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Grenada: 2002 Article IV Consultation—Staff Report; Use of Fund Resources—Request for Emergency Assistance; Public Information Notice and Press Release on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the Article IV consultation with Grenada and use of Fund resources—request for emergency assistance, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation and use of Fund resources—request for emergency assistance, prepared by a staff team of the IMF, following discussions that ended in **mid-December 2002**, with the officials of Grenada on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 13, 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) and Press Release, **summarizing the views of the Executive Board as expressed during its January 27, 2003, discussion** of the staff report on issues related to the Article IV consultation and the request for emergency assistance, respectively.

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

Statistical Appendix

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GRENADA

Staff Report for the 2002 Article IV Consultation

Prepared by the Staff Representatives for the 2002 Consultation with Grenada

Approved by Guy M. Meredith and Matthew Fisher

January 13, 2003

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- **After three years of rapid growth, real GDP declined by 3 percent in 2001** reflecting the global slowdown and the impact—particularly on tourism—of the September 11 attacks. A further decline of ½ percent is projected for 2002.

- **The current account deficit declined somewhat in 2001 to 18 percent of GDP as the weakening of tourism and export demand was more than offset by a fall in imports, but rose to an estimated 25 percent of GDP in 2002 as a result of higher imports and lower service receipts.** The deficit was financed by official commercial loans and foreign investment.

- **The overall central government deficit (after grants) more than doubled from 3 percent of GDP in 2000 to 8½ percent of GDP in 2001.** This reflected sharp rises in both current and capital expenditures. Increased deficits were partly financed by rising central government arrears which reached 2.2 percent of GDP at end 2001, while government savings declined by about 4 percentage points.

- **The government's efforts to contain the central government deficit for 2002 to less than 6 percent of GDP, by reducing both current and capital expenditures below budgeted levels, were partly undermined by unexpected expenditures to cope with the immediate after-effects of tropical storm Lili.** The provisional estimated outturn is a deficit of approximately 8 percent of GDP. The government has taken steps to strengthen revenue enforcement and reduce long-standing tax exemptions. Over the medium term, the authorities are targeting a reduction in the central government deficit by 2 percentage points to 6 percent of GDP in 2003 and to 2½ percent of GDP by 2005.

- **Rising fiscal deficits have resulted in a build up of public sector debt,** which reached 85 percent of GDP at end 2001, including contingent liabilities. The debt is projected to have risen to over 100 percent of GDP in 2002, of which around three-fifths was external.

- **The government issued a US$100 million international bond in June 2002.** The proceeds have been used to retire more expensive debt and eliminate government arrears.

- **The offshore financial sector—particularly banks—has contracted sharply, with adverse revenue consequences,** as the institutions involved proved unable or unwilling to meet more rigorously enforced prudential standards. The authorities are considering options for the sector to ensure that it does not become a drain on public finances.

- **The government has requested emergency assistance from the Fund to help deal with the extensive damage caused in September 2002 by tropical storm Lili.**

I. Introduction

1. Grenada is one of the small territories in the Eastern Caribbean consisting of the islands of Grenada, Carriacou, and Petit Martinique and has a land area of 345 square kilometers (or 133 square miles), a population of around 100,000, and per capita income of US$4,000. The economy is based on tourism, the export of spices, and other services. Grenada is a member of the Eastern Caribbean Currency Union (ECCU) of which the Eastern Caribbean Central Bank (ECCB) is the central bank. The currency of Grenada is the Eastern Caribbean dollar, which has been pegged to the U.S. dollar since July 1976 at the rate of EC$2.70 per U.S. dollar. Grenada's relations with the Fund are summarized in Appendix II.[1]

2. **Discussions for the 2002 Article IV consultation were held in St. George's during April 9–18 and July 29-August 1.**[2] The discussions continued up to mid-December, reflecting the government's request for emergency assistance after tropical storm Lili in September and presentation of the budget for 2003 in November 2002. The mission met with the Prime Minister, the Minister of Finance, the Financial Secretary, and senior officials, as well as with representatives of the private sector, the labor unions, and the political opposition.

3. **The last Article IV consultation was concluded by the Executive Board on July 11, 2001 (EBM/01/71).** On that occasion, Executive Directors noted that Grenada's recent economic performance had been among the most favorable in the Caribbean region. They saw Grenada's main challenge as that of sustaining investment, economic growth and social progress in the face of a less favorable external environment. Directors recommended that the authorities reduce tax concessions, particularly discretionarily granted, curb further growth in the wage bill, maintain a strong fiscal position and avoid recourse to expensive commercial borrowing. Directors recommended a greater role for the ECCB in financial sector supervision and welcomed the efforts to enforce anti-money laundering guidelines.

4. **The authorities' provision of core statistical data to the Fund has improved since the last consultation** with continued participation in the GDDS. In particular, detailed information on central government finances, public sector debt, and the banking system is

[1] Grenada has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

[2] The April mission comprised Messrs. DaCosta (head), Balakrishnan, Duffy, and Rizavi (all WHD). Ms. Smith of the ECCB and Ms. Dawson of the Caribbean Development Bank (CDB) contributed to the mission's work and participated in the discussions. The July/August mission comprised Mr. Boote (head), Ms. Francis, and Mr. Rizavi (all WHD). Mr. Whitehall, Advisor to the Executive Director for Grenada, participated in the final round of discussions in April.

available on a regular and timely basis. However, weaknesses in the timeliness and coverage of other data, including the national income accounts, and the balance of payments, especially capital flows, hamper the effective monitoring of economic developments (see Appendix V).

II. Recent Developments

5. **After GDP growth averaging 7 percent a year from 1998–2000, real GDP declined by 3 percent in 2001 and a further decline of ½ percent is projected for 2002 (Table 1 and Figure 1).** The output fall in 2001 reflected the global slowdown, completion of most of the large infrastructure and tourism projects, and the effects on tourism of the September 11 attacks in the United States. For 2002, the further fall in output reflects continued weaknesses in tourism, agriculture, manufacturing (including agro-processing), and construction.

6. **The fiscal situation deteriorated markedly in 2001.** The central government deficit (after grants) widened from 3½ percent of GDP a year in 1998–2000 to 8½ percent of GDP in 2001, reflecting a sharp increase in spending (about 6 percent of GDP) on social sectors, the wage bill, and goods and services (Table 2).[3] The government incurred arrears equivalent to almost 2 percent of GDP, reflecting obligations to the National Insurance Scheme (NIS) and suppliers. The fiscal situation has remained fragile in 2002, reflecting the continued output decline exacerbated by the damage from tropical storm Lili (see paragraph 13). The projected outturn based on the first nine months of 2002 is an overall fiscal deficit of 8 percent of GDP. The higher than projected deficit mainly reflects a delay in grants, the effect on revenues of continued weakness in the economy, and unexpected expenditures for disaster relief after the tropical storm. The deficit would have been higher in the absence of expenditure compression and revenue enhancing measures taken by the authorities prior to the storm (see paragraph 15).

7. **The stock of public debt, including the government guaranteed debt of public enterprises and the private sector (nearly 30 percent of GDP), reached almost 85 percent of GDP at end-2001 (Table 3).**[4] The central government's own debt has increased by nearly 10 percentage points over the previous three years, with domestic debt service as a percent of current revenue rising from 9 percent to 12 percent. Over the same period, the external debt service ratio rose by 2 percentage points to 6 percent of exports of goods and services. The government issued a **US$100 million (nearly 25 percent of GDP)**

[3] The increase in the wage bill (2 percentage point of GDP) reflected an agreement that provided for a retroactive salary increase (averaging 2½ percent a year) to civil servants, covering the period 1996–2001.

[4] The data on government guaranteed debt are provisional and may involve some double-counting.

10-year international bond in June 2002 yielding 9.5 percent, 475 basis points above the U.S. Treasuries. The proceeds have been used to retire more expensive debt (including financial leases), to clear arrears, and finance high priority investment projects.[5] As a result, external debt at end 2002 is projected to have risen by over 20 percentage points of GDP to 62 percent, with total debt at around 104 percent of GDP.

8. **The financial condition of the rest of the public sector appears sound.** All the public enterprises for which audited accounts are available recorded small operating surpluses in 2000 and 2001.[6] The NIS generates annual surpluses of about EC$30 million and, according to the most recent actuarial review, is projected to remain in surplus for the next 40 years.[7]

9. **The growth in broad money and private sector credit slowed during 2001,** but the prime lending rate remained unchanged despite a percentage point reduction in the central bank's discount rate in October 2001. Data for the first nine months of 2002 indicate that private sector credit remained largely unchanged in nominal terms, while there was some growth in broad money due to expansion in deposits partly reflecting arrears clearance by the government (Table 4).

10. **The external current account deficit declined from 20 percent of GDP in 2000 to around 17½ percent of GDP in 2001,** as lower receipts from tourism and merchandise exports were more than offset by a decline in imports associated with a slowdown in investment in tourism and other sectors (Table 5). The narrowing of the external current account despite fiscal deterioration suggests that a rise in private savings may have also contributed to the output fall in 2001. The deficit is projected to have widened to 25 percent of GDP in 2002, reflecting a pick up in import demand and lower service receipts. It has been financed largely by foreign investment and external borrowing.

11. **The CPI-based real effective exchange rate (REER) measured for Grenada, has depreciated by about 2 percent in the year to October 2002.** The depreciation was broadly in line with that of the other ECCU countries (Figures 2 and 3), and reflected the weakening of the U.S. dollar.[8]

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[5] These projects include, building farm roads, promoting tourism, and student scholarships.

[6] Audited accounts for 2001 were available for only a few of the public enterprises including the largest, the Grenada Ports Authority.

[7] The sixth review was completed in May 2000. The seventh review, which is currently underway, is expected to be completed by end-2002.

[8] The absence of reliable data on other prices and wages precludes the construction of alternative measures of competitiveness.

12. **The authorities completed the Module 1 self-assessment conducted with the assistance of the Fund and the ECCB in September 2001, and Grenada was removed by the OECD from the list of noncooperative tax havens in February 2002.** However, Grenada remains on the Financial Action Task Force's (FATF) list of noncooperative countries in the fight against money laundering. In June 2002, the FATF noted that Grenada had enacted most of the legislation needed to remedy the deficiencies in its anti-money laundering laws, and asked it to submit plans to implement the new legislation, which could provide the basis for Grenada to be removed from the list.

13. **In late September 2002, the country was hit by tropical storm Lili, causing extensive damage to infrastructure and export crops.** The authorities have estimated the damage to be about EC$21 million (equivalent to nearly 2 percent of GDP), in addition to a potential loss of EC$15 million of export earnings, mostly in 2003. To cope with the effects of the storm, the authorities have requested assistance from the Fund under its policy for emergency assistance in the case of natural disasters.

III. Report on the Discussions

14. **The discussions, which were carried out in a two step process and then followed up during the Annual Meetings, focused on policies to re-establish growth, cope with the effects of the storm, and to restore fiscal soundness over the medium-term.**[9] Compared with the 2001 discussions, when the primary focus of the discussions was on measures to promote growth and reduce unemployment, the discussions centered more on policies to restore fiscal sustainability. The authorities made some progress in dealing with these earlier challenges, including in protecting social expenditures despite fiscal restraint in a very difficult external environment. Given Grenada's strong growth performance during 1998–2000 and its relatively more diversified economic base than other ECCU countries, the authorities view, and the staff broadly agrees, the current decline in growth as temporary and mainly reflecting exogenous factors. Over the medium-term, they see the main drivers of growth as (i) expansion in manufacturing-based agro-processing operations; (ii) growth in agriculture, including nutmegs (see Box 1); (iii) tourism, as international travel, especially stay-over tourists, recovers post September 11; (iv) construction related to new hotel projects, the new cruise ship terminal and public sector investment; and (v) communications services, as liberalization provides the impetus for lower prices, increased volumes, and new services.[10] Based on these factors, it is projected that after a moderate recovery in 2003, growth will pick up to 4 percent a year from 2004 onwards.

[9] During the April mission, the authorities agreed with the staff's assessment of the unsustainability of the fiscal situation and requested a follow-up mission in late July, once they had revised the budget targets.

[10] Productivity could be enhanced by the recent lifting of restrictions on labor mobility among the ECCU countries.

A. Fiscal Policies

15. The authorities are now projecting a central government deficit (after grants) of approximately 8 percent of GDP for 2002, including some storm-related capital expenditures.[11] The authorities have: (i) reduced the government's capital expenditure by *2* percentage points of GDP to about 13 percent of GDP in 2002, while ensuring that key social programs remain unaffected; (ii) reduced spending on goods and services to below the 2001 level through tighter control over procurement of supplies and services; (iii) limited the growth in the wage bill; and (iv) lowered some tax exemptions and strengthened revenue administration.[12] The staff supported the authorities' actions, and viewed the overall fiscal target as feasible despite a shortfall in grants. The mission pointed out that adverse external shocks have exposed the fiscal vulnerabilities in the areas of both revenue collection and expenditure management. While agreeing with the staff and affirming their aim of fiscal consolidation, the authorities stressed the impact of the unprogrammed storm-related capital expenditures. The mission emphasized the desirability of avoiding any further fiscal slippages given the adverse effect these would have on future debt dynamics (see Annex I).

[11] The authorities are still finalizing the data for the 2002 fiscal outturn and in particular the reasons for the overrun beyond their earlier target of a 6 percent of GDP deficit. If more information becomes available on this, the staff will provide an update at, or prior to, the Board meeting.

[12] The authorities have passed legislation to limit the customs duty exemptions of St. George's University School of Medicine, and Cable & Wireless. They also have limited the automatic rollover of tax breaks after the expiration of tax-holidays.

BOX 1. THE POTENTIAL OF NUTMEG DERIVATIVE PRODUCTS

Grenada is the second largest producer of nutmegs in the world after Indonesia.

- There are three main nutmeg based products: nutmeg essential oil; nutmeg oleoresin; and nutmeg butter. Nutmeg essential oil is used to flavor many different foods and beverages, as well as in a variety of medicinal and aromatherapy applications. Nutmeg oleoresin is a concentrated liquid form of nutmeg and can be used as flavoring agent. Nutmeg butter is widely used by the medicinal and pharmaceutical industries.

- **Current nutmeg oil production.** In the year ending June 30, 2001, the sales of nutmeg oil were around EC$1.6 million (23 percent of exports). Depending on the availability of nutmeg refining capacity, the output of nutmeg oil can expand by between 15-20 percent over the next few years. Expanded output of nutmeg could be used as input to diversify nutmeg oleoresin and nutmeg butter production.

- **Entry of a new firm.** A new firm has recently entered the market. Its business plan consists of three phases: (1) the development of nutmeg essential oils; (2) development of nutmeg oleoresin and nutmeg butter; and (3) a regional program to develop agro-processing products in other countries. Based on the firm's preliminary estimates of potential output, nutmeg-derivative products could be an important contributor to growth in Grenada.

- **Producing nutmeg based products offers much higher value-added** than can be captured by producing raw nutmegs. There is approximately a 10 percent yield per kilogram of nutmegs into nutmeg oil, yet nutmeg oil commands a price substantially higher than 10 times that of raw nutmegs. Further, nutmeg oil can be produced from defective nutmegs—approximately 30 percent of the total stock according to local estimates.

