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GRAY/08/373

February 1, 2008

Statement by Mr. Lushin and Ms. Ustyugova 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 a set of well-focused papers on the Eastern Caribbean Currency Union, which, in our view, contribute to the best practices in the Fund's regional surveillance. We find it helpful that this discussion is scheduled in coordination with the bilateral Article IV Consultations for several member countries of the ECCU, which allows considering policy initiatives concurrently on both the countries' and regional levels.

We are pleased to note that despite several external shocks, the economic activity in the ECCU member countries has remained strong. The exchange rate peg has served the currency union well, contributing to low inflation, financial stability and foreign investors' confidence. At the same time, the region faces a variety of serious internal problems and continues to be highly vulnerable to external shocks. The staff report is appropriately focused on policies to promote sustainable economic development of the union in light of existing vulnerabilities, and we broadly agree with key policy recommendations presented in the papers. We will add only a few comments.

The largest risk to the economic outlook for the ECCU lies in the fiscal and debt areas. Many ECCU economies rank among the most indebted countries in the world. While the situation differs from country to country and the external shocks have no doubt affected islands' finances, a part of the problem lies in policies that generated large deficits. We note that despite the relatively strong economic performance, the recent marginal improvements in the public debt indicators were mostly due to restructuring operations. The sustained resolution of debt problems should not lie in debt restructuring only, but rather in a rapid improvement of fiscal balances. A system of fiscal benchmarks, approved by the ECCB's Monetary Council a year and a half ago was a step in the right direction to address fiscal imbalances, but it has not become operational yet. We are interested to hear about the reasons for the delay in implementation of this framework. Is it because of the lack of regional consensus on the individual fiscal adjustment paths? It is certainly important, as indicated in the report, to establish ambitious but achievable annual budget targets consistent with the revised ECCU benchmarks. But we note that several national authorities consider the degree of fiscal adjustment required to be "daunting" and "not socially feasible". How does the staff assess the overall feasibility of new fiscal targets? In the absence of any enforcement mechanisms, it is especially important that the benchmarks are feasible and, thus, credible. Moreover, fiscal targets that are not "owned" by the authorities and regarded as a sort of externally imposed constraint will most likely fail to deliver the required fiscal adjustment.

A heavy exposure of the social security funds in the ECCU to government financing needs has always been a matter of concern. In this regard, the authorities' intentions to enact reforms in social security schemes are encouraging. We agree with the staff that the diversification of the social security schemes away from public sector to private sector assets, including international, should be a compulsory element of these reforms. As the region's equity and bond markets are thin and illiquid, the staff may wish to elaborate on possible consequences of such a diversification for the domestic financial markets, domestic interest rates and government budget constraints. What is the possible timeframe for the undertaking of this reform?

Following the implementation of many recommendations in the FSAP, the banking sector appears to be generally sound, although the still high exposure to government securities needs to be monitored and appropriately provisioned. We acknowledge the progress made in strengthening the institutional framework for financial sector supervision and in developing a broader capital market. At the same time, we encourage the authorities to align the prudential regimes of offshore banks with those of domestic banks and to enforce supervision over the rapidly growing nonbank financial sector.

As underscored by Mr. Fried and Ms. Morgan in their Buff statement, the vulnerability of the region to natural disasters is compounded by climate change consequences, in particular by rising sea levels and temperature. In our understanding, increases in the sea level may erode significant portions of valuable beachfronts, which is sure to undermine the region's top economic activity - tourism. Undoubtedly, there are other economic consequences that need to be addressed. We encourage the staff to include the analyses of policy implications associated with the climate change for the Caribbean in their further research agenda. High quality analysis of this topic may be very relevant for small ECCU countries and regional institutions with limited research capacity.

We agree with the authorities and the staff that elimination of weaknesses in the quality, timeliness and dissemination of statistics is important for the efficient policymaking and accountability for economic management. More emphasis should be placed on regional arrangements in this vital area.

Finally, we welcome the recent steps towards a deeper integration between the ECCU members, and in particular the 2007 decision to create a single economic and financial space within the OECS countries. We wish the authorities all the success on their way to the OECS Economic Union Treaty and look forward to hearing about the progress in this field during the next discussion of the ECCU's common policies.