International Monetary Fund

St. Kitts and Nevis
and the IMF

Press Release:
IMF Executive Board Completes Fifth and Sixth Reviews Under Stand-by Arrangement with St. Kitts and Nevis and Approves US$6.45 Million Disbursement
July 25, 2013

Country's Policy Intentions Documents

St. Kitts and Nevis: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

June 28, 2013

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

Basseterre, St. Kitts
June 28, 2013

Ms. Christine Lagarde
Managing Director
International Monetary Fund
Washington DC, 20431

Dear Ms. Lagarde:

For the past few years, economic activity has contracted in St. Kitts and Nevis, hampered by global economic headwinds. However, with an expected pick up in tourism activity and a number of major construction projects coming on stream, there are prospects for a moderate recovery in 2013. In this challenging context, prudent macroeconomic management has positioned us well to meet our 2013 targets under the program.

The Government of St. Kitts and Nevis reaffirms its commitment to the success of its home-grown medium-term reform program (supported by the Fund's Stand-By Arrangement (SBA)), which will benefit the people of St. Kitts and Nevis. Since the SBA was approved in July 2011, we have been determined to further our reform agenda and successfully implement our policies. This is reflected in having met our fiscal targets for end-September 2012 through end-March 2013 and all other quantitative performance criteria except for the continuous one on the accumulation of external arrears, which were minor and have since been repaid.[1] We also met our structural benchmarks for end-December 2012, albeit with a few months delay on completing the actuarial review of social security, due to a procedural setback. The structural benchmark for end-March 2013 on including in the Finance Administration Act provisions recognizing the Government Entities Oversight Board and strengthening its enforcement authority will be met with some delay following parliamentary approval of these amendments. There has been further progress on the restructuring of our public debt. Our bilateral negotiations with our Paris Club creditors are now complete and we have reached agreements with all but one of our domestic creditors. In terms of the St. Kitts debt land swap, the Board of the SPV is now in place and has approved its underlying principles according to best international practices. The recruitment process for its management team is under way. We welcome your continued strong support for these initiatives.

In the attached Memorandum of Economic and Financial Policies (MEFP) and the Technical Memorandum of Understanding (TMU), we present our plans through 2013 to achieve the

[1] We accumulated arrears to the Caribbean Development Bank in the amount of EC$0.88 million (0.04 percent of GDP) in October 2012, EC$0.75 million (0.04 percent of GDP) in January 2013, and EC$0.86 million of GDP (0.04 percent of GDP) in April 2013; these arrears were cleared as of May 15 2013.

objectives of our program supported by the IMF. Based on the strength of these policies, and given our performance under the program and our continued commitment, we request the completion of the combined fifth and sixth program reviews, waiver of applicability for the end-June 2013 performance criteria[2], waiver of non-observance for the continuous performance criterion on external arrears for this review and the release of the sixth tranche of SDR 4.266 million. Due to the delay in adopting the budget for 2013, we request that the availability of the May 2013 purchase be delayed to September 2013 for the seventh review and corresponding adjustments made for the availability date of subsequent purchases related to the remaining reviews under the SBA. In this regard, we also request combining the last two purchases and eliminating the last review, in order to remain within the initially envisaged duration of the SBA.

We are confident that our policy commitments will support the achievement of our program objectives. However, we need to remain vigilant to downside risks of lower-than expected growth in the global economy and are prepared to address them through policy actions. We stand ready to take additional corrective actions that would be needed to address these risks if they materialize. We will continue to consult with the Fund on the adoption of such actions in advance of necessary revision of policies contained in this letter and the attached Memorandum, in accordance with the IMF's policies.

The Government authorizes the IMF to make public the contents of this letter, the attached MEFP and TMU, and the Staff Report to clearly communicate our policies and to signal the seriousness of our commitment to the program to the people of St. Kitts and Nevis and to the international community.

Sincerely,

/s/

Denzil Douglas (Rt. Hon. Dr.)
Prime Minister and Minister of Finance

[2] While end-June 2013 performance criteria (PC) govern the fifth and sixth review, due to unavailability of data to assess them and the absence of clear evidence that the end-June PCs will not be met, the fifth and sixth review is based on the end-March 2013 PCs.

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

1. St. Kitts and Nevis has continued to be successful in implementing its home grown economic program supported by the IMF Stand-By Arrangement (SBA). In support of the key goal of boosting growth and employment, the focus continues to be on putting public finances on a sustainable trajectory, finalizing a comprehensive debt restructuring to address the debt overhang, and further strengthening the financial system. This Memorandum of Economic and Financial Policies (MEFP) updates these policies in the context of the fifth and the sixth reviews under the SBA.

