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St. Vincent and the Grenadines: Staff Report for the 1999 Article IV Consultation

This report was prepared by a staff team of the International Monetary Fund following discussions with the officials of St. Vincent and the Grenadines on economic developments and policies. The report was then considered by the IMF's Executive Board in the context of the IMF's periodic consultation with St. Vincent and the Grenadines, as required under Article IV of the IMF Articles of Agreement. The views expressed in the staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities of St. Vincent and the Grenadines; a supplementary statement by IMF staff may also be included. The views of the Executive Board as expressed in the discussion of the Article IV consultation report and as summarized in a Public Information Notice (PIN) are also included. In addition, a statement by the member country authorities may be appended. Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports allows for the deletion of market sensitive information.

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ST. VINCENT AND THE GRENADINES

Staff Report for the 1999 Article IV Consultation

Prepared by the Staff Representatives for the
1999 Consultation with St. Vincent and the Grenadines

Approved by C. Loser and I. Kapur

October 26, 1999

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Executive Summary

The 1999 Article IV consultation discussions with St. Vincent and the Grenadines were held in Kingstown during July 29–August 7, 1999. The mission met with Prime Minister Mitchell, Finance Minister Eustace, senior officials, and representatives of the private sector.

Since 1990 St. Vincent has sought to diversify its sources of economic growth to reduce its dependence on banana exports, which have encountered reduced preferential access to the EU market, as well as quality problems and disease. The government has encouraged diversification through infrastructure projects, technical assistance and several incentives, including tax exemptions, case-by-case approval of foreign direct investment projects and import licenses. Macroeconomic policy has been strong as the overall public sector has generated savings and has registered a surplus in most years since 1994. Monetary and exchange rate policies are handled by the Eastern Caribbean Central Bank (ECCB), which has kept the exchange rate peg to the U.S. dollar unchanged since 1976.

This set of policies helped sustain real GDP growth at an average of over 4 percent a year in the period 1990–98, while inflation was on the order of 2–3 percent a year. Tourism grew in relation to GDP, while agriculture fell sharply, reflecting a strong decline in banana production and exports. However, other sectors besides tourism have not contributed to stronger economic growth. In 1999, real GDP is projected to rise by 4 percent, with inflation at 2 percent. The overall public sector surplus is projected at close to 1 percent of GDP.

Looking to 2000 and beyond, fiscal policy is likely to remain sound. The authorities intend to maintain a strong public savings effort and to reduce public sector external debt in relation to GDP. A more specific evaluation of fiscal policy for 2000 and beyond is difficult, because in the past the budget for the central government has differed by a wide margin from the actual outcome and public enterprise data are reported with a long delay. The staff recommended that the authorities aim at an overall public sector surplus of 2 percent of GDP, which is roughly the surplus on social security operations.

The authorities believe the financial system is basically sound, but nonperforming loans are relatively high, with low loan loss provisions. They are working with the ECCB and the problem banks to turn around this situation. The authorities agreed to strengthen supervision of the offshore financial sector.

The authorities believed their system of incentives was justified in the case of St. Vincent, and noted that the tax and tariff exemptions were consistent with regional arrangements. The staff supported some aspects of their approach, but suggested that the authorities scale back and simplify the incentives.

I. Introduction

1. The 1999 Article IV consultation discussions with St. Vincent and the Grenadines were held in Kingstown during July 29–August 7, 1999.[1] The mission met with Prime Minister Mitchell, Finance Minister Eustace, senior officials, and representatives of the private sector.

2. **At the conclusion of the last Article IV consultation on December 3, 1997, Executive Directors stressed that the key challenge for St. Vincent was to reduce the serious unemployment problem and achieve sustained economic growth**, particularly in light of the imminent loss of St. Vincent's preferential access to the European Union (EU) banana market.[2] In this regard, they welcomed the government's efforts to diversify the economy, which combined steps to encourage more efficiency in the banana sector and to expand tourism and services. Directors emphasized the importance of maintaining external competitiveness through an appropriate fiscal policy, including wage restraint, and saw the need for further improvements in the incentive framework, in particular through eliminating price controls and import licensing requirements, and reducing impediments to foreign investment.

3. **Directors also reiterated calls for an urgent improvement in the scope and quality of St. Vincent's economic statistics.** The statistical base is deficient in scope and quality, hampering the government's ability to assess economic developments. In particular, real sector data are incomplete and data on public enterprises are not compiled in a systematic fashion. The reporting of some core data to the Fund is irregular and often subject to long delays.

II. Background

4. **Like several other countries in the region, St. Vincent has sought since 1990 to reduce its dependence on banana exports by diversifying its sources of economic growth.**[3] Until 1993, banana exports from certain countries in Africa, the Caribbean and Asia (ACP)

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[1] The staff team comprised Messrs. Rennhack (Head), Salehizadeh, Cardoso (all WHD), and Visconti (World Bank). Mr. van Beek (WHD), Mr. Bernes, Executive Director for St. Vincent, and Mr. Chelsky, Advisor to the Executive Director for St. Vincent, participated in the final round of discussions. Mr. Campbell from the Eastern Caribbean Central Bank (ECCB) participated in the mission.

[2] St. Vincent's relations with the Fund are presented in Appendix I. Relations with the World Bank are presented in Appendix II.

[3] The issues facing the banana industry in St. Vincent and other Eastern Caribbean islands are set out in **The Eastern Caribbean Currency Union—Recent Developments and Policy Issues**, (SM/99/69).

enjoyed free access to the markets of the United Kingdom and some other European countries, while other banana producers faced restricted access. This arrangement helped sustain vigorous economic growth in St. Vincent and elsewhere in the region during the 1980s. After the creation of a single European market in 1993, the regime for ACP banana producers was shifted to a set of preferential tariffs and quotas and licensing arrangements that subsidized banana imports from ACP countries. Other banana producing countries challenged this new regime. In 1997, the WTO ruled that several aspects of the new regime, including the licensing arrangements, were inconsistent with WTO rules, and the preferences for ACP producers are to be scaled back considerably starting in 2000. With this climate of uncertainty, the number of active growers in St. Vincent declined significantly, and as a result also of quality problems and plant disease, the volume of banana production and exports fell by over 50 percent between 1990 and 1998.

Real GDP Growth in the Eastern Caribbean

	Average 1980–89	Average 1990–95	1996	1997	1998	Average 1990–98
	(Annual percentage change)					
Antigua and Barbuda	6.7	2.0	5.1	3.3	3.8	2.7
Dominica	6.5	2.9	3.3	1.8	2.5	2.8
Grenada	4.8	3.6	3.5	3.6	3.6	3.6
St. Lucia	5.9	6.1	1.4	2.1	2.9	4.8
St. Kitts and Nevis	4.9	3.6	6.5	1.9	3.6	4.1
St. Vincent and the Grenadines	6.2	3.8	1.5	3.7	5.2	3.7
Average	5.8	4.0	3.5	3.3	3.6	3.9

Source: Eastern Caribbean Central Bank

5. **The cornerstone of the authorities' efforts to promote economic diversification has been the maintenance of strong macroeconomic policies.** As a member of the Eastern Caribbean currency union, St. Vincent's monetary and exchange rate policy are handled by the ECCB, which has kept the exchange rate peg to the U.S. dollar unchanged since 1976.[4]

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[4] The operation of the currency union is explained in more detail in **The Eastern Caribbean Central Bank—Institutional Arrangements and Issues in a Currency Union** (SM/99/70).

6. **The authorities are committed to fiscal discipline, particularly in view of the monetary arrangement, and the overall public sector has usually registered a surplus since 1994 (Tables 1–3, Figure 1).** Since the late 1980s, the government has been relying on Stabex grants from the EU to support the banana industry.[5] Starting in 1995, these grants have been linked to macroeconomic conditions, including public savings targets, and have been increasingly channeled to fund projects outside the banana sector, such as poverty alleviation and economic diversification. With the support of the EU, the government boosted public investment from about 6½ percent of GDP in 1995–96 to almost 14 percent of GDP in 1998 to develop infrastructure in a wider range of sectors, including the construction of a new cruise ship terminal on the mainland and continuing funding for an irrigation project for bananas. Public savings rose to 8½ percent of GDP in 1997, but the overall public sector balance still swung to a moderate deficit in 1997, owing to delays in the drawdown of grants. The overall balance moved to a modest surplus in 1998, as grants reached almost 5 percent of GDP while public savings remained stable in relation to GDP. The EU's financial support also includes concessional loans, and at end-1998, public external debt amounted to US$167 million (53 percent of GDP) in nominal terms and US$78 million (25 percent of GDP) in net present value terms.

