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December 21, 1984

To: Members of the Executive Board

From: The Secretary

Subject: St. Christopher and Nevis - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with St. Christopher and Nevis.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Yadav, ext. 7685.

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INTERNATIONAL MONETARY FUND

St. Christopher and Nevis

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the 1984
Article IV Consultation with St. Christopher and Nevis

Approved by E. Wiesner and S. Kanesa-Thasan

December 20, 1984

The first Article IV consultation discussions with St. Christopher and Nevis were held in Basseterre in the period October 13-31, 1984. The Kittitian representatives in the discussions included the Prime Minister, who is also Minister of Finance, Home Affairs and Foreign Affairs; most of the other members of the Cabinet; senior officials in the ministries; and representatives of public enterprises. The mission also met with the Governor and other senior officers of the Eastern Caribbean Central Bank (ECCB) and with representatives of commercial banks and private businesses. Mr. Pickering, the Advisor in the Office of the Executive Director for St. Christopher and Nevis, participated in the principal policy discussions. The staff team consisted of Messrs. Yadav (Head), DaCosta, Furtado (all WHD), Mr. van den Boogaerde (TRE), Mr. Hacche (CBD), and Ms. Quelch (Secretary--WHD). The mission was assisted by Mr. Gantt, the Regional Advisor. A mission consisting of staff members of the World Bank, the Caribbean Development Bank (CDB), and the Inter-Agency Resident Mission (IARM) was in Basseterre during part of the time of the Fund mission.

St. Christopher and Nevis became a Fund member on August 15, 1984, and accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement earlier this month. The authorities stated that their exchange system was free of any restrictions on payments and transfers on current international transactions (Appendix D of the Recent Economic Developments). A staff member from the Western Hemisphere Department visited the country as part of a World Bank mission in July 1983. Fund relations are described in Attachment I.

I. Background

St. Christopher and Nevis, a federal state under a parliamentary system of government, achieved independence on September 19, 1983. The constitution provides for (i) the Government of the Federation of St. Christopher and Nevis, and (ii) the Nevis Island Administration.

The islands of St. Christopher and Nevis are located in the northeastern part of the Caribbean and are separated by a strait two miles wide. Together they cover an area of 269 square kilometers and have a population of about 45,000. In 1980, the latest year for which official data are available, the labor force and employment were estimated at 17,000 and 13,400, respectively, implying an unemployment rate of some 20 percent. Per capita GDP in 1983 was estimated at about SDR 1,250. In 1983 the government-owned sugar industry accounted for one quarter of estimated employment, about 12 percent of GDP, and some 60 percent of merchandise exports. Sugar is exported mainly under quota to the preferential markets of the United States and the United Kingdom. The economic infrastructure has been improved significantly in the past five years with the completion of several major projects, including a new airport terminal, a deep-water port, and the expansion of electricity generating capacity.

St. Christopher and Nevis is a member of the ECCB, and shares a common currency, the Eastern Caribbean dollar (EC$), with six other island countries. The Eastern Caribbean dollar has been pegged to the U.S. dollar since July 1976. The financial system of St. Christopher and Nevis consists of the ECCB, six commercial banks, the government-owned Development Bank of St. Kitts and Nevis, and a few credit unions and insurance companies. Three of the commercial banks are branches of foreign banks and a fourth is 60 percent owned by the Government. Of the other two commercial banks, which are owned by the local private sector, one is mainly a savings bank and the other has been in default since mid-1981.

II. Recent Economic Developments

Real GDP growth slowed to 2 percent in 1982 from an annual average of 5 1/2 percent in 1980-81, as agriculture, tourism, and construction activity declined and value added in distributive trades and transport and communications stagnated (Table 1). In 1983, real GDP fell by 2 1/2 percent because of a prolonged drought which reduced agricultural and agro-based manufacturing output. Real GDP is projected to rise by 3 percent in 1984 reflecting a recovery in agricultural and manufacturing production, a continued increase in construction activity, and a sharp upturn in tourism.

The rate of increase in consumer prices moderated in each year of the period 1981-83, reflecting mainly a favorable trend in import prices. On the basis of preliminary indications, consumer prices are estimated to rise by about 3 percent in 1984. Information on wage trends is limited. However, a small sample of wage settlements in the private manufacturing sector suggests that annual wage increases have moderated from an average of 32 1/2 percent a year in 1980-81 to an average of about 8 percent a year in 1983-84. In the government-owned sugar industry wage increases fell from 25 percent in 1980 to about 2 percent in 1983-84. Salaries for government employees were raised by 40-50 percent in 1981; no further adjustment in these salaries has been made since that time.

Table 1. St. Christopher and Nevis: Selected Economic Indicators

	1980	1981	1982	Prel. 1983	Proj. 1984	Proj. 1985
(In millions of Eastern Caribbean dollars)						
GDP at current market prices	133.1	156.6	160.9	164.0	174.7	185.4
(Annual percentage change)						
GDP at current market prices	21.1	17.7	2.7	1.9	6.5	6.1
GDP at factor cost at 1977 prices	4.1	6.5	2.2	-2.4	3.0	3.0
Of which:						
Agriculture	(-4.0)	(0.6)	(-0.6)	(-15.1)	(5.0)	(5.0)
Manufacturing	(1.5)	(-10.4)	(9.1)	(-11.4)	(8.0)	(8.0)
Construction	(26.2)	(3.9)	(-10.0)	(8.3)	(8.0)	(8.0)
Hotels and restaurants	(-7.1)	(11.5)	(-13.8)	(--)	(15.0)	(12.0)
Distributive trades	(7.2)	(21.6)	(--)	(7.8)	(2.0)	(2.0)
Transport and communications	(9.5)	(34.8)	(1.1)	(2.1)	(2.0)	(2.0)
Implicit GDP deflator at factor cost	13.4	12.3	8.2	2.5	3.0	3.0
Consumer price index	17.8	10.4	5.9	2.3	2.8	3.0
Sugar export price	48.7	10.7	-26.5	6.1	4.7	-3.8

Sources: Statistical Office, Planning Unit; and Fund staff estimates.

