

Eastern Caribbean Currency Union: Selected Issues



EASTERN CARIBBEAN CURRENCY UNION

SELECTED ISSUES

April 2024

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EASTERN CARIBBEAN CURRENCY UNION

SELECTED ISSUES

March 22, 2024

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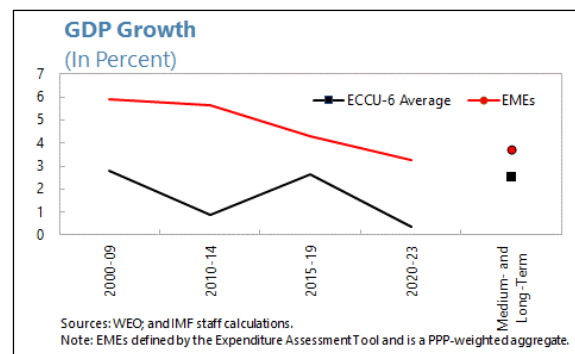
TOWARD MORE EFFICIENT, SUSTAINABLE, AND FAIR PENSION SCHEMES IN THE ECCU¹

Despite recent reform efforts, the financial sustainability of the ECCU's defined benefit social security schemes remains under strain, largely reflecting the still relatively low contributions and generous payouts. This, coupled with a rapidly ageing population and high labor market informality, increases the need for a comprehensive review and adoption of further parametric and non-parametric reforms of the pension systems to avoid abrupt and more sizable adjustments in the future as well as to reduce the risks of old-age poverty. This annex reviews pension schemes in the ECCU, with a focus on assessing their design and performance and identifying policy options to improve their efficiency, fairness, and sustainability. Key recommendations include swift adoption of further comprehensive reforms to address design weaknesses, improving coverage, investment strategy, administrative efficiency, and transparency, and establishing automatic adjustment mechanisms.

A. Introduction

1. The financial sustainability of the defined benefit pension systems in the ECCU is under strain, partly reflecting design weaknesses and tepid economic growth.

Since their inception in the 1970-80s, the pay-as-you-go (PAYG) social security schemes had generated large surpluses in the early years due to minimal expenditure. However, as the schemes mature, the pension reserves have increasingly come under pressure due to relatively low contributions compared to the payouts. In response, some countries have implemented partial parametric reforms, but these reforms improved the financial situation only temporarily. Furthermore, economic growth and employment creation have on average been slow in the ECCU, partly due to frequent economic and natural disaster shocks, and growth is expected to remain well below the emerging market (EME) average in the medium and long term, further straining the sustainability of the pension systems.²



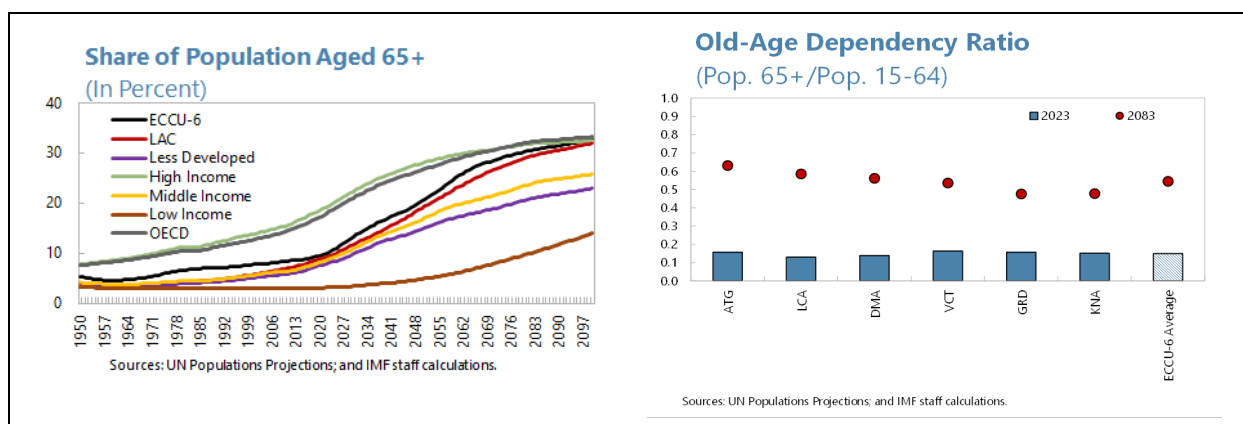
2. The ECCU's population is also aging rapidly, exerting further pressures on the pension systems.

With increasing life expectancy and low fertility, plus significant emigration of the young, the rise in the old-age dependency ratio—the ratio of population aged 65 or older and population

¹ The selected issue paper was prepared by Sergei Antoshin, Sophia Chen, Nan Geng (lead), Sinem Kilic Celik, and Spencer Siegel. The authors would like to thank Lin Li for her valuable contributions and for Antigua and Barbuda and Grenada teams for providing useful data on the two countries.

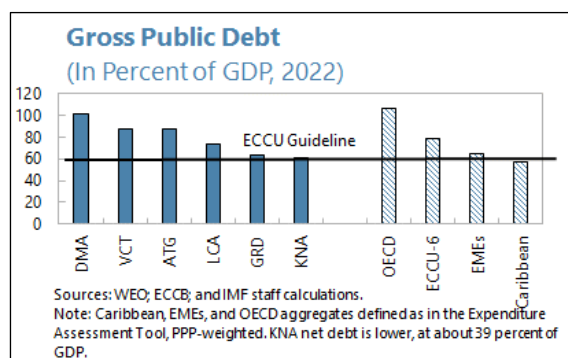
² The impact of the frequent shocks (e.g., the pandemic and natural disasters) has worsened the financial situation of the social security schemes as contribution growth plunged and benefit payments surged, including due to the higher number of early retirees, the temporary unemployment benefit schemes in some countries, and higher sickness and other benefits related to the shocks.

aged between 15 and 64 years—for the ECCU is projected to accelerate dramatically starting in 2025. Should this trend continue, by 2083, it would exceed 0.5—significantly above the averages of middle- and low-income countries and approaching the OECD level.



3. Addressing these concerns requires a comprehensive review and further reform of the pension systems, especially in view of the already high public debt. Public debt is already elevated in the ECCU countries, above the regional target of 60 percent of GDP. Unsustainable pension systems present significant contingent liabilities and introduce uncertainty for economic actors as governments may have to cover pension shortfalls

with higher taxes and lower investment or risk abrupt and disorderly adjustments of the pension system. This calls for a stock-taking assessment of the pension systems with a view to identify further reforms needed and for their timely implementation, which would reduce the size of the required adjustments and inter-generational inequality.



B. Overview of Pension Schemes in the ECCU

4. The pension systems in the ECCU countries generally consist of three components with the national insurance scheme (NIS) being the largest.³ The major component, the contributory NIS or social security administration, provides two types of benefits for public and private sector employees, self-employed, and voluntary contributors. Long-term benefits, mainly pensions, represent on average 80 percent of the NIS spending. This is the main factor behind the sustainability concerns over the NIS and is the focus of this analysis. The remaining part is the short-term benefits related to sickness, maternity, injury, etc. The second component is the non-contributory Public Sector Pension Scheme (PSPS) for civil servants, funded through budget revenues (Table 1). It exists in all ECCU-6, except for St. Lucia (LCA), and is estimated to cost around 2 percent of GDP annually in each of the three countries with available data. Being noncontributory,

³ Voluntary occupational schemes are offered by large enterprises in some countries.

in addition to NIS pensions, and with younger retirement age than NIS, the PSPS is viewed as overly generous and raises equity concerns vis-a-vis private sector workers. The third component is pillar zero or support to the poor elderly, as part of overall social assistance spending by the government. It is available in most countries, but the overall amounts are generally small.

Table 1. ECCU-6 Public Sector Pension Schemes

	Has separate pension for public sector?	Fiscal costs per year (in percent of GDP)	Statutory retirement age	Early retirement age
Antigua and Barbuda	Yes	...	65	...
Dominica	Yes	0.5	60	...
Grenada 1/	Yes	...	55	...
St. Kitts and Nevis	Yes	2.0	62	55
St. Lucia	No, since 2003	1.9
St. Vincent and the Grenadines	Yes	2.0	60	n.a. 2/

Source: Country authorities.

1/ Grenada's constitutional court ordered the reinstatement of the PSPS in 2022 after it was closed for new entrants in 1985.

2/ 55 for those hired before and on August 3rd, 1983.

5. Most countries have implemented partial parametric reforms of the NIS schemes in recent years (Appendix Table 1). The NISs were established in the ECCU in the 1970-80s (Table 2). The NIS coverage among the formal sector employees is generally high—around 80-90 percent in most countries. However, only four countries require mandatory participation of self-employed. NIS benefits are financed by a payroll contribution from both employers and employees. Qualifying conditions for pension benefits include vesting periods that are generally between 10 and 15 years and a regular or minimum (early) retirement age. In response to sustainability concerns revealed by actuarial studies, all ECCU-6 except for St. Kitts and Nevis (KNA), introduced reforms over the past decade, with some of the approved reforms still phasing in. Antigua and Barbuda (ATG), Dominica (DMA), Grenada (GRD), and St. Vincent and the Grenadines (VCT) are raising contribution rates. All countries except for KNA have approved reforms to raise retirement age to 65 but allow an early retirement age of 60. In addition, ATG, GRD, and VCT are prolonging the vesting period to 15 years.

