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January 2001
Country Report No. 01/09

St. Kitts and Nevis: 2000 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Authorities of St. Kitts and Nevis

As required under Article IV of its Articles of Agreement, the International Monetary Fund conducts periodic consultations with its member countries. In the context of the 2000 Article IV consultation with St. Kitts and Nevis, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **July 19, 2000,** with the officials of St. Kitts and Nevis on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on September 22, 2000.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- the Public Information Notice (PIN), which summarizes the **views of the Executive Board as expressed during the October 23, 2000, Executive Board discussion** of the staff report that concluded the Article IV consultation.

- a statement by the authorities of St. Kitts and Nevis.

The document listed below has been separately released.

Recent Economic Developments paper

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

ST. KITTS AND NEVIS

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for the
2000 Consultation with St. Kitts and Nevis

Approved by Claudio Loser and Christian Brachet

September 22, 2000

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EXECUTIVE SUMMARY

Background

Economic growth in St. Kitts and Nevis slowed recently, mainly as a result of hurricanes in 1998–99 that inflicted severe damage to infrastructure. Growth is beginning to rebound, led by recovery in construction, tourism, and manufacturing. Inflation has generally remained below 2 percent per year, anchored by the currency board arrangement.

The overall balance of the nonfinancial public sector weakened in the mid 1990s, shifting from a surplus of about 2½ percent of GDP in 1995 to a deficit of about 6½ percent of GDP in 1998. The deterioration is owing to higher deficits of the central government—mainly on account of increases in expenditure on wages and salaries, goods and services, and interest payments—and of the sugar company. The deficit of the central government widened in recent years reflecting expenditure increases and revenue weakness stemming mainly from the hurricanes, and it further sharply deteriorated in the first half of 2000.

Although the external current account deficit tends to be high, it widened in 1999 as a result of higher imports related to reconstruction, weaker tourism receipts, and lower exports of agricultural goods (mainly sugar). In recent years, capital inflows, mainly foreign direct investment in the hotel sector, have been sufficient to build up imputed international reserves. External debt service obligations have grown rapidly in recent years, reflecting a rising external debt level and rising effective interest rates as a result of the loss of concessional status.

Policy issues

To restore rapid economic growth and ensure its medium-term sustainability, the main challenges to the government are to narrow the central government deficit, to reduce the losses of the sugar industry, to strengthen the banking system, which has been financing the growing public sector deficits, and to strengthen external competitiveness. The authorities have recently taken strong measures that would contain the fiscal deficit to a projected 8½ percent of GDP in 2000 and then gradually reduce it to 3½ percent of GDP by 2003. The staff recommended a combination of tax reforms, including base broadening, and spending restraint, mainly in wages and goods and services, to achieve a balanced budget by 2003, as agreed to in the 1998 emergency assistance program. The staff urged the authorities to address quickly the problems of the sugar company, to finance its deficits directly through the budget, and to put in place a social safety net for sugar company workers.

Although they are still a small part of the economy, the activities of the offshore sector have been growing rapidly in recent years, especially on the island of Nevis. The authorities are taking steps to address areas of weakness in the regulation and supervision of this sector. In particular, they are strengthening laws against money laundering and have agreed to entrust the regional central bank with the supervision of offshore banks. They are committed to working on a regional basis to ensure that international best practices on these issues are put in place.

I. Introduction

1. **The 2000 Article IV consultation discussions with St. Kitts and Nevis were held in Basseterre and Charlestown during July 6–19, 2000**. The mission met with the prime minister, the premier of Nevis, the permanent secretary in the ministry of finance, and other senior officials of the government and public enterprises. The mission also met with the governor and other senior officials of the Eastern Caribbean Central Bank (ECCB), as well as representatives of the private sector.[1]

2. **St. Kitts and Nevis has been on the 24-month consultation cycle, and the last Article IV consultation was concluded by the Executive Board on June 18, 1997**. Since that time, an interim staff visit took place in May 1998 and staff visits in connection with the use of Fund resources (emergency assistance) and for policy discussions took place in November 1998 and May 1999.

3. **In concluding the last consultation, Directors commended the authorities for prudent economic policies that had contributed to strong growth and stable prices, but expressed concern about the deteriorating fiscal position**. Directors recommended that the authorities safeguard revenues, mainly through improvements in tax administration and better cost recovery for public utility services. On the expenditure side, they urged the authorities to restrain public sector wage increases to amounts justified by productivity gains. Directors noted the deteriorating financial position of the sugar company and recommended that the authorities seek World Bank assistance in solving the company's problems.

4. **St. Kitts and Nevis has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions (Appendix I).**[2] The country is a member of the Eastern Caribbean Currency Union, and the common currency of the union, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC$2.70 per US$1 since July 1976. The exchange regime is administered by the ECCB.

5. **St. Kitts and Nevis is vulnerable to hurricanes. In the fall of 1998, the country suffered a direct hit by Hurricane Georges**, which caused extensive damage to infrastructure and tourist facilities, the sugar crop, and housing, estimated at about US$400 million (about 140 percent of annual GDP).[3] On December 17, 1998, the Executive Board approved emergency assistance

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[1] The staff team comprised Ms. Stotsky (Head), Mr. Cueva, Mr. Melhado, Mr. Njoroge, Mr. Tokarick, and Ms. Hewitt, staff assistant (all WHD). Mr. Itam (WHD) joined the mission for the initial days. Four staff members of the ECCB also participated in the mission. Mr. van Beek (WHD, who was heading an overlapping mission to the ECCB), Mr. Bernes (Executive Director for St. Kitts and Nevis), and Ms. Turner-Huggins (Advisor to the Executive Director) participated in the final round of discussions.

[2] Relations with the World Bank and the Caribbean Development Bank are summarized in Appendices II and III, respectively.

[3] An estimated two-thirds of the damage was to the housing stock.

totaling SDR 1.625 million (25 percent of the old quota) in support of the government's economic recovery program, which included measures to strengthen the public finances and establish a contingency fund to help meet future emergencies.[4] A portion of the damage was covered by private insurance. Aid from other multilateral institutions also assisted in the reconstruction.

6. **St. Kitts and Nevis provides core data to the Fund. However, shortcomings in the quality and coverage of the data and long lags in their provision hamper monitoring of economic developments**. A key area of weakness is the absence of data on labor markets. In addition, there are weaknesses in data on the financing of the central government and public enterprises, including the sugar company, and external trade and certain components of the capital account of the balance of payments.

II. Background and Recent Developments

7. **St. Kitts and Nevis is a small, open economy that is heavily dependent on tourism and other services, and some light manufacturing.**[5] In recent years, the economy has greatly reduced its dependence on its traditional base of sugar production.[6] Despite extensive damage to infrastructure as a result of a series of hurricanes since 1995, the economy has continued to grow, although at rates slower than in the early 1990s, when real GDP grew by an average of 5½ percent a year. Growth slowed to 1 percent in 1998 (Table 1 and Figure 1), mainly owing to weakness in tourism, in other services, and in agriculture, following Hurricane Georges. Growth rebounded to 2¾ percent in 1999, led by improved performance in construction, the service sector, and manufacturing. However, the lingering effects of Hurricane Georges on tourist facilities and the aftermath of Hurricanes Lenny and Jose in 1999, which caused extensive coastal damage, limited the recovery in tourism and agriculture.

8. **The exchange rate peg to the U.S. dollar and strict limits on central government borrowing from the ECCB have helped maintain inflation at low levels**, averaging below 2 percent in recent years.[7] As measured for St. Kitts and Nevis, the value of the EC dollar in real effective terms has in the past three years been about 10–15 percent more appreciated than the average of 1990–97 (Figure 2), mainly owing to the strength of the U.S. dollar.

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[4] EBS/98/217 and Supplement 1.

[5] In 1999, the population was estimated at about 43,000 and per capita GDP at about US$7,100.

[6] Sugar has declined in importance to the economy, as sugar production and sugar-related manufacturing accounted for less than 2 percent of GDP and the value of sugar exports was less than 7 percent of total exports of goods and nonfactor services in 1999. Employment has fallen by about one-third in the past five years to 1,400 full-time workers, or about 7–8 percent of the workforce.

[7] Higher inflation in 1997 resulted from the conversion of the consumption tax base from the import duty-exclusive to the import duty-inclusive value of imports of goods.

9. **Labor force data are not collected in St. Kitts and Nevis, but shortages of highly skilled labor are reported to exist** and migrant workers are being employed in both agriculture and construction. The quality of the housing stock has been upgraded in the past few years, mainly through the National Housing Corporation, and with government subsidies, as substandard housing destroyed by Hurricane Georges is being replaced.

10. **Despite rapid economic growth, the central government's deficit rose gradually in the early 1990s**, reflecting a large across-the-board rise in spending, only partly offset by revenue improvements, mainly in nontax fees. Reflecting the effects of Hurricane Georges, the deficit nearly doubled, to 6½ percent of GDP, in 1998 (Table 2). Higher current spending late in the year reflected a substantial increase in relief and reconstruction activities, despite the authorities' nonpayment of the traditional 13th month salary, as agreed to in the emergency assistance package. The deficit narrowed to about 5¾ percent of GDP in 1999, reflecting the implementation of a 50 percent increase in the property transfer tax and cancellation of the partial hotel tax rebate to the hotel association, as well as capital expenditure restraint.

11. **The surplus of the social security system of about 4¾ percent of GDP a year has been offset by growing deficits in the other public entities**. The main public enterprise—the St. Kitts Sugar Manufacturing Corporation—continues to generate losses (reaching about 3½ percent of GDP a year recently), given high fixed costs, decreasing production levels, and a drop in the price of sugar in the European market. These losses have been primarily financed by the government-owned National Bank through an overdraft account. Over the medium-term, the prospects for sugar may further worsen if St. Kitts's sugar quota in the European market is reduced.

12. **Holdings of broad money grew faster than nominal GDP during 1998 and 1999 (Table 3)**.[8] Reflecting the ECCB's traditionally strong backing of the EC dollar, ECCB credit to the government has remained limited, well below the potential amount available under the ECCB's credit allocation formula, even as the fiscal position weakened. Commercial banks have provided a large share of domestic financing to the public sector in recent years. They were able to sustain credit to the private sector by increasing their foreign liabilities, resulting in a negative net foreign asset position by end-1999.

13. **The commercial banks have maintained strong capital indicators**, with an increase in the capital to risk weighted assets ratio to about 31½ percent, as of December 1999. The unsatisfactory assets to total loans ratio (including the sugar company's overdraft but not the central government's overdraft) increased from 15¾ percent at end 1998 to 19¼ percent at end 1999, after falling in the mid 1990s.[9]

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[8] Broad money growth has tended to be unstable in St. Kitts and Nevis. The acceleration in broad money growth in 1999 is mostly explained by Y2K concerns.

[9] Unsatisfactory assets are defined by the ECCB as loans and credit facilities that are past due and that are inactive for 90 days or more, and nonperforming overdrafts (those for which there has been no transactions for at least three months, or for which credit is insufficient to cover interest and bank charges over a three-month period).

