March 28, 2011
Approval: 4/4/11

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 11/3-1

10:00 a.m., January 12, 2011

1. St. Lucia—Request for Disbursement Under the Rapid Credit Facility and Emergency Natural Disaster Assistance

Documents: EBS/10/245 and Correction 1, and Supplement 1

Staff: Schipke, WHD; Martijn, SPR

Length: 20 minutes

Executive Board Attendance

M. Portugal, Acting Chair

Executive Directors	Alternate Executive Directors
	M. Saho (AE)
	E. Ndong Ondo Bilee (AF), Temporary
	O. Hendrick (AG), Temporary
	H. Lee (AU), Temporary
	M. Kollar (BE), Temporary
P. Nogueira Batista, Jr. (BR)	
	Q. Chen (CC), Temporary
	L. Jimenez (CE), Temporary
	S. O'Sullivan (CO)
	G. Leost (FF), Temporary
	S. von Stenglin (GR)
	P. N. Weerasinghe (IN)
	L. Briamonte (IT), Temporary
	M. Makino (JA), Temporary
	M. Daïri (MD)
	M. Merhi (MI), Temporary
	Y. Friedmann (NE), Temporary
	K. Korhonen (NO), Temporary
	V. Khramov (RU), Temporary
	S. Alnefaee (SA), Temporary
	R. Pokharel (ST), Temporary
	S. Antic (SZ), Temporary
	J. Franco (UA), Temporary
	G. Drummond (UK), Temporary

J. Lin, Acting Secretary
R. Dall'Orto, Assistant

Also Present
Legal Department: W. Bergthaler, C. Ogada. Secretary's Department: P. Martin, O. Vongthieres. Strategy, Policy, and Review, Department: J. Martijn. Western Hemisphere Department: A. Schipke. Senior Advisors to Executive Directors: N. Des Vignes (BR), H. Lee (AU). Advisors to Executive Directors: E. Saboia (BR), M. Ghassemi (MD), R. Ngugi (AE), T. Tira (AU).

1. ST. LUCIA—REQUEST FOR DISBURSEMENT UNDER THE RAPID CREDIT FACILITY AND EMERGENCY NATURAL DISASTER ASSISTANCE

Mr. O'Sullivan submitted the following statement:

The authorities wish to thank the staff for their swift response in the wake of the hurricane which struck the country on October 30-31, 2010. A staff team was in place in St. Lucia just three weeks later for discussions on how best to support the authorities' efforts to cope with the immediate aftermath of the disaster. These discussions led to the formulation of a request for a disbursement under the Rapid Credit Facility (RCF) and the Emergency Natural Disaster Assistance (ENDA). The authorities would be grateful for Board approval of that request. As well as helping directly to meet St. Lucia's immediate balance of payments financing needs, Board approval would facilitate the mobilization of resources from other institutions.

Impact of the Hurricane

Hurricane Tomas was an event of historic proportions for St. Lucia. The level of rainfall recorded in a 24 hour period was double that recorded during Tropical Storm Debbie in 1994 and has been assessed as a 1 in 180 year event. The entire population was impacted by the reduction in the water supply to just 1 percent of the pre-hurricane supply. Sanitation was a major issue as a large portion of the population was without access to safe water. There was extensive damage to roads, forestry and to the banana crop. Preliminary estimates of the damage to the banana industry assessed the impact at 80 to 90 percent losses. The infrastructure of the agricultural sector received major damage and will require much re-investment. Large landslides occurred, affecting transport infrastructure. Also, some hotels were affected and tourism activity was disrupted. Reconstruction work will be needed in housing, roads, water supply, river courses, forestry, the banana industry, the tourism sector and economic infrastructure generally. The staff report puts the overall impact of the hurricane at 34 percent of GDP.

Economic Context

The focus of the authorities has for some time been on managing the transition from an agricultural economy dominated by a single product to a more modern services-based economy. Prior to the downturn in the global economy, St. Lucia had been making appreciable strides towards this goal. GDP growth, supported by significant volumes of foreign direct investment, was running at around 4 percent. However, gross public-sector debt was uncomfortably high at around 67 percent of GDP and debt service costs were absorbing almost 40 percent of current revenues. This level of indebtedness reflected in part the commitment of the authorities to invest heavily in infrastructural development. Evidence that this was paying off was to be seen in the marked increase in tourism capacity and the growth in tourism earnings. However, as the staff report says, it will take considerable efforts and resources to put the economy back on its pre-hurricane growth path.

The hurricane of August 2007 and the earthquake later that year combined with the subsequent downturn in the world economy to disrupt progress. These events led to a sharp fall in output in 2009 which, together with the necessary countervailing policy measures introduced by the authorities, resulted in a weakening of the government accounts and an increase in the burden of public debt of around 12 percentage points of GDP.

