Session II. Promoting Effective Debt Management in Small States

A Comprehensive Debt Framework for Small States

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Challenges of Small States

1. Diseconomies of Scale Associated with Public Services
2. High Cost for Trade
3. Exposure to Fluctuations in International Prices
4. Vulnerability to Natural Disasters
5. Low Productivity
6. Low and Volatile Growth
7. Limited Fiscal Space
8. Financial Sector Vulnerability
9. High Debt and Financing Challenge

Small States are heterogeneous and therefore the problems facing each country differs.
Contributing Factors to High Debt

Primary balance, high interests payments and low growth play an important role in explaining Caribbean’s high debt.

Source: WB staff calculations
### Contributing Factors to High Debt

- Natural disasters

### Percentage Point change in Debt-to-GDP level

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Source: WB staff calculations

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- U.S. Recession
- Global Financial Crisis

**Note:**
- Red indicates a major natural disaster coincides with a significant change in debt-to-GDP ratio.
- Source: WB staff calculations.
Contributing Factors to Financing Challenge in the Pacific Islands

The Pacific Islands face a significant financing challenge, which results in an over-reliance on official development assistance (ODA).

- Some of the reasons for the limited international market access are:
  - Capacity constraints
    - Legal barriers
    - Administrative frameworks
  - Structural constraints
    - small market size,
    - absence of credit bureaus and
    - shallow money markets.
- This has resulted in their inability to gain access to international capital markets and attract capital inflows (with the exception of Fiji and the Maldives)

### ODA as a percent of GNI in 2011

<table>
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<th>Country</th>
<th>ODA as % of GNI 2011</th>
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<td>Tuvalu</td>
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<td>Solomon Islands</td>
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<td>Micronesia, Fed. States</td>
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<td>Marshall Islands</td>
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<td>Fiji</td>
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Source: OCDE - International Development Statistics
Challenges Require a Multifaceted Solution

• Given the myriad of challenges facing small states, there is no simple solution.
• Piecemeal solutions to the challenges will not set these countries on a sustainable path.
• Debt restructuring while important has not always resulted in a sustained reduction in the debt burden.
• The benefit of debt restructuring has generally been in reducing debt service. In terms of reducing the ratio of public debt to GDP the impact has been less.

**Diagram: Ratio of Public Debt to GDP before and after Restructuring**

- Jamaica (2010)
- Belize (2007)
- Dominica (2004)
- Seychelles (2009)
- Grenada (2005)
- Dominican Republic (2005)

Source: IMF – WEO and IMF staff estimates.
Note: t indicates the launch of the debt restructuring. Source: Jahan, S, in IMF (2013)
The Way Forward: 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
Pillar 1: Enhancing private sector growth

Reducing Debt to GDP by expanding the denominator

- Private sector is the hope for growth as high wage bills, limited fiscal space and high debt constrain public sector expansion and uncertainty of public financing.

- Barriers to private sector growth include:
  - Business friendly environment
  - High costs of logistics
  - High energy costs
  - Limited supply of human capital
Pillar 2: Improving fiscal management

Boost the overall public balance by:

- Raising fiscal revenues – could move to more efficient tax systems such as VAT
- Cutting expenditures but prioritizing growth enhancing capital expenditure
- Exploiting cross country provision of public goods that will allow reduction of costs through greater scale

Improve debt management through:

- control off budget spending and the issuance of public guarantees
- improving audit capacity
- developing debt management strategies and risk assessment
Pillar 3: Mitigating impact of natural disasters

- Expand use of insurance such as through the Caribbean Catastrophe Risk Insurance Facility or self insurance through sovereign funds
- Increase public investment in areas that increase resilience to natural disasters
- Use of Cat-Bonds

Pillar 4: Debt Restructuring

- A: Debt buy-back operation, and/or
- B: Debt for debt swap, together with
- C: Debt equity swap/Debt asset swap

Principles of design

- Equitable treatment of all creditors
- Fair distribution of restructuring burden – eg. Countries should, where possible, use their own assets to repay their obligations
Implementation of the CDF: Caribbean

Small States

Grenada

The Government of Grenada has designed a comprehensive program to boost inclusive growth and restore fiscal sustainability. The program is being supported by the IMF and the World Bank and discussions are ongoing for an ECF and DPL.

