

St. Lucia: 2002 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 2002 Article IV consultation with St. Lucia, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 25, 2002**, 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 January 10, 2003.** 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.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its January 27, 2003 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for St. Lucia.

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

Debt Sustainability Analysis
Statistical Appendix

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

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INTERNATIONAL MONETARY FUND

ST. LUCIA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation with St. Lucia

Approved by Anthony R. Boote and Matthew Fisher

January 10, 2003

The consultation discussions were conducted in Castries during November 12–25, 2002. Staff met with Prime Minister and the Minister of Finance Dr. Kenny Anthony, the Acting Permanent Secretary of Finance (Mr. Braithwaite), the Permanent Secretaries of External Affairs and International Trade (Mr. Richardson), and Tourism (Ms. Fowell), the Director of Research of the Ministry of Finance (Mr. Leon), other senior officials, and representatives of the private sector and trade unions. Mr. Bennett, Executive Director for St. Lucia, Mr. Vermaeten (OED), as well as Mr. Nicholls representing the Eastern Caribbean Central Bank (ECCB) and Mr. Dalrymple from the Caribbean Development Bank (CDB) participated in the final discussions.

The staff team comprised Messrs. Gajdeczka (PDR-Head), Duffy, Pearson, and Visconti (all WHD). The team was assisted by Ms. Benjamin and Ms. Williams from the ECCB and Mr. Howell from the CDB.

St. Lucia has been on a 24-month consultation cycle, and the last Article IV consultation was concluded by the Executive Board on March 7, 2001 (Box 1). St. Lucia has accepted the obligations of Article VIII, Sections 2, 3, and 4. 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 of EC\$250,000 can be made. Subject to the clearance, the ministry of finance routinely approves all bona fide requests above this threshold.

Appendices I through III summarize relations with the Fund, the World Bank, and the CDB.

St. Lucia, with a population of 158,000 and per capita GDP of US\$4,100, 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 is in the second year of its second five-year term that expires in December 2006.

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EXECUTIVE SUMMARY

Recent developments: St. Lucia's economy is very small and highly dependent on tourism and banana production. After growing by an average 3 percent a year in 1998–99, output stagnated in 2000, and fell by an estimated 5¼ percent in 2001. This reflected a severe drought in 2001, as well as lower tourism activity owing to the global economic slowdown and the terrorist attacks of September 2001. No growth is expected in 2002. Public finances have weakened significantly since 2000. The public sector's overall balance shifted from a surplus of 2 percent of GDP in FY 1999/00 (April–March) to a deficit of 3½ percent of GDP in FY 2001/02. Preliminary information on the central government finances in the period April–October 2002 indicates a further deterioration in total revenue, despite new measures implemented during the fiscal year, and a deficit of above 7 percent of GDP is projected for FY 2002/03.

Policy discussions: Against the background of economic recession and a widening gap in public finances, discussions focused on policies aimed at strengthening the fiscal position and enhancing productivity growth and external competitiveness. The main policy issues are:

- Front-loaded fiscal consolidation is needed to restore public savings and avoid an excessive buildup of debt. Staff recommended a fiscal adjustment path with a 2 percentage point of GDP reduction in the central government deficit to 5¼ percent of GDP in FY 2003/04, with additional steps in the following years to stabilize the total public debt/GDP ratio at about 60 percent. The authorities, while recognizing the need for strong fiscal adjustment, could not commit to this adjustment path or new measures until preparations for the 2003/04 budget are more advanced.
- On fiscal revenues, there was agreement that efforts should focus on broadening the tax base, rather than raising tax rates. Staff recommended that tax concessions be phased out, the petroleum pricing formula fully implemented, and preparations for adopting a VAT-type tax accelerated.
- For FY 2003/04, staff suggested cuts in expenditures on goods and services and transfers, and broadly stable (in nominal terms) wage bill and capital expenditure.
- Absent fiscal adjustment, public debt could increase to 80 percent of GDP by 2007. Debt sustainability analysis indicates that under unchanged policies scenario, adverse economic shocks could generate unstable debt dynamics.
- The rapid increase in banking system nonperforming loans is a concern and the proposed strengthening of financial supervision and legal changes aimed at containing their future increase are welcome. St. Lucia will participate in the regional FSAP.
- The authorities agreed for the next Article IV consultation to be held on a 12-month cycle (one-time change from the present 24-month cycle).

II. BACKGROUND AND RECENT ECONOMIC DEVELOPMENTS

1. **St. Lucia's economy is very small and highly dependent on tourism and banana production** (14 percent and 3½ percent of 2000 GDP, respectively). Since the mid-1990s, banana output has fallen by more than half and a large number of farmers have been displaced—as in other OECS countries—as the banana industry has been undergoing a retrenchment in the face of competition from lower cost producers. However, the tourism industry grew rapidly making St. Lucia the number one tourist destination among ECCU members, and the export of other services expanded. St. Lucia has a strong track record of maintaining a sound fiscal position. However, reflecting a weak economy and increased spending, the public sector overall balance has deteriorated rapidly since 1999.

2. **After growing by an average 3 percent a year in 1998–99, output stagnated in 2000, and fell by an estimated 5¼ percent in 2001 with no growth expected in 2002** (Table 1).¹ This reflected a severe drought in 2001, as well as lower tourism activity owing to the global economic slowdown and the terrorist attacks of September 2001. The unemployment rate increased to about 19 percent in 2001, from 16½ percent in 2000. In 2002, tourism was weak and tropical storm damage prevented a stronger recovery in banana production.² Inflation has remained in the low single digits, and the price level remained broadly unchanged in August 2002 relative to August 2001.

3. **After improving in 1998–99, public finances have weakened since 2000.** The public sector's overall balance shifted from a surplus of about 2 percent of GDP in FY 1998/99 to a deficit of 3½ percent of GDP in FY 2001/02.³ The dominant influence is the central government's deficit with the rest of the public sector running a small surplus. Central government current revenue fell by 2 percent of GDP in FY 2001/02, largely owing to the steep recession; and spending increased mostly because of higher interest payments and a small increase in the wage bill (Box 2). Preliminary information on the central government finances in the period April–October 2002 indicates a further increase in the deficit,

¹ Despite the measures taken by the authorities (support to the banana sector, promotional campaign in tourism and increased public investment).

² Banana production for the period January–August 2002 was about 50 percent higher than in the corresponding period of 2001 but tropical storm Lili in September destroyed half of the banana crop and, for the full year, production is estimated to be about 30 percent higher than in 2001.

³ The nonfinancial public sector is defined here as the central government, the Castries City Council, the St. Lucia Air and Sea Ports Authority, the Water and Sewerage Company (WASCO), the National Development Corporation (NDC), and the Marketing Board.

Box 1. St. Lucia: Policy Recommendations and Implementation

Over the past several years, the Fund has advised St. Lucia to strengthen public finances, with a focus on wage restraint, while implementing a comprehensive tax reform to broaden the tax base and reduce tax concessions.

In concluding the 2000 Article IV consultation, Directors stressed that further diversification and enhancements to international competitiveness are needed to raise long-term growth and to reduce the external vulnerability of the economy, particularly in light of the uncertainties facing the crucial banana industry. They recommended that additional steps be taken to increase revenue and tighten expenditure controls, as well as to move from the system of fuel tax adjustment to permit domestic fuel prices to reflect fully changes in import prices. They urged wage moderation and supported steps to strengthen supervision of the financial system.

Progress in implementing Fund policy advice has been mixed, especially with regard to fiscal consolidation as economic conditions deteriorated. After considerable progress in 1998–99, fiscal consolidation was reversed in 2000–02 as the economy descended into recession, despite the implementation of fuel price adjustments to protect tax revenue and significant restraint in wage bill growth. Current revenues declined and expenditures increased significantly relative to GDP, widening the central government deficit and resulting in a sharp increase of the public debt. On the structural front, financial system supervision is being strengthened in collaboration with the ECCB, including with regard to offshore operations and programs are underway to restructure public sector enterprises, reinvigorate banana production and enhance the attractiveness of the St. Lucia tourism product.

notwithstanding new measures implemented during the fiscal year (Table 2).⁴ As of end-September 2002, the total public sector debt reached 56 percent of GDP (Box 3).

4. **Responding to the region-wide economic downturn, the ECCB cut its discount rate** from 8 to 7 percent in October 2001 and lowered the floor on the passbook saving rate from 4 to 3 percent in September 2002. In St. Lucia, domestic interest rates remained stable in 2000–01, with a weighted average lending rate of about 13 percent and deposit rates in the 3–9 percent range. The growth of credit to the private sector slowed in 2001, while the public sector continued to build up deposits with the banking system, and commercial banks reduced their net foreign assets by about US\$10 million (Table 3). During the 12 months ending in September 2002, these trends reversed—broad money and credit to the private sector grew moderately, while the public sector (including the National Insurance Corporation—NIC) reduced its net creditor position with the banking system by 16½ percent.

⁴ Fuel price increases averaging about 10 percent were implemented on May 5, 2002.

Box 2. St. Lucia: Factors Underlying the Deterioration in Central Government Finances

Following two years of strong performance in 1998/99 and 1999/00 (April–March fiscal years) when the current balance averaged 6 percent of GDP and the overall balance (after grants) was positive, the central government finances have deteriorated sharply, largely reflecting the decline in economic activity. Based on current trends, in 2002/03 central government current revenues are projected to be lower by 3 percent of GDP, current expenditures higher by about 4 percent of GDP, and the overall balance (after grants) worse by 8 percent of GDP relative to 1999/00. The following elements account for this deterioration:

Revenue

During 2000/01–2002/03, total revenue and grants are estimated to decline by 16 percent in nominal terms, largely reflecting reduced current revenue. About three quarters of the decline is accounted for by a fall in current revenue and the rest by a 45 percent decline in external capital grants. The decline in the current revenue is mostly due to reduced tax revenue. Lower receipts from taxes on income and profits and on international trade—both linked to the level of (declining) economic activity—account for more than the total decline in tax revenue, as collection of property taxes and taxes on goods and services (including taxes on petroleum products) marginally increased. Nontax revenue (including revenues from government departments, transfers of ECCB profits, interest and rent payments, and fees) remained broadly stable. The decline in external grants is largely accounted for by a change by the EU from direct budgetary support to other forms of assistance.

