February 25, 2020
Approval: 3/3/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/65-2

3:55 p.m., July 13, 2018

2. Grenada—2018 Article IV Consultation

Documents: SM/18/183 and Correction 1, and Supplement 1, and Supplement 2

Staff: Lissovolik, WHD; Goodman, SPR

Length: 27 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	E. Sishi (AE), Temporary
	H. Razafindramanana (AF)
	E. Rojas Ulo (AG), Temporary
	C. Barron (AP)
	P. Fachada (BR)
	H. Ma (CC), Temporary
	J. Rojas (CE), Temporary
N. Horsman (CO)	
M. Erbenova (EC)	
	C. Rebillard (FF), Temporary
	K. Merk (GR)
	M. Siriwardana (IN)
	I. Lopes (IT), Temporary
	Y. Saito (JA)
	M. Saadaoui (MD), Temporary
	P. Al-Riffai (MI), Temporary
	V. Rashkovan (NE)
	T. Sand (NO), Temporary
	S. Potapov (RU), Temporary
	F. Rawah (SA), Temporary
	H. Alias (ST), Temporary
	P. Inderbinen (SZ)
	O. Haydon (UK), Temporary
	P. Pollard (US), Temporary

G. Bauche, Acting Secretary
S. Maxwell, Summing Up Officer
D. Daly, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: Raphael Anspach, Maria Elena Candia Romano. Legal Department: Julianne Ams, Gabriela Rosenberg. Strategy, Policy, and Review Department: Mary Bushnell Goodman, Erik Jerker Goran Lundback. World Bank Group: Tamoya Annika Lois Christie. Western Hemisphere Department: Nigel Andrew Chalk, Manuk Ghazanchyan,

Kotaro Ishi, Takuji Komatsuzaki, Bogdan Lissovolik, Andrew Edward Wayne Mitchell, Sonia Munoz.

2. GRENADA—2018 ARTICLE IV CONSULTATION

Ms. Horsman and Mr. Sylvester submitted the following statement:

Our Grenadian authorities would like to thank staff for the constructive dialogue within the context of the 2018 Article IV consultation and for their balanced assessment and policy advice. Grenada continues to face many challenges related to its small size, openness, narrow economic base, and high susceptibility to climate change and natural disasters, amongst other delimiting factors. On account of these challenges, as well as policy slippages, Grenada has experienced a secular slowdown in potential growth, high output volatility, unsustainable fiscal and debt dynamics, and protracted high unemployment and poverty levels over many years. More recently, our Grenadian authorities have charted a new course. They believe that the successful completion of the Fund-supported homegrown structural adjustment (HGSAP) 2014-17, which saw significant improvement in macroeconomic fundamentals, has provided a relatively strong foundation on which they can continue to build. Within this context, our authorities remain committed to implementing sound macroeconomic policies and structural reforms aimed at transforming Grenada into an economic success story, delivering robust, inclusive, job-rich and sustained growth, and improved living standards for all its citizens. They look forward to the continued support of their regional and international partners.

Recent Economic Developments and Outlook

Grenada's economy is currently in an expansionary phase that will likely be sustained into the medium term. Real GDP growth picked up in 2017 driven by strong activity in the tourism, construction, and education sectors. This means that real GDP growth has expanded robustly at an average of 5.6 percent since 2014. Our authorities share staff's positive outlook going forward, despite continued risks and vulnerabilities, with growth expected to remain well above potential over the medium term. Inflation remained subdued in 2017, but is estimated to edge up in 2018 due to rising oil prices and moderate over the medium term as global oil production increases.

Potential output is trending upwards. Since 2014, the estimate of potential output has been inching upward and is now estimated at around 2.7 percent. Our authorities believe that this reflects dividends from their previous and ongoing ambitious reform program. They are determined to further boost potential growth through sustained productivity and competitiveness reforms.

Grenada’s fiscal position was further bolstered in 2017, and the new and improved fiscal framework has remained intact. Our authorities continued to outperform the targets under their Fiscal Responsibility Law (FRL). During 2017, the primary surplus reached 5 ¾ percent of GDP as against the target of 3.5 percent, supported by strong economic activity, buoyant revenues, and recurrent expenditure restraint. With support from the World Bank, Grenada’s flagship social safety net program was revamped and is now better structured and targeted. In 2017, spending on this program was appropriately increased. Further, our authorities have made progress in improving the fiscal framework, including through strengthening fiscal oversight and transparency.

Further progress was made in reducing debt vulnerabilities. Public debt fell sharply to just below 71 percent of GDP at end-2017, a 37-percentage point reduction since 2013, reflecting robust economic growth, fiscal consolidation, and the completion of the final phase of the commercial bond restructuring. As it stands, Grenada is on track to reach its FRL debt target of 55 percent of GDP by 2020, as well as the Eastern Caribbean Currency Union (ECCU) debt target of 60 percent of GDP, ten years ahead of the 2030 deadline.

The current account deficit widened, but remained amply financed by FDI and capital transfers. In 2017, the current account deficit increased by 3 ½ percentage points of GDP, to 6.7 percent of GDP, driven largely by construction-related imports. Reserves of 3.7 months of import are assessed as adequate for cushioning shocks and preventing disorderly market conditions.

Financial sector improvements continued during 2017, but emerging issues require close monitoring. Our authorities share staff’s assessment that the financial sector is relatively sound in terms of capital adequacy, asset quality, liquidity, and profitability. They are heartened that bank credit is picking up after years of stagnation and, while welcoming the strong growth in credit union lending, acknowledge that associated risks need close monitoring.

Policy Continuity

The current environment supports policy continuity. Our authorities were recently re-elected on a platform of building on the progress made through a Fund-supported program. They are committed to building on the lessons learned during those critical years, including strengthening social cohesion. Alongside other programs to build social cohesion, our authorities have moved to strengthen the Committee of Social Partners, including through youth participation.

Fiscal and Debt Management

Maintaining Fiscal Discipline remains a top priority for our authorities. The Fiscal Responsibility Law (FRL) has provided an important anchor for sound fiscal policy and has contributed to a much stronger fiscal and debt position. Our authorities remain committed to the new framework and will continue to evaluate all spending decisions, including those related to pension and health care reform, within the context of the FRL. That said, our authorities are of the view that the new fiscal framework should complement their integrated resilience-building approach. In this regard, they believe that a review of the framework, including the FRL, is necessary at this stage to ensure that the parameters are not constraining this key objective, including allowing for critical climate-resilient investments. They are looking forward to the Fund for technical assistance to support this important review process.

Our authorities commend staff for the additional analysis and policy advice relating to Public Expenditure Management, as detailed in Annex IV of the Report. They concur that sustained reforms in this area are necessary to ensure that public investment is efficient, provides growth dividends, and ensures Grenada's resilience to natural disasters.

Tackling remaining debt arrears remains a priority. Our authorities are committed to restoring full creditworthiness and, despite ongoing difficulties, will press ahead to regularize arrears with the three remaining creditors.

Safeguarding Financial Sector Soundness

Our authorities have made important progress in reducing financial sector vulnerabilities and will continue to advance reforms in this regard. In this context, they agree with staff that the recent rapid growth in lending by credit unions warrants close monitoring. Our authorities also recognize the increasingly important role that credit unions and other non-bank financial institutions are playing in deepening financial intermediation and will continue to encourage their growth and development. That said, they are working with the Eastern Caribbean Central Bank (ECCB) to enhance the regulation and supervision of the non-bank financial institutions in Grenada and across the ECCU.

Our authorities wish to record their ongoing concern regarding the risk of loss of correspondent banking relationships (CBRs). They note that the realization of this risk can be very disruptive and damaging to the economy. They will sustain efforts to mitigate this threat through national and regional initiatives, including strengthening their AML/CFT framework, but encourage the Fund to continue to bring stakeholders together to identify concrete solutions. Our authorities are aware of the concerns surrounding CBI programs in the region, and possible implications for loss of CBRs and financial sector stability more broadly. Our authorities maintain that its CBI program is an important source of revenues to help bolster resilience and support economic growth. Accordingly, they will continue to make best efforts to mitigate all risks associated with this program.

Building Resilience

Grenada is at the frontier of building resilience to climate change and natural disaster in the region. Our authorities currently save 40 percent of the CBI proceeds to help respond to natural disasters. Also, our authorities have been successful in incorporating disaster relief provisions ("hurricane clauses") in some of its loan instruments. Furthermore, they have been successful in securing a loan of US$30 million from the World Bank to support climate and fiscal resilience. These are just some of the initiatives currently underway. Going forward, our authorities will continue to accelerate climate-smart development policies and programs, including upscaling investments in climate-resilient infrastructure. The recent establishment of a dedicated Ministry with responsibility for building climate resilience is testimony to this commitment. Accordingly, they look forward to receiving support from the Fund in conducting a Climate Change Policy Assessment (CCPA). They believe that the CCPA will crystalize their resilience framework, as well as act as a catalyst in mobilizing donor support.

Supporting Sustainable and Inclusive Growth

Continued implementation of structural reforms is indispensable for fostering more robust, inclusive, and job-rich growth. This will contribute towards developing a vibrant private sector and further diversifying the country's narrow economic base—key elements of a more resilient economy. In this regard, our authorities will accelerate growth-friendly reforms to further improve the business climate, reduce fiscal risks arising from SOEs and PPPs, boost productivity in the labor market, and implement targeted sectoral policies, including in tourism, agriculture, and energy. To further promote diversification, our authorities are pursuing several initiatives, including efforts to sustainably exploit the country's vast marine space. They are working with the World Bank and other partners to explore opportunities in the area. A medium-term agenda is being prepared, with TA from the World Bank, with the objective of anchoring medium-term planning and strategic interventions to accelerate growth and poverty reduction.

Conclusion

Our authorities believe that the Grenadian economy is at an important juncture in its economic history. While there are no doubts of significant existing and potential challenges, our authorities view this period as an unprecedented opportunity to continue to sow the seeds of economic transformation. They are committed to sound macroeconomic management and structural reforms. They will continue to highly value the support of the Fund and other partners in supporting this paradigm shift.

Mr. Fachada and Mr. Cheong submitted the following statement:

We thank staff for the report and Ms. Horsman and Mr. Sylvester for their informative statement. Supported by strong policies, the Grenadian authorities have made significant progress in restoring fiscal and public debt sustainability, while at the same time improving the external position. The economy has benefited from a favorable external environment, as the direct and indirect impacts from increased tourism activity buoyed GDP growth. We welcome the authorities' intention to use the positive economic momentum to continue to implement their fiscal and structural reforms agenda.

