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Central banking in a regional economic setting: Possible contributions to integration

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Abstract: Central banks can play an important role in facilitating and promoting regional economic and monetary integration. Examples are the European monetary union and a more recent initiative by a group of Asian central banks to boost liquidity in local bond markets in Asia through the “Asian Bond Fund 2”. This paper highlights the role of central banks in these efforts and points to issues that could be of relevance for the ongoing integration process in the Caribbean. It argues that the creation of a single currency area was based on a lengthy process, that economic integration came before monetary union, and that it required a strong degree of political determination; furthermore, integration is also assisted by the building of institutions and ongoing cooperation and dialogue among relevant authorities.

Introduction

Countries in the Caribbean have been working for many decades at embracing the challenges of an increasingly globalised world, including liberalised financial flows, the growth of offshore banking, foreign direct investment, migration of labour away from the region, and increased remittances to the region. One of the responses to those challenges has been efforts at increased regional cooperation and integration. Another response is increased interaction with, and contribution to, global efforts of cooperation and coordination, not the least in the world of central banking and banking supervision.¹

The 35th Anniversary of the Central Bank of Barbados provides an opportunity for some reflection on the information that is available on some of the Caribbean economies, efforts towards integration and examples of central bank contributions towards regional integration in other parts of the world.

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¹ For instance, as part of the Offshore Group of Bank Supervisors, the Central Bank of Barbados works closely with the Basel Committee on Banking Supervision (BCBS) and has hosted a conference on the new Capital Adequacy Framework of the Basel Committee, known as “Basel II”, in July 2006. The Central Bank is also part of ASBA (www.asba-supervision.org), the Association of Bank Supervisors of the Americas, and of CEMLA (www.cemla.org), an entity owned by central banks in Latin America and the Caribbean.

Barbados in BIS publications

Barbados is mentioned in over ten BIS Annual Reports, the first time 1947 (in relation to “currencies of non-metropolitan areas”), then in 1973, when Barbados was among the group of countries that chose to float with the Sterling, a decision, by the way, that was shared in the Caribbean by Jamaica and Trinidad & Tobago. It could actually be interesting for a historian to look back and see whether that decision was taken on the basis of regional consultations or by each central bank individually.

A further mention of Barbados came in connection with the growth of euro-currency markets in the 70s, and the BIS Annual Report of 1976 mentions Barbados among the offshore centres that were both the source as well as users of Euro-currency funds.

A very different type of publication is the BIS Review that contains speeches by central bank Governors. Governor Williams, who has attended several BIS meetings, has also contributed on numerous occasions to that publication.²

A further source of information that one can consult in order to find out about on the financial positions of Barbados as well as other countries in the Caribbean and of many other countries around the world are the very extensive BIS International Financial Statistics³.

Caribbean facts

These statistics collected by central banks in reporting countries and processed by the BIS allow for interesting comparisons relating to capital flows, developments of financial markets and other information of interest to central banks. They can be of particular interest in a regional economic setting, and this of course includes CARICOM.

In 1972, the same year that the Central Bank of Barbados was born, Commonwealth Caribbean decided to transform the Caribbean Free Trade Association (CARIFTA) into a Common Market and establish the Caribbean Community, of which the Common Market

² For instance: “Foreign exchange reserves - how much is enough?”, BIS Review 12/2006; January 2006; “The development of the Caribbean capital market”, BIS Review, 32/2004; “What is in store for the Barbadian economy as we enter the CSME”, BIS Review 20/2005; all at www.bis.org/review.

³ The locational banking statistics gather quarterly data on international financial claims and liabilities of bank offices in the reporting countries. Total positions are broken down by currency, by sector (bank and non-bank), by country of residence of the counterparty and by nationality of reporting banks. Worldwide consolidated data are reported on a contractual (immediate borrower) basis by banks' head offices in 30 reporting countries. These data exclude banks' cross-border inter-office business contained in the locational data, but include additionally local claims in foreign currency of all their foreign branches and subsidiaries. For more information, see http://www.bis.org/statistics/about_banking_stats.htm, and McGuire and Wooldridge (2005).

would be an integral part.⁴ The Treaty establishing the Caribbean Community, as you all know, was signed on 4 July 1973.

Among the objectives of the Community, identified in Article 6 of the Revised Treaty, are accelerated, coordinated and sustained economic development and convergence.

The Heads of Government of CARICOM countries have expressed their determination to work toward establishing a single market and economy. According to CARICOM, the proper functioning of the Caribbean Single Market and Economy (CSME) also requires, amongst others, economic policy measures, such as coordination and convergence of macroeconomic policies⁵ and performance, and monetary policy measures, such as coordinating exchange rate and interest rate policies, as well as the commercial banking market.

It is in this context that central banks are called upon to play their unique role of managing monetary policy and overseeing financial stability.

The objectives of the Central Bank of Barbados show parallels with the overall goals of CARICOM, as they consist of promoting monetary stability and a sound financial structure, fostering development of the money and capital markets, channelling commercial bank credit into productive activities, and fostering credit and exchange conditions conducive to the orderly and sustained economic development of Barbados.⁶

Other central banks in the region have very similar objectives, but they have to operate under economic scenarios that are at times quite different.

First, the following data, derived from the International Financial Statistics, referred to above, show differences and commonalities between selected countries in the Caribbean.⁷

a) Let us look, for instance, at the maturity distribution of consolidated claims of BIS reporting banks on the Caribbean, and Latin America. We know that countries in general attempt to avoid needing to face high debt repayments in the short term which could lead to a liquidity crunch. Countries which succeed in lengthening the maturity of their debt, so that the proportion of short-term vs. long-term debt shifts away from short-term debt, gain in external stability and confidence of financial market participants.

⁴ See <http://www.caricom.org>.

⁵ On this point in particular, see Bourne (2006).

⁶ See <http://www.centralbank.org.bb>.

⁷ As the statistics capture merely banking data, they do not necessarily provide a full picture of exposures. For instance, holdings by foreigners of domestic bonds would not be captured by the data. Furthermore, while trends might be similar, the actual amounts in question can differ considerably.

