

EBS/81/104

CONFIDENTIAL

May 6, 1981

To: Members of the Executive Board
From: The Secretary
Subject: Grenada - Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is a request from Grenada for a stand-by arrangement equivalent to SDR 3.425 million. It replaces Grenada's requests for an extended arrangement and a purchase in the first credit tranche contained in EBS/81/55 (3/13/81) and Supplement 1 (3/20/81). A draft decision appears on page 11.

This subject, together with the staff report for the 1980 Article IV consultation with Grenada (SM/81/55, 3/13/81, and Correction 1, 5/6/81), will be brought to the agenda for consideration on Monday, May 11, 1981.

Att: (1)

INTERNATIONAL MONETARY FUND

GRENADA

Use of Fund Resources - Request for Stand-by Arrangement

Prepared by the Western Hemisphere Department

(In consultation with the Exchange and Trade Relations,
Legal, and Treasurer's Departments)

Approved by E. Walter Robichek and Manuel Guitian

May 6, 1981

I. Introduction

In the attached letter dated May 5, 1981, the Government of Grenada requests a stand-by arrangement for a period of one year, in an amount equivalent to SDR 3.425 million, or 76 per cent of Grenada's quota. Should Grenada purchase the full amount, the Fund's total holdings of Grenada's currency would rise to 225 per cent of quota--47 per cent under the compensatory financing facility, 1 per cent under the oil facilities, and the rest within tranche policies. A waiver of the limitation in Article V, Section 3(b)(iii) is required.

Purchases under the requested stand-by arrangement are phased as follows: up to SDR 1.7 million until August 15, 1981, up to SDR 2.3 million until November 15, 1981, and up to SDR 2.9 million until February 15, 1982.

The economic and financial program in support of which the Government of Grenada is requesting a stand-by arrangement was discussed with a Fund staff team comprised of Messrs. Stephens (Head), Habanananda, Ozeki, Yadav (all WHD) and Mrs. Ah Leong (Secretary-BUR); Ms. Elvis and Ms. Velasco (both IBRD) and Mr. Byam (CDB) participated in the mission.^{1/} The mission was also assisted by Mr. Thorn, a member of the panel of fiscal experts who was then on assignment as Budget Advisor in the Ministry of Finance. Mr. Casey, Alternate Executive Director, attended the main policy discussions. The staff report for the 1980 Article IV consultation with Grenada (SM/81/55) and the paper on recent economic developments (SM/81/56), which was circulated earlier, describe Grenada's recent economic performance and policies.

^{1/} Mr. Stephens again visited Grenada during February 8-12, and May 3-4, 1981 to hold further discussions with the authorities in connection with this request.

II. Economic Background and Performance Under the Recently Terminated Stand-By Arrangement

After expanding at an average rate of about 4 per cent per year throughout the 1960s, real GDP declined between 1970 and 1974; the decline was particularly pronounced in the latter year (an estimated 20 per cent), as civil unrest led to closure of the main port, cessation of international trade for about three months, and a sharp drop in tourist arrivals. Economic activity recovered steadily between 1975 and 1979, but this did no more than restore the GDP to approximately the 1970 level. A setback in agriculture caused by flood damage in late 1979 and a hurricane in mid-1980 contributed to an estimated 1 per cent decline in real output in 1980.

Capital formation declined from levels equivalent to 25 to 30 per cent of GDP in the early 1970s to 7 per cent in 1978. Private investment activity was particularly sluggish, apparently because of widespread lack of confidence, while public investment was constrained by a lack of public sector savings and by manpower and administrative problems. Following a change in government in March 1979 there was a pronounced upturn in public investment which raised gross capital formation to an average of 17 per cent of GDP in 1979-80 despite a continued fall in private capital expenditure.

Grenada's external position has been precarious for a number of years, reflecting a lack of freely available foreign assets and limited access to the resources held by the East Caribbean Currency Authority (ECCA). The balance of payments of Grenada was strained further in 1980 by a 27 per cent decline in export earnings as a consequence of floods and hurricane damage (Table 1). The impact of the export shortfall on output and employment was cushioned in part by emergency foreign assistance and by Grenada's purchase in March 1981 of SDR 2.1 million (almost 50 per cent of Grenada's quota) under the compensatory financing decision.