I. RECENT ECONOMIC DEVELOPMENTS

- **Growth and inflation.** After contracting for four years through 2012, the economy is showing some signs of recovery. The contraction in real GDP is estimated at 1.3 percent in 2012, due to a weak performance of construction and banking services, combined with a decline in tourism, partly caused by the disruption stemming from Hurricane Sandy in the northeastern United States—a key market—in the last quarter of 2012. Available indicators point to a recovery in economic activity in 2013Q1, with growth of stay-over arrivals estimated at 2.3 percent (y/y). Imports of building materials, cement and equipment have picked up; suggesting that activity in the construction sector may have bottomed out. Inflation continued to decline, from 2.8 percent (y/y) at end-December 2011 to 0.3 percent (y/y) at end-December 2012 and 0 percent at end-March 2013.

- **External sector.** The current account deficit is projected to have declined from 15.6 percent of GDP in 2011 to about 13 percent of GDP in 2012, below a projected 15 percent of GDP, on account of weaker imports than previously envisaged and strong receipts from the Citizenship by Investment program (CBI). Overall, imputed international reserves increased by EC$54 million in 2012 and EC$100 million in the first two months of 2013, as the pick-up in imports was overcompensated by a recovery in tourism and continued momentum of CBI-financed FDI receipts.

- **Financial sector.** Despite abundant liquidity, bank credit was subdued, due to the sluggish economy and rising NPLs. Credit to the private sector remained flat through end-December 2012, growing by only 0.2 percent (y/y), but contracted in 2013Q1 (by 1.6 percent (y/y) at end-March). Deposits continued to increase steadily, growing by 13.4 percent (y/y) at end-March 2013, spurred by the strong CBI inflows. The quality of the credit portfolio and profitability deteriorated somewhat in 2012Q4 and 2013Q1. Updated stress tests as of December 2012 continue to confirm earlier results with respect to the resilience of the banking sector to a range of shocks, including the full impact of the debt restructuring, but with vulnerability to a liquidity shock for one bank. There has been no request to access the Banking Sector Reserve Fund (BSRF) set up under the SBA to date.

- **Debt restructuring.** We continue to make inroads on the comprehensive debt restructuring by:

  - **Effecting a debt/land swap.** Following the transfer of 1,200 acres of land to the St. Kitts-Nevis-Anguilla National Bank Limited in October 2012, it proved necessary to develop a supplement to the shareholders' agreement (signed on June 19 2013) in order to allow incremental debt/land swaps, as needed, to extinguish the debt. We have included a description of the lands available for sale in this supplementary agreement. On this basis, the transfer of 1,200 acres of land corresponds to a debt write-off of EC$565 million as of July 1 2013. The board of the Special Purpose Vehicle (SPV) has now been appointed and developed a clear schedule for achieving full operation of the Company. The early meetings of the Board will discuss and approve operational guidelines and reporting requirements which are aligned with international best practices. A search for the SPV's new managing director is under way, as is the tender for three real estate brokers. The Nevis SPV has been established and the reassessment of the land to be exchanged has been completed.

  - **Progressing in our discussions on the debt exchange with other domestic creditors.** Agreements to reschedule the debt of the central government through lower interest rates and extended maturity with its remaining domestic creditors are near completion. Negotiations were recently concluded between the Nevis Island Administration (NIA) and all but one of its domestic creditors.

  - **Finalizing a bilateral agreement with our remaining Paris Club creditor**. Our negotiations with the remaining Paris Club creditor, the United States, were concluded in January 2013.

  - **Engaging our other bilateral creditors.** Negotiations with Venezuela have undergone several iterations, while discussions with Taiwan POC and Kuwait continue.

  These operations, combined with our fiscal efforts, will reduce total public debt, including arrears, from 153.7 percent of GDP at end-2011 to 105.1 percent of GDP at end-2013, in line with our objective to reach the ECCU target of 60 percent of GDP by end-2020.

II. Performance Under the Program

2. We have fulfilled our commitments under the program at end-March 2013 as detailed below. In this context, we request completion of the fifth and sixth program reviews, and request a waiver of non observance of the performance criterion on the accumulation of external arrears by the central government in October 2012, January 2013 and April 2013, which have since been repaid.

- **Fiscal performance.** We have continued to meet all of our fiscal targets for end-September 2012 through end-March 2013, despite the persisting economic contraction. In 2012, strong receipts from the CBI and grants were key factors, compensating for tax revenue shortfalls and some overruns in current and capital outlays. At end-March 2013, the overall fiscal balance reached a surplus of EC$69 million, above the adjusted program floor of EC$11 million. Similarly, the primary surplus of EC$85 million was well above the adjusted indicative program target of EC$35 million. In addition to continued strong receipts from the CBI,[1] tax collections performed near program expectations, and spending was contained to within the constitutionally allowed limits (based on the 2012 budget, in the absence of an approved budget for 2013).

