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NEEDS, STRATEGIES, EXPERIENCE AND LESSONS LEARNT- ECONOMIC DIVERSIFICATION

St. Kitts and Nevis (SKN) was one of the 18 ACP countries that were impacted by changes to the EU/ACP Sugar Protocol, that resulted in a 36% fall in the intervention price of sugar in the EU market over a four-year period beginning in 2006. SKN was in a unique position when compared with other ACP states in that consequent on these changes, it made the decision to cease the production of sugar for export under the Protocol arrangements and was the only ACP state to have do so in 2006.

The strategic response of St. Kitts and Nevis in exiting from sugar production has to be understood from the perspective of the historical context and what were the regional and global economic trends then. Historically, the combination of monoculture and primary production together with diseconomies of scale in production and the openness of the economy have resulted in economic vulnerability and a lack of sustained economic growth over time.

Correspondingly, the contemporary global economic scene presented SKN with some extremely difficult challenges. These challenges included increased trade liberalisation resulting in the erosion of preferential trade arrangements; changes brought about by advanced technological developments particularly in the field of information and communications; the declining availability of concessional aid; a widening and intensification of international linkages in trade, finance and production; and increased competition in the wider global economy.

In addition to the changing external environment, there were challenges inherent within the domestic context given the high levels of public sector indebtedness and fiscal imbalances, in conjunction with the closure of the sugar industry, and relatively high levels of poverty. Economic restructuring and transformation in SKN was therefore necessary in order to meet these challenges and ultimately to facilitate greater integration into the world economy.

One of the major challenges SKN faced was how to take advantage of the opportunities presented in the context of globalisation and increased trade liberalisation. In confronting this challenge, SKN begun to implement programmes to achieve sustainable economic growth, with emphasis on improving international competitiveness and promoting private sector development. As a consequence, the focus on economic policy sought to maintain the shift away from direct government intervention in the market, by limiting its participation in the production and trade of goods and services, and creating an enabling environment for

private sector development and for the efficient operation of the market.

The latter entailed, *inter alia*, the maintenance of macroeconomic stability, the development of appropriate legal and regulatory frameworks and the efficient provision of public goods (such as, education and health). There was also a key role for the Government and the donor community to play in facilitating and strengthening the supply-side capabilities of the economy. A crucial role for the donor community was the provision of adequate levels of concessional finance to fund infrastructural and social development programmes and technical assistance aimed at enhancing management and policy formulation capacity within the public sector in SKN.

Accelerating and sustaining economic growth in SKN was identified as important to foster social development, improve fiscal performance, reduce unemployment and poverty, and ensure a more sustainable external position in an increasingly competitive regional and international environment. The acceleration and sustainability of economic growth will depend significantly on the country's ability to improve competitiveness. The strategic focus in promoting growth in SKN was predicated on five areas: (i) macroeconomic policies to reduce vulnerability, encourage and facilitate investment; (ii) improving competitiveness in the production and export of goods and services; (iii) interventionist social policies to support economic development and protect the most vulnerable; (iv) ensuring an environmentally sustainable development agenda; and (v) organising to achieve success in economic restructuring and transformation. It was also important to emphasize that the programme of social and economic transformation arising from these strategies was to be implemented within a challenging institutional environment that included public sector reform, private sector development, regional integration and a programme of infrastructure improvements to support the development process.

Macroeconomic Policies to Reduce Vulnerability and Facilitate Investment

The challenge of sustaining economic growth required that the Government undertake structural and economic reforms to create a more investment-friendly economic environment, hinged on the key components of good economic management, stable macroeconomic policy, secure property rights, reliable infrastructure, and effective institutional capacity. The promotion of sustained growth in SKN required focused attention to a number of areas, including: improving the environment for private sector led growth through rationalisation of the role of the state in economic activity; accelerating the pace of economic diversification; promoting an investment environment conducive to private sector development by simplifying the regulatory framework within which businesses were to operate; and improving and maintaining the infrastructure to support economic growth. Structural reforms that make the economy more

flexible and raise long-term growth potential would also make the economy more resilient against external shocks. However, realising the benefits of a stable macro-economic environment could be jeopardised if the implementation of adjustment measures was not properly scheduled.