The expansion of the public sector's investment program in the past two years has been financed by a sharp increase in foreign grants and loans on concessionary terms. The increase in capital spending was accompanied by a strengthening of public sector current operations under a financial program supported by a stand-by arrangement in the first credit tranche (which terminated at the end of 1980). This program also entitled Grenada to a Trust Fund loan in respect of the second period of disbursement. The fiscal program called for a significant reduction of fiscal arrears by the end of 1980, the restoration of a credit margin with ECCA, a reduction in short-term indebtedness to the commercial banks, the generation of central government savings equivalent to at least 3 per cent of GDP, and the containment of the overall deficit to roughly 1-1/2 per cent of GDP.

The objectives of the program were partially achieved. The fiscal arrears were reduced, a fixed schedule of payments was arranged for the remainder, and outstanding obligations to commercial banks were reduced

Table 1. Grenada: Balance of Payments

(In millions of U.S. dollars)^{1/}

	1976	1977	1978	1979	Prel. 1980	Proj. 1981
<u>Current account</u>	-0.6	1.2	-4.5	10.8	-0.6	-19.1
Goods and services	-1.9	-4.0	-6.6	-15.5	-21.0	-37.1
Merchandise balance	-12.3	-17.2	-18.7	-31.9	-39.2	-55.7
Exports, f.o.b.	(13.0)	(14.2)	(17.0)	(21.7)	(15.8)	(18.3)
Imports, c.i.f.	(-25.3)	(-31.4)	(-35.7)	(-53.6)	(-55.0)	(-74.0)
Service balance	10.4	13.2	12.1	16.4	18.2	18.6
Net transfers	1.3	5.2	2.1	26.3	20.4	18.0
Official	1.3	0.7	0.6	13.1	12.2	9.8
<u>Capital account</u>	-2.8	2.4	1.6	1.0	5.4	12.4
Public sector						
borrowing (net)	1.7	2.1	0.4	2.0	2.0	11.8 ^{2/}
Commercial banks	-4.5	0.4	-0.2	-2.6	3.0	0.2
Private direct						
investment (net)	...	-0.1	1.4	1.6	0.4	0.4
<u>Errors and omissions</u>	2.1	-3.5	1.4	-13.4	-5.0	--
<u>IMF transactions</u>	--	--	0.2	0.8	0.5	0.4
SDR allocation	--	--	--	0.4	0.4	0.4
Profits ^{3/}	--	--	0.2	0.4	0.1	--
<u>Overall surplus or deficit (-)</u>	-1.3	0.1	-1.3	-0.8	0.3	-6.3
<u>Financing</u>	1.3	-0.1	1.3	0.8	-0.3	6.3
Net IMF borrowing	0.5	0.2	0.8	0.5	-0.2	5.9
Net ECCA borrowing	0.5	--	0.2	0.4	0.3	0.4
Government foreign assets (increase -)	0.3	-0.3	0.3	-0.1	-0.4	--

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

^{1/} Grenada does not prepare an official set of balance of payments statistics and data on some transactions, customarily covered in balance of payments, became available only in 1977.

^{2/} Includes US\$1.0 million for the Port Authority.

^{3/} Consists of profit distribution from IMF gold sales and the gold restitution profits.

faster than planned. Considerable progress toward a positive savings rate was also made, notwithstanding shortfalls in revenues from export duties and unplanned expenditure for repairs to flood-damaged roads and bridges. In fact, the Government's current budgetary operations were in approximate balance in 1979 and 1980 following chronic deficits in previous years.^{1/} In the past two years, public administration has been improved through provision of Fund technical assistance. In addition, the Government has restructured its Planning Department, and with the help of bilateral and international agency assistance, has enhanced its capability to identify, design, and implement investment projects. The strengthening of the public finances has improved Grenada's creditworthiness so that the Government has been able to obtain project-related loans from the local banking system.

III. Financial Program for 1981

The authorities intend to make further progress in fiscal management over the next 12 months in the framework of a financial program, described below, in order to set the stage for a concerted attack on Grenada's fundamental economic problems, which are a slow rate of economic growth and large unemployment (estimated to be in the range of 30 to 40 per cent). In support of this program, the authorities have requested in the attached letter of intent, dated May 5, 1981, a stand-by arrangement for one year.

Since Grenada, as a member of ECCA, does not have an independent monetary or exchange rate policy and does not intend to use trade or payments restrictions to influence its balance of payments, the financial program centers on fiscal management.