- The **nutmeg capacity** is expected to increase over the medium term due to planting of new trees, of approximately 2000 per year, and the possible reopening of idle farms.

- The main producer of nutmeg does not currently report its annual accounts to the CSO or Inland Revenue and its exports are not registered by customs or taxed. This lack of information makes any estimates of the impact of agro-processing on value added subject to considerable uncertainty.

16. **The mission suggested that stronger controls by the Ministry of Finance were required for the public sector-investment program (PSIP)** to enhance its effectiveness and to ensure achievement of the authorities' objective to give priority to foreign-funded projects (the proportion of which has been declining).[13] The mission also urged bolder action to reduce tax exemptions further, particularly discretionary exemptions.[14] It suggested that the authorities should initiate a review of licenses and user fees, and phase out the subsidy on gasoline consumption.[15]

[13] Despite the one-third reduction in the PSIP, the proportion of locally financed projects has risen and was over 50 percent in the first half of 2002.

[14] For example, customs lost more revenues in 2001 through exemptions than were collected.

[15] This subsidy is provided through variations in the petroleum and other taxes to ensure that domestic petrol prices remain unchanged.

17. **The authorities generally agreed with the staff's proposals and stated that they planned to take steps to strengthen capacity in the Ministry of Finance to improve the PSIP formulation process, including using more stringent criteria for project selection.** Regarding savings in current expenditures, especially wages, they were awaiting the results of the World Bank's ongoing public expenditure review, and hoped it would provide policy advice and financing for the government's efforts to reduce employment and improve productivity (through contracting out of some services to the private sector). The authorities agreed on the need to establish transparent criteria for government guarantees for private sector loans and for borrowing by public enterprises. The mission welcomed the authorities' intention to establish a macro-economic analysis unit in the Ministry of Finance, with help from CARTAC, which would, among other tasks, review the government's financing strategy.

18. **The authorities noted clearance of arrears to the NIS (totaling around 3 percent of GDP), and suppliers, partly using the proceeds of the US$100 million international bond issue.** In addition, more than 70 percent of the receipts of the bond issue have been used to retire more expensive debt, including lease-purchase arrangements, and the authorities confirmed that there would be no further recourse to such arrangements. This was in line with their debt management strategy which entails giving priority to concessional borrowing from multilateral and official bilateral sources, strictly controlling the granting of debt guarantees to public enterprises and the private sector, and continued adherence to the policy of prior approval by the Ministry of Finance for any borrowing by the public enterprises. The mission welcomed the steps taken by the authorities to clear arrears and pay off (and avoid in future) expensive borrowing and urged that no new arrears be accumulated. The authorities agreed that the Treasury Management System might need to be upgraded to provide real time debt-service payments in the planned regional securities market.

19. **For 2003, the budget as presented to parliament envisages a deterioration of about 1 percent of GDP in the central government's deficit compared with 2002,** due to higher capital expenditure. However, the authorities indicated that, notwithstanding the budgeted large increase in the capital expenditures, they aim to restrict capital spending to the 2002 level, targeting a central government deficit of about 6 percent of GDP.[16] The budget envisages an increase in revenue of about 1.5 percent of GDP based on better growth prospects, a lower level of statutory concessions, and improved tax administration. The revenue projections for 2003 reflect the full-year impact of the removal of duty exemptions implemented last year (see footnote 11), and further action to reduce tax free concessions. The achievement of this revenue target will be challenging—requiring considerable political

[16] The budget include capital projects which may be beyond the country's absorptive and implementation capacity, partly reflecting the building of political consensus by recognizing outstanding needs of various social groups. The staff urged that, on fiscal transparency grounds, the budget, fully reflect the authorities' proposed fiscal stance, rather than containing an over-inflated estimate of capital expenditure.

resolve—though feasible, given ample scope for revenue generation through rationalization of tax exemptions (see footnote13), and room for strengthening tax administration.

20. **Over the medium term, the authorities envisage reducing the central government deficit to around 2½ percent of GDP by 2005 in the context of economic recovery and fiscal consolidation.** The focus of policy would remain on broadening the tax base, strengthening collections, and prioritization of capital spending. **The staff considers this target broadly appropriate, consistent with medium–term fiscal sustainability and achievable with a determined implementation of the envisaged fiscal measures in the context of an assumed pick up in the world economy.** It will require strengthened debt management and streamlining of the PSIP (including giving priority to externally funded projects), implementation of the recommendations of the World Bank's on-going public expenditure review, and a further broadening of the tax base through reducing discretionary exemptions.[17]

21. **The authorities should be able to meet their medium-term financing requirements, which fall over time, through domestic sources (borrowing from commercial banks and issuance of T-bills in the context of the recently started regional securities market) and a mix of donor support and modest external borrowing.** The resulting debt dynamics should improve somewhat as some of the more expensive debt has been retired (with yearly savings of nearly 2 percent of GDP), greater prudence is exercised in providing debt guarantees, and expensive external borrowing is eschewed. Preliminary results of the public debt sustainability analysis for Grenada indicate that its debt dynamics over the medium-term would remain fragile and would warrant close monitoring (Annex I).

B. Monetary and Financial Sector Policies

22. **Monetary and exchange rate policy in the ECCU is conducted by the common central bank with the objective of maintaining the fixed peg to the U.S. dollar.** The central bank has applied strict limits on borrowing by the governments and the banks and has ensured that a high foreign exchange cover is maintained. The authorities reaffirmed their support of the current monetary arrangements which they see as having served the country well by keeping inflation low. The authorities recognized that large and persistent deficits could undermine the monetary arrangement and saw their efforts at fiscal consolidation in the larger context of the sustainability of the monetary union.

23. **Based on indicators compiled by the ECCB, the overall financial condition of the banking system appears sound (Table 8).** The share of nonperforming loans has fallen to

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[17] The authorities, along with other OECS countries, have requested technical assistance from FAD, for a comprehensive regional tax reform. They have also expressed an interest in technical assistance on pension reform to deal with the growing burden of noncontributory pensions, which they see as a wider OECS problem.

6 percent, and capital ratio has improved. However, the staff expressed concern about the continued operation of a small local bank, even though it did not comply with the regulatory guidelines of the central bank, nor had in place adequate payments arrangements. The authorities indicated that they were waiting for a written court judgment before taking action on this bank.[18]

24. **Business activity has declined drastically in the offshore financial sector due to tough enforcement of prudential regulations (Box 2).** It is likely that all existing offshore banks will have their licenses revoked in the near future as they are unable or unwilling to meet these requirements, with adverse implications for the revenue derived from this sector. The authorities believe that removal by the FATF from the noncooperating countries and territories list, which they see as likely, will help attract reputable institutions to the sector. They are considering options—such as attracting niche financial services, amalgamation of supervision of all financial institutions in an umbrella agency or possible closure—to avoid supervision of the sector being a net drain on the public finances. The authorities have replied to the AML/CFT questionnaire and their responses are being assessed.

C. External Policies

25. **Grenada's trade policies are largely determined in the context of the country's membership in the Organization of Eastern Caribbean States (OECS) and CARICOM.** With the implementation of the final phase of import tariff reductions under CARICOM's common external tariff agreement, average tariffs in Grenada have been reduced to 16 percent,[19] the same level as in other OECS member countries.[20] Together with the other countries of the Caribbean region, Grenada is participating in discussions aimed at creating a single market within CARICOM,[21] and a Free Trade Area of the Americas (FTAA). There has been no change in Grenada's external trade regime since the previous Article IV consultation discussions.

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[18] Under existing regulations, the authority to grant or revoke a bank's license rests with the Ministry of Finance and not the ECCB.

[19] The average tariff on consumer goods is 20 percent, while that on capital and intermediate goods is 5 percent.

[20] Grenada has a rating of '6' in PDR's index of trade restrictiveness.

[21] A major study on the Caribbean Single Market and Economy (SME) is scheduled to be completed by the CDB and the CARICOM Secretariat during 2002.

BOX 2. GRENADA: OFFSHORE FINANCIAL SECTOR

At its peak, in early 2000, the offshore financial sector employed an estimated 300 persons, and its contribution to revenue was equivalent to 1 percent of GDP. Reflecting the ongoing efforts to clean up the sector, by April 2002, its contribution to revenue had become negligible with significant job losses.

The Module-1 self-assessment of the offshore sector, completed in late-2001, identified a number of areas for strengthening. These included the legal framework (to bring it up to international standards), on-site and off-site inspection, staffing, and the sharing of information with other regulatory agencies. In response, in June 2002, the authorities initiated steps to increase the role of the ECCB in the supervision of offshore banks and trusts, and introduced a number of measures to address deficiencies in the regulatory framework, including amendments to some key offshore financial legislation, dealing with money laundering.

For ECCB's joint (with the government) supervisory role in the offshore financial sector, necessary legislative amendments are underway, with CARTAC's assistance. A Memorandum of Understanding with the ECCB is expected to be signed before end-2002. The issue of ECCB's ability to share information with other regulators is also being addressed through appropriate legislation as part of a sub-regional initiative.

The amendments to the legislation have allowed sharing of information on a client's account, with the regulatory authorities allowed to impose penalties for noncompliance. The legislative changes for the fight against money laundering provide authority to conduct inspections of all registered agents, and broaden the definition of "suspicious transactions."

26. **The authorities remain fully committed to the objective of regional economic integration,** and support the efforts of the regional institutions for greater fiscal convergence, harmonization of tax systems, including investment incentives, a common regulatory framework for business and financial activities, and the establishment of regional money and capital markets. Grenada fully supports the goal of a single market and economy for all CARICOM countries.

D. Structural Reforms

27. **The authorities reaffirmed their commitment to reduce the role of the public sector in the economy and enhance its efficiency.** A major part of this work is being undertaken in the context of the Public Sector Reform Commission.[22] The main objective of the commission is to improve the efficiency of the public service by (i) further increasing the commercialization of public services; (ii) outsourcing work of the public agencies; and (iii) reducing the number of non-established workers. This reform will require severance payments packages for which resources have yet to be identified. The commission has undertaken work on a framework outlining the role of the public service in the long run. Work is also underway to amend the Public Service Act, which governs the functioning of the public service and public service unions. Grenada participates in programs intended to

[22] The public sector reform program is being supported by the British government.

strengthen the education sector, and the fight against HIV/AIDS, supported by the World Bank.

28. **The unemployment rate remains high at around 12 percent, reflecting structural rigidities in the labor market.** To enhance labor market flexibility, the authorities are participating in a regional web-based employment exchange project supported by the U.S. Department of Labor and the ILO. The government also plans to amend the dispute resolution law to prevent solidarity strikes by workers in essential services.

E. Medium-Term Prospects and Vulnerability

29. **Based on a medium-term scenario prepared by the staff in consultation with the authorities, the growth prospects of the Grenadian economy appear positive** (Tables 6 and 7). This reflects the prospect of enhanced activity in agriculture and tourism sector, including elimination of the monopoly in the nutmeg industry through private sector participation, initiation of a number of private sector based tourism projects, increased airlift, and a very large expansion of the cruise ship terminal.

30. **An annual primary surplus slightly in excess of 2 percent of GDP would be required to bring the stock of debt down to a more sustainable level by 2005.** This could be achieved by a stable revenue to GDP ratio, and a gradual decline of expenditures (by 1-1½ percent of GDP a year), through reductions in expenditures on salaries, goods and services, and capital spending.

31. **The main downside risks to such a scenario are**: (i) lower growth in the U.S. and Europe—a 1 percent reduction in growth could reduce Grenada's growth by up to 1½ percent given that nearly 80 percent of its exports are destined for this region; (ii) a sustained rise in the price of oil—this could undermine Grenada's growth prospects and fiscal consolidation efforts by raising the price of electricity generation and transport, and squeezing the revenue intake (see footnote 14); and (iii) a potential conflict in the Middle East—particularly if prolonged—could adversely affect tourism by reducing the willingness to travel.

IV. Staff Appraisal

32. **After a strong economic performance during 1998–2000, growth declined in 2001 by 3 percent.** This reflected the global economic slowdown exacerbated by the events of September 11. Along with this decline, the fiscal situation deteriorated sharply—by around 5 percentage points of GDP, resulting in central government deficit of 8 percent of GDP—due mainly to higher current and capital spending. The fiscal situation in 2002 remained fragile. The main challenges facing the government are to reverse the fiscal deterioration by sustained efforts to overcome weaknesses in revenue generation and expenditure control unmasked by the economic slowdown, bring down the high level of

government indebtedness to avoid the consequences of adverse debt dynamics, and help promote economic recovery to reduce unemployment and alleviate poverty.

33. **To meet these challenges, despite tropical storm Lili, the authorities have taken steps to reduce current and, in particular, capital spending and strengthen revenues, including reductions in tax exemptions, to contain the central government deficit in 2002.** While the thrust of these measures is in the right direction, the staff believes that there is considerable scope for their strengthening. For 2003, the authorities' target of a 2 percentage points of GDP reduction in the deficit to 6 percent of GDP appears broadly appropriate. Achievement of this target will require vigorous and determined implementation of the envisaged measures, particularly to increase revenues. Over the medium term, additional stronger actions will be required to meet the authorities' target of a central government deficit of 2½ percent of GDP by 2005 and to attain fiscal sustainability, including broadening the tax base through a further reductions in exemptions and incentives, strengthening revenue enforcement, increasing the efficiency of spending, and strict prioritization of capital spending. The proposed regional review of the tax system with FAD assistance is welcome. The results of the World Bank public expenditure review should provide scope for further expenditure reductions through increasing efficiency as should the ongoing work of the Public Sector Reform Commission. The authorities should strengthen the current shift towards private sector participation in large infrastructure projects evidenced by the expansion of the cruise ship terminal.

34. **As the economy recovers, the authorities' recognize that further fiscal consolidation will be required to reduce current high levels of public sector debt.** Such consolidation is necessary to cushion the public finances from any future adverse external shocks. Notwithstanding the need to achieve political consensus, the **process of PSIP formulation** should be strengthened to include projects which have been carefully selected on the basis of rigorous economic criteria. Project expenditure management should be strengthened to ensure that priority is given to foreign-funded projects, as the authorities intend. It would be desirable if transparent criteria were established for government guaranties of private sector loans.

35. **The successful bond issue of US$100 million reflects investor confidence in Grenada.** The use of these funds to retire more expensive debt and pay off government arrears to the NIS and suppliers is appropriate. The resulting cash flow relief should not be viewed as an opportunity to reaccumulate debt given that the debt dynamics of Grenada remain fragile over the medium term. The government is to be commended for its action to clear all arrears and to eschew future recourse to expensive lease-purchase financing arrangements. The government should remain current on all its obligations. Treasury management should be strengthened to effect debt payments in the planned regional securities market. The proposed establishment of a macro-economic analysis unit in the Ministry of Finance is welcome.

