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

June 20, 2008

The following item is a Letter of Intent of the government of Grenada, which describes the policies that Grenada intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Grenada, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
St. George’s, Grenada
June 20, 2008

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Strauss-Kahn:

Since the approval of the PRGF arrangement in April 2006, the economy has continued its recovery from the devastating effects of Hurricanes Ivan and Emily. Our medium-term prospects appear bright, with a number of major tourism projects underway and others in the pipeline. These achievements have been possible thanks to the sacrifice and efforts of the people of Grenada, and with strong support from donors and creditors.

Our Letter of Intent and the Memorandum of Economic Policies (MEP) of March 21, 2006, requesting an arrangement under the Fund’s Poverty Reduction and Growth Facility (PRGF), outlined the government’s strategy under its home-grown medium-term reform program to enhance growth, alleviate poverty, maintain macroeconomic stability, and reduce vulnerabilities. While the broad objectives and policies for the duration of our economic program remain unchanged from those detailed in the MEP, we have further refined these policies in the context of this first review of the program.

We have made solid progress on fiscal measures, including introducing the politically difficult National Reconstruction Levy, adopting a flexible fuel pricing mechanism, and enhancing our efforts to collect tax arrears. All quantitative performance criteria for end-June 2006 were met, except for the performance criterion on the central government primary balance. As the result of pressing capital spending needs to complete the reconstruction and to achieve our developmental goals, capital expenditure exceeded the targeted level. As a result, this performance criterion and the indicative target on net credit to the public sector at end-June 2006 were missed. Accordingly, we request a waiver for the missed performance criterion. We have adopted a more realistic target for capital spending and tighter expenditure controls for 2008.

We have also made progress with our structural agenda on customs reform, the Public Sector Investment Program (PSIP), and transparency with respect to tax concessions. However, we have needed more time to enact new legislation regarding investment incentives in light of our recent experience with major projects and other policy issues which took time to clarify.

In regard to our aim to reduce vulnerabilities, we have taken steps to mitigate the risks posed by a small unregulated bank by appointing a receiver and are appealing the High Court’s
decision that the appointment of the receiver was unlawful. Notwithstanding legal obstacles, we are developing a plan to resolve the bank.

We have maintained our best efforts to complete the restructuring of our bilateral debt. We will continue good faith efforts to reach collaborative agreements with the few remaining nonparticipating commercial creditors.

The deterioration in Grenada’s terms of trade caused by higher world food and oil prices will raise the import bill significantly in 2008. To help facilitate the adjustment while addressing our additional balance of payments needs, the government requests an augmentation of access under the arrangement in an amount equivalent to SDR 1.46 million (12.5 percent of quota).

Grenada remains committed to the program, and the attached supplement to our MEP presents our policies for 2008 and beyond. These policies are designed to consolidate the gains we have made so far and establish the basis to maintain the growth momentum. Proposed quantitative performance criteria and indicative targets are indicated in Table 1 of the Supplementary MEP; the proposed structural benchmarks and performance criteria are indicated in Table 2. We are committed to working to achieve these program targets, including the fiscal targets. On this basis, the Government of Grenada hereby requests the completion of the first review under the PRGF arrangement and the release of the associated disbursement under the arrangement. Given the delay in completing the first review, we also request an extension of our PRGF arrangement by one year and a rephasing of remaining disbursements. We request the second disbursement, with the augmentation, of an amount equivalent to SDR 2.98 million.

The government will continue to provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies. The government believes that the policies and measures set forth in our previous MEP and the attached Supplementary MEP will achieve the program’s objectives. The government also stands ready to take additional policy measures as appropriate to ensure the attainment of these objectives. We will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEP, in accordance with the Fund’s policies on such consultations. The second review under the PRGF arrangement is expected to be completed by October 15, 2008 and the third review by April 15, 2009.

The government authorizes the Fund to make public the contents of this letter and the attached supplement to the MEP, as well as the accompanying staff report, to facilitate wider access to our policies and to signal the seriousness of our commitment to the program to civil society and the international community.

