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February 27, 2013

**Statement by Mr. Hockin and Mr. Dalrymple on Eastern Caribbean Currency Union
Executive Board Meeting
March 1, 2013**

Our Eastern Caribbean Currency Union (ECCU) authorities continue to appreciate the ongoing policy dialogue with, and advice from the Fund. They are especially grateful for the detailed analysis in the Staff Report for the 2012 discussion on Common Policies of Member Countries as well as the Selected Issues Paper. Equally, they are pleased with the dialogue with staff on individual missions in ECCU member countries.

The staff assessment is very candid about the medium-term challenges facing the authorities, namely low economic growth, large fiscal deficits occasioned by higher expenditure coupled with lower revenues, financial sector challenges arising from failed insurance companies, rising non-performing loans (NPLs), and the need for reforms in regulation and supervision of the financial sector. Our authorities agree with some of the proposals as well as the timing of their implementation.

The Economic Context and Institutional Setting

The ECCU comprises six (6) independent Caribbean countries of the Organization of Eastern Caribbean States (OECS): Antigua and Barbuda, Dominica, Grenada, St. Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, and two OECS member states that are also overseas territories of the UK: Anguilla and Montserrat.

This sub-region has been dependent on a narrow set of economic sectors such as tourism, agriculture (bananas, sugar and some other agricultural products), and a small range of services, which have all suffered severe adverse shocks. Since the loss of trade preferences with the European Union, sugar and bananas have ceased to provide the growth impetus they once did. The emerging sectors of tourism and international financial services have also suffered from the loss of competitiveness as well as from sustained pressure from the financial world labeling many of these economies as tax havens. These sectoral challenges, in conjunction with international recessions and natural hazards events, viz. hurricanes, mudslides, and earthquakes, have had a significant negative impact on the growth performance. In addition, the staff cites weakened labor productivity, and overvalued exchange rate regimes among other reasons that have contributed to the decline in growth performance. The ECCU's average growth from 1985-1994 was 6 percent, then from 1995 to 2008 it fell sharply to about 4 percent, and reached a low during the crisis 2009-2012 when

it declined even further to an average -2 percent. The crisis appears to have bottomed out and it is projected that there will be some improvement in the growth outlook in 2013 to about 3 percent in the medium term.

The Eastern Caribbean Central Bank (ECCB), a quasi-currency board that is the bedrock of the economic framework of the ECCU, is governed by the Eastern Caribbean Central Bank Act of 1983. To complement this arrangement the Organization of Eastern Caribbean States signed the Treaty of Basseterre, which has most recently strengthened the cooperation between members of the Union. The Revised Treaty, signed in 2010, establishes the OECS Economic Union and was ratified on January 21, 2011. This makes it possible to create a single financial and economic space within which goods, people, and capital move freely and where monetary and fiscal policies are harmonized. Countries are also expected to continue to adopt a common approach to trade, health, education, and environment, as well as to the development of such critical sectors as agriculture, tourism and energy. Our authorities firmly believe that this move towards deeper economic integration will have positive impacts in terms of more flexibility in labor markets and competition in goods markets, and will mitigate some of the adverse effects of the lack of economies of scale in the region, boosting competitiveness as a result.

For the past 30 years, the ECCU has allowed the sub-region to operate under a fixed exchange rate regime, which has provided a strong nominal anchor and created a very stable and predictable environment for investment and business to take place. In this regard, we thank the staff for raising the issues related to changes in the exchange rate policy. However, our ECCU authorities are very concerned that any external devaluation would have a negative effect on the sub-region's macroeconomic environment. The ECCU region is heavily tourism dependent and has been impacted by tourism generating markets that are undergoing austerity; as a result the reduction of discretionary income by these countries' nationals is impacting the tourism industries of the region. An external devaluation, in our authorities' view, would lead to import compression, high pass-through to domestic prices, and in a rise in inflation. This will be detrimental to small open economies that depend on imports for domestic consumption as well as for utilization in the tourism industry. In addition, our authorities do not foresee any expenditure switching from an external devaluation, given the pattern of established consumption in these economies. Recognizing the need for greater competitiveness and as an alternative, the ECCU is more inclined towards a fiscal or internal devaluation with much of the adjustment falling on the public sector, which must be right-sized with efficiency gains secured for the future.