7. **The government has encouraged better productivity in bananas and other agricultural products and helped develop local production in other sectors, such as manufacturing, tourism, offshore financial services and informatics.** Its actions have included:

- Technical assistance to banana farmers and producers of other crops and livestock;
- Specific fiscal incentives, including a waiver of the income tax for farmers, long tax holidays for some tourist projects, a 10 to 15 year tax and import duty waiver for start-up manufacturers, and a discretionary duty waiver scheme;
- Case-by-case approval of foreign investment projects, including through the administration of the alien landholding act, which requires that non-residents obtain a license to hold land or shares in companies;[6]
- Complete revision in 1996 of the laws governing offshore financial activity to encourage the development of that sector;
- Public guarantees of private external debt;

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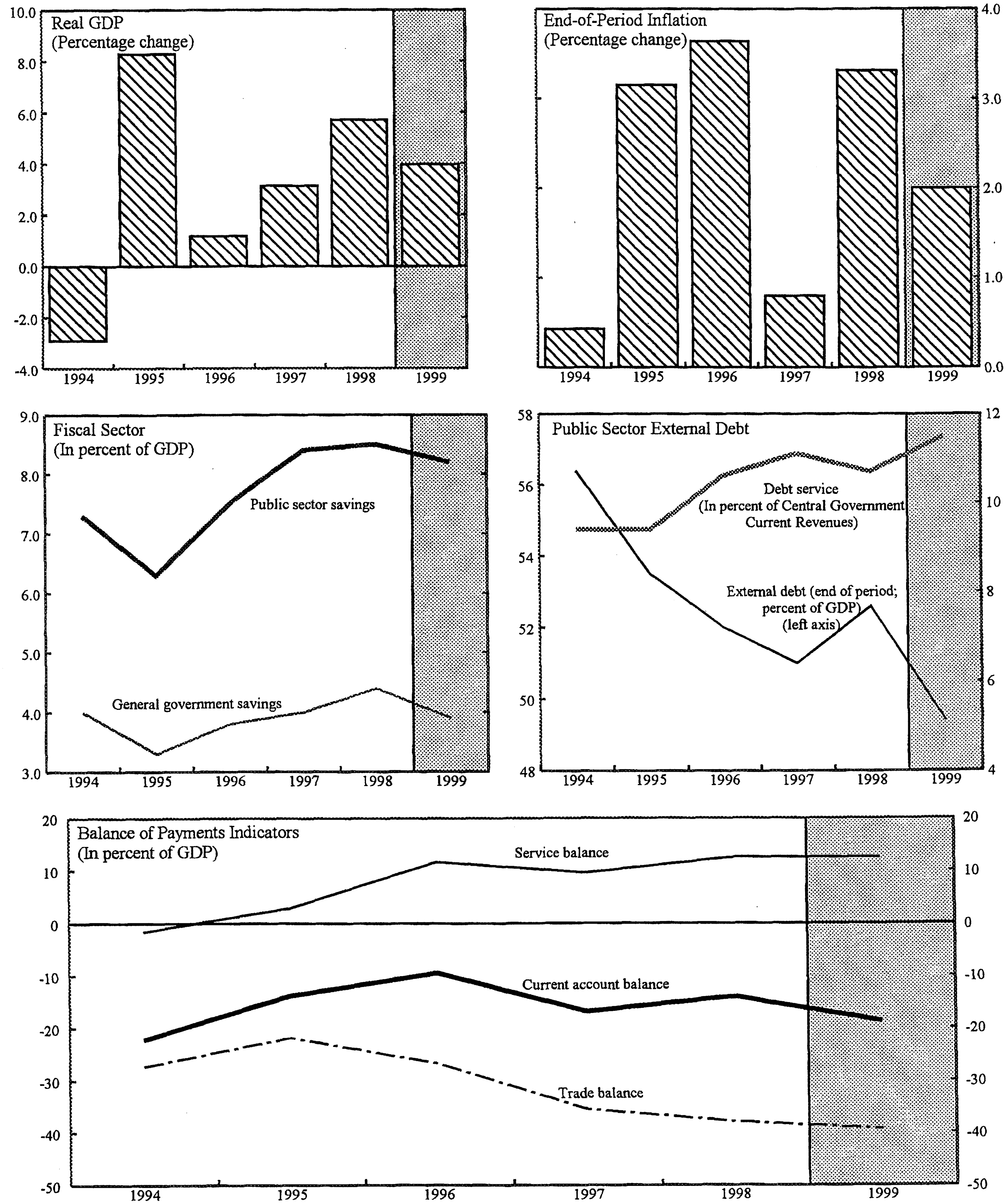
[5] For each year in which there are export losses, the EU sets a Stabex allocation and then negotiates its use with the authorities. Thus, the funds actually become available with a lag of 2 to 3 years and actual drawdowns depend on project implementation.

[6] Alien landholding legislation is common to all Eastern Caribbean countries.

Figure 1. St. Vincent and the Grenadines:
Selected Economic Developments, 1994-99



Sources: Ministry of Finance and Planning; Eastern Caribbean Central Bank; and Fund staff estimates and projections.

- Licenses for the importation of products from outside the region that compete with exports produced by other countries in the region. Licenses are required for about 100 products, including many food items, wood and upholstered furniture, and certain household items; and

- Price controls (usually limits on markups over import costs) on several products, including rice, milk, sugar, flour, bread, school books, cement, petroleum products, motor vehicles, and motor vehicle parts.

8. **Economic developments through 1998 suggest that the diversification strategy met with some success.** Tourism-related activities rose from 29 percent of GDP in 1990 to over 38 percent of GDP in 1998, partly related to the construction of a private hotel (Canuan Island) with a total cost of about 50 percent of GDP. During this period, agriculture's share in output fell from 18 percent to 9 percent. Moreover, St. Vincent attracted high-end tourism, and its share of tourist expenditure in the Caribbean region rose from 5 percent in 1990 to 9½ percent in 1998. This shift helped sustain real GDP growth at an average of somewhat over 4 percent a year, well below the average of over 6 percent in the 1980s but still in line with the regional average in the period 1990–98. Domestic inflation was broadly in line with world inflation (on the order of 2–3 percent a year). Nonetheless, unemployment remained high (although no official statistics are available), and communications and banking had not yet responded, even though both of these sectors accounted for increasing shares of economic activity elsewhere in the region.

Structure of Economic Activity

	ECCB Area 1/		St. Vincent and the Grenadines	
	1990	1998	1990	1998
	(In percent of GDP)			
Agriculture	12.2	8.5	17.9	9.2
Manufacturing	6.7	6.0	7.2	5.8
Communication	6.4	9.6	5.8	5.8
Banking	8.0	10.8	6.2	6.4
Tourism-Related 2/	42.9	44.6	29.1	38.5
Government Services	16.2	15.2	14.1	15.2
Others	7.6	5.3	19.7	19.8

Source: Eastern Caribbean Central Bank; Ministry of Finance.

1/ Anguilla, Antigua and Barbuda, Dominica, Grenada, Monserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

2/ Construction, wholesale and retail trade, hotels and restaurants, and transport.

9. **The external current account deficit widened from less than 10 percent of GDP in 1996 to about 15 percent of GDP a year in 1997–98.**[7] In addition, merchandise exports stagnated in 1997–98, reflecting the effect of adverse terms of trade and pests on agricultural exports. Also, manufacturing exports may have been affected adversely by the real effective appreciation of the exchange rate for St. Vincent this decade, which has been caused by the appreciation of the U.S. dollar in relation to several major European currencies (Figure 2). The growth in tourism receipts was dampened by a sharp fall off in cruise arrivals, after St. Vincent raised the per passenger fee above the prevailing rate in the region. Both public and private capital inflows financed this higher deficit, and the overall balance of payments remained in surplus. The domestic financial system remained relatively liquid, as broad money rose in relation to GDP in the period 1996–98 and onshore banks provided liquidity to the rest of the region.

10. **So far in 1999,** consumer prices rose by 2.6 percent during the 12 months ended in July. Preliminary information suggests that growth in construction remains strong, but slower than in 1998, as the Canuan Island project and some other major investment projects move out of the construction phase. In the first six months of 1999, merchandise exports in U.S. dollar terms were 4 percent larger than in the same period of 1998, tourist arrivals (through April) 24 percent, and merchandise imports 9 percent. The overall balance of payments remained in surplus, and broad money rose by 13 percent during the 12-months ended in June (Table 4).

