‘The Alignment of Monetary Policy and Banking Regulations in Belize’

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Table of Contents

Introduction: 1

Chapter I: Banking Sector in Belize and the role of the Central Bank of Belize 6

Chapter II: Roles and functions of Central Banks 15

Monetary Policy makers..... 21

Regulators of the banks (prudential regulation)..... 24

Chapter III: The independence or interdependence of monetary policies or regulatory policies of the central bank 28

The US Experience..... 30

The EU Experience:..... 35

ChapterIV: A perspective on the regulatory and monetary dichotomy to the operation of the Central Bank of Belize 41

The policy and economic framework:..... 41

The legal and legislative instruments..... 45

Chapter V: Conclusion..... 47

Introduction:

"The Central bank at the heart of the financial sector in the economy with a key role in the conduct of monetary *policy, and the banks as the financial intermediaries that reach a high percentage of the population, are essential elements in the economic framework of every modern state."*[1]

Financial panics, crisis, meltdowns….

The Great Depression, Great Moderation, Disinflations and the Great Recession…

Its shocks are so intense they can be felt across markets globally….

"The global financial crisis and, more recently, the euro crisis have reminded us that no economy is immune from financial instability and the adverse effects on employment, economic activity, and price stability that financial crises cause."[2] Financial crisis are not something new, not something of the past to be forgotten nor is there any guarantee that they will not again sneak up as the last crisis did. What we do know is that the impact of a financial crisis can be destructive and that there is a lot to learn from them as we move ahead.

In the summer of 2007, the United States was experiencing problems in the subprime mortgage market which triggered "the most destructive event of the last eighty years."[3] The

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[1] Rosa Maria Lastra (1996). 'Central Banking and Banking Regulation.' Financial Markets Group, London School of Economics and Political Science. (p.1).

[2] Janet L Yellen (2014). 'Monetary Policy and Financial Stability.' Yellen adds that "…the recent financial crises have appropriately increased the focus on financial stability at central banks across the world." Retrieved on August 15th, 2014 from:
< http://www.federalreserve.gov/newsevents/speech/yellen20140702a.htm>

[3] Howard Davies (2010). 'The Financial Crisis: Who is to Blame?' (p1). Polity Press, USA.
Though there are some who classify the crisis as a "Minsky Moment" others like Paul McCulley, Paul Davidson and Frank Shostak in Davies (2010)(n3) reject the Minsky hypothesis that "financial systems are inherently susceptible to bouts of speculation that, if they last long enough, end in crisis" and that "capitalism is inherently unstable and has self-destructive tendencies" Davies quoting Justin Lahart. Davies, on the other hand, argues, based on analysis, that it is the existence of the Central Bank that creates instability in modern capitalism and that

delinquencies in the mortgage market impacted not just financial institutions but also the global market. Many weaknesses have been exposed within the financial system since. The macroeconomic framework that had been successful in keeping the economy stable throughout the Great Moderation Period[4] was turned up side down. Confidence in micro-prudential rules as "the set of rules" of regulation to maintain financial stability was shaken and opened way for the use of macro-prudential rules of financial regulation.[5]

Economists have posed the question of who is to blame yet there is no consensus on who or what is to be blamed for the financial crisis. Some attention had been drawn by central bankers as to the risks being posed by "global imbalances, surging credit, and liquidity, and narrowing risk spreads" for financial stability prior to the crisis but when the crisis occurred even central bankers were surprised.[6] A lot has been said and a lot has been written and a lot has happened since. Numerous lessons have been noted and a lot of developments have taken place

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it is market interventions from the government, via the central bank, that gives way for the financial system to engage in a reckless expansion of credit. He give credit to the Community Reinvestment Act of 1977, a government effort to fill inequity gaps that placed low-income borrowers at a disadvantage when applying for loans when considered under a pure economic criteria.

Stanley Fischer (July 10th, 2014) in his speech 'Financial Sector Reform: How far are we?' describes the crisis as "the worst economic crisis and the worst financial crisis since the 1930's" an almost second Great Depression which did not happened thanks to the lessons policy makers had learned from the Great Depression. Retrieved from < http://www.federalreserve.gov/newsevents/speech/fischer20140710a.htm> on July 30th, 2014

[4]Ben S. Bernanke (2004). 'The Great Moderation.'- a period from mid 1980's to 2007, where there was a decline in the variability of both real output and inflation indicating improvements in market functioning, a reduction in the use of resources needed to hedge risks of inflation, employment stability and reduced economic uncertainty. In his address, Bernanke associates the growth experienced throughout this period to the use of "Taylor type rules."< http://www.federalreserve.gov/Boarddocs/Speeches/2004/20040220/> Retrieved on July 31st, 2014

[5] Barry Eichengreen et'al (2011). 'Rethinking Central Banking.' (Committee of International Economic Policy and Reform).

[6] Howard Davies and David Green. 'Banking on the future: The Fall and Rise of the Central Bank.' They say that the severity and speed of the crisis came as a surprise to many including central bankers. They claim that the securitization based subprime mortgages in the US was the proximate causes of the crisis and the first major liquidity problem in the banking system was noted in Europe and what followed was a series of bank failures starting in Germany with the collapse of IKB followed by Northern Rock in London.

particularly in the form of intense policies and regulations.[7] These new policies and regulations are intended to lead to the overall soundness and stability of the global economy but have not been free from dissent.[8] Regulation, after all, is not about running a popularity contest but about creating a system that works for the benefit of the wider economy.

What needs to be done to make the system work to ensure financial stability? Is it a matter of weak monetary policy and weak banking regulations as stated in some of the writings post crisis? Can the interconnection of these two mechanisms create the desired outcome of soundness and stability of both the financial and economic systems? Who is responsible for ensuring the soundness of the financial system? How can financial and economic stability be attained when financial globalization has created a strong interconnection of financial systems which brings a lot of benefits but also creates a lot of vulnerabilities?[9] The financial crisis

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[7] This surge of financial rules and regulations has been described as tsunamis but "Tsunamis are one-off events triggered by individual earthquakes. This situation is more like a hurricane or typhoon, where intense activity comes in waves and there are periods of great calm in the middle of the storm" or where there is calm ashore but with intense activity being formed at the center or at the tail of the storm.

[8] Barbara Matthews in Brooke Masters (May 21st, 2010). The Financial Times, 'Tsunami of Regulations Batters Banks.' Retrieved from:< http://www.ft.com/cms/s/0/d3ae2968-646f-11df-8cba-00144feab49a.html#axzz3ASit2E2Q> Retrieved from the worldwide web on July 15th, 2014. She describes this surge of financial rules and regulations as tsunamis but "Tsunamis are one-off events triggered by individual earthquakes. This situation is more like a hurricane or typhoon, where intense activity comes in waves and there are periods of great calm in the middle of the storm." The question lies in whether the reforms that have taken place will serve their intended purpose of maintaining soundness and stability of the financial and economic systems.
Charles W. Calomiris (2009). 'Bank Regulatory Reform In the Wake of the Financial Crisis.' Retrieved on July 15th, 2014 from: < http://siteresources.worldbank.org/INTFR/Resources/Charles_Calomiris.pdf >
He writes that the regulatory actions resulting from the Great Depression were unwise and it took a very long time to be able to reverse them. One of the policies introduced was deposit insurance along other safety net policies. Calomiris claims that deposit insurance will probably never be reversed and highlights it as the "primary source of the unprecedented financial instabilities" leading to the crisis. The hope is that the lessons learned from past events trigger a regulatory reform that comes from wisdom otherwise the backlash of regulations being faced would not serve their intended purpose. Calomiris adds that not all reforms may result in sensible legislation and that though there is "substantial risk for mischief making" the reform seems to have an "encouraging absence of terrible ideas."

[9] For a deeper understanding of the interconnectedness of the financial system see: The International Monetary Fund. 'Understanding Financial Interconnectedness.' As expressed in this paper, the risk that is created via this interconnection is the "speed in which illiquidity and losses in some markets can translate into global asset re-composition." This risk is not only related to the interconnectedness of the system but also the efficiency in the transmission and intermediation of its processes.

brought to light a serious malfunction of global financial regulation, the structure of committees and institutions, the membership of these bodies and of the rules themselves.[10] Central banks played a key role in addressing the malfunctions of a shaking financial and economic system using their balance sheets as reinforcement to the financial system.

There is absolutely no doubt that both economic and financial stability are central to the international financial system. This need for overall stability has highlighted the important role of central banks in the world of finance, a role that was historically always performed by the central bank but in early years with a very limited scope and scale.[11] I will present on this paper that Banking Regulations and Monetary Policy are an interconnected function of the central bank that jointly seek to help withstand the impact that financial imbalances and systemic risks have on the entire financial system and the economy on a whole.

Chapter I will focus on the banking sector in Belize and the role that the Central Bank of Belize plays within the banking sector. It will give an overview of some of the effects of the financial crisis to Belize and will seek to present what has been Belize's economic challenge as a result.

Chapter II looks at the various roles and functions of a central bank; at the central bank's historical role of financial stability and its evolvement; at the central bank in terms of its role as monetary policy maker and bank regulator while trying to understand how countries may

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[10] Howard Davies and David Green (2008). 'Global Financial Regulation: The Essential Guide.' Polity Press, UK. The crisis had a lot of implications in relations to bank capital requirements, the relationship between banks and insurers, insurers and securitization and other aspects of financial regulation. The Financial Stability Board (comprising of finance ministries, central bankers and regulators) was seen as the institution that could best pull all the loose strands together and was granted

[11] Benoit Coeure (2013). 'Monetary Policy and Banking Supervision.' Speech delivery at a Symposium entitled "Central Banking: Where Are We Headed?" Retrieved on July 15th, 2014 from: <http://www.ecb.europa.eu/press/key/date/2013/html/sp130207.en.html>

respond to financial instabilities under a system that combines the functions of monetary policy and banking regulation and supervision against those that have separated them under different authorizing bodies.

