



## SMALL STATES FORUM

### EMERGING DEBT PROBLEMS OF SMALL MIDDLE INCOME ECONOMIES AND A FRAMEWORK FOR ADDRESSING THEM



Presentation by

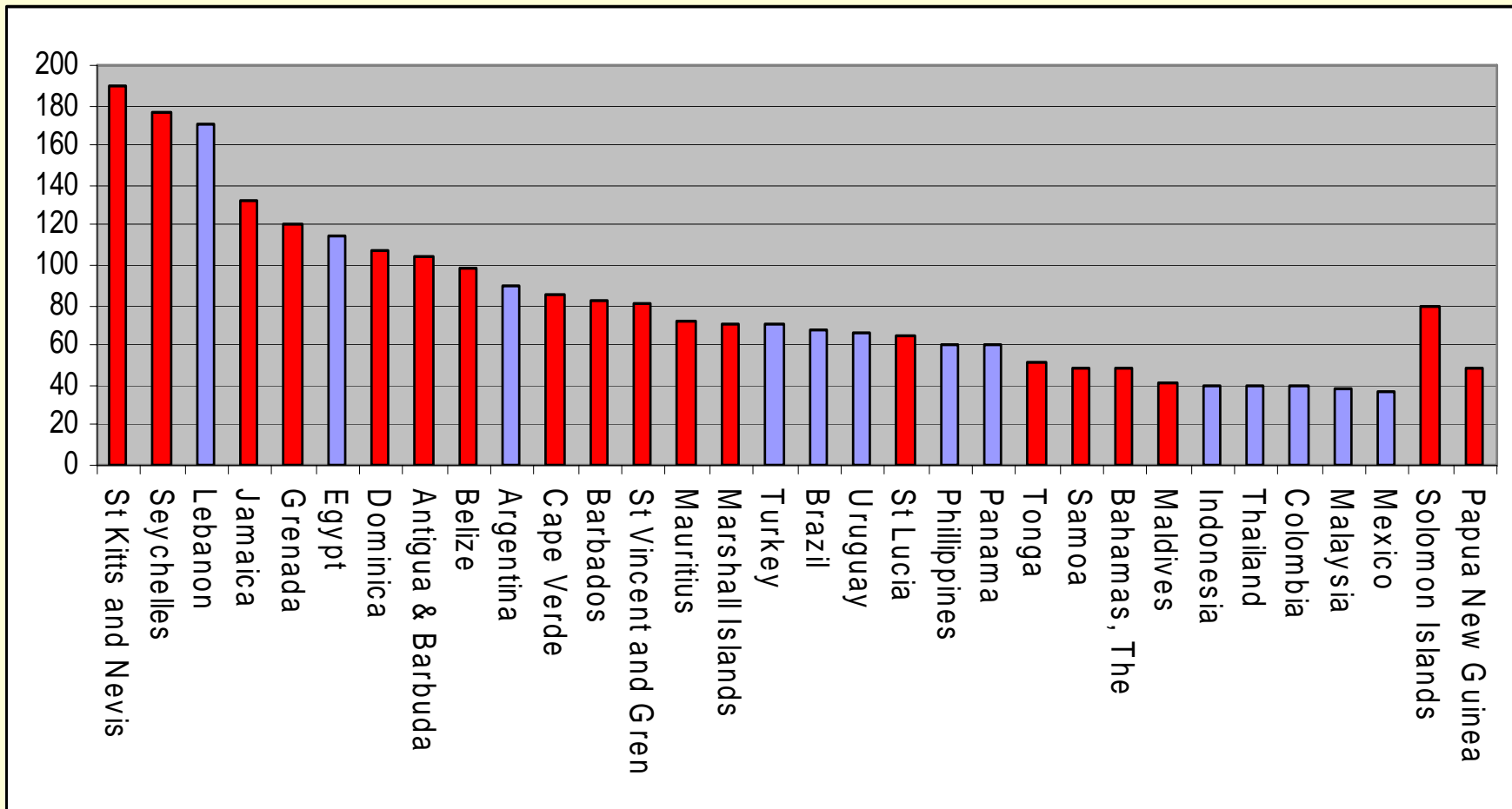
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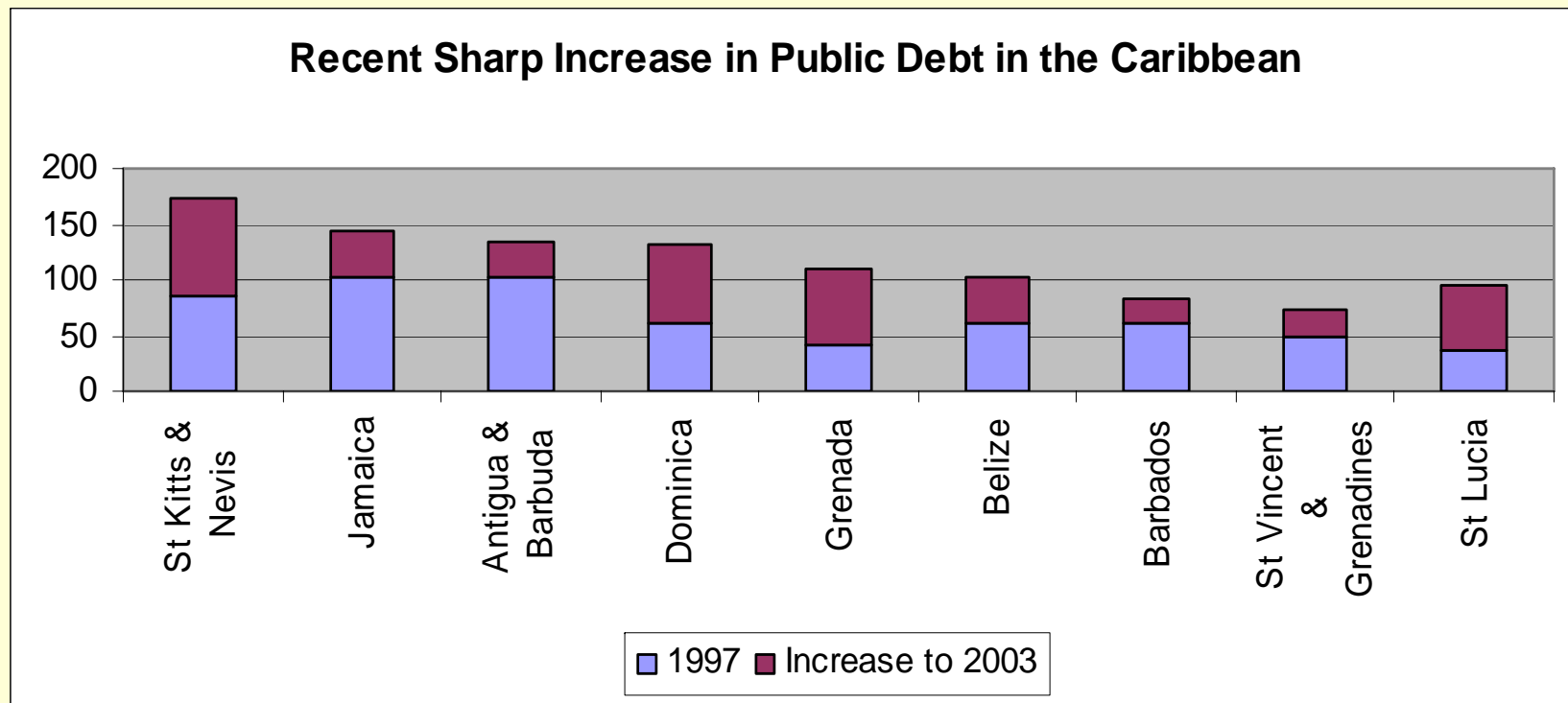