Table 2. ECCU-6 NIS Pension Schemes Overview

	Year established	Share of contributors among employees (percent)	Mandatory for self-employed	Past / ongoing reforms?	Current contribution rate (employer + employee; percent)	Contribution rate post reforms (percent)	Current Statutory retirement age	Statutory retirement age post reforms	Early retirement age	Current vesting period (years)	Vesting period post reforms (years)
Antigua and Barbuda 1/	1973	85-90	Yes	Yes	15	15.5 by 2025	64	65 by 2025	60	14	15 by 2025
Dominica	1976	93.80	Yes	Yes	14	15.75 by 2031	65	65 (in 2021)	60	10	n.a.
Grenada 2/	1983	~90	Yes	Yes	12	15 by 2031	60	65 by 2029	60	10	15 by 2029
St. Kitts and Nevis	1978	90	Yes	No	11	n.a.	62	n.a.	n.a.	10	n.a.
St. Lucia	1979	70	No	Yes	10	n.a.	65	65 (in 2015)	60	15	n.a.
St. Vincent and the Grenadines	1987	83	No	Yes	10	15 by 2027	63	65 by 2028	60	13	15 by 2028

Source: Country authorities.

1/ Early retirement option will be removed once statutory retirement age reaches 65 in 2025 in ATG.

2/ Total contribution rate after reforms will be 16 percent, which includes 1 percent for the newly established unemployment insurance.

C. Assessing the Performance and Design of NIS Against Its Policy Objectives of Affordability, Adequacy, Efficiency, and Equity

NIS Financial Positions and Sustainability

6. The ECCU countries regularly carry out actuarial studies and publish their actuarial reviews and annual reports—but usually with long delays (Table 3). In line with best practices, KNA and VCT post all actuarial reviews online. The approval and publication of actuarial reports are generally done with a considerable delay, with the last publicly available actuarial report for LCA dating back to 2003.⁴ The lack of transparency about the financial sustainability of the NIS obstructs timely monitoring and independent analysis and, most importantly, may hinder garnering public support for future reforms.

Table 3. ECCU-6 NIS' Financial Positions

	Year of Latest Published Actuarial Review	Year of Latest Available Actuarial Review 1/	Reserves (in percent of GDP)	Year Expenditures Surpass Contribution Income	Year Expenditures Surpass Total Income	Year When Reserves Are Exhausted
Antigua and Barbuda	2015	2017	15.5	2022	2028	2035
Dominica	2014	2020	30.0	2021	2051	2063
Grenada	2018	2021	31.9	2016	2022	2053
St. Kitts and Nevis	2021	2021	72.2	2015	2024	2040
St. Lucia	2003	2015	55.2	2018	2035	2051
St. Vincent and the Grenadines	2021	2019	18.3	2016	2021	2060

Sources: Country authorities; and IMF staff calculations.
 1/ There is a 1-2 year lag between the date of the analysis and the publication date. The analysis is generally based on 3 prior years.
 Note: Data in columns 4-7 are based on the latest information from the authorities (often after the actuarial reviews).

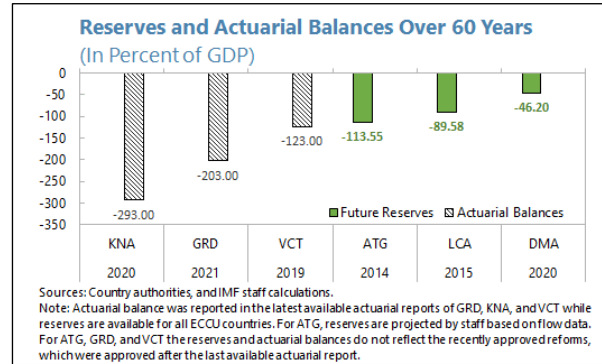
7. Reserves are sizable now but under current policies are projected to be depleted in the next two decades in some countries (Table 3). The NIS currently have large reserves in percent of GDP, especially in KNA and LCA.⁵ However, expenditures had already exceeded contribution income in all the countries and will likely exceed total income (which includes investment income) soon in most countries. As such, the reserves will be depleted in 2035 in ATG and in 2040 in KNA in the best-estimate scenario.

8. Under the current schemes, implied pension liabilities would exert a high burden on fiscal accounts over the next 60 years. A key measure to assess the financial sustainability of a

⁴ An updated actuarial report with parametric reform suggestions to achieve sustainability has been submitted to the cabinet in 2023.

⁵ The existence of double-digit reserves puts the ECCU countries in a better position than most other countries with PAYGO schemes. Among OECD countries, only Canada, Finland, Israel, Japan, Korea, Luxembourg, New Zealand, Sweden, and the United States have reserve funds with more than 10 percent of GDP in assets. However, some OECD countries have fully funded schemes.

pension scheme is the actuarial balance or net implicit debt. For a given period,⁶ the actuarial balance is the sum of current reserves and the present value of future contributions and investment income net of future benefits and administrative expense. Another measure of financial sustainability is future reserves, which measures a pension scheme's financial position at a future point in time instead of the present (see equations below). Depending on assumptions on the relative magnitudes of discount rate and nominal GDP growth rate, the resulting actuarial balance (or future reserves) to GDP ratio may differ somewhat in their valuation. They, nevertheless, can shed light on the relative severeness of the financial strains of a pension scheme. The net implicit debt over the forecast horizon is estimated to be most burdensome in KNA, and lowest in DMA. Despite being in a relatively better position, DMA's estimated reserves of -46 percent of GDP in 60 years implies an annual fiscal burden of close to 1 percent of GDP.



$$\begin{aligned} \text{Actuarial balance}_{T,60}/\text{GDP}_T &= \{ \text{Current reserves}_T + \text{PV}(\text{contributions}_{T,T+60}) \\ &+ \text{PV}(\text{investment income}_{T,T+60}) - \text{PV}(\text{benefits}_{T,T+60}) \\ &- \text{PV}(\text{administrative expense}_{T,T+60}) \} / \text{GDP}_T \end{aligned}$$

$$\begin{aligned} \text{Reserves}_{T,60}/\text{GDP}_{T+60} &= \{ \text{Current reserves}_T + \text{contributions}_{T,T+60} + \text{Investment income}_{T,T+60} \\ &- \text{benefits}_{T,T+60} - \text{Administrative expense}_{T,T+60} \} / \text{GDP}_{T+60} \end{aligned}$$

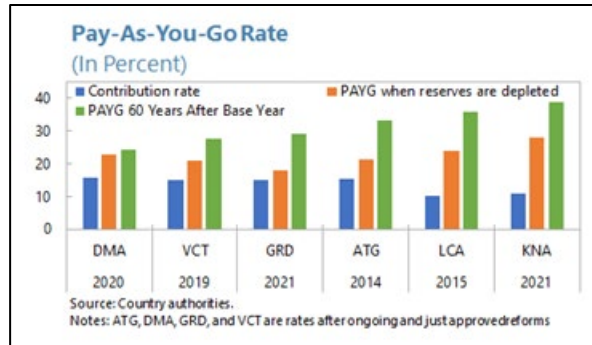
Contributions

9. Contribution rates are too low compared to what is needed to cover total expenditure over the next 60 years. The low contribution rates are one of the main reasons behind the NIS' sustainability problems. The average contribution rate of the ECCU-6 countries is 13.7 percent compared to an average of 15.3 percent in EMEs and 17.8 percent in OECD. In terms of the distribution of contributions across employers and employees, the ECCU is comparable to emerging markets but relies more on the employer contributions than the LAC and OECD countries. In addition, current contribution rates (after considering approved reforms which are still phasing in) are well below the general average premium (GAP)—the level of contribution rate required to fully cover the total expenditure over a 60-year period. The general premium gap—the difference between GAP and current contribution rate—is largest in KNA, followed by GRD, and ATG.

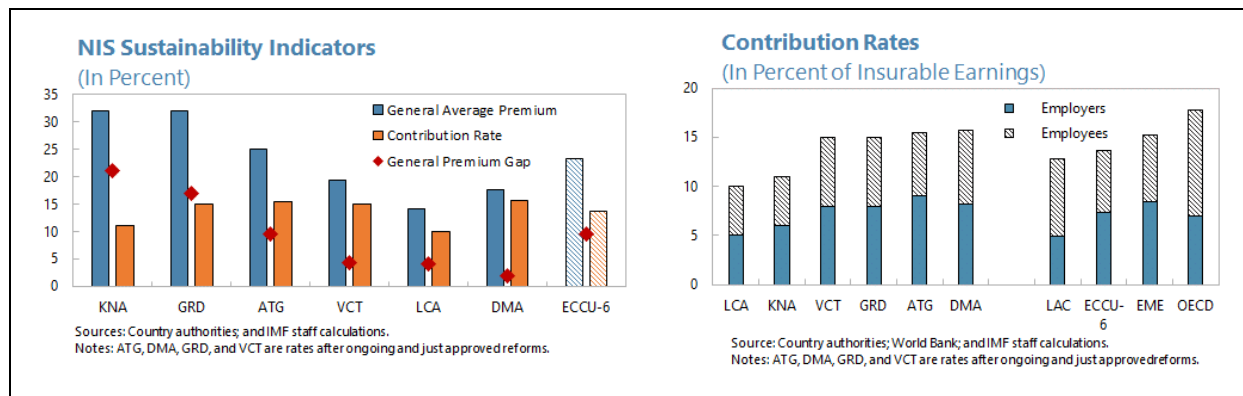
10. In the absence of further reforms, abrupt increases in contribution rates or reductions in payments would be necessary once reserves approach depletion. The PAYG measures annual expenditure as percentage of covered wages. It is the contribution rate that would be necessary to

⁶ The conventional projection horizon of actuarial analysis is 60 years.

pay all expenditures (benefits plus administration) for breakeven in a given year. The projected PAYG rates are well above the current contribution rates in all the ECCU-6 when reserves are depleted and will continue rise rapidly thereafter. This implies that, under the current pension parameters, abrupt increases in contribution rates would be needed to cover pension expenditures.⁷



Furthermore, the longer the delay of further reforms, the larger the needed adjustments. To avoid this, early reforms would allow a gradual implementation and avoid abrupt and more sizable adjustment in the future. This will also help improve intergenerational equity by avoiding unduly imposing a high contribution burden on the younger generations.