- **Other performance criteria.** The ceilings on central government budget expenditure arrears accumulation and the stock of external short-term debt have all been met (Table 2). We missed the PC on the accumulation of external arrears—we accumulated minor arrears to the Caribbean Development Bank (CDB) in the amount of EC$0.88 million (0.05 percent of GDP) in October 2012, EC$0.75 million (0.04 percent of GDP) in January 2013, and EC$0.86 million (0.04 percent of GDP) in April 2013; these arrears were cleared as of May 15, 2013.

- **Structural benchmarks.** We have met two of the three structural benchmarks for end-December 2012. The existing stress tests of banks were updated and we developed an explicit medium-term debt management strategy that takes account of the cost-risk tradeoff of alternative financing options within the context of the overall macroeconomic environment. This was issued in conjunction with the 2013 budget. However, the regular actuarial review of the Social Security Scheme was finalized only in May 2013. We have submitted to the Attorney General's office proposed amendments to the Finance Administration Act recognizing the Government Entities Oversight Board and strengthening its enforcement authority; the relevant structural benchmark (targeted for end-March 2013) will be met once submitted to and approved by Parliament.

- **Projected fiscal performance through end-June 2013.** While we do not yet have fiscal outturn data for end-June 2013, we are confident that the fiscal over performance for end-March 2013 will carry through the second quarter of 2013.

III. POLICIES DURING 2013

3. **We are optimistic that 2013 will be a year of economic recovery.** Construction activity should further improve, on account of the strength of the CBI program and related FDI projects already in the pipeline. Further support will come from the Sugar Industry Diversification Foundation (SIDF) projects (such as the People for Employment Program (PEP), the Small

[1] Relative to program expectations, the over performance in the receipts from the CBI was EC$91 million in 2012 and EC$48.5 million in 2013Q1.

Entrepreneur Enterprise Development program (SEED), the Fund for the Realization of Economic Empowerment through Subsidized Housing (FREESH) and the Equity Assistance Fund (EAF)),[2] aimed at enhancing growth and employment. As a result, real GDP growth is projected to reach 2 percent for 2013 and 3-3½ percent over the medium term as tourism and construction continue to recover. Nevertheless, downside risks continue to weigh on this outlook.

4. **We remain firmly committed to the program.** The Parliament of St. Kitts and Nevis approved the 2013 budget on April 9 2013, in line with program parameters. Following the change in the Nevis Island Administration (NIA) government in late January 2013, its budget was approved on April 26 2013. On the basis of these fiscal frameworks, we are confident that the program's fiscal targets will continue to be met.

A. Fiscal Policy

5. **The 2013 budget envisages raising tax revenue and placing more emphasis on growth-enhancing capital outlays.** We will enhance our tax revenue collections through sustained improvements in the revenue administration and the full year impact of the amendments to the Income Tax Act in May 2012 (Country Report No. 12/284, MEFP ¶8). The major tax policy initiative is the reduction in the corporate income tax rate from 35 percent, the highest of the Organization of Eastern Caribbean States (OECS), to 33 percent, which will only apply starting with income in 2013 to be collected towards the end of 2013. Non tax revenue is expected to decline somewhat as a share of GDP, relative to 2012, based on conservative projections for revenue from the CBI. Current outlays would decline on account of the continued freeze of the nominal wage bill and interest savings following the debt restructuring. The budget envisages a reallocation of some of these savings to public investment. In support of the 2013 wage bill objectives, the NIA is committed to hiring civil servants only through attrition. We will aim for an overall fiscal surplus of 2.5 percent of GDP in 2013, corresponding to a primary surplus of 7.4 percent of GDP and consistent with moving towards debt sustainability.

6. **We are committed to further strengthening the pro-growth orientation of our program by adhering to our public investment target for 2013.** As such, we agree to adjust upwards the program floor on the overall balance of the central government, not financed by grants and loans, by the amount of under-execution of revenue financed public investment.

[2] Programs supported by the Sugar Industry Diversification Foundation (SIDF) include: the PEP, which provides on-the-job training by subsidizing wages; the SEED, which provides interest-free loans ranging from EC$5,000 to EC$100,000, to finance start-up businesses; the FREESH, which subsidizes interest rates on residential mortgages of up to EC$500,000 for new residential housing acquired by borrowers in the lower to middle income brackets; and the EAF, which provides equity assistance for FREESH-qualifying mortgages.

Revenue Enhancing Reforms

7. We firmly commit to sustained increases in tax revenue in 2013 and over the medium term through fundamental and continued reforms in our revenue administration.

- **We will implement a new organizational structure that will provide strong direction and guidance to reforms and operations and continue to reinforce procedures.**

  - ***Program design, planning and monitoring.*** Building on the organization structure which we have already developed for the Inland Revenue Department (IRD), we are establishing in the IRD a unit dedicated to program design, planning and monitoring and plan to operationalize it by end-September 2013 (structural benchmark for end-September 2013).[3] This unit will be headed by a deputy comptroller. Monitoring of the implementation of the five strategic initiatives[4] adopted for the IRD in 2013 will be transferred to the new unit once it becomes operational.

