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**Exchange Rate Policy and External Imbalance:
The Jamaican Experience 1973-1982**

INTRODUCTION

The decision of the Jamaican government, in January of 1983, to transfer the major portion of the country's foreign exchange transactions from the official market operating with fixed exchange rates, to the parallel market where exchange rates could freely fluctuate, was further evidence of the difficulty the country has experienced, in the past decade, in implementing appropriate measures to cope with its balance of payments problems. In that period, a combination of direct controls on foreign payments and exchange rate adjustments had been employed. These measures did not contribute towards any significant easing of the problem.

The policy initiative of January 1983 set off a crisis within the Caribbean Community. The other member states took the position that the Jamaican government had adopted what amounted to an arbitrary use of exchange rate devaluation, which would give the country an unfair advantage in the regional trading association.

In this paper, an analysis will be conducted of the role of exchange rate adjustment in the country's struggle to cope with its balance of payments crisis. It is generally argued that the external payments problems faced by a developing country, such as Jamaica, is in large part, indicative of the fact that the currency is overvalued. This overvaluation contributes to a serious misallocation of resources for both

domestic and external purposes. This makes it more difficult to develop new export and import substitution industries. There is, also, the counter argument, that an attempt by a small open economy, such as Jamaica, to employ exchange rate devaluation as a means of establishing an appropriate international price relationship, will be unsuccessful, in that such a measure will simply result in an increase in domestic prices. These issues will be addressed in the first section of the paper where an analysis will be conducted of the evolution of the country's exchange rates with the currencies of its major trading partners.

Apart from the question of the importance of exchange rate adjustment in establishing the appropriate international price relationships to assist the export earning capability of the country, there is the associated question of the role of exchange rate management in helping to minimize the leakage of foreign exchange from the official market. The greater the leakage, the more difficulty will be experienced in mobilizing foreign exchange to restructure economic activities to alleviate the payments crisis. In the second section of the paper we will investigate the relationship between exchange rate management and the growth in black market, or unofficial trading, in foreign exchange.

In the final section of the paper we will present a brief evaluation of the response of the CARICOM states to the Jamaican decision of 1983. In this regard, we will examine the charge of unfairness levelled against the country for effectively devaluing its currency against those of its CARICOM partners.

EVOLUTION OF JAMAICA'S EXCHANGE RATES 1973-1982

The period of the early 1970s witnessed the breakdown of the Bretton Woods system and a move by the major industrial countries to abandon fixed exchange rates for a

system of floating exchange rates. The uncertainties generated by this development in the international payments system was further compounded by the first OPEC price shock in 1973. The payments difficulties created by these international developments for the Jamaican economy were further compounded by the fact that the large capital inflows which had supported capital expansion in the bauxite industry, starting in the late 1960s, came to an end at that time.

In 1973, the currency was devalued and pegged to the U.S. dollar. The rate J\$1.10 = \$1 US, established in 1973, remained unchanged until mid-1977 when a dual rate system was adopted. The dual rate system was a part of the policy response to the virtual exhaustion of the country's foreign exchange reserves. The 1973 rate was retained for essential imports and transactions of the government and bauxite sectors. A special rate was introduced for all other transactions. This rate, J\$1.25 = \$1 US, represented a 37.5 per cent devaluation. It was hoped that this special rate would help to encourage export expansion and import substitution activity. The retention of the 1973 rate for essential products, such as imported foods, was for the purpose of avoiding the inflationary impact of a general devaluation.

The measures introduced in 1977 did not help to ease the foreign exchange crisis. In January of 1978, there was a further devaluation of the special rate. Finally, in May of that year, as a condition for receiving support from the International Monetary Fund (IMF) under the Extended Fund Facility, the dual rate was replaced by a single rate of J\$1.55 = \$1 US. This uniform rate represented, at the time, a 47 per cent devaluation of the rate for essential imports, government and bauxite transactions, and a 15 per cent devaluation in terms of the special rate. In addition to this initial unification and devaluation of the currency, it was agreed that there would be further monthly minidevaluations of between one and one and a half per cent, which would result in a further 15 per cent devaluation of the currency by the end of May

