International Monetary Fund

Grenada and the IMF

Press Release:
IMF Executive Board Completes First Review Under Extended Credit Facility Arrangement for Grenada, and Approves US$2.9 Million Disbursement
December 12, 2014

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Grenada: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

November 20, 2014

The following item is a Letter of Intent of the government of Grenada, which describes the policies that Grenada intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Grenada, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Letter of Intent

November 20, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
UNITED STATES OF AMERICA

Dear Madame Lagarde,

Grenada has made a strong start in implementing its home-grown economic programme, supported since June 2014 by an IMF arrangement under the Extended Credit Facility (ECF). The fiscal consolidation is on track and the fiscal targets for end-June were met with ample margins. We continue our engagement with all creditor groups toward reaching a cooperative and meaningful solution for the Country's large debt overhang. Our ambitious structural reform agenda—aimed at addressing bottlenecks to higher potential growth and strengthening our fiscal policy framework—is being implemented with technical and financial assistance from our international partners.

The strong start of the programme, with support from all social partners, is contributing to a renewed sense of confidence in the Grenadian economy. Economic recovery is taking hold, and we project moderate growth to continue this year. The economy continues to face significant challenges in terms of high unemployment, a large debt overhang, and weak competitiveness.

To address these challenges, the Government remains fully committed to the objectives and targets of its programme, as set out in the June 2014 Memorandum of Economic and Financial Policies (MEFP). The attached supplement to the MEFP discusses performance under the programme thus far and updates policies toward meeting the objectives of the home-grown economic programme. Our key focus going forward will be on: (i) pressing ahead with reforms to create a propitious operating environment for the private sector and reform the energy sector; (ii) continuing the ongoing fiscal consolidation and seeking to finalize agreement with all creditors on a comprehensive and collaborative restructuring of Grenada's public debt; (iii) bringing to completion the reforms to strengthen the fiscal policy framework, by introducing fiscal responsibility legislation, reforming the tax incentive regime, strengthening debt management and tax administration and modernizing the public service; and (iv) strengthening financial stability following the completion of the regional asset quality review.

On the basis of our performance under the programme so far and our commitment to the continued implementation of the programme, including its proposed revisions, the Government requests that the Executive Board of the IMF complete the first review of the arrangement under the ECF, approve the proposed new performance criteria for June 2015 and December 2015, as well as the new structural benchmarks for 2014-15, and approve the second disbursement under the arrangement of SDR 2 million.

We are confident that the policies described in the June 2014 MEFP and in the attached supplement are adequate to achieve the programme's objectives. However, if necessary, the Government stands ready to take any additional measures that may be required. The Government will consult with the Fund on the adoption of such measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The Government will also provide the Fund staff with all the relevant information required to complete programme reviews and monitor performance on a timely basis.

We consent to the publication of this letter, the attached supplementary MEFP and Technical Memorandum of Understanding, and the related staff report.

Yours truly,

/s/

Dr. The Rt. Hon. Keith C. Mitchell
PRIME MINISTER AND MINISTER OF FINANCE

Attachment I. Memorandum of Economic and Financial Policies for 2014-17

1. **Grenada is making important progress in overcoming one of its worst crises in recent history.** The Government embarked on a home-grown economic reform programme in 2013 to improve prospects for growth and job creation, restore fiscal sustainability, and entrench financial stability. Since June 2014, the programme has been supported by an arrangement under the IMF's Extended Credit Facility (ECF), as well as programmes with the World Bank and the Caribbean Development Bank. Programme implementation has been strong: the fiscal consolidation is proceeding as programmed and the ambitious structural reform agenda is broadly on schedule with all quantitative performance criteria met for the first review (Tables 1 and 2). These developments have improved confidence in Grenada's ability to overcome the crisis and restore growth. We are confident that continued strong implementation of our programme will lead to a more stable macroeconomic environment and set the stage for strong and sustainable growth of the Grenadian economy.

2. **We recognize that broad social consensus and a shared commitment to reform are critical to the success of Grenada's home-grown programme.** To engage all stakeholders in the implementation of the programme, Grenada's social partners have established a Monitoring Committee for the Homegrown Programme, with broad participation of the Grenadian society, including the government, private sector, labor unions, civil society, churches, and the Eastern Caribbean Central Bank. The Committee has the mandate to monitor the implementation of the programme, receive and review monthly reports from the Ministry of Finance on performance vis-à-vis programme conditionality, assist the government in achieving the agreed targets and benchmarks, as well as recommend corrective actions as necessary. The Committee has already met a number of times and has issued communiqués after each meeting on its findings and recommendations.

3. **We remain fully committed to the objectives of our reform programme outlined in the June 2014 Memorandum of Economic and Financial Policies (MEFP).** These reforms are further developed in this supplementary MEFP with a view to ensuring their full implementation, and center on: (i) improving the investment environment and boosting growth through structural reforms (¶6); (ii) restoring fiscal sustainability through fiscal consolidation and debt restructuring (¶7-12); (iii) instilling long-lasting fiscal discipline and strong public financial management through fiscal structural reforms (¶13-20); and (iv) strengthening the financial system (¶21-23). The quantitative targets that serve as performance criteria and indicative targets under the programme have been updated and extended through December 2015. These updated targets are presented in Table 1. The structural conditionality under the programme, incorporating several modifications as discussed below, is presented in Table 2.

