Preface

The inherent vulnerability of small states affects the implementation of monetary and fiscal policies in these countries. This inherent vulnerability stems from their high dependence on a narrow range of exports and on strategic imports such as food and fuel. These features render small states disproportionately exposed to external economic shocks. Other characteristics which pose disadvantages for small states include their limited ability to exploit economies of scale, and their limited opportunities for diversification. These features have constrained policy implementation and success in small states and increased the importance and influence of external reserves, external financing, foreign investment and the international economic climate on domestic policy.

This study examines the implementation of monetary and fiscal policies in twelve Commonwealth Caribbean small states, and the impact of this on growth and development in these countries. The study also identifies the monetary and fiscal policy options most suited to these countries. For small developing states with little ability to identify new financial resources in periods of stress and during episodes of exogenously-induced crisis, monetary and fiscal policies remain among the few policy levers available to policy-makers. Their choices are crucial for these countries in successfully warding off and more typically mitigating the impacts of crisis. Getting these choices right depends on policy circumstance, institutional constraints, the range of additional policy levers available to governments and some good fortune. This volume carefully sets out both the policy and institutional constraints in monetary and fiscal policy management for an important set of Commonwealth Caribbean small states, and provides a rich illustration of policy implementation in practice in some of these states. It also provides an excellent summation of both the transmission mechanisms and the degree of success in implementation of monetary policy in these countries. The volume will fill an important gap in understanding monetary and fiscal policy instruments, policies and choices in small states.

The study surveys the monetary frameworks practised by Caribbean Community (CARICOM) member countries with a view to examining whether stabilisation and real side performances were related to the style of monetary policy practised by the respective central banks. This is particularly important given that member countries are heterogeneous in the monetary policy frameworks practised, which is typified by variation in the exchange rate regimes. It is found that the exchange rate anchor has been useful in maintaining low inflation. However, there was a tendency for the exchange rate in these countries to become overvalued as economic activity picked up as evidenced by increased lending. This led to two principal problems: it led to deterioration in the balance of payments, and economic agents were forced to absorb increased economic costs. On the other hand, those territories which moved off the fixed exchange rate were presented with their own challenges. Once not backed by adequate earning of foreign exchange, the exchange rate tended to depreciate continuously, leading to socioeconomic challenges. This was exacerbated by the downgrading of credit ratings, leading to further instability in the foreign exchange market. Regional markets therefore face the question of whether to continue with a fixed exchange anchor and attain stabilisation at the risk of losing market competitiveness in the long run, or whether to give up the exchange rate anchor and improve competitiveness while accommodating instability in the short run, the length of which is undefined. This volume's findings suggest that monetary theory is still unable to deal with the balance of payment constraints of small open economies, particularly where countries possess inadequate foreign exchange reserves.

Natural disasters are a major source of vulnerability in the Caribbean. These hazards take a heavy toll, causing casualties and damages to the environment and the whole economic system. So, it is necessary to examine if and how fiscal policy contributes to the resilience of the economy in this region. The study assesses the importance of fiscal stabilisation using an econometric approach. Although many fiscal reforms were implemented in the 2000s, the 2008 crisis placed emphasis on the fiscal leeway of small states to absorb economic shocks.