RNM/OECS COUNTRY STUDIES TO INFORM TRADE NEGOTIATIONS: ST. KITTS AND NEVIS

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ST. KITTS AND NEVIS

INTRODUCTION

In recent years the tourism sector has become the major source of foreign exchange earnings, income and a major source of employment. The slowdown in the sector has been reversed in the last few years by aggressive marketing and addition to the stock of hotel rooms. Room capacity continues to expand and another 1000 rooms would shortly come on stream. However, the sector is still plagued by a shortage of regularly scheduled airline seats and resort to back-to-back charters for filling the hotel rooms.

The production of sugar still remains a major source of employment and income, if not foreign exchange earnings. Its viability is threatened by the high cost of production compared to the price it fetches on the European market. Progressive liberalisation of the market for sugar in the European Union is likely to force the price paid for Caribbean sugar downwards and result in a further price cost squeeze on the industry.

RECENT ECONOMIC PERFORMANCE

Over the period 1986 to 1998 the economy of St. Kitts and Nevis grew at an average rate of 7.5% annually. However, the performance of the economy can be divided into three distinct sub-periods. The high growth rates of the early 1980s carried over into the period 1986 to 1989 and the rate of growth averaged 8.8% and a rate of growth of 20.4% was achieved in 1988. The growth during this period was fueled by expansion in the tourism, construction and communication sectors and to a lesser extent financial services. The construction sector grew at a rate of 25.4% annually during this sub-period buoyed by expansion in the tourism sector. There was also expansion in the economic and social infrastructure of the country. The Tourism sector expanded at an average annual rate of 7.5% but this rate would have been higher but for the passage of hurricane Hugo in 1988. The communications sector grew rapidly and the annual average growth rate recorded for the period was 30.6% and a rate in excess of 60% was achieved in 1988. Meanwhile the agricultural and manufacturing sectors experienced much slower growth. In particular value-added in the agricultural sector for 1989 was only 0.07 percentage points higher than the level achieved in 1986. This was largely due to a 7% decline in output of that sector consequent on the passage of hurricane Hugo in 1988.

During this period the deficit on the current account of the balance of payments widened from 11.3% of GDP in 1986 to 32.2% in 1989. The passage of hurricane Hugo led to a EC$53m increase in merchandise imports between 1998 and 1999 while exports increased by EC$11m. Except for 1988 the Overall balance of payments recorded an overall surplus during the other years. Capital transfers amounting to 5% of GDP and Foreign Direct Investment (FDI) averaging 16.4% of GDP were able to offset the widening current account balance.

The period 1990-1994 was marked by a period of much slower growth, which averaged approximately 4.2% - less than one half of the growth rate achieved during the earlier period. A
negative growth rate of -16.8% in the agricultural sector in 1990 and a further decline of 3.4% in 1994 accounted for slowing of expansion of the economy during the period 1990-94. At the same time expansion in the construction and tourism sectors also slowed from the highs achieved in the 1980s. Only the communications sector continued to grow at a rapid pace, but this rate of growth was much less than what was achieved in the earlier period. The general slow down in the world economy, consequent on the gulf war, compounded by after effects of the passage of hurricane Hugo in 1988 accounted for the decline in growth rates.

This period saw the steady improvement of the current account of the balance of payments as it narrowed from 35.1% of GDP to 14.5.5%. Merchandise exports increased by 18% annually while imports grew at a rate of 2.1% annually. Meanwhile, earnings from tourism increased from an average of EC$92m in the early period to an average of EC$169m during the period 1990-94. Not surprisingly, the overall balance of payments recorded a deficit of EC$17.4m in 1990 but improved steadily thereafter except for 1992 when a small deficit was realised. In this period FDI flows declined slightly to 13.8 % of GDP and Capital transfers declined to less than 3% of GDP.

Since 1994 the economy of St. Kitts-Nevis has been in state of almost continuous adjustment to hurricanes. Hurricanes Louis and Marilyn in 1994 resulted in a reduction in the rate of growth to 3.5% in 1995. The years 1996 and 1997 were periods of recovery but hurricane Georges in 1998 led to a reduction in the rate of growth to 1.64%. The country was again affected by hurricanes Lenny and Jose in 1999. The destruction wrought by 4 hurricanes in the space of 5 years is ample evidence of the extreme vulnerability of the economy. The frequent passage of hurricanes and other natural disaster not only leads to interruption of economic development but increases the burden of debt on the economy since damaged infrastructure have to be rehabilitated with additional loans.

Growth in the economy during the period 1995-1998 was fuelled by expansion in the construction, communications, financial services and tourism sectors. In particular the communications sector expanded at a rate of almost 10% on average during that four-year period. The performance of the agricultural sector was mixed as the sector contracted significantly in the years that followed the passage of major hurricanes. The tourism sector also responded in the same way after the hurricanes but only in 1995 was there a decline of the sector (-21.9%).

The instability in the real sector as a result of the adjustment to many hurricanes during this period led to some instability in the current account of the balance of payments. While the level of imports continued to grow at a fairly rapid pace (5.7%) due to rehabilitation and the inflow of FDI mainly in the tourism sector, exports grew rather more erratically. FDI inflows fell to 11.96% of GDP but increased earnings from tourism services and the inflows from insurance claims arising from the hurricane damage to private property generated overall surpluses on the balance of payments except for minute deficit (EC$1.6m) in 1996.
RECENT FISCAL PERFORMANCE

The fiscal performance of St. Kitts and Nevis has been characterised by extreme fluctuations in the fiscal account partly as a result of disruptions in the economy caused by hurricanes and partly caused by periodic generous wage settlements and transfers to public enterprises. During the period 1984 to 1989 the current account strengthened from a deficit equivalent to 4.1% of GDP in 1985 to a surplus equivalent to 2.8% of GDP by 1989; but deteriorated thereafter except for improved performances in 1993 and 1997. The current account surplus in 1997 increased to 1.8% of GDP but fell again to less than 0.5% by the end of 1998. Despite moderate outlays on public sector investments, the overall balance resulted in increasing deficits which peaked at over 6.0% of GDP by the end of 1998. The deficit was financed by extensive use of non-concessional borrowing. St. Kitts has been graduated as an IDA eligible country and has experienced reduced concessional flows since 1992.

Recurrence revenues averaged 27.6% of GDP during the period 1984 to 1994; but rose sharply to 36.1% of GDP by 1997 following major reforms in tax assessments and collection at the Inland Revenue. Overall revenue buoyancy averaged 1.0 over the period 1984 to 1998. Tax revenue buoyancy averaged 1.2. However, taxes on international trade showed less encouraging results with an average buoyancy ratio of 0.9 during the same period. Revenue flows from international trade showed a greater susceptibility to disruption as a result of hurricanes than was the case with domestic taxes. Additionally, government’s policy to the administration of fiscal incentives and ad hoc concessions resulted in low rates of collection of customs revenue. Only about 48.0% of potential revenue from that source is realised.

The ratio of recurrent expenditure to GDP had fallen from 32.4% in 1984 to 24.5% in 1991; but rose sharply to 34.3% by the end of 1997. The sharp increase in the latter period was largely due to substantial wage adjustments and increased employment following the introduction of an apprenticeship programme to encourage employment growth in the public and private sectors. On average interest payments increased annually by 19.2% followed by transfers at 14.1%, salaries and wages 12.4% and goods and services by 7.0%. The rise in interest payments reflects the increasing use of non-concessional financing from 1995 onwards.

The disbursed outstanding external debt rose rapidly from EC$71.8 million in 1988 to EC$295.3 million by the end of 1998. Although incomplete information on the sectoral allocation of this debt is available, a large portion of the total being classified as multi-sector debt, the tourism and communications sectors accounted for 16.1 and 15.4% of total external debt respectively according to available data.

Sectoral allocation of expenditure did not change significantly over the period 1990 to 1995. General administration continued to consume over 38.0% of revenue resources allocated to recurrent expenditure, with education accounting for just over 15.0%, economic services (including tourism) 13.0% and health 13.8%. The balance of resources was shared between social security and welfare, housing and community development and other services. The share of wages and salaries in total recurrent expenditure rose from 42.9% in 1984 to 50.7% in 1998. The share of interest payments also rose from 7.2% to 10.6%; and transfers from 4.4% to 10.9%. In contrast, the share of goods and services for the same period declined from 45.5% to 27.8%.
Current trends indicate the need to rationalise employment and pay policy within the civil service as well as to adopt a more prudent approach to debt management. The increasing levels of transfers raise issues affecting public enterprise management including pricing policies, commercialisation and divestment of state assets.

**STRUCTURE OF REVENUES**

Although the share of taxes on international trade fell from 42.9% in 1984 to 36.4% in 1998, the apparent shift has been caused by the increasing importance of domestic tax revenue which rose from 20.0% of total revenue in 1984 to 37.7% of total revenue in 1998. As a per cent of GDP, however, taxes on international trade rose from 13.3 to 14.1 while domestic taxes increased from 6.2 to 12.4 and non-tax revenue fell from 11.5 to 9.4.

St. Kitts and Nevis abolished personal income tax in 1981; but introduced a flat tax on income, referred to as a social services levy, in 1984. Basically, the tax structure is similar to those of the other OECS countries and consists of the following:

**Taxes and Charges on Domestic Goods and Services**

- social services levy on salaries and wages at the rate of 6.0% (3.0% borne by the employee and 3.0% borne by the employer);
- corporate income tax at 38.0% of net income;
- a house tax at 5.0% of annual rental value;
- land tax at rates ranging from $1.00 to $12.00 varying for cultivated, uncultivated but cultivable and uncultivated and uncultivable land;
- land transfer tax at 8.0% of transfer value to be paid in equal portions by the purchaser and vendor;
- condominium tax at 5.0% of transfer or conveyance value to be paid in equal portions by the purchaser and vendor;
- consumption tax on locally produced goods at a basic rate of 15.0% with varying rates for clothing, rum and beer; and on professional services at 4.0%;
- excise duty on rum ($1.20 per gallon) and sugar ($1.00 per 100 lbs);
- hotel room tax at 7.0% of bill charge, including food and beverage;
- entertainment tax on ticket price;
- traders tax at 3.0% of sales, above a threshold of $8,000.00, not liable to corporation tax;
• insurance premium tax at 5.0% of the value of non-life premium with a registration fee of
  $2.00 for every $1,000.00 of premium sold up to a maximum of $30.00;

• a tax on overseas telephone calls at 5.0% of the billed charge;

• a tax on cable TV at $3.00 per month for each consumer;

• a vehicle rental levy at 5.0% of rental charge;

• a number of licenses on trade, professions and motor vehicles.

Taxes on International Trade

• import duty at rates varying between 5.0 to 35.0% with special rates on agro and agro-
  processed products rising to 40.0%;

• a consumption tax at a general rate of 15.0% with lower rates for clothing, basic food items
  and industrial gases and specific rates for petroleum, alcoholic and other beverages and
  tobacco;

• a customs service charge at 3.0% of c.i.f. value;

• a mercantile tax of 10.0% of the value of duty-free goods;

• embarkation tax levied on departing passengers at airports at $10.00 for residents and $27.50
  for non-residents; and a travel tax of 10.0% of the value of airline tickets originating from
  St. Kitts and Nevis.

• Withholding tax at 10.0% on profits, management fees and expenses, technical services,
  accounting and auditing services, royalties. Non-life insurance premium and rents.

The tax structure in St. Kitts and Nevis has remained generally compatible with WTO standards.
However, variation occurs in the application of embarkation tax with a higher rate for
non-nationals which may not be strictly in line with MFN principles. The requirement for
non-nationals to obtain a license and pay a fee before entering into land transactions also appears
to be in violation of these principles. Although the customs service charge at 3.0% is lower than
in most OECS states, the current rate still exceeds the limit allowed for cost recovery.

St. Kitts and Nevis’ reliance on international trade taxes is lower by comparison with other
OECS states, although it has progressed only up to Phase II of the common external tariff
implementation schedule. The high proportion of domestic taxes derives from the extensive
range and breadth of taxes on domestic goods and services, including a consumption tax on
professional services, insurance premium tax, a tax on overseas telephone calls, on cable TV and
on vehicle rentals. The diverse nature of the tax structure calls for consolidation of internal taxes
on goods and services into a single intersectoral tax that will be less complicated and costly to
administer.
Recent Tax Changes

Since the major tax reforms in 1981 in which the tax burden was shifted more towards expenditure than income, St. Kitts and Nevis has continued to take regular revenue enhancement measures. In 1997 the following tax changes were implemented:

- Traders tax was increased from 2.0% to 3.0% of sales;
- Consumption tax on services was increased from 2.5% to 10.0%;
- The social services levy was increased from 4.0% to 6.0%;
- Vehicle and drivers license fees were increased substantially;
- The base of the consumption tax on imports was broadened to include import duties as part of the taxable value;
- Business and professional fees were restructured.

Taxes and fees from offshore services have assumed major importance in Nevis rising from $2.8 million in 1996 to $4.5 million by 1998. Most of the receipts from this source derive from registration and annual fees which together accounted for $4.3 million of the total.

Fiscal Prospects

The effects of intermittent natural disasters and unfavourable market conditions for sugar in St. Kitts and Nevis over the past several years have interrupted sustained growth in the economy and at the same time weakened fiscal performance. The prospects for early recovery will be challenged by the increasing rate of non-concessional borrowing and the generous wage adjustments that have been a feature of the recent past. The authorities intend to commission a study on revenue measures that will help to stabilise the fiscal account. Some of the measures that are being examined include:

- A restructuring of the property tax to shift the base from annual rental to market value;
- An expansion or readjustment of petroleum taxes;
- A further adjustment of the social services levy;
- A 50.0% increase in property transfer fees;
- A general review of utility tariffs (current data indicate that operating expenses of the water department for 1998 exceeds revenue by more than 100.0%);
- A review of the incentive framework and social safety net to reduce the high cost of revenue forgone.

