

THE MONETARY SYSTEM OF THE BAHAMAS

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HISTORICAL PERSPECTIVE

The evolution of monetary arrangements in the Bahamas follows a pattern which at least in its earlier stages is not unlike that in other Caribbean countries and indeed other colonial territories.

The first central monetary institution was the Currency Commission which came into being with the Currency Act of November, 1919. The Commission was a passive institution whose function was simply to issue and redeem locally printed currency notes of the Government of the Bahamas against Sterling. The Commission maintained a Sterling asset cover for the note issue in the Currency Note Fund. The Fund consisted of gold and silver coins and Sterling assets in a ratio roughly one-third coins and two-thirds Sterling assets. The assets were obligations of the United Kingdom and other Sterling Area countries, principally Africa.

The currency cover could not legally fall below 100% of the note issue since any depreciation in the value of the assets had to be met from the General Revenue of the Colony. The Act prohibited the Fund from holding any local securities.

The expenses of the Commission were met from the Currency Note Income Account. Any surplus in this account at the end of the year was transferred to the General Revenue. The transfer of any surplus in the income account was however, subject to the decision of the Secretary of State.

Laying aside the question of economic efficiency and the outright transfer of the country's resources overseas, from an administrative point of view (and that was perhaps the overriding concern at the time) the system worked simply and well. It was anti-inflationary and the check on the country's balance of payments was automatic.

Asset Cover of the Note Issue
for 10-Year Period 1925-34
(expressed to nearest £)

	(1)	(2)	(3)	(4)	(5)
	Currency Note Issue	Sterling Investments (Face Value)	Coin Portion of Currency Note Fund	Columns (2) + (3)	Column 4 as a Per Cent of Column 1
1925	60,000	42,821	20,000	62,821	105
1926	60,000	43,728	20,000	63,728	106
1927	100,000	71,820	33,333	105,153	105
1928	110,000	80,476	36,667	117,143	106
1929	110,000	80,476	36,667	117,143	106
1930	110,000	81,047	36,667	117,714	107
1931	110,000	81,047	36,667	117,714	107
1932	110,000	81,507	36,667	118,174	107
1933	110,000	81,474	36,667	118,141	107
1934	110,000	82,762	36,667	119,429	109

The Bahamian dollar came into being as the legal tender under the Currency Act of 1965 which decimalised the currency. The dollar was equivalent to seven shillings. Upon devaluation of Sterling in 1967, the first act to indicate that the currency was not unalterably linked to Sterling was taken with the decision to remain at parity with the United States dollar. The Bahamian dollar then became equivalent to eight shillings and two-pence.

The Currency Act of 1965 made provision for investing funds from the note issue locally. Under the Act the external backing of the currency was reduced to 50% with the additional 50% becoming a contingent liability on the Government. However, the Sterling Agreement placed a greater restriction on the amount of local assets which could be held.

Present Context

The Monetary Authority

In 1968 the Bahamas Monetary Authority came into being with the adoption of the Monetary Authority Act. The principle objectives are:

- a) the issue and redemption of currency;
- b) supervision of banks' and trust companies' operations;
- c) fostering of close relations between the banks themselves and between the banks and Government;
- d) advising Government on banking and monetary matters;
- e) administering exchange control; and
- f) performing such activities as may be necessary to fulfil these objectives.

As an independent body, the Authority has perpetual succession. It is fully owned by the Government, and general administration and policy are in the hands of a Board of Directors.

In both timing and objective, the Authority is a way-station between the Currency Commission and a central bank, although it is much nearer a central bank than the "passive" Currency Commission. The traditional central bank's tools of monetary policy, i.e., variations of the bank rate and reserve requirement, and open market operations are essentially without the Authority's scope. However, the monthly treasury bill auction which it has conducted since mid-1971 has given it a measure of viability of monetary significance.

The Authority issues and redeems the Bahamian dollar against Sterling by law, although it has on occasion purchased United States dollars as a convenience to the commercial banks.

The Commercial Banks The commercial banking system consists essentially of foreign branch banks whose direction as well as ownership are external. There are fifteen of these institutions sharing between them the domestic banking business, although the seven members of the Clearing Association account for over 80% of local banking.

The seven Clearing banks are appointed by Exchange Control as Authorised Dealers in foreign currencies and as Authorised Agents on behalf of beneficial owners of investment currency or foreign currency securities. The remaining eight are appointed Authorised Dealers.

The major portion of the business of these banks is overwhelmingly external. The deposit liabilities of the local banking system at the end of 1971 is given below:

Deposit Liabilities as at December, 1971

<u>Currency</u>	<u>Deposits (B\$ Millions)</u>	<u>Per Cent of Total</u>
B\$	165	6.89
£	146	6.09
US\$	1948	81.38
Can.\$	19	0.80
Other	116	4.84
	<u>2394</u>	<u>100.00</u>

Except where the banks carry a net foreign currency position, the "offshore" portion of the banks' business has no monetary significance. However, this does not include those cases where foreign currencies are lent to non-residents who invest them locally. Also marginally foreign currencies are lent to residents.

