1. IDENTIFICATION

<table>
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<th>Title/Number</th>
<th>ANTIGUA AND BARBUDA - GENERAL BUDGET SUPPORT - VULNERABILITY FLEX 2010</th>
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<td>CRIS number :</td>
<td>022-407</td>
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<td>Total cost EUR</td>
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<td>Aid method / Management mode</td>
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<td>DAC-code</td>
<td>51010  Sector General Budget Support</td>
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2. RATIONALE AND COUNTRY CONTEXT

In reaction to the international economic and financial crisis, the Communication Supporting development countries in coping with the crisis (COM 2009-160 final), foresees inter alia the creation of the Vulnerability FLEX mechanism. The Commission Decision C(2009)6135 concerning an increase in allocation of resources for unforeseen needs from the 10th EDF to support the most vulnerable and least resilient ACP countries in coping with the impact of the global financial crisis by setting up an ad-hoc Vulnerability FLEX mechanism details its rationale, eligibility criteria and modalities. The Vulnerability FLEX mechanism has set aside an amount of EUR 500 million from the reserve of the national and regional indicative programmes under the 10th EDF for the purpose at hand.

The National Authorising Officer of Antigua and Barbuda has requested on 15th of March 2010 an exceptional additional support to mitigate the impact of the crisis. Antigua and Barbuda is considered eligible under Vulnerability FLEX on the basis of a limited set of economic and social vulnerability criteria, the nature of the residual financing gap and the capacity of the EC to quickly provide meaningful support. This allocation aims at creating a new General Budget Support programme in order to channel the 2010 Vulnerability Flex allocation in one fixed tranche of EUR 9 000 000, to be financed from the B-envelope of the 10th EDF. The ongoing Public Financial Management Programme for EUR 3 000 000 financed under the 10th EDF provides the framework for this operation.

2.1 Country Context and National Policy and Strategy

2.1.1 Economic and social situation and poverty analysis

The experiences of Antigua and Barbuda during the recent crisis were tumultuous, firstly stemming from the effects of the global economic and financial crisis on the Eastern Caribbean Currency Union (ECCU) offshore financial sectors. Secondly, in February 2009, fraud charges were levied by the U.S. Securities and Exchange Commission against Sir Allen Stanford and the Stanford International Bank (SIB), an offshore bank based in Antigua and Barbuda.

The economy of Antigua and Barbuda was among the worst hit among the OECS countries in 2009, undergoing a contraction of real GDP of 7.0%. One of the most significant changes in
recent years is the contraction of 25% in FDI-financed projects in 2009 and a further 5% in 2010. In the most recent Article IV mission in March 2010, the IMF observed that further deterioration in the economy is directly attributable to the global economic downturn as manifested by reductions in tourism receipts, foreign direct investment (FDI) inflows, government revenue and economic activity. The current IMF forecast indicates that the economy will contract a further 2% in 2010 with a possible growth of 0.8% in 2011 and 2.5% in 2011 when external markets which Antigua and Barbuda rely on for tourism revenue begin to improve.

Antigua and Barbuda ranks 47th out of 182 countries in the United Nation’s Human Development Index in 2009, moving upwards by 12 points since the last UNDP report in 2007. In the most recent Country Poverty Assessment (2007) around 18.4% of the population are considered to be poor with an indigence of 3.7%.

2.1.2 National Development/ Cooperation Policy and Strategy

Historically, there was no overarching strategy to guide national economic development in Antigua and Barbuda. The annual budget was the main vehicle used by the Government of Antigua & Barbuda (GoAB) to guide annual economic development. On gaining office in 2004, the new administration began implementing a fiscal reform programme which was outlined in the 2005 Budget Statement. Over the medium term, the Government's objective was to reform the public sector, reduce the debt-to-GDP ratio to sustainable levels, introduce measures to alleviate poverty and reduce vulnerability to natural disasters.

In the context of the global economic crisis the GoAB adopted the National Economic and Social Transformation (NEST) strategy in December 2009, which outlines a series of fiscal and structural measures aiming at resolving its economic problems. The strategy was the result of wide consultations with the private sector, non-state actors and its citizens.

