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**Statement by Mr. Hockin and Mr. Rolle on Eastern Caribbean Currency Union
Executive Board Meeting
September 27, 2010**

Our authorities thank the staff for the very constructive engagement that continues to inform the policy discussions among the Eastern Caribbean Currency Union (ECCU) members. This year's dialogue has been appropriately focused on the heightened challenges that confront the region and the policy responses that the authorities are formulating. These themes were also collectively examined at the first ECCU/OECS-IMF Roundtable Consultation on Growth, Adjustment and Integration, held in St. Kitts and Nevis on June 25 2010. There is broad agreement with the staff assessment.

Impact of the Recession

The global recession and the weakening in the US economy provided a stark reminder of the vulnerability of the regional economies and exposed weaknesses in the financial sector. Real GDP contracted significantly in 2009, as tourism and remittance inflows declined. Also FDI inflows stalled, adversely affecting construction activity. In this context, average unemployment increased, albeit weakness in domestic demand helped to narrow the current deficit. The region, however, benefitted from the global easing in inflation and was spared damage from hurricanes.

Constrained by high debt levels, ECCU authorities had limited scope to engage in countercyclical fiscal policies. With the fall-off in revenues and increased spending on social safety nets, the average fiscal imbalances widened, increasing average the debt-to-GDP ratios. The deterioration in the debt ratios was also amplified by the reduction in nominal GDP.

Laying the Foundations for a Sustainable Recovery

While there are encouraging signs that the recession is bottoming out over the course of 2010, the recovery is expected to be slow and subdued, trailing household sector improvements in the major tourist markets in North America and, to a lesser degree, Europe. The authorities do not take these prospects lightly. In December 2009, OECS governments endorsed the ECCU's Eight Point Stabilization and Growth Program, as the blueprint for steering the region beyond the recovery and on to a stable path of growth and fiscal sustainability. Governments are committed to implementing comprehensive programs to stabilize the real and financial sectors and position economies on more sustainable paths with resilient and better regulated non-bank financial institutions.

Developing Sustainable Fiscal Policy Frameworks

The ECCU authorities have agreed to develop a comprehensive strategy to reduce each member's debt-to-GDP ratio to at least 60 percent by 2020. In the September 2010 special meeting of the ECCB's Monetary Council, it was agreed that the best way to operationalize this strategy is to establish annual targets for primary fiscal balances, tailored to the magnitude of the adjustment that is needed in each country. The central bank's Debt Management Advisory Services Unit, established with funding from CIDA, assists member governments with strengthening debt management capacity and in examining restructuring options to reduce debt burdens.

Adequate budgetary space is also vital to sustain public sector investment programs (PSIPs) that provide important fiscal stimulus and advance the region's development objective. ECCU members recognize that access to external financing for PSIPs will depend on the strength of their home grown adjustment programs.

While increased fiscal policy coordination is vital for strengthening the currency union, political constraints affect the pace at which some institutional frameworks can be modified. At this stage it is impractical for the authorities to submit the parameters of their proposed national budgets to the Monetary Council for scrutiny. Scheduling a consolidated assessment of such plans would be complicated by the lack of uniform fiscal year periods across countries. Monetary Council pronouncements would also not be able to preempt decisions taken by national legislatures. The authorities, however, expect important gains from coordinating their medium-term fiscal frameworks and the peer pressure that will be brought to bear from publishing the primary balance targets.

The strengthening of revenue and expenditure frameworks will be at the center of the fiscal consolidation process. Revenue reform will be guided by the work of the Commission on Tax Policy and Tax Administration Reform, that studied ways to rationalize fiscal incentives and improve yields, including through efficient use of the VAT. The expenditure review process will be driven by input from the Expenditure Commission and the Commission on Pensions and Pensions Administration Reform. The Expenditure Commission, which is expected to report in 2011, has been asked to identify common regional approaches to increasing efficiencies and savings, focusing on major spending elements, including the wage bill and social safety net systems. The Pension Commission, submitted its recommendation to the ECCB's Monetary Council in July 2010, signaling favor for fully-funded government schemes that are integrated with social security systems and for regular parametric adjustments to take account of increasing life expectancy.