The overall deficit of the nonfinancial public sector narrowed from 13 1/2 percent of GDP in 1980 to 5 percent of GDP in 1983, reflecting in large part a sharp reduction in capital spending following the completion of major infrastructural projects (Table 2). At the same time, there was a shift in the current balance from a surplus of 5 1/2 percent of GDP in 1980 to a deficit of 3 1/2 percent of GDP in 1983, as current revenue weakened and current expenditure (particularly personal emoluments) rose. Revenue was affected adversely by the elimination of the personal income tax in May 1980, a rise in tax arrears and a large decline in sugar prices in 1982 that has been only partially reversed. The overall deficit in 1980 was financed largely from external sources, but in 1981-83 domestic borrowing was the principal source of financing. The Government and the sugar industry have borrowed substantially from

Table 2. St. Christopher and Nevis: Consolidated Operations of the Public Sector 1/

	1980	1981	1982	Prel. 1983	Projected 1984	1985
(In millions of Eastern Caribbean dollars)						
Revenue and grants	70.8	68.6	64.6	69.0	68.0	84.5
Current revenue	56.8	62.8	57.1	58.5	61.3	65.9
Government	(50.9)	(55.1)	(49.0)	(49.4)	(51.9)	(55.1)
Surplus of Social Security Scheme	(5.9)	(7.7)	(8.1)	(9.1)	(9.4)	(10.8)
Capital receipts 2/	1.0	1.4	1.5	3.3	3.0	3.2
Foreign grants	13.0	4.4	6.0	7.2	3.7	15.4
Total expenditure	88.5	81.6	74.1	76.9	73.9	94.1
Current expenditure	49.6	63.1	61.6	64.4	63.0	64.0
Government	(44.9)	(56.8)	(58.5)	(58.0)	(60.8)	(62.0)
Current deficit of nonfinancial public enterprises	(4.7)	(6.3)	(3.1)	(6.4)	(2.2)	(2.0)
Capital expenditure	38.9	18.5	12.5	12.5	10.9	30.1
Current balance	7.2	-0.3	-4.5	-5.9	-1.7	1.9
Overall balance	-17.7	-13.0	-9.5	-7.9	-5.9	-9.6
Financing	17.7	13.0	9.5	7.9	5.9	9.6
Net external borrowing 3/	10.0	3.9	1.0	2.8	5.8	6.1
Net ECCB borrowing	--	--	2.6	0.5	--	--
Net change in foreign assets	4.5	-0.2	1.8	-0.2	-0.5	--
Net domestic borrowing	3.2	9.3	4.1	4.8	0.6	--
Bank	(3.0)	(11.8)	(2.8)	(2.9)	(2.5)	(--)
Nonbank 4/	(0.2)	(-2.5)	(1.3)	(1.9)	(-1.9)	(--)
Financing gap	--	--	--	--	--	3.5
(In percent of GDP)						
Revenue and grants	53.2	43.8	40.1	42.1	38.9	45.6
Current revenue	42.7	40.1	35.5	35.7	35.1	35.5
Of which: Government	(38.2)	(35.2)	(30.5)	(30.1)	(29.7)	(29.7)
Foreign grants	9.8	2.8	3.7	4.4	2.1	8.3
Total expenditure	66.5	52.1	46.1	46.9	42.3	50.8
Current expenditure	37.3	40.3	38.3	39.3	36.1	34.5
Of which: Government	(33.7)	(36.3)	(36.4)	(35.4)	(34.8)	(33.4)
Current balance	5.4	-0.2	-2.8	-3.6	-1.0	1.0
Capital expenditure	29.2	11.8	7.8	7.6	6.2	16.2
Overall balance	-13.3	-8.3	-5.9	-4.8	-3.4	-5.2
Net external financing	10.9	2.4	3.4	1.9	3.0	3.3
Net domestic borrowing	2.4	5.9	2.5	2.9	0.3	--
Financing gap	--	--	--	--	--	1.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Refers to the nonfinancial public sector comprising the Government (the Government of the Federation of St. Christopher and Nevis and the Nevis Island Administration), the Social Security Scheme, and five nonfinancial enterprises (the National Agricultural Corporation, the St. Kitts Sugar Manufacturing Corporation, the Central Marketing Corporation, the Frigate Bay Development Corporation, and the Port Authority).

2/ Since 1983, includes an estimated cash component of the sale of the Royal St. Kitts Hotel by the Frigate Bay Development Corporation to a foreign company.

3/ Mostly on concessionary terms.

