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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/13-3

2:33 p.m., February 3, 2020

3. Eastern Caribbean Currency Union—2019 Discussion on Common Policies of Member Countries

Documents: SM/20/21, and Cor. 1, and Cor. 2, and Cor. 3, and Cor. 4, and Sup. 1; SM/20/24, and Cor. 1, and Cor. 2, and Cor. 3

Staff: Munoz, WHD; Goodman, SPR

Length: 49 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
	F. Sylla (AF)
	R. Morales (AG), Temporary
N. Ray (AP)	
	P. Fachada (BR)
	Y. Zhao (CC), Temporary
L. Villar (CE)	
L. Levonian (CO)	
	C. Just (EC)
A. Buisse (FF)	
	K. Merk (GR)
	R. Goyal (IN), Temporary
	A. Ribeiro Mateus (IT), Temporary
	K. Chikada (JA)
	K. Osei-Yeboah (MD), Temporary
	M. Merhi (MI), Temporary
	V. Rashkovan (NE)
	J. Sigurgeirsson (NO)
	A. Tolstikov (RU), Temporary
	R. Alkhareif (SA)
A. Mahasandana (ST)	
	P. Trabinski (SZ)
	A. Clark (UK), Temporary
M. Rosen (US)	

C. McDonald, Acting Secretary
E. Tsounta, Summing Up Officer
B. Zhao, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Legal Department: M. Itatani, K. Kao, K. Kwak, R. Sykes. Monetary and Capital Markets Department: G. Hosin nee Heywood. Strategy, Policy, and Review Department: M. Goodman, D. Hart. Statistics Department: M. Bani Hani. World Bank Group: R. Li. Western Hemisphere Department: L. Bonato, F. Bornhorst, V. Chensavasdijai, B. Lissovolik, S. Munoz, K. Srinivasan, R. Vishvesh. Executive Director: M. Mouminah (SA), S. Riach

(UK). Alternate Executive Director: M. El Qorchi (MD), A. Guerra (CE). Senior Advisors to Executive Directors: S. Buetzer (GR), Z. Mohammed (BR), M. Sidi Bouna (AF), L. Smith (CO), G. Vasishtha (CO). Advisors to Executive Directors: M. Albert (FF), M. Bernatavicius (NO), J. Corvalan (AG), J. Essuvi (AE), K. Florestal (BR), J. Garang (AE), K. Kuretani (JA), B. Rankin (CO), J. Yoo (AP), A. Zaborovskiy (EC).

3. EASTERN CARIBBEAN CURRENCY UNION—2019 DISCUSSION ON COMMON POLICIES OF MEMBER COUNTRIES

Ms. Levonian and Mr. Sylvester submitted the following statement:

Our Eastern Caribbean Currency Union (ECCU) authorities are committed to building strong, resilient, and inclusive economies. In this context, they thank staff for the constructive engagement during the 2019 regional consultations on common policies and welcome the insightful Report and Selected Issues Paper (SIP). Despite growing risks and persistent challenges, our authorities continue to advance their economic development agenda. They remain committed to pursuing sound macroeconomic policies and reforms at the national and regional levels and look forward to the continued engagement of the Fund and other development partners. They broadly share staff's appraisal and many of their recommendations. In this Buff, they wish to emphasize ongoing national and regional efforts aimed at addressing the challenges identified in the Report, and to respond to some of the issues raised by staff.

Leveraging Regional Integration

Our authorities welcome the focus of the 2019 regional consultation on policies to advance regional integration. As a grouping of small island developing states, the ECCU region is beset by multiple challenges and risks, some of which could be mitigated by taking regional approaches. Our authorities thank staff for their analytical work and policy recommendations on fiscal and financial integration and solidifying the monetary union. They see some merit in greater fiscal integration, for instance, on CBI program due diligence processes, but note some challenges to harmonize tax incentives among sovereign states facing different domestic circumstances. They also see the potential merits of building buffers, including through a regional stabilization fund, but point to the difficult tradeoff with limited fiscal space and insufficient external support. That said, some of our authorities have moved ahead with the establishment of national savings funds. Furthermore, the Eastern Caribbean Central Bank (ECCB) has a small regional "rainy day" fund and would welcome staff's support on how this fund could be enhanced, including through external donor support. Regarding greater financial integration, our authorities are already moving forward with efforts to strengthen the NPL resolution and crisis management frameworks, as well as plans to introduce a deposit insurance (DI) scheme. On solidifying the monetary union, our authorities have made significant progress in modernizing the payment system by introducing the Eastern Caribbean Automated Clearing House (ECACH) and the Electronic Funds Transfer

(EFT) systems and are moving ahead with plans to introduce a digital version of the EC dollar.

Our authorities strongly believe that a digital version of the EC dollar (DXCD) will help support the economic transformation of the ECCU. A DXCD will support the modernization of the payment system by making it more resilient and efficient through reducing the heavy reliance on the use of cash and cheques, improving the speed and decreasing the cost of transactions, and minimizing the social costs of hard currency. Consistent with this strategic vision for the ECCU, the ECCB launched a DXCD pilot in March of 2019 to inform the development and implementation of what will essentially be the world's first central bank digital currency. Our authorities are approaching this reform in a deliberate manner with due consideration to key safeguards, including cybersecurity and AML/CFT requirements. Our authorities welcome staff's useful SIP, which reinforces many of the important design elements currently under consideration by the ECCB and look forward to the Fund's continued support in leveraging technology and innovation in the region.

Real Sector Developments and Policies

Our authorities welcome the strong rebound in growth and the broadly favorable outlook. After growing by less than 1 percent in 2017, due largely to the devastating impact of Hurricanes Irma and Maria, real GDP grew strongly by 3.9 percent and 3.2 percent in 2018 and 2019, respectively, driven by a strong recovery in tourism and construction. On medium-term growth, our authorities are slightly more optimistic than staff and expect growth to hover around 3.5 percent but concur that the outlook is subject to considerable downside risks, not least from natural disasters, a global economic slowdown, a further loss of CBRs, and cyber threats.

Our authorities are strongly committed to building resilience to natural disasters and climate change. The increasing frequency and intensity of natural disasters is a major source of vulnerability to growth and fiscal health in the ECCU. Our authorities face a vicious cycle of natural disasters, followed by low growth and a buildup of indebtedness and debt distress. In this regard, our authorities will continue to prioritize reforms and policies to support resilience building, including participating in the Caribbean Catastrophe Risk Insurance Facility (CCRIF SPC), adopting appropriate building standards, and investing in climate resilient infrastructure. They greatly appreciate the Fund's increased focus in recent years in supporting countries vulnerable to catastrophic natural disasters to build ex ante resilience, including the current efforts in Grenada and Dominica with disaster resilience strategies (DRSs). They call on the Fund and other development partners to increase access to reliable and affordable financial and technical support in this area, including through efforts to promote the widespread uptake of disaster-linked clauses in debt instruments.

Fiscal and Debt Developments and Policies

Our authorities are committed to the prudent management of public finances to support fiscal and debt sustainability. They note positively the improvement in the overall fiscal deficit in 2019, following the spike in 2018, largely due to disaster-related spending. They further take note of the positive and downward movement of the public debt ratio. While acknowledging these positive developments, our authorities remain mindful of the significant risks to public finances and the absolute necessity to pursue prudent fiscal and debt management policies. The ECCB will continue to support member countries in developing strong fiscal and debt frameworks, including medium-term fiscal frameworks and debt management strategies. Our authorities note staff's concerns regarding some member countries' progress towards reaching the 60 percent of GDP debt target by the 2030 timeline and reaffirm their commitment to meeting this target, including closely monitoring progress and taking actions, as appropriate. However, our authorities continue to stress the difficult challenge to meet critical investments to support growth and poverty reduction and to build fiscal buffers to support resilience, while keeping debt levels down, with little or no fiscal space and external support. They call on the international community to support those efforts, including through increasing access to grant financing.

The ECCB will continue its effort to promote fiscal discipline across the ECCU, including through the adoption of rules-based fiscal resilience frameworks. In addition to Grenada and Anguilla, which have fiscal rules in place, more of our authorities are looking to advance elements of their own fiscal frameworks. While all our authorities have committed to fiscal prudence, it is unlikely that they will agree to uniform fiscal frameworks. The ECCB encourages staff to explore with our authorities a set of common minimum fiscal anchors that could be adopted.

Financial Sector Developments and Policies

Financial sector conditions in the ECCU remained stable in the past year, but vulnerabilities persist. Our authorities welcome staff's assessment that banking sector liquidity and capital ratios have remained strong and the level of non-performing loans (NPLs) has continued to decline. However, the NPL ratio is still above the regulatory standard and weak credit growth persists. Our authorities are acutely aware that sustained efforts are needed to address remaining financial sector weaknesses, mitigate risks, and increase the sector's contribution to growth. They broadly share staff's assessment of the key risks and challenges, including the exit of global banks, a rapidly growing credit union sector, and ongoing pressures related to further losses of correspondent banking relationships (CBRs). They believe that their current efforts will continue to deliver important results for financial sector strengthening.

Our authorities remain committed to advancing their reform agenda to boost financial sector stability and build resilience. The ECCB intends to build on the progress already made in many areas to strengthen financial oversight and operations. They will continue to press ahead with reforms to, inter alia, accelerate NPL resolution, harmonize regulation for non-banks, develop systemic risk monitoring, and enhance the AML/CFT framework. Our authorities note staff's concerns regarding the slow pace of financial sector reforms due in part to delays in the passing of legislation by individual countries. While the ECCB authorities agree that these reforms should move faster, they believe that staff need to be more pragmatic in assessing the pace of regional reforms giving due consideration to different country circumstances. Our authorities do not support phasing out the minimum savings rate (MSR) at this time and will consider its removal in conjunction with other reforms, including the introduction of deposit insurance.

Our authorities continue to be concerned about the possibility of further CBR losses. They are grateful to the Fund and other international partners for their efforts in helping to find concrete solutions to this problem. While CBR losses in the ECCU have stabilized somewhat, the possibility of further withdrawals remains a major concern. Our authorities urge the Fund and others to remain actively engaged on this burning issue in support of member countries' efforts. The ECCB will press ahead with efforts to harmonize and strengthen AML/CFT supervision at the regional level.

Boosting Growth and Inclusion

Our authorities will continue to implement structural reforms to promote sustainable and inclusive growth. They see economic growth as a critical factor in helping to address many of their challenges, including high levels of poverty, inequality, and unemployment. Accordingly, our authorities will continue to pursue reforms aimed at removing obstacles to higher growth and employment levels, and poverty reduction by focusing on improving the climate for doing business; diversifying the economic structure, including through investments in renewable energy; further developing the regional capital market; and addressing rigidities to labor market performance, including through education and training. Regional initiatives currently being implemented, such as the World Bank-supported Eastern Caribbean Partial Credit Guarantee Corporation, will support SMEs' development and employment generation. Our authorities concur with staff that technology, particularly Fintech, has the potential to boost economic growth. Our authorities are moving ahead with reforms to facilitate the adoption of technology and promote innovation, both at the national and regional levels, including through investment in a high-speed fiber-optic broadband network and e-government platforms. Our authorities look to the Fund for technical assistance to support Fintech development in the region.

Engagement with the Fund and other Development Partners

Our authorities highly value the continuing strong relationship with the Fund and other development partners. They are very grateful for the sound policy advice, the considerable amount of technical assistance (TA) through the Caribbean Regional Technical Assistance Centre (CARTAC) and other mediums, and the various technical exchanges, including through programs such as the Garfield T. Riley Seminar Series, an initiative of the Research Department of the ECCB. Our authorities look forward to the continued strong support of the Fund and other development partners in helping the region address its many development challenges.

Conclusion

While growth has rebounded strongly and the near-term outlook remains favorable, the economic landscape in the ECCU region remains fragile in the face of daunting risks and challenges. Our authorities are acutely aware of the difficult road ahead and remain committed to confronting the many challenges, with the support of its partners. In this regard, the continued flow of TA and financial support to the region and the effective coordination of ECCU work programs with regional and international institutions are critical in helping our authorities tackle these challenges in a steady and sustained manner.

Mr. Psalidopoulos and Ms. Mateus submitted the following statement:

We thank staff for the report on Common Policies of Eastern Caribbean Currency Union (ECCU) Member Countries, as well as for the Selected Issues Paper and Ms. Levonian and Mr. Sylvester for their Buff statement. While the currency union seems to have been serving Eastern

Caribbean countries well, there is room for strengthening its institutional framework for the long-term benefit of all member countries.

Currency unions warrant robust economic policies and stabilization mechanisms. The lack of an independent exchange rate policy requires other mechanisms to deal with asymmetric shocks and possible rigidities in labor and financial markets. We agree with staff that the ECCU would benefit from increased integration, more articulated fiscal policies and, notably, regional stabilization mechanisms. We also agree that the authorities should be cautious in devising and deploying a well sequenced approach to the enhanced integration framework, starting with adhering to credible fiscal frameworks, with medium-term goals, and aiming at a regional stabilization fund. We furthermore also see benefits in reassessing tax incentives among the currency union countries in an integrated manner, avoiding competitive tax system designs, ultimately detrimental to public accounts. The vulnerability to natural disasters requires resilience building and is yet another reason for considering regional stabilization mechanisms. In accordance with the existent fiscal space, the authorities should start building resilience to natural disasters and climate change, following the development of long-term strategies and roadmaps.

Strengthening the independence of the Union's central bank is key to shielding the currency union. We agree with staff that enhancing the ECCB's autonomy would help in improving the currency union policy framework and enabling the central bank to better pursue its goals. For that purpose, the authorities should strengthen the autonomy of the ECCB, adapt its governance rules and clearly define a hierarchy of objectives for the central bank to pursue. Moreover, the ECCB should have the legal capacity and the tools to provide emergency liquidity to solvent banks.

The financial sector in Eastern Caribbean countries would benefit from improvements. We take note that the authorities seemed to have progressed somewhat in harmonizing regional regulation of deposit-taking institutions, but we urge them to fully align the deposit-taking credit unions' regulatory regime with that of banks. While this could be implemented in a proportional fashion, adjusting for size and complexity of the institutions, it would help create a better level-playing field and strengthen the resilience of institutions. The authorities should also continue incentivizing banks to deal with the significant level of NPLs, starting by requiring them to provision such loans appropriately. Tackling current vulnerabilities in the financial sector is also of utmost importance given the need to shield public accounts from a materialization of downside risks in this sector.

Mr. Bhalla and Mr. Goyal submitted the following statement:

We would like to thank the Staff for the reports and Ms. Levonian and Mr. Sylvester for a helpful buff.

The Eastern Caribbean Currency Union recorded better income growth as the impact of natural calamities subsided. This reflected mainly in buoyancy in the tourism sector and strengthening of Citizen by Investment (CBI) flows. However, with the continued weak fiscal situation, sizeable external imbalances and weakness in the financial sector, overall, the economies have remained fragile.

We note that the financial sector is vulnerable with the sizeable impaired asset, presence of under-provisioning, rising market risks with banks investing in riskier assets abroad, and global banks withdrawing from these economies. Payment system and banking services are inefficient and costly and are slow in adopting the new technologies.

One of the critical reasons for the weak fiscal scenario is competitive fiscal incentives being offered by the Caribbean countries for attracting foreign direct investments and CBI inflows, which have turned out to be costlier without commensurate benefits. In this regard, we support Staff and encourage authorities to coordinate and streamline fiscal incentive structure for potential FDI flows. Similarly, regional coordination is needed by way of appropriate pricing and the use of country-wise quotas to streamline CBI flows. Regional coordination would be mutually beneficial to all the ECCU countries.

However, we would like to flag a few concerns which Staff may like to elaborate or respond.

Given the proximity, risks arising from natural calamities, CBI revenue uncertainty, tourism, and global financial shock may be fairly correlated across the economies. Studies show that ECCU countries are structurally similar and more likely to be subject to symmetric shocks. Under such a scenario, how far the regional risk-sharing by way of regional stabilization fund created by the pooling of resources would be effective?

The size and ability of the individual economy within the union varies significantly. Would it be warranted and possible to achieve the same level of fiscal discipline and debt benchmark? It may be recognised that given the currency union, the adjustment may solely be needed through fiscal efforts.

Lastly, with low adoption of new technologies across the financial sector, would experiment with digital currency be successful?

Mr. Ray, Mr. Sigurgeirsson, Mr. Evjen and Mr. Yoo submitted the following joint statement:

We thank staff for the comprehensive report and Ms. Levonian and Mr. Sylvester for their informative Buff statement. Growth in the ECCU rebounded over the past two years following a respite from major hurricanes and is expected to be robust in 2020. Nevertheless, challenges remain amid weak fiscal performance, sizeable external imbalances, financial sector weaknesses, and vulnerabilities to natural disasters. We broadly concur with staff's analysis and recommendations but would like to emphasize the following points.