14. Reserve requirements have remained unchanged at 6 percent on deposit liabilities, while the floor on passbook savings accounts has been kept at 4 percent. Interest rates have remained stable, averaging about 4¼ percent on deposits and 11¼ percent on lending. A spread of this magnitude is typical in the region, partly reflecting the high costs of banking services.

15. **In the offshore banking area, the islands of St. Kitts and Nevis are two different jurisdictions from a legal and regulatory perspective. Offshore financial services have been growing, especially in Nevis**, though they still account for only a small share of GDP (they have a somewhat larger budgetary impact in Nevis). The Nevis Financial Services Department is in charge of the supervision of all the offshore financial institutions there.[10] The laws provide for a high degree of confidentiality and for income tax exemption. St. Kitts and Nevis has been concerned about strengthening the supervision of the offshore financial service sector, and the recent international initiatives against weak regulatory and supervisory practices in offshore financial centers have given further impetus to the authorities' efforts.

16. **Despite the effects of Hurricane Georges, the external current account deficit narrowed to 16½ percent of GDP in 1998, from 21 percent of GDP in 1997,**[11] owing mainly to strong tourism receipts before the hurricane hit and an increase in insurance transfers following the hurricane (Table 4). The balance of payments recorded an overall surplus of 2¾ percent of GDP in 1998, owing to the large foreign direct investments in the hotel sector.[12]

17. **The current account deficit rose sharply, to 26 percent of GDP, in 1999, as a result of a deterioration in tourism receipts and sugar exports, and higher imports associated with post-hurricane reconstruction**. However, continuing strong direct foreign investment led to an overall balance of payments surplus of 1 percent of GDP, while the ratio of imputed reserves to broad money declined modestly.

18. **As a consequence of higher public sector deficits, partly reflecting large air and sea port investment projects, external public debt almost doubled from end-1995 to end-1999**, with external public debt service rising from about 5¼ percent of exports of goods and services in 1995 to 11¼ percent in 1999.[13] Although, in the past, much of the external debt was contracted at concessional terms, because of the growth in per capita income, St. Kitts and Nevis is no longer eligible for concessional assistance.

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[10] There is currently only one offshore bank, a subsidiary of the Bank of Nevis. Other financial services include trusts, international business companies and limited liability companies.

[11] St. Kitts and Nevis, like most of the other small island economies in the region, typically runs a large trade deficit, mainly because the production base is very small.

[12] Coverage of direct investment and short-term capital in the capital and financial account of the balance of payments and of exports in the current account is incomplete.

[13] External public debt at end-of-year rose from 24¾ percent of GDP in 1995 to 46½ percent of GDP in 1999, and domestic debt rose from 34¾ percent of GDP in 1995 to 39 percent of GDP in 1999.

III. Summary of the Discussions

19. **The discussions with the authorities focussed on fiscal and other economic policies that would foster investment and growth, and strengthen competitiveness. The most pressing problems are to ensure a sustained reduction in the central government deficit and to stem the losses of the sugar industry**. Addressing these problems would strengthen the banking system and free up resources for use in productive areas of the private economy. Since St. Kitts and Nevis is a member of the common central bank for the region, it has no independent monetary and exchange policies.

A. Measures to Enhance Economic Growth

20. **The government has committed itself to developing the tourist industry as the linchpin of the economy in the future**, with some diversification into assembly-type manufacturing, offshore services, and other services. Ongoing investments in the hotel industry in 2000 should spearhead a general pick-up in economic activity, with real GDP growth projected to rise to 3¾ percent, in the absence of any severe hurricanes in the fall. Inflation is expected to remain subdued at about 2 percent, despite higher oil prices, owing to the currency board arrangement. Labor market shortages may, however, constrain growth and could lead to strong upward pressures on wages. Raising productivity and wage restraint will be essential to improving competitiveness of the economy.

21. **In the past few years, private investors have made large commitments to increasing hotel capacity in St. Kitts**. Room capacity is expected to more than double from 1999 to 2001. Investors have shown an initial interest in the proposed Whitegate project on St. Kitts, which would be government-owned and could use as much as 5,000 acres of government-owned land in the northern part of the island. It would introduce a tourism concept based on a reconstruction of a historical sugar plantation in a resort setting, combined with modern forms of recreation. Nevis is also seeking to attract another luxury hotel to boost economic development there. The authorities perceive the increase in hotel rooms planned in the next few years as giving the country a critical mass for expanding the tourism sector. With the upgrading of the airport through the addition of an improved control tower in 2001 and with the expected completion before the end of 2000 of repairs to the cruise-ship pier, the transportation infrastructure is expected to be in place to support a substantial increase in tourist arrivals.

22. **To support economic development, the government is expanding educational opportunities** to the population through the construction of institutions of advanced learning and substantial investments in primary and secondary schools. It is also improving health care facilities on the two islands.

B. Fiscal Policies

23. **The recent modest economic upturn in 2000 has been accompanied by a further worsening of the fiscal situation, reflecting spending pressures and a lack of buoyancy in the tax system**. In the first half of 2000, the central government deficit expanded to about 11 percent of GDP on an annual basis, as a result of a substantial rise in expenditures on goods and service, and in

the wage bill, reflecting a 10 percent hike in public sector wages in March retroactive to January 2000. Collections of hotel taxes and of import duties and consumption taxes on imports were weak, owing in part to the continued closure of a major hotel. Higher oil import costs led to a sharp reduction in gasoline tax revenues so that prior to the increase in gasoline prices in July, the government owed retailers a rebate under the gasoline tax for each gallon of gasoline sold.

24. **In an effort to reduce the fiscal deficit, the government has recently implemented a series of reforms, including the remaining measures agreed to in the emergency assistance package**. The expenditure measures included freezing public sector employment, centralizing procurement of government supplies to enhance control and realize volume discounts, and limiting capital expenditures to projects already underway. To rein in the growth of wages and salaries in the budget, the authorities intend to grant a general wage increase only at the time of the next salary review in 2003. The revenue measures included an EC$0.08 per kilowatt hour increase in electricity tariffs (with a limited offset for low-income consumers), a sixfold increase in the very low water tariffs, and a EC$0.90 per gallon increase in regulated retail gasoline prices (with a limited offset to bus drivers on import duties on new buses and some bus parts to enable them to maintain bus fares at current levels). With these measures, the central government deficit is projected to be contained to 8½ percent of GDP in 2000, financed through a combination of domestic and foreign sources.[14]

25. **The staff welcomed the authorities' commitment to reversing the weakening in budgetary performance through the implementation of this strong set of measures**. The job of rebuilding the economy's infrastructure following each hurricane is difficult and exhausting, and productive investments do need to be made in public infrastructure to facilitate development of the islands. Nevertheless, it is essential to strengthen the fiscal position, given the rapid accumulation of debt in recent years and the large scale reliance on domestic banks to finance the deficit.[15]

26. **With the authorities' commitment to maintaining expenditure restraint and to raising utility tariffs each year until they reach regional averages, the central government deficit is projected to narrow** to about 6½ percent of GDP in 2001 and 3½ percent of GDP by 2003, well short of the goal of reaching a balanced budget in that year, as agreed to in the emergency assistance package. To achieve a balanced budget by 2003, the staff recommended measures to reduce expenditures by a further two percent of GDP, primarily in the wage bill and goods and services spending, and to raise revenues by another 1½ percent of GDP through tax reform and administrative improvements, with roughly equal phasing for both expenditures and revenues in each of the next three years.

27. **The staff supported continued expenditure restraint in all areas of the budget** and the decisions to reduce public sector employment through attrition and to limit general wage increases,

[14] The authorities also plan to set up a contingency fund for future disasters, but given current budgetary difficulties, have postponed its establishment.

[15] St. Kitts and Nevis will obtain some relief on debt owed to the United Kingdom, dating from the time of independence, through the Commonwealth Debt Initiative. The modalities of this relief are still being worked out, though debt relief would likely be used to support programs to assist low-income children.

but also emphasized the importance of increasing the number of higher-skilled workers, particularly in key ministries such as the ministry of finance. The authorities indicated that they face serious pressures in hiring highly skilled employees to work in government because wages in the private sector are much higher than in the public sector.

28. **To strengthen revenues, the staff suggested that emphasis be placed on broadening tax bases**, including broadening the base of the social services levy to a more comprehensive definition of wage income; expanding taxation of the self-employed, especially high-income professionals whose tax contributions are negligible; and reducing tax concessions (duty concessions have recently totaled about 5 percent of GDP a year). These measures could yield as much as 1 percent of GDP in additional recurrent revenue by 2001. The authorities favored expanding the coverage of the social services levy and agreed to move toward reducing tax concessions, but emphasized the need to address this issue on a regional basis.

29. **For the medium term, the staff proposed other, fundamental reforms to the tax system**, which could include deregulating the price of gasoline (or introducing regular price adjustments) and replacing the current gasoline tax with a tax levied in the form of a unit tax per gallon of gasoline sold or an ad valorem tax (or some combination of both). The staff also favored reintroducing a personal income tax (which was abolished in 1980), while phasing out the social services levy and the limit on wage deductibility by corporations, to enhance the progressivity and improve the structure of the tax code; and strengthening the system of property taxation. The staff argued that over the medium term and with adequate planning, it would also be possible to replace the current consumption tax with a value-added tax.[16] These measures would enable the government to reduce the common external tariff to 20 percent (which was supposed to be in place by end-1998) as agreed to with the Caribbean Community (CARICOM) and to continue reducing the corporate income tax rate in steps to 35 percent. The authorities were willing to consider restructuring the gasoline tax but expressed some reservations about allowing the price of gasoline to be market-determined because of a fear that there would be collusion in setting price among the small number of sellers in their country. They were also wary of the difficulties in reintroducing the personal income tax, but remain committed to reducing the common external tariff and corporate income tax rate, without establishing a specific timetable. Although the authorities intend to expand the domestic sales tax, they felt it would not be prudent to commit to the implementation of a value-added tax until an adequate administrative capacity was in place and were seeking technical assistance in this regard.

30. **Government administration continues to be hampered by the small size of the country**, the duplication of services between St. Kitts and Nevis, and difficulties competing for highly skilled employees with the private sector. Nevertheless, there are several key areas for improvement in management. Policymaking, in general, would be enhanced if the public sector investment program were better integrated into the annual budget process and a medium-term framework. The

[16] Given the economy's high import level, most of the initial collections of the value-added tax would continue to take place at Customs. However, the tax would offer the opportunity to tax domestic value added more effectively. A simple tax, harmonized across neighboring countries, would ease administrative burdens.

investment program tends to be driven by the availability of foreign financing. To improve the efficiency of capital investments, the authorities should link investments to an explicit medium-term program, with estimates for capital spending and financing for each year announced in the budget.[17] Tax and customs administration would benefit from closer cooperation between the relevant services. Currently there is relatively little regular sharing of information. Revenue administration would also benefit from closer cooperation between separate departments on each island.

