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# The Eastern Caribbean Economic and Currency Union

## Macroeconomics and Financial Systems



EDITORS
Alfred Schipke, Aliona Cebotari, and Nita Thacker



INTERNATIONAL MONETARY FUND

## Note to Readers

This is an excerpt from *The Eastern Caribbean Economic and Currency Union: Macroeconomics and Financial Systems*. The Eastern Caribbean Economic and Currency Union (OECS/ECCU) is one of four regional currency unions in the world. This handbook provides a comprehensive analysis of the key macroeconomic and financial sector issues in the OECS/ECCU from both the individual country and regional perspectives. It also provides an in-depth analysis of the relevant institutions, economic and financial sector linkages, and political economy issues for the region, as well as policy recommendations to foster economic growth. It emphasizes the progress that has been made and focuses on areas for reform for both the short and medium terms. Combining coverage of the various analytical topics with a discussion of the institutional setup of the economic and monetary union, the handbook provides background information on the social, political, and economic setting in the region. An understanding of these issues is important for the formulation and successful implementation of sound policies.

The Table of Contents, Foreword, Preface, and Chapter 1 are included in this excerpt.

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# Contents

# Foreword

Like countries everywhere, policymakers in the Eastern Caribbean Economic and Currency Union face major challenges—creating jobs, making growth more inclusive, fiscal consolidation, bank reform, and managing volatility. The IMF is committed to being a partner to help our member countries manage these challenges.

Building stronger partnerships with countries across the Caribbean, including members of the economic and currency union, is an important priority for the IMF. We have stepped up our efforts to support these countries, including through enhanced dialogue, increased capacity building, more analytical work, and additional financing. For example, over the past couple of years, the IMF approved a total of eight requests for financial support for five members of the union.

This handbook draws on a wide range of work that captures the depth and breadth of the IMF's analysis across the region. It covers many important issues, among them growth, public revenue and expenditure, the financial sector—including linkages between the financial sector and the macroeconomy—as well as obstacles to private sector development. The handbook also delves into issues specific to the institutional underpinnings for the monetary union and the functioning of the Eastern Caribbean Central Bank. Finally, it includes case studies on recent experiences with debt restructurings and a chapter on developing regional capital markets—both topics of broader interest.

Much of this work in the region goes hand-in-hand with the IMF's efforts to give more attention to issues facing small states—especially those most vulnerable to external shocks, such as in the Caribbean—and to ensure effective IMF support for low-income countries.

To improve the living conditions of all citizens, the IMF remains committed to its continuing relationship with the Eastern Caribbean Economic and Currency Union, both for each country and for the union as a whole. I hope this book will serve as a resource for policymakers in the region and for those interested in monetary unions, microstates, and island economies.

*Christine Lagarde*
Managing Director
International Monetary Fund

# Preface

This publication is the first of its kind and provides a comprehensive analysis of the key macroeconomic and financial sector issues in the Eastern Caribbean Economic and Currency Union (OECS/ECCU). It complements two previous IMF publications on the Caribbean, *The Caribbean: From Vulnerability to Sustained Growth* (2006) and *The Caribbean: Enhancing Economic Integration* (2008), as well as a World Bank publication, *The Organization of Eastern Caribbean States: Towards a New Agenda for Growth* (2005). This volume combines coverage of the various analytical topics with a discussion of the institutional setup of the economic and monetary union, and provides background information on the social, political, and economic setting. An understanding of all of these areas is important for the formulation and successful implementation of sound policies.

This book would not have been possible without the support of many economists and research assistants, cutting across a large number of IMF departments and the Eastern Caribbean Central Bank (ECCB). The authors would also like to express their appreciation for the useful comments and suggestions received from the authorities in the region, the ECCB, and the participants at the 2011 conference “Options for the Caribbean after the Global Financial Crisis”—organized jointly by the University of the West Indies, the Central Bank of Barbados, and the IMF in Barbados—as well as the participants at the 2011 Joint ECCB/IMF Seminar in St. Kitts. The editors would like to thank Laurel Bain and Karen Williams of the ECCB for their support throughout the project.

The authors are indebted to Rodrigo Valdéz and David Vegara for their comments and guidance. Special thanks go to Adrienne Cheasty, who was instrumental in organizing the development of the chapters on fiscal revenue and public expenditure. Xin (Mike) Li did an outstanding job of managing, producing, and formating the many figures and tables in record time. The authors would also like to thank Joy Villacorte for coordinating the production of the manuscripts and keeping tabs on the many contributions. Most important, the authors would like to thank Sherrie Brown for an outstanding job in copy editing the manuscript and Joanne Johnson of the IMF External Relations Department, who not only coordinated the production of the publication, but was instrumental in developing the project.

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# Abbreviations

| | |
|---|---|
| ABIB | Antigua and Barbuda Investment Bank |
| AfDB | African Development Bank |
| AML/CFT | anti-money laundering and combating the financing of terrorism |
| BAICO | British American Insurance Company |
| BIS | Bank for International Settlements |
| BPM5 | IMF, *Balance of Payments and International Investment Position Manual*, fifth edition |
| BPM6 | IMF, *Balance of Payments and International Investment Position Manual*, sixth edition |
| CAC | collective action clause |
| CARICOM | Caribbean Community and Common Market |
| CARTAC | Caribbean Regional Technical Assistance Center |
| CDB | Caribbean Development Bank |
| CET | common external tariff |
| CIT | corporate income tax |
| CLICO | Colonial Life Insurance Company |
| CPI | consumer price index |
| CPIS | Coordinated Portfolio Investment Survey |
| CSME | CARICOM Single Market and Economy |
| CSO | Central Statistical Office |
| EC$ | Eastern Caribbean dollar |
| ECCB | Eastern Caribbean Central Bank |
| ECCM | Eastern Caribbean Common Market |
| ECCU | Eastern Caribbean Currency Union |
| ECSE | Eastern Caribbean Securities Exchange |
| ECSM | Eastern Caribbean Securities Market |
| ECSRC | Eastern Caribbean Securities Regulatory Commission |
| EM-DAT | Emergency Disaster Database |
| EPA | Economic Partnership Arrangement |
| EU | European Union |
| FATF | Financial Action Task Force |
| FDI | foreign direct investment |
| FSB | Financial Stability Board |
| FSSA | Financial System Stability Assessment |
| G-7 | Group of Seven |
| G-20 | Group of 20 |
| GDDS | General Data Dissemination System (of the IMF) |
| GDP | gross domestic product |
| GFSM | IMF, *Government Finance Statistics Manual* |
| HIV/AIDS | human immunodeficiency virus/acquired immunodeficiency syndrome |
| IADB | Inter-American Development Bank |
| IBCs | international banking companies (corporations) |
| IBM | interbank market |

| | |
|---|---|
| IFS | IMF, *International Financial Statistics* |
| IIP | international investment position |
| ILO | International Labor Organization |
| IRD | Inland Revenue Department |
| ITC | information and communications technology |
| MDG | Millennium Development Goal |
| NPL | nonperforming loan |
| NPV | net present value |
| NSB | national statistical bureau |
| OCA | optimal currency area |
| OECD | Organization for Economic Cooperation and Development |
| OECS | Organization of Eastern Caribbean States |
| OFC | offshore financial center |
| PAYGO | pay as you go |
| PE | parastatal entity |
| PIT | personal income tax |
| PPP | public-private partnership |
| PRGF | Poverty Reduction and Growth Facility |
| PSIP | public sector investment program |
| PWT | Penn World Tables |
| RCA | revealed comparative advantage |
| RDCC | Regional Debt Coordinating Committee |
| RGSM | Regional Government Securities Market |
| RSB | regional statistical bureau |
| RTGS | real-time gross settlement |
| SNA | System of National Accounts |
| SPV | special purpose vehicle |
| SRU | Single Regulatory Unit |
| SVAR | structural vector autoregression |
| TIEA | Tax Information Exchange Agreement |
| UN | United Nations |
| VfM | value for money |

PART I

# Introduction and Summary

CHAPTER 1

# The Eastern Caribbean Economic and Currency Union: Overview and Key Issues

ALFRED SCHIPKE, ALIONA CEBOTARI, AND NITA THACKER

The Eastern Caribbean Economic and Currency Union (OECS/ECCU) is one of four regional currency unions in the world.[1] The small, open, middle-income, and tourism-dependent island economies that comprise the union include six independent countries (Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, Saint Lucia, and St. Vincent and the Grenadines), as well as Anguilla and Montserrat, which are overseas territories of the United Kingdom.[2] All of these member states are located among the archipelago of islands (called the West Indies or, more commonly, the Caribbean) dispersed between North America and South America in the Caribbean Sea. All of the members are also considered microstates. The union shares a common currency pegged to the U.S. dollar, which has provided a strong anchor for macroeconomic stability and low rates of inflation, and has facilitated financial system development.[3]

As in other parts of the world, the fallout from the 2008–09 global economic and financial crisis brought to the fore significant weaknesses that need to be addressed in both the short and medium terms. Overcoming these weaknesses is particularly challenging in monetary unions, given existing institutional frameworks and insufficient policy coordination among the members. In many respects, the OECS/ECCU is a microcosm of the euro area and its difficulties. Growing fiscal deficits, lack of fiscal integration, unsustainable debt, and challenges in the financial sector could threaten the currency union's very foundation. Although the currency arrangement remains an appropriate exchange rate regime, there are some indications that the region has lost competitiveness. The common currency's continued success rests on the region's ability to spur strong economic growth, reduce poverty, collectively enforce fiscal discipline, and strengthen and harmonize financial sector regulation and supervision. The tasks for policymakers are significant and the rapidly changing global environment has increased the need for action. The current challenges, however, also present a unique opportunity to generate broadly based public and political support to advance the reform agenda and strengthen the union further.

