TRANSPARENCY IN FISCAL AND MONETARY POLICY IN TRINIDAD AND TOBAGO

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But soon or late, it is ideas not vested interests which are dangerous for good or evil - Keynes

Introduction

Towards the end of his path-breaking book *The General Theory of Employment, Interest and Money*, Maynard Keynes noted that

...the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defiant economist. Madmen in authority, who hear voices in the air, are distilling their frenzy, from some academic scribbler of a few years back.

These sentiments were not only exceedingly prophetic in respect of the *General Theory* but also foreshadowed the way in which ideas, concepts and paradigms would interact between the academic world and policy makers over the second-half of the twentieth century. Historians of economic thought and philosophy recognize the importance of ideas and schools of thought and how these perspectives are generally translated into economic policy making. In the industrialized economies, the ease with which economists have moved between academia and public policy formulation has led to a proliferation of several different approaches to policy making. It is against such a background that issues of governance and transparency have dominated the economic policy literature in the 1990's. This paper explores the various meanings of 'governance' since the critical 1992 study by the World Bank and takes a closer look at one of the four pillars ascribed to governance by the international financial institutions. In

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In this regard, the paper examines governance in respect of the codes of conduct which have been drawn up to support monetary and financial issues. The paper closes with an initial assessment of adherence to these Codes of Conduct in Trinidad and Tobago.

**Definitional Issues**

Most analysts are in general agreement that recent ideas on “good government” and “governance issues” emerged on the international policy arena at the beginning of the last decade with two critical documents published by the World Bank.¹ This author’s first acquaintance with current governance issues was in 1992 with a conference paper which explored specifically the relationship between statistics and governance.² In early definitions, governance is described as “the manner in which power is exercised in the management of a country’s economic and social resources to improve the welfare of its people” (see Ward 1992). In this regard, governance is related to “good order” and the existence of institutions and rules which are laid down, known in advance, and actually applied according to procedure. These discussions on the context and meaning of governance later shifted into two basic camps—the World Bank’s concerns and the concerns of international aid donors.

In the initial discussion, the World Bank identified four key dimensions of governance—accountability, public sector management, the legal framework for development and information and transparency. Some early critics of good governance issues had argued that the concept was rather loosely defined, while more recent critics describe governance as ‘elastic’ and ‘plastic’ (see Moore 1993 and Kapur 1997). Nonetheless, over this period, the Bank focussed on procedural issues—how is authority exercised in managing economic and social resources in an economy; can the relevant government design and implement macroeconomic policies effectively; what is the nature of the political regime under which ‘good government’ will operate fairly well. At the other side of the spectrum the donor agencies recognized that governance was linked to “economic development and were becoming unwilling to support systems that were inefficient and unresponsive to the basic needs of people.” Indeed, the OECD Report on Good Governance provided convincing evidence to indicate that bilateral donors were concerned with issues of human rights, democracy and, in particular, participatory democracy, strengthening civil society and the promotion of human rights.

If early discussions of governance issues may have made some distinction between institutional reform and measures designed to democratize society, these two strands of thought are clearly intertwined by 1997 when Michel Camdessus, Managing Director, International Monetary Fund (IMF), in addressing the UN Economic and Social Council, stated:

…good governance is important for countries in all stages of development….our approach is to concentrate on those aspects of good governance that are most closely related to our surveillance over macro economic policies—namely the transparency of government accounts, the effectiveness of public resource management, and the stability and transparency of the economic and regulatory environment for private sector activity.
Unlike the World Bank, the IMF had adopted initially a rather pragmatic approach to governance issues, although its earliest pronouncements were usually concerned with the size of military expenditures in borrowing member countries. By September 1996, however, the Interim Committee of the IMF, in its declaration, *Partnership for Sustainable Global Growth*, had identified:

...promoting good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption...

as an essential element of a framework within which economies can prosper. Following this declaration, the Executive Board of the IMF met over a period of time to develop guidelines for governance issues, and by July 1997 had approved a Guidance Note on governance. In particular the note stressed that the IMF could contribute to good governance through its policy advice and technical assistance in two main areas – improving the management of public resources through reform of public sector institutions and supporting the development and maintenance of a transparent and stable economic and regulatory environment conducive to private sector activities.

