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Eastern Caribbean Currency Union: Selected Issues

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EASTERN CARIBBEAN CURRENCY UNION

Selected Issues

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Approved by the Western Hemisphere Department

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Executive Summary

- **Tourism in the Eastern Caribbean: Meeting the Competitive Threat**

The ECCU suffered an unprecedented decline in output in 2001, an increase in unemployment, and a sharp deterioration in its fiscal position following the September 11 attacks on the US—partly a result of weak performance by the tourism industry. This chapter concludes that the ECCU countries have lost competitiveness globally and vis-à-vis newly emergent Caribbean tourist destinations as a result of both price and non-price factors. The short-term measures implemented by the countries seem to have been insufficient to prevent further declines in 2002. Over the medium term, the ECCU will need to implement measures to restructure the industry in order to deal with the competitive threat from other Caribbean destinations, including through wage restraint and productivity increases, and aim to enhance the region's nonprice competitiveness. The latter would include efforts to enhance the business climate, with a view to attracting significant amounts of foreign direct investment (FDI) to help modernize the industry and raise the quality of service to international standards; devising methods to raise the value-added by cruise ship passengers; fostering strategic regional alliances in tourism promotion; and taking measures to address key environmental concerns.

- **World Bank—Fiscal Issues Review**

The World Bank is conducting a series of studies on public expenditure policies and practices in the OECS, expected to be completed by end-2003. This chapter presents the main issues arising out of the ongoing work and the preliminary findings.

- **Strengthening Fiscal Discipline through Fiscal Benchmarks**

The ECCB has developed a set of policy rules in the form of fiscal benchmarks designed to ensure long-run fiscal sustainability, in addition to limiting negative spillovers and external vulnerability, and to support the integrity of the currency board arrangement. Well-designed criteria can be useful, but do not obviate the need for prompt action under the current circumstances of large fiscal imbalances. The benchmarks must balance the need to be stringent enough to reduce vulnerability, and be realistically attainable, and need to be supported by a framework of surveillance and incentives for compliance.

- **Fiscal and Debt Sustainability**

Debt sustainability analyses were conducted for the six member countries of the ECCU using the recently developed framework by IMF staff. Staff's projections are for debt ratios to diminish over the medium term in each country. Stress tests indicate that under plausible risks debt levels could increase even further from the present high levels, particularly for Antigua and Barbuda, and St. Kitts and Nevis—clearly in some cases approaching levels that would call into question their sustainability.

- **Financial Sector: Institutions, Oversight and Risks**

This chapter describes the institutional setting and existing structure of the financial sector in the ECCU. A preliminary assessment of the overall financial conditions of banks is made in the second part of the paper, using the standard banking soundness indicators.

- **Financial Sector Vulnerabilities and Challenges**

This chapter discusses the main areas of vulnerabilities in the ECCU's financial sector, summarizing the main challenges in the financial sector and highlighting the sources of vulnerabilities in the banking sector and the inefficiencies in the wider financial system. Specific recommendations are made on how these vulnerabilities could be reduced and more generally, how the challenge of strengthening the financial sector could be met.

- **Social Security Issues in the ECCU**

The public social security systems in the ECCU countries will experience severe financial pressures in the coming decades, as the number of pensioners relative to the workforce is expected to quadruple by 2050. Although still a few decades away, this demographic prospect warrants attention and action now, before its potentially devastating fiscal consequences become too difficult to manage. This chapter sheds light on the challenges facing the social security systems of the ECCU countries and recommends policy actions that may help to alleviate the upcoming aging crisis. The main points are (i) the projected population dynamics in the ECCU are expected to render the current social security arrangements insolvent and to exacerbate their already critical fiscal position; (ii) besides its direct negative effect on pensions and government debt, aging will have spillover effects into the financial sector, due to the close link among public pensions, the government, and commercial banks; and (iii) immediate action is required to avoid last-minute disruptively large changes of the pension systems; recommended policies include parametric reform of the national insurance schemes, a revamping of the investment strategy of the pension funds, a policy of continuing accumulation of reserves, and a restructuring of government pensions.

- **Regional Integration and Trade Policy**

This chapter first describes the principal objectives and structure of the Organization of Eastern Caribbean States (OECS) and the Caribbean Community (CARICOM), as vehicles of regional integration for the ECCU members: The ECCU members are caught at a confluence of these two distinct forces towards regional integration. Other regional institutions in the OECS are also described. In the second part of the paper, the main aspects and developments with regard to the trade regime of the ECCU members with non-CARICOM countries are described.

I. TOURISM IN THE EASTERN CARIBBEAN: MEETING THE COMPETITIVE THREAT[1]

A. Introduction

1. **Tourism's contribution to the economies of the Eastern Caribbean Currency Union (ECCU) spans the real, fiscal, and external sectors of each economy.** Over 1990-2001, the correlation coefficient between the growth in stay-over tourist arrivals in the ECCU and real economic growth was 0.7, reflecting the strength of the underlying sectoral linkages. In the aftermath of the September 11 terrorists' attacks, the ECCU suffered an unprecedented decline in output (-1½ percent) in 2001, an increase in unemployment, and a sharp deterioration in its fiscal position (the central government deficit widened from 5½ percent of GDP in 2000 to around 7 percent of GDP in 2001).

2. This chapter analyzes the performance of the tourism industry in the ECCU following the September 11 attacks. While tourism in the Caribbean as a whole has kept pace with world tourism, the ECCU countries and their CARICOM partners have lost ground to newly emergent destinations elsewhere in the Caribbean. Moreover, the September 11 attacks exacerbated a declining trend in competitiveness, which has been apparent since the mid 1990s. Although the data suggest some erosion in the ECCU and CARICOM's price and non-price competitiveness, the region's resiliency in the face of significant price differentials vis-à-vis the rest of the Caribbean suggests that its comparative advantage may lie in non-price factors, which are not as easily quantifiable.

3. Although ECCU countries quickly implemented several measures in response to the economic crisis that ensued after September 11, such responses have been short-term in nature and focused primarily at mitigating the effect of the current crisis. **However, a medium-term solution would require a strategic restructuring of the industry to deal with the competitive threat from emerging Caribbean destinations**. Differences in cost and industry characteristics among Caribbean countries would make broad-based regional cooperation difficult, but strategic alliances of varying scope could better serve the ECCU countries. The paper argues that more effort could be spent on both upgrading and modernizing the facilities and the quality of service in these countries than on marketing in the current situation.

4. This chapter is structured as follows: Section B discusses the nature of tourism's contribution to the economies of CARICOM; Section C analyzes the recent developments in Caribbean tourism, with particular emphasis on the ECCU, so as to give some context to the effects of September 11; Section D discusses the competitiveness of tourism in the ECCU; and Section E describes the short-term policy responses of ECCU countries, and a proposed

[1] Prepared by Ruby Randall and Wendell Samuel (both WHD). This chapter is part of a longer working paper to be published later this year.

medium-term strategy for restructuring the industry. Some concluding comments and recommendations are presented in Section F.

B. Tourism's Economic Contribution

5. **Tourism's impact can be felt through direct, indirect, and induced channels in the following sectors:** (i) the real sector, through the Gross Domestic Product (GDP), employment, and investment, as governments and the private sector invest in infrastructure and facilities needed to support the tourism industry; (ii) the balance of payments (BOP); and (iii) the fiscal sector, through government revenue. In all of these areas the ***direct effect*** results from economic activity directly related to tourism (for example, the provision of hotel and restaurant services, recreation and entertainment, transportation, and access to retail trade); the ***indirect effect*** results from economic activity related to suppliers' provision of inputs (including raw materials and energy) to hotels and restaurants, and other retailers; and the ***induced effect*** results from economic activity created by the spending of household disposable income derived from either the direct or indirect effects.[2]

6. **The size of the ratio of visitor expenditure to total export of goods and services reveals the extent of dependency of the external sector on tourism and consequently highlights the vulnerability of the economy's foreign exchange earnings to shocks from the tourism industry.** However, the tourism industry also has a high import requirement for goods and services—both through the direct and indirect effect. So the combined direct, indirect, and induced effects of visitor spending on imported goods serve as leakages and represent an outflow of income not available to generate domestic economic activity. Thus, tourism's net effect on the current account of the balance of payments would be the combined effect of tourism receipts (a credit item) offset in part tourism-related imports.

7. In the case of government revenue, tourism generates the payment of **direct taxes** by individuals and corporations directly involved in the provision of goods and services to tourists, and the payment of **indirect taxes**—including tourism-related taxes (such as the hotel occupancy tax, the airport departure tax, the cruise ship head tax, related licenses, and environmental levies), valued added tax, and other taxes on goods and services; and taxes on international trade and transactions, including import duties (to the extent that the imports by the tourism industry are not zero-rated). An induced revenue effect results from the payment of taxes on income generated by the spending of disposable income earned from the direct and indirect effects. However, in addition to the revenue effects, on the expenditure side, the nature of the fiscal response to the recent adverse shock to tourism also impacted CARICOM governments' overall balances. For instance, in the wake of the September 11 crisis, some

[2] A thorough analysis of tourism's impact on ECCU region would require an input/output analysis that assesses, first at the country level, the direct, indirect and induced effects on the real (output and investment), fiscal, and external sectors, and then aggregates the individual country outcomes by netting out intra-regional linkages. This would be a major undertaking, and is not the objective of the current study.

governments in the region adopted a counter-cyclical stance, and sought both to stimulate economic activity and increase tourism advertising and promotions through additional spending financed by draw-downs in accumulated deposits or through additional borrowing—which further exacerbated an already weakened fiscal position, with the latter adding to countries' debt burdens.

8. **Table 1.1 summarizes the findings of a study of tourism's contribution to the St. Lucian economy in 1998, and helps to illustrate the potential magnitude of the sectoral linkages discussed above.**[3] [4] According to Table 1.1, EC$1 in tourism expenditure generated EC$0.6 in income (ECS$0.4 through the direct effect, EC$0.1 through the indirect effect, and ECS$0.1 through the induced effect), and tourists' expenditures collectively accounted for 28 percent of GDP in 1998. Regarding employment, tourism expenditure generated 21 percent of all St. Lucian jobs, and approximately 16 jobs were created per EC$1 million of tourism expenditure. Regarding fiscal revenues, EC$1 of tourism expenditure generated EC$0.1 of government revenue, which accounted for 20 percent of total government revenue in 1998. The largest source of government revenue was the direct effect, which was more than double the magnitude of the indirect and induced effect—suggesting the absence of substantial backward linkages between tourism and the rest of the economy. Visitor expenditures accounted for 72 percent of St. Lucia's exports of goods and services in 1998, suggesting a high level of dependency of foreign exchange earnings on tourism and a high vulnerability to exogenous external shocks affecting tourism. Finally, Table 1.1 shows that the revenue leakage through the importation of goods and services for use by tourists is fairly substantial—EC$212 million—more than double tourism's total contribution to government revenue of EC$95 million.

[3] Information obtained from the CTO's Tourism Economic Impact Analysis Project Draft Report, entitled "St. Lucia: Economic Impact of Visitor Expenditure—1998," August 25, 2000.

[4] It should be noted, that in the wake of the September 11 crisis, many hotels resorted to shortening the workweek of their staff in lieu of lay-offs, and that there has been heavy discounting of hotel room rates. These behaviors would be expected to alter the multipliers reported above.

Table 1.1. St. Lucia: Summary of Impact Estimates

GDP Impact of Visitor Expenditure – 1998

	GDP Impact (M EC $)	Percentage Share of 1998 GDP	GDP Normal Multiplier 1/
Direct Impact	310.80	18.05	0.41
Indirect Impact	112.11	6.51	0.15
Induced Impact	62.18	3.61	0.08
Total impact	**485.09**	**28.17**	**0.65**

Impact on Employment – 1998

	Employment Annual Ave.	Percentage Share of 1998 Employment	Emp. Normal Multiplier 2/
Direct Impact	8,033	14.24	10.72
Indirect Impact	1,963	3.48	2.62
Induced Impact	1,669	2.96	2.23
Total impact	**11,664**	**20.67**	**15.56**

Impact on Government Revenue - 1998

	Revenue Impact (M EC $)	Percentage Share of Gov't Revenue	Normal Multiplier 3/
Direct Impact	50.69	0.11	0.07
Indirect Impact	22.24	0.05	0.03
Induced Impact	22.00	0.05	0.03
Total impact	**94.93**	**0.20**	**0.13**

Impact on Imports of Goods and Services

	Imports of Goods and Services	Share of Total Imports
Direct Impact	100.88	8.8
Indirect Impact	59.65	5.2
Induced Impact	62.32	5.4
Total impact	**222.85**	**19.4**

Source: Caribbean Tourism Organization, Tourism Economic Impact Project, "St. Lucia: Economic Impact of 2000."
Visitor Expenditure—1998," August 25, 2000.
1/ Multiplier: Value added per $1 of visitor expenditure.
2/ Multiplier: No. of jobs per $1m of visitor expenditure.
3/ Multiplier: revenue per $1 of visitor expenditure.

C. Tourism Developments in the 1990s

9. During the first eight months of 2001, world and Caribbean stay-over tourist arrivals grew by 3.0 and 2½ percent, respectively, relative to the same period in 2000, which was followed by a sharp contraction of 11 and 16¾ percent, respectively, during the last four months of the year in the aftermath of the September 11 terrorist attacks.[5] **For the year as whole, world tourism[6] and world tourism receipts[7] declined by ½ percent and 2½ percent, respectively (Table 2.1).** Although the decline in Caribbean tourist arrivals exceeded the world average, the decline in Caribbean tourism receipts was less than half the world average decline, resulting in an increase in the Caribbean's world share of tourism receipts.[8]

10. **The 2001 outcome was a break in the trend observed during the 1990s, when annual growth in world and Caribbean tourist arrivals and receipts were both consistently positive (Tables 2.2a and 2.2b).** Caribbean tourism out-performed world tourism over 1990-2000, with an average annual growth rate of stay-over tourist arrivals of almost 5 percent compared to a world average of 4½ percent, while Caribbean tourist receipts grew at an average annual rate of 7¾ percent, which was roughly in line with the average growth rate of world tourist receipts (7¾ percent). The decline in stay-over visitors observed in 2001 was not uniform across the various sub-regions of the world, and did not generalize to cruise passenger arrivals. In particular, despite a sharp contraction in North American tourism (-6 percent), which was second only to the tourist arrivals decline experienced in South Asia (-6½ percent), **the Caribbean region maintained its stay-over arrivals market share of 2.9 percent—and did so consistently since 1997**. In addition, cruise passenger arrivals in the Caribbean grew at an average annual rate of close to 7 percent over 1995-2000, and registered positive growth in 2001 (3 percent) (Appendix Table 3).[9]

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[5] The source for this data is the Caribbean Tourism Organization. Data refers specifically to stay-over tourist arrivals.

[6] Measured as stay-over arrivals.

[7] Data based on tourism receipts as recorded in the balance of payments.

[8] This outcome is due in part to an increase in cruise passenger arrivals in 2001 and to the fact that the English-speaking Caribbean countries are traditionally high-end destinations.

[9] Comparable world statistics for cruise passenger arrivals were not available.

Table 2.1. World Tourism: Tourist Arrivals and Tourism Receipts by Region

	2000		2001		Percent Change 2002/01	
	Arrivals	Receipts	Arrivals	Receipts	Arrivals	Receipts
	(thous.)	(Billion of US$)	(thous.)	(Billion of US$)		
World	696.7	474.4	692.6	462.2	-0.6	-2.6
Africa	27.2	10.9	28.2	11.7	3.7	7.3
Americas	128.4	132.8	120.8	122.4	-5.9	-7.8
Of which:						
Caribbean 2/	**20.3**	**19.7**	**19.9**	**19.4**	**-2.0**	**-1.2**
East Asia and the Pacific	109.1	81.4	115.1	82.0	5.5	0.7
Europe	402.7	233.0	400.3	230.1	-0.6	-1.2
Middle East	23.2	11.5	22.5	11.2	-3.0	-2.6
South Asia	6.1	4.9	5.7	4.7	-6.6	-4.1
	(As a percentage of world totals)					
	2000		**2001**		**Change in Shares 2002/01**	
	Arrivals	Receipts	Arrivals	Receipts	Arrivals	Receipts
Africa	3.9	2.3	4.1	2.5	0.2	0.2
Americas	18.4	28.0	17.4	26.5	-1.0	-1.5
Of which:						
Caribbean	**2.9**	**4.1**	**2.9**	**4.2**	**0.0**	**1.4**
East Asia and the Pacific	15.7	17.2	16.6	17.7	1.0	0.6
Europe	57.8	49.1	57.8	49.8	0.0	0.7
Middle East	3.3	2.4	3.2	2.4	-0.1	0.0
South Asia	0.9	1.0	0.8	1.0	-0.1	0.0

Source: World Tourism Organization.

1/ Data on the Caribbean were provided by the Caribbean Tourism Organization (CTO).

Table 2.2a. International and Caribbean Stay-Over Tourist Arrivals: 1990-2001
(In thousands)

Year	All Countries		Caribbean		Caribbean Share of World Tourism	
	Tourists	Percent Change	Tourists	Percent Change	Share	Percent Change
1990	457.2	7.2	12.8	6.7	2.8	-0.5
1991	464.0	1.5	13.1	2.3	2.8	0.8
1992	503.4	8.5	13.9	6.1	2.8	-2.2
1993	519.0	3.1	14.9	7.2	2.9	4.0
1994	550.5	6.1	15.7	5.4	2.9	-0.7
1995	565.4	2.7	16.2	3.2	2.9	0.5
1996	599.0	5.9	16.7	3.1	2.8	-2.7
1997	618.2	3.2	17.8	6.6	2.9	3.3
1998	636.6	3.0	18.5	3.9	2.9	0.9
1999	650.0	2.1	19.1	3.2	2.9	1.1
2000	696.7	7.2	20.3	6.3	2.9	-0.8
2001	692.6	-0.6	19.9	-2.0	2.9	-1.4
Avg. 1990-1994	498.8	5.3	14.1	5.5	2.8	0.3
Avg. 1995-2000	627.7	4.0	18.1	4.4	2.9	0.4
Avg. 1990-2000	569.1	4.6	16.3	4.9	2.9	0.3

Source: World Tourism Organization; Caribbean Tourism Organization.

Table 2.2b. International and Caribbean Tourist Receipts: 1990-2000
(in billion of US$)

Year	All Countries		Caribbean		Caribbean Share of World Tourist Receipts	
	Receipts	Percent Change	Receipts	Percent Change	Share	Percent Change
1990	267.8	21.1	9.8	12.6	3.7	-7.0
1991	277.6	3.7	10.0	2.0	3.6	-1.6
1992	313.6	13.0	11.9	19.0	3.8	5.3
1993	323.1	3.0	12.4	4.2	3.8	1.1
1994	352.6	9.1	13.1	5.6	3.7	-3.2
1995	403.0	14.3	14.0	6.7	3.5	-6.7
1996	437.6	8.6	15.2	8.6	3.5	0.0
1997	438.2	0.1	16.2	7.0	3.7	6.9
1998	439.4	0.3	17.3	6.5	3.9	6.2
1999	454.6	3.5	18.3	5.6	4.0	2.0
2000	474.4	4.4	19.7	7.7	4.1	3.2
2001	462.2	-2.6	19.4	-1.2	4.2	1.4
Avg. 1990-1994	306.9	10.0	11.4	8.7	3.7	-1.0
Avg. 1995-2000	441.5	5.2	16.8	7.0	3.8	1.9
Avg. 1990-2000	357.2	7.7	13.4	7.8	3.7	0.3

Source: World Tourism Organization; Caribbean Tourism Organization.

11. Table 2.4 shows selected *Caribbean market share* indicators for the key sub-groups over the period 1995-2001 (detailed country data are presented in Appendix Tables 1-8). **This table reveals erosion in the market shares of CARICOM vis-à-vis other Caribbean destinations for three out of four tourism indicators over the period 1995-2001.** In particular, consistent with Table 2.3, CARICOM's share of Caribbean (stay-over) tourist arrivals declined steadily over the review period; and within CARICOM, non-ECCU countries accounted for the greatest declines in the arrivals' market share. This suggests, ceteris paribus, a reduction in CARICOM's tourism competitiveness in the market for stay-over visitors vis-à-vis the rest of the Caribbean. Moreover, given that the average daily expenditures of stay-over tourists typically surpasses that of cruise passengers, the erosion in stay-over tourists' market share through 2000 was also reflected in an erosion in CARICOM's market share of visitor expenditures. Once again, the non-ECCU countries accounted for a greater proportion of the decline. Finally, consistent with the rapid expansion in the market share of "other Caribbean" stay-over visitors, this group's market share of tourist accommodations rose steadily over 1995-2000 before leveling off in 2001.

Table 2.3.Tourist (Stay over) Arrivals

	1990	1995	1999	2000	2001
World Tourist Arrivals	457.3	552.3	652.2	696.7	692.7
Of Which:					
English-Speaking CARICOM	4.0	4.5	4.9	5.1	4.9
Of Which:					
ECCU	0.7	0.8	0.9	0.9	0.8
Other Caribbean destinations 1/	3.6	11.7	14.2	15.2	15.1
As a percent of World Totals					
English-Speaking CARICOM	0.88	0.81	0.75	0.73	0.70
ECCU	0.15	0.15	0.14	0.13	0.12
Other Caribbean destinations 1/	0.78	2.12	2.18	2.18	2.18
Caribbean's World Share	1.66	2.93	2.92	2.91	2.88

Source: World Tourism Organization and the CTO.

1/ Reflects the inclusion of the Dominican Republic and Puerto Rico in 1993, and Cancun and Cozumel in 1994.

Table 2.4. Selected Caribbean Market Share Indicators

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Change 1995-2000	2001	Change 2000-01
				Tourist (Stay-Over) Arrivals						
CARICOM	27.8	27.2	26.4	25.7	25.5	25.0	26.3	-2.8	24.3	-0.7
ECCU	5.0	4.9	4.9	4.8	4.8	4.5	4.8	-0.6	4.2	-0.3
Non-ECCU	22.7	22.3	21.5	20.9	20.8	20.5	21.5	-2.2	20.1	-0.4
Other	72.2	72.8	73.6	74.3	74.5	75.0	73.7	2.8	75.7	0.7
				Cruise Passenger Arrivals						
CARICOM	37.3	36.2	34.9	35.2	37.7	39.1	36.7	1.8	37.8	-1.3
ECCU	10.1	9.7	10.0	11.3	10.8	10.7	10.4	0.6	10.6	0.0
Non-ECCU	27.2	26.5	24.9	23.9	26.9	28.4	26.3	1.2	27.2	-1.3
Other	62.7	63.8	65.1	64.8	62.3	60.9	63.3	-1.8	62.2	1.3
				Estimates of Visitor Expenditure						
CARICOM	28.9	28.0	27.2	26.1	26.3	26.2	27.0	-2.7	25.0	-1.3
ECCU	5.6	5.3	5.4	5.2	4.9	4.5	5.1	-1.1	4.4	-0.1
Non-ECCU	22.7	22.2	21.5	20.6	21.1	21.3	21.6	-1.4	20.2	-1.1
Other	71.1	72.0	72.8	73.9	73.7	73.8	73.0	2.7	75.0	1.3
				Rooms in Tourist Accommodation						
CARICOM	30.6	29.9	28.8	28.1	27.9	27.2	28.8	-3.5	27.1	0.0
ECCU	7.0	6.4	6.1	6.0	5.8	6.0	6.2	-1.0	5.7	-0.3
Non-ECCU	23.6	23.6	22.7	22.1	22.2	21.1	22.5	-2.5	21.4	0.3
Other	69.4	70.1	71.2	71.9	72.1	72.8	71.2	3.5	72.9	0.0

Source: National Tourism and Statistical Offices, and CTO.

12. **On the other hand, the data suggest that CARICOM's competitiveness in cruise ship tourism was improved over 1995-2000, as the region's market share of cruise passenger arrivals rose from 37 percent in 1995 to 39 percent, although the region lost ground in 2001.** Moreover, at 37 percent, CARICOM's average market share of cruise arrivals over 1995-2000 exceeded that of the other indicators, which were below 30 percent. This outcome is largely attributable to the performance of The Bahamas, which accounted for an average of 15½ percent of total Caribbean cruise ship arrivals over 1995-2000—clearly the cruise ship industry leader Caribbean-wide. These observations suggest that this category of tourism may not be as constrained by the size restrictions and diseconomies of scale that typically constrain performance in the stay-over tourist market, and could offer the potential for future growth, subject to capacity limits imposed by environmental considerations. The experience of The Bahamas is also instructive in this regard since its share of visitor expenditure was the fourth highest in the Caribbean, suggesting a higher weighted average for daily tourist expenditure than its CARICOM counterparts. Thus, to the extent that other CARICOM destinations are able to design ways of enhancing the value added by cruise passengers, there could be untapped potential for growth in this area.

13. **During the 1990s, there was also a shift in the market origin of stay-over visitors to the Caribbean.** In particular, the percentage share of visitors from the United States declined, from 57 percent in 1990 to 49 percent in 1999, owing to increased competition from various U.S. destinations, such as Florida and Hawaii. However, the percentage share of European visitors increased, from 17 percent in 1990 to 26½ percent in 1999, while the shares of Canadian and Caribbean visitors were roughly unchanged (Table 2.5). The U.S. share then rose again to 50 ½ percent in 2001, owing to strong performance during the first eight months of the year, while the European share decreased to 26 percent.

14. Finally, Appendix Table 9 shows preliminary data for stay-over tourist and cruise passenger arrivals for 2002. In the case of most of the destinations shown, there has been a significant contraction in the number of stay-over tourist arrivals vis-à-vis the same period in 2001. Although, it is difficult to draw any firm conclusions from this table given the absence of fourth quarter data, the extent of the declines observed throughout the Caribbean region (especially among some of the larger destinations) for the first half of 2002 suggest the possibility of a second consecutive year of decline in Caribbean tourism. **The extent to which the ECCU is able to recover some of the recent erosion in market share will depend on its ability to enhance its competitiveness vis-à-vis other Caribbean destinations.**

Table 2. 5 Stay-Over Tourist Arrivals in the Caribbean by Main Market: 1990-2001
(Arrivals data in millions)

Year	Total Tourists	United States			Canada			Europe			Caribbean		
		Tourists	Percent Change	Percent Share	Tourists	Percent Change	Percent Share	Share	Percent Change	Percent Share	Share	Percent Change	Percent Share
1990 1/	12.8	7.4	n.a.	57.4	0.8	n.a.	6.6	2.2	n.a.	17.2	0.9	n.a.	6.9
1991	13.1	7.4	0.2	56.2	0.9	0.9	6.5	2.5	13.9	19.2	1.0	11.3	7.5
1992	13.9	7.7	4.9	55.6	0.9	2.7	6.3	2.8	10.9	20.0	1.0	-1.3	7.0
1993	14.9	8.4	8.8	56.4	0.9	1.7	6.0	3.0	8.7	20.3	1.0	3.2	6.7
1994	15.7	8.6	2.7	55.0	0.9	-1.2	5.6	3.5	16.5	22.5	1.1	10.7	7.1
1995	16.2	8.5	-1.2	52.7	0.9	6.0	5.8	3.8	7.2	23.4	1.2	7.1	7.3
1996	16.7	8.7	2.0	52.1	0.9	0.0	5.6	4.1	9.1	24.7	1.1	-6.8	6.6
1997	17.8	9.1	4.7	51.2	1.0	5.5	5.5	4.5	8.9	25.2	1.2	4.8	6.5
1998	18.5	9.4	2.6	50.5	1.1	6.8	5.7	4.8	6.3	25.8	1.2	6.7	6.7
1999	19.1	9.4	0.8	49.4	1.1	2.3	5.6	5.1	6.8	26.7	1.3	6.8	6.9
2000	20.3	10.1	7.3	49.8	1.2	14.8	6.1	5.3	3.1	25.9	1.4	6.6	6.9
2001 2/	19.9	10.1	-0.4	50.6	1.3	6.8	6.6	4.9	-7.3	24.5	1.4	-1.6	7.0
Avg. 1990-1994	14.1	7.9	4.2	56.1	0.9	1.0	6.2	2.8	12.5	19.9	1.0	6.0	7.0
Avg. 1995-2000	18.1	9.2	2.7	51.0	1.0	5.9	5.7	4.6	6.9	25.3	1.2	4.2	6.8

Source: World Tourism Organization; Caribbean Tourism Organization.
1/ Break in the series caused by the addition of Cancun.
2/ The increase in the U.S. ratio in 2001 reflects developments in the first three quarters of 2001 prior to September 11.

D. Competitiveness of Tourism in the ECCU

15. This section discusses the competitiveness of the ECCU's tourism in relation to its regional competitors. **It notes that these destinations have lost competitiveness in the second half of the 1990s and that this has been exacerbated by the effect of the September 11 terrorist attacks on the U.S.—their major tourism market**. This loss of competitiveness is evidenced by the slower rate of growth of tourist arrivals and expenditure, a decline in market share and lower foreign direct investment (FDI) in the sector.

16. Competitiveness has two dimensions: price and non-price.[10] Price competitiveness arises from greater efficiency in resource use that lowers production cost. Non-price factors such as product design, packaging, quality service, reliability of supplies, after-sales-service, distribution networks, marketing, and market intelligence are just as important in consumer choice. Non-price factors are even more important for the competitiveness of the tourism industry, which aims to provide a unique experience at a lower cost and a higher level of service to that of similar destinations. Bad experiences, including crime, with any of the contacts during the trip cannot be erased by price or advertising.

17. As noted in Section C, the market share of the Caribbean countries increased initially and stabilized in recent years, however there has been an erosion in the market shares of English-speaking CARICOM countries (including the ECCU) vis-à-vis the rest of the Caribbean since the mid-nineties. The Caribbean's share of world tourism increased from 2½ percent in 1980 and stabilized at 2.9 percent in 1997, while the market share of the ECCU remain roughly unchanged at 0.12 percent over the same period through 2001.

18. **FDI flows to the ECCU countries are mainly for the expansion of tourism facilities, and while still high, they have declined in recent years.** These flows are generally lumpy, given the scale of hotel construction. For the ECCU countries, FDI averaged 12 percent of GDP during 1997-99, but has declined to an average of around 9 percent of GDP since 2000 (Table 3.1).

19. **The recent loss of competitiveness of ECCU destinations is the result of both price and non-price factors.** These factors include: high accommodation and food prices—partly resulting from higher labor and utility costs and appreciating exchange rates—a maturing tourism product, insufficient advertising prior to the September 11 crisis, and a low quality of service.[11]

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[10] The unavailability of data restricted the analysis of competitiveness to a few readily available indicators including relative growth rates of tourist arrivals and expenditure, market share and FDI flows into the sector

[11] The increased frequency of hurricanes (5 during 1995-2000) and an emerging problem of crime and violence have also affected the performance of the sector.

20. **While product differentiation can permit higher prices, ECCU destinations may be pricing themselves out of the market as destinations like Cuba, the Dominican Republic, and Mexico offer lower prices for similar products**. ECCU destinations have always argued that they cater for an exclusive clientele and that their product is directed towards the upper-end of the market.[12] Although higher prices could be justified by characteristic demand theory (Lancaster, 1971), there is a limit to which prices of one differentiated product can exceed another. ECCU destinations seem to be close to or beyond that margin. Table 3.2 gives a sample of rates for 7-day all-inclusive packages offered by Signature Vacations at four-star plus hotels in the Caribbean and Mexico for the 2002-2003-winter season. The general pattern is that emerging Caribbean destinations like Cuba and the Dominican Republic offer much lower rates for a similar vacation product. **Vacation costs in the ECCU sub-region, which average around US$3,500, are almost twice as expensive as the Caribbean coast of Mexico, Cuba and the Dominican Republic**. This finding is similar to earlier studies, which show that Caribbean hotel rates are higher, and shows the greatest discount in off-peak periods (cited in Blanchard, 2002).

21. Airfares are broadly similar for all destinations, although other vacation-related expenses like departure taxes and hotel room taxes are sometimes higher in the non-English-speaking destinations. Hotel room taxes average 7 percent in the ECCU compared with 12 and 13 percent respectively in Cancun and the Dominican Republic (Table 3.2). However, these vacation-related expenses constitute only a small part of the package, and the differences are insufficient to offset the higher accommodation and food costs in the Eastern Caribbean.

22. **Higher labor and utility costs are partly responsible for the higher accommodation and food costs in the Eastern Caribbean**. Table 3.3 shows average wage and utility rates in selected Caribbean countries. Average wages are higher in the ECCU (US$170 per week) and are highest in Anguilla (around US$250 per week).[13] A similar pattern holds for utility rates as a result of small size and lack of economies of scale. Economic impact studies conducted by the CTO show that labor cost and utility rates account for as much as 20 percent and 8 percent of room revenue, respectively, in St. Lucia. This finding accords with microeconomic data compiled by Price Waterhouse in the now discontinued "Report on the Hospitality Sector in the Eastern Caribbean."[14] ECCU Member countries should pursue efforts to deregulate or privatize utility companies within the context of a regional regulatory framework—with a view to enhancing efficiency and the cost competitiveness of tourism enterprises.

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[12] Countries as small as these cannot afford to cater to mass tourism without destroying the environmental characteristics—quiet, pristine surroundings, uncluttered beaches, etc.—on which the industry is based.

[13] Data for Antigua and Barbuda, Montserrat and Grenada are not available.

[14] The Hospitality Report was compiled on a quarterly basis by Price Waterhouse for Antigua and Barbuda, Barbados, and St. Lucia but was discontinued in 1995.

23. **Recent appreciation of the real effective exchange rate (REER) has exacerbated the loss of competitiveness of Eastern Caribbean tourism**. Table 3.4 and Chart 1 show that the REER of most of the countries appreciated sharply in line with the appreciation of the U.S. dollar since 1995 (although there has been some reversal with the weakness of the U.S. dollar during 2002). The REER appreciated an average of 2 percent per year between 1995 and 2001 with St. Kitts and Nevis recording the highest increase (around 2.5 percent). Appreciating exchange rates combined with inflexible labor markets have increased real labor costs significantly.

24. **The non-price competitive factors in ECCU tourism have also deteriorated in recent years.** Most of the destinations have become mature, the quality of service has not kept pace with market trends, and budgetary constraints have lowered the region's visibility in the market place.

25. **After close to thirty years of operation, most ECCU destinations are approaching the mature stage of development, and have not attracted sufficient FDI to rejuvenate the industry**. Decline can be avoided by injecting new capital to rejuvenate the destination. However, while the ECCU destinations are still receiving some new investments, they have not been able to attract the levels of FDI required to refurbish older hotels and build new ones at a fast enough rate. Meanwhile, the quality of service in hotels, restaurants and other attractions has not kept pace with market trends. The ECCU lags behind the rest of the world in technological advances to address the needs of customers, such as automated checkout, Internet access, and state-of-the-art websites for information and reservations.[15]

26. In a market that has become increasingly competitive, **the ECCU has fallen behind in expenditure on advertising to improve its visibility in the market place**. Moreover, worsening fiscal positions have impaired spending on advertising at a time when it is most critically needed. Traditionally, hotels have spent more on marketing than public tourism organizations, but public interventions are crucial in maintaining the country's visibility in the market place.[16] In the post-September 11 period, advertising in the ECCU territories has been hardest hit by budgetary constraints. On average, the ECCU countries spent around US$14 per stay-over arrival on promotions in 2001 compared to US$36 in the Cayman Islands and US$16 in Jamaica (Blanchard, 2002).

27. **Air access has always been a bottleneck for regional tourism during the high season and this has been aggravated by the by recent route cutting by major airlines, which started before September 11 but increased thereafter**. Caribbean tourism is seasonal with large swings between the high and low season. Airlines have typically added

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[15] The Sandals chain is an exception: they are on the cutting edge of quality service in the industry.

[16] This type of advertising provides an externality and the level of expenditure would not be optimally provided by the private sector.

more flights in the winter season and airlift is usually supplemented by charters organized by tour companies, sometimes in conjunction with national tourism organizations.[17] Major airlines like British Airways and American had started cutting back service to the region before September 11 because of low load factors. A number of charter services had also ceased operating in the region (JMC and Condor from the UK and Canada 3000 and Sky Service). With major airlines racking up huge losses especially since September 11, many Caribbean routes were eliminated or service was reduced. In spite of recent efforts to maintain the level of air access to the region (e.g., new services by U.S. Airways), the number of seats to the region is lower than in 2000.

Policy Responses to the Crisis

28. This section reviews the short- and medium-term policy responses to the downward trend in tourism arrivals in the Eastern Caribbean. It comments on the impact of short-term policy responses to the crisis post-September 11, when possible, and discusses a proposed medium-term strategic response.

Short-term responses

29. **Governments and the private sector in the ECCU have responded swiftly to the crisis by implementing short-term measures to reduce the impact of September 11**. However, these measures were insufficient to prevent a further decline in arrivals in 2002. The responses can be divided into government initiatives, private sector initiatives and joint public-private sector initiatives.

30. Government initiatives included the upgrading of security at ports and airports, to reassure travelers that it is safe to travel to these countries; subsidies to the industry in the form of tax waivers; tax incentives and subsidized credit to refurbish hotels; and efforts to maintain airlift to the region. They moved swiftly to upgrade security at airports and ports. The World Bank assisted by providing technical assistance to assess the security needs and made available US$21 million under a quick-disbursing loan program to five ECCU countries.

