I Overview

Eastern Caribbean countries institutionalized political and economic cooperation through the establishment of the Organization of Eastern Caribbean States (OECS) with the Treaty of Basseterre in 1981. Two years later they set up the Eastern Caribbean Central Bank (ECCB), which replaced the Eastern Caribbean Currency Authority. The eight member countries and territories of the ECCB are Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, which are independent states and members of the IMF, and Anguilla and Montserrat, which are territories of the United Kingdom.[1] The six independent OECS states and Montserrat are also members of the Caribbean Common Market, CARICOM, established in 1973.

The OECS members share a common currency, the Eastern Caribbean dollar, which has been pegged to the U.S. dollar since 1976 at EC$2.70=US$1, and was pegged to the British pound at EC$4.80=£1 from 1950 to 1976. Prior to the recent inception of the European Central Bank, the ECCB was one of only three common central banks in the world and the only one where the member countries have pooled all their foreign reserves, the convertibility of the common currency is fully self-supported, and the parity of the exchange rate has not been changed.

This occasional paper reviews recent developments, policy issues, and institutional arrangements in the member countries of the Eastern Caribbean Currency Union (ECCU), and looks at the ECCB's institutional arrangements, the financial system and its supervision, and the central bank's initiatives to establish a single financial space.

Two aspects of the ECCU economies stand out—their very small size and their vulnerability to shocks. Geographic barriers complicate the functioning of a single market, and even taken as a whole, the ECCU is a very small economy. The total population is approximately half a million and combined gross domestic product (GDP) was estimated at US$2.6 billion in 1998, or about $4,500 per capita, which is relatively high in the Caribbean. Per capita GDP varies from a high of nearly US$9,000 for Antigua and Barbuda to a low of about $2,800 for St. Vincent and the Grenadines (Table 1). Indivisibilities and high unit costs are barriers to many forms of economic activity: the market is so small that importing is sometimes unprofitable, and production even more so. The independent states range in size from St. Kitts and Nevis, with 269 sq. km., to Dominica, with 750 sq. km., and populations range from 41,000 in St. Kitts and Nevis to 140,000 in St. Lucia (Anguilla and Montserrat are even smaller). The OECS economies are exposed to natural disasters—particularly hurricanes, and less frequently drought and volcanic eruption. Because of their small size, the impact of a natural disaster can be far more devastating than for a larger economy where the damage is localized.[2]

Until the 1950s, the Eastern Caribbean countries were overwhelmingly agricultural—mainly specializing in either bananas or sugar. There has since been a steady shift, accelerating in the 1980s, away from agriculture and toward tourism. In general, the countries in which income has risen most are those where this shift has proceeded the furthest. Overall, tourism today accounts for 10 percent of GDP and agriculture 8 percent. Manufacturing remains relatively small (less than 6 percent) and consists largely of food processing and enclave industries such as garments and small assembly plants. Construction is significant (around 10⅓ percent), much of it serving the needs of tourism.

The economies in the region are very open: merchandise imports averaged 53 percent of GDP during 1990–98; merchandise exports 16⅓ percent of GDP; and the surplus in the nonfactor services balance, 24 percent of GDP. Also, the sum of current and capital transfers has been very large, averaging close to 8

[1]Anguilla did not join the ECCB until 1987. The British Virgin Islands are an associate member of the OECS, but not of the ECCB.

[2]For a discussion of vulnerability and other aspects of the economies of small states, see *Small States: Meeting Challenges in the Global Economy*, Report of the Commonwealth Secretariat/World Bank Joint Task Force on Small States, April 2000.

Table 1. ECCB Area: Selected Economic Indicators[1]