Chapter III looks at the independence or interdependence of monetary policies and regulatory policies of the central banks and sharing on both the EU and US experience.

Chapter IV looks at the prospect of application of the monetary and regulatory dichotomy to the operation of the Central Bank of Belize focusing on Belize's policy and economic framework and its legal and legislative instruments. Chapter V Concludes.

Chapter I: Banking Sector in Belize and the role of the Central Bank of Belize

Belize operates within a small open market economy within a fixed exchange rate system.[12] The stability of the exchange rate is as a result of the Belize dollar being pegged to the US dollar[13]at a fixed rate of exchange of 2 Belize dollars (BZ$) to 1 US dollar (US$). This fixed exchange rate has been maintained since 1976[14] and it can be said to have done Belize well, granted that it has been able to avoid devaluation and adequate control of its inflation rates by keeping them from rising to extremely high levels.[15]

Belize's economic policies have been shaped by various external realities[16] but domestic constraints have played a very central role. In 1982 along with Belize's independence came the establishment of the Central Bank whose mandate clearly made exchange rate policies an integral part of its macroeconomic framework. Essentially, the monetary and financial system of Belize is regulated by the Central Bank of Belize whose mandate is stipulated very clearly in Clause 6 of the Central Bank Act Chapter 262 Revised Edition 2003 of the substantive laws of Belize which states:

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[12] Clive Y. Thomas, '*Global Economic Crisis: CARICOM Impacts and Responses*' (2009).A fixed exchange rate can suffer pressures if it is coupled with rising foreign currency demands that result from increases in the price for imports and a fall in supply due to a decline in exports.

[13] Bulmer-Thomas, '*The Economic History of Belize: From the 17th Century to Post Independence.*' (2012) Cubola Productions. They explain that the main economic argument for pegging the Belize dollar to the US dollar rather than to Sterlin was because the US played a very important role in Belize's external trade.

[14] Central Bank of Belize. *'Foreign Exchange Controls: What it means to you?'* < https://www.centralbank.org.bz/docs/rsh_4.7_educational-materials/foreign-exchange-controls--what-it-means-to-you-.pdf?sfvrsn=6>

[15] Glenford Ysaguirre, the Governor of Central Bank of Belize,'*The Global Financial Crisis, its effect on Belize and suggestions on how the business sector can stimulate the economy.'* (2009) Retrieved from the Central Bank of Belize Official Website on July 15th, 2014: <http://www.centralbank.org.bz/> A speech delivered by the Governor of the Central Bank of Belize (18th June 2009). He claims that the resilience of the Belize's economy is testimony to the success of maintaining a fixed exchange rate. Found at: < https://www.centralbank.org.bz/docs/rsh_4.6_speeches/global_financial_crisis_bcc-speech--final-.pdf?sfvrsn=4>

[16] Bulmer-Thomas (2012)p.157 (n 12).

> "Within the context of the economic policy of the Government, the Bank shall be guided on all its actions by the objectives of fostering monetary stability, especially as regards stability of the exchange rate, and promoting credit and exchange conditions conducive to the growth of the economy of Belize."

The mission of the Central Bank of Belize is "to advance the wellbeing of Belize by facilitating sustained economic growth, protecting the value of the Belize dollar and assuring a safe, sound and efficient financial system." The Central Bank holds a monopoly for the issuance of the Belize currency and within its objectives it regulates the issue and availability of money and its international exchange. Essentially its primary objective is to maintain monetary and price stability, supervise and regulate the integrity and reputation of the financial system in an effort to assure a high degree of confidence within the financial system.[17]

The Central Bank aims to achieve its objectives by meeting the following goals:

- "Provide prompt and well-considered macroeconomic information and advice to the Government of Belize, the business sector and the general public
- Provide efficient banking services to the commercial banks, the Government of Belize and various public sector bodies and regional and international organizations that hold accounts at the Bank
- Provide guidelines to the banking community on matters such as money supply, interest rates, credit and exchange rates

[17] When a country faces rising unemployment, reduced household incomes, reduced consumption on basic needs like food, reduced government spending in basic social services which are some of the effects developing countries face as a result of the financial and economic crisis there is definitely loss of confidence. The perception that circumstances may worsen may lead to people losing confidence in the banking sector and this may lead to bank runs which would further exacerbate financial and economic conditions.

- Set high standards of efficiency and organization so as to encourage higher levels of attainment in the Bank."[18]

Its mission and goals and objectives may have been put to a test during the financial crisis but thankfully Belize, though not completely immune, was able to withstand shocks that could have caused a severe damage to its economy. Belize as a small developing country has often been criticized for not having a highly sophisticated intermediation financial market and for not participating within the complex and diversified financial market structures as other countries do. But it was as a result of this lack of sophistication along with Belize's foreign exchange controls and a highly conservative foreign reserve management strategy that Belize was able to withstand some of the effects of the subprime crisis that initiated in the US and were channeled through complex market structures.[19] Belize's real sector did not enjoy the same luck; the aftershocks that came as a result of a "crisis-induced recession on international trade in larger countries who are Belize's economic partners and the international credit crunch"[20]hit this sector hard. Moreover, at the time Belize was experiencing a food and energy crisis that already had a negative impact on the Belize economy.[21] On another note, it is also important to keep in

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[18] See Central Bank of Belize official website: <http://www.centralbank.org.bz/>

[19] Glenford Ysaguirre (2009), (n 13).

[20] Glenford Ysaguirre (2009). (n 13). He explains that the predictions of vulnerabilities particularly in tourism, foreign direct investments (FDI), foreign remittances and deteriorating export commodity markets were confirmed in a 2.2 GDP contraction as set out in the data for the first quarter of 2009.

[21] Patricia Mendoza, ''Rapid Impact Assessment of Financial and Economic Crisis on Poverty and Vulnerability in Belize and Dangriga.' (2011). Mendoza's Assessment report offers a good insight on the socio-economic effects the financial crisis had on Belize. She presents on key macroeconomic factors and related transmission channels through which Belize was affected and describes economic trends. It shows that the crisis impacted Belize mainly through the commodity export and tourism and other sectors (these sectors are of importance particularly because they are a source of employment to the poor). Belize's foreign direct investment and remittances were also affected. There was also a shift to higher levels of private sector domestic credit during the crisis period which suggests a contraction in trade credits.
Some of the channels through which the external changes are transmitted to the local economy are through goods and services exports, credit to the agriculture and commercial fishing sectors, direct foreign investment, official grant receipts and inward remittances (These channels are further explored by Clive Thomas (2009) and Nissanke and Thorbeke (2005)).

mind that the experiencing "high levels of government debt in advanced countries and the slowing growth of traditional export markets for developing countries can create new sources of political pressures;" this is definitely a challenge for Belize and something that the central banks and policy makers need to think of and be prepared for.[22]

In response to the financial crisis the Central Bank of Belize implemented an enhanced regulatory oversight program with a prudential measure to monitor the asset quality, capital adequacy and liquidity for all the financial institutions that they supervised including credit unions in an effort to ensure their safety and soundness.[23]

Monetary Policy in Belize:

The Central Bank is the sole authority for monetary policy. The monetary policy framework is made up of two sets of variables. One of these variables includes institutions, organizations and the group of people involved in the formulation and implementation of monetary policies and also those who have a response to policy decisions. The second variable comprises of monetary and financial tools and targets through which policymakers try to influence economic activity levels.

[22] Barry Eichengreen and others, '*Rethinking Central Banking*' (2011). They include this as one of the reasons why the use of conventional framework of Inflation Targeting needs to be rethought. (p.7)
[23] For more details on these measures see Glenford Ysaguirre (2009). (n 13).

The instruments under the first set of variables can be adjusted to result in desired changes in the targets of monetary policy. The instruments include interest rate floor and ceiling, central bank lending rate to commercial banks, open market operations and selective credit controls.[24]

The primary variables targeted by monetary policy include the growth of the money supply, credit expansions and fluctuations in the real exchange rate. Interest rate adjustments, open market operations via the sale of treasury bills, changes in reserve requirements and exchange controls are some of the instruments used to influence these variables. When objectives are too many there may be problems designing the right mix of economic policy.[25]

Monetary Policy in Belize is guided upon direction of the government and has primarily been through the adjustment of cash reserve requirements (cash and liquidity) which fall under the two-tier statutory reserve requirements that are considered to be less disruptive to the credit market. These adjustments are made through alterations in commercial bank reserve requirements. The Central Bank of Belize manages Belize's international reserves and administers the Exchange Control Regulations whose aim is to keep the value and the convertibility of the Belize dollar. The Central Bank of Belize is the sole issuer of notes and coins as provided by Section 22 of the Central Bank Act; it may act as the fiscal agent, trustee and as banker to the Government of Belize (Section 33 of the Central Bank Act) and it has been granted the power to control the rate of interests (Section 45 of the Act). The Central Bank of Belize sets the interest rates on commercial bank loans and deposits, it directs the volume of credits and it sets the terms and conditions on loans. It also serves as the banker of all the

[24] Carla N. Barnett, '*Creating a Monetary Policy for the 1990's*' Central Bank of Belize. (1999)
[25] Rosa Maria Lastra, 'Central Banking and Banking Regulations.' London School of Economics and Political Science (1996).

banks and financial institutions to which it grants licenses and also serves as the Lender of Last Resort (LOLR) to those banks (Section 38). It has the fiduciary role of participating in the primary and secondary market for government securities.

