>	<i>Nominal Effective Rates</i>		<i>Real Effective Rates</i>	
	Mean	Standard Deviation	Mean	Standard Deviation
<i>Barbados</i>	0.0	0.0	3.3	7.7
<i>Belize</i>	3.5	2.0	-0.1	3.4
<i>Guyana</i>	-8.5	20.6	-1.1	10.9
<i>Jamaica</i>	0.0	0.0	19.4	21.4
<i>Trinidad and Tobago</i>	1.7	4.3	0.6	4.8
<i>Antigua & Barbuda</i>	1.1	2.8	0.8	2.5
<i>Dominica</i>	2.1	2.9	0.4	3.5
<i>Grenada</i>	6.1	5.7	0.1	3.3
<i>St. Kitts & Nevis</i>	0.6	1.8	1.1	3.1
<i>St. Lucia</i>	2.9	3.4	1.4	2.9
<i>St. Vincent and the Grenadines</i>	3.5	3.5	1.0	3.1

Source: Computed from data in IMF Financial Statistics Yearbook

Table 3
Arithmetic Mean and Standard Deviations
of Percentage Real GDP Growth Rates : 1990-2001

<i>Country</i>	<i>Gross Domestic Product</i>		<i>Per Capita GDP</i>
	Mean	Standard Deviation	Mean
<i>Barbados</i>	1.1	3.5	0.5
<i>Belize</i>	5.5	3.7	1.9
<i>Guyana</i>	3.5	4.1	3.8
<i>Jamaica</i>	0.7	1.8	-0.1
<i>Trinidad & Tobago</i>	2.6	2.3	2.3
<i>Antigua & Barbuda</i>	3.3	3.1	2.0
<i>Dominica</i>	2.4	1.4	1.9
<i>Grenada</i>	3.7	2.5	2.5
<i>St. Kitts & Nevis</i>	4.2	1.8	4.3
<i>St. Lucia</i>	2.2	2.0	3.1
<i>St. Vincent and the Grenadines</i>	3.4	3.4	2.4

Source: Columns 1 and 2 computed from data in Caribbean Development Bank Social and Economic Indicators of Borrowing Member Countries, 2001 (Economics and Programming Department, April 2002). Column 3 taken from World Bank (2002).

Table 4

**Unemployment Rates: 1990-2000
(%)**

Year	Antigua & Barbuda	The Bahamas	Barbados	Belize	Grenada	Jamaica	St. Lucia	St. Vincent & the Grenadines	Trinidad & Tobago
1990	6.8	0.0	15.0	0.0	0.0	15.3	0.0	20.0	20.0
1991	6.0	12.3	17.3	0.0	13.9	15.4	0.0	18.5	18.5
1992	7.8	14.8	23.0	0.0	-	15.4	-	19.6	19.6
1993	6.7	13.1	24.3	9.8	16.5	16.3	-	19.8	19.8
1994	6.7	10.9	21.8	9.0	26.7	15.4	17.1	18.4	18.4
1995	7.8	11.5	19.6	12.5	-	16.2	16.3	17.2	17.2
1996	7.0	9.8	15.8	13.8	17.0	16.0	16.3	16.2	16.3
1997	-	7.8	14.5	12.7	15.5	16.5	20.5	15.0	15.0
1998	-	7.8	12.3	14.3	15.2	15.5	21.6	14.2	14.2
1999	-	-	10.4	12.8	14.0	15.7	18.1	13.2	13.2
2000	-	-	9.2	11.5	11.5	15.5	16.5	12.8	12.8

Source: *Caribbean Development Bank Social and Economic Indicators of Borrowing Member Countries, 2001*
(Economics and Programming Department, April 2002).

