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A CASE FOR THE ESTABLISHMENT OF A CENTRAL BANK FOR THE EASTERN CARIBBEAN COMMON MARKET COUNTRIES

by

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1. Introduction

The case for the establishment of a relatively strong centralised monetary institution to facilitate implementation of a coherent set of monetary policies for the countries belonging to the ECCM sub-regional grouping, is but a mere part of a more generalised case for the deepening of the process of monetary and financial integration within the Caricom as a whole. It seems to us, therefore, that it would be useful from the point of view of clarification of some fundamental issues, to examine the need for deepening monetary and financial integration, before we delve into the principal task of ascertaining whether there are net benefits to be derived from the establishment of an East Caribbean Central Bank to replace the existing East Caribbean Currency Authority.

The recent experience of virtually all the regional economic groupings in the Third World has clearly demonstrated that the failure, on the part of the countries involved in these groupings, to deal with balance of payments problems, has led to the imposition of restrictive trade measures and by the same token to the weakening of the integration process. The Caricom economic integration movement is a case in point. Prior to the advent of the international economic crisis and the serious balance of payments problems which it brought in its wake, the trade liberalisation measures as conceived in the Chaguaramas Treaty establishing the Caribbean Community and Common Market were

being implemented with great facility. Within the last couple of years, however, the payments problems have been exacerbated; and given the almost total absence of regional monetary and financial instruments and mechanisms to deal with payments problems, there has been a rising tide of trade restrictive measures, which has weakened the entire Caricom integration process. Granted, belated efforts were mounted with a view to establishing a regional balance of payments mechanism, namely, the interim Caricom Balance of Payment Mutual Support Facility. However, this has not been firmly established. We have also seen the recent establishment of a Multilateral Clearing Arrangement for Caricom to facilitate intra-Central Bank settlements.

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But these two instruments have not sufficed in correcting the regional monetary chaos, arising out of the absence of a common currency, the restrictive use of the currencies of certain member countries of Caricom, the unrealistic differentials between external values of the respective currencies reflecting the total absence of any policy on relative exchange rates, restrictions on capital flows within Caricom, the absence of a Unit of Account and indeed the absence of a set of regional monetary instruments and mechanisms, which will facilitate trade and payments. All these problems persist because of a failure to institute a regional monetary system, after the break-up of the regional currency board system. Moreover, the establishment of Central Banks in the independent countries of Guyana, Barbados, Jamaica and Trinidad and Tobago and the issue of independent currencies, meant the elimination of the common currency as well as the orderly system of regional monetary arrangements.

Time does not permit any in-depth analysis of the causes leading to monetary and financial chaos in Caricom, but it must be stated in answer to some observations currently being made, that it is surely not the establishment of Central Banks as such that has led to the problems of monetary integration facing the Region, but the failure to establish an alternative integrating mechanism to replace that which has been eliminated. The lesson of Caricom should be heeded by the LDCs. The following fundamental questions should be carefully examined: Can trade liberalisation and integration of production succeed to any reasonable extent without integration on the monetary-financial side? Should not the present common currency and unified exchange rates of those countries participating in ECCA be retained, and a common monetary agreement, albeit limited in scope, be formulated? Would it be of advantage to have a strong centralised monetary institution with the full powers of a Central Bank established to help implement a sub-regional monetary policy, in close collaboration with the respective member countries? Is it possible to set up a system whereby the powers given to the central monetary institution do not in any way inhibit the powers of national governments in the area of monetary and financial policies?

This Paper would attempt to answer some of these fundamental questions, examine the case for the replacement of the East Caribbean Currency Authority (ECCA) by a sub-regional Cental Bank, and present some alternative proposals.

2. Monetary Co-operation Among Caricom States and the Effects of Independence

The so-called Less Developed Countries (LDCs) of the Caricom Region - Antigua, Dominica, Grenada, Montserrat, St. Kitts/Nevis/Anguilla, St. Lucia and St. Vincent, pursue a relatively high degree of monetary co-operation by having both a common currency and a common sub-regional monetary institution, the East Caribbean Currency Authority (ECCA). The ECCA is undoubtedly an institution in transition from that of a traditional currency board to a modern Central Bank. Indeed, it can be described as a hybrid institution in that it combines the features of both these institutions. Like the typical currency board, one of its principal tasks is the issue of the currency and the maintenance of the legally prescribed Sterling-asset backing for the currency issued. On the other hand, it performs a series of central Banking and quasi-central banking functions, namely, the grant of conditional advances to Governments and other financial institutions, the limited creation of domestic credit, and the like. However, certain crucial Central Bank functions which would give the institution the power to affect the liquidity of commercial banks and the financial system as a whole, are lacking. We shall discuss this matter in greater detail below.

Without any exceptions, the newly independent countries which formerly operated under a currency board system, controlled from the metropolitan centres, found it advantageous on the attainment of independence to set up independent monetary and financial systems under the umbrella of central banks. In effecting the transition from colonial monetary arrangements to independent central banking systems, the ex-

colonial territories, converted most of their metropolitan securities into liquid assets. Granted in the conversion of their Sterling assets into liquid funds certain losses were realised, given the maturity structure of their asset holdings, most of which were held in long-dated securities. We note that under the Colonial Currency Board System all domestic currency issued in the colonies had an asset-backing in the metropolitan centre, London on a 1:1 ratio basis. On the attainment of political independence, most of the former Colonial territories - India, Ghana, Zambia, etc., realised the greater proportion of the Sterling asset-backing, in order to finance economic development at the national base. The holding of British and other Commonwealth Government Securities was tantamount to financing the economic development of countries such as the United Kingdom, Australia, New Zealand, South Africa, etc., which had developed capital markets and issued securities in London. Apart from the whole psychology of ending colonial monetary dependence of the form described above, the major advantage derived from the termination of the colonial monetary arrangements and the advent of central banking, lay in the resources made available, through conversion of a proportion of the Sterling balances in London, for the financing of economic development at home. A lot of criticisms have been levied at the extent and rate at which these Sterling balances were run down and the end use to which they were put. Nonetheless, we feel that with the present greater awareness of the need to undertake better financial planning of resource use and the role in this matter assigned to the newer central banks, more beneficial use of these resources could be achieved. But the newer Central

Banks have also exercised the new-found privilege of diversification of their foreign currency reserves as a means of minimising the risks of devaluation of some major reserve currencies.

The achievement of political independence and the establishment of Central Banks also brought with it, membership of international financial organisations such as the International Monetary Fund (IMF). Membership of the IMF gives access to a whole range of financial resources - drawings under the various tranches, drawings under the various special IMF facilities (e.g. Compensatory financing facility) and Special Drawings Rights (SDR) allocations. The consequential financial benefits accruing to the countries were tremendous. But more than this, IMF membership and the countries' acceptance of the obligations to implement the Articles of the Fund Agreement, brought with it respectability and confidence, which served to open up new sources of finance - foreign financial institutions, international capital markets and the like. Indeed the establishment of central banking system coupled with IMF membership opened up new vistas in the financial world.

Apart from the crucial role in external financial relations as indicated above, the newer Central Banks are involved in the following important functions:-

(i) resource mobilisation at the domestic level through capital market and other operations;

(ii) the creation of credit and the channeling of credit into certain prescribed areas i.e. resource allocation;

(iii) the development of a certain kind of financial structure and legal framework, thereby exercising control over the important financial institutions, especially the commercial banks.

