VI Conclusions

Throughout the past 25 years of turbulence in the international financial system, the countries in the eastern Caribbean have enjoyed remarkable monetary stability. Indeed, the Eastern Caribbean Currency Union and its flagship, the ECCB, provide an impressive example of successful, long-standing monetary cooperation. The monetary and exchange arrangements maintained by the ECCB have served the region well, fostering confidence through stable domestic prices anchored in a peg to the U.S. dollar. The "strong Eastern Caribbean dollar" policy pursued by the ECCB has imposed hard limits on its ability to extend credit to participating governments. As a result, a premium has been placed on fiscal discipline, with most participating governments following prudent fiscal policies.

Price and exchange rate stability has also contributed to financial system stability. Despite the relatively frequent occurrence of major natural disasters and the secular decline of key economic activities, the financial systems in the region have remained stable and virtually free from banking crises. However, it is important that the ratio of nonperforming to total bank loans be brought down to well below the prudential guideline of 10 percent. It is encouraging, therefore, that the ECCB and member governments continue to work to safeguard financial soundness by enhancing prudential standards and extending them to nonbank financial institutions as well as offshore banks, and by strengthening compliance and intervention mechanisms.

Preserving fiscal discipline should help countries in the region maintain the value of the currency in the face of the possible phasing out of trade preferences for key exports. To support the transition to more service-based economic structures, governments in the region are seeking to improve physical and human infrastructure. To help fund such increases in public sector investment, and thereby the prospects for sustained growth, member governments should act to counter the weakening of public sector saving that has been evident in the last several years. The ECCB's fiscal reform program is a good start, but the saving targets may not be ambitious enough for some countries, especially those faced with the need to ensure the competitiveness of their banana production under a revamped EU banana regime.

Expenditure restraint, in particular containment of the government wage bill, is key to maintaining the region's competitiveness and safeguarding the currency arrangement. The latter will also require efforts to improve the flexibility of goods and factor markets, and intensified efforts at trade and capital liberalization. It is encouraging that the Monetary Council has recommended that each country establish a tripartite council on prices, wages, employment, and productivity, in recognition of the need for price and wage discipline.

The ECCB has taken the lead in efforts to extend the success of monetary cooperation to the integration of national money and capital markets. Moving from the current segmentation of financial systems to the eventual formation of a single, regional, financial space could help provide the basis for a future economic union. Achieving the latter, however, will also require substantial deepening of the links among the member countries, including through greater integration of labor and product markets. Progress toward economic integration among the Eastern Caribbean states will have to be coordinated with the formation of the single market economy, to which all CARICOM states, except the Bahamas, have formally committed themselves.