The ECCU countries are among the most vulnerable to natural disasters in the world. These large adverse shocks, combined with frequent fiscal slippages, have led to high public debt across the region, further inhibiting the countries' ability to borrow in the international markets and squeezing fiscal space needed for public investment. The ECCU countries overarching problems remain fiscal sustainability challenges and policy procyclicality. We welcome the authorities' commitment to meeting the debt target of 60 percent of GDP. But as fiscal deficits have increased and growth is expected to moderate in the medium term, achieving the target may prove challenging.

Amid the growing intensity of external shocks, we agree that country-level fiscal policies remain the most important lever. The fiscal policy framework should center around resilient country specific fiscal responsibility frameworks supported by strong institutions, and specific ex ante mechanisms to deal with natural disasters, including through investment in resilient infrastructure and adequate insurance coverage.

We agree that the ECCU should consider taking further steps towards regional integration. We highly appreciate staff for not only presenting recommendations but also laying out sequencing of the key reform agenda (shown in page 10). We take positive note of staff's SIP on fiscal integration which argues that fiscal coordination could potentially create fiscal space along several dimensions. With this in mind, we agree that regional fiscal policy coordination could usefully supplement national policies in dealing with adverse shocks. As tax concessions to attract FDI have led to a race to the bottom, we concur that ECCU countries could benefit from streamlining their tax incentives, supplemented by regional agreements. Likewise, harmonizing CBI due diligence could also help supporting revenues. We are impressed with the extensive analysis in the SIP that quantifies the economic benefits and costs from establishing a regional stabilization fund. While recognizing that the authorities were skeptical about practical implementation, we strongly encourage the authorities to further explore the idea of pooling resources in a stabilization fund. Such a fund could serve as a buffer of pooled resources against natural disasters, as well as reduce public expenditure procyclicality, by saving in good times and financing investment in bad times.

Financial sector vulnerabilities are building up in both the bank and nonbank sectors. Asset quality remains a concern. We welcome that the national authorities have advanced a range of reforms to modernize and improve financial oversight, including banking supervision. But we note that progress has been slowed by delays in passage of critical legislation. We encourage the authorities to step up their efforts in implementing reforms to reduce financial sector weaknesses. In particular, the ECCB's and deposit-taking institutions' governance frameworks should be reviewed and passage of critical legislation, including AML/CFT, should be expedited by remaining countries to increase compliance and enforcement.

We note positively the ECCB's progress on its pilot project on a central bank digital currency (CBDC). A CBDC could be beneficial given that the costs of cash usage are high and the payment system is underdeveloped in the region. While we encourage the authorities to explore this idea further, we agree with staff that they should proceed cautiously. The various risks of the digital currency, including for financial intermediation, financial integrity, and cybersecurity should be carefully assessed. We wonder if staff has the willingness to or can join the ECCB's pilot review. It could be beneficial for the ECCU as well as for the international community. Any comments are welcome.

We welcome the authorities' commitment to continuing to pursue structural reforms to boost potential growth. Considering the tough challenge to meet critical investments in infrastructure and to build fiscal buffers to support resilience, while maintaining debt sustainability, more resources from higher income is crucial. How much do staff estimate potential growth can be raised if key structural reforms such as improving the climate for doing business, improving public sector efficiency and advancing labor market reforms are implemented?

We encourage the authorities to consent to publication of the report.

Mr. Jin and Ms. Zhao submitted the following statement:

We thank staff for the informative report and Ms. Levonian and Mr. Sylvester for the helpful Buff statement. We take positive note that growth in the Eastern Caribbean Currency Union has rebounded strongly and remained robust so far. Yet, given elevated fiscal deficits, sizable external imbalances and high financial sector vulnerabilities, it is essential to strengthen the national fiscal framework, enhance financial stability and advance structural reforms. In light of the close connections between countries within the region, we welcome the focus of the report on enhancing regional integration to leverage policy responses. As we broadly support staff's assessment, we will limit ourselves to the following points.

Regional coordination on fiscal policies can be mutually beneficial for the ECCU countries. Taking note of the challenges faced by most countries in the region to meet the regional 60 percent of GDP debt benchmark by 2030, we agree with staff that the fiscal priority is to achieve debt sustainability and to build resilience to natural disasters, including limiting excess growth of public consumption in good times to create scope for resilience building and other growth. We encourage the authorities in the region to coordinate on tax policies, while taking note of some authorities' concerns on practical difficulties to enforce coordination among sovereign countries. Could staff elaborate more on possible measures to address their concern? In addition, taking into account the substitution effect between ECCU and other regions, could staff provide more information regarding the potential impact of increasing regional tax on the FDI inflows to ECCU?

Continued efforts are needed to safeguard financial stability. We welcome the authorities' reform plans to modernize banking supervision so far and encourage the authorities to take prompt policy measures to avoid delayed reform implementation. We encourage national authorities to provide adequate resources, improve enforcement and address the data gaps of nonbank institutions. We also take note of the overvaluation of the exchange rates of around 9 percent in 2018. We wonder whether the labor market in this region is flexible enough to allow for wage adjustments to offset currency overvaluation. Could staff comment on the impact of the currency's overvaluation on the region's price level, real interest rate, bank asset quality as well as financial stability?

Structural efforts are also crucial to the region's competitiveness and inclusive growth. In addition to fiscal consolidation and financial sector reform, we also agree that long-term commitment to implementing structural reforms in investment and business climate, public sector efficiency and labor market reforms will be instrumental to enhance the region's competitiveness.

We welcome the digital currency pilot project to be deployed in Spring 2020 and encourage the authorities to conduct a comprehensive cost and benefit analysis of the new digital currency ecosystem.

Mr. Rosen, Mr. Farber, Ms. Pollard and Mr. Shenai submitted the following statement:

We thank staff for the well-written staff report and Selected Issues Paper, as well as Ms. Levonian and Mr. Sylvester for their thoughtful Buff.

We support staff's recommendations for further fiscal and financial integration. Greater regional coordination of tax incentives and CBI revenues can avert race to the bottom dynamics and would thus enhance fiscal space. Fiscal rules can strengthen regional fiscal credibility. We positively note the authorities' consideration of a deposit insurance scheme and Emergency Liquidity Assistance, though these measures may pose difficult tradeoffs between fiscal sustainability and financial stability that the authorities should monitor.

We recognize the importance of increasing payments efficiency and decreasing the relatively high cost of electronic payments in the ECCU. As staff highlight, this high cost reflects the underutilization of non-bank e-payment services and the lack of a regulatory framework for mobile wallet services. Improving financial access can enhance productivity while reducing product market rigidities and transactions costs.

However, we identify several risks of Central Bank Digital Currency (CBDC) in the ECCU, including:

Financial intermediation and stability risks: CBDC could directly compete with banking system deposits, potentially impacting bank funding and financial stability.

Financial integrity and cybersecurity: Actual or perceived weaknesses in due diligence, detection, and prevention controls could reduce systemic confidence.

Financial access and reputation: CBDC adoption may fuel perceptions of the ECCU as a high-risk financial jurisdiction, in turn exacerbating financial access challenges.

Large and unfunded future liabilities: Maintenance and cybersecurity costs over the life of the program may exceed the frontloaded savings of reduced cash usage.

Concentration risks: The system's reliance on a single third-party provider could have macro-critical consequences if the provider faces disruptions in its operations.

Offline capability: The region's susceptibility to weather-related disasters may hamper the system's functioning during periods of vulnerability.

Given these risks, we strongly believe that the ECCB should reconsider its central bank digital currency (CBDC) while actively exploring proven alternatives to improving electronic payments systems. If the pilot program proceeds, it should be targeted, time-limited, and segregated from existing critical payment systems to enable the authorities to assess the project and its broader implications on the economy. Strong oversight and supervision, along with transparent contractual language that clearly addresses the duties and responsibilities of third-party providers for CBDC projects, is paramount. Can staff comment on the bottlenecks to developing non-bank e-payment services in the ECCU and provide an assessment of whether CBDC will offer a cost or financial access advantage over more traditional forms of electronic payments, including mobile banking?

Learning from other country experiences would be beneficial. We understand that Fund members are exploring improving financial access and reducing costs via existing mobile payments technologies, such as in Japan and Kenya. We hope that the ECCB can learn from other members seeking to address similar challenges and believe the Fund can play a role in convening likeminded countries and promoting information sharing.

Mr. Rashkovan submitted the following statement:

We thank staff for their comprehensive and focused reports and Ms. Levonian and Mr. Sylvester for their helpful Buff statement. We highly value staff's approach on the different levers to enhance the region's integration, a facet that has proven to be an important element for the functioning of a currency union, especially economic integration. Overall high current account deficits – that moreover vary significantly between countries – point to room for convergence and an increase in the overall level of competitiveness by fostering the structural reform agenda.

Financial integration within a currency union can come with risks - demanding a strong harmonized institutional framework to detect and address financial vulnerabilities. As the external borrowing constraint loosens for countries in a currency union, a high degree of financial integration could go hand in hand with episodes of inefficient capital flights out of capital-scarce countries, as we have seen in the euro area in the past. In the ECCU, we notice that still elevated weaknesses in asset quality of banks constrain their lending, while less-regulated non-bank entities fill that gap in terms of credit growth but further contribute to the sector's vulnerabilities. We concur with staff that the focus of financial reforms should be on repairing bank balance sheets and strengthening of oversight functions, including those for non-banks. In the long-run, financial integration could be further enhanced through a well-sequenced plan toward a fuller banking union alongside stronger steps to safeguard financial stability.

The case needs to be made for a regional stabilization fund to counter the current procyclicality in public expenditures and consequent low public investment expenditures and limited fiscal space. Given the limited role that monetary policy can play is, it is necessary to have fiscal policy available as a stabilization tool. This does not mean that there is a need for bigger redistribution between the countries, but countries should be able and required to use fiscal policy to stabilize their economies. Improved national fiscal frameworks should both strengthen the stabilizing mechanism and ensure debt sustainability.

We do see the need to help countries building resilience against natural disasters that are expected to intensify as a result of climate change. As we have seen in Dominica for example, natural disasters can take a huge toll on economic growth and significantly reduce spending room in the budget. We therefore do see merit in the idea of pooling resources to provide these countries with insurance against those risks. With support from staff and other development partners, existing initiatives, such as Caribbean Catastrophe Risk Insurance Facility (CCRIF SPC) and the small 'rainy day' Fund that the authorities' mention in their Buff statement, could be further strengthened and elaborated on.

The ECCB's pilot on the central bank digital currency seems to require more cautiousness, against the background of the by staff indicated need for a review of ECCB governance and the need for an upgrade of the regulatory and AML/CFT oversight frameworks. While staff mentions the risks of (central bank) digital currencies (e.g. for financial integrity and cybersecurity), staff's findings do not assure that the regulatory and oversight frameworks to identify and address these risks are currently in place. Staff's comments are welcome.

Mr. Fachada and Ms. Mohammed submitted the following statement:

We thank staff for the reports and Ms. Levonian and Mr. Sylvester for their statement. We commend the authorities of member states and of Eastern Caribbean Currency Union (ECCU) institutions for their policy implementation in recent years, which has substantially improved macroeconomic outcomes and reduced vulnerabilities. In particular, public debt in the ECCU states has declined by almost 20 percentage points of GDP since the peak in 2011/2012. Despite robust growth in 2018 and 2019, improved public debt dynamics and continued strong Citizenship-by-Investment (CBI) inflows, the ECCU area continues to grapple with financial stability challenges, while correspondent banking relationships (CBR) and vulnerability to natural disasters remain major concerns. We welcome the authorities' commitment to addressing these risks and advancing towards regional integration.

Notwithstanding significant progress, fiscal sustainability remains a challenge given still elevated public debt levels and high risks of natural disasters. The adoption of a robust fiscal framework on a national level can help members meet the public debt regional target of 60 percent of GDP by 2030 and mitigate sustainability challenges. We agree with staff that there are merits in regional coordination of CBI programs and tax incentives, especially in limiting the "race to the bottom". Further, we agree that there are potential benefits in a regional stabilization fund in the long-term. However, like the authorities, we wonder how practical the implementation of such a fund is, especially given member states' substantial differences in fiscal positions and economic fundamentals.

Addressing financial sector vulnerabilities by prioritizing the reform agenda with a well-sequenced plan is crucial in moving towards financial integration. Although the banking sector is liquid and backed by apparently strong capital ratios, the asset quality and under-provisioning in some banks remain a concern. We support the call to repair bank's balance sheets, including via sales to the Eastern Caribbean Asset Management Company (ECAMC) and look forward to the implementation of the new treatment of impaired assets standards by January 2020, as planned. Can staff advise whether there has been any progress on this front? Moreover, we welcome stronger oversight of non-banks in light of the increased risks from rapid growth of credit unions and domestically systemic institutions with softer prudential requirements. We note that preserving CBRs remains a major challenge and encourage the ECCB to continue to closely monitor the issue. Member states should also expedite the passage of legislation to update regulatory and AML/CFT oversight frameworks to ensure compliance and enforcement.

Sound financial fundamentals are the cornerstone to a solid banking union. Whilst we agree that a deeper banking union in the long term is beneficial, we concur with the authorities that addressing the weaknesses that currently exist is a priority. We support the continued efforts to modernize the payment system and urge the authorities to hasten the review of the legal framework to allow Fintech and electronic payment services to operate and innovate. We support the ECCB call for the Fund's technical assistance on governance and legal framework for FinTech. The cautious piloting of a digital currency is welcomed, as it would allow various risks to be examined including financial integrity and cyber security.

Strengthening resilience to natural disasters and containing their economic impact continues to be essential. As recent disasters have shown, the international community support is essential in helping not only the ECCU members but the whole Caribbean region to build resilience to natural disasters while preserving fiscal sustainability. In parallel, advancing structural reforms to boost growth, raise productivity and reduce unemployment is fundamental to promote social inclusion and strengthen regional integration. In this regard, improving the business climate and advancing labor reforms as well as reducing the cost of energy and transportation can foster investment and boost potential growth.

Mr. Buisse, Mr. Rozan and Ms. Albert submitted the following statement:

We thank staff for their detailed report and Ms. Levonian and Mr. Sylvester for their informative Buff statement. Integration within the ECCU can usefully complement national policies to improve the outlook, build resilience against natural disasters, support fiscal sustainability and smooth the cycle through mechanisms such as the creation of a regional stabilization fund. Moreover, financial vulnerabilities should be monitored closely and could pave the way toward stronger integration overtime. We encourage the authorities to create more fiscal space through the reduction of tax incentives and adopt more redistributive fiscal policies. More generally, we think that the efforts by staff to offer a prioritization and sequencing of the proposed reforms and policy advice to be much welcome. We also welcome the considerable amount of technical assistance dedicated to the region. We share staff's appraisal and would like to add the following comments:

The economy of the ECCU continues to recover but the risk associated with natural disasters remains high and we encourage the authorities to pursue their efforts to build resilience. The reconstruction efforts after the 2017 hurricanes have helped support growth in the short term, but structural reforms are needed to boost potential growth and reduce the current account gap, as pointed out by the external position, which is weaker than the fundamentals. These reforms should help promote a vertical diversification within tourism, and to boost competitiveness through the improvement of business climate, the reduction of energy and transportation costs and more regional integration. Moreover, we welcome the progress made regarding building resilience against natural disasters in the region and encourage the development of the country's disaster resilience strategies, which should provide a comprehensive framework to catalyze resources for better policy responses. We note the administrative capacity constraints to meet requirements to access donor grants. As the ECCU countries remain under-insured, we encourage staff to continue working with the World Bank and to deepen analysis to find ways to lower insurance costs, and to look more about the tradeoffs between purchasing insurance and self-insuring against disasters.

We share the staff message on greater regional integration of fiscal and financial policies, but would have appreciated some analysis about the benefits of this integration in terms of income convergence process and more globally human development in the report. We found the detailed work on the SIP interesting and consider regional integration as a useful mean to share risks and improve cross-border labor mobility. However, we would have welcomed some elements about the convergence process of income levels, as well as the potentials gains associated to further regional integration and recommendations in this area. Some elements from a recent IMF WP could have been integrated, as it provides interesting analysis, by pointed the "slower convergence of incomes and the widening gap between the lowest and highest income brackets across the region highlight the need to ensure the region benefits from integration as a group".