Recent Economic Developments

Prior to the hurricane, St. Lucia was on track to outperform expectations at the time of the Article IV discussions last March. As indicated in the staff report, the pre-hurricane expectation was for GDP growth of 1.7 percent, some 0.6 percentage points above previous forecasts. The primary deficit, at 0.6 percent of GDP, would have been just one-fifth of that envisaged in March 2010 and the cash deficit, at 4.3 percent, would have been three percentage points lower. The principal driver of this improvement was the very strong performance of the tourism sector which was significantly outstripping expectations, validating the earlier commitment of the authorities to invest in necessary infrastructural upgrades.

Economic Prospects

The outlook for 2011 is for a return to a growth rate of around 4 percent. This exceeds pre-hurricane expectations, reflecting a stimulus effect from post-hurricane activity and a recovery in tourist arrivals. Looking further ahead, however, debt dynamics have altered in that the primary surplus required to achieve the regional objective of a 60 percent debt level by 2020 has increased from around 1.6 percent to 2.9 percent.

Policy Issues

The policy issues mentioned in the course of the March 2010 Article IV discussions remain on the table. The central issue is still the need to assure debt sustainability within the context of economic development and poverty reduction. Financial sector stability remains on the agenda and the warning note sounded by staff on the occasion of the Article IV review in relation to the incidence of non-performing loans (NPLs) is still relevant.

The full suite of policy issues will be taken up in the context of the Article IV review which will take place in the coming months. In the course of those discussions, the authorities will return to the issues touched on in the Prime Minister's Letter of Intent which accompanies the current request, including the recent progress on legislation to introduce a market-based property tax and their commitment to introduce a value-added tax (VAT) next year. They will also set out their intentions in relation to the control of public sector wage costs and their plans for a medium-term expenditure framework.

Conclusion

The authorities welcome staff's acknowledgement of their solid track record of sound fiscal policies and of close collaboration with the Fund. In return, they wish to express their appreciation for the support shown by the Executive Board of their efforts. They would be grateful for Board approval of the request for a purchase and disbursement under ENDA and the RCF amounting to 35 percent of quota and they look forward to re-engaging more fully on the full set of policy issues during the forthcoming Article IV consultations.

Mr. Legg and Mr. Gronn submitted the following joint statement:

We support the authorities' request for disbursement under the Rapid Credit Facility and Emergency Natural Disaster Assistance to support their efforts in addressing urgent balance of payments (BOP) need arising from the damages caused by Hurricane Tomas. We consider the level of access requested to be appropriate.

However, the outlook prior to the hurricane indicated existing fiscal imbalances, as well as stress to the financial sector. Whilst the Fund support through the Exogenous Shocks Facility (ESF) disbursed in 2009 and the RCF/ENDA are providing immediate support at the time of St. Lucia's need, there is an underlying need for more permanent, medium to longer-term measures.

St. Lucia's vulnerability to external shocks, its high level of public debt, as well as its limited scope for monetary adjustment, underscore the need for fiscal consolidation measures to be implemented sooner rather than later.

A stronger fiscal position, as well as greater macroeconomic stability will arguably provide a buffer against future macroeconomic risks. In this context, the top priority should be achieving medium-term debt and fiscal sustainability. The authorities' commitment and actions taken to implement both, revenue and expenditure measures, as well as pursuing the required structural reforms, are encouraging. We consider that laying the groundwork for the successful and effective implementation of a market-based property tax and VAT to be important. Along with the required legal framework, this should also include training of staff, increased public awareness, and addressing institutional capacity gaps.

We note that staff will raise the possibility of a formal Fund arrangement in the context of the forthcoming Article IV consultation. However, there does not seem to be any indication of the authorities' inclination towards such an arrangement, and we would appreciate further information from staff on this issue.

We take note of the debt sustainability analysis (DSA) presented by staff and underline that it remains relevant, as long as credit conditions do not deteriorate further and there are no further delays to the implementation of measures to improve fiscal balances. Strengthened monitoring and supervision of the financial sector are crucial, whilst a strong fiscal position also helps to insure against financial sector risks. In addition, small, open, and vulnerable economies, such as St. Lucia, argue for low levels of public debt as a means of mitigating against future external shocks. In this context, we caution staff against setting specific medium-term debt targets as part of their policy advice, in particular where the medium term target is imported from other countries or regions that do not mirror the country's specifics.

Mr. Elder and Ms. Drummond submitted the following statement:

We agree with the staff recommendation.