In the context of the above, let us now examine the ECCA and the extent of its powers in terms of how they approximate to those of a full-fledged central bank.

Powers of the East Caribbean Currency Authority

The general powers of the East Caribbean Currency Authority are set out in Part 4 of the Currency Ordinance No. 2 of 1965. Article 19 of the Ordinance states that the Authority may -

"(a) issue demand drafts and effect other kinds of remittances payable at its own offices or at the office of agents or correspondents;

(b) purchase and sell gold coin and bullion;

(c) act as agent of the participating Governments either collectively or individually;

(d) open accounts for and accept deposits payable on demand from banks in the territories of the participating Governments and from the Government of any Federation of the territories of the participating Governments;

(e) maintain accounts with central banks and other banks abroad;

(f) purchase, sell, discount and rediscount inland bills of exchange and promissory notes payable in East Caribbean dollars, and arising out of the

processing, movement or marketing of agricultural produce or out of other bona fide commercial transactions, bearing two or more good signatures, one of which shall be that of a bank and maturing within ninety days, exclusive of days of grace, from the date of an acquisition;

(g) purchase, sell, discount and rediscount <u>Treasury Bills</u> issues by any of the participating Governments, payable in East Caribbean dollars, forming part of a public issue, and maturing within ninety-three days; but the holding of Treasury Bills of any one Government at any one time, other than Bills held under paragraph (i) or held as collateral under paragraph (k) of this Article, shall not exceed ten per cent of the estimated current revenue of the Government in question for the current financial year;

(h) purchase and sell publicly issued securities (other than Treasury Bills) or guaranteed by any of the participating Governments, payable in East Caribbean dollars and maturing in not more than seventeen years, but the holding of such securities at any one time, other than securities held under paragraph (i) or held as collateral under paragraph (k) of this Article, shall not exceed three million East Caribbean dollars or fifteen per cent of the Authority's notes and coins in circulation and other demand liabilities, which ever is the greater;

(i) invest in securities of the participating Governments to any amounts and to mature at any time on behalf of staff and superannuation funds and other internal funds of the Authority;

(j) subscribe to, buy and sell shares or debentures of any corporation set up with the approval of, or under the authority of, any participating Government or Governments or the financing of development.

(k) grant to any bank advances for fixed periods not exceeding three months against promissory notes payable on demand and secured by the pledge with the Authority of -

(i) gold, coin or bullion

(ii) publicly issued securities of any of the participating Governments or of the United Kingdom Government, payable in East Caribbean dollars or sterling, which are to mature within fifteen years (or in the case of Treasury Bills, within ninety-three days);

(iii) such bills of exchange as are eligible for purchase, discount or rediscount by the Authority;

(iv) warehouse warrants or their equivalent (securing possession of goods) in respect of staple commodities or other goods duly insured and with a letter of hypothecation by the owner;

Provided that advances under this paragraph shall not exceed seventy-five per cent of the current market value of the securities referred to in sub-paragraph (ii), seventy-five per cent of the nominal value of the bills referred to in sub-paragraph (iii) and sixty per cent of the current market value of the commodities or goods referred to in sub-paragraph (iv);

(l) purchase and sell external currencies and investments payable in short notice in those currencies;

(m) act as correspondent, banker or agent for any external bank or other monetary authority and for any international bank or international monetary authority established under governmental auspices;

(n) give facilities for bank clearing systems in the territories of the participating Governments;

(o) subject as is expressly provided in this Agreement, do all such things as are incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Agreement."

Critique of Existing Powers of ECCA

It is obvious that the powers granted to the Authority under Article 19 of the Currency Act are very far-reaching and transcend that of a traditional currency board. Clauses (f) and (g) give it considerable leeway to operate in the short-term securities market. That its lending to participating governments via the purchase of Treasury Bills cannot exceed ten per cent of the government's estimated current revenue also implies that it is an instrumentality of fiscal restraint. Clause (h) which permits the Authority to deal in long-dated securities (maturing not more than seventeen years) gives the Authority the where-withal to participate in financing long-term economic development. This is further underscored in (j) which expressly states that it can have equity participation in government approved corporations or buy and sell securities of any government

sponsored corporation for the financing of development. The possibility of equity participation in the proposed Caricom Enterprises and a role in development of private capital markets come to mind, if this clause is given wide interpretation.

Clause 19(c) bestows upon the Authority the status of agent for the Governments either collectively or individually, although it does not specifically state its agency role with international financial institutions. This is essentially a Central Bank role, usually shared with Finance Ministries.

Clause 19(k) gives power to grant advances to commercial banks albeit on preconditions which are quite conservative. There is an element of the 'last resort' role indicated here. The modern central bank has greater flexibility. In this regard Commercial banks must also maintain compulsory reserve requirements with the Central Bank. Clause 19(l) and (m) give some indication of the role of the Authority in external financial relations, although its dealings with the IMF are not spelt out.

The Authority's role in the regional clearing system is spelt out in Clause (n).

Thus we see certain legal features which give the Authority some Central Bank powers but which do not go far enough. For example, one of the principal central banking techniques used to control commercial bank liquidity, i.e. the obligation on the part of the banks to hold fixed or variable reserves with the Central Bank, does not fall in the arsenal of the Authority's powers.

In practice the commercial banks maintain certain cash balances with the Authority merely to facilitate inter-bank clearing transactions plus the issue and redemption of currency. There is no legal obligation to hold other balances although in practice the banks do, in terms of furthering their own interests. Moreover, the Authority pays interest to these banks on the deposits they maintain with it.

One of the major weaknesses of the Currency Act 1965, as viewed in the context of the contemporary Caribbean with more countries having attained or on the verge of attaining political independence, is the Act's failure to relate the Authority's power vis-a-vis that of the independent Governments or vis-a-vis the Minister responsible for Finance in the respective countries. The power of every Central Monetary Authority in an independent setting (once the dominance of Metropolitan London has ceased), must be related to the powers of the responsible Finance Minister. The U.K. model of Central banking,[1] indicates the respective roles of the Governor of the Bank of England and the Chancellor of the Exchequer (The Treasury) with respect to the formulation and execution of monetary policies and practices. Granted, personalities ultimately play a crucial role in this power game, but some separation of powers has to be worked out, if conflicts are to be minimised. Reference will be made again to this fundamental problem when we examine the Draft East Caribbean Central Bank Agreement 1977, but we can note here that, that document seems also to have committed

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[1] This model has been adopted by most Commonwealth Countries.

this cardinal sin of omission. Political independence and all that this implies for independence in financial dealings, must of necessity lead governments to wish to safeguard a relatively high degree of autonomy in this area.

The separation of financial powers in this sub-regional context is a problem of great importance. We shall analyse this problem later. Having undertaken a preliminary examination of some of the constraints imposed upon the Authority, let us now take a look at Article 17 of the Currency Act with respect to management of the external assets and what this implies for limits of the fiduciary issue.

Article 17(1) states that "subject to paragraph (2) of this Article the Authority shall at all times maintain a reserve of external assets consisting of gold, sterling or currencies convertible into gold or sterling for an amount not less than seventy per cent of its value of its notes and coins in circulation and other demand liabilities ...."

The minimum percentage referred to in paragraph (1) of this Article may be reduced to sixty per cent by the Authority if each of the participating Governments gives its agreement ...."