We concur with staff that meeting the regional 60 percent of GDP debt target in 2030 remains challenging. The underlying deficit (net of CBI inflows) remains high, reaching 5.1 percent of GDP in 2018. Revenues from Citizenship by Investment inflows play a key role to limit the deficit increase but we note that they remain volatile, are subject to the risk of a race to the bottom, and present financial integrity risks. We therefore encourage the authorities to improve their management. In a context of rising expenditures due to the efforts to build resilience against natural disasters, more efforts should be made to increase revenues. Consequently, we see the streamlining of the pervasive use of tax incentives, the strengthening of the tax administration and the broadening of the tax base as paramount. Moreover, the cooperation on tax incentives at the regional level is key regarding their low positive impact on growth and their large negative impact on revenues (loss of 5.8 percent of GDP in 2010-2018). A regional stabilization fund in the long term could also be a useful counter-cyclical tool to smooth the impact of extreme climate events but should be carefully designed, regarding the heterogeneity of the ECCU countries and will require fiscal space as well as strong political will to establish a sound governance. We note from the Buff statement that a small regional "rainy day" fund exists, and we would be interested, as the authorities, to know how staff integrated it in its analysis and how it could be enhanced. Adopting stronger fiscal responsibility frameworks would also help to ensure an overall credible strategy, and if fiscal rules are considered, as is the case for Anguilla and St Lucia, they should be sufficiently flexible and well-calibrated to find the right balance between sustainability and resilience building. Finally, does staff have any recommendation regarding the improvement of the progressivity of the tax system in the region?

Significant further efforts are necessary to deal with the financial vulnerabilities. The still high level of NPL at 10 percent of total loans and the possibility of further loss of CBRs represent risks to monitor. We found especially useful the clear sequencing of the financial reform agenda in the report. We see the stronger regulation and supervision of nonbanks as well as the reinforcement of the AML/CFT framework and tax transparency standards as top priorities. We encourage the swift passage and implementation of the legislation designating ECCB as Supervisory Authority for AML/CFT for banks by all remaining territories. Moreover, the financial integrity of the region's CBI schemes should be ensured to avoid illicit activities and reputational risk. We note that the authorities do not support phasing out the ECCU minimum saving deposit rate at this time whereas Staff recommended it. Could staff explain more precisely the difference of views on this matter and develop the advantages and drawbacks of a phasing out? Improving and modernizing the current payment system should help to reduce the elevated costs of the cash system. We note the ECCB's digital currency pilot project, and generally concur with staff recommendation that it should proceed cautiously, with adequate safeguard measures. Could staff explain whether any international financial institutions are providing the ECCB with specific advice and technical assistance related to this pilot project?

Mr. Mahlinza and Mr. Jappah submitted the following statement:

We thank staff for the comprehensive set of reports and Ms. Levonian and Mr. Sylvester for their informative Buff Statement. Economic activity in the Eastern Caribbean Currency Union (ECCU) has remained robust owing to an expansion in the tourism and construction sectors. While the outlook remains favorable, vulnerabilities persist, compounded by the potential effects of natural disasters. In addition, the ECCU continues to be challenged by structural impediments to growth and competitiveness. Against this backdrop, we support staff's recommendation that decisive policy measures are required to improve the fiscal position, enhance resilience to natural disaster, strengthen financial sector governance and oversight, and boost non-tourism exports.

Credible national fiscal responsibility frameworks are important to achieving the 60 percent debt target by 2030 and creating space for disaster resilience financing. Given the vulnerability to natural disasters, we encourage member countries to pursue growth-friendly fiscal policies, underpinned by sound medium- term fiscal frameworks and debt management frameworks, to lower debt and build fiscal space to finance disaster-resilient infrastructure. Huge fiscal revenues foregone through generous tax incentives, have led to significant fiscal costs to countries within the region and provided only marginal benefits. Therefore, as part of efforts to ensure greater fiscal integration, we encourage the authorities to streamline individual countries tax incentives and work to consolidate them under a formal regional agreement. That said, we take note of the authorities' concerns on harmonizing tax incentives among sovereigns facing different domestic circumstances. Could staff elaborate on how they see the streamlining of tax incentives under these circumstances.

Solid governance arrangements and risk management frameworks will help strengthen the financial sector. While we recognize the efforts made by the authorities to advance financial sector reforms, other key aspects of the reform agenda need to be accelerated, including the consolidation of regional financial oversight for all deposit -taking institutions by the ECCB. Further, in the absence of an over-arching regional framework, individual countries should continue to support the local regulatory authorities to enable effective non-bank financial supervision. We take comfort in concrete steps taken by the ECCB to strengthen and harmonize the regulatory and AML/CFT frameworks for banks and non-bank financial institutions as well as efforts to standardize regional approaches to risk-based supervision. We call for the timely passage of legislation, at the local levels, to support these endeavors.

We take positive note of the efforts to introduce an EC dollar (DXCD), which aims to reduce the cost of business. However, we urge the authorities to remain vigilant in tackling inherent risks. In this context, we support the ongoing review of the legal and regulatory framework to strengthen prudential oversight and introduce safeguards against risks related to the authorities' strategic vision to digitize the financial sector. We are concerned about the continuous decline in correspondent banking relationships (CBRs), and therefore see merit in bank consolidation to enhance the efficiency and resilience of the banking sector, particularly to address capital needs and reduce concentration risks.

Long-term growth and stability hinges on sustained progress on structural reforms, supported by greater regional policy coordination. To make the region more attractive to FDI flows, we encourage the authorities to continue to pursue growth-enhancing fiscal structural reforms that focus on economic diversification, investment in regional infrastructure to achieve economies of scale, lowering the costs of doing business, boosting competitiveness, enhancing resilience to natural disasters, and increasing flexibility of labor market policies.

Mr. Just and Mr. Zaborovskiy submitted the following statement:

We thank staff for the well-written papers and Ms. Levonian and Mr. Sylvester for their insightful Buff statement. The recent growth recovery in the Eastern Caribbean Currency Union (ECCU) provides a good window of opportunity to advance reforms and strengthen economic fundamentals of the member countries and currency union as a whole. Sustaining this rebound over a longer period of time while boosting the growth potential remains a key challenge amidst downside risks and obstacles peculiar to the specifics of small island economies. While we broadly support staff's policy recommendations, we agree with Ms. Levonian and Mr. Sylvester that staff need to be more pragmatic in assessing the pace of regional reforms giving due consideration to different country circumstances.

Strengthening the fiscal frameworks of the union countries while gradually proceeding with fiscal integration and growth-friendly consolidation would preserve fiscal and debt sustainability. We agree that well-aligned actions are needed at the union as well as at the national levels to reduce pro-cyclicality and improve efficiency of the fiscal policies. The member countries should strengthen their national fiscal frameworks considering country-specific circumstances and limitations by advancing Public Financial Management (PFM) Reforms, domestic revenue mobilization, and disaster resilience strategies. Developing stronger fiscal institutions and improving fiscal transparency remain critical. We acknowledge the complexity of the further fiscal integration in such a diverse group of countries and learn from the Buff statement that it is unlikely that the ECCU authorities will agree to uniform fiscal frameworks. Nevertheless, having a set of common minimum fiscal anchors would be warranted. At the union level, coordination of tax incentives, Citizenship-by-Investment programs, as well as enhancing the regional financial risk sharing would help leveraging the ECCU potential and reduce fiscal costs for the member states. We agree with staff that creation of the regional stabilization fund (RSF) could result in significant savings from risk pooling. However, strong fiscal governance at the national levels as well as greater alignment of the member countries' fiscal frameworks are essential preconditions. We note that the ECCU authorities stressed resource constraints and other challenges impeding the RSF establishment. Could staff further comment on how to overcome these obstacles?

A multifaceted reform agenda to facilitate financial integration and secure financial stability is critical to boost lending to the private sector and enhance financial inclusion. We welcome the progress made by the ECCU countries in modernizing banking supervision, accounting practices, risk monitoring, and NPL resolution. However, this progress is uneven within the ECCU and the pockets of vulnerabilities, including banks with elevated NPLs, vulnerable non-bank financial institutions, as well as regulation and supervision loopholes, should be addressed. We support staff's recommendation to provide greater autonomy to the ECCB and design a holistic and well-sequenced plan to address the remaining challenges in financial regulation and supervision. We are also concerned about the declining trend in correspondent banking relationships and encourage the ECCU authorities to press ahead with addressing the drivers of this negative development. Could staff comment on the immediate priorities as well as on how the IMF can help the authorities to reverse this trend?

Enhancing efficiency of the payment system, including by leveraging digital technologies, should be underpinned by stronger legal, regulatory, and cybersecurity measures. We welcome staff's analysis of a central bank digital currency in the ECCU, highlighting both its risks and opportunities in a balanced way. We are encouraged to learn from the Buff statement that the digital version of the EC dollar is well-positioned to become the world's first central bank digital currency. Could staff further elaborate whether the ECCB is being assisted by any IFOs or developmental partners in this endeavor, and whether there are any infrastructural bottlenecks which might affect the progress?

Structural reforms to facilitate economic diversification should be pursued. We would have preferred a broader discussion in the report on the ways to leverage the ECCU to facilitate structural transformation of the member states' economies. We also echo staff's call on the authorities to improve the quality and timeliness of the ECCU economic statistics, including on debt and the external sector. Further harmonization of the reporting methodology among the ECCU members as well as with international standards should be a priority.

With these remarks we wish the ECCU authorities all the best in their reform endeavors.

Mr. Chodos and Mr. Morales submitted the following statement:

We would like to thank staff for their well-written reports and Ms. Levonian and Mr. Silvester for their informative Buff statement. We welcome the emphasis on integration policies, which could help the Eastern Caribbean Currency Union (ECCU) exploit regional synergies and heighten joint resilience. However, as pointed out by Ms. Levonian and Mr. Silvester, efforts on these fronts should be mindful of idiosyncratic country differences and limited fiscal and external resources.

GDP growth recovered in 2018-19 in the absence of major weather-related shocks. A pickup in tourism and construction activity would contribute to maintain the growth momentum, combined with higher tourism investment and agribusiness projects in some countries. Over the medium term, growth is projected to moderate towards its 2¼ percent long-term average. Also, downside risks remain significant, given the region's high vulnerability to a downturn in global economic activity and natural disasters. For that reason, economic policy should focus on building buffers at the regional and national level.

Fiscal deficits in the region remained moderate, leading to a decline in public debt in 2018 and 2019. Citizen-by-Investment (CBI) inflows supported revenue, with some countries building fiscal deposit buffers and contingency funds for natural disasters. In this regard, we welcome the ECCU initiative to harmonize CBI programs' due diligence processes that would help to adopt common policies in this important area. However, we are concerned that fiscal policies have been limited to ad-hoc measures for most countries. Overall, fiscal frameworks tailored to country characteristics should allow for the introduction of operational targets to guide fiscal policy aiming at achieving regional targets and building up buffers. In this regard, we agree with staff that regional initiatives aiming at addressing common challenges would support fiscal sustainability. In particular, the region should explore steps towards rationalizing tax incentives to attract FDI drawing on best international practices and trends in global taxation; harmonizing CBI policies on pricing and the use of quotas; and designing a regional stabilization fund to pool resources to protect against natural disasters, CBI revenue uncertainty, and global financial shocks.

Financial intermediation is still impaired by long-standing weaknesses. Non-performing loans remain high and provisions are below requirements. We note that the purchase of NPLs by the Eastern Caribbean Asset Management Corporation was delayed again, but we wonder whether the NPL's salvage value would be significant given that they have been outstanding for many years. Banks are raising portfolio investment abroad to offset low profitability of domestic operations. In this regard, it would be useful if staff could indicate what are the banking regulations regarding portfolio investment by ECCU institutions and if banks expanding their portfolio investments abroad comply with regulations. Moreover, banks' ROA remain below 1 percent while credit unions' lending continues to grow taking advantage of regulatory advantages and high liquidity. Are there any profitability indicators available for the credit union sector? More broadly, progress on financial reform has been limited, as reflected in Annex I, showing delays on many fronts. For this reason, although we agree with the staff's recommendation to introduce a financial reform agenda with clear priorities and a clearly defined sequence of short and medium-term actions, we wonder if such a comprehensive plan should follow a narrow set of measures to address immediate problems with managing non-performing loans, raising provisioning, and upgrading AML/CFT oversight frameworks. Staff comments are welcome.

We appreciate the need to address payment system inefficiencies and high costs. High costs in the ECCU are associated with the high use of cash and checks, low use of electronic payments, and low penetration of payment technologies. However, we urge caution in the move to a central bank digital currency to overcome these problems. In addition to the challenges highlighted by staff, including disintermediation, financial integrity, and cybersecurity risks; known and unknown transition costs could be significant, especially considering that international standards are not yet established, and technical hands-on experience is limited. We agree with the authorities' approach to start with a digital currency pilot project under the supervision of the Eastern Caribbean Central Bank (ECCB) and within a control environment, initially circumscribed to small value retail payments. Steps to mitigate financial integrity and security risks are key for a successful transition. We expect Fund staff to be fully engaged in this process as these plans are implemented.

Most ECCU banks have managed to maintain at least one active correspondent bank. Progress in this front would be necessarily gradual and should be helped by the entrance of new players to the ECCU financial market. To reverse market negative perceptions, countries should continue strengthening compliance with AML/CFT and tax transparency standards. Also, the designation of the ECCB as AML/CFT supervisor should be confirmed by all countries, and legislation updates, including for non-banks, should be promptly introduced.

With these comments, we wish the authorities success in their policy endeavors.

Mr. Guerra and Mr. Rojas Ramirez submitted the following statement:

The Eastern Caribbean Currency Union (ECCU) faces the need for fundamental reforms in order to attain economic stability, debt reduction and long-term sustainable growth. Economic and institutional integration is crucial for ECCU. In this regard, a consistent policy framework, strengthening the fiscal and financial sector, generating economies of scale, and mitigating large external shocks underpin the consolidation of the currency union. We thank staff for their report and discussion of the common policies of ECCU member countries. We also thank Ms. Levonian and Mr. Sylvester for their Buff statement. We broadly concur with the staff assessment and appreciate the policy analysis in the Selected Issues paper.

Fiscal prudent management is crucial for sustainability of the currency union. We concur with staff that the overriding problem remains fiscal sustainability and policy procyclicality. Revenues rely heavily on Citizenship-by-Investment (CBI) and tourism inflows. On the expenditure side, the union shows high vulnerabilities stemming from natural disasters and external shocks. Notwithstanding relatively favorable conditions and members' ad-hoc efforts to improve public finances, it will be instrumental to build additional fiscal buffers, and create contingency funds for natural disasters. In this regard, we welcome ECCB actions aimed at improving the ECCU fiscal institutional framework, debt sustainability, harmonizing fiscal data, improving debt management, and steering the countries' medium-term fiscal frameworks. We agree with staff to encourage Authorities to further advance the coordination of regional tax incentives and the creation of a regional stabilization fund (RSF)

Payment system reform will contribute to ECCU's economic efficiency and sustained growth. We note that the ECCU payment system is predominantly cash-oriented, bearing high costs and inefficiencies. We agree with the recommendation to increase the use of digital payments to achieve higher productivity. We commend ECCB's reform initiatives to enhance small and medium-sized enterprises through a more efficient payment system. We welcome the launch of the Electronic Funds Transfer (EFT) system and the digital currency pilot project using blockchain technology for reducing cash and checks transactions. We concur with the staff's recommendation on the revision of the payment system legal and regulatory framework to allow emerging Fintech and nonbank e-payment services operations and innovation. Going forward, it will be critical to fully assess financial intermediation and financial integrity risk, as well as revisit the AML/CFT, and data and privacy governance framework.

ECCU's financial institutions remain stable with sound liquidity and capital indicators, but vulnerabilities persist. In this regard, we praise the authorities' commitment to advance their reform agenda to boost financial sector stability and build resilience. We agree with staff that urgent measures are needed to monitor and address market and operational risk in the financial system, including from correspondent banking relationships. Thus, we join the authorities' call requesting the IMF and other relevant partners to remain actively engaged in support of the union member countries' efforts to address the risk of further correspondent banking withdrawal.

Ms. Mahasandana and Ms. Latu submitted the following statement:

We thank staff for the comprehensive set of reports and Ms. Levonian and Mr. Sylvester for their helpful Buff statement. Notable progress in advancing the ECCU region's economic development agenda has contributed to a rebound in growth, low inflation and continued decline in the public debt-to-GDP ratio. That said, the underlying fiscal position has weakened, the external imbalances and financial sector vulnerabilities are mounting, and sizable challenges remain. Strong commitments by the ECCU member countries towards economic and financial integration and necessary common policy reforms to bolster resilience both on the regional and national levels are key to strengthening internal and external stability. We broadly agree with staff's assessment and offer the following comments for emphasis.

