SDF 8/2-NM-10

CARIBBEAN DEVELOPMENT BANK

SPECIAL DEVELOPMENT FUND

A FRAMEWORK FOR THE CONTINUATION OF RESOURCES TO ADDRESS FISCAL DISTRESS

May 2012

CURRENCY EQUIVALENT

Dollars ($) throughout refer to United States dollars (USD) unless otherwise stated.

ABBREVIATIONS

ANT	-	Antigua and Barbuda
BAH	-	Bahamas (The)
BAICO	-	British American Insurance Company Ltd.
BAR	-	Barbados
BMCs	-	Borrowing Member Countries
bn	-	billion
BOP	-	Balance of Payments
BZE	-	Belize
CDB	-	Caribbean Development Bank
CG	-	Central Government
CLICO	-	Colonial Life Insurance Company Ltd.
CPA	-	Country Poverty Assessment
DOM	-	Dominica
DSA	-	Debt Sustainability Analysis
ECCU	-	Eastern Caribbean Currency Union
GDP	-	Gross Domestic Product
GRN	-	Grenada
GUY	-	Guyana
HRD	-	Human Resource Development
IMF	-	International Monetary Fund
JAM	-	Jamaica
MDGs	-	Millennium Development Goals
mn	-	million
NGOs	-	Non-Governmental Organisations
NIS	-	National Insurance Scheme
OECS	-	Organisation of Eastern Caribbean States
PBL	-	Policy-Based Loan
PFM	-	Public Financial Management
pp	-	percentage point
PRS	-	Poverty Reduction Strategy
PSIP	-	Public Sector Investment Programme
%	-	per cent
SDF	-	Special Development Fund
SIDS	-	Small Island Developing States
SKN	-	St. Kitts and Nevis
STL	-	St. Lucia
SVG	-	St. Vincent and the Grenadines
TA	-	Technical Assistance
T&T	-	Trinidad and Tobago
UNDP	-	United Nations Development Programme
VAT	-	Value-Added Tax
WB	-	World Bank

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EXECUTIVE SUMMARY

1. The Caribbean Development Bank's (CDB) Borrowing Member Countries (BMCs) are confronting unprecedented social and economic challenges. Notwithstanding social gains achieved over the past four decades, poverty levels have remained relatively high in many BMCs and in some instances have risen in the wake of the global economic crisis. Indeed, there are challenges in accelerating the pace of poverty reduction, and these can become acute given the deceleration in regional growth, which started prior to the global crisis, and the less than sanguine prospects going forward. The global crisis also imposed significant fiscal hardships, exacerbating already large deficits and high debt, and pushing public debt to unsustainable levels in many BMCs. The acute socioeconomic and fiscal challenges confronting most of the BMCs reinforce the case for continued technical and financial assistance, particularly concessionary resources from development partners. This support is important to help countries consolidate socioeconomic progress already achieved and to reduce the risks of regression, so as to ensure that most of the Millennium Development Goals (MDGs) are met. Indeed, development gains are under threat of reversal in the absence of ratcheted-up assistance from the donor community.

2. The Special Development Fund (SDF) set-aside for fiscal distress is one such means of support. However, as budgets of development partners are squeezed, scarce resources must be allocated to areas where they will have the greatest development impact. Support to address fiscal distress is considered an important area for support, given that acute fiscal and debt problems threaten the sustainability of the Region's development process. Accordingly, the case for continued allocation of the set-aside is premised on the following imperatives: (a) special and continued support, given the acute fiscal and debt challenges in the Region and implications for poverty; (b) increased transparency and effectiveness in the use of Contributors' resources; (c) sustaining development results attained through interventions of SDF 6 and 7; and (d) mitigation of the economic and social costs of adjustment to prevent further increases in poverty.

3. Consistent with the SDF objectives and in order to structure the allocation process, two broad sets of eligibility criteria for access to the fiscal distress set-aside are proposed:

(a) Borrowing Member Countries are experiencing one or more of the following:

(i) persistent fiscal current account deficits;

(ii) high or rising overall fiscal deficits before grants;

(iii) public or Central Government (CG) debt service payments ratios to revenue in excess of 30 per cent (%);

(iv) the existence of debt servicing arrears;

(v) unsustainable levels of public debt;

(vi) balance of payments (BOP) difficulties;

(vii) deterioration in social services; and

(viii) high and/or rising levels of unemployment, poverty and indigence.

(b) Borrowing Member Countries have a medium-term economic adjustment programme, home-grown or otherwise, with the following components:

(i) social/livelihood protection policies including strategies to enhance social protection/safety nets systems; human resource development (HRD), specifically targeting vulnerable groups; productive sector development and promote inclusive growth; and

(ii) a credible medium-term fiscal consolidation plan that has as key features: (a) debt reduction; and/or (b) strengthening financial sector governance.

4. Indeed, three important conclusions have emerged from the discussions that form the basis of a recommended agenda for the way forward:

(a) the current levels of poverty are too high and the pace of poverty reduction is slow in many BMCs. Hence, there is continuing need for strong social protection systems and strategies for minimising the adverse economic and social consequences of various shocks and accelerating the pace of economic growth and poverty reduction;

(b) the current level of debt accumulation in BMCs, with the general exception of the Overseas Territories, is too high and there is a continuing need for growth-sensitive fiscal and debt adjustments in most BMCs; and

(c) BMCs will need substantial technical and financial assistance, in some cases for extended periods, given the negative economic consequences of high debt accumulation, together with the challenges and risks of the fiscal consolidation process. Beyond this remains the challenging and very costly and unfinished task of repositioning BMCs in the context of trade liberalisation and globalisation, which will require high levels of budgetary resources.

5. Management supports the critical and expanded role for SDF in enabling the Bank to assist with the resolution of fiscal distress in its BMCs. Contributors are requested to approve the proposed eligibility criteria for accessing the SDF set-aside for fiscal distress.

1. INTRODUCTION

1.01 Caribbean economies are not only confronting fiscal and debt challenges, given the depth and protracted nature of the global crisis, but also facing structural hurdles that weigh heavily on productivity, competitiveness and, by extension, economic growth. Additionally, levels of poverty and vulnerability in many countries remain unacceptably high. Indeed, there are challenges in accelerating the pace of poverty reduction, and these can become acute given the deceleration in regional growth in recent years and the less than sanguine prospects going forward. Development gains are under threat of reversal in the absence of fundamental reforms to prevent further socioeconomic unravelling. Reforms are ongoing and will require ratcheted-up assistance from the donor community to ensure sustainability. Technical and financial support to address fiscal distress is considered important, given the acute fiscal and debt problems that threaten the sustainability of the Region's development process. Indeed, the socioeconomic consequences of high fiscal deficits and debt are well established both theoretically and empirically.[1/]

1.02 During the SDF 7 replenishment, Contributors felt compelled to make a separate set-aside for fiscal distress. This was done because Contributors were acutely aware of and sensitive to various additional factors that were weighing on BMCs' fiscal performance. These factors included: (i) the budgetary requirements of seeking to address unacceptably high levels of poverty; and (ii) the substantial economic dislocations attendant upon the shifting trade and economic trends related to trade liberalisation and the need for economic restructuring. The allocation for the fiscal distress set-aside was forty-seven million United States dollars (USD47 mn).

1.03 Fiscal distress is defined as any form of fiscal and debt unsustainability. Fiscal sustainability incorporates two key concepts: solvency and liquidity. Solvency implies that a government is able to comfortably repay its debts sometime in the future. Liquidity requires that a government's liquid assets and available financing are sufficient to meet its maturing liabilities. A country's fiscal policy is unsustainable if: (i) Government's budget cannot be easily financed without a large future correction in revenue and/or expenditure or without resorting to debt default or excessive debt monetisation; and (ii) normal external shocks result in acute debt repayment difficulties (fiscal/debt distress).

1.04 Currently, the conditions for access to the SDF set-aside for fiscal distress, and the adequacy of the set-aside, still remain undecided. The purpose of this Paper is to make the case for the continuation of the set-aside and to make proposals for CDB's intervention for maximising development results. The paper is divided into five sections. Section 2 lays out the social and fiscal context, while Section 3 presents the case for continued SDF support to address fiscal distress. Section 4 proposes a framework that establishes the conditions under which the SDF set-aside can be accessed and Section 5 concludes with recommendations for the way forward.

[1/] For a theoretical and empirical discussion of fiscal and debt sustainability, see Appendix 1.

