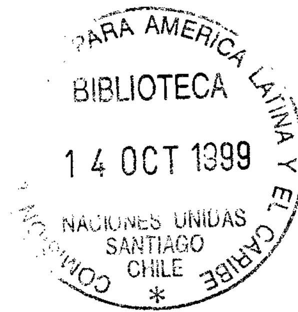
GLOBALIZATION OF FINANCIAL MARKETS:

Implications for the Caribbean

UNITED NATIONS
ECONOMIC COMMISSION
FOR LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean
CARIBBEAN DEVELOPMENT
AND COOPERATION COMMITTEE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Port of Spain, Trinidad and Tobago, 1999

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Table of Contents

0. INTRODUCTION 1

1. THE GLOBALIZATION OF FINANCIAL MARKETS 1
- 1.1 What drives globalization 4
- 1.2 Factors contributing to globalization 5

2. CARIBBEAN RESPONSE TO GLOBALIZATION: A REVIEW OF MACROECONOMIC POLICY 7
- 2.1 The Caribbean in the World Economy 7
- 2.2 The Barbados experience 8
- 2.3 The Jamaica Experience 11
- 2.4 The Trinidad and Tobago experience 14
- 2.5 Summary: Caribbean macroeconomic policy in a global environment 17

3. THE CURRENT FINANCIAL CRISIS AND ITS IMPLICATIONS FOR THE CARIBBEAN 19
- 3.1 The international financial crisis 19
- 3.2 Implications for the Caribbean 20
  - 3.2.1 Commodity prices 21
  - 3.2.2 Interest Rates 21
  - 3.2.3 The neighbourhood effect 22
  - 3.2.4 Investment 22
  - 3.2.5 Trade 23
  - 3.2.6 Dollarization 24

4. SUMMARY AND POLICY RECOMMENDATIONS 24

REFERENCES 27

APPENDIX 30

List of Tables

1. International Financial Deepening: International Banking in Relation to World Output, Trade and Investment, selected years (percentages) 1

2. International Integration of Financial Markets, selected years 2

3. Resource flows to Developing Countries 3

4. Degree of Financial Integration in Latin America and the Caribbean 8

5. Barbados: Selected Economic Data, 1990-97 9

6. Jamaica: Selected Economic Data, 1990-97 12

7. Trinidad and Tobago: Selected Economic Data - 1990-97 15

8. Vat Revenue, 1992-1996 16

9. Selected Caribbean Countries: Imports from Asia 23

A1. Aggregate Net Resource Flows and Net Transfers (Long-Term) -Trinidad & Tobago 30
A2. Aggregate Net Resource Flows and Net Transfers (Long-Term) – Jamaica 30
A3. Aggregate Net Resource Flows and Net Transfers (Long-Term) – Barbados 30
A4. US Dollar Deposit Accounts for Trinidad and Tobago (US$Mn) 31
A5. US Dollar Deposit Accounts for Jamaica (US$Mn) 31
A6. Domestic Currency Deposits as a Percentage of GDP - Jamaica and Trinidad and Tobago 31
A7. Financial Deepening Indicators for Jamaica - J$Mn. 32
A8. Financial Deepening Indicators for Trinidad and Tobago - TT$mn 32

List of Figures

1. Resource Flows to Developing Countries 4

0. INTRODUCTION

Globalization can be defined in terms of the internationalization of production [Goode, 1998, p.125], or in terms of the internationalization of markets [Lloyd, 1998, p. 163]. The former recognizes the fact that even relatively minor products are frequently found to be made with components from several countries. The latter, on the other hand, recognizes that the cross border flows of the products themselves have increased tremendously over the last two decades. This is particularly true in the case of international financial services.

This report examines the globalization of financial markets and the potential consequences for selected Caribbean countries. The countries studied in this report are Barbados, Jamaica, and Trinidad and Tobago. The evolution and extent of financial globalization is examined in section 1. In section 2, a review of the macroeconomic policies of the countries in the study pertaining to trade, fiscal, monetary policy and exchange rates is presented. Further, section 3 discusses the current financial crisis and its potential for disrupting or enhancing the positioning and economic welfare of the countries. And finally, section 4 posits some recommendations, in the context of the preceding discussion, pertaining to desirable macroeconomic policy in the presence of globalized financial markets and the ongoing financial crises.

1. THE GLOBALIZATION OF FINANCIAL MARKETS

The increasingly global nature of financial markets has been widely acknowledged since early in the current decade [see Table 1]. The growth of the relative size of the international banking sector in relation to world production, trade and investment since the 1960s has been phenomenal. For example, by 1991 the gross size of the international banking market had increased to 215.6 per cent of world trade and to 270 per cent of world gross fixed capital formation.

Table 1
International Financial Deepening: International Banking in Relation to World Output, Trade and Investment, selected years (percentages)

Item	1964	1972	1980	1985	1991
As a Share of World Output:					
Net international bank loans	0.7	3.7	8.0	13.2	16.3
Gross size of international banking market	1.2	6.3	16.2	27.8	37.0
As a Share of World Trade:					
Net international bank loans	7.5	31.5	42.6	80.4	104.6
Gross size of international banking market	12.4	53.7	86.3	169.7	215.6
As a Share of gross fixed domestic investment					
Net international bank loans	6.2	25.6	51.1	103.7	131.4
Gross size of international banking market	10.3	43.7	103.6	219.2	270.9

Source: United Nations, **World Investment Report 1994**

The force of integration is so compelling that governments can either embrace globalization or try "to resist it"[Pfeffermann, 1995, p. 2]. This is the widespread view concerning the worldwide integration of capital markets, especially during the decade of the 1990s. This is dramatically illustrated by the data displayed in Table 2.

Table 2
International Integration of Financial Markets, selected years

Category	Early 1970s	1990
Cross-border interbank liabilities		
All countries (billions of US dollars)	455	5560
Share of Borrowing banks in industrial countries	70per cent	75%
Share of lending banks in industrial countries	68%	75%
Cross-border bank credit to non-banks		
All countries (billions of US dollars)	54	1708
Share of lending to Borrowers banks in industrial countries	31%	58%
Share of lending by banks in industrial countries	80%	69%
Cross border bank deposits of non-banks		
All countries (billions of US dollars)	75	1695
Share of banks located in industrial countries	81%	76%
Share by resident of industrial countries	16%	50%

Source: United Nations, **World Investment Report 1994.**

Cross border bank deposits increased globally from $54 billion in the early 1970s to over $1.7 trillion by 1990. This represents an approximate increase of 3,200 per cent during that period. Also, cross border bank deposits of non-banks went from $75 billion in the same period to $1.695 trillion. Further evidence of international financial integration is reflected in the staggering increase in foreign exchange transactions. From April 1986 to March 1992, the combined daily average volume of foreign exchange trading on the New York, London and Tokyo markets went from $188 to $623 billion [Root, 1994, p.297]. This reflected a 231 per cent rate of growth. Furthermore, by 1996 "the daily average turnover in foreign exchange markets, much of it accounted for by banks, was estimated to total $1.6 trillion"[Dobson and Jaquet, 1998, p.113].

In particular, the recent increase in the pace of globalization is reflected in the rising flows of private investment to developing countries, the so-called emerging markets [see Table 3].

Table 3
Resource flows to Developing Countries
(Billions of US dollars)

	1990	1991	1992	1993	1994	1995	1996
I. OFFICIAL DEVELOPMENT FINANCE (ODF)	**69.50**	**69.7**	**70.4**	**70.24**	**71.90**	**72.1**	**66.4**
1. Official Development Assistance (ODA) (a)	52.8	58.6	59.0	56.4	60.5	59.7	58.2
2. Other ODF	16.7	11.1	11.4	13.8	11.4	12.4	8.2
II. TOTAL EXPORTCREDITS	**5.0**	**1.4**	**0.5**	**-1.5**	**6.1**	**4.80**	**3.5**
III. PRIVATE FLOWS(PRF)	**48.5**	**47.6**	**72.4**	**64.7**	**133.5**	**255.9**	**234.0**
1. Foreign direct investment (DAC)*	23.5	21.0	23.8	34.5	44.9	54.9	60.0
2. International bank lending (b)	15.0	11.0	31.0	9.0	42.6	60.0	70.0
3. Total bond lending	0.5	4.9	-0.8	11.4	32.0	30.0	86.0
4. Other private	4.4	5.3	1.4	4.0	8.0	10.0	12.0
5.Grants by NGOs	5.1	5.4	6.0	5.80	6.0	6.0	6.0
6. Portfolio investments(PI)	3.2	7.2	11.0	45.0	32.6	95.5	109.5
TOTAL NET RESOURCE FLOWS	**123.0**	**119.7**	**143.3**	**133.4**	**211.5**	**332.8**	**303.9**

Source: OECD, and IMF [1997]
***Development Assistance Committee (of the OECD)**
(a) excluding forgiveness of non-ODA debt for the years 1990-92
(b) excluding bond lending by banks(item III.3) and guaranteed financial credits (incl. In II)

There has been a major shift away from official development assistance to greater reliance on private capital to finance projects in the developing countries. This helps to explain the World Bank [1997] assertion that the world is truly on the way to having a unified\global capital market. Of particular interest is the rapid rise in portfolio flows. These flows are a kind of barometer for financial integration, since they represent purchases of shares in emerging markets. They are now more prevalent than foreign direct investment (FDI) and foreign aid flows which dominated international financial flows to developing countries up until the 1990s. Figure 1 displays the relative movements of the various flows to developing countries through 1996.