Expenditure

Total expenditure and net lending is estimated to increase by 11 percent in nominal terms during 2000/01–2002/03, on account of a 20 percent increase in the current expenditure and a 9 percent fall in capital outlays. Wages and salaries, which are the largest component of current expenditure, are estimated to be about 7 percent higher in nominal terms in 2002/03 relative to 1999/00. Interest payments nearly doubled reflecting both rising debt and increased recourse to borrowing on commercial terms. A significant part of the increase in transfers shown in 2002/03 is due to reclassification of certain items previously included in capital spending, and a one-time contribution to WASCO, and is not comparable over time. Capital outlays declined in the last two years, but are projected to rise significantly in the current fiscal year reflecting in part the authorities' intention to stimulate economic activity.

5. **The external current account deficit, which had declined in 2001 to 5¾ percent of GDP as imports fell sharply, is estimated to have increased to 8½ percent in 2002** mainly owing to a decline in receipts from services (Table 4). These deficits have been more than covered by capital inflows including public sector borrowing and private capital. Reflecting the government borrowing, public and publicly guaranteed external debt rose rapidly in recent years (from an average of 23½ percent of GDP in 1998–99 to about

Box 3. St. Lucia: Public Sector Assets and Liabilities

Public debt. Reflecting the weak economy and the fiscal deterioration, total public sector debt has risen rapidly in the past three years (see below). At end-September 2002, the public debt amounted to EC\$990 million (56 percent of GDP), with the central government accounting for about 77 percent of the total. Domestic debt accounts for about 43 percent of total public debt. Major external creditors include the CDB, the World Bank, and commercial banks.

Public debt (Percent GDP)	FY 99/00	FY 00/01	Prel. FY 01/02	Proj. FY 02/03
Total	41.5	46.8	52.5	56.6
Domestic	18.0	19.3	21.5	18.0
External	23.5	27.5	31.0	38.6
Central government	28.4	34.3	39.9	44.8
Domestic	15.7	16.1	18.6	15.3
External	12.7	18.2	21.3	29.6

Public sector deposits with the banking system amounted to about EC\$473 million (26 percent of GDP) as of end-September 2002. About 35 percent of total deposits is held by the NIC. Central government deposits include unused balances of grant and loan disbursements and sinking-fund accounts for debt repayment. The amount of unearmarked deposits is very small.

31 percent at end-2001), and is estimated to have increased to 38½ percent of GDP at end-2002.⁵ Mindful of the rising cost of debt, as part of their debt management strategy, the authorities completed in October 2002 a US\$45 million refinancing package.⁶ Owing largely to the depreciation of the U.S. dollar vis-à-vis other major currencies, the external value of the Eastern Caribbean dollar as measured for St. Lucia depreciated in real effective terms by about 5½ percent during the first nine months of 2002 (Figure 1). The real exchange rate is currently 13 percent above its most depreciated level in the mid-1990s.

⁵ Although St. Lucia's external public debt remains moderate, a regional debt buildup remains a concern (Box 3 of SM/03/6).

⁶ The package (US\$40 million plus B\$10 million) underwritten by Citibank of Trinidad and Tobago, took advantage of lower interest rates and extended the maturity of the government's debt. The U.S. dollar part of the facility carries a fixed 7¾ percent interest rate, a maturity of 10 years, with a 2-year grace period, and semiannual principal repayments. The Barbados dollar facility carries interest rate of 7¼ percent, maturity of 15 years, 3-year grace period, and semiannual principal repayments. This financing is being used to repay domestic and external short-term debt to banks carrying 10¼ percent average interest rate and maturing in the coming months.

6. **The government is making progress in restructuring several sectors.** It established the “banana emergency action program” that aims to reverse the recent decline in production, by targeting support to high-yield farms and assisting improvement of fruit quality. The World Bank is supporting the Water Sector Reform program to prepare WASCO for private sector participation, including by reforming the regulatory framework. The WASCO has improved its financial performance through new management and a metering program. A World Bank supported region-wide liberalization in the telecommunications sector is underway, leading to competition in services such as cellular telephony. Finally, social security legislation aims to make the system more financially sound by raising the retirement age from 60 to 65 years over a period of 15 years.

III. POLICY DISCUSSIONS

7. Against the background of economic recession and a widening gap in public finances, the discussions with the authorities focused on policies aimed at strengthening the fiscal position and enhancing productivity growth and external competitiveness.

A. Key Issues and Outlook

8. **St. Lucia faces the following challenges:**

- **Economic activity remains weak and there are significant risks to recovery in the short and medium term.** Although output growth in 2003 is now projected at 1½ percent,⁷ St. Lucia’s economic recovery may be further adversely affected by the continued weak global economy, higher oil prices and reluctance to travel post September 11. For the medium term, the impact on tourism of September 11 now appears to be more lasting than previously anticipated. Moreover, St. Lucia’s tourism product is increasingly exposed to regional and global competition, and banana exports will face the challenge of the loss of trade preferences after 2005. The envisaged program to restructure the banana sector and the imperative to increase the efficiency of public sector enterprises will add to pressures in the labor market already heightened by the recession.
- **The rapid deterioration in the finances of the central government needs to be reversed.** Relative to 1999/00, current revenues are projected to be lower by nearly 5 percent of GDP and current expenditures higher by about 4 percent of GDP in 2000/03, and the central government deficit (after grants) is expected to reach about 7¼ percent of GDP in 2002/03, nearly double the level of the previous fiscal year. Without corrective measures, the

⁷ Based mainly on a further recovery in banana production and tourism arrivals.

deficit would remain broadly unchanged in 2003/04, even assuming a modest economic recovery.

- **Continued increases in public sector debt would undermine fiscal sustainability.** The rapid growth in the stock of debt increases the economy's vulnerability to exogenous shocks and limits the government's scope for countercyclical policy action in the future.

9. **In the context of the 2002/03 budget, the government set out four objectives in response to the challenges ahead:** (i) restoring and strengthening fiscal stability; (ii) stimulating economic activity in the short term; (iii) enhancing investment prospects; and (iv) revitalizing the agricultural sector. However, progress in implementing this agenda has been mixed, especially with regard to fiscal consolidation as economic conditions deteriorated.

10. **Staff prepared a medium-term macroeconomic framework consistent with a sustainable fiscal position** (Appendix V).⁸ However, prior to the 2003/04 budget, the authorities were not ready to commit to the 2003/04 adjustment suggested by staff and assumed in the projections. By 2005–06, real GDP growth would reach 3 percent under the staff scenario, based on economic diversification and enhanced competitiveness of the banana industry and tourism.⁹ Economic growth would need to be driven by external demand and domestic private investment as domestic saving would increase underpinned by fiscal consolidation. This would allow to stabilize the public debt/GDP ratio at about 60 percent. According to the debt sustainability analysis (SM/03/11), stabilizing the total public debt/GDP ratio at 60 percent would allow the absorption of economic shocks without generating unstable debt dynamics. Most shocks would, however, shift the debt ratio upwards, requiring further adjustments to restore the preshock level.

11. **Under an unchanged policies scenario,¹⁰ public debt would increase to unsustainable levels.** Absent fiscal adjustment, the central government deficit would remain at above 7 percent of GDP in 2003/04 and the public sector debt could reach above 80 percent of GDP by 2007.

⁸ Also consistent with the authorities' medium-term development strategy presented at the June 2002 meeting of the CGCED at the World Bank which targets a total public debt to GDP ratio of 50 percent, with a ratio of 60 percent considered as a critical level.

⁹ Allowing positive per capita income growth and a reduction in unemployment.

¹⁰ Assuming no new revenue measures, with noninterest expenditures increasing in line with nominal GDP, while the interest burden would continue to increase.

B. The Challenge of Fiscal Consolidation

12. **The authorities recognize the need to reverse fiscal deterioration and consider the ECCB proposed fiscal convergence guidelines as appropriate targets for the medium term.**¹¹ While recognizing the risks to the short-term macroeconomic outlook, the authorities noted the challenge of making further adjustments in the present difficult economic climate, and would not commit to the magnitude of the adjustment suggested by staff nor to new measures until preparations for the next budget are more advanced. Staff saw front-loaded fiscal consolidation as the main priority to restore public savings and avoid an excessive buildup of debt. It recommended a fiscal adjustment path envisaging a 2 percentage point of GDP reduction in the central government budget deficit to 5¼ percent of GDP in FY 2003/04, with additional steps in the following years to stabilize the total public debt/GDP ratio at about 60 percent, while making room for adequate levels of public investment.¹² In FY 2003/04 the adjustment could be achieved by reductions in expenditures on goods and services and transfers, and by holding the wage bill and capital expenditure broadly stable in nominal terms. After peaking at 10 percent of GDP in 2002/03, the public sector gross borrowing requirement would decline to an average of 5½ percent of GDP in 2004–07, reducing exposure to rollover/funding risks.¹³

13. **Preparations for medium-term tax reform are underway.** The authorities welcomed the Fund's support for modernizing St. Lucia's tax system which at present is based on import duties and cascading indirect taxes, partly offset by an extensive array of exemptions and concessions.¹⁴ St. Lucia and other countries in the region formed a Tax Reform Commission to recommend ways to streamline and harmonize tax systems. The

¹¹ The ECCB's current proposal comprises the following four targets: central government current account surplus of 4–6 percent of GDP; an overall government budget deficit of no more than 3 percent of GDP; total outstanding central government debt of no more than 60 percent of GDP; and debt service payments by the central government of no more than 15 percent of current revenue.

¹² Based on the sustainability analysis (SM/03/11), the staff recommended adjustment path is more ambitious than the one implied by the 60 percent debt/GDP ceiling proposed by the ECCB which applies to central government and not total public debt (see footnote 11 above).

¹³ The large financing requirement in 2002/03 reflects the large maturities refinanced externally. In the event of urgent funding needs, the authorities could draw on the public sector deposits earmarked for future repayment of accumulated debt.

¹⁴ A FAD staff team visited St. Lucia in December 2002 to review the current tax system and recommend ways to broaden the tax base and replace current distortionary taxes with a VAT-type tax.

authorities are receptive to curtailing tax concessions and introducing a VAT-type tax in a regional context, but have concerns about its administrative costs and complexity.

14. **On revenues, staff agreed with the authorities that efforts should focus on broadening the tax base, rather than raising tax rates.** The authorities reiterated their commitment to the existing petroleum price and taxation formula which yields the targeted level of revenues.¹⁵ They saw tax concessions as managed in a transparent and responsible way and necessary for attracting investment when similar incentives are offered by regional competitors, but looked forward to the outcome of the FAD review. They also expect improvements in tax administration from the introduction in 2003 of a single taxpayer identification number. Staff emphasized the need to take further steps to broaden the tax base and it recommended a gradual phasing out of tax concessions, by first reducing the scope of newly granted concessions and limiting their approval to new projects (no renewals), and through introduction of monitoring of compliance with the initial conditions and targeted economic benefit;¹⁶ and completing preparations (with CDB support) for basing the property tax on market values. It also urged that domestic fuel price adjustment to pass through costs and stabilize revenues from taxes on petroleum products be made as frequently and as fully as required by the price formula.

