DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR
AGENDA

SM/85/345

CONTAINS CONFIDENTIAL
INFORMATION

December 31, 1985

To: Members of the Executive Board

From: The Acting Secretary

Subject: St. Vincent and the Grenadines - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with St. Vincent and the Grenadines which will be brought to the agenda for discussion on a date to be announced.

Mr. Amselle (ext. 7682) or Mr. Khor (ext. 7687) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

ST. VINCENT AND THE GRENADINES

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the 1985
Article IV Consultation with St. Vincent and the Grenadines

Approved by E. Wiesner and S. Kanesa-Thasan

December 30, 1985

The 1985 Article IV consultation discussions with St. Vincent and the Grenadines were held in Kingstown during the period October 30-November 14, 1985. The representatives of St. Vincent and the Grenadines included the Prime Minister (who is also Minister of Finance), the Director of Finance and Planning, senior officials in the ministries, and representatives of the major public enterprises. Mr. Leonard, the Alternate Executive Director for St. Vincent and the Grenadines, participated in the final round of policy discussions with the authorities. The staff representatives were Messrs. Amselle (Head), Caetano, Khor, Tareen (all WHD), Mr. Feldman (TRE), and Ms. Archer (Secretary-WHD). The mission was assisted by Mr. Gantt, the Fund's Regional Advisor, and by Mr. Byam of the Inter-Agency Resident Mission. A World Bank mission was visiting St. Vincent and the Grenadines at the same time as the Fund mission. St. Vincent and the Grenadines accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement in August 1981.

I. Recent Economic Developments

Following a three-year period of relatively strong recovery from the damage of natural disasters, real GDP growth declined to 3 1/2 percent in 1984 because of a slowdown in manufacturing, construction, and tourism (Table 1). Despite a rapid growth in agriculture and a recovery in tourism, output is estimated to have risen by only 3 percent in 1985, mainly reflecting sluggish activity in the manufacturing, construction, transport, and retail trade sectors. Prospects for 1986 are for a significant upturn in economic growth led mainly by construction, which will benefit from the startup of the Cumberland hydroelectric project.

Table 1. St. Vincent and the Grenadines:
Selected Economic Indicators

(Percent change)

	1981	1982	1983	Prel. 1984	Est. 1985	Proj. 1986
GDP at current market prices	23.8	16.6	9.4	8.4	7.1	9.9
GDP at 1977 factor cost	7.4	5.9	5.1	3.6	3.0	6.8
Agriculture	(41.1)	(5.8)	(4.8)	(4.5)	(10.0)	(10.0)
Manufacturing	(1.9)	(5.8)	(2.6)	(1.1)	(1.0)	(8.9)
Construction	(1.9)	(1.0)	(6.0)	(3.1)	(2.0)	(20.0)
Transport and communication	(13.4)	(10.3)	(12.2)	(5.8)	(1.2)	(4.8)
Hotels and restaurants	(-12.5)	(4.3)	(6.2)	(0.3)	(7.2)	(2.1)
Consumer prices (average)	12.7	7.3	5.4	2.7	2.2	3.5
Terms of trade 1/	4.2	4.7	3.8	-2.6	1.3	--

Sources: Statistical Office, Ministry of Finance; Organization of Eastern Caribbean States Secretariat; and Fund staff estimates.

1/ Export price includes goods and tourism.

The rate of increase in consumer prices declined from 12 1/2 percent in 1981 to about 2 percent in 1985. The moderation in the rate of inflation in recent years can be attributed mainly to a substantial reduction in the rate of increase of import prices that reflected the appreciation of the currency, the slowdown of inflation in the United States and other trading partners, and the decline in the prices of imported petroleum products. During 1981-83, export prices--including tourism--rose at an average annual rate of 4 percent and resulted in a modest improvement in St. Vincent's terms of trade. In 1984, however, export prices declined by 3 1/2 percent, leading to a small deterioration in the terms of trade for that year.

Information on wage trends is limited. A sampling of negotiated settlements in the private sector and major public enterprises suggests that the upward pressure on wages has eased somewhat in recent years, although settlements have continued to provide for nominal wage increases in excess of the rate of inflation. Wage settlements for a sample of selected enterprises declined from an average of 13 1/2 percent in 1981 and 1982 to less than 9 percent in 1985. Following a two-year freeze on civil servants' salaries, the Central Government agreed in July 1981 to a three-year contract which provided for a 30 percent increase in salaries of permanent workers in FY 1981/82 and for annual increases of 10 percent for the next two fiscal years. Since the expiration of the agreement in June 1984, no further salary increase has been granted to civil servants.

According to a household survey undertaken in July 1984, the rate of unemployment in St. Vincent was more than 43 percent of the labor force, which was defined to include 71 percent of the population over 14 years of age. More recent estimates, however, suggest that the rate of unemployment is more likely to be in the neighborhood of 35 percent of the labor force.

The public finances deteriorated markedly in FY 1983/84, mainly because of stagnating central government revenues, a sharp decline in the revenues of the Philatelic Service department, and the mounting operating losses of the state-owned Sugar Industry Ltd. As a result, public sector savings declined from 1 1/2 percent of GDP in FY 1982/83 to less than 1/2 of 1 percent in FY 1983/84, while the overall deficit rose in the same period from 5 1/2 percent of GDP to 6 1/2 percent (Table 2). About two thirds of the deficit was financed domestically, largely through overdrafts and advances by the state-owned National Commercial Bank (NCB), which seriously strained the liquidity position of that institution.