This handbook provides a comprehensive analysis of key macroeconomic and financial sector issues in the OECS/ECCU, from both the individual country and the regional perspectives. In addition to the analytical work, it provides an in-depth analysis of the relevant institutions, including the setup of the union, as well as economic and financial sector linkages and political

[1] In addition to the European Economic and Monetary Union, there are two regional currency unions in Africa: the Central African Economic and Monetary Community and the West African Economic and Monetary Union.

[2] Although the OECS also formally includes the British Virgin Islands as an associate member, that territory does not use the Eastern Caribbean dollar. Anguilla, in turn, is only an associate member of the Organization of Eastern Caribbean States (OECS), but a full member of the currency union. In this book, unless otherwise specified, the OECS/ECCU refers to those members that form part of both regional arrangements.

[3] See Figures 1.1 and 1.2 and Tables 1.1 through 1.4 at the end of this chapter for descriptive statistics of the region.

economy issues. It emphasizes the progress that has been made and focuses on areas for reform for both the short and medium terms.

The remainder of this chapter provides short summaries of the subsequent chapters in the book. It starts with a discussion of the social, political, and economic settings of the OECS/ECCU, including the level of integration and its institutional organization. Based on growth analyses, the book provides policy recommendations to improve economic growth and the living standards of its citizens. On the fiscal front, the book reviews a range of important fiscal policy and administration issues—revenue, public expenditure, fiscal multipliers, and public debt—and provides a number of insights from experiences with debt restructurings, both within the region and beyond. Because the region's financial sector is fairly well developed but also faces significant challenges, the book covers the key sectors of the financial system (including linkages) ranging from banking, to credit unions, the insurance sector, and capital markets. A chapter on offshore financial centers (OFCs) looks at both the potential for growth and the implications for the union of a number of global initiatives. Given the monetary union and its peg to the U.S. dollar, two chapters cover the role and institutional setup of the Eastern Caribbean Central Bank (ECCB) and the region from the point of view of an optimal currency area. Progress on addressing impediments to private sector development, a crucial engine for growth, are discussed in a separate chapter. A chapter on macroeconomic statistics completes the book.

## THE SETTING

The successful implementation of economic and financial policies requires a good understanding of a country's history, social and economic development, and institutional setup. In the OECS/ECCU, both country-specific and wider regional issues must be addressed.

### The Social, Political, and Economic Setting

Before independence in the 1970s and 1980s, economic activity in the OECS/ECCU was primarily determined by colonial policies centered on the agricultural sector. Native inhabitants and African immigrants were forced to work on sugar and cotton plantations until slavery was finally abolished in 1838. Following independence, the region became the testing ground for a wide range of economic theories and ideologies that shaped its social, political, and economic history; these include the plantation economy model, industrialization by invitation, small open economy models, and diversification into tourism.

The Eastern Caribbean scores relatively well on most social indicators. For example, life expectancy averages 74 years, which is 4 years more than the average for middle-income countries. The primary school completion rate, a measure of basic education, is close to 100 percent. Significant progress has also been made toward meeting the United Nations Millennium Development Goals. Notwithstanding these successes, individual country poverty assessments show a different picture in that rural, agricultural communities exhibit characteristics of illiteracy and poverty, including inadequate housing and poor sanitation, which are even worse in some urban communities. High levels of poverty not only limit the region's growth potential, but also undermine the sustainability of its development gains. Despite the lack of regular labor market surveys, unemployment—especially youth unemployment—is a major concern threatening the very fabric of the societies.

The Westminster-based political systems have delivered stable democracies, with relatively smooth transfers of power and high participation rates in national elections. At the same time, the systems seem to exaggerate political business cycles and have resulted in persistently increasing public debt levels. They also appear to engender a focus on short-term policy solutions, thus evading long-term planning that would promote higher levels of sustained growth. Attempts at reforming the political system have been made, including regional political integration and domestic constitutional reforms.

### The Institutional Setup of the OECS/ECCU

Although economic integration in the Eastern Caribbean has taken place on a number of levels (multilateral trade liberalization, in the context of the Caribbean Community [CARICOM] single market, and at the OECS/ECCU level), the integration model is determined by the region's common currency. In addition to the monetary union and the ECCB, the Eastern Caribbean—as part of CARICOM—envisages the establishment of a customs union, but so far it has not been put in place. With an open capital account and the right of establishment for companies and financial institutions, the financial sector is already well integrated and includes a functioning regional government securities market. Although the free movement of labor (pursued at the CARICOM level) is limited to university-trained persons and the informal sector, the region is implementing measures to ensure an integrated labor market for the future.

At the beginning of 2011, the Eastern Caribbean made an important further step toward the creation of a fully fledged Eastern Caribbean Economic and Currency Union by ratifying the revised OECS treaty (Treaty of Basseterre). Among other actions, the revised treaty will strengthen the governance structure of the union and transfer legislative authority in a number of areas (trade, financial, and monetary policy) to the OECS Authority, comprising the respective prime (chief) ministers. Also, the region has established the Assembly of Parliamentarians, which functions as the regional parliament, comprising elected parliamentarians from each member of the currency union (including both ruling and opposition parties). Although the revised union treaty also mentions fiscal policy coordination, it continues to remain within the sole purview of national governments. At the same time, the authorities put in place a number of important commissions (on tax and tax administration, pension and pension administration, and public expenditure review), with a view to implementing reforms regionwide.

The greatest benefits from further economic integration in the Eastern Caribbean will come from scale economies (rather than intraregional trade), risk sharing, rationalizing the provision of public services, eliminating duplication of administrative structures, and the ability to better represent the region in international forums. The 2008–09 global crisis, however, has exposed significant weaknesses. In particular, faced with very high public debt, the region needs to put in place a mechanism to enforce fiscal discipline because the success of the common currency depends on simultaneously satisfying eight national budget constraints. As the experiences from the European Union demonstrate, cross-border spillover—especially via the financial sector—from the weakest member could undermine confidence and trigger a regionwide crisis. In the medium term, a more centralized regional fiscal authority or even a fiscal union should be considered. Financial sector regulation and supervision also needs to be strengthened to avoid regulatory arbitrage and overbanking.

## ECONOMIC GROWTH

After growing faster than the rest of the world in the early years following independence, the OECS/ECCU countries have experienced a significant decline in growth since the 1990s. The region has been buffeted by a series of adverse exogenous shocks over time, including the erosion of trade preferences with Europe, terms-of-trade shocks, reductions in official foreign assistance, recessions in the developed countries—the main source of tourism and foreign direct investment for the region—and frequent natural disasters. Thus, growth has declined from an average of 6 percent in the 1980s to slightly more than 2 percent since 2000, with most OECS/ECCU countries reporting negative growth in 2009–10. However, there is considerable heterogeneity across OECS/ECCU countries reflecting different policy responses to a challenging external environment.

Two different methods are used in this book to explore the reasons for the deterioration in growth performance: the growth accounting framework and regression analysis. The growth accounting framework suggests that a decline in total factor productivity, rather than a lack of investment, is the principal reason for the growth slowdown. The regression model, which includes tourism, suggests that tourism and related services have been significant contributors to growth, and in many countries there remains scope for further expansion of this sector. At the same time, it also suggests that the OECS/ECCU's public indebtedness has hampered growth considerably.

There are several important takeaways from this analysis. First, policies that facilitate further development of tourism could pay dividends at the current stage of economic development. Second, structural reforms aimed at improving the competitiveness of tourism, combined with efforts to develop better products, could provide a boost to growth. Last, but not least, the most promising role for policy lies in fiscal consolidation to support long-term growth.

## FISCAL POLICY AND ADMINISTRATION

High public debt has been a policy challenge in the OECS/ECCU—as well as other Caribbean countries—for some time, calling for an analysis of the causes of debt accumulation and its structure. Putting public debt on a sustainable path will require significant fiscal adjustments and improvements in tax and customs administration. Furthermore, in light of the currency union and the small scale of its members, further regional coordination of fiscal policies will be paramount. In most members of the OECS/ECCU, neither revenue mobilization nor expenditure rationalization alone will be sufficient, and comprehensive measures will be needed on both fronts. The challenge will be to minimize any adverse impact on growth in the short term. In some of the countries, debt restructuring or debt-equity swaps could be part of the solution.

### Public Debt

Public debt in OECS/ECCU countries has been among the highest in the world, and all independent member countries—except Dominica—rank within the 15 most indebted emerging market and developing economies and exceed the OECS/ECCU's debt-to-GDP target of 60 percent. Although other emerging market and developing economies saw their debt levels rise as a result of the 2008–09 global economic and financial crisis, the OECS/ECCU was particularly hard hit. In terms of the structure of public debt, about half is owed to domestic creditors (aided by a captive financial system) and half is external debt, more than 20 percent of which is external debt owed to multilaterals, with the majority owed to the Caribbean Development Bank.