The Banking Sector:

Banks are very susceptible to the macroeconomic environment and to policies set out by the central bank and government. The economic decisions made by the government and the central bank have a strong influence in banking operations. Whether it is through periods of economic expansion and contraction instabilities in the economy can have serious effects to the banking sector. Therefore, the capacity of banks as financial intermediaries, their strength and solidity and the need for performance or adjustments to monetary policies are key ingredients to financial stability.[26]

Commercial banks in Belize play a very important role in the movement of financial resources to finance banking activities. International Banks offer traditional banking services in foreign currencies to non-residents. Today, a small domestic commercial banking sector, an international banking sector and credit unions make up that portion of the financial sector under the oversight of the Central Bank of Belize.[27] Belize's Banking Sector currently comprises of six domestic commercial banks and six international banks.[28] The domestic banks are

[26] Barnett (1999) (n. 24).

[27] In 1996 with the passing of the Offshore Banking Act, the Central Bank of Belize expanded its regulatory and supervisory oversight from domestic commercial banks to include the oversight of offshore banks. An amendment to the Offshore Banking Act in 2002 replaced its title from the term offshore to international and in December of 2005 an amendment to the Credit Union Act expanded the Central Bank of Belize's regulatory oversight to include credit unions.

[28] The six domestic commercial banks are: The Belize Bank Limited, Atlantic Bank Limited, First Caribbean International Bank (Barbados) Limited, Scotia Bank (Belize) Limited, Heritage Bank Limited and the National Bank of Belize Limited. There are two categories of International banks: Class A, Unrestricted License and Class B, Restricted License. The following are International banks with unrestricted licenses are: Choice Bank Limited, Caye International Bank LTD, Belize Bank International, Heritage International Bank & Trust Limited and Atlantic

governed by the Domestic Banks and Financial Institutions Act (DBFIA), enacted in January of 2013, and grants the central bank the authority to ensure their compliance with international standards and best practices as set out by the Basel Committee on Banking Regulations and Supervisory Practices. The international banks are governed by the International Banking Act (initially enacted as Offshore Banking Act in 1996) which grants the central bank the responsibility of granting licenses and oversight of International banks.[29]

International banks were originally intended to only focus their business on a non-resident clientele as a means to have little impact on the domestic financial system. This was changed when an amendment to the International Banking Act in 2002 allowed resident commercial and export processing zone companies to conduct full banking business with international banks operating in Belize. This has resulted in a significant reduction in domestic bank liquidity since Export Processing Zone companies shifted a portion of the foreign exchange earnings, deposits and borrowing from the domestic commercial banks to the international banks.

The banking sector plays a very important role in Belize's economy and as a result needs adequate supervision and regulation of its operations to ensure its soundness and stability. The Central Bank of Belize practices a CAMELS approach to on-site supervision of banks which focuses on five important areas of the bank namely, Capital Adequacy, Asset Quality, Liquidity,

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International Bank Limited, Market Street Bank Limited. Further information on each banking institution can be found at <https://www.centralbank.org.bz/financial-system/regulated-institutions/international-banks >

[29] Belize has been branded as a tax haven and though the offshore banking sector holds an important role in generating economic benefits for Belize it has demanding international responsibilities and can become a risk to Belize's reputation. The Central Bank plays a key role in mitigating the risks that may arise within this sector and has a commitment to "preserving and fostering Belize as a responsible international financial center." Manuel G. Vasquez, '*The Structure of Financial Markets/Institutions in Belize.*' (1996)Publication can be retrieved from the Central Bank of Belize Official Website: <http://www.centralbank.org.bz/>

Earnings and Efficiency.[30] As stated in the Central Bank of Belize 2013 annual report, Asset Quality is weak and is therefore an area of concern for the central bank.[31]

Banking Supervision:

Belize's access to cheap financing is one of the primary obstacles to Belize's competitiveness. In 2009 Belize's banking system was experiencing a buildup of liquidity. This upsurge in liquidity was noted as an opportune and key player in attempting to align domestic rates that could reflect the global situation. The Central Bank saw it necessary to establish a monetary policy reform strategy that gave more flexibility and precision to its monetary policy measures and engaged banks in a discussion to liberalize interest rates. Governor Ysaguirre requested financial institutions to collaborate with the productive sector particularly with those businesses with high debt servicing through the renegotiation of loans at least until the recession was over. Furthermore, he advised banks that "shaving a few points off the lending rates will not cause any of our banks to fail but not doing so can be the difference between failure and survival for many of your customers." After all, an important objective of the central banks is to create an environment that aims at achieving public welfare and building public confidence.

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[30] The Central Bank of Belize. "2013 Annual Report and Statement Accounts". Retrieved from the Central Bank of Belize Official Website: <http://www.centralbank.org.bz/>

[31] This weakness calls for better supervision from examiners in an effort to ensure that the quality of assets is adequate to avoid possible credit risks associated to loans. As an extension to this, the IMF 2013 Country Report for Belize, Article IV Consultation states that Belize's banking system continues to find itself under stress. According to the report new provisions and loan classification standards set out by the Central bank at the end of 2011 has "resulted in declining Non-Performing Loans (NPL's) in the banking sector and improving provisions." The Central Bank, in compliance with prudential measures, requires for banks to write off bad loans within 3–5 years (US$18.7 million in 2012). They make a call for improvements in the assessment of loan portfolios to ensure that the quality of assets is consistent with the level of risk each portfolio is exposed to.
The IMF 2013 Belize Country Report can be found at:
<https://www.imf.org/external/pubs/ft/scr/2013/cr13227.pdf>
For a deeper reading on the evaluation and rating of Asset Quality see Federal Deposit Insurance Corporation [US] at <https://www.fdic.gov/regulations/safety/manual/section3-1.pdf>

The objectives of the Central Bank of Belize of monetary and exchange rate stability do not go without challenges. One of the main challenges is the subservience of monetary policy to the fiscal stance.[32] Both monetary policy and fiscal policy are important instruments to achieving macroeconomic objectives. On one side fiscal policy aims at improving aggregate output and on the other side monetary policy focuses on price stability via the control of interest rates and inflation. With the primary objective of macroeconomic policy being sustainable economic growth in light of price stability it is of utmost importance to have efficient policy coordination.[33] On another note, whether financial policy can either contribute or not to price stability, monetary policy is what generally determines price stability. As seen in the financial crisis, for the achievement of sustainable macroeconomic growth there needs to be a right mix of not only these policies but also of proper banking regulations and supervision to avoid incompatibilities that can create vulnerabilities that can be a detriment to the macro-economy.

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[32] Gloria Garcia and others, '*The Evolution of the Financial Sector in Belize (1996-2007)*.' (2009) and Nigeli Sosa and others, '*The development of the Financial System of Belize (1970-1995).*' (1996)Retrieved from the Central Bank of Belize Official Website: <http://www.centralbank.org.bz/> The Central Bank Act clearly states that it is within the context of the economic policy of the government" that the bank must conduct its objectives of monetary policy and exchange rate stability and promoting credit and exchange rate conditions that are conducive to the growth of the economy. Garcia et'al add that "Central Bank autonomy and fiscal dominance have made way for implementing policies that contributed to large balance of payments deficits, the intensification of pressures on the fixed exchange rate, a burgeoning external debt and economic instability."

[33] Bernard Laurens and Enrique G de la Piedra, '*Coordination of Monetary and Fiscal Policies.*' (1998)International Monetary Fund Working Paper.
< https://www.imf.org/external/pubs/ft/wp/wp9825.pdf >
They state that a weak policy stance in one area can become burdensome to the other and thus become unsustainable in the long run. Furthermore, for there to be efficient policy coordination there needs to be policy sustainability and credibility. The different time frames within which each policy operates needs to be taken into consideration granted that monetary policy actions tend to fine-tune much faster than actions of fiscal policy. In the case of Belize, monetary policy and fiscal policy are married under the Central Bank given its role as the fiscal agent for government. This marriage, need not be a detriment to the economy, it is in fact very useful particularly in the smooth management of fiscal debts and in stimulating financial markets.

Chapter II: Roles and functions of Central Banks

Looking at the origin of central banking we find the Swedish Riksbank as the first central bank established in the world in 1668 followed by the Bank of England in 1694 (to assist in state financing during times of war)[34] and the Federal Reserve in 1913 (with the Federal Reserve act being a direct outcome of the banking crisis experienced in 1907)[35] and the European Central Bank in 1999[36]; these being the major central banks in the world of banking. Central banks were originally established to assist with government finance and held the monopoly of note issuers but these roles have changed overtime.[37] Furthermore, micro-level concerns on systemic instability and its contagion is said to have led to the introduction of central banks in the late 19th and 20th centuries.[38]

> "*Certain events just happen…There is little difference in the effect of one accident and another upon our credit system. We must be prepared for all of them, and we must prepare for all of them in the same way*…."[39]

As mentioned in the introduction, although central banks were initially created to meet the objectives of monetary policy they have always, though limited, taken on the role of banking sector supervisor and regulator. The supervisory role of banking became more significant with

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[34] Charles Goodhart. 'The Changing Roles of Central Banks. BIS Working Papers No. 326. Monetary and Economic Department. Retrieved From: <http://www.bis.org/publ/work326.pdf>

[35] Charles Goodhart (1989). "What Do Central Banks Do" in Charles Goodhart (1995). "The Central Bank and the Financial System." (p.218)

[36] Rosa Maria Lastra. 'Central Bank Independence and Financial Stability.' Retrieved From: <http://www.bde.es/f/webbde/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/10/May/Fic/ref0318.pdf>

[37] Charles Goodhart (1988) in Maria Rosa Lastra 'Central Bank Independence and Financial Stability.' (n 30).

[38] Charles Goodhart (1989). 'What do Central Banks Do' in Charles Goodhart (1995). (n 29).