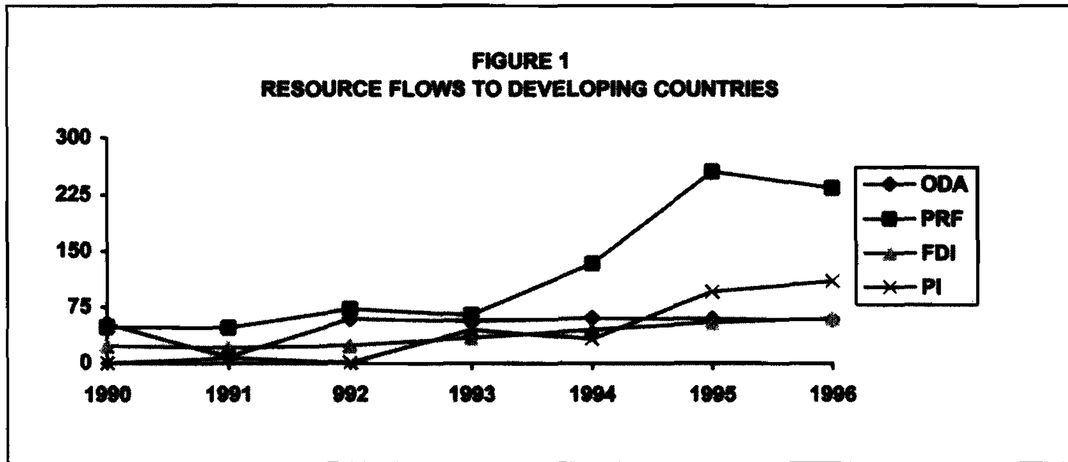

FIGURE 1
RESOURCE FLOWS TO DEVELOPING COUNTRIES

Source: See Table 3

1.1 What drives globalization?

A major force driving the globalization of financial markets is the search for economic profits, that is, earnings above and beyond normal profits. Conventional economics suggests that the closer one gets to a perfectly competitive market the smaller is the economic profit. It could be argued that the markets among industrialized countries were becoming extremely competitive and saturated. In fact, long-term interest rates have been on a downward spiral in industrialized countries during the 1990s. For example, LIBOR, (the London interbank offer rate on six month US dollar deposits) fell to as low as 3.4 percent in 1993. The World Bank [1997a, p.148] concurs: "The analysis suggests that the decline of global interest rates in 1990 provided a strong impetus to private flows (especially portfolio flows) to developing countries". Japan, the world's largest creditor nation, is currently running real interest rates of about 1 per cent. It is not surprising, therefore, that emerging financial markets became attractive during this period. This is so, despite the real and perceived greater risks associated with such markets.

Another major factor which influenced the early growth of a global capital market was the avoidance of regulation and excessive taxation in some countries. During the 1960s, for example, the United States maintained controls on interest rates, known as "Regulation Q". This provided the incentive for Americans to move assets abroad into Eurodollar deposits and as a result "the market grew exponentially and has become the greatest floating pool of capital in the history of the world" [Wriston, 1998, p. 333].

Economic growth and prudent macroeconomic management in many countries also played a positive role in furthering the growth of international flows. Years of positive growth and consistent policies have convinced many an investor, for example, that the East Asian economies were a good place to do business.

1.2 Factors contributing to globalization

Economic theory suggests that global welfare is maximized when capital is allowed free movement across borders. This movement requires a friendly and facilitating environment in receiving countries. In recent years, a large number of developing countries, many under the influence of the International Monetary Fund (IMF) and World Bank, have adjusted their economic policies in such a way so as to attract these flows. This is done on the premise that such capital inflows will be growth enhancing and have other positive development spin-offs.

These policy adjustments have contributed significantly to the rapid increase in international financial market integration. In fact, the World Bank uses the ratio of private capital flows to GDP as one measurement of financial integration into the world economy[1]. On this basis, among developing countries, they find that "the number of countries that are classified as highly integrated increased from 2 in 1985-87 to 13 in 1992-94, whereas the number of countries classified as moderately integrated increased from 24 to 26"[World Bank, 1997a,p.19]. Table 4 illustrates the movement of Latin American and Caribbean countries towards greater financial integration into the global economy.

Additionally, "During 1991-93, 11 countries undertook full or extensive liberalization of their exchange restrictions, 23 liberalized controls on foreign direct investment (FDI), 15 eased controls on portfolio inflows, and 5 eased restrictions on portfolio outflows. By the end of 1995, 35 developing countries had fully open capital accounts" [World Bank, 1997a, p.101].

Deregulation. The deregulation of national financial markets in developing countries opened the door for increased foreign capital flows, especially into high yielding stock markets. Domestic financial market liberalization often includes:

(a) The allowing of eurocurrency[2] deposits
(b) The removal of restrictions on foreign ownership of local assets
(c) The removal of interest and credit limits from financial intermediaries

Policy makers in these countries now have to make trade-offs between meeting their domestic objectives and remaining competitive in the global market place. But, as pointed out by Dobson and Jaquet [1998,p.112], most have chosen "to relax their rules and become more open and, in the process, intensify international competition and deepen international integration".

---

[1] The measure is weighted as follows: "Portfolio flows were given a weight of 5, bank flows a weight of 3, and FDI a weight of 1' World Bank [1997a,p.17].

[2] Eurocurrency deposits are any currency deposits outside the country of issue, for example, Japanese Yen in a Brazilian bank is considered to be euroyen deposit.

The abolition of exchange control and floating exchange rates. Under the system of exchange control operated by many developing countries, all foreign exchange transactions had to go through the central bank. There were cumbersome forms and regulations to determine foreign exchange allocation among competing ends. The freeing up of the system has made international transfers of funds into and out of these countries much quicker and more convenient. This, it is hoped, will lead to greater levels of investment and improve the rate of economic growth.

The switch, however, has also opened the door for greater speculation on foreign currencies in some countries. The implementation of these floating exchange rates while, in most cases, resulting in the elimination of the parallel market, nevertheless opened the door for legal "round-tripping". This happens when domestic agents buy United States dollars at low, perhaps pre-float rates, then bring this money back into the local economy and exchange it at higher, post-float rates in order to purchase real assets. The profits made from these assets are further used to purchase more dollars and the process repeated, this is on the assumption that the local currency will continue to depreciate.

Privatization. The privatization of major State enterprises, a policy implemented in both industrialized and developing countries during the 1980s and 1990s, has provided international investors with an additional avenue for portfolio diversification and increased profits. For example, Latin America and the Caribbean have experienced over US$82.6 billion in revenue inflows due to privatization during the period 1990 to 1996 [World Bank, 1998,p. 104]. Of course, the greater proportion of this was concentrated in the larger economies of Mexico, Argentina, and Brazil.

Financial innovations. The development of new financial instruments has also made international financial integration cheaper by "reducing the cost differential between the rate of return paid to the investor and the cost of capital paid by the ultimate borrower" [Caves, Frankel, and Jones, 1993, p. 466]. The relatively recent innovations involve the increased use of instruments such as derivatives, hedge funds, and eurobond financing. Derivatives are "synthetic financial instruments derived from underlying commodities or financial instruments" [World Bank, 1998, p.17]. One example of a derivative is a futures contract. This involves an agreement between two parties to buy or sell a specific quantity of a commodity or bonds, for example, at a predetermined price by an agreed upon date, known as the settlement date. Hedge funds, on the other hand, "are private partnerships with wide flexibility to invest in securities or financial futures and few regulatory requirements" [World Bank, 1998, p.17]. These funds invest in a large variety of instruments such as: bond, stocks, and currencies. The number of these funds dedicated to emerging markets increased from five in 1992 to 57 in 1997 [World Bank, 1998, p. 17]. What distinguishes hedge funds from other similar funds is their distinct lack of legal requirements. A eurobond, however, is a bond that is floated in a currency different from the domestic currency in which it is issued. For example, the recent US$150 million bond issue of the Trinidad and Tobago Government is considered a eurobond.