Performance criteria are: (a) limits on the cumulative overall deficit of the Central Government in 1981 of EC\$19.9 million for the period January 1 to June 30; EC\$24.9 million for the period January 1 to September 30; and EC\$28.2 million for the period January 1 to December 31; (b) the reaching of understandings with the Fund by December 31, 1981 on the cumulative overall deficit of the Central Government during the remaining months of the standby arrangement; and (c) the normal understandings regarding exchange and trade practices.

a. The 1981 budget

In the past, the failure of the Government to generate the resources needed to cover administrative expenditure and its inability to execute investment projects (including those for which foreign resources were available) have limited capital formation. As was noted above, the present administration has made progress in strengthening public finances through more effective control over expenditure and tax enforcement, and has improved project implementation. In 1981, the Government has aimed

^{1/} The small current surplus (on a cash basis) achieved in 1977 was exceeded by a buildup in fiscal arrears.

to consolidate the improvement in the fiscal performance while expanding further its investment program on the basis of secured foreign financing from a wide range of sources.

The Central Government's budget for 1981 includes a 9 per cent rise in total revenues to EC\$97 million (36 per cent of GDP), and a 62 per cent increase in total expenditure to EC\$151 million (equivalent to 56 per cent of GDP) (Table 2). The Government plans to cover the overall deficit ^{1/} by the SDR allocation, net use of Fund resources, foreign concessional borrowing, ECCA advances, local bank borrowing for specific projects, and net local issue of debentures (see Table 1). Net local bank financing includes EC\$2.8 million previously committed by a consortium of banks for low-cost housing, and a utilization of EC\$2.8 million in funds received as grants in 1980 and held on deposit locally.

The Grenadian authorities have been able to mobilize foreign funds from a wide array of sources in the form of capital grants and loans equivalent to 70 per cent of the 1981 capital program. The main sources of foreign loans in 1981 are: Algeria (EC\$11 million), Libya (EC\$11 million), the Central Bank of Brazil (EC\$3.5 million), Caribbean Development Bank (EC\$3.3 million), and the Organization of Petroleum Exporting Countries (EC\$2.7 million).

An important element in the financial program is the intention of ensuring, that the Central Government's current operations are in approximate balance. Current revenue has been estimated at EC\$69.9 million, based on a projected increase in nominal GDP of about 14 per cent, a reduction in foreign grants from EC\$30 million in 1980 to EC\$26 million in 1981, a package of new fiscal measures, and further improvements in tax administration. This revenue estimate represents an increase of about 19 per cent in relation to the previous year's level. Approximately one third of the revenue increase would be derived from additional taxation introduced in February 1981. The new revenue measures include increases in stamp duty on imports, higher consumption duties on gasoline, beer, and spirits, a larger motor vehicle tax, and a postal rate hike.

Current expenditure is expected to rise by about 22 per cent in 1981 to EC\$69.9 million. The major factor accounting for the projected increase is a new wage and salary award to civil servants that the authorities considered unavoidable. Civil servants were last granted a wage increase in March 1978 (the increases were 30 per cent, 25 per cent,

^{1/} For purposes of the program, the fiscal deficit that is to be monitored is defined as the aggregate of net purchases from the Fund (excluding any final Trust Fund loan disbursement), the counterpart of the Special Drawing Rights allocation of January 1, 1981, net borrowing from domestic sources (including the commercial banks), ECCA, and foreign commercial banks, and net use of foreign assets. Government outlays financed by foreign grants and concessional loans do not affect the cumulative ceilings on the fiscal deficit. On this basis, the fiscal deficit for 1981 has been projected at EC\$28 million.

Table 2. Grenada: Central Government Operations

	1977	1978	1979	Prel. 1980	Budget 1981
(In millions of East Caribbean dollars)					
Total revenue	35.3	47.0	90.6	89.1	96.5
Current revenue	33.2	44.8	54.9	58.9	69.9
Capital revenue	0.1	--	0.2	0.2	0.2
Foreign grants	2.0	2.2	35.5	30.0	26.4
Total expenditure	39.9	57.0	97.3	93.3	154.0
Current expenditure	31.3	48.8	53.9	59.6	69.9
Capital expenditure	6.3	3.9	41.5	31.4	84.1
Net lending	2.3	4.3	1.9	2.3	--
Current balance	1.9	-4.0	1.0	-0.7	--
Overall balance	-4.6	-10.0	-6.7	-4.2	-57.5
Financing	4.6	10.0	6.7	4.2	57.5
Foreign assets (increase -)	-0.9	0.9	-0.2	-1.1	--
SDR allocation	--	--	1.1	1.1	1.1
Net borrowing from IMF	0.7	2.1	1.3	-0.7	15.9
Net borrowing from ECCA	--	0.6	1.0	0.9	1.2
Other net foreign borrowing 1/	4.1	--	4.8	4.2	29.3
Net local bank borrowing	--	5.5	-3.1	1.8	7.4
Other net domestic borrowing	0.3	0.7	1.4	0.6	2.6
Residual	0.4	0.2	0.4	-2.6	...
(As per cent of GDP)					
Total revenue	26.3	27.0	42.3	37.6	35.7
Current revenue	24.7	25.7	25.6	24.8	25.9
Total expenditure	29.7	32.7	45.4	39.3	57.0
Capital expenditure	4.7	2.2	19.4	13.2	31.1
Overall balance	-3.4	-5.7	-3.1	-1.8	-21.3

