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St Helena's forgotten currency board

St Helena's small but perfectly formed currency board provides an example to the rest of the world, argue Steve Hanke and Matt Sekerke.

The tiny isle of St Helena was discovered in 1502 and settled permanently by the East India Company in 1659. It was only after the British dispatched Napoleon to its shores in 1815 that St Helena became a real “place,” however.

In the monetary sphere, St Helena wasn't on the map until 1976. Until then, the British dependency did not have its own unit of account and primarily used currencies issued elsewhere. That changed, however, when the passage of the Currency Fund Ordinance of 1975 and the Currency Regulations of 1976 established a currency board and the new St Helena pound became legal tender. Surprisingly – given the burgeoning currency board literature – St Helena's currency board remains unreported. In what follows, we correct that oversight.

From the beginning of the East India Company's administration, sterling was the official unit of account in St Helena. Nevertheless, the predominant circulation was Spanish dollars, not pounds. In 1684 an Order in Council introduced St Helena's first unique coinage, a series of copper bars stamped with their weight and valued at one penny per ounce. This awkward money was refused by ships calling at the island and shunned by St Helenians. Consequently, the unwieldy copper bars had more or less disappeared by the early eighteenth century. Such too would be the fate of St Helena's later forays into the coinage business (Vice 1983).

Life before the currency board

As an active port of call – owing to its strategic placement in the middle of trans-Atlantic trade routes – St Helena hosted traders from around the world, merchants laden with the international currencies of the day. St Helena became a sort of exchange house on the high seas in which currencies traded at rates fixed by the council.

When the council's fixed rates of exchange departed from those prevailing in the world markets, visiting traders spotted arbitrage opportunities and exploited them ruthlessly. In some cases, the island was virtually depleted of currency in the process. For example, legislation devaluing Spanish pieces of eight from 6s to 5s in March 1708 allowed

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traders to buy Spanish dollars cheap in St Helena and sell them dear in Madras at the 6s rate. Soon the East India Company needed to order new coins struck to provide the cash-strapped island with circulation. The company's quick action was key to reviving St Helena's economy in the early 18th century. In time, however, gold pagodas and Venetian florins, undervalued in India, returned to fill St Helena's vaults and further lubricate the island's commercial activity.

St Helena's high point This situation prevailed into the early 1800s, when St Helena reached its zenith. With the arrival of Napoleon and his extensive entourage in 1815, the island's population doubled and trading activity and the demand for money trebled. The council's catalogue of official exchange rates, see Sampson (1973), reveals the staggering array of currencies circulating on the island in 1823, two years after Napoleon's death.

After the post-Napoleon slump, St Helena (and many other British possessions) faced a new challenge as a result of fluctuations in the gold price of silver. The old parities for silver standard currencies vis-a-vis gold standard currencies became obsolete when the price of silver fell. Arbitrageurs sold silver currencies in St Helena and other locales where the old exchange rates prevailed, at high cost to those territories. Gresham's Law struck with a vengeance.

Such exchange-rate difficulties arose not long after St Helena was handed over to the Crown in 1834. Orders in Council adjusting parities to market levels solved the problem, albeit at a cost. St Helena took the first such action on July 15 1843, when most foreign coins were exchanged for silver and sent away to be melted into bullion. Spanish doubloons and dollars remained in circulation alongside sterling at the rate of 4/2d. A subsequent decline of the Spanish dollar from 4/2d. to 3/8d. in 1879 prompted the St Helena Council to demonetise the Spanish coins, leaving sterling as the sole official medium.