With the adoption of the Fiscal Responsibility Law (FRL) and steadfast discipline, the authorities have achieved remarkable improvements in the fiscal and debt positions. Accordingly, under staff's baseline scenario, the authorities are expected to achieve their 55 percent debt-to-GDP targets within 3 years. We take positive note of the authorities' commitment to ensure that changes in tax policy, such as the proposed reductions in PIT and CIT, fall within the parameters of the primary balance and public debt targets. Meanwhile, given that the triggers for the roll-out of Phase III of the FRL may be approaching, a careful review of the framework should be undertaken with the aim to maintain fiscal prudence, particularly in light of risks stemming from the public pension system and to a lesser extent state-owned enterprises (SOE). We welcome the authorities' plans to strengthen tax administration, establish a natural disaster fund and address remaining bilateral arrears.

Asset quality in the banking system has improved, but new risks have emerged. Banks' non-performing loan (NPL) ratio has fallen significantly from the highs of 2014, their profitability has recovered and capital is above the regulatory minimum. With new regional standards and IFRS 9 coming into effect shortly, do staff anticipate any difficulties banks may face in meeting additional provisioning and capital requirements? The increasing prominence of the credit union sector requires a robust regulatory framework, which should be geared towards containing risks while continuing to allow the segment to play a role in Grenada's development. In this regard, we welcome the authorities' plans to enforce capital requirements, improve data collection and conduct regular stress tests.

With unemployment and poverty still relatively high, structural reforms aimed at lifting potential growth should be undertaken as part of Grenada's development strategy. We welcome the authorities' plans to enhance the business environment, as well as labor market strategies designed to address skill mismatches. Noting that employers indicated that there are shortages for high skilled labor, notwithstanding the presence of a recognized university in the country, can staff indicate what are the impediments to higher educational attainment and what incentives, if any, have the authorities considered to encourage university enrollment?

Lastly, we commend the authorities for their initiatives to increase natural disaster and climate change resilience, and their success in accessing Green Climate Fund grants. With many small island states facing difficulties in accessing such financing, perhaps Grenada's experience can serve as an example to others. That said, we look forward to the upcoming IMF/WB Climate Change Policy Assessment (CCPA) and share the authorities' hope that this will help unlock further climate change financing.

Mr. Hurtado and Mr. Rojas Ramirez submitted the following statement:

Grenada's economy has performed well over the last years following the implementation of the policies under the ECF program. The authorities are committed to reforms for sustained inclusive growth, fiscal soundness, a stable external position and economic diversification. We thank staff for the 2018 Article IV report and Ms. Horsman and Mr. Sylvester for their comprehensive buff statement.

We note that the implementation of the FRL framework has successfully restored fiscal balance by generating a significant primary surplus, progressively reducing debt levels and establishing bases for accountability, transparency, and strengthening credibility and fiscal responsibility. We commend authorities for the creation of the Responsibility Oversight Committee (FROC) that will enhance fiscal administration by keeping sound balances thru efficient management and monitoring of the real primary expending but, if necessary, adjustments will be made. There is room for additional improvements on the FRL framework via a better assessment of the policy by establishing more accurate real expending calculations, encompassing the FRL framework with legal and fiscal components, the legal framework as the regulations on the National Transformation Fund, the Public Financial Management Act (on the definition of PPPs), and constitutional and parliamentary procedures. At the same time, a variety of improvements are possible by enhancing budget administration and establishing expending and revenue benchmarks according with approved regulations. In the medium term, we agree with staff and encourage authorities to implement a comprehensive structural fiscal reform aimed at supporting budgetary policy and inclusive growth and building resilience to shocks by further implementing changes in public financial management (PFM), budget and tax administration, broadening the tax base, improving transparency, reforming of SOEs, and solving bilateral arrears.

The banking system has been a multiyear restructuring process. We note that the sector has experienced a process of deleveraging, a reduction of NPL and implementation of the solvency framework. We encourage authorities to enhance prudential and oversight regulations and procedures. Regional harmonization of rules and supervision of the non-bank financial sector are recommended and ensuring and enforcing compliance with AML/CFT regulations are essential for Grenada’s insertion in the international financial system.

Grenada’s authorities are committed to structural transformation, poverty eradication, and sustainable, inclusive growth with reforms oriented at boosting growth by improving the business climate, enhancing labor market by improving education and training, and increasing resilience to natural disasters and possible future hydrocarbon exploitation.

The strategy is oriented at improving job opportunities by enhancing the education system thru university, vocational, and training programs. Strengthening corporate governance and transparency, facilitating business-friendly tax and customs procedures, developing a credit registry, and improving property rights and registration (e.g., land bank) would help catalyze progress, as well as diversifying the sources of economic growth by fostering the agriculture, tourism, and energy sectors.

Finally, Grenada needs to develop a climate change and resilience to natural disasters plan. To this aim, the report establishes that authorities are advancing plans and strengthening institutions to address climate change and adopt supportive policies. Also, crucial to attain this goal is access to financing.

Mr. Claver-Carone and Ms. Pollard submitted the following statement:

We commend the Grenadian authorities for the substantial progress they made toward macroeconomic stability under the 2014–2017 ECF program and their commitment to addressing the remaining challenges facing the economy. In the past year, the authorities have built on the framework they put in place during the program to strengthen the fiscal balance and continue to reduce debt, while working to address remaining arrears to a few creditors. Growth remains strong but unemployment, although declining is still very high. We agree with staff that the focus going forward should be on boosting potential growth, strengthening the rules-based fiscal framework and improving financial regulation and supervision.

Fiscal Policy

The public debt to GDP ratio has declined substantially over the past several years, aided by debt restructuring, adherence to the Fiscal Responsibility Law (FRL), and strong growth. With the debt to GDP ratio expected to reach 55 percent by 2020, now is the time to consider how to manage the fiscal space that should become available once Phase III of the FRL is triggered. This is especially important given the authorities plans to expand health care and pension expenditures while needing to leave room for other growth-enhancing public investments and considering absorptive capacity. Given Grenada’s vulnerability to external shocks, balancing these expenditure pressures while continuing to build buffers will not be easy. We agree with staff that a comprehensive review of the FRL is needed, but suggest it be incorporated into a broader look at addressing pension and tax reform as well as strengthening public financial management. Given the challenges facing the authorities and the need to strengthen capacity, we appreciate their willingness to engage with the Fund on technical assistance, but wonder whether a non-disbursing program, such as a PSI, could help the authorities in their reform efforts. Has staff discussed with the authorities how best to engage over the next several years?

Financial Sector

We welcome the increasing stability of the banking sector but are concerned that risks have shifted to credit unions where oversight is weak and data availability limited. The 2017 report on the ECCU raised concerns about the gap in regulation of credit unions. We note the authorities' intention to improve data collection and start stress testing credit unions, but believe more needs to be done to improve supervision, including at the regional level. Thus, we were pleased to read in Ms. Horsman and Mr. Sylvester's buff statement that the Grenadian authorities are working with the ECCB to enhance the regulation and supervision of the non-bank financial sector not only in Grenada but across the ECCU. We expect to see this addressed in the 2018 ECCU staff report.

Structural Reforms

We support efforts to improve the business environment to promote greater growth. However, business expansion may be limited until skills mismatches are addressed. Improving education attainment, especially for girls, should help, but we encourage the government to work with the business sector to develop training programs that can have shorter-run payoffs. With nearly a quarter of the labor force unemployed, Grenada has significant untapped resources available to boost growth.

Statistical Issues

We thank staff for addressing data issues in the staff report, rather than solely in the Informational Annex. High quality data are vital for policymaking and economic assessment. Recent revisions to balance of payments data led to substantial changes but staff believe further revisions may be warranted to accurately assess components of the current account. This uncertainty calls into question the assessment of the current account and real effective exchange rate. Fiscal data, although improving, still have some serious gaps as do GDP data. We appreciate the authorities' recognition that these are priorities and urge them to work promptly to address these.

Ms. Barron and Mr. David submitted the following statement:

We thank staff for their reports and Ms. Horsman and Mr. Sylvester for their informative buff statement. With the support of the 2014-17 Extended Credit Fund program, Grenada has made significant economic progress. We note that while the medium-term outlook looks positive, more can be done to boost growth potential, build resilience to shocks and continue with the structural reforms. We agree with the general thrust of the report and staff's recommendations and make the following comments.

We commend the Grenadian authorities for their strong economic policies and programs. Given the recent economic developments and the favorable political climate, we agree that the focus should now be on raising potential growth by building on the economic gains and pursuing necessary reforms. We encourage the authorities to strengthen the rule-based fiscal framework that would keep public debt on a downward path. We support the authorities' call for a review of the framework, in particular to allow for critical climate-resilient investments, and Fund technical support. More broadly, the authorities are to be commended for the steps they have taken to assist in their response to natural disasters.

Efforts should also be made to implement the public sector's management reform strategy, recommendations of the PIMA assessment, improving tax administration, pursuing the public financial management (PFM) reforms, improving fiscal transparency and continue reforming State-Owned Enterprises. We note that as in the previous (2016) recommendations, staff have again recommended broadening corporate income tax base by restricting deductions and taxing foreign-source interests, rents, royalties and fees. Could staff comment on the reason(s) for the lack of progress with this recommendation since the 2016 report?

We note the rapid growth in lending by credit unions, especially for mortgage and personal loans, following the restructuring and deleveraging of NPLs by banks. We agree that close monitoring of this trend is important and welcome the memorandum of understanding that has been agreed to between the Eastern Carribean Central Bank (ECCB) and the Grenada Authority for the Regulation of Financial Institutions (GARFIN). We also support the authorities' call for the Fund to continue its important role in bringing stakeholders together to identify concrete solutions to the loss and potential loss of correspondent banking relationships. Re-assessing the regulatory and supervisory framework for the whole financial system would be crucial for Grenada, going forward, and we welcome the TA support from the Caribbean Regional Technical Assistance Centre (CARTAC). We note that the last FSAP for members of the regional Eastern Caribbean Currency Union (ECCU) was conducted in 2003. Would staff advise on whether there are plans for another FSAP for ECCU members?

We see merit in the authorities undertaking supply side reforms that would improve productivity and increase resilience to shocks. Improving the business environment and productivity through infrastructure investment and upgrading education and training, as well as expanding opportunities for the tourism and agricultural sectors would assist. We are encouraged by the authorities' efforts to build climate resilience, including their success in securing funding from the Green Climate Fund. Expanding the export base would increase foreign exchange inflows. Apart from the recently announced oil and gas discovery, we note from recent media reports the consideration for bluefin tuna farming in Grenada and wonder if staff feel that this would be a viable project?

