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CONFIDENTIAL

March 3, 1981

To: Members of the Executive Board

From: The Secretary

Subject: St. Vincent and the Grenadines - Use of Fund Resources - Compensatory Financing Facility

Attached for consideration by the Executive Directors is a paper on a request expected to be received from St. Vincent and the Grenadines for a purchase equivalent to SDR 1.3 million under the compensatory financing facility. A draft decision appears on page 10.

This subject has been tentatively scheduled for discussion on Friday, March 20, 1981.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

ST. VINCENT AND THE GRENADINES

Use of Fund Resources--Compensatory Financing Facility

Prepared by the Research and Western Hemisphere Departments

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

Approved by Wm. C. Hood and E. Walter Robichek

March 3, 1981

The Managing Director has been informed that the authorities of Saint Vincent will shortly request a purchase of SDR 1.3 million (50 per cent of new quota) under the compensatory financing decision. The request is being made with respect to a shortfall in merchandise exports estimated for the calendar year 1980 and, if approved, would be the first purchase by St. Vincent under the decision; it would raise the Fund's holdings of the member's currency from 107.7 to 157.7 per cent of quota.

This paper, which is being circulated in advance of the formal request from St. Vincent is presented in five sections and an annex. The sections deal with: (1) balance of payments position, (2) estimation of the export shortfall, (3) causes of the shortfall and export prospects, (4) repurchase, and (4) staff appraisal and proposed decision. The annex summarizes St. Vincent's relations with the Fund.

1. Balance of payments position

St. Vincent is a member of a common currency area--the East Caribbean Currency Authority--and has virtually no freely available international reserves. The foreign asset holdings of the Government (primarily sinking funds against external and local bonded debt) are small and the government has limited access to borrowing abroad for balance of payments purposes.

Between 1975 and 1978 rising receipts from merchandise exports, tourism, and emigrants' remittances allowed a steady expansion of imports and a concurrent reduction in the current account deficit. In 1979 and 1980, however, the current account deficit widened dramatically, mainly as a result of natural disasters. In 1979 the eruption of the La Soufriere volcano was the main factor responsible for a 9 per cent decline in domestic exports, while imports

Table 1. St. Vincent: Balance of Payments

(In millions of SDRs)

	1977	1978	1979	Estimated 1980	Projected 1981
A. Current account balance	-6.5	-2.4	-13.1	-17.1	-11.5
Merchandise trade balance	-17.5	-15.8	-26.5	-32.1	-26.2
Exports, f.o.b. including re-exports	(8.5)	(13.0)	(11.3)	(11.8)	(16.0)
Non-oil imports, c.i.f.	(-24.2)	(-26.8)	(-35.4)	(-40.1)	(-37.6)
Oil imports, c.i.f.	(-1.8)	(-2.0)	(-2.4)	(-3.8)	(-4.6)
Services and transfers balance	11.0	13.4	13.4	15.0	14.7
Travel (gross)	(3.4)	(6.3)	(7.1)	(7.8)	(7.6)
Government payments 1/ 2/	(-0.3)	(-0.2)	(-0.6)	(-0.6)	(-0.6)
Government interest 1/	(-0.1)	(--)	(-0.2)	(-0.4)	(-0.4)
Other services (net)	(1.3)	(-0.2)	(--)	(0.2)	(0.1)
Private transfers	(6.7)	(7.5)	(7.1)	(8.0)	(8.0)
B. Capital movements (net)	6.8	2.2	13.2	16.2	8.2
Government borrowing (net)	-0.1	0.6	1.4	2.1	1.5
Government transfers 1/	1.9	3.4	3.5	3.9	4.6
Special financing	--	--	5.4	8.4	2.1
Errors and omissions 3/	5.0	-1.8	2.9	1.8	--
C. Allocation of SDRs	--	--	--	0.2	0.2
D=A+B+C Overall balance	0.3	-0.2	-0.1	-0.7	-3.1
Financing	0.4	0.2	0.1	0.7	3.1
ECCA	--	--	--	--	--
Change in foreign assets	0.4	0.2	0.1	--	--
Change in IMF position	--	--	--	0.7	3.1
CFF	(--)	(--)	(--)	(--)	(2.6)4/
Under tranche policy	(--)	(--)	(--)	0.7	(0.5)4/

Sources: Ministry of Finance; and Fund staff projections.

