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St. Lucia: 2000 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for St. Lucia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2000 Article IV consultation with St. Lucia, the following documents have been released and are included in this package:

- the staff report for the 2000 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 21, 2000**, with the officials of St. Lucia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on February 13, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- the Publication Information Notice (PIN) summarizing the **views of the Executive Board as expressed during the March 7, 2001, Executive Board discussion** of the staff report that concluded the 2000 Article IV consultation.

- a statement by the Executive Director for St. Lucia.

The document(s) listed below have been or will be separately released.

Selected Issues and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

ST. LUCIA

Staff Report for the 2000 Article IV Consultation

Prepared by the Staff Representatives for the
2000 Article IV Consultation with St. Lucia

Approved by Claudio M. Loser and Liam Patrick Ebrill

February 13, 2001

- The consultation discussions were conducted in Castries during November 8–21, 2000. The staff met with Prime Minister K. Anthony, who also is the Minister of Finance, the Permanent Secretaries of Finance and of Commerce, the Directors of Research of the Eastern Caribbean Central Bank (ECCB) and of the Ministry of Finance, other senior officials, and representatives of the private sector. Mr. Charleton, Alternate Executive Director, participated in the final discussions.

- The staff team comprised Mr. Cardemil (Head), Mr. Davico, Ms. Francis, Mr. Mendis, and Mr. Salehizadeh (all WHD). The team was assisted by Messrs. Augustine and Mounsey from the ECCB and Mr. Howell from the Caribbean Development Bank (CDB).

- St. Lucia is on a 24-month consultation cycle, and the last Article IV consultation was concluded by the Executive Board on March 23, 1999. St. Lucia has accepted the obligations of Article VIII, Sections 2, 3, and 4. Relations with the Fund, the World Bank, and the CDB are summarized in Attachments I to III.

- St. Lucia, with a population of 155 thousand and per capita GDP of US$4,560, is one of the eight small island states of the Organization of the Eastern Caribbean States (OECS) with a common central bank, the ECCB. The Eastern Caribbean dollar has been pegged to the U.S. dollar at EC$2.70=US$1 since 1976.

- The present administration of Prime Minister Anthony of the Labor Party (SLP) is in its fourth year of a five-year term that expires in May 2002.

Contents Page

Executive Summary

St. Lucia's economy is emerging from several years of sluggish growth, resulting from the retrenchment of the banana industry following the erosion of preferential access to the EU market. Banana output appears to be stabilizing as the economy moves increasingly toward tourism, other services exports, and nontraditional agriculture. GDP growth has picked up to annual rates of 2 to 3 percent over the past three years and the unemployment rate, while still at around 16 percent, is on a downward trend.

The public finances improved in 1998–99, but there has been some erosion in the current FY2000/2001 (starting April 1). The central government saving performance has weakened and the overall balance is expected to shift from a small surplus to a deficit of 3 percent of GDP. Revenue was adversely affected by delays in fuel price adjustments in line with fuel import costs, and expenditures are rising. The government recently took measures to prevent further revenue erosion (including a partial adjustment of fuel prices and an increase in consumption taxes). In the absence of additional actions, in FY2001/02, central government's saving will remain at about 4½ percent of GDP (compared with 6 percent two years earlier), while the deficit may drop slightly.

The government's medium-term strategy to restore growth rates of 4-5 percent a year on the basis of a strong private investment must be underpinned by solid public finances. Recent fiscal measures need to be followed up with further revenue actions and strengthened expenditure policies to restore the upward trend in public saving to sustain the necessary strong levels of infrastructure and social investment.

The tax system buoyancy needs strengthening by phasing out tax concessions, fully adjusting fuel prices to reflect import costs, and further simplifying indirect taxation, while moving toward adopting the VAT. Current outlays need to be tightened, and in particular, restraint on wage increases will be crucial, as these usually provide a signal for economy-wide wage setting behavior. There is a need to tighten selection criteria on individual investment projects and to ensure appropriate concessional and multilateral financing.

Structural reforms should focus on the orderly restructuring of the banana sector, while improving social services to facilitate absorption of released labor in other activities. Trade reform should be further advanced by phasing out remaining import licenses, and the financial position of the state-owned water and sewerage company further improved to help prepare for its planned privatization.

Supervision of nonbank financial institutions needs to be strengthened, and the ECCB should move ahead with its plans of extending to these institutions the principles and practices applied to banks. The authorities are developing an offshore financial center (OFC), and it is of utmost importance to establish a strong supervisory and regulatory system. Proper amendments should be sought to current OFC laws and regulations to ensure compliance with best international practices. The authorities are encouraged to follow up their ongoing self-assessment module with the subsequent steps in the process toward participating in the ECCB area-wide FSAP expected to take place in 2001.

I. BACKGROUND

1. The consultation discussions were held against the background of the ongoing retrenchment of St. Lucia's banana industry, which began in the mid-1990s with the erosion of, and uncertainties over, the preferential access to the EU market.[1] Over the past several years, banana output has fallen by more than 50 percent and a large number of farmers have been displaced (a situation similar to that of other OECS banana producers). As a result, from 1993 to 1997 economic growth averaged only 1.3 percent a year (negative 0.3 percent in per capita terms), down from more than 7 percent a year during the preceding 10-year period. During this period, the tourist industry grew rapidly (St. Lucia became the number one tourist destination among the ECCB members), and the export of other services expanded. While St. Lucia has continued to live up to its long standing tradition among ECCB countries of maintaining a sound fiscal position, between 1993 and 1997 the public finances weakened somewhat, reflecting a narrower revenue base and increases in current outlays, including the public wage bill. As the authorities attempted to limit the fiscal deficit, and with a low level of foreign grants, public investment declined in this period, with adverse effects on the country's growth performance.

2. In concluding the last Article IV consultation, Executive Directors indicated that, given the prospects of further reduction in preferential access to the EU banana market, economic growth over the next several years would largely depend on improving competitiveness and the conditions for export diversification. To this end, it was crucial to strengthen the public finances to help raise national savings and domestic investment. They recommended more stringent selection criteria for public investment projects to ensure sound financing in support of a private-sector-led economic diversification strategy. Directors urged the authorities to reduce tax exemptions and restrain the growth of current expenditures. They also pointed out that an appropriate framework for supervision should be instituted before the government approves licenses for offshore financial activities.

3. St. Lucia provides core data to the Fund and the information generally meets the requirements for the conduct of surveillance. The coverage, timeliness, and quality of the statistical information has improved in recent years, but weaknesses remain, particularly in national income, balance of payments, and public enterprises accounts. Recently, St. Lucia adopted the General Data Dissemination System (GDDS), and the authorities have set out plans for addressing data deficiencies, including through technical assistance.

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[1] Preferential market uncertainties were heightened in 1997 when the WTO ruled that the EU preferences were inconsistent with its guidelines. After several attempts at modifying the system of preferential quotas, in December 2000 the EU replaced it with one based on tariff preferences. The new system is to be replaced by one based on a flat tariff by 2006.

II. Developments since 1998

4. **Economic growth performance has improved since 1998.** In 1998–99, real GDP rose by an average of 3 percent a year, as banana production largely stabilized (despite adverse effects from a drought in 1999) and trade and construction activity expanded rapidly with the large renovation and expansion of hotels and tourist facilities. In the first half of 2000, activity slowed somewhat as growth in tourism and domestic investment moderated; for the year as a whole, banana output rose by 8 percent, and with continuing expansion in construction, commerce, and services the overall GDP growth rate is estimated to have been between 2 and 2½ percent. The unemployment rate, which had peaked at 21½ percent in 1998, fell to 15½ percent in 2000. The 12-month inflation rate (traditionally maintained in the low single digits) rose to 6 percent at the end of 1999, owing in part to higher drought-related food costs and international oil prices, but fell below 1 percent in December 2000 (Table 1 and Figure 1).

5. **After several years of weak performance, the public finances improved in 1998–99.** Notwithstanding a strong increase in investment spending, the deficit of the central government after grants shifted to small surpluses in FY 1998/99 and FY 1999/00, from a deficit averaging 1¼ percent of GDP in the previous two years.[2] [3] Central government saving rose by 2½ percentage points to 6 percent of GDP in FY 1998/99 and FY 1999/2000, as revenue was boosted with new tax measures adopted by the new administration in 1998 and current outlays were tightened. With higher grants, investment outlays rose by 2½ percentage points of GDP to an average of 8½ percent in 1998–99.

6. **Despite recent improvements, the underlying fiscal position has remained fragile.** In the current fiscal year (2000/01), saving of the central government is projected to weaken and the overall balance after grants to shift to a deficit estimated at about 3 percent of GDP. Notwithstanding recent tax measures (indicated below), the revenue performance weakened over the past year and a half owing to a steady decline in the yield from the consumption tax on petroleum products (fuel tax)—as the government kept domestic fuel prices constant despite the sharp rise in international prices[4]—as well as continued lack of buoyancy of the tax system. At the same time, overall spending has increased, in part because

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[2] The fiscal year begins April 1. The discussion on fiscal developments and policies in this report focuses on the operations of the central government, including transactions with the rest of the public sector. Trends in the overall public sector finances closely reflect movements in the financial position of the central government (Tables 2 and 3).

[3] The deficit before grants narrowed in FY 1998/99; it doubled in FY 1999/00 with a sharp increase in investment, but was more than covered by grants.

[4] The fuel tax is the difference between the domestic retail price and the cost of imported fuel (including profit margins for distributors and retailers).

of pressure from the wage bill and capital outlays, while foreign grants have declined.[5] The deficit in FY 2000/01 is being covered with a bond issue recently placed abroad.

7. In order to offset the revenue loss resulting from the scheduled reduction in import duties under the CARICOM agreement, in January 2000 the government raised average consumption taxes, and broadened the coverage of excises.[6] At the same time, a differentiated environmental levy on certain imported goods was introduced (Box 1). The overall annual yield of these measures (net of import duty reductions) is estimated at close to 1 percent of GDP. In October 2000, the government raised the domestic price of gasoline (for the first time since 1998) by about 8½ percent to increase the yield of the fuel tax. This action, with an annual yield of about ½ percent of GDP, fell well short of what would have been needed to compensate for the increase in international oil prices. While tax revenue would still fall slightly in terms of GDP in FY 2000/01, the full year effect of the higher fuel prices would bring the tax ratio in 2001 back to the level in 1999 (23 percent of GDP), albeit still slightly lower than in 1998.

8. In a sign of continued financial deepening (similar to other ECCB countries), since 1998 monetary aggregates and bank credit to the private sector continued to expand at rates somewhat faster than nominal GDP, though with some slowdown in 2000, while the public sector continued to build up deposits with the banking system (Table 4). Between 1998 and 2000, the ECCB raised its rates on commercial banks' 3-month deposits from less than 5 percent to 6½ percent, while commercial banks' average lending rates rose by nearly 2 percentage points to slightly above 13 percent. Somewhat later than in other territories in the ECCB area, St. Lucia enacted legislation in December 1999 permitting the establishment of offshore financial institutions.[7] Following a visit by an MAE/LEG team in early November 2000, the authorities began participating in Module I (self-assessment) of the Fund's offshore financial program.

9. **Following a decline in 1998, the external current account deficit widened again to about 13 percent of GDP in 1999,** reflecting a higher trade deficit owing mainly to lower banana exports and no improvement in the services account (Table 5). In 2000, the current account deficit is estimated to have declined to about 12 percent of GDP, as import growth

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[5] External grants are expected to fall temporarily to the equivalent of 1 percent of GDP in FY 2000/01 (from an average of 3¼ percent over the preceding 2 years), because of slow implementation of EU grants-financed programs.

[6] On January 1, 2000, St. Lucia implemented the third and fourth phases of the Common External Tariff (CET) agreement, lowering maximum import duties from 30 to 20 percent.

[7] The Financial Stability Forum (FSF) has placed St. Lucia (together with four other ECCB countries) in the group of offshore centers perceived as having a low quality of supervision, and the OECD has included it in the list of 35 "tax havens" published in June 2000.

Box 1. St. Lucia: Key Revenue Measures Implemented

in FY 1999/2000 and FY 2000/01

1. The **airport departure tax** on CARICOM nationals traveling within the region was reduced from EC$40 to EC$35 and that for extra-regional travelers was increased from EC$40 to EC$54, effective April 19, 1999, yielding an additional EC$1–2 million on a full-year basis.

