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## The Practice of Central Banking in Barbados: An Interpretation of the First Fifteen Years

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*Courtney N. Blackman*

### Introduction

I am grateful for the opportunity to set down my interpretation of the first fifteen years of the existence of the Central Bank of Barbados (June 11, 1972 to March 31, 1987), during which I served as its Governor. Contemporary students of institution building will want to judge the extent to which the goals and aspirations of the founders were achieved; future scholars of Caribbean money and banking will certainly be curious about the thinking that informed the establishment and early practice of central banking in the region, and of the Central Bank of Barbados in particular. This is the audience whom I will be addressing in the following pages. Following this introduction, I discuss principles of central banking which governed my tenure at the Bank. In Sections 2 and 3, I review approaches to national economic policy making and financial development, respectively, during this period. In Section 4, regional issues, particularly the experience with the Caricom Multilateral Clearing Facility, are discussed. Section 5 examines my relationship with the politicians whom I served, and the need for greater independence of Central Banks in the Caribbean. I reflect on my interaction with fellow central bankers before summarizing in Section 7 the major principles of central banking and economic management which were confirmed by my central banking experience.

This exercise is essentially autobiographical and involves the frequent use of the first person. However, I am deeply conscious that little would have been achieved had Prime Ministers not given me room to operate and to grow, had the Directors not shared their experience and wisdom, and if managers and staff had not given their unstinting support.

## 1. Rationale of Central Banking

My first foray into central banking theory was quite conventional. In a graduate term paper circa 1966 I accepted the examples of the Bank of England and the United States Federal Reserve System as “true” central banks, and perceived the art of central banking in developing countries as essentially one of “working up to” the state of “true” central banks - mimicking is a harsher but probably more appropriate terminology. This is not far from the position of today's financial liberalizers, who want central banks in less developed countries to focus on open market operations and generally to use the same tools as the Federal Reserve System.

My term paper approach informed my Ph.D. draft proposal. Fortunately, I was able to discuss the problem with Dr. Clive Y. Thomas and Lloyd Best. They showed me the error of my ways, and indicated the need for me to develop a “normative” theory of central banking as a basis for assessing the performance of the Bank of Jamaica. A normative model would incorporate the generic elements of central banking and would apply to central banks everywhere, whereas my “true” model was really a special theory applicable only to central banks in developed conditions. I therefore sought to develop a general theory of central banks, whose operation would be modified by the circumstances of the particular country.

Liquidity, the ease with which assets can be transformed into cash, was identified as the primary concept in the theory of central banking. We may speak of the liquidity of an individual asset and, by extension, the liquidity of the portfolios of particular economic units, of the economy as a whole, or of a particular sector, including its external sector. In the latter instance, liquidity is indicated by the convertibility of domestic currency into foreign exchange, the level of foreign exchange reserves and the availability of foreign credit. It is the level of liquidity of his portfolio which enables its holder to purchase goods and services.

The economic role of the Central Bank is to regulate, in an optimal fashion, the overall level of liquidity in the economy, its distribution among various sectors, and between domestic and external sectors. Because of the Central Bank's ability to create money, its portfolio may be described as infinitely liquid. Through calculated purchases and/or sales of financial assets it can significantly

enhance or diminish the liquidity of individual economic units, economic sectors or of the economy as a whole.<sup>1</sup>

The challenge then in 1972 was one of devising central banking policies appropriate to Barbadian circumstances rather than those that merely mimicked the practices of the Bank of England and the Federal Reserve System. Such policies would take into account two main factors: first, Barbados' main goal of economic development, and secondly, the underdeveloped and oligopolistic financial market environment in which the Central Bank would have to operate. The goal of economic development required monetary policies which favoured savings and investment, necessarily at the expense of consumption; the imperfection of financial markets meant that the Central Bank could not rely solely, or even primarily, on the "free market" to allocate credit among the major economic players.

Whereas the central bank in a developed country can make small adjustments in interest rates or money supply growth and confidently expect the financial markets to bring about the desired allocation, central banks in developing countries may need to intervene directly to slow economic expansion. For example, the Bank on occasion raised legal down payments on durable good purchases and lowered the maturity on consumer loans in order to curb consumer imports. At the same time, the small number of financial institutions also allows the Governor to use "moral suasion" in Barbados whereas U.S. Chairman Greenspan, with his 12,000 banks, cannot. Empirical research on the local situation also led us to focus on commercial bank credit, rather than the traditional money supply, as the critical monetary control variable, and made us skeptical of a direct relationship between real savings and positive real interest rates.