2. CONTEXT

Social Context

2.01 Poverty levels remain high in BMCs notwithstanding the socioeconomic gains achieved over the past four decades. Country Poverty Assessments (CPAs) findings for the past 15 years indicates that while indigence/extreme poverty has been decreasing in some countries, and that the severity and persistence of poverty vary widely across BMCs, overall, poverty continues to be a major development challenge. In excess of 25% of the population in eight of the BMCs are living below national poverty lines (see Appendix 2). Poverty in the Caribbean is predominantly rural, but there is increasing incidence in urban areas. Additionally, high income inequality or skewed income distribution is one of the critical factors contributing to poverty in the Caribbean.[2/] High poverty levels are recorded among persons employed in low-skilled and low-paying jobs such as in agriculture, construction and light manufacturing and those in the informal sector who make up the increasing numbers of the *Working Poor*. Poverty is also over-represented among deprived or at-risk groups, such as indigenous people, the elderly living alone, the disabled, school-aged youth (especially those in female-headed households), and households with large numbers of youth and elderly dependents. Vulnerability to natural hazards and economic shocks is also one of the critical factors associated with poverty. BMCs are vulnerable to hurricanes; tropical storms; seismic and volcanic hazards; global economic cycles; and terms of trade and other shocks. When these events occur, they frustrate social and economic progress and pose significant challenges to the Region's development.

2.02 Small size and resource constraints limit BMCs' ability to consistently deploy the required human and financial resources to anti-poverty investments. Consequently, persistent poverty poses a major challenge to their development. This challenge is exacerbated during times of economic crisis and fiscal distress and, as such, intensifies as a major threat to the sustainable development of the Region. A recent study on the effects of the current global economic crisis on Caribbean countries by United Nations Development Programme (UNDP)[3/] indicates that the crisis is creating a decline in "tourism, construction sector activity, remittances, and constrains the Governments' fiscal space." It indicated further that the impacts of the crisis have tended to be greater in countries with the following characteristics:

(a) relatively large share of tourism and off-shore financial sectors in the economy;

(b) high reliance on single export markets;

(c) high reliance on exports that fall into the category of discretionary spending (e.g.) tourism and bananas;

(d) little diversification of economy with high dependence on one service, commodity or company;

(e) little access to international capital markets; and

(f) less ability to resort to countercyclical spending.

[2/] CPA findings show that in some countries the richest 10% of the population account for 30% of total consumption expenditure, while the poorest 10% of the population account for a mere 5%.

[3/] *Social Implications of the Global Crisis in Caribbean Small Island Developing States: 2008/09*, Synthesis of the Findings of Seven Country Studies, Final Draft, February 27, 2010, UNDP, Barbados and the Organisation for Eastern Caribbean States.

2.03 The report identified unemployment and under-employment as the most common social impacts of the economic crisis. Prior to the crisis (that is, 2005-08), unemployment levels ranged from 4 to 19% within BMCs. While current data are unavailable, it is expected that those percentages would have increased with the onset of the crisis and that those at the bottom of the labour market, particularly young women and seasonal workers, would be affected most. In many countries, self-employed persons working in the tourism sector, hotel and restaurant employees, small contractors, persons employed in the informal sector, and other non-public sector employees who have either been laid off or operate with reduced working hours, have experienced a significant drop in income. Threats to job security and reduced household income have major implications for social development in key areas such as education, health, nutrition, crime and overall wellbeing, and could lead to further marginalisation and long-term unemployment of socially excluded persons.

2.04 As a result of the crisis, households once able to support elderly parents and children, either from their own incomes or remittances, are forced to turn to Government for assistance; but this is happening at a time when access to such support is becoming more difficult. In order to curtail public expenditure, governments cut their budgets and this, in many cases, results in reduced funding of the social services needed by the most vulnerable members of the population. With the reduction in household income, applications for assistance to social welfare and other government public assistance programmes have increased at a time when funding of these services is reduced. Non-Governmental Organisations (NGOs) also experience increased applications for assistance, but they too are less able to satisfy the increased demand due to difficulties in acquiring the funds needed. As a consequence, the poorest and most vulnerable groups are at further risk of deprivation. In addition to reducing expenditure, several governments have also increased taxes and fees, including Value Added Tax (VAT) in order to increase revenue. The regressive nature of such indirect taxation produces increased cost of living effects at a faster rate for low income families than for high income households. This, in some cases, has resulted in increased deprivation, indebtedness in relation to utilities such as water and electricity and increased evictions.

2.05 Therefore, without access of BMC governments to resources to implement countercyclical measures and to provide continued access to key social services and social protection measures, the economic crisis could result in an increased group of people being at risk of becoming more marginalised and more distant from the labour market.[4/] This is particularly an issue for women and children, unemployed young people, people with low level qualifications and skills and other vulnerable groups such as indigenous people, the elderly and disabled who are already being affected disproportionately by the lingering effects of the crisis.

Fiscal Context

2.06 The global economic and financial crisis imposed significant fiscal hardships on many of CDB's BMCs, exacerbating already large deficits and high debt. While public revenues plummeted in some countries, constrained external borrowing further limited the scope for countercyclical fiscal policies. Certain expenditures that are vital for poverty reduction and growth (infrastructure, for example) were significantly reduced. Moreover, the situation prompted concerns about medium-term fiscal and debt sustainability and heightened fiscal distress risks and as such, necessitated fiscal adjustment. Indeed, the countercyclical fiscal policy that began in 2009, for the most part, in 2010 was reined in with concerted efforts at expenditure reduction (primarily, but not exclusively, capital expenditure) and the introduction of new taxes and/or increases in existing tax rates and/or fees in some countries. VAT was introduced in Grenada (GRN) and St. Kitts and Nevis (SKN), while there were increases in tax rates in Antigua and

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[4/] *Social Impact of the Crisis and Developments in the Light of Fiscal Consolidation Measures*, Hugh Frazer and Eric Marlier, European Union Network of Independent Experts on Social Inclusion, February 2011.

Barbuda (ANT) (stamp duties and embarkation tax); the Bahamas (BAH) (stamp duties and departure tax); Barbados (BAR) (increase in VAT); and Belize (BZE) (business and excise tax).

2.07 Though the fiscal situation improved in the majority of BMCs in 2011 relative to 2009 and 2010, the fiscal challenge still remained acute in many of the BMCs. The overall fiscal deficit as a percentage of Gross Domestic Product (GDP) remained high and unsustainable in 7 of the 12 BMCs, exceeding 4.5% of GDP in 4 of the 7 countries. The average deficit for the Region as a whole averaged 3.9% of GDP, down from the 2010 average of 5.1% of GDP. Regarding the primary deficit, though the regional average remained virtually unchanged at 0.6% of GDP in 2011, there were deteriorations in the primary balance positions in 4 of the 12 BMCs. Public debt as a ratio of GDP ranged from 48.9% in BAH to 151.3% in SKN. The regional average of the public-debt-to GDP ratio increased to 87% in 2011, two percentage points (pp) above the average in 2010.

2.08 At the country level, there were several BMCs with low or very low debt ratios prior to the crisis which rose sharply. Most notable in this regard are BAH, St. Lucia (STL), St. Vincent and the Grenadines (SVG), and Trinidad and Tobago (T&T). BAR debt-to-GDP ratio prior to the crisis was relatively moderate but has since risen sharply. As Appendix 3 shows, 5 of the 12 BMCs recorded an increase in their debt-to-GDP ratio in 2011. The largest pp increase occurred in STL, followed by T&T. In 10 of the 12 BMCs, the debt-to-GDP ratio exceeded 60% at the end of 2011. Of the 10 countries, 4 (Dominica [DOM], Guyana [GUY], STL and SVG) had ratios ranging from 61 to 80%. Three BMCs (ANT, BZE and GRN) had ratios ranging from 81 to 99% and three (BAR, Jamaica [JAM] and SKN) had ratios surpassing 100%. In only two countries (BAH and T&T) were the ratios less than 60%. In nominal terms, public debt in the Region was estimated at a total of $45 billion (bn) in 2011, up from $31 bn in 2008. In per capita terms, the large stock of public sector debt in the Region equated to a debt burden of around $7,000 in 2011.

2.09 Disaggregating the debt dynamics (Appendix 4) shows that primary deficits and interest costs were the largest contributors to the rise in the debt ratio in 2011. For example, interest costs contributed 8.4 and 8.3% to the build-up in the debt ratios in STL and SVG in 2011, respectively. In the remaining BMCs where the debt ratio fell, increases in nominal GDP were the main contributors in most of the countries. In JAM and SKN, the decline also reflected strong fiscal adjustment measures, which in the case of JAM also included debt restructuring.