2. In order to offset the decline in government revenue resulting from the reduction of the CET, the following measures were adopted, effective January 1, 2000:

a. The **consumption tax** (on both the imported and domestically-produced goods) was restructured: the maximum rate was reduced to 35 percent and the number of rates was reduced from 18 to 8 (i.e., 0, 5, 10, 15, 20, 25, 30, and 35 percent).

b. Consumption taxes on imported alcoholic beverages, motor vehicles, and explosives were abolished, but the coverage of the **excise tax** (which was previously applied only on locally produced rum) was broadened to include all locally produced and imported alcoholic beverages, motor vehicles, and explosives, and the tax rates on some alcoholic beverages were increased.

The additional yield from these measures is expected to be EC$10 million on a full-year basis.

3. An **environmental levy** was introduced on all imported goods except foodstuffs, clothing and footwear, and pharmaceuticals, effective March 1, 2000, with an expected yield of EC$7 million on a full-year basis.

4. In order to raise the yield of the consumption tax on imports of **petroleum products** (which is calculated as the residual between the pump price and the c.i.f. price less the margins for wholesaler and retailer), prices at the pump were increased, effective October 16, 2000, by 8.6 percent for gasoline, 8.3 percent for diesel, and 2.9 percent for a 20-pound container of liquefied petroleum gas (LPG). This measure is expected to yield an additional EC$8 million on a full-year basis.

moderated while tourist receipts picked up. The current account deficits have been more than covered since 1998 by surpluses in the capital account, which have included rising private direct investment flows and, in 2000, an increase in official borrowing. At the end of 2000, net (imputed) international reserves at the ECCB stood at US$77.6 million, equivalent to 73 percent of narrow money.

10. **The external value of the Eastern Caribbean dollar, as measured for St. Lucia, appreciated** by about 4 percent in real effective terms during the 12 months through October 2000, reflecting higher average inflation in St. Lucia than in trading partners and the appreciation of the U.S. dollar vis-à-vis other major currencies (Figure 2). The real appreciation of the currency has reached close to 20 percent since the low point in the early 1990s, offsetting an equivalent depreciation during the previous eight-year period. **Public sector external debt** (owed or guaranteed by the central government), which had

been maintained at around 25 percent of GDP in the mid-1990s, is estimated to have risen to about 30 percent of GDP in 2000; over the same period, the debt service as a ratio of exports of goods and services has risen from 3½ percent to 4¾ percent.

11. **In the area of structural reforms,** efforts have continued at restructuring the banana sector to enhance efficiency and competitiveness. In 1998, the St. Lucia Banana Corporation was privatized, which allowed for the entrance of other fruit buying companies into the market creating competition for the growers' output. In preparation for the changes to the EU banana regime, and with the technical and financial assistance of the EU, St. Lucia (along with the other Windward Islands—Dominica, Grenada, and St. Vincent and the Grenadines) started implementing a three-year banana recovery plan in 1998, which included expanded irrigation and fertilization programs. Under the plan, private investment and fruit quality are being promoted through a reduction in price volatility and a premium price for quality fruit.

12. The **privatization program** also advanced in 1998-2000 with the divestment of the state-owned National Commercial Bank (NCB), while the Water and Sewerage Authority was restructured into a commercial company, WASCO.[8] As part of WASCO restructuring, the government implemented long delayed water rate increases (by 100 percent) effective January 1, 2000. Also, in 1999 WASCO repaid an outstanding debt to the central government with a commercial loan from an international bank.

III. Policy Discussions

13. Policy discussions were framed in the context of the government's medium-term strategy, which aims at restoring St. Lucia's historical growth rates of 4 to 5 percent per annum on the basis of strong private sector investment and the continued expansion of tourism, other services exports, and nontraditional agriculture. The discussions included the medium-term prospects of the banana sector which is under some uncertainties as to whether, and how extensive, a further retrenchment might be necessary in the period leading to the elimination of EU preferential tariffs, currently scheduled by 2006. While value added in the banana sector already has been reduced to less than 4 percent of GDP, a further significant contraction would adversely affect the prospects for economic growth.

14. For 2001, the authorities project real GDP growth of 3 percent, with tourism, wholesale trade, and other services rising slightly faster than in 2000, more than compensating for likely flat banana output. The authorities broadly agreed with the staff that in the near term, policies should be geared toward attaining a sustainable fiscal position with a strong public investment component, strengthening social programs, and moving forward with the completion of trade reform and the privatization of remaining public enterprises.

[8] The government maintains a minority ownership in the NCB. The electric power company (LUCELEC) became a private corporation in 1994 with minority government ownership.

A. Fiscal Policy

15. The authorities are currently working on their budget for FY 2001/02, which is to be presented to parliament in March 2001. They indicated that their recent efforts at raising central government revenue might be followed up with other initiatives, but were uncommitted as regards to the timing of the possible actions. A special government commission has been studying several of the recommendations made by the 1998 FAD technical assistance mission, and a report is expected in the first half of 2001; in addition, property taxes are being reviewed with a view to linking them more closely to property value, and draft legislation to this effect is to be presented in about 15 months.

16. On expenditure, the authorities saw a need to maintain a high level of public investment, and indicated that social expenditure may have to be increased in the near term, including on programs to assist displaced farmers in the banana sector. On public wages, the government recently granted retroactive salary increases to selective categories of employees (effective in the second half of the current fiscal year). In addition, a new three-year wage agreement is to be negotiated in the first half of 2001, and the authorities expressed some concern that these negotiations will likely be more difficult than the previous round in 1998, as workers are expected to link the recent higher inflation to their demands.

17. In the absence of additional measures in the forthcoming budget presentation, the staff projected that central government saving will be about 4½ percent of GDP in FY 2001/02 (similar to this year's level but lower than the 6 percent in 1998-99). On the basis of investment outlays at current levels, the deficit before grants would rise slightly to 4½ percent of GDP in FY 2001/02, and with the anticipated higher grants, the deficit after grants would drop to 2½ percent of GDP, from 3¼ percent in FY 2000/01.

18. The mission stressed **the need to restore the upward trend in the saving position of the central government**, and suggested to aim at attaining the saving level of around 7 percent of GDP called for in the government's own medium-term strategy report (presented at the biennial consultative group meeting held at the World Bank in June 2000). This level of saving, to be achieved over the next 2 years (which implies an adjustment of 2½ percentage points of GDP over the projected level), would help sustain a strong level of investment outlays (about 10 percent of GDP) within the framework of a deficit fully covered with grants and concessional and other multilateral financing.[9] This would permit to reverse the increase in the debt to GDP ratio observed in recent years.

19. To this end, actions on both revenue and expenditure would be required. The staff reiterated **the need for a comprehensive reform of the tax system**, in line with the recommendations by FAD. The main components of the reform should comprise (i) phasing

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[9] For the public sector as a whole, these targets would imply a saving rate of around 10 percent of GDP and investment outlays of about 12 percent of GDP.

out the existing extensive array of tax concessions, which as in other ECCB countries, continue to hinder revenue performance; (ii) adopting the VAT as the main instrument for indirect taxation, and as an intermediate step, further simplifying consumption taxes and expanding the base; and (iii) phasing out the system of fuel tax adjustments to permit domestic fuel prices to fully reflect changes in import prices (full adjustment of fuel prices to conform with current import prices would reduce the deficit by about 1 percent of GDP).

20. **On expenditure**, the staff urged the authorities to tighten current outlays, particularly the wage bill in the context of the upcoming wage negotiations. A cautious wage policy would help safeguard external competitiveness, given the public sector's leadership role in private sector wage setting behavior. In general, public sector wage increases should be based on merit and guided by economy-wide productivity gains; in this context, adopting a proposal advanced by ECCB for a tripartite wage-price-productivity council to help avoid wage-price inflation might be helpful. To avoid backward indexation, the staff recommended that wage increases not exceed the projected average rate of inflation. Furthermore, civil service streamlining should be pursued, aimed at increasing efficiency in the provision of services while providing incentives to recruit and retain qualified staff. Regarding public investment program, the staff supported the Caribbean Development Bank's assessment that it correctly emphasizes physical and social infrastructure to further enhance conditions for a strong level of private investment; nonetheless, there is a need to increase efficiency of individual projects by applying sound and strict selection criteria, and to ensure appropriate concessional and multilateral financing.

21. The authorities expressed broad agreement with the thrust of the mission's recommendations, but indicated that only a gradual approach at implementation would be feasible. They noted that discretionary tax concessions were being substantially narrowed, and that most remaining incentives were of a statutory nature, and subject to legislation; consumption taxes had been restructured with a reduction in the number of rates from 18 to 8, and the intention was to simplify them further to just 4 rates. While agreeing with the merits of the VAT, the authorities indicated that its adoption may require a concerted approach with other ECCB members, and the strengthening of administrative capacity (possibly with technical assistance). They acknowledged that fuel prices had not been raised sufficiently, in order to avoid social dislocations, but indicated that they would look at this issue again, probably in the second quarter of 2001 with more stable international oil prices, to determine if an additional upward adjustment was still warranted. The authorities stressed their efforts to control expenditure, including through improved selection criteria of investment projects, and indicated that a streamlining of the civil service was a desired objective, but could be attained only gradually through attrition.

22. Regarding the **public enterprises**, the authorities indicated that the restructuring of WASCO is expected to continue with the joint financial and technical assistance of the World Bank and the CDB, and reiterated their intention of an eventual privatization of the company. The staff noted that the increase in water rates adopted in January 2000 was an important step in the right direction, but in the view of the World Bank and the CDB a further financial strengthening will be necessary to improve the company's cash flow and the

upgrading of capital equipment. The authorities said that to improve WASCO's financial position, the government may assume part of its overall debt, and noted that to strengthen revenue performance, a program of metering had been initiated in March 2000 with completion expected by November 2001. Also, a US$6.7 million loan from the World Bank/CDB for metering and capital improvement is to be appraised shortly.

B. Monetary and Financial Issues

23. Under the fixed exchange rate system, the ECCB conducts its credit operations with the objective of maintaining strong foreign exchange cover for currency issue (currently close to 100 percent), leaving little scope for credit policy to the national governments. The ECCB maintains a uniform reserve requirement of 6 percent on all bank deposits.[10] Interest rates are freely determined, except for a statutory 4 percent floor on passbook savings maintained since 1984 aimed at benefiting small savers.

24. The ECCB is the regulatory and supervisory authority of banks in the region, and in its judgment, the banking system in St. Lucia remains basically sound.[11] However, the ECCB is constrained by law from disclosing bank soundness indicators, and this restriction prevents a proper assessment of compliance with the Basle Core Principles. The authorities recognize this limitation, and the ECCB Monetary Council has agreed to seek appropriate legislative amendments to permit such disclosure. They stressed that all banks meet minimum capital adequacy ratios and the share of nonperforming loans in the total loan portfolio of banks, which had increased during 1995–98 (mostly as a result of the difficulties in the banana industry), has stabilized at less than 13 percent since end-1998 (Table 6).

25. St. Lucia's nonbank financial institutions have grown rapidly in recent years, and some remain under the government's supervision.[12] While these institutions are required to submit their financial statements on a regular basis, they are not subject to on-site inspection. The staff stressed again the importance of strengthening supervision of nonbank financial institutions, possibly under the purview of the ECCB. The ECCB is currently considering a number of initiatives, on a regional basis, aimed at: (i) ensuring that these institutions meet capital adequacy standards and are subject to on-site inspection; (ii) strengthening their

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[10] For a description of the key aspects of ECCB credit policy and recent efforts to develop regional interbank and governments' securities markets, see the accompanying staff document "*ECCU: Recent Developments and Main Regional Policy Issues*" February 2001.

[11] Five of the seven commercial banks in St. Lucia are branches of multinational banks.

[12] Nonbank financial institutions comprise 24 insurance companies, 13 credit unions, and 5 finance companies, and hold 17 percent of assets and 7 percent of deposits of the financial system. Insurance companies are under the supervision of the Ministry of Finance, credit unions are under the Ministry of Cooperatives and Development, and finance companies are under the ECCB.

regulations and supervision according to international best practices; and (iii) possibly, extending to them the application of reserve requirements.