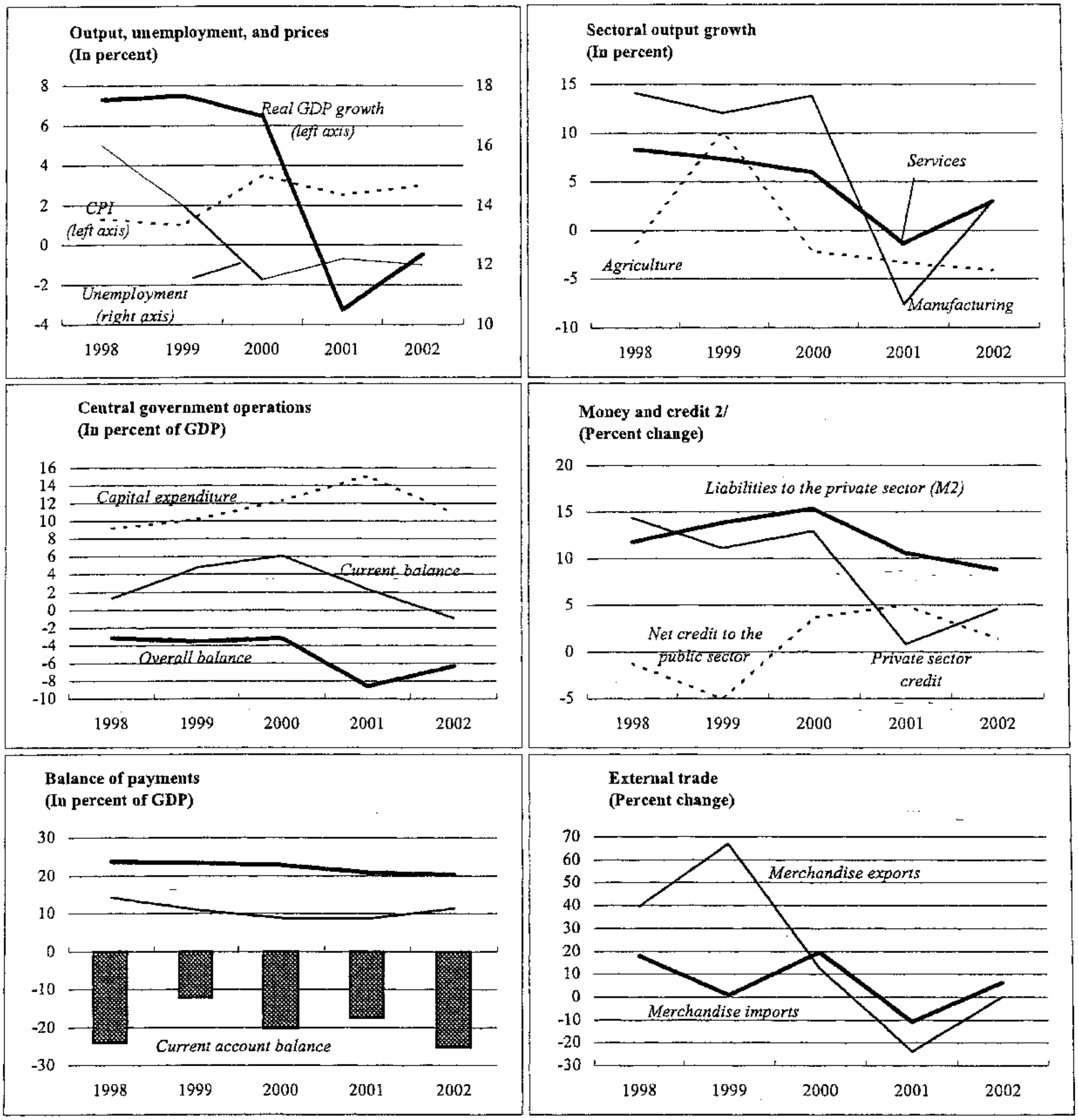
36. **Indicators compiled by the ECCB appear to point to a broadly sound domestic banking system.** Once the legal issues have been resolved, early action should be taken to deal with one bank that does not report to the ECCB. **The authorities have made**

considerable efforts to strengthen supervision of the offshore sector. It is desirable to implement quickly the proposals of the Module 1 self-assessment report in setting up a more rigorous supervisory framework, with the ECCB playing a greater supervisory role. The decline in the offshore sector as a result of strengthened supervision has significant economic implications. The authorities should quickly examine the possible options to ensure that the sector does not become a net drain on public finances.

37. **While the statistical base has improved in recent years, weaknesses remain that adversely affect the quality of economic analysis,** particularly in the areas of national income accounts, the balance of payments, and labor statistics. The authorities are encouraged to seek technical assistance, including from CARTAC, to improve the reliability and timeliness of these data.

38. The staff recommends that the next Article IV consultation be conducted on the standard 12-month cycle.

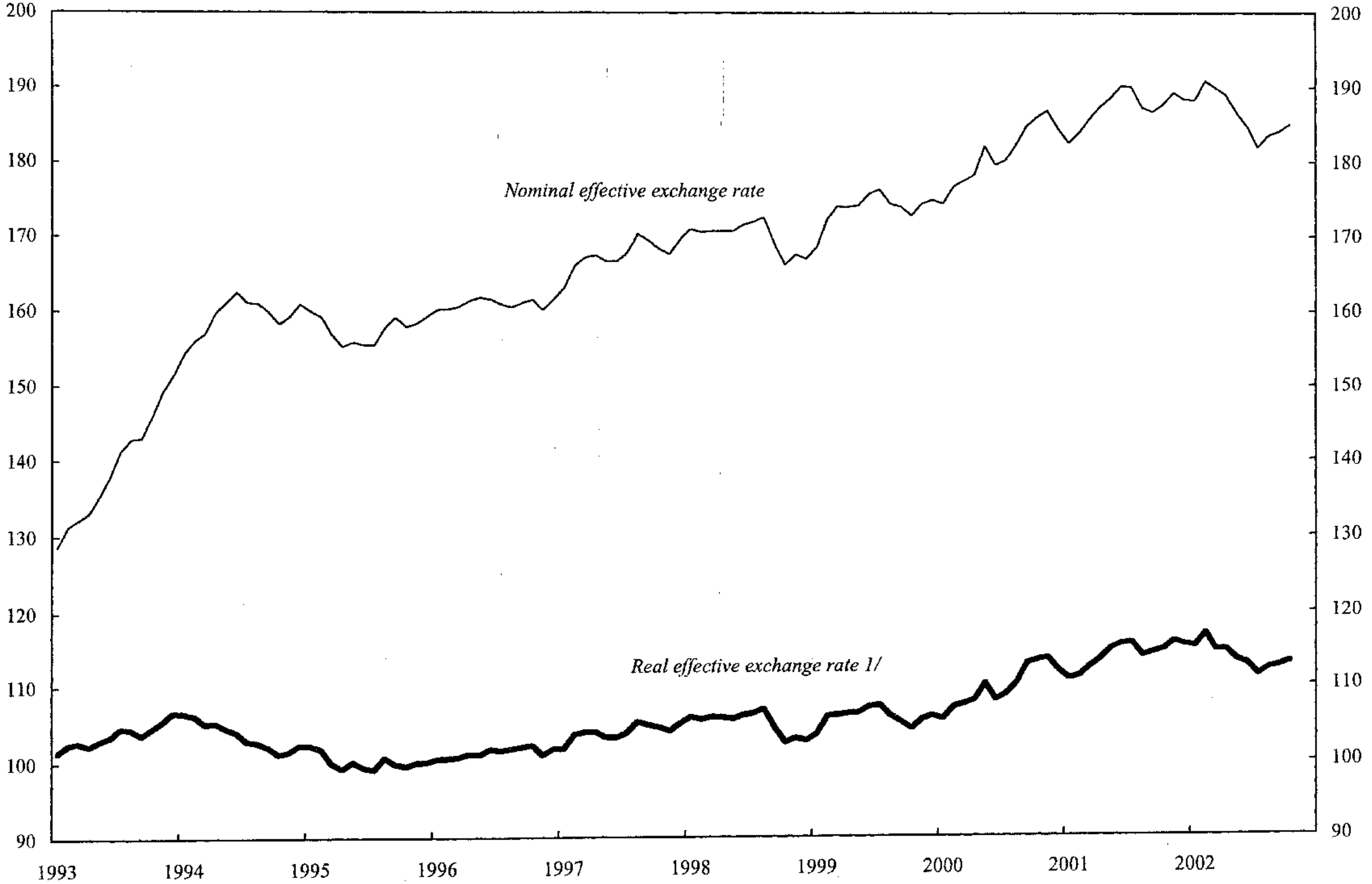
Figure 1. Grenada: Selected Macroeconomic Indicators, 1998–2002 1/



Sources: Ministry of Finance; Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Estimated data for year 2002.

2/ As a percent of liabilities to the private sector at the beginning of each year.


Nominal effective exchange rate
Real effective exchange rate 1/
200
190
180
170
160
150
140
130
120
110
100
90
1993
1994
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1998
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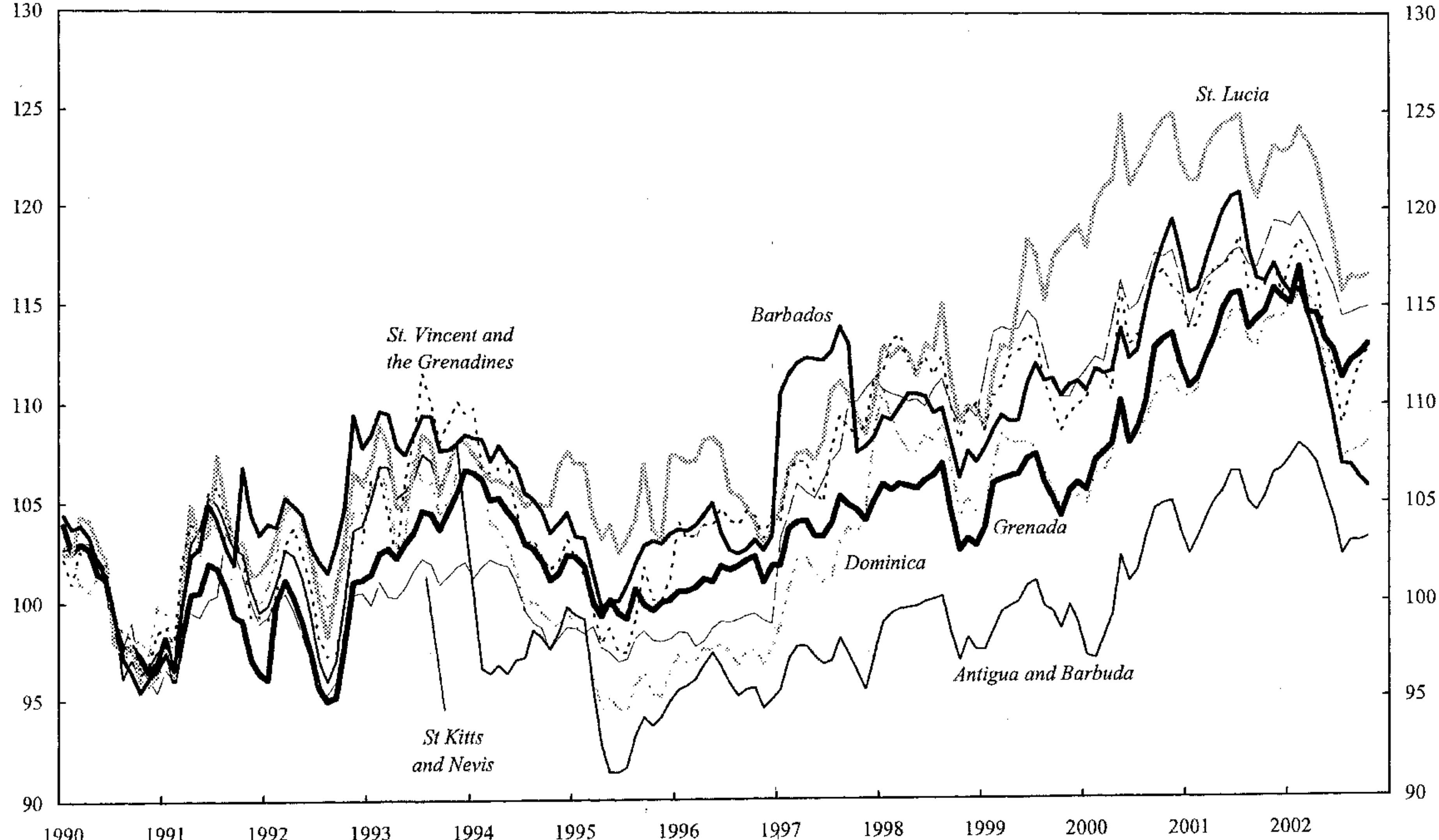
2000
2001
2002


St. Lucia
Barbados
St. Vincent and
the Grenadines
Grenada
Dominica
Antigua and Barbuda
St Kitts
and Nevis
130
125
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115
110
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1990
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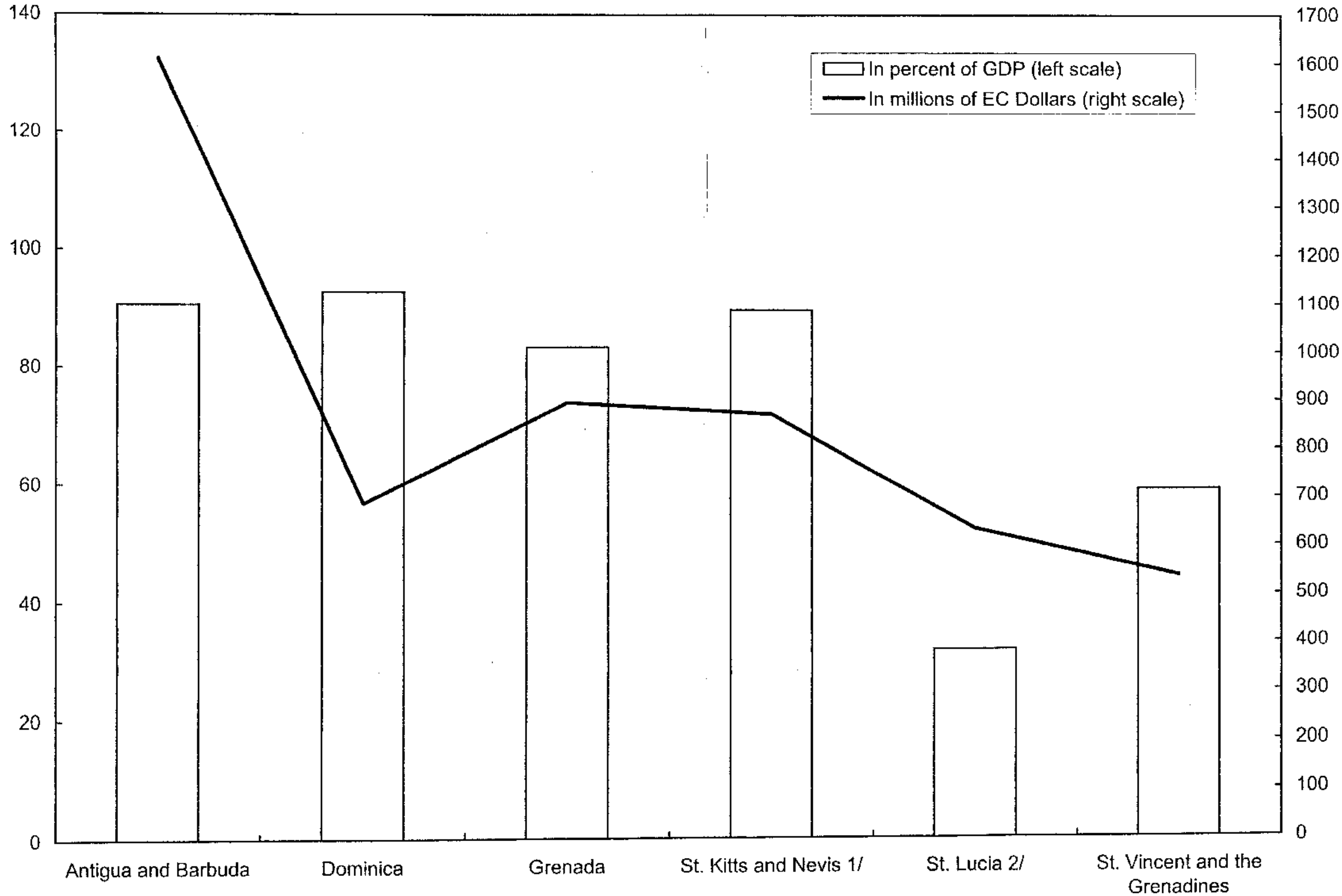
In percent of GDP (left scale)
In millions of EC Dollars (right scale)
140
120
100
80
60
40
20
0
1700
1600
1500
1400
1300
1200
1100
1000
900
800
700
600
500
400
300
200
100
0
Antigua and Barbuda
Dominica
Grenada
St. Kitts and Nevis 1/
St. Lucia 2/
St. Vincent and the Grenadines