Yours sincerely,

/s/
Honorable Keith Mitchell
Prime Minister and Minister of Finance
SUPPLEMENTARY MEMORANDUM OF ECONOMIC POLICIES

1. Grenada has made important progress in implementing its economic program set forth in our Memorandum of Economic Policies (MEP) dated March 21, 2006. Our home-grown economic reform program continues to focus on promoting sustained high economic growth by improving the climate for private investment, putting public finances on a sustainable trajectory; reducing vulnerabilities; and alleviating poverty through more effective social development programs and safety nets. This supplementary MEP refines and updates these policies in the context of the first review of this program.

I. PERFORMANCE UNDER THE PROGRAM

2. Economic growth has rebounded and prospects are favorable. Real GDP growth increased to 4.3 percent in 2007, driven by tourism. Looking forward, several major tourism sector projects are coming on-stream. The external current account deficit narrowed during 2007, reflecting an increase in tourism receipts, underpinned by 9 percent growth in stayover visitor arrivals. Annual inflation has increased sharply to an annual average of 3.9 percent in 2007, reflecting the pass-through of rising world fuel and food prices.

3. We have introduced a number of fiscal reforms to strengthen revenue collection:
   - National Reconstruction Levy (NRL)—we introduced this politically difficult measure in 2006 as part of the effort of the Grenadian people to share the burden of filling the large financing gaps which emerged in the aftermath of the hurricanes. The NRL has been streamlined somewhat from that envisaged in our March 2006 MEP.
   - Automatic fuel pricing mechanism—we adopted this mechanism in October 2006, with adjustments of fuel prices every eight weeks and a specific tax of ECS$3 per gallon, taking advantage of falling international prices at the time to reduce the initial impact on the population. This approach allows us to isolate fiscal revenue from fluctuations in international oil prices.
   - Collection of tax arrears—we created a unit in Inland Revenue to focus on the collection of tax arrears that collected ECS$9 million during 2007.

4. The fiscal position nevertheless deteriorated in 2006, despite a delay in reaching agreement with public service unions on a wage increase, as a result of capital expenditure overruns. Capital expenditure needed for reconstruction and to achieve our developmental goals was much higher-than-anticipated. In view of these needs, the Cabinet issued special warrants to increase expenditure beyond budgeted levels. As a result, the end-June 2006 performance criterion on the central government primary balance and the indicative target on the change in net credit of the banking system to the public sector were missed by about 1.2 percent and 0.5 percent of GDP, respectively. Moreover, the overall deficit for 2006 increased to 6.4 percent of GDP (8.2 percent based on below-the-line

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1 In 2007, we revised GDP upward to incorporate the contribution of St. George’s University, the largest private employer in Grenada. The revision for 2006 was an increase of 7 percent. All GDP ratios below reflect this upward revision.
financing data) compared with 1.9 percent under the program. Ultimately, this additional expenditure had to be financed with unsustainable sources, in particular, overdrafts and the drawdown of bank deposits.

5. **Fiscal slippages continued into 2007.** The overall deficit was 8.5 percent of GDP in 2007 (8.0 percent of GDP below the line), despite delay in reaching agreement on a public service wage path. This compares with a deficit of 2.4 percent of GDP in the 2007 budget. The slippages largely reflect maintaining capital expenditure notwithstanding a substantial shortfall (4.7 percent of GDP) in grants. The shortfall in grants (mostly capital grants) stemmed from: implementation difficulties; overestimation of funds expected in 2007 from a multiyear project; and EU grants held up by delay in completing the first PRGF review. Financing the higher-than-expected fiscal deficit required a drawdown of deposits and partial drawdown of a new EC$25 million syndicated loan facility from the five banks operating in Grenada. We were able to reduce expenditure arrears by EC$19 million.

6. **We have taken measures to improve control of expenditure commitments.** Procedures are now in place for the Ministry of Finance to review proposals for additional spending before they go to Cabinet, thereby strengthening the ministry’s oversight over the budget process. In addition, the Cabinet changed its policy in January 2008 in order to limit use of special warrants.

7. **While some progress has been made with our structural reform agenda, we have nevertheless experienced some delays in the implementation of our structural benchmarks for the first review** (see text table).