Developments and Outlook

4. **Economic recovery is taking hold, led by strong growth in tourism**. The economy is estimated to have grown by 2.4 percent (market prices) in 2013, higher than the 1.5 percent previously estimated, due largely to buoyant construction activity. For 2014, we are also projecting moderately higher growth (1.2 percent) than anticipated at the time of the approval of the arrangement (1.1 percent), as the slowdown in construction activity with the winding down of the Sandals resort construction is expected to be more than offset by a rapid pickup in tourist arrivals associated with the operation of the resort. For the period 2015-2017, we project average growth of 1.5 percent, with a steady pickup over the medium-term to 2-2 ½ percent. While we are encouraged by the ongoing economic recovery, unemployment is high, private credit is declining as bank balance sheets are burdened by high non-performing loans, and the debt overhang remains to be addressed.

5. **Consumer prices continue to trend noticeably downward.** Prices declined by 1.2 percent on average during the first nine months of 2014 relative to a year earlier, with a significant drop in the cost of telecommunication services, declines in the prices of clothing and furniture, and muted food price inflation. We project prices to stabilize going forward as the transitory effect of the decline in telecommunication costs wanes. Inflation is expected at about -½ percent in 2014 and 1.3 percent in 2015 and to pick up gradually to about 2 percent over the medium-term with the economic recovery.

Growth-Boosting Structural Reforms

6. **Boosting economic growth and strengthening the social safety net remain the main focus of the Government's economic programme.**

- *Growth and Poverty Reduction Strategy* (GPRS). To guide our efforts towards a higher, sustainable and more equitable growth path, the Government has developed a new Growth and Poverty Reduction Strategy (GPRS) for the period 2014-18. The new GPRS is the outcome of extensive national consultations and reflects broad-based consensus on the policy framework for promoting job creation, poverty reduction and economic growth; it was approved by the Cabinet in August 2014 and will be published after final edits are made to reflect the Cabinet discussion. The strategy is closely intertwined with our home-grown economic programme that aims at addressing the immediate crisis, but has a more medium-term vision for the development of Grenada's growth and job creation potential.

- *Increasing efficiency of product markets*. The Government has initiated a number of reforms to increase the efficiency of product markets, many of them affecting the key agricultural sector. In particular, the Government has begun to commercialize its agricultural estates (about 500 acres of land in four main estates) by leasing underutilized government land to the private sector for strategic agricultural production. Thus far, two estates have been leased, with the remaining two likely to be commercialized over the course of 2014-15. These reforms are aimed at increasing production efficiency and export capacity in the sector, while ensuring some fiscal savings. With support from the IDB-sponsored Compete Caribbean project, the Government is also working to modernize the key nutmeg and cocoa sectors, with a view to enhancing their investment environment, competitiveness and productivity. Efforts will focus on reforming the 1947 legal and administrative framework governing the sectors, strengthening their governance and institutional capacity, and introducing export quality standards for the sectors.

- *Improving the investment environment.* The cornerstone of our efforts to improve the investment environment is a comprehensive revamping of the investment regime to bring it in line with international best practice. To this end, with technical assistance from the World Bank and IFC and financial assistance from DFID, we have prepared a new Investment Law that streamlines and simplifies the investment regime and provides investors with transparency. The draft law is expected to be approved by Grenada's Parliament in November 2014, in line with the structural benchmark. Following the enactment of the new Investment Law, we will continue our efforts to strengthen the investment environment by implementing a robust and sustainable institutional framework for attracting and retaining investment in Grenada through reforms to the Grenada Industrial Development Corporation or a successor agency. This framework will include the key pillars of investment promotion, facilitation (including the streamlined delivery of services to investors), generation and policy advocacy.
- *Energy sector reforms. Reforms in the* energy sector to support a more efficient pricing of electricity remain an integral component of our growth strategy. The reforms are currently focused on strengthening the regulatory framework for electricity through amendments to the Electricity Supply Act, now expected to be completed in the first half of 2015. As set out in the June 2014 MEFP, the reforms aim to establish an independent regulatory authority, revise the tariff-setting mechanism, enable the regulation of the sector by a regional authority once it is fully operational; and set out the roadmap for transitioning to renewable energy.
- *Social protection and poverty reduction.* We are committed to protecting the most vulnerable groups during the period of fiscal adjustment. The indicative floor on social spending through SEED for end-June 2014 was missed by a small margin (EC$300 thousand or US$111 thousand) as we worked with the World Bank to overcome capacity constraints and improve targeting of our social assistance programmes with a new information management system. As the new targeting system is not yet fully operational, the end-December floor is also likely to be missed. We continue to work with the World Bank to strengthen our social assistance programmes and are committed to bringing spending to programmed levels to ensure that the necessary social support is in place during the ongoing fiscal consolidation.

Fiscal Consolidation

7. ***Grenada faces a significant fiscal consolidation effort during 2014-17 to correct the fiscal imbalances.*** The Government started this effort in the context of the 2014 budget and

subsequently introduced a large package of fiscal consolidation measures, with staggered implementation dates, in early 2014. These measures are yielding encouraging results both on the revenue and spending side: the Government moved into a slight primary surplus position in the first half of 2014, despite large retroactive wage settlements, compared to the adjusted targeted deficit of EC$33 million. We thus expect that the 2014 fiscal targets will be fully met, which will allow us to draw on some of the over-performance to date for growth-supporting investments that would have otherwise not been undertaken.