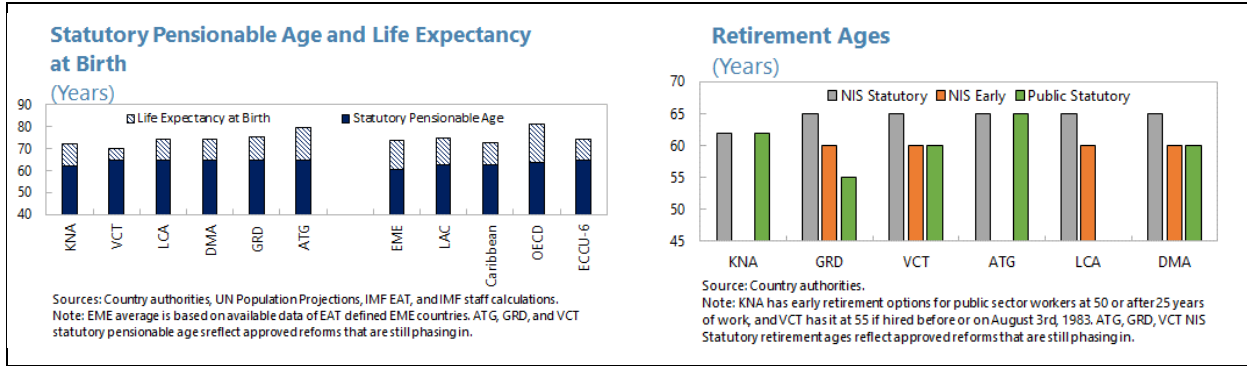


Retirement Age

11. The statutory retirement ages are broadly in line with peers, but early retirement options are widespread, and an automatic adjustment mechanism is missing. After all the approved reforms for ATG, GRD, and VCT are phased in (by 2025, 2029, and 2028, respectively), statutory pension ages in all ECCU countries but KNA will be 65—which is in line with the OECD average and slightly above regional averages. KNA’s statutory pension age remains low. None of the ECCU countries links the statutory retirement age to the life expectancy, which would improve the financial sustainability of the pension system and inter-generational equity in the face of the longer life expectancy. In addition, DMA, GRD, LCA, and VCT have an early retirement option under the NIS. The statutory retirement ages for public sector pensioners under the PSPS for DMA, GRD, KNA, and VCT are significantly lower than those under the NIS, creating concerns about equity between private and public sector workers.⁸

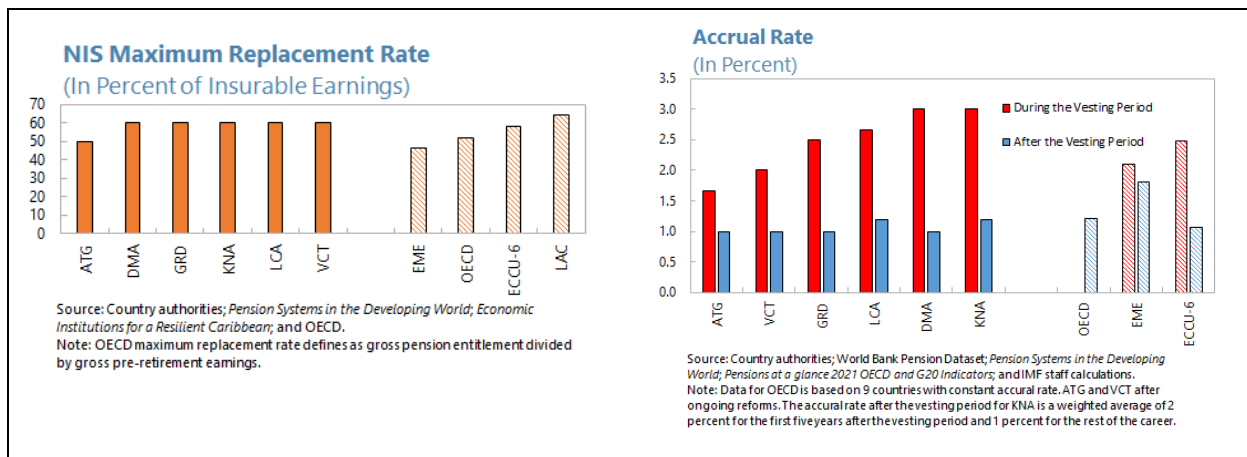
⁷ A too large increase in the contribution rate could have negative consequences on formal labor supply, as many workers would interpret it as a tax. Hence, it is advisable to implement a comprehensive reform as a package to avoid overly large adjustment in any individual parameter.

⁸ DMA provides a bridging pension to public sector workers who have statutory retirement age of 60 and get their pension from the PSPS until they qualify for retirement under NIS at the age of 65.



Benefit Rules

12. Benefit rules are too generous to ensure the sustainability of the NIS. The maximum replacement rates⁹—the ceiling of pension benefit as a share of the insurable wage—in the ECCU countries (60 percent in all but ATG) are higher than the EME and OECD averages.¹⁰ Furthermore, many public sector workers enjoy dual benefits under both the NIS and PSPS, making the maximum combined replacement rates above 100 percent in some countries.¹¹



13. The current accrual rate structure also gives very high rates of return to persons with short wage histories. The accrual rates, at which the replacement rate increases with years of service in the ECCU countries are front-loaded and generous. The accrual rate during the vesting

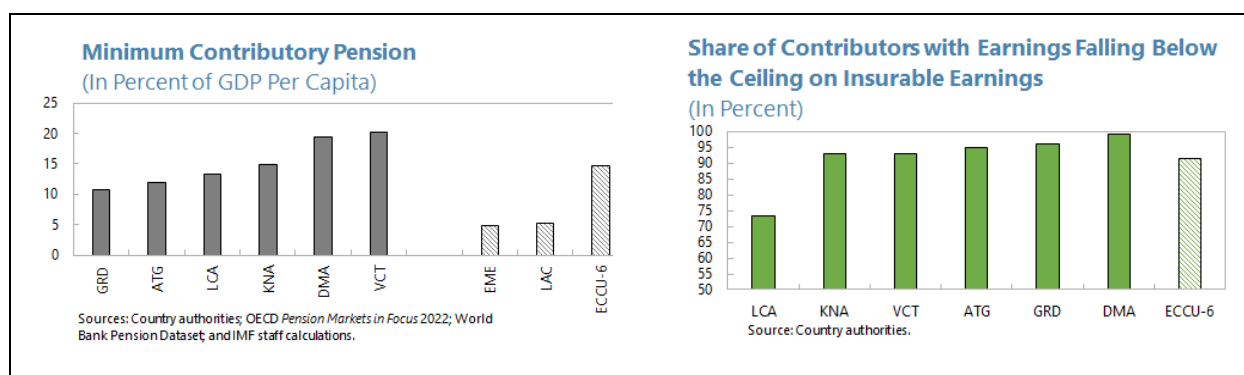
⁹ The maximum replacement rate defines the ceiling of pension benefit as a share of the insurable wage. The effective replacement rate may differ from the maximum rate as the former considers taxation on pension and depends on the reference wage, whose calculation depends on wage growth and number of years considered. ECCU countries generally have reference wages dependent on the last few years of earnings, which makes benefits more generous than if full careers were taken into account. Similarly, with pensions not taxed in many ECCU countries, the effective replacement rate will be even more generous compared with countries where pensions are taxed. On the other hand, if the reference wage is not revalorized with average earnings growth, the effective replacement rates would be a bit lower than otherwise.

¹⁰ The average maximum replacement rate in LAC countries is high, which is one factor behind the serious pension sustainability issues in LAC.

¹¹ For example, public sector workers are entitled for an estimated maximum combined replacement rate of greater than 110 percent in GRD and 127 percent in VCT.

period (the initial years after joining the NIS)¹² is high compared to the EME and OECD averages. A front-loaded accrual rate rewards workers with short contribution histories. This may discourage workers from having a longer career in the formal sector.

14. The thresholds for the minimum contributory pension and for the insurable wage appear broadly adequate. The minimum contributory pension is the smallest amount of pension that any participant of the NIS could receive after reaching the statutory retirement age or meeting the minimum contribution requirements. The ECCU countries' minimum contributory pensions are above the LAC and EME averages.^{13,14} The insurable wage threshold—which is also the ceiling for the average earnings used to calculate benefits—is adequately high in the ECCU countries, with a large share of contributors having their wages fully covered by NIS.



Coverage

15. The pension system's coverage of employees and self-employed has room for improvement. Two key metrics for coverage are the contributor ratio—the share of working-age population contributing to the pension scheme—and the pensioner ratio—the share of elderly population claiming pension benefits.¹⁵ While coverage in the ECCU countries is above the regional

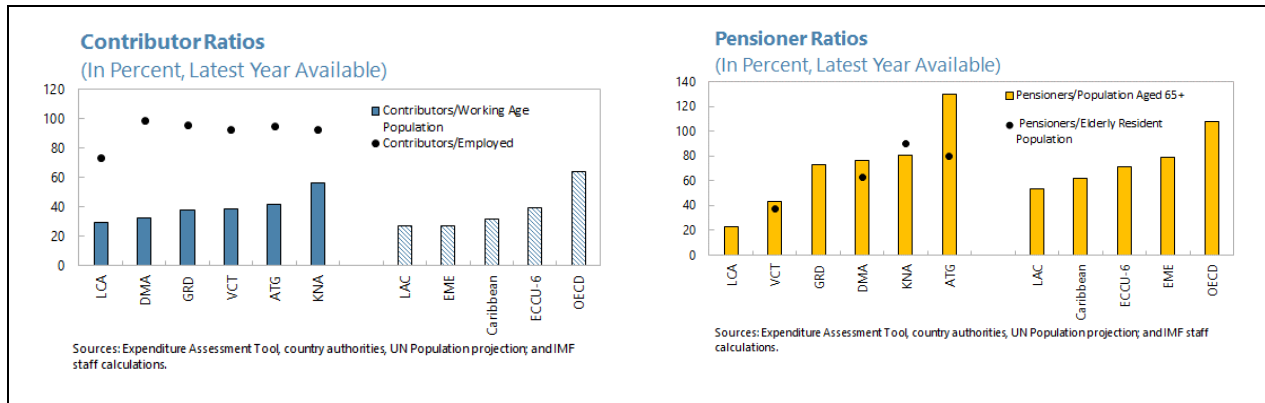
¹² In general, vesting periods or minimum years of contribution requirements are problematic. It allows the pension scheme to pay generous benefits to those who reach the requirement by transferring from individuals with short careers to long careers. Apart from the perverse redistribution, it discourages contributions by older workers with short careers. Instead, additional entitlements for every year of contributions provide the best and fairest incentives and should not jeopardize fiscal sustainability provided that contribution and accrual rates are reasonable. The minimum contribution requirement could be maintained for the minimum pension, or the level of the minimum pension can be made dependent on career length.