At the same time the government plans to grant higher spending priority to improving its human resource by introducing computer literacy at the primary level (secondary schools already receive computer training), upgrading health services by rehabilitation of plant and decentralisation and generally upgrading economic infrastructure.

The authorities believe that all these measures will together reduce the fiscal deficit by 1.0% in the short term and bring the fiscal account in balance by 2003.
There are a number of other initiatives which will contribute towards this stabilisation. These include:

- maintaining and deepening the systems and procedures to strengthen the administration of income tax and other inland revenues, including property tax and licenses (SIGTAS); already the new system has increased tax coverage by an estimated 50.0%;

- improvements in customs administration (CRM and ASYCUDA) which have so far helped to minimise the impact of tariff adjustments;

- budget reform which has the potential to improve resource allocations, eliminate waste and identify areas for possible commercialisation or cost recovery;

- enhancing the accounting and regulatory system to maintain better control on public spending (SIGFIS).

Despite the initiatives enumerated above, there are a number of issues that must be addressed to maintain sustained improvement in the fiscal account. These issues fall under the broad categories of:

- Tax reform
- Public sector reform
- Budget reform

The ratio of recurrent revenue to GDP in St. Kitts was 36.1 in 1997, the highest in the OECS region. The unequal distribution of taxes on a sectoral basis creates serious distortions in burden sharing and encourages non-compliance and a tendency to make arbitrary assessments that are largely ignored by taxpayers. This together with the present weakness in tax administration in enforcing tax laws results in increasing arrears. Complicated tax laws constrain the ability of tax officials to enforce collection although this problem has been alleviated by the assignment of legal support to the inland revenue department. Recent initiatives have been taken to strengthen inland revenue through the SIGTAS programme, including the streamlining of operations, computerising assessment and collections processes, simplifying some sections of the tax laws and improving the technical skills of tax officers.

The current incentive regime further distorts burden sharing among sectors as well creating opportunities for evasion of tax on other taxable incomes. Customs revenue is affected similarly through the generous concessions granted to preferred sectors and on an ad hoc basis. It is estimated that nearly 52.0% of potential revenue is not collected as a result of exemptions and concessions granted. The incentive framework itself is not as transparent as it should be, allowing for discretionary grants with little consistency in their application. Additionally, the recipients of benefits under the incentive scheme are not held accountable for benefits received. All this undermines the authority of both inland revenue and customs officials to enforce tax compliance.

A review of the range of taxes currently administered in St. Kitts and Nevis reveals another area of inefficiency which should be critically examined. Given the present capacity in the two
principal revenue departments – inland revenue and customs - there is need to review the number of taxes which have to be administered and to assess their cost effectiveness. Any tax reform programme should focus on fewer and broad based taxes with wide coverage that do not discriminate between sectors. St. Kitts and Nevis has already made some advances in this direction by extending its consumption tax to professional services albeit at a lower rate than is applied to goods.

Recurrent expenditure in 1998 was equivalent to 35.5% of GDP. The share of wages and salaries in total recurrent expenditure stood at 50.7%. At the same time the cost of administrative services took up 38.8% of the recurrent expenditure budget. These ratios indicate a need to review the operations of government with a view to rationalising the allocation of resources consistent with government’s overall goals and objectives.

Government scaled down employment in the public service after the expiration of the work experience programme which provided for supporting temporary employment both within the public sector and in the private sector. Nonetheless a comprehensive review of manpower needs and a review of government’s wage and incentive policy would go a long way in rationalising expenditure on the various services, in particular the general administrative services. An inward looking approach to wage setting has brought civil service salaries at mid and upper management out of line with those paid by private sector comparators. This requires readjustment if government is to be competitive in the market for required skills. Annual wage adjustments are negotiated through the wage bargaining process which does not necessarily follow preset parameters. Mutually acceptable guidelines between government and representative unions would bring transparency and consistency in the factors determining the rate of adjustment to be made annually.

The government has recently completed implementing a budget reform programme designed to evaluate government expenditure programmes and to monitor performance. The programme, which is supported by the introduction of a standard integrated government financial information system (SIGFIS), has the potential to strengthen the review process for the allocation of budget resources, enhance accountability of management and operators and to generate management information to facilitate policy reformulation. However, the application of the new system on a rigid organisational and planning structure does not permit much flexibility in resource allocation. Although in principle a strategic approach to programme design and resource allocation is followed, in practice programmes are designed around rigid institutional arrangements that does not allow for objective assessment of actual resource needs consistent with changing priorities. Nevertheless the new system has enabled more control on spending and has facilitated greater analysis of expenditure.

One of the obvious benefits is the production of data to review the effectiveness and unit cost of providing services to the public and internally. Some of this information can be used to upgrade cost recovery charges and as a basis for commercialisation or divestment of social and economic services presently provided by government.

Public sector investment in 1998 amounted to 8.1% of GDP. In a situation of low current account savings (only 0.5% of GDP in 1998) and the virtual elimination of grant funding and
concessionary financing the public sector borrowing requirement in that year was as high as 6.4% of GDP. While the debt ratio is still at a moderate level at 43.9% of GDP debt service cost already consume 10.6% of recurrent expenditure. While economies of scale in providing basic infrastructure and the need to provide utilities and other infrastructure in both parts of the federation tend to magnify investment expenditure, more careful selection and prioritisation of projects should help to keep the public debt and debt servicing costs within manageable levels.

MEDIUM POLICY OBJECTIVES

The medium term policy objectives are related to the following:

(i) Increasing the level of saving and investment. National saving as a percentage of GDP has decline from 33.8% in 1992 to approximately 20% in 1998. Both the public and private sectors are responsible for this declined. At the same time investment as a percentage of GDP increased from 38.7% in 1992 to 51% in 1998. Much of this is related to rehabilitation after the hurricanes. The saving-investment gap is financed by foreign savings. This has come largely in the form of loans, much of which have been contracted on a non-concessional basis since rising per capita income has led to the country being graduated from access to soft funds.

(ii) Fiscal consolidation: As noted above, the level of government saving has been on a declining trend since 1992. Although revenue growth has been robust expenditure has increased at a faster rate. The major element of increase has come from personnel emoluments which account for approximately 50.7% of GDP. This has been the result of salary increase which average about 10-15% annually, in addition to a thirteenth month salary paid in December and a temporary work programme aimed at providing young persons with experience. Fiscal consolidation would require: the continuation of recent improvements in tax collection at customs and inland revenue departments, reduction of tax exemptions, introduction of appropriately designed property taxes, increased levels of cost recovery in utility services and health, and expenditure control.

(iii) The development of a comprehensive framework for economic management: The development of the economy would be facilitated by a comprehensive and integrated development strategy. Several steps have been made in this direction these include:

(a) Strategic visioning in conjunction with the World Bank Vision 2020 programme;

(b) A coherent medium term strategy that will guide budgeting decision;

(c) A financial programme to guide short term policy actions;

(d) Improvement in the selection of capital projects so that they are more in line with sectoral objectives;
(e) Analysis of the recurrent financing implications of capital projects within a multi-year framework;

(f) Comprehensive budgetary reform to move from line item to programme budgeting.

(iv) The regulatory environment: The 1998 MTESP recognised the importance of an appropriate macroeconomic framework to encourage domestic and foreign investment and to enhance the competitiveness of the economy. In this regard, the government has sought to make the tax regime more favourable to private sector development by reducing the corporate income tax from 40% to 38% with the intention of progressively reducing it to 35%. The government is committed to reviewing the Fiscal Incentives and Hotel ordinance Acts - the major planks of the incentive regime. The review will be aimed at the following:

(a) reforming the incentive scheme to make it more performance related and include tax incentives for training;

(b) ensuring that small hotels enjoy similar benefits to those currently enjoyed by their larger counterparts;

(c) revising the scheme in order to encourage local investors in new export oriented manufacturing and services, including data processing and business and financial services.

SECTORAL STRATEGIES

The Authorities in St. Kitts-Nevis are focussing on four major areas for the development of the economy over the medium-term. These are Agriculture (both sugar and non-sugar), tourism, the services sector (including offshore financial services) and manufacturing. The specific strategies for these sectors will be discussed under the appropriate sub heading. However there are some cross cutting issues that affect all four sectors that can be discussed at this point. These are related to economic infrastructure, social infrastructure and the environment. These are potential constraints to the development of the productive sectors and would need to be addressed if the country is to take advantage of the opportunities afforded by trade liberalisation.

ECONOMIC INFRASTRUCTURE

The infrastructure of St. Kitts and Nevis has undergone significant improvement in recent years. Both St. Kitts and Nevis have built new seaports, In the case of St. Kitts the new port is used mainly as a tourist terminal, while the new seaport in Nevis is a multi-purpose port. The cruise terminal was established as a major attraction to large cruise ships and significant debt was contracted to complete it. It was damaged on three separate occasions by hurricanes. Since the damaged inflicted by hurricane Lenny in 1999, it has not been repaired, but, never the less there were more cruise ship calls in 2000 than ever in the island’s history. This brings into question the wisdom of building the cruise ship port in the first place, since many of the cruise lines have
stated that significant investment cruise terminals is unnecessary. The authorities have stated that the cruise ship facility will not be reconstructed in its current form given its susceptibility to hurricane damage. Both countries have also up-graded their airport facilities. In the case of Nevis the airstrip has been lengthened to take mid-sized, propeller driven aircraft used by the two airlines that offer scheduled service to the federation. The airport terminal buildings in St. Kitts has undergone a EC$60 million refurbishment and expansion.

Electricity generation capacity has also been improved with the installation of a new 14-megawatt generator in St. Kitts. This would improve the existing capacity and provide for the projected demand that would come from the almost doubling of hotel room capacity that is expected in the next few years.

The water supply is usually adequate during the wet season but some shortages occur in some areas in St. Kitts during the dry season. It would be necessary to improve the water supply to take care of the projected expansion in the tourist sector.

The road network in St. Kitts is good and significant improvements have taken place during the last couple of years. In Nevis the road network needs upgrading but this would be handled by a CDB financed project.

**SOCIAL INFRASTRUCTURE**

The development of human resources has been identified as a critical prerequisite for the improvement of the competitiveness of the economies. In addition, it is also a social service to the society and one of the more effective avenues for the redistribution of wealth. While the output of the education system - both in terms of quantity and quality - is generally good, it is inadequate to build sustainable competitiveness. Hence much effort and finance would need to be expended to upgrade the quality of the education system. The Government of St. Kitts Nevis spends about 15% of current expenditure on education. However most of it is on personnel emoluments and not much is left over for supplies and materials.

The Basic Education project which was officially launched in 1996 is aimed at improving the quality education through teacher training, curriculum development, construction of new schools and the refurbishing of the existing stock. The Ministry of education was used as the pilot for the programme budgeting exercise and the establishment of an education planning division staffed with a qualified education planner have greatly enhanced the management of the education sector.

Access to and improvement in the quality of education would be enhanced by the following initiatives identified in the 1998 MTESP.

(i) Improvement in the efficiency and effectiveness of education management at all levels of the sector;

(ii) Improvement in technical and vocational education training programmes;
(iii) Expansion of tertiary education programmes at the Clarence Fitzroy Bryant College through offering first year University of the West Indies courses and the establishment of a Hospitality Division;

(iv) Development of training programmes for middle managers in industry; and

(v) Exploration of financing options such as cost recovery in the sector, particularly in the area of tertiary education.

The provision of adequate level of primary health care at a reasonable cost is one of the major challenges for the authorities. It would require significant enhancement of the healthcare delivery system. This would involve improvement in both, the management of the system, and the physical infrastructure. At present expenditure on health accounts for approximately 13.8% of the recurrent budget. Several health sector studies undertaken in recent times point to a number of deficiencies in the sector. These include the intractability of the system, productivity and client care orientation. In particular the 1998 MTESP notes that the sector needs to address poor quality assurance, weak planning capacity within the sector, the absence of capacity to deal with mental health and substance abuse. The weakness in government finances and the need to generate savings to improve social and economic infrastructure had prompted the administration to begin looking at cost recovery mechanisms and greater private sector participation in the provision of health services.

THE ENVIRONMENT

Like most small island economies, St. Kitts and Nevis must always be aware of the fragility of its ecosystem. This is particularly so since one of its major industry, tourism, is heavily dependent on the preservation of the environment but at the same time can be heavily destructive of the environment. Thus greater attention has to be paid to environmental issues including protection of the fragile ecosystem, bio-diversity, environmental impact assessment and general environmental issues. The major environmental problems facing the country are:

(i) inadequate solid waste management;

(ii) marine and coastal pollution

(iii) soil and beach erosion; and

(iv) lack of urgency among natural resource users to adopt/embrace sustainable use practices.

The establishment of the Solid Waste Management Corporation (SWMC) under the World Bank project for the OECS is seeking to address the inadequacy of solid waste management. Steps are being taken to reduce the incidence of marine pollution like refusal of building permits and repair and rehabilitation of malfunctioning sewage disposal systems. The passage of several hurricanes in recent years has aggravated the problem of beach erosion which results from illegal beach sand mining and poor construction practices. In addition soil erosion especially on the fringes of ghauts is becoming a critical problem and may have resulted in flooding and
mudslides which affected the capital city in 1998. The country is receiving much needed technical assistance to promote sustainable uses of its resource base and several awareness programmes have been undertaken to sensitise the citizens of the country on this issue.