8. **We have also taken action to lock in the yield of adjustment measures and improve control over spending:**

- *Attrition policy*. Since August 2014, we have been implementing a strict attrition policy across the Public Service in support of the programmed reduction in the wage bill. Under the policy, no more than three out of every ten employees departing the public service will be replaced. To ensure the optimal deployment of human resources, the policy is being implemented in a targeted manner, with hiring concentrated on positions critical to delivering on the Government's strategic priorities. In addition, we plan to abolish at least 90 percent of the remaining vacant positions (about 496 positions at end-September 2014) in 2015, and have introduced a policy of creating new positions only when offset by the abolition of another position. As part of our efforts to strengthen control over public payrolls, we undertook a survey of public sector employment in early 2014. The results provide a comprehensive picture of the structure of the Public Service and existing vacancies, and will inform our efforts to eliminate vacancies and redeploy the public service in support of the Attrition Policy.
- *Treasury Single Account*. The Government has made important strides in moving toward a Treasury Single Account (TSA) as an efficient and cost effective solution for management of scarce public resources. Since 2009, about 180 central government accounts have been closed or merged into the TSA. Of the 20 remaining accounts, most are related to projects financed by international financial institutions and will be closed as the projects wind down, likely by end-2015.
- *Capital spending controls.* We have taken a number of steps in 2014 to strengthen control over capital spending. Most importantly, the Government has integrated all of its remaining accounts into the payment system and is now issuing checks against a single account, allowing the timely monitoring and recording of all project spending. We have also established controls to ensure timely recording of the spending from the project loans, which were previously recorded with a delay.

9. **The permanent fiscal consolidation gains achieved so far will help the Government attain its primary surplus target of 1.3 percent of GDP in 2015**. We will take the following additional steps to ensure that the targets for 2015 are achieved:

- *Remaining measures*. The Government will enact the remaining measures agreed in the June 2014 MEFP needed for the programmed fiscal adjustment in 2015:

a. The Government has negotiated, and parliament approved in August 2014, a revised agreement with St. George's University for the 2015-2020 period, which envisages halving of the tax exemptions on motor vehicles and construction materials, an increase in the personal income tax rate for the non-national employees from 12½ to 15 percent, and the removal of the exemptions on its property tax liabilities.

b. The Government will introduce a new environmental levy on tyre imports by end-December 2014 with a two-tiered rate structure aimed at raising revenue (0.1 percent of GDP) while discouraging the import of used tyres.

c. The Government will also introduce a new tax on financial activities, to capture services provided by the financial institutions that are currently exempt from VAT. In addition, the government will introduce a small business tax before end-July 2015 to facilitate tax compliance by small businesses. In line with international practice, the tax will replace the VAT, income and other taxes that small businesses are subject to, and is expected to be broadly neutral on the tax burden faced by small businesses. Moreover, the Government will publish the recently revised property market values, last updated in 2001, by end-June 2015. These are expected to entail an average increase in property values by at least 20 percent, and will come into effect in 2016.

d. To support the targeted reduction in the wage bill, the government reached agreement with the trade unions on a nominal wage freeze and will continue negotiations with unions on employment conditions over the next three years. A binding wage bill ceiling will also be introduced under the proposed fiscal responsibility legislation, capping its growth from 2015 on to levels that can be sustained by the tax inflows.

- *2015 Budget*. The Government is committed to formulating a 2015 budget consistent with the programme targets, and its Parliamentary approval will be a **new structural benchmark** for end-December 2014.

- *Contingency measures*. To ensure that the fiscal consolidation remains on track in the face of an uncertain outlook, the Government has identified a number of contingent fiscal measures for 2015. These include: (i) a widening of the income tax base to capital gains, dividends and interest; (ii) a broadening of the VAT base by removing exemptions on fee-based banking services, property and casualty insurance policy premia, as well as margins of gaming operators; and (iii) a further increase of excise tax rates on alcohol and tobacco, which remain low by the international standards. If shortfalls materialize later in the year, the government will reduce next-quarter expenditure allocations relative to the programme.

10. **The recently launched citizenship-by-investment (CBI) programme has begun to receive applications and the Government is committed to the sustainable and transparent management of the programme, including of its receipts.**

- *CBI fees to the budget.* As committed in the June 2014 MEFP, the Government will use all CBI fees paid directly to the budget for general budget financing. The fees will be managed through a sub-account of the Treasury Single Account – the CBI Fund. The receipts will be prioritized to clear the existing stock of supplier arrears in order to restore liquidity to the private sector and reinvigorate growth. Any additional CBI revenues will be dedicated to general budget financing to help achieve a sustainable reduction in government debt and for contingency financing, including for natural disasters and potential risks from disruptions of the PetroCaribe arrangement.

- *Governance of the CBI programme*. As outlined in the June 2014 MEFP, we remain committed to take steps to ensure that: (i) applications are subject to adequate criminal background checks; and (ii) appropriate AML/CFT measures and oversight are targeted to the new citizens. Strong and transparent governance of the NTF is also critical to the success of the CBI programme. The recently approved public financial management legislation (see below) requires consolidated reporting of special funds (such as the NTF) as part of the public accounts and includes provisions for their external audit by the Director of Audit. To further strengthen governance of the NTF, the Government will approve, by end-February 2015, stand-alone regulations for the NTF to clarify its relationship with the budget, Government oversight, reporting requirements, and more generally the NTF's institutional, governance and investment framework (**new structural benchmark**).

- *Management of NTF resources*. The regulations above will also include policy guidelines on the use of NTF resources, to be approved by the Ministry of Finance and to require rigorous project evaluation and selection. To avoid an unsustainable scaling up of public investment, which could undermine the fiscal position and/or macroeconomic stability, the policy guidelines will require that spending on a project be undertaken only after sufficient funds are secured to finance the project (i) to completion and (ii) through its maintenance over the medium-term. Both the NTF and the budget will be required to report on the spending out of the NTF. To allow the full repayment of supplier arrears by the end-2015 deadline, the NTF will transfer through the budget to the CBI Fund the first EC$2 million of its monthly inflows for the settlement of arrears. The Government will monitor the magnitude of NTF funds and will take further measures as needed to ensure that NTF spending (both on and off budget) is consistent with a sustainable fiscal framework.