Technological/cost factors. Reductions in the "costs of transport and transmission of data" [Pfeffermann, 1995, p. 2] have played a critical role in furthering the process of globalization. There are few who would doubt that the advent of faster, and more reliable computers and networks have revolutionized the world of international finance. As noted by Wriston [1998, p.2] "the marriage of computers with telecommunications has created a truly global market in everything from money to commodities". Additionally, "not only is the sheer volume of turnover today an order of magnitude different from yesterday, but telecommunications has so closely linked the world's nervous system that markets often move in sympathy with each other" [Writson, 1998, p.2]. In fact, it is very unusual for the varying stock and foreign exchange markets in developed market economies to move in opposing directions today.

Political factors. The collapse of the Soviet Union and the consequent fall of the Berlin wall have also had an impact. This contributed to globalization in two ways: first, by contributing to an ideological shift away from reliance on non-market forces in many developing countries. This new ideological trust has improved the general investment climate in these countries. And second, by making Eastern Europe open to marketization.

2. CARIBBEAN RESPONSE TO GLOBALIZATION: A REVIEW OF MACROECONOMIC POLICY

2.1 The Caribbean in the world economy

The small open economies of the Caribbean are, especially in terms of international trade and finance, the ultimate price-takers. That is, their output and policy decisions have absolutely no impact on global prices. On the other hand, changes in global prices can have very significant effects on the economic welfare and policies of these economies. Given the openness of Caribbean economies, it seems highly unlikely that they will be able to ignore or resist the pressures and consequences of globalization.

In fact, Jamaica and Trinidad and Tobago have followed many developing countries in adopting policies that will enhance their integration into a global economy. For example, the two countries moved from being lowly to moderately integrated into the world economy from the 1980s to the 1990s. Jamaica shows a higher degree of integration than Trinidad and Tobago. Barbados, on the other hand, was not included in this survey. This is so perhaps because of the country's relatively limited use of IMF facilities, and its well known efforts at resisting exchange rate liberalization. Table 4 shows Latin American and Caribbean countries in terms of their progress towards international financial integration. A closer look at each of the case study country's experience of attempting to cope with a globalized economy is now presented.

Table 4

Degree of Financial Integration Latin America and the Caribbean		
Country	**Period**	
	1985-87	**1992-94**
Argentina	Medium-	high
Bolivia	Low	Low
Brazil	Low	high
Chile	Medium	high
Colombia	Medium	medium+
Costa Rica	Low	Low
Dominican Rep.	Low	Low
Ecuador	Medium-	medium-
El Salvador	Low	Low
Guatemala	Low	Low
Guyana	Low	Low
Haiti	Low	Low
Honduras	Low	medium-
Jamaica	**Low**	**medium+**
Mexico	Medium	High
Nicaragua	Low	Low
Panama	Low	medium+
Paraguay	Low	medium-
Peru	Low	medium
Suriname	Low	medium-
Trinidad and Tobago	**Low**	**medium-**
Uruguay	Medium-	medium
Venezuela	Low	Low

Source: World Bank [1997a, p.18]

2.2 The Barbados experience

Barbados represents a country that appears to have successfully adapted to the pressures of globalization and liberalization without financial and exchange rate liberalization. They have steadfastly held on to policies that many other developing countries have seen it fit to move away from. Table 5 presents some basic economic indicators for Barbados.

Table 5
Barbados: Selected Economic Data, 1990-97
(millions of US dollars, unless otherwise indicated)

	1990	1991	1992	1993	1994	1995	1996	1997
GDP Growth	-3.3	-3.9	-5.7	0.8	4.0	2.9	5.2	3.6
Inflation	3.1	6.3	6.1	1.1	0.1	1.9	2.4	7.1
Interest Rates(Comm. Banks)								
Deposit (avg.)	6.28	6.53	6.68	4.39	4.32	5.11	5.20	4.58
Lending (avg.)	11.42	12.42	13.54	8.92	9.08	10.00	10.00	9.83
Spread	5.14	5.89	6.86	4.53	4.76	4.89	4.80	5.25
Exchange Rate	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Foreign Direct Investment	26.6	27.2	28.0	17.5	7.8	8.8	2.6	3.8
Unemployment Rate	15.0	17.1	23.0	24.5	21.9	19.7	15.8	16.1
Foreign Debt	429.7	417.2	377.5	352.3	357.2	358.9	364.0	
Government Budget Deficit	-33.2	-124.0	-26.5	-26.0	-34.4	-18.4	-14.3	-64.0
Deficit/GDP(%)		7.3	1.7	1.6	2.0	1.0	0.7	2.9
Trade Balance	-408.7	-416.1	-277.8	-326.7	-354.8	-445.8	-456.2	-592.4
Exports	218.9	206.7	189.9	187.6	189.9	245.5	236.8	171.5
Imports	-627.6	-622.8	-467.7	-514.3	-544.7	-691.2	-743.0	-717.3
Services(net)	403.8	398.8	409.7	417.0	494.7	550.0	573.1	604.0
Current Account Balance	-7.8	-23.4	145.5	65.4	134.6	90.1	104.4	7.8

Source: Central Bank of Barbados and IMF; **International Financial Statistics**

The decade of the 1990s has ushered in a period of economic reform and domestic stabilization measures for the economy of Barbados. Slow growth and a significant fall in investment prompted government to pursue expansionary fiscal policies in the latter half of the 1980s. This expansion, together with a sharp downturn in tourism, precipitated a crisis of major proportions in 1991.

Declining real activity in the main foreign exchange earning sectors, together with heavy spending by government and the private sector led to a rapid decline in international reserves. In order to defend the external account and the value of the Barbados dollar, the government instituted cuts in expenditure, started negotiations on a stabilization program with the IMF, introduced a supplementary budget and reduced access to credit. As the economy contracted, unemployment started to rise, together with the rate of inflation.

Trade policy and balance of payments. There has been a major move to liberalize the trading regime in recent years. A great deal of the protectionist measures which were in place into the early 1990s have been dismantled. The system now relies upon a tariff system in line with the CARICOM common external tariff (CET). Temporary surcharges have replaced most quantitative restrictions. Also, the value added tax (VAT) is now preferred to the combination of stamp duties and consumption tax. This policy shift is in line with those carried out in other CARICOM States, particularly, Jamaica and Trinidad and Tobago.

The fiscal measures, as noted above, which were put in place to stabilize the balance of payments dampened activity in the construction sector and slowed the growth of financial activity and business services. The current account deteriorated noticeably during 1991. By 1992, however, the trade deficit had decreased from $416 to $277.8 million and the current account recovered to a positive $145.5 million. Barbados typically runs trade deficits along with current account surpluses since most of the country's foreign exchange is earned by the tourism sector and these are counted as services in the balance of payments.

By the end of 1993 imports grew to $514.3 million. This led to an increase in the trade deficit over the previous year since exports declined marginally. In fact, since 1993 the trade deficit continued to increase and stood at $545.8 million in 1997. This was, however, offset by an impressive rise in tourism earnings, as reflected in the services account. From 1993 to 1997 this account grew by over 50 percent from $398.4 to $604.3 million. Nevertheless, the healthy current account account surplus of $104.4 million in 1996 was followed by a comparatively less flattering $7.8 million surplus in 1997.

Fiscal policy. The fiscal deficit of $124 million recorded in 1991 underscored the crisis facing Barbados during that period. This represented a government deficit to GDP of 7.3 percent. The drastic budget cuts which followed the adoption of the IMF programme saw this deficit fall to only $26.5 million in 1992. This was also partly due to an improved revenue outturn. Moreover, there was a reduction in capital spending from the high level of the preceding year. In spite of a net inflow of foreign financing and a decline in total domestic financing, borrowing from the Central Bank was significant since commercial banks had little excess liquidity.

As part of the IMF stabilization programme, emphasis was placed on additional taxation, reduced expenditure and tighter credit. Also, since 1993 the government has implemented a tax administration and public expenditure management project to improve all aspects of fiscal operations. The budget deficit was kept to reasonable levels during the 1993 to 1996 period. Increased collections of property taxes, and to a lesser extent, personal and corporate taxes all contributed to increased government revenues over the period

Furthermore, there was high liquidity in the banking system in 1997 which enabled commercial banks to finance the bulk of government's fiscal deficit which rose again to $64million. This occurred despite increases in government revenue due to the introduction of the VAT system on 1 January 1997. The government's adoption of an intensified capital works programme is most likely to have been responsible for this development. Finally, the central government's external debt has steadily decreased from 23 per cent of GDP in 1991 to 16.8 per cent in 1997.

Monetary policy. Given the deterioration of the balance of payments account in 1991, the Central Bank of Barbados announced measures to curtail the supply of credit to complement the fiscal package which followed. The minimum savings rate increased

from 5.5 per cent to 7 per cent per annum while residential mortgage rates moved from 9 per cent to 11 per cent. In addition, the Bank's discount rate was increased from 13.5 per cent to 16 per cent and the requirement for banks to hold cash and government securities from 30 per cent to 32 per cent of deposit liabilities. Hence, the weighted average loan rate increased to 13.54 per cent in 1992. The rate fell sharply in 1993 to 8.92 per cent as the current account continued its positive trend from the previous year and economic growth resumed. In the past, interest rates were varied with the express purpose of deterring large capital outflows.