2.10 The baseline fiscal and debt outlook shows only gradual improvement in the majority of countries. Taking into account country-specific fiscal adjustment measures ongoing and/or announced, the medium-term fiscal and debt projections (Appendix 5) show that by 2015, overall deficits will still exceed 3% of GDP in five of the BMCs, suggesting that large financing needs will persist. Primary surpluses are projected for 7 of the 12 BMCs with the regional average estimated at 1% of GDP over the medium term. However, the sizes of the primary surpluses only allow for gradual debt reduction over the medium term. The regional average for the public debt is projected at 80.5% of GDP in 2015, representing a cumulative decrease of 6.5pp. In BAR, JAM, and SKN the public debt ratio will still exceed 100% of GDP in 2015. The baseline fiscal outlook and debt profile are vulnerable to shocks related to the global economic recovery and natural hazards; higher-than-anticipated fuel and commodity prices; and fiscal costs associated with financial sector interventions relating to the Colonial Life Insurance Company Limited (CLICO), British American Insurance Company Limited (BAICO) resolutions and restructuring of the financial sector in the Eastern Caribbean Currency Union (ECCU). It is estimated that the financial costs associated with the CLICO crisis is about 10-15% of regional GDP.

2.11 An illustrative Debt Sustainability Analysis (DSA), the results of which are presented in Appendix 6, shows that primary surpluses in the range of 1-14% of GDP are required to significantly reduce debt-to-GDP ratios over the medium to long term. Consequently, in many BMCs, large-scale

fiscal adjustment will be required for debt reduction, for example, 60% of GDP by 2020 for countries where the ratio exceeded 60% of GDP in 2011, or by 25 pp by 2020 for countries where the ratio was less than 60% of GDP in 2011. The magnitudes of fiscal adjustment are for example, 11.4% in ANT; 9.7% in BAR; 8% in GRN, 7.3% in SKN; 7.1% in STL; and 6.3% in BAH. BZE is the only country that will not require fiscal adjustment because of the favourable growth/interest differential and primary surplus position. However, with stepped-up interest costs associated with its super bond (not captured in the DSA), the actual medium-term outturn could be vastly different to the DSA estimates. Primary surpluses needed to stabilise debt-to-GDP ratios at the 2011 level, range from 1.2% of GDP in BAH to a surplus of 7.1% of GDP in ANT. The sustainability indicators[5/] (column 9, Appendix 6), which were at/or exceeded one, suggest that the fiscal stance at the end of 2011 was on an unsustainable path in all countries.

2.12 Figures 1 to 12 in Appendix 7 illustrate the trajectory for public debt in each BMC based on the following assumptions: (i) the 2011 fiscal outturns with no policy change going forward; (ii) an extreme growth shock equivalent to a 1pp reduction in the 2011 real GDP growth rate; and (iii) the country's own medium-term growth projections. With the exception of BZE, GRN, GUY and JAM, the trajectory for public debt is upward and in some cases explosive (ANT, BAR, SKN, STL and T&T) under the scenario of an extreme growth shock. Even with more benign medium-term growth assumptions, there is still an upward trajectory for public debt in BAH, BAR and STL. DSA estimates reinforce the fact that the fiscal outlook is highly vulnerable to shocks. Indeed, in some countries the fiscal challenge is more acute (ANT, BAR, GRN, JAM, SKN and STL). In countries such as BAH, SVG and T&T, debt ratios, while low in the pre-crisis period, have risen sharply and are on an upward trajectory over the medium tem in the absence of strong fiscal adjustment.

2.13 The fiscal challenge appears less acute in BZE, DOM and GUY, but risks to the outlook are tilted to the downside. The DSA illustration reinforces the case for continued technical and financial assistance from development partners to support economic and fiscal adjustment programmes to firmly entrench fiscal and debt sustainability. SDF resources are one such source of support. Such support will be particularly critical in the context of weak growth prospects that are highly susceptible to downside risks. Economic growth for the Region as a whole is projected to average 2.5% over the medium term. It is important to underscore that support for reforms should go beyond fiscal consolidation to the inclusion of policies more directly supportive of growth. Donor support should concentrate on both short and medium-term interventions but must also pay attention to the longer-term policies and initiatives essential to enhanced growth performance, quality employment and poverty reduction. Indeed, the adjustment process must not be inimical to growth.

[5/] Values greater (less than) one implies that the current fiscal policy is unsustainable (sustainable) and inconsistent (consistent) with the debt-to-GDP ratio converging to a lower target.

3. THE CASE FOR CONTINUED SPECIAL DEVELOPMENT FUND SET-ASIDE TO ADDRESS FISCAL DISTRESS

3.01 The current high levels of poverty and indebtedness in the Caribbean Region are particularly serious development issues that require the earnest attention of regional policymakers and the wider development community. Several BMCs with high debt stock and onerous repayment burdens have found themselves severely constrained with respect to resources required for: (i) investment and growth; (ii) social development; and (iii) direct poverty reduction interventions. The BMCs are mainly small island economies very vulnerable to exogenous shocks (natural disasters; terms of trade [for example, oil and food prices, prices of key exports]; global trading arrangements, which they are powerless to influence and which have decimated their main exports; and global economic and financial crises not of their own making).

3.02 In the last two decades, all of the foregoing challenges have confronted these economies simultaneously and in some cases with close to overwhelming intensity. Note for example, the impact of the current global and financial crisis, which is still unfolding amidst hurricanes and high food and oil prices. The debt challenge is accentuated, given BMCs constrained borrowing capacity and limited access to multilateral concessional financing. BMCs have had to borrow extensively on commercial terms (both externally and domestically), adding to the debt build-up. Indeed, high interest cost is one of the main contributors to fiscal and debt unsustainabilty. The problems of fiscal and debt unsustainability, which BMCs currently confront, will not be easily resolved by the BMCs themselves, given their resource limitations. Therefore, assistance to address fiscal distress is considered an important area for support given that the acute fiscal and debt problems have serious implications for poverty reduction and threaten the sustainability of the Region's development process. However, as budgets of development partners are squeezed, scarce resources must be allocated to areas where they will have the greatest development impact. Accordingly, the case for the continuation of SDF resources specifically to address fiscal distress is premised on the following:

(a) The Need for Special Support, Given the Acute Fiscal and Debt Challenges in the Region and the Implications for Poverty

3.03 The acute socioeconomic and fiscal challenges confronting most of the BMCs reinforce the case for continued technical and financial assistance, and particularly concessionary resources from development partners. Support is required because the reality is that countries' balance sheets simply cannot accommodate an overweighting of non-concessional financing. Indeed, concessional financing is critical to prevent further deterioration in debt dynamics. Sufficient concessional resources are critical to cater to the acute development needs of BMCs, especially given the constraints they face in accessing external commercial financing, and moreover, to curb the reliance on domestic financing that can have serious implications for financial sector stability and macroeconomic stability. Additionally, concessional donor funding is also needed to compensate for the decline in international private capital inflows (especially since the global financial crisis) and to ensure that long-term fiscal sustainability is achieved and maintained. Indeed, concessional financing has become a critical source of development financing. It is also important to help countries to consolidate socioeconomic progress already achieved and reduce the risks of regression, enabling attainment of most of the Millennium Development Goals (MDGs).

(b) The Need to Increase Transparency and Effectiveness of Contributors' Resources

3.04 The allocation of specific resources to address fiscal distress helps to enhance the transparency and effectiveness of Contributors' resources through a more structured and defined mechanism for assistance. The establishment of a set of agreed, transparent governance arrangements within the context of the wider SDF would minimise the inherent uncertainties that accompany an *ad hoc* process. The

detailing of the process for accessing the fiscal distress set-aside and the amounts of resources that can be made available to requesting BMCs adds structure and coherence to the process. A more structured process helps Contributors to ensure accountability to their principals. Performance indicators relating to fiscal improvement and social development can be better monitored and assessed.

(c) The Need to Sustain Development Results Attained Through Interventions of Special Development Fund 6 and 7

3.05 In some countries, recent (2006 onwards) fiscal and economic reforms, which have been supported by CDB through the SDF set-aside, have yielded positive results in the areas of revenue administration and tax reform; expenditure management and waste reduction; debt management and public financial management (PFM). Reforms in these strategic areas have intensified in recent years, especially in the wake of the global crisis. In all countries, ongoing reforms in these strategy areas are being pursued to ensure the maintenance of macroeconomic stability and advance social development. There have also been improvements in the governance arrangements that underpin social protection frameworks. Reforms in certain strategic areas, especially public enterprise governance; debt management; financial sector stability; and social sector development need to be deepened so as to firmly underpin macroeconomic stability as a key precondition for accelerating the Region's development process. Indeed, pushing ahead with the reform agenda in this uncertain global environment will require sustained donor support as the Region seeks to lock in the positive development results achieved thus far. Appendix 8 gives examples of fiscal, structural and social reforms that are ongoing in BMCs.