Accelerating the implementation of prudent national fiscal policies is warranted to strengthen fiscal and debt sustainability. This would support building fiscal buffers and resilience to natural disasters while authorities are grappling with other competing priorities such as poverty reduction and public investments to support growth and developmental needs. This would also help put debt in a firm downward trajectory to meet the debt-to-GDP ratio target of 60% by 2030 and achieve debt sustainability.

We see merit in staff's recommended increased fiscal integration through regional coordination of tax incentives and CBI revenues. We appreciate the analysis in Box 1 and the Selected Issues Paper (SIP) of the effectiveness of tax incentives in the region. Nonetheless we take note of authorities' concerns on the practical difficulties of enforcing policies' coordination and encourage staff to assist the authorities in appropriately sequencing the recommended reforms towards harmonizing the tax incentives. We agree with enhancing the sustainability and integrity of CBI inflows given their significance in addressing the region's fiscal and external imbalances.

We welcome the analysis in Box 2 and the SIP which supports the pooling of resources in a regional stabilization fund (RSF) as buffers for future shocks. The authorities' initiatives to build national savings funds and regional "rainy day" funds at the ECCB are steps in the right direction towards building the RSF. Given this development, can staff comment on how to effectively address the authorities' concerns about the practical implementation of the RSF? We also encourage the authorities to ensure a robust fiscal governance framework is in place to support the success of the fiscal reform agenda and help catalyze external donor support for the RCF.

Firm pursuance of financial sector reforms is key to mitigating the rising financial sector vulnerabilities and safeguarding financial stability. This would ensure healthy credit growth is restored to support domestic economic development and enable banks to reduce investments in riskier assets. We encourage staff to assist the authorities in ensuring their reform agenda is well-sequenced in consideration of their implementation capacity and respective country situations. Tackling the risks to possible further loss of CBRs should be prioritized and we encourage ECCB to press ahead with the planned reforms including the strengthening of the AML/CFT oversight frameworks. To this end, can staff clarify the Fund's work to enhance the role of the international community in containing the risks of further loss of CBRs to further augment the member countries' efforts? Equally important is expediting the efforts to strengthen the supervision of non-banks given their growing systemic importance.

Enhancing payment efficiency through digital means supports financial stability and inclusive access to financial services. Reducing inefficiencies in the payment system would facilitate quicker and safer conduct of business transactions, lower transaction costs and help build the required economies of scale to encourage private sector innovation. However, promoting usage of digital payments should go hand-in-hand with efforts to enhance financial literacy and consumer protection to ensure customers' confidence and usage of financial services. We are encouraged by the authorities' initiatives to modernize the payment system and to pilot the central bank digital currency as a solution to improving payment efficiencies. That said, we agree with staff that the pilot should proceed cautiously with appropriate safeguard measures and we look forward to being updated on the results in the next report. We also encourage ongoing support from the Fund and other relevant IFIs for the authorities to examine and address the associated risks and policy gaps from these digital opportunities.

Continued pursuance of structural reforms is crucial to ensuring external sustainability and promoting durable and inclusive growth. We welcome the authorities' commitment to bolster growth and foster private sector activity such as diversifying the economic structure to boost non-tourism exports, improving the business environment, and implementing labor market reforms. We take positive note of the authorities' planned investment in high-speed fiber-optic broadband network and e-government platforms to enhance connectivity and use technology to promote innovation. This would support the initiatives to improve payments' efficiency and access to affordable financial services.

Mr. Ronicle and Mr. Clark submitted the following statement:

We thank staff for the informative papers and Ms. Levonian and Mr. Sylvester for their comprehensive Buff statement. We welcome the positive economic progress and commend the authorities for the growth acceleration and gradual decline in public debt levels.

However, although growth momentum has remained strong, driven by the tourism sector, sizable Citizenship-By-Investment (CBI) flows and the recoveries from recent hurricanes, there remain a number of long-standing structural issues and vulnerabilities that may drag on current growth rates, including high debt levels, low potential growth, exposure to climate change & natural disasters and financial sector challenges. In this context, we welcome the thoughtful contributions from staff on how to collectively tackle these challenges through stronger regional integration.

Recent fiscal developments have been positive: deficits have narrowed, and debt is on a downward path. We take positive note of the authorities' commitment to meeting the 60% of GDP debt target and encourage them to maintain their efforts to keep debt on a downward trajectory. We have sympathy with the authorities' view that greater fiscal integration is challenging given differences in domestic circumstances. That said, we find the staff evidence compelling that a race to the bottom in tax incentives is in no one's interest, and we support the staff suggestion for greater coordination in these areas.

We also share the staff view that there are potential economies of scale in disaster preparedness and resilience – though robust national strategies will remain crucial. Noting the authorities' skepticism with regard to a regional stabilization fund, do staff have views on alternatives that might be effective, without the need for complex new institutional arrangements, for example collective fiscal action or new financial instruments at the regional level?

We are pleased to note the positive progress on banking sector liquidity, capital ratios and NPLs, but financial sector vulnerabilities remain, specifically around asset quality and riskier investments. We encourage country level action on the agreed regional multipronged reforms of financial oversight, with a focus on: regulation & supervision; ECCB governance; measures to minimize the risks to correspondent banking relationships, and; updates to AML/CFT oversight frameworks.

The pilot of the digital EC dollar (DXCD) is a bold experiment, with potential to significantly enhance the ease of payments in the region and reduce costs. We are pleased to see that a thorough review will be conducted following the pilot, and that reforms to the traditional payment system are proceeding in parallel. We acknowledge the risks highlighted by staff and are pleased to see that the authorities plan to proceed cautiously, mindful of the potential risks and appropriate safeguards.

Over the longer-term there should be renewed vigor on the structural reform agenda to enhance the region's competitiveness and boost private sector activity. Key structural reforms are overdue to ensure external stability and enhance growth potential. This should include strengthening the investment and business climate, reducing energy and transport costs, and enhancing regional economic integration.

Mr. Chikada and Mr. Kuretani submitted the following statement:

We thank staff for the informative report and Ms. Levonian and Mr. Sylvester for the insightful statement. We welcome that the authorities in the Eastern Caribbean Currency Union (ECCU) continue to advance their economic development agenda. However, its outlook is clouded by downside risks, such as its vulnerabilities to natural disasters and financial sector weakness. We encourage the authorities to keep efforts to implement critical reform agenda to address the risks. As we broadly support the thrust of the staff's appraisal, we would like to limit our comments to the following:

Fiscal Policy

We support the proposed fiscal integration and encourage further progress on building resilience. Given the major vulnerabilities are due to natural disasters, we encourage the authorities to improve national fiscal frameworks to build resilience to natural disasters and also improve debt sustainability. In this context, we agree with staff that the ECCB has critical roles to promote fiscal discipline, and that regional integration could support fiscal sustainability, especially in tax incentives and CBI revenues. Also, we encourage the authorities to further build resilience to natural disasters by strengthening CCRIF and improving DRSs with support from international organizations.

Financial Sector

Addressing financial system vulnerabilities under the reform agenda is critical. We welcome that ECCB's reform has strengthened financial stability and built resilience, including regulation for increasing non-banks, NPL resolution, and AML/CFT frameworks. However, we note with caution that systemic important credit unions remain inadequately regulated and supervised; the NLP ratio is still above the regulatory standard; and that the reform implementation has been slowed by delays in the passage of legislation by individual countries. We encourage the authorities to continue to progress these reforms going forward with the Fund's Technical Assistance.

The ECCB's digital currency project entails both opportunities and risks. We take a note with surprise and sort of excitement that DXCD will essentially be the world's first central bank digital currency while there also seems to be much need for improving the current payment system. If implemented and managed well DXCD could make the Union leapfrog and modernize its payment system. However, we also note that the digital currency could expose the ECCB and their financial system to several risks as noted in staff report, and there seems to be some low-hanging fruits to improve the current payment system (e.g., reducing credit/debit card merchant fees). In this regard, we wonder what the right sequencing and prioritization of improving the existing payment system and advancing the digital currency could be in light of relatively limited capacities of the member countries, and welcome staff's views.

Mr. Beblawi, Mr. Mouminah, Ms. Merhi and Mr. Rawah submitted the following joint statement:

We thank staff for the comprehensive set of reports and Ms. Levonian and Mr. Sylvester for their useful Buff statement. It is encouraging to note that growth in ECCU countries remains robust. However, key challenges remain, particularly regarding the countries' vulnerability to natural disasters and global shocks, exposing them to large output and revenues swings. Against this backdrop, we see scope for deeper policy integration among ECCU countries, which would enhance resilience and strengthen macroeconomic stability. In this regard, practical steps aimed at increasing the fiscal and financial regional integration and exploring ways to solidify the monetary union are encouraged. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We see merit in deepening fiscal integration, which could supplement national policies in facing shocks. To this end, several preconditions have to be met, starting with improving the fiscal framework at the national level. Here, we echo staff's call for accelerating the efforts toward implementing credible country-specific fiscal responsibility framework to help achieve the regional debt-to-GDP target. This could be complemented by continued upgrading of fiscal institutions and PFM as well as developing country-specific disaster resilience strategies. In this regard, fiscal buffers such as self-insurance and insurance against natural disasters should be integral part of the fiscal framework. At the same time, we note that, while tax incentives remain a primary tool to attract FDI in the Caribbean economies, their benefits are marginal, and the associated fiscal costs are large. Also, the intensified competition among ECCU to attract foreign investment, including in the context of CBI programs, has magnified the race to the bottom. Therefore, in our view, there is a room for regional coordination on tax incentives and CBI programs. This could also help in boosting public resources to address development needs, including through better streamlining, guided by clear principles and best practices. Separately, underpinned by strong governance framework and well-sequenced implementation plan, a regional stabilization fund (RSF) could be a useful tool to address policy procyclicality and support the ECCU countries' resilience over the long-term.

Financial sector reform agenda needs to be prioritized and well-sequenced to address existing issues and set the stage for a deeper regional financial integration. Here, we take positive note of staff's assessment that the common monetary policy has served the region well. Also, we welcome the ECCB and national authorities' efforts towards enhancing the financial sector oversight. Efforts, however, should be accelerated as pockets of vulnerabilities are building up in both bank and non-bank sectors. To this end, strengthening banks' balance sheets, including through the completion of NPL acquisitions by ECAMC and continued modernization of the insolvency and foreclosure laws, should continue to help improve asset quality, and support the banks in achieving the NPL target of 10 percent and 5 percent by mid-2020 and end-2023, respectively. Also, the governance frameworks for ECCB and the deposit taking institutions should be reviewed and modernized. We share the authorities' concern about the possibility of further losses in correspondent banking relationships. We note that the number of correspondent banks continues to decline with higher transaction costs, even though most ECCU banks continue to have more than one correspondent. We welcome in this regard the ECCB plans to press ahead with efforts to harmonize and strengthen AML/CFT oversight at the regional level. We also encourage the authorities to intensify information sharing between respondent and correspondent banks, achieve full compliance with tax transparency standards, complete national risk assessments as well as improve the governance of CBI programs. As meaningful progress in addressing critical short- and medium-term priorities takes place, steps toward a fuller banking union could be taken in the long-term, as noted by staff. Moreover, consolidation of non-bank sector oversight would help in addressing weaknesses in the sector, including regional systemic risks.

We note the ECCB's plan to issue the digital version of the EC dollar (DXCD) to support the modernization of the payment system, improve the speed and decrease the cost of transactions, as well as minimize the social costs of hard currency, as elaborated in the Buff. We also note that the authorities will pay due consideration to key safeguards, including cybersecurity and AML/CFT requirements. In this context, the currency pilot will provide an opportunity to examine risks related to financial integrity and cybersecurity as well as to assess policy gaps. Nevertheless, a central bank digital currency alone would not solve the problem and that the authorities have to continue their efforts to modernize the traditional payment systems based on bank deposits, as noted in the interesting SIP. We would be interested in staff's comments whether the cost of technology is the only impediment to the utilization of electronic payments as well as mobile payments, which remain limited. If technology is available but underutilized, this could also apply to the use of the digital currency.

With these remarks, we wish the authorities further success.

Mr. Raghani and Mr. Bah submitted the following statement:

We would like to thank staff for the well-balanced report and the selected issues paper (SIP) and Ms. Levonian and Mr. Sylvester for their insightful Buff statement.

We are encouraged by the growth recovery in the Eastern Caribbean Currency Union (ECCU) in the aftermath of severe natural disasters experienced in 2017 as well as the declining public debt and the subdued inflation. The expansion of tourism sector's activities and sizable financial flows under the citizenship-by-investment (CBI) are noteworthy. We note that the impact of the hurricanes on the economies of member countries is being addressed through the large reconstruction plans, which weigh on fiscal and external positions. In addition, financial sector's vulnerabilities remain, with stagnant credit to the private sector, high level of Non-Performing Loans (NPLs) and the persistent withdrawal of corresponding banking relationships (CBRs). Against this backdrop, further efforts towards fiscal and financial integration, enhancing the monetary union and deepening structural reforms are needed to strengthen resilience and decisively tackle the challenges facing the ECCU going forward. In this regard, we broadly share the staff's policy recommendations and offer the following comments for emphasis.

Supporting fiscal sustainability through leveraging regional integration is of paramount importance. The ECCU is confronted to sizable fiscal challenges due among others to the recurrent natural disasters and its limited fiscal framework. The precarious revenue and financing base lead to important constraints for public investment with an adverse impact on growth and resilience to exogenous shocks. Continued efforts to upgrade fiscal institutions and improve public financial management will be warranted in this regard. Moreover, we see merit in establishing a regional coordination of tax incentives as well as for CBI revenues. We also agree on the setting up of a regional stabilization fund (RSF) seen as a fiscal buffer against shocks stemming from natural disasters, uncertainties of CBI revenue and tourism activities, with a view to smoothing out investment expenditures. As made evident in the insightful SIP, such RSF can carry positive implications for private investment, employment, output and wages. Can staff elaborate on the diversity of policy views and fiscal sustainability challenges that may hamper the implementation of such fund? Moreover, staff's comments on possible external financing of the initial capital of the fund will be appreciated. We welcome the authorities' renewed commitment to meet the 60 percent-of-GDP regional debt target. The Fund should assist member countries in implementing adequate debt sustainability strategies to finance these countries' development needs.

While liquidity and capital ratios of the banking sector in the ECCU are broadly strong, there is significant room for enhancing financial stability through stronger regulatory and supervisory as well as adequate safety nets. We note that vulnerabilities are increasing stemming from the heterogeneity in the size of banks' impaired assets and from systemic spillovers. In addition, the departure of global banks and the loss of CBRs are sources of concern. We encourage the authorities to pursue the reforms aimed at modernizing banking supervision and accounting practices, accelerating NPL resolution and harmonizing the regulations of non-banks while further enhancing the AML/CFT framework. We also urge them to effectively implement the Fund's recommendations and leverage technical assistance to address the issue of correspondent banking relationships. We echo the authorities' call for a greater role of the international community in containing CBRs-related risks. Furthermore, there is a need to establish a regional financial safety net to further strengthen financial stability in the ECCU. This safety net including a deposit insurance scheme and emergency liquidity arrangement will help broaden risk diversification and enable banks' access to more resources.

We welcome the initiatives launched by the ECCB to modernize the Union's payment system and encourage a prudent implementation of the digital currency project. The central bank's initiatives in this area will help reduce the cost of doing business. The promotion of the digital payment technology could lead to higher labor productivity growth. We also note that the digital currency pilot project launched in March 2019 intend to reduce excessive reliance on cash and cheques, improve the efficiency of the retail payment system and boost economic development of ECCU member countries. To ensure the success of all these initiatives, we agree on the need to continue concerted efforts at both national and regional levels. Could staff indicate whether similar pilot projects have been undertaken within the Fund membership and what lessons could be applicable to the ECCU, including as they relate to the strengthening of cybersecurity and AML/CFT operations?

Advancing structural reforms is essential to boost potential growth and ensure external sustainability. We encourage the authorities to speed up the implementation of structural reforms aimed at bolstering competitiveness and diversifying exports. In this regard, the authorities' efforts should focus on improving investment climate, enhancing public sector efficiency, pursuing labor market reforms and advancing regional integration. Reducing energy and transportation costs, will be also necessary to increase competitiveness in the ECCU.

With these remarks we wish the ECCU's authorities every success in their future endeavors.