TABLE 1: NOMINAL EXCHANGE RATE INDICES
1975=100

Year	United States	United Kingdom	Canada	West Germany	Japan	SDR	Import ² Weighted	Export ³ Weighted	Trade ⁴ Weighted
1973	100.0	110.4	101.7	92.1	106.5	103.1	101.8	102.8	102.3
1974	100.0	105.3	104.0	94.9	100.0	104.6	101.5	102.1	101.8
1975	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1976	100.0	81.3	103.2	95.3	100.0	99.3	97.9	96.2	97.1
1977 ¹	100.0	78.6	95.7	106.0	109.7	103.8	98.5	95.8	97.2
1978	157.9	136.4	140.8	193.4	219.4	207.5	166.4	159.6	163.0
1979	194.4	185.6	168.8	260.9	261.3	220.5	200.6	194.7	197.7
1980	196.0	205.2	170.5	265.2	254.8	213.5	202.5	198.8	200.7
1981	196.0	178.9	166.3	213.3	261.3	194.8	194.6	190.2	192.4
1982	196.0	154.4	161.6	198.7	232.3	184.7	188.5	183.2	185.9

Notes

1. Index does not incorporate the effect of the special rate introduced in April 1977.
2. Weighted by import shares: 1975-1977 US 59 per cent; UK 11 per cent; Canada 6 per cent; West Germany 3 per cent; Japan 3 per cent. The residual 18 per cent weighted by SDR.
3. Weighted by export shares: 1975-1977 US 57 per cent; UK 21 per cent; Canada 7 per cent; the residual 15 per cent weighted by SDR.
4. Weighted by share in overall trade.

Sources: International Monetary Fund, *International Financial Statistics, Annual*;
International Financial Statistics: Supplement on Exchange Rates No. 1.
Department of Statistics, *External Trade 1977*, Jamaica.

1979. The result of all these adjustments was that by 1980, the exchange rate, with respect to the US dollar, had declined by 96 per cent relative to the pre-1977 devaluations.

Let us now proceed with a closer examination of the impact of the devaluation in terms of the US dollar on the country's trading position. Given the fact that the US dollar was floating against the currencies of the major industrial countries, it is then necessary to determine how that devaluation affected exchange rates with all its major trading partners. Nominal exchange rate indices for the Jamaican dollar in terms of the currencies of the country's major trading partners and the SDR are set out in Table 1.

The Jamaican dollar generally appreciated relative to these currencies during the 1973-76 period, reflecting the appreciation of the US dollar on foreign exchange markets. The situation was reversed between 1977 and 1980. In that period, the Jamaican dollar depreciated more against the currencies of the United Kingdom, Germany, Japan and the SDR than the official devaluation against the US dollar. This reflected the appreciation of the currencies of the European, OECD countries and Japan relative to the US dollar. In addition to the bilateral indices, we have included in the table import and export weighted indices, in an effort to capture the effect of the divergent exchange rate movements on the country's trade. Changes in the import and export weighted indices indicate an effective devaluation, slightly in excess of the nominal devaluation against the US dollar. This is indicative of the dominant position held by the United States as a market for the country's export and a source of imports.

The nominal depreciation in a country's exchange rate does not accurately measure the extent to which its competitive position in international markets might have changed. It is also necessary to determine the extent to which the decline in the international value of the currency might have been offset by the fact that the rate of inflation in the country

exceeded that of its major trading partners. These effects are captured in real exchange rate indices. In Table 2, we have reported real bilateral and trade weighted indices for the period 1974 through 1981.

These estimates were derived by deflating the nominal exchange rate indices by the product of the ratio of the Jamaican GDP deflator to the respective wholesale price indices. These indices reveal a general appreciation of the bilateral exchange rate up to 1977 as well as in the export and import weighted indices. The real appreciation in the exchange rates in this period was greater than the nominal rates, largely due to the fact that although the nominal US dollar exchange rate was unchanged during this period, the higher domestic rate of inflation, relative to that in the United States, meant that there was a real appreciation in the exchange rate. In the period following the 1977-78 devaluations, the real depreciation in the exchange rates is revealed to be substantially less than the nominal devaluation. In real terms, the currency had depreciated by 54 per cent against the US dollar by 1980 as compared with the nominal devaluation of 96 per cent. There were also major differences between the real and nominal trade weighted indices. The maximum real depreciation was 70 per cent, as compared with a decline of 106 per cent in the nominal rates. Not only did the higher domestic rate of inflation help to moderate the impact of the devaluation on the domestic-international price relationship, but we can see from Table 2 that the import weighted index had started to appreciate by 1980 and the export weighted index in 1981. Nevertheless, it would appear that the devaluations of the late 1970s did give rise to a significant change in purchasing power parities consistent with the desired goal of stimulating exports and encouraging import substitution.