- **Several structural benchmarks have been met:** We have initiated work to strengthen planning and implementation of the Public Sector Investment Program, with assistance from the Caribbean Development Bank (CDB). We have also initiated comprehensive reforms to the Customs Administration, contracting PricewaterhouseCoopers to assist with this effort. In addition, starting in September 2006, information on all new concessions has been made available on the web site of the Grenada Industrial Development Corporation (GIDC). Agreement with public service unions on the 2006–08 wage path was delayed by their concerns on the measurement of inflation; we reached agreement in January 2008 with public service workers except teachers, who account for 38 percent of the wage bill.

- **However, other structural benchmarks have not yet been met:** To strengthen the environment for investment, we intend submit to Parliament legislation to repeal the current incentives legislation and to amend the Income Tax Act over the course of this year. We have, however, granted tax holidays on five occasions: (i) a request for a tax holiday was made in 2005 by a local hotel undergoing extensive reconstruction in the aftermath of the hurricanes, but was only addressed in April 2006; and on the
basis of the regional competition for large investments, (ii) tax holidays were subsequently granted in 2006 for Port Louis, in 2007 for the Mt. Hartman (based upon a 2004 agreement) and Levera projects, and in 2008 for the Century project (based upon a 2003 agreement).

8. **Looking ahead, the outlook is favorable.** Economic growth is projected to remain fairly strong at 3.7 percent in 2008, stimulated by the initiation of several major private sector tourism projects. Our plans, as outlined below, should ensure that our fiscal program for 2008 is in line with debt sustainability and fully financed in a sustainable manner.

9. **We remain committed to engaging our external commercial creditors in good faith negotiations.** In February 2007, we issued a press release inviting the few remaining nonparticipating creditors in the debt exchange to come forward and accept the terms and conditions offered to other commercial creditors. We have signed bilateral rescheduling agreements under the Paris Club Agreed Minute with Belgium, France, the United Kingdom, and the United States, and are in contact with the Russian Federation to reach agreement on rescheduling terms. We are in negotiations with the Export-Import Bank of Taiwan Province of China to resolve a lawsuit filed against Grenada related to outstanding debt.

### II. POLICIES DURING 2008

#### A. Fiscal Policy

10. **Our 2008 fiscal program targets an overall deficit of 4.1 percent of GDP.** This deficit, along with appropriately prudent fiscal policy in the coming years, will accommodate capital expenditure needed to complete the reconstruction and address pressing development needs, while allowing us to reach our debt target of 60 percent of GDP by 2018, two years ahead of the revised ECCB benchmark date. We will need to reduce capital expenditure relative to the approved 2008 budget to ensure that the fiscal program is financed in a sustainable manner, while reducing expenditure arrears.

**Spending**

11. **Capital expenditure will fall from the unusually high levels in 2006 and 2007—18.8 percent and 13.7 percent of GDP respectively—to 9.6 percent of GDP in 2008.** This decline reflects completion of the new cricket stadium financed by China in 2006 and the gradual completion of the reconstruction effort. We are committed to achieving our fiscal targets, primarily by reducing capital expenditure below the currently budgeted ratio of 13.6 percent of GDP. This will require exerting tight control over expenditures after last year’s large overrun (see below). This targeted level of capital expenditure would be lowered further, however, if grants or divestment proceeds fail to materialize as projected. Conversely, this level could be raised if grants, concessional financing, or divestment proceeds were greater than currently projected. If divestment proceeds exceed the projected amount, we would use half of the additional financing to lower our debt.

12. **We have identified specific contingent measures to reduce spending if needed to meet our targets.** These include limiting grants and subventions while protecting transfers to vulnerable groups, improved targeting, and further rationalizing capital spending.
13. **The 2008 budget provided room for an increase in public sector wages in line with inflation.** As noted above, in January 2008, we reached agreement with public service workers (except teachers) unions on a wage path for 2006–08 in line with inflation and intend to reach agreement with teachers on the same terms. The budget also incorporates lump sum payment of retroactive increases for 2006 and 2007, which will be paid by August 2008. We have commissioned a pay and grade study, financed by a grant from the CDB, to examine options for bringing the pay of public servants in line with that of the private sector, with a report expected by August 2008. We will seek agreement on a wage path for 2009–11 that is in line with inflation.