	1990	1991	1992	1993	1994	1995	1996	1997	1998
				(Annual percentage change)					
Real GDP at factor cost[2]	4.7	0.7	3.9	2.6	3.0	0.7	2.7	3.1	2.3
Real per capita GDP[2]	3.7	1.4	2.5	0.9	1.9	0.0	2.8	2.7	2.9
Export volume	–0.4	–11.8	8.7	–6.0	–10.4	6.6	–5.4	–6.2	10.9
Import volume	0.8	0.1	–4.5	8.8	–3.5	–2.2	5.7	14.7	4.8
Terms of trade	n.a.	1.9	–3.1	–1.0	1.2	–3.9	–3.1	3.7	4.6
Consumer prices (end of period)	5.1	4.3	3.6	2.5	2.2	2.1	2.1	2.6	3.1
				(Percent of GDP)					
Overall fiscal balance	–2.4	–2.5	–1.1	–0.7	–2.0	–0.6	–0.6	–3.8	–2.8
Government tax revenue	21.5	21.1	20.9	21.4	21.1	21.4	21.5	21.4	21.3
External current account balance[2]	–16.9	–16.6	–10.6	–10.7	–11.0	–9.7	–14.4	–16.0	–15.8
Gross national saving[3]	16.7	14.2	16.7	18.8	17.8	22.2	17.5	15.9	15.3
Public saving	3.6	3.8	4.0	4.7	4.0	4.0	4.0	3.3	3.8
Private saving	13.1	10.4	12.7	14.1	13.8	18.1	13.5	12.6	11.6
Gross domestic investment	33.6	30.8	27.3	29.4	28.8	31.9	31.9	32.0	31.2
Public investment	8.7	9.1	7.0	8.0	8.4	7.2	7.3	4.3	9.6
Private investment	24.9	21.7	20.3	21.4	20.4	24.7	24.6	22.7	21.6
Gross foreign assets, ECCB	12.0	12.4	14.6	13.5	12.3	14.2	12.6	12.6	13.7
Public external debt (end of period)[4]	42.6	49.8	49.2	48.4	49.3	50.5	47.9	45.7	45.1
				(U.S. dollars)					
Per capita GDP	3,145	3,312	3,508	3,592	3,789	3,882	4,087	4,291	4,538
Anguilla	6,262	6,200	6,548	6,911	7,471	7,280	7,429	7,450	7,631
Antigua and Barbuda	6,139	6,425	6,551	6,959	7,530	7,301	7,876	8,459	8,976
Dominica	2,328	2,535	2,679	2,750	2,912	2,995	3,184	3,229	3,376
Grenada	2,334	2,527	2,600	2,578	2,685	2,805	2,979	3,165	3,348
Montserrat	5,652	5,117	5,390	5,907	6,118	5,673	6,186	10,754	10,822
St. Kitts and Nevis	3,802	4,013	4,261	4,557	5,151	5,298	5,812	6,502	6,814
St. Lucia	3,103	3,293	3,601	3,555	3,634	3,815	3,869	3,876	4,138
St. Vincent and the Grenadines	1,872	1,995	2,172	2,183	2,214	2,387	2,504	2,631	2,810
Memorandum items:									
Total GDP of the region, at market prices (US$ m)[2]	1,674	1,769	1,898	1,970	2,099	2,176	2,295	2,415	2,579
Total population of the region (thousands of inhabitants)[2]	532	534	541	548	554	561	562	563	568

Sources: Eastern Caribbean Central Bank, and IMF staff estimates.
[1]The area includes Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines; except otherwise indicated.
[2]Also includes Anguilla and Montserrat.
[3]Defined as the gross domestic investment plus the external current account balance.
[4]Includes external arrears.

percent of GDP over the same period. Foreign direct investment (over 9 percent of GDP) and loans to the public sector help cover the current account deficit. Most of the region's trade is with the United States and the European Union, both of which grant trade preferences; Japan and other Caribbean countries are also important trading partners.

Despite difficult fundamentals, economic performance in the region was strong in the late 1970s and 1980s and has remained broadly satisfactory in the 1990s. Real GDP growth averaged 6 percent a year during 1977–89, but slowed to an average of 2⅓ percent a year during 1990–98; partial information suggests that real GDP grew by around 3 percent in 1999. Given the openness of the economies and the exchange rate peg, inflation has been in line with that in the major trading partners, averaging about 3 percent a year during 1990–98; in 1999, inflation was less than 2 percent. This outcome was facilitated by the "strong EC dollar policy" pursued by the ECCB and the generally sound fiscal policies followed by most countries.

In the course of the 1990s, however, the slowdown in growth was accompanied by a weakening of the fiscal positions in several countries, and the medium-term outlook has changed. The availability of concessional foreign financing has been declining, as some countries have "graduated" and donors have shifted priorities; the European Union's (EU) banana regime is being opened to competition; sugar production, even for export to the protected markets,[3] is of questionable viability; and there are indications that the light manufacturing sector is losing ground to lower wage areas.[4]

On the brighter side, the region has seen a marked increase in tourist arrivals in recent years. At the same time, some diversification is taking place, with moderate growth in nontraditional agriculture and the emergence of firms involved in data processing and informatics, and in offshore financial and gaming services.

[3]St. Kitts and Nevis produces some 20,000 tons of sugar a year for export under quotas to the United States and the European Union. The state-owned sugar company incurs a loss of some EC$18 million a year.

[4]There is some evidence that firms have left the region for Mexico to benefit from the NAFTA arrangement.