St. Vincent and the Grenadines: Staff Concluding Statement of the 2018 Article IV Mission

November 21, 2018

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

Background

1. **The economy of St. Vincent and the Grenadines has been recovering.** The closure of Buccament Bay Resort (the largest hotel on the main island) and heavy rains with flooding and landslides slowed down growth in the second half of 2016 and early 2017. Following the opening of the new airport, however, tourist arrivals have recovered, boosting tourism-related services (such as hotels, restaurants, and retail). Increased demand for reconstruction materials from Dominica (struck by Hurricane Maria in September 2017) also helped the recovery. As a result, quarterly data show that output growth (year-on-year) has turned positive since the third quarter of 2017. Over the past year, inflation has remained around 2-3 percent.

2. **Nonetheless, St. Vincent and the Grenadines continues to face challenges in sustaining the growth momentum over the longer-term.** Like other Caribbean economies, its high exposure to natural disasters, a narrow production and exports base, and limited physical and human capital constrain potential growth. The mission focused on policies to achieve stronger and sustainable growth, build fiscal buffers, bolster resilience to natural disasters, and ensure financial stability.

Outlook and Risks

3. **The growth outlook is positive.** Staff expects real GDP growth to rebound from 0.7 percent in 2017 to 2 percent in 2018, and further to 2.3 percent in 2019, driven by increases in tourist arrivals, tourism-related activities (including investment in hotels and

resorts), and related local production. Beyond 2020, growth would be sustained at around 2.3 percent, assuming steady tourism and investment growth.

4. This outlook is subject to both external and domestic risks. External risks include weaker-than-expected global growth, tighter global financial conditions, and higher oil prices. Domestic risks include more severe and frequent natural disasters and the loss of correspondent banking relationships. There is also upside potential stemming from stronger-than-expected tourist arrivals, investor interest, concessional financing for capital projects, and the successful completion of the geothermal power plant.

KEY POLICY MESSAGES

5. **Advancing structural reforms remains key to capitalize on growth opportunities created by the new airport.** Its economic benefit is already visible with the increased number of tourists. For its benefits to reach broader economic sectors beyond tourism, the authorities need to make further efforts to foster private sector activity, by improving the investment environment and strengthening physical and human capital. More specifically:

- To enhance transparency, reduce red tape, and attract investors, tax incentives should be streamlined, discretional tax concessions minimized, and an investment law established. *Invest SVG* (the government's investment promotion agency) should be revamped as a one-stop-shop.

- Efforts should continue to improve infrastructure, particularly irrigation, roads, and ports, that are resilient to natural disasters. Developing a long-term infrastructure plan, in collaboration with key stakeholders, would help prioritize projects consistent with the government's strategic development goals, solicit donors' support, and boost investors' interest.

- The government's focus on improving education is welcome, but more efforts are warranted to reduce labor skill mismatches and unemployment which remains very high. The effectiveness of the ongoing Technical and Vocational Education and Training program should be periodically reviewed.

6. **The mission welcomes the government's commitment to bringing the debt-to-GDP ratio down to 60 percent by 2030.** To this end, under the mission's baseline scenario, the primary surplus needs to be raised by ½ percentage points to around 1 percent of GDP. This could be done by containing wage bill growth at 3.5 percent a year and setting capital expenditure at 3.9 percent of GDP.

- The 2019 budget should demonstrate the government's commitment to fiscal consolidation, by maintaining the primary surplus at around 0.7 percent of GDP, slightly above the 0.6 percent of GDP (the mission's estimate) in 2018.

- The mission recommends incorporating expected fiscal costs of natural disasters, equivalent to 1.4 percent of GDP a year (the average of the past 15 years), in the budget framework. This could be partly covered by the contingency fund and insurance payouts (in total, 0.7 percent of GDP), with the balance covered through allocating expenditure reserves for emergency operations.

- Consideration should be given to expanding the coverage of disaster insurance, especially against floods to achieve additional buffers.

