

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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CONFIDENTIAL

May 12, 1981

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

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Grenada agreed at Executive Board Meeting 81/79, May 11, 1981.

Att: (1)

Grenada: Stand-by Arrangement

Attached hereto is a letter, dated May 5, 1981 from the Minister of Finance, Trade, Industry and Planning 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 a period of one year, from May 11, 1981 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.

ATTACHMENT

Ministry of Finance
Trade, Industry and
Planning
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 resuscitation, 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,

/s/

Bernard Coard
Minister of Finance,
Trade, Industry and Planning