THE IMPACT OF HIGH DEBT BURDENS
ON
SMALL CARIBBEAN STATES

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Introduction:

The growth and development of many small Caribbean states are being negatively impacted by their onerous debt burdens, which force them to generate high primary surpluses as a percentage of Gross Domestic Product (GDP) and thereby prevent them from spending on infrastructure development and the provision of basic social services which are necessary to attract investments and improve their absorptive capacities.

The primary surplus represents the extent which a government is prepared to reduce expenditure on basic social services such as- health, education, national security and infrastructure development in order to service the public debt. However, in order to properly assess the impact of the debt burden on the growth and development of small Caribbean states, it is of paramount importance to take a contemporary as well as historical perspective.

While the international community, particularly the Washington based International Monetary Fund (IMF) and its sister agencies, the World Bank and the Inter-American Development Bank (IDB), as the African Development Bank (ADB), are focused on the debt problems of major debtors, as well as highly indebted poor countries (HIPC), very little attention is being paid to the debt problems of small Caribbean states, such as Jamaica which are middle income countries.

Empirical analysis indicate that since 1990 the debt burdens, particularly the external debts of small states have been growing faster than those of low income countries, with the biggest jumps being recorded by members of the Organisation of Eastern Caribbean States (OECS) East Caribbean Central Bank (ECCB) and Belize.

The same data also revealed that since 1999 the rate of external debt accumulation in small states has been twice that as fast as that of developing countries as a whole. A further analysis of the situation also indicate that this represented a reversal of the situation in 1990 when the external debts of developing countries rose twice as fast as those of small states.

A deeper analysis of the data reveals that during the year 2003 small states such as Belize, Dominica, St Kitts and Nevis as well as Samoa recorded external debt to GDP ratios of more than 100 per cent. Meanwhile, Grenada, and Antigua had external debt to GDP ratios of over 75 per cent according to data provided by the Washington based, World Bank.

Using the net present value of external debt thresholds, the Bank posited that St Kitts/ Nevis, Grenada, Jamaica, St Lucia and St Vincent and the Grenadines were moderately indebted. The government's of these small Caribbean states do not only have to service their external debts, but their total debt burden, which includes the high cost internal debt in Jamaica's case. Jamaica's total debt to GDP ratio currently stands at 121 per cent.

DEBT TO GDP RATIOS OF SMALL CARIBBEAN STATES (%)

Country	Dec. 2000	Dec. 2001	Dec. 2002	Dec. 2003
Barbados	73.3	81.6	83.8	84.1
Dominica	92.5	107.5	124.6	127.3
Grenada	59.5	82.6	116.4	116.7
Jamaica	140.0	146.4	142.6	136.4
St Lucia	43.2	49.6	56.2	62.8
St Vincent	66.7	68.2	74.4	74.9

Genesis of crisis:
The international debt crisis became apparent in 1982 when Mexico defaulted on its foreign debt, sending shock waves through the international community, as creditors feared that other countries would do the same.

The immediate cause of the crisis occurred in 1973 through the process of petro dollar recycling- when the members of the then Sheik Ahmed Zaki Yamani–led Organisation of Petroleum Exporting Countries (OPEC) quadrupled the price of crude and invested the excess liquidity in European and American Commercial Banks.

These banks then used these funds to make loans to developing countries without conducting proper sovereign and credit risk analyses and monitoring of these loan flows.

This irresponsible behaviour on the part of the creditors and many donor governments resulted in a lot of these funds being squandered on non productive projects such as, the purchase of armaments, grandiose public development initiatives and other private sector ones which only benefited public officials and the ruling elites. The jump in oil prices in 1973 also helped to spread the inflation virus in the United States and Europe.

In 1979 OPEC raised the price of oil- the precious commodity again and the US Federal Reserve Board (Fed)- the world's most powerful central bank which was then led by Paul A volcker- hiked interest rates in order to contain the spreading inflation virus leading to a recession.

