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September 24, 2010

Statement by Mr. Luo and Ms. Chen on Eastern Caribbean Currency Union (Preliminary)
Executive Board Meeting
September 27, 2010

We thank staff for their very informative report and Messrs. Hockin and Rolle for their helpful statement. We broadly concur with staff's appraisal. Hit hard by the global recession, the regional GDP for the ECCU deteriorated sharply in 2009. At this important juncture, the ECCB was restrained to use monetary policy to offset spillovers from external turbulence by maintaining a currency board system. Fiscal policy had to take the brunt of the adjustment. However, with two thirds of the budgetary revenue used for wages and high debt-servicing costs, member authorities had limited options to stimulate growth. Since almost half of bank lending in the ECCU was concentrated on consumer loans and private sector investment was mainly driven by FDI sources, recovery was more difficult, given the increased unemployment rate, tightened credit standard, and reduced FDI. Because of the grim regional economic outlook, we encourage the ECCU members to prioritize public expenditure and strengthen fiscal consolidation to sustain public sector investment programs. We would also stress the necessity to promote structural reform that would increase productivity and enhance competitiveness to steer the economic development on a sustainable path.

As fiscal cross-border spillovers from the weakest member could trigger a full-blown crisis, we would like to stress the pressing need for fiscal consolidation. First, we agree with staff that transferring the medium-term debt-to-GDP target to an annual primary surplus target will be an effective tool to guide the budget and will benefit debt sustainability based on the successful experiences of some member countries. Second, containing current expenditure—especially reducing wage bills, rationalizing statutory bodies, implementing pension reforms to enhance public expenditure efficiency—is crucial and a top priority to restore fiscal sustainability in the short run. Third, in the long run, enhancing debt management efficiency and reducing public financing from the banking system will help public debt return to a declining trajectory and cultivate regional or domestic capital market.

The experience of the European Union proves that the continued success of a currency union depends on members' fiscal coordination, requiring strong political will and deep convergence. In this regard, we see merit in the Fund's involvement in coordinating members’ fiscal policies through Fund programs and TAs in the near future. *Could staff compare the various Fund programs on the fiscal front among ECCU members?*

The ECCB’s stress tests indicate that 7 out of the 14 local banks will have liquidity problems. The collapse of CL Financial and its two subsidiaries disclosed the vulnerability of the insurance sector. We commend the authorities for their efforts in strengthening the contingency and crisis management framework. Nevertheless, we join staff in urging the authorities to step up the establishment of a regional regulatory institution for the nonbank financial sector and harmonize financial sector legislation.