15. **The authorities agreed that budgetary expenditures need further rationalization to curtail their steady growth, but pointed out a number of constraints.** In recent years, the wage bill increase has been very limited, while several projects coming on stream will require additional personnel, and some wage increases may be needed to safeguard the attractiveness of public sector employment especially at higher grades. The present level of the Public Sector Investment Program (PSIP) was appropriate to support economic growth. Staff recommended that the upcoming wage negotiations should not result in an increase in the wage bill, and that nominal expenditures on goods and services and current transfers be reduced. While the effectiveness of the PSIP implementation had improved, its efficiency can be further enhanced, by giving priority to growth-oriented projects for which official long-term financing is available and cutting domestically financed projects whose contribution to growth or poverty alleviation is not clear. A better prioritization of projects in the PSIP could be achieved by involving the Project Monitoring Committee in screening future projects, in addition to addressing the implementation bottlenecks.

¹⁵ Under the present system, domestic fuel prices are adjusted to ensure that the consumption tax per gallon does not deviate from specified midpoints beyond narrow margins (plus or minus 10 cents). However, the May 2002 price adjustment did not reflect fully the increase in import prices.

¹⁶ Tax exemptions are defined in the Tourism and in the Fiscal Incentives Acts; tax concessions can also be granted by a Cabinet decision outside this legislated framework. According to authorities' estimates, tax concessions resulted in a loss of revenue equivalent to up to 5 percent of GDP or 23 percent of tax revenue in 2001/02.

16. **The authorities welcomed the fiscal and external sustainability analysis prepared by staff (SM/03/11) as a useful basis for their future budget discussions and reiterated their commitment to prudent fiscal policy.** They noted that increased recourse to external borrowing was necessary to help respond to the recent severe exogenous shocks. They intend to review debt management objectives in the context of their investment strategy, and will continue to seek opportunities to take advantage of lower interest rates. Staff recommended that a medium-term framework be developed to guide fiscal policy. It also recommended to establish a monitoring mechanism for a regular review of all future debt-service obligations of the central government and the rest of the public sector.

C. Monetary and Financial Sector Issues

17. **As the economy weakened, nonperforming loans in the banking system increased from about 14 percent at end-2000 to about 20 percent at end-September 2002 and are among the highest among the ECCU members.**¹⁷ Banks report excess liquidity, note little impact on their lending activity of the reduction in the ECCB discount rate and the floor on passbook saving deposits, and are concerned about judicial system constraints that cause delays in their recovery of property-based collateral. Staff expressed concern about the high and rising levels of nonperforming loans, noting that banks' capital bases and profitability would likely be eroded, and the risks associated with potentially large quasi-fiscal liabilities. Staff was informed that preparations for the enactment of amendments to the Uniform Banking Act (envisaged for early 2003) are on target, and that supervision of nonbank financial institutions will be strengthened as uniform regulatory bodies are established, with CARTAC assistance, in each ECCU member country.

18. **Since its inception in 1999, the total number of registrations in the offshore financial center (OFC) and associated revenues have been modest relative to the cost of regulation and supervision.**¹⁸ In 2001, St. Lucia completed the Fund assisted self-assessment of the OFC (Module I) which identified some areas where the laws and regulations need to be enhanced. The authorities stressed their commitment to a well supervised OFC; a financial intelligence unit is being established and the regulatory and supervisory system strengthened, including the anti-money laundering regime. They also noted the burden arising from the frequent requests for information from international agencies on OFC and money laundering issues. The authorities hope to finalize an agreement

¹⁷ The ECCB is in charge of banking regulation and supervision. There is no publicly available information on the level of loan-loss provisions, but individual banks reported to the mission that they had increased both provisions and loan write-offs.

¹⁸ By early December 2002, the OFC comprised 733 international business companies, 10 insurance companies, 9 trusts and 1 bank.

with the OECD on tax cooperation in early 2003.¹⁹ They are looking forward to the regional Financial Sector Assessment Program (FSAP) scheduled for the second half of 2003. Staff suggested periodic reviews of the benefits of hosting an OFC.

D. Promoting Growth Through Structural Reforms

19. **The authorities' strategy focuses on enhancing competitiveness in tourism and agriculture while supporting economic diversification.** They noted that September 11 events changed the tourism market and the industry responded through price flexibility while the authorities contributed to a regional promotional campaign in target markets. Moreover, tourism legislation is being revamped to create a better business environment and facilitate coordination among different agencies developing the St. Lucia tourism product.²⁰ In agriculture, a Banana Emergency Recovery Program is underway, providing assistance targeted to the most productive farms with the potential to meet the product certification standards set by the market. In addition, with European Union support, a major irrigation and drainage program is being implemented. Staff noted that the monetary and exchange rate arrangement has served St. Lucia well in maintaining low inflation and fostering prudent economic policies. The real effective exchange rate has depreciated recently, which is welcome. Moreover, price flexibility has been an appropriate response to the recent changes in market conditions, which has helped bolster competitiveness and activity in the key tourism sector. Staff agreed that a comprehensive strategy is needed to respond to the challenge of boosting growth and employment, and encouraged prompt completion of a program to stimulate agricultural diversification including through increased linkages to tourism and regional trade.

20. **Staff stressed the importance of strengthening the link between wages and productivity, increasing private sector involvement in the economy and raising the efficiency of public sector enterprises as measures to lower the "cost of doing business."** The authorities noted that the labor code is being revised in consultation with employers and trade unions and that productivity-related issues feature prominently in the social dialogue. They are committed to continue to strengthen the operations of public sector enterprises and favor increased private sector participation in the economy, including through privatization. In addition, the government contributed to a Productive Sector Equity Fund that will take stakes in small and medium enterprises, an Office of Investment Coordination was

¹⁹ In April 2002, after committing to address harmful tax practices, St. Lucia was excluded by the OECD from its list of noncooperative "tax havens."

²⁰ On tourism competitiveness see Box 4 in ECCU—Staff Report Following Discussions with Regional Institutions (SM/03/6), and St. Lucia—Selected Issues and Statistical Appendix (SM/01/61).

established to facilitate the approval of private sector projects, and private investment in WASCO will be sought based on the lease of assets. Notwithstanding these initiatives, the authorities noted that while efforts will continue to lower production costs, including the cost of public utilities, they will remain relatively high given their very small scale of operations. While welcoming a modernization of the labor code, staff urged that this opportunity be used to enhance labor market flexibility to create conditions for increasing employment and safeguarding competitiveness.

21. The authorities are strongly committed to regional integration and trade liberalization. In close collaboration with the ECCB, preparations continue to consolidate financial supervision, and there is agreement to support a greater role of the Regional Government Securities Market which was launched in November 2002. St. Lucia has already removed the constraints on capital movements within OECS, the program to phase out remaining nontariff trade barriers by June 2003 is on track and further steps are under preparation to achieve the OECS/CSME economic space by 2007. The authorities were concerned about the adverse impact the FTAA may have on St. Lucia's economy unless special safeguards are introduced for small island states. Staff pointed out that while trade liberalization inevitably involves challenges to the existing economic structure, it also opens new opportunities for development. The ongoing trade liberalization combined with a broad tax reform under preparation will contribute to reducing the existing distortions and lower tax rates supported through broadening the tax base, thereby increasing efficiency of the economy and enhancing competitiveness.

22. The authorities are committed to increasing transparency, accountability and better governance across the public service. The Government of St. Lucia provides extensive information through its official website, key policy documents (including the budget) are published, and public consultations are held on key issues. In September 2002, a National Economic Council (comprising representatives of the private sector, labor and government) was established to advise the government on economic strategy. The authorities continue to pursue the goal of comprehensive civil service reform, and look forward to the completion of the public expenditure review by the World Bank that would also help enhance fiscal transparency and governance. Staff stressed the importance of enhancing public expenditure management, and encouraged a review of the public sector to increase its efficiency and avoid duplication of functions and services.

23. The government—assisted by the World Bank and the Caribbean Development Bank—is implementing programs for reducing poverty, improving education and health services, and protecting the environment. To foster employment, a National Skills Center was set up, and based on a government/private sector partnership an apprentice system was established.

24. St. Lucia participates in the General Data Dissemination System, and the authorities are committed to further improvements in the country's economic statistics (Appendix IV). Staff encouraged the authorities to develop indicators of competitiveness and tourism activity.

IV. STAFF APPRAISAL

25. **During 2000–02, St. Lucia’s economy has suffered from significant exogenous shocks**, as banana production was damaged by severe weather conditions and tourism declined owing to the global economic slowdown and the terrorist attacks of September 2001. Unemployment rose and the public sector budget deficit and debt increased sharply. Economic activity remained weak in 2002, notwithstanding the steps taken by the authorities to reinvigorate economic activity, and there are significant risks to recovery in 2003, as St. Lucia may be further adversely affected by the continued weak global economy, higher oil prices, and reduced travel related to a possible war in Iraq.

26. **Given the very large fiscal deterioration over the last three years, strong adjustment measures are needed in the 2003/04 budget to preserve St. Lucia’s long-standing record of sound fiscal management.** In the staff’s view, the central government budget deficit should be reduced by about 2 percent of GDP in 2003/04. While recognizing the constraints on new tax measures in the short term, staff urges the authorities to reverse the steady decline in government revenues. The scope of newly granted tax concessions should be reduced, their approval limited to new projects, and a mechanism to monitor compliance with the initial conditions and targeted economic benefit established. Granting of tax exemptions not defined in the Tourism and in the Fiscal Incentives Acts should be abolished. A region-wide tax reform leading to the adoption of a value-added type tax provides a good opportunity to phase out tax concessions. The domestic fuel price adjustment mechanism should be fully implemented to stabilize the tax on petroleum products. The introduction of a property tax based on market value and the implementation of the single taxpayer identification number should be completed in 2003.