1. **AGRICULTURE SECTOR**

**Sectoral Contribution and Performance**

In spite of its relatively small size and difficulties experienced in the leading crop industry, agriculture remains a significant component of the St. Kitts economy, generating 42% of merchandise exports and employing about 35% of the labour force. Agricultural production has traditionally been synonymous with sugar (St. Kitts) and cotton (Nevis). While St. Kitts has continued production of sugar cane despite the difficulties experienced in the industry, cotton production in Nevis has been essentially replaced by a mix of vegetable production and small ruminant rearing. St. Kitts is estimated to house a total cultivable area of about 15,000 acres, of which sugar cane cultivation occupies 80% of the cropped area. Total acreage under sugar cane cultivation is currently less than 12,000 acres.

The relative importance of sugar to agriculture is seen in the positive relationship between sugar production and agricultural GDP growth. High positive growth in gross value added from sugarcane production exerts a strong upward pull on overall crop production and agricultural GDP. This is clearly indicated in Table 13 over the 1996 and 1997 period, where sugar cane production surged in response to favourable market prices. Similarly, negative growth in sugar cane cultivation in 1995, and more so in 1998 exerted a strong downward pull on crop production, resulting in decline in the gross agricultural output. The passage of Hurricane Georges in late 1998 adversely affected production in 1998 and 1999.

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</tr>
</thead>
<tbody>
<tr>
<td>Agriculture Share in GDP %</td>
<td>6.81</td>
<td>5.86</td>
<td>6.09</td>
<td>6.84</td>
<td>6.03</td>
<td></td>
</tr>
<tr>
<td>Agricultural growth %</td>
<td>4.08</td>
<td>-5.54</td>
<td>10.01</td>
<td>20.68</td>
<td>-10.45</td>
<td></td>
</tr>
<tr>
<td>- Crops</td>
<td>4.33</td>
<td>-3.66</td>
<td>14.53</td>
<td>34.14</td>
<td>-20.95</td>
<td></td>
</tr>
<tr>
<td>- Sugarcane</td>
<td>3.32</td>
<td>-0.10</td>
<td>13.07</td>
<td>49.78</td>
<td>-21.31</td>
<td></td>
</tr>
<tr>
<td>- Livestock</td>
<td>6.70</td>
<td>5.71</td>
<td>5.41</td>
<td>5.13</td>
<td>4.88</td>
<td></td>
</tr>
<tr>
<td>- Forestry</td>
<td>4.38</td>
<td>4.64</td>
<td>-0.38</td>
<td>3.05</td>
<td>6.04</td>
<td></td>
</tr>
<tr>
<td>- Fishing</td>
<td>1.26</td>
<td>1.03</td>
<td>5.25</td>
<td>11.24</td>
<td>-8.97</td>
<td></td>
</tr>
<tr>
<td>Real GDP Growth</td>
<td>3.85</td>
<td>3.46</td>
<td>5.90</td>
<td>7.33</td>
<td>1.64</td>
<td></td>
</tr>
</tbody>
</table>

Source: CSO
The relationship between the performance of sugar cultivation and growth in the agriculture sector is not as strong as in the banana-producing economies of the OECS. This is illustrated when the economy grew by 3.4% despite a 5% contraction in agricultural GDP. This relatively minor influence of the primary agricultural sector on economic growth derives from the relatively low share (less than 10%) primary of agriculture to GDP. Gross agricultural output has been on the decline since 1977, when its contribution to GDP was 18.4%. Between 1980 and 1989, the sector’s contribution to real GDP declined further to 12.0%. The 1990s also witnessed a continuation of the declining percentage share of agriculture to GDP, averaging roughly 6% between 1990-1999. This trend is reflective of both a reduction in agricultural activity as well as deteriorating performance of the leading crop industry, sugar.

The sugar industry benefits from the EU Sugar Protocol quota and the US quota. For this reason sugar exports depend totally on these preferential arrangements. In fact more than 90% of the sugar produced in St. Kitts is exported to these markets with the EU market being the larger. The sugar industry has been experiencing decline since the mid-1980s, due largely to organisational and managerial problems that were accelerated with low sugar production and rising production costs. In 1987 the government took over the debt of the industry amounting to ECS$6.2 million and another ECS$31 million accumulated up to 1991. Most of its operating expenses are covered by an overdraft facility from the National Bank of St. Kitts.

As indicated, sugar cane production displayed some variability over the 1994-1999 period, due in part to drought conditions which resulted in a 21% decline in output in 1998 compared to the peak output of 305,181 tons in 1997. Between 1997-1999 output of sugar declined at an average of 24.8% to 16,945 tonnes. This was attributed to lower yields and a reduction in acreage under cultivation. Sugar exports followed a similar pattern set by production. All sugar produced in St. Kitts is exported to the UK market and to a lesser extent, the US market. The continued inability to maintain its quota could have profound reaching implications for the future of sugar exports from St. Kitts. The variability in export volumes could also be reflective of the deteriorating production and factory efficiency levels.

<table>
<thead>
<tr>
<th>Table 14: Sugar Industry Performance Indicators 1994 – 1999</th>
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<tbody>
<tr>
<td>Sugar Cane Production (Tons)</td>
</tr>
<tr>
<td>Sugar Exports: Tons</td>
</tr>
<tr>
<td>Sugar Exports: EC$M</td>
</tr>
<tr>
<td>Total Merchandise Export (EC$M)</td>
</tr>
</tbody>
</table>

Source: St. Kitts Sugar Manufacturing Company

As indicated, a 13% increase in sugar cane production in 1996 yielded less than 2% in increased sugar production. Productivity improvements appeared to have played some part in the doubling of both sugar cane and sugar production in 1997. However, the steady decline thereafter suggests that these productivity improvements were not sustained, which made the industry vulnerable to external conditions. In 1999, the external price fell by 4.8% to EC$1,700 per ton.
As a result, revenue from the export of sugar, which accounted for 36.2% of total merchandise export revenue in 1995 was reduced to 20.75% in 1999. Inspite of the difficulties experienced in the sugar industry, sugar cane cultivation maintained its dominant share of agricultural GDP in the 1990s.

By the end of 1999, however, there was uncertainty regarding the future of the sugar industry in St. Kitts, particularly given the critical situation regarding its financial viability. Increasing production costs and low world market prices have led to greater concentration on agricultural diversification, which is also being encouraged in order to reduce the dependence on food imports. However, due to the intense competition between land under sugar cultivation and land for housing and tourism-related constructions, as well as the geological constraints, the development of non-sugar-cane agriculture has been very slow and unstable. As a result, the contribution of non-sugar crops to GDP has remained small over the years averaging 0.94%. Non-sugar agriculture comprises largely of part-time, subsistence farmers engaged in mixed cropping of root crops and vegetables.

Short-term crops, mainly white potato, peanuts, onion, tomato, sweet pepper, pumpkin, watermelon, cabbage and carrot, are being grown to meet increasing local demand. Some improvement in non-sugar production was reported over the period, albeit with mixed results. Available data indicate that the production of non-sugar crops has been unstable during the period 1994-1999 as some of the major crops recording an increase while others recorded decreased output. Production of cabbage has tended to increase over time while tomato and white potato production tends to fluctuate around 100,000 and 150,000 kgs per annum, respectively (Table 15). Production of onion, yams, pumpkin and watermelon has been showing a declining trend during the period.

**Table 15**

<table>
<thead>
<tr>
<th>St. Kitts and Nevis: Performance of Non-Sugar Production</th>
</tr>
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<tbody>
<tr>
<td>Tomato 100 81 109.0 97.3 52.5 90.0</td>
</tr>
<tr>
<td>Sweet pepper 23 13 17.5 16.0 22.5 13.0</td>
</tr>
<tr>
<td>Cabbage 114 68 56.0 124.9 68.0 149.0</td>
</tr>
<tr>
<td>Carrot 52 53 126.0 103.5 80.0 55.0</td>
</tr>
<tr>
<td>Watermelon 73 68 55.0 59.7 35.0 211.0</td>
</tr>
<tr>
<td>White Potato 219 150 102.0 162.0 173.0 211.0</td>
</tr>
<tr>
<td>Onion 115 128 132.0 41.7 55.0 37.0</td>
</tr>
<tr>
<td>Peanuts 15 22 57.3 60.0 48.0 41.2</td>
</tr>
<tr>
<td>Pineapple NA 24 25.5 33.0 40.0 25.0</td>
</tr>
<tr>
<td>Yam 52 48 68.0 72.4 2.9 4.5</td>
</tr>
<tr>
<td>Pumpkin 52 75 116.5 93.0 90.0 68.0</td>
</tr>
</tbody>
</table>

Source: Ministry of Agriculture St. Kitts

The fairly limited range and volume of non-sugar agriculture is also reflected in trade data, which reports virtually no exports of non-sugar agricultural commodities. Efforts at exporting
peppers during the mid-1990s were short-lived and unsuccessful. In fact, the inability of domestic agricultural production to meet some acceptable proportion of domestic consumption has gained the country as a net-food importer. Imports thus constitute the primary source of the bulk of food supplies for both the local population and the growing tourism sector. The Windward Islands are the main source of food crops, with the bulk of processed food products originating from non-CARICOM countries.

The livestock sub-sector is deemed to possess the largest area of market potential, and emphasis has been placed on dairy, beef, mutton, pork and poultry production. In the livestock sub-sector, output of broiler meat and pork production were reported to have increased in 1995, while mutton and beef declined. This growth pattern continued to 1997 for all livestock, except pork production, which decreased. Growth in this sub-sector is reflected in the positive and relatively high annual real growth over the 1995-1998 period.

About 92% of the farmers in St. Kitts operate farms of less than three acres. With the exception of sugar estates there has been no strong farming in St. Kitts. This, coupled with the geological constraints, has been a central factor explaining the lack of a strong agricultural base in St. Kitts and Nevis.

**Policies and Prospects**

The future of preferential arrangements for sugar are threatened by a number of factors:

- the 1993 Uruguay Round of GATT which called for the liberalisation of world agricultural trade;
- the internal harmonisation of the EU market;
- NAFTA which has resulted in a reduction in the US quota and
- EU and the developed world since they themselves are now the world’s largest producers. In this regard, under the EU preferential arrangements for sugar from the ACP states are likely to be terminated in 2002.

Moreover, the worldwide consumption of sugar is assumed to be declining because consumers are now becoming more health conscious. In 1992, under a World Bank’s Agricultural Development Support Project, a number of steps were taken to improve the financial viability of SSMC and to increase production and efficiency of the industry. Noted among these were the mechanisation of production and harvesting. Nevertheless, despite increases in production and revenue in 1997 the industry still remains unsustainable.

Against the backdrop of a declining sugar industry, which has the potential to adversely impact both the agricultural and manufacturing sector, and employment, the Government is urgently addressing the need to strengthen the industrial sector as part of the economic diversification programme. While there appears to be no definite policy regarding the future of the sugar industry, the government has undertaken to hold public discussions on the future of the
enterprise. This in part reflects the sensitive political economy nature of the sugar industry in the country.

There is the view in some quarters for diversification within the industry itself is a possible solution to its problem. One approach to internal diversification is to use sugarcane to produce commodities, such as, cardboard and animal feed. Another view supports the total eradication of the sugar cane industry and the utilisation of the lands for livestock, root crop production and urban development. Though it is still difficult to correctly predict the future present activities such as the retrenchment of workers and the development a housing scheme using sugar land suggests that the government is gradually moving to cease sugar production.

2. **Manufacturing Sector**

Over the 1990-1999 period, gross value added from manufacturing maintained a fairly constant 11.5% share of GDP (Table 16). However, if sugar manufacturing is included under agriculture’s contribution to GDP, then manufacturing GDP becomes more or less equivalent with agricultural GDP. In terms of employment opportunities, however, the manufacturing industries generate fewer employment opportunities than the agricultural sector, and in the enclave industries in particular, has established only limited linkages with the rest of the economy.

| Table 16 | St. Kitts Share and Growth Indicators, Manufacturing Sector |
|----------------------|--------------|------|------|------|------|------|
| Manufacturing in GDP % | 11.91 | 11.21 | 11.14 | 11.55 | 10.34 | |
| Sugar in Manufacturing GDP % | 15.81 | 15.48 | 14.90 | 20.45 | 17.86 | |
| Manufacturing GDP – Real growth % | 1.26 | 1.03 | 5.25 | 11.24 | -8.97 | |
| Sugar Manufacturing growth | 7.65 | 0.00 | 1.32 | 52.60 | -20.48 | |
| Other Manufacturing growth | -0.86 | 6.38 | 5.97 | 3.99 | -6.01 | |
| Real GDP Growth | 3.85 | 3.46 | 5.90 | 7.33 | 1.64 | |

Sugar manufacturing is the single largest industry in the manufacturing sector, averaging over 15% of all manufacturing activity. The other more significant manufacturing sub-sector is the electronics industries. In terms of real growth, the performance of the manufacturing sector over the 1990-1997 period was encouraging. This was due largely to growth in the sugar industry, which surged in 1997. The relationship between sugar and the manufacturing sector was clearly illustrated with a 20% decline in the sugar output being a major contributor to the 8% decline in the overall manufacturing sector. This situation was exacerbated by an overall decline in other manufacturing industries, by 6% from 1997. In fact, gross output of non-sugar manufacturing industries reported positive, albeit declining growth between 1995 and 1997. This performance, undoubtedly contributed to the maintenance of positive growth in the economy of St. Kitts during that period.
The Government of St. Kitts is committed to diversifying the economy and has had success with the development of light manufacturing industries. In fact, by the late 1980s, St. Kitts had the largest electronics assembly industry in the OECS, and by had developed a successful garment industry. In the mid-1990s, plans were initiated to develop the informatics industry with the development of new incentives package. By the mid-1990s, three fully developed industrial sites were operational to facilitate industrial development. In 1999, plans to establish a new site, on 20,239 acres is expected to provide a boost to industrial development.