¹³ Based on another metric of minimum contributory pension as ratio of average insurable earnings for which there are available data, VCT is broadly comparable with the OECD, at about 23 percent (Lifeworks, 2021 and OECD, 2011).

¹⁴ While the minimum pensions in the ECCU do not seem very high, the vesting periods in combination with the lack of comprehensive social pensions makes the difference in benefits quite stark between those that do not reach the vesting time and those that just do and receive a minimum pension. A more gradual approach in which social pensions and minimum pensions are integrated would create more even incentives to contribute and be more equitable.

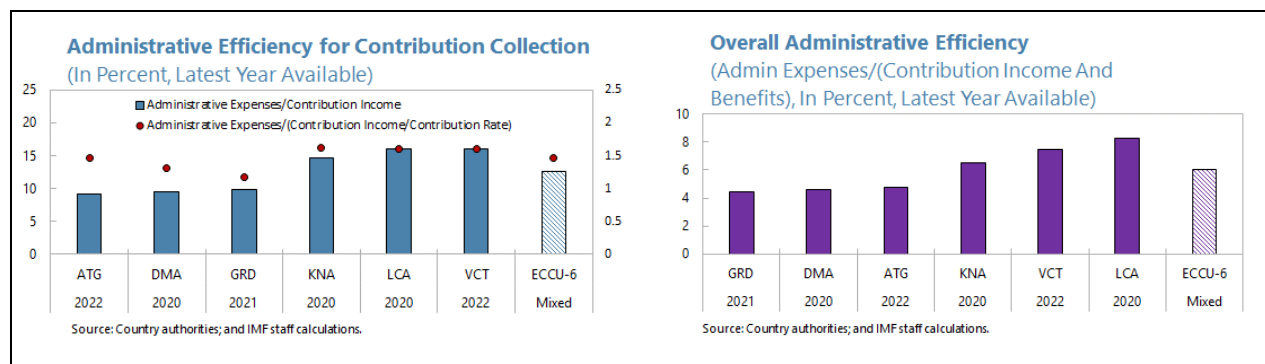
¹⁵ Given the lack of up-to-date statistics to provide a full picture of formal and informal labor market, the contributor-to-employment ratio are estimates from authorities' actuarial reports which capture mainly the formal market.

average, it is below the EME (on pensioner ratio) and OECD averages (on both). The lower coverage ratios in the ECCU are likely attributable to higher unemployment and informality, and lower labor force participation. Finally, in KNA, LCA, and VCT, participation of the self-employed is not required, and making their participation mandatory would increase the coverage of the pension system and reduce informality¹⁶ and old-age poverty. In addition, consolidating data collection between the NIS and the tax authorities to strengthen compliance, digitalization of records to make the system more efficient and user-friendly, and reducing the size of informal sector can help improve the coverage.



Administrative Efficiency

16. Administrative efficiency varies among the ECCU countries. Administrative efficiency is measured as (1) the ratio of administrative costs to contribution income and (2) the ratio of administrative costs to contribution income and benefits (where benefits capture the operational efficiency of the NIS schemes’ two main operations—collecting contributions from workers and paying out benefits to pensioners). The relatively high administrative costs reflect the small size of the systems. Nevertheless, there is scope for KNA, LCA, and VCT to converge to the regional better practices in ATG, DMA, and GRD and create savings. Modernizing administrative systems using available technology and converging to international best practices can help improve performance in all the ECCU countries.



¹⁶ See Chapter 2 of the Selected Issues on Labor Market Performance and Policies.

Investments of NIS Funds

17. The share of foreign investments of NIS’ portfolios is low compared to other small states (Figure 1). Notwithstanding the variation across the ECCU countries, the ECCU average share of foreign investments is much lower than in the small and mid-sized countries in Latin America, and even more so in Europe. The very large share of domestic investments makes the ECCU highly exposed to domestic and regional risks, such as natural disasters and any tourism-related shocks. Given the less-developed capital market in the region, domestic investments are concentrated in deposits, government paper and other public sector,¹⁷ making the NIS exposed to the sovereign risk. In addition, given that the reserves will start declining soon under current policy, this makes the government exposed to the rollover risk.

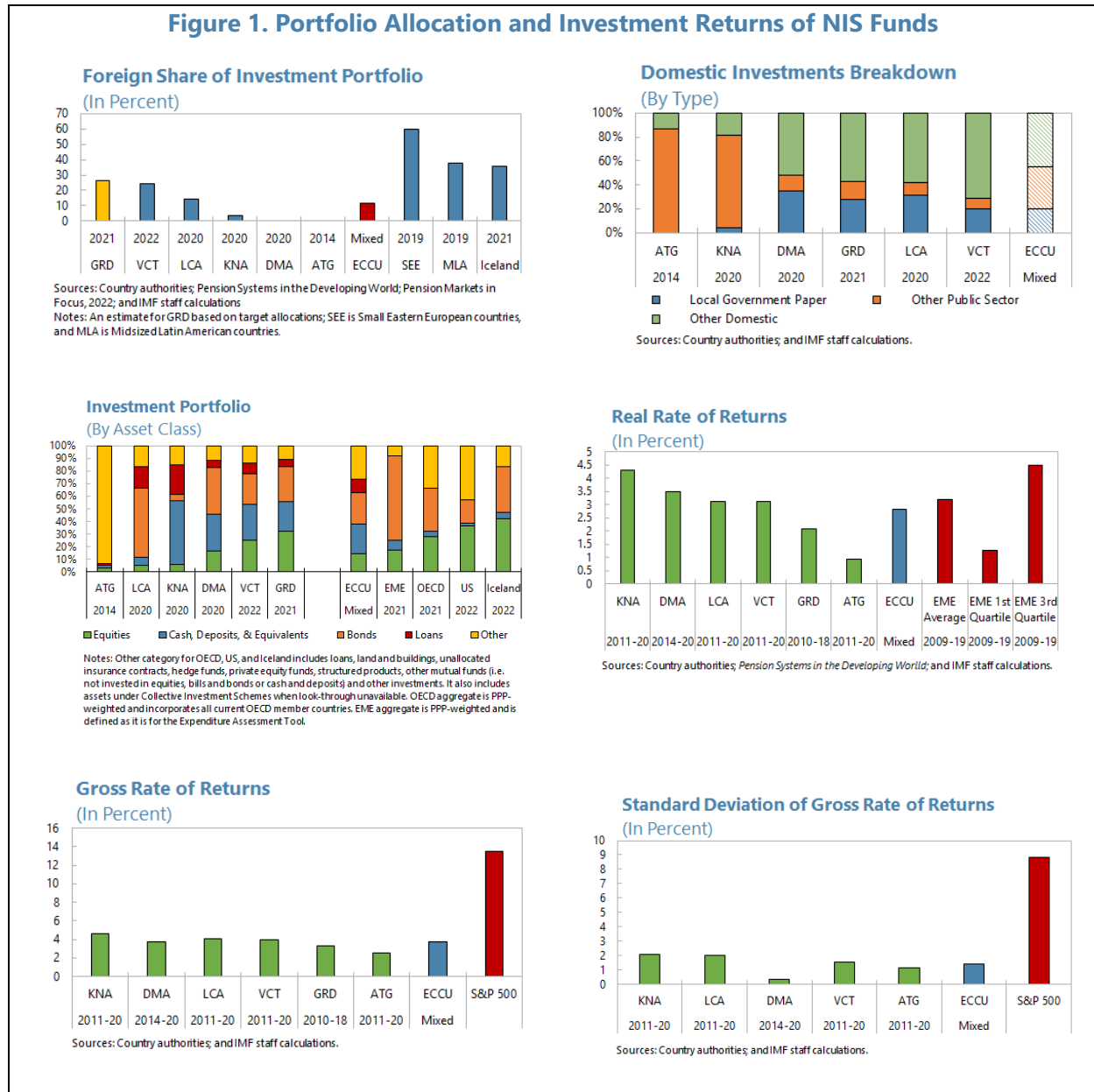
18. A higher share of foreign investments would allow a shift from cash to global bonds and, in some cases, global equities, improving investment returns and asset diversification. The shares of equities and bonds in the ECCU’s NIS assets are low compared to international benchmarks, whereas the share of cash is high (Figure 1). While cash has the merits of being the safest and most liquid asset, investment returns—which are reasonably good compared to other emerging markets over the past decade—can be further improved by a shift to international markets to allow higher shares of international equities (liquid) and bonds (safe and liquid). The relative proportions of global equities and bonds should be governed by the expected lifetime of the investment portfolio. While global equities, for example, the US equity market can offer returns several times higher, investment in global equities is prudent only when the investment horizon is very long given the much higher market volatility, and hence only suitable for the NIS with long lifetime of the pension funds. In addition, raising the share of foreign investments in the ECCU would allow for more risk diversification by geography (e.g., physical risk), sector (given the ECCU’s high dependence on tourism), as well as by asset class, for example, away from the “Other” category, whose risk profiles that are completely different from the OECD (i.e., both include real estate, but in the ECCU, real estate is both heavily exposed to the physical risk of natural disasters and illiquid, while in the OECD there is much greater scope for other alternative investments, such as structured products).