Sterling assets and assets convertible into gold or sterling shall, for the purpose of paragraph (1) of this Article, consist of cash, balances with banks, investments payable at short notice and securities of first class standing which are readily convertible into cash and which are due to mature within six years of their purchase by the Authority."

Article 17(1) and (2) tell us that a fundamental change in the traditional currency board structure has been achieved since there is not the necessity to hold 100 per cent sterling backing for currency and other demand liabilities of the Authority but a minimum 60 per cent reserve asset holding. This also means that the permissable fiduciary issue is now 40 per cent i.e. the extent of currency and demand liabilities which need not be backed by reserve assets. But this provision is tantamount to a fairly high degree of monetary restraint. Moreover, if Article 17(3) is to be observed, given the requirement of undertaking investments payable at short notice and securities of first class standing with a high degree of liquidity, then it means that most of the backing must be held in capital markets much more sophisticated and developed than those which exist in Third World Countries such as the Commonwealth Caribbean. This makes for the original criticism of the currency board system that it facilitates the financing of investments in developed market situations and not in the poor countries where they find their location and resources. What is worse is that given the absence of developed capital markets in the Commonwealth Caribbean and the continued pattern of overseas investment, eligible external assets to demand liabilities stood at 103.6%, 95.5%, 89.9% and 83.2% at the end of the years 1973, 1974, 1975 and 1976 respectively. (See Table I). Moreover, the Authority's current accounts and money-at-call in London stood at EC$89.7 million and EC$156.4 million at end of year 1975 and 1976 respectively. (See Table I). The reason for this may well be in the weakness of the capital market structures plus the constraints imposed by Article 17 in general.

It should be noted, however, that there has been a significant growth in the Authority's holding of participating Governments Treasury Bills and Debentures (bonds). (This can also be seen in Table I). In 1973 the Authority had the sum of EC$8.0 million invested in these securities, and this grew to EC$17.6 million and EC$25.0 million in 1975 and 1976 respectively. This is tantamount to a major contribution by the Authority to the development of the Governments' securities market and fiscal resources.

On balance it can be said that ECCA has pursued monetary conservatism of the traditional currency board, with an increasing degree of flexibility in recent years. But it is clear that the constraints imposed by Articles 17 and 19 on the powers of the ECCA, especially in the crucial area of investment of its resources in the participating countries themselves rather than externally, could only be dealt with if these severe constraints are removed, as has been suggested in the Draft East Caribbean Central Bank Agreement 1977. Indeed, the limitations in this regard have been brilliantly put by the Deputy General Manager of the ECCA in a paper he wrote entitled "Reflections on the World Bank Commentary on the East Caribbean Currency Authority". Paragraph 3 on page 10 of the said paper states the following:

> "The Authority's investment in Government securities is governed not only by the implicit fiduciary provisions but also by the limits stipulated in Article 19. Maximum investment in the Treasury Bills of any one territory is 10% of estimated recurrent revenue and the ceiling on debenture holdings is 15% of Currency in Circulation

TABLE I

EAST CARIBBEAN CURRENCY AUTHORITY

ASSETS

(Unit: 000's ECR)

Period Ended	EXTERNAL ASSETS: Current A/Cs & Money at call in London	EXTERNAL ASSETS: U.K. Govt. Treasury Bills	EXTERNAL ASSETS: Other UK Govt. Securities	EXTERNAL ASSETS: Other Securities	EXTERNAL ASSETS: Notes and Coin in Process of Redemption	Local Govt. Debentures	Local Treasury Bills	Other Assets	Total Assets	Eligible External Assets to Demand Liabilities
1973 Dec.	3,630	20,834	34,389	-	123	4,333	3,542	2,890	69,741	103.6
1974 Dec.	18,234	6,142	24,558	-	1,050	5,613	7,547	9,591	72,735	95.5
1975 Dec.	89,668	4,784	22,328	-	2,187	7,208	10,365	3,976	140,516	89.9
1976 Mar.	109,868	14,302	17,728	4,999	1,095	7,458	10,365	6,828	172,642	94.9
Jun.	165,908	-	35,076	17,400	2,060	7,458	10,395	3,070	241,367	99.6
Sep.	171,846	-	9,963	9,635	1,422	9,858	10,394	2,649	215,767	89.4
Dec.	156,352	-	4,056	8,622	4,859	13,464	10,984	2,675	201,012	83.2

Source: ECCA Economic and Financial Review (Volume 8 No. 2 September 1977).

and other demand liabilities. There are therefore three built-in constraints on the capacity of the Authority to invest in Government paper (i.e. the Treasury Bill limit, the debenture ceiling and the implicit 40% fiduciary) and they are not in practice necessarily complementary. Under one provision it may be possible to increase purchase but under the other further purchases may not be permitted. Country A with an estimated recurrent revenue of $20 million, should also be able to sell $2 million in Treasury Bills to the Authority but may find that the fiduciary provision limits the Authority's capacity to purchase its Treasury Bills to $1.5 million. The converse is also possible."

3. The Rationale for Establishment of a Sub-Regional Central Bank

On the basis of comparative empirical evidence - if we take the Central American Common Market on the one hand, and the Caricom on the other - it can safely be concluded that some degree of monetary integration or monetary union is a necessary complement to integration of certain productive sectors, trade liberalisation, payments arrangements and all the other elements which make for economic integration. In other words, the evidence suggests that a certain degree of monetary co-operation coupled with some measure of monetary policy harmonisation (at least in some crucial areas) if not a completely harmonised monetary policy (which may be impractical), is a *sine qua non* to the achievement of the goals of economic integration. (The Central American Case is discussed in Part 5 of this Paper). *En passant*, it should be noted

that the Commonwealth Caribbean in shaping its Multilateral Clearing Facility drew heavily upon the Central American Common Market experience in this regard.

A Centralised Monetary Authority is a necessary if not a sufficient condition for the implementation of regional monetary policy objectives agreed to by participating member countries. The central monetary institution might be a regional Central Bank or a Monetary Council (supported by an executive secretariat) co-ordinating the policies of the respective member central banks, to achieve the purposes of the Monetary Agreement. The latter forms the core of Central American regional monetary arrangements.

For the LDCs, however, it seems impractical for each individual country to set up independent central banks. Constraints on staffing, limited financial resource base, size, etc., seem to negate this proposition. It is assumed, therefore, that the LDCs would continue to maintain their common currency and their monetary union in some form, after they have all attained political independence. On this basis we shall proceed to enumerate the advantages of a strong centralised monetary institution for the sub-region, the limitations of such an institution, and see whether we can envisage whether in practice there are not benefits to be derived from this sort of arrangement. The advantages are as follows:

(a) ending the present quasi-colonial monetary arrangements and with it the necessity to hold idle a large amount of financial resources which could alternatively be used to finance domestic economic development.

(b) further to the above, facilitating the mobilisation of financial resources extra-regionally, i.e. on international financial markets through lines of credits to and borrowings by a larger centralized and more viable institution.

(c) facilitating external financial relations especially with the International Monetary Fund.

(d) being the instrument of operating and maintaining a common currency, common exchange rate, etc., which facilitates inter-island trade and payments.

(e) being the instrument of the growth and control of financial instruments and institutions in the sub-region with a view to expansion of mobilisation and allocation of financial resources consonant with development policy objectives of participating governments.

(f) being the instrument whereby a common monetary agreement among the LDCs could be implemented in furtherance of monetary and financial integration which is a necessary complement to economic integration in other areas.