Achieving and maintaining macroeconomic stability was dependent on the creation of a stable environment to stimulate higher levels of domestic savings and investment. The importance of domestic savings was increasingly relevant when viewed against the background of declining access to concessionary resources to finance the growth in the level of public sector investment. The strengthening of public expenditure management and an increase in revenue collection were needed in order to achieve significant levels of savings in the sector. Reducing debt accumulation and achieving debt sustainability would likewise be critical in achieving this goal.

Strong fiscal policies were required to achieve fiscal sustainability. Prudent fiscal and monetary policies would have created a favourable climate for private sector investment and for promoting productivity. Fiscal deficits were to be better managed so as to discourage explosive borrowing by the public sector. Fiscal reforms were also necessary to reduce the debt to GDP ratio and to restore debt sustainability. This was supported by fiscal consolidation through the implementation of tax reforms and improved expenditure management. The strengthening of fiscal institutions was led to improve fiscal performance and enabled a better allocation of resources in the economy.

Improving Competitiveness in the Production and Export of Goods and Services

While the Government of St Kitts and Nevis was able to attract significant investment in the tourism industry and the offshore education sector over the years, labour mobility from agriculture to services was not easy especially for those individuals displaced by the closure of the sugar industry. At this juncture in the country's development, therefore, building a strong skills base was particularly important for improving competitiveness because of the country's growing reliance on services. Education and training, focused on improving the productivity of the labour force, were identified as key initiatives in the economic transformation process. Performance-based remuneration packages and other similar labour market reforms were also recommended. The following were planned: (a) a framework for constantly reviewing the curriculum of educational institutions to ensure relevancy to the job market, and (b) encouraging and facilitating job fairs to expose students to available job opportunities.

Improving the efficiency of traditional sectors and diversifying the economy was the twin approach

identified to restructure the productive and export sectors. The dismantling of preferential trading arrangements and the closure of the sugar industry reinforced the urgency for rapid diversification of production and exports. In this regard and given the rate of growth of the services sector worldwide, there appeared to be considerable potential for St. Kitts and Nevis to expand the services sector. The sector offered significant scope for increasing economic growth, employment, and foreign exchange earnings and for developing and strengthening linkages with other economic sectors. The Government launched initiatives to exploit opportunities especially in the areas of tourism, information and communication technology, offshore financial services and other services and channeled substantial resources into human resource development and in upgrading the infrastructure needed to accommodate the development of the productive sector.

The Government's strategy for the development of agriculture, following the closure of the sugar industry, was to significantly increase agricultural production in a competitive and sustainable manner through the transformation of the sector to satisfy local demand and for exports. Production was to be market led and special emphasis was placed on the development of competitive commercial farms in both crop and livestock production. In this context issues to be addressed included irrigation, feeder roads, extension services, marketing, the application of technology and land allocation and tenure. Developing and strengthening farmer groups was an area of particular concentration while the working relationship with stakeholder groups was to be further enhanced.

International tourism continued to be an important contributor to gross domestic product, employment and foreign exchange earnings in SKN. However, long-term tourism development required careful planning and marketing, which had to be responsive to changing market demands. Niche marketing was recognized as an important aspect of tourism development, and the tourism authorities identified the segment(s) of the market in which SKN could compete effectively in terms of price and quality. Success in accessing niche markets depended on effective institutional and management capacity and appropriate human resource development. The Government, in association with the private sector, sought to upgrade the tourism infrastructure, including hotels, tourist attractions, roads, and utilities (electricity and water services). The sector also benefited from new promotional strategies aimed at repackaging tourism products to increase their value and interest to tourists.

The development of a competitive information communication technology services sector in the medium term in SKN was to be complemented by rapid growth in domestic information technology applications and the development of the necessary local expertise and facilities based on a modern telecommunication infrastructure. SKN was selective in its approach to product mix and the type of capability to develop, taking into consideration a realistic entry strategy and the choice of carriers. SKN needed to continue to upgrade

and reform its telecommunications infrastructure and legislative framework to be in a position to export ICT services competitively.