Non-Sugar Manufacturing

Non-sugar manufacturing output has been growing with the establishment of the Paul Southwell Industrial Park in the 1970s. About twenty companies are presently operating in this area. There are nine (9) enclave firms employing about 1,500 workers and producing exclusively for the external market under the CBI initiative. Domestic firms, mainly engaged in agro-industrial activity, export within the CARICOM market. Available data (Table 17) show an increase of 53.8% in the value of non-sugar manufactures in 1999 relative to 1998. Manufacturing firms producing electronics and beverages also recorded an increase in output. Data on export are not available.

Table 17: Value of Non-Sugar Industrial Output Selected Years

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<tr>
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</thead>
<tbody>
<tr>
<td>Beverages</td>
<td>11.64</td>
<td>10.21</td>
<td>16.0</td>
<td>15.55</td>
</tr>
<tr>
<td>Bakery Products (food)</td>
<td>8.24</td>
<td>1.88</td>
<td>3.8</td>
<td>0.75</td>
</tr>
<tr>
<td>Electronics</td>
<td>45.00</td>
<td>33.39</td>
<td>11.72</td>
<td>23.18</td>
</tr>
<tr>
<td>Clothing</td>
<td>31.50</td>
<td>1.55</td>
<td>NA</td>
<td>0.82</td>
</tr>
<tr>
<td>Other</td>
<td>0.18</td>
<td>0.04</td>
<td>13.53</td>
<td>28.34</td>
</tr>
<tr>
<td>Total</td>
<td>96.56</td>
<td>47.07</td>
<td>44.64</td>
<td>68.65</td>
</tr>
</tbody>
</table>

There are a number of factors affecting non-sugar manufacturing output in St. Kitts. Labour cost is considered higher than in most OECS countries. The government of St. Kitts has established a minimum wage of EC$160.00 per week for the sector and efforts are underway to raise that level. However, the average wage in the sector is about EC$270.00 per week and this can be much higher in the enclave industries where there has always been a shortage of labour. While there is no minimum wage legislation in Grenada, wages in the sector average EC$200.00 per week. The existence of such uncompetitively high wages was a significant factor in the closure of an enclave firm in late 1998.

The cost of utilities (in particular electricity) is considered high relative to countries like Grenada and St. Lucia where the consumption rates per KW/H are EC$47.5 and EC$39.2 respectively. Supply has not been consistent over the years, in spite of recent efforts to increase supply. Water supply is adequate but the quality is poor which affect production cost and output of those firms that use water as a major input. Rents, however, are comparatively low.

While transportation costs in St. Kitts are considered low due to the proximity of the international airport and the good quality of the roads, port charges and freight are considered
exceptionally high. This seems to affect export competitiveness of domestic producers who market regionally. High freight and port charges may also provide a possible explanation for the non-successful implementation of Article 56 of CARICOM. It has been reported that goods produced in the OECS are receiving competition from extra-regional producers.

**Constraints to the Development of Manufacturing**

The manufacturing sector in St. Kitts-Nevis operates under several constraints. These include:

**Finance.** Although large firms have access to foreign finance or can attract local financing quite easily, indigenous firms face great difficulties in accessing finance. The commercial banks have a penchant for short term less risky lending and hence lend more for mercantile activities, rather than for manufacturing and agriculture. The percentage of loans to the personal and distributive sectors account for more than 60% of loans outstanding while the manufacturing sector receives less than 10%. Moreover indigenous firms do not have the requisite expertise in the conceptualisation of projects and presenting them to commercial banks as projects for financing. Neither do the commercial banks have the expertise to assist in this type of activity.

In addition, the high cost of finance in the face of high price elasticities of consumer demand, regional trade and payments problems, excess production capacity, primitive technology, deficient technical skills, unreliable transport and quality of raw materials all constrain the development of the sector.

**Technology and technical skills** are two other sources of concern in spite of St. Kitts’ superiority among the OECS countries in this area. The rapid pace of technological development worldwide hastens the obsolescence of capital and erodes the competitiveness of less technologically dynamic countries. The high cost of upgrading capital and the inadequacy of technical capability to speed up the transfer and diffusion of technology retards the export competitiveness of the firms. Hence their inability to penetrate extra-regional markets and even its ability to hold on to domestic markets. The paucity of technical training results in wastage of raw materials, inadequate maintenance leading to loss of production during down times, and the need for foreign technical assistance to diagnose and solve some very simple problems.

**High labour costs.** St. Kitts and Nevis is by no means a low wage area. Higher remuneration in the tourism sector has tended attract workers away from manufacturing. Labour cost is considered higher than in most OECS countries. The government of St. Kitts has established a minimum wage of ECS$160.00 per week for the sector and efforts are underway to raise that level. However, the average wage in the sector is about ECS$270.00 per week and this can be much higher in the enclave industries where there has always been a shortage of labour. The existence of such uncompetitively high wages was a significant factor in the closure of several enclave firms in the late 1990s.

**Inadequate transportation links.** The paucity and reliability of transportation links is another constraining factor. Sea transport is not only scarce but sometimes unreliably. At time cargo from the other OECS countries is routed through Miami. In addition, the cost of sea transport is not significantly lower than air transport which is usually more reliable. In spite of the shortage
of scheduled passenger services St. Kitts and Nevis is in the enviable position of having fairly adequate dedicated cargo space. For many years there was a twice-weekly dedicated jet service for cargo out of Miami with connections to New York. This service has recently been upgraded daily except on weekends. The reliability of air cargo service has attracted number of firms in the enclave sector particularly in the manufacture of electronic components. While transportation costs in St. Kitts are considered low due to the proximity of the international airport and the good quality of the roads, port charges and freight are considered exceptionally high. This seems to affect export competitiveness of domestic producers who market regionally.

**The size of firms and local market.** As mentioned earlier, most of the manufacturing firms in the country employ less than 20 employees. This limits the ability of the firms to reap economies of scale and spread overheads. Moreover the majority of indigenous firms are contented to produce for protected local markets which are extremely small. The markets are protected by the CARICOM CET and in some cases by Article 56 of the CARICOM treaty¹.

**The regulatory framework for businesses.** The regulatory and legal framework in which business operate may have impeded the development of the manufacturing sector. The process by which projects are approved is too long and circuitous. In addition, there is the perception that the process favours foreign investment over local investment. Some regulations and legal requirement tend to impede the flexibility of the firms.

**The effects of protection.** The protection accorded by the CET along with an incentive regime which treats production for the local market and production for export in the same way create an anti-export bias. There is no incentive to produce for the more competitive, more risky export market, while production for the protected local market is quite profitable. The reduction in the CET would tend to redress this bias to some extent but specific incentives have to be put in place to encourage production for export. However the regime of quantitative restrictions is being considered for phasing out via a process of tariffication which would initially increase the import duty.

**Fiscal charges.** The size of the country and the inadequacy of transportation links already impose severe disadvantages on the countries in terms of their ability to compete internationally. Thus it is essential that no inordinate charges are imposed to prevent the firms from sourcing their inputs at international prices. Additional charges like high port charges impose further restrictions the ability of the firms to compete internationally. The consumption tax on inputs which is not rebated on export goods creates a disadvantage for firms in St. Kitts-Nevis vis-à-vis their CARICOM counterparts whose exports are zero-rated under the VAT.

**Non-tariff barriers in export markets.** The existence of non-tariff barriers in the export markets especially the USA has tended to impede the growth of manufacturing exports. Exports from St. Kitts-Nevis face a myriad of regulations which only experience in the markets can help to get around. Many firms are seeking ISO and other international certification to facilitate entry into international markets. Although the greater transparency under the new WTO rules may

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¹ Article 56 allows the less developed CARICOM countries to impose quantitative restrictions and suspend origin treatment for goods of the more developed countries in an effort to develop the manufacturing sector in the less developed countries.
have reduced the uncertainty of entry, many indigenous firms may be unable to finance the cost of the barrage of legal challenges, which they may face in these markets.

**Knowledge of export markets.** The paucity of knowledge about export markets is another significant obstacle to export development. Basic information regarding the structure of markets, changes in taste, import regulations in the foreign country, appropriate technology, new processes, new products and potential competitors has to be assembled. Market intelligence is a costly exercise for the individual producer and there are also externalities associated with this activity. This suggests the need for co-ordinated action at the OECS level. The activities of Export Development and Agricultural Diversification Unit (EDADU) are aimed at reducing some of these difficulties, but the organisation remains largely under-funded and suffers from a lack of clear commitment and strategic focus. In addition tapping into international producer and market information networks would reduce significantly the cost of gathering market intelligence.

The cost of utilities (in particular electricity) is considered low relative to countries like Grenada and St. Lucia where the consumption rates per KW/H are EC$47.5 and ECS39.2 respectively. Supply has not been consistent over the years, in spite of recent efforts to increase supply. Water supply is adequate but the quality is poor which affect production cost and output of those firms that use water as a major input. Rents, however, are comparatively low.

**Policies and Prospects**

With regards to non-sugar manufacturing activities, St. Kitts benefits from the incentive schemes existing for other OECS countries. As such many of the programmes for the development of the manufacturing sector in other OECS countries can also be applied in St. Kitts. However, there is need for greater institutional support for the manufacturing sector in St. Kitts. Unlike the other OECS, the Manufacturing Association in St. Kitts functions not as an independent body, but rather as an arm of the Chamber of Industry and Commerce. While the Association has sub-groups that discuss issues of relevance to the industry, decision taking is delayed, as the Association has limited autonomy in own decision-making.

There is need to increase public awareness of role of the manufacturing sector in the island. The sector needs to be promoted as a viable option in the country’s development and as a viable and profitable income and investment opportunity. Public awareness can also take the form of buy local campaigns to increase domestic consumption and viability of domestic firms given the small size of the domestic market.

**TOURISM**

The latter part of the 1980’s was a period of rapid growth in the tourism industry in St. Kitts and Nevis. Stay-over visitor arrivals grew on average by 11.2% to 66,247 during 1986-89 (Table 7). Cruise ship passengers also experienced rapid growth of 10.2% to 37,151. During this period visitor expenditure also grew rapidly by 14.7% to $92.6m. Hotel room capacity also increased during this period.
The completion of the Four Seasons Resort in Nevis during 1990-94 further added to room capacity and facilitated the increase in stay-over visitor arrivals during this sub period. As the tourism product matured in addition to a worldwide recession in the early 1990’s stay-over visitor arrivals slowed to 5.8% 84,525. Meanwhile cruise ship passenger arrivals rose on average by 27.3% to 71,349. Total visitor expenditure continued to grow during this period by 14.3% to $169.3m.

The passage of a number of natural disasters commencing with hurricanes Luis and Marilyn in 1995 and Georges in 1998 resulted in serious damage to economic and social infrastructure. Additionally a number of floods were experienced by the destination during this review period. Most of the major resorts experienced considerable damage during these hurricanes and affected the normal marketing and promotion of the industry. Consequently stay-over visitor growth declined to less than 1% but was partially offset by cruise ship passengers that grew on average by 12.0%. The cumulative impact of these natural disasters was a decline in visitor expenditure growth to less than 1%. The economy has become to depend on tourism as the lead industry with the services penetration index increasing from 1.5 during 1986-89 to 2.6 during 1990-94 and declining slightly to 2.2 during 1995-98. The decline in the latter years reflects the disruption of the natural disasters on the performance of service exports.

The USA maintained its market share over all sub periods. This share increased from 39.3% during 1986-89 to 45.9% during 1990-94 and declined slightly to 44.2% by 1995-98. The Canadian market ranked second in importance during 1986-89 at 15.8% but has lost its position over time to the Caribbean which has emerged as the second most important market for stay-over visitors. The market share of the Caribbean has increased over time from 11.3% during 1986-89 to 30.2% during 1995-98. The hosting of a summer music festival since 1996 contributed to the increased influx in visitors from the Caribbean region. Visitors from the UK have consistently increased their market share from 6.6% during 1986-89 to 11.1% by 1995-98.

St. Kitts-Nevis has been bedevilled by the problem that faces most small destinations, that of the interaction between airlift and the number of hotel rooms. In a country where the number of hotel rooms is small (1500) it is impossible to attract any major airline to put on a scheduled service since the number of rooms would be insufficient to generate the required amount of traffic. On the other hand hotel chains are reluctant to build because of the lack of airlift. The problem was solved in the past by resorting to back-to-back charters to fill the hotel rooms. However, the authorities seem to have been able to break out of the circle since an additional 1000 rooms are under construction by two hotel chains and more seem to be in the offing. With an increase in the hotel rooms they country may soon reach the critical mass required to attract scheduled jet service.