A closer look at the individual countries in the region (*Graph 1*) points out some interesting differences. Offshore centres in general have managed to reduce such vulnerability considerably as compared to 15 years ago, but the short-term component is still the most important and remains pronounced in, for instance, Barbados or St Vincent and the Grenadines. We can also see that most progress was made in the last decade, and that for the last 6 years, the overall maturity distribution remained almost unchanged, the allocation being almost equally split between short- and long-term claims.

b) As Caribbean countries are increasingly integrated into the global financial system, another interesting observation results from looking at the respective shares of banks, the public sector, and the non-bank private sector in obtaining credit from foreign institutions. Taking as a source the consolidated positions from institutions based in reporting countries (*Graph 2*), we note for all of the Caribbean and Latin America a gradual decrease of the exposure of the public sector, and a strong increase in the exposure of foreign banks to the non-banking private sector. This trend is echoed in most Caribbean countries, both the larger ones and the smaller countries.

In Jamaica, Dominica, and Grenada, we see rising amounts of claims on the public sector, while in the small island economies, lending to the banking or public sectors is practically non-existent. Interbank lending activity remains important in Barbados and to a certain extent in Jamaica. In the offshore centres it still accounts for a large part of the total claims, but as of 1998, claims on the non-bank private sector have risen sharply, reaching over \$1 trillion in 2006.

The acceleration of lending to the non-banking private sector that has been observed in some countries since around 2005 could be attributed to increasing hedge fund activity out of Caribbean states,⁸ but could perhaps also be attributed to the real-estate boom that some are experiencing at the moment.

c) A further interesting observation concerns the creation of local financial markets. One obvious way to reduce the vulnerability to external financing is the development of a domestic credit market. As we can see in *Graph 3*, the percentage of local claims as compared to foreign claims has increased in the last 10 years. Again, we can see that many, but not all Caribbean countries are in line with this trend. Offshore centres, where international claims remain the main type of lending, appear to be an obvious exception.

In fact, BIS reporting banks' foreign claims on the Caribbean and Latin America tripled in less than two decades. Of these, claims on local residents (denominated in local

⁸ In fact, the scale of non-bank private sector borrowing in offshore centres is often seen as a trend indicator of hedge fund activity, which fluctuates according to opportunities in "carry trades", for instance, borrowing Japanese yen or Swiss francs at low interest rates from the banks (thus boosting their "international" claims) and lending these funds to the markets with higher interest rates (such as Brazil).

currency and booked by reporting banks' affiliates) grew from less than 10% to more than 150% over the same number of years.

Second, Caribbean countries do not all use the same or similar exchange rate regimes and monetary policy instruments, an observation that is also true for the Central American region. (Table 1).

Third, as Governor Ewart Williams of the Central Bank of Trinidad and Tobago recently noted, the story of the Caribbean as a whole is that of steadily declining growth in per capita GDP, from 3.9% in the 1970s to 2.2% in the 1980s and to 1.9% in the 1990s. This would be a further reason why the region sees the implementation of the Caribbean Single Market Economy (CSME) by 2009 as an essential element of any strategy to further the development of the regional economies.⁹

Examples of central bank contributions to regional integration

There are certainly many aspects to how central banks can contribute to regional integration.

I shall briefly mention two quite different examples. *First*, the creation of monetary union, ie the creation and management of a common currency, and *second*, a fairly recent example set by Asian central banks to foster the development and deepening of local bond markets through the Asian bond fund initiative.¹⁰

1) Monetary Union

The most challenging is certainly the creation of a monetary union, the creation of a new currency area with a central bank that covers several countries, most often with formerly independent currencies, monetary policies and separate monetary authorities or central banks.¹¹ Central banks of the region have been examining the issue of Caribbean monetary union since the early 1990s, triggered to some extent by a concern about the European move towards a single European market and the formation of the North American Free Trade Agreement (NAFTA),¹² formally launched in January 1994.¹³

⁹ Willams (2007).

¹⁰ Other examples of central bank's contributions to regional integration are perhaps less evident or less well known. One example is the Central American Monetary Council, the hub for cooperation among central banks from Central America and the Dominican Republic, with its central secretariat based in Costa Rica. One of the Council's more recent initiatives, though not yet finalised, is the creation of a joint payment systems network, based on common general legal principles that are to become law in very member country. See http://www.secmca.org/Proyectos_SistemaPagos.htm.

¹¹ On the challenges, benefits and risks related to currency areas and exchange rate regimes, see Artus et.al. (2005), with, in particular Hawkins and Klau (2005) and Manioc and Montauban (2005)

¹² CARICOM agreed in 1992 that its eight members that were not part of the ECCB area (Bahamas, Barbados, Belize, Guyana, Haiti, Jamaica, Suriname and Trinidad and Tobago should join it to form a

The most evident example in this region is the Eastern Caribbean Currency Union (ECCU), with the Eastern Caribbean Central Bank, established in 1983, managing a common currency for practically all members of the Organisation of Eastern Caribbean States (OECS).¹⁴

On a larger scale, the creation of the European Central Bank (ECB) as part of the European System of Central Banks (ESCB) and a new common currency, the euro, was certainly an enormous challenge.

As regards monetary unions, I cannot speak for the ECCB or the ECB, but allow me to briefly comment on the European experience.

The monetary integration process at European level was neither easy nor fully accepted by all from the outset. The successful introduction of the euro also did not occur by accident. Rather it was the result of a long and painstaking preparatory process.

This process started under the aegis of the Committee of EC Central Bank Governors, and it started in Basel at the BIS, as it was there where the Committee had its Secretariat. The Committee of Governors was central to the preparation of the Statute of the ESCB and the Maastricht Treaty¹⁵ and, after the signing of the Treaty, undertook the initial groundwork for the move to monetary union. After its creation in 1994, the European Monetary Institute (EMI), as the institutional precursor to the ECB foreseen in the Treaty, took over the preparatory work. These preparations drew on the accumulated experience of central banks throughout the world, but - of course - especially those in the euro area.¹⁶

European monetary cooperation in a broader sense began with the establishment of the European Payments Union (EPU) in 1950¹⁷, well before the emergence of the Common Market and of the European Community.¹⁸ The beginning of the practical process towards monetary union, however, goes back to the Hague Summit in 1969 when the heads of state or of government "agreed that on the basis of the memorandum presented by the Commission on 12 February 1969 and in close collaboration with the

Caribbean wide single currency. Farrell (1995). On the desirability and feasibility of NAFTA as a common currency area, Bayoumi and Eichengreen (1993).

