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April 22, 2021

**Statement by Mr. Merk and Ms. Koh on Eastern Caribbean Currency Union
(Preliminary)
Executive Board Meeting
April 26, 2021**

We thank staff for its informative report and Ms. Levonian and Ms. Edwards for the insightful BUFF. We agree with the thrust of the appraisal. Due to its heavy reliance on the tourism sector, the ECCU has been hit particularly hard by the Covid-19 pandemic. Real GDP is estimated to have declined by 16 % in 2020 (compared to -7 % in the LAC region). Unlike for most other countries, staff does not expect a quick recovery this year (-0.2 % in 2021, compared to +6 % in the LAC region). Strict containment measures – including travel restrictions – imposed in spring 2020 were lifted subsequently and tourist arrivals started to recover slowly during the winter season. However, we take note that staff expects tourism exports to remain below 30 % of the pre-pandemic level this year, which is the main driver of the deteriorating current account deficit from -6.5 % of GDP in 2019 to the projected -21.6 % in 2021.

The pandemic interrupted the authorities' efforts to align public debt with levels consistent with the debt-to-GDP ceiling of 60 % of GDP, and we note that the ECCB Monetary Council has moved the target date to return to the ceiling from 2030 to 2035. While the quasi-currency board limits the availability of monetary policy tools for stabilization, space for countercyclical fiscal policy measures is limited as well. Even under the assumption that tourism exports will recover to pre-pandemic levels by 2025, the outlook remains very challenging, with significant vulnerabilities from high public debt, adverse external sector dynamics absent strong adjustment, as well as risks to financial stability and from frequent natural disasters.

We would like to offer our comments on these issues in the following and have some additional questions.

We agree with staff that the revision of the medium-term fiscal anchor should be accompanied by additional measures to preserve its credibility. Those measures should include a strengthening of fiscal frameworks through robust ECCU-wide common standards for national fiscal policies and an independent fiscal oversight body. Due to the high level of vulnerability of ECCU countries to natural disasters and climate related risks, national disaster resilience strategies including fiscal buffers for those types of events could make an important contribution towards more sustainable public finances over the medium term.

Depending on updated projections for individual countries, public debt could be unsustainable in some ECCU countries and a number of ECCU countries will need to implement substantial policy adjustments to correct unsustainable flow imbalances. Given large imbalances and risks, any Fund support will require strong safeguards including on debt sustainability and adequate conditionality. Debt operations – if and where needed – should generally be designed and implemented in a timely manner to achieve a sustainable debt situation (prevent "too late") and to avoid the need for exceptionally large new credit from the Fund (prevent "too little").

Regarding the appropriate pace of fiscal consolidation, we note that staff judges that achieving the 2030 debt target may no longer be feasible for “several countries in the region”. While the appropriate and feasible pace of fiscal consolidation will depend on country-specific circumstances, the referenced cumulative fiscal adjustment effort of 6 percent of GDP for the ECCU up to 2030 would certainly not be unprecedented or exceedingly ambitious in international comparison. In some cases, it might be commensurate with the magnitude of fiscal imbalances and the need to build resilience to shocks in ECCU countries. Moreover, the estimated impact on GDP growth appears to be quite limited consistent with fiscal multipliers in ECCU economies that are likely to be rather small. Last but not least, it is unclear whether debt projections for the ECCU as a whole incorporate any debt restructurings or reprofilings in individual countries. *Additional staff comments would be welcome.*

We agree with staff that recurring natural disasters, potentially devastating impacts from climate change and the strong dependence on tourism-related activity provide an interesting rationale for issuing state-contingent debt instruments. In the past, state-contingent debt instruments were used in phases of sovereign default or debt restructuring (as in the cases of Grenada and Barbados and most other prominent cases).¹ Future debt restructurings in ECCU countries are likely to be complex and potentially protracted inter alia due to the composition of public debt. Thus, a careful assessment will be needed of whether state-contingent instruments can be helpful to solve these issues. In addition, the literature references complex design and data quality issues as potential problems for

¹ International Monetary Fund (2017), "[State-Contingent Debt Instruments for Sovereigns](#)", IMF Policy Paper, 22 May, Washington.

adequate market pricing – especially the availability and quality of official statistics appears to be a challenge in the context of the ECCU. *Additional staff comments would be welcome.*

We agree with staff that in the short run, ECCU countries do not have any other choice than to control the pandemic, acquire a maximum of vaccine doses and try to safely re-open the economy for tourist inflows. While this may reduce the current account deficit, staff's projections for tourism exports imply that the deficit would remain significantly larger than before the crisis. Thus, ECCU economies will have to strengthen their external competitiveness and resilience through structural reforms, more targeted investments and fiscal consolidation once the pandemic subsides. In addition, we encourage the authorities to design contingency plans for subdued tourist arrivals for a longer period of time or for a scenario with international travel activity never recovering to pre-pandemic levels.

We welcome the authorities' request for technical assistance for the compilation of external sector statistics. The absence of timely information on the ECCU-wide current account makes a credible external sector assessment very difficult. Given the special circumstances and the large estimated current account deficit of the ECCU, timely compilation and high quality of external statistics are essential for policy advice and the formation of market expectations.

We agree with staff that the authorities need to strengthen CFT/AML supervision, especially as they envisage higher revenues from citizenship-by-investment (CBI) programs in the future. This is particularly important in the context of the prominent perception of abuse surrounding CBI programs. In this context, the authorities should enhance regional coordination and centralization of supervision to ensure a robust vetting of applicants. The publication of all names granted citizenship under CBI programs would be a powerful measure to enhance the reputation and longevity of this source of revenue.

We are worried about the high share of NPL to total assets on the books of majority state-owned banks. The problem will likely become worse in the future – staff estimates almost a tripling of NPLs in the next three years. While majority state-owned banks have the highest share of NPLs among all groups, they also have the lowest level of loan-loss provisions. We agree with staff that these developments reflect a large contingent fiscal liability, which is likely to become a major problem for public debt sustainability soon. The authorities should monitor these risks closely and ensure both adequate loan loss provisions as well as effective frameworks for NPL resolution.

In light of the eruption of the Volcano “La Sofrière” and the evacuation efforts on St. Vincent and the Grenadines, does staff have estimates for the potential economic loss? (How do the destruction and the response so far compare to the estimates on the effects of the 1979 eruption of 20 % of total GDP?).

We were a bit surprised to find little follow-up on the ECCB's work on a **digital currency** in this year's report and recall that the Fund has encouraged the authorities to proceed cautiously in the past. *Additional staff comments would be welcome.*