Today the IMF distinguishes four pillars of governance as follows: political accountability, participation and ownership, effective rule of law and transparency and information flows. A close examination of these pillars and the discussion above shows the convergence of views between the World Bank and the IMF. Individual member constituents are urged to adopt these four pillars as they are critical to the success of sound macro-economic management. Some questions may well be raised in respect of the link between good governance and macro-economic outcomes, and empirical evidence on this matter is still inconclusive. Several critics argue that these dimensions of governance, and particularly the political dimension, are well beyond the scope of the IMF and, indeed, the World Bank's authority. Perhaps in recognition of this fact, the Executive Board of the IMF insists that IMF staff should address governance issues on the basis of economic considerations so that in the longer term the resources of the Fund may be more properly safeguarded. Although the other pillars of governance are interesting, the main focus of this paper, however, is the fourth pillar, the issue of transparency and information flows.

Transparency issues are generally considered as the appropriate collection and release of data about policies and performance of governmental institutions. Most economists recognize that information which is readily available to decision makers in both the public and private sectors is key to the development process and effective economic behaviour. Indeed, in very many economic models, the assumption of 'perfect information' is important for the derivation of highly stylized results. As many countries pursue more market oriented policies, information flows are seen as critical to market efficiency and good outcomes. In support of these objectives, the IMF has introduced two important Codes of Conduct for its staff to use in their interactions with member countries. These are the Code with respect to *Fiscal Transparency* and the *Code of Good Practices in Transparency in Monetary and Financial Policy*. The first Code came into being in 1998 and the second around July 2000. These codes of conduct
are two elements of a wider array of standards - international standards which have been endorsed by the international financial institutions. However, if the current model of governance and transparency issues had its genesis in the 1989 World Bank Report, the development of standards had its impetus in the Mexican crisis of 1994 and accelerated with the onset of the Asian and Russian crises over the 1997/1998 period.

As indicated in Forde (1996), the focus of attention on the response of the international financial community to the Mexican crisis which erupted in December 1994 was on the US$17.8 billion financial package provided by the IMF. Less attention was placed on the position taken by the IMF that the crisis could have been averted if the surveillance function had been more effective. The IMF argued that one key element in strengthening the surveillance function is the establishment of data dissemination standards, both special as well as general, the so called SDDS and GDDS. Following the Asian crisis, a major theme for discussion at international financial fora was the need to strengthen the architecture of the international monetary system; this would include, among other features, the establishment of internationally accepted standards and norms to raise the transparency of economic policy, greater transparency and reporting by public and private sector entities, and more involvement by the private sector in preventing and resolving crises. These positions were clearly articulated in background documents and communiqués emanating from annual meetings of the IMF, World Bank and even the BIS.

The international financial community recognizes that the world’s financial architecture needs to be strengthened. The contagion effects of the several crises in Mexico (1994), Asia (1997), Russia (1998) and Brazil (1999) together with perceived weaknesses in both payments systems and financial systems, for example, created a headlong rush to impose discipline and international standards on member countries of the IMF and the World Bank. If these standards are known and adhered to, then well functioning markets will impose the appropriate discipline for those in breach. Some critics have argued, however, that the supply of ready made codes and standards could impede the development of domestic legal standard (see Pistor 2000). The argument continues that these standards developed at the supranational level tend to be distilled from legal practices in individual countries without any tests in a legally functioning system. In addition, their adoption reduces the choice of lawmakers for developing their own legal solutions to better fit their own institutions or the unique problems faced.

Pistor (2000) distinguishes between harmonization of laws and regulatory competition or decentralized law-making, and believes that in the latter case laws are usually produced whose relevance is understood domestically. This implies that any innovation and adaptation which takes place is endogenous and is not determined by specific external events. The author concludes that this search for a common denominator often disguises the influence of a particular national legal order. In many instances, this national legal order may represent standards from the industrialized economies and, in particular, US, UK standards. Indeed, it is important to note that many of the industrialized countries whose standards are seen as ‘fit and proper’ became developed and moved ahead before these codes of conduct are now considered
as best practice. Although Pistor's comments were primarily in respect of standards in accounting, auditing, securities regulation and insurance regulation, they have equal validity in the area of monetary and fiscal policy. The next section provides a brief description of the standards set out for good practices in relation to fiscal and monetary policy.