Mr. Trabinski and Ms. Urbanowska submitted the following statement:

We thank staff for the comprehensive set of reports, and Ms. Levonian and Mr. Sylvester for their helpful Buff statement. Economic recovery in the

ECCU member countries remains strong, reflecting the uplift in construction and tourism. In the medium term, growth is projected to level off and inflation to remain subdued. However, prevailing fiscal and external imbalances cloud the growth outlook. Several downside risks, such as natural disasters, a global economic slowdown, and a further loss of CBRs could affect economic activity. Structural bottlenecks and unresolved financial sector weaknesses could further jeopardize growth prospects. Against this background, we agree with staff's main policy recommendations, particularly the need to reinforce and leverage regional integration. We would like to add the following comments for emphasis.

Achieving debt sustainability and avoiding fiscal procyclicality is key. Despite an overall decline in public debt, fiscal deficits remain high. Meeting the 2030 regional benchmark of 60 percent of GDP remains challenging for most countries. That said, we welcome the authorities' commitment to prudent fiscal and debt management policies, as stated in the Buff. Adoption of robust, country-specific fiscal frameworks, anchored by the debt objectives, remains crucial to support durable fiscal consolidation efforts. Also, building buffers for much needed priority spending, including public investments in resilient infrastructure, would complement these efforts. We would like to stress that the CBI inflows – although they have become large – are subject to volatility and should best not be regarded as a continuous source of revenue.

Building ex-ante resilience to climate change and natural disasters remains the region's main priority. We see merit in staff's call for a greater fiscal integration through streamlined revenue policies among member states, but we also acknowledge country-specific circumstances that need to be considered. Establishing a Regional Stabilization Fund (RSF) is a good step forward in providing necessary buffers against natural disasters. Moreover, in the longer term, the RSF could be an important tool for smoothing government consumption, should a shock occur. In this regard, we encourage the authorities to ensure RSF's strong governance framework and safeguards. Furthermore, we welcome the ongoing work on two pilot projects in Dominica and Grenada on comprehensive disaster resilience strategies (DRSs). The latter should serve as a roadmap for resilience building efforts and facilitate the necessary donor support from international community.

Accelerating the ECCB reform agenda would help address longstanding financial sector vulnerabilities. We agree with staff that the reform agenda needs to be well sequenced and implemented in a decisive manner. Priority should be given to a further reduction of the elevated NPLs, including through sales to the Eastern Caribbean Asset Management Corporation (ECAMC). Additionally, progress in enhancing the insolvency legislation would facilitate loan recovery and minimize potential fiscal costs. We commend the authorities for a number of recently introduced reforms that enhance the overall banking sector supervision. We agree with staff that, going forward, the financial supervision reform agenda would benefit from good sequencing. We also encourage the authorities to focus their attention on strengthening the AML/CFT regime, which is particularly relevant in the context of ongoing pressures related to further CBR withdrawals.

Modernizing the payment system would support the economic transformation of the ECCU region. We welcome the ECCB's pilot project in testing digital payments in four ECCU countries. The digital payment technology would decrease the cost of doing business, enhance financial integrity, and increase labor productivity, as pointed by staff in the SIP. Despite the underlying benefits, an array of risks is emerging. To mitigate these risks, safeguard measures need to be included in the design of the digital currency, including strengthened cybersecurity and AML/CFT requirements. As stressed by staff, the ECCB plans to test the digital currency in a controlled environment. Do staff have an estimate of what the preliminary limit for holdings of and transactions with the digital currency might be, and how the regulation will be enforced?

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for the set of insightful papers on the Eastern Caribbean Currency Union (ECCU) and Ms. Levonian and Mr. Sylvester for their helpful buff statement. In 2018-19 the ECCU growth was robust, as reconstruction efforts, increased tourist arrivals, and sizeable citizenship-by-investments (CBI) supported economic activity. Fiscal deficits have moderated, and public debt has continued to decline. However, with still high public debt, sizeable external imbalances and substantial weaknesses in financial sector, the ECCU economies remain vulnerable to external shocks, including natural disasters, global economic slowdown, and further loss of the correspondent banking relationships.

We welcome the report's focus on the ways to reap the benefits of enhanced regional policy coordination and economic integration, which can substantially improve the effectiveness of the currency union, while reducing vulnerabilities. In this regard, we would like to highlight three areas, where the authorities are well advised to move forward.

First, the ECCU countries can gain substantially from regional coordination of revenue policies. We support staff's advice to harmonize tax incentives and the CBI programs. Providing competitive tax incentives could lead to the race-to-the-bottom situation, while increased revenue could help improve infrastructure, boosting the region's attractiveness for investors.

Second, the ECCU could benefit from establishing a regional stabilization fund (RSF). According to staff, in comparison with individual national savings funds, which are created by many ECCU countries, an RSF could result in significant savings from risk pooling. It could improve protection of ECCU countries from external shocks and lead to increased investments. While some authorities remain skeptical about feasibility of implementing this proposal, we encourage additional discussions on this matter.

Third, the introduction of the central bank digital currency in the ECCU is an important step forward, as it could become the world's first central bank digital currency. We appreciate the comprehensive discussion of this topic in the SIP. A modern digital payment system may boost growth and productivity in ECCU countries, eliminating inefficiencies and costs of paper currency and checks. Taking into account the ECCU-specific obstacles for development of electronic payment system on the private basis, we welcome the ECCB leadership in this project. We agree that the project should proceed cautiously as the risks pertaining to the central bank digital currency have yet to be fully understood. We expect that staff will provide necessary technical assistance to the authorities in completing this project.

With these remarks, we wish the authorities success.

Mr. Mojarrad and Mr. Ahmed submitted the following statement:

We thank staff for the well-written papers and Ms. Levonian and Mr. Sylvester for their helpful Buff statement. We are encouraged that the authorities and staff have broadly similar views on the Union's macroeconomic outlook and policy proposals, and we welcome the authorities' continued commitment to reforms. We concur with the report's assessment and main policy recommendations.

We welcome the ECCU members' fairly strong growth performance, underpinned by a buoyant tourism sector, sizeable Citizenship-by-Investment (CBI) inflows, and public sector reconstruction in the aftermath of 2017 hurricanes. While higher growth and moderate fiscal deficits have reduced the public debt ratio in recent years, important external imbalances remain, and there are pockets of financial vulnerability in both banks and non-banks.

The experience of ECCU members compares positively with the volatility that many large Caribbean states have experienced in recent decades. The fixed exchange rate has helped maintain low inflation and contributed to the development of the financial sector.

Additionally, the pooling of resources has facilitated risk diversification, helping members mitigate the impact of natural disasters, allowing them to mobilize resources and ensuring continued currency conversion. Furthermore, the reduction in cross-border transaction costs has made it easier for domestic companies to remain relatively competitive.

At the same time, the ECCU also faces significant challenges, which can be mitigated by enhanced regional integration in a well-sequenced manner. We note that there is scope for strengthening economic and institutional integration among members, particularly in the fiscal and financial spheres. The medium-to-long term integration proposals put forth by staff require sustained implementation and strong pre-conditions.

Strengthening regional integration would require harmonization of fiscal and financial sector policies. On the fiscal front, procyclical policies in the context of small developing island economies exposed to recurring natural disasters pose particular fiscal sustainability challenges. In this regard, we support the notion of pooled fiscal buffers to withstand shocks from natural disasters. Some countries have already built large fiscal buffers; such an initiative at the regional level would greatly enhance fiscal integration.

The ECCB Monetary Council is targeting a public debt level equivalent to 60 percent of GDP by 2030, but the planned fiscal consolidation appears to be weaker than what would be required to deliver on the debt target. In general, fiscal integration in the ECCU has lagged monetary integration, but we hope that the ECCU members will continue to strive to meet the regional debt-to-GDP benchmark. Could staff please comment on the capacity of the Union to enforce its edicts on individual members?

The recent ECCU initiative to harmonize the CBI programs' due diligence processes is welcome. Similar coordination on CBI pricing and the use of quotas to support these revenues over time, and the harmonization efforts on tax policies, including on tax concessions to attract FDI, will also help support fiscal sustainability. Staff's empirical analysis (presented in the SIP) supports such harmonisation and coordination amongst ECCU members. For instance, while the fiscal costs of tax concessions to attract FDI are estimated at about one-fifth of government revenues in the region on average, the concessions have little impact on overall FDI, GDP growth or employment generation. The analysis would support tax harmonisation, rather than tax competition.

The Financial Sector in ECCU is sound, liquid, and efficient. We compliment the authorities for pursuing multi-pronged reforms to modernize banking supervision and accounting practices, including the identification of systemically important financial institutions, a deposit insurance scheme, creation of a single regulator for non-banks, and operationalization of the credit bureau. We welcome the ECCB initiative to pilot a digital currency EC dollar to address the issues of high cost and low efficiency in payment services. This should also encourage the adoption of new technologies and enhance the role of the private sector in expanding cost-effective access to and usage of financial services. However, since digital currency poses its own risks (as identified in the SR), we recommend the authorities to proceed with caution.

With these remarks, we wish the authorities continued success.

The Acting Chair (Mr. Furusawa) made the following opening statement:

In your gray statements you welcomed the region's improved growth performance and public debt reduction over the past two years. You noted that major challenges remain, including high debt levels, sizeable external imbalances, financial sector weaknesses, and vulnerabilities to natural disasters. You stressed that greater regional integration and sound national policies are needed.

Going over your gray statements, I believe we could focus our discussion today on the following points: How to address the practical difficulties to fiscal and financial integration, the role of the Fund on issues related to correspondent banking relationships (CBRs) withdrawal, and the implementation of the digital currency project. As it was noted in the buff statement, this will potentially become the first central bank digital currency worldwide.

Ms. Levonian made the following statement:

At this point I just wanted to emphasize my authorities' perspective on the Eastern Caribbean Central Bank (ECCB) digital currency pilot project. Directors' views were mixed with many calls for caution, and so our authorities are very grateful for the candid feedback. In their view, this project has the potential to revolutionize the payment system in the ECCU. The benefits could be far-reaching and possibly transformative in addressing the current frictions for people and businesses using physical cash.

The current environment could be contributing to financial exclusion, and the digital currency can help provide an environment of greater financial inclusion. Our authorities want to assure Directors that they are mindful of the risks, and for this reason, they are proceeding with this important reform in a judicious manner by way of a pilot approach. This approach will allow them to carefully consider the risks and the mitigation strategies required. As pointed out in the Selected Issues Paper (SIP), the project has several built-in safeguards to mitigate or manage and protect against potential risks. Let me just mention a few.

With respect to financial intermediation and stability risk, to counteract these risks, the central bank digital currency (CBDC) is not being designed as a substitute to bank deposits. The funds that will be used for the digital currency are already in the banking system, and all banks are expected to eventually be involved in making the digital currency available to their customers. Also, the digital currency is being designed in a small value payment instrument, which will limit the amount customers can hold. Furthermore, the digital currency will be noninterest bearing and so will not create competition for funds, and the risks of a run on banks because of the digital currency.

With respect to financial integrity and cybersecurity, it is important to look at the financial integrity and cybersecurity risks from two perspectives. First, on the question which form of cash is better positioned to combat money-laundering and terrorist financing (AML/CFT): physical cash, which is completed anonymously, or digital cash, which is managed anonymity, clearly in this case I think the latter is better. With the understanding that all noncash transactions are exposed to cybersecurity risks, our authorities are confident that this risk can be managed similar to other cybersecurity risks that exist with other payment platforms.

On financial access and reputation, the authorities expect the digital version of the currency to have the same reputation as the hard currency version. That said, the ECCB has undertaken an extensive consultation process with stakeholders and continues to engage them. In particular, the ECCB has reached out to two correspondent banks to inform them of the pilot and will continue to update them on its progress.

I think it is important to note that all novel ideas carry risk. Acting prudently would mean carefully weighing the risks against the rewards before deciding on next steps. The mere existence of risk is not a good enough rationale to delay or refuse to act on critical reforms. I think that staff's assessment was broadly neutral in calling for a cautious approach, a view supported by most Directors.

We encourage the Fund to intensify support for small states, including their initiatives for financial inclusion and payment efficiencies. In this regard, it is critical that the Fund establish a view on CBDCs as well as position itself to provide support to members who are interested in going down this road.

The staff representative from the Western Hemisphere Department (Ms. Munoz), in response to questions and comments from Executive Directors, made the following statement:[1]

I would like to comment briefly on updates on balance of payments (BOP) data and the authorities' plans to ensure regulatory standards, the practical implementation of a regional savings fund in the long run, and the Directors' question on potential Fund assistance reviewing the central bank digital currency pilot.

At end-December 2019, the ECCB published balance of payments estimates for 2018 and revisions to balance of payments estimates from 2014-2017. The ECCB's estimate suggests a current account deficit of 12.1 percent of GDP in 2018, compared to the 8.4 percent of GDP we presented in the staff report. The ECCB estimates are still preliminary and subject to further revisions in coming months. Staff feels the estimate presented in the staff report is the best estimate for 2018.

A Director asked about problems on the implementation of the new treatment of impaired assets standards by January 2020. We responded in writing that the issuance was expected by January 2020, and we were following up with the authorities. We received an update from the authorities during the weekend stating that the issuance of the treatment of impaired assets standards has been delayed with a target of end-March 2020.

Several Directors asked about the practical implementation of a regional savings Fund in the ECCU. We responded in detail in our responses, but we would like to emphasize that this is a long-term recommendation, and progress towards the achievement of the 2030 public debt target will smooth some of the differences in the country's fiscal positions, thereby facilitating the regional savings fund implementation.

As the staff emphasized in the staff appraisal, robust national fiscal responsibility framework to ensure public debt sustainability and buffers to natural disasters remain key to improving economic performance. However, over the long-term, a well-designed regional fund will provide positive incentives for participation and support fiscal sustainability since a multi-country arrangement can act as a commitment device, especially in terms of enforcing savings withdrawal rules. Members will have incentives to scrutinize qualification requirements for withdrawal.

As noted in the staff report, a staff analysis indicates that risk pooling implies access to the same financing potential but with about half of the

[1]Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

savings requirement, alleviating one of the constraints to participation related to the opportunity costs of a savings fund, for instance, in terms of reducing public debt and interest cost or in terms of the development on infrastructure investment.

The regional savings fund will complement national savings funds for self-insurance against natural disasters at a lower cost than other insurance alternatives such as Catastrophe Risk Insurance Facility (CCRIF) or catastrophe (CAT) bonds.

Responding to the Director's question on whether staff is willing or can join the ECCB's pilot review, we have not received a request by the ECCB to help with a review of the pilot. In the event that we are asked, we would respond based on the nature and scope of the request and subject to staff expertise in consultation with colleagues from MCM, Legal, and SPR. In such a context, as is normally the case, staff's engagement through technical assistance (TA) will be informed by relevant existing policy guidance endorsed by the Board.

Mr. Rosen made the following statement:

We acknowledge that the authorities are trying to solve a key problem of reducing the high cost of financial transactions and lower rates of financial access in their currency monetary union. These challenges are compounded by the ECCU's scale, disadvantages, and differing regulatory landscapes. We recognize the benefits of greater financial access, so we welcome the authorities' focus on improving payment systems. However, as staff convincingly argued in their report and as my colleagues, Mr. Buisse, Mr. Sigurgeirsson, Mr. Ray, Mr. Chodos, and others have pointed out, the authorities should proceed cautiously on their CBDC pilot. Indeed, we have strong reservations that CBDC is the right solution for the ECCU.

Staff note that it is too early to derive meaningful lessons from other ongoing pilots in much more advanced financial systems, and the ECCU seems to be pioneering an untested and unproven financial technology that bears significant risk. We see more merit in the authorities' addressing domestic roadblocks to more traditional means of enhancing payments, such as mobile banking. We acknowledge scale disadvantages faced by small island states regarding e-payment options. Still staff has said that the ECCU lacks the legal and regulatory framework specifically for mobile payment services, and we think addressing these roadblocks would be an excellent first step.

Staff also note that the authorities have not yet carried out a cost-benefit analysis (CBA) of alternatives and that such an analysis is currently underway. We believe this cost-benefit analysis perhaps should have come before the launch of the pilot. We urge the authorities to reconsider CBDC until they have completed a thorough cost-benefit analysis of the program, addressed roadblocks to mobile payments, and exhausted all other alternatives to enhancing financial access and reducing costs.

Going forward, we think the Fund can play a critical role in convening like-minded members to exchange views and country experiences on fintech and hope that the authorities can remain engaged with other central banks to promote information sharing on lessons learned.

Mr. Just made the following statement:

We thank staff for the good report which overall provides useful input to the authorities on how to realize and ideally increase the benefits of a currency union. These are a harmonization of rules, regulation, time and transposition of directives, international legislation, and adhering to those, also strengthening the risk-sharing aspects and having a shared understanding that national policies should ideally not undermine the Union or result in a race to the bottom.

