

Framework for Sustainable Fiscal Policy in the Caribbean

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Overview of Issues

- **Some countries in the Caribbean have unsustainable debt and fiscal paths. This presentation:**
 - Examines the **impact of the global financial** crisis in the region
 - Identifies **lessons** on successful fiscal consolidation from around the world
 - Discusses the **challenges** of fiscal consolidation in the Caribbean
 - Considers how to **reorient** policy to meet these challenges

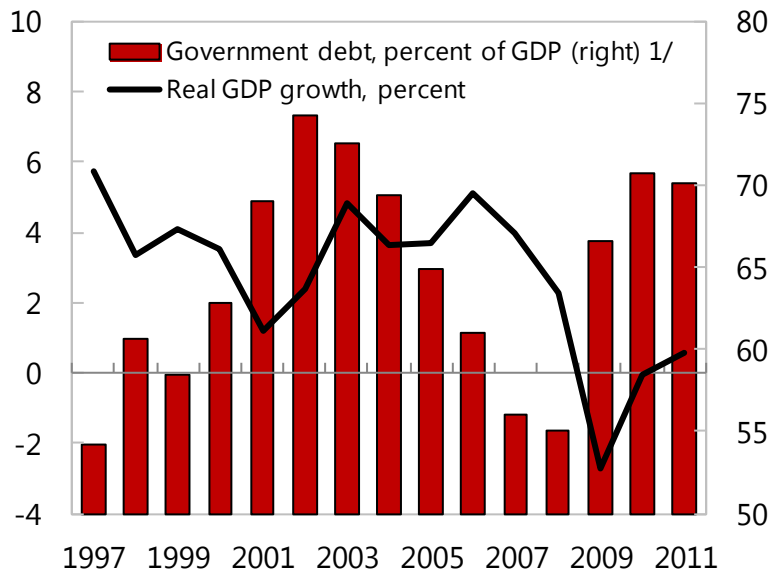
Main Messages

- **Debt levels are high and fiscal consolidation is needed**
- **This will require a comprehensive strategy**
- **Both revenue and expenditure sides have a role to play**
- **Fiscal rules are needed to lock in hard won gains**
- **Structural reforms are required to boost growth**

The global financial crisis worsened the already high debt burdens

- Faster growth, fiscal consolidation and debt relief helped lower debt ratios by about 18 points of GDP between 2001 and 2007
- During 2008-2011, debt rose by about 15 points of GDP

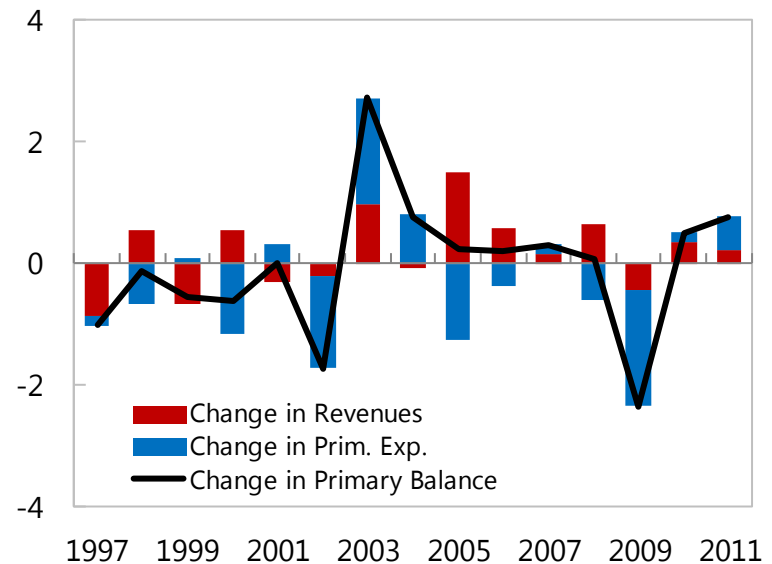
Real GDP Growth and Government Debt



Source: IMF staff estimates.

1/Weighted average.