A simple analysis of the sources of debt accumulation for 2005–08 shows that both deficits in the primary balance and other "residual" factors were the main culprits. The latter suggests that public sector deficits were underestimated, possibly because of off-budget operations, bailouts, and the granting of debt guarantees to public enterprises. Conversely, the differential between real interest rates and growth played a minor role before the economic and financial crisis, but the collapse in economic activity in the wake of the crisis was one of the major factors contributing to the surge in the public debt ratio in 2009. Although some countries have undertaken fiscal consolidation measures and debt restructuring, debt levels remained at elevated levels in 2011.

Along with highlighting the importance of fiscal consolidation, the analysis also reveals the need for complementary measures to place debt on a firmly downward trajectory. Depending on members' initial conditions, the required adjustments would have to range from 2½ to almost 10 percent of GDP to achieve the OECS/ECCU's target of reducing the public-debt-to-GDP ratio to 60 percent or less by 2020. The debt decomposition suggests that fiscal adjustments need to be complemented by measures to prevent the transfer of government activities to off-budget operations and also possibly debt restructuring. Given the currency board arrangement and peg to the

U.S. dollar, the simultaneous implementation of fiscal reforms by all members is crucial for preventing spillovers from the weakest member, which could undermine confidence in the currency.

## Enhancing Fiscal Revenue

The overall tax effort in the OECS/ECCU fares well in international comparisons, but the fiscal adjustment needs ahead are particularly large and urgent, and make revenue-boosting reforms unavoidable. Tax revenue averages about 21 percent of GDP in the OECS/ECCU (albeit with significant heterogeneity), higher than what could be expected for the members' level of development or what has been observed among most emerging market economies. These tax ratios have been bolstered by tax reforms initiated in the early 2000s that included, most notably, the introduction of the value added tax (VAT), but also reforms in income and corporate taxes and strengthened revenue administration. Given their high degree of openness and the relative ease of collecting taxes at customs, trade-related taxes have remained an important source of revenue, but revenue from these sources will decline with trade liberalization and tariff reform. Direct taxation, however, is weaker and generally below that of countries with similar income levels as a result of low tax rates, low tax bases, or small corporate sectors.

Despite strong overall levels, the potential for further revenue mobilization is considerable. A large number of activities continue to escape the tax net either through exemptions, high thresholds below which income taxes are not charged, or widespread tax incentives to attract investment. Bringing these activities into the tax net—by scaling back tax incentives; limiting exemptions from the VAT, income, and property taxes; and expanding the scope of excise taxes to all traditionally excisable goods—along with efforts to fight tax evasion, provides significant potential for the revenue mobilization needed to address existing fiscal imbalances. Thus, the key challenge facing policymakers is to avoid raising the tax burden on those economic activities already in the tax net, while broadening the tax base significantly. This would achieve a more equitable distribution of the tax burden and at the same time allow for a reduction in tax rates, which, in turn, will enhance competitiveness and strengthen revenue performance.

The growing regional economic integration makes tax policy coordination and harmonization increasingly important. The success of many revenue mobilization efforts, especially a meaningful widening of the tax base in all OECS/ECCU countries, will hinge critically on such coordination. Tax coordination is needed to retain mobile resources and prevent a welfare-reducing race to the bottom, in which a tax reduction in one country triggers a response from other countries in the region resulting in narrow tax bases and low tax revenue. This applies in particular to tax incentives, but there is significant scope to more closely align other aspects of taxation, including the treatment of capital income, losses, and depreciation.

Significant improvements were achieved during the past decade in OECS/ECCU revenue administrations, mainly related to the introduction of the VAT. The VAT turned out to be the catalyst for reform of entire internal revenue departments because it was supported by improvements in all core functions—taxpayer services, collections enforcement, and assessments and appeals. Customs administration reforms were also very successful and focused on upgrading information technology (IT) systems and streamlining procedures to facilitate trade. To support revenue mobilization, efforts should focus on reinvigorating tax administration reforms to upgrade IT systems, strengthen audit capacity, and move toward institutional organizations based on function and taxpayer size (rather than tax type) to improve the focus and efficiency of tax collections. However, many of the deep-seated weaknesses in revenue administration are rooted in the lack of economies of scale and lack of skills caused by the small size of the countries, and need to be addressed at a regional level. A move toward integration of some revenue administration services—such as large taxpayer audit, IT management and maintenance, and legal services—could provide significant benefits.

## Expenditure Rationalization for Fiscal Stability

High and rising public expenditure in the OECS/ECCU region underscores the need for broadly based public expenditure reforms. Reducing public expenditure to more sustainable levels will not only help to ensure fiscal and public debt sustainability, but will also create fiscal space for expanding well-targeted social assistance programs and for responding to shocks, including natural disasters. Experience in other countries indicates that expenditure-based fiscal consolidation efforts are more successful than revenue-enhancing measures, especially given the structure of expenditures in the OECS/ECCU. Over the medium term, a broad expenditure rationalization strategy in the region could reduce public spending on a cumulative basis by 3 to 5 percent of GDP. Reducing the wage bill (which accounts for one-third of total government expenditures), reforming social security systems, and rationalizing the parastatals (statutory bodies) should be critical elements of any expenditure reform strategy in the region. Some countries have implemented temporary measures to control wage-bill growth in times of crisis, but these efforts have not been underpinned by an overall reform strategy. Over the medium term, this issue needs to be addressed through comprehensive civil service reforms.

It is also important to streamline total compensation spending (including benefits and allowances, pensions, and the like). Social security systems and statutory bodies are also key sources of fiscal risk. However, comprehensive financial information on the operations of these bodies is not publicly available, limiting a public assessment of possible fiscal risks. Unfavorable demographics and generous pension benefits could threaten the sustainability of social security systems in the region. Some schemes are already running cash deficits and others will do so in the near future unless system parameters are adjusted. Actuarial estimates suggest that contribution rates would have to increase between four and seven times the current rates by 2050 for contributions to cover the promised benefits. To address some of these issues, an OECS/ECCU-wide pension commission made important policy recommendations, which now need to be implemented. With regard to parastatals, financial reporting and monitoring of their activities are weak, partly due to capacity constraints. Governments in more than one country have had to take over the debt-service obligations of some entities unable to service their debt. Regular reporting and publication of audited financial statements are key to reducing risks from these entities.

Steps to rationalize spending in other areas will also be important for successful expenditure reform. Population aging and noncommunicable chronic diseases are expected to put strong upward pressure on health spending in the medium term. Projections indicate that health care costs could rise as much as 10 percent of GDP in some countries by 2050 under high cost growth assumptions. Strengthening cost controls, including through reviews of the cost effectiveness of service delivery, cost recovery, and benefit packages, would be important for containing the growth of heath care costs in the future.

At about 5 percent of GDP, education spending is high relative to other countries in the wider Caribbean. This is also true for per capita spending in education, reflecting the priority attached to the sector in the post-independence period. Nevertheless, education outcomes are not always commensurate with the high spending, pointing to inefficiencies. Rationalizing the education workforce consistent with changing student demographics, reallocating spending toward non-salary components, and better targeting of subsidized educational programs could simultaneously contain costs and improve education outcomes.

There is also considerable scope to rationalize social assistance programs through improved targeting and enhanced monitoring. Spending on such programs ranges between 1 and 2 percent of GDP, but much of this is not well targeted. Program designs need to be more flexible to improve the ability to respond to shocks. Linking social assistance to actions that promote human capital development can help break the intergenerational transmission of poverty. All of these areas offer opportunities for greater regional cooperation to reap benefits from economies of scale.

## Fiscal Multipliers

The ability of government policies to manage output dynamics in the OECS/ECCU is limited. In the absence of monetary and exchange rate policy, fiscal policy is one of the few instruments governments in the OECS/ECCU can wield to deal with output fluctuations. Because of the relatively large share of the government sector in total output, the peg to the U.S. dollar, and the level of economic development, changes in tax and public expenditure policies may play an important role in output dynamics. At the same time, factors such as the high degree of trade openness and the high level of public indebtedness may weaken the effectiveness of fiscal policies.

Tax and public expenditure multipliers provide a quantitative measure of the change in output resulting from a unitary increase in taxes or government spending, and are critical for evaluating the effectiveness of fiscal policies to manage output fluctuations. The magnitude of fiscal multipliers has been under close scrutiny because the 2008–09 crisis prompted government intervention worldwide in the form of tax reductions and expenditure programs aimed at avoiding a global deflationary scenario. Two questions arise with regard to the OECS/ECCU: To what degree is fiscal policy successful in affecting aggregate demand? And which of the available instruments (changes in taxes, public consumption spending, and public investment spending) is better suited to accomplishing this objective?