St. Lucia clearly faces difficult challenges to address the damage inflicted by Hurricane Tomas, not least of which is an urgent balance of payments need. While this disbursement is not without risks, we are comforted by the St. Lucian authorities' strong track-record and their renewed commitment to achieve medium-term debt sustainability.

We note that IMF resources are expected to play a catalytic role in mobilizing financing support from other IFIs and RDBs. Can staff provide further information on the likely sources and amount of such funding?

Mr. Assimaidou submitted the following statement:

We agree with staff appraisal, including the analysis of the impact of the Hurricane Tomas which struck at the end of October 2010, and concur with the assessment of the large, immediate balance of payments needs caused by this disaster. Furthermore, the external and public debt sustainability analysis (EPDSA) indicates that St. Lucia's has a good debt servicing record, which denotes its capacity to repay. Therefore, we support the authorities' requests for Fund's assistance under the Rapid Credit Facility (RCF), supplemented by the Emergency Natural Disaster Assistance (ENDA). We concur with the view that access to this funding will be crucial to maintaining macroeconomic stability; implementing structural reforms aimed at promoting private sector-led growth and improving economic efficiency and competiveness.

We note that St. Lucia's economic performance is anticipated to have been restrained last year, due to the continued effect of the global downturn and the recent hurricane. Thanks to the authorities' aggressive immediate relief actions to victims and urgent rebuilding efforts conducive to restoring macroeconomic stability, growth is now envisaged to solidify this year. We welcome donors and development partners' engagement for the financing of such emergency actions, and trust that the international community will maintain its support to this hard-hit island.

The authorities' commitment to address the debt sustainability issue and align the national debt-to-GDP ratio with the regional target of 60 percent is commendable. To this end, the strategic planning to limit the financing of rehabilitation and reconstruction efforts to grants and external concessional resources is appropriate. Such resources will be critical in light of the island country's economic development and poverty reduction objectives. We encourage the international and regional financial institutions, as well as other development partners to support this strategy.

We look forward to the forthcoming Article IV consultations which should help address pending issues. These include notably the stability of the financial sector—with the incidence of the large non-performing loans—and developments on the fiscal front, in particular the introduction of a market-based property tax, the envisaged establishment of a value-added tax, and the necessary control of the public sector wage bill.

With these remarks, we wish the authorities of St. Lucia every success in their challenging endeavors.

Mr. Nogueira Batista and Ms. Des Vignes submitted the following statement:

We thank staff for their report and Mr. O'Sullivan for his buff statement. St. Lucia's economy was gradually recovering from the effects of the global economic crisis when the hurricane struck causing loss of lives and devastation to economic infrastructure and agriculture. As a consequence of Hurricane Tomas, the growth estimated for 2010 is now minimal, the fiscal position has deteriorated further and external financing is urgently needed. We therefore support the request for disbursement under the Rapid Credit Facility (RCF) and the Emergency and Natural Disaster Assistance.

According to staff, the request equivalent to 35 percent of quota will only cover 20 percent of the financing gap in 2011. The remainder will be sourced from grants and concessional loans which the authorities have already identified. However, the authorities indicated that they will resort to bridge financing (including bond issuance and commercial bank borrowing), if any of the disbursements related to the identified hurricane financing are delayed. This could be costly and have implications for debt servicing going forward. Thus, the amount of resources to be provided by the IMF may be inadequate. The staff's comments are welcome.

We welcome the authorities' commitment to their medium-term objectives of fiscal and debt sustainability while restoring macroeconomic stability and growth and protecting the vulnerable sectors of society (as discussed at the time of the 2010 Article IV consultation). The mix of both revenue enhancing and expenditure curtailing measures will be instrumental in placing debt on a downward trajectory.

The fiscal situation is uncomfortable. The overall central government cash deficit (including grants) is estimated at more than 6 percent of GDP in 2010 and 2011. Gross public debt has risen considerably in recent years and is around 80 percent of GDP. Moreover, St. Lucia's current account deficit is expected to reach 25 percent of GDP in 2011.

However, according to the staff's debt sustainability analysis, the risk of debt distress remains moderate. Safeguarding debt sustainability is critical and the authorities remain committed to achieving the debt target of 60 percent of GDP by 2020, despite the added challenges. We welcome the authorities' intention to finance their rebuilding of the economic infrastructure through grants and concessional borrowing.