Debt Restructuring and Regularization of Arrears

11. **The Government has continued to engage with all creditor groups in its effort toward meaningfully restructuring its debt.**

- *Bilateral official debt*. The Paris Club provided financing assurances for Grenada and has agreed to discuss the treatment of its claims following progress with the restructuring of private debt. All non-Paris Club bilateral official creditors have been contacted to request comprehensive restructuring of their claims on Grenada. The Government is at an advanced stage in its negotiations with the Export Import Bank of Taiwan Province of China (Ex-Im Bank) on a restructuring agreement. Both parties informed New York court in mid-November that an agreement is in final drafting stages.

- *Private debt*. The Government continues to work toward the launch of a formal offer for the restructuring of the EC$2025 and US$2025 bonds. Negotiations with the creditor committee representing the majority of creditors for the 2025 bonds are intensifying, with both sides committed to reaching a solution that is both firmly sustainable and amicable. Negotiations have focused on an agreement being reached by year-end. Negotiations with remaining domestic private creditors are proceeding in parallel to the restructuring of the 2025 bonds.

12. **The Government remains committed to clearing its domestic and external arrears during the programme period**. As indicated in the June 2014 MEFP, a clearance framework for the existing stock of Government debt arrears will be agreed as part of the ongoing debt restructuring process and the Government will not incur additional debt arrears during the duration of the programme outside the restructuring process. With respect to supplier arrears, arrears to public entities will be settled with Government paper or assets, while arrears to private suppliers will be settled in cash in quarterly installments until December 2015. The Government remains committed to not incurring additional arrears on membership fees to regional and international organizations, and has revised the 2014 fiscal programme to reflect the higher payments associated with this commitment. The strategy for regularizing the stock of existing arrears on membership fees will be developed in the context of the technical assistance on public debt management from the IMF and the World Bank expected in early 2015.

Fiscal Structural Reforms

13. **We are in the process of reforming our fiscal policy framework to ensure fiscal discipline and lock-in the gains from fiscal consolidation**. Below we provide an update on the status of the reforms and develop further the agenda set out in the June 2014 MEFP, to focus on the implementation of reforms that are being legislated and to develop the agenda in areas where additional reform needs have been identified.

14. **We have overhauled and modernized our public financial management legislation, and will now focus on its implementation.** In August 2014, Parliament approved a new Public Finance Management (PFM) Bill to align it with best international practice (the Government has thus met the associated structural benchmark). The new legislation broadens the coverage of public accounts and the scope of the PFM requirements to the entire public sector; strengthens budget preparation and execution, especially with a view to moving away from the practice of spending outside the budget without prior parliamentary approval ; strengthens control over statutory bodies and state-owned enterprises; reforms the practice of granting tax incentives to limit the discretion of the executive in granting them and make the system more transparent; and introduce meaningful penalties for noncompliance with the provisions of the act. To ensure the prompt implementation of the new Act, the Regulations for the Act will be approved before end-June 2015 (**new structural benchmark**). The Government will seek technical assistance in drafting the Regulations from the IMF. In addition to the PFM Act, Parliament has approved in August 2014 a revised Procurement Act that is better aligned to best international practice. A revised Customs Act, to bring it in line with best international practice is expected to be considered by Parliament by end 2014.

15. **The Government is preparing draft Fiscal Responsibility Legislation (FRL) to transition to a rule-based fiscal framework and ensure durable fiscal discipline going forward**. As outlined in the June 2014 MEFP, the legislation will cap overall and personnel spending to ensure their sustainability, and will require forward-looking rather than retroactive wage negotiations, among other. Parliamentary approval of the FRL is expected before end-2014, and the approval of the associated regulations to ensure prompt implementation is expected before end-June 2015. The approval of the regulations will be a **new structural benchmark**, and the Government will seek assistance from the IMF on this reform initiative.

16. **The ongoing sovereign debt crisis has revealed the need to strengthen the management of public debt.** As a first step, the Government will strengthen the legislative framework for public debt management (PDM) by consolidating the currently fragmented framework into a modern and comprehensive PDM law, introducing requirements for setting clear objectives, developing a medium-term debt management strategy annual borrowing plans; evaluating and managing guarantees, and reporting on a timely basis. The PDM legislation will be drafted with assistance from the IMF and its parliamentary approval is expected before end-March 2015 (**new structural benchmark**), with the associated regulations expected to be approved by end-October 2015. To ensure that the new legislative framework leads to measurable improvements in debt management, the Government will, after the completion of the debt restructuring, receive technical assistance from the IMF and the World Bank to develop a medium-term debt management strategy and to strengthen debt management capacity.

17. **Addressing the financial challenges faced by state-owned enterprises (SOEs) and statutory bodies is critical to the success of the Government's fiscal adjustment effort.** With technical assistance from CARTAC, we undertook a strategic review of the financial position, viability and rationale of statutory bodies during May-August 2014. Based on the recommendations of the review, Cabinet approved in principle a strategy to strengthen the financial position of the sector by reforming their employment, wage-setting and pension practices; pursuing targeted reform of existing tariffs and other policies; and prioritizing individual institutions to be restructured, liquidated, or privatized (existing structural benchmark for end-October 2014). Cabinet has moved to implement, by end-2014, the near-term elements of the strategy, which include: (i) developing a centralized policy for employment conditions in SOEs and statutory bodies, (ii) publishing the list of SOEs and statutory bodies subject to the new PFM Act, and (iii) standardizing and improving budget disclosures for SOEs and statutory bodies. To implement the medium-term elements of the strategy, the Cabinet has set up a Committee to consider reform strategies for individual institutions, including their feasibility and cost; the Committee is expected to report to Cabinet on a final strategy by end-2014. Based on this strategy, the Government will further develop its reform agenda to take the reforms of the statutory bodies to their fruition.