The empirical evaluation of the fiscal multipliers for the eight members of the OECS/ECCU is based on the estimation of structural vector autoregression models using panel data. The calculation of tax and public spending multipliers for the short and long terms is based on the dynamic response of GDP to shocks in those fiscal variables. It turns out that government investment expenditure indeed affects output. However, with a multiplier of less than 1 (0.6 in the long run), the initial increase in aggregate demand is eroded somewhat by effects that counteract the initial increase in public spending, probably because of the high import content of investment in OECS/ECCU countries. The results also reveal that public consumption spending and taxes are largely ineffective, suggesting that countercyclical policy in the OECS/ECCU, if warranted, should focus on public investment.

## Experiences with Debt Restructuring: Case Studies from the OECS/ECCU and Beyond

When faced with very high public debt levels, fiscal adjustments through revenue mobilization and expenditure rationalization alone are sometimes not enough to put debt on a sustainable path. Given that the OECS/ECCU is among the most highly indebted regions in the world, it is not surprising that four out of the six member countries have undergone—or are currently embarking on—debt restructurings. Although no two debt restructurings are alike and there is no simple blueprint, the OECS/ECCU cases (Dominica, Grenada, Antigua, and St. Kitts and Nevis), supplemented by case studies from other emerging market and small tourism-dependent economies (the Dominican Republic, Belize, Seychelles, and Jamaica) that underwent debt restructurings during the past 10 years, provide some useful insights. Each case study country either used a unique aspect of debt reduction, or was among the first to adopt a new toolkit. Although the unique approach adopted by a country depends on its circumstances, other countries could replicate or adapt the novel methods to suit their needs. The case studies reveal significant variation in the origin of debt problems, the size and structure of public debt, the choice of flow versus stock reductions, the proportion of creditors accepting the terms of agreement, or the ultimate result of the restructuring, as well as IMF involvement.

Despite the differences across countries, the case studies provide the following lessons: (1) a convincing set of policy reforms in the country requesting a debt restructuring is a fundamental element of any successful restructuring; (2) engaging with creditors through an intense dialogue and pursing an effective communication strategy contributes significantly to the success of the debt restructuring; (3) debt restructuring can often be better coordinated through a leading creditor group, such as the Paris Club or London Club; (4) despite a country's best efforts, there are often "holdout" creditors, and the establishment of escrow accounts can encourage the closing of negotiations with nonparticipating creditors at a later stage; (5) restructurings can be challenging if debt has special features but there are novel solutions (such as debt-for-land swaps for debts secured by land); (6) the stability of the domestic financial and banking sectors during the debt-restructuring process can be protected through the creation of a stabilization or reserve fund to provide necessary liquidity; (7) to achieve high participation, collective action clauses, the delisting of bonds, cross-default clauses, and principal reinstatement clauses can be helpful; (8) the involvement of regional development banks through partial guarantees and other support can improve the success of the debt exchange; and (9) although IMF support varied by country, it played an important role in each of these cases.

## THE FINANCIAL SECTOR

The OECS/ECCU is among the world's most highly monetized regions. In line with other countries at similar stages of economic development, the OECS/ECCU financial sector is dominated by commercial banks, but other financial institutions, a regional capital market, and offshore financial centers (OFCs) also play important roles. The fallout from the 2008–09 global economic and financial crisis, however, revealed significant weaknesses and caused the failure of a number of institutions. In the future, major reforms will be needed to strengthen the system to ensure the viability of the currency union and the peg and to ensure that the financial system continues to support the development of the economies. Although some reforms are already ongoing, they need to be intensified and broadened.

### Banking Sector

Despite the small size of the countries, the banking sector in the OECS/ECCU is well developed. In addition to foreign banks, which account for about 50 percent of assets and liabilities, the region has 14 indigenous banks. The development of indigenous institutions, capitalized from within the OECS/ECCU, was encouraged by the newly independent states as far back as the 1980s to fill a void that was not served by existing foreign banks. With 40 licensed institutions and a population of about 15,000 per bank, signs of overbanking are becoming apparent.

Adverse shocks can be transmitted to the OECS/ECCU's banking sector through different linkages. In addition to real sector linkages, a number of major financial sector channels exist, both with the rest of world and across the OECS/ECCU and the broader Caribbean. With respect to linkages to the rest of the world, the strong presence of Canadian banks turned out to be a source of stability during the 2008–09 crisis. One bank from Trinidad and Tobago also operates in the OECS/ECCU. The collapse of an offshore bank related to the Stanford Financial Group, however, triggered a large deposit run on an onshore affiliate (Bank of Antigua), requiring subsequent intervention. There is also significant interconnectedness within the OECS/ECCU via cross-ownership; a regional interbank market; and holdings of deposits, loans, and investments. For example, some banks hold equity positions in other banks, while credit unions and insurance companies hold deposits in banks.

As in other parts of the world, the 2008–09 global crisis adversely affected the banking sector in the region. It put stress on banks' balance sheets, nonperforming loans surged, a number of institutions faced tight liquidity conditions, and the exposure of some indigenous banks to government increased. It also appears that provisioning for loan losses is not consistent with international norms and although financial soundness indicators suggest that the banking sector is meeting prudential norms, capital is likely to be overstated. The authorities responded on a number of fronts, including by assuming control of two institutions, privatizing a third, establishing a Resolution Trust Company, and announcing their intention to consolidate the indigenous banking sector to reduce the number of institutions. The authorities are also evaluating the benefits and costs of establishing a deposit insurance scheme. However, more needs to be done, and in light of the recent experiences from around the world and the OECS/ECCU, regulation, supervision, and resolution frameworks need to be strengthened. The ECCU's Eight Point Stabilization and Growth Program already envisages a strengthening of the regulatory and supervisory framework.

## Credit Unions: Prospects and Challenges

In addition to banks, 61 credit unions play an important role in the region's financial intermediation. Credit union membership in the OECS/ECCU ranks among the 13 economies with the highest ratio of credit union members to total population in a sample of 93 countries. Two members, Montserrat and Dominica, top this list with membership ratios exceeding 80 percent, in contrast to a worldwide average ratio of about 10 percent. Despite the impact of the global economic and financial crisis, assets and liabilities increased steadily during the 2005–10 period. At end-2010, credit unions accounted for about 12 percent of deposits and 10 percent of total private sector loans.

Credit unions filled a void in the financial system when they were initially founded in the 1940s in the Caribbean—similar to microcredit institutions in today's world. Originally, members shared a common bond, usually place of residence or occupation. However, credit unions are now open to anyone and compete with commercial banks in the market for deposits and consumer loans and many other financial products.

The lack of reliable data, including soundness indicators in line with PEARLS standards,[4] makes it difficult to assess and monitor the health of the sector. In addition to more timely and accurate data, and given the importance and size of credit unions in the region and the risk of spillovers to the broader financial system through a number of channels, regulation and supervision urgently needs to be strengthened. In the short term, this could entail transferring the supervision of systemically important credit unions to the ECCB, and in the medium term the creation of a regional supervisory body. Effective supervision also calls for the consolidation of the sector to allow improved oversight and to strengthen performance.

## The Insurance Sector and the Collapse of CL Financial

Another part of the financial system well developed in the OECS/ECCU is the insurance sector. At end-2010, the OECS/ECCU had some 161 registered insurance entities. Several regional firms based in Trinidad and Tobago and Barbados have notable market shares. The 2009 collapse of Trinidad and Tobago–based CL Financial Limited (CLF) and related companies, however, caused a major upheaval throughout the Caribbean, putting at risk depositors, investors, and policyholders, including individuals, corporate and public pension schemes, banks, and credit unions. With a gross exposure to CLF of about 12 percent of GDP, the OECS/ECCU was hit particularly hard.

What caused the CLF subsidiaries Colonial Life Insurance Company (CLICO), CLICO International Life (CIL), and the British American Insurance Company (BAICO) to collapse and why did the OECS/ECCU suffer the most? Among other reasons, CLF sourced itself via deposit-like annuity products sold by its insurance subsidiaries. The products offered returns that were

[4] PEARLS standards comprise protection, effective financial structure, asset quality, rates of return and costs, liquidity, and signs of growth.

substantially higher than bank interest rates, but were not subject to stricter banking regulation and supervision. The flow of funds from the OECS/ECCU through BAICO Bahamas and CLICO Barbados before the crisis was largely in one direction—funds were taken in locally and the corresponding assets generally were held elsewhere. Assets, in turn, were concentrated in such illiquid sectors as real estate and energy. Faced with the 2008–09 global crisis, CLF suffered both liquidity and solvency problems. A critical factor in the collapse of CLF was the weakness in the regulatory framework and supervision, which provided supervisors with insufficient authority to address these issues. Furthermore, in the OECS/ECCU, the supervisory authorities relied too much on home country supervision and—with the exception of Saint Lucia—statutory fund requirements were not adequately enforced. Insurance supervision was chronically undersourced because of the small size of the countries, the fact that each country has its own national supervisory authority, and the large number of insurance companies in the region.

To deal with the fallout from the collapse of CLF, the authorities have made some progress in implementing their revised strategy. The strategy was announced in February 2011 and includes the setting up of a health fund to provide relief to health policyholders, and the sale of the traditional insurance business. The relief for holders of the nontraditional assets, however, will depend on available resources, including financial support from Trinidad and Tobago. The OECS/ECCU authorities are also aware of the need to strengthen insurance regulation and supervision. In October 2011, the Monetary Council approved the principles of a consolidated insurance sector and implementation of enhanced regulations and prudential requirements. Despite agreement on these broad principles, including the establishment of a regional supervisor, many details still need to be fleshed out, and implementation needs to be expeditious and uniform across jurisdictions.