(d) The Need to Mitigate Economic And Social Cost of Adjustment to Prevent Further Increases In Poverty

3.06 Fiscal and debt unsustainability impose the need for fiscal consolidation with all of its attendant economic, social and political uncertainties. Imprudent fiscal and debt management that have necessitated harsh adjustments measures have often had significantly adverse effects on the poor and vulnerable. While fiscal and debt unsustainability can inflict substantial macroeconomic instability with deleterious consequences, the uncertainties inherent in the consolidation process itself can be broader and deeper, occasioned by social and political instabilities emanating from the consolidation process. Therefore, there is a need to provide assistance, both technical and financial, to initiate as early as possible the consolidation process before macroeconomic instability reaches crisis proportions. This would reduce substantially the costs of adjustment by avoiding a long, burdensome and uncertain process. Moreover, there is also a need for soft resources to enable governments in fiscal distress to provide for the poor and vulnerable during the adjustment process. Indeed, the fiscal space in CDB's BMCs needs to be enlarged so that appropriate policies can be pursued and the adverse effects of the crisis on the attainment of the MDGs and long-term poverty reduction and development goals can be mitigated. This requires stepped-up, timely and adequate transfer of technical and financial resources to BMCs.

4. <u>ENHANCED FRAMEWORK FOR SPECIAL DEVELOPMENT FUND RESOURCES TO REDUCE FISCAL DISTRESS AND POVERTY</u>

4.01 The Bank's interventions in its BMCs, with the aid of SDF resources for fiscal distress, have played an important role in narrowing/filling financing gaps. Indeed, since the late 1980s, CDB has engaged in a number of interventions to support economic adjustment in its BMCs. These include: three interventions in DOM [Structural Adjustment Programme (1987); Economic Stabilisation Loan (2003); and Provision of Exceptional Financial Assistance (2004)]; two interventions in JAM [Financial Sector Adjustment Programme (2000); two interventions in SKN in the form of Policy-Based Guarantees (2006, 2011) to help in debt restructuring in addition to converting some of CDB's SKN OCR loans into SDF loans; and one intervention in GUY [Economic Recovery Programme (1990)].

4.02 Going forward, the Bank's interventions can be even more of a strategic catalyst for the consolidation and advancement of progress and for effecting positive, structural and social change that can deliver solid and durable development dividends. This will require a revamping of CDB's lending and advisory frameworks as they pertain to fiscal distress interventions. Consistent with SDF objectives and to structure the allocation process with respect to the fiscal distress set-aside, the following eligibility criteria for access to the set-aside are proposed below. A composite indicator will be developed based on the variables below, which all be used to prioritise access to the SDF set-aside. Analytical work is ongoing with respect to developing a composite indicator and principles for managing the allocation of the set-aside.

(a) <u>Borrowing Member Countries are experiencing one or more of the following</u>**:**

(i) persistent fiscal current account deficits;

(ii) high or rising overall fiscal deficits before grants;

(iii) public or CG debt service payments ratios to revenue in excess of 30%;

(iv) the existence of debt servicing arrears;

(v) unsustainable levels of public debt;

(vi) BOP difficulties;

(vii) deterioration in social services; and

(viii) high and/or rising levels of unemployment, poverty and indigence.

(b) <u>BMCs have a medium-term economic adjustment programme (home-grown or otherwise) with the following components:</u>

(i) social/livelihood protection policies including strategies to enhance (a) social protection/social safety nets; (b) human resource development; and (c) productive sector development and promote inclusive growth; and

(ii) A credible medium-term fiscal consolidation plan that has as key features (a) debt reduction and/or (b) strengthening financial sector governance.

Social Protection Policies:

(i) Short-term social protection initiatives (food security, short-term employment, access to basic services – health, utilities, housing etc.)

4.03 As regards the protection of the livelihoods of the poor in the time of fiscal distress, the basic objective should be to determine the impact on the poor of the various policy and institutional changes being undertaken within the context of fiscal consolidation and to support the formulation and implementation of countermeasures. Past regional experience with fiscal consolidation and its impact on social and political stability does justify greater sensitivity to the social implications of the policies that the Bank is funding. This would be consistent with the Bank's and SDF Contributors' overarching goal of poverty reduction. Hence, the need for programmes that address important, macrosocial impacts and reforms.

(ii) Poverty reduction programmes and the strengthening of social protection systems.

4.04 In terms of enhancing the life chances of the poor, two important possibilities for SDF resource interventions are: (i) ensuring the existence, effective implementation and evaluation of outcomes of national Poverty Reduction Strategies in all BMCs; and (ii) evaluations of the capacity, efficiency and effectiveness of public sector institutions that deal with the poor. In the context of fiscal and debt unsustainability, the effectiveness and efficiency of expenditure assume greater urgency. While increased control over the quantum of government expenditure from the point of view of the fiscal balances and the impact on debt is important, so also, or even more so, is an evaluation of what is achieved with the expenditure. Generally absent from economic adjustment programmes is an analysis of social expenditure, as well as the capacity, effectiveness and efficiency of social institutions/sectors responsible for the delivery of social services such as the education and health systems.

4.05 SDF set-aside for fiscal distress can be used to undertake evaluations of the strength of the safety nets in BMCs and the putting in place of the appropriate policies and measures to address deficiencies. Macroeconomic crises have social consequences. While BMCs undertake policy and institutional strengthening initiatives to deal with the former, generally policies and institutional strengthening initiatives are not undertaken concomitantly with respect to the social safety net. Governments try to address the social crisis in many ways through ad hoc measures rather than attempting to maintain and even expand the social safety net so that it can better respond to macroeconomic crises.

(iii) Social sector reforms with particular emphasis on human resource development,

4.06 An important underlying assumption in the link between growth and poverty reduction is a developed human resource base. Growth can and does generate employment. However, the quality of skills, and hence of employment and remuneration is critical to determining whether one merely increases the ranks of the working poor. For example, in several BMCs with a large tourism industry, employment is largely seasonal, sometimes just a few months of the year. Even though there is much mention of growth and poverty reduction in economic adjustment programmes, there are generally no policies or institutional development initiatives probing and strengthening this critical link via which poverty reduction is achieved – human resource development (HRD). This will require removal of constraints to equitable access and effective participation in HRD. Note also that in the long run, HRD is an important determinant of fiscal and debt sustainability both through the provision of adequate skills in the public sector, particularly in areas critical to good macroeconomic management, and also through the attainment of higher growth and income levels which provide a much more expanded revenue base.

(iv) Structural/productive sector reforms that address some of the binding constraints on economic growth and the identification of new growth sectors, as well as strategies for broad-based growth, inclusive of the poor.

4.07 Policies are needed to identify the binding constraints on economic growth and the attendant policy priorities in addressing the imperatives of employment creation and poverty reduction. Economic adjustment programmes should include productive sector development policies that address structural impediments that undermine economic transformation and, by extension, constrain economic growth and development. Additionally, the character of the drivers of growth, particularly as regards the quantity and quality of employment generation is also critical. While economic growth is fundamental for poverty reduction, the relationship between economic growth and poverty reduction is not necessarily linear. The impact of economic growth on poverty reduction hinges crucially on how the gains from economic growth are distributed. To ensure that high economic growth results in significant reductions in poverty, unemployment, and income inequality, economic growth has to be inclusive. Therefore, adjustment programmes should not only include growth promoting strategies but more fundamentally, strategies to promote inclusive, pro-poor, broad-based growth.

Credible Medium-term Fiscal Consolidation Plan:

(i) Orderly mechanism for debt reduction.

4.08 Given the high opportunity cost of maintaining onerous debt repayment levels over extended periods in terms of growth foregone, together with the substantial adjustment and welfare costs involved in meeting repayment requirements in the form of reduced consumption in the context of high levels of poverty, an integral part of the support for fiscal consolidation should be reduction of regional debt repayments towards more manageable levels. BMCs have engaged in negotiations with commercial creditors to obtain debt restructuring through the markets, with other creditors through the Paris Club or bilateral discussions so as to reduce the debt stock and debt servicing burdens. For example, SKN is currently engaged in all three types of debt restructuring. Generally, the larger the debt stock the greater the need for debt restructuring. However, as indicated by the experience of Greece, debt restructuring can be a long painstaking process in which the debtor nation often needs substantial technical and financial support. In the context of acute fiscal challenges across BMCs, the Bank, SDF and other donors ideally should decide what structured role collectively they can play and the amounts and types of resources that they can make available in order to accelerate the reduction process, thereby reducing the prolonged instabilities and uncertainties that can accompany this process. This would reduce *ad hoc* approaches and optimise the outcomes for BMCs. The main thrust of the suggestion is that BMCs ideally would emerge better off and more quickly from the restructuring process if adequately supported in the negotiation process rather than engage in the process alone.