We welcome the authorities' intention to improve education, especially for women. The staff note that greater education should help boost female employment and address the gender gap in the labor market. We note, however, that the chart in Box 2 (page 17) indicates that women have higher unemployment rates than men at all education levels. The staff's comments would be welcome.

We note that the DSA for Grenada indicates that the external debt risk rating remains 'in debt distress'. We urge the authorities to move forward with full regularization of arrears with bilateral creditors and continue with fiscal discipline to ensure debt is on a downward path so as to deal with the existing vulnerabilities to external shocks and natural disasters.

Finally, we would encourage the authorities to agree to the publication of the staff reports.

Mr. Agung and Mr. Alias submitted the following statement:

The Grenadian economy has been growing robustly in the past few years, thanks to the successful completion of the Fund-supported home-grown structural adjustment program (HGSAP) 2014-17, that has contributed to commendable improvements in the fiscal position, debt sustainability and growth outlook. The economy is projected to grow by 3 ½ percent in 2018-2019 benefiting from supportive global economic conditions, and continued strength in construction and tourism sectors. Risks to the outlook are two sided—to realize the potential growth and mitigate downside risks, the authorities should maintain efforts to secure fiscal and debt sustainability, strengthen the financial sector and foster inclusive growth. We broadly agree with the thrust of staff's appraisal and thank staff for the comprehensive report and Ms. Horsman and Mr. Sylvester for their informative buff statement.

Sustained fiscal discipline is crucial to protect the hard-earned fiscal performance. We welcome that Grenada is on track to reach public debt-to-GDP ratio of 55 percent by 2020 as well as the Eastern Caribbean Currency Union (ECCU) debt target of 60 percent of GDP, ten years ahead of the 2030 deadline. This also reflects the authorities' strong ownership of the fiscal framework. Moving forward, we support a comprehensive review of the Fiscal Responsibility Law to help ensure it remains consistent with Grenada's inherent debt-sustainability risks, and increase fiscal space for high quality pro-growth public spending. Could staff share latest developments on Petrocaribe financing and whether other Petrocaribe countries are also at high risk of losing this financing source? We would also appreciate staff's clarification on why fiscal risks from the Grenlec power company are not considered to be material. On the revenue side, improvements in tax administration and Treasury Department operations along with measures to broaden the tax base should remain a priority, particularly in enforcing tax compliance. We are concerned that Grenada's sizeable external arrears have the potential to cause debt distress. Nevertheless, we are comforted by the authorities' commitment to regularize arrears with the remaining creditors as mentioned in the buff statement. Timely completion of structural fiscal reforms would further mitigate fiscal risks—many of which have been appropriately identified by the authorities and are progressing well, particularly modernization of the public sector, strengthening the delivery of public investment and SOE management. Constrained by absorption capacity and technical know-how, we strongly encourage the authorities to make the best use of the technical assistance by the World Bank and the IMF.

Financial sector stability has broadly improved but the rapid lending growth in credit unions warrants close monitoring. Risks to financial stability could stem from generally weaker prudential standards and supervisory capacity to better monitor risks from credit union activities. It is also important to have a holistic understanding of the links between banks, credit unions and insurance companies; in order to understand transmission channels and interdependence between the financial system and the broader economy. In this regard, we welcome that ECCU are taking steps to harmonize regulation and oversight of the non-bank financial sector to better manage financial stability risks. In addition, ensuring strict compliance with AML/CFT regulations at all levels remains critical to secure Grenada's continued access to cross-border payments and help mitigate the risk of losing correspondent banking relationships (CBRs). We join Ms. Horsman and Mr. Sylvester's buff to call on the Fund to continue to bring stakeholders together to identify concrete solutions to CBR related issues.

We encourage the authorities to redouble efforts to improve macro-economic fundamentals by boosting private sector growth, removing capacity constraints and lowering high unemployment. We are encouraged by the authorities' efforts to address high unemployment which calls for a better alignment of the education curriculum with the needs of the labor market, as well as development of training and job search programs in collaboration with the private sector. In addition, further improvements of the investment climate focusing on the sectors where Grenada has strong comparative advantage are welcome. On climate change, we are encouraged to note from the buff statement that the authorities are continuing their efforts in upscaling climate resilience infrastructure.

With these remarks, we wish the authorities success in their endeavors.

Mr. Mr. Mkwezalamba, Razafindramanana, Ms. Nainda, and Mr. Olhaye submitted the following joint statement:

We commend the authorities for the successful completion of the 2014 – 2017 ECF-supported program, which facilitated important economic reforms. Under the arrangement, economic growth has been robust, fiscal performance was strong, resulting in a significant reduction in Grenada's debt, and the financial sector strengthened. Looking ahead, growth is projected at 3.5 percent for 2018-19, benefiting from strong growth in the United States and sound macroeconomic policies supported by a favorable political environment. While the macroeconomic outlook is positive, vulnerabilities remain, related to still-high unemployment, inadequate skills, weak institutional capacity for policy implementation, and external debt which is currently assessed to be in high risk of distress. That said, we note the diverging views on growth estimates between the authorities and staff, and welcome staff comments on the underlying differences in the projections. With these initial remarks, we thank staff for the comprehensive report, and provide the following additional points for emphasis.

The authorities' strong commitment to the Fiscal Responsibility Legislation (FRL) has yielded positive results, which includes a downward trajectory for public debt and better than expected outcome on key targets. Moreover, their commitment to maintain a large primary surplus, as set out in the 2018-2020 fiscal plan, combined with the creation of the Fiscal Responsible Oversight Committee (FROC) is welcome. In addition, we are encouraged by the authorities' commitment to maintaining fiscal discipline guided by the FRL, as indicated in Ms. Horsman and Mr. Sylvester's informative buff statement. In this context, steps to address the remaining uncertainties in FRL's operational framework should be pursued, and ultimately the FRL should be aligned with Public Financial Management (PFM) and Public Debt Management legislations. We are further encouraged by the authorities' ongoing engagement with the Fund to develop a broad framework to inform the anticipated increase in fiscal space in 2020 when public debt ratio is projected to fall below 55 percent of GDP, to reinforce economic growth. In addition, we note the authorities' commitment to structural fiscal reforms, premised on enhancing buffers to external shocks and facilitating more inclusive growth. Among the identified priorities, progress made on state-owned enterprises (SOEs) reforms and the achievement of base coverage for the key social assistance program, the Support for Education, Employment and Development (SEED), are welcome developments.

Reforms in the banking sector have demonstrated greater prudence with the completion of multi-year restructuring, improved insolvency framework, and NPL alleviation. We, therefore, commend the authorities on this front. While credit unions have moved to fill the gap in lending activities, we urge the authorities to enhance regulation to mitigate risks that may arise to the financial system owing to the weaker oversight on credit union activities. In this respect, we welcome the introduction of IFRS9 later this year. Furthermore, while we note that the AML/CFT framework remains adequate, risks are on the rise. Could staff comment on current CBI inflows, projections going forward, and how potential associated risks to AML/CFT framework may be abated?

Given the high unemployment levels and recent investments that appear to be temporal in nature, we encourage the authorities to accelerate efforts to improve the business environment, enhance competitiveness, increase job creation, and elevate growth prospects. In this regard, the forthcoming measures to improve the business environment and efforts to reduce skills mismatches and increase vocational training are encouraging. To conclude, we welcome the creation of the new Ministry focused on climate resilience, and take note of their expected participation in the Fund's Climate Change Policy Assessment initiative. In this regard, we urge authorities to take full advantage of the program to strengthen institutions for climate change response.

Mr. Merk and Mr. Lieber submitted the following statement:

We thank Ms. Horsman and Mr. Sylvester for their candid buff statement and staff for their insightful report. We broadly concur with the staff appraisal.

We commend the authorities on the substantial reduction in public debt that has been achieved over the course of the recent ECF arrangement through a combination of strong fiscal adjustment, debt restructuring and favorable growth dynamics as well as for their pro-active steps on enhancing climate resilience. This said, unemployment remains at very high levels, especially among the young and unskilled.

While public debt has declined steeply, it is still high and progress achieved so far should not give rise to complacency. Against the backdrop of Grenada's external debt risk rating remaining "in debt distress," we are somewhat surprised by the authorities' plans to raise pension and health care benefits. Topping up pensions to public servants seems particularly questionable in view of already substantial actuarial imbalances which require urgent reforms, as suggested by staff, to put the system on sustainable footing. While the authorities note that "the planned pensions and health care expansions were critical to the long-standing dialogue with social partners to address social problems and inequities," we are wondering whether targeted transfers, e.g. within social assistance programs, would not be more pertinent to this end as broad-based boosts to pensions tend to predominantly benefit the already better off.

We advise the authorities to exert caution and refrain from weakening fiscal discipline. While we agree on the importance of safeguarding and executing capital expenditures, not least to make the country more resilient against natural disasters, it is of the essence to further rebuild fiscal buffers within a strengthened and updated fiscal rules framework. Like staff, we deem that careful planning is needed to improve the fiscal responsibility law and maintain its rules-based framework which is essential to support policy credibility. Moreover, we would like to reiterate staff's call for greater debt transparency, SOE reform and progress on resolving outstanding bilateral arrears.

We concur with staff that oversight of non-bank financial institutions should be strengthened, while ensuring compliance with AML/CFT regulations at all levels, including strict enforcement of the due diligence process of the Citizenship-by-Investment program, is key for Grenada's continued access to stable cross-border payments.

To bring down unemployment and strengthen the country's growth potential over the medium term, the implementation of targeted education and labor market policies should become a priority going forward. Fostering potential growth also requires reforms that aim at improving the business climate and making the public sector more efficient, in particular with a view to the planning, allocation and implementation of public investment projects.

With a view to the rapid rise of the current account deficit, the authorities should remain vigilant against the build-up of external imbalances, especially when external financing is used for consumptive rather than investment-related purposes.

Finally, we encourage the authorities to further upgrade economic statistics and consent to the publication of the staff report.

Mr. Ostros and Ms. Sand submitted the following statement:

We thank staff for the report and Ms. Horsman and Mr. Sylvester for their informative buff statement. We concur with the thrust of the staff's appraisal and offer the following comments for emphasis.