7. **Fiscal risks remain, however.** If growth momentum falters or natural disasters intensify, the 60 percent target would not likely be achievable by 2030. The government also plans to launch several large developmental projects in the tourism and transport sectors to enhance growth, but this could widen the deficit if they are not accompanied by new fiscal consolidation measures.

8. **It would thus be prudent to introduce some additional measures to increase buffers and create space for additional capital projects, by aiming to increase the primary surplus to 1.6 percent of GDP within the next two years.** Both revenue and expenditure measures should be explored, for instance by streamlining tax and customs duty concessions and moving ahead with pension system reform. In the capital budget, prioritizing projects, seeking grants or concessional loans, and containing procurement costs remain important.

9. **Structural fiscal reforms should continue, in order to enhance the effectiveness of fiscal policy and operations.**

- Moving towards a risk-based approach to collect customs revenues would facilitate timely customs clearance. The effectiveness of revenue collections can be bolstered by fully implementing the single Tax Identification Number and enacting the Tax Administration and Procedures Act. IT systems should also be upgraded.

- The planned submission of the Medium-term Fiscal Framework to parliament together with the 2019 budget is welcome. The effectiveness of the recently established Cash Management Committee should be further enhanced by preparing cash flow forecasts periodically, and the stock of arrears be reviewed and cleared. Going forward, the authorities should also consider introducing fiscal rules.

- The Ministry of Finance (MOF) is planning to issue a regulation requiring state owned enterprises to submit timely financial information, aimed at strengthening oversight over state-owned enterprises. The MOF should also put in place a framework to assess financial risks pertaining to Public-Private-Partnerships.

10. **The new Contingency Fund is important to protect public finances from natural disasters.** To ensure its effectiveness, a specific legal framework defining the governance and operational framework should be established. Alongside, efforts should continue to strengthen disaster preparedness, which includes updating the National

Emergency and Disaster Act, conducting a national risk assessment for disasters, and updating river basin flood risk maps. Enhancing public education and awareness would be useful to improve compliance with the regulations on land use planning and the building code. A strategy to relocate communities facing threats from coastal erosion should also be developed, while the National Emergency Management Office should be provided with resources for immediate emergency disaster response.

11. **The financial system remains broadly stable but has vulnerable spots in the non-bank sector.** Most credit unions report the capital ratio above 10 percent, but the implementation of IFRS 9 may raise their provisioning requirements and reduce their capital. Accordingly, the Financial Services Authority (FSA) should remain vigilant. It should also maintain the enhanced supervision of the Building and Loan Association. To strengthen the FSA's power to enforce prudential standards, the regulations of the FSA Act, the amendments to the Building Societies Act, and the Friendly Societies Act should be enacted promptly. The review of the adequacy of the FSA's budgetary resources is also encouraged.

12. **Efforts to safeguard financial system stability should continue.** Stress testing has been introduced as a supervisory tool for credit unions. It should be extended to (i) analyze multi-factor shock scenarios for credit unions, (ii) cover insurance firms, and (iii) incorporate interlinkages among various institutions in collaboration with the Eastern Caribbean Central Bank (ECCB). Supervision of insurance firms can be further strengthened by enhancing group-wide supervision. The mission encourages the FSA to more periodically communicate its financial stability assessment to the public. Furthermore, the authorities should consider preparing a crisis management plan for the non-bank financial sector, in consultation with the MOF and the ECCB, and setting up a Financial Crisis Management Committee, involving representatives from the FSA, MOF, and ECCB.

13. **Progress has been made in addressing remaining legal deficiencies in the AML/CFT framework.** Last year, the government amended several AML/CFT related laws, which helped close many of the deficiencies identified in the 2010 AML/CFT assessment. The authorities should now focus on ensuring the effectiveness of AML/CFT preventative measures. To this end, the National Risk Assessment should be completed by September 2019.

The IMF team would like to thank the authorities, private sector counterparts, and other stakeholders for their warm hospitality, and constructive dialogue.