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January 27, 1989

To: Members of the Executive Board

From: The Acting Secretary

Subject: St. Vincent and the Grenadines - Staff Report for the 1988 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1988 Article IV consultation with St. Vincent and the Grenadines, which will be brought to the agenda for discussion on a date to be announced.

Mr. Kawar (ext. 7685) or Mr. Shibuya (ext. 7693) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

ST. VINCENT AND THE GRENADINES

Staff Report for the 1988 Article IV Consultation

Prepared by the Staff Representatives for the
1988 Article IV Consultation with St. Vincent and the Grenadines

Approved by S. T. Beza and S. Kanesa-Thasan

January 25, 1989

The 1988 Article IV consultation discussions with St. Vincent and the Grenadines 1/ were held in Kingstown during the period November 22-December 7, 1988. The representatives of St. Vincent included the Acting Prime Minister, the Director General of Finance and Planning, and other senior officials of the Government and the public enterprises. Mr. Engert, Advisor to the Executive Director for St. Vincent, participated in the concluding round of meetings. The staff representatives were Messrs. Kawar (Head), Pearson, Shibuya, Thornton, and Ms. Rowles (Secretary), all from WHD. St. Vincent accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement in August 1981. 2/

The last Article IV consultation with St. Vincent was concluded by the Executive Board on July 6, 1987 (EBM/87/98); at that meeting, it was recommended that the next Article IV consultation be held on an 18-month cycle. St. Vincent is eligible to use both the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF) but thus far has not expressed an interest in doing so.

I. Economic Background and Recent Developments

The economy of St. Vincent is based primarily on agriculture, with bananas and vegetables as the major crops. A small manufacturing sector developed in the early 1980s under the stimulus of generous fiscal incentives and relatively low labor costs, but since 1985 its growth has been slowed down by infrastructural bottlenecks and rising real wages. Tourism has not developed into a major activity and remains hampered by difficulties of international access.

Real GDP grew at an average annual rate of nearly 6 percent during the period 1984-88 even after allowing for a mild slowdown in 1987 when agricultural crop production was adversely affected by two tropical storms and by drought early in the year. The recent growth performance

1/ Hereafter referred to as St. Vincent.
2/ Relations with the Fund are presented in Appendix I.

has been paced by a sharp recovery of agricultural production in 1988, by the buoyancy of construction activity since 1986 largely attributable to work on the Cumberland hydroelectric project, and by the growth of the trade sector (Table 1). Meanwhile, the growth of aggregate demand has been moderate, essentially in reflection of restrained fiscal policy, and inflation, as measured by the consumer price index, has remained low; the index has risen by less than 2 percent annually from mid-1984 to mid-1988 but its behavior is perhaps not fully reflective of underlying price pressures in view of the pervasiveness of controls.

Table 1. St. Vincent and the Grenadines: Selected Economic Indicators, 1983/84-1987/88 1/

(Annual percentage change)

	1983/84	1984/85	1985/86	1986/87	Est. 1987/88
GDP at current market price	10.2	9.3	11.4	11.2	7.4
GDP at constant factor cost	6.0	5.9	6.3	5.9	5.6
Agriculture	(7.2)	(7.4)	(5.9)	(-0.7)	(6.7)
Manufacturing	(5.6)	(4.8)	(2.8)	(4.6)	(4.9)
Construction	(2.4)	(1.0)	(9.1)	(13.2)	(7.0)
Wholesale and retail trade	(3.3)	(6.5)	(9.4)	(9.1)	(9.1)
Consumer prices (average)	4.0	2.5	1.5	1.7	1.7
Terms of trade	1.4	3.8	8.9	5.5	-1.1

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

1/ The fiscal year begins on July 1.

Much of the growth in sectors such as agriculture and construction has resulted from productivity increases brought about by more intensive utilization of chemicals in agriculture, the shift to dry field packing of bananas, mechanization in construction, and on-the-job training in manufacturing; there has been little generation of additional employment opportunities, in part reflecting the pace of wage increases in the private sector, which at 7-11 percent annually significantly exceeded the rate of price increases. Unemployment is believed to be substantial although no reliable data on the size of the labor force and the extent of unemployment are available. The unemployment rate is thought to be particularly high for women in rural areas and for secondary school graduates.

The public finances were strengthened considerably during FY 1984/85 and FY 1985/86 1/ as a result of both revenue and expenditure measures. On the revenue side, consumption taxes, port charges, and utility rates were increased, and financial controls on some state enterprises were tightened thereby improving cash flow. The growth of expenditures was restrained with the aid of a freeze on wages and salaries and the closing down of the state-owned sugar refinery which had been operating at a loss. With these measures, public sector savings as measured by the current account balance rose from a negative level in FY 1983/84 to the equivalent of 8 percent of GDP in FY 1985/86 (Table 2). Over the same period, the overall balance of the nonfinancial public sector shifted from a deficit equivalent to 6 1/2 percent of GDP to surpluses averaging 3 percent of GDP, which made possible a large reduction in domestic public debt. Public sector savings continued to rise in FY 1986/87 and FY 1987/88 despite wage increases averaging 6 percent annually, but the overall balance swung back into deficit as a result of a sizable increase in capital outlays following the launching of the three-year public sector investment program (PSIP). Since most of public investment was financed from external sources, however, the net indebtedness of the public sector to the domestic commercial banks continued to decline.