Commercial banks' liquidity was high for most of 1994 because of strong economic growth of 4 per cent combined with increased capital inflows. The excess liquidity ratio, which moved from 8.1 per cent at December 1993 to a peak of 13.6 per cent at mid-June 1994, fell to 9 per cent at the end of September. This decline was due to the combined effect of rising credit demand and some weakening of private sector deposits. The year 1995 recorded marginal improvements in commercial banks' liquidity while in 1996, liquidity was unusually high with the excess liquidity ratio reaching 13.8 per cent compared to 11.3 per cent of domestic deposits in 1995. The excess liquidity ratio remained high in 1997 but declined in the third quarter as credit demand began to pick up and domestic deposit growth slowed. The high level of liquidity drove the treasury bill rate down to 1.53 per cent in August, but the rate increased when liquidity began to tighten toward the end of the third quarter.

A significant development, in terms of international financial integration, has been the rapid growth in offshore banks registered in Barbados. Their numbers have grown from 19 in 1993 to 40 through July 1997. This is just about a 101 per cent increase in four years. More striking, perhaps, is that, over the same period, the overall number of international business companies registered has grown from 2,351 to 4,946. The largest growth area was in "foreign sales corporations" which went from 923 to 2,479 [IMF, 1998, p.58].

Exchange rate policy. The authorities have maintained a fixed exchange rate of B$2.00 = US$1. The Central Bank has established exchange rate stability as its primary goal. In fact, beyond the Central Bank, there seems to be a unified social consensus that the exchange rate should remain fixed. Arguments as to why a floating exchange rate is not needed range from the undesirable effects of the float itself to the fact that the Bank has seldom, if ever, had to intervene in order to defend the Barbados dollar. Also, the government preferred to cut public sector wages rather than devalue during the crisis of 1991. This according to Dalrymple [1995, p. 296] was supported by the IMF since "It became clear that Barbados, with no 'natural resources' would not benefit from a devaluation".

2.3 The Jamaica Experience

Jamaica has had the longest relationship with the IMF of any English-speaking Caribbean country. The economy appears to be in a permanent state of adjustment. In

fact, Jamaica has been undergoing structural adjustment for over 20 years. The economic stabilization and adjustment process, begun in the 1970s, advanced significantly during the decade of the 1980s and the stages of deregulation and liberalization were accelerated rapidly in the 1990s. This included the liberalization of the foreign exchange market, allowing for market determined interest rates, removal of price controls, elimination of subsidies, lowering fiscal borrowing requirements, and increasing the pace of privatization. Tax reforms were also undertaken with the introduction of the General Consumption Tax (GCT) and the CET.

Table 6
Jamaica: Selected Economic Data, 1990-97
(millions of US dollars, unless otherwise indicated)

	1990	1991	1992	1993	1994	1995	1996	1997
GDP Growth	5.5	0.5	1.5	1.4	1.1	0.5	-1.8	-2.4
Inflation	29.8	80.2	40.1	30.1	26.9	25.5	15.8	9.2
Interest Rates(Com Banks)								
Deposit (ave.)	23.9	24.7	33.6	27.6	36.4	23.2	25.2	14.0
Lending (ave)	30.50	31.5	44.8	43.7	49.5	43.6	44.2	36.3
Spread								
Exchange Rate	8.04	21.49	22.19	32.48	33.20	39.62	34.87	36.34
Foreign Direct Investment	137.9	133.2	142.4	78.6	116.8	166.7	285.3	
Unemployment Rate	15.7	15.7	15.9	16.3	15.4	16.2	16.0	16.5
Foreign Debt	4,662.3	4,516.6	4,392.6	4279.0	4300.0	4300.0	4000.0	4200.0
Government Budget Deficit			**88.3**	**97.6**	**108.9**	**121.0**	**-38.3**	**-411.8***
As % of GDP(%)			**6.3**	**10.1**	**11.3**	**14.9**	**9.7**	**-48.5**
Trade Balance	**-502.1**	**-391.6**	**-424.6**	**-815.1**	**-551.2**	**-824.5**	**-994.2**	**-1110.0**
Exports	1,190.6	1,196.7	1,116.5	1,105.4	1548.0	1796.0	1721.0	1,698.9
Imports	-1,692.7	-1,588.3	-1,541.1	-1,920.5	-2,099.2	-2,620.5	-2,715.2	-2,808.9
Service(net)		321.8	389.6	437.2	401.6	369.3	326.1	303.1
Current Account		-240.1	28.5	-184.0	6.9	-183.2	-237.7	-375.9

* projected
Source: IMF, and Institute for National Planning of Jamaica

Trade Policy. Like Barbados, Jamaica typically runs a trade account deficit with tourism being a major source of foreign exchange which makes a positive contribution to the current account. The Government's policy regarding external trade has tended to be focused on export expansion and diversification, as well as the reduction of the rate of growth of imports, through a mix of exchange rate, interest rate, and pricing policies. The success of these measures was evident during the first three quarters of 1990, when exports grew consistently and the growth of imports was slowed considerably. However, in the fourth quarter, there was a surge in imports due to the increase in the oil bill resulting from the Persian Gulf Crisis. There was an overall improvement, however, in the merchandise trade deficit from $502.1 million in 1990 to $391.5 million in 1991.

The current account balance of payments improved during the fiscal year 1991/92 to record a modest surplus of $28.5. This was due to an increase in tourist revenue as reflected in the net service account. In 1993, there was again a current account deficit of

$184 million. Merchandise imports declined by 0.6 per cent in 1994 with exports increasing by 13.4 per cent. This trend continued until 1997 when merchandise imports increased by 6.5 per cent and exports remained unchanged. The result was a further deterioration in the current account to a deficit of $375.9 million in 1997.

Fiscal policy. At the end of FY[3] 1991/92, central government recorded a surplus of 6.3 per cent of GDP. This was followed by another two years in which healthy fiscal surpluses were recorded. The improvement was the result of tight demand management policies, aimed at limiting domestic borrowing, as well as fiscal measures, including further removal of subsidies, improvements in revenue collections and tax administration, and improved financial management and accountability.

Central government's operations deteriorated in FY 1995/96 influenced by strong increases in debt servicing costs, with total expenditure amounting to J$8,0329.8mn or 38.2 per cent over the similar period of 1995. Increases in other obligatory expenditure items also accounted for the increase. This occurred despite the implementation of the Tax Administration Reform Project (TaxARP), designed to enhance revenue, in January 1995. An apparent conflict emerged also between the FYs 92/93 and 1995/96 as the public sector ran surpluses while, at the same time, the public debt was increasing. As Jefferson [1998,p. 22] points out "a significant portion of the incremental debt would have been accounted for by transactions related to reserve accumulation by the Bank of Jamaica which is not reflected in the deficit calculations".

In FY 1996/97, the fiscal deficit widened due to the cost of servicing the domestic debt, higher than projected wages and salaries, and lower than projected tax revenues. Crowding out has resulted in very high nominal interest rates, with average lending rates currently running at 42 percent which is "32 percentage points above the inflation and 18 percentage points above the Treasury Bill rate" [Jefferson, 1998, p. 24].

Monetary policy. Within the framework of the 1991/92 Stand-By Agreement with the IMF, monetary policy in Jamaica was aimed at controlling growth in liquidity and aggregate demand consistent with programmed balance of payments targets. With the abolition of exchange controls in September 1991, monetary policy was geared primarily toward the stabilization of the exchange rate.

The first half of the year 1991 saw a relative loosening in monetary policy to encourage investment. This entailed the removal of credit restrictions (January 1), the removal of the non-cash portion of the liquid assets ratio (April 1), and a lowering of both the Treasury Bill and Certificate of Deposit rates. During the second half of the year treasury bill rates moved from 28.4 per cent in January to a low of 15.2 per cent in June. The rate again moved upward to 35.1 per cent at the end of December. Certificates of Deposit followed a similar pattern, declining from 31.3 per cent in January to 19.3 per cent in June and rebounding to 46.9 per cent at year's end.

[3] FY - Fiscal Year

During 1993, the Government maintained its continued tight monetary policy in order to achieve the economic and financial targets critical to the success of the overall economic program. Stringent monetary policy was evident in aggressive open market operations and the maintenance of a 50 per cent minimum liquidity requirement for commercial banks. As a consequence, interest rates which had begun to decline since the latter half of 1992, increased sharply during the second half of 1993.

