Monetary Unions in the Caribbean Context – The Challenges faced by the Eastern Caribbean Currency Union since the crisis

Prepared by
Mr Trevor O B Brathwaite
Deputy Governor

March 2016

Eastern Caribbean Central Bank
Basseterre, St Kitts
Monetary Unions in the Caribbean Context – The Challenges faced by the Eastern Caribbean Currency Union since the crisis

Historical Perspective
The current monetary arrangements in the Eastern Caribbean Currency Union (ECCU) emerged from the mid-20th Century when the established international banks, Barclays and Royal began issuing their own currency under the authority of the British government. Most of the English speaking territories were British colonies and thus authorized the circulation of these currency notes. Then in 1950, the British Caribbean Currency Board (BCCB) which was headquartered in Trinidad was the first monetary authority and served Trinidad and Tobago, Guyana, Barbados and the territories of the ECCU, namely Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, Saint Lucia and St Vincent and the Grenadines.

The 1960s saw the quest for independence by Trinidad and Tobago and Guyana. These two countries withdrew from the BCCB. As a result the Eastern Caribbean Currency Authority (ECCA) was formed. The institution was headquartered in Barbados until 1974 when Barbados withdrew from the arrangement to form its own Central Bank. Following this dissolution, the headquarters was moved to Basseterre, St Kitts. The OECS Treaty of Basseterre in 1981, called for common central banking, as a result the Eastern Caribbean Central Bank (ECCB) was established by agreement in 1983.

The charter of the ECCB calls for the following:

- Regulation of the availability of money and credit;
- Promotion and maintenance of monetary stability;
• Promotion of credit and exchange conditions and a sound financial structure conducive to balance growth and development of the economies of the ECCCU territories;
• Active promotion through means consistent with its other objectives the economic development of the ECCU territories.

The above elements of the charter point to a traditional but unique role of the ECCB in the monetary union of the ECCU. The traditional role of the central bank is covered in the first three elements of the charter i.e. the availability of money and credit, through the maintenance of an efficient payment system, monetary stability, and financial stability. The uniqueness of the central bank is its mandate to actively promote growth and development in line with its core central bank mandate.

**Features of the ECCB**
The ultimate decision making body of the ECCB is the Monetary Council which is comprised of Ministers with the responsibility for Finance. The Board of Directors of the Bank comprises of one appointee from each of the member territories, the Deputy Governor and the Governor who is the Chair of the Board. The Board is responsible for policy and administration, with the appropriate recommendations being made to the Monetary Council for their approval. The central bank has functional departments each headed by a Director who report to the Deputy Governor and the Managing Director respectively. The Managing Director is the chief staff appointee, while the Governor and Deputy Governor are appointed by the Monetary Council on fixed term renewable contracts.
Successes of the ECCB

Even before the creation of the ECCB in 1983, the EC dollar, the issued currency was fixed at a parity of EC$2.70 to US$1.00. This parity has remained for close to 40 years and has promoted price stability in the Currency Union. This established parity has remained sacrosanct and notwithstanding the debates on moving the parity, there has been strong resistance from policy makers and the citizens of the currency to maintain the existing parity. The parity has promoted stability, assured certainty and confidence.

Another success factor for the ECCB is the unanimity rule. The ECCB is a rules based organization and thus its governance is shaped by these rules. The unanimity rule means that decisions taken by the Monetary Council are based on the principle of unanimous agreement by all members of the Council. So in the case of the parity for example, all members must agree to the change in the parity.

Yet another success factor of the ECCB model is the pooling of foreign reserves. All foreign currency earned from the exports of goods and services are pooled and invested in international markets. The level of international reserves as a function of demand liabilities determines the international reserves backing of the currency. The legal backing is 60%, while the administrative backing is 80%. Currently the backing ratio hovers around 96-97%. The current backing ratio level in addition to the unanimity rule strengthens the argument for not adjusting the parity of the EC dollar. In fact the level of foreign reserves represents approximately 9.8 months of import cover, way above the IMF limit of 3 months.
Challenges

The revised Treaty of Basseterre created the concept of a single financial and economic space within the currency union. This revised approach facilitated the ECCB as it is now strengthens the concept of a single central bank operating in a legal common space. The single space promotes the creation of uniform legislation, which the ECCB Agreement is, and uniform banking and insurance legislation. There are plans to introduce uniform insolvency and foreclosure laws, a deposit insurance fund and a credit bureau. The creation of an ECCU Business Council is seen as a means of promoting private sector development in the space. The Council has developed its own charter and is working on modalities for creating an enhanced business climate in the single space.

The major challenge for the single space is the population size. With just over 600,000 citizens, the need for scaling up the activities in the created single space is paramount. These small economies are susceptible to natural disasters and the vagaries of the international economies. The economies of the territories are characterized by significantly large imports representing about 40.19% of GDP, the level of commodity exports relative to imports is 6.01% of GDP, while tourism and other services represent 92.71% of GDP. These factors present significant challenges to the region and inhibit the economies to respond quickly to economic challenges posed by international events.