Table 5
Arithmetic Mean and Standard Deviation
of Percentage Rate of Inflation (CPI) : 1990-2001

<i>Country</i>	<i>Mean</i>	<i>Standard Deviation</i>
<i>The Bahamas</i>	2.7	2.1
<i>Barbados</i>	2.8	2.6
<i>Belize</i>	1.9	2.0
<i>Guyana</i>	21.6	27.6
<i>Jamaica</i>	26.0	20.7
<i>Trinidad & Tobago</i>	6.0	2.8
<i>Antigua & Barbuda</i>	3.5	2.2
<i>Dominica</i>	2.2	1.7
<i>Grenada</i>	2.3	0.8
<i>St. Kitts & Nevis</i>	3.4	1.8
<i>St. Lucia</i>	3.3	2.0
<i>St. Vincent and the Grenadines</i>	2.5	2.3

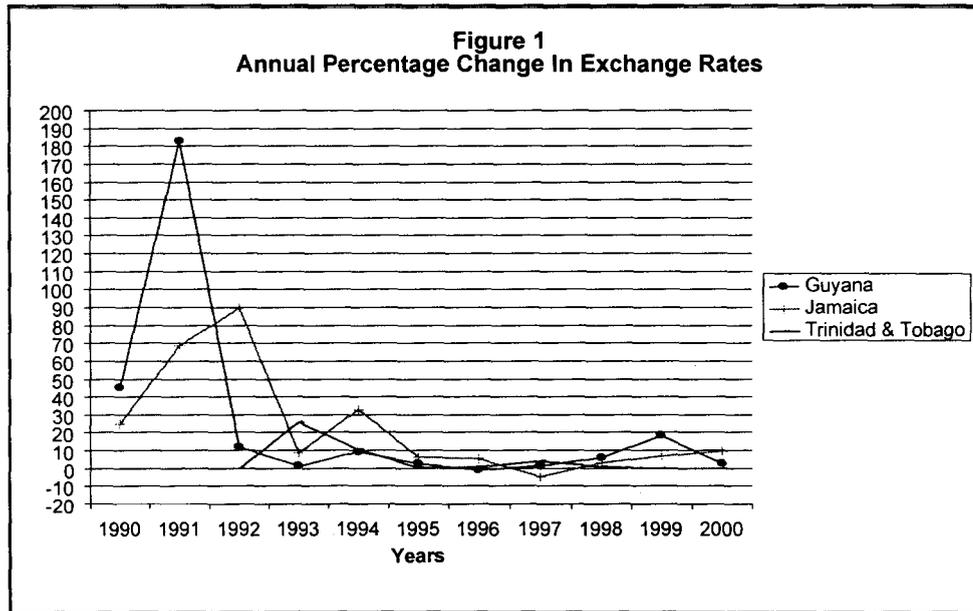
Source: *Computed from data in Caribbean Development Bank Social and Economic Indicators of Borrowing Member Countries, 2001 (Economics and Programming Department, April 2002).*

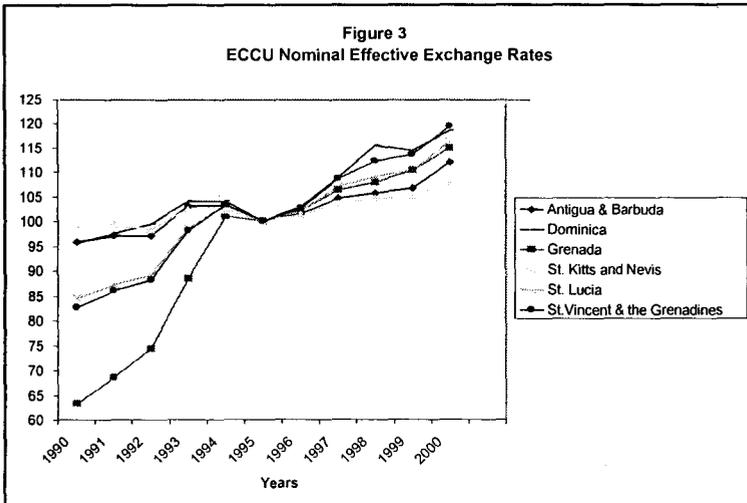
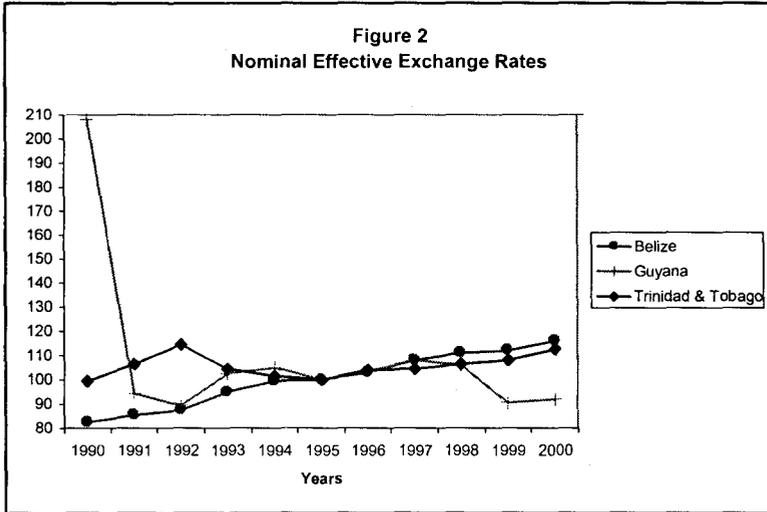
Table 6