Contributions to Primary Balance Changes 1/
(percent of GDP)



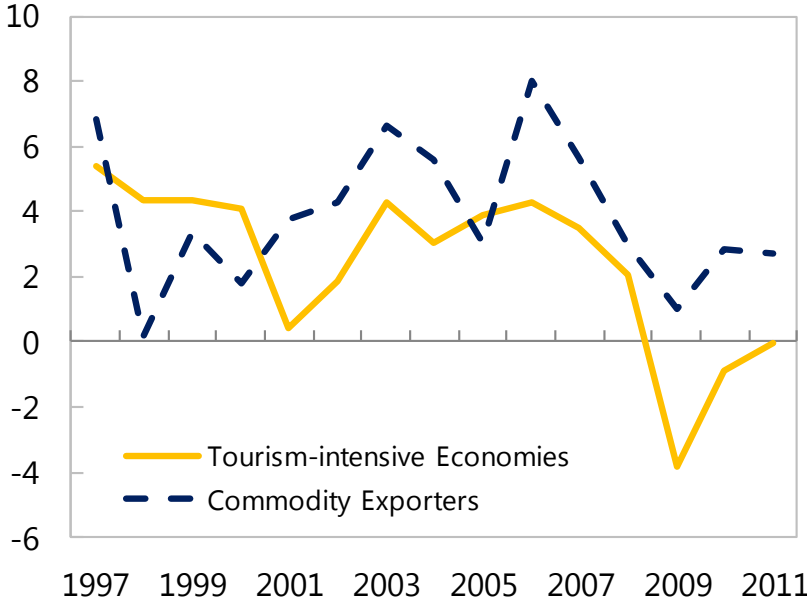
Source: IMF staff estimates.

1/ A decrease in primary expenditures is depicted as a positive contribution to an improvement of the primary balance.



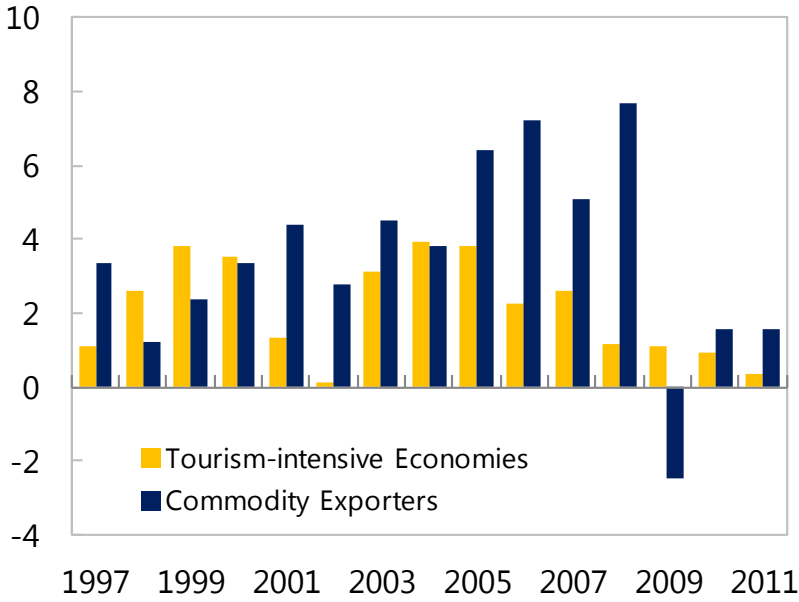
Tourism dependent countries fared badly

Real GDP Growth
(percentage change)



Source: IMF staff estimates.

Primary Balance
(weighted average, percent of GDP)



