

THE ECONOMY & YOU

International Trade, External Borrowing & Foreign Exchange

In the Caribbean, we cannot produce the whole range of goods and services we need or want to have; therefore we try to produce a few that we can do well, in order to pay for those we want from the rest of the world. Obviously, the more we can produce and earn for our efforts, the more we can purchase from outside, and the better our material lives would be. We are therefore squarely in the business of international trade. Trade is as crucial for us as it could be for any other country in the world, large or small.

In international trade, the currency of one country is seldom accepted in other countries as payment. This means that in order to purchase foreign goods, ECCB area countries must first acquire foreign currency. How is this done? Countries earn foreign currency mainly by producing goods and services and selling them in foreign markets, or selling them to tourists who spend foreign currency locally. This foreign currency is then exchanged for EC dollars issued by the Central Bank.

Countries engage in external borrowing to supplement their domestic resources. Both the government and the private sector engage in foreign borrowing. However, these loans must be repaid using foreign exchange. Therefore, in the same way that the government or an individual must earn more income than it spends in order to repay domestic loans, the country must earn more foreign exchange than it uses, in order to repay foreign loans.

The rules of the international monetary system make it necessary for all countries to accumulate a stock of foreign currency assets, readily acceptable to pay any

outstanding foreign obligations. This is called “reserve” or “hard currency”, and includes the US dollar, the pound sterling, the French Franc, the Deutsche Mark and the Japanese yen. To engage in international trade, a country must have access to these “hard currencies”. From the viewpoint of Caribbean countries, an important difference between hard currencies and our own currency is that our governments cannot produce foreign exchange, we have to earn it.

In the case of the ECCB member states, foreign exchange is earned mainly through exports of bananas, nutmegs, cocoa, sugar, through expenditure by tourists; through investments made in the region by foreigners, and through external loans and aid received.

On the other hand, the need for foreign exchange is created by the purchase of imports, by travel abroad by citizens and by the need to settle foreign loans and investments already contracted.

Just as individuals do, countries have to work hard to ensure that the use of foreign exchange does not continuously exceed receipts from overseas. Therefore, ECCU countries have to hold foreign exchange reserves to settle the differences that arise every year.

The majority of the foreign exchange reserves for the region are held and managed by the Eastern Caribbean Central Bank on behalf of the governments of the region. In addition, the commercial banks hold a portion of foreign reserves, mainly to finance transactions. As trading nations it is in our interest to see that those reserves are generally increasing, rather than decreasing; for they serve not only to settle outstanding foreign obligations, but are also an important source of income and as a general indicator of the economic health of the region.