(g) facilitating inter-central bank settlements and reciprocal credits.

(h) facilitating the growth of capital markets.

(i) providing the basis of financial confidence by being the lender of 'last resort' to commercial banks in the system.

(j) facilitating the flow of capital funds on a regulated basis in the sub-region by the administration of Exchange Control.

(k) in general, facilitating the extra-regional flow of funds into the sub-region, especially multilateral funds.

Let us examine in greater detail some of the major advantages of effecting a complete transition from a currency board system to a Central banking system and moreso the advantages of a regional central bank for the countries currently served by the East Caribbean Currency Authority (ECCA).

Whereas the colonial monetary arrangements contain built-in safeguards against the sort of financial indiscipline which inevitably leads to the creation of excess liquidity with resultant inflation and balance of payments problems especially in open economies, it nonetheless has certain features which inhibit the active pursuit of a monetary and financial policies aimed at the promotion of growth and development. The necessity to hold an undue amount of assets in metropolitan centres as backing for demand liabilities means that the alternative of using these funds for financing economic development at the domestic base is foregone. Reference has been made above to this rather pernicious feature of the system. The tremendous resources tied up in sterling assets in London has been demonstrated in Table I above. Countries starved for capital funds find themselves obliged to invest these funds elsewhere as opposed to investing them for economic development at home. This does not mean that in a central banking system, following the rueles of the International Monetary Fund, there is no financial disciple and no holding of foreign assets as backing, but it does give a greater degree of flexibility in reserve management and

the pursuit of an independent monetary policy. Moreover, it permits a certain degree of flexibility in the maintenance of a diversified portfolio of external assets i.e. in various currencies which is a safeguard against the adverse effects of devaluation of the single currency in which all the reserves are held - sterling assets in the case of the British Colonial currency board system. This is one of the principal reasons why all the independent countries of the Commonwealth proceeded on the attainment of independence to instal central banking systems and to run down their sterling assets in London. In this sense the major criticism levelled at ECCA for holding such unduly large amounts of sterling assets in London despite the modifications of the traditional system to allow a fiduciary issue of 40%, is not justifiable. This undesirable feature of the present system could only be altered by the adoption of a full-fledged central banking system.

Apart from the increased flexibility in portfolio management which comes with central banking, there is also the expanded scope in the mobilisation of financial resources from international financial markets on a relatively more structured basis. A regional central bank supported by a number of countries would be in a much more favourable bargaining position than any individual small developing country, in negotiating lines of credit, and other types of borrowings on international markets. In addition, it could act as a channel for short-term and even long-term funds granted on a multilateral basis. The case of Central America is quite instructive in this regard. Under the Central American Monetary Agreement, through the instrumentality of the Executive Secretariat and its agencies lines of credit and loans on international markets are negotiated, on behalf of the member countries of the Central American Common Market.

There exists a Central American Monetary Stabilization Fund in which such resources are held to meet certain specified purposes. Any such regional financial arrangement has a standing which facilitates international confidence - an important matter in international financial dealings. A group of small countries, such as the ECCM countries, would find it advantageous to conduct financial negotiations in this manner.

Further, on the question of external financial relations, it follows from the above, that there would also be advantages to be derived from negotiating with international financial agencies such as the International Monetary Fund on a group basis, through the instrumentality of a regional central bank. The IMF itself seems to have a preference for this procedure in the case of the LDCs. Although Grenada has achieved political independence and IMF membership, it is reported that the IMF has expressed a strong preference for dealing jointly with its potential LDC members. The question of size, human and financial resource base for manning and operating a series of small central banks, and the like, must be factors making for this kind of preference. The Central Bank could act as the technical negotiating arm of individual governments or the collectivity of governments. The highly technical business of negotiating Standby Agreements would be more easily conducted and with better safeguards for individual and collective interests, if undertaken with the technical assistance of a sub-regional institution. The case of the regional development bank - the Caribbean Development Bank - is a case in point. So is the case of the Executive Secretariat of the Central American Monetary Council - the inter-bank mechanism for the CACM.

With respect to the maintenance of a common currency, our experience in the Commonwealth Caribbean amply demonstrates the inumerable benefits to be derived from its use. Indeed, whatever criticisms one may justifiably level at the British Caribbean Currency Board when it operated the regional monetary system and a common currency for all the territories of the then British West Indies, one has to honestly recognise the supreme advantages bestowed by the common currency. Inter-island trade and payments at all levels but especially at the level of the small man - the small trader - was carried on without difficulty. The common currency found general acceptability throughout the region. The tragedy was that with the ending of the British Caribbean Currency Board system, no proper regional monetary arrangements were substituted. The result is that the Trinidad and Tobago dollar does not find easy acceptance in Barbados, despite its external reserve backing of over US$1.3 billion; and TT dollar has an external value lower than that of the Barbados and Jamaica dollars. The Guyana and Jamacian dollars are not accepted in normal dealings in the rest of the territories. We wish to reiterate that this situation of monetary chaos has been exacerbated by the almost total lack of regional monetary/financial arrangements to deal with regional payments problems. As has been pointed out above, the lack of a regional financial institution or arrangement to facilitate some solutions to balance of payments problems in the Caricom puts Caricom in jeopardy. It would be foolish to conclude that the problems have been precipitated by the establishment of central banks per se. Granted there has been a great measure of financial indiscipline by some countries, which discipline is being reintroduced by the IMF, but our conclusion seems reasonable.

It seems to us, therefore, that the ECCM sub-region should learn from the lessons of Caricom and maintain a common currency, a common pattern of exchange rates, and a strong centralised monetary institution to help in the implementation of some other aspects of a Monetary Agreement. Again we wish to reiterate that the experience of Caricom and other regional economic groupings, adequately demonstrates that the failure to achieve a certain measure of monetary and financial integration spells doom for integration of production and trade liberalisation i.e. the other aspects of the economic integration exercise. The lesson is clear.

It seems to us that it would also be of great advantage to the sub-region of the ECCM, not only to have a common financial institution charged with the task of providing common financial services, but also charged with the task of helping in the development and control of financial institutions and instruments, which would facilitate the mobilisation and proper allocation of financial resources from both regional and extra-regional sources. We feel that a system could be devised whereby this could be achieved with a minimum of policy conflicts.

An East Caribbean Central Bank would facilitate the participation by the LDCs in regional monetary arrangements such as the Caricom multilateral clearing arrangements and the proposed balance of payments support facility. If as has been proposed, the latter would be partially funded by the Caribbean Aid Consortium, then the institution could deal with such multilaterally granted financial help. The institution can also undertake the development of national capital markets in the LDCs, to help in the solution of some of the problems which arise from the weaknesses of securities markets.

While the above advantages are not exhaustive, they represent the major ones. The principal problems that faces us now is to ascertain whether all these advantages could outweigh the major limitation of any such regional arrangement which obviously would to some degree limit the power of individual member countries in the pursuit of their own monetary policies, aimed at the achievement of certain national goals which may not necessarily be consistent with the regional goals. The fundamental question remains therefore, as to whether a system could be devised whereby the powers of policy formulation in the monetary and fiscal spheres could be so co-ordinated or divided between the proposed centralised monetary institution and the respective Governments or Ministers of Finance. We feel that the system we have proposed below would meet this essential criterion.

