Addressing Macroeconomic Challenges in Small States

Jeffrey D. Lewis
Director, Economic Policy, Debt and Trade Department
World Bank

What makes many small states different from larger peers?

High Vulnerability

- Exposure to international price fluctuations/ concentrated exports & high import dependence
- High costs of trade
- Vulnerability to natural disasters
- Financial sector vulnerability
- Importance of aid (esp. Pacific)

Restricted Policy Space/Limited Resilience

- Diseconomies of scale in delivery of public services
- Economic impact of natural disasters large relative to policy buffers
- High Debt and Financing Challenges
- Limited Fiscal Space
- Low and volatile growth

Impact of Natural Disasters in Caribbean states

- Natural disasters

Percentage Point change in Debt-to -GDP level

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Antigua & Barbuda	20.5	4.9	10.4	-1.3	-7.0	-23.5	-5.7	-12.5	-0.5	25.4	-12.5	4.1	-5.2
Bahamas, The	-0.9	0.3	2.0	1.7	1.9	-0.5	0.0	1.0	2.9	4.3	7.5	-13.2	3.5
Barbados	6.5	8.5	9.1	-3.2	1.4	-11.4	3.6	7.3	9.1	10.2	12.8	-0.2	-0.2
Belize	23.5	9.5	5.0	13.7	-0.3	-0.1	-9.9	-7.6	-8.0	3.3	2.4	-2.0	-4.1
Dominica	8.7	39.1	5.3	-1.6	-17.8	-7.1	-4.1	-5.2	-9.4	0.6	5.6	1.3	1.5
Grenada	4.2	5.8	42.6	-0.5	18.9	-10.3	6.2	-5.5	-8.8	20.1	5.3	0.9	-4.9
Guyana	-1.1	-10.1	1.7	-11.8	-1.3	-2.5	-22.6	-33.1	1.6	-1.1	0.5	-0.1	-4.8
Jamaica	7.6	15.0	0.7	-0.7	-4.5	-1.9	-9.1	-7.8	39.4	15.3	13.3	2.2	5.0
St. Kitts & Nevis	9.7	17.3	23.2	18.5	12.0	1.4	-6.6	-8.0	-11.3	14.7	14.2	-10.1	-16.0
St. Lucia	4.3	6.7	12.8	-2.1	5.8	1.0	-0.9	1.0	-1.3	9.4	2.1	6.5	7.3
St. Vincent & Grens.	0.9	0.6	2.2	1.8	5.9	2.7	-4.0	-9.3	2.6	5.5	3.4	4.0	2.4
Suriname	17.7	-17.4	-1.6	-7.6	-3.2	-3.5	-6.5	-8.4	-3.1	2.3	3.0	0.6	0.1
Trinidad & Tobago	-2.0	3.0	3.2	-8.3	-6.9	-8.2	-3.8	-3.8	-3.7	11.4	5.1	-3.6	6.3

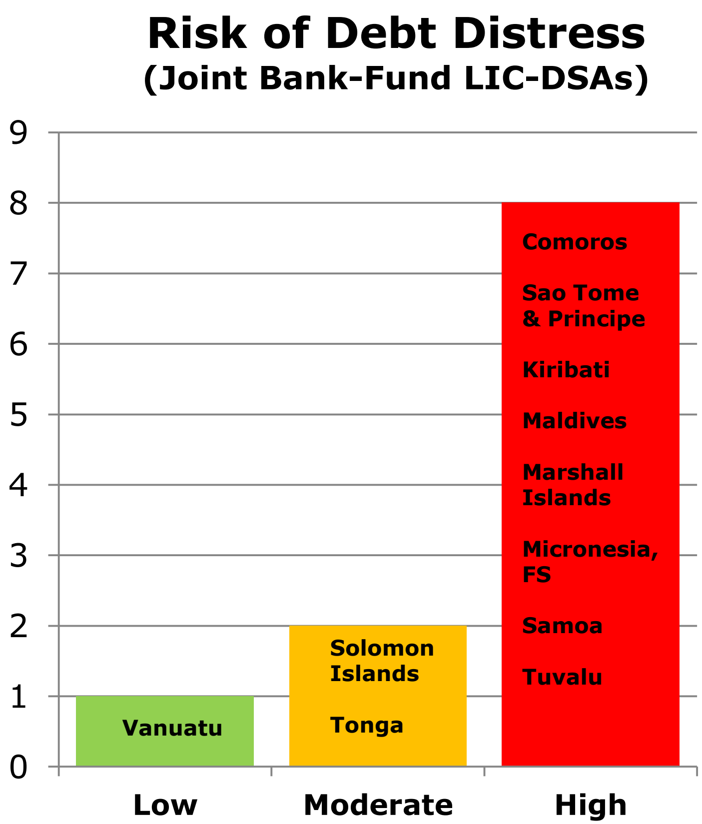
U.S. Recession (2001–2002)