Ms. Vongpradhip and Mr. Pokharel submitted the following statement:

We broadly agree with staff's assessment in the report. In light of the difficult challenges brought about by Hurricane Tomas, as outlined by Mr. O'Sullivan in his helpful buff statement, as well as the country's track record of sound fiscal policies and commitment to close policy dialogue with the Fund, we support the authorities' request for disbursement under Rapid Credit Facility (RCF) and Emergency Natural Disaster Assistance (ENDA)

That said, we will limit our comments to the following:

Fiscal Sustainability

We note that St. Lucia has a high gross public sector debt-to-GDP ratio prior to Hurricane Tomas. As such, the authorities' intent to limit infrastructure and rehabilitation spending to available grants and concessional financing is appropriate; so as to limit downside affects to the country's debt dynamics. In this connection, we echo Mr. Elder and Ms. Drummond's request for further information on likely sources and amounts of additional support from other international and regional financing institutions, and what the progress regarding such arrangements are to date.

Given St. Lucia's small economy, its vulnerability to sudden and exogenous shocks, and the constraints on the monetary policy front, we urge the authorities to persist with efforts to achieve debt sustainability over the medium term. As such, we welcome their continued commitment to reach a debt-to-GDP target of 60 percent by 2020, as well as the intent to press ahead with structural reforms which would lay the foundations for more sustainable growth and heightened economic resilience.

Financial Sector

We note staff's assessment that St. Lucia's banking sector appears to be in a position to weather the effects of the hurricane. That said, the increase in NPLs and weak credit growth remained concerns, and we agree with the need for heightened caution and monitoring. We look forward to revisiting these and other issues in the upcoming Article consultation.

Mr. Bakker and Mr. Friedmann submitted the following statement:

We support St. Lucia's request for disbursement under the RCF and ENDA, which would assist St. Lucia in meeting its immediate BOP needs arising from the damages caused by Hurricane Tomas. The damages caused by Hurricane Tomas are estimated at around a third of St. Lucia's GDP. Hence, without doubt, both the RCF and ENDA are appropriate facilities for St. Lucia to get access to Fund resources.

We note St. Lucia's high public debt-to-GDP level, and its deteriorating fiscal stance, which partly results from the hurricane. It is clear that the large amount of resources needed for rehabilitation will not allow for fiscal consolidation in the short term. Yet we are reassured by the authorities' commitment to limit the financing of the capital spending related to the rehabilitation of the economy only to grants and concessional loans, as well as by St. Lucia's commitment to reduce its public debt-to-GDP ratio in the medium term. St. Lucia's good track record makes us believe that this is achievable. In this regard, the implementation of measures both on the revenue side and on the expenditure side, as planned by the authorities, are crucial for achieving the authorities' medium and long-term fiscal goals, and to create fiscal buffers to cope with external shocks in the future.

Mr. Fayolle submitted the following statement:

We thank staff for a clear and well focused report, as well as Mr. O'Sullivan for his useful buff statement.

We support this request for disbursement under the Rapid Credit Facility and Emergency Natural Disaster Assistance, which will help the country to face immediate financing needs. As stressed by Mr. O'Sullivan, the approval of this request would also facilitate the mobilization of resources from other institutions, like the European Union or the World Bank—an emergency recovery loan should be approved in February.

We are confident in St. Lucia's capacity to repay this loan. As stressed by staff, the country has an exemplary debt service record, and the external and public debt sustainability analysis shows that the risk of external debt distress remains moderate.

This major natural disaster underscored again that St. Lucia is highly vulnerable to exogenous shocks. It is hence crucial to adopt a very cautious approach to public finances, in order to create fiscal space to react to any external shock, without undermining the efforts made to achieve the objective of bringing the debt-to-GDP ratio down to below 60 percent by 2020. We hence welcome the authorities' strong commitment to implement crucial measures, like the introduction of a VAT by April 2012. We also welcome their willingness to maintain a close policy dialogue with the Fund, and we note the possibility of a formal arrangement with the Fund, which could be discussed in the context of the next Article IV consultation.

Finally, we commend the authorities for having the country removed from the OECD's "grey" list of tax heavens, and we now encourage them to further strengthen and improve overall tax and information exchange arrangements ahead of the Global Forum's peer review process.

Mr. Pérez-Verdía and Mr. Jiménez submitted the following statement:

We support St. Lucia's request for a disbursement under the Rapid Credit Facility and Emergency Natural Disaster Assistance in view of the significant challenges, in terms of economic policy, that the authorities have to face in addressing the damage caused by Hurricane Tomas. We hope that help provided by the Fund may be of value to address urgent balance of payments needs.

We also support the staff's assessment and the authorities' plans to tackle rebuilding needs while at the same time implementing measures to achieve fiscal consolidation and medium-term debt sustainability. In our view, to limit financing of the rehabilitation and reconstruction efforts to concessional financing and grants is a sensible policy. Structural reforms, particularly regarding the tax framework and public expenditure, are also constructive towards this effort, although these should be implemented carefully. Moreover, we believe that no effort should be spared in order to continue implementing further structural reforms to alleviate poverty and increase productivity.