Jamaica

The Government of Jamaica is implementing a medium term economic program targeting elimination of risks associated with the high debt levels and the promotion of sustained growth. The IMF is supporting fiscal reforms and debt management through an EFF. The IDB and the World Bank are currently preparing a program.

The Comprehensive Debt Framework has been presented in the OECS, Barbados and Belize.
Implementation of similar approaches in other small states

Sao Tome and Principe

On June 6, 2013, a Development Policy Operation was approved

- The program aims to:
  - strengthen economic governance
  - improve the management and reporting of statistics
  - promote fiscal stability and strengthening public debt management; and
  - support broad-based growth

≡ CDF Pillars 2&4
Seychelles crisis response program

- Seychelles has come a long way since its 2008 crisis:
  - High GNI per capita (US$11,070 in 2011)
  - High standards of living
  - Good levels of human development
  - Better governance indicators than many comparator countries

High external indebtedness and loss of competitiveness built up over prior years precipitated a depletion of foreign exchange reserves and a payment default.

Seychelles has strongly pursued reforms:
- Fundamental liberalization of the exchange regime
- Significant and sustained tightening of fiscal policy
- A reduction in the state’s role in the economy
- Public debt portfolio was restructured by the Paris Club and other private creditors
- Secured generous debt relief

CDF Pillars 1, 2, & 4
Building natural resources resilience

Innovative solutions for small island states against natural disasters
- Pacific Catastrophe Risk Insurance Pilot
  - Regional initiative with fragile states
  - Five IDA countries highly exposed to natural disasters
  - Innovative financial products to increase financial resilience against natural disasters
  - combined with advisory services to strengthen ex ante budget planning and post-disaster budget execution
  - Involvement of the private sector
  - Partnership with donor partners
  - Collaboration within the World Bank – EAP, SDN, FPD, TRE, LEG, CFP

CDF Pillar 3
Mauritius

Building economic resilience through diversification

1970
- Monocrop Economy
  - SUGAR
  - MANUFACTURING (local)

1980
- Manufacturing & Tourism
  - SUGAR
  - MANUFACTURING (local)
  - TEXTILE
  - SUGAR
  - TOURISM
  - FINANCIAL SERVICES
  - FREEPORT

1990
- Manufacturing & Services Economy
  - TEXTILE
  - SUGAR
  - TOURISM
  - FINANCIAL SERVICES
  - ICT / BPO
  - IRS
  - SEAFOOD

2000
- Manufacturing & Services Economy
  - SUGAR
  - TEXTILE
  - TOURISM
  - FINANCIAL SERVICES
  - ICT / BPO
  - IRS
  - SEAFOOD
  - FINANCIAL SERVICES
  - ICT/BPO
  - REAL ESTATE & P D
  - KNOWLEDGE IND
  - MEDICAL SERV
  - RENEWABLE ENERGY

2010
- Business Platform
  - SUGAR CANE (C)
  - TEXTILE & FASHION (C)
  - HOSPITALITY (C)
  - SEAFOOD (C)
  - FINANCIAL SERVICES
  - ICT/BPO
  - REAL ESTATE & P D
  - KNOWLEDGE IND
  - MEDICAL SERV
  - RENEWABLE ENERGY

...where the pillars by themselves are being implemented

- Formal and informal mechanisms of interaction between Private sector and Government have designed the reforms that were needed to transform the country

Source: Raj Makoond

CDF Pillar 1
Thank you
Annex
Caribbean Countries and other small states are amongst the most highly indebted in the World

Emerging Markets and Developing Countries with General Government Gross Debt above 60 percent of GDP in 2012

- The debt-to-GDP ratio is high and above the emerging markets and developing countries average in most Caribbean countries and other small states.

Source: IMF – WEO and Article IV