The fifteen commercial banks have between them some seventy branch offices so that there is on average one banking office for every 2,600 residents.

Traditionally, the commercial banking system held Sterling assets in London against the bulk of their Bahamian dollar deposit liabilities. This resulted from a lack of private liquid assets to match the volatility of the deposits, and the Government's unwillingness to pay interest on treasury bills when it had no need for short-term funds. It was fostered by the banks' inclination until 1967, to posit an unalterably fixed relationship between Sterling and the local currency.

The banks' dilemma was further reinforced by their ability to generate Bahamian dollar deposits independently of the local economic context. These are the externally-owned Bahamian dollar deposits which arise when a foreign resident wishing to take advantage of the tax situation advises that a Sterling deposit be held in Bahamian dollars. Various kinds of external transactions can also give rise to a Bahamian dollar deposit liability. Of the B\$165 Million deposits at the end of 1971, B\$22 Million were externally-owned.

The commercial banking sector is perhaps the most developed in the Bahamas. This is to some extent due to the fact that it has had to service vast "offshore" investments, and due partly to the sophistication of the international system in which it has had to function.

In some ways, however, the system lags well behind in institutional practices which is to some extent the result of the underdevelopment of the structure of the overall economy. An example is the complete absence of any commercial paper.

The banking system is closely linked with New York and particularly London. This is due to several factors. The Authority guarantees the convertibility of local currency against Sterling, and the Bahamian dollar exchange rate is fixed to Sterling, eliminating a major element of risk. A second factor is the importance of both the United States dollar and Sterling in the country's international trade and payments. A third factor is the absence of any local money market. These factors taken together with the shortage of acceptable local assets have understandably fostered a close relationship to external financial centres.

In 1971 a system of voluntary reserve deposits was instituted. Under the system the commercial banks agreed to maintain a minimum of 5.5% of their Bahamian dollar liabilities in till cash and deposit balances with the Authority. Until then the banks were completely free to determine their own liquidity needs. There are even now no legal requirements, and the 5.5% is not really intended to be a benchmark of the liquidity needs of the banks. Indeed, only the seven Clearing banks are to maintain this ratio. To some extent, at least, the existence of the overseas head office blunts the "banking" if not the "monetary" significance of a liquidity requirement.

Other Banks In addition to the banks just described, there are some three hundred other banks falling essentially into the class of "Euro-banks". Their operations are in Euro-currencies and their foreign currency position is balanced. With little exception they operate outside the economy, their only contact being through local expenses for salaries, rents, fees, etc. There are of course, one or two notable exceptions, but in the aggregate they need not be considered in the context

of local monetary arrangements.

Trust Companies Like the banks, trust companies are non-resident owned and directed. The trusts consist of foreign currency funds against which foreign assets are held, although some trust companies have marginally "laid-off" funds in the local mortgage market. Like banks they too have deposits of externally owned Bahamian dollars against which they may hold local mortgages.

Deposits Taken by Trust Companies and Assets*
Held Against them by Currencies 1965 - 1971
(Expressed in B\$ Millions)

	EXTERNAL LIABILITIES				EXTERNAL ASSETS		
	B\$ Non- Local	£	US\$ and Can.\$	Other	£	US\$ and Can\$	Other
1965	4	12	78	1	11	64	1
1966	5	27	143	-	27	71	-
1967	3	26	133	-	25	129	-
1968	5	42	103	-	41	106	-
1969	3	28	243	9	23	142	4
1970	1	25	186	14	22	186	10
1971	1	22	397	5	20	390	1

Although their assets do not reflect their deposit balances with banks locally, it becomes clear from the table that trust companies tend to balance their accounts within currencies. Any differences represent the amount placed in local banks in foreign currencies.

*It must be noted that the trust companies do not report deposits in foreign currencies with local banks which accounts for much of the discrepancy between assets and liabilities within currencies.

Insurance
Companies

There are an estimated 108 insurance companies doing business in and from within the Bahamas. Most of these are subsidiaries or branches of foreign companies and they operate here to take advantage of the tax situation. They conduct their business outside the Bahamas and their activities are directed from abroad, but a few companies are estimated to have a fairly significant portfolio of local mortgages.

There are a small number of locally incorporated companies with Bahamian shareholders, but the bulk of the local business is handled by branches of foreign companies.

Very little information is at present available on the local operations of insurance companies. An attempt to separate their local from the offshore business is only now being made.

Post
Office
Savings
Bank

The Post Office Savings Bank was established under the Post Office Act of 1914. Although it was revised in 1936 and 1965 it still has a decidedly colonial flavour.

It was, and still continues to be the only savings institution able to offer its facilities to the outlying districts of the Islands. And so, despite its unrealistic and non-competitive rate of interest, it continues to serve a very useful function in this respect.