The Government that was elected in July 1984 acted promptly to redress the fiscal imbalance. On the basis of recommendations of a fiscal study sponsored by the Organization of Eastern Caribbean States, the new Government restructured the personal income tax; eliminated the 3 percent traders' turnover tax; and consolidated some import duties, existing consumption taxes, and stamp duties into a single consumption tax with a considerably broader base and a higher average tax rate. In addition, a travel tax was imposed on airline tickets and license fees on motor vehicles were raised. These tax changes contributed to a 15 1/2 percent increase in central government revenues in FY 1984/85. At the same time, overall expenditures of the Central Government were curbed by keeping wages under tight control, reducing outlays for goods and services, and temporarily delaying certain lower priority investment projects.

The financial position of the state enterprises continued to be weak in FY 1984/85 because of operating deficits incurred by the enterprises producing sugar, bananas, and arrowroot, as well as by some public utilities and the Housing and Land Development Corporation. Notwithstanding an increase in the operating deficit of the consolidated state enterprises, public sector savings rose to the equivalent of 4 1/2 percent of GDP in FY 1984/85, while the overall balance shifted to a surplus of 1 1/2 percent of GDP, thus permitting the public sector as a whole to reduce its net indebtedness with the NCB for the first time in many years.

In 1982, the commercial banks' net domestic credit expanded more rapidly than their liabilities to the private sector, resulting in a substantial decline in the banks' net international assets and a

Table 2. St. Vincent and the Grenadines: Operations of the Consolidated Public Sector 1/

	Fiscal Year Beginning July 1					
				Prel.	Staff Proj.	
	1981	1982	1983	1984	1985	1986
	(In millions of Eastern Caribbean dollars)					
Total revenue and grants	79.6	84.4	86.3	95.4	115.2	134.0
Current revenue	66.2	73.5	75.8	87.1	98.0	107.7
Capital grants	13.4	10.9	10.5	8.3	17.2	26.2
Total expenditure	89.2	97.6	103.1	90.9	133.8	146.7
Current expenditure	63.6	70.0	75.3	74.5	78.3	83.9
Capital expenditure	25.6	27.6	27.8	16.4	55.5	62.8
Of which: public enterprises	(10.4)	(6.4)	(16.4)	(6.3)	(41.6)	(38.1)
Public sector savings	2.6	3.5	0.5	12.6	19.6	23.8
Central Government	-5.2	2.8	-1.6	11.2	9.7	11.7
Rest of general government	3.8	4.1	4.1	4.9	5.0	5.5
Public enterprises	4.0	-3.5	-2.1	-3.6	5.0	6.6
Overall surplus or deficit (-)	-9.6	-13.2	-16.8	4.5	-18.7	-12.7
Central Government	-7.4	-7.4	-5.2	8.3	4.7	1.4
Rest of general government	3.6	3.9	3.9	4.7	4.8	4.7
Public enterprises	(-5.9)	(9.8)	(15.6)	(8.5)	(28.1)	(18.8)
Financing	9.6	13.2	16.8	-4.5	18.7	12.7
External (net)	3.6	6.5	6.0	-1.5	26.0	26.8
Domestic (net)	6.0	6.7	10.8	-3.1	-7.3	-14.1
Central Government	(4.6)	(7.6)	(4.7)	(-5.0)	(-0.6)	(-6.2)
Rest of general government	(-3.7)	(-4.1)	(-4.2)	(-4.8)	(-4.9)	(-4.7)
Public enterprises	(5.1)	(3.2)	(10.4)	(6.7)	(-1.8)	(-3.2)
	(In percent of fiscal year GDP)					
Total revenue and grants	38.1	35.8	33.6	34.5	38.4	40.8
Current revenue	31.7	31.2	29.5	31.5	32.6	32.8
Capital grants	6.4	4.6	4.1	3.0	5.7	8.0
Total expenditure	42.6	41.4	40.2	32.9	44.6	44.7
Current expenditure	30.4	29.7	29.4	26.9	26.1	25.6
Capital expenditure	12.2	11.7	10.8	5.9	18.5	19.1
Public sector savings	1.3	1.5	0.2	4.5	6.5	7.3
Central Government	-2.5	1.2	-0.6	4.0	3.2	3.6
Rest of general government	1.8	1.7	1.6	1.8	1.7	1.7
Public enterprises	1.9	-1.5	-0.8	-1.3	1.7	2.0
Overall surplus or deficit (-)	-4.6	-5.6	-6.5	1.6	-6.2	-3.9
Central Government	-3.5	-3.1	-2.0	3.0	1.6	0.4
Rest of general government	1.7	1.7	1.5	1.7	1.6	1.4
Public enterprises	-2.8	-4.2	-6.1	-3.1	-9.4	-5.7

Sources: Ministry of Finance; and Fund staff estimates.

1/ The public sector comprises the Central Government, the Kingstown Board, the National Provident Fund, and 11 nonfinancial public enterprises.

deterioration in their reserve position with the Eastern Caribbean Central Bank (ECCB). The banks' position tended to stabilize in 1983 and was reversed in 1984-85 through a slowdown in the growth of credit to the private sector and the above-mentioned net repayments by the public sector to the NCB. The commercial banks' ratio of loans and advances to deposits declined from 87 1/2 percent at the end of 1983 to 84 percent at the end of September 1985, mainly because of the improvement in the liquidity position of the NCB.

In late 1984, the authorities removed the ceiling on commercial banks' lending rates to new borrowers, which had been 12 1/2 percent for most operations, and permitted the banks to deduct the existing 2 percent tax on interest-bearing deposits from their income tax liabilities. Also, the authorities permitted the banks to reduce the base for the computation of this tax by offsetting against it lending for residential mortgages. Because of the improvement in the liquidity of the banking system in recent months, these changes have not resulted in any significant changes in the structure of interest rates.

