FOR AGENDA

SM/83/78

CONTAINS CONFIDENTIAL INFORMATION

May 13, 1983

To: Members of the Executive Board

From: The Secretary

Subject: St. Lucia - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with St. Lucia. It is proposed to bring this subject to the agenda for discussion on Wednesday, June 8, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Ms. Bierman, ext. 75233.

Att: (1)

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INFORMATION

INTERNATIONAL MONETARY FUND

ST. LUCIA

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the 1983
Article IV Consultation with St. Lucia

Approved by E. Wiesner and W. A. Beveridge

May 11, 1983

The 1983 Article IV consultation discussions with St. Lucia were held in Castries in the period February 24-March 10, 1983. The St. Lucia representatives included the Prime Minister, who is also Minister of Finance and Planning; the Director of Finance and Planning and his three Deputy Directors; the Director of Statistics; senior officials in other ministries; and representatives of the major public enterprises. At the request of the authorities, the mission also met with a wide range of private sector organizations, commercial banks, labor unions, and individual enterprises. The staff mission consisted of Ms. Bierman (Head), Messrs. Khor (WHD), Mcdonald (FAD), and Sundgren (WHD), and Ms. Archer, (Secretary-WHD). The mission was assisted by Mr. Stephens, the Fund's Regional Advisor. St. Lucia accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement on May 30, 1980.

1. Background

The second half of the 1970s had been characterized by rapid economic expansion accompanied by relatively low inflation, but in the wake of Hurricane Allen, the average annual real growth rate of St. Lucia's GDP declined to 2-1/2 per cent in the period 1980-82 while inflation--measured by the consumer price index--doubled to an annual rate of 19-1/2 per cent in 1980, before declining to 15 per cent in 1981 and 4-1/2 per cent in 1982 (Table 1).

The economic expansion in the second half of the 1970s was led by agriculture, tourism, manufacturing, and construction. A conservative fiscal stance ensured adequate domestic financial resources for the growth of the productive sectors. In this period, the increase in merchandise exports and tourism receipts offset the rise in imports and service payments, excluding the Hess Oil Company's imports for construction of its transshipment terminal.1/ Complete balance of payments

1/ This construction was initiated in 1977 and associated imports were financed directly by the Hess Oil Company. During the construction period Hess investment accounted for over 40 per cent of gross domestic investment, and the Company's share of total merchandise imports was approximately 18 per cent.

Table 1. St. Lucia: Selected Economic and Financial Indicators 1980-83

	1980	1981	1982	Proj. 1983
(Annual percentage changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	-0.1	3.0	2.1	2.4
GDP deflator	12.3	9.0	3.0	4.0
Consumer prices	19.6	15.0	4.6	4.0
External sector (on the basis of U.S. dollars)				
Exports, f.o.b.	44.2	-9.6	--	7.0
Imports, c.i.f.	22.3	3.9	-8.3	-14.1
Nominal effective exchange rate (depreciation -)	-2.4	5.1	7.9	...
Real effective exchange rate (depreciation -)	-0.7	8.2	6.0	...
Central government 1/				
Revenues	10.0	12.6	14.5	7.1
Total expenditure and net lending	22.5	13.2	19.7	-2.4
Money and credit 2/				
Domestic credit (net)	19.5	13.5	3.3	2.5
Of which: central government	(2.0)	(0.7)	(2.4)	(—)
private sector	(30.3)	(16.5)	(8.1)	(5.6)
Money and quasi-money (M2)	11.9	14.8	5.2	3.0
Velocity (GDP relative to M2)	1.8	1.7	1.7	1.7
Interest rate (annual rate, 3-months deposits)	5.50	7.00	7.00	7.00
(In per cent of GDP, unless otherwise specified)				
Central government savings 1/	0.4	0.4	-2.7	2.1
Central government budget deficit (overall) 1/	-6.6	-5.0	-6.9	-0.5
Domestic financing	3.0	1.2	4.4	...
Foreign financing (ECCA and IMF)	3.9	3.8	2.5	...
Gross domestic investment	59.5	58.7	42.3	28.9
Gross domestic savings	21.0	14.3	8.7	12.4
Current account deficit (BOP)	29.2	31.1	23.2	7.6
Current account deficit BOP (excluding Hess)	8.2	8.2	12.8	6.3
External debt (including IMF)	15.9	17.8	21.0	22.1
Debt service as a per cent of exports and service receipts 3/	1.4	1.6	2.9	9.9
Interest payments (in per cent of exports and service receipts) 3/	1.0	1.1	1.3	1.8
(In millions of SDRs, unless otherwise specified)				
Overall balance of payments	-2.4	-3.6	1.1	-0.5
ECCA and other gross official reserves (months of imports) 4/	1.1	1.1	1.1	1.2
External payments arrears	--	--	--	--

1/ Fiscal year ending on March 31 in the following year. Deficit on commitment basis.

2/ Changes in relation to liabilities to private sector at beginning of period.

3/ Excluding re-exports.