31. **To prevent massive lay-offs in the industry, most governments waived the payment of some classes of hotel taxes for periods between 6 to 12 months** e.g. Antigua and Barbuda and St. Kitts and Nevis. In many cases, this was equivalent to an outright grant, since the waiver was on tax revenues already collected from visitors on behalf of the government that hotels were allowed to keep.[18] The estimate of forgone tax revenue is

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[17] Tourism organizations often guarantee a percentage of the seats on major airlines and charters to ensure the service.

[18] It is notable that while this provided some financial assistance to hotels, this measure did not serve as an additional financial incentive to visitors.

equivalent to around 1 percent of GDP in the ECCU member countries, which further exacerbated the shortfall in government revenue associated with the decline in economic activity.

32. **In some instances, tax incentives were provided and credit was granted on concessionary terms to facilitate refurbishment of hotels**. Imports of capital goods for hotel expansion and refurbishment were exempted from duties putting further pressure on the fiscal positions. Some ECCU countries provided more funding through their national development banks for improvement of tourism-related facilities.[19]

33. **Post September 11, the CARICOM governments tried to stem the decline in airlift by increasing subsidies to regional airlines and negotiating with foreign airlines to maintain the level of service.** For example, BWIA received an injection of US$13 million and LIAT received US$4 million (EC$11) to keep them flying.[20] An air access strategy now aims to negotiate air services agreements on a regional basis;[21] provide incentives to improve cooperation among regional airlines; support the development of strategically placed hubs to improve air transportation efficiency; provide support to external and regional carriers; and establish a regional aviation oversight authority.

34. **In the private sector, hotels and airlines have responded to the September 11 crisis by offering steep discounts and reducing costs through a streamlining of their operations, including layoffs.**[22] Hotels have been offering discounts of 30-50 percent in an effort to boost occupancy levels. These efforts have been partially successful as the decline in arrivals has not been as steep as expected and occupancy levels have also not declined as much. However, tourist receipts have declined at a faster rate than arrivals. Preliminary data for the first half of 2002 indicate that in the ECCU tourism receipts declined by approximately 6.5 percent, while stay-over arrivals declined by around 5 percent.

35. **In the airline industry, similar discounting and cost-reducing restructuring have taken place.** While it is difficult to calculate the average airfare because of the complexity of airfare pricing structures, the data suggest that airfares are now lower than they were in 2000. At the same time, the number of routes has been reduced and smaller aircrafts are now being

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[19] In Jamaica the subsidized credit scheme was funded by part of the funds returned to commercial banks when the reserve requirement was reduced.

[20] Although BWIA is a Trinidadian airline, many ECCU countries depend on it to provide airlift, particularly from Canada and Europe, and have designated BWIA as their national carrier in air services agreements with third countries.

[21] A high-level meeting of airline executives was convened to discuss cooperation between regional airlines.

[22] Although some hotel associations have given rough estimates of job losses, there are no hard data on the extent of layoffs.

used on some routes to reduce fuel cost and increase the load factor. Food service has also been scaled back. Recent job losses caused by airline retrenchment and restructuring, have been partially offset by increases in security personnel.

36. **Governments and the private sector are cooperating to jointly market Caribbean tourism at both regional and national levels**. The most significant marketing initiative is an ambitious US$16 million joint advertisement program entitled "The World needs the Caribbean."[23] The program was to be funded by the governments and private sector tourism interests in all of the CTO member countries, and markets the whole region as a destination, providing an umbrella under which national marketing programs could be developed. The share of the budget for each country is based on the number of hotel rooms. A number of high profile destinations including Cancun, Cozumel Dominican Republic, Puerto Rico, and the Cayman Islands have pulled out, citing the need to use scarce promotional resources more effectively. However, the remaining countries are pressing ahead with the program, some with loans from the CDB to pay their share of the budget.[24] CTO officials said that the marketing program is paying some dividends, judging by the number of hits to the website and the amount of bookings, which cite the ad campaign.

37. **Several countries also have joint public and private sector promotions that supplement the regional marketing program**. In addition to increased advertisement budgets, many countries are offering special promotions on hotels and other attractions. The ECCU countries have been modest in their promotional activities, restricting their promotions to discounts offered by the hotels and specials on side attractions.

38. All of these promotional activities impact on the fragile fiscal position of the ECCU countries, either through direct expenditure or through reduced tax revenues from lower receipts for hotel rooms and other services. Such expenditures may be inescapable if the countries are to successfully weather the present crisis and maintain their market profile, however they should ensure that these resources are efficiently spent to re-position themselves to benefit from a recovery in world tourism. **However, over the medium term, the ECCU's tourism industry needs to be radically restructured to ensure its survival in an increasingly competitive industry.**

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[23] The marketing program plays on the words of a David Rudder calypso, which suggests that the world no longer needs islands. It is patterned on a similar program in the earlier 1990s, which coincided with a period of faster growth in Caribbean tourism.

[24] The Caribbean Development Bank (CDB) made available US$8 million to borrowing members under a special window to offset the effects of 9/11.

Proposed Medium-Term Strategic Response

39. More important than the short-term policy responses to the September 11 crisis, is an appropriate medium-term strategy, which would encompass a restructuring of the industry to deal with the competitive threat from emerging Caribbean destinations. **In the current situation, more effort could be spent on upgrading and modernizing the facilities and improving the quality of service in these countries than on marketing**. In particular, over the medium term, ECCU countries should aim to address issues of price competitiveness—through wage restraint and productivity increases; attract significant amounts of FDI to refurbish hotels and build new ones and raise the quality of service to international standards; while also addressing environmental concerns. In the cruise ship industry, many ports have been upgraded to accommodate mega-ships, but these countries need to provide attractions to improve the value added by cruise passengers.

40. **Although the price competitiveness of the industry was helped somewhat by the weakness of the U.S. dollar in 2002, over the medium term, overall wage restraint and the adoption of wage policies that tie wage awards to productivity increases would be essential in the face of fixed and heavily managed exchange rates**. The ECCU countries are initiating programs to address these issues, similar to the framework for productivity and wage negotiations already in use in Barbados. Moreover, it is essential that timely productivity indices be produced, and that there is strict adherence to adopted wage protocols.

41. **To remain competitive, many of the ageing hotels would need to be refurbished.** However, the bulk of the investment resources would need to be sourced from outside of the region, given the small capital market. In addition, to encourage greater investment (by both domestic and foreign companies), ECCU countries would need to improve the business environment and overall competitiveness of their economies, including the regulatory framework and the level of taxation of the tourism industry.[25] A modified value added tax that zero-rates tourism could increase the profitability of the industry and encourage greater investment.

42. **However, capital improvements to hotel facilities must also be complemented by improvements in the quality of service.** To address quality concerns, the CTO has proposed the development of a *quality assurance framework* for use in hospitality institutions along with increased training in the industry. The CTO also recommends the passage of legislation to achieve the free movement of skills across the region.

43. Countries are becoming more aware that the industry needs to develop in harmony with the environment and many have passed legislation requiring environmental impact assessments for major projects. However, much needs to be done to enforce the

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[25] There are several taxes on the same base, which often prove difficult to collect. For example, in Antigua and Barbuda there are three different hotel room taxes.

environmental laws and to provide incentives for sustainable use of the natural resources of these countries.

44. **Most ECCU countries have invested heavily in port facilities to handle mega cruise ships; however, the investment does not seem to be paying off since the value-added by cruise tourism is diminishing with the enhancement of on-board cruise facilities**. Nevertheless, these countries would need to try to recoup some of their investment by strengthening the links between cruise tourism and the domestic economy. This could be achieved by increasing the services and attractions offered to cruise passengers and negotiating provisioning contracts with cruise ships.

45. The CTO conference held in the Bahamas in November 2002 proposed a continuation of regional marketing on a permanent basis, and a broad program of cooperation spanning all aspects of the industry. The regional marketing program would be financed through a Sustainable Tourism Development Fund, with the proceeds of a mandatory US$5 tax on all tourist arrivals. The fund would be used partly to finance the region's marketing efforts and partly for investment in regional projects. Given the competitiveness of the industry and the track record with the implementation of such head taxes, consensus on the fund could be difficult to achieve.

46. **Broad-based cooperation could be difficult to achieve, but in its absence, strategic alliances could be a viable option for the ECCU.** The broad cooperation envisaged under the CTO strategic objectives does not take account of the differences in cost structures, market segments targeted and the prospects for expansion across its diverse membership. Under these circumstances, there may not be a stable cooperative solution for the regional tourism industry. While a cooperative solution in which all countries participate could bring benefits to the region as a whole, the ECCU may find it difficult to make common ground with the emerging tourist destinations and may be better served by addressing the issues of modernization and quality as a priority, and pursue strategic alliances of differing scope to deal with other aspects of the industry. For example, Grenada and St. Vincent and the Grenadines may want to market the Grenadines jointly with Barbados and Martinique, but they may want to address air access on a broader regional basis. Similarly, the ECCU could jointly promote packages that provide chartered yacht services to cruise the islands at one end of the chain, and drop off services at the other.

E. Conclusion

47. The September 11 terrorists' attacks caused the ECCU to suffer an unprecedented decline in output, increased unemployment, and a sharp deterioration in its fiscal position. This brought into clearer focus the underlying weaknesses in the tourism sector in these economies. It could also serve as a wake-up call to modernize the hotel industry and improve the quality of services to meet the competitive threat from newly emergent Caribbean destinations. The main conclusions and recommendations are the following:

- Tourism is an important source of income, employment, government revenue, and serves as a major source of foreign exchange earnings in the ECCU and the rest of CARICOM. The September 11 crisis resulted in an unprecedented contraction in ECCU output, and contributed to a significant deterioration in its fiscal position.

- Nevertheless, despite a significant decline in tourist arrivals and the economic crisis in its tow, the Caribbean region as whole maintained its market share of world tourist arrivals (namely, 2.9 percent), and its share of world tourist receipts increased, albeit marginally.

- Despite the robustness of the Caribbean's share of world tourism in the period post-September 11, the ECCU and its CARICOM partners have lost competitiveness in a global sense, as demonstrated by the reduction in the region's world tourist arrivals share, and vis-à-vis newly emergent Caribbean destinations.

- In order to enhance its external competitiveness and regain some of its lost ground, ECCU member states should adopt policies to address both price and non-price competitiveness.

Measures to address price competitiveness:

- Given the prevailing fixed exchange rate regimes, the ECCU should seek to enhance wage competitiveness through wage restraint and strict adherence to wage protocols that tie wage awards directly to demonstrable gains in productivity.

- The ECCU member states should pursue efforts to deregulate or privatize utility companies within the context of a regional regulatory framework—with a view to enhancing productive efficiency and cost competitiveness of tourism enterprises.

Measures to address non-price competitiveness include:

- Enhancing the business climate, with a view to attracting more foreign direct investment to the region.

- Continuing efforts to enhance the quality of service—including strengthening crime prevention and the establishment of an appropriate *quality assurance framework*.

- Continuing participation in regional joint advertising/promotion campaigns—including the promotion of multiple island package bundles, designed to enhance the attractiveness and widen the appeal of Caribbean vacations.

- Developing better tourist facilities and attractions designed to enhance the value added of cruise passengers.

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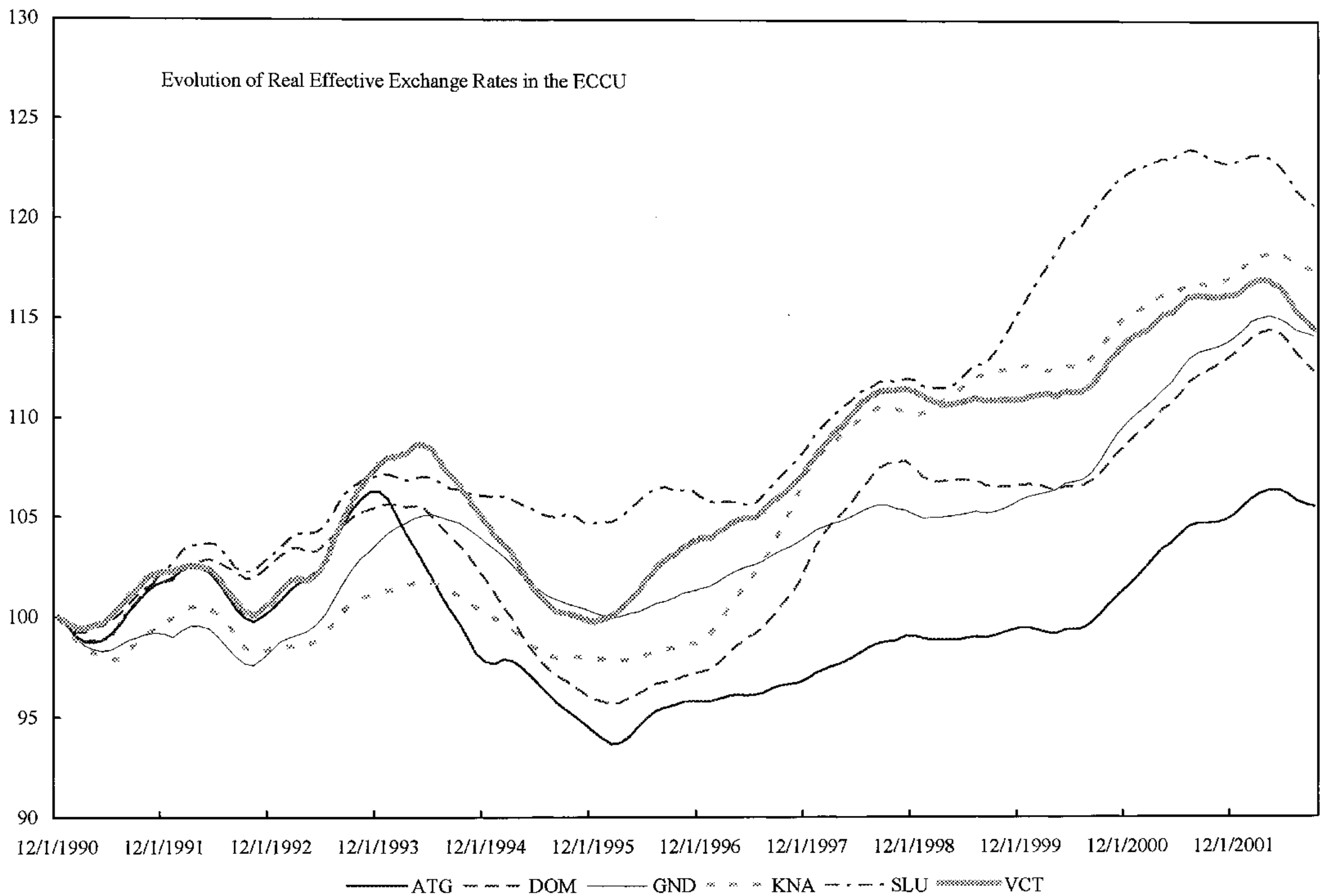
Evolution of Real Effective Exchange Rates in the ECCU
130
125
120
115
110
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100
95
90
12/1/1990
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12/1/2001
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DOM
GND
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SLU
VCT

Table 3.1. Caribbean Region: Foreign Direct Investment
(In percent of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002
ECCU	9.1	10.9	11.9	12.1	12.1	10.7	9.7	8.4
Anguilla	24.1	41.9	23.9	29.7	38.2	21.5	29.6	...
Antigua	6.7	3.6	4.0	4.4	4.1	3.6	5.7	...
Dominica	11.3	3.2	3.5	1.0	2.5	1.5	2.1	1.0
Grenada	6.8	6.2	10.6	14.3	11.0	8.8	8.6	11.4
Montserrat	2.0	-0.7	6.3	6.8	23.4	7.4	3.1	...
St. Kitts	11.6	14.3	7.2	11.1	18.9	29.2	25.6	...
St. Lucia	5.9	3.2	8.3	13.5	13.9	9.0	3.4	...
St. Vincent and the Grenadines	4.6	15.1	31.3	27.9	17.0	8.7	9.2	8.9
Other Caricom								
Bahamas	3.4	4.9	8.4	20.2	11.2	9.6	3.3	4.0
Barbados	...	...	1.4	0.7	2.2	6.0	5.0	1.0
Belize	3.1	1.8	1.3	2.1	4.7	3.0	2.9	2.9
Guyana	12.5	7.5	6.9	6.1	6.9	9.4	8.0	8.5
Jamaica	1.7	1.5	2.3	4.1	4.8	6.9	5.6	6.5
Trinidad and Tobago								
Other Caribbean								
Dom. Republic	3.4	0.7	2.8	4.4	7.7	4.8	4.7	4.7

Sources: ECCB, IMF staff estimates

Table 3.2. Caribbean Region: Hotel Rates and Other Charges
(Quoted in US dollars unless otherwise stated)

	Hotel Name	Rating	Jan 5-12 2003	Mar 23-30 2003	Air fare	Departure Tax	Cruise Passenger Ta	Hotel Room Tax
ECCU								
Anguilla						10.00	-	8.0
Antigua and Barbuda	Sandals Antigua Resort	4+	3,619.0	3,289.0	699.0	20.00	6.0	8.5
	St. James Club	4+	3,388.0	2,439.0				
Dominica						10.00	5.0	5.0
Grenada	La Source	4+	3,869.0		899.0	16.65	3.0	8.0
	Spice Island Beach Resor	4+	3,859.0					
St. Kitts and Nevis						16.50	1.5	7.0
St. Lucia	Sandals Halcyon, St. Luc	4+	3,169.0	3,199.0	699.0	20.00	6.5	8.0
	Le Sport	4+	3,029.0					
St. Vincent and the Grenadines						11.11	10.0	7.0
Other CARICOM								
Bahamas	Atlantis	5	2,199.0	2,499.0		15.00	15.0	6.0
	Sheraton Grand Resort	4	1,749.0	2,179.0				
Barbados	Crystal Cove Hotel	4+	4,149.0	3,879.0		12.50	6.0	7.5
	Turtle Beach Resort	4+	5,049.0	4,769.0				
Belize						15.00	5.0	7.0
Guyana						15.00	-	10.0
Jamaica	Sandals Montego Bay	4+	2,648.0	2,658.0		27.00	15.0	6.3
	Beaches Negril	4+	3,089.0	3,169.0				
Suriname								
Trinidad and Tobago						16.13	5.0	8.0
Other Caribbean								
Cuba	Brezes Costa Verde	4+	1,308.0	1,599.0	629.0	20.00	-	6.0
	Beaches varadero	4+	1,699.0	1,719.0				
Cancun	Royal Solaris	4+	1,558.0	1,929.0	669.0	-	-	12.0
	Omni Cancun Hotel	5	1,339.0	1,429.0				
Dominican Republic	Baecelo Capella Beach	4+	1,298.0	1,529.0	669.0	10.00	1.0	13.0
	Bavaro Princess	4+	1,729.0	1,569.0				

Sources: Signature Vacations, Caribbean Tourism Organization, Blanchard 2002.

Table 3.3 Caribbean Region: Wages and Utility Costs (1999)

	Average Wage US$ per week 1/	Electricity US$ / Kilowat	Telephone Subscription	Telephone calls 3 mins. To USA	Water US$/1000 gls
ECCU					
Anguilla	251.85	...	10.37	5.9	...
Antigua & Barbuda	...	0.16	22.20	5.90	18.52
Dominica	133.82	0.25	7.52	...	4.63
Grenada	...	0.15	40.74	4.00	5.86
Montserrat	...	0.20	...	5.00	4.44-9.63
St. Kitts & Nevis	170.50	0.13	10.37	4.00	2.60
St. Lucia	198.61	0.17	10.09	4.00	3.81
St. Vincent & the Grenadines	146.70	0.16	14.81	4.00	3.70
Other CARICOM					
Bahamas	...	...	24.5	1.38	...
Barbados	...	0.15	42.38	4	...
Belize	...	0.20	10.00	3.7	4.95
Jamaica	152.00	0.17	5.79	5.2	4.33-17.25
Trinidad & Tobago	...	0.03	27.78	3.3	...
Other Caribbean					
Cancun	...	...	19.94	3.01	...
Cuba	...	...	...	...	...
Domincan Republic	30.70	...	19.6	3.9	...

Sources: International Labor Organization, World Bank: International Development Indicators, National Authorities.

1/ Average wage for the whole economy for Jamaica, St. Kitts-Nevis and St. Vincent; Hotel and restaurant for Anguilla, D.R. and St. Lucia.

Table 3.4. Caribbean Region: Real Effective Exchange Rates
(1990 = 100)

	1995	1996	1997	1998	1999	2000	2001	2002 1/
ECCU								
Antigua and Barbuda	94.3	95.8	96.9	99.0	99.4	101.5	105.1	106.0
Dominica	95.9	97.3	102.6	107.5	106.6	108.7	113.3	113.7
Grenada	100.2	101.4	104.0	105.1	105.9	109.8	114.0	114.7
St. Kitts and Nevis	97.9	98.7	107.3	110.2	112.6	115.2	117.2	117.9
St. Lucia	104.7	106.0	108.5	111.9	115.5	122.3	122.9	122.3
St. Vincent and the Grenadines	99.7	103.9	107.5	111.4	110.9	113.9	116.2	116.1
Other CARICOM								
Bahamas	100.6	101.1	103.3	105.2	108.1	110.9	113.7	114.4
Barbados	101.9	103.4	111.2	109.0	110.2	114.3	117.7	115.8
Belize	95.5	100.6	103.7	103.4	100.9	102.4	104.3	104.6
Guyana	103.5	111.7	117.8	118.5	107.4	113.3	114.3	112.3
Jamaica	92.4	109.9	126.9	134.2	133.0	130.6	131.8	133.3
Suriname	124.6	137.6	151.4	178.4	172.9	193.7	158.9	161.5
Trinidad and Tobago	84.2	85.8	86.2	90.4	92.8	97.2	104.6	106.5
Other Caribbean								
Dominican Republic	113.7	116.4	122.0	121.3	120.1	125.4	133.1	132.1
Haiti	119.4	134.1	152.7	171.3	183.0	184.6	191.3	186.6

Sources: IMF Information Notice System.
1/ Average January-September, 2002.

Appendix Table 1. Tourist (Stay-Over) Arrivals (Thousands)

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Percent Change 1995-2000 1/	2001	Percent Change 2000-01
Total Caribbean	**16,194.2**	**16,756.6**	**17,791.9**	**18,462.3**	**19,054.8**	**20,283.4**	**18,090.5**	25.3	**19,942.0**	-1.7
Of Which:										
English-Speaking CARICOM	**4,499.4**	**4,557.1**	**4,694.6**	**4,737.3**	**4,862.6**	**5,068.6**	**4,736.6**	3.5	**4,850.0**	**-4.3**
(Percent of Caribbean Total)	*27.8*	*27.2*	*26.4*	*25.7*	*25.5*	*25.0*	*26.2*		*24.3*	*-2.7*
ECCU	**816.1**	**823.7**	**866.6**	**879.6**	**908.0**	**906.2**	**866.7**	0.6	**839.3**	**-7.4**
(Percent of Caribbean Total)	*5.0*	*4.9*	*4.9*	*4.8*	*4.8*	*4.5*	*4.8*		*4.2*	*-5.8*
Anguilla 2/	38.5	37.5	43.2	43.9	46.8	43.8	42.3	0.0	48.0	9.5
Antigua and Barbuda	220.0	228.2	240.4	234.3	239.6	237.7	233.4	0.1	200.4	-15.7
Dominica	60.5	63.3	65.4	65.5	73.5	69.6	66.3	0.1	66.4	-4.6
Grenada	108.0	108.2	110.7	115.8	125.3	128.9	116.2	0.1	123.4	-4.3
Montserrat	17.7	8.7	5.1	7.5	9.9	10.3	9.9	0.0	9.8	-4.9
St. Kitts and Nevis	78.9	84.2	88.3	93.2	84.0	73.1	83.6	0.0	70.6	-3.4
St. Lucia	232.3	235.7	248.4	252.2	260.6	269.9	249.9	0.2	250.1	-7.3
St. Vincent and Grenadines	60.2	57.9	65.1	67.2	68.3	72.9	65.3	0.1	70.7	-3.0
Non-ECCU	**3,683.3**	**3,733.4**	**3,828.0**	**3,857.7**	**3,954.6**	**4,162.4**	**3,869.9**	3.0	**4,010.7**	**-3.6**
(Percent of Caribbean Total)	*22.7*	*22.3*	*21.5*	*20.9*	*20.8*	*20.5*	*21.4*		*20.1*	*-2.0*
Bahamas	1,598.1	1,633.1	1,617.6	1,527.7	1,577.1	1,596.2	1,591.6	0.0	1,552.9	-2.7
Barbados	442.1	447.1	472.3	512.4	514.6	544.7	488.9	0.6	507.1	-6.9
Belize	130.8	132.8	145.9	176.1	180.8	195.6	160.3	0.4	196.0	0.2
Guyana	105.5	92.0	75.7	68.5	74.9	105.0	86.9	0.0	95.1	-9.4
Jamaica	1,147.0	1,162.5	1,192.2	1,225.3	1,248.4	1,322.7	1,216.4	1.1	1,276.5	-3.5
Trinidad and Tobago	259.8	265.9	324.3	347.7	358.8	398.2	325.8	0.9	383.1	-3.8
Other Caribbean Countries	**11,694.7**	**12,199.5**	**13,097.3**	**13,725.0**	**14,192.2**	**15,214.8**	**13,353.9**	21.7	**15,091.9**	**-0.8**
(Percent of Caribbean Total)	*72.2*	*72.8*	*73.6*	*74.3*	*74.5*	*75.0*	*73.8*		*75.7*	*0.9*
Aruba	618.9	640.8	646.0	647.4	683.3	721.2	659.6	0.6	691.4	-4.1
Bermuda	387.5	389.6	379.7	370.0	354.8	332.2	369.0	-0.3	278.2	-16.3
Bonaire	59.4	65.1	62.8	61.7	61.5	51.3	60.3	-0.1	50.4	-1.8
British Virgin Islands 3/	219.5	243.7	244.3	279.1	285.9	281.1	258.9	0.4	295.6	5.2
Cancun (Mexico)	1,672.0	1,836.0	2,069.3	2,012.3	2,072.2	2,255.3	1,986.2	3.6	2,178.7	-3.4
Cayman Islands 3/	361.4	373.3	381.2	404.2	394.5	354.1	378.1	0.0	334.1	-5.7
Cozumel (Mexico)	243.5	231.9	159.0	181.6	324.7	230.0	228.4	-0.1	240.5	4.6
Cuba	762.7	1,004.3	1,170.1	1,415.8	1,602.8	1,744.0	1,283.3	6.1	1,774.5	1.8
Curacao	223.8	214.3	205.1	198.6	198.3	191.2	205.2	-0.2	204.6	7.0
Dominican Republic	1,775.9	1,925.6	2,211.4	2,309.1	2,649.4	2,972.6	2,307.3	7.4	2,868.9	-3.5
Guadeloupe	640.0	625.0	660.0	693.0	711.0	807.0	2,307.3	1.0	773.4	-4.2
Haiti 4/	145.4	150.2	148.7	146.8	143.4	140.5	2,307.3	0.0	141.6	0.8
Martinique	457.2	477.0	513.2	548.8	564.3	526.3	514.5	0.4	460.4	-12.5
Puerto Rico	3,053.9	3,127.7	3,241.8	3,396.1	3,024.1	3,341.4	3,197.5	1.8	3,551.2	6.3
Saba	10.0	9.8	10.6	10.6	9.3	9.1	9.9	0.0	9.0	-1.0
St. Eustatius	8.8	8.2	8.5	8.6	9.2	8.9	8.7	0.0	9.6	7.8
St. Maarten	479.7	364.7	439.2	458.5	444.8	432.3	436.5	-0.3	402.6	-6.9
Suriname 4/	43.4	53.2	61.4	54.6	57.3	57.7	2,307.3	0.1	69.9	21.1
Turks and Caicos Is. 3/	77.8	86.5	92.1	105.9	117.6	151.4	105.2	0.5	165.2	9.1
US Virgin Islands	454.0	372.6	392.9	422.3	483.8	607.2	455.5	0.9	592.0	-2.5

Source: Caribbean Tourism Organization.

1/ Change calculated as a percentage of beginning of period "total Caribbean" cruise arrivals.

2/ Anguilla is an Associate Member of CARICOM.

3/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.

4/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 2. Tourist (Stay-Over) Arrivals
(Percentage shares)

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Change 1995-2000 1/	2001	Change 2000-01
English-Speaking CARICOM	**27.8**	**27.2**	**26.4**	**25.7**	**25.5**	**25.0**	**26.3**	**-2.8**	**24.3**	**-0.7**
ECCU	**5.0**	**4.9**	**4.9**	**4.8**	**4.8**	**4.5**	**4.8**	**-0.6**	**4.2**	**-0.3**
Anguilla 2/	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0	0.2	0.0
Antigua and Barbuda	1.4	1.4	1.4	1.3	1.3	1.2	1.3	-0.2	1.0	-0.2
Dominica	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.0	0.3	0.0
Grenada	0.7	0.6	0.6	0.6	0.7	0.6	0.6	0.0	0.6	0.0
Montserrat	0.1	0.1	0.0	0.0	0.1	0.1	0.1	-0.1	0.0	0.0
St. Kitts and Nevis	0.5	0.5	0.5	0.5	0.4	0.4	0.5	-0.1	0.4	0.0
St. Lucia	1.4	1.4	1.4	1.4	1.4	1.3	1.4	-0.1	1.3	-0.1
St. Vincent and Grenadines	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.0	0.4	0.0
Non-ECCU	**22.7**	**22.3**	**21.5**	**20.9**	**20.8**	**20.5**	**21.5**	**-2.2**	**20.1**	**-0.4**
Bahamas	9.9	9.7	9.1	8.3	8.3	7.9	8.9	-2.0	7.8	-0.1
Barbados	2.7	2.7	2.7	2.8	2.7	2.7	2.7	0.0	2.5	-0.1
Belize	0.8	0.8	0.8	1.0	0.9	1.0	0.9	0.2	1.0	0.0
Guyana	0.7	0.5	0.4	0.4	0.4	0.5	0.5	-0.1	0.5	0.0
Jamaica	7.1	6.9	6.7	6.6	6.6	6.5	6.7	-0.6	6.4	-0.1
Trinidad and Tobago	1.6	1.6	1.8	1.9	1.9	2.0	1.8	0.4	1.9	0.0
Other Caribbean Countries	**72.2**	**72.8**	**73.6**	**74.3**	**74.5**	**75.0**	**73.7**	**2.8**	**75.7**	**0.7**
Aruba	3.8	3.8	3.6	3.5	3.6	3.6	3.7	-0.3	3.5	-0.1
Bermuda	2.4	2.3	2.1	2.0	1.9	1.6	2.1	-0.8	1.4	-0.2
Bonaire	0.4	0.4	0.4	0.3	0.3	0.3	0.3	-0.1	0.3	0.0
British Virgin Islands 3/	1.4	1.5	1.4	1.5	1.5	1.4	1.4	0.0	1.5	0.1
Cancun (Mexico)	10.3	11.0	11.6	10.9	10.9	11.1	11.0	0.8	10.9	-0.2
Cayman Islands 3/	2.2	2.2	2.1	2.2	2.1	1.7	2.1	-0.5	1.7	-0.1
Cozumel (Mexico)	1.5	1.4	0.9	1.0	1.7	1.1	1.3	-0.4	1.2	0.1
Cuba	4.7	6.0	6.6	7.7	8.4	8.6	7.0	3.9	8.9	0.3
Curacao	1.4	1.3	1.2	1.1	1.0	0.9	1.1	-0.4	1.0	0.1
Dominican Republic	11.0	11.5	12.4	12.5	13.9	14.7	12.7	3.7	14.4	-0.3
Guadeloupe	4.0	3.7	3.7	3.8	3.7	4.0	3.8	0.0	3.9	-0.1
Haiti 4/	0.9	0.9	0.8	0.8	0.8	0.7	0.8	-0.2	0.7	0.0
Martinique	2.8	2.8	2.9	3.0	3.0	2.6	2.8	-0.2	2.3	-0.3
Puerto Rico	18.9	18.7	18.2	18.4	15.9	16.5	17.7	-2.4	17.8	1.3
Saba	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.0	0.0	0.0
St. Eustatius	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
St. Maarten	3.0	2.2	2.5	2.5	2.3	2.1	2.4	-0.8	2.0	-0.1
Suriname 4/	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0	0.4	0.1
Turks and Caicos Is. 3/	0.5	0.5	0.5	0.6	0.6	0.7	0.6	0.3	0.8	0.1
US Virgin Islands	2.8	2.2	2.2	2.3	2.5	3.0	2.5	0.2	3.0	0.0

Source: Caribbean Tourism Organization.

1/ Change calculated as a percentage of beginning of period "total Caribbean" cruise arrivals.

2/ Anguilla is an Associate Member of CARICOM.

3/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.

4/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 3. Cruise Passenger Arrivals (thousands)

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Percent Change 1995-2000 1/	2001	Percent Change 2000-01
Total Caribbean 2/	**9,884.8**	**10,949.8**	**12,087.6**	**12,422.4**	**12,144.8**	**14,476.3**	**11,994.3**	**46.5**	**14,895.1**	**2.9**
English-Speaking CARICOM	**3,685.0**	**3,964.6**	**4,215.0**	**4,371.6**	**4,581.7**	**5,659.1**	**4,412.8**	**20.0**	**5,632.3**	**-0.5**
(Percent of Caribbean Total)	37.3	36.2	34.9	35.2	37.7	39.1	36.8	1.8	37.8	-3.3
ECCU	**994.3**	**1,061.2**	**1,207.1**	**1,408.1**	**1,311.7**	**1,543.4**	**1,254.3**	**5.6**	**1,582.4**	**2.5**
(Percent of Caribbean Total)	10.1	9.7	10.0	11.3	10.8	10.7	10.5	0.6	10.6	-0.4
Antigua and Barbuda	227.4	269.6	285.5	336.5	328.0	429.4	312.7	2.0	408.8	-4.8
Dominica	134.9	193.4	230.6	244.6	202.0	239.8	207.6	1.1	207.6	-13.4
Grenada	249.9	267.0	246.6	265.9	245.5	180.3	242.5	-0.7	147.4	-18.3
St. Kitts and Nevis	120.9	85.8	102.7	154.1	137.3	164.1	127.5	0.4	252.2	53.7
St. Lucia	175.9	182.2	310.3	372.1	351.2	443.6	305.9	2.7	489.9	10.4
St. Vincent and Grenadines	85.3	63.2	31.4	34.9	47.7	86.2	58.1	0.0	76.5	-11.3
Non-ECCU	**2,690.7**	**2,903.4**	**3,007.9**	**2,963.5**	**3,270.0**	**4,115.7**	**3,158.5**	**14.4**	**4,049.9**	**-1.6**
(Percent of Caribbean Total)	**27.2**	26.5	24.9	23.9	26.9	28.4	26.3	4.4	27.2	**-4.4**
Bahamas	1,543.5	1,687.1	1,743.7	1,730.0	1,981.5	2,512.6	0.2	9.8	2,551.7	1.6
Barbados	484.7	509.9	517.9	506.6	432.9	533.3	497.6	0.5	527.6	-1.1
Belize	7.9	0.1	2.7	14.2	34.1	58.1	19.5	0.5	48.1	-17.2
Jamaica	605.2	658.2	711.7	673.7	764.3	907.6	720.1	3.1	840.3	-7.4
Trinidad and Tobago	49.4	48.1	31.9	39.0	57.2	104.1	55.0	0.6	82.2	-21.0
Other Caribbean Countries	**6,199.8**	**6,985.2**	**7,872.6**	**8,050.8**	**7,563.1**	**8,817.2**	**7,581.5**	**26.5**	**9,262.8**	**5.1**
(Percent of Caribbean Total)	62.7	63.8	65.1	64.8	62.3	60.9	63.3	-1.8	62.2	
Aruba	294.0	316.9	297.7	257.8	289.0	490.1	324.3	2.0	487.3	**-0.6**
Bermuda	169.7	181.7	181.9	188.3	193.0	209.7	187.4	0.4	180.0	-14.2
Bonaire	10.7	14.9	20.4	20.2	14.8	43.5	20.8	0.3	40.5	-6.9
British Virgin Is. 3/	122.1	159.6	104.9	105.1	180.7	188.5	143.5	0.7	202.5	7.4
Cayman Is. 3/	682.9	771.1	866.6	871.4	1,035.5	1,030.9	876.4	3.5	1,214.8	17.8
Cozumel (Mexico)	908.9	986.7	1,087.9	1,248.9	1,304.0	1,504.6	1,173.5	6.0	1,595.4	6.0
Curacao	171.7	173.1	214.7	231.0	220.7	309.4	220.1	1.4	300.1	-3.0
Dominican Republic	30.5	110.9	270.8	392.7	283.4	182.4	211.8	1.5	211.4	15.9
Guadeloupe	419.2	612.6	470.1	334.3	292.7	329.3	409.7	-0.9	361.7	na
Haiti 4/	225.4	250.4	238.4	246.2	243.3	304.5	251.4	0.8	357.4	na
Martinique	428.0	408.4	386.8	414.6	339.1	286.2	377.2	-1.4	202.4	-29.3
Puerto Rico	1,001.1	1,025.1	1,227.4	1,243.4	1,148.6	1,301.4	1,157.8	3.0	1,350.3	3.8
St. Maarten	564.3	657.4	886.0	881.4	615.6	868.3	745.5	3.1	867.8	-0.1
US Virgin Islands	1,171.3	1,316.4	1,619.0	1,615.5	1,402.7	1,768.4	1,482.2	6.0	1,891.4	7.0

Source: Caribbean Tourism Organization.

1/ Change calculated as a percentage of beginning of period "total Caribbean" cruise arrivals.

