

## **Eastern Caribbean Currency Union: 2006 Regional Discussions—Staff Report; and Public Information Notice on the Executive Board Discussion on the Eastern Caribbean Currency Union**

This staff report on discussions with regional institutions for the Eastern Caribbean Currency Union (ECCU) was prepared by a staff team of the International Monetary Fund in the context of the periodic regional surveillance on the ECCU. The regional perspective of such discussions is intended to strengthen the bilateral discussions that the IMF holds with members in the region under Article IV of the IMF's Articles of Agreement. The following documents have been released and are included in this package:

- the staff report for the 2006 Regional Surveillance, prepared by a staff team of the IMF, following discussions that ended on October 19, 2006, with the officials of the ECCU regional institutions on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 21, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF; and
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 17, 2007 discussion of the staff report that concluded the discussion of regional surveillance.

The document listed below has been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

EASTERN CARIBBEAN CURRENCY UNION

**Staff Report for the 2006 Regional Discussions**

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by Christopher Towe and Matthew Fisher

December 21, 2006

**Eastern Caribbean Currency Union (ECCU):** Comprises six Fund members: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines; and two territories of the United Kingdom, Anguilla and Montserrat. They share a common central bank, the Eastern Caribbean Central Bank (ECCB) and a common currency, the Eastern Caribbean (EC) dollar, that has been pegged at EC\$2.70 per U.S. dollar since July 1976 under a quasi-currency board arrangement (CBA). ECCU members have all subscribed to the Fund's General Data Dissemination System, but deficiencies in the quality, timeliness, and dissemination of statistical data hamper effective economic management and surveillance.

**Previous Board Discussion:** Executive Board discussions on the ECCU were held on July 13, 2005 and in an informal seminar on December 21, 2005. The staff report and selected issues papers were published as IMF Country Reports No. 05/304 and 05/305, respectively.

**Key Issues**

- Growth in the region has accelerated to its highest level in more than 15 years. Sustaining this strength will be facilitated by steps to improve the investment climate.
- Fiscal positions have improved only modestly. Bringing debt to more manageable levels requires further fiscal consolidation based on comprehensive tax reforms that are already underway in most countries and containing expenditures.
- Financial sector supervision needs to monitor emerging risks from the deepening of regional capital markets and the growth of nonbank financial institutions. Progress has been made in strengthening the supervisory framework for the banking system, but enforcement will be key.

**Discussions** were held during July 10–19, August 1–4, October 10–13 and October 18–19 in each of the six member countries, as well as with the ECCB, the Caribbean Development Bank (CDB), and regional donors based in Barbados. The team included at various stages, D. O. Robinson (Head), P. Cashin, J. Chai, R. Goyal, P. Khandelwal, S. Roache (all WHD), and P. Schellekens (MCM). C. Towe (WHD) and J. Fried and P. Charleton (both OED) participated in key discussions. The mission met with the Prime Ministers of each country, other senior government officials, civil society representatives and the media in most countries. The selected issues papers were presented in seminars in each country, including in a full-day National Economic Policy Symposium in Antigua and Barbuda on July 17.

Contents	Page
Executive Summary .....	4
I. Background .....	5
II. Recent Economic Developments and Near Term Prospects .....	8
III. Sustaining Growth.....	16
IV. Preserving Macroeconomic Stability .....	21
V. Fostering a Sound and Dynamic Financial System.....	29
VI. Institution Building.....	32
VII. Staff Appraisal.....	33
 Boxes	
1. The 2007 Cricket World Cup .....	9
2. Macroeconomic Impact of Higher Global Oil Prices .....	10
3. The Resilience of the ECCU Banking System .....	14
4. Implementation Status of FSAP Recommendations on Banking Supervision .....	30
 Figures	
1. Key Characteristics.....	6
2. External Environment Has Been Difficult.....	7
3. Central Government Actual and Structural Budget Balances .....	11
4. Banking System Vulnerabilities .....	15
5. External Competitiveness, 1990–2006 .....	18
6a. Public Debt Sustainability: Bound Tests .....	23
6b. External Debt Sustainability: Bound Tests.....	24
7. Health Care.....	28
 Tables	
1. Selected Economic and Financial Indicators, 2002–07 .....	35
2. Selected Central Government Indicators by Country, 2002–07 .....	36
3. Summary Balance of Payments, 2002–07.....	37
4. Summary Accounts of the Banking System, 2002–07 .....	38
5. Creditor Composition of Public Debt at End-2005 .....	39
6. Selected Vulnerability Indicators, 2002–07 .....	40
7. Public Sector Debt Sustainability Framework, 2001–11.....	41
8. External Debt Sustainability Framework, 2001–11 .....	42
 Appendices	
I. Relations with the Fund.....	43
II. CARTAC: Capacity Building in the ECCU .....	45
III. Caribbean Development Bank: Overview of Activities in the OECS.....	48
IV. Relations with the World Bank Group .....	51

**List of Acronyms**

CARICOM	Caribbean Community
CARTAC	Caribbean Regional Technical Assistance Centre
CBA	Quasi Currency Board Arrangement
CDB	Caribbean Development Bank
CSM	CARICOM Single Market
CWC	Cricket World Cup
DSA	Debt Sustainability Analysis
ECCB	Eastern Caribbean Central Bank
ECCU	Eastern Caribbean Currency Union
ECSE	Eastern Caribbean Securities Exchange
EU	European Union
FSAP	Financial Sector Assessment Program
NBFI	Nonbank Financial Institution
NPL	Nonperforming Loan
OECD	Organization of Economic Cooperation and Development
OECS	Organization of Eastern Caribbean States
PRSP	Poverty Reduction Strategy Paper
PSIP	Public Sector Investment Program
RGSM	Regional Government Securities Market
VAT	Value Added Tax
WTTC	World Travel and Tourism Council

## EXECUTIVE SUMMARY

**Economic activity in the region is buoyant, despite high global oil prices and the further erosion of EU trade preferences.** Growth is driven by tourism and construction ahead of the 2007 Cricket World Cup (CWC).

**Fiscal revenues have improved, but there has been only a modest improvement in fiscal and debt positions.** Tax revenues have strengthened with the uptick in economic activity, administrative efforts, and tax reforms—particularly a move to VATs—should strengthen revenues further over the medium term. However, capital expenditures have increased sharply, largely on infrastructure investments ahead of the CWC. Public debt remains very high, averaging 107 percent of GDP at end-2005, despite restructuring in Dominica and Grenada and some debt relief in Antigua and Barbuda.

**Moving to a more sustainable growth path will require structural reforms to improve competitiveness.** As the impetus from the current construction boom fades, there is a risk of a hard landing particularly as competition in the tourism sector within the Caribbean is likely to intensify. Steps to address weaknesses in the investment climate would facilitate the generation of new employment and growth opportunities.

**The ECCU region joined the CARICOM Single Market (CSM) in June 2006, but the near-term benefits are likely to be modest.** Obstacles remain to the further liberalization of labor and capital markets.

**Fiscal positions represent an important vulnerability and need to be brought into line with the fiscal benchmarks.** A modified system of benchmarks was introduced in July 2006, which emphasize medium-term debt strategies and greater transparency, with the target date for compliance moving from 2007 to 2020. It will be important for the national authorities to credibly demonstrate their commitment to attaining these goals. Building a broad and durable social consensus on the importance of fiscal prudence and preventing revenue increases from translating into new expenditure commitments will be a key step.

**The financial system has been resilient, but additional efforts are needed to strengthen the supervisory framework in the face of emerging risks.** Progress continues to be made in implementing the FSAP recommendations, but there is a need to ensure enforcement of the new regulatory framework. Supervision of the nonbank financial sector—which appears to be growing rapidly—is weak. The liberalization and deepening of regional capital markets in the context of CSM also poses supervisory challenges.

## I. BACKGROUND

1. **During their first 25 years of independence, the countries of the ECCU have seen improved social outcomes but with deepening macroeconomic imbalances**

(Figures 1 and 2). Declining aid flows, the transition from traditional agriculture (bananas and sugar) to tourism as preferential access to European markets eroded, and natural disasters have presented difficult policy challenges. Governments, with political mandates to improve social conditions, generally accommodated shocks and have used the public sector to lead the development strategy. Rising government expenditures resulted in the rapid accumulation of a very heavy debt burden. Nonetheless, the regional quasi-currency board arrangement (CBA) has continued to deliver price and exchange rate stability, fostering a relatively deep and stable financial system.

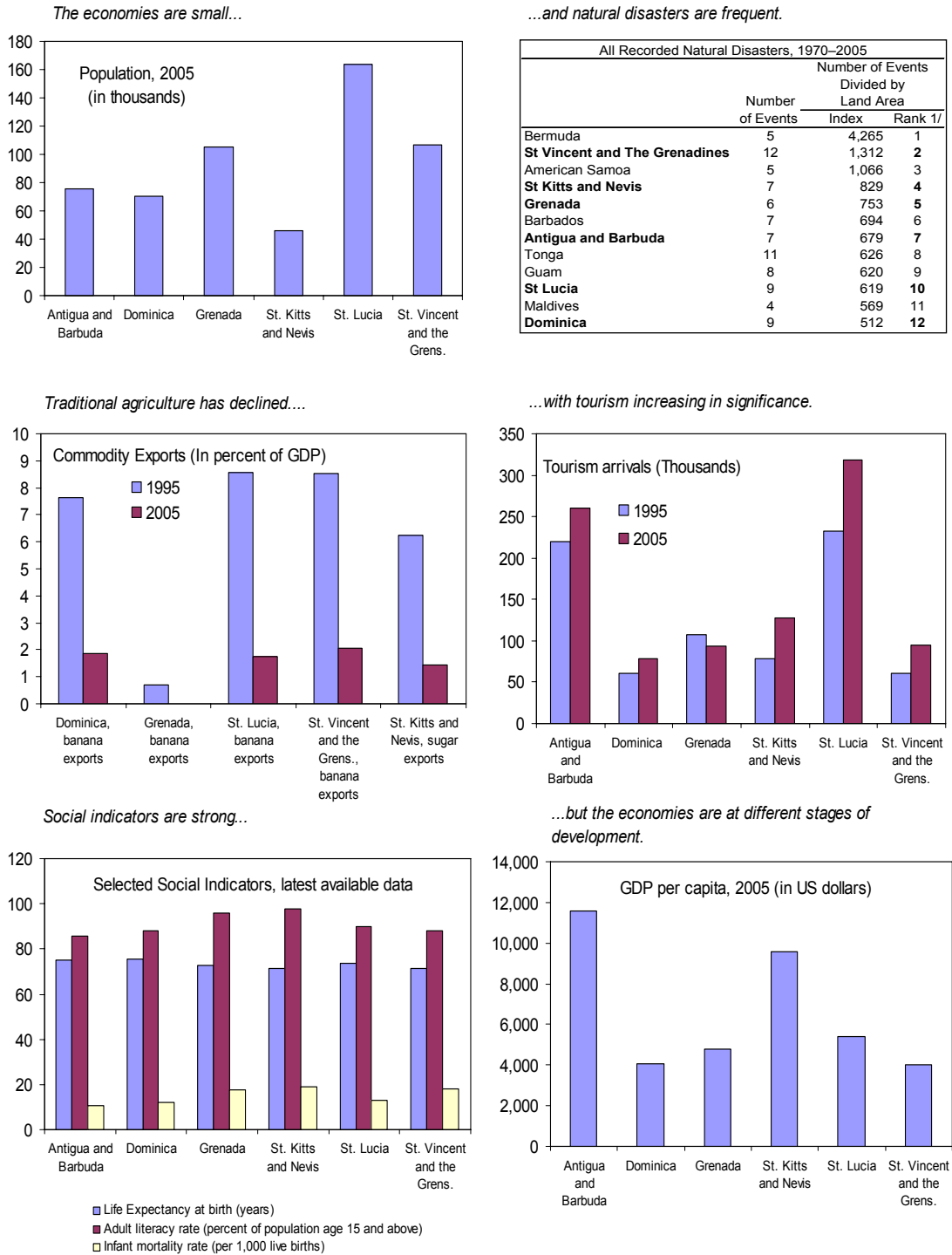
2. **Supported by strong growth, important steps have been taken in the last few years to respond to the fiscal imbalances.** Activity was driven initially by tourism—which was depressed in the aftermath of the 9/11 attacks—and subsequently by a construction boom ahead of the 2007 Cricket World Cup (CWC). Fiscal revenues have strengthened and countries are modernizing their tax systems based on the introduction of VATs and reduced reliance on trade taxes. Expenditure restraint has proven more difficult due to efforts to meet social priorities and enhance public infrastructure, including airports, to support the growing tourism sector. Dominica and Grenada have also put their debt on a more stable footing through an approach to creditors, while Antigua and Barbuda is moving in a similar direction.

3. **The ECCU is also responding to a new political environment.** As traditional development partners in Europe have scaled back their involvement in the region, new partners—China, Taiwan Province of China, and Venezuela—have become important providers of concessional support for public infrastructure projects. Regional integration within CARICOM has advanced and the ECCU countries joined the CSM in June 2006. At the same time, the framework for integration within the OECS is being revisited in the context of discussions on a revised OECS Economic Union Treaty.

4. **Discussions focused on three key economic issues:**

- How to ensure a transition to a sustained growth path?
- How to preserve macroeconomic stability and reduce imbalances?
- How to promote the emergence of a dynamic but stable financial system?

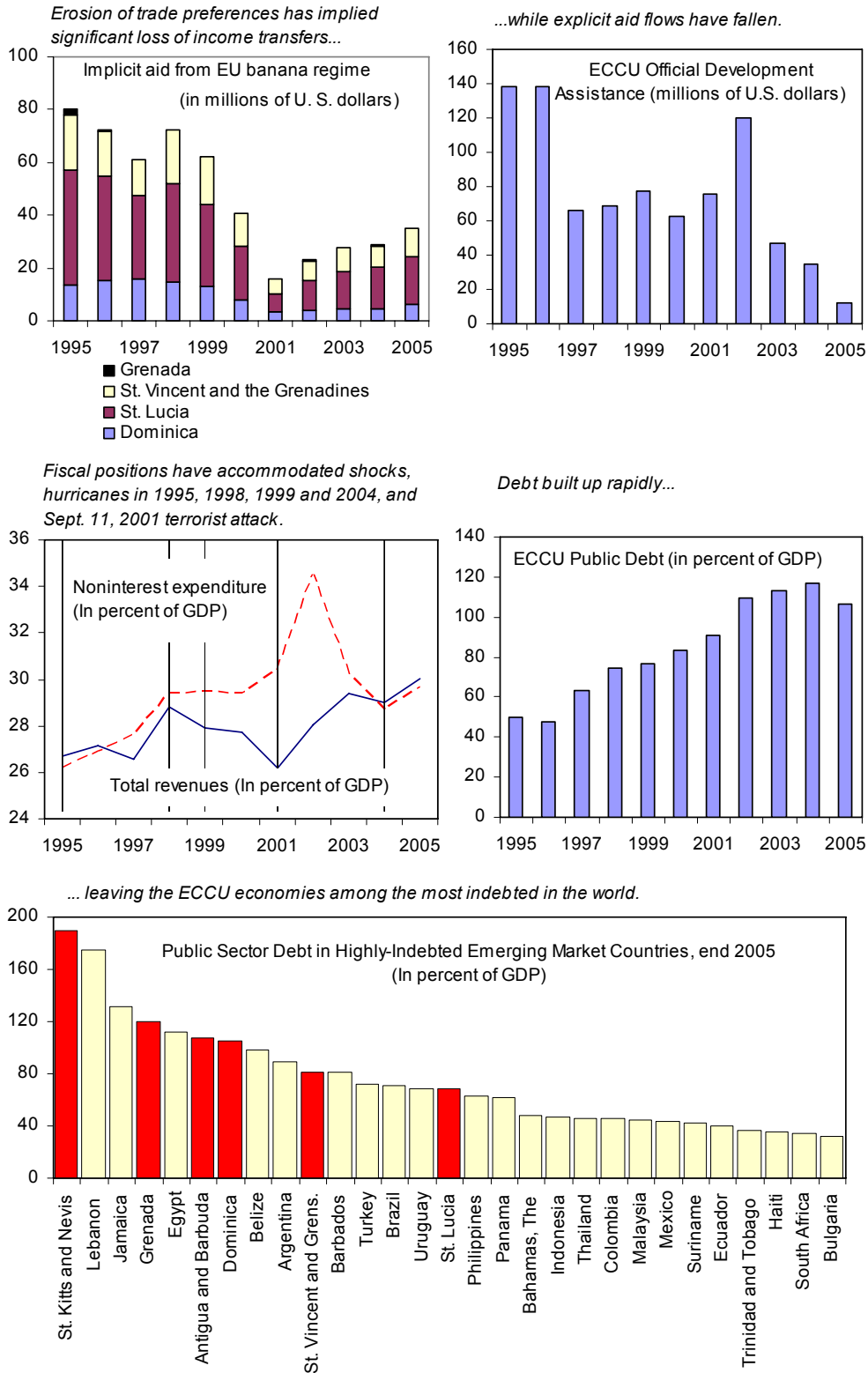
Figure 1. ECCU: Key Characteristics



Sources: IMF, WEO; World Bank, WDI; EM-Dat; ECCB; and Fund staff calculations.  
 1/ Rank out of 184 countries, with "1" indicating the most exposed to natural disasters.



Figure 2. ECCU: External Environment Has Been Difficult



Sources: World Bank, World Development Indicators; IMF, International Financial Statistics; IMF, World Economic Outlook; OECD, International Development Statistics; ECCB; and Fund staff calculations.

## II. RECENT ECONOMIC DEVELOPMENTS AND NEAR-TERM PROSPECTS

5. **Economic activity in the ECCU region is buoyant.** Growth is at its strongest rate in more than 15 years, driven by tourism and construction. Construction activity reflects

significant expansions in hotel capacity—particularly in Antigua and Barbuda and St. Lucia—grant-financed investments in cricket stadia ahead of the 2007 CWC (Box 1), and supporting public infrastructure. Separately, inflation has picked up as countries gradually moved to a higher pass-through of global oil prices, but remains in the low single digits.

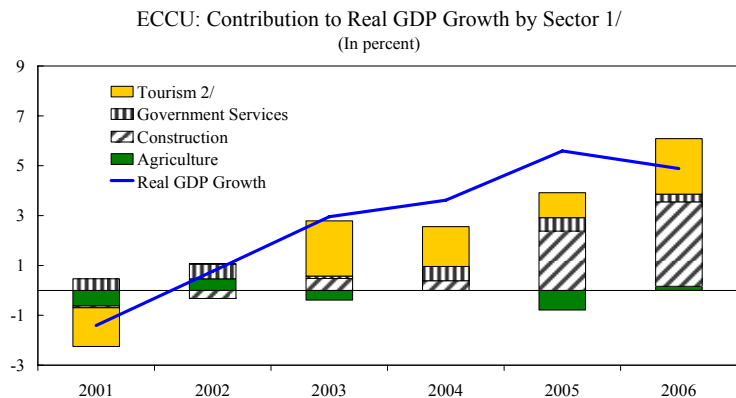
Despite the acceleration in activity, there are few signs of overheating, and labor shortages in the construction sector have been met with imported labor.

6. **The growth acceleration has occurred despite high global oil prices and the further erosion of trade preferences.** The ECCU countries are among the world's most oil-import dependent economies and oil import bills increased by a cumulative 6 percent of GDP during 2003–05 (Box 2). Most governments delayed the pass through to retail prices, at a substantial fiscal cost, but, as the permanence of the shock became clearer, have begun to adjust domestic prices. With the further erosion of preferential access for banana and sugar exports to EU markets, production continues to decline and St. Kitts and Nevis closed its sugar industry in 2005.

7. **Notwithstanding improvements in tax revenues, higher infrastructure and CWC-related spending limited the improvement in fiscal balances.** Strong growth and administrative efforts have led to improved revenues, despite the delay in adjusting fuel prices, which are likely to increase further as ambitious tax reforms—notably the introduction of VATs in most countries—come into effect. A surge in CWC-related capital

	2003	2004	2005	Proj.	
				2006	2007
	(Annual percentage change)				
Real GDP	3.0	3.6	5.6	4.9	4.4
CPI inflation, period average	1.6	2.1	3.5	3.7	3.2
CPI inflation, end of period	1.8	2.4	4.2	3.7	3.0

Sources: Country authorities, and Fund staff estimates.  
1/ Excluding Anguilla and Montserrat.



	2003	2004	2005	Proj.	
				2006	2007
	(In percent of GDP)				
Revenues	26.9	27.2	27.1	27.6	27.9
Of which: Tax revenue	23.0	23.8	24.5	24.8	25.1
Grants	2.4	1.8	3.0	3.5	1.8
Noninterest current expenditures	22.2	22.3	21.9	21.9	20.8
Interest expenditures	4.7	4.8	4.2	4.3	4.2
Capital expenditures	8.0	6.4	7.8	8.9	7.0
Primary balance (including grants)	-0.8	0.2	0.4	0.3	2.0
Overall balance	-5.6	-4.5	-3.8	-4.0	-2.3
<b>Memorandum item</b>					
Public sector debt	113.5	117.1	106.6	104.5	99.7

Sources: Country authorities; and Fund staff estimates.  
1/ Excluding Anguilla and Montserrat.

expenditures, particularly on roads and airports, has meant that the region's overall fiscal balance has not improved, even with output running at or beyond estimates of potential in most countries (Figure 3).

#### **Box 1. The 2007 Cricket World Cup**

**The ninth Cricket World Cup (CWC) will be held in the West Indies from March 5 to April 28, 2007, and will be the largest sporting event ever held in the region.** Organizers expect that close to 800,000 tickets will be sold, over 2 billion people worldwide will watch the matches by television, and about 100,000 non-Caribbean visitors will travel to the region. Games are to be played in Antigua and Barbuda, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, as well as in other countries in the broader Caribbean.