[39] Walter Bagehot. 'Lombard Street, Chapter VI: Why Lombard Street is often very dull and sometimes extremely excited?' In this context Bagehot was referring to the need of central banks to keep large cash reserves to prevent financial panics. For those who have not ventured to read Bagehot's Lombard Street, I say that it is a must read and an easy read. Bagehot offers his perspective on the early central banking operations of the Bank of England with a focus on how to prevent financial panics in the fulfillment of their role of Lender of Last Resort.

time and in many countries it became a developing role within the central bank. The practices of the central banks and the instruments it utilizes to bring forth change have been impacted by many events starting with the Great Depression, to the Great Moderation, to the Great Recession and the disinflations in between. These events have also triggered new financial regulations in the form of deposit insurance[40], regulation of securities, and the supervision of banks along with improvements in monetary policy.

Central banks have generally had three major functions:

i.) "To maintain price stability, subject to the monetary regime in current operation, for example the gold standard, a pegged exchange rate or an inflation target;

ii) To maintain financial stability, and to foster financial development more broadly;

iii) To support the State's financing needs at times of crisis, but in normal times to constrain misuse of the State's financial powers. In the past this meant preventing debasement and misuse of the inflation tax. Prospectively it may in future also involve preventing misuse of the bank tax."[41]

A debate of central banks' role in maintaining financial stability was reopened after the crisis. The conventional way of doing banking was shaken and it created a movement toward a rethinking of central banking. In the years leading to the crisis a number of central banks both

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[40] The US has a deposit insurance under the Federal Deposit Insurance Corporation (FDIC). The FDIC serves as insurer, supervisor and receiver in an effort to help resolve failing institutions that it insures. This type of stabilization mechanism has been criticized for creating the moral hazard of increased risk taking from banks which may lead to instabilities within the banking sector.
Unlike the US, Belize does not have this kind of mechanism in place.

[41] Charles A E Goodhart, '*The Changing Role of Central Banks.*' (2010) BIS Working Papers No. 326. Monetary and Economic Department. Retrieved From: <http://www.bis.org/publ/work326.pdf>

from developed and emerging economies were using a flexible inflation targeting framework.[42] An emerging consensus indicated that this framework was too narrow and that financial stability must become an explicit goal of the central bank.[43] There was a close relationship between inflation targeting and macroeconomic stability that gave the impression that financial stability should be something solely pursued by micro-prudential supervision and regulations but now the confidence in an inflation targeting regime has been shattered.[44] There were missing elements within that regime and now there is a wider perception that macro-prudential regulation should complement micro-prudential regulation to ensure stability of the financial sector thus limiting risks to the wider economy.[45]

Another important development to note is the use of unconventional measures that have been undertaken by the central banks in an attempt to address the resulting problems from the crisis.[46] These unconventional measures of central banking have been used by several central banks including the European Central Bank and the Federal Reserve in an attempt to address gaps in the monetary policy channels.[47] These unconventional measures may be in the form of

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[42] Eichengreen and others,'*Rethinking Central Banking*.' (2011) <http://www.brookings.edu/~/media/research/files/reports/2011/9/ciepr%20central%20banking/rethinking%20central%20banking.pdf>

[43] Barry Eichengreen et'al (2011). 'Rethinking Central Banking.' (n 35).

[44] Octaviano Canuto and Matheus Cavallari, 'Monetary Policy and Macro Prudential Regulation: Whither Emerging Markets.' (p. 119-154).

[45] Canuto and Cavallari (n. 44).

[46] Allan S. Blinder, 'After the Music Stopped: The Financial Crisis, the Response and the Work Ahead' The Penguin Press, New York (2013). defines conventional monetary policy as the "raising or lowering of the federal fund rate (a virtually riskless rate) in order to manage the state of aggregate demand." Annything else the central bank does constitutes as unconventional monetary policy including the use of quantitative easing policies.
For a further read on unconventional monetary policy and their effectiveness in helping to restore financial markets see: The IMF, 'Unconventional Monetary Policy-Recent Experience and Prospects' (2013). < https://www.imf.org/external/np/pp/eng/2013/041813a.pdf> accessed on August 30th, 2014

[47] Kotaro Ishi et'al (2009). IMF Working Paper: 'Unconventional Central Bank Measures for Emerging Countries.' Retrieved from: < https://www.imf.org/external/pubs/ft/wp/2009/wp09226.pdf>

"large scale liquidity support to banks", "forward guidance of ultra-low policy rates over extended time horizons" and "large-scale financial market interventions, in particular huge asset prices."[48] These measures may aim to meet goals such as "stimulating aggregate demand", "repairing the wounded financial system, and so restoring aggregate demand" or "combating a financial panic, and thereby limiting the damage to aggregate demand."[49] The simplest form yet of these kinds of policies is to "making a verbal commitment to keep short-term interest rates low for a protracted period of time."[50] Keeping interest rates low for an extended period can help to bring down intermediate and longer-term interest rates because it affects expectations of how long this highly accommodative stance will remain as conditions improve.[51] All of these efforts aim at stabilizing financial markets and the economy.

Stability in the general level of prices defines monetary stability and a smooth functioning of the institutions and markets that make up the financial system define financial stability; both forms of stability are related and the stability of one signifies stability of the other.[52] Despite this, there has been an extensive debate over the argument of keeping both monetary policy

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The term unconventional is used because central banks are using measures that had not been traditionally used through the policy implementation structure of the central bank in the past two decades.

[48] Christiaan Pattipeilohy, Jan Willem van den End, Mostafa Tabbae, Jon Frost and Jakob de Haan, '*Unconventional monetary policy of the ECB during the financial crisis: An assessment and new evidence'* DNB Working Paper No. 381(2013). They offer insight on the ECB's use of unconventional policies and their effectiveness within the EU.

[49] Allan S. Blinde (2013) (n. 46).

[50] Allan S. Blinder (2013) (n.46) Blinder states that this is a measure that the Federal Reserve used during and after the crisis. It made a commitment to keep the Federal fund rates low and has extended this commitment to run until 2015.

[51] Janet Yellen, 'Monetary policy: many Targets, Many instruments, Where Do We Stand?' (2013). <http://www.federalreserve.gov/newsevents/speech/yellen20130416a.htm> accessed on August 15th. Yellen adds that prior to the crisis the Fed had focused on a one policy instrument, the short term policy interest rate. Some central banks did not rely on a single policy target and relied on an inflation targeting framework.

[52] Andrew Crockett (1997). 'The Theory and Practice of Financial Stability.' Retrieved from: < http://aulavirtual.bde.es/wav/documentos/area_docu_estabilidad_1.pdf>

and banking regulation and supervision within the confines of the central bank.[53] Those who are in support of this argument state that there is a strong relationship between monetary and financial stability and that due to this relationship "it is inconceivable that the monetary authorities could quietly pursue their stability oriented monetary policy objectives if the financial system through which policy is carried on-and which provides the link with the real economy-were collapsing around their ears."[54] Moreover, the Central bank serves as Lender of Last Resort to all banks. Under this role, it is only logical for the central bank to want to supervise and regulate the operations of banks to prevent unwanted risks that can result in contagion from one bank to the other. The repository of skills in financial markets and financial regulations owned by the central bank and their high degree of independence from government make them less subjective in their operations; though this is not the case for the United Kingdom.[55]

The central argument for the separation of monetary policy and banking regulation is in the context of potential conflicts of interest.[56] This conflict may arise when monetary policy objectives require high interest rates but these rates are kept low to help keep the profitability of the banking system.

Next, we shall look at the Central Bank in terms of its role as monetary policy maker and as prudential regulator of the banking system and how these roles have changed in light of financial crises.

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[53] Arguments for and against the interconnectedness of monetary policy and banking regulation can be found in Howard Davies and David Green (p.194-202) (n 10).

[54] Eddie George (1994) in Howard Davies and David Green (2009). (p195) (n 10). Eddie George was at the time the Governor of the Bank of England.

[55] In the Uk, the regulator for banks is separate. In many developing countries this is not the case, central banks carry out both functions of regulating and monetary policy.

[56] Charles Goodhart and Dirk Schoenmaker, '*Institutional Separation between Supervisory and Regulatory agencies*.' (1993) Financial Markets Group. An ESRC Research Center. London School of Economics and Political Science. Special Paper No. 52.

Monetary Policy makers

Monetary Policy has been generally accepted as the primary function of central banks and price stability the cornerstone of monetary policy with the goal being price stability and the instrument, monetary policy.[57] It therefore seems important, that any perspective of monetary policy be made in light of price stability. But does a focus on price stability reflect into stability of the financial system which should also be a focus of the central bank?

The consensus in the 90's was for the central bank to use its control over money market interest rates to achieve price stability.[58] Some of the debates at the time included whether central banks should consider "developments in asset prices, leverage, and credit growth."[59] "Major booms and busts in credit and asset prices, sometimes ending in serious strains on the financial system can amplify business cycles and derail monetary policy objectives, including price stability."[60]

While price changes can be measured via indicators such as the consumer price index, financial stability has no defined indicator to measure its stability. The monetarist approach to financial instability stresses that the growth of monetary aggregates can be helpful to monitor and can serve as good indicators of the vulnerabilities within the financial system. [61] Furthermore

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[57] Rosa Maria Lastra. (n 30). This was the almost universally accepted function of central banks in the 1970's and 1980's to address the excessive inflation during that time. As Lastra points out, the measurement of inflation ignored asset prices like those of housing prices therefore creating the asset price bubble that eventually burst in 2007. As sees in the financial crisis central banks shifted their primary concern from price stability to restoring financial stability.

[58] Charles Goodhart. (p.217) (n 18).

[59] These developments however, may be neglected if central banks maintain a narrow price stability objective.

