GRAY/08/358

February 1, 2008

Statement by Mr. Rutayisire on Eastern Caribbean Currency Union--2007 Discussion on Common Policies of Member Countries
(Preliminary)
Executive Board Meeting 08/11
February 4, 2008

1. We thank Mr. Fried and Ms. Morgan for their insightful Buff statement and the staff for a very informative set of papers. The economic activities in the ECCU region have been broadly satisfactory over the past two years, although their pace was uneven across the member countries. Real GDP growth has been strong at 6 percent in 2006, and is projected at about 5 percent in 2007, driven largely by construction, tourism and financial services. Inflation has remained low, despite its recent pick up following pressures from rising world prices of food and oil, and the depreciation of US dollar to which the regional currency is pegged to. On external front, although the current account deficit has broadened since 2004 largely due to the higher growth of imports while export were decreasing, the structure of its financing has been stable underpinned by FDI inflows, and the regional balance of payments is estimated to be consistent with external stability. In addition, the level of the gross international reserves are expected to reach about US$ 770 million by end-2007. The authorities are to be commended for these achievements.

2. Looking forward however, the region still faces daunting challenges. Although all member countries have, to some extent, moved away from agriculture-dependent economies and have made noticeable progress in improving social indicators, they remain vulnerable in light of their exposures to natural disasters, their increasing dependence to tourism, and the apparent limited scope for economic diversification. On the macroeconomic front, the economies are highly indebted, which poses threat to the credibility of the currency union regime. The authorities' clear recognition of the challenges and the policies prescriptions, which are underlined in the staff report as well as in the buff statement, give hope about the medium-term economic prospects. Since we broadly agree with the thrust of the staff appraisal, we will comment on few points for emphasis.

3. We concur that a deepening of the structural reforms will be needed, in order to raise productivity and diversify the sources of **region's growth and competitiveness**. We

welcome the authorities' determination to carry these reforms alongside with the deepening of the integration process, so as to enable the ECCU members countries to wipe out the benefits from the economies of scales and compete within the Caribbean region and globally. In this regards, the decision made in October 2007 to create a single economic and financial space within the Organization of the East Caribbean States (OECS), to reposition as an economic bloc in the planned wider Caribbean Single Market and Economy (CSME), is an encouraging step. Along the road, however, difficulties remain particularly in achieving the necessary consensus on certain common policies and strategies, which underscores the need to build the capacities of regional institutions, and equip them with credible instruments so as to enabling them to effectively promote common approaches to the regional challenges. Regional consensus is particularly needed in the design and implementation of common strategies for the promotion of tourism and its economic ramification, create an enabling environment for the development of domestic private sector and further attracting FDI, improve the regional infrastructure systems, and build common disaster preparedness and mitigation mechanisms.

4. On the **fiscal and debt front**, we welcome the progress made so far with the implementation of far-reaching tax reforms, including the introduction of VAT and market-valuation based property taxes, which have improved tax revenues. We encourage the authorities to keep up this momentum and step up efforts to further strengthen the tax systems and broaden the tax base, including forging a regional agreement to resolve the inefficient tax exemptions and incentives, which has proved inefficient on cost-benefit basis. Nevertheless, in view of the declining official development assistance, the higher levels of public debt and debt servicing costs, and the difficulties of creating adequate fiscal space to enable member countries finance their development agenda, more efforts will be needed to streamline expenditure if the fiscal consolidation is to be achieved. The authorities' commitments – as stated in Mr. Fried and Ms. Morgan's buff – to restrain expenditure, their approval of a medium-term framework of fiscal benchmarks, and their commitment to link annual budgets to this framework are steps in the right direction. We also welcome the decision to establish a Public Expenditure Commission at the regional level, which would help in forging regional consensus on expenditure priorities and the role of government. Moving forward, we urge the authorities to build the capacity of the Commission, and set up credible enforcement mechanisms at the regional level, so as to ensure successful implementation of the agreed fiscal benchmarks. Fund technical assistance to strengthen debt management capacity in ECCU member countries will be welcome, particularly in light of the growing vulnerability to a tightening in the global liquidity conditions and the rise of world interest rates. Authorities are also encouraged to continue engaging their foreign donors, particularly the European Union to resolve the outstanding issues regarding compensation for the erosion of trade preferences, and their foreign creditors on issue of debt restructuring.

5. It is commendable that ECCU's **financial sector** has remained broadly sound, despite the many shocks triggered by economic downturns and natural disasters. Capital adequacy ratio of the banking sector are more than double the prudential requirements, the ratio of

non-performing loans have been declining, and public confidence remains sound supported by the strong presence of foreign-owned banks as well as the credibility of the regional central bank. Importantly, beyond the gains resulting from exchange rate and price stability, the stability of the banking sector was underpinned by the progress made by the authorities in strengthening bank supervision. Nonetheless, we read from Box 3 of the staff report that these positive indicators may be overstated by the rapid expansion of the private sector credit in recent years and by potential under-provisioning, particularly for the indigenous banks. We note also that indigenous banks have higher government exposures, possibly reflecting moral suasion or the lack of suitable investment opportunity. Furthermore, the weakness in the supervision of non-bank sector raises concern, particularly in light of their growing deposit-taking activities. While noting that the authorities consider the underlying risks not to be significant on account of improved credit underwriting in the region's banks, and the improved prudential benchmarks, we encourage the authorities not only to remain vigilant about these risks, but also to continue strengthening the regulatory framework, enhance the capacity and decision-making of the supervision bodies, establish a comprehensive risk-based supervisory framework, and strengthen the supervision of cross-border financial flows as well as that of the non-bank financial sector. We welcome the steps being taken to establish a regional oversight body, comprising of the East Caribbean Central Bank (ECCB), the Securities Commissions and the countries' Single Regulatory Units (SRU). Similar efforts should be encouraged to improve the effectiveness and efficiency of the regional financial markets.

6. With these remarks, we wish the authorities of the ECCU member countries every success in their future endeavors.