27. **Budgetary expenditures need to be curtailed and rationalized.** In the 2003/04 budget, central government current outlays need to be contained, including by limiting the increases in the wage bill, by strictly controlling spending on goods and services, and by reducing current transfers. The authorities should draw on the results of the public expenditure review under preparation by the World Bank. The ongoing public sector reform should help increase efficiency and avoid duplication of functions within the government. Staff supports the main thrust of the PSIP emphasizing poverty reduction through social sector development coupled with infrastructure development in support of private-sector-led growth. Efforts should continue to further improve project selection and project monitoring, including through the establishment of a regular schedule of meetings of the Project Monitoring Committee to address bottlenecks in the ongoing program and to screen future projects.

28. **Safeguarding fiscal sustainability and curtailing the growth of public debt should remain key policy objectives.** To guide fiscal policy, the authorities are urged to develop a medium-term framework aiming at public debt sustainability. To strengthen debt management, a mechanism for a regular review of future debt-service obligations on domestic and external debt of the central government and the rest of the public sector should be developed. The authorities should avoid expensive borrowing and continue to seek

opportunities to take advantage of lower interest rates to retire existing expensive commercial debt.

29. **Efforts to reinvigorate growth should favor private sector involvement, public enterprise restructuring and other measures to enhance competitiveness.** The fixed exchange rate regime has served St. Lucia well in the past, although the strong U.S. dollar has eroded competitiveness in the 1990s. Structural reforms and other measures to enhance competitiveness are warranted as well as determined fiscal consolidation. Absent such measures, there are risks of economic stagnation, rising poverty, and financial instability. In tourism, sustained efforts to increase diversification, to raise standards across the industry and to increase services to enhance further the attractiveness of the St. Lucia tourism product are essential. The banana sector recovery program needs to be pursued vigorously to increase competitiveness prior to the loss of preferential tariffs by end-2005. Agricultural diversification, including by increasing the linkages to tourism and regional trade, should be pursued. To enhance competitiveness, the link between wages and productivity should be strengthened, and the modernization of the labor code under preparation should target improved flexibility and efficiency of the labor market. Public sector enterprise restructuring should continue to enhance their efficiency as a measure to reduce the “cost of doing business” in St. Lucia. Staff welcomes the steps to increase private sector involvement in the economy, including through management contracts and the lease of assets in public sector enterprises, supported by an adequate regulatory framework, promotion of private business development through the equity fund, and through initiatives such as the Investment Coordination Unit. The recently created National Economic Council provides an important forum for consultation on national economic strategy.

30. **The ongoing efforts to strengthen financial sector regulation and supervision are welcome.** Preparations for enactment of amendments to the Uniform Banking Act in early 2003 and steps to strengthen supervision of nonbank financial institutions, including in the offshore sector should be completed as planned. Staff encourages periodic reviews of the benefits of hosting an offshore sector against the costs of supervision.

31. **Staff welcomes the authorities’ strong commitment to regional integration.** The elimination of all limitations on capital movement within the OECS is welcome and the authorities are encouraged to remove the remaining obstacles to enable free movement of goods and services, labor and capital and achieve the OECS/CSME common economic space by 2007 and fulfill their trade liberalization commitments in the context of the FTAA.

32. **St. Lucia continues to make progress in the provision of core data to the Fund.** However, data deficiencies continue to hamper surveillance, and additional efforts are needed to improve quality and timeliness, in particular in national accounts, public sector finance, and balance of payments statistics, in line with the plans for statistical development under the GDDS. The authorities are also encouraged to develop competitiveness indicators and measures of tourism activity.

33. 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 can be made. As no timetable has been set for removing this restriction, Fund approval for its retention is not proposed.
34. It is recommended that the next Article IV consultation be held on a 12-month cycle.

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

	1998	1999	2000	Prel. 2001	Projections	
					2002	2003
(Annual percentage changes, unless otherwise specified)						
Output and prices						
Real GDP at factor cost	3.1	3.1	0.2	-5.2	-0.5	1.5
GDP at current market prices	9.8	3.9	2.8	-5.1	1.9	3.8
GDP deflator at factor cost	3.9	1.8	3.1	1.3	1.9	2.0
Consumer prices (end of period)	3.6	6.1	0.4	2.1	1.9	2.0
Unemployment rate	21.6	18.1	16.5	18.9
Banana production	2.6	-11.0	7.8	-51.6	29.0	22.0
Tourist stayovers	1.5	3.3	3.6	-7.6	1.3	3.0
External sector						
Exports, f.o.b.	0.2	-13.4	3.5	-17.8	6.0	11.2
Imports, f.o.b.	0.9	5.7	0.1	-17.2	7.1	6.6
Travel receipts	9.6	0.3	6.8	-13.4	-2.2	6.1
Terms of trade	6.6	6.1	-3.6	6.8	-1.7	...
Excluding tourism	23.6	3.0	-9.5	-0.8	-9.1	...
Nominal effective exchange rate (end of period, depreciation -) 1/	-2.3	4.6	6.4	1.8	-2.8	...
Real effective exchange rate (end of period, depreciation -) 1/	-0.3	8.4	2.9	0.4	-3.5	...
Money and credit 2/						
Domestic assets (net)	0.9	10.8	4.7	4.6	5.2	3.9
Credit to public sector (net)	-5.9	-2.9	-1.8	-2.0	-1.0	-0.6
Credit to private sector	9.7	13.6	8.0	5.1	7.3	4.9
Money and quasi-money	12.1	9.7	7.9	4.7	3.0	4.0
Velocity of money (M2) 3/	1.8	1.7	1.6	1.4	1.4	1.4
(In percent of GDP, unless otherwise specified)						
Nonfinancial public sector 4/						
Current balance	6.4	8.0	6.8	2.7	-0.2	1.7
Of which: Central government	6.0	6.2	5.4	1.6	-0.9	0.7
Capital outlays	8.3	11.5	9.0	7.8	9.4	9.0
Overall balance (before grants)	-1.5	-3.3	-2.1	-4.9	-8.7	-7.1
Overall balance (after grants)	1.7	0.1	-1.5	-3.4	-6.8	-5.3
Of which: Central government	1.7	0.6	-1.4	-3.9	-7.3	-5.3
Overall balance (after grants), including the National Insurance Corporation (NIC)	4.6	2.9	1.9	-0.2	-4.1	-2.3
Total public sector debt 5/	40.9	41.5	46.8	52.5	56.6	59.8
Of which: Central government	28.1	28.4	34.3	39.9	44.8	48.5
External sector						
Current account balance	-10.3	-12.3	-9.2	-5.8	-8.4	-8.6
External debt (end of period) 6/	22.6	24.2	27.6	30.9	38.6	40.5
Debt-service ratio 7/	3.3	3.9	4.7	9.3	12.1	8.3
(In millions of U.S. dollars)						
GDP at current market prices	639.2	663.8	682.7	647.7	659.8	684.8
Change in net international reserves (increase -) 8/	-9.5	-3.9	-4.5	-10.1	7.4	-5.3

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

1/ For 2002, 12-month change through September 2002.

2/ Changes in relation to liabilities to private sector at beginning of period.

3/ Nominal GDP at market prices divided by the average stock of money (measured as the simple average of the current period stock and the stock 12-months earlier).

4/ Data are for fiscal years beginning April 1. The nonfinancial public sector is defined here as the central government, the Castries City Council, the St. Lucia Air and Sea Ports Authority, the Water and Sewerage Company, the National Development Corporation, and the Marketing Board. Data for 2003 reflects policy adjustment discussed in Section II.B.

5/ Includes liabilities to the NIC.

6/ Total public and publicly guaranteed debt.

7/ In percent of exports of goods and services.

8/ Imputed reserves at the ECCB.

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

(In percent of GDP)

	1999/00	2000/01	Prel. 2001/02	Proj.	
				2002/03	2003/04 1/
Total revenue and grants	29.4	27.0	26.1	24.9	25.3
Current revenue	25.8	26.4	24.4	22.8	23.3
Tax revenue	23.3	23.7	21.9	20.9	21.3
Taxes on income and profits	7.0	7.9	6.7	5.7	5.8
Taxes on property	0.1	0.1	0.3	0.2	0.2
Taxes on goods and services	9.5	9.5	9.6	9.8	9.9
Consumption taxes	6.8	5.5	6.0	6.0	6.2
Imports	6.2	5.0	5.7	5.8	5.9
Domestic goods	0.6	0.6	0.3	0.3	0.3
Hotel occupancy tax	1.0	1.2	1.1	1.1	1.1
Excises	0.3	1.5	1.2	1.1	1.2
Other	1.4	1.2	1.3	1.6	1.4
Taxes on international trade	6.7	6.5	5.3	5.2	5.5
<i>Of which</i>					
Import duties	4.0	3.5	2.9	2.9	3.0
Service charge (imports)	1.9	1.8	1.6	1.5	1.6
Nontax revenue	2.6	2.7	2.5	1.9	2.0
Capital revenue	0.1	0.0	0.2	0.1	0.1
Capital grants	3.4	0.6	1.5	1.9	1.8
Total expenditure and net lending	28.9	28.4	30.0	32.2	30.6
Current expenditure	19.6	21.1	22.8	23.8	22.6
Wages and salaries	11.0	11.5	12.1	11.8	11.5
NIC contributions and retirement	1.5	2.0	2.0	1.8	1.7
Goods and services	3.9	4.1	4.1	4.4	3.9
Transfers	1.9	1.9	2.2	3.2	2.7
Interest payments	1.3	1.6	2.4	2.6	2.8
Domestic	0.9	1.2	1.3	1.3	1.2
External	0.4	0.5	1.1	1.4	1.6
Capital expenditure and net lending	9.2	7.4	7.2	8.4	8.0
Current balance	6.2	5.4	1.6	-0.9	0.7
Overall balance (before grants)	-2.9	-2.0	-5.4	-9.2	-7.1
Overall balance (after grants)	0.6	-1.4	-3.9	-7.3	-5.3
Memorandum items:					
Public sector overall balance (after grants) 2/	2.9	1.9	-0.2	-4.1	-2.3
<i>Of which</i>					
Noncentral government	2.3	3.3	3.7	3.2	3.0
Nominal GDP (in EC\$ millions)	1,805.0	1,819.6	1,756.9	1,798.4	1,868.2

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

1/ Reflects policy adjustment discussed in Section II.B.

2/ Including the NIC.