In Table 3, we report estimates of real exchange rate indices, employing on this occasion, consumer price indices as deflators. These indices reveal significantly different effects

TABLE 2: REAL EXCHANGE RATE INDICES*
1975=100

Year	United States	United Kingdom	Canada	West Germany	Japan	SDR ²	Import ¹ Weighted	Export ¹ Weighted	Trade ¹ Weighted
1974	108.6	104.3	113.2	109.8	117.6	107.5	108.5	107.9	108.2
1975	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1976	96.1	86.1	97.8	89.3	94.9	97.2	95.1	94.3	94.7
1977	91.6	88.8	87.3	90.8	94.4	97.8	92.2	91.6	91.9
1978	123.3	133.6	111.5	133.2	146.2	163.9	132.0	130.7	131.4
1979	147.7	175.9	131.9	162.4	161.1	166.7	154.1	155.4	154.8
1980	148.3	196.2	129.6	154.5	158.7	153.1	153.8	157.8	155.8
1981	144.5	174.2	129.5	125.1	153.4	139.9	145.7	149.0	147.4

* Nominal exchange rates divided by the product of the ratio of the Jamaican GDP deflator — the respective wholesale price indices

Notes

1. Weights are the same as those used in Table 1
2. Adjusted by a weighted average of wholesale price indices reflecting the SDR basket.

Sources: OECD *Main Economic Indicators*, 1983.

International Monetary Fund, *International Financial Statistics: Supplement on Price Statistics No. 2*.

of the devaluation on purchasing power parities. We find far more modest increases in the bilateral and trade weighted indices. Furthermore, of even greater importance, was the fact that the effects of the devaluation were short-lived. In the case of the trade weighted indices, the devaluations were reflected in a 41 per cent depreciation by the end of 1979. However, this was followed by a 20 per cent appreciation of the currency by the end of 1982. At that time, the trade weighted index represented a 12 per cent devaluation relative to the pre-devaluation values of 1977. In the case of the United States, the country's major trading partner, the rate at the end of 1982 amounted to a 14 per cent devaluation relative to the pre-1977 levels.

The indices reported in Table 3 might be considered to more accurately reflect the real effect of the devaluations on the change in the international competitive position of the country. The principal reservation against using the consumer price index in this context is the weight given to services and non-traded goods in the index. On the other hand, one must consider that the devaluations of 1977-78 were part of a complex IMF stabilization package, which apart from the devaluations, required the government to increase indirect taxes and raise the prices on commodities subject to government control. The combined effect of all these measures on the cost of living, and the associated implications for internal income distribution held important implications for the ease or difficulty with which the desired changes in resource allocation could be realized. The total effect of these measures is more accurately reflected in the consumer price index.

A major objective behind the exchange rate adjustments and the other measures adopted in the late 1970s was that of providing greater incentives for expanding non-traditional exports, primarily exports of manufactured products. In an effort to determine the potential effect of the devaluations in promoting such exports, we have reported in Table 4, nominal and real export weighted indices, where the weights are

TABLE 3: REAL EXCHANGE RATE INDICES*
1975=100

Year	United States		United Kingdom		Canada	West Germany		Japan	SDR ¹	Import Weighted		Export Weighted		Trade Weighted	
1973	120.6	111.9	120.9	118.6	111.8	114.5	118.2	117.9	118.1						
1974	107.5	99.5	110.2	105.1	104.9	110.2	107.2	106.4	106.8						
1975	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0						
1976	96.5	86.4	101.2	90.7	99.7	98.5	96.0	95.0	95.5						
1977	92.3	86.9	91.0	93.8	106.1	93.0	92.2	91.2	91.7						
1978	116.2	121.1	108.1	130.5	163.3	160.4	126.1	123.3	124.7						
1979	123.3	144.7	109.6	141.8	156.0	143.8	130.1	129.9	130.0						
1980	111.0	148.5	95.9	120.0	129.3	123.0	117.2	119.6	118.4						
1981	108.7	128.4	93.3	90.6	123.4	106.7	109.5	111.5	110.5						
1982	105.2	109.9	91.7	81.2	102.8	98.7	103.0	104.3	103.7						