4/ Includes residual.

domestic banks, mainly in the form of overdrafts with the government-controlled commercial bank; these borrowings have been partly offset by the rise in deposits with the banks by the Social Security Scheme and earmarked trust funds administered by the Government.1/

Preliminary indications suggest that the overall deficit of the public sector will narrow to 3 1/2 percent of GDP in 1984. Such an outturn would be consistent with a reduction in the current account deficit to 1 percent of GDP, stemming from a rise in current revenue and an improvement in the current operations of public enterprises resulting from a partial recovery of sugar exports. The overall deficit is expected to be financed primarily by external borrowing on concessionary terms.

Comprehensive banking data on a comparable basis are available from the end of 1981. In 1982-83, commercial banks' liabilities to the private sector increased at an average annual rate of about 16 percent--considerably faster than GDP--and net domestic credit, which is mainly directed to the private sector, expanded at an average rate of about 19 1/2 percent a year (in relation to the stock of liabilities to the private sector). Thus, commercial banks' holdings of cash and net foreign assets declined in this period; these holdings increased sharply in the first nine months of 1984, with banks' liabilities to the private sector rising faster than net domestic credit. The increase in liabilities reflected partly an easing of foreign currency deposit regulations, which led to an increase in resident holdings of U.S. dollar deposits that was matched by a buildup of banks' foreign assets. Interest rates have remained largely unchanged since 1980, and presently range up to 7 percent on deposits and from 8 percent to 17 1/2 percent on loans.

The current account deficit of the balance of payments widened from 5 percent of GDP in 1980 to an estimated 7 1/2 percent of GDP in 1984 (Table 3). (The deficit had risen to 24 1/2 percent of GDP in 1983, but this reflected some nonrecurring factors, including imports associated with foreign private investment in tourism and a veterinary school, as well as depressed sugar exports caused by drought.) The growth of tourist receipts fell to 11 percent in 1982 from an average of 20 percent a year in 1980-81, mainly because of the recession in industrial countries. Tourist receipts stagnated in 1983 as a major

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1/ The trust funds are collected mainly from the government-owned sugar industry and partly from the private sector for earmarked expenditures. The trust funds collected from the sugar industry are for price support, acquisition of equipment, wage increases and bonuses, purchase of land, and payments to existing participants of the National Provident Fund (replaced by the Social Security Scheme in 1978). The Government has limited discretion over the timing and the magnitude of the disbursements from some of these funds. Despite the difficult financial position of the sugar industry, the balance in these accounts (mostly in the form of government deposits with the local commercial banks) rose from EC$19.6 million at the end of 1981 to EC$26.1 million at the end of 1983.

Table 3. St. Christopher and Nevis: Summary Balance of Payments, Actual and Projected

	Actual			Prel.	Est.	Projected				
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
	(In millions of U.S. dollars)									
Current account balance	-2.4	-3.6	-4.6	-14.9	-4.9	-4.3	-4.5	-4.5	-4.3	-4.1
Trade balance	-20.5	-22.4	-23.0	-32.9	-23.6	-29.0	-32.9	-34.0	-33.4	-36.5
Exports	(24.3)	(25.3)	(20.8)	(18.1)	(20.3)	(21.7)	(22.7)	(24.1)	(25.4)	(27.0)
Imports	(-44.8)	(-47.7)	(-43.8)	(-51.0)	(-43.9)	(-50.7)	(-55.6)	(-58.1)	(-58.8)	(-63.5)
Service balance	6.8	8.1	8.4	7.7	9.2	10.4	11.7	13.7	16.0	18.8
Of which: travel receipts	(8.0)	(9.9)	(11.0)	(11.1)	(13.3)	(14.6)	(16.1)	(18.5)	(21.3)	(24.5)
Interest payments	(-0.2)	(-0.2)	(-0.3)	(-0.4)	(-0.6)	(-0.7)	(-0.7)	(-0.8)	(-1.0)	(-1.2)
Private transfers (net)	6.5	9.1	7.8	7.6	8.1	8.6	9.1	9.6	10.1	10.6
Official transfers	4.8	1.6	2.2	2.7	1.4	5.7	7.6	6.2	3.0	3.0
Capital account	0.8	3.7	2.9	14.8	5.2	4.3	4.5	4.5	4.3	4.1
Official borrowing (net)	3.9	1.4	0.6	1.1	2.2	2.3	1.8	1.5	1.5	1.5
Financial intermediaries	...	3.5	1.3	0.1	-1.6	-1.0	-0.5	-0.5	-0.7	-0.9
Private direct investment	1.0	0.9	1.3	13.6	4.6	3.0	3.2	3.5	3.5	3.5
Errors and omissions	-4.1	-2.1	-0.3	--	--	--	--	--	--	--
Overall balance	-1.6	0.1	-1.7	-0.1	0.3	--	--	--	--	--
Financing	1.6	-0.1	1.7	0.1	-0.3	--	--	--	--	--
Net ECCB position	--	--	1.0	0.2	--	--	--	--	--	--
Change in official foreign assets	1.6	-0.1	0.7	-0.1	-0.3	--	--	--	--	--
	(In percent of GDP unless otherwise specified)									
Trade balance	-41.6	-38.6	-38.6	-54.2	-36.5	-42.2	-45.2	-44.1	-40.8	-42.1
Current account balance	-4.9	-6.2	-7.7	-24.6	-7.6	-6.3	-6.2	-5.8	-5.2	-4.7
Overall balance	-3.3	0.2	-2.9	-0.2	0.5	--	--	--	--	--
Memorandum items										
Outstanding debt 1/	21.4	20.5	21.0	22.4	24.4	26.4	27.6	28.7	29.3	29.8
Debt service as a percentage of exports of goods and services and private transfers 2/	1.1	1.0	1.4	1.6	2.3	2.7	2.9	2.9	3.1	3.3

Sources: Ministry of Finance; Statistical Office, Planning Unit; and Fund staff estimates.

