

CENTRAL BANK OF TRINIDAD AND TOBAGO

THE EVOLUTION OF MONETARY AND CREDIT POLICY

The Experience of Trinidad and Tobago

by

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INTRODUCTION

The objective of this paper is to review the evolution of monetary and credit policy in Trinidad and Tobago. The financial structure is an integral part of the development process of an economy. Each economy has peculiar characteristics which are very much determined by its historical evolution among other factors. Thus to appreciate the role of finance in the development process a keen sense of historical experience is crucial.

The purpose of the paper is not to evaluate the performance of credit and monetary policy as such. It is merely to trace its development in the light of the historical experience and the specific characteristics of the economy. This basic approach will undoubtedly put the role of finance in development in a clearer perspective and hopefully will be of some value to similarly placed developing economies.

It is divided into four sections as follows:

Section I - describes the banking and monetary arrangements which existed prior to the establishment of the Central Bank in 1964.

Section II - gives the background to the establishment of the Central Bank. The powers granted to it and the implications of their use are discussed.

Section III - outlines the developments in both the real and financial sectors discussing trends mainly in Gross Domestic

Product, prices and credit allocation, and the monetary decisions taken in the relevant context. The discussion is broadly based in the pre-and-post-1972 period on the basis of the change in exchange control legislation, but the post 1974 period is also highlighted on the basis of the change in the country's resource base.

Section IV - the conclusion summarises the basic changes in the system and outlines the structural constraints to the effectiveness of monetary policy which still persist.

SECTION 1

The Currency Board and Commercial Bank Branch banking prior to the Establishment of the Central Bank<sup>1</sup>

Before the attainment of political independence in 1962, Trinidad and Tobago formed part of the British Colonial territories. As such its monetary management was handled by the British Caribbean Currency Board, which was comprised of representatives of nine governments in the Eastern Caribbean with the Crown Agents entrusted with the responsibility of managing the asset portfolio of the Board. The Board was empowered to issue local currency on demand against a deposit of an equivalent amount of sterling to its credit in an account in London, and to redeem currency on demand by paying out an equivalent amount from its sterling holdings in London. This was done at a fixed exchange rate plus a commission of 3/8 of one per cent. The bulk of sterling funds thus acquired by the Board was invested in sterling securities with the result that including the net earnings from these assets the local currency had a sterling backing of more than 100 per cent.<sup>2</sup> In practice the Board dealt directly with only a small proportion of transactions. Most business was done with the commercial banks which in turn sold sterling to the Board. These banks were branches of international concerns and their policies were based more on decisions made externally than on factors related to the domestic situation. From the acquisition of local currency by the local branches

1. For a detailed statement of the theoretical framework and a full case study Thomas C.Y.: Monetary and Financial Arrangements in a dependent monetary Economy - A study of British Guyana, 1945-1962. Mona (Jamaica), University of the West Indies, 1965.
2. Later the B.C.C.B. was allowed a fiduciary issue. See page 6.

the head office would deposit sterling to the Board's account in London. Since the head offices including those of Canadian and American branch banks held almost all their external assets in London, and also automatically transferred sterling from surplus to deficit overseas branches' sterling accounts, it meant that any demand for local currency by the local branches had to be met Practically automatically by the Currency Board.

These monetary arrangements had important implications for the operation of the financial sector and the effect on the domestic economy as a whole:

1. The Currency Board, by the automatic nature of its operations could have no active role in the determination of the monetary policy or the control of monetary aggregates.
2. Variations in the money supply were mainly dependent on the additions to and the leakages of sterling from the system. This was in turn mainly dependent on the balance of payments position which was determined by the volume of trade.
3. The expansion of loans and advances was only controlled by the policy directives of individual banks' head offices based on their total international sterling position and not on the position of the individual bank or the requirements of the domestic economy. Thus monetary flexibility was dependent on these institutions whose decisions might not always be to the best national interest.
4. No local authority had the power to vary the rate of exchange in the foreign market. Such decisions were made in London.