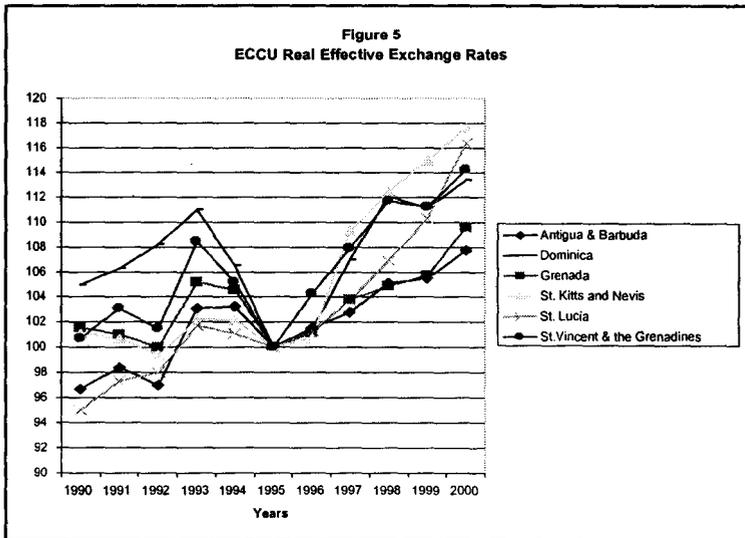
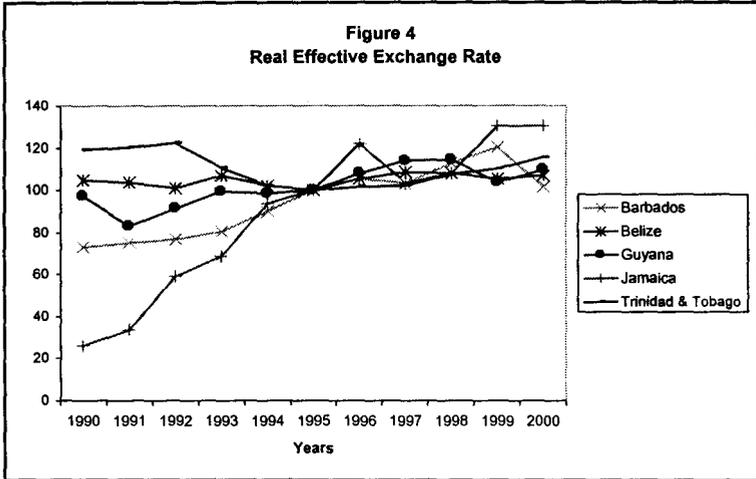
**Arithmetic Mean of Overall and Current Account
Fiscal Balance as a % of GDP: 1990-2001**