The locomotive theory contends that the American economy is the locomotive of the international economy because of its share of the world's Gross Domestic Product (GDP), therefore the recession in the US and the combined impact of rising fuel prices, as well as interest rates led to worldwide recession.

Developing countries suffered the most from this crisis as the demand for their exports basically collapsed, while the cost of production jumped on the back of the higher crude prices- simply put terms of trade or the ratio of export prices to import prices deteriorated badly.

The debt burdens of many Latin American and Caribbean countries surge in both absolute and relative terms, as the cost of servicing their variable rate debt climbed.

African governments also reacted to the worldwide collapse in commodity prices by borrowing from other governments and multilateral agencies at both market and concessional rates. When Mexico finally announced that it could not repay its external debt the international financial system appeared to be on the brink of collapse, forcing the world's major creditors to take coordinated actions to save the commercial banks and the world economy.

Impact on the South:

The existence of debt has social, financial and political implications for example heavily indebted poor countries have higher rates of infant mortality, disease, illiteracy and malnutrition than the developing and developed ones. Massive debt repayments preclude them from dealing with many of these problems simultaneously.

From a financial stand point, high levels of indebtedness is a signal to the international financial community that a country is an investment risk because it is either unwilling or unable to repay its debts. This contributes to the cutting off of these countries from the international capital markets, unless they are willing to pay extremely high rates.

The United Nations Development Programme (UNDP) posits that the interest paid by poor countries were four times as high as those paid by developing countries in the 1980s, due to their inferior credit ratings, as well as currency deteriorations.

Impact on Small Caribbean States:

Many small Caribbean states, including Jamaica, are still suffering the same fate as their counterparts in Africa, Asia and Latin America. For example, Jamaica was not able to successfully re-enter the international capital markets until 1997 and even then the country had to pay and high cost.

The high cost of serving this massive debt and the need the generate huge primary surpluses in order to service this debt has severely constrained the abilities of these countries to invest in basic social services and human as well as infrastructural development.

Let’s use Jamaica as a case in point, the country’s has mobilized almost US$5 billion in direct investment during the last five years, but despite this the economy has officially grown at a weak annual average rate of 1 per cent.

This is mainly because the cost of servicing the debt as a percentage of the budget which climbed to as high as 70 per cent during the year 2000 before falling to 54 per cent last year preventing the government from pumping the kind resources needed in order to facilitate the development of education solid waste management, health care and infrastructure as well as human resources.

In Jamaica the $210 billion or 33 per cent of GDP needed to service the debt prevents the government from funding the vital area of national security properly. Data released by the International Monetary Fund (IMF) and the World Bank posit that crime is costing the country some 4 per cent of GDP or $40 billion annually.

The cost of crime to the economy, in combination with the weak absorptive capacity, due to the insufficiency of investments in education, training and infrastructural development have severely constrained the official rate of growth of the Jamaica economy during the last 10 years.

REAL RATE OF GROWTH OF JAMAICAN ECONOMY (%)

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
-2.4	1.0	0.8	0.7	1.5	1.1	2.3	0.7	2.4	2.9

GUYANA:

Guyana's debt burden which stood at 189 per cent of GDP in 1999 forced the country to seek debt relief under the Highly Indebted Poor Countries Initiative (HIPC) in 1999 in order to maintain macro economic stability. In October 2000 the country also became eligible for additional debt relief under the enhanced HIPC initiative.

Guyana however experienced some serious set backs in its quest for debt relief, in particular, the country went off-track with its IMF programme in December 2002 when it refused to reduce its public sector apparatus and privatize the Guyana Sugar Company (GUYSUCO).

The country also narrowly escaped being sued by Booker Plc for an old debt, which should have been cancelled under the HIPC initiative. Booker however dropped the case, on the back of British based, Jubilee campaigners. The debt sustainability analysis for the country which has a per capita GDP of US$1,040 however indicates that it has enough resources to service its debt, while fully funding its Millennium Development Goals (MDGS).

The change in ideology, which followed the 1985 elections, enabled Guyana to borrow heavily from western governments. During the 1970s when the country pursued an anti-western stance its total public debt stood $83 million, or 33 per cent of its $247 million GDP. This figure however jumped to $1.7 billion or 161 per cent of its $651 million GDP.