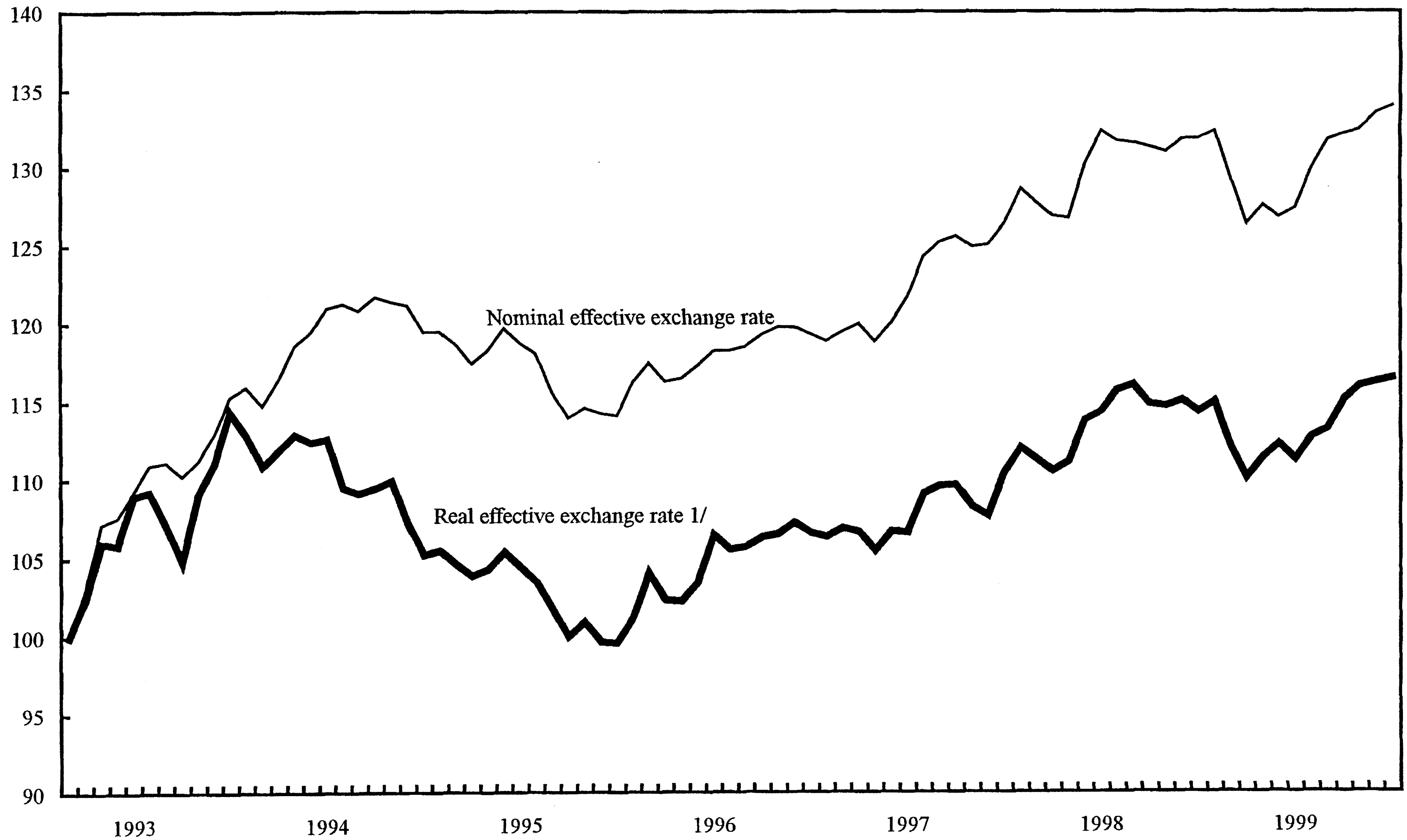
11. **The macroeconomic outcome for 1999 is likely to be satisfactory.** Real GDP growth is projected to slow from 5.7 percent in 1998 to 4 percent in 1999, as construction and banana output are slowing. Consumer prices are likely to rise by 2 percent during the year. The overall public sector surplus is expected to increase from 0.4 percent of GDP in 1998 to 0.8 percent of GDP in 1999, with a sizable decline in investment and a moderate falloff in public savings in relation to GDP. The external current account deficit may reach about 19 percent of GDP, as imports continue to grow rapidly, while net official transfers decline. Credit to the private sector and broad money are both expected to grow at about 13 percent during 1999.

III. Policy Discussions

12. **The policy discussions focused on the government's efforts to diversify the economy.** The authorities take the view that the goal of macroeconomic stability must be supplemented by actions, such as fiscal incentives, to help channel resources to sectors that are likely to generate employment and growth. They pointed out that externalities are particularly important in a small developing economy, like St. Vincent, where the option of emigration has become less available.

[7] It is quite likely that exports of fish, tourism receipts and remittances are substantially underestimated.

Figure 2. St. Vincent: Exchange Rate Developments, 1992-99
(September 1992=100)



Source: IMF Information Notice System.

1/ The real effective exchange rate is estimated as a trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices. Increase means appreciation.

It is essential to avoid a rapid rural-urban migration, which could disrupt social stability and harm long-term growth prospects, especially in tourism. The authorities are well aware that this approach can put pressure on fiscal policy by weakening public savings or adding to public external debt and that promising sectors may not develop into reliable sources of growth. However, they believe these risks can be managed carefully. The staff agreed that well-placed infrastructure projects and technical assistance to farmers could be very useful, but suggested that the authorities scale back and simplify the wide range of incentives.

A. Fiscal Policy

13. **The projected increase in the overall public sector surplus in 1999** reflects a decline in the central government deficit to 1.3 percent of GDP in 1999 (Table 3). Central government savings are expected to weaken, as current revenues continue to decline in relation to GDP, but central government investment is expected to fall by over 2½ percent of GDP. The major public enterprises (port authority and the water and electricity companies) maintain strict control over costs and are expected to generate savings of about 2 percent of GDP this year and a small overall surplus. The National Insurance System (NIS—the public, fully funded pension system) is projected to continue to run a surplus of about 2 percent of GDP, owing to a favorable demographic profile.

14. **The staff raised questions about the budgeting process.** The budget deficit for the central government that is approved by parliament has tended to substantially overstate the actual outcome. (For example, the 1998 and 1999 budgets had projected overall deficits of about 10 percent and 6½ percent of GDP, respectively, while the actual deficit in 1998 was about 2 percent of GDP and the 1999 deficit is projected at 1.3 percent of GDP). In addition, discrepancies between budgeted and actual outcomes for the public enterprises have been large at times, and information on the budget execution of public enterprises is often transmitted with a long lag to the minister of finance. The staff urged the authorities to remedy this situation to minimize the potential for a loss of fiscal control. The authorities said that they would press the public enterprises to report on their operations more quickly. With regard to the central government, they commented that actual current revenue and expenditure were normally close to the budgeted levels, with the gap in the overall outcome arising from uncertainties about the pace of implementation of capital spending, which was generally financed with concessional external resources.

15. **With this budgeting process, it is difficult to evaluate the government's fiscal plans for 2000 and beyond.** The staff recommended that the authorities target an overall public sector surplus in line with the NIS surplus, with a view to saving these funds for the period when current contributors begin to retire (in about 10–15 years). While agreeing with this approach in principle, the authorities felt that it could be difficult to generate annual surpluses of that magnitude each year. Grants were likely to decline from the high levels of 1998–99, and current revenues of the public sector were already over 31 percent of GDP. The authorities intend to diversify the assets of the NIS, which are currently held almost entirely in the National Commercial Bank (NCB), the state-owned commercial bank. They have started to gradually increase the share of NIS funds

deposited at other domestic commercial banks, and have contracted private bankers to develop guidelines for widening the scope of NIS investments even further.

16. **As a medium-term fiscal objective**, the authorities want to maintain strong public savings, which will help attract continued financial support from the EU.[8] In addition, they want to reduce the nominal value of external public and publicly guaranteed debt from about 53 percent of GDP at end-1998 to 45 percent of GDP over the next few years, while keeping the current debt service ratio (about 12 percent of government current revenues) stable. They stressed that the government would no longer guarantee private external debt, because this policy had placed financial burdens on the government. For example, in the early 1990s, the government guaranteed a US$50 million loan to the Ottley Hall project, which was a joint venture (51 percent private, 49 percent public) to build a marina. This project went sour quickly, in part because of fraudulent actions by the private partners, and set off a lengthy legal dispute. Unpaid interest and penalties raised the loan amount to US$72 million by mid 1999. In July 1999, the government signed an agreement that forgives up to half of the US$72 million obligation, with the balance to be repaid over 20 years.

17. **The authorities are considering several options to improve the airport capacity on the mainland, while keeping the external debt objective in mind.** This project is important to develop tourism further and reduce the cost of exporting perishables, and the major airline servicing St. Vincent may be shifting to planes that require a larger airport. However, all the options under consideration are very expensive: expansion of the current airport would cost about US$60 million (about 20 percent of GDP), while construction of a new airport would cost as much as US$250 million (80 percent of GDP). So far, there are no firm plans to go ahead with this project, but the authorities are leaning towards the least cost option to keep the public external debt burden manageable.

18. **With regard to specific fiscal policies that could boost public savings**, the staff noted that the central government wage bill was about 13 percent of GDP, or over half of the government's current spending, and suggested that moderate wage increases and attrition could trim the wage bill over time. The authorities replied that public wages were low by regional standards, because St. Vincent needed a relatively large work force to provide public services on all seven islands. However, they thought there might be some scope for trimming the wage bill over time. In this regard, it would be useful to adopt institutional reforms that could improve the efficiency of the central government workforce, although they noted that such reforms faced legal hurdles. The staff suggested that the government raise water and electricity rates, which had declined in real terms in the past several years (the last increases occurred in 1985 and 1995, respectively). The authorities agreed to review water rates, but felt that electricity rates were appropriate. These prices were already in line with electricity rates in the region and were adjusted

[8] The agreement with the EU targets public savings of 9 percent of GDP in 2000.

regularly for changes in international petroleum prices. Any further increase in these rates could impair the economy's competitiveness.