  - ***Procedures.*** We continue to build on the significant reforms accomplished in the IRD to improve operations. We will enforce business processes at the IRD's recently established Tax Roll and Intelligence Unit by reviewing job descriptions and setting up a data entry testing system. We will harmonize the Tax Administration Procedures Act with the VAT Act to extend best practices in enforcement to taxes other than the VAT by the second half of 2013. We hope to receive technical assistance in this area.

- **We are implementing measures to improve taxpayer compliance, a key strategic priority for 2013 and over the medium-term.** To that effect, we undertook a comparative analysis of registration data for the VAT and income tax and have drafted an internal report evaluating and summarizing the findings. On that basis, we are reprioritizing the audit program accordingly. We have also redirected our audit operations to focus on large taxpayers. We plan to establish a Large Taxpayer Unit (LTU) by December 2013, which will be integrated in our new organizational structure, including with a description of business processes and core job descriptions. In order to strengthen enforcement at the Customs and Excises Department (CED), we will submit to Parliament the new Customs law by end-December 2013 (structural benchmark). We have started post-clearance audits on June 1. We will implement risk-management practices at the CED, including risk profiling in cargo clearance procedures, which will be facilitated by the implementation of the ASYCUDA World system, expected to be

[3] A similar structure was implemented in the Customs and Excise Department (CED).

[4] Our strategic initiatives are to: facilitate tax compliance by improving services; enhance the legal framework; modernize the administration of the IRD and the CED; address effective non-compliance; and improve relations with stakeholders.

finalized by end-March 2014. With the objective of improved control over potential abuses of tax incentives and VAT refunds, we have intensified enforcement of the provisions in the tax legislation that require beneficiaries of tax incentives to file income tax returns. We are also starting the process of amending our Income Tax Act accordingly. We will also tighten export controls at Customs through implementation of the new regime for export verification by end-September 2013. In addition, we will intensify the collection of tax arrears.

8. Boosting tax revenue also hinges critically on further broadening the tax base. While we extended the temporary VAT and customs duties exemptions on construction materials through end-2013, we remain committed to a thorough review of the system of customs duties and tax exemptions (EBS 12/147 MEFP¶7) and have received technical assistance to that effect. We intend to overhaul the system of tax incentives included in the Small Business Development Act, the Fiscal Incentives Act, the Hotels Aid Act, the Special Incentive Package for Small Hotels and the Special Resorts Development Act and not to grant ad hoc incentives and progressively reduce the level of discretionary exemptions.

Expenditure Reforms

9. We aim to improve the efficiency of public expenditure by:

- **Overhauling our procurement procedures.** With TA support, we will draft a Procurement Action Plan and finalize the implementing regulations for the Procurement and Contract Act by end-December 2013 (structural benchmark for end-December 2013). These regulations will broaden the composition of the Administration Review Board to include representatives of the private sector and independent bodies. Standard Bidding Documents will also be developed subsequently. We will summarize in a widely disseminated document the scope of the new Act, its regulations and the underlying strategic vision and objectives by end-March 2014.

- **Reforming the civil service.** We are introducing a top down notion of accountability in the management of government employees. To that effect, we will operationalize the implementing regulations (pertaining to recruiting, discipline, promotion, and standing orders) of the 2011 Civil Service Act, by amending the general orders accordingly, (structural benchmark for end-July 2013). As a first step to rationalizing the wage bill and informing the design of policies, we have launched the procurement process to conduct an audit of the public payroll, with the support of the World Bank, and plan to complete a report with our findings and recommendations by end-March 2014.

- **Limiting contingent liabilities arising from public enterprises.** Along with strengthening the authority of the Government Entities Oversight Board (EBS 12/147 MEFP¶8), we are committed to adopting policies and actions that will strengthen the financial position of public enterprises. We intend to articulate our energy policy by end-December 2013; this will help guide the electricity company SKELEC's investment plans. We will reach an agreement with SKELEC on modalities for collecting overdue electricity bills accumulated prior to its corporatization in August 2011. In addition, the NIA and NEVLEC are working on a plan to settle the overdue electricity payments. Finally, as we elaborate a plan for the resolution of the debt of the Nevis Housing and Land Development Corporation (NHLDC), we will make sure that no new loans are contracted.

- **Containing budgetary transfers.**

    - ***Health insurance scheme.*** We have announced in the 2013 budget our intention to pursue universal health care. This initiative will be comprehensively costed, based on bids that we have requested from private health providers. In addition to some consolidation of existing programs, careful consideration will be given to the level of eventual participants' benefits and contributions. This will be more fully articulated at the time of the preparation of the 2014 budget.