On the back of the government's economic program, supported by the ECF-program that ended last year, Grenada has made significant economic progress. We commend the authorities for the impressive fiscal adjustment, and note that the fiscal situation improved further in 2017, and that the government continues to overperform on the fiscal responsibility law (FRL) targets. Going forward, it will be important to sustain fiscal discipline to protect the gains in fiscal performance. We strongly agree with staff that the new initiatives on pension and health care should be imbedded in the rules-based fiscal framework, as we note that the government's electoral promises in these areas have not been costed and are not incorporated in the baseline. Going forward, we support the recommendation of a more comprehensive review and revision of the FRL that could provide more fiscal space in the near term to support more high-quality infrastructure spending while containing the deficit. As Grenada is highly susceptible to climate change and natural disasters, we understand the authorities wish to ensure that the FRL does not constrain critical climate-resilient infrastructure investments. We welcome the planned Fund TA to support the review of the FRL and the upcoming Climate Change Policy Assessment (CCPA). We hope the CCPA can help identify priority areas in the resilience framework and help encourage further donor support to this cause.

The authorities' compliance with the FRL has kept the debt-to-GDP ratio on a downward path. As noted in the buff statement, Grenada is on track to reach the FRL debt target of 55 percent of GDP by 2020, which also means it will reach the Eastern Caribbean Currency Union debt target of 60 percent of GDP ten years ahead of the 2030 deadline. We welcome the authorities' efforts to resolve the remaining arrears with the three remaining external creditors.

We welcome the progress made in increasing the stability of the banking sector. However, the shift in lending activity to the less regulated non-bank sector, in particular credit unions, give rise to financial stability concerns. We agree with staff that an acceleration of the process towards regional harmonization of regulations and oversight of the non-bank financial sector taken by the Easter Caribbean Central Bank would help reduce potential stability risks in Grenada.

The high rate of unemployment, with youth unemployment still at 40 percent, remains an urgent matter to address. As the high unemployment is primarily structural and related to skill mismatches, we emphasize the importance of the staff's recommendation to review the education system to better align skills with the needs of the labor market. We encourage the authorities to mobilize efforts on the implementation of these policy recommendations.

Mr. Psalidopoulos, Mr. Rashkovan, Ms. Kalezic, and Ms. Lopes submitted the following joint statement:

We thank staff for the instructive report and Ms. Horsman and Mr. Sylvester for their helpful buff statement. Grenada's economy continued to perform well beyond the program, thanks to the authorities' strong commitment to a solid fiscal position, sustainable debt and a positive growth outlook. In light of the still prevailing downside risks, most prominently the country's proneness to weather-related shocks, continuing the strong fiscal performance in the medium term is essential. These efforts should be leveraged by strengthening the nonbanking financial supervision and pursuing structural reforms centered on enhancing the business environment and unlocking growth potential. We agree with the thrust of the staff appraisal and offer the following comments for emphasis.

The two debt restructuring episodes (in 2004–06 and 2013–15) are forceful reminders that fiscal consolidation should continue, gatekeeping the hard-earned buffers and safeguarding debt sustainability. Building on the commendable results in solidifying debt sustainability, the target to maintain a primary surplus of over 5 percent in the medium term appears challenging, yet highly justified. We take positive note that the 2017 Budget outturn signals the authorities' awareness of the remaining fiscal challenges. To this end, we support the recent creation of the Fiscal Responsibility Oversight Committee (FROC) and support the authorities' efforts to close the gaps and address ambiguities and operational shortages of the Fiscal Responsibility Law (FRL). Further improvements of the custom administration, tax administration (tax compliance) and procurement could only contribute to stronger ownership of the fiscal responsibility legislation. At the same time, while the reform of the public-sector pension system is highly warranted, the authorities should insist on its fiscal neutrality and gradualism. Public administration reform aimed at right-sizing of the public sector, in the context of a small economy, should focus on a functional review of public sector employment, that would assist this process without threatening to create capacity bottlenecks. On tax policy, we welcome the high level of implemented IMF recommendations, but share staff's view that the recommended restriction of CIT exemptions might serve the country better than lowering the CIT rate. Given the compressed available fiscal space, improving public investment management is indispensable in closing the infrastructural gap.

Given that the country is highly susceptible to climate change related risks, the authorities should continue investing in adaptive capacities and natural disaster resilience. We take a positive note that Grenada continues to make important strides with addressing climate change risks, starting with the completion of the National Development Plan, formation of a special Ministry with a mandate to build up climate resilience, to requesting a Climate Change Policy Assessment (CCPA) from the Fund. Similarly, we are encouraged that despite the modest fiscal space, the authorities are developing innovative financial schemes to strengthen climate resilience and transitioning to a 'blue economy.' While we welcome that currently the authorities save 40 percent of the Citizenship-By- Investment (CBI) proceeds to help respond to natural disasters, these revenues are intrinsically volatile, and we would like to hear staffs' views on how this funding mechanism could become more sustainable.

Closing the oversight gap on non-banking institutions is highly warranted. While the banking system balance sheet improved on the back of compressed NPLs, insisting on prudent lending standards led to an acceleration in lending of unsupervised credit unions. We support the authorities' efforts to closely monitor developments in the non-banking sector and to work closely with the Eastern Caribbean Central Bank (ECCB). As the CBI continues to play an important role in supporting climate resilience and development of Grenada, the authorities should insist on the strict compliance with the AML/CFT regulations to alleviate the risks of correspondent banking relationships (CBRs) losses.

Improved macro-fundamentals create an opportunity for the authorities to address private sector development barriers in conjunction with labor market mismatches and inefficiencies. We are encouraged by strong compression of unemployment in recent years, while continuing this trend hinges on improvements in the education system and skills' development. These reforms should be complemented by the necessary energy sector reforms as well as infrastructure and coastal development, conducive for a gradual transition to a blue economy supportive of seafood production and tourism.

In closing, we commend the authorities for improving the BOP statistics and hope for further progress with developing fiscal statistics and statistics of national accounts.

Mr. Saito and Ms. Mori submitted the following statement:

We thank staff for the reports and Ms. Horsman and Mr. Sylvester for their informative buff statement. We commend that Grenada authorities achieved significant fiscal adjustment under the 2014-2107 ECF-supported program while maintaining growth momentum. The economy is projected to maintain solid growth in 2018 and 2019 supported by favorable global economic conditions and continued strength in construction and tourism. Having said that, more can be done to address still relatively high public debt, insufficient job creation, and weak institutional capacity for policy implementation. In this regard, we are encouraged by the authorities' commitment to implement sound macroeconomic policies and structural reforms. As we broadly agree with the thrust of the staff appraisal, we will limit our comments to the following points:

Fiscal Policy

We welcome that compliance with the fiscal responsibility law (FRL) together with buoyant revenue and strong economic activity results in strong fiscal performance such as larger than expected primary fiscal surplus and public debt reduction. We encourage the authorities to adhere to the FRL while addressing ambiguities or gaps in the FRL's operational framework. Going forward, we agree with staff that increase in the available fiscal space would need to be well-managed, once the 55 percent of debt to GDP ratio is achieved and primary balance rule is loosened. In this regard, it is important to recalibrate the FRL while striking a balance between achieving fiscal prudence and debt sustainability and addressing necessary expenditures including climate-resilient investment and aging-related spending. We positively note that the authorities and staff are on the same boat about the possible Fund's TA support in this area. We expect future Fund support will help make comprehensive solution. At the same time, improving the fiscal financing strategy and project implementation is crucial to efficiently use limited resources. We encourage the authorities to continue to tackle shortcomings identified by PIMA-based analysis.

Financial Sector

The rapid growth of credit unions' lending activity should be monitored carefully. It is encouraging that banks are generally sound with supervision and regulation being conducted at the ECCU level. We note that the oversight and availability of data on credit union activities is weaker. We concur with staff that supervision of credit unions should be further improved and steps should be taken toward a single regional non-bank supervisor. In this context, we would like to ask staff whether there are any signs of credit quality deterioration in credit unions. Also, could staff elaborate more on the regulation gaps between the bank and non-bank financial sector, and recommended measures to Grenada authorities to strengthen monitoring of credit unions until the ECCU's steps toward harmonization complete?

Structural Reforms

Structural reforms are indispensable to boost potential growth. We agree with staff that policy priorities are in the areas of business environment and labor market. Given the high and long-term unemployment rate and skills mismatches, further effort to upgrade education and training are necessary. Increasing resilience to climate change and natural disasters are important to reduce the impact of shocks. In this regard, we commend that the authorities are taking steps including creation of new Ministry dedicated to climate resilience, success in securing financing from the Green Climate Fund, incorporation of disaster relief clauses in some of loan instrument, and saving of 40 percent of the citizenship-by-investment proceed to help respond to natural disasters. We also welcome the authorities' planned participation in the IMF's Climate Change Policy Assessment initiative and expect them to utilize the initiative for building resilience.

Mr. Armas and Mr. Rojas Ulo submitted the following statement:

We thank staff for a clear and candid report and Ms. Horsman, and Mr. Sylvester for their helpful buff statement.

Grenada's economy under the EFC arrangement shows a positive recovery but the outlook remains challenging towards an increase in potential growth. The country has made significant and satisfactory macroeconomic progress in implementing corrective actions in recent times. Economic growth is projected to slow down from 4.5 percent in 2017 to 3.6 percent in 2018-2019 and stabilize at 2.7 percent in the medium term, generating a moderate growth rate. We concur with the staff's recommendation on the implementation of policies and structural reforms focused on strengthening and preserving macroeconomic stability, boosting to potential growth to enhancing the economy resilience, increasing productivity, and promoting inclusive growth.

The target to maintain fiscal discipline through the fiscal responsibility law (FRL) to build resilience to shocks and support policy credibility is important. In recent years, the fiscal sector improved notably; the overall balance and the primary balance are expected to continue decreasing slowly but both indicators remain positive in the medium term due to the impact of sustained fiscal discipline and backed by the implementation of the FRL. Recent efforts to bolster revenues, limit the current spending, and adjustments made to clarify the FRL's operational should continue. In this context, we support the structural fiscal reforms to prioritize improving the efficiency of public spending, strengthen productivity of SOEs, and improving tax administration and fiscal transparency.

The banking system's soundness indicators are positive but further actions are needed to strengthen risk control to financial stability. As the staff report shows, despite that the banking sector remains liquid, with robust deposit expansion, and well capitalized, the banking credit has stagnated and credit union lending is growing rapidly. The authorities should continue to closely monitor the performance of the banking sector, maintain the trend to achieve to non-performing loans (NPL), and strengthen the oversight of non-banking financial institutions. We are inclined to support the staff recommendation on upgrading the system's oversight, such as credit unions and insurance companies, toward a single regional non-bank supervisor. We encourage the authorities' actions necessary to ensure compliance with AML/CFT regulations.