We also needed to develop the appropriate organizational model of a central bank for implementing our normative theory of central banking. The objective was to establish a modern organization which performed at international operational and professional standards - including the quality of office accommodation! The institutional parameters of the new organization were set by the Central Bank Act, which closely followed the Bank of England model, and which provides for operational autonomy within the framework of overall government policy. We were therefore able to prevent politicization of the Bank's operations, especially in the key areas of staffing and publications. Except where required by law, appointments were not discussed with the Minister, nor were

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<sup>1</sup>For a more elaborate discussion see Blackman (1980).

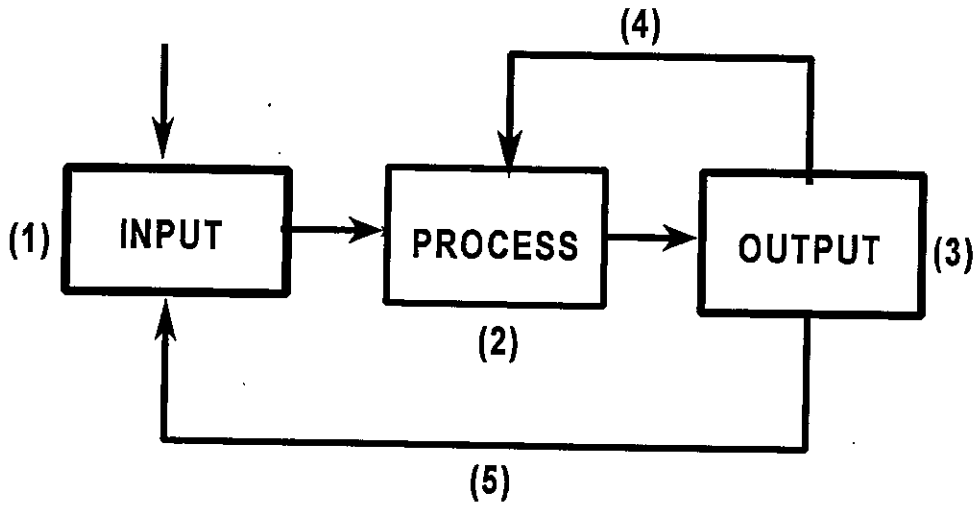
press releases, speeches and statistical publications submitted for ministerial vetting. This represented a major departure from the tradition of statutory corporations in Barbados. Although working closely with the Ministry of Finance, the Central Bank would develop a personality of its own and a *modus operandi* quite different from that of the Civil Service.

The functional aspects of the new organization were determined by the perception of the Central Bank as an information system. At my very first meeting with the Board of the Central Bank, and at numerous other meetings with my managers, I described a management model of the Bank - three horizontal rectangles joined by two lines. Figure 3.1 presents a more elaborate version of this model. The Bank, I explained, was an information system in which inputs of information from several sources were processed by the technical, professional and management skills of the staff into outputs of monetary policies and decisions, advice to Government, and the information and education of the general public. The managerial implications of this model are that the quality of the Bank's outputs depended on the Bank's research and analytical capabilities which, in turn, required continuous staff training and development. I stressed that the central bank was foremost an intellectual institution.

The public relations function also incorporates the economic education of the public. Through the Bank's annual and quarterly reports, regular Press briefings, speeches by the Governor, and Senior Economists, etc., the Barbadian public has been transformed into the Caribbean's most literate society in terms of economic affairs. It was undoubtedly the public understanding of the relationship between wages and the exchange rate which helped the Sandiford Administration to avert the devaluation of the Barbados dollar in the economic crisis of 1991-92. On leaving the Bank, I listed a well-trained staff as my proudest achievement; perhaps I could also have cited an electorate sophisticated in economics.

Four factors aided the task of building the new institution. First, we were starting from scratch, with a *tabula rasa* on which we could inscribe our new patterns. Secondly, we had a young staff open to new ideas - at 39 I was one of the oldest; thirdly, we were able to operate for over 13 years in a Union-free environment, thus escaping the rigidities of trade union constraints. We tried hard to prevent the Bank from degenerating into a bureaucracy, i.e. an organization more committed to the preservation of existing processes than with the achievement of the novel goals assigned to it. Finally, and most important, the political directorate was generally permissive.

Figure 3.1. Information Model of a Modern Central Bank



Legend:

- (1) Input: Information from Environment
- (2) Process: Intelligent People/Intelligent Machines - Memory, Analysis, Judgement
- (3) Output: Knowledge-based Services - Policy Decisions, Advice to Government, Services to Economic Units, Education of Public
- (4) Feedback: To permit monitoring and, if necessary, correction of results
- (5) Feedback: Information generated by output

Source: Adapted from Miller and Starr (1969).