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

1/ At concessional terms.

and 20 per cent for low, middle, and high salary brackets, respectively). Although no official price indices exist for the period prior to 1979, the Grenadian authorities have estimated that consumer prices rose by roughly 60 to 70 per cent in the three years since the last wage award implying a substantial erosion of the real income of public servants. As a consequence, the Government had begun to encounter difficulty in recruiting and maintaining qualified staff at the senior and middle management levels, a development that could affect adversely the efficiency of the public service. In the letter of intent, the Government has indicated its intention to grant a new three-year wage and salary award which provides for an across-the-board increase of 40 per cent. Unlike previous awards, the increase would be payable over three years-- 20 per cent in 1981, and 10 per cent each in 1982 and 1983. Provisions have been made in the 1981 budget for a 20 per cent increase in basic wages and salaries of civil servants, although a final agreement has not yet been reached with the union representatives.

The elimination of subsidies to state farms and the Central Water Commission is another important feature of the 1981 budget. In recent years, subsidies to state farms have averaged about EC\$0.8 million a year. To place the State Farm Corporation on a sound financial basis, provision is made in the budget for a capital contribution of EC\$2 million, while the profits of the Corporation will be subject to company taxation. Likewise, the financial operations of the Central Water Commission have been placed on a more sustainable basis by a substantial increase in its rates.

b. The 1981 investment plan

The pronounced surge in total government expenditure in 1981 reflects a more than doubling of projected capital outlays, from EC\$31 million in 1980 to EC\$84 million in 1981 (or from 13 per cent of GDP to 35 per cent). This massive increase in public investment is the centerpiece of the Government's efforts to restructure the economy. The Grenadian authorities are confident that an investment effort of the magnitude envisaged can be implemented this year, inasmuch as approximately 65 per cent of the total involves ongoing projects and a sizable proportion (the airport and some basic infrastructure) would be executed on a turn-key basis. Outlays for construction of the airport in 1981 represent some 38 per cent of the total; agricultural projects, including feeder roads and sea defenses, about 26 per cent; education, health, and housing, 11 per cent; and other transportation and infrastructure investment accounts for the bulk of the remainder (Table 3).

The investment plan for 1981 is designed as a first stage of a more ambitious program. In the letter of intent the authorities explain that the Government of Grenada is at the present time preparing a multi-year investment program designed to restructure the economy and to strengthen the country's balance of payments. As soon as the preparation of this multiyear plan has been finalized and complementary macroeconomic policies formulated, the Government intends to seek assistance from the

Table 3. Grenada: Capital Expenditures, 1981

(In thousands of East Caribbean dollars)

	Source of Foreign Fund	Total	External	Local 1/
<u>Total</u>		<u>84,152</u>	<u>58,515</u>	<u>25,637</u>
<u>Agriculture and fisheries</u>		<u>22,173</u>	<u>12,622</u>	<u>9,551</u>
Fisheries development	IFAD	1,599	1,050	599
Banana development	UK	297	297	--
Soil conservation	UNDP	474	383	91
Forestry and equipment	USSR/OPEC	705	705	--
Sheep development - Carriacou	CDB	192	174	18
Cocoa propagation and rehabilitation	CIDA	2,666	2,353	313
Sugarcane resuscitation	--	1,180	--	1,180
Plant propagation	EDF/OPEC	720	720	--
Agricultural equipment	USSR	3,000	3,000	--
Mirabeau Farm Training Center	EDF	580	480	100
Broiler Units	Venezuela	100	50	50
Feeder Roads II	CDB	3,000	2,500	500
Major road reconstruction	EDF	3,453	210	3,243
Other roads, bridges, and retaining walls	CDB/US	1,266	655	611
Irrigation and drainage	--	250	--	250
State Farm Corporation	--	2,000	--	2,000
Miscellaneous projects	EDF	691	95	596
<u>Agroprocessing</u>		<u>893</u>	<u>223</u>	<u>670</u>
Agroindustry complex	--	180	--	180
Agrolab	--	100	--	100
Multipurpose plant	UNDP	462	72	390
Spice grinding plant	OAS	151	151	--
<u>Transportation and infra- structure</u>		<u>48,869</u>	<u>40,656</u>	<u>8,213</u>
International Airport - Point Salines	Iraq/Libya Algeria	32,000	27,000 2/	5,000
Eastern main road	EDF	5,980	5,080	900
Western main road	CDB	600	600	--
Medium wave transmitter	Cuba	1,000	500	500
Public transportation - buses		570	--	570
Carriacou - port	--	200	--	200
Carriacou - roads	EDF/Iraq	2,818	2,818 3/	--
Carriacou - Hillsboro jetty	EDF	977	850	127
Central garage	CIDA	650	350	300
Purchase of airplane for LIAT	Brazil	4,074	3,458	616