**Preparations for the CWC have been costly—both in terms of direct government expenditure and through the provision of new tax concessions—but it has been associated with a surge in private investment.** Stadium construction costs have for the most part been covered by grants from China or Taiwan Province of China, though there have been significant nongrant financed public expenditures on roads, public utilities, and security, as well as planned improvements at airports in Antigua and Barbuda and St. Vincent and the Grenadines. In Antigua and Barbuda, Grenada and St. Lucia, large private sector investments in the tourism sector have been announced that could lead by end-2007 to a substantial increase in room capacity on these islands—an almost doubling in the case of Antigua and Barbuda. Private investors have received generous fiscal incentives that will erode the tax base going forward, and government recurrent expenditures will also need to rise to maintain the new facilities.

**The net economic costs and benefits of the CWC are unclear.** Studies of other states hosting large one-off sporting and cultural events (such as the 2003 CWC in South Africa and 2002 FIFA World Cup in Korea/Japan) generally find a small net positive effect. As with other countries, the key near-term impact in the ECCU has been a construction-led economic boom, which is providing some increase in revenues and, importantly, an opportunity to transition labor from traditional agriculture (or the public sector in the case of Antigua and Barbuda). The impact on tourism may be limited in 2007, as the CWC will be played during the peak winter tourism season when occupancy rates typically are already very high. Benefits are expected to be highest in those countries hosting major national teams and their traveling supporters (England and New Zealand in St. Lucia; Australia and South Africa in St. Kitts and Nevis). Over the longer term, the net benefit will be determined by how successful the countries are in attracting additional tourists to fill the expanded hotel room capacity and the use that can be made of the new stadia.

## Box 2. Macroeconomic Impact of Higher Global Oil Prices

**The global increase in the price of oil from 2003 to mid-2006 posed difficult policy choices for ECCU governments.** The countries are highly dependent on imported oil products both for direct consumption and for electricity generation—alternate energy sources, such as solar or geothermal, are at present little used. Most ECCU countries have maintained a fixed retail pricing regime with the price established based on the import price and fixed margins for wholesalers and retailers, with the consumption tax serving as the residual. Dominica (from September 2003), Grenada (from October 2006), and St. Kitts and Nevis (from December 2006) have flexible pricing mechanisms with full pass-through to consumers. Driven by social concerns, most governments resisted raising the retail price of petroleum products, which served to limit the inflationary impact of the price changes but aggravated the macroeconomic costs:

**The current account impact has been around 6 percent of GDP over 2003–05, accentuated by the lack of adjustment in domestic consumption.**

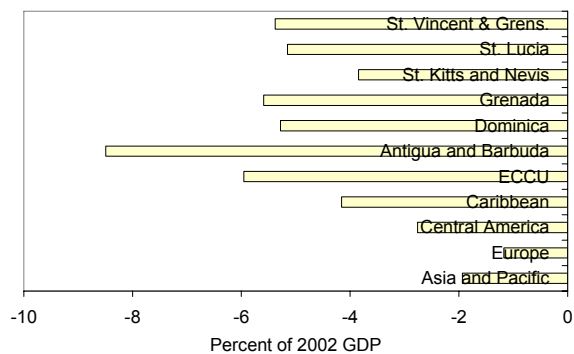
Oil import bills have increased substantially—recent estimates from the World Economic Outlook identify the ECCU region as being among the worst affected by the increase in energy prices. Assuming a price elasticity of oil demand of -0.25, flexible pricing could have reduced oil imports in 2005—ranging from 0.5 percent of GDP in St. Kitts and Nevis to 0.9 percent of GDP in Antigua and Barbuda.<sup>1/</sup>

**Government revenues have declined by as much as 1 percent of GDP annually as a result of the lack of adjustment in domestic prices.** The ECCB Monetary Council agreed in October 2005 that the region should move to a flexible pricing mechanism. However, after some initial moves in late-2005, there have been few subsequent adjustments. Staff estimates suggest that a flexible pricing mechanism would (based on end-2005 prices) have generated an additional ¼–1 percent of GDP in revenues annually, depending on the country.

**The growth impact is likely to have been large.** A World Bank study *Assessing the Impact of Higher Oil Prices in Latin America*, (April 2006), concludes that Caribbean islands are likely to suffer the largest losses in per capita growth due to increases in oil prices. For ECCU countries, the reduction in growth rates is estimated to range between 0.08 and 0.12 percentage points per annum, resulting from a 14 percent projected annual increase in prices between 2006–10 (the average spot price of petroleum increased almost 36 percent annually in 2004–05).

<sup>1/</sup> Elasticity estimates for a group of non-OECD countries from D. Gately and H. Huntington, 2002, “The Asymmetric Effects of Changes in Price and Income on Energy and Oil Demand,” *The Energy Journal*, 23(1), pp. 19–55.

ECCU: First-Round Current Account Impact of Changes in Oil Prices, Cumulative 2003-05



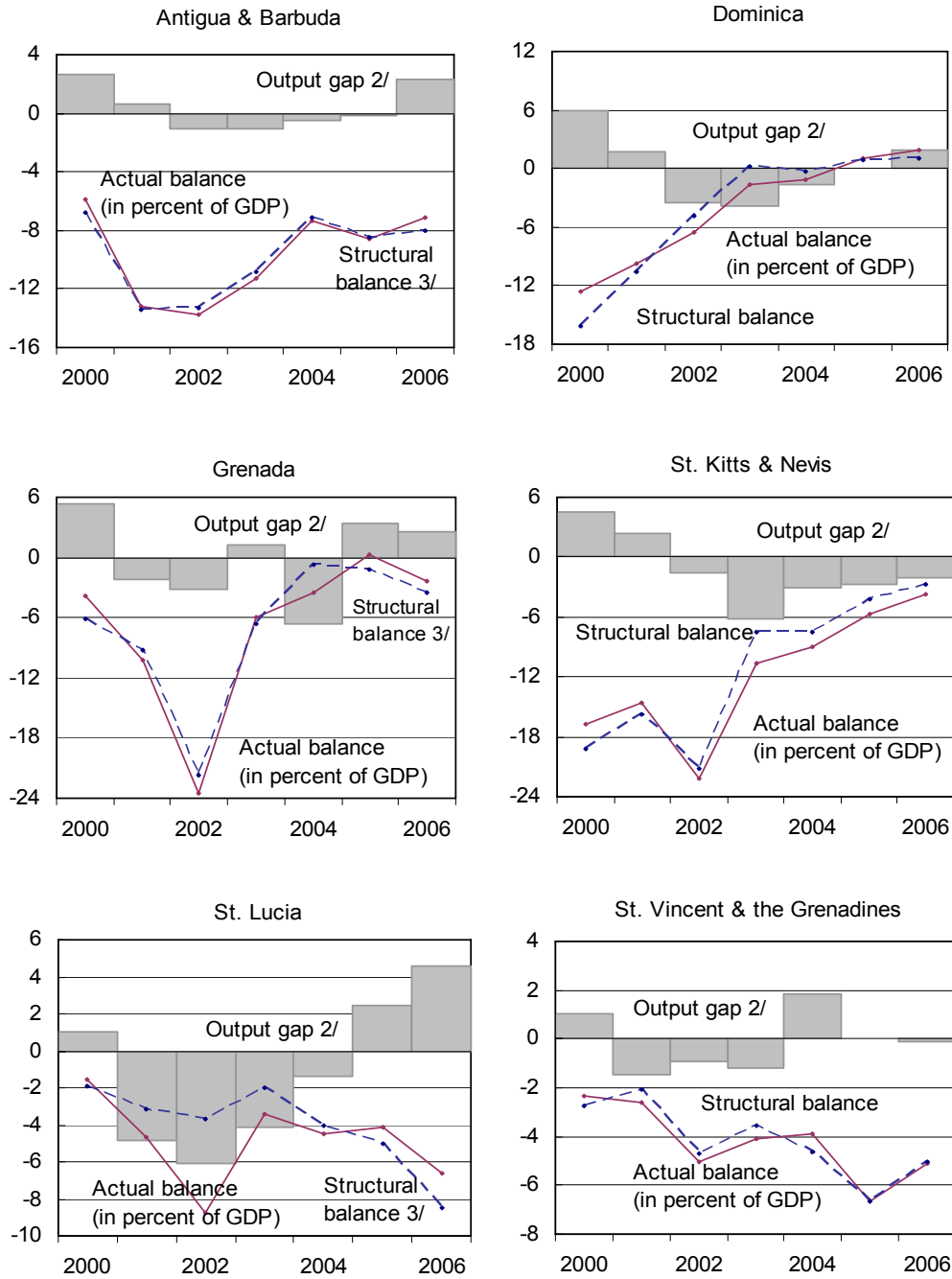
ECCU: Effective Gasoline Tax Rates, 2003–05 1/ (Yearly average)

	2003	2004	2005
ECCU			
Antigua and Barbuda	73.6	45.9	41.8
Dominica	73.6	61.3	47.7
Grenada	58.4	25.2	13.8
St. Kitts and Nevis	39.9	10.9	26.2
St. Lucia	73.2	53.9	26.2
St. Vincent and the Grens.	47.9	23.3	15.5
United States	37.0	29.9	23.8

Sources: U.S. Department of Energy, ECCB, and Fund staff calculations.

1/ In percent of c.i.f. price.

Figure 3. ECCU: Central Government Actual and Structural Budget Balances 1/ (In percent of potential GDP)



Sources: Country authorities; ECCB; and Fund staff estimates.

1/ Actual balance is the overall balance (revenue and grants less expenditure), and is expressed as a percentage of actual output. Actual output is measured as gross domestic product (GDP) at factor cost.

2/ The output gap is actual output less potential output, as a percent of potential output.

3/ Structural balance is expressed as a percent of potential output. The structural balance is the budgetary position (overall balance) that would be observed if the level of actual output coincided with potential output.

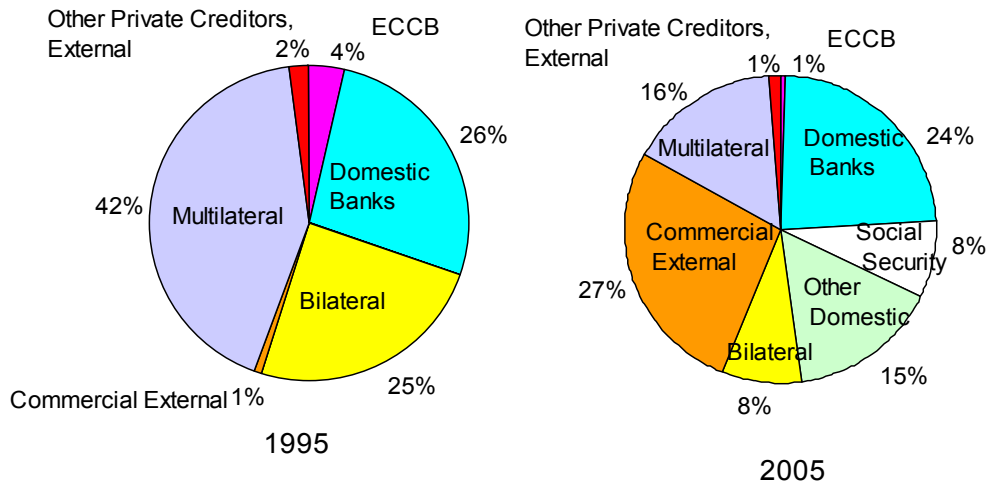
8. **The region faces a substantial debt burden.** Despite a sharp decline in 2005—largely due to a debt write-off provided to Antigua and Barbuda—average public sector debt remains above 100 percent of GDP (see Figure 2). Debt service absorbs a substantial portion of revenues in most countries—the exceptions being Dominica and Grenada who have made considerable progress in reaching agreements with creditors.

9. **Access to new financing has been maintained, though funding sources have changed.** Over the past decade, in response to the collapse in aid flows and reduced access to concessional multilateral and bilateral financing, governments have increasingly relied on commercial financing. On the

ECCU: Selected Indicators of Debt Burden					
	2003	2004	2005	Proj.	
				2006	2007
(In percent of current revenues)					
<b>Interest payments</b>					
Antigua and Barbuda	25.7	22.9	23.3	18.2	20.6
Dominica	18.8	17.9	16.3	8.0	7.9
Grenada	18.9	25.2	7.7	9.1	7.7
St. Kitts and Nevis	23.2	20.8	22.4	24.0	22.6
St. Lucia	11.4	11.9	11.8	15.5	14.1
St. Vincent and the Grens.	8.7	8.6	10.4	13.0	11.3
<b>Debt service 1/</b>					
Antigua and Barbuda 2/	41.9	43.9	106.6	26.3	29.8
Dominica	35.6	35.5	24.1	13.0	13.8
Grenada	27.1	40.4	13.5	14.8	12.3
St. Kitts and Nevis	36.3	33.2	34.5	31.3	36.8
St. Lucia	14.8	14.8	16.9	23.0	27.1
St. Vincent and the Grens.	14.7	19.3	21.3	24.9	23.9

Sources: Country authorities; and Fund staff estimates.  
 1/ Includes only external amortization.  
 2/ For 2005, the estimates include a restructuring of Antigua and Barbuda's debt with Italy.

ECCU: Composition of Public Debt, 1995 and 2005  
 (In Percent of Total Public and Publicly Guaranteed Debt)

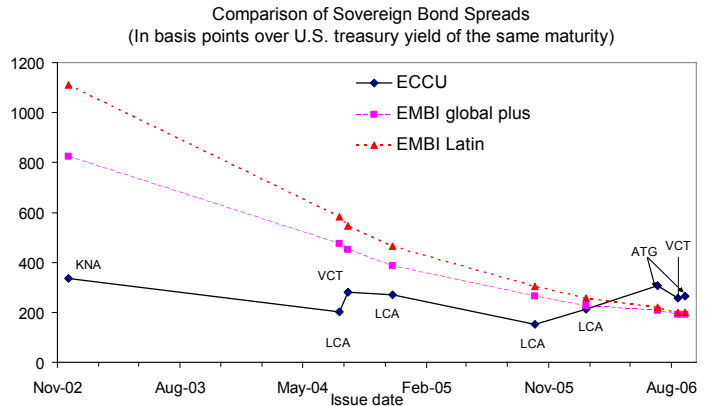


Sources: Country authorities; ECCB; World Bank, Global Development Finance; and Fund staff estimates.

Note: Due to a lack of a comprehensive database on debt, these statistics have been compiled by combining various data sources. Debt is classified based on issuance as information on ultimate holders is unavailable.

external side, this has led to a sharp increase in the cost of funds; though recently, governments have tapped concessional funds from nontraditional donors such as China, Venezuela, and Taiwan Province of China. Domestic funding has come from commercial banks and social security surpluses, facilitated by the development of the Regional

Government Securities Market (RGSM) since 2001 on which almost 6 percent of outstanding central government debt at end-2005 was raised. Borrowing costs were significantly below those of other emerging market sovereigns, though the spread has been eliminated as emerging market spreads have narrowed.



Sources: Bloomberg; and Eastern Caribbean Central Bank.  
Note: ATG denotes Antigua and Barbuda, KNA denotes St. Kitts and Nevis, LCA denotes St. Lucia, and VCT denotes St. Vincent and the Grenadines.

**10. Stronger growth contributed to a widening of external current account deficits in 2005 and into 2006, to well over 20 percent of GDP.**

Higher oil prices and construction activity spurred an increase in imports; while, growth in travel receipts slowed due to one-off factors such the impact of Hurricane Ivan in Grenada. Exports of agricultural products also

declined as a result of preference erosion and hurricane damage. Foreign direct investment and grants (linked to both CWC and the reconstruction effort in Grenada) largely covered the deficit, and a dip in reserves at end-2005 was more than reversed by mid-2006.

ECCU: Selected External Indicators, 2003–07					
	2003	2004	Est. 2005	Proj. 2006–2007	
(In percent of GDP)					
External current account balance	-22.0	-16.4	-21.7	-22.9	-20.8
Direct investment (net)	17.9	13.1	12.3	15.2	13.5
Gross international reserves (US\$m)	539.9	632.4	600.8	651.7	711.3
(Annual percentage change)					
Exports of goods	0.7	14.4	-7.6	4.6	4.4
Imports of goods	13.2	8.1	12.2	6.0	4.9
Travel (net)	17.9	12.1	1.0	5.8	10.2
Real effective exchange rate	-4.2	-3.6	-1.0	...	...

**11. Monetary aggregates continue to expand rapidly, with a credit boom in the private sector.** Broad money expanded in line with nominal GDP, and banks have slowed their acquisition of net foreign assets. Instead, credit to the private sector has grown to

finance increased tourism capacity and the mortgage market. Nonetheless, reserve coverage of demand liabilities by the CBA rose to over 96 percent at end-2005.

ECCU: Selected Monetary Indicators, 2003–07					
	2003	2004	2005	Proj. 2006–2007	
Broad money	9.5	13.2	8.4	9.8	9.5
Net foreign assets 1/	8.7	6.8	1.4	0.3	1.8
Net domestic assets 1/	0.8	6.4	7.1	9.5	7.7
Of which					
Private sector credit 1/	2.0	5.1	9.2	11.7	7.2
Currency backing ratio, in percent	95.3	96.2	96.5	...	...

1/ Twelve-month change in percent of broad money at the beginning of the period.

**12. Available indicators are generally reassuring regarding banking system soundness, but information on nonbank financial institutions is sparse.** The banking system has withstood recent large shocks (Box 3) and continues to be highly liquid, with

capital adequacy ratios well above prudential norms. NPL ratios are declining, though this in part reflects the rapid recent credit growth (Figure 4). However, exposures to government are very high, and issues with the recognition and provisioning for NPLs potentially imply an overstatement of capital in some cases. A system of harmonized supervision of nonbank financial institutions is under preparation.

ECCU Banking System: Financial Soundness Indicators, September 2006  
(In percent)

	Antigua and Barbuda	Dominica	Grenada	St. Kitts and Nevis	St. Lucia	St. Vincent and Grens.	ECCU
Capital adequacy 1/	13.3	21.4	18.3	46.4	15.8	16.8	19.2
NPLs/total loans	11.8	9.3	4.9	5.2	10.1	4.2	8.2
Provisions for Loan Losses/NPLs	23.7	24.1	55.0	19.2	42.2	48.9	32.4
Gross government exposure/total assets	10.1	10.4	11.8	30.8	13.4	19.3	15.1
Loans to households/total loans	47.0	56.0	59.8	34.0	39.4	54.1	45.8
Liquid assets/total assets	40.8	44.1	25.1	31.6	17.2	34.1	27.7
(Pre-tax) return on average assets 2/	0.88	0.47	1.02	0.85	0.56	0.52	0.73

Sources: ECCB. Estimates are based on bank submissions with infrequent onsite verification.

1/ Locally incorporated banks only.

2/ Quarterly return.

### Box 3. The Resilience of the ECCU Banking System

**Despite frequent large shocks, there have been few instances of banks coming under severe stress.**

In just the past two years, Grenada has been hit by two hurricanes, with Hurricane Ivan alone causing over 200 percent of GDP damage in September 2004. In the same period, the Governments of Dominica, and Grenada undertook debt restructuring operations. Since its establishment in 1983, the ECCB has only intervened in two banks—the Bank of Montserrat in 1993, and the Nevis Cooperative Bank in 1995. In neither case did depositors suffer a write-down.

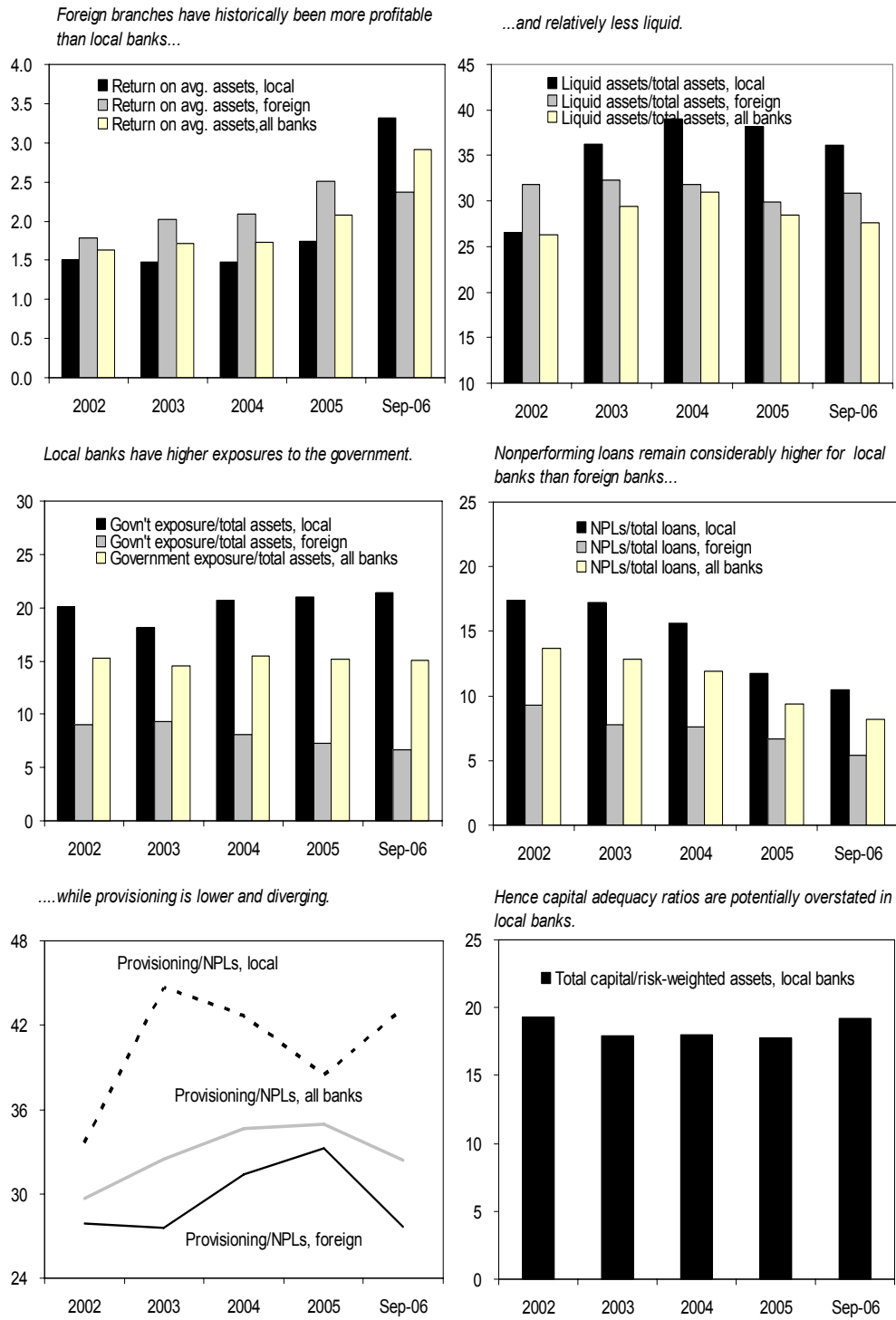
**The stability appears to stem from three factors:**

- **Inflows of insurance payments as well as external assistance in the aftermath of a natural disaster help preserve a high level of liquidity in the banking sector.** Grenada's financial indicators were among the strongest in the region prior to Hurricane Ivan and have been largely stable since. Debt-servicing moratoria in the months following the disaster, together with some loan renegotiations, helped maintain solvency.
- **Sovereign debt restructurings have been designed to minimize the impact on the domestic banking system.** In both Dominica and Grenada, treasury bills were not restructured in order for the government to retain market access for liquidity purposes. Where the banking sector was included, for instance in Grenada, syndicated loans and overdrafts were restructured on terms more favorable than for other instruments. Resultant capital losses have been manageable.
- **Confidence in the currency board has not wavered.** The ECCB has demonstrated its independence by not bailing out member countries as fiscal pressures mounted, so that fiscal crises have not resulted in pressures on the exchange rate. In addition, the presence of large well-capitalized foreign banks provides additional stability in that, in the event of pressures on the system, deposits are likely to flow to foreign banks rather than out of the system, helping to mitigate pressures on the exchange rate.