The information model described above required maximum staff participation in the conduct of the Bank's operations. This was attempted through the medium of a Staff Association, which negotiated salaries and other conditions of employment with the Management. With salaries and working conditions superior to those in the Public Sector, industrial relations at the Bank were good to excellent for the first thirteen years. The Bank was especially generous in its training policies, and numerous staff members were assisted in obtaining Diplomas, Bachelor's and Master's degrees, and even Ph.D.s, without the conditionality of remaining in the Bank's service.

Staff relations were undermined by the economic conditions of the 1980s. First, job opportunities were not available for trained staff whose promotion was blocked in a no longer expanding Bank staff. Secondly, economic stagnation led inevitably to a clash between the Bank's policy stance on "wage restraint" and the salary demands of junior staff. They successfully sought representation by the Barbados Workers' Union who had tried unsuccessfully to represent the staff in 1974. Supervisory staff, who had accepted the Bank's offer, joined in an act of solidarity. Negotiations with the BWU, especially on the issue of categories to be represented, were less than cordial.

## **2. National Economic Policy Making**

A World Bank report (1991) conceded that "during the first 20 years of its independence (1966-86) Barbados' economy was managed with great skill and acumen." This, in spite of the fact that Barbadian economic policy seldom obeyed the orthodoxy of Washington's international financial institutions. We never devalued; we never pursued a high-interest rate policy for any extended period; and we did not hesitate to intervene directly in the financial markets when the situation demanded.

The Bank's participation in national economic policy-making formally began with the establishment of the Research Department in January 1973, but its full range of policy instruments did not become available until the issue of the new currency in December that year. It was, indeed, a baptism of fire. The year 1973 had seen a sharp rise in world commodity prices, and in January 1974 the OPEC countries tripled the price of oil, precipitating a world recession in 1975. The already high inflation rate of 23% for 1973 rose to 40% in 1974, while unemployment reached 22.5% at year-end 1975. Government and Central Bank officials reacted pragmatically to these disruptive and unprecedented events, and by the mid-1970s the outline of a national macroeconomic policy began to appear.

The main thrust of macroeconomic policy was to maximize our surplus on current account and to finance capital expenditures whenever possible from soft institutional loans. Second, devaluation was ruled out as a proactive policy instrument; third, the imperative of high and positive real interest rates was rejected; fourth, the practice of automatic wage indexation was resisted. It was from this time that I began my insistent calls for wage restraint - but more about this later! Record foreign exchange earnings of US\$55 million for the 1975 sugar crop eventually saved the day, and with the recovery of the international economy in 1976, the Barbadian economy experienced its five most prosperous years since the 17th century.

By the mid-1970s a distinctive methodology of economic policy-making had also emerged. The assembly and analysis of economic data was the accepted responsibility of the Research Department of the Central Bank. Macroeconomic policy recommendations emerged from deliberations of the Bank's Board of Directors, on which the Director of Finance and Planning sat, and were sent up to the Prime Minister/Minister of Finance.

Although the Central Bank maintained some distance from the Ministry of Finance, I can recall no bureaucratic turf battles between them, as technicians from both institutions cooperated in a routine fashion. In the Tom Adams Administration, meetings of the Prime Minister, the Director of Finance and Planning, Mr. Steve Emtage and the Governor developed into a kind of Finance Executive Committee, with senior technicians in attendance as the situation demanded. The term "cordial but frank" accurately describes the relationship between the three of us. Prime Minister Owen Arthur, in a recent conversation, referred to that period as the "Augustan Era" of our national economic management.

By the end of the 1970s international financial officials had coined the term "The Barbados Model," which was held up to other LDCs as an example to be emulated. The incoming DLP Administration effectively modified the methodology described above with the introduction of the 1986 Alternative Budget, which was developed outside that framework and in the face of serious reservations on the part of senior finance officials.

Barbados' commendable performance during this period was marred by three serious policy errors. The first was the excessive taxation of windfall sugar earnings in 1975. Because taxes were imposed on gross rather than on net incomes, some plantations made losses in a year when real sugar prices were at their highest in living memory. The industry was therefore unable to make good the deficits of the previous five years or so, and has struggled ever since.

The second serious policy error was the excessive spending on the eve of the 1981 elections, leading to a record deficit of BDS\$155 million. In its weakened fiscal condition, the economy was hardly well braced for the short but sharp recession of 1981-82, and struggled for the next four years. However, it can be said for Mr. Adams that once the problem was recognized, he made an early approach to the IMF, before his options were exhausted. In this way he avoided the surrender of economic sovereignty to the Fund.