St. Vincent's balance of payments position strengthened markedly in recent years, mainly because of the rapid growth in exports of vegetables and manufactured goods. 1/ The current account deficit of the balance of payments narrowed from 10 percent of GDP in 1982 to about 1 1/2 percent in 1984, while during the same period the overall balance shifted from a deficit of 4 1/2 percent of GDP to a surplus of similar magnitude (Table 3). The balance of payments remained strong in 1985 as exports of bananas increased markedly, and an overall surplus equivalent to 3 percent of GDP is estimated for the year, reflecting St. Vincent's imputed share of the gain in the ECCB's net international assets and its net repayments to the Fund.

St. Vincent's outstanding foreign debt, including debt to the Fund, rose modestly from US$19 million at the end of 1981 to US$22.5 million at the end of 1984, but over this period it dropped in relation to GDP, from 27 percent to 23 percent. However, as disbursements for the Cumberland hydroelectric project started in late 1985, the outstanding foreign debt at the end of this year is estimated at US$29 million (about 27 1/2 percent of GDP). Because most of the foreign debt is on concessionary terms, 2/ annual debt service payments in 1981-84 amounted to only 3 percent of exports of goods and services. In 1985, the debt service ratio rose to 4 percent, mainly because of repayments to the Fund.

1/ Exports of traditional vegetables (eddoes and dasheens) to Trinidad and Tobago have increased in value from 7 percent of total exports in 1981 to 17 percent in 1984, while exports of manufactured goods (mainly to the United States) have increased during the same period from 27 percent of total exports to 41 percent.

2/ St. Vincent's foreign debt has an average rate of interest of 5 percent and an average maturity of 15 years. Over 80 percent of St. Vincent's outstanding debt has a maturity of more than 10 years.

The World Bank has not made any loans to St. Vincent and the Grenadines and, with the exception of the IDA participation in the Cumberland project (US$5 million), no direct financing from the World Bank group is included in the PSIP. The World Bank is of the view that the overall composition of the investment program is consistent with the Government's development strategy, but has expressed reservations about St. Vincent's institutional capacity to implement and monitor the PSIP with local personnel alone. Therefore, in order to facilitate the timely execution of the PSIP, a large technical assistance component has been embodied in the hydroelectric project, as well as in other externally financed key projects.

The Cumberland project will have a major impact on investment in the next few years, but its contribution to employment is expected to be modest. Therefore, the Government is promoting the growth of other sectors of the economy with higher potential for the absorption of labor. The authorities are aware that production of export-oriented manufactured goods has been a key factor in the generation of employment in recent years, and have fostered the establishment of these industries by constructing factory shells for leasing. However, the supply of such facilities by the Government is lagging behind demand. Strong interest has been expressed by private local entrepreneurs to develop factory shells with financial assistance from U.S. AID channeled through the local commercial banks, but construction has been delayed because of issues concerning allocation of land for the industrial estates and the need to develop adequate infrastructure to the sites.

2. Fiscal policy

The central government budget for FY 1985/86 projected a current account surplus equivalent to 3 percent of GDP and an overall surplus of 1 1/2 percent of GDP. The fiscal performance of the Central Government since the beginning of July 1985 has been in line with budget estimates and suggests that the budgetary targets for the fiscal year as a whole are realistic and achievable. Although only minor tax measures were introduced with the current budget, the authorities have strengthened tax administration and made efforts to collect tax arrears to the Treasury. With respect to current expenditure, the authorities have continued to exercise restraint by not granting any wage increase for the current fiscal year and by seeking reductions in government subsidies. In addition, the Ministry of Finance has tightened expenditure control through the introduction of a system of monthly fiscal reporting and quarterly allotments to the various ministries.

In an effort to improve the situation of the financially troubled state enterprises and to prevent a further drain on the resources of the National Commercial Bank--which has been the main source of financing for their operating deficit--the Government closed down the sugar operation at the end of June 1985, sharply increased port charges and water and electricity rates, and overhauled the management of several enterprises. At the same time, the Government assumed responsibility deterioration in their reserve position with the Eastern Caribbean Central Bank (ECCB). The banks' position tended to stabilize in 1983 and was reversed in 1984-85 through a slowdown in the growth of credit to the private sector and the above-mentioned net repayments by the public sector to the NCB. The commercial banks' ratio of loans and advances to deposits declined from 87 1/2 percent at the end of 1983 to 84 percent at the end of September 1985, mainly because of the improvement in the liquidity position of the NCB.

In late 1984, the authorities removed the ceiling on commercial banks' lending rates to new borrowers, which had been 12 1/2 percent for most operations, and permitted the banks to deduct the existing 2 percent tax on interest-bearing deposits from their income tax liabilities. Also, the authorities permitted the banks to reduce the base for the computation of this tax by offsetting against it lending for residential mortgages. Because of the improvement in the liquidity of the banking system in recent months, these changes have not resulted in any significant changes in the structure of interest rates.

St. Vincent's balance of payments position strengthened markedly in recent years, mainly because of the rapid growth in exports of vegetables and manufactured goods. 1/ The current account deficit of the balance of payments narrowed from 10 percent of GDP in 1982 to about 1 1/2 percent in 1984, while during the same period the overall balance shifted from a deficit of 4 1/2 percent of GDP to a surplus of similar magnitude (Table 3). The balance of payments remained strong in 1985 as exports of bananas increased markedly, and an overall surplus equivalent to 3 percent of GDP is estimated for the year, reflecting St. Vincent's imputed share of the gain in the ECCB's net international assets and its net repayments to the Fund.