Table 1. Grenada: Selected Economic and Financial Indicators

	1998	1999	2000	2001	Est. 2002	Proj. 1/ 2003
(Annual percentage change, unless otherwise specified)						
Output, prices, and labor						
Real GDP	7.3	7.5	6.5	-3.3	-0.5	2.5
Consumer prices (annual average)	1.4	0.5	2.2	3.2	3.0	2.5
Consumer prices (end of period)	1.2	1.0	3.5	2.5	3.0	2.5
Unemployment rate (estimated)	16.0	14.0	11.5	12.2	12.2	12.0
Banking system						
Net foreign assets 2/	0.3	6.1	0.3	6.8	0.3	1.1
Money and quasi-money (M2)	11.8	13.9	15.4	10.6	8.1	6.1
Net domestic assets 2/	11.4	7.8	15.0	3.8	7.8	0.5
Of which						
Credit to the public sector (net)	-1.2	-5.0	3.7	5.0	3.2	0.6
Credit to the private sector	14.4	11.1	12.9	0.8	1.8	6.1
Average interest rate on deposits (percent per year)	5.5	5.5	5.5	5.5	4.0	4.0
Average prime rate (percent per year)	9.8	10.0	10.0	10.0	10.0	10.0
External sector						
Merchandise exports, f.o.b. (in U.S. dollars)	39.6	67.1	12.5	-24.7	1.1	-6.2
Merchandise imports, c.i.f. (in U.S. dollars)	18.1	0.9	19.7	-10.9	6.4	4.6
Terms of trade	30.9	13.3	-0.3	-1.7	3.8	-2.4
Real effective exchange rate 3/	-2.2	3.1	5.7	3.1	-2.1	...
(In percent of GDP)						
Central government finances						
Total revenue and grants	30.0	28.1	30.1	30.5	29.5	32.2
Current revenue	25.2	26.2	27.1	26.3	26.3	28.2
Capital revenue	0.2	0.0	0.1	0.0	0.2	0.0
Foreign grants	4.6	1.9	3.0	4.2	3.0	4.0
Total expenditure	33.1	31.6	33.3	39.1	37.4	38.3
Current expenditure	23.9	21.4	21.0	24.0	24.4	25.6
Of which						
Salaries and allowances 4/	12.2	11.7	10.4	11.9	11.0	10.8
Capital expenditure	9.2	10.2	12.3	15.1	13.2	12.7
Current balance	**1.3**	**4.8**	**6.1**	**2.3**	**2.2**	**2.5**
Overall balance (after grants)	**-3.1**	**-3.5**	**-3.2**	**-8.6**	**-7.9**	**-6.0**
Foreign financing	2.1	2.8	1.9	3.9	5.6	3.8
Domestic financing	1.0	0.7	2.7	2.5	5.0	5.1
Arrears	0.0	-1.0	-1.5	2.2	-2.7	0.0
External sector						
Current account deficit (including current official grants)	-24.1	-12.2	-20.3	-17.6	-25.3	-28.6
External public debt (end-period) 5/	27.2	26.2	25.3	40.4	62.4	62.7
(In millions of U.S. dollars)						
Official net imputed reserves (end of period)	46.8	50.9	57.7	63.9	66.9	66.9
Memorandum item:						
GDP at current market prices						
In EC$ millions	920	1,020	1,098	1,075	1,118	1,186
In US$ millions	341	378	407	398	414	439
Stock of central government arrears (EC$ millions)				23.7	0.0	0.0

Sources: Ministry of Finance; Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Fiscal numbers based on 2003 budget recently presented to Parliament.

2/ As a percent of money and quasi-money at the beginning of the year.

3/ 2002 data as of October.

4/ The increase in 2001 reflect an agreement that provided for retroactive salary increases to civil servants, covering 1996-2001 (average of 2 1/2 percent a year).

5/ Government and government guaranteed debt. The sharp increase for 2001 and 2002 partly reflects a broader coverage of del by the authorities to include contingent liabilities, the estimates of which are still being reviewed by the authorities. The figure for 2002 also reflects the estimated net impact of new borrowing/debt restructuring.

Table 2. Grenada: Summary of Central Government Finances

	1998	1999	2000	2001	Est 2002 1/	Budget 2003
	(In millions of Eastern Caribbean dollars)					
Revenue and grants	**275.8**	**286.9**	**330.5**	**328.1**	**329.5**	**381.8**
Revenue	233.5	267.3	297.9	283.2	296.0	334.1
Current revenue	232.0	267.3	297.2	282.7	293.5	334.1
Tax revenue	204.7	232.0	265.2	254.5	267.8	303.8
Nontax revenue	27.3	35.3	32.1	28.2	25.7	30.3
Capital revenue	1.5	0.0	0.7	0.5	2.5	0.0
Grants	42.3	19.6	32.6	45.2	33.5	47.8
Total expenditure	**304.6**	**322.8**	**365.7**	**420.7**	**418.0**	**467.0**
Current expenditure	219.9	218.6	230.5	258.1	269.9	304.0
Salaries and allowances	112.3	119.3	114.4	127.6	123.0	128.2
Goods and services	35.8	27.1	26.5	35.4	29.8	42.9
Lease payments 2/	1.4	3.1	17.3	17.5	17.3	0.0
Interest	14.7	23.0	24.2	27.9	45.4	67.6
Domestic	9.8	15.0	11.7	13.3	16.5	20.6
Foreign	4.9	8.0	12.5	14.6	28.9	47.1
Transfers and subsidies	57.1	46.1	48.2	49.9	57.6	65.3
Capital expenditure	84.7	104.2	135.2	162.6	148.0	183.0
Current balance	**12.1**	**48.7**	**66.7**	**24.6**	**23.6**	**30.1**
Overall balance (before grants)	**-71.1**	**-55.5**	**-67.7**	**-137.5**	**-122.0**	**-153.0**
Overall balance (after grants)	**-28.8**	**-35.9**	**-35.2**	**-92.3**	**-88.5**	**-105.2**
Financing	**28.8**	**35.9**	**35.2**	**92.6**	**88.5**	**105.2**
Foreign (net)	19.7	28.1	21.3	42.1	76.8	45.2
Domestic	9.1	17.7	30.1	26.4	42.0	60.0
Arrears 3/		-29.8	-16.2	23.7	-30.3	0.0
	(In percent of GDP)					
Revenue and grants	**30.0**	**28.1**	**29.8**	**30.5**	**29.5**	**32.2**
Revenue	25.4	26.2	26.9	26.3	26.5	28.2
Current revenue	25.2	26.2	26.8	26.3	26.3	28.2
Tax revenue	22.2	22.7	23.9	23.6	24.0	25.6
Nontax revenue	3.0	3.5	2.9	2.6	2.3	2.6
Capital revenue	0.2	0.0	0.1	0.0	0.2	0.0
Grants	4.6	1.9	2.9	4.2	3.0	4.0
Total expenditure	**33.1**	**31.6**	**33.3**	**39.1**	**37.4**	**41.0**
Current expenditure	23.9	21.4	21.0	24.0	24.1	25.6
Salaries and allowances	12.2	11.7	10.4	11.9	11.0	10.8
Goods and services	3.7	2.7	2.4	3.3	2.7	3.6
Lease payments 2/	0.2	0.3	1.6	1.6	1.6	0.0
Interest	1.6	2.3	2.2	2.6	4.1	5.7
Domestic	1.1	1.5	1.1	1.2	1.5	1.7
Foreign	0.5	0.8	1.1	1.4	2.6	4.0
Transfers and subsidies	6.2	4.5	4.3	4.6	5.2	5.5
Capital expenditure	9.2	10.2	12.3	15.1	13.2	15.4
Current balance	**1.3**	**4.8**	**6.0**	**2.3**	**2.2**	**2.5**
Overall balance (before grants)	**-7.7**	**-5.4**	**-6.1**	**-12.8**	**-10.9**	**-12.9**
Overall balance (after grants)	**-3.1**	**-3.5**	**-3.2**	**-8.6**	**-7.9**	**-8.9**

Sources: Ministry of Finance; and Fund staff projections.

1/ Based on policies proposed by the staff, and endorsed by the authorities.
2/ Payments related to government office buildings and the national stadium, constructed under lease agreements.
3/ The fiscal accounts are on an acrural basis, hence the arrears accumulation has no impact on the deficit.

Table 3. Grenada: Public and Publicly Guaranteed Debt
(In millions of EC dollars)

	2001	Proj. 2002
Total Debt	**913.7**	**1160.0**
Domestic debt	**479.8**	**462.0**
Central government	475.6	457.8
Public enterprises	4.2	4.2
External debt	**433.9**	**698.0**
Central government	408.6	605.2
Multilateral	161.8	161.8
Bilateral	246.8	443.4
Commercial	57.1	278.9
Public enterprises	25.3	92.8
Memorandum items:		
As ratio of GDP		
Total debt	85.0	103.8
Domestic debt	44.6	41.3
External debt	40.4	62.4
Nominal GDP in millions of EC$	1,075	1,118

Source: Ministry of Finance; and Fund staff projections.

Table 4. Grenada: Summary Accounts of the Banking System

	1998	1999	2000	2001	Est 2002
	(In millions of Eastern Caribbean dollars, end of period)				
	I. Consolidated Banking System				
Net foreign assets	**88.2**	**133.8**	**136.7**	**203.4**	**206.9**
Net domestic assets	**662.3**	**720.8**	**849.2**	**886.9**	**971.7**
Net credit to the public sector	46.5	8.7	40.0	89.2	123.5
Central government	71.2	43.6	59.8	94.7	151.1
Nonfinancial public enterprises 1/	-24.8	-34.9	-19.8	-5.5	-27.6
Credit to private sector	684.7	767.9	878.4	886.4	906.3
Other	-68.9	-55.8	-69.2	-88.6	-58.1
Liabilities to private sector (M2)	**750.4**	**854.6**	**985.8**	**1090.4**	**1178.6**
Money	159.4	175.1	182.4	192.3	204.3
Quasi-money	591.0	679.4	803.5	898.0	974.3
	II. Eastern Caribbean Central Bank				
Imputed net international reserves	126.4	137.3	155.7	172.6	180.6
Net domestic assets	13.3	10.5	7.6	8.7	4.6
Base money	**139.6**	**148.0**	**163.4**	**181.3**	**203.8**
Currency held by the public	64.1	64.8	71.1	70.2	68.9
Commercial bank reserves	75.5	83.3	92.2	111.1	134.9
	III. Commercial Banks				
Net foreign assets	-38.2	-3.5	-19.0	30.8	26.3
Net claims on ECCB	73.4	83.8	92.2	107.6	133.0
Net domestic credit	**651.2**	**709.5**	**841.5**	**881.7**	**926.3**
Net credit to the public sector	33.2	-1.8	32.2	80.4	118.9
Credit to private sector	684.7	767.9	878.4	886.4	906.3
Other	-66.7	-56.6	-69.1	-85.1	-98.9
Liabilities to the private sector	686.4	789.8	914.7	1020.2	1109.7
	(12-month change in percent of M2 at the beginning of the period)				
Consolidated banking system					
Liabilities to private sector	11.8	13.9	15.4	10.6	8.1
Net foreign assets	0.3	6.1	0.3	6.8	0.3
Net domestic assets	11.4	7.8	15.0	3.8	7.8
Credit to private sector	14.4	11.1	12.9	0.8	1.8

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes the National Insurance Scheme.

Table 5. Grenada: Summary Balance of Payments Estimates

	1998	1999	2000	2001	Est 2002
	(In millions of U.S. dollars)				
Current account balance	**-82.2**	**-46.2**	**-82.6**	**-70.0**	**-106.9**
Exports (f.o.b.)	45.9	74.3	84.5	63.6	64.3
Imports (f.o.b.)	182.6	184.1	220.4	196.4	209.0
Services (net)	48.3	70.0	67.4	65.7	55.2
Receipts	117.6	148.5	150.7	144.7	131.9
Of which					
Travel	80.9	88.2	92.6	83.5	84.5
Payments	69.3	78.5	83.3	79.0	76.7
Income (net)	-23.1	-25.5	-34.3	-26.3	-39.2
Interest	-3.3	-4.9	-6.7	-6.6	-10.7
Other	-19.7	-20.7	-27.6	-19.7	-28.5
Transfers (net)	29.2	19.2	20.1	23.4	21.8
Private	19.8	19.6	17.8	20.0	20.9
Official	9.3	-0.4	2.3	3.4	0.9
Capital and financial account	**83.1**	**60.6**	**91.9**	**74.3**	**99.9**
Capital account (transfers)	28.6	31.2	29.7	35.7	36.2
Public sector (net) 1/	10.0	11.5	9.6	13.9	15.4
Private sector (net) 2/	18.5	19.7	20.1	21.8	20.7
Financial account	54.6	29.4	62.2	38.6	63.8
Direct investment (net)	48.7	41.6	35.7	34.3	47.4
Portfolio investment (net) 3/	-0.1	0.4	19.7	0.0	99.8
Other investments (net)	5.9	-12.6	6.8	4.3	-83.4
Of which					
Public sector net borrowing 4/	1.3	9.6	5.0	15.6	-29.0
Net errors and omissions	**3.2**	**-9.7**	**-2.6**	**1.9**	**10.0**
Overall balance	**4.2**	**4.7**	**6.6**	**6.3**	**3.0**
Memorandum items:					
Net imputed international reserves (end of period)	46.8	50.9	57.7	63.9	66.9
	(In percent of GDP)				
Current account balance (including current official grants)	-24.1	-12.2	-20.3	-17.6	-25.3
Current account balance (excluding current official grants)	-26.8	-12.1	-20.9	-18.4	-25.5
Trade balance	-40.1	-29.1	-33.4	-33.3	-34.9
Exports of goods	13.5	19.7	20.8	16.0	15.5
Imports of goods	-53.6	-48.8	-54.2	-49.3	-50.5
Public sector net borrowing 4/	0.4	2.5	1.2	3.9	-7.0
Direct investment	14.3	11.0	8.8	8.6	11.4
Overall balance	1.2	1.2	1.6	1.6	0.7

Sources: Eastern Caribbean Central Bank (ECCB); Ministry of Finance; and Fund staff estimates.