1/ Relates to Central Government's fiscal year ending June 30.

2/ Mainly transfers to University of the West Indies.

3/ Includes private capital.

4/ Assuming a stand-by arrangement in the first credit tranche and a second CFF purchase.

rose by over 30 per cent, partly as a result of reconstruction requirements. The increased current account deficit was mainly covered by inflows of special assistance from abroad. In mid-1980, the island was struck by Hurricane Allen. Domestic exports declined further while imports were boosted by additional reconstruction requirements, and the deficit on current account widened further to SDR 17 million. Most of this deficit was covered by inflows of special assistance and development aid; however, there was an overall deficit of SDR 0.7 million, which was financed by a reserve tranche purchase equivalent to SDR 0.3 million and by a first credit tranche purchase of SDR 0.4 million under the tranche policies as emergency assistance.

In 1981, exports are projected to recover sharply, while imports are expected to fall, resulting in a significant improvement in the trade balance and in the current account deficit, even though receipts from tourism and emigrants' remittances are not expected to rise in 1981. However, because of the drop in foreign special assistance, the balance of payments is forecast to show a relatively large overall deficit. This is expected to be financed by drawings from the Fund under the CFF and in the first credit tranche under a projected stand-by arrangement.

2. Estimation of the export shortfall

The authorities of St. Vincent have requested that the calendar year 1980 be treated as the shortfall year, and since actual data are available only through September 1980, the staff in cooperation with the authorities has estimated exports for the last three months of the shortfall year. Export earnings for these three months are estimated at SDR 0.46 million per month, compared with SDR 0.92 million per month for the first nine months of 1980. The lower rate of exports in the last quarter of the year is mainly due to the sharp reduction in banana exports caused by hurricane damage in August.

Total export earnings in 1980, estimated at SDR 9.6 million, are 18 per cent below the average level of earnings in 1978-79. The decline is considered to be temporary, since in 1981-82 export earnings are expected to recover to an average level of SDR 15.3 million, which is 60 per cent above the 1980 level. On the basis of this judgmental projection, the shortfall for 1980 is estimated to be SDR 2.9 million which is more than twice the amount of the purchase expected to be requested (Table 2).

A staff mission visited St. Vincent in March this year to conduct the first Article IV consultation and negotiate a stand-by arrangement in the credit tranche, and it is probable that a second compensatory financing purchase may be requested at the same time as the purchase under the arrangement.

Table 2. St. Vincent: Estimation of the Export Shortfall

(In millions of SDRs)

	Calendar Years				
				1981-82 Geometric average	
	1978	1979	1980	Formula 1/	Judgmental
Total exports 2/	12.45	10.94	9.62	17.90	15.35
Shortfall					
Formula			3.71		
Judgmental			2.91		
Proposed purchase			1.30		

1/ Calculated from yearly earnings shown in the first row of Table 3 as:

$$(12.45 \times 10.94)^{1/2} \times \left(\frac{9.62 \times 10.94 \times 12.45}{7.89 \times 7.84 \times 5.84}\right)^{1/3}$$

2/ Domestic exports.

St. Vincent received an advance transfer of approximately SDR 0.5 million in October 1980 from the European Community under the STABEX scheme in respect of a shortfall in banana exports to the EC in 1980. This transfer has been taken into account in assessing the member's balance of payment need.