Social Policies to Support Economic Development and Protect the Most Vulnerable

Vulnerable groups in society were not forgotten during the economic adjustment process. It was necessary to cushion the effects of adjustment on the most adversely affected groups. Special safety net provision was made for the poor and for selected former workers of the sugar industry. The extent to which social safety net programmes were successful throughout the adjustment period depended on how well they were combined with programmes to retrain and resettle displaced workers and the unemployed into meaningful jobs that were needed in the economy.

The underlying rationale for raising the skills base of the economy, specifically in the advanced technology fields, was that many of the opportunities for expanding exports involved effectively combining technology with labour to significantly enhance labour productivity. This required a sound programme of education and training geared towards producing the skills required in the new economic environment in SKN. Raising the level of education of the general public would contribute to raise productivity in the country. However, in the new global economy, production and competitiveness were becoming increasingly knowledge-based. The ability of SKN to compete effectively depended on a skilled, educated and flexible labour force capable of adapting and integrating new technologies into the production process. Consequently, there was the need to address human resource development through increased investment in education, especially at the technical and vocational levels.

The balance between social and economic development was a primary focus for the Government of St Kitts and Nevis. It was generally felt that there had to be greater linkages between social programmes and other aspects of the country's economic development strategy. The increased level of criminal activity particularly among young people, caused great concern in communities given the potential to undermine the quality of life for all and its negative impact on the investment climate for industries like tourism. The Government therefore implemented a strategy that focused on the reduction of crime and violence through more vigilant and effective law enforcement and also located the implementation of comprehensive crime reduction programmes within the context of the social, psychological and economic dimensions of criminal behaviour. The government also collaborated with its partners in the sub-region to merge corrections and probation services. In the medium term, however, it became necessary to fully modernise the security apparatus of the state in order to ensure the long-term viability of strategic approaches.

Ensuring an Environmentally Sustainable Development Agenda

The social and economic benefits of environmental protection were not easily quantifiable. The sugar industry in SKN fulfilled a significant environmental management role and bore the costs of extensive environmental services from which the country as a whole benefited. Many of these services such as ghaut stabilisation and the maintenance of drainage systems also contributed directly to natural disaster preparedness and mitigation. As a direct result of the closure of the sugar industry, therefore, the GSKN now had to absorb both the costs and actual activities associated with these environmental services, in particular the conservation activities formerly undertaken by the SSMC.

The environment remains the marrow of any post sugar adjustment programme because GSKN recognised that maintaining environmental sustainability was critical to sustaining economic activities particularly tourism, agriculture and fisheries. Improving environmental policies and mitigating the environmental impact of the closure of the sugar industry were also important for sustaining long term economic growth and competitiveness, reducing poverty and improving the quality of life of people in the Federation. Consequently, as part of an integrated approach to the adjustment process GSKN sought to implement projects within the following broad areas: land use planning and management, watershed management, coastal area management, management of protected areas, and disaster management and risk reduction.

Cross-Cutting Issues

The GSKN was involved in a rolling public sector reform process where the emphasis shifted between different areas of the public sector as circumstances dictated. The objective of the reform agenda was to foster a modernisation imperative that would allow the sector to fulfil its enabling and facilitating role in an efficient and effective way while adhering to the good governance ideals of transparency and accountability. The focus was on civil service improvements, privatisation and commercialisation, and statistical development. The three areas of focus were interconnected and highlighted what the major public service concerns were to be for a small state like SKN at that time: firstly how to carry out all the functions of a democratic society with an extremely limited human resource base; secondly what should be the proper limits for a developing country like SKN on state participation in direct economic activity; and finally how to harness technology to support the state in all its multifarious roles.

Private sector led growth was the basis of the adaptation strategy that was put forward by SKN. This came from the understanding that the state cannot do everything and that even if it could that would not be

desirable. The Government's programme was therefore posited on creating the conditions for the development of a strong and independent private sector by among other things: supporting the sector through the provision of public goods like education and health; entering into partnerships with the sector when it was in the public interest to do so; and above all maintaining a stable political and economic system. In the context of St. Kitts and Nevis, private sector led growth had to involve moving away from the inherited mercantile model and developing an indigenously based, productive sector that could create and exploit the opportunities that would bring prosperity.