31. **The government has embarked upon a consultative process with the public to determine a solution to the sugar industry's problems and expects to make a decision on the future of the industry in the next few months**. While acknowledging the many difficult issues that must be tackled in deciding the sugar company's fate, the authorities emphasized their desire to quickly develop a plan to stem the losses of the sugar company and to ensure an adequate social safety net is put in place for those workers unable to find suitable alternative employment.[18] The staff urged the government to make a realistic analysis of the fiscal costs of the alternatives. The main expenses associated with closure of the industry would be payment of one year of severance pay to employees (estimated at about 2–3 percent of GDP), income transfers and retraining expenses for employees, subsidies to help establish nonsugar agricultural production on some of the land taken out of sugar production, and the costs of land preservation measures. These costs could be offset against any revenue earned from the sale of government-owned land on which sugar production takes place, above that required to extinguish the company's existing debts to the National Bank and other creditors.

C. Monetary and Banking Policies

Domestic banking system

32. **The domestic banking system is generally managed in a sound manner, though the increasing overdraft at the National Bank is a source of concern**. The sugar company's overdraft is now estimated at about 17 percent of GDP,[19] for which the bank has been given a mortgage on 2,500 acres of government-owned sugar land, with an estimated value higher than the amount of the overdraft. In the absence of a formal deposit guarantee, the securing of the overdraft with this land helps protect the interests of the bank's depositors (including the social security fund) and the bank's private shareholders. The staff suggested that the government allow the National Bank to securitize the overdraft (including the amount attributable to the central government) to restore the original purpose of an overdraft facility (to accommodate temporary shortfalls in cash flow) and to improve the bank's liquidity position. In future years, the government should also

[17] The annual budget presentation tends to overstate likely capital spending, while actual spending depends on the availability of resources.

[18] A summary of the options that the government is considering is contained in the accompanying Recent Economic Developments report.

[19] The total overdraft, including the central government, is about 32 percent of GDP.

explicitly include a transfer for the sugar company's losses in the annual budget, rather than providing financing through the National Bank, especially out of social security deposits.

33. **There are other potential areas of risk, which the authorities should monitor in conjunction with the ECCB, which supervises onshore banks.** Some banks are taking direct equity stakes in real estate investments. Given the vagaries of the real estate market, particularly commercial real estate, the staff emphasized the importance of monitoring carefully bank commitments in this area.[20] There are no restrictions on banks' net foreign exchange positions, but foreign exchange lending practices appear to be conservative.

Offshore financial services

34. **Both the federation authorities and the government of Nevis are actively involved in the CARICOM-sponsored reform efforts in the offshore financial services area and generally welcomed the Fund's assistance in developing reforms.** The authorities are already taking steps to improve monitoring in the financial services industry and to strengthen enforcement powers. They intend to entrust the ECCB with the supervision of offshore banks (as in Dominica) and to support enhancement of the ECCB's supervisory powers to improve the quality of supervision of all financial institutions. They also intend to extend existing money laundering legislation to cover crimes other than proceeds from drug trafficking (which is already criminalized) and to review existing companies, banking, trust, financial services, and confidentiality legislation to address issues related to disclosure of beneficial ownership. Finally, they plan to establish a financial intelligence unit and implement a system for reporting suspicious transactions.

D. External Policies

35. **The deficit on the external current account, which is traditionally high, is projected to widen to 34½ percent of GDP in 2000, largely as a result of higher imports associated with the investments in the hotel sector.** Goods exports are expected to post modest growth, with a decline in sugar exports more than offset by an increase in exports of electronic components to the U.S. market. Service exports are projected to rise toward the end of the year, as tourism picks up. A further increase in foreign direct investment (mainly for hotels) is projected to buoy the capital account in 2000, and the overall balance of payments is expected to be roughly balanced.

36. **St. Kitts and Nevis may have lost some competitiveness in recent years (Box 1)**, as evidenced by fairly weak performance of exports of goods and services and real exchange rate appreciation, similar to several other countries in the region. Available indicators based on relative prices point to an erosion in external competitiveness, while indicators based on unit labor costs are not directly available. However, indirect evidence suggests that unit costs have risen, based on the

[20] The risk of real estate investments may rise if the government begins to sell a significant acreage of land.

Box 1: Developments in External Competitiveness

St. Kitts and Nevis is a small, open economy that competes directly with many other islands in the Caribbean region for tourism receipts. It is therefore important for St. Kitts and Nevis to prevent an erosion in external competitiveness. Examination of a number of indicators of external competitiveness for St. Kitts and Nevis between 1995 and 1999 suggests that it likely lost some competitiveness over this period.

The tabulation below presents two price-based indicators of external competitiveness for St. Kitts and Nevis: the real effective exchange rate (REER) and the relative price of nontradeables to tradeables. The REER is calculated using relative consumer price indices from the INS database, weighted by commodity trade. The relative price of tradeables is computed by constructing value-added deflators on a sectoral basis, using national accounts data. The sectors are classified as either tradeable or nontradeable, and the sectoral deflators are then used to construct the appropriate price indices. For St. Kitts and Nevis, the tradeable sectors include agriculture, mining, manufacturing, tourism, and air transportation. Nontradeable sectors include construction, electricity and water, banking, insurance, and real estate.

The movements in both the REER and the relative price of nontradeables to tradeables suggest a consistent pattern of real appreciation from 1995 to 1999, which might indicate a decline in the profitability of producing tradeable goods and a shift of resources into the production of nontradeables. These movements in price-based indicators of competitiveness seem to be consistent with the observed movements in the ratio of exports of goods to GDP, and the ratio of exports of goods and services (including tourism receipts) to GDP. Between 1995 and 1999, both of these indicators remained relatively flat or declined slightly. It is, however, difficult to infer anything definite from these movements, since hurricanes in many of these years have had a strong impact on the economy.

One way of gauging trends in competitiveness is to compare changes in real wages with changes in labor productivity. If real wage growth exceeds growth in productivity, then there may be an erosion of competitiveness. While data on aggregate wage increases are not available, a measure of growth in aggregate labor productivity can be calculated by dividing real GDP by total employment. As shown below, aggregate labor productivity *declined* on average by 0.2 percent a year between 1996 and 1999 (1995 is excluded as an outlier). It is unlikely that real wages declined by this magnitude in recent years, given the size of public sector wage increases and that private sector wage increases have generally been higher. Indications point to an increase in real wages in recent years, suggesting a loss of competitiveness given the poor productivity performance. Nevertheless, the economy has attracted large investments in recent years.

Indicators of Competitiveness 1995–99

	1995	1996	1997	1998	1999
(Annual percentage change, unless otherwise indicated)					
Real effective exchange rate 1/	-2.2	0.8	8.7	2.7	2.5
Price of nontradeables relative to tradeables 1/	1.7	1.5	0.9	7.2	1.2
Exports of goods and services/GDP (in percent) 2/	54.1	51.7	54.4	55.0	49.5
Exports of goods/GDP (in percent) 2/	15.9	14.0	18.7	17.0	15.9
Aggregate labor productivity	-15.6	0.6	-1.3	3.6	-3.6

1/ A positive value denotes an appreciation. The changes in the REER are calculated using period averages.
2/ In 1997, both of these ratios jumped owing to the inclusion of a new category of exports.

size of public sector wage awards and the weak productivity performance in recent years.[21] Looking ahead, the prospects for growth in export earnings have brightened as a result of the sizeable investments in the hotel industry and an expansion of light manufacturing facilities. Nevertheless, it is essential that the authorities exercise wage restraint in the public sector, and strive to increase productivity to strengthen competitiveness over the medium term.

37. **On trade issues, the staff noted that implementation of the recommendations for strengthening the system of domestic taxation would allow St. Kitts and Nevis to meet its obligations under CARICOM to harmonize the common external tariff at 20 percent**. Staff strongly urged the authorities to phase out quantitative restrictions that apply to several consumer products (such as beer, aerated beverages, pasta, and furniture), and convert them into roughly equivalent tariffs.[22] The authorities have not set a specific timetable for lowering the CET or phasing out remaining quantitative restrictions. Reduction of the CET is likely to be linked to implementation of a strengthened domestic sales tax.

E. Structural Policies

38. **Although the social security system is still generating substantial surpluses, over the longer term, the system is likely to come under strains because of aging of the population**. The staff suggested several options for restructuring the social security system to ensure its long-term solvency. The restructuring should include broadening the base of the tax (as with the social services levy) and raising the maximum taxable income; raising the retirement age above the current 65 years of age; and allowing the social security system to invest in a broader range of (safe) assets, including international and regional securities, rather than having it deposit most of its surplus in the National Bank. The authorities plan to review the long-term solvency of the social security system at the time of the next actuarial review and in the meantime are broadening investment possibilities for surplus funds, including lending money for building low-income housing.

39. **The planned reduction of the rate charged by the National Housing Corporation on its mortgages is likely to increase the budgetary cost of the government's subsidized housing programs**. To reduce this burden, the staff recommended that the National Housing Corporation package and sell its mortgage holdings at a discount to commercial banks, and that any further housing assistance take the form of housing vouchers to the very poor. The authorities indicated that they will consider mechanisms to reduce the budgetary effect of the housebuilding program.

40. **The government seeks to break up the monopoly on telecommunications to facilitate growth in the information processing industry**. Staff recommended that over time the electricity

[21] For some information on the competitive position of St. Kitts and Nevis, and the performance of other countries in the Caribbean region, see **Economic Overview of the Caribbean Region,** (SM/00/128).

[22] A summary of the trade regime is contained in the accompanying Recent Economic Developments report.

and water departments be separated from the budget and transformed into autonomous entities to enhance their commercialization. Privatization of public utilities is being contemplated but given the small size of the market, public utility services are likely to continue to be provided by only one supplier on each island, which will need to remain regulated by government.

F. Statistical and Technical Assistance Issues

41. **The authorities shared the staff's concern about improving the quality and timeliness of statistics and expressed interest in technical assistance.** Staff urged the authorities to budget adequately for the statistics function. The core monetary data collected by the ECCB are of good quality and are available in a timely manner. The ECCB is currently working on updating the consumer price index, which uses 1978 weights, and improving data on the external sector. The government should also develop quarterly GDP estimates and a regular labor force survey.

42. **There are several other clear technical assistance requirements.** In the area of public expenditure management, the ministry of finance needs to strengthen its ability to monitor the debt and finances of the public enterprises. In the area of tax policy, considerable restructuring of the tax system is necessary to give St. Kitts and Nevis a modern tax system. The authorities have continued to make progress in implementing new systems designed to enhance administration of Customs and Inland Revenue. However, there remains considerable scope for improving compliance rates with the major taxes and using the data generated by new computer systems to improve tax auditing and collection.

IV. Medium-Term Outlook

43. **Barring any major damage from hurricanes in the next few years, and with progress on reducing the budgetary imbalance and resolving the sugar industry's problems, economic conditions are likely to be favorable over the medium term.** The economy is expected to grow at a pace averaging about 5 percent a year over the 2001–2005 period, led by investments in tourism (Table 5 and Figure 3). Shortages of labor may constrain growth and limit the government's ability to expand the tourism sector while at the same time diversifying the economy. However, the government's efforts to upgrade educational skills, to remove the monopoly on telecommunications, and to broaden domestic tax bases, while lowering import duties, would help raise the economy's potential rate of growth.

44. **The fiscal position is likely to remain difficult**, though the recently implemented measures should, if sustained, lead to a gradual reduction in the deficit over the medium term, as was discussed above. With these measures, the central government's debt as a share of GDP is projected to peak at 75 percent of GDP in 2000 and gradually decline, as the deficit falls and economic growth picks up.