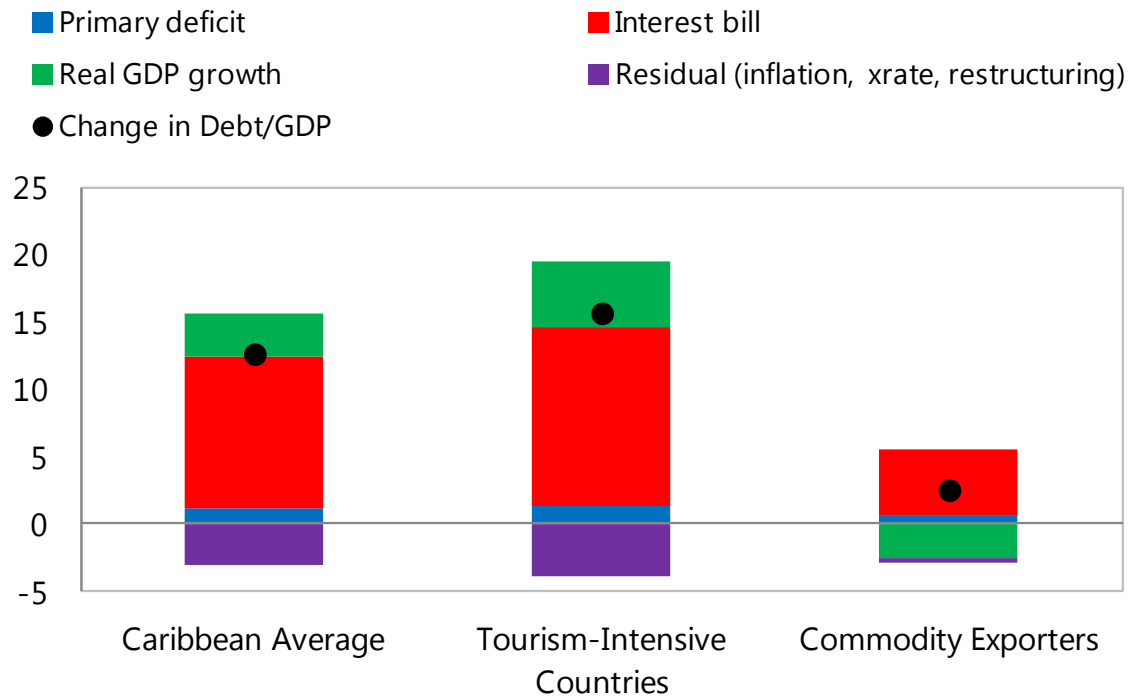
Source: IMF staff estimates.



Interest bill is major factor in higher debt

Decomposition of Debt Accumulation, 2008-11

(percent of GDP)



Source: IMF staff estimates.

Fiscal consolidation—lessons from global experience

- **Easier to build consensus for change in difficult times**
- **Expenditure vs. revenue based consolidation**
- **If adjustment needs are large, a combination is needed**
- **Front loaded (revenue) vs. gradual adjustment (spending)**
- **Fiscal rules are associated with larger and sustained fiscal consolidation effort**

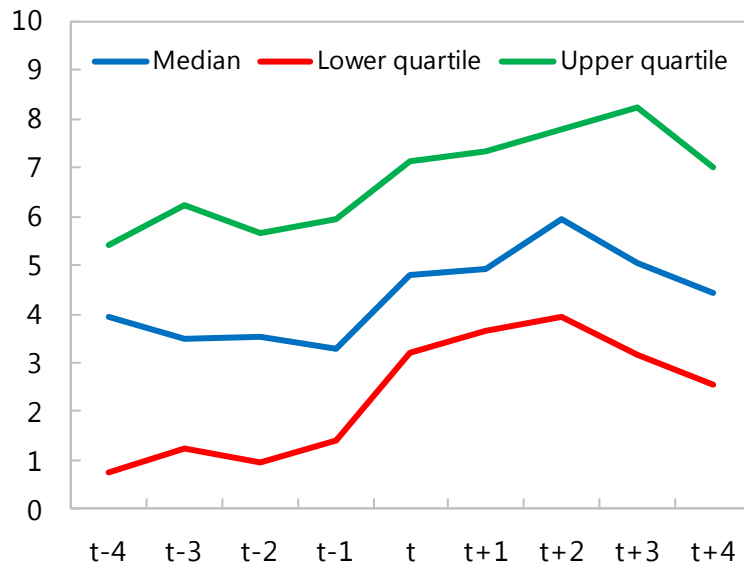
World experience provides interesting insights for the region

- **Over half of global debt reductions were achieved through fiscal consolidation and just under half through debt restructuring**
- **The high number of debt restructuring is due to the inclusion of low income countries in the sample. Many of them received debt relief (HIPC and MDRI)**
- **In the consolidation cases, the median decline in the debt to GDP ratio was 27 percent over a five-year period**
- **About a quarter of the episodes were preceded or accompanied by fiscal rules**

Large declines in debt levels were driven by decisive fiscal consolidation and strong growth...