There is little scope for conducting an active monetary policy in St. Vincent since the Eastern Caribbean Central Bank (ECCB), which acts as a common central bank to eight small Caribbean islands, 2/ is restricted by statute in the amount of credit it can extend to the public sector and must maintain a 60 percent foreign currency cover against its deposits and other demand liabilities. The net reserve position of St. Vincent's commercial banks improved considerably from 1984 to 1988, reflecting the reduction of public sector debt, slow growth of credit to the private sector, and a sharp increase in private sector deposits related to the growth of agricultural incomes. At the end of August 1988, the commercial banks' net reserve position--consisting of their net foreign assets and claims on the ECCB--amounted to nearly EC$91 million, equivalent to more than 54 percent of their liabilities to the private sector, compared with a slightly negative position in mid-1984. During the same period, the loan-to-deposit ratio declined from 94 percent to 67 percent.

Interest rates in St. Vincent are not regulated officially except for an ECCB stipulation that banks pay a minimum annual rate of 4 percent on savings deposits. Interest-bearing deposits are subject to a 2 percent tax but the effective rate of this tax has been progressively reduced by allowing banks to treat it as a deductible expense for income tax purposes and by lowering any bank's taxable base by the amount of its mortgage lending activity. Notwithstanding these tax concessions and the increased liquidity in the system, the prime lending rate has

1/ Fiscal years beginning July 1.

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

Table 2. St. Vincent and the Grenadines: Operations of the Consolidated Public Sector 1/, FY 1983/84-FY 1990/91

	1983/84	1984/85	1985/86	Prel. 1986/87	Est. 1987/88	Proj. 1988/89	Proj. 1989/90	Proj. 1990/91
	(In millions of Eastern Caribbean dollars)							
Total revenue and grants	85.7	97.0	117.2	143.4	151.0	152.4	167.4	179.3
Current revenue	75.2	88.7	103.2	116.5	132.1	133.4	141.6	151.5
Capital grants	10.5	8.3	13.9	26.9	18.9	19.0	25.8	27.8
Total expenditure	103.1	90.5	105.1	147.5	160.5	163.7	180.0	186.4
Current expenditure	77.5	74.8	78.0	87.3	97.5	113.7	122.2	130.5
Capital expenditure	25.6	15.7	27.2	60.1	63.1	50.0	57.8	55.9
Of which: public enterprises	(15.2)	(5.1)	(13.9)	(32.1)	(28.5)	(8.2)	(5.4)	(7.1)
Public sector savings	-2.3	13.9	25.3	29.2	34.7	19.7	19.4	21.1
Central Government	-2.8	10.2	15.9	15.6	15.5	-1.6	-3.4	-3.1
Rest of general government 2/	4.1	4.9	5.2	5.9	8.6	9.5	10.1	10.7
Public enterprises	-3.6	-1.3	4.2	7.7	10.6	11.8	12.6	13.4
Overall surplus or deficit (-)	-17.4	6.4	12.0	-4.1	-9.5	-11.3	-12.6	-7.1
Central Government	-5.4	6.7	9.9	0.8	-2.8	-24.7	-31.3	-26.3
Rest of general government	3.9	4.7	5.0	5.1	7.4	8.2	8.8	9.4
Public enterprises	-16.0	-5.0	-2.8	-9.9	-14.1	5.2	9.8	9.9
Financing	17.4	-6.4	-12.0	4.1	9.5	11.3	12.6	7.1
External (net)	5.3	-2.0	0.5	19.7	20.7	11.4	12.0	10.0
Domestic (net)	12.1	-4.5	-12.5	-15.7	-11.2	-0.1	0.6	-2.9
	(In percent of GDP)							
Total revenue and grants	32.2	33.6	36.4	40.1	39.3	36.2	37.3	37.8
Of which: current revenue	28.2	30.7	32.1	32.6	34.4	31.7	31.5	32.0
Total expenditure	38.7	31.3	32.7	41.2	41.8	38.9	40.1	39.3
Current expenditure	29.1	25.9	24.2	24.4	25.4	27.0	27.2	27.5
Capital expenditure	9.6	5.4	8.5	16.8	16.4	11.9	12.9	11.8
Public sector savings	-0.9	4.8	7.9	8.2	9.0	4.7	4.3	4.4
Of which: Central Government	-1.0	3.5	5.0	4.4	4.0	-0.4	-0.8	-0.6
Overall surplus or deficit (-)	-6.5	2.2	3.7	-1.1	-2.5	-2.7	-2.8	-1.5
Of which: Central Government	-2.0	2.3	3.1	0.2	-0.7	-5.9	-7.0	-5.6

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

1/ The public sector comprises the Central Government, the Kingstown Board, the National Insurance Scheme, and nine nonfinancial public enterprises. No adjustments were made to the accounts of those statutory bodies whose financial years were different from that of the Central Government.

2/ Mainly the national pension plan.

changed little in recent years, fluctuating in the range of 11 1/2-12 1/2 percent, making it the highest among all the members of the East Caribbean currency union. Meanwhile, time deposit rates have declined from the range of 4-7 1/2 percent to the range of 3 1/2-6 1/2 percent.