The third and most serious policy error was the 1986 Alternative Budget, which copied the Reagan "Supply Side" initiative. The real damage came in 1987 when a massive fiscal deficit of BDS\$219 million, second only to the 1990-91 pre-election deficit of BDS\$248 million, threatened to destroy the balance of payments and to derail the economy. It required sharp policy reversals in 1988 to restore the situation.

The policy measure for which I am probably best remembered and was most criticized was that of "wage restraint." Early in my tenure of office, the trade-off between exchange rate stability and wage increases became quite obvious to me (Blackman (1991)). If we opted for a fixed parity with the US dollar, we would have to limit overall wage hikes to increases in national economic output. Failure to do so would lead inevitably to inflation, reduced employment, balance of payments collapse, and eventually to an IMF imposed currency devaluation when our foreign exchange reserves and international credit dried up. Indeed, devaluation was only narrowly avoided in 1992 by Prime Minister Sandiford's deal with the IMF to cut public service salaries by 8%. The Contract drawn up in 1993 between the Social Partners - Government, Business and Labour - to restrain wage increases, was for me a bitter-sweet vindication of policy recommendations I had made 20 years earlier, and which one trade unionist had described as "untimely, unwarranted and malicious."

### 3. Financial Markets

The first challenge of the new Central Bank was to establish its primacy in the area of money and banking without inviting confrontation with the financial community, which was initially quite skeptical of the new institution. However, it could hardly be expected that the foreign banks, which had ruled the economic roost for so long, would surrender without demur. They balked at the Bank's regulation of commissions on the sale of foreign exchange, and they were reluctant at first to open the "confidential affairs" of their clients to the Bank's Supervisors; but they soon fell into line. The Bank seldom invoked the provisions of the



Central Bank Act but depended primarily on "moral suasion" to secure the cooperation of commercial banks.

In contrast to the trend in the rest of Caricom towards nationalization or indigenization of banks (Mr. Forbes Burnham, late President of Guyana, called it "miniaturization of the foreign financial sector"), neither the Barrow nor the Adams Administration put any pressure on foreign commercial banks to change their status. The four American banks<sup>2</sup> which pulled up stakes did so for their own corporate reasons. I heartily supported this policy of the Government, viewing the relationship between the Bank and the foreign commercial banks as a positive-sum (win-win) game rather than a zero-sum game. They were to be regarded as constituents of the Central Bank, which had a duty to safeguard their interests when these were not in conflict with the national welfare. In particular, I valued their ready access to outside sources of precious foreign exchange. This policy was vindicated in December 1983 when the foreign commercial banks agreed to introduce US\$14 million from their head offices to avert failure of one notorious IMF "Test". The continued presence of foreign commercial banks has been an important asset in Barbados' drive to establish itself as a world-class off-shore financial centre.

This benign policy towards foreign commercial banks did not imply hostility towards indigenous banks. Two local initiatives to set up local banks came to my attention and obtained my support; neither came to fruition. Eventually, the Barbados National Bank (BNB) would become the first indigenous commercial bank. The financial success of the BNB was greatly compromised by its unfortunate yoking with the former Sugar Industry Agricultural Bank. I opposed the marriage of a commercial bank with a not-for-profit development institution - without success. Nevertheless, the Central Bank placed its technical and training facilities at the full disposal of the new institution. Moreover, both former IMF Director, Paul-Pierre Schweitzer and the late G. Arthur Brown, former Governor of the Bank of Jamaica, had also warned me that indigenous banks would prove more difficult to regulate than foreign banks. This warning proved to be prophetic.

The administration of Exchange Control was another area of challenge for the Central Bank. Here again, our policies ran counter to the draconian measures invoked by Guyana, Jamaica and later, though to a lesser extent, by Trinidad and Tobago. Our strategy was to administer exchange control regulations with the lightest hand possible. There were to be no time-consuming declarations of

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<sup>2</sup>Bank of America, Chase Manhattan, Citibank and First National Bank of Chicago.

foreign exchange holdings and no humiliating body searches of passengers at the airport, unless firm grounds for suspicion of crime existed. I strongly advised against prosecutions for foreign exchange infraction. Whenever the balance of payments permitted we increased travel allowances and, above all, we processed exchange control applications with maximum sympathy and despatch.

The purpose of exchange control was to monitor payment flows and gather qualitative information about such flows. Outflows of foreign exchange were to be restricted, not at the water's edge, but at the fountainhead - through the tightening of monetary and fiscal policy. The public can only buy foreign exchange if they possess domestic cash or credit. The intent of this relaxed approach was to reassure the general public that their legitimate requirements of foreign exchange would be met. I warned the Exchange Control Department against challenging the public to a game of foreign exchange hide-and-seek: there were 250,000 of them working day and night and only 20 exchange control officers working forty hours per week! We simply could not win. This policy worked well.