¹³ On NAFTA, see <http://www.nafta-sec-alena.org>.

¹⁴ Liburd (1995), Randall, Rosales, et al. (2000). On the OECS see <http://www.oecs.org>.

¹⁵ The Maastricht Treaty, formally the "Treaty of European Union", was signed 7 February 1992; <http://europa.eu.int/en/record/mt/top.html>.

¹⁶ Duisenberg (2000).

¹⁷ On the EPU see Kaplan and Schleiminger (1989), and, on the role of the BIS in EPU in particular, Toniolo (2005).

¹⁸ Lamfalussy (2005).

Commission a plan by stages should be drawn up by the Council during 1970 with a view to the creation of an Economic and Monetary Union".¹⁹

It is important to bear in mind that monetary union would probably not have been possible without a) a well defined process b) a central hub, in which all formerly independent central banks participate, and c) a common interbank payment system that enables financial institutions to have access to the same central bank money.

Initially, there was quite some scepticism towards European monetary integration, at least from countries with strong currencies and highly reputed central banks, although over time a general attitude of "constructive scepticism" emerged. One former central banker from the Bundesbank even said that it would have been considered heresy if anyone in that institution had predicted that within 20 years the beloved D-Mark would be replaced by the euro.²⁰

It is worth noting the role of central banks in the unification process. The political leaders entrusted the central bankers right from the beginning with a major role in the preparation of the Maastricht Treaty, for instance when they decided to set up the Delors Committee which was made up to a large extent by eminent central bankers.²¹ It was also decided that the majority of the meetings, and practically all the preparatory work for the meetings, would take place at the BIS, with both rapporteurs being central bankers.²²

While the Maastricht Treaty left open a number of issues, it was quite clear on two subjects that could have created serious conflicts between governments and the central bankers. The independence of the ECB was well defined; and so were the convergence criteria for accession to EMU. Among these criteria the fiscal ones, and naturally the inflation criterion, were of crucial importance for avoiding major conflicts between governments and the central banks on the road to monetary union.

The institution-building process, too, was governed by the Maastricht Treaty²³. It set out a roadmap in great detail, described reasonably clearly what should be the division of labour between the Council, the Commission and the central bankers of the EMI and of

¹⁹ On the history of the euro, see for instance http://ec.europa.eu/economy_finance/euro/origins/origins_2_en.htm, and www.dip-badajoz.es/eurolocal/entxt/emu/antecedentes/chaya.htm.

²⁰ Pleines (2007).

²¹ Most notably the and the Governor of the Bank of England, Robert Leigh-Pemberton, and the Governor of the Deutsche Bundesbank, Karl Otto Pöhl.

²² On interesting questions of governance in policy making in the EU, from cooperation, over "competition and negotiation", to "competition and hierarchy" in the runup to European monetary union, to today's "negotiation, competition and coordination", see Verdun and Monnet Chair (2006).

²³ *Supra*, at note 15.

the ECB, and, most important, set 1 January 1999 as the latest date on which the single monetary policy should start operating.

The European Monetary Institute, which, as noted above, had been put in charge of setting up the ECB, defining the operational infrastructure of the single monetary policy and preparing the future monetary policy strategy, was initially located at the BIS in Basel and then moved to Frankfurt where it developed into the ECB.

As regards infrastructure, European monetary union would not have worked without a joint payment system, TARGET²⁴, and a collateral arrangement²⁵, that allowed for settlements in central bank money which in turn is an essential element for effective monetary policy implementation.

In a way TARGET as a common payment systems platform is a working example that true integration is only possible with standard frameworks within which those participating in the system in their respective enterprises can interact, with standard procedural components, with standard specifications and with basic technical conditions: in short, standards on whose application the participants are in agreement or which they are committed to use.²⁶

Some of the experiences from the European monetary integration process could very well apply also to other regions such as the Caribbean. First, the process was a lengthy one; second, economic integration, that is trade and free movement of capital as well as capital account liberalisation, came before monetary union; and third, it required a strong degree of political determination.²⁷

²⁴ TARGET = Trans-European Automated Real-time Gross settlement Express Transfer system. On functional details, regulatory basis and statistics of usage, see the ECB's "Blue Book" at <http://www.ecb.int/paym/market/blue/html/index.en.html>. TARGET 2, the "next generation" of the system, will go live on 19 November 2007. Furthermore, the ECB and ESCB are working on "TARGET2-Securities", an IT service for settling securities; www.ecb.int/paym/market/secmar/integr/html/index.en.html and www.ecb.int/ecb/cons/html/t2s.en.html

²⁵ CCBM=Correspondent central banking model; <http://www.ecb.int/ecb/legal/1003/107597/html/index.en.html>, and, <http://www.ecb.int/ecb/legal/1003/107597/html/index.en.html>. On consultations for a new common platform for CCBM, www.ecb.int/ecb/cons/html/t2securities.en.html.

²⁶ Hartmann (1998)

²⁷ See also Noyer (2007)..

2) Joint furthering of capital markets: The Asian Bond Fund initiative²⁸

While a monetary union on the basis of common policy criteria seeks to improve monetary stability and obtain benefits from removing foreign exchange risk within the area of the union, a different set of benefits can be obtained from developing financial markets and increasing liquidity in domestic bond markets.

Such a goal can be well in the interest of central banks. And they can even be part of the general mission statement of a central bank, as the example of the Central Bank of Barbados shows.²⁹

An example for coordinated efforts towards better functioning financial markets, coming from a different part of the world is the recent initiative by Asian central banks to boost liquidity in local bond markets in Asia, the “Asian Bond Fund 2” (ABF2) initiative.

The background to the coordinated effort in Asia was the following. Despite a rapid expansion of markets in Asia over the last decade, there were indications that Asians have largely been investing part of their high savings in low-yielding foreign financial assets in developed countries abroad. Investments in Asia from abroad, in the form of bank lending and portfolio inflows, tended, however, to be volatile. In order to develop a source of long-term borrowing for Asian borrowers, Asian policymakers have responded by launching a number of cooperative initiatives, but perhaps the most intriguing is the ABF2, a regional fund for which the BIS has been appointed administrator.³⁰

This regional fund was established by the 11 monetary authorities of the Executives’ Meeting of the East Asia and Pacific group¹ (or EMEAP as it is better known).³¹ In less than two years, this venture has identified – and in many cases addressed – myriad impediments to trading in local bond markets. Most importantly, under the ABF2 initiative, EMEAP central banks provided the seed money from their international reserves to purchase certain funds.