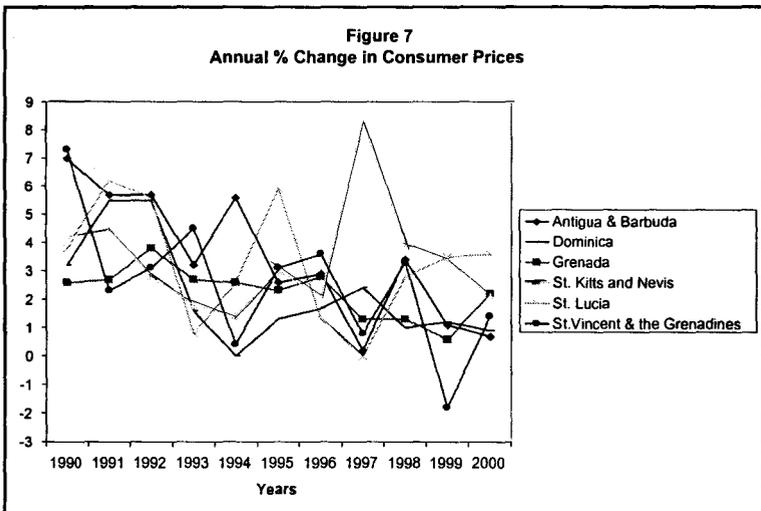
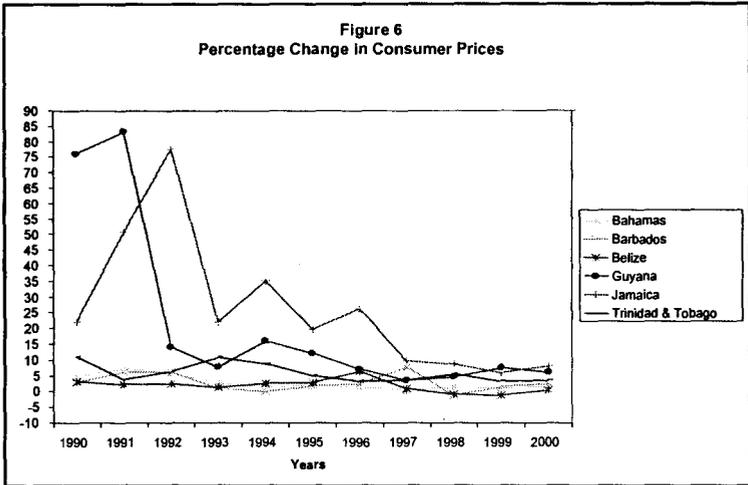
<i>Country</i>	<i>Overall</i>	<i>Current Account</i>
<i>The Bahamas</i>	1.9	1.0
<i>Barbados</i>	-5.1	0.8
<i>Belize</i>	5.1	3.8
<i>Guyana</i>	-9.2	-1.5
<i>Jamaica</i>	-2.3	0.8
<i>Trinidad & Tobago</i>	-0.7	0.8
<i>Antigua & Barbuda</i>	-2.1	0.9
<i>Dominica</i>	-4.7	0.4
<i>Grenada</i>	-2.9	1.8
<i>St. Kitts & Nevis</i>	-4.8	-0.3
<i>St. Lucia</i>	0.3	5.6
<i>St. Vincent and the Grenadines</i>	-1.9	3.3