St. Vincent's outstanding foreign debt, including debt to the Fund, rose modestly from US$19 million at the end of 1981 to US$22.5 million at the end of 1984, but over this period it dropped in relation to GDP, from 27 percent to 23 percent. However, as disbursements for the Cumberland hydroelectric project started in late 1985, the outstanding foreign debt at the end of this year is estimated at US$29 million (about 27 1/2 percent of GDP). Because most of the foreign debt is on concessionary terms, 2/ annual debt service payments in 1981-84 amounted to only 3 percent of exports of goods and services. In 1985, the debt service ratio rose to 4 percent, mainly because of repayments to the Fund.

1/ Exports of traditional vegetables (eddoes and dasheens) to Trinidad and Tobago have increased in value from 7 percent of total exports in 1981 to 17 percent in 1984, while exports of manufactured goods (mainly to the United States) have increased during the same period from 27 percent of total exports to 41 percent.

2/ St. Vincent's foreign debt has an average rate of interest of 5 percent and an average maturity of 15 years. Over 80 percent of St. Vincent's outstanding debt has a maturity of more than 10 years.

Table 3. St. Vincent and the Grenadines: Summary Balance of Payments

	1981	1982	1983	1984	Est. 1985
	(In millions of U.S. dollars)				
Goods, services, and transfers	-4.7	-8.2	-2.9	-1.2	-1.8
Exports	29.8	34.3	41.8	54.2	61.5
Imports	-58.2	-63.6	-70.4	-76.6	-85.5
Services (net)	7.3	3.6	5.3	6.1	5.4
Of which: tourism	(13.7)	(12.8)	(13.6)	(14.0)	(15.9)
interest payments	(-0.9)	(-1.0)	(-1.0)	(-1.1)	(-1.1)
Transfers (net)	16.4	17.5	20.4	15.1	16.8
Of which: private	(13.0)	(13.9)	(17.4)	(12.6)	(13.2)
official grants	(4.1)	(4.5)	(4.0)	(3.5)	(4.7)
Capital account	4.0	4.5	3.2	5.7	4.9
Public sector borrowing (net)	2.7	2.4	2.6	2.2	7.2
Drawings	(3.2)	(2.9)	(3.3)	(3.0)	(8.4)
Amortizations	(0.5)	(0.5)	(0.7)	(0.8)	(1.2)
Commercial banks	-2.0	2.6	-1.4	2.4	-2.5
Private capital 1/	3.5	-0.5	2.0	1.1	0.2
Overall balance	-0.5	-3.7	0.3	4.5	3.1
Financing	0.5	3.7	-0.3	-4.5	-3.1
IMF (net)	1.6	--	--	-0.5	-0.9
Change in imputed ECCB reserves	-1.1	3.6	-0.6	-4.1	-1.7
Change in foreign assets	--	0.1	0.3	0.1	-0.5
	(In percent of GDP)				
Trade balance	-39.7	-35.2	-31.3	-22.6	-22.7
Current balance 2/	-6.6	-9.9	-3.2	-1.2	-1.8
Overall balance	-0.7	-4.5	0.4	4.6	2.9

Sources: Ministry of Finance; and Fund staff estimates.

1/ Includes SDR allocations and errors and omissions.
2/ Includes official grants.

II. Economic Policies and Prospects

At the conclusion of the 1984 Article IV consultation with St. Vincent and the Grenadines, Executive Directors stressed the need to improve the savings performance of the Central Government and to reduce the operating deficit of certain state enterprises, particularly the state-owned sugar company. Directors noted that an improvement in the public sector finances was necessary to restore the liquidity position of the NCB to an adequate level. They also urged the authorities to adopt a more flexible interest rate policy, and to re-examine the policy of taxing bank deposits, in view of the need to encourage saving and improve resource allocation. Directors drew attention to the rise in St. Vincent's real effective exchange rate and observed that restraint in government wages was important, not only to improve the public finances, but also to enhance St. Vincent's export performance and competitiveness. As indicated in the section above, St. Vincent and the Grenadines has implemented most of the Fund's recommendations since the last Article IV consultation.

1. Economic development strategy and employment

The Government's development strategy is focused mainly on export promotion and employment generation based on agriculture, manufacturing, and tourism. The Government has stated that the private sector should play the major role in the development process, with the public sector providing an adequate infrastructure and pursuing policies aimed at encouraging private sector activity. The Government is engaged in the preparation of a three-year rolling development plan with a five-year framework, to be implemented beginning FY 1986/87. The existing public sector investment program (PSIP), which has been updated recently with the help of the Inter-Agency Resident Mission (IARM), has been prepared with a view to its integration into the forthcoming development plan.

The revised PSIP for FY 1985/86 to FY 1987/88, which includes only projects with reasonably secure sources of financing and with a known schedule of implementation, amounts to approximately EC$176 million, equivalent to about 18 percent of the GDP for the period. The most important project in the program--representing about half of the PSIP outlays for the period--is the integrated Cumberland power project aimed at increasing hydroelectric capacity, rehabilitating existing facilities, and installing new transmission and distribution lines. This project is being financed by the International Development Association (IDA), the European Investment Bank, the Caribbean Development Bank, the Canadian International Development Agency, and the U.S. Agency for International Development. The PSIP also provides for construction of new factory shells, the improvement of feeder roads and port facilities, and support for agricultural activities. The domestic contribution to the PSIP for the three years is estimated at 14 percent of the total.