D. Policies Toward More Efficient, Sustainable, and Fair Pension Schemes

19. There is a need to restore the sustainability of the ECCU pension systems. The looming large pension liabilities have increased the need for comprehensive pension reforms as soon as feasible to allow for gradual implementation, minimize intergenerational inequality, and avoid the need for abrupt and large adjustments in the future. Moreover, the shrinking pension portfolios imply less demand from the pension funds for government debt in the foreseeable future. Staff analysis suggest there is scope for improvements in the system design to strengthen the financial sustainability, efficiency, and equity, including through a comprehensive parametric reform,

¹⁷ The NIS (or SSA) in KNA keeps the bulk of its cash and cash equivalents at the systemic state-owned bank. ATG’s social security portfolio is heavily exposed to the government under a Memorandum of Understanding, where transparency and legal clarity should be improved.

improving investment and administrative efficiency of the NIS, aligning the PSPS closer with the NIS and eliminating their overlap for public sector servants, and legislative reforms to establish automatic adjustment mechanisms. These reforms need to go hand in hand with other important reforms, including strengthening fiscal sustainability, developing regional capital market, diversifying and growing the economies, creating job opportunities, to avoid potential unintended spillover effects on labor market, government financing, and financial stability.



20. Priorities of comprehensive parametric reforms of the NIS include:

- **Increase contributions.** Contribution rates should be increased towards the EM and OECD averages (16-18 percent) expeditiously.

- **Rationalize benefit rules.** Considering the relatively generous benefit accrual rates, *replacement rates* could be reduced. This can be achieved by reducing the high *accrual rates* during the vesting period and adopting a uniform accrual rate (e.g., 1.2 percent) for all years of service. This will promote long careers and improve the equity of the system by equalizing the marginal replacement rates for pensioners with different length of service. *Reference wage* (i.e., the base used for calculating benefits) should be calculated to mirror career average instead of basing the current methodology of the best few years of earnings out of the last 10-15 years. A good practice is to calculate reference wage using average earnings over 25-40 years, with past wages indexed to incentivize early contributions. This approach avoids inequities and a reduction in the insurance value of age pensions resulting from favoring individuals whose earnings rise rapidly over their career (typically high-income workers) over those whose earnings are relatively flat over their career (typically low-income workers).¹⁸ Given the relatively generous benefit rules, pension benefits could be frozen over the medium term to allow the older generation to share some reform burden and increase the intergenerational equity of the reforms. Thereafter, ad hoc adjustments should be replaced by an annual adjustment in line with inflation.¹⁹
- **Improve retirement age rules.** While most ECCU countries have already approved reforms to increase the statutory *retirement age* to 65, reforms in KNA are pending. Early retirement should be eliminated or tightened in all countries. A faster implementation of the approved retirement age increases in GRD and VCT could also be considered. As a further step towards ensuring long-term sustainability, it could also be considered to link retirement age to life expectancy following international best practices (e.g., to increase automatically by two-thirds of the life expectancy gains at age 65).
- **Expand coverage.** Making contributions *mandatory for self-employed* (in KNA, LCA, and VCT), strengthening *compliance*, and promoting participation will help improve coverage and reduce informality and the risks of old-age poverty. Focused intervention can include: (i) consolidating collections and compliance between the NIS and the tax authority or, at a minimum, information sharing between the agencies; (ii) improving the transparency of pension operation and governance; and (iii) increasing digitalization to make the platform more user-friendly and deliver better customer service.

21. Careful attention should be paid to the investment strategy of the NIS to ensure that it maximizes the risk-adjusted rate of return on the portfolio. The investment portfolio should be sufficiently diversified to limit its exposure to domestic risk, including by raising allocations to global equities for the NIS with long investment horizons (DMA and LCA) and mostly to global bonds for those with short investment horizons (GRD and VCT).

¹⁸ This is because workers with flat wage profiles make a larger share of the contributions early in their careers, foregoing the use or return on the money for a longer period than workers with rising wages.

¹⁹ Indexation of pensions to consumer prices should not significantly affect projected pension system finances relative to the baseline which roughly incorporated this assumption de facto in the current actuarial balance estimates.

22. Administrative efficiency and transparency can be improved. As shown above, administrative costs are relatively high in KNA, LCA, and VCT. While there is no single benchmark or target that is ideal for all countries, there is scope to reduce administrative costs to 10 percent of contributions in the medium term by modernizing the administrative system. There are also potential gains from combining some elements of social security administration within the region. Increasing regional coordination of the NIS, including by sharing of administrative structures and harmonizing system design, will further enhance the portability of accumulated pension rights—building upon the existing [CARICOM Social Security Agreement](#)—and facilitate regional labor mobility. In addition, transparency can be enhanced, including by timely publishing actuarial reports, and making the government’s review of reforms put forward in the actuarial reports legally binding.

23. The PSPSs should be reformed to rationalize their overly generous benefits and better aligned with the NIS to increase fairness and reduce fiscal costs. Noncontributory PSPS pensions with benefits in addition to NIS pensions and potential combined replacement rate exceeding 100 percent are not efficient and create inequities between public and private sector workers. The PSPS should be closed to new entrants expeditiously and its retirement age aligned with that under the NIS. Pension benefits under the PSPS and NIS should be consolidated to avoid duplication and unfair treatment across sectors.²⁰

24. Establishing automatic adjustment stabilizers will ensure the long-term sustainability of the pension system. Given the uncertain economic outlook, the Pension Acts could be amended to enable timely and coordinated adjustments to benefits and funding policies. The individual adjustments in benefits and funding policies discussed above are interconnected. For example, a desired level of benefits may result in required contributions that exceed those permitted or desirable by the funding policies. One way to systemically deal with such conflicts as they reappear is to establish automatic adjustment mechanism (that is, rules to reduce benefits or increase contributions when one or more triggers are met).²¹ Examples of triggers include projected funding falling short of prudent levels and projected reserve depletion years falling short of a certain number of years. Automatic stabilizers are particularly important when proposed reform packages are not sufficient to eliminate all actuarial deficits in the projection horizon.²²

²⁰ One argument for additional government pensions is to compensate public sector workers because their salaries are lower than they could earn in the private sector. Nevertheless, in the ECCU government wages are generally on average higher than private sector wages for comparable duties. Even if this was the case, compensating public sector workers directly based on careful analysis of public-private earning differentials is a much more efficient way to address this problem than a noncontributory duplicative pension scheme.

²¹ Automatic adjustment mechanisms need to be carefully designed to avoid creating volatile conditions in small countries. For instance, automatic adjustment mechanisms that rely on the ratio of contributors to benefit recipients (a measure used in Germany to adjust benefits) would create large swings in benefits or contributions if economic activities collapse (e.g., due to natural disasters or pandemics).

²² Estimated outcomes of selected reform packages suggest that they can postpone reserve depletion date or lower long-term pay-as-you-go rate but are not sufficient to eliminate all actuarial deficits. For example, the ATG actuarial report shows that an increase in pensionable age to 65 can reduce the long-term pay-as-you-go rate from 30 percent to under 25 percent. The GRD actuarial report shows that increasing the contribution rate to 15 percent alone will only postpone reserve depletion by about 5 years. When combined with an increase in pensionable age to

(continued)

Appendix I. Past and Ongoing Approved Major Pension Reforms in ECCU-6 Over the Past Decade

Antigua and Barbuda	<ul style="list-style-type: none"> •Statutory retirement age increased from 60 in 2016 to 64 in 2023, will be 65 in 2025. Close early retirement option once statutory retirement age reaches 65 in 2025. •Minimum contribution requirement increased from 500 weeks in 2016 to 700 in 2023, will be 750 in 2025. •Employer contribution rate increased from 6 percent in 2016 to 8.5 percent in 2023, will be 9 percent in 2025. •Employee contribution rates for public and private sector workers increased from 3 and 4 percent to 5.5 and 6.5 percent in 2023, will be 6 and 7 percent in 2025, respectively.
Dominica	<ul style="list-style-type: none"> •Statutory retirement age increased by 6 months each year, from 60.5 in Mar 2012 to 65 in Jan 2021. Early retirement age remains at 60. •Accrual rate for contribution period after 10 years reduced from 2 to 1 percent and the maximum replacement rate reduced from 70 to 60 percent. •Ongoing increase in contribution rates from 10.75 percent (4 percent from the employees, 6.75 percent from the employers) in 2012 to 15.75 percent by January 2031, with contribution rate increase of 0.25 percent each year alternating between the employees and employers.
Grenada	<ul style="list-style-type: none"> •The pensionable age will increase from 60 to 65 years over the period of 2024 to 2029, with vesting periods increased from 500 to 750 weeks correspondingly. •The contribution rate will increase gradually by 0.5 percent annually from 2024 until it reaches 15 percent (plus 1 percent in unemployment insurance) in 2031.
St. Kitts and Nevis	•None.
St. Lucia	•Statutory retirement age increased from 60 to 65 in 2015, with vesting periods increased from 500 to 750 weeks correspondingly.
St. Vincent and the Grenadines	<ul style="list-style-type: none"> •Contribution rate for regular employers and employees will increase from 10 percent to 15 percent (7 percent from employers, 8 percent from employees) by 2027. •Statutory retirement age (the number of contributions required for a full age pension) are being increased from 60 (500) in 2015 to 61 (550) in 2016-18, 62 (600) in 2019-21, 63 (650) in 2022-24, 64 •The years of insurable wages averaged when calculating age pension were changed from best 3 in 15 years prior to age 60 to the best 7 years over all contribution years. The age for a widow(er) to automatically qualify for a Survivors' pension for life was increased from 50 to 55. Age limits for Survivors' pension to children increased from 16 to 18, and from 18 to 21 if a full-time student.