18. **The Government will renew its efforts to improve tax administration, which we see as key to sustaining the fiscal gains and ensuring an equitable contribution to the consolidation effort**. We undertook a comprehensive diagnosis of the deficiencies in tax administration with

technical assistance from the IMF and CARTAC during September-October 2014. Based on the recommendations of this technical assistance, we will further develop our reform agenda going forward. Meanwhile, the Government intends to introduce a new Tax Administration Act, to be drafted with technical assistance from the IMF, to unify and ensure consistency between tax administration procedures, which are currently fragmented across multiple tax laws. Its parliamentary approval will be a **new structural benchmark** for end–November 2015. To properly align incentives for strengthened tax collection, Cabinet approved—as a prior action for approval of the arrangement—a decision to eliminate the bonus that tax collectors receive on interest from tax arrears. The enactment of this decision required additional administrative procedures to adjust the grade of the tax collectors. Cabinet has now approved an allowance equivalent to the approved grade adjustment until the latter can take effect and the new compensation regime will take effect from November 2014 (prior action for first review).

19. **We are reforming the tax incentive regime to make it more rule-based and transparent, reduce tax expenditures and maximize the growth impact of the incentives**. The recently approved PFM legislation already introduces major reforms to the tax incentive regime by requiring clear public records of all incentives and introducing formal periodic reviews of their rationale and costs to ensure that they remain aligned with Government's strategic priorities. Going forward, the Government will amend the affected tax legislation to, codify all incentives and eliminate executive discretion in granting them (existing structural benchmark for end-November 2014). With assistance from the IMF, the draft amendments to the relevant tax legislation have been prepared and are under consideration by Cabinet. However, with a heavy reform agenda leading up to end-2014—including the approval of the PFM legislation, preparation of the Fiscal Responsibility legislation, the Investment Promotion Act, ongoing customs and procurement legislation reforms, as well as preparations for the 2015 budget—the tax incentive reform is expected to be finalized in early 2015. With assistance from the World Bank and IFC, and in the context of the reform to the Investment Promotion Act, the government will also: (i) align the newly codified tax incentives with the Government's priorities as delineated in the Growth and Poverty Reduction Strategy; and (ii) assess the revenue impact of the codified incentives to ensure their consistency with the fiscal targets.

20. **Public sector modernization reforms are critical to improving the efficiency, quality, and cost effectiveness of the public sector**. To this end, the Government will undertake a strategic review of the public sector in early 2015 with financial assistance from the European Union and technical assistance from international partners. The results of the review will inform the development of our reform strategy, to be approved by the Cabinet before end-September 2015 (**new structural benchmark**). Based on the reform strategy, we will revise the existing legislation on government functions, civil services, and public compensation (including the 1969 Public Service Law) within the subsequent six months.

Financial Sector Reforms

21. **We continue to take a proactive approach to ensuring financial stability and have completed an assessment of the potential impact of the debt restructuring on the financial system**. In partnership with the ECCB, the regional supervisor of commercial banks, we assessed the potential impact of the debt restructuring on the banking system. The results suggest that, under the existing regulatory framework, the banking system would remain adequately capitalized following the debt restructuring. Finally, an initial assessment conducted by GARFIN suggests that the insurance and credit union sectors, with their limited exposure to government debt, would be able to absorb the potential impact of the debt restructuring. We are committed to proactively engaging with all financial institutions to ensure adequate capitalization following the debt restructuring.

22. **We remain actively engaged with our ECCU partners on the regional strategy to strengthen the banking sector.** The upcoming asset quality review (AQR) of commercial banks across the region, which is expected to be completed in 2015Q1, will provide important insight into the financial position of banks in the region. Following the completion of the AQR, we are committed to taking immediate action as needed to strengthen the financial position of commercial banks and will work with the ECCB to determine an appropriate strategy in this regard. To strengthen the legislative framework for banking regulation and supervision, we will expeditiously seek Parliament approval of the revised Banking Act and ECCB Agreement Act after their approval by the ECCB Monetary Council.

23. **We are continuing our efforts to strengthen regulation and supervision of the nonbank financial sector.** In the insurance sector, we continue to support the establishment of the Eastern Caribbean Financial Services Regulatory Commission as the regional regulator and supervisor. We are also committed to moving to consolidated supervision of the insurance sector and will work with our home country authority partners to effectively implement consolidated supervision. As in the insurance sector, we are committed to regional regulation/supervision of the credit union sector over the medium-term. To this end, we are participating in the Caribbean Association of Credit Union Supervisors, launched in August 2014, with our regional counterparts as a first step toward regional regulation and supervision of the sector. For the entire nonbank financial sector, we will adopt full risk-based supervision in line with established best international practice. We will seek technical assistance from CARTAC to assist with our efforts to implement consolidated supervision of the insurance sector and risk-based supervision of the entire non-bank financial sector.

Programme Monitoring

24. The programme will be subject to semiannual reviews and semiannual performance criteria, indicative targets and structural benchmarks, as well as continuous performance criteria, as set out in Tables 1-2 and in the attached Technical Memorandum of Understanding (TMU). We anticipate that the third and fourth reviews will take place on or after September 30, 2015 and March 31, 2016,

respectively, and will require observance of the continuous performance criteria and of the conditionality for end-June 2015 and end-December 2015, respectively. To facilitate programme monitoring, we are committed to providing detailed statistical information as specified in the TMU. Progress in the implementation of the policies under the programme will also be monitored on a quarterly basis through staff visits.

