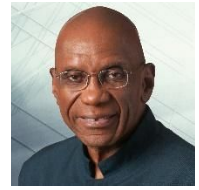

Economic Letter November 2019

Investment, Inequality and Coordination Between Governments and Central Banks

The International Banking Seminar held on October 20, following the conclusion of the Annual Meetings of the IMF and World Bank, was an occasion to reflect on the main concerns of the international financial community. Three issues stood out in the presentations at the seminar: the lack of adequate investment globally, particularly in infrastructure and projects to reverse the worsening health of the environment; the absence of policies to address global inequalities, despite much hand-wringing; and the need to coordinate the policies of Governments and their central banks.

Financial markets are flooded with money, but there is little investment in infrastructure and improving the environment

The trade disruptions caused by the aggressive tariff policies of the US administration, and low and negative interest rates were cited as the main reasons for the lack of interest by private finance in investment projects. The backlash against globalisation, most clearly manifested in the Brexit referendum, has worsened the general sense of uncertainty. Anyone investing in a hotel in Barbados or an ethanol plant in Trinidad will be expecting to attract an adequate rate of return on their investment. The imposition of new tariffs, fluctuations in the rate of exchange, setting up of new borders and erratic movements in commodity prices, all raise question marks about the demand for products and services, and the prices at which they may be sold. In these circumstances the typical investor will hold off investment until prospects become clearer.

The presenters at the International Banking Seminar had recommendations for boosting investment, though all agreed that a return to common sense on international trade policy was the most important factor in reducing investment uncertainties. Sadly, there is no immediate prospect of that. One recommendation was for strong tax incentives, subsidies and other inducements for investment in infrastructure and projects to improve the environment. As it stands, costs of production do not include the costs of environmental degradation, and harmful substances like plastics are cheaper than the alternatives. Companies cannot afford the costs of cleaning up their processes, and people cannot afford environmentally friendly products. Tax rebates, subsidies and other incentives are required, until environmentally-friendly products and services become the affordable norm.

A second recommendation for boosting green investment is that Governments must take the lead in making investments directly for infrastructure and to better the environment. Government investment is essential, because many environmentally necessary investments and much infrastructure, do not provide a commercial rate of return, or they are too expensive if produced by private firms. In this connection, it was suggested that governments reconsider debt limits to release funds for infrastructure and environmentally friendly investment.

Policies to reduce inequality

One recommendation for giving low income groups better access to credit was for more intensive and widespread promotion of cooperatives. In my view, credit unions, which are financial cooperatives, are the future of personal banking. The typical worker, who in the 1950s and 1960s would have deposited their savings with the Barbados Savings Bank, nowadays is more likely to save with a credit union. As their name implies, credit unions offer access to credit in appropriate ways and on affordable terms. There is an international network of credit unions which provides support, and Caribbean countries maintain regulatory oversight of credit unions.

Speakers at the International Banking Seminar recognised that small and medium enterprises play a crucial role in offering employment and opportunity. Government initiatives to provide premises, finance and other support for SME's can help to lower inequality by providing opportunities for social mobility. Perhaps the most intriguing recommendation for addressing inequality came from David Marcus, who heads Facebook's Libra project. He said that the motivation for Libra is to give access to payments systems to poor communities and remote areas. In his global travels he observed that cell phones were ubiquitous, even in communities with no public electric or water supply. Therefore, providing access to payments systems through a cell phone empowers poor communities, by enabling them to sell and buy to wider markets. One cannot help but wonder if the fact that Libra would level the playing field in this way colours the debate over its desirability.

Making sure there is consistency and coordination between the policies of Government and the Central Bank

A third theme of the seminar, and of the Annual Meetings, was the need for coordination between the policies of Government and the Central Bank. The Governors of the Central Banks of Japan and Kenya gave examples of the consistency of monetary and fiscal policies in their countries, and the Governor of Thailand's Central Bank implied that the economic evidence provided by the Central Bank was used to guide fiscal policy. However, while the speakers all agreed monetary-fiscal coordination works when it works, no-one had anything to offer for circumstances when Government does not exercise financial prudence, ignoring the advice of the Central Bank.

In practice, what is required is joint policy making by Government and the Central Bank. The Central Bank may then buy Government some breathing space, in case expenditure falls short of revenue, in which to make adjustments to restore the balance. The conventional wisdom, which has the Central Bank acting independently of Government's financial policies, is simply not sustainable when the Government does not manage its finances prudently.

The International Banking Seminar is organised by the Group of 30, a unique organisation comprising 30 of the world's pre-eminent financial experts, with membership by invitation only. It was founded by Geoffrey Bell, Barbados' capital markets advisor for many years, who is now retired.