4. Comments on the Draft Central Banking Agreement 1977

The Draft Central Banking Agreement 1977 which proposes the establishment of an East Caribbean Central Bank contains thirteen (13) sets of provisions laid out in the following manner:

Part I - Preliminary;
Part II - Establishment of the Bank;
Part III - General Reserve Fund and Profits;
Part IV - Administration and Management;
Part V - Currency;
Part VI - External Reserve;
Part VII - Foreign Exchange Operations;
Part VIII - Relations with Financial Institutions;
Part IX - Relations with Participating Governments;
Part X - Miscellaneous;
Part XI - Accounts and Statements;
Part XII - Immunities, Privileges and Arbitration of Disputes;
Part XIII - Final Provisions

We shall first make some general observations and then proceed to comment on certain specific provisions of the Draft Agreement.

The participating Governments of the ECCA agreed as far back as 1970 to the establishment of an East Caribbean Central Bank which in effect entails the up-grading of the ECCA to give it the status of a full-fledged Central Bank. The Draft Agreement we are considering has been the subject of lengthy discussions over the years without any final agreement being arrived at.

One can only conclude from this failure to expedite the matter -

(a) that certain very fundamental problems exist with the essential elements of the Agreement from the standpoint of the LDC Governments;

(b) that the political climate which existed in 1970 when the original decision was taken has been so significantly altered to the extent that Governments may have serious second thoughts;

(c) that the two parties in the negotiations, namely, the staff of the ECCA and the IMF on the one hand and the LDC Governments on the other, have fundamentally different interests;

(d) that the fundamental question of autonomy in financial affairs, so jealously guarded by independent countries, is not satisfied by the Draft Agreement, and moreover some Governments may wish to leave the ECCA with its present powers and status.

It is clear that the changes since 1970 in the political climate and in the level of aspirations, are making for a certain reluctance to conclude any agreement of the type being proposed. Let us examine the trend of events in the political economy of Central Banking in the Caribbean.

The MDCs - Barbados, Guyana, Jamaica and Trinidad and Tobago, on the attainment of political independence established central banking systems and independent currencies and achieved full membership of the IMF. Within the LDC grouping, Grenada, on the attainment of political independence, became a member of the IMF and has already made use of IMF financial resources, although it has no Central Bank (the Ministry of Finance is obviously the fiscal agent for the country). Dominica and St. Lucia are in the process of negotiating their political independence and it is reported that they too are seeking IMF membership.

It has however been reported that the IMF, for some of the reasons we have discussed above, has indicated some preference for dealing with a sub-regional Central Bank. This, however, does not mean that a country's sovereign right to IMF membership could be denied, despite its miniscule size and resource base. Given this sort of stark political reality, we must conceive of a different sort of financial institution to the one proposed in the *Draft Agreement*, especially with respect to its relationship with domestic financial institutions (Part VIII of Draft Agreement) and its relationship with participating Governments.

Fundamental changes in the proposed relations with domestic financial institutions might dictate the need to have separate Banking Acts for each member country under the umbrella of a Common Banking Act. Moreover, given the establishment of national banks in most of the territories - banks which are being given special quasi-central bank roles, it seems to us that the revised financial structure should take cognisance of this important development.

The Draft Agreement does not propose a structure which would cater to the perrenial problem of a workable division of powers between the Central Bank and the Minister responsible for finance in the respective member countries. This problem exists in every system with national central banks, where the formulation and implementation of monetary/financial policies always seem to involve conflicts between the Governor of the Central Bank and the Minister responsible for finance. The problem would be greater in the case of a regional central bank. An appropriate structure will have to be devised to deal with this crucial problem. It has to be recognised that differing socio-economic problems and differing policy goals, will make for differing monetary policies in the relative countries and hence regional co-ordination could be difficult if an appropriate structure is not established. The Draft Agreement fails miserably in this respect.

There is now a consensus emerging, that the Draft Agreement should be amended to provide for a different structure of decision-making in sub-regional monetary affairs. It has been suggested that the West Indies Associated States Council of Ministers (WISA Council) which is now the supreme decision-making body, should appoint a Sub-Committee of Ministers of Finance of the respective Governments, who would assume this role on its behalf. This Committee would parallel the Standing Committee of Finance Ministers at the Caricom level and would therefore be a more appropriately constituted body for this purpose. Moreover, this alternative arrangement is likely to lead to a greater measure of monetary policy coordination among the countries, as well as between the country grouping and the International Monetary Fund. Normally, the Minister of Finance is the Governor of Board of Governors of the IMF. The Alternate Governor is usually the Governor of

the Central Bank. Thus with respect to the proposed sub-regional Central Bank for the East Caribbean, the proposed Sub-Committee of Finance Ministers can choose one of their members, on a rotation basis, to occupy the position of Governor of the Board of the International Monetary Fund for specified periods. With respect to representation on the Board of Executive Directors of the IMF, the Sub-Committee of Finance Ministers will also have to agree on the grouping in the IMF in which they would like to be represented. For exemple the arrangement for independent countries of the Commonwealth Caribbean are as follows: Barbados, Grenada and Jamaica find themselves in a grouping with the Bahamas, Canada and Ireland; while Guyana and Trinidad and Tobago are in a grouping with Brazil, Colombia, the Dominican Republic, Haiti, Panama and Peru. The principle of rotation as applied generally could also apply to the East Caribbean representation. The Sub-Committee of Finance Ministers would be the link between the countries and their IMF representative. Policy coordination on matters relating to international monetary affairs could thus be facilitated.

A consensus seems to be emerging that the proposed Central Bank should act in a strong advisory role to the Sub-Committee of Finance Ministers, in the initiation and maintenance of financial relations with international financial institutions especially the IMF. Given the proposed Central Bank's status as fiscal agent for potential member countries, as expressed in Article 37 of the Draft Agreement, it is suggested that the Central Bank should at all times provide technical advice to any member country which may enter into negotiations of stand-by Agreements with the IMF. In light of this, Article 37 should therefore be amended as follows:

"The Bank shall serve as the depository and fiscal agency of, and the institution through which dealings by any participating Government shall be conducted with the International Monetary Fund and other international financial institutions."

It is suggested that this arrangement, whereby the Central Bank provides a technical advisory service in international financial dealings, would serve the interests of member countries for the following reasons:

(i) the negotiation of stand-by arrangements or agreements with the IMF, has become a serious technical exercise of over-riding politico-economic significance. Stand-by agreements between the IMF and member countries, which permit member countries to use Fund resources with varying degrees of conditionality, depending on the size of the resource relative to quota, involve on the part of the member countries, obligations to pursue certain types of monetary, fiscal, exchange rate, foreign reserve and sometimes price and income policies. In practice also, limits are set for net domestic credit, the size of fiscal deficits, the size of net foreign reserves, etc. Also exchange rate adjustments (usually downwards, i.e., devaluation), which usually comes as an essential part of the package, is an exercise

of far-reaching economic and political consequences. What is implied here, is that concluding Stand-by Agreements is tantamount to the acceptance of constraints on the degree of freedom which the Bank and participating governments could exercise in the policy areas referred to above. The Bank's involvement in actual negotiations would be to ensure that the interests of all are properly safeguarded and grave inconsistencies in the policies being pursued by the Bank on the one hand, and participating member countries on the other, do not result from the provisions of any Stand-by Agreement which may be concluded. Nothing in the above precludes the right of any sovereign government to negotiate with the IMF. It merely underlines the mutual advantage of the respective parties in adopting the suggested procedure.