²⁸ This section relies to a large extent on: “Report of the EMEAP Working Group on Financial Markets: Review of the Asian Bond Fund 2 Initiative”, June 2006, <http://www.emeap.org>, and Knight (2006); information on the PAIF and ABF is also available from <http://www.abf-paif.com>.

²⁹ *Supra*, note at note 6.

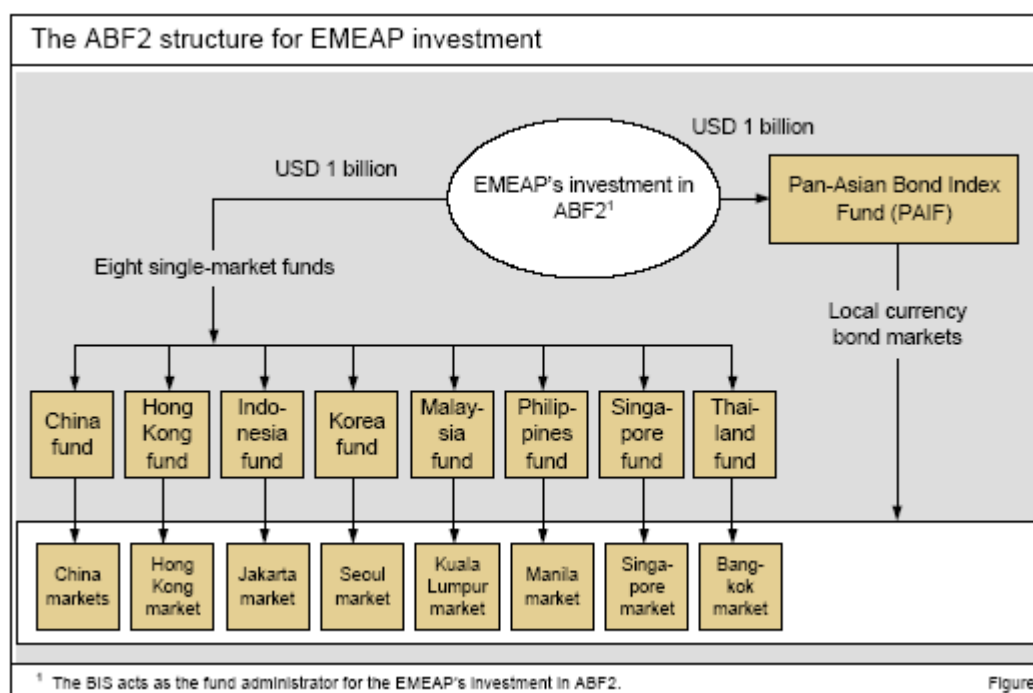
³⁰ Furthermore, EMEAP investments in the ABF2 are held through a BIS investment vehicle the USD denominated BIS Investment Pool (BISIP). As such, the BIS monitors the performance of the nine underlying funds, compiles monthly reports, and rebalances the allocation of funds to the nine funds. It is also responsible for implementing procedures for transitioning of EMEAP investments from phase one (funds for EMEAP only) to Phase 2 (funds open to the public, subject to regulatory requirements), and preparation of the annual report and audited financial statements.

³¹ The 11 EMEAP central banks and monetary authorities are the Reserve Bank of Australia, People’s Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, Bangko Sentral ng Pilipinas, Monetary Authority of Singapore and Bank of Thailand

ABF2 actually consists of nine separate funds: a Pan-Asian Bond Index Fund (PAIF) that invests in sovereign and quasi-sovereign domestic currency bonds in eight EMEAP bond markets; and eight Single-market funds each investing in the same bonds of the respective markets (Chart 1). These nine local currency-domestic bond funds, which are managed by private sector managers, replicate specific bond benchmarks provided by a third party.

EMEAP agreed to invest a total of USD 2 bn in the ABF2, with USD 1 bn being allocated to the PAIF and USD 1 bn distributed among the eight Single-market Funds. Although investments in ABF2 were initially confined to placements of official international reserves by the 11 EMEAP founders, the Fund is now being opened up to other institutional and retail investors.

Chart 1



The PAIF targets primarily regional and international investors who want to invest in the eight Asian bond markets through a single product. The Single-market Funds are intended to provide local retail investors a convenient way to invest in a portfolio of local bonds and, at the same time, to give regional and international investors the flexibility to invest in individual Asian bond markets of their own choice.

One could say that the ABF2 is also a commercial success. The launching of public bond funds in Indonesia, Korea and the Philippines, in addition to the four individual market funds launched last year, helped to bring the overall size of the ABF2 to \$3.1 billion at end-March 2007. Approximately \$800 million of private investment now complements the investment by central banks, which has grown from \$2 billion to \$2.3

billion. The PAIF returned about 17% in its first 21 months of operation, ending in March 2007.

Despite its relatively modest size in the Asian perspective, ABF2 has proven to be unusually effective in promoting reform efforts within domestic bond markets. By bringing together officials from the EMEAP countries to discuss the practicalities of actually establishing these bond funds, the ABF initiative has helped to improve their understanding of idiosyncrasies in their own domestic markets and to identify in detail significant market impediments. In general, it has highlighted the importance of standardisation of issues and the perils of segmentation. More specifically, ABF2 has prompted various countries to liberalise their capital control regimes.³²