We welcome the authorities' efforts to achieve reduction in the public debt. Since 2013, public debt ratio fell by 37 percentages points of GDP reflecting favorable economic policies, and through a successful debt restructuring. The Debt Sustainability Analysis (DSA) indicates that the external public debt trajectory has a favorable outlook; nevertheless, due to the remaining external arrears, the external risk continues to be "in debt distress." Grenada needs to generate fiscal space to implement investment projects enhancing the efficiency in financing, and to expand the potential growth. To finance these investments, a set of legal frameworks and institutional arrangements will be needed, consistent with the FRL and to help their debt management capacity.

We support the implementation of structural reforms to raise potential growth. Grenada's economy has characteristics that constrain to economic growth and include relative undiversified economy, insufficient labor skills, high energy costs, weak institutions, and in the long term it is susceptible to natural disasters. We encourage the authorities to continue and accelerate the implementation of economic structural reforms to enhance the productivity by improving the business environment and implementing sectoral strategies. In this framework, we support the reforms which would improve the institutional and legal framework for public investment management.

With these comments, we wish Grenada and its people success in their future endeavors.

Mr. Inderbinen submitted the following statement:

We are grateful to staff for the good documents, and we also thank Ms. Horsman and Mr. Sylvester for their helpful buff statement.

We commend the authorities on the good economic outcome. Performance since the completion of Grenada's ECF-supported adjustment program has been noteworthy. Growth is solid, the fiscal position has strengthened further, and debt has been substantially reduced in the course of the restructuring. As staff emphasizes, the clear mandate of the re-elected government provides an ideal opportunity to address the remaining vulnerabilities and advance on reforms.

Progress in strengthening the fiscal position and reducing debt vulnerability is welcome. Going forward, the authorities will be well-advised to further strengthen and clarify the fiscal framework. It would seem critical to maintain a prudent stance also once the debt-to-GDP target is reached. This would allow for the build-up of buffers and create room for a policy response in the case of adverse shocks. A solid fiscal framework would also seem important in view of prospective oil and gas revenue.

Continued efforts are required to resolve the remaining arrears. The lack of progress in resolving the remaining arrears to official creditors since the completion of the ECF-supported program is regrettable. We urge the authorities to redouble their efforts to this end, in order to restore Grenada's creditworthiness. We welcome the commitment of the authorities in this regard, as emphasized in the buff statement.

Developments in the financial sector call for increased vigilance. The progress in reducing the level of NPLs in the banking sector is welcome. Nonetheless, bank lending to the economy has not picked up. This contrasts with the rapid increase in non-bank credit. We understand that the credit unions, as opposed to banks, are subject to regulatory oversight at the national, rather than the ECCU, level. Could staff elaborate on how the prudential regulations and requirements for banks and credit unions compare? Are the responsibilities and the resourcing of the local regulator currently sufficient to ensure an adequate oversight of the non-bank sector?

We note the authorities' continued concern regarding the withdrawal of correspondent banks. According to the staff report, it is mainly the non-banks that are at risk of losing CBRs. The ongoing efforts to strengthen the AML/CFT framework are welcome and will be critical in mitigating these risks. We also note the concerns regarding the CBI scheme. What is staff's assessment of the integrity risks associated with Grenada's CBI program?

We commend the efforts to increase resilience to climate change and natural disasters. We note the adoption of the National Climate Change Policy, as well as the Climate Change Adaptation Plan, and the establishment of a dedicated ministry. We also note that domestic constraints will necessitate continued access to multilateral funds. Sound macro-policies and a strong fiscal framework will likely be instrumental in securing such financing. We look forward to the forthcoming CCPA.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for their well-written report and Ms. Horsman and Mr. Sylvester for their informative buff statement.

Grenada has made significant strides in its homegrown structural reform agenda with the support of the recently concluded ECF arrangement, bolstering confidence. Growth has exceeded expectations and inflation is under control. More importantly, the debt to GDP ratio has declined steadily by 37 percent from 2013, with exemplary improvement in fiscal performance, supported by the new and improved fiscal framework, including the Fiscal Responsibility Law (FRL). Measures have also taken to strengthen state owned enterprises (SOEs) and the financial system, as well as to improve the business environment. We commend the authorities for these notable achievements, backed by the domestic stakeholders' broad-based support of reforms and the measures to strengthen social cohesion indicated in the buff statement. However, notwithstanding these achievements, the economy faces important challenges, including low potential growth, chronically high unemployment, high poverty and inequality, requiring continuation of sound macroeconomic policies and reforms to strengthen the economic resilience, reduce poverty and inequality, and better face natural disasters. We broadly concur with staff's assessment and wish to make following remarks for emphasis.

The continuation of fiscal reforms is imperative to further reduce the public debt to 55 percent of GDP by 2020 as per FRL. This would particularly include further improving operational, accountability and transparency aspects of the fiscal policy. The medium-term projections envisage that, despite the current positive output gap, the growth will converge to the potential after 2021 and capital spending will start to increase only after 2021. Could staff provide more information on the trends in capital expenditures and growth outlook? Moreover, the need for accommodating quality capital spending, critical climate-resilient spending and cost of new initiatives on health and pensions etc. would require carefully revisiting the provisions in FRL in its next phase. The staff's comments on the room for accommodating such expenditures in the FRL are welcome.

The ongoing efforts to improve revenue mobilization and administrative efficiency are critical to maintaining stability of the fiscal situation. In addition, we encourage the authorities to improve public expenditure management, address future aging costs, and direct targeted public resources to the poorest and most vulnerable in achieving this objective. Faster resolution of the remaining bilateral arrears by redoubling the negotiations with creditors is also encouraged, given the current "in distress" classification of debt and need for maintaining confidence. The continued reforms in SOEs and reducing risks from Public Private Partnerships (PPPs) will help further strengthening productivity in the economy and minimizing fiscal risks.

The financial system remains relatively sound in terms of capital adequacy, liquidity and improving asset quality. NPLs have declined steadily. However, financial sector reforms need to be continued to face emerging challenges. In this context, we agree with the need for upgrading financial oversight of non-bank financial institutions, which are under the purview of the local regulator, to pre-empt potential financial stability risks.

Supply side reforms to improve productivity and competitiveness are essential to raise potential growth. Given that the current high growth is mainly driven by temporary factors, such as an increase in construction, we encourage the authorities to continue their commendable efforts to address remaining gaps that inhibit doing business in Grenada to sustain the medium-term growth. The skills mismatch (Box 2) in the labor market requires upgrading and training to promote private sector job creation, particularly to address the significantly high youth and women unemployment. We welcome the ongoing work with the World Bank on an agenda for anchoring medium-term interventions to accelerate growth and poverty reduction. We stress the need for careful planning and time bound implementation to promote inclusive growth. To address capacity constraints in key sectors, we support the continued TA from the Fund.

As a small country susceptible to natural disasters, Grenada needs further strengthening climate resilience measures for durable growth in the medium-term. We commend the recent efforts and encourage the planned measures, including the participation in the Climate Change Policy Assessment (CCPA) initiative of the Fund, aimed at further crystalizing natural disaster resilient framework which will also help mobilizing donor support.

We positively note the ongoing measures to improve the AML/CFT framework. The authorities should remain firm in taking measures to address remaining and emerging concerns related to this to prevent any potential loss of correspondent banking relationships. However, we would have expected a detailed discussion on the important area of governance, including the perception of corruption, in the staff report. Could staff comment?

With these remarks, we wish all the very best to Grenadian authorities in their future endeavors.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for a well written report and Ms. Horsman and Mr. Sylvester for their helpful buff statement. Under the recent ECF arrangement the authorities have implemented many important reforms that contributed to a more stable macroeconomic environment, strengthened fiscal position, and robust growth rates. Real GDP growth is estimated to have accelerated to 4.5 percent in 2017, supported by tourism and related construction activity. Inflation remains under control. Foreign exchange reserves are adequate. At the same time, the Grenadian authorities face significant challenges, including still high public debt and unemployment, as well as vulnerability to external shocks. Structural reforms are necessary to boost growth potential, address income inequality, and reduce poverty. We broadly agree with staff's recommendations and limit our comments to the following points.

Although the fiscal stance has significantly improved, public debt remains high. Overall fiscal adjustment over the recent years amounted to about 10 percent of GDP. This, together with solid growth rates and the completion of debt restructuring, allowed the authorities to reduce public debt level from 108 percent of GDP in 2013 to around 71 percent of GDP in 2017. We note, however, that Grenada remains "in debt distress" category, given the outstanding arrears to three remaining bilateral creditors. We welcome the authorities' efforts to regularize these arrears in good faith. We encourage the authorities to continue prudent fiscal policy by adhering to the Fiscal Responsibility Law (FRL), which will be critical to bringing Grenada back to debt sustainability. Prudent fiscal strategy will help in safeguarding credibility of the fiscal rule. Could staff elaborate on the potential cost of the new fiscal initiatives, including on pensions and health care?

On the one hand, staff offered compelling arguments in favor of avoiding material changes to the core FRL's rules, particularly the primary expenditure rule. Once the authorities' objective of 55 percent of GDP-to-debt ratio is achieved, the authorities would embark on careful recalibration of the FRL to provide additional fiscal space for priority infrastructure and social spending. On the other hand, carefully designed public investments in infrastructure could help in maintaining sustainable growth momentum. The IMF has substantial experience in this area, and we encourage the authorities to request technical assistance from the Fund to carefully redesign the key elements of the FRL. We also agree with staff that in order to use any fiscal space effectively, the authorities need to improve public investment management. In this respect, the analysis in Annex IV offers a useful set of policy recommendations to improve quality and returns of public investment.

While falling, the unemployment rate remains high, close to 24 percent. Further efforts are required to translate economic expansion into additional reduction in unemployment, particularly among the young and women. We join staff in calling on the authorities to address labor market mismatches through well-targeted policies, including better tailored training and job search services.

We welcome the authorities' plans to accelerate structural reforms aimed at improving business environment, boosting productivity, and increasing resilience to natural disasters. Grenada's very low ranking in the 2018 Doing Business Database points to the scope for ambitious reforms. Efforts in this area would also be helpful in addressing challenges associated with governance and institutional weaknesses. Strengthening the provision of data should remain a priority for the authorities, particularly with regards to public debt statistics. Could staff elaborate on the remaining barriers to growth in Grenada, and on comparative advantages the country could use to achieve higher and more sustainable growth?

Mr. Sun and Ms. Ma submitted the following statement:

We thank staff for the concise report and Ms. Horsman and Mr. Sylvester for their helpful buff statement. We commend the authorities for their steadfast reform efforts that have helped to improve economic and fiscal performance, and have enabled the policy discussions on boosting potential growth. Nevertheless, significant challenges remain down the road, which the authorities are fully aware of. We broadly concur with the thrust of staff's appraisal, and would like to offer the following points for emphasis.