Global Financial Crisis (2009–2010)

coincides with major natural disaster

Source: WB staff calculations

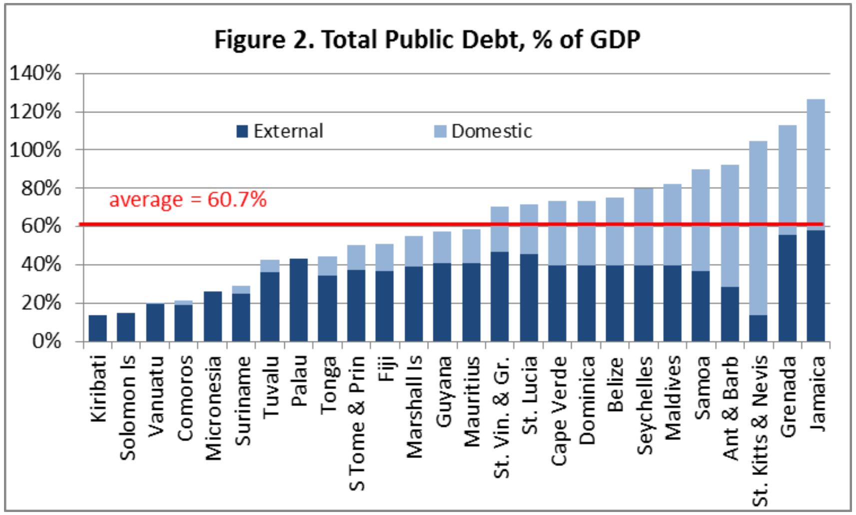
Many small states moderately to highly indebted

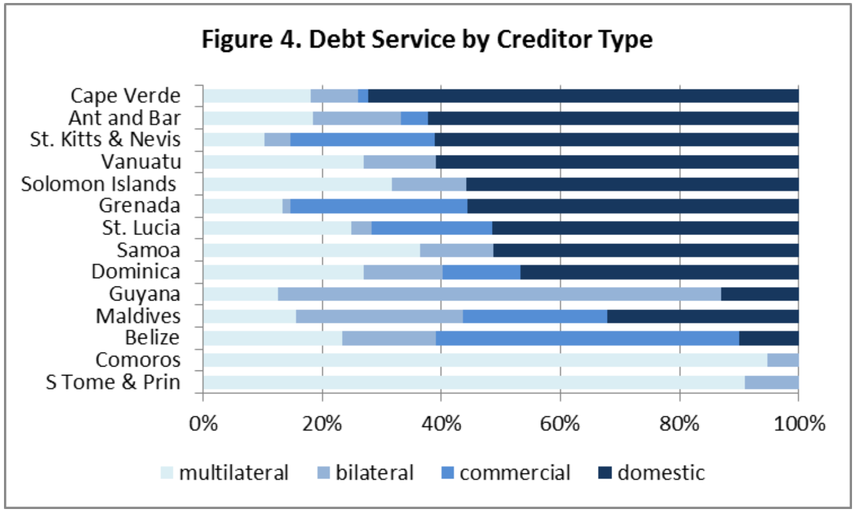


- Amongst <u>IDA</u> countries, all but one of the small states are at **moderate to high risk** of external debt distress; among <u>WB</u> clients, 14 out of 53 countries with moderately high to high risk to *domestic or external* debt distress are small island states
- 8 of the 15 countries at **high risk** of external debt distress are small island states

Some additional issues for small higher-income countries

- Many SIDS are:
  - middle- and high-income countries (according to WB's income classification)
  - not eligible for IFI concessional resources or debt relief
- Some have had to rely on bonds
  - Complicated debt restructuring process
  - High debt to private creditors
- Several SIDS have also rely heavily on domestic debt





Proposals on financial instruments to small states

- Debt swaps for climate change adaptation and mitigation
  - Challenge: unlikely to represent a comprehensive solution
- Vulnerability as a criteria for eligibility to access concessional resources
- World Bank initiatives:
  - In IDA-17 lending terms to small island states exempted from lowering maturity and grace of regular IDA terms
  - Annual minimum base allocation increased from SDR 3 million to 4 million, which likely benefits mostly small states
  - Countercyclical loans (IDA-17 Crisis Response Window)
- Resilience building as a policy condition for international financial institution lending

The Challenge: Building Resilience

- Macro/budget management
  - Prudent macroeconomic management best positions the economy against shocks and facilitates rapid donor response
  - Sound budget management maximizes value from resources
- Debt headroom
  - Maintaining a cushion between current debt levels and 'debt distress' thresholds provides room to use concessional loans to mitigate the impact of shocks on the economy
- Asset buffers
  - Build prudential reserves
  - Catastrophe loans/bonds/contingent credit lines
- Reduce vulnerability
  - Facilitate use of alternative energy to reduce oil dependence
  - Facilitate natural resource/tourism industry development
  - Expand labor market access to secure remittances

The Comprehensive Debt Framework

The framework is structured around four pillars, reflecting the fundamental causes and symptoms of high debt in small states.

4 pillars for reducing long term debt:

Enhancing private sector led growth

Improving fiscal management

Mitigating fiscal impact of natural disasters on debt and fiscal profile

Restructuring debt portfolios

3 instruments for debt restructuring

A: Debt buy-back operation

B: Debt for debt swap

C: Debt equity/asset swap

Implementation of the CDF and Similar Approaches in SIDS

Grenada CDF	The Government of Grenada has designed a comprehensive program to boost inclusive growth and restore fiscal sustainability. The program is being supported by the World Bank, IMF, and CDB; discussions are ongoing for an ECF and DPL
Pacific Catastrophe Risk Insurance Pilot CDF Pillar 3	Innovative solutions for SIDS highly exposed to natural disasters: • Innovative financial products to raise resilience • Advisory services to strengthen budget planning and execution • Private sector involvement • In collaboration with donor partners
Seychelles CDF Pillars 1,2, &4	Crisis Response: High debt, loss of competitiveness and reserve losses led to payments default. Reforms have reinstated high pc GNI, standards of living and human development indicators, and better governance than comparators. Reforms included: Exchange rate liberalization; significant tightening of fiscal policy; reducing state's role in economy; debt restructuring; debt relief.