Price controls for staples and social safety net.

- **We are moving forward with plans for introducing a full pass-through pricing system for the LPG market** (in line with commitments to the Monetary Council of the ECCB). Plans involve the replacement of the existing universal subsidy with a targeted demand side subsidy that will be incorporated into a restructured National Social Protection system, currently under development. Based on the findings of a recently completed study, Cabinet approved a strategy for enhancing the competitiveness of the market for petroleum products. Implementation of this strategy will involve the renegotiation of the LPG pricing formula, the strengthening of the price control oversight system and complementary changes in the regulatory framework.

- **We are also moving forward with planning work for the National Social Protection system.** In that regard, we will need a bit more time to finalize our method for the proxy-means testing for the eligibility criteria of the planned consolidated cash transfer program (structural benchmark now set for end-December 2013). The government-operated Supply Office in St. Kitts was closed on January 15 2013, and responsibilities for managing the supply of related staples have been transferred to the private sector.

- ***Pensions of civil servants.*** We have adopted the new Pension Act at end-2012, which redefines the government-provided pension for new entrants in the civil service. This will involve a shift from a defined benefit to a defined contribution regime, and will generate significant budgetary savings over the longer term. We intend to complete implementing regulations to the Pension Act by end-September 2013.

10. Progress has been made in improving fiscal transparency. Following the upgrade of the Ministry of Finance's website, we will commence quarterly publication of reports on fiscal operations by end-July 2013 and will do so for gross financing needs starting in September 2013. The audited financial statements of the Sugar Industry Diversification Foundation (SIDF) for 2011 have been finalized and will be published by September 2013.

B. Debt Restructuring

11. With the debt/land swap now completed, we will swiftly proceed to land sales. In addition to finalizing the search for the SPV's managing director, the Company intends to complete the staffing of the SPV as well as the selection of three real estate brokers. The guiding principles of the Company will emphasize seeking competitive market value for the SPVs' assets and engaging in sales in a timely fashion.

C. Financial Sector

12. We are committed to continue to safeguard the stability of the financial sector, in conjunction with the ECCB. The ECCB's quarterly stress tests have allowed us to closely monitor the banking sector. We also support the initiatives by indigenous banks to seek out diversified sources of revenue and to intensify recovery of NPLs. The BSRF will remain in place to address any liquidity pressures. Finally, consistent with the IMF's safeguards policy requirement and current practice, we will continue to maintain all foreign exchange balances at the ECCB.

D. Labour Market

13. We are reforming legislation to improve working conditions and labor market flexibility, and taking steps to better match workers' skills with employers' needs. Revisions to the Labour Code, in collaboration with the ILO, will be completed by December 2013. They are centered on reforming the severance fund, to improve its sustainability, and rules for the termination of employment. They also aim to improve employment conditions, enhance flexibility on working hours and establish an independent tribunal on labor disputes. To upgrade the skills of job seekers and improve their employment prospects, we have developed partnerships to implement a host of training initiatives.[5]

[5] These include: the National Technical and Vocational Education and Training (TVET) Implementation Plan, the Skills Training and Entrepreneurial Program (STEP), the People Employment Program (PEP), the National Entrepreneurship Development Division (NEDD), the Youth Business Trust and Capisterre Farm.

E. Program

Table 1. St. Kitts and Nevis: Schedule of Reviews and Purchases

	Amount of Purchase		
Availability date 1/	Millions of SDR	Percent of Quota	Conditions
July 27, 2011	22.150	248.9	Approval of arrangement
January 25, 2012	11.470	128.9	First review and end-September 2011 performance criteria
May 21, 2012	3.161	35.5	Second review and end-December 2011 performance criteria
August 3, 2012	3.161	35.5	Third review and end-March 2012 performance criteria
November 30, 2012	3.161	35.5	Fourth review and end-June 2012 performance criteria
February 15, 2013	4.266	47.9	Fifth and sixth review and end-March 2013 performance criteria 2/
September 15, 2013	1.105	12.4	Seventh review and end-June 2013 performance criteria
December 15, 2013	1.105	12.4	Eight review and end-September 2013 performance criteria
March 15, 2014	1.105	12.4	Ninth review and end-December 2013 performance criteria
June 15, 2014	1.826	20.5	Tenth review and end-March 2014 performance criteria
Total	**52.510**	**590.0**	

Source: Fund staff estimates

1/ For completed reviews the dates refer to Board dates and for future review the dates refer to availability dates.
2/ The end-June PC govern the combined fifth and sixth reviews but are being waived due to data unavailability.