65 and a reduction in average benefit for new pensioners by 20 percent, reserve depletion will be postponed by about 20 years. The latest approved package in 2023 is estimated to postpone reserve depletion by 20 years. The package includes an increase in pensionable age to 65, an increase in contribution rate by 0.5 percent each year until reaching 16 percent in 2031, revised early retirement provisions to roughly 5 percent each year before 65, an increase in the minimum required contributions from 500 to 750 weeks to qualify for pension benefits, and an increase in minimum pension from EC\$46.5 to EC\$58 per week (from 17 to 29 per week for survivor pension). The KNA actuarial report shows that an increase in pensionable age to 65, combined with a lowering of accrual rate and an increase in contribution rate will postpone reserve depletion by 10 years. The LCA actuarial report shows that an annual increase of contribution rate by 0.25 percent until reaching 17.05 in 2051 will postpone reserve depletion from 2050 to 2066. Staff's back-of-the-envelope assessment for VCT suggests that an increase in contribution rate to 15 percent, combined with benefit cuts for new pensioners (by reducing the maximum replacement rate from 60 percent to 55 percent), a speedier increase in pensionable age, and linking retirement age to life expectancy will postpone reserve depletion outside of the 60-year projected horizon but will not eliminate actuarial imbalance.

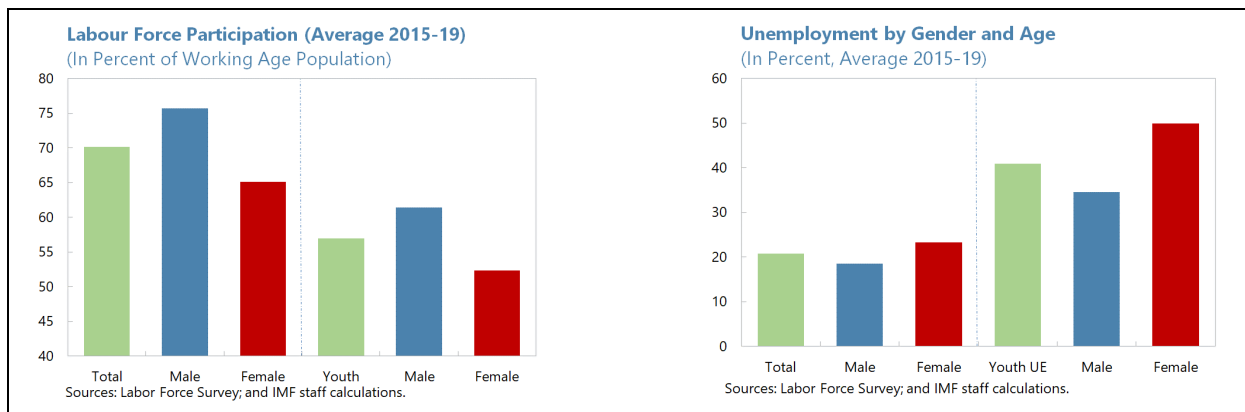
LABOR MARKET PERFORMANCE AND POLICIES^{23, 24}

Labor markets in the ECCU have been recovering in tandem with the economic rebound from the pandemic, but longstanding bottlenecks constrain labor supply and growth potential. A recalibration of labor market institutions can achieve a more effective balance between efficiency and equity objectives, particularly as unemployment insurance becomes more commonplace. Reforms in this context should be supported by active labor market policies (ALMPs), where targeted policies can help reduce the presence of informality, decrease skills mismatches, and raise participation rates while easing gender and youth gaps. Improving data collection is a pre-requisite to enhance evidence-based labor market policymaking.

A. Labor Markets in the ECCU

The Pre-Pandemic Landscape

25. Youth and female workers consistently exhibited lower labor force participation rates and higher rates of unemployment. While countries with higher growth rates over the period 2015-19 generally saw higher participation rates, female labor force participation was lower than male and participation rates for youth (aged 15-24) were lower than the total working age population in all countries. Young female workers had the lowest participation rates of all. Across all countries, youth unemployment was higher than total unemployment, and female unemployment tended to be higher than male unemployment.

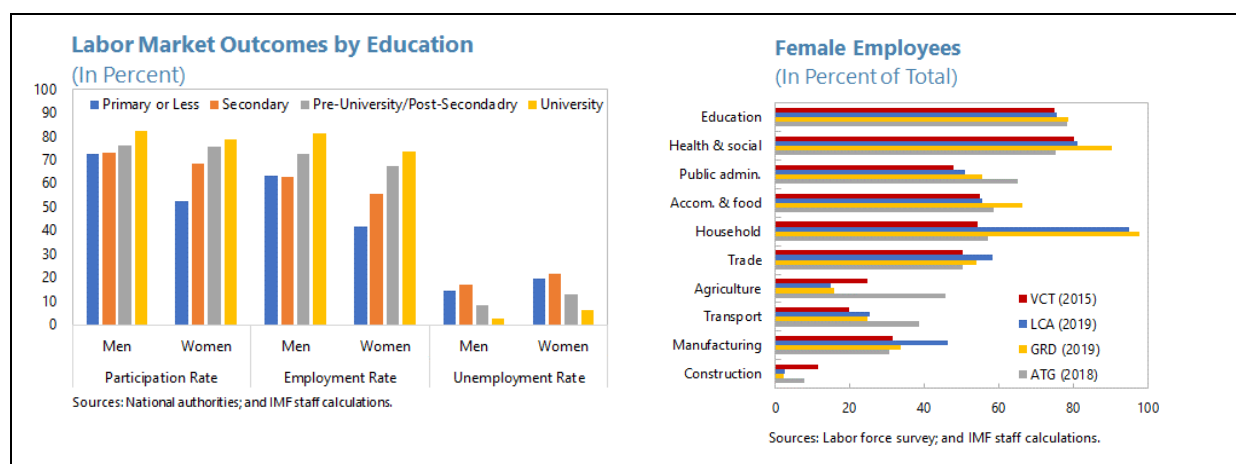


26. Higher education levels were associated with higher participation and employment rates, especially for women employed in the education and health sectors. Workers with

²³ Prepared by C. Faircloth, S. Hannan, H. Lin, F. Moreau, P. Nagle, H. Park, and H. Wang.

²⁴ Since Labor Force Survey (LFS) data is generally unavailable for ECCU countries, this analysis supplements Social Security (SS) data, which provides monthly employment and wage data by sector, age, and gender for five ECCU countries. Measures of employment from the SS database/LFS are referred to as *formal / total* employment, respectively. Given limitations associated with SS data, more granular data analysis is limited to Grenada and St. Lucia where LFS information is available.

university education generally had the highest participation and employment rates, except in Grenada. Men with primary or less education in Antigua and Barbuda, St. Lucia, and St. Vincent and the Grenadines had participation and employment rates that were higher than (or comparable) to men with secondary or pre-university/post-secondary education. This finding may reflect the presence of large employment sectors like construction and agriculture that do not require higher education levels and have a higher share of male workers. The female share of total employment was higher in education, health and social work, and household work in most ECCU countries.



27. While female labor force participation rates in the ECCU are higher than other regions, there are indications of substantial gender pay gaps. The participation rate gap between men and women in ECCU countries are between 7 and 14 percentage points (pp), which is relatively low compared to the Latin America and the Caribbean (LAC) and world average (23pp and 26pp respectively) and comparable to the OECD average (15pp). Nevertheless, available information suggests that gender pay gaps for comparable work and/or levels of educational attainment—which are common in labor markets globally—are also an issue in the ECCU region. For example, the unexplained gender pay gap—the difference between female and male income for the same job and equivalent characteristics—in the overall labor market is estimated at 19 percent in St. Lucia (Box 1).

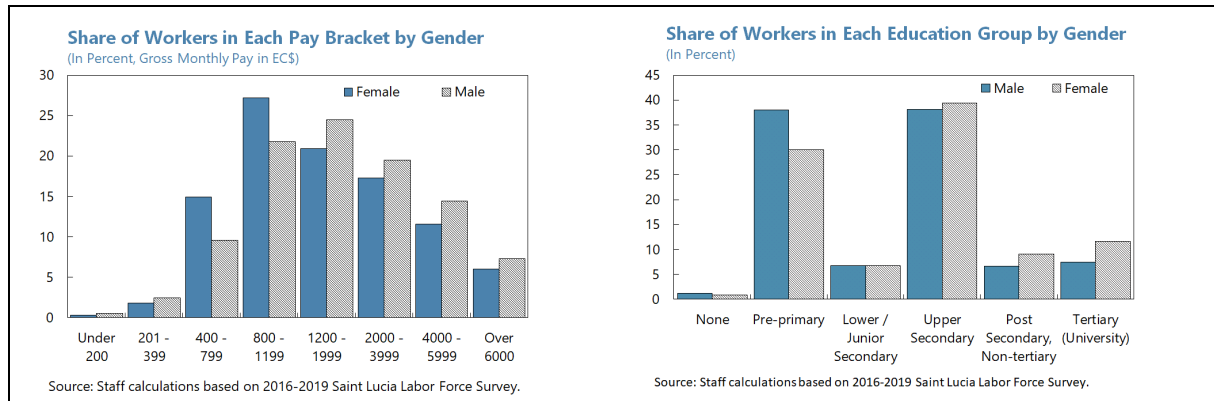
During the Pandemic

28. The decline in formal employment in the ECCU was smaller than the output contraction, but its recovery is lagging the rebound in growth. The number of formal jobs declined by an average of 8 percent across ECCU countries at the peak of the pandemic in 2020 compared to an average contraction in real output of 15 percent. The smaller employment decline potentially reflects the combined impact of COVID-related employment retention measures, a relatively high share of public employment in total employment in the ECCU region (roughly 30 percent), and employers choosing to reduce hours worked per worker, rather than reducing the number of workers. In 2021, while real output started recovering along with the gradual reopening of most countries from the COVID-related closures, formal employment continued declining, though at a slower pace in all countries, except in St. Vincent and the Grenadines. The hospitality