The development of capital markets is the "in" thing these days among international financial institutions. As early as 1973 the Central Bank of Barbados commissioned an Organization of American States (OAS) Study on Capital Markets. Our first steps were to resuscitate the treasury bill market so as to provide reliable and economical funding of Government operations; we then promoted the government bond market by customizing maturities to the needs of Life Insurance Companies; we underwrote Barbados Development Bank Issues; we designed special National Savings Bonds for the general public; and we gave our fullest support to the establishment of the Securities Exchange of Barbados, our local stock exchange.

However, the Bank's most important contribution in the field of financial development was the establishment of Barbados as an Off-Shore Financial Centre, an innovative plank in the 1976 BLP Manifesto. I felt that it was important for the Bank to get in on the ground floor and guide the process along the right path. The Bank took the initiative in researching and selling the project to the public. The Adams Administration and the Central Bank agreed on two basic principles. First, the Offshore Financial Centre would not be host to nefarious activities. Secondly, it would not be simply a domicile of brassplate companies, but would offer substantial services to international clients. In time the Central Bank was able to persuade the banking, legal and accounting professions that they could benefit financially, and since then they have virtually carried the ball. Today the offshore financial business earns more foreign exchange for Barbados than does sugar.

#### 4. Regional Issues

The Central Bank of Barbados was the fourth to be established in the region, following the Bank of Jamaica in 1961, the Bank of Guyana in 1962, and the Central Bank of Trinidad and Tobago in 1963. Early in 1974 we joined the system of bilateral clearing agreements which already existed for the settlement of trade balances among regional authorities, including the Eastern Caribbean Currency Authority (ECCA)<sup>3</sup> from which we had seceded in 1973. The bilateral arrangements would later develop into the Caricom Multilateral Clearing Facility (CMCF). The collapse of the CMCF in 1983, when the Bank of Guyana defaulted, was a bitter blow for Caricom central bankers and the occasion for much criticism of Governors and uninformed academic analysis. The missing piece in the mosaic was an understanding of the strategic thinking of the Governors who shaped and administered the CMCF. Only two of us survive; it is time to tell the story before it is too late.

The purpose of bilateral clearing systems is to economize on the use of scarce foreign exchange in the settlement of intra-regional payments. Instead of settling each transaction immediately in cash, debit and credit payments are offset against each other over a period of time and settled on a monthly, quarterly or half-yearly basis. This reduces the level of "float" which participants in the agreement must hold and thus minimizes the opportunity cost of trading. Multilateral payments agreements can produce even greater savings. This meant that Caricom trading partners could finance larger volumes of trade with reduced outlays of foreign exchange. Indeed, CMCF operations led to the highest levels of intra-regional trade on record.

The CMCF began at a time of high promise for the future of CARICOM and the regional integration movement, to which the regional central bank Governors fully subscribed. Indeed, the late Victor Bruce, who chaired the CMCF throughout its active operation, was the region's leading exponent of regionalism, in practice if not in rhetoric. Accordingly, when Guyana and Jamaica began in the late 1970s to experience balance of payments problems, the Governors did all they could to alleviate their difficulties. First, they lengthened the period of settlement from monthly to quarterly; secondly, they introduced an element of credit so as to give some leeway to Central Banks which were short of foreign exchange.

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<sup>3</sup>The ECCA has now been transformed into a Central Bank called the Eastern Caribbean Central Bank (ECCB).

The truly innovative feature of the CMCF was the differential interest rates for debtors and creditors. If the former paid a rate of 6%, say 2% below LIBOR, the creditors received only 4%. The 2% differential was invested in a No. 2 Account with the Federal Reserve Bank of New York and allowed to accumulate. It was expected that these funds would eventually become the capital for a kind of regional IMF, with a Legal personality, which could then be levered through market loans to provide medium-term support for participants in balance of payments difficulties. Indeed, a similar "safety net" proposal had been earlier put forward by the Caricom Secretariat, but proved abortive.

Early models of the CMCF included limits on the extent of credit that participants would be called upon to bear. The Central Bank of Trinidad and Tobago, with its massive foreign holdings (a peak of US\$3 billion in 1983), accepted the highest credit limit, while the ECCA was granted the lowest. However, the expansion of exports from Trinidad and Tobago and Barbados soon exceeded the debt limits placed on Jamaica and Guyana. The Governors, in their eagerness to promote intra-regional trade and its concomitant job expansion, and anxious too to ease the corresponding pressure on the dwindling foreign exchange reserves of Guyana and Jamaica, raised the general limits of the Facility to US\$100 million, and removed the country credit limits altogether.