26. The authorities reiterated their intention to develop an offshore financial center (OFC), following legislation approved at the end of 1999. The offshore sector, which in recent months has grown to comprise eight service providers (designated as registered agents), 61 business companies, two insurance companies, and one international mutual fund, is under the supervision and regulation of the Ministry of Commerce. The staff emphasized the need for establishing a strong regulatory and supervisory framework for the OFC, preferably with an active role by the ECCB, and encouraged the authorities to follow up the current Module I self-assessment with subsequent modules in the process toward completing an FSAP in 2001. The authorities were disappointed over the FSF and OECD listings for low quality supervision and tax havens, but they welcomed the assistance provided by MAE, and expressed strong appreciation for the role the Fund was playing with impartiality on the assessment of regulations and supervision of offshore financial activities. They saw the assessment as an opportunity in their efforts to build a clean jurisdiction.

C. External Sector Prospects and Policies

27. St. Lucia is not expected to face any serious balance of payments pressures in the near term. The projected external current account deficit in 2001, at 12½ percent of GDP (which remains among the lowest in the ECCB area), would be similar to the average over the past four years, and is estimated to be fully covered with grants, multilateral financing, and continued foreign direct investment; FDI constitutes the bulk of private sector inflows.[13] Import growth is projected to pick up with the domestic activity and the continued construction and expansion in the hotel sector. Tourist earnings are expected to remain strong (as new facilities come on stream), although exports will be affected by lower banana revenues (with an anticipated further decline in international prices). St. Lucia's public external debt is projected to increase to 31 percent of GDP, and the debt service as a ratio of exports of goods and services to rise to 6 percent.

28. The authorities are aware that prospects for maintaining a strong balance of payments position in the medium term will depend largely on strengthening competitiveness in the export and tourism sectors. In the context of the fixed exchange rate, competitiveness depends crucially on continued fiscal discipline, wage moderation, and increased factor productivity. While information on productivity is scarce, St. Lucia does not appear to have a problem of export competitiveness, notwithstanding the recent real appreciation of the

[13] As in other ECCB countries, the size of St. Lucia's external current account deficit moves closely with the level of capital inflows. The import requirements of investment expenditure are very high because of the narrowness of the economic base, while the (imputed) official reserves have traditionally been maintained stable in relation to monetary aggregates.

currency.[14] Indeed, over the past 6 to 8 years St. Lucia has gained market share in the tourist sector within the Caribbean region with improved product quality and product differentiation (designed to attract the upper-end of the market), while wage cost increases have been comparatively more moderate. At the same time nontraditional agriculture and fisheries have grown rapidly in their close association with the strong tourist sector expansion. Furthermore, new activities in electronics assembly and information technology have shown growth potential and are increasingly becoming an important source of employment and exports.[15]

29. The authorities saw room for improving competitiveness through further productivity gains resulting from the ongoing restructuring in the banana sector (discussed below), reductions of telecommunication costs for the expanding services exports and continued trade reform. In telecommunications, a new operating license for Cable and Wireless for OECS countries starting in April 2001, together with new regulations by the recently established Eastern Caribbean Communications Authority (ECTEL), are expected to enhance competition and lower costs.[16] In the trade policy area, as mentioned above, St. Lucia completed the final phase of the CET reduction with the lowering of the maximum tariff rate to 20 percent. Because various import tariffs remain at rates above the maximum,[17] the average tariff rate fell only to 10.1 percent from a previous 10.4 percent, and the Fund's index of trade restrictiveness remained unchanged at 5. The staff urged the authorities to advance further with trade liberalization by narrowing the dispersion of tariff rates and continuing the process of phasing out import licensing. The staff also encouraged them to reduce the existing customs service charge to the cost of processing import transactions, as required by WTO guidelines. The authorities indicated that they are moving ahead with plans to phase out the system of import licenses required for the "negative list" of imports and replace them with tariffs, in accordance with WTO guidelines.[18]

[14] An index based on weights on country origin of tourist arrivals also shows a small currency appreciation since the mid-1990s, while a third index, comparing St. Lucia's prices with those of its Caribbean competitors in tourism, shows a real currency depreciation in the six-year period through 1998, which was partially reversed in 1999–2000. (Figure 3)

[15] See the accompanying staff document on selected issues, Chapter III "Nontraditional agriculture, Informatics and Economic Diversification in St. Lucia".

[16] With the support of the World Bank's OECS Telecommunications Reform Project, ECTEL was established in May 2000 with the aim of harmonizing the regulatory framework and enhancing competition in this sector in the region.

[17] The maximum tariff does not apply to agricultural products and arms/ammunition, which continue to be subject to maximum rates of 40 percent and 70 percent.

[18] The negative list of imports from outside the CARICOM covers 72 items and the list of imports from non-OECS countries that are subject to licensing covers 12 items.

30. As other ECCB countries, St. Lucia retains the policy of requiring approval by the Ministry of Finance of all single outward remittances above EC 250,000 (US$ 93,000). The Ministry of Finance routinely approves all bona fide requests above this threshold, except in cases where the individual or corporation making the request has outstanding tax liabilities. In such cases, the individual or corporation is required to make arrangements for the eventual clearance of tax arrears before the remittance is approved. The Fund's Legal Department has determined that this requirement, as it also applies to current international transactions, gives rise to an exchange restriction subject to approval by the Fund under Article VIII. The authorities stressed the fact that there is no restriction on all bona fide transactions, and that this measure is in place with the sole purpose of strengthening tax administration.

D. Structural and Social Issues

31. The authorities expressed cautious optimism on a successful consolidation of the **restructuring of the banana industry**, aimed at creating a streamlined and more efficient sector over the next few years. Banana growers will be under the pressure of increasing competition and weakening prices in the near term and some observers are of the view that a further significant retrenchment might take place before consolidation. However, the authorities and representatives of banana farmers believe that output would stabilize at around present levels on the basis of increasing acreage and labor productivity in the context of the ongoing Banana Recovery Plan for the Windward Islands.[19] They acknowledged, however, that a further displacement of banana farmers and their absorption into other agricultural activities will be necessary, but expressed confidence that the output loss will be more than offset, and with an improvement in quality, by the more efficient farmers. The resources provided under the EU's Special Framework of Assistance would be targeted for investment in irrigation and drainage and other infrastructure work (Box 2).

32. The authorities reiterated their intention to **privatize some state-owned companies**, in addition to WASCO, including the St. Lucia Development Bank (SLDB) and the Marketing Board (SLMB). They said that the divestment of the SLDB was to be completed in the near term, with the government most likely keeping a minority shareholding. As for the SLMB, the government will decide on the timing of its divestiture following completion of a study on options, which is to be funded by a grant from the EU.

33. With assistance from the CDB and the World Bank, the government is implementing a number of **social programs for reducing poverty and improving education and health services.** St. Lucia has traditionally maintained a relatively low incidence of poverty, although partial information point to a weakening in some of the social indicators in recent

[19] While the international price of bananas in the free market is projected to increase moderately over the medium term, the relevant price for St. Lucia's (and other Windward Islands') banana exports is likely to fall, as the preferential EU market is phased out by 2006.

Box 2. St. Lucia: EU Grants

1. **STABEX**: Under the system of stabilization of export earnings (STABEX), the EU has provided grants to the Windward Islands (Dominica, Grenada, St. Lucia, and St. Vincent and the Grenadines) since the late 1980s to compensate for losses in banana exports resulting from adverse weather conditions and/or unfavorable market developments. For each year in which export losses are incurred, the EU sets a STABEX allocation for each country and agrees with the government on its use. Since April 1998, the Framework of Mutual Obligations (FMO), governing the use of the STABEX allocations: (i) allows the use of funds for the public sector investment program; (ii) introduces macroeconomic conditions for their disbursement; and (iii) establishes an increase in the share of funds allocated to human capital, economic diversification, and poverty alleviation.

On December 1, 1998 the EU and St. Lucia signed the FMO governing the use of the 1996-1997 allocations totaling about € 12.6 million, of which € 10.2 million would be **budgetary support**, with the remainder being project support. The budgetary support was to be disbursed in three annual tranches. The first tranche (40 percent) was disbursed in December 1999 when the conditions specified in the FMO had been satisfied, including the attainment by the consolidated public sector in FY 1998/99 of saving of 7.0 percent of GDP, and the implementation of the fourth phase of the reduction of the CET of the CARICOM. The conditions for the disbursement of the second tranche (30 percent), expected before the end of FY 2000/01, include the commitment of 70 percent of the first disbursement; achieving central government and public sector saving of 3 percent of GDP and 7.8 percent of GDP, respectively, in FY 1999/2000; and ensuring that expenditures for education and health in FY 1999/2000 are at least at the same real level as in FY 1998/99. The release of the third tranche (30 percent), expected in FY 2001/02, is subject to an increase (of 0.2 percentage points of GDP) in both the savings of the central government and the overall public sector in FY 2000/01, utilization of 70 percent of the first and second tranches, and the same conditions for the expenditures on education and health in FY 2000/01 as for the disbursement of the second tranche.

2. **SFA**: In order to help the Windward Islands in the restructuring of their banana industries, the EU has established the Special Framework of Assistance (SFA). Under the SFA, St Lucia is being allocated € 8.5 million a year over 10 years beginning in 1999, subject to annual commitments. The EU has approved St. Lucia's strategic plan for the banana industry, and in September 2000 the EU and St. Lucia signed the first year agreement under the SFA for **projects** totaling € 8.5 million. Of this amount, € 5.2 million is earmarked to finance investments in irrigation and drainage in the banana industry (the EU has specified that only commercially-viable farmers will be targeted which implies displacement of some 1,000 farmers); € 1.5 million for agricultural diversification; and € 1.8 million, to fund social recovery programs that will provide safety net to facilitate the transition of displaced farmers into new areas of economic activities. The amount for the second year SFA would be € 8.9 million, of which € 8.0 million would be earmarked to the three categories mentioned above and the remainder to be used for technical assistance and monitoring.

years (St. Lucia ranked 88, of 175 countries, in the UN Human Development Index in 1998, compared with 56 in 1994). The authorities attributed this situation to the problem associated with the displacement of rural families in the banana areas. They said that social conditions had improved in the past two years with the expansion in social programs, which they thought were generally being carried out effectively, but noted that higher social investment will be needed in the near term to strengthen the provision of social services in the rural areas.

IV. Medium-Term Outlook

34. St. Lucia is expected to maintain a growth rate of at least 3 percent in the near term and has the potential to achieve growth rates of 4 to 5 percent per annum over the medium and long term, on the basis of a stabilized banana industry, and expanding tourism, other services exports, and nontraditional agriculture. These higher rates of growth will help to restore the upward trend in income per capita and reduce unemployment and poverty on a sustained basis.

35. The staff baseline projections assume the strengthening of public finances, in line with the authorities' medium-term strategy, the completion of trade reform and privatization programs, and the gradual improvement of social conditions through effective implementation of current social and poverty reduction programs. Growth of tourism and other services exports is assumed to rise gradually from 3 percent in 2000 to about 5 percent in 2005–06, on the basis of a slight further increase in regional market share; as regards the banana industry, a moderate weakening in export prices has been assumed (a decline of about 10 percent in nominal US dollar terms over 2001–06), which could be absorbed by higher productivity and quality improvements, with the result that output would be maintained at about current levels. Under this scenario, real GDP growth would rise from 2–3 percent in 2000–01 to about 4½ percent in 2006, with domestic investment rising by 4 percentage points of GDP to 30 percent and the external current account deficit stabilizing at close to 14 percent of GDP [20] (Table 7). The current account deficit would be financed with capital account surpluses, as private inflows increase in response to the improved conditions for private investment. The external debt of the public sector would decline from the equivalent of 31 percent of GDP in 2001 to 28 percent in 2006.

36. The sensitivity of the medium-term projections to weaker prospects in the banana and tourist sectors was tested. On an alternative assumption, that banana export prices fall more sharply (by some 15 percent in nominal terms) which cannot be fully absorbed by increases in productivity, and with an accompanying decline in output of some 20 percent from current levels by 2006, real GDP growth would be more than 1 percentage point less than in the baseline scenario, reaching about 3¾ percent in 2006. Tourism and export services are sensitive to economic conditions in the U.S. and Europe. Growth in these sectors by one percentage point lower than in the baseline scenario would slow overall output growth by about ¾ of one percentage point. The combination of declining banana output and slower

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[20] As in other small Caribbean islands, the ratio of domestic investment to GDP growth is relatively high and can show significant fluctuations from year to year because of scale indivisibilities and large overhead costs of infrastructure projects in relation to GDP.

tourism growth could result in a GDP expansion rate of less than 3 percent a year. In this case the current account deficit would stabilize at a lower level (11–12 percent of GDP), with slower growth of imports and less buoyant private investment and capital inflows.