2.2 Eligibility for budget support and Vulnerability FLEX.

Antigua and Barbuda is eligible for financing under the Vulnerability Flex instrument based on the fulfilment of the following criteria:

- **high economic, social and political vulnerability (i.e. less than 2 months of import cover expected in 2010):** The deterioration of foreign reserves as a result of the crisis at the end of 2008 led to Antigua and Barbuda having 1.8 months of import coverage at the end of 2008, 1.6 months in 2009 and is expected to reach 1.7 months in 2010. The slight increase in import cover forecasted in 2010 is due to a fall in imports from US$671.1 million in 2008 to US$496.0 million in 2010, a 26% decline as a result of the contraction in the economy. The imputed reserves would decline to 0.5 months of import cover without the exceptional finance foreseen from the IMF and the CDB. The main causes of the deteriorating Balance of payments (BoP) situation are lower foreign direct investment, lower tourism receipts and investments. FDI has declined by 25% to US$129.5 million in 2009 and is expected to decline by a further 6% in 2010 to US$122.3 million. The forecasted decline in 2010 is more than 29.4% when compared to 2008 when FDI was US$173.4 million. Gross tourism receipts are expected to decline by 13% from US$334 million in 2008 to US$290.5 million in 2010. Therefore, this criterion on foreign reserves, when a country has less than two months of import cover is clearly met in Antigua and Barbuda. As regards the criterion on government revenue, the decisive steps taken by the government over the last months to increase tax
collection mean that it does not meet the revenue criterion. Similarly, the considerable fiscal adjustment agreed with the IMF is expected to reduce the fiscal deficit drastically, as a result of which the fiscal deficit criterion is not met.

- **fiscal financing gap not covered by ongoing or pledged commitments of the donor community or foreign or domestic borrowing and will involve further reduction in planned expenditures:** The 2010 budget approved by Parliament in December 2009 contained a financing gap of ECS46 million (EUR 12.6 million\(^1\)). It is understood that the GoAB intended to pursue debt rescheduling with its creditors to bridge the gap. However, the recent IMF mission in March 2010 recommended removing the possibility of debt relief from the Paris Club creditors and revised revenue projections which increased the residual fiscal financing gap to ECS63 million (EUR17.3 Million) after the projected interventions of the IMF Stand-By Arrangement (SBA) and the CDB's Policy Based Loan (PBL). In the absence of these exceptional financing interventions from the IMF of ECS114 million and the CDB of ECS27 million the gap in 2010 would be ECS204 million (EUR 56 million). The origin of this gap can be explained through an increase in interest payments, below the line service amortisation payments, stemming from the substantive arrears accumulated with domestic and international creditors at the end of 2009 and falling revenue in the first two months of 2010.

- As a result, the Government of Antigua and Barbuda has requested EUR 10.0 million as Vulnerability Flex contribution for the current fiscal year, in order to cover 58% of the residual fiscal financing gap in 2010. Due to the number of requests received and limited funds available under the 2010 Vulnerability Flex allocation the Commission can make only EUR 9.0 million available for Antigua and Barbuda, which will cover 52% of the residual financing gap. In the absence of an ongoing budget support programme or a large EU funded project that could absorb the funds, channelling Vulnerability Flex financing will require the creation of a new short-term budget support programme.

On the basis of the analysis in Section 2.1.1 and 2.2, the country is deemed to be eligible for the Vulnerability Flex instrument.

### 2.2.1 National Development or Cooperation Policy and Strategy

A well defined national policy is provided by the NEST strategy which addresses the GoAB response to the recent crisis and the economic, fiscal and structural challenges over the next four years. There are four pillars of the NEST Strategy:

1. The **Fiscal Consolidation Programme** includes a series of revenue and expenditure measures. The expenditure measures are a 25% reduction in the 2009 recurrent expenditure allocations for all ministries; reduction in capital expenditure to 2.5% of GDP in 2010-2014; a freeze on all new employment except for critical positions; a suspension of all personal advances; restrictions on overtime; no new contracts for roads; restrictions on purchase of new vehicles and streamlining programmes and services to eliminate duplication. The revenue measures include new taxes, levies and duties and increase non-tax revenue through visas, passports, work permits and naturalisation fees.

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\(^1\) Exchange rate Eastern Caribbean Dollar - ECS/EUR : 3.64 (Source InforEuro, March 2010)
2. The Economic Action Plan is focused on encouraging economic activity and creating employment. The plan includes a stimulus package for the hotel sector, a housing project, a home ownership programme, promotion of micro and small business through a credit guarantee scheme, implementing projects approved by Antigua and Barbuda Investment Authority (ABIA) and increasing incentives if investors commence projects over next 6 to 12 months.