Table 3. St. Lucia: Monetary Survey

	1998	1999	2000	Prel. 2001	Proj. 2002
(In millions of Eastern Caribbean dollars, end of period)					
Net foreign assets	92.6	81.4	116.6	117.4	90.1
Net imputed international reserves	185.0	195.6	207.8	235.2	215.3
Commercial banks	-92.4	-114.2	-91.2	-117.8	-125.2
Net domestic assets	903.8	1,011.9	1,062.8	1,116.9	1,181.3
Net credit to the public sector	-210.2	-239.1	-258.4	-281.6	-293.6
Claims on government (net)	-38.9	-63.8	-85.8	-113.1	-141.8
ECCB net credit to central government	12.2	7.9	3.5	10.9	24.5
Commercial bank net credit to government	-51.1	-71.7	-89.3	-124.0	-166.4
Net credit to other public sector	-171.3	-175.4	-172.7	-168.6	-151.8
Credit to private sector 1/	1,258.2	1,394.2	1,481.7	1,541.8	1,632.4
Other items (net)	-144.2	-143.2	-160.5	-143.3	-157.4
Money and quasi-money (M2)	996.4	1,093.3	1,179.4	1,234.3	1,271.4
Money	247.9	267.6	286.1	283.8	274.3
Currency outside banks	77.5	84.1	84.6	82.1	80.9
Demand deposits	170.4	183.6	201.5	201.7	193.4
Quasi-money	748.5	825.7	893.3	950.5	997.2
Time deposits	273.6	292.2	334.7	364.4	340.0
Savings deposits	467.9	512.5	551.1	573.3	637.1
Foreign currency deposits	7.1	20.9	7.6	12.8	20.1
(12-month change in percent of M2 at the beginning of the period)					
Net foreign assets	11.2	-1.1	3.2	0.1	-2.2
Net imputed reserves	2.9	1.1	1.1	2.3	-1.6
Commercial banks	8.3	-2.2	2.1	-2.3	-0.6
Net domestic assets	0.9	10.8	4.7	4.6	5.2
Credit to the public sector	-5.9	-2.9	-1.8	-2.0	-1.0
Credit to the central government	-1.7	-2.5	-2.0	-2.3	-2.3
Credit to the rest of the public sector	-4.1	-0.4	0.2	0.3	1.4
Credit to the private sector	9.7	13.6	8.0	5.1	7.3
Other items (net)	-2.9	0.1	-1.6	1.5	-1.1
(12-month percentage change)					
Credit to the private sector	7.4	10.8	6.3	4.1	5.9
Money and quasi-money	12.1	9.7	7.9	4.7	3.0
Money	3.6	8.0	6.9	-0.8	-3.4
Quasi-money	15.3	10.3	8.2	6.4	4.9
Memorandum item:					
Income velocity of M2 2/	1.8	1.7	1.6	1.4	1.4

Sources: ECCB; and Fund staff estimates and projections.

1/ Includes assumption by government of EC\$40 million in debt from the St. Lucia Banana Growers Association in 1998, previously included under credit to the private sector.

2/ Nominal GDP at market prices divided by the average stock of money (measured as the simple average of the current period stock and the stock 12-months earlier).

Table 4. St. Lucia: Summary Balance of Payments

(In millions of U.S. dollars)

	1998	1999	2000	Prel. 2001	Proj.	
					2002	2003
Current account	-66.1	-81.8	-63.0	-37.3	-55.6	-59.0
Trade balance	-224.7	-251.1	-249.4	-206.9	-222.2	-234.3
Exports, f.o.b.	70.4	60.9	63.1	51.8	54.9	61.0
Imports, f.o.b.	-295.1	-312.0	-312.4	-258.7	-277.1	-295.4
Services (net)	139.1	147.3	169.2	156.0	153.2	161.3
Receipts	317.3	323.5	343.6	308.0	309.0	326.5
Travel	277.6	278.6	297.4	257.6	252.1	267.5
Other nonfactor services	36.2	42.5	42.5	47.9	54.4	56.5
Factor services	3.5	2.4	3.7	2.5	2.5	2.6
Payments	178.2	176.2	174.3	152.0	155.8	165.2
Travel	31.2	33.0	33.3	31.5	31.5	32.7
Other nonfactor services	101.0	103.1	94.0	77.4	78.6	81.6
Factor services	46.0	40.1	47.0	43.1	45.7	51.0
<i>Of which</i>						
Interest payments (public sector)	5.7	6.2	7.9	9.4	11.1	15.0
Current transfers (net)	19.5	22.0	17.1	13.7	13.4	14.0
Capital and financial account	75.6	89.5	71.3	49.1	56.8	66.9
Capital transfers (net)	22.4	26.1	15.8	26.4	20.4	22.2
Official borrowing (net)	9.6	14.0	30.6	13.1	51.6	22.5
Loans (net)	8.5	14.0	7.1	-0.3	3.6	28.5
Drawings	15.5	22.6	18.0	23.7	35.8	39.6
Amortizations	7.0	8.6	10.9	24.0	32.2	11.1
Bonded debt (net)	1.1	0.0	23.5	13.4	48.0	-6.0
Private capital 1/	43.5	49.4	24.9	9.6	-15.3	22.2
Overall balance	9.5	7.7	8.3	11.8	1.2	7.9
Change in imputed reserves (increase -)	-9.5	-3.9	-4.5	-10.1	7.4	-5.3
Memorandum items:						
Current account balance 2/	-10.3	-12.3	-9.2	-5.8	-8.4	-8.6
Debt-service ratio 3/	3.3	3.9	4.7	9.3	12.1	8.3

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

1/ Includes errors and omissions.

2/ In percent of GDP.

3/ In percent of exports of goods and services.

Table 5. St. Lucia: Comparative Economic Performance

	St. Lucia	ECCU 1/
I. Social and Demographic Indicators		
Area (square kilometers)	616	2,810
Population (thousands, 2001 estimate)	158	570
Social indicators		
Population per physician 2/	2,533	1,453
Population per hospital bed 2/ 3/	292	288
II. Economic Indicators		
GDP per capita (US\$; 2001 est.)	4,099	4,731
Real GDP growth at factor cost (percent; 1998–2001 avg.)	0.3	2.3
Unemployment rate (percent, 2001 est.)	18.9	15.0
Inflation (percent; average rate; 1998–2001)	3.0	2.7
Prime lending rate (2001)	10.5	12.0
Central government revenue and grants (percent of GDP; 1998–2001 avg.) 4/	28.0	28.2
Central government expenditure (percent of GDP; 1998–2001 avg.) 4/	28.3	32.1
Central government wage bill (percent of GDP; 1998–2001 avg.) 4/	11.2	12.6
Central government balance (percent of GDP; 1998–2001 avg.) 4/	-0.3	-3.9
Central government saving (percent of GDP; 1998–2001 avg.) 4/	4.9	1.1
Tourism growth, stay-overs (percent, 1997–2001 avg.)	1.2	0.2
Export volume growth (percent, 1998–2001 avg.)	-8.5	7.0
External current account balance (percent of GDP; 1998–2001 avg.) 5/	-9.4	-14.9
Public sector external debt (percent of GDP; 2001) 6/	30.9	49.9

Sources: ECCB; and Fund staff estimates.

1/ Comprises the ECCB member countries, which are Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

2/ Data unavailable for Antigua and Barbuda.

3/ Data unavailable for St. Kitts and Nevis.

4/ St. Lucia data are for fiscal years beginning April 1.

5/ Including migrants' remittances.

6/ Government and government-guaranteed debt, end of period.

Table 6. St. Lucia: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	Est. 2001	Proj.	
					2002	2003
Financial indicators						
Broad money (percent change, 12-month basis)	12.1	9.7	7.9	4.7	3.0	4.0
Private sector credit (percent change, 12-month basis)	7.4	10.8	6.3	4.1	5.9	3.8
Nonperforming loans (3 months and over)/total loans (percent) 1/	12.8	12.4	13.7	18.7	19.9	...
(Average nonperforming loans for other ECCU countries)	19.7	20.3	14.8	16.2
Capital/risk weighted assets (percent)	8.7	15.6	13.4
Three-month treasury bill rate 2/	7.0	7.0	7.0	7.0	7.0	...
Three-month treasury bill rate (real) 2/ 3/	3.4	0.9	6.6	4.9	5.1	...
External indicators						
Exports of goods and services (percent change, 12-month basis, in US\$)	7.1	-0.6	5.5	-11.3	1.1	6.5
Imports of goods and services (percent change, 12-month basis, in US\$)	3.4	4.9	-1.8	-16.4	5.3	5.8
Current account balance	-10.3	-12.3	-9.2	-5.8	-8.4	-8.6
Capital and financial account balance	11.8	13.5	10.4	7.6	8.6	9.8
Net imputed official reserves (in US\$ millions)	68.6	72.5	77.0	87.2	79.8	85.1
Net official reserves in months of imports of goods and services	1.9	1.9	2.1	2.8	2.5	2.5
Net official reserves to broad money (percent)	18.6	17.9	17.6	19.1	16.9	17.4
Total public external debt	22.6	24.2	27.6	30.9	38.6	40.5
Total external debt to exports of goods and services (percent) 4/	37.7	42.0	46.8	56.0	70.5	72.0
External interest payments to exports of goods and services (percent) 4/	1.5	1.6	1.9	2.6	3.0	2.8
External amortization payments to exports of goods and services (percent) 4/	1.8	2.2	2.7	6.7	5.7	5.3
External interest payments to fiscal revenue (percent) 4/ 5/	1.6	1.6	1.7	4.5	5.9	7.0
External amortization payments to fiscal revenue (percent) 4/ 5/	2.0	1.8	2.9	3.2	11.1	3.6
Exchange rate (per US\$, end of period)	2.7	2.7	2.7	2.7
REER appreciation (12-month basis) 6/	-0.3	8.4	2.9	0.4	-3.5	...
Travel receipts to exports of goods and services (percent)	72.3	72.9	73.8	72.1	69.7	69.5

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

1/ For 2002, refers to end-September 2002.

2/ Average rate of discount (end of period). For 2002, refers to end-July.