Water and Electricity Rates in Selected Eastern Caribbean Countries
(May 1998)

	Water (EC$ per 2,500 gallons)	Electricity (EC$ per kwt)
Antigua and Barbuda	53.5	0.56
Dominica	37.8	0.56
Grenada	24.2	0.56
St. Kitts and Nevis	3.8	0.55
St. Lucia 1/	15.3	0.30
St. Vincent and the Grenadines	22.5	0.50

Source: Eastern Caribbean Central Bank.

1/ October 1998.

B. Financial Supervision

19. **The authorities believe that the onshore financial system is basically sound, but are concerned about the persistence of the relatively high level of nonperforming loans.**[9] They have been working closely with the ECCB, which establishes prudential guidelines, conducts on-site and off-site inspections and takes corrective actions through "memoranda of understanding" agreed with banks that fall out of compliance with the guidelines.[10] In their view, the problem stems from poor credit analysis by certain banks and reduced income to the banana sector. Memoranda of understanding have been agreed with the onshore banks in difficulty. However, the staff asked about the enforcement power of the ECCB. The authorities replied that the special emergency powers under the amended ECCB Agreement Act were always in effect. These powers gave the ECCB the authority to issue cease and desist orders and to remove

[9] Nonperforming loans (more than 90 days overdue) fell from over 11 percent of loans at end-1995 to about 6 percent of loans by end-1996, and then rose steadily to over 13 percent of loans by end-1998. Provisioning fell from 4 percent of loans at end-1997 to 2 percent of loans at end-1998.

[10] See SM/99/70 for a description and assessment of bank supervision procedures and problems in the ECCB region, especially pp. 30–39.

management of a financial institution. Nonetheless, revoking a license of a financial institution required approval of a minister.

20. **The authorities agreed with the need to improve their own supervision of the offshore sector,** which has grown rapidly since the comprehensive revision in 1996 of St. Vincent's laws covering these activities. At present, a relatively small staff supervises some 7,000 offshore companies and 20 offshore financial institutions now registered to operate in St. Vincent. The authorities pointed out that they did not want to encourage money laundering, and carried out very thorough due diligence of any applicant for an offshore license. They also noted that there was a legal firewall to insulate the domestic economy from the offshore sector. The staff pointed out that strong ongoing supervision of both the offshore and the onshore sectors was critical to minimize the risk that illicit activities, such as money laundering, were taking place and to ensure the effectiveness of the firewall. The authorities indicated they would work to allocate more staff to offshore supervision and said the Monetary Council has agreed to the proposal for ECCB supervision of offshore banks. They are well aware of the international concerns about tax evasion and the need to maintain St. Vincent's reputation. However, they consider the OECD position on offshore financial centers a threat to a vital economic activity in the region.

C. Structural and Other Issues

21. **In the discussion of the benefits of the targeted incentives to support diversification,** the authorities noted that all fiscal incentives/import duty concessions are in line with Caribbean Common Market (CARICOM) arrangements and that St. Vincent completed the transition to the Common External Tariff of CARICOM in 1998, as scheduled. Many of the import licenses are used for sanitation purposes and, in any case, all import restrictions are in line with Article 56 of the CARICOM agreement, which is intended to help develop manufacturing in the region and has been extended through 2005. A study is currently underway by the CARICOM secretariat to evaluate the possible substitution of import licenses and other import restrictions by tariffs to bring their system in line with WTO guidelines.

22. **As for the price controls,** the authorities explained that these are intended to prevent monopoly pricing in markets dominated by one or two firms and to smooth the adjustment of domestic prices to strong fluctuations in international prices. The authorities indicated that they intend to remove the markup limits on motor vehicles and motor vehicle parts.

23. **The staff inquired about the possibility of privatizing some of the public enterprises, including reducing the government's stake in the NCB.** While not opposed in principle to privatization, the authorities doubted whether the private sector would provide basic services, such as water, electricity, and banking, to all seven islands in the country. Public enterprises were better placed to generate the cross subsidization needed to deliver these services across the country. However, they agreed that it might be possible to sell shares in the NCB in the future.

24. **The authorities intend to establish a national development bank** to provide 10-year credits at market interest rates to small, start-up businesses, which are currently cut off from access to financing. The Caribbean Development Bank (CDB) is expected to fund and supervise this bank. The authorities agreed that the credit extension from the development bank needs to be limited to deal with likely demand pressures.

25. St. Vincent participates in the **poverty reduction program** (the Basic Needs Trust Fund) of the CDB, which is intended to strengthen social infrastructure. The CDB also provides financial support to build schools and train teachers. The World Bank supports an **environmental protection program** (the regional Waste Management Project) to reduce public health risks and protect the environmental integrity of the Eastern Caribbean islands and their coastal and marine systems. (Relations with the CDB are presented in Appendix III.)

26. **The authorities would like to upgrade the quality of economic statistics**. They have requested technical assistance from STA and would like more of their staff to attend INS training courses on statistical methodology. They commented that a new consumer price index is to be introduced early next year.

27. **The level of Y2K preparedness varies among the different sectors.** The central government, the large public enterprises and commercial banks are Y2K compliant. The ECCB is ready to meet a potential sharp increase in the demand for currency. The main communications provider, Cable & Wireless, has indicated that its systems are ready, but is concerned about the risks posed by suppliers and interconnects. Small, private enterprises are believed to unprepared.

IV. Medium-Term Outlook

28. Given St. Vincent's vulnerability to external and weather-related shocks, and the required transition to a more diversified economy, the authorities intend to maintain strong economic policies. Consistent with their medium term fiscal objective, the medium term scenario assumes net external borrowing of 2 percent of GDP a year on average in the period 2000–04, which would bring public external debt down to 45 percent of GDP early in the next decade (Tables 5–7). This level of net external borrowing would allow the public sector to avoid spending the NIS surplus, provided public savings remained on the order of 8–9 percent of GDP and the overall public sector balance registered moderate surpluses. Consistent with this fiscal outlook, the external current account deficit would decline to about 15 percent of GDP in the medium term, with real growth of 4 percent a year. Banana exports in U.S. dollar terms are projected to rise by 4–5 percent a year between 2000 and 2004. Gains in export volume generated by the efforts to boost productivity in banana production are projected to more than compensate for the fall in banana prices precipitated by the end of preferential access. Tourism receipts are expected to grow by about 5 percent a year, following the completion of the hotel project this year and of the cruise ship terminal on the mainland. Imports would decline slightly in 2000, as the construction

of the hotel comes to an end, but would remain well above the levels of 1996–98, and then rise by 5–6 percent a year in the period 2000–04.

V. STAFF APPRAISAL

29. **The government has been pursuing a strong macroeconomic policy.** The overall public sector has registered surpluses in most years since 1994, and the participation in the Eastern Caribbean currency union provides a credible nominal anchor.

30. **The authorities' medium term fiscal objective is to maintain a strong public savings effort and to reduce the burden of public sector external debt.** Some projects, such as the possible airport expansion, are very large in relation to the economy, and careful fiscal and debt management are essential to keep the external debt situation under control. The authorities have decided to stop guaranteeing private external debt. It will be important to secure external financing for an airport project, if it moves forward, on terms consistent with reducing public external debt to 45 percent of GDP. The staff sees merit in aiming at overall public sector surpluses broadly in line with the surplus of the NIS (about 2 percent of GDP a year), so as to avoid undue pressures on the fiscal position when the current contributors enter retirement. Also, in a vulnerable economy, a strong fiscal position would provide a better buffer if needed to respond to an adverse shock. Possible measures to strengthen the fiscal position include a gradual trimming of the government wage bill over time and a re-examination of water and electricity rates. It would also be very useful to set budgets that coincide more closely with likely outcomes to minimize the risk of a loss of fiscal control. More realistic budgets would also allow for better planning of macroeconomic policies. On a related matter, the authorities' plan to diversify the assets of NIS over time is welcome.

31. **The authorities intend to continue to work closely with the ECCB and domestic banks to improve the strength of the financial sector**. The staff notes that, in view of the relatively high nonperforming loans and low provisioning levels, this is an urgent task. Supervision of the offshore financial market, which has grown rapidly, should be strengthened to ensure that the legal firewall functions effectively.

32. **The prospective phasing out of the preferential regime for banana exports has added urgency to the task of diversifying the economy without endangering social stability.** Beyond the maintenance of sound macroeconomic policies, well-placed infrastructure projects and technical assistance to the banana growers and other farmers are indispensable. The authorities welcome foreign direct investment but monitor these inflows, which can be large in relation to the size of the economy, in order to minimize any disruptive effects.