1/ Mainly capital grants.

2/ Migrants' transfers.

3/ Figure for 2002 reflects proceeds of US$100 million bond.

4/ Government and government guaranteed debt.

Table 6. Grenada: Summary Medium-Term Scenario 1/

	2000	2001	Est 2002	Budget 2003	Projections 2004	2005	2006
	(Annual percentage change)						
GDP and prices							
GDP at constant prices	6.4	-3.3	-0.5	2.5	4.5	4.6	4.6
Consumer prices (annual average)	2.2	3.2	3.0	2.5	2.5	2.5	2.5
	(In percent of GDP)						
Central government finances							
Revenue and grants	30.1	30.5	29.5	32.2	29.7	29.0	28.3
Revenue	27.1	26.3	26.5	28.2	27.7	27.6	27.7
Grants	3.0	4.2	3.0	4.0	1.9	1.4	0.6
Expenditure	33.3	39.1	37.4	41.0	33.2	31.4	29.7
Current expenditure	21.0	24.0	24.1	25.6	24.2	23.4	27.7
Salaries and allowances	10.4	11.9	11.0	10.8	10.5	10.3	10.0
Goods and services	2.4	3.3	2.7	3.6	3.4	3.2	3.1
Interest	2.2	2.6	4.1	5.7	5.0	4.7	4.5
Lease payments	1.6	1.6	1.6	0.0	0.0	0.0	0.0
Other	4.3	4.6	4.8	5.3	5.2	5.1	5.0
Capital expenditure	12.3	15.1	13.2	15.4	9.0	8.0	7.0
Current balance	6.1	2.3	2.2	2.5	3.4	4.0	4.8
Overall balance (after grants)	-3.2	-8.6	-7.9	-8.9	-3.5	-2.4	-1.4
	(In millions of U.S. dollars)						
External sector							
Current account balance	-82.6	-70.0	-106.9	-120.0	-114.8	-118.6	-122.6
(In percent of GDP)	-20.3	-17.6	-25.3	-28.6	-25.5	-24.6	-23.7
Official net imputed international reserves (end of period)	57.7	63.9	66.9	66.9	66.9	66.9	66.9

Sources: Ministry of Finance; and Fund staff estimates and projections.

1/ Projections of domestic savings and investment are not incorporated in the table, as work is still ongoing on finalizing the estimates of the national accounts by expenditure.

Table 7. Grenada: Medium-Term Balance of Payments

	2000	2001	2002	Projections 2003	2004	2005	2006
	(In millions of U.S. dollars)						
Current account balance	**-82.6**	**-70.0**	**-106.9**	**-120.0**	**-114.8**	**-118.6**	**-122.6**
Exports (f.o.b.)	84.5	63.6	64.3	60.3	63.7	67.6	71.7
Imports (f.o.b.)	220.4	196.4	209.0	218.7	229.7	241.6	254.9
Services (net)	67.4	65.7	55.2	62.5	68.3	74.6	82.4
Receipts	150.7	144.7	131.9	137.4	147.5	158.4	171.3
Of which							
Travel	92.6	83.5	84.5	90.1	97.0	104.4	113.4
Payments	83.3	79.0	76.7	74.9	79.2	83.8	88.9
Income (net)	-34.3	-26.3	-39.2	-37.3	-40.1	-43.0	-46.2
Interest	-6.7	-6.6	-10.7	-17.4	-9.1	-9.8	-10.6
Other	-27.6	-19.7	-28.5	-28.9	-30.9	-33.2	-35.6
Transfers (net)	20.1	23.4	21.8	22.3	23.0	23.7	24.4
Private	17.8	20.0	20.9	21.4	22.1	22.8	23.4
Official	2.3	3.4	0.9	0.9	0.9	0.9	0.9
Capital and financial account	**91.9**	**74.3**	**99.9**	**115.5**	**114.8**	**118.6**	**122.6**
Capital transfers	29.7	35.7	36.2	41.6	38.3	39.6	40.8
Public sector (net)	9.6	13.9	15.4	17.7	11.3	9.5	5.8
Private sector (net)	20.1	21.8	20.7	23.9	27.0	30.2	35.1
Financial account	62.2	38.6	63.8	73.9	76.5	79.0	81.8
Direct investment (net)	35.7	34.3	47.4	48.0	51.4	55.1	59.1
Portfolio investment (net) 1/	19.7	0.0	99.8	0.0	0.0	0.0	0.0
Other investments (net)	6.8	4.3	-83.4	25.9	25.1	23.9	22.6
Net errors and omissions	-2.6	1.9	10.0	0.0	0.0	0.0	0.0
Overall balance	**6.6**	**6.3**	**3.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum item:							
Net imputed international reserves (end of period)	57.7	63.9	66.9	66.9	66.9	66.9	66.9
	(In percent of GDP)						
Current account balance (including current official grants)	-20.3	-17.6	-25.3	-28.6	-25.5	-24.6	-23.7
Current account balance (excluding current official grants)	-20.9	-18.4	-25.5	-28.9	-25.7	-24.8	-23.9
Trade balance	-33.4	-33.3	-34.9	-37.8	-37.0	-36.1	-35.4
Exports of goods	20.8	16.0	15.5	14.4	14.2	14.0	13.9
Imports of goods	-54.2	-49.3	-50.5	-52.2	-51.1	-50.2	-49.3
Overall balance	1.6	1.6	0.7	0.0	0.0	0.0	0.0

Sources: Eastern Caribbean Central Bank (ECCB); Ministry of Finance; and Fund staff estimates and projections.

1/ Figure for 2002 reflects proceeds of US$100 million bond.

Table 8. Grenada: Indicators of External and Financial Vulnerability

	1998	1999	2000	Prel. 2001	Proj. 2002
(In percent of GDP, unless otherwise indicated)					
External Indicators					
Exports (percent change, 12-month basis in US$)	40.1	61.7	13.8	-24.8	1.0
Imports (percent change, 12-month basis in US$)	17.9	0.9	19.7	-10.9	6.4
Terms of trade (percent change, 12 month basis)	30.9	13.3	-0.3	-1.7	3.8
Current account balance	-24.1	-12.2	-20.3	-17.6	-25.3
Capital and financial account balance	24.4	16.0	22.6	18.7	24.1
Reserves to broad money (end of period)	16.8	16.1	15.8	15.8	15.3
External debt to exports of goods and services 1/	55.3	43.6	42.8	77.0	132.0
External interest payments to exports of goods and services 1/	3.7	4.0	3.1	1.2	5.6
External amortization payments to exports of goods and services 1/	8.4	7.9	3.0	3.7	4.6
REER appreciation, 12 month basis (percent change, Dec-Dec) 2/	-2.2	3.1	5.7	3.1	-2.1
(In percent)					
Financial Indicators					
90-day Treasury bill, average discount rate 3/	6.0	7.0	7.0	7.0	...
1-year Treasury bill, average discount rate 3/	7.0	...	8.0	8.0	...
Share of non-performing loans in total loans of banks 4/	11.3	10.0	8.5	5.9	...
Banks' total capital to risk-weighted assets	15.3	13.4	13.8	14.4	...
Ratio of banks' before-tax profits to assets	2.2	2.2	2.5	2.4	...

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Government and government guaranteed debt only.

2/ 2002 data as of October.

3/ Treasury bills are sold only infrequently, at low volumes and at pre-announced discount rates.

4/ Nonperforming (i.e., unsatisfactory) loans are defined as those which have been in arrears for 90 days or more.

Grenada: Public Sector Debt Sustainability Analysis

This note summarizes the public sector debt sustainability analysis for Grenada. The main results of this exercise are given in the attached table.

The baseline scenario assumes a real GDP growth of nearly 4 percent per year over the medium-term, sustained fiscal consolidation resulting in primary fiscal surpluses of about 2 percent of GDP each year by 2005, and inflation kept in low single digits. It is further assumed that the government would continue to pursue a prudent debt management strategy entailing retiring of more expensive debt, and eschewing excessive nonconcessional borrowing.

Based on the baseline projections, the debt dynamics for Grenada indicate a gradual reduction in the debt burden over the medium-term with the debt-to-GDP ratio declining from approximately 104 percent in 2002 to 83 percent in 2008. The gradual pace of reduction in the debt burden reflects (i) a declining share of concessional debt contracted in the past; and (ii) the effect of high fiscal deficits in 2001-03 which are financed mainly by commercial borrowings.

The robustness of Grenada's debt sustainability relative to the baseline scenario was assessed by applying a variety of sensitivity tests. If the values of interest rates, real GDP growth rate, and primary balance, were two standard deviation lower than their five-year historical averages (scenario 2-4) in 2003-04, the debt-to-GDP ratio would rise to about 124 percent in 2004 and then will decline only to 91 percent by 2008.

The rate of improvement in the debt situation is most sensitive to the country's growth performance (scenario 3). This suggests, given the vulnerability of Grenada's growth to exogenous factors, the need for a concerted medium-term effort to bring down Grenada's debt-to-GDP ratio to more sustainable levels which would reduce the vulnerabilities of Grenada to such shocks.

Table . Grenada: Public Sector Debt Sustainability Test, 2002-2008

		Projections					
	2002	2003	2004	2005	2006	2007	2008
(In percent)							
I. Baseline medium-term projections							
Real GDP growth (at factor cost)	2.5	4.5	4.6	4.6	4.6	4.6	4.6
Inflation (period average)	3.0	2.5	2.5	2.5	2.5	2.5	2.5
External current account balance in percent of GDP	-25.3	-28.6	-24.4	-23.6	-22.7	-21.9	-21.2
Total Debt in percent of GDP 1/	103.7	106.7	103.1	98.6	93.4	88.4	83.5
External Debt in percent of GDP	62.4	62.7	55.7	52.7	49.7	46.7	43.7
II. Fiscal sustainability stress test: Effect on public sector debt-to-GDP ratio 1/							
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007	103.7	105.9	107.8	109.6	111.5	113.3	115.2
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004	103.7	110.3	111.1	106.3	100.8	95.6	90.5
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	103.7	113.9	119.8	114.4	108.3	102.4	96.6
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004	103.7	111.5	115.6	110.7	105.1	99.8	94.6
5. Combination of 2-4 using one standard deviation shocks	103.7	114.1	124.3	116.2	107.6	99.3	91.1
6. One time 30 percent real devaluation in 2003 2/	103.7	106.8	103.2	98.6	93.3	88.2	83.2
7. 10 percent of GDP increase in other debt-creating flows in 2003	103.7	116.8	113.0	108.2	102.8	97.6	92.5
8. Impact on debt-to-GDP ratio if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04	103.7	114.4	115.8	110.9	105.3	100.0	94.8
8a. Impact on debt-to-revenue ratio if government revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04 3/	347.2	451.8	457.0	373.3	363.4	343.5	324.9
III. External sustainability stress test: Effect on public sector external debt-to-GDP ratio							
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-07	62.4	54.6	44.3	38.6	33.5	28.4	23.2
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004	62.4	63.8	59.9	56.8	53.7	50.6	47.4
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	62.4	68.3	68.4	65.0	61.6	58.3	54.9
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004	62.4	65.2	59.9	56.8	53.6	50.5	47.4
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004	62.4	65.3	62.9	59.7	56.5	53.3	50.1
6. Combination of 2-5 using one standard deviation shocks	62.4	64.3	63.8	60.5	57.3	54.0	50.8
7. One time 30 percent nominal devaluation in 2003 2/	62.4	89.6	81.7	77.8	74.1	70.3	66.6

Historical Statistics for Key Variables	**Baseline Averages**	**Historical Averages**	**Standard 3/ Deviation**
Public sector primary balance 4/	1.1	-1.7	2.3
Real GDP growth (in percent) 4/	3.6	3.1	3.5
Nominal interest rate (in percent) 4/ 6/	5.1	5.6	1.6
Real interest rate (in percent) 4/	2.5	3.4	1.7
Inflation rate (GDP deflator, in percent) 4/	2.6	2.2	1.2
Central government revenue and grants-to-GDP ratio4/	29.4	28.4	1.5
Current account deficit, excluding interest payments (in percent of GDP) 5/	21.7	17.3	5.0
Net non-debt creating capital inflows (in percent of GDP) 5/	10.7	10.7	2.6

Sources: Eastern Caribbean Central Bank; Ministry of Finance and Planning; and Fund staff projections.

1/ Indicate coverage of gross public sector net of NIS borrowings, e.g., general government and nonfinancial public sector.

2/ Real devaluation is defined as nominal devaluation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

3/ These relate to historical averages.

4/ Ten year historical average.

5/ Five year historical average.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

Grenada—Fund Relations
(As of November 30, 2002)

I. Membership Status: Joined: 08/27/75; Article VIII.

II. General Resources Account:	SDR Million	Percent of Quota
Quota	11.70	100.0
Fund Holdings of Currency	11.70	100.0

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	0.93	100.0
Holdings	0.00	0.34

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	08/24/83	01/23/84	13.50	1.13
Stand-by	05/11/81	05/10/82	3.43	2.90
Stand-by	11/06/79	12/31/80	0.65	0.65

VI. Projected Obligations to Fund: None

VII. Exchange Arrangement:

The currency of Grenada is the Eastern Caribbean dollar, which has been pegged to the U.S. dollar since July 1976 at the rate of EC$2.70 per U.S. dollar.

Grenada accepted the obligations of Article VIII, Sections 2, 3, and 4 in January 1994. There are no restrictions on the making of payments and transfers for current international transactions. There are exchange controls on payments for invisibles (i.e., indicative limit on travel allowances), but all bona fide transactions are approved.

VIII. Article IV Consultation:

The last Article IV consultation was concluded by the Executive Board on July 11, 2001. Grenada is on the standard 12-month consultation cycle.

XI. Technical Assistance:

MAE: In September 2001, a mission evaluated the Module 1 self-assessment of the offshore financial sector

MAE: In January 2001, a mission assisted in preparing self-diagnostic exercises to assess the regulatory framework and operations of the offshore financial sector.

LEG: In July 2000, a mission examined the tax laws and made recommendations for increasing compliance.

FAD: In October 1999, a mission advised on the possible introduction of a VAT.

Grenada—Relations with the World Bank Group

(As of September 12, 2002)

I. Projects

There are four active World Bank projects in Grenada with net commitments of approximately US$15.7 million. These projects are part of the OECS sub-regional programs of the World Bank.

The **OECS Solid Waste/Ship Generated Waste Management Project**, approved in FY95, 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 this project is US$41 million, of which the Grenada component is financed with US$1.3 million from the GEF).