After improving in FY 1984/85 and recording a surplus in FY 1985/86, the current account of the balance of payments reverted to deficits equivalent to 10 percent of GDP in FY 1986/87 and 15 percent in FY 1987/88. This reflected a weather-related decline in the production and export of bananas, reduced exports of vegetables to neighboring Trinidad and Tobago following the devaluation of the Trinidad dollar, and an acceleration in the growth of imports related to the construction of the Cumberland hydroelectric station. However, since most of project-related imports are financed with external grants and loans, the deterioration in the current account was generally offset by an improvement in the capital account and the overall balance has been in surplus every year since FY 1984/85 with the exception of FY 1986/87, when a deficit of US$2 million was recorded (Table 3).

External debt was equivalent, on average, to 22 percent of GDP in the three fiscal years 1984/85-1986/87 but rose to about 27 percent in FY 1987/88, primarily because of disbursements associated with the Cumberland project (Table 4). However, most of the debt has been contracted on concessionary terms with an average interest rate of less than 5 percent a year and repayment periods averaging more than 15 years. In FY 1987/88, debt service payments amounted to about 3 percent of exports of goods and services.

The currency of St. Vincent is the Eastern Caribbean dollar (EC$), which has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar since July 1976. The index of the real effective exchange rate rose from its 1980 base to a peak of 121 in February 1985 but subsequently declined to 98 in May 1988; since then the index has risen slightly, reaching 101 in October 1988, the latest month for which data are available, reflecting the appreciation of the U.S. dollar.

St. Vincent is a member of the Caribbean Community (CARICOM) which aims to establish a common market between the member states and to standardize external trade tariffs with respect to third countries. The agreement unifying tariffs on most commodities imported from third parties took effect on October 1, 1988 but allows members to protect for a limited period a number of commodities produced within each state. Otherwise, St. Vincent's economy is highly open with no restrictions on the movement of goods or on current transfers.

Table 3. St. Vincent and the Grenadines: Summary Balance of Payments 1983/84-1990/91

	1983/84	1984/85	1985/86	1986/87	Prel. 1987/88	Proj. 1988/89	Proj. 1989/90	Proj. 1990/91
	(In millions of U.S. dollars)							
Current account balance	-6.8	-0.2	8.2	-13.7	-21.8	-4.7	-10.1	-12.3
Trade balance	-27.4	-19.0	-11.4	-34.6	-45.0	-31.1	-38.7	-43.9
Exports, f.o.b.	(45.0)	(60.0)	(70.3)	(56.2)	(65.3)	(72.0)	(76.9)	(82.3)
Imports, c.i.f.	(-72.4)	(-79.0)	(-81.7)	(-90.8)	(-110.3)	(-103.1)	(-115.6)	(-126.2)
Services (net)	6.9	6.3	5.8	6.0	7.2	9.5	10.6	12.5
Tourism (net)	(9.3)	(9.6)	(10.0)	(10.4)	(11.8)	(14.2)	(15.7)	(17.7)
Other services (net)	(-1.4)	(-2.3)	(-3.1)	(-3.3)	(-3.3)	(-3.4)	(-3.5)	(-3.5)
Interest	(-1.0)	(-1.1)	(-1.1)	(-1.1)	(-1.3)	(-1.4)	(-1.6)	(-1.7)
Transfers (net)	13.7	12.5	13.8	14.9	16.0	17.0	18.0	19.1
Capital account balance	10.5	6.3	2.4	11.9	9.3	4.7	10.1	12.3
Official grants	3.9	3.1	5.1	10.0	7.0	7.0	9.5	10.3
Official borrowing (net)	2.4	1.2	2.9	5.2	7.0	4.8	5.0	4.4
Drawings	(3.1)	(2.3)	(4.4)	(6.6)	(8.6)	(6.3)	(6.7)	(6.4)
Amortization	(0.7)	(1.1)	(1.5)	(1.4)	(1.6)	(1.5)	(1.7)	(2.0)
Commercial banks (net)	2.5	0.4	-8.0	-6.6	-8.2	-9.9	-6.4	-4.2
Private direct investment	1.8	1.6	2.4	3.3	3.6	2.8	2.0	1.8
Other (including errors and omissions)	-5.8	2.7	-0.9	-0.6	12.9	—	—	—
Overall balance	-2.1	8.8	9.7	-2.2	0.5	—	—	—
Financing	2.1	-8.8	-9.7	2.2	-0.5	—	—	—
Change in official reserves	1.4	-7.5	-8.6	2.6	-0.1	—	—	—
Change in foreign assets	0.9	-0.6	-0.4	-0.4	-0.4	—	—	—
Net credit from IMF	-0.2	-0.7	-0.7	—	—	—	—	—
	(In percent of GDP)							
Current account	-7.0	-0.2	6.9	-10.3	-15.3	-3.0	-6.1	-7.0
Trade balance	-28.0	-17.8	-9.6	-26.1	-31.6	-20.0	-23.3	-25.0
Exports, f.o.b.	(46.0)	(56.1)	(59.0)	(42.4)	(45.9)	(46.2)	(46.3)	(46.9)
Imports, c.i.f.	(-74.0)	(-73.9)	(-68.6)	(-68.5)	(-77.5)	(-66.2)	(-69.5)	(71.8)
Service balance	7.0	5.9	4.9	4.5	5.1	6.1	6.4	7.1
Tourism (net)	9.5	9.0	8.4	7.8	8.3	9.1	9.4	10.1
Capital account	10.8	5.9	2.1	8.9	6.6	3.0	6.1	7.0
Official grants	4.0	2.9	4.3	7.5	4.9	4.5	5.7	5.8
Official borrowing (net)	2.5	1.1	2.4	3.8	4.9	3.1	3.0	2.5