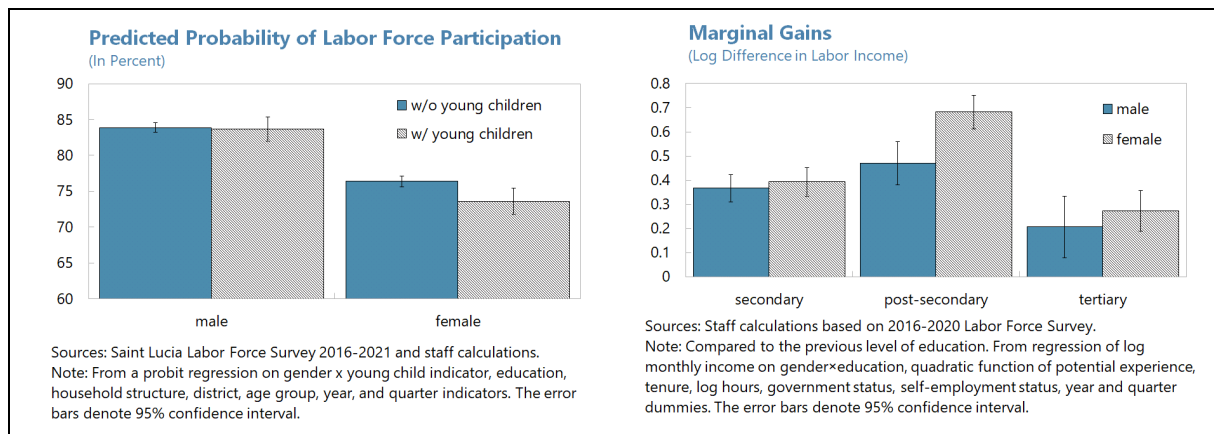
(accommodation and food) and other services sectors were most hit by the pandemic, followed by transportation and health and social workers.

Box 1. Gender Gaps in ECCU Labor Markets: Evidence from St. Lucia

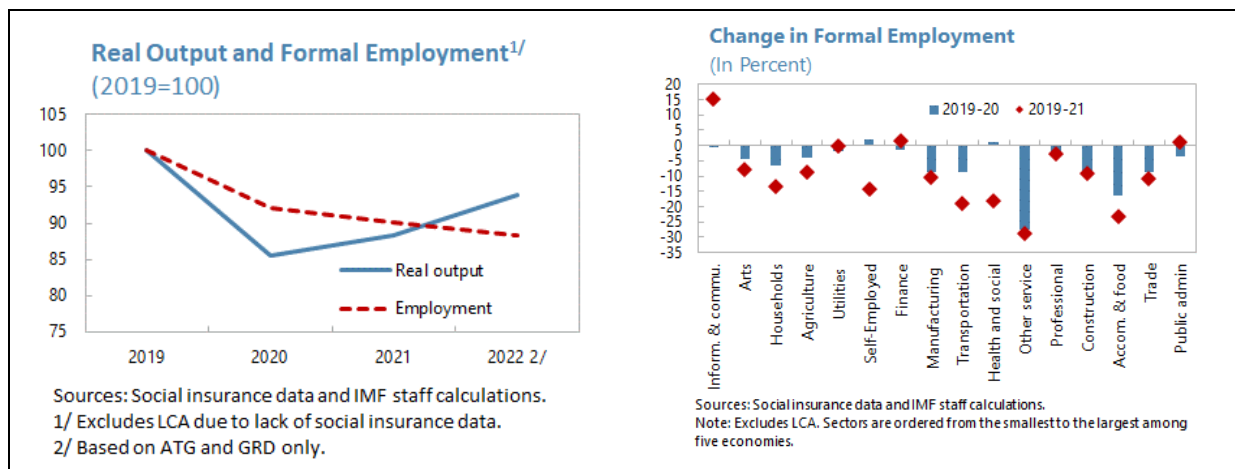
Labor force information for St. Lucia is indicative of a prevailing gender pay gap after controlling for common characteristics (e.g., education, occupation, and industry). Female workers are less likely to be in high earnings brackets than male workers, despite having more years of schooling.



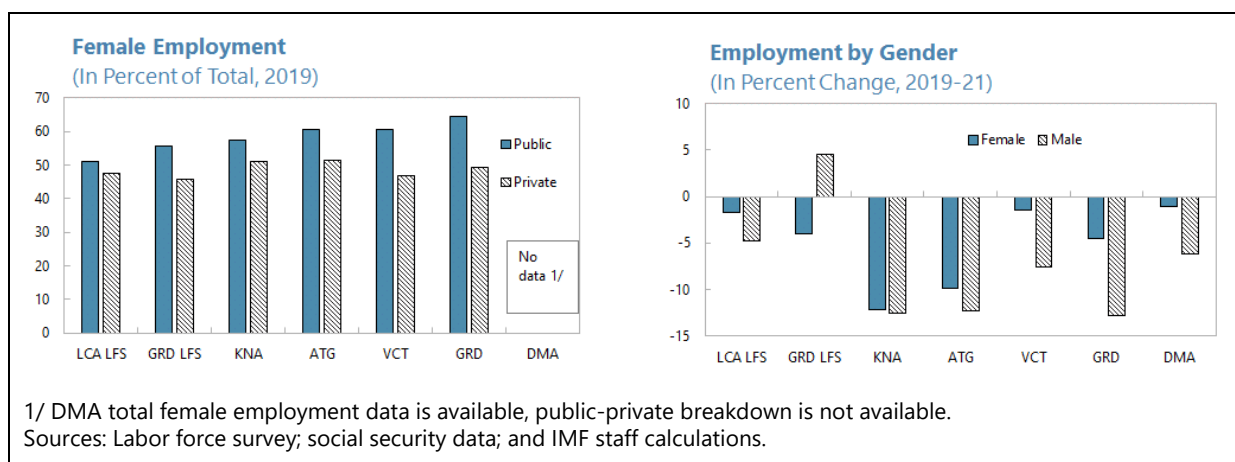
Staff’s econometric analysis confirms that, for the same relevant characteristics, women are less likely to work and earn less compared to men when they do.¹ Working-aged women in St. Lucia are 8 percentage points less likely to participate in the labor force compared to men, with the same observable characteristics. Notably, women with children under the age of 5 in their household are 3 percentage points less likely to participate in the labor market than other women with the same observable characteristics. The unexplained gender pay gap—the difference between female and male income for the same characteristics—in the overall labor market (controlling for potential experience, tenure, education, occupation, industry, hours worked, self-employment status, and government employee status) is 18 percent, which is consistent with the world average in another study (International Labor Organization Global Wage Report, 2018/19). The unexplained pay gaps are 21, 21, 8, and 2 percent for workers with primary, secondary, post-secondary (non-tertiary), and tertiary educations, respectively, suggesting that the overall gender pay gap may be driven by workers with secondary or lower education and that women may have higher marginal gains from post-secondary education than men.



¹ Results should be interpreted with caution since it is based on survey data where income is reported in brackets.



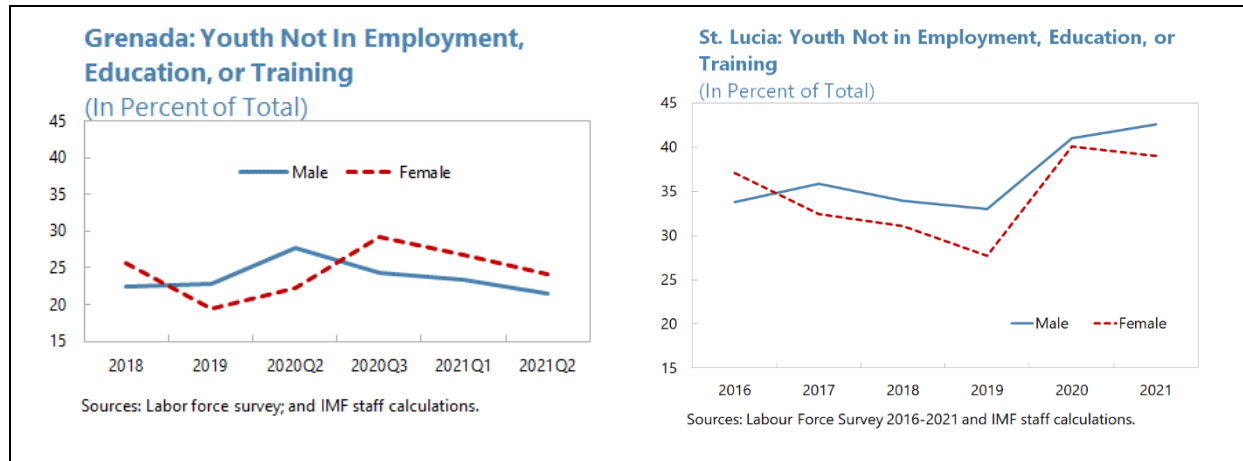
29. Formal sector job losses were relatively severe among male as compared to female workers, reflecting different sectoral compositions. In all ECCU countries, the public sector had the least formal job losses and employs more women. In contrast, the private sector, which saw greater formal job losses, employs more men than women in all countries except Antigua and Barbuda and St. Kitts and Nevis (where men account for 49 percent of employment). In countries where there is a larger difference in the gender sectoral composition (such as Grenada and St. Vincent and the Grenadines), male job losses were much more severe than female job losses reflecting larger declines in private sector jobs.²⁵



30. The share of both male and female youth who are not in employment, education, or training (NEET) increased during the pandemic. School closures and business shutdowns during the pandemic resulted in unprecedented disruptions in learning and on-the-job training that have potentially widened the skills gaps. Employers in the region note difficulties in finding skilled workers due to a combination of emigration (Box 2) and skill mismatches. The fallout in terms of

²⁵ In Grenada, the LFS data indicates a large increase in informal jobs for men, which led to an overall increase in total male employment despite a significant decline in formal male jobs reported in the national insurance scheme (NIS or Social Security)

NEET is evident in both Grenada and St. Lucia. However, while the male NEET rate has stayed higher than female in St. Lucia since 2021, the opposite holds for Grenada. This is consistent with the LFS finding that male employment recovered faster than female employment in Grenada.