2/ Total excludes Montserrat and Cuba, for which there was insufficient data.

3/ British Virgin Islands and Cayman Islands are Associate Members of CARICOM.

4/ Haiti is a non-English Speaking Members of CARICOM.

Appendix Table 4. Cruise Passenger Arrivals 1/
(Percentage shares)

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Change 1995-2000	2001	Change 2000-01
English-Speaking CARICOM	**37.3**	**36.2**	**34.9**	**35.2**	**37.7**	**39.1**	**36.7**	**1.8**	**37.8**	**-1.3**
ECCU	**10.1**	**9.7**	**10.0**	**11.3**	**10.8**	**10.7**	**10.4**	**0.6**	**10.6**	**0.0**
Antigua and Barbuda	2.3	2.5	2.4	2.7	2.7	3.0	2.6	0.7	2.7	-0.2
Dominica	1.4	1.8	1.9	2.0	1.7	1.7	1.7	0.3	1.4	-0.3
Grenada	2.5	2.4	2.0	2.1	2.0	1.2	2.1	-1.3	1.0	-0.3
St. Kitts and Nevis	1.2	0.8	0.8	1.2	1.1	1.1	1.1	-0.1	1.7	0.6
St. Lucia	1.8	1.7	2.6	3.0	2.9	3.1	2.5	1.3	3.3	0.2
St. Vincent and Grenadines	0.9	0.6	0.3	0.3	0.4	0.6	0.5	-0.3	0.5	-0.1
Non-ECCU	**27.2**	**26.5**	**24.9**	**23.9**	**26.9**	**28.4**	**26.3**	**1.2**	**27.2**	**-1.2**
Bahamas	15.6	15.4	14.4	13.9	16.3	17.4	15.5	1.7	17.1	-0.2
Barbados	4.9	4.7	4.3	4.1	3.6	3.7	4.2	-1.2	3.5	-0.1
Belize	0.1	0.0	0.0	0.1	0.3	0.4	0.1	0.3	0.3	-0.1
Jamaica	6.1	6.0	5.9	5.4	6.3	6.3	6.0	0.1	5.6	-0.6
Trinidad and Tobago	0.5	0.4	0.3	0.3	0.5	0.7	0.5	0.2	0.6	-0.2
Other Caribbean Countries	**62.7**	**63.8**	**65.1**	**64.8**	**62.3**	**60.9**	**63.3**	**-1.8**	**62.2**	**1.3**
(Percent of Caribbean Total)	0.6	0.6	0.5	0.5	0.5	0.4	0.5	-0.2	0.4	
Aruba	3.0	2.9	2.5	2.1	2.4	3.4	2.7	0.4	3.3	-0.1
Bermuda	1.7	1.7	1.5	1.5	1.6	1.4	1.6	-0.3	1.2	-0.2
Bonaire	0.1	0.1	0.2	0.2	0.1	0.3	0.2	0.2	0.3	0.0
British Virgin Islands 2/	1.2	1.5	0.9	0.8	1.5	1.3	1.2	0.1	1.4	0.1
Cayman Islands 2/	6.9	7.0	7.2	7.0	8.5	7.1	7.3	0.2	8.2	1.0
Cozumel (Mexico)	9.2	9.0	9.0	10.1	10.7	10.4	9.7	1.2	10.7	0.3
Curacao	1.7	1.6	1.8	1.9	1.8	2.1	1.8	0.4	2.0	-0.1
Dominican Republic	0.3	1.0	2.2	3.2	2.3	1.3	1.7	1.0	1.4	0.2
Guadeloupe	4.2	5.6	3.9	2.7	2.4	2.3	3.5	-2.0	2.4	0.2
Haiti 3/	2.3	2.3	2.0	2.0	2.0	2.1	2.1	-0.2	2.4	0.3
Martinique	4.3	3.7	3.2	3.3	2.8	2.0	3.2	-2.4	1.4	-0.6
Puerto Rico	10.1	9.4	10.2	10.0	9.5	9.0	9.7	-1.1	9.1	0.1
St. Maarten	5.7	6.0	7.3	7.1	5.1	6.0	6.2	0.3	5.8	-0.2
US Virgin Islands	11.8	12.0	13.4	13.0	11.5	12.2	12.3	0.4	12.7	0.5

Source: Caribbean Tourism Organization.
1/ Total excludes Montserrat and Cuba, for which there was insufficient data.
2/ British Virgin Islands and Cayman Islands are Associate Members of CARICOM.
3/ Haiti is a non-English Speaking Members of CARICOM.

Appendix Table 5. Estimates of Visitor Expenditure (US$ millions)

Destination	1995	1996	1997	1998	1999	2000 1/	Average 1995-2000	Percent Change 1995-2000	2001	Percent Change 2000-01
Caribbean	**13,974.6**	**15,181.1**	**16,247.2**	**17,298.1**	**18,260.3**	**19,666.2**	**16,771.3**	**40.7**	**19,435.3**	**-1.2**
English-Speaking CARICOM	**4,043.1**	**4,254.4**	**4,419.5**	**4,519.1**	**4,803.9**	**5,162.2**	**4,533.7**	**27.7**	**4,856.7**	**-5.9**
(Percent of Caribbean Total)	28.9	28.0	27.2	26.1	26.3	26.2	27.0	-2.7	25.0	
ECCU	**788.3**	**810.7**	**872.7**	**899.6**	**892.8**	**884.1**	**858.0**	**12.2**	**851.2**	**-3.7**
(Percent of Caribbean Total)	5.6	5.3	5.4	5.2	4.9	4.5	5.1		4.4	
Anguilla 1/	48.5	48.0	60.4	61.7	57.7	56.9	55.5	17.3	62.5	9.8
Antigua and Barbuda	246.7	257.9	277.5	281.3	290.0	290.5	274.0	17.8	272.1	-6.3
Dominica	34.1	36.6	48.3	46.5	50.7	48.2	44.1	41.3	45.4	-5.8
Grenada	65.1	59.5	59.4	61.1	66.7	69.8	63.6	7.2	62.9	-9.9
Montserrat	19.9	9.7	5.5	8.0	8.7	8.5	10.1	-57.3	8.6	1.2
St. Kitts and Nevis	65.1	66.8	67.3	75.7	67.6	58.2	66.8	-10.6	61.9	6.4
St. Lucia	267.8	268.5	283.7	291.3	272.5	276.7	276.8	3.3	257.6	-6.9
St. Vincent and the Grenadines	41.1	63.7	70.6	74.0	78.9	75.3	67.3	83.2	80.2	6.5
Non-ECCU	**3,254.8**	**3,443.7**	**3,546.8**	**3,619.5**	**3,911.1**	**4,278.1**	**3,675.7**	**31.4**	**4,005.5**	**-6.4**
(Percent of Caribbean Total)	23.3	22.7	21.8	20.9	21.4	21.8	21.9	-1.5	20.6	
Bahamas	1,346.2	1,450.0	1,416.2	1,354.1	1,582.9	1,814.0	1,493.9	34.7	1,665.3	-8.2
Barbados	611.8	632.9	657.2	703.0	666.2	711.3	663.7	16.3	686.8	-3.4
Belize	77.6	88.6	88.0	108.3	111.5	120.2	120.5	54.9	120.5	0.2
Guyana	78.2	70.3	61.4	55.8	61.4	86.8	69.0	11.0	86.6	-0.2
Jamaica	1,068.5	1,092.2	1,131.4	1,197.1	1,279.5	1,333.0	1,183.6	24.8	1,232.0	-7.6
Trinidad and Tobago	72.5	109.7	192.6	201.2	209.6	212.8	166.4	193.5	214.3	0.7
Other Caribbean Countries	**9,931.5**	**10,926.7**	**11,827.7**	**12,779.0**	**13,456.4**	**14,504.0**	**12,237.6**	**46.0**	**14,578.6**	**0.5**
(Percent of Caribbean Total)	71.1	72.0	72.8	73.9	73.7	73.8	73.0	2.7	n.a.	n.a.
Aruba	521.2	613.5	668.3	732.3	661.6	739.1	656.0	41.8	743.5	0.6
Bermuda	487.9	472.3	477.5	486.8	476.4	431.0	472.0	-11.7	350.5	-18.7
Bonaire	37.0	42.3	44.1	43.4	62.7	62.0	48.6	67.6	63.7	2.7
British Virgin Is. 2/	211.0	227.6	220.4	255.4	299.9	315.1	254.9	49.3	313.9	-0.4
Cancun (Mexico)	1,370.6	1,704.6	1,768.1	1,808.7	2,143.7	1,996.0	1,798.6	45.6	1,977.5	-0.9
Cayman Islands 2/	488.6	456.3	501.2	533.6	524.6	559.2	510.6	14.4	585.1	4.6
Cozumel (Mexico)	146.4	281.2	327.4	398.3	320.0	349.8	303.9	138.9	371.4	6.2
Cuba	977.0	1,185.0	1,326.0	1,571.0	1,714.0	1,756.0	1,421.5	79.7	1,721.0	-2.0
Curacao	175.4	185.5	200.5	261.1	220.2	226.7	211.6	29.2	252.7	11.5
Dominican Republic	1,568.4	1,765.5	2,099.4	2,153.1	2,483.2	2,860.2	2,155.0	82.4	2,689.8	-6.0
Guadeloupe	380.4	353.9	371.5	390.1	400.2	454.2	391.7	19.4	435.3	-4.2
Haiti 3/	56.0	58.0	57.0	56.0	55.0	56.0	56.3	0.0	54.0	-3.6
Puerto Rico	1,842.1	1,930.2	2,046.3	2,232.9	2,138.5	2,387.9	2,096.3	29.6	2,728.1	14.2
Martinique	414.8	410.6	271.3	302.1	262.6	292.2	325.6	-29.6	244.4	-16.4
St. Maarten	348.8	321.9	378.6	412.9	442.7	483.9	398.1	38.7	460.6	-4.8
Suriname 3/	31.0	38.0	63.1	43.7	58.2	44.0	46.3	41.9	50.0	13.6
Turks and Caicos Islands 2/	52.6	99.3	112.9	157.0	238.0	314.0	162.3	497.0	341.0	8.6
US Virgin Islands	822.3	781.0	894.1	940.6	954.9	1,176.7	928.3	43.1	1,196.1	1.6

Source: Caribbean Tourism Organization.

1/ Anguilla is an Associate Member of CARICOM.

2/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.

3/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 6. Estimates of Visitor Expenditure (US$ millions)
(Percentage shares)

Destination	1995	1996	1997	1998	1999	2000 1/	Average 1995-2000	Change 1995-2000	2001	Change 2000-01
English-Speaking										
CARICOM	28.9	28.0	27.2	26.1	26.3	26.2	27.0	-2.7	25.0	-1.3
ECCU	5.6	5.3	5.4	5.2	4.9	4.5	5.1	-1.1	4.4	-0.1
Anguilla 1/	0.3	0.3	0.4	0.4	0.3	0.3	0.3	-0.1	0.3	0.0
Antigua and Barbuda	1.8	1.7	1.7	1.6	1.6	1.5	1.6	-0.3	1.4	-0.1
Dominica	0.2	0.2	0.3	0.3	0.3	0.2	0.3	0.0	0.2	0.0
Grenada	0.5	0.4	0.4	0.4	0.4	0.4	0.4	-0.1	0.3	0.0
Montserrat	0.1	0.1	0.0	0.0	0.0	0.0	0.1	-0.1	0.0	0.0
St. Kitts and Nevis	0.5	0.4	0.4	0.4	0.4	0.3	0.4	-0.2	0.3	0.0
St. Lucia	1.9	1.8	1.7	1.7	1.5	1.4	1.7	-0.5	1.3	-0.1
St. Vincent and the Grenadines	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.1	0.4	0.0
Non-ECCU	22.7	22.2	21.5	20.6	21.1	21.3	21.6	-1.4	20.2	-1.1
Bahamas	9.6	9.6	8.7	7.8	8.7	9.2	8.9	-0.4	8.6	-0.7
Barbados	4.4	4.2	4.0	4.1	3.6	3.6	4.0	-0.8	3.5	-0.1
Belize	0.6	0.6	0.5	0.6	0.6	0.6	0.7	0.1	0.6	0.0
Jamaica	7.6	7.2	7.0	6.9	7.0	6.8	7.1	-0.9	6.3	-0.4
Trinidad and Tobago	0.5	0.7	1.2	1.2	1.1	1.1	1.0	0.6	1.1	0.0
Other Caribbean Countries	71.1	72.0	72.8	73.9	73.7	73.8	73.0	2.7	75.0	1.3
Aruba	3.7	4.0	4.1	4.2	3.6	3.8	3.9	0.0	3.8	0.1
Bermuda	3.5	3.1	2.9	2.8	2.6	2.2	2.8	-1.3	1.8	-0.4
Bonaire	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.1	0.3	0.0
British Virgin Is. 2/	1.5	1.5	1.4	1.5	1.6	1.6	1.5	0.1	1.6	0.0
Cancun (Mexico)	9.8	11.2	10.9	10.5	11.7	10.1	10.7	0.3	10.2	0.0
Cayman Islands 2/	3.5	3.0	3.1	3.1	2.9	2.8	3.0	-0.7	3.0	0.2
Cozumel (Mexico)	1.0	1.9	2.0	2.3	1.8	1.8	1.8	0.7	1.9	0.1
Cuba	7.0	7.8	8.2	9.1	9.4	8.9	8.5	1.9	8.9	-0.1
Curacao	1.3	1.2	1.2	1.5	1.2	1.2	1.3	-0.1	1.3	0.1
Dominican Republic	11.2	11.6	12.9	12.4	13.6	14.5	12.8	3.3	13.8	-0.7
Guadeloupe	2.7	2.3	2.3	2.3	2.2	2.3	2.3	-0.4	2.2	-0.1
Guyana	0.6	0.5	0.4	0.3	0.3	0.3	0.3	-0.3	0.3	0.0
Haiti 3/	0.4	0.4	0.4	0.3	0.3	12.1	12.5	11.7	14.0	1.9
Puerto Rico	13.2	12.7	12.6	12.9	11.7	1.5	1.9	-11.7	1.3	-0.2
Martinique	3.0	2.7	1.7	1.7	1.4	2.5	2.4	-0.5	2.4	-0.1
St. Maarten	2.5	2.1	2.3	2.4	2.4	0.2	0.3	-2.3	0.3	0.0
Suriname 3/	0.2	0.3	0.4	0.3	0.3	1.6	1.0	1.4	1.8	0.2
Turks and Caicos Islands 2/	0.4	0.7	0.7	0.9	1.3	1.6	1.0	1.2	1.8	0.2
US Virgin Islands	5.9	5.1	5.5	5.4	5.2	6.0	5.5	0.1	6.2	0.2

Source: Caribbean Tourism Organization.

1/ Anguilla is an Associate Member of CARICOM.

2/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.

3/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 7. Rooms in Tourist Accommodation

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Percent Change 1995-2000	2001	Percent Change 2000-01
Total Caribbean	**198,614**	**209,633**	**219,382**	**232,631**	**237,706**	**252,434**	**225,067**	**27.1**	**261,700**	**3.7**
English-Speaking CARICOM	**60,786**	**62,783**	**63,261**	**65,267**	**66,426**	**68,542**	**64,511**	**12.8**	**71,030**	**3.6**
(Percent of Caribbean Total)	30.6	29.9	28.8	28.1	27.9	27.2	28.7	47.1	27.1	
ECCU	**13,931**	**13,331**	**13,383**	**13,937**	**13,692**	**15,254**	**13,921**	**9.5**	**15,004**	**-1.6**
(Percent of Caribbean Total)	7.0	6.4	6.1	6.0	5.8	6.0	6.2	35.0		
Anguilla 1/	951	866	915	1,045	1,120	1,067	994	12.2	1,069	0.2
Antigua and Barbuda	3,317	3,185	3,185	3,185	3,185	3,185	3,207	-4.0	3,185	0.0
Dominica	588	764	824	824	857	890	791	51.4	899	1.0
Grenada	1,652	1,669	1,775	1,802	1,928	1,822	1,775	10.3	1,734	-4.8
Montserrat	710	n.a	n.a	n.a	243	264	406	-62.8	266	0.8
St. Kitts and Nevis	1,563	1,610	1,729	1,762	1,754	1,754	1,695	12.2	1,564	-10.8
St. Lucia	3,974	3,986	3,701	3,769	3,065	4,525	3,837	13.9	4,525	0.0
St. Vincent and Grenadines	1,176	1,251	1,254	1,550	1,540	1,747	1,420	48.6	1,762	0.9
Non-ECCU	**46,855**	**49,452**	**49,878**	**51,330**	**52,734**	**53,288**	**50,590**	**13.7**	**56,026**	**5.1**
(Percent of Caribbean Total)	23.6	23.6	22.7	22.1	22.2	21.1	22.5		21.4	
Bahamas	13,421	13,288	13,288	14,243	14,153	13,824	13,703	3.0	15,195	9.9
Barbados	5,084	6,315	5,349	5,752	6,585	6,456	5,924	27.0	6,781	5.0
Belize	3,708	3,690	3,905	3,921	3,963	4,106	3,882	10.7	4,463	8.7
Guyana	639	639	730	730	730	730	700	14.2	730	0.0
Jamaica	20,896	21,984	22,954	22,713	23,067	23,640	22,542	13.1	24,007	1.6
Trinidad and Tobago	3,107	3,536	3,652	3,971	4,236	4,532	3,839	45.9	4,850	7.0
Other Caribbean Countries	**137,828**	**146,850**	**156,121**	**167,364**	**171,280**	**183,892**	**160,556**	**33.4**	**190,670**	**3.7**
(Percent of Caribbean Total)	69.4	70.1	71.2	71.9	72.1	72.8	71.3		72.9	0.0
Aruba	6,881	6,822	6,962	7,212	7,320	7,500	7,116	9.0	7,500	0.0
Bermuda	4,141	4,152	4,135	3,857	3,276	3,339	3,817	-19.4	3,337	-0.1
Bonaire	1,052	1,128	1,069	1,086	989	1,050	1,062	-0.2	1,001	-4.7
British Virgin Islands 2/	1,452	1,558	1,587	1,594	1,626	1,637	1,576	12.7	1,688	3.1
Cancun (Mexico)	20,278	21,850	21,683	23,581	24,610	25,434	22,906	25.4	26,194	3.0
Cayman Islands 2/	3,585	4,477	4,501	4,216	4,318	5,364	4,410	49.6	5,494	2.4
Cozumel (Mexico)	3,367	3,468	3,562	3,704	3,956	4,101	3,693	21.8	4,826	17.7
Cuba	24,233	26,878	31,837	35,708	33,000	38,072	31,621	57.1	40,158	5.5
Curacao	1,950	2,343	2,696	2,528	2,768	2,941	2,538	50.8	3,203	8.9
Dominican Republic	32,475	35,729	38,250	42,412	49,410	51,916	41,699	59.9	53,964	3.9.
Guadeloupe	7,917	8,294	8,350	8,371	8,260	8,136	8,221	2.8	8,019	-1.4
Haiti 3/	1,758	1,758	1,758	1,758	1,758	1,758	1,758	0.0	1,758	0.0
Martinique	7,210	7,300	7,400	7,400	7,341	8,733	7,564	21.1	8,733	0.0
Puerto Rico	10,251	10,245	10,849	11,828	11,635	11,928	11,123	16.4	12,753	6.9
Saba	186	186	186	91	87	80	136	-57.0	85	6.3
St. Eustatius	139	77	77	77	62	62	82	-55.4	62	0.0
St. Maarten	3,707	3,910	4,049	4,174	3,065	3,545	3,742	-4.4	3,548	0.1
Suriname 3/	1,024	1,088	1,276	1,276	1,276	1,276	1,203	24.6	1,276	0.0
Turks and Caicos Islands 2/	1,068	1,500	1,493	1,562	1,674	2,023	1,553	89.4	2,023	0.0
US Virgin Islands	5,154	4,087	4,401	4,929	4,849	4,997	4,736	-3.0	5,048	1.0

Source: Caribbean Tourism Organization.

1/ Anguilla is an Associate Member of CARICOM.

2/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.

3/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 8. Rooms in Tourist Accommodation
(Percentage shares)

Destination	1995	1996	1997	1998	1999	2000	Average 1995-2000	Change 1995-2000	2001	Percent Change 2000-01
English-Speaking CARICOM	30.6	29.9	28.8	28.1	27.9	27.2	28.8	-3.5	27.1	0.0
ECCU	**7.0**	**6.4**	**6.1**	**6.0**	**5.8**	**6.0**	**6.2**	**-1.0**	**5.7**	**-0.3**
Anguilla 1/	0.5	0.4	0.4	0.4	0.5	0.4	0.4	-0.1	0.4	0.0
Antigua and Barbuda	1.7	1.5	1.5	1.4	1.3	1.3	1.4	-0.4	1.2	0.0
Dominica	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.1	0.3	0.0
Grenada	0.8	0.8	0.8	0.8	0.8	0.7	0.8	-0.1	0.7	-0.1
Montserrat	0.4	n.a.	n.a.	n.a.	0.1	0.1	0.2	-0.3	0.1	0.0
St. Kitts and Nevis	0.8	0.8	0.8	0.8	0.7	0.7	0.8	-0.1	0.6	-0.1
St. Lucia	2.0	1.9	1.7	1.6	1.3	1.8	1.7	-0.2	1.7	-0.1
St. Vincent and Grenadines	0.6	0.6	0.6	0.7	0.6	0.7	0.6	0.1	0.7	0.0
Non-ECCU	**23.6**	**23.6**	**22.7**	**22.1**	**22.2**	**21.1**	**22.5**	**-2.5**	**21.4**	**0.3**
Bahamas	6.8	6.3	6.1	6.1	6.0	5.5	6.1	-1.3	5.8	0.3
Barbados	2.6	3.0	2.4	2.5	2.8	2.6	2.6	0.0	2.6	0.0
Belize	1.9	1.8	1.8	1.7	1.7	1.6	1.7	-0.2	1.7	0.1
Guyana	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.0	0.3	0.0
Jamaica	10.5	10.5	10.5	9.8	9.7	9.4	10.1	-1.2	9.2	-0.2
Trinidad and Tobago	1.6	1.7	1.7	1.7	1.8	1.8	1.7	0.2	1.9	0.1
Other Caribbean Countries	**69.4**	**70.1**	**71.2**	**71.9**	**72.1**	**72.8**	**71.2**	**3.5**	**72.9**	**0.0**
Aruba	3.5	3.3	3.2	3.1	3.1	3.0	3.2	-0.5	2.9	-0.1
Bermuda	2.1	2.0	1.9	1.7	1.4	1.3	1.7	-0.8	1.3	0.0
Bonaire	0.5	0.5	0.5	0.5	0.4	0.4	0.5	-0.1	0.4	0.0
British Virgin Islands 2/	0.7	0.7	0.7	0.7	0.7	0.6	0.7	-0.1	0.6	0.0
Cancun (Mexico)	10.2	10.4	9.9	10.1	10.4	10.1	10.2	-0.1	10.0	-0.1
Cayman Islands 2/	1.8	2.1	2.1	1.8	1.8	2.1	2.0	0.3	2.1	0.0
Cozumel (Mexico)	1.7	1.7	1.6	1.6	1.7	1.6	1.6	-0.1	1.8	0.2
Cuba	12.2	12.8	14.5	15.3	13.9	15.1	14.0	2.9	15.3	0.3
Curacao	1.0	1.1	1.2	1.1	1.2	1.2	1.1	0.2	1.2	0.1
Dominican Republic	16.4	17.0	17.4	18.2	20.8	20.6	18.4	4.2	20.6	0.1
Guadeloupe	4.0	4.0	3.8	3.6	3.5	3.2	3.7	-0.8	3.1	-0.2
Haiti 3/	0.9	0.8	0.8	0.8	0.7	0.7	0.8	-0.2	0.7	0.0
Martinique	3.6	3.5	3.4	3.2	3.1	3.5	3.4	-0.2	3.3	-0.1
Puerto Rico	5.2	4.9	4.9	5.1	4.9	4.7	4.9	-0.4	4.9	0.1
Saba	0.1	0.1	0.1	0.0	0.0	0.0	0.1	-0.1	0.0	0.0
St. Eustatius	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
St. Maarten	1.9	1.9	1.8	1.8	1.3	1.4	1.7	-0.5	1.4	0.0
Suriname 3/	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.0	0.5	0.0
Turks and Caicos Islands 2/	0.5	0.7	0.7	0.7	0.7	0.8	0.7	0.3	0.8	0.0
US Virgin Islands	2.6	1.9	2.0	2.1	2.0	2.0	2.1	-0.6	1.9	-0.1

Source: Caribbean Tourism Organization.
1/ Anguilla is an Associate Member of CARICOM.
2/ British Virgin Islands, Cayman Islands, and Turks and Caicos Islands are Associate Members of CARICOM.
3/ Haiti and Suriname are non-English Speaking Members of CARICOM.

Appendix Table 9. Tourist (stop-over) and Cruise Arrivals in 2002 3/

Destination (Stay-Over)	Period	Stay-over Arrivals 2002	% Change 2002/01	Destination (Cruise)	Period	2002 Cruise Arrivals	% Change 2002/01
English-speaking CARICOM							
ECCU							
Anguilla	Jan-Jun	25,448	-12.8	Anguilla	–	–	–
Antigua & Barbuda 1/	Jan-Jul	120,936	-2.1	Antigua & Barbuda	Jan-Sep	220,942	-23.8
Grenada	Jan-Sep	98,035	0.4	Grenada	Jan-Sep	94640	-7.9
Montserrat	Jan-Feb	1,443	12.4	Montserrat	–	–	–
St Lucia	Jan-Oct	214,454	-0.2	St Lucia	Jan-Oct	299315	-21
St Vincent & Gren.	Jan-Jul	47,747	8.4	St Vincent & Gren.	Jan-Jul	50003	-7.9
Non-ECCU							
Aruba	Jan-Oct	536,020	-8.8	Aruba	Jan-Aug	392522	23.5
Bahamas 1/ 4/	Jan-Sep	1,105,777	-6.1	Bahamas	Jan-Jul	1691355	7.4
Barbados	Jan-Sep	365,025	-5.8	Barbados	Jan-Sep	363746	-2.1
Belize	Jan-May	93,718	-1.3	Belize	Jan-Jun	123901	407.7
Guyana	Jan-Oct	87,878	15.8	Guyana	–	–	–
Jamaica	Jan-Aug	890,401	-6.7	Jamaica	Jan-Aug	554215	-8.4
Trinidad & Tobago	Jan-Jun	175,755	-7.1	Trinidad & Tobago	Jan-Apr	40941	-31.4
Other Caribbean Countries							
Bermuda 1/	Jan-Jun	137,341	-2.7	Bermuda	Jan-Jun	72662	15
Bonaire	Jan-Aug	32,909	-11.4	Bonaire	Jan-Jun	26874	-0.3
Cayman Islands	Jan-Oct	225,289	-20.4	Cayman Islands	Jan-Oct	1115135	30.3
Cuba	Jan-Aug	1,148,188	-12	Cuba	–	–	–
Curacao	Jan-Sep	161,799	5.9	Curacao	Jan-Sep	238063	12.2
Dominican Republic 1/	Jan-Aug	1,928,567	-9.1	No Cruise Reported	–	–	–
Martinique	Jan-Apr	182,165	-11.5	Martinique	Jan-Jun	94262	-27.8
Puerto Rico 2/	Jan-Aug	903,130	0.1	Puerto Rico	Jan-Jun	634326	-17.6
Saba	Jan-Jun	4,573	-4.4	Saba	–	–	–
St. Eustatius	Jan-Jun	4,483	-5.9	St. Eustatius	–	–	–
St Maarten 1/	Jan-Aug	267,724	-12	St Maarten	–	–	–
Turks & Caicos Is	Jan-Mar	43,472	-17.4	Turks & Caicos Is	–	–	–
US Virgin Is. 2/	Jan-Sep	458,950	-5.1	US Virgin Is.	Jan-Sep	1,282,830	-6.3

Source: Caribbean Tourism Organization.

'- No cruise figures are reported

1/ Non-resident air arrivals

2/ Non-resident hotel registrations only

3/ Figures are subject to revision by reporting countries

4/ Preliminary data for the Bahamas

II. World Bank—Fiscal Issues Review[26]

48. The World Bank is conducting a review of fiscal issues in the OECS with the objective of recommending actions to improve the allocation of public expenditures in a fiscally sustainable manner in each of the member countries. Individual reports are being prepared for each country and will cover four key areas: (i) issues related to the conduct of overall fiscal policy and macroeconomic management including the cyclicality and sustainability of public expenditures; (ii) management and execution of the public sector investment program (PSIP); (iii) public sector wages and employment; and (iv) public expenditures in the social sectors and for social safety nets. Reports on four countries (Grenada, St. Kitts and Nevis, St. Lucia, and Dominica) have been drafted and the complete set of reports is expected by end-2003. The following are preliminary findings of this analysis, to date.

A. Fiscal Policy

49. **The majority of the countries lack a well-defined and coherent medium-term economic framework (MTEF) to guide fiscal management and create space for counter-cyclical policies**. This is manifested in a combination of (passively) pro-cyclical public spending; irregular and often poorly conceived public investment programs and consequently weak debt management; and an excessive use of tax concessions aimed at attracting foreign investment.

- In light of the repeated external shocks to which these economies are exposed—including natural disasters—there is a curious absence of medium term risk management strategies in terms of both fiscal policy and real activity, e.g., disaster mitigation and preparedness. As a result, fiscal policies appear to have been passively pro-cyclical and have amplified the economic cycles.

- The main reason for the recent rapid build-up of indebtedness has been increases in government expenditures, namely for large, poorly conceived public investment projects that have been financed by commercial borrowing and have not yielded the expected impact on growth and diversification. The management of public sector investment programs (PSIPs) needs to be systematic based on sound analysis for project selection. The OECS countries also need to articulate clear debt management strategies in the context of medium-term economic frameworks and to improve public debt management, in particular by strengthening legal and institutional frameworks and increasing the transparency of public debt contracting mechanisms.

- Tax concessions, both discretionary and statutory, have been the preferred instrument for investment promotion, rather than efforts to lower the cost of doing business and raise competitiveness.

[26] Prepared by Antonella Bassani (World Bank). These are preliminary findings.

50. As a currency union, the OECS needs to make steady progress on options requiring sub-regional coordination, both at the policy and service-provision levels—including the establishment of *fiscal benchmarks* for preserving the exchange regime within a consistent policy framework; harmonization of tax policy and fiscal incentive regimes; and functional cooperation (i.e., regional provision) in more public services to exploit economies of scale.

B. Budget and Financial Management

51. **Within the OECS, the formal institutional frameworks (national constitutions, legislation, regulations, and procedures) for budget management are broadly adequate, and have been improving steadily.** However, these improvements have not been supported by the necessary complimentary reforms in public sector management policies and practices. As a result, these efforts have not yet altered incentives of some line ministries to push for consistently higher budgetary allocations and spending. Consequently, repeated overestimation of revenues and expenditures has undermined the usefulness of the budget as a tool for priority setting. In some cases, approved estimates are not viewed by line ministries as hard budget constraints and new initiatives are introduced on an ad hoc manner outside the budget process. The framework for budgeting needs more explicit and systematic use of a medium-term economic framework as a tool for drawing up public expenditure plans.

- **Budgets are often still not consolidated or comprehensive.** Most OECS countries still operate systems of dual budgeting for capital and recurrent expenditures. Also, large amounts of external assistance are still not brought into the main public accounts, because donors and project directors do not report aid receipts and expenditures promptly to the Accountants General. In addition, in many cases operations of the state-owned enterprises often escape effective scrutiny by the Ministries of Finance and consequently public accountability.

- **The legislative framework for financial management is in need of updating in most of the OECS countries,** and efforts to do so have begun to take place, with support from the CIDA-financed program known as ECEMP. While St. Lucia has moved forward with legislative reforms, the other countries have not passed and implemented new legislation. High priority should be given to completing this process.

- **Progress on automating systems for government budgeting, accounting, and reporting has facilitated effective monitoring and up-to-date accounting for current transactions.** However, in most countries, these systems have not been rolled out to all line ministries. In addition, although the new systems will prevent excess expenditures by automatically rejecting any over-budget requests, they will not prevent excessive commitments. The systems in use (SIGFIS/SmartStream, St. Kitts and Nevis FourGen and the Antigua and Barbuda Oracle system) should have commitment control functionality, for better expenditure control and cash management.

52. **Oversight of public finances and financial management is generally weak in the OECS countries.** Public Accounts Committees do not function effectively in most countries, thereby severely reducing the effectiveness of the audit function. Internal control is left to heads of departments who have no internal audit units and very little technical support. The actual autonomy of Directors of Audit in many cases is not enshrined in the legislation and depends entirely on informal relationships. Moreover, the production and tabling of audited financial reports for central government, while generally timely in Dominica and St Kitts and Nevis has significant backlogs in Antigua and Barbuda, Grenada, St. Lucia, and St. Vincent and the Grenadines. Clearance of these backlogs would be an important step toward improving the control environment in these countries. Given the shortage of skilled staff through the sub-region, the audit function is a good candidate for regionalization.

C. Public Sector Investment

53. Despite significant improvements introduced in recent years, the PSIP process in most of the OECS countries still presents significant weaknesses. Specifically, there is **relatively little technical analysis to support project prioritization and selection** and, usually, no cost-benefit studies are undertaken unless required by financing agencies. The absence of a medium term economic framework and/or detailed development strategies further complicates prioritization, cross-sectoral tradeoffs and programmatic (multi year approaches). As such, hard decisions about project selection are often avoided. In general, the single most important element in project selection is the availability of external financing, which makes external agencies key players in establishing governments' priorities. Moreover, there is little central monitoring of physical project execution, and ex-post evaluations are generally not performed unless required by international agencies.

54. **The impact of capital projects on the current budget is not consistently estimated** and, therefore, operations and maintenance activities are usually not budgeted for.

55. **Implementation rates are usually low** because of overestimation of annual capital budgets for reasons mentioned above; capacity constraints within line ministries to manage large and multiple projects; and complex local procurement procedures including an over-centralization of procurement authority; and the diversity of donor processes which slow down disbursements of external assistance. St. Kitts and Nevis and St. Lucia have made progress in pooling capacity within and across line ministries through the use of a single project management unit, while St. Vincent and the Grenadines refocused their PSIP on key sectors in order to more effectively utilize limited technical personnel.

56. **Improvements in procurement rules and practices could help raise implementation rates for public investment.** Procurement rules, including procurement methods and awards of contract, are incomplete and imprecise, leading to arbitrary decisions that result in inefficiency and lack of transparency. The regulatory framework for procurement within the sub-region could be strengthened by the enactment of a common legal instrument comprising an adequate *legal and administrative framework* and complete procurement rules

and the establishment of a permanent independent body to which the contractors and suppliers can appeal decisions. In addition, decentralizing decision-making authority to line ministries, with appropriate capacity building and central oversight, would help to accelerate investment projects.

D. Public Sector Wage and Employment

57. While large public sector wage bills are a generalized phenomenon in the OECS, the pattern varies across countries as to whether this is underpinned by large employment numbers or high average wages. In addition, the trends also vary significantly between countries. In some countries, there has been little control over the increase in the number of established and non-established workers. In others, apparent, and some yet-to-be-determined compensation, entitlements (pending Court rulings) are sources of concern. In yet others, there are structural reasons for relatively large public service establishments related to the mode of delivery of social services at the community level.

58. **Performance appraisal systems work unevenly in different OECS countries** and some do not perform as expected due mainly to implementation difficulties. As a result, in some cases performance increases are awarded in the absence of an *a priori* overall spending envelope that limits unreasonable increments.

59. **Public wage increase awards are generally not based on any explicit or implicit trends in productivity.** As such, the impact on competitiveness within a fixed exchange rate regime generally does not factor into wage negotiations.

E. Social Sector

60. **Past investments in human and social development have yielded relatively good social outcomes in the OECS countries.** However, the current fiscal crisis and medium-term macroeconomic outlook indicate that systems may have become too expensive to maintain, resulting in declining quality of service and outcomes. Non-wage current expenditure in the social sectors is generally inadequate and the public sector investment program is often inconsistent with the strategy in the education and health sectors.

61. Demographic changes, improvements in transportation and communications, and curriculum reform do offer some scope for reducing costs and raising the quality of outcomes, mainly through the consolidation of service delivery points and better deployment of human resources, and protection of critical non-wage inputs. In some cases, reallocation of human resources toward some functions (e.g., planning and policy in Ministries of Education and Health, and for nurses) is recommended. In others, high teacher-pupil ratios could be reduced to achieve greater efficiency.

62. **In addition, there is scope for increased cost recovery and better targeting of subsidies in a number of services.** In the health sector, heavy subsidies for patients are extended at all levels (including hospital facilities and drugs). The modest revenue generated

by the system is deposited (by law) into the Consolidated Fund, providing little incentive for better performance. This is a critical financial issue for countries targeting universal secondary education and protecting the social development gains of the last decade in the face of a difficult external environment and slower growth prospects over the medium term.

F. Social Safety Nets

63. **In all OECS countries, there is a lack of an overall social protection strategy, and consequently a duplication of uncoordinated safety nets programs and administrative systems across the public sector**. For instance, in St. Kitts and Nevis, there are approximately twenty social protection programs, administered by at least five different ministries and statutory bodies, and using four separate means testing systems.

64. **Inappropriate or non-existent targeting mechanisms diminish the transfer of resources reaching the actual poor**. Despite the lack of data on the incidence of programs and public spending, anecdotal evidence clearly suggests the need for more transparent and reliable means testing.