V. Staff Appraisal

37. St. Lucia's economy is emerging from several years of sluggish growth, resulting from the retrenchment of the banana industry following the erosion of preferential access to the European market. While the industry may still undergo additional contraction, the process appears to be stabilizing as the economy moves increasingly toward tourism, other export services, and nontraditional agriculture. Output growth has picked up to annual rates of between 2 and 3 percent over the past three years and the unemployment rate, while still high at 16 percent, appears to be on a downward trend.

38. The authorities are working to restore higher and sustainable growth rates over the medium term on the basis of a continuing strengthening of national saving and private investment, which must be underpinned by solid public finances. In this context, the staff supports the strategy laid out in the government's medium-term strategy paper of June 2000, which calls for raising public sector saving to sustain the necessary strong levels of public infrastructure and social investment within a sound fiscal framework.

39. The public finances improved in 1998–99, although there has been some erosion in the current fiscal year, in large part because of weakening revenue performance, but also rising expenditure. The government has recently taken measures to prevent further revenue erosion, and the staff would advise the authorities to follow up in the period ahead with further revenue actions and strengthened expenditure policies. Efforts should be made to raise the buoyancy of the tax system by broadening its base. Key elements would be phasing out the still extensive array of tax concessions, eliminating the system of fuel tax adjustments in order to permit domestic fuel prices to fully reflect movements in import prices, and further simplifying indirect taxation, while moving toward the adoption of a value-added tax, possibly in the context of a region-wide system.

40. A cautious expenditure policy will be crucial to support fiscal consolidation. Current outlays of the central government need to be contained, in particular through a prudent wage policy based on merit and economy-wide productivity gains. It would be important to exercise utmost restraint on wage increases in the context of the upcoming three-year wage negotiations, as these usually provide a signal for economy-wide wage setting behavior. Moving forward with civil service reform, possibly gradually through attrition, as the authorities intend to do, while providing incentives to recruit and retain qualified staff, would help increase efficiency in the provision of services within a streamlined public sector. The public investment program appears well designed in its objectives and priorities, and the authorities are advised to monitor carefully the selection of individual projects to strengthen their effectiveness while ensuring their appropriate financing from public savings and noncommercial sources.

41. Completion of ongoing structural reforms will be important in the period ahead to strengthen the basis for higher growth. The orderly restructuring of the banana sector toward a streamlined and more efficient industry needs to be completed. This requires the support of public investment in irrigation and other infrastructure to help increase productivity, while improving social services to facilitate the absorption of released labor in other activities. Recent progress in trade reform should be further advanced by completing the process of phasing out remaining import licenses and moving toward establishing a low and uniform tariff rate. The financial position of the state-owned Water and Sewerage, WASCO, needs to be further improved, and in this context, the authorities are correctly pursuing the restructuring of the enterprise, with the assistance of the World Bank and the Caribbean Development Bank (CDB). This will help prepare WASCO for its planned privatization, which together with divestment of other public enterprises, would open new venues for private sector investment and improve economic efficiency.

42. Rapid growth of St. Lucia's financial system and the country's vulnerability to external shocks require close surveillance of banks and other financial institutions. The banking system remains sound in the judgment of the regional central bank, the ECCB, although this institution is prevented by law from disclosing bank soundness indicators. The authorities are advised to act without delay in securing approval of legislative amendments to permit a proper assessment of bank practices, including elimination of the prohibition on exchange of information that would ensure full compliance with the Basle Core Principles. Supervision of nonbank financial institutions needs to be strengthened, including through the possible transfer of supervisory responsibilities to the ECCB, and it would be important that the authorities move forward with the implementation of the recent ECCB initiatives of extending to these institutions the principles and practices currently applied to banks.

43. The authorities are fostering the development of an offshore financial center, and have expressed their intention to build a clean jurisdiction. To this end, it is of utmost importance to establish a strong supervisory and regulatory system. The staff would urge the prompt completion of the government's current review of the laws and regulations applicable to offshore sector, and to seek the proper amendments, as needed, to ensure compliance with best international practices. The authorities are encouraged to follow up their ongoing self-assessment module with the subsequent steps in the process toward participating in the ECCB area-wide FSAP expected to take place in late 2001.

44. Participation in the regional exchange rate arrangement has served St. Lucia well in maintaining low inflation, fostering prudent economic policies, and stimulating investor confidence. St. Lucia maintains an exchange restriction, arising from the requirement that arrangements for the clearance of any tax arrears be made before profit remittances above a threshold could be made. As no timetable has been set for removing this restriction, Fund approval for its retention is not proposed.

45. It is recommended that the next Article IV consultation continue to be held on the 24-month cycle.

Table 1. St. Lucia: Selected Economic and Financial Indicators

	1996	1997	1998	Prel. 1999	Est. 2000	Proj. 2001
(Annual percentage changes, unless otherwise specified)						
Output and prices						
Real GDP at factor cost	1.4	0.6	2.9	3.0	2.0	3.0
GDP at current market prices	1.2	2.6	7.2	4.7	6.1	5.6
GDP deflator at factor cost	0.1	2.4	2.2	2.3	4.0	2.5
Consumer prices (end of period)	-2.3	1.6	3.6	6.1	2.0	2.5
Unemployment rate	21.0	20.5	21.5	18.1	...	...
Banana production	0.1	-32.4	2.6	-10.9	7.4	0.0
Tourist stayovers	1.4	5.4	1.5	3.3	-2.0	1.5
External sector						
Exports, f.o.b.	-24.7	-18.6	0.2	-13.4	3.8	8.1
Imports, c.i.f.	-1.0	9.3	0.9	5.7	5.0	4.2
Travel (net)	1.7	7.7	10.1	-3.0	7.3	0.4
Terms of trade	0.5	5.6	8.6	3.9	5.6	2.7
Excluding tourism	-5.5	7.9	17.8	0.6	-0.7	0.5
Nominal effective exchange rate (end of period, depreciation -) 1/	1.3	6.6	-2.3	4.6	9.5	...
Real effective exchange rate (end of period, depreciation -) 1/	-3.4	6.4	0.5	8.5	4.2	...
Money and credit 2/						
Domestic assets (net)	11.9	8.9	0.6	9.5	4.8	7.9
Credit to public sector (net)	-0.9	-2.0	-6.0	-3.0	-2.1	-2.7
Credit to private sector	15.3	12.1	9.8	13.7	10.3	11.5
Money and quasi-money	1.8	6.7	11.9	8.4	9.0	9.0
Velocity of money (M2)	1.8	1.8	1.7	1.7	1.6	1.6
(In percent of GDP, unless otherwise specified)						
Nonfinancial public sector 3/						
Current balance	7.1	7.2	9.5	9.8	8.3	8.0
Capital outlays	6.5	6.5	8.4	10.5	10.2	10.5
Overall balance (before grants)	1.0	1.0	1.4	-0.5	-1.8	-2.4
Overall balance (after grants)	2.0	2.3	4.7	2.9	-0.8	-0.4
Saving and investment						
Gross national saving	11.2	11.0	13.6	12.7	12.4	13.5
Public	7.2	6.7	9.2	9.2	8.7	9.5
Private	4.0	4.3	4.5	3.5	3.7	3.5
Gross domestic investment	21.4	24.6	23.9	25.8	24.5	26.0
Public	6.8	6.4	8.4	10.0	10.3	10.0
Private	14.6	18.2	15.5	15.8	14.2	16.0
External sector						
Balance of payments current account balance	-10.2	-13.6	-10.3	-13.1	-12.1	-12.5
External debt (end of period) 4/	24.9	25.4	26.1	27.1	30.2	31.6
Debt-service ratio 5/	3.5	3.8	3.7	4.7	4.7	6.0
(In millions of U.S. dollars)						
GDP at currrent market prices	566.4	579.8	625.0	666.6	707.1	746.6
Change in net international reserves (increase -) 6/	6.9	-4.9	-9.5	-3.9	-6.0	-7.8

Sources: St. Lucian authorities; ECCB; and Fund staff estimates and projections.

1/ Data for 2000 refer to the 12-month period ending in October 2000.
2/ Changes in relation to liabilities to private sector at beginning of period.
3/ Data are for fiscal years beginning April 1. For 1999 and 2000, estimated on the assumption that the movements in rest of government and public enterprises will not deviate from past trends.
4/ Total public and publicly guaranteed debt.
5/ In percent of exports of goods and services.
6/ Imputed reserves at the ECCB.

Table 2. St. Lucia: Operations of the Central Government 1/

(As percent of nominal GDP at market prices)

	1996/97	1997/98	1998/99	Prel. 1999/00	Apr.-Nov. 2/ 1999	2000	Budget 2000/01	Proj. 3/ 2000/01	Proj. 3/ 2001/02
Total revenue and grants	**25.4**	**25.4**	**29.0**	**29.1**	**25.0**	**24.4**	**31.1**	**25.7**	**27.1**
Current revenue	**24.2**	**23.9**	**25.4**	**25.5**	**24.2**	**24.1**	**26.7**	**24.6**	**25.0**
Tax revenue	**21.4**	**22.2**	**23.4**	**23.0**	**21.7**	**21.5**	**22.7**	**22.6**	**23.0**
Taxes on income and profits	6.1	6.4	6.1	7.0	6.2	6.5	5.9	7.0	7.0
Taxes on property	0.1	0.1	0.1	0.0	0.0	0.1	0.3	0.1	0.1
Taxes on goods and services	8.7	9.4	11.0	9.9	9.2	8.9	10.6	9.5	9.9
Consumption taxes	6.6	6.6	8.2	6.7	7.0	5.2	7.0	5.3	5.7
Imports	6.0	5.9	7.5	6.1	6.3	4.5	6.4	4.6	5.0
Domestic goods	0.6	0.7	0.7	0.6	0.7	0.7	0.6	0.7	0.7
Hotel occupancy tax	0.9	0.9	1.0	1.0	0.9	1.1	1.1	1.3	1.3
Excises	0.1	0.1	0.1	0.3	0.0	1.4	1.2	1.4	1.3
Other	1.2	1.8	1.8	1.8	1.3	1.3	1.3	1.6	1.6
Taxes on international trade	6.5	6.2	6.2	6.1	6.1	6.0	5.9	6.0	6.0
Of which:									
Import duties	4.3	4.0	4.0	3.9	3.9	3.5	3.7	3.5	3.5
Service charge (imports)	1.9	2.0	1.9	1.9	1.9	1.8	1.9	1.8	1.8
Nontax revenue	**2.8**	**1.8**	**2.0**	**2.6**	**2.5**	**1.9**	**4.0**	**2.0**	**2.0**
Capital revenue	**0.2**	**0.1**	**0.3**	**0.1**	**0.2**	**0.0**	**0.3**	**0.0**	**0.1**
Capital grants	**1.1**	**1.4**	**3.3**	**3.4**	**0.6**	**0.3**	**4.1**	**1.0**	**2.0**
Total expenditure and net lending	**27.0**	**26.3**	**27.2**	**28.7**	**24.3**	**24.5**	**35.3**	**28.9**	**29.6**
Current expenditure	**20.6**	**20.2**	**19.4**	**19.6**	**19.1**	**18.7**	**20.3**	**19.9**	**20.6**
Wages and salaries	10.9	11.0	10.6	11.0	11.1	10.6	11.0	11.0	11.3
NIS contributions and retirement	0.9	1.5	1.3	1.7	1.7	1.9	1.5	1.5	1.5
Goods and services	4.6	4.2	3.9	3.7	3.2	3.4	4.2	4.0	4.0
Transfers	3.4	2.5	2.3	1.9	1.9	1.5	1.8	1.8	2.0
Interest payments	0.9	1.0	1.3	1.4	1.2	1.3	1.8	1.6	1.8
Domestic	0.5	0.5	0.8	0.9	...	0.9	1.0	1.0	1.0
External	0.4	0.5	0.4	0.5	...	0.4	0.8	0.6	0.8
Capital expenditure and net lending	**6.4**	**6.0**	**7.9**	**9.1**	**5.2**	**5.8**	**15.0**	**9.0**	**9.0**
Current balance	**3.6**	**3.7**	**6.0**	**5.9**	**5.1**	**5.4**	**6.4**	**4.7**	**4.4**
Overall balance (before grants)	**-2.7**	**-2.2**	**-1.5**	**-3.1**	**0.1**	**-0.4**	**-8.3**	**-4.3**	**-4.5**
Overall balance (after grants)	**-1.6**	**-0.8**	**1.8**	**0.3**	**0.7**	**-0.1**	**-4.2**	**-3.3**	**-2.5**
Memorandum item:									
Nominal GDP (in millions of EC dollars)	1538.3	1584.6	1715.7	1827.2	...	...	1935.9	1935.9	2043.3

Sources: St. Lucian authorities; and Fund staff estimates and projections.