## Capital Markets: An Example of a Regional Market

Although financial intermediation in the OECS/ECCU remains dominated by banks, in early 2000, the union took an important step toward the development of capital markets by launching the Eastern Caribbean Securities Exchange Limited, the Eastern Caribbean Securities Market for the issuance and trading of corporate securities, and the Regional Government Securities Market (RGSM) for government securities. The primary segment of the RGSM has been the larger and more dynamic component of the regional capital markets. Among the monetary unions in the world, the OECS/ECCU is the only one with a regional government securities market that has a common platform for sovereign debt issuance and a coordinated auction calendar to facilitate an orderly issuance process, although it does not yet offer bonds issued by all members of the union.

The RGSM has fostered the active participation of some member governments and a more diversified investor base for governments' debt issuances, including from outside the OECS/ECCU. The geographical distribution of investor participation has largely reflected the dominant issuers on the RGSM, and banks continue to play a pivotal role as key investors in government securities. Primary issuance has been predominantly in the form of Treasury bills, and only a few countries have issued instruments with longer maturities. The relatively competitive nature of Treasury bill auctions is reflected in both the limited variation in Treasury bill yields across auctions (although yields vary across individual countries) and the tendency for oversubscription at auctions. In the past issuers tended to choose a noncompetitive subscription process for their bond issuance, and yields only varied to reflect bonds' duration and currency of issuance, along with investors' perceptions of the creditworthiness of the issuer. Secondary market activity in government securities has been virtually nonexistent, hampered by both a tendency for investors to buy and hold securities to maturity and a broker/dealer system that has not effectively facilitated secondary market trading.

Despite its success so far, there is much room for further expansion and deepening of the RGSM. A key challenge will be to increase participation by both issuers and investors. Streamlining procedures in the primary market of the RGSM, including moving to a competitive auction process for bond issuance, and changing to a dealer-based model to facilitate greater trading activity in the secondary market, will go a long way toward encouraging greater participation by issuing governments and investors. In addition, greater direct institutional investor participation in the RGSM would result in an important shift away from bank loans in the financing model historically used by institutions investing in government securities in the region, and hence would be more supportive of financial stability. Issuing common OECS/ECCU government debt securities is also worth pursuing as a long-term objective, particularly in the context of improved long-term fiscal conditions or a complete fiscal union. It would be the logical next step to further deepen the integration of regional debt markets. Larger debt instruments, too, would also be more attractive to international investors, particularly if the secondary market is functioning better. The corporate equity and debt markets have remained relatively small, and given the high cost of complying with transparency, monitoring, and reporting requirements for a well-functioning corporate equity market, the OECS/ECCU may want to consider tying its corporate securities market to larger equity markets in the region.

## Offshore Financial Centers (OFCs): To Be or Not to Be?

OFCs in the OECS/ECCU have relatively small shares of total worldwide offshore activity, GDP, and fiscal contribution, but they offer financial services ranging from international banking for corporations and individuals, to foreign direct investment, to insurance. Unlike some other OFCs before the 2008–09 global crisis, the sector in the OECS/ECCU was not active in providing special purpose vehicles (SPVs) such as securitizing mortgages, collective investment schemes to feed hedge funds, or other headquarters services. Within the Eastern Caribbean, Anguilla, Antigua and Barbuda, Montserrat, and St. Kitts and Nevis have the most active offshore financial sectors.

OFCs are again the focus of both local and international policymakers. On the one hand, faced with lower growth prospects, OECS/ECCU members are considering diversifying their economies, including through the further development of offshore financial services. Not only do OFCs provide employment opportunities for local labor, they can also generate spillovers to other sectors in the economy, including tourism and infrastructure, because they require improved telecommunications and transportation. The empirical analysis in this book suggests that OFC-related portfolio flows contribute to economic growth. On the other hand, international pressure has built in recent years to ensure that OFCs follow stricter prudential and supervisory financial standards, control money-laundering activities, and limit opportunities for tax evasion. These initiatives are spearheaded by a number of global institutions, including the Global Forum on Transparency and Exchange of Information, the Financial Stability Board, and the Financial Action Task Force. If the standards are not met, “naming and shaming” can result, which has significant adverse implications for the sector, as well as for the reputation of a country that focuses on the provision of high-end tourism services. Furthermore, problems in two OFCs caused stress and a bank run in the OECS/ECCU, threatening the stability of the banking sector and hence the currency union.

Although OECS/ECCU members have taken steps to demonstrate their commitment to adhere to international standards (e.g., by signing the Tax Information Exchange Agreements), continued efforts will be needed to ensure compliance with all of the initiatives, especially because these initiatives are moving toward the mutual assessment and effectiveness stages. The empirical evidence suggests that countries and territories that adopt good regulatory standards benefit from higher inflows. Because complying with increasingly higher standards is costly, the OECS/ECCU members should evaluate the benefits and costs of providing OFC services. Given the small size of the countries and territories in the region, the OECS/ECCU might want to take advantage of economies of scale and collaborate with each other or create a regional body to provide accurate information about changing global requirements and technical assistance. Although the

Monetary Council established a ministerial subcommittee for the offshore sector in the context of a system to strengthen regulation of the sector and to put forward recommendations to the Monetary Council, its scope could be expanded.

## MONETARY AND EXCHANGE RATE ISSUES

Given the quasi–currency board arrangement in the OECS/ECCU, two important questions arise: What is the role of the Eastern Caribbean Central Bank (ECCB) and how does it operate? And what is the optimal exchange rate regime for the union?

### The Role of the Eastern Caribbean Central Bank

The ECCB is responsible for monetary policy, liquidity management, maintenance of the payment system, and banking sector regulation and supervision. It was established on October 1, 1983, as part of the Treaty of Basseterre establishing the Organization of Eastern Caribbean States. It followed two previous fixed-peg currency arrangements: the British Caribbean Currency Board, which was established in 1950 to issue currency for most of the English-speaking Caribbean countries, and its successor, the East Caribbean Currency Authority in 1965. The Monetary Council, which is the highest decision-making body of the ECCB and consists of the finance ministers of each participating member government, provides overall policy guidance. Although the ECCB has most of the tools available to central banks to conduct monetary policy, given the openness of the economies and the quasi–currency board arrangement, both of which limit the effectiveness of monetary policy tools and lender-of-last-resort capacity, its main job is preserving the currency's external value.

The fixed exchange rate regime has facilitated the import of the monetary policy credibility of the U.S. Federal Reserve System, bringing low and stable inflation. For the most part, however, the inflexible exchange rate, coupled with sticky interest and wage rates, means that adjustment to exogenous shocks occurs through quantity changes in the form of output and employment declines, rather than through prices. In particular, recessions in the OECS/ECCU have been deeper and more prolonged, and recoveries slower, than in other Caribbean countries.

The ECCB manages a common pool of reserves and extends credit to governments and banks when needed, up to a limit determined both by the reserve coverage and by individual country limits. Under the quasi–currency board arrangement, the ECCB must hold foreign exchange equivalent to at least 60 percent of its demand liabilities (mainly currency in circulation and commercial banks' non-interest-earning reserves). Operationally, it targets 80 percent reserve coverage, but in practice it has been close to 100 percent. This mechanism limits the risk of a balance of payments crisis, but the reserve cover rule is achieved at the expense of flexibility in providing liquidity. This suggests that if there were to be a large systemic shock, the ECCB would be challenged to provide adequate liquidity to the system and might have to take measures to curtail the demand for liquidity. With respect to financial sector regulation and supervision, the 2008–09 global crisis uncovered weaknesses that need to be addressed, including the too narrow perimeter of regulation.

### Optimal Currency Area

For almost four decades, the countries and territories of the OECS/ECCU have maintained a fixed exchange rate at 2.7 Eastern Caribbean dollars to the U.S. dollar, which has been a stabilizing influence for the economies of the region. The prevailing view is that fixed exchange rate regimes are the most practical basis for monetary and exchange rate policy in microstates such as those in the OECS/ECCU, be they in the form of currency boards, dollarization, or other monetary arrangements using an outright peg. Conversely, flexible exchange rate regimes are considered to have major disadvantages for microstates, including high volatility and the need for a costly central bank. The theoretical advantages of a flexible regime, including maintaining an independent monetary policy, may offer no more than limited benefits for small states. However, some recent examples, such as Seychelles, suggest that maintaining an effective flexible exchange rate regime may not be as difficult for a small state to implement as previously believed.

Given that the structure of the OECS/ECCU economies changes over time, it is useful to assess empirically which exchange rate regime would be the most appropriate over the medium term. The assessment is made on the basis of empirical comparisons between the OECS/ECCU and neighboring Caribbean countries with respect to inflation, interest rates, bank balance sheets, and other factors. Measures of economic integration with the United States, including output correlations and trade relations, are also evaluated.