Figure 4. ECCU: Banking System Vulnerabilities 1/

Local banks are weaker than foreign-owned banks, and have lower asset quality.



Sources: Eastern Caribbean Central Bank; and Fund staff calculations.

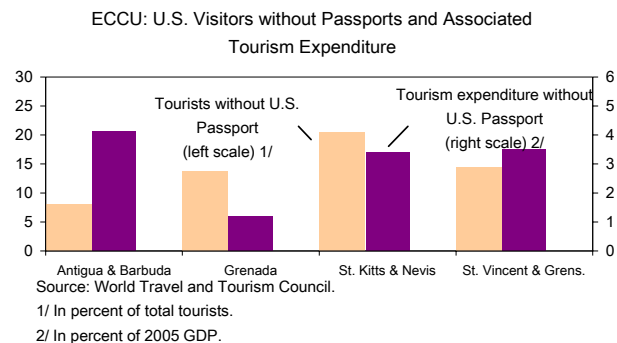
1/ Prudential indicators are reported by commercial banks, with infrequent onsite verification by the ECCB.

### III. SUSTAINING GROWTH

13. **Discussions focused on the need for policies to help ensure that the current construction boom translates into sustainable growth.** Substantial private sector investments in the tourism sector are underway throughout the Caribbean, implying a sharp increase in the hotel room stock over the next couple of years. Complementary public infrastructure investments—for example roads and airports—are planned to support this expansion. Even allowing for a marketing boost from the CWC, it is unclear whether tourism demand—historically strongly correlated with advanced countries’ growth—will keep pace with the expansion in tourism capacity.

14. **The authorities generally saw little risk of a hard landing.** Most governments considered that their tourism sectors serve a niche market and are, therefore, unlikely to be significantly impacted by the increased room stock in other countries. Further, they noted that many of the large new investments were by international hotel chains with well-established marketing channels that could reasonably be expected to fill their rooms. Staff suggested that there was a risk that the new capacity would intensify pressures on the older hotel stock, which is typically locally-owned and with exposure to local banking sectors.

15. **The authorities were concerned, however, that new passport requirements for U.S. citizens traveling to the Caribbean have exacerbated downside risks.** Under the U.S. Western Hemisphere Travel Initiative—designed to enhance security—all U.S. citizens returning to the U.S. from the Caribbean will be required to hold passports from January 23, 2007 for air and from January 1, 2008 for cruise-ships. WTTC estimates suggest that the loss of tourism receipts could amount to as much as 4 percent of GDP a year if those without passports do not travel.<sup>1</sup> This is likely an upper bound on the economic impact.



16. **Growth is expected to slow in the next few years.** Several countries have seen a clustering of construction projects ahead of the CWC as investors sought to take advantage of the additional incentives that had been provided. However, others such as Grenada, St. Kitts and Nevis, and St. Vincent and the Grenadines have substantial investment projects

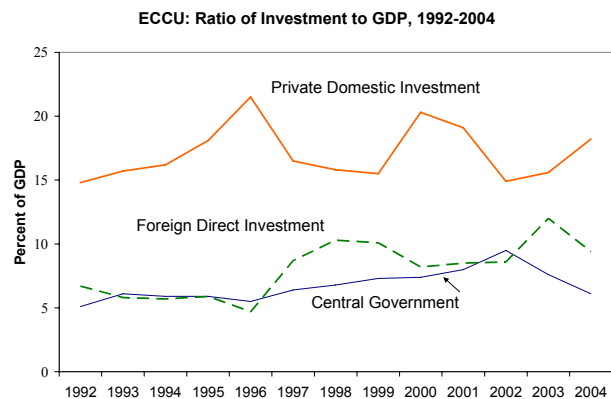
<sup>1</sup> Few data are available on the proportion of U.S. visitors to the region that do not hold passports—data for Antigua and Barbuda for 2005 imply that 30 percent of U.S. visitors did not have passports, or less than 10 percent of total tourists.

that are still at the design phase and which could serve to maintain the region's growth momentum in the latter part of the decade.

17. **The staff noted that most measures point to a significant improvement in competitiveness in recent years** (Figure 5). The depreciation of the U.S. dollar in recent years has resulted in the real effective exchange rate—measured relative to either trade weights, tourism competitors, or tourism source markets—reaching its most depreciated level in more than 15 years. Exports of goods and nonfactor services have declined, but this may reflect data weaknesses.<sup>2</sup> It was agreed that the region remains a high-cost destination for tourists, but the authorities argued that this reflected the niche nature of the tourism market together with the scale of the industry that made it impossible for the region to compete purely on the basis of price. They also noted that the high levels of FDI inflows—albeit supported by large tax concessions—suggested the absence of a competitiveness problem.

18. **The authorities reiterated their strong commitment to the exchange rate peg.** They stressed that the peg had yielded a long period of price stability and that if clear evidence of a misalignment of the exchange rate were to emerge, it was best addressed via structural reforms. The staff broadly concurred with this assessment, but stressed that maintaining the peg would require determined efforts to bring fiscal and debt positions to more sustainable levels, and to increase the flexibility of labor and product markets.

19. **Staff noted that while the region has seen high investment, the growth returns have been disappointing.**<sup>3</sup> The low impact of investment on growth may reflect the fact that some investment is directed to repairing hurricane damage rather than providing a net increase in the capital stock.<sup>4</sup> Nonetheless, staff noted the need to examine structural impediments that could lead to either a misallocation of capital or prevent the realization of productivity gains. The low return on public sector investment reflects the absence of an effective PSIP mechanism in many countries, and a lack of prioritization of capital spending.



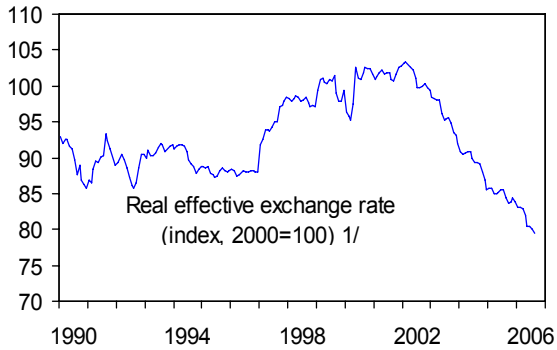
<sup>2</sup> Tourism expenditures are calculated based on arrivals data plus an estimate for daily expenditures that is based on surveys undertaken in the mid-1990s.

<sup>3</sup> See Roache, Chapter V in *ECCU: 2006 Selected Issues* “Domestic Investment and the Cost of Capital.”

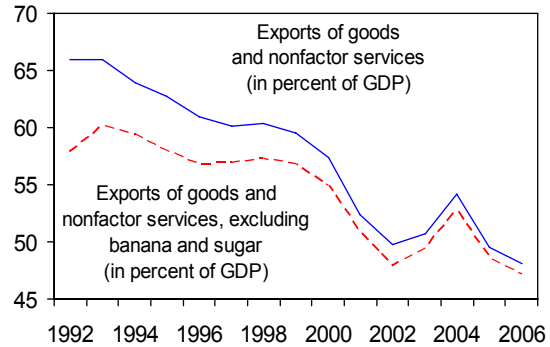
<sup>4</sup> National accounts data are weak. Data on domestic investment are inflated by the inclusion of personal sector construction, while FDI data are in some cases based on announced rather than actual flows.

Figure 5. ECCU: External Competitiveness, 1990–2006

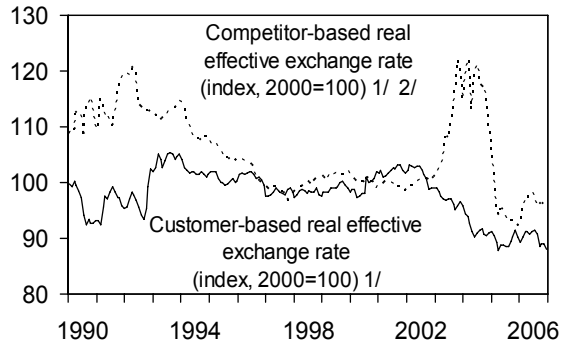
While the CPI-based real effective exchange rate has depreciated sharply since 2002...



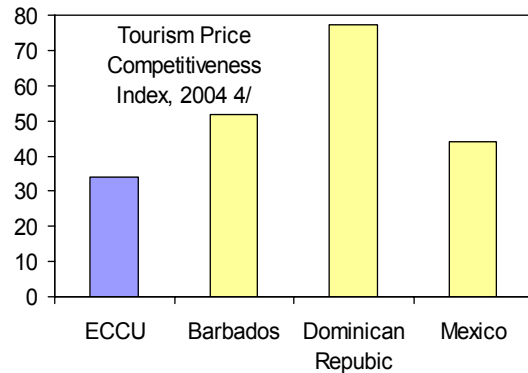
...overall exports have weakened dramatically.



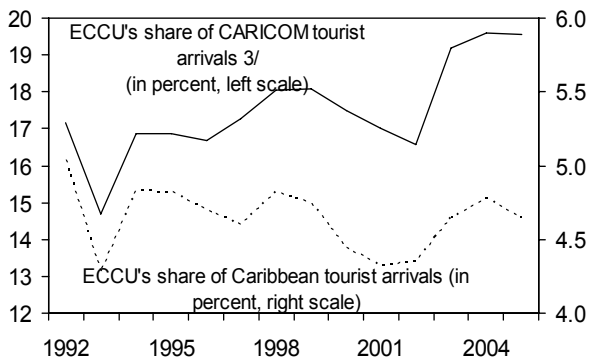
In the tourism sector, a customer based measure of the REER has depreciated considerably since 2002...



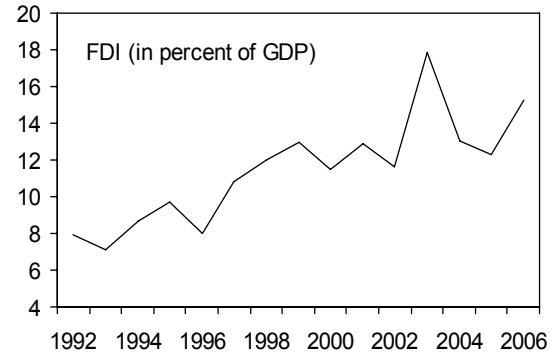
...but the ECCU is a high-cost destination.



The ECCU's share of stay-over arrivals in both CARICOM and the Caribbean has risen recently...



...and FDI flows remain strong.



Sources: ECCB; Caribbean Tourism Organization; and country authorities; World Travel and Tourism Council; and Fund staff estimates.

1/ An increase (decrease) indicates an appreciation (depreciation).

2/ The sharp movements in the competitor-based real exchange rate in 2002–04 were largely driven by the Dominican Republic's peso.

3/ Total tourist arrivals of Suriname are not included in 2003, and those of Haiti are not included in 2003, 2004 and 2005.

4/ Scaled from 1 to 100. A higher value means that the country is more competitive in the tourism market.

**20. In this context, staff questioned the efficacy of tax incentives to spur investment and growth.**

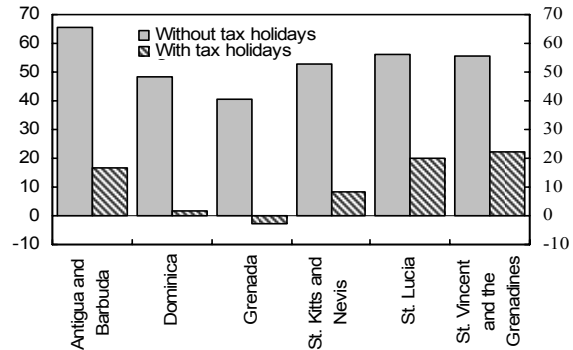
In particular, the region's share in world FDI has been declining, even relative to other small-island economies.<sup>5</sup>

Moreover, the generous terms of these concessions in the ECCU—tax holidays can be granted for up to 30 years and tend to be renewed—have pernicious effects:

- Tax bases have been eroded, forcing higher tax burdens on nonfavored sectors.
- The average annual revenue foregone from concessions, for 2000–03, is estimated at between 10–16 percent of regional GDP. This has squeezed resources available for social and infrastructure expenditures and contributed to the debt build up, with negative implications for fiscal sustainability and growth.
- To the extent that incentives are linked to the size of the investment, the regime discriminates against smaller (typically locally-owned) projects in favor of large projects (typically foreign-owned).

**21. Views differed within the region on the desirability and modalities of changing the concessions regime.** The authorities generally stressed that given the shallowness of domestic capital markets, their economies were very dependent on FDI in the tourism sector for employment generation and growth, and that regional competition for FDI was fierce. Efforts are underway in many countries to contain concessions through a tightening of administration, and by eliminating the granting of discretionary concessions. A more fundamental overhaul is being introduced in Grenada to a system based on accelerated depreciation and loss carry-forward provisions, so that the incentives are clearly tied to new investment. Regional coordination—such as through a common incentive regime as had been under discussion within CARICOM since 1973, might also play a role in limiting the degree to which investors could induce governments to compete against each other, though it was acknowledged that it would be difficult to design an effective enforcement mechanism.

ECCU: Marginal Effective Tax Rate on Investment, 2003  
(In percent)



Source: Sosa, S., 2006, Tax Incentives and Investment in the Eastern Caribbean, IMF Working Paper WP/06/23.

Note: METRs are calculated for the tourism sector, the asset considered is machinery, with financing a weighted average of debt (35 percent) and equity (65 percent).

<sup>5</sup> See Chai and Goyal (2006), Chapter 10 in Sahay, Robinson, Cashin (eds.) *The Caribbean: From Vulnerability to Sustained Growth* “Tax Concessions and Foreign Direct Investment.”

22. **Staff suggested that more emphasis is needed on regulatory, administrative, and legal reforms to help lower the cost of doing business.** The *2006 Doing Business Indicators*, while providing a generally positive evaluation of the region—St. Lucia was ranked highest at 27<sup>th</sup> in the world, with all countries in the top half—also identified a number of areas of weakness. In particular: the cost of capital is high and access to finance is limited; it is difficult and costly to register property; property rights and contract enforcement are weak; and there are obstacles to closing a business. Public utilities, particularly electricity, also tend to be relatively expensive and unreliable.

ECCU: Doing Business Indicators Country Rankings, 2006

	Antigua & Barbuda	Dominica	Grenada	St. Kitts & Nevis	St. Lucia	St. Vincent & Grens.	Trinidad & Tobago
Overall ranking	33	72	73	85	27	44	59
Starting a business	22	24	50	105	43	29	35
Dealing with licenses	15	51	12	7	10	1	81
Employing workers	40	50	34	35	29	48	27
Registering property	71	78	145	136	51	101	154
Getting credit	101	101	83	117	101	83	48
Protecting investors	19	19	19	19	19	19	15
Paying taxes	145	20	45	116	9	32	27
Trading across borders	47	97	84	37	45	48	22
Enforcing contracts	47	159	143	135	160	125	156
Closing a business	54	151	151	151	39	151	151
<b>Memorandum item</b>							
Overall ranking, 2005	33	65	63	85	27	42	55

Source: Doing Business Indicators Database, World Bank.

23. **The authorities agreed that the CSM held the promise of improving efficiency in the region, but many obstacles to closer integration remained.** The ECCU countries formally joined the CSM in June 2006, though only after a number of requirements—particularly the proposed liberalization of the Alien Land Holdings Acts—were postponed. It was agreed that the key benefit to the region would likely arise over the medium term following the greater liberalization of labor markets that would enable the timely elimination of skill shortages that have frequently cropped up in the region. The authorities had mixed views on the feasibility of the free movement of labor within CARICOM, which on the one hand would provide valuable opportunities for national populations, but at the same time risked overwhelming small societies and overburdening their health and education systems. The authorities stressed that the Regional Development Fund, which has been established with an initial capitalization of US\$130 million (with an aim of reaching US\$250 million through contributions by international donors), is a key component of the CSM and should be used to finance infrastructure and education projects in the smaller states to enhance their competitiveness.

24. **The authorities expressed concern over the impact of changes in the EU's trade regime for bananas and sugar on rural populations and employment.** Staff estimates suggest that the value of implicit assistance derived from EU banana preferences has declined from about 15 percent of GDP in the early 1990s to about 2 percent of GDP in 2005.<sup>6</sup> Dominica, St. Lucia, and St. Vincent and the Grenadines could all experience a permanent loss of between 1–2 percent of GDP and a deterioration in fiscal balances of ½–1 percent of GDP. The sugar sector in St. Kitts and Nevis has already been closed. The

authorities agreed with staff's assessment that the growth impact was likely modest, but emphasized that the key challenge was in relation to employment, as a significant part of the labor force is still dependent on these sectors.<sup>7</sup> In terms of policy responses, staff suggested that the movement of labor be facilitated—through temporary income transfers to farmers, retraining programs, and limited subsidies on agricultural inputs—and urged authorities to accelerate the redeployment of land to generate alternative investment and growth opportunities. The authorities stressed the need to move cautiously, emphasizing the sensitivities associated with land in small economies and that they were under severe resource constraints for transitioning labor.

**25. The authorities expressed deep frustration with traditional development partners—particularly the EU—for failing to deliver on pledged transition assistance.** The authorities noted the complex bureaucratic procedures for obtaining disbursements from the EU which they argued explained the very low level of disbursements.

**ECCU: Status of EU Banana Support 1/**

	Dominica			Grenada			St. Lucia			St. Vincent and the Grens.		
	Amount Committed	Amount Disbursed	Percent Disbursed	Amount Committed	Amount Disbursed	Percent Disbursed	Amount Committed	Amount Disbursed	Percent Disbursed	Amount Committed	Amount Disbursed	Percent Disbursed
	(In € million)			(In € million)			(In € million)			(In € million)		
1999	6.5	3.9	60.0	1.0	0.5	50.0	8.7	6.6	75.9	6.2	4.5	72.6
2000	6.5	0.4	6.2	0.5	0.4	80.0	8.9	6.3	70.8	6.5	0.4	5.8
2001	6.7	3.4	50.7	0.5	0.4	80.0	9.3	4.1	44.1	6.4	0.0	0.0
2002	6.4	1.3	20.3	0.5	0.0	0.0	8.8	0.2	2.3	6.1	1.2	19.7
2003	5.9	0.0	0.0	0.5	0.0	0.0	8.0	0.0	0.0	5.6	0.2	3.6
2004	5.3	0.0	0.0	0.5	0.1	20.0	7.2	0.0	0.0	5.3	0.0	0.0
2005	6.2	0.0	0.0	0.5	0.0	0.0	4.5	0.0	0.0	4.5	0.0	0.0
2006	3.8	0.0	0.0	0.5	0.0	0.0	5.4	0.0	0.0	3.9	0.0	0.0
<b>Total</b>	<b>47.3</b>	<b>9.0</b>	<b>19.0</b>	<b>4.5</b>	<b>1.4</b>	<b>31.1</b>	<b>60.8</b>	<b>17.2</b>	<b>28.3</b>	<b>44.5</b>	<b>6.3</b>	<b>14.1</b>

Source: Delegation of the European Commission, Barbados.

1/ Under Special Framework of Assistance. As at end-September 2006.

#### IV. PRESERVING MACROECONOMIC STABILITY

**26. The growth up-tick, orderly debt restructurings, and structural fiscal improvements have strengthened the currency union, but significant vulnerabilities remain.** The staff's DSAs clearly illustrate that the still very high debt level leaves little room for maneuver in the event of an adverse shock, and that a key risk is that fiscal policy does not deliver a lasting improvement relative to recent years (Figures 6a and 6b).<sup>8</sup> While

<sup>6</sup> See Mlachila and Cashin, Chapter II in *ECCU: 2006 Selected Issues* "Macroeconomic Impact of Trade Preference Erosion on the Windward Islands."