Thus the effects of the Great Depression of 2008/9 are still being felt today. Prior to the Depression, our economies were growing in the range of 5-6% of GDP, while recent data shows growth rates of approximately 2% projecting to approximately 3% in 2017/18. These growth rates are not sufficient to increase per
capita incomes. We estimate that a growth rate of close to 5% will be needed on a consistent and sustained basis in order to double per capita income over ten years.

The region is also characterized by higher than average debt. At the start of the crisis the average debt to GDP ratio of the ECCU was around 82.03% of GDP of which St Kitts and Nevis was 147.76%, Grenada 93.48% and Antigua and Barbuda 85.23%. These three territories sought IMF programmes because of their fiscal and debt challenges. By 2015 the ECCU average of Debt to GDP had decreased to approximately 76%. While the reduction in debt was largely due to debt restructuring, of the three countries under IMF programmes only Antigua and Barbuda’s debt did not materially change even though there were efforts at debt restructuring. The genesis of debt accumulation can be largely attributed to the need to rebuild infrastructure which came about as result of natural disasters. So we have had weather events in the Windward Islands, St Vincent and the Grenadines, Saint Lucia, Grenada and Dominica. While in Antigua and Barbuda, debt accumulation was as a result of financial sector restructuring. For example in Dominica, the most recent weather event was tropical storm Erika which in August 2015 caused damage to the infrastructure in the order of approximately 96% of GDP, and recently as a few weeks ago, there were road collapses and other water damage as a result of heavy rains.

Another challenge has been financial sector events. The region has suffered from the fallout of the insurance conglomerates of CLICO and BAICO. The cost of the collapse was estimated at 15% of 2009 GDP of the territories. The effect had a devastating impact on households and companies, many of whom have not recovered. Based on present calculations, the effected clients of these insurance companies will not be recovering the full amount lost.
The ECCU response to this debacle was as follows:

- The drafting of Uniform Insurance legislation for enactment in all territories of the ECCU. The insurance legislation will give more power to the supervisor to pre-empt actions of insurance operators which could affect the clients of these institutions;
- The establishment of a regional supervisory institution which will regulate and supervise NBFIs including Insurance companies
- And in accordance with the 8 point Stabilisation and Growth Programme, encourage the rationalization of insurance entities, of which there are 161 insurance entities operating in the ECCU.

The financial sector was under further strain as the Central Bank had to intervene in four licensed commercial banks operating in the ECCU. In 2009 the Bank of Antigua (BOA) collapsed as a result of the SEC charging and arresting its owner for engaging in a Ponzi scheme. This arrest spurned a run on the bank precipitating its collapse as a result of the run. The Central Bank intervened and as a result transited the good assets and liabilities to a newly created bank, the Eastern Caribbean Amalgamated Bank (ECAB). The establishment of this new bank demonstrated the strength of the currency union as the bank shareholders comprise of four national banks from four territories and the Government of Antigua and Barbuda. Today the ECAB is one of the strongest capitalized national banks in the ECCU and has featured in the absorption of another bank that was intervened.

In August 2011, the central bank intervened in another national bank that became insolvent as a result of the pressures from the financial crisis created by the Great Depression. The ABI Bank Ltd., located in Antigua and Barbuda, had a wide shareholding but was unable to withstand the risks which resulted from ambitious
credit expansion which it undertook prior to the global collapse. The central bank managed the institution, ensuring that normal banking services was rendered to its customers. The resolution of the bank occurred on November 27, 2015 with the ECAB acquiring the good assets and liabilities, while other deposit liabilities above a calculated threshold were placed in a Depositor Protection Trust, while the remaining assets and liabilities are held in receivership to be monetized over time for the benefit of the Government who offered protection to the depositors who were not transferred to the ECAB. This method of resolution was in order to give full protection to all depositors as this was a mandate of the Monetary Council.

In July 2013, the central bank intervened in two national banks in Anguilla, the National Bank of Anguilla and the Caribbean Commercial Bank. The banks had become insolvent as a result of the collapse in the economy of Anguilla. Prior to the Great Depression, the Anguillan economy, a tourism dependent economy, was growing at an average annual rate of 20%, however with the onslaught of the crisis; the economy fell by an equivalent amount of 20%. This resulted in the insolvency of the bank which represented approximately 75% of the banking activity in Anguilla.

The central bank is now in extensive discussions with the Government of Anguilla on the resolution of the Banks. The approach to the resolution will follow the same approach as that taken in Antigua and Barbuda, which has proven to be largely successful. It is anticipated that this resolution would take place in next few weeks.
Responses
In order to respond to the economic crisis caused by the Great Depression, the Eight Point Stabilization and Growth Programme was developed and endorsed by all member territories of the Currency Union. The Eight Point Programme is a comprehensive plan of action to address the protracted negative impact of the global economic and financial crisis on the economies of the Eastern Caribbean Currency Union.