**Contribution to GDP**

The tourism’s relative contribution to real GDP has remained relatively stable at around 8.0% during both 1986-89 and 1990-94 (Table 8). The passage of several hurricanes in the 1995-98 period however resulted in a decline in real value added to 7.0%. Real GDP growth mirrored growth in stay-over visitor arrivals over the three sub periods. It grew on average by 14.0% during 1986-89, by 8.2% during 1990-94 and decline to −1.3% during the 1995-98 sub-period.
Again the negative real growth reflected the adverse impact of natural disasters on the economic activity within the industry.

**Role of Foreign Direct Investment**

In the early stages of the evolution of the tourism industry, FDI flows into the economy were substantial and represented 16.3% of GDP during 1986-89 (Table 9). These inflows accounted for 13.8% of GDP by 1990-94 and leveled off at 12.0% of GDP by 1995-98. Major projects during 1986-89 included the Jack Tar Village and the commencement of the Four Seasons Resort in Nevis.

FDI inflows into the economy accounted for 16.7% of total inflows into the currency union during 1986-89 but declined during 1990-94 to 12.4%. St. Kitts and Nevis’s share of inflows however rose to 14.0% with the construction of Golf View, Paradise Resort and the extensions to Royal St. Kitts Resort during the 1995-98 period.

The role of land sales increased over all sub periods linked to the construction of up market vacation homes, condominiums and establishment of a number of resorts.

**Constraints to Tourism**

The tourism industry has been constrained by inadequate number of flights do the destination. Despite having a modern airport that could accommodate large commercial aircraft arrivals to the territory are facilitated through either hubs in Antigua or Puerto Rico. The addition to plant capacity by the construction of a number of resorts in the Frigate Bay area will influence future flight schedules to the destination.

Human resource development in the areas of management, customer service and quality chefs must form part of the strategic development of the industry. Similarly, the failure to attract FDI inflows into the South East Peninsula lowers the rate of return on the considerable infrastructural investment in that area since 1989. This area offers by far the greatest potential for additional development in upscale resorts within the destination.

**CONSTRUCTION**

**Recent Economic Developments**

The construction sector grew at a robust 17.4% and contributed 11.9% to total real GDP during 1986-89. During this period both private and public sector construction was buoyant. In the public sector construction activity centred on the economic and social infrastructure including the commencement of the South Eastern Peninsula Road. In the private sector there a number of hotel expansion projects in the Frigate Bay area, the construction of factory shells at the industrial site and the expansion of the telecommunications system.

Despite increasing its relative share of real GDP at 12.9% during 1990-94, growth in construction slowed to 2.6% with the completion of a number of large public sector projects.
Although private sector activity was sustained by residential and commercial construction, activity was affected by the completion of the Four Seasons Resort in Nevis.

The construction sector increased its relative share to real GDP 13.7% during 1995-98 and grew at a faster pace at 7.7%.

**TRANSPORTATION**

The transportation sectors relative contribution to real GDP has ranged between 7.6% to 8.0% over the three sub periods of analysis. The period 1986-89 demonstrated the highest levels of growth at 11.4% while average real growth during 1990-94 and 1995-98 ranged between 4-5%. Road transport accounted for the largest share of the relative contribution to the transportation sector. Sea transportation ranked second, followed by air transport.

The highest periods of growth in the sector mirrored overall economic activity within the economy. During the 1980’s the tourism industry recorded its highest levels of growth. In response to the robust performance of service exports, investment in vehicles was substantial. During the 1990’s with a slow down in the performance of the export sector the sector as a whole recorded moderate growth.

**COMMUNICATIONS**

The liberalisation of basic telecommunications under the General Agreement on Trade in Services (GATS) signed in 1997 has unleashed a wave of competitive pressures which has resulted in a spate or international mergers, as formerly protected national telecommunications companies scramble to position themselves to be players in the global market. No doubt this development has forced the monopoly provider of telecommunications services in the Organisation of Eastern Caribbean States (OECS) countries to soften its stance and agree to renegotiate its contract with five of the independent OECS countries\(^2\). Many of these contracts date well into the new millennium.

At the same time, technological advances in the telecommunications industry is threatening to create a glut of bandwidth internationally that would force the price of telecommunications services to near zero levels. These advances are taking place at all three critical points in telecommunications networks, i.e., international/long distance carrying capacity, switching gear and the local loop. Cost reduction in the local loop is critical for 75.0 to 80.0% of the cost of a call consists of the cost of the link in the last couple of miles. About two thirds of the assets of telephone companies is invested in this segment hence making them a candidate for natural monopolies.

The reform of the telecommunications sector in St. Kitts Nevis began in 1998 with the privatisation of the telecom services. The telecommunications reform occasioned by the re-negotiation of the

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\(^2\) Five of the independent OECS countries are involved in a World Bank financed project to reform the telecommunications industry. The five countries are Dominica, Grenada, St Kitts-Nevis, St Lucia and St Vincent and the Grenadines.
licenses and continued advances in technology will usher in major changes in the industry for which the country needs to be prepared.

**Recent Performance**

The communications sector in the absence of a vibrant tourism sector is by far the most important source of FDI inflows into the territory. This sector’s relative contribution to real GDP has increased from 5.6% in 1986-89 to 9.7% during 1995-98. Real GDP growth was highest during the 1986-89 period with substantial investment in telecommunications infrastructure. Given, the increasing role of reinvested earnings over time real GDP growth was sustained in the 1990’s averaging 7.1% and 8.9% over 1990-94 and 1995-98 respectively.

Telecommunications is already the fastest growing area in St. Kitts and Nevis and its increased contribution to GDP has largely offset the decline in the contribution of agriculture in recent years. Over the period 1977 to 1998, the contribution of agriculture to GDP declined from 18.4% to 6% while the contribution of communications have grown from 1.4% to 10.4%. Hence any prices stimulus that increases demand and hence the equilibrium quantity of telecom services would be adding to an already dynamic leading sector. In examining the effect which the reform process would have on the GDP for St. Kitts and Nevis, it is important to recognise the role which telecommunications play in economic development. In doing so, it is imperative that one examines the sector’s contribution to GDP over a given period of time.

St. Kitts and Nevis like the other OECS countries which have a comparative advantage in the provision of services. The information infrastructure is the pillar on which many of these services are delivered. Therefore, the fall in the cost of international and regional communications which liberalisation of the telecommunications sector is expected to achieve, will in fact increase the potential for trade in services and consequently improve the regions value of services produced. As was mentioned earlier, expansion in areas such as the informatics industry would have a positive impact on the regions Gross Domestic Product.

**FINANCIAL SERVICES**

**Offshore Financial Services**

The term Offshore Financial Services refers to a variety of activities which take place between corporations registered in a country with residents in the rest of the world with little interaction with domestic residents. It is rather limiting for offshore financial services does not accurately describe the range of activities undertaken in these centres and may also limit the scope of opportunities considered when one is trying to visualise the future development of the industry. A more accurate descriptor would be International Business Facilitation Centres. Not only does this nomenclature cover the wide range of services provided by the offshore sector, it also makes for a much neater classification of the activities and would ultimately assists in resolving some of the ticklish regulatory issues, since different types of activities do not necessarily need the same level of regulation.
The offshore sector was developed to provide services which are normally provided in the domestic economy at lower cost or under a less demanding regulatory environment. Thus, all of the activities which take place in the offshore sector have counterparts in the domestic economy and it is quite natural that any such classification would be equally applicable to the offshore sector. The International Monetary Fund along with the other international institutions has recently revised its classification of financial institutions and this framework can be useful in the development a taxonomy of International Business Facilitation Services (IBFS).

The IMF Classification divides corporations/enterprises into five mutually exclusive sectors, Households, General Government, Financial Corporations, Non-financial corporations and non-profit institutions. IBFS are concerned with Financial Corporations and Non-financial Corporations and the bulk of the activity is concerned with the former.

The offshore Services Sector in the OECS territories is currently at varying stages of development ranging from Antigua and Barbuda which is the most established, dating back to 1982 and St. Lucia where the legislation was passed in 1999 (see appendix I). The oldest offshore centre is St. Vincent and the Grenadines which had offshore banking and ship registry legislation enacted in 1976. However the activities, promoted by the St. Vincent Trust Authority Limited based in Liechtenstein have not really taken off. The legislation was modernised in 1996 to give the sector a new lease on life. The most dynamic centres are Nevis and Anguilla which have recently passed modern legislation which have created fiscal consumer products which are on the leading edge of the industry.

The legislation of most of the OECS countries is patterned on that of the British Virgin Islands which is reputed to be one of the most successful emerging offshore financial services centres. The sector is usually exempt from all forms of corporation taxes in the jurisdiction of incorporation. These include income taxes, corporate taxes, capital gains taxes, inheritance taxes, withholding tax, other indirect taxes levied on international business activity. Offshore activities are also exempt from indirect taxes such as stamp duties and customs duties. Government revenue from these activities is generated by modest licence fees. A variety of products are offered but countries seem to be operating in specific niches as shown in appendix I.

Several opportunities exist for the countries in the ECCB jurisdiction to develop offshore financial centres. The opportunities can be discussed under seven broad categories:

**Tax Advantages** - Individuals of high net worth and multinational corporations are attracted to offshore jurisdictions because of the many tax advantages they offer. These jurisdictions offer legitimate deferment, reduction or avoidance of taxes on certain profits earned abroad. Most of the OECS countries have chosen to be no tax jurisdictions. This factor makes them attractive to external investors as possible tax havens. However, this non-tax situation may make these offshore jurisdictions reluctant to enter into bilateral double taxation agreements with other nations because the initial benefits are not always apparent. These bilateral agreements do however have certain distinct advantages for the developing financial services provider jurisdictions. Some of the benefits may be that the home country provides the developing host offshore jurisdiction with avenues for resolving disputes, procedures for exchanging information
regarding drug abuse and other illegal activities, favourable tax treatments for residents or companies organised under signatory laws.

**Product Development** - Offshore financial product and laws can be viewed as fiscal consumer goods. The range of legal products offered can be as broad as the jurisdiction so desires and spans the fields of banking, brokerage and other "traditional" financial services, immigration and nationality, manufacturing and general law services. Emerging jurisdictions are advised that the more readable, and understandable the laws, the more saleable is the jurisdiction. Putting the appropriate legislation in place is a therefore a necessary, albeit not sufficient, condition for the development of the offshore sector. Jurisdictions have to be vigilant to ensure that their legal products always remain on the leading edge of the industry.

**Niche Positioning** - Since it may not be possible or advisable for an emerging centre to simultaneously develop the full range of financial services to the same degree, countries should seek to develop niches and therefore position themselves and gain an international advantage. In the development of a niche profile countries should seek to render quick, efficient and professional service, and be innovative in meeting the needs of a niche clientele in a changing and dynamic environment. It is advisable for emerging centres to develop niches and to seek to gain an international advantage in a particular segment of the market. This strategy may, however, prove difficult to pursue given that other more established and resourceful jurisdictions are competing to diversify into new and different products.

**Marketing and Promotion** - A continuous marketing and public relations programme is necessary to support the legislation in place.

**Private-public Sector Co-operation** - Other successful Caribbean jurisdictions have identified the need to have co-operation between the private sector professionals and government officials.

**Communications Technology** - Private banking and other financial services increasing utilise high technology communications systems and electronic payments systems, which offer opportunities for emerging centres to compete globally. Moreover an offshore jurisdiction cannot compete effectively if it does not offer twenty-four hour online searches and registration.

**Supervisory and Regulatory System** - Those jurisdictions with effective systems for supervision are increasingly the choice of reputable institutions and individuals. The threats of money laundering and other illegal activities require that countries put in place a competent and efficient regulatory system.

Among the major challenges facing the offshore industry in the OECS are the following:

**Limited Professional Expertise** - To attract desirable investors OECS countries must have in place an infrastructure accompanied by highly trained professional accountants, bankers, taxation specialists and legal experts.
Telecommunications and Air Transportation - The cost of telecommunication service in the region is generally regarded as high and in some cases prohibitive. The irregularity or unavailability of international flights also inhibits efficient travel services.

Regulation and Supervision - Unregulated or inadequately regulated financial services centres pose a threat to global financial stability. Hence the need for new regulatory standards for their operation. The new regulatory standards will constrain growth of new centres due to increased financial and human resources requirements. At the same time the need for a good reputation should ensure that laxity in regulation frameworks is not encouraged.

Financial Liberalisation in Developed Markets - In the 1980's many of the regulations which encouraged institutions to move offshore were dismantled as developed countries have liberalised and deregulated their economies. New threats are always emerging from the anti-tax haven posture of the U.S Government and new laws are being continuously passed which serve to restrict the development of offshore centres. The recent threat by the OECD countries on harmful tax competition follows in this same vein. Such challenges are likely to increase in the future. It is therefore incumbent on newly-emerging offshore centre like the OECS countries to maintain the highest standard of regulation and propriety.

In spite of these constraints the offshore sector provides significant opportunities for economic diversification. The global offshore sector is growing at a rapid pace propelled by the growth in the world economic wealth. Countries embarking on this path however need to remain cognisant of the many responsibilities they face to uphold the integrity of the financial system.

OFFSHORE FINANCIAL SERVICES IN ST. KITTS-NEVIS

The financial services industry has emerged as a potential source of government revenue in recent years. Although the industry is in its early stages of development the Federation emerged as the market leader in the cumulative number of registered International Business Companies (IBCs) within the currency union. The number of IBCs rose from 9,753 in 1997 to 13,814 in 1998. Nevis accounted for over 98.0% of all incorporations in the Federation. Difficulties in the implementation of the automated company on line registration network (ACORN) in Anguilla in addition to adverse publicity surrounding the industry in Antigua and Barbuda have in part facilitated the growth in the number of registrations. In addition the development of the industry commenced in the mid 1980’s allowing for sufficient market exposure in the marketing and promotion of the jurisdiction.