* Nominal exchange rates divided by the product of the ratio of the Jamaican Consumer Price Indices — the respective consumer price indices.

1. Adjusted by a weighted average of consumer price indices reflecting the SDR basket.

Sources: Same as for Tables 1 and 2.

TABLE 4: EXCHANGE RATE INDICES:
NON-TRADITIONAL EXPORTS*
1975 = 100

Year	Nominal Index	Real ¹ Index
1974	103.5	105.5
1975	100.0	100.0
1976	94.2	93.2
1977	95.3	92.0
1978	156.7	124.1
1979	188.3	131.7
1980	188.9	120.1
1981	184.8	118.2
1982	182.2	120.4

* Exports in SITC classes 5 to 8 weighted by export shares 1975-1977 as follows: Trinidad and Tobago 46 per cent; Barbados 18 per cent (including ECCA and Belize) Guyana 6 per cent; US 13 per cent; UK 2 per cent; Canada 1 per cent; SDR 14 per cent.

1. Nominal exchange rates deflated by consumer price indices.

Sources: Same as for Table 2.

export commodities falling within SITC classes 5 through 8.

Once again there is a major difference between the nominal and real effect of the devaluations. Although there was an appreciation in the real rates in 1980 of 9 per cent subsequent to the devaluation of 43 per cent in the 1977-79 period, the real rate remained relatively stable after 1980. There then appeared to have been a lasting effective devaluation of 30 per cent compared with the situation prior to the 1977-78 adjustment. The fact that the devaluations seemed to have had a lasting real impact might be attributed to the fact that in excess of 70 per cent of the country's exports falling in this category was with its CARICOM partners. The

currencies of these countries are all pegged to the US dollar. The substantial devaluations were clearly, in this instance, not offset by higher rates of inflation relative to its major trading partners, the CARICOM countries. However, if at the same time one considers that there was also the objective of developing non-traditional exports for traditional markets, for example, the OECD countries, then the exchange rate adjustment would not have had a significant impact on easing entry to those markets.

The following factors emerge from our review of the evolution of the country's exchange rates over this period. Prior to 1977, there had been a significant appreciation in the country's exchange rates in real terms. In light of the deterioration in the balance of payments during that period, a devaluation in the exchange rate would seem to have been appropriate. However, the evolution of the real rates since the 1977-78 devaluation highlights the limited usefulness of this policy instrument by a small developing country which attempts to realign international purchasing power parities by this method. This arises from the fact that the potential inflationary impact of the devaluation undermined the potential beneficial effect of the nominal price change. Moreover, in this instance, the direct effect of the devaluation in contributing to inflation through raising the domestic cost of imported goods was reinforced by the price raising effects of other elements in the stabilization package.

EXCHANGE RATE POLICY AND FOREIGN EXCHANGE LEAKAGES

The issue of leakage of foreign exchange from the official market has been one of continued concern to Jamaican authorities throughout this period of crisis in international payments. Between 1973 and 1980 the government's response was to tighten controls on the purchase and sale of foreign exchange and to impose penalties for unofficial dealings in foreign exchanges. In spite of these efforts, the

unofficial or parallel market dealings in foreign exchange did not appear to have been curtailed and in fact, is generally believed to have expanded. After the change in government in 1980, a new approach to the unofficial exchange market was adopted. Many of the penalties which had previously been imposed on dealings on the parallel market, were allowed to lapse. There was, in effect, a tacit acceptance of these operations. The new government's position was that given the critical shortages of food and raw materials brought about by a shortage of foreign exchange, every effort should be made to mobilize foreign exchange to deal with these critical shortages, irrespective of the source of the foreign exchange.