4/ Includes imputed share of ECCA's international reserves.

statistics are not available for the entire five-year period, but indications are that the deficit on the non-Hess current account of the balance of payments remained relatively stable at 8 to 10 per cent of GDP during the period. It was financed by a small amount of net public sector foreign borrowing, and by capital inflows to the commercial banks and the private sector.

Between 1979 and 1982 this overall development pattern changed dramatically, as the fiscal stance became expansionary, and the private sector lost much of its dynamism. A hurricane which hit St. Lucia in 1980 reduced output of agricultural commodities--especially St. Lucia's major merchandise exports, bananas and coconuts--and adversely affected tourism, the other major foreign exchange earner. The deterioration in the public finances also began in FY 1980/81, as the 1980 hurricane impacted adversely on central government revenue, while expenditure associated with disaster relief increased. In the following two years, the public finances were characterized by a persistent high central government deficit. In this period, the government sector showed the most rapid growth, increasing its contribution to GDP from 15 per cent in 1979 to 20-1/2 per cent in 1982, while all other sectors' share of GDP--with the exception of manufacturing and other services--was below their pre-hurricane levels (Table 2). The lack of private sector dynamism in the period was reflected in a decline in merchandise export value as well as in the slow growth of tourism receipts between 1980 and 1982; when extraordinary hurricane-related transfers diminished by 1982, the current account deficit of the balance of payments--excluding Hess imports--widened to 13 per cent of GDP.

II. Recent Developments and Prospects

1. Supply and demand

In the two post-hurricane years 1981 and 1982 real GDP rose at an annual average rate of 2-1/2 per cent mainly on the strength of the expansion in the Government and manufacturing sectors. In 1982, a 20 per cent decline in construction was more than outweighed by a 12 per cent increase in government services, a 13 per cent increase in manufacturing, and a 9-1/2 per cent rise in agricultural output. The decline in construction reflected the completion during 1982 of the Hess Oil transshipment terminal.1/

In 1980 and 1981 import prices were rising, while hurricane damage and slow growth of domestic output led to supply shortages, and domestic demand pressure was intensified by high public and private sector wage settlements. As measured by the consumer price index the annual rate of price increase doubled to 19-1/2 per cent in 1980 and was 15 per cent in 1981. Domestic demand pressure abated in 1982 as private investment dropped by some 28 per cent, far outweighing the expansion

1/ Hess accounted for 57 per cent of private investment in 1981.

Table 2. St. Lucia: GDP at Constant Factor Cost by Sectoral Origin

(In per cent of GDP)

	1978	1979	1980	1981	1982	Proj. 1983
GDP	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	16.5	14.5	12.5	12.3	13.2	13.9
Mining	0.7	1.5	2.0	2.0	1.3	1.2
Manufacturing	10.4	8.4	10.0	9.6	10.7	10.9
Utilities	2.9	3.1	3.0	2.9	3.0	3.0
Construction	9.1	12.6	12.6	12.9	10.1	8.9
Transport and communications	11.8	11.9	11.9	11.0	10.8	10.9
Wholesale and retail	15.2	15.2	13.6	13.2	13.0	13.8
Hotels and restaurants	6.5	6.6	7.0	5.9	5.9	5.8
Banking and finance	7.5	8.0	7.6	7.7	7.8	7.9
Government services	16.0	14.9	16.4	18.9	20.7	20.2
Other services	3.4	3.3	3.4	3.5	3.5	3.5

Sources: Statistical Department; and Fund staff estimates.

in consumption which resulted from continued high wage settlements.1/ For the year as a whole, the consumer price index rose by only 4.6 per cent.

2. Wage trends

Comprehensive information on wage trends is not available. It appears, however, that in the past the size of public sector awards has contributed to upward pressure on wages in the private sector. The last two-year contract for the Government's daily-paid workers--agreed in 1981--provided for a 40 per cent increase in April 1980 and a 20 per cent increase in April 1981. The most recent settlement reached between the Central Government and the civil servants in April 1982 provided for nominal salary increases of approximately 10 per cent per annum for the contract period October 1980-March 1983 net of a 5 per cent cost of living allowance which took effect in November 1980 in accordance with the earlier contract.2/ The Government is at present negotiating new contracts with both the civil servants and the daily-paid workers.

In 1981 wage settlements in unionized industries provided for salary increases of 25 to 30 per cent for the first year and 15 to 25 per cent for the second year of a two-year agreement. Settlements even within the same industries have been varying widely in 1982, mainly because of the wide difference in wages paid for similar work in different enterprises. Awards of 20 to 30 per cent for a two-year contract appear to have been most common, with higher awards granted by enterprises which so far have been low paying by industry standards.

