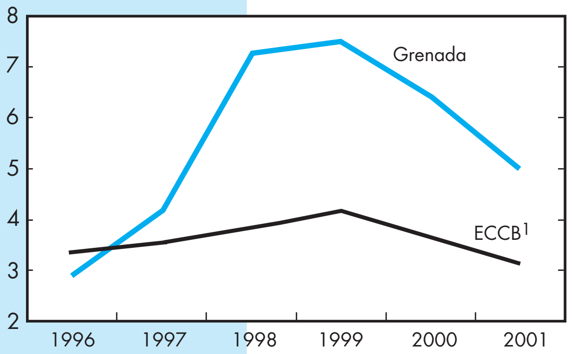
Caribbean economy

Grenada faces challenge of managing the economy of a small state

Over the past three to four years, Grenada, a member of the Caribbean Community (CARICOM) and the Eastern Caribbean Currency Union (ECCU), has been one of the fastest growing of the member countries of CARICOM (see chart, this page). Its success has been largely due to determined efforts aimed at strengthening the economy and diversifying its export product base.

ECCB region: real GDP growth

(percent)



[1]ECCB is the Eastern Caribbean Central Bank, whose member countries are Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

Data: Grenadian authorities; and IMF staff estimates

Economic developments

The factors behind Grenada's recent economic performance may be traced to the economic programs undertaken by the authorities beginning in 1992, aimed at breaking the cycles of slow growth and fiscal weakness that characterized much of the 1980s. The main objectives of the programs were to speed up the pace of growth, lower unemployment, and reduce poverty by promoting private sector investment in tourism and nontraditional sectors, improving roads and other infrastructure, and making the public sector leaner and more efficient. Private investment would be stimulated through the existing regime of fiscal incentives—mainly for manufacturing and tourism—that is common throughout the ECCU, a simplification of regulations governing investment, and reforms that lower tax rates and simplify the tax structure while broadening the tax base. The strategy to promote private investment also included the sale of the major state enterprises, including the electricity, telecommunications, and sugar companies; the privatization of the state-owned banks; and the contracting out of selected government activities, such as road construction and maintenance.

Public sector reforms focused on increasing fiscal saving through a reduction in the size of the civil service and a temporary wage freeze, and efforts to link pay more closely to performance. Grenada expected to alleviate a high incidence of unemployment and poverty—which stood at about one-third of the population at end-1992—through faster rates of economic growth. In addition, the economic programs undertaken by the authorities also incorporated more specific antipoverty measures, including an increase in spending on programs aimed at ensuring the basic minimum needs for young children, the aged, and the disabled.

Indications that the measures were bearing fruit began to appear in the mid-1990s. Real GDP growth rose from an average of close to zero in 1992–93 to 3 percent in 1995–96 and 7 1/2 percent in 1998–99, before falling back to 6 1/2 percent in 2000. Also, unemployment fell to 12 percent in 2000, and inflation remained in the low single digits, largely owing to the

Grenada: a small island economy

Grenada comprises three small islands in the eastern Caribbean, with a total land area of 345 square kilometers and a population of some 102,000. The country is a member of the Caribbean Community (CARICOM), and the Eastern Caribbean Currency Union (ECCU) (see box, page 339). Banana cultivation and exports, the main economic activity until the early 1990s, declined rapidly during the middle of the decade and virtually ceased in 1997 as a result of low productivity and poor fruit quality, disease, and uncertainty regarding access to preferential markets in the European Community. The country remains heavily dependent on tourism and spices. In recent years, however, it has been able to weather the effects of the collapse of the banana industry by successfully diversifying into light manufacturing, offshore financial services, and—lately—telephone and Internet-based marketing.

fixed peg to the U.S. dollar. Growth was broad-based, with manufacturing (mainly electronic components and paper products), residential and hotel construction, and other services (particularly telecommunications and financial services) registering strong advances. This development, combined with high export prices for spices, led to an increase in GDP per capita from $2,650 in 1991 to almost $4,000 at end-2000 (see table, page 340).

A key feature of the recovery was the marked improvement in Grenada's fiscal performance (see chart, this page). Government savings, which were negative during 1990–94, rose to 6 percent of GDP in 2000, reflecting strong economic activity, improved tax and customs administration, and measures to contain expenditure, particularly the wage bill, which fell from 13 percent of GDP in 1990–94 to 10 percent of GDP in 2000. The strengthened savings performance permitted increased capital spending (from 7 percent of GDP in 1990–94 to 11 percent in 1998–2000). Much of this spending centered on improving the country's road network and sea defenses. Other large projects included the construction of government office buildings and a sports stadium, financed by commercial banks under lease-to-own arrangements. In the social area, the increased fiscal savings allowed increased transfers to small-scale rural projects, such as village roads, clinics, and water supplies, as well as higher direct payments to the poor.

Prospects and challenges

As in other countries in the Caribbean region, economic activity in Grenada is expected to slow in 2001, mainly because of the effects on the vital tourism sector of the slowdown of the U.S. economy that began to be felt in the first half of the year, and which were exacerbated by the September 11 attacks on the United States. (Tourism accounts for an estimated 25 percent of GDP, 40 percent of exports of goods and services, 9 percent of government revenue, and about 15 percent of total employment.) Initial estimates for 2001–02 indicate that the combined effects of these shocks would result in a sharp reduction in the growth rate and a worsening in the fiscal and external positions.