45. **A risk to the medium term is that the islands will be struck again by severe hurricanes in the next few years.** In that event, a strong fiscal position will enable the government to finance necessary reconstruction and maintain an adequate standard of living during the recovery period. Removing the sugar industry's drain on the government finances would brighten the prospects for the health of both the banking system and the social security system.

46. **The external current account deficit is projected to widen further in 2001, as a result of higher imports associated with the rapid expansion in the number of hotel rooms** and then begin to narrow thereafter as imports tail off and service exports rise, falling to 22 percent of GDP by 2005. In the goods account, decreases in sugar exports are projected to be offset by increases in exports of electronics to the U.S. market. The outflow of net factor payments may rise as compensation to foreign employees increases with the likely expansion in their hiring to meet demands of the expanding hotel sector. The current account deficit is expected to be financed by foreign direct investment flows sufficient to build reserves. The balance of payments is projected to generate a surplus of about 1¾ percent of GDP annually over the 2001–2005 period, with imputed international reserves rising slightly as a share of broad money.

V. Staff Appraisal

47. **St. Kitts and Nevis has withstood a series of devastating hurricanes in recent years, which have weakened economic growth and the fiscal position**. However, if fiscal balance is restored promptly, in the context of price and exchange rate stability, underpinned by the quasi-currency board arrangement of the ECCB, the prospects for sustained growth over the medium term are good. Major investments in tourism will continue to generate growth, while diversification will strengthen the economy's ability to withstand external shocks, such as hurricanes. Labor markets appear to be tight and may constrain growth. Shortages of skilled labor and construction and agricultural labor are likely to continue being met by foreign workers.

48. **The two most important tasks are to stem growing central government deficits and the losses of the sugar industry**. The authorities have already taken strong steps in 2000 to rein in the budget deficit, which include freezing civil service employment, cutting expenditures on goods and services, and limiting capital projects to those already underway. To boost revenues, the authorities have raised electricity and water tariffs, and increased gasoline prices. With these measures, the increase in the central government deficit is projected to be moderated in 2000 and then start narrowing. To achieve the authorities' goal of a balanced budget in 2003, the staff recommends a roughly equal mix of further expenditure cuts and revenue measures in the 2001–2003 period. The staff proposes several areas for reforming the tax system, which should permit higher revenues as well as room for reduction in the common external tariff and corporate income tax rate. In the medium term to 2005, the government should aim to generate a budget surplus and set aside a contingency fund for hurricane relief.

49. **The government is to be commended for engaging in an open consultation with the public on the future of the sugar industry. The sugar industry's medium-term prospects are poor**, and the government cannot continue indefinitely financing the large losses of the industry. The sugar company's overdraft at the National Bank, which finances the losses, has been secured with a mortgage on government-owned sugar land, providing some assurances to the bank's depositors (including the social security system). Financing these losses directly from the budget would enhance transparency, and securitization of the overdraft would enhance the bank's liquidity position. The government's efforts to develop alternative agriculture may provide employment for some workers in the industry, but it is essential that any reform plan put in place an adequate social safety net for workers unable to find alternative employment.

50. **Although the rest of the domestic banking system appears to be sound, there is scope for increased scrutiny of the investments of commercial banks**, particularly in real estate. In the offshore sector, the staff welcomes the authorities' efforts to improve supervision of this industry, to expand the ECCB's supervisory authority over offshore banks, and to extend existing money laundering legislation. The staff urges the authorities to ensure that the regulatory and supervisory framework is consistent with international best practices.

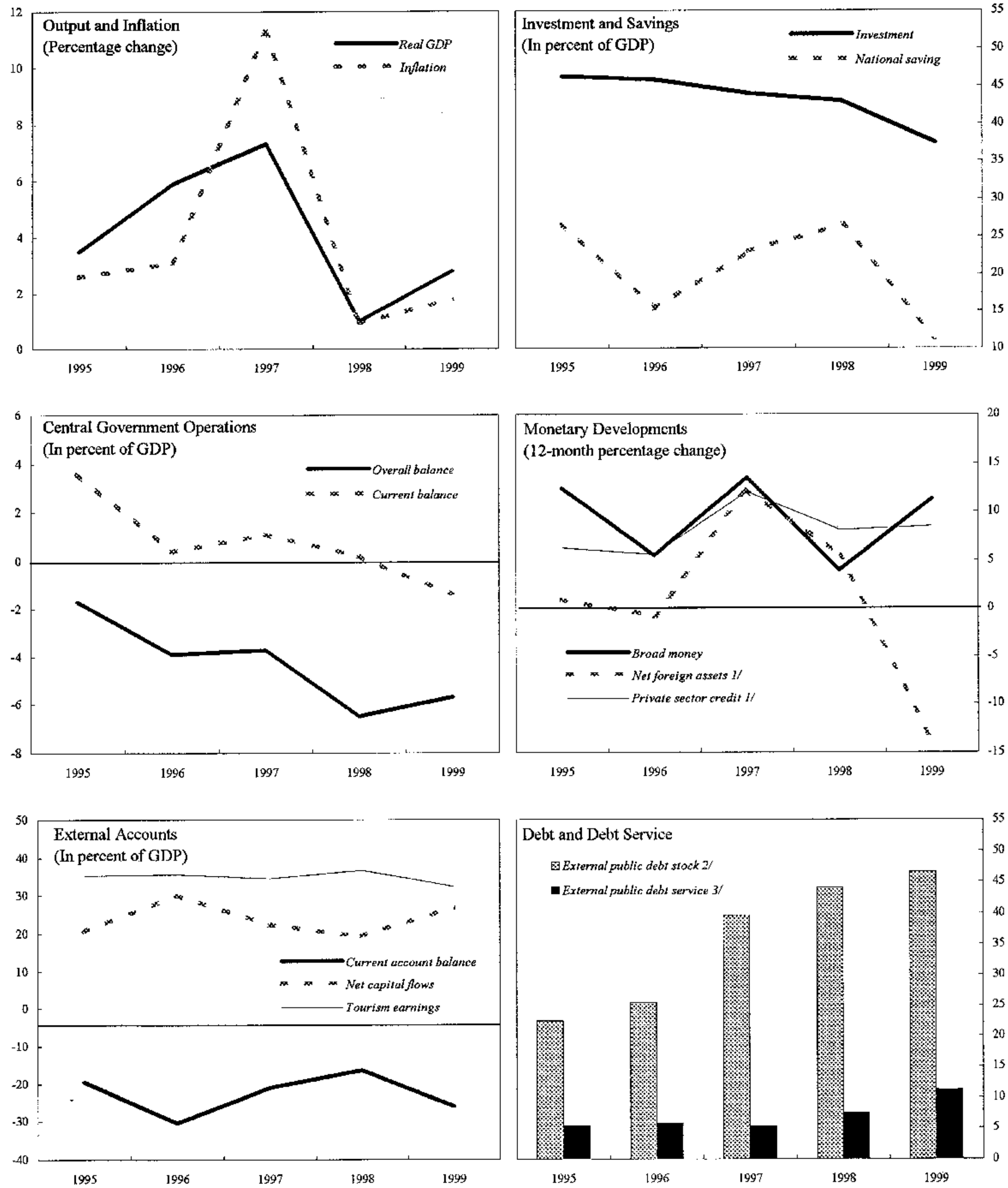
51. **The recent widening of the external current account deficit has been financed by foreign direct investment sufficient to build imputed reserves.** Staff projections indicate some widening of the deficit in the next few years in the face of additional large hotel investments, but over the medium term to 2005, the current account deficit should narrow as tourist revenues and exports of assembly-type manufactures increase and imports moderate. The staff projects a continued moderate buildup of imputed reserves in the ECCB, sufficient to raise slightly the reserves to broad money ratio. Nevertheless, indicators point to an erosion of external competitiveness in recent years. The staff urges the authorities to improve competitiveness by keeping wage increases in line with productivity growth. Public sector wage restraint is especially important, as it influences private sector wage increases. The staff strongly supports the reduction of the common external tariff to 20 percent and the elimination of the remaining quantitative restrictions on certain goods imports, and encourages the authorities to set a specific timetable for achieving these goals.

52. **Although the statistical base is adequate for monitoring macroeconomic developments, there still remain weaknesses, including the absence of data on the labor market**. Other areas for improvement include national income accounts estimates, financing of the central government and public enterprises, and external trade and some components of the capital and financial account of the balance of payments. The staff urges the authorities to seek technical assistance and to ensure that the statistics office is adequately staffed.

53. The staff welcomes the authorities' decision to publish the staff report, and notes their decision to move to a 12-month consultation cycle and their acceptance of the fourth amendment to the Articles of Agreement.

54. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. St. Kitts and Nevis:
Selected Economic Indicators, 1995 - 1999



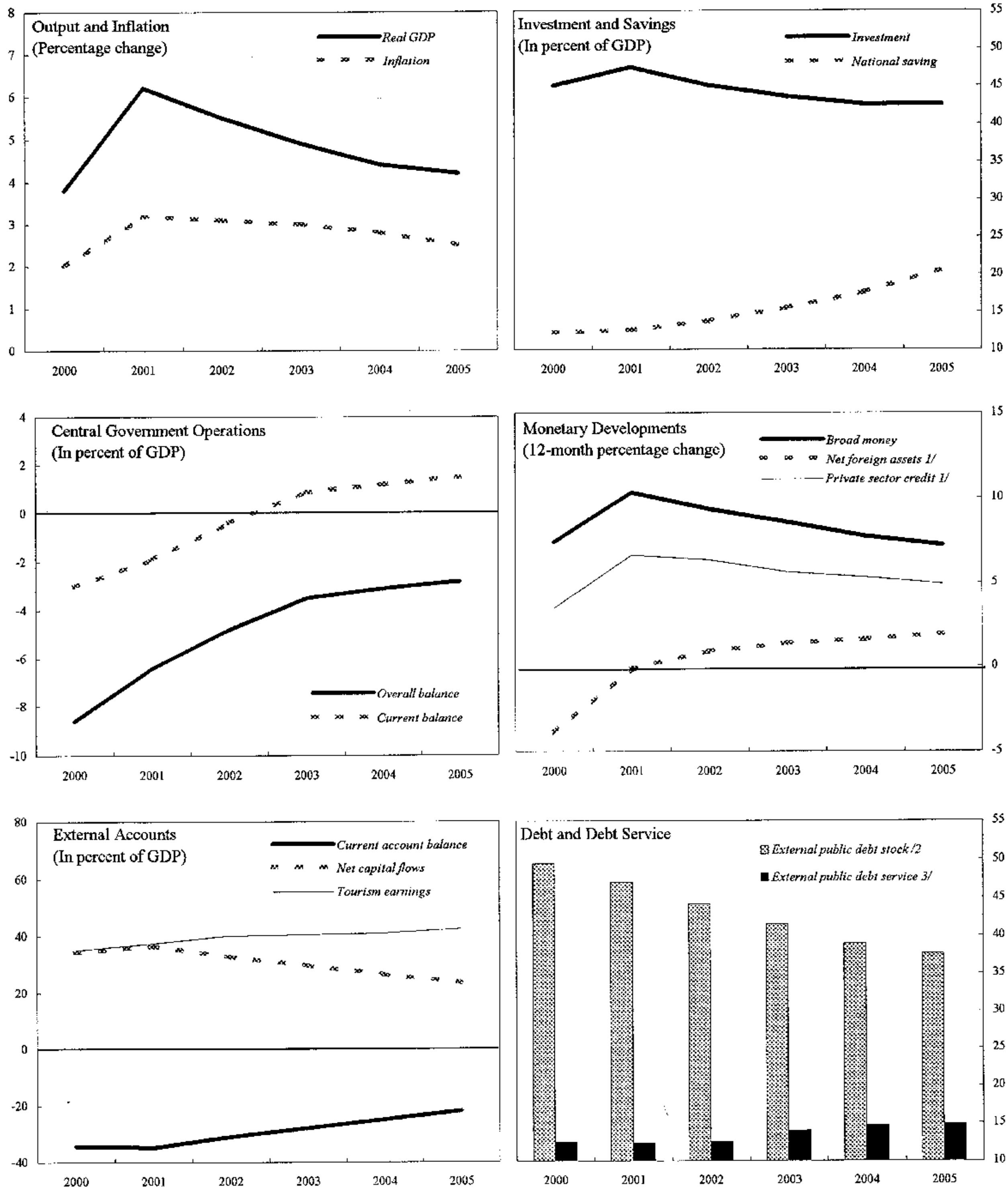
Source: Data provided by the St. Kitts and Nevis authorities; and Fund staff estimates.