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

Table 4. St. Vincent and the Grenadines: Public and Publicly-Guaranteed External Debt 1983/84-1990/91 1/

	1983/84	1984/85	1985/86	1986/87	1987/88	Projected 1988/89	1989/90	1990/91
	(In millions of U.S. dollars)							
Total debt (end of period)	22.8	23.0	25.2	31.0	37.9	42.7	47.6	52.0
Total debt service obligations	1.8	2.9	3.3	2.6	2.8	2.9	3.3	3.7
Amortization	0.8	1.8	2.2	1.4	1.6	1.5	1.8	2.0
Interest	1.0	1.1	1.1	1.1	1.3	1.4	1.6	1.7
Debt service on loans disbursed through Dec. 31, 1987	1.8	2.9	3.3	2.6	2.8	2.9	3.0	3.2
Amortization	0.8	1.8	2.2	1.4	1.6	1.5	1.7	2.0
Interest	1.0	1.1	1.1	1.1	1.3	1.3	1.3	1.2
Debt service on loans disbursed after Dec. 31, 1987	--	--	--	--	--	--	0.3	0.6
Amortization	--	--	--	--	--	--	--	--
Interest	--	--	--	--	--	--	0.3	0.6
	(In percent)							
Average interest rate 2/	5.0	5.0	4.8	4.5	4.0	3.6	3.7	3.6
Total debt/GDP	23.3	21.5	21.2	23.4	26.6	27.4	28.7	29.6
Debt service/exports of goods and services	2.9	3.7	3.7	3.4	3.3	3.2	3.4	3.5

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

1/ Medium- and long-term debt. Includes obligations to the Fund but excludes obligations to the ECCB.

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

II. Economic Policies and Prospects

At the conclusion of the 1987 Article IV consultation with St. Vincent, Executive Directors welcomed the authorities' continued commitment to sound fiscal policies and expressed support for their development strategy of promoting private sector activity through improvements in the infrastructure and the establishment of a special development window at the state-owned financial institutions. The authorities were encouraged to exercise restraint in granting pay increases and to improve project-implementation capacity. Directors also observed that it was important to encourage private sector participation in the construction of factory shells. Additionally, it was noted that actions to encourage foreign investment and to reduce the spread between deposit and lending rates would be helpful.

1. Development strategy and policies

The rolling three-year PSIP has been updated to cover the period 1988-90. The thrust of the development strategy remains unchanged, i.e., to broaden the economic base by promoting private sector activities in agriculture, manufacturing, and tourism. The Government's role is to provide infrastructure and supporting legislation. Total public investment over the three-year period is budgeted at nearly EC$230 million (about 22 percent of projected GDP) of which nearly one quarter is to be spent on agriculture, and a similar proportion on transportation. The principal agricultural project is the Orange Hill development program which aims to broaden the agricultural base by redistributing the largest agricultural estate to individual farmers while improving the rural road network and farmer access to credit, inputs, and extension services. Another key project is the development of the Diamond industrial estate through the construction of factory shells and the provision of the necessary water, electricity, and roads to attract manufacturers to the new site. The World Bank is of the view that the PSIP is consistent with the Government's objective of promoting private activity but has expressed reservations about the project-implementation capacity of the public sector in view of the shortage of technical personnel.

The authorities indicated that they had taken action to improve the implementation of the PSIP. A wage reclassification scheme structured so as to increase the compensation of key technical personnel was approved in December 1988 with the objective of reducing shortages of personnel in departments responsible for the implementation of public investment. Moreover, customs exemptions have been granted to private sector importers of heavy equipment in order to speed up progress on construction work, and a quarry development project aimed at reducing the shortage of crushed stone for mixing with cement has been assigned high priority. The authorities, however, noted the disappointing response of the private sector thus far to their initiatives as well as to the increased availability of finance through both a public enterprise--the Development Corporation (DEVCO)--and the commercial banking system; few new employment-generating projects have been undertaken by the private sector. The authorities indicated that there were increasing calls for the public sector to undertake directly productive activities, especially in the tourism sector, in order to alleviate the unemployment problem.

Notwithstanding the actions being taken to improve the implementation of public investment, there were several issues that still needed to be addressed by the policy makers. Firstly, the appreciation of the pound sterling has increased the profitability of banana exports to the traditional outlet in the United Kingdom. This resulted in the diversion of land away from other crops and into bananas, thereby increasing the concentration of the production structure and making agriculture more vulnerable to a possible diminution of preferential access to the U.K. market following the elimination of internal trade barriers in the European Economic Community in 1992. Secondly, continuation of price controls, particularly on food products, discouraged domestic production of such traditional commodities as fish and meat. Thirdly, the economy of neighboring Trinidad and Tobago, which had traditionally served as the principal outlet for Vincentian vegetables and manufacturing exports, had slumped and the timing of its recovery was uncertain. Fourthly, the development of the manufacturing sector remained constrained by the lack of progress in preparing the Diamond estate site and by cumbersome administrative procedures for approval and licensing of projects.