**Revenues**

14. **We have delayed introduction of a VAT until after elections, which are due by April 2009.** The January 2007 VAT White Paper announced a rate of 15 percent, with a special rate of 10 percent for hotels. Once we have set a date for VAT implementation, a number of preparatory measures will be needed, including preparing facilities for the VAT staff and operations, passing VAT and Excise Tax Laws, recruiting staff, upgrading relevant IT modules, and adopting transitional procedures for bonded warehouses.

15. **We will continue to employ the automatic fuel pricing mechanism adopted in October 2006, which incorporates adjustments every eight weeks.** This new price mechanism allows us to delink fuel tax revenues from fluctuations in international prices. The new mechanism has been fully implemented since October 2007. We will ensure that domestic fuel prices will continue to be revised every eight weeks in line with changes in international prices.

16. **We have recently created a unit in Inland Revenue focused on the collection of tax arrears.** This unit is expected to collect about EC$12 million during 2008 and will also guard against the accumulation of further arrears in the future. The Ministry of Finance is also taking steps to improve the collection of nontax arrears, including dividends, licenses, and rent.

**Fiscal reforms**

17. **We have drafted a new Investment Act that will provide capital write-offs rather than tax holidays and ensure a transparent nondiscretionary process for granting tax concessions.** The delay in submitting this legislation to Parliament reflected the need to clarify several policy issues. In particular, we decided to grant additional tax holidays as noted above that were already in the pipeline, and to make the new regime available to all eligible investments rather than only those above a threshold. Following final drafting by the Ministry of Legal Affairs and Cabinet approval, the legislation will be submitted to Parliament by December 2008.

18. **We have gained significant momentum with customs reforms.** We prepared a comprehensive business plan for customs reform in February 2008. The key elements of this plan are a fraud control plan, improving customs systems and procedures, upgrading information technology, and reducing customs clearance times. By September 2008, we will
sign a memorandum of understanding on information sharing between Inland Revenue and Customs, and adopt a Fraud Control Program (benchmark). The ASYCUDA computer system, which had been out of service since the hurricanes, resumed operation in February 2007. With the assistance of the World Bank, we plan to move to ASYCUDA World by end-2009, which will improve the interface between Customs and IRD. We are also taking measures to reduce customs clearance from 4 to 1½ days over the next three years.

19. **We will enhance our in-house capability to prioritize capital expenditure.** The CDB has provided training to staff from the Ministry of Finance and line ministries to strengthen our implementation of our Public Sector Investment Program (PSIP) and plans to provide us with further technical assistance to increase our capability to evaluate projects. We will utilize our strengthened capacity in implementation of the PSIP process during the preparation of the 2009 budget.

20. **We will continue to enhance our control over expenditure commitments.** We reduced unpaid claims from EC$47 million (3.1 percent of GDP) at end-2006 to EC$28 million (1.7 percent) at end-2007 and intend to reduce these arrears by half by end-2008. To control expenditure, the Ministry of Finance will carefully review proposals to increase spending before they go to Cabinet and strictly apply the new policy limiting special warrants. In addition, we will ensure that the approval of the Public Tender Board chaired by the Ministry of Finance is obtained for any tender over EC$100,000.

21. **We will complete the cadastral survey in August 2008 as a basis for reassessing the value of property.** Because the last assessment was in 1994, a move to market valuation could raise substantial revenue without changing rates. Based on a sales analysis, we have established average land and property values by region. We will enact a law to allow Inland Revenue to adjust valuations between cadastral surveys. The new valuations would be applied beginning January 1, 2010.

22. **We will redouble efforts to improve fiscal transparency.** We will disseminate quarterly information on the overall fiscal situation and gross financing needs starting July 2008, and publish information on public enterprise finances. In line with the new Public Financial Management Act of May 2007, we will require public enterprises to submit audited financial statements four months after the close of the financial year, as required by law. We remain committed to ensure that all expenditures are reported on the budget. Recruitment of new staff and training for the Audit Department is underway. We will continue to publish newly granted or extended tax concessions.