5. The sterling reserves used to back the note cover were invested in the sterling securities, theoretically throughout the sterling area. However, in practice these investments were made in the developed capital markets, notably the United Kingdom market, and in the markets of the more developed Commonwealth countries. Thus in fact, savings generated in the less developed countries such as Trinidad and Tobago were being used to finance activities in the more advanced countries of the Commonwealth. Moreover, this arrangement provided little scope for diversification in the investment portfolio so that investment risks were not minimised.
6. Local interest rates were determined largely by the trend in rates in the London market because of the close integration of the two systems.

These main features resulted in a potentially volatile monetary system in Trinidad and Tobago. External factors were the major determinants of changes in the monetary aggregates and the money supply was determined principally by the volume of trade.

In this connection Trinidad and Tobago was somewhat more fortunate than the rest of the Eastern Caribbean in that its export trade, based as it was mainly on oil, was less subject to the vagaries of price fluctuations than is the pattern where agricultural exports predominate. The level of credit also depended to a large extent on the level of business activity which in turn was mainly a function of conditions in the export market. All in all, expansion in money supply and National Income was dependent on the balance of

payments, fluctuations in which were externally determined.

These powerful external influences were also reflected in the commercial banks' operations. Their vertical integration with their Head Offices and the United Kingdom money market resulted in banks' operating ratios (loans to deposits, liquid assets to deposits, etc.) bearing no relation to domestic conditions and in fact they fluctuated within wide extremes. For example one of the major considerations governing the holdings of cash, besides the fluctuations in the public's demand for money, was the yield, in excess of conversion costs, that could be obtained on these liquid funds as foreign balances instead. Thus even the cash to deposits ratio really depended on external considerations.

This domination of the commercial banking sector by the external influences, particularly the London money market, was also reinforced by factors such as the lack of a local money market to provide the banks with marketable local securities, the absence of a local banking movement that could have influenced the banks to gear their operations increasingly to local needs and the importance of the United Kingdom economy in the country's external trade and payments.

It would appear that the entire pre-independence monetary system evolved in such a way that on the one hand it required co-operation and integration among the Eastern Caribbean countries (and British Guiana) served by the Board, and on the other, integration with the United Kingdom.

This did not prove to be a healthy institutional arrangement as developments in connection with the proposals for a fiduciary issue showed. It took four years for the Board to get a small issue of \$12 million<sup>1</sup> after the British government in 1954 had authorised the purchase of limited amounts of local

1. See Thomas C.Y.: *Op. Cit.* - pg. 25 and 26.

securities. It was political considerations mainly the drive towards self-government, and not only caution over investing in securities in the largely unorganised markets that caused this relatively slow reaction to a provision which in general was to the benefit of the individual territories involved. When, after 1958, this issue was raised to \$26 million, it could not be effected mainly because of the break-up of the political federation. In contrast, by the end of 1958, Jamaica had a fiduciary issue of £1.4 million out of a £6.3 million currency liabilities.

In the circumstances, the attainment of independence brought with it awareness of the need to foster a monetary system that was geared to serve the peculiar needs of the country in place of the one that evolved when the country was part of an international Empire. This realization was adequately articulated by the then Trinidad and Tobago Minister of Finance in piloting the Central Bank Bill of 1964 when he said, "It is obvious, apart from theory, that the existing (monetary) arrangement cannot continue much longer in practice for the obvious reasons that the political system which these monetary arrangements supported has completely broken down. Consequently, there is absolutely no *raison d'etre* for the continuation of this colonial pattern in the field of our monetary arrangements."<sup>1</sup>