33. **However, there are several difficulties with the government's approach.** There is wide scope for discretion in granting tax or import duty exemptions or in approving foreign direct investment projects. The fiscal incentives reduce public savings and diminish the resources

available to support health and education reform, which would promote growth and employment in the long run. The import licenses, which in some cases may apply for health reasons, are a form of protection for domestic manufacturing, which may not be in line with St. Vincent's comparative advantage. The price controls distort consumption and production patterns. On balance, the system of incentives is very complex and nontransparent. While tourism will benefit from the Canuan Island project and the completion of the cruise ship terminal, non-banana exports have not performed well in recent years, and sectors other than tourism have not been dynamic. This suggests that the system of incentives is not making the economy as competitive as possible. It may be better to narrow and simplify the tax and import duty exemptions; establish clear rules for granting incentives and approving foreign direct investment projects; and phase out the import licenses and price controls.

34. There are serious deficiencies in economic statistics that impede the conduct of surveillance, particularly in the area of public finances. The staff notes the authorities' interest in addressing their statistical weaknesses through enhanced training in statistical methodology and technical assistance and, in this connection, will explore possible options for responding to their needs with the concerned departments in the context of the FY 2001 budget.

35. The staff recommends that the next Article IV consultation with St. Vincent be conducted on the standard 12-month cycle.

Table 1. St. Vincent and the Grenadines: Selected Economic Indicators

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
Real GDP growth (at market prices; percent)	-2.0	7.6	1.5	3.7	5.2	4.0
Inflation (average; percent)	0.4	2.3	4.4	0.5	2.1	2.0
Inflation (end of period; percent)	0.4	3.1	3.6	0.8	3.3	2.0
Banana export volume (thousands of metric tons)	30.9	50.0	44.8	31.3	38.9	43.0
Banana export earnings (millions of US$) 1/	15.1	21.9	19.7	14.7	20.6	21.9
Export unit value (US$ per ton)	489.0	437.6	439.2	470.7	528.3	508.2
Total number of visitors (thousands)	164.6	218.1	216.0	199.6	202.1	247.0
Of which						
Stay-over visitors (thousands)	55.0	60.2	57.9	65.1	67.2	64.6
Tourism expenditure (millions of US$)	39.0	56.2	64.0	72.1	74.8	83.2
Central government savings (percent of GDP) 2/	4.0	3.3	3.8	4.0	4.4	3.9
Public sector savings (percent of GDP) 2/	7.3	6.3	7.5	8.4	8.5	8.2
External current account balance (percent of GDP	-22.2	-13.8	-9.4	-16.9	-14.0	-18.7
Stock of public external debt (end of period; millions of US$)	137.3	141.2	144.8	149.8	166.5	165.7
External public debt service (millions of US$)	6.3	6.6	8.3	9.2	9.4	10.6
Debt service (as percent of central government current revenues)	9.4	9.4	10.6	11.1	10.7	11.5
Memorandum item:						
Nominal GDP (millions of US$ at market prices)	243.3	263.9	278.4	293.8	316.4	335.3

Sources: Eastern Caribbean Central Bank; Ministry of Finance and Planning; Department of Tourism; Banana Growers Association; and Fund staff estimates.

1/ Excludes small amounts of banana exports to regional markets.
2/ Excluding grants.

Table 2. St. Vincent and the Grenadines: Consolidated Public Sector Operations

(In percent of GDP)

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
Total revenue and grants	**32.5**	**30.3**	**32.6**	**34.3**	**37.2**	**35.7**
Current revenue	30.7	29.4	31.5	32.7	31.6	31.3
Capital revenue and grants	1.8	0.9	1.1	2.1	5.6	4.4
Total expenditure	**35.7**	**29.2**	**30.8**	**35.3**	**36.8**	**34.9**
Current expenditure	23.4	23.2	23.9	23.8	23.1	23.2
Capital expenditure and net lending	12.2	6.0	6.9	11.5	13.8	11.7
Current balance	**7.3**	**6.3**	**7.5**	**8.4**	**8.5**	**8.2**
Overall balance before grants	**-4.3**	**0.6**	**0.8**	**-2.8**	**-4.5**	**-3.2**
Overall balance after grants	**-3.2**	**1.1**	**1.8**	**-0.9**	**0.3**	**0.8**
Financing	**3.2**	**-1.1**	**-1.8**	**0.9**	**-0.3**	**-0.8**
External financing	3.1	-1.0	-0.4	0.5	3.4	1.8
Domestic financing 1/	0.1	-0.1	-1.3	0.5	-3.7	-2.6
Memorandum items:						
Central government						
Current balance	4.0	3.3	3.8	4.0	4.4	3.9
Overall balance	-1.0	0.5	0.2	-4.5	-2.1	-1.3
Public enterprises						
Current balance	3.7	3.0	3.7	4.4	4.1	4.3
Overall balance	-1.8	0.6	1.6	3.5	2.5	2.1

Sources: Ministry of Finance and Planning; and Fund staff estimates.

1/ Includes bonds placed with the private sector by the central government and statistical discrepancies, in addition to financing from the banking system.

Table 3. St. Vincent and the Grenadines: Summary of Central Government Operations

	1994	1995	1996	1997	Prel 1998	Proj 1999
	(In millions of Eastern Caribbean dollars)					
Total revenue and grants	**191.6**	**194.8**	**218.5**	**238.6**	**285.2**	**286.2**
Current revenue 1/	**181.1**	**189.8**	**210.4**	**223.8**	**237.5**	**248.2**
Tax revenue	**156.6**	**165.7**	**182.6**	**193.1**	**210.5**	**215.3**
Of which:						
Taxes on income	51.0	48.0	55.4	59.9	71.5	63.8
Taxes on goods and services	20.3	22.8	26.6	26.3	26.6	34.7
Taxes on international trade and transactions	77.4	85.7	87.2	95.8	101.1	107.7
Nontax revenue	24.5	24.1	27.9	30.7	27.1	32.9
Capital revenue (land sales only)	4.1	2.3	0.9	2.1	6.2	3.0
Grants (capital)	6.4	2.8	7.3	12.8	41.4	35.0
Total expenditure	155.1	166.4	181.6	192.0	199.8	213.0
Current expenditure	155.1	166.4	181.6	192.0	199.8	213.0
Wages and salaries	85.4	90.8	96.4	103.2	109.7	116.3
Other goods and services	34.0	36.1	41.2	42.0	37.2	39.4
Interest payments	8.6	12.4	12.6	12.4	13.5	19.7
NIS contribution	2.1	2.3	2.5	4.3	3.6	3.6
Central government transfers	24.9	24.8	28.9	29.9	34.6	34.0
Fixed investment (PSIP)	43.3	24.9	35.7	82.0	103.3	85.0
Current balance	26.0	23.4	28.9	31.7	37.7	35.3
Overall balance	-6.8	3.5	1.3	-35.4	-17.9	-11.7
	(In percent of GDP)					
Total revenue and grants	29.2	27.3	29.1	30.1	33.4	31.6
Current revenue 1/	27.6	26.6	28.0	28.2	27.8	27.4
Capital revenue (land sales only)	0.6	0.3	0.1	0.3	0.7	0.3
Grants (capital)	1.0	0.4	1.0	1.6	4.8	3.9
Total expenditure	30.2	26.8	28.9	34.5	35.5	32.9
Current expenditure	23.6	23.3	24.1	24.2	23.4	23.5
Fixed investment (PSIP)	6.6	3.5	4.7	10.3	12.1	9.4
Current balance	4.0	3.3	3.8	4.0	4.4	3.9
Overall balance	-1.0	0.5	0.2	-4.5	-2.1	-1.3

Sources: Ministry of Finance and Planning; and Fund staff estimates.

1/ Net of tax refunds. Includes balances of the airport and the post office.

Table 4. St. Vincent and the Grenadines: Monetary Survey

	December 31					Prel. June 30	Proj. Dec. 31
	1994	1995	1996	1997	1998	1999	1999
	(In millions of Eastern Caribbean dollars)						
Net foreign assets	**143.0**	**114.3**	**105.6**	**131.0**	**179.5**	**248.1**	**229.4**
ECCB (imputed reserves)	82.3	78.2	79.3	82.1	102.5	110.3	104.1
Commercial banks	60.7	36.1	26.2	48.8	77.0	137.9	125.3
Net domestic assets	**203.7**	**260.2**	**285.4**	**313.6**	**336.5**	**298.6**	**354.3**
Net credit to the public sector	-39.8	-47.4	-68.9	-72.3	-101.0	-110.2	-131.8
Credit to the private sector	300.1	361.0	413.1	447.2	486.4	517.1	553.7
Other	-56.6	-53.4	-58.8	-61.3	-48.8	-108.3	-67.6
Money and quasi-money	**346.7**	**374.5**	**391.0**	**444.6**	**516.0**	**546.0**	**583.7**
	(Annual percentage change)						
Net credit to the public sector 1/	0.3	-2.2	-5.7	-0.9	-6.5	-7.6	-6.0
Credit to the private sector 1/	7.6	17.6	13.9	12.4	8.8	12.9	13.0
Money and quasi-money	5.5	8.0	4.4	13.7	16.1	13.0	13.1
	(As a percentage of GDP)						
Net credit to the public sector	-6.1	-6.7	-9.3	-9.1	-11.8	-12.9	-14.5
Credit to the private sector	45.9	50.9	55.6	56.4	56.9	60.5	60.7
Money and quasi-money	53.1	52.8	52.6	56.1	60.4	63.9	64.0

Sources: Eastern Caribbean Central Bank; Ministry of Finance and Planning; and Fund staff estimates.