<sup>7</sup> See Cashin and Wang, Chapter I in *ECCU: 2006 Selected Issues*: "Income Dispersion and Co-Movement in the ECCU" on the differential growth experience in the agriculture-dependent Windward Islands and the tourism-dependent Leeward Islands.

<sup>8</sup> The DSAs are based on an adjustment scenario consistent with those developed during the most recent bilateral discussions with country authorities. While details of the fiscal adjustment reflect national reform

(continued...)

the external DSA highlights a growth shock as a key concern, the region's ability to continue to run very large current account deficits will depend critically on private sector inflows (including FDI) and the public sector's ability to access financing from capital markets and official creditors. Discussions focused on two key questions:

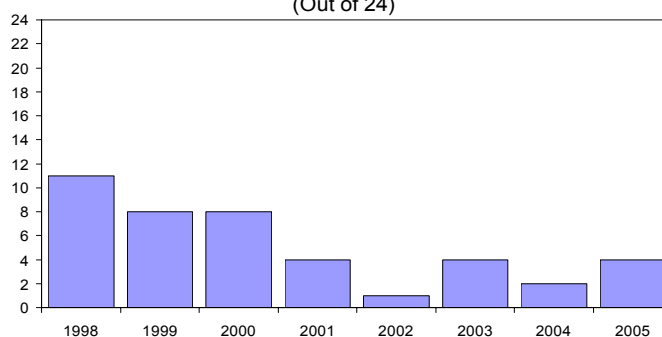
- How to ensure that fiscal policies are consistent with the needs of both the currency union and national objectives; and
- How to prepare for the fiscal consequences of population aging.

### *Fiscal benchmarks*

27. **The fiscal benchmarks introduced in 1998 were unsuccessful in achieving fiscal convergence by the target date of 2007.** Indeed, fiscal outcomes moved progressively further from the benchmarks, which the authorities noted did not reflect a lack of commitment, but rather the consequence of a series of shocks in the second half of the 1990s (hurricanes, erosion of preferences, decline of official development assistance), and then the disruption to tourism following the 9/11 attacks.

28. **A new system of fiscal benchmarks was approved by the ECCB's Monetary Council in July 2006.** In addition to pushing compliance back to 2020, the new benchmarks place increased emphasis on integrating annual budget objectives with the achievement of the medium-term goals. The authorities noted that there was little appetite for an enforcement mechanism based on

ECCU Countries: Total Number of Fiscal Benchmarks Met, 1998–2005 (Out of 24)



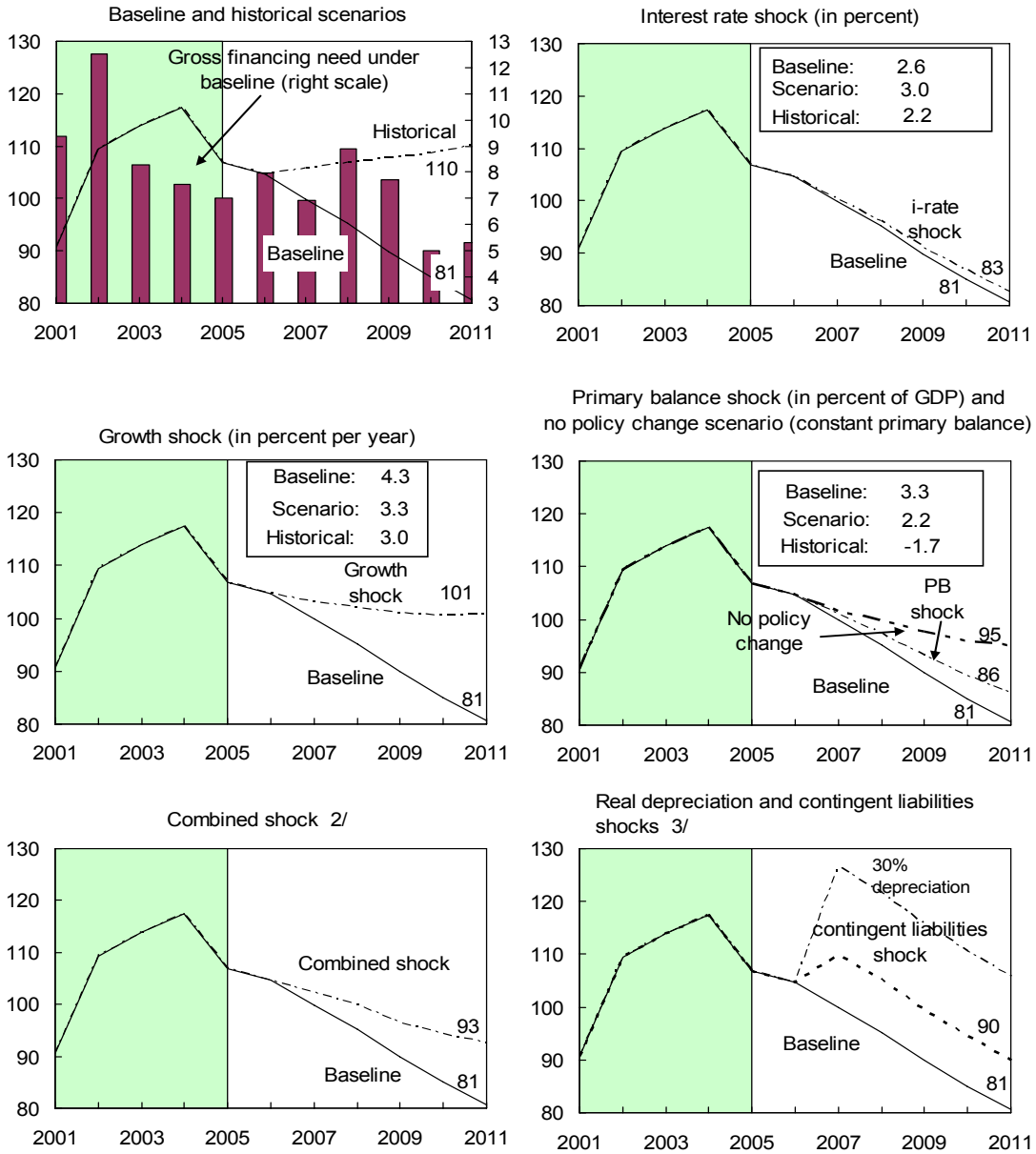
ECCU: Fiscal Benchmarks		
	Old	New
Public debt	Gross central government debt to be less than 60 percent of GDP.	Gross public and publicly guaranteed debt to be less than 60 percent of GDP.
Deficit	Current balance of the central government to be between 4 and 6 percent of GDP. Overall balance of the central government to be less than -3 percent of GDP.	This measure was dropped. Primary balance of the public sector to be consistent with achieving and maintaining the public debt target by 2020.
Debt service	Total debt service to be less than 15 percent of current revenues.	This measure was dropped.
Application	Benchmarks applied equally across countries and to be achieved by 2007.	Different speeds of convergence can be permitted, with intermediate targets established for each country, based on initial conditions and constraints to be achieved by 2020.

Source: Eastern Caribbean Central Bank.

strategies, the introduction of VATs throughout the region serves to compensate for the lower level of grant receipts post-CWC. Expenditures are anticipated to decline as capital expenditures revert to more sustainable levels.



Figure 6a. ECCU: Public Debt Sustainability: Bound Tests 1/  
(Public debt in percent of GDP)



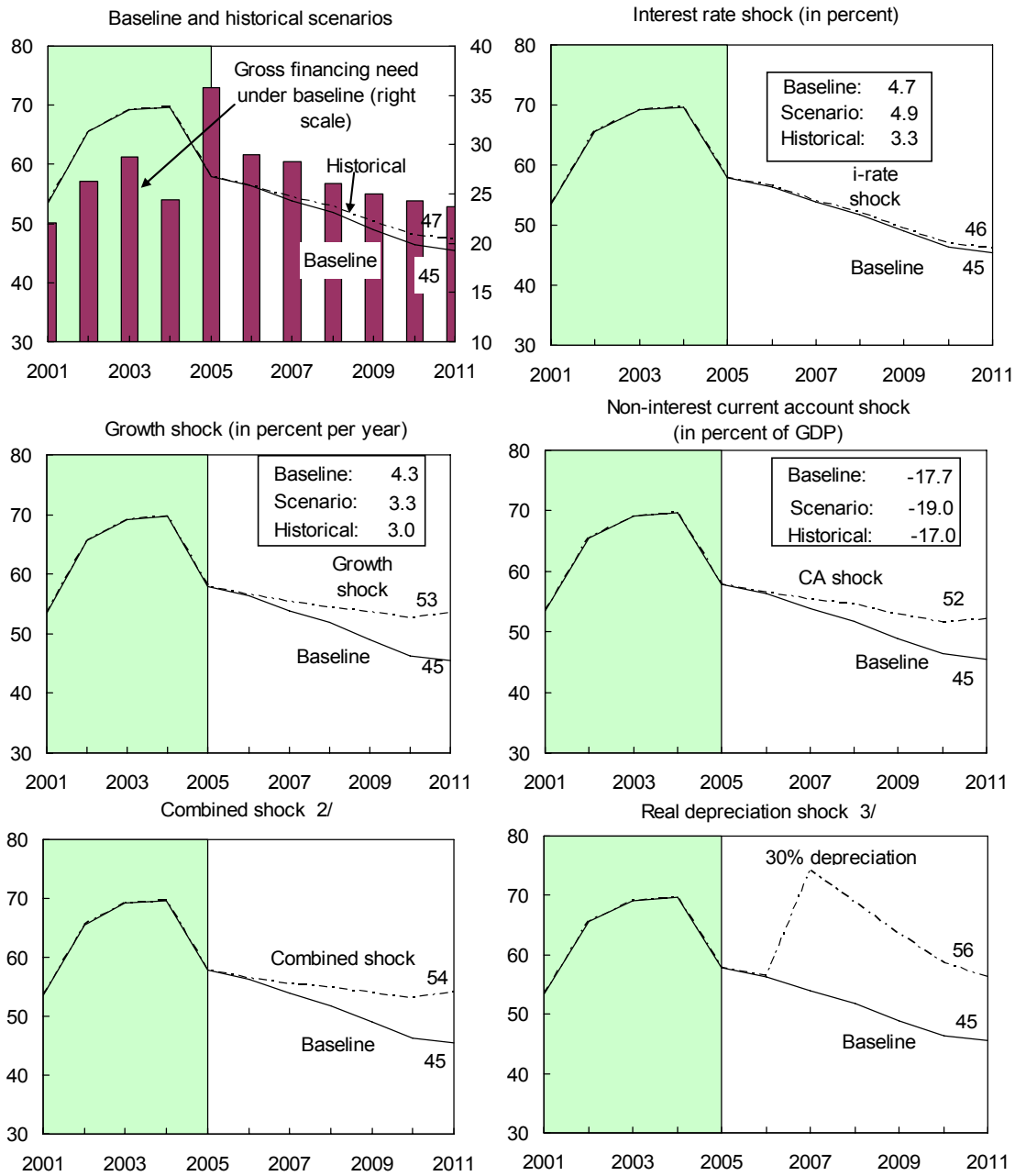
Source: Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent one-fourth standard deviation shocks applied to real interest rate, growth rate, and primary balance.

3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 6b. ECCU: External Debt Sustainability: Bound Tests 1/  
(External debt in percent of GDP)



Source: Fund staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

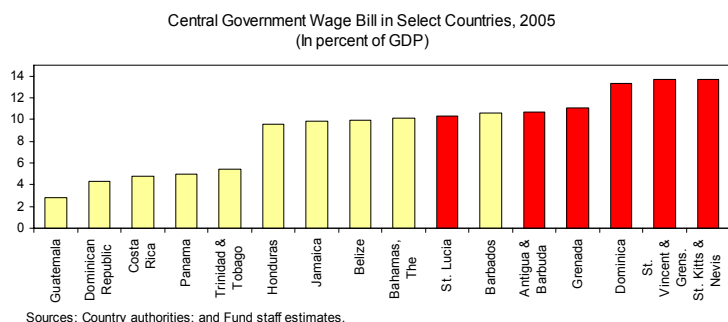
3/ One-time real depreciation of 30 percent occurs in 2007.

economic sanctions—which they considered had been ineffective in the European Union. The credibility of the new system would be maintained through a system of peer review in the Monetary Council, and greater transparency.

29. **Staff noted that while the modifications were a pragmatic step, there was a clear need to credibly demonstrate commitment to the new benchmarks.** Ensuring the credibility of the adjustment path is increasingly critical given the increased reliance on market sources of financing for government and the anticipated diminution of social security surpluses as regional pension systems mature. In this context, it would be important to establish and meet annual targets that are appropriately ambitious and plausibly consistent with achieving the medium-term objectives even in the event of adverse shocks. The emphasis on public sector, rather than central government, targets is a welcome step but creates a need for countries to regularly compile such data and, in some cases, enforce reporting requirements on statutory bodies.

30. **Achieving and sustaining the fiscal effort needed to meet the benchmarks will require a broad and durable social consensus on the importance of fiscal prudence.** Staff noted that revenue reforms were well underway, so that much of the fiscal adjustment going forward would stem from expenditure restraint. Staff suggested a public discussion on the role of government in the economy to establish expectations on expenditure entitlements that would be consistent with available fiscal envelopes. Such discussions could occur in the context of an OECS commission on expenditure, as had been done successfully in the area of tax policy. Key components could include:

- Development of comprehensive poverty-reduction strategies—such as those articulated in the PRSP of Dominica, and I-PRSPs in St. Vincent and the Grenadines and Grenada—including well-targeted social safety nets.
- A clear statement of the services to be provided by government and an assessment of the most effective means of delivering such services.
- Civil service reform to ensure appropriate incentives for the efficient provision of government services and to help reduce the size of government wage bills which, while they have been reduced in some countries, remain very high by international standards.
- Well-prioritized Public



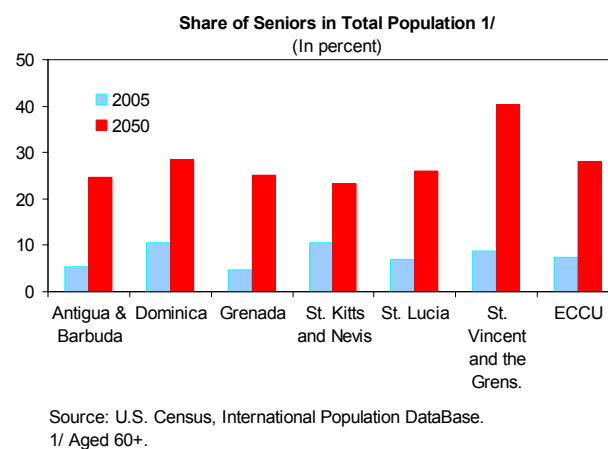
Sector Investment Programs (PSIPs), including economic cost-benefit analysis, and consistent approval and evaluation procedures.

- Options for providing further services at the regional level, for example in debt management.

31. **The authorities agreed on the importance of fiscal prudence, but considered that curbing expenditure would be difficult given a changing global environment and development needs.** They expected that government would need to continue to lead the development process, especially in light of the erosion of trade preferences, lower aid flows, and pressures by industrial countries on offshore financial sectors and online gaming. Also, in some cases, substantial public infrastructure investments—for example new international airports—would be needed to secure future employment opportunities and that this would imply debt ratios rising further in some countries in the coming years. Accordingly the burden of fiscal adjustment would continue to fall on efforts to mobilize revenues.

#### *Population aging*

32. **The ECCU region is likely to see a rapid aging of its population over the next few decades, creating additional pressures for fiscal expenditures.** The share of seniors in the population is projected to more than triple in most countries over the next 30–40 years, owing to increased longevity, lower birth rates, and returning migrants. The demographic shift will place increased pressure on both social security finances and health care systems.



33. **Pension reforms are needed in a number of countries to ensure viability going forward.** While national social security schemes were intended to be fully funded, pension liabilities in some countries are significantly larger than assets.<sup>9</sup> Staff urged prompt action—involving adjustments to

Net Pension Liabilities 1/ (Percent of 2004 GDP)	
Antigua and Barbuda	95.7
Dominica	167.4
Grenada	38.2
St. Kitts and Nevis	20.7
St. Lucia	-4.0
St. Vincent and the Grenadines 2/	n.a.

1/ Figures for ECCU based on a 60-year horizon and a 5.5 percent discount rate.

<sup>9</sup> The net pension liability (or actuarial balance) is the net present value of future income and expenditure streams. It is sensitive to long-run assumptions regarding key variables, especially the interest rate. See Rasmussen and Roache, Chapter IV in *ECCU: 2006 Selected Issues* “Social Security in the ECCU.”

contribution rates, benefits formulae, the retirement age, and portfolio management—to ensure long-term sustainability of social security and bring parameters more in line with other Caribbean islands. Civil service pensions—noncontributory and provided in addition to social security pensions—had been addressed in Dominica, Grenada, and St. Lucia, and staff urged the remaining national authorities to take steps to limit this potentially massive fiscal liability. All country authorities recognized the concerns and the urgency of reform; some noted that they have already begun a process of public consultations to build social consensus for the needed reforms—Dominica has recently approved a reform package that is expected to eliminate its unfunded liability.

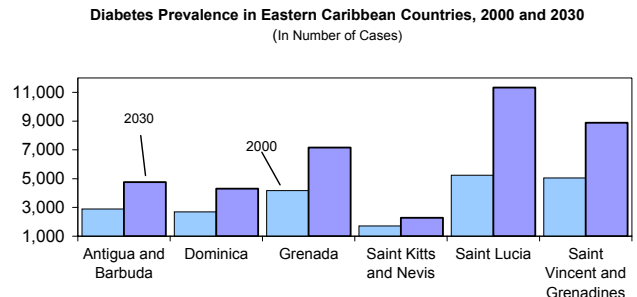
Caribbean Countries: Selected Pension System Parameters, 2004

	Retirement Age		Social Security Contribution Rate			Administrative Costs as % of Contributions
	Civil Service	Social Security	Insured Person	Employer	Total	
Antigua and Barbuda	60	60	3	5	8	16
Dominica	60	60	3	7	10	16
Grenada	60	60	4	5	9	12
St. Kitts and Nevis	55	62	5	6	11	15
St. Lucia	55	61	5	5	10	13
St. Vincent and the Grenadines	55	60	2.5	3.55	6.05	17
Barbados	60	65	6.82	7.57	14.4	6
Jamaica (M/F)	65/60	70/65	2.5	2.5	5	12
Trinidad	55	65	2.8	5.6	8.4	7

Sources: U.S. Social Security Administration, ILO, Social Security in The English-speaking Caribbean, and IMF country desks.

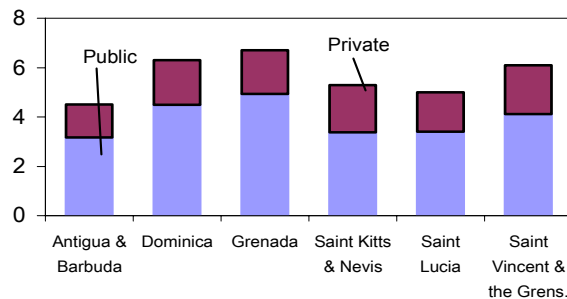
**34. Early action is needed to contain the growth of health care costs.**

The incidence of noncommunicable diseases is increasing rapidly, with diabetes already among the leading causes of death in many countries. The authorities expressed their deep concern over this trend, noting that the impact of noncommunicable diseases significantly exceeded that of HIV/AIDS which was being addressed through grant financed programs. Staff noted that the resources devoted to public health systems are already large and likely to grow with population aging, so that careful consideration was needed of the government’s role in providing health care (Figure 7). Balancing public provision of health care within available fiscal envelopes, requires a multi-pronged approach—exploiting efficiency gains through regional sharing arrangements, encouraging healthier lifestyles, and alternative financing arrangements such as



Source: Wild et al. (2004), "Global Prevalence of Diabetes: Estimates for the year 2000 and projections for 2030" *Diabetes Care*, vol. 27, pp. 1047–53.

**Spending on Health, 2003**  
(In percent of GDP)

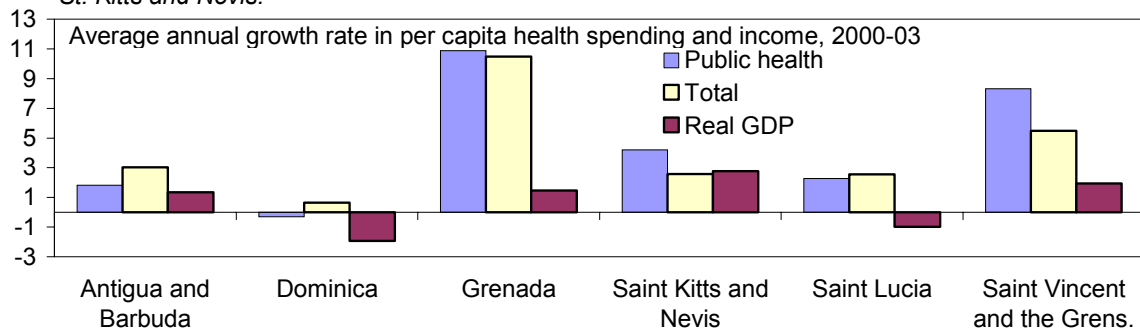


Source: World Health Organization.