65. **In addition, expenditure on safety net programs is not systematically reported** in the budget since they are considered sub programs for budget purposes. As a result, there is lack of comprehensive expenditure information and consequently Governments have little ability to assess the cost, incidence, and effectiveness of the various programs and overall spending on safety nets.

66. **In light of the existing fiscal constraints in the ECCU** and their need to address the possible social cost of stabilization and structural reforms, the rationalization and coordination of social safety net programs and their effective targeting have become a priority.

III. STRENGTHENING FISCAL DISCIPLINE THROUGH FISCAL BENCHMARKS[27]

67. **The participation of the ECCU member states in the currency union has provided benefits of monetary stability and credibility enhancement well recognized in the region and beyond.** It also confers obligations on individual members, not least of which is the need for fiscal prudence and policy coordination. This is especially true in the context of a currency union pegged to another currency, which exerts even more stringent constraints on national economic policies required for the region's competitiveness and sustained growth. The fixed peg to the U.S. dollar anchored by a currency board arrangement (CBA) severely limits the scope for independent monetary policy and the ability to use interest rates as policy instrument, putting added weight on members' fiscal policies.

68. **Against the background of the sharp deterioration in the budgetary positions and uncertain economic prospects for ECCU members over the last two years, and in light of the structural adjustments that will follow pending trade liberalization, the ECCB has designed a set of policy rules in the form of fiscal benchmarks**. These aim to ensure long-run fiscal sustainability, in addition to limiting negative spillovers, external vulnerability and to support the integrity of the CBA. Well-designed criteria can limit "free-rider" problems by binding members through their pre-commitment to good fiscal behavior. Such rules-based regimes have been instituted in the context of monetary unions in Europe (the European Monetary Union's Maastricht Treaty and Growth and Stability Pact), and in West and Central Africa—the West African Economic and Monetary Union (WAEMU), and the Central African Economic and Monetary Community (CEMAC). Like the ECCU, WAEMU and CEMAC are comprised of smaller, developing countries, with a currency that is pegged to a major currency (in this case the euro). The scope for independent monetary policy in each of these unions is therefore limited, and fiscal policies are of prime importance. Convergence criteria of WAEMU and CEMAC are described in Box 1.

A. The ECCB fiscal benchmarks

69. The fiscal benchmarks are as follows: [28]

- Government current account surplus of 4–6 percent of GDP;
- Overall government budget deficit of no more than 3 percent of GDP;

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[27] Prepared by Robert Price, PDR.

[28] The benchmarks are a subset of a broader group of guidelines—termed "Corridors of Normality"—developed by the ECCB, that include corridors for exchange rate variables (inflation, real effective exchange rate); foreign reserves (reserve cover and import cover); credit (to government and to commercial banks); and liquidity variables (loans to deposits, delinquency and solvency ratios), in addition to the fiscal corridors.

- Total central government debt outstanding of no more than 60 percent of GDP;
- Debt service payments of no more than 15 percent of current revenue.

Box 1. WAEMU and CEMAC Convergence Criteria

Convergence criteria have recently been adopted by two African regional monetary unions—the West African Economic and Monetary Union (WAEMU), and the Central African Economic and Monetary Community (CEMAC). Both unions use a common currency—the CFA franc—which has been pegged to the French franc since 1948 and to the euro since 1999, and issued by a common central bank—the Banque Centrale de l'Afrique d'Ouest (BCEAO) for WAEMU, and the Banque des Etats de l'Afrique Centrale (BEAC) for CEMAC:

WAEMU convergence criteria

The union, which was created in 1994, consists of eight member governments (Benin, Burkino Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo). The convergence criteria were established in 1999 within the framework of the *Convergence, Stability, Growth, and Solidarity Pact.* In addition to the convergence criteria, WAEMU countries have taken other important steps toward greater regional integration and coordination of macroeconomic policies, including establishing a common external tariff and harmonizing taxes. There are four primary convergence criteria and four secondary criteria, supplemented by a host of other indicators recommended by the Council of Ministers. The norms established with respect to these criteria had to be met by end-2002, but the target date has been extended to end-2005. The primary criteria are the following:

- the ratio of the basic fiscal balance (revenue excluding grants minus expenditure excluding foreign financed investment outlays) to nominal GDP (key criterion), which must be in balance or in surplus;
- the ratio of outstanding domestic and foreign debt to nominal GDP, which must not exceed 70 percent;
- the average annual inflation rate, which should not surpass 3 percent a year; and
- the nonaccumulation of domestic and external payment arrears.

The secondary criteria are as follows:

- the ratio of the wage bill to tax revenue, which cannot exceed 35 percent;
- the ratio of domestically financed public investment to tax revenue, which must be at least 20 percent;
- the ratio of the external current account deficit, excluding grants, to nominal GDP, which cannot exceed 5 percent; and
- the tax-to-GDP ratio, which must be 17 percent or more.

CEMAC criteria

CEMAC groups six countries (Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon), but in contrast to WAEMU, CEMAC's integration efforts in other areas are not very advanced, including implementation of a common external tariff, harmonizing tax policies, and adopting common sectoral and structural policies. At end-2001, a framework was introduced that includes three-year forward looking convergence programs, an annual report on the convergence strategy prepared by the CEMAC secretariat, and the adoption of convergence criteria. Starting in July 2002, the CEMAC evaluates the degree to which each member country respects four convergence criteria in the previous year:

- a non-negative basic fiscal balance (excluding grants and externally financed investment expenditures);
- consumer price inflation of no more than 3 percent;
- a level of external and domestic public debt of no more than 70 percent of GDP;
- and the non-accumulation of external or domestic payments arrears.

B. Status of the fiscal benchmarks

70. A fiscal framework that includes the benchmarks was agreed in principle by the ECCB's Monetary Council, which is comprised of the finance ministers of member states, implying acceptance by the national fiscal authorities. However, the ECCB has no formal jurisdiction or legal mandate over national fiscal matters, and the benchmarks are not binding on member states. ECCB member states have not integrated the benchmarks into their national budgets or laws. Furthermore, neither the central bank nor the national authorities have formal surveillance or enforcement mechanisms to ensure compliance.

C. Development of the ECCB benchmarks

71. **The starting point for the ECCB's benchmarks is recognition of the need for public sector investment.**[29] They stem from a target for public sector investment of 12 percent of GDP, centered within the Caribbean Development Bank's (CDB) recommended range of approximately 10 to 15 percent of GDP for member countries. Based on further assumptions derived from historical ratios of capital expenditures of the central government and public enterprises, and the shares of external and domestic financing, member countries would need to generate central government savings of approximately 5 percent of GDP. A range of 4 to 6 percent is used as the target.[30]

72. The target for the overall central government balance (maximum deficit of 3 percent of GDP) combines the central government capital expenditure and current account surplus targets.

73. The approach to the debt sustainability benchmarks takes the historical performance of ECCB members on the above two measures, and picks as a target the ratios for those countries which, given their experience, were able to generate public sector savings that fell within the targeted levels for central government savings of 4–6 percent described above. St. Lucia and St. Vincent and the Grenadines were the only countries to meet the targeted savings ratio, during the period 1990 to 1998. Their debt to GDP ratios averaged 51 and 34 percent respectively (within a range of 26 to 76 percent), and debt service payments to current revenue, 2 percent and 7 percent, respectively (over the same time frame, and ranging from 1 percent to 10 percent).[31] Based on this backward-looking evidence, the analysis

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[29] The method used by ECCB staff to develop the levels for the fiscal benchmarks are laid out in two papers. See "The Targeted Public Sector Savings in the Member Countries of the ECCB" (undated, unpublished) and "Developing Sustainable Debt Indicators for the ECCB" (July 2001, unpublished).

[30] Including the rest of the public sector, raises the public sector savings requirement to between 6 and 7 percent of GDP, however, the ECCB's benchmarks focus on the central government only, partly owing to lack of full data on public enterprise accounts.

[31] ECCB estimates.

concludes that the "ideal" debt to GDP ratio would be between 30 and 45 percent, given the size of these countries. However, an outer bound of 60 percent is used for the benchmarks, with a debt service to current revenue ratio not exceeding 15 percent.

D. Timeframe for Convergence

74. **A clear and realistic time frame for "convergence" would be important for any rules-based regime, fiscal or otherwise. As with the choice of benchmarks themselves, the timeframe should balance the need to be ambitious enough, but also be realistic, to remain credible.** The Monetary Council did not specify a timeframe for convergence when it approved the fiscal benchmarks. However, the ECCB regards January 2007 as a critical juncture, following the lapse of preferential treatment for exports to the EU and culmination of trade liberalization initiatives under the WTO and FTAA. In this regard, the Monetary Council has endorsed the stabilization and transformation plans for members for the four- year period through 2007.

75. **At the same time, it is clear that several member states are a long way from reaching the suggested targets (Table 1).** For example, in the case of St. Kitts and Nevis, meeting the proposed debt ceiling of 60 percent of GDP, over a 4-year horizon would require debt pay downs in the order of more than 20 percent of GDP in each year, given its extremely high level of outstanding debt (projected at 161 percent of GDP in 2002). Of the six Fund members, only one (St. Lucia) would currently meet the 60 percent of GDP benchmark. No country would meet the benchmark for the current account surplus, and only St. Vincent and the Grenadines satisfied the overall budget deficit target at end-2001.

76. **A four-year timeframe for convergence would be longer than those adopted by WAEMU and CEMAC countries**. WAEMU's Convergence, Stability, Growth, and Solidarity Pact, which was formally adopted in December 1999, identified two periods: a convergence phase (2000-2002), at the end of which member countries were expected to be in compliance with the criteria, and a stability phase (from 2003 onward).[32] For CEMAC countries, at end-2001, a framework was introduced that includes three-year forward looking convergence programs, an annual report on the convergence strategy prepared by the CEMAC Secretariat, and the adoption of the four convergence criteria.

[32] During the transitional period from the date of entry into force of the pact to December 31, 2002, member countries were to prepare three-year convergence programs, with the annual objectives of gradually ensuring compliance with these criteria.

Table 1. ECCU AREA: Compliance with Proposed Central Government Fiscal Benchmarks 1/
(In percent of GDP, unless otherwise indicated)

Convergence Criteria	Status of Implementation of Guidelines in 2001 by Country						Number of Countries Meeting the Guidelines			
	Antigua and Barbuda	**Dominica**	**Grenada**	**St. Kitts and Nevis**	**St. Lucia**	**St. Vincent and the Grenadines**	**2001**	**2000**	**1999**	**1998**
Current account surplus (guideline: 4 - 6 percent of GDP)	-5.1	-4.1	2.3	-4.9	0.5	0.7	0	1	1	1
Overall deficit (guideline: < or = 3 percent of GDP)	-9.7	-11.0	-8.6	-12.4	-3.8	-2.4	1	2	2	1
Govt & govt guar. debt outstanding 2/ (guideline: < or = 60 percent of GDP)	84.5	92.1	85.0	138.0	42.7	68.1	1	2	1	3
Debt service payments 3/ (guideline: < or = 15 percent of current revenue)	9.4	19.3	2.4	13.5	5.5	5.0	5	5	5	5
Number of benchmarks met in 2001	1	0	1	1	2	2				
Number of benchmarks met in 2000	1	0	2	1	4	2				
Number of benchmarks met in 1999	0	0	3	1	3	2				
Number of benchmarks met in 1998	0	1	2	1	3	3				

Sources: ECCU member country authorities, and Fund staff estimates.

1/ Excludes the territories of Anguilla and Montserrat.
2/ Includes external arrears.
3/ Excludes domestic debt amortization.

77. **The European experience under the Maastricht Treaty may argue for a somewhat longer but more realistic timeframe than rushing to an arbitrary deadline.** While the credibility and hence the effectiveness of the fiscal benchmarks depends on balancing the setting of ambitious targets, and establishing realistic targets and a timeframe, it is clear that immediate actions are needed to address the current fiscal difficulties, which should be placed within a convergence context as soon as possible. Given the widely differing starting positions of the ECCU countries on the fiscal benchmarks, along with differing growth and budget projections for each country, consideration may need to be given to implementing country-specific paths for convergence to the criteria.

E. Surveillance and Incentives for Compliance

78. **To be effective, the fiscal benchmarks need to be supported by a framework of incentives, or sanctions against noncompliance.** None has yet been specified. In addition, the incentive framework will need to be supported by a system of monitoring and surveillance of members' compliance. Ideally, this should be performed at regular intervals by a regional institution.

79. The Council of Ministers and the WAEMU Commission perform regional surveillance under the WAEMU Pact. Countries submit semiannual performance reports to the Council, which monitors progress on convergence. A member country not satisfying one of the primary criteria will prepare a program of corrective measures, in cooperation with the WAEMU commission and within 30 days of notification of the Council of Ministers' resolution. The WAEMU Commission has the responsibility to verify that the proposed measures are

consistent with the Council of Ministers' resolution and the union's economic objectives. If implementation of the program of corrective measures does not result in the desired progress on primary criteria other than the key criterion, a new series of appropriate measures prepared by the WAEMU Commission for the member country in question will be approved by Council directive.

80. **The ECCB has no formal mandate or jurisdiction over fiscal policies of its members. Nevertheless, given the central bank's key role in developing the benchmarks, the composition of the ECCB's Monetary Council (comprised of the eight finance ministers of its member states), and its regional perspective, the ECCB is a logical choice to undertake surveillance and assess compliance with the benchmarks**. The ECCB could gather and review country data and compile progress reports on convergence with the benchmarks. The progress reports could be submitted to the Monetary Council and published at regular intervals (minimum of semi-annually). Regular publication of progress reports would provide a strong incentive for compliance, through peer and market pressures. Such peer pressure has reportedly been an effective incentive in supporting the WAEMU Pact. Transparency with respect to performance against the benchmarks could be bolstered by differentiation of sovereign credit spreads in the regional government securities market (RGSM), when this market becomes fully operational.[33]

81. **Official sanctions, similar to those under the WAEMU Pact,[34] could also be envisaged.** Under certain conditions, central bank credit facilities, or lending by the CDB could be made contingent on, or priced according to, country compliance with the benchmarks.[35] The ultimate sanction for a member that exhibits persistent poor fiscal behavior

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[33] St. Kitts and Nevis became the first debt issuers on the RGSM in November 2002, when it sold EC$75 million 10-year bonds at 7.5 percent at par. St. Vincent and the Grenadines is expected to follow with its own issue.

[34] In WAEMU the mechanism of sanctions is specified in the WAEMU Treaty. It ranges from moral suasion (publication of findings) to the withdrawal of financial support from regional institutions, including the withdrawal of West African Development Bank (BOAD) financing and the outright suspension of central bank financing. If the key criterion is not being satisfied, a penalty procedure will be initiated, unless otherwise dictated by extraordinary circumstances. The penalty procedure is initiated only in cases of noncompliance observed during the assessment of results at end-December in the convergence phase. Noncompliance is determined when progress on the key criterion relating to the basic fiscal balance is deemed unsatisfactory. During the stability phase, programs will be assessed on the basis of structural change in respect of the key criterion, after correction for changes in economic conditions. (See Box 2. in *West African Economic and Monetary Union—Recent Economic Developments an Regional Policy Issues in 2000*, SM/01/246, August 6, 2001.)

[35] Although not actively used as an instrument, ECCB lending to governments under the "partial" currency board arrangement, is restricted to no more than 40 percent of currency and other demand liabilities. As specified in the ECCB charter, temporary lending is further restricted to 5 percent of a government's recurrent revenue; treasury bill holdings (with a maximum term of 91 days) by the ECCB are limited to 10 percent of recurrent revenue; and long-term bond holdings are limited to 5 percent of currency and other demand liabilities. Because the total of these amounts may exceed the allocation available under the backing ratio (i.e., the 40 percent), in practice the ECCB allocates credit to individual member governments based on the ratio of each government's recurrent revenue to the

(continued...)

would be to envisage a process of expulsion from the currency union, recognizing that each member's performance affects the credit standing of other members in the union through the common currency. However, changes to the ECCB charter require unanimous approval by members of the Monetary Council.[36]

F. Scope of coverage and accommodation of shocks

82. The ECCB benchmarks pertain only to the accounts of the central government; public enterprises and government guaranteed debt is excluded. The broader public sector position should ideally be incorporated into the framework; however, this is subject to the constraint of government's inability in some cases to produce accurate and timely data for these debts.

83. Unlike some other fiscal rules, the benchmarks include no provisions for the accommodation of exceptional circumstances.[37] Given their small size and openness, and the lack of the exchange rate buffer, the ECCU economies are prone to external cyclical shocks—the downturn in tourism in the wake of the September 11 terrorist attacks is a recent example. Furthermore, ECCU members are particularly prone to natural disasters, such as hurricanes and volcanoes. Consideration should be given to allowing some short-term flexibility in the measurement of progress against the benchmarks, and before application of possible sanctions. However, the benchmarks are specified as ceilings, implying that countries should on average be well below the thresholds, and allowing too much flexibility would undermine the credibility of the fiscal rules.

G. Conclusions

84. There is a pressing need for ECCB members to take strong measures to reduce the large fiscal imbalances, particularly under the fixed exchange rate regime supported by the CBA. Credible fiscal rules can be helpful, but do not obviate the need for prompt action under the current circumstances. The benchmarks must balance the need to be stringent enough to reduce vulnerability, be realistically attainable, and need to be supported by a framework of surveillance and incentives for compliance.

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total recurrent revenue for all member countries. This allocation scheme is an ECCB operating procedure that is not specified in the charter.

[36] *East Caribbean Central Bank Agreement Act, 1983*, Article 55.

[37] WAEMU's Convergence, Stability, Growth and Solidarity Pact provides that sanctions will not be initiated in exceptional circumstances, defined as a temporary recession equivalent to a GDP decline of 3 percentage points from the average of the three preceding years. A recent paper in the context of WAEMU convergence argues further that both the growth performance and the terms of trade need to be taken into account in assessing countries' progress toward convergence targets. See Paul Masson and Ousmane Doré, *Experience with Budgetary Convergence in the WAEMU*, IMF WP/02/108, June 2002.

85. While economic theory offers little guidance on whether or which benchmarks should be chosen or what constitutes an appropriate level of public debt or deficit targets, a small number of simple benchmarks are preferable, as these would be easier to monitor, more transparent, and less likely to be mutually inconsistent. The four ECCB benchmarks would appear to broadly satisfy such criteria. The benchmarks must be consistent with other regional objectives, such as commitments toward trade liberalization and the harmonization of domestic taxation.

86. The ECCB's preliminary work to identify appropriate fiscal benchmarks is grounded in a target for public sector investment. It relies on past debt and deficit figures for those ECCU members that have met the assumed public sector investment target to justify the quantitative norms. The derivation of targets as essentially *residual items* does not address the fundamental issue of debt and fiscal sustainability, which should be taken as the appropriate *starting point* in the design of appropriate and mutually consistent fiscal benchmarks.[38] Nevertheless, the derived benchmarks may seem broadly appropriate in light of experience. If formally integrated into the national budget and planning processes, the benchmarks would mandate vigorous fiscal action and commitment.

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[38] Kufa, Pellechio, and Rizavi (*Fiscal Developments and Policy Issues in the East Caribbean Currency Union*, forthcoming working paper) analyze fiscal sustainability of ECCU members using the simple budget constraint model, targeting stabilizing the public debt ratio. They question the focus of the current benchmarks on generating public savings to support a high level of public investment, which does not necessarily achieve a strong rate of economic growth. They conclude that the debt-stabilizing primary balance varies considerably across countries, and the aggregate public sector primary surplus should be around 4 percent of GDP for the ECCU to achieve sustainability.

IV. Fiscal and Debt Sustainability[39]

87. The fiscal position of the region has deteriorated sharply in recent years, resulting in public sector dissavings, marked increases in public debt, and arrears in some cases. The overall deficit widened from 5½ percent of GDP in 2000 to around 7 percent of GDP in 2001. As a result, total debt of the six countries has climbed steadily over the past 5 years, reaching more than three-quarters of GDP in 2001. Within the countries in the region, the debt stock at end-2001 ranged between 43—134 percent of GDP. Only St. Lucia, based on end-2001 data, would meet the ECCB's proposed benchmark for debt-to-GDP (maximum ratio of 60 percent).

88. It is clear that rising deficits and debt levels pose a key risk to several ECCU member states. Furthermore, the risks of contagion that would result from the inability of one member to rollover its domestic or external debt obligations are high, given the linkage through the common currency and the ECCB. An episode of default in one country could undermine confidence in the currency, and call into question the sustainability of the currency board arrangement.

A. Fiscal Sustainability

89. Debt sustainability analyses were conducted for the six member countries of the ECCU using the recently developed framework by IMF staff.[40] A common definition of the public sector and debt was used where possible for each country. The definition aims at a broad definition of non-financial public sector debt, including public enterprises, netting out in some cases substantial social security holdings of government debt (see Box 1). The sensitivity analyses are based on historical averages and standard deviations for the previous 5 years (1997 through 2001) applied to the staff's current growth and debt projections for the respective country (baseline scenarios).[41]

90. In each case, except for St. Lucia, scenarios for the countries' debt-to-GDP ratios using historical averages for key macro-variables (real GDP growth, real interest rate and primary balance) exceed the staff's own baseline medium-term projections:

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[39] Prepared by Robert Price (PDR).

[40] See "Assessing Sustainability," May 28, 2002, http://www.imf.org. As that paper discusses, assessments of sustainability are inherently probabilistic; the proposed framework does not supply these probabilities explicitly, but traces the implications of alternative scenarios and leaves the user to determine the probabilities that should be attached. In this case, no specific probabilities were assigned to the alternate scenarios for ECCU countries.

[41] 10 years was used in the case of St. Lucia. The 5-year time frame is a departure from the proposed framework in "Assessing Sustainability," which is based on 10-year averages and standard deviations. A shorter time frame was chosen to capture the period of lower inflation and lower average growth and for the more pragmatic reason that reliable data were in some cases not available for some countries for the longer period.

- The fiscal situations in **Antigua and Barbuda** and **St. Kitts and Nevis** appear particularly vulnerable. For the former, the staff projection shows a gradual diminution in public sector debt after peaking at 96 percent of GDP in 2003. However, stress tests using historical averages for key macroeconomic variables result in a continual increase in the debt ratio, reaching more than 120 percent in 2007. Moreover, the debt-to-revenue ratio, which stands at 340 percent, although below the peak of 428 percent in 1995, remains high through the projection period (mostly above 350 percent), raising questions about the ability to service the public sector debt. The debt-to-GDP ratio for St. Kitts and Nevis is among the highest in the world, projected at 160 percent in 2002. Under the combined shocks—using historical averages for real GDP growth, the real interest rate, and primary balance—there is a marked divergence through the period between the stress tests and staff projections for debt-to-GDP: the stress test scenario is 45 percentage points higher in 2007 than the staff's projection (169 percent of GDP against 124 percent), indicating possible downside risks to the staff outlook.

- Similarly, the risks to staff's debt-to-GDP ratio for **Dominica** appear to be on the downside: using historical averages under the stress tests results in steady increases, up to 120 percent of GDP in 2006, while the staff projection is for gradual declines from 2003 to 2006 (105 percent to 98 percent).

- **Grenada's** large public debt, projected at 104 percent of GDP at end 2002, tops out in 2003 and declines thereafter (88 percent in 2007) under the staff's medium-term projections. However, using historical averages for key variables, the stock of debt continues to increase as a percent of GDP, reaching 113 percent over the medium-term horizon.

- For **St. Lucia**, with the lowest debt-to-GDP ratio of the six ECCU members (57 percent at end-2002 (projected)), the medium-term scenario prepared by the staff assumes continued fiscal consolidation and is compatible with sustainable debt levels even in the presence of adverse economic shocks. Debt-to-GDP declines gradually through 2007 under the scenario using historical averages for key variables.

- Although the public sector debt for **St. Vincent and the Grenadines** is projected to climb to 72 percent of GDP in 2002, the debt dynamics appear well behaved and sustainable through the period. The ratio remains virtually unchanged if real GDP growth, the real interest rate, primary balance and non-debt flows are at historical averages in 2003-2007, while the staff projection peaks in 2003 before declining through 2007.

Additional stress tests were conducted for four of these countries based on two alternative scenarios:[42]

- **No growth scenario:** Assumes no (zero) real growth for three years (2003 to 2005) and then 1 percent and 2 percent growth in 2006 and 2007 respectively. This scenario attempts to take account of the global economic and regional uncertainties.

- **Worst-case scenario:** Assumes negative growth of 2 percent for three years (2003 to 2005) followed by no (zero) growth for 2 years (2006 and 2007). This scenario is intended to capture extreme events, including the possibility of a war with Iraq, increased terrorism, repeated hurricanes, etc.

91. As would be expected, the results are comparatively worse under the no growth and worst-case scenarios. The debt-to-GDP ratios range from 58 percent (Grenada, under no growth scenario) to almost 200 percent (St. Kitts and Nevis, worst case) in 2007 using historical averages. Debt profiles for these countries under the alternative scenarios are shown in Figure 1.

92. **No hard or simple rules can be cited for the level of debt that is sustainable or the level beyond which a crisis would emerge. Indeed, the distribution of the debt-to-GDP ratio ranges widely in a study of 53 debt corrections over the period 1979-2001—from less than 10 percent to more than 150 percent.**[43] However, about two-thirds of the observations occur at a debt-to-GDP ratio of below 60 percent and more than three-quarters of the observations occur at a debt-to-GDP ratio of below 70 percent. The latter ratios are well below those now observed for most of the ECCU members. While staff's baseline projections are for debt ratios to diminish over the medium-term in each country, the stress tests indicate that the balance of risks may be for debt levels to increase even further from the present high levels—clearly in some cases approaching dangerous levels that would call into question their sustainability.

93. The ECCB's suggested fiscal benchmarks, which would place a ceiling on debt-to-GDP at 60 percent, could prove a useful binding commitment to reverse this disturbing trend. The stress tests underline the need for prompt and vigorous action by some national authorities.

[42] The countries are Antigua and Barbuda, Grenada, St. Kitts and Nevis, and St. Vincent and the Grenadines. The staff projection and baseline stress test for Grenada were recently updated, and the no-growth and worst-case scenarios are not comparable (Figure 1, Chart 3).

[43] See "Assessing Sustainability," Appendix I, May 28, 2002, http://www.imf.org.

B. External debt sustainability

94. **External debt for the region, most of which is denominated in US dollars, stood at 45 percent of GDP at end 2001**(excluding external arrears).[44] The level varies considerably by country, reaching as high as 70 percent of GDP for St. Kitts and Nevis. Large proportions of foreign-currency denominated debt (FCD), particularly for those under fixed exchange rate regimes, can be a source of risk. ECCU countries are counting on the development of the regional government securities market to provide a viable source of domestic financing that could ultimately supplant FCD (see Box 2.).

95. Staff's own baseline projections appear to show that the external debt burdens are manageable. However, sensitivity to shocks to the projections indicate that some countries remain vulnerable, particularly those countries with high initial external debts:[45]

- **Dominica's** program baseline scenario for external debt appears sustainable. The debt-to-GDP ratio is expected to increase in 2002 and 2003 owing to the high financing requirement of the public sector, which is envisaged to be covered by external multilateral disbursements. The debt ratio would stabilize in 2003-2005 and begin declining in 2006. The sensitivity tests show this is consistent both with historical trends (using 10-year averages) and with interest rate and external inflation shocks as well. The use of ten-year averages for the key parameters increases the debt ratio by about 5 percent of GDP in the period 2001-2003, while the baseline scenario shows a build-up of about 15 percent of GDP. For 2001-2006, both past values and the scenario would indicate an 11 percent of GDP debt increase. For the standard interest rate and external inflation shocks, the sensitivity tests produce about the same increase in external debt as the baseline scenario, in both periods. In the case of shocks to the non-interest current account balance, which would cause deficits to be much higher than envisaged, the test suggests the shock would make the debt about 40 percentage points higher through the forecast period than under the baseline projection. Nevertheless, the likelihood of this much larger deficit is considered low in light of the observed link between current account deficits and non-debt creating flows, typically for high import-content investment outlays, most of which are externally financed.

- **Grenada**, for which the external debt burden is projected to decline smoothly (from 57 percent of GDP in 2002 to 44 percent in 2006) through the period, would fare even better if interest rate, GDP growth, inflation and the non-interest current account deficit are maintained at the average of the past 5 years (the debt-to-GDP ratio drops to 15 percent by 2006). However, the forecast is highly sensitive to adverse shocks to

[44] External arrears continue to be high in Antigua and Barbuda.

[45] No projections were made for Antigua and Barbuda.

these variables: debt-to-GDP rises sharply in each case, rising to above 130 percent in the case of a two-year/two standard deviation shock to GDP.

- The position of **St. Kitts and Nevis**, burdened with a high external debt position projected at 70 percent of GDP in 2002, appears sustainable under the staff's baseline projection. Using historical averages (over the past 5 years) for the key parameters, the external debt would decline through 2007.

- Initial external debt burdens are lowest for **St. Lucia** (projected at 32 percent of GDP in 2002) and **St. Vincent and the Grenadines** (46 percent), which the staffs project to remain roughly unchanged during the period 2003-2007. This debt appears manageable under most adverse scenarios.

96. **Much of the external debt is concessional, from bilateral and multilateral international financial institutions and development agencies.** Several countries have also contracted external debt with private banks in the region, a number of which are domiciled in Trinidad and Tobago. These debts are reported to carry high overall interest charges, when sinking fund provisions are included, relative to current interest rates. The mandate of the Regional Debt Coordinating Committee, comprising Directors of Finance and Financial Secretaries of ECCU members and the ECCB, in addition to helping plan and guide debt issuance on the domestic market through the RGSM, should be extended to include debts issued externally.

97. **A one-to-one ratio of reserves to short-term external debt (public and private) has been suggested as a useful rule-of-thumb to reduce vulnerability.**[46] Most public sector external debt of ECCU countries is longer term.[47] External debt data for the private sector are unavailable. The high foreign currency-backing ratio under the CBA would likely exceed the combined short-term external debts of the public and private sectors for ECCU countries, but the ECCB and national statistical offices should as a priority address the gap in their data collection on private sector debts.

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[46] See "*Debt- and Reserve-Related Indicators of External Vulnerability*," March 23, 2000, http://www.imf.org.

[47] At end December 2000, 81.2 percent of external debt had a remaining maturity of greater than 10 years, and 97.6 percent was beyond 5 years.

Box 1. Definition of Public Sector Debt in the ECCU Region for the Purpose of the Debt Sustainability Exercise

	Agreed practice for the DSA Exercise
Definition of Debt	○ Widest possible inclusion of debts of the NFPS consistent with the Fund definition of debt, which would include, inter alia, comfort letters, and privately and publicly held government and publicly guaranteed debt. ○ Government guarantees to private enterprises in the form of a minimum rate of return should be mentioned in a footnote. ○ In general, any outstanding debt within the IMF definition of debt, which cannot be included because of lack of data availability, should be mentioned in a footnote.
Coverage	○ Central Government, net of social security holdings of government debt. ○ Central government debt held by social security should be reported as a memorandum item and a comment on the solvency of the social security system included in a footnote. ○ Public Enterprises' debt should be included to the extent information is available. ○ Financial public sector's (central bank and banks owned government) debts should be excluded.
External versus domestic	○ Treasury bills are classified as domestic debt (unless the foreign holdings are known). ○ Interregional debt (including debt to Anguilla and Montserrat) would be classified as domestic debt with a footnote specifying the treatment. ○ For all other cases, the IMF definition of residency would apply.
Gross versus net	○ External debt: Gross basis, netting out only sinking funds (tied to particular borrowing). ○ Domestic debt: Gross basis. Further research needed to examine maturity and liquidity of existing deposits of NFPS in domestic banks. ○ Debt projections need to take into account possible financing of NFPS deficits by drawing down domestic deposits and/or use of privatization proceeds. The corresponding assumptions need to be specified in a footnote.
Nominal versus real value	○ Nominal debt
Book versus face value	○ Face value (including a note if any large differences between the face and book value are known).
Residual versus original maturity	○ Residual maturity where possible. Assumption should be specified in a footnote.

Box 2. The East Caribbean Securities Exchange and Regional Government Securities Market

The East Caribbean Securities Exchange (ECSE) was officially launched on October 19, 2001, providing a regional trading platform for primary and secondary securities trading for the eight ECCU member states. The exchange is regulated by a uniform Securities Act of 2001, covering both equity and debt securities. The exchange supports fully electronic trading, remote trading and access, with settlement meeting G-30 standards on a T+1 basis. The ECCB acts as the settlement bank and the ESCE owns separate registry and depository facilities—the Eastern Caribbean Central Securities Registry (ECCSR) and Eastern Caribbean Central Securities Depository (ECCSD), respectively. The exchange has 47 owners, the largest of which is the ECCB, with a 30 percent share. There are 6 intermediaries, all of which are banks.

The ESCE is designed to support both equity trades and government and private debt securities. Secondary trades are executed by a daily call auction. In its first year of operation, the ESCE has been unable to generate much volume. At present, only two companies are listed—the Bank of Nevis Ltd., and the East Caribbean Financial Holding Company Ltd. (holding company of the Bank of St. Lucia), and one debt issue (a 10-year Government of St. Kitts and Nevis bond, issued). Secondary trading volume has been low. Of 27 publicly held companies in the region, about roughly, half are deemed by the ESCE to be eligible for listing. Listing requirements for equities were recently relaxed somewhat to entice further participation.[48]

Listing requirements for the regional government securities market (RGSM) include quarterly reporting, annual audited financial statements, and timely disclosure of material information by issuers. The ECCB acts as the fiscal agent for government issuers. Bonds and bills can be sold under one of three formats—uniform- or multiple-price auctions, or fixed price/quantity. The St. Kitts and Nevis bond, issued in November 2002, was sold at a fixed price, and was slightly oversubscribed.

The viability of both the ESCE and RGSM depends on a substantial build-up in volume. The possibility of opening up the trading platform by the ECCU to other countries in the Caribbean region should be explored. A liquid regional market for government securities would give fiscal authorities added flexibility in debt management, and potentially reduce external vulnerability by replacing foreign-currency denominated with domestic debt. This may be particularly important in the context of the fixed exchange rate. The authorities will need to be cautious that this flexibility does not itself reduce the resolve to reduce the overall debt burden. The overall increase in public debt has largely been financed domestically over the past 5 years, with much of the increase being taken up by governments and government institutions, including the national insurance and pension schemes. Moreover, the currency board arrangement provides little scope for active debt management operations by the central bank, including the support of primary auctions.

[48] The new requirements include (i) semi-annual reporting of (unaudited) financial statements within 30 days, with a two-year grace period for new issuers (previously quarterly, with no grace period); (ii) provision of annual audited financial statements within 120 days (90 days previously); and (iii) disclosure of material changes within 7 days (no change).

V. The Financial Sector: Institutions, Oversight and Risks [49]

A. Financial Institutions and Market Shares

98. **The ECCU has a well-developed banking system, with a ratio of deposits to GDP of 146 percent in 2001.** In addition to banks, savings are mobilized by national insurance funds (18 percent of GDP), private pension funds and insurance companies, as well as smaller institutions such as credit unions. The Eastern Caribbean Securities Exchange was opened in 2001 with two companies listed. The bulk of financial system assets are held by banks, followed by the national insurance scheme (NIS) funds. (See Table 1).

99. Antigua and Barbuda is the largest financial market in the ECCU, with a quarter of total ECCU assets at end-June 2002.[50] Grenada, St. Kitts and Nevis and St. Lucia each had between 15 percent and 17 percent of total financial assets; St. Vincent and the Grenadines 11 percent, and Montserrat 1 percent. While most countries' share of the regional financial market was in line with their share of regional GDP; St. Lucia's was significantly below, while shares for St. Kitts and Nevis, and Anguilla, were much higher. (see Table 2).

100. **Seven foreign-owned banks, with headquarters in Canada, the U.K., Trinidad and Tobago, and France, together accounted for 60 percent of the assets of banks and other deposit taking institutions at end-June 2002.** Nine privately owned domestic banks have a 23 percent share of assets, with four majority state-owned banks accounting for the remaining 17 percent. Foreign banks have a majority share ranging from 54 percent to 90 percent, in the markets of Antigua and Barbuda, Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines. Private domestic banks hold a majority share only in Anguilla, while in St. Kitts and Nevis the state-owned and foreign banks have about equal shares. Only in Montserrat does the state-owned bank account for a majority of assets (see Table 3). Since end-1997, there has been a decline of 2 percentage points in the share of state banks, in favor of foreign banks, as a result of the privatization of 70 percent of the shares of the state-owned commercial bank in St. Lucia.

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[49] Prepared by Delisle Worrell (MAE).

[50] Excluding NIS, pension funds and insurance companies.