1/ End of year.
2/ Includes debt service on new loans in the period 1985-89.

hotel was temporarily shut down by fire, but are estimated to recover by 20 percent this year. The current account deficits of recent years have been covered mainly by private capital inflows.

The external public debt rose from US$10.5 million (21 1/2 percent of GDP) at the end of 1980 to US$13.6 million (22 1/2 percent of GDP) at the end of 1983 and is estimated to rise to US$15.8 million (24 1/2 percent of GDP) at the end of 1984. Nearly 90 percent of the external public debt, owed mainly to the CDB, is on concessionary terms; debt service payments in relation to current receipts (exports of goods and services and private transfers) rose from 1 percent in 1980 to an estimated 2 1/2 percent in 1984.

In regard to the country's relations with the IBRD group, the World Bank assisted in preparing the country's public sector investment program for 1985-87. The IBRD group has not made any direct loan to St. Christopher and Nevis, and lending is not in prospect for the near future. However, the country has been receiving loans on concessionary terms from the CDB which receives part of its funding from the International Development Association.

There is no country page on St. Christopher and Nevis in International Financial Statistics, and the authorities have indicated that they will seek Fund assistance in data preparation and reporting. Banking data are sent regularly to the Fund by ECCB, but all other data, prepared mainly by the Planning and Finance Ministries, are made available on an ad hoc basis. The estimates of annual GDP at factor cost and monthly consumer price indices are kept current, but comprehensive labor force and employment data are available only at ten-year intervals. The fiscal data are prepared on a current basis. There are no official estimates of the balance of payments; however, trade data are available, albeit with a time lag, and some information is available on services and capital transactions.

III. Economic Policies and Prospects

1. Growth strategy

The authorities indicated that their policies are designed to reduce the economy's dependence on sugar by diversifying agriculture and expanding tourism and nonsugar manufacturing. As regards agriculture, the aim of the Government is to make sugar production more efficient and to release marginal sugar land for small-farm production of fruits, vegetables, and other nontraditional crops. A study sponsored by the United Kingdom on agriculture and the sugar industry--the first part of which is expected to be completed shortly--would form a basis for the development of the Government's policy on the sugar industry; it would also set the stage for developing a land use and tenure policy in the country, the absence of which has been a serious obstacle to the agricultural diversification program. In the meantime, farmers have been receiving various incentives to expand and diversify production, including access to special credit lines, extension services, marketing facilities, technical assistance, and duty-free imports of agricultural equipment.

Industrial policy aims at establishing small- and medium-sized manufacturing units which would rely on the use of local inputs and, as far as possible, export outside the CARICOM region. In particular, it emphasizes agro-based industries, the production of labor-intensive goods, and enclave industries. The tourist sector has benefited from improvements in sea and air communications and from the intensification of government tourism promotion efforts. To expand tourism further, the authorities intend to continue to promote off-season tourism and long-stay visitors, and to improve infrastructure in the Frigate Bay area. Also, they are seeking foreign assistance to develop the Southeast Peninsula, which has the country's best beaches, into a large tourist resort.

The role of the public sector continues to be limited primarily to the development of agriculture and provision of basic infrastructure. In addition, the authorities believe that the public sector should be prepared to play a catalytic role, as it did in the tourist sector through the construction of a major hotel which was later sold to a foreign private investor. St. Christopher and Nevis has an active private sector which benefits from the country's political stability, harmonious labor relations, competitive wages and fiscal incentives by the standards of the region, and a relatively developed infrastructure. In addition, the Government provides vocational training to meet the needs of the private sector and assists in securing financing for new industries through the St. Kitts and Nevis Development Bank. Also, the Government is considering the establishment of an Industrial Development Corporation and an Advisory Committee on Investment and Export Promotion, with private sector representation. Recently, the CDB approved a loan for the construction of factory space which would raise the existing capacity by some 30 percent. Some foreign and local private investors have built their own factory shells, and the authorities are now discussing a private sector proposal to build factory shells for rent, with the assistance of a U.S. AID loan administered by ECCB.

2. Public finances

The 1985 budgets of the Government (the combined operations of the Government of the Federation of St. Christopher and Nevis and the Nevis Island Administration) and public enterprises were at a preliminary stage of preparation at the time of the mission's visit. The authorities nonetheless indicated to the staff certain key considerations that were likely to be reflected in the budget:

(i) Recently the authorities prepared a public sector investment program for the period 1985-87 in consultation with major donors and the World Bank (Chapter II of the Recent Economic Developments paper). The program envisages a total spending of EC$83 million, equivalent to 14 percent of GDP in 1985-87 compared with an estimated 7 percent of GDP in the preceding three years. Some 80 percent of the total investment spending would be directed to the development of infrastructure and agriculture. About 90 percent of the total capital outlays is expected to be financed by external grants (63 1/2 percent) and concessionary loans (26 1/2 percent). While domestic sources are expected to finance only 10 percent of the three-year investment program, they would cover 22 1/2 percent of the projected public sector investment--mostly relating to ongoing projects--in 1985.

