THE MONETARY AUTHORITY AND ITS IMPACT ON COMMERCIAL BANKING IN BELIZE.

by Dorla Humes

Economic activity in Belize centers around production for export. This feature is deeply rooted in the history of the country, dating back as far as the 16th century when British Sellers explorted the timber resources of the colony and mahogany and logwood became the two primary exports. Since then sugar has superceded timber as the main export (in terms of output, value, and employment). The transition which did not come until the 1950's came only with the depletion of timber reserves, the switch from wood to metal in the ship-building industry, and the discovery of aniline dyes. These events were reinforced by the importance of sugar in Europe, the recognition that a large segment of the arable lands was ideally suited for sugar production and the realisation that sugar was the only crop grown in an area which housed over 30% of the population.

Concentration on satisfying an export market meant that the economy produced very little of what was consumed locally. The result was that the economy became highly dependent on its export earnings to finance the varied import demands of its residents. The importance of one crop, sugar which is susceptible to the vagaries of the weather and diseases, unstable world prices, and more recently, rapidly fluctuating exchange rates, has made this dependence more acute. While attempts have been made to diversify and citrus and fishing are making increased contribution to foreign exchange earnings, sugar remains, by far, the dominant crop.

The dominant industries, sugar, citrus and timber, for example, were primarily owned by large international concerns and no attempts were made to carry the production process beyond the primary stages, while the haphazard development of industries resulted in very little intersectoral linkages. In addition, the seasonal nature of its major crops and the shortage of skilled manpower created and still create unemployment problems. In addition, with the concentration of the population in urban areas, urban unemployment has coexisted alongside the need to import workers from neighbouring countries for cane cutting and citrus picking during crop time.

REGIONAL MONETARY STUDIES CONFERENCE, 197

These are only some of the features which characterise the economy. This structure has been perpetuated, no doubt, by its institutional framework. The commercial banks, for example, have traditionally operated to finance the export - import trade, and even today one finds that the largest portion of bank lending goes to the sugar industry. While an increasing portion of bank lending has been going to manufacturing, in particular, light manufacturing, a large proportion of the raw materials used in this industry must be imported. Being branches of large international concerns, the banks' easy access to overseas funds enhanced their lending ability while also inhibiting the development of any indigenous commercial banking sector.

The existing structure was also perpetuated by the Currency Board, the predecessor to the Monetary Authority of Belize. The Currency Board system grew out of and facilitated the existing relationship, in particular the trading relationship between Britain and her territories in the Caribbean. The Board, essentially, had no discretionary function, being required primarily to function as a money-changing institution. Each unit of local currency issued had to be backed by its equivalent value in sterling. This policy required that the Board maintain a Currency Fund with the Crown Agents in London, thereby providing cover for the complete issues of currency notes in Belize. While the assets of the fund were held mainly in British Government,-guaranteed securities, the Currency Board Ordinance did provide for $1 million of these assets to be held in Belize Government Securities.

There was, in effect, no institution charged directly with monitoring the behaviour and operations of the banking institutions in Belize, and therefore, little was done to ensure that the full benefits of their operations in respect of Belize accrued to the Economy. The 1963 Banking Ordinance represented one of the first attempts to exercise some degree of control on the banking sector. The Ordinance, the framework of the Banking Ordinance, 1976, contained clauses relating to the banks' capital, their reserves, and their holdings of liquid assets. The banks issued and paid-up capital could not be less than Bze $200,000. (or its equivalent for banks with Head Office Outside Belize). Every bank incorporated in and operating in

Belize had to maintain a reserve fund into which it must transfer each year not less than 50% of net profits until the amount of the fund was equal to one-half of the bank's paid- up capital and thereafter, 25% of such net profits until the fund is equal to the bank's paid-up capital. The liquid assets provision related only to 'scheduled' banks and required that the bank's holdings of liquid assets should not, on average, be less than 30% of its deposit liabilities and designated approved liquid assets as:

a) Till money
b) Net balances with other banks in Belize
c) Balances held with banks overseas and money at call overseas, freely transferable into Belize dollars
d) United Kingdom Government Treasury Bills
e) Other assets approved by the Minister of Finance which can be quickly turned into cash in the country.