1. *Hansard 20th November 1964 - Central Bank Bill Debate - pg. 278.*



## SECTION II

### Establishment of the Central Bank

When Trinidad and Tobago became an independent country in 1962, the need for the dismantling of the economic machinery that facilitated the political and economic arrangements of the colonial era and replacement by institutions with powers better geared to the servicing of the economic needs of the new nation was recognised. The establishment of the Central Bank in 1964 must be viewed as a part of this trend. This institution was vested with various monetary functions which until that time fell under the portfolios of various other government departments. It was felt that "the case for a Central Bank institution exercising some kind of control or management over all these functions therefore, rests upon the need to rationalise our monetary system and management; on the need to pay a great deal more attention to matters which only sporadic attention or no attention at all has been paid to in the past; and on the need to relate one aspect of financial and monetary management to another so that we do not all unrelentingly pursue conflicting and contradictory goals."<sup>1</sup> The role that the Central Bank was intended to play was not however to be limited to this narrowly conceived function of merely rationalising and streamlining existing monetary operations. Besides the pure monetary and credit regulating function, the Central Bank in the context of the development process must undertake other promotional activities. Conventional theory of central banking was developed from the experience in the industrialised

1. *Op. Cit.* page 280.

countries. In these mature economies the financial sectors are well developed and the overriding function of a Central Bank is to act as a regulating mechanism. Some writers thus outline the role of a Central Bank by enumerating several functions which the Banks normally carry out in the pursuit of this aim. De Kock<sup>1</sup> postulates that a Central Bank "constitutes the apex of the monetary and banking structure of its country and . . . . performs as best as it can in the national economic interest the following function:

1. The regulation of currency in accordance with the requirements of the general public, for which purpose it is granted either the sole right of note issue or at least a partial monopoly thereof;
2. The performance of general banking and agency services for the state;
3. The custody of the cash reserves of the commercial banks;
4. The custody and management of the nation's reserves of international currency;
5. The granting of accommodation in the form of rediscounts or collateral advances to commercial banks, bill brokers and dealers, or other financial institutions, and the general acceptance of the responsibility of lender of last resort;
6. The settlement of clearance balances between the banks; and
7. The control of credit in accordance with the needs of business and with a view to carrying out the broad monetary policy adopted by the state."

1. De Kock. M.D. - Central Banking - Staples Press, London WC2, pg: 22.

In the reality of the situation prevailing in developing countries the traditional regulatory role envisaged for a Central Bank is overshadowed by the promotional role. In fact the predominant role of a Central Bank, at least in the initial stages of the development process is to create and improve adequate financial infrastructure and to use innovative techniques to foster increased resource mobilisation and bring about its proper utilisation including providing a flow of long-term investment capital into the productive sectors of the economy. This is aimed at reaching a balance between consumption and production that is in the best national interest. Hence the primary purpose of the Central Bank was envisaged under Section 3(3) of the Central Bank Act of Trinidad and Tobago, 1964 as follows:

"The Bank shall have as its purpose the promotion of such monetary credit and exchange conditions as are most favourable to the development of the economy of Trinidad and Tobago and shall ....

- c. maintain, influence and regulate the volume and conditions of supply of credit and currency in the best interest of the economic life of Trinidad and Tobago;
- d. maintain monetary stability, control and protect the external value of the monetary unit, administer external monetary reserves, encourage expansion in the general level of production, trade and employment; ...."

Despite this development bias however, the day-to-day management problem of a Central Bank basically remains the control of the financial variables (notably the money supply) in pursuit of domestic stability. To do this Central Banks are usually given a set of four basic powers by which commercial banks deposits (the major component of the money supply) can be controlled:

1. Open market operations, i.e. buying and selling financial assets (usually government securities) for its own account;
2. the establishment of a primary reserve ratio;
3. facilities for rediscounts and advances to the commercial banks at an interest rate that can be made penal; and
4. Moral suasion.

The powers granted the Central Bank of Trinidad and Tobago encompassed these major instruments and they were also supplemented by provisions for:

1. selective credit control; and
2. the setting of maximum working balances in foreign exchange that a commercial bank can hold.

#### Implications of the Bank using these powers

The effectiveness of the Bank in using these established powers as a control mechanism is severely curtailed in some areas by the structural constraints of both the financial sector and the economy as a whole.