There appeared to be no alternative over the medium term to bananas as the premier agricultural export in view of the well established production and marketing arrangements. It was thus important for the authorities to focus on improving the international competitiveness of bananas by a strategy relying on containment of cost increases, improvement of quality and yields, and regional cooperation to reduce external marketing costs. Key ingredients in such a strategy would be upgrading of rural roads in order to reduce damage to the crop while being transported, construction of covered sheds to reduce spoilage due to exposure and infestation, and expansion of extension services. Additionally, there was scope to encourage increased domestic production of traditional food commodities through the removal of price controls, thereby helping to reduce the concentration of agricultural production.

For the development of manufacturing, the dispute regarding compensation for the site of the Diamond estate remained unresolved. It was important that this matter be resolved soon, and it also was desirable that the procedures for approving investment requests be streamlined and concentrated in a single government department in order to speed up the processing of investment applications. The authorities indicated that they were mindful of the proliferation of responsibilities for reviewing investment applications and that the new investment law now under preparation would streamline the authorization procedures. The mission expressed the view that the authorities should exercise caution before raising the minimum wage to the level being pressed by labor unions, noting that attractive labor costs constituted a principal appeal to foreign investors and that some existing manufacturing concerns would not be profitable at the contemplated new level of the minimum wage.

2. Fiscal policy

The fiscal position has been weakened in the current fiscal year (1988/89) by revenue losses resulting from increasing the exemption level for payment of personal income tax, from EC$5,000 to EC$10,000, and by the granting of numerous exemptions from customs duties. On the expenditure side, the wage bill is projected to increase by 17 percent following adoption of the comprehensive wage reclassification scheme which resulted in sizable and broad-based wage increases and awarded one-time bonuses for those employees who were not granted wage increases.

The authorities explained that the increase in the income tax threshold level, apart from fulfilling one of the commitments on which the Government won the last general election, was intended to reduce the burden of individual income taxation which they felt was among the highest in the Caribbean region and contributed to work disincentives. The customs exemptions were regarded as an important inducement to the importation of heavy equipment needed to improve the implementation of public investment. In the expenditure area, the authorities regarded the wage reclassification scheme as the cornerstone in the alignment of pay scales with the demand for skilled personnel in the public sector. They were mindful of the need to contain the growth of the wage bill and thus their policy over the short term was to fill only essential vacancies.

Projections of the outcome of the consolidated public sector finances for FY 1988/89 were prepared on the assumption that no new revenue measures would be enacted, the announced exemptions would be maintained, the wage reclassification scheme would become effective as drawn up, and the PSIP would be implemented at a 65 percent rate which would be in line with past performance. On this basis, there would be little growth of revenues, and current expenditures would rise by about 17 percent while capital expenditures would fall by about 21 percent, mainly reflecting the completion in large part of the Cumberland hydroelectric project. The current account surplus would decline from the equivalent of 9 percent of GDP to about 5 percent (with central government operations actually showing a current account deficit). The overall deficit would widen further to the equivalent of 3 percent of GDP with the central government operations projected to show a deficit of nearly 6 percent of GDP. The overall deficit would likely be covered entirely from available concessionary financing of the investment program thus obviating recourse to the domestic banking system.

Although the current account balance of the public sector is projected to remain in surplus, there were factors that called for action to strengthen the public finances. Firstly, the fiscal position had been bolstered for some time by the large surpluses of the National Insurance Scheme (NIS), which thus far had experienced a very favorable cash flow and built up substantial deposits with the National Commercial Bank (NCB). However, these assets would be drawn upon in the future, and thus the accumulation by the NIS should not be regarded as depicting a sustainable public sector position. Secondly, it appeared desirable to reduce reliance on external financing of the PSIP in order to provide greater flexibility in implementing priority projects that may not have the support of external finance agencies.

It was recommended that additional revenues be generated through increasing consumption taxes and licensing fees, and by raising user charges for public utilities. Increases in income taxes may not be feasible following the recent adjustment of the threshold level and given the need to maintain a competitive employment and investment environment in relation to neighboring countries. Furthermore, for St. Vincent, higher customs duties will be possible only in the case of a few commodities because of the entry into effect of the CARICOM duties harmonization agreement.

The authorities reaffirmed their strong commitment to prudent fiscal policies which they stressed had been a key tenet of the present Government since it assumed office in July 1984. They pointed to the past record of revenue mobilization and control over current expenditures which had resulted in the systematic generation of surpluses on current account and had enabled the Government to finance an increasing proportion of the public investment program. They also agreed with the need for revenue mobilization but indicated that their immediate efforts would concentrate on administrative improvements in the tax collection mechanism.

3. Monetary developments

The progressive reduction in the public sector's indebtedness to the banking system, together with a series of balance of payments surpluses, has steadily improved the liquidity position of commercial banks. This has been reflected in a decline in deposit interest rates but lending rates have not followed suit despite the authorities' move to reduce the cost of funds to banks by allowing the tax on deposits to be deducted for purposes of business profit tax calculations. Although banks have indicated that lending rates would decline if the tax were removed, the authorities were reluctant to act unless some understanding were reached with the banks to ensure a commensurate reduction in lending rates. Moreover, removal of the tax would result in the loss of about 3 percent of the Government's current revenues.