It was confidently expected that Trinidad's exports of manufactures, based as they were on cheap oil, would swamp the regional markets and that the Central Bank of Trinidad and Tobago would very soon become the chronic creditor to all other participants. To make this rule politically palatable for Trinidad and Tobago, the other participants agreed to the lifting of all country credit limits. Theoretically then, Barbados or Jamaica, as much as Trinidad and Tobago, could end up with US\$100 million credit to the Facility, but no one believed that this would happen, and US\$100 million was seen as a negligible percentage of the foreign reserve holdings of the Central Bank of Trinidad and Tobago.

As it turned out Barbadian exporters, especially of furniture and garments, overwhelmed the Trinidad and Tobago producers and began to build up heavy credits with the Facility. On the other hand, exports virtually dried up from Guyana, which had been a frequent creditor in the earlier bilateral agreements. But the mortal blow to the CMCF was struck when, in an attempt to shore up a tottering Guyanese balance of payments, it was agreed that oil payments from Guyana to Trinidad and Tobago might pass through the CMCF. These payments were so large as to put Central Bank of Trinidad and Tobago in credit with the CMCF, so that Barbados effectively shared with Central Bank of Trinidad and Tobago the burden of financing Guyana's oil imports. Meanwhile the Jamaicans

employed numerous devices to avoid imports from the rest of Caricom; ECCB was a modest creditor. The profile of CMCF credits and debits in the early 1980s came to look roughly like that depicted in Table 3.1. With Guyana both weak and unwilling to pay, Central Bank of Trinidad and Tobago able to pay but not in debt, and Barbados with reserves too limited to comfortably shoulder such a heavy credit burden, the CMCF participants reached an impasse.

One solution was to allow Barbadian oil imports from Trinidad to pass through the Facility, thus reducing the drain of the Central Bank of Barbados' reserves to pay for oil imports. At this point fate intervened with the death of Dr. Eric Williams. However inscrutable the great Trinidadian statesman, his commitment to Caribbean peoples was unquestioned. In spite of his open hostility to President Forbes Burnham's ideology and policies, he continued to extend substantial loans and grants to Guyana. Indeed, it was upon the rock of Dr. Williams' magnanimity that Victor Bruce's own commitment to CARICOM ultimately rested. The incoming Chambers Administration reversed gears, and severely limited Bruce's degrees of freedom. He simply could not get the National Oil Company to accept payment of Barbados' oil imports through the Facility. In Dr. Williams' day it would have taken a five minute phone call! Nor could he continue his policy of allowing Barbados to repay an earlier TT\$48 million foreign bond through the CMCF. The Barbadians were stuck.

**Table 3.1: Profile of Later CMCF Debits and Credits**

	Credits	Debits
Barbados	60	0
Trinidad and Tobago	35	0
Guyana	0	95
ECCB	5	0
Jamaica	0	5
	100	100

*Source: Central Bank of Barbados*

We had considered US\$30 million a realistic ceiling for Barbados' credit to the Facility and, as that figure was reached and exceeded, secession from the CMCF seemed the obvious tactic. On the eve of a crucial meeting of the Board of the CMCF, I informed Prime Minister Adams that I intended to threaten secession in order to extract concessions from my colleagues and that, were my bluff called, I would have to take that step. "You do not have that card in your hand, Courtney," he replied. Obviously, he considered the political cost of breaking up the CMCF to be unacceptable. In fact, the following day, Governor Bruce offered Barbados a "buy out" from the CMCF, but I had to let it pass. Some weeks later, when the Facility reached its legal US\$100 million limit, Barbados called for its suspension. In spite of numerous false starts, the CMCF operations were never resumed.

Various reasons were put forward for the demise of the CMCF. We should have insisted on prompt settlement. There should have been no element of credit. Prime Minister Adams was annoyed that the Governors had, in their administrative experiment, not sought political direction, and had thus "acted as if they were politicians". In fact, the extension of credits over time is a norm of international trade - all the more so among nations professedly moving towards a common market. And, as Lloyd Best recently consoled, "If you had sought political direction you would have done nothing!"