The offshore financial services sector in Nevis grew up largely independent of that in St. Kitts. The Sector was launched in 1984 with the Nevis Business Corporation Ordinance. The Jurisdiction has since widened the choice of services offered to include Exempt Trusts, Limited Liability Companies and Offshore Banking. There are over 50 service providers registered in Nevis. In the year 2000, Nevis separated the marketing and promotion functions from regulatory and supervision. The Offshore Banking Legislation was amended to make the Eastern Caribbean Central Bank to supervisor. A joint task force was established with St. Kitts that drafted legislation to establish a Regulatory Commission, a Financial Intelligence Unit and comprehensive ant-money Laundering legislation.
The Offshore financial services sector was launched in St. Kitts in 1997 with the enactment of legislation governing companies limited by guarantee of shares, Limited Liability Partnerships and Trusts. At the same time, the Financial Services Regulation Order was introduced, which sought to regulate offshore financial services in both St. Kitts and Nevis. This generated much controversy as the Nevis financial services sector had operated autonomously up to that point. In recent times the two jurisdictions have cooperated on critical issues relevant to the development of the sector.

In 1998 Government revenue was estimated at $5.6m in registration fees from IBC maintenance and incorporation. This revenue represented 2.3% of current revenue and 8.5% of non-tax revenue. Revenue increased to $6.5m and $7.7m in 1999 and 2000 respectively. Most of this was collected in Nevis.

Most of the financial services are intermediated through Service Providers (usually a local law firm), which provides a second source of revenue and foreign exchange earning to the country. Some employment is created but this is minimal. Some institutions are required to maintain a physical presence in the country and the rents and expenditure by the expatriate workers are additional sources of foreign receipts. Local spending by the firms that maintain a presence in the Federation, rental of office space and well-paid high-end employment are other benefits of the sector.

The major threat to the sector is the listing of the jurisdiction by the OECD. However, the country has begun addressing some of the concerns raised with respect to the regulatory framework so that it accords with international best practice. Addressing these concerns are critical to the success of the sector in contribution to the diversification of the economy.

### St. Kitts-Nevis

**Government Revenue from Offshore Financial Services**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Economic Citizenship</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Offshore Banking</td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IBCs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internet Gaming</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exempt Trust</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exempt Insurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management Companies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other Services</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,754</td>
<td>3,954</td>
<td>5,600</td>
<td>6,510</td>
<td>7,720</td>
</tr>
</tbody>
</table>

* Includes revenue for Nevis only.

Source: Ministry of Finance
**Domestic Financial Services**

During 1986-89 banking sector assets grew on average by 9.5% to $401.9m. During this sub-period loans accounted for 55.0% of total assets. Net foreign assets of the banking system grew at an average 22.6% to $62.2m reflecting relatively liquid conditions. There was increased growth in assets of 12.4% during 1990-94 to $647.5m. However as liquidity conditions tightened, net foreign assets grew on average by 5.0% to $74.6m. This momentum was sustained during 1995-98 at 12.4% growth while the stock of assets stood at $1,113.6m. Renewed inflows of FDI in addition to claims from reinsurance resulted in a faster growth in net foreign assets of 22.4% to $122.0m.

Domestic credit grew rapidly during the 1986-89 period (21.2%) consistent with overall economic expansion. Net credit to central government and credit to the private sector grew by 19.7% and 22.4% respectively. By 1990-94 there was slower pace in the expansion in domestic credit in line with lower overall economic growth. Domestic credit grew by 8.7% while credit to the private sector grew by 13.5%. Net credit to Central Government declined during this period. By 1995-98 domestic credit increased its rate of growth from the previous period to 9.6%. Net credit to Central Government accelerated by 27.1% while credit to the private sector rose by 7.9%. Net credit to Central Government reflected the need for rehabilitation and repair of social and economic infrastructure after the passage of a number of hurricanes during the 1995-98 period.

**Structure and Financial Data of the St Kitts & Nevis Banking System**

<table>
<thead>
<tr>
<th>FINANCIAL INSTITUTIONS</th>
<th>No.</th>
<th>Total Assets</th>
<th>Loans</th>
<th>Deposits</th>
<th>Loans/Assets</th>
<th>Deposits/Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>$M</td>
<td>$M</td>
<td>$M</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>6</td>
<td>1,471.4</td>
<td>969.2</td>
<td>1,114.7</td>
<td>65.9</td>
<td>75.8</td>
</tr>
<tr>
<td>Non-Bank Financial Institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Development Banks*</td>
<td>1</td>
<td>54.2</td>
<td>49.3</td>
<td>-</td>
<td>91.0</td>
<td>-</td>
</tr>
<tr>
<td>Credit Unions*</td>
<td>4</td>
<td>29.8</td>
<td>23.5</td>
<td>25.0</td>
<td>78.9</td>
<td>84.1</td>
</tr>
<tr>
<td>Insurance Companies/Agencies</td>
<td>10</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>National Development Foundations</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Finance Companies</td>
<td>1</td>
<td>36.0</td>
<td>26.1</td>
<td>22.8</td>
<td>72.5</td>
<td>63.3</td>
</tr>
<tr>
<td>Building &amp; Loan Associations</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

*Most Recent Data - December 1999
### Offshore Companies

<table>
<thead>
<tr>
<th>Type of Institution</th>
<th>St Kitts Number</th>
<th>Nevis Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Insurance</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Trusts</td>
<td>1</td>
<td>24</td>
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<tr>
<td>IBC’s</td>
<td>-</td>
<td>15,894</td>
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<tr>
<td>Exempt Companies</td>
<td>-</td>
<td>363</td>
</tr>
<tr>
<td>Internet Gaming</td>
<td>48</td>
<td>-</td>
</tr>
<tr>
<td>Economic Citizens</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Registered Agents</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Limited Liability Companies</td>
<td>2,159</td>
<td>-</td>
</tr>
</tbody>
</table>

Total monetary liabilities (M2) grew on average by 20.3% during 1986-89 due in part to the strong performance of the tourism industry this sub period. Additionally FDI equity inflows related to the tourism industry were substantial during this period. With slower growth in the tourism industry during 1990-94 M2 grew by 8.7%. This rate of growth was also sustained during 1995-98 at 8.8% due to the disruptive effect of a number of hurricanes on the hotel plant and on economic and social infrastructure in general. Savings deposits accounted for the majority of quasi money throughout all sub periods.

### TRADE LIBERALISATION

St. Kitts and Nevis is simultaneously taking part in a number processes of trade liberalisation. The first results from the deepening of the CARICOM Integration movement, which has resulted in a phased reduction of the CET. At the same time the country is participating in a number of international negotiations which would lead to freer trade. These include the FTAA, the post Lomé IV, the millennium round of the WTO and a number of CARICOM sponsored trade liberalisation negotiations.

### STATUS OF CET

As part of the regional integration movement and towards the structural adjustment of the economies of the CARICOM countries, a common external tariff was adopted for implementation in 1991. The tariff was later reviewed in the light of developments in the international economic environment with greater emphasis on trade liberalisation and competitiveness as well as the formulation and expansion of regional economic groupings. A number of factors were taken into account in formulating policies for the new tariff structures:

- differences in the levels of development of member states;
- differences in their industrial structures;
- their respective exchange rate regimes;
- the nature of their fiscal regimes;
- their respective administrative capabilities.
These factors determined the principles guiding the design of the new tariffs:

i. international competitiveness;

ii. efficient production for the regional market;

iii. the preservation of government revenues;

iv. controlling inflation so as not to increase the price of basic foods and social services;

v. duty exemptions regime should be reduced/removed so as to foster uniform treatment of production inputs across the common market;

vi. there should be uniform rates for the same items notwithstanding their economic use;

vii. the special needs of the LDCs should be taken into account;

viii. the tariff structure should be simplified with fewer rate bands with less room for discretionary application.

The phasing of implementation of the new common external tariff for the OECS was as follows:

<table>
<thead>
<tr>
<th>Date Range</th>
<th>Rate Bands</th>
</tr>
</thead>
<tbody>
<tr>
<td>January – June, 1993</td>
<td>0 – 5% to 30/35%</td>
</tr>
<tr>
<td>January – June, 1995</td>
<td>0 – 5% to 25/30%</td>
</tr>
<tr>
<td>January – June, 1997</td>
<td>0 – 5% to 20/25%</td>
</tr>
<tr>
<td>January – June, 1998</td>
<td>0 – 5% to 20%</td>
</tr>
</tbody>
</table>

St. Kitts and Nevis implemented Phase II of the CET in 1993 without significant loss of revenue. An estimated loss of $0.5 million was more than compensated for by improvements in customs administration and a marginal shift of trade towards non-CARICOM imports which brought in an additional $2.0 million.

St. Kitts and Nevis has not moved beyond Phase II. It has, however, requested a study of the implications of further adjustments, including a final move to Phase IV. The study is to take account of revenue and price effects given the tendency to windfall profits on the part of distributors that tend to nullify the beneficial effects of demand elasticity that normally follows tariff reductions.

**Trade Liberalisation Negotiations (FTAA & WTO)**

St. Kitts and Nevis is to conduct negotiations on trade liberalisation through the Regional Negotiating Machinery established by CARICOM to represent the interest of the region at WTO and FTAA.
Although St. Kitts and Nevis has not moved beyond Phase II of the CET implementation programme, its experience with tariff reductions on the limited scale required by CARICOM has been favourable. Price elasticity of demand and a slight diversion of trade towards third country imports has more than compensated for any direct revenue loss that might have occurred.

However, trade liberalisation on a global scale takes on much greater significance as far as the fiscal situation of St. Kitts and Nevis is concerned. As mentioned above the fiscal situation has deteriorated in 1998. The fiscal regime needs strengthening both on the revenue and the expenditure side. In this situation there are a number of factors to be taken into account in moving towards complete trade liberalisation. Among them are:

- the importance of import duties as a share of total recurrent revenue;
- the deficiencies in the current fiscal regime;
- the market structure of the import trade and its response to changes to border prices;
- possible contraction in the economy arising from negative sector response to external competition which could have an impact on revenue generating capacity.

Import duty amounts to 15.8% of total recurrent revenue. St. Kitts and Nevis dependence on international trade, measured as a proportion of taxes on international trade to total recurrent revenue, is 36.4%. Even if it were practicable to shift the burden on to other taxes, for example, the consumption tax, the magnitude of the adjustment required could create difficulties for domestic prices and the competitiveness of domestic production. The problem is even more critical given the tendency for firms to take windfall profits from tariff reductions rather than pass on the benefits to consumers.

Moreover, while price elasticity of demand could stimulate short term increases in the volume of imported goods and keep the revenue buoyant, they could also reduce demand for import substitute goods and cause the domestic economy to contract in the long term unless exchange rate adjustment complements fiscal adjustment. But given the high import content of domestic production, especially import substitute goods, any gains from exchange rate adjustments would at best be marginal.

The net effect could be a fall in demand and contraction in both the economy and government revenues.

The programme of reform indicated above should help to strengthen the fiscal regime to better withstand the shock of trade liberalisation. Extensive support may be required in the design and implementation of the programme of changes required to the tax system, the government wage and employment strategies and the management of the budget.

While it is not possible at this time to estimate the time scale and cost of such a programme, the sequencing should allow for the strengthening of the tax and budgetary systems before the major thrust towards trade liberalisation and should be done in two distinct phases as follows:
1. A comprehensive reform of the tax system and further review of the budgeting system together with a strategic review of the public services towards achieving a satisfactory and sustainable level of budgetary savings and investments.

2. A phased approach towards the implementation of tariff elimination so as to minimise disruptions to revenue flow.

In order to address the latter the following simulation exercise of the effects of tariff reductions was conducted.

TRADE AND REVENUE EFFECTS OF CET

The Common External Tariff (CET) represents an attempt by CARICOM countries to promote industrialisation in the region and to harmonise their trade policies as a first step in meeting the challenges of global competition and trade liberalisation. The CET proposes that all CARICOM members should apply common tariffs on imports from non-CARICOM countries. Starting in 1993, the CET was to be implemented in four phases.

By the end of the last phase, which was adopted for implementation by 1998, all CARICOM countries should have the following CET rates (on non-CARICOM imports) in place: (1) a 0-5% import tariff on non-competing, primary, intermediate, and capital inputs; (2) a 10% tariff on competing primary inputs and capital goods; (3) a 15% tariff on competing intermediate inputs; (4) a 20% tariff on non-competing final goods; and (5) a 20% tariff on garments, general manufactures and agro-industry commodities. For most CARICOM countries to meet the requirements of the CET, they would need to decrease import tariffs on some items and increase it on others. Declines in imports arising from tariff rate increases may suggest the extent to which CARICOM production is being substituted for non-CARICOM imports. On the other hand, tariff rate decreases imply loss of tariff revenues that member countries may need to make up for by increasing non-CET import taxes.

This study analyses the effect of changes in CET rates on OECS tariff revenues, and non-CARICOM agricultural imports. OECS imports were grouped in accordance with seven CET rate brackets: 0%, 0-5%, 5-10%, 10-20%, 20-30%, 30-45%, and >45%. The analysis will help OECS policy planners to anticipate, in the presence of CET rate changes, the extent to which CARICOM production would substitute for non-CARICOM imports, and the amount by which non-CET import taxes would have to rise to keep net import tax revenues unchanged. To conduct the analysis, the study employed a simulation exercise in which the CET rate on non-CARICOM agricultural imports was increased by 5, 10 and 15%. Next, CET rates were adjusted to ensure that commodities in each rate group faced a CET rate of 100%.