We also would like to come back on the digital currency issue and also from the cost-benefit analysis. Arguably the most effective way to improve the retail system is to build upon the current account-based two-tier system to accommodate faster payments. The ECB should be able to ensure level playing fields, and it also controls the market access. It could offer small banks or credit unions the possibility to settle access on a pre-funded basis. The SIP also mentions that the reasons for the introduction are the high fees, which may be a competition issue. There are identified regulatory gaps which the authorities could also address. And we did not quite buy the argument of the smallness of the market. Fintech is often portrayed as the very solution for smallness of scale.

The intention of the authorities to introduce a retail payment digital currency is groundbreaking. It opens the 24/7 availability of payments, different degrees of anonymity, peer-to-peer transfers, et cetera, and we think it is very good that the ECCB has already ruled out the scope for applying interest rates to deposits, which would be viewed as security risks and also to limit the value of the deposits. Both constraints should prevent that ECCB becomes everybody's lender and deposit taker, which carry significant risks and operational costs. Since the focus is retail, we see AML/CFT as critical. It has to be clearly spelled out who would take responsibility for the enforcement of Know Your Customer anti-money laundering regulations, and the designing of the data privacy governance may be challenging. Also, the strengthening of the soft infrastructure—regulation, supervision cybersecurity—over risk management is necessary.

Payment solutions depend on the central bank providing public goods of unit of accounts, finality of settlements, lender of last resort, and regulatory oversight. The technology used is ultimately secondary to the underlying economics. We would like to better understand the underlying economics behind ECCB's thinking and more insight into the underlying architecture for payments in the ECCU. In this specific case, it would be useful also to understand the expected impact on market structure and competition due to possible crowding-out effects. We therefore would appreciate if staff could take this into account for the forthcoming work on the CBDC and the Eastern Caribbean Currency Union.

Finally, we observe with interest that the authorities welcome Fund's TA on the governance and legal framework for fintech. Fintech is evolving and we do not have any best practices. We would be interested in what kind of advice staff will give the authorities. Thank you.

Mr. Merk made the following statement:

We concur with many of the report's recommendations but would like to voice two concerns, which have also been reflected in the statements of several other Directors.

In principle, we share the view expressed by Mr. Rosen and other Directors on the potential risks of a distributed ledger based central bank digital currency. CBDC is a challenging undertaking with risks associated to it, as Ms. Levonian explained and as well Mr. Rosen elaborated in his gray on it, so we would call as well for a very cautious approach. As well, alternatives could be explored.

Another point we would like to raise is related to staff's suggestion of regionally coordinating Citizenship by Investment programs (CBI). We take note that the program has been criticized on concerns pertaining to money laundering and the illicit flow of funds. Given that, staff should emphasize the necessity for transparency and adherence to strong AML/CFT frameworks.

Mr. Sylla made the following statement:

We all know that in the conduct of common monetary policy in that system you need to rely on a very strong statistical system, and you have alluded to that in your report in paragraph 31 where you are stating that the ECCB should continue to improve the area of statistics, and that was the only reference to that, so still I would raise that concern; how is the statistics system in this monetary union, mainly in the data compilation, related to monetary issues and the fiscal issues?

Ms. Mateus Ribeiro made the following statement:

We took good note that the Currency Union has served the Eastern Caribbean countries well. However, currency unions need to be well hinged on sound economic policies, including fiscal discipline, and warrant some form of stabilization mechanisms to compensate for lack of an autonomous exchange rate policy. This is more necessary in a context where economic cycles are not synchronized, and shocks can impact countries asymmetrically. In the Caribbean countries, so vulnerable to the impact of climate change-related phenomena, one example of asymmetric shocks can unfortunately be a natural disaster. Let me take this opportunity to also thank staff for clarifying these issues of asymmetries in their responses to technical questions.

Also, in this context, we reckon that stronger forms of fiscal integration, including some form of regional stabilization, would be beneficial for all. In this regard, we found the fiscal integration for the ECCU issue very interesting. We consider the establishment of national saving funds, as noted by Ms. Levonian's buff statement, by some authorities as a step in the right direction. Other national authorities could consider similar decisions with the ultimate goal of pooling scarce resources for the common good of stabilization. While we acknowledge the difficulties that the authorities expressed in advancing towards this path, a well thought and sequenced strategy could bring great benefits for all. We wish the authorities all the best in strengthening the currency union.

Mr. Fachada made the following statement:

When I was reviewing our gray statement prepared by my excellent senior advisor here behind me, I started editing all the references to ECCU member countries because I took for granted that it is a discussion on common policies of all ECCU member jurisdictions, including two British overseas territories that are not formally countries and are not IMF members. However, I noticed that the title of the staff report refers explicitly to common policies of member countries. So my question is perhaps to Legal. Are we discussing common policies to all eight ECCU member jurisdictions or just for six ECCU sovereign countries?

That said, we appreciate the focus of the consultation on fiscal and financial integration and on the efficiency and development of the payment system, which is an issue that we do not discuss very often here at the Board.

On fiscal, first let me commend the authorities of the ECCU members and the regional authorities for the progress over the last decade. The ECCU has in general better fiscal frameworks and lower public debt rate partly because of one-offs such as debt renegotiations, debt swaps, and other operations, but also because of better fiscal policies and fiscal consolidation efforts everywhere in the region and despite exogenous shocks, especially natural disasters.

I fully agree with the recommendation for better regional integration on Citizen by Investment revenues and on tax incentives, although I understand that the issue of tax incentives and the race to the bottom is perhaps not led by tax competition within the ECCU members, but by tax competition extra-ECCU. In other words, the race to the bottom may be triggered by competition between ECCU members and other countries in the Caribbean, Dominican Republic, Aruba, Bahamas, and others outside the ECCU. If this is true, there is not much that can be done without the Caribbean-wide approach. Maybe staff could further elaborate on this specific issue.

On the recommendation for a regional stabilization fund, I thank Ms. Munoz for the comments. We welcome the rationale, although the feasibility seems relatively limited in the short term. This is more a long-term issue. Even in monetary and economic areas that are much more mature than the ECCU, they have not made significant progress, and in this regard, I fully agree with the authorities that the idea has merits, but practical implementation would be extremely difficult in the short and medium term.

Finally, I appreciate the discussion about fintech and digital currency. I thank Ms. Levonian for her comments and fully take note that the authorities are taking cautious steps with the digital currency pilot project with special attention to implementation, risks, and mitigation policy, including on financial integrity and cybersecurity risks.

Mr. Ray made the following statement:

The Caribbean is one of those areas that we all know are highly susceptible to natural disasters. They are trying to build resilient infrastructure from climate change and also to maintain debt sustainability with a very limited resource base, so this is quite challenging. In that world, it is pretty important that you do not give away revenue, and that is the context for the recommendation that staff are making. I don't see it so much as about coordinating the tax base but just encouraging each member to do what is actually in their best interests, which is to get rid of these tax concessions that actually do not achieve anything other than giving money away. That is the way I think about that sort of exercise.

On the regional saving fund, I thought that was a really interesting idea because what it shows is that if you pool risk, you can actually reduce the cost of insurance, and that is a pretty good practical example, but I can understand why it might take the members of the union a long time to get there, so it is good that it is a long-term thing, but it is something to set the ball rolling.

Turning to the digital currency, I am worried that small island states are ones at the forefront of experimenting in this field, and I need to be cautious in this chair given my membership. But it does worry me, and it worries who is working with them at times. I would encourage the authorities to go very, very cautiously and to try and lever off as much support as possible in developing and innovating in this field, which is why we asked the question about whether or not staff might be willing to engage with the authorities in more detail, and I guess it is the reverse given the answer this afternoon, whether the authorities would be willing to work with the Fund. Given that I read both the authorities' views and Ms. Levonian's comments that the authorities are going to proceed down this path, at least for the time being, I wonder how we can encourage them to work and be as transparent as possible, because we all know who likes nontransparent transactions, and it is not the sorts of people you want in your financial system.

Lastly, I do worry about whether or not the authorities have thought about the potential implications for correspondent banking relationships of going down this digital currency route, and I would be interested in Ms. Levonian's thoughts on that and perhaps staff's. Thank you.

Mr. Buisse made the following statement:

We really liked the focus of this consultation on regional integration as a way to address the member countries' vulnerability and enhance resilience. Any progress on regional integration will take time, and that is why we appreciated staff's focus on a possible sequencing for deeper integration, which gives a more realistic approach to policy advice. We broadly support staff's conclusion, and I wish to emphasize three points.

First, I would like to insist on the importance of the tool to build resilience against natural disasters, more specifically regarding insurance instruments; and as the region remains underinsured, expanding the use of CAT bonds, for example, and hurricane clauses and new sovereign bond insurance could be useful. We understand that defining an optimal level of insurance is complicated and that insurance costs remain high for these small economies, but we encourage staff to continue to explore solutions to reduce these costs. We note, for example, that the World Bank has recently offered providing funding in the first two years to help countries lower disaster risk transfer premiums, such as for Jamaica. We also welcome the interesting working paper published a few weeks ago about the natural disaster insurance for sovereigns, which is especially enlightening in this regard.

Second, we thank staff for the written answers, but we remain interested to hear more about the income convergence process and the brain drain issues in the next review. Indeed, we note that convergence of incomes within the Caribbean Community (CARICOM) region is limited. Natural disasters play a major role to explain volatility in income variation, but other factors, such as limited interregional labor mobility of tax policies, could also play a significant role. The importance of brain drain in the region remains a critical issue as it impairs the capacity for the economy to grow, and the region is actually one of the largest recipients of remittances and is characterized by the strong loss of high-skilled workers.

Finally, we would reiterate our message regarding the importance of streamlining the pervasive use of tax incentives and preserve the financial integrity of the region's Citizenship by Investment scheme, especially through an appropriate AML/CFT framework.

The staff representative from the Western Hemisphere Department (Ms. Munoz), in response to further questions and comments from Executive Directors, made the following statement:

On what kind of TA can be given to central bank digital currencies and more generally in fintech, as apart from what I mentioned before that we will evaluate any TA request as it comes to the Fund in consultation with Legal and MCM and SPR, I wanted to say that because of the Bali Fintech Agenda, MCM and the other departments stand ready to discuss TA requests in light of the issues that they are inside of the agenda. These are broader as central bank digital currencies. We are also working on fintech. We will address each TA as it comes in consultation with all the departments that are involved.

On the necessity of emphasizing transparency on AML/CFT in the context also in the central bank digital currency, I wanted to mention that we mentioned that in paragraph 29 of the staff report, when we mention after the pilot the things that the authorities should focus, one of them is to strengthen cybersecurity and AML operations. So all the policies related to AML/CFT have to be very clearly stated and implemented before any subsequent steps that the authorities might do.

How the statistics are compiled on fiscal and also monetary in the region? As you know, because there is one central bank and there are differing authorities, some of the authorities, especially on the fiscal, obviously these statistics are collected at the national level, and then also the ECCB makes an effort to put it together at the ECCU level. It requires a lot of coordination from both sides. That is why also there are some delays in publication, as you know. In this context, Caribbean Regional Technical Assistance Centre (CARTAC) and the IMF have helped in this regard. As you know, we have an extensive program on the statistics in CARTAC in Barbados that are helping the authorities and the ECCB to coordinate these issues in an effort to be more agile and more precise with the data.

There was maybe a question for Legal, Mr. Fachada, whether we are discussing the policies of six or eight. What I can tell you from my side, and I will leave the Legal Department to answer that, is that when we do the ECCU consultation, because the eight countries are members, we visit the eight, and we speak to each of the prime ministers and the people we discussed, so we discuss with the prime ministers and the different policymakers in the country all the policies. As you know, there are some policies that are applied to the six only and not to the other two, because for budgetary they depend on the

UK. The other ones are independent fiscally. Not all the issues apply to them, but we discuss all the issues because they are regional and somehow they affect them. That is from our perspective, so when we talk here, if there is any draft that only has six and not eight, it is because we do not have the data. Otherwise, we try to put all the statistics of the eight. That is from my side.

On the question about tax competition and race to the bottom, whether it applies to the ECCU, we have evidence that there is competition in the ECCU. Apart from the competition with other members, there is tax competition between regions on CBI program. There is competition also internally, so that is why we are raising this issue here. There is a graph also in the report that shows how one country does any change in the conditions of the CBI programs, when the CBI's flows from the other country goes down, so it is quite automatic, I would say.

The staff representative from the Strategy, Policy, and Review Department (Ms. Goodman), in response to questions and comments from Executive Directors, made the following statement:

The IMF staff holds bilateral Article IV discussions with individual members. The staff holds separate annual discussions with the regional institutions in the case of a currency union, as in this case. Those discussions are of the common policies that apply to all of the members of the ECCU, so in this case, the eight countries. This is a regional discussion of the common policies that apply and common issues that apply to the eight members. But in terms of individual Article IV consultations with individual bilateral members, that would be with the six.

Ms. Levonian made the following concluding statement:

I have already discussed the ECCB digital currency issue, but I just want to say two things about it. One, authorities are very keen to have the Fund establish a view on CBDCs, as well as position itself to be able to provide members with advice on digital currencies.

On CBRs, I just want to mention that the authorities have thought about this, and they have engaged with correspondent banking banks and are continuing to have a dialogue on this particular issue, so they are very aware and cognizant and want to ensure what they do is not going to cause any issues there.

While the ECCU authorities are taking deliberate and appropriate steps to advance their economic agenda, these efforts need to be deepened and accelerated to tackle the plethora of challenges confronting the region. The report and gray statements have clearly spelled out these challenges, including weak growth, fiscal and debt challenges, sizeable external imbalances, and financial sector vulnerabilities, which are further exacerbated by large external shocks, including from frequent and intense natural disasters. It is clear to address these challenges the region needs a well-articulated and sequenced strategy that is pursued with tenacity and swiftness. I am going to mention five things.

First, on leveraging regional integration, I think that further dialogue with the authorities on how these policies could be advanced would be helpful, taking into consideration the concerns that they have raised, including dissimilar domestic circumstances. So on harmonizing tax incentives, for example, while staff's analysis presents a strong case, this recommendation is not new and has not gained traction with the authorities. Staff's support in helping to make a more compelling argument would be helpful.

Second, on central bank governance, I take note of Directors' call for strengthening the governance of the ECCB and will relay this to our authorities. That said, our authorities view the current governance framework as appropriate and adequate in the ECCU context and one that has served the region well.

Third, Directors have noted that there is scope for our authorities to create fiscal space to support fiscal and debt sustainability through greater revenue mobilization, including by leveraging regional synergies and by increasing the efficiency of spending. Our authorities agree but emphasize that there is very little wiggle room in the face of huge development needs, including to build climate resilience infrastructure, which is something that has been advocated at this Board in terms of building resilience to shocks.

Fourth, the need for continued support to build ex ante resilience to natural disasters in climate change in the region and elsewhere. I think Directors were almost unanimous in calls for the Fund and other development partners to remain actively engaged in this issue. Our authorities are highly appreciative of recent efforts to help countries build ex ante resilience to natural disasters, and they look forward to continued assistance in this regard.

Finally, I note the strong call for more determined progress on financial sector issues. As highlighted in our buff, our authorities are cognizant of the many risks and challenges and are pursuing an ambitious reform agenda to boost financial sector stability and integrity, inclusive of efforts to mitigate the risk of further loss of correspondent banking relationships. They believe it is important to reiterate the inherent challenges in coordinating reforms across various sovereign states with dissimilar domestic circumstances, including capacity, and the need to be pragmatic about the pace of financial sector reforms. They thank the Fund for the past support in financial sector strengthening and look forward to continued strong engagement going forward.

In closing, let me once again thank colleagues for their constructive comments in the gray statements and the points raised today. I want to again thank staff. Thank you very much.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. While welcoming the ECCU's improved growth performance and public debt reduction in recent years, Directors noted that growth is expected to moderate going forward. In this context, achieving debt sustainability while building resilience to natural disasters would remain challenging for most ECCU countries. To help ensure strong and resilient growth and anchor sustainability in the region, Directors called for further fiscal consolidation, expedited structural reforms, and a speedy resolution of financial sector vulnerabilities. They underscored the importance of regional integration in complementing national policies to achieve those objectives.

Directors welcomed ongoing efforts in some ECCU countries to advance their fiscal responsibility frameworks and underpin the commitment to meet the 2030 regional debt target. They emphasized the importance of countercyclical policies to create space for building resilience to natural disasters, which would be supported by comprehensive Disaster Resilience Strategies that are currently being piloted in Dominica and Grenada.

Directors underscored the importance of fiscal integration and suggested enhanced cooperation in the design of tax incentives and the Citizenship-by-Investment programs. Such efforts would not only improve governance and limit a "race to the bottom", but they could also create additional fiscal space. They added that, over the longer term, a regional stabilization fund—underpinned by a strong governance framework—could also be considered.