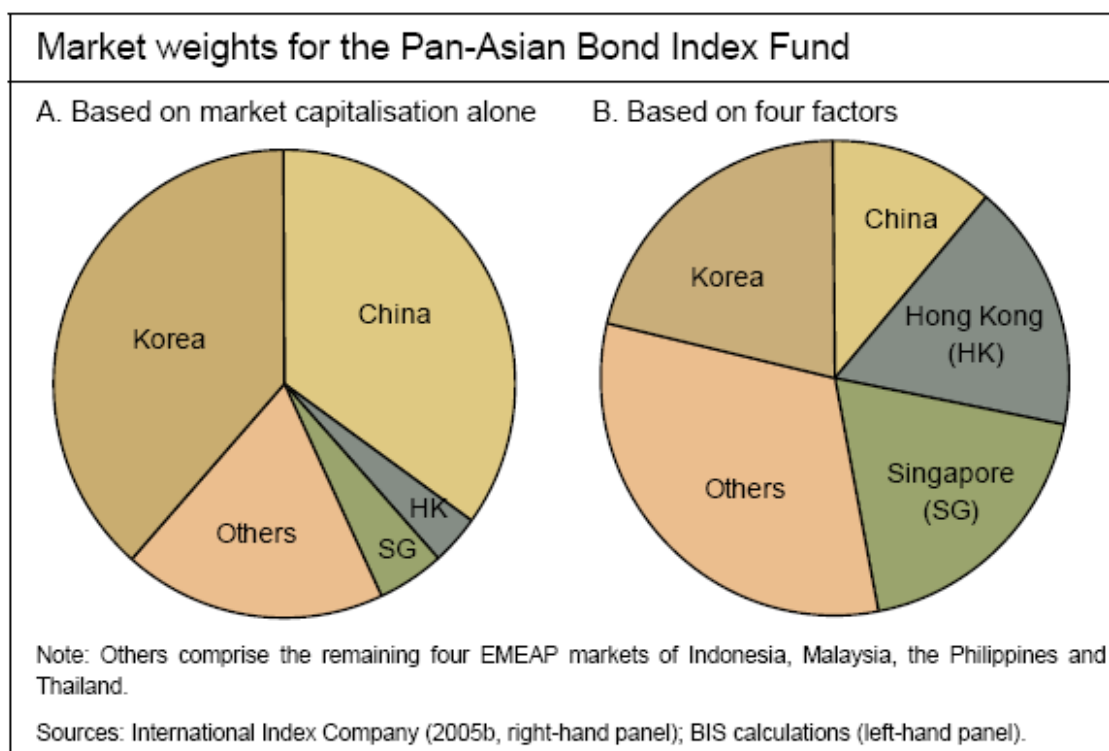
ABF2 has also fostered a better understanding among participants of each other's regulatory framework, enabling a fund domiciled in one jurisdiction to be sold in another.

For example, the Pan-Asian Bond Index Fund is domiciled in Singapore where it can take advantage of a variety of bilateral tax agreements between Singapore and other EMEAP members. Yet it has been initially listed in Hong Kong in recognition of the greater liquidity available in that market.

A particularly innovative aspect of ABF2 is a mechanism that helps to provide incentives for EMEAP countries to reduce market impediments in their jurisdictions. In determining the portfolio allocations within the PAIF among the eight EMEAP markets, a significant weighting is given to "market openness", which takes account of the extent to which capital controls and withholding taxes are still in place, the availability of hedging instruments and the effectiveness of clearing and settlement systems. Starting from an equal proportional allocation of the Pan-Asian Bond Fund for bonds issued in each local market, the allocation for bonds of a given domestic market will be increased over time if its "market openness" (as well as other lower-weighted factors) scores better than the averages for the other markets. Chart 2, below, shows that such weight adjustments can be significant.

³² Malaysia, for example, has dismantled many of the restrictions that were introduced during the Asian crisis. Other measures have been introduced to reduce tax impediments: five out of eight participating countries have so far exempted non-residents investing in domestic sovereign or quasi-sovereign issues from withholding tax.

Chart 2



Last, but not least, the ABF2 initiative showed that central banks can play a useful role in spearheading and coordinating regulatory reforms, in particular as bond market development did not fall squarely within the mandate of any government agency.³³

The impressive expansion in domestic bond markets since the late 1990s has not only allowed governments and other borrowers to fund themselves more efficiently but has contributed to the overall stability of domestic financial systems. But these opportunities have been offset by a lack of liquidity, which often falls considerably short of that found in developed economies. The experience of the Asian Bond Fund 2 demonstrates how determined efforts to remove market impediments can achieve very concrete results within a surprisingly short time frame.

Benefits of a common hub for coordination – the example of the BIS

The initiatives described above were all the result of intense dialogue among central banks that had been going on over several years. It might have been possible to reach a

³³ EMEAP, *supra*, notes 27 and 32.

result without a history of cooperation, but it was certainly easier to move forward and to reach agreements in a setting in which central banks had built mutual trust and knowledge of shared strengths and weaknesses.

There are various ways, more or less formalised or institutionalised, to build such confidence-enhancing structures among central banks. In this context let me point out some of the experiences of the BIS, an institution in which central banks have cooperated since 1930, which makes it the oldest international financial institution in the world.

Since 2003, the BIS is owned by 55 central banks; among them are 24 non-European members and 16 central banks from major emerging market economies. It is financially independent, and its governance structure makes it also highly independent from political influence. Apart from being a bank for over 120 central banks and some 20 international organisations, it was designed to act as a forum for international financial cooperation, and it is also a renowned centre for monetary and economic studies on issues of relevance to central banks.

The BIS hosts and supports the Secretariat for some expert committees that work in areas such as monetary policy, payment systems or banking supervision.³⁴ It is at the BIS that the Governors of central banks from major economies meet very two months, and central banks from other countries, for instance from the Caribbean, are regularly invited to participate in BIS events, held both at the Head Office in Basel as well as in the regions.

The reputation and relative success of the BIS is perhaps based on two noteworthy facts. First, it is important to point out that the BIS has no regulatory powers whatsoever, and second, that the documents that come out of the BIS or of the various Committees it supports are not the result of majority decisions, or voting. Rather, it is the often long process of seeking consensus, or simply sharing concerns and insights in an atmosphere of trust that results in a high degree of acceptability.³⁵

Questions and open issues

As regards the relevance of the above for a further Caribbean integration, it would appear that a consensus on some of the following questions would need to be sought.

³⁴ For instance, the BCBS, the Committee on the Global Financial System (CGFS), the Committee on Payment and Settlement Systems (CPSS), the Irving Fisher Committee (IFC), the Markets Committee (MC) or the Group of Computer Experts (GCE); see <http://www.bis.org> for more information. Furthermore, the BIS invited the secretariats of more recent, independent, groups of the financial regulatory and supervisory community to be located in Basel, such as the Financial Stability Forum (<http://www.fsforum.org>), the International Association of Insurance Supervisors (www.iaisweb.org) and the International Association of Deposit Insurers (<http://www.iadi.org>).

³⁵ See Giovanoli (2000), Heinrich (2006)..

Should there be a monetary union at all?