3. Public finances

The deficit of the consolidated public sector on a commitment basis rose from an average of 1.5 per cent of GDP in the period FY 1978/79 to FY 1979/80 to 4 per cent of GDP in FY 1980/81 to FY 1982/83, reflecting the weakening performance of the Central Government (Table 3). The Central Government's deficit on a commitment basis rose from 1.7 per cent of GDP in the preceding two years to 6-1/2 per cent in FY 1980/81 (Table 4). The overall performance improved somewhat in both absolute and relative terms in FY 1981/82 when the deficit declined to 5 per cent of GDP; but in FY 1982/83 it rose to 6-1/2 per cent of GDP. The deterioration in FY 1980/81 reflected a slowdown in the growth of the Central Government's current revenue to 10 per cent (from an average annual growth rate of 22 per cent in FY 1977/78 to FY 1978/79) and a

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1/ Excluding the investment activities of the Hess Company, domestic demand rose relative to supply in 1982, as evidenced by the rise in the corresponding current account deficit of the balance of payments.

2/ The adverse effect of the settlement on the Central Government's performance was concentrated in FY 1982/83 when, in addition to the salary increase agreed for that fiscal year, large retroactive payments were made. (See below Section III3.)

Table 3. St. Lucia: Operations of the Consolidated Public Sector

	1978/79	1979/80	1980/81	1981/82	Estimated Outturn 1982/83
(In millions of East Caribbean dollars)					
Total revenue and grants	70.25	97.26	100.62	122.57	137.61
Current revenue	64.54	84.14	91.67	106.00	116.52
Current grants	0.43	2.79	0.16	0.19	0.30
Capital grants	5.28	10.33	8.79	16.38	20.79
Total expenditure and net lending 1/	72.88	102.26	117.17	128.80	155.35
Current expenditure	50.80	74.35	82.17	95.18	115.99
Capital expenditure and net lending	22.08	27.91	35.00	33.62	39.36
Current account surplus (excluding grants)1/	13.74	9.79	9.50	10.82	0.53
Overall deficit (-)1/	-2.63	-5.00	-16.55	-6.23	-17.74
Change in central government payment arrears (increase +)	0.69	6.25	-6.63	6.36	7.39
Overall deficit on cash basis (-)	-1.94	1.25	-23.18	0.13	-10.35
Financing	1.94	-1.25	23.18	-0.13	10.35
Foreign assets	0.12	-0.15	-0.48	0.75	-0.25
Net borrowing from ECCA (includes counterpart of purchases from IMF)	2.78	2.60	11.88	9.91	-2.94
Other foreign borrowing (net)	3.50	9.05	0.93	1.64	13.69
Net domestic bank borrowing	-1.14	-3.19	8.27	-10.34	-3.36
Other domestic borrowing including residual	-3.32	-9.56	2.58	-2.09	3.21
(In per cent of calendar year GDP)					
Total revenue and grants	31.4	34.8	32.9	35.7	38.0
Of which: revenue	28.8	30.1	29.9	30.9	32.2
Total expenditure and net lending	32.5	36.6	38.3	37.6	42.9
Of which: current expenditure	22.7	26.6	26.8	27.8	32.0
Current account surplus	6.1	3.5	3.1	3.2	0.1
Overall deficit (-)	-1.1	-1.8	-5.4	-1.8	-4.9
Overall deficit on a cash basis (-)	-0.9	-0.4	-7.6	--	-2.9

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

1/ Central government expenditure on a vouchers' issued basis; rest of public sector on a cash basis. Since central government payments arrears include some arrears to the rest of the public sector, deficits on this basis are likely to be overestimated when central government arrears are increasing and underestimated when they are decreasing.

Table 4. St. Lucia: Central Government Operations

	1979	1980	1981	1982	Budget 1983	Est. Outturn 1982/83	Proj. 1983/84
	(In millions of East Caribbean dollars)						
Total revenue and grants	61.36	87.48	90.77	108.74	170.38	126.65	145.06
Revenue	55.65	74.36	81.82	92.17	141.32	105.56	113.06
Current grants	0.43	2.79	0.16	0.19	0.24	0.30	0.25
Capital grants	5.28	10.33	8.79	16.38	28.82	20.79	31.75
Total expenditure and net lending 1/	66.53	90.63	111.06	125.73	200.35	150.56	147.00
Current expenditure	49.94	73.21	80.49	90.92	129.66	115.50	105.00
Capital expenditure and net lending	16.59	17.42	30.57	34.81	70.69	35.06	42.00
Current balance (excluding grants)1/	5.71	1.15	1.33	1.25	11.66	-9.94	8.06
Overall deficit (including grants)(-)1/	-5.17	-3.15	-20.29	-16.99	-29.97	-23.91	-1.94
Change in payment arrears (increase +)	0.69	6.25	-6.63	6.36	—	7.39	...
Overall deficit on cash basis (-)	-4.48	3.10	-26.92	-10.63	-29.97	-16.52	...
Financing	4.48	-3.10	26.92	10.63	29.97	16.52	...
Foreign assets	0.12	-0.05	-0.48	0.75	—	-0.25	...
Net borrowing from ECCA (includes counterpart of purchases from IMF)	2.78	2.60	11.88	9.91	—	-2.94	...
Other net foreign borrowing	1.30	1.07	0.13	2.43	29.97	12.23	...
Net domestic bank borrowing	1.03	-0.10	12.50	-2.60	—	2.90	...
Other net domestic borrowing	-0.69	0.36	3.33	1.57	—	4.58	...
Residual	-0.06	-6.98	-0.43	-1.43	—	—	—
	(In per cent of calendar year GDP)						
Total revenue and grants	27.4	31.3	29.6	31.7	47.1	35.0	37.2
Revenue	24.8	26.6	26.7	26.9	39.0	29.2	29.0
Grants	2.6	4.7	2.9	4.8	8.0	5.8	8.2
Total expenditure and net lending	29.7	32.4	36.3	36.7	55.3	41.6	37.7
Current expenditure	22.3	26.2	26.3	26.5	35.8	31.9	26.9
Capital expenditure and net lending	7.4	6.3	10.0	10.2	19.5	9.7	10.8
Current account surplus or deficit (-)	2.5	0.4	0.4	0.4	3.2	-2.7	2.1
Overall deficit (-)	-2.3	-1.1	-6.6	-5.0	-8.3	-6.6	-0.5
Overall deficit on cash basis	-2.0	1.1	-8.8	-3.1	...	-4.6	...