1/ Data are for fiscal years beginning April 1.
2/ As percent of GDP for the eight-month period.
3/ Projections are based on the continuation of current policies.
4/ Includes treasury bills placed abroad and increase in foreign assets.

Table 3. St. Lucia: Operations of the Consolidated Public Sector 1/

(In percent of nominal GDP at market prices)

	1996/97	1997/98	1998/99	Prel. 1999/00	Proj. 2000/01
Total revenue and grants	**31.4**	**31.2**	**34.9**	**35.0**	**32.4**
Current revenue	30.0	29.6	31.3	31.4	31.3
Tax revenue	21.4	22.2	23.4	23.0	22.7
Nontax revenue	7.1	6.2	6.9	7.4	7.1
Operational surplus of public enterprises	1.5	1.2	1.0	1.0	1.5
Capital revenue	0.3	0.2	0.4	0.2	0.1
Capital grants	1.1	1.4	3.3	3.4	1.0
Total expenditure	**29.4**	**28.8**	**30.2**	**32.0**	**33.2**
Current expenditure 2/	22.9	22.3	21.8	21.5	23.0
Of which:					
Wages and salaries	11.3	11.4	11.1	11.4	11.4
Interest	1.6	1.6	1.8	1.9	2.1
Capital expenditure	6.5	6.5	8.4	10.5	10.2
Central government	6.2	6.0	7.9	9.1	9.3
Rest of general government	0.1	0.1	0.1	0.1	0.1
Public enterprises	0.2	0.4	0.5	1.3	0.8
Current balance	**7.1**	**7.2**	**9.5**	**9.8**	**8.3**
Central government	3.6	3.7	6.1	5.9	4.4
Rest of general government	2.7	2.7	3.0	2.9	2.8
Public enterprises	0.9	0.8	0.5	1.0	1.0
Overall balance before grants	**1.0**	**1.0**	**1.4**	**-0.5**	**-1.8**
Overall balance after grants	**2.0**	**2.3**	**4.7**	**2.9**	**-0.8**
Central government	-1.6	-0.8	1.8	0.3	-3.3
Rest of general government	2.6	2.6	2.9	2.8	2.9
Public enterprises	1.0	0.6	0.1	-0.2	1.1

Sources: St. Lucian authorities; and Fund staff estimates and projections.

1/ The public sector comprises the central government, the Castries City Council, the National Insurance Scheme, and four nonfinancial public enterprises.

2/ Refers to central government, the Castries City Council, and the National Insurance Scheme only, except for interest payments which refer to public enterprises as well.

Table 4. St. Lucia: Monetary Survey

	Dec. 31					
	1996	1997	1998	1999	Est. 2000	Proj. 2001
	(In millions of Eastern Caribbean dollars)					
Net foreign assets	**11.8**	**-7.0**	**92.6**	**81.4**	**128.3**	**149.4**
Net (imputed) international reserves	146.1	159.4	185.0	195.6	211.8	232.9
Commercial banks	-134.3	-166.4	-92.4	-114.2	-83.5	-83.5
Net domestic assets	**817.2**	**891.4**	**896.8**	**990.9**	**1040.5**	**1124.6**
Domestic credit	868.1	968.0	996.7	1114.5	1203.5	1287.6
Net credit to the public sector	-141.6	-158.5	-211.5	-241.1	-263.6	-293.6
Claims on government (net)	-15.7	-23.8	-40.2	-65.8	-82.6	-96.6
ECCB net credit to central government	24.1	13.6	10.9	5.9	2.4	2.4
Commercial bank net credit to government	-39.8	-37.3	-51.1	-71.7	-85.0	-99.0
Net credit to other public sector	-125.9	-134.7	-171.3	-175.4	-181.0	-197.0
Credit to nonbank financial institutions	-61.5	-45.3	-49.9	-38.6	-38.6	-50
Credit to private sector 1/	1071.3	1171.8	1258.2	1394.2	1505.7	1631.3
Other items (net)	-50.9	-76.7	-100.0	-123.5	-163.0	-163.0
Money and quasi-money (M2) 2/	**829.0**	**884.3**	**989.4**	**1072.3**	**1168.8**	**1274.0**
Money	225.7	239.3	247.9	267.6	289.0	312.1
Currency outside banks	70.3	69.6	77.5	84.1	90.8	98.0
Demand deposits	155.4	169.6	170.4	183.6	198.2	214.1
Quasi-money	603.3	645.1	741.5	804.7	879.8	961.9
Time deposits	186.1	217.6	273.6	292.2	319.5	349.3
Savings deposits	417.2	427.4	467.9	512.5	560.3	612.6
	(12-month change in percent of M2 at beginning of the year)					
Net foreign assets	-10.1	-2.3	11.3	-1.1	4.4	1.8
Net imputed reserves	-2.3	1.6	2.9	1.1	1.5	1.8
Commercial banks NFA	-7.8	-3.9	8.4	-2.2	2.9	0.0
Net domestic assets	11.9	8.9	0.6	9.5	4.6	7.2
Domestic credit	11.8	12.1	3.2	11.9	8.3	7.2
Net credit to public sector	-0.9	-2.0	-6.0	-3.0	-2.1	-2.6
Credit to nonbank financial institutions	-2.6	2.0	-0.5	1.1	-0.3	0.0
Credit to private sector	15.3	12.1	9.8	13.7	10.4	10.8
Other items (net)	0.1	-3.1	-2.6	-2.4	-0.1	1.1
	(12-month percentage change)					
Credit to private sector	13.2	9.4	7.4	10.8	8.0	8.3
Money and quasi-money	1.8	6.7	11.9	8.4	9.0	9.0
Money	-5.9	6.0	3.6	8.0	8.0	8.0
Quasi-money	5.0	6.9	14.9	8.5	9.3	9.3
Memorandum item:						
Income velocity of M2	1.8	1.8	1.7	1.7	1.6	1.6

Sources: ECCB; and Fund staff estimates and projections.

1/ Includes assumption by government of EC$40 million in debt from the SLBGA in 1998, previously included under credit to the private sector.

2/ Excludes private sector foreign currency deposits, which in this presentation are recorded under other items (net) of the net domestic assets.

Table 5. St. Lucia: Summary Balance of Payments

	1996	1997	1998	Prel. 1999	Est. 2000	Proj. 2001
	(In millions of U.S. dollars)					
Current account	**-57.7**	**-79.1**	**-64.5**	**-87.5**	**-85.8**	**-93.3**
Trade balance	-181.1	-222.2	-224.7	-251.1	-264.3	-282.8
Exports, f.o.b.	86.3	70.2	70.4	60.9	63.3	64.6
Imports, f.o.b.	267.4	292.4	295.1	312.0	327.6	347.4
Services (net)	110.2	130.1	140.7	141.6	156.7	167.6
Receipts	270.2	291.7	317.2	316.1	333.0	355.3
Travel	236.6	253.3	277.6	272.6	288.9	308.8
Other nonfactor services	30.2	35.1	36.2	41.1	41.6	43.9
Factor services	3.4	3.3	3.4	2.4	2.5	2.6
Payments	160.0	161.6	176.5	174.5	176.3	187.6
Travel	28.8	29.5	31.2	33.0	35.0	36.9
Other nonfactor services	91.8	91.2	98.1	100.2	101.0	104.5
Factor services	39.4	41.0	47.2	41.4	40.4	46.2
Of which:						
Interest payments	5.1	5.6	6.9	7.5	8.2	12.2
Current transfers (net)	13.2	13.0	19.5	22.0	21.9	21.9
Capital and financial account	**50.8**	**84.1**	**74.0**	**91.4**	**100.5**	**101.1**
Capital transfers (net)	10.4	15.6	22.4	24.9	9.7	15.3
Official borrowing (net)	16.0	10.5	16.0	15.1	32.9	17.7
Drawings	19.6	12.5	15.7	24.1	19.6	30.7
Amortizations	4.4	4.8	7.0	8.6	10.3	13.1
Bonded debt (net)	0.8	2.8	7.3	-0.4	23.5	0.0
Private capital 1/	24.4	58.0	35.6	51.4	57.9	68.2
Overall balance	**-6.9**	**4.9**	**9.5**	**3.9**	**14.6**	**7.8**
Change in imputed reserves (increase -)	6.9	-4.9	-9.5	-3.9	-14.6	-7.8
	(In percent of GDP)					
Memorandum item:						
Current account balance	-10.2	-13.6	-10.3	-13.1	-12.1	-12.5

Sources: St. Lucian authorities; ECCB; and Fund staff estimates and projections.

1/ Includes errors and omissions.

Table 6. St. Lucia: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	Est. 2000	Proj. 2001
Financial indicators						
Broad money (percent change, 12-month basis)	1.8	6.7	11.9	8.4	9.0	9.0
Private sector credit (percent change, 12-month basis)	13.2	9.4	7.4	10.8	8.0	8.3
Nonperforming loans (3 months and over)/total loans (percent) 1/	6.5	8.9	10.7	12.8	12.4	...
(Average nonperforming loans for other ECCB countries)	15.2	14.9	...	14.6	...	...
Capital/risk weighted assets (percent) 1/	11.6	10.4	8.7	15.6	13.4	...
Three-month T-bill rate 2/	7.0	7.0	7.0	7.0	7.0	...
Three-month T-bill rate (real) 3/	9.3	5.4	3.4	0.9	2.0	...
External indicators						
Exports of goods and services (percent change, 12-month basis, in US$)	-7.5	1.5	7.1	-2.7	5.1	6.0
Imports of goods and services (percent change, 12-month basis, in US$)	-1.0	6.2	3.9	3.2	3.6	6.2
Current account balance	-10.2	-13.6	-10.3	-13.1	-12.1	-12.5
Capital and financial account balance	9.0	14.5	11.8	13.7	14.2	13.5
Gross official reserves (in US$ millions)	54.1	59.0	68.5	72.5	78.5	86.3
Net reserves to broad money (percent)	17.6	18.0	18.7	18.2	18.1	18.3
Total public external debt	24.9	25.4	26.1	27.1	30.2	31.6
Total external debt to exports of goods and services (percent) 4/	39.6	40.7	42.1	47.9	53.9	56.2
External interest payments to exports of goods and services (percent) 4/	1.4	1.5	1.8	2.0	2.1	2.9
External amortization payments to exports of goods and services (percent) 4/	1.2	1.3	1.8	2.3	2.6	3.1
External interest payments to fiscal revenue (percent) 4/	3.7	4.0	4.4	4.4	4.7	6.6
External amortization payments to fiscal revenue (percent) 4/	3.2	3.4	4.5	5.1	5.9	7.0
Exchange rate (per US$, end of period)	2.7	2.7	2.7	2.7	2.7	...
REER appreciation (12-month basis) 5/	-3.4	6.4	0.5	8.5	4.2	...
Travel receipts to exports of goods and services (percent)	66.4	70.0	71.6	72.3	72.9	73.5

Sources: St. Lucian authorities; ECCB; and Fund staff estimates and projections.

1/ For 2000, refers to end-June 2000.
2/ Average rate of discount (end of period).
3/ T-bill rate adjusted for actual year-on-year inflation.
4/ Refers to public sector debt.
5/ For 2000, 12-month change to October 2000.