1/ Contribution to liquidity growth.
2/ In percent of GDP.
3/ In percent of exports of goods and services.

Figure 2. St. Kitts and Nevis:
Exchange Rate Developments, 1990 - 2000 1/

Source: IMF Information Notice System.
1/ 1990 = 100.
2/ An increase (decrease) indicates appreciation (depreciation).

Figure 3. St. Kitts and Nevis:
Medium-Term Projections, 2000 - 2005



Source: Data provided by the St. Kitts and Nevis authorities; and Fund staff estimates.

1/ Contribution to liquidity growth.
2/ In percent of GDP.
3/ In percent of exports of goods and services.

Table 1. St. Kitts and Nevis: Selected Economic and Financial Indicators

	1996	1997	1998	Est. 1999	Proj. 2000	Proj. 2001
(Annual percentage change; unless otherwise specified)						
National income and prices						
Real GDP	5.9	7.3	1.0	2.8	3.8	6.2
GDP deflator	0.0	4.8	3.3	1.8	1.8	3.3
Consumer prices						
End-of-year	3.1	11.3	0.9	1.8	2.0	3.2
Period average	2.0	8.7	3.7	3.5	0.0	2.6
External sector						
Exports, f.o.b.	6.9	48.9	-4.7	2.2	10.9	18.6
Imports, c.i.f.	12.6	-1.7	5.9	5.0	24.0	14.5
Export volume	10.0	39.2	-4.9	-3.2	8.6	
Import volume	10.0	-11.9	7.4	12.1	12.8	
Terms of trade (deterioration -)	-1.1	-0.1	1.8	-2.1	-2.6	0.8
Nominal effective exchange rate; (1990=100) end-of-period (depreciation -) 1/	0.6	3.2	-1.1	1.5	1.5	...
Real effective exchange rate; (1990=100) end-of-period (depreciation -) 1/	0.7	12.4	-1.8	3.0	-4.3	...
Banking system						
Net foreign assets 2/	-0.8	12.3	5.5	-13.9	-3.9	-0.1
Net domestic assets 2/	6.3	1.2	-1.5	25.2	11.3	10.4
Of which:						
Credit to public sector 2/	8.5	-7.5	-2.8	14.2	8.9	5.5
Credit to private sector 2/	5.6	12.0	8.1	8.5	3.5	6.6
Broad money	5.5	13.5	4.0	11.3	7.4	10.3
Of which:						
Money	11.5	-2.1	11.2	16.1	7.0	9.7
Quasi-money	4.3	16.9	2.6	10.3	7.5	10.5
Weighted deposit interest rates (in percent per annum)	4.0	4.1	4.2	4.3	4.3	4.3
Weighted lending interest rates (in percent per annum)	10.9	11.2	11.4	11.2	11.2	11.2
Treasury bill rates (in percent per annum)	8.0	8.0	8.0	8.0	8.0	8.0
(In percent of GDP)						
Central government						
Overall central government balance	-3.9	-3.7	-6.5	-5.7	-8.6	-6.4
Total revenue and grants	30.9	30.4	30.8	31.2	29.7	31.0
Total expenditure and net lending	34.8	34.1	37.2	36.8	38.3	37.4
National income and prices						
Gross domestic investment	45.8	44.0	43.0	37.4	45.0	47.5
Gross national savings	15.4	23.0	26.5	11.3	10.5	12.6
External sector						
External current account balance	-30.5	-21.0	-16.4	-26.0	-34.4	-34.9
Trade balance	-39.6	-28.5	-30.8	-32.1	-38.7	-39.5
Net capital inflow 3/	30.2	22.5	19.3	26.9	34.4	36.5
External public debt (end-of-period)	25.4	39.6	44.0	46.6	49.4	47.0
(In percent of exports of goods and services)						
External public debt service	5.7	5.3	7.5	11.2	12.5	12.4
Interest payments	1.7	1.9	3.3	5.4	5.6	5.2
(In millions of U.S. dollars; unless otherwise specified)						
Overall balance of payments	-0.6	3.9	8.2	2.7	0.0	5.6
Net imputed reserves at the ECCB, end-of-period	37.7	41.6	49.8	52.5	52.5	58.1
In percent of broad money	22.0	21.4	24.5	23.3	21.6	21.5
In percent of base money	121.5	136.8	146.6	133.2	123.9	124.3

Sources: St. Kitts and Nevis authorities; Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ For 2000, 12-month change through June.

2/ In relation to broad money at the beginning of the period.

3/ Includes errors and omissions.

Table 2. St. Kitts and Nevis: Summary of Central Government Finances

	1996	1997	1998	1999	Proj. 2000	Proj. 2001
	(In millions of Eastern Caribbean dollars)					
Total revenue and grants	**204.7**	**225.7**	**238.4**	**252.9**	**251.9**	**290.4**
Total revenue	203.1	223.9	237.7	251.7	250.4	288.8
Current revenue	200.6	223.0	236.9	250.6	249.4	287.7
Tax revenue	143.6	164.8	175.2	183.5	184.6	205.3
Nontax revenue	57.0	58.2	61.8	67.0	64.8	82.5
Capital revenue	2.5	0.9	0.8	1.1	1.0	1.1
Grants	1.7	1.8	0.8	1.2	1.5	1.5
Total expenditure	**230.6**	**252.8**	**288.5**	**298.8**	**324.7**	**350.2**
Current expenditure	198.1	214.6	235.4	262.3	275.3	305.3
Wages and salaries	98.0	100.1	110.3	121.9	130.0	143.6
Goods and services	58.3	69.4	72.8	84.8	76.0	84.7
Interest	19.9	20.9	24.7	32.0	39.0	43.8
Transfers	21.8	24.2	27.5	23.6	30.2	33.2
Capital expenditure	32.6	38.2	53.2	36.5	49.4	44.9
Current balance	**2.5**	**8.4**	**1.6**	**-11.7**	**-25.9**	**-17.5**
Primary balance (after grants)	**-6.0**	**-6.3**	**-25.4**	**-13.9**	**-33.8**	**-16.0**
Overall balance (after grants)	**-25.9**	**-27.1**	**-50.1**	**-45.9**	**-72.8**	**-59.8**
Financing	25.9	27.1	50.1	45.9	72.8	59.8
Net foreign financing	6.0	59.8	52.1	33.4	27.3	15.5
Net domestic financing	38.9	-24.5	27.2	58.4	45.5	44.3
Of which:						
Banking system	32.7	-33.9	33.3	45.0	35.2	33.0
Residual 1/	-19.0	-8.2	-29.2	-45.9	0.0	0.0
	(In percent of GDP)					
Total revenue and grants	**30.9**	**30.4**	**30.8**	**31.2**	**29.7**	**31.0**
Total revenue	30.6	30.2	30.7	31.0	29.5	30.9
Current revenue	30.2	30.0	30.6	30.9	29.4	30.8
Tax revenue	21.6	22.2	22.6	22.6	21.8	21.9
Nontax revenue	8.6	7.8	8.0	8.3	7.6	8.8
Capital revenue	0.4	0.1	0.1	0.1	0.1	0.1
Grants	0.3	0.2	0.1	0.2	0.2	0.2
Total expenditure	**34.8**	**34.1**	**37.2**	**36.8**	**38.3**	**37.4**
Current expenditure	29.9	28.9	30.4	32.3	32.5	32.6
Wages and salaries	14.8	13.5	14.2	15.0	15.3	15.3
Goods and services	8.8	9.3	9.4	10.4	9.0	9.1
Interest	3.0	2.8	3.2	3.9	4.6	4.7
Transfers	3.3	3.3	3.5	2.9	3.6	3.5
Capital expenditure	4.9	5.2	6.9	4.5	5.8	4.8
Current balance	**0.4**	**1.1**	**0.2**	**-1.4**	**-3.0**	**-1.9**
Primary balance (after grants)	**-0.9**	**-0.8**	**-3.3**	**-1.7**	**-4.0**	**-1.7**
Overall balance (after grants)	**-3.9**	**-3.7**	**-6.5**	**-5.7**	**-8.6**	**-6.4**
Financing	3.9	3.7	6.5	5.7	8.6	6.4
Net foreign financing	0.9	8.1	6.7	4.1	3.2	1.7
Net domestic financing	5.9	-3.3	3.5	7.2	5.4	4.7
Of which:						
Banking system	4.9	-4.6	4.3	5.5	4.2	3.5
Residual 1/	-2.9	-1.1	-3.8	-5.7	0.0	0.0

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

1/ Unidentified difference between the overall balance and financing. Because of the government's accounting methods, the mission was unable to construct a precise measure of central government financing, using Government Finance Statistics (GFS) methodology. The discrepancy could be indicative of an overstatement of revenues or financing, or an understatement of spending. It has arbitrarily been classified under financing. The authorities are working on presenting the accounts using GFS methodology.