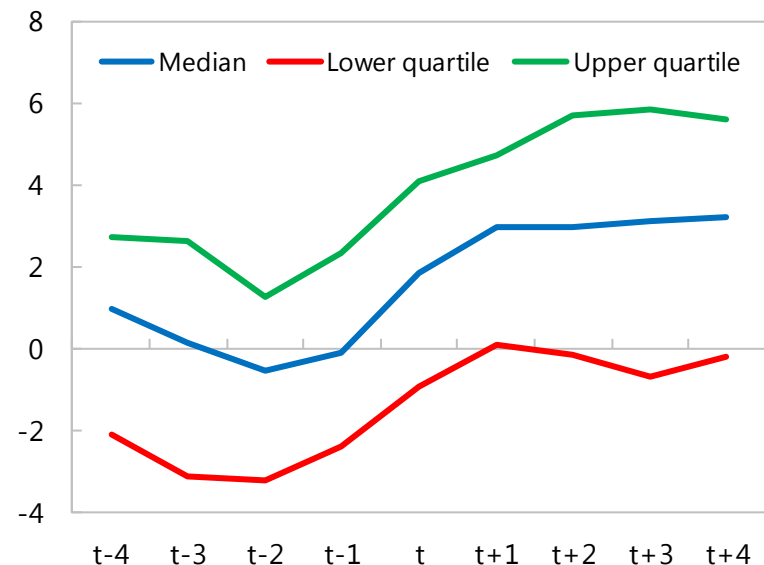
- **Primary balance** started to improve at least 2 years before debt ratios started to decline, and was sustained during the first 5 years
- **Economic growth was sustained during the adjustment.** Growth averaged 5 percent a year during the first 5 years of consolidation

Real GDP Growth
(percentage change)



Source: IMF staff estimates.

Primary Balance
(percent of GDP)



Source: IMF staff estimates.

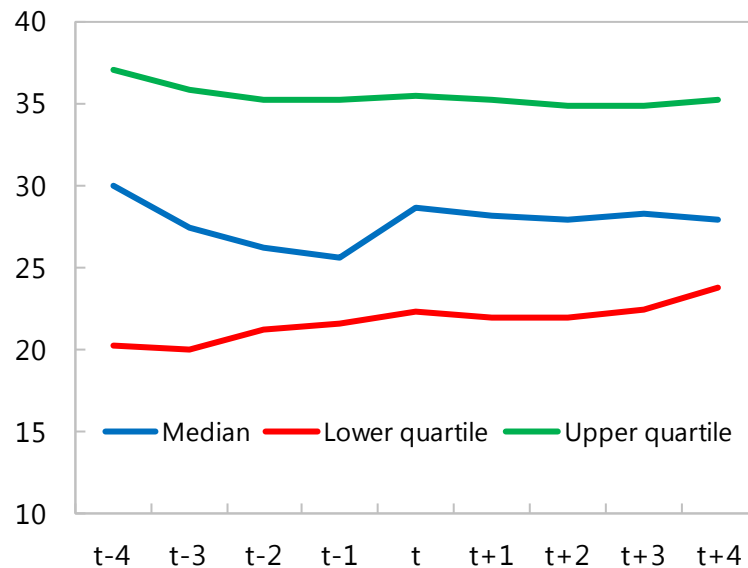


... fiscal consolidations were due to both spending and revenue actions

- The revenue effort averaged 3 points of GDP.
- The median decline in government **spending** was 4 points of GDP over a five year period. The reduction came mainly from cuts in **current spending**. **Capital spending** was broadly flat

Government Revenues

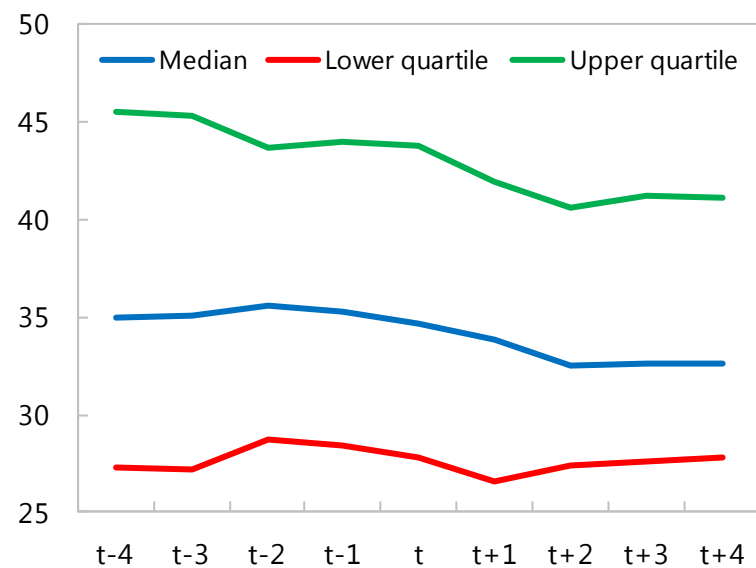
(percent of GDP)



Source: IMF staff estimates.

