Derick Boyd & Ron Smith

_Monetary Policy, Central Banking and Economic Performance in the Caribbean._

Kingston: University of the West Indies Press, 2011. xi + 143 pp. (Paper US$40.00)

The year 2011 marked fifty years since the first Caribbean central bank opened its doors. While the language varied from country to country, these banks had four basic functions: maintenance of the internal and external value of the currency, economic development, financial stability, and capital market development (Blackman 1988). The anniversary provides an opportune time to assess the success of regional central banks in relation to these four objectives.

_Monetary Policy, Central Banking and Economic Performances in the Caribbean_ is divided into two main parts. Chapters 1–2, the substantive section, provide an assessment of the monetary features of the Caribbean in order to explore the link between monetary policy and economic performance. Chapters 3–8, the methodological section, describe the monetary policy transmission mechanism—how changes in monetary policy variables (e.g. interest rates) impact economic performance—through the use of empirical techniques.

One of the main pressures faced by these pioneers of central banking in the Caribbean was the trade-off between economic development and stability. In its early history the Bank of Jamaica, for example, fully backed its currency with foreign reserves, similar to its Currency Board predecessor. However, the approach was seen at the time as a “dereliction of duty to the domestic economy” (p. 23). This argument, combined with rise of Keynesian demand-side management thinking, placed significant pressure on some central banks in the region to provide deficit financing. Two groups of countries therefore emerged from this era: one with institutional arrangements that reinforced monetary stability (e.g., currency board and fixed exchange rate economies) and another that did not (floating exchange rate economies). Boyd and Smith took the stability of microstates with fixed exchange rates through the 1970s, 1980s and 1990s—without devaluation—as evidence of the value of this institutional approach. In addition to institutions, however, and perhaps more important, were the policy choices made by some of these fixed exchange rate economies. Peter Blair Henry and Conrad Miller (2009) note, for example, that in addition to exchange rate policy, the existence of growth-facilitating policies, fiscal discipline, openness to trade, and wage flexibility were important determinants of the superior performance of some of the fixed exchange rate countries in the region.

The second section estimates various models of the monetary transmission mechanism for a group of twelve Caribbean islands. Using an unrestricted
VAR ("vector autoregression"), Boyd and Smith report that monetary policy shocks have no significant impact on output and only a marginal effect on prices. These results largely agree with previous research in the area: income and prices in the Caribbean are largely driven by world income and prices, respectively. As explained in this book, many Caribbean islands are dependent on tourism, which to a large degree is driven by fluctuations in incomes of key source markets. In addition, the limited production base of many islands would imply that world prices quickly spill over to domestic prices through imports. Throughout the 1980s and 1990s, many Caribbean islands devalued their currencies with the hope that this would increase competitiveness and restore balance of payments equilibrium. The outcome, however, was not as expected. Many of the islands that engaged in this type of nominal exchange rate adjustment only experienced modest gains in their trade balance. Chapter 8 provides a partial answer as to why this occurred: the elasticity on the real exchange rate variable was statistically insignificant in most countries, which implies that devaluation would not bring about an improvement in the balance of trade. This finding is largely related to the types of goods exported by the region. By and large, the region’s main exports are services and commodities. In the case of tourism, a small change in the exchange rate is unlikely to bring about a significant rise in tourist arrivals, while the region is such a small player on the world market in relation to its commodity exports that the benefits of competitive devaluations are not easily seen. Given these characteristics, competitive devaluations—as shown by Boyd and Smith—are unlikely to work in the Caribbean context.

Monetary Policy, Central Banking and Economic Performances in the Caribbean provides a useful assessment of the efficacy of monetary policy in the Caribbean. For policymakers, the lack of a significant relationship between monetary policy and economic performance is an instructive result. It suggests that macroeconomic management would largely fall on the shoulders of fiscal authorities in the region. For those of us teaching courses in macroeconomics, the text provides a quite readable introduction to the history and difficulties of monetary policy in a small open economy. Overall, the book is a useful contribution to the field of monetary policy studies and could serve as the basis of future research in the area.

Winston Moore
Department of Economics, University of the West Indies
Cave Hill Campus, Bridgetown BB11000, Barbados
winston.moore@cavehill.uwi.edu
References
