

the details of VSC macroeconomics here – the empirical overview teaches us that there are very few VSC with their own currency and an independent monetary policy. This proposition also holds for those VSC that have been disregarded in Table A.9 due to their low per capita GDP. An own monetary system, therefore, does not seem to be indispensable, although not having it, of course, imposes costs as well. Besides losing an important macroeconomic policy instrument, the «*loss of some significant value in terms of pride, usually attached to having an independent currency as a symbol of nationhood*» (Jayaraman, 2000, p. 2) cannot be disregarded.

Additionally, international economics clearly tells us that under a fixed exchange rate system and perfect capital mobility, the scope for fiscal policy is also very limited, so that the actual degree of independence of economic policy might be very limited. Note that economic shocks tend to be more severe the smaller the country which is struck by the shock, and, therefore, a certain freedom in fiscal policy is a *conditio sine qua non* for VSC. Leaving aside the mostly strong specialization of VSC economies in certain branches or services, there are quite a few VSC which are exposed to natural hazards.⁸³ The latter fact seems to be one of the explanations for the economic slack in Oceanic VSC. It is evident that vulnerability and frequent natural hazards require certain flexibility in public finances.

In a monetary union, an unsound fiscal policy generally has external effects on other members. VSC have the obvious advantage that they can more easily free ride, because their impact on the currency area is, at best, negligible. To overcome this possibility, rules on deficits are often imposed on the members of currency unions, as is also the case for the currency union of the Eastern Caribbean countries. It is, nevertheless, interesting to note that the inflation rates of almost all VSC are under the world's average and near the average of the high income economies.⁸⁴

⁸³ The most common natural hazards are hurricanes in the Caribbean and typhoons in the Pacific. Several VSC also suffer from droughts (e.g. Palau) and volcanic activity (e.g., St. Lucia and St. Vincent and the Grenadines).

⁸⁴ Consult Olafsson (1998) for details and a short discussion.