The World Bank has not made any loans to St. Vincent and the Grenadines and, with the exception of the IDA participation in the Cumberland project (US$5 million), no direct financing from the World Bank group is included in the PSIP. The World Bank is of the view that the overall composition of the investment program is consistent with the Government's development strategy, but has expressed reservations about St. Vincent's institutional capacity to implement and monitor the PSIP with local personnel alone. Therefore, in order to facilitate the timely execution of the PSIP, a large technical assistance component has been embodied in the hydroelectric project, as well as in other externally financed key projects.

The Cumberland project will have a major impact on investment in the next few years, but its contribution to employment is expected to be modest. Therefore, the Government is promoting the growth of other sectors of the economy with higher potential for the absorption of labor. The authorities are aware that production of export-oriented manufactured goods has been a key factor in the generation of employment in recent years, and have fostered the establishment of these industries by constructing factory shells for leasing. However, the supply of such facilities by the Government is lagging behind demand. Strong interest has been expressed by private local entrepreneurs to develop factory shells with financial assistance from U.S. AID channeled through the local commercial banks, but construction has been delayed because of issues concerning allocation of land for the industrial estates and the need to develop adequate infrastructure to the sites.

2. Fiscal policy

The central government budget for FY 1985/86 projected a current account surplus equivalent to 3 percent of GDP and an overall surplus of 1 1/2 percent of GDP. The fiscal performance of the Central Government since the beginning of July 1985 has been in line with budget estimates and suggests that the budgetary targets for the fiscal year as a whole are realistic and achievable. Although only minor tax measures were introduced with the current budget, the authorities have strengthened tax administration and made efforts to collect tax arrears to the Treasury. With respect to current expenditure, the authorities have continued to exercise restraint by not granting any wage increase for the current fiscal year and by seeking reductions in government subsidies. In addition, the Ministry of Finance has tightened expenditure control through the introduction of a system of monthly fiscal reporting and quarterly allotments to the various ministries.

In an effort to improve the situation of the financially troubled state enterprises and to prevent a further drain on the resources of the National Commercial Bank--which has been the main source of financing for their operating deficit--the Government closed down the sugar operation at the end of June 1985, sharply increased port charges and water and electricity rates, and overhauled the management of several enterprises. At the same time, the Government assumed responsibility for servicing the large outstanding debt of the sugar corporation, but it intends to cover part of the additional expenditure by selling imported sugar domestically at approximately twice the landed cost.

The staff estimates that the adoption of these corrective measures, coupled with an expected increase in volume and price for bananas, would permit a turn-about in the current operations of the state enterprises from a deficit of 1 1/2 percent of GDP in FY 1984/85 to a surplus of similar magnitude in the current fiscal year. Thus, overall public sector savings are projected to increase from 4 1/2 percent of GDP in FY 1984/85 to about 6 1/2 percent of GDP in the current fiscal year. Notwithstanding the projected improvement in the public sector current account, the overall balance is expected to move into deficit because of a sharp increase in externally financed investments associated mainly with the Cumberland hydroelectric project.

In discussing prospects for FY 1986/87, the authorities considered that it would be very difficult to freeze civil servants' salaries for a third consecutive year. Moreover, there was a need to restructure the civil service with a view to attracting better qualified personnel in key technical and managerial positions. As noted by the World Bank, St. Vincent's capacity to implement and monitor its investment program in the future would hinge on its ability to attract qualified local personnel. Consequently, the authorities believed that an increase in the wage bill in FY 1986/87 was unavoidable, but indicated their determination to limit such increase to no more than 10 percent. The authorities intend to exercise tight control on other expenditures and to continue improving the situation of the state enterprises. Therefore, the prospects for FY 1986/87 appear to be favorable (see Table 2).

3. Monetary policy

As noted earlier, the Government has repealed the Money Lending Ordinance (which set ceilings on lending rates) and adopted measures to lower the effective rate of taxation on commercial banks' interest-bearing deposits. In addition, the authorities are giving serious consideration to extending the tax deduction presently in effect for residential mortgage lending to lending for productive activities. 1/

The Government has revamped the management of the National Commercial Bank and taken steps to rebuild its liquidity. Efforts are being made to collect overdue loans and advances to the private sector, and the net indebtedness of the public sector to NCB is being reduced. Once the financial position of the NCB has been restored to an adequate level, the authorities would like the bank to take a more active role in

---

1/ As noted earlier, interest-bearing bank deposits are subject to a 2 percent tax payable by the banks. Recently, the authorities have permitted the banks to reduce the base for the computation of this tax by the amount of lending for residential mortgages.

lending for productive purposes, particularly in view of the absence of a development bank in St. Vincent.

In January 1985, the Eastern Caribbean Central Bank (ECCB) imposed a minimum interest rate of 4 percent on savings deposits at commercial banks in all member countries. This measure resulted in an increase of up to 1 1/2 percentage points in the saving deposit rates offered by some banks in St. Vincent. Rates for other types of deposits, however, have remained unchanged because of the improved liquidity of the domestic banking system.

4. External sector policies and outlook

The authorities expressed guarded optimism about the balance of payments prospects for the next five years. They observed that the productivity of the banana industry had been raised considerably by the use of field packing, and they expected further gains through a more widespread application of fertilizers under a government-sponsored program. The authorities noted that exports of staple vegetables to Trinidad and Tobago had become a major source of foreign exchange earnings and were confident about the prospects for increased production; however, they expressed concern about future access to the Trinidad and Tobago market.

The authorities believed that the outlook for exports of manufactured goods was very promising. A number of foreign firms had expressed interest in setting up plants in St. Vincent, pending the availability of factory shells. The Government is constructing factory shells with assistance from the Caribbean Development Bank, and already has firm commitments for the space to be available in 1986. However, as noted earlier, the private sector has shown interest in the construction of additional factory shells but is awaiting resolution of certain administrative problems that have arisen in connection with the allocation of land for industrial sites.