It turns out that the existing exchange rate regime remains appropriate and that the currency board and peg to the U.S. dollar continue to offer substantial benefits to the OECS/ECCU economies. These benefits are reflected in low inflation and relatively low nominal interest rates enjoyed within the OECS/ECCU, which are below average rates elsewhere in the Caribbean and in other developing economies. While full dollarization could provide the credibility and stability benefits that accrue to the quasi–currency board, it would carry with it additional costs that would likely outweigh any further stability gains. Chief among these would be seigniorage losses, the loss of any potential monetary flexibility, and the possibility of functioning as a lender of last resort.

## IMPEDIMENTS TO PRIVATE SECTOR DEVELOPMENT

Private sector development is important to overall economic growth. Often, however, structural impediments, including the lack of access to financing, constrain the development of the private sector. To analyze whether this is the case in the OECS/ECCU, it is helpful to take a snapshot of structural impediments and the level of financing. This snapshot is constructed using a number of indicators, such as a new toolkit developed by the World Bank that allows "benchmarking" among countries, the IMF's Financial Access Survey, Enterprise Surveys (firm-level surveys conducted by the World Bank for the first time for the OECS/ECCU), and the World Bank's Doing Business Indicators.

With respect to financing, the indicators suggest that the financial sector is well developed. Although capital markets play a smaller role and a strengthening of these markets could lead to some further deepening, financial sector deepening is not sufficient if private companies and individuals do not have adequate access to financing. The IMF's Financial Access Survey reveals that geographical access to finance in the OECS/ECCU is on par with that in Latin America and the Caribbean. Firm-level surveys, however, tell a different story. Enterprise Surveys show that a quarter of firms consider access to financing to be the biggest obstacle to development—a level higher than the average for Latin America and the Caribbean, as well as the world. The results are echoed by the Doing Business Indicators, which show that getting credit ranks below the average for other regions, reflecting difficulties in obtaining credit information and the lack of centralized information sources such as credit bureaus.

Furthermore, other structural problems in the OECS/ECCU impede the development of the private sector. In addition to facing significant difficulties with electricity, the OECS/ECCU ranks particularly low on registering property, enforcing contracts, and resolving insolvency. At the same time, the rankings for dealing with construction permits and protecting investors are high, suggestive of their dependency on foreign direct investment–related activities and construction for growth. In summary, the OECS/ECCU performs well in financial deepening but firms still face constraints to access. Addressing the issues of access and removing other structural impediments will bolster the development of the private sector.

## MACROECONOMIC STATISTICS FOR POLICYMAKING

The design, monitoring, and evaluation of sound macroeconomic policies require accurate and timely macroeconomic statistical information. The establishment of the economic union and the signing of the revised economic union treaty by the members of the OECS/ECCU call for a further harmonization of statistics, not only to support the coordination of economic policies by member governments and inform economic decision making by market participants, but also to ensure the efficient use of very scarce resources in these small economies.

During the past 10 years, the region has made significant progress in upgrading and harmonizing its statistical systems. In particular, the region improved the coverage, data sources, concepts, and methodologies of the national accounts and rebased the GDP series. The countries also introduced a revised consumer price index. With regard to external sector statistics, member countries are currently working toward compliance with the IMF's *Balance of Payments and International Investment Position Manual,* sixth edition, by 2013. The monetary and financial statistics produced and disseminated by the ECCB are fully harmonized across all members and are sufficient for surveillance purposes. In addition, the ECCB is making further progress in expanding institutional coverage to include other financial entities such as credit unions and insurance companies.

Despite the progress to date, a number of areas need to be addressed. Apart from high-frequency indicators to monitor the real sector, data on the important tourism sector, labor markets, foreign investment, and private capital flows need to be enhanced to support effective policymaking in the OECS/ECCU. Another big challenge will be the resource needs for producing macroeconomic statistics. Very small island economies do not have the resources available to large economies; therefore, a regional approach offers the best use of scarce resources. This should include the establishment of a regional statistical bureau, as well as a center of excellence at the regional bureau, where staff would specialize in the production of key indicators and serve as a resource center for the entire region.

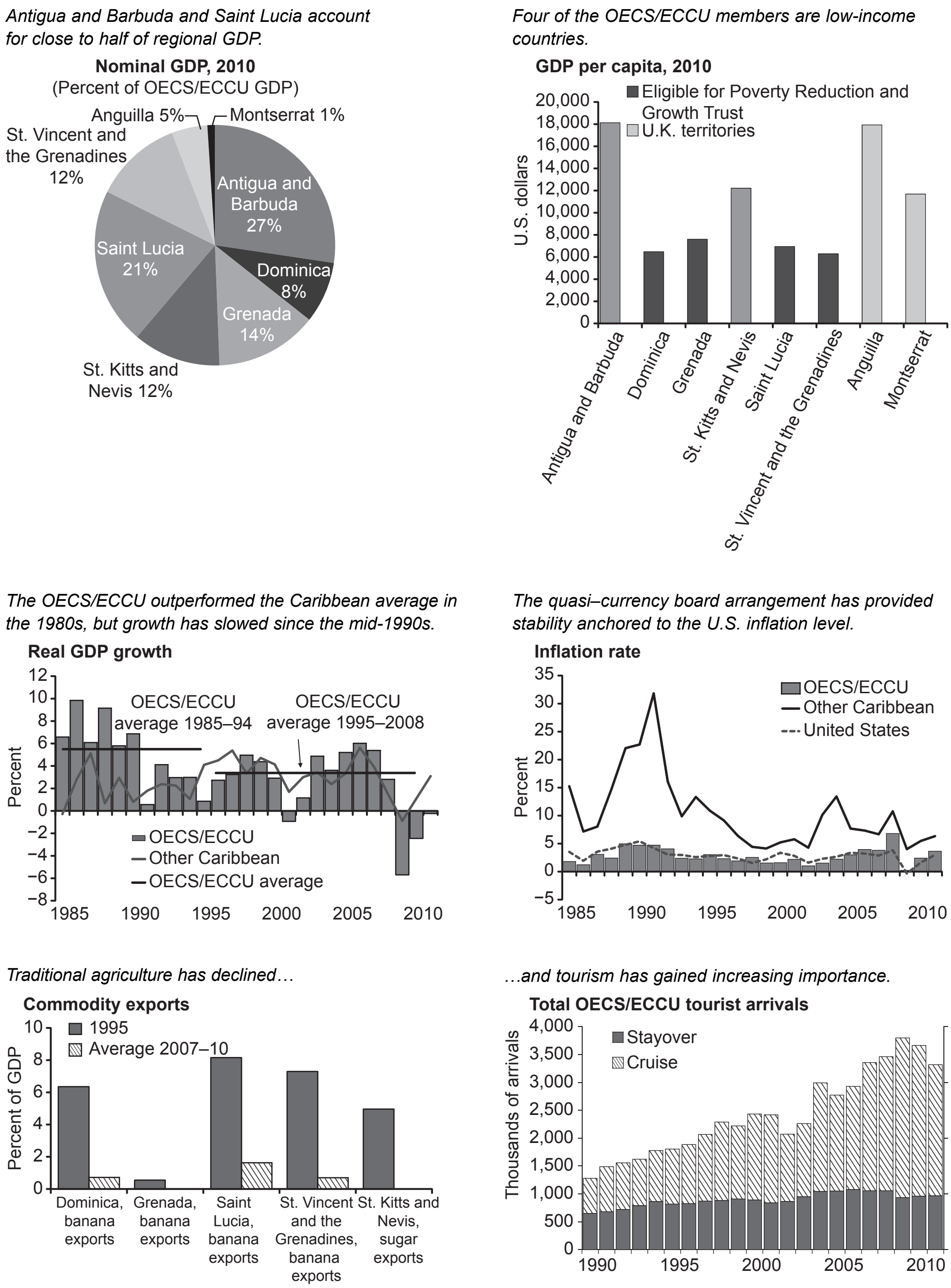
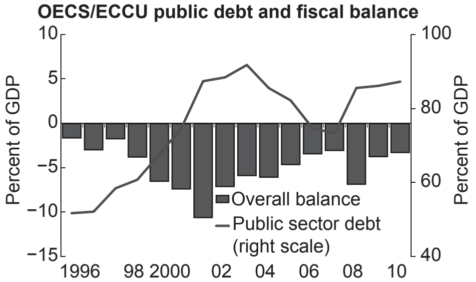



**Figure 1.1** OECS/ECCU: Selected Economic Indicators

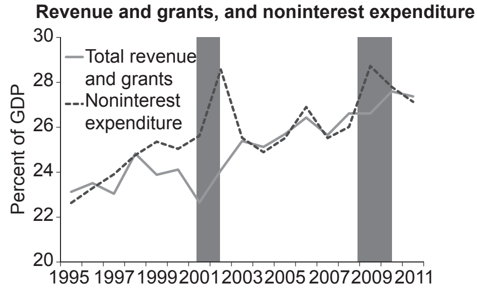
Sources: Eastern Caribbean Central Bank; World Bank; and IMF staff estimates.

Note: OECS/ECCU: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, Saint Lucia, St. Vincent and the Grenadines, and the two U.K. territories Anguilla and Montserrat. Other Caribbean: Simple average of The Bahamas, Barbados, Belize, the Dominican Republic, Guyana, Haiti, Jamaica, and Trinidad and Tobago.