Table 1. ECCU: Financial System Structure

	Dec-97			Dec-99			Dec-01			Jun-02		
	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets	Number	Assets (EC$M)	Percentage of Total Assets
Banks	**44.0**	**7884.7**	**90.1**	**43.0**	**9525.7**	**87.6**	**43.0**	**10466.5**	**88.2**	**43.0**	**11082.7**	**83.8**
Private												
Domestic	8	1793.4	20.5	8	1731.4	15.9	9	2346.2	19.8	9	2534.3	19.2
Foreign	31	4495.1	51.4	30	5671.1	52.1	30	6421.9	54.1	30	6664.9	50.4
State-Owned	5	1596.2	18.2	5	2123.2	19.5	4	1698.4	14.3	4	1883.5	14.2
Institutional Investors	**148**	**n.a.**	**n.a.**	**127**	**n.a.**	**n.a.**	**122**	**n.a.**	**n.a.**	**122.0**	**n.a.**	**n.a.**
Insurance Companies												
Life & Retirement	46	n.a	n.a	39	n.a	n.a	35	n.a	n.a	35	n.a	n.a
Non-life	88	n.a	n.a	76	n.a	n.a	75	n.a	n.a	75	n.a	n.a
Composite 1/	14	n.a	n.a	12	n.a	n.a	12	n.a	n.a	12	n.a	n.a
National Insurance Funds	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a	**6**	**1176.9 1/**	**8.9**
Other Nonbank	**109.0**	**865.5**	**9.9**	**107**	**1351.3**	**12.4**	**107**	**1399.6**	**11.8**	**107**	**969.7**	**7.3**
Finance Companies	8	28.4	0.3	8	324.7	3.0	8	371.6	3.1	8	339.1	2.6
Securities Firms	-	-	-	-	-	-	-	-	-	-	-	-
Mortgage Institutions	6	242.5	2.8	5	269.5	2.5	5	301.4	2.5	5	309.9	2.3
Credit Unions	79	468.2	5.4	79	556.4	5.1	80	669.5	5.6	80	320.7	2.4
National Foundation	7	n.a	-	7	n.a	-	7	n.a	-	7	n.a	-
Other	9	126.4	1.4	8	200.7	1.8	7	57.1	0.5	7	n.a	-
Total Financial System	**301**	**8750**	**100**	**277**	**10877**	**100**	**272**	**11866**	**100**	**278**	**13229**	**100**

Source: ECCB

1/Offer both Life and Non-life Insurance

Table 2. Distribution of Assets by Country, Compared with GDP

	Assets, June 2002 (EC$ m.)	Percent of Total Assets	GDP, 2001 (EC$ m.)	Percent of ECCU Total
Anguilla	926	8	240	4
Antigua and Barbuda	2,897	24	1,592	25
Dominica	878	7	601	9
Grenada	1,803	15	888	14
Montserrat	179	1	83	1
St. Kitts and Nevis	2,047	17	796	12
St. Lucia	1,946	16	1,489	23
St. Vincent-Grenadines	1,379	11	785	12
ECCU	12,055	100	6,474	100

Source: ECCB

Table 3: Foreign, Domestic, and State Bank Shares in Total Assets, by Country (Percentages)

	Domestic Private	Foreign	State (51% +)
Anguilla	64	36	0
Antigua and Barbuda	46	54	0
Dominica	0	59	41
Grenada	10	90	0
Montserrat	0	33	67
St. Kitts and Nevis	5	47	48
St. Lucia	28	72	0
St. Vincent-Grenadines	0	63	37
ECCU	23	60	17

Source: ECCB

101. **For the ECCU as a whole, foreign banks, with average assets of EC$952 million at end-June 2002 were twice as large as the government-owned banks, which in turn were twice the size of the average privately owned bank**. However, the government-owned banks were much larger in their domestic markets than was the average foreign bank presence in each market (See Table 4).

102. **Government mobilizes considerable financial resources via national insurance funds, which together held EC$824 million of deposits with the banking system equivalent to 9 percent of bank deposits at end-June 2002.** In addition, the national insurance funds hold government securities, equity and fixed assets. Over 100 insurance companies were reported to be operating in the ECCU, though only a few companies headquartered in non-ECCU /CARICOM countries probably accounted for most of the assets outstanding in the segment. Finance companies, mortgage finance institutions and credit unions each contributed the equivalent of approximately 2.5 percent of the total assets of deposit-taking institutions at end-June.[51]

103. **Antigua and Barbuda, with 22 banks licensed at December 2001, is the only ECCU member with a significant number of banks in the offshore sector**. Most member countries have withdrawn licenses of institutions that were either dormant or not in compliance with legislative requirements (for example, with respect to the qualification of directors and the holding of meetings of directors), leaving a total of only seven banks in the ECCU, apart from those registered in Antigua and Barbuda, according to most recent reports from the ECCB. At December 2001 there were 18 insurance companies registered in the offshore sector in Antigua and Barbuda, and 11 in the rest of the ECCU. There were significant numbers of trust companies registered in St. Kitts and Nevis and St. Vincent and the Grenadines, large numbers of gaming companies in Antigua and Barbuda, large numbers of foreign sales corporations (FSCs) in St. Kitts and Nevis and numerous international business companies in all ECCU member countries (see Suss, Williams, and Mendis, 2002, Table 2, page 13).

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[51] The only regional secondary market institution is the Eastern Caribbean Home Mortgage Bank (ECHMB), which has issued EC$70 million in bonds, and has acquired a portfolio of EC$50 million of mortgages from lending institutions in Antigua and Barbuda, Grenada, St. Kitts and Nevis and St. Lucia.

Table 4. Average Size of Banks, by Country
(EC$ million)

	Domestic Private	Foreign	Government
Anguilla	199	331	0
Antigua and Barbuda	410	293	0
Dominica	0	125	354
Grenada	171	367	0
Montserrat	0	58	121
St. Kitts and Nevis	102	230	937
St. Lucia	219	224	0
St. Vincent and the Grenadines	0	202	472
ECCU	282	952 1/	471

Source: ECCB
1/ This does not correspond to the country average because the same foreign banks are represented in a majority of countries.

Table 5. Interest Rates by Country, May 2002
(In Percentage)

	Treasury Bill Rate	Deposit Rate	Loan Rate
Antigua and Barbuda 1/	7.0	6.0	11.5
Dominica	6.4	6.0	10.5
Grenada	6.5	5.75	10.5
St. Kitts and Nevis	6.0	6.0	12.5
St. Lucia	7.0	6.0	10.5
St. Vincent and the Grenadines	6.5	6.0	11.0

Source: International Finance Statistics.
1/ December 2001.

B. Market Infrastructure

104. **Several indicators provide evidence that the ECCU financial market is segmented by country, with low volumes of intra-ECCU financial transactions, apart from trade financing**. First, there has been no tendency towards a convergence of interest rates. At end-May, 2002 loan rates varied across countries, from 10.5 percent to 12.5 percent. Treasury bill rates ranged from 6½ percent for Dominica to 7 percent for Antigua and Barbuda and St. Lucia. There was even some variation in deposit rates, in spite of the fact that the ECCB sets a floor on the deposit rate (see Table 5). Secondly, net asset holdings by banks with other banks in the ECCU were equivalent to less than ½ percent of total assets (end-June 2002), about the same proportion as at end-December 2001. It is likely that these balances reflect trade finance transactions. Thirdly, there is little cross-country holding of government securities among ECCU members. Fourthly, cash-to-deposit ratios varied widely across member countries at end-May 2002, from 11 percent for Grenada to 18 percent for St. Kitts and Nevis.

105. **The ECCB has taken initiatives to strengthen institutional arrangements for intra-ECCU financial transactions.** There is uniform legislation in all members for banking, securities trading and corporate governance. The ECCB fostered the establishment of the Eastern Caribbean Securities Exchange (ECSE), which commenced operations in October 2001, and the Regional Government Securities Market (RGSM), on which the first placement took place in November 2002. The ECCB also provided initiative and finance for the establishment of the Eastern Caribbean Home Mortgage Bank (ECHMB) in 1994.

106. **Arrangements for direct inter-bank borrowing and lending were introduced in October 2001.** Prior to this, the ECCB had in effect acted as intermediary for inter-bank borrowings. From a volume of EC$17 million in the first month of operation, transactions have risen to an average of EC$102 million in the three months to July 2002. Three-quarters of transactions by volume are for a duration of eight to 30 days, with the remainder mostly for one week or less. The term structure of interest rates was inverted initially, but in May 2002, a normal structure emerged. The interest rate for shorter maturities in July was just under 6 percent, compared to 6½ percent for the longer maturities.

107. **Inter-bank foreign exchange transactions vary with the demand for short-term trade financing.** The mean value of monthly changes in banks' holdings of net foreign assets, which reflects these transactions, ranged from negative EC$1.5 million for banks in St. Lucia, to EC$0.5 million for banks in St. Kitts and Nevis, for the period January 1992 to May 2002. Standard deviations ranged from around EC$8 million (Dominica) to EC$23 million (St. Kitts and Nevis). For large transactions, banks periodically buy from and sell foreign exchange to the ECCB. The mean value of changes in the central bank's foreign assets was EC$15 million for the period January 2001 to March 2002, and the standard deviation was around EC$20 million. The commercial banks' foreign exchange exposure is maintained at very low levels. At end-June 2002, net foreign assets, including net balances

with banks abroad and foreign currency loans, were equal to the amount of foreign currency deposits, EC$1½ billion, or 15 percent of bank deposits.

108. **The largest proportion of securities issued in ECCU financial markets is treasury bills, government bonds and bonds issued by development banks and state enterprises**. Government securities outstanding at end-June 2002 were EC$1.1 billion (17 percent of GDP), evenly split between treasury bills and long-term bonds. The largest issuers were Dominica, with 24 percent of the total outstanding (in comparison with its 9 percent share in the region's GDP); and St. Kitts and Nevis, 25 percent of the amount outstanding (12 percent share of ECCU's GDP). St. Vincent and the Grenadines, with a GDP share similar to that of St. Kitts and Nevis, was responsible for only 7 percent of the amount outstanding. In contrast to other ECCU members, St. Kitts and Nevis has issued treasury bills almost exclusively (86 percent), and banks hold 69 percent of those. Apart from that country, banks held 28 percent of government securities outstanding. Government institutions, including NIS funds, held 38 percent of the total outstanding. ECCB's holdings were 10 percent of the total (see Table 6). Prior to the establishment of the ECSE, the home mortgage bank (ECHMB) was the only institution whose bonds were purchased widely throughout the ECCU. The ECSE has had an extremely modest beginning, with two companies listed, and market capitalization of EC$108 million (1.7 percent of the region's GDP in 2001). St. Kitts and Nevis issued the first government bond to be offered on the exchange, in November 2002.

Table 6. Government Securities Outstanding by Holder, June 2002
(EC$ million)

Holders	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	St. Lucia	St. Vincent and Grenadines	ECCU Total
Treasury Bills								
ECCB	16.2	12.9	13.9	0	5.8	30.7	0	79.5
Banks	10.2	8.9	19.0	0	162.1	15.7	37.5	253.4
OFIs	4.8	3.8	9.5	0	10.9	17.3	4.4	50.7
Govt. Institutions	19.2	21.0	11.9	0	24.8	46.1	2.5	125.5
Pvt. Investors	8.3	0	2.0	0	32.7	0.5	3.2	46.7
Total	**58.7**	**46.6**	**56.3**	**0**	**236.2**	**110.3**	**47.6**	**555.7**
Debentures								
ECCB	14.8	6.5	2.7	0.8	3.5	5.0	4.0	37.3
Banks	12.1	26.2	9.2	0.4	3.5	18.0	14.6	84.0
OFIs	8.6	133.4	7.1	0.4	0.8	26.9	6.0	183.1
Govt. Institutions	37.0	38.7	76.9	2.4	25.0	23.6	4.5	208.1
Pvt. Investors	1.0	12.2	19.0	0	5.5	1.7	1.0	40.4
Foreign Investors	0	1.3	0	0	0	8.1	0	9.4
Total	**73.4**	**218.4**	**114.9**	**4.0**	**38.3**	**83.2**	**30.0**	**562.1**
Total T-bills and Debentures	132.1	264.9	171.2	4.0	274.5	193.5	77.6	1,117.9
In percent by Country	11.8	23.7	15.3	0.3	24.6	17.3	6.9	100

Source: ECCB

109. **The ECCB maintains a manual clearing system for checks, with daily clearings in the bank's representative offices in each country, and settlement over the reserve balances, which all banks maintain with the ECCB**. A private company provides electronic clearing of credit card transactions, which are settled over accounts at one of the foreign banks. Two initiatives are underway on payments reform; a committee including representatives of the ECCB, commercial banks and the credit card clearing company (CCCC) have completed a study for the implementation of an automated clearing house (ACH) for small value payments; and the ECCB is in the process of preparing a proposal for the implementation of an automated settlement process for large value and time critical payments.

C. Regulation and Supervision

110. **The ECCB has responsibility for the regulation and supervision of commercial banks, development banks, mortgage finance companies and other finance companies**. Licenses are issued by national governments—the ECCU has no federal legislative structure—on the recommendation of the ECCB. There is a uniform banking act on the statute books of all members. The Banking Act and the ECCB Agreement Act give the ECCB certain powers of regulation, supervision and intervention, but there is a need for strengthening particularly with respect to closures but there is need for the removal of some restrictive clauses and additional protection for supervisors.[52]

111. **The ECCB's Bank Supervision Department (BSD) is in the process of upgrading techniques for risk-based supervision and financial sector risk assessment.**[53] BSD conducts on- and off-site examinations of all institutions for which the ECCB has responsibility. Analytical reports for off site inspection are provided by the ECCB's excellent statistical database system, which has the capacity to produce a variety of macroeconomic and prudential reports in flexible formats. All institutions that are in violation of the ECCB's prudential norms are on a "watch list," and have signed memoranda of understanding with deadlines for bringing the deficient areas into compliance.

112. **The Monetary Council of the ECCB has initiated a program for the coordination and upgrading of regulation and supervision of firms in the offshore, as well as insurance companies, mutual funds, money transfer agencies and micro-finance organizations providing domestic financial services.** Consolidated supervisory units are to be established in each country, drawing together the functions of a variety of supervisory agencies in a single unit, which will be separate from the agencies that promote offshore activity. The consolidated units will be coordinated by the ECCB, which will provide training and expertise, with technical assistance from CARTAC. The ECCB will share responsibility

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[52] Amendments to incorporate these changes have been drafted, commented on by the Fund's Legal Department and are expected to be enacted by January 2003.

[53] See Polius-Mounsey and Millington (2001) and Polius-Mounsey and Sahely (2002).

for the supervision of offshore banks with the country supervision bodies, with areas of responsibility defined in memoranda of understanding.

113. **A CARTAC expert, to bring Grenada's provisions in line with Basel principles, has drafted amended legislation for the offshore sector. This legislation is intended as a model for the other ECCU members, except Antigua and Barbuda**, and all are expected to adopt it by January 2003. Antigua and Barbuda has already completed updates of the legislative framework for its IFSC. A joint ECCB/CARTAC team, with participation of Caribbean and international supervisors, has completed a review of the offshore sector in St. Vincent and the Grenadines. A similar review for Grenada is underway.

114. **Following the U.S. model, their own regional non-governmental, jointly operated institution, the Caribbean Council of Credit Unions (CCCU), which has its business center in St. Kitts and Nevis, supervises Credit Unions.** It provides training and other technical assistance to its members, with the assistance of the international credit union federation. The federation sets prudential guidelines for credit unions based on a system analogous to the CAMEL rating system. It is known by the acronym PEARLS (protection, effective financial structure, asset quality, rates of return and cost, liquidity, signs of growth).[54] CARTAC is cooperating with the CCCU in a program to strengthen the offices of the registrars of cooperatives, and to assist credit unions with procedures for ensuring that they observe the PEARL guidelines. The Monetary Council of the ECCB has recommended legislation to regulate the activities of money transfer agencies. CARTAC has agreed to provide technical assistance for drafting, and a uniform law is to be put in place by all ECCU members by early 2003. The trading of private securities is supervised by an independent Securities and Exchange Commission, and the trading of government securities by an intergovernmental committee. They both draw on ECCB expertise and services.

115. **The ECCB will need to expand the resources of its regulatory, supervisory and risk management functions, in view of the growing scope of its responsibilities.** In addition to the supervision of offshore banks, the co-ordination of the country consolidated supervisory units and the servicing of the securities regulators; the ECCB is in the process of developing its capability for assessment of the financial sector and conducting of stress tests. The central bank has a strategy for upgrading its capability, with the assistance of CARTAC. It includes improvement in prudential data collection, introduction of new assessment techniques and the revision of supervision manuals.

D. The Contingency Framework

116. The high proportion of ownership of the banking system by large, well-capitalized foreign banks may provide a "first line of defense" in case of a crisis of confidence

[54] See Richardson, 2001.

in the domestic banking sector. Foreign banks would be a haven in case of a flight to quality, and, because they are much larger, they can readily absorb any additional liquidity, which would result from a switch of domestic currency deposits away from indigenous banks. The failure of a domestic bank thus would not necessarily trigger a systemic crisis.

117. **However, the failure of any large financial institution could raise questions of credibility about the ability and commitment to maintain the currency peg.** Such concerns could shift depositors' preferences from domestic to foreign currency-denominated assets. As a currency board, the ECCB has a commitment mechanism to deal with such capital flows, to support the fixed exchange rate parity. The ECCB maintains a ratio of 97 percent of net foreign assets to its demand liabilities,[55] and the ratio has not fallen below 90 percent since 1990. However, because it is not a pure currency board, the ECCB is able to act as a lender of last resort for illiquid but solvent banks. Each year the central bank budgets a maximum amount of short-term accommodation, for approval by the Monetary Council, for banks and governments, the latter by way of purchase of marketable securities. The budgeted amount is designed to ensure that the reserve cover (the ratio of foreign reserves to demand liabilities) remains above 80 percent.

E. Macroeconomic Risks to the Financial Sector

118. **Banks in the ECCU have a high level of loan concentration to households (24 percent of total loans), for mortgages, construction and repair**. A combination of shocks and adverse market developments affecting the region's major tradable commodities—tourism, bananas and sugar—has depressed household incomes in some countries, and some household incomes are adversely affected by shortfalls in government revenues, leading to arrears in government payments, including salaries in some cases. No clear evidence of a deterioration of the banks' portfolio of household-related loans has yet emerged, but that remains a possibility. There is no anecdotal evidence, to date, of a decline in property values as a result of economic contraction. (There are no statistics on real estate prices.) This is a potential source of difficulty for financial institutions, because of the impact on collateral values. **Large exposure by banks to the public sector (governments and enterprises) poses a major risk in the event of a failure to rollover debt.**

119. **Other risks to the financial sector from the international economy appear to be contained.** Banks' credit exposure to the major tradable sectors is very modest. Loans to the tourism sector were 7 percent of total loans at end-June 2002, loans for sugar cultivation were 3 percent of total, and loans to other agriculture were less than 1 percent. Financial institutions, which are licensed for the domestic market, are permitted to open accounts for IFSC firms only for operating expenses, and the balances are consequently very

[55] As at June 2002.

small. Contraction of the offshore sector has not had a measurable impact on the domestic financial market. There is no significant portfolio capital inflow, and therefore little exposure to risk of financial contagion from international markets as a result of a change in their appetite for foreign investment.

F. Financial Soundness Indicators

120. **At end-December 2001, banks in ECCU were well capitalized, with a risk-weighted capital asset ratio (RW-CAR) of 17.5 percent, almost all of which was in Tier 1 paid up capital and reserves.** The ratio of capital to total assets including government obligations, which have zero risk weight, was 11½ percent. Unsatisfactory assets were high and well above the ECCB's norm of 10 percent, at around 14 percent of total loans, largely on account of the indigenous banks, and provisions were sufficient to cover only about 28 percent of unsatisfactory assets. Banks were heavily exposed to the household sector, but not to any single producing sector. Their vulnerability appears to be to a general economic downturn, rather than a shock to single sector. Banks were profitable across the region, the foreign banks rather more so than the indigenous banks. Both domestic and foreign banks were highly liquid (see Table 7).

121. **High levels of bank capitalization were typical of all ECCU member countries.** Banks in Anguilla had low ratios of unsatisfactory assets, in contrast to those in Dominica and St. Kitts and Nevis, where ratios were comparatively high. (Montserrat, where the economy has been devastated by volcanic eruption, is a special case.) Provisions vary from adequate (Anguilla and Montserrat) to low (for Antigua and Barbuda, Grenada, St. Lucia, and St. Vincent and the Grenadines) to very low (for Dominica and St. Kitts and Nevis). Net returns in Antigua and Barbuda and St. Vincent and the Grenadines are considerably below those for the rest of the region. The reasons may be that the net interest margin of banks in those countries is at the bottom of the range for the ECCU, and the rates of operating to total expenses for Antigua and Barbuda is second only to Grenada's. Net interest margins, average returns on loans and costs of funds varied across the ECCU, with a range of 180-210 basis points between countries with the highest and lowest rates. The liquid assets ratio for banks in St. Lucia was much lower than for banks elsewhere in the ECCU. (FSIs by country are shown in Table 8.)

122. **The financial condition of banks has broadly improved over the period 1997-2001.** Risk weighted capital to assets ratios were already high in 1997, and they have since improved. The ratio of unsatisfactory assets for the system as a whole declined slightly. For indigenous banks the rates was slightly lower in December 2001 than at the end-1997, while for foreign banks the situation worsened somewhat. Nevertheless, the ratio for the foreign banks remained only half as large as that for the indigenous banks, at the end of 2001. Average provisions to unsatisfactory assets were somewhat higher; though still less than 30 percent. Profitability increased up to 1999, but thereafter it fell. The return on assets of 2.1 percent in 2001 was lower than for 1997. There was an improvement for indigenous banks, while the profitability of foreign banks fell somewhat, although at December 2001, the

foreign banks remained significantly more profitable. Liquidity ratios for the system as a whole, and for foreign and domestic banks, rose steadily over the period, except for a temporary reversal in 2000, for indigenous banks only. (Trends in FSIs are shown in Figures 1-3, for the ECCU as a whole, and for indigenous and foreign banks.)

Table 7. ECCU: Financial Sector Indicators, Domestic and Foreign Banks, December 2001
(Percentages)

	ECCU	Domestic	Foreign
Capital Adequacy			
RW-CAR	17.5	17.5	Not Applicable
Tier 1 RW-CAR	16.4	16.4	Not Applicable
Capital/Assets	11.4	11.4	Not Applicable
Asset Quality			
Past Due/Loans	5.4	7.0	3.6
Unsatisfactory/Assets	13.6	n.a	n.a
Provisions/Unsatisfactory	27.8	25.6 1/	34.9 1/
Contingent/Assets	8.5	6.3	11.3
Largest Sector/Loans	46.6	50.1 1/	42.1 1/
Largest Group/Loans	n.a.	4.4	n.a
Earnings			
RoAA	2.1	1.9	2.3
RoAE	27.8	16.9	Not Applicable
Net Interest Margin	5.0	5.0	5.1
Interest on Loans/Loans	11.0	11.0	11.0
Avg. Cost of Funds	4.4	4.6	4.2
Operating/Total Expenses	44.4	44.0	44.1
Liquidity			
Loans/Deposits	81.1	79.7	82.7
Liquid/Total Assets	24.3	27.2	29.6
Liquid Assets/Current Liabilities	n.a	12.5	n.a

Source: ECCB

Table 8. Financial Sector Indicators, Domestic Banks by Country, December 2001
(Percentages)

	Anguilla	Antigua and Barbuda	Dominica	Grenada	Montserrat	St. Kitts and Nevis	St. Lucia	St. Vincent and Grenadines
Capital Adequacy								
RW-CAR	17.4	14.3	35.4	14.1	31.1	29.0	13.9	17.7
Tier 1	16.2	12.9	34.1	11.7	25.8	33.5	11.5	18.4
Capital/Assets	11.8	10.3	23.3	9.7	11.5	11.9	9.8	11.5
Asset Quality								
Past Due/ Loans	1.3	6.8	11.8	4.5	16.0	11.3	7.5	6.4
Unsatisfactory/Loans	9.7	17.5	31.5	9.3	27.1	17.2	24.5	18.8
Provisions/ Unsatisfactory Loans	21.4	25.8	18.0	40.7	67.9	28.2	23.7	30.4
Contingent/Assets	4.4	8.5	18.2	7.2	9.5	2.0	7.5	7.2
Largest Sector	51.8	36.1	29.8	55.8	69.7	29.5	38.7	50.3
Largest Group	5.9	5.1	3.3	3.4	5.2	3.0	3.9	4.4
Earnings								
RoAA	2.5	0.5	3.0	2.2	2.1	3.4	1.6	1.0
RoAE	22.3	44.6	13.5	23.5	18.8	28.6	16.6	8.3
Net Interest Margin	4.9	4.5	5.0	5.9	4.6	5.0	5.2	4.1
Interest on Loans	11.3	11.1	9.9	10.9	9.7	11.5	11.4	9.8
Avg. Cost of Funds	3.7	5.3	4.1	4.1	3.4	4.7	5.5	4.0
Operating/Expenses	43.7	47.7	47.1	49.6	34.6	32.6	42.0	45.6
Liquidity								
Loans/Deposits	69.9	88.5	85.9	76.2	27.9	77.4	91.1	71.1
Liquid/Curr.Lia.	20.5	8.9	11.4	14.9	18.4	16.7	7.1	8.4
Liquid/Total Assets	37.9	22.4	23.3	23.2	41.3	38.1	15.7	33.2

Source: ECCB

Figure 1. All Banks: Trends in Financial Soundness Indicators

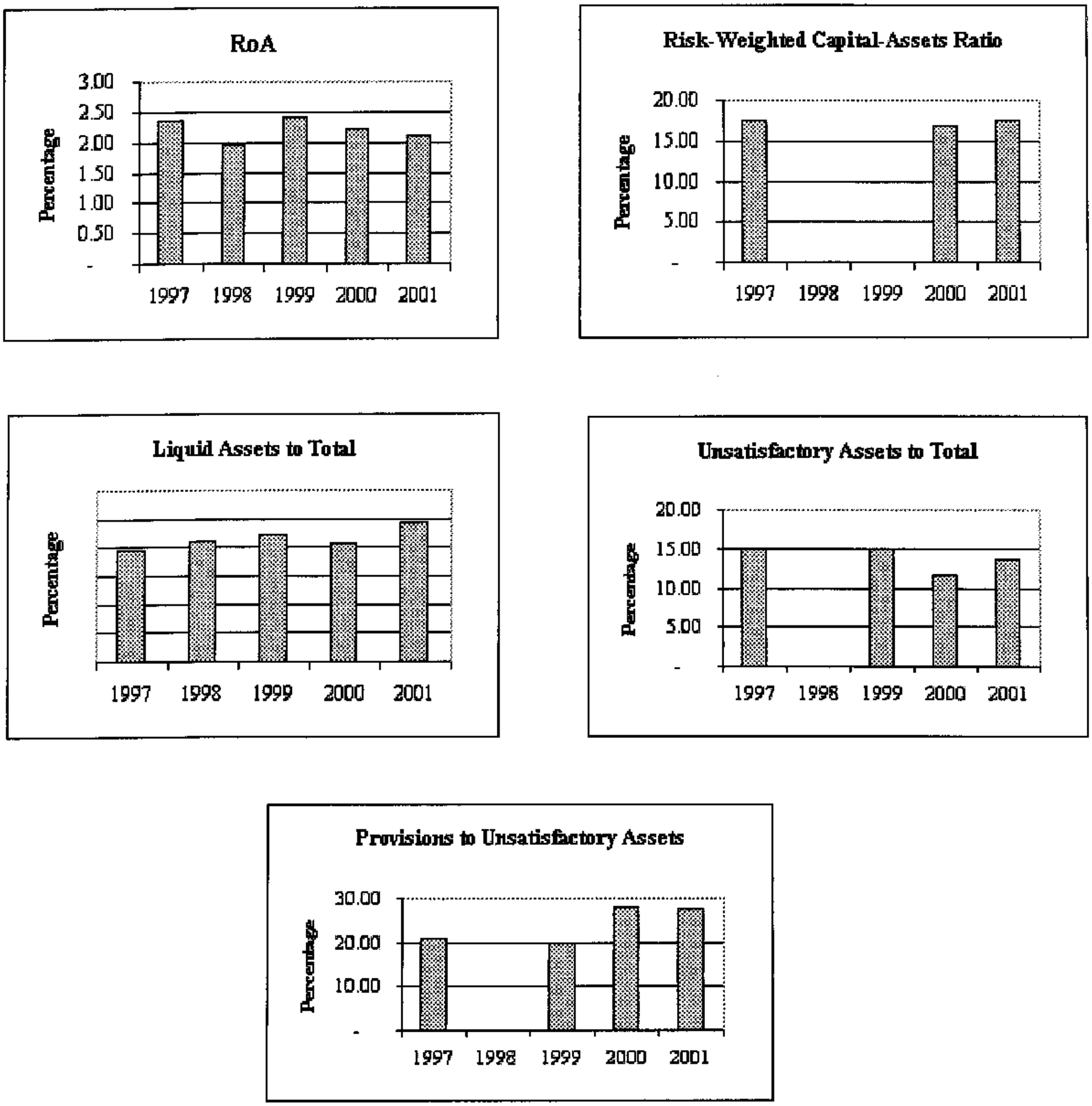


Figure 2. Foreign Banks: Trends in Financial Soundness Indicators

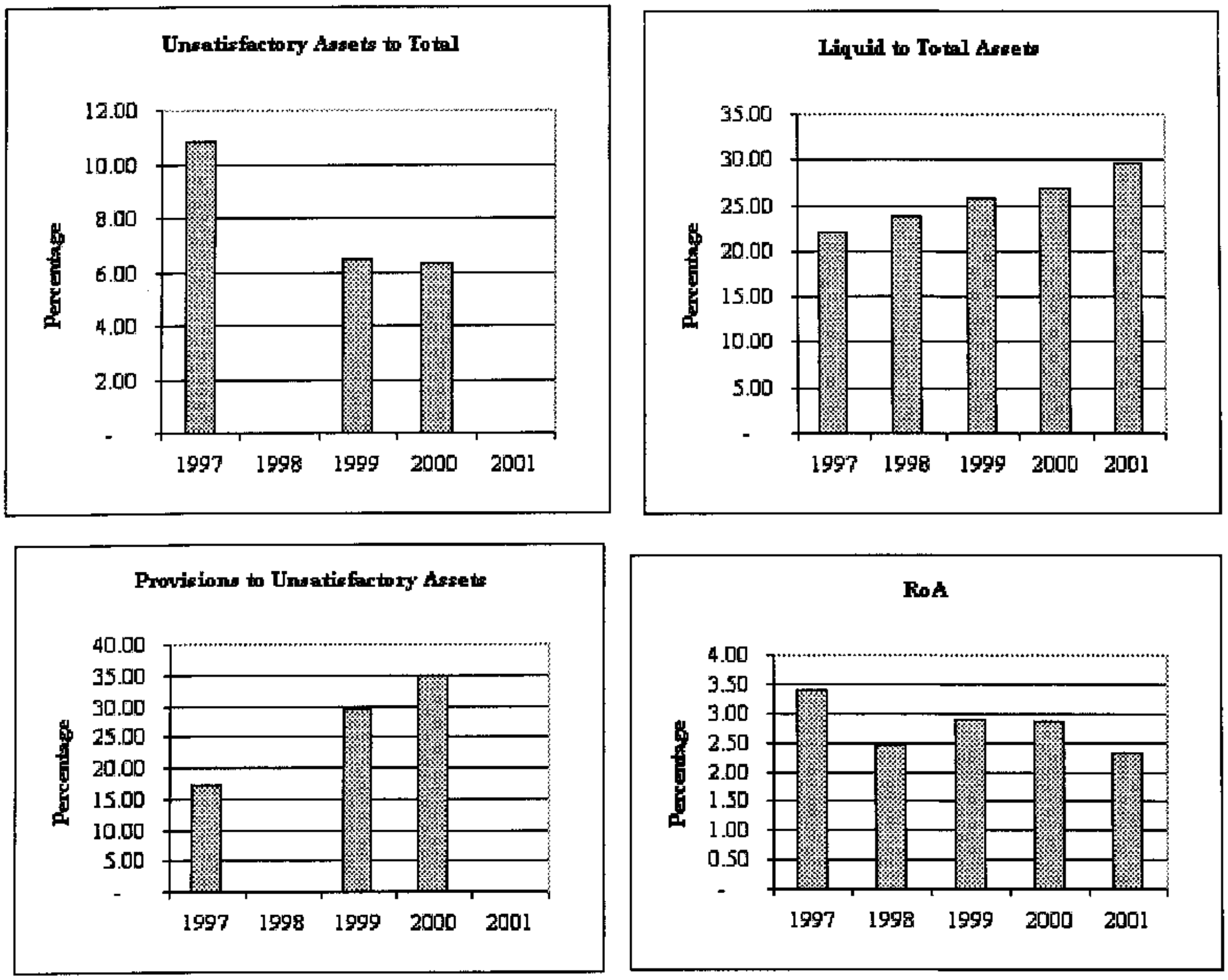
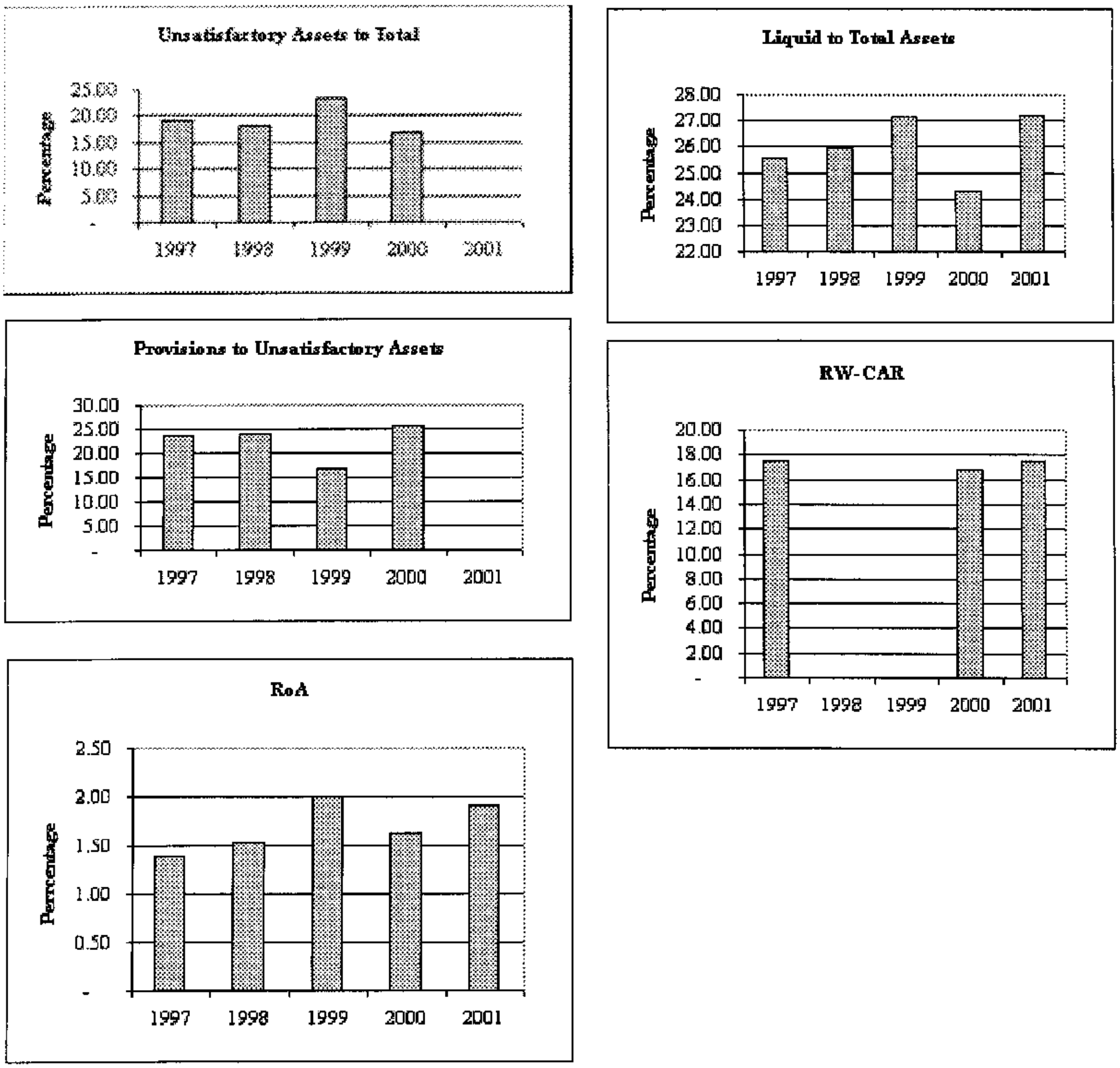


Figure 3. Indigenous Banks: Trends in Financial Soundness Indicators



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VI. FINANCIAL SECTOR VULNERABILITIES AND CHALLENGES[56]

123. The Eastern Caribbean Currency Union (ECCU) draws together eight Caribbean countries and territories under a single monetary and exchange arrangement, under the auspices of the Eastern Caribbean Central Bank (ECCB). Even though the current framework was established in 1983, this followed a long history of a currency union arrangement under a pegged exchange rate regime. The currency union arrangement has served the region well, keeping inflation in line with that of the trading partners, maintaining financial stability, and providing an environment of adequate economic growth. These benefits have come in the face of numerous shocks ranging from natural disasters, diminution of concessional financing, and loss of preferential access to commodity markets, and the impact of some structural reforms. However, the recent financial crises in Asia, Russia, and South America have highlighted the risks and potential costs of weaknesses in the financial sector, and highlighted the need for strengthening the sector. In light of this recent experience, several weaknesses emerge in the ECCU's financial sector.

124. This chapter discusses the main areas of vulnerabilities in the ECCU's financial sector. It addresses the issue of how these vulnerabilities could be reduced, hoping to sharpen the policy debate on the sustainability of the underlying institutional arrangements. Specific recommendations are also made to meet the ECCU's challenge of strengthening the financial sector. The next section discusses the financial sector challenges, highlighting the areas of weakness and including some recommendations. The section is organized around two themes; banking sector vulnerabilities, and the efficiency of the financial system. Finally, some conclusions are presented.