Table 1. Grenada: Quantitative Program Targets

	2013	2014				2015		2016
	Dec.	Jun.			Dec.	Jun.	Dec.	Dec.
	Act.	Prog.	Adj. Prog. 1/	Act.	Prog.	Proposed		Ind.
Performance criteria								
A. Cumulative floor on central government primary balance (EC$ mln) 2/	-90	-50	-33	1	-57	9	31	86
B. Cumulative ceiling on central government primary spending (EC$ mln) 2/	564	318	321	282	622	281	550	518
C. Ceiling on stock of central government budget expenditure arrears (EC$ mln)	86	109	109	80	86	43	0	0
D. Ceiling on accumulation of external debt arrears (continuous)		0	0	0	0	0	0	0
E. Ceiling on non-concessional external borrowing by the central government (continuous)		0	0	0	0	0	0	0
Indicative targets								
F. Cumulative ceiling on net increase in debt contracted or guaranteed by the central government (EC$ mln) 2/		90	90	73	149	39	66	25
G. Floor on social spending by central government (EC$ mln)		6.5	6.5	6.2	13.0	6.7	13.4	14.0
Monitoring								
H. Wage bill target 3/								
Original program target	227	115	115	111	230	113	227	220
Proposed new target	272	138	138	134	276	136	272	264
I. Public employment target 3/								
Original program target	6479	6358	6358	5940	6308	6258	6208	6108
Proposed new target	7755	7218	7218	7168	7584	7534	7484	7384

1/ Adjusted for the wage and pension back-pays below the program, the shortfall in SEED spending, the revenue overperformance, and the grant shortfall compared to the program as applicable according to the TMU.
2/ From end-December of the previous year. End-June 2014 actual number on net increase in debt contracted or guaranteed includes disbursements of EC$40.5 million from World Bank, EC$27 million from CDB, and EC$8.4 million from IMF.
3/ New targets are proposed for the broadened coverage of wage bill and public employment (TMU¶17&18).

Table 2: Grenada: Structural Program Conditionality

Measure	Timing	Implementation Status
Prior Action for the First Review		
Make effective the new compensation regime for tax collectors		Met
Structural Benchmarks		
Growth- Enhancing Reforms		
Parliamentary approval of the revised Investment Promotion Act	November 30, 2014	Expected to be met
Fiscal Adjustment Measures		
Parliamentary approval of 2015 budget consistent with program commitments	December 31, 2014	Proposed
Fiscal Structural Reforms		
Parliamentary approval of the revised PFM legislation	August 31, 2014	Met
Cabinet approval of a strategic plan for the statutory bodies	October 31, 2014	Partially Met
Parliamentary approval of the revised legislation on tax incentive regime	November 30, 2014	In progress
Parliamentary approval of the legislation for the fiscal policy framework	December 31, 2014	
Minister of Finance approval of regulations for the National Transformation Fund	February 28, 2015	Proposed
Parliamentary approval of a public debt management law	March 31, 2015	Proposed
Minister of Finance approval of regulations for the revised PFM legislation	June 30, 2015	Proposed
Minister of Finance approval of regulations for the fiscal responsibility legislation	June 30, 2015	Proposed
Cabinet approval of a strategic plan to modernize the public sector	September 30, 2015	Proposed
Parliamentary approval of a tax administration act	November 30, 2015	Proposed

Attachment II. Technical Memorandum of Understanding

1. Grenada's performance under the Extended Credit Facility (ECF arrangement), described in the Memorandum of Economic and Financial Policies from June 2014 and its November 2014 supplement, will be assessed on the basis of observance of quantitative performance criteria, indicative targets, as well as compliance with structural benchmarks. This Technical Memorandum of Understanding (TMU) defines the performance criteria and indicative targets under the ECF arrangement. It also describes the modalities for assessing performance under the programme and the information requirements for monitoring this performance.

2. **Definitions**. For the purpose of the programme, *central government* will cover all items included in the government budget. The definition of debt is set out in the Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangement Executive Board Decision No. 6230-(79/140), as subsequently amended. *External debt* is defined as central government contracted or guaranteed debt owed to creditors residing outside of Grenada, while *domestic debt* covers central government contracted or guaranteed debt owed to residents of Grenada. For ease of monitoring, all securities issued at the Regional Government Securities Market (RGSM) and debt owed to ECCB will be regarded as domestic debt.

I. PERFORMANCE CRITERIA

A. Cumulative Floor on the Central Government Primary Balance

3. The central government primary balance will be measured from above the line, as: (a) total revenue and grants of the central government, less (b) total non-interest expenditure of the central government:

- Total revenues and grants will record (i) project grants only to the extent that they have been spent; (ii) half of the budgetary grants (grants not earmarked for capital outlays) will be recorded when received and will be saved to settle supplier arrears (see below), with the remaining budgetary grants treated as project grants and recorded when spent on capital outlays; and (iii) transfers from the National Transformation Fund (NTF) for the settlement of arrears will be recorded as non-tax revenue and treated similarly to the CBI receipts.
- Expenditures will be recorded on an accrual basis, with: (a) budget execution data as reported by the Ministry of Finance (MOF); supplemented by (b) data on unprocessed claims to be collected and reported by the MOF.

4. The central government primary balance will also be monitored from below the line, as the negative sum of:

i. *Net domestic bank financing,* which will be measured by the change in the domestic banking system credit to the central government minus government deposits in the banking system, as reported in the monetary survey. Domestic banking system credit to the central government is defined as the sum of ECCB and commercial banks' financing to the central government.

ii. *Net nonbank financing,* which will be measured by the: (a) net changes in holdings of government securities by nonbanks; and (b) net borrowing from nonbank institutions. Items (a) and (b) will be reported by the MOF and GARFIN respectively.

iii. *Net government issuance of securities in the Regional Government Securities Market (RGSM)* excluding holdings by the domestic banking and nonbanking system as captured in point (i) and (ii) above.

iv. *Net external financing of the central government,* defined as the sum of: (a) net disbursements of project and non-project loans, including securitization; (b) net proceeds from issuance of external debt; and (c) reduction in cash deposits held outside the domestic financial system. The data will be reported by the MOF on a monthly basis.

v. *The change in the stock of arrears of the central government*, measured as the net change in (a) unpaid checks issued, (b) unprocessed claims, (c) pending invoices, (d) interest payments past due, and (e) other forms of expenditures recorded above the line but not paid, such as contributions to the National Insurance Scheme (NIS). The data will be reported by Ministry of Finance on a monthly basis.

vi. *Gross receipts from divestment,* defined as proceeds received from any privatization/divestment and sale of assets; and

vii. *Any exceptional financing* (including rescheduled principal and interest).

viii. *Less* domestic and external interest payments on a due basis.

ix. *Less* grants received but unutilized.