[60] Claudio Boro and Philip Lowe. '*Securing Sustainable Price Stability: Should credit come back from the wilderness?*' (2004)BIS Working Paper, No 157. Retrieved From: <http://www.bis.org/publ/work157.pdf>

[61] Friedman and Schwartz, 1963 in E. Philip Davis, '*Financial Data Needs for Macroprudential Surveillance-What are the Key Indicators of risks to Domestic Financial Stability*.' (1999) Handbooks in Central Banking Lecture Series. Retrieved from:

assessing financial stability risks requires good judgment and good knowledge of historic events and the data of past crises to see what may or may not constitute as normal economic conditions.[62]

The use of Exchange Rates as a monetary tool looks at Flexible Exchange rates and Fixed Exchanged rate pegged to the currency of another country. Once the anchor country, in Belize's case the US, provides price stability there will be a long-term trend with the pegged currency. If the anchor country is unable to provide price stability there may be massive disturbances to the country having the pegged rate. As Goodhart explains, if the anchor country is able to provide price stability in the long run but if cyclical shocks are not synchronized in the anchor country there is the likelihood of a rough ride.

"Volatile inflation has often been a precursor to instability"[63] but it is important to note that inflation alone is not a precondition to instabilities but as seen in the US thrift crises increases in prices can definitely contribute to financial instabilities.[64]

Monetary Aggregates categorized into narrow money (M1), intermediate money (M2), and broad money (M3) aggregates differ in relations to the "degree of moneyness of the assets included."[65] The use of money aggregates can be of help in controlling inflation rates. It is said that once it is accompanied with a "simple, transparent and rigorous theoretical structure, monetary targets can be a good channel of communication with the general public and

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<http://www.bankofengland.co.uk/education/Documents/ccbs/ls/pdf/lshb02.pdf >

[62] E. Phillip Davis (1999) in Phillip E. Davis (2004) (n 47) provides a deeper analysis of financial sector instabilities. The International Monetary Fund (IMF 2006) and the European Central Bank (Agresti et'al., 2008) have developed macroprudential indicators to assess market pressures and both external and banking system vulnerabilities. Stress-testing techniques, as an example, are being used by financial institutions to measure possible vulnerabilities.

[63] Philip E. Davis (1999). (n 47).

[64] The US Thrift crisis can be seen in light of increase in prices but the effects were compounded by a slacking prudential supervision framework.

[65] European Central Bank.
< http://www.ecb.europa.eu/stats/money/aggregates/aggr/html/hist.en.html> accessed on 15th August, 2014

promote a convergence of inflation expectations." "In framing monetary policy central banks should pay particular attention to credit developments. A focus on monetary aggregates alone is unlikely to be an adequate substitute."[66] Furthermore, central bank's response to financial instabilities are said to be asymmetrical where in the presence of economic vulnerabilities they may loosen policy beyond the normal but they will not lean against them as they build up.[67]

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[66] Bank of International Settlements. Claudio Borio and Philip Lowe, '*Securing Sustainable Price Stability: Should Credit Come Back from the Wilderness?*' (2004)BIS Working Papers, No.157. Retrieved from: <http://www.bis.org/publ/work157.pdf >

[67] Claudio Borio (2004). (n 50).

Regulators of the banks (prudential regulation)

The role of central banks to maintain financial stability has been something emphasized by the recent financial crises. In light of this, there is the need for central banks to allocate more time and resources to strengthen the monitoring of financial stability where regulating and supervisory bodies aim at limiting the buildup of systemic risks within financial markets.[68] Andrew Crockett adds that "to build most productively on past achievements in the pursuit of financial stability, we should strive for a better marriage between the micro-prudential and macro-prudential dimensions of the task."[69]

Financial regulation plays a very important role in providing the public good of systemic stability,[70] something thought to be undersupplied pre-crisis in both micro and macro-prudential regulation.[71] A widely accepted source of systemic risk is the contagious effect of institutional failure in the financial sector where the failure of or the insolvency of one or a few financial institutions begins to jeopardize the viability of other institutions. This may result from either real contagion or information contagion[72].

The pursuit of global financial stability has seen various developments and reforms in the area of banking regulation and supervision. One of the most influential reforms of international

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[68] Regulation as noted in E. Phillip Davis (1999), is a needed response to the rise of potential instabilities within the financial system. It is important to note that for regulation to limit systemic risks it needs to be adequately formulated and implemented to ensure that there are no effects of moral hazards resulting from the perception that when facing difficulties, all banks will be saved. That competition does not lead to undesired levels of risk taking that have effects on the wider sector including central banks.

[69] Andrew Crocket,'*Marrying the Micro and Macro Prudential Dimensions of Financial Stability*.' (2000) < http://www.bis.org/review/r000922b.pdf> accessed on 15th August, 2014

[70] Mads Andenas and Iris H-Y Chiu. (p. 4) (n 1).

[71] Mads Andenas and Ir-s H-Y Chiu. (p. 12)(n 1).

[72] For a deeper reading on information contagion and the how the effects of distorted information can be amplified and cause a financial crisis see Tony Ahnert and Ali Kakhbod, '*Information, Amplification and Financial Crisis.*' (2014) <http://www.toni-ahnert.org/Amplification_Ahnert-Kakhbod.pdf>

cooperation comes from the Basel Committee on Banking Supervision with Basel III being the most recent. Basel III seeks to strengthen the regulation and supervision along with the management of risks for banks. It uses microprudential and macroprudential[73] tools of regulation which aim at making individual banks more resilient to periods of instability and creates buffers, such as capital buffers to help prevent systemic risks that can make the entire financial system unstable.[74] Regulation and supervision have become a critical component of the reforms that make up the international regulatory framework for banks. These reforms may result in undesirable actions if it forces banks to increase credit prices thus resulting in more costly credit throughout the banking system and a sluggish growth rate due to a potential decline in business investments and consumer expenditure. The impact of such increase including the increase in interest rates can only be understood in light of the economic foundations of monetary policy.[75]

The macro-prudential perspective presses on the potential risks that actions carried by individual banks within a micro-prudential perspective may not necessarily be actions that offer

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[73] Macroprudential objectives call for a wider focus which shifts away from "narrow depositor protection" and toward a more systemic focus with the benefit of a convergence of official intervention and market discipline. This shift will then aim at the assessment of the systemic importance of individual firms. Strengthened supervision should result in sounder firms and will help prevent imbalances that can produce systemic risks. See (n 58).

[74] Generally, when you think of micro-prudential objectives you have to think of regulators and their supervisory role to ensure the protection of individual debtors and the financial stability of individual banks. Macro-prudential objectives, on the other hand, look at reducing costs to the economy by limiting systemic risks that may affect a significant part of the financial system.

[75] For more on Basel III form of regulation see < http://www.bis.org/bcbs/basel3.htm> Also See Nick Forrest 'A Practitioners Guide to Basel III, Chapter 18 "Implications for the Economy' (p.441-449) for a further read on how banks and banking regulation impact the economy. Forrest outlines various responses taken by banks in the face of new reforms including increased costs for credit, a reduction in interests paid to savers, loss of jobs not only for employees within the banking system but for bank suppliers, reduced lending and others which may have potential risks for further financial instabilities. Peek and Rosengen (1995) in Nick Forrest, present evidence from New England banks where capital regulation resulted in a reduction of credit activity during the recession of 1990-1991. However, the reduction of lending for banks with more adequate capitalization was less than those who were not adequately capitalized.

or would result into desired outcomes for the entire system. For example, in times of recession it seems logical for a single bank to want to tighten its lending standards but if all banks take the same stance reduced lending may lead to reduction of market prices thus creating liquidity problems and an unstable financial system.[76] On another note, a more timely and detailed data on banks and good judgment is important to preventing potential risks. The data needed would have to be reflected in the accounts of the banks through the information on capital, liquidity, income in relation to assets, non-performing loans in relation to capital and equity and asset returns to name a few. The collection of data is very important but what is critical in the examination process to be able to measure its potential risks is good judgment from supervisors.[77]

Macro-prudential policy has been elemental in the pursuit of financial stability but a question lies as to how this policy objective supports monetary policy.[78] In other words, how do the objectives set out by regulatory and supervisory authorities work in support of monetary authorities such as the central bank and similar monetary institutions in creating a sound and stable financial and economic system? There is the need for a reconsideration of monetary

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[76] Nick Forrest. (n 60). Forrest states that banks' lending and pricing decisions in response to reforms will have an impact on the macro-economy. This impact of banks on the economy, Forrest Adds, has been well studied in relations to its role on determining the impact to monetary policy. By understanding the consequences of their decisions to the wider economy banks can limit the undesired economic impact of reforms and help to amplify their stability benefits and thus contribute to overall financial and economic stability.

[77] Philip E Davis (1999) (n 37). The critical point is to measure the gravity of the data under review by "observing the overall pattern of economic and financial developments in a judgmental manner, informed by the events of the past that have entailed systemic risks, and with a broad conceptual framework derived from theory to identify appropriate danger signals." Some of the imbalances noted may not lead to a crisis but having timely and detailed bank information may help to add meaning to and address in a timely manner any vulnerability that may potentially lead to systemic risk and contagion.