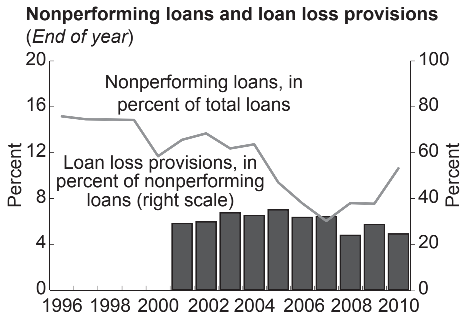
*Public debt levels are high….*



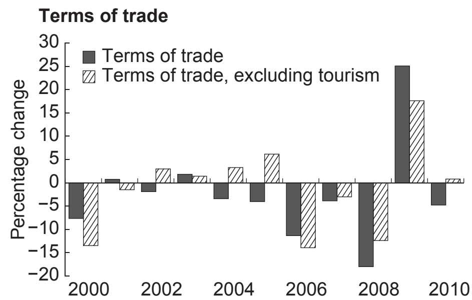

*…and fiscal positions tend to accommodate shocks emanating from the United States.*[1]




*Despite an increase in nonperforming loans, loan loss provisions remain low.*




*Terms of trade are adversely affected by increases in international food and fuel prices.*




*Economic performance is highly correlated with stayover arrivals.*

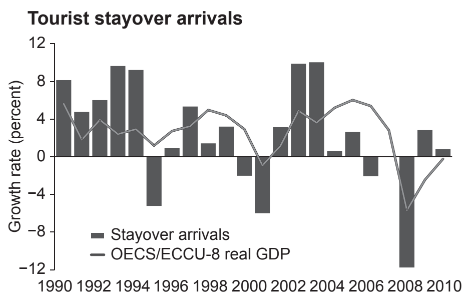



**Figure 1.2** OECS/ECCU: Additional Economic Indicators

Sources: Eastern Caribbean Central Bank; IMF, *International Financial Statistics* and *World Economic Outlook*; Organization for Economic Cooperation and Development, International Development Statistics; World Bank, *World Development Indicators*; and IMF staff calculations.

[1] Shaded areas represent periods of U.S. recessions.

**TABLE 1.1**

## Social and Demographic Indicators

| Indicator | Anguilla | Antigua and Barbuda | Dominica | Grenada | Montserrat | St. Kitts and Nevis | Saint Lucia | St. Vincent and the Grenadines | Total |
|---|---|---|---|---|---|---|---|---|---|
| Population (thousands, estimate) | 16.9 | 87.6 | 70.7 | 104.3 | 5.1 | 56.2 | 166.6 | 107.3 | 597.9 |
| Poverty headcount index, 2000[1] | n.a. | 12.0 | 33.0 | 32.0 | n.a. | 31.0 | 25.0 | 38.0 | 28.5 |
| Human Development Index rank, out of 187 countries | n.a. | 60 | 81 | 67 | n.a. | 72 | 82 | 85 | n.a. |
| Average life expectancy at birth (years) | 80.9 | 72.6 | 77.5 | 76.0 | 73.2 | 73.1 | 74.6 | 72.3 | 74.2 |
| Illiteracy rate (percentage of population age 15 and over, 2004) | 5.0 | 14.0 | 12.0 | 4.0 | 3.0 | 2.2 | 5.2 | 11.9 | 7.5 |
| Mortality rate, infant (per 1,000 live births, 2010) | 3.5 | 7.0 | 11.0 | 9.0 | 16.8 | 7.0 | 14.0 | 19.0 | 12.0 |
| Gini coefficient (2007) | n.a. | 0.53 | 0.49 | 0.50 | 0.30 | 0.45 | 0.47 | 0.45 | 0.45 |
| GDP per capita (US$, estimate) | 16,346 | 13,552 | 6,909 | 7,765 | 11,842 | 12,699 | 7,435 | 6,475 | 8,687 |
| GDP at market prices (US$ million, estimate) | 276 | 1,187 | 489 | 810 | 60 | 714 | 1,239 | 695 | 5,193 |
| Share in nominal GDP (percent, estimate) | 5.3 | 22.9 | 9.4 | 15.6 | 1.2 | 13.7 | 23.9 | 13.4 | 100.0 |

Sources: Eastern Caribbean Central Bank; United Nations, *Human Development Report*; World Bank, *World Development Indicators;* and IMF staff estimates.
Note: n.a. = Not available. Estimates are for 2011, except where noted.
[1] Percentage of population living below each country's locally defined poverty line in 2000.

**TABLE 1.2**

## Economic and Financial Indicators, 1991–2011

| Indicator | 1991–2000 | 2001–08 | 2009–10 | 2011[1] |
|---|---|---|---|---|
| | *Annual percentage change* | | | |
| **National income and prices** | | | | |
| Real GDP (at factor cost) | 3.0 | 3.5 | –4.1 | 0 |
| GDP deflator | 2.6 | 2.7 | 1.2 | 3.6 |
| Consumer prices, average[2] | 2.3 | 2.9 | 1.4 | 4.1 |
| **Monetary sector[3]** | | | | |
| Liabilities to the private sector (M2) | 10.9 | 9.2 | 2.4 | 3.1 |
| | *Annual change, in percentage of M2 at the beginning of the year* | | | |
| Net foreign assets | 1.9 | 2.9 | –0.5 | –0.7 |
| Net domestic assets | 9.0 | 6.3 | 2.9 | 3.8 |
| Private sector credit | 10.4 | 8.3 | 2.3 | 1.3 |
| Credit to central government | 0.8 | 0.4 | 0.6 | 0.6 |
| | *Percentage of GDP* | | | |
| **Public sector finance** | | | | |
| Overall central government balance | –2.3 | –4.7 | –5.3 | –3.8 |
| Primary central government balance | –0.4 | –1.5 | –1.8 | –0.8 |
| Central government current account balance | 1.2 | 0.1 | –1.6 | –0.5 |
| Total public debt (end of period) | 51.6 | 82.2 | 85.6 | 86.9 |
| | *Annual percentage change* | | | |
| **External debt and balance of payments[4]** | | | | |
| Exports, f.o.b. | 1.8 | 2.6 | 4.3 | 0.5 |
| Imports, f.o.b. | 5.2 | 8.8 | –8.9 | 1.6 |
| Real effective exchange rate (end of period)[5] | 0 | –1.7 | 2.0 | –3.0 |
| Terms of trade[5] | –2.3 | –1.8 | –0.1 | –0.1 |
| | *Percentage of GDP* | | | |
| External current account balance | –11.3 | –20.9 | –20.1 | –19.9 |
| Trade balance | –31.1 | –34.0 | –32.0 | –32.0 |
| Service, income, and transfers | 19.8 | 13.1 | 11.9 | 12.0 |
| Travel | 26.8 | 21.2 | 17.3 | 16.8 |
| Capital and financial accounts[6] | 11.9 | 22.1 | 21.9 | 20.3 |
| Net FDI inflows | 8.6 | 15.6 | 11.2 | 10.2 |
| Gross public external debt | 33.1 | 45.6 | 41.9 | 44.5 |
| ***Memorandum*** | | | | |
| Gross international reserves of the ECCB, end of period[7] | | | | |
| In millions of U.S. dollars | 339.9 | 617.9 | 863.5 | 1,007.5 |
| In months of imports | 3.1 | 4.1 | 4.8 | 5.4 |
| In percent of broad money | 18.8 | 18.9 | 18.6 | 20.8 |
| Currency backing ratio (percent)[8] | 90.3 | 97.3 | 95.8 | 95.1 |
| Holdings of SDRs (millions of U.S. dollars)[9] | n.a. | n.a. | –34.3 | 4.0 |

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

Note: ECCB = Eastern Caribbean Central Bank; FDI = foreign direct investment; f.o.b. = freight on board; M2 = M1 (liabilities to the private sector + demand deposits) and quasi money (EC$ checks and drafts issued + savings deposits + time deposits + foreign currency deposits); n.a. = not available; SDR = special drawing right.

[1] IMF staff projections.

[2] Consumer prices for Antigua and Barbuda begin in 1994, and for Anguilla in 1991.

[3] Monetary data begin in 1997.

[4] Balance of payments data begin in 1993.

[5] Excludes Anguilla and Montserrat. A negative value indicates depreciation.

[6] Includes errors and omissions.

[7] Gross international reserves data begin in 1996.

[8] ECCB's foreign assets as a percentage of its demand liabilities.

[9] SDR allocation of US$93.7 million (SDR 59.9 million) implemented in 2009.