St. Kitts and Nevis is a member of a two-tier regional integration system consisting of the OECS and CARICOM. Like many similar arrangements, while the logic and benefits are obvious, the process of achieving integration through institution building, harmonisation, and convergence has not been easy. In addition to issues around the pooling of sovereignty, the differences in country size and stages of development are some of the obstacles that had to be overcome if the CSME initiative was to succeed. St. Kitts and Nevis was one of the OECS countries that decided to join the CSME in June 2006. The country was classified as a Less Developed Country (LDC) within the CARICOM organization because of the vulnerability posed by its small size. Given its high level of indebtedness and the financial losses incurred by the closure of the sugar industry, SKN relied on instruments like the proposed CARICOM development fund to produce a fairer competitive environment for it within the CSME.

St. Kitts and Nevis needed to provide the appropriate physical and social infrastructure if it was to deliver on the major proposed sectoral strategies and associated programmes. Telecommunications though an aspect of ICT, was given consideration as a whole area and consequently it was viewed as a vehicle to help drive the transformation programme. Certain types of infrastructure development were related to safety and security and protection of the environment and yet others functioned in tandem with specific economic and development projects to ensure their feasibility. The GSKN had both a role and also a responsibility to provide or to facilitate the provision of infrastructure that fell into the category of public goods, some of which constituted basic human rights for its citizens e.g. water, shelter. It was important for SKN to earmark resources for the infrastructure inputs of the adaptation strategy so that they were not shelved in the financial squeeze resulting from high indebtedness, and the financial impact of the loss of the sugar industry.

Achieving Success in Economic Restructuring and Transformation

Strengthening public sector governance, improving public sector management, ensuring transparency and accountability in the management of public enterprises, and maintaining a sound economic environment

improved the allocation of resources and in turn the growth potential in SKN.

It was also necessary to review the role of the Government, in order to shift its emphasis from one of direct involvement in economic activity to one in which it focused primarily on creating an environment conducive to the evolution of a strong and active private sector. The Government's role in economic management was to be directed at achieving economic stability, sustained growth, high levels of employment and low inflation. In addition to implementing appropriate policies, the Government had a central role in establishing a regulatory and supervisory framework that promoted competition; protected investors, employers and labour; and, in general, ensured that markets were fair.

The groundwork for the new role of the Government was already being undertaken as evidenced by the commercialization and privatization thrust and initiatives to encourage fiscal discipline with the implementation of the Structural Adjustment Technical Assistance Programme (SATAP). There were also ongoing initiatives to reform the tax structure as an important component of the effort to stimulate both domestic and foreign investor interest. The Government nevertheless needed to develop a clear vision and a structured framework for charting the future of the economy and society. This involved establishing the appropriate institutional framework and restructuring public institutions for effective public administration.

The public sector investment programme was to be reviewed to ensure that it focused on the provision of appropriate physical infrastructure, poverty reduction and the development of human resources, and other social services. In the context of the large debt overhang and relatively weak fiscal performance, the focus on investment projects was to be on those activities that could generate rapid and significant economic growth and increased tax revenues to allow for the timely servicing of the debt.

Careful review in the provision of the economic infrastructure, including air and seaports; roads and bridges; tourist-related facilities and public utilities including water, electricity and telecommunications, were to be undertaken.

The following were some important elements for achieving success in the economic restructuring and transformation programme in SKN.

- (a) Government's leadership in the process of adjustment and transformation. It was important for the Government to clearly express its firm commitment to the economic restructuring process by actively participating in its design and development.
- (b) Realistic programmes needed to be developed. There was need for a clear agreement on programmes and realistic expectations. External donors would need to be realistic in

preparing the financing plans to support the restructuring/transformation programme in SKN.

- (c) Flexibility in policymaking was important but consistency of government policy was necessary to build confidence in the private sector.
- (d) The development of institutional capacity needed to be emphasized from the outset, because institution-building takes time and the results would not be immediate. It would have been essential to implement measures that economized on the use of scarce resources.
- (e) Fiscal discipline such as tax and other structural reforms and improved expenditure management were to be paramount.