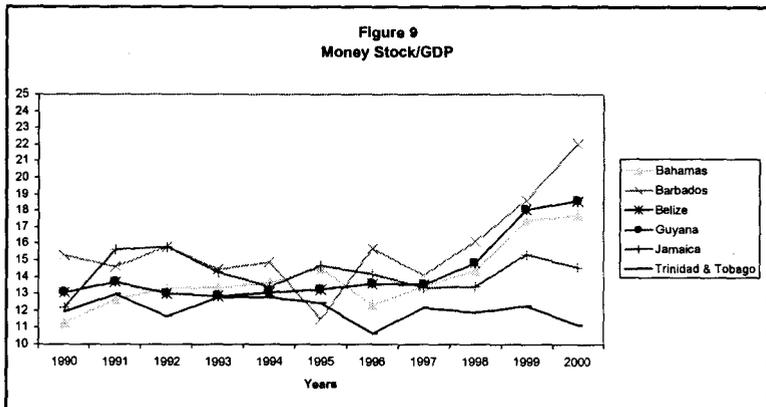
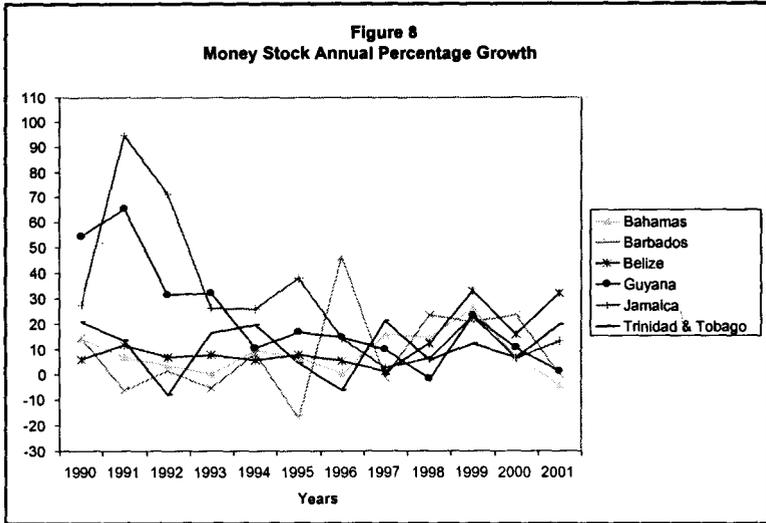
Source: *Computed from data in Caribbean Development Bank Social and Economic Indicators of Borrowing Member Countries, 2001 (Economics and Programming Department, April 2002).*

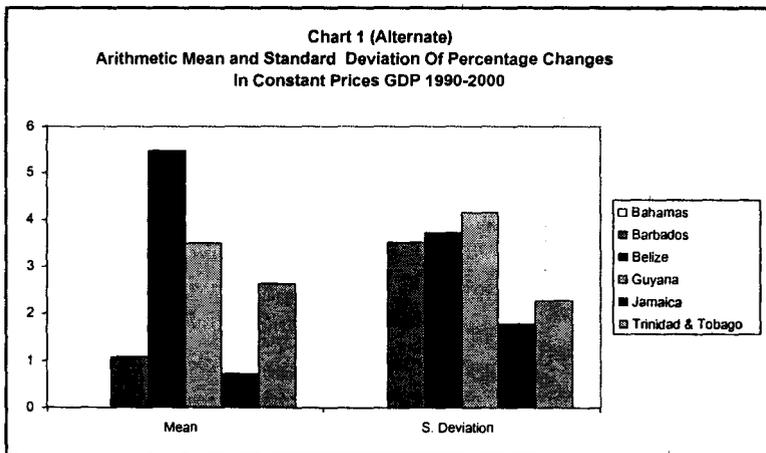
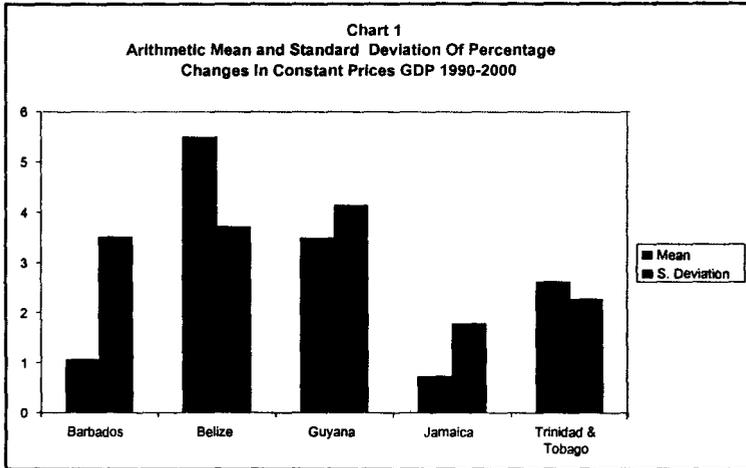