**Financing**

23. **Our revised fiscal program for 2008 is now fully financed in an sustainable manner.** In light of our aim to achieve debt sustainability and reduce vulnerabilities, we will refrain from use of nonconcessional external financing (performance criterion) and avoid reliance on the overdraft facility or arrears. We will clear or restructure remaining EC$10.9 million arrears on unrestructured domestic debt to the nonbank public by end-2008.
24. **We plan an ambitious divestment program for 2008 which will allow us to reduce public and publicly guaranteed debt from 112 percent of GDP at end-2007 to 106.5 percent at end-2008**. We received EC$27 million (1.5 percent of GDP) in January 2008 from the sale of land for the Four Seasons project and expect the remaining EC$50 million (2.8 percent of GDP) at the end of the year or in early 2009. We have also announced plan to sell two-thirds of our shares in Cable and Wireless to the public in two equal lots, the first of which is expected to yield EC$50 million. The timing and terms of the second lot would depend on the experience with the first lot.

25. **We began importing diesel fuel under the PetroCaribe Agreement in October 2007, via a new state-owned company PetroCaribe Grenada Ltd.** Based on May 2008 oil prices, this Agreement could provide concessional financing on the order of 2.5 percent of GDP per year. In light of Grenada’s high public debt levels, we will ensure that this additional financing is managed conservatively and does not contribute to concerns about debt sustainability. In particular, PetroCaribe Grenada will set aside in a special account (invested in interest-bearing assets) an amount sufficient to service the loan. The remainder would be transferred to the budget to finance social programs. Moreover, retail fuel and electricity prices would continue to reflect world prices and would not be reduced as a result of the PetroCaribe Agreement.

26. **We are improving our capability to monitor economic developments and program performance.** We have put in place a system for monthly monitoring of below-the-line financing of the central government overall balance, and will update this on a monthly basis. To this end, we will ensure the consistency of Ministry of Finance and ECCB data on the position of the government with the banking system.

27. **We are considering applying for a concessional loan of around US$85 million (13 percent of GDP) from the Export-Import Bank of China to finance a state agency’s construction of a port and marina.** We will continue to explore private sector financing for the project. We intend to share the feasibility study with the IMF, as well as the World Bank or the Caribbean Development Bank. Should the study not point to positive net benefits of the project, we would plan to restructure the project before proceeding. We will continue to consult with the Fund staff and will seek a high level of concessionality if we proceed with the loan.

### B. Structural Policies

28. **A key objective of our program is to improve the investment climate, taking advantage of recently gained momentum with foreign-financed projects:**

- As we noted above, we expect to submit the new investment legislation to Parliament by December 2008.

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2 The amount of the loan has not yet been finalized.
**A key objective of structural reforms is to improve Grenada’s Doing Business Indicators.** We are developing a action plan to improve specific indicators, by August 2008 (benchmark). Three priority areas have been identified: starting a business, registering property, and facilitating trade. Once specific outcome targets have been identified, we will add one of these as a benchmark.

**We still intend to make the Grenada Industrial Development Corporation (GIDC) a one-stop shop for investors.** However, while the bulk of work on the legal framework has been completed, the process is proving more complex than initially expected, and we are utilizing technical assistance to accomplish this goal. In particular, we will prepare a comprehensive investment strategy by November 2008. In 2009, we will work toward establishing an Investment Facilitation Network, an IT platform which will facilitate communications between all impacting organizations involved in investment and project approval. At the same time, we will work toward strengthening the capacity of the GIDC, Planning Approval, and other associated agencies, a process which will be facilitated by the Ministry of Economic Development and Planning created in 2007 with oversight for all of the above agencies. Ultimately, this should substantially reduce the time required to move from an initial project request to approval.

**To facilitate land transactions,** we will upgrade the land registry, moving to a fully computerized system, to allow public access, as indicated in ¶14 of our March 21, 2006 MEP. However, we have revised the date for completing this action from end-2006 to 2010, reflecting delays due to the adoption of a new technical approach. We will also continue our work toward establishing a new land agency, with the assistance of the World Bank, following passage of the Executive Agencies Act in February 2008.