The authorities expressed concern about the limited expansion of bank credit to the private sector for productive purposes. Similarly, despite being in operation since 1982, a special development window financed by the Caribbean Development Bank (CDB) and administered by DEVCO has been utilized very little. The commercial banks and DEVCO, however, attributed this situation to risk aversion on the part of entrepreneurs and to a shortage of bankable projects. In the banks' view, businessmen typically prefer to borrow for short-term trading purposes and would avoid undertaking long-term commitments unless interest rates were to be reduced very substantially below the prevailing levels. Additionally, there appeared to be little demand for borrowing by foreign investors who relied on external financing for their projects.

To stimulate housing construction, the Government launched in June 1988 a mortgage financing facility which is being administered by the NCB. This facility, with total resources of about EC$12 million, is being funded in equal shares by the CDB, the NIS, and the NCB. Since its inception, the facility has committed more than one half of its total resources to financing housing construction on the standard terms of 10 percent interest and a 20-year repayment period.

4. External sector policies and outlook

Exports of bananas are likely to remain buoyant in FY 1988/89 reflecting additional production brought about by sharply higher prices. Gains is this area are expected to more than offset the slack in other agricultural exports caused by reduced demand in the Trinidad and Tobago market and difficulties encountered in expanding manufacturing exports given the capacity constraints associated with delays in developing the Diamond industrial estate. Moreover, net earnings from tourism are projected to increase by about 20 percent in reflection of growth in short-stay cruise business. Imports are projected to decline in FY 1988/89 because of the winding down of work on the Cumberland hydroelectric project, but this would be matched by a reduction in net official capital inflows. Debt service is projected to continue rising in view of the increase in the stock outstanding but would remain at about 3 percent of exports of goods and services. Overall balance in the external accounts is projected for FY 1988/89.

For the medium term, the external environment favors increased exports of bananas inasmuch as prices are expected to remain sufficiently high to attract more marginal producers while increased cultivation efficiency is projected to raise the output of existing producers. Although the access of Caribbean bananas to the U.K. market will be reviewed in 1992, the authorities expect a continuation of some preferential treatment and are therefore not acting to discourage increased production. In fact, an increase in the price paid to banana producers for the 1989 agricultural season is under consideration. Moreover, an increase in production is widely viewed as better positioning St. Vincent for future access to the European market to take advantage of the possible adoption of an EEC-wide quota.

For the immediate future, the principal concern of the authorities in the export area is related to the decline of demand for Vincentian exports by Trinidad and Tobago. They are therefore exploring the costs and benefits of shifting production away from ground crops to tropical fruits which are believed to enjoy better sales prospects in the North American market. The PSIP contains allocations for such an expansion in cultivation and the authorities have been encouraged by tests performed by the U.S. Food and Drug Administration which confirm that Vincentian tropical fruits are free from fruitfly infestation and can therefore enter the U.S. market. Also, the authorities expressed optimism about the prospects for manufacturing exports over the medium term following the development of the Diamond estate, notwithstanding the inadequacy of the existing port facilities.

The authorities expected continuing growth of tourism following the completion of plans to expand airport facilities in the Grenadines islands, the establishment of a maritime museum, and improvements in facilities for cruise-ships on the main island of St. Vincent. However, they recognized that tourism could not be developed on the scale of other Caribbean islands in view of the large investments that would be required for bringing airport facilities to international standards and providing additional accommodation, and because of concern about the fragile marine ecology of such areas as the Tobago Cays. Consequently, over the medium term the development of tourism would continue to focus on special niches in the market such as diving, visits by yachts and cruise-ships, and the up-market tourist seeking exclusivity and privacy.

As noted earlier, the real effective value of the Eastern Caribbean dollar for St. Vincent has declined from the high level reached in early 1985. The authorities consider that the exchange rate is adequate for the time being. They noted that although average real wages had risen significantly, the rise had in most instances been matched by productivity increases and thus had not resulted in an erosion of the economy's competitiveness.

The exchange system for St. Vincent is free of restrictions on payments and transfers for current international transactions and has not changed since the last Article IV consultation.

III. Staff Appraisal

St. Vincent's economy has performed well during the four fiscal years ending June 1988, with high rates of real GDP growth, balance of payments surpluses notwithstanding adverse weather conditions, and reasonable price stability. A principal contributor to those developments was the strengthening of the public finances which resulted in a steady reduction of the public sector's indebtedness to the banking system.

For the fiscal year 1988/89, prospects are for a continuation of rapid output growth based on a strong performance of the agricultural sector, which has been buoyed by increased profitability of banana cultivation, and of construction activity encouraged by strong demand for housing. The balance of payments should continue to benefit from favorable external developments, particularly with respect to banana prices and tourism. However, the public finances are expected to weaken because of actions which have lowered taxes and increased civil servants' wages.

Despite the satisfactory growth and price performance of recent years and favorable prospects for the period immediately ahead, unemployment remains substantial and there are several areas of uncertainty as regards the medium- and longer-term economic outlook. First, the structure of agricultural production has become more dependent on bananas, the export of which is vulnerable to the possible diminution of preferential access to the U.K. market after 1992. Second, the economy of neighboring Trinidad and Tobago, which has traditionally served as outlet for Vincentian exports, has been experiencing difficulties. Third, the development of manufacturing remains constrained by administrative bottlenecks and delays in the construction of factory shells. Finally, the economy remains heavily dependent on external aid to finance public investment.