Obviously, there is no easy answer to this question, and there is no single model of monetary cooperation which could be duplicated around the world. But obviously many countries are confronted with similar challenges that Europe faced over 15 years ago, in particular whether it is possible to reconcile greater economic integration with exchange rate volatility, and, if not, whether fixed or pegged exchange rate regimes can be sustained in an environment of full capital mobility.³⁶

It appears that one of the reasons why the original idea as promoted by CARICOM heads of state has not yet come to fruition could lie in the fact that, individually taken, the economies of CARICOM states are more competitive than complimentary, and that the trade potential among them seems to be already exploited; on the other hand, a monetary union could provide member states with a collective public good that could be a catalyst for further integration.³⁷

Should central banks share a common institution?

A major part of the European monetary unification process has had to do with institution building.

If regional central bank cooperation in the Caribbean were to be further institutionalised, one can think of several options. A first-step low-key solution could be to create a name for the common framework and a Secretariat, but rotate the secretariat among members rather than creating a new administrative entity.³⁸ An intermediate step could make use of an existing structure or institution whose mandate might need to be expanded,³⁹ and probably the most complex option would be to create a new institution which could serve as the embryo for a future joint central bank. An example for the latter option is the EMI as pathfinder for, and predecessor of, the ECB.

In any event, one would need to think of whether such an entity could or should become a formal CARICOM institution. It appears that at this time the Caribbean Investment Bank, created by regional governments in 1969, is the only common financial institution of CARICOM.

³⁶ Noyer, *supra*, at note 27.

³⁷ Manioc and Montauban, *supra*, footnote 11. On the proposals of the Council of Central Bank Governors regarding different options for monetary integration, and on the proposal for a strategy of reserves pooling, see Nicholls, Birchwood et.al. (2000). Commitment to a currency board as a potentially vital step in achieving a currency union for the Caribbean is supported by Worrell (2003). On monetary integration in Africa, see Gudmundsson (2006).

³⁸ This is the case, for instance, for the Central American Council of Bank Supervisors ("Consejo Centroamericano de Supervisores Bancarios).

³⁹ Existing structures are, for instance, the Caribbean Group of Bank Supervisors (CGBS), or the Caribbean Centre for Monetary Studies (CCMS).

The governance structure of any new institution, the decision making process and the ability to speak on behalf of others would of course pose further challenges.⁴⁰

Infrastructures: harmonisation of payment system development, supervision, stock exchanges

Independent of the question of a monetary union, a further integration and in particular the development of financial markets would appear to require the development or strengthening of existing infrastructures, in particular payment and settlement systems, and possibly also a common, more formal framework for banking supervision and regulation.⁴¹

One could ask whether such development is better achieved if each country works on its own, but shares experiences as they move along; or whether the development should occur on the basis of common standards and procedures that are to be developed within a common central bank infrastructure.⁴² A common payments infrastructure in an integrated economy, with benefits to all users, also at retail level, can however be a long process.⁴³

⁴⁰ As regards governance of central banks, the BIS has supported cooperation and information sharing among central banks for a number of years, lead by the Central Bank Governance Forum and now supported by a new section on “Central Banking Studies” within the Monetary and Economic Department of the BIS (2006).

⁴¹ Regional supervisory authorities do cooperate through the Caribbean Group of Bank Supervisors (CGBS), established in aegis of the CARICOM Central Bank Governors. For instance, the CGBS Technical Working Group has been looking at minimum features for consolidated supervision to be embodied in legislation and proposals have been put forward to the Group of CARICOM Central Bank Governors; see Anderson (2007). While the CGBS has a central website, <http://www.cgbsnet.org/>, and since 2003 a group within Bank of Jamaica has been administering the Secretariat for CGBS, the Group of Governors does not appear to have a central hub, a website or joint publications. Individual Caribbean authorities are, however, members in ASBA, the Association of Supervisors of Banks of the Americas, www.asbaweb.org.

⁴² One needs to distinguish between agreeing to follow general basic principles and agreeing on common technical standards, legal principles and perhaps even one or more technical platform to be shared by all. As regards basic principles, see CPSS (2001) and (2006). On legal harmonisation, see Heinrich (February 2006).

⁴³ Note, however, that while TARGET has been successfully operating as platform for settlements in central bank money in Europe, the realisation of the “Single euro Payments Area” (SEPA) as “a means to advance European integration with a competitive and innovative euro area retail payments market that can bring with it higher service levels, more efficient products and cheaper alternatives for making payments”, began in the 1990s and is still not finalised. See: <http://www.ecb.int/paym/pol/sepa/html/index.en.html>

Should there be first movers to a monetary union?

If monetary union is to take shape, one would probably need to think about whether all countries are to join such a union at the same time, or if there could be a group of “first movers” which would build a core group. In Europe, as you know, not all members of the European Community have already adopted the euro. Some have decided not to adopt that common currency for the time being; others are working towards joining the eurozone but do not yet fulfil the necessary preconditions as set out in the convergence criteria.⁴⁴ For the Caribbean, one would need to think whether to create a new currency area or to expand existing ones, ie to continue with CARICOM's original plan to have regional countries join the ECCB⁴⁵, or to see first how sub regional initiatives for economic union, like for instance for the OECS⁴⁶, progress.

It is on all these issues that joint work and a common understanding by central banks could provide essential guidance to politicians on the best way forward.

⁴⁴ The Czech Republic, for instance, plans to adopt the euro by 2010 and is confident to fulfil all the convergence criteria of the Maastricht Treaty related to price stability, long-term interest rates and fiscal positions, government debt and exchange rate conversion; www.czech.cz/en/economy-business-science/

⁴⁵ *Supra*, note 12.

⁴⁶ Seven of the nine member states of the OECS i.e. Antigua and Barbuda , Dominica , Grenada , Montserrat, St.Kitts and Nevis, St.Lucia and St. Vincent and the Grenadines are participating in the economic union initiative that started in 2001. Anguilla and the British Virgin Islands the two remaining member states have requested time for further consideration. See www.oecs.org.