A. Challenges in the Period Ahead

125. The currency union arrangement has regularly been assessed as having served the region well, allowing the members to achieve a high degree of economic prosperity in a volatile environment. The ECCB has played the principal role in operating the arrangement, upholding its sustainability—particularly through a strong backing of its currency issue—and ensuring the orderly development of the financial sector. However, as discussed below, several areas of weakness remain which make the currency union arrangement vulnerable to financial crisis. The challenge for the period ahead is to put into place policies and measures that would reduce the existing vulnerabilities and strengthen the financial sector within the currency union. Expectedly, these policies would be set against a backdrop of measures to ensure a sound macroeconomic environment.

126. The most obvious source of vulnerabilities in the ECCU are the acutely weak fiscal positions in some of the member countries, resulting in a marked increase in public debt

[56] Prepared by Patrick Njoroge (WHD). This is part of a longer working paper to be completed later this year.

and also some accumulation of arrears.[57] As elaborated in the literature on the sustainability of fixed exchange rate regimes, sustained deficits represent significant macroeconomic imbalance and undermines the long-term viability of a fixed exchange rate system. Additionally, significant fiscal flexibility is needed within such a regime so as to respond adequately to domestic macroeconomic shocks, including allowing for inter-regional transfers in cases of idiosyncratic shocks within a currency union. This in turn demands a credible commitment to sustainable fiscal positions and debt levels, an issue that is taken up by Pellechio et al. (2002).

127. With regard to the financial sector, vulnerabilities exist to the extent that the financial system and particularly the banking system is not entirely sound or is weakly supervised, and to the extent that the regime does not fully conform to the rigidities of the currency broad arrangement (CBA) under which the ECCB operates. CBAs, with their fixed exchange rates and legislated reserve backing rules that limit the central bank's monetary liabilities to a ratio of its foreign currency reserves, have been used widely as a vehicle for achieving stabilization in the wake of economic crisis and for achieving longer-term stability of the currency with a view to providing an environment for adequate economic growth. However, the strict backing rule limits the issuance of unbacked monetary liabilities, which in turn limits the scope of other central bank functions. In particular, the central bank's role as a lender-of-last-resort (LOLR), its pursuit of active monetary policy and its lending to the government are all sharply constrained. At the same time, the CBA subordinates other policy objectives to the fixed exchange rate objective, and thereby depends on interest rates as the main channel for restoring macroeconomic equilibrium. Consequently, as discussed by Santiprabhob (1997), a sound banking system is essential for the efficient operation of a CBA and its long-term viability: Unsound banks weaken the transmission of interest rate signals, and given their greater willingness to take higher risks, may lead to unpredictable reaction to interest rate changes. This in turn weakens the principal mechanism for adjustment in a CBA, and therefore casts doubt on the long-term viability of the CBA. Given the limited ability of the central bank in providing support to the banking sector, greater reliance has to be placed on the other mechanisms of maintaining bank soundness. As Santiprabhob (1997) argues, this includes establishing stricter prudential regulation, explicit LOLR facilities, a deposit insurance and deposit protection, and an exit policy for banks. In addition, any rigidity that encumbers or distorts the operations of the financial system may introduce additional vulnerabilities to the currency union, and could serve as a channel for the transmission and magnification of incipient financial crisis.

128. The remainder of the paper discusses the financial sector vulnerabilities in the ECCU area, along with the policies that could minimize the vulnerabilities and enhance the

[57] The combined overall deficit for the central governments in the ECCU widened from 5½ percent of GDP in 2000 to about 7 percent of GDP in 2001, and the stock of public debt for countries in the region ranged between 42–134 percent of GDP at end-2001.

credibility of the currency arrangement. The vulnerabilities are grouped according to their source: the banking sector, and inefficiencies in the financial system.

B. Banking Sector Vulnerabilities

129. The unavailability of detailed individual bank data thwarts a robust assessment of the banking sector. Nevertheless, the aggregated banking soundness indicators that are compiled by the ECCB, point at some issues of concern but without suggesting an overall assessment that the banking sector is unsound. For the entire ECCU area, the share of nonperforming loans in total loans has averaged between 12 and 15 percent every year since 1996,[58] improving over the recent years but worsening from 12 percent in 2000 to 14 percent in 2001. Additionally, the banking system's high exposure to the public sector remains a cause for concern; credit to the public sector as a share of total loans has risen from 17½ percent in 1997 to 21½ percent in 2001, and ranged in 2001 in the individual countries from 11 percent in St. Lucia to 40 percent in St. Kitts and Nevis (Table 1). Even though these data do not suggest acute concern of an unsound banking sector, they point to some issues of concern.

130. In addition, there is a need to strengthen the ECCU's banking system in keeping with accepted best practices and thereby reduce the vulnerability to a financial crisis. To this end, the lessons from the recent global and regional financial crises are instructive; Box 1 summarizes the lessons from the Jamaican banking crisis that started in the mid-1990s. The financial system in the ECCU needs to be brought into greater conformity with the reality of the existing currency union arrangement that operates under a currency board arrangement (CBA). In common with other CBAs, the such a regime limits the flexibility of the ECCB to conduct other central bank functions—particularly the function of a lender-of-last-resort and the pursuit of an active monetary policy—and even as a weak banking system would adversely affect the CBA's credibility and consequently its effectiveness. In this regard, the issues for consideration are well described in Santiprabhob (1997). With this in mind, these issues and the related policies are discussed below from the perspective of the ECCU.

Bank Supervision

131. The Uniform Banking Act places the ECCB at the center of the supervisory and regulatory regime of all banking businesses in the ECCU, i.e., commercial banks, finance and trust companies. The regulatory framework is broadly in line with the recommendations of the Basel Core Principles on Effective Banking Supervision and adopted by the Caribbean Banking Supervisors Group, but certain deficiencies remain in spite of the ECCB's recent efforts to improve supervision.

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[58] The ECCB's prudential guidelines for commercial banks require nonperforming loans to be less than 10 percent of total assets.

Box 1. Lessons from the Jamaican Financial Crisis

During the early 1990s, the financial sector in Jamaica expanded rapidly as a result of financial liberalization, in spite of slow output growth, high inflation, and high nominal interest rates, caused by fiscal imbalances and labor market rigidities. This growth was interrupted when a number of financial institutions failed in 1995-96, and investigations revealed an inadequately regulated, largely insolvent financial sector. The cost of resolving the Jamaican financial crisis amounted to about US$2.8 billion (40 percent of GDP). It increased public sector debt, raised interest rates and prolonged the stagnation of the economy. The following are some lessons from the crisis[1]:

- Resolution of financial crises can be very costly and focus should be on their prevention. Early detection of the incipient problems reduces costs, preserves the financial system and gives more policy options.
- Financial liberalization must be preceded by adequate prudential regulation.
- The regulatory framework should create a level playing field for all types of institutions to reduce arbitrage opportunities.
- Integrated supervision of all financial institutions would minimize information asymmetries and scope for regulatory arbitrage. In the aftermath of the crisis, consolidated supervision at the regional level may be advantageous particularly given the greater financial integration that resulted from the sales of the assets of the financial sector to regional firms.
- Foreign commercial banks played a positive role in reducing the adverse impact of the crisis; hence there is some support for a judicious mix of foreign and local institutions in the financial system.
- It is desirable to have a comprehensive exit strategy in place that deals with resolution and orderly exit from the industry before crisis develop.
- The early move to give a blanket guarantee calmed the financial markets and prevented runs on the institutions but may have added to the cost by creating moral hazard.
- Efforts to reform the legal and regulatory environment and the development of deposit insurance were positive steps, which took place after the outbreak of the crisis.
- It is not possible to protect all parties, hence adequate loss-sharing arrangements between the shareholders and the entity charged with resolving the crisis would reduce the burden on the public purse.
- Resolution by a public sector entity creates moral hazard that may increase the cost. However, with assets of 60 percent of the financial sector affected, market-based solutions to resolve the crisis may not have been feasible.

1/ Adapted from "*Lessons from the Jamaican Financial Crisis*," Chapter I of International Monetary Fund (2002).

132. The first issue relates to *the licensing process* (core principles 2 to 5 of the Basel Committee), exemplified in the dichotomy between the licensing and supervisory authorities. As stipulated in the Banking Act, the minister of finance in each country is responsible for issuing bank licenses, after consultation with the ECCB. The Act requires the ECCB to conduct a detailed investigation on the applicant so as to inform its recommendation, but the minister is not required to abide by this recommendation.[59] Thus, the minister is not required to issue a license only if the applicant meets the standards applied in ongoing supervision. Similarly, the minister is not required to abide by the ECCB's recommendations on such matters as the approval of new business premises, change in the structure of the bank, revocation of a bank license, etc. While the bank licensing and supervision may be entrusted to separate authorities, a mechanism is needed for their close collaboration in the exercise of their duties and to ensure that the ECCB's recommendations, based on the clear and objective criteria in the Banking Act, are fully incorporated in the licensing decisions. In particular, this should lead to the strengthening of the ECCB's role in the approval of bank licenses, changes in the structure of a bank and decisions on the revocation of bank licenses, ensuring that no decisions are made that are in contradiction to the ECCB's recommendation.

133. The second issue of concern relates to *the formal powers of the ECCB as a supervisor* (core principle 22). The ECCB has various instruments at its disposal to propose corrective measures to a bank that fails to meet supervisory requirements or engages in unsuitable business conduct. These range from moral suasion to drawing up a memorandum of understanding with the bank, but none of which are coercive or attach penalties. The ECCB does not have formal powers to require corrective action by the bank's management, nor can it intervene in a bank or impose penalties. Thus, the instruments available to the ECCB may not be sufficient to deal expeditiously with a serious crisis and widespread contagion, as would require ensuring that banks undertake certain actions that they would not accept voluntarily. The ECCB also does not have power to close a non-viable bank that has thwarted previous attempts to resolve its problems. The ECCB's supervisory powers would need to be strengthened so as to allow it to require corrective measures to be implemented when weaknesses are not addressed promptly, including by imposing penalties. The ECCB should also be vested with sufficient powers to intervene in a weak bank, and be able to issue a cease-and-desist order.

134. Another issue relates to the constraints on the ECCB's on the *sharing of information with supervisors in other jurisdictions* (core principle 24) *or with international organizations*. The Banking Act provides for only very few cases in which the ECCB could provide information to other supervisors such as on specific bank-clients or depositors

[59] There is already a bank operating in one of the ECCB-member countries as licensed by the minister, but remains outside the ECCB's supervision. The continued operation of that bank misleads the public about how closely it is supervised, since the public believes that it operates under the supervision of the ECCB like all other banks in the region.

without their consent, which falls short of accepted international best practices. These restrictions extend to the sharing of information with international institutions such as the IMF, which severely limits access to bank-specific data and consequently hampers the robustness of any assessment of bank soundness. The current restrictions would need to be amended to allow more transparent practices that are in line with best international practices.

135. Other areas of concern include strengthening the Acts to formally provide for the issuance of prudential regulations and criteria for risk-weighted capital adequacy, requiring banks to regularly publish accurate financial statements, and allowing for consolidated supervision.

The Problem of local banks

136. A potential source of vulnerabilities in the ECCU continues to be the weak locally owned banks, and particularly the four government-controlled banks or national banks.[60] For historical reasons these banks are of systemic importance in the ECCU, in light of their large relative size,[61] greater importance for small depositors, and importance as a source of lending to the public sector. The governments' control of these banks has given rise to their close alignment with the objectives of the government, by acting as the government's lender-of-last-resort and lending to public enterprises including for non-commercial and non-viable projects, which has given rise to a concentration of their lending in the public sector. For instance, the National Bank in St. Kitts and Nevis increases its lending to the insolvent sugar company by about EC$30 million each year, totaling EC$178 million in outstanding credits at end-2001 or 21 percent of the bank's assets, all of which are guaranteed by the government. In addition, the bank's total claims on the public sector were equivalent to 60 percent of its total claims. In Dominica, the National Commercial Bank has recently been the principal source of financing for the budget. Additionally, with regard to the liabilities of the national banks, the principal depositors are the social security boards, which channel their surpluses into deposits.

137. While the prevailing state of affairs of the national banks raises several issues of concern. ***First***, the concentration of their credits in the public sector exposes them to the risk that the governments may not honor their obligations on a timely basis as a result of tight

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[60] These are the National Commercial Bank in Dominica (100 percent government owned), the St. Kitts and Nevis-Anguilla National Bank in St. Kitts and Nevis (51 percent), the National Commercial Bank in St. Vincent and the Grenadines (51 percent) and the Bank of St. Lucia (38 percent government ownership but still the largest shareholder. The Bank of St. Lucia was formerly called the National Commercial Bank in St. Lucia, until July 1, 2001, when it merged with St. Lucia Development Bank to form the East Caribbean Financial Holding Co, with Bank of St. Lucia as the primary subsidiary).

[61] These four banks account for a large share of the banking sector. The share of their loans in their respective countries, range from 25 percent in St. Lucia, 37 percent in both Dominica and St. Vincent and the Grenadines, and almost 50 percent in St. Kitts and Nevis.

public finances.[62] All governments have so far honored their debts to the domestic banking sector, in part with additional lending from the banks, earmarking current revenues, and the relief provided by external borrowing. However, some governments have been running arrears in other areas of their budgets, as a result of their weak fiscal positions; the government of Antigua and Barbuda has for several years been running arrears on external payments, estimated at 16¼ percent of GDP at end-2000, and arrears have now extended into all expenditure categories. The government of Dominica has arrears on its social security payments estimated at 4½ percent of GDP at end-2000 and has also been accumulating arrears to local suppliers. In Grenada, the government has been running arrears on its contributions and debt services payments to the national social security board (the National Insurance Scheme), estimated at about 10 percent of GDP at end-March 2002. Thus, even though all governments have so far met their repayments to domestic banks, there is the risk that the weak fiscal finances could give rise to a default on some government credits and result in deterioration in the quality of bank assets. ***Second***, the government's interests as the principal shareholder of any of these banks and a dominant borrower may conflict with its licensing and regulatory responsibilities. This could give rise to such outcomes as excessive regulatory forbearance over unsound decisions or practices by the bank, reluctance to take certain decisions that would improve banking supervision if these were not favorable to the government in its other roles. ***Third***, these banks will come under pressure when the social security boards, the principal depositors, begin to diversify their portfolio and move some of their deposits into other investments within the region and abroad.[63] These boards have in the past been barred from investing outside their own territories but there is already growing pressure to allow them to invest in safe but relatively lucrative foreign investments, in an effort to safeguard the long-term viability of these social boards.

138. The vulnerabilities arising from the close connection between the national banks and the public sector can be dealt with in two ways. More immediately, the ECCB could increase the risk-weight that banks apply to government securities and credits in the calculation of capital adequacy. The current structure applies a risk-weight of 0 percent on all domestic currency claims on the government and on government guaranteed debts, which satisfies the "minimum" recommended by the Basle Accord for such assets. However, within a setting of persistently weak budgetary finances and a central bank that does not accommodate the government's financing needs, it is arguable that a higher risk-weight should apply on all

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[62] There are antecedents of crises that are triggered by a default by the sovereign, the most notable being the Russian crisis that started in August 1998 when the central government defaulted on its domestic securities.

[63] This is reminiscent of the collapse in 1994 of the Social Bank in Estonia (representing about 20 percent of total bank assets), which was triggered by the government's decision to move its deposits elsewhere following concerns about the solvency of the bank. In the end, substantial liquidity support by the central bank, a merger with a smaller private bank, and subsequently with the fourth largest bank could not compensate for the weak management and poor quality of its loans that were at the root of its problems.

claims on the sovereign.[64] Additionally, the risk-weight that applies on claims on public enterprises but not guaranteed by the government should be raised to match the risk-weight on claims to the private sector. These changes could be carried out in the context of an immediate revision of the overall structure of the risk-weights. Less immediately, the government's control of the national bank in each of the countries should be reduced. This can be done by either selling off some of the shares that the government currently holds, selling off new shares to dilute the government's control and increase the capital base, or by a merger with some private bank, which could also be used as a strategy to strengthen management, and lending practices. It is therefore recommended that each of the governments design a time-bound plan of strengthening the practices of the national bank and its transformation into a modern bank.

139. A robust assessment of the soundness of the four national banks requires unavailable detailed information to ascertain the adequacy of capitalization, quality of assets, operating costs, liquidity situation, etc. However, some tentative conclusions can be made from an examination of some available indicators.

Lender of Last Resort Facility

140. The ECCB does not have a lender-of-last-resort (LOLR) facility through which it could extend liquidity support to a troubled but solvent bank. This is distinct from lending as part of the conduct of conventional monetary policy or through the standing facilities, such as through the ECCB's rediscount window for treasury bills.[65] Such a LOLR facility is important in mitigating the impact of a banking crisis and minimizing contagion, but its scope is considerably smaller under a CBA since the backing rule limits the available resources. Two factors may have contributed in the past to minimizing the need of a LOLR in the ECCU: **First**, the dominant presence of foreign-owned banks, which in a case of need could have obtained liquidity support from their headquarters.[66] **Second**, in the absence of extensive financial integration with the rest of the world, the banking sector in the ECCU has

[64] Following the August 1998 sovereign default in Russia, Russian banks are required to apply a risk-weight of 10 percent on claims on the central government and on domestic public sector entities. Other countries that assign non-zero weights to government assets include Ecuador (30 percent), Georgia (2 percent), Lebanon, Ukraine (100 percent), Venezuela (20 percent), and the six member countries of Central African Economic and Monetary Community (CAEMC) where risk-weights vary according to the debtor-country's adherence to defined "convergence criteria." Nicaragua will soon begin applying a 20 percent risk-weight, to be reviewed annually and increased if fiscal balances have not improved.

[65] However, the ECCB has emergency powers to intervene in the case of a bank of systemic importance in any of its territories. Still, in its credit allocation exercise, the ECCB takes into consideration that it may extend credit to a troubled institution.

[66] However, the experience in the recent Argentine crisis has demonstrated that foreign banks are not always willing to provide liquidity support to their local affiliates.

been relatively sheltered from the destabilizing effects of external shocks. However, the impact of both these factors would lessen in the period ahead, in light of the move towards greater integration with global markets, swifter capital flows, and the increasing role of local banks.

141. Given the high backing ratio the ECCB maintains compared to what is required by law and also the operating norm, theoretically the ECCB has a lot of room to extend credit to a troubled bank. However, regardless of the circumstances that would surround a specific case, it is doubtful that the ECCB would be willing to act as the LOLR at a significant level, lest this risked its own credibility and jeopardized the current regime. However, in the absence of formal rules that circumscribe the ECCB's functions as a LOLR, uncertainties remains with respect to the ECCB's reaction to a bank in distress, which weakens the ECCB's credibility of its commitment to the CBA. A formalization of a LOLR facility would therefore also be beneficial to banks in clarifying the incentive structure within which they operate.

142. Current best practices should be considered in designing the LOLR facility.[67] To this end, several issues would need to be taken into account. **First**, the LOLR should be rules-based, clarifying the requirements, terms and mechanisms, but without granting automatic access to the facility. **Second**, clearly defined limits would need to be set on the volume of the operations of this facility, so as to ensure that the credibility of the CBA is not impaired. **Third**, the design of the facility should follow best practices in limiting moral hazard in the behavior of banks. In particular, lending should be collateralized, short-term, at a penalty rate, and should have a clear exit. In addition, the borrowing bank should be subject to enhanced supervision, and consideration should be given for public disclosure of such operations. **Fourth**, if the bank in distress was also deemed to be at risk of insolvency, then the relevant Minister of Finance should also be involved in the decision to extend support.

Exit Policy for Banks

143. In addition to establishing a LOLR facility to deal with banks facing liquidity constraints, the vulnerability to a financial crisis would be further reduced by putting in place an exit policy for banks, to deal efficiently and expeditiously with the closure of an insolvent bank. Such an exit policy would be designed to minimize the risk of contagion from the failed bank to the rest of the financial system, and minimize costs to both the government and depositors.

144. The ECCB Act currently provides the ECCB with broad emergency powers to intervene in a bank, but only when the bank poses a serious risk to the financial system in a given country.[68] However, these powers do not extend to closing an institution. On the other

[67] See He (2000) for a discussion of the design of LOLR facilities, and Freixas et al. (1999) for a review of the literature on the subject.

[68] ECCB Agreement Act, Part IIA. This was introduced in 1993 as an amendment to the Act.

hand, the Banking Act provides that the Minister of Finance in whose jurisdiction a bank is operating can revoke the bank's license after recommendation from the ECCB, but only upon giving the bank notice of his intentions and awaiting a response for a minimum period of 30 days.[69] Thus, while the ECCB can move expeditiously to intervene in a weak bank of systemic importance, it cannot quickly close the bank if it judged it to be insolvent. Further, in the case of an insolvent bank that does not pose a systemic risk to a country's financial system, the ECCB does not have powers to intervene nor can the operations of such a bank be terminated quickly. Such a delay potentially increases the overall cost that will be borne by depositors and taxpayers, since any delay in closing the bank will allow further losses of the bank's assets.

145. The exit policy of banks in the ECCU is in urgent need of improvement. This should allow the ECCB to intervene on a timely basis in any bank, systemic or not, in cases of serious operational deficiencies. The policy would also allow the timely and orderly closure of an insolvent bank. It would be best if the exit policy was rules-based, allowing only minimal discretion to the ECCB and the Minister of Finance, with triggers that define the steps to be taken at every stage of the intervention. The cost for such intervention should, to the extent possible, be allocated in advance between the ECCB and the relevant government.

Deposit Insurance

146. In addition to a LOLR facility and an exit policy for banks, a well-functioning deposit insurance fund (DIF) would help to reduce the system's vulnerability to a financial crisis. A DIF discourages runs on banks by depositors by enhancing public confidence in the liquidity of bank deposits, and thereby reducing the potential of self-fulfilling bank runs and contagion in the event of a bank failure. A DIF compensates depositors in a pre-defined manner, and can therefore also provide targeted protection to small depositors by providing immediate payout of their deposits. Additionally, compared to an implicit deposit protection system, as arises when the public believes that the government will step in to pay depositors in a failed bank, a DIF is preferred in that it clarifies the authorities' responsibility while limiting discretion, which reduces the government's exposure. However, taken by itself, the introduction of a DIF may exacerbate moral hazard problems by giving banks an incentive to take excessive risks and maintain lower levels of capital, as well reduce the quality of supervision by depositors and other creditors and thereby weakening market discipline. A DIF should therefore be seen as just one facet of the financial safety net and within the context of the supervision and regulatory framework, all of which aim to minimize agency problems maximize social benefits.

147. **There is currently no explicit system of deposit insurance in the ECCU area.** However, it is quite likely that the public perceives an implicit government guarantee on deposits, as was the case during the 1996-97 banking crisis in Jamaica. While a major financial

[69] Banking Act, Section 10.

crisis has not occurred in the ECCU area, increased global integration has increased the banking system's vulnerability. Along with the need to align the safety net and structure of incentives with the supervision and regulatory regime, this provides grounds for the introduction of a DIF. Issues that would need to be addressed in the design of such a DIF include, the disparity of ownership structures of banks in the region which generates different regimes of oversight by owners and depositors, disparity in the strength of individual banks, the need to improve the supervision and regulatory regime, etc. As advocated by the FSF, such an initiative should start with an assessment of the financial sector and its context, which could be done before or in the context of conducting the World Bank/IMF assisted FSAP for the region.

C. Enhancing the Efficiency of the Financial System

148. There is ample evidence of existing inefficiencies in the ECCU's financial sector. This evidence includes the uneven interest rates in the banking system across the ECCU area (Table 2), their rigidity and lack of responsiveness to liquidity conditions, the large spreads, the mandatory floor on savings rates, and a non-banking sector that has hardly innovated its operations and services. The inefficiencies evidenced by the interest rate structure derive in part from bank-specific difficulties, such as high operating costs and the impact of nonperforming loans.[70] Additionally, anecdotal evidence suggests that lenders (and especially banks) utilize the monopolistic power afforded by information asymmetries with respect to their borrowers; lending is based mainly on historical relationships and on collateral lending rather than on robust credit analysis, which provides an informational advantage to the repeated lender and hinders borrowers from switching lenders.[71] Lending institutions may also want to have large liquidity cushions as a protection against potential risks, in the absence of other mechanisms such as a LOLR facility and a DIF. Nevertheless, these inefficiencies represent a cost to the intermediation process, which could be reduced by implementing policies to strengthen the overall financial sector and reducing the barriers to capital movement so as to facilitate regional integration.

Strengthening of the Financial Sector

149. **The implementation of the policies to strengthen the banking sector as elaborated in the previous section, would contribute substantially in reducing the inefficiencies that exist in the banking sector.** In addition, improvements in the lending practices should be supported, aimed at fostering a greater reliance on credit assessments and cash flow analysis while reducing the importance of collateral lending and historical

[70] Randall (1998) identifies high operational costs as a key determinant of the large interest rate spreads in the ECCU area.

[71] The problematic nature of collateral lending was exemplified in the Asian financial crisis, as discussed in Lindgren et al. (1999), pp. 14-15.

relationships. However, while the ECCB can encourage such improvements, fostering such developments necessarily falls beyond its mandate, and may also in turn require improving both the accounting and transparency standards for companies and financial institutions in the ECCU area, to match best international practices.

150. **With regard to the non-bank financial institutions, the most urgent task is the strengthening of the weak and irregular supervision of credit unions, insurance companies, development banks and other financial institutions.** In addition to creating a potential for a crisis in the non-banking sector, the weak supervision increases the potential for regulatory arbitrage with the banking sector, where non-banking institutions create bank-like products that compete effectively against banks, and encourages the development of financial conglomerates that aim to take advantage of their weakly supervised parts. Thus, a high priority should be assigned to developing a regional framework for supervisory activities for non-bank financial institutions, to bring the practices in the non-banking sector in line with best international practices and provide the same high quality of supervision as in the banking sector.

Capital Controls

151. The existing regime of capital controls in the ECCU is summarized in Table 3. These controls are administered in each country by the ministry of finance, and can be characterized as follows: Capital account transactions are *de jure* fairly liberal, largely requiring prior approval for large outward transactions and some restrictions on lending to nonresidents; in practice the controls are administered even more liberally; the controls in any country do not discriminate between transactions with residents of other ECCU countries and residents of countries outside the ECCU; and the controls on transactions with residents of countries outside the region are uneven across the ECCU countries. However, some restrictions also apply on current account transactions, principally in the form of an approval requirement for invisible transactions above a certain limit,[72] and except for Antigua and Barbuda and also Anguilla, surrender requirements apply though these are not enforced.

152. At the outset, the existing regime of capital controls could be brought in line with current practice, and thereby make their administration more predictable. However, the regime could be improved further in three ways: first, capital movements between the ECCU should be fully liberalized, given their close connectedness—through a common regime of monetary policy, pooling their foreign exchange reserves at the ECCB, a relatively integrated banking system, etc.—and that the control of capital flows within the ECCU area cannot be justified on the grounds of safeguarding macroeconomic stability. Whereas these intra-ECCU controls may have arisen because of difficulties in distinguishing capital flows that originate (or terminate) within and outside the ECCU area, the resultant market segmentation gives rise

[72] These restrictions do not formally constitute exchange restrictions under Fund jurisdiction, since *bona fide* requests above these limits are approved.

to economic costs and hampers the development of the financial sector. The elimination of capital controls within the ECCU will facilitate greater financial integration in the region and contribute to enhancing of the financial system's efficiency. Second, given the connectedness of the ECCU members, an uneven regime of capital controls across ECCU member for flows outside the region cannot be justified except by historical circumstances, and from a point of view of safeguarding macroeconomic stability within the region, the effective regime is the most liberal. The current regime of controls could thus be improved by introducing a uniform and fairly liberal regime for capital flows with non-ECCU territories. This would in turn strengthen the credibility of the existing CBA and facilitate greater integration with the rest of the world. Finally, in line with the suggested consolidation of the capital controls, some cost saving could be obtained if the responsibility for their administration and enforcement was centralized within the ECCB, which is also better placed to carry out an effective oversight especially in the extreme cases when the stability of the financial system is in jeopardy.

D. Conclusions

153. Despite the remarkable stability of the financial sector in the ECCU even in the face of financial crises in other parts of the world, some areas of weakness remain that render the sector vulnerable to a crisis that could jeopardize the existing currency arrangement. With regard to the banking system, available data do not indicate an unsound aggregate banking sector but there is particular concern about the national banks. The financial system in the ECCU also needs to be brought into greater conformity with the reality of the existing currency union arrangement operating under a currency board arrangement (CBA). Other banking sector vulnerabilities are mainly structural in nature, and include weaknesses in supervision and the regulatory regime, the absence of a LOLR facility and a DIF, and the lack of a defined exit policy for banks. Additionally, there are significant inefficiencies and distortions in the overall financial system that could serve as a channel for the transmission and magnification of incipient financial crisis. These include those emanating from a weak and irregular supervision regime for nonbank financial institutions, and the existing regime of capital controls.

154. Looking ahead, it is critical that these weaknesses and related vulnerabilities are addressed so that a robust financial system may emerge, which is essential for the preservation of the current exchange rate and monetary regime in ECCU. Additionally a strengthened financial sector would more adequately contend with the ongoing transformation of these economies, including the risks that are borne by a closer integration to the global financial markets and trading structures. The paper has described specific measures, in line with the accepted best practices, that would reduce the vulnerabilities in the financial system. Measures to improve supervision and regulatory environment of banks are elaborated. Other measures include those that would address the weaknesses of the national banks, the creation of a lender-of-last-resort facility and of a deposit insurance fund, improving the regulatory regimes and the supervision of non-bank financial institutions, and enhancing the accounting and transparency practices of businesses and financial institutions.

155. **Prompt action to address the existing vulnerabilities should be emphasized if the current arrangements of ECCU are not to be jeopardized. To this end, several tasks that fall within the current powers the ECCB and the ministries of finance can be carried out immediately,** while other policies may have to await a consensus among the various governments. Still, it is urgent that all policies that are needed to strengthen the financial sector be implemented as quickly, in light of the paramount importance of a healthy financial system and particularly the banking sector. It is hoped that this paper can help sharpen the policy debate on these issues, and more generally, on the sustainability of the ECCU's institutional arrangements. Finally, we note that a particularly opportune focal point for the debate on financial sector vulnerabilities would be the region's assessment under the IMF and World Bank's Financial Sector Assessment Program (FSAP), expected in the second half of 2003. A detailed roadmap of the policies that remain to be implemented could be drawn up at that stage.

Table 1. Commercial Bank Credit to the Public Sector 1/
(end of period; as a percentage of total loans)

	1996	1997	1998	1999	2000	2001	March 2002	June 2002
Antigua and Barbuda	18.5	17.9	20.1	22.2	21.9	20.6	20.5	19.5
Dominica	21.5	22.0	21.2	22.0	22.2	23.3	22.8	22.5
Grenada	12.5	13.7	13.2	10.3	12.6	15.6	17.0	17.6
St. Kitts and Nevis	33.1	29.0	32.7	35.1	39.0	41.7	41.6	43.9
St. Lucia	9.8	9.9	11.1	10.6	11.5	11.0	11.1	11.6
St. Vincent and the Grenadines	19.4	17.9	17.1	17.1	18.6	20.0	22.0	26.4
All six countries	**18.1**	**17.3**	**18.5**	**18.9**	**20.4**	**21.1**	**21.4**	**22.3**

Source: Calculated from data provided by the ECCB.

1/ Bank sector claims on the central government, local governments and public enterprises as a percentage of all claims.

Table 2. ECCU: Weighted Commercial Bank Interest Rates

(In percent per annum)

	1996	1997	1998	1999	2000	2001
ECCU Area						
Weighted deposit rate	4.1	4.3	4.3	4.3	4.5	4.3
Weighted loan rate	11.8	11.9	11.6	12.0	11.9	11.5
Weighted reducing balance rate	11.1	11.3	11.0	11.6	11.4	11.0
Weighted add-on loan rate	15.2	15.5	15.2	15.1	14.9	13.9
Spread between loan and deposit rate	7.6	7.6	7.3	7.7	7.4	7.2
Anguilla						
Weighted deposit rate	3.7	3.8	3.7	3.8	3.8	3.3
Weighted loan rate	11.8	11.3	11.2	11.3	11.4	10.6
Weighted reducing balance rate	11.1	10.8	10.6	10.7	10.7	10.2
Weighted add-on loan rate	16.0	14.0	14.2	14.2	15.8	13.3
Spread between loan and deposit rate	8.1	7.5	7.5	7.5	7.6	7.3
Antigua and Barbuda						
Weighted deposit rate	4.2	4.5	4.4	4.3	5.0	4.4
Weighted loan rate	12.3	12.1	12.2	12.2	12.2	11.5
Weighted reducing balance rate	11.7	11.7	11.7	11.8	11.9	11.2
Weighted add-on loan rate	14.4	14.5	14.1	13.5	13.6	12.7
Spread between loan and deposit rate	8.1	7.6	7.8	7.9	7.2	7.1
Dominica						
Weighted deposit rate	4.3	4.3	4.0	3.8	3.7	4.0
Weighted loan rate	11.5	11.0	11.2	11.7	10.6	11.0
Weighted reducing balance rate	11.0	10.5	10.5	11.0	10.2	10.4
Weighted add-on loan rate	16.5	16.6	17.2	17.3	16.1	17.3
Spread between loan and deposit rate	7.2	6.7	7.2	7.9	6.9	7.0
Grenada						
Weighted deposit rate	3.8	4.0	4.3	4.3	4.2	4.2
Weighted loan rate	10.1	11.5	11.8	11.7	11.5	10.1
Weighted reducing balance rate	9.7	11.4	11.7	11.6	11.2	9.4
Weighted add-on loan rate	13.7	13.1	13.2	13.5	13.4	11.7
Spread between loan and deposit rate	6.3	7.5	7.6	7.3	7.3	5.9
Montserrat						
Weighted deposit rate	3.3	2.5	2.8	3.3	3.5	3.4
Weighted loan rate	12.2	12.4	12.1	11.4	11.4	11.6
Weighted reducing balance rate	11.9	12.1	11.7	11.0	11.4	11.3
Weighted add-on loan rate	15.2	16.4	15.2	14.4	11.8	13.5
Spread between loan and deposit rate	8.9	9.9	9.3	8.2	8.0	8.2
St. Kitts and Nevis						
Weighted deposit rate	4.0	4.1	4.2	4.3	4.3	4.2
Weighted loan rate	11.0	11.3	11.3	11.2	11.1	11.1
Weighted reducing balance rate	10.7	10.6	10.7	10.7	10.6	10.7
Weighted add-on loan rate	12.1	14.9	15.4	14.9	14.5	14.0
Spread between loan and deposit rate	7.0	7.2	7.1	6.9	6.8	7.0
St. Lucia						
Weighted deposit rate	4.6	4.6	4.8	4.8	4.9	4.8
Weighted loan rate	12.9	12.8	11.2	13.1	13.1	12.8
Weighted reducing balance rate	11.8	11.7	10.0	12.3	12.3	12.1
Weighted add-on loan rate	18.7	17.5	16.7	16.9	16.7	17.5
Spread between loan and deposit rate	8.4	8.1	6.5	8.3	8.1	8.0
St. Vincent and the Grenadines						
Weighted deposit rate	4.1	4.2	4.4	4.6	4.5	4.5
Weighted loan rate	11.2	11.4	11.4	11.6	11.5	11.9
Weighted reducing balance rate	10.6	10.8	11.3	11.4	11.4	11.5
Weighted add-on loan rate	14.5	14.4	14.5	16.5	15.5	18.1
Spread between loan and deposit rate	7.1	7.2	7.0	7.0	7.0	7.3

Source: Eastern Caribbean Central Bank.

1/ Annual averages shown are based on end of quarter rates.

Table 3. ECCU: Controls on Capital and Other Transactions

	Invisible Transactions and Current Transfers	Capital Transactions
1. Anguilla	There are no restrictions, except for a 2 percent levy on foreign exchange purchases from a commercial bank.	There are no restrictions, except for a 2 percent levy on foreign exchange purchases from a commercial bank.
2. Antigua and Barbuda	Payments for invisibles exceeding EC$250,000 requires prior approval for certain categories, e.g. travel, medical and studies abroad. There are no surrender requirements.	The Financial Secretary may phase large outward transfers of direct investment over time. Approval is required for lending to nonresidents.
3. Dominica	Prior approval is required to buy foreign exchange of more than EC$250,000, except for some categories such as pensions, family maintenance funds, subscriptions. The surrender of foreign exchange from invisible transactions is mandatory.	All outward capital transfers in excess of EC$250,000 require prior approval. Approval is required for lending to nonresidents. Also, lending locally in foreign currency is generally not permitted.
4. Grenada	Payments for invisibles exceeding EC$250,000 requires prior approval, except subscriptions and membership fees. The surrender of foreign exchange from invisible transactions is mandatory.	All outward capital transfers in excess of EC$250,000 require prior approval. Local currency lending to nonresidents requires approval but is generally not permitted.
5. Montserrat	Prior approval is required to buy foreign exchange of more than EC$250,000. Payments for invisibles require prior approval. There is a 1.75 percent levy on the purchase of foreign exchange. The surrender of foreign exchange from exports is mandatory.	All outward capital flows in excess of EC$250,000 require prior approval. There is a 1.75 percent levy on the purchase of foreign exchange. Prior approval is required to open a foreign currency account.
6. St. Kitts and Nevis	Payments for invisibles exceeding EC$250,000 requires prior approval. The surrender of foreign exchange from invisible transactions is required.	Outward capital transactions exceeding EC$250,000 require prior approval. Approval is required for lending to nonresidents. Also, lending locally in foreign exchange requires prior approval.
7. St. Lucia	Payments for invisibles exceeding EC$250,000 requires prior approval. The surrender of foreign exchange from invisible transactions exceeding EC$250,000 is required.	Outward capital transactions exceeding EC$250,000 require prior approval. Lending locally in foreign currency is conducted only in U.S. dollars.
8. St. Vincent and the Grenadines	Except for payments for invisibles related to authorize imports, other payments for invisibles exceeding EC$250,000 requires prior approval. The surrender of foreign exchange from invisible transactions is required.	Outward capital transactions exceeding EC$250,000 require prior approval. Lending locally in foreign currency is conducted only in U.S. dollars.