This initiative did have the effect of making more funds available for relieving the constraints on imports of consumer goods. Nevertheless, there was a recognition of the fact that this approach to the problem had resulted in too great a portion of the limited foreign exchange being used to finance consumption. The needed resuscitation of investment in support of export activity, as well as production for the domestic market, continued to be crippled by a scarcity of foreign exchange to finance raw materials and capital goods. As a consequence, there was increased official acceptance of the need to reduce the volume of transactions conducted on the parallel market.

In January of 1983, the government finally faced up to the fact that more effective control over the use of the limited foreign exchange could only be realized by removing the price incentive to trading on the unofficial market. A dual foreign exchange market system was introduced which permitted the commercial banks to compete for foreign exchange by offering competitive prices. In addition, most of the country's international transactions would now have to be financed on this free market operated by the banks. The upshot of these developments was that there was, in effect, a

substantial devaluation in the country's currency, although there was no official devaluation.

Let us now examine more closely the question of the potential relationship between exchange rate management and foreign exchange leakage. Direct evidence on the extent of this leakage from the official market is hard to come by. The approach adopted here is to examine the issue indirectly by comparing the sources and uses of foreign exchange, as reported in the annual foreign exchange budgets since 1977, with international transactions recorded in the balance of payments statements.

Table 5 sets out data on the amounts allocated for imports recorded in the foreign exchange budget and outlays on imports reported in the balance of payments statement.

The differences in values from the two sources can be explained by the fact that the foreign exchange budget reflects a cash flow situation for the relevant period and does not then incorporate imports financed through tied credit lines or imports for which no direct funding is required. The latter would include transactions where importers had negotiated their financing independently and, to a certain extent, imports of consumer goods which were financed by overseas relatives of residents. Finally, there was also the matter of importers not making their payments on time. Estimates of the annual use of various tied lines of credit, as well as payments arrears are reported in the table. Between 1978 and 1981, there was a substantial increase in the margin between the reported amounts allocated for imports in the foreign exchange budget and the value of imports recorded in the balance of payments, even when allowance is made for the use of tied lines of credit and payment arrears. In 1982, there were no reported payment arrears, but the margin between the foreign exchange budget allocations and the balance of payments remained approximately at the 1981 level.

TABLE 5: ESTIMATES OF IMPORTS NOT FINANCED ON THE OFFICIAL MARKET
US\$ mn

Year	1	2	3	4	5	6
	Total Imports (f.o.b.)	Import Outlays Foreign Exchange Budget	Lines of Credit	Arrears	Balance 1-(2+3+4)	Balance % 1
1978	750.0	660.0	12.7	30.4	146.9	19.6
1979	882.6	577.5	30.7	44.3	230.1	26.1
1980	1038.1	612.2	51.2	76.4	298.3	28.7
1981	1296.7	691.2	57.2	66.5	491.8	37.9
1982	1202.7	653.3	66.9		482.5	40.1

Source: Bank of Jamaica Report and Statements of Accounts, Annual.

It is reasonable to conclude from the evidence presented in the table that an increased share of the country's imports in this period was financed through dealings on the unofficial market. The share of imports for which no identifiable source of financing could be found rose from 20 per cent in 1978 to 40 per cent in 1982. It is also interesting to note that following the implicit official acceptance of the parallel market in 1980, the share of imports not financed through official sources, increased from 29 per cent to 40 per cent.

Given the evidence of significant leakage of foreign exchange from the official market, let us now consider how this leakage might be explained by deficiencies in exchange rate policy and, more generally, by deficiencies in foreign exchange management. In the analytical treatment of the question of foreign exchange leakage, or black market operations, it is usually argued that the basic reason for this occurrence is the fact that the official exchange rate is pegged at a level below the market clearing rate.¹ The unsatisfied demand at the official rate gives rise to a situation in which buyers will willingly pay a premium above the official price to secure the desired foreign exchange. The willingness of buyers to pay a premium, in turn, provides the incentive for holders of foreign exchange to divert sales from official markets to the black market. This logically leads to the conclusion that the appropriate policy response to curb the leakage would be a devaluation of the official rate. This approach leaves unanswered the following questions. To what extent should the black market rate be used as guide to the appropriate degree of devaluation required? Will the maintenance of the existing control mechanism for allocating foreign exchange still result in certain demands remaining unsatisfied and, consequently, provide the necessary conditions for a continuation of black market operations?