(ii) The authorities recognized that in order to implement the medium-term investment program, the public sector savings performance would have to be improved markedly. They noted that low sugar export prices would continue to dampen the growth of public sector revenue, and acknowledged the need for taking revenue measures. The authorities indicated that they might consider some adjustments in tax rates but this would not yield sufficient additional revenue. They noted that, on the basis of a recent report by an advisory committee on taxation, they would introduce new sources of revenue (not discussed with the staff) in the 1985 budget to offset part of the loss of revenue from the sugar industry. However, they were not planning to reintroduce the personal income tax. The authorities agreed that tax administration would need to be tightened as tax arrears rose from EC$0.4 million in 1980 to EC$7.3 million (about 4 percent of GDP) at the end of May 1984.

(iii) The authorities said that government current expenditure in 1985 would be held down to about the 1984 level, mainly through restraints on civil service wages and employment. They stated that the Government would not be granting any wage increase in 1984, as would have been indicated by the established five-year cycle of wage adjustments, and would resist an increase in 1985. Also, with the assistance from the Inter-Agency Resident Mission, the Government is conducting a manpower management study of the civil service with a view to curbing its overall size. In addition, the expenditure associated with the 1984 elections would not be a factor in 1985.

(iv) The operating deficit of departmental enterprises (water, electricity, and telephone), which are included in the government budget, has declined from 3 1/2 percent of GDP in 1980 to an estimated 1/2 of 1 percent of GDP in 1984, owing mainly to increases in electricity rates in 1982 and 1983. The authorities said that billing and collection procedures would be improved further to help eliminate this deficit in 1985. They acknowledged the importance of adjusting utility rates to cover costs and to contribute to capital formation, but felt that the water subsidy would have to be maintained and that the telephone services would have to be improved significantly before a rate adjustment could be considered. The Government was seeking a joint venture in telecommunications which would permit this operation to be run on a commercial basis.

(v) The operations of the rest of the public sector are dominated by the deficits of the sugar industry, which are financed primarily by the surpluses of the Social Security Scheme through the intermediation of the government-controlled commercial bank. The authorities projected the operating surplus of the Social Security Scheme to rise from EC$9.4 million in 1984 to EC$10.8 million in 1985 due to a higher rate of contribution associated with an expected increase in benefits in 1985. However, the growth of this surplus was anticipated to slow down after 1985. As to the sugar industry, its current operations are expected to improve only marginally in 1985 reflecting a small rise in sugar export earnings. The authorities noted that the growth in export volume would be mostly offset by the decline in the average unit value of sugar exports in 1985 reflecting partly the recently announced cut of 25 percent in the country's quota to the United States. As was noted above, the Government plans to complete a review of the operations of the sugar industry in early 1985.

The staff drew the authorities' attention to the heavy use of the counterpart of Social Security Scheme's surpluses and the trust funds for covering current operations of the Government and the sugar industry, and cautioned that such financing, while helping to limit the recourse to net bank credit by the public sector, might be storing up problems for the future. The staff emphasized the need to ensure that the Government and the sugar industry do not get locked on to a high spending trend supported by the trust funds and by the Social Security Scheme's surplus which would shrink from the high levels experienced in the initial years of its establishment. A greater savings effort would be required to prevent the emergence of a squeeze on the liquidity position of the government-controlled commercial bank when the trust fund balances are drawn down.

On the basis of the above discussion, and in the absence of significant revenue measures, the staff estimated that an overall public sector deficit of just over 5 percent of GDP could emerge in 1985, with an unfinanced gap of about 2 percent of GDP (see Table 2). For this purpose, it was assumed that the decline in government current receipts observed since 1981 would be halted in 1985 by the expected improvements in tax administration and in revenue collection procedures of the departmental enterprises. The authorities stressed that the revenue measures they planned to introduce in the 1985 budget would be more than sufficient to eliminate the unfinanced gap projected by the staff. The realization of the Government's expectations would depend on the specific measures included in the budget for 1985 that is to be presented this month.

3. Monetary policy

The ECCB, which replaced the East Caribbean Currency Authority on October 1, 1983, acts as the Central Bank for St. Christopher and Nevis and six other countries in the region. It is empowered to impose on financial institutions reserve requirements, minimum holdings of government securities, interest rate limits, and credit controls. In March

1984, ECCB imposed a 6 percent reserve requirement on the deposit liabilities (excluding interbank deposits) of all banks operating under its jurisdiction; this reserve requirement superseded the 5 percent special deposit requirement that had been applied by the Government of St. Christopher and Nevis.

Interest rates are set freely by commercial banks in St. Christopher and Nevis, but the ECCB intends to impose from January 1, 1985 a minimum interest rate of 4 percent on savings deposits at commercial banks in all member countries. The officials of the ECCB believe that the oligopolistic structure of the banking sector has held down interest rates on savings deposits in the ECCB area. This measure is regarded as a first step toward the harmonization of regional interest rates to minimize disruptive capital flows among member countries. Further steps are expected to include removal of taxes on deposits and on interest paid by commercial banks in some countries, inasmuch as such taxes have resulted in a widening of interest rate spreads; St. Christopher and Nevis does not impose such taxes.