Table 7. St. Lucia: Medium-Term Outlook

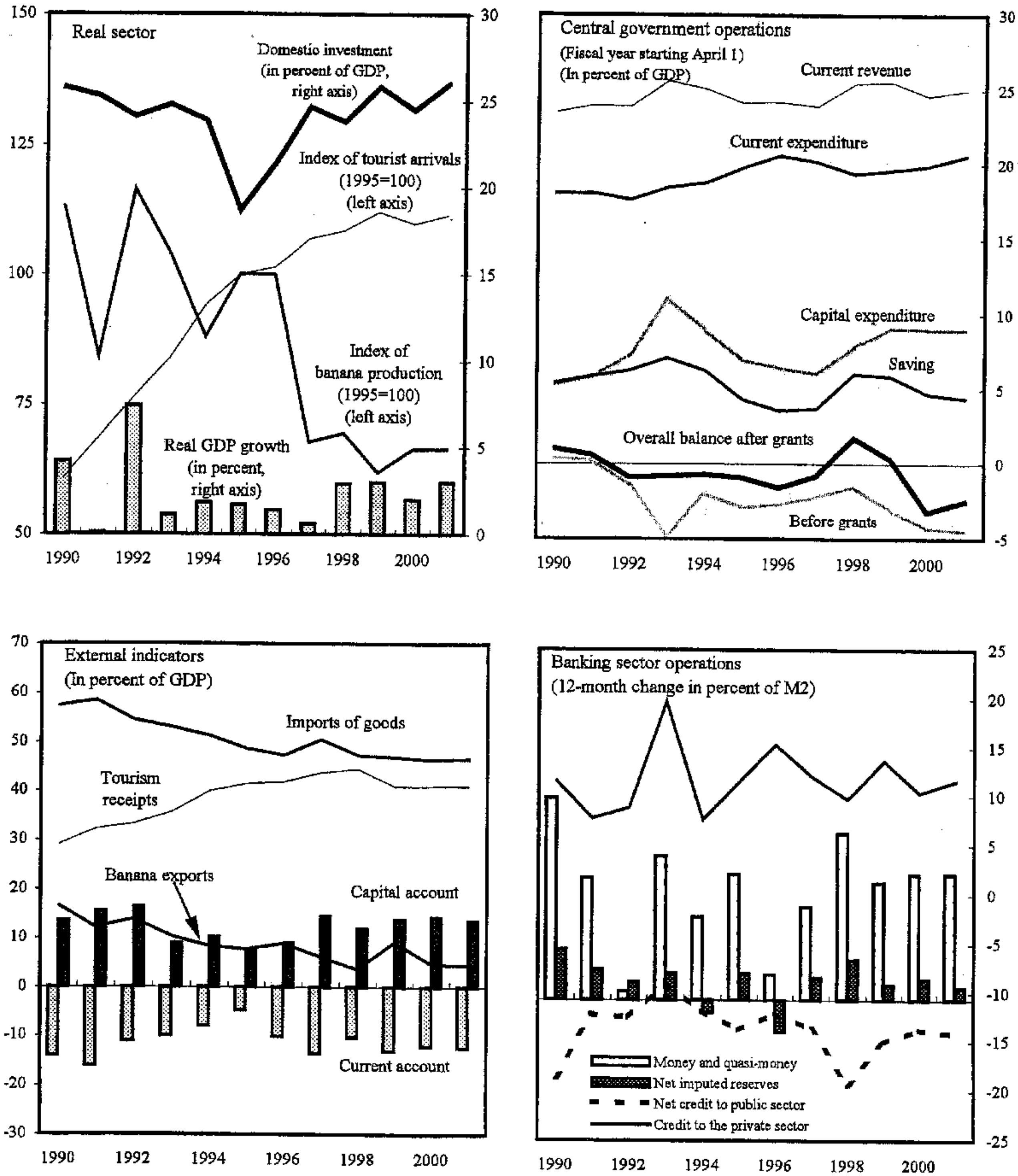
	Average 1998-99	Est. 2000	Projections 1/ 2001	2002	2003	2004	2005	2006
Real GDP growth	**3.0**	**2.0**	**3.0**	**3.3**	**3.7**	**4.3**	**4.4**	**4.6**
			(In percent of GDP)					
Saving and investment								
Gross domestic investment	24.9	24.5	26.0	27.0	28.0	28.7	29.5	29.5
Public	9.2	10.3	10.5	10.8	11.2	11.5	12.0	12.0
Private	15.7	14.2	15.5	16.2	16.8	17.2	17.5	17.5
National saving	13.1	12.4	13.5	14.0	14.7	15.2	15.7	15.7
Public	9.2	8.7	9.2	9.5	9.5	9.8	9.8	9.8
Private	3.9	3.7	4.3	4.5	5.2	5.4	5.9	5.9
Public sector 2/								
Overall balance (before grants)	0.5	-1.8	-2.4	-2.7	-3.0	-3.2	-3.4	-3.6
Grants	3.4	1.0	2.0	2.0	2.0	2.0	2.0	2.0
Central government saving	6.0	4.7	5.3	6.0	6.5	7.0	7.0	7.0
Current revenues	25.5	24.6	25.9	26.5	27.0	27.0	27.0	27.0
Current expenditure	19.5	19.9	20.6	20.5	20.5	20.0	20.0	20.0
External sector								
Current account	-11.7	-12.1	-12.5	-13.0	-13.3	-13.5	-13.8	-13.8
Of which:								
Exports of goods and services	59.3	56.0	56.2	56.4	56.7	57.3	57.9	58.4
Imports of goods and services	74.2	71.3	71.7	72.2	72.6	73.2	74.0	74.4
Capital and financial account	12.8	14.2	13.5	13.6	13.8	14.0	14.3	14.5

Sources: St. Lucian authorities; ECCB; and Fund staff estimates and projections.

1/ Projections for 2001-2006 are based on improved fiscal policies.

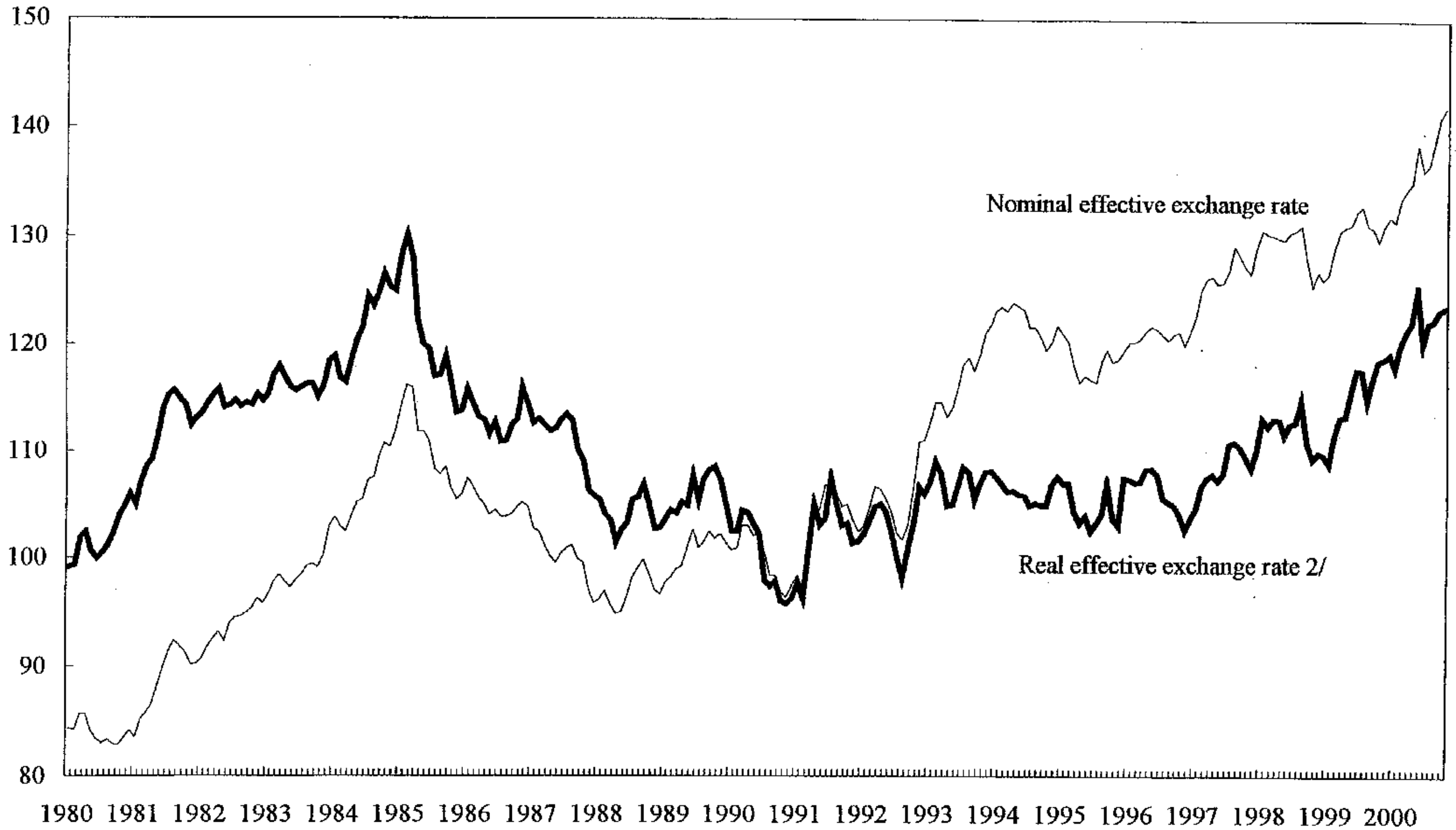
2/ Data are for fiscal years beginning April 1. Data for overall balance (before grants) refer to the public sector as a whole.

Figure 1. St. Lucia
Selected Economic Indicators



Sources: St. Lucian authorities; and Fund staff estimates and projections.

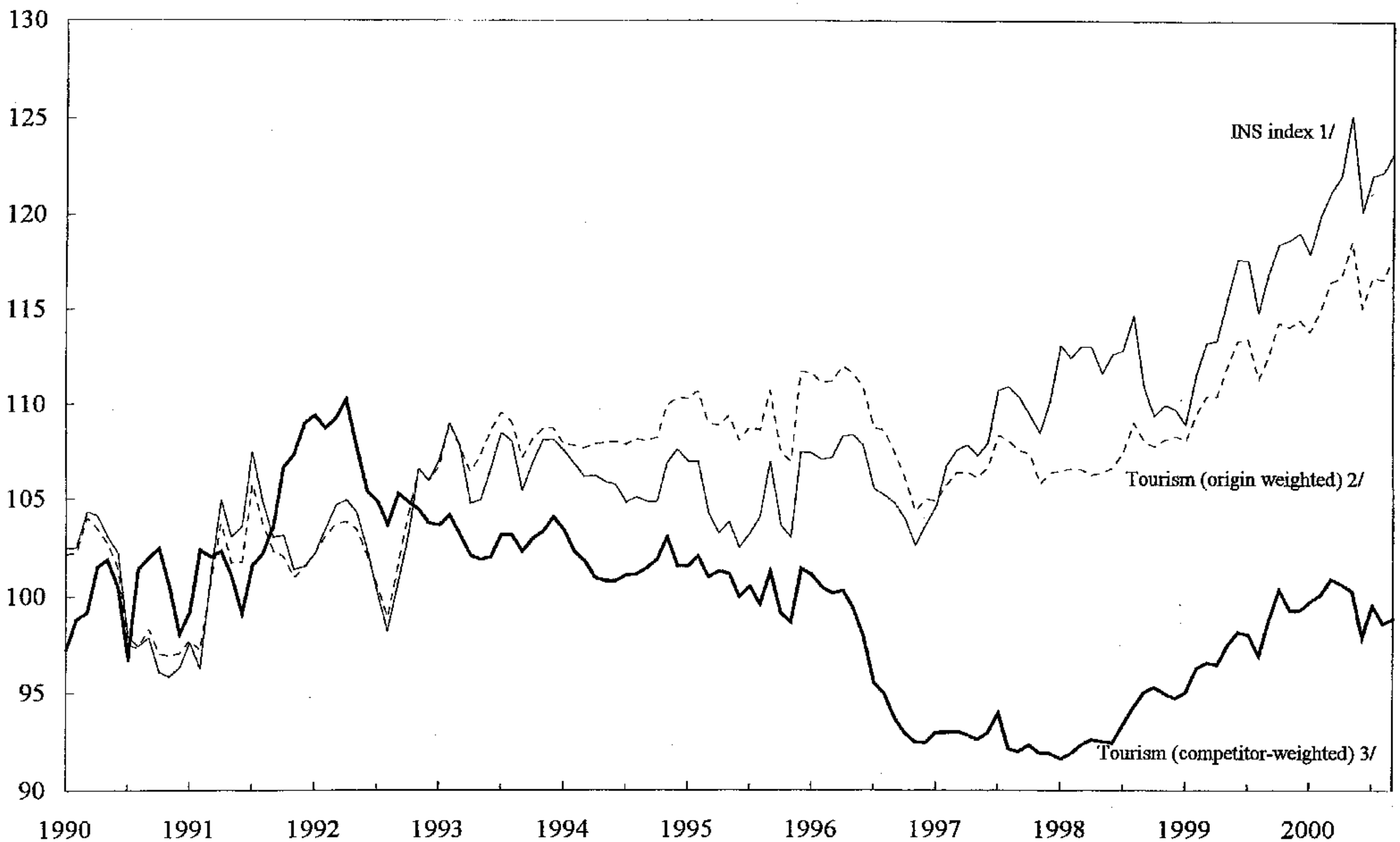
Figure 2. St. Lucia: Exchange Rate Developments, 1980-2000 1/
(1990=100)



Source: IMF Information Notice System.