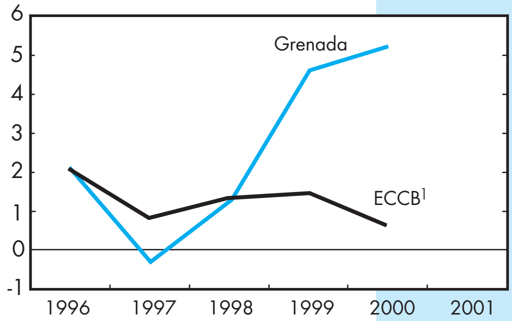
In response to the slowdown, earlier this year the government began to prepare contingency spending cuts, including a curtailment of large, domestically financed projects and of spending on goods and services. In addition, it will be important to take steps to contain the size of the wage bill, which accounts for about one-half of current expenditure. In line with the recent decision of the member countries of the Eastern Caribbean Central Bank (ECCB), the government has also undertaken to further strengthen revenue administration, including through the phasing out of some tax exemptions. These measures, together with the country's ability to secure temporary financing because of its recent strong fiscal performance, should help Grenada weather most of the effects of the crisis.

Looking ahead, the challenge facing Grenada is how it can combine prudent fiscal policy with measures to sustain adequate rates of growth to reduce unemployment and alleviate poverty. Meeting these challenges will require building on the gains Grenada has achieved so far in reforming the economy and creating an environment that will continue to attract private investment and jobs. Prospects for growth still appear favorable based on ongoing and proposed tourist-related construction projects, proposals to expand the processing of spices and other agricultural products, and prospects for the further development of the telecommunications sector. In addition, the government remains confident that there is scope for promoting a well-regulated offshore financial services sector, though renewed efforts to strengthen regulation and to tackle money laundering are needed. While banana output has begun to recover under the government's rehabilitation program, this sector is not likely to play a major new role in the economy, in part because of the continued uncertainty surrounding access and prices in export markets.

Maintaining a sound fiscal position will be essential for sustaining adequate growth rates and providing resources for further infrastructural and social programs without raising the debt burden. Proposals

ECCB region: central government current balance

(percent of GDP)



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Data: Grenadian authorities; and IMF staff estimates.

Eastern Caribbean Currency Union

In addition to Grenada, ECCU members comprise Anguilla, Antigua and Barbuda, Dominica, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines. The common currency of the ECCU, the Eastern Caribbean dollar, has been pegged to the U.S. dollar at the rate of EC$2.70 = US$1 since July 1976. Monetary and exchange rate policies of the ECCU are administered by the Eastern Caribbean Central Bank (ECCB).

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on fiscal policy that are currently being discussed center on reducing tax exemptions, as part of a common regionwide effort; introducing a regional value-added or sales tax; continued efforts to reduce the size of the civil service; and avoidance of commercial lease-to-own contracts to finance infrastructure projects, as part of a strategy to strengthen debt management and slow the growth of lease and interest payments. Early progress on the tax proposals is likely to be difficult, because their implementation requires a regional consensus, considerable preparation, and technical assistance.

Grenada's economic performance since the mid-1990s, and, in particular, following the collapse of the banana industry in 1997, has demonstrated the country's capacity to weather adverse shocks by adopting appropriate policies. The country's ability to adapt its policies to deal with new external shocks will be severely tested as it takes steps to address the impact of the terrorist attacks on the United States. In these difficult circumstances, adhering to a strategy based on promoting investment, maintaining sound fiscal management, reforming the public sector, and alleviating poverty is likely to continue to serve Grenada well. ■

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Grenada: main economic indicators

(annual percentage changes, unless otherwise indicated)

	1990–94 (Averages)	1995	1996	1997	1998	1999	Est. 2000
Real sector							
Nominal GDP	3.1	5.4	6.6	6.9	8.2	10.9	8.6
Real GDP	2.4	3.1	2.9	4.2	7.3	7.5	6.4
Consumer price index[1]	2.9	2.1	3.1	0.9	1.2	1.0	3.5
Unemployment rate	. . .	26.7	17.5	17.0	16.0	14.0	12.0
Central government finances[2]							
Revenue and grants	27.2	28.2	28.9	26.9	30.0	28.1	29.8
Expenditure	31.6	28.8	32.7	33.1	33.1	31.6	33.0
Current	24.7	23.0	23.0	24.4	23.9	21.4	20.8
Capital	6.9	5.8	9.7	8.7	9.2	10.2	12.2
Current balance	–0.4	2.2	2.1	–0.3	1.3	4.8	6.0
Overall balance	–4.4	0.6	–3.7	–6.2	–3.1	–3.5	–3.2
External sector							
Current account balance[2]	–11.6	–9.2	–19.6	–24.9	–23.0	–8.0	–15.6
Real effective exchange rate (depreciation –)	–0.7	–2.0	1.8	3.4	–2.2	3.1	5.8

[1]End of period.
[2]In percent of GDP.
Data: Grenadian authorities; and the Eastern Caribbean Central Bank

Available on the web (www.imf.org)

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