The liquid assets provision was then made in-operative by the fact that all commercial banks operating in Belize were classified as 'scheduled' banks.

The 1977 - 1979 Development Plan of the Government of Belize recognised and attempted to deal with the structural weakness of the Economy. In summary, the strategy involved: -

1. increasing the rate of growth in real output orginating in the expansion of
   a) form output for export and import substitution and import replacement.
   b) industrial production for export and import substitution and import replacement.
2. Increasing the volume of national savings, especially the share generated by the public sector and, through this means, increasing the participation in the key sectors of the Economy.
3. bringing about an absolute reduction in the current account deficit of the Balance of Payments.

4. Increasing employment opportunities.
5. diversifying the Economic structure so as to increase the liability of the Economy (that is, reducing the dependence on a few crops).

The strategy, in effect, hit at making the Economy as Self- sufficient as possible with the public sector providing the inpastructure and institutions, and the impetus to the private sector to ensure its success. Encouraging the inflow of foreign capital was a 'cornerstone' of the strategy given the belief that the domestic economy could not, on its own, generate the level of savings required for the growth rate envisaged by the plan.

It was anticipated that the setting up of the Monetary Authority of Belize would represent a major contribution to the achievement of the goal of greater Self-sufficiency. The Monetary Authority Ordinance and the Banking Ordinance (1976) were designed to equip the new institution with sufficient power for increased monetary management and control over the financial sector in the interest of the Belize Economy. Given that there were no obstacles to the implementation of its functions, it was anticipated that the new institution would make a significant contribution to a reorganisation of the Economic Structure. The impact the Authority was expected to make is evidence in the role of the institution as described by the Ordinance. The Monetary Authority Ordinance lists the functions of the Authority as: Economy of Belize.

1. to manage the currency of Belize.
2. to perform banking services for the Government, for the banks and other financial institutions, operating in Belize, and for foreign central banks and international organisations and financial institutions.
3. to assure monetary stability in Belize and to promote monetary conditions which are condricive to the balanced growth of the

economy of Belize and which are compatible with the policy of Government.

4. to maximise and mobilise savings and to optimise distribution of credit in Belize.
5. to ensure that the foreign exchange reserves of Belize are administered in the interest of their customers and of the general public and consistently with the economic policy of the Government.
6. to ensure that the business of the banks and other financial institutions operating in Belize is conducted in the interest of their customers and of the general public and consistently with the economic policy of the Government.

The role of the Authority, therefore spanned beyond the money-changing function of the Currency Board. For the Authority to have maximum effect, however, it would require significant alternations in the operations of the commercial banks to accomodate the new relationship that was to exist between the Authority and the banks.

The Banking Ordinance 1976 which was to assist the Authority in the fulfillment of its goals, is, in many ways an extension of the 1963's. An interesting feature is the distinction it makes between banks incorporated in Belize and foreign banks. While the local bank is required to have a subscribed capital equal to no less than Bze $400,000. ($200,000 of which must be paid-up in cash). The foreign bank's subscribed capital must be no less than $3 million, which must be paid-up in cash, and $200,000 of which must be held by the bank in respect of its operations in Belize.

Another interesting feature of the Banking Ordinance 1976 is the extension of the liquid assets definition to include:

1. Notes and coins which are legal tender in Belize.
2. Balances and deposits held in accounts with the Authority.
3. Net balances and deposits denominated in Belize dollars and held with other banks and financial

institutions in Belize and not exceeding 90 days to maturity.

4. Cheques and other sight drafts drawn on other banks in Belize and in the course of collections.
5. Net balances and money at call and at short notice not exceeding 90 days held with institutions outside Belize and denominated in currencies freely convertible in Belize dollars.
6. Foreign notes and coins denominated in Belize dollars.
7. Inland bills of exchange which are financing commercial transactions which bear the acceptance of a bank and which are payable in not more than 90 days from the date on which they were drawn or accepted.
8. Treasury Bills and other securities issued or guaranteed by the Government of Belize and maturing in not more than 90 days.
9. Treasury Bills and other securities which have been issued or guaranteed by governments abroad which mature in not more than 180 days and which are denominated in currencies freely convertible into Belize dollars.
10. Such other liquid assets as the Authority with the approval of the Minister (of Finance) may declare to be approved liquid assets for the purposes of the sector.