3. Causes of the shortfall and export prospects

More than 60 per cent of the overall shortfall of SDR 2.9 million was accounted for by bananas, which made up somewhat less than half (44 per cent) of the value of total exports in 1980. The shortfall in bananas was entirely attributable to a fall in the volume of exports, due to hurricane damage. The much smaller shortfall of SDR 0.04 million for arrowroot was also mainly due to volume factors. All other exports, largely agricultural products, incurred a shortfall of SDR 0.9 million.

a. Bananas

Bananas are by far the largest single source of export earnings and, since production is highly susceptible to weather, export earnings have tended to fluctuate more according to the volume of exports than to price changes. As is the case with the other Windward Islands, almost all the

Table 4. St. Vincent: Value, Volume and Unit Value by Major Commodities

(1980=100)

	Value Share in Total Exports in 1980 (In Per Cent)	Calendar Years								Shortfall in Per Cent of Level in Shortfall Year
		1975	1976	1977	1978	1979	1980	1981	1982	
Value	50.9	77	107	106	131	103	100	170	222	38.5
Bananas	43.6	81	115	114	140	108	100	178	226	43.5
Arrowroot	7.3	56	54	60	77	73	100	120	199	6.1
Volume		110	168	147	171	145	100	144	182	45.4
Bananas		110	179	155	182	132	100	152	190	47.3
Arrowroot		110	101	96	108	87	100	98	135	4.4
Unit Value		70	64	72	77	71	100	118	122	-4.7 (excess)
Bananas		74	64	74	77	82	100	117	119	-2.5 (excess)
Arrowroot		51	53	62	71	84	100	122	147	1.4

Table 3. St. Vincent: Export Earnings and Shortfalls by Major Commodities

(In millions of SDRs)

	Calendar Years								Shortfall	
	1975	1976	1977	1978	1979	1980	1981	1982	Geometric	Arithmetic
Total exports 1/	5.84	7.84	7.89	12.45	10.94	9.62	13.74	17.15	2.91	3.16
Bananas	3.39	4.85	4.79	5.90	4.55	4.20	7.47	9.48	1.83	2.12
Arrowroot	.39	.38	.42	.54	.51	.70	.84	1.39	0.04	0.10
Other exports	2.06	2.61	2.68	6.01	5.88	4.72	5.43	6.28	0.92	0.94
Agricultural products 2/	(.82)	(1.34)	(.97)	(1.36)	(1.44)	(1.61)	(1.72)	(1.80)	(-0.03) (excess)	
Manufactures 3/	(1.24)	(1.27)	(1.71)	(4.65)	(4.44)	(3.11)	(3.71)	(4.48)	(0.92)	
	(Annual rate of percentage charge in earnings)									
Total exports		34.2	0.6	57.8	-12.2	-12.1	42.8	24.8		
Bananas		43.1	-1.2	23.2	-22.9	-7.7	77.9	26.9		
Arrowroot		-2.6	10.5	28.6	-5.6	37.3	20.0	65.5		
Other exports		26.7	2.7	124.2	-2.2	-19.7	15.0	15.6		
Agricultural products 2/		(63.4)	(-27.6)	(40.2)	(5.9)	(11.8)	(6.8)	(4.7)		
Manufactures 3/		(2.4)	(34.6)	(171.9)	(-4.5)	(-30.0)	(19.3)	(20.8)		

Source: Authorities of St. Vincent and Fund staff estimates.

1/ Excludes re-exports.
2/ Includes mostly tubers and root vegetables such as sweet potatoes, eddoes, dasheens, yams and carrots, as well as plantains, nutmeg and mace.
3/ Includes mostly manufactures such as clothing, foods and beverages, but in addition, coconuts and coconut oil.

bananas available for export are exported to the United Kingdom under preferential arrangements. Under these arrangements, all the bananas offered are bought at a price determined each week in the light of market conditions, provided that they meet the necessary quality standards.

The eruption of the La Soufriere Volcano early in 1979 adversely affected agricultural output. The volume of banana exports, which in 1978 had reached the highest level in nine years (30,700 tons), fell by 27 per cent to 22,300 tons in 1979. Recovery to the pre-volcano level had been achieved by early 1980, but in August, production was seriously set back by Hurricane Allen and exceptionally heavy rainfall. The damage affected most of the mature trees; no exports were possible for four weeks and then only at a reduced rate for the remaining 2 1/2 months of the year. The volume of exports in 1980 is estimated to have fallen to less than 17,000 tons or 24 per cent below the depressed 1979 level. Partly compensating for these volume reductions, there were rises in export unit values in both 1979 and 1980, by 6 per cent and 22 per cent, respectively. These rises were largely due to a buoyant market in the United Kingdom, and partly due in 1980 to the strength of sterling, the currency in which contract prices are expressed.

