



Debt Burden in Small Island Caribbean States and Prospects for Debt Relief

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INTRODUCTION

This chapter is divided into three sections. The first describes the evolution of the Caribbean debt burden, its structure and composition, and the particular challenges which have resulted from the debt overhang. The analysis also addresses the requirements for fiscal sustainability. The

The views expressed in this chapter are those of the authors and do not necessarily reflect the views of the organization they are affiliated with.

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second section explains the factors that gave rise to the debt accumulation since such an explanation is critical to an appropriate policy response. The discussion addresses the fact that the current policy prescriptions assume that the debt arises largely from fiscal discretion and in the extreme case fiscal excess. It is suggested that debt accumulation also arises from falling export capacity that shows up as persistent deficits on the current account. The chapter also examines the link between debt accumulation and the impact of such vulnerabilities—i.e., extreme events and climate change. The third section reviews debt reduction proposals that have been suggested, namely those put forward by the Commonwealth Secretariat, the World Bank and the Economic Commission for Latin America and the Caribbean (ECLAC), as well as the implications of each to address the underlying challenges posed by the overhang. The chapter then concludes.

THE EVOLUTION OF CARIBBEAN DEBT

The Caribbean region has had a long-standing problem with public debt accumulation beginning in the 1970s with the debt crisis among developing countries and then in the 1980s before the intensification of World Bank/IMF structural adjustment programs. This section examines in detail the evolution of public debt for the period 2000 to 2020 and compares it with the debt burden of other developing countries. In 2001, the average gross general government debt was 69.7% of GDP for Caribbean¹ countries which was just below the average for developing countries of 71.9%. Subsequently these two debt trajectories began to diverge with the Caribbean sustaining higher levels of debt throughout the period. The debt burden of the Caribbean peaked at 78.6% in 2004 while it was 66.1% for developing countries. The Caribbean debt began to fall just before the global financial crisis of 2008–2009 and was 66.1% in 2007. This was due to, among other factors, an expansion in growth consequent of the buoyant tourism sector and the primary commodity boom which benefited commodity exporters in the region.

In the case of developing countries, the debt to GDP ratio declined steadily to 42.6% in 2007. Following the global financial crisis, the debt

¹ For this section, the Caribbean refers to Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago.

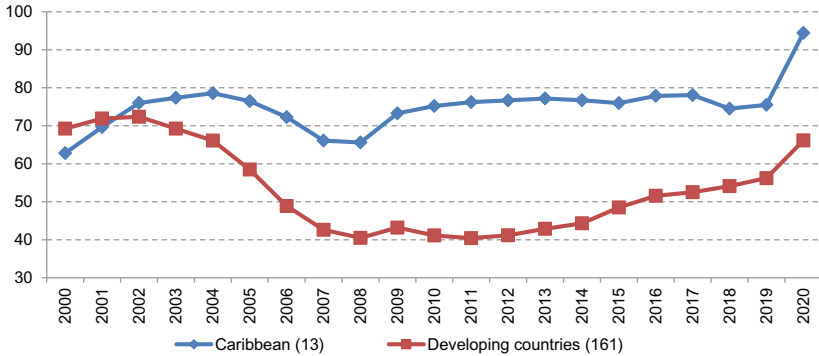


Fig. 2.1 Gross general government debt (Percent of GDP) (*Source* International Monetary Fund, World Economic Outlook Database, April 2021)

burden of both sets of countries rose but again the trajectories were very different. For the Caribbean between 2009 and 2019, the debt to GDP ratio never fell below 70% and was 75.5% of GDP in 2019. For developing countries, the average rose from 43.1% in 2009 to 56.2% in 2019. The COVID-19 pandemic has affected all countries and both the developing countries' average debt and that of the Caribbean increased sharply in 2020. The latter is due to the collapse of the tourism sector, the decline in primary commodity prices, border closures, and the spillover effects at the domestic level. As is observed in Fig. 2.1, the average has increased for both groups, but substantially more in the Caribbean due to the limited fiscal space and lack of concessional finance. Clearly the debt challenge is not peculiar to the Caribbean, but they represent outliers in the debt accumulation process.

Decomposing the Caribbean Debt

It is of interest to decompose the change in debt to determine what impulses led to its increase or decrease over most of the periods, 2001–2005, 2006–2008, and 2009–2015. A standard decomposition technique is used to separate the change in central government debt over the periods into the following effects:

- The real exchange rate effect: a devaluation increases the debt ratio and vice versa.
- The growth effect: If growth is positive this effect decreases debt and vice versa.
- The interest rate effect: Increases the debt ratio if nominal interest rates increase and/or economic growth decreases, and vice versa.
- The primary balance effect: A primary balance surplus decreases the debt ratio and vice versa.
- The residual: Effects from all other sources, including the government taking on contingent liabilities (Fig. 2.2).

In 2001–2005, the real interest rate effect and a large residual effect (due mainly to unanticipated shocks in a number of countries) pushed debt up. In this period economic growth and primary balance effects were not large enough to reduce the debt.

In the second period, the Caribbean managed to achieve a decrease in average central government debt due to strong economic growth and reduced real interest rates. A major contributor to the decline in this period was the decline in Guyana’s debt ratio, which fell from 188.3%

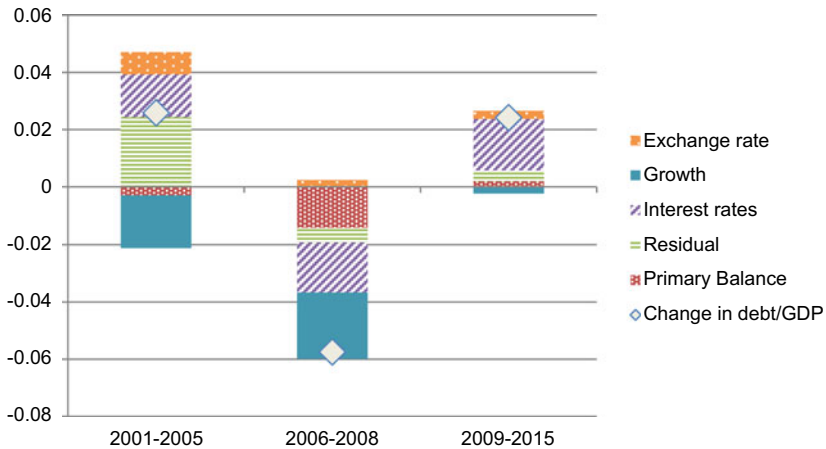


Fig. 2.2 Average contribution to debt accumulation in the Caribbean, 2001–2015 (Percent of GDP) (*Source* Authors calculations, based on official sources and World Bank data)

of GDP in 2005 to 97.0% of GDP in 2006. Guyana was a beneficiary of the Highly Indebted Poor Countries (HIPC) debt relief initiative, later followed by the MDRI initiative. Trinidad and Tobago, which was in the midst of an oil boom, saw its debt to GDP ratio fall from 37.6% in 2002 to 10.9% in 2008. In this period, the global financial crisis also took place but its effect was generally felt from 2009.

In the post-crisis period, the debt to GDP ratio increased again as a result of reduced growth. Despite falling interest rates, the real interest rate effect was still positive as growth had been absent. Service producing economies fared particularly poor in the wake of the global financial crisis. In more recent years, the commodity producing economies² like Suriname and Trinidad and Tobago saw their previous strong growth disappear in the face of falling commodity prices.

The Heterogeneity of Caribbean Debt

While the average Caribbean debt to GDP ratio is in excess of the arbitrary limits suggested by the IMF of 60% for debt sustainability, a closer look reveals a very diverse situation. In 2020, total public sector debt varied from 156.9% of GDP in Suriname to 24.8% in Guyana. Twelve of the fourteen Caribbean countries had higher public debt to GDP ratios than the average for developing countries (48.5%), and all except Guyana have debt ratios of over 60% of GDP.

Countries also had different debt profiles in terms of the composition of creditors. Six of the Caribbean countries had a higher share of domestic debt in the total debt, while the rest had a greater share owed to external creditors. The highest domestic debt to GDP ratio in 2020 was observed in Barbados (96.9%), and the highest external debt ratio belonged to Suriname (106.0%) which faces severe foreign exchange risks (Fig. 2.3).

The available data allow for a further examination of external debt for seven Caribbean countries. The overall results for the seven countries show that in 2010 49.3% of the debt was owed to the private sector, 14.8% to bilateral creditors, and the rest (36.0%) was owed to multilateral creditors. For 2019 the ratios were 50.5%, 12.8%, and 36.8% respectively.

² The commodity (or goods) producing economies of the Caribbean are defined as Belize, Guyana, Suriname and Trinidad and Tobago. The remaining Caribbean economies constitute the service producers.

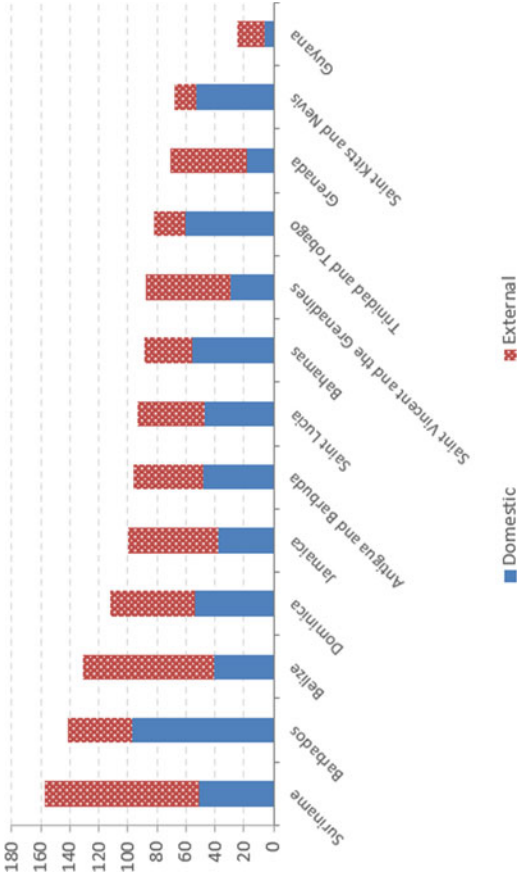


Fig. 2.3 Caribbean domestic and external public sector debt, 2020 (Percent of GDP) (*Source* Economic Commission for Latin America and the Caribbean, on the basis of official figures)

The high share of private debt reflects the lack of concessional finance and the need to go to the private market. In some cases, domestic debt is denominated in foreign currency and these could bear foreign exchange risks.

The external debt structure also displayed a high level of heterogeneity between countries (see Fig. 2.4). In 2010 three of the seven countries, (Belize, Grenada, and Jamaica) had debt to private creditors in excess of 40% of total external debt. In 2019 as well, three of the seven countries (Belize, Jamaica, and Saint Lucia) had the share of debt to private creditors greater than 40%; of these three, only in Jamaica was the share greater than 55%. Debt from multilateral sources was clearly more dominant, particularly in Guyana and Saint Vincent and the Grenadines, where it accounted for 65.2% and 80.9% respectively.

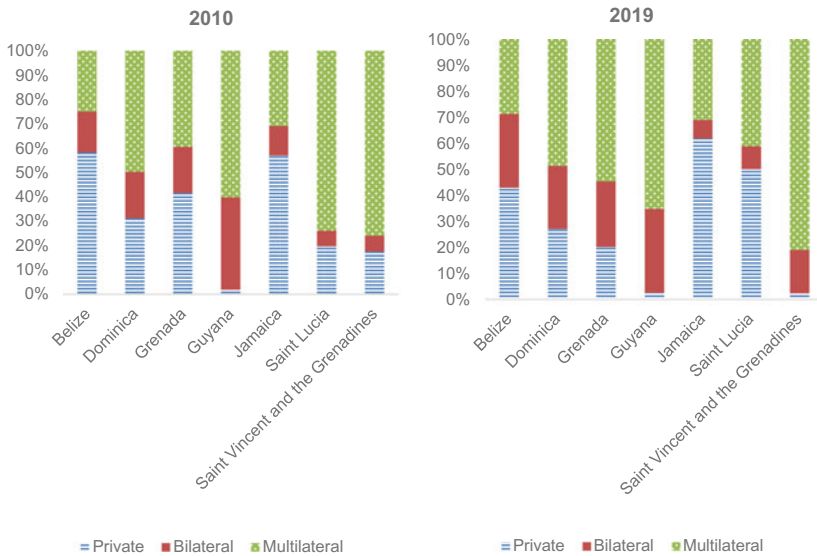


Fig. 2.4 Composition of public and publicly guaranteed external debt, 2010 and 2019 (Percentage) (*Source* World Bank International Debt Statistics database)

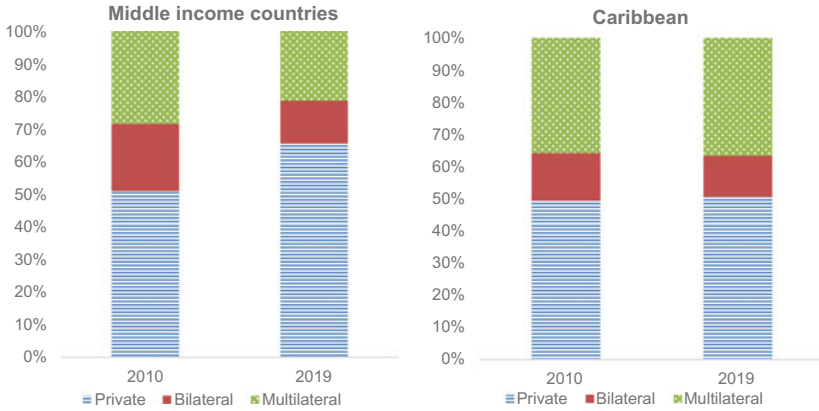


Fig. 2.5 Average composition of public and publicly guaranteed external debt, 2010 and 2019 (Percentage) (*Source* World Bank World Development Indicators Database)

The figure below compares the composition of external debt for the Caribbean to that of middle-income countries.³ Whereas almost half of the Caribbean countries' external debt is from private sources, 49.3% in 2010 and 50.5% in 2019, for middle-income countries it was 50.9% and 65.5% respectively. Meanwhile multilateral debt was 36.0% and 36.8% in 2010 and 2019 respectively for the Caribbean, while for middle-income countries it was 28.4% and 21.3%, demonstrating that the Caribbean relies more heavily on multilateral sources than most other middle-income countries (Fig. 2.5).

The Debt Repayment Burden

The burden of high debt is not only demonstrated in the debt to GDP ratio, but in the debt service costs. Every dollar spent repaying debt is a dollar not spent on health, education, or any other form of economic development.⁴ The chart below plots the external debt service payments

³ Middle-income economies are defined by the World Bank and this chapter as those in which 2015 GNI per capita was between \$1,026 and \$12,475.

⁴ This assumes that past debt accumulation was to support consumption rather than investment and capital accumulation either human or physical.

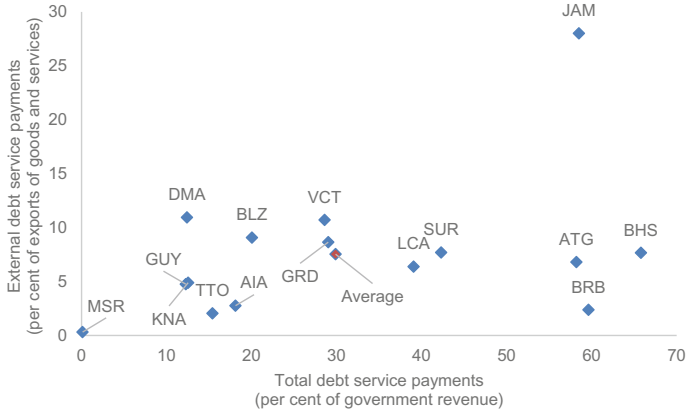


Fig. 2.6 Debt service payment ratios for the Caribbean, 2015–2019 average (*Source* Economic Commission for Latin America and the Caribbean, on the basis of official figures)

as a percent of exports of goods and services against total debt service payments as a percent of government revenue. On average, external debt service payments amounted to 7.5% of exports of goods and services and absorbed 29.9% of government revenue. The highest external debt service ratios were seen in Jamaica, Dominica, and Saint Vincent and the Grenadines, while the highest total debt service ratios were seen in the Antigua and Barbuda, The Bahamas, Barbados, and Jamaica, where they absorbed over 50% of government revenue (Fig. 2.6).

Unpleasant Fiscal Arithmetic

A debt sustainability analysis was conducted to determine just how difficult it is to stabilize the debt and what primary surpluses are required (ECLAC, 2016).⁵ Using the standard approach outlined in the work of Buiter (1985) and Blanchard (1990), the primary surpluses, in percent of GDP, required to stabilize debt at its 2013 levels for Belize, Dominica, Grenada, Guyana, Jamaica, Saint Lucia, and Saint Vincent and the

⁵ The results are based on ECLAC's debt strategy paper (ECLAC, 2016).

Grenadines were computed. The results were that the debt stabilizing surpluses ranged from 0.56% of GDP in Dominica to 3.82% in Jamaica.

More importantly, the exercise also calculated the fiscal adjustment, in percent of GDP, required to achieve the debt stabilizing primary surplus. It is calculated by subtracting the current primary surplus from the debt stabilizing primary surplus. It gives an idea of how difficult it would be for governments to contain debt at its current levels. The calculated adjustments to achieve debt stabilizing primary surpluses ranged from 0.00% of GDP in Jamaica⁶ to 5.41% in Grenada.

As part of the debt sustainability analysis, the primary surpluses required to reduce debt to 60% of GDP over 10 years (ECLAC, 2016)⁷ and their corresponding fiscal adjustments were computed. The results were mixed, given the varying levels of government debt. Belize, Dominica, Saint Lucia, and Saint Vincent and the Grenadines had government debt to GDP ratios of 75.8%, 75.1%, 79.6%, and 74.0%, respectively, in 2013 (IMF, 2014). To reduce their debts to 60% of GDP, they would have required fiscal adjustments of 1.54%, 2.93%, 5.02%, and 4.49% of GDP, respectively. Grenada and Jamaica had much higher government debt levels of 109.8% and 141.6% of GDP, respectively. While Grenada⁸ would have required a massive 10.04% of GDP adjustment to reduce its debt to 60% of GDP, Jamaica only required an adjustment of 3.4% of GDP since its primary surplus was already so high in 2013. The results from this analysis provide some evidence of the difficulty that Caribbean governments face in stabilizing their debt ratios, much less reducing them.

⁶ Jamaica's primary surplus in 2013 was already above the debt stabilizing value. Jamaica has since achieved success in reducing its debt to GDP ratio. It is important to note that the primary surplus posted by Jamaica of around 7% of GDP is not congruent with their historical experience and may itself be stifling growth.

⁷ The required primary surplus would have to be maintained over the period.

⁸ The debt burden of Grenada has fallen since due to Paris Club restructuring.

STRUCTURAL FACTORS CONTRIBUTING TO DEBT ACCUMULATION OVER TIME

The Major Structural Factors

In light of the heavy debt burden facing Caribbean countries, an important question is: what are the factors contributing to debt accumulation? Does the problem stem from fiscal mismanagement, structural constraints, or a combination of both?⁹ There is empirical evidence that fiscal policy in the Caribbean tends to be pro-cyclical, which means that fiscal buffers cannot be easily built. In addition, the fiscal multipliers are relatively weak (Alleyne & Pantin, 2013; Guy & Belgrave, 2012) which implies that expanding public spending results in pressures on foreign exchange through the important intensity of consumption and intermediate imports.¹⁰ More generally, however, it is not obvious that debt accumulation is simply a fiscal challenge because in open Caribbean economies there are multiple sources of such accumulation including fiscal sources, the current account sources, and impulses coming from the monetary policy focus of the central bank.

The policy diagnosis has tended to suggest that the immediate fiscal challenge characterized by high debt and repayment costs are the result of fiscal excesses. As a result, much of the emphasis of adjustment has been on fiscal reforms designed to squeeze expenditure and raise taxes.¹¹ Implicit in this view is that cutting government spending inspires confidence in the private sector to expand consumption and investment.¹² In addition, some governments have been persuaded to implement fiscal rules to guarantee fiscal discipline—for example, in the case of Grenada and Jamaica. The adjustment exercises, whether home grown, as in Barbados, or under the IMF/World Bank group, assume that correcting

⁹ None of the major debt initiatives maintain that the debt was accumulated solely due to vulnerabilities and the ECLAC proposal maintains that fiscal management and structural reforms are both important.

¹⁰ When the economy is buoyant various social groups try to improve their position lost during the downturn. Often this is because there is not enough social dialogue to address costs and benefits of adjustment.

¹¹ A recent IMF paper argues for improving tax administration. See Stephane Schlotterbeck (2017).

¹² Ironically fiscal compression is taking place at a time of reduced external and domestic demand.

the fiscal imbalances will place these countries on the path to renewed growth. This approach runs counter to the functional finance position expounded by Sawyer (2009) that is based on Keynesian lines along which it is argued that fiscal policy has a positive impact on growth.¹³ However, in an open economy context, this latter position may be too optimistic given that fiscal multipliers are weak. From a small states perspective, the critical issue is not the presence of a current account deficit but the persistence of such deficits and their sustainability.

In order to clarify these issues, the relationship between the current account deficit and fiscal deficits, the so-called twin deficit hypothesis, was examined using a vector autoregressive moving average (VARMA) framework developed to determine the percentage of the variation attributable to both the fiscal and current account deficits resulting from shocks arising from either of the two variables. The results suggest that for several Caribbean countries, the current account deficit Granger causes the fiscal deficit and in others, the relationship was bidirectional (Alleynes et al., 2011). Ramirez and Wright (2017) also echoed this conclusion using a framework of macroeconomic fundamental and fiscal policy variables to derive the fiscal limits of 18 Central American and Caribbean countries. They pointed out that trade volatility in these small open economies significantly impacted their ability to service their sovereign debt. According to Haque et al. (2016), the major driver of increased debt accumulation for small states was the size of the current account deficit (11.5% of GDP for lower middle-income small states, 10.4% of GDP for upper middle-income small states, and 5.6% of GDP for larger states). They also point out that slower growth in smaller states also exacerbated negative external debt dynamics. Birchwood and Matthias (2007) examined the factors that drive positive or negative fiscal balances in developing countries and concluded that persistent fiscal deficits were the result of both fiscal indiscipline and structural factors.

The chart below shows the current account balance and the overall fiscal balance for Caribbean countries distinguished by goods and service producers. Since the global crisis, the goods producers have experienced deterioration in their current account balance aggravated by the steep decline in commodity prices while for the service producers there has been an improvement aided by reduction in import prices and

¹³ This is the perspective of functional finance.

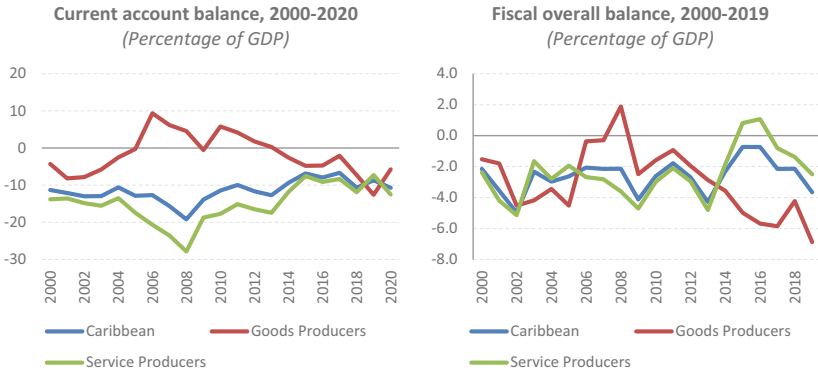


Fig. 2.7 Balances: Current account and fiscal (Percent of GDP) (*Source* Economic Commission for Latin America and the Caribbean, on the basis of official figures)

improved tourism receipts. The overall fiscal balances have also moved correspondingly between the two groups of countries (Fig. 2.7).

The current account balance is linked to reduced competitiveness and falling productivity (Alleyne et al., 2011; Ruprah et al., 2014). McLean (2017) has shown that the capacity of Caribbean economies to service their trade agreements is very low and there has been increased concentration on a few services and commodities in the export basket. The implication is that reducing the fiscal balance to stabilize the public debt offers a partial response to factors underlying debt accumulation.¹⁴ The solution lies in solving the problems in the external sector through investment in those sectors and activities that improve the current account as against those that create an unsustainable balance. One area for careful support would be sectors that use domestic capital to raise the level of innovation and the share of new and existing products and services in dynamically growing markets.

¹⁴ A number of goods exporting economies have been facing balance of payment difficulties in light of the significant reduction in foreign exchange inflows and this has led to implicit foreign exchange rationing.

THE IMPACT OF DISASTERS AND CLIMATE CHANGE

Countries have also accumulated debt as a consequence of increased expenditures to address the impact of extreme events and climate change attendant difficulties.¹⁵ Most Caribbean countries are located in the hurricane belt and are prone to earthquakes and other hazards. Indeed, a disaster resulting in damage and losses in excess of 5% of GDP can be expected to hit any Caribbean country every few years. Moreover, over the period 2000–2014, it is estimated that the economic cost of natural disasters (CRED)¹⁶ in Caribbean countries was in excess of US\$30.7 billion. In addition to the exposure to natural disasters, climate change represents the most serious challenge to the sustainable development of the Caribbean (ECLAC, 2011). The figure below shows the level of vulnerability of Caribbean states based on UNEP's vulnerability index (Fig. 2.8).

With respect to climate change, the region produces less than 1% of emissions of greenhouse gases (GHGs) in the world, while the impact of climate change in the subregion is disproportionately greater (UNEP, 2008). The Intergovernmental Panel on Climate Change has observed in the Caribbean an increase in sea level of about 1.8 mm per year. The consequences of this increase in sea level, associated with increased ocean temperatures, are visible in the subregion. It is estimated that 70% of the beaches are affected by loss of shoreline at a rate of between 0.25 and 9 mm per year. This loss causes damage to private and public infrastructure (roads, airports, power generators, etc.), which is particularly critical because it is estimated that 70% of the population lives in coastal areas. Similarly, the loss of coast negatively affects the quality of coastal and marine resources, which has two main effects. First, a reduction in protection against storms and hurricanes, accelerating erosion, and damage caused to infrastructure. Second, apart from the environmental degradation that it causes, it also affects the tourism sector, which represents approximately 15.5% of employment and contributes 13% to GDP. The disproportion between greenhouse gas emissions and the effects

¹⁵ The recent passage of Hurricane Irma, a category 5 storm, through the Caribbean makes this point vividly.

¹⁶ EM-DAT database is compiled by the Centre for Research on the Epidemiology of Disasters (CRED).

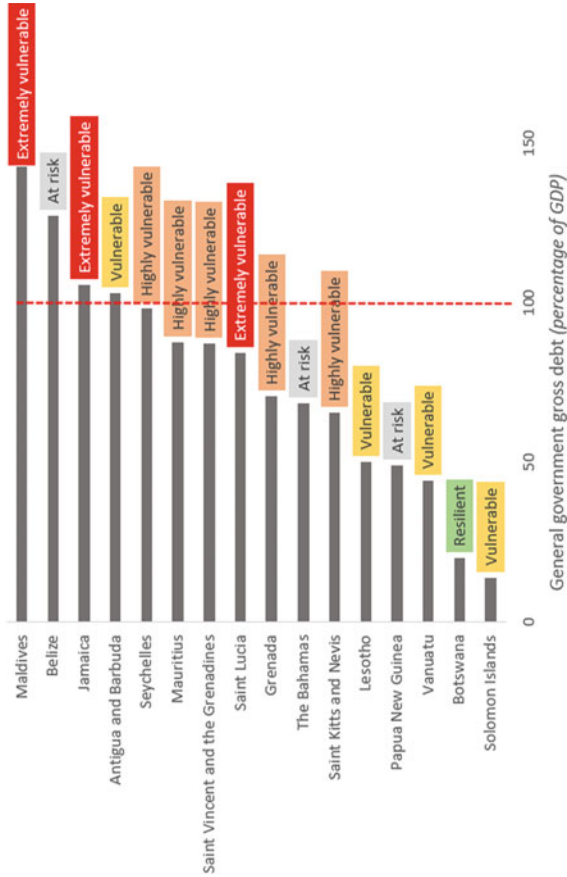


Fig. 2.8 Indebtedness and environmental vulnerability of Commonwealth Small States, 2020 (Source IMF World Economic Outlook April 2021 database, UNEP Environmental Vulnerability Index 2000)

generated by climate change in the Caribbean is one of the fundamental problems facing the subregion as it pursues sustainable development.

Despite these obvious threats, governments have had to focus their spending on addressing the debt burden. In addition, severe adjustment has been taking place on the capital side since this is easier to reduce in the short run. This modification has two consequences—the first of which is that countries have to forego funding much needed mitigation and adaptation programs, which will yield returns over the medium term. Second, by forgoing public capital investment, those aspects of infrastructural investment that are a complement to private investment will cause the private sector to underinvest, which harms growth. The next section examines three proposals for Caribbean debt reduction.

PROPOSALS FOR DEBT REDUCTION

Proposal by the Commonwealth Secretariat

A variety of proposals have been offered to address the severe debt challenge of Caribbean countries. Among these are three approaches that are worth considering given their differences in perspectives and degree of coverage of the debt. The first of these to be discussed is an initiative by the Commonwealth Secretariat (Commonwealth Secretariat, 2013a, b; Mitchell, 2016).

The proposal makes a number of initial assumptions, including that donors would wish to increase the sum of their climate finance disbursements in order to close the climate financing gap, and that climate finance providers do not have funds earmarked for particular recipient countries, especially when such funds are delivered through the Green Climate Fund (GCF). The proposal further assumes that debtor governments have identified a set of environments projects through an environmental plan. They also assume a trust fund is already set up either nationally or via a regional entity through, for example, the Caribbean Biodiversity Fund. The fund can then invest received resources into risk free securities to add to investments in climate adaptation projects. Finally, there is a legal agreement that provides for the write down of the debtor government's liabilities held by multilateral creditors and that the debt service previously owed will be paid to the trust fund to deliver climate adaptation projects.

Under this scheme, climate finance providers will contribute some proportion of their pledges to debt reduction based on the liabilities to

the multilateral institutions. The debtor governments' equivalent transfer to the trust fund is made in local currency. Assuming that relief is to be granted, then debt could be purchased at a discount (haircut) or repayment can be made at a lower interest rate or the repayment period could be extended to ease the liquidity burden. The Commonwealth Secretariat specified a number of scenarios that reflect a combination of all three of these conditions, or some combination of them, as a path to relief. The optimum condition is the scenario in which the climate provider gets the most development finance with the least up-front financing. The Commonwealth Secretariat point to the benefit of fast-tracking disbursements and improving the economic viability of indebted countries through the conversion of foreign debt to domestic debt. The proposal recognizes that due to the heterogeneity of the debt, some countries will benefit more than others. The proposal also argues that this same mechanism can also tackle commercial and bilateral debt; however, the argument along these lines is not developed. The main challenge with this approach is that it does not offer any succor for the most indebted and speaks just to multilateral debt for which only a few countries will benefit. The multilateral debt in 2013 for seven Caribbean countries was US\$4.7 billion, of which less than half was concessional. As shown in the previous section, "The Evolution of Caribbean Debt," for some countries multilateral concessional debt is quite substantial relative to their external debt. The Commonwealth Secretariat proposal is a minimalist approach developed to first determine how the markets will react and then push for further debt relief and hangs heavily on negotiating with multilateral creditors.

PROPOSAL BY THE WORLD BANK

The World Bank has also offered an approach that it hopes can begin first as a pilot with at least one member state (Haque et al., 2016). In this approach, two perspectives are offered. The first refers to a debt for nature and resilience swap and the second is a guarantee instrument that will leverage private financing in international financial markets. The World Bank argues that for countries facing high debt, the persistence of low growth will make it difficult for them to address the debt overhang. They recognize that the debt can be so large that it is difficult to refinance the current debt while financing future growth-enhancing projects. They argue that these countries face solvency and liquidity issues

while needing to address debt and address climate change effects plus exposure to extreme events issues. The debt swap initiative is designed to retire high-cost commercial or bilateral debt while strengthening the policy and institutional framework for environmental sustainability and climate resilience.

Their debt swap strategy would be optional for countries in a World Bank program and where there is a track record of reform implementation. It would work through two important steps. First, the country in question would have to implement policy changes to strengthen its environmental management and its policies on climate resilience. Second, expensive debt could be bought at a discount or replaced by cheaper debt with longer maturity under World Bank terms. The savings would be absorbed by the budget, thus increasing the fiscal space to finance capital spending. It is not clear who would purchase this debt at a discount, but it could be speculated that the World Bank might persuade the creditors (bilateral donors) to participate. Of course, it is not clear whether such donors have the appetite to assist so-called “middle-income” and “high-income” Small Island Developing States (SIDS) at this time.

The other suggested option is to help countries to leverage funds in the international capital market and to obtain additional liquidity to deal with their debt situation through a guarantee instrument, or a so-called Policy-Based Guarantee. They argue that those eligible would be governments with a strong macroeconomic management objective and have shown progress toward their development goals. Specifically, those offered must have a strong track record of performance; a sustainable external financing plan; and a coherent borrowing strategy to establish borrowing in the country’s own name without a guarantee over the medium term.

From this third plank, the countries can benefit from the World Bank’s support and improved market access terms and possibly, good relations with the private sector. While the World Bank’s plan is more comprehensive than the Commonwealth Secretariat’s approach, it reflects a menu based on a case-by-case basis. While countries will continue to face new borrowing requirements, contracting more debt—especially among highly indebted countries—would be a hard sell. Given the challenges faced by the most highly indebted countries, it is not clear how the first two of three criteria under the second strategy will be fairly operationalized.

PROPOSAL BY THE ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN (ECLAC)

The ECLAC proposal is more comprehensive than the other two since it takes the view that the high debt levels in the Caribbean area are a regional issue and that a comprehensive regional resolution is optimal. However, in light of the heterogeneous nature of the debt structure in the various countries a menu approach which recognizes country differences is advocated. ECLAC observes that a number of factors explain debt accumulation and among these are four that can be highlighted:

- Firstly, the Caribbean is one of the most vulnerable regions with respect to exposure to extreme events. A significant proportion of debt was accumulated due to expenditure required to address such events and despite the presence of the Caribbean Catastrophic Insurance Fund (CCRIF), reconstruction expenditures are never enough to address the effects of such events.
- Secondly, the Caribbean lacks fiscal buffers which make it difficult to employ countercyclical measures in response to negative shocks. It is also the case that in post recessions, the Caribbean economies respond more slowly than other regions to increasing investment (ECLAC, 2012; Alleyne et al., 2011; Guy & Belgrave, 2012; Pentecost & Turner, 2010).
- Thirdly, there is no doubt that weak fiscal management has been an important factor in debt accumulation; however, the lack of good fiscal management is not the only factor driving debt.
- Fourthly as was suggested in section two the debt accumulation is the result of declining competitiveness and pressures coming from the expanding current account deficit. Recent work by Ramirez and Wright (2017) corroborate this finding when they concluded that, "... the open economy model with terms-of-trade and flexible exchange rate shocks produced lower distribution fiscal limits than the model without terms of trade. This shows that trade volatility in these small, open developing economies significantly impacted their ability to service sovereign debt."

The proposal also recognizes that the primary balances required for stabilizing the debt are also the cause of low growth and in addition the

high debt service limits the ability of Caribbean countries to address the agenda for sustainable development.

The ECLAC debt for climate adaptation swap initiative is anchored by a central proposal to establish a Caribbean Resilience Fund (CRF). It will be designed as a Pan-Caribbean Segregated Portfolio Resilience Trust Fund. This approach will allow for the segregation of its risks and portfolios, enabling investment in a range of areas including debt reprofiling and debt swaps, and accommodating the receipt of resources from all donors, investors or enterprises deemed eligible. This is essentially a special purpose financing vehicle intended to leverage long-term low-cost development financing for the Caribbean, while at the same time ensuring the availability of resources for investment in adaptation and mitigation initiatives, in the development of green industries, thereby promoting both resilience building and the structural transformation of Caribbean economies.

The structure of the CRF comprises three distinct windows. The first window, called the resilience building window, is intended to attract finance for the development of blue and green industries and for wider investment in mitigation and adaptation as indicated above. Importantly, this window, with its in-built mechanism for the design of projects that respond to climate vulnerability in the Caribbean, will serve as a mechanism to leverage concessional financing from the Green Climate Fund to finance climate-related projects and other investment in resilience building.

The second window, called the growth and competitive window, will be dedicated to attracting funds from multiple sources for investment in projects that promote growth and economic recovery, and that enhance the competitiveness of the subregion. This window would seek to harness innovative instruments, appropriately calibrated to address individual country risks.

The third window, addressing liquidity and debt reduction, will be devoted to debt reprofiling, including the operationalization of ECLAC's debt swap initiative, with the requisite resource mobilization. The approach to debt relief proposed by ECLAC is that for countries with high debt from private creditors, a debt buyback scheme, as well as debt for equity swaps will be utilized. The debt repayment (in local currency) will be placed in a Caribbean Resilience Fund to finance green growth aimed strictly at mitigation and adaptation projects as agreed by the parties. In the case of multilateral and bilateral debt negotiations with

the Paris Club and with the international financial institutions would be necessary; their participation would be important to guarantee success in such a scheme.

ECLAC proposes a pilot phase to launch the debt swap initiative, involving Antigua and Barbuda, Saint Lucia, and Saint Vincent and the Grenadines as the three pilot countries. It is hoped that this initiative can be expanded to include other indebted Caribbean countries.

The ECLAC proposal has several advantages over other schemes. It is focused on sustainable debt reduction which has so far not been the case in debt reduction schemes in the Caribbean. This proposal should also be attractive to all creditors. It proposes an initiative which guarantees reduced repayment risks, strengthens the resilience of Caribbean countries, and helps to build up a Fund that over time may be augmented by investments that have positive rates of return. It also is an opportunity for member states, to secure the fiscal space to generate much needed investment while pursuing adaptation and mitigation strategies. Finally, the proposal can inspire region-wide approach to improved fiscal management, designed to help to address future debt build up.

CONCLUSION

This chapter has examined the evolution of the Caribbean debt focusing on its structure and composition. It argues that the explanations which treat the debt accumulation as a fiscal problem is a partial explanation since Caribbean economies are affected by a variety of vulnerabilities which threaten their fiscal resilience. It is shown that at least for some countries, structural factors are important to the debt build up and this is manifest in the persistent current account imbalance in the Caribbean. The chapter suggests that in light of large primary surpluses required to stabilize or reduce the debt, the Caribbean needs some relief in order to properly address the sustainable development goals. The chapter also evaluates proposals for debt reduction presented by the Commonwealth Secretariat, the World Bank and by ECLAC respectively. It argues that the ECLAC initiative is more comprehensive and has the potential for supporting sustainable development.

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