Mr. Sadun and Mr. Briamonte submitted the following statement:

We support the authorities' request for access of SDR 5.36 million (35 percent of quota) under the Rapid Credit Facility (RCF) and the Emergency Natural Disaster Assistance (ENDA).

We acknowledge that the actual request is due to the urgent balance of payments (BOP) needs resulting from the damages to infrastructure and agriculture caused by the hurricane last October. However, this request is following the 2009 request under the Fund's Rapid-Access Component under the Exogenous Shocks Facility (RAC-ESF) to mitigate the impact of the global crisis on the economy.

As the debt sustainability analysis (DSA) shows clearly, the expenditure related to the hurricane and the impact of the global crisis has changed both the deficit and debt trajectory in the medium and the long term. Therefore, we believe that a program aimed at addressing the BOP financing needs in the medium term and aimed at bringing the economy back onto a sustainable path would have been more appropriate. In particular, a program would have been an effective way to implement those expenditure and revenue measures, including a public expenditure reform and the introduction of a property tax and a VAT, that have been continuously delayed. This would have fostered further the confidence in the authorities' commitment toward their debt target. Accordingly, we support staff's intention to raise the issue of a formal Fund arrangement during the next Article IV consultation.

Mr. Majoro submitted the following statement:

The effects of Hurricane Tomas that struck St. Lucia in October 2010 may be felt for a much longer time if no immediate assistance is provided in financing rehabilitation and reconstruction activities. The hurricane has had significant impact on the core sectors and structures of the economy and this is already disrupting the emerging recovery anticipated in the pre-hurricane period. Already the growth figures for 2010 show the economy will not achieve the projected 1.7 percent growth rate but instead may only reach 0.5 percent. Furthermore, the authorities face limited options in sourcing for finance as they have to carefully consider the implications on debt sustainability, macroeconomic stability and the development agenda given the weak fiscal status. We commend the authorities for seeking concessional funding in financing the reconstruction and rehabilitation activities.

Several development partners have indicated their support. However, the authorities face a delicate balance if there are any delays in disbursements. Borrowing from the market could deteriorate debt sustainability faster, while postponement of infrastructure development may deny the economy an opportunity to sustain the tourism sector which is a key factor in its recovery path. Currently, the authorities have reallocated funds from the investment budget to move on with the reconstruction efforts as they await the disbursements. IMF contribution to the kitty is about 20 percent (or 29 percent of the authorities' reallocated funds) and its disbursements could play a critical role to the authorities' efforts in mobilizing resources from other development partners. We thus support the authorities request for disbursement under the Fund's RCF/ENDA.

The commitment by the authorities to achieving fiscal consolidation in the medium term is critical in attaining fiscal credibility and for debt sustainability. However, this needs to be carefully implemented to minimize any adverse implications on growth and employment as the recovery has been made more fragile. The commitment to implement tax reforms especially with the introduction of VAT should be upheld. In addition, the authorities should develop a medium-term debt strategy which will help to avoid any increases in the risk of debt distress. Further, the structural reforms aimed at fostering private sector-led growth should be such that they facilitate diversity of economic activities. Finally, we look forward to the development of a comprehensive economic and social program.

With these remarks, we wish the authorities well as they move on with the reconstruction.

Mr. Kiekens and Mr. Kollar submitted the following statement:

We sympathize with the people of St. Lucia for the hardship caused by the October 2010 hurricane. St. Lucia's economy had just started to recover from the slowdown after the global economic and financial crisis. The reconstruction-related imports will seriously affect the current account balance of St. Lucia, causing a balance of payments financing gap. We support the authorities' request for a timely disbursement under the RCF/ENDA facilities that would help St. Lucia to meet the immediate foreign exchange needs.

St. Lucia's public debt ratio was on the rise when the hurricane struck, as were NPLs in the banking sector.

We are assured by the authorities' commitment to finance the post-hurricane economic reconstruction primarily through budget reallocations, grants and external concessional financing. Nevertheless, the hurricane-related fiscal expenditures will increase public debt to about 81 percent of GDP by 2012. We welcome the authorities' commitment to reaching a 60 percent debt-to-GDP target by 2020. Reaching this target requires a primary surplus of 2.9 percent of GDP in the medium term.

We encourage the authorities to continue their efforts with respect to the ongoing reform of the VAT and the property tax. The public sector wage bill should be stabilized in terms of GDP. Structural reforms should foster private sector-led growth.

The staff should closely monitor the balance-of-payments developments, in particular the volatile banana exports and tourism receipts, as well as construction, food, and fuel-related imports.