There is also a strong potential for growth in tourism, particularly in the Grenadines, and the Government is supporting actively tourism development through direct promotion and the negotiation of arrangements with other governments in the region to facilitate the flow of in-transit passengers. The Government is also seeking to develop small airfields in some of the islands to permit direct access by air.

The medium-term balance of payments scenario prepared by the staff (Tables 4 and 5) assumes no modification of the present exchange rate. Merchandise exports for 1986 are expected to grow by 12 1/2 percent, based on present plans for banana production and the expected availability of 30,000 square feet of factory space for enclave-type manufacturing industries. For the 1987-90 period, however, the growth in the value of merchandise exports is expected to fall to about 5 percent a year, reflecting a slowdown in the growth of traditional agricultural exports. Banana output is likely to taper off as field

Table 4 . St. Vincent and the Grenadines: Medium-Term Outlook of the Balance of Payments, 1986-90

	1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)					
Goods, services, and transfers	-1.8	-7.8	-6.5	-6.2	-6.4	-6.6
Exports	61.5	69.2	72.6	76.3	80.1	84.1
Imports	-85.5	-103.5	-107.0	-108.1	-112.8	-117.7
Services (net)	5.4	5.9	6.3	6.1	6.4	6.7
Transfers (net)	16.8	20.6	21.6	19.5	19.9	20.3
Of which: private	(13.2)	(14.0)	(14.5)	(15.0)	(15.5)	(16.0)
official	(4.7)	(8.0)	(8.5)	(6.0)	(6.0)	(6.0)
Capital account	4.9	10.3	8.5	7.2	7.4	7.6
Official borrowing (net)	7.2	11.5	9.7	7.0	7.0	7.0
Drawings	(8.4)	(12.7)	(11.0)	(8.3)	(8.5)	(8.9)
Amortizations	(1.2)	(1.2)	(1.3)	(1.3)	(1.5)	(1.9)
Commercial banks	-2.5	-2.0	-2.2	-1.0	-1.0	-1.0
Other	0.2	0.8	1.0	1.2	1.4	1.6
Overall balance	3.1	2.5	2.0	1.0	1.0	1.0
Financing	-3.1	-2.5	-2.0	-1.0	-1.0	-1.0
IMF (net)	-0.9	-0.2	--	--	--	--
Change in imputed ECCB reserves	-1.7	-1.9	-1.6	-0.6	-0.6	-0.6
Change in foreign assets	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4
	(In percent of GDP)					
Trade balance	-22.7	-29.5	-27.1	-23.2	-22.1	-21.0
Current balance 1/	-1.8	-6.7	-5.1	-4.5	-4.3	-4.1
Overall balance	2.9	2.2	1.6	0.7	0.7	0.6

Source: Fund staff estimates.

1/ Includes official grants.

Table 5. St. Vincent and the Grenadines: Projections of the Public and Publicly-Guaranteed External Debt 1/

		1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)						
1.	Outstanding debt at mid-year	29.3	40.5	50.4	57.4	64.5	71.7
2.	Total debt service obligations (3+4)	3.2	2.8	2.9	3.4	3.9	4.6
	Interest	1.1	1.4	1.6	2.1	2.4	2.7
	Amortization	2.1	1.4	1.3	1.3	1.5	1.9
3.	Scheduled obligations on loans committed as of June 1985	3.1	2.6	2.5	2.7	2.7	3.0
	Interest	1.0	1.2	1.2	1.4	1.4	1.6
	Amortization	2.1	1.4	1.3	1.3	1.3	1.4
4.	Scheduled obligations on new loans after June 1985	0.1	0.2	0.4	0.7	1.2	1.5
	Interest	0.1	0.2	0.4	0.7	1.0	1.1
	Amortization	--	--	--	--	0.2	0.5
	(In percent)						
	Debt service/exports of goods and services	4.0	3.1	3.1	3.5	3.8	4.2
	Interest	1.4	1.5	1.7	2.1	2.3	2.5
	Amortization	2.6	1.6	1.4	1.4	1.5	1.7
	Average interest rate	4.9	4.6	4.0	4.1	4.2	4.2
	Outstanding debt/GDP	27.7	34.8	39.7	41.9	43.6	44.9

Source: Fund staff estimates.

1/ Includes IMF.

packing approaches 100 percent of production (at present, field packing covers about 90 percent of total production). Based on present trends and advance reservation schedules, tourism receipts are expected to rise by 9 percent in 1986 and by at least 5 percent a year thereafter.

Imports are projected to increase by 21 percent in 1986, mainly because of imports of machinery in connection with the Cumberland project; the growth of imports is likely to decelerate significantly after 1986, reflecting the expected slowdown in public sector investment. The downward trend in investment will be accompanied by lower inflow of official capital. It is also expected that commercial banks will improve somewhat their net foreign asset position as their liquidity position continues to strengthen.

External debt outstanding is projected to increase significantly in relation to GDP in the coming years, from 27 1/2 percent at the end of 1985 to about 45 percent at the end of 1990. However, because of the concessionary nature of the loans, the yearly debt service is expected to remain in the range of 3-4 percent of exports of goods and services through 1990. Based on these assumptions, the current account deficit is expected to narrow gradually through 1990, while the overall balance is projected to show a declining but positive balance (see Table 4).

The payments system of St. Vincent and the Grenadines is free from restrictions on current international transactions, and has remained unchanged since the last Article IV consultation.