(ii) With regard to other financial institutions, it is felt that given the Bank's status as representing seven Governments, it would be in a much more favourable position to negotiate on behalf of the seven, lines of credit, etc., with large financial institutions abroad, as well as borrowing funds from international capital markets.

With respect to Part IV of the Draft Agreement dealing with Administration and Management, we regard Article 8(6) as extremely contentious and suggest that it be eliminated altogether from the Draft. The question of the appointment of the first Governor and Deputy Governors of the Central Bank should be left to the discretion of the participating governments acting through their appointed representatives in the supreme decision-making Authority, be it the WISA Council or the proposed Sub-Committee of WISA - the Sub-Committee of Finance Ministers. The sovereign right of independent countries in a delicate matter of this nature, should not be pre-empted. We feel that the elimination of Article 8(6) would facilitate final agreement of the Draft.

With respect to Part VI of the Draft Agreement dealing with External Reserves, while we agree that Article 23(1) is a vast improvement on the corresponding provision in the Currency Act, in that it provides for a more diversified holding of assets i.e. not only sterling assets but a whole range of internationally recognised assets, we feel that Article 23(2) and (3) do not go far enough. These sections of Article 23 propose that the external reserve backing for the Bank's demand liabilities be set at a maximum of 60% and a minimum of 50%. In the Currency Act the corresponding figures are 70% and 60%. The situation is therefore not altered fundamentally. We feel that given the Central Bank's potential to raise loans and negotiate lines of credits with other Central Banks and financial institutions, and the countries' potential to draw on IMF resources (using the Bank as depository), there is no need to maintain this large external reserve backing. This feature of the colonial monetary arrangements could be further modified to permit a much larger fiduciary issue, say, a -

minimum of 30% as opposed to 50% proposed in Article 23(3).

Also the modus operandi of reserve management as proposed in Article 23(4), in this era of floating exchange rates ought to be modified. A flexible reserve management and exchange rate policy should be the subject of continuous review by the Sub-Committee of Finance Ministers, advised by the Central Bank and the Group's representative on the Board of Executive Directors of the IMF.

Countries with central banking systems, especially those Commonwealth countries that have adopted the UK model, have both Central Bank Acts and Banking Acts. These in conjunction with the Companies Ordinances serve to regulate the monetary and financial dealings within the country and more specifically set out the relationship between the Central Bank and the commercial banks as well as other financial institutions. Given the fact that the Draft Agreement presumes the adoption of the UK Central Bank model, then it would be logical to conclude that some sort of Common Banking Agreement would have to be adopted for the sub-regional group or more realistically the respective member countries would have to enact separate Banking Acts to operate in the context of this Common Banking Act.

If the potential members of the Central Bank agree to pursue such a course of action, then it can be concluded that Part VIII of the Draft Agreement which seeks to set out guidelines and rules regarding Relations with Financial Institutions, would have to be subjected to substantial amendments.

It is reasonable to assume that the respective countries would like to exercise a great degree of autonomy as is possible within a regional arrangement having a monetary agreement, and that these countries with differing socio-economic circumstances, differing socio-economic goals, would be disposed to pursue different monetary policy objectives. If these assumptions are realistic then we can conclude that Part VIII of the Draft Agreement should be couched in more general terms, allowing for greater freedom in monetary policy formulation at the domestic or national level. Hence while Part VIII should set guidelines on fiscal policies, rediscount policies, reserve requirements, interest rate policies and other elements of monetary control, actual limits and other details should be set by the Minister of Finance (and possibly the National Bank or some Monetary Policy Committee) in each individual country. It is at the level of the Sub-Committee of the Ministers of Finance that some degree of coordination could be attempted. In other words, the objective of achieving harmonisation of monetary policy in the sub-group, an objective which Part VIII reflects, should be abandoned as highly unrealistic. This of course is with reference to domestic monetary policies. A greater degree of harmonisation of external monetary policies - exchange rate policies, the maintenance of a common currency, etc., could more easily be achieved through coordination at the sub-regional level.

The corollary to the above, is that any proposed Common Banking Act will have to be put in generalised terms, with the details written into the domestic Banking Acts.

Regarding Part IX of the Draft Agreement - Relations with the Participating Governments, our suggestions on the establishment of the Sub-Committee of Finance Ministers and the Bank's role in external financial relations especially with the IMF would have to be written into this Part, if agreed upon. For example, Article 37 should be modified to read:

> "The Bank shall serve as the depository and fiscal agency of and the institution through which dealing by any participating Government shall be conducted with the International Monetary Fund and other international financial institutions."

Finally, it would be most appropriate to have the Bank administer the agreed upon harmonised exchange control regulations and practices (Article 40). Agents could be appointed at the national level.

5. Two Case Studies of Regional Monetary Arrangements

It seems fitting at this juncture to take a look at some examples of regional financial arrangements representing varying degrees of monetary integration amongst some Third World countries, with a view to seeing whether we can gain further insights into the problem, which would facilitate our formulation of some alternative proposals to the one suggested for the ECCA countries. The following examples shall be examined:

(i) The Central American Monetary Union; and

(ii) The West African Monetary Union.

The countries comprising the Central American Common Market - Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua - operate through the instrumentality of their respective Central Banks, the Central American Monetary Agreement, the principal objective of which is "to harmonise and coordinate exchange and monetary policies in order to carry out gradually and progressively the Central American Monetary Union and to foster the process of regional economic integration."

The signatory Central Banks to the Agreement, in accordance with their respective national laws, agree to maintain uniform exchange systems which would ensure convertibility of their own currencies, and the generalised use of each others currencies in the transactions and payments among Central American countries. While there is no common currency as such, each country having its own currency, every currency has a fixed relationship with the US dollar and the Banks consult each other on any decisions regarding change of external values. They also aim at -

maintaining convertibility of their currencies, joint management of their foreign reserves, measures to correct balance of payments problems, and a permanent system of consultation aimed at achieving a certain degree of harmonisation with respect to monetary, exchange and credit policies.

From point of view of administrative structure, there is a Central American Monetary Council, comprising of the Presidents of the respective Central Banks and their Alternates. This is in effect the Board of Directors, charged, inter alia, with the following functions:

(a) to evaluate periodically the monetary policies of the Central American countries, proposing the necessary measures to coordinate and harmonise such policies;

(b) ... to act as a regional consulting board whenever it appears convenient to unify the Central Bank's policies and take a joint position before foreign or international financial organisations;

(c) to propose the adoption of international agreements to further the Monetary Union;

(d) to adopt the policy and supervise the system for multilateral compensation and reciprocal credits under the Central American Clearing Scheme;

(e) to adopt the policy and supervise the Central American Monetary Stabilisation Fund established to help countries with balance of payments problems;

(f) to appoint the Executive Secretary, the Under-Secretary and Chief of the Central American Clearing House.

The Monetary Council is advised by several Advisory Committees which are technical bodies comprising of representatives of the various Central Banks; these technical bodies have their activities coordinated by the Executive Secretariat which is the technical and administrative organ of the Monetary Council.

The main coordinating Unit - the Executive Secretariat, is a small one. Its technical functions include the formulation of monetary and financial mechanisms and instruments such as the Central American Monetary Stabilisation Fund. It has also been active in the negotiations of lines of credits, borrowings, etc., with foreign financial institutions, on behalf of signatory central banks, for the funding of the Stabilisation Fund. It has established a set of criteria for borrowing from the Stabilisation Fund and is in effect a sort of mini-IMF for Central America.

