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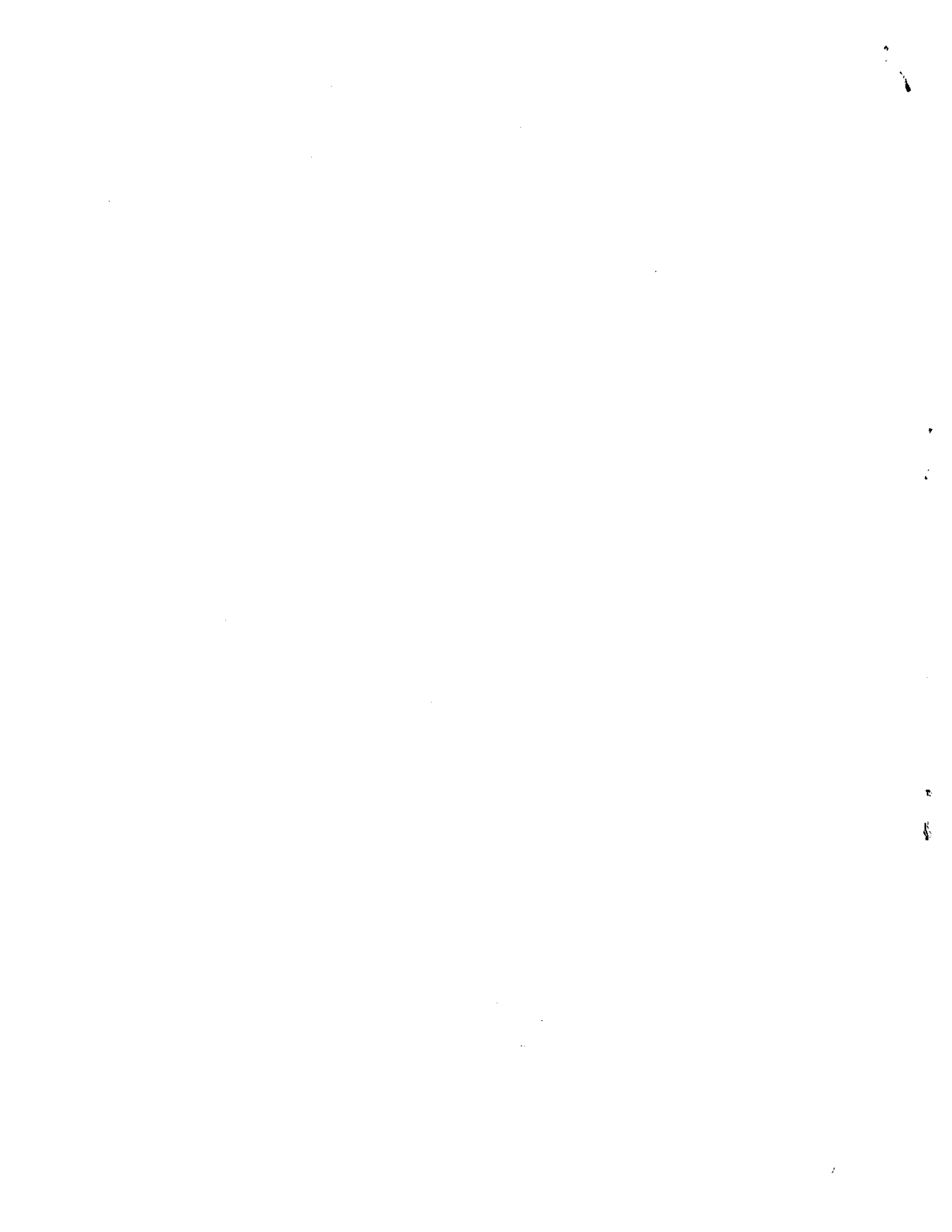
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ECONOMIC COMMISSION FOR LATIN AMERICA
Office for the Caribbean

ESTABLISHMENT OF CENTRALISED FINANCIAL SERVICES
FOR COUNTRIES NOW COMPRISING THE
WEST INDIES ASSOCIATED STATES

Prepared by
S. St. A. Clarke
Director



Establishment of Centralised Financial Services
for Countries now comprising the
West Indies Associated States

Background

For some years there has been debate about expanding the functions of the ECCA to include some central banking functions; and in fact draft text of instruments for revising the ECCA agreement had been prepared and examined by Ministers of the Associated States. There has been no substantial progress towards final decisions on the terms of a new agreement governing the operations of ECCA.

In the meantime individual states have initiated and are operating exchange controls under the co-ordinating aegis of the ECCA which in addition still performs its primary functions as Currency Authority.

It is understood that already several of the states have applied to the IMF for membership in anticipation of independence. The precedent for this seems to be the action taken by Grenada on gaining her independence. It is also understood that IMF would be inclined to propose the creation of a Regional Central Bank to serve all the countries. A draft instrument along these lines exists.