4. Balance of payments outlook and exchange rate

A medium-term scenario has been developed by the staff to assess the country's balance of payments prospects. This scenario assumes that both real GDP and prices would be rising at an average annual rate of about 3 percent in 1985-89. Reflecting the development strategy, the expansion of output would be led by manufacturing and tourism, while agricultural production would be rather sluggish owing to stagnation in sugarcane production after 1985. It is also assumed that the public sector investment program would be implemented as planned. Public sector borrowing from local commercial banks would be small in the medium term, except perhaps in 1985 if the revenue measures planned for the 1985 budget could not close the unfinanced gap discussed above. Commercial banks' credit to the private sector is assumed to grow significantly faster than GDP, and is to be covered by expansion in their deposit liabilities, with an allowance for a buildup of liquid assets.

Under the scenario, exports would increase at almost the same rate as GDP in 1985-89, with manufacturing exports rising by some 13 percent a year and sugar exports remaining unchanged. The growth of manufacturing exports would mainly reflect the ongoing expansion of production capacity in clothing and electrical machinery and appliances. Sugar exports, which enjoy preferential price treatment under quotas in the U.S. and U.K. markets, would be constrained by the existing quota and price arrangements. Tourist receipts would grow by 10 percent a year in 1985-86; the growth rate would rise to 15 percent a year in 1987-89 reflecting the ongoing expansion in hotel capacity. Net receipts from other services and private transfers are assumed to rise marginally over the medium term.

Under the impact of the public investment program, which is to be financed mainly by external grants and concessionary loans, the rate of growth of imports would pick up substantially in 1985-86 but after the completion of some major projects included in the program, import growth would slow down in 1987-88. According to the three-year investment program prepared by the authorities in consultation with the World Bank and other major donors, inflows of project-related external grants would rise from an estimated annual average of 3 1/2 percent of GDP in 1981-84 to about 9 percent of GDP in 1985-87. It is assumed that after 1987, these inflows would fall back to about the annual average estimated for 1981-84.

On the basis of this scenario, the external current account deficit would be in the range of 5-6 percent of GDP in 1985-89. The deficit would be financed by public sector borrowing on concessionary terms and private direct investment from abroad. The external public debt would grow from an estimated 24 1/2 percent of GDP at the end of 1984 to 30 percent of GDP at the end of 1989. However, as most of this debt would continue to be on concessionary terms, debt service payments would remain small; they would rise slowly from an estimated 2 1/2 percent of current receipts in 1984 to 3 1/2 percent in 1989.

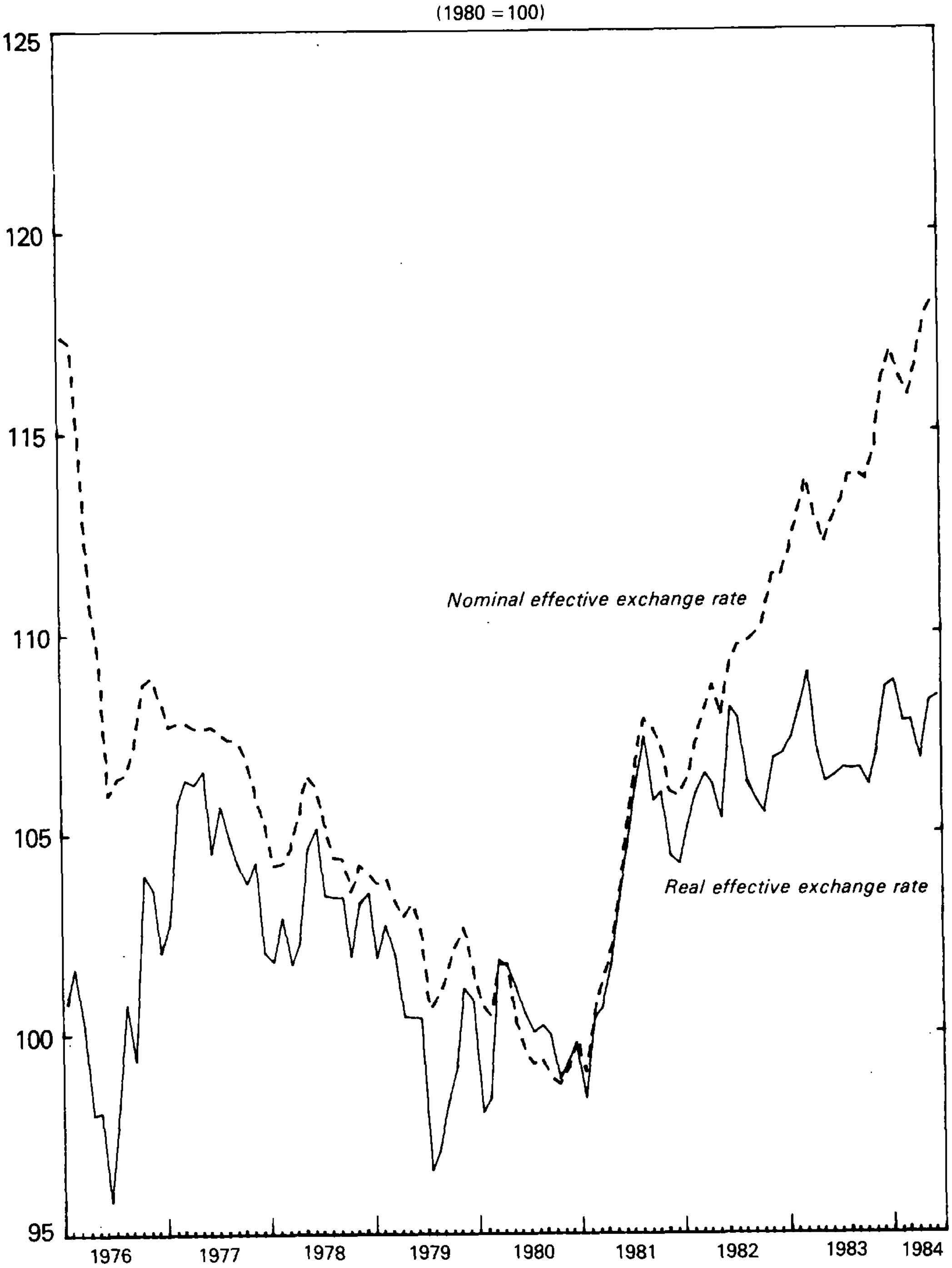
The nominal effective value of the currency of St. Christopher and Nevis fell by 6 1/2 percent from July 1976 (when it was pegged to the U.S. dollar) to January 1981 but increased by 19 1/2 percent in the following three and a half years mainly owing to the appreciation of the U.S. dollar in relation to other major currencies (Chart 1). Adjusted for relative consumer price changes, the real effective value of St. Christopher and Nevis' currency remained virtually unchanged from July 1976 to January 1981 although it fluctuated considerably during this period. However, it rose by 9 1/2 percent in the seven months through August 1981, and since then has shown no definite trend. As of mid-1984, the real effective value of the currency of St. Christopher and Nevis was 10 percent above its level in July 1976; the real appreciation of the Eastern Caribbean dollar since its pegging to the U.S. dollar has been substantially larger for most other members of ECCB.