Table 3. Grenada: Capital Expenditures, 1981 (Concluded)

(In thousands of East Caribbean dollars)

	Source of Foreign Fund	Total	External	Local
<u>Paneer</u>		<u>2,000</u>	<u>1,000</u>	<u>1,000</u>
Purchase of generator		<u>1,000</u>		<u>1,000</u>
Cariacou - electricity	Iraq	1,000	1,000	--
<u>Housing</u>		<u>2,800</u>	<u>--</u>	<u>2,800</u>
Special project		<u>2,800</u>	<u>--</u>	<u>2,800</u>
<u>Health</u>		<u>1,967</u>	<u>683</u>	<u>1,284</u>
Hospital equipment, etc.	--	<u>1,052</u>	<u>--</u>	<u>1,052</u>
Health centers (construction)	CDB/US	615	533	82
Other	UN/WFP	300	150	150
<u>Education</u>		<u>4,225</u>	<u>3,108</u>	<u>1,117</u>
Schools rehabilitation and construction	CDB/US	1,542	1,340	202
Mount Harmon and community centers	EDF	1,025	514	511
Library service development	EDF	400	400	--
Bernadette Bailey School	UK	457	108	349
Miscellaneous projects	Various	801	746	55
<u>Other</u>	<u>EDF</u>	<u>1,225</u>	<u>223</u>	<u>1,002</u>

Source: Ministry of Finance, Trade, Industry and Planning.

1/ Includes resources obtained through purchases from the Fund.

2/ Includes EC\$1.0 million received as grant in 1980.

3/ Includes EC\$1.8 million received in 1980.

International Monetary Fund in the form of an extended arrangement. As part of the preparation of the investment plan during the period of the stand-by arrangement, the Government plans to complete a feasibility study of an airport complex and related facilities.

IV. Staff Appraisal

Grenada has made considerable progress in strengthening the finances of the public sector during 1979 and 1980. Current operations were brought into approximate balance following dissaving in previous years, fiscal arrears were reduced, and a fixed schedule of payments was arranged for the remainder. The positive public sector savings target was not attained, however, mainly because flooding and a hurricane resulted in revenue shortfalls and unplanned expenditures.

The authorities have designed a financial program for 1981 which aims at consolidating the fiscal improvement achieved during the past two years while at the same time stepping up the rate of investment spending. Increases in wages and salaries of civil servants--considered unavoidable as domestic inflation since the last adjustment in 1978 is estimated at 60 to 70 per cent--have been budgeted along with discretionary tax changes so as to ensure, as a minimum, equilibrium in the Central Government's current budgetary operations. Subsidies to state farms and the Central Water Commission have been eliminated and their financial management has been improved.

The execution of a sizable increase in investment in 1981 is intended as the first stage of an investment program aimed at diversifying Grenada's productive structure so as to attain over the medium term, higher rates of growth of output and employment and a stronger balance of payments performance. In the course of the coming year, the authorities plan to complete the design of a multiyear investment plan. The staff would urge the Grenadian authorities to seek the collaboration of appropriate international development agencies in the formulation of this plan in order to ensure its success over the medium term.