Directors commended the ECCB for advancing essential regional financial sector reforms and called for accelerating the progress to address financial system vulnerabilities within a well-sequenced plan. Immediate efforts should focus on repairing bank balance sheets and operationalizing the new standard for impaired assets, modernizing insolvency frameworks and reviewing governance frameworks for the ECCB and deposit-taking institutions. Equally important is expediting the efforts to strengthen the supervision of non-banks, given their growing systemic importance. Directors also urged the national authorities to expeditiously pass critical legislation, particularly for strengthening AML/CFT measures, which are particularly relevant given sustained pressures on correspondent banking relations.

Directors noted that once the critical near-term priorities are addressed along with credible fiscal backstopping, steps toward a fuller banking union could take place in the long term. Such steps should include a robust deposit insurance scheme and a regional resolution and crisis management framework.

Directors highlighted the scope for the ECCB, national authorities, and financial institutions to further modernize the payment system to strengthen the monetary union. They pointed to the ongoing review of the legal framework for the payment system as being critical to facilitate emerging Fintech and nonbank e-payment services to operate and innovate.

While welcoming the authorities' pursuit for more financial innovation, Directors recommended that the ECCB's digital currency pilot project should proceed with caution. In particular, they advised that the authorities fully implement safeguard measures to contain various risks, including those related to financial intermediation, financial integrity, and cybersecurity. After the pilot, a cost and benefit analysis of the digital currency would be useful coupled with consideration of other alternatives focusing on upgrading the payment systems.

Directors encouraged the authorities' continued pursuance of structural reforms to boost private sector-led growth and ensure external sustainability.

Directors agreed that the views they expressed today will form part of the Article IV consultation discussions with individual ECCU members. It is expected that the next common policies consultation with the ECCU will be held on the standard 12-month cycle.

APPROVAL: January 19, 2022

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Integration

1. ***Given the proximity, risks arising from natural calamities, CBI revenue uncertainty, tourism, and global financial shock may be fairly correlated across the economies. Studies show that ECCU countries are structurally similar and more likely to be subject to symmetric shocks[1]. Under such a scenario, how far the regional risk sharing by way of regional stabilization fund created by the pooling of resources would be effective***?

- We agree with Directors' observations in terms of similarities of economic structures across ECCU economies, and significant exposure to regional shocks affecting countries simultaneously. The referenced paper provides evidence in this direction, and so does the SIP attached to the staff report that shows government expenditure has been procyclical for the regional aggregate, indicating countries' cycles show positive correlation. However, this correlation is partial (which is confirmed by the results of the referenced paper, particularly if the correlation is evaluated at shorter horizons), providing room for efficiency gains which are the source of the gains estimated by staff.
- Significant asymmetries remain across islands that explain the estimated saving from risk pooling. For example, natural disasters are unlikely to hit all islands in the same year. Dependency on tourism varies across countries, not only in their contribution to GDP but also in terms of the niche market they target, including, for example, the type of tourism they offer (low end, high end or luxury), the country of origin of tourists, and the type of activities/experience they offer. The relative size of economic sectors also varies across islands (for example, Dominica has a relatively large agriculture sector, while St. Kitts and Nevis has a relatively more important manufacturing sector). There is also differentiation both in terms of the potential of CBI inflows and the reliance on them (for example, St. Vincent and the Grenadines does not have a CBI program, while Dominica has recently received record-high revenue), and the targeted markets have differences. Financial sectors also show some similar trends, but idiosyncratic differences remain, especially given the varying importance of non-bank credit institutions (especially credit unions), different degrees of integration with global financial markets, and influence of government credit crowding-out (i.e. St. Lucia is more reliant on domestic credit than other islands).

2. ***The size and ability of the individual economy within the union varies significantly. Would it be warranted and possible to achieve the same level of fiscal discipline and debt benchmark? It may be recognised that given the currency union, the adjustment may solely be needed through fiscal efforts.***

- We agree that there is heterogeneity in the ECCU countries' fiscal capacity and other characteristics—against the background of the common public debt target for 2030— and that in a currency union fiscal policy is a dominant policy tool. As discussed in the 2018 ECCU Article IV Common policies consultation, the heterogeneity entails finding a right balance between common and country-specific fiscal benchmarks. For example, the same consultation recommended that the ECCU countries retain the common 60 percent of GDP public debt benchmark as a ceiling, but envisioned lower country-specific targets tailored to the individual country characteristics, particularly their susceptibility to shocks.

3. ***We encourage the authorities in the region to coordinate on tax policies, while taking note of some authorities' concerns on practical difficulties to enforce coordination among sovereign countries. Could staff elaborate more on possible measures to address their concern? In addition, taking into account the substitution effect between ECCU and other regions, could staff provide more information regarding the potential impact of increasing regional tax on the FDI inflows to ECCU?***

- While we recognize the mentioned practical difficulties as a key bottleneck that has hindered implementation so far, we feel that in the near future there will be two important "game-changers" that may improve the countries' incentives to coordinate: (i) a serious push for global minimum taxes by the advanced countries, which will likely reduce the impact of tax incentives on investment decisions; and (ii) greater awareness within the ECCU of the need to create fiscal space to address climate change risks both at national and regional levels. We feel that in this new environment, coordination on tax incentives will have a greater chance of success, particularly as regional coordination has received a recent boost with respect to CBI revenues and preparedness/response to natural disasters.
- With respect the potential impact of a tax on FDI inflows, our regression analysis in the SIP – which de-facto internalizes the mentioned substitution effect -- suggests that tax incentives do not have a material effect on FDI (and there is significant empirical literature which suggests that other factors, such as the business climate, the quality of infrastructure, and policy certainty, are often more relevant for investment decisions that tax incentives). At an anecdotal level, the recent rationalization of tax incentives in Grenada in 2016 has not been followed by a decline in FDI flows in 2017-18, but this stylized fact needs to be taken with caution as many other factors were at play.

FDI to GDP ratio in Grenada

2014	2015	2016		2017	2018
10.7	13.5	9.1		12.4	12.8

4. ***Further, we agree that there are potential benefits in a regional stabilization fund in the long-term. However, like the authorities, we wonder how practical the***

implementation of such a fund is, especially given member states' substantial differences in fiscal positions and economic fundamentals.

- There are indeed operational issues in the implementation of a RSF that relate to incentives for participation, notably given the differences in fiscal position and economic fundamentals. The authorities were in general supportive of a regional saving fund, but some expressed concerns about participation given fiscal sustainability challenges that could undermine the member countries' ability to make saving contributions under adverse economic circumstances. Staff noted this concern and clarified that this is a long-term recommendation and progress toward the achievement of the 2030 public debt target will smooth some of the differences in the countries' fiscal positions, thereby facilitating the RSF's implementation. Moreover, a well-designed regional fund would provide positive incentives for participation and support fiscal sustainability. First, the multi-country arrangement can act as a commitment device, especially in terms of enforcing saving withdrawal rules—members would have incentives to scrutinize qualification requirements for withdrawal. Second, risk pooling implies access to the same financing potential with about ½ the saving requirement, alleviating one of the constraints to participation related to the opportunity cost of a saving fund (i.e. in terms of reducing public debt and interest cost, or in terms of development or infrastructure investment). Third, the RSF can complement national saving funds for self-insurance against natural disasters at a lower cost than other insurance alternatives such as CCRIF or CAT bonds.

5. ***We found the detailed work on the SIP interesting and consider regional integration as a useful mean to share risks and improve cross-border labor mobility. However, we would have welcomed some elements about the convergence process of income levels, as well as the potentials gains associated to further regional integration and recommendations in this area. Some elements from a recent IMF WP[1] could have been integrated, as it provides interesting analysis, by pointed the "slower convergence of incomes and the widening gap between the lowest and highest income brackets across the region highlight the need to ensure the region benefits from integration as a group."***

- Staff integrated some of the analysis in the referenced working paper, for example, by including the chart on page 10 of the SR that shows insufficient income convergence (high variation of per capita GDP) as an illustration of the remaining gap in economic integration in the ECCU. The Working Paper is focused on the broader Caribbean region, not just the ECCU—for the latter, the conclusion about lack of convergence is less clear-cut, because of the smaller number of observations and perceptible data volatility. In this context, we feel that for the ECCU, natural disasters and other large external shocks are a key factor behind the volatility of income variation, which justifies our focus on the analysis of policies that can mitigate such shocks.

6. ***We note from the Buff statement that a small regional "rainy day" fund exists, and we would be interested, as the authorities, to know how staff integrated it in its analysis and how it could be enhanced.***

- The "rainy day" facility operates as a revolving fund financed from a portion of ECCB profits. It provides loans and, to a lesser extent, grants, under substantial discretion of ECCB's Monetary Council. The fund is indeed very small: the *maximum* amount of access by a given country is around USD2.5 million, or 0.2 percent of GDP of an average ECCU country, with feasible annual amounts of support being a fraction of that.
- This fund has not been integrated into the analysis of the SIP because it does not meet the "macro-relevance" test under the current source of funding: the amounts are not sufficient to meaningfully address the policy procyclicality problem that was diagnosed in staff's analysis. However, scaling up the facility to address macro-relevant issues would be challenging. If the increase in funding is supported by the ECCB balance sheet, or is loan-financed, it would undermine the quasi-currency board. Grant financing would be difficult to raise in significant amounts' let alone on a sustained basis, given the competing priority of raising such financing by member governments for building resilience. In this context, fiscal resources appear to us the only sustainable and macro-relevant source of funding, as envisioned in the SIP.

7. ***Finally, does staff have any recommendation regarding the improvement of the progressivity of the tax system in the region?***

- The tax systems—and the case for its progressivity—in the region vary by country. Generally, Fund staff (mainly through FAD TA) concludes that the tax systems in most ECCU countries have become more progressive over time but recommends further moderate increases in progressivity.
- Examples include advice on the PIT in Grenada (introducing child tax credit), design of the new carbon tax in St. Lucia (calibrated to impact higher income households), as well as changes in property taxation in Antigua and Barbuda.

8. ***Therefore, as part of efforts to ensure greater fiscal integration, we encourage the authorities to streamline individual countries tax incentives and work to consolidate them under a formal regional agreement. That said, we take note of the authorities' concerns on harmonizing tax incentives among sovereigns facing different domestic circumstances. Could staff elaborate on how they see the streamlining of tax incentives under these circumstances.***

- We agree that the process could start from better national fiscal policy, which would prompt countries to realize that streamlining some inefficient incentives would be in their economies' self-interest (including because of minimum global taxation): in terms of creating fiscal space for essential spending and providing sustainable support to FDI through better infrastructure. For example, investment incentives appear to be substantially more effective in favoring investment than tax holidays. Such analysis could extend to the regional level, whereby there would be more clarity and consensus regarding which regional sectors benefit from tax competition and in what sectors it is harmful. Harmonization would be a final step that would aim to codify and realize the benefits of limiting harmful competition for all countries based on the best technical expertise.

9. ***We note that the ECCU authorities stressed resource constraints and other challenges impeding the RSF establishment. Could staff further comment on how to overcome these obstacles?***
10. ***The authorities' initiatives to build national savings funds and regional "rainy day" funds at the ECCB are steps in the right direction towards building the RSF. Given this development, can staff comment on how to effectively address the authorities' concerns about the practical implementation of the RSF?***
11. ***As made evident in the insightful SIP, such RSF can carry positive implications for private investment, employment, output and wages. Can staff elaborate on the diversity of policy views and fiscal sustainability challenges that may hamper the implementation of such fund? Moreover, staff's comments on possible external financing of the initial capital of the fund will be appreciated.***

- Some governments agreed with the benefits of a regional saving fund and expressed their support but explained fiscal constraints could impede their ability to participate, which would depend on donor grant financing. The main recommendation to address this obstacle has been to address fiscal sustainability challenges in each country, discussed during the individual Article IV consultations and usually followed by technical assistance. In addition, during the 2018 ECCU consultation staff also discussed institutional arrangements to enhance fiscal sustainability, including specific fiscal rules with minimum common targets to be adopted by all ECCU countries—including to support achievement of the regional public debt ceiling of 60 percent of GDP by 2030 agreed at the ECCB Monetary Council. The Fund has provided technical support on the preparation of DSAs to support this process.
- A regional saving fund is an instrument to strengthen fiscal sustainability, as opposed to becoming an additional burden. For example, a regional saving fund would be a cost-effective instrument to finance rehabilitation expenditure after natural disasters, which in the ECCU are recurrent and would otherwise require additional debt issuance or more costly alternatives such as market insurance. The resource constraint could be potentially alleviated with the help of CBI inflows. We note that the RSF proposal is underpinned by fiscal saving during revenue booms, when the resource constraint is less binding.
- Implementation of a RSF will require a strong institutional arrangement and governance framework, with high transparency standards.
- Staff's view is that the initial capital of the RSF needs to be financed from fiscal resources. External financing could contribute, but any debt operations need to be intermediated through the countries' sovereign borrowing. For countries with CBI, staff

recommends financing of the initial capital with CBI resources, which underpin significant government deposits in ECCU countries—at end-2018, three countries had government deposits of around 10 percent of GDP or more that largely reflected the accumulated CBI inflows. Countries would also be required to contribute annual savings to make the RSF financially sustainable, as explained in the SIP. Those countries unable or unwilling to use deposits for start-up financing could start with annual saving contributions to build up the stock gradually, and accrue access to funding to the RSF commensurately, as savings accumulate over time.

12. ***Noting the authorities' scepticism with regard to a regional stabilisation fund, do staff have views on alternatives that might be effective, without the need for complex new institutional arrangements, for example collective fiscal action or new financial instruments at the regional level?***

- One alternative on the financing side is to enhance the operations of the Regional Government Securities Market, especially with development of an active secondary market that would improve the liquidity of domestic (regional) government bonds and increase their demand and/or reduce the interest cost. Improvement of the auction mechanism could also contribute to reduce interest rates on government bonds—Fund TA has been provided to that effect. We note, however, that access to markets would typically not be immediately available and more costly after a disaster, so this would be a second-best strategy relative to the RSF.
- While understating the institutional complexities, staff and the authorities agreed on the potential benefits of a regional saving fund in the long term. Authorities' concerns relate to participation incentives considering fiscal challenges in some ECCU countries. Staff is of the view that a regional saving fund could be designed to address these challenges, along with medium-term fiscal sustainability frameworks to reach the regional debt target, aided by fiscal rules –discussed in the 2018 ECCU regional consultation. For example, a regional saving fund could keep track of the net asset position of each contributing country, thereby explicitly addressing property rights and allowing imposition on a net-liability ceiling.

13. ***In general, fiscal integration in the ECCU has lagged monetary integration, but we hope that the ECCU members will continue to strive to meet the regional debt-to-GDP benchmark. Could staff please comment on the capacity of the Union to enforce its edicts on individual members?***

- ECCU members (with the caveat that there are two British Overseas Territories) enjoy sovereignty. Therefore, enforcement powers are limited to those signed within intergovernmental agreements, whereby each participating government confirms that it has accepted the agreement in accordance with its laws and has taken all steps necessary to enable the agreement.

Financial Stability and Integration

14. ***We support the call to repair bank's balance sheets, including via sales to the Eastern Caribbean Asset Management Company (ECAMC) and look forward to the implementation of the new treatment of impaired assets standards by January 2020, as planned. Can staff advise whether there has been any progress on this front?***

- The ECAMC has signed Letters of Intent from several approved financial institutions (including banks), however it has not yet acquired any non-performing loans (NPLs) as no financing arrangements have yet been settled. The proposed CDB funding arrangement to finance the ECAMC's acquisition, management and disposal of NPLs requires direct borrowing or guarantee by the respective governments in relation to NPLs for their individual jurisdictions. This has been communicated directly to the ECCU member governments and the ECAMC is awaiting the relevant confirmations.
- The treatment of impaired assets standard is expected in January 2020; the mission team will continue to follow-up in this regard.

15. ***We note that the authorities do not support phasing out the ECCU minimum saving deposit rate at this time whereas Staff recommended it. Could staff explain more precisely the difference of views on this matter and develop the advantages and drawbacks of a phasing out?***

- The authorities noted staff's view with regards the distortionary nature in credit markets of the minimum saving rate (MSR) and some governments agreed with its elimination. ECCB authorities and some government officials explained the MSR was important for social reasons, notably as a source of additional income for relatively low-income households and to stimulate saving. Staff noted its social importance and the fact that large numbers of individuals hold MSR accounts, but also explained that social support could be provided more efficiently with well-targeted government transfer programs. Staff also argued that the MSR reduces the scope for reducing NPLs by increasing banks' cost and thereby lowering profit capitalization. It also sets a high floor on bank lending rates, reducing lending. ECCB authorities explained they would be willing to consider elimination of the MSR at a later stage, within a broader reform that includes deposit insurance.