Government Spending

(percent of GDP)



Source: IMF staff estimates.



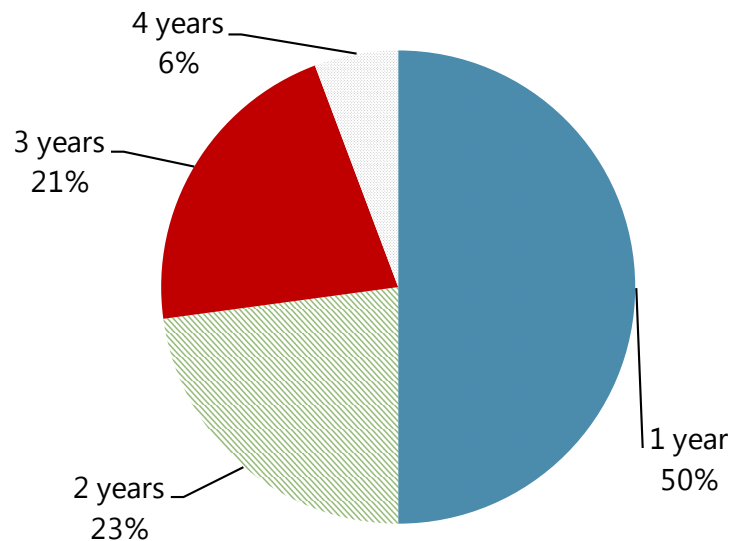
In the Caribbean, the fiscal consolidation experience has been mixed

- **Fiscal adjustments have not been sustained**
- **Revenue measures have been preferred to spending cuts, except under Fund programs (more balanced)**
- **Spending cuts have been led by capital spending**
- **Primary surpluses have not been high enough to reduce debt**
- **In a few cases, debt restructuring played a role**

The duration of fiscal consolidation has been short lived

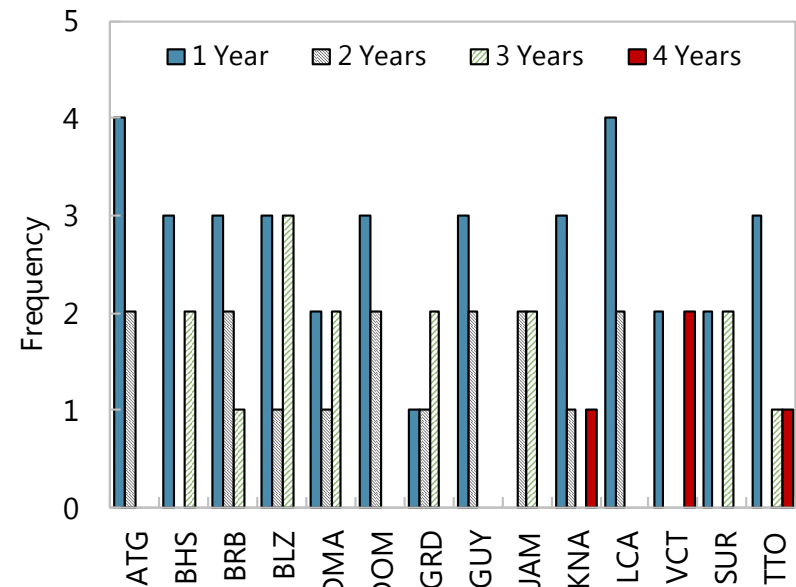
- Attempts at fiscal consolidation in the Caribbean have been infrequent. However, when countries undertook consolidation, they were **successful in about half of the cases** (success is measured as a decline of at least 5 percent in the debt-to-GDP ratio)

Duration of Episodes



Source: IMF staff estimates.