The Act provides that moneys of the Bank shall in no way be "applied to the purposes of the Colony". The assets of the Bank are held in Sterling. Under certain conditions, and at the discretion of the Governor, revenue surpluses may be transferred to the general revenue of the country.

The deposits of the Bank have been fairly static over the last five years, and there has in fact been a fall-off in the number of depositors.

The Bank is quite obviously uneconomic both from the points of view of the individual investor and of the country.

Other Financial Institutions There are five major finance companies of note operating in the local market with an asset portfolio of about B\$45 Million. The great bulk of this is in domestic mortgages with the remainder in automobile financing and consumer purchases.

The remaining financial institutions, including investment dealers, mutual funds and unit trusts are characteristically "offshore" in nature.

SOME BRIEF COMMENTS ON THE SYSTEM

The commercial banks operate their lending policies against the background of a permanent balance of payments current account deficit. Evidence indicates that the banks' lending policies respond primarily to the supply of acceptable assets. Acceptability is somehow a positive function of some notion of credit-worthiness of the borrower and the liquidity of the loan. The interest rate seems to have been insensitive to changes in the relationship between the supply of assets and the supply of loanable funds. At any rate it seemed downward-inflexible.

The banking system is normally characterised by excessive liquidity but this has not traditionally brought any downward pressure on rates.

The greatest volume of the balance of payments flow is in United States dollars, however, receipts and payments essentially balance although not on current account. The banks operate within prescribed margins for foreign currencies. Their net position for United States dollars against local currency may not exceed \$250,000. They may however, carry any position in Sterling or any position in one foreign currency against another.

The banks find the foreign exchange requirements among themselves. It was indicated earlier that the banking system through certain purely external transactions, or in response to a directive from an external depositor, could increase its Bahamian dollar deposit and hence the local money supply. The system is somewhat artificial in that no local resident had command over this portion of the money supply, and one tends to get misleading readings from it. For example, if one attempts to get an indication of the level of development of the monetary system by examining deposits as a per cent of the money supply (defined as demand balances and currency circulation) for the year 1969, one gets a reading of the most developed monetary systems.

Demand Deposits as a Per Cent
of Money Supply 1969
(B\$000)

	(1) Currency Circulation	(2) Demand Deposits	(3) Column (2) as a Per Cent of (1) + (2)
March	13702	69728	83.57
June	15052	76918	83.63
September	14017	72161	83.73
December	17227	73328	80.97

Another complication arises with the money supply in terms of the foreign currency component.

A local resident (by Exchange Control definition) may have a United States dollar account into which he places the United States proceeds from his local operations and from which he makes payment in United States

dollars, perhaps for imports. This constitutes for him a 'transactions balance'. These foreign currency deposits on local accounts at the end of 1971 was nearly double the Bahamian dollars on local account. In other words, total deposits on local account at the end of 1971 were B\$410 Million, or nearly B\$100 Million more than the estimate of Gross National Product.

Another noteworthy factor in our monetary system is the significant amount of United States dollar notes in local circulation. Although the amount is now greatly reduced, at the high point the amount was estimated at something approaching 20% of total currency in circulation.

This is a brief and rather superficial comment on the monetary system in the Bahamas. It is intended to be descriptive rather than analytic. Undoubtedly, the monetary system is going to play a very significant role in the future development of the country, both in terms of providing for the employment of funds at home, and in 'encouraging' the most efficient use of these funds.

Even now a new chapter in monetary arrangements is beginning to be written as the Authority gears itself to assume the role of a central bank, and as other financial institutions such as the development bank which is now on the drawing board come into being.

DETAILS OF CURRENCY

Month	Total Currency in Circulation	Currency in Banks	Currency in Active Circulation
<u>1969</u>			
January	24,059	11,967	12,092
February	25,742	10,321	15,421
March	23,736	9,971	13,765
April	23,387	9,834	13,553
May	23,662	8,233	15,429
June	23,704	8,580	15,124
July	24,984	9,441	15,543
August	24,985	10,275	14,710
September	24,603	11,146	13,457
October	24,847	9,146	15,701
November	24,977	7,653	17,324
December	27,669	10,370	17,299
<u>1970</u>			
January	24,706	8,115	16,591
February	23,996	7,611	16,385
March	24,633	7,825	16,838
April	24,633	8,657	15,976
May	24,826	7,705	17,121
June	24,047	7,586	16,461
July	23,806	7,095	16,711
August	23,683	7,164	16,519
September	23,961	8,589	15,372
October	23,806	6,868	16,938
November	23,516	6,624	16,892
December	25,785	8,057	17,728
<u>1971</u>			
January	22,810	6,455	16,355
February	22,469	6,039	16,430
March	22,484	6,733	15,751
April	22,535	6,712	15,823
May	22,618	6,732	15,886
June	22,553	7,818	14,735
July	21,944	6,671	15,273
August	21,713	7,283	14,430
September	21,180	6,612	15,568
October	21,437	5,207	16,230
November	21,051	6,411	14,640
December	25,060	9,875	15,185