Sources: IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions* (various years); and official websites of the authorities in Montserrat and Anguilla.

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VII. Social Security Issues in the Caribbean[73]

A. Introduction

156. Population aging is a global phenomenon. A confluence of increasing life spans and declining fertility rates is expected to swell elderly dependency ratios worldwide. Most developed countries have already started to experience the first signs of aging, while the developing countries are still enjoying the benefits of a relatively young population and workforce. However, in a few decades from now, the situation of the developing nations will dramatically change, due to a much more rapid aging process than in the developed world. The countries of the Caribbean are no exception. As shown in Figure 1, the elderly dependency ratio in the countries of the Eastern Caribbean Currency Union (ECCU),[74] defined as the number of individuals aged 65 and older divided by the total number of working-age individuals (16-64 years old), is projected to *quadruple* from about 0.09 to about 0.36 in only thirty five years starting in 2015.[75] In contrast, the same ratio for the countries of Western Europe, Japan, and North America will have only doubled over a period of fifty years between 2000-2050 (when projections end).

157. Increasing dependency rates are expected to put pressures on national saving rates, government budgets, and public pension systems, as fewer workers will have to support a larger number of retirees. For the ECCU countries, the projected rapid aging calls for immediate action, although there are still almost two decades before the so-called age-quake starts to unfold. A quick policy response would avoid disruptively large last-minute policy changes that would be needed to shore up the public social security systems in the ECCU. Despite having accumulated significant surpluses, unless they are reformed, the systems will quickly run out of resources soon after the currently large labor force reaches retirement. Future prospects look even bleaker when one takes into account a fiscal situation that in some countries is already unsustainable or is heading in that direction.

158. The purposes of this chapter are to shed light on the challenges facing the social security systems of the ECCU countries and to recommend policy actions that may help to alleviate the aging crisis projected to start around 2020. The main theses of the chapter are: (1) the projected population dynamics in the ECCU are expected to render the current social security arrangements insolvent and to exacerbate their already critical fiscal position; (2) besides its direct negative effect on pensions and government debt, aging will have spillover effects into the financial sector, due to the close link between public pensions, the government, and commercial banks; and (3) immediate action is required to prevent the potentially disastrous consequences of the aging problem, including: structural reform of the national insurance schemes, a revamping of

[73] This section is prepared by Wendell Samuel and Delia Velculescu (both WHD) and is part of a larger analytical paper to be completed later in the year.

[74] These are: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia and St. Vincent and the Grenadines; and the UK territories of Anguilla and Montserrat. These countries are also members of the Organization of Eastern Caribbean States (OECS) and the Caribbean Community (CARICOM).

[75] The data is from the U.S. Census Bureau, International Data Base, and can be found at http://jolis.worldbankimflib.org/Pathfinders/Sectors/HNP/hnpstats.htm

the investment strategy of the pension funds, a policy of continuing accumulation of reserves, and restructuring government pensions.

159. This chapter is structured as follows: Section B describes the social security systems in the ECCU, delineating the common elements and main differences across countries. The main issues and problems with the current arrangements stemming from population aging are analyzed in Section C. In Section D, we outline a few policy recommendations. Section E concludes the discussion.

B. Characteristics of Public Social Security Systems in the ECCU

160. The public social security systems in the ECCU are composed of a National Insurance System (henceforth named the NIS) and a system of government pensions.[76] The NIS is the major component of public social security and is structured as a partially funded, defined-benefit system financed by payroll taxes. In the majority of ECCU countries, public sector employees also receive government pensions in addition to NIS benefits. Government pensions, however, are unfunded and non-contributory and constitute a contingent liability for the government.

161. Given that the ECCU countries are bound to face a severe demographic challenge in the next decades, a careful analysis of the structure of their national insurance systems is warranted. Identification of structural risks and weaknesses early enough could permit these countries to find adequate solutions and adopt them in a more gradual and hence less socially disruptive manner. The rest of this section will describe, in some detail, the structure of pension systems in the ECCU. Based on this discussion, the next sections will isolate the main problems with the systems and will propose solutions for reform.

C. The Basic Structure of the NIS

162. The National Insurance Systems (NIS) in the ECCU were initially set up in the mid 1960's, following the British social insurance model. As such, they share many common elements. All started up as Provident Funds, which were later expanded into public social insurance systems. At present, they operate as partially funded defined-benefit plans financed by payroll taxes. This arrangement implies that the social security administration collects payroll taxes from employees and employers and uses the proceeds to provide a given level of benefits to those covered under the system. Since the ECCU economies are predominantly young, the taxes collected exceed the current claims on benefits. The remaining contributions are saved in the systems' investment funds.[77] These funds constitute a cushion against possible shocks to the systems, but as this chapter argues, they will prove insufficient to guarantee the solvency of the NIS when the population starts to age.

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[76] Social safety nets are also available in the ECCU. Thy are mean tested and age-independent, and constitute only a small fraction of total public benefits.

[77] In contrast, a pure unfunded pay-as-you-go system would simply adjust taxes to match claims on benefits at each point in time. This system is rarely seen in practice, as frequent adjustments in tax rates are socially undesirable.

163. The NIS is financed by payroll taxes paid by both employees and employers. Total contributions to the systems range from 6.1 percent in St. Vincent and the Grenadines to 11 percent in St. Kitts and Nevis, with the majority of contributions being around 8-11 percent, as Table 1 shows. Furthermore, all countries have ceilings on covered earnings. These ceilings facilitate intra-generational redistribution from the higher to lower income groups, as the benefits of low earners represent a higher fraction of total earnings compared to the benefits of the high earners. Essentially, the lower the ceiling, the higher the degree of redistribution under the system[78]. As shown in Table 1, there are significant differences among the NIS of the ECCU, with countries such as St. Vincent and the Grenadines, St. Lucia and Grenada being relatively more progressive compared to Dominica and St. Kitts and Nevis.[79]

164. Social insurance taxes are used to provide benefits, which are divided into three broad categories: long-term benefits, including old-age pensions, disability and survivorship benefits, short-term benefits, such as sickness and maternity, and work injury benefits. The benefit structure of the NIS, summarized in Tables 2 and 3, is widely similar across the ECCU. Two important common elements, low legal retirement ages and low required contributions, facilitate the redistribution of resources inter-generationally.[80] Despite the uniformity across countries with respect to benefit levels, there is large variation in the maximum old-age benefit-to-contribution rate, which measures the relative generosity of pension systems. According to this indicator, the NIS systems in Grenada and St. Kitts and Nevis are less generous than those in the other ECCU countries, with the systems in St. Vincent and the Grenadines and Dominica emerging as the most generous (Figure 2).

165. **Rather than operating on a strict pay-as-you-go basis, the NIS is partially capitalized.** This arrangement allows the systems to save part of the resources that are not used to pay out benefits. Table 4 summarizes the historical evolution of the revenues, expenditures, balances and reserves of the NIS from 1980 to 2001. As shown, NIS balances as percentage of GDP have been roughly stable over time at around 2 percent of GDP, with two notable exceptions. The first exception is Dominica, where despite relatively similar increases in both contributions and benefit expenditures, NIS balances doubled in recent years. They now stand at above 4 percent of GDP, mainly due to increases in interest and other revenues, which more than compensated for the increase in administrative expenses. The second exception is St. Kitts and Nevis, where higher than average contributions relative to GDP led to higher balances, in the range of 4 to 6 percent of GDP.

166. **Since the NIS systems have consistently run positive balances over time, they have accumulated substantial investment funds.** As illustrated in Table 4, reserves as a percentage of GDP have doubled from 1980 to 2000 in most countries except Grenada and St

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[78] Assuming no limit or earnings or contributions.

[79] However, the systems may be less progressive than this suggests, because high earners tend to live longer and thus collect more benefits, as suggested by a study with U.S. data conducted by Panis and Lillard (1995).

[80] At the same time, low retirement ages, together with ceilings on old age benefits discourage extended participation in the labor force by elderly individuals.

Lucia, where they have actually quadrupled. In recent years, reserves have stood at around 20 to 30 percent of GDP in all countries except in St. Kitts and Nevis, where they have been as high as almost 50 percent of GDP. The reserve-expenditure ratio measures how many years of payments the funds could make if no future contributions or interest were received and no additional benefits were awarded. As shown in Figure 4, this ratio is in the range of 10 to 20. St. Vincent and the Grenadines has the highest reserves in the region, which could cover about 22 years of benefit payments with no additional revenues. At the other extreme, Dominica could only pay for 3.5 years if no other income were received.

167. Despite their centralized structure, the NIS systems in the ECCU entail very high administrative costs, ranging from 0.3 to 0.7 percent of GDP, except in Dominica, where they are at 1.5 percent of GDP. An alternative, and perhaps more useful, measure of administrative expenses is their ratio to total contributions. This ratio, as shown in Figure 3, ranges from about 10 to 20 percent across the ECCU region. These unusually high numbers can be partially justified by the large scale of NIS operations, which include administration of income and other individual taxes not related to social security. However, major inefficiencies in the system exist and need to be corrected.

168. Since capital markets in the ECCU countries are relatively shallow, the investment funds of the NIS are concentrated on a narrow range of investments, including mainly fixed deposits, treasury bills, debentures, and cash. Figure 5 shows the investment portfolios of each country's NIS for 2001, broken down into their main components. The average share of investments in deposits at banks and other financial institutions is the largest component, at around 42 percent of total assets. It ranges from 15 percent in Dominica to 68 percent in St. Vincent and the Grenadines. The next most prominent average share is comprised of other assets (including other local and non-local assets), at about 32 percent. Average regional foreign investments are at 11.6 percent, but excluding Montserrat, whose share of investments in foreign assets is at 53.3 percent, the average for the region falls to 5.7 percent. As will be discussed later in the chapter, the NIS could benefit from more diversified investment portfolios.

D. Government Pensions

169. In addition to NIS benefits, public employees in many ECCU countries also receive government pensions.[81] These **non-contributory, defined-benefit pension schemes** are restricted to established government workers, who are entitled to pension at retirement or after a specified number of years of service. At retirement (usually 55 but with an option to take early retirement at 50), government employees can opt for a gratuity (lump sum) based on years of service, or a reduced gratuity along with a pension for the rest of their lives. Most employees opt for the reduced gratuity for which different combinations of gratuity and pensions can be chosen.

170. Pension payments are a small but growing part of government expenditure, but they have the potential to mushroom as the population ages. Pension payments are paid out of the

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[81] Grenada, Dominica, and St. Lucia offer either NIS benefits or government pensions to public employees.

government-consolidated fund on a pay-as-go basis, since they are non-contributory. In 2001, the total pension payments by the ECCU countries amounted to around 2 percent of GDP. Some governments have tried to modify the pension arrangements in order to reduce their impact on general resources. The Government of Grenada has integrated the government pensions into the National Insurance Scheme by mandating that all workers who joined the service after 1983 would only be covered by the NIS, while existing workers at that time would continue under the old pension arrangements. A similar attempt was made by St. Vincent and the Grenadines in 1996, but the government reverted to the old arrangements in 2000. Government non-contributory pensions in Dominica only cover the period between the government retirement age (55) and the age at which they begin to receive social security pensions (60).

E. Issues with the Current Public Social Security Arrangements in the ECCU

171. The current public social security arrangements in the ECCU face significant challenges stemming from population aging. Although demographic trends are similar among the ECCU countries, the levels and rates of aging vary across the region. As Table 5 shows, by 2050, elderly dependency ratios are projected to range from 26.9 percent in St. Kitts and Nevis, to 56.5 percent in St. Vincent and the Grenadines. The most rapid population aging is projected to occur in Antigua and Barbuda and St. Vincent and the Grenadines, which will experience a *six-fold* increase in their elderly dependency ratios from around 2010 to their peak in 2050. At the other extreme, St. Kitts and Nevis is expecting a more 'modest' increase of about 2.5 fold in its dependency ratio during 2015-2050.

172. **Unless they are reformed, the NIS will be threatened by bankruptcy, as pension liabilities will exceed contributions.** Increases of 200 to 600 percent in the number of elderly individuals relative to the working–age population will swell expenditures relative to the revenues of public social security systems. Although the schemes have accumulated substantial investment funds, these will prove insufficient when the currently large labor force starts to draw the promised pension benefits. The countries with larger current reserves or expecting a more gradual increase in their elderly dependency ratios are at a slight advantage to the rest, in that they have more time until their National Insurance Systems will become bankrupt.

173. According to official projections, under current arrangements, the NIS of both St. Kitts and Nevis and St. Vincent and the Grenadines are expected to be able to meet expenditure requirements using contribution and interest revenues until about 2020. From 2020 onwards, they will need to draw on their accumulated reserves to pay off pension benefits that come due. In approximately 10 years, reserves are projected to be exhausted, and the long-term branches of the NIS will be bankrupt. Since the LTB concentrates more than 70 percent of the resources of the NIS, bankruptcy of the LTB essentially implies the likely bankruptcy of the whole system.[82]

174. It is interesting to note that while the end outcome is projected to be roughly the same in St. Kitts and Nevis and in St. Vincent and the Grenadines, the reasons behind it are quite

[82] Varying the assumptions that underlie the projections could worsen the projections presented above. A lower real rate of return and higher administrative expenses would precipitate the bankruptcy of the NIS.

different. On one hand, St. Kitts and Nevis is able to stay afloat for another three decades due to the more favorable demographics it will experience. St. Vincent, on the other hand, will manage to function under the current pension arrangements for another thirty years due to the returns generated by its high level of accumulated reserves.

175. In contrast to the two cases described above, a much more worrisome situation is projected for Dominica. The reserve to expenditure ratio of the Dominican NIS is a meager 3.5, currently the lowest in the region. By 2011, its LTB is expected to have to dip into reserves to finance benefits. Consequently, reserves will be quickly exhausted by 2023. A lower growth rate of the economy and non-recovery of contributions in arrears are shown to lead to an even faster pace of reserve depletion and an earlier bankruptcy of the system.

176. Actuarial data is not available for the rest of the ECCU countries. However, similar to the three case studies presented above, the NIS of these countries are likely be bankrupt around 2020-2030.[83] Unless their national insurance systems are reformed soon, drastic measures will need to be taken to bail out the systems later on, as will be explained in the next section.

177. **The portfolios of the ECCU NIS schemes have not generated a large enough return to ensure the viability of the schemes** (sometimes with long periods of negative real returns), as a result of insufficient diversification and ineffective portfolio management. Diversifying into foreign assets and strengthening their investment profile can improve their performance.

178. The ECCU NIS have a total portfolio of EC$1.5 billion, or approximately 20 percent of GDP. Such a significant amount of resources needs to be managed appropriately so as to generate returns to pay pensions when surpluses dry out. However, over the period 1980 to 1998, the NIS achieved average real yields of around 1 percent, which are substantially lower than the average real growth rate for the period (5 percent), suggesting significant under-performance (Table 6 from Nicholls 2002).[84] St. Lucia achieved average real yields of around 3 percent over the same period, while Antigua and Barbuda experienced negative real yields.[85] Furthermore, in all countries except St. Lucia, the variability of the yield was greater than the mean, which could indicate excessive risk in the portfolios.

179. Some of the reasons for the low yields on the NIS investment portfolios are: the skewness of the portfolio to deposits in commercial banks and government paper, concentration of the portfolio in domestic assets, and social lending. A shortage of high-grade domestic securities has caused the portfolios of the NIS to be highly skewed towards deposits in

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[83] We are currently working on an analytical model, which would allow us to forecast the evolution of NIS balances and reserves for all ECCU countries. This analysis will be available in the final form of this paper later this year.

[84] An analysis of the sub-periods shows gradual improvement in performance of most of the NIS with the exception of Antigua and Barbuda. The average yield for the ECCU was close to zero during the period 1980-1985. However, Anguilla, Grenada, and St. Kitts and Nevis moved from around 1 to 3 percent.

[85] Real yields for Montserrat are much higher, but the data is incomparable due to data unavailability over the entire period.

commercial banks and domestic government paper. These instruments have generally been remunerated at less than market rates.

180. In addition, among the category other local investments (14 percent in 2001) are land and buildings and other social lending programs, which are not remunerated at market rates. It can be argued that as custodians of such large amounts of resources, the NIS should have some social responsibilities. However, the lower returns on the social activities need to be offset by higher earnings in the other portfolio categories.

181. **While there is no formal legislation restricting investment in foreign securities, the unwritten policy is that the savings of the NIS should be invested at home.**[86] Some of the reasons for investing domestically include the purported higher returns in capital scarce islands, the need to develop capital markets at home, exchange rate risk in foreign investment, and lower returns in developed countries due to their age structure. While, theoretically, returns should be higher in capital scarce countries, the vulnerability of the ECCU economies to natural disasters and external shocks implies that in practice, the portfolios would be riskier. Furthermore, the link between pension assets and capital market development is not well established. Although the investments of pension funds helped to develop the stock market in some Latin American countries, Reisen (1997) found a negative relationship between stock market development and pension assets in a survey of OECD and non-OECD countries. Finally, exchange rate risks can be hedged and the effect of population structures on investment yields can be offset by productivity increases.

182. **The nexus among the NIS—government—state-owned banks is increasingly fragile.** The relationship between the central government and public sector financial institutions masks some of the risks in the financial system and the sustainability of the public sector finances. A large part of social security funds is deposited into government-owned commercial banks, and at the same time, the commercial banks have large exposure to government debt. There are several risks to this arrangement.

183. **First, the NIS and the domestically owned commercial banks have excessive mutual exposure to each other**, which could result in instability of the financial system. By policy, the NIS keep the majority of their deposits in domestically owned institutions, averaging around 42 percent of their total portfolios. This practice was initially adopted to give the newly created national banks a slight advantage over their well-established foreign competitors, but the domestic banks have not yet been able to wean themselves from this largely captive source of funds. Domestic commercial banks, which depend on the NIS for an average of around 12 percent of their deposits, can be easily destabilized by modest shifts in the portfolio of the NIS. At the same time, the social security schemes have excessive exposure to the credit risk of these usually weak institutions. Thus even though the NIS may want to shift resources to optimize their return and reduce risk, they are held captive by the weakness of the national financial institutions.

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[86] Less than 6 percent of the NIS portfolio was invested in foreign securities in 2001, excluding Montserrat.

184. **Second, in some cases, the social security funds are deposited in the commercial banks at below market rates to provide loans to the government, lowering the overall return on their portfolio.** In addition, a part of their other local investments are loans to the development banks at below market rates to fund social projects such as student loans and low-income housing schemes. In this way, the NIS are required to subsidize governmental social programs, when in fact, they should command higher rates in the market because of their size. The lower rate of return lessens the long-run viability of the NIS and increases the possibility of a government bailout in the future.

185. **Third, the commercial bank lending to the government masks the exposure of the NIS to the government.** In many cases the NIS are over-exposed to the government. The ECCU average proportion of the social security portfolio invested in government paper in 2001 was approximately 10 percent but was as high as 30 percent in Grenada and 23 percent in Dominica. An arrangement that practically permits the commercial banks to lend social security deposits to the government indirectly increases even further the exposure of the NIS to the government, as well as raising borrowing costs and lowering rates of return to the NIS.

186. Finally, this system of intra-public sector resource flows could easily spill over onto the payments system if fiscal pressures cause the central government to build up arrears on their liabilities to the weak domestically owned commercial banks.[87] In this situation, there is a risk that the failure of one of the commercial banks would put a significant portion of the NIS funds at risk.

187. **Government pensions will add to the contingent liabilities of the government once population aging starts to unfold.** While the government pension payments are not a huge burden now, they have the potential to grow as the population ages and the size of the government workforce increases, as has been the case in recent years. The promised benefits under these schemes will have to be paid either from the resources of the NIS or from general revenues, which will exacerbate the problems of the NIS or will add to the fiscal deficit and government debt.

Policy Recommendations

188. The rapid pace of population aging projected for the ECCU countries is expected to lead to significant rises in public pension expenditures over the next five decades. Options for pension reform in the next few years need to be explored in order to avoid last-minute large changes of the social security systems, which would be economically disruptive and socially undesirable. With debt to GDP ratios already on an unsustainable path and with high budget deficits, the scope for using general fiscal measures to address the problems of the social security systems is very limited. Hence, reforms of the pension systems must be considered now. This section discusses some guidelines for reforming the social security systems in the ECCU.

[87] The situation could be exacerbated if government arrears to the private sector cause a default on obligations to the commercial banks.

189. **Reforming the NIS, which is the largest component of pensions, should have top priority.** There are two main approaches to reform public pension systems:[88] the "parametric approach," which maintains the pay-as-you-go defined-benefit structure of the system while modifying its parameters, and the "the systemic approach," which involves a structural change of the system towards a fully funded, defined-contribution, privatized scheme. Parametric reform is potentially easier to implement than changing the entire structure of the system, but it is not immune to future adverse demographic shocks. Consequently, additional changes could be required if the population aging is more severe than expected, or if other unforeseen shocks render the system insolvent. Systemic reform has the advantage of linking individual contributions to benefits and of not requiring additional changes, but usually entails high administrative costs and very large implicit transition costs[89].

190. Parametric reform of the NIS seems more appropriate for the ECCU, since systemic reform would imply large transition costs that would add to the already unsustainable debt-to-GDP ratios in the region. The ECCU governments favor the parametric approach, and have put forth a series of recommendations, including increasing the minimum retirement age, raising contribution rates, increasing the period over which insurable earnings are averaged to calculate benefits, reducing the maximum benefit level, and indexing the parameters of the schemes to price or wage indices. In addition, since the LTB branch of the NIS is bound to be hit hardest by population aging, redirecting part of the funds from other branches to the LTB may help alleviate some of the pressures stemming from aging. While the proposed modifications are likely to improve the long run viability of the NIS, their effectiveness depends on several factors, which need to be considered.

191. **First, the proposed changes under the parametric approach may meet with political resistance and could be delayed.** The currently large labor force, which constitutes the majority of voters in the ECCU countries, will not easily be persuaded to accept higher rates now and lower benefits in the future. Furthermore, since the countries of the ECCU already face high debt levels and large budget deficits, they may need to raise income or other individual taxes to restore sustainability of their fiscal balances. Having to increase social security rates at the same time is likely to be difficult politically, yet delaying reform may have potentially very serious future social welfare consequences.

192. **The NIS in the ECCU need to adopt a gradual approach to raising pension rates with immediate implementation.** Delaying pension reform implies either sharp increases in contribution rates and reductions in benefits later on, or significant intervention by the government

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[88] Chand and Jaeger (1996), Diamond (1988, 1993), etc.

[89] The costs associated with the transition from a pay-as-you-go system to a fully funded one stem from the need to pay the accumulated benefits of current or future retirees who have contributed to the pay-as-you-go system throughout their careers. These costs could be either paid by the present generations, by increasing their contribution rates to provide both for their own retirement and for the benefits of current retirees, or spread among present and future generations, by issuing recognition bonds (as in the case of Chile). While raising contribution rates may be difficult politically, issuing new bonds may add to the fiscal burden of the government, and may not be advisable for the ECCU governments, given their already alarmingly large debt-to-GDP ratios

to bail out the insolvent pension systems at the risk of running even larger budget deficits in the future. According to projections in its actuarial review, St. Kitts and Nevis would need to *triple* its LTB contribution rate from 8 percent to 25 percent in 2030, when its reserves will be exhausted, and to continue to raise rates to more than 30 percent over time in order to keep its system afloat. Similarly, Dominica would need to *double* its rate around 2023 from 6 to 12 percent and to continue to raise it to 22 percent by 2050. Hence, the sooner reforms are implemented, the lower will be the required changes in contribution rates.[90]

193. **Second, raising the retirement age may not necessarily be as effective as intended.** The usual argument for increasing the retirement age is that it would not only lower pension spending, but it would also potentially increase the contribution base. However, as Bakker et. al. (1996) point out, if participation rates of the elderly into the labor force are low due to the availability and generosity of early retirement or disability,[91] then this reform may turn out to be counterproductive, as individuals would simply substitute old-age pensions for early retirement or disability benefits. In addition, increasing the retirement age may crowd out the employment chances of younger persons. This could add to the already significant burden of high unemployment rates in the ECCU countries.

194. **Third, the parametric modifications put forth may not be sufficient to ensure the viability of the NIS.** As discussed in the previous sections of the chapter, the social security systems of the ECCU suffer from high administrative costs, poor investment performance and exposure to the risks in the domestic financial markets. Changing the parameters of the system does not help solve these important problems. Thus, in addition to parametric reform, the NIS must undertake other congruent measures, such as reducing administrative costs, modifying the investment strategy of the pension funds so as to increase their real return and to reduce their exposure to domestic banks and the government.

195. The investment portfolios of the NIS need to be improved through greater diversification and strengthening of the investment decision-making process, while ensuring that portfolio adjustments are not too abrupt to destabilize the financial sector. Diversification of the portfolios to include more regional and foreign securities could result in higher returns and lower riskiness of the portfolios. It would also reduce some of the inherent financial sector instability generated by the mutual exposure of the financial sector and the NIS. However, restructuring of the portfolios must be undertaken gradually.

196. The optimal level of diversification depends on the social objectives of the institutions, the size of the portfolios, the macroeconomic effects and the impact on the domestic financial system. Reisen (1997) suggests that pension funds optimally hold world portfolios with domestic assets proportional to their country's financial market capitalization as a percentage of global capitalization. For the ECCU, this would imply that the bulk of the resources should be invested abroad. However, the opportunity cost of foreign investment is the cost to the economy

[90] We plan to generate simulation results for alternative scenarios of parametric reform using our analytical model. This would enable us to determine the optimal timing and magnitude of required tax increases in each country case.

[91] See Samuel (2002) for a discussion of alternative employment opportunities for the elderly.

in terms of forgone real sector development and through lower interest rates. The optimal portfolio needs to balance the benefits of risk diversification against these costs. Hence, the outcome would be greater investment in foreign assets but less than that predicted by the Reisen model.

197. **Adjusting investment portfolios too rapidly to reach the optimal level of foreign investment can be dangerous.** Fast adjustment of the NIS portfolios could destabilize the banking system given the dependence on the domestically owned banks on NIS deposits. Moreover, sudden portfolio shifts could result in a rapid depletion in the level of official reserves, even though the total foreign assets of the region remain the same. A gradual approach to the adjustment of the NIS portfolios could minimize the risks to the financial system while steps are taken to strengthen the position of the domestically owned commercial banks.

198. **Strengthening the investment decision-making process could also enhance the returns of the NIS.** Nicholls (2002) notes that while the NIS legislations require the establishment of investment committees, they do not appear to function effectively. He recommends strengthening these committees by broadening the membership to include persons with investment and negotiating skills or the function could be contracted out to investment professionals.

199. **Government pensions need to be either funded or eliminated before the population aging crisis hits**. This can be accomplished by governments making specific funding arrangements or incorporating them into NIS. Several attempts that have been made to reform government pensions failed because they did not adequately deal with the accumulated pension rights. Thus, attempts at reform would need to manage these obligations in a fair manner.

200. **One solution would be to fully fund the government pension scheme and separate it from the consolidated fund.** This would ensure that the rising obligations do not put pressure on government financing. The major difficulty with this approach would be to find a way to provide the resources needed to fund the accumulated rights given the fragile budgetary position of most governments of the ECCU. One possibility would be to make specific budgetary allocations on an annual basis to achieve actuarial viability of the fund by a specific time. Another possibility would be to move the government pension funds to private sector organizations and finance the transition with a combination of cash and government bonds. In this way, the contingent liabilities would be recognized explicitly as government debt, but the transitional costs would add to the already unsustainably high debt burden in the ECCU.

201. **A second solution, favored by most governments, is to integrate the government pensions into the National Insurance Schemes.** This is fairly straightforward when government workers are not covered by the NIS, as in the case of St. Lucia. The government would provide the resources to cover the pension rights as under the privatization option (discussed above) and workers will receive the NIS benefits. In cases where NIS benefits are inferior to the expected government pensions, the difference could be made up in cash payments or government securities. Where the government pension benefits are additional to the NIS, privatization may be the better option.

F. Conclusions

202. **The ECCU faces a major population-aging challenge.** A quadrupling of elderly dependency ratios is expected to swell pension expenditures relative to contributions.

203. Although still a few decades away, this demographic prospects warrants attention and action now, before potentially devastating fiscal consequences become too difficult to manage. Early identification of risks and weaknesses associated with the social security arrangements in the ECCU could allow the governments to find adequate solutions and adopt them in a more gradual and hence less disruptive manner. The present chapter describes the social security system in place in the ECCU, flags the main issues stemming from population aging, and makes several policy recommendations.

204. Due to their pay-as-you-go structure, the social security systems in the ECCU show increasing signs of vulnerability to population aging. We have identified several salient issues with the social insurance arrangements in the region that will need to be addressed before the aging challenge. First, **unless they are reformed, the National Insurance Schemes of the ECCU will be threatened by bankruptcy as their liabilities will exceed their assets.** Although the schemes have accumulated substantial investment funds, these will prove insufficient when the current large labor force starts to draw the promised pension benefits. Second, **the nexus among the NIS—government—state-owned banks is an increasing source of financial sector vulnerability,** with the government borrowing from the NIS, and the NIS depositing its funds in weak domestic banks. Third, **the current investment portfolio of the NIS is risky and insufficiently diversified.** Fourth, **government pensions will add to the contingent liabilities of the government.**

205. Options for pension reform in the next few years need to be explored in order to avoid last-minute large changes of the social security systems, which would be both economically and socially undesirable. With debt to GDP ratios already on an unsustainable path in several of the ECCU countries, the scope for using general fiscal measures to address the problems of the social security systems is very limited. Hence, reforms of the pension systems must be considered. This chapter proposes some guidelines for reforming the social security systems in the ECCU, including a gradual approach to parametric reform of the NIS with immediate implementation, diversification of the investment portfolio of the NIS so as to improve rates of return, prolong the viability of the system, and lessen the spillover effects into the financial system, and funding or incorporating government pensions into the NIS.

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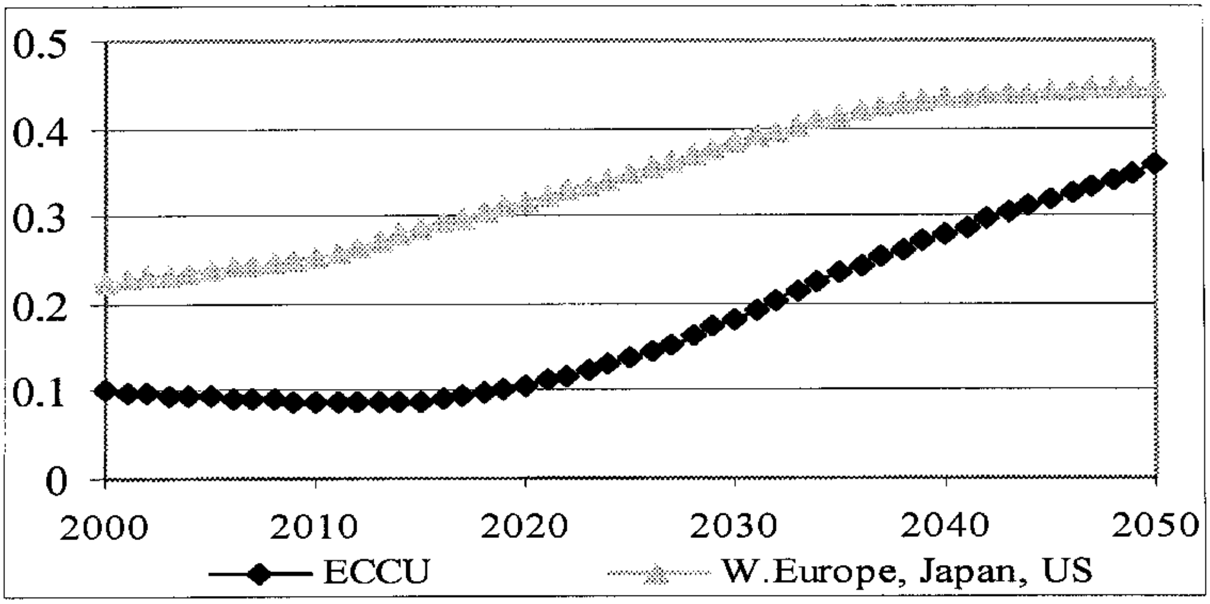
Figure 1. Elderly Dependency Ratios in the ECCU, and Western Europe, U.S. and Japan



Source: U.S. Census Bureau, International Data Base

Table 1. NIS Contribution Rates in Percentage of Earnings/Payroll

Country	Employee's contribution and max./min. taxable earnings		Employer's contribution		Total	Self Employed
	Long-term benefits	Short-term benefits	Long-term benefits	Short-term benefits		
			In percent			
Anguilla	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Antigua and Barbuda	3.0 2.0 public sector Max. EC$ 54,000/year	0.0	5.0	0.0	8.0	8.0
Dominica	3.0 Max. EC$ 60,000/year	0.0	7.0	0.0	10.0	7.0
Grenada	4.0 Max. EC$ 36,000/year	0.0	5.0	0.0	9.0	6.8
Montserrat	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
St. Kitts and Nevis	5.0 Max. EC$ 6500/month	0.0	5.0	1 work injury	11.0	10.0
St. Lucia	5.0 Max. EC$ 36,000/year	0.0	5.0	0.0	10.0	n.a.
St. Vincent and the Grenadines	2.5 Max. EC$ 2600/month	0.0	3.5	0.1	6.1	n.a.

Source: U.S. Social Security Administration: Social Security Systems Throughout the World, 1999

Table 2. NIS Long Term Benefits

Country	Min. Age	Qualifying Contributions	Minimum/Maximum Old-Age Pension	Survivorship Benefits	Disability Benefits
Anguilla*	n.a.	500 credited (250 paid) disability: 50 paid	EC $120/wk – 60 percent of earnings	EC $27/wk - 60 percent of pension	EC $105-30 percent
Antigua and Barbuda	60	500 paid/credited disability: 156 paid/credited old-age grant: 26 paid/credited	25 percent - 50 percent of earnings Old age grant Old -age assistance	50 percent of pension to widow 20-40 percent of pension to children Funeral grant: EC$2000	same as old-age pension
Dominica	60	500 credited (150 paid) disability: 150 paid/credited	30 percent - 70 percent of earnings Old age grant Old -age assistance	50 percent of pension to widow 25-30 percent of pension to children Funeral Grant: EC$ 1800	same as old-age pension
Grenada	60	500 credited (150 paid) disability: 50 paid/credited old-age grant: 150 paid/credited	30 percent of earnings min.: EC$40/wk Old age grant	75 percent of pension to widow 25-50 percent of pension to children Funeral Grant: EC$ 2000, 1500 (spouse), 750 (child)	same as old-age pension
Montserrat*	n.a.	150 paid disability: 150 paid/credited	EC$173/mt - 60 percent of earnings	50 percent of pension to widow 30 percent of pension to children	same as old-age pension
St. Kitts and Nevis	62	500 credited (150 paid) disability: 150 paid/credited	30-60 percent of earnings min. EC$200/month Old age grant	50 percent of pension to widow 15-30 percent of pension to children Funeral Grant: EC$ 2500, 2500 (spouse), 1600 (child)	same as old-age pension
St. Lucia	60	10 years of contributions disability: 5 years of contributions	40 percent of earnings, no max.Old age grant old age grant	75 percent of pension to widow 25-50 percent of pension to children Funeral Grant: EC$ 1500	same as old-age pension
St. Vincent and the Grenadines	60	500 credited (150 paid) disability: 150 paid/credited old-age grant: 50 paid/credited	30-60 percent of earnings min. EC$ 40/week Old age grant	75 percent of pension to widow 25-50 percent of pension to children Funeral Grant: EC$ 2000	same as old-age pension

Source: U.S. Social Security Administration: Social Security Systems Throughout the World, 1999.