This growth in the debt was not accompanied by growth in the economy and this exacerbated the political instability which characterized the country for most of the previous decade. The fall in commodity prices also led to a steep reduction in the country’s revenues from exports.

Guyana is a very interesting case because the country went through the HIPC Initiative twice-first it was the original HIPC and then it was the enhanced HIPC.

The original HIPC was launched in 1996 and the admission criteria related to sustainability of debt. The ratio between the net present value of the total public debt and exports, as well as revenues was the two eligibility criteria used.

A country's debt was considered unsustainable if its ratio of debt to exports was more than between 200 to 250 per cent. The debt was also said to be unsustainable if the ratio of debt to revenues was more than 280 per cent. Guyana's debt to exports was only 180 per cent but the NPV of its debt was 469 per cent of its revenues therefore its debt service burden was deemed to be unsustainable.

The country reached the decision point under the original HIPC programme in 1997 and the completion point in 1999. Meanwhile, the enhanced HIPC programme was launched 1999, on the back of pressures from jubilee campaigners and the indicators used for admission were lowered to a NPV to export ratio of 150 per cent and a NPV to revenue ratio of 250 per cent.

The IMF and the World Bank decided that some of Guyana's debt should be cancelled in 1997 because of the recognition that the country's debt burden was onerous and therefore servicing it means that the country had to divert resources from the provision of basic social services in order to pay the debt. Simply put- the country would have to generate huge primary surpluses. The country has also been running large fiscal deficits for years.

The country however had to give a commitment to implement the neo liberal policies of the Washington consensus, which includes structural reforms, privatization, public sector restructuring, debt management and poverty alleviation measures.

The IMF contended in its latest Article Four Consultations on the economy dated May 11, 2007 that the country grew by 5 per cent in 2006, after declining by 2 per cent during the year 2005. This recovery was driven by strong increases in private sector credit, remittance flows and foreign direct investment.

Inflation fell to 4 per cent last year but the country's current account deficit zipped to 28 per cent of GDP from 9 per cent in 2004 due to a big jump in imports of capital and consumer goods. The country's fiscal deficit however declined from 13.6 per cent of GDP in 2005 to 11.2 per cent last year, despite an ambitious public sector investment programme.

The deficit- excluding the cost of the public sector modernization programme was however projected at 5 per cent of GDP. Public expenditures were estimated at 25.5 per cent of GDP in 2006, while total public expenditures social services remained at a high 23 per cent of GDP.

Public sector wage increases were also kept in line with inflation in order to support the process of fiscal consolidation. The executive directors of the Fund also commended the authorities for implementing sound macro economic policies, leading to higher levels of growth lower levels of inflation and an improved in the debt sustainability outlook.

GUYANA SELECTED ECONOMIC INDICATORS

(ANNUAL % CHANGE)

	2003	2004	2005	2006	2007
GDP	0.7	1.6	-1.9	3.5	5.2PR
GDP DEF	5.4	4.3	7.5	4.3	4.2
CPI	5.0	5.5	8.3	5.7	5.0
EX RAT	1.3	2.8	0.3	0.2	
RER	-5.6	-4.3	8.9		

Source: International Monetary Fund.

Guyana's Public Finances % of GDP

	2003	2004	2005	2006	2007
Rev/grants	39.6	44.0	44.1	51.3	45.2
Non int ex	42.0	43.2	49.0	51.9	46.6
Pri-surp**.**	-2.4	0.9	-4.9	-0.5	-0.9
Int.payment	5.8	5.0	4.4	4.2	3.7
Savings	5.8	10.1	6.7	11.4	9.2

Source: International Monetary Fund.

ST LUCIA:

St Lucia had the best debt to GDP ratio of all independent Caribbean states, apart from Trinidad & Tobago in December 2004. The country's public debt however jumped during the last 14 years because of a steep reduction in the level of grants and aid, which it received, forced it to borrow more.