1/ In relation to money and quasi-money at the beginning of the period.

Table 5. St. Vincent and the Grenadines: Balance of Payments

	1994	1995	1996	1997	Prel. 1998	Proj. 1999
	(In millions of U.S. dollars)					
Current account balance	**-54.0**	**-36.3**	**-26.2**	**-49.5**	**-44.3**	**-62.7**
Trade balance	-66.5	-57.4	-74.3	-104.1	-119.4	-131.4
Exports, f.o.b.	48.9	61.9	52.6	47.3	49.6	52.9
Imports, f.o.b.	-115.4	-119.4	-126.9	-151.5	-169.1	-184.3
Nonfactor services (net)	8.1	19.2	42.9	41.1	53.7	58.0
Of which						
Travel receipts	44.0	52.9	64.0	70.7	74.0	83.2
Factor services (net)	-12.0	-11.7	-10.4	-12.8	-14.0	-15.6
Of which						
Public sector						
Interest payments	-2.4	-2.6	-2.8	-2.9	-3.2	-4.5
Net private transfers	11.6	12.4	14.0	14.2	14.9	15.3
Net official transfers	4.9	1.2	1.7	12.1	20.5	11.0
Capital account balance	**54.5**	**36.0**	**26.6**	**50.6**	**51.9**	**63.3**
Net official borrowing	8.7	-0.9	0.7	4.5	12.5	4.2
Net private capital	45.8	29.7	37.9	55.3	27.0	30.6
Of which						
Direct investment (net)	47.3	30.6	42.6	55.1	27.8	24.9
Other (including errors and omission	-0.1	7.3	-12.1	-9.1	12.4	28.5
Overall balance	**0.5**	**-0.3**	**0.4**	**1.0**	7.6	**0.6**
Financing	**-0.5**	**0.3**	**-0.4**	**-1.0**	-7.6	**-0.6**
Of which						
Change in imputed reserves 2/	1.0	1.4	-0.4	-1.0	-7.6	-0.6
	(In percent of GDP)					
Merchandise exports	20.2	23.5	18.9	16.1	15.7	15.8
Merchandise imports	47.7	45.3	45.6	51.5	53.5	55.0
Trade balance	-27.5	-21.8	-26.7	-35.4	-37.8	-39.2
Current account balance	-22.3	-13.8	-9.4	-16.8	-14.0	-18.7

Sources: Eastern Caribbean Central Bank; Ministry of Finance and Planning; Department of Touris and Fund staff estimates.

1/ Includes changes in commercial banks' net foreign assets.

2/ At the Eastern Caribbean Central Bank.

Table 6. St. Vincent and the Grenadines: Summary of External Debt Operations 1/

	1994	1995	1996	1997	Prel 1998	Proj 1999
	(In millions of U.S. dollars)					
Total debt at end of period	**137.3**	**141.2**	**144.8**	**149.8**	**166.5**	**160.8**
Central government	77.2	77.5	74.8	78.6	91.7	96.8
Rest of public sector	9.9	10.0	12.2	9.0	7.8	7.0
Publicly-guaranteed	50.2	53.7	57.2	62.2	67.0	57.0
Drawings	**12.7**	**3.1**	**6.1**	**10.8**	**19.9**	**10.3**
Central Government	7.6	2.5	2.9	10.7	19.9	10.0
Rest of public sector	5.1	0.6	3.3	0.1	0.0	0.3
Valuation adjustment	**1.6**	**1.4**	**-1.2**	**-3.8**	**-1.8**	**0.1**
Amortization	**4.0**	**4.0**	**5.4**	**6.3**	**6.2**	**6.1**
Central Government	3.5	3.5	4.6	4.5	5.1	5.1
Rest of public sector	0.4	0.4	0.9	1.8	1.2	1.0
Debt service on total debt	**6.3**	**6.6**	**8.3**	**9.2**	**9.4**	**10.6**
Amortization	4.0	4.0	5.4	6.3	6.2	6.1
Interest	2.4	2.6	2.8	2.9	3.2	4.5
Central government debt	2.1	2.1	2.2	2.1	2.7	4.1
Rest of public sector debt	0.3	0.5	0.6	0.8	0.5	0.4
	(In percent)					
Average interest rate 2/	**3.1**	**1.9**	**2.0**	**2.0**	**2.1**	**2.7**
	(In percent of GDP)					
Total debt outstanding	**56.8**	**53.5**	**52.0**	**51.0**	**52.6**	**48.0**
Debt service	3.5	3.5	3.5	3.5	3.5	3.5
Of which						
Interest payments	1.0	1.0	1.0	1.0	1.0	1.3
	(In percent of exports of goods and nonfactor services)					
Amortization	3.5	2.9	3.7	4.5	3.9	3.7
Interest	2.1	1.9	1.9	2.0	2.0	2.7
	(In millions of U.S. dollars)					
Memorandum items:						
GDP	241.9	263.8	278.4	293.9	316.3	335.2
Exports of goods and nonfactor services	112.6	136.3	145.4	142.6	159.5	166.5

Sources: Ministry of Finance and Planning; Caribbean Development Bank; and Fund staff estimates.

1/ Includes obligations created by the US$50 million government-guaranteed debt to the private sector in connection with the Ottley Hall project.

2/ Ratio of total interest payments to debt at beginning of period.

Table 7. St. Vincent and the Grenadines: Medium-Term Scenario

	1998	1999	2000	2001	2002	2003	2004
		Projections					
	(In millions of U.S. dollars)						
Current account balance 1/	**-44.3**	**-62.7**	**-49.7**	**-51.0**	**-57.2**	**-60.3**	**-65.6**
Exports, f.o.b.	49.6	52.9	54.1	56.7	58.0	60.7	63.2
Imports, f.o.b.	-169.1	-184.3	-175.1	-182.8	-188.5	-198.7	-208.8
Services	39.7	42.4	43.2	46.0	45.4	48.6	49.6
Transfers 1/	35.5	26.3	28.1	29.1	27.9	29.1	30.4
Capital account balance (including errors and omissions)	**51.9**	**63.3**	**50.0**	**51.4**	**57.6**	**60.7**	**66.0**
Overall balance	**7.6**	**0.6**	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**
	(In percent)						
Real GDP growth at factor cost	5.7	4.0	4.0	4.0	4.0	4.0	4.0
Inflation (CPI, period average)	3.3	2.0	2.0	2.0	2.0	2.0	2.0
	(In percent of GDP)						
Current account balance	**-14.0**	**-18.7**	**-14.2**	**-13.7**	**-14.5**	**-14.4**	**-15.1**
Exports of goods and non factor services	50.4	49.7	48.7	47.7	46.3	45.2	45.1
Imports of goods and non factor services	-71.2	-71.5	65.9	64.4	63.1	62.0	62.6
Public external debt	52.6	49.3	48.0	45.1	44.7	44.2	44.0
Debt service 2/	5.9	6.4	7.5	7.3	7.7	7.6	8.2
Memorandum items:							
Banana export volume (in thousands of metric tons)	38.9	43.0	46.0	49.1	52.5	56.1	60.0
Banana export unit values (US$ per ton)	528.3	508.2	488.9	480.7	472.6	464.4	456.3
Total banana export receipts (millions of US$)	20.6	21.9	22.5	23.6	24.8	26.1	27.4
Total number of visitors (in thousands)	202.1	247.0	259.7	273.2	286.8	301.2	316.2
Of which:							
Stay-over visitors	67.2	64.6	75.6	79.5	83.5	87.6	92.0
Tourism receipts (millions of US$)	74.0	83.2	87.4	92.0	96.6	101.4	106.5
Debt service 2/	5.9	6.4	7.5	7.3	7.7	7.6	8.2

Sources: Eastern Caribbean Central Bank; Ministry of Finance and Planning; Department of Tourism; and Fund staff estimates.

1/ Includes official grants.

2/ In percent of exports of goods and nonfactor services.

St. Vincent and the Grenadines: Fund Relations
(As of September 30, 1999)

I. **Membership status**: Joined 12/28/79; Article VIII.

II.	**General resources account**:	**SDR Million**	**Percent of Quota**
	Quota	6.00	100.0
	Fund holdings of currency	5.50	91.7
	Reserve position in Fund	0.50	8.3
III.	**SDR department**:	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	0.35	100.0
	Holdings	0.06	17.6

IV. **Outstanding purchases and loans**: None.

V. **Financial arrangements**: None.

VI **Projected obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs): None.

VII. **Exchange rate arrangement**: Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

VIII. **Article IV consultation**: The last Article IV consultation was concluded by the Executive Board on December 3, 1997 (EBM/97/115). St. Vincent is on the 12-month consultation cycle.

