

ABSTRACT

The ECCB Monetary Arrangement in Macroeconomic Perspective

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The monetary union administered by the Eastern Caribbean Central Bank (ECCB) is widely admired and, indeed has been proposed as a model for the monetary constitution for a larger Commonwealth Caribbean grouping. Whilst the ECCB's success in maintaining a fixed peg for its currency is well-known, little has been published on the workings of the arrangement and this study aims to fill that gap.

We start by placing the currency arrangement in historical perspective showing how it emerged from the post-independence fragmentation of the British West Indies. This exercise allows us to identify more clearly the rationale for its present structure. The implications of the operational framework for the relationship between governments, the commercial banks and the ECCB are then explored using a simple macroeconomic model. Finally, the model is parameterized and used to examine empirically the evolution of the economy of one of the ECCB member states, St. Vincent and the Grenadines.

It emerges that the monetary union operates very much along the lines of its predecessor currency boards. Now, as then, the key to maintaining the external value of the currency turns out to be a 'foreign asset rule' which ties the value of the currency issue to the ECCB's holdings of foreign reserves. This rule has two important, but independent, implications. Firstly, it produces a more or less automatic adjustment of the member economies to external shocks and, secondly, by limiting central bank financing of budget deficits, it restricts the scope for governments to adopt discretionary policies to impede such adjustments. What emerges very clearly then as the crux of the arrangement is that membership ties the hands of its member governments in some very important ways and it is this, in turn, which enables the currency peg to be preserved.

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