Table 3. St. Kitts and Nevis: Summary Accounts of the Banking System

	As of December 31				Proj.	
	1996	1997	1998	1999	2000	2001
(In millions of Eastern Caribbean dollars)						
Net foreign assets	**97.9**	**154.6**	**183.2**	**107.3**	**83.9**	**83.5**
ECCB imputed reserves	88.2	97.3	126.3	133.6	133.6	148.6
Crown agents	13.7	14.6	7.7	7.8	7.8	7.8
Commercial banks	-4.0	42.7	49.2	-34.1	-57.5	-72.9
Net domestic assets	**364.7**	**370.5**	**362.7**	**500.0**	**568.4**	**636.3**
Net credit to the public sector	22.2	-12.6	-27.2	50.5	104.7	140.7
Net credit to central government	113.1	79.1	112.5	157.6	192.8	225.8
Net credit to St. Kitts	106.9	74.3	107.1	140.8	165.4	188.4
Net credit to Nevis	6.2	4.8	5.4	16.8	27.4	37.3
Net credit to other public sector	-90.8	-91.7	-139.8	-107.0	-88.0	-85.0
Net credit to social security	-181.7	-188.5	-216.3	-247.6	-282.6	-315.6
Net credit to public enterprises	90.8	96.8	76.6	140.6	194.6	230.6
Net credit to nonbank financial institutions	-4.7	-4.0	0.2	-3.5	-3.8	-4.2
Credit to the private sector	465.6	521.1	563.7	610.2	631.7	674.7
Net other assets 1/	-118.4	-133.9	-173.9	-157.1	-164.3	-175.0
Broad money	**462.6**	**525.0**	**545.9**	**607.4**	**652.3**	**719.8**
Money	83.9	82.2	91.4	106.1	113.5	124.5
Currency in circulation	32.4	31.9	35.8	41.5	44.2	48.3
Demand deposits	51.5	50.3	55.6	64.6	69.3	76.2
Quasi-money	378.7	442.9	454.5	501.3	538.8	595.2
Savings deposits	217.9	228.8	239.6	267.0	287.7	318.5
Time deposits	76.5	93.3	110.8	115.3	121.2	132.7
Foreign currency deposits	84.3	120.8	104.1	119.0	129.9	144.1
(Percentage change in terms of broad money at beginning of period)						
Net foreign assets	**-0.8**	**12.3**	**5.5**	**-13.9**	**-3.9**	**-0.1**
Net domestic assets	**6.3**	**1.2**	**-1.5**	**25.2**	**11.3**	**10.4**
Net credit to the public sector	8.5	-7.5	-2.8	14.2	8.9	5.5
Net credit to central government	7.5	-7.3	6.4	8.2	5.8	5.1
Net credit to other public sector	1.1	-0.2	-9.1	6.0	3.1	0.5
Net credit to nonbank financial institutions	0.4	0.1	0.8	-0.7	0.0	-0.1
Credit to the private sector	5.6	12.0	8.1	8.5	3.5	6.6
Net other assets 1/	-8.3	-3.4	-7.6	3.1	-1.2	-1.6
(Percentage change; unless otherwise specified)						
Broad money	**5.5**	**13.5**	**4.0**	**11.3**	**7.4**	**10.3**
Money	11.5	-2.1	11.2	16.1	7.0	9.7
Currency in circulation	6.9	-1.6	12.5	15.7	6.5	9.4
Demand deposits	14.5	-2.4	10.4	16.3	7.3	9.9
Quasi-money	4.3	16.9	2.6	10.3	7.5	10.5
Savings deposits	5.4	5.0	4.7	11.4	7.8	10.7
Time deposits	-2.9	22.0	18.7	4.1	5.1	9.5
Credit to the private sector (in real terms)	**3.5**	**0.6**	**7.2**	**6.3**	**1.5**	**3.5**
Memorandum items						
Income velocity of money	7.9	9.0	8.5	7.7	7.5	7.5
Income velocity of broad money	1.4	1.4	1.4	1.3	1.3	1.3
Private sector credit/GDP (in percent)	70.2	70.2	72.7	75.2	74.5	72.1
Foreign currency deposits/GDP (in percent)	12.7	16.3	13.4	14.7	15.3	15.4
Broad money/GDP (in percent)	69.7	70.7	70.4	74.8	76.9	76.9
Weighted deposit interest rates (in percent per annum)	4.0	4.1	4.2	4.3	4.3	4.3
Weighted lending interest rates (in percent per annum)	10.9	11.2	11.4	11.2	11.2	11.2

Sources: Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ Includes subsidiaries and affiliates and capital accounts.

Table 4. St Kitts and Nevis: Summary Balance of Payments

	1996	1997	1998	Est. 1999	Proj. 2000	Proj. 2001
(In millions of Eastern Caribbean dollars)						
Exports, f.o.b.	93.1	138.7	132.1	129.2	143.3	170.0
Imports, f.o.b.	-356.2	-350.3	-371.1	-389.6	-471.8	-540.0
Trade balance	**-263.1**	**-211.6**	**-239.0**	**-260.4**	**-328.5**	**-370.0**
Services net	**71.0**	**80.3**	**113.5**	**85.4**	**96.0**	**135.0**
Services, receipts	236.3	255.9	284.6	262.8	298.0	350.0
Services, payments	-165.3	-175.6	-171.1	-177.4	-202.0	-215.0
Factor income (net)	**-56.4**	**-67.7**	**-84.0**	**-84.0**	**-105.0**	**-140.0**
Transfers (net)	**46.5**	**42.9**	**82.2**	**47.7**	**45.4**	**48.9**
Official (net)	-2.1	-2.9	-0.1	-2.5	-4.8	-4.8
Private (net)	48.5	45.8	82.4	50.2	50.2	53.7
Current account balance	**-202.1**	**-156.2**	**-127.3**	**-211.2**	**-292.1**	**-326.1**
Capital and financial account balance	**138.4**	**143.31**	**143.66**	**317.6**	**292.1**	**341.1**
Official	**23.9**	**130.1**	**55.0**	**48.8**	**45.3**	**25.2**
Capital transfers (net)	9.2	3.2	3.9	14.1	5.0	4.4
Long-term borrowing (net)	14.7	126.9	51.1	34.7	40.3	20.8
Private capital	**114.4**	**13.2**	**88.6**	**268.9**	**246.8**	**315.9**
Capital transfers (net)	5.5	6.9	9.3	7.1	7.1	7.1
Direct investment (net)	94.8	53.1	90.7	208.6	237.0	287.8
Portfolio investment (net)	21.7	0.0	0.0	0.0	0.0	0.0
Short-term capital (net)	-7.5	-46.8	-6.5	83.3	23.4	15.4
Commercial banks	1.8	-46.8	-6.5	83.3	23.4	15.4
Other	-9.3	0.0	0.0	0.0	0.0	0.0
Other private	0.0	-5.7	-5.0	-30.2	0.0	5.6
Errors and omissions	**62.0**	**23.4**	**5.7**	**-99.0**	**0.0**	**0.0**
Overall balance	**-1.7**	**10.5**	**22.1**	**7.4**	**0.0**	**15.0**
Stock of official reserves (end of period) 1/	**101.9**	**112.4**	**134.0**	**141.3**	**141.3**	**156.3**
(In percent of GDP)						
Exports, f.o.b.	14.0	18.7	17.0	15.9	16.9	18.2
Imports, f.o.b.	-53.7	-47.2	-47.9	-48.0	-55.6	-57.7
Trade balance	**-39.6**	**-28.5**	**-30.8**	**-32.1**	**-38.7**	**-39.7**
Services (net)	**10.7**	**10.8**	**14.6**	**10.5**	**11.3**	**14.5**
Factor income (net)	**-8.5**	**-9.1**	**-10.8**	**-10.3**	**-12.4**	**-15.0**
Transfers (net)	**7.0**	**5.8**	**10.6**	**5.9**	**5.4**	**5.2**
Current account balance	**-30.5**	**-21.0**	**-16.4**	**-26.0**	**-34.4**	**-35.0**
Capital and financial account balance	**20.9**	**19.3**	**18.5**	**39.1**	**34.4**	**36.6**
Errors and omissions	**9.3**	**3.2**	**0.7**	**-12.2**	**0.0**	**0.0**
Overall balance	**-0.3**	**1.4**	**2.8**	**0.9**	**0.0**	**1.6**
Stock of international reserves (end of period)						
Ratio to broad money (in percent)	22.0	21.4	24.5	23.3	21.6	21.5
Ratio to base money (in percent)	121.5	136.8	146.6	133.2	123.9	124.3
External public debt service						
Ratio to exports of goods and services (in percent)	5.7	5.3	7.5	11.2	12.5	12.4
Of which:						
Interest (in percent)	1.7	1.9	3.3	5.4	5.6	5.2

Sources: Eastern Caribbean Central Bank; and Fund staff estimates and projections.

1/ Imputed reserves at the ECCB plus balances held with the Crown Agents.

Table 5. St Kitts and Nevis: Summary Projections of Medium-Term Economic Indicators 1/

	2000	2001	2002	2003	2004	2005	Average 2000-05
	(Annual percentage change)						
National accounts and prices							
Real GDP growth	3.8	6.2	5.5	4.9	4.4	4.2	4.8
Inflation 2/	2.0	3.2	3.1	3.0	2.8	2.5	2.8
External terms of trade	-0.9	1.0	0.2	0.0	0.0	0.0	0.1
	(In percent of GDP)						
Gross national investment	45.0	47.5	45.0	43.5	42.5	42.5	44.3
Of which:							
Central government	5.8	4.8	4.7	4.7	4.6	4.6	4.9
Gross national savings	10.5	12.6	13.8	15.5	17.6	20.6	15.1
Of which :							
Central government	-3.0	-1.9	-0.4	0.9	1.2	1.5	-0.3
Public finances							
Central government							
Revenue 3/	29.7	31.0	32.3	33.6	34.0	34.3	32.5
Expenditure	38.3	37.4	37.1	37.1	37.1	37.2	37.4
Of which:							
Capital and net lending	5.8	4.8	4.7	4.7	4.6	4.6	4.9
Current balance	-3.0	-1.9	-0.4	0.9	1.2	1.5	-0.3
Overall balance	-8.6	-6.4	-4.8	-3.5	-3.1	-2.8	-4.9
	(In millions of U.S. dollars)						
External sector							
Current account	-108.2	-120.8	-118.2	-115.0	-110.2	-104.1	-112.8
Capital account	108.2	126.3	124.1	121.7	117.6	111.9	118.3
Of which :							
Direct investment	80.1	106.6	107.8	105.6	106.2	100.0	101.1
Overall balance	0.0	5.6	5.9	6.7	7.4	7.8	5.6
Net imputed international reserves (end of period)	52.3	57.9	63.9	70.5	77.9	85.7	68.0
	(In percent of GDP; unless otherwise specified)						
Current account	-34.4	-34.9	-31.2	-28.0	-24.9	-21.9	-29.2
Overall balance	0.0	1.6	1.6	1.6	1.7	1.6	1.4
External debt service ratio 4/	12.5	12.4	12.5	14.0	14.7	14.9	13.5
External debt (end of period)	49.4	47.0	44.1	41.5	38.9	37.6	43.1
Memorandum item:							
LIBOR (6 months; in percent per annum)	6.8	7.1	7.1	7.1	7.1	7.1	7.0

Sources: St. Kitts and Nevis authorities; and Fund staff estimates and projections.

1/ The medium-term projections are based on the authorities' current policies and on relevant WEO assumptions for the external sector.

2/ Retail price index (end period).

3/ Includes grants.

4/ In percent of exports of goods and services.

