EASTERN CARIBBEAN CENTRAL BANK

FINANCE AND DEVELOPMENT IN THE EASTERN CARIBBEAN CURRENCY UNION

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FINANCE AND DEVELOPMENT IN THE ECCU

The Eastern Caribbean Currency Union (ECCU) is now at a critical stage of its development.

The external and domestic environment in which it now exists and the events which lie in the immediate future require the policy makers in the ECCU to reflect deeply and produce strategic approaches to these current and impending circumstances.

One of the strategies which has been in the forefront of the authorities' approaches has been money and capital market development.

Over the last decade the ECCB has taken measured steps to establish markets and institutions which could facilitate the development of its member countries.

These steps have brought some measure of success and in light of the new circumstances we need to pause, reflect and chart the next steps in this process.

The circumstances which now confront the ECCU can be identified under three headings, namely:

- International
- Regional
- Domestic

At the international level the issues with which we are confronted are many, but the following stand out:

- The performance in general of the international economy, and in particular, that of the United States which is our main trading partner, the leading source of our tourist earnings and direct foreign investment, as well as the area in which the largest portion of our foreign exchange reserves are invested.

- The impact of the new trading regimes on our extremely small, open and vulnerable economies. The WTO, EPA and FTAA can and will have a disproportionate impact on these entities.

  Already the erosion of trade preferences has led to a significant decline in our banana industry and the demise of the sugar industry in St Kitts and Nevis.

- The dramatic increase in the price of oil has put severe pressure on the economies of the ECCU making it increasingly difficult to carry through on efforts to adjust to the new international circumstances, particularly in the trading arena.

- Rising interest rates are also likely to have a negative impact on our external debt obligations and may affect the inward flow of capital.

- Finally, the increasing number of regulatory hurdles and standards and codes will have a disproportionate effect on the smaller members of the international community. The cost of putting these regulatory arrangements in place will further tilt the playing field towards larger and better endowed participants.

At the regional level, the ECCU will have to contend with the advent of the CSM and the CSME. The question would be *how can the ECCU successfully integrate itself into the wider regional arrangements?* These arrangements will encompass the following:

- *Regional currency arrangements* which facilitate cross border movements of commodities, services, capital and labour at lower transactions cost without unnecessary exchange rate risks.

- *Inter bank transfers* which are completed expeditiously at low transactions cost.
- *A government securities market* which has a range of maturities and allows for a regional listing of such securities.

- *A regional market for equities* quoted on a single exchange.

- *A regional legislative framework* to regulate the financial sector which is uniform and supervised by a single authority or a consortium of such bodies.

- The *development of a range of financial institutions* whose scope is regional as opposed to national.

At the national level, ECCU member countries have some very challenging issues including:

- Low productivity in both the public and private sectors;

- High debt levels and fiscal imbalances;

- A secular decline in growth;

- Severe diseconomies of scale and scope in public administration, production, marketing and distribution;

- There are also increasing social and environmental challenges in such areas as crime, social alienation among the youth, particularly males, HIV/AIDS, coastal erosion and traffic congestion.

The countries of the OECS, of which the ECCU is an integral part, have signaled their intention to establish an Economic Union in response to these various challenges.

The Economic Union, as conceived, will create new political arrangements to support a single financial and economic space.

This new domain, so to speak, will have common socio economic objectives encompassing the following:

- Economic Transformation
- Growth
- Employment
- Poverty Reduction
- Human Development Indices

It will also identify the various policy instruments which would be appropriately applied to the achievement of these objectives.

The areas of monetary and financial integration, development and regulation would be our primary concern.

An objective assessment of the current circumstances of the ECCU would indicate that with respect to comparative and competitive advantage, *services* are somewhat superior to the production of commodities.

The analysis would also reveal that while *tourism* is the main foreign exchange earner, *finance* is critical in two areas. Firstly, in its normal role as intermediator between savers and investors, and secondly, as an earner of foreign exchange in its own right.