A recovery in banana exports is expected to be quite rapid in the two post-shortfall years (1981-82) as a number of rehabilitation programs financed by special foreign assistance have been put in effect. While mature trees were destroyed by the hurricane, smaller plants and roots were not affected, so that it was even possible to resume exports on a reduced scale by mid-September 1980. In 1981 the volume of exports is expected to reach nearly 26,000 tons, or about 52 per cent above the 1980 level, though still below the levels reached in 1976-78. A further volume increase of 25 per cent to 32,000 tons is anticipated in 1982, on the assumption that the measures being taken by the government to expand production and improve yields are successful. Average export unit prices, which had risen by 22 per cent in 1980, are forecast to rise by a further 17 per cent per annum in 1981, to a level which is 2 per cent above the average level during the last half of 1980. A further small increase of 2 per cent is forecast for 1982. On these volume and price assumptions, the value of banana exports is projected to grow by 43 per cent in 1981 and by 25 per cent in 1982. The shortfall of SDR 1.8 million estimated for 1980 is entirely attributable to volume factors.

b. Arrowroot

St. Vincent is the world's leading exporter of arrowroot, although it only accounted for about 7 per cent of the islands' exports earnings in 1980. The hurricane in August did no serious damage to the plantations, but the damage to roads and to the processing factories resulted in the volume of exports in 1980 being less than anticipated. In 1980 export volume was 7 per cent less than in the best previous year, 1978, but 15 per cent above the level in 1979, which had been affected by volcano damage. Arrowroot prices have been advancing steadily over the last five years as consumer preference for natural nutritive starches has strengthened. In 1980, the export unit values of arrowroot for St. Vincent were 19 per cent higher than in 1979 when in turn they were 18 per cent higher than in 1978.

The main impact of the hurricane damage will be reflected in 1981 when the volume of arrowroot exports is expected to fall 2 per cent below the 1980 level. Once road and factory damage has been repaired, and a planned increase in the area planted of about 10 per cent implemented, exports will rise sharply; the volume of exports in 1982 is expected to be 38 per cent higher than in 1981. Export unit values are forecast to rise by about 20 per cent a year in the two post-shortfall years, only slightly above the rate in 1979-80. On these assumptions, the value of exports in 1981-82 is projected to average SDR 1.08 million which is one and a half times the value of exports in 1980, and the shortfall for 1980 is estimated at SDR 0.04 million.

c. Other exports

The available data for these exports in 1980 are not consistent with the data presented in previous years, and it is therefore not possible to provide details of volumes and values for each of the products included. A broad distinction can, however, be drawn between agricultural products and manufactures, even though there is some overlapping.

(1) Agricultural products

This group includes a variety of items ranging from root crops such as sweet potatoes, yams, eddoes, dasheens and carrots, to plantains, nutmeg and mace, but it does not include coconut and coconut oil, which are included in (2) below. Although exports of some of these products, such as plantains, nutmeg and mace, were affected after August by the hurricane damage, others were not, and because of growth in the first seven months of the year their total value for the whole of 1980 is estimated to have been 12 per cent higher than in 1979. Less rapid growth is anticipated in the post-shortfall period--7 per cent in 1981 and 5 per cent in 1982. A small export excess of SDR 0.03 million is estimated for 1980.

(2) Manufactures

There is a small manufacturing sector in St. Vincent which includes flour milling, a dairy, the manufacture of foam rubber, industrial gloves, corrugated cardboard boxes, coir products and clothing. In addition, exports of coconuts and coconut oil are included in this group.

Only part of the output of most of the industries is exported, but the damage done by Hurricane Allen in August affected export facilities such as roads and ports as well as the manufacturing facilities. The value of exports of manufactures in 1980 is estimated to fallen 30 per cent below the 1979 level, which itself was about 5 per cent below the peak of 1978. Work is already under way to repair the infrastructure and other damage, so that output from existing industries can resume normal levels. In addition, the planning of several new export-oriented industries is in an advanced stage, and some are expected to be in full production before the end of 1982. These include a brewery, and plants for the manufacture of animal feeds, corrugated galvanized sheets, electronic components and clothing. The value of this group of exports is projected to increase by approximately 20 per cent in each of the next two years. The shortfall for the group in 1980 is estimated at SDR 0.9 million.