St. Kitts and Nevis—Relations with the Fund
(As of August 31, 2000)

I. Membership Status: Joined: 08/15/84; Article VIII.

II. General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	8.90	100.0
Fund holdings of currency	10.44	117.4
Reserve position in the Fund	0.08	0.9

III. SDR Department:	**SDR Million**	**Percent of Allocation**
Holdings	0.00	N/A

IV. Outstanding Purchases and Loans:	**SDR Million**	**Percent of Quota**
First credit tranche:	1.63	18.3

V. Financial Arrangements: None

VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Overdue	**Forthcoming**			
	7/31/2000	**2001**	**2002**	**2003**	**2004**
Principal		0.0	0.8	0.8	0.0
Charges/Interest		0.1	0.1	0.0	0.0
Total		**0.1**	**0.9**	**0.8**	**0.0**

VII. Exchange Arrangement:

St. Kitts and Nevis is a member of the Eastern Caribbean Central Bank (ECCB), which manages monetary policy and the exchange system for its eight members. The common currency, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar since July 1976. The ECCB in practice has operated like a quasi-currency board, maintaining foreign exchange backing of its currency and demand liabilities of close to 100 percent.

St. Kitts and Nevis accepted the obligations of Article VIII, Sections 2, 3, and 4 in December 1984. There are no restrictions on the making of payments and transfers for current international transactions. There are exchange controls on payments for invisibles (i.e., indicative limit on travel allowances), but all bona fide transactions are approved.

VIII. Last Article IV Consultation and Recent Contacts:

The last Article IV consultation was concluded by the Executive Board on June 18, 1997; St. Kitts and Nevis has been on a 24-month consultation cycle. The staff documents were SM/97/135 and SM/97/140. Since that time, an interim staff visit took place in May 1998 and staff visits in connection with the use of Fund resources (EBS/98/217) took place in November 1998 and May 1999.

IX. Technical Assistance:

FAD: In 1996, a mission advised St. Kitts and Nevis on tax policy.

LEG: In 1996, a mission advised St. Kitts and Nevis on drafting changes to income tax laws.

St. Kitts and Nevis: Relations with the World Bank Group

(As of August 31, 2000)

I. Projects

St. Kitts and Nevis is a participant in the World Bank supported OECS Solid Waste/Ship-generated Waste Management Projects which were approved in FY95. The objective of these operations 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 total regional financing for these projects is US$41 million. The St. Kitts and Nevis component is US$5.4 million—US$2.1 million from the World Bank, US$1.3 million from the Caribbean Development Bank, and US$1.9 million from the Global Environment Facility.

In FY98, the World Bank approved US$6 million for an OECS Telecommunications Reform Project. St. Kitts and Nevis share of this project is US$1.2 million. The objective 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 OECS Emergency Recovery and Disaster Management Program, the first phase of which totals US$19.5 million, was approved by the World Bank in FY99. The first phase of this program included three OECS countries (Dominica, St. Kitts and Nevis, and St. Lucia). The program aims to support the physical and institutional efforts of the participating countries for disaster recovery and emergency preparedness and management. The St. Kitts and Nevis project totaling US$8.5 million included a fast disbursing component (US$2.5 million) to assist St. Kitts and Nevis with reconstruction following Hurricane Georges. The St. Kitts and Nevis project was declared effective on April 22, 1999.

The lending program for the next 18 months includes a share of a regional CARICOM HIV/AIDS program (US$45–50 million) and a share of the sub-regional OECS Education Program (US$16–20 million).

II. Financial Relations

(As of August 31, 2000)

(In millions of U.S. dollars)

Operations	**Principal**	**Disbursed**	**Undisbursed**
OECS waste management	2.13	0.20	1.93
OECS telecommunications	1.20	0.12	1.08
OECS emergency recovery	8.50	2.89	5.61

Gross Disbursements and Debt Service During Fiscal Year

	Actual						Projections		
	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total disbursements	0.1	0.8	0.0	0.0	0.1	0.2	2.9	0.0	2.8
Repayments	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.0	0.1
Net disbursements	0.1	0.8	0.0	-0.1	0.0	0.1	2.8	0.0	2.7
Canceled	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest and fees	0.0	0.0	0.1	0.1	0.2	0.2	0.2	0.0	0.2

III. Economic and Sector Work

The most recent OECS Country Assistance Strategy dates from April 10, 1995. The World Bank is currently working on a new CAS, which is expected to be presented to the Board in FY2002. In addition, the World Bank is working on an institutional review of Eastern Caribbean States to identify areas where it is politically and technically feasible to develop cross-country agreements that reduce the unit costs of public services.

The Medium-Term Economic Strategy Paper for the period 2000–02 was prepared by the Government of St. Kitts and Nevis in cooperation with the World Bank and the Caribbean Development Bank and was distributed and presented at the June 2000 meeting of the Caribbean Group for Cooperation in Economic Development (CGCED).

St. Kitts and Nevis: Relations with the Caribbean Development Bank 1/
(As of June 30, 2000)

(In millions of U.S. dollars)

	1995	1996	1997	1998	1999	Jan-June 2000
Cumulative total credit approved	51.6	67.6	76.0	79.9	86.9	90.5
Cumulative disbursements 2/	31.1	33.9	39.6	45.9	54.3	55.9
Disbursements 3/	3.2	2.9	5.4	4.5	8.9	2.2
Ordinary capital resources	1.2	1.3	1.7	2.7	4.2	1.1
Special development fund	1.3	1.0	3.7	1.7	4.3	1.0
Other special fund resources	0.7	0.6	0.0	0.1	0.4	0.1
Amortization 3/	1.0	1.3	1.3	1.2	1.9	0.5
Ordinary capital resources	0.1	0.1	0.2	0.2	0.5	0.1
Special development fund	0.7	1.0	0.8	0.7	1.1	0.3
Other special fund resources	0.2	0.2	0.3	0.3	0.3	0.1
Outstanding debt 2/	23.1	24.6	29.1	33.2	40.2	41.3
Interest and commitment fees 3/	0.8	0.9	1.0	0.9	1.3	0.5
Ordinary capital resources	0.3	0.3	0.5	0.5	0.8	0.3
Special development fund	0.4	0.5	0.4	0.3	0.5	0.2
Other special fund resources	0.1	0.1	0.1	0.1	0.0	0.0

Source: Caribbean Development Bank.

1/ The CDB provides funds to St. Kitts and Nevis mainly for infrastructure projects, such as road construction. Generally speaking, these projects are being implemented on schedule.
2/ Excluding valuation effects of exchange rate variations.
3/ Ordinary capital resources are hard loans, and special development fund resources are soft loans.

ST. KITTS AND NEVIS: STATISTICAL ISSUES

1. Real sector

There are a number of deficiencies in the real sector statistics. First, data on GDP are not available quarterly and are produced with a long lag. Second, data on GDP broken down by expenditure are not available at constant prices, while the expenditure data at current prices are not reliable. Regarding prices, the government publishes the consumer price index monthly, and provides it to Fund staff on request. The base year for the CPI is outdated (1978), but the government has made efforts to update it and plans to begin publishing the revised index soon. No data are currently available on labor market developments (unemployment rates and wage developments).

2. Public finances

Data on revenue, expenditure, and financing of the consolidated central government accounts (St. Kitts and Nevis) are made available to Fund staff on request. Preliminary data for 1994 were last reported for publication in the GFS yearbook. There are a number of technical problems that need to be addressed, including a discrepancy between the overall balance (the difference between revenues and expenditures) and available financing. The mission explored a number of possible explanations for this discrepancy, including differences in classification, especially expenditures, and an inability to separate central government financing transactions from those of other entities. The authorities could benefit from technical assistance in devising a set of fully integrated accounts for the central government that are produced on a regular basis. Also, it would be helpful if the authorities instituted regular reporting of public enterprise financial data, including the National Housing Corporation.

3. Balance of payments and external debt

Data on the balance of payments are only available with long lags. Data on external trade (especially exports) are not comprehensive, as they omit important categories of goods. Certain components of the data on capital flows also need improvement, including portfolio flows. It would be useful to integrate the data on the public sector investment plan for external loans with the external debt database compiled by the ECCB.

St.Kitts and Nevis: Core Statistical Indicators

As of August 31, 2000

	Exchange Rates 1/	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	External Current Account Balance	Overall Government Balance	GDP/GNP	External Debt and Debt Service
Date of Latest Observation	n.a	June 2000	June 2000	June 2000	June 2000	June 2000	June 2000	1999	1999	June 2000	1999	1999
Date Received	n.a	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000	July 2000
Frequency of Data	n.a	Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Annual	Quarterly	Annual	Annual
Frequency of Reporting	n.a	On request	On request	On request	On request	On request	On request	On request	On request	On request	On request	On request
Source of Update	n.a	ECCB 2/	ECCB	ECCB	ECCB	ECCB	Ministry of Finance	ECCB	ECCB	Ministry of Finance	Ministry of Finance	Ministry of Finance
Mode of Reporting	n.a	Mail	Mail	Mail	Mail	Mail	Mail	Mail	Mail	Mail	Mail	Mail
Confidentiality	n.a	Unre-Stricted	Unre-stricted	Unre-stricted	Unre-stricted	Unre-stricted	Unre-Stricted	Unre-stricted	Unre-stricted	Unre-stricted	Unre-stricted	Unre-stricted
Frequency of Publication	n.a	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and monthly	Annual	Annual	Annual	Annual	Annual and semi-annual

1/ St Kitts and Nevis is a member of the Eastern Caribbean Monetary Union, in which the common currency of all member states (EC dollar) has been pegged to the U.S. dollar at US$1=EC$2.70 since July 1976.

2/ Eastern Caribbean Central Bank.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/104
FOR IMMEDIATE RELEASE
December 4, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with St. Kitts and Nevis

On October 23, 2000, the Executive Board concluded the Article IV consultation with St. Kitts and Nevis.[1]

Background

St. Kitts and Nevis is a small, open economy that is heavily dependent on tourism and other services, and some light manufacturing. In recent years, the economy has greatly reduced its dependence on its traditional base of sugar production. After a period of rapid growth in the early to mid 1990s, economic growth in St. Kitts and Nevis slowed in recent years, mainly as a result of hurricanes in 1998−99 that inflicted severe damage to infrastructure. Growth is beginning to rebound, led by recovery in construction, tourism, and manufacturing. The exchange rate peg to the U.S. dollar and strict limits on central government borrowing from the regional central bank, the Eastern Caribbean Central Bank, have helped maintain inflation at low levels, averaging below 2 percent in recent years.

The central government's deficit rose gradually in the early to mid 1990s, reflecting a large across-the-board rise in spending, only partly offset by revenue improvements. Reflecting the effects of Hurricane Georges, the deficit nearly doubled to 6½ percent of GDP in 1998. Higher current spending late in the year reflected a substantial increase in relief and reconstruction activities. The deficit narrowed to about 5¾ percent of GDP in 1999, mainly reflecting capital expenditure restraint, but again widened sharply in the first half of 2000.

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[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.

Although the social security system has recently recorded surpluses of about 4¾ percent of GDP a year, the main public enterprise—the St. Kitts Sugar Manufacturing Corporation—continues to generate losses (reaching about 3½ percent of GDP a year), which are mainly being financed by the government-owned National Bank.