## Small Middle Income among the most publicly indebted





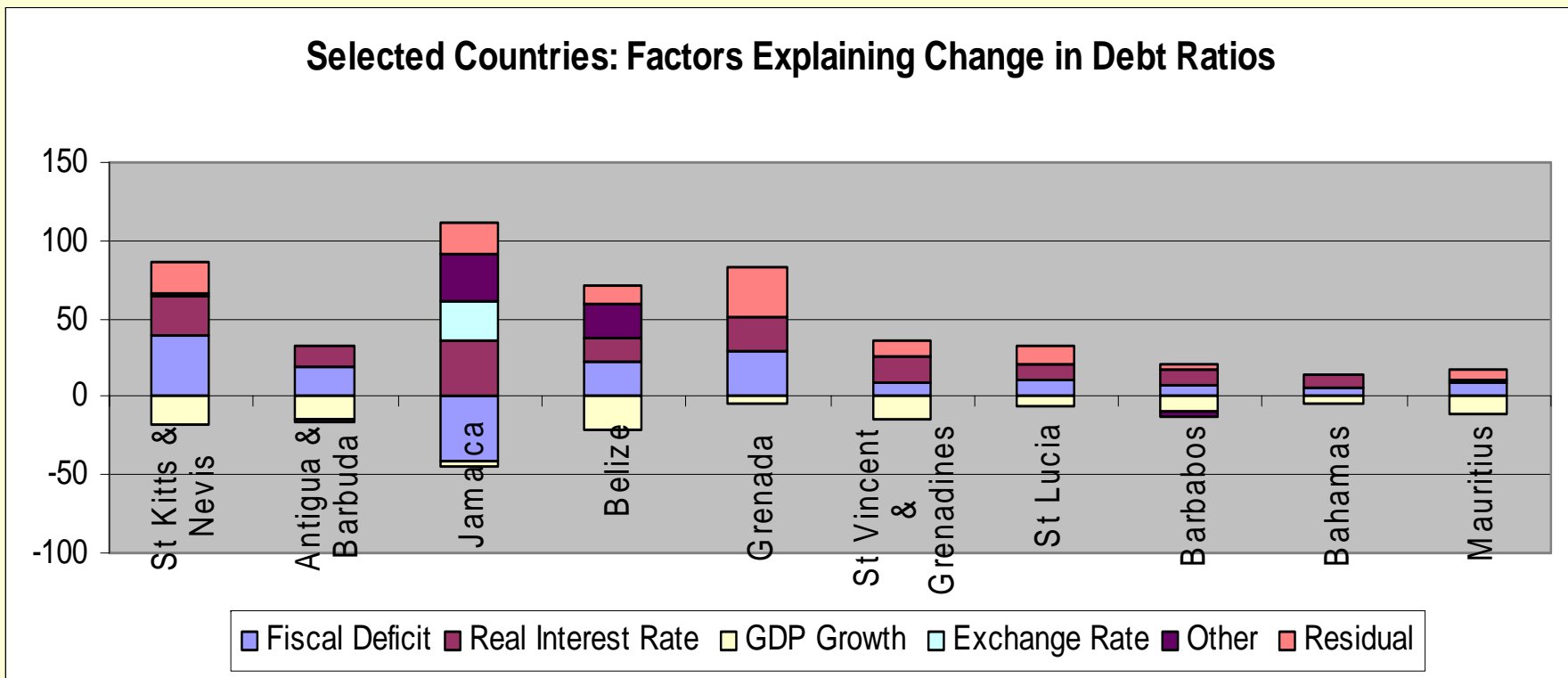
# Sharp Increase in Indebtedness in Recent Years





# Factors Responsible for Increased Debt Ratios

Selected Countries: Factors Explaining Change in Debt Ratios





# *Factors Responsible for Increased Debt Ratios: Longer Term Trends*

## ● GDP Growth

- Caribbean: significant slowdown from 1970s/1980s
  - pressures on preferential arrangements, tourism & private investment
  - exogenous shocks, incl. natural disasters
- Pacific & Indian Ocean: significant improvement in 1990s but early 2000s negative growth in some Pacific due to civil conflict & other shocks

## ● Primary Deficits

- Caribbean (except Jamaica): significant deterioration in 1998-2003 c/w 1991-1997.
  - Expansionary/counter-cyclical policies to counter slowdown & shocks
- Pacific
  - country specific situations but without large grant support many would be running very large deficits.

## ● Increased interest costs: Caribbean & Indian Ocean

- significantly higher external interest rate due to decline in concessional borrowing and ODA



# Future Debt Prospects

- **IMF DSAs: Caribbean baseline scenarios**
  - significant decline in public debt ratios by 2011 in most, but St Kitts and Nevis & Jamaica significantly above 100% other four Caribbean-6, above 80%; for all Caribbean-3 above 60% & in Bahamas rising to 56%.
  - alternative scenarios & shocks yield worse outcomes
- **Indian Ocean DSA only for Mauritius**
  - significant deterioration in public debt ratio under baseline premised on government running significant deficits & strong reform would ensure the ratio falling under 60% by 2010/11.
- **Pacific**
  - Limited data for few countries, but Tonga, PNG & Solomon Islands remain above NPV Debt thresholds of over 30% of GDP