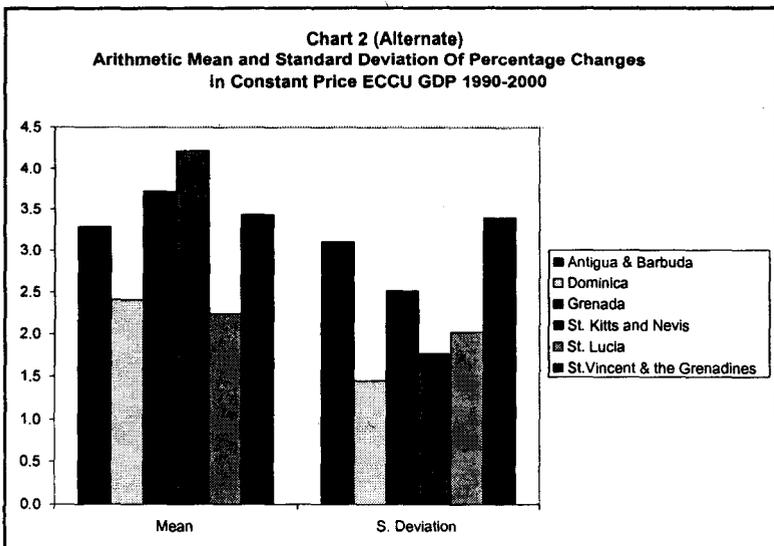
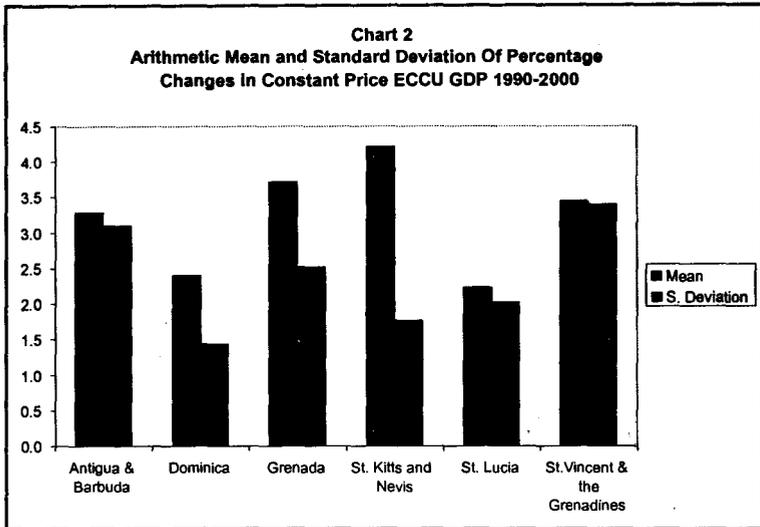