The authorities observed that the real appreciation of the Eastern Caribbean dollar had not adversely affected tourism, but receipts from sugar exports expressed in local currency had weakened. In 1982-84, agricultural exports were adversely affected by drought and depressed sugar export prices. Exports of nonsugar manufactures, which are directed almost exclusively to the United States and neighboring countries whose currencies are pegged to the U.S. dollar, declined from 1980 to 1982 owing to the closure of two factories which had technical difficulties; however, from 1982 to 1984, such exports are estimated to have increased by 22 percent a year. The authorities noted that the current level of the exchange rate was not inappropriate for the growth of St. Christopher and Nevis' exports and tourism, as might be the case for some other members of the ECCB. However, the authorities have agreed to cooperate with the ECCB in a study of the implications of the recent real appreciation of the Eastern Caribbean dollar for the member countries.

CHART 1

ST. CHRISTOPHER AND NEVIS
EFFECTIVE EXCHANGE RATE INDICES[1], 1976-84

(1980 = 100)



Sources: Statistical Office, Planning Unit; and Fund staff estimates.
[1]The indices are weighted with the trade and tourist shares of St. Christopher and Nevis' trading partners. An increase in the index means an appreciation of the Eastern Caribbean dollar.

IV. Staff Appraisal

St. Christopher and Nevis' development strategy seeks to diversify agricultural production away from sugar, and to expand manufacturing and tourism. The role of the public sector is limited to the development of agriculture and the provision of infrastructure. The country has a vibrant private sector and has been relatively successful in attracting foreign private investment because of its political stability, harmonious labor relations and competitive wages, generous fiscal incentives, and a relatively adequate infrastructure. Because of the smallness of the domestic market, the authorities emphasize exports and tourism to achieve their growth and employment objectives. The staff considers that the thrust of the development strategy, which is reflected in the public investment program prepared in consultation with the major donors and the World Bank, is broadly appropriate. It would encourage the authorities to complete without delay the operational content of the policy framework for the agricultural sector (including sugar) to promote the private sector diversification efforts and to improve the operations of the sugar industry.

Preliminary estimates for 1984 point to a recovery in output after a decline in the preceding year, as well as improvements in the public finances and the balance of payments. Further expansion in output and a reduction in the current account deficit of the balance of payments are expected in 1985. The staff projection for 1985 suggests that the current account of the public sector would move into a small surplus while the overall deficit would widen because of an anticipated rise in public investment. On this basis, there would be a public sector financing gap of some 2 percent of GDP unless additional revenue and expenditure measures are taken.

The staff takes note of the authorities' intentions to introduce new sources of revenue in the 1985 budget and to improve revenue collection procedures, and would stress the importance of ensuring that such measures be sufficient to cover the public sector's financing gap. Also, the authorities are encouraged in their efforts to curb the growth of current expenditure, mainly through restraint on the growth of the wage bill. These efforts, together with the expected improvements in the operations of the sugar industry, would help reduce the risk of financial problems arising from a prolonged use of the counterparts of the Social Security Scheme's surplus and trust funds for covering current operations of the Government and the sugar industry.

In the medium term, actions to improve public sector savings would have to be intensified in order to strengthen the country's saving and investment. Because of the crucial role of private investment in the country's economic growth process, it is important that the economic environment remains attractive for private investment. While the wage and exchange rate developments in recent years apparently have not hampered the country's merchandise exports and tourism, developments in these areas nonetheless should be monitored closely to ensure that the economy's international competitiveness and the profitability of investment are not impaired. The staff welcomes the authorities' intentions to expedite a review--jointly with other members of ECCB--of the external value of the Eastern Caribbean dollar.

The staff notes that the exchange system of St. Christopher and Nevis is free of any restrictions on payments and transfers on current international transactions, and welcomes the authorities' recent decision to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

It is recommended that the next Article IV consultation with St. Christopher and Nevis be concluded by mid-1986.