3. The Social Transformation Programme envisages streamlining social protection programmes, implementing an unemployment insurance scheme, safeguarding social spending, prevention and control of crime, introduction of social safety nets and developing a Poverty Reduction Strategy with assistance from the CDB. The funds allocated under the Vulnerability Flex allocation in 2010 will assist the GoAB maintain current social programmes including meals for the elderly, public health services, school uniform programme and teacher training programmes at all education levels.

4. The Financial Sector Stability component includes enacting legislation to establish the single regulatory unit for nonbanks (FSRC); moving Antigua off the Financial Action Task Force (FATF) black list; finalizing the recapitalization of Bank of Antigua and harmonizing its Insurance Act with other ECCU countries. The GoAB has sought support from the EU in improving transparency in tax governance.

The monitoring mechanisms for implementation of the NEST are already in place through high level monthly strategy meetings chaired by the Minister of Finance and attended by all management of the relevant ministries. Institutional capacity for strategic planning and coordination of the NEST is limited insofar as Antigua and Barbuda has a small administration. The CDB plans to provide technical assistance to strengthen the Statistics and Planning Division of the Ministry of Finance during the period 2010-12. Given the linkage between the NEST, CDB and IMF financed programmes which include quarterly monitoring targets and the efforts already made by the GoAB in implementing reforms in 2009 and 2010, there is a strong commitment to the implementation of the NEST.

As already elaborated in Section 2.1.1 many of the reforms in the fiscal stabilisation programme have already been frontloaded by the GoAB in the context of the CDB and IMF programmes.

2.2.2 Macroeconomic situation

Given the increasingly difficult macro-economic situation, the Government of Antigua and Barbuda (GoAB) sought assistance from various development partners. In this context GoAB reached agreement with the Caribbean Development Bank (CDB) in December 2009 on a policy based loan (PBL) for US$30 million which will provide financial support to the country’s fiscal consolidation programme. On the 8th of June 2010, the International Monetary Fund (IMF) approved a three-year Stand-By Arrangement (SBA) for an amount equivalent to SDR 81 million (about US$ 117.8 million) with Antigua and Barbuda. The arrangement will support the authorities’ efforts to restore fiscal and debt sustainability and set the stage for a sustained recovery. During the latest Article IV mission the GoAB reached agreement with the IMF to provide financial support to the country’s fiscal consolidation programme in the form of a Stand-By Arrangement (SBA). The objective of the programme is to restore fiscal sustainability to put the country back on a path of sustainable growth.
The fiscal position will be strengthened under the SBA through a range of policy measures, including more efficient tax collection, a reduction in the interest bill on both domestic and external debt, and actions to streamline government expenditure and raise revenue, while protecting targeted social spending. The fiscal programme and debt-management strategy are geared to both eliminate debt arrears and reduce the debt-to-GDP ratio over the coming years. This fiscal strategy will be supported by reforms to: (i) strengthen public financial management; (ii) improve the collection of revenues at the Customs and Inland Revenue Department; and (iii) ensure the long term sustainability of the pension system. Additional reforms will strengthen the financial sector, including legislation to transform the Financial Sector Regulatory Commission into a single regulatory unit for offshore banks and nonbanks.

The authorities have already taken important steps towards restoring fiscal sustainability through the approval of its fiscal consolidation programme by Cabinet on the 30th of September 2009. Some of the measures already implemented in this programme include: the reduction of recurrent expenditure by 25%, improving the administrative systems and procedures to raise the rate of compliance by taxpayers, implementation of the reduced basket of zero-rated items in the Antigua and Barbuda Sales Tax (ABST) aimed at increasing revenue, replacement of the customs service tax (CST) with the Antigua and Barbuda Revenue Recovery Charge levied at 10 percent on all non-oil imports and domestic production and increasing the embarkation tax.

Despite the negative economic developments, the GoAB is responding to the crisis by establishing an appropriate fiscal policy demonstrated in the fiscal stabilisation pillar of the NEST strategy supported by donors (IMF and CDB), by revising expenditure planning, and using domestic and external financing when possible. The SBA with the IMF is closely aligned with the CDB PBL and provides for a tight and strict macro-fiscal monitoring framework.

Another important aspect is that the GoAB has made recently clear commitments to improve transparency in financial matters, in line with the Commission's proposals. It has also asked for technical assistance in this field, which should be provided soon.

2.2.3 Public Financial Management

An assessment of the Public Finance Management (PFM) situation was carried out in Antigua and Barbuda in October 2008 in the context of the preparation of the 10th EDF PFM programme. A PEFA assessment undertaken by CARTAC began in early May 2010, a draft report was submitted in June 2010 and a final report is expected by July 2010. The preliminary findings of the PEFA point to weaknesses in most of the dimensions of the PFM system in Antigua and Barbuda. However, the assessment also confirmed that reforms had taken place in 2009/2010 and there was commitment at the highest level to address the weaknesses in the system.