St. Vincent's index of the real effective exchange rate--based on the average for 1980--rose to a high of 126.1 in February 1985 but declined to 115.3 in September 1985, with the decline in the value of the U.S. dollar. The authorities do not believe that the general appreciation since 1980 has reduced significantly the country's competitiveness. Notwithstanding some increase in real wages in recent years, average unit labor costs are believed to be quite low in relation to competitors in the region, and the Government is confident that foreign investors interested in labor-intensive manufacturing for export will continue to be attracted to St. Vincent, subject to the availability of factory space and adequate infrastructure. Given the relatively favorable prospects for the balance of payments, on the basis of fairly conservative assumptions, the authorities do not favor a modification of the parity for the Eastern Caribbean dollar at the present time. The authorities, however, have recently collaborated with a mission from the ECCB to review exchange rate matters as pertains to St. Vincent and the Grenadines, and have indicated their willingness to cooperate with the ECCB in its current examination of exchange rate developments in the region as a whole.

III. Staff Appraisal

Since the last Article IV consultation with the Fund, St. Vincent and the Grenadines has made considerable progress toward implementing the recommendations of the Executive Board. The Central Government's financial position has improved significantly, the situation of the state enterprises has been strengthened, the external competitiveness has been bolstered by the prudent wage policy pursued by the Government, the liquidity position of the National Commercial Bank has been improved, and additional flexibility has been introduced in the management of interest rates. At the same time, however, there has been a slowdown in economic activity in the last two years and the rate of unemployment remains high. Prospects for 1986 are for a strong recovery in the growth of real GDP, mainly because of construction associated with the Cumberland hydroelectric project and the expansion of export-oriented manufacturing.

The Government's success in improving the public finances in the last two years is commendable, and the staff believes that the continued strengthening of the public finances is important for sustained growth in the economy. The cautious wage policy followed by the Government since mid-1984 has been instrumental in moderating increases in real wages in the rest of the economy and has contributed to bolster its external competitiveness. Although average wages have experienced some increase in real terms, they remain relatively low and manufacturing activity in the enclave-type industries producing for export has continued to expand.

The staff considers that the continued expansion of export-oriented industries constitutes the most promising means for dealing with the problem of unemployment. Therefore, it welcomes the authorities' plans to continue giving their support to the development of this sector through the provision of adequate infrastructure, and would urge them to act promptly to remove administrative impediments to the construction of factory shells by the private sector.

The staff is mindful of the need to improve the quality of the civil service and recognizes that in the process the public sector's wage bill may increase for FY 1986/87. However, the staff would urge the authorities to limit the increase in wages for civil servants to amounts that do not undermine the public finances or the competitiveness of the economy.

The staff welcomes the recent measures adopted by the authorities to remove the ceiling on interest rates and to reduce the effective tax on interest-earning bank deposits. However, in view of the improvement in the Central Government's finances, the staff would recommend that the tax be removed altogether. This action would provide additional flexibility to the interest rate structure and would bring it more in line with those prevailing in other countries of the region.

The movement in St. Vincent's index of the real effective exchange rate indicates an appreciation smaller than in most of the other members of the ECCB, and the trend of recent months has involved a substantial depreciation. Nevertheless, the staff is of the view that exchange rate policy continues to warrant close attention. Therefore, the active collaboration of St. Vincent with the ECCB in its review of the appropriateness of the external value of the Eastern Caribbean dollar is encouraged.

It is recommended that the next Article IV consultation with St. Vincent and the Grenadines be conducted on an 18-month cycle.

ATTACHMENT I

St. Vincent and the Grenadines--Fund Relations
(As of November 30, 1985)

I. Membership Status

(a) Date of membership: December 28, 1979

(b) Status: Article VIII

(A) Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 4.0 million

	Millions of SDRs	Percent of Quota
(b) Total Fund holdings of St. Vincent and the Grenadines currency	4.33	108.13
(c) Fund credit:		
Total	0.33	8.13
Of which: Credit tranche	--	--
CFF	0.33	8.13
(d) Reserve tranche position:	--	--

III. Current Stand-by and Special Facilities

(a) Current stand-by or extended arrangement: None

(b) Previous use of Fund resources: on Novewmber 21, 1980, the Executive Board approved a purchase of SDR 0.425 million by St. Vincent and the Grenadines under the first credit tranche as emergency assistance following a hurricane disaster.

(c) Compensatory financing facility: on March 20, 1981, the Executive Board approved a purchase of SDR 1.30 million by St. Vincent and the Grenadines under the CFF.

IV. SDR Department

(a) Net cumulative allocation: SDR 0.35 million

(b) Holdings: SDR 1,043 or 0.29 percent of allocation

(c) Current designation plan: None

V. Administered Accounts: None

VI. Overdue Obligations to the Fund: None

(B) Nonfinancial Relations

VII. Exchange rate arrangement: Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per U.S. dollar.

VIII. Last Article IV Consultation: The last Article IV consultation was held in Kingstown in April-May 1984 and was concluded by the Executive Board on August 1, 1984.

IX. Technical Assistance: Mr. Clifford Stacey, a member of the Fund panel of fiscal experts, was assigned to St. Vincent and the Grenadines from May to October of 1985 to assist the authorities in designing a system of fiscal monitoring and expenditure control.

X. Resident Representative/Advisor: Mr. Andrew Gantt, the Fund's Regional Adivsor who is stationed in Antigua and Barbuda, has been accredited to St. Vincent and the Grenadines since January 1984.