The **OECS Telecommunications Reform Program**, approved in FY98, seeks to introduce pro-competition reforms in the telecommunications sectors and increase the supply of informatics-related skills in five OECS borrowing countries: the Commonwealth of Dominica ,Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The project has helped the OECS countries negotiate with the sub-regional telecom monopoly and lower the long distance and regional telephone rates. Grenada's share of the US$6.0 million loan is US$1.2 million.

The **Disaster Management Project**, approved in FY99, is part of a regional program for the five OECS borrowing countries to fortify, reconstruct, and rehabilitate key economic and social infrastructure and facilities to minimize damage caused by natural and man-made disasters and to speed-up emergency recovery following such disasters. Additionally, the project aims to strengthen countries' institutional capacities to prepare for and respond to disaster emergencies efficiently and effectively. The total program size is US$46 million, and the Grenada project is US$10.1 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 to revitalize tourism, which had fallen off as a result of the events of September 11, 2001. The Bank's support to Grenada under this project is for US$3.8 million.

II. Financial Relations

(In millions of U.S. dollars)

Operations	Principal	Disbursed	Undisbursed
Grenada Disaster Management	10.07	2.16	7.91
Telecommunications Reform	1.20	0.30	0.88
Grenada Emergency Recovery Project	3.8	0	3.8

Gross disbursements and debt service during fiscal year

	Actual							Projections	
	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total disbursements	0.00	0.00	0.50	0.30	1.40	2.00	2.60	2.64	4.50
Repayments	0.00	0.10	0.10	0.10	0.10	0.10	0.10	0.03	0.06
Net disbursements	0.00	-0.10	0.40	0.20	1.30	1.90	2.50	2.61	4.44
Interest and fees	0.10	0.10	0.10	0.10	0.10	0.10	0.30	0.27	.035

III. Economic and Sector Work

The World Bank's Management presented to its Board an Eastern Caribbean Sub-Region Country Assistance Strategy (CAS), on June 4, 2001. For FY02-06, the CAS, which covers Grenada, proposes new commitments of US$107 million for the five OECS World Bank borrowers.

Under this CAS, in FY03, Grenada will participate in a US$20 million sub-regional OECS Education Reform Project, of which US$4 million would be allocated to Grenada; and US$3 million out of a US$150 million Caribbean-wide HIV/AIDS program (negotiations were held in May, 2002 for this project). The CAS also foresees lending to Grenada for a Regulatory Reform Project for the electricity sector ((US$5.0 million) and a Public Sector Reform project (US$4.0 million), both in FY05.

In addition, the Bank is preparing four reports in the area of OECS institutional development. In the last stages before publication issuance are three reports: the OECS Institutional and Organizational Review, the Country Procurement Assessment Review, and the County Financial Accountability Assessment. In addition, a fiscal issues analysis is underway, which the Bank expects to complete within FY03.

At the meeting of the Caribbean Group for Cooperation in Economic Development (CGCED), which took place in Washington in June 2002, the Bank presented four reports covering the Caribbean region, with a specific emphasis on the OECS: Natural Hazard Risk Management in the Caribbean: Revisiting the Challenge; Youth Development in the Caribbean; Development Assistance and Economic Development in the Caribbean Region: Is there a Correlation; and Caribbean Economic Overview 2002: Macroeconomic Volatility, Household Vulnerability, and Institutional and Policy Responses.

Grenada: Relations with the Caribbean Development Bank

(As of September 31, 2002)

I. Projects

The Caribbean Development Bank's (CDB's) operations in Grenada have been designed to support the country's economic and social development through the financing of carefully selected capital projects and technical assistance, and through policy advice on major developmental issues. Against this backdrop, the CDB's involvement with Grenada has covered such areas as: (i) infrastructure development to facilitate private investment, (ii) sectoral development to promote diversification, (iii) enhancing human resource capabilities and institutional strengthening, (iv) emergency disaster rehabilitation, and (v) macroeconomic policy formulation.

CDB provided the equivalent of US$120 million in loans (47 capital loans and 7 contingently recoverable loans were approved) and grants (51 technical assistance grants) to Grenada in 2001. Of this, loans accounted for $107.8 million, 67.2 percent of which were provided from "soft" resources. Under economic infrastructure (including road development, expansion and improvements in the water supplies, and upgrading the port), a loan of $2.3 million was approved for the Rural Enterprise Development Project designed to help reduce poverty in the rural areas in a sustainable and gender-sensitive manner. The funds will be used to assist in financing a Rural Investment Fund, the institutional strengthening of financial intermediaries and in providing technical assistance for agricultural production, marketing, and project coordination activities. A total of $17.1 million was approved for a Bridge and Road Improvement Project to assist in financing the replacement of 14 bridges, and the restoration of approximately 20 kilometers of the principal road network in and around the capital, St George's. At end-December 2001, Grenada had a total outstanding loan balance of US$51.3 million.

II. Financial Relations

(As of September 31, 2002)

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998	1999	2000	2001
Cumulative total credit approved	51.35	68.92	68.16	71.86	76.28	77.01	90.25	110.17
Cumulative disbursements 1/	49.31	52.28	53.07	56.08	61.18	67.10	71.66	79.80
Disbursements 2/	**5.23**	**2.97**	**0.79**	**3.01**	**5.1**	**5.92**	**4.56**	**7.32**
Ordinary capital resources	0.36	0.09	0.65	1.86	2.85	4.59	2.29	3.29
Special development fund	4.75	2.46	0.14	0.48	0.36	0.82	1.39	2.28
Other special fund resources	0.12	0.42	0.00	0.67	1.89	0.51	0.88	2.25
Amortization 2/	**1.66**	**1.48**	**2.30**	**2.07**	**2.1**	**2.68**	**1.98**	**2.19**
Ordinary capital resources	0.13	0.11	0.35	0.54	0.52	0.63	0.57	0.39
Special development fund	1.25	1.07	1.56	1.21	1.24	1.72	1.21	1.50
Other special fund resources	0.28	0.30	0.39	0.32	0.34	0.33	0.20	0.30
Outstanding debt (end of period)	39.07	41.09	39.28	39.89	42.17	45.09	47.91	51.32
Interest and commitment fees 2/	**1.15**	**1.18**	**1.90**	**1.29**	**1.36**	**1.63**	**1.57**	**1.75**
Ordinary capital resources	0.23	0.44	0.81	0.59	0.59	0.83	0.88	1.05
Special development fund	0.84	0.65	1.01	0.64	0.71	0.73	0.62	0.60
Other special fund resources	0.08	0.09	0.08	0.06	0.06	0.07	0.07	0.10

Source: Caribbean Development Bank.

1/ Including valuation adjustments.

2/ Ordinary capital resources are hard loans, and special development funds and other special fund resources are soft loans.

Grenada—Statistical Issues

Outstanding statistical issues

The coverage, consistency and timeliness of the statistical information reported to the Fund for surveillance has improved, particularly in the national accounts, the public finances, and debt. However, the underreporting of production and export data could compromise macroeconomic projections and analysis.

Grenada is a participant in the Fund's General Data Dissemination System (GDDS), and posts its metadata on the Dissemination Standards Bulletin Board. The metadata detail plans for statistical development in the main macroeconomic areas in the near and medium term.

Real sector

Except for consumer prices, no other real sector data are provided between missions. Data on the national accounts (in constant and current prices) are available annually, but there is a long lag with respect to the availability of data on aggregate domestic expenditure. The methodologies used to estimate capital formation and sectoral price deflators need to be improved and documented. The results of a labor market survey, which was initiated in 1994, still awaits publication. No comprehensive or regular labor statistics are available.

Government finance

The reporting of the central government data has improved significantly in recent years, but major weaknesses remain in the rest of the public sector. The authorities are now reporting quarterly central government operations in Fund economic classification format, with lags of one to two months. Regarding the rest of the public sector, there is no systematic reporting of information to the ministry of finance; annual statements for the major public enterprises are obtained from the ministry during Fund missions. Work is still ongoing by staff to compile consolidated public sector accounts. The 2000 GFS Yearbook contains data for 1991–95. The data cover the central government only (operations of the National Insurance Scheme are excluded), and no financing data are reported.

Monetary accounts

Monthly data for publication in *IFS* are reported by the ECCB, normally with a two-month lag for monetary authorities and a three-month lag for commercial banks. The data are reliable, and reported on a regular basis.

Balance of payments

Balance of payments estimates are compiled by the ECCB on an annual basis and incorporate the information collected by the CSO. The compilation of foreign trade statistics is hampered by software and hardware constraints, and there are discrepancies between the estimates prepared by the customs division and the CSO. Statistics on the direction of trade are relatively current. Imports by SITC section are available on a quarterly and annual basis. The methodology used to estimate tourist receipts (based on a 1986 survey) needs to be reviewed, and the data on services and the capital account are not comprehensive. The latest data published in IFS and the Balance of Payments Yearbook are for 1996. However, the ECCB recently reported annual data for the period through 2000, which have yet to be published in the Fund publications pending clarification of a number of issues.

External debt

While, there has been some improvement in the coverage of government and government-guaranteed external debt, the information on external loans contracted and guaranteed by the government, as detailed in the annual budget estimates, remains incomplete insofar as it excludes some loans, and may underestimate the amounts outstanding of some loans which are included.

Grenada: Core Statistical Indicators

As of November 30, 2002

	Exchange Rates 1/	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	External Current Account Balance	Overall Government Balance	GDP/GNP	External Debt and Debt Service
Date of Latest Observatio	n.a	Mar. 2001	Mar. 2001	Mar. 2001	Mar. 2001	Mar. 2001	Mar. 2001	1999	1999	Mar. 2001	Dec. 2000	Dec. 2000
Date Received	n.a	May 2001	May 2001	May 2001	May 2001	May 2001	May 2001	June 2000	June 2000	May 2001	Feb. 2001	March 2001
Frequency of Data	n.a	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly	Annual/ quarterly	Annual	Monthly	Annual	Annual
Frequency of Reporting	n.a	Monthly with one-to-two-month lag	Monthly with one-to-two-month lag	Monthly with two-to-three-month lag	Monthly with one-to-two-month lag	Monthly with one-to-two-month lag	Monthly with one-to-two month lag	Article IV Mission	Article IV Mission	Monthly with one-to-two-month lag	Article IV Mission	Article IV Mission
Source of Update	n.a	ECCB 2/	ECCB	ECCB	ECCB	ECCB	CSO 3/	CSO 3/	ECCB CSO	Ministry of Finance	CSO	Ministry of Finance
Mode of Reporting	n.a	Fax/e-mail	Fax/-email	Fax/e-mail	Fax/e-mail	Fax/e-mail	Fax	Article IV Mission	Article IV Mission	E-mail	Article IV Mission	Article IV Mission/ e-mail
Confidentiality	n.a	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Unrestricted	Restricted	Unrestricted	Unrestricted
Frequency of Publication	n.a	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and quarterly	Annual and monthly	Annual	Annual	Semi-annual	Annual	Annual and semi-annual

1/ Grenada is a member of the Eastern Caribbean Currency Union, in which the common currency of all member states (E.C. dollar) has been pegged to the U.S. dollar at US$1=EC$2.70 since July 1976.
2/ Eastern Caribbean Central Bank.
3/ Central Statistical Office.

INTERNATIONAL MONETARY FUND

GRENADA

Use of Fund Resources—Request for Emergency Assistance

Prepared by the Western Hemisphere Department

Approved by Guy M. Meredith and Matthew Fisher

January 13, 2003

Contents

EXECUTIVE SUMMARY

- **In September 2002, Grenada was hit by tropical storm Lili,** which caused considerable damage to infrastructure, agriculture, and property estimated at about EC$ 21 million (equivalent to nearly 2 percent of GDP).

- **The potential loss of export receipts is estimated at nearly EC$15 million, mostly in 2003, and is around one third of agricultural exports.** This mainly reflects the damage to Grenada's main export crop of nutmeg.

- **The government has received grant assistance from Taiwan, Province of China, and approval of** a US$500,000 loan from the Caribbean Development Bank (CDB) under its Immediate Disaster Relief Facility.

- **The government has allocated in the 2003 budget slightly in excess of EC$32 million (US$12million)** for infrastructure maintenance and emergency recovery and disaster management. It has requested additional assistance from external partners: so far, it has received US$600,000.

- **The after-effects of tropical storm Lili will add fiscal and balance of payments pressures** on top of those resulting from continuing adverse effects of the September 11 events on tourism and slower-than-expected pace of global economic recovery.

I. Introduction

1. On the early morning of September 24th 2002, tropical storm Lili struck Grenada causing extensive damage to infrastructure, crops, and property. The overall damage is estimated at EC$21 million, nearly 2 percent of GDP. In addition, the potential loss of export earnings from the destruction of crops, in particular nutmeg, is estimated at about EC$15 million (US$5.6million).

2. The areas most affected by the storm were St. Marks and the northern parish of St. Patrick's where over 70 percent of the damage took place. Damage also occurred in the parish of St. Andrew's as well as to the sister isles of Carriacou and Petit Martinique.

3. The brunt of the storm was borne by the physical infrastructure in the form of damage to roads, bridges, pipelines, and telephone and electricity lines and poles. In addition, livestock, houses, other buildings, and vehicles were destroyed. The estimated damage to infrastructure is about EC$18 million. The destruction of road surfaces and bridges, especially those in rural areas, seriously affected the ability of the farmers to access markets for their produce.

4. Grenada has traditionally been dependent on agriculture for income, employment, and output. While agricultural production has been declining in recent years, the sector still accounts for about 10 per cent of GDP. The destruction caused by Lili involved severe damage to nearly 50 acres of prime agricultural land with mixed cultivation of cocoa, nutmeg and bananas, which are Grenada's main agricultural exports from the northeastern part of the island. This area represents the main agricultural belt in Grenada accounting for over 75 percent of the country's agricultural output. Estimates based on the output losses of these crops, mainly nutmeg, indicate a potential shortfall in export earnings of nearly EC$ 15 million.

II. The Economic Impact of the Damage

5. The loss of output and rehabilitation expenditures will put further pressure on an already difficult fiscal situation facing Grenada, reflecting the continuing after-effects of the events of September 11 on tourism, a slower-than-expected pace of global economic growth, and loss of revenue due to a sharply shrinking offshore financial sector as a result of strengthened monitoring and stricter legal requirements for its operation.

6. The balance of payments effect of the damage of tropical storm Lili would mostly be felt in 2003, as contracts for the export of cocoa and nutmegs were already concluded in the first quarter of 2002, and most purchases of these crops generally take place in the first half of the year during peak production. Most of the impact on bananas was felt in 2002, but its contribution to the agricultural sector is relatively small.

7. There will also be substantial strain placed on government finances, as expenditures are to be increased to meet the economic needs of the storm victims, and to spur economic recovery in the affected areas. The government intends to provide most of the agricultural inputs free of charge to the affected farmers as a means of assisting in recovery.

III. Policy Response

8. The government responded immediately after the storm and temporarily repaired rural roads and bridges to avoid food shortages, and to help restore normal economic activity. Measures are being taken to rehabilitate infrastructure on a more permanent basis, and given the topology of the region, this rehabilitation work would involve extensive repairs to stabilize slides, reinstating rural roads and repairs to structures such as rebuilding retaining walls and bridges.