This is especially so with the use of open-market operations. In Trinidad and Tobago this is limited to dealings in the treasury bill market by the Central Bank. The size of the Treasury Bill issue is determined primarily by fiscal considerations. However, through the use of this instrument the Bank should be able to siphon off financial resources from the system and so contract money supply and available loanable funds by selling bills, or alternatively, cause expansion by buying bills. On the other hand, because of the thin capital market and the general shortage of credit worthy projects in which banks are willing to venture, the banks' deposit position is usually way above the legal

reserve limit. Furthermore the banks themselves are the major holders of these bills and thus changes in their bill holdings are reflected mainly in a change in their cash position and not in expansion or contraction in bank lending. Even in the hypothetical case where the Bank attempts to bring about expansion by buying bills from other non-bank entities, this purchase would only result in an increase in the particular entity's bank deposits. Given the traditional excess liquidity position of the banks caused mainly by the lack of loan demand that fits into their criteria of credit worthiness, this deposit increase would bring no secondary expansion. Furthermore even if the Bank is able to bring about expansion by providing the banks' with more liquidity through open market purchases of bills, the credit worthy new borrower is more likely than not to be an importer or intends to spend a large part of the loan on imports. Thus the expected secondary monetary expansion caused by this increased lending is blunted in most cases by resulting leakage consequent on the drain on foreign reserves as borrowed funds are spent on imports.

More recent trends in the capital market have put this limitation to open market operations in stark reality. The available marketable securities both of the public and private sector tend to become concentrated in a few hands particularly in the hands of large institutional investors. Until these holdings are more widespread the use of open market operations techniques to reflect monetary and credit conditions will be severely limited.

The reserve ratio which was stipulated to be not less than 5 per cent in the Act, is a much cruder but effective instrument of monetary policy. Even a small change would promptly release or absorb a substantial amount of bank reserves. Any increase in the ratio will have a contractionary influence provided that the new level is higher than the actual level held prior to the

increase; and a reduction in ratio will be expansionary but only if it is not already below the level that the banks in their normal operations think it prudent to hold. However, any effect of this instrument on banks' credit policies can be offset if the banks can conveniently shift other assets, e.g., external balances and, more recently, special deposits.

The provision for rediscount facilities by the Bank were bound up in the Banks' intended role of lender of last resort. This is mainly a stand-by provision used in a case where an individual bank is temporarily short of required reserves. The rediscount rate also provides some, though marginal, scope for the Bank to influence the structure of interest rates in the country. Changes in this rate by the Central Bank can be a way of demonstrating its views on credit conditions, and can influence the financial sector to make the indicated adjustments before more stringent powers are applied.

Of the other regulatory instruments made available to the Central Bank, selective credit controls and moral suasion provide the effective weapons. These depend on the co-operation of the commercial banks which from all indications is readily given.

In sum it appears that for the major regulatory powers to be effective certain pre requisites must be met, viz:

1. the capital market must be broadened and deepened for open market operations to be effective;
2. the banking system must be localised so that external influences would not moderate the effectiveness of domestic monetary policy.

It is against this background that the performance of the Central Bank of

establishment of the Bank the domestic economy has undergone fundamental changes especially in the resource base. However, the problems faced by the Bank in the development process have remained. In a nutshell they were the problems of moderating any existing inflationary pressures while setting the conditions for the adequate flow of credit into the productive sector and yet maintaining some degree of external stability.

### SECTION III

#### THE CENTRAL BANK IN ACTION

##### Economic Survey

The Central Bank was formally established in December 1964, but did not become operational until 1966. At that time the economy of Trinidad and Tobago was characterised by a high degree of structural imbalances and foreign control of some of the key sectors.

The economy was marked by:

1. heavy reliance on the petroleum sector;
2. a weak agricultural and manufacturing sector;
3. a high rate of imports, with very limited quantitative restrictions;
4. the domination of economic activity by multinational corporations primarily in sectors such as mining and refining of petroleum, fertilisers, sugar, banking,

insurance and light manufacturing;

5. an undeveloped pattern of production which was characterised by lack of linkages among the sectors so that growth in one sector could not readily have a spill-over effect in others.