It is possible to identify a number of factors which gives the financial sector in the ECCU a significant edge over other sectors.

- The underlying stability of the currency and currency arrangements;

- An extremely high level of monetization;

- A track record of financial stability and no major systemic crises as a result of effective supervision of the banking system;

- A good mix of foreign and local banks;

- High levels of management and banking skills supported by good training facilities;

- High level of technology and automation;

- Access to information, domestically, regionally and internationally;

- A large pool of skilled workers to draw on through the local education system and graduates in the region and diaspora;

- Proximity to the north eastern United States which is in the same time zone as the Currency Union.

Given this platform, it is now necessary that the financial sector should play a leading role in the development process.

The strategic approach adopted by the ECCB has been to move towards the creation of a single financial space through the removal of the legal and administrative barriers dividing the financial systems in each country and creating regional markets and institutions.

The passage of uniform legislation has been the means by which barriers have been removed. Banking, Insurance, Credit Union and Securities Legislation has been drafted on this basis, and several administrative bottlenecks have been dealt with through mutual agreement.

With respect to markets and institutions the following have been created over the last few years:

- An Inter Bank Market for liquid funds between the commercial banks in the Currency Union;

- A Regional Government Securities Market for Treasury Bills and Bonds;

- A Regional Market for Equities;

- A Secondary Market for Home Mortgages.

With respect to institutions, there has been created:

- The Eastern Caribbean Home Mortgage Bank;
- The Eastern Caribbean Securities Exchange.

Two other institutions are now on the drawing board namely –

- The Eastern Caribbean Enterprise Fund;
- The Eastern Caribbean Unit Trust.

The former is intended to be a multi purpose institution providing venture capital services, debt instruments, technical assistance and export credit guarantees. This institution will seek to mobilize funding for small and medium enterprises within the Currency Union.

The Unit Trust will seek to provide saving instruments of a wider range to low and medium range income earners who have very few options outside of the banking system.

In addition to the above, the ECCB has encouraged the formation of sector associations, for example,

- The Bankers Association;
- The Institute of Chartered Accountants;

- The Eastern Caribbean Institute of Bankers.

The ECCB now finds it necessary to proceed on the basis that there is an urgency to proceed with this programme of money and capital market development in order to position its member countries to be successfully integrated into the new dispensation.

We will have to distinguish between those things the Bank can do with the active support of the member countries, and those things which must be left to the market and the private sector.

In the latter case, creating the appropriate environment for private sector activity will be critical. The regulatory framework will have to embody the right balance to ensure that innovation is not stifled. The natural tendency for monopolies to be established in small markets will also have to be taken into consideration weighing the advantages of economies of scale and scope against the uncompetitive consequences of monopoly.

The regionalization of financial institutions and activities at all levels will expand the scale of operations, mitigate risks and improve the possibilities of competitive markets. However, this is not a complete solution and a wider sphere of activity will be required to improve the possibility of viability.

The issue then becomes *how competitive can the Currency Union become in selling financial services to the international community?* There are several models of small states successfully offering these services - the Cayman Islands, the BVI, the Bahamas, Bermuda. *Is there room in the market for a Currency Union as opposed to a single state, and if there is, how can such an opportunity be exploited?*

The preconditions of stability are very important but some crucial ingredients are missing at this stage.

Firstly, the judicial system needs to be significantly upgraded to facilitate this new arrangement. The current system has established a reputation for competence but needs to be transformed in two ways –

1. A complete integration of the Magistracy into the regional system so that standards will be raised at all levels of the judiciary;

2. A division of labour of the court into Criminal, Family Law, and Commercial Divisions so that there can be effective specialization in these areas.

A positive result of both (1) and (2) above would be to provide a career path in the Judicial Public Service which would be attractive to talented individuals who did not want to go into private practice.

Secondly, there needs to be the institutional and technical capacity to be on the cutting edge of legislation, so that the jurisdiction could maintain its competitive advantage.