**TABLE 1.3**

## OECS/ECCU: Selected Economic Indicators by Country, 1991–2011

| Indicator | 1991–2000 | 2001–08 | 2009–10 | 2011[1] |
|---|---|---|---|---|
| | | *Annual percentage change* | | |
| **Real GDP** | **3.0** | **3.5** | **–4.1** | **0** |
| Antigua and Barbuda | 3.5 | 4.5 | –9.6 | –0.5 |
| Anguilla | 4.0 | 7.6 | –11.1 | –2.1 |
| Dominica | 2.1 | 2.3 | –0.2 | 0.5 |
| Grenada | 4.6 | 3.4 | –3.5 | 1.1 |
| Montserrat | –9.0 | 2.5 | –2.3 | 3.9 |
| St. Kitts and Nevis | 4.4 | 3.6 | –4.1 | 0.0 |
| Saint Lucia | 2.4 | 2.1 | 1.1 | 0.2 |
| St. Vincent and the Grenadines | 3.1 | 3.9 | –2.1 | –0.4 |
| **Consumer price index (end of period)** | **2.3** | **2.9** | **1.4** | **4.1** |
| Antigua and Barbuda[2] | 0.5 | 1.7 | 2.7 | 3.9 |
| Anguilla | 3.2 | 4.5 | 0.0 | 8.6 |
| Dominica | 1.6 | 2.2 | 2.4 | 4.0 |
| Grenada | 2.5 | 3.3 | 0.9 | 3.5 |
| Montserrat | 3.1 | 3.2 | 2.5 | 4.5 |
| St. Kitts and Nevis | 3.2 | 4.0 | 3.1 | 1.4 |
| Saint Lucia | 3.3 | 2.8 | 0.6 | 4.8 |
| St. Vincent and the Grenadines | 2.1 | 3.7 | –0.7 | 4.7 |
| | | *Percent of GDP* | | |
| **Current account[3]** | **–11.3** | **–20.9** | **–20.1** | **–19.9** |
| Antigua and Barbuda | –4.5 | –18.3 | –16.1 | –10.8 |
| Anguilla | n.a. | –36.6 | –26.4 | –22.4 |
| Dominica | –13.2 | –17.9 | –21.2 | –22.9 |
| Grenada | –11.5 | –21.6 | –24.7 | –24.4 |
| Montserrat | n.a. | –23.6 | –20.8 | –15.7 |
| St. Kitts and Nevis | –13.9 | –21.3 | –23.7 | –22.5 |
| Saint Lucia | –11.0 | –20.3 | –13.9 | –17.1 |
| St. Vincent and the Grenadines | –15.1 | –19.0 | –30.5 | –28.8 |
| **Capital and financial account[3]** | **11.9** | **22.1** | **21.9** | **20.3** |
| Antigua and Barbuda | 1.7 | 13.0 | 16.3 | 8.8 |
| Anguilla | n.a. | 37.0 | 35.2 | 21.6 |
| Dominica | 13.5 | 15.3 | 20.0 | 22.9 |
| Grenada | 13.6 | 26.9 | 25.8 | 22.5 |
| Montserrat | n.a. | 17.9 | 25.3 | 19.3 |
| St. Kitts and Nevis | 15.9 | 22.2 | 23.4 | 18.4 |
| Saint Lucia | 12.3 | 21.3 | 13.0 | 16.1 |
| St. Vincent and the Grenadines | 14.9 | 16.3 | 28.7 | 28.8 |
| **Overall balance[3]** | **0.6** | **1.2** | **1.8** | **0.4** |
| Antigua and Barbuda | –2.8 | –5.3 | 0.2 | –1.9 |
| Anguilla | n.a. | 0.5 | 8.8 | –0.8 |
| Dominica | 0.3 | –2.7 | –1.2 | 0 |
| Grenada | 2.1 | 5.3 | 1.1 | –1.8 |
| Montserrat | n.a. | –5.7 | 4.5 | 3.6 |
| St. Kitts and Nevis | 2.0 | 0.8 | –0.3 | –4.0 |
| Saint Lucia | 1.3 | 1.0 | –0.9 | –1.0 |
| St. Vincent and the Grenadines | –0.1 | –2.7 | –1.8 | 0 |

Sources: Eastern Caribbean Central Bank; and IMF staff estimates.
Note: n.a. = not available.
[1] IMF staff projections.
[2] Data for Antigua and Barbuda begin in 1998.
[3] Balance of payments data for Anguilla and Montserrat begin in 2002 and 2003, respectively.

**TABLE 1.4**

## OECS/ECCU: Selected Economic Indicators by Country, 1991–2011
*(Percent of GDP)*

| Indicator | 1991–2000 | 2001–08 | 2009–10 | 2011[1] |
|---|---|---|---|---|
| **Total revenues and grants** | **23.2** | **25.2** | **27.1** | **26.9** |
| Antigua and Barbuda | 18.1 | 20.1 | 20.3 | 20.2 |
| Anguilla | 17.8 | 21.8 | 21.4 | 26.4 |
| Dominica | 26.9 | 30.6 | 37.0 | 33.6 |
| Grenada | 22.6 | 24.3 | 23.4 | 22.4 |
| Montserrat | 49.7 | 85.3 | 89.4 | 80.3 |
| St. Kitts and Nevis | 24.3 | 27.7 | 31.8 | 34.4 |
| Saint Lucia | 25.1 | 25.6 | 27.1 | 27.3 |
| St. Vincent and the Grenadines | 25.1 | 25.0 | 28.5 | 26.0 |
| **Total expenditure** | **25.5** | **29.9** | **32.4** | **30.7** |
| Antigua and Barbuda | 21.6 | 27.1 | 29.5 | 22.2 |
| Anguilla | 18.4 | 22.9 | 26.2 | 25.0 |
| Dominica | 30.8 | 31.3 | 38.9 | 36.0 |
| Grenada | 25.1 | 29.5 | 27.6 | 27.0 |
| Montserrat | 50.2 | 89.2 | 86.8 | 80.3 |
| St. Kitts and Nevis | 28.2 | 34.2 | 37.2 | 36.5 |
| Saint Lucia | 25.1 | 30.2 | 31.1 | 34.8 |
| St. Vincent and the Grenadines | 26.9 | 27.6 | 33.0 | 29.9 |
| **Primary balance** | **–0.4** | **–1.5** | **–1.8** | **–0.8** |
| Antigua and Barbuda | –0.3 | –3.2 | –4.6 | –0.1 |
| Anguilla | –0.5 | –0.4 | –3.6 | 2.7 |
| Dominica | –1.7 | 2.6 | –0.4 | –0.7 |
| Grenada | –0.7 | –2.6 | –2.0 | –2.2 |
| Montserrat | 0.3 | –3.5 | 2.7 | 0 |
| St. Kitts and Nevis | –1.3 | –0.5 | 1.4 | 4.6 |
| Saint Lucia | 1.0 | –1.9 | –1.0 | –4.4 |
| St. Vincent and the Grenadines | –0.4 | –0.3 | –1.7 | –1.4 |
| **Overall balance** | **–2.3** | **–4.7** | **–5.3** | **–3.8** |
| Antigua and Barbuda | –3.4 | –7.0 | –9.2 | –2.1 |
| Anguilla | –0.6 | –1.1 | –4.9 | 1.4 |
| Dominica | –3.9 | –0.8 | –1.9 | –2.3 |
| Grenada | –2.5 | –5.2 | –4.1 | –4.6 |
| Montserrat | –0.4 | –3.8 | 2.6 | 0 |
| St. Kitts and Nevis | –3.9 | –6.5 | –5.4 | –2.1 |
| Saint Lucia | 0.1 | –4.6 | –4.0 | –7.5 |
| St. Vincent and the Grenadines | –1.9 | –2.6 | –4.5 | –3.9 |
| **Total public sector debt[2]** | **51.6** | **82.2** | **85.6** | **86.9** |
| Antigua and Barbuda | 93.7 | 103.6 | 95.6 | 88.0 |
| Anguilla | 9.1 | 13.8 | 24.5 | 24.1 |
| Dominica | 58.4 | 84.8 | 66.9 | 70.0 |
| Grenada | 40.3 | 81.2 | 98.7 | 103.0 |
| Montserrat | 30.0 | 12.9 | 5.5 | 4.9 |
| St. Kitts and Nevis | 67.1 | 136.6 | 154.1 | 151.3 |
| Saint Lucia | 32.8 | 59.4 | 64.3 | 71.9 |
| St. Vincent and the Grenadines | 50.9 | 59.5 | 66.3 | 71.4 |

Sources: Eastern Caribbean Central Bank; and IMF staff estimates.
[1] IMF staff projections.
[2] Debt data for Anguilla and Montserrat begin in 2000, and for Grenada in 1996.

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With national debt approaching 200 percent of GDP in St. Kitts and Nevis, we decided to restructure our debt and implement a home-grown economic program, with the assistance of the IMF, reducing public debt to less than 100 percent of GDP in 2012, putting it on a path to reach 60 percent of GDP by 2020. This will not only reduce vulnerabilities and improve the growth prospects of our twin islands, but will also strengthen the Eastern Caribbean Economic and Currency Union. These and other important macroeconomic and financial sector issues are covered in this comprehensive book. This handbook will not only be a useful reference and guide for policymakers, students, and informed citizens of the region, but will also provide insights that might be relevant for other countries, including micro states, members of monetary unions, and island economies.

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Long before there was the euro, there was the ECCU (Eastern Caribbean Currency Union). While the former monetary union has been analyzed to death, the latter has received hardly any attention, even from researchers. This timely contribution from Alfred Schipke and his colleagues now begins to rectify the omission.

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The book sets out to present a comprehensive survey and review of the major macroeconomic issues of relevance to the ECCU and it accomplishes this with great success! The level and scope of the analysis will make it attractive to policymakers and regional academics. Particular chapters can be used to augment standard readings for courses on macroeconomics and Caribbean economic development.

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