IX. **Technical assistance**: (1993–Present). A technical assistance mission in the area of tax administration visited St. Vincent for two weeks in March 1993. From March 15 to April 30, 1993, an expert from STA visited six countries of the East Caribbean area including St. Vincent, to discuss the compilation of fiscal data for publication in GFS. A fiscal expert was also assigned as Budget Advisor in the Ministry of Finance and Planning for a period of eight weeks starting in November 1993.

In response to the request of the ECCB Governor for regional based statistical training courses, a joint CEMLA/IMF regional training course in money and banking statistics was conducted at the ECCB during September 8–26, 1997, for all member countries. Following the course, a fact finding mission took place during September 29–October 1, 1997 to discuss with ECCB officials methodological, compilation and reporting issues concerning money and banking statistics in the member countries of the ECCB.

A new version of the seminar on money and banking statistics is scheduled to take place in April 2000, cosponsored by ECCB/CEMLA.

St. Vincent and the Grenadines: World Bank Relations
(As of August 31, 1999)

1. St. Vincent and the Grenadines is a participant in the World Bank supported OECS Waste Management Project which was approved in FY95. The objective of this operation is to reduce public health risks and protect the environmental integrity of the Eastern Caribbean islands and their coastal and marine systems, by improving solid waste management facilities. The country's share in this project amounts to US$3.6 million—including US$0.8 billion from the Global Environment Facility.

2. In FY98 the World Bank approved US$6 million for an OECS Telecommunications Reform Project. St. Vincent is to receive US$1.2 million from this project. The objective of the project is to introduce pro-competition reforms in the telecommunications sector and increase the supply of informatics-related skills in the five OECS borrowing countries (the one exception being Antigua).

3. In FY99 the Board of Directors of the World Bank approved the OECS Emergency Recovery and Disaster Management Program aiming at reducing loses caused by weather-related disaster and expedite the economic recovery in the affected countries. St. Vincent is expected to join other OECS member countries in this project by FY00 with a likely share of about US$5 million.

4. The most recent Country Assistance Strategy dates from April 10, 1995. The World Bank is currently working on a new CAS which is expected to go to the Board in the last quarter of FY00.

IBRD and IDA Operations
(US$ millions)

	Principal	Disbursements	Undisbursed
OECS Waste management 1/	3.6	0.1	3.5
OECS Telecom. Reform project	1.2	0.1	1.1
OECS Emergency Recovery and Disaster management program 2/	5.0	0.0	5.0

	Actual							Projected	
Fiscal year 3/	1994	1995	1996	1997	1998	1999	2000	2001	2002
Disbursements	0.1	0.1	0.1	0.1	0.0	0.2	1.2	4.2	1.6
Repayments	0.0	0.2	0.2	0.2	0.2	0.1	0.2	0.2	0.2
Interest and fees	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.4

Source: The World Bank.

1/ Includes US$0.8 million from the Global Environment Facility.
2/ Projected as future lending.
3/ World Bank fiscal year begins on July 1.

St. Vincent and the Grenadines: Caribbean Development Bank Relations
(As of September 31, 1999)

1. St. Vincent and the Grenadines is a participant in the Caribbean Development Bank supported Education Project. A loan of US$6.2 million was approved in June of 1996 for the construction of three primary schools, the extension of one other and, teacher training programs. The project is to be completed by August 2000. So far, 18 percent of the approved funds have been disbursed.

2. In 1996, the Caribbean Development Bank approved US$1.84 million (the government contributed with US$0.2 million) for the Basic Needs Trust Fund aimed at improving social infrastructure (health clinic construction and repair). The program, which started in 1997, is scheduled to finish by 2001.

St. Vincent and the Grenadines: Statistical Issues

St. Vincent's statistical base is deficient in scope and quality, hampering the government's ability to assess economic developments. The reporting of some core data to the Fund is irregular and often subject to long delays. Technical assistance is required to improve the database and the reporting system. St. Vincent's statistical publications are provided to the Fund on an irregular basis.

1. Real sector

The consumer price index and foreign trade data are reported punctually, but data on production and national accounts are not yet reported to STA. However, the authorities have provided data during Fund missions and between consultations. Statistical bulletins are only provided to the Fund on an irregular basis.

Data on gross domestic product are available through 1996 and complete accounts by major expenditure category are only available through 1992.

2. Government finance

STA's database includes annual data for the central government which are published in the **GFS Yearbook** and in IFS. No data on financing are provided to STA. The authorities state that they can only provide government finance data on an annual basis. More updated data on central government finances are provided to Fund missions, but data on the public enterprises are not compiled in a systematic fashion and, in most cases, are available only with a long lag.

3. Monetary statistics

Monetary survey data are compiled by the Eastern Caribbean Central Bank (ECCB) on a monthly basis. The data are reported regularly to the Fund, although the timeliness of data for the accounts of the ECCB (lag of six weeks) could be improved. The monetary survey does not include the accounts of credit unions that accept demand deposits. The ECCB is aware of the need to improve the coverage of the monetary statistics and has taken steps to collect reliable data on credit unions.

4. Balance of payments

St. Vincent's balance of payment statistics are also provided to STA by the ECCB, albeit not in the new Fund format. In addition to significant delays, some variables are only provided on an aggregate basis. The compilation of the Balance of Payments statistics could be greatly improved by providing more details in the services balance and financial accounts.

St. Vincent and the Grenadines: Core Statistical Indicators

as of October 13, 1999

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	Fixed Rate	July 99	July 99	July 99	July 99	July 99	Aug. 99	June 99	1998	1998	1998	Dec. 98
Date Received		Sep. 99	Sep. 99	Sep. 99	Setp. 99	Sep. 99	Sep. 99	Aug. 99	Jul.99	Aug. 99	Jul.99	Jul.99
Frequency of Data 1/		M	M	M	M	M	M	M	A	A	A	M
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1/ D-daily, W-weekly, M-monthly, Q-quality, Bi-W-bi-weekly; SV-staff visit.
2/ ECCB-Eastern Caribbean Central Bank, MOF-Ministry of Finance.
3/ E-electronic data transfer, C-facsimile.
4/ B-for use by the staff and the Executive Board, U-for unrestricted use.

INTERNATIONAL MONETARY FUND
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IMF Concludes Article IV Consultation with St. Vincent and the Grenadines

On November 10, 1999, the Executive Board concluded the Article IV consultation with St. Vincent and the Grenadines.[1]

Background

Since 1990 St. Vincent and the Grenadines has reduced its dependence on banana exports, which are undergoing a reduction in preferential access to the European Union (EU) market. The government has attempted to promote diversification through several actions, including public investment in infrastructure, technical assistance, fiscal incentives, and new laws promoting offshore activities. In recent years, it has also made substantial efforts to boost productivity in banana production. The government has maintained sound macroeconomic policies, achieving overall fiscal surpluses (including official grants) for most years since 1995. Monetary and exchange rate policies are handled by the Eastern Caribbean Central Bank (ECCB), which has kept the currency unchanged since 1976.

During 1990–98 real annual GDP growth and inflation averaged 4 and 3 percent, respectively. Tourism's importance to the economy grew, and agriculture's fell, with other sectors' contributions remaining relatively stable. In 1999, real GDP growth and inflation are expected to slow to about 4 and 2 percent, respectively. The overall public sector surplus is expected to increase slightly to about 1 percent of GDP.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

Over the medium term, the authorities' goal is to maintain a high level of public sector savings to attract donor support, generate funds for public investment, and reduce the public external debt in relation to GDP. The government will no longer guarantee private external debt.

Executive Board Assessment

They commended St. Vincent and the Grenadines for its track record in maintaining reasonable economic growth and low inflation, noting in particular the high level of public savings and strong overall fiscal position. They stressed that the key challenge for St. Vincent and the Grenadines was to maintain macroeconomic stability and strengthen economic diversification in order to generate employment and growth, and reduce poverty.

Directors endorsed the authorities' medium-term fiscal objectives and saw merit in setting the overall balance of the public sector in line with the surpluses of the National Investment Scheme (NIS). They stressed that a strong fiscal position was critical in view of St. Vincent and the Grenadines' vulnerability to external and weather-related shocks and its participation in a currency union. In this regard, Directors suggested gradually trimming the government wage bill in relation to GDP and reviewing water and electricity rates. They also stressed that any large infrastructure projects, such as the proposed airport, should be financed on terms consistent with the authorities' goal of keeping public external debt and debt service manageable.

Directors noted that the banking system suffers from a relatively high level of nonperforming loans and a low level of provisioning. They urged the authorities, together with the Eastern Caribbean Central Bank (ECCB), to maintain strong supervision of onshore banks. Directors also expressed concern that the growth of offshore financial activities was straining the capacity of the supervisory authorities to combat money laundering. They welcomed the authorities' intention to increase staff overseeing offshore activities, and encouraged further consideration of the proposal to let the ECCB supervise offshore banks. In this connection, Directors noted the ECCB's request for a financial system stability assessment (FSSA), and called upon staff to give this request due consideration.