# *Need for a Comprehensive Framework*

- Limited International attention
- Antigua Workshop: framework to include actions by small states & donor community, to be applied on case by case basis
  - Fiscal discipline, underpinned by benchmarks, fiscal responsibility laws & domestic consensus;
  - Improved debt management; and debt restructuring/ NPV debt reduction, in all appropriate cases;
  - insurance & grant financing mechanisms for reconstruction needs following natural disasters/other shocks in a timely manner, without adding to debt burden;
  - Continued grant & concessional financing for small states, particularly ensuring no premature withdrawal of support
  - Adequate compensation for preference erosion & support for the efforts of small states to promote private investment for diversification and growth.



# ***Fiscal Discipline***

- Most embarked upon fiscal adjustment, announcing medium term fiscal strategy with intermediate &/or final targets
- Fiscal benchmarks introduced in ECCU in 1998 but poor compliance: New benchmarks: PPG Debt <60% by 2020 with Different speeds of convergence
- At Antigua participants agreed that small states, should consider
  - establishing annual targets consistent with achieving medium term objectives,
  - strengthening peer review in the regional context; establishing fiscal responsibility laws and /or rules with appropriate exit clauses in times of genuine need,
  - implementing public sector reform and
  - promoting active public discussion both at the national and regional level on the role of government in the economy to ensure a broad and durable consensus on fiscal prudence.



# ***Debt Management & Restructuring***

- At Antigua, participants emphasized need to
  - improve collection/reporting of govt. financial statistics
  - modify CS-DRMS software to include DD analysis
  - move towards more active debt management: minimize cost with a prudent degree of risk,
  - develop more liquid domestic debt markets & broaden investor base
  - implement institutional arrangements that promote active debt management & co-ordination between debt management and fiscal & monetary policies.
- Participants also recognized that in some countries,
  - debt restructuring would be necessary
  - value of institutional arrangements that involved all creditors that was tailored to specific Small States circumstances and which involved a significant debt reduction in NPV terms.
  - priority given to reducing debt servicing costs & to the lengthening of the maturity structure of domestic debt



# Mechanisms to Respond to Natural Disasters & Other Shocks

- strengthened domestic measures (public education, stricter enforcement of damage prevention measures; insurance penetration; mechanism to address the plight of the disadvantaged who are uninsured; & budget contingency fund for natural disasters).
- Depending on CCRIF pilot project results, replication in other regions, extension to private entities which can buy catastrophe insurance at a competitive price, & broadening to include other risk categories such as floods.
- Given CCRIF coverage not directly related to specific losses & reconstruction costs, establishment of properly constituted grant financed mechanisms, especially,
  - information sharing on regional funds for disaster prevention and mitigation such as the Government of Trinidad and Tobago Petroleum Stabilization Fund, and
  - greater collaboration between the donor community & regional institutions to develop broad based & more meaningful mechanisms for potential beneficiary states.



# Importance of Concessional Finance

- At Antigua, participants agreed on the
- importance of continuing grants/concessional financing to Small States for the achievement of sustainable debt levels (many DSAs continue to assume such financing)
- continuing validity of rationale for 1985 IDA decision on Small States exception in the IDA-eligibility criterion, and need for similar explicit recognition of Small States in concessional windows of regional development banks.
- Need for bilateral donors to remain engaged with Small States to assist them to achieve the MDGs,
  - Low MDG indicators in the Pacific
  - pockets of poverty and inequality in the Caribbean, & worst affected region in the Western Hemisphere in relation to HIV/AIDS.



## ***Compensating for preference erosion & promoting private investment***

- At Antigua, participants recognized the importance for debt sustainability & development of the following:
- improved growth rates (& growth enhancing measures)
- (Given major role played by trade preferences in the past, being eroded leading to substantial losses in terms of implied transfers), binding commitments, as part of the Doha Round and ACP-EU EPA negotiations, to transfer equivalent financial resources to the preference erosion affected countries based on a policy agenda for trade & growth consistent with a country's development strategy.
- (Given difficulties many Small States face in attracting investment due to their small size, remoteness and extreme vulnerability ('small economy risk')) active consideration of use of official finance to offset the 'small economy risk' to encourage private investment in SMEs in Small States.