9. To date, the government has benefited from an emergency grant of US$100,000 from Taiwan, Province of China, and these funds have been used to meet immediate needs of displaced families and carry out cleaning and repairs works. In response to the government's request, the Caribbean Development Bank (CDB) has approved a US$500,000 loan under its Immediate Disaster Relief Facility. In the 2003 budget approved by parliament in November, the government has allocated slightly more than EC$32 million for infrastructure rehabilitation on an emergency basis and for strengthening its disaster management and emergency relief operations. In 2003, the government intends to request three-year loans from the CDB and the World Bank for rehabilitation.

10. For 2003 and beyond, the government intends to pursue prudent macroeconomic policies to ensure fiscal and debt sustainability and higher growth. These policies entail a strengthened effort to broaden the tax base, curtail expenditures, and closely monitor the debt (see attached LOI).

IV. Staff Appraisal

11. Grenada has suffered substantial infrastructure and crop damage from Tropical Storm Lili. The authorities have taken quick action to rehabilitate temporarily infrastructure and restore normal life in the affected areas with the support of donors and multilateral institutions.

12. The government of Grenada, which has a strong record of cooperation with the Fund through its Article IV consultations, staff visits, and technical assistance, is requesting a purchase of Fund resources equivalent to 25 percent of quota under the guidelines for emergency assistance in the case of natural disaster to help meet its immediate financing needs, without seriously depleting its international reserves, arising from the storm.

13. The burden of additional expenditures to cope with the effects of the storm would exert further pressure on public finances already under strain, as a result of the after-effects

of the September 11 events on tourism, the global slowdown, and a loss of revenue from a shrinking offshore financial sector.

14. The authorities have indicated that they intend to pursue prudent macroeconomic policies in the context of the budget for 2003 and beyond to ensure fiscal and debt sustainability. The authorities do not intend to impose or intensify restrictions on the making of payments and transfers for current international transactions, introduce or modify multiple currencies practices, conclude bilateral payments agreements that are inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments reasons.

15. In view of the foregoing, the staff supports Grenada's request for emergency assistance in the amount requested and believes that it is in accordance with Fund policies regarding the provision of financial assistance in the case of natural disasters.

Table 1. Grenada: Selected Economic and Financial Indicators

	1998	1999	2000	2001	Est. 2002	Proj. 1/ 2003
(Annual percentage change, unless otherwise specified)						
Output, prices, and labor						
Real GDP	7.3	7.5	6.5	-3.3	-0.5	2.5
Consumer prices (annual average)	1.4	0.5	2.2	3.2	3.0	2.5
Consumer prices (end of period)	1.2	1.0	3.5	2.5	3.0	2.5
Unemployment rate (estimated)	16.0	14.0	11.5	12.2	12,2	12.0
Banking system						
Net foreign assets 2/	0.3	6.1	0.3	6.8	0.3	1.1
Money and quasi-money (M2)	11.8	13.9	15.4	10.6	8.1	6.1
Net domestic assets 2/	11.4	7.8	15.0	3.8	7.8	0.5
Of which						
Credit to the public sector (net)	-1.2	-5.0	3.7	5.0	3.2	0.6
Credit to the private sector	14.4	11.1	12.9	0.8	1.8	6.1
Average interest rate on deposits (percent per year)	5.5	5.5	5.5	5.5	4.0	4.0
Average prime rate (percent per year)	9.8	10.0	10.0	10.0	10.0	10.0
External sector						
Merchandise exports, f.o.b. (in U.S. dollars)	39.6	67.1	12.5	-24.7	1.1	-6.2
Merchandise imports, c.i.f. (in U.S. dollars)	18.1	0.9	19.7	-10.9	6.4	4.6
Terms of trade	30.9	13.3	-0.3	-1.7	3.8	-2.4
Real effective exchange rate 3/	-2.2	3.1	5.7	3.1	-2.1	...
(In percent of GDP)						
Central government finances						
Total revenue and grants	30.0	28.1	30.1	30.5	29.5	32.2
Current revenue	25.2	26.2	27.1	26.3	26.3	28.2
Capital revenue	0.2	0.0	0.1	0.0	0.2	0.0
Foreign grants	4.6	1.9	3.0	4.2	3.0	4.0
Total expenditure	33.1	31.6	33.3	39.1	37.4	38.3
Current expenditure	23.9	21.4	21.0	24.0	24.4	25.6
Of which						
Salaries and allowances 4/	12.2	11.7	10.4	11.9	11.0	10.8
Capital expenditure	9.2	10.2	12.3	15.1	13.2	12.7
Current balance	**1.3**	**4.8**	**6.1**	**2.3**	**2.2**	**2.5**
Overall balance (after grants)	**-3.1**	**-3.5**	**-3.2**	**-8.6**	**-7.9**	**-6.0**
Foreign financing	2.1	2.8	1.9	3.9	5.6	3.8
Domestic financing	1.0	0.7	2.7	2.5	5.0	5.1
Arrears	0.0	-1.0	-1.5	2.2	-2.7	0.0
External sector						
Current account deficit (including current official grants)	-24.1	-12.2	-20.3	-17.6	-25.3	-28.6
External public debt (end-period) 5/	27.2	26.2	25.3	40.4	62.4	62.7
(In millions of U.S. dollars)						
Official net imputed reserves (end of period)	46.8	50.9	57.7	63.9	66.9	66.9
Memorandum item:						
GDP at current market prices						
In EC$ millions	920	1,020	1,098	1,075	1,118	1,186
In US$ millions	341	378	407	398	414	439
Stock of central government arrears (EC$ millions)				23.7	0.0	0.0

Sources: Ministry of Finance; Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Fiscal numbers based on 2003 budget recently presented to Parliament.

2/ As a percent of money and quasi-money at the beginning of the year.

3/ 2002 data as of October.

4/ The increase in 2001 reflect an agreement that provided for retroactive salary increases to civil servants, covering 1996-2001 (average of 2 1/2 percent a year).

5/ Government and government guaranteed debt. The sharp increase for 2001 and 2002 partly reflects a broader coverage of deb by the authorities to include contingent liabilities, the estimates of which are still being reviewed by the authorities. The figure for 2002 also reflects the estimated net impact of new borrowing/debt restructuring.

Table 2. Grenada: Summary of Central Government Finances

	1998	1999	2000	2001	Est 2002 1/	Budget 2003
	(In millions of Eastern Caribbean dollars)					
Revenue and grants	**275.8**	**286.9**	**330.5**	**328.1**	**329.5**	**381.8**
Revenue	233.5	267.3	297.9	283.2	296.0	334.1
Current revenue	232.0	267.3	297.2	282.7	293.5	334.1
Tax revenue	204.7	232.0	265.2	254.5	267.8	303.8
Nontax revenue	27.3	35.3	32.1	28.2	25.7	30.3
Capital revenue	1.5	0.0	0.7	0.5	2.5	0.0
Grants	42.3	19.6	32.6	45.2	33.5	47.8
Total expenditure	**304.6**	**322.8**	**365.7**	**420.7**	**418.0**	**467.0**
Current expenditure	219.9	218.6	230.5	258.1	269.9	304.0
Salaries and allowances	112.3	119.3	114.4	127.6	123.0	128.2
Goods and services	35.8	27.1	26.5	35.4	29.8	42.9
Lease payments 2/	1.4	3.1	17.3	17.5	17.3	0.0
Interest	14.7	23.0	24.2	27.9	45.4	67.6
Domestic	9.8	15.0	11.7	13.3	16.5	20.6
Foreign	4.9	8.0	12.5	14.6	28.9	47.1
Transfers and subsidies	57.1	46.1	48.2	49.9	57.6	65.3
Capital expenditure	84.7	104.2	135.2	162.6	148.0	183.0
Current balance	**12.1**	**48.7**	**66.7**	**24.6**	**23.6**	**30.1**
Overall balance (before grants)	**-71.1**	**-55.5**	**-67.7**	**-137.5**	**-122.0**	**-153.0**
Overall balance (after grants)	**-28.8**	**-35.9**	**-35.2**	**-92.3**	**-88.5**	**-105.2**
Financing	**28.8**	**35.9**	**35.2**	**92.6**	**88.5**	**105.2**
Foreign (net)	19.7	28.1	21.3	42.1	76.8	45.2
Domestic	9.1	17.7	30.1	26.4	42.0	60.0
Arrears 3/		-29.8	-16.2	23.7	-30.3	0.0
	(In percent of GDP)					
Revenue and grants	**30.0**	**28.1**	**29.8**	**30.5**	**29.5**	**32.2**
Revenue	25.4	26.2	26.9	26.3	26.5	28.2
Current revenue	25.2	26.2	26.8	26.3	26.3	28.2
Tax revenue	22.2	22.7	23.9	23.6	24.0	25.6
Nontax revenue	3.0	3.5	2.9	2.6	2.3	2.6
Capital revenue	0.2	0.0	0.1	0.0	0.2	0.0
Grants	4.6	1.9	2.9	4.2	3.0	4.0
Total expenditure	**33.1**	**31.6**	**33.3**	**39.1**	**37.4**	**41.0**
Current expenditure	23.9	21.4	21.0	24.0	24.1	25.6
Salaries and allowances	12.2	11.7	10.4	11.9	11.0	10.8
Goods and services	3.7	2.7	2.4	3.3	2.7	3.6
Lease payments 2/	0.2	0.3	1.6	1.6	1.6	0.0
Interest	1.6	2.3	2.2	2.6	4.1	5.7
Domestic	1.1	1.5	1.1	1.2	1.5	1.7
Foreign	0.5	0.8	1.1	1.4	2.6	4.0
Transfers and subsidies	6.2	4.5	4.3	4.6	5.2	5.5
Capital expenditure	9.2	10.2	12.3	15.1	13.2	15.4
Current balance	**1.3**	**4.8**	**6.0**	**2.3**	**2.2**	**2.5**
Overall balance (before grants)	**-7.7**	**-5.4**	**-6.1**	**-12.8**	**-10.9**	**-12.9**
Overall balance (after grants)	**-3.1**	**-3.5**	**-3.2**	**-8.6**	**-7.9**	**-8.9**

Sources: Ministry of Finance; and Fund staff projections.

1/ Based on policies proposed by the staff, and endorsed by the authorities.
2/ Payments related to government office buildings and the national stadium, constructed under lease agreements.
3/ The fiscal accounts are on an acrural basis, hence the arrears accumulation has no impact on the deficit.

Table 3. Grenada: Summary Accounts of the Banking System

	1998	1999	2000	2001	Est 2002
	(In millions of Eastern Caribbean dollars, end of period)				
	I. Consolidated Banking System				
Net foreign assets	**88.2**	**133.8**	**136.7**	**203.4**	**206.9**
Net domestic assets	**662.3**	**720.8**	**849.2**	**886.9**	**971.7**
Net credit to the public sector	46.5	8.7	40.0	89.2	123.5
Central government	71.2	43.6	59.8	94.7	151.1
Nonfinancial public enterprises 1/	-24.8	-34.9	-19.8	-5.5	-27.6
Credit to private sector	684.7	767.9	878.4	886.4	906.3
Other	-68.9	-55.8	-69.2	-88.6	-58.1
Liabilities to private sector (M2)	**750.4**	**854.6**	**985.8**	**1090.4**	**1178.6**
Money	159.4	175.1	182.4	192.3	204.3
Quasi-money	591.0	679.4	803.5	898.0	974.3
	II. Eastern Caribbean Central Bank				
Imputed net international reserves	126.4	137.3	155.7	172.6	180.6
Net domestic assets	13.3	10.5	7.6	8.7	4.6
Base money	**139.6**	**148.0**	**163.4**	**181.3**	**203.8**
Currency held by the public	64.1	64.8	71.1	70.2	68.9
Commercial bank reserves	75.5	83.3	92.2	111.1	134.9
	III. Commercial Banks				
Net foreign assets	-38.2	-3.5	-19.0	30.8	26.3
Net claims on ECCB	73.4	83.8	92.2	107.6	133.0
Net domestic credit	**651.2**	**709.5**	**841.5**	**881.7**	**926.3**
Net credit to the public sector	33.2	-1.8	32.2	80.4	118.9
Credit to private sector	684.7	767.9	878.4	886.4	906.3
Other	-66.7	-56.6	-69.1	-85.1	-98.9
Liabilities to the private sector	686.4	789.8	914.7	1020.2	1109.7
	(12-month change in percent of M2 at the beginning of the period)				
Consolidated banking system					
Liabilities to private sector	11.8	13.9	15.4	10.6	8.1
Net foreign assets	0.3	6.1	0.3	6.8	0.3
Net domestic assets	11.4	7.8	15.0	3.8	7.8
Credit to private sector	14.4	11.1	12.9	0.8	1.8

Sources: Eastern Caribbean Central Bank; and Fund staff estimates.

1/ Includes the National Insurance Scheme.

Table 4. Grenada: Summary Balance of Payments Estimates

	1998	1999	2000	2001	Est 2002
(In millions of U.S. dollars)					
Current account balance	**-82.2**	**-46.2**	**-82.6**	**-70.0**	**-106.9**
Exports (f.o.b.)	45.9	74.3	84.5	63.6	64.3
Imports (f.o.b.)	182.6	184.1	220.4	196.4	209.0
Services (net)	48.3	70.0	67.4	65.7	55.2
Receipts	117.6	148.5	150.7	144.7	131.9
Of which					
Travel	80.9	88.2	92.6	83.5	84.5
Payments	69.3	78.5	83.3	79.0	76.7
Income (net)	-23.1	-25.5	-34.3	-26.3	-39.2
Interest	-3.3	-4.9	-6.7	-6.6	-10.7
Other	-19.7	-20.7	-27.6	-19.7	-28.5
Transfers (net)	29.2	19.2	20.1	23.4	21.8
Private	19.8	19.6	17.8	20.0	20.9
Official	9.3	-0.4	2.3	3.4	0.9
Capital and financial account	**83.1**	**60.6**	**91.9**	**74.3**	**99.9**
Capital account (transfers)	28.6	31.2	29.7	35.7	36.2
Public sector (net) 1/	10.0	11.5	9.6	13.9	15.4
Private sector (net) 2/	18.5	19.7	20.1	21.8	20.7
Financial account	54.6	29.4	62.2	38.6	63.8
Direct investment (net)	48.7	41.6	35.7	34.3	47.4
Portfolio investment (net) 3/	-0.1	0.4	19.7	0.0	99.8
Other investments (net)	5.9	-12.6	6.8	4.3	-83.4
Of which					
Public sector net borrowing 4/	1.3	9.6	5.0	15.6	-29.0
Net errors and omissions	**3.2**	**-9.7**	**-2.6**	**1.9**	**10.0**
Overall balance	**4.2**	**4.7**	**6.6**	**6.3**	**3.0**
Memorandum items:					
Net imputed international reserves (end of period)	46.8	50.9	57.7	63.9	66.9
(In percent of GDP)					
Current account balance (including current official grants)	-24.1	-12.2	-20.3	-17.6	-25.3
Current account balance (excluding current official grants)	-26.8	-12.1	-20.9	-18.4	-25.5
Trade balance	-40.1	-29.1	-33.4	-33.3	-34.9
Exports of goods	13.5	19.7	20.8	16.0	15.5
Imports of goods	-53.6	-48.8	-54.2	-49.3	-50.5
Public sector net borrowing 4/	0.4	2.5	1.2	3.9	-7.0
Direct investment	14.3	11.0	8.8	8.6	11.4
Overall balance	1.2	1.2	1.6	1.6	0.7

Sources: Eastern Caribbean Central Bank (ECCB); Ministry of Finance; and Fund staff estimates.