For the purposes of this exercise, the CET rate increases and adjustments were applied only to commodities that fell within the CET rate brackets of >20% (20-30%, 30-45%, > 45%). The study assumes that non-CARICOM imports entering the OECS face symmetric unitary import demand elasticities. The elasticities are symmetric in that a given percentage increase or decrease in CET rates (or in import prices) would produce the same magnitude of change.
In 1997, OECS (excluding Antigua) imports of agricultural commodities from non-CARICOM countries amounted to $232.62 million. About 54% of these imports faced no import tariffs, 21.4% faced import tariffs of 5% or less, 4.9% faced rates ranging between 5 and 10%, 4.2% faced rates between 10 and 20%, and another 15% faced tariff rates in excess of 20%. Over $15 million in CET revenues were collected, representing 41% of all import taxes. Commodities falling in the >20% rate groups accounted for a disproportionate 80% of the CET revenues.

The simulation results suggest that the CET rate increases on commodities in the >20% rate groups would cause imports to fall, CET tariff revenues to rise, and the resulting decline in imports would cause non-CET import tax revenues to decline. However, increases in CET revenues would more than offset non-CET revenue losses. For example, a 10% increase in the CET rate would cause OECS imports to fall by 1.2%, CET revenues to rise by 15.3%, or $2.40 million, and net import tax revenues to rise by 6%, or $2.25 million.

**ST. KITTS AND NEVIS:**

St. Kitts and Nevis imported $29.5 million worth of agricultural commodities from non-CARICOM countries in 1997, an increase of 8.7% from 1996. The share of these imports facing import duties of less than 5% increased from 55 to 57%. On the other hand, the share of the >20% rate groups fell from 22 to 20%. Both CET and non-CET import tax revenues increased over the two-year period such that total trade tax revenues rose by 30% from $5.4 million to $7 million. Among the imports that fell in the >20% rate groups, the 20-30% rate group accounted for 78.7% of these imports and 73.1% of corresponding CET revenues. In comparison, the 30-45% rate group accounted for 20.3% of these imports and 24.5% of CET revenues. On the other hand, imports associated with the >45% rate group represented less than one% of imports and only 2.3% of tariff revenues.

Between the two years, 1996 and 1997, the average tariff rate of the 20-30 and 30-45% rate groups changed only slightly, however, for the >45% rate group the average tariff rate decreased significantly from 75 to 63%. A 5% increase in CET rates among the >20% commodity rate groups would cause imports to fall by 0.8%, CET revenues to rise by 8.4%, and net import tax revenues to increase 2.6%, from $7 million to $7.2 million. Similarly, a 10% CET rate increase would induce a 1.6% decline in imports, a 15.9% rise in CET revenues and net import taxes would increase by $337 thousand, a 4.8% rise.

For a 15% CET rate increase, imports would fall by 2.4%, while CET and net import tax revenues would rise by 22.5 and 6.7%, respectively (Fig. 4.a). On the other hand, imposing a CET rate of 100%, would lead to an 11.8% decline in imports, but CET and net import tax revenues would rise, respectively, by 34.1 and 3.8%. These results are depicted in Figures 5.a and 5.b. The 20-30% rate group accounted for the largest share of the decline in imports and the rise in tariff revenues, while the 100% tariff imposition was the simulation scenario that produced the greatest effect. Other results indicate that the simulation exercises caused the average tax rate of the 20-30% rate group to increase from a base level of 25% to 36% when the tariff rate was increased by 15% (Fig. 5.b). Similarly, the average tariff rate associated with the 30-45% rate group rose from 33 to 43% and that of the >45% group increased from 63 to 71%.
SIMULATIONS OF A REDUCTION IN TRADE TAXES

This section proposes to analyse the impact on the fiscal accounts, the sequential reduction in tariff rates based on trade liberalisation. The basis of the exercise is premised on a given set savings investment balance of the economies in question. By how much would indirect taxes have to increase in order to maintain this balance. The adjustment is therefore entirely fiscal and consistent with the economic foundations of the Eastern Caribbean Currency Union. Given the limits placed on the degree of Central Government borrowing from the monetary authorities, there is a binding constraint on governments’ ability to monetise their deficits. This adjustment is further reinforced by the choice of nominal anchor whereby the exchange rate is pegged at a fixed rate to the United States dollar. Given our degree of openness the economies of the Currency Union have been heavily dependent on taxes on international trade and transactions as a major source of revenue. This degree of dependence increases the vulnerability of the economies to shocks arising from increased trade liberalisation. The likely establishment of Regional Economic Partnership Arrangements (REPAs) under the new Lomé 5 protocol and accession to the Free Trade Area of the Americas (FTAA) will alter tariff rates among the membership in these regional trading blocks.

Member countries of the Currency Union therefore must take a proactive and anticipatory stance in mitigating the costs of adjustment arising during the transitional period.

The One Country, Two Sector, Three Good (123) Model

This model refers to one country with two producing sectors and three goods. The sectors are the traded and non-traded goods sectors while the goods produced are the export good, a domestic good and an import good. The three agents involved in the model are a producer, a household and the rest of the world. There are a total of twenty equations and two accounting identities. Five equations describe the underlying relationships that generate real flows. Six explain price relationships. Four describe nominal flows while the remainder describe equilibrium or market clearing conditions. These market-clearing conditions state that supply must equal demand and that the balance of trade constraint must be satisfied. The model does not assume that all tradables are perfect substitutes with domestic goods. The model is static and does not yield a dynamic solution but a one period result based on the type of shock that is selected.

TRANSMISSION MECHANISM OF A REDUCTION IN TARIFFS

One of the key assumptions underlying the model is imperfect substitution between tradables and non-tradables. This assumption enables deviations from the law of one price which is standard in classical trade theory. By relaxing the assumption of perfect substitution between traded and non-traded goods the model reflects the body of empirical evidence that indicates that changes in the price of imports and exports are only partially transmitted to the prices of domestic goods. Product differentiation of both imports and exports given the level of aggregation permits an extension of the Salter Swan model and gives rise to normally shaped offer curves. All domestic goods that are not exported are effectively treated as non-tradables (semi-tradables). Another
key assumption in the model is the small country assumption whereby the country is a price taker in both import and export markets.

In this model, consumers consume a composite good (Q) that is comprised of imports (M) and domestic good (D). Relatedly all income is spent on the composite good to satisfy the equilibrium condition that the value of goods demanded must equal aggregate expenditure. The desired ratio of imports to the domestic goods is a function of relative prices for a given degree of substitution. This allows for the relative demand functions to be linearly homogeneous of degree zero thus mitigating issues of “money illusion”.

When the import tariff rate is cut this changes the relative price of imports to the domestic good. Imports become cheaper and there is a real appreciation of the exchange rate. There are two effects that arise: the income effect and the substitution effect as imports become relatively more attractive. For a given propensity to import consumers maximise utility by consuming more of the import good as real income is now higher. For most developing countries such as those of the currency union the income effect is likely to dominate given low elasticities of substitution. Both exports and the domestic good will be more expensive relative to imports.

In the simulation the constraint that the overall savings investment balance should remain the same is imposed. The simulation basically asks the question how much would sales tax/value added tax or excise tax revenues have to be raised in order to ensure revenue neutrality. The current revenue has three components related to (a) tradable sector; (b) non-tradable sector and (c) overall income. Revenue is therefore a function of the product of the import tariff rate times the real exchange rate times the value of imports plus the product of the sales/excise/value added tax rate times value of demand for the composite good plus the product of the direct tax rate times total income. Hence when the import tariff rate is cut it, the income effect results in more imports hence the quantity effect dominates the price effect for a given propensity to import in the revenue function. The second effect is traced through the sales/excise or value added tax rate as it is applied to demand for the composite good which is comprised of both imports and domestic goods. The sales or excise tax provides a compensatory mechanism that ensures that the savings investment balance is maintained for a given cut in the import tariff rate. Walras’ Law ensures that the sum of the price-weighted excess demands summed over all markets must be zero.

SIMULATIONS

The simulations were based on a 25.0%, 50.0% and 100.0% reduction of import tariff rates in the face of increasing trade liberalisation. The method of adjustment assumed was internal based on a change in the tax regime. It was assumed that given the reliance on trade taxes for most revenue that indirect tax rates would have to change in order to maintain the existing savings investment balance. The indirect taxes could take the form of a sales tax or some other form of indirect tax on consumption. The baseline year chosen was 1998.

The degree of dependence on trade taxes in St. Kitts and Nevis have declined from an average of 49.1% per year in the 1980’s to 39.4% in the 1990’s. The passage of a number of hurricanes in
the 1990’s that led to the granting of concessions in the rehabilitation of the economy may explain this trend. This category of taxes accounted for 11.9% of GDP in the 1980’s but this ratio declined to 10.0% of GDP by the 1990’s.

The degree of revenue buoyancy was 0.68 in the 1980’s when GDP growth was on average much higher than in the 1990’s. Trade tax elasticities during the same period was 0.41. During the 1990’s revenue elasticity rose to 1.72 due to discretionary increases in trade taxes in the latter part of the 1990’s. The trade tax elasticity for the same period was 1.53.

### St. Kitts and Nevis Revenue and Trade Tax Elasticities

<table>
<thead>
<tr>
<th></th>
<th>1980-98</th>
<th>1980's</th>
<th>1990's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1.72</td>
<td>0.68</td>
<td>1.72</td>
</tr>
<tr>
<td>Trade Tax</td>
<td>1.57</td>
<td>0.41</td>
<td>1.53</td>
</tr>
</tbody>
</table>

In evaluating the impact of tariff reform on the fiscal accounts, the simulations explored a 25%, 50% and 100% in the reduction of the average tariff rate. The results indicate that given the lower degree of reliance on trade taxes in comparison to the other member countries of the ECCB, indirect taxes (sales tax) would have to be increased to yield approximately 2.3% of GDP with a 25% reduction in the tariff rate. With a 50.0% reduction indirect taxes would have to be increased to yield 4.7% of GDP. For full liberalisation indirect or sales taxes would have to be raised to yield 11.1% of GDP.

### St. Kitts and Nevis Simulations

<table>
<thead>
<tr>
<th>Tariff Rate</th>
<th>Indirect Tax Rate Per Cent GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>25% reduction in Import Tariff</td>
<td>2.3</td>
</tr>
<tr>
<td>50% reduction in Import Tariff</td>
<td>4.7</td>
</tr>
<tr>
<td>100% reduction in Import Tariff</td>
<td>11.1</td>
</tr>
</tbody>
</table>
### Table 6: St. Kitts and Nevis Baseline Indicators

<table>
<thead>
<tr>
<th></th>
<th>EC$M</th>
<th>1998 Baseline Per cent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Market Prices</td>
<td>778.68</td>
<td></td>
</tr>
<tr>
<td>Consumption</td>
<td>617.81</td>
<td>79.3</td>
</tr>
<tr>
<td>Private</td>
<td>461.98</td>
<td>59.3</td>
</tr>
<tr>
<td>Public</td>
<td>155.8</td>
<td>20.0</td>
</tr>
<tr>
<td>Domestic Saving</td>
<td>160.9</td>
<td>20.7</td>
</tr>
<tr>
<td>Investment</td>
<td>337.36</td>
<td>43.3</td>
</tr>
<tr>
<td>Imports of Goods</td>
<td>451.7</td>
<td>58.0</td>
</tr>
<tr>
<td>Exports of Goods</td>
<td>130.13</td>
<td>16.7</td>
</tr>
<tr>
<td>Current Account</td>
<td>-119.95</td>
<td>-15.4</td>
</tr>
<tr>
<td>Av. Tariff Rate /1</td>
<td>0.191</td>
<td></td>
</tr>
<tr>
<td>Current Revenue</td>
<td>236.57</td>
<td>30.4</td>
</tr>
<tr>
<td>Trade Taxes</td>
<td>86.1</td>
<td>11.1</td>
</tr>
<tr>
<td>Current Expenditure</td>
<td>233.78</td>
<td>30.0</td>
</tr>
<tr>
<td>Current Account Balance /2</td>
<td>3.41</td>
<td>0.4</td>
</tr>
<tr>
<td>Overall Balance</td>
<td>-49.49</td>
<td>-6.4</td>
</tr>
</tbody>
</table>

1 /Defined as the ratio of Trade Taxes to Imports of Goods  
2 /Denotes Current Account After Grants

### LIBERALISATION OF TRADE IN SERVICES

The international obligations of St. Kitts-Nevis for the liberalisation of trade in services are related to its commitments under the GATS and Protocol II amending the CARICOM treaty. The commitments under Protocol II represent advancement on the GATS hence this section begins with a discussion of the GATS.
**COMMITMENTS UNDER GATS AND TRADING ARRANGEMENTS**

The general objective of the GATS is to develop a set of rules that would foster increased transparency, consistency, certainty and non-discriminatory norms and regulations in the governance of trade in services. The services not covered by the agreement pertain to transportation and airline services. With regards to modes of supply four specific mechanisms apply as follows:

1. Cross border supply;
2. Consumption abroad;
3. Commercial presence; and

The Most Favoured Nation (MFN) principle under the GATS dictates that trading partners whether with the Free Trade Area of the Americas (FTAA) or the Regional Economic Partnership Agreements (REPA) of the EU. Albeit temporary exemptions may be allowed for transitional purposes. The principle of National Treatment dictates that once a foreign entity supplies a service to WTO member country then there should be no discrimination between this entity and a local one.