16. ***We are also concerned about the declining trend in correspondent banking relationships and encourage the ECCU authorities to press ahead with addressing the drivers of this negative development. Could staff comment on the immediate priorities as well as on how the IMF can help the authorities to reverse this trend?***

- The ECCU authorities have been implementing a number of measures to address the negative developments in the area of CBRs. As part of the strategies, the ECCU authorities have been closely monitoring CBRs, but they have been constrained by banks' data availability. Efforts should continue to ensure banks have accessible and readily usable data and capacity for their own internal transaction monitoring. Moreover, the ECCB should further strengthen is own monitoring capacity. The IMF is supporting these efforts through TA by CARTAC and MCM. In addition, the authorities have been intensifying information sharing and communication with correspondent banks, strengthening the AML/CFT regulatory and supervisory frameworks as well as consolidating AML/CFT supervision at the ECCB level.

- The immediate priorities for addressing this risk include (i) the passage by all ECCU member countries of legislation and implementation of frameworks approved by the Monetary Council for strengthening AML/CFT and international taxation regimes and continued strong cooperation to address any further frameworks enhancements necessary; (ii) continued close monitoring and oversight of the risk, targeting improved reporting by banks based on IMF TA to support implementation of the IMF CBR monitoring tool; and importantly (iii) continued engagement with and support from the international community to help contain the risk.
- Staff continues to follow a multipronged approach to support its member countries by providing policy advice; leveraging its convening powers to discuss how to ease CBR pressures with the industry and regulators; monitoring risks; building capacity to strengthen the legal, regulatory and supervisory frameworks; and actively coordinating with other relevant stakeholders. Staff is ready to consider capacity development to further strengthen AML/CFT supervision at the regional level.

17. ***Banks are raising portfolio investment abroad to offset low profitability of domestic operations. In this regard, it would be useful if staff could indicate what are the banking regulations regarding portfolio investment by ECCU institutions and if banks expanding their portfolio investments abroad comply with regulations.***

- The banking laws set various prudential limits on exposures to individual and groups of counterparties relative to capital. These include, for example, section 53 which provides that (except with the approval of the Central Bank) a licensed financial institution's holdings of shares should not exceed (i) 10 per cent of its capital base in the case of shares in an individual company; nor (ii) sixty per cent of its capital base for its aggregate holdings of shares.

18. ***Are there any profitability indicators available for the credit union sector?***

- Currently, there are no publicly available profitability indicators for the credit union sector. Typically, statistics published by the member countries' respective credit union leagues and the Caribbean Confederation of Credit Unions cover membership and select balance sheet aggregates (e.g. assets, loans, reserves, deposits). The CCCU's 2018 annual report and the ECCB's 2018 annual financial stability report also provide some information on the sector's non-performing loans.

19. ***For this reason, although we agree with the staff's recommendation to introduce a financial reform agenda with clear priorities and a clearly defined sequence of short and medium-term actions, we wonder if such a comprehensive plan should follow a narrow set of measures to address immediate problems with managing non-performing loans, raising provisioning, and upgrading AML/CFT oversight frameworks. Staff comments are welcome.***

- Staff agrees with this position and notes that the sequencing requires that critical near-term priorities are addressed before steps are taken to move towards a fuller banking union. These critical priorities include repairing bank balance sheets with accelerated measures to reduce NPLs; increasing provisioning (through prompt implementation of the treatment of impaired assets standard) and capital where required; modernizing insolvency frameworks; expediting passage of legislation and implementation of upgraded AML/CFT oversight frameworks; and strengthening the monitoring and management of market and operational risks.

20. ***To this end, can staff clarify the Fund's work to enhance the role of the international community in containing the risks of further loss of CBRs to further augment the member countries' efforts?***

- Addressing the withdrawal of CBRs requires a coordinated and collective efforts on the part of public and private stakeholders. The role of the Fund and the international community in addressing CBRs pressures has also proved to be critical. The Fund collaborates on an ongoing basis with the Financial Stability Board (FSB) (i.e. including by co-chairing the FSB working group on capacity building), World Bank, G20, Financial Action Task Force (FATF), the Arab Monetary Fund, the Committee on Payments and Market Infrastructures (CPMI), among others, to identify the scale and drivers, assess the impact of the withdrawal of CBRs and facilitate international dialogue to develop coordinated policy responses. Efforts continue to be underway to ensure a coordinated approach by the international community.

Central Bank Digital Currency

21. ***Lastly, with low adoption of new technologies across the financial sector, would experiment with digital currency be successful?***

- For the pilot, the ECCB has selected only 15 financial institutions, which in the ECCB's judgement, have technical and operational capacity to participate in the pilot. In addition, for the pilot, the digital currency system is designed as "stand alone," not linked to the ECCB's and financial institutions' operating systems.
- This, however, implies that there would be many hurdles to overcome before expanding the scope of the digital currency system — e.g., allowing a larger number of

financial institutions to participate and connecting the digital currency system to the other payment and operating system at the ECCB and financial institutions. One of the key challenges would be strengthening cybersecurity operation at the ECCB and financial institutions.

22. The various risks of the digital currency, including for financial intermediation, financial integrity, and cybersecurity should be carefully assessed. *We wonder if staff has the willingness to or can join the ECCB's pilot review. It could be beneficial for the ECCU as well as for the international community. Any comments are welcome.*

- Staff will respond to this question during the Board meeting.

23. Can staff comment on the bottlenecks to developing non-bank e-payment services in the ECCU and provide an assessment of whether CBDC will offer a cost or financial access advantage over more traditional forms of electronic payments, including mobile banking?

- The bottlenecks to developing non-bank e-payment services include: (i) the lack of economies of scale with a population averaging less than 0.1 million in each ECCU member economy; and (ii) the absence of a legal and regulatory framework specially for mobile payment services.
- Non-bank financial services are mainly regulated by national authorities, which would also add to costs of doing business. For example, to increase economies of scale, a non-bank e-payment service provider wants to operate not only in one specific country but in the whole ECCU region. To this end, however, the business needs to require licensing from each of ECCU member authorities, which is quite challenging, especially because there is no specific legal and regulatory framework for mobile payment services.
- A cost and benefit analysis is not readily available, in part because it requires significant data availability. Accordingly, we encouraged the authorities to conduct a comprehensive cost and benefit analysis of the digital currency system, fully incorporating both direct costs (e.g., costs of developing the digital currency system) and indirect costs (e.g., cyber security costs, maintenance costs), which would be borne by all stakeholders (including the ECCB, financial institutions, merchants, and business and individual users).

24. While staff mentions the risks of (central bank) digital currencies (e.g. for financial integrity and cybersecurity), staff's findings do not assure that the regulatory and oversight frameworks to identify and address these risks are currently in place. *Staff's comments are welcome.*

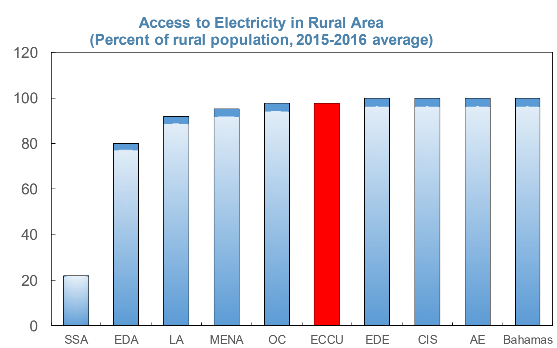
- The ECCB is planning to conduct the pilot in a tightly controlled environment with a limited number of participants. The ECCB's primary focus is to test the feasibility of issuing its digital currency, evaluate user demand, and assess operational challenges and risks. They have yet to focus on the needed regulatory and supervisory reforms, in part because there is no certainty that the ECCB will formally introduce its digital currency. This said, as discussed in the staff report, staff stressed that reviewing the regulatory and supervisory frameworks would be one of the prerequisites for the ECCB to adopt the digital currency.

25. *Could staff explain whether any international financial institutions is providing the ECCB with specific advice and technical assistance related to this pilot project?*

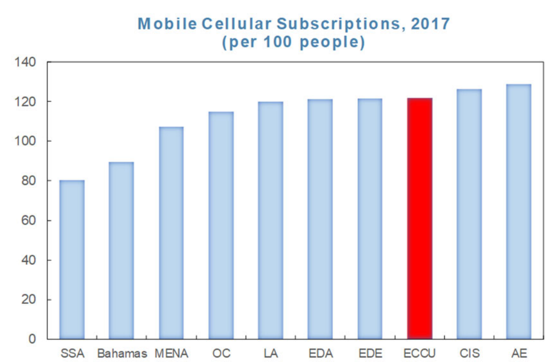
- The ECCB is informally communicating with other central banks, which are currently studying or exploring the feasibility of central bank digital currency.

26. We are encouraged to learn from the Buff statement that the digital version of the EC dollar is well-positioned to become the world's first central bank digital currency. *Could staff further elaborate whether the ECCB is being assisted by any IFOs or developmental partners in this endeavor, and whether there are any infrastructural bottlenecks which might affect the progress?*

- The ECCB is informally communicating with other central banks, which are currently studying or exploring the feasibility of central bank digital currency.
- Infrastructure appears to be adequate, which the authorities have confirmed. For example, the electrification rate is nearly 100 percent even in the rural area, and mobile cellular subscription rate is about 120 per 100 people. Rather, key challenges would be strengthening "soft infrastructure," including regulation and supervision, cybersecurity, overall risk management.



Sources: World Bank WDI
Note. Other Caribbean (OC) includes Dominican Rep. and Trinidad and Tobago.



Sources: World Bank WDI
Note. Other Caribbean (OC) includes Dominican Rep. and Trinidad and Tobago.

27. In this regard, we wonder what the right sequencing and prioritization of improving the existing payment system and advancing the digital currency could be in light of relatively limited capacities of the member countries, and welcome staff's views.

- After the pilot, the authorities will review its results. We are also encouraging the authorities to conduct a comprehensive cost and benefit analysis of the digital currency, in comparison with other options. Based on the findings, the authorities could develop a strategic payment modernization plan in the ECCU.

- Meanwhile, the authorities need to complete the ongoing review of the legal and regulatory framework for the payment system, with a view to allowing emerging Fintech and nonbank e-payment services to operate and innovate. They also need to seek options to integrate credit unions in the payment systems to enhance competition.

28. We would be interested in staff's comments whether the cost of technology is the only impediment to the utilization of electronic payments as well as mobile payments, which remain limited. If technology is available but underutilized, this could also apply to the use of the digital currency.

- In addition to cost factors, a relatively strong cultural preference for cash would also matter. This reflects various reasons, including convenience, acceptability, and anonymity.
- The pilot is expected to provide the opportunity for the ECCB to analyze to what extent people would prefer digital currency to other payment instruments, including cash.

29. Could staff indicate whether similar pilot projects have been undertaken within the Fund membership and what lessons could be applicable to the ECCU, including as they relate to the strengthening of cybersecurity and AML/CFT operations?

- Several countries (both advanced and emerging and developing economies) are actively exploring the issuance of a CBDC, some of which have already launched. Most recently, Bahamas rolled out the first phase of its CBDC pilot in December 2019. Other countries that are anticipating launching a digital currency include China and Cambodia. Finally, some countries have considered and/or launched a CBDC and ultimately abandoned the idea (e.g., the Ecuadorian dinero electrónico, launched in 2015 and subsequently deactivated).
- It is too early to derive meaningful lessons from ongoing pilots. Countries wishing to embark on similar pilot projects should remain vigilant to the risks, in particular, the cybersecurity and the ML/TF risks and ensure that they have conducted, as a first step, the necessary research to ensure a proper understanding of these risks. [placeholder for cybersecurity risks] Countries should ensure that they implement appropriate AML/CFT measures to mitigate the risks identified. This notably entails ensuring that AML/CFT preventive measures (including customer due diligence measures) are adequately implemented, that compliance with AML/CFT requirements is monitored, and that ML/TF activities are adequately investigated and sanctioned.

30. As stressed by staff, the ECCB plans to test the digital currency in a controlled environment. Do staff have an estimate of what the preliminary limit for holdings of and transactions with the digital currency might be, and how the regulation will be enforced?

- The authorities have yet to finalize the limit for holing and transaction value. Our understanding is that the limits would be embedded in the system design.

Structural Reforms

31. How much do staff estimate potential growth can be raised if key structural reforms such as improving the climate for doing business, improving public sector efficiency and advancing labor market reforms are implemented?

- Staff has estimated potential growth of ECCU countries in the context of the 2016 Regional Consultation. It was based on a growth accounting exercise that incorporates the impact of natural disasters, which reduce the capital stock and the productivity of infrastructure, and also accounts for labor migration of skilled and unskilled workers. Results indicate low potential growth, in the range of 1.5-2.5 percent. The most recent empirical analysis was performed in 2017 and published in the book "Unleashing Growth and Strengthening Resilience in the Caribbean." The results vary by country and should be interpreted as very long-term effects. Improving business climate to the top decile of small states is estimated to increase growth in the ECCU on average by about 0.5 percentage point per year – this indicator should be interpreted as a combined effect of labor market and other ease-of-doing-business reforms. Reducing public sector debt, which may be a proxy of government efficiency, would contribute another 0.3 percentage point. Improving crime and human capital, which are related to government efficiency, would add 0.3 and 0.2 percentage point, respectively.

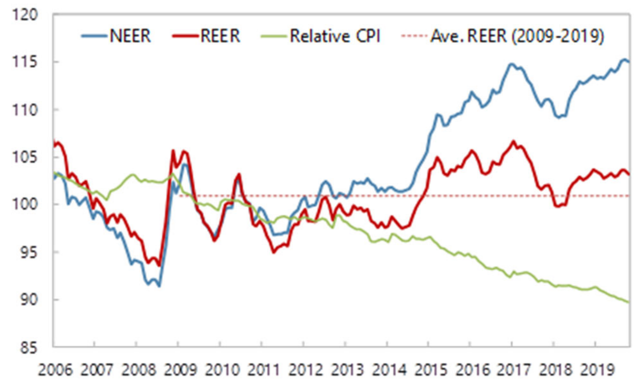
32. We also take note of the overvaluation of the exchange rates of around 9 percent in 2018. We wonder whether the labor market in this region is flexible enough to allow for wage adjustments to offset currency overvaluation. *Could staff comment on the impact of the currency's overvaluation on the region's price level, real interest rate, bank asset quality as well as financial stability?*

- The extent of regulated labor market flexibility in the ECCU varies by country and, in some cases, there are rigidities that can affect employment. Unemployment is reportedly high, around 20 percent in several jurisdictions, but staff analysis is limited because of the lack of data on unemployment.
- Currency overvaluation is one of the factors possibly related to high unemployment in the region. An additional factor is the relatively high public sector wage, often above market level for similar skill and/or productivity—typically public sector salaries are second only to the financial sector.
- Unrestricted labor mobility across ECCU countries, as part of an integrated regional labor market, helps mitigate idiosyncratic shocks, while international labor migration supports accommodation of regional shocks. The OECS is working on initiatives to improve labor mobility and facilitate employment. This said, labor out-migration sets a floor on

ECCU wages because domestic firms need to compete with international wages, especially to attract skilled workers.

- Currency overvaluation also affects competitiveness of key sectors with comparative advantage, especially tourism, undermining investment and growth prospects—vacation cost in the Caribbean is among the highest in the world, as measured by the Week at the Beach index produced by WHD staff, despite significant tax exemptions often granted to tourism investment.
- Currency overvaluation implies high relative price of non-traded goods and services, and results in inflation remaining below international levels in some ECCU countries. Domestic prices have shown some downward flexibility. Over the past decade, the relative price index in the ECCU has continued to fall. This has helped offset the part of nominal exchange rate appreciation, moderating the real exchange rate overvaluation.

ECCU: Effective Exchange Rates
(2010 = 100)



Sources: IMF Information Notice System

- Available data suggests no significant exchange rate premium affecting interest rates, despite the currency overvaluation estimate. The impact of exchange rate overvaluation on interest rates appears limited, especially considering excess liquidity in bank and on-bank financial sectors, and low spreads in primary government bond auctions in the Regional Government Securities Market (which capture also sovereign risk and liquidity premia) vis-à-vis risk-free international interest rate benchmarks. It may, however, undermine bank asset quality and financial stability because it increases loan collateral valuation, undermining financial institutions ability to sell collateral (or increasing asset loss) and thereby reducing prospects of NPL reduction, and by reducing incentives for capital injection.