[78] Claudio E. V. Borio and Ilhyock Shim,'*What can (macro-) prudential policy do to support monetary policy?*' (2007) BIS Working Papers No. 242. Monetary and Economic Department.
< http://www.bis.org/publ/work242.pdf> Efforts by both the monetary and prudential authorities can be rendered void when weaknesses in the financial sector undermine the efficacy of monetary policy measures. A weakened or unstable monetary environment can easily trigger instabilities within the financial sector. This scenario alone is an indication of the interrelation that exists between the financial sector and the monetary environment.

policy goals and objectives[79] and for a consolidated shift in perspective that complements the micro-prudential perspective with an increased awareness of the macro-prudential component to meet financial stability.[80]

A study was conducted on a sample of 24 countries, 104 banks all together, where 11 used a combined regime and 13 used a separated regime to examine whether being under a particular regime makes countries less prone of bank failures and whether the nature of bank failure resolutions were different under each regime. The study revealed that there were statistically significant fewer banking failures in those countries which had both the monetary and supervisory and regulatory authority under one institution, in other words, operating under a combined regime yet these countries were not necessarily the most efficient in welfare terms.[81]

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[79] Janet L. Yellen, '*Monetary Policy and Financial Stability*.'(2014) International Monetary Fund <http://www.federalreserve.gov/newsevents/speech/yellen20140702a.htm> explains that a consideration of monetary objectives and strategy is one of the tasks the Federal Reserve is focusing on but nonetheless argues that monetary policy is currently significantly challenged as a tool that can support financial stability.

[80] Andrew Crocket (2000). (n 55).

[81] Charles Goodhart and Dirk Schoenmaker, '*Should the function of Monetary Policy and Banking Supervision Be Separated?*' (1995) Oxford Economic Papers. Vol 47. No. 4 (JSTOR download at : http://www.jstor.org)
The study identified four different sources of funding inclusive of the central bank, commercial banks, deposit insurance, and the government. Although this study was conducted over a decade ago, this historical data is useful in offering significant insight on how countries operate within differing regimes and how stabilizing efforts in the form of financing can vary under each regime.

Chapter III: The independence or interdependence of monetary policies or regulatory policies of the central bank

Central banks can either be dependent on Treasury or Ministry of Finance to meet monetary policy goals or they can be completely independent in the formulation and implementation of monetary policy. For those banks that are not independent, it is the Treasury or the Ministry of Finance that is responsible for determining monetary policy goals with the implementation of them being done by the central bank.

A flexible inflation targeting framework was the policy framework being used in the early 2000's by central banks from developed and emerging countries to achieve price and macroeconomic stability at levels both nationally and internationally.[82] Though this framework achieved price stability in many emerging countries there is the recognition to rethinking the traditional approach to central banking along with a redefinition of the relationship between the stability of prices and the wider goals of macroeconomic and financial stability.

One of the recommendations offered by the Committee on International Economic Policy and Reform based on an analysis of the lessons learned from the financial crisis is that "Central banks should go beyond their traditional emphasis on low inflation to adopt an explicit goal of

[82] Barry Eichengreen et'al, '*Rethinking Central Banking.*' (2011)Committee on International Economic Policy and Reform. Retrieved from: <http://www.brookings.edu/~/media/research/files/reports/2011/9/ciepr%20central%20banking/rethinking%20central%20banking.pdf>

financial stability. Macroprudential tools should be used alongside monetary policy in pursuit of that objective. Mechanisms should also be developed to encourage large-country central banks to internalize the spillover effects of their policies."[83] They also say that central banks should make clear that monetary policy is not an independent policy response but one that works in conjunction with fiscal policies, structural policies and financial sector regulations.

What has been the experience of the United States of America (US) and the European Union (EU) in light of the financial crisis? What have been the economic reforms that have been implemented and how have these impacted the international community of banking and finance?

[83] Barry Eichengreen et'al. (2011) (n 68).

The US Experience

"Responding to the very difficult economic and financial challenges we face, the Federal Reserve has gone beyond traditional monetary policy to develop new policy tools to address the dysfunctions in the nation's credit markets" Ben Bernanke (2009).[84]

One of the challenges after a crisis is the restoration of economic growth but output levels tend to take a long time to return to desired levels after a banking crisis. While some associate the economic weaknesses experienced today as being associated with the housing and household debt others point out to the banking crisis, uncertainty of policies and excessive regulation.[85] Though economic weaknesses persist and overall economic recovery process has been slow the efforts of the Federal Reserve in meeting its dual mandate have evidently not been fruitless.

But what exactly happened?

In 2007 the US was experiencing problems in its housing sector due to a debt-fueled housing boom. These problems eventually spilled into the real economy and created problems that were first observed in the financial sector. Many investors doubted the true value of the structured securities in the form of real estate collaterals that were backing up CDs and this developed a lack of confidence and a reduction in the trading of these financial assets and a decline in their price. This also led to a call for bankruptcy from some investment funds.

This "debt-fueled housing boom artificially boosted household spending from 2000 to 2006, and then the collapse in house prices forced a sharp pull-back because indebted households

[84] In 2009, the then Chairman of the Federal Reserve Ben Bernanke addressing the National Press Club said that "Extraordinary times call for extraordinary measures."

[85]Atif Mian and Amir Sufi, '*More Evidence Supporting the House of Debt.*' (2014) <http://houseofdebt.org/2014/08/08/more-evidence-supporting-the-house-of-debt.html>

bore the brunt of the shock. The lack of policies targeting this problem exacerbated the effects of the housing crash on consumer spending."[86] As noted, the gap created by these effects on consumption was deeper among "hard hit" states in comparison to those considered to have largely avoided the housing collapse.[87]

The financial sector experienced a severe liquidity problem which eventually led to the fall of big banks such as Northern Rock in the UK, Bear Sterns in the US and eventually the bankruptcy of Lehman Brothers. The effects experienced as a result were devastating to the US economy with spillovers into the global economy.

The financial crisis left many countries in a state of recession. The interconnectedness of global economies in times of recession may cause severe impact in economic growth especially for a country like the US which is very well interconnected with the rest of the world. The US has experienced quite a number of recessions with the first recession experienced in the late months of 1937 with the crash of the stock market. Many jobs are lost and history shows that job losses in times of a recession are never recovered. In an effort to address this and restore employment and gain consumer confidence it was important to restore the health of the financial sector particularly of banks.

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[86] Atif Mian and Amir Sufi (2014). (n 71).

[87] Atif Mian and Amir Sufi (2014). (n 71). They explain that the gap between the consumption of durable goods from 2006 to 2012 has been larger than the gap between the consumption of non-durable goods. Furthermore and more surprising was the increasing gap for the consumption of services even through 2012. The reason for a larger gap in between durable gap is because of its direct correlation with the housing market which fuels purchases such as home appliances, furniture and electronics. As for non-durable goods such as food and clothing the gap has been smaller primarily because these goods are considered more of a need than the durable items that complement a housing market.

What was the US policy response?[88]

A number of developments emerged in the US after the crisis. Immediately after the crisis the Federal Reserve dropped its discount rate and fund rate but this was of little help. Later on, came the fall of Lehman brothers along with the collapse of Indymac Bank, private bank acquisitions and the government takeover of Fannie Mae and Freddie Mac. By 2008 the Fed had to resort to interest rate cuts to 1% and fund rate cuts to 1.75% accompanied with liquidity injections. This was the pattern followed by other countries but these efforts did not seem to be sufficient to restore the economy.

The Fed introduced a financial rescue plan that included stress tests which produced a number for adequate capital needed to prevent further bank failures. The Treasury introduced a Troubled Assets Relief Plan (TARP) to help get rid of bad assets. A Term Asset-backed Securities Loan Facility (TALF) program was developed as a Federal Reserve credit facility under section 13(3) of the Federal Reserve Act.[89] This credit facility was a fiscal stimulus package designed to help with economic recovery that included small tax cuts.

The U.S. government then came out with the National Economic Stabilization Act of 2008. The Act created a corpus of $700 billion for TARP to purchase distressed assets, especially mortgage-backed securities but this figure was reduced to $475 by the Dodd Frank Wall Street Reform and consumer Protection Act (Dodd-Frank Act) and was distributed among the five

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[88] A detailed description of developments mentioned in this section are offered by Martin Neil Baily and Douglas J Elliott, '*The US Financial and Economic Crisis: Where Does it Stand and Where Do We Go From Here*?' (2009)<http://www.brookings.edu/~/media/research/files/papers/2009/6/15%20economic%20crisis%20baily%20elliott/0615_economic_crisis_baily_elliott.pdf>

[89] As set out within the Terms and Conditions of TALF found at:
< http://www.federalreserve.gov/newsevents/press/monetary/monetary20081125a1.pdf>

programs under TARP.[90] Different governments came out with their own versions of bailout packages, government guarantees and outright nationalization.

Monetary Economists write that every Central Bank should operate under a dual mandate.[91] In the case of the United States (US) its Federal Reserve Bank, the Fed as it is mostly referred to, has a dual mandate. One is to maintain price stability and the other is to maximize employment. This dual mandate is important because central banks need to minimize fluctuations in both inflation and output gaps by having a "strong nominal anchor" which in return anchors both inflation and inflation expectations and provides for a more efficient monetary policy.[92]

The long accommodative policies and other efforts made by the Federal Reserve since the crisis including maintaining interest rates close to the zero range and the use of quantitative easing via the purchases of US Treasuries and asset backed securities have helped to stimulate the growth of the US economy. Despite this, these efforts may have serious consequences particularly in "potential runaway inflation." Gary Thayer says that, "there is currently a divide within the Federal Reserve between a few policymakers who think that the Fed should try to prevent financial bubbles caused by rising asset prices and others who believe that the Fed should focus on achieving its goal of maximum employment, especially if wage and price

[90] For more on TARP programs see the US Department of the Treasury website at: < www.treasury.gov>
[91] Frederic Mishkin in an interview with Gary H. Stern (September 2007)<
https://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=1138& >
[92] Frederic Mishkin. (n 14).

inflation is still well contained."[93] This topic of inflation will be the center of debate at the 2014 annual conference of the world's top central bankers and economists in Jackson Hole.[94] This conference should be able to provide a good platform for expanding such debate beyond interest rates and labor markets and offer positive insight as to the role that central banks play in influencing their national economies.