In addition the level of liquid assets required was reduced from 30%, as under the old legislation, to 20% of average deposit liabilities.

Two completely new additions to the 1976 Banking Ordinance are :

1. the banks must maintain on an account with the Authority a minimum balance which on average shall be equal to at least 5% of its average deposit liabilities and

2. the banks cannot grant any advance or credit facility that is greater than 25% of the sum of capital and reserves to any person, company, group of persons or group of companies without the permission of the Minister of Finance. This latter restriction and these requirements are intended to place constraints on the credit creating of the commercial banks while minimising the risks on deposits with the banks.

Prior to the coming into operation of the Monetary Authority, the banks maintained no fixed ratio on their holdings of liquid assets. The designation of the 4 banks operating in Belize as 'secheduled banks' exempted them from the liquidity requirements of the Banking Ordinance 1963. In addition, in many instances the banks were illiquid in respect of their Belize operations. This practice was a direct outgrowth of the branch-banking nature of their operations which allowed them to operate with extremely low liquidity ratios with minimal risks to themselves, and allowed them easy access to Head Office funds and the overseas capital markets. The commercial banks could then, if the situation so demanded, meet any unforeseen or unusually high demand by depositors by acquiring sterling from abroad, and depositing it with the Currency Board in return for its equivalent in Belize dollars. The banks, then, during the Currency Board operation, was able to operate adequately with, for example, cash/deposits averaging as low as between 4% and 5% (in contrast to the average of 10% - 11% which they now hold).

The implementation of the new liquidity requirements demanded a reorganisation in the banks' assets structure, in particular, their loan portfolio, given their long established principle of maintaining high Advances/Deposits ratios. To prevent any drastic changes in the initial period and to guard against embarrassing the banks, the provision under section 18 (3)(j) which allows the Authority, with the approval of the Minister to designate certain other assets as liquid assets was utilised. When the Banking Ordinance became operative in February, 1977, designated as liquid assets under the special arrangement was 80% of Public Sector loans and 10% of Private sector loans outstanding as at December 31, 1976.

The special provision was intended as a temporary provision to enable the banks to adjust gradually to the new requirement. The fact that the provision, somewhat modified, is still operative, reflects, to a large extent, the antagonism of the banking sector to the restrictions of the Ordinance and the reluctance to adjust banking behaviour. Discussions still continue with the banks regarding the full implementation of the provisions of Section 18. The banks have argued that without the special arrangement they would be unable to meet the liquidity requirements and they would have to place restricitons on their ability to extend credit given that deposit growth has not kept pace with the demand for credit. Examination of data on liquidity, however, showed that during the period June 1978 - June 1979 there was only one period when the banking sector as a whole was not liquid (excluding the special arrangement).. In addition, while there has been no significant increase in bank lending between December 76 and June 79, deposits had grown by 11.o% (and 20.1% between December 76 and August 79, a period when the banking sector is most liquid). It has also been suggested that the banks convert a portion of their-core overdrafts into bills of exchange which are themselves tradeable and qualify as liquid assets.

Given the reluctance of the banking sector to abandon the special provision, the Authority has adopted a policy of gradually phasing out the special provision. The special provision was frist amended to include 100% loans to Government and 5% of all other loans. Following this, and effective 1st July 1978, 100% loans and advances to Government and other public sector entities/ Complete eradication of the special provision was further delayed following the banks claim that loans to public sector agencies should be classed as liquid assets and that the banks extended credit to these agencies on the basis that they would qualify as liquid assets. The latest adjustment to the special provision therefore, has been that, effective Nov. 1, 1979, only loans to the two staturoty bodies would qualify under the

/qualified as liquid assets.

special provision.