If the difference between the primary balance measured from above the line and from below the line is larger than EC$10 million in 2014, EC$6 million in 2015 and EC$3 million in 2016 the MOF will consult with IMF staff.

5. The floor on the central government primary balance will be adjusted as follows:

i. Downward (larger deficit)/upward (smaller deficit) by the amount of retroactive wage and pension payments for the 2009-2012 period in excess/shortfall relative to the programmed amounts, as detailed in the table below, with cumulative payment during the programme period not exceeding EC$26.5 million.

Grenada: Retroactive wage and pension payouts programmed, 2013-16	2013	2014 [1]		2015	2016
	Dec.	Jun.	Dec.	Dec.	Dec.
(EC$ millions)					
Programmed retroactive wage and pension payments	17.4	26.5	26.5	0	0

[1] Cummulative from end-2013

ii. Upward by the amount of fees received (non-tax revenues in the budget) from the recently legislated citizenship-by-investment (CBI) programme and by the amount of transfers from the NTF for the settlement of arrears.

iii. In the event that revenues (excluding the fees from the CBI programme and transfers from the NTF) exceed those projected under the programme, the primary balance target will be adjusted upward by one half of the excess during January-June, to allow for additional capital spending while safeguarding compliance with the annual fiscal targets. The following table shows the accumulated projected revenue and budgetary grants for 2014-16, as well as capital spending, to which the actual outcomes will be compared.

Grenada: Programmed revenues and budgetary grants, 2013-16	2013	2014 [1]		2015 [1]		2016
	Dec.	Jun.	Dec.	Jun.	Dec.	Dec.
(EC$ millions)						
Non grant revenue	443.4	231.1	459.9	253.6	504.4	547.4
Budgetary grants	0	0	0	0	0	0
Capital spending	160.5	97.0	215.6	79.5	176.5	151.0

[1] Cummulative from end of the previous year.

iv. Upward by half of the amount of budgetary grants received in excess of those projected under the programme.

v. Upward for any shortfall in the targeted cash transfers (SEED) from their indicative target.

6. The authorities will consult with IMF staff on corrective measures in the event of shortfalls in government revenue and financing. The Government will safeguard the over-performance in revenue achieved in the first half of any year by increasing the capital budget allocations for the last two quarters of the year only up to 2/3 of the over-performance.

B. Cumulative Ceiling on Central Government Primary Spending

7. The primary spending of the central government will be calculated as the sum of revenues and grants that have been utilized minus the primary balance of the central government as measured above in section A. The performance criterion on primary spending will be subject to the same adjustors as applied to the primary balance target as applicable. An additional adjustor would apply to the primary spending target to allow for the full use of available project grants and half of the amount of budgetary grants: the target will be adjusted upward by the full amount of additional capital grants, and by the amount of budgetary grants, received and spent on capital outlays in

excess of programmed levels (but only up to half of the total budgetary grants received) and will be adjusted downward by half of the shortfall in capital grants compared to the programmed levels to safeguard the fiscal targets (table above).

C. Ceiling on the Stock of Central Government Budget Expenditure Arrears

8. A ceiling is set on the stock of central government budget expenditure arrears equal to EC$86 million at end-December 2014, EC$43 million at end-June 2015, and EC$0 million at end-December 2015. Budget expenditure arrears are defined as the sum of: (i) any invoice that has been received by a spending agency from a supplier of goods, services, and capital goods delivered and verified, and for which payment has not been made within the contractually agreed period (taking into account any applicable contractual grace period),or in the absence of a grace period, within 60 days after the due date; (ii) wages, pensions, or transfers (including to the Solid Waste Company), for which payment has been pending for longer than 60 days to domestic or foreign residents; and (iii) interest and amortization payments on domestic debt for which payment has not been made within the contractually agreed period (taking into account any applicable contractual grace period). Arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition. The data will be reported by the Accountant General's office.

D. Non-Accumulation of External Debt Arrears (Continuous)

9. The central government will not incur new arrears in the payment of their external obligations (contracted or guaranteed) at any time during the arrangement. Arrears are defined as a payment of debt which has not been made within the contractually agreed period (taking into account any applicable contractual grace period). Overdue membership fees to regional and international organizations as well as arrears resulting from the nonpayment of debt service for which a clearance framework has been agreed or for which the government or the institution with government guaranteed debt is actively and in good faith pursuing a debt restructuring are excluded from this definition. The performance criterion will be applied on a continuous basis under the programme.

E. Ceiling on Non-Concessional External Borrowing by the Central Government (Continuous)

10. The ceiling on non-concessional borrowing will be applied to the contracting or guaranteeing by the central government of medium and long-term external debt (maturity greater than one year). Excluded from the ceiling is borrowing from regional financial institutions or markets (Caribbean Development Bank and the RGSM). The contracting and guaranteeing of non-concessional external debt will be monitored and reported to the Fund staff by the DMU, after

reconciliation with the Accountant General's office, on a monthly basis. The performance criterion will be applied on a continuous basis under the programme.

11. A debt is non-concessional if the grant element (in net present value relative to face value) is less than 35 percent. The discount rate used for this purpose is 5 percent.