In view of Grenada's investment effort, further progress in raising the public sector's saving rate will be essential if Grenada's dependence on foreign resources for its economic development is to be reduced in the future. Continued restraint in public sector wage and salary adjustments, along with improved tax enforcement and efficiency in the operation of the statutory entities, will be essential in this regard.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Government of Grenada has requested a stand-by arrangement for the period of one year beginning May __, 1981 for an amount equivalent to SDR 3.425 million.
2. The Fund approves the stand-by arrangement attached to EBS/81/104.
3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Grenada - Stand-By Arrangement

Attached hereto is a letter dated May 5, 1981 from the Minister of Finance, Trade and Industry requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Grenada intend to pursue for the period of this stand-by arrangement. To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period of one year from _____ Grenada will have the right to make purchases from the Fund in an amount equivalent to SDR 3.425 million, subject to paragraphs 2, 3, and 4 below, without further review by the Fund.

2. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 1.7 million until August 15, 1981, the equivalent of SDR 2.3 million until November 15, 1981, and the equivalent of SDR 2.9 million until February 15, 1982, but none of these limits shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Grenada's currency in the credit tranches beyond 25 per cent of quota.

3. Grenada will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Grenada's currency in the credit tranches beyond 25 per cent of quota:

(a) during any period in which the limit on the cumulative deficit of the Central Government set forth in paragraph 16 of the attached letter is not observed; or

(b) after December 31, 1981, if understandings on the limit of the cumulative deficit of the Central Government have not been reached in consultation with the Fund, as contemplated by paragraph 16 of the attached letter, or if such limit, having been established, is not being observed;

(c) during the period of this stand-by arrangement, if Grenada

- (i) imposes restrictions on payments and transfers for current international transactions, or
- (ii) introduces new or modifies existing multiple currency practices, or
- (iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or
- (iv) imposes or intensifies import restrictions for balance of payments reasons.

When Grenada is prevented from purchasing under this stand-by arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Grenada and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Grenada's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Grenada. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 4, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Grenada, and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Grenada, the Fund agrees to provide them at the time of the purchase.

6. Grenada shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

7. (a) Grenada shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase as Grenada's balance of payments and reserve position improves.

(b) Any reductions in Grenada's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

8. During the period of the stand-by arrangement Grenada shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Grenada or of representatives of Grenada to the Fund. Grenada shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Grenada in achieving the objectives and policies set forth in the attached letter.

9. In accordance with paragraph 17 of the attached letter Grenada will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 3 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Grenada has outstanding purchases in the upper credit tranches, Grenada will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Grenada's balance of payments policies.

Ministry of Finance
Trade and Industry
St. George's
Grenada, W.I.

May 5, 1981

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosiere:

1. Shortly after acceding to power in early 1979, the present Government of Grenada adopted a financial program that was supported by a first credit tranche stand-by arrangement with the Fund covering a 14-month period to the end of 1980; this program also qualified Grenada for a Trust Fund loan in respect of the second period of disbursement. Despite serious economic setbacks occasioned by floods in 1979 and hurricanes in 1980, substantial progress has been made in strengthening the public finances, although the public sector savings objective, a key objective of the program, was only partially achieved.

2. The improvements in public finances have been accompanied by a marked rise in the efficiency of public administration and in the ability of the Government to prepare and implement projects. The latter has been facilitated by the dedication of public servants and by high level technical assistance provided by regional and international organizations, including the International Monetary Fund, and by friendly Governments. Grenadians and regional experts with proven technical and managerial competence have been recruited from abroad to work in Grenada. We intend to make further progress in economic management over the next twelve months in the framework of a financial program in order to set the stage for a concerted attack on Grenada's fundamental economic problems, most notably a slow rate of economic growth and large unemployment of manpower. In support of this program, which is described below, the Government of Grenada requests from the International Monetary Fund a stand-by arrangement for a period of one year in an amount equivalent to SDR 3.425 million.

3. The Government of Grenada is at the present time preparing a multiyear investment program designed to restructure the economy and to strengthen the country's balance of payments over the next five to eight years, through fuller utilization of existing production capacity in the short run and expansion of foreign exchange earnings or savings sectors over the medium term. As soon as the preparation of its multi-year investment program has been finalized and complementary macroeconomic policies formulated, the Government intends to seek assistance from the International Monetary Fund under its extended arrangement facility. As part of

the preparation of the investment plan during the period of the stand-by arrangement, the Government plans to complete a feasibility study of an airport complex and related facilities under terms of reference acceptable to Grenada and the Fund.