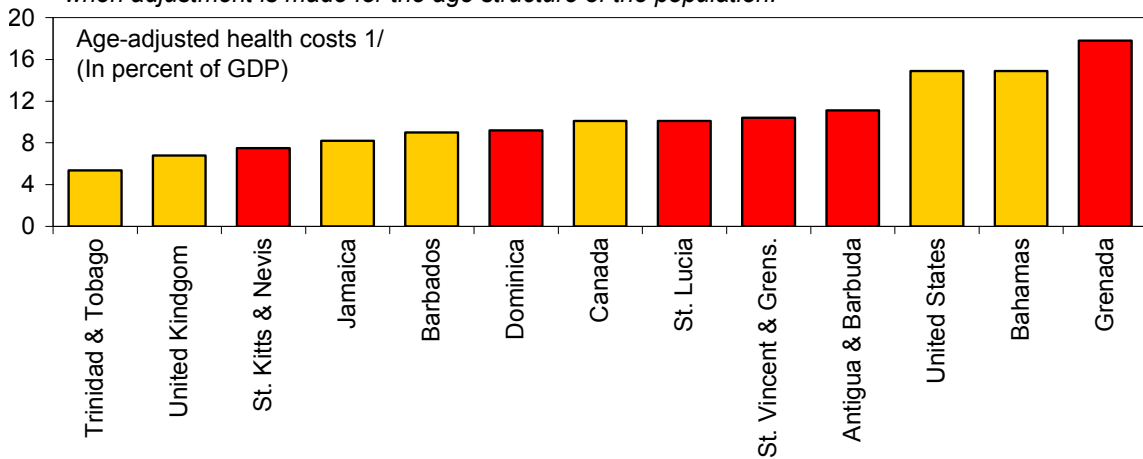
well-targeted user fees and private insurance. The authorities agreed but noted that it was very difficult for any government—particularly for a small state—to deny health care to a needy person and that there were pressures to introduce universal health care systems.

Figure 7. ECCU: Health Care

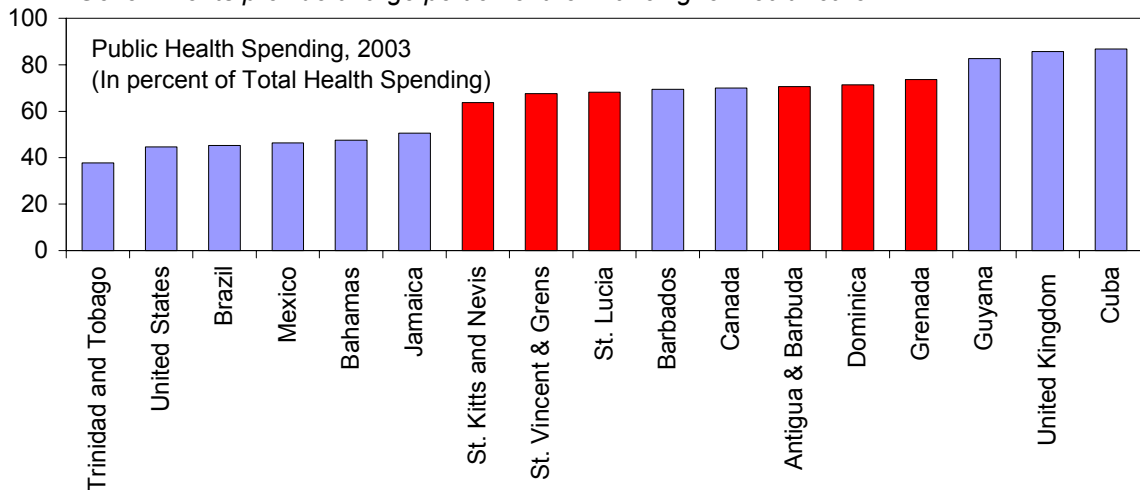
Health expenditures have increased faster than GDP in all ECCU countries, except St. Kitts and Nevis.



ECCU countries spend almost as much for the provision of health services as OECD countries when adjustment is made for the age structure of the population.



Governments provide a large portion of the financing for health care.



Sources: U.S. Census Bureau; World Health Organization; International Financial Statistics; and Fund staff estimates.

1/ Hypothetical health spending that would arise, if each country has the same proportion of its population above the age of 65, as Canada (Esmail, 2006). It assumes an elasticity of health spending in percent of GDP to the share of population over 65 of 0.698.

## V. FOSTERING A SOUND AND DYNAMIC FINANCIAL SYSTEM

35. **The authorities noted the progress made in implementing FSAP recommendations to strengthen the regulatory framework for banks (Box 4).** In particular, the harmonized Banking Act has been passed in all countries, and new prudential guidelines have been implemented, including requiring provisioning for nonperforming government debt. Staff welcomed the progress made but cautioned that enforcement remained a challenge, especially with regard to banks that have delayed taking remedial measures. Progress in developing a risk-based supervisory framework has also been slow and resource constraints have limited the scope and frequency of on-site inspections by the ECCB.
36. **Stress tests conducted by the ECCB pointed to the robustness of the banking system to plausible shocks, but identified credit risk as a concern.** In particular, interest rate risk, foreign exchange risk, and liquidity risk, were not found to be significant risk factors. Credit risk is a weakness throughout the region—and NPLs are already relatively high. However, ECCB staff did not view the current credit boom as exacerbating these risks as it reflected improved long-term prospects, rather than just the CWC. Government exposures, which differ significantly among countries, were found to be a particular vulnerability in just one country. More generally, staff noted the importance of strengthening accounting and auditing standards to ensure the accuracy of banks' balance sheet data to enable an accurate assessment of capital and underlying risks. They suggested that weaknesses in the legislative frameworks for foreclosures and collateral realization had contributed to the high and persistent NPLs. The authorities concurred but stressed the sensitivities associated with evicting borrowers from their homes and that an effective education program would be needed so that the public recognized the problem as one of protecting depositors' rights.
37. **Progress is underway in introducing a harmonized framework for supervising nonbank financial institutions (NBFIs), but this remains an area of concern.** The authorities agreed that there is a gap in the supervision of NBFIs at present, with little monitoring or data collection. Some progress has been made in setting up single regulatory units in each country, although the development and subsequent approval of harmonized legislation was a time-consuming process.
38. **The ECCB's frameworks for liquidity support and crisis management need to be kept under close review.** The authorities noted that the institutional setup of the CBA implied that liquidity and risk management at individual institutions was the first line of defense. They considered that previous experience with past banking problems had demonstrated that coordination and information-sharing between the various constituencies could be handled effectively by the Monetary Council, so that there was no need for a commonly agreed and fully articulated crisis management framework—an FSAP recommendation.

#### Box 4. Implementation Status of FSAP Recommendations on Banking Supervision

Recommendations	Status
Reprioritize the ECCB's resources and work program to focus on the regulation and supervision of systemically important institutions, especially domestic banks, and realign resources to on-site inspections.	Only 7 full scope on-site inspections were undertaken in 2005–06, despite a number of large shocks hitting the region (such as Hurricane Ivan and debt restructurings in Dominica and Grenada). The ECCB has not taken a lead role in supervision of systemically important credit unions.
Develop a more structured program of risk-focused supervision and give priority to developing action plans and implementation of remedial measures by weak banks.	A risk-profiling matrix is being developed that would form the basis for risk-focused supervision and is expected to be put in place by the end of 2006. An early warning system is being developed- prudential reports now identify weak institutions and an enhanced stress testing framework was applied to 2005 data. Banking Supervision uses a ladder approach to compliance that identifies specific corrective actions that the ECCB will take at each successive stage of violation. The new Banking Act permits the supervisor to impose fines at each stage, but these have, to date, been used infrequently, despite the large number of outstanding items on banks' Memoranda of Understandings.
Strengthen data integrity and collection practices to improve the accuracy and completeness of prudential returns submitted by the institutions.	Some progress has been made in improving data collection, but data weaknesses remain. A program was put in place to strengthen timely and accurate prudential reporting, and improvements in returns were noted from June 2005. However, infrequent on-site verification of returns poses the potential risk of mis-reporting.
Strengthen prudential regulation and give greater attention to financial sector governance, including the composition of boards of directors, internal audit and control, and regulations to set minimum capital commensurate with the risks of each institution.	Three guidelines with regard to liquidity risk management, corporate governance, and related party transactions were issued in May 2006. The guideline on internal and external auditors is expected to be issued soon, and those on revised treatment of assets and classification of loans and provisioning, and market risk management are in process. The legislation for minimum capital requirements is in the legislative queue.
Address the union-wide risks entailed in government borrowing from banks.	Positive risk-weighting and provisioning of nonperforming public sector exposures have been implemented since January 1, 2006. The effect on banks' capital is limited for two reasons: (1) there are few nonperforming government exposures; and (2) the partial risk weighting and low uniform provisioning requirement (20 percent risk weighting for only the portion that is non-performing and 10 percent provisioning regardless of how long the loan has remained non-performing) give the public sector exposure much more favorable treatment than private sector exposures. Moreover, the absence of a mark-to-market accounting requirement may lead to an understating of sovereign default risk.
Enhance the powers of the ECCB to achieve greater effectiveness in the regulation and supervision of domestic banks.	Amendments to the uniform Banking Act were passed in all countries. However, the authorities decided that bank licensing authority would remain with the Ministers of Finance.

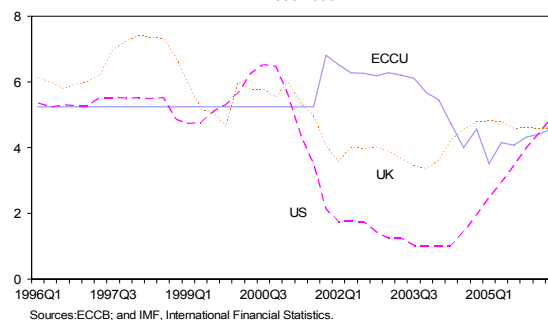


39. **Efforts to develop regional capital markets are bearing fruit. Key markets include:**

- *Interbank market.* Market volumes have increased significantly and the ECCB has not participated in the market since 2002. Interbank rates are slowly converging to those on international markets.
- *Regional Government Securities Market (RGSM).* The total issue amount is small relative to the size of total central government borrowing (around 6 percent at end-2005), but several national governments—Antigua and Barbuda, St. Lucia, and St. Vincent and the Grenadines—regularly access the market and all countries have at least one issue listed. Reflecting the high level of liquidity within the ECCU—notably at the national social security schemes and at local banks—about 50 percent of primary issues have been taken up by ECCU investors.
- *Eastern Caribbean Stock Exchange (ECSE).* Market capitalization has increased sharply following the cross-listing of two CARICOM conglomerates in 2005. However, the volume of trading remains very limited.

40. **Regional markets remain fairly segmented, despite the absence of capital controls, and with fairly rigid pricing.** Staff noted that while volumes on the RGSM had increased, the nonresponsiveness of regional interest rates to changes in global interest rates was puzzling. The authorities explained that rates on the RGSM remained largely determined by

Federal Funds Rate, LIBOR, and the ECCU Interbank Rate  
1996-2006



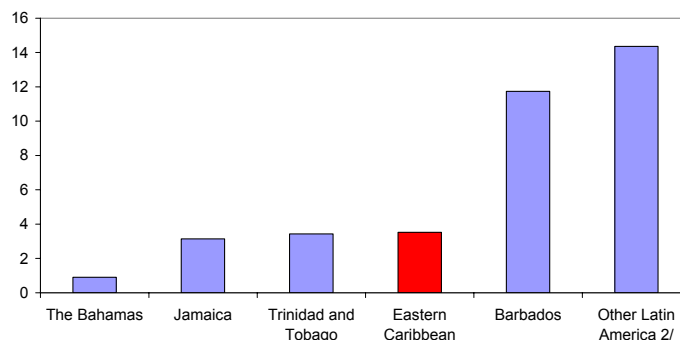
Sources: ECCB; and IMF, International Financial Statistics.

ECCU: RGSM Market Capitalization, EC\$ million

	2002	2003	2004	2005	June 2006
<b>Bonds and notes</b>					
10-year	75	75	185	210	235
6-year	...	...	27	27	27
5-year	...	...	50	100	100
<b>Bills</b>					
365 day	...	25	52	77	77
91 day	...	63	48	48	99
<b>Total</b>	<b>75</b>	<b>163</b>	<b>362</b>	<b>462</b>	<b>538</b>

Source: ECCB.

Liquidity in Selected Stock Exchanges, 2002-04 1/  
(Period average, in percent)

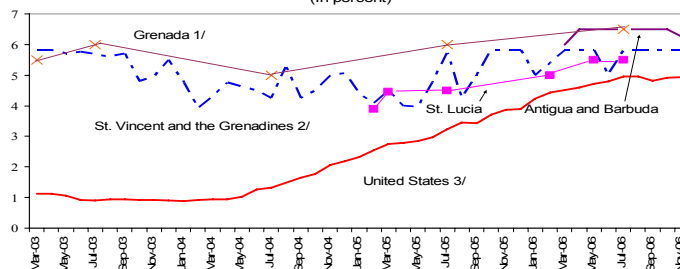


Sources: Caribbean Trade and Investment Report, 2005; and ECSE.

1/ This is the ratio of total share value traded to total domestic market capitalization.

2/ Includes Bermuda, Argentina, Colombia, Peru, Mexico, Chile, and Brazil.

ECCU: Interest Rate on 91-Day Treasury Bills Compared with U.S., 2003-06  
(In percent)



Sources: Eastern Caribbean Regional Government Securities Market; and U. S. Federal Reserve.

1/ Grenada rate is on 13-week T-bills issued on March 2003 and 1-year T-bills issued since.

2/ March-03, May-03, and Feb-06 rates for St. Vincent and the Grenadines are interpolated.

3// U. S. rate is the interest rate on 13-week Treasury bills.

local market conditions. Thus the high level of liquidity of local markets and the portfolio allocation decisions of social security funds had generated a high level of demand for locally issued securities, despite the generally high debt levels.

41. **Markets are expected to deepen with progress toward CSM and further infrastructure improvements.** The authorities noted that the technological infrastructure is state-of-the-art, with an electronic trading platform with T+1 settlement and a dematerialized Central Securities Depository System. Trading costs are high by international standards, but comparable to those in other Caribbean stock exchanges. They noted that it would take time for capital markets to develop—especially given the absence of market makers, the prevalence of family-owned businesses, and the predominance of “buy and hold” investors in the region. The Exchange Control Act was recently revoked—eliminating remaining capital controls except for a few prudential restrictions<sup>10</sup>—which should boost the integration of ECCU markets with those in the broader Caribbean and provide opportunities for regional investors to raise capital at lower costs. Additional steps that are underway are the introduction of a master REPO agreement to facilitate secondary trading in government securities, and to develop an Eastern Caribbean Unit Trust to enhance trading in equities and create an additional savings vehicle.

## VI. INSTITUTION BUILDING

42. **The authorities noted that small states faced difficult capacity constraints when implementing policy reforms.** They welcomed, therefore, the technical assistance from CARTAC, the Fund, and donors in supporting both the design and implementation of key measures.<sup>11</sup> As the policy reform agenda remained large, they foresaw additional needs for technical assistance, especially for the implementation of VATs, strengthening financial sector supervision, improving public expenditure management systems, and in debt management.

43. **Data weaknesses remain a key impediment to policymaking, consensus building, and surveillance in the region.** Particular concerns are data on: (i) operations of the broader public sector; (ii) domestic and external debt of the public sector; (iii) balance of payments and national accounts—particularly the coverage of tourism and foreign direct investment;<sup>12</sup>

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<sup>10</sup> The remaining restrictions include the restriction on local resident to hold foreign currency account, the restriction on lending abroad by local financial institutions, and the Alien Land Holding Act that requires approval for nonresidents to hold financial and real assets (holdings through the ECSE are exempt in four countries).

<sup>11</sup> Detailed descriptions of the assistance provided by CARTAC, the Fund, the World Bank, and the CDB are contained in the Informational Annex.

<sup>12</sup> Vuletin, Chapter III in *ECCU: 2006 Selected Issues* “The Size of the Informal Economy in the Caribbean,” suggests the presence of a large informal sector in most countries which may not be captured in the official statistics.

(iv) indicators of competitiveness, such as labor market outcomes; (v) financial soundness indicators; and (vi) poverty and other social indicators.

## VII. STAFF APPRAISAL

44. **The ECCU region is benefiting from a welcome resurgence of economic activity, but the challenge will be to sustain the growth momentum in 2007 and beyond.** Growth has reached a 15-year high, reflecting the effects of the preparations for the CWC as well as a pick up in private investment. This has helped create new employment opportunities and ameliorate the adverse effects of both the decline in traditional agriculture and, in some countries, a scaling back of public sector employment. Although the risk of a hard landing following the CWC seems manageable, the region still faces significant headwinds, including still high world energy prices, declining trade preferences, and a massive public debt burden.

45. **The CBA continues to serve the ECCU well.** The exchange rate peg has underpinned a prolonged period of price stability that has contributed importantly to economic development in the region. Available indicators suggest that the currency remains competitive, reserve coverage has been adequate, and the significant new private investment underway in the tourism sector points to continuing strong prospects in the key sector of the economy.

46. **Nonetheless, the region's exchange rate peg and vulnerability to natural disasters and other shocks makes it even more critical to place fiscal positions on a sustainable path.** The public debt ratio remains among the highest in the world, and fiscal situations are likely to become even more challenging in coming years as population aging causes social security surpluses to wane and increases pressures on public health systems. Against this background, the improvement in fiscal and debt positions in recent years appears too modest, especially given growth and revenue buoyancy. Going forward, the key priorities include:

- **Early and sustained progress toward meeting the new fiscal benchmarks:** Demonstrating commitment to the revised timeline is essential given the failure of the previous benchmarks to ensure fiscal convergence.
- **Effective tax reform:** Encouraging steps have been taken to strengthen tax systems throughout the region, and care will be needed to ensure that VAT implementation is effective, with limited exemptions.
- **Expenditure consolidation:** With CWC spending pressures easing and domestic fuel prices now largely having been adjusted, it will be important to establish firmer spending controls and to allow increased tax revenues to support rapid and sustained declines in debt positions. Civil service reform—both to enhance the efficiency of government service provision and to reduce wage bills that remain very high—will be a key component of the expenditure consolidation. In addition, domestic and regional

approaches to building a social consensus on the role of government could be useful, especially in the area of health care, where demands are likely to rise sharply in the coming years.

47. **Efforts are also needed to foster the conditions that support private-sector-led growth.** Tax concessions have proven to be extremely costly and appear to be relatively ineffective in encouraging new investment, and the region would benefit from coordinated approaches to disciplining the provision of concessions. Increased focus on strengthening the regulatory, administrative, and legal impediments to private business activity is also important for encouraging investment. Moreover, the CSME provides an important opportunity to further liberalize factor markets and allow the region to benefit more fully from the opportunities provided by globalization.

48. **Financial sector supervision needs to be strengthened to contain emerging risks and provide a reliable basis for further financial market development.** Progress has been made in strengthening the supervisory framework for the banking system, but the framework needs to be translated into effective interventions to bring banks into compliance with the norms. Supervision of the nonbank financial sector needs to be bolstered and while existing initiatives to harmonize and consolidate regulation and supervision are welcome, expeditious implementation will be key.

49. **Weaknesses in the quality, timeliness, and dissemination of statistics is a constraint on effective economic management and public transparency.** Innovative solutions, possibly including a greater role for regional entities in compiling and analyzing data, are needed to overcome the capacity constraints inherent in small economies. While transparency has improved in many countries through greater use of public consultations on key policy issues, enhanced dissemination of relevant data would both enable a more informed debate and provide a better basis for creditors and investors.

50. **It is proposed that the next consultation on ECCU policies take place in 12 months.**

Table 1. ECCU: Selected Economic and Financial Indicators, 2002–07

	2002	2003	2004	2005	Proj.	
					2006	2007
(Annual percentage change)						
<b>National income and prices 1/</b>						
Real GDP	0.8	3.0	3.6	5.6	4.9	4.4
GDP deflator	0.5	1.2	2.1	2.5	2.3	2.9
Consumer prices, average	1.1	1.6	2.1	3.5	3.7	3.2
<b>Monetary sector</b>						
Liabilities to the private sector (M2)	6.6	9.5	13.2	8.4	9.8	9.5
(Annual change, in percent of M2 at the beginning of the year)						
Net foreign assets	5.9	8.7	6.8	1.4	0.3	1.8
Net domestic assets	0.7	0.8	6.4	7.1	9.5	7.7
<i>Of which</i>						
Private sector credit	1.8	2.0	5.1	9.2	11.7	7.2
Credit to central government	-0.2	-1.3	-1.0	2.0	-1.0	0.5
(In percent of GDP)						
<b>Public sector 1/</b>						
Primary central government balance	-6.6	-0.8	0.2	0.4	0.3	2.0
Overall central government balance	-10.9	-5.6	-4.5	-3.8	-4.0	-2.3
Total revenue and grants	28.0	29.4	29.0	30.1	31.1	29.7
Total expenditure and net lending	38.9	34.9	33.5	33.9	35.1	32.0
Foreign financing	6.0	6.1	3.8	-4.1	1.8	-0.4
Domestic financing including arrears	3.1	1.8	0.6	3.1	1.8	1.4
Central government current account balance	-2.5	-0.2	0.1	0.9	1.3	2.9
Total public debt (end-of-period)	109.3	113.5	117.1	106.6	104.5	99.7
(Annual percentage change)						
<b>External sector</b>						
Exports, f.o.b.	-0.2	0.7	14.4	-7.6	4.6	4.4
Imports, f.o.b.	0.1	13.2	8.1	12.2	6.0	4.9
Stayover visitors	-2.7	14.3	10.0	0.2	...	...
Nominal effective exchange rate 1/2/ (1990 =100) end-of-period (depreciation -)	-0.5	-3.2	-2.7	-0.4	...	...
Real effective exchange rate 1/2/ (1990 =100) end-of-period (depreciation -)	-1.0	-4.2	-3.6	-1.0	...	...
(In percent of GDP)						
External current account balance	-20.2	-22.0	-16.4	-21.7	-22.9	-20.8
Trade balance	-34.1	-38.0	-37.6	-40.0	-39.7	-38.7
Services, incomes and transfers	13.9	16.0	21.2	18.3	16.8	18.0
<i>Of which</i>						
Travel	24.5	27.5	28.7	26.2	25.8	26.5
Capital and financial accounts 3/	22.3	23.5	19.7	20.8	24.2	22.2
<i>Of which</i>						
Foreign direct investment	11.6	17.9	13.1	12.3	15.2	13.5
External public debt (end-of period) 1/	65.6	69.2	69.7	57.9	56.4	53.8
External debt service, in percent of goods and nonfactor services	8.8	9.7	10.4	16.0	8.5	9.3
<i>Of which</i>						
Interest	4.2	4.7	4.6	4.1	4.3	3.9
End-year gross foreign reserves of the ECCB						
In U.S. dollar million	504.8	539.9	632.4	600.8	651.7	711.3
In months of imports	4.6	4.4	4.7	4.0	4.1	4.3
In percent of broad money	20.2	19.8	20.5	17.9	17.7	17.6
Currency backing ratio, in percent 4/	97.1	95.3	96.2	96.5	...	...