On the monetary side, the financial sector was characterised by lack of:

1. exchange control against sterling;
2. controls against the movement of funds between the foreign owned banks and their head offices;
3. provisions to harness the foreign exchange earnings of the petroleum sector into the national foreign reserves.

In addition the Insurance Companies, one of the major mobilisers of domestic savings were free to use those in foreign investment for there were no provisions for them to keep a local assets ratio.

Between 1968 and 1972, Gross Domestic Product<sup>1</sup> (at current prices) in Trinidad and Tobago grew at an annual average rate of 8.9 per cent. After a strong increase of 15.8 per cent in 1968 a sharp deceleration to a 2.6 per cent increase in 1969 was followed by annual acceleration - 4.1 per cent in 1970, 10.4 per cent in 1971, 13.4 per cent in 1972 and 21.3 per cent in 1973. The petroleum sector was a major contributor to GDP but its contribution declined over most of the period from 27.1 per cent in 1967 to a low as 20.2 per cent in 1971 before rebounding to 28.6 per cent in 1973 for an average of 24.7 per cent for the period. The other dominant sector, Services, averaged 36.0 per cent with the subsector, Distribution, following a fluctuating downward path

1. See Table IV and VI, Statistical Appendix.



for an annual average of 14.6 per cent. The relative contribution of the manufacturing sector to GDP increased steadily from 6.6 per cent in 1967 to 9.0 per cent by 1973, while that of agriculture held almost steady at around 6.0 per cent for the period. The construction sector showed relative buoyancy with its contribution to GDP increasing from 4.2 per cent in 1967 to 7.1 per cent in 1973.

These trends were markedly different after 1974. From 1974 the resurgence of the petroleum sector as a result of increased oil prices began to be felt as this sector's contribution to GDP surged to 43.8 per cent in 1974, hit a peak of 49.2 per cent in 1975 then tapered slightly to 48.5 per cent by 1977. As a result most other sectors showed a decrease in contribution after 1974 with manufacturing registering an annual average of 6.9 per cent, agriculture, 3.8 per cent and services 18.8 per cent. The financial sector was able to capitalise on the new flow of resources and increased profits was the major factor causing a sharp rise in their contribution to GDP after 1974. The only other sector to register an increased average was construction, the contribution of which went to 6.2 per cent.

Mainly because of this renewed activity in the petroleum sector, the annual average rate of growth of GDP which was 8.9 per cent between 1968 and 1972, accelerated to 30.4 per cent between 1973 and 1977. The trend in retail prices<sup>1</sup> followed a roughly similar pattern. Between 1968 and 1971 retail price rose at an annual average rate of just about 3.0 per cent. In 1972 this rate picked up to 8.0 per cent then accelerated to 24.4 per cent in 1973. Since then, although the annual increases remained double digit a deceleration from 18.6 per cent in 1974 down to 11.3 per cent by 1977 was recorded.

1. Trends based on changes in Annual average retail price index for the respective years.

## Monetary Policy Decisions in the pre 1972 period

In the context of these developments in the real sector, the Central Bank had an active role to play. However, the newly established Central Bank, operating as it was within the framework of the branch banking system, coupled with the absence of exchange control against sterling, initially could not be very much more effective in controlling money and credit conditions than the Currency Board was. However, the Bank made increasing use of its monetary policy instruments, soliciting the co-operation of the banking sector in some cases, in making them effective in bringing about the desired changes in the financial environment.

The major policy instruments before 1972 can be summarised thus:

### (a) Reserve Requirement

The initial step was in August 1966 when a 5 per cent reserve requirement was instituted. This was a provision of the Central Bank Act, designed to give the Bank some measure of control over the liquidity position of the commercial banks. Further, in 1967, the Bank instituted a 5 per cent secondary reserve requirement on the banks mainly because of soaring bank liquidity consequent on the transfer to the domestic economy of funds previously held in London in the wake of external monetary instability. This was to be made up initially of Treasury Bill holdings, which also provided a source of funds for government borrowing. Some trade in this short term paper was also maintained - a beginning, though modest, of the capital market. In March 1968, in response to the shortage of Treasury Bills, the secondary reserve requirement was extended to include interest-bearing special deposits that the commercial banks would make

with the Central Bank. This facility was provided by the Central Bank as a further outlet for surplus funds of the commercial banks but was not meant to be a prime source of bank investment. It also provided a further source of funds that the Central Bank could channel into resources available to the government for use in national development.