We learn from the staff report that the authorities do not request an ECF at the current juncture. Nonetheless, the staff will raise the possibility of a formal Fund arrangement in the context of the next Article IV consultation this spring in order to address the country's medium-term challenges. We support staff's approach because a Fund program may act as a catalyst for mobilizing further external financing for St. Lucia.

Mr. von Stenglin and Mr. Dahlhaus submitted the following statement:

We thank staff for their concise set of papers as well as Mr. O'Sullivan for his informative statement.

Against the background of the severe balance of payments impact in the aftermath of the hurricane with significant export losses, we consent to the proposed decision. While we accept the urgent balance of payments need, some general remarks are warranted regarding the blending of GRA and concessional resources and its role in supporting graduation.

Program Issues

Blending underlies a complex rationale based on substitutability between GRA and PRGT resources. The staff is well advised to apply the necessary degree of caution before recommending such a use of Fund resources. Any blending request needs to be based on a careful and transparent consideration of the respective national income level, vulnerabilities to debt sustainability and access to other sources of concessional and/or non-concessional financing. Despite a relatively high per capita GNI, St. Lucia remained on the list of PRGT-eligible LICs primarily due to short-term vulnerabilities. Yet, a more comprehensive staff assessment on the rationale for this blending arrangement would be welcome. Beyond the current urgent balance-of-payments need, we also take note that staff has the intention to raise the possibility of a formal Fund arrangement; albeit, little justification is provided. The staff's comments would be welcome.

Fiscal Policy

The key challenge is to put public debt on a downward trajectory. For St. Lucia, as a small open economy and part of the Eastern Caribbean Currency Union (ECCU), it is vital to sustain fiscal space to be able to absorb recurring exogenous shocks—including natural disasters, unstable tourism receipts, and volatile energy and food prices. The authorities are well-advised to establish a firm track record, also given that the revenue shortfalls and spending pressures related to the adverse economic effects of Hurricane Tomas are not yet known and current macroeconomic projections may turn out to be optimistic.

The high debt level requires comprehensive fiscal measures to reach the ECCU's debt target by 2020 and we urge the authorities to take decisive actions both on the revenue and expenditure side. The intended freeze of expenditures on wages and salaries is generally welcome but the envisaged target may not be ambitious enough as it corresponds to the average over the past five years. We would welcome a more ambitious reduction to sustain fiscal space for infrastructure investment. Furthermore, the authorities need to speed up the implementation of additional revenue measures and ensure that the value-added tax and market valuation-based property tax generates sufficiently high revenue to meet the ambitious but necessary primary surplus of 2.9 percent of GDP over the medium term—as envisaged in the Letter of Intent. To the extent the outlook of 3 percent real GDP growth in the medium term does not materialize, additional fiscal adjustment would be necessary.

Mr. Daïri and Mr. Ghassemi submitted the following statement:

While still recovering from the global crisis, aided by the 2009 RAC-ESF, the St. Lucian economy has been severely impacted by the October 2010 hurricane. We note from the staff report and Mr. O'Sullivan's statement that there is an urgent need for concessional emergency financing to address the significant hurricane damages. Against this background and based on the authorities' commitment to sound economic policies, as well as the catalytic role of Fund assistance, we support the authorities' request for a disbursement under the RCF and ENDA.

Medium-term fiscal sustainability hinges on striking the right balance between addressing the impact of the hurricane and improving growth performance, on the one hand, and putting the public debt firmly on a declining path, on the other. Hence, continued implementation of revenue and expenditure measures, along with a strong debt management, remain critical

> for achieving the ambitious primary surplus of 2.9 percent of GDP in FY2014/15 (from a deficit of 2.4 percent in FY2010/11), and the ECCU's debt target of 60 percent of GDP by 2020. It is reassuring that the government will limit the financing of its rehabilitation and rebuilding efforts primarily to available grants and concessional resources. Implementing the envisaged civil service reform will help rationalize spending further. We look forward to timely introduction of the planned market-based property tax and a VAT.

Ms. Franco supported the authorities' request and agreed with staff's analysis and recommendations.

The staff representative from the Western Hemisphere Department (Mr. Schipke), in response to questions and comments from Executive Directors, made the following statement:[1]

> Executive Directors raised a number of questions related to the prospect of a formal Fund arrangement, access, and blending between GRA and PRGT resources. I will answer the first two. My colleague from SPR will answer the latter.
>
> With respect to Fund engagement, the authorities have reiterated their commitment to implementing policies, especially with respect to revenue measures, such as the value-added tax and expenditure reforms, in line with the recommendations in the 2010 Article IV consultation and the Letter of Intent (LOI) for this request, irrespective of the engagement with the Fund. They are committed to the policies.
>
> Given the election cycle, however, the authorities indicated that, in the short term, they are not likely to request a formal Fund program. As background: parliamentary elections have to be called by the end of March 2012, but they can take place at any time.
>
> Having said that, staff agreed to revisit this issue in the context of the upcoming Article IV consultation, which is tentatively scheduled for April 2011. At that point, the authorities would have a better sense of whether there has been significant shortfall or delay in terms of the identified sources of financing, and staff will have additional data on the impact of the shock on the balance of payments.