Consolidation Episodes by Duration



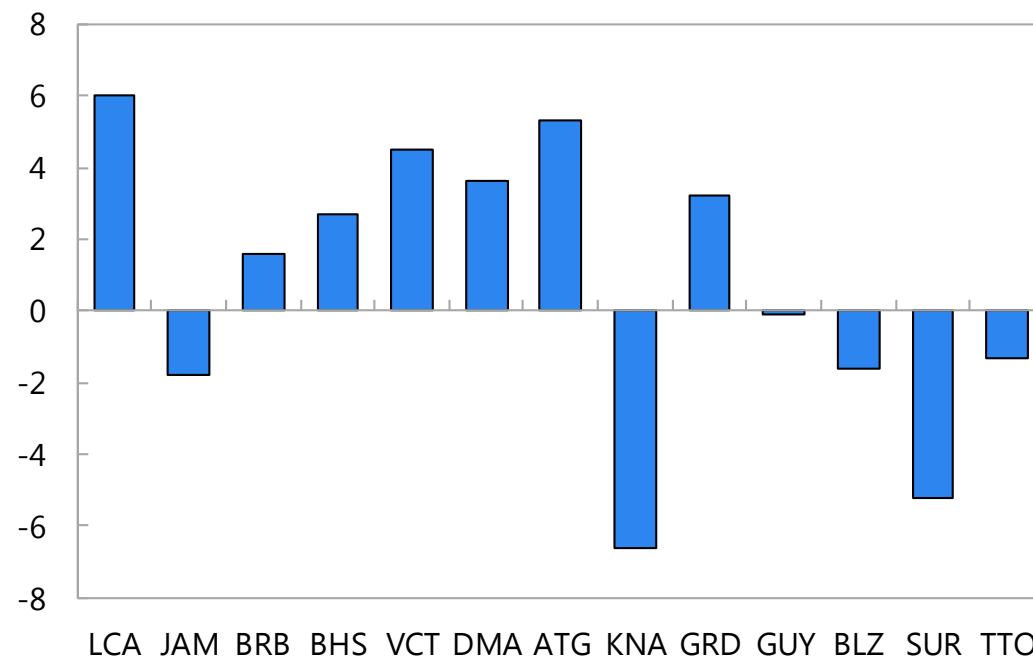
Source: IMF staff estimates.



The Caribbean faces challenges to stabilize debt

- Stabilizing public debt would require a **fiscal effort** of about 1 percent of GDP
- Large **variations** across countries

Caribbean: Increase in Primary Balance Needed to Stabilize Public Debt
(percent of GDP)



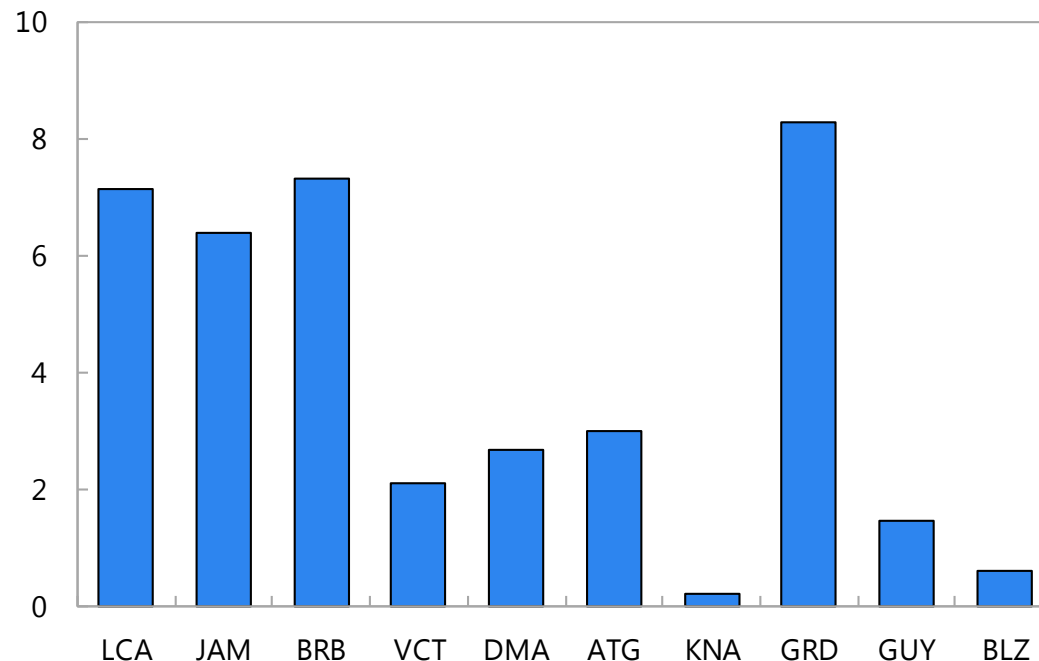
Source: IMF staff estimates.



Reducing public debt to 60 percent of GDP by 2020 will require significantly higher effort...

- Improvement of over 6 percentage points of GDP in the **primary balance** in some countries
- Computations do not take into account **contingent liabilities**

Caribbean: Increase in Primary Balance Needed to Reduce Public Debt
(percent of GDP)



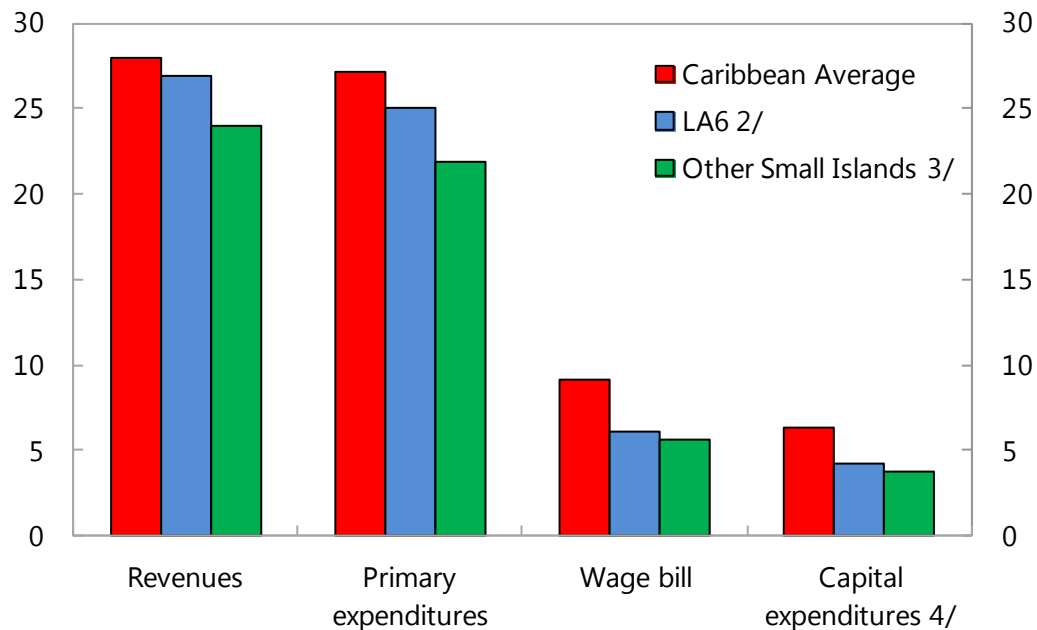
Source: IMF staff estimates.



... mainly through spending cuts while protecting well targeted social safety nets

- The wage bill is high by international standards. Capital spending has declined since 2008 but is higher than in Latin America
- Scope for using PPPs? Scope for privatizing public enterprises? Improving selection of capital projects?

Caribbean Fiscal Indicators 1/
(percent of GDP)



Sources: Authorities; and Fund staff estimates and projections.

1/ 2007 to 2011 Averages.

2/ LA6 includes: Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.

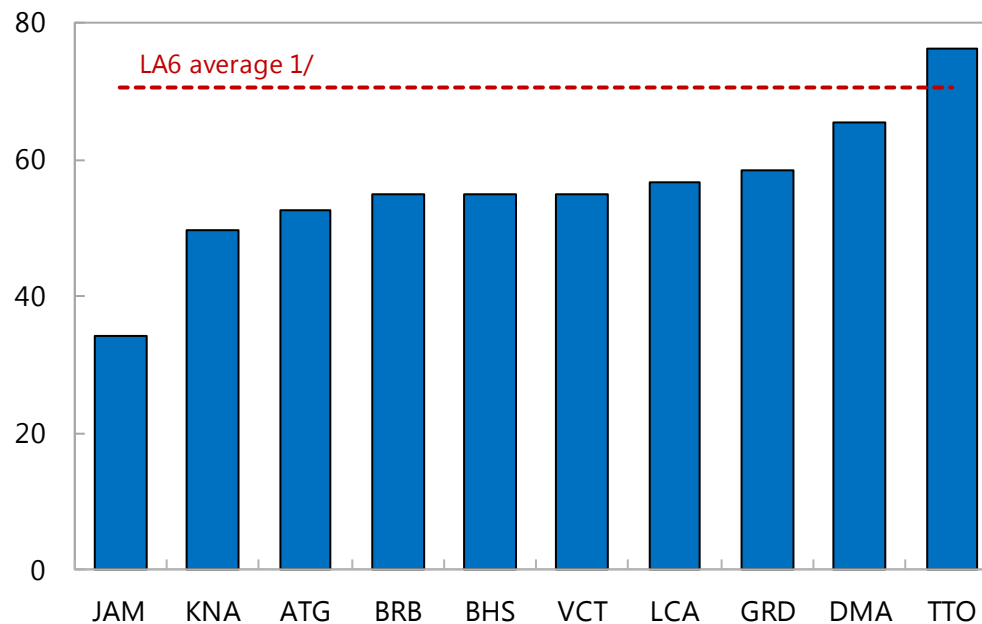
3/ Includes Dominican Republic, Mauritius, and Seychelles.

4/ For LA6 countries capital expenditures is acquisition of nonfinancial assets.

There is also a need to reduce fiscal rigidities

- **Fiscal rigidities are higher in the Caribbean than in Latin America, due to high nondiscretionary expenditures (wages and interest payments)**

Caribbean: Fiscal Flexibility Index 1/
(100=highest flexibility)



Source: IMF staff estimates.

1/ Simple average for Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.



Reorienting fiscal policy—where to go from here?

- **There is a clear need to restart fiscal adjustment**
- **Both spending and revenue sides have a role to play**
- **It is imperative to protect the poor. To that effect, social safety nets and well-targeted programs need to be enhanced, including by reducing general subsidies**
- **Fiscal rules will help increase discipline and the credibility of fiscal policy**
- **Structural reforms to boost growth will be crucial**

A comprehensive package of reforms is needed

- **Tax policy, focus on:**
 - **Broadening the tax base** and lowering excessive rates
 - Optimizing revenues; **reducing waivers**
- **Spending, focus on:**
 - Reducing the level of current spending, including through public sector rationalization
 - Protecting **well-targeted social safety nets**
 - Improving the selection and monitoring of **capital spending**
- **Structural reforms:**
 - Improve institutional **debt management capacity**
 - Contain the growth of **contingent liabilities**

Thank You



Country experiences with fiscal rules

- There are currently 76 countries with fiscal rules, up from only 5 in 1990
- Fiscal rules can be in different forms—debt rule, balance budget rule, structural budget rule, expenditure or revenue rule
- Escape clauses can provide flexibility to rules in dealing with rare events
- Fiscal rules require a number of supporting arrangements and good institutional capacity
- Independent fiscal councils are being used to further enhance credibility of fiscal rules

The Chilean experience

- **Chile adopted a fiscal rule after reducing debt from 165% in 1985 to 20 % of GDP in 2000.**
- **The rule requires that the cyclically adjusted primary balance be in surplus and was written into law in 2006 (fiscal responsibility law)**
- **The ceiling under the structural budget balance was originally set as 1 percent of GDP but was changed to allow counter cyclical response to the crisis.**
- **The calculation of ex ante structural revenues is the lynchpin of the rule.**
- **The computation takes into account cyclical factors and copper price fluctuations.**
- **The surplus rule implies that eventually, the government must be a net creditor.**

Reasons for the Chilean success

- **The existence of a committee of independent experts:**
 - they are responsible for providing the government with assumptions regarding GDP and long run copper prices
 - They are involved in the budget process and produce cyclically adjusted figures
- **The transparency of the process:**
 - The calculation of the cyclically adjusted balance are presented and explained to the public
 - The recent target changes were carefully and candidly explained to the public
- **The relationship between parliament and the presidency:**
 - The power to set the budget is entirely in the hands of the president
 - Parliament is not allowed to reduce taxes or raise spending