Table 2. St. Kitts and Nevis: Quantitative Performance Criteria and Indicative Targets
(in EC$ million)

	End-Sep. 2012				End-Dec 2012				End-Mar. 2013				Performance Criteria	Proposed Performance Criteria	
	Prog.	Adjusted	Actual	Status	Prog.	Adjusted	Actual	Status	Prog.	Adjusted	Actual	Status	End-Jun. 2013	End-Sep. 2013	End-Dec. 2013
Performance Criteria:															
Central government overall balance including grants (floor) :	-91	-93	84	√	24	51	164	√	8	11	69	√	28	48	52
Stock of central government budget expenditure arrears accumulation (ceiling) 3/	0	0	-50	√	0	0	-48	√	0	0	-52	√	0	0	0
Stock of external short term debt (ceiling)	0	0	0	√	0	0	0	√	0	0	0	√	0	0	0
Central government or guaranteed external arrears accumulation (ceiling) 4/	0	0	0.7	X	0	0	0.9	X	0	0	0.8	X	0	0	0
Indicative Target:															
Central government primary balance (floor) 1/ 2/	8	7	176	√	181	207	283	√	32	35	85	√	61	121	152

1/ Cumulative within each calendar year.
2/ See the TMU for a description of adjustors.
3/ Including the estimated stock of expenditure payable on electricity.
4/ To be monitored on a continuous basis.

Table 3. St. Kitts and Nevis: Structural Benchmarks

Action	Target Date	Objectives	Status
I. Fiscal and Public Sector Reforms			
Revenue Administration			
new proposed measures:			
Establish and operationalize a unit dedicated to program design, planning and monitoring in the Inland Revenue.	End-September 2013	Strengthen revenue administration	proposed
Submit to parliament the new Customs Law	End-December 2013	Strengthen revenue administration	proposed
Public financial management			
Submit to Cabinet proposal to rationalize the subsidy on liquefied petroleum gas (LPG)	End-March 2012	Strengthen public financial management	completed
Update the registry of additional 600 acres of land	End-June 2012	Strengthen public financial management	completed
Undertake valuation of additional 600 acres of land	End-June 2012	Strengthen public financial management	completed
Submit draft of new Procurement Act to Parliament	End-June 2012	Strengthen institutional framework	completed
Draft proposal for the establishment of an asset management company	End-June 2012	Strengthen public financial management	completed
Establish a medium-term expenditure framework with agreed fiscal targets	End-June 2012	Improve medium-term orientation of the budget	completed
new proposed measures:			
Finalize the implementing regulations to the Procurement and Contract Act	End-December 2013	Strengthen public financial management	proposed
Civil service reform			
Cabinet to approve a plan for civil service reform covering human resource policy, reviewing the organization and structure of the civil service and addressing wage policy and payroll management	End-June 2012	Strengthen public financial management	completed
new proposed measures:			
Operationalize the implementing regulations of the 2011 Civil Service Act (pertaining to recruiting, discipline, promotion, and standing orders) by amending the general orders accordingly	End-July 2013	Strengthen public financial management	proposed
Actuarial review of Social Security			
Regular review of the Social Security Scheme.	End-December 2012	Strengthen public financial management	met with delay in May 2013
Public enterprise reform			
Rationalize public land sales and development agencies	End-September 2012	Strengthen public financial management	completed on October 5
Include in the Finance Administration Act provisions recognizing the Government Entities Oversight Board and strengthening its enforcement authority	End-March 2013	Strengthen public financial management	pending
Strengthen social safety net			
Submit social safety net reform strategy to Cabinet	End-March 2012	Streamline social safety nets	completed
Develop method for the proxy means testing for the eligibiity criteria of the planned consolidated cash transfer program	End-December 2013 (moved from end-September 2013)	Streamline social safety nets	
II. Financial Sector Reforms			
Update the existing stress tests of banks	To be monitored on a quarterly basis	Financial sector stability	completed
III. Medium-term			
Develop an explicit medium-term debt management strategy that takes account of the cost-risk tradeoff of alternative financing options, within the context of the overall macroeconomic environment	End-December 2012	Improve medium-term orientation of the budget	completed
Draft proposal for a comprehensive pension reform	End-June 2013	Strengthen public financial management	delayed

Sources: St. Kitts and Nevis authorities; and Fund staff.

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. St. Kitts and Nevis' performance under the Stand-By Arrangement (SBA) will be assessed on the basis of the quantitative performance criteria and indicative targets, as well as the structural benchmarks. This Technical Memorandum of Understanding (TMU) defines the variables set out in Tables 2 and 3 of the Memorandum of Economic and Financial Policies (MEFP). It also lays down the reporting requirements to adequately monitor the program.

2. For the purposes of the program, the exchange rate of the East Caribbean dollar (EC$) to the U.S. dollar is set at EC$2.70 = US$1 and the exchange rate of the Euro to the U.S. dollar is set at EUR1 = US$1.3. Foreign currency accounts denominated in currencies other than the U.S. dollar and the Euro, excluding SDRs, will be first valued in the U.S. dollar at actual end-of-period exchange rates used by the ECCB to calculate the official exchange rates. SDR-denominated accounts will be valued at the program exchange rate of U.S. dollar 1.6 per SDR.