Addressing Financial Sector Vulnerabilities

A firm handle is being placed on strengthening the resilience of the financial sector, with the most immediate priority being to resolve difficulties in the banking and insurance sectors. The ECCB's Monetary Council is actively engaged in these matters, with a number of ministerial sub-committees and technical committees of regulators coordinating the regional work. All ECCU governments are committed to establishing single regulatory units to supervise non-bank activities that fall outside of the responsibility of the ECCB, under harmonized regulatory frameworks and with strong regional coordination mechanisms. Barring political constraints, the first best solution would be to create a single regulator at the regional level. The restructuring of banking sector balance sheets will support a healthy recovery from the recession and enhance the sector's role in development of the regional economy. The authorities plan to transfer NPLs off the balance sheets of the indigenous banks, ensure their recapitalization and advance consolidation of the sector.

Confidence in the insurance sector has been shaken by the collapse of the Trinidad and Tobago-based CL Financial Group, and the failure of its two subsidiaries operating in the ECCU region. Resolution will involve some fiscal costs, which the authorities plan to contain through some balancing of the burden of loss sharing across all exposed interests. As the staff notes, the outcome could also significantly affect recapitalization costs in the commercial banking sector, and valuations on credit unions' balance sheet.

Given elevated stability concerns, the ECCB has heightened its surveillance of the banking sector. To ensure comprehensive regulation of all institutions, the central bank relies on enhanced offsite monitoring, stress-testing and risk profiling as part of an early warning system to identify vulnerable banks. The onsite examinations framework is fashioned after the Canadian model, with risk-based triggers determining which institutions are selected for inspection When necessary, the ECCB also conducts special focused examinations on issues that are flagged within particular commercial banks. As part of the stepped up monitoring, stressed institutions must regularly liaise with the ECCB on strategic operational decisions, which can be vetoed at the discretion of the central bank. Also, liquidity conditions in watch-listed banks are monitored on a daily basis.

Deepening the Integration Process

The June 2010 signing by ECCU governments of the revised Treaty of Basseterre, establishing the Organisation of Eastern Caribbean States (OECS) Economic Union, will strengthen policy setting at the regional level in a number of important areas, but not fiscal policy. Once ratified at the national level in each parliament, the treaty will accelerate the economic integration process. It empowers the OECS Authority, comprised of the elected heads of government, with exclusive legislative powers in five areas: the common market and customs union, monetary policy, trade policy, maritime affairs and civil aviation. A more integrated OECS will widen scope for efficiency and competitive gains in international trade, and more readily expose collaborative opportunities to increase public sector efficiency.

Growth and Competiveness

ECCU authorities concur that increased competiveness is needed to sustain growth over the medium-term, and that both improvements in the business climate and increased labour force productivity should promote this process. Given the peculiarities of the region, however, it is debatable whether the level of public debt is a significant constraint on growth. Indeed, rather than domestic financing, private sector investments are more propelled by FDI sources, with domestic credit more directed towards consumption. The competition for resources aside, there is admittedly scope to boost the returns from public sector investments, and increase the carrying capacity of the debt relative to GDP. The authorities, however, are committed to stimulating an increase level of productive private investments that are financed by domestic resources, and view the creation of the single economic space as creating more opportunities for this. In this regard, promoting further development of the regional capital markets and improving the flow of credit for SMEs are priorities.

The ECCU are also convinced that international services can be an engine of growth, with tourism as an important pillar. They acknowledge that with the increasing global regulatory demands being placed on financial services, some cost benefit analysis is necessary to determine the role that this sector should play in these economies, and are open to pursuing technical assistance in this area. There is, nevertheless, a strong commitment to strengthening the mechanisms for international cooperation and information sharing. All of the ECCU countries have successfully negotiated the requisite number of TIEAs needed to be removed from the OECD's grey list.

Engagement with External Partners

The ECCU's stepped up engagement with the Fund, World Bank and other international partners and donors has provided a very supportive framework for managing the current crisis and laying the foundation for critically needed structural reforms. The region continues to benefit from highly valuable technical assistance intended, among other purposes, to enhance public financial management systems, increase public sector efficiency, and strengthen financial sector regulation and supervision. Medium-term objectives remain firmly focused on debt reduction and increasing the fiscal space to respond to exogenous shocks and to optimally fund public sector investment programs. Continued access to external financing resources will be critical, especially during the adjustment process, mindful that the high degree of vulnerability should justify a reasonable level of access to concessional resources.