The ECCU has been very hard hit by the global financial and economic crisis and has responded appropriately by launching an Eight Point Stabilization and Growth Plan (EPSGP). This plan comprises: 1) *Suitably Adapted Financial Programs* for each member country aimed at conducting an analysis of the current financial situation to better address challenges and take control of finances during economic downturns; 2) *Fiscal Reform Programs* that develop efficient and effect revenue and expenditure plans to support growth that is sustainable over the medium term; 3) *Debt Management Programs* that bring debts into a sustainable position; 4) *Public Sector Investment Programs* that can devise and implement investment programs that will attain financial goals and secure economic well

being throughout time; 5) *Social Safety Net Programs* that identify the vulnerable areas in life, family, and the wider community and set aside funds to channel to these areas; 6) *Financial Safety Net Programs* that put in place a plan to address any substantial budgetary pressures that may be faced in the future; 7) *Amalgamation of the Indigenous Commercial Banks* that aims at reducing the number of such entities in the ECCU and making them more efficient; and 8) *Rationalization, Development and Regulation of the Insurance Sector* aimed to improve the quality of the cross-border insurance sector in the ECCU. The EPSGP remains the blueprint that guides the ECCU's work to reform the Union and restore it to full economic health. All aspects of the comprehensive EPSGP are aimed at addressing the weaknesses in the macroeconomic and financial sector. Our authorities acknowledge that the progress made on the various elements of the EPSGP has not been as rapid as they would have liked but this is due to the prolonged nature of the crisis and inadequate resources, both financial and human, in the member countries of the ECCU. This notwithstanding, our authorities are grateful and very appreciative for the technical assistance from development partners in facilitating progress on key aspects of the Plan and look forward to their continued support.

Financial Sector Policies

Both the banking and non-banking financial sectors have been faced with significant challenges over a protracted period. The banking sector is comprised of foreign and local banks, on the one hand comprising well capitalized foreign banks, but with some of them having high NPLs, and on the other hand the domestic banking sector, which is more vulnerable. Our authorities are currently addressing these challenges through the Joint Financial Sector Task Force. In this regard, there has been agreement on the identification of the scale and scope of required technical assistance going forward. Specifically, the authorities are appreciative of the very valuable technical assistance from the World Bank on the regulation of the non-banking sector. Out of the reforms that the ECCU will be undertaking, there will be three regulatory bodies. Joining the ECCB and the Securities Exchange Commission, the authorities plan to introduce a non-bank commission that will oversee the non banking sector in the ECCU. To complete the suite of reforms in this sector, the introduction of a Stabilization Fund and a Deposit Insurance scheme has also been proposed.

Our authorities have also been responding to the challenges to bank supervision by significantly increasing the staffing complement to deal with the additional workload created by the deterioration of the financial sector in recent years. Moreover, there has been significant and encouraging, movement on the BAICO insurance failure whereby some BAICO clients have started to receive payments in some of the ECCU territories. In the case of CLICO there are issues that continue to be resolved by the court-appointed Judicial Managers.

Fiscal Policies

The challenges in the sub-region's economy have been manifested in rising deficits. Modest countercyclical fiscal policy has eroded policy buffers, which now have to be rebuilt

relatively quickly. Debt-to-GDP ratios are in excess of the ECCU target of 60 percent within the region and to address this our authorities are taking a number of necessary measures, such as rationalization of tax and customs exemptions, restraint in the wage bill and other current outlays, greater privatization, expanded public investment programs, and a reduction of statutory bodies' dependence on the budget. Our authorities have also been examining several modalities, such as Public Private Partnerships (PPPs), to alleviate the impact on the public finances of investment spending and to reduce the number of state-owned enterprises. In addition, attempts are being made to corporatize statutory bodies and government departments to make them more viable and efficient.

All our independent member's authorities have systematically implemented the Value Added Tax (VAT) as the preferred indirect tax. In doing so they reduced their dependence on trade taxes and took decisive steps to broaden the tax base. Our authorities are also committed to working towards greater harmonization of tax incentives as a means of reducing the arbitrage faced by member countries.