II. INDICATIVE TARGETS

F. Cumulative Ceiling on Net Increase in Debt Contracted or Guaranteed by the Central Government

12. Net increase in debt contracted or guaranteed by the central government is defined as issuance minus repayments of debt contracted or guaranteed by the central government and approved by Parliament by each relevant date and minus the accumulation of central government deposits. For the purposes of the programme, such debt will be considered to have been contracted as of the date when both: (1) an agreement to provide such a lending facility or guarantee has been concluded and signed; and (2) the proposed borrowing or guarantee has been approved by Parliament, in the case of external debt. The ceiling excludes debt instruments to be issued as part of the process of debt restructuring.

13. In cases where the government facilitates the financing of Public-Private Partnership (PPP) projects by concessionaires, the debt of the central government will be increased by the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

14. The ceiling on the debt contracted or guaranteed by the central government will be adjusted as follows**:**

- Upward by the amount paid by the government to reimburse the policy holders of the failed regional insurance companies BAICO and CLICO, less the grant-financed share of these payments.
- Upward to a maximum amount of 5 percent of GDP to accommodate PPP related expenditures.

15. The data used to monitor debt contracting will be provided by the DMU, after reconciliation with the Accountant General's office, on a monthly basis.

G. Floor on the Social Spending by the Central Government

16. The social spending of the central government will only include the expenditures incurred by central government towards the SEED programme (support for education empowerment and development). This will be reported by the Ministry of finance on a quarterly basis.

H. Memorandum Item: Wage Bill Target

17. The wage bill of the central government will include the expenditures incurred by the central government towards the payment of wages, salaries and personnel allowances that are made under line items 310, 312, 314, 318, 319, 320, 322, 324, 326, 340, 420, 47001 and 47008 of the Chart of Accounts, and exclude one-off retroactive wage payments. This will be reported by the ministry of finance on a quarterly basis.

I. Memorandum Item: Public Employment

18. The public employment of the central government will include the established (permanent), unestablished (temporary) workers, and project workers. This will be reported by the Ministry of Finance on a quarterly basis.

III. PROGRAMME REPORTING REQUIREMENTS

19. Performance under the programme will be monitored from data supplied to the IMF by the Ministry of Finance and the Central Statistics Office as outlined in the table below. The authorities will transmit promptly to IMF staff any data revisions as well as other information necessary to monitor the arrangement with the IMF.

IV. OTHER

20. The prior action on eliminating the tax collector’s bonus will require:

- For both unestablished and established civil servants: (i) a Cabinet decision approving a duty allowance equivalent to the re-grading of the tax collectors; and (ii) confirmation from the PS of Finance that new compensation regime is in effect.

Table: Summary of Data to be Reported

Information	Frequency	Reporting Deadline	Responsible
Fiscal Sector			
Central Government budget and outturn	Monthly	30 days after the end of month	AG [1/]/Budget Office
Grants	Monthly	Same as above	AG
Budgetary grants	Monthly	Same as above	AG
Project grants	Monthly	Same as above	AG
Spending on SEED program	Monthly	Same as above	AG
Employment data for established and un-established workers	Quarterly	30 days after the end of quarter	AG
Financial statements of all statutory bodies	Annually	Within 12 months after year end	AG
Change in the stock of domestic arrears	Monthly	30 days after the end of month	AG
Unpaid claims	Monthly	Same as above	AG
Interest arrears	Monthly	Same as above	AG
Financial Sector			
Consolidated balance sheet for all credit unions	Monthly	30 days after the end of quarter	GARFIN [2/]
Consolidated balance sheet for all insurance companies	Quarterly	By the end of subsequent quarter	GARFIN
Real and External Sector			
Updates on annual National Accounts: by sector	Annually	Within 6 weeks after availability	CSO/MOF [3/]
Tier 1 high frequency indicators [4/]	Monthly	60 days after the end of month	CSO/MOF
Tier 2 high frequency indicators [5/]	Monthly	6 weeks after the end of quarter	CSO/MOF
Balance of Payments data	Annually	Within 3 months after year end	CSO/MOF
Details of exports breakdown	Quarterly	By the end of subsequent quarter	Customs Dept.
Details of imports breakdown	Quarterly	Same as above	Customs Dept.
Details of tourism data	Quarterly	Same as above	CSO
Customs revenue foregone	Monthly	30 days after the end of month	Customs Dept.
CPI	Monthly	Same as above	CSO
Debt			
External and domestic debt and guaranteed debt (by creditor) [6/]	Monthly	30 days after the end of month	DMU [7/]
Disbursements	Monthly	Same as above	DMU
Amortization	Monthly	Same as above	DMU
Interest payments	Monthly	Same as above	DMU
Stock of external debt	Monthly	Same as above	DMU
Stock of domestic debt	Monthly	Same as above	DMU
Arrears on interest and principal	Monthly	Same as above	DMU
Financial statement of Petrocaribe Grenada	Monthly	Same as above	DMU/AG
Gross receipts from divestment	Monthly	Same as above	Budget Office
Exceptional domestic financing	Monthly	Same as above	DMU
Proceeds from bonds issued abroad	Monthly	Same as above	DMU
Copies of any new loan agreements	As occurring		DMU

1/ Accountant General's Office.
2/ Grenada Authority for the Regulation of Financial Institutions.
3/ Central Statistics Office/Ministry of Finance.
4/ The following are defined as Tier 1 high frequency indicators: retail sales; imports of construction materials; agricultural production; manufactured production; production of water and electricity.
5/ The following are defined as Tier 2 high frequency indicators: building permits; registration of vehicles; cargo and aircraft statistics.
6/ For Central Government and Public Sector Enterprises.
7/ Debt Management Unit.