Directors welcomed the progress made in diversifying the economy, but questioned whether the use of several different fiscal incentives was facilitating the needed improvement in competitiveness. They suggested scaling back, simplifying, and reducing the discretionary nature of the tax and import duty exemptions, which diminish fiscal revenues and encourage an inefficient allocation of resources. Directors also recommended the establishment of clear rules for granting incentives and approving foreign direct investment projects. Directors commended the authorities for reducing the maximum external tariff, and noted their intention to remove price controls on motor vehicles and motor vehicle parts. They urged the authorities to phase out the remaining price controls.

Directors noted that the deficiencies in economic statistics impeded the conduct of surveillance, particularly in the area of the public finances, but were encouraged by the authorities' interest in addressing statistical weaknesses.

Directors welcomed the authorities' intention to participate in the pilot project for the release of Article IV consultation reports.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. As part of a pilot project, the staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 1999 Article IV consultation with St. Vincent and the Grenadines is also available on the IMF's website (http://www.imf.org).

St. Vincent and the Grenadines: Selected Economic Indicators 1996–1998

	1995	1996	1997	1998
	(Annual percentage change)			
Real economy				
Real GDP	7.6	1.5	3.7	5.2
Inflation (end of period)	3.1	3.6	0.8	3.3
Money and credit				
Broad money	8.0	4.4	13.7	16.1
Credit to private sector	20.3	14.4	8.3	8.8
	(In percent of GDP)			
External sector	-18.7	-9.4	-16.8	-14.0
External current account	-0.1	0.1	0.3	2.4
Overall balance				
Public finance				
Savings	6.3	7.5	8.4	8.5
Investment	6.0	6.9	11.5	13.8
Overall balance	0.6	1.8	-0.9	0.3
External debt	53.5	52.0	51.0	52.6

Source: Ministry of Finance; Eastern Caribbean Central Bank, and IMF staff estimates.

Statement by Thomas A. Bernes, Executive Director
for St. Vincent and the Grenadines
November 10, 1999

1. On behalf of my Vincentian authorities, I would like to express my thanks to the mission chief, Mr. Rennhack, and his team for a helpful and informative consultation. My authorities appreciated the mission's constructive advice and the degree to which staff's assessment took into account the unique challenges faced by small-island economies. This "more nuanced" approach -- particularly with respect to civil-service reform and land holding -- was a welcome evolution in the ongoing dialogue between St. Vincent and the Grenadines and the IMF.

2. The authorities are in general agreement with the content of the staff report. I will therefore offer only a few comments and clarifications.

3. On the **macroeconomic** front, there is not much to add to staff's analysis. A word is probably warranted, however, with respect to what might appear at first glance to be a large current account deficit (about 15 percent in 1997-98). As staff note, exports suffered from adverse terms of trade developments and from pests on agricultural exports. The country's mango production was affected as were some root crops. Remedial action is well underway but there is likely to be a loss of access to the U.S. market for a period of up to three years. This is truly a regrettable development but it is worth noting that, as farmers begin to adopt more advanced agricultural practices like the use of greenhouse technologies (which are being actively promoted by the Government), the incidence of such infestations will be significantly reduced.

4. At the same time, Directors should be aware that the current account deficit is well financed, with concessional resources representing a significant component of the financing. This situation is likely to persist since a significant portion of STABEX grants from the EU have yet to disbursed and, as staff note, official data likely understate receipts from tourism and the fishing sector. On the former, current data on tourism are based on an expenditure survey that is five years old. Given developments in the tourist industry since then, it is likely that per visit expenditure has increased substantially. The authorities acknowledge the need to undertake a new survey of spending patterns in the period ahead.

5. Staff have raised questions about the **budgeting process** – in particular, the fact that actual expenditures have significantly undershot budgeted expenditure. To improve the situation, the authorities accept the need to strengthen the reporting requirements of public enterprises (although it should be noted that the largest public enterprises provide data in a timely manner). They note, as well, that actual capital expenditures are higher than recorded

on account of the disbursement of some donor funds directly to suppliers and contractors. Shortfalls in recorded expenditures are also partly due to uncertainties with the *pace* at which capital projects are implemented. While not condoning such deviations from budget, it should be noted that actual outcomes consistently *undershoot* targets, which is certainly preferable to the more-often witnessed situation of budget overruns! Directors may be interested to note that, with assistance from the Canadian International Development Agency (CIDA), projects have been launched to address weaknesses in financial management and budgeting.

6. In the context of an evolving global economy, no discussion of a small Carribbean island economy would be complete without attention being paid to the question of **economic diversification**. As many of its neighbors, St. Vincent and the Grenadines faces daunting challenges on a number of fronts. These include the erosion of agricultural preferences, periodic pest infestations of important agricultural crops, and civil-service capacity constraints. The situation is further complicated by the telecommunications monopoly position held by Cable and Wireless – a legacy of past administrations – that constrains St. Vincent's ability to take full advantage of the opportunities provided by an increasingly globalized economy. It is in no small measure due to the determination of the authorities to maintain a stable and sound macroeconomic environment and to be proactive in policy making that St. Vincent and the Grenadines has been as successful as it has. Success in developing the tourism sector – where a single major project can have an enormous impact on GDP – is particularly noteworthy. However, as staff point out, and as the authorities fully appreciate, serious challenges remain.

7. Among the questions to be resolved is that of **airport expansion**. Currently, St. Vincent and the Grenadines lacks airport facilities capable of handling jet aircraft. This is problematic as it limits the extent to which St. Vincent can take advantage of charter carriers, bringing tourists to the region directly from major centres like Chicago, Toronto and New York. Other productive sectors, including fishing, manufacturing, informatics and the offshor financial sector are also affected by limitations on the existing facilities. However, as staff indicate, options are complex and many of them prohibitively expensive. That being said, the authorities record for fiscal prudence can be counted on to ensure that whatever decision is eventually taken, the fiscal consequences will be kept well within the Government's ability to pay.

8. The authorities continue to regard development of the **offshore sector** as a key pillar of their diversification strategy. They remain fully cognizant of their responsibilities to assist the international effort to combat money laundering and, within their own internal resource constraints, have strengthened supervisory capacity. With respect to "harmful tax competition" concerns, the authorities are awaiting a clearer indication of the outcome of OECD efforts in this area. They remain concerned that – at a time when other avenues of economic diversification are being closed to them on account of telecommunications monopolies and trade disputes -- efforts in this direction may fall victim to excessive zeal on the part of some industrial countries to turn OFCs into "tax collectors" for industrial countries. As noted, they accept their responsibility as it pertains to illegal activities but

underline the fact that "tax avoidance" is not illegal (as is tax "evasion"). Nevertheless, they continue to cooperate with the OECD as it addresses issues of tax competition associated with the offshore sector.

9. Among the efforts made by the Government to develop and diversify the economy, staff list the extension of "public guarantees of private external debt". As noted by staff, and as a result of a few serious and expensive past missteps with this vehicle (most notable being the Ottley Hall project), the authorities have *no intention* of extending such guarantees in the future. They would also hope that their experience will provide a cautionary note to other governments contemplating resort to such guarantees.

10. Staff have concerns with the degree of "discretion" in granting **tax or import duty exemptions** or in approving **foreign direct investment** projects. On the former, the authorities agree there is some scope to improve transparency, particularly by simplifying the range of incentives. With respect to foreign direct investment, the difficulty in establishing rigid rules on this front for a small island economy are well known given the potential for even a single FDI project to significantly affect land prices and alter the environmental landscape. That being said, all major decisions on FDI are taken by the full Cabinet.

11. Staff note that "price controls distort consumption and production patterns". While this is clearly true in a "theoretical" sense, the question of the *degree* of distortion is key since the controls could be a second-best solution to an existing market imperfection. Indeed, small island economies are notable for the extent to which market imperfections exist. There is indeed scope to simplify the system of price controls, but the authorities see little evidence that any of the existing controls are binding enough to seriously distort consumption and production patterns.

12. With respect to the **financial sector,** the authorities share staff's concern with the relatively high level of NPLs and are working with the ECCB and the banks in question to address the situation. A significant portion of the value of NPLs is accounted for by a single loan, for which the National Commercial Bank (NCB) believes that it can recoup a significant portion of the loss from the sale of the associated assets.

13. In terms of the issues staff raise with respect to the adequacy of the ECCB regulatory and supervisory framework, it should also be noted that officials of the ECCB requested an FSSA from MAE staff during last month's Annual Meetings. They are still awaiting a positive response from the Fund and would welcome any encouragement Directors could provide to staff to ensure this is undertaken in the not-too-distant future.

14. Staff have provided an accurate description of the authorities plans for the NCB. The authorities have also undertaken measures to level the playing field with private banks, in particular, by permitting the NCB to charge a market rate on government overdrafts and by extending the one percent deposit levy currently paid by private-sector commercial banks to the NCB. The authorities also plan to establish a national development bank (on a modest scale). This is partly intended to permit the NCB to get out of the development loan business.

and concentrate on strictly commercial lending. Development loans, by their very nature, are of longer maturity and their successful use requires the provision of specific business-related technical assistance to borrowers, neither of which the NCB has a comparative advantage in providing.

15. Finally, I am pleased to note that St. Vincent and the Grenadines is a participant in the pilot project on the release of Article IV staff reports.