The authorities' plans for dealing with these issues are enunciated in the updated three-year development plan, 1988-90. The staff supports the authorities' strategy of concentrating on the provision of infrastructure and relying on the private sector to undertake employment generating activities. In this connection, the authorities should resist calls for investing in direct employment generating activities. Rather, the focus should be on improving the implementation of the investment program by addressing the administrative and physical bottlenecks, and to reallocate investment so as to cencentrate on improving the agricultural and manufacturing infrastructure.

Measures aimed at increasing the international competitiveness of bananas through containment of cost increases, improvement of quality and yields, and regional cooperation to reduce marketing costs could have significant yields. A number of additional measures could be taken to help broaden the economic base. The streamlining and simplification of licensing and other regulatory procedures would encourage new private investment in manufacturing while the removal of price controls would restore production incentives in such traditional activities as fishing and animal husbandry.

Strengthening the government finances and restoring a high level of public saving would help reduce dependence on the surpluses of the National Insurance Scheme and external aid for funding the public sector investment program. Additional resources should be mobilized primarily through increasing indirect taxes and user charges for public utilities. While supporting the policy of selective increases in civil servants' pay scales in view of the difficulties experienced in attracting and retaining qualified personnel in some crucial positions--a factor which has contributed to the underimplementation of the investment program--the staff would stress that these adjustments should be made within a framework of overall containment of the wage bill.

There is little scope for conducting monetary and exchange rate policy in St. Vincent given that the country shares a common currency and central bank with seven other states. Concerning the level of the exchange rate, in light of the real effective depreciation of St. Vincent's currency that has taken place since 1985, the present level of the exchange rate appears to be adequate for St. Vincent's circumstances.

With its generally good record of economic growth and prudent financial management, a shift of St. Vincent from the present 18-month consultation cycle to a 24-month cycle was discussed. However, given the uncertain prospects for exports, tourism, and aid, the authorities have expressed a preference to remain on the 18-month cycle. Accordingly, it is recommended that St. Vincent continue on the present consultation cycle.

St. Vincent and the Grenadines--Fund Relations
(As of December 31, 1988)

I. Membership Status

(a) Date of membership: December 28, 1979

(b) Status: Article VIII

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 4.0 million

(b) Total Fund holdings of currency: SDR 4.0 million (100 percent of quota)

(c) Use of Fund credit: None

(d) Reserve tranche position: Nil

III. Use of Fund Resources

(a) Current stand-by or extended arrangement: None

(b) Previous stand-by arrangement: on November 21, 1980, the Executive Board approved a purchase of SDR 0.425 million under the first credit tranche as emergency assistance following a hurricane.

(c) Compensatory financing facility: on March 20, 1981, the Executive Board approved a purchase of SDR 1.30 million

IV. SDR Department

(a) Net cumulative allocation: SDR 0.35 million

(b) Holdings: SDR 1,369 (0.4 percent of allocation).

(c) Current designation plan: None

V. Administered Accounts: None

VI. Overdue Obligations to the Fund: None

(B) Nonfinancial Relations

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

VIII. Last Article IV Consultation: The last Article IV consultation discussions were held in Kingstown from March 17 to April 1, 1987, and the consultation procedures were concluded by the Executive Board on July 6, 1987 (EBM/87/98).

IX. Technical Assistance: Mr. Clifford Stacey, a member of the FAD panel of fiscal experts, was assigned to St. Vincent and the Grenadines from May to September 1985 to assist the authorities on expenditure control and budgeting. Mr. Winglee (STAT) visited ECCB headquarters for two weeks in November 1987 to advise on data reporting by commercial banks.

St. Vincent and the Grenadines--Basic Data 1/

Area	388 sq. kilometers
Population and related vital statistics (1987)	
Population (thousand)	113.1
Rate of population growth (percent)	2.5
Density	
Total (per sq. kilometer)	288.0
Arable land (per sq. kilometer)	587.0
Life expectancy at birth (years)	68.5
Infant mortality rate (per thousand)	46.8
Child death rate (per thousand)	3.0
Income distribution	...
Access to safe water (1986)	
Urban (percent of population)	90.0
Nutrition (1986)	
Caloric intake as percent of requirement	96.9
Per capita protein intake (grams per day)	52.7
Health (1981)	
Population per physician	4,791
Population per hospital bed	1,695
Distribution of land ownership	...
Access to electricity	...
Education (1983)	
Primary school enrollment (percent)	90.0
GDP (1987/88)	US$ 142.3 million
GDP per capita (1987/88)	US$1,258

Origin of GDP	1984/85	1985/86	Prel. 1986/87	Est. 1987/88
		(percent)		
Agriculture	19.3	19.6	18.4	17.1
Mining	0.2	0.3	0.3	0.3
Manufacturing	12.0	10.7	9.9	9.8
Construction	7.4	8.9	10.0	10.2
Government	17.6	16.8	17.2	17.1
Other services	43.5	43.7	44.2	45.5