4. Repurchase

In accordance with paragraph 7 of the compensatory financing decision, the St. Vincent authorities are expected to represent that they will make a prompt repurchase in respect of any outstanding part of this purchase if the amount purchased on the basis of partly estimated data (i.e., estimates made for the three months October through December 1980) exceeds the amount that could have been purchased on the basis of actual earnings for the entire shortfall year. The amount to be repurchased would be equivalent to the excess purchased by using partly estimated, rather than actual data for the shortfall year.

5. Staff appraisal and proposed decision

The authorities of St. Vincent are expected to request a purchase equivalent to SDR 1.3 million, under the compensatory financing facility in respect of a shortfall estimated for the calendar year 1980. Exports for the last three months of the shortfall year have been estimated by the staff in cooperation with the authorities. The proposed purchase is equivalent to 50 per cent of quota and, if approved, would be the first purchase by St. Vincent under the facility.

The current account deficit, which had increased steeply in 1979, widened further in 1980, and the overall balance of payments situation moved from equilibrium in 1979 to a deficit of SDR 0.7 million in 1980. In 1981, even though a substantial improvement in the current account is projected, the overall deficit is projected to rise to SDR 3.1 million, because of a decline in emergency assistance. The staff considers that the proposed purchase is justified by the balance of payments need of St. Vincent.

Export earnings for 1980 are estimated to be 18 per cent below the average level of earnings for 1978-79 and 60 per cent below the average level projected for 1981-82. The estimated shortfall of SDR 2.9 million for 1980 is largely accounted for by bananas (SDR 1.8 million) which are the island's chief export, making up almost half of the total export earnings in 1980. A much smaller shortfall of SDR 0.04 million was incurred by arrowroot, and the shortfall for all other exports together is estimated at SDR 0.9 million. The shortfalls were due almost exclusively to volume reductions caused by hurricane damage in August 1980, and are therefore attributable to factors beyond the member's control. A significant recovery in all categories of exports is projected for 1981-82 as a result of efforts to increase production, the establishment of new export industries and a further improvement in prices, particularly of arrowroot. In the light of the expected recovery, the shortfall is considered by the staff to be temporary in character, and as noted above, to be beyond the member's control.

The request is expected to include a statement that the member will cooperate with the Fund in an effort to find, where required, appropriate solutions for its balance of payments difficulties. A Fund staff mission visited St. Vincent in March 1981 to conduct Article IV consultations and to negotiate a stand-by arrangement in the first credit tranche. The staff considers that the expected request meets all the requirements set forth in the compensatory financing decision. Accordingly, the following draft decision is proposed for adoption by the Executive Board after a duly authenticated request has been received:

1. The Fund has received a request from the Government of St. Vincent and the Grenadines for a purchase of the equivalent of SDR 1.3 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representation of St. Vincent and the Grenadines and approves the purchase in accordance with the request.

Fund Relations with St. Vincent and the Grenadines
(as of January 31, 1981)

Date of membership:	December 28, 1979	
Status:	Article VIII or Article XIV status not yet determined.	
Quota:	SDR 2.6 million.	
Fund holdings of St. Vincent currency:	Millions of SDRs	Per Cent of Quota
Total	2.80	107.7
Under tranche policy	(2.80)	(107.7)
SDR Department:	Millions of SDRs	Per Cent of Cumulative Allocation
Net cumulative allocation	0.35	100.0
Holdings	0.23	64.0
Recent contacts:	A Fund staff member participated in the IBRD-led mission to St. Vincent in February 1981 under the Caribbean Group for Cooperation in Economic Development. A staff mission visited St. Vincent in March 1981 to carry out the first Article IV consultations and to negotiate a stand-by arrangement in the first credit tranche.	