**To reduce vulnerabilities to natural disasters, we will work toward giving the Building Code force of law.** As a step forward in mandating the Code and associated Guidelines, we brought into force a Construction Quality Assurance Mechanism in November 2007, which involves contractors, engineers, architects, and financial institutions working together. This mechanism entails training, certification, and procedures to assist all stakeholders to ensure that buildings are built to the required standards. We will bring into force the new planning regulations by July 2008, after amending the revised National Development and Control Act (structural benchmark).

**We have signed up for the World Bank’s Caribbean Catastrophe Risk Insurance Facility.** As a participant in this facility, we began purchasing parametric insurance beginning in June 2007 that pays the government a predetermined amount in case of hurricane or earthquake. The World Bank will pay Grenada’s insurance premium in the first year and half the premium for the next two years.

**We have prepared a final draft of our National Export Strategy, which has been approved by Cabinet.** The Organization of American States has funded the Export Competency Development Strategy for a two-year period. The World Bank is collaborating with the Ministry of Economic Development and Planning to assist with establishing a Trade
Information Network and strengthening the Bureau of Standards. We plan to adapt draft model legislation for the National Export Council. We have negotiated more airlift for passengers and products to North America.

32. **As a key objective of our economic reform program, we will remain focused on reducing poverty and supporting the most vulnerable of our citizens.** During 2008, we plan to maintain the measures introduced with the 2006 budget to cushion the impact of fuel price increases on vulnerable groups: (i) an increase in the monthly transfer to needy elderly persons to ECS150, and (ii) temporary subsidization of the increase in bus fares for tertiary students. To address the high costs of imported foods, following the CARICOM decision, we have suspended for one year the Common External Tariff on the following products: cooking oil, baby formula, baking powder and yeast, and dried breakfast cereals. We have put in place margin controls on the same products and have waived the customs service charge on the import of bulk milk by the Marketing and National Importing Board.

33. **We are also preparing a full PRSP, as follow-up to the interim PRSP at the time of the PRGF program approval.** We had experienced some delays in undertaking an updated Country Poverty Assessment (CPA), implying that we were unable to meet our original goal of completing the full PRSP by October 2007. This poverty assessment, with the assistance of the CDB, is now underway, with results expected by end-December 2008 (benchmark). Thus, we will work with the World Bank, with the aim of finalizing the full PRSP by November 2009. We have separately provided a PRSP Preparation Status Note.

**C. Financial Sector**

34. **We have enacted the Grenada Authority for the Regulation of Financial Institutions (GARFIN) legislation to help safeguard the soundness of Grenada’s financial sector.** This legislation became effective in September 2006 and GARFIN began operation in February 2007, bringing together under one supervisory authority a wide range of financial institutions, including, among others, credit unions, cooperatives, and insurance and offshore companies. We will ensure that the insurance sector, which is offering deposit interest rates above those of commercial banks, follows sound practices and does not pose risks to the financial system, insurance holders, and deposit holders. We intend to enact a new Insurance Act by end-2008.

35. **GARFIN has made progress on the regulation and supervision of nonbank financial institutions.** It has set up a reporting system and begun offsite monitoring of credit unions and building and loan societies; the same process will be undertaken for insurance companies in 2008. For the offshore sector, GARFIN will remove inactive International Business Corporations from the register by May 2008. The amended GARFIN Act came into force in March 2008, making GARFIN the registrar and supervisor of insurance companies and broadening the definition of money services under its jurisdiction. Several pieces of legislation are slated for submission to Parliament in 2008, including the Cooperatives Society Act, and Money Services Act. The Offshore Banking Act took effect in December 2007.
36. **We are also addressing the problem of unregulated investment schemes** by issuing a public warning on the risks of such schemes and a financial advisory indicating which schemes are operating without a license. If the Eastern Caribbean Securities Regulatory Commission (ECSRC) determines that the scheme does not fall under its jurisdiction, or does not make a decision by end-June 2008, GARFIN will act to prevent the scheme from taking in new client deposits or applying for a cease and desist order from the High Court under the amended GARFIN Act.