The major devaluation of the currency, as reported earlier, commenced in 1977, and by 1980, the nominal devaluation against the US dollar was 96 per cent. The trade

weighted devaluation was in excess of 100 per cent. The black market rate from 1974 to 1975 was 22 per cent above the official rate.² As the payments crisis deepened in 1976 the black market rate rose to 46 per cent above the official rate. The initial devaluation, with the introduction of the special rate in 1977 was 37.5 per cent and by the end of 1977, the black market rate at J\$2.00 = \$1 US was 60 per cent above the special rate. This margin was maintained through 1978.

The increase in the differential of the black market rate relative to the official rate following the devaluations and the continued expansion in the level of black market transaction is not surprising in this context. The devaluations were associated with a tightening in the restrictions imposed on the official allocation of foreign exchange, particularly for financing imported consumer goods. At the same time, as indicated in the previous section of the paper, the increase in the rate of inflation meant that there was a much smaller change in real exchange rates. Consequently, there would be a smaller disincentive to import consumer goods. The demand for foreign exchange on the black market would then be sustained.

It is generally argued that the existence of exchange controls and the imposition of severe penalties for dealing on the black market will work to dampen the supply and demand for currency on that market.³ This would result in a higher black market premium based on the assumption that there would be a greater decrease in supply than demand. This conclusion is based on partial equilibrium static analysis. The available evidence suggests an expanding level of black market transactions. This can be reconciled with the argument outlined above, in that the effects of the severe shortages prevailing in the economy of virtually all consumer goods and the hostility of the private sector to the government of that period, all had a stronger positive impact on

black market operations than the negative impact of the controls and penalties.

The change in approach to black market operations adopted in 1980 meant, in effect, that the penalties for dealing in that market were virtually eliminated. In terms of the standard analytical treatment of black market operations, one would have expected an increase in the level of transactions. This, in fact, is what did occur, as reported earlier.

In summary, the policies adopted, currency devaluation, rigid exchange controls and penalties for black market trading in foreign exchange would have appeared on the surface to be the appropriate policy mix given the situation of 1977. The policies were not effective for the following reasons. First of all, the effectiveness of the devaluations were offset by the subsequent increases in prices. The consumer price index, based on 1975 prices, rose from 109.6 in 1976 to 270.3 in 1980. The resulting limited real effective devaluation, combined with the failure of the other measures to increase export earnings from traditional and new sources caused a widening in the gap between the demand for and supply of foreign exchange. It was this overall scarcity which provided the support for an expanded black market. The relaxation of controls on black market operations in 1980 only served to provide a further stimulus to that market.

The decision taken in January of 1983 to introduce an official free market for foreign exchange is of significance in that by allowing the commercial banks to offer competitive prices, it attacks the major incentive for selling currency on the black market. This policy initiative meant, however, that there was a further major devaluation of the currency. The rates quoted by the banks ranged between 47 per cent and 62 per cent above the official price for the US dollar. Nevertheless, as we have stated repeatedly, a devaluation is not likely to contribute to a fundamental easing of the external

payments problem, given the likelihood of subsequent price increases.

THE CARICOM RESPONSE TO THE EXCHANGE RATE INITIATIVE OF 1983

The response of the CARICOM member states to the policy initiatives of 1983 was that it represented an arbitrary use of exchange rate devaluation by Jamaica to gain an unfair competitive advantage over its trading partners. Barbados reacted initially by floating its currency against the Jamaican dollar. In view of the fact that the currencies of all the CARICOM countries are pegged to the US dollar, one might be better able to evaluate this dispute by assessing the effects of the previous Jamaican devaluations on the price relationships with these countries. Jamaica's real exchange rate

TABLE 6: JAMAICA BILATERAL CARICOM REAL EXCHANGE RATE INDICES*
1975 = 100

Year	Barbados	Guyana	Trinidad and Tobago
1974	96.0	114.9	106.1
1975	100.0	100.0	100.0
1976	96.6	91.9	89.7
1977	93.7	89.2	91.5
1978	119.9	120.3	118.0
1979	133.8	135.0	129.0
1980	121.4	122.3	120.2
1981	123.3	122.7	121.9
1982	127.1	124.3	129.3

Nominal exchange rate indices divided by the ratio of the product of the Jamaican consumer price indices with respect to the consumer price indices of the countries listed.