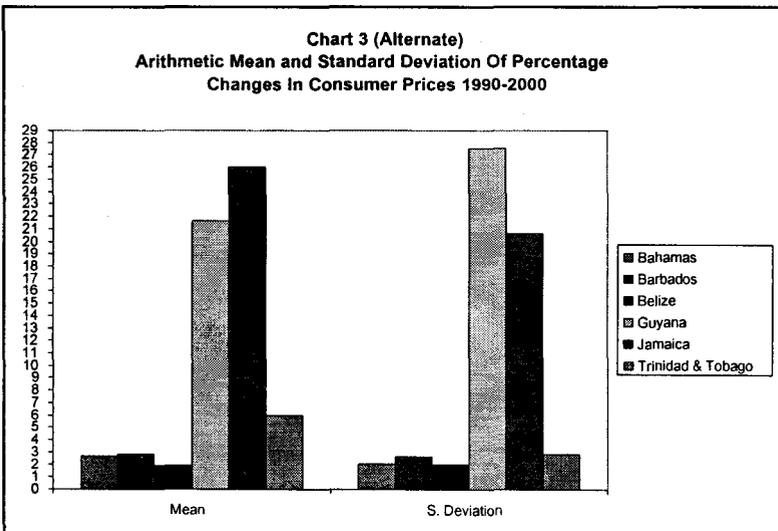
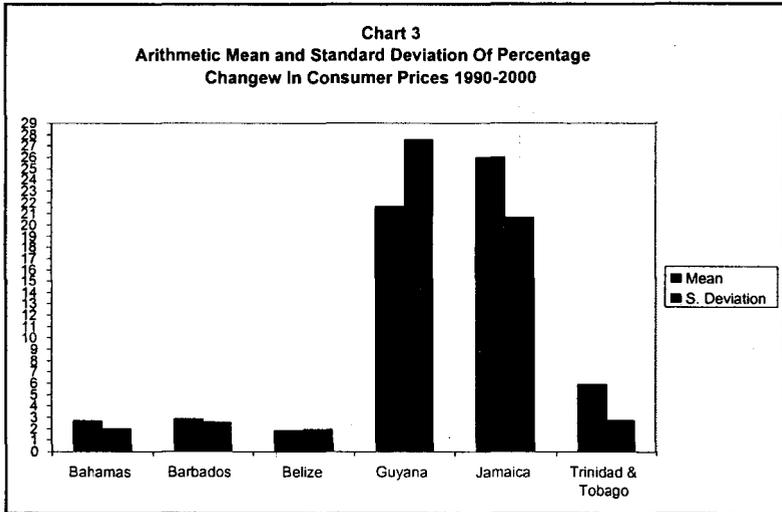


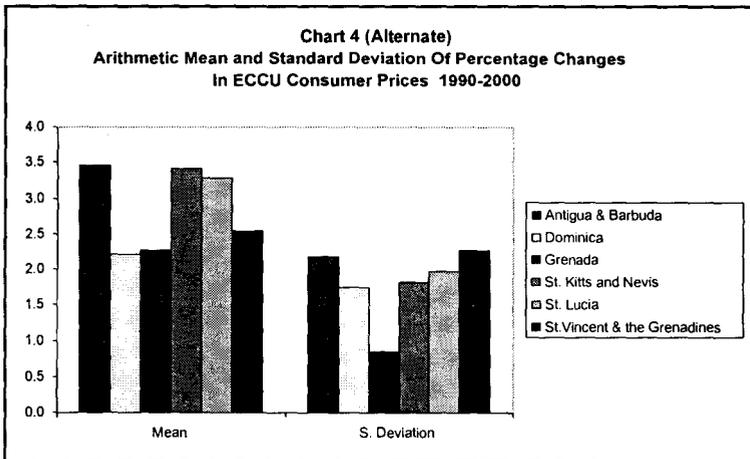
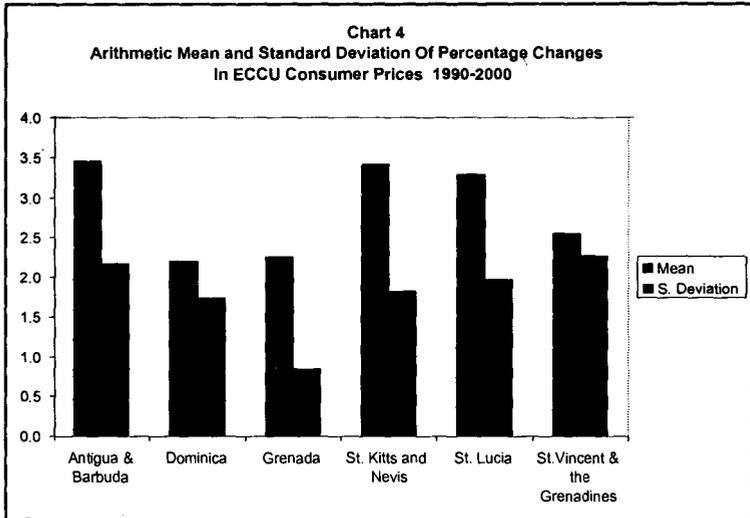












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