The ECCU has committed to a target of 60 percent debt-to-GDP ratio but, in recent times, members have missed this target due to several exogenous shocks including economic crises and natural hazards. To cushion the impact of these shocks, two of its members have resorted to Fund instruments such as the Rapid Credit Facility (RCF). The ECCU is fully resolved to returning to the stated mandate of achieving the debt-to-GDP target in the medium term. ECCU's debt management has improved markedly at both the strategic and the operational levels due to strong support from the Canadian International Development Agency (CIDA) under the Debt Management Advisory Services (DMAS) Program. Experts from the Centre for Latin American Monetary Studies (CEMLA) are also now engaged in the program. We thank the staff for evaluating the options relating to fiscal frameworks. Our authorities will be examining a number of key issues related to consolidation and coordination within the ECCU at the Monetary Council's Special Meeting on March 8, 2013. The Revised Treaty of Basseterre is an excellent first step aimed at a deeper and more meaningful attempt to achieve fiscal coordination and integration.

Enhancing Growth

Our ECCU authorities are keenly aware of the need to make structural changes to the economies to diversify these economies and enhance growth. The recently observed reduction in capital expenditure in some members has reduced the amount of activity to provide infrastructure that creates an enabling environment for growth. However, with a return to growth, especially in the construction sector, capital expenditure is expected to increase again. We are mindful that in small and even micro economies the impact of a single transformational and catalytic project can be large. In this context the construction of an international airport in St. Vincent and the Grenadines can catalyze its tourism sector and attract new hotels and ancillary services in much the same way as a new hospital in Grenada can greatly improve health services, not only for its domestic economy but as a source of health services for export as well.

This notwithstanding, there is a concerted effort underway to create the preconditions for growth by reducing debt-to-GDP ratio as well as fiscal and current account deficits. In addition, to attract FDI, our authorities are taking steps to modernize the business climate to ensure that it is conducive to productive investment. Our authorities take very seriously the advice and rankings contained in the Doing Business Report of the World Bank Group as well as other reports that inform on the competitiveness of our economies. We recognize that competitiveness of the ECCU countries will be required for growth, and a keen examination of impediments to growth is being undertaken. Some of our members have reshaped investment promotion agencies to make them suitably nimble to attract more FDI and, after capturing it, ensuring that it contributes to the productive capacity of the countries. Significant effort is also being placed on reducing the costs of doing business by capturing and harnessing the potential of the alternative energy sources. To foster the discussion of these issues, our authorities welcome the Caribbean Growth Forum – an initiative of the World Bank Group launched last year. There has been significant traction in the ECCU with four chapters of the Forum already launched. With all of these initiatives before them, the ECCU will meet in May 2013 to discuss the OECS Development Strategy, which details plans for economic growth and development in the region.

Engagement with the IMF and other IFIs

Our authorities engage with the IMF and the IFIs at various levels, namely program reviews, surveillance, and technical assistance. Two countries in the region that have IMF-supported programs (Stand-By Arrangement (SBA) have performed well on their targets and are seeing tangible progress from their engagement with the Fund.

The ECCU also enjoys a healthy relationship and partnership with the IFIs as well as a number of bilateral donors. Through this relationship, a significant amount of valuable technical assistance (TA) is provided. Principal among these is the Caribbean Regional Technical Assistance Centre (CARTAC), a multi donor agency led by the IMF, which has been exceptionally agile in responding to the needs of ECCU. The IMF also provides valuable assistance to the ECCU from headquarters.

The relationship with the bilateral donors has also been useful and particularly valued in the context of the lack of fiscal space in the ECCU, especially given the constrained circumstances of the donors themselves. The new SEMCAR initiative, with the assistance of major donors, is also starting to have some traction in the region.

Conclusion

Our ECCU authorities are committed to confronting the challenges facing the sub-region and to using appropriate means and new measures to restore growth and financial stability. As global growth returns, our authorities are convinced that with more fiscal space they will be able to correct the imbalances on the domestic side and focus on increasing exports. The Organization of Eastern Caribbean States (OECS) has been fashioning responses to the objective circumstances facing the countries since the onset of the crisis. The main responses agreed by the OECS authorities are to upgrade the Treaty of Basseterre; implement the Eight

Point Stabilization and Growth Program (EPSGP); and coordinate work programs at the currency board and the regional and international institutions. The cooperation between the governments of ECCU and these institutions is crucial to foster the adjustment of policies in the region with the objective of transforming these economies as the global economic situation improves overtime.