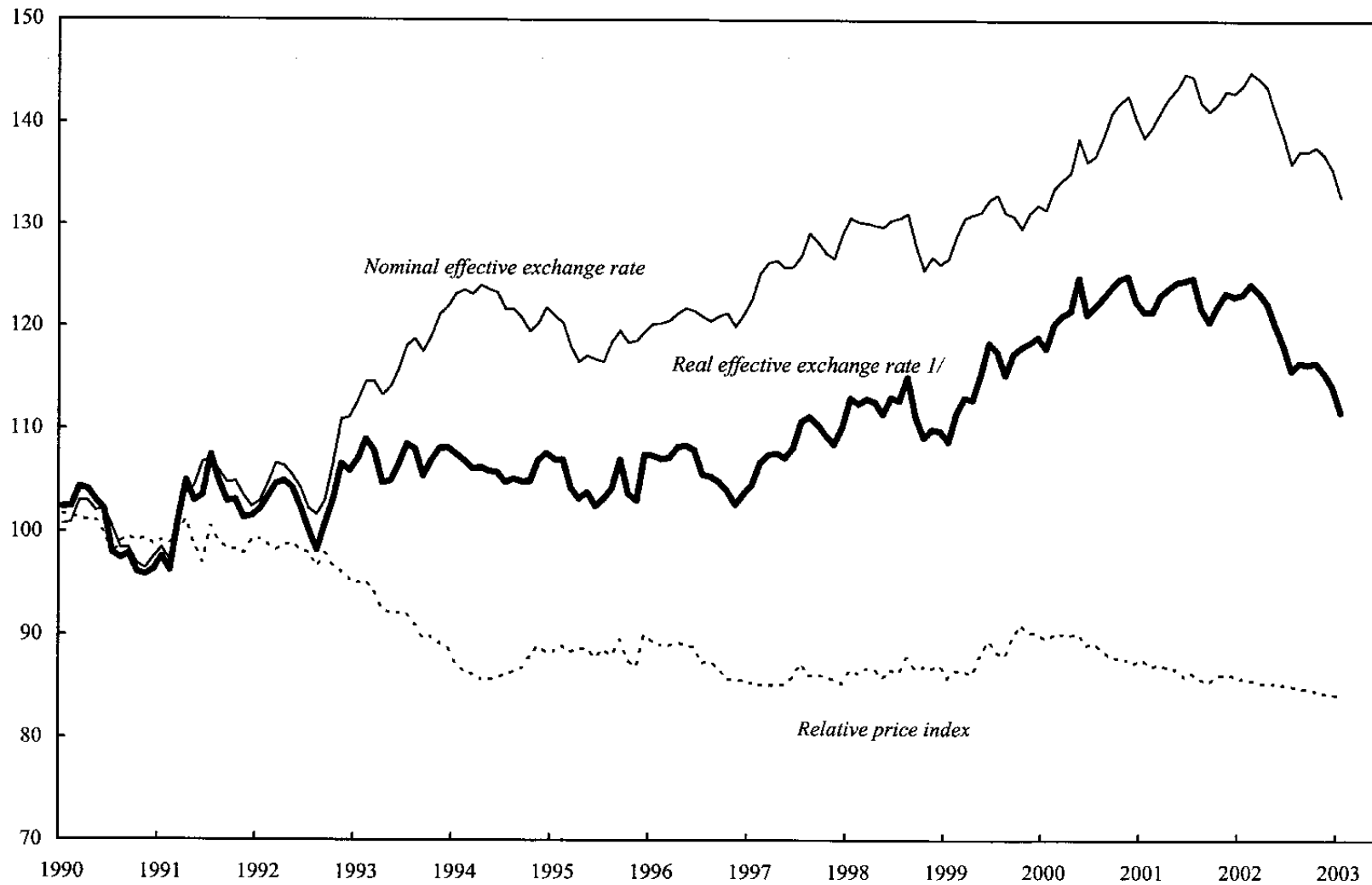
3/ Treasury bill rate adjusted for actual year-on-year inflation.

4/ Debt service refers to public sector debt. Fiscal revenue refers to central government's current revenue.

5/ For fiscal years beginning April 1.

6/ For 2002, 12-month change through September 2002.

**Figure 1. St. Lucia: Exchange Rate Developments
(Index 1990=100)**



Sources: IMF Information Notice System; and staff estimates.

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

St. Lucia: Fund Relations
(As of November 30, 2002)

- I. Membership Status:** Joined 11/15/79; Article VIII
- | II. General Resources Account | SDR Million | Percent of Quota |
|--------------------------------------|--------------------|-------------------------|
| Quota | 15.30 | 100.0 |
| Fund holdings of currency | 15.30 | 100.0 |
| Reserve position in Fund | 0.00 | 0.0 |
-
- | III. SDR Department | SDR Million | Percent of Allocation |
|----------------------------|--------------------|------------------------------|
| Net cumulative allocation | 0.74 | 100.0 |
| Holdings | 1.48 | 199.2 |
- IV. Outstanding Purchases and Loans:** None.
- V. Financial Arrangements:** None
- VI. Projected Obligations to the Fund:** None.
- VII. Exchange Rate Arrangement:** St. Lucia is a member of the Eastern Caribbean Currency Union, which has a common central bank (the Eastern Caribbean Central Bank) and currency (the Eastern Caribbean dollar). Since July 1976, the Eastern Caribbean dollar has been pegged to the U.S. dollar at the rate of EC\$2.70 per U.S. dollar. St. Lucia maintains an exchange restriction arising from the requirement imposed on individuals or corporations who request the approval of a single outward remittance above EC\$250,000 and who have outstanding tax liabilities, to make arrangements for the eventual clearance of such tax arrears before the remittance is approved by the ministry of finance.
- VIII. Article IV Consultation:** St. Lucia has been on the 24-month cycle. The 2000 Article IV consultation was concluded by the Executive Board on March 7, 2001 (EBM/01/23); the relevant documents are SM/01/49 and SM/01/61.
- IX. Technical Assistance:** FAD and CARTAC—Tax Policy and Administration—November–December 2002; FAD—Tax Policy and Administration—February–March 1998.

St. Lucia: Relations with the World Bank Group
(As of December 17, 2002)

I. PROJECTS

There are currently five ongoing World Bank projects in St. Lucia, with net commitments of approximately US\$29.9 million. In addition, there are two projects which are part of the OECS subregional programs of the World Bank.

The St. Lucia **Disaster Management Project**, approved in FY 1999, 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 World Bank on March 8, 2002, approved \$20.9 million in loans and credits to support **Emergency Recovery Projects** in Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The projects support efforts aimed at fostering recovery from the fallout of the events of September 11, 2001. The projects seek inter alia to: (i) facilitate recovery from the ensuing drop-off in tourism; (ii) create the enabling conditions for recovery by enhancing security arrangements at airports and ports; and (iii) accelerate the reform of controls on offshore financial, business, and related services. The Bank's support to St. Lucia under this project is for US\$6.3 million.

The **St. Lucia Water Sector Reform Technical Assistance**, was approved in December 2001 for \$2.6 million. It supports the Government of St. Lucia's goal of improving the water and sewerage service provision through the private sector participation (PSP) in the operation of WASCO, the water supply and sewerage utility. The project finances the development of a regulatory framework (a consulting firm has been selected and initiated work on October 8, 2002), the preparatory work for PSP transaction as well a dissemination and consensus building campaigns.

The **St. Lucia Poverty Reduction Fund**, approved in FY 2000 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 **OECS Education Reform Project** is a follow-up to the Basic Education project. It was approved in FY 2002 (June 2002) for US\$12.0 million, and was signed in September 2002. It is expected to become effective by the end of this calendar year. This is one of several subprojects included in a regional horizontal APL. The overall objective of this project is to build human capital in the OECS which, in turn, will contribute to the diversification of their

economy and more sustainable growth. This objective will be achieved by: (i) increasing equitable access to secondary education; (ii) improving the quality of the teaching and learning process, with more direct interventions at the school level and a focus on student-centered learning, and (iii) strengthening management of the sector and governance of schools.

The **OECS Solid/Ship Generated Waste Management Project**, approved in FY 1995, 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\$50.5 million. The St. Lucia national component is US\$7.7 million—US\$4.6 million from the World Bank, US\$1.1 million from the Global Environment Facility, and US\$2.0 million from the Caribbean Development Bank. The project has assisted St. Lucia and the other OECS participating countries establish the appropriate legal, institutional and financial frameworks, and improve equipment and infrastructure to enable effective management and disposal of waste.

The **OECS Telecommunications Reform Program**, approved in FY 1998 for US\$6 million, aims to introduce procompetition 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.

It is expected that one project benefiting St. Lucia—the OECS Catastrophe Insurance and Risk Management Project which will support the development of an insurance pool for public assets, strengthening the domestic insurance sector and options for coverage of low-income household assets, will be presented for Board consideration this fiscal year.

II. FINANCIAL RELATIONS

As of November 30, 2002
(In millions of U.S. dollars)

Operations	Principal	Disbursed	Undisbursed
OECS Solid/Ship Generated Waste Management	4.6	1.7	2.9
OECS Telecommunications Reform	1.2	0.4	0.8
Disaster Management	6.0	2.4	3.6
Poverty Reduction Fund	3.0	1.4	1.6
Water Sector Reform	2.6	0.0	2.6
Emergency Recovery Project	6.3	3.7	2.6
Education	12.0	0.0	12.0

Disbursements and Debt Service (Fiscal Year Ending June 30)

	Actual								Projections	
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Total disbursements	1.0	4.3	1.5	3.3	1.7	1.9	1.2	1.8	6.7	4.0
Repayments	0.0	0.2	0.2	0.2	0.2	0.4	0.8	0.8	1.3	1.0
Net disbursements	1.0	4.1	1.3	3.1	1.5	1.5	0.5	0.9	5.4	3.0
Canceled	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest and fees	0.1	0.2	0.3	0.3	0.4	0.5	0.4	0.4	0.5	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) a number of reports are under preparation or being finalized including: a Fiscal Issues report, the CFAA and a CPAR. (b) the 2002 Caribbean Economic Overview which examines the theme of macroeconomic volatility and its effects on household vulnerability in the Caribbean countries; and (c) a study on youth development in the Caribbean.

An update of the Red Book, which gives disbursements by donors to the OECS, will be prepared during FY 2003.

St. Lucia: Relations with the Caribbean Development Bank
(As of November 2002)

The operations of the Caribbean Development Bank (CDB) 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 US\$222.3 million (10.9 percent) of net cumulative loans, contingent loans, equity, and grants approved since 1970. Of this amount, US\$105.4 million were provided from the Ordinary Capital Resources while the remainder was from “soft” resources. At the end of September 2002, St. Lucia had a total outstanding balance of US\$81.6 million on some 46 loans representing 17 projects under implementation.

Below is a summary of the cumulative sectoral distribution of CDB assistance to St. Lucia.

Sectoral Distribution of Capital Projects, 1970–2001

Sectors	In Millions of U.S. Dollars	In Percent
Transportation	49.4	22.5
Education	42.4	19.3
Manufacturing	29.9	13.5
Agriculture	21.4	9.6
Water	18.4	8.3
Tourism	10.7	4.8
Housing	19.1	8.6
Health	5.6	2.5
Power and energy	1.5	0.6
Multisector	23.6	10.6
TOTAL	222.0	100.0

St. Lucia: Statistical Issues

St. Lucia's statistical database is inadequate for meeting the authorities' needs and for Fund surveillance. There are weaknesses in coverage, frequency, quality, and timeliness that continue to frustrate effective economic analysis and policy formulation. The weakest areas are the national accounts, the fiscal accounts, and balance of payments. Also, 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.