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[93]Dunstan Prial, '*Debate Over Role of Central Banks Expected in Jackson Hole*.' (2014) Fox Business. The theme for the conference is "Re-evaluating Labor Market Dynamics." This is a topic that the new Fed's chairperson, Janet Yellen holds dearly. Yellen has expressed that one of her goals is to use monetary policy to strengthen US labor markets.
< http://www.foxbusiness.com/economy-policy/2014/08/20/jackson-hole-is-summer-camp-for-central-bankers/>

[94] Gary Thayer, Chief macro strategist at Wells Fargo Advisors in Dunstan Prial (2004). (n 63).

The EU Experience:

The economic crisis experienced in Europe was a part of the ripple effect of the banking crisis that initiated in the US. There were several European banks which had significantly invested in the US's mortgage market and when the problems within the US mortgage market exploded it hit those banks really hard. Governments of countries like the UK, Germany, France, Ireland, Denmark, the Netherlands and Belgium had to come to the rescue to prevent further bank failings.

By 2009 European countries were experiencing an economic recession. The problems that were affecting the banking sector had started to also affect government's finances since the crisis encouraged countries to increase their public debt in an effort to prevent further harmful effects. Between the periods 2008 to 2011 the EU committed 1.6 trillion euros to prevent a collapse of the entire banking system.[95] Governments who had accumulated debt to help finance their budgets now found markets to be hesitant in facilitating lending and what was only a debt crisis eventually turned into a sovereign debt crisis for some European countries.[96],[97]

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[95] This figure was equivalent to 13% of the EU's annual GDP as mentioned in the European Commission, 'Responding to the Financial Crisis.' Found at: <http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis/responding_to_the_financial_crisis/index_en.htm>

[96] A Few countries including Greece, Spain, Ireland, Portugal and Cyprus found themselves in a bad economic state and were unable to borrow at financial markets at reasonable interest rates. The EU thus created a crisis resolution mechanism to assist these countries which found themselves in financial difficulties. Furthermore, other countries created a "firewall" confidence building measure to help with the financing of other countries' debts particularly of those which were experiencing difficulties in borrowing from the financial market. For a more detailed explanation of each of these countries' economic situation after the crisis see: European Commission, '*Assisting Countries in trouble.'* <http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis/assisting_countries_in_trouble/index_en.htm>

[97] Laurent Weill, '*The Financial Crisis and the Debt Crisis in Europe: a Brief Overview*.' < elfa-afde.**eu**/app/download/5801174965/l.weill.pd> accessed on July 15th, 2014

Economic imbalances were being experienced and what has also exacerbated the economic situation may be associated to the adjustment that member states have had to undergo within the euro area. Further economic imbalances and economic bubbles can be limited if countries take into account the rules that make the euro function and work at adopting common economic policies as required by the agreement to share a common currency within a single monetary policy. Some of the imbalances included a strong emphasis on deficits, lack of surveillance of competitiveness and economic imbalances, weak enforcement, slow-decision making capacity and emergency financing were a few of the shortcomings identified in the EU's economic governance system after the crisis.[98] The current situation called into question the adequacy of the institutional structure in times of crisis, of both the EU's Economic and Monetary Union (EMU) and the euro.[99] The European Central Bank as the single monetary authority for the EU is thus challenged.

How has the European Union (EU) responded?

The Treaty for the Functioning of the European Union (TFEU) provides for measures that seek to enhance fiscal disciplines under a single currency. Some of these provisions apply to the areas of monetary financing prohibitions, including no bail-out clauses, avoidance of excessive government deficits under Articles 123, 125 and 126 respectively. Outside of these provisions, there is the Stability Growth Pact (SGP)[100] which sets out a fiscal policy framework for the EU

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[98] A more detailed explanation on these shortcomings can be found at: European Commission, 'European Economy Explained-Why Did the Crisis Spread.'<
http://ec.europa.eu/economy_finance/explained/the_financial_and_economic_crisis/why_did_the_crisis_spread/index_en.htm>

[99] Philippine Cour-Thimann and Bernhard Winkler, '*The ECB's Non-Standard Monetary Policy Measures: The Role of Institutional Factors and Financial Structure.*' (2013). European Central Bank, Working Paper Series No 1528 (2013).

[100] European Commission. Economic and Financial Affairs. '*Stability and Growth Pact'*

for improved discipline under a preventive and a corrective arm. Articles 121 and 126 of the TFEU form the legal basis of the SGP outlining the preventive and corrective arms respectively.

The European Central Bank is the independent monetary policy authority for the EU working under a two pillar approach monetary policy strategy in the areas of "*economic analysis*" and "*monetary analysis.*" The economic analysis focuses on "the assessment of current economic and financial developments and the applied short to medium-term risks to price stability."[101] The monetary analysis relies on the medium to long term relation that exists in between monetary growth and inflation. While tying these two strategies along with money and liquidity considerations, the ECB aims at looking beyond the temporary impact of shocks and thus avoiding aggressive actions.

The European Central Bank has been responsible for the monetary policy of the European Union since January 1, 1999, when the euro currency was adopted by the EU members and is the authorized decision making body of the European System of Central Banks (ESCB). The European Central Bank and central banks from all member states make up the European System of Central Banks (ESCB).

The primary objective of the European System of Central Banks as stated in Article 127 (1) of the Act is that it shall maintain price stability and "without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the

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< http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm> accessed on August 30th ,2014.

[101] ECB Policies and Eurosystem Activities (Chapter 3), '*The Conduct of Monetary Policy*.' < www.ecb.europa.eu>

Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources, and in compliance with the principles set out in Article 119.[102] The basic tasks carried out through the ESCB shall be to define and implement the monetary policy of the Community; to conduct foreign exchange operations consistent with the provisions of Article 111; to hold and manage the official foreign reserves of the Member States and to promote the smooth operation of payment systems.

In an effort to offer financial assistance and to show solidarity to countries in need, the EU built two instruments in the form of temporary funds with the capacity to lend a total of 500 billion euros via the European Financial Stabilization Mechanism (EFSM)[103] and the European Financial Stability Facility (EFSF).[104] By 2012 it created a permanent fund via the European Stability Mechanism (ESM)[105] which serves as the backbone of EU's financial firewall and of a comprehensive strategy of maintaining financial stability within the euro area.

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[102] Official Journal of the European Union. 'Institutional Provisions.' Found at:
< https://www.ecb.europa.eu/ecb/legal/pdf/c_32620121026en.pdf>

[103] The EFSM is a temporary mechanism set in place to provide financial assistance to EU member states under financial difficulties.

[104] The EFSF Framework Agreement was established in June 7th 2010 and section 2 of the EFSF's preamble states that it was incorporated to provide stability support to euro-area member states. The euro-area member states within the agreement are: Kingdom of Belgium, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Grand Duchy of Luxembourg, Malta, the Kingdom of the Netherlands, the Republic of Austria, the Portuguese Republic, the Republic of Slovenia, the Slovak Republic and the Republic of Finland <http://www.efsf.europa.eu/attachments/20111019_efsf_framework_agreement_en.pdf>

[105]The ESM Treaty of 02/02/2012. The ESM is a permanent stability mechanism that was created to assume the tasks of the EFSM and the EFSF in providing where needed financial assistance to euro member states. Found at: < http://www.esm.europa.eu/ >

To further strengthen the resilience of the EU's banking sector to financial shocks and to increase financial sector oversight the EU set up three supervisory and regulatory bodies in the form of:

i. The European Banking Authority (EBA) which supervises banking sector and recapitalization of banks.
ii. European Securities and Market Authority (ESMA) which supervises capital markets.
iii. European Insurance and Occupational Pensions Authority (EIOPA) dealing with Insurance supervision.

The European Systemic Risk Board (ESRB) was another body that was established in an effort to strengthen the macro-prudential policies within the EU.[106]

The crisis showed the EU that an economy built on debt is not sustainable; therefore, new and stronger rules were developed to tighten the checks on public debts and on budget deficits. A new fiscal treaty was signed to help build confidence and a framework for the supervision and prompt fixing of macroeconomic imbalances was introduced.

[106] Philippine and Winkler. (n 86). Figure 1. They offer an illustration of the current institutional structure of the EU where the ECB serves as the monetary policy authority for the EU, where the responsibility of Fiscal sustainability lies on national governments and financial stability lying under both the responsibility of single and collective governments.

The EU has a 2020 growth strategy which aims for high levels of employment, productivity, and social cohesion. The growth strategy established a system of policy implementation coordination where countries get the chance to review one another's economic and fiscal policies and offer reform recommendations. Throughout the year, there should be monitoring of the implementation of the policies.

The ECB has used unconventional policies to help stabilize the EU's economy. After the collapse of Lehman Brothers it reduced its interest rates to extremely low levels. It introduced what was termed an Enhanced Credit Support with a focus on the banking sector which included but not limited to the setting of interest rates and liquidity provisions.[107]

[107] Pattipeilohi and others (2013) (n. 46).

ChapterIV: A perspective on the regulatory and monetary dichotomy to the operation of the Central Bank of Belize

"The importance of appropriate legal and institutional frameworks for the performance of economies is increasingly being recognized. However, trying to combine the legal approach (logically coherent) with the economic approach (empirically evident) without disregarding the political and social considerations underlying both legal structures and economic models, is not an easy task." [108]

The policy and economic framework:

As mentioned in Chapter I, the framework for monetary policy falls under two variables. The first variable consists of institutions (central bank, central government, financial institutions such as commercial banks, international banks, credit unions, insurance companies etc.), organizations and persons such as policymakers and supervisors who formulate and implement monetary policy. The second variable includes financial and monetary tools and targets. The Central Bank, an autonomous institution, is at the center of this framework holding the sole authority of the formulation and implementation of monetary policy with an extended mandate of regulation and supervision of the banking sector and fiscal agent for the Government of Belize.

