Debt Burden and Fiscal Sustainability in the Caribbean Region - IMF Presentation

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Views expressed should not be reported as representing the official position of the International Monetary Fund.
Introduction

- Debt Sustainability continues to be a challenge for many Caribbean economies as emphasized in the presented paper.
- According to IMF’s Debt Sustainability Assessment, many Caribbean countries have high risk of debt distress.
- Despite inconclusive results on the relationship between growth and debt in the present study, debt burdens in the Caribbean continue to: i) limit fiscal flexibility; ii) discourage private investment; iii) increase macroeconomic vulnerability; and iv) dampen favorable growth dynamics in the region.
- Available policy options to restore sustainability entail:
  - Consistent **Fiscal Consolidation**
  - Comprehensive **structural reform to foster growth and enhance competitiveness to the region**
  - **Debt Restructuring**
The policy response to the Global Financial Crisis was to allow a deterioration in the fiscal accounts that has worsened the already high public debt burden.

**Caribbean Public Debt and Real GDP Growth**

- **Public Debt, Percent of GDP (WA)**
- **Real Growth Rate (WA)**

**Average Primary Balance in the Caribbean**

- **(in Percent of GDP)**

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1/ Excludes Trinidad and Tobago
Source: IMF Staff Calculations

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Source: IMF Staff Calculations
A silent debt crisis built over many years

- The global crisis and the subsequent slow recovery in advanced economies had undermined growth and exposed pre-existing balance sheet vulnerabilities in the more tourism-dependent countries of the Caribbean.

- **Debt accumulation and vulnerabilities emanated from:**
  - Increased public spending to counteract declining trade performance (partly due to the erosion of trade preferences)
  - Rebuilding costs after frequent natural disasters
  - Off-balance-sheet spending, including for financial sector bailouts
  - Government takeover of liabilities of state enterprises
The Tale of Two Carribbeans:

Commodity-based Countries  OK ; tourism-dependent Caribbean caught in a “High Debt-Low Growth” trap

➢ Tourism –dependent countries: Debt to GDP ratio higher by  15 percentage points since 2008. GDP Growth averaged -1.0 % over 2009-13.

➢ Commodity exporters: high commodity prices led to rapid economic rebound; Debt ratio stabilized at relatively low levels.

Public Debt by Country Group

Real GDP Growth
( YoY Percent Change)

Source: IMF Staff Calculations
Stabilizing Debt levels may prove challenging, particularly in light of low growth and high interest burden.

### Public Debt Burden, 2013
(In Percent of GDP)

<table>
<thead>
<tr>
<th>Country</th>
<th>Debt Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jamaica</td>
<td>150</td>
</tr>
<tr>
<td>Grenada</td>
<td>120</td>
</tr>
<tr>
<td>St Kitts</td>
<td>100</td>
</tr>
<tr>
<td>Antigua</td>
<td>80</td>
</tr>
<tr>
<td>Barbados</td>
<td>70</td>
</tr>
<tr>
<td>St. Lucia</td>
<td>60</td>
</tr>
<tr>
<td>St. Vincent</td>
<td>50</td>
</tr>
<tr>
<td>Belize</td>
<td>40</td>
</tr>
<tr>
<td>Dominica</td>
<td>30</td>
</tr>
<tr>
<td>Guyana</td>
<td>20</td>
</tr>
<tr>
<td>Bahamas</td>
<td>15</td>
</tr>
<tr>
<td>Trinidad</td>
<td>10</td>
</tr>
<tr>
<td>Suriname</td>
<td>5</td>
</tr>
</tbody>
</table>

### Interest Burden
(In Percent of total revenues)

<table>
<thead>
<tr>
<th>Country</th>
<th>Interest Burden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jamaica</td>
<td>40</td>
</tr>
<tr>
<td>St. Kitts</td>
<td>30</td>
</tr>
<tr>
<td>Grenada</td>
<td>20</td>
</tr>
<tr>
<td>St. Lucia</td>
<td>15</td>
</tr>
<tr>
<td>Bahamas</td>
<td>10</td>
</tr>
<tr>
<td>Antigua</td>
<td>5</td>
</tr>
<tr>
<td>St. Vincent</td>
<td>3</td>
</tr>
<tr>
<td>Dominica</td>
<td>2</td>
</tr>
<tr>
<td>Belize</td>
<td>1</td>
</tr>
<tr>
<td>Suriname</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Source: IMF Staff Calculations
Because of their middle income status, the majority of Caribbean countries has not benefited from international debt relief. At the present time, there is still little appetite among the membership regarding relief for non-HIPC members.

Moreover, only few Caribbean countries still qualify for concessional borrowing at the World Bank.

A three-pillar approach to restoring debt sustainability involves:

A. Significant fiscal consolidation, through a “balanced combination” of spending cuts and revenue enhancement

B. Growth Enhancing Structural reform to accelerate exit from the debt trap

C. Debt restructuring that may be inevitable in some circumstances.
A. Fiscal consolidation efforts need to be consistently and diligently pursued over time

- On the spending side, governments need to pursue:
  - Better control of the public wage bill
  - Better targeting of subsidies and transfer payments, including pension reform
  - Improvements in expenditure efficiency through prioritizing spending toward productive and growth enhancing infrastructure.
  - Stronger oversight and rationalization of state-owned enterprises.

- On the revenue mobilization side:
  - Enhance the efficiency of revenue collection and minimize the practice of pervasive discretionary tax concessions. *Tax concessions result in an estimated forgone revenue of about 8 percent of GDP for ECCU countries.*
  - Harmonize tax rates and broaden the tax base.
  - Fiscal consolidation needs to be complemented by *tax policy reforms, containment of contingent liabilities, and rationalization of public services.*
Restoring Debt levels to the 60 Percent regional target by 2020 requires ambitious fiscal consolidation by many Caribbean countries.