1/ An increase in the exchange rate indices indicates an appreciation.
2/ The real effective exchange rate is estimated as a trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices.

Figure 3. St. Lucia: Real Effective Exchange Rates
(1990=100)



Sources: Information Notice System; and Caribbean Tourism Organization.

1/ IMF Information Notice System; weights based on merchandise trade and tourism.
2/ Weights based on origin of tourist arrivals in 1993-98.
3/ Weights based on stayover arrivals in 1993-1998, by country of destination in the Caribbean.

St. Lucia: Fund Relations
(As of December 31, 2000)

I. Membership Status:
Joined: 11/15/79
Status: Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	15.3	100.0
Fund holdings of currency	15.3	100.0
Reserve position in Fund	0.0	0.0

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	0.74	100.0
Holdings	1.43	193.3

IV. Outstanding Purchases and Loans:
None

V. Financial Arrangements:
None

VI. Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):
None

VII. Exchange Rate Arrangement:
Since July 1976 the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC$2.70 per US$1.

VIII. Article IV Consultation:
The last Article IV consultation was concluded by the Executive Board on March 23, 1999 (SM/99/57 and SM/99/76). St. Lucia is on the 24-month consultation cycle.

St. Lucia: Relations with the World Bank Group
(As of December 28, 2000)

I. Projects

There are currently four ongoing World Bank projects in St. Lucia, with net commitments of approximately US$21.5 million; one project was recently completed. Three of these projects are part of the OECS subregional programs of the World Bank.

The **Basic Education Reform Project**, approved in FY1995 for US$6.7 million, closed on October 31, 2000 having disbursed US$5.8 million. The overall objective of this project was to develop the requisite manpower to attain economic transition in St. Lucia. It supported the first stage of a major reform of basic education, aimed at increasing the efficiency and effectiveness of the education system, and at enhancing equity of access to educational opportunities.

The **OECS Solid Waste/Ship Generated Waste Management Project**, approved in FY1995, aims to reduce public health risks and protect the environmental integrity of the OECS countries and their coastal and marine systems by improving solid waste management systems. The total regional financing for these projects is US$41 million. The St. Lucia component is US$7.8 million—US$4.6 million from the World Bank, US$1.2 million from the Global Environment Facility, and US$2.0 million from the Caribbean Development Bank.

The **OECS Telecommunications Reform Program,** approved in FY1998 for US$6 million, aims to introduce pro-competition reforms in the telecommunications sector and increase the supply of informatics-related skills in the five OECS borrowing countries—Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The project has assisted the OECS countries negotiate with the subregional telecom monopoly for less one-side contract and lower long distance and regional telephone rates. The St. Lucia component is US$1.2 million.

The St. Lucia **Disaster Management Project**, approved in FY1999, is part of a regional program for the five OECS borrowing countries to fortify, reconstruct, and/or rehabilitate key economic and social infrastructure and facilities, in order to minimize damage or disruption caused by future natural and man-made disasters, and to speed emergency recovery following such disasters. Additionally, the project is expected to strengthen the countries' institutional capacity to prepare for and respond to disaster emergencies efficiently and effectively. The total program size is US$46 million, and the St. Lucia component is US$6 million.

The **Poverty Reduction Fund**, approved in FY2000 for US$3 million, aims to develop the institutional and operational framework for a social fund, and pilot its ability to provide quality basic social and economic infrastructure and services to St. Lucia's vulnerable poor. The project will thus contribute to a sustainable infrastructure, fostering community-led development.

The lending for the remainder of FY2001 includes a US$2.3 million dollar project for technical assistance for water sector reform, strengthening the institutional capacity of St. Lucia's Water and Sewerage Company; and a regional CARICOM HIV/AIDS program, of which US$3–5 million will be allocated to St. Lucia.

Lending to St. Lucia in FY2002 is expected to consist of a subregional OECS Education Program (US$18–20 million for three countries), of which US$9–11 million will be allocated to the country; and a US$6 million seven country subregional Catastrophe Reinsurance Program, of which about US$0.9 million will be apportioned to St. Lucia.

II. Financial Relations

As of December 28, 2000
(In millions of U.S. dollars)

Operations	Principal	Disbursed	Undisbursed
OECS Waste Management	4.6	0.2	4.4
OECS Telecommunications Reform	1.2	0.2	1.0
Disaster Management	6.0	0.6	5.4
Poverty Reduction Fund	3.0	0.4	2.7

Disbursements and debt service (fiscal year ending June 30)

	Actual								Projections	
	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total disbursements	3.6	0.6	1.0	4.3	1.5	3.3	1.7	1.9	1.6	2.5
Repayments	0.0	0.0	0.0	0.2	0.2	0.2	0.2	0.4	0.6	1.1
Net disbursements	3.6	0.6	1.0	4.1	1.3	3.1	1.5	1.5	1.0	1.4
Canceled	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest and fees	0.0	0.1	0.1	0.2	0.3	0.3	0.4	0.5	0.3	0.5

III. Economic and Sector Work (ESW)

The Bank is working on a number of ESW programs (involving no disbursements) of direct relevance to St. Lucia: (a) the work on Small States that has led to ESW on catastrophic insurance, volatility of consumption, and information technologies; (b) the development of technical papers on four key themes—tourism and the environment, risk diversification, governance, and education—that were discussed together at the June 2000 CGCED meeting; (c) the Eastern Caribbean Regional Institutional Review, which aims to explore ways to enhance the institutional capacity of the OECS countries to provide good governance, deliver high quality public services, and meet emerging challenges effectively and at the lowest possible cost; and (d) Country Assistance Strategy for the Eastern Caribbean (under preparation).

St. Lucia: Relations with the Caribbean Development Bank
(As of December 31, 2000)

CDB's operations in St. Lucia have been designed to support the economic and social development efforts of the government by financing priority capital projects, providing technical assistance and engaging in policy dialogue on key development issues. Guided by its mandate and the development objectives of the government, the CDB has collaborated with St. Lucia in such areas as: (i) the formulation and implementation of macroeconomic, social, and sectoral policies geared towards providing a framework for growth; (ii) infrastructure development to facilitate private sector investment; (iii) human resource development to facilitate economic growth and diversification and the reduction of poverty; (iv) direct and indirect lending to agriculture, tourism, and manufacturing; (v) environmental protection to promote sustainable development; and (vi) poverty reduction.

St. Lucia is the second largest user of CDB resources, accounting for $181.3 million (10.4 percent) of net cumulative loans, contingent loans, equity, and grants approved since 1970. Of this amount, $84.7 million were provided from the Ordinary Capital Resources while the remainder was from "soft" resources. At the end of December 2000, St. Lucia had a total outstanding balance of $75.4 million on some 43 loans representing 9 projects under implementation (Rural Enterprise Development, Student Loan Scheme (5^{th} Loan), Industrial Estate (8^{th} Loan), Consolidated Estate (4^{th} Loan), Basis Education 1, Consolidated Line of Credit (5^{th} Loan), OECS Solid Waste Management Project, Consolidated Line of Credit (6^{th} Loan), and Disaster Mitigation) and 34 operational projects.

Capital projects accounted for $171.3 million of the total resources going to St. Lucia between 1970 and 1999. Of this amount, the largest portion (28.7 percent) went to the transportation sector, including two Road Improvement and Maintenance Projects (RIMP) and the Roads Program approved in December 1999. At the end of 1999, St. Lucia was the second largest recipient of resources for the education sector, and education accounted for 17.1 percent of total capital project flows to St. Lucia, reflecting, *inter alia*, the approval of $4.2 million for the Basic Education Project. The manufacturing sector accounted for 15.7 percent of total capital projects, mainly for the construction of factory shells. The table below presents the sectoral distribution of CDB's financing of capital projects in St. Lucia.

Sectoral Distribution of Capital Projects, 1970–1999

Sectors	In Millions of U.S. Dollars	In Percent
Transportation	49.2	28.7
Education	29.3	17.1
Manufacturing	26.9	15.7
Agriculture	19.1	11.1
Water	13.6	7.9
Tourism	10.3	6.0
Housing	8.2	4.8
Health	5.6	3.3
Power and energy	1.3	1.0
Multisector	7.8	4.2
TOTAL	171.3	100.0

St. Lucia: Statistical Issues

The periodicity, timeliness, coverage, and quality of the statistical information reported to the Fund for surveillance have improved in some areas. However, data deficiencies particularly in national accounts, government finance, and balance of payments, continue to hamper to some extent economic analysis and policy formulation. In addition, comprehensive and regular labor statistics are not available. The Ministry of Finance publishes annually an economic and social review, which includes statistics covering developments in all macroeconomic sectors. The Eastern Caribbean Central Bank (ECCB) publishes a quarterly economic and financial review and an annual balance of payments for each member country.

Recently, St. Lucia completed requirements for participation in the Fund's General Data Dissemination System (GDDS) when it posted its metadata on the Dissemination Standards Bulletin Board. The metadata include detailed plans for statistical development in the main macroeconomic areas in the short and medium term.

Real sector

The authorities are developing a new methodology for the computation of the GDP, aimed mainly at obtaining better sectoral estimates. However, the process is being stymied by data collection problems. Attempts are being made to compile quarterly GDP estimates with funding from the OAS. Given the increasing importance of tourism activities, a new comprehensive survey of the sector seems necessary to establish key data, such as average length of stay in different types of accommodations and average daily expenditure by type of tourist arrivals. This information should then be cross checked with other related activities, i.e. restaurants and transportation, to ensure consistency. Work on updating the base year for the CPI, currently 1984, is expected to be completed by mid-2001. Finally, better labor statistics are needed, in particular, on private and public employment and wages.

Public sector finance

Reporting of the central government data has improved substantially over the last few years, but some major deficiencies remain in the rest of the public sector. The authorities are now reporting monthly central government's current revenue and expenditure using a Fund-compatible economic classification, and with lags of one to two months. However, the frequent large revisions to the figures after they are first reported suggest that further improvements in the quality of monthly data are needed. With regard to the rest of the public sector, the periodicity and timeliness of its data should be improved; annual statements and projections are currently obtained directly from each entity during Fund missions and consolidated public sector accounts are compiled by the Fund staff. No fiscal data are reported to STA for publication in the *GFS Yearbook* or in *IFS*.

Money and banking

The ECCB compiles monthly data on commercial banks with a lag of about six weeks. The information is reliable and is reported on a regular basis. Data for a group of nonbank financial intermediaries are compiled by the Ministry of Finance with a lag of about three months and reported on an irregular basis.

Balance of payments

Balance of payments data are compiled by the ECCB on an annual basis. The ECCB has recently reported to the Fund data covering the period 1992–99. Although these data provide a more detailed breakdown of goods than in the past, in other areas they do not follow the standard classification used in the fifth edition of the *Balance of Payments Manual*, particularly services, income, current transfers, direct investment, and other investment. The data have yet to be published, pending resolution of these classification issues. In general, enhanced data sources and better compilation procedures are needed to improve the accuracy, realiability, and timeliness of the balance of payments statistics. Efforts should also be made to compile a quarterly balance of payments.

External debt

The Ministry of Finance has a comprehensive database for public and publicly guaranteed external loans that provides detailed and reasonably up-to-date breakdowns of disbursements and debt service. Information on bonds placed abroad is compiled annually and monthly data are provided only at the staff's request. Recently, the quality of information on these bonds has weakened as the disaggregation between resident and nonresident holders was discontinued. It would be useful to restore this disaggregation.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/32
FOR IMMEDIATE RELEASE
March 29, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with St. Lucia

On March 7, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with St. Lucia.[1]

Background

After a period of slow growth in the mid-1990s, mainly due to a decline in banana output, economic growth has improved since 1998. In 1998–99, real GDP rose by an average of 3 percent a year, as banana production largely stabilized (despite adverse effects from a drought in 1999) and trade and construction activity expanded rapidly with the large renovation and expansion of hotels and tourist facilities. The growth rate in 2000 is estimated to have been between 2 and 2½ percent, as growth in tourism and domestic investment moderated. The unemployment rate, which had peaked at 21½ percent in 1998, fell to 15½ percent in 2000, while 12-month inflation eased to low single digits.