The GoAB has pursued various reform initiatives in the area of PFM in the past few years, intensified in recent months in the context of the upcoming IMF SBA and CDB PBL. The ongoing CARTAC support to strengthening of the PFM system includes: controls in budget spending including the installation of a new payment voucher management system expected to be phased in mid 2010; improvement of systems to track revenue and provide timely reporting; budget preparation support through implementation of new policy processes, redesign of the budget call, creation of budget ceilings as well as support in developing a
Medium term expenditure framework (MTEF); and training officials in the implementation of the Financial Administration Act (FAA).

In addition, the Government has expressed its commitment to PFM reform as demonstrated by its intention to approve and implement a PFM Action Plan based on the findings of the latest PEFA assessment and the implementation of PFM reforms in the framework of targets and benchmarks for the forthcoming IMF SBA and CDB PBL. The Government intends to continue its PFM reform with CARTAC’s support financed by DFID in 2010 and the EU 10th EDF PFM reform programme already approved will assist in supporting the country improve its PFM systems over the next three years.

On the basis of the analysis in sections 2.2.1, 2.2.2 and 2.2.3, the country is deemed to be eligible for budget support.

2.3 Lessons learnt

In the context of the food and oil price crisis and the current financial crisis, it has been demonstrated that core spending needs to be sustained during such periods, if current development gains are to be preserved and long term development goals achieved.

Antigua and Barbuda has no previous experience implementing a general budget support programme.

2.4 Complementary actions

Given the seriousness of the economic crisis, significant donor resources have been mobilised to support the GoAB including the following interventions; EU and DFID PFM technical assistance programmes for EUR 3 million and GBP 1.5 million respectively, CDB PBL with the objective of restoring fiscal sustainability for USD 30 million, World Bank (WB) Public Sector Reform programme for USD 310 000, CIDA debt management project in the ECCU and the IMF SBA for USD 117.8 million was approved on the 8 June 2010. Under the EU Technical Cooperation Facility programme of EUR 0.4 million, EUR 100 000 has been assigned to assist the Financial Sector Regulatory Commission (FSRC), to assist the GoAB in expediting pending legislation to transform the FSRC into a single regulatory unit for offshore banks and nonbanks, in line with regional agreements and international best practice.

2.5 Donor coordination

The Commission, in close cooperation with international organisations and notably the IMF and the WB, has assessed the impact of the global financial and economic crisis on the ACP States, concluding that the crisis may adversely affect macro-economic stability and progress towards achieving the millennium development goals in many of the countries.

A coordinated approach of the Commission with the IMF, World Bank, Member States and the CDB is essential throughout the Vulnerability Flex process to ensure that the response results in the maximum benefit to affected countries. As mentioned in Section 2.4, there has been a concerted effort by the donors in the region, including the IMF, to assist Antigua and Barbuda in this current crisis.

The GoAB has established a team of 4 persons within the Ministry of Finance spearheaded by the Deputy Financial Secretary to coordinate donor financed programmes between the various government departments and agencies involved in economic management.
3. **DESCRIPTION**

3.1 **Objectives**

The overall objective of the present programme is to contribute to macroeconomic stability and to support the implementation of the home-grown National Economic and Social Transformation (NEST) strategy and the macroeconomic policies of the Government of Antigua and Barbuda framed by a Stand By arrangement with the IMF and a Policy Based Loan with the CDB.

The specific objective of this Vulnerability Flex programme is to provide financial support to the Government of Antigua & Barbuda to close the residual financing gap identified in the fiscal year 2010 arising as a result of the impact of the global financial crisis.

3.2 **Expected results and main activities**

The expected result of this short-term General Budget Support programme facilitating access to Vulnerability Flex allocation is a reduction of the residual fiscal financing gap by 52% in FY 2010, in order to maintain priority expenditures in 2010, especially as they relate to social spending.

Main activities relate to policy dialogue on macroeconomic stability, public finance management reform and implementation of the national development policy.

3.3 **Stakeholders**

This Vulnerability Flex is expected to benefit the Antigua and Barbuda population in a general sense, since its direct beneficiary is the Government, through the Ministry of Finance, Economy and Public Administration (MoFEPA).