(ii) Strengthening of financial sector governance

4.09 A casualty in the context of fiscal and debt unsustainability in recent years in the Caribbean has been the stability of the financial sector as several governments have used extensively nationally-owned financial institutions to finance government operations. In many cases, these are dominant financial institutions in the sector and even in the Region, as in the case of ECCU. The inability to repay debts owed by governments to these institutions, among other factors, has placed several of them at risk. Examples include the National Bank of SKN, which is the major creditor to Government and also the Bank of Nevis, which has also extended substantial levels of credit to Government. The Government of SKN has also borrowed substantial sums from the National Insurance Scheme (NIS). NIS has become a significant source of credit to Governments in many BMCs, raising concerns in some cases about liquidity and solvency. The issue of financial sector instability in some BMCs clearly has implications

for the level of resources, both technical and financial, to which BMCs must have access to aid resolution of the problems of fiscal and debt unsustainability. This was evident for example, in the case of Policy-Based Loans (PBLs) to Anguilla (2010); to SVG (2010); and the Financial Sector Adjustment Programme loan to JAM (2000).

4.10 Additionally, several Governments in the Region currently face large contingent liabilities as a result of the CLICO and BAICO crisis, the resolution of which is still unfolding. The recent episodes of financial failures in some of CDB's BMCs also brought to the fore the critical and urgent need to reassess existing approaches to financial sector supervision and the governance regimes that underpin regulatory agencies. Given that the fiscal impacts of financial failures can be massive, threatening fiscal and debt sustainability, it is critical that mechanisms be established that incorporate financial sector monitoring, risk management in large institutions, and contingency planning for financial sector failures into the PFM process. Moreover, financial failures have profound implications for the deepening of poverty in the Region through the reduction of fiscal policy space and the erosion of private sector savings and other assets. In the wake of recent crises, financial sector problems can no longer be delinked from fiscal and social issues and development issues more broadly.

5. CONCLUSION AND RECOMENDATIONS

5.01 The paper has sought to make the case for continued SDF support to address fiscal distress, and has proposed a framework for enhancing CDB's interventions and Contributors' support for this purpose. The four pillars of the argument in support of the continuation of the SDF set-aside are the imperatives for: (i) special support to BMCs, given the acute fiscal and debt challenges in the Region and the implications for poverty; (ii) increased transparency and effectiveness in the use of Contributors' resources; (iii) sustaining development results attained through interventions of SDF 6 and 7; and (iv) mitigating the economic and social costs of adjustment to prevent further increases in poverty. The paper also proposes conditions under which the SDF fiscal set-aside resources can be accessed. Indeed, three important conclusions have emerged from the discussions that form the basis for a recommended agenda for the way forward:

(a) the current levels of poverty are too high and the pace of poverty reduction is slow in many BMCs. Hence, there is continuing need for strong social protection systems and strategies for accelerating the pace of economic growth and poverty reduction;

(b) the current level of debt accumulation in BMCs, with the general exception of the Overseas Territories, is too high and there is a continuing need for growth-sensitive fiscal and debt adjustments in most BMCs; and

(c) BMCs will need substantial technical and financial assistance in some cases for extended periods, given the negative economic consequences of high debt accumulation, together with the challenges and risks of the fiscal consolidation process. Beyond this remains the challenging and very costly and unfinished task of repositioning BMCs in the context of trade liberalisation and globalisation, which will require high levels of budgetary resources.

5.02 Management supports the critical and expanded role for SDF in enabling the Bank to assist with the resolution of fiscal distress in its BMCs. Contributors are requested to approve the proposed eligibility criteria for accessing the SDF set-aside for fiscal distress.

APPENDIX 1

THE ECONOMIC CONSEQUENCES OF FISCAL AND DEBT UNSUSTAINABILITY

The relationship between real income growth and the Central Government budgetary balance/public sector debt is by no means unambiguous. In fact, it has two theoretical strands. The first is the Keynesian approach of anticyclical governmental stimulus to economic growth through deficit/debt financing, a strategy embraced by many Borrowing Member Countries (BMCs). The second is of more recent vintage and relates in part to the findings of Landau (1986), Barro (1991), Easterly and Rebelo (1993) and others of a negative relationship between government spending and growth. It is a policy stance also echoed in the Washington Consensus and the policy positions of the major international financial institutions as regards the role of Government in the economy – less is better.

While the Keynesian model is well-known, the arguments for the new model of government intervention in the economy are not as familiar. One of the best presentations in this regard is that of Fischer (1993). He couched his argument for a stable fiscal policy essentially within the framework of the positive spinoffs of a stable macroeconomic environment which he defined as comprising sustainable fiscal policy; low, predictable inflation; healthy balance of payments; and a competitive and predictable exchange rate. Fischer (1993) also argued that reduced economic uncertainty as a result of macroeconomic stability stimulates investment through a decline in risk. In an uncertain macroeconomic environment, investors are likely to adopt a wait and see attitude. Economic uncertainty can also lead to capital flight. It can also lead to a flight of skills. Additionally, Fischer (1993) argued that fiscal deficits are likely to affect growth, in part, through crowding out.

Reflective of the foregoing theoretical line of thought, international credit agencies (Moody's; and Standard and Poors) attach much significance to fiscal policy in assigning credit ratings to countries. Fiscal distress generally leads to a lowering of credit ratings, to higher cost of international finance or even reduced access to capital markets as happened recently in the case of Barbados and Grenada. In some cases, fiscal distress has led also to reduced access or even denial of funds by international and regional financial institutions. As the highly indebted BMCs have found, sustained pursuit of expansionary fiscal policy can lead to unsustainable debt, unhealthy balance of payments, substantial loss of international reserves and exchange rate instability, thus engendering the macroeconomic instability and its consequences to which Fischer (1993) alluded. Notable examples of this are Jamaica and Guyana in the late 1980s and 1990s.

Using a slightly different line of argument, Sachs (2002) similarly concluded that high debt is a major contributor to poor growth performance in heavily indebted countries. He argued that huge debt stocks lead to high debt payments, a substantial outflow of resources in the case of external debt and also contribute to the vicious circle of high budgetary deficits, yet higher debt stock and increased economic uncertainty. WB and the International Monetary Fund (IMF) (2012) indicate that high interest rates have been a leading cause of the deterioration of debt ratios in the Eastern Caribbean Currency Union (ECCU).[6/] The expectation of increased taxation to repay the debt can also scare away private investment (debt overhang theory), stimulate an increased appetite for short-run investments especially in financial assets or even induce capital flight [Alesina and Tabellini (1989)]. The debt overhang theory additionally argues as noted in several BMCs [for example, St. Kitts and Nevis (SKN), Jamaica (JAM)] that the process of fiscal consolidation can lead eventually to cuts in productive public capital expenditure thus reducing economic efficiency, investment and growth.

[6/] WB, IMF, 2012, p.16.

Against these negatives is the counter argument that efficient use of debt can lead to enhanced capital accumulation and increased productivity in the private sector through productivity-enhancing infrastructure investment, thereby stimulating growth. Additionally, proponents of debt financing point to the substantial constraint on growth imposed by a lack of foreign exchange. Foreign savings play an important complementary role to domestic savings. Given the foregoing arguments and counterarguments, it becomes necessary to resort to the empirical findings on country experiences to assess the validity of these competing hypotheses. A review of the empirical analyses is also very important, given the centrality of real income growth *vis-a-vis* the cost of borrowing in fashioning the dynamics of the debt accumulation process and hence the sustainability or lack thereof.

A number of empirical studies have tested the relationship between the external debt stock, external debt servicing and growth (Chowdhury (1994); Scott (1994); Choudhury (2003); Patillo, Poirson and Ricci (2002), (2004). Chowdhury (2004) and Pattillo et al (2002; 2004) found a negative relationship between the external debt stock and the growth rate of per capita income. In fact, the preponderance of empirical studies so far have found a negative relationship between the foregoing variables and growth. As noted in the World Bank, IMF study of ECCU economic performance, there has been a trend decline in growth performance since the beginning of the 1990s with growth averaging 6.2 per cent (%) in the 1980s, 2.9% in the 1990s and 1.6% in the 2000s at a time of increasing public sector debt accumulation across the Region.[7/]

This observation is consistent with the findings of the non-Keynesian theoretical paradigms and empirical literature on the relationship between public sector debt and economic growth discussed above. Public sector debt in the ECCU increased from an average of 59% in 1995 to 109.1% in 2004 and currently averages more than 80% of Gross Domestic Product (GDP) (83%).[8/] On the basis of the empirical evidence, WB, IMF (2012) has argued for a reduction in the debt stock in the ECCU region to boost economic growth. Recognition of the deleterious effects of high debt accumulation clearly led to the establishment by the ECCU of the target of 60% of GDP by 2020, a policy which was itself predated by the European Union's Growth and Stability Pact of a target of 60% of GDP as the limit for public sector debt accumulation, among other macro targets to achieve macroeconomic stability.