Current and Target Primary Surpluses 1/
(in Percent of GDP)

1/ assumes a debt target of 60 percent of GDP by 2020
Source: IMF Staff Calculations
The IMF’s Debt Sustainability Assessment Framework models adjustment efforts in some Caribbean countries that are high by historical standards.
B. Absent a credible solution to address the debt overhang, debt restructuring may be considered as a last resort

- If fiscal consolidation *fails to achieve debt sustainability* and macroeconomic vulnerabilities remain significant, restructuring may play a role.

- However, debt restructurings should always be part of a *credible and a comprehensive reform program* that restores both debt sustainability and creditors’ confidence.

- Restructuring should be supported by key stakeholders, including multilateral support.

- Effective communication of government policy and strategy is crucial.

- Spillovers and contagion effects should be effectively contained.
...however, debt profile may limit restructuring options,

- Highly indebted Caribbean countries have significant exposure to external lenders
- External Debt (non-Paris club) maybe more difficult to restructure

**Public Debt by Source**
( in Percent of Total Public Debt)

**Composition of External Debt**
( in Percent of Total Public Debt)

Source: IMF Staff Calculations
...and attempts to restructure domestic debt can also be costly.

- Restructuring **domestic debt** has to be mindful of the impact on the **domestic financial system**, which in some cases is already distressed.
- In the Caribbean, **Over 60 percent of domestic debt** is held by domestic financial institutions.
- **Social security schemes** may be set to lose unless protected.

### Holders of Domestic Debt in the Caribbean 1/ (in Percent)

- **Central Bank**: 7%
- **Commercial Banks**: 36%
- **Non-bank financial institutions**: 27%
- **Social security schemes**: 20%
- **Others**: 10%

1/ latest breakdown in all Caribbean countries as of 2011
Source: IMF Staff Calculations
Risks to the financial sector in Jamaica and St. Kitts and Nevis were somewhat mitigated by **the creation of reserve funds** to provide temporary liquidity support to solvent financial institutions that might be affected by the debt restructuring.

#### Recent Sovereign Debt Restructurings in the Caribbean

<table>
<thead>
<tr>
<th>Case</th>
<th>Preemptive or Post-Default</th>
<th>Type</th>
<th>Date of Exchange</th>
<th>IMF Program</th>
<th>Debt Exchanged (in billion US$)</th>
<th>Cut in Face Value (percent)</th>
<th>NPV Haircut Estimate (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Antigua &amp;Barbuda</td>
<td>Post-Default</td>
<td>Debt Exchange</td>
<td>2009</td>
<td>Yes</td>
<td>1.0</td>
<td>26%</td>
<td></td>
</tr>
<tr>
<td>Jamaica</td>
<td>Preemptive</td>
<td>Debt Exchange</td>
<td>2010</td>
<td>Yes</td>
<td>6.7</td>
<td>0%</td>
<td>21%</td>
</tr>
<tr>
<td>Jamaica</td>
<td>Preemptive</td>
<td>Debt Exchange</td>
<td>2013</td>
<td>Yes</td>
<td>8.9</td>
<td>0%</td>
<td>10%</td>
</tr>
<tr>
<td>St. Kitts and Nevis</td>
<td>Preemptive</td>
<td>Debt Exchange</td>
<td>2012</td>
<td>Yes</td>
<td>0.14</td>
<td>22%</td>
<td>65%</td>
</tr>
<tr>
<td>St. Kitts and Nevis</td>
<td>Preemptive</td>
<td>Debt-Land Swap</td>
<td>2013/4</td>
<td>Yes</td>
<td>0.3</td>
<td>0%</td>
<td></td>
</tr>
</tbody>
</table>

Source: IMF Staff
C. Restoring growth in the region is fundamental to debt sustainability

- Restoring growth mandates a set of robust structural reforms alongside policy options to enhance competitiveness, including *internal devaluation, fiscal devaluation and, in some instances, exchange rate adjustment.*
- Other reform efforts have been effectively picked up in the **Caribbean Growth Forum (CGF):**
  - **Reducing energy costs** by reforming the sector, addressing its inefficiencies and exploring renewable energy options.
  - Adopting a strategy for **human resource development** and investing in skill development and vocational training.
  - Reorienting public spending toward **productive infrastructure**
  - Increasing the **role of private sector** in the economy and considering public-private partnerships (PPP) in implementing key developmental projects.
Structural reform should seek to enhance Macroeconomic Resilience

- Small states in the Caribbean are **highly vulnerable** to frequent and costly natural disasters.

- A successful growth strategy should be mindful of existing vulnerabilities and should attempt to **build long-term resilience to recurrent disasters** to avoid negative repercussions on debt dynamics.

- Caribbean small states should also continue to pursue climate-change funding.

- Additionally, efforts should be stepped up, both to identify and provision for any **vulnerabilities in the financial system to stem potentially sizable contingent liabilities**.

- Reform agenda should **build institutional capacity, particularly in public financial management**.
Conclusions

- **Fiscal adjustment is unavoidable** given the extent of fiscal and external imbalances and the debt overhang.

- **A comprehensive growth strategy** that centers on greater private-sector involvement and investments in human capital is necessary to exiting the “high debt-low growth” trap.

- Any strategy should focus on **enhancing resilience to natural disasters**.

- **A Stronger supervisory and regulatory framework** is needed to tackle long-run fiscal risks, particularly large contingent liabilities stemming from financial system vulnerabilities.

- **Partnering with IFIs** can help develop balanced strategies that achieve debt sustainability while securing inclusive growth.