**Codes of Conduct:**

**Fiscal and Monetary Policy**

As indicated in the previous section, good governance as articulated by the IMF is characterised by four pillars: transparency, accountability, efficiency and fairness. In this paper the discussion relates primarily to the first pillar and focuses on transparency as outlined in the Codes of Good Practices in Fiscal and Monetary Policy. The Code of Good Practices on Fiscal Transparency was adopted by the Interim Committee of the Board of Governors of the IMF in April 1998 while the Code of Good Practices on Transparency in Monetary and Financial Policies was adopted by the Interim Committee in September 1999 and approved by the Executive Board on July 24, 2000.4

A close examination of the two codes reveals that the four defining principles of each code are common to each other. These principles are: clarity of roles and responsibilities, the public availability of information, an open process for formulating and reporting of policy decisions and, finally, independent assurance of integrity. What do these principles translate into in respect of fiscal transparency? First and foremost, the Code of Fiscal Transparency posits that boundary management between fiscal, monetary and public sector activities should be well defined and widely understood. The activities of the different levels of government and entities of government should be clearly spelt out with an outline of the appropriate legal and administrative setting. Secondly, transparency must be paramount when the public is provided with full disclosure on current, future and past information on fiscal activities by governments. The Code stresses the importance of making public quasi-fiscal activities assigned to or undertaken by agencies outside of general government. In particular, the availability of accurate, relevant and timely information is seen as of paramount importance. The third area of fiscal transparency is that of openness in budget preparation, execution and reporting of information. In the local context, for instance, this would translate into the Minister of Finance making public all the assumptions on which he/she based his annual budget, for example, not only the assumptions about the average price of crude oil but production assumptions and the relationship between oil taxes and government revenues. In addition, the Code stresses the need for harmonization of domestic and international and accounting standards in budgetary reporting. This also implies that one can then compare budgetary statistics over many different jurisdictions. The fourth general principle emphasizes the importance of independent assurances of integrity through external audit of public sector accounts, e.g., the annual audit by the Auditor General.

These same four general principles are also applicable to the Code of Good Practices on Transparency in Monetary and Financial Policies (MFP). While this second code covers both central banks and other financial agencies, the discussion below relates solely to monetary policy which falls under the aegis of the Central Bank.5 The first principle of the MFP Code states that the ultimate
objective and framework of monetary policy should be outlined in law or regulation, while the relationships between fiscal and monetary operations should be clearly defined. When considered in conjunction with the Fiscal Code, transparency requires a distinct delineation of roles and objectives of both fiscal and monetary authorities. Thus, for example, if the central bank performs any agency functions for the government, these roles should be made known in an open manner. The second principle of the MFP Code suggests that the framework, instruments, and targets which are utilized in the pursuit of monetary policy should be well articulated. It is also desirable that where possible the meeting schedules of all permanent policy-making bodies should be publicly disclosed, and whenever there are changes in policy, these changes must be announced and explained in a timely manner. In this regard, when the Central Bank changes the cash reserve requirement of the commercial banks, this notice is gazetted and a press release provided for wider public consumption. The public information available in respect of the recent change (May 2001) in the reserve ratio for licensed commercial banks was consistent with this requirement. The third element of the Code recognises the importance of public availability of information on the Central Bank’s balance sheet, as well as aggregate information on financial support to any agency. If the Central Bank provides support to a licensed financial institution, and disclosure of this support is not disruptive to the overall stability of the financial system, then this information should be made public. Finally, the Code points out that there should be regular publication of annual audited statements as well as standards for the conduct of officials and staff of the Central Bank.

Proponents of both the Fiscal and MFP Codes argue that openness in policymaking keeps financial and other markets well informed; these markets can be then expected to impose discipline on those countries which are not more accountable and whose policies are not credible. Indeed, some supporters of the Codes suggest that implementation should be a condition of IMF and World Bank support. At the heart of such discussions is the role of market forces in economic activity. Lower transactions costs allow markets to operate efficiently and one important component of transactions costs is information; the view is generally held that ‘perfect knowledge’ leads to openness in policy making and helps to lower these transactions costs.

However, even if one were to downplay the role of market forces, there are still elements of both Codes which policymakers may do well to implement in Trinidad and Tobago. The Fiscal Code highlighted the need to identify and make public quasi-fiscal activities undertaken by state agencies. In several jurisdictions, these quasi-fiscal activities have been a burden for some central banks and led to losses for those institutions which engaged in them, and there are many examples to be found in the TT context. In a greater majority of instances, the activities are well known and appropriately costed but in others not much information is publicly available. For example, the costs of any commercial bank crisis in Trinidad and Tobago will be handled by the Deposit Insurance Company (DIC) which was established in 1986 with a clear mandate. Prior to the establishment of the DIC, the costs of the NFI crisis were borne in the main by the state, although liquidity support was also partly supplied by the commercial banks via the
central bank; one may wish to contrast this approach with that taken by the government of Jamaica in respect of the recent financial system problems and the operations of FINSAC. Another example of quasi-fiscal activity is the operation of the dual exchange rate regime in Trinidad and Tobago in the 1985-1987 period. It may not be well understood that with a dual exchange rate regime, the public sector provides a subsidy to the private sector. Some analysts may argue that this subsidy may well be needed in the pursuit of a much wider social benefit; however, the costs of these subsidies were never publicly quantified.