(b) The Re-discount Rate

This rate, which is the rate which the Central Bank charges on loans to commercial banks through promissory notes and bills of exchange issued for commercial, industrial or agricultural purposes, maturing in 180 days, is an instrument of monetary policy designed to influence the interest rate structure of the banks. Variations in this rate were meant to relax or tighten credit conditions. However, because the banks had limited transactions with the Central Bank partly because of their easy access to Head Office funds, this policy instrument was rendered ineffective for this purpose. As it turned out the most effective use of this instrument was in ensuring that the domestic economy was adequately supplied with funds from external investors for it had the effect of keeping interest rates competitive with rates offered on other markets. Its use also prevented funds from being borrowed on the local market at a low interest rate for relending at a higher interest rate on a foreign market.

The rate was first set at 6 per cent in August 1966. It was subsequently changed some nine times largely in response to changing parities of world currencies that affected interest rates in the United Kingdom and the United States markets. These changes were necessary before 1968 in order to prevent a capital flight from the

country, for sterling was not yet a foreign currency, and, moreover, local funds were very sensitive to interest rates abroad because of the operations of the insurance companies as well as the commercial banks.

After the devaluation of sterling in 1967 and the complementary devaluation of the Trinidad and Tobago dollar the commercial banks converted foreign assets into local assets at such a rate as to cause high liquidity in the banking system. This new policy of the banks reinforced later by new exchange control regulations, enabled the Central Bank to pursue a more independent path in interest rate policy after 1967. Subsequent changes in the rediscount rate were more in response to domestic considerations. The rate was kept steady from 1969 to October 1971 despite fluctuations of foreign interest rates.

Keeping this rate steady was partly in recognition of the limited effectiveness of using variations in this rate as an instrument to influence the interest rate structure of the banks. The Central Bank instead influenced the level of the prime and other commercial bank rates by direct suggestion. However, when the rediscount rate was lowered in October 1971 following official concern about the slow rate of expansion of credit for investment purposes despite high bank liquidity, the commercial banks were quick to co-operate, by lowering the rates payable on credit used for investment.

(c) Exchange Control

During the period also the impact of the unsettled state of the world monetary situation on the domestic economy particularly after 1967 resulted in new aspects of monetary policy with respect to exchange control by the Central Bank. Prior to this, exchange control was aimed only at restricting the volume of outflows to countries outside the Sterling Area. In November 1967, following the devaluation of the pound sterling and later during the international monetary crisis of March 1968, the exchange control restrictions were temporarily broadened to include currencies of the Sterling Area countries as well.

However, in 1969 the increase in the short-term interest rates in the major international financial centres threatened to trigger off substantial outflows of foreign exchange from the country. The Central Bank's variation of the exchange charge on outward movements of funds failed to remove the imbalances in the foreign exchange market<sup>1</sup>, and, in a further bid to regularise this market a new policy "The Exchange Market Procedures", was initiated in April of that year. Its main purposes were (1) to make exchange charges levied by the Central Bank more effective in influencing net movements of exchange by the general public as changing circumstances may from time to time require;

(2) to ensure an adequate flow of exchange through the banking system to meet the needs of the general public .  
Under these procedures the banks agreed to sell surplus foreign exchange either among themselves or to the Central Bank and the Central Bank in turn would make foreign exchange available to the banks for all legitimate

1. For a fuller discussion see Annual Report, Central Bank 1969, pp. 8 & 9. "Exchange Charges and Exchange Market Procedures."

purposes. A system of rates aimed at stabilising the market was also introduced by the Central Bank. These rates were designed to maintain a consistent spread between the purchases and sales of foreign exchange by the commercial banks so that there would be no incentives to invest externally.