For me, the culprit was the remarkable indifference of the Guyanese Administration of the day. It did not have to settle the entire outstanding debt to the Facility. Payment of the interest, at well below commercial rates, would have been enough. All kinds of arrangements for debt deferral were offered following the suspension of the Facility at meetings where Guyanese officials showed not the slightest interest. Public trustees are expected to pass the test of reasonable prudence. The Central Bank Governors of CARICOM might be forgiven for expecting member governments to act in a reasonable manner. The Guyanese government of the day did not! The CMCF failed; but I like to think of it as a "gallant failure"

## **5. The Politics of Central Banking**

The defining attribute of the Central Bank is its power of money creation. This is also a potential, almost inevitable, source of conflict between the Minister of Finance and the Central Bank Governor. Excessive money creation is anathema to a responsible Central Bank Governor, while Ministers of Finance can always do with more money. This endemic conflict recedes in time of buoyant government revenues and re-emerges in times of deficit spending, especially on

the eve of general elections. A further ambiguity derives from the fact that Government is usually both the major borrower from the Central Bank and also its sole or dominant shareholder.

Manifestations of this endemic conflict run the gamut of total government domination of the Central Bank, as practised for so long in Africa and Latin America, and the independence of the Bundesbank, protected by both law and the memory of the horrific hyperinflations of 1923 and post World War II. Caribbean central banking practice is rooted in the British model, in which the Bank of England is operationally independent within the framework of Government policy, and differences are worked out away from the public gaze; impeccable decorum is observed at all times in the interest of public confidence. Because of its famous unanimity rule, the Eastern Caribbean Central Bank enjoys the greatest independence within Caricom; the Bank of Guyana has at times operated in almost total submission to the Ministry of Finance.

In the absence of clear-cut laws governing the relationship between Governor and Minister, personalities play an important part. As can be imagined, the Governor must walk a careful path. He serves at the will of the Minister, but is required to give him advice that is frequently unpalatable; and he must certainly resist resolutely if the Minister encroaches on the legal prerogatives of the Bank. My relationship with Mr. Barrow the first time around (1972-76) was the most comfortable of all. He had appointed me and had a stake in my success. Thirteen years my elder, he exhibited an avuncular air, attributing my short-comings to youth and inexperience.

The incoming Adams Administration must have been convinced of my disinterested politics, and the transition in 1976 from the Barrow to the Adams Administration was virtually seamless as far as the Central Bank was concerned. With Mr. Adams a mere 18 months older, I lost my alibi of youth but we quickly developed a cordial and effective working relationship which was never threatened by occasional differences of opinion. This spilled over into the St. John Administration. At all times I eschewed both the substance and the appearance of political partisanship. Mr. Adams once described the Bank as not only "apolitical" but "above politics." But the greatest tribute to the Bank's non-partisanship were the repeated referrals of Opposition members to the Bank's Annual Report as the "Economic Bible."

The public hostility of the returning Barrow Administration in 1986 was unfortunate in that it created the impression that the position of Governor was political, rather than technical. The boycott of the Opening of the new Central Bank Headquarters by Government Ministers was inexplicable. I have been greatly relieved by the civility displayed during the 1994 transition from the DLP

## 6. The Brotherhood of Central Bankers

On leaving my first dinner at the Bank of England, held in honour of visiting Central Bankers in June 1973, the Governor of the Central Bank of Mauritius took me aside and in a paternal fashion whispered, "You have joined a good club." In fact, I had been admitted into a brotherhood. The ideology which knits central bankers everywhere - not only Governors - is a fervent commitment to sound money. We all agree with John Maynard Keynes that the most certain method of destroying a society is the debasement of its currency. As we have witnessed so starkly in the region, once people lose their confidence in their currency the descent into political, social and economic morass is steep and difficult to reverse. Hence my astonishment at the exuberant partiality of the "Washington Consensus" for frequent and sharp currency devaluations, a prescription so certain in its deleterious effects upon the general well-being of a society.

The "Brotherhood" provided a rich and reliable source of technical support for the Bank, especially in the early years. The Bank of England and the Federal Reserve Bank of New York provided numerous training opportunities for senior and middle-level staff, as did the IMF, the central bankers' Central Bank. Bank staff also gained considerable experience through assignments at the Bank of Canada, the Federal Reserve Banks of Boston, St. Louis and Atlanta, the Federal Reserve Board in Washington, D.C., and as far afield as the Bank of Pakistan.

Naturally the connection was closest with the Caricom cell of the "Brotherhood". The experiences of the recently established Central Banks of Jamaica, Trinidad and Tobago and Guyana were obviously more relevant to a Caribbean start-up operation than those of the "Old Lady of Threadneedle Street" or other long-established Central Banks. They all willingly shared their experience with their young brother from Barbados. In particular, their distinguished Governors, G. Arthur Brown of Jamaica, Victor Bruce of Trinidad and Tobago, and Willie D'Andrade of Guyana proved superb role models. Already legendary figures in Caricom financial circles, they could have been forgiven had they patronized me; they never did. From the very first they treated me as a colleague and friend, for which I am extremely grateful. May they all rest in peace!