The country's was also unable to generate the levels of budget surpluses needed to fund certain public sector projects, forcing it to borrow more heavily. The country as also been running large fiscal deficits during the last few years.

ST LUCIA'S OVERALL BALANCE (%)

1998	1999	2000	2001	2002
1.8	2.3	-1.4	-3.9	-7

Source: The Business of Debt.

ST.LUCIA'S DEBT TO GDP RATIO (%)

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2001	2002	2003
28.4	32.7	35.6	40.8	43.5	42.7	46.8	40.0	41.8	41.4	46.0	56.2	62.8

Source: The Business of Debt

IMF ARTICLE FOUR CONSULTATIONS:

The IMF posited in its most recent Article Four Consultation that the St Lucian economy strengthened in recent years. Real GDP growth ran at an annual average of 4 per cent during the period 2003-2005 and about 5 per cent last year.

Economic activity was driven by the construction and government services, related the hosting of Cricket World Cup 2007. Inflation remained low anchored on the country's membership in the Eastern Caribbean Currency Union (ECCU). The pace of growth is however expected to decelerate to 3.5 per cent this year, on the back of slower tourism earnings.

The country's current account deficit however rose sharply to 30 per cent of GDP last year, despite strong capital inflows. This was mainly due to the higher levels of imports related to hotel construction and a deterioration in the terms of trade.

This deficit is however expected to narrow this year due to a slowing of CWC related import spending and a modest rebound in exports of goods and services. This current account deficit is projected to be largely financed by foreign direct investment flows.

The country however remains vulnerable to external shocks, due its dependence on oil, declining European Union (EU) banana preferences, volatile tourism receipts and heavy exposure to natural catastrophes.

There was however a general acceptance of the key challenge related to the achievement of sound public finances and ensuring debt sustainability during the consultation process.

Although St Lucia's debt is the lowest in the ECCU, it is still high by international norms. The IMF also pointed out that the country's high debt service costs constrain the extent of the fiscal room in which it has to manoeuvre in order to deal with adverse economic shocks.

The IMF also supported the St Lucian Authorities' medium-term objective to deepen fiscal consolidation, reducing the public debt through tighter spending and increasing the efficiency of tax collections.

DOMINICA:

Goohoon Kwon, chief of the IMF's mission to Dominica and his team recently stressed that economic activity picked-up in Dominica last year with economic growth projected at 4 per cent therefore the short-term outlook is positive.

Kwon and his team also contended that last year growth, which was the strongest in 10 years, was accompanied by a fall in the inflation rate to 2 per cent. The current growth trajectory is however expected to slow during the short-term mainly because of the closing down of large manufacturing entity. It is however projected to continue above trend, on the back of strong performances by the tourism and construction sectors.

Dominica's public debt to GDP ratio also continues to fall, reflecting the country's strong fiscal effort and continued economic expansion. This expansion was driven by the availability of more credit to the private sector, due to the process of fiscal consolidation carried out by the authorities.

There was a surge in grants to 14 per cent of GDP, which helped the government to improve the country's infrastructure, while consolidating the fiscal accounts, leading to an improvement in the debt ratios. The IMF team and the authorities agreed on the need to target a primary surplus of 3 per cent of GDP under the growth and social protection strategy.

The upcoming public sector wage increases indicate that the government has very little fiscal flexibility therefore a delicate balance must be struck between tax reductions as well as exemptions and higher levels of investment spending. There is however, likely to be an increase in private sector access to credit, due the fiscal consolidation being carried out by the government.

ST VINCENT/GRENADINES:

An IMF mission led by Paul Cashin, deputy chief of the western hemisphere department, visited St Vincent & the Grenadines during the period July 25 to August 2 in order to conduct the annual Article Four Consultations. The discussions covered the current and medium-term economic outlook.

The team concluded that the country's near-term economic outlook remains favourable, as the economy is estimated to have grown by 4 per cent last year, fuelled by the construction, tourism and agricultural sectors. There was however an up-tick in inflationary pressures due to higher international prices but inflation remained low due to the country's membership in the ECCB.