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

1/ Expenditure on vouchers issued basis.

22-1/2 per cent rise in expenditure, mainly related to relief and reconstruction outlays.1/ In FY 1981/82 current revenue and expenditure rose at approximately equal rates, while inflows of capital grants almost doubled. With the exception of FY 1980/81, the wide discrepancy between the deficit on commitment basis and cash basis in the last four years is evidence of the financing problems encountered by the Central Government.

In FY 1980/81 and FY 1981/82 no agreement was reached on a new wage contract for civil servants to succeed the contract which expired in April 1980 and consequently expenditure on wages and salaries rose by only 2 per cent between FY 1979/80 and FY 1981/82. The settlement reached in April 1982 with the civil servants was moderate when compared to the previous contract, although still above the 27-1/2 per cent rise in the cost of living over the three years which it covered. However, because of its large retroactive component it was reflected in an estimated 52 per cent increase in the wage bill in FY 1982/83. Nevertheless, the budget for FY 1982/83 had sought an EC$11.7 million current account surplus (3.2 per cent of GDP) but as revenue fell 30 per cent short of budget, the current account registered an EC$10 million deficit, equivalent to 2.7 per cent of GDP, even though the Government effected savings of 16 per cent in its current expenditure.2/ The main overestimated components of the budget were import duty collections and proceeds from the levy on foreign exchange transactions introduced in October 1982.

Even though capital grants continued to rise in FY 1982/83 the Government had to reduce greatly its capital budget because of lack of resources. Apart from borrowing from ECCA (including the IMF) the Central Government can only obtain limited amounts of foreign credits. Its substantial net foreign borrowing in FY 1982/83 reflected an extraordinary regional effort to help finance the budget, by purchasing St. Lucia Treasury bills in an amount of EC$10.9 million. In addition, direct domestic financing of the central government deficit amounted to EC$7.6 million while payments arrears increased by EC$7.4 million. The rest of the general government has maintained an overall--although declining relative to GDP--surplus position averaging 1.7 per cent of GDP in the period FY 1978/79 to FY 1982/83, and the selected public enterprises whose current account surplus was declining until FY 1980/81, reversed this situation in FY 1981/82, when also the previous year's overall deficit was turned into a surplus equivalent to 1.1 per cent of GDP.

1/ The 34 per cent growth in current revenue in FY 1979/80 was abnormally high as a civil service strike in March 1979 reduced collections, which were therefore not recorded until FY 1979/80.

2/ Eleven per cent relative to budget which had excluded a 5 per cent retroactive salary component.

4. Monetary development

The Central Government's increasing recourse to domestic financing has led to an apparent liquidity squeeze in the private sector. Despite a rise in commercial banks' interest rates--which are not subject to regulation--nominal growth rate of private sector deposits with commercial banks declined to 6 per cent in 1982 after rising by 12 per cent and 17 per cent in 1980 and 1981, respectively. As the commercial banks' liquidity position was tightened by the imposition of a 10 per cent legal reserve requirement in the period June 1980-June 1981, credit expansion to the private sector declined from an annual rate of 26-1/2 per cent in 1980 to 12-1/2 per cent in 1981, and 6-1/2 per cent in 1982. Some of the commercial banks have recently stopped lending to the private sector due to lack of funds caused by slow deposit growth, the Government's use of bank financing, and the depressed conditions of the banana and tourism industries in which they have invested a large part of their portfolio.

5. The balance of payments

Between 1980 and 1981, the current account deficit on the balance of payments--excluding self-financing Hess Company imports--remained in the 8 to 10 per cent range registered in the 1970s as the widening trade deficit was offset in both years by extraordinarily high hurricane-related transfers, but in 1982 the current account deficit is estimated to have risen to 13 per cent of GDP (Table 5).

In both 1981 and 1982 the value of merchandise exports was below their 1980 level while non-Hess imports rose by 4 per cent over the two years. The current account deficit in 1982--excluding Hess transactions--was primarily covered by official capital inflows, including a special sale of Treasury bills to other Caribbean governments. The overall balance of payments was in surplus, as ECCA financing was more than offset by repayment to the IMF of overcompensation under the compensatory financing facility.