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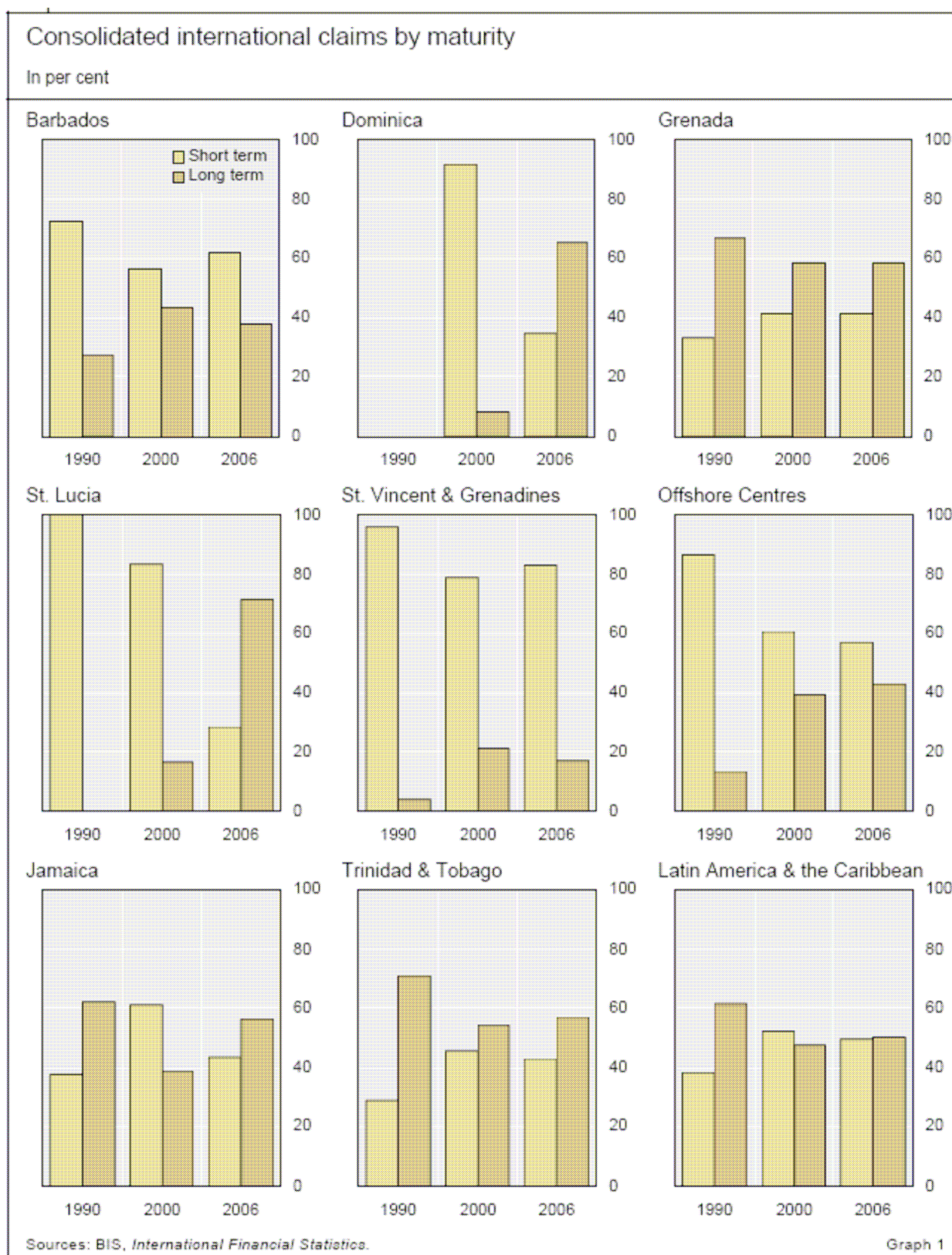
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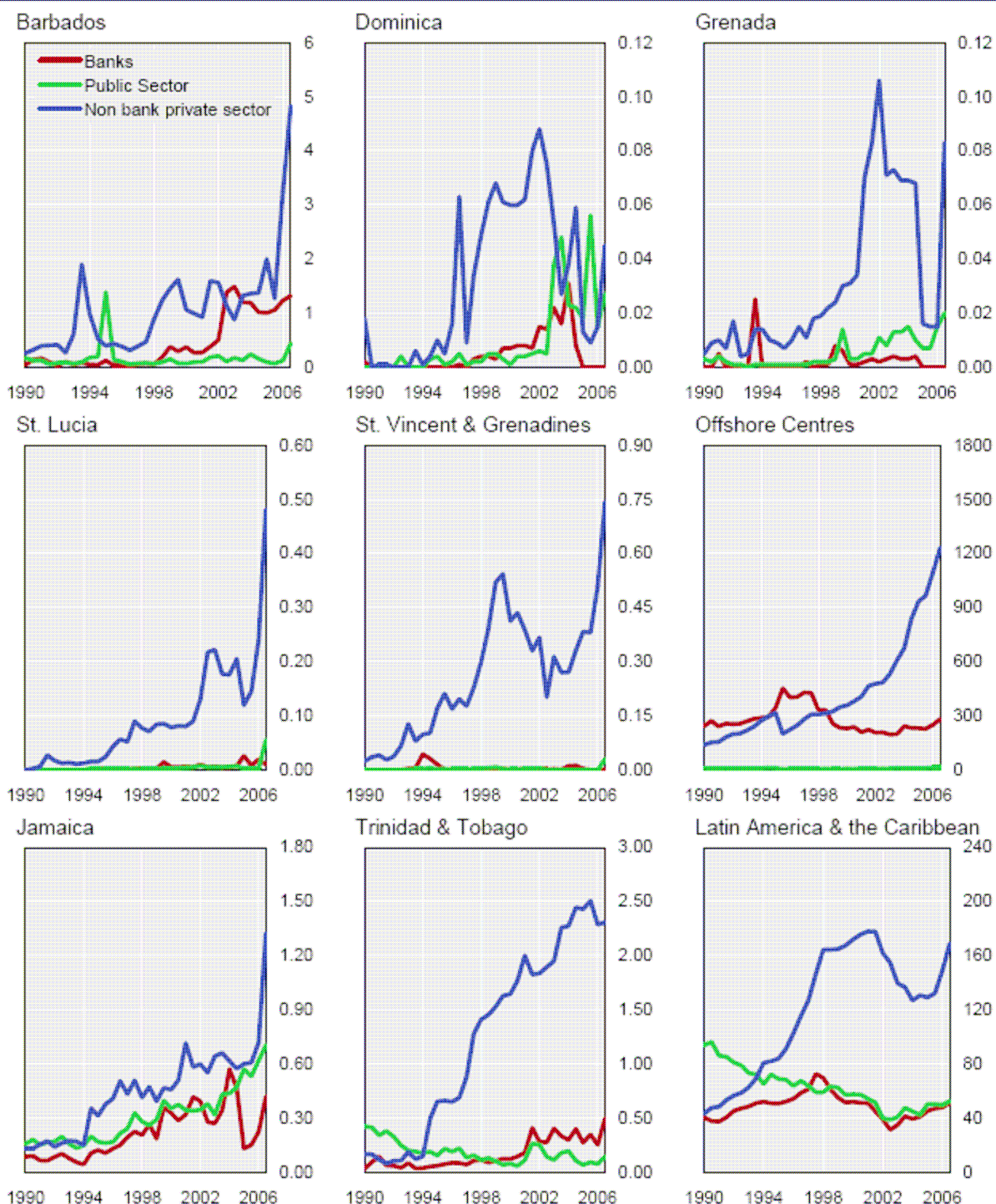
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ANNEXED GRAPHS:



