

SM/07/389
Correction 1

April 2, 2008

To: Members of the Executive Board
From: The Secretary
Subject: **St. Kitts and Nevis—Staff Report for the 2007 Article IV Consultation**

The attached correction to SM/07/389 (12/18/07) has been provided by the staff:

Mischaracterization of the Views of the Authorities

Page 11, para. 16, first line: for “The mission supported the plan to introduce a transactions-based or”
read “The mission supported the authorities’ consideration of a transactions-based or”

Questions may be referred to Ms. Wagner (ext. 38847) and Ms. Sun (ext. 35371) in WHD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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Department Heads

comprehensive civil service reform aimed at eliminating duplication between agencies and rationalizing the public sector workforce, while ensuring that compensation is sufficient to retain highly-qualified civil servants.

- ***Goods and services.*** Tighter control over spending on goods and services is crucial. The mission supported plans to corporatize the electricity department, which has been a substantial drain on the budget, and suggested a similar approach for water services.
- ***Capital expenditure and net lending.*** Capital spending needs to be prioritized, based on rigorous cost-benefit analysis and financing availability. The authorities agreed on the need to strengthen the PSIP process. The NIA indicated that increased capital spending was needed to attract FDI and transform the economy toward high-end tourism. Restraining net lending activities would also be important.⁴
- ***Civil servant pension reform.*** Commendable progress has been made in establishing a contributory pension scheme for civil servants. The mission welcomed the authorities' plan to cap double pensions for civil servants and increase their retirement age to match that under the social security scheme.

16. The mission supported the ~~plan to introduce~~ authorities' consideration of a transactions-based or value-added tax (VAT), but only with a unified administration. A VAT would replace the current consumption tax and allow for some increase in revenues to offset the implementation of the Common External Tariff (CET) under CARICOM.⁵

- ***Tax/customs administration*** needs to be revamped to ensure successful introduction of a VAT. Currently, there are two separate administrations—one for each island—which do not share revenues. Successful VAT implementation will require a unified regime administered at the federal level and effective revenue-sharing. Following a recent FAD/CARTAC mission, both islands agreed to establish a joint management committee to oversee tax/customs administration. While the St. Kitts Government believed revenue sharing would be feasible, the NIA, which has viewed revenue autonomy as crucial to its economic development strategy, reserved a firm decision pending more details on a proposed revenue-sharing mechanism.
- ***Thorough preparation***, including developing an action plan for tax administration reform, is essential for the VAT's success. Such a plan would include creation of a project team and steering committee and preparation of a detailed roadmap for VAT

⁴ Net lending in St. Kitts has been mainly on-lending of foreign official credit to statutory bodies, as creditors preferred to channel funds through the central government (¶18).

⁵ The authorities intend to implement Phase IV of the CET gradually over three years, given concerns about potential revenue losses.

implementation, including TA needs. The authorities intend to assemble a strong VAT team soon and to keep the public fully informed to address uncertainty and misperceptions.

17. **Other reforms to enhance the tax system's equity and efficiency were discussed.**

- ***Social services levy.*** Adopting a comprehensive personal income tax (PIT) could broaden the tax base and enhance progressivity. However, given limited implementation capacity and the need to focus on introducing a VAT, it was agreed that reforming the existing social services levy, including broadening the definition of income, could be preferable to introducing a new PIT at this stage.
- ***Property tax.*** The government has made substantial progress in moving toward a market-based valuation system, with assessments expected to be completed by end-2007 and implementation to start in 2008.
- ***Tax concessions.*** St. Kitts and Nevis has granted costly investment incentives, including generous tax holidays. While the authorities believe that a unilateral elimination of incentives could place St. Kitts and Nevis at a disadvantage relative to other countries in the region, a new Investment Code under preparation will specify a transparent, nondiscretionary regime that provides investment incentives based on projected economic impact. The government was considering import duty concessions on some foods and other basic necessities to mitigate the impact of rising prices. The mission advised against this approach as it could lead to sizable revenue losses. Instead, targeted transfers could better compensate low-income households.
- ***Corporate income tax.*** The existing Income Tax Act was enacted some 40 years ago and has many loopholes. The mission endorsed the plan to introduce a new Corporate Tax Act, which should also limit the room to grant tax concessions.

18. **Control over the broader public sector needs to be strengthened.** The adoption of a new Finance Administration Act (FAA) is a welcome step. Its strict enforcement will be key, particularly on borrowing and data provision by public enterprises. The mission advised that borrowing by public enterprises using land as collateral should be strictly avoided, and government guarantees should be contingent on full and timely disclosure of financial information.

19. **Debt management capacity, albeit improved, needs further strengthening.** With assistance from CARTAC, the debt unit has compiled a comprehensive government debt database. The mission recommended incorporation of nongovernment-guaranteed external debt in the database and closer monitoring of public debt developments. The government intends to hire a debt management consultant and seek Fund technical assistance to further strengthen the debt unit, improve debt management capacity of statutory bodies, and formulate a strategy to retire more costly debt.