Tight monetary policy continued in 1994 with high interest rates contributing to an expansion in the net foreign assets of the banking system. Commercial banks lending rates rose to historically high levels in response to the high yields on government fixed income securities and a high statutory reserve requirement. The average lending rate increased from 43.7 per cent at the end of December 1993 to 49.5 per cent in 1994. The real average lending rate was 22.6 per cent at year's end. With respect to deposit rates, the average interest rate on saving deposits increased from 20 per cent in December 1993 to 22.5 per cent in June 1994. However, by the end of the year, the rates again fell to 20 per cent.

Interest rates declined during 1995 to an average 23.2 per cent from 36.4 per cent the previous year in an attempt to encourage investment. There was also a decrease in the liquidity reserve requirement of the banking system from 50 per cent to 47 per cent. This continued throughout 1997 with the cash reserve ratio at 25 per cent for commercial banks. Effective August 1, this year (1998) the ratio was further reduced to 23 per cent.

In general, Jamaica's monetary policy has been entangled with its fiscal policy. The government's use of the Bank of Jamaica as a source of funding has eroded any illusions of independence on the part of the bank. This has resulted in continuous failure in achieving balance of payment and exchange rate stability.

Exchange rate policy. In September 1990, a flexible exchange rate and interbank system was instituted in Jamaica. Under this system, authorized dealers were free to buy and sell foreign exchange on their own account and set their buying and selling rates. In September 1991, exchange controls were abolished. All repatriation and surrender requirements for earners of foreign exchange were discontinued and residents were allowed to hold foreign currency accounts locally and abroad. In line with what had become a worldwide trend, a policy of deregulation and liberalization was therefore pursued.

2.4 The Trinidad and Tobago experience

Trinidad and Tobago began the process of trade and financial liberalization during the late 1980s. The major policy shifts, however, occurred within the period 1991 to 1993. For example, the abolition of the negative list for imports, on the trade side, and the abolition of exchange control, on the financial side, took place within this period. These policy shifts came as a response to the collapse of the oil boom and several years

of negative economic growth. The country's relationship with the IMF would also have contributed to the urgency with which they were implemented. The government was forced to deal with the IMF and undergo structural adjustment in order to reschedule its external debt which peaked to US$2.5 billion at the end of 1990.

Trade policy. Since its independence, the country had maintained a policy of high import tariffs and negative lists. This was all part of the familiar import substitution strategy adopted by many developing countries during the 1960s.

Table 7
Trinidad and Tobago: Selected Economic Data - 1990-97
(millions of US dollars, unless otherwise indicated)

	1991	1992	1993	1994	1995	1996	1997
GDP Growth (1985=100)	2.9	-1.1	-2.6	5.1	3.2	2.8	2.9
Inflation	3.8	6.5	10.8	8.8	5.3	3.3	
Interest Rates(Com Banks)							
Deposit (avg.)	5.5	6.34	6.53	6.5	5.84	6.39	5.26
Lending (avg.)	11.77	12.76	13.08	13.85	13.36	14.24	11.84
Spread							
Exchange Rate	4.25	4.25	5.34	5.87	5.94	6.03	6.28
Foreign Direct Investment	169.3	177.9	379.2	516.2	289.9		979.7
Unemployment Rate	18.5	19.6	19.8	18.4	17.2	16.2	14.9
Foreign Debt	2329.0	2215	2102.1	2063.5	1905.2	1875.8	1526.8
Trade Balance	341.0	434	163.3	597.7	592	338.3	-610.4
Exports	1751.3	1869.6	1662.2	1971.9	2477.2	2492.3	2427.2
Imports	1410.3	1435.6	1498.9	1374.2	1885.2	2154	3037.6
Current Account	-66.7	32.5	-107.8	221.4	269.9	68.2	-526.3

Source: Central Bank of Trinidad and Tobago

A major policy shift was initiated in the late 1980s with a systematic removal of restrictions on imports and a lowering of tariffs. Combined with the abolition of exchange control this has resulted in an import boom. Total imports have risen by slightly over 102 percent from 1993 to 1997.

The healthy trade surpluses of 1994 to 1996 seemed to suggest that Trinidad and Tobago was reaping major trade benefits from its policy shift to liberalization. The continued steep rise in imports, however, has resulted in a rather large trade deficit of US $610 million by the year ending 1997. This deficit may not yet be a serious cause for concern since it is primarily the result of intermediate imports in the foreign exchange generating energy sector. In this sector, foreign direct investment inflows amounted to US$ 979.7 million in the same year. Additionally, the government is acquiring significant revenue inflows due to the collection of VAT and other import duties. For example, during the last quarter of 1997, the VAT on imports grew by 45 percent to TT$452.9 million over the corresponding period in 1996. Overall VAT revenues have been steadily increasing through 1997 [Table 8].

Table 8: Vat Revenue, 1992-1996
(millions of TT$)

	1992	1993	1994	1995	1996
VAT	969	1177	1259	1345	1421

On the other hand, incentives given to local manufactures in the past appear to be showing dividends as there has been a dramatic increase in exports within the CARICOM region. Exports to this grouping increased by over 120 percent during the 1993 to 1997 period. Exports to areas outside of the CARICOM region have also increased, especially into Latin America. This success has encouraged the government to sign a number of bilateral trading agreements with Latin American and Caribbean countries, including, for example, the Dominican Republic. At the same time, the country is actively involved in furthering hemispheric integration within the framework of the Association of Caribbean States (ACS) and the Free Trade Area of the Americas (FTAA).

Fiscal policy. Tight fiscal policy has been the order of the day since the process of liberalization started almost a decade ago. Successive governments have stuck with adjustments programmes agreed to by their predecessors with the IMF. Fiscal measures have included: wage restraint, privatization, restructuring of the public service and income tax reduction. There has been little or no real increases in public sector wages during the 1990s. The small nominal increase recently granted to teachers would not have been enough to keep pace with inflation.

The policy of privatization has contributed to increased government revenues which has been used to help reduce the size of the fiscal deficit in a number of years. Privatization, it is also hoped, will further enhance the fiscal surplus by reducing the need for State subsidies to many unprofitable enterprises. There is the danger, however, that when there is no longer any more public assets to be sold off, the small budget surpluses may disappear. Increased government revenues have also come from the introduction of the VAT in the 1990s. Better enforcement and more compliance can potentially boost this consumption tax as a major revenue source away from direct taxes on income.

There is concern, however, over the increasing internal debt of the central government. This has risen by 52 per cent from TT$5,360 in 1993 to $8,155 million at the end of 1997 [Central Bank, 1997]. During 1998, there have been further increases of this debt. A warning has been issued by the Governor of the Central Bank, that: "the gap between the government's domestic revenue and domestic expenditure has been widening leading to an acceleration of money creation in the financial system" [Dookeran, 1998, 63]. Somewhat like in the case of Jamaica, government overspending is being accommodated by use of its overdraft facilities with the Central Bank.

Monetary policy. Since liberalization, monetary policy appears to be driven by the need to maintain exchange rate stability. During the 1990s, there has been a series of increases in the reserve requirement aimed at removing liquidity in the banking system in order to dampen demand for foreign exchange. Open market operations, started in

September 1996, have also been utilized with the same objective. The policy of high reserve requirements has resulted in fairly onerous domestic interest rates on all types of commercial loans while there exists a situation of excess liquidity in the financial system. In more recent developments, the government has begun speaking about the need for lower interest rates in order to stimulate domestic investment. In fact, the government is promising to have the reserve requirement reduced significantly in the near future.

Inflation has generally been held in check, dropping to a low of 3.3 per cent in 1996. This has led to positive real rates of returns on a number of deposit instruments. This was not often the case during the pre-liberalization and oil-boom years. Of greater concern, however, is the continued large spreads between deposit and lending rates. This indicates "capacity for monopolistic pricing" as the "spread in Trinidad and Tobago is in a very high range, much higher than in neighboring countries" IMF[1997, p. 51]. Up until 1994 the Central Bank maintained the right to intervene in order to influence interest rates. This right was seldom, if ever, utilized.

Exchange rate policy. The abolition of exchange control in 1993 signaled a major break with the past and a full commitment to liberalization. For years the country relied on a fixed exchange rate and capital controls as the mainstay of its exchange rate policy. The switch to a floating rate resulted in an immediate depreciation of the Trinidad and Tobago dollar from $4.50 to $5.75 per United States dollar in April of 1993. Since then, the Trinidad and Tobago dollar has only depreciated by a further 9 per cent to 6.28 per United States dollar to the end of 1998. This relative stability of the currency can be attributed to, perhaps, the country's ability to earn foreign exchange from its natural resource industries and its relatively sound macroeconomic fundamentals during the 1990s.

The Central Bank has stepped in to defend the rate on a number of occasions, indicating a commitment to a managed float. As noted above, however, the bank has relied more heavily on interest rate policy to stabilize the exchange rate. Due to the large accumulation of United States dollar deposits in the banking system, the commercial banks, may have an incentive in not seeing too rapid a depreciation of the currency. This may lead to a run on these deposits. Trinidad and Tobago, therefore, has found itself in the strange situation where the prevailing exchange rate has become a socially desirable one for the major actors within the system.