I. COVERAGE

3. For the purpose of the program, **central government** will cover all items included in the government budgets of the Federation (both St. Kitts and Nevis).

4. The **nonfinancial public sector** is defined as the total central government and nonfinancial public enterprises. Public enterprises consist of the Development Bank of St. Kitts and Nevis, Financial Services Regulatory Commission, Frigate Bay Development Corporation, La Vallee Greens Ltd, National Housing Corporation, Nevis Air and Sea Port Authority, Nevis Cultural Development Foundation, Nevis Electricity Corporation, Nevis Housing and Land Development Corporation, Nevis Solid Waste Management Authority, Nevis Tourism Authority, St. Christopher and Nevis Solid Waste Management Corporation, St. Christopher Tourism Authority, St. Kitts Urban Development Corporation, St. Christopher Air and Sea Ports Authority, White Gate Development Corporation, and ZIZ Broadcasting Corporation.

5. **External debt** is defined as all debt owed to creditors residing outside of St. Kitts and Nevis, while **domestic debt** covers all debt owed to residents of St. Kitts and Nevis. The latter covers all T-bills, including those held by creditors residing outside of St. Kitts and Nevis, and the bond issued at the Regional Government Securities Market (RGSM).

II. QUANTITATIVE PERFORMANCE CRITERIA

A. Central Government's Overall Deficit (PC)

6. The **central government overall balance** will cover all of its revenue, grants, expenditure, and transfers. Revenues will exclude any proceeds from the sale of public assets such as land, which will be considered as financing below the line. Expenditures will exclude clearance of arrears, which will be considered as financing below the line.

7. The central government's overall balance will be measured from the financing side as the sum of the net domestic financing, net external financing, plus proceeds from the sale of public assets, minus clearance of arrears.

8. **Net domestic financing** of the central government is defined as the sum of:

- net domestic bank financing as measured by the change in the domestic banking system credit to the central government net of deposits, as reported by the consolidated balance sheet of the monetary authorities and commercial banks, including special tranches from the ECCB;
- net nonbank financing as measured by the net changes in holdings of government securities by nonbanks, and net borrowing from nonbank institutions;
- the changes in the stock of domestic arrears of the central government defined as net changes in unpaid checks issued, unprocessed claims, pending invoices, plus accrued interest payments, and other forms of expenditures recorded above the line but not paid;
- gross receipts from divestment defined as proceeds received from any privatization, divestment, and sale of asset (land); and
- any exceptional financing, including rescheduled principal and interest.

9. **Net external financing** of the central government is defined as the sum of:

- disbursements of project and non-project loans, including securitization;
- proceeds from bonds issued abroad (with an original maturity of one year or greater);
- net changes in short-term external debt (with an original maturity of less than one year), excluding exceptional financing;
- net changes in cash deposits held outside the domestic banking system;
- any changes in arrears on external interest payments and other forms of external expenditures recorded above the line but not paid;

- any exceptional financing, including rescheduled principal and interest;

less:

- payments of principal on current maturities for bonds and loans on a due basis, including any prepayment of external debt.

10. The **floor on the overall balance of the central government** will be adjusted as follows:

- **downward** (i.e., a larger overall deficit target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.

- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.

- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution—any amounts spent in excess of this programmed contingency will need to be funded within the program limit on the overall deficit.

- **upward** to the extent that clearance of arrears fall short of the amounts specified.

- **upward** to the extent of exceptional financing achieved through debt restructuring.

Table 1. Programmed Disbursements of Budgetary Grants in 2013
(in EC$ millions)

Quarters	I	II	III	IV
Grants	15	33	28	54

Sources: St. Kitts and Nevis authorities; and Fund staff estimates.
Note: Values presented are cumulative from the beginning of the year.
There is a revision of program targets from 2013Q3.

- **upward** to the extent of under-execution of revenue financed capital expenditure relative to the program targets. For the purpose of the program revenue financed capital expenditure refers to capital expenditure not financed by loans or grants.

Table 2. Programmed Capital Outlays of the Central Government, 2013
(in EC$ millions)

Quarters	II	III	IV
Capital expenditure	26	61	90
Capital expenditure net of grants and loans	17	37	53

Sources: St. Kitts and Nevis authorities; and IMF Staff estimates.

Note: Values presented are cumulative from the beginning of the year. 2013QII corresponds to targets from the fourth review under the SBA

B. Stock of Central Government Short-Term External Debt (PC)

11. **The limit on short-term external debt** applies to debt owed or guaranteed by the central government of St. Kitts and Nevis, with an original maturity of up to and including one year. Excluded from the limit are any rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits. Normal import credit is understood to be a self-liquidating operation where the proceeds from sales of imports are used to retire the debt. Debt falling within the limit shall be valued in U.S. dollars at the time of the contract or guarantee becomes effective.