6. Prospects for 1983

In 1983 real GDP is projected to increase by 2-1/2 per cent despite a further decline in construction activity, which reflects the full year impact of the completion of the Hess Oil Company's transshipment terminal. Contrary to the observed growth pattern for 1980-82 the goods-producing sectors are expected to be the most dynamic elements in 1983, on the assumption that adequate financing is available for the private sector.

Consistent with this scenario, the non-Hess current account deficit of the balance of payments is projected at 6-1/2 per cent of GDP in 1983 reflecting a small growth in exports and--with the fall in oil prices--a decline in imports.

Table 5. St. Lucia: Summary Balance of Payments

	1978	1979	1980	1981	1982	Proj. 1983
	(In millions of U.S. dollars)					
Goods, services and transfers	-23.4	-27.3	-33.1	-39.5	-31.1	-11.0
Exports, f.o.b.	26.8	31.9	46.0	41.6	41.6	44.5
Imports, c.i.f.	-82.8	-101.2	-123.8	-128.6	-117.9	-101.3
Of which: Hess Co.	(-14.2)	(-19.0)	(-23.8)	(-29.1)	(-14.0)	(-2.0)
Services (net)	22.8	30.0	29.9	27.2	26.8	26.8
Private transfers (net)	7.7	7.8	11.1	14.9	11.0	10.0
Official grants	2.1	4.2	3.7	5.4	7.4	9.0
Capital account	22.6	26.3	29.5	34.7	32.3	10.5
Public borrowing (net)	2.7	3.0	1.6	3.1	6.0	2.6
Of which: central government	(1.4)	(0.2)	(0.3)	(2.8)	(6.3)	(2.6)
Commercial banks	4.0	1.4	3.3	-1.6	-1.3	0.3
Private direct investment	20.6	26.0	30.9	38.2	20.0	7.0
Of which: Hess Co.	(19.0)	(24.0)	(28.9)	(34.1)	(17.0)	(4.4)
Currency holdings 1/	-1.0	-1.9	-1.0	-0.9	-0.8	-0.8
Errors and omissions	-3.7	-2.2	-5.3	-4.1	8.4	1.4
SDR allocation	--	--	0.5	0.5	--	--
Overall surplus or deficit (-)	-0.8	-1.0	-3.1	-4.3	1.2	-0.5
Financing	0.8	1.0	3.1	4.3	-1.2	0.5
Net ECCA borrowing	0.7	1.2	0.9	0.4	0.5	0.6
Change in foreign assets (increase -)	0.1	-0.2	-0.1	0.4	-0.1	-0.1
IMF borrowing	--	--	2.3	3.5	-1.6	--
	(In per cent of GDP)					
Current account	-28.2	-26.4	-29.2	-31.1	-23.2	-7.6
Current account (excluding Hess)	-11.0	-8.0	-8.2	-8.2	-12.8	-6.3
Capital account 1/	27.2	25.4	26.5	27.7	24.1	7.3
Overall balance	-1.0	-1.0	-2.7	-3.4	0.9	-0.3

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

1/ Includes SDR allocation.

III. Summary of Policy Discussions

1. Fiscal policy

One of the top priorities of the Administration, which took office in May 1982 after three years of a politically unsettled environment, was a strengthening of the public finances. In this setting the fiscal policy discussions centered on measures to improve the Central Government's finances in FY 1983/84 and over the medium term, considering the deterioration in its performance since FY 1979/80. Regarding the rest of the public sector, the mission noted that performance to date appeared satisfactory. The marginal decline in the rest of the general government's overall surplus in FY 1982/83 is explained by the effect of the high unemployment level on national insurance contributions. Furthermore, the selected public enterprises have improved their financial performance significantly since FY 1980/81.

The authorities agreed that the persistence of the Central Government's large deficits since the hurricane-related deterioration in FY 1980/81 reflected an excessive rise in current expenditure rather than lack of buoyancy in tax revenue. From FY 1978/79 to FY 1982/83 current expenditure rose by 9-1/2 percentage points of GDP to 32 per cent of GDP, while current revenue rose by 4-1/2 percentage points of GDP to 29 per cent of GDP; as a result, the current account surplus turned into a deficit equivalent to more than 2-1/2 per cent of GDP in FY 1982/83. The authorities noted that they had taken action to contain the growth in current expenditure. Thus, in 1981 the Government had laid off approximately 2,000 daily-paid workers because of lack of funds, and more recently vacancies in the civil service have remained unfilled. The authorities also pointed to the large savings which were obtained through improved management and control of expenditure on goods and services. Nevertheless, the Central Government had been in a critical financial situation since the third quarter of FY 1982/83; its overdraft facility with the commercial banks was exceeding its legal limit, and its payments arrears--estimated at EC$15.5 million at the end of FY 1982/83--were considered to have reached critical levels.