3.4 **Risks and assumptions**

Macroeconomic Risk – The GoAB is undertaking a very challenging adjustment programme in the context of restoring macro-economic stability. Risks arise from the ability of the GoAB to secure the desired level of debt restructuring necessary to eliminate the arrears; reduce public debt to a manageable level and restore the credit-worthiness of the country. To partially mitigate this risk, the GOAB has front-loaded measures to demonstrate its commitment to reform. This led to the approval of the CDB PBL in December 2009 and the IMF SBA was approved on 8 June 2010. The GOAB has also developed a communications programme to enlist public support for the reforms, and mechanisms to safeguard vulnerable groups from the negative fallout from adjustment. It is hoped that the entry into a formal IMF programme will pave the way for an engagement of Paris Club members, as well as other creditors in re-negotiation discussions which will help the debt restructuring process. It is expected the combination of fiscal and structural measures and improving global economic conditions will help the GoAB achieve fiscal and debt sustainability.

Weak Implementation Capacity - Capacity constraints can jeopardise timely and successful implementation. The programme will benefit, however, from substantial training and other assistance from development partners to the Ministry of Finance and the Economy (MOF), in particular, to implement key elements of the adjustment programme. It is assumed that a PFM action plan will be developed and endorsed by the GoAB by October 2010 in response to the recent PEFA carried out in May 2010.
Vulnerability to Natural Disasters - A high incidence of hurricanes and other natural disasters has posed major challenges for the management of public finances. Since the rash of hurricanes in the 1990s, GoAB has taken several steps to reduce vulnerability, including enforcing stricter building codes; mounting public awareness campaigns; strengthening the National Office of Disaster Services; and participating in the Caribbean Catastrophe Risk Insurance Facility (CCRIF).

3.5 Crosscutting issues

The programme has clear positive implications in the sphere of good governance. The NEST sets out the strong commitment by the GoSKN on social issues including streamlining social protection programs, implementing an unemployment insurance scheme, safeguarding social spending, prevention and control of crime, introduction of social safety nets and the plan to develop a Poverty Reduction Strategy.

4. IMPLEMENTATION ISSUES

4.1 Budget and calendar

Operational duration of this General Budget Support programme will be 12 months from the signature of the Financing Agreement (FA). The total amount allocated to this programme is EUR 9 000 000, 100% of which is for Budget Support. As the EU is already implementing a significant PFM reform support programme under the 10th EDF, no further complementary support is foreseen. The disbursement profile is presented in the table below:

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<tr>
<td>Total budget support</td>
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<td>9</td>
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</tbody>
</table>

TOTAL PROGRAMME  9

The GBS will be disbursed through one fixed tranche of EUR 9 000 000 which will be released immediately after the signature of the Financing Agreement, provided that the three general conditions expressed in section 4.4 below are met.

4.2 Budget support modalities

The programme consists of a direct and untargeted budget support, according to the modalities agreed upon on the Vulnerability FLEX decision.

4.3 Procurement and grants award procedures

Not applicable.
4.4 Performance monitoring and criteria for disbursement

The General Budget Support programme will be monitored by the EC in the assessment of the general conditions. The disbursement of the fixed tranche will be subject to the fulfilment of the three general conditions:

i) Satisfactory progress in the implementation of the National Economic and Social Transformation strategy. The assessment will be based on submission of a progress report by GoAB demonstrating progress in NEST implementation.

ii) Satisfactory progress in the maintenance of a stability oriented macro-economic policy. The assessment will be based on submission of a progress report by the GoAB on the implementation of the IMF Stand by Arrangement and available IMF Mission Reviews.

iii) Satisfactory progress in the implementation of the programme to improve public financial management. The assessment will be based on submission of a progress report on the implementation of PFM reforms in 2009 and 2010. This also requires as a pre-condition the approval of a PFM Action Plan.

The Government of Antigua and Barbuda shall use its best efforts to supply the EC in a timely manner with all the necessary information to formulate an assessment based on (i), (ii) and (iii) above, as well as ensure dialogue around the objectives supported by this General Budget Support programme, such as participation in IMF mission discussions. The GoAB is expected to host one high level review to discuss the implementation of the NEST strategy, the macro-economic situation and PFM reform programme prior to the disbursement of the fixed tranche.

4.5 Evaluation and audit

Given that these Budget Support funds are untargeted, there will be no specific audit required.

4.6 Communication and visibility

The Government will convene one formal high-level review which will promote visibility of the programme. Disbursement of V FLEX funding will receive specific media coverage assured by the GoAB.