Underpinned by the fiscal responsibility law (FRL), fiscal performance has been very strong, with fiscal outcomes much better than targets. We welcome the authorities' commitment to FRL and readiness to conduct a comprehensive review and refinement of FRL parameters. The authorities' plan to manage increases in pension and health care expenditure within the FRL's parameters is welcome, while staff sees potential conflict with the FRL's spending growth rule. What are the reasons for the divergent views? Fiscal consolidation, solid growth, and debt restructuring have reduced public and publicly guaranteed (PPG) debt from 108 percent to 71 percent between 2013 and 2017. The PPG is projected to decrease to 55 percent in 3 years. However, due to remaining arrears that have not regularized, the external debt risk rating remains "in debt distress," which fails to reflect the significant improvement in recent years. Could staff explain why the current assessment framework could not capture the improvement?

Multi-pronged structural reforms are needed to improve productivity. High structural unemployment calls for better alignment of labor supply with labor demand through better education attainment and training. Given the large imbalances in the pension scheme, parametric reforms of the pension system are urgently needed. Noting staff's recommendation for leveraging on the PPP framework to improve access to financing, we invite staff's comments on the authorities' implementation capacity and potential risks to the public finance. We welcome Grenada's participation in the IMF's Climate Change Policy Assessment to enhance resilience to natural disasters.

Efforts are needed to strengthen oversight of non-bank financial institutions. Rapid lending growth in credit unions warrants close monitoring. We welcome the regional harmonization of regulations of the non-bank financial sector by the ECCU. Though there is no meaningful loss of CBRs, we encourage the authorities to improve AML/CFT compliance and due diligence of the CBI program to ensure continued access to stable cross-border payments.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Castets and Mr. Rebillard submitted the following statement:

We thank staff for a comprehensive set of reports, as well as Ms. Horsman and Mr. Sylvester for their informative buff statement. We commend the authorities for their impressive achievements on the fiscal front over the past few years under the ECF program, and welcome the completion of the final phase of bond restructuring. Going forward, fiscal discipline should be maintained in order to create fiscal space to enhance resilience to natural disasters, especially regarding infrastructure. We encourage the authorities to seize the political window of opportunity to deepen progress on structural reforms and foster potential growth. We broadly agree with the staff's appraisal and recommendations, and would like to add the following comments:

Fiscal Policy

The fiscal adjustment carried out since 2013 has been impressive, totaling 9.5 percent of GDP, and (together with debt restructuring) enabled a significant reduction in public debt from 108 to 71 percent of GDP. The primary fiscal balance is projected to remain at around 5.5 percent of GDP through 2020, allowing for a further reduction of the debt-to-GDP ratio. Once the objective of 55 percent of GDP is attained, we concur that a recalibration of the parameters of the Fiscal Responsibility Law is needed to loosen the fiscal stance and use the fiscal space created to invest in resilient public infrastructure. Could staff provide details about the infrastructure plan being prepared in partnership with China Development Bank?

We take note of the authorities' intention to reduce personal and corporate income tax rates by 5 percentage points. While we understand the rationale to implement growth-friendly tax policy changes, direct taxes are usually progressive and cuts could induce an increase in inequality. Could staff elaborate on how Grenada compares to peers in terms of tax rates and inequality?

Financial System

We concur that the rapid shift in credit provision from banks to credit unions should be monitored closely to control risks to financial stability and growth. While banks have not suffered significant losses of correspondent banking relationships, risks remain and AML/CFT concerns should be addressed without delay. We strongly encourage the authorities to ensure the integrity of the Citizenship-By-Investment program and to work towards the swift adoption of legislation formalizing the annual registration of entities, as a way to better identify AML/CFT risks.

Supply-Side Reforms

While growth has remained robust over the past few years, staff assesses potential growth at around 2.7 percent. Despite some improvement due to data revisions following the shift to BPM6, the external position is weaker than implied by medium-term fundamentals and desirable policies. Given that Grenada is a member of the Eastern Caribbean Currency Union, with its currency pegged to the dollar, competitiveness issues need to be addressed primarily through structural reforms. We fully concur with staff's recommendations to improve the business environment, address skills mismatches, improve sectoral policies and ensure inclusive growth.

As Grenada is highly vulnerable to natural disasters, special attention is warranted to climate resilience policies. We commend the authorities for their commitment in this regard. As already mentioned, we strongly support the use of the available fiscal space for resilient infrastructure building. In addition, we welcome Grenada's recent success in securing financing from the Green Climate Fund. Finally, we look forward to the planned Climate Change Policy Assessment by the Fund.

Mr. Fachada made the following statement:

I thank the staff for the report and commend the Grenadian authorities for the apt execution of economic policy, with good results in the last three to four years. The authorities have maintained macroeconomic responsibility even after the end of the Extended Credit Facility (ECF) program.

I wanted to raise one issue that I also raised recently in the case of Dominica, and it is not clear if it is an oversight or if it is a more ideological position of staff related to Petrocaribe. Petrocaribe is still seen in the risk assessment matrix as a risk of high impact to Grenada. Seeing the numbers of the balance of payments and the debt of Grenada, the flow of financing of Petrocaribe last year was just US$0.5 million. When I saw the number, I thought it was a percentage of GDP; but it is in dollar terms; it is equivalent to 0.0005 percent of GDP.

We have already discussed this issues many times here at the Board. Petrocaribe's financing was phased out naturally because of the fall in oil prices, and because of the reduction in oil production from Venezuela; so I would like to hear a justification of why this is still being maintained in the risk assessment matrix.

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

We have submitted responses to the technical questions. I will make a few remarks. One is an update on recent GDP data, and then I will dwell on two broad themes that emerged from the gray statements. One is on the fiscal policy, and the other is on governance issues.

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

I will begin with an economic update. Until now our GDP estimates for full year 2017 were not yet based on official data. After the Board received the staff report, the Eastern Caribbean Central Bank (ECCB) released the GDP growth number for 2017, which is 5.1 percent growth. That compares to 4.5 percent growth in the staff report. This is moderately higher. This does not change the thrust of our analysis, but reinforces the view that Grenada's economic momentum is relatively strong.

Turning to fiscal policy, a few Directors noted the challenges and risks of implementing the fiscal responsibility law given the need to accommodate spending needs, in particular on health care, pensions, and possibly resilience building. This is an understandable concern in light of the history of the Caribbean. In the past, many Caribbean region countries tended to use good times to ramp up public spending and be procyclical; and the initiatives like pensions and health care or similar ones would have been used to ramp up the spending further. I am happy to say that this is not happening in Grenada. Grenada continues to enact disciplined fiscal policy, and the initiatives on pensions and health care are not being seriously considered. Why is Grenada so different? Much of the credit goes to the policymakers who make judicious policies, but additionally, I would argue that the fiscal responsibility law offers a useful tool to support these policies and generate surpluses in good times.

We view this fiscal responsibility law not just as a straightjacket of rules, but rather like a broader policy context that shows reasonable policies; and it helps that the fiscal responsibility law was elaborated based on a broad social consensus that strengthens the social appeal.

Moreover, it is not only just a policy stance that the fiscal responsibility rule prescribes. It also allows for good procedures. One such procedure is that new initiatives, like on pensions and health care, cannot be adopted until their assessment is made.

The other good part of the fiscal responsibility law are the extensive accountability procedures for public officials that improve the reach of the law. Going forward, it would be important to preserve this broad-based, positive impact of the fiscal responsibility law as a reasonable way to conduct fiscal policy. One issue is that it needs more flexibility to accommodate useful spending.

On another fiscal policy issue, Mr. Merk makes a good point that social transfer policy should be key to address social inequities, including in the pension system. We believe that this is a good idea, including for Grenada, but more as a long-term objective. In the short term, the problem is that the size of the core social support program is relatively small. The extent of redistribution in Western Hemisphere countries in general is relatively small. As an example, it is less than 0.5 percent of GDP, while the inequities in the pension system are quite large. They derive from a decision taken 35 years ago. In the short-term, there needs to be more policy space and broader sets of tools, while over the long-term, a strategic direction must be well-charted out to scale up social assistance programs for more fair and inclusive growth.

I would like to make a point on governance issues. Grenada is a small country. It is not easy to holistically assess such a country. Based on cross-country rankings from Transparency International, Grenada is performing broadly in line with countries that are considered "its peers," for example, a country like Dominica or St. Lucia. In fact, the published rating indicates that Grenada is a bit worse than the average of those peer countries. But the situation is completely different if we look at the situation of governance. Based on our professional experience and our work with the authorities, we note that the fiscal responsibility law provides important accountability procedures that do not exist for country peers without such a law.

Similarly, our experts at the Caribbean Regional Technical Assistance Center (CARTAC) tell us that Grenada's level of monitoring of state-owned enterprises (SOEs) is much better than elsewhere in the region. And as regards the Citizenship-by-Investment program, Grenada is the only country that publishes the data.

All those things need to be improved, but all those dimensions are important for the way we assess governance from a macro-critical perspective, and once we ramp up work on governance, it will be a challenge to properly rank those issues, which are difficult to compare.

I would like to make a comment with respect to Mr. Fachada's point about Petrocaribe. The issue about Petrocaribe is that there is a flow issue and a stock issue. The stock of debt of Petrocaribe is relatively large. It is the stock that the local enterprise, PDV Grenada, owes to Venezuela; and the accumulated liability for that is more than 10 percent of GDP. The way we account for the public debt of Grenada does not include this particular figure. This is public knowledge. That was a decision made in 2014, and it is published as part of the staff report. There is an annex to a staff report which explains why this is not part of public debt, which is basically because the government is not responsible for the entire debt of this enterprise. It is only responsible for the shares, or about 45 percent. There is some risk that this can materialize, and we cannot completely rule it out; so that is why we mention the issue, but it is not really a flow issue, it is more like a stock issue.

Mr. Fachada made the following statement:

As in the case of Dominica, the Petrocaribe issue is not a problem of flows. It is a problem of debt stock, but with a very long-term repayment. What I cannot understand is that the risk assessment is normally associated with external financing constraints. And as balance of payments data clearly shows, there is no major problem of the discontinuity of Petrocaribe to affect the flow of financing, as Mr. Lissovolik has just reinforced.

Further, there was a question in Mr. Agung's gray statement about Petrocaribe, and in the written response, the staff said that the scheme has already been suspended. There were no major implications. Again, I still have doubts about this idea that a high-level of debt stock with Venezuela, with a repayment scheme that is very long, can provoke high-risk to Grenada's economy.