St. Christopher and Nevis - Fund Relations
(As of December 15, 1984)

I. Membership Status

(a) Date of membership: August 15, 1984
(b) Status: Article VIII

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 4.5 million
(b) Total Fund holdings: 100.00 percent of quota
(c) Fund credit: None
(d) Reserve tranche position: None

III. Current Extended Arrangement and Special Facilities: None

IV. SDR Department

(a) Net cummulative allocation: None
(b) Holdings: None
(c) Current designation plan: None

V. Administered Accounts: None

VI. Overdue Obligations to the Fund: None

(B) Nonfinancial Relations

VII. Exchange Rate Arrangement: St. Christopher and Nevis and the other six member countries of the Eastern Caribbean Central Bank share a common currency, the Eastern Caribbean dollar, which since July 1976 has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

VIII. Consultation with the Fund: None.

IX. Technical Assistance: Mr. Supersad, a member of the panel of fiscal experts, visited St. Christopher and Nevis between August 16 and 28, 1981, to review the country's tax structure and administration.

ST. CHRISTOPHER AND NEVIS - Basic Data

Area and population	
Area	101 sq. miles (269 sq. kilometers)
Population (end-1982)	45.1 thousand
Average annual rate of population increase (1978-82)	0.3 percent
GDP (1983)	SDR 56.8 million US$60.7 million EC$164.0 million
GDP per capita (1983)	SDR 1,250

Origin of GDP	1981	1982	Prel. 1983	Proj. 1984
		(percent)		
Agriculture and fishing	15.6	20.0	17.0	17.2
Manufacturing	14.2	13.4	12.8	12.9
Construction	8.6	7.0	7.9	8.1
Transport and communications	11.9	12.2	13.1	13.2
Government	20.8	20.2	20.6	20.5
Other services	28.9	27.2	28.6	28.1
Ratios to GDP				
Exports of goods and nonfactor services	66.2	57.9	52.4	55.2
Imports of goods and nonfactor services	92.6	84.1	95.7	77.9
Current account of the balance of payments 1/	-9.0	-11.4	-29.0	-9.7
Public sector revenue and grants	43.8	40.1	42.1	38.9
Public sector total expenditure	52.1	46.1	46.9	42.3
Public sector current surplus or deficit (-)	-0.2	-2.8	-3.6	-1.0
Public sector overall surplus or deficit (-)	-8.3	-5.9	-4.8	-3.4
External public and government-guaranteed debt (end of year)	20.5	21.0	22.4	24.4
Gross national savings	4.5	-1.7	-2.1	-2.0
Gross investment	13.5	9.7	26.9	7.7
Liabilities to the private sector 2/	33.2	37.9	42.5	45.6 3/
Annual changes in selected economic indicators				
Real GDP per capita	6.2	1.9	-2.7	2.7
Real GDP at factor cost	6.5	2.2	-2.4	3.0
GDP at current market prices	17.7	2.7	1.9	6.5
Domestic expenditure (at current prices)	15.4	2.6	15.9	-8.8
Gross investment	(-48.2)	(-26.1)	(182.7)	(-69.4)
Consumption	(35.2)	(6.0)	(2.0)	(5.2)
GDP deflator at factor cost	12.3	8.2	2.5	3.0
Consumer prices (annual averages)	10.4	5.9	2.3	2.8
Public sector revenue and grants	-3.1	-5.8	6.8	-1.4
Public sector total expenditure	-7.8	-9.2	3.8	-3.9
Liabilities to the private sector 2/	...	17.3	14.3	20.1 3/
Net domestic bank credit 4/	...	24.0	14.8	7.2 3/
Credit to public sector (net)	(...)	(3.3)	(3.0)	(2.7)
Credit to private sector	(...)	(16.0)	(14.9)	(9.9)
Merchandise exports, f.o.b.	4.1	-17.8	-13.0	12.2
Merchandise imports, c.i.f.	6.5	-8.2	16.4	-13.9
Travel receipts (gross)	23.8	11.1	0.9	19.8

Public sector finances	(millions of Eastern Caribbean dollars)			
Revenue and grants	68.6	64.4	69.0	68.0
Total expenditures	81.6	74.1	76.9	73.9
Current account surplus or deficit (-)	-0.3	-4.5	-5.9	-1.7
Overall surplus or deficit (-)	-13.0	-9.5	-7.9	-5.9
Foreign financing (net)	3.7	5.4	3.1	5.3
Domestic financing (net)	9.3	4.1	4.8	0.6

Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	25.3	20.8	18.1	20.3
Merchandise imports (c.i.f.)	47.7	43.8	51.0	43.9
Travel (net)	7.5	8.0	7.9	9.9
Other services and private transfers (net)	9.7	8.2	7.4	7.4
Official grants	1.6	2.2	2.7	1.4
Balance on current account	-3.6	-4.6	-14.9	-4.9
Official borrowing (net)	1.4	0.6	1.1	2.2
Private capital (net) and residual	2.3	2.3	13.7	3.0
Overall surplus or deficit (-)	0.1	-1.7	-0.1	0.3

1/ Before official grants.
2/ Data on the stock of currency outside banks are unavailable in St. Christopher and Nevis.
3/ As at end-September 1984.
4/ Changes in relation to liabilities to the private sector at the beginning of the year.