37. **In response to the rapidly deteriorating financial condition of the unregulated bank, we appointed a receiver on February 15, 2008.** The bank was highly illiquid and unable to honor deposit withdrawals, and there had been increasing evidence that the bank was likely insolvent. We obtained a court order to appoint the receiver. The Eastern Caribbean Central Bank (ECCB) had reiterated its recommendation to revoke the bank’s license, while urging action to safeguard the interests of the depositors.³ There has been no contagion to the regulated banking system (the bank is not in the formal clearing and payments system) and contagion is unlikely. There is no systemic risk as the bank accounts for a small share of the banking system.

38. **We are determined to move forward to resolve the bank, notwithstanding legal difficulties.** On May 7, the High Court ruled in favor of the bank’s owner and found the appointment of the receiver unlawful. We have obtained a stay of this decision and have filed an appeal; the receiver will remain in place pending the outcome of the Appeals Court.

39. **We have maintained a clear communications strategy regarding the bank.** We indicated that while the government is prepared to work with depositors, it cannot commit to compensating depositors until the plan for resolving the bank is in place. We are considering, however, transferring small deposits (under EC$500) to another financial institution. We will refrain from compensating related party depositors. Preliminary indications suggest that total deposits are around EC$21.8 million (1.2 percent of GDP), excluding a large deposit—which is offset by a large investment, and related party deposits, and that around 70 percent of the 5,800 deposits are small deposits. In addition, 54 percent of the bank’s loan portfolio (to a related party) is reportedly nonperforming. The receiver’s report indicates that the bank appears to be insolvent.

40. **Our strategy to resolve the bank will protect depositors while minimizing costs to the government.** In consultation with the ECCB, we developed a plan for resolution of the bank that was submitted to the High Court on April 14, 2008. The process has been, and may continue to be slower than we anticipated, due to legal challenges. On the positive side, several investors have expressed interest in some form of asset purchase and assumption of liabilities. Reorganization or initiating the process of liquidation of the bank would be a performance criterion for November 2008.

³ An ECCB representative observed the initial phase of the receivership.
<table>
<thead>
<tr>
<th>Performance Criteria:</th>
<th>Adjusted Target</th>
<th>Actual</th>
<th>Adjusted Target</th>
<th>Actual</th>
<th>Proposed 2008 Targets</th>
<th>End-June</th>
<th>End-Sept. 1/</th>
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1/ Indicative target.
2/ Cumulative.
3/ See the TMU and supplementary TMU for a description of adjustors.
4/ To be monitored on a continuous basis.
5/ Excludes PetroCaribe.
Table 2. Grenada: Proposed Structural Measures

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<th>Initial Reforms for the First Review</th>
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<th>Target Date</th>
<th>Comment</th>
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<td>Appoint a receiver for the unregulated bank</td>
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<tr>
<td>Prepare a comprehensive business plan for customs reform 1/</td>
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<td>May 2008</td>
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<td>Reach agreement on public service wage path for 2006-08 1/</td>
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</tr>
<tr>
<td>Submit Executive Agency Bill to Parliament, as a step toward establishing a new land agency 1/</td>
<td></td>
<td>August 2008</td>
<td>Enacted in February 2008</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Second Review</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Develop an action plan to improve Doing Business Indicators 2/</td>
<td></td>
<td>August 2008</td>
<td>Benchmark</td>
</tr>
<tr>
<td>Bring into force new planning regulations, as a first step toward giving the Building Code force of law</td>
<td></td>
<td>July 2008</td>
<td>Benchmark</td>
</tr>
<tr>
<td>Develop and begin implementing a customs Fraud Control Plan and sign an MoU on information sharing between customs and Inland Revenue</td>
<td></td>
<td>September 2008</td>
<td>Benchmark</td>
</tr>
<tr>
<td>On Investment Act, amended Income Tax Act, and drafts to repeal tax incentives legislation, update with final policy decisions and obtain Cabinet approval</td>
<td></td>
<td>September 2008</td>
<td>Benchmark</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Third Review</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Reorganize or initiate liquidation of Capital Bank</td>
<td></td>
<td>November 2008</td>
<td>Performance criterion</td>
</tr>
<tr>
<td>Complete the Country Poverty Assessment</td>
<td></td>
<td>December 2008</td>
<td>Benchmark</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>VAT-Related Measures 3/</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Complete update of SIGTAS with VAT returns and refunds processing modules</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enact new VAT and Excise Laws</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Recruit and begin training staff and adopt transitional procedures for bonded warehouses, to ensure smooth implementation of the VAT</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1/ The authorities proposed that two of these three measures would be completed.
2/ Three priority areas have been identified. Once specific outcome targets (for example reducing by a specified amount the number of steps required to start a business) have been identified, one of these will be added as a benchmark for the third review.
3/ Once the timing of VAT implementation is decided, these measures would be included as structural conditionality for future reviews.
Supplementary Technical Memorandum of Understanding