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

I cannot speak for the Dominica team, but one issue with respect to Grenada—and I do not know how Dominica accounts for it—is that since this particular debt is not part of our baseline calculation, our numbers are without that debt. We consider ourselves accountable for as complete a picture of the risks that are presented. Since this risk is non-zero, non-negligible, there is a possibility that may be small that the government can take over part of that debt, and the debt could jump, so it would not be 71 percent of GDP now, but it could jump as a one-off thing. We would like to put it as part of this risk structure.

I am not sure about how Dominica addresses this particular issue, and the balance of payments issues will also be important in the sense that while in the past, the Petrocaribe arrangement helped protect the country a bit from fluctuations in the energy prices, now it will be buying fuel elsewhere and will have to pay market prices. In the event that there is volatility and higher prices, obviously there would be some impact on the balance of payments position as well. I would not fully discount that.

Ms. Horsman made the following concluding statement:

On behalf of our authorities, I thank Directors for their candid and insightful comments and questions in their gray statements. As usual, we will convey Directors' sentiments to our authorities. I also thank Mr. Lissovolik and his team for their diligent efforts in preparing the staff reports and for the constructive engagement with our authorities and with our office prior to this meeting. We have issued a comprehensive buff statement, and so I would just like to elaborate on a few points.

The Grenadian authorities have made significant progress in strengthening the economy and financial sector in recent years, but they also understand that there is no room for complacency in light of significant existing and potential challenges. Our authorities fully intend to press ahead in a resolute way to overcome these challenges. They broadly agree with the staff assessment that key policies should focus on reforms to boost potential growth, enshrine fiscal and debt stability, and address financial sector vulnerabilities.

As Directors have rightly pointed out, building resilience to external shocks is indispensable to achieving more robust, sustained, job-rich and inclusive growth. Our authorities continue to make important strides in this crucial area and are committed to continuing these efforts, but much more needs to be done. It is clear that the cost of building resilience far exceeds the capacity of many small states that are already challenged in many other ways. Access to multilateral and donor financing and other support is therefore critical. Our authorities call on the regional and international community to support small states' resilience-building efforts.

Our authorities remain committed to strengthening the country's macro-fiscal framework. They welcome Directors' support for a comprehensive review of the fiscal framework, including the fiscal responsibility law, to remove ambiguities and to ensure that the framework complements key development objectives. Our authorities believe that further work on linking climate and fiscal resilience to growth is needed to help secure broad-based stakeholder support for important reforms.

Broad-based stakeholder support has been a key ingredient in Grenada's notable achievements in recent years. Sustaining and strengthening this area can further enhance policy implementation.

Our authorities reiterate that resolving the public pensions issue and instituting national health insurance are important for strengthening social cohesion and wish to assure Directors that these initiatives will be rolled out within the boundaries of the fiscal responsibility law.

We welcome Directors' support on the correspondent banking relationships issue. Clearly, this remains a pressing concern for our authorities. They are cognizant of the important part that they are required to play, including ensuring strict compliance with Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regulations. We reiterate our call for the Fund to continue its important role in, among other things, bringing stakeholders together to identify concrete solutions.

Turning to debt management, arrears regularization, and statistics, we have noted the concerns raised by Directors on these issues. Our authorities are committed to redoubling their efforts to make gains in these critical areas.

In closing, I would like to thank the new mission chief and his team for their diligent work. I want to assure Directors that our authorities recognize that the task ahead is extremely challenging, and they are aware that their efforts must be sustained.

The Acting Chair (Mr. Zhang) noted that Grenada is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for implementing sound policies leading to a strong economic and fiscal performance and sustained debt reduction. While the outlook remains positive, Directors stressed that continued policy resolve and public support for reforms are critical to restoring debt sustainability, improving medium-term growth prospects, and strengthening the financial sector.

Directors welcomed the continued fiscal adjustment in compliance with the framework of the Fiscal Responsibility Law (FRL), which has supported policy credibility. They noted that while there is scope to improve the FRL's operational aspects, more substantive changes to the framework should be approached as part of a comprehensive plan that balances debt reduction with the need to create fiscal space for high-quality infrastructure spending. Directors welcomed the authorities' intention to implement the recent initiatives on pensions and health care in a way that is consistent with the FRL's targets.

Directors encouraged the authorities to support the FRL through continued reforms to improve public financial management, expenditure efficiency, and fiscal transparency. They saw scope to further strengthen social assistance programs to protect the most vulnerable and to strengthen the productivity of state-owned enterprises. Directors emphasized the need to continue tax administration reforms and resolve remaining bilateral arrears. They welcomed advances in fiscal transparency, including the establishment of the Fiscal Responsibility Oversight Committee, and encouraged further progress in this area.

Directors welcomed indications of a strengthened banking system and considered that banks are better poised to contribute to private sector investment and growth. They noted the rapid increase in lending by credit unions and called for strengthening the supervision of the sector by the local regulator to reduce potential financial stability risks. Going forward, they encouraged the authorities to support steps taken at the ECCU level toward a regional approach to regulation and supervision of the non-bank financial sector. Directors emphasized the importance of complying with AML/CFT regulations, including enforcement of the due diligence process of the Citizenship-by-Investment program, noting that this was critical for Grenada's continued access to stable cross-border payments.

Directors underscored the importance of implementing structural reforms to boost potential growth, noting Grenada's susceptibility to natural disasters in addition to structural weaknesses such as high unemployment and the external competitiveness gap. They emphasized the need for measures to improve the business environment and labor market, address weaknesses in the implementation of public infrastructure spending, and reduce skill mismatches. Directors also encouraged the authorities to continue building on their efforts to strengthen resilience to natural disasters.

It is expected that the next Article IV consultation with Grenada will be held on the standard 12-month cycle.

APPROVAL: March 3, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. ***That said, we note the diverging views on growth estimates between the authorities and staff, and welcome staff comments on the underlying differences in the projections.***

- The views on growth estimates and outlook are broadly similar between staff and the authorities. For 2018-20, for which specific projections can be compared, staff's projection (3.4 percent on average) is marginally higher than the latest available projections made by the authorities in their budget framework paper (3.3 percent). The difference could be explained by different vintages of these projections.

- During the mission, the authorities have noted that *long-term potential growth* could be higher than the rate of 2¾ percent estimated in the staff report. The staff agrees that the authorities' past and ongoing reforms create a possibility for improving potential growth and will continue to update its estimates. At the same time, we see merits of erring on the side of caution before rapidly upgrading the estimates, given (i) temporary elements in the ongoing construction-driven economic strength and (ii) past criticisms of an overoptimistic bias in staff's projections for Grenada.

Financial Sector

2. ***In this context, we would like to ask staff whether there are any signs of credit quality deterioration in credit unions. Also, could staff elaborate more on the regulation gaps between the bank and non-bank financial sector, and recommended measures to Grenada authorities to strengthen monitoring of credit unions until the ECCU's steps toward harmonization complete?***

- Potential deterioration of credit quality in credit unions due to a rapid credit expansion is a concern shared by both staff and the authorities, although signs of credit quality deterioration have not emerged, possibly because the economic growth is robust.

- In contrast with regulation of banks, risk-weighted assets are not calculated for credit unions. Other regulation gaps include shortage of data provision (granular data such as sectoral breakdown of loans, collateral, NPL distribution among sectoral breakdown of loans, are not collected), financial stability indicators (no financial stability indicators for the credit union sector are published, unlike for banks), and lack of regular stress testing. The authorities are fully aware of these issues and are addressing them with the technical assistance from CARTAC, but progress is gradual due to capacity constraints. Credit union department of GARFIN is severely understaffed, with only two full-time examiners and a manager undertaking the bulk of activity of supervising institutions.

3. ***Could staff elaborate on how the prudential regulations and requirements for banks and credit unions compare? Are the responsibilities and the resourcing of the local regulator currently sufficient to ensure an adequate oversight of the non-bank sector?***

- In contrast with regulation of banks, risk-weighted assets are not calculated for credit unions. Other regulation gaps include shortage of data provision (granular data such as sectoral breakdown of loans, collateral, NPL distribution among sectoral breakdown of loans, are not collected), financial stability indicators (no financial stability indicators for the credit union sector are published, unlike for banks), and lack of regular stress testing. The authorities are fully aware of these issues and are addressing them with the technical assistance from CARTAC, but progress is gradual due to capacity constraints. Credit union department of GARFIN is severely understaffed, with only two full-time examiners and a manager undertaking the bulk of activity of supervising institutions.

4. ***Could staff comment on current citizenship-by-investment (CBI) inflows, projections going forward, and how potential associated risks to AML/CFT framework may be abated?***

- CBI inflows have increased over time, although their levels are still moderate. The staff does not have a strong view on the direction of future CBI inflows, and use the latest data as the basis of medium-term projections.

- CBI programs present inherent AML/CFT and integrity risks (e.g. channel for the concealment of criminal activities and avoidance of extradition or prosecution), which call for appropriate mitigating measures. To that end, authorities have been encouraged to continue their efforts to maintain strong due diligence process that mobilize law enforcements agencies and international cooperation channels. It has been noted that the authorities recently increased capacity at the Financial Intelligence Unit and access international databases. The staff will continue to emphasize the importance of maintaining integrity of the CBI program, including by encouraging the publication of the names of economic citizens.

5. ***What is staff's assessment of the integrity risks associated with Grenada's CBI program?***

- CBI programs present inherent AML/CFT and integrity risks (e.g. channel for the concealment of criminal activities and avoidance of extradition or prosecution), which call for appropriate mitigating measures. To that end, authorities have been encouraged to continue their efforts to maintain strong due diligence process that mobilize law enforcements agencies and international cooperation channels. It has been noted that the authorities recently increased capacity at the Financial Intelligence Unit and access international databases. The staff will continue to emphasize the importance of maintaining integrity of the CBI program, including by encouraging the publication of the names of economic citizens.

6. ***With new regional standards and IFRS 9 coming into effect shortly, do staff anticipate any difficulties banks may face in meeting additional provisioning and capital requirements?***

- While the introduction of IFRS9 are expected to lead to an increase in provisioning, initial indications are that banks can absorb the additional provisioning needs without jeopardizing the capital requirements, as indigenous banks generally have ample capital buffers, relatively low NPLs, and are spending substantial resources to prepare for the introduction of IFRS9. Having said that, staff will keep monitoring the situation, as the banks' preparation for the IFRS9 introduction is not complete yet.

7. ***Would staff advise on whether there are plans for another FSAP for ECCU members?***

- There is no plan for an FSAP at the moment, although there is an ongoing, extensive TA program as is pointed out. By way of background, the last FSAP took place for the ECCU in 2004, and for non-systemic countries, FSAPs are conducted every 10-15 years at the request of the authorities. The authorities have not requested one so far.