Despite the effects of Hurricane Georges, the external current account deficit narrowed to 16½ percent of GDP in 1998 from 21 percent of GDP in 1997, owing mainly to strong tourism receipts before the hurricane hit and an increase in insurance transfers following the hurricane. Large foreign direct investments in the hotel sector led to a balance of payments surplus of 2¾ percent of GDP in 1998. The current account deficit rose sharply to 26 percent of GDP in 1999, as a result of a deterioration in tourism receipts and sugar exports, and higher imports associated with post-hurricane reconstruction. However, continuing strong direct foreign investment led to an overall balance of payments surplus of 1 percent of GDP. As a consequence of higher public sector deficits, partly reflecting large air and sea port investment projects, external public debt almost doubled from end-1995 to end-1999, with external debt service rising from about 5¼ percent of exports of goods and services in 1995 to 11¼ percent in 1999.

Offshore financial services have been a growing sector, especially in Nevis. The laws provide for a high degree of confidentiality and for income tax exemption. St. Kitts and Nevis has been concerned about strengthening the supervision of the offshore financial service sector, and the recent international initiatives against weak regulatory and supervisory practices in offshore financial centers have given further impetus to the authorities' efforts.

The government has committed itself to developing the tourist industry as the linchpin of the economy in the future, with some diversification into light manufacturing, offshore financial services, and other services. Ongoing investments in the hotel industry in 2000 should spearhead a pick-up in economic activity, with real GDP growth projected at 3¾ percent. Inflation is likely to remain low.

The recent modest economic upturn has been accompanied by a further worsening of the fiscal situation. The authorities have recently taken strong measures to contain expenditures, including freezing civil service employment. Recent revenue measures include an increase in electricity and water tariffs, and a substantial increase in regulated retail gasoline prices. With these measures, the central government deficit is projected to be contained to 8½ percent of GDP in 2000.

The government is currently deciding on the future of the sugar industry and a course of action to stem the industry's losses. The National Bank has been given a mortgage on government-owned sugar land to protect the interests of the bank's depositors (including the social security fund).

The external current account deficit is projected to increase to about 34½ percent of GDP in 2000, as a result of higher imports associated with large investments in the hotel sector. Growth in service exports will begin to pick-up toward the end of the year. Buoyed by large direct investments in hotels, the capital account surplus is projected to lead to a small overall balance of payments surplus. St. Kitts and Nevis's imputed reserves with the ECCB have grown consistently since 1997. Nevertheless, competitiveness remains a key concern for this service-based economy.

Executive Board Assessment

They noted that in recent years hurricanes have severely damaged infrastructure and adversely affected tourism. Also, the sugar sector is in decline and recording heavy losses. Largely reflecting these factors, growth has weakened and the public sector's deficit and its level of indebtedness have risen substantially in relation to GDP. Directors stressed the importance of forestalling the threat of adverse debt dynamics in which rising debt and interest payments would increasingly strain the budget and hold back growth. Against this background, they welcomed the measures taken by the authorities to improve the fiscal position and to make the economy more resilient to exogenous shocks. Directors saw as the main challenge in the period ahead the need to build on what has already been done to create a diverse, competitive, and financially stable economy.

Directors commended the authorities' plans to reduce the public sector deficit progressively and substantially through a combination of revenue and expenditure measures, thereby reversing the undesirably rapid growth in public debt in recent years. They welcomed the fiscal measures taken in 2000, including price increases for gasoline, water and electricity tariffs. They emphasized the need to curtail public spending, and urged the authorities to proceed with civil service reform and to exercise restraint in granting wage increases. They also emphasized the need to broaden the tax base, while taking account of local conditions.

Directors noted the bleak prospects for the sugar industry, which has become a significant drain on the budget, and absorbs a substantial share of bank credit. They encouraged the authorities, in their pursuit of a lasting and generally acceptable solution, to explore all possibilities, including reallocation of land and labor now absorbed by sugar production to other uses while ensuring adequate social protection for those affected. Directors supported efforts to develop alternative employment opportunities in other types of agriculture and in tourism, although a few Directors advised against over-dependence on the latter.

Directors noted that the stability of the domestic banking system had, over time, supported growth of the economy. They also took note of the possible impact on the banking system arising from the problems of the sugar sector, and urged that any arrangements adopted to address these problems be fully transparent. In addition, Directors called for greater supervision of commercial banks' investments in real estate.

Directors noted the rapid growth of the offshore financial sector. They stressed that the authorities must step up efforts to enhance supervision, combat money laundering, and investigate financial crimes, and urged them to adopt a regulatory and supervisory framework for the offshore financial sector that meets international best practices. Directors welcomed the start that the authorities have made in addressing these issues, including their request for an FSAP-type assessment of financial sector vulnerabilities. They encouraged the provision of appropriate Fund technical assistance in this area.

Directors considered that the exchange rate system operated by the Eastern Caribbean Central Bank has served the country well in maintaining macroeconomic stability and low inflation. To preserve competitiveness and promote the needed diversification of the economy, Directors saw determined pursuit of structural reform measures as essential. These measures should include training and other means to raise productivity, as well as steps to increase flexibility in labor and product markets. Directors encouraged the authorities to harmonize the tariff structure with the common external tariff of the CARICOM area and to eliminate quantitative import restrictions.

Directors emphasized the importance of strengthening the statistical base, including labor statistics, to permit a fuller assessment of economic developments. They suggested that the authorities seek Fund technical assistance to address these data deficiencies.

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.

St. Kitts and Nevis: Selected Economic Indicators

(Annual percentage change; unless otherwise indicated)

	1996	1997	1998	1999
Real sector				
Nominal GDP	6.6	11.9	4.4	4.7
Real GDP	5.9	7.3	1.0	2.8
Consumer price index 1/	3.1	11.3	0.9	1.8
Unemployment rate	n.a.	n.a.	n.a	n.a.
Central government finances 2/				
Revenue and grants	30.9	30.4	30.8	31.2
Expenditure	34.8	34.1	37.2	36.8
Current	29.9	28.9	30.4	32.3
Capital	4.9	5.2	6.9	4.5
Current account balance	0.4	1.1	0.2	-1.4
Overall balance	-3.9	-3.7	-6.5	-5.7
Money and interest rate				
Net domestic assets of the banking system 3/	6.3	1.2	-1.5	25.2
Public sector	8.5	-7.5	-2.8	14.2
Private sector	5.6	12.0	8.1	8.5
Broad money 3/	5.5	13.5	4.0	11.3
Average lending rate (percent per year)	10.9	11.2	11.4	11.2
External sector				
Current account balance 2/	-30.5	-21.0	-16.4	-26.0
Public external debt 2/	25.4	39.6	44.0	46.6
Public external debt service ratio (in percent of exports of goods and services	5.7	5.3	7.5	11.2
Real effective exchange rate (depreciation -)	0.7	12.9	-1.8	3.0

Sources: St. Kitts and Nevis authorities; and IMF staff estimates.

1/ End of period.

2/ In percent of GDP.

3/ Annual change in percent of initial stock of broad money.

Statement by Thomas A. Bernes, Executive Director for St. Kitts and Nevis
October 23, 2000

My authorities in St. Kitts and Nevis are generally in agreement with the broad findings of the staff report and would like to express their appreciation to the staff for their valuable advice and frank discussions, as usual, during the Article IV consultation. In this regard, my authorities have taken a decision to publish the staff report and have requested a reduction in consultation cycle from 24 months to 12 months.

My authorities are well aware of the need to bring the fiscal deficit down to acceptable and sustainable levels. It must be emphasized that emergency conditions arising from vulnerabilities to hurricanes are the root cause of the high fiscal deficit at this time. They have been taking steps to contain the fiscal deficit and develop alternatives to the sugar industry. However, these efforts have been greatly hindered by the devastation of the hurricanes, which has damaged coastal facilities and hindered the recovery of tourism and agriculture. Nevertheless, they have embarked on a stringent three-year program of restraint which should contain the deficit to 8 percent of GDP in 2000 and reduce it to 3 percent by 2003. Notably, tariffs on electricity, water and gasoline have recently been significantly increased, and alternative strategies to broaden the tax base are being studied. Further moves in this direction will require a strengthening of administrative capacity through technical assistance.

It does not appear prudent to work toward a three-year time frame for achievement of a balanced budget by 2003 as suggested by the staff report. We have noted a sharp rise in unemployment arising out of the decline in the sugar industry and the extensive damage of successive hurricanes. Thus, my authorities are understandably hesitant to introduce measures which would drastically reduce the level of public sector employment and further weaken the social safety net at this time. They plan, however, to review the long term solvency of the social security system at the time of the next actuarial review. My authorities are also conscious of the need to minimize the impact of the weakening of the sugar industry on both the public sector and the St. Kitts-Nevis-Anguilla National Bank Ltd. They have engaged in public discussion on the issue and are studying alternative proposals to improve the situation. Thus, they remain committed to sustained efforts to strengthen the public finances.

Apart from ongoing efforts to reduce the fiscal deficit, my authorities continue to focus their efforts on measures to enhance economic growth, improve the technical capacity of the labour force and improve the competitiveness of the economy. It was recognized that the competitiveness of agriculture was declining owing to high costs at a time when preferential arrangements for sugar exports were being displaced. Thus, my authorities made attempts to diversify the economy through efforts to improve the capacity to produce tourism and other services. Sugar production and related processing activities now account for just

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2 percent of GDP and 7 percent of exports. We are heartened by the rise in hotel investment, which we expect to lead to a doubling of room capacity in 2001 from its level in 1999. This should contribute to higher growth of real GDP averaging 5 percent over the medium term. This development reflects the continued high level of local and foreign private sector confidence in the economy, facilitated by the environment of price and exchange rate stability underpinned by strict controls on fiscal accommodation by the regional Eastern Caribbean Central Bank (ECCB).

My authorities are conscious of the need to reduce the level of external public debt. The debt arises mainly from large air and sea port investment projects between 1995 and 2000 to facilitate international transportation for the tourism sector. In addition, there have been substantial investments to facilitate construction of educational and health care facilities. These investments, over a relatively short period of time, have led to a bunching of the debt. However, it is estimated that in the medium term, the debt burden will gradually be reduced to more sustainable levels i.e., from 49.4 percent in 2000 to 37.6 percent in 2005.

With regard to the financial services sector, my authorities recognize the importance of adequate regulation and monitoring and are taking steps to strengthen both onshore and offshore supervision. They intend to entrust to the ECCB the supervision of offshore financial institutions and generally strengthen the systems for monitoring suspicious transactions. They are also extending legislation with respect to money laundering to cover areas other than drug trafficking and are reviewing other aspects of financial services legislation (companies, trusts, confidentiality etc.) in the context of strengthening disclosure requirements.

These plans will necessitate some strengthening of technical capacity. Even before the unfortunate decision by certain agencies to publish lists which name and shame, the ECCB requested an FSAP type mission to assess financial sector vulnerabilities in the sub-region. In this context, the IMF recently had a very productive outreach meeting in St. Kitts where they presented three alternative models of technical assistance and made progress towards the determination of a priority schedule for such assistance. My authorities are looking forward to a very constructive dialogue with the Fund as it prioritises its work in the Caribbean in the context of assessing financial sector vulnerabilities.

Finally, on behalf of my St. Kitts and Nevis authorities, I would like to express my sincere thanks to the staff, management and the Board of the IMF for their support of our economic recovery program during this trying period.