	1984/85	1985/86	Prel. 1986/87	Est. 1987/88
Ratios to GDP		(percent)		
Exports of goods and nonfactor services	74.7	75.1	57.3	60.6
Imports of goods and nonfactor services	83.9	77.5	76.5	84.9
Current account of the balance of payments	-0.2	6.9	-10.3	-15.3
Public sector revenue	33.6	36.4	40.1	39.3
Public sector expenditure	31.3	32.7	41.2	41.8
Public sector savings	4.8	7.9	8.2	9.0
Public sector overall surplus or deficit (-)	2.2	3.7	-1.1	-2.5
External public debt (end of year)	21.5	21.2	23.4	26.6
Money and quasi-money (end of year)	40.8	42.6	45.0	47.8
Change - Money and quasi-money	3.0	4.8	5.9	6.5
Annual changes in selected indicators				
Real GDP (at factor cost)	5.9	6.3	5.9	5.6
Nominal GDP (at market price)	9.3	11.4	11.2	7.4
GDP deflator (at factor cost)	2.7	3.9	5.1	3.9
Consumer prices (annual average)	2.5	1.5	1.7	1.7
Central government revenue	14.1	10.1	14.7	10.9
Central government expenditure	-1.1	7.1	26.3	14.1
Liabilities to private sector 2/	8.9	14.4	17.0	17.3
Money	(1.2)	(-1.7)	(4.4)	(2.4)
Quasi-money	(7.7)	(16.2)	(12.6)	(14.9)
Net domestic assets of the banking system 2/	-5.4	-15.5	-5.9	3.9
Credit to public sector	(0.5)	(-18.0)	(-13.5)	(-7.0)
Credit to private sector	(4.3)	(3.5)	(9.3)	(13.6)
Merchandise exports (in U.S. dollars)	33.3	17.2	-20.1	16.2
Merchandise imports (in U.S. dollars)	9.1	3.4	11.1	21.4
Central government finances 1/	(millions of Eastern Caribbean dollars)			
Revenue	91.5	100.7	115.5	128.1
Expenditure	84.8	90.8	114.7	130.9
Current account surplus or deficit (-)	10.2	15.9	15.6	15.5
Overall surplus or deficit (-)	6.7	9.9	0.8	-2.8
External financing (net)	-3.0	-3.5	15.3	16.4
Balance of payments	(millions of U.S. dollars)			
Merchandise exports	60.0	70.3	56.2	65.3
Merchandise imports	-79.0	-81.7	-90.8	-110.3
Travel receipts (net)	9.6	10.0	10.4	11.8
Investment income (net)	-2.0	-2.1	-2.2	-2.0
Other services and transfers (net)	11.2	11.7	12.7	13.4
Current account balance	-0.2	8.2	-13.7	-21.8
Capital grants	3.1	5.1	10.0	7.0
Official capital	1.2	2.9	5.2	7.0
Banking system	0.4	-8.0	-6.6	-8.2
Private capital, including errors and omissions	4.3	1.5	2.9	16.5
Overall balance	8.8	9.7	-2.2	0.5

1/ Fiscal years begin July 1 of the year indicated.
2/ In relation to commercial bank liabilities to the private sector at the beginning of the period.

St. Vincent and the Grenadines: Statistical Issues

1. Outstanding statistical issues

a. Real sector

Data on national accounts, prices, production, and foreign trade are not reported regularly to the Fund even though the Bureau of Statistics sends standard reporting forms to both the Eastern Caribbean Central Bank (ECCB) and the Director General of Finance and Planning.

b. Government finance

Annual government finance data are reported but relate to the accounts of the Central Government only.

The 1987 Government Finance Statistics Yearbook (GFSY) includes data for the period 1978-86 for Table A, Revenue and Grants, and Table B, Expenditure by Function, and for the year 1986 only for Table B.2, Capital Expenditure by Function, and Tables F and G, Outstanding Debt by Type of Debt Holder and by Type of Debt Instrument, respectively. The GFS correspondent has sent 1987 data for Tables A, B, B.2, F, and G, for inclusion in the forthcoming 1988 GFSY. No data for the rest of the statistical tables or for the derivation table have been provided.

A technical assistance mission on government finance statistics is included in the current mission schedule of the Bureau of Statistics.

c. Monetary accounts

Financial data are reported regularly by the ECCB although the frequency of reporting data has deteriorated over the last year. A technical assistance mission visited ECCB headquarters in November 1987. The mission's recommendations for the revised reporting system of the commercial banks and other banking institutions have been accepted by the authorities and are being implemented in member countries.

d. Balance of payments

Data are not reported.

2. Coverage, currentness, and reporting of data in IFS

The listing below shows the currentness and coverage of data published in the country page for St. Vincent in the January 1989 issue of IFS. The data are based on information provided to Fund missions, and on reports sent to the Bureau of Statistics by the ECCB.

Status of IFS Data

		Latest Data in January 1989 IFS
Real Sector	- National Accounts	1985
	- Prices: CPI	June 1988
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1986
	- Financing	n.a.
	- Debt	1986 only
Monetary Accounts	- Monetary Authority	December 1987
	- Deposit Money Banks	July 1988 (partial)
	- Other Financial Institutions	n.a.
Interest Rates	- Treasury Bill Rate	December 1987
	- Bank Lending/Deposit Rates	July 1988
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	1986
	- Prices	n.a.
	- Balance of Payments	1986
	- International Reserves	September 1988
	- Exchange Rates	November 1988