St. Lucia participates in the General Data Dissemination System (GDDS) and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board (<http://dsbb.imf.org>) since September 21, 2000. The metadata include detailed plans for statistical development in the main macroeconomic areas over 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. 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. Data on domestic debt of the public sector are not available on a regular basis. 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. Although recent 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 (BPM5)*, particularly services, income, current transfers, direct investment, and other investment. Data for the period from 1996 through 2000 were published in late 2001 in *IFS*. Data for 2001 and revised data for earlier years have recently been provided to the Fund but have yet to be published, pending conversion to the *BPM5* classifications. In general, enhanced data sources and better compilation procedures are needed to improve the accuracy of the balance of payments statistics. Efforts should also be made to compile quarterly balance of payments statistics.

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.

St. Lucia: Core Statistical Indicators
(As of December 27, 2002)

	Exchange Rates	International Reserves	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt
Date of latest observation	Fixed rate since 1976	6/2002	8/2002	9/2002	9/2002	12/2001	12/2001	12/2001	8/2002	2001	3/2002
Date received		8/15/2002	10/15/2002	12/03/2002	12/03/2002	8/15/2002	6/10/2002	6/10/2002	10/10/2002	6/10/2002	6/10/2002
Frequency of data series		Monthly	Monthly	Monthly	Monthly	Monthly	Monthly	Annual	Monthly	Annual	Monthly
Frequency of reporting to IMF		Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	Monthly (lag of 1-2 months)	On request	Annual	Monthly	Annual	On request
Source of update		ECCB	ECCB	ECCB	ECCB	Central Statistical Office (CSO), Ministry of Finance	CSO/ECCB	ECCB	Ministry Of Finance	ECCB & Central Statistical Office, Ministry of Finance	Debt Unit Ministry of Finance
Mode of reporting		E - Mail	E - Mail	E - Mail	E - Mail	Fax	Mission/Fax	Mission/ E - Mail	Mission/ Fax	Mission/ E - Mail	Mission/ Fax
Confidentiality		Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Restricted	Unrestricted	Restricted
Published data		Yes	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	No

MEDIUM-TERM OUTLOOK

St. Lucia has the potential to achieve a growth rate of 3 percent per annum over the medium term, on the basis of a stabilized banana industry and developed nontraditional agriculture, and expanding tourism and other services exports. These higher rates of growth would allow to restore the upward trend in income per capita and reduce unemployment and poverty on a sustained basis.¹

The staff adjustment policies projections assume the strengthening of public finances, the completion of trade reform and privatization programs, and the implementation of current social and poverty reduction programs. Following declines in 2001–02, the volume of tourism and other services exports is projected to grow 2–3 percent per annum in 2003–07, as market conditions improve. Based on the satisfactory implementation of the Banana Recovery Program, by 2005–07 banana export volumes are expected to be somewhat above their 2000 levels, with export prices rising by about 1½ percent per year. With annual 2 percent increases, by 2007 tourist arrivals would regain their 2001 level, while expenditure is projected to increase marginally faster. On this basis, real GDP growth would rise from 1½ percent in 2003 to 3 percent in 2005–07, driven by external demand and underpinned by domestic investment rising by over 2 percentage points of GDP to 19½ percent in 2007. External current account deficits are projected in the 8½–10 percent of GDP range (Table 7), and are expected to be financed largely with private inflows increasing in response to the improved conditions for private investment.

Consistent with the fiscal consolidation scenario prepared in the context of fiscal sustainability assessment (see SM/03/11) and assuming GDP growth from the baseline projection, the total public debt would stabilize at around 60 percent of GDP and the external debt at around 40 percent of GDP during 2003–07.

Under unchanged fiscal policies (no new revenue measures and noninterest expenditures increasing in line with nominal GDP), the overall deficit of the public sector would exceed 7 percent of GDP in FY 2003/04, leading to a continued increase in the public debt to above 80 percent of GDP by 2007. The actual costs of delaying fiscal consideration may be greater than presented in this scenario, given the likely impact of unchanged policies on private capital inflows and investment, which in turn could result in slower growth.

¹ The authorities' medium-term strategy released in mid-2002 targets by 2004 real GDP growth of 5 percent; central government savings of 5.3 percent of GDP; and total public sector debt at 48 percent of GDP. See Medium-Term Development Strategy Paper, the Government of St. Lucia, June 2002. Prior to the 2003/04 budget, the authorities were unwilling to commit to the 2 percentage points of GDP reduction in the central government deficit for FY 2003/04 proposed by staff and assumed in these projections.

The medium-term projections are sensitive to weaker prospects in the banana and tourism sectors. On an alternative assumption, with banana export prices falling by 15 percent in nominal terms, and with an accompanying decline in output of some 20 percent from current levels by 2007, and with growth in tourism and services exports 1 percentage point lower than in the baseline scenario would slow overall output growth by about 1½ percent a year to about 1½ percent. In this case the current account deficit would stabilize at a lower level (7–8 percent of GDP), with slower growth of imports and less buoyant private investment and capital inflows.

Table 7. St. Lucia: Medium-Term Outlook

	Average	Est.	Projections 1/					
	1999-00	2001	2002	2003	2004	2005	2006	2007
(Annual percentage change)								
National income and prices								
Real GDP growth	1.7	-5.2	-0.5	1.5	2.0	3.0	3.0	3.0
Implicit GDP deflator (factor cost)	2.4	1.3	1.9	2.0	2.0	2.0	2.0	2.0
(In percent of GDP, unless otherwise stated)								
Saving and investment								
Gross domestic investment	22.2	16.1	17.0	17.2	17.6	18.2	19.4	19.5
Public	10.3	8.1	9.0	9.1	8.5	8.8	9.0	9.0
Private	12.0	8.0	8.0	8.1	9.1	9.4	10.4	10.5
Gross domestic saving	11.4	10.3	8.6	8.6	8.9	9.5	9.5	9.6
Public	7.4	3.7	0.5	1.2	3.5	4.6	4.9	5.0
Private	4.0	6.6	8.1	7.4	5.4	5.0	4.6	4.6
Public sector 2/								
Public sector overall balance	-0.7	-3.4	-7.3	-5.3	-2.4	-2.8	-2.7	-2.6
<i>Of which</i>								
Central government	-0.4	-3.9	-7.3	-5.3	-2.4	-2.8	-2.7	-2.6
Central government saving	5.8	1.6	-0.9	0.7	3.1	3.7	4.0	4.0
Current revenues	26.1	24.4	22.8	23.3	24.5	25.2	25.4	25.5
Current expenditure	20.3	22.8	23.8	22.6	21.4	21.6	21.5	21.5
External sector								
Current account	-10.8	-5.8	-8.4	-8.6	-8.7	-8.7	-9.9	-9.9
<i>Of which</i>								
Exports of goods and services	58.3	55.2	54.8	56.2	58.1	58.3	57.3	57.1
Imports of goods and services	66.0	56.8	58.7	59.8	61.4	61.6	61.8	62.6
Capital and financial account 3/	12.0	7.6	8.6	9.8	9.8	9.8	10.9	10.9
Public sector debt and debt service								
Total debt	43.6	52.5	56.6	59.8	59.7	59.7	59.5	59.1
<i>Of which</i>								
External debt	25.9	30.9	38.6	40.5	40.5	40.4	40.2	39.9
External debt/exports 4/	44.4	56.0	70.4	72.1	69.7	69.3	70.2	69.9
External debt service/exports 4/	4.3	9.3	12.1	8.3	8.6	7.5	9.1	10.1

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

1/ Projections are based on improved fiscal policies.

2/ Data are for fiscal years beginning April 1. Data for the public sector overall balance exclude the National Insurance Corporation.

3/ Including errors and omissions.

4/ Exports of goods and services.



INTERNATIONAL MONETARY FUND

Public Information Notice

EXTERNAL
RELATIONS
DEPARTMENT

Public Information Notice (PIN) No.03/61
FOR IMMEDIATE RELEASE
May 9, 2003

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

IMF Concludes 2002 Article IV Consultation with St. Lucia

On January 27, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with St. Lucia.¹

Background

St. Lucia's economy is very small and highly dependent on tourism and banana production. Since the mid-1990s, banana output has fallen by more than half as the banana industry has been undergoing a retrenchment in the face of competition from lower-cost producers. However, the tourism industry has grown rapidly making St. Lucia the number one tourist destination among Eastern Caribbean Currency Union members, and the export of other services has expanded.

After growing by an average 3 percent a year in 1998–99, output stagnated in 2000, and fell by an estimated 5¼ percent in 2001. This reflected a severe drought in 2001, as well as lower tourism activity owing to the global economic slowdown and the terrorist attacks of September 2001. The unemployment rate increased to about 19 percent in 2001, from 16½ percent in 2000. In 2002, no growth is expected as tourism was weak and tropical storm damage prevented a stronger recovery in banana production. Inflation has remained in the low single digits, and the price level remained broadly unchanged in August 2002 relative to August 2001.

After improving in 1998–99, public finances have weakened since. The public sector's overall balance shifted from a surplus of 2 percent of GDP in FY 1999/00 to a deficit of 3½ percent of GDP in FY 2001/02. The dominant influence is the central government's deficit with the rest of

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.

the public sector running a small surplus. Central government current revenue fell by 2 percent of GDP in FY 2001/02, largely owing to the steep recession; and spending increased mostly because of higher interest payments and a small increase in the wage bill. Preliminary information on the central government finances in the period April–October 2002 indicates a further increase in the deficit, notwithstanding new measures implemented during the fiscal year. As of end-September 2002, the total public sector debt reached 56 percent of GDP.

The growth of credit to the private sector slowed in 2001, while the public sector continued to build up deposits with the banking system, and commercial banks reduced their net foreign assets by about US\$10 million. During the 12 months ending in September 2002, these trends reversed—broad money and credit to the private sector grew moderately, while the public sector (including the National Insurance Corporation—NIC) reduced its net creditor position with the banking system by 16½ percent.