Looking further ahead, the IMF posited that the country remained vulnerable because of its dependence on imported oil, the erosion of trade preferences in bananas and frequent natural disasters.

The country however, needs to accelerate economic growth in order to reduce poverty, foster greater levels of income equality and it was therefore against this background that the IMF team emphasized the need to consolidate its fiscal accounts.

More specifically, on the fiscal front, the IMF recommended a prudent fiscal policy stance, which would balance the pressures between fiscal stimulus in times of low economic growth and debt sustainability. This is in order to prevent fiscal stimuli from leading to an increase in the public debt and as a consequence debt service charges, as occurred in the past.

Cashin and his team also supported the authorities' plans to replace several indirect taxes with a value added tax this year, in order to place the fiscal accounts on a solid footing, leading to an increase in debt sustainability in the long-run. There was also agreement on other fiscal nd debt sustainability measures such as the prioritization of the capital budget, the challenges facing the National Insurance Service (NIS), education and investments in human capital.

The prudential indicators also pointed to a strengthening of the country's financial sector, due to steps taken to enhance the regulatory and supervisory framework of both the banking and non-banking financial institutions.

BARBADOS:

An IMF team led by Christina Daseking, deputy division chief of its western hemisphere department conducted the most recent Article Four Consultations on the Bajan economy July of this year. The team concluded that economic growth was very solid was very solid during the year 2006, with a drop in the unemployment rate to historical lows.

The Fund also posited that the prospects for this year are favourable because growth is projected at 4 per cent and inflation at 5.5 per cent. The country's external current account deficit is however programmed at 8.5 per cent, despite the decline in recent years.

Fiscal consolidation to reduce the country's external current account deficit, and the high public debt in an effort to maintain the scope for an effective policy response and uphold the credibility of the country's exchange rate regime were also recommended by the team.

TRINIDAD&TOBAGO:

Article Four Consultation on the Trinidad & Tobago economy was conducted by Jose Fajgenbaum, deputy director of the western hemisphere department and Max Alier mission chief for the country and their team. They concluded that the country has been able to grow rapidly during the last decade because of the reforms implemented in the 1990s by the George Chambers led administration.

The Fund also concluded that T&T's economic peformance was spectacular when compared to other countries in the region, as well as other energy producers. Despite the dip in energy output the economy is projected to canter at a rate of 6 per cent this, due to higher foreign direct investment inflows.

The conclusion was however drawn that fiscal policy needs to be tightened in response to signs that the economy is currently operating at full capacity, in order to contain the spreading inflation virus. The country's external current account is programmed to generate another surplus.

The IMF supported the country's efforts to contain expenditures in order to contain the deficit, while stressing that the non-energy deficit is widened to 16 per cent of GDP last year. The Fund also argued that this was mainly due to the tax cuts given to the non-energy, growing subsidies and rapidly rising capital expenditures.

The mission also recommended that the government cut expenditures, while pointing out that in order improve medium-term fiscal sustainability a tighter fiscal stance will have to be adopted.

The IMF also posited that a non-energy sector deficit of 10 per cent is needed to prevent large policy reversals when energy income declines. Pacing the use of energy resources now would lead to the maintenance of investment and social spending during the medium-term.

SUMMARY:

The high public debt to GDP ratios of the six Caribbean countries mentioned above, has led to a paucity of public sector resources needed to improve their infrastructure, human resources and provision of basic social services such as health, education and national security.

This has led to a reduction of their absorptive capacity or ability to maximize growth from the high levels of foreign direct investment inflows from which they have benefited during the last 10 years.

The heavy debt burdens of these countries also constrain their ability to provide the most basic social services, while paying down the debt. This inability to provide adequate levels of basic social services and lack luster economic growth have contributed significantly to the migration of skilled personnel from the region, which also helps to further undermine economic growth.

These countries however have very little choice but to continue with the process of fiscal consolidation in order to generate the higher levels of economic growth needed to reduce their debt burdens. Simply, put they will have to continue to make certain social and economic sacrifices in order to grow their way out of debt.

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