More recently, information on the operations of the Downtown Merchants Association (DOMA) facility has become publicly available. Following the destruction of some buildings in central Port of Spain in 1990, the government agreed to provide a subsidy on the interest payable by those businesses on loans used to rebuild downtown Port of Spain. Under this arrangement, the Central Bank makes the subsidy payments to the financial institutions for the account of the relevant business firm and is reimbursed by the government. Some 10 years later, the Central Bank had paid $74.2 million in subsidies while $38 million had been reimbursed by the government. Such detailed information on the operations of DOMA is available for the first time in the Bank's Annual Report 2000.

In the area of monetary policy, good governance and transparency requires that the goals of monetary policy should be explicit, e.g., in the pre-1993 period, monetary policy was designed to support a particular balance of payments position and a fixed exchange rate regime. In the post-1993 period, policy makers have had some difficulty in articulating that the ultimate goal of monetary policy remains the maintenance of internal and external price stability. The difficulties arise from the dominance of intermediate targets (e.g., the nominal exchange rate) in the policy mix, as well as a perceived sensitivity in discussing exchange rate behaviour and external price stability. This results sometimes in the over-reliance on highly technical jargon in official documentation and less transparency.

But while there are merits to the acceptance of these Codes of Conduct, there are a number of downside risks associated with these standards. Firstly, there are costs involved in the pursuit of transparency - these costs include operational costs and technical costs to maintain highly trained and qualified staff to analyse and generate the necessary information. Beyond the financial costs, however, are the costs of changing to a particular culture and tradition. Kopits and Craig (1998) argue that policy makers need to shed the prevailing culture of secrecy. In small societies however where central banks are key institutions in domestic policy-making and may be the only single institution which prepares forecasts, there may be technical problems in releasing that single forecast. Similarly, there must be some degree of maturity in the wider society to accept independent testimony from the Governor of the Central Bank before Parliament, and especially if that testimony is critical of fiscal policy.

Another cost associated with the adoption of these codes is the possibility of a new type of conditionality. As indicated earlier, some G-7 Members believe that any access to IMF/IBRD resources must include acceptance of these codes which would imply a broadening of the current conditionalities.
associated with, e.g., IMF supported adjustment programmes. The stark reality may turn out to be that a country challenged by fiscal and external disequilibria may now be faced with sector reforms and governance issues (e.g., accountability and transparency) well beyond the initial cause of the disequilibrium. It is not clear that all the consequences of such actions have been well thought out. On a more encouraging note, however, the new Managing Director of the IMF, Mr. Horst Kohler, initiated a review of the scope of conditionalities in Fund-supported programmes, and the Board of the IMF has taken a decision to implement a move from broader to more selective applications of conditionalities. This approach, it is felt, would make conditionalities better focussed and less intrusive.

Nonetheless, those critics, Mohammed (1997) for example, who point to the problems involved in efforts to achieve greater transparency, insist that governance and transparency issues are generally outside of the core competencies of the multilateral lending institutions as well as their legal mandate. Indeed, Mohammed and Woods (1998), for example, may well be on the right track when they question whether governance issues should not be applied to these institutions themselves in respect of the policy advice they give.

Concluding Comments

This paper explored recent views on the concept of governance and traced the link between governance and a generalised move to international standards in fiscal and monetary policy. In particular, the paper outlined the characteristics of the Codes of Good Practices in Fiscal and Monetary Policy, and commented in broad terms on Trinidad and Tobago’s adherence to these Codes. All member countries of the IMF have subscribed in principle to them; however, actual implementation of these ‘Good Practices’ may well hinge on whether these countries need to access resources from the international financial institutions. While these standards possess many positive elements, care must be taken to ensure that in moving towards this so-called common denominator, the influences of particular national legal orders do not dominate the local jurisdiction.
End Notes


3. These other standards include international standards on banking supervision, securities market regulation, insurance regulation, accounting, auditing, bankruptcy, corporate governance and payments and settlement systems.

4. Acceptance of these Codes by the highest policy making body of the IMF implies acceptance by all member countries of the IMF.

5. The remaining sections of the Code of Good Practices on Transparency in Monetary and Financial Policies relate to other supervisory authorities for institutions (insurance and securities firms) and markets (securities, derivatives, commodity futures).

References