4. The outline of the investment strategy for the medium-term has already been established by the government. Major emphasis is being placed in developing agriculture, fishing, and tourism in order to raise the growth rate of GDP from virtually zero in 1979-80 to 5 per cent by 1983. The strategy for achieving a substantial increase in agricultural output will focus on measures to bring idle land into productive use, to rehabilitate traditional export crops and sugarcane, and to expand production of root crops, fruits and vegetables. The emphasis on agricultural diversification will also serve to decrease the country's vulnerability to adverse weather conditions and to sharp fluctuations in export prices.

5. Some of the major agricultural projects which are ongoing or will commence in 1981 are cocoa rehabilitation, food crops development, sugar production, and banana rehabilitation. With the assistance of CIDA, the Government intends to replant about 330,000 cocoa trees per year over a six-year period, thus ensuring increased output and income from this major foreign exchange earner. The project for food crop development involves approximately 2,000 acres and will expand output of vegetables and fruits both for local consumption and for export. The project for sugarcane re-suscitation, which envisages a 50 per cent increase in acreage and substantial rise in productivity, would generate additional employment and foreign exchange savings. Finally, the ongoing banana rehabilitation program is expected to raise output at a rate of 10 per cent per annum over the next five years.

6. The Government plans to expand further the small fishing industry as a source of employment. This expansion will emphasize small-scale fishing to supply the local market for fresh fish through training of fishermen and the provision of boats and proper storage facilities and commercial fishing to supply the processing plant which produces salted-fish, an important element in local and regional diet. The output of the fish processing plant will substitute for imported cod initially, but will gradually be exported to neighboring islands.

7. The Government is also firmly committed to the development of an agro-industry and has already established a pilot plant, which produces a range of products--nectars, fruit preserves, and juices, etc. The plant, which will be assured of a steady supply by the state farms, will be expanded in 1981.

8. Inadequate access by air to Grenada has been the major constraint to expansion of the tourist industry. The Government has initiated the first phase in the construction of a new international airport to accommodate wide-bodied airplanes near the capital city of Grenada, St. George's, so as to fully exploit the country's tourist potential. As presently envisaged, the airport development project also provides for a substantial

increase in hotel capacity, the upgrading of sewerage facilities, the expansion of telephone communication and electricity capacity, and the construction of access roads.

9. The Government recognizes that the mobilization of the required resources for its investment program will not be an easy task, even with the anticipated direct participation of foreign private investors in the tourist sector. This realization necessarily imposes strict discipline not only on the Government of Grenada, but also on all her people to ensure that available scarce resources, domestic or foreign, grants or loans, are employed most efficiently. Moreover, it is of paramount importance that Grenada contributes strongly to its own economic and social development.

10. The Government regards fiscal discipline as being indispensable to the achievement of its economic objectives. During the period of the stand-by arrangement, public finances will continue to be improved mainly through strict expenditure controls, elimination of subsidies to public sector enterprises, discretionary tax changes, and increased efficiency of the tax administration machinery. The Government already has introduced discretionary tax changes and with technical assistance from the Fund has initiated a program of field audits by the staff of the Inland Revenue Department with a view to ensuring full compliance by tax payers. Likewise, the Customs Ordinance has been amended to improve the method of valuation of imported goods, and on January 1, 1981, a valuation branch in the Department of Customs was established to ensure, that valuations contained in customs declaration forms are carefully scrutinized. The present government has eliminated all past due obligations, in part through rescheduling in line with our earlier commitment to the Fund and has reduced its indebtedness to the local commercial banks substantially faster than scheduled.

11. It has been the expressed policy of the Government that each state enterprise should generate sufficient resources to cover its operating expenditures and contribute to its capital expansion program. To this end, the tariffs of the Central Water Commission have just been raised substantially which, together with the more efficient management now in place, will eliminate the need for a Government subsidy in 1981. Subsidies to state farms have also been eliminated following a cash contribution by the Government to the equity of the State Farm Corporation.

12. Because of the openness of the economy, the rate of inflation in Grenada is largely determined by price trends abroad. Within this constraint, the authorities have worked towards softening the domestic impact of sharp variations in world prices of imported basic commodities. We have established the Import and Marketing Board in 1979 to purchase in bulk certain essential items--sugar, rice, and cement; about 15 other essential imported products will be added to the list following a clear demonstration of the Board's efficiency. The Board uses the existing distribution network operated by the private sector, and, normally, economies derived from bulk purchases are reflected in lower prices than would

otherwise prevail after allowances for administrative costs and the build-up of reserves for mitigation of sharp import price variations. For social and political reasons the cost of some consumer products may be subsidized, so long as the weighted average price of the goods sold by the Board covers its weighted unit cost and provided that the subsidy does not impede the production of local substitutes.