Fiscal Policy

8. ***Could staff provide more information on the trends in capital expenditures and growth outlook?***

- Capital expenditure in the medium term is primarily on physical infrastructure. Construction is expected to occur over a multi-year period with the growth dividend being realized subsequent to project completion. The trend in capital expenditure is distinguished by two phases. The first phase (2018-2020) is determined by the FRL's primary balance and real primary expenditure rules to reach the debt-to-GDP target of

55 percent. Post 2020, the country has more fiscal space and the FRL rules would facilitate more capital expenditure.

9. ***The need for accommodating quality capital spending, critical climate-resilient spending and cost of new initiatives on health and pensions etc. would require carefully revisiting the provisions in FRL in its next phase. The staff's comments on the room for accommodating such expenditures in the FRL are welcome*.**

- Expenditures in the FRL are limited by the 2 percent real primary expenditure growth rule less capital grants which is applied annually. The expenditure forecast through 2020 is consistent with those FRL provisions. Additional expenditures can be accommodated if financed by capital grants, reducing other spending, or changing the rule. The authorities have recognized the need for a careful approach and indicated that they would seek Fund's TA to review the FRL.

10. ***Could staff elaborate on the potential cost of the new fiscal initiatives, including on pensions and health care?***

- The cost of the reduction in the rates of the CIT and the PIT is estimated at between 0.6 and 0.7 percent of GDP. The staff do not have sufficiently precise information to estimate the likely potential cost of pensions and health care, as they would depend both on data (which have substantial gaps) and modalities of implementation. As mentioned in the staff report, the FRL requires that such estimates be elaborated before any policy initiatives could be adopted. Thus, it is expected the estimates could be discussed in the context of future staff visits and technical assistance work.

11. ***Could staff comment on the reason(s) for the lack of progress with the recommendation to broaden the corporate income tax base since the 2016 report?***

- The authorities implemented many of the tax policy recommendations identified in the 2014 FAD/TA report during the period of the ECF-supported economic Program. While they agreed in principle with the desirability of broadening the tax base they identified, given their limited resources, and the necessity of also implementing and strengthening tax administrative capacity in the interim to improve efficiency, other policy actions were prioritized.

12. ***We understand the rationale to implement growth-friendly tax policy changes, direct taxes are usually progressive and cuts could induce an increase in inequality. Could staff elaborate on how Grenada compares to peers in terms of tax rates and inequality?***

- With respect to PIT rates, Grenada's two tax rates of 10 and 30 percent place it roughly in the middle of the pack. (In the Caribbean region, PIT tax rates vary from a low of 5 percent to a high of 40 percent). However, comparisons are complicated because other peers have a different structure: several countries have as many as 5 tax bands, with the median tax rate being usually 25 percent. Comparisons are further complicated because of the difference in non-taxable thresholds (which is higher in Grenada than in the region) and because, unlike Grenada, many countries have tax allowances to provide relief on tax payable to households to offset education costs, mortgage interest payments, and the number of children. The latter are more administratively costly but provide relief to various income groups. Grenada, like many countries in the ECCU does not tax domestic interest income and foreign-earned income—this favors higher income households.

- Grenada's CIT rate (30 percent) is in the mid-range in comparison to other countries in the region.

13. ***Could staff share latest developments on Petrocaribe financing and whether other Petrocaribe countries are also at high risk of losing this financing source? We would also appreciate staff's clarification on why fiscal risks from the Grenlec power company are not considered to be material.***

- Latest reports indicate that Petrocaribe financing has dried up with the suspension of PDVSA oil exports to Grenada.

- The potential fiscal risks from a court judgement that favors the GRENLEC power company is mentioned in paragraph 11 of the staff report. The perceived risk has not changed since the sixth ECF review staff report: it would amount to a one-off increase in the gross public debt path but would not affect the rate of debt reduction.

14. ***While we welcome that currently the authorities save 40 percent of the Citizenship-By-Investment (CBI) proceeds to help respond to natural disasters, these revenues are intrinsically volatile, and we would like to hear staffs' views on how this funding mechanism could become more sustainable.***

- The staff agree that the revenues are volatile. At the same time, volatile revenue sources should better be used for saving funds as opposed to regular budget expenditure. That said, given the need for buffers, it would be desirable to strengthen the stability of inflows to the saving funds, and more stable sources could be tapped once public debt is sufficiently reduced and the fiscal space under the FRL opens up.

15. ***Could staff provide details about the infrastructure plan being prepared in partnership with China Development Bank?***

- The US$60m (almost 6 percent of GDP) loan is for refurbishment and repair of the international airport.

16. ***Fiscal consolidation, solid growth, and debt restructuring have reduced public and publicly guaranteed (PPG) debt from 108 percent to 71 percent between 2013 and 2017. Could staff explain why the current assessment framework could not capture the improvement?***

- The framework does not capture the improvement because Grenada remains in arrears to official bilateral creditors, with the stock of such arrears amounting to 1.4 percent of GDP.

- While the LIC DSA guidance note envisions a possibility of upgrading the "in distress" classification, none of the specific conditions mentioned in the note currently apply to Grenada.

- The most relevant of these conditions is that official arrears be below 1 percent of GDP. This underscores the need to regularize remaining arrears, as it would help significantly upgrade Grenada's external debt risk rating.

17. ***Given the large imbalances in the pension scheme, parametric reforms of the pension system are urgently needed. Noting staff's recommendation for leveraging on the PPP framework to improve access to financing, we invite staff's comments on the authorities' implementation capacity and potential risks to the public finance.***

- The authorities established a PPP policy framework with support from the World Bank in 2015. They do not have a dedicated PPP unit to facilitate implementation. Thus far they have solicited assistance from the Caribbean Development Bank, which has the capacity, to assess PPP prospects.

- The FRL includes several provisions to limit PPP risks (which would be capped at 5 percent of GDP).

Structural Issues

18. ***Could staff elaborate on the remaining barriers to growth in Grenada, and on comparative advantages the country could use to achieve higher and more sustainable growth?***

- The key barriers to growth are elaborated on in the staff report (para 2 and section C), including susceptibility to shocks, insufficient labor skills, and inefficient public sector. In this context, we would also like to elaborate on Grenada's poor ranking of in the 2018 Doing Business Estimates that is mentioned in the same Gray. This ranking is not fully justified: for example, Grenada is unduly penalized in its scores on insolvency procedures because the methodology is not well-tailored to small countries. This issue was extensively studied in the selected issues paper for the 2016 Article IV consultation.

- Grenada's comparative advantages include: (i) sectoral niches in tourism (which is relatively cost-competitive within the Caribbean) and agriculture (including the production of high-quality spices and chocolate) and potentially energy; (ii) the presence of an offshore university with a potential of positive spillovers; (iii) good access to finance, and (iv) relatively low crime.

- The prospective attainment of fiscal space, combined with continued reforms to boost the efficiency of public sector and of public investment and education, presents an opportunity to raise employment and potential growth.

19. ***Noting that employers indicated that there are shortages for high skilled labor, notwithstanding the presence of a recognized university in the country, can staff indicate what are the impediments to higher educational attainment and what incentives, if any, have the authorities considered to encourage university enrollment?***

- The offshore university is an important source of education for Grenadians. However, its impact on overall education is dented by the fact that the university is largely a medical school primarily teaching foreign students. Only one of its departments is largely supplying education for the Grenadians—the Arts and Sciences Department.

- The authorities are working with the university to further increase the uptake of Grenadian students and expand the curriculum available to Grenadian students, including in the context of the university expansion plans.

20. ***Apart from the recently announced oil and gas discovery, we note from recent media reports the consideration for bluefin tuna farming in Grenada and wonder if staff feel that this would be a viable project?***

- We have seen these media reports, which are very recent, but we did not have the opportunity to discuss this specific project on mission. On the face of it, the idea looks promising as it would tap into the broader priority to diversify the economy and use the country's natural endowments. But we would reserve specific judgment on the project's viability due to lack of detailed information and expertise.

21. ***The chart in Box 2 (page 17) indicates that women have higher unemployment rates than men at all education levels. The staff's comments would be welcome.***

- While women have higher unemployment than men, the key message of the chart is that gender differences in unemployment are very small at higher education levels as opposed to lower education levels, indicating that higher educational attainment of women would go a long way toward improving their employment opportunities and narrowing the gender differences.

- The broader gender disadvantage of women in the labor market is not unique to Grenada and is present in the broader Caribbean region. (The situation is even more stark in St. Lucia, for example).

- The gender disadvantage of women in the labor market in the Caribbean is a deep-rooted and multi-faceted phenomenon and has been researched extensively in the public domain. (See for example Stephanie Seguino "WHY ARE WOMEN IN THE CARIBBEAN SO MUCH MORE LIKELY THAN MEN TO BE UNEMPLOYED?" *Social and Economic Studies*. Vol. 52, No. 4, FOCUS ON GENDER II (December 2003), pp. 83-120).

22. ***We would have expected a detailed discussion on the important area of governance, including the perception of corruption, in the staff report. Could staff comment?***

- The Board approved the framework for enhanced Fund engagement on governance and corruption in April 2018, well after initiation of the analytical and background work for the 2018 Article IV consultation. That said, Fund engagement with Grenada has addressed—and will continue to address—governance and corruption issues.

- Transparency International 2017 Corruption Perceptions Index and the 2016 WB's World Wide Governance Indicators Control of Corruption Index place Grenada broadly in line with peer countries. On the positive side, Grenada has introduced or amended significant pieces of legislation during its ECF-supported program 2014-17 to improve governance, transparency and accountability – see Table 11 in IMF Country Report No. 17/131. These include legislation for (i) Fiscal Policy Frameworks on public financial management, public procurement and disposal of property, fiscal responsibility, Citizenship-by-Investment and (ii) Governance and Security such as proceeds of crime and electronic crimes, integrity in public life, interception of communication, and ombudsman.

- The authorities are also making an effort to maintain integrity of financial transactions. Adding resources to the FIU unit, close cooperation with ECCB on AML/CFT aspects of bank supervision, and an initiative to formalize annual registration of entities for AML/CFT purposes are all in this direction.

Fund Engagement

23. ***We wonder whether a non-disbursing program, such as a PSI, could help the authorities in their reform efforts. Has staff discussed with the authorities how best to engage over the next several years?***

- The staff has not had a discussion of a PSI with the authorities, as the authorities have not indicated an interest in a formal arrangement with the Fund, such as a non-disbursing program. This is consistent with the authorities' decision of one year ago to not be subject to Post-Program Monitoring when the ECF program expired in mid-2017.