Consolidated international claims by sector

In billions of dollars

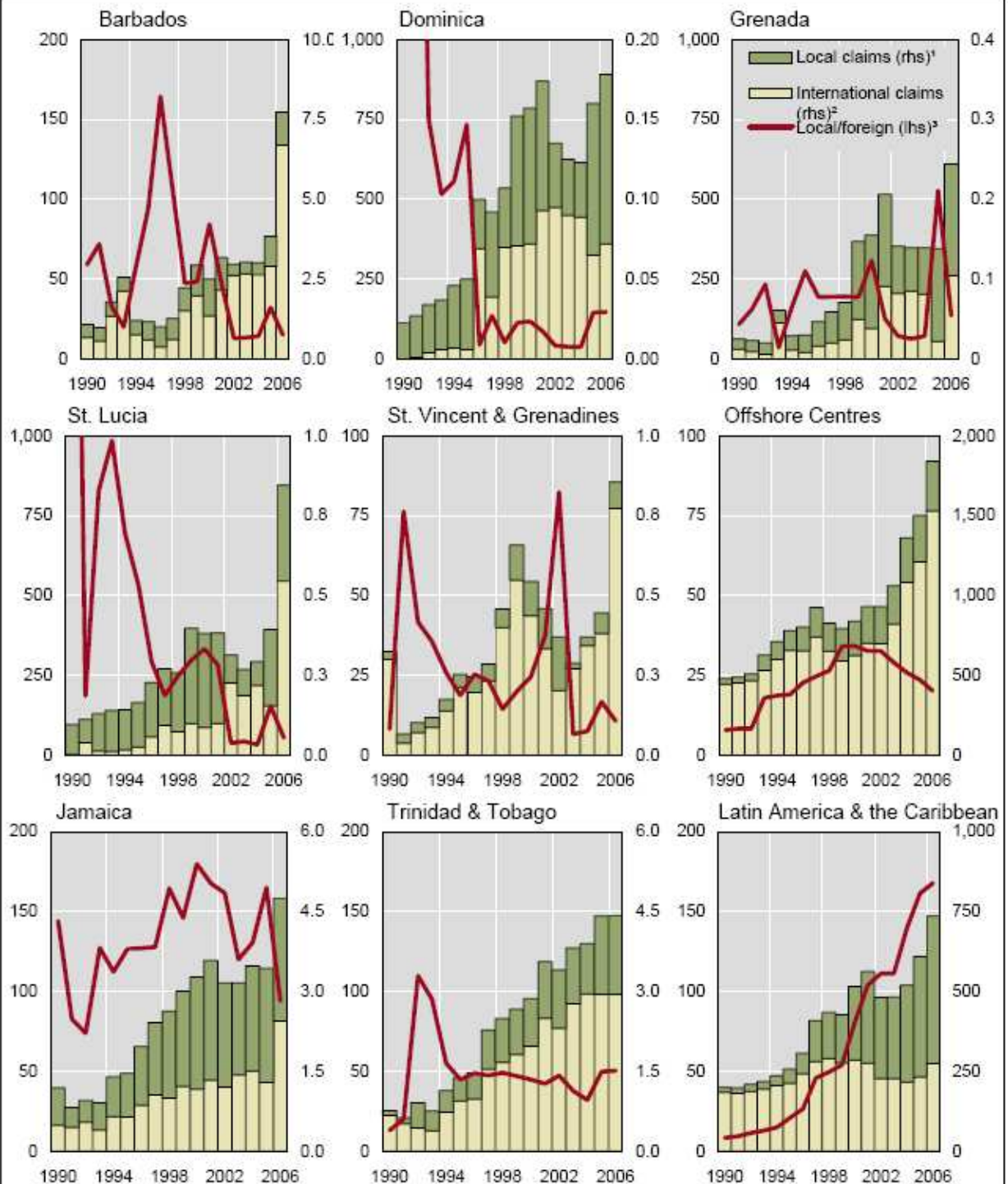


Sources: BIS, *International Financial Statistics*.

Graph 2

BIS reporting bank's foreign claims

By residency of immediate borrower, in billions of US dollars



¹ Claims on local residents denominated in local currencies and booked by reporting banks' local affiliates. ² Cross-border claims in all currencies plus claims on local residents denominated in foreign currencies and booked by reporting banks' local affiliates. ³ Local claims as a percentage of foreign claims; for 2006, September data.

Sources: BIS, *International Financial Statistics*.

Graph 3

Table 1

Monetary policy framework							
	Exchange rate anchor				Monetary aggregate	Inflation target	IMF supported or other mon.progr. ²
	Dollarised ¹	Currency board	Fixed pegs	Crawling pegs			
Caribbean							
Aruba			x				
Bahamas			x				
Barbados			x				
Dominican Republic							x
ECCU		x					
Haiti							x
Jamaica					x		
Trinidad & Tobago							x
Brit. Virgin Islands	x						
Central America							
Belize			x				
Costa Rica				x			
El Salvador	x						
Guatemala						x	
Honduras				x			
Nicaragua				x			
Panama	x						
1) A foreign currency is legal tender; 2) May imply floors for international reserves and ceilings for the central bank's net domestic assets, and consequently also indicative targets for reserve money. Source: IMF, Annual Report on Exchange Arrangements and Exchange Restrictions, 2005.							