Looking to FY 1983/84 the authorities considered that the financial position of the Central Government had reached a state where the Government would have no alternative but to maintain the wage fund at its FY 1982/83 level, excluding retroactive payments made in that year. The staff inquired how this target would be achieved, given that negotiations are under way with the daily-paid workers--whose contract expired a year ago--and the civil servants whose contract expired at the end of March 1983. The authorities explained that their stand did not necessarily imply a wage freeze, but that--as they saw no way of financing additional current expenditure--any increase in wage and salary levels would have to be offset by a corresponding reduction in the Government's work force. They noted the already high ratio of tax revenue to GDP, and emphasized that they were determined to further improve the efficiency of the public administration and reduce its burden on the economy.

The authorities also noted their intention to continue to strengthen the management and expenditure control procedures established in FY 1982/83 and they believed that a further reduction relative to FY 1982/83 might be made in expenditure on goods and services. With a projected 7 per cent increase in current revenue--in line with the projected growth of nominal GDP--the Central Government would return to a surplus on current account, equivalent to 2 per cent of GDP in FY 1983/84; given the capital expenditure program as set out in the public sector investment program, the Central Government would incur only a small overall deficit in FY 1983/84.

The recent improvement in management methods and project implementation capacity was not reflected in a rise in capital expenditure in FY 1982/83 as the liquidity position of the Government hampered its investment activity. In FY 1983/84 some increase in investment outlays is expected, consistent with the public sector investment program developed with the cooperation of the World Bank. However, the projected increase in investment will depend crucially on the availability and magnitude of capital grants to the Central Government, inasmuch as part of the projected current account surplus would have to be used to reduce payments arrears. In the medium term, the authorities plan to continue to apply tight expenditure controls to free resources for implementation of investment projects which require local financing.

The public sector investment program includes four major projects (development of geothermal energy sources, reconstruction of the West Coast Road, establishment of an industrial free zone, and a water supply scheme) to which the St. Lucia authorities are attaching prime importance but which would require large-scale external assistance. The authorities have requested financing for these projects from members of the Caribbean Group for Cooperation and Economic Development but so far only partial financing has been agreed upon for the water scheme and the development of the geothermal energy source, both of which are in preliminary stages.

2. Monetary policy

St. Lucia has no central bank of its own, and it shares a currency, the East Caribbean dollar issued by ECCA, with six other states. ECCA has certain attributes of a central bank but has used its statutory powers only sparingly. Negotiations are under way among ECCA members to convert ECCA into a full-fledged central bank.

Except for the rates charged by the St. Lucia Mortgage Finance Company and the St. Lucia Development Bank, interest rates in St. Lucia are market determined. In 1978-80, domestic interest rates were far below international rates, but since then developments in St. Lucia have led to upward pressure on domestic rates while world market rates began to decline in 1982. The authorities noted that the gradual imposition

between mid-1980 and mid-1981 of a 10 per cent mandatory reserve requirement on commercial bank deposit liabilities tightened the banks' liquidity position. Furthermore, notwithstanding the present comparatively high domestic interest rates a significant decline in the growth rate of the commercial banks' resources had aggravated their liquidity problems, while the depressed state of the tourism sector, and the slow recovery in agriculture after the hurricanes were reflected in the freezing of a large part of their portfolio. The authorities were determined to restore some liquidity to the system by improving the Central Government's position with the banks.

In an effort to direct available credit toward productive areas the Government is considering the introduction of selective credit controls, specifying for a list of durable consumer goods their financing terms, including the minimum downpayment and maximum repayment period applicable. As an alternative, the authorities had considered the introduction tion of an import quota system. The staff noted that the credit controls--while preferable to import quotas--might be easily circumvented, and suggested that an increase in import duties on consumer goods would achieve the dual effect of discouraging such imports while improving the Central Government's financial position.

3. Wage and price policies and industrial relations

The Government felt that the settlement with the civil servants, which took effect in April 1982, had left many civil servants with wages significantly above those obtainable for similar work in the private sector. Even more important, in the view of the authorities, the resulting wage bill exceeds the country's capacity to pay, and they expect that both the civil service association and the daily-paid workers will moderate their wage demands in light of the recent experience whereby high wage settlements have forced the Government to reduce its work force.

Wage pressure in St. Lucia has moderated with the recent decline in inflation and the rise in unemployment, but a considerable amount of industrial unrest is rooted in the lack of established procedures for union recognition as several labor unions have been attempting to organize employees in the private sector in recent years. A Labor Code has been drafted with the assistance of the International Labor Organization and the authorities are considering presentation to Parliament of those sections which deal with union recognition. It is expected that in the present circumstances of high unemployment, the unions will focus on the issue of recognition procedures rather than on wage demands. Information on recent wage settlements in the private sector points to increases somewhat above those in the public sector in 1982, but with a tendency to cluster around 10 to 15 per cent per annum.