C. External Arrears of the Public Sector (PC)

12. The **non-accumulation of arrears to external creditors** will be a continuous performance criterion under the program. This performance criterion applies to arrears accumulated related to debt contracted or guaranteed by central government. External payment arrears consist of external debt service obligations (principal and interest) falling due after December 31, 2010 that have not been paid at the time due, taking into account the grace periods specified in contractual agreements. Arrears resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this definition.

D. Budget Expenditure Arrears (PC)

13. A ceiling is set on central government budget expenditure arrears, equal to the stock of such arrears as at December 31, 2010 (Table 3). The ceiling applies to the increase in the sum of: (1) 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, or in the absence of a grace period, within 60 days; and (2) unpaid wages, pensions, or transfers, pending for longer than 60 days to domestic or foreign residents, irrespective of the currency denomination of the debt. Interest and amortization arrears on domestic debt resulting from nonpayment of debt service for which a clearance framework has been agreed or a rescheduling agreement is being sought are excluded from this ceiling. For ease of monitoring, all debt issued on the Regional Government Securities Market (RGSM), irrespective of who holds it, will be regarded as domestic debt.

Table 3. Stock of Budget Expenditure Arrears at end-December, 2010
(In EC$ millions)

Stock of arrears 1/	133
Unpaid checks issued	…
Unprocessed invoices	…
Pending invoices	…
Interest and amortization arrears on domestic debt	0
Total	133

Source: St. Kitts and Nevis authorities.

1/ The stock of arrears related to the fuel purchase is being audited by international auditors .

III. Indicative Target on the Primary Balance of the Central Government

14. The **central government's primary balance** is defined as revenue and grants minus non-interest expenditures. As in the definition of the overall balance, revenue will exclude any proceeds from the sale of public assets. Net lending is a non-interest expenditure item (negative net lending is a revenue item). Interest expenditures include interest payments on outstanding arrears, as defined above in sections IIC and IID (at their contractual rates) converted to a cash basis.

15. The **floor on the primary balance of the central government** will be monitored from the financing side as the sum of the net domestic financing, net external financing, proceeds from the sale of public assets, plus domestic and external interest payments on a due basis.

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

- **downward** (i.e., a smaller primary surplus target would apply) to the extent that budgetary grants fall short of the programmed amounts by less than EC$3 million.

- **upward** to the extent that budgetary grants exceed the annual amounts specified in the program.

- **downward** by the cumulative amount of up to EC$15 million spent on bank recapitalization and support to the British American Insurance Companies or CLICO as part of a regional solution.

- **upward** to the extent of exceptional financing achieved through debt restructuring.

- **upward** to the extent of under-execution of non-grant financed capital expenditure relative to the program targets.

IV. DATA AND INFORMATION

17. To enable monitoring of performance relative to the above quantitative performance criteria and indicative targets, the St. Kitts and Nevis authorities will provide Fund staff with the following specific data and information within 8 weeks after the end of each month.

Fiscal sector

- Central government budgetary accounts.

- Capital expenditure.

- Total monthly disbursements and grants receipts, disaggregated into: (a) budgetary support (by type—either loans, external "bonds" and/or other securities); (b) project loans; (c) budgetary grants; and (d) project grants.

- Central government domestic debt data (St. Kitts and Nevis).

- Stock of domestic arrears, including unpaid checks issued, stock of unprocessed claims due and invoices pending; interest and amortization on domestic debt.

- Stock of external arrears by creditor.

- Detailed monthly external debt report from the Debt Unit in the Ministry of Finance, showing fiscal year-to-date disbursements, amortization, interest payments and outstanding stocks, for the central government and public enterprises.

- Copies of loan agreements for any new loans contracted, including financing involving the issue of government paper, and of any renegotiated agreements on existing loans.

Financial sector

- Monetary survey for St. Kitts and Nevis as prepared by the Eastern Caribbean Central Bank.

Real sector

- Consumer price index.

18. Reporting on a **quarterly basis** will include the following:

Fiscal

- A detailed overview of capital expenditures on a project by project basis and the composition of financing.
- Financial position of the public enterprises (as listed in paragraph 4).

Real sector

- Economic indicators under the real sector.

External sector

- Economic indicators under the external sector.

19. Reporting on an **annual basis** will include the following:

External and real sectors

- GDP and its components.
- Balance of payments accounts.

20. **Other reporting** will include:

- Reports of legislative changes pertaining to economic matters.
- Notification of any establishment of new public enterprises.
- All disbursements and outstanding balances from the use of the Banking Sector Reserve Fund on a weekly basis.