Sources: Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ Excludes Anguilla and Montserrat. ECCU aggregates are calculated as weighted averages of individual country data; ratios to GDP are then calculated by dividing this sum by the aggregated GDP of the region.

2/ Figure for 2005 corresponds to 12-month percentage change until September.

3/ Includes errors and omissions.

4/ ECCB's foreign assets as a ratio of its demand liabilities.

Table 2. ECCU: Selected Central Government Indicators by Country, 2002–07 1/  
(In percent of GDP)

	2002	2003	2004	2005	Proj.	
					2006	2007
<b>Total revenues and grants</b>	<b>28.0</b>	<b>29.4</b>	<b>29.0</b>	<b>30.1</b>	<b>31.1</b>	<b>29.7</b>
Antigua and Barbuda	21.7	21.1	21.6	21.8	26.1	23.4
Dominica	32.5	40.0	38.8	41.1	38.7	37.5
Grenada	29.0	34.5	33.9	36.8	36.5	30.3
St. Kitts and Nevis	34.8	33.3	34.1	39.3	40.1	38.8
St. Lucia	27.0	27.9	27.4	25.9	26.3	27.5
St. Vincent and the Grenadines	31.7	31.3	30.0	30.5	31.1	31.7
<b>Tax revenues</b>	<b>22.1</b>	<b>23.0</b>	<b>23.8</b>	<b>24.5</b>	<b>24.8</b>	<b>25.1</b>
Antigua and Barbuda	18.4	18.8	19.3	19.3	21.6	21.4
Dominica	24.3	27.1	28.4	30.3	27.6	26.5
Grenada	23.8	24.9	24.2	25.3	24.6	25.7
St. Kitts and Nevis	22.1	23.6	25.7	28.8	29.0	29.2
St. Lucia	21.9	23.4	25.2	24.1	23.8	24.4
St. Vincent and the Grenadines	26.3	25.2	24.9	26.5	27.2	27.9
<b>Current expenditure</b>	<b>28.0</b>	<b>26.9</b>	<b>27.1</b>	<b>26.1</b>	<b>26.3</b>	<b>25.0</b>
Antigua and Barbuda	28.8	26.7	25.2	24.9	25.6	22.9
Dominica	32.8	31.2	31.0	30.4	27.0	27.0
Grenada	25.9	24.3	28.6	22.1	23.0	21.9
St. Kitts and Nevis	34.0	33.7	34.3	37.2	36.1	34.6
St. Lucia	23.5	23.8	23.3	21.8	22.7	22.4
St. Vincent and the Grenadines	28.0	26.7	26.3	27.8	27.7	26.7
<i>Of which</i>						
Interest payments	4.4	4.7	4.8	4.2	4.3	4.2
Antigua and Barbuda	5.3	5.4	4.9	4.9	4.2	4.7
Dominica	5.5	5.8	5.8	5.4	2.4	2.3
Grenada	4.7	5.2	6.6	2.0	2.4	2.1
St. Kitts and Nevis	7.3	7.5	6.9	8.1	9.1	8.6
St. Lucia	2.5	2.9	3.2	3.0	3.9	3.7
St. Vincent and the Grenadines	2.6	2.7	2.5	3.0	3.9	3.4
<b>Current balance</b>	<b>-2.5</b>	<b>-0.2</b>	<b>0.1</b>	<b>0.9</b>	<b>1.3</b>	<b>2.9</b>
Antigua and Barbuda	-8.3	-5.7	-3.8	-4.1	-2.4	0.1
Dominica	-5.0	-0.2	1.7	2.9	3.0	2.0
Grenada	0.6	3.2	-2.5	4.3	3.6	5.7
St. Kitts and Nevis	-2.9	-1.2	-1.0	-0.9	1.7	3.5
St. Lucia	0.4	1.9	4.1	3.9	2.7	3.6
St. Vincent and the Grenadines	2.6	4.1	2.9	1.2	1.9	3.6
<b>Primary balance</b>	<b>-6.6</b>	<b>-0.8</b>	<b>0.2</b>	<b>0.4</b>	<b>0.3</b>	<b>2.0</b>
Antigua and Barbuda	-6.9	-4.2	-1.2	-2.3	-1.7	0.8
Dominica 2/	-1.6	5.4	3.5	6.7	4.0	3.0
Grenada	-14.5	0.4	3.7	2.3	0.5	2.0
St. Kitts and Nevis	-11.2	-1.2	-0.4	3.6	6.1	5.7
St. Lucia	-4.8	-0.1	-0.6	-0.3	-1.4	1.3
St. Vincent and the Grenadines	0.4	-0.6	-1.1	-2.6	-0.4	0.8
<b>Overall balance</b>	<b>-10.9</b>	<b>-5.6</b>	<b>-4.5</b>	<b>-3.8</b>	<b>-4.0</b>	<b>-2.3</b>
Antigua and Barbuda	-12.2	-9.5	-6.1	-7.1	-6.0	-3.9
Dominica	-5.4	-1.3	-0.9	1.2	1.6	0.7
Grenada	-19.2	-4.8	-2.8	0.2	-1.9	-0.1
St. Kitts and Nevis	-18.5	-8.7	-7.3	-4.5	-3.0	-2.9
St. Lucia	-7.3	-3.0	-3.9	-3.4	-5.4	-2.3
St. Vincent and the Grenadines	-2.3	-3.3	-3.6	-5.6	-4.2	-2.6
<b>Total public sector debt 3/</b>	<b>109.3</b>	<b>113.5</b>	<b>117.1</b>	<b>106.6</b>	<b>104.5</b>	<b>99.7</b>
Antigua and Barbuda	140.1	146.8	137.4	107.7	103.5	100.9
Dominica	125.5	127.4	113.2	105.5	99.2	94.6
Grenada	109.6	110.0	132.7	120.2	118.2	108.4
St. Kitts and Nevis	161.0	179.3	192.1	190.2	183.4	172.1
St. Lucia	64.4	63.9	69.3	68.5	68.3	65.9
St. Vincent and the Grenadines	70.5	72.3	78.1	81.6	84.5	83.5

Sources: Country authorities; and Fund staff estimates.

1/ Excludes Anguilla and Montserrat. Fiscal years for Dominica and St. Lucia.

2/ Dominica's primary balance is measured by below-the-line financing and may not equal the above-the-line definition.

3/ Government and government guaranteed debt stock. Includes external arrears.

Table 3. ECCU: Summary Balance of Payments, 2002–07

	2002	2003	2004	2005	Proj.	
					2006	2007
(In millions of U.S. dollars)						
<b>Current account</b>	<b>-595.2</b>	<b>-680.9</b>	<b>-544.9</b>	<b>-798.6</b>	<b>-904.4</b>	<b>-882.1</b>
Trade balance	-1,005.6	-1,176.2	-1,252.3	-1,474.0	-1,567.6	-1,646.2
Exports	305.1	307.3	351.6	324.7	339.8	354.8
Imports	-1,310.7	-1,483.5	-1,603.9	-1,798.8	-1,907.4	-2,001.0
Services and income	310.7	366.0	486.6	468.0	509.5	605.4
Services	524.7	603.6	744.9	700.9	750.5	847.3
Transportation	-104.8	-137.7	-146.7	-171.6	-184.2	-198.0
Travel	723.0	852.6	955.8	965.4	1,021.3	1,125.9
Other services	-93.5	-111.2	-64.2	-92.9	-86.6	-80.5
Income	-214.0	-237.6	-258.3	-232.9	-241.0	-241.9
Current transfers	99.7	129.3	220.8	207.5	153.7	158.7
<b>Capital and financial account</b>	<b>656.4</b>	<b>726.8</b>	<b>654.9</b>	<b>764.8</b>	<b>955.3</b>	<b>941.7</b>
Capital transfers (net)	131.9	131.0	136.0	327.5	205.0	140.0
Financial account	524.4	595.8	518.8	437.3	750.3	801.7
Direct investment	342.0	553.2	434.9	452.4	602.4	572.4
Portfolio investment	165.7	150.4	67.5	31.3	45.9	47.3
Public sector long term	35.1	17.8	16.6	-105.3	19.7	-16.2
Other public sector capital	0.6	0.0	0.0	0.0	0.0	0.0
Commercial banks	-77.3	-168.2	-105.9	-74.7	40.7	-5.4
Other capital 1/	58.3	42.6	105.8	133.6	41.6	203.6
<b>Overall balance</b>	<b>61.2</b>	<b>45.8</b>	<b>110.0</b>	<b>-33.8</b>	<b>50.9</b>	<b>59.6</b>
<b>Financing</b>	<b>-61.2</b>	<b>-45.8</b>	<b>-110.0</b>	<b>33.8</b>	<b>-50.9</b>	<b>-59.6</b>
(In percent of GDP)						
<b>Current account</b>	<b>-20.2</b>	<b>-22.0</b>	<b>-16.4</b>	<b>-21.7</b>	<b>-22.9</b>	<b>-20.8</b>
Exports	10.3	9.9	10.6	8.8	8.6	8.3
Imports	-44.5	-47.9	-48.1	-48.9	-48.3	-47.1
Services, incomes and transfers	13.9	16.0	21.2	18.3	16.8	18.0
Of which						
Travel	24.5	27.5	28.7	26.2	25.8	26.5
Current transfers	3.4	4.2	6.6	5.6	3.9	3.7
<b>Capital and financial account</b>	<b>22.3</b>	<b>23.5</b>	<b>19.7</b>	<b>20.8</b>	<b>24.2</b>	<b>22.2</b>
Of which						
Direct investment	11.6	17.9	13.1	12.3	15.2	13.5
<b>Overall balance</b>	<b>2.1</b>	<b>1.5</b>	<b>3.3</b>	<b>-0.9</b>	<b>1.3</b>	<b>1.4</b>
(Annual percentage change)						
Exports	-0.2	0.7	14.4	-7.6	4.6	4.4
Imports	0.1	13.2	8.1	12.2	6.0	4.9
Travel, net	-3.0	17.9	12.1	1.0	5.8	10.2
<b>Memorandum items:</b>						
End-year gross reserves of the ECCB, US\$ millions	504.8	539.9	632.4	600.8	651.7	711.3
In months of current year imports	4.6	4.4	4.7	4.0	4.1	4.3
ECCU GDP at market prices, US\$ millions	2,947.6	3,099.2	3,331.5	3,682.2	3,951.6	4,249.2

Source: Eastern Caribbean Central Bank.

1/ Includes errors and omissions.

Table 4. ECCU: Summary Accounts of the Banking System, 2002–07

(In millions of Eastern Caribbean dollars)

	2002	2003	2004	2005	Proj.	
					2006	2007
<b>I. Monetary Survey (Consolidated Banking System)</b>						
<b>Net foreign assets</b>	<b>1,814.1</b>	<b>2,401.8</b>	<b>2,902.0</b>	<b>3,016.4</b>	<b>3,043.9</b>	<b>3,219.4</b>
<b>Net domestic assets</b>	<b>4,920.4</b>	<b>4,975.4</b>	<b>5,447.2</b>	<b>6,036.7</b>	<b>6,897.8</b>	<b>7,663.1</b>
Net credit to the public sector	-87.2	-217.4	-219.2	-10.7	-105.2	-58.8
Central government	644.7	554.8	482.9	652.3	557.8	604.3
Nonfinancial public enterprises 1/	-731.9	-772.3	-702.1	-663.0	-663.0	-663.0
Credit to private sector	6,090.8	6,222.3	6,599.4	7,370.9	8,426.1	9,145.0
Other	-1,083.2	-1,029.5	-933.0	-1,323.5	-1,423.1	-1,423.1
<b>Liabilities to private sector (M2)</b>	<b>6,734.5</b>	<b>7,377.1</b>	<b>8,349.1</b>	<b>9,053.1</b>	<b>9,941.7</b>	<b>10,882.5</b>
Money (M1)	1,319.2	1,505.7	1,884.2	2,084.1	2,288.7	2,523.6
Quasi-money	5,415.3	5,871.5	6,464.9	6,968.9	7,653.0	8,358.9
<b>II. Eastern Caribbean Central Bank</b>						
<b>Net foreign assets</b>	<b>1,355.1</b>	<b>1,449.1</b>	<b>1,702.9</b>	<b>1,611.7</b>	<b>1,749.1</b>	<b>1,910.0</b>
<b>Net domestic assets</b>	<b>-961.9</b>	<b>-1,022.0</b>	<b>-1,219.4</b>	<b>-1,092.9</b>	<b>-1,179.4</b>	<b>-1,286.3</b>
Net position with banks and other institutions	-910.9	-1,005.9	-1,161.7	-1,043.7	-1,130.2	-1,237.2
Credit to government	1.9	31.5	-39.0	-14.8	-14.8	-14.8
Other	-53.0	-47.6	-18.7	-34.3	-34.3	-34.3
<b>Liabilities to private sector</b>	<b>393.2</b>	<b>427.1</b>	<b>483.6</b>	<b>518.8</b>	<b>569.8</b>	<b>623.7</b>
Currency issued	558.7	605.7	660.3	730.3	801.9	877.8
Currency held by banks	-165.4	-178.6	-176.8	-211.4	-232.2	-254.2
<b>III. Commercial Banks</b>						
<b>Net foreign assets</b>	<b>459.0</b>	<b>952.6</b>	<b>1,199.0</b>	<b>1,404.7</b>	<b>1,294.8</b>	<b>1,309.4</b>
Net claims on ECCB	902.5	948.9	1,170.4	1,029.2	1,130.2	1,237.2
<b>Net domestic credit</b>	<b>4,979.8</b>	<b>5,048.6</b>	<b>5,496.1</b>	<b>6,100.4</b>	<b>6,947.0</b>	<b>7,712.3</b>
Net credit to the public sector	-89.1	-248.9	-180.2	4.1	-90.4	-44.0
Central government	642.8	523.3	522.0	667.1	572.6	619.1
Rest of the public sector	-731.9	-772.3	-702.1	-663.0	-663.0	-663.0
Credit to private sector	6,090.8	6,222.3	6,599.4	7,370.9	8,426.1	9,145.0
Other	-1,021.9	-924.8	-1,069.6	-1,388.7	-1,388.7	-1,388.7
<b>Liabilities to the private sector</b>	<b>6,341.3</b>	<b>6,950.0</b>	<b>7,865.6</b>	<b>8,534.2</b>	<b>9,372.0</b>	<b>10,258.8</b>
<b>(Percentage growth compared to M2 at the beginning of the year)</b>						
Net foreign assets	5.9	8.7	6.8	1.4	0.3	1.8
Central bank	2.6	1.4	3.4	-1.1	1.5	1.6
Commercial banks	3.3	7.3	3.3	2.5	-1.2	0.1
Net domestic assets	0.7	0.8	6.4	7.1	9.5	7.7
Of which						
Net credit to the public sector	-0.3	-1.9	0.0	2.5	-1.0	0.5
Credit to the private sector	1.8	2.0	5.1	9.2	11.7	7.2
<b>(Annual percentage change)</b>						
Liabilities to the private sector (M2)	6.6	9.5	13.2	8.4	9.8	9.5
Private sector credit	1.9	2.2	6.1	11.7	14.3	8.5
Income velocity of broad money	1.2	1.1	1.1	1.1	1.1	1.1
Private sector credit/GDP (percent)	76.5	74.4	73.4	74.1	79.0	79.7
Broad money/GDP (percent)	84.6	88.2	92.8	91.1	93.2	94.9
Foreign currency deposits/GDP (percent)	11.5	11.7	13.1	14.2	14.5	14.3

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes the national insurance schemes.



Table 5. ECCU: Creditor Composition of Public Debt at End-2005 1/

(Share of total)

	Antigua and Barbuda 2/	Dominica	Grenada	St. Kitts and Nevis	St. Lucia	St. Vincent and the Grenadines
<b>External debt</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Central government	92.4	77.8	89.3	68.7	84.4	99.7
Multilateral	1.4	39.8	26.8	18.1	34.2	34.0
Official bilateral	13.6	18.9	16.7	5.6	6.1	13.9
Commercial	38.3	17.6	43.0	25.2	37.3	52.1
Other	0.0	0.0	0.0	19.7	6.4	0.0
Arrears, total	39.2	1.6	2.8	0.0	0.0	0.0
Other public sector	7.6	22.0	10.7	31.3	15.6	0.3
<b>Domestic debt</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Central government	96.3	86.4	83.3	57.7	84.7	89.6
ECCB	0.4	7.7	1.5	0.9	6.1	2.3
Private domestic banks	17.8	22.6	13.6	33.3	48.1	53.8
Nonbank financial institutions	...	0.0	...	0.0	0.3	12.0
Insurance funds	...	40.5	4.5	7.9	29.4	11.9
Other	10.4	14.4	...	15.5	0.8	9.6
Arrears, total	67.6	1.2	1.1	0.0	0.0	0.0
Other public sector	3.7	14.0	16.7	42.3	15.0	10.4
<b>Memorandum items:</b>						
Public debt (end-2005, percent of GDP)	102.2	105.5	120.2	190.2	68.5	81.6
<i>Of which</i>						
External debt	37.4	72.7	86.5	72.9	47.7	54.7
Public debt (end-2005, U.S. dollars)	982.5	308.6	605.8	841.0	604.7	351.0
<i>Of which</i>						
External debt	359.8	212.7	435.8	322.4	420.9	235.2

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Excludes Anguilla and Montserrat.

2/ Data for Antigua and Barbuda are as of June 2006. Other domestic category includes government securities.

Table 6. ECCU: Selected Vulnerability Indicators, 2002–07

	2002	2003	2004	2005	Proj.	
					2006	2007
<b>Key economic and market indicators</b>						
Real GDP growth 1/	0.8	3.0	3.6	5.6	4.9	4.4
CPI inflation, end of year in percent 1/	1.2	1.8	2.4	4.2	3.7	3.0
Interbank interest rate 2/	6.3	6.1	4.7	4.0	4.9	...
Exchange rate, NC/US\$ (end of period)	2.7	2.7	2.7	2.7	...	...
<b>External sector</b>						
Current account balance (percent of GDP)	-20.2	-22.0	-16.4	-21.7	-22.9	-20.8
FDI inflows (percent of GDP)	11.6	17.9	13.1	12.3	15.2	13.5
Export growth (f.o.b)	-0.2	0.7	14.4	-7.6	4.6	4.4
Travel (percent of GDP)	24.5	27.5	28.7	26.2	25.8	26.5
Terms of trade (12-month percentage change) 3/	0.5	0.0	0.2	-0.8	-0.1	-0.5
Real effective exchange rate (1990=100) 1/	101.6	97.4	93.8	92.9	...	...
Gross international reserves in US\$ billion	0.5	0.5	0.6	0.6	0.7	0.7
Net international reserves in US\$ billion	0.5	0.5	0.6	0.6	0.6	0.7
Total gross external public debt in percent of GDP 1/	61.9	65.1	64.7	53.7	52.3	50.0
Gross external financing requirement (in US\$ billion) 4/	0.7	0.8	0.7	1.0	1.0	1.0
<b>Consolidated public sector 1/</b>						
Overall central government balance	-10.9	-5.6	-4.5	-3.8	-4.0	-2.3
Primary central government balance	-6.6	-0.8	0.2	0.4	0.3	2.0
Central government current account balance	-2.5	-0.2	0.1	0.9	1.3	2.9
Public sector gross debt (end-of-period)	109.3	113.5	117.1	106.6	104.5	99.7
<b>Public and private financial sector (in percent) 2/</b>						
Capital adequacy ratio (indigenous banks) 5/	17.4	16.4	16.2	16.6	17.3	...
NPLs/total loans	13.7	12.8	11.9	9.4	8.2	...
Indigenous banks	17.4	17.2	15.6	11.7	10.5	...
Foreign banks	9.3	7.8	7.6	6.7	5.4	...
Loan loss provision/NPLs	29.7	32.5	34.7	34.9	32.4	...
Indigenous banks	27.9	27.6	31.3	33.2	27.6	...
Foreign banks	33.6	44.6	42.6	38.4	43.2	...
Loans to agricultural sector/total loans	3.9	4.0	4.0	3.6	3.2	...
Loans to tourism sector/total loans	7.9	7.5	7.7	8.0	9.1	...
Loans to household sector/total loans	46.4	48.4	47.5	47.5	45.8	...
Gross government claims/total assets	15.3	14.5	15.5	15.2	15.1	...
Government deposits/total deposits	17.6	17.2	16.9	17.1	18.3	...
FX deposits/total deposits	15.7	15.3	15.4	16.0	16.9	...
Liquid assets/total assets	26.4	29.5	31.0	28.5	27.7	...
Large loans and advances/total loans	30.0	28.4	28.7	28.2	28.9	...
Large deposits/total deposits	24.1	23.5	22.6	22.2	22.1	...
Risk-weighted assets/total assets	57.6	58.7	53.4	56.2	56.8	...
Contingent liabilities/capital (indigenous banks)	59.3	65.7	75.1	86.9	81.9	...
(Pre-tax) return on average assets	1.6	1.7	1.7	2.1	2.9	...
(Pre-tax) return on average equity	12.6	12.9	13.6	16.2	28.1	...
<b>Memorandum items:</b>						
ECCB reserve cover (in percent) 6/	97.1	95.3	96.2	96.5	...	...
ECCB gross reserves/broad money (in percent)	20.2	19.8	20.5	17.9	17.7	17.6

Sources: Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ Excludes Anguilla and Montserrat.