Sterling holds sway Sterling remained the exclusive legal tender until the passage of the St Helena Coinage Order of 1925. This order made legal tender in St Helena "all coins which are legal tender coins in the United Kingdom under the Coinage Acts of 1870 and 1891 and all silver coins which are legal tender in the Union of South Africa under the Coinage Act, 1922" (Colonial Office 1949, 18). By legalising South Africa's currency, the council hoped to lay the groundwork for a more formidable trading relationship with South Africa. Unfortunately, that relationship failed to develop (Vice 1983, 125). The government ultimately replaced the 1925 measure with the Currency, Coinage and Legal Tender Ordinance, No. 5 of 1948, as amended by Ordinance No. 12 of 1949, "which provided, inter alia, that [St Helena's] currency should be Bank of England notes and United Kingdom coins which are legal tender in the United Kingdom from time to time" (Colonial Office 1950, 15).

The only branch of a foreign commercial bank to operate in St Helena was the Standard Bank of British South Africa, a corporate ancestor of today's Standard Charter Bank (Henry and Siepmann 1963). It operated briefly from 1864 to 1865 and was closed for commercial reasons. At that time, St Helena was rapidly declining as a port of call because steamships began to replace sailing ships and could bypass the island without

obtaining provisions. Today, banking on the island is carried out by the Government Savings Bank.

It was in this context that St Helena passed the Currency Fund Ordinance of 1975 and the Currency Regulations of 1976 in the interest of generating seigniorage revenue. These measures established a currency board, giving the island its first unique legal tender currency. The currency fund issues the St Helena pound, which is at parity with the pound sterling, in denominations from 1p coins to £20 notes. As of March 31 2001, there was £3,480,256 in circulation, or roughly £480 per capita. The currency fund's story, like that of any currency board, is told by its financial statements. These are presented in Tables 1 and 2 below¹.

The currency board solution

The currency fund is managed on behalf of St Helena's Commissioners by Crown Agents Asset Management, Ltd. Formerly a British public corporation, Crown Agents is now a private firm owned by the Crown Agents Foundation, whose members include other firms, NGOs, the British government, and various international agencies. Crown Agents Asset Management charges a fee of 0.5% of the market value of the funds under management (a "safe custody" charge of 0.02% was added in fiscal year 2001). Orthodox currency boards are characterised by small staffs and low expense, with expenses typically amounting to 0.5-1% of total assets. The currency fund is no exception.

A good deal all round

Table 1: St Helena's balance sheet

	1996/97	1997/98	1998/99	1999/2000	2000/01
Assets					
Investments in Securities	3174845	2881266	2969067	2434915	2372269
Bullion value of coin	205308	239673	213935	220527	217236
Deposits at bank call	832389	1228031	1218565	1138399	1474276
Deposits with Treasury					
Sterling CD				239998	
Cash in hand					
Remittances in transit		8980	5020	8340	
Total assets	4212542	4357950	4406587	4042179	4063781
Net assets (total less overdrafts)	4212542	4357950	4384447	4005899	4118641
Liabilities					
Cash overdrawn with Treasury	0	0	22140	36280	-54860
Currency fund (notes and coins)	3276988	3391310	3446774	3420423	3480256
of which notes	2445970	2525970	2553970	2492470	2539470
of which coins	831018	865340	892804	927953	940786
Total Liabilities	3276988	3391310	3468914	3456703	3425396
General reserve	935554	966640	937673	585476	638385
Liabilities + net worth	4212542	4357950	4406587	4042179	4063781
In St Helena pounds (= £1 GBP)					
Reserve coverage ratio (Net assets/currency fund)	128.5%	128.5%	127.2%	117.1%	118.3%

¹ We are indebted to Mr. D. H. Wade, chief finance officer of St Helena, for furnishing us with these documents. Regrettably, information for the years 1976-1993 is not available.

Table 2: St Helena's income statement

	1996/97	1997/98	1998/99	1999/2000	2000/01
Revenue					
Interest receivable	323933	286584	290014	244706	245267
Local sales of coins	38285	14722	5277	24778	1025
Sales by Royal Mint Commission					
Other income	619	654	1864	5389	2849
Currency written off					
Total revenue	362837	301960	297155	274873	249141
Expenses					
Printing expenses			37295		
Minting expenses			13648	23839	
Investment management charges	15906	15258	14745	13918	12847
Audit fees	2400	1200	1200	1200	1200
Other expenses	489	865	2819	2915	2056
Total expenses	18795	17323	69707	18033	16103
Operating surplus (transferred to general reserve)	344042	284637	227448	256840	233038
In St Helena pounds (= £1 GBP)					

The fund's foreign assets are UK gilts and bank deposits, both denominated in sterling, and the bullion value of commemorative coins in circulation is likewise included. Ten-year gilts have been the investment of choice. The currency fund's bank deposits are kept in overseas banks and have been moved around of late between several banks².