The differing objectives of each of these roles may be conflicting and thus pose challenges for the central bank and the wider economy. Monetary policy and economic policy share the same targets of "full employment, economic growth, price stability and balance of payment

[108] Stigler (1988, p.216) in Rosa Maria Lastra, '*Central Bank and Banking Regulations*.' London School of Economics and Political Science (1996) (p. 7).

equilibrium."[109] Not all of these targets contribute to GDP nor do they contribute to social welfare but generally, these are the targets that policy makers often focus on. Different targets mean different objectives that may be conflicting with each other and posing problems to economic policy formulation; finding the right mix of objectives and designing tools that aim at fulfilling specific targets and that are the least harmful to the economy may be a good solution to this problem.[110] Other challenges of having all these policy objectives under one roof are related to conflicts of interest, reputational risk[111] and central bank independence.[112]

A potential conflict of interest arises because as regulator the Central Bank has easy access to liquidity and as a result may from time to time relax its monetary policy. This poses problems as it may generate an inflationary bias, it may weaken its credibility and thus create a moral hazard of more risk taking from banks.[113] All these elements pose great concerns to the stability within the market.[114]

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[109] Rosa Maria Lastra, 'Central Bank and Banking Regulation' Chapter 5: Monetary Policy (1996). London school of Economics and Political Science. (p. 68).
[110] Lastra (n. 97). In a scenario where unemployment is high and prices are rising stimulating demand may address the unemployment problem but would put more pressure on rising prices and if demand is constrained it will augment unemployment levels but would put the rise in prices in balance. Too many targets thus create conflicting objectives. Lastra presents 2 possible solutions to this problem: 1.) a 'trade-off' where there is a preference to combined policy objectives. A right combination of objectives does not necessarily mean that all or any objective is fully met but the preferred combination would be the one that poses the least damage to the economy. 2.) devising additional tools that aim specifically at meeting targets.
[111] Conflicts of Interest arise when a person in the position to exercise judgment on a situation happens to have differing interests.
The Federal Reserve (US) defines reputational risk as 'the potential that negative publicity regarding an institution's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions.'< http://www.federalreserve.gov/bankinforeg/topics/legal_risk.htm>

[112] Benoite Coeure, 'Monetary Policy and Banking Supervision' (2013).
<http://www.ecb.europa.eu/press/key/date/2013/html/spl30207.en.html>
[113] Benoite Coeure,'Monetary Policy and Banking Supervision.' (2013). (n 97).
[114] 1.)The research done on conflicts of interest is not well developed in the literature.
2.) If there are banking system concerns in relations to their micro-health and stability and whether this might alter the Central Bank's conduct of macro-policy then there would be a need for separation of these functions. For more examples see: See Goodhart and Schoenmaker, 'Should the Functions of Monetary Policy and banking Regulation be Separated?' (1995).

To limit reputational risk there is a need to improve and strengthen the supervision of the banking sector where there is an appropriate mix of macro and micro-prudential tools of supervision.

Central Banks, in exercising their duties and functions, can either be dependent, autonomous or independent from government and parliament. Various central banks around the world aim for independence "as a credible institutional arrangement for a monetary policy committed to price stability."[115] In the case of Belize which operates under a democratic form of government there is "no real case"[116] for the central bank to be fully independent of government. What is needed in such a case is for government to keep a central bank that is independent as a "widely knowledgeable and expert source of advice and information which can contribute to and implement monetary and banking policy"[117]and where the central bank is accountable and sensitive to democratic processes.[118]

Though there may be challenges having one institutional framework under which all these authorities operate there should be improved sharing of information and perspectives among each other which may yield fruitful to meeting varying targets and objectives. Moreover the central bank with a monetary policy objective needs to look at the macro-economy to understand its connections to the financial sector. The Central Bank conducts a lot of economic

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[115] Lastra (n. 97).
[116] Lastra (n. 97).
[117] Fair (1979, p.37) in Lastra (n. 97).
[118] Joseph Stiglitz, '*Central Banking in a Democratic Society*,' (1998).

research and analysis which is helpful information to better understand impacts on the financial sector; this is something that is lacking in supervisory authorities.[119]

In an effort to address these concerns, there has to be effective governance of the operations of the bank. There is the perception that there would be more efficient and effective formulation of policies and regulations that can potentially limit the effects of policy decisions than if these three mandates were separated under different authorities. Having a combined function of supervision and monetary policy along with the added role of fiscal agent[120] for the government of Belize, makes the central bank better equipped to formulating well-coordinated policies from both a macro and micro-economic perspective that will yield economic growth and financial stability.

[119]Charles Goodhart, Dirk Scheonmaker and Paolo Dasgupta, '*The Skill Profile of Central Bankers and Supervisors*' (2002) Eurpopean Finance Review 6. (p.397-427).

[120] Though fiscal policy falls under a different authority than the central bank, the implementation of one policy has implications over the other, therefore it is important to understand the interconnections among them to meet the bank's overall objective.

The legal and legislative instruments

The legal and legislative instruments of Belize grant autonomy to the Central Bank of Belize over the governing of monetary policy and the supervision and regulation of banks (those banks licensed by the bank). They all reinforce the Central Bank of Belize's commitment to maintaining monetary, financial and economic stability.

The Central Bank of Belize Act Chapter 262 of the Substantive Laws of Belize:

Section 4(1) of the Act provides that: "A Bank to be known as the Central Bank of Belize shall be and is hereby established as an autonomous institution governed by the provisions of this Act." Furthermore Section (6) provides that "within the context of the economic policy of the Government, the Bank shall be guided in all of its actions by the objectives of fostering monetary stability, especially as regards stability of the exchange rate, and promoting credit and exchange conditions conducive to the growth of the economy of Belize."

Part VII Sections (33-37) of the Act governs Central Bank's relations with the Government thus becoming its bank and fiscal agent.

Part VII Sections (38-49) of the Act governs central bank's relations with banks thus generally becoming the banker of such banks licensed under the central bank.

The Domestic Banks &Financial Institutions Act:

This Act grants the Central Bank the responsibility for the administration of the Act. Part II Sections (6-11) grants the Central Bank overall supervision and regulation of banks and financial institutions with the primary objective as provided for in section 6(2) "to maintain confidence in and promote the safety and soundness of, the financial system in Belize."

The International Banking Act Chapter 267:

This Act allows the Central Bank supervisory and regulatory authority to oversee and grant licenses to international banks.

The Exchange Control Act:

This forms the regulatory framework for the governing foreign exchange transactions as well as transactions between residents and non-residents. Accompanying regulations seek to address financial transaction involving exports and imports between residents and non-residents.

The Treasury Bills Act:

This allows the Government of Belize to borrow from the public through the sale of securities.

Chapter V: Conclusion

Regulation and supervision have become a critical component of the reforms that make up the international regulatory framework for banks. These reforms paired with the objectives of monetary and also fiscal policy are elemental in the support of a stable and sound financial and economic system.

In conclusion I will simply highlight some of the key points raised throughout this paper

- The effect of the financial crisis on Belize's economy:
  - Smaller economies with undeveloped financial markets are frowned at for their lack of development in their markets, a true case for Belize. The lack of a developed market protected Belize from the shocks that were channeled through complex market systems. Belize's real sector, however, suffered the blunt of the financial crisis via real contagion. This real contagion had a significant macroeconomic impact on Belize's exports and GDP as a result of its close relationship with the US as one of its biggest trading partners. The US was experiencing a decline in GDP and imports thus causing a decline on the GDP and exports in Belize.
  - The Central Bank of Belize carries both a function of monetary policy and banking supervision and regulation. Although the bank is not responsible for fiscal policy it serves as fiscal agent for the Government of Belize. Through this combination of functions the Central Bank is better equipped at creating a strong buffer against imbalances that can seep into the whole system thus causing undesired economic damages.

- Though economic weaknesses persist and overall economic recovery has been slow the efforts of the central banks in introducing innovative tools of monetary policy, strengthening of prudential regulations both at the micro and macro levels have been able to slow down and prevent a worse economic and financial crisis. What stands as a highlight of the financial crisis is the strong and substantial cooperation within the national and international domains of policy makers in the strengthening of the financial system, in facilitating global economic recovery and in preventing a future financial crisis.
- Globalisation has made it important for countries to expand their focus on its financial system from a national focus to a more international focus granted the international interconnectedness of financial systems. It is important to take note on the special features that make each country unique but despite any uniqueness financial imbalances can arise within any nation and no country is immune to experiencing a financial crisis.
- The need for combined policy efforts:
    - Monetary Policy cannot serve as a single tool to address the systemic risks that lead to economic instabilities created by financial crises. As presented in this paper, monetary policy is limited in its reach and requires the cooperation of government, regulators, and individual banks to better fight the battle of a financial crisis.

- As further emphasized by the Basel Committee:
    - Central banks should make clear that monetary policy is not an independent policy response but one that works in conjunction with fiscal policies, structural policies and financial sector regulations.
    - Central banks need to also reconsider their conventional tool of low inflation and try to embrace financial stability as a more explicit goal.
    - Central banks should have more of a macroeconomic approach and use Macro-prudential tools alongside monetary policy in pursuit of that objective. From a more international perspective, it recommends that mechanisms should be developed to encourage large-country central banks to internalize the spillover effects of their policies.

It is evident that there is a need to rethink the role of central banks in producing financial stability. Interest rates and Inflation which are tools used by the monetary authority have an impact on banking sector operations. These impacts can only be understood in light of the economic foundations of monetary policy.

The strengthening of regulation and supervision within the banking sector can create vulnerabilities within the system but with a macroeconomic perspective that takes into account micro and macro-prudential instruments they will be able to strengthen their policies and regulations. As a result, the banking sector will become more disciplined and efficient in the management of their operations and will be able to limit potential risks and create a more stable and solid banking system and a more stable economy.

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