St. Vincent and the Grenadines--Basic Data

Area and population	
Area	150 sq. miles (388 sq. kilometers)
Population (1985)	112.2 thousand
Annual rate of population increase	1.9 percent
Unemployment rate	35-45 percent
GDP (1985)	SDR 104.3 million
GDP per capita (1985)	SDR 929.7

Origin of GDP	1982	1983	Prel. 1984	Est. 1985
		(percent)		
Agriculture	17.0	17.4	17.8	19.3
Mining	0.3	0.3	0.3	0.3
Manufacturing	11.0	10.4	10.0	9.7
Construction	11.6	11.3	11.2	11.0
Government	18.6	18.7	18.8	18.5
Other services	41.5	41.9	41.9	41.2
Ratios to GDP				
Exports of goods and nonfactor services	57.9	63.0	72.5	74.7
Imports of goods and nonfactor services	86.4	87.1	86.8	89.8
Current account of the balance of payments	-9.8	-3.1	-1.2	-1.7
Central government revenues 1/	34.4	31.3	32.8	32.2
Central government expenditures 1/	37.5	33.3	29.8	30.6
Public sector savings	1.5	0.2	4.5	6.6
Public sector overall surplus or deficit (-)	-5.6	-6.6	1.6	-6.2
External public debt (end of year)	24.6	24.1	22.9	27.7
Gross national savings	20.5	28.9	25.9	30.3
Gross domestic investment	30.4	32.0	27.1	32.0
Money and quasi-money (end of year)	35.7	36.9	38.5	37.9
Change - Money and quasi-money	2.1	4.3	4.4	2.0
Annual changes in selected indicators				
Real GDP	5.9	5.3	3.5	3.1
GDP at current prices	16.6	9.4	8.4	7.1
Domestic expenditures (at current prices)	16.5	7.1	-1.6	7.9
Investment	(6.6)	(15.4)	(-8.2)	(26.4)
Consumption	(19.9)	(4.5)	(0.7)	(2.1)
GDP deflator (at market prices)	10.1	3.9	4.7	3.9
Consumer prices (annual averages)	7.3	5.4	2.7	2.2
Central government revenues 1/	14.6	-0.9	13.1	6.3
Central government expenditures 1/	13.1	-3.2	-3.5	11.3
Liabilities to private sector 2/	6.2	13.2	13.0	5.6
Money	(-1.1)	(2.2)	(6.2)	(-5.6)
Quasi-money	(7.3)	(11.0)	(6.8)	(11.1)
Net domestic assets of the financial system 2/	15.5	8.7	20.1	-0.9
Credit to public sector	(14.7)	(-0.1)	(-4.2)	(-6.7)
Credit to private sector	(12.6)	(18.4)	(6.7)	(5.8)
Merchandise exports (in U.S. dollars)	15.1	21.9	29.7	13.5
Merchandise imports (in U.S. dollars)	9.3	10.6	8.8	11.6

	1982	1983	Prel. 1984	Est. 1985
Central government finances 1/	(millions of Eastern Caribbean dollars)			
Revenues	81.0	80.3	90.8	96.5
Expenditures	88.3	85.5	82.5	91.8
Current account surplus or deficit (-)	2.9	-1.6	11.2	9.7
Overall surplus or deficit (-)	-7.3	-5.2	8.3	4.7
External financing (net)	3.9	0.6	-3.4	-4.3
Balance of payments	(millions of U.S. dollars)			
Merchandise exports	34.3	41.8	54.2	61.5
Merchandise imports	-63.6	-70.4	-76.6	-85.5
Travel receipts (net)	7.2	6.3	8.0	8.9
Investment income (net)	-1.9	-1.3	-2.2	-2.6
Other services and transfers (net)	15.8	20.7	15.4	15.9
Balance on current account	-8.2	-2.9	-1.2	-1.8
Official capital	2.4	2.6	2.2	7.2
Banking system	2.6	-1.4	2.4	-2.5
Private capital, including errors and omissions	-0.5	2.0	1.1	0.2
Basic balance	-3.7	0.3	4.5	3.1

1/ Data are for fiscal years beginning July 1 of the year indicated.
2/ In relation to liabilities to the private sector at the beginning of the period.

St. Vincent and the Grenadines--Statistical Issues

1. Outstanding Statistical Issues

a. Prices and merchandise trade

The currentness of the data on consumer prices and merchandise trade needs to be improved.

b. Government finance

The data published in IFS are the annual budgetary central government data for revenue, grants, expenditure and lending minus repayments provided for publication in the GFS Yearbook. Data for 1983 have been received and are being processed. They contain a number of problems which the authorities have agreed to pursue further. Data on the economic classification of expenditure, on financing and debt, and the derivation of principal aggregates from national sources have not yet been provided.

c. Monetary accounts

Statistical issues in this field are dealt with by the Eastern Caribbean Central Bank (ECCB). There are no major outstanding issues.

d. Balance of payments

St. Vincent does not prepare an official set of balance of payments statistics. The data in the Bureau files are IMF staff estimates based on data provided by the Ministry of Finance, Planning, and Development and by the Eastern Caribbean Central Bank.

2. Coverage, Currentness, and Reporting of Data in IFS

The table below shows the currentness and coverage of data published in the country page for St. Vincent in the December 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Ministry of Finance, Planning and Development, the Statistical Office, and the Eastern Caribbean Central Bank, which during the past year have been provided somewhat irregularly.

Status of IFS Data

		Latest Data in December 1985 IFS
Real Sector	- National Accounts	1983
	- Prices: Consumer Prices	December 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1982
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	June 1985
	- Deposit Money Banks	August 1985
	- Other Financial Institutions	n.a.
External Sector	- Merchandise Trade: Value	Q4 1982
	Prices	n.a.
	- Balance of Payments	1983
	- International Reserves	June 1985
	- Exchange Rates	October 1985