The following are the elements of the 8-point programme:

- Suitably adapted Financial Programmes for each country
- Fiscal Reform Programmes
- Debt Management Programmes
- Public Sector Investment Programmes
- Social Safety Net Programmes
- Financial Safety Net Programmes
- Amalgamation of the Indigenous Commercial Banks
- Rationalisation, Development and Regulation of the Insurance Sector

For the first three elements of the programme, the Central Bank with the assistance of the International Financial Institutions has conducted Boot Camps for policy units and debt units in the ECCU. These Boot Camps were geared to providing training in Financial and Fiscal programmes, Debt Sustainability Analyses and other debt monitoring tools including Debt negotiation and use of appropriate software tools. A debt management advisory services unit located at the Central
Bank was created from funding provided by the Canadian government. This Advisory service is targeted to end in June 2017.

The Central Bank in association with the Caribbean Development Bank (CDB) has facilitated training for the development of PSIP development and monitoring. This activity is continuing in countries.

The governments of the territories have a number of Social safety net programmes, these range from providing short term employment to the poor and marginalized to assisting persons to start their own businesses. Given the number of these programmes in each territory, governments are in the process of rationalizing these programmes to make them more effective.

In response to the challenges that were encountered from the crisis, the ECCB is spearheading the development of a Deposit Insurance Fund, which we anticipate will be established in another 12-18 months. Technical assistance is being sought from the IFIs and Canadian government to facilitate the establishment of the Fund. The ECCB is also spearheading the establishment of a Credit Bureau with assistance with the IFC. Legislation has already been drafted and submitted for review by the Attorneys General in territories.

As a result of the crisis, non-performing Loans escalated. The ECCU benchmark is 5%, while the latest figures show a ratio of approximately 17%. This unacceptable high level has to be tackled as it weakens the performance of banks and is a threat to financial stability. To address this two institutions are being created. The Eastern Caribbean Asset Management Corporation (ECAMC) will begin operations in the next few months. The operating mandate of the ECAMC is
to purchase non-performing loans from banks and to manage the receivership of insolvent banks. Appropriate legislation has already been passed in the territories of the ECCU to facilitate its establishment. The headquarters of the ECAMC will be in Antigua and Barbuda, with staffing coming from the territories. A second institution the Eastern Caribbean Appraisals Institute (ECAI) is scheduled to become operational in October 2016. The objective of the Institute is to professionalize the conduct of appraisals of properties in the ECCU so that more reliance can be placed on appraisal values which are used as collateral for loans by the banks.

The ECCB has also promoted the passage of new banking legislation. This uniform legislation has been passed in all territories. The Banking Act enhances the ability of the Central Bank to more effectively regulate and supervise the licensed banks in the ECCU. The Act allows for the Central bank to be more preemptive in its regulation and supervision procedures and adopts the latest Basle II principles. In addition amendments have been to the central bank law for congruence with the provisions of the New Banking Act.

There are now 39 licensed commercial banks operating in the ECCU, 26 of those being international Canadian bank branches. We have observed that the branch banks in concert with their operations in other parts of the Caribbean and Canada, are rationalizing their operations, to make them more operationally efficient. The same cannot be said about the 13 national banks as they have a different operational footprint. The 8-point plan is aimed at promoting the approach of amalgamation and consolidation given that the present operational environment with its huge costs of compliance would be administratively burdensome on the individual national banks. Already we see some movement in the right direction.
and the Central Bank will continue to be persuasive to encourage national banks to move in that direction. We believe that this move will lead to a more robust national banking sector.

As indicated above, given the outfall of the CLICO/BAICO collapse, rationalization of the Insurance sector is critical. A new regulatory body, the Eastern Caribbean Financial Services Regulatory Commission (ECFSRC) is scheduled to be established by year end, with the initial objective of regulating and supervising the Insurance sector. The other NBFIs such as Credit Cooperatives, Money Transfer Agencies will be brought under the regulatory umbrella of the ECFSRC.

There continues to be quite a bit of enthusiasm for the outcome of the 8-point plan as it clearly lays a pathway for strengthening the economies and financial sector in the region.

**Conclusion**

As can be seen from the foregoing experiences, the ECCU has made substantial progress in weathering the storms of the financial crisis that emanated from the Great Depression. Growth rates are trending upwards; there is much resolve at the policy level to continue to make the adjustments that are necessary to bring our economies and the financial sector on a firm footing. With the cooperation of our citizens and the international and regional partners we are optimistic that there is a firm desire to see us through to more sustainable and stable environment.

A few questions remain – did it work? What would we have done without the current arrangements? It is arguable that with eight monetary arrangements i.e.
one for each member territory, it would have been extremely difficult to coordinate the solutions to the challenges we faced. So to answer the questions, it did work and the current arrangements promoted a coordinated approach. However there is much left to be done.
Bibliography