[1] Prior to the Board meeting, SEC circulated the staff representative's additional responses by email. For information, these are included in an annex to this minute.

Somewhat related to the question of a formal Fund arrangement is the question of access and temporary bridge financing.

The overarching objective of this Fund program has been: first, to accompany the authorities in the development of the macroeconomic policy response to the shock; second, to act as a first line of defense by providing financing quickly; and third, to act as a catalyst for donor support and resources from other regional and international financial institutions.

In terms of access, staff believes that 35 percent of quota is appropriate, based on three reasons: the projected fiscal and balance of payments needs, the already identified sources of financing, and the policies that the authorities have committed to implement. At the same time, it is also useful to highlight that, given St. Lucia's vulnerability to natural disasters and other external shocks, the already outstanding stock of PRGT resources that relate to last year's Fund financing under the RAC-ESF and the cumulative limits under the RCF, the 35 would maintain additional cushion if another natural disaster were to hit the country in the near future.

In terms of the need for potential bridge financing, given the relative few players in terms of potential donors and support from regional and other international financial institution, the authorities have a relatively good sense of both the potential amount of sources and the potential timing of approval and disbursement. The World Bank has already indicated that the Board meeting is likely to take place in February, and another key contributor, the Caribbean Development Bank, is expected to have its Board meeting in March. Furthermore, the authorities have a clear intention to keep commercial bridge financing to a minimum, and also be very temporary. The staff therefore believes that the implication for debt servicing would be marginal.

Having said that, if at that time of the Article IV consultation in April there are signs that identified financing sources are significantly delayed or fiscal and balance of payments needs turn out to be larger than currently projected, the formal Fund arrangement might be more appropriate. In this context, staff would also have to revisit the corresponding policies.

On the appropriateness of applying the regional medium-term debt target to St. Lucia, in staff's view, the regional target of 60 percent of GDP is a ceiling. Given the vulnerabilities, staff wants the country to get there as soon as possible.

The staff representative from the Strategy, Policy, and Review Department (Mr. Martijn), in response to questions and comments from Executive Directors, made the following statement:

> There was a question on the application of the blending policy. The blending policy was revised by the Executive Board in July 2009 with the objective of ensuring a more consistent use of blending arrangements for the countries that meet the blending criteria. Under the revised policy, blending is presumed for PRGT-eligible countries that have either sustained access to international financial markets, or a per capita GNI that exceeds the IDA operational cutoff, which is currently US$1,165. However, blending is normally not to be used for countries that are at high risk of debt distress.
>
> St. Lucia’s 2009 GNI was US$5,190, which is more than four times the threshold for blending, and it does not have a high level of debt distress. Hence, the criteria that create a presumption for blending, and that are expected to be applied more consistently than in the past, are met, and the proposal is in line with this presumption.
>
> The specific modality of the blend, with 25 percent of quota under the PRGT and 10 percent under the GRA, is also in line with the 2009 rules for blending, since 25 percent of quota is the normal minimum for concessional access within a blend.

Mr. Nogueira Batista asked whether the authorities had requested a higher level of access because, according to the staff report, the level of access would cover only 20 percent of the financing gap, and the resort to bridge financing might be costly and affect debt servicing and debt sustainability if it was prolonged.

The staff representative from the Western Hemisphere Department (Mr. Schipke), in response to further questions and comments from Executive Directors, made the following additional statement:

> Yes, we discussed access in the context of the sources that we had already identified at that particular time, the risk of future natural shocks, and the ability to come to the Fund quickly. And the authorities had a very good sense of the minimum resources that they would like to get. The staff is very comfortable with the access of 35 percent of quota as well.
>
> In addition, my colleague from the World Bank informed me this morning that, while it has not been approved yet—it was in an internal process—the World Bank is now looking to provide 15 million; they had

initially indicated that they would provide 5 million of resources at a minimum. If we combined these 15 million with our resources, we would have already 60 percent of the required financing under our current projections.

We had a long discussion with the authorities on a formal Fund arrangement. While they did not rule it out, they thought that if there were any hiccups in terms of accessing funds, which we do not believe will happen, they would discuss it with us at the time of the Article IV consultation.