13. Increases in the world price of petroleum have been fully passed on to final consumers. In view of Grenada's dependence on foreign sources of energy, we have stepped up conservation measures and are searching for alternative energy sources. In an effort to reduce gasoline consumption, a system of odd and even days was instituted in August 1979 and the Government is now exploring the possibility of taxing gasoline for private automobiles at a higher rate than for public transport vehicles to encourage use of public transportation. An Interministerial Energy Committee has also been set up which, with the help of a strengthened planning and monitoring staff, is to promote energy efficiency and explore new energy sources, such as mini-hydroelectric power plants.

14. With respect to the determination of wages, the Government subscribes to the principle of free collective bargaining between employers and employees. However, it intends to play a positive role in linking wage increases to productivity gains since excessive wage adjustments tend to undermine Grenada's competitive position and exacerbate the unemployment situation. In this regard discussions will be initiated in 1981 in order to reach a national consensus regarding a trade-off between nominal wage increases and profit-sharing in collective wage settlements. For its part, the Government has begun to invite the unions representing civil servants to participate in all stages of the budget exercise to highlight the severe budgetary constraints. Following the sharp erosion of salaries of public servants over the last three years, we intend to increase the wage fund by 20 per cent in 1981, and by 10 per cent each in 1982 and 1983. The Government had hoped to reach agreement with the unions to link these increases in wages and salaries to the relative performance of the employees but the prospects for doing so this year now seem unfavorable. A concurrent decision has been taken to retrench about 5 per cent of government employees in 1981 and to implement further reductions in future years when alternative employment becomes available through expansion in the investment program.

15. The above described fiscal, pricing, and wage policies have been incorporated in the budget which covers the 12 months ending December 31, 1981. This budget provides for a 19 per cent increase in current expenditure to a total of EC\$69.9 million. The rise is largely accounted for by a wage award to civil servants, the full effect of which has been partially offset by retrenchment of some daily paid workers, and the elimination of subsidies to the state farms and the Central Water Commission. The Government has also introduced new tax measures to yield additional tax revenues of EC\$3.5 million in 1981. These include increases in stamp duty on imports (EC\$2.14 million), consumption duties on gasoline, beer and spirits (EC\$0.98 million), motor vehicle tax (EC\$0.21 million), and

postal rates (EC\$0.18 million). These measures will enable the Government to achieve an approximate balance on recurrent budgetary operations in the current financial year ending December 31, 1981. Investment outlays have been budgeted at EC\$84 million, the composition of which is consistent with the objectives of the medium-term strategy described above. The planned investment expenditure in 1981 is limited to the amount of identified financing, and will be enlarged only if the Government is successful in securing additional foreign grants and loans.

16. The cumulative deficit of the Central Government for the fiscal year beginning January 1981 will not exceed EC\$19.9 million for the period January 1, 1981 to June 30, 1981; EC\$24.9 million for the period January 1, 1981 to September 30, 1981; and EC\$28.2 million for the period January 1, 1981 to December 31, 1981. The Government will review with the Fund the progress made in implementing the agreed pattern of public expenditure and will reach an understanding with the Fund on the cumulative deficit for the remaining months of the stand-by period before December 31, 1981. For this program the Central Government's deficit is defined as the sum of net use of Fund resources, the counterpart of Special Drawing Rights allocation on January 1, 1981, net borrowing from ECCA, foreign commercial banks and from domestic sources including the commercial banking system, and net use of foreign assets.

17. The Government of Grenada believes that the set of measures described above is adequate to achieve the objectives of the program. In addition, it will take any measures that might be judged appropriate for that purpose. During the period of the stand-by arrangement, Grenada will periodically consult with the Fund in accordance with the Fund's policies on such consultations.

18. The exchange and trade system is virtually free from restrictions on payments and transfers for current international transactions. For budgetary purposes, Grenada imposed a tax of 2-1/2 per cent on foreign exchange transactions in April 1977, which was doubled in March 1978; the Fund approved the retention of this multiple currency practice until October 26, 1980. In view of the temporary erosion of the tax base, the Government believes that immediate removal of the foreign exchange tax would be inopportune. During the period of the stand-by arrangement, the Government does not intend to impose restrictions on payments and transfers for current international transactions, introduce any new or intensify existing multiple currency practices, conclude bilateral payments agreements which are inconsistent with Article VIII, or impose import restrictions for balance of payments purposes.

Sincerely yours,

Bernard Coard
Minister of Finance,
Trade and Industry