While this example of Central American monetary arrangements is not totally applicable to the ECCM countries (it would be more applicable to Caricom as a whole, with its Multilateral Clearing Scheme and Balance of Payments support facility, etc.) it is not difficult to conceive of a Monetary Council for the LDCs - comprising of Ministers of Finance with

their Permanent Secretaries as Alternates on the Council. This Council could be charged with the implementation of a limited Monetary Agreement aimed at maintenance of a common currency, exchange rate stability, convertibility of the currencies within the grouping, relations with international and foreign financial institutions and the like. A small technical Executive Secretariat can then be charged with the implementation of the Agreement and the coordinating of policies.

The West African Monetary Union is a regional financial arrangement in which six countries - Benin, Ivory Coast, Niger, Senegal, Togo and Upper Volta - have a common Central Bank (the Banque Centrale des Etats de l'Afrique de l'Ouest - BCEAO), and use a common currency - the CFA franc, which is fully convertible into French francs at a fixed rate. The system has features somewhat similar to the old British Currency Board System. The fundamental features of the CFA system are the guarantee of parity and convertibility of the CFA franc into French francs by the French Treasury. The Executive Board of the Central Bank comprises of directors of member countries and France. The official foreign reserves are pooled with the Common Central Bank and this pooling enables member countries in balance of payments difficulties to use the common pool of reserves so as to avoid abrupt changes in monetary and fiscal policies and limit the use of exchange restrictions. In fiscal matters, the Governments have agreed to limit their borrowing from the Central Bank to 15% of the previous year's fiscal revenue and for a duration of 240 days (or to the end of the year).

At the national level the countries enjoy a fair degree of autonomy in monetary affairs, since in each member country there is a five-member national Monetary Committee appointed by the Government. This Committee implements the general credit and rediscount policy decisions taken by the Board of Directors.

A fair degree of coordination is only achieved since the head of the Central Bank (the BCEAO) attends personally or through a delegate, all meetings of the Board and the National Monetary Committee and also represents the Bank in all its external relations.

It is interesting to note that the BCEAO has the sole right to issue currency in each member country. The identification of notes by a letter following the serial number enables the Bank to keep separate accounts for each country's currency in circulation. Coins are not identified by country.

With the exception of small working balances held with foreign correspondents the external reserves of the Bank are held in French francs in a single account in the French Treasury. There are a set of regulations governing reserve management. Also any change in parity of the monetary unit requires the approval of all member countries and France.

In accordance with the principles outlined in the treaty establishing the West African Monetary Union, the Board of the Bank recommended model banking legislation for member countries. However, as the responsibility for bank supervision in each member country rests with the national authorities, each country has adapted the model legislation to suit local conditions.

The Central Bank fixes liquidity and solvency ratios for all local banks and other financial institutions. In all member countries the Bank has agencies and in most there are National Credit Councils, with advisory functions and Banking and Financial Institutions Committees which supervise the banks. The Manager of the Bank's Agency in each country is a member of the Council and the Committee.

In summary, the BCEAO is a regional central bank which issues a common currency, regulates monetary and credit policies for the countries in the group, and holds their foreign reserves. Effective October 1974, the BCEAO statutes were revised to provide more flexibility in the application of monetary policy in the member countries. The revised statutes also broadened the range of central bank policy instruments by enabling it to require compulsory reserves in the form of special deposits with the Bank, and by authorising it to establish sectoral priorities and different minimum interest rates for credit depending upon the purpose for which the credit is extended.

Although the link with the French Treasury and the French franc smacks of monetary dependence, the model should be of interest to the LDCs.

6. <u>Alternative Proposals for the Establishment of a Common Monetary Authority</u>

In the discussions as outlined above, we have attempted to present a rationale for the establishment of centralised financial services for the countries comprising the ECCM sub-regional economic grouping. On further reflection, it seems to us that the politico-economic circumstances in which the LDCs find themselves, demand not only a Common Services Regime in a number of areas but also common monetary and financial services, as a logical consequence of this system. It is clear that there are great advantages to be derived from a monetary union and moreso among countries, extremely limited in human and financial resources. The argument for deepening the process of monetary/financial integration which already exists among the LDCs, is even more compelling, given the fact that they are involved in an exercise in economic integration.

While there seems to have emerged a consensus among the LDCs that some sort of centralised monetary services under the umbrella of a sub-regional Central Bank ought to be established, there are still some outstanding difficulties and unanswered questions as to the form the proposed upgraded sub-regional financial arrangements should take, whether the upgrading of the ECCA through the grant of additional powers to make it a full-fledged Central Bank would not result in a situation where the sovereign powers of independent countries in matters of monetary-financial policies would be compromised, and the like.

We are of the opinion that a sub-regional financial structure could be devised, whereby a relatively high degree of coordination and harmonisation of monetary policy objectives could be achieved and in which there could be a division of powers between the Central Monetary Authority and the member Country so as to minimise some of the conflicts which sometimes arise in these arrangements.

One can assume that the various Governments of the LDCs, prior to making any final decision as to what sort of financial arrangements they would like to see evolved, would agree on the fundamental question as to whether it is in their best interests to have a <u>strong</u> Central Bank or a <u>weak</u> Central Bank, in terms of monetary policy formulation and implementation at the domestic level of their respective countries.

We therefore present below two alternative proposals, which we hope will satisfy these two policy choices. They are not mutually exclusive.

The first proposal constitutes an amended version of the Draft Central Banking Agreement 1977. Our suggestions with respect to the amended version are contained in Part IV of the paper entitled "Comments on the Draft Central Banking Agreement 1977". Some other suggestions can be found in the main body of the paper but these can be summarised as follows:

(i) that the structure of decision-making should be altered in such a way that all major decisions on sub-regional monetary and financial matters in general and the powers and functions of the Central Monetary Authority in particular, should be taken by a Sub-Committee of Finance Ministers

of the LDCs, to be appointed by the WISA Council. The Sub-Committee of Finance Ministers would therefore constitute the Board of Governors of the Central Bank and would be the supreme decision-making body. The Finance Ministers may name as their alternates on the Board of Governors their Permanent Secretaries as the case may be. This structure would permit monetary policy coordination between the respective countries and the Central Monetary institution.

(ii) that the Board of Directors of the Central Bank, apart from those members that have been suggested in the Draft Agreement, should also comprise the General Manager of the national banks of the respective countries where such national banks exists.

(iii) that at the international level the Standing Sub-Committee of Finance Ministers should name one of their members to serve on the Board of Governors of the International Monetary Fund on a rotation basis; the alternate on the Board of Governors of the IMF should be the Governor of the Central Bank.

(iv) that the Standing Sub-Committee of the Finance Ministers should appoint a top ranking Civil Servant to represent their interests on the Board of Executive Directors of the IMF and this again to be done on a rotation basis among the respective member countries. It is hereby implied that the supreme decision-making body would have to choose the grouping in the Fund in which they feel their interest would best be served. Reference has been made above to the choices made by Jamaica, Barbados, Trinidad and Tobago and Guyana.

Given this kind of structural arrangement, it seems to us that the problem of policy coordination at the national, sub-regional, regional and international levels could be better achieved and that this structural arrangement should be spelt out in the Draft Agreement.