However, of particular interest, and some would argue, closer to expectations, are the empirical results of Pattillo et al. (2002, 2004). Using a panel of 93 developing countries for the period 1969-98, Pattillo et al (2002, 2004) found a non-linear relationship (inverted U) between the stock of external debt and per capita income growth. However, they admitted difficulty in estimating with certainty the point at which indebtedness begins to impact negatively on growth performance. They estimated the turning point between 5 and 50% of GDP, but thought that the range was most likely between 35 to 40% of GDP. They concluded that high levels of indebtedness depress growth performance both through reduced investment and lower factor productivity, but particularly through the latter channel. The expectations of higher taxes to repay debt and the crowding out of private sector investment may also be contributing factors.

Kendall (2006) who investigated the relationship between growth and debt of a sample of the Caribbean Development Bank's BMCs (Antigua and Barbuda, Belize, Dominica, Grenada, JAM, and SKN) during the period 1993 to 2002, using panel data, also encountered that the relationship between the stock of external debt and growth was that of an inverted U. In Kendall (2006), the estimate of the point

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[7/] WB, IMF, 2012, p.1-2.

[8/] Op. Cit, p.6, p.38.

of negative impact of external debt accumulation varied between 42 and 54% of GDP. WB and IMF (2012) estimated that the average sustainable level of debt for ECCU is 54.7% of GDP and argues that the target of 60% of GDP may be too high for the ECCU region.[9/] Kendall (2006) also found a negative relationship between external debt servicing and growth and between fiscal deficits and growth.

[9/] Op. Cit, p.43.

APPENDIX 2

BORROWING MEMBER COUNTRIES (Excluding Haiti) WITH POVERTY LEVELS EXCEEDING 25 PERCENT

No.	Country	Year	Poverty Indicators		Gini Coefficient
			% below Poverty Line	% below Indigence Line	
1	Belize+	1996	33.0	13.4	n.a
		2002	33.5	10.8	0.40
		2009	41.0	16.0	0.42
2	Dominica°	2002	39.0	15.0	0.35
		2009	28.8	3.1	0.44
3	Grenada °	1999	32.1	12.9	0.45
		2008	37.7	2.4	0.37
4	Guyana*	1993	43.0	29.0	n.a
		1999	35.0	19.0	n.a
		2006	36.1	18.6	0.35
5	Montserrat	2009	36.0	3.0	0.34
6	S. Lucia	1996	25.1	7.1	0.50
		2006	28.8	1.6	0.42
7	St. Vincent and the Grenadines	1996	37.5	25.7	0.56
		2008	30.2	2.9	0.40
8	Turks and Caicos Islands	1999	25.9	3.2	0.37

n.a not available
°CPAs conducted by CDB; *Government of Guyana; +Government of Belize (GOB)

FISCAL PERFORMANCE: 2010-11
(% of GDP)

Countries	Overall Balance		Primary Balance		Public Debt	
	2010	**2011^p**	**2010**	**2011^p**	**2010**	**2011^p**
ANT	(2.3)	(1.7)	3.0	(1.0)	83.2	92.0
BAH	(4.4)	(4.7)	(2.4)	(2.4)	45.4	48.9
BAR	(7.9)	(6.7)	(3.7)	(1.0)	117.8	116.0
BZE	(1.3)	(1.2)	1.7	2.2	83.3	80.4
DOM	(2.6)	(1.7)	(1.2)	(0.3)	67.3	67.3
GRN	(2.9)	(4.6)	0.3	(5.5)	93.0	88.7
GUY	(4.3)	(3.1)	(2.8)	(0.9)	60.2	60.4
JAM[10/]	(12.7)	(7.5)	5.3	3.0	143.4	140.0
SKN	(7.8)	(2.1)	4.6	6.7	157.9	151.3
STL	(6.3)	(6.1)	(2.4)	(3.5)	65.5	78.9
SVG	(5.7)	(3.2)	(2.9)	(0.3)	61.5	69.5
T&T	(3.0)	(4.5)	(5.8)	(3.8)	40.1	50.0
Caribbean Average	**(5.1)**	**(3.9)**	**(0.5)**	**(0.6)**	**84.9**	**86.9**

Sources: CDB, IMF, Country Authorities.
Notes: p means preliminary

[10/] Fiscal year, April-March

APPENDIX 4

DEBT DYNAMICS

Countries	Public Debt-to-GDP Ratio (%)			Annual Change in Debt Ratio (pp)	Change in Debt-to-GDP Ratio in 2011 due to: (%)		
	2006-09	2010	2011^{p}	2011/2010	Primary Balance	Growth	Interest Rate
ANT	85.4	83.2	92.0	8.8	1.0	(4.6)	3.9
BAH	32.7	45.4	48.9	3.5	2.4	(2.3)	2.4
BAR	96.2	117.8	116.0	(1.8)	1.0	(7.2)	6.9
BZE	85.4	83.3	80.4	(2.9)	(2.2)	(4.0)	3.2
DOM	72.5	67.3	67.3	0.0	0.3	(2.1)	4.5
GRN	85.5	93.0	88.7	(4.3)	5.5	(4.1)	4.4
GUY	69.0	60.2	60.4	0.3	0.9	(5.4)	4.0
JAM	124.7	143.4	140.0	(3.4)	(3.0)	(12.9)	10.8
SKN	143.6	157.9	151.3	(6.6)	(6.7)	(7.9)	8.3
STL	63.8	65.5	78.9	13.4	3.5	(3.5)	8.3
SVG	58.6	61.5	69.5	8.0	0.3	(0.8)	8.4
T&T	30.3	40.1	50.0	9.8	3.8	(3.9)	3.7

Sources: CDB, IMF, Country Authorities.
Notes: p means preliminary.

BASELINE FISCAL OUTLOOK

Countries	Fiscal Indicators (% of GDP)PF											
	Overall Balance				Primary Balance				Public Debt			
	2012	2013	2014	2015	2012	2013	2014	2015	2012	2013	2014	2015
ANT	(0.8)	(0.1)	0.3	(0.6)	3.8	4.2	4.2	3.2	90.2	88.5	86.8	85.1
BAH	(5.0)	(4.4)	(4.3)	(4.3)	(2.3)	(1.9)	(1.7)	(1.7)	49.9	51.8	53.4	54.8
BAR	(5.6)	(4.5)	(3.4)	(1.9)	0.2	1.2	2.1	3.4	116.3	114.8	112.6	110.0
BZE	(1.8)	(2.2)	(2.1)	(2.1)	1.9	1.9	2.0	2.0	78.1	76.5	74.9	73.4
DOM	1.4	(0.8)	(1.0)	(1.0)	0.1	0.7	0.4	0.4	66.7	65.4	64.2	63.1
GRN	(0.3)	0.6	0.9	1.4	3.3	4.0	4.4	4.8	86.7	84.8	83.0	81.2
GUY	(3.2)	(3.1)	(3.0)	(3.0)	(1.8)	(0.8)	(1.7)	(1.6)	61.4	61.4	61.4	61.6
JAM[11/]	(6.6)	(5.7)	(5.6)	(5.5)	2.8	3.3	3.3	3.3	136.2	132.4	128.8	125.2
SKN	(3.0)	(2.1)	(3.5)	(3.2)	3.4	4.7	3.2	3.4	148.2	143.0	138.5	133.4
STL	(3.0)	(1.7)	1.4	(1.4)	1.4	2.7	2.9	2.9	76.8	74.7	72.4	70.2
SVG	(3.7)	(2.6)	(1.7)	(0.9)	(0.8)	0.0	0.8	1.5	71.9	70.5	67.6	64.7
T&T	(2.3)	(0.1)	2.3	3.6	(4.1)	(4.2)	(4.2)	(3.5)	50.7	48.1	45.5	43.1
Caribbean Average	**(2.8)**	**(2.2)**	**(1.6)**	**(1.6)**	**0.7**	**1.3**	**1.3**	**1.5**	**86.1**	**84.3**	**82.4**	**80.5**

Sources: CDB, IMF, Country Authorities.
Notes: PF means preliminary forecast.