By the end of 1969 however, new destabilising factors emerged in the external market as the existence of lower local interest rates vis-a-vis the rest of the world and controls on capital exports from the metropolitan countries combined to cause a marked deceleration in the inflow of capital. Pressure was put on bank liquidity as the non-resident controlled firms stepped up their demand for credit on the local market.<sup>1</sup> This had a further impact on the country's balance of payments position. The Bank attempted to control this situation by placing restrictions on the volume of loans going to these non-resident firms and individuals, classifying them as "Regulated Borrowers. A later amendment lowering the ceiling on credit to these borrowers and including commercial bills as a component, made the measure so effective as to cause a sharp fall in the proportion of credit going to them. The proportion fell from 20 per cent to 16 per cent during 1971.

Later on in 1970, the exchange control regulations were updated. The new Act<sup>2</sup> proclaimed in 1971 treated Sterling Area currencies as foreign currencies. The original Defence (Finance) Regulations on

1. *Central Bank of Trinidad and Tobago Annual Report, 1970, pg. 11.*
2. *Exchange Control Act No. 34 of 1971, assented on November 12, 1971.*

which Exchange Control policies rested, were passed at a time when Trinidad and Tobago had no independent currency and were in reference to the Sterling Area as a whole. The situation has changed since 1964 and these new regulations were more in keeping with the current conditions.

These exchange control provisions of 1971 were of critical importance to the evolution of money and credit policies in the country. Whereas before the proclamation of this Act monetary policy was based almost solely on moral suasion, these new exchange controls reduced the effect of various external influences that served to frustrate monetary policy, and hence provided the Central Bank with more avenues for controlling the financial sector. This trend was greatly aided by the national drive towards localisation of existing institutions, first outlined in the third five-year development plan and restated in the 1972 budget.

This localisation policy in the banking sector was pre-dated by the exchange market procedures by which penalties were imposed on the banks for holding excessive balances abroad and the requirements of a local assets ratio which forced the banks to make a certain percentage of their investments locally. Restrictions were also placed on the opening of new branches by foreign banks. These provisions were aimed at retaining national savings for domestic use and it was hoped they would force banking decisions to be made with the wider national interest as the chief consideration.

Under the localisation drive, the banks were required to be brought under majority local ownership within five years (from 1972), with 51 per

cent of the shares being offered to citizens of Trinidad and Tobago. Other provisions required the parent bank to assist in the development of the local branch, and also controlled the pace of repatriation of proceeds of the sale of its shares to the local bank. However, to date (1978) two banks have not attempted to meet these requirements. On the other side indigenous banking was encouraged. The National Commercial Bank was established in 1970 when government bought over the assets of a foreign bank. Later in 1972 the Workers' Bank was established and the Trinidad Co-operative Bank, an indigenous savings bank, was given commercial status in 1976.

#### Monetary Policy after 1972

After 1972 the Central Bank's monetary and credit policies were expected to be much more effective in controlling the financial sector, since the external influences that moderated the effect of these policies were greatly reduced following the imposition of the Exchange Control regulations of 1971. The first opportunity to test this new potential in monetary policy came when in 1972 the high liquidity position of the banks had resulted in rapid expansion of consumer credit. This had caused heavy consumer spending which traditionally had a high import content. The resulting undesirable effect on the balance of payments position and on the rate of inflation was substantial. In a bid to correct this situation the Central Bank used a package of three monetary measures, viz:

1. the reserve ratio was raised from 5 per cent to 7 per cent in February 1973 so as to reduce bank liquidity;
2. the rediscount rate was raised to 6 per cent as a signal to



the banks to raise the cost of credit; and

3. new instalment credit guidelines raising the minimum down-payment and shortening the repayment period on hire-purchase and other credit agreements with respect to the purchasing arrangements for a wide range of consumer durables, were introduced.