2.5 Summary: Caribbean macroeconomic policy in a global environment

Jamaica and Trinidad and Tobago have pursued the path of rapid liberalization and integration into the global economy. Barbados, on the other hand, has traveled a more cautious road. That country has been able to maintain a fairly good rate of economic performance using policies that the other two countries have abandoned for lack of effectiveness. It also represents a case where there is a social commitment to keeping their currency stable and emphasizing other policy variables to achieve desirable

economic outcomes. For example, as mentioned earlier, Barbados chose public sector wage cuts over devaluation.

This is quite different, for example, from the case of Jamaica where there has been a great deal of preoccupation with the exchange rate. Like Barbados, Jamaica is heavily dependent upon tourism for foreign exchange. The significant difference, however, is that Jamaica has a substantial external debt that has only slightly diminished during the 1990s, despite years of adjustment. The need to service this debt has seriously limited the options available to its policy makers. Major policy mistakes, in a globalized financial market, are punished severely as investors demand high premiums when governments slip up. Hence, the Jamaican Government now has to contend with paying extremely high rates of interest on its treasury bills. Its internal debt continues to worsen as the Financial Sector Adjustment Company (FINSAC) absorbs more failed financial institutions. For example, the government's internal debt was J$12.08 billion Jamaican dollars in fiscal year 1991/92. This has further skyrocketed to $J 85.191 billion by fiscal year 1996/97. This over 600 per cent increase in the internal debt has resulted in that proportion of total government debt rising from 15.5 to 45.5 per cent from 1991 to 1997 [National Planning Institute of Jamaica, 1998, p. 6.5].

In the case of Trinidad and Tobago, financial liberalization has gone a lot smoother than in Jamaica. This is due perhaps, to a number of factors: (1) the country has more reliable sources of foreign exchange than Jamaica; (2) there have been large capital inflows, in the 1990s, of foreign direct investment, capital inflows into Jamaica appeared to be more of a speculative nature[4]; (3) financial institutions seemed to be better managed; and (4) Trinidad and Tobago's external debt has been reduced to somewhat more manageable proportions, while Jamaica's has remained problematic.

The conduct of macroeconomic policy in the context of a liberalized and global economy presents very different challenges from those that were present in the 1970s and 1980s. The regulatory power of the region's central banks, for example, can be seriously undermined as residents continue to increase their saving in United States dollars which is then, to a large extent, taken out of the financial system. The ability to conduct successful monetary policy is weakened as commercial banks find new ways of neutralizing any policy initiative on the part of the Central Bank.

The two countries which have liberalized, Jamaica and Trinidad and Tobago, have not shown any significant increase in the level of financial deepening thus far [Tables A.7 and A.8]. This is supposed to reflect financial maturity and be one of the main benefits of liberalization. Also, in the case of Jamaica, financial integration via liberalization have been very problematic as many financial institutions have collapsed during the period. There have been bouts of high inflation and rapid currency

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[4] Private short-term inflows were greater than FDI and other long-term capital inflows by wide margin for the period 1992 to 1994. Short-term inflows totaled US$693.9 while the sum of FDI and other long-term inflows totaled US$364.4 for the same period.(Bank of Jamaica; Balance of Payments)

depreciation. This represents a clear case, it seems, where the fundamental prerequisites for successful financial liberalization were not in place and they have, hence, paid the price. It should be stressed, however, that the Jamaican economy was already in trouble before liberalization began.

In Trinidad and Tobago, the process has gone a lot smoother. There has not been any rapid depreciation of the exchange rate and inflation has been held in check. Economic growth has also been positive. The question could still be raised, however, as to whether these positive developments are the result of the liberalization policies or some other factor. The huge foreign direct investment inflows to the energy sector, peaking at almost a billion United States dollars in 1997, seems to be more likely the catalyst for the kind of mini boom seen in the last five years. Nevertheless, it could be argued that these inflows might not have come if structural adjustment and liberalization had not been implemented beginning in the late 1980s.

Additionally, the case of Barbados illustrates that wholesale liberalization is not always necessary for success in today's global economy. Prudent and consistent fiscal policies combined with monetary restraint has seen the economy come out of a major crisis in the early 1990s without having to resort to the major policy instruments of liberalization. This, combined with the negative experience of Jamaica, perhaps could be taken as a lesson to other small developing countries, that you should only liberalize when your fundamental prerequisites are met, otherwise, resort to traditional policies of fiscal discipline and demand management.

3. THE CURRENT FINANCIAL CRISIS AND ITS IMPLICATIONS FOR THE CARIBBEAN

3.1 The international financial crisis

The collapse of East Asian stock markets and sharp depreciations of several currencies initiated an international financial crisis beginning in the first quarter of 1997. For the East Asian economies involved, in 1997, "the sum of short-term borrowing, stock market net flows, and net outflows from domestic residents, which has usually registered a relatively small net inflow, suddenly grew to an outflow of $92 billion" United Nations [1998, p.76]. According to Aschinger [1998] the crisis originated in Thailand's property sector and quickly spread to Malaysia, Indonesia and the Philippines. The further meltdown of the Russian economy, followed by the massive capital flight out of Brazil added a greater degree of internationalization to the crisis. These developments led to a general decline in stock prices on a global scale.

The depth and breath of the financial crisis, has led to a flurry of research into its causes and the consequences for the global economy (see Goldstein[1998], UNECLAC[1998], Nunnenkanp[1998], Aschinger[1998], and Kuttner[1998]). The successful globalization of financial markets which was being increasingly proclaimed

has come under serious question since the onset of the crisis. This is due to the fact that the policies that influenced its success are the same ones being blamed for its failure. The rapid liberalization of the capital account, for example, is now being seen as, if not a possible reason for the crisis, at least a factor in worsening its effects.

Of course, financial liberalization could appear to be unsuccessful and problematic if the necessary preconditions are not in place at the beginning of the process. According to Fry [1997, p. 159] successful financial liberalization has several important prerequisites: (1) "adequate and prudential supervision of commercial banks, (2) a reasonable degree of price stability, (3) fiscal discipline (4) profit maximizing, competitive behavior by the commercial banks, and (5) a tax system that does not impose explicit or implicit discriminatory taxes on financial intermediation". These, he argues, have been observed over the last 20 years internationally.

Nevertheless, there are two general themes in terms of explaining the crisis: fundamental imbalances and destabilizing speculation. The first has to do with "distorted incentives, inadequate disclosure and supervision, poorly managed financial liberalization, and lax regulatory standards" [World Bank,1998, p. 36]. The second has to do with "the sudden exposure of these nations to the speculative whims of unregulated financial capital" [Kuttner, 1998, p.1]. Added to these are a dangerous mix of moral hazard and "the herd effect".

There are two dimensions to the moral hazard problem. First, local banks may have taken advantage of inadequate supervision in order to engage in risky and unsecured activities expecting that they will be rescued by the country's monetary authorities if things went wrong. And second, the monetary authorities themselves could be guilty of being less watchful than perhaps they should have been, knowing fully well that in the event of a serious crisis they would be bailed out by the international lending agencies, based on what transpired in the Mexican case.

The "herd effect" refers to the situation where agents do not act on their own evaluation of a country's economic conditions. They observe that 'reputable' or high profile portfolio managers are withdrawing from the country and decide that this must be the right thing to do. The payoff to this type of behavior is that when they are correct they appear to be as smart as the best. And if it turns out to be a hasty decision then it can be justified on the grounds that everyone was doing it, including the best and the brightest. This herd mentality is blamed for exacerbating the massive outflow of capital from economies where the economic fundamentals did not necessarily warrant such behavior.

3.2 Implications for the Caribbean

The globalization of financial markets and the international financial crisis can potentially create problems and present new challenges for policy makers in the Caribbean. While there are no obvious direct avenues for transmission of the crisis to the

region there are, however, indirect and secondary linkages that can still prove to be crucial.

3.2.1 Commodity prices

The general deflationary trend since the Asian financial crisis has put downward pressure on commodity prices. The World Bank [1998,p. 18] warns that "Declining trends in commodity prices will reduce the potential for large windfall gains accruing to mere natural resource ownership, while rewarding the most efficient producers". The Bank's projection for all categories of commodities to the year 2006 is downward, falling to prices well below their 1990 level, in real terms. In particular, the price of oil is projected to fall to about 60 per cent of its 1990 price over that period [Morgan Guaranty, 1998].

Lower oil prices are partly a result of an oversupply. The effects of lower demand for oil in East Asia, due to the economic crisis, is also having an impact on prices. Oil prices have fallen to their lowest levels since the early 1970s. This is causing major concerns in Trinidad and Tobago where government revenues are directly linked to the price of oil. The government's 1999 budget was based on a projected oil price of US$ 14 per barrel. The current price is in the vicinity of US$10.00 per barrel. This will result in serious revenue shortfalls and could force drastic cuts in public sector spending.