Thirdly, that the firm structure of service providers in the financial sector should be upgraded from single proprietorships to genuine firms or partnerships with depth and expertise to service a highly sophisticated international clientele. Accounting firms, legal firms and financial advisers fall into these categories.

Fourthly, telecoms and computer facilities need to be significantly upgraded to provide the technological facilities for international connectivity.

Fifthly, the Real Estate Sector needs to be able to respond to the needs of such a services sector by providing office space and residential accommodation as an attraction in and of itself.

Sixthly, the Leisure Industry which is a critical part of the tourism industry needs to provide first class facilities such as golf and yachting.

Seventhly, travel between the member states of the Currency Union needs to be seamless, that is, within the ECCU, there should be no immigration or customs requirements, thus allowing the benefits to be more evenly spread.

With these preconditions in place, both indigenous and foreign institutions will have the opportunity to provide the range and quality of services which will not only facilitate the effective mobilization and allocation of resources, but also to do so at a level which would make these services exportable beyond the Currency Union.

For local financial institutions this will probably suggest that in addition to the natural moves to provide a variety of services on a local basis, they will have to engage in mergers and acquisitions across the Currency Union if they are to be nationally, Currency Union wide and internationally competitive.

The timing of this next step could take place before all the barriers to a single financial space are removed or after that event.

If one is to use the experience of other small countries, it is possible to envisage the type of financial structure that could evolve in the Currency Union over the near to medium term.

There could be one or possibly two local financial conglomerates providing universal banking services and such other services as insurance, investment banking brokerage/dealers, etc.

Two major international banks, Scotia Bank and the Royal Bank of Canada.

A hybrid institution FirstCaribbean International Bank.

The two regional banks RBTT and Republic Bank of Trinidad and Tobago.

A growing number of foreign institutions in specialized areas to provide services both for the Currency Union and the regional and international community.

The Credit Union sector will be consolidated both within individual countries and across the Currency Union and will provide a broader range of services to their clients.

The Insurance Sector will also be consolidated in both the Life and Non Life areas with local financial conglomerates being among the major providers across the Currency Union.

The Eastern Caribbean Enterprise Fund would effect a major alliance with and consolidation of the Development Banks and development banking across the Currency Union.

This new entity will in addition to its core function of financing development enterprises serve two critical functions. At the external level to be on interlocutor between such external institutions as the IFC and MIGA, European Investment Bank, CDB and any other large funding agency and the Currency Union. At the domestic level to provide umbrella support for the micro financing agencies such as the SEDUs and National Development Foundations.

This will constitute in its entirety a system of development financing throughout the Currency Union which is interlocking, has significant economies of scale in administration and technical capacity as well as having access to increased funding sources.

In the same vein the regionalization of social security systems within the Currency Union would be a natural and evolutionary response to the free movement of labour and capital, particularly in light of the current reciprocity arrangements.

It would also be a rational response to the current challenges of these systems so that they can bulk up and increase their size to achieve significant improvement in economies of scale and mitigation of risk.

The underlying and obvious theme in this futuristic outlook is the need to increase the size and scale of institutions and markets to the minimum critical operational levels that facilitates and stimulates further growth and diversification.

As the regional and international system opens up and the Currency Union and its institutions have to contend with increasingly open and highly competitive systems we will have no choice but to engage in lateral arrangements across the Currency Union to create institutions of sufficient size, heft and influence to preserve a local presence in our own market place.

The way forward would therefore involve deep and objective reflection on the current situation and the options facing us in this new and very challenging environment.

We need to identify the gaps in the current financial system which we need to fill, as well as the remaining impediments to the creation of a single financial space.

We need to carefully examine the mix of public and private sector activities which are necessary to achieve our goals.

We also need to identify the regional and international institutions in both the public and private sectors which can be of critical value to us in achieving these goals.

We need to clearly identify the legislative arrangements which are critical to go forward.

Finally, we need to take into account the precise strategies and means by which the Currency Union can successfully integrate itself into the regional and international financial systems.

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