These were complemented by fiscal measures which were characterised by increased purchase taxes on some consumer durables, and a cut in the level of government spending, which was contributing to the increased liquidity position of the commercial banks. As a result of these combined measures, instalment credit outstanding increased by a mere \$4.9 million in 1973 as against \$32.3 million in 1972. These measures also contributed, along with other factors, to the curb on the drain on foreign reserves which fell by only 19.6 per cent in 1973, much lower than the 31.8 per cent fall registered in 1972.

Further evolution of money and credit policies in Trinidad and Tobago must be examined in the context of developments in the real sector and in the context of the Central Bank's objective of fostering monetary and credit conditions that would best bring about the financing of the productive sectors so leading to economic growth and development. The commercial banks are the dominant mobilisers of savings in Trinidad and Tobago. Their credit operations are thus crucial for economic development, and changes in their lending policies, whether they be induced by the Central Bank's policies or result from changes in the economic environment, must be noted. These trends in the developments of the financial sectors and the level and pattern of resource mobilisation can be traced, and public policy (including monetary and credit

policy) examined in the light of the rapid change in the country's resource base after 1974.

Commercial bank branches grew from thirty-seven in 1962 to eighty-eight in 1973 and this has been instrumental in instilling the banking habit in the population that has resulted in fairly rapid deposit growth in the banks. Bank deposits<sup>1</sup> grew from \$249.1 million in 1966 at an annual average rate of 17.7 per cent to \$778.5 million by 1973 with a high of 28.4 per cent growth rate in 1971 contrasting with an 8.0 per cent growth rate in 1967. The non-corporate sector had an increasing contribution to this growth. At the same time total bank credit increased at an annual average rate of 21 per cent. Bank liquidity after its peak in 1967 when the excess reserves to deposits ratio registered 11.7 per cent, contracted to a modest 2.5 per cent and 4.6 per cent in 1969 and 1970 respectively. In 1971 the wage settlements again caused a surge in inflows into the banks and the ratio climbed to 12.1 per cent. Heavy credit demand that followed again caused this ratio to follow a contractionary path as it registered a 5.1 per-cent in 1972 then a mere 0.6 per cent in 1973.

In assessing the banks' allocation of financial resources it must be borne in mind that in the context of development the sectors that needed to be encouraged are those that can bring about diversification, import replacement, forge sectoral economic linkages and generate greater output and employment.

In this context the chief sectors meeting these criteria are manufacturing, agriculture and construction. Of the other sectors the ones least desirable would be those that encourage consumption (given the present consumption

1. See Tables II and III, Statistical Appendix.

pattern that lead to outflows of resources) and also those sectors that encourage imports of consumption items. It can be concluded that the main sectors that fall into this latter category are the sector individuals (for non-business purposes), and the distributive trades sector.

However, it is precisely in these two latter areas the bulk of bank credit was concentrated. Between 1966 and 1969 together they accounted for an average of 44.1 per cent of total bank credit.<sup>1</sup> The share was only marginally lower for the next four years, 1970-1975 inclusive, when it averaged 42.3 per cent. On the other hand the share going to manufacturing averaged 12.8 per cent and 16.9 per cent in the respective sub-periods; agriculture accounted for 2.7 per cent and 2.0 per cent respective average and construction 3.5 per cent and 2.4 per cent respectively. When these shares in credit allocation were matched up against the respective sectors' contribution to GDP, the imbalance becomes clear.<sup>2</sup> The distributive trades contributed only 15.3 per cent and 14.0 per cent to GDP in the respective sub-periods, compared with their credit intake of 24.1 per cent and 18.0 per cent. On the other hand, agriculture contributed 5.9 per cent and 5.7 per cent to GDP in the respective sub-periods and construction 4.5 per cent and 7.1 per cent respectively. The contribution of both to GDP was thus higher than their relative credit intake. Various factors, notably market constraints, have kept the contribution of the manufacturing sector to GDP below the relative share in credit allocated. In the manufacturing sector the regulated

1. See Table VIII, Statistical Appendix.

2. It must be noted however, that by the nature of their operations, some sectors require more credit for a given value added.