Other commodities such as bauxite, methanol, ammonia, and fertilizers are also crucial, bauxite in the case of Jamaica, and the latter three in the case of Trinidad and Tobago. Depressed demand in Asia can further exacerbate the already downward trend in the prices of these commodities. For example, methanol prices continue to struggle despite having recovered somewhat in 1997. The average price was US$187 per ton in 1997, whereas in 1996 it was only US$153 per ton. However, this is far below the 1995 price of US$268 per ton. The Caribbean's production of these commodities is not significant enough to have an impact on the world price. As noted above, changes in world demand can have a serious impact on commodity prices and the fortunes of these countries. The fall in oil prices can be good news, however, for the mainly petroleum importing countries of the Caribbean.

3.2.2 Interest Rates

The international financial crisis has triggered a deflationary trend among industrialized economies. This trend combines relatively low rates of inflation with low interest rates. This allows policy makers the luxury of reducing interest rates without the usual fears that inflation will be triggered. Because of the high degree of interdependence among these economies, coordinated monetary policy has become indispensable. For example, the recent move to lower interest rates in the United States was partly motivated by the need to "help" the ailing Japanese economy. If the United States maintained high interest rates relative to Japan then there would have been a greater flight to United States dollar denominated assets, hence putting downward

pressure on the Japanese Yen and further facilitating an outflow of capital from Japan. This, in turn, would have exacerbated the ongoing Japanese recession. This was believed to be inimical to United States and by extension G-7, interests and probably the world economy. The United States move toward lower interest rates was also motivated by concerns over the possible slow down in its own economic growth and a potential worldwide recession.

For Caribbean countries, this development has the potential to lower their debt servicing obligations on the variable rate portion of their debt and reducing the cost of new loans. This is so, since some portion of each country's external debt is based on variable interest rates. For example, about half of Trinidad and Tobago's external debt in 1997, US$738.7 out of US$1526.8 million, was based on a variable interest rate [Central Bank of Trinidad and Tobago, 1998, Table 19].

3.2.3 The neighbourhood effect.

On the other hand, the Asian financial crisis could result in higher interest rates due to the "neighbourhood effect". That is, investors may lose confidence in any emerging market since they associate these with instability and huge losses. They will, therefore, demand higher risk premiums when extending new loans. Also, Caribbean countries may find it difficult to get international subscribers to their bond issues. Virtually all Caribbean government bond issues are rated as junk or near junk, as they are usually put at below investment quality by recognized rating agencies, to begin with. The current financial crisis can, therefore, exacerbate the problem.

For example, Jamaica, as noted above, has to offer its treasury bills at a real rate of interest well above international levels even to get residents to subscribe. Also, there was virtually no foreign interest in the recent United States dollar bond issue of the Trinidad and Tobago Government. At an interest rate of 8 percent the issue could not attract international investors and had to be taken up strictly by local banks and finance houses.

3.2.4 Investment

There is virtually no international portfolio investment to speak of in the three Caribbean countries in this study. This fact has led the Chief Executive Officer of the Royal Bank of Trinidad and Tobago to assert that "we have a fledging capital market in the Caribbean and the fact that there is little in the way of non-regional portfolio investment should insulate us somewhat from the fallout"[Newsday,1998, p.9]. The real issue, however, is that these countries have undergone structural adjustment involving major policy shifts in order to attract all types of foreign investment. This potential portfolio inflow is placed in jeopardy by the financial crisis. The question then arises, however, as to why isn't there more of this type of investment in the Caribbean? The answer lies in the liquidity constraints in the system due to a long time lag in settlements and the lack of international rating of regional companies. The Jamaica stock exchange

has made some improvement in this regard and steps are on the way in Trinidad and Tobago to fully computerize stock trading.

Foreign direct investment flows to the region should not be affected directly by the crisis. Any effects would be of an indirect nature transmitted via weak commodity prices. It may be indirectly affected, however, if the international fortunes of the multinational investors are severely compromised by the crisis. They may then seek to scale back their operations and hence withdraw potentially lucrative projects in the region. Also, investment in tourism related activities would probably be affected if the crisis worsens and a worldwide recession ensued. Global recession could also lead to a fall in tourist arrivals.

3.2.5 Trade

The Caribbean does not have a significant trading relationship with the crisis afflicted East Asian countries. These countries, however, will be seeking to increase their exports to boost economic growth. This could result in the Caribbean being flooded with cheap imports from Asia. Currently, for example, there is an issue involving a shipment of cement from Thailand, the country where the crisis started, in Trinidad and Tobago. The importers of the cement claim that it is of good quality and cheaper than the one locally produced. The local cement company, however, is counter-claiming that the cement is being dumped from Thailand and requesting that the government takes action. As seen in Table 9, Barbados receives a trivial amount of imports from Asia. Jamaica and Trinidad and Tobago have a more substantial import relationship with Asia, however, with the latter seeing a significant rise from US$56 million to 90.4 million from 1996 to 1997.

Table 9
Selected Caribbean Countries: Imports from Asia
(millions of U.S. dollars)

Year	1990	1991	1992	1993	1994	1995	1996	1997
Barbados	23.0	29.0	21.0	21.0	18.0	11.0	11.0	1.0
Jamaica	50.0	45.0	111.0	104.0	118.0	110.0	96.0	99.7
Trinidad and Tobago	51.0	73.0	69.0	63.0	51.0	73.0	56.0	90.4

Source: IMF, Direction of Trade Statistics

More recent data already suggests a continuing trend towards increased imports from Asia, particularly in the case of Trinidad and Tobago. For the period January to August 1998 imports have increased by 49.6 per cent from Japan, 28.7 per cent from Taiwan, and a huge 84.4 per cent from Thailand over the corresponding period in 1997 [Central Statistical Office, 1998, p.9].

3.2.6 Dollarization

The globalization of financial markets and the international financial crisis could hasten the rate of dollarization. This process is fairly much on the way in Jamaica and Trinidad and Tobago. United States dollar deposits in the banking system grew to over one billion dollars for Jamaica by end of 1997 [Table A.5]. In Trinidad and Tobago, United States dollar deposits in commercial banks and non-bank financial intermediaries stood at around $766 million as at May 1998 [Table A.4]. At current exchange rates this is equivalent to TT$ 4,814 million! When citizens save in United States dollars they are effectively engaging in capital flight since this money is generally not available to the average investor in the form of loans.

Regional investors will most likely continue to partake in the 'flight to quality' by shifting assets into United States securities. This could deprive the Caribbean countries of scarce foreign exchange and potential domestic investment. This will present the monetary authorities with a great challenge to formulate policy that encourage residents to maintain their assets in local currency without resorting to coercive or punitive measures.

4. SUMMARY AND POLICY RECOMMENDATIONS

The globalization of financial markets is being driven fundamentally by the search for economic profits and the need for portfolio diversification. The process of globalization has been facilitated by policy changes in the developing countries that have made them more attractive to international investors. These changes include: the liberalization of the capital account, the switch to floating exchange rates, the privatization of State owned firms, and the development of new and diverse financial instruments. The policy changes have also aligned the developing countries somewhat with many industrialized countries which began their liberalization processes in the 1970s and continued into the 1990s.

The Caribbean countries of Barbados, Jamaica and Trinidad and Tobago have each had to confront the reality of these developments. Jamaica and Trinidad and Tobago have chosen to liberalize and rapidly integrate into the global economy. Barbados, on the other hand, because of what it sees as the lack of clear gains from the globalization process has opted for a more cautious approach. It has maintained a policy of fixed exchange rates and capital controls despite worldwide trends away from these policies. The fact remains, however, that the Barbados economy has been performing relatively well in recent times and the country is usually rated as number one among developing countries in terms of human development. This has encouraged policy makers there to adopt the approach of "if it isn't broke then don't fix it".

Jamaica, perhaps, represents the diametrically opposite case to Barbados. It has liberalized both its trade and financial sectors and has, unfortunately, not reaped the

promised benefits. Whereas, Trinidad and Tobago represents the intermediate case since the partial liberalization of trade and finance appear, thus far, to be reaping some rewards.

The international financial crisis was caused by speculation as well as insufficient regulation of financial enterprises and flows. The Caribbean countries can learn the easy way by avoiding the mistakes of the East Asian countries. Hence, some suggestions and policy recommendations seem relevant:

First, Caribbean countries should make sure that their banking supervision laws are updated and enforced to ensure prudent practices on the part of commercial banks. Rules and regulations governing non-bank financial institutions should also be revisited in light of the growing influence of these institutions in the financial system. For example, insurance companies have become very involved in almost every aspect of the financial system. They have formed strategic alliances with commercial banks which they own large chunks of and have increased the number of instruments in which they deal. Policies must be in place to ensure arms length practices and transparency on the part of these companies, as well as, all other quasi-banking type companies.