One of the functions of the Authority relates to the management of the country's foreign reserves, a factor of extreme importance given the nature of the economy's dependence on trade. To facilitate the financing of the banks international transactions, the banks are allowed to hold balances abroad. However, following the build-up in the banks' foreign asset holdings in the latter part of 1977 and following discussions with the banks themselves, it was agreed that in respect of foreign banks, not less than 95% of their average deposit liabilities and capital would be held in Belize denominated securities while in respect of the local bank, a maximum of Bze $1.5 million could be held in Foreign Assets.

the negative attitude which the banks have adopted towards the Banking Ordinance and the Authority's attitude that it wants the full co-operation of the banks in implementing these policies have not made the Authority's job any easier. Another area where bank hostility has been keen is in regards to the maintenance of reserves in Belize. (This is particularly with regards to the foreign banks). Discussions have been going on from 1978 about the bank reserves holding. Again, as happened in the case with liquid assets, the foreign banks were allowed short term exemption from Section 9 of the Ordinance. While the Authority argues that the provision of the sector is designed to ensure that the local economy receives maximum benefits from capital and reserves assigned to or in respect of its local operations, it is in the interest of these banks, in terms of returns they could earn abroad and in terms of reducing the reserve requirements of their operations as a whole, to keep their reserves abroad. The argument over reserves points to a basic defect in the Banking Ordinance since although it stipulates the level of reserve holdings, it does not require that the reserves be held locally. The present legislation, therefore, is being amended to remedy this situation.

While the liquidity requirements and the provisions of section 13(a) requiring the banks to consult with the Authority in respect of loans valued at more than 25% of their capital and reserves, are designed, to an extent, to restrict and channel bank credit, it is questionable whether there has been any change in the pattern of bank lending since 1976. Agriculture (sugar) and Distribution still command more than 50% of these loans. While there has been an increasing percentage going to manufacturing, the firms in this area has been concentration on light manufacture, for example, furniture and clothing.

The low level of capital market development and the inadequacy of outlets for investment of bank funds facilitated the banks' reluctance to sever their ties with their foreign counterparts. Not much progress has been made in this area given that the only move toward the devlopment of the capital market has been the issue of Government of Belize Treasury Bills. The issue of Treasury Bills has provided the banks with an additional form in which to hold their liquid assets while providing the Government with an additional source of short-term finance. Since the first issue in August 1977, the issue of bills have been increased from quarterly to monthly issues. A commission charge based on the days to maturity of the bills was also later introduced on bills traded between the Authority and the banks. While the original intentions was to stimulate tradings between the banks themselves, the banks seem to have a preference for dealing directly with the Authority.

More indirect methods have been used by the Authority to enhance its effectiveness. Monthly meetings, for example, are held with the commercial banks in an effort to resolve any differences that may exists between the two sets of institutions. The Authority has adopted a policy whereby the banks are allowed to participate as fully as possible in decisions regarding their operations. This approach, as pointed out earlier has led to the slow implementation of the banking provisions, given the reluctance of the banks to alter existing behaviour.

The functioning of the Authority have been hinderred too, by the reluctance of the banks to divulge information. While this is possibly a reaction to the point made above, it is possible also that the staff members of the banks are unable to cope adequately with the demands of the Authority, given the low level of trained personnel. Attempts had been made to hold discussions with bank staff directly with producing information for the Authority. However such attempts have been largely unfruitful given the practice by the banks of periodical changes in staff duties.

The powers vested in the Authority attest to the fact that it was intended that the scope of the Authority would span beyond the money changing function of the Currency Board. While the powers were to enable the exercise of greater control on bank behaviour, the impact of the Authority have been restricted by, among other things, the branch-banking nature of the commercial banks, their reluctance to severties with their Head Offices and their opposition to changing their existing behaviour. These institutional features pinpoint some of the problems with which dependent economies such as Belize are faced with in their bid to exercise control over these institutions to ensure that the domestic economy benefits to the fullest from their operations. Such features, too, are representative of only a part of the whole structural problem facing the economy and while the setting up of the Authority represents a brave attempt to tackle one aspect of the problem, other institutional changes for example, the reorganisation of the production sector, must be made before the full effect of the Authority can be felt.

* Not responsive to rural sugar

* localisation as a tool

* data collection

How Com. banks attempting to influence loan policy?