The external current account deficit, which had declined in 2001 to 5¾ percent of GDP as imports fell sharply, is estimated to have increased to 8½ percent in 2002 mainly owing to a decline in receipts from services. These deficits have been more than covered by capital inflows including public sector borrowing and private capital. Reflecting the government borrowing, public and publicly guaranteed external debt rose rapidly in recent years (from an average of 23½ percent of GDP in 1998–99 to about 31 percent at end-2001), and is estimated to have increased to 38½ percent of GDP at end-2002. Owing largely to the depreciation of the U.S. dollar vis-à-vis other major currencies, the external value of the Eastern Caribbean dollar as measured for St. Lucia depreciated in real effective terms by about 5½ percent during the first nine months of 2002. The real exchange rate is currently 13 percent above its most depreciated level in the mid-1990s.

Executive Board Assessment

Directors noted that the St. Lucian economy suffered adverse exogenous shocks during 2001-02: tourism was affected by the global economic slowdown and the terrorist attacks of September 2001, and agriculture suffered from a severe drought and a tropical storm. The result was a fall in economic activity, a rise in unemployment, and sharp increases in the public sector budget deficit and public debt.

Directors commended St. Lucia's long record of prudent macroeconomic policies. They expressed concern, however, about the large fiscal deterioration in the last three years, and urged strong adjustment measures to curtail the growth of public debt. In this context, Directors welcomed the authorities' commitment to implement measures in the 2003/04 budget that would significantly reduce the central government deficit and reverse the fiscal deterioration. They emphasized the importance of expenditure restraint, in particular through limiting wage bill increases. They welcomed the authorities' collaboration with the World Bank and the Caribbean Development Bank to enhance the efficiency of public expenditure and to focus public investment on projects aiming at private sector-led growth and poverty reduction.

Directors stressed the need to reverse the steady decline in government revenues. They were encouraged by the authorities' commitment to tax reform and support for the adoption of a value-added-type tax. They noted the substantial technical assistance that the Caribbean

Technical Assistance Center and the Fund's Fiscal Affairs Department are providing in the area of tax reform. Directors recommended other steps to boost revenues and broaden the tax base, such as a further reduction in tax concessions, and early introduction of a market-value-based property tax. The authorities were also encouraged to fully implement the domestic fuel price adjustment mechanism.

Executive Directors supported the authorities' efforts to further diversify St. Lucia's economy and to enhance competitiveness. They encouraged the authorities to continue their efforts to raise standards across the tourism industry and promote agricultural diversification. There was support for the banana sector recovery program, which aims to improve competitiveness ahead of the loss of preferential tariffs scheduled for end-2005. Directors advised the authorities to strengthen the link between wages and productivity, reform the labor code to enhance the flexibility and efficiency of the labor market, and continue the restructuring of public enterprises to improve their efficiency.

Directors expressed concern about the increase in nonperforming loans and potential quasi-fiscal liabilities of the financial sector. They supported ongoing efforts to strengthen financial sector regulation and supervision, and encouraged prompt enactment of amendments to the Uniform Banking Act as well as steps to strengthen the supervision of nonbank financial institutions. They welcomed the completion of the Fund-supported self-assessment of the regulatory and supervisory regime of the offshore financial sector, as well as efforts to strengthen the anti-money laundering regime, including by establishment of a financial intelligence unit. Directors also welcomed St. Lucia's agreement to participate in the ECCU area-wide Financial Sector Assessment Program scheduled for the second half of 2003.

Directors encouraged further efforts to improve the quality and timeliness of data in line with the plans for statistical development under the General Data Dissemination System.

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

	1998	1999	2000	Prel. 2001	Est. 2002
<i>Output and prices (change in percent)</i>					
Real GDP at factor cost	3.1	3.1	0.2	-5.2	-0.5
Consumer prices (end of period)	3.6	6.1	0.4	2.1	1.9
Banana production	2.6	-11.0	7.8	-51.6	29.0
Tourist stayovers	1.5	3.3	3.6	-7.6	0.0
<i>Public finance (in percent of GDP) 1/</i>					
Central government saving	6.0	7.9	5.4	1.6	-0.9
Central government overall balance (after grants)	1.8	2.3	-1.4	-3.9	-7.3
<i>Money and credit (end of year, percent change) 2/</i>					
Money and quasi-money	12.1	9.7	7.9	4.7	3.0
Credit to private sector	9.7	13.6	8.0	5.1	7.3
<i>Balance of payments and external debt (percent of GDP)</i>					
Current account balance	-10.3	-12.3	-9.2	-5.8	-8.4
External debt 3/	22.6	24.2	27.6	30.9	38.6
Debt-service ratio 4/	3.3	3.9	4.7	9.3	12.1
<i>Exchange rate (change in percent)</i>					
Real effective exchange rate (end of period, depreciation -) 5/	-0.3	8.4	2.9	0.4	-3.5
Terms of trade	8.6	3.9	5.6	2.7	...
Excluding tourism	17.8	0.6	-0.7	.05	...

Sources: St. Lucian authorities; ECCB; and IMF 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 2002 refer to the 12-month period ending in September 2002.

Statement by Ian E. Bennett, Executive Director for St. Lucia
January 27, 2003

1. On behalf of the authorities of St. Lucia, I would like to express gratitude to the staff for the very helpful Article IV consultation. The discussions were extremely valuable for the authorities, and the addition of the Debt Sustainability Analysis for this year's consultation added a useful new dimension. Given the significant developments in the region, and the fact that a regional FSAP is scheduled to be undertaken this year, the authorities have agreed to a reduction in the consultation cycle from 24 to 12 months for the next Article IV, after which the consultation would revert back to the 24-month cycle.

Background

2. St. Lucia has a solid record of prudent economic management, traditionally running only small overall fiscal deficits, and in some years even overall surpluses. Therefore, debt levels remained at very manageable levels. Unfortunately, like other countries in the region, St. Lucia has been hit by a series of external shocks which have severely affected economic growth and the fiscal position of the government. In particular, banana farmers suffered as a result of a drought in 2001, while the tourism industry was hit by the global slowdown and the aftermath of the terrorist attacks of September 11. The recovery of both sectors in 2002 was set back by tropical storm Lili, which struck in September.

3. GDP fell by over 5 percent in 2001, and dropped further in 2002. The deterioration in the fiscal position was even more dramatic – the overall balance fell from a healthy surplus in 1999-00 (just prior to the last Article IV consultation) to an estimated deficit of around 7 percent of GDP in 2002-03. This resulted in an increase in the overall public sector debt from about 44 percent of GDP in 1999-00 to current levels of just under 60 percent.

Fiscal Policy

4. The staff has recommended a coherent set of policy measures designed to stabilize the government's finances and enhance growth, with which the authorities agree in large measure. However, the challenge for the authorities is to find the appropriate pace for implementing policies in a manner that minimizes, to the extent possible, the adverse consequences for growth, employment, and social cohesion. The authorities are particularly concerned that significant fiscal retrenchment could undermine the nascent economic recovery. They also feel that, given its long track record of prudent economic management, St. Lucia has the scope to allow for a more gradual pace of adjustment.

5. That being said, the authorities fully recognize the need to reverse the fiscal deterioration and are now considering the adjustment measures suggested by staff (and assumed in staff projections) for inclusion in the 2003-04 budget. They also consider the fiscal convergence benchmarks being proposed by the ECCB as appropriate. To this end, they are resolved on promoting further tax reform, revenue enhancement, and improved

public expenditure management. St. Lucia is participating in the Regional Tax Commission and very much welcomes the complementary work being undertaken by the Fiscal Affairs Department (FAD). The government, in conjunction with other OECS countries, is currently researching the feasibility of a VAT-type tax. The research activities include matters relating to administrative costs and simplifications.

6. The authorities agree fully that changes are needed to broaden the tax base. While staff emphasizes that concessions are a source of revenue leakages that need to be contained, the authorities want to stress that concessions are currently necessary to attract international investment (given that similar incentives are offered by competitors in the region), and in this respect, concessions can boost economic growth and government revenues. However, the authorities look forward to the outcome of the FAD review, and are hopeful that increased harmonization of practices within the region will reduce pressure to provide tax concessions.

7. On the expenditure side, the authorities are committed to restraint on government expenditures and they continue their pursuit of improved efficiency and effectiveness in this spending. In this context, they look forward to continuing to work with the World Bank and the CDB to enhance the efficiency of public expenditure and, in the PSIP, to give priority to growth-oriented projects for which official long-term financing is available.

Monetary and Financial Issues

8. The authorities view the common monetary and exchange arrangement with the ECCB as indispensable to maintaining low inflation, fostering prudent economic policies and maintaining economic stability. The ECCB is also in charge of banking regulation and supervision, and has determined that the banking system of St. Lucia remains sound overall. Preparations for the enactment of amendments to the Uniform Banking Act are well underway, and the supervision of non-bank finance institutions is being strengthened with the establishment of uniform regulatory bodies (with CARTAC's assistance).

9. St. Lucia was a relative late-comer in providing offshore financial services, and to some extent, this provided the authorities with the opportunity to get the regulatory and supervisory framework right from the start. The authorities remain committed to this task, and improvements to the supervision of the OFC are ongoing. For example, St. Lucia completed the Fund self-assessment of the OFC (Module I); the regulatory and supervisory system is being strengthened (including the anti-money laundering regime) and a financial intelligence unit is being established. The authorities look forward to the regional FSAP scheduled for later this year.

Structural Reform and Growth

10. The authorities' focus is on enhancing the competitiveness of the economy, particularly in tourism and agriculture, while supporting economic diversification. Their strategy involves improving the efficiency of the public sector and encouraging greater private sector involvement in the economy, all within a social dialogue aimed at enhancing

productivity and moderating wage growth. The recent depreciation of the real effective change rate, due primarily to the depreciation of the US dollar, will also provide a welcome fillip to competitiveness. Maintaining the viability of banana farming will be achieved by targeting assistance at the most productive farms, by encouraging the consolidation of farms and by improving irrigation (with EU assistance).

11. Despite concerns about the adverse impact the FTAA may have on St. Lucia's economy, the authorities remain committed to regional integration and trade liberalization. St. Lucia has already removed remaining constraints on capital movements within the OECS and is on track to phase out the remaining non-tariff barriers by June 2003.

12. The authorities are also committed to improving governance, particularly through increasing transparency and accountability. The availability of government information through the government's official website has increased significantly and consultations with the public are held on key issues. The public expenditure review by the World Bank is expected to further enhance fiscal transparency and governance. The authorities would welcome any additional technical assistance the staff could provide to continue the process of strengthening data, particularly to improve the methodology of national accounts projections, CPI compilation and balance of payments statistics.