The Caribbean has not been, thus far, a major destination for large speculative capital flows. Given the size of these economies, however, the inflows do not have to be particularly large in order to create serious disruptions. The region's governments should be willing, at very short notice, to implement capital controls if and when a crisis begins to develop. To sit back and do nothing, or allowing the country's foreign reserves to be depleted does not seem to make any sense. This is so despite the obvious criticisms which will result from this move. Paul Krugman, a noted economist, is now on record as admitting that temporary controls may be justified in some instances. Caution in doing so, however, must be emphasized since the failure of exchange control policies of the past should not be easily forgotten. Nevertheless, as it stands now, there should already be discussions on the possibility of having reserve requirements placed on both short-term and long term capital inflows as is done in Colombia and Chile.

Second, given the projected turbulent times ahead for commodity prices there should be an approach to fiscal policy which aims at evening out spending over time. Considerations should be given to having multi-year budgets. The idea that a country's budget must be done on a yearly basis must be re-examined. A switch to multi-year budgets will allow more realism in the planing process and greater emphasis to be placed on medium to long term goals. It can also go a long way to ensuring macroeconomic stability.

Third, although trade between the Caribbean countries in this study and Asia remains relatively minor, these countries should seek to protect themselves from a flood of cheap imports from that region. While cheap imports may be good news for the region's consumers it could result in injury to many local firms. However, a return to the old excessively protectionist policies of the past will not work. Once these imports cannot be reliably shown, however, to be a case of dumping then they should be allowed

to flourish and this could act as a stimulus for regional producers to become more efficient.

And finally, on a potentially positive note, the money that is leaving Asia and some parts of Latin America has to find somewhere to go. If Caribbean countries can strategically position themselves they may be able to benefit from the fallout from the crisis. They have to pursue policies which guarantee macroeconomic stability and must complement liberalization with prudent supervision of their financial sectors.

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APPENDIX

A.1

AGGREGATE NET RESOURCE FLOWS AND NET TRANSFERS (LONG-TERM)

TRINIDAD ANDTOBAGO

	1990	1991	1992	1993	1994	1995	1996
Net Resource Flows	-26	57	168	313	551	239	324
Net Flow of long term debt (ex. IMF)	-148	-115	-18	-71	26	-70	-3
Foreign Direct Investment (net)	109	169	178	379	516	299	320
Portfolio Equity Flows	0	0	0	0	0	0	0
NET TRANSFERS	-401	-349	-225	-45	169	-171	-123
Interest on long term debt	177	169	143	118	132	147	167
Profit Remittances	197	236	251	240	250	263	280

Source: World Economic Survey, 1998. United Nations

A.2

AGGREGATE NET RESOURCE FLOWS AND NET TRANSFERS (LONG-TERM)

JAMAICA

	1990	1991	1992	1993	1994	1995	1996
Net Resource Flows	249	474	137	279	75	187	107
Net Flow of long term debt (ex. IMF)	-6	59	-62	-41	-133	-43	-108
Foreign Direct Investment (net)	138	133	142	78	117	167	175
Portfolio Equity Flows	0	0	0	0	0	0	0
NET TRANSFERS	-142	110	-87	107	-134	-37	-116
Interest on long term debt	202	192	167	167	185	193	193
Profit Remittances	189	172	57	5	24	31	30

Source: World Economic Survey, 1998. United Nations

A.3

AGGREGATE NET RESOURCE FLOWS AND NET TRANSFERS (LONG-TERM)

BARBADOS

	1990	1991	1992	1993	1994	1995	1996
Net Resource Flows	14.4	-16.3	-31.3	-28.6	28.7	9.4	274.2
Net Flow of long term debt (ex. IMF)	2.1	-24.3	-45.3	-57.6	13.8	-3.6	19.2
Foreign Direct Investment (net)	11.0	7.0	14.0	9.0	12.9	12.0	13.0
Portfolio Equity Flows	0	0.0	0.0	0.0	0.0	00	240.0
NET TRANSFERS	-34.0	61.5	-72.5	-65.0	1.7	-22.0	243.3
Interest on long term debt	39.3	37.5	32.2	28.3	27.0	27.4	26.9
Profit Remittances	9.1	7. 7	9.0	8.0	0.0	4.0	4.0

Source: World Economic Survey, 1998. United Nations

A.4
US DOLLAR DEPOSIT ACCOUNTS FOR TRINIDAD AND TOBAGO (US$MN.)

YEAR	COMMERCIAL BANKS	NON-BANK FINANCIAL INSTITUTIONS	TOTAL
1993	152.5	-----	152.5
1994	312.9	11.89	324.79
1995	414.9	31.32	446.22
1996	496.2	47.48	543.68
1997	549.3	91.14	640.44
1998*	668.7	98.00	640.44

Source: Central Bank of Trinidad and Tobago - Monthly Statistical Digest, June1998.

- up to May

A.5
US DOLLAR DEPOSIT ACCOUNTS FOR JAMAICA (US$MN)

YEAR	COMMERCIAL BANKS	BUILDING SOCIETIES	MERCHANT BANKS	TOTAL
1991	59.9	23.5	0.04	83.5
1992	279.4	37.1	1.7	316.6
1993	428.4	65.6	4.6	497.3
1994	598.0	79.6	13.7	691.4
1995	666.3	102.6	14.7	783.6
1996	623.3	134.8	12.7	770.9
1997	808.4	178.2	34.1	1020.7

Source; Bank Of Jamaica - Statistical Digest (Various Issues)

A.6
DOMESTIC CURRENCY DEPOSITS AS A PERCENTAGE OF GDP - JAMAICA AND TRINIDAD AND TOBAGO

YEAR	JAMAICA			TRINIDAD AND TOBAGO		
	DEMAND DEPOSITS	SAVINGS DEPOSITS	TIME DEPOSITS	DEMAND DEPOSITS	SAVINGS DEPOSITS	TIME DEPOSITS
1992	8.9	17.9	6.0	-----	-----	-----
1993	9.2	18.2	6.4	7.1	13.8	14.7
1994	6.9	18.7	9.1	7.9	12.6	11.4
1995	8.1	8.1	9.3	7.8	13.0	9.6
1996	9.1	9.1	8.5	7.1	12.7	8.1
1997	7.3	7.3	7.5	7.8	13.5	7.6

Source: Bank of Jamaica - **Statistical Digest**, may 1998.
Central Bank of Trinidad and Tobago - **Monthly Statistical Digest**, June 1998. **Annual Economic Survey** (various issues).

A.7

FINANCIAL DEEPENING INDICATORS FOR JAMAICA - J$MN

YEAR	REAL GDP	BROAD MONEY	BROAD MONEY/GDP
1990	30476.7	7780.8	0.26
1991	44158.4	10599.4	0.24
1992	73253.4	17533.8	0.24
1993	99843.2	24520.1	0.25
1994	132377.2	36776.0	0.28
1995	170133.0	50389.9	0.30
1996	203109.0	55781.0	0.27
1997	220556.0	66980.8	0.30

Source : Bank of Jamaica - **Statistical Digest** (various issues).
where GDP represents real gross domestic product and broad money includes currency in circulation plus quasi money.

A.8
FINANCIAL DEEPENING INDICATORS FOR TRINIDAD AND TOBAGO - TT$MN.

YEAR	GDP	M2	M2*	M3	M3*	M2/GDP	M2*/GDP	M3/GDP	M3*/GDP
1990	21765.7	9225.9	-----	-----	-----	0.42	-----	-----	-----
1991	22434.3	9656.6	-----	-----	-----	0.43	-----	-----	-----
1992	23129.0	9017.7	-----	-----	-----	0.39	-----	-----	-----
1993	24490.5	9479.7	10355.0	-----	-----	0.39	0.42	-----	-----
1994	29311.7	10100.5	11917.7	12311.1	14198.0	0.34	0.41	0.42	0.48
1995	31568.1	10453.0	12647.1	13304.7	15645.3	0.33	0.40	0.42	0.50
1996	33997.2	10368.3	13336.0	12864.8	16105.8	0.30	0.39	0.38	0.47
1997	36399.4	11563.3	14914.9	14245.4	18095.5	0.32	0.41	0.39	0.50

Source: Central Bank of Trinidad and Tobago - **Quarterly Statistical Digest** (various issues).
where GDP represents real gross domestic product,
m2 - currency in active circulation plus demand, savings and time deposits of commercial banks
m2* - m2 plus resident foreign currency deposits of commercial banks
m3 - m2 plus time and savings deposits of licensed non-bank financial institutions
m3* - m3 plus foreign currency deposits of both commercial banks and non-bank financial institutions.

UNITED NATIONS
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