The Technical Memorandum of Understanding associated with the LOI and MEP of March 21, 2006 remains the operative document for monitoring and reporting requirements and for defining how the quantitative performance criteria and indicative targets, specified in Table 1 of the supplementary MEP, will be interpreted, except for the specific changes in the following:

Section I. In paragraph 4, delete “nonfinancial” and replace the “and Grenada International Financial Services Authority” with the “Grenada Authority for the Regulation of Financial Institutions, and the National Insurance Scheme”.

Section II. Replace paragraph 10 with “The floor on the central government primary balance excluding grants will be adjusted as follows:

(i) downward\(^4\) to the extent that grants exceed programmed amounts, as specified in Table 1 below.

(ii) upward to the extent that grants fall short of the programmed amounts, as specified in Table 1 below, by more than EC$10 million through end-June or after.

(iii) downward to the extent that concessional financing from multilateral development banks exceeds programmed amounts, as specified in Table 1.

(iv) upward by an amount equivalent to 50 percent of the shortfall of divestment proceeds from the programmed amount, as specified in Table 1.

(v) downward by an amount equivalent to 50 percent of divestment proceeds in excess of EC$57 million, with a maximum adjustment of EC$32 million. The remaining excess divestment proceeds will be used to pay down debt, targeting more expensive debt first.

(vi) upward to the extent that bank restructuring costs fall short of the programmed amount, as specified in Table 1.

Table 1. Programmed Disbursements of Concessional Loans and Grants, Divestment Proceeds, and Bank Restructuring Costs, 2008

<table>
<thead>
<tr>
<th></th>
<th>Q1 Actual</th>
<th>Q2 Prog.</th>
<th>Q3 Prog.</th>
<th>Q4 Prog.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concessional loans</td>
<td>5.3</td>
<td>14.2</td>
<td>28.5</td>
<td>37.4</td>
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<tr>
<td>Grants disbursements</td>
<td>15.5</td>
<td>26.4</td>
<td>54.1</td>
<td>65.0</td>
</tr>
<tr>
<td>Divestment proceeds</td>
<td>27.0</td>
<td>27.0</td>
<td>57.0</td>
<td>57.0</td>
</tr>
<tr>
<td>Bank restructuring costs</td>
<td>0.0</td>
<td>0.0</td>
<td>27.0</td>
<td>27.0</td>
</tr>
</tbody>
</table>

\(^4\) Downward adjustment means a higher deficit; upward implies a lower deficit.
Section III. Add “(as specified in Table 1)” at the end of paragraph 12, point (ii).

Section V.A. Replace paragraph 17 with “Excluded from the ceiling are credits from the IMF and credits on concessional terms.”

Insert a new section as follows:

“V. C. PERFORMANCE CRITERION ON BILATERAL CONCESSIONAL DEBT WITH AN ORIGINAL MATURITY OF AT LEAST ONE YEAR CONTRACTED OR GUARANTEED BY THE CENTRAL GOVERNMENT

With the definitions given in Section V. A., there will be a ceiling on the contracting or guaranteeing of official bilateral concessional debt, excluding PetroCaribe-related debt.”