Table 3. NIS Short Term and Employment Injury Benefits

Country	Qualifying contributions	Sickness benefits (amount, duration)	Maternity benefits (amount, duration)	Employment injury benefits (EI)
Anguilla*	sickness: 26 wks maternity: 26 wks	60 percent of avg. wage 26 weeks	60 percent of avg. wage 13 weeks grant: EC$250	n.a.
Antigua and Barbuda	sickness: 26 wks maternity: 26 wks	60 percent of avg. wage	60 percent of avg. wage 13 weeks grant: EC$400	none
Dominica	sickness: 13 wks maternity: 30 wks	60 percent of avg. wage 26 weeks (max. 52)	60 percent of avg. wage 12 weeks grant: EC$500	60 percent of avg. wage medical benefits
Grenada	sickness: 13 wks maternity: 30 wks EI: max. wages: EC$36000/yr	65 percent of avg. wage 26 weeks (max. 52)	65 percent of avg. wage 12 weeks min. EC$450	70 percent of avg. wages 26 weeks medical benefits
Montserrat*	sickness: 26 wks maternity: 30 wks	60 percent of avg. wage 26 weeks	60 percent of avg. wage 12weeks grant: EC$400	n.a.
St. Kitts and Nevis	sickness: 26 wks maternity: 39 wks EI: max. wages: EC$ 6500/mth	65 percent of avg. wage 26 weeks	65 percent of avg. wage 13 weeks grant: EC$450/child	75 percent of avg. wages 26 weeks medical benefits
St. Lucia	sickness: 6 mts maternity: 7 mts EI: max. wages: EC$36000/yr	65 percent of avg. wage 26 weeks (max. 52)	65 percent of avg. wage 3 months grant: EC$450	EC $ 30 for medical costs
St. Vincent and the Grenadines	sickness: 26 wks maternity: 30 wks	65 percent of avg. wage 13-26 weeks	65 percent of avg. wage 13 weeks grant: EC$300	70 percent of avg. wages 26 weeks medical benefits

Source: U.S. Social Security Administration: Social Security Systems Throughout the World, 1999

Table 4. NIS Receipts, Payments, and Reserves in Percent of GDP

Country		1980	1985	1990	1995	2000	2001
Antigua and	NIS Balances	2.38	1.91	2.07	0.48	1.81	n.a.
Barbuda	Total Revenues	3.20	3.03	3.29	2.37	3.86	n.a.
	Total Expenses	0.82	1.12	1.22	1.81	1.99	n.a.
	Total Reserves	12.79	16.00	16.26	22.49	25.82	n.a.
Dominica	NIS Balances	2.33	2.91	2.41	2.10	4.05	4.33
	Total Revenue	3.13	4.31	4.48	4.98	10.86	11.17
	Total Expenses	0.68	1.01	1.35	1.54	8.30	8.47
	Total Reserves	12.20	17.68	20.94	24.96	29.05	30.16
Grenada	NIS Balances	n.a.	0.09	1.78	2.22	n.a.	2.57
	Total Revenue	n.a.	0.11	2.41	3.34	n.a.	4.22
	Total Expenses	n.a.	0.03	0.63	1.12	n.a.	1.65
	Total Reserves	n.a.	6.01	11.59	19.80	n.a.	24.84
St. Kitts and	NIS Balances	4.54	5.12	4.88	6.50	6.10	6.02
Nevis	Total Revenue	5.77	7.70	5.10	6.70	7.27	7.79
	Total Expenses	0.72	1.28	1.65	1.89	2.86	2.58
	Total Reserves	23.74	42.17	31.60	41.47	46.58	48.63
St. Lucia	NIS Balances	2.04	1.71	1.75	2.44	3.03	n.a.
	Total Revenue	2.32	2.24	2.37	3.69	4.72	n.a.
	Total Expenses	0.28	0.36	0.53	0.99	1.53	n.a.
	Total Reserves	8.34	13.24	15.23	21.86	29.71	n.a.
St. Vincent and	NIS Balances	2.30	1.60	1.71	2.57	2.00	n.a.
the Grenadines	Total Revenue	2.71	2.05	2.31	3.13	3.23	n.a.
	Total Expenses	0.41	0.46	0.60	0.56	1.08	n.a.
	Total Reserves	12.89	13.74	15.77	19.79	23.92	n.a.

Source: ECCB and WEO

Table 5. ECCU Dependency Ratios

	2000	2010	2020	2030	2040	2050
OECS	10.05	8.71	10.61	18.24	27.96	35.79
Anguilla	10.59	10.15	14.76	25.04	35.64	42.14
Antigua and Barbuda	7.56	4.97	9.23	24.42	34.04	32.29
Dominica	12.40	11.29	11.86	19.39	32.55	35.22
Montserrat	17.92	15.36	13.31	18.12	28.10	42.78
St. Kitts and Nevis	14.68	11.30	13.42	20.45	23.51	26.89
St. Lucia	8.59	7.61	8.66	14.06	22.78	31.05
St. Vincent and the Grenadines	10.04	9.51	12.14	19.91	33.10	56.46

Source: U.S. Census Bureau, International Data Base

Figure 2. Maximum Old-Age Benefit Rates Relative to Individual Contribution Rates

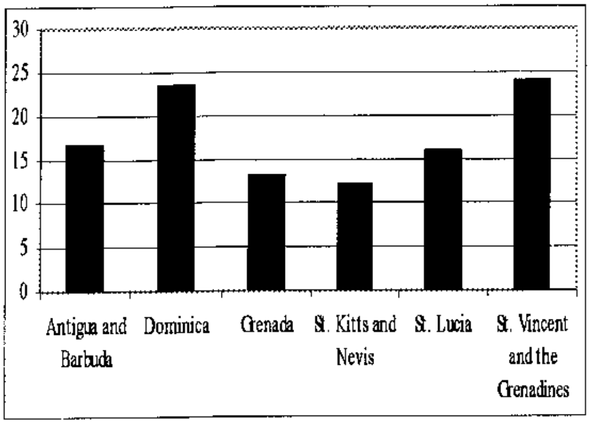


Figure 3. Administrative Expenses as Percentage of Total Contributions

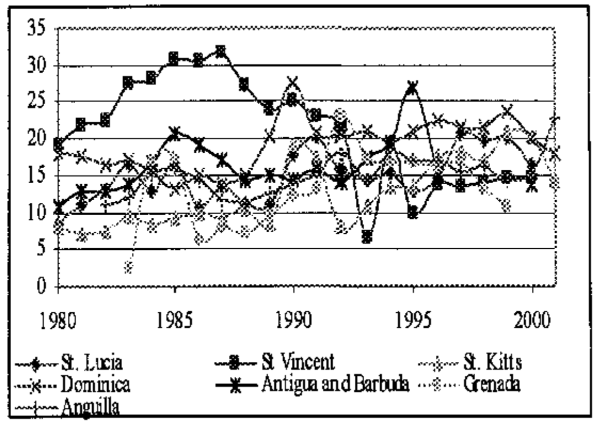


Figure 4. Reserve to Expenditure Ratio

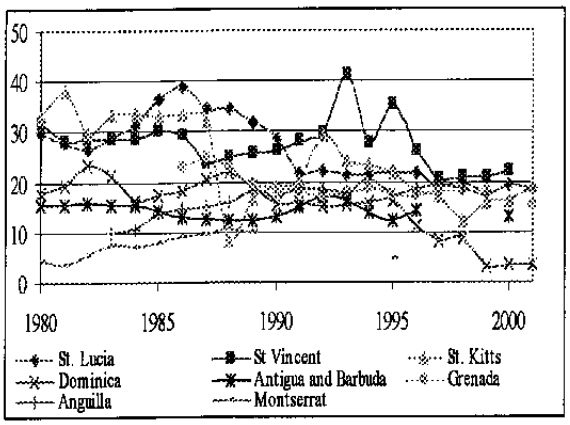
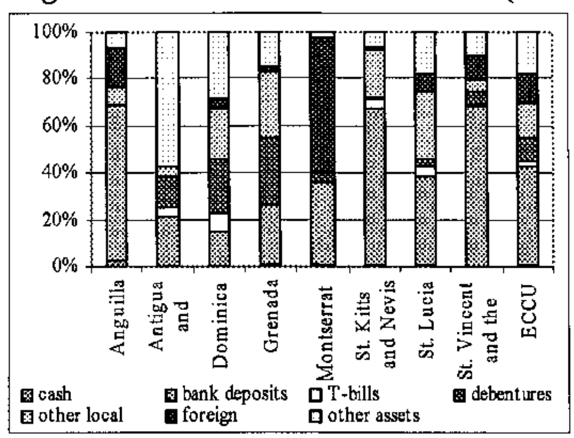


Figure 5. NIS Investment Portfolio (2001)



Source for Figures 2, 3, 4, and 5: ECCB

Table 6. NIS Investment Yields, Inflation, and Economic Growth

	Real Yields						Inflation		Economic Growth	
	1980-1998		1980-1985	1985-1990	1990-1995	1995-1998	1980-1998		1980-1998	
	Mean	Variability	Mean	Mean	Mean	Mean	Mean	Variability	Mean	Variability
Anguilla	0.1	4.3	-0.8	-4.2	3.5	3	6	3.8	3.7	5.6
Antigua and Barbuda	-1.7	2.3	-1.8	-2.8	0	-1.1	5.4	3.1	5.2	4.9
Dominica	1.8	2.3	0.8	0.7	2	3.7	4.9	2.3	4.1	3.7
Grenada	2.2	3.5	-1	1.6	3.7	4.1	3.6	2.5	4.3	3
Montserrat	17	8.9	NA	18.7	15.2	NA	4.7	3.4	2.2	6.5
St. Kitts and Nevis	0.1	3.6	-0.2	-1	1.1	1.5	5.7	3.8	5.2	2.9
St. Lucia	3.1	2.6	2	2.8	2.6	3.5	4.1	2.5	3.1	4.7
St. Vincent and The Grenadines	2.2	3.2	0.6	2.5	2.7	3.5	5	3.7	3.8	4.3

Source: Nicholls (2002)

VIII. Regional Integration and Trade Policy[92]

206. The members of the ECCU are at the confluence of two distinct forces towards regional integration the first involves the smaller group of Caribbean leeward and windward islands, the Organization of Eastern Caribbean States (OECS), while the second covers the wider Caribbean region, the Caribbean Community (CARICOM). Regional integration and cooperation have remained key political objectives in the region, which gave rise to the forerunners of the current regional organizations. Particularly noteworthy are the British West Indies Federation (1958 to 1962), the Caribbean Free Trade Area (CARIFTA) which was CARICOM's immediate predecessor, and a variety of institutions for the provision of common services,[93] all set against a backdrop of the region's political independence movement. This paper describes the principal objectives and structure of the vehicles of regional integration for the ECCU members, particularly the OECS and CARICOM. Given that trade is key in integrating the region to the rest of the world, the last section presents the principal aspects and developments with regard to the trade regime with non-CARICOM countries.

A. The Organization of Eastern Caribbean States (OECS)

207. The Organization of Eastern Caribbean States (OECS) was established by the "*Treaty of Basseterre*" which was signed in June 1981 by seven of the region's governments: Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. Since then the British Virgin Islands and Anguilla have both been admitted to the OECS as associate members.[94] Important precursors to the OECS Treaty are the West Indies Associated States (WISA) Council of Ministers, which was created in 1966 to administer the members' common services and to serve as a forum for common issues, and the Eastern Caribbean Common Market (ECCM) which was created in 1968 to promote the harmonious and equitable development of the Eastern Caribbean region, both of which attempted to fill the gap that was left following the collapse in 1962 of the British West Indies Federation. The secretariats of WISA and the ECCM were eventually subsumed and integrated into the OECS Secretariat.

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[92] Prepared by Patrick Njoroge (WHD)

[93] These include the University of the West Indies (UWI), a regional shipping services, and a regional meteorological service.

[94] Thus, the OECS comprises the eight member countries and territories of the ECCU and the British Virgin Islands (BVI). The BVI and Anguilla were admitted in 1984 and 1995 respectively. Unlike a "full member," the rights and obligations of an "associate member" do not extend to all aspects of the Treaty and these are specified when the member is admitted.

Box 1. Areas of Special Relevance to the Objectives of the OECS[1]

The OECS Treaty lists the following 18 areas as of particular importance for members to coordinate, harmonize and pursue joint policies, so as to achieve the main objectives of the OECS. These are:

1. External relations including overseas representation,
2. International trade agreements and other external economic relations,
3. Financial and technical assistance from external sources,
4. International marketing of goods and services including tourism,
5. External transportation and communication including civil aviation,
6. Economic integration among the members through the provisions of the Agreement establishing the East Caribbean Common Market,
7. Matters relating to the sea and its resources,
8. The judiciary,
9. Currency and central banking,
10. Audit,
11. Statistics,
12. Income tax administration,
13. Customs and excise administration,
14. Tertiary education including university,
15. Training in public administration and management,
16. Scientific, technical and cultural cooperation,
17. Mutual defense and security, and
18. Such other activities calculated to further the purpose of the OECS as the members may from time to time decide.

1/ "*The Treaty Establishing the Organisation of Eastern Caribbean States*" June 1981, Article 3.2

208. The purposes of the OECS include: promoting cooperation among the members at the regional and international level; promoting unity and solidarity among the members and defending their sovereignty, territorial integrity and independence; assisting members in realizing their obligations and responsibilities to the international community; seeking the harmonization of members' foreign policy, including common positions on international issues and arrangements for joint overseas representation and/or common services; and promoting economic integration among the members. To this end the OECS Treaty identifies 18 areas of special relevance for the coordination and harmonization of policies (see Box 1). The **OECS Authority** is the highest decision-making body, comprising of the Heads of Government (Prime Ministers and Chief Ministers) of the member states and territories. The OECS Authority meets at least twice a year, under a rotating chairmanship, and the ordinary business of the OECS is entrusted to a secretariat that is headed by the Director-General, who is appointed by the OECS Authority.

209. The current responsibilities of the **OECS Secretariat** include the regional coordination of the development policies of the members, representing the member government's interests in external trade negotiations, and advising them on the fulfillment of their respective commitments in this area. Additionally the Secretariat is responsible for the OECS Health Sector Reform Program, funded by the government of France, which aims at strengthening the ministries of health, re-organizing the health systems to allow greater sharing of health services and improving its quality. Other principal responsibilities and projects are organized around the following units:

- *The OECS Education Reform Unit (OERU)*, works with the region's governments and other partners to expand access, improve the quality and ensure equity in the education system aimed at developing human resources for effective participation in a competitive global environment. The OERU is currently responsible for two projects; the Eastern Caribbean Education Reform Project (ECERP) with Canadian funding, to reform the formal education system to improve the quality of the human resource, and the Human Resource Development Tertiary Level Program with funding from the European Development Fund, to increase tertiary education capacity to improve the level of trained human resource in priority sectors.

- *The OECS Export Development Unit (OEDU)* which is responsible for the development, promotion, and expansion of exports, by mobilizing technical and financial support for private sector enterprises in agriculture, manufacturing and services, and providing relevant advice to the region's governments. The OEDU is currently responsible for the Small and Medium Enterprise Development Project (SMEDP) with funding from USAID.

- *The OECS Environment and Sustainable Development Unit (OESDU)*, which provides environmental management services to the region's governments, through the provision of technical assistance and development of harmonized policies. The OESDU is currently responsible for six projects, with funding from various donors, covering coastal and marine resources management, environmental planning, watershed management, waste management and information, communication and public awareness.

- *The OECS Pharmaceutical Procurement Service (OPPS)*, responsible for monitoring the supply of drugs and other items, and negotiating on behalf of the region.

- *The OECS Social Development Unit (OSDU)*, which assists member governments to strengthens the linkages between economic and social strategy development and also provides the OECS Secretariat with the capacity to assess and monitor human and social development related activities. Work underway includes formulation of social development policies, preparation of poverty reduction documents, design, and development of social indicators database, preparation of human development reports.

OECS Regional Integration

210. At the July 2001 meeting, the OECS Authority agreed to deepen their economic integration by creating an economic union. This followed an appreciation of the disadvantages stemming from their small size and the strength of a collective approach in addressing the challenges of globalization and trade liberalization, and gave new impetus to the aspiration for economic integration specified in the OECS Treaty. The intention is the creation of a single OECS Economic Union within which products, labor and capital moves freely, which would allow diversified economic growth, increased employment, and position the OECS to interface more effectively with the wider CARICOM Single Market and Economy initiative.

211. At the January 2002 meeting of the OECS Authority an agreement was reached, excepting Anguilla and the British Virgin Islands,[95] on measures that would allow free movement of labor, including amendments on immigration and landholding laws, and the introduction of an OECS passport. At the October 2002 meeting, the OECS Authority reiterated its commitment to the creation of the OECS Economic Union and agreed on appointing a committee that would review the "*Treaty of Basseterre*" and recommend how this could be aligned with the requirements of an economic union. The OECS Authority also established target dates for the free movement of goods and services (end-2003), free movement of labor (end-2007), and endorsed the ECCB's program to develop and unify the money and capital markets.

The OECS Development Charter

212. At the October 2002 meeting, the OECS Authority approved "*The OECS Development Charter*" which outlines the development objectives for the region and how these would be achieved. The Charter presents the overarching development objective for the region as advancing the well-being of the population, expressed in terms of their needs, aspirations, and capacity. This objective is to be pursued by implementing programs that will raise living standards, improve working conditions, enhance labor skills, and protect vulnerable groups. The immediate objectives for these programs would include: reducing poverty, especially by training programs that target the poor, and particularly women and youth; facilitating a substantial increase in private sector employment; expanding access to education; improving access and the quality of health services; a sustainable use of environmental resources; empowering the disadvantaged; developing sports; and improving governance. The Charter recognizes the constraints facing the region and embraces the strengthening of a collective approach, deepening regional integration, and cooperation through regional institutions and particularly the creation of the OECS Economic Union.

213. The Charter outlines the set of economic policies that would underpin the development objective. These policies would aim to enhance investment and employment opportunities, encourage domestic savings, and stimulate economic activity in a competitive environment. These policies include a fiscal reform that would contain the accumulation of debt, and increase the efficiency of the expenditure and revenue systems; a public sector reform; improvement in the incentive regime for investments; maintenance of low inflation and a stable exchange rate. In addition, the Charter outlines policies to transform agriculture in line with the region's comparative advantage, enhance the tourism sector's contribution, support the development of the non-tourism service sector, strengthen the development of the domestic and offshore financial services sector, strengthen the development of enclave manufacturing and agro-processing and reduce emphasis on import substitution, and establish a well-functioning transportation network.

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[95] Both these members were anxious that their acceptance of such an agreement may exacerbate labor conditions in their territories or might interfere with their existing special relations with some non-OECS countries and territories.

214. At the approval of the Charter, the OECS Authority gave guidance on critical areas of priority action and provided additional guidance on some of the initiatives that would be implemented. The region's medium-term targets were defined and agreement was reached on a reform and transformation process that would begin in January 2003 with the first phase would end in December 2007. [96] Key priorities for the reform and transformation process include

- the free circulation of goods and services within the OECS by end-2003;
- free movement of labor within the OECS by end-2007;
- maintaining the existing fixed exchange rate system and low inflation;
- strengthening the fiscal situation, by implementing adjustment programs that include a tax reform in line with the advice expected from the Tax Commission, a public sector reform that establishes an appropriate expenditure system, strengthens the efficiency of expenditures particularly in the social sector and the Public Sector Investment Program (PSIP), and improved debt management;
- reaching agreement on income policies through tripartite committees (representing the government, trade unions and the private sector) for an equitable distribution of productivity gains; and
- the immediate priorities in tourism, agriculture, manufacturing, and the information technology sectors were also outlined.

215. In sum, "*The OECS Development Charter*" provides appropriate general guidance on the region's development agenda, which is further specified by subsequent statements of the OECS Authority. However, the relevance of the Charter will be demonstrated by how closely the policies in the region conform to the agreed statements.

Joint Overseas Representation

216. The OECS governments have made known their wish to establish offices abroad of joint representation, and thus benefit from the economies of scale. So far, a joint High Commission has been established in Ottawa, Canada (for the OECS members except Anguilla and the British Virgin Islands), and in Brussels, Belgium (for the OECS members except Anguilla, Antigua and Barbuda, Montserrat and Grenada). Negotiations are to be requested with the government of Switzerland and the WTO, for the establishment of a joint mission in Geneva.

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[96] The agreed medium-term targets were: sustained annual real growth of 6 percent; high quality employment with unemployment of less than 6 percent; poverty levels below 6 percent; Human Development Index (HDI) targets that are consistent with international standards, and the establishment of diversified and competitive economies.

B. Other Non-Financial Regional Institutions in the Eastern Caribbean

217. There are other regional institutions in the Eastern Caribbean in addition to the regional financial institutions,[97] some of which pre-date the OECS. This section puts forward these other regional institutions in the Eastern Caribbean and summarizes their main objectives.

Eastern Caribbean Telecommunications Authority (ECTEL)

218. This was established by the ECTEL Treaty of May 2000, signed by five countries: Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The purpose of ECTEL is to advise and coordinate with the member countries on regulatory policy in the telecommunications sector, while promoting its liberalization and development. The ECTEL is guided by a Council of Ministers that meets at least once a year, with the more immediate guidance of its operations entrusted to a Board of Directors and to a Managing Director. In exercising its duties, the ECTEL is in regular contact with the National Telecommunications Regulatory Commission in each of the member countries. The ECTEL is headquartered in St. Lucia.

The Directorate of Civil Aviation (DCA)

219. The DCA regulates and provides safety oversight over all aspects of civil aviation within the territories of the OECS members except for the British Virgin Islands. The DCA operates under the guidance of a Civil Aviation Regulatory Board, comprising of the ministers responsible for civil aviation. The DCA has been in existence since 1957, though its structure and operations have changed with realities of political changes and in the field of civil aviation. The DCA is headquartered in Antigua and Barbuda.

Eastern Caribbean Supreme Court (ECSC)

220. The "West Indies Associated States Supreme Court Order" No. 223 established the Eastern Caribbean Supreme Court in 1967. It is the superior court for the OECS members, with unlimited jurisdiction in accordance with the respective Supreme Court Acts.[98] The ECSC comprises of the Court of Appeal, which sits as needed in the member's countries, and the High Court, which sits continually in each member country. The head of the ECSC is the Chief Justice, who is appointed by the Queen of England.

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[97] The financial institutions include the Eastern Caribbean Central Bank (whose older predecessor, the British Caribbean Currency Board, was established in 1950), the Eastern Caribbean Home Mortgage Bank (established in 1994), the Eastern Caribbean Securities Exchange (established in 2001), and the Eastern Caribbean Regional Government Securities Market (established in 2002). Efforts are underway to establish two new institutions; the Eastern Caribbean Unit Trust and the Eastern Caribbean Enterprise Fund.

[98] The highest court in the region, however, is the British Privy Council. It is expected that this will be replaced by the Caribbean Court of Justice, once this is established, following an agreement reached in the February 2001 meeting of CARICOM Heads of Government.

221. The Court of Appeal hears appeals from the decisions of the High Court and Magistrates' Courts of the members in both civil and criminal matters. The Court of Appeal also hears appeals from the Industrial Court in Antigua and Barbuda and the Administrative Tribunals in the British Virgin Islands and Montserrat.

Windward Islands Banana Development and Exporting Company (WIBDECO)

222. Banana farmers and the governments of Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines jointly own WIBDECO. WIBDECO provides technical and agronomic support to farmers, and markets and transports the product to the UK. WIBDECO is headquartered in St. Lucia.

C. The Caribbean Community (CARICOM)

223. The Caribbean Community (CARICOM) was established by the "*Treaty of Chaguaramas*" which was signed in Trinidad in July 1973 by Barbados, Jamaica, Guyana, and Trinidad and Tobago, and were joined shortly thereafter by eight other territories principally from the Eastern Caribbean.[99] The creation of CARICOM was the culmination of regional integration efforts that spanned more than a decade, with the Caribbean Free Trade Area (CARIFTA) as its immediate predecessor.

224. The purpose of CARICOM is to promote economic cooperation among its members, to coordinate foreign policy among its independent members, and to provide an instrument for cooperation in common services and in social and other areas. The Conference of Heads of Government (**The Conference**) is the highest decision-making body, comprising of the Heads of Government of the members.[100] The Council of Ministers (**The Council**) is the second highest body, consisting of two ministers from each member, one being the minister responsible for CARICOM affairs. The Council is responsible for CARICOM's strategic planning and coordination in the areas of CARICOM's mandate, and for establishing a system of consultations within the region so as to ensure the effectiveness of CARICOM's decision-making and implementation processes. In addition, CARICOM has four **Ministerial Councils** to assist in the specific areas as follows:

- *the Council for Trade and Economic Development (COTED)*, to promote CARICOM's trade and economic development, and to oversee the operations of the single market and economy initiative,

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[99] The current 15 members of CARICOM are: Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. Haiti is the newest member, as from July 2002. Anguilla, the British Virgin Islands (BVI), Cayman Islands, and Turks and Caicos are associate members.

[100] In 1992, a Bureau was created comprising the current, incoming and outgoing chairmen of the Conference, and CARICOM's Secretary-General, to deal with some of matters of the Conference. The Bureau meets as needed and reports to the Conference.

- *the Council for Foreign and Community Relations (COFCOR)*, to determine CARICOM's relations with international bodies and third states,

- *the Council for Human and Social Development (COHSOD)*, to promote human and social development, and

- *the Council for Finance and Planning (COFAP)*, to coordinate economic policy and financial and monetary integration of CARICOM members.

225. Additionally, the "*Treaty of Chaguaramas*" provides for three committees: *The Legal Affairs Committee*, comprising of ministers responsible for legal affairs or the Attorney Generals; the *Committee of Central Bank Governors*, consisting of the heads of central banks or their nominees; and *the Budget Committee*, consisting of senior officials of the members. A Secretariat was also provided for, headed by a Secretary-General, to carry out the ordinary business of CARICOM.

Caribbean Single Market and Economy (CSME)

226. In 1989, the Conference decided to integrate the CARICOM economies into a unified market with free movement of goods, services, capital and labor, and a single economy that would operate under the same coordinated and harmonized economic policies. The intention was that this would allow the region to exploit economies of scale from a large internal market and strengthen its international bargaining position, in an effort to deal with globalization, but without establishing a political union. It was apparent that to implement the CSME the "*Treaty of Chaguaramas*" needed to be modified, which was done subsequently by negotiating nine Protocols (see Box 2). However, two issues continue to plague its implementation. *First*, the process has been characterized by slow progress in bringing national laws in line with the tenets of the Protocols. The lack of political will and reluctance to give up control at the national level appear to be the relevant impediments.[101] *Second*, there has been a lack of awareness by the citizens in the member countries of the CSME agreements and their implications.

227. Protocol II was signed in 1997 but did not come into effect until July 1998. Since 1989, the focus of the issues under this Protocol has been the removal of restrictions on the rights of establishment, provision of services, and free movement of capital. Lists of these restrictions were developed with the help of consultants, and a process of phasing them out started in January 2001. The restrictions have been grouped into three, and agreement reached for their elimination by end-2003, 2004 and 2005.

[101] It has been suggested that the need to protect individual country sovereignty and the risk that the CSME process may eventually lead to a process of political unification, has been at the core of the delays in implementing the CSME.

Box 2. The Caribbean Single Market and Economy (CSME)

In the 1989 *"Grand Anse Declaration"* agreement was reached on the establishment of the CSME as soon as possible, and a work program that would achieve this **by July 4, 1993**. The work program was as follows:

1. Revising and coming into force of the three instruments required by the "Treaty of Chaguaramas" for the establishment of a common market (on the common external tariff, rules of origin, and a harmonized scheme of fiscal incentives), by January 1991.
2. Strengthening customs administration in the member countries and their cooperation, in advance of the establishment of a customs union.
3. The signing of the agreement establishing the CARICOM Industrial Programming Scheme (CIPS), by September 30, 1989.
4. Enactment of the legislation required to give effect to CIPS and the CARICOM Enterprise Regime (CER), by January 1990.
5. Introduction of a scheme for the movement of capital, starting with the cross-listing and trading of securities on existing stock exchange, by 1993.
6. Immediate start of technical work on the establishment of a regional Equity/Venture Capital Fund.
7. Strengthening and re-establishing of the CARICOM Multilateral Clearing Facility for current and capital transactions, by December 1990.
8. Enhancement of arrangements to intensify consultation and cooperation on monetary, financial and exchange rate policies, by July 1990.
9. Removal of all remaining barriers to intra-CARICOM trade, by July 1991.
10. Immediate activation of relevant part of the "Treaty of Chaguaramas" so as to promote consultation, cooperation and coordination of policies at the macro-economic, sectoral and project levels.
11. Free movement of skilled workers and professionals, and contract workers on a seasonal or project basis, by January 1991.
12. Developing a regional system of air and sea transportation, including the pooling of resources by existing air and sea carriers, by July 4, 1992.
13. Immediate collective effort for joint representation in international economic negotiations and the sharing of facilities and offices.

Following the *"Grand Anse Declaration"* and subsequent negotiations, the CSME was pursued by adopting nine Protocols that amended the "Treaty of Chaguaramas" in the areas of agreement, and by re-aligning each member's laws and policies to these agreements. To date, the main provisions of the CSME are set out in Protocols II and IV, as the free trade of goods and services within CARICOM, and the free movement of labor, capital and persons; the harmonization and liberalization of non-CARICOM trade; and the harmonization and coordination of economic policy within CARICOM. These are to be achieved by the removal of cross-border restrictions, establishing a common regime for trade with non-CARICOM countries, and a reduction of external tariffs. The purposes of the other protocols are the following:

- Protocols III and V outlines the region's industrial and agricultural policies that would provide an competitive environment for the industrial, services and agriculture sectors.
- Protocol VI deals with establishing an adequate, save and competitive transportation system.
- Protocol VII provides for temporary technical and financial support to the disadvantaged member countries and those sectors or countries that will be harmed by the establishment of the CSME.
- Protocols VIII and IX provides for fair competition, consumer protection, and mechanism for disputes settlement, and
- Protocol I provides the regional institutional framework to support the CSME process.

However, delays have arisen in bringing these Protocols into force and their implementation by member countries, and discussions have continued towards the objectives in the other areas. In an effort to accelerate the implementation of the CSME, a revised Treaty was signed in **February 2002** which incorporated all the previous Protocols, and whose ratification would bring into force the agreed components of the CSME.

228. Protocol IV was signed in 1999 and came into force in February 2000, and there has been a twofold focus on the issues under this Protocol, namely first, providing unrestricted access to each other's product markets by the removal of existing restrictions but with few exceptions. An agreement was reached to dismantle the remaining restrictions by end-1996. To date, these restrictions have almost completely been dismantled but some members still retain some restrictions that are inconsistent with the Protocol second, the continuation of efforts towards common external trade policies and trade liberalization. The "*Treaty of Chaguaramas*" had set a deadline of August 1981 for members to adopt a common external tariff (CET), which was not met by 1989. A subsequent deadline was set and missed, culminating in the introduction in October 1992 of a phased reduction of the CET and by January 1, 1998. Only two countries (Trinidad and Tobago and St. Vincent and the Grenadines) met that deadline, and four members (including Antigua and Barbuda, St. Kitts and Nevis, and Montserrat) had still not achieved it as at end-2002. A regional negotiating body that represents CARICOM members in international trade negotiations, was established in 1994.

229. Implementation of Protocol IX has focused on establishing the Caribbean Court of Justice as the highest court in the region, and the arbitrator on matters pertaining to the "*Treaty of Chaguaramas.*" An agreement was reached in 2001 though several members have yet to sign and ratify the agreement, and none has enacted it into national legislation. It is expected that the Caribbean Court of Justice will be established in 2003.

230. On other issues, a proposal for monetary integration was approved in 1992. A common currency area for a selection of countries with stable and convertible currencies and low inflation (OECS countries, The Bahamas and Belize), was proposed along with the coordination of monetary policies and a gradual reduction of exchange rate fluctuations in the other countries. It was expected that this would allow the creation of a common currency area for the entire region by 2000. However, in 1994, the *Committee of Central Bank Governors* advised the Conference against pursuing a monetary union on the announced timetable, and the issue has not been addressed since then. More broadly, there has been little progress at the CARICOM level towards the coordination of macroeconomic and sectoral policies. Some progress has been made towards developing a regional capital market. Cross-listing and cross-border trading of securities can take place on three stock exchanges, and a stock exchange for the OECS countries was opened in 2001.

D. External Trade Policy and Practices in the ECCU

231. Given the substantial liberalization of intra-CARICOM trade, the bulk of the external trade policies of the ECCU members relates to their trade with non-CARICOM countries. This section discusses the principal aspects and developments with regard to the trade regime with non-CARICOM countries.

Characterizing the External Trade Policy

232. As discussed above, in October 1992 OECS countries agreed with other CARICOM members on a phased reduction of the common external tariff (CET), starting on January 1, 1993 and a target date of January 1, 1998 for the introduction of the final phase (Phase IV). Whereas the only country in the OECS to reach this goal was St. Vincent and the Grenadines, other countries have subsequently introduced Phase IV of the CET and as at end-2002 only Antigua and Barbuda and St. Kitts and Nevis had yet to introduce it. Under the Phase IV of the CET, tariffs on agricultural products were set at a maximum of 40 percent. Tariffs on the non-agricultural products were to be lowered to a maximum of 20 percent. However, there have been other complicating factors that have allowed duties to vary widely in the region. *First*, exemptions to the CET were allowed for a list of revenue-sensitive products, and for goods that a country regards as competing and wished to protect, but whose production accounts for less than 75 percent of regional consumption. *Second*, temporary suspension of CET rates on a number of agricultural products to the less developed members (mainly the OECS countries) was introduced. *Third*, the CET includes a list of conditional duty exemptions, mainly to be used for approved purposes. Duties can also be suspended in cases of temporary supply shortages.

233. The external tariff regime in the ECCU countries at end-2001 is summarized in Table 1. While the simple average tariffs are lower than 15 percent, customs and other charges are significant and there is wide dispersion in the tariffs. The maximum tariffs are also high, especially in Dominica, Antigua and Barbuda, St. Kitts and Nevis, and St. Lucia.[102] Additionally, the Fund's restrictiveness index characterizes these regimes as moderately restrictive.

Table 1. ECCU: Summary of Tariff Regime for Non-CARICOM Trade, as at end-2001
(as a percent, unless otherwise indicated)

	Antigua and Barbuda	Dominica	Grenada	St. Kitts and Nevis	St. Lucia	St. Vincent and the Grenadines
Combined Average	24.5	15.1	16.2	16.5	14.1	14.9
Customs and other charges	10.0	2.0	5.0	5.0	4.0	4.0
Average tariff (simple average)	14.5	13.1	11.2	11.5	10.1	10.9
Agriculture	20.9	24.7	18.2	16.1	16.6	18.0
Non-Agriculture excluding petroleum	13.1	10.9	9.8	10.6	8.8	9.6
Maximum tariff	70.0	200.0	40.0	70.0	70.0	40.0
Minimum tariff	0.0	0.0	0.0	0.0	0.0	0.0
Standard deviation	...	21.6	10.1	...	...	...
Number of tariff lines (number)	4,077	6,333	6,334	6,368	6,330	6,237
Overall Trade Restrictive Rating (index)	7	6	6	6	5	5
Tariffs (index)	4	3	3	3	2	2
Non tariff barriers (index)	2	2	2	2	2	2

Sources: WTO's reports on the OECS-WTO Trade policy review; IMF's Trade Restrictiveness Database.

[102] The maximum of 70 percent in St. Lucia applies to arms and munitions, otherwise the maximum is 45 percent.

The OECS-WTO Trade Policy Review

234. In June 2001, the WTO completed the first review of the trade policies and practices of the OECS-WTO members.[103] Several issues were highlighted at that review, especially that the OECS members were slow in applying domestically their WTO commitments, including on WTO notification and the needed legislative reform to implement the WTO agreements. It was argued that these delays were principally due to the lack of human resources and adequate infrastructure. Other areas of concern included:

- Customs service charges have not reflected processing cost but have been used more like tariff surcharges.
- WTO bindings were exceeded by the applied rate in some cases, and in even more cases when the customs service charge is also included.
- Except for Dominica, quantitative restrictions apply on some imports. It is expected that these will be converted to tariffs by 2005. Import licensing is also widely used.
- Customs valuation methods are not fully WTO-consistent.
- Updated legislation on trade-related aspects of intellectual property rights (TRIPS) are generally not in place.
- The process for government procurement seemed to lack transparency.

Special Trading Arrangements for Banana and Sugar Exports

235. Along with others in the African Caribbean and Pacific (ACP) countries, banana exporters in Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines have over the years benefited from the various Lomé Conventions These encapsulated trade cooperation with the EU in the awards of preferential tariffs and quotas. This regime benefited the ACP countries but recently came under heavy scrutiny since it was not WTO-compatible. Concomitantly, sugar exporters in the OECS and other Caribbean countries have benefited from the EU's "*Sugar Protocol,*" which provides specific quotas for imports to the EU at a set price that is well above world prices.

236. In June 2000, the OECS and other ACP countries signed with the EU the Cotonou Agreement, which is the successor of the Lomé Conventions. Under this agreement,

[103] All ECCU members except Montserrat and Anguilla are members of the WTO. Their membership's dates are: January 1, 1995 for Antigua and Barbuda, Dominica, St. Lucia, and St. Vincent and the Grenadines; February 21, 1996 for St. Kitts and Nevis; and February 21, 1996 for Grenada.

the existing system of preferential tariffs and quotas will be dismantled progressively and replaced by WTO-compatible trading arrangements. Specifically, the tariff and quota regime for bananas will be phased out by 2006 when it will be replaced by a WTO-compatible tariff regime, and the preferential arrangement for sugar will be phased out by 2009. The Cotonou Agreement stipulates that cooperation with the EU in trade-related areas will be enhanced, and detailed in an "*Economic Partnership Agreement*" that will be negotiated with each ACP country by 2007.

Trade Negotiations

237. As discussed, the OECS members coordinate their joint negotiating position through the OECS Secretariat. In turn, the OECS Secretariat will through the Caribbean Regional Negotiating Machinery (RNM) coordinate these views with those of other CARICOM members, to yield a common position that will be presented at the negotiations by the RNM on behalf of all CARICOM members. Of the negotiations that are ongoing, these include on the WTO's Doha Development Agenda, the Free Trade Area of the Americas (FTAA), and the EU's "*Economic Partnership Agreement.*" With regard to the FTAA negotiations, the OECS and other CARICOM countries are committed to the agreed goal of concluding the negotiations on the FTAA Agreement by January 2005, and its entry into force by December 2005. .