St. Kitts and Nevis has made commitments under GATS for the following services:

1. Communication services, specifically electronic mail, voice mail, on-line information and data processing not including telefax;
2. Financial services, specifically offshore companies and trust not including insurance companies and banks;
3. Tourism and tourism related services;
4. Recreational, cultural and sporting services; and
5. Transport services.

In the above five areas limitations to market access pertain to horizontal commitments are specific to commercial presence and presence of natural persons. In the case of commercial presence, foreign service providers must incorporate or establish locally in conformance with the regulatory requirements with the St. Kitts and Nevis Commercial Code. The acquisition of property by foreign entities is enshrined within the Alien Landholding Act which stipulates the need for a license. St. Kitts and Nevis reserves a number of small business service opportunities for nationals. With respect to movement of natural persons every person who is not a national of St. Kitts and Nevis is required to obtain a valid work permit if employment is sought in the territory.
Communication Services

There are no limits to market access with respect to the following value-added electronic services, e-mail, voice mail and on-line information and data processing. The latter is however unbound with respect to presence of natural persons except as indicated in the horizontal sections. There are no limitations on national treatment in the areas of cross-border supply, consumption abroad, commercial presence nor presence of natural persons.

Financial Services

Commitments under financial services are specific to the registration of offshore and trust companies. Under both limitations to market access and national treatment there are no restriction on cross-border supply and consumption abroad. However with regards commercial presence, this is subject to the International Business Companies Act of 1992 and the Nevis Business Corporation Ordinance 1984. Licensing is facilitated through a local registered agent who is either practicing accountant or lawyer.

Tourism and Tourism Related Services

Specifically hotels and restaurants are unbound with respect to cross-border supply in the areas of market access and limitations on national treatment. There are no limitations on consumption abroad. However in the area of commercial presence the construction of hotel plant is limited to those in excess of 50 rooms. Foreign entities are also subject to withholding tax. The presence of natural persons is also unbound with the exceptions indicated in the horizontal sections i.e. work permit and immigration regulations.

Recreational and Sporting Services/Transport Services

With regards to entertainment services there are no limitations to market access for cross-border supply and consumption abroad. A specific limitation to commercial presence is the proviso that the foreign entertainer may be required to employ national artists. The presence of natural persons is however unbound and subject to work permit and immigration regulations. There are no limitations to market access for sporting services other than the presence of natural persons is unbound.

The major limitations to market access for ship registrations are under commercial presence. Specifically the Merchant Shipping Act 1985 facilitates the registration of ships in St. Kitts and Nevis. The Director of Maritime Affairs with the following requirements effects registration:

(a) wholly owned by citizens of St. Kitts and Nevis;

(b) bodies corporate established under the laws of St. Kitts and Nevis; and

(c) and ships regardless of the nationality of the owners is sea-going ship of 1600 or more net register tonnes and is engaged in foreign-going trade.
The presence of natural persons is also unbound with exception of work permit and immigration requirements

**LIBERALISATION OF TRADE IN SERVICES IN CARICOM**

If the CARICOM regime of free trade in services is to have meaning, it must provide for a greater level of liberalisation than is implied by the current bindings of the countries under the GATS. Protocol II amending the Treaty of Chaguaramas provides the framework for the regime of free trade in services. However, in its current form Protocol II provides a statement of intentions and the elements of the regime will only be clearly defined when the implementation schedule is adopted.

Protocol II provides for Rights of Establishment, Provision of Services and the Movement of Capital. Article 35 provides for a standstill on restrictions to the rights of establishment and for member states to notify the Council for Trade and Economic Development (COTED) of the existing restrictions. It also provides for establishment of criteria to safeguard these rights. The Article also addresses the abolition of restrictions on the right of establishment on a phased basis. It also establishes a consultative mechanism for the establishment of a programme for the abolition of restrictions on right of establishment in progressive stages. COTED would identify the activities to which rights of establishment shall not apply; establish the conditions under which it would be achieved and the stages and time frames for the removal of restrictions. Article 35 also provides for access to land and buildings, free movement of skills, the treatment of monopolies and the mutual acceptance of certificates and other evidence of qualifications.

Article 36 provides for a standstill and the progressive removal of restrictions on restrictions on the provision of services within the community. It also mandates COTED in consultation with the competent organs of the community to establish a programme for the progressive removal of restrictions on trade in services. The Article does not explicitly mention the various modes of provision of services, together with the Article 35 and Article 37 which deals with the movement of capital all four modes would be covered. However, the right to exclude certain financial services from the provisions of this Article is given to the Council for Finance and Planning (COFAP). As with the WTO certain government services are excluded from Protocol II. These include the operations of Central Banks or monetary authorities, national security and the maintenance of public order, social security and public retirement plans.

Protocol II provides a framework for free trade in services, by providing for a standstill on current restrictions and a progressive liberalisation of the existing restrictions. The nature of the regimes which emerges depends on the strength of the programmes established for the progressive removal of restrictions. If the current WTO commitments are anything to go by, member states would have to improve significantly these if the trade in services regime is to be meaningful.

The completion of a regime in services would unleash competitive effects similar to goods with a consequent reduction in the price of these services. Because the use of services especially financial services permeates all types of production (including services themselves), there is a further knock-on boost for all types of businesses using these services. Competition in the
provision of financial services can lead to the reduction in cost of credit if firms can raise their loans in other CARICOM territories. Similarly, the prices of insurance services can be reduced by increased competition.

CONCLUSION

The economic performance of St. Kitts and Nevis has been conditioned by adjustment to the passage of 5 hurricanes during the last six years. Hence growth during this period has been much less than 8.8% per annum achieved during the period 1986-1989. It is against this backdrop of slower growth rates that the economy must be repositioned in the face of the changes in the international environment.

The competitiveness studies suggest the country has export competitiveness in sugar production, margarine, fish and beverages. Among the OECS countries, St. Kitts has significant potential in the area of manufacturing. In particular the country has done well in the area of export of electronic components. However, like most of the rest of the manufacturing sector it has developed under protective arrangements and would need to stand the test of a competitive environment.

The survival of some firms in the manufacturing sector may be doubtful without the protective arrangements. In this regard the authorities may need to allow the least efficient firms to exit the sector in an orderly manner while providing support to those firms that have the potential to be export competitive. A package of assistance would need to be provided to these firms and may include, finance and technical assistance in product development, factory layout, marketing etc. Given the tight budgetary constraints facing the country and the expected loss of revenue from trade liberalisation it may be necessary to access the required resources from external sources.

The Federation of St. Kitts and Nevis like member territories of the Organisation of Eastern Caribbean States invests heavily in health and education. The investment in human capital is critical to future economic transformation in a knowledge-based environment. The ongoing investment in economic infrastructure and its maintenance is a pre-requisite for the future economic of services. Telecommunications reform will offer the opportunity to tailor this medium to the specific developmental needs of the territory. It would afford the development of education services through distance learning. It would also afford small to medium size companies a cheaper platform for communication with the rest of the world.

St. Kitts and Nevis has a long tradition in public companies that have an issued share capital of $235m or 29.1% of the total issued share capital within the currency union. There is also a well-developed treasury bill market. The advent of the Eastern Caribbean Securities Exchange (ECSE) will afford secondary trading of these securities and ultimately primary issues. There is an opportunity for the development of additional financial products as part of a wider strategy of fostering growth in financial services. These include mutual funds and derivatives.

The tourism industry will continue to be the nucleus of all services but care has to be exercised in the choice of product. The cost and benefits of cruise-based tourism has to be evaluated given
St. Kitts and Nevis’ tax structure is broadly consistent with WTO standards. However, there are two areas where discriminatory practices occur. The variation in the application of the embarkation tax with a higher rate on non-nationals and the requirement for non-nationals to obtain and pay for an alien land holding license appear to be in violation of MFN principles enshrined in the WTO. The first can be corrected without significant loss of revenue. However, the deregulation of land transactions could have social implications in that price/demand forces could immediately alienate the poorer segment of the St. Kitts and Nevis community from lands urgently needed for basic shelter. A phased approach to deregulation to ensure the alleviation of the critical need for lower and middle-income housing is indicated.

Fiscal performance in St. Kitts and Nevis has suffered through frequent disruptions by natural disasters as well as high outlays on recurrent expenditure resulting form increased public service employment and generous wage settlements. High outlays on investment projects and declining concessional aid flows together contributed to a further deterioration in the fiscal account, with widening fiscal deficits and steep increases in debt and debt servicing costs.

Although revenue buoyancy has been relatively high, serious distortions and inefficiencies occur in the distribution of the tax burden. Incentives and concessions create further inequalities in burden sharing leading to non-compliance and rent seeking diversion of investment. Improvements to the tax code and in tax administration are needed to maintain revenue buoyancy on a sustainable basis.

Continued improvements are also needed to rationalise and control budgetary spending to help to increase fiscal savings. A widening of the savings/investment gap has resulted in unsustainable fiscal deficits and use of commercial borrowing. There is urgent need for a coherent medium term strategy that will inform budgetary allocations and lead to improvements in project selection and financing as to stem the growth in public debt and debt servicing costs.

As a prerequisite for moving towards further trade liberalisation, there should be a comprehensive fiscal reform including a restructuring of the tax system in order to simplify the tax code, shift taxes downstream from imports to expenditure, strengthen tax administration and improve efficiency in budget allocations and spending. Such reform will need considerable international support and a transition period that takes account of the institutional weaknesses that presently exist in St. Kitts and Nevis.

The study suggests that the market for services in St. Kitts is already characterised by significant liberalisation further liberalisation would benefit the country more than it would lose. Thus a negotiating strategy would move to further liberalise the services sector in exchange for concessions in agriculture. The study could not identify a case for the St. Kitts-Nevis as part of the OECS grouping to pursue a negotiating strategy that was different from the rest of CARICOM except in so far as the sequencing of adjustment measures and the transition period for liberalisation are concerned. Action to be taken and the transition period required are indicated in the Section on the Way Forward in the Overview.
Table 7: St. Kitts and Nevis Tourism Statistics

<table>
<thead>
<tr>
<th></th>
<th>Mean 1986-89</th>
<th>Mean 1990-94</th>
<th>Mean 1995-98</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stay-overs</td>
<td>66,247</td>
<td>84,525</td>
<td>85,917</td>
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<tr>
<td>Cruise ship Passengers</td>
<td>37,151</td>
<td>71,349</td>
<td>115,884</td>
</tr>
<tr>
<td>Stay-over growth</td>
<td>11.20</td>
<td>5.78</td>
<td>0.29</td>
</tr>
<tr>
<td>Cruise ship Passenger growth</td>
<td>10.23</td>
<td>27.34</td>
<td>11.95</td>
</tr>
<tr>
<td>Total Visitor Growth</td>
<td>9.22</td>
<td>14.41</td>
<td>5.84</td>
</tr>
<tr>
<td>Visitor Expenditure $ECM</td>
<td>92.63</td>
<td>169.27</td>
<td>187.65</td>
</tr>
<tr>
<td>Visitor Expenditure Growth</td>
<td>14.72</td>
<td>14.31</td>
<td>0.23</td>
</tr>
<tr>
<td>Service Penetration Index /1</td>
<td>1.54</td>
<td>2.57</td>
<td>2.17</td>
</tr>
<tr>
<td>USA Market Share</td>
<td>39.32</td>
<td>45.88</td>
<td>44.20</td>
</tr>
<tr>
<td>UK Market Share</td>
<td>6.58</td>
<td>7.84</td>
<td>11.14</td>
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<tr>
<td>Caribbean Market Share</td>
<td>11.31</td>
<td>15.07</td>
<td>30.22</td>
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<tr>
<td>Canadian Market Share</td>
<td>15.81</td>
<td>12.40</td>
<td>10.18</td>
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</table>

1/ Defined as the ratio of service exports to merchandise exports

Table 8. St. Kitts and Nevis Foreign Direct Investment (FDI) Profile

<table>
<thead>
<tr>
<th></th>
<th>Mean 1986-89</th>
<th>Mean 1990-94</th>
<th>Mean 1995-98</th>
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<tbody>
<tr>
<td>FDI as % of GDP</td>
<td>16.34</td>
<td>13.75</td>
<td>11.96</td>
</tr>
<tr>
<td>FDI as % of ECCB Inflows</td>
<td>16.68</td>
<td>12.43</td>
<td>14.1</td>
</tr>
<tr>
<td>Equity Share of FDI</td>
<td>30.38</td>
<td>4.81</td>
<td>27.19</td>
</tr>
<tr>
<td>Land Sales Share of FDI</td>
<td>15.11</td>
<td>41.67</td>
<td>46.99</td>
</tr>
<tr>
<td>Reinvested Earnings Share of FDI</td>
<td>13.39</td>
<td>12.67</td>
<td>20.73</td>
</tr>
<tr>
<td>Other Investment Share of FDI</td>
<td>41.12</td>
<td>42.53</td>
<td>5.1</td>
</tr>
<tr>
<td>Service</td>
<td>Contribution</td>
<td>Growth</td>
<td>Contribution</td>
</tr>
<tr>
<td>------------------</td>
<td>--------------</td>
<td>--------</td>
<td>--------------</td>
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<tr>
<td><strong>Tourism</strong></td>
<td>8.06</td>
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Table 10: St. Kitts and Nevis Savings Investment Profile

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(In% GDP Market Prices)

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