

The contents of this document are preliminary and subject to change.

GRAY/08/364

February 1, 2008

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

We thank the staff for the very interesting and well-written set of papers on the Eastern Caribbean Currency Union (ECCU). We also thank Mr. Fried and Ms. Morgan for their Buff statement which provides further insight into the region.

**Fiscal issues**

The rising fiscal deficit and persistently high levels of public debt call for prudent fiscal policies. We take note of the ECCB's Monetary Council ambitious medium-term goal to reduce public debt from the current level of 100 percent of GDP to 60 percent of GDP by 2020. Accomplishing this goal will demand serious fiscal consolidation and strong implementation of structural reforms to boost competitiveness and economic growth. The national authorities should also set up annual fiscal targets to achieve the goal.

The Staff Report shows that the authorities have made significant progress on the revenue side. A major challenge in this area now lies in the need to preserve the integrity of the newly introduced VAT to eliminate distortions and increase the transparency of corporate tax concessions. Expenditure measures have proven to be trickier, with maneuvering space limited by large debt servicing costs. The planned Public Expenditure Commission could provide useful guidelines for expenditure priorities. Beside infrastructure spending and targeted social assistance, they should also include the building up of contingency funds to be drawn upon in case of natural disasters.

In order to increase fiscal space for priorities, prudent debt management will be necessary. We support the authorities' request for technical assistance in this area. Debt management strategies could also include debt service rescheduling as well as seeking concessional resources. However, even projects financed by concessional sources must be carefully evaluated and prioritized, as rightly emphasized by the staff. In this context, we regret the continued deadlock of the EU trade preference compensation funding and encourage the

regional authorities and the European Commission to promptly find the way to enable their disbursement. In order to ensure long-term sustainability of public finances, the countries that have not yet done so, are encouraged to reform their costly social security schemes.

### **Financial sector**

Most indicators regarding the health of the financial sector in the ECCU countries have improved. However, the declining provisioning in the context of rapid credit growth is a matter of concern. In this context, we are interested in knowing about the extent to which this development has been driven by relaxed credit policies or objectively increasing quality of the new loans portfolio. Staff's comments are welcome. In any case, the staff's emphasis on effective regulation and supervision of financial institutions cannot be overstated. We understand that the authorities face a tricky challenge to ensure prudent behavior of financial institutions in the context of the existing cost and capacity constraints of on-site inspections. We call on the authorities to bring the supervision of off-shore banks in line with the rules applied to domestic financial institutions and to expedite the establishments of the single regulatory units (SRU) for rapidly growing nonbank financial institutions.

Access to capital in the ECCU countries can be further enhanced by the capital market reforms as suggested by the staff. Beside other existing barriers, staff mentions the high cost of capital and has therefore emphasized increased competition as a way to reduce it. In this context, we would like to know what the current obstacles for entry of new entities into the market are.

### **Competitiveness**

Main challenges for the region lie in the narrowing of the scope of major economic activities and the high vulnerability to exogenous shocks, including energy prices and natural disasters. While the economic growth in the region has recently been strong, it is expected to decline due to the evaporation of the one-off effect related to the 2007 Cricket World Cup (CWC). With increasing dependency on tourism following the erosion of EU trade preferences on agricultural products, improving the business environment to promote investment remains crucial. The ongoing economic integration and coordination should provide a further stimulus to the region's competitiveness and growth.