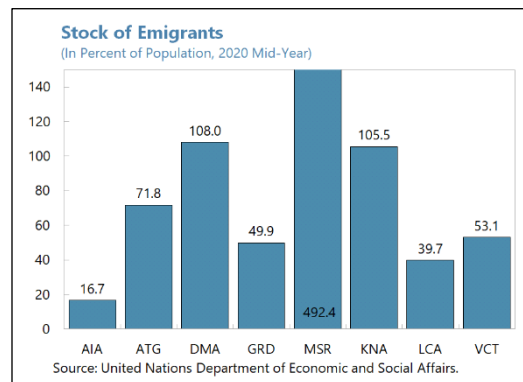


Box 2. ECCU Migration and Labor Policies

The Eastern Caribbean is a region shaped by migration, with close to two thirds of ECCU citizens residing abroad, mostly in the United States, Canada, and the United Kingdom. Among the top 10 countries with the largest diasporas in 2019, five are ECCU members.¹ During the pandemic, those diasporas’ remittances provided a lifeline for recipients as well as counter-cyclical currency inflows for ECCU economies.

Following post-pandemic reopening, emigration outflows from the ECCU have stabilized including for temporary workers programs and student visas. For high-skill workers, large salary gaps between ECCU countries and similar jobs abroad (“place premium”) continue to guarantee attractive private returns on migration while creating shortages in domestic markets and foregone revenues for the state.

Several policies could help the region make the most of migration opportunities while alleviating potentially negative impacts on domestic labor markets. First, continued aging in advanced economies is expected to increase demand in some sectors, particularly healthcare workers where the global shortage is estimated at 14.5m (World Health Organization). To reap these benefits, targeted education investments and partnerships with destination countries to organize stable, predictable, legal pathways could play an important role. Climate change is also expected to be an increasing driver of emigration in the region, underscoring the importance of investment in physical and financial resilience to weather-related natural disasters.



Second, remittances transfer fees remain high. By ensuring interoperability among payment systems, including Central Bank Digital Currencies, the authorities can enhance cross-border payments and lower the remittances fees (although cross-border challenges need to be carefully managed). More could be done to leverage the benefits of the ECCU’s diaspora, for instance developing return migration strategies, improving the portability of pensions and other social security benefits, to incentivize migrants to bring knowledge, capital, skills, and experience, which can benefit local economic development.

At the regional level, the free mobility regime under CARICOM’s Single Market and Economy (CSME) could be further strengthened by broadening the skills certificate regime to reduce potential labor misallocations

Box 2. ECCU Migration and Labor Policies (concluded)

within the region. In addition, the Caribbean Migration Consultations (CMC) established in 2016 and on hold during the pandemic could be relaunched.

Finally, addressing important data gaps—on the characteristics of the diaspora, emigration motives, and intra-regional data—would allow a more systematic migration policy evaluation.

¹ International Organization for Migration, 2023.

B. Labor Market Policies and Institutions

31. A priority for ECCU countries is to strike a good mix of labor market institutions and policies to effectively balance competing efficiency and equity objectives.²⁶ ECCU countries are challenged in the same way as emerging market and developing countries (EMDCs) in ensuring an appropriate mix of these policies. They have limited available resources available to fund potentially costly labor market frameworks (e.g., an actuarially sound unemployment insurance scheme) and confront administrative capacity constraints.²⁷ Furthermore, the presence of widespread informality limits the effectiveness of labor market institutions and leaves them prone to abuse. *This section summarizes key considerations from a labor market policy and institutional context to inform policy discussions to alleviate structural labor market frictions and improve participation, employment, and productivity outcomes.*²⁸

Employment Protection Legislation (EPL) and Unemployment Insurance (UI)

32. EPL regimes vary across ECCU countries largely in the absence of UI schemes. All countries have laws that provide employment protection (for formal workers) against unfair dismissal and discrimination. These protections vary across ECCU jurisdictions, sometimes to a wide degree. Undue employment protections, including burdensome dismissal processes and costly severance payments, can negatively impact the efficient turnover of labor, disincentivize hiring (particularly at times of uncertainty), and incentivizes labor informality. IMF analysis suggests that reducing uncertainty about the cost and duration of dismissal procedures might be more important than the level of severance payments and recommends that the stringency of EPLs be linked to the buildup of the benefit system, such the introduction of UI schemes. These schemes are rare among ECCU countries, with Grenada being the only country to offer UI on a permanent basis, but other jurisdictions are exploring options to follow suit.²⁹

²⁶ Key labor market institutions include (i) employment protection legislation (EPL); (ii) unemployment insurance (UI); and (iii) minimum wage frameworks. Labor market policies complement institutional frameworks by helping more people access the labor force by: (i) enhancing incentives to seek employment; (ii) improving job readiness and assisting in finding suitable employment; and (iii) expanding employment opportunities.

²⁷ As a result, employment protection legislation is a more common tool than unemployment insurance in EMDCs, as there are no direct fiscal costs and requires less administrative capacity while still offering workers some protection.

²⁸ Broader policy reforms to enhance growth and investment conditions and recalibrate migration policy that have a bearing on employment and labor supply/demand are not covered.

²⁹ Grenada started its UI scheme in May 2023. It covers 50 percent of a worker's salary for up to three months where eligibility is set at 52 weeks of contributions into the scheme. While there are no other existing schemes, Dominica
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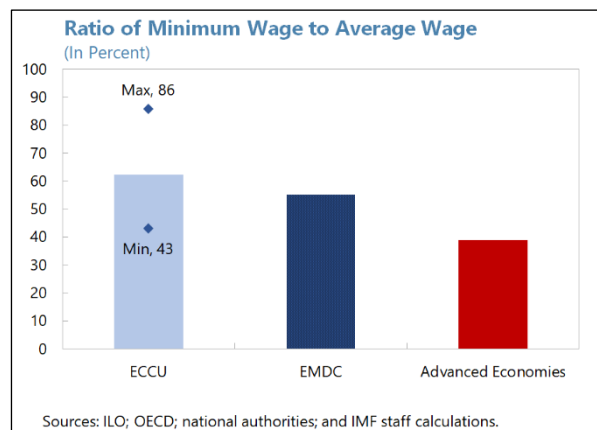
33. Gradually recalibrating the institutional landscape towards a mixed EPL-UI framework has the potential to improve labor market equity and efficiency in ECCU countries. The exact combination of EPL and UI depends on country characteristics, such as the stage of development and the existence of complementary policies. In principle, the introduction and/or expansion of UI can proceed as the economy grows and administrative capacity develops. At the same time, EPL can be made less stringent, simpler, and more predictable.

Minimum Wages

34. Minimum wages are less effective if they are poorly targeted, misaligned, and rigidly applied. They are found to reduce inequality to a lesser extent when the share of informal workers in total employment is large, or when the starting level of minimum wage is high. The risks of adverse employment effects should be considered when setting statutory minimum wages. Allowing for differentiation across population groups, regions, industries—dimensions along which productivity varies—can help minimize this risk but may prove too complicated for emerging and developing economies limited administrative capacity. Rigid minimum wages that are set too high can have particularly adverse effects on the employment opportunities of less productive workers (e.g., less educated youth) and hamper the competitiveness of small firms or firms with low productivity.

35. There is potential scope to recalibrate minimum wages among ECCU countries to improve efficiency in labor market outcomes.

A common yardstick to gauge the level of the minimum wage is as a ratio against the average (or median) wage. The minimum-to-average wage ratio among ECCU countries was close to, or above, the prevailing average of 55 percent for EMDCs and significantly higher than the average in advanced countries. While estimates for the appropriate level of the minimum wage vary and differ for individual countries, empirical studies broadly advocate a ratio of between 25 and 50 percent of the average wage level (IMF 2016a). In addition, at levels of between 40–50 percent, further increases can have greater economic trade-offs, including in employment. These metrics suggest potential scope to recalibrate minimum wages in ECCU countries.



Active Labor Market Policies (ALMPs)

36. Targeted ALMPs can potentially help address prevailing gender and youth gaps and support the transition to UI. Data available for some ECCU countries indicate that child and elderly

and St Vincent and the Grenadines (VCT) introduced temporary support schemes during the pandemic to help workers that lost their jobs because of pandemic-related restrictions. Both are actively exploring options to introduce a formal UI scheme.

care needs are linked with lower participation of female workers, while higher education levels are associated with increased participation, particularly among women (IMF 2024). Governments could seek assistance from development partners to help improve education attainment—including vocational education and training—to address skill mismatches and promote improved labor outcomes of women and youth. Education programs could be reviewed with a focus on strengthening employability. Social programs could be better tailored to tackle non-economic barriers to employment, for example, to address low education attainment and school dropouts, which is more acute among boys. More parental and elderly care leave could increase participation and level employment opportunities, thus helping to narrow gender salary gaps. More broadly, emerging best practices to reduce gender inequalities include supporting female entrepreneurs by increasing their access to finance, increasing parity between maternity and paternity leave, and promoting access to affordable, high-quality childcare (Dabla-Norris and Kochhar, 2019). ALMP programs can support UI schemes where training and job search activities are a mandatory condition to qualification. This can partly substitute for job search monitoring, which is challenging in an ECCU context due to weak administrative capacity, and thereby help ensure that the unemployed do not work in the informal sector while receiving UI benefits.

C. Enhancing Data Collection

37. Improving data collection and analysis is a pre-requisite for enhancing evidence-based labor market policymaking. This would entail, as a first step, conducting and publishing regular labor force surveys and censuses that will provide general information about labor market outcomes. Collecting good information on the characteristics of jobseekers and other groups on the margins of the labor market and employment barriers they face will help in tailoring ALMPs. Measuring the extent of informality in the economy would also inform the potential effectiveness of labor market institutions and scope for reform.

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