After several years of weak performance, the public finances improved in 1998/99. Notwithstanding a strong increase in investment spending, the deficit of the central government after grants shifted to small surpluses in FY 1998/99 and FY 1999/2000, from a deficit averaging 1¼ percent of GDP in the previous two years. Central government saving rose by 2½ percentage points to 6 percent of GDP in FY 1998/99 and FY 1999/2000, as revenue was boosted with new tax measures and current outlays were tightened. Despite recent improvements, the underlying fiscal position has remained fragile. In FY 2000/01, saving of the central government is projected to weaken and the overall balance

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the March 7, 2001 Executive Board discussion based on the staff report.

after grants to shift to a deficit of about 3 percent of GDP. Revenue was adversely affected by delays in fuel price adjustments in line with fuel import costs, and expenditures have increased in terms of GDP. The government recently took measures to prevent further revenue erosion (including a partial adjustment of fuel prices and an increase in consumption taxes).

In a sign of continued financial deepening (similar to other Eastern Caribbean Central Bank (ECCB) countries), since 1998, monetary aggregates and bank credit to the private sector continued to expand at rates somewhat faster than nominal GDP, though with some slowdown in 2000, while the public sector continued to build up deposits with the banking system. Somewhat later than in other territories in the ECCB area, St. Lucia enacted legislation in December 1999 permitting the establishment of offshore financial institutions. Following a visit by a Fund technical assistance team in early November 2000, the authorities began participating in Module I (self-assessment) of the Fund's offshore financial program.

Following a decline in 1998, the external current account deficit widened again to about 13 percent of GDP in 1999, reflecting a higher trade deficit owing mainly to lower banana exports and no improvement in the services account. In 2000, the current account deficit is estimated to have declined to about 12 percent of GDP, as import growth moderated while tourist receipts picked up. The current account deficits (among the lowest in the ECCB area) have been more than covered since 1998 by surpluses in the capital account, which have included rising private direct investment flows and, in 2000, an increase in official borrowing.

Executive Board Assessment

Executive Directors welcomed the recent strengthening of the St. Lucian economy and the reduction in unemployment, stemming from the stabilization of banana production and the development of tourism along with related activities. They stressed that further diversification and enhancements to international competitiveness are needed to permanently raise long term growth and to reduce the external vulnerability of the economy, particularly in light of the market uncertainties facing the crucial banana industry. This called for fiscal discipline and perseverance with structural reforms to raise national savings and investment, and to preserve macroeconomic stability.

While complimenting the authorities for their efforts to improve the public finances since 1998, which had resulted in higher public sector savings, Directors observed that the fiscal position remains fragile and strongly recommended that additional steps be taken to increase revenue and tighten expenditure controls. They supported a comprehensive tax reform to broaden the tax base, which would phase out tax concessions, and would introduce either a value-added tax or a simpler sales-based tax. Directors also advised the authorities on the need to phase out the system of fuel tax adjustments to permit domestic fuel prices to fully reflect changes in import prices.

Directors considered wage restraint to be a crucial element of expenditure control and international competitiveness. They urged moderation in adjusting wages during upcoming public sector wage negotiations to contain current expenditure as well as to provide an appropriate signal for wages in the private sector. Directors noted that the public investment program appeared to be sound, and advised the authorities to carefully monitor the selection of projects and limit financing to public savings and noncommercial borrowing. Directors encouraged the authorities to move forward with civil service reform to achieve a more efficient public sector.

Most Directors supported the authorities' effort to restructure the banana industry to make it more efficient and competitive. They noted that this would involve some dislocation of labor, which will require expanded social services and measures to enhance employment opportunities in rural areas. Directors also encouraged the authorities to phase out remaining import licenses, and to adopt a low and uniform import tariff rate. They welcomed the restructuring of the state-owned water and sewerage company, and the intention to privatize it along with other public enterprises.

Directors pointed out that rapid growth of St. Lucia's financial system and the economy's vulnerability to external shocks require close surveillance of banks and other financial institutions. Noting that the regional central bank is constrained by law from disclosing bank soundness indicators, Directors urged the authorities to seek the necessary legislative amendments that would provide assessment of banking practices necessary to comply with the Basel Core Principles. They also supported strengthened supervision of nonbank financial institutions, and encouraged the authorities to proceed with the implementation of the recent ECCB initiatives in this area.

Directors noted the intention to develop an offshore financial center as a step toward economic diversification, and stressed the importance of establishing a strong supervisory and regulatory system. They urged authorities to quickly complete review of the laws and regulations applicable to the offshore sector, and to implement the necessary amendments to ensure full compliance with international best practices. Directors encouraged authorities to follow up their ongoing self-assessment by commencing preparation for the regional FSAP expected to take place in late 2001.

Directors welcomed the background paper on the Eastern Caribbean Currency Union. They agreed that while the common currency arrangement has served the region well, it has increased the importance of the implementation of policies in individual countries to strengthen competitiveness. These include increasing public savings—as proposed by the ECCB—and improving the quality of public expenditure. There is also a need to strengthen regional money and capital markets, as well as a need for the ECCB to play a larger role in prudential supervision, including supervision of offshore financial centers.

Directors noted that data coverage, timeliness and quality have improved in recent years, but that weaknesses remain, especially in national income and balance of payments accounting. In the context of the General Data Dissemination System, which St. Lucia recently adopted, Directors strongly encouraged the authorities to step up implementation of their plans for addressing data deficiencies.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

St. Lucia: Selected Economic Indicators

	1996	1997	1998	Prel. 1999	Est. 2000
Output and prices (change in percent)					
Real GDP at factor cost	1.4	0.6	2.9	3.0	2.0
Consumer prices (end of period)	-2.3	1.6	3.6	6.1	2.0
Banana production	0.1	-32.4	2.6	-10.9	7.4
Tourist stayovers	1.4	5.4	1.5	3.3	-2.0
Saving and investment (percent of GDP)					
Gross national saving	11.2	11.0	13.6	12.7	12.4
Gross domestic investment	21.4	24.6	23.9	25.8	24.5
Public finance (in percent of GDP) 1/					
Nonfinancial public sector saving	7.1	7.2	9.5	9.8	8.3
Nonfinancial public sector capital expenditures	6.5	6.5	8.4	10.5	10.2
Nonfinancial public sector overall balance (after grants)	2.0	2.3	4.7	2.9	-0.8
Money and credit (end of year, percent change) 2/					
Money and quasi-money	1.8	6.7	11.9	8.4	9.0
Credit to private sector	15.3	12.1	9.8	13.7	10.3
Interest Rates (percent)					
Average deposit rate	4.6	3.6	4.8	4.6	4.8
Average lending rate	12.9	12.8	11.2	13.0	13.1
Balance of payments and external debt (percent of GDP)					
Current account balance	-10.2	-13.6	-10.3	-13.1	-12.1
External debt 3/	24.9	25.4	26.1	27.1	30.2
Debt-service ratio 4/	3.5	3.8	3.7	4.7	4.7
Exchange rate (change in percent)					
Real effective exchange rate (end of period, depreciation -) 5/	-3.4	6.4	0.5	8.5	4.2
Terms of trade	0.5	5.6	8.6	3.9	5.6
Excluding tourism	-5.5	7.9	17.8	0.6	-0.7

Sources: St. Lucian authorities; ECCB; and Fund staff estimates and projections.

1/ Data are for fiscal years beginning April 1.
2/ Changes in relation to liabilities to private sector at beginning of period.
3/ Total public and publicly guaranteed debt.
4/ In percent of exports of goods and services.
5/ Data for 2000 refer to the 12-month period ending in October 2000.

Statement by Thomas A. Bernes, Executive Director for St. Lucia
March 7, 2001

My St. Lucian authorities wish to express their thanks to the IMF team for a helpful and constructive set of discussions. They broadly agree with both the analysis and conclusions of the report. These consultations help to keep up the momentum for reforms which might otherwise to swamped by the pressures of day to day management of a very small economy. To the extent there are any differences of view between my authorities and the staff, these relate to the timing, speed, and practical implementation of an essentially agreed policy strategy.

The issues facing St. Lucia are similar to those facing many small economies. The forces of globalisation are calling into question the viability of the traditional core activity (banana production): existing well-established players are resisting diversification by these small economies into new activities and the general trend towards trade liberalisation is impinging on traditional revenue sources.

In this environment, St. Lucia has been going through a period of uncomfortable adjustment with rather sluggish growth and a decline in social indicators.

The banana industry remains a key factor in the St. Lucian economy. While bananas account for only 4 percent of GDP, this greatly understates the impact of the decline of this industry on the overall economy. In reality, throughout the Windward Islands (including St. Lucia) bananas form the basis of the entire rural economy and society. My authorities have recognized that retrenchment is inevitable but they must strive to stabilize this industry and to raise productivity. The recovery plan is progressing and they are grateful for the technical and financial assistance provided by the EU. They are confident that a viable industry can be sustained but acknowledge the not insignificant risks that forces entirely beyond their control could call into question its entire existence in the years ahead.

While the staff report details specific causes of fiscal fragility, the basic pattern of sluggish economic growth and the ongoing erosion of traditional trade taxes have contributed to a general lack of revenue bouyancy. Essentially new sources of revenue are needed and FAD has provided useful technical assistance. It is now a question of how quickly the tax system can be restructured without damaging private sector confidence or disrupting revenue flows in a small economy with relatively limited administrative resources. The issue of introducing a VAT provides a good example. My authorities accept the intellectual superiority of VAT but to change to it could be rather disruptive. In some other islands it has been a great success: in others it has been a disaster. Its adoption will require careful preparation and planning. In the meantime, they are progressively simplifying the existing consumption taxation in a manner which would facilitate a change to VAT. Property taxation is another area where reform is feasible but also requires careful planning and implementation if it is not to be thwarted. My authorities would also like to phase out various tax concessions and are working to limit them. These are, however, no more extensive in St. Lucia than in many other competing economies or, indeed, in the broader

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industrial world. Fuel prices have been raised but not fully in line with international oil prices. This has entailed a fiscal loss but, again, many countries both large and small have felt obliged to protect consumers from the full effect of oil price rises.

St. Lucia has been quite successful in diversifying into tourism and related industries and these remain a source of potential growth. There is always a danger, however, that the economy switches from a single product (banana) economy to a single product (tourism) economy. Income levels would be higher but the economy would remain very vulnerable. In itself, tourism is a fickle industry, vulnerable to weather and to variations in disposable incomes in the major industrial economies. Recent years have been good for tourism in St. Lucia but who knows what a period of retrenchment in the U.S. economy would bring?

On financial sector issues, staff express some concern about the relatively rapid growth of non-bank financial institutions. These institutions are, however, properly regulated and submit regular statements and data to the authorities. They may not be subject to on-site inspection but we would question whether it is either necessary or appropriate to supervise every entity as if it were a bank. In most countries where credit unions exist, they are not heavily supervised. No attempt is made to form an objective view as to whether there is any problem to be solved. We should also not forget that supervisory resources are scare and expensive.

On the question of internationally traded financial services, my authorities see this as a potential source of diversification and a reduction in vulnerability. They were surprised last year when the FSF report classified St. Lucia as either having inadequate supervision or as being unco-operative as, at that time, there was no so-called 'off-shore' business. Perhaps St. Lucia is seeking to enter this rather crowded field at a rather late stage but it is entirely their prerogative to do so. The late entry does, at least, provide an opportunity to get the regulatory and supervisory framework right from the start. This is probably the most productive use of the limited supervisory resources and my authorities are participating fully in the MAE exercise to assess financial sector stability in the ECCB area, which will feed into a full FSAP. It should be borne in mind, however, that an essential element of new competition in any business is that new entrants do not do everything exactly the same as established players: they force existing players to adopt to new circumstances and this is not necessarily a bad thing.

On a rather small point, para. 26 refers to a clean jurisdiction. The general debate on so-called OFCs has not been helped by the use of ill-defined, arbitrary and prejudicial labels and we should be wary of adding to the list. Are some countries now in danger of being classified as 'unclean'?