I was most consciously influenced by the first two. Brown was a world-class technocrat, who held his own easily with the world's brightest and best. Bruce was the ultimate administrator; blessed with a remarkable physique and presence, he projected his influence throughout the Third World and, indeed, throughout the international banking community. In particular, he taught me that in central banking "style is also substance." At the numerous conferences we



5. Fiscal discipline is the bedrock of balance of payments stability. Unsustainable fiscal deficits in highly open economies lead swiftly to balance of payments collapse.
6. The operation of monetary policy in the narrow and shallow financial markets of developing countries involves sharp movements in interest rates, with devastating side effects on the real economy. The brunt of economic adjustment must therefore be borne by fiscal policy, and monetary policy resorted to only *in extremis*.
7. Exchange rate instability is hazardous to sustainable economic growth, while the narrowness and shallowness of foreign currency markets in developing countries rules out a regime of floating exchange rates. Some technique of exchange rate stabilization must be utilized, such as the fixed rate regime adopted by the Barbadian authorities.
8. The decision to maintain a fixed exchange rate regime creates the imperative of an incomes policy to restrain aggregate demand, promote external competitiveness and maintain employment levels.
9. Economic policy-makers in developing countries should pay less attention to equilibrium interest and exchange rates and focus instead on the basic factors which directly affect output - education, law and order, infrastructure and governance.
10. High quality political leadership is the critical factor in economic development.

## 8. Conclusion

One way to judge the quality of the foundation laid during the Bank's first fifteen years is to examine the integrity of its superstructure in the 25<sup>th</sup> year. The findings are pleasing on several grounds:

1. The Bank has palpably performed its prime function of promoting the island's macroeconomic stability. The value of

attended in the Caribbean and throughout the world, I seldom left the shadow of these two great men during my early years in office.

I have also been the beneficiary of much brotherly attention from my former colleagues at the Central Bank of Barbados. Senior Bank officials shielded me in large degree from the fiercest blasts of incivility surrounding my departure, and assisted me in numerous ways in the pursuit of my private consultancy from 1987-1994.

## 7. Lessons of Experience

Listed below are not so much the lessons learned from the first fifteen years of the Bank's operation as the confirmation of propositions which could have been initially suggested by commonsense or deduced logically from realistic assumptions about the Barbadian economy, namely, that it is small and highly open, with imperfect financial markets. There are ten major principles of central banking and national policy-making confirmed by the experience of the Central Bank's operations during its first fifteen years:

1. Operational autonomy is the *sine qua non* of effective corporate organization - especially in the case of central banks.
2. Central banking is an intellectual, not a political, exercise.
3. The primary concern of national economic managers should be to preserve control over domestic policymaking. They will succeed only when implementing policies which they themselves have formulated, and in which they are confident. Conditionalities imposed by International Financial Institutions (IFIs) have seldom succeeded since their economic models are based on assumptions which are unrelated to the realities of developing countries.
4. The maintenance of a viable balance of payments position is the foundation of economic policymaking in small, open developing countries. Balance of payments collapse will result in unsustainable foreign debts and, even worse, submission to the conditionalities of IFIs.

the Barbados dollar, pegged to the US dollar in July 1975 at a parity of BDS\$2.00 = US\$1.00, remains unchanged. Throughout this period the inflation rate has seldom moved beyond the single digit range: and, except for a few months in 1991-92, the Bank has been in a position to meet legitimate public demands for foreign exchange. Indeed, the Bank's foreign exchange position throughout 1996 was at its strongest ever.

2. The Bank's operations have been a model of efficiency and customer satisfaction. Its quarterly and annual reports have been produced in a timely manner, and its finances conducted without any suspicion of malfeasance.
3. The Bank has been a leader in monetary and economic research in the region, with its economists frequently outperforming their academic counterparts in the publication of papers in learned journals. Its economic analyses continue to provide the basis of decision-making for both DLP and BLP Administrations, and its senior economists and technical staff are regularly called upon to carry out consulting assignments for regional and multilateral institutions.
4. The acid test of any organization, however apparently successful, is how its employees fare. Too many organizations, both public and private, throughout the region and even in Barbados, have become graveyards for the careers of promising men and women. In stark contrast, the Bank has served as a platform for the launching of distinguished careers both within and without the Bank.

To sum up, the Central Bank of Barbados has taken its place, by reason of its record, among the world's leading central banks. It enjoys and deserves the confidence of the Barbadian public, as it continues to operate "above politics."

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