2/ Figures for 2006, as at end-September.

3/ Excludes Anguilla, Antigua and Barbuda, and Montserrat.

4/ Defined as external current account deficit plus external amortization.

5/ Tier I capital over risk weighted assets.

6/ Foreign assets as a percentage of demand liabilities.

Table 7. Public Sector Debt Sustainability Framework, 2001–2011  
(In percent of GDP, unless otherwise indicated)

	Actual			Projections							Debt-stabilizing primary balance 10/	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010		2011
<b>1 Public sector debt 1/</b>	90.6	109.4	113.9	117.4	106.8	<b>104.6</b>	<b>99.9</b>	<b>95.2</b>	<b>89.9</b>	<b>85.0</b>	<b>80.6</b>	
Of which: Foreign-currency denominated	53.4	65.6	69.2	69.7	57.9	56.4	53.8	51.7	48.9	46.4	44.2	-1.2
2 Change in public sector debt	7.6	18.8	4.5	3.5	-10.6	-2.2	-4.8	-4.7	-5.3	-4.9	-4.4	
3 Identified debt-creating flows (4+7+12)	7.4	9.6	1.1	-2.0	-5.3	-3.5	-5.1	-5.2	-5.5	-5.3	-5.2	
4 Primary deficit	4.2	6.5	0.8	-0.3	-0.4	-0.3	-2.0	-3.2	-3.5	-3.6	-4.0	
5 Revenue and grants	26.1	28.1	29.5	29.1	30.1	31.2	29.7	29.8	29.3	29.5	29.3	
6 Primary (noninterest) expenditure	30.3	34.5	30.3	28.8	29.7	30.9	27.8	26.5	25.9	25.2	25.4	
7 Automatic debt dynamics 2/	3.1	3.4	0.4	-1.4	-4.6	-2.9	-3.0	-1.5	-1.6	-1.3	-0.8	
8 Contribution from interest rate/growth differential 3/	3.1	3.4	0.4	-1.4	-4.6	-2.9	-3.0	-1.5	-1.6	-1.3	-0.8	
9 Of which: contribution from real interest rate	1.9	4.1	3.5	2.5	1.5	1.9	1.3	2.0	2.5	2.5	2.7	
10 Of which: contribution from real GDP growth	1.2	-0.7	-3.1	-3.9	-6.1	-4.9	-4.3	-3.5	-4.1	-3.8	-3.5	
11 Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
12 Other identified debt-creating flows	0.1	-0.3	-0.2	-0.3	-0.3	-0.2	-0.2	-0.4	-0.4	-0.4	-0.4	
13 Privatization receipts (negative)	0.1	-0.3	-0.2	-0.3	-0.3	-0.2	-0.2	-0.4	-0.4	-0.4	-0.4	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3)	0.1	9.2	3.5	5.5	-5.2	1.3	0.4	0.5	0.2	0.4	0.8	
Public sector debt-to-revenue ratio 1/	346.7	389.7	386.6	403.7	354.7	335.3	335.9	319.2	306.4	291.1	274.7	
<b>Gross financing need 5/</b>	9.4	12.5	8.3	7.5	7.0	8.0	6.9	8.9	7.7	5.0	5.3	
In billions of U.S. dollars	0.3	0.3	0.2	0.2	0.2	0.3	0.3	0.4	0.3	0.2	0.3	
<b>Key Macroeconomic and Fiscal Assumptions</b>												
Real GDP growth (in percent)	-1.4	0.8	3.0	3.6	5.6	4.9	4.4	3.7	4.6	4.6	4.4	4.3
Average nominal interest rate on public debt (in percent) 6/	4.4	5.0	4.5	4.4	4.0	4.4	4.4	5.0	5.3	5.5	5.5	5.1
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.3	4.6	3.4	2.4	1.5	2.0	1.5	2.2	2.9	3.1	3.4	2.6
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Inflation rate (GDP deflator, in percent)	2.1	0.5	1.2	2.1	2.5	2.3	2.3	2.9	2.8	2.4	2.3	2.1
Growth of real primary spending (deflated by GDP deflator, in percent)	1.9	15.7	-9.0	-1.4	11.5	8.8	-5.9	-1.0	2.0	3.2	3.5	0.4
Primary deficit	4.2	6.5	0.8	-0.3	-0.4	-0.3	-2.0	-3.3	-3.5	-3.6	-4.0	-3.3
<b>A. Alternative Scenarios</b>												
A1. Key variables are at their historical averages in 2007–11 7/						<b>104.6</b>	<b>105.8</b>	<b>107.0</b>	<b>107.7</b>	<b>108.6</b>	<b>110.0</b>	-1.3
A2. No policy change (constant primary balance) in 2006–11						<b>104.6</b>	<b>101.6</b>	<b>99.9</b>	<b>97.7</b>	<b>96.0</b>	<b>95.2</b>	-1.3
<b>B. Bound Tests</b>												
B1. Real interest rate is at baseline plus one standard deviations						<b>104.6</b>	<b>100.4</b>	<b>96.1</b>	<b>91.2</b>	<b>86.7</b>	<b>82.6</b>	-0.9
B2. Real GDP growth is at baseline minus one-half standard deviation						<b>104.6</b>	<b>103.2</b>	<b>102.1</b>	<b>101.0</b>	<b>100.5</b>	<b>100.8</b>	-0.4
B3. Primary balance is at baseline minus one-half standard deviation						<b>104.6</b>	<b>101.0</b>	<b>97.4</b>	<b>93.2</b>	<b>89.3</b>	<b>86.0</b>	-1.3
B4. Combination of B1-B3 using one-quarter standard deviation shocks						<b>104.6</b>	<b>102.2</b>	<b>99.7</b>	<b>96.6</b>	<b>94.3</b>	<b>92.6</b>	-0.7
B5. One time 30 percent real depreciation in 2007 9/						<b>104.6</b>	<b>126.6</b>	<b>121.5</b>	<b>115.7</b>	<b>110.4</b>	<b>105.8</b>	-1.5
B6. 10 percent of GDP increase in other debt-creating flows in 2007						<b>104.6</b>	<b>109.9</b>	<b>105.0</b>	<b>99.5</b>	<b>94.5</b>	<b>90.0</b>	-1.3

1/ Gross government and government-guaranteed debt.

2/ Derived as  $[(r - p(1+g) - g + ae(1+r))/(1+g+p+gp)]$  times previous period debt ratio, with  $r$  = interest rate;  $p$  = growth rate of GDP deflator;  $g$  = real GDP growth rate;  $a$  = share of foreign-currency denominated debt; and  $e$  = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as  $r - \pi(1+g)$  and the real growth contribution as  $-g$ .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as  $ae(1+r)$ .

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest rate divided by previous period debt stock.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ The implied change in other key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 8. ECCU: External Debt Sustainability Framework, 2001–2011  
(in percent of GDP, unless otherwise indicated)

	Actual					Projections					Debt-stabilizing non-interest current account 7/	
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010		2011
<b>1 Baseline: External debt</b>	53.4	65.6	69.2	69.7	57.9	56.4	53.9	51.8	48.9	46.4	45.5	-17.8
2 Change in external debt	6.4	12.1	3.6	0.5	-11.8	-1.5	-2.5	-2.1	-2.9	-2.6	-0.9	
3 Identified external debt-creating flows (4+8+9)	0.2	3.7	-2.7	-4.6	-4.7	-0.1	1.9	-0.2	-0.4	-0.3	-0.3	
4 Current account deficit, excluding interest payments	17.4	19.2	20.8	15.0	21.2	22.4	20.3	17.4	17.1	16.9	16.6	
5 Deficit in balance of goods and services	15.9	17.3	19.6	16.4	22.6	22.3	20.3	17.5	17.3	17.2	17.1	
6 Exports	55.3	52.7	53.9	58.3	52.4	51.5	54.4	53.3	53.1	53.0	53.1	
7 Imports	71.2	70.0	73.5	74.7	75.0	73.7	74.6	70.8	70.4	70.2	70.2	
8 Net nondebt creating capital inflows (negative)	-18.5	-17.0	-23.5	-18.5	-22.8	-22.0	-18.1	-17.9	-17.6	-17.4	-17.3	
9 Automatic debt dynamics 1/	1.3	1.6	-0.1	-1.1	-3.1	-0.5	-0.3	0.3	0.1	0.2	0.3	
10 Contribution from nominal interest rate	1.6	2.2	2.6	2.7	2.2	2.1	2.0	2.2	2.4	2.3	2.2	
11 Contribution from real GDP growth	0.7	-0.4	-1.9	-2.4	-3.6	-2.6	-2.3	-1.9	-2.2	-2.1	-1.9	
12 Contribution from price and exchange rate changes 2/	-1.0	-0.2	-0.8	-1.4	-1.7	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	6.3	8.4	6.3	5.1	-7.1	-1.4	-4.4	-1.9	-2.5	-2.3	-0.6	
External debt-to-exports ratio (in percent)	96.6	124.4	128.4	119.4	110.5	109.5	99.1	97.2	92.2	87.5	85.6	
<b>Gross external financing need (in billions of US dollars) 4/</b>	0.6	0.7	0.8	0.8	1.2	1.1	1.1	1.1	1.1	1.2	1.2	
in percent of GDP	22.1	26.3	28.7	24.4	35.8	28.9	28.3	26.0	25.0	24.3	23.7	
<b>A. Alternative Scenarios</b>												
A1. Scenario with key variables at their historical averages 5/												
A2. Natural Disaster-Scenario 6/												
<b>Key Macroeconomic Assumptions Underlying Baseline</b>												
Real GDP growth (in percent)	-1.4	0.8	3.0	3.6	5.6	4.9	4.4	3.7	4.6	4.6	4.4	
GDP deflator in US dollars (change in percent)	2.1	0.5	1.2	2.1	2.5	2.3	2.9	2.8	2.4	2.3	2.1	
Nominal external interest rate (in percent)	3.5	4.2	4.1	4.1	3.4	4.1	4.0	4.5	4.9	5.1	5.3	
Growth of exports (US dollar terms, in percent)	-8.2	-2.7	7.2	14.8	-0.8	5.5	13.5	4.5	6.7	6.8	6.8	
Growth of imports (US dollar terms, in percent)	-5.5	0.4	10.1	7.8	10.9	5.5	8.7	1.0	6.6	6.6	6.6	
Current account balance, excluding interest payments	-17.4	-19.2	-20.8	-15.0	-21.2	-22.4	-20.3	-17.4	-17.1	-16.9	-16.6	
Net nondebt creating capital inflows	18.5	17.0	23.5	18.5	22.8	22.0	18.1	17.9	17.6	17.4	17.3	
<b>B. Bound Tests</b>												
B1. Nominal interest rate is at historical average plus one-half standard deviation						56.5	54.5	52.8	50.4	48.1	47.4	-19.2
B2. Real GDP growth is at historical average minus one-half standard deviations						56.5	56.4	57.3	59.2	59.6	56.7	17.9
B3. Non-interest current account is at historical average minus one-half standard deviations												
B4. Combination of B1–B3 using 1/4 standard deviation shocks												
B5. One time 30 percent real depreciation in 2006												

1/ Derived as  $[r - g - r(1+g) + ea(1+r)]/(1+g+r+gr)$  times previous period debt stock, with  $r$  = nominal effective interest rate on external debt;  $r$  = change in domestic GDP deflator in US dollar terms.

g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as  $[r(1+g) + ea(1+r)]/(1+g+r+gr)$  times previous period debt stock.  $r$  increases with an appreciating domestic currency ( $e > 0$ ) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.

6/ Natural disaster impacting half the countries in the region. Dynamics of GDP growth, the current account, and aid inflows are taken from the median impact of 12 large natural disasters in the ECCU (Rasmussen, WP/04/224).

7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

**Appendix I. ECCU—Relations with the Fund**  
(As of December 21, 2006)

**I. Membership Status:** Not Applicable

**II. Exchange Arrangement:**

The Eastern Caribbean Currency Union, consists of eight countries that have a common currency, monetary policy, and exchange system. The common currency, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC\$2.70 per U.S. dollar since July 1976. The common central bank, the Eastern Caribbean Central Bank (ECCB), has operated like a quasi-currency board, maintaining foreign exchange backing of its currency and demand liabilities of close to 100 percent.

**III. Safeguards Assessment**

Under the Fund's safeguards assessment policy, the ECCB is subject to a full safeguards assessment. The on-site safeguards assessment was completed on February 20, 2003, and concluded that the ECCB has in place appropriate mechanisms to manage resources, including Fund disbursements and that the vulnerabilities that remain do not pose an undue risk. The safeguards assessment proposed specific measures to address these vulnerabilities, which have been substantially implemented by the ECCB.

**IV. Report on the Observance of Standards and Codes**

The Financial System Stability Assessment for the Eastern Caribbean Currency Union was completed in April 2004, and examined the adherence of the domestic banking sector to the Basel Core Principles for Effective Banking Supervision.

In domestic banking supervision, assessors noted the need to strengthen the legislative framework to enhance the powers and autonomy of the ECCB and to generally beef up the enforcement process. More frequent and comprehensive on-site examinations are required particularly in light of the high levels of non-performing loans and perceived gaps in data integrity. Implementation of a risk-based capital framework for banks should be a priority, which adequately reflects risk of public sector loans. Supervisory practices should develop further in the direction of risk-focused supervision that also takes into consideration ongoing communication with external auditors and overseas supervisors. The need to establish a more formal information exchange mechanism with the home supervisor was also identified as a priority, especially with regard to the consolidated supervision of significant regional banking groups.

Some of these concerns have been addressed: new regulatory guidelines for risk-weighting non-performing public sector exposures have gone into effect in January 2006, and amendments to the Uniform Banking Act have been passed and gazetted in each jurisdiction.

## Appendix II. CARTAC: Capacity Building in the ECCU

The Caribbean Regional Technical Assistance Center (CARTAC) was established in November 2001 as a regional resource, based in Barbados, to provide technical assistance (TA) and training to 20 Caribbean countries. CARTAC's core areas of TA include tax policy and administration, public finance management, macroeconomic policy and financial programming, financial sector supervision and economic and financial statistics. It is a multi-donor project with the IMF as executing agency.<sup>13</sup> An active Steering Committee consisting of representatives from the participating countries, the donor agencies, CARICOM and the CDB, provides strategic guidance and ensures ownership and commitment.

The ECCU countries have been among the most active countries in requesting TA and training in all of CARTAC's core areas. In the last year, however, the largest areas of CARTAC involvement in the ECCU countries have been in VAT implementation and in helping them to develop their "home-grown" Structural Adjustment Technical Assistance Programs (SATAPs). This TA support has represented a significant addition to the Fund's TA to the ECCU region. Some examples and highlights of CARTAC's TA to the ECCU countries in the various core areas are provided below.

In the area of **tax policy and administration**, CARTAC and FAD conducted a comprehensive review of the OECS tax systems and administrations. Half of the ECCU countries have started to implement the recommendations of the review. Dominica introduced a VAT (March 1, 2006); while Antigua & Barbuda (January 29, 2007), St. Vincent & the Grenadines (May 1, 2007) and Grenada (October 2007) are actively working to introduce a VAT within the noted time periods; St. Kitts & Nevis possibly in 2008 while St. Lucia is expected to follow. Training has been provided in customs valuation to three OECS countries in coordination with CCLEC and with support from the Canadian and US Customs agencies, while Antigua & Barbuda has established a customs reform program with CARTAC assistance. CARTAC has assisted the ECCB in the estimation of VAT and excise tax revenue yields for Anguilla, Antigua & Barbuda, Grenada, Dominica, St. Kitts & Nevis, St. Lucia and St. Vincent & the Grenadines. CARTAC has also been helping to establish a Personal Income Tax system in Antigua & Barbuda, and significant TA and training has been provided in Antigua & Barbuda, Dominica, Grenada and St. Vincent & the Grenadines related to their VAT implementation. CARTAC will, during the remainder of the 2007 fiscal period: (1) continue to provide pre- and post-VAT TA to Antigua & Barbuda, Dominica, Grenada, St. Vincent & the Grenadines and start VAT TA in St. Kitts & Nevis;

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<sup>13</sup> CIDA and DFID provide over 50 percent of CARTAC's total funding, with CDB, EU, IDB, Ireland, IMF, UNDP, USAID, the World Bank, and CARTAC member countries contributing the remainder.

(2) undertake a full revenue administration assessment mission in Dominica; (3) undertake a regional customs mission providing strategic and modernization recommendations; and (4) provide a regional workshop on revenue authorities pros and cons. Further, CARTAC will continue to assist four OECS countries build their capacity in the area of collections enforcement through formal training, on the job coaching, and enhanced manuals.

In **public finance management**, CARTAC and the ECCB assisted ECCU countries in diagnostic exercises as part of the Fiscal Machinery Project to draw up action plans to address public expenditure management weaknesses. Following up on these diagnostic assessments, CARTAC has focused on improving cash management, budgeting procedures and debt management in the ECCU countries, with both seminars and short-term missions. A review of the Treasury function has been conducted in Antigua & Barbuda and a report was presented to the Minister of Finance. An analysis of St. Lucia's budget system was undertaken in October and recommendations submitted to the authorities. CARTAC has funded the attachment of a budget officer from Grenada to the ECCB for the purpose of addressing Grenada's consolidated public sector accounts. CARTAC has also been helping in establishing an internal audit unit in St. Lucia. A training manual and a training program have been developed and were delivered on November 20, 2006. In order to support a coordinated regional approach to public finance reform, CARTAC has supported the establishment of the Caribbean Public Finance Management Association (CAPFA), in which the ECCU countries have been active.

At the request of the ECCB, CARTAC has provided TA to the currency union in developing and implementing their own **SATAP** programs aimed at achieving a set of fiscal/debt targets by 2007. As part of the SATAP, CARTAC consultants have worked with small teams across the ECCU to prepare macroeconomic projections under a baseline scenario; identify imbalances and formulate policy measures to address them; and prepare a framework to monitor the key quarterly targets of the program. Over the last year, economists across the ECCU benefited from two training programs. In November 2005, CARTAC, in collaboration with the IMF Institute, hosted a regional two-week course on *Financial Programming and Policies* at the ECCB headquarters, St Kitts & Nevis, while in June 2006, CARTAC organized a *Macroeconomic Statistics for Economists Course* to complement the ongoing SATAP. Efforts aimed at building capacity in the ECCU continued with SATAP missions to Anguilla, Antigua & Barbuda, St Kitts & Nevis, St. Lucia, and St. Vincent & the Grenadines. CARTAC continued to provide support to the government of Dominica to monitor the ongoing PRGF.

In the past year, the **financial sector supervision** advisors have focused on upgrading the legislative framework for the non-bank sector. Efforts are underway to finalize a harmonized insurance act for the ECCU jurisdictions. CARTAC, with the assistance of the Legal Department of the Fund (LEG), is assisting with finalizing the Money Services Business Act for the ECCU jurisdictions. The offshore insurance legislation is being upgraded for

St. Lucia and for St. Vincent & the Grenadines. Upgrades to the legislative framework for credit unions have been undertaken. In an effort to gauge the level of activity and risks in the operations of credit unions and to inform the development of relevant regulations, CARTAC conducted limited scope inspections of five credit unions in Dominica. Those inspections included the local supervisory authorities, which helped them to apply the training they had previously been provided. Also in Dominica, a feasibility study of the offshore financial sector was conducted to aid the authorities in determining the strategy for that sector. An inspection of an agricultural, industrial and development bank of Dominica was conducted with bank examiners from the Caribbean and outside experts. Other efforts to build capacity within the supervisory offices include a CARTAC-sponsored attachment of Barbados insurance supervisors to St. Lucia, to conduct the first ever insurance company inspection; and a CARTAC sponsored attachment from Dominica to conduct the first ever inspection of a credit union in Montserrat. A draft Financial Services Commission Act in Montserrat, sponsored by CARTAC, has been submitted to the authorities. CARTAC is currently assisting Grenada with the setting up of the Grenada Authority for the Regulation of Financial Institutions (GARFIN).

During the past year, the CARTAC program to improve **economic and financial statistics** in the ECCU concentrated on three main areas, namely, national accounts, prices and external sector statistics. CARTAC continued to assist Anguilla, Dominica, St. Kitts & Nevis and St. Vincent & the Grenadines in strengthening their national accounts statistics through the compilation of supply and use tables (SUTs), while work began in Grenada and St. Lucia. The detailed and comprehensive SUT framework has facilitated the identification of gaps and other shortcomings in the basic data. It also proved useful in establishing benchmark data for the national accounts rebasing exercise currently underway in the ECCU. In the area of price statistics, CARTAC extended its project for the development of export-import price indices (XMPIs) to include Anguilla, Grenada and Montserrat. Three other ECCU members already compile and disseminate XMPIs. Work on external sector statistics focused on EUROTRACE, the computer software used for processing external trade data. CARTAC assisted Dominica in updating its EUROTRACE database, while Grenada, St. Kitts & Nevis and St. Vincent & the Grenadines benefited from training in compiling data on external trade, through professional attachments and similar initiatives. Six of the eight ECCU members participated in a two-week regional workshop on external debt statistics in September 2006. The workshop, which was hosted by CARTAC and conducted by the IMF in collaboration with the Commonwealth Secretariat, provided participants with an understanding of the conceptual framework for debt compilation as well as with practical guidance on the collection and analysis of data on external debt.