The currency fund holds deposits in the St Helena Treasury, and the latter provides the Fund with cash overdraft facilities. The currency board has also provided the Treasury with a tidy source of revenue, averaging £300,000 in operating profit each year, or about 5% of the Treasury's self-generated revenue.

The Fund's balance sheet makes it clear that the currency board operates very close to orthodox currency board rules³. It does not hold any domestic assets, does not regulate banks, and therefore has no

scope for engaging in sterilisation or introducing a domestic monetary policy. Its only deviation from orthodoxy is the relatively large foreign exchange cover for its monetary liabilities, which has ranged from 117% to 138%. Orthodox currency boards of the British colonies typically operated with 110-115% cover.

Insulated from government

This small departure from orthodoxy is no cause for alarm, however, because the board remains insulated from the kind of government and banking sector shenanigans which recently engulfed Argentina's unorthodox currency board. Argentina's unorthodox board suffered from wild fluctuations in its foreign exchange cover of its monetary liabilities and in its net domestic assets, as it engaged in aggressive sterilisation. Although the unorthodox currency boards in Bosnia and Herzegovina, Bulgaria, Estonia, Hong Kong and Lithuania have avoided the problems encountered in Argentina, they, too, have scope for sterilisation and have used it⁴. By contrast, the currency fund has no scope for sterilisation.

² As of April 1, 1992, cash deposits were held in three banks: Deutsche Bank London, Westpac London, and Bank of Scotland. The Westpac London account was closed by the end of FY 1996 (the fiscal year ends on March 31). Beginning FY 1997, deposits have been kept at the St Helena Treasury. The Deutsche Bank London account was transferred to Midland Bank during FY 1998. This account was then moved to HSBC and Bayerische Landesbank in FY 2000. The Bank of Scotland account was closed in FY 1999, and in FY 2001, the Bayerische Landesbank account was transferred to Rabobank Nederland and Société Générale.

³ For the elements of currency board orthodoxy, see Hanke, Jonung and Schuler (1993).

⁴ For an account of sterilisation in the unorthodox currency boards listed in this paragraph, see Hanke (2003).

Since the currency board was introduced, the St Helena pound has been trouble free. With the currency board, the Treasury has also gained a source of revenue which reduces, in part, the island's dependence on the United Kingdom⁵. Judging by this example, currency board orthodoxy pays, and other currency boards should draw lessons from St Helena's experience. Clearly, other small territories (not to mention the 61 larger countries identified in Hanke (2002)) would benefit from following St Helena's example. Some obvious candidates are listed in Table 3 below. Each has a central bank that issues a domestic currency. In all cases, a currency board would be more suitable than a central bank.

Lessons from St Helena

Table 3: Candidates for currency boards

Country	GDP (US\$m)	Central bank staff	Established	Exchange rate regime
Cape Verde	600	101	July 1 1976	Pegged
Comoros	424	37	NA	Pegged
Sao Tome and Principe	189	53	August 26 1992	Floating
Seychelles	605	50	December 1978	Pegged
Solomon Islands	800	74	1983	Pegged
Tonga	225	49	July 1 1989	Pegged
Vanuatu	257	52	December 18 1980	Pegged

Sources: GDP – CIA World Factbook 2002. Central bank staff, establishment dates, and exchange rate regimes – “Morgan Stanley Central Bank Directory” 2002.

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⁵ Revenue from the currency board amounts to 8% of the grants-in-aid received from the United Kingdom.