1/ Mainly capital grants.

2/ Migrants' transfers.

3/ Figure for 2002 reflects proceeds of US$100 million bond.

4/ Government and government guaranteed debt.

Grenada
November 5, 2002

Dear Mr. Köhler,

On the early morning of September 24th 2002, tropical storm Lili struck the State of Grenada causing extensive damage to infrastructure, crops, and property.[1] The overall damage is estimated at EC$21 million, nearly 2 percent of GDP. In addition, the potential loss of export earnings from the destruction of crops, in particular, nutmeg is estimated at about EC$15 million. The areas most affected by the storm were St. Marks and the northern parish of St. Patrick's where over 70 percent of the damage took place. Damage also occurred in the parish of St. Andrew's as well as to the sister isles of Carriacou and Petit Martinique. To assist Grenada meet its immediate financing needs without seriously depleting its external reserves, the government requests a purchase from the Fund for the equivalent of SDR 2.93 million (25 percent of its quota in the Fund) under the emergency assistance procedure.

Most of the damage from the storm was due to the destruction of the physical infrastructure, including roads, bridges, pipelines, and telephone and electricity lines and poles. The estimated damage is about EC$18 million. The destruction caused by Lili also affected nearly 50 acres of prime agricultural land, and we estimate that Grenada is likely to suffer a loss of export earnings of about EC$15 million in 2003.

The government responded immediately after the storm and temporarily restored rural roads and bridges to avoid food shortages, and measures are being taken to rehabilitate them on a more permanent basis. In order to assist the affected farmers, the government intends to supply them free of charge with agricultural inputs to restart their cultivation. To help meet part of the cost of rehabilitation and disaster relief, the government has received an emergency grant of US$100,000 from Taiwan, Province of China, and the Caribbean Development Bank (CDB) has approved a US$500,000 loan under its Immediate Disaster Relief Facility. The government in its 2003 budget has allocated slightly more than EC$32 million for infrastructure rehabilitation on an emergency basis and for strengthening its disaster management and emergency relief operations. In 2003, the government intends to approach multilateral institutions to seek further financial and technical assistance to strengthen its disaster management operations.

The loss of output and rehabilitation expenditures will put further pressure on an already difficult fiscal situation facing Grenada, reflecting the continuing after-effects of the events of September 11 on tourism, a slower-than-expected pace of global economic growth, and the shrinking offshore financial sector.

[1] The State of Grenada consists of Grenada, Carriacou, and Petit Martinique.

The amount of assistance the Fund can make available represents a substantial portion of our present needs, and the speed with which it can be disbursed and consequently used will aid the process of economy recovery and increase the government's ability to provide assistance for the affected population. It will also provide a concrete sign of Grenada's close cooperation with the Fund and will help catalyze additional financial assistance from other sources.

On its part, the government, notwithstanding the current difficult economic circumstances facing Grenada, intends to continue prudent macroeconomic policies to ensure fiscal sustainability and higher growth. Regarding fiscal policy for 2003, we are targeting a central government deficit of 6 percent of GDP. To achieve this target, we will strengthen our efforts to broaden the tax base initiated in 2002 by revoking the tax exemption status of Cable & Wireless and St. Georges' University School of Medicine. In this context, for 2003, we have instituted the following measures:

- a case-by-case review of requests for renewal of tax exemptions in place of the previous policy of automatic renewal;
- reducing the percentage of import duty exemptions (from 100 percent to 50 percent);
- shortening the period for which the duty exemption will be granted;
- strengthening of Customs and Inland Revenue Departments.

Looking ahead, we intend to benefit from the recommendations of the recent FAD/CARTAC technical assistance mission dealing with a comprehensive review of our tax policy and administration.

On the expenditure side, for 2003, we aim to restrain the level of discretionary expenditures to the level of 2002 primarily by a judicious implementation of the capital budget and curtailing other recurrent spending. To further strengthen our public expenditures, we are looking forward to the on-going Public Expenditure Review being conducted by the World Bank.

Regarding debt management, with the proceeds of a US$100 million bond we have retired a large part of our more expensive debt, cleared all arrears to suppliers, and reached agreement with the National Insurance Scheme for the repayment of their arrears. We intend to adhere to a prudent debt management policy by avoiding expensive commercial borrowing, and eschewing entering into any lease-purchase agreements. Given the high level of our debt, we plan to maintain it under close monitoring.

The Government of Grenada has a strong record of cooperation with the Fund, and it has benefited from the Fund advice in its macroeconomic policy formulation. We will maintain a close dialogue with the Fund staff and will consult them in case of serious deviations from our stated fiscal objectives for 2003.

The government of Grenada does not intend to impose new, nor intensify existing restrictions on payments and transfers for current international transactions, introduce any multiple currency practices or impose new, or intensify existing import restrictions for balance of payments purposes.

Sincerely yours,

/s/
Anthony Boatswain
Minister of Finance

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 03/10
FOR IMMEDIATE RELEASE
February 4, 2003

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

IMF Concludes 2002 Article IV Consultation with Grenada

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

Background

After GDP growth averaging 7 percent a year from 1998–2000, real GDP declined by 3 percent in 2001, reflecting the global slowdown, completion of most of the large infrastructure and tourism projects, and the effects on tourism of the September 11 attacks in the United States. For 2002, despite damage to crops and infrastructure caused by a tropical storm in September, economic growth is expected to be slightly positive owing to a higher tourism activity in the fourth quarter.

The fiscal situation deteriorated markedly in 2001 with the central government deficit rising to 8½ percent of GDP, reflecting a sharp increase in spending (about 6 percent of GDP) on social sectors, the wage bill, and goods and services. The authorities aimed to reduce the deficit to 8 percent of GDP in 2002 by: (i) reducing capital spending by 2 percentage points of GDP, while ensuring that key social programs remain unaffected; (ii) limiting spending on goods and services to the 2001 level through tighter control over the procurement of supplies and services; (iii) limiting the growth in the wage bill; and (iv) curtailing some tax exemptions and

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[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.

strengthening revenue administration, including limiting the automatic rollover of tax breaks after the expiration of tax holidays.

A US$100 million (nearly 25 percent of GDP) 10-year international bond was issued in June 2002 yielding 9.5 percent, 475 basis points above U.S. Treasuries. The success of this issue reflects investor confidence in Grenada. The receipts of the bond issue have been used to retire more expensive debt, including lease-purchase arrangements, to clear arrears, and to finance high priority investment projects. This debt consolidation is to be supported by a debt management strategy that gives priority to concessional borrowing from multilateral and official bilateral sources, strictly controlling the granting of debt guarantees to public enterprises and the private sector, and entails continued adherence to the policy of prior approval by the Ministry of Finance for any borrowing by public enterprises.

In late September the country was hit by tropical storm Lili, causing extensive damage to infrastructure and export crops. The authorities have estimated the damage to be about EC$21 million equivalent to nearly 2 percent of GDP, in addition to a potential loss of EC$15 million of export earnings. To cope with the effects of the storm, the authorities have requested assistance from the Fund under its policy for emergency assistance in the case of natural disasters.

Grenada completed the initial self-assessment (Module 1) of its offshore financial sector, conducted with the assistance of the Fund and the Eastern Caribbean Central Bank (ECCB) in September 2001, and was removed by the Organization for Economic Cooperation and Development (OECD) from the list of noncooperative tax havens in February 2002. In June 2002, the Financial Action Task Force (FATF) noted that Grenada had enacted most of the legislation needed to remedy the deficiencies in its anti-money laundering laws, and asked it to submit plans to implement the new legislation.

Structural reform efforts focused on enhancing the efficiency of the public sector through: (i) further increasing the commercialization of public services; (ii) outsourcing work of the public agencies; and (iii) reducing the number of non-established workers. Work is also underway to amend the Public Service Act, which governs the functioning of the public service and public service unions. The unemployment rate remains high at around 12 percent, reflecting structural rigidities in the labor market. To enhance labor market flexibility, the authorities are participating in a regional web-based employment exchange project supported by the U.S. Department of Labor and the International Labor Organization (ILO). The government also plans to amend the dispute resolution law to prevent solidarity strikes by workers in essential services.

Executive Board Assessment

Directors agreed with the thrust of the staff appraisal. Grenada, like other countries in the Caribbean region, faces a difficult economic and financial situation, with a decline in growth, an increasing fiscal deficit, and a high level of public debt. The tropical storm that hit the island in September 2002, destroying important agricultural production assets and infrastructure, has retarded the economic recovery. The main challenge now is to reduce the fiscal deficit while protecting social expenditures, bring down the level of public debt, and reinvigorate growth on a sustainable basis.

Directors emphasized the need for strong fiscal adjustment in 2003 and over the medium term. A pervasive system of tax and duty concessions for certain industries is partly responsible for the fiscal deterioration. Recent actions to reduce some of these exemptions and subject the rest to a review as they come up for renewal were welcomed. At the same time, the granting of discretionary exemptions should be eliminated. These steps would reduce distortions in the economy, enhance transparency, and simplify tax collection. Directors stressed the need for a comprehensive reform of tax policy and tax administration—preferably on a regional basis—based on the outcome of the work underway by the Fiscal Affairs Department and the Caribbean Regional Technical Assistance Center (CARTAC). There is also a need to improve expenditure management, especially capital outlays and project selection, including by undertaking only economically justified projects with priority for those that can be financed from external concessional sources.

Directors urged the authorities to reverse over the medium term the recent sharp and unsustainable increase in the public debt. Debt management should be strengthened, and caution exercised in granting debt guarantees to public enterprises and the private sector. Directors welcomed the authorities' recent action to retire some of the more expensive debt, including for commercially-financed lease-purchase infrastructure projects, and their commitment not to resort to such financing in the future. They commended the authorities for the successful placement of an international bond that had provided funds to retire higher-priced loans, which they considered reflected the confidence of international investors in Grenada.

Directors noted the considerable efforts made to strengthen supervision of the offshore financial sector. They recommended that the proposals in the financial sector self-assessment report to set up a more rigorous supervisory framework, with the Eastern Caribbean Central Bank (ECCB) playing a greater role, be implemented quickly. At the same time, it would be important that the costs of effective supervision of the offshore sector did not overburden administrative capacity or the public finances.

Directors considered that Grenada's domestic banking system is fundamentally sound. To maintain its good financial health the authorities should ensure, in collaboration with the ECCB, that all banks meet all legal and prudential requirements. Directors commended the authorities for taking most of the legislative and administrative measures needed in the campaign to combat money laundering and the financing of terrorism; they urged them to move forward on the few remaining issues to meet the international standard on money laundering and countering of terrorism.

Directors welcomed Grenada's participation in the General Data Dissemination System (GDDS), and the improvement in debt statistics. They stressed the need for improvement in other areas, including national accounts and labor statistics.

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.

Grenada—Selected Economic Indicators

(Annual percentage changes, unless otherwise indicated)

	1998	1999	2000	2001	Prel. 2002
Real Sector					
Nominal GDP	8.2	10.9	7.7	-2.1	4.0
Real GDP	7.3	7.5	6.5	-3.3	-0.5
Consumer Price Index 1/	1.4	0.5	2.2	3.2	3.0
Unemployment rate	16.0	14.0	11.5	12.2	12.2
Central government finances 2/					
Revenue and grants	30.0	28.1	30.1	30.5	29.5
Expenditure	33.1	31.6	33.3	39.1	37.4
Current	23.9	21.4	21.0	24.0	24.4
Capital	12.2	11.7	10.4	11.9	11.0
Current Balance	1.3	4.8	6.1	2.3	2.2
Overall Balance (after growth)	-3.1	-3.5	-3.2	-8.6	-7.9
Money and Interest Rate					
Net domestic assets of the banking system 3/	11.4	7.8	15.0	3.8	7.8
Public sector	-1.2	-5.0	3.7	5.0	3.2
Private sector	14.4	11.1	12.9	0.8	1.8
Liabilities to the private sector	11.8	13.9	15.4	10.6	8.1
Average prime rate (percent per year)	9.8	10.0	10.0	10.0	10.0
External sector					
Current account balance 4/	-24.1	-12.2	-20.3	-17.6	-25.3
Public external debt 5/	27.2	26.2	25.3	40.4	62.4
Public external debt service ratio (in percent of exports of goods and nonfactor services)	5.5	8.5	5.9	7.2	26.0
Real effective exchange rate	-2.2	3.1	5.7	3.1	-2.1

Sources: Grenada Authorities; and IMF staff estimates.

1/ End of period.
2/ In percent of GDP.
3/ In percent of initial stock of liabilities to the private sector.
4/ In percent of GDP including current official grants.
5/ In percent of GDP. The sharp increase in 2001 partly reflects a broader average of debt by including debt guaranteed by the central government. The increase in the debt-service ratio in 2002 reflects pre-payment of expensive debt using the proceeds of the US$100 million bond.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves US$4 Million in Emergency Assistance for Grenada

The Executive Board of the International Monetary Fund (IMF) today approved SDR 2.93 million (about US$4 million) in emergency assistance for Grenada in support of the government's efforts to deal with the devastating effects of tropical storm Lili, which struck the island on September 24, 2002. The amount approved is available immediately.

Tropical storm Lili caused considerable damage to Grenada's infrastructure, agriculture, and property, estimated at nearly 2 percent of the country's GDP. The potential loss of earnings from the destruction of crops, in particular nutmeg, is estimated at about one-third of agricultural exports in 2002.

The government responded immediately after the storm and temporarily repaired roads and bridges to help restore normal economic activity. Measures are being taken to rehabilitate infrastructure on a more permanent basis. In the 2003 budget, approved by parliament in November, the government increased the allocation for infrastructure rehabilitation on an emergency basis and for strengthening its disaster management and emergency relief operations. The government has also taken steps to broaden the tax base and curtail expenditures to ensure fiscal and debt sustainability and higher growth.

The IMF provides emergency assistance to member countries hit by natural disasters so that they can meet immediate balance of payments financing needs, and maintain or restore macroeconomic stability. The emergency loan, which currently carries a charge of 2.51 percent, will be repaid in eight equal quarterly installments over 3¼ to 5 years from the disbursement date.

At the conclusion of the Executive Board's discussion on Grenada, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"The authorities are to be commended for their speedy response to the effects of tropical storm Lili, which caused extensive damage—equivalent to nearly 2 percent of GDP—to infrastructure and the nutmeg crop, Grenada's main agricultural export. Essential infrastructure was repaired, and emergency assistance provided to the affected population. In the budget for 2003, the government has allocated funds for infrastructure rehabilitation and for strengthening its disaster management and emergency relief operations. The Fund's financial assistance will supplement the efforts of the authorities, and other donors, in rebuilding the infrastructure on a more permanent basis and restoring economic activity."