Mr. O'Sullivan made the following concluding statement:

The grays for this morning's discussion presented a balanced picture: Mr. Legg's gray emphasized the issues that are out there on the fiscal side; Mr. Elder and Mr. Bakker spoke of the track record of the authorities; and Mr. Nogueira Batista, Mr. Majoro, Mr. Kiekens and others mentioned the progress St. Lucia had been making prior to the hurricane.

Mr. Daïri put his finger on the core issue for St. Lucia which, in common with other countries in the region, is the need for fiscal stability with growth requirements over the medium term.

All Directors recorded their views as being in favor of the staff's proposal; and the authorities, to whom I have already sent the full set of grays, are appreciative of that support.

The Acting Chair (Mr. Portugal) made the following summing up:

Executive Directors noted that St. Lucia faces difficult policy challenges in addressing the impact of Hurricane Tomas, which caused loss of life and significant damages to its infrastructure and agriculture. The reconstruction needs are expected to have a significant fiscal and balance of payment impact in 2011, and put additional strain on the financial system. They underscored that the authorities' continued track record of sound policies is crucial to maintain macroeconomic stability and debt sustainability during the rehabilitation, as well as help catalyze additional support from other development partners.

Directors noted St. Lucia's deteriorating fiscal position since 2009, the rising public debt burden, and the economy's high vulnerability to external shocks. They welcomed the authorities' continued commitment to fiscal consolidation and the medium-term debt target, and supported the planned revenue and expenditure measures, including the introduction of a market valuation-based property tax in early 2011 and a value-added tax by April 2012. Directors stressed the importance of restraining the civil service wage bill over the medium term, within the context of broader civil service reforms, and the need to improve productivity and efficiency and to limit the temporary increase in capital spending to additional grants and external concessional financing that become available. They encouraged full implementation of a formal public sector investment program, aimed at increasing the efficiency of spending and underpinned by a medium-term expenditure framework.

Directors encouraged the authorities to press ahead with the structural reform agenda, aimed particularly at enhancing the investment climate to foster private sector growth. They welcomed the ongoing efforts to strengthen the oversight and resilience of the financial sector, and looked forward to the establishment of the Single Regulatory Unit.

The Executive Board took the following decisions:

St. Lucia—Request for Disbursement Under the Rapid Credit Facility

1. St. Lucia has requested a loan disbursement in an amount equivalent to SDR 3.83 million (25 percent of quota) under the Rapid Credit Facility of the Poverty Reduction and Growth Trust.

2. The Fund notes the intentions of the Government of St. Lucia as set forth in the letter from the Prime Minister and Minister for Finance and Planning, dated December 21, 2010, and approves the loan disbursement under paragraph 1 above in accordance with the request. (EBS/10/245, 12/28/10)

Decision No. 14830-(11/3), adopted
January 12, 2011

St. Lucia—Request for Purchase Under Emergency Natural Disaster Assistance

1. St. Lucia has requested a purchase in an amount equivalent to SDR 1.53 million (10 percent of quota) under the Fund's policy on Emergency Assistance for Natural Disasters.

2. The Fund notes the intentions of the Government of St. Lucia as set forth in the letter from the Prime Minister and Minister for Finance and

Planning, dated December 21, 2010, and approves the purchase under paragraph 1 above in accordance with the request.

3. This decision shall become effective only upon the adoption of Decision No. 14830-(11/3) by the Executive Board. (EBS/10/245, 12/28/10)

Decision No. 14831-(11/3), adopted
January 12, 2011

APPROVAL: April 4, 2011

SIDDHARTH TIWARI
Secretary

Annex

The staff representative from the Western Hemisphere Department (Mr. Schipke), in response to technical questions from Executive Directors, circulated the following written answers before the Executive Board meeting:

Financing

Can staff provide further information on the likely sources and amount of financing support from other IFIs and RDBs and what the progress regarding such arrangements is to date?

- Given St. Lucia's relatively few potential sources of grants/concessional financing, the authorities have a good understanding of the likely resources for hurricane-related rehabilitation and reconstruction efforts.

- Based on discussions with donors/regional development partners, the authorities have identified the following sources of concessional financing: Caribbean Development Bank (EC$61 million); EU (EC$7 million); and CARICOM Development Fund (EC$4.1 million). In addition, the authorities have identified grants of around EC$50 million, mostly from the CDB and Japan.

- Similar to St. Vincent and the Grenadines, the World Bank has committed to provide an Economic Recovery Credit (ERC) to St. Lucia of EC$13.5 million. At the same time, and reflecting the size of the damages, it has set in motion an internal process to increase the size of support beyond the already committed amount. A World Bank board meeting could take place in February, while CDB's board could consider St. Lucia's requests as early as March.