Progress has been inhibited by considerations of the relationship of the Central Bank to individual Governments, including the extent to which Ministers of Finance would need to forego certain functions and have them vested in a regional body. One must recognize too the individual aspirations of each state, that it might itself provide the widest possible range of "central banking" services of which it is capable. In part this relates to the need for a measure of regulation of commercial banking activity within the national boundary, which is an essential element of economic strategy.

An alternative solution

Whatever formulation is considered must commence by taking into account:

- i) the existence of a single currency (EC\$);

- ii) the existence and operations of the currency authority which is serving all the countries;
- iii) existing machinery at individual state level for exchange control purposes;
- iv) the existence in some cases and the long term necessity for national commercial banking functions;
- v) the strong objections that surround the question of inevitable division of functions and authority between Ministers of Finance and a Regional Central Bank;
- vi) the prestige of being independent and providing services on the basis of internal institutional structure.

The recommendation so far has been the standard one of establishing a Central Bank, except that in this case it be regional serving the group of countries. This raises more problems than it solves. Central to the whole exercise is the fact that though a single policy line might be accepted, in each country there has to be some particular adjustment. In fact some aspects of a Regional Central Bank market operations would be ineffective, because of the variations in levels of development and structures of the economies. A more innovative approach has to be adopted.

It is here proposed that the "central banking" functions be vested in a Reserve System. In such a system it becomes possible to devise a division of functions between those operations which need to be effected on collective basis, and other operations which need to be effected on individual basis, i.e. at national level. Clearly, with a single currency any change of exchange rate affects the whole group of countries, and such action therefore needs to be taken collectively; consequently this should be a function of the reserve system. Similarly, any fiscal measure that has to be implemented, can be implemented only through national legislation at national level. In the event that fiscal measures form part of collective adjustment machinery within a package of actions for correcting balance of payments, two steps are

necessary: (a) co-ordination at Reserve System or collective level, and (b) implementation at individual (i.e. national) level. The majority of specific actions, whether fiscal or market, can be implemented only through national legislation and by the national administrations, (there is no regional Parliament and the extent of any particular kind of action will vary from country to country).* The solution therefore is that these functions be divided between national units which derive their co-ordination from the Reserve System.

A method for establishing and operating the national units is already conveniently to hand. Some of the countries already have national banks; those that do not, will soon follow suit and establish their own. In any event it is necessary that national banks exist so as to provide a basis for regulating the activities of branches of expatriate banks. It will inevitably develop that all the countries will have national banks with commercial banking operations. The proposal would be that the national bank should have two departments: a Reserve System Department and a Commercial Banking Department. The commercial banking department would function as a normal commercial bank, while the reserve system department would have the functions of exchange control and some market operations. All the reserve system departments taken together would comprise the banking department of a normal central bank.

The Reserve System would have the main responsibility for co-ordinating the range of functions to be performed at the national level (by the reserve system departments) with the range of functions that are undertaken collectively by the countries. The Reserve System could have as its governing body a Board of Governors comprising the Ministers responsible for Finance in the individual countries. The Board of Governors would be served by a small secretariat^{1/} of technicians

* Except of course changes in the Exchange rate.

^{1/} Aside from the basic research activities which span and serve both the "currency department" and "banking department" aspects the secretariat would be the focal point for co-ordinating banking activities.

who would perform inter alia the functions normally entrusted to the Research Department in any central bank.

The same Minister, being responsible for the Finance Portfolio, would be the "agent" for his country, and in respect of the reserve system department of the national bank, be the link for fiscal and monetary policies.

The ECCA would remain as the currency authority of the Reserve System performing the functions of a currency department of any normal central bank and co-ordinating the collective aspects of exchange control.

Comments

The above constitutes a rudimentary outline for the sort of institution that would hold out a possibility of meeting the political realities. The dual role of the Minister, at the level of the Reserve System and at the national level, takes care of some aspects of the division of functions and authority, one aspect that attracts strong objection in the Regional Central Bank kind of approach.

At the same time, the Reserve System formula has the immediate advantage of building on what exists, by taking into its scope the machinery and expertise that exists. This is relevant in terms of the additional costs that establishment of functions associated with central banking will attract anyhow. The Reserve System approach provide a way of broadening the services without exorbitant costs. It also reduces the problem of agreement on cost sharing formulae.

Of considerable importance is the consideration that there is the probability it would be more functionally efficient that a regional central bank located in one of the countries, in that it would have "fingers" within the individual countries through which it could operate. The national units (i.e. reserve system departments) would in each case be automatically geared to the needs of the country. The Regional Central Bank alternative would in any event need to establish some kind of national agency.

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