Sources: Same as for Table 2.

indices for its three major CARICOM trading partners are set in Table 6. This covers the period 1974 through 1982:

Between 1974 and 1977, there was a significant appreciation of the currency relative to the Guyana and Trinidad and Tobago dollar. The rates of appreciation were 29 per cent and 16 per cent respectively. There was virtually no change in the real exchange rate for the Barbadian dollar in that period. Subsequent to the 1977-78 devaluations, the movement in the indices reveals a depreciation of 30 per cent with respect to the Barbadian dollar, 51 per cent and 41 per cent with respect to the currencies of Guyana and Trinidad and Tobago, by the end of 1979. The higher Jamaican rate of inflation in 1980 led to an appreciation in real exchange rates. The currency appreciated by 9 per cent against the Barbadian and Guyanese dollar and 7 per cent against the Trinidadian dollar. The relatively lower rates of inflation in Jamaica in 1981 and 1982 caused a further depreciation in real exchange rates. The end result was that by the end of 1982, the Jamaican dollar had depreciated by 6 per cent against the Barbadian dollar, 3 per cent against the Guyanese dollar, and 10 per cent against the Trinidadian dollar compared with the parities established after the initial devaluations. By the end of 1982, the real exchange rate relationship between the Jamaican dollar and the CARICOM countries was then not significantly different from that prevailing in 1978, immediately following the initial devaluation.

It might be argued that the Jamaican currency was over-valued relative to that of other CARICOM currencies prior to 1978, given the higher cost of living in Jamaica. The substantial nominal devaluation and subsequent changes in relative costs might suggest that the appropriate parities had been established. The transfer of CARICOM trade to the parallel market involved an additional significant devaluation. It is then understandable that the country's CARICOM partners would view a second major devaluation within a

period of five years, as providing the country with a decidedly unfair regional trading advantage. Furthermore, throughout this period of balance of payments crisis, CARICOM exporters had experienced difficulty in entering the Jamaican market and had suffered an absolute decline in sales. At the same time, the CARICOM market continued to be the major outlet for Jamaica's non-traditional exports with the country realizing major increases in export rates.

The crisis in CARICOM created by this Jamaican policy change highlights the need for new initiatives in regional payments to complement the trading arrangements. An initial step might be to establish formal links between the currencies of the member states. Eventually, if CARICOM is to continue to develop, steps must be taken towards the establishment of a regional unit of account. Serious consideration will also have to be given to the question of reserve pooling.

FOOTNOTES

¹ See, for example Gupta [1981]; Culbertson [1975]; Sheikh [1976].

² The rate was J\$1.11 = \$1 US. This information was derived from *Pick's Currency Yearbook 1977-1979*.

³ See Sheikh [1976, pp. 16-20].

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**The Retail Price Index of Trinidad and Tobago
and its Relevance as a Measure of Changes
in the Cost of Living**

INTRODUCTION

The Retail Index (RPI) published monthly by the Central Statistical Office is the chief device used both officially and unofficially to measure the rate of inflation in the economy. In this capacity, it is often used to deflate time series data in order to get an idea of real changes in the particular series. It also tends to be interpreted as a Cost of Living Index, and is widely used by trade unions and employers in wage and salary negotiations. Cost of Living Allowances (COLA) are often directly tied to movements in the RPI through the insertion of escalator clauses in wage and salary contracts. Increases in pensions also tend to be linked to changes in the RPI. The Retail Price Index was designed for a particular purpose, and its use beyond this always has to be seen against its primary or original objectives and methodology.

In this paper, we intend to discuss the nature and structure of the RPI and its usefulness as a Cost of Living Index. The paper is divided into three sections. In the first, we describe the history and methodology of the RPI. The second is devoted to an analysis of price movements in recent years as reflected in the RPI and in the third, we assess the RPI and discuss some of its main shortcomings as a Cost of Living Index.