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GRAY/10/3783

September 24, 2010

Statement by Mr. Rutayisire on Eastern Caribbean Currency Union
(Preliminary)
Executive Board Meeting
September 27, 2010

We thank Mr. Hockin and Mr. Rolle for their insightful Buff statement, and staff for a set of excellent reports, including the *Selected Issues* paper which clearly highlights the growth and fiscal challenges facing the Union members.

Following a sustained period of economic growth, the Eastern Caribbean Currency Union (ECCU) countries have been severely hit in recent years by a succession of adverse shocks, including hurricanes, food and fuel price increases, and the global economic downturn. As a result of a collapse in tourism, FDI and construction activity, the real regional GDP contracted sharply in 2009 and growth will remain subdued in 2010 and 2011. We also note that unemployment has increased, thus endangering the hard won gains in poverty reduction. We broadly agree with the view that the surging fiscal deficits and rising debt levels (exacerbated by stimulus measures to counter the contractionary effects of the crisis), insufficient institutional arrangements for fiscal consolidation and vulnerabilities in the financial sector could pose a threat to the Union and the currency board, particularly as the economic outlook of the region faces considerable downward risks associated with the global economy.

Against this backdrop, we commend the ECCU authorities for implementing sound crisis-mitigating strategies and for keeping up with the pace of reforms aimed at strengthening the resilience of the Union to exogenous shocks. These include notably (i) their Eight-point Stabilization and Growth program which encompass financial programs, fiscal reforms, a stimulus package and reforms of the banking and insurance sectors; (ii) their plan to translate the current debt target of 60 percent of GDP by 2020 into annual primary surplus targets to put public debt levels on a firmly downward path; and (iii) the progress being made on the resolution of the failed insurance companies (e.g. BAICO). At the same time, it is critical for the ECCU authorities to seize the opportunity caused by the crisis to put in place medium-term reforms that would tackle forcefully the structural impediments to growth, notably adoption of productivity-enhancing measures; enhancement of the tourism sector's competitiveness in terms of both costs and product quality; and establishing credible fiscal consolidation plans underpinned by stronger public financial management (PFM) systems.

All these reforms should also help improve investor confidence in the region.

To help sustain the authorities' challenging efforts, we strongly support the strengthening of Fund's engagement in the ECCU through both technical assistance and financing. Regarding TA, we urge staff to provide the necessary assistance, not only to individual countries, but also to the ECCU authorities, with an emphasis on institution building in the fiscal and regional integration areas, as coordination of policies and reforms will be key to the success of the economies of the Union.

Fiscal policy and debt sustainability

We welcome the ambitious measures undertaken by some countries of the Union to bring fiscal balances to levels consistent with a debt-to-GDP ratio of 60 percent by 2020, and encourage the other states to follow suit, with due consideration to their specific circumstances, notably with regard to the size of the adjustment and the mix of revenue and expenditure measures. Nevertheless, as the region is characterized by extremely high revenue-to-GDP ratios, a significant part of the fiscal adjustment is expected to come from the expenditure side. In this regard, we share the view that building political consensus in this challenging environment will be key to sustaining the implementation of the envisaged measures, especially those related to the wage bill and public investment spending.

In the same vein of fiscal consolidation and debt reduction, we encourage the authorities to enhance the PFM system and further strengthen debt management capacity, and praise the Canadian donor for funding the ECCB's Debt Management Advisory Service.

We take good note of the point underscored in the second section of the *Selected* Issues paper regarding the limited access to concessional external financing faced by some states of the Union, which is detrimental to their debt profile.

Monetary and exchange rate policies

The quasi-currency board arrangement has served the economies of the ECCU countries well, providing a tested anchor to price stability, and continue to be appropriate. We note that the ECCU real exchange rate is broadly aligned with fundamentals. We agree that its continued success will depend on the establishment of consistent fiscal policies across members and on policy coordination.

Financial sector policies

We share the view that the financial sector stability in the ECCU is intertwined with fiscal sustainability given the banks are largely exposed to government's payment capacity. We welcome the authorities' close monitoring of banks' situation and their plan to engage in a proactive resolution of weak indigenous banks in face of their liquidity and potential solvency problems. *We would appreciate staff's update, if any, on the strategies being contemplated by the authorities, notably in terms of bank merger and capital opening to foreign investors.* We encourage the ECCB authorities to further enhance risk-based bank supervision, align regulation and supervision with international best practices to reduce incentives for over-exposure to government, and strengthen the supervision of offshore bank affiliates of indigenous banks. The ECCU authorities are also encouraged to deepen financial markets to complement the indigenous banking and national social security systems as providers of financing to the private sector.

With respect to the offshore financial sector, given the important sources of revenue it represents for many ECCU countries, we would have expected already a staff analysis on the likely fiscal impact of the sector's compliance to the new international standards, or that of an exit from the sector, as suggested by staff in the main report. *Staff elaboration on this matter is welcome.*

Growth-enhancing reforms

We welcome the focus of the first section of the *Selected Issues* paper on reducing the obstacles to growth and improving competitiveness. The observed decline in TFP growth, despite high levels of capital accumulation, and the gap in competitiveness in the tourism sector are areas where the authorities should pay careful attention. We welcome the recently-signed Organization of Eastern Caribbean States (OECS) Treaty, which will advance regional economic integration and help the countries to further achieve economies of scales.

With these remarks, we wish the ECCU authorities success in their challenging endeavors.