### APPENDIX III. CARIBBEAN DEVELOPMENT BANK: OVERVIEW OF ACTIVITIES IN THE OECS

The Caribbean Development Bank (CDB) has as one of its core mandates the mobilization of resources to finance projects and programs that contribute to the development of its 17 borrowing member countries. In this regard, the CDB has played an important role in the development of the eight countries in the OECS sub-region. Since inception, the CDB has approved US\$2.6 billion to its borrowing member countries, with the OECS as a whole accounting for approximately 39.1 percent. To date, most of the CDB's interventions in the OECS have been directed towards infrastructural development, and is in part directly related to the incidence of natural disasters in the region, and the need to ensure adequate infrastructural support for investments in tourism and other productive sectors. Resources approved for physical and social infrastructure have, on average, accounted for 60 percent of overall lending to the sub-region, and focused mainly on upgrading transportation and communication, educational services, power and energy, and housing. Interventions in the productive sectors account for 20.8 percent of total activity, and have focused largely on manufacturing and agriculture—the two sectors most severely impacted by developments in the external environment. Multi-sectoral interventions, have also been an important element of the CDB's activities in the OECS and may take the form of *inter alia* natural hazard management, lines of credit, activities of the Caribbean Technological Consultancy Services (CTCS) which provides technical assistance to the private sector, institutional strengthening of government departments, feasibility studies, and the assessment and implementation of transactions-based taxes. Multi-sectoral interventions to date represented 19.2 percent of all interventions to the sub-region.

St. Lucia has been the largest recipient of CDB activity in the OECS, accounting for approximately 26 percent of approvals to the OECS. Most of the projects currently on-going in St. Lucia are in the areas of physical and social infrastructure development, with interventions to improve the water supply, road rehabilitation, natural disaster mitigation and solid waste management, (which forms part of a wider OECS solid waste management programme). Within the productive sectors, CDB has been involved mainly in tourism and stimulating the recovery of banana production. In 2005, an additional \$22.6 million was approved for the road development programme.

The CDB has also played an extremely critical role in assisting Dominica to pursue its development objectives. Projects underway in Dominica are in the areas of education sector enhancement, natural disaster management, waste management and the upgrading of eco-tourism sites. In addition to the CDB's capital project-related interventions, the Bank has actively assisted Dominica in its economic reconstruction effort through the provision of stabilization/structural adjustment loans. In 2005, CDB approved \$5.9 mn to assist in road rehabilitation and improvement and the development of a strategic plan for the tourism sector to assist Dominica in its diversification efforts.

Approvals to St. Vincent and the Grenadines amounted to US\$166.7 million over the period 1970 to 2004. A further \$0.1mn was approved in 2005 for emergency assistance in the wake of Hurricane Ivan and technical assistance through the CTCS and an additional \$50,000 for institutional strengthening in the Ministry of Finance in 2006. The main areas of CDB ongoing involvement are in road rehabilitation, basic education, solid waste management, and natural disaster management.

St. Kitts and Nevis has been another significant beneficiary of CDB's activities since 1970. Ongoing activities in St. Kitts and Nevis are mainly in the areas of disaster rehabilitation and

natural disaster management, with some emphasis on improving the provision of education services and enhancing the waste management function. In 2005, a further \$0.8mn was approved for the corporatization of the electricity department, management of the transition of the sugar industry and water resource management. In 2006 an additional \$8.4 million was approved to enhance the electrical power supply as well as improve operational and administrative effectiveness of the Nevis electricity company. The CDB's first policy-based guarantee was also approved in 2006 for St. Kitts and Nevis for an amount not exceeding \$8.2 million to assist in the orderly adjustment of its fiscal framework.

Resources approved to Grenada account for 16.9 percent of approvals to the sub-region. The development of physical infrastructure has been the main focus of ongoing activities in this island, with significant emphasis being placed on bridge and road improvement, the rehabilitation of schools, waste management improvement, and natural disaster management. In 2005 assistance approved amounted to \$25.1 million and was largely in response to the need for rehabilitative as well as mitigative work in the wake of natural disasters in 2004 and 2005. The bulk of assistance was directed towards improving transportation and communication on the island, followed by multi-sectoral assistance and improvement to the housing stock.

Activity in Antigua and Barbuda has been small by comparison, with approvals to this island accounting for only 4.8 percent. Education sector enhancement has been the main focus of recent assistance along with security improvements to the air and sea ports. In 2005, multi-sectoral interventions through the CTCS in the amount of \$21,000 were approved for Antigua and Barbuda.

Activity in Anguilla is also relatively small, representing 3.3 percent of total approvals since 1970. Ongoing projects in Anguilla are predominantly in natural disaster management. In 2005 \$11.1 mn was approved in the directly productive sectors of agriculture and manufacturing, as well as infrastructural development in the energy sector, housing and education services.

Approvals to Montserrat have also been minimal accounting for a mere 1.7 percent of total approvals to the sub-region over 1970–2005. Most of the recent work in Montserrat is in involves improvements to the education sector. Multi-sectoral assistance through the CTCS was the only new intervention approved for Montserrat in 2005 and totalled \$9,000. In 2006 the CDB approved a grant in the amount of \$98,000 for a diagnostic review of a commercial bank.

### CDB Operations in the OECS

(In millions of U.S. dollars)

	Approval 1970– 2004	Disbursement 1970–2004	Approval 2005	Disbursement 2005	Approval Jan.–Oct 2006
Anguilla	23.2	22.5	11.1	0.7	0.0
Antigua & Barbuda	49.2	30.0	0.0	6.4	0.0
Dominica	163.5	141.4	5.9	8.3	0.0
Grenada	148.0	110.9	25.2	15.0	0.0
Montserrat	17.1	13.5	0.0	0.1	0.1
St. Kitts & Nevis	148.9	108.8	0.8	6.3	16.6*
St. Lucia	244.0	194.9	22.6	20.0	0.0
St. Vincent & the Grens.	167.2	105.5	0.1	8.8	0.1
OECS Sub- region	961.1	727.5	65.9	65.7	16.8

\* Includes \$8.2 million limit approved for Policy-Based Guarantee.

## **Appendix IV. OECS: RELATIONS WITH THE WORLD BANK GROUP** (As of November 3, 2006)

### **World Bank Group Strategy**

The World Bank Group strategy in the OECS is focused on helping these small states meet the development challenges that face them. The guiding principles of the strategy are: (a) supporting regional integration and coordination efforts; (b) partnering and harmonization in both lending and analytical work with other development partners; and (c) active pursuit of simplification and capacity building initiatives tailored to small states. The Bank will continue to take the lead on public sector reforms with a particular focus on the efficiency of public spending, social expenditures (including safety nets), disaster mitigation, and environmental management.

**Bank-Fund collaboration in specific areas:** The World Bank Group and the IMF will continue to collaborate on the financial sector, on the medium-term structural reform agenda and in providing technical assistance on macroeconomic management issues jointly with the Caribbean Regional Technical Assistance Center (CARTAC). The Bank and the IMF will also continue to collaborate on supporting the countries of the OECS in the preparation of their Poverty Reduction Strategies (PRS).

**Group strategy:** The World Bank Group Management presented to its Board the Eastern Caribbean Sub-Region Country Assistance Strategy (CAS), on September 13, 2005. The World Bank Group's strategy for the four years covered by this CAS (FY06-09) supports the sub-region's development agenda through two main pillars: (1) stimulating growth and improving competitiveness; and (2) reducing vulnerability, by promoting greater social inclusion and strengthening disaster risk management. Recognizing the OECS countries' high debt ratios, Bank activities will focus on leveraging available donor grant financing. Following the recommendations of the recently completed growth and competitiveness study for the OECS, IBRD and IDA assistance would focus on providing technical and financial assistance for interventions to support the two main pillars of the CAS. The CAS proposes a total lending envelope of US\$103.4 million. An indicative Base Case lending scenario consists of about US\$51.3 million in IDA resources for the four OECS blend countries (Dominica, Grenada, St. Lucia and St. Vincent and the Grenadines). This envelope includes the estimated IDA country allocations for each of the four countries during FY06-09, and an IDA Regional allocation of US\$15.2 million for two regional projects: US\$12 million for Catastrophe Risk Insurance and US\$3.2 million for Infrastructure and Utilities Reform. The indicative high case lending scenario consists of approximately US\$52.1 million in IBRD investments and development policy operation commitments for the six OECS countries, in addition to the Base Case lending scenarios mentioned above.

**Increasing competitiveness and reducing vulnerability.** In addition to stabilizing macroeconomic conditions and reducing fiscal deficits and public debt levels, the OECS countries are focusing on: (i) improving the investment climate by broadening the tax base, and streamlining the investment incentive regime and making it more transparent; (ii) improving public sector performance, by

raising the efficiency of public investment and improving service delivery; (iii) reducing transaction costs, by strengthening regulation and efficiency of public utilities; (iv) promoting appropriate education and skills development to take advantage of new opportunities in the global environment; and (v) reducing vulnerability, by strengthening the social protection mechanisms and strengthening disaster risk management. The OECS authorities also are targeting to expand their positive experiences with sub-regional functional cooperation (e.g., common central bank, telecommunications regulation, pharmaceutical procurement) to other areas including energy sector regulation, as a way of better allocating the region's scarce human and financial resources.

The Bank is supporting these efforts through a comprehensive series of recently completed, ongoing and planned analytical and advisory activities as well as new operations to support the CAS' two main pillars including the following activities: "Towards a New Agenda for Growth"-OECS growth and competitiveness study, Caribbean Air Transport Rationalization report (draft recently completed), a Caribbean Skills and Curriculum Study, a report on Institutions, Performance and the Financing of Infrastructure Services in the Caribbean (recently completed), Caribbean Financial Sector and Regulation report, Caribbean Social Projection Strategy Review (recently completed), a regional study on Crime and Violence in the Caribbean (draft recently completed) and an OECS private sector financing study planned for the current fiscal year. A planned **OECS Telecom Reform** project, an ongoing pilot **St. Lucia Water Sector Reform Project**, and technical assistance in the power and energy sectors are expected to serve as a basis for future work on **Regulatory Reform** for other utilities including electricity.

**Managing volatility:** Recent analytical work on macroeconomic vulnerabilities has shown that the frequent natural disasters in the OECS are a major cause of income insecurity and high poverty rates in the sub-region, as many households cycle in and out of poverty in tandem with these events.

*Disaster Management.* Despite the regularity of natural disasters, the authorities in the OECS have generally pursued reactive policy responses rather than mitigation measures. Given declining aid flows and limited institutional capacity, the countries need to move to proactive responses with greater cooperation between governments, donors and civil society at both the national and the sub-regional levels. The Bank is working to strengthen mitigation and response planning through the ongoing **OECS Disaster Management Programs I and II**. In addition, the Bank has been working on the development of a Caribbean Catastrophe Risk Insurance Facility (CCRIF) for Caribbean Basin countries.

*Safety Nets.* Despite relatively high per capita incomes, unemployment (estimated between 5-20 percent) and poverty levels (ranging 12–38 percent) are quite high in the OECS. However, current safety nets suffer from a plethora of uncoordinated programs, which lack appropriate targeting mechanisms and adequate coverage. These will need to be improved to address the impact of eroding trade preferences on the rural sector, emerging problems with youth-at-risk, an aging population, continued vulnerability to external shocks, and new vulnerabilities arising from the HIV/AIDS epidemic. Improvements to the efficiency and targeting of social safety nets were examined under the public expenditure reviews. The Bank has provided financial support for an ongoing **Poverty Reduction Fund** in St. Lucia, which has piloted community procurement, a **Social Protection Review** for Dominica, and an **IDF grant** to strengthen poverty measurement in

the OECS. A **Caribbean Regional HIV/AIDS** program, including Barbados, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines is being implemented.

### **Planned Operations**

There are also a number of planned country specific and regional operations for the OECS, including: a Growth and Social Protection Technical Assistance Project for Dominica, which will support the Government in enhancing private sector-led growth and improving social protection. An OECS Risk Financing Project is also planned to support the countries in the sub-region in their participation in the Caribbean Catastrophe Risk Insurance Facility (CCRIF). The Bank is also preparing an OECS Skills Enhancement for Inclusive Growth Project, the objective of which is to assist the Governments of the region to increase the employability of youth through the establishment of a competitive training fund that finances demand-driven training and traineeships. Other operations are also planned for the environmental, utilities, and infrastructure sectors.

**Financial Relations**  
(In millions of US dollars)

Regional Operations	Original Principal	Disbursed	Undisbursed
Telecom. & ICT Development Project (DMA,GRD,LCA,KNA,VCT)*	2.71	0.36	2.49
HIV/AIDS Prevention and Control (GRD,LCA,KNA,VCT)	23.49	2.99	21.04
Education Development Project (GRD,LCA,KNA,VCT)	31.20	10.53	22.22
<b>Total regional projects</b>	<b>57.40</b>	<b>13.87</b>	<b>45.75</b>
<b>Total (all projects)</b>	<b>97.18</b>	<b>27.28</b>	<b>72.05</b>
<b><u>Dominica</u></b>			
<b>Total **</b>	0.54	0.07	0.53
<b><u>Grenada</u></b>			
Hurricane Ivan Emergency Project	19.78	7.17	12.61
Public Sector Modernization Technical Assistance Credit	3.50	0.35	3.37
<b>Total</b>	<b>37.86</b>	<b>9.93</b>	<b>29.04</b>
<b><u>St. Lucia</u></b>			
Water Supply Infrastructure Improvement	7.70	2.52	5.20
Disaster Management Project II	7.50	3.35	4.23
Water Sector Reform Technical Assistance Project	1.30	0.01	0.89
<b>Total</b>	<b>35.44</b>	<b>14.27</b>	<b>22.06</b>
<b><u>St. Kitts &amp; Nevis</u></b>			
<b>Total</b>	9.59	1.65	7.84
<b><u>St. Vincent and the Grenadines</u></b>			
<b>Total</b>	13.74	1.36	12.59

\*DMA = Dominica, LCA= St. Lucia, VCT= St. Vincent and the Grenadines, GRD=Grenada, KNA= St. Kitts & Nevis

\*\*Totals include country allocations for regional projects listed above



INTERNATIONAL MONETARY FUND

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EXTERNAL  
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International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Executive Board Concludes 2006 Regional Discussions with Eastern Caribbean Currency Union**

On January 17, 2007, the Executive Board of the International Monetary Fund (IMF) concluded the 2006 Regional Discussions with the Eastern Caribbean Currency Union (ECCU).<sup>1</sup>

### **Background**

Economic activity in the region is buoyant, despite high oil prices and the further erosion of European Union trade preferences. Growth is at its strongest rate in more than 15 years, at 5.6 percent in 2005, driven by tourism and construction ahead of the 2007 Cricket World Cup. Construction activity reflects significant expansions in hotel capacity—particularly in Antigua and Barbuda, and St. Lucia—grant-financed investments in cricket stadia, and supporting public infrastructure. The growth acceleration occurred despite high global oil prices—ECCU countries are among the world's most oil-import dependent economies—and further erosions of trade preferences that have impacted the economies with still large sugar and banana sectors. Inflation has picked up somewhat, reflecting the pass-through of global oil prices, but remains in the low single digits.

Despite the strong growth, there has been only a modest improvement in the overall fiscal and debt position. Tax revenues have strengthened with the uptick in economic activity, administrative efforts, and tax policy reforms—including the introduction of value-added taxes (VATs). Expenditure restraint has proven more difficult due to social priorities and enhanced public infrastructure ahead of the Cricket World Cup. As a result, public sector debt remains

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.



very high, averaging 107 percent of end-2005 GDP, despite restructuring in Dominica and Grenada and some debt relief in Antigua and Barbuda.

The fiscal benchmarks established by the Eastern Caribbean Central Bank's (ECCB) Monetary Council were modified in July 2006 with a focus on medium-term strategies to achieve the debt targets and increased emphasis on transparency. The target date for compliance has been moved from 2007 to 2020.

Monetary aggregates have been expanding rapidly, with a credit boom in the private sector. The financial system has been resilient, and progress continues to be made in strengthening financial sector supervision consistent with the 2004 Financial Sector Assessment Program recommendations. Capital markets have continued to develop, particularly the Regional Government Securities Market (RGSM) which has become a key regional market—all countries have at least one issue listed.

Stronger growth contributed to a widening of external current account deficits in 2005 and into 2006—to well over 20 percent of GDP—financed mostly by foreign direct investment and grants. Higher oil prices and construction activity spurred an increase in imports, while growth in travel receipts slowed due to one off-factors such as the impact of Hurricane Ivan in Grenada. Exports of agricultural products also declined as a result of preference erosion and hurricane damage. A dip in gross international reserves of the ECCB in 2005 was more than reversed by mid-2006, with the coverage of monetary demand liabilities at over 96 percent—well above the legally mandated floor of 60 percent.

The ECCU region joined the CARICOM Single Market (CSM) in June 2006. At the same time the framework for integration within the Organization of Eastern Caribbean States (OECS) is being revisited in the context of discussions on a revised OECS Economic Union Treaty.

### **Executive Board Assessment**

Directors welcomed the resurgence in economic activity in recent years. They noted that the acceleration in growth had been driven by tourism, preparations for the Cricket World Cup and a pickup in private investment, and emphasized that the challenge will be to sustain the growth momentum in 2007 and beyond. While Directors considered that a soft landing can be achieved following the Cricket World Cup, they observed that the region continues to face significant obstacles, including elevated world energy prices, declining trade preferences, and a heavy public debt burden.

The quasi-currency board arrangement continues to serve the ECCU well. Directors observed that the exchange rate peg has fostered a long period of price stability and that the currency appears to remain competitive.

In light of the region's exchange rate peg, very high debt levels, vulnerability to natural disasters and other shocks, the key priority is to place fiscal positions on a sustainable path. Directors emphasized that it is critical that the present favorable cyclical circumstances be used to accelerate fiscal consolidation and to demonstrate a commitment to the new fiscal benchmarks

through early and sustained reductions in debt ratios. In this context, they noted that fiscal pressures will intensify in the coming years as a result of population aging, and recommended prompt action to reform social security and public health systems. A few Directors noted their concern over the delay in the disbursement of donor grants to support adjustment to preference erosion and thereby help to smooth the transition process.

Directors welcomed the steps that have been taken to modernize tax systems throughout the region, and stressed the need for strengthened efforts to rationalize expenditure in order to ensure that the increased tax revenues translate into falling public debt ratios. They emphasized the importance of avoiding distortions in the tax system, including by strictly limiting exemptions to the VAT and by reining in tax concessions, which are costly and relatively ineffective in boosting investment. In this regard, a number of Directors considered that a regional approach to harmonizing and reducing tax concessions would help limit revenue losses and avoid counterproductive tax competition. They urged firm control over spending, including by limiting new expenditure commitments and by containing government wage bills in the context of civil service reforms.

Progress has been made in enhancing the regulatory framework for the banking system. Moving forward, Directors urged continued strengthening of the supervisory and regulatory framework for both banks and nonbanks, to contain emerging risks and to provide an environment that supports financial market development. They stressed the importance of ensuring the credibility of the new regulatory framework through effective enforcement, and of bolstering the supervision of the nonbank financial sector.

Further regulatory, administrative and legal reforms are needed to remove impediments to private business activity. In particular, Directors emphasized that liberalizing factor markets in the context of the Caribbean Single Market and Economy could play an important role in allowing the region to benefit more fully from globalization.

Directors stressed the importance of strengthening the quality, timeliness and dissemination of statistics, in support of more effective economic management and public transparency. While welcoming the greater use of public consultations on key issues, they observed that enhanced dissemination of relevant economic data will help foster social consensus for key policy decisions. Directors considered that CARTAC has played an effective role in assisting ECCU members and looked forward to continued donor support for technical assistance.

**Public Information Notices (PINs)** form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

**Eastern Caribbean Currency Union: Selected Economic Indicators**

	2003	2004	2005	Proj. 2006	Proj. 2007
(Annual percentage change)					
<b>Real sector 1/</b>					
Real GDP	3.0	3.6	5.6	4.9	4.4
GDP deflator	1.2	2.1	2.5	2.3	2.9
Consumer prices, end of year	1.8	2.4	4.2	3.7	3.0
(In percent of GDP)					
<b>Public finances 1/</b>					
Central government overall balance	-5.6	-4.5	-3.8	-4.0	-2.3
Revenue and grants	29.4	29.0	30.1	31.1	29.7
Expenditure and net lending	34.9	33.5	33.9	35.1	32.0
Total public sector debt	113.5	117.1	106.6	104.5	99.7
(In percent of GDP, unless otherwise indicated)					
<b>External sector</b>					
Current account balance	-22.0	-16.4	-21.7	-22.9	-20.8
Trade balance	-38.0	-37.6	-40.0	-39.7	-38.7
Travel	27.5	28.7	26.2	25.8	26.5
Exports, f.o.b. (annual percentage change)	0.7	14.4	-7.6	4.6	4.4
Imports, f.o.b. (annual percentage change)	13.2	8.1	12.2	6.0	4.9
Stayover visitors (annual percentage change)	14.3	10.0	0.2	...	...
Terms of trade (12-month percentage change) 2/	0.0	0.2	-0.8	-0.1	-0.5
Real effective exchange rate (annual percentage change) 1/ 3/	-4.2	-3.6	-1.0	...	...
End-year gross foreign reserves of the ECCB					
In U.S. dollar million	539.9	632.4	600.8	651.7	711.3
In months of imports	4.4	4.7	4.0	4.1	4.3
In percent of broad money	19.8	20.5	17.9	17.7	17.6
External public debt (end-of-period)	69.2	69.7	57.9	56.4	53.8
(Percentage change)					
<b>Money and credit</b>					
Net foreign assets 4/	8.7	6.8	1.4	0.3	1.8
Net domestic assets 4/	0.8	6.4	7.1	9.5	7.7
Broad money	9.5	13.2	8.4	9.8	9.5

Sources: ECCU country authorities; and IMF staff estimates.

1/ Excludes Anguilla and Montserrat. ECCU aggregates are calculated as weighted averages of individual country data; ratios to GDP are then calculated by dividing this sum by the aggregated GDP of the region.

2/ Excludes Anguilla, Antigua and Barbuda, and Montserrat.

3/ End-of-period (depreciation -), 1990=100.

4/ In relation to broad money at the beginning of the period.