Further, on the assumption that the countries would wish to establish a strong Central Monetary Authority and would wish to give that institution a major role in international financial dealings, we proposed that the new Central Bank should be given the authority under the Agreement to enter into negotiations with the International Monetary Fund. While we recognised that the IMF in negotiating so-called Standby Agreements deal directly with member countries, we feel that the Central Monetary Authority charged with the implementation of an agreed regional monetary policy should be involved in such negotiations.

We have argued that Standby Agreements involve a series of wide-ranging policy measures, for example, Exchange Rate Policy, Monetary Policy, Fiscal Policy and in some cases, Income Policy as well. It seems logical therefore than an institution that has as its principal task the implementation of monetary and financial policies should be involved in negotiations affecting these policies, be it at the national, regional or international level. We therefore suggested an amendment to the Draft Agreement to take care of this important point. We further argued that the draft should reflect the Central Bank's power to participate in the negotiation of lines of credit and borrowings from international capital markets on behalf of member countries either collectively or individually.

If the Governments agree that there should be a strong centralised Monetary Authority for the LDCs, then this first proposal would be appropriate.

The second alternative proposal we wish to advance, presupposes that the participating Governments wish to have established a relatively weaker centralised monetary institution with a view to giving national financial arrangements and mechanisms a greater role in monetary policy formulation and implementation at the domestic level. The arrangement suggested gives to the Minister of Finance, acting on behalf of the Cabinet, a crucial role; it further suggests important supplementary roles for the Financial Secretaries, the General Manager of the National Bank, and the Accountant General or the Head of the Treasury.

The principal feature of the proposal is the establishment of a National Monetary Committee with the main task of formulating monetary and financial policies and ensuring that the necessary institutional arrangements are established for their implementation. As the principal coordinating and integrating mechanism, the Committee should also ensure that national monetary policies are in line with the main policy guidelines set at the sub-regional and regional levels, by the Standing Sub-Committee of Finance Ministers of the LDCs and the Standing Committee of Finance Ministers of Caricom respectively.

The National Monetary Committee should comprise the following persons: the Minister of Finance, the Governor of the Central Bank or his Deputy, the Financial Secretary, the Accountant General, the Attorney General, the General Manager of the National Bank or some other indigenous financial institution, a representative of the foreign commercial banks, and a representative of the foreign commercial banks, and a representative of labour.

The National Monetary Committee is the counterpart institution at the national level to the Standing Sub-Committee of Finance Ministers at the sub-regional level. The Minister responsible for Finance, acting with the concurrence of the Cabinet, shall not only be Chairman of the National Monetary Committee but shall use his initiative to bring to the Committee for their consideration monetary and financial policy matters in the process of formulation, so that the Committee's views can be given due weight. The Minister shall be advised by his Financial Secretary who shall be his Alternate on the Committee. Given the increasingly important

role of indigenous financial institutions, especially the indigenous commercial banks, we have given a special place on the Committee to the General Manager of the National Bank or some other similar financial institution. In cases where a National Bank has not yet been established, then the Accountant General (or the Chief Officer in the Treasury) would be the substitute. We have included the Attorney General because of the many legal matters which would be considered by Committee, namely, local banking legislation, local exchange control regulations, and the like. A representative of the Labour Movement seems appropriate in an era when due importance is being given to financial resource allocation to the lower income groups at reasonable rates of interest and for purposes such as mortgage finance, etc.

The National Monetary Committee should have the following functions:

(a) formulate local banking legislation, under the umbrella of a Common Banking Law;

(b) formulate legislation for the control of Companies, including Insurance Companies, taking into account any harmonised Company Legislation which may be agreed to for the Caricom Region;

(c) appoint an agent for the implementation of the local banking legislation with particular regard to bank supervision;

(d) set guidelines on interest rates, reserve requirements, liquidity ratios, etc., for local commercial banks and other financial institutions, bearing in mind the goal of achieving a measure of harmonisation of these policies at the sub-regional level, but taking local conditions into account;

(e) formulate detailed regulations with respect to Exchange Control under the umbrella of a Common Exchange Control Act, taking into account local circumstances;

(f) advise on local securities legislation, the development of the local capital market (public and private), and the rationalisation of local financial institutions. For example, the merging of development finance institutions with other financing institutions; the conversion of Post Office Savings Banks into Commercial Banks, etc.;

(g) advise on measures to combat inflation;

(h) advise on the mobilisation and allocation of financial resources especially the allocation to priority sectors such as agriculture, industry and tourism;

(i) adopt measures for effecting coordination between policies of the Central Bank and the national Government in monetary and fiscal matters.

Another important feature of the proposed financial structure is the indigenous financial institutions represented by the National Banks. When we first conceived this structure, our intention was to give to the National Banks a sort of quasi-Central Bank role. On further reflection, however, it appeared to us that certain conflicts of interest may arise if the National Banks were to act as agents for the Central Bank, while at the same time undertaking commercial banking operations subject to Central Bank control. Moreover only a few of these banks have so far been established. Alternatively, therefore, we propose that the National Monetary Committee, in consultation with the Central Bank, should appoint agents in the respective countries. It is suggested that the Accountant General's Office or the Treasury as it is sometimes designated, should assume this Agency role in matters relating to Exchange Control, Bank Supervision, Currency Issue and Redemption, Domestic Clearings, Investments in public and private securities, etc. The Treasury should also be the local depository for the Central Bank. A special Department of the Treasury could be set up to undertake the tasks as specified. In other words, the Treasury could be the quasi-Central Bank at the national level.

In this institutional environment, the member countries can formulate a Monetary Agreement, in which should be outlined the respective roles and relationships of the Central Bank, the Ministries of Finance, the National Monetary Committees and the supreme policy making body - the Standing Sub-Committee of Finance Ministers.

(vi) promote the increased use of local currencies for sub-regional and regional transactions; participate in regional clearings through the Caricom Multi-lateral Clearing Agreements;

(vii) participate in actual and potential regional balance of payments, support mechanisms and be the agent for any multilateral aid funds granted for such purpose e.g. under the proposed Caribbean Development Facility;

(viii) participate in all those regional and international monetary instruments and mechanisms which the Standing Sub-Committee of Finance Ministers shall determine as necessary to the fostering of monetary integration in the sub-region;

(ix) act in all the above, in close collaboration with the national monetary and financial institutions e.g. the National Banks, the National Monetary Committees, the Ministries of Finance in the respective countries, in such a manner as to achieve close collaboration and coordination in the formulation and implementation of monetary and financial policies;

(x) act in close liaison with the chosen representative of the Group on the Executive Board of the IMF, on all relevant matters - IMF quotas, use of the fund facilities, exchange rate adjustments, etc., and keep the Standing Sub-Committee continuously advised on these matters. (All final decisions with respect to these matters to be taken by the Standing Sub-Committee.)

We believe that the second alternative proposal would achieve the sort of compromise which has been sought for some considerable time now. Moreso it meets the desired objective of leaving a large degree of autonomy to the independent States in matters of monetary policy formulation and implementation while at the same time giving a significant role to the sub-regional monetary institution. The crucial role allotted to the Ministers of Finance at the national, sub-regional regional and international levels, ought to meet the need for policy coordination at all these levels.

What is left to be done, is agreement by the Governments on some of the fundamental policy issues which would then be written into a Monetary Agreement, in which could be specified the powers and functions of the Standing Sub-Committee of Finance Ministers, the Central Bank, the National Monetary Committees and other national integrating mechanisms. Attempt should also be made to specify the inter-relationships between the various elements of the structure at all levels.