In the area of price controls, there has been no policy change and none is contemplated. Since 1980 a Prices Commission has advised a Price Control Division in the Ministry of Trade, Industry, Tourism and

Foreign Affairs on price controls. The authorities consider that such controls protect the domestic consumer against excessive mark-ups and in their judgment the system is not a deterrent to local producers. The controlled prices, mainly for imported goods, take the form of fixed maximum prices for sugar, flour, bread, fish, meat, rice, propane gas and fuels, while maximum mark-ups are set for most other imported foods, school supplies, and vehicles.

4. External policies

Given St. Lucia's lack of a cushion of international reserves the economy has been very sensitive to shifts in external conditions. The authorities had expected to begin to build up a cushion of reserves in FY 1982/83 by not using fully the Central Government's borrowing entitlements with ECCA. However, this goal would now have to be deferred until FY 1983/84 at the earliest.

The authorities expressed their concern over export prospects for 1983 in view of the recent changes in the Jamaican exchange system which had meant that Jamaican producers had gained competitiveness relative to imports. In 1982 Jamaica's share of St. Lucia's total merchandise exports was 11 per cent. CARICOM members would meet shortly to hear the Jamaican explanation of the new system and discuss solutions to the problems which it appeared to have created.

At present most manufacturing establishments are export-oriented with Jamaica and Trinidad as the major markets. The authorities believed that further development of the manufacturing sector requires an even higher degree of export orientation, and in addition that exports, as well as export markets, be diversified. An Export Development Committee will be set up to seek new markets and promote exports.

Payments and transfers for current international transactions are subject to controls but are not restricted. The surrender of exchange proceeds from exports and invisible transactions is mandatory but not enforced. Although outward transfers of capital are in principle restricted, these restrictions are ineffective as there is freedom of capital movement within the ECCA region, which is linked by a common currency, and exchange controls and restrictions vis-a-vis the rest of the world differ in scope and degree of enforcement among ECCA's member states. In addition, banks can move funds freely within ECCA, and ECCA does not impede the banks from transferring such funds outside the region.

St. Lucia's external debt service payments were relatively low at approximately 3 per cent of foreign exchange earnings from merchandise exports and tourism in 1982. The debt service has remained low, as St. Lucia has not been in a position to borrow abroad on commercial terms.

As a member of ECCA, the exchange rate of St. Lucia's currency, the East Caribbean dollar, can only be changed by unanimous agreement by all member states. The East Caribbean dollar was pegged to the pound sterling at EC$4.80 per pound sterling until July 1976, when its peg was changed to the U.S. dollar at EC$2.70 per U.S. dollar. The real effective exchange rate of the East Caribbean dollar (with St. Lucia trade weight) depreciated by 10 per cent between 1976 and 1979 but has appreciated by 14 per cent since then. In particular, the authorities were concerned about their recent loss of competitiveness in the European tourist market, at a time when the Mexican devaluation was perceived to adversely affect North American tourism to St. Lucia. The authorities also considered that at the present exchange rate, proceeds from banana exports to the United Kingdom barely covered production costs.

IV. Staff Appraisal

St. Lucia's economy recovered moderately in 1981 and 1982 following Hurricane Allen. In 1981 continued domestic demand pressures associated with an expanding government sector, buoyant public and private sector wage settlements, and relatively buoyant investment levels were reflected in persistent high inflation rates, notwithstanding a moderation in the rate of price increase in St. Lucia's major trading partners. In 1982 domestic demand pressures eased as private investment dropped sharply, wage settlements moderated somewhat, and the inflation rate declined. Indications are that growth in 1983 will remain at around 2-1/2 per cent, but contrary to the two previous years will be concentrated in the private sector. In particular, no expansion in the government sector is projected.

Wage policy, and its impact on the economy, remains the crucial issue in St. Lucia, in view of recent wage awards granted to private and public workers. In the case of the former, wage adjustments were well in excess of domestic price increases, while in the case of the latter, the rising wage bill--including its large retroactive component--exceeds the government payment capacity. Thus, notwithstanding a tightening of expenditure controls in general, a drastic curtailment of investment outlays, and a laying off of excess personnel, the Government has incurred large deficits and has accumulated arrears. The financing of these deficits has limited the expansion of credit to the private sector.

The staff concurs with the authorities that St. Lucia can ill afford the present burden of public administration and must reduce it by a combination of general expenditure controls and wage restraint. The authorities' proposed limits on further wage awards to public employees for FY 1983/84 goes far in returning the Government--and the economy--to a sustainable position. The projected improvement in the Government's performance would enable it to begin to reduce accumulated payments arrears. However, moderation in current expenditure will have to be

pursued over the medium term to ensure that resources are available to finance high priority investment projects, to eliminate payments arrears, and to repay the Government's debt with the commercial banks. The staff notes that the Government is committed to such a medium-term policy, and believes that a basis has been laid for its implementation.

A prudent fiscal policy stance will reduce the present upward pressure on interest rates, while helping to provide the financial resources needed for a recovery of the private sector. However, given the magnitude of the Government's payments arrears, these beneficial effects will come only gradually under the best of circumstances, unless additional external resources become available to St. Lucia.

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

Fund Relations with St. Lucia
(On April 30, 1983)

Membership date: November 15, 1979

Status: Article VIII

Quota: SDR 5.4 million

Fund holdings of St. Lucia currency:

	Millions of SDRs	Per cent of quota
Total	7.95	147.22
Under tranche policy	(1.35)	(24.99)
Compensatory financing facility	(1.20)	(22.22)

SDR Department:

	Millions of SDRs	Per cent of cumulative allocation
Net cumulative allocation	0.74	100.00
Holdings	--	zero

Exchange rate: 2.70 East Caribbean dollars = 1 U.S. dollar

Recent contacts: The last Article IV consultation discussions were held in Castries in November 1981 and concluded by the Executive Board in February 1982 (SM/82/21 and SM/82/22). A staff mission from the Fund's Bureau of Statistics visited Castries from March 30 to April 6, 1982 to discuss statistical developments. Mr. A. Osei, a member of the panel of fiscal experts, was assigned as Accounting Advisor to the Ministry of Finance in August 1980. He concluded his assignment in September 1982. Mr. Stephens, Fund Regional Advisor to Antigua and Barbuda, Dominica, Grenada, St. Vincent and the Grenadines, and St. Lucia, was stationed in St. Lucia from January 13, 1982 to February 4, 1983, when he took up residence in Antigua.

ST. LUCIA

Area and population	
Area	238 sq. miles (616 sq. kilometers)
Population (mid-1982)	124 thousand
Annual rate of population increase (1977-82)	1.5 per cent
GDP (1982)	SDR 121.5 million
GDP per capita (1982)	SDR 980

Origin of nominal GDP (1982)	(per cent)
Agriculture and fishing	15
Manufacturing	8
Construction	11
Government	20
Other	46

Ratios to GDP (1982)	
Exports of goods and nonfactor services	61.3
Imports of goods and nonfactor services	94.9
Central government revenues (fiscal year from April 1)	29.2
Central government expenditures (fiscal year from April 1)	41.6
External public and government-guaranteed debt (end of year)1/	17.8
Gross domestic savings	8.7
Gross investment	42.3
Money and quasi-money (end of year)2/	57.9

Annual changes in selected economic indicators	1979	1980	1981	1982
		(per cent)		
Real GDP per capita	8.2	-1.6	1.4	0.5
Real GDP (at factor cost)	9.0	-0.1	3.0	2.1
Nominal GDP at market prices	24.7	9.7	11.9	5.6
Domestic expenditure (at current prices)	23.2	9.4	16.7	-2.2
Investment	(24.8)	(16.9)	(10.4)	(-23.8)
Consumption	(22.1)	(4.4)	(21.4)	(12.2)
GDP deflator	13.6	12.3	9.0	3.0
Consumer prices (annual averages)	9.4	19.6	15.0	4.6
Central government revenues (fiscal year from April 1)	33.6	10.0	12.6	14.5
Central government expenditures (fiscal year from April 1)	36.2	22.5	13.2	19.7
Money and quasi-money 2/	17.1	11.9	14.8	5.2
Money	(26.0)	(6.1)	(7.4)	(10.5)
Quasi-money	(13.3)	(14.8)	(18.1)	(3.0)
Net commercial bank assets 3/	18.3	19.5	13.5	3.3
Credit to Central Government (net)3/	(4.2)	(2.0)	(0.7)	(2.4)
Credit to private sector 3/	(24.5)	(30.3)	(16.5)	(8.1)
Merchandise exports (f.o.b, in U.S. dollars)	19.0	44.2	-9.6	--
Merchandise imports (c.i.f., in U.S. dollars)	22.2	22.3	3.9	-8.3
Travel receipts (gross, in U.S. dollars)	20.6	21.3	-4.9	5.5

	1979	1980	1981	Proj. 1982
Central government finances (fiscal year from April 1)	(millions of East Caribbean dollars)			
Revenues and grants	87.5	90.7	108.7	126.7
Expenditures	90.6	111.1	125.7	150.6
Current account surplus or deficit (-)	1.2	1.3	1.3	-9.9
Overall surplus or deficit (-)4/	-3.1	-20.3	-17.0	-23.9
Overall surplus or deficit on cash basis	3.1	-26.9	-10.6	-16.5
External financing (net)	3.6	11.5	13.1	9.0
Domestic financing (net) and residual	-0.5	15.4	-2.5	7.5
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	31.9	46.0	41.6	41.6
Merchandise imports (c.i.f.)	-101.2	-123.8	-128.6	-117.9
Travel (net)	29.2	34.1	30.7	31.2
Other services and transfers (net)	12.8	10.6	16.8	14.0
Balance on current and transfer accounts	-27.3	-33.1	-39.5	-31.1
Official capital (net)	3.0	1.6	3.1	6.0
Private capital (net) and errors and omissions	23.3	27.9	31.6	26.3
SDR allocation	--	0.5	0.5	--
Change in official net reserves (increase -)	1.0	3.1	4.3	-1.2

1/ Excludes ECCA and IMF.
2/ Includes deposits of nonresidents.
3/ Changes in relation to liabilities to the private sector at beginning of period.
4/ On a commitment basis.