[11/] Fiscal year: April-March

APPENDIX 6

ILLUSTRATIVE DEBT SUSTAINABILITY ANALYSIS

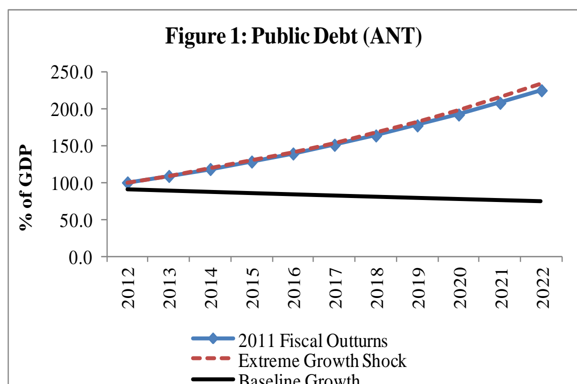
Countries	Real Growth/Interest Rates in 2011 (%)		% of Gross Domestic Product: Fiscal Outturns in 2011		Public Debt in 2020	Primary Balance Required to Reduce Debt/GDP to 60% by 2020 ^(or by 25 pp) by 2020	Fiscal Adjustment Required for Debt Reduction	Sustainability Indicator	Primary Balance to Stabilise Debt/GDP at 2011 Level
	Growth^{P}	**Interest rate^{P}**	**Public Debt^{P}**	**Primary Balance^{P}**	**Estimates**				
ANT	(5.5)	1.8	92.0	(1.0)	192.1	10.1	11.4	1.6	7.1
BAH	2.0	4.5	48.9	(2.4)	59.0	4.1	6.5	1.3	1.2
BAR	0.5	2.3	116.0	(1.0)	146.0	8.7	9.7	1.2	2.1
BZE	2.3	1.6	80.4	2.2	56.2	2.1	(0.2)	1.0	(0.6)
DOM	0.9	1.9	67.3	(0.3)	76.4	1.5	1.9	1.3	0.7
GRN	1.1	(0.4)	88.7	(5.5)	77.4	2.5	8.0	1.2	(1.3)
GUY	5.4	0.9	60.4	(0.9)	40.8	1.0	1.9	1.0	(2.6)
JAM	1.5	(0.8)	140.0	3.0	114.0	3.3	0.3	1.0	(3.2)
SKN	0.0	2.3	151.3	6.7	185.7	14.0	7.3	1.1	3.5
STL	2.0	3.8	78.9	(3.5)	92.4	3.6	7.1	2.3	1.4
SVG	0.8	3.9	69.5	(0.3)	89.2	3.2	3.5	1.0	2.1
T&T	(1.4)	3.0	50.0	(3.8)	74.0	4.9	8.7	1.6	2.3

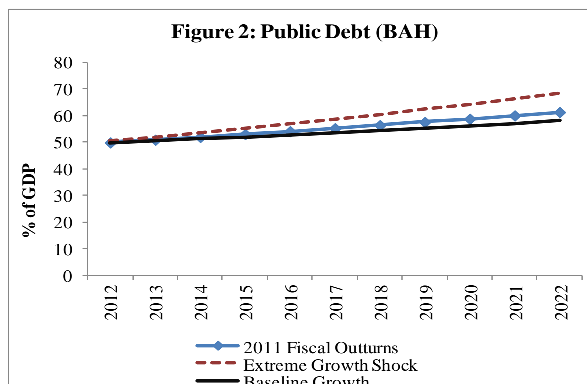
Sources: CDB, IMF, Country Authorities.

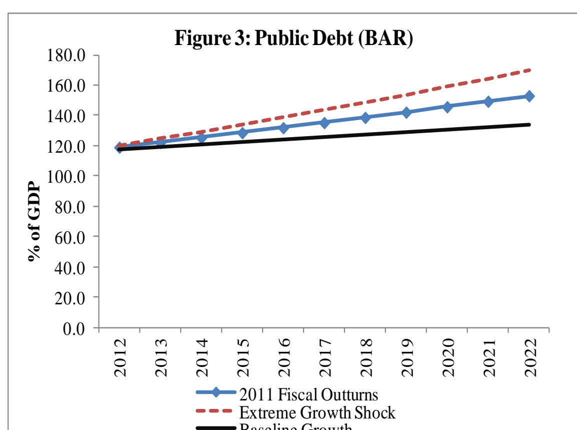
Notes: P means preliminary. Estimates are calculated as at April 2012. ^ relates to countries with public debt less than 60% of GDP in 2011.

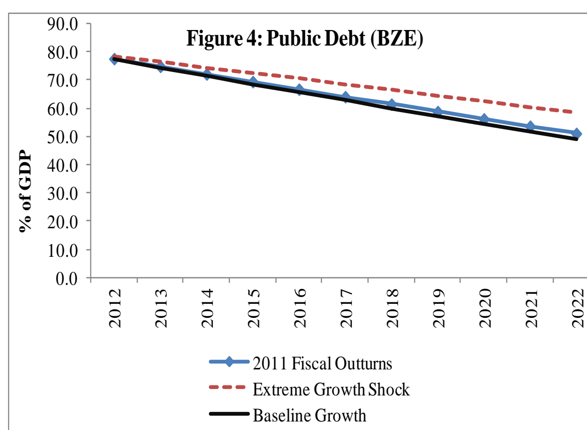
APPENDIX 7

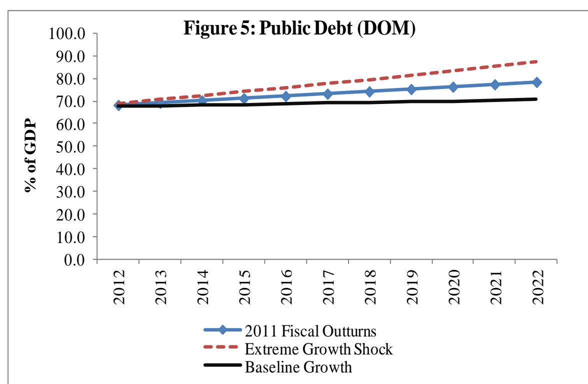
ILLUSTRATIVE DEBT TRAJECTORY OF BORROWING MEMBER COUNTRIES

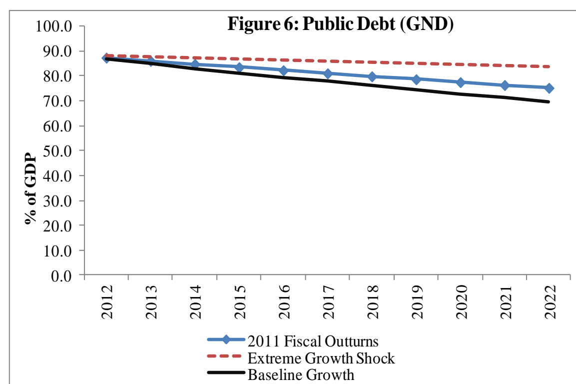












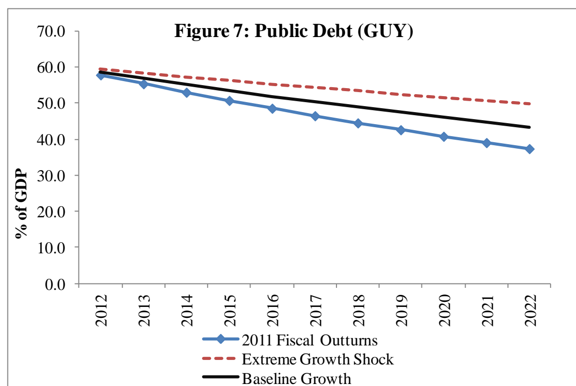


Figure 7: Public Debt (GUY)
% of GDP
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock
Baseline Growth

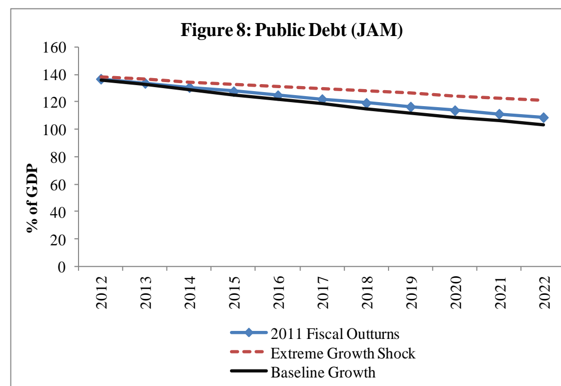


Figure 8: Public Debt (JAM)
% of GDP
160
140
120
100
80
60
40
20
0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock
Baseline Growth

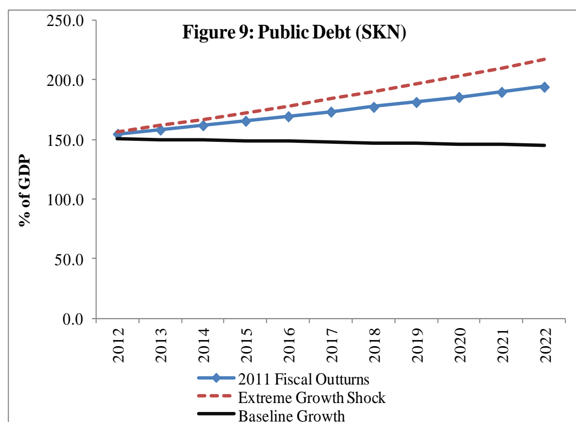


Figure 9: Public Debt (SKN)
% of GDP
250.0
200.0
150.0
100.0
50.0
0.0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock
Baseline Growth

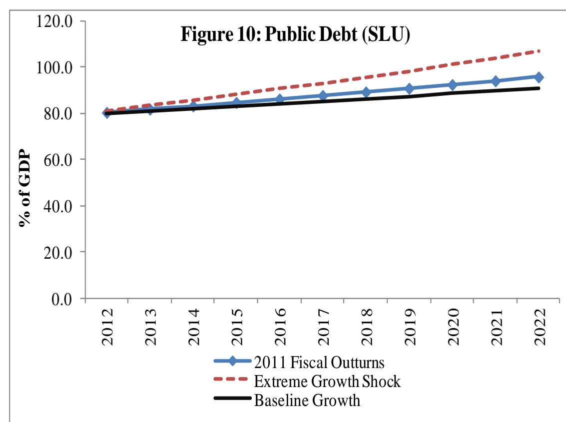


Figure 10: Public Debt (SLU)
% of GDP
120.0
100.0
80.0
60.0
40.0
20.0
0.0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock
Baseline Growth

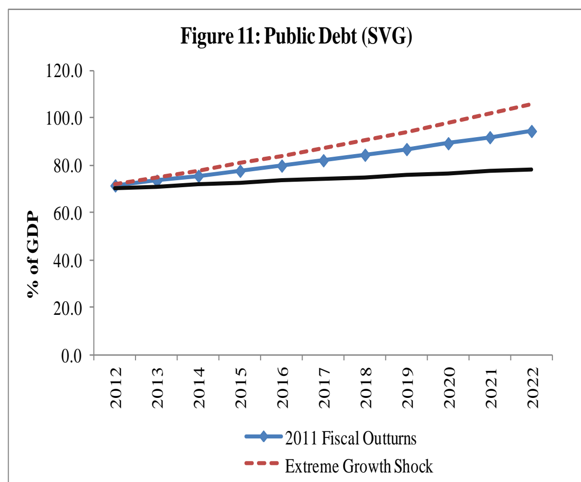


Figure 11: Public Debt (SVG)
% of GDP
120.0
100.0
80.0
60.0
40.0
20.0
0.0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock

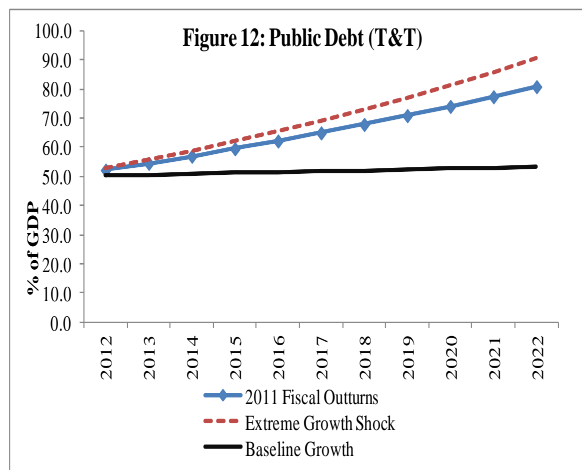


Figure 12: Public Debt (T&T)
% of GDP
100.0
90.0
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2011 Fiscal Outturns
Extreme Growth Shock
Baseline Growth

APPENDIX 8

FISCAL, STRUCTURAL AND SOCIAL REFORMS

Revenue Administration and Tax Reform

In recent years, revenue performance has generally improved, underpinned by tax reforms and enhancements in revenue administration. Since 2006, most countries have introduced new taxes and/or have increased existing tax rates as they shifted from the reliance on border taxes in the face of trade liberalisation. The General Sales Tax and VAT were introduced in BZE and DOM, respectively, in 2006. ANT introduced the ANT Sales Tax in 2007 as part of the first phase of its fiscal adjustment programme that began in 2005. During the period 2010-11, fiscal stimulus provided during the crisis period was unwound through the introduction of new taxes and/or the increase in existing tax rates and/or fees. VAT was introduced in 2010 in GRN and SKN, while there were increases in existing tax rates in ANT (stamp duties and embarkation tax); BAH (stamp duties and departure tax); BAR (increase in VAT); and BZE (business and excise tax). STL plans to introduce VAT in September 2012. Countries have also sought to enhance revenue/tax administration. In 2010, a Risk Management Unit for Customs was set up in ANT, and in BAH a Tax Administration Department was established. DOM undertook the final phase of its income tax reform programme, while JAM and GUY increased the income tax thresholds. BAR is in the process of establishing a Central Revenue Authority. Several countries have also sought to modernise Customs and Excise Departments (ANT, BAR, BZE, DOM, GRN, JAM, STL and SVG).

Expenditure Management

Expenditure management reforms have typically focussed on reducing wasteful spending and improving the cost effectiveness and efficiency of service delivery. Several initiatives were undertaken during the pre-crisis and crisis periods. ANT introduced a voluntary separation package for public employees (2005-07) and a freeze in employment and wages (2009); BAR undertook reforms to improve public procurement; while BZE carried out reforms to the governance of its Public Sector Investment Programme (PSIP). GRN established a Waste Reduction Unit in 2009. Reforms in 2010-11 involved explicit expenditure cuts in some countries. In 2010, BAH introduced a wage freeze and pay cuts for government ministers; subsidies and grants were reduced in BAH and BAR; JAM lowered discretionary tax waivers; and SKN reduced/capped allowances and overtime for public servants. In other countries more structural expenditure management reforms continued. For example, GRN established a Procurement Unit in 2010 and STL carried out a functional review of government ministries and introduced the automatic pass through of fuel prices.

Public Financial Management and Debt Management

PFM reforms have generally focussed on improving fiscal planning and budget discipline and credibility. The Caribbean Technical Assistance Centre and the World Bank (WB) are the main donors providing technical assistance (TA) in this area. In 2010, BZE introduced a Fiscal Responsibility and Transparency Act, while JAM established a fiscal responsibility framework. Other countries have sought to improve PFM following Public Expenditure and Financial Accountability assessments (BAR, BZE and SKN). With respect to debt management, several countries have undergone debt restructuring in recent years: ANT (2006-08, 2010); BZE (2008); GRN (2006); JAM (2010); SKN (2012); and SVG (2010 - refinancing). Additionally, formal debt management units have been set up in BAR (2010) and GRN (2009). The Canadian International Development Agency and the Commonwealth Secretariat have been the main providers of TA in the area of debt management.

Social Sector/Structural Reforms

Social sector reforms have been focussed on streamlining social assistance programmes. Indeed, each country has a plethora of social programmes. Some of these include: conditional cash transfer programmes; food assistance programmes; free text books programme; low income housing support; and welfare assistance programmes, to name a few. Some countries have recently completed poverty/living conditions assessments and in some cases have developed a poverty reduction strategy (PRS) (ANT and GUY), while others (BAR and SKN) have initiated the process. Regarding structural reforms, several countries have undertaken reforms to address some of the key constraints on economic growth. BAH, BAR and STL established small business development funds in 2010 with a view to improving the business climate. GRN's ranking jumped five places in the 2011 global rankings for doing business owing to reforms in the following four areas: (i) starting a business; (ii) registering property; (iii) trading across borders; and (iv) paying taxes. GUY, JAM and SVG also undertook reforms to improve their business climate, notably a lowering of corporate tax rates. Financial sector reforms have become particularly important in the wake of the global crisis. All countries, particularly BAR, BAH, T&T and those in the ECCU have been making concerted efforts to strengthen supervision and regulation of the banking and non-bank financial institutions. However, deeper financial sector reforms are needed to protect